

## ARTICLES

### REGULATING THE UNREGULATED: THE ADVENT OF FINTECH REGULATIONS AND THEIR IMPACTS ON EQUITY-BASED CROWDFUNDING

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*The concept of equity-based crowdfunding (ECF) has become one of the latest innovative financing alternatives for startups and SMEs throughout the world during the last decade. This article aims to assess the revised crowdfunding directive of Turkey and its role in the development of the ecosystem. The concept of ECF is elucidated with its stakeholders, challenges, and solutions. Then the effect of the revised regulation is analyzed through a case study of the first active ECF platform in Turkey, Fonbulucu. Finally, the article discusses the potential improvements to the existing directive considering the practices of Fonbulucu.*

*Keywords: crowdfunding; regulation; investment; risk; equity-based crowdfunding; ECF platform; Fintech.*

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## **Introduction**

Hollywood star Tom Hanks's most iconic role might be Forrest Gump; an American comedy-drama film about a fictional story of a man, Forrest Gump.<sup>1</sup> In the movie, despite his low IQ – 75, – Forrest becomes rich thanks to his investment decision. He reveals his source of wealth as investing in a “fruit company,” Apple Inc. After a while, he does not have to worry about money because he becomes a “gazillionaire.” This is a dream outcome for all investors to catch the right startup at the right time, i.e. very early stage. Such an investment may bring ten times, 100 times, or even 1000 times return on investment according to the startup's future success. This might be one of the main logic behind equity-based crowdfunding in the eyes of investors, through which ordinary people can gain a very high return by investing in early-stage startups in a legally regulated way.

When we explore the term “crowdfunding,” it has been broadly visible since the 2000s. It has become an innovative and alternative means of financing for small and medium-sized enterprises (SMEs) and startups, especially after the 2008 financial crisis.<sup>2</sup> Declining the availability of conventional financing opportunities after the crisis might be the main reason SMEs look for alternatives. Fund seekers see crowdfunding as a suitable alternative to traditional instruments during a crisis, although conventional investors usually look for safe-haven assets like gold or oil when there is high uncertainty in the market.<sup>3</sup> Although this inverse relationship, the crowdfunding sector has proliferated since that time. The annual market volume reached \$40bn in loan-based, \$7bn in donation-based, \$1.5bn equity-based, and \$1.25bn in reward-based crowdfunding in 2020.<sup>4</sup>

<sup>1</sup> Forrest Gump, IMDB (Jul. 20, 2023), available at [https://www.imdb.com/title/tt0109830/?ref\\_=vp\\_vi\\_tt](https://www.imdb.com/title/tt0109830/?ref_=vp_vi_tt).

<sup>2</sup> Krystallia Moysidou & J. Piet Hausberg, *In Crowdfunding We Trust: A Trust-Building Model in Lending Crowdfunding*, 58(3) J. Small Bus. Mgmt. 511 (2020).

<sup>3</sup> Mustafa Disli et al., *In Search of Safe Haven Assets During COVID-19 Pandemic: An Empirical Analysis of Different Investor Types*, 58 Res. Int'l Bus. Fin. 101461 (2021).

<sup>4</sup> Tania Ziegler et al., *The 2<sup>nd</sup> Global Alternative Finance Market Benchmarking Report* (2021).

Crowdfunding can be defined as raising a relatively small amount of funds from a large group of people – the crowd – as a donation or in exchange for equity, reward, or interest through digital platforms.<sup>5</sup> Thus, it could be classified into four categories: donation-based, reward-based, debt-based, and equity-based crowdfunding, as illustrated in Figure 1 below. Entrepreneurs can raise capital in exchange for equity through Equity-based crowdfunding – ECF. The Internet is crucial in developing the concept of ECF as it facilitates the mediatory roles of platforms between investors and entrepreneurs. Hence, the rapid increase of ECF can also be directly linked to technological advancement, especially in Internet connection, Web services, and fast, secure digital payment infrastructures. Technology-driven fintech solutions continuously disrupt the conventional financial system, which creates new opportunities and innovations for the development of ECF ecosystems.<sup>6</sup>

Figure 1: **Types of crowdfunding**

	<b>Donation-based crowdfunding</b>	<b>Lending-based crowdfunding</b>	<b>Reward-based crowdfunding</b>	<b>Equity-based crowdfunding</b>
<b>Kinds of contributors</b>	Philanthropists	Investors	Early customers	Partners
<b>Expectations as a return</b>	No expected return	Loan to be returned with interest	Receive a reward, probably the product	Share of all future profits

Adopted from Nuno Bento et al. 2019<sup>7</sup>.

As a result of the growing demand for ECF, the need for a trusted and regulated ecosystem has emerged, and the U.S. is the first country which regulated the crowdfunding market in 2012, followed by the UK in 2014.<sup>8</sup> Interventions of governments have shaped crowd-based ecosystems because regulations set obligations and limits for ECF campaigns, investors, entrepreneurs and ECF platforms. Consequently, many academics see the impact of regulations as worth

<sup>5</sup> C. Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 21(6) Colum. Bus. L. Rev. 1081 (2012).

<sup>6</sup> Ahmet F. Aysan & Zhamal Nanaeva, *Fintech as a Financial Disruptor: A Bibliometric Analysis*, 1(4) Fin-Tech 412 (2022).

<sup>7</sup> Nuno Bento et al., *Crowdfunding for Sustainability Ventures*, 237 J. Clean. Prod. 117751 (2019).

<sup>8</sup> Antonella F. Cicchiello, *Harmonizing the Crowdfunding Regulation in Europe: Need, Challenges, and Risks*, 32(6) J. Small Bus. Entrepreneurship 585 (2020).

investing in.<sup>9</sup> On the other hand, contrary to the U.S. and the UK, Turkey has lately regulated the field in 2019 and revised a final version on 27 October 2021 with the title of “Communique on Equity-Based Crowdfunding.”<sup>10</sup> The policy implementation experience of Turkey might be beneficial to develop ECF policies for some east Balkan and Middle East countries, which share similar cultures and socio-economic conditions but haven’t regulated the ECF market yet.

There were only eight licensed ECF platforms in Turkey when this paper was written. Although a few articles focus on the new Turkish ECF regulation and compare it with regulations of different countries, no paper concentrates on the practical impact of the new directive of Turkey. Hence, the effect of the regulation on the development of ECF needs to be explored to assess the impacts and to set examples for other developing countries. This paper aims to fill this gap by analyzing the theoretical aspects of ECF and its practical application in Turkey. The paper employs a case study methodology to discuss the effect of the directive on the first and the most active ECF platform of Turkey – Fonbulucu.

The findings from the case indicate that the regulation could be accepted as supportive as it fosters the ecosystem. After the release of the communique, eight players started to operate in the market, and the leading platform reached significant figures in a short time, which are positive indicators for an emergent crowdfunding ecosystem. However, the case study reveals some areas for improvement in the existing regulations, for which Fonbