

## PERSPECTIVES OF CROWDFUNDING AS INNOVATIVE AND ALTERNATIVE FINANCE PLATFORM IN LATVIA

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**Abstract.** Crowdfunding is funding a project or venture by raising monetary contributions from a large number of people. Crowdfunding basically operates in the form of crowdsourcing and alternative finance. Crowdfunding is also an alternative funding such as mutual loan or "peer-to-peer lending", collective loans or "equity crowdfunding" donation based money funding or "crowdfunding" means financing models, which are not dependent on banks, institutions, non-bank lenders or various funds and organisations. Crowdfunding is a relatively new type of financing, especially in Latvia; thus, the research aim is to evaluate the possibilities for Latvia's promoters to raise funding through crowdfunding platforms. The research proved that crowdfunding success engine is "People Funding Stories", since people are fascinated by stories - no matter whether these stories tell about a dream of a new entrepreneur or helping other people. Latvia's residents are open to new technologies and support the idea of crowdfunding. The basic concerns relate to organisational aspects of transactions not on the necessity of raising funds. Energetic and ambitious people from Latvia have also tried their luck to raise funds through international crowdfunding platforms like "Kickstarter" and "IndieGoGo". Here one can mention production of a cartoon "Stones in my pocket", start-up for production of "AirDog" - a small, agile, foldable quadcopter, especially designed for filmmakers and action sports enthusiasts who use GoPro cameras, development of an electric water heater "MIIT" (on "Kickstarter") and manufacturing of a board game "Mission to Mars 2049" (on "IndieGoGo").

**Key words:** crowdfunding, platforms, support, projects, innovation.

**JEL code:** G23, M51.

### Introduction

Crowdfunding is a financial source demonstrating a worldwide rapid trend of increase; however, it is little researched in Latvia with main studies done abroad (Belleflamme, Lambert, Schwienbacher, 2010; Blace, Grubisic, 2016; Brüntje, Gajda, 2016; Cohen, 2016; Freedman, Nutting, 2015; Nagymihaly, 2013; Müllerleile, Joenssen, Müllerleile, 2014; Poetz, Schreier, 2012; Stemler, 2013; Valanciene, Jegeleviciute, 2013; Wardrop, Zhang, Rau, Gray, 2015). Crowdfunding is an efficient method of project financing, which acts as a platform where a number of people or groups help support other efforts via providing financial resources. Hence, crowdfunding is an alternative form of finance as a result of non-traditional financial system. Its model is made up of three running parts: the promoter, which offers ideas for funding or project; people who support the idea; and an intermediary organisation or a platform that brings together the parties involved to implement ideas. This platform has emerged as a springboard for countless projects, and in recent years its importance has increased significantly,

since 1) the provider of financial support maximises result with the particular amount of financing; 2) financial risk of each provider of support decreases due to the risk division among all partners; and 3) the quality of project implementation grows due to the control of several organisations. The research **hypothesis**: crowdfunding has a potential as demanded and supported tool for fund raising in Latvia. Therefore, the research **aim** is to evaluate the possibilities for Latvia's promoters to raise funding through crowdfunding platforms. The following tasks are advanced to achieve the set aim: 1) to study functionality, demand and dynamics of crowdfunding in the world; 2) to describe the most essential crowdfunding platforms in the world; and 3) to describe the success and possibilities to collect funding on Latvia's crowdfunding platforms. The information compiled by the European Commission, the World Bank, scientific publications of foreign researchers, and other materials have been used for the purpose of the study. The research is mainly based on the monographic descriptive method as well as the methods of analysis and

synthesis are used to study the problem elements and synthesise coherencies or formulate regularities.

### **Research results and discussion**

Functionality, demand and dynamics of crowdfunding

Crowdfunding idea has various interpretations and types. Most often it is compared with micro-financing, peer-to-peer lending, equity crowdfunding, donation-based crowdfunding, rewards-based crowdfunding and others. Poetz and Schreier (2012) consider that crowdsourcing attempts to outsource the phase of idea generation to a potentially large and unknown population of users (the "crowd").

According to some other authors, crowdfunding is a method of collecting many small contributions, by means of an online funding platform, to finance or capitalize a popular enterprise (Freedman and Nutting, 2015). Müllerleile, Joenssen et al. (2014) have argued that crowdfunding is a process where commercial or noncommercial projects are initiated in a public announcement by organisations or individuals to receive funding, assess the market potential, and build customer relationships. The European Commission, in turn, defines crowdfunding as an open call to the public to raise funds for a specific project (European, Commission, 2014). Blace and Grubisic (2016) in their article have studied the European Commission approach and admit that "there are two possible divisions of types of crowdfunding. The first one includes crowd sponsoring (donation, reward or pre-sales based crowdfunding), crowd investing (profit-sharing or securities-based) and crowd lending campaigns. Further they state that crowdfunding is still in the early development stage so these main models can evolve in the future. The second division is that crowdfunding is associated with non-financial returns (donations, rewards and pre-sales) and with financial returns (crowd investing and crowd lending)" (Blace and Grubisic, 2016).

The research author agrees to these opinions, as crowdfunding may be found in various expressions.

The history of early crowdfunding may be traced back even to 1700s, while its modern aversion appeared at the very end of the 20<sup>th</sup> century. The first recorded successful instance of **crowdfunding** occurred in 1997, when a British rock band funded their reunion tour through online donations from fans. Inspired by this innovative method of financing, ArtistShare became the first dedicated crowdfunding platform in 2000 (The History ..., s.a.). Therefore, it is a new and innovative type of funding due to the fact that the most essential and successful fundraising platforms have launched their operation only some 10-12 years ago.

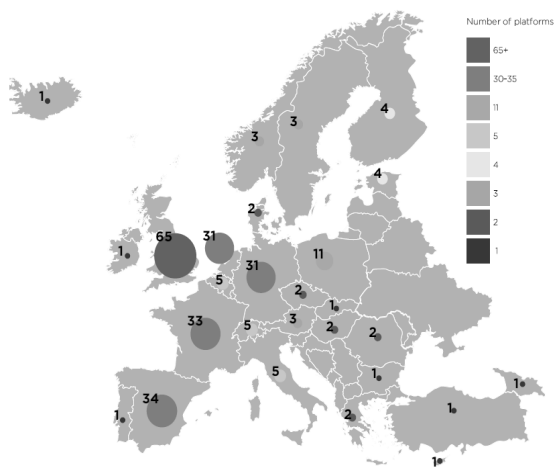
Crowdfunding is also an alternative funding as such mutual loan or "peer-to-peer lending", collective loans or "equity crowdfunding" donation based money funding or "crowdfunding" means financing models, which are not dependent on banks, institutions, non-bank lenders or various funds and organisations.

One of the best known is a crowd funding principle ("rewards-based crowdfunding"). This type of lending allows financing of some creative and innovative projects, business ideas or start-in return for products or services after the project implementation (Pieaug alternativas ..., 2016). This is the principle many platforms follow.

Therefore, one can say that crowdfunding is a simple, safe and efficient financial mechanism based on collective fundraising and investing. Crowdfunding is an EU-wide phenomenon, as crowdfunding projects are identified in every Member State. However, there are significant differences in levels of activity between Member States (European Commission, 2016).

In 2015, professors from the University of Cambridge published a comprehensive report on the development of crowdfunding in Europe "Moving Mainstream. The European Alternative Finance Benchmarking Report". The researchers

here admit the strength of the European online alternative finance market. They have surveyed 255 platforms in 27 European countries between 2012 and 2014 and concluded that these platforms had facilitated EUR 4.66 million worth of funding to European consumers, entrepreneurs, creative artists, SMEs, social enterprises, renewable energy projects, community organisations and good causes (Wardrop et al., 2015). However, the dispersion of crowdfunding platforms in Europe by countries is quite heterogeneous (Figure 1).



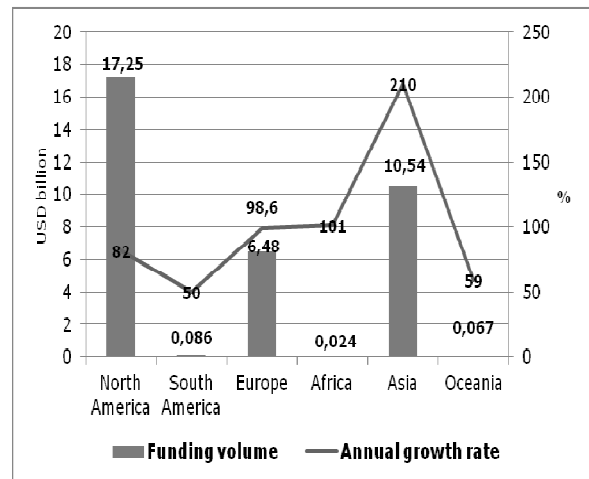
Source: Wardrop et al., 2015

Fig.1. The geographical distribution of alternative finance platforms in Europe in 2015

The absolute leader in the number of crowdfunding platforms is the UK with 79 % share of alternative finance platforms in Europe. The UK online platform-based alternative finance industry has reached EUR 2.34 million in 2014 with a 168 % annual growth rate. The European online alternative finance market, excluding the UK, has grown by 147 % from EUR 137 million in 2012 to EUR 338 million in 2013 (Wardrop et al., 2015). The previously mentioned report shows that the three-year average growth rate for the European market is 115 %. As the geographical distribution of surveyed alternative finance platforms illustrates, the online alternative finance markets are well developed in Spain (which has 34 platforms), France (33), Germany

(31) and the Netherlands (31) (Wardrop et al., 2015).

Success of crowdfunding is evidenced also by forecasts related to the annual funding volume and growth rate (Figure 2).



Source: author's construction based on Crowdfunding Industry Report, 2015

Fig.2. Regional crowdfunding volume and growth rate prediction for 2015

According to the Crowdfunding Industry Report, the largest amount of funding is raised in the North America with the key centre of the USA, followed by Asia and Europe. However, the highest annual growth rate is to be observed in Asia (210 %), Africa (101 %) and Europe (98.6 %). The World Bank has identified that "despite its slow adoption in developing economies, crowdfunding has been heralded as an opportunity to expand access to capital for entrepreneurs. Developing countries in Africa are among the lowest performing in the world in terms of utilizing crowdfunding. In 2015, the African crowdfunding market totals about USD 70 million, which accounts for less than half of one percent of global crowdfunding activity and about 21 % of emerging market activity" (Crowdfunding in Emerging ..., 2015).

### Crowdfunding platforms in the world

Crowdfunding might be considered as a truly global phenomenon with many platforms operating in different countries of the world sourcing both transactions and investors. Apart from many others like "Crowdfunder",

"EquityNet", "Crowdrise" and "RocketHub", the world's largest crowdfunding platforms for the implementation of various ideas are "Kickstarter", "IndieGoGo" and "GoFundMe". Each of these platforms has its own specific features and slightly different principles of operation, which have to be taken into account when promoting a project and raising foundation (Table 1).

Table 1

**Comparison of three largest crowdfunding platforms in the world**

	<b>Kickstarter</b>	<b>GoFundMe</b>	<b>IndieGoGo</b>
<b>Year of foundation</b>	2009	2010	2007
<b>Aim</b>	platform for creative projects	social fundraising platform	platform for entrepreneurial ideas
<b>Principle of funding</b>	very limited campaign period and, if it fails to collect the desired amount, it will be returned to the investors and the promoter will derive no material benefit	promoters may keep every donation they receive	unsuccessful fixed funding campaigns refund all contributions and fees
<b>Fundraising fee for successful projects</b>	8-10% from the raised amount	5% from each investment	8-10% from the investment amount
<b>Fundraising fee for unsuccessful projects</b>	0%	5% from each investment	8-10% from the investment amount
<b>Benefit to supporters</b>	sponsors receive smaller of bigger gift from the project promoters	sponsors receive moral satisfaction instead of a material one	sponsors may receive not only a symbolic gift or produced output but they may receive also the company's shares
<b>Processing fee</b>	3%	3%	2.9%

**Source: author's construction based on websites of Kickstarter, GoFundMe and IndieGoGo**

The platform "IndieGoGo" is the oldest out of all three analysed fund raising platforms and it brings together a wide range of projects and is unique in the fact that nonprofits and socially minded campaigns enjoy a 0 % platform fee. The platform "Kickstarter" designed for artists, musicians, film designers and other creative people is like an enormous global community - everything from films, games, and music to art, design, and technology. "Kickstarter" is full of ambitious, innovative, and imaginative ideas that are brought to life through the direct support of others. Kickstarter annually donates 5 % of its after-tax profit towards arts and music education, and to organisations fighting to end systemic inequality (Kickstarter, s.a.). The platform "GoFundMe" is intended mostly to individual objectives and personal development, such as education or medical expenses. Unlike a number of other sites, the project applicant may retain his donated money even if it has not reached the desired amount but "GoFundMe" reserves 5 % of

each contribution, while the contributor obtains satisfaction, rather than any material benefit.

Energetic and ambitious people from Latvia have also tried their luck to raise funds through international crowdfunding platforms like "Kickstarter" and "IndieGoGo". Here one can mention production of a cartoon "Stones in my pocket", start-up for production of "AirDog" - a small, agile, foldable quadcopter, especially designed for filmmakers and action sports enthusiasts who use GoPro cameras, development of an electric water heater "MIIT" (on "Kickstarter") and manufacturing of a board game "Mission to Mars 2049" (on "IndieGoGo").

As Brian Meece one of the founders of the USA crowdfunding company "RocketHub" admits that crowdfunding success engine is "People Funding Stories", since people are fascinated by stories - no matter whether these stories tell about a dream of a new entrepreneur or helping other people. Directly stories are those that allow feeling closer to any idea and helping it become a reality. Meece compares crowdfunding with a new type of ecosystem of ideas, driven by people's stories, besides crowdfunding allows bringing together different segments of society and building a sense of community (Crowdfunding ..., 2013). Nevertheless, probably the key to success is being able to tell ideas and vision, and arguing for them. It is no secret that women are able to successfully communicate and a sense of community building is easier for them; thus, women are more successful in attraction of financing directly with the crowdfunding (Crowdfunding ..., 2013). Though, crowdfunding is not a panacea for each company or idea, says Meece (Crowdfunding ..., 2013). Projects attracting people emotionally, those being creative and exciting are better funded on these platforms. In general, enthusiasm with the idea is the key to success.

**Crowdfunding ideas and projects in Latvia**

In Latvia, "ziedot.lv" has been the only internet-based financing platform for many

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years. It was established in 2003 as charity organisation to channel individual and business donations to people in need. According to the information found on the organisation's website its "goal is to encourage the social change by providing an opportunity to donate" (ziedot.lv, s.a.). The organisation does not keep any commission; hence, all donations for 100 % reach the charity goals.

Almost ten years later in 2014, Lielvarde local action group "Zied zeme" set up an internet platform "Idejuarmija.lv" (Army of Ideas), which was the first crowdfunding platform in Latvia. Its mission was to find additional funding for local creative projects. In April 2015, a collective investment platform "Projektu banka" (Project Bank) started to operate after merging of two similar projects "idejuarmija.lv" and "mecenats.lv". The platform "Project Bank" operates after "rewards-based crowdfunding" principle allowing the financing of creative and innovative projects, business ideas or start-ups in return for products or services after the project implementation.

During the current operation period of almost 21 month (April, 2015-January, 2017), the "Project Bank" has successfully supported 23 projects in various fields - gathered the necessary funding for cultural events, music recordings, books, business plans, and other creative projects. In total, different project supporters have invested EUR 51 142, i.e., exceeding the necessary support amount by EUR 5413 or 111.84 % (Projektu banka ..., s.a.). The largest support in the amount of EUR 10 494 was received by a full-length criminal comedy "Criminal Excellence Fund". The project was supported by 239 investors who in turn received cinema tickets, roles in the comedy and some other smaller benefits (T-shirts). The raised financing equalled to 104.94 % of the needed amount. Second largest successfully implemented project was a short fiction film "En garde!", which tells about a noble and elegant

sport with an aristocratic charm - fencing. The film participated in the Cannes Film Festival and was ranked among the best films. The project promoters for raising EUR 4000 offered from invitations to the first showing to those who invested EUR 5 to invitation to the first showing, name on the big screen, digital copy of the film and film poster with filmmakers' autographs to those who invested EUR 35 and more. Another interesting project raising funding 2.8 times with 180 supporters more than required was showing the trilogy "Matrix" on the big screen. Some other interesting ideas been supported include projects submitted by a gaming manufacturer "Kokmaizites", whose games are aimed at promoting children's literacy skills by offering a simple and entertaining card game; funding for apple juice production equipment and funds for 45 children's protective clothing to students organize tours bee apiary (Projektu banka ..., s.a.).

Unfortunately, not all ideas end successfully and raise funding; thus, 21 projects managed to collect only part of the necessary financing, while 5 projects ended with zero.

M. Cirulis, the manager of the platform "Project Bank" explaining the principle for attracting funding notes that "people sell their ideas. If a person is willing to pay, he will invest money in a project and get something back, it is not only the principle of charity. People are investing their money in the project and actually buying a future product. It may be something tangible, like a thing, object, event or service" (Asere, 2016). Besides he admits that often crowdfunding platforms offer advance purchase of a product but it is not so always because the invested amount does not always correspond to the value of gratitude. For example, the "Project Bank" supports a project directed to charity - creation of a children's playground. "Investing EUR 5, a person will receive a child's smile each time a person walks past the playground. It is not a selling in advance - you cannot sell a

child's smile. You invest rather in people's ideas than pre-purchase of a book or disk. Contribution may be larger than just the price of the book", says M.Cirulis (Asere, 2015).

Services of the "Project Bank" are currently free of charge thanks to the Society Integration Fund of Latvia, Island, Liechtenstein and Norway that support financing and maintenance of the platform. However, a small commission for those who want to raise funds might be introduced in the future.

Fifty-three new projects are on the queue to be launched on the "Project Bank" platform with funds ranging between EUR 200 for reflective security bridles for dogs ensuring their visibility at night to EUR 10 000 for a book describing the history of a small town Talsi in Kurzeme region of Latvia. Projects "Latvia in the Space" (EUR 8500) offering to build a rocket and launch it in the height of 100 km on Latvia's centenary in 2018, "Woodline" (EUR 5000) offering to manufacture wooden sinks and "Symbols of Latvia (EUR 900) – a table game aimed at acquisition of different national symbols could be mentioned among the most interesting future projects.

In Latvia, refunding is organised similar to international crowdfunding platforms, i.e. if the project campaign comes to an end and the required amount is not collected, all the investors get back their money via the virtual "Project Bank" account. This sum may be diverted to another project or on request returned to the investor. Promoters of the project, which was not 100 % supported, in turn, may reconsider the idea through lessons learned, rework the project and try to submit it for the second time. However, experience shows that it is better to work on the first campaign at full capacity. If the project has collected more funds than necessary, then all funds raised are directed for the implementation of the project and it means that people believe in the idea and see its necessity.

Another specific feature of crowdfunding may be related to raising funds in the real estate sector.

In December 2016, a real estate crowdfunding and buying platform "Bulkestate.com" started its operation. The platform is owned by LP Private Property, a company with national capital. The companies BDO and Latvia Ober Haus Real Estate Latvia are the innovative project partners. "Figuratively speaking, Bulkestate.com may be called a platform that combines real estate owners and potential investors who are willing to finance a specific project and to make a profit, well above the banks offered deposit interest" (Latvijas investori ..., 2017). The minimum contribution is EUR 50. Bulkestate mission is to make quality real estate investments available to everyone whether a person wants to invest and make a profit or purchase an apartment. The cost of its services is included in the deal price. It means that for group buying offers purchase price already includes cost of the services and there will be no separate fee. For investment projects the expected return on investment represents income after cost of the services (Bulkesatte.com, 2017). As soon as the chosen project has raised the necessary funding, the person becomes an investor. Similar to the platform "Project Bank" if the investment target is not reached, potential investors receive their investment to the bank account within 48 hours.

The platform "Bulkestate.com" provides both investing and group buying possibilities. Investing means investments (from EUR 50) in certain real estate projects, for example, investing in the reconstruction of an apartment house which is published on the platform. Potential investors may choose the amount they want to invest in this project. The second tool is a group buying of real estate. In this case, the platform Bulkestate.com acts as a partner. "In this scenario, for example, we get from the bank apartment houses on the wholesale price," explains I. Puntuss "and offer them to investors

on the retail prices. The customer can choose an apartment in the house. Then he makes a reservation and pays a deposit price per square metre. This possibility of the apartment acquisition process allows to save 30-40 %" (Latvijas investori ..., 2017).

An apartment house in Riga was the first investment object offered by the platform on 12 December, 2016. Fundraising deadline was set to 31 December, and the required amount of investments – EUR 60 000 was collected on time", says I. Puntuss, a board member of Private Property LP (Latvijas investori ..., 2017). The project profitability accounted for 15 % per annum with the investment recovery period of 1 July, 2017. It is worth mentioned that the platform has already attracted around 150 investors.

Several Estonian real estate crowdfunding platforms like "Crowdstate" and "EstateGuru" also operate in Latvia from 2016. Since its founding the "Crowdstate" has attracted private investors in financing 30 projects for EUR 12.88 million (Latvija izveidota ..., 2017).

Hence, it may be concluded that crowdfunding as a new idea gains popularity in Latvia.

### **Conclusions, proposals, recommendations**

- 1) Crowdfunding is an efficient method of project financing, which acts as a platform where a number of people or groups help support other efforts via providing financial resources. Crowdfunding is an EU-wide phenomenon, as crowdfunding projects are identified in every Member State.
- 2) The absolute leader in the number of crowdfunding platforms is the UK with 79 % share of alternative finance platforms in Europe. The UK online platform-based

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alternative finance industry has reached EUR 2.34 million in 2014 with a 168 % annual growth rate.

- 3) Apart from many others like "Crowdfunder", "EquityNet", "Crowdrise" and "RocketHub", the world's largest crowdfunding platforms for the implementation of various ideas are "Kickstarter", "IndieGoGo" and "GoFundMe". Each of these platforms has its own specific features and slightly different principles of operation, which have to be taken into account when promoting a project and raising foundation.
- 4) Latvia's residents are open to new technologies and support the idea of crowdfunding. The basic concerns relate to organisational aspects of transactions not on the necessity of raising funds.
- 5) The crowdfunding platform "Project Bank" operates on mutual trust and confidence principle to achieve higher goals. The managers of the platform examine a project promoter's personality, project compliance with criteria, while investors may analyse the promoter through social networks to get the maximum confidence.
- 6) Most Internet platforms work with consumer credits and are not interested in the real estate market development. By contrast, real estate financing team paves the way to the market via a wide audience, and not only major financial players are among them.
- 7) The research proved the advanced hypothesis that crowdfunding has a potential as demanded and supported tool for fund raising in Latvia. The justification follows from the growing demand for services of crowdfunding platforms.

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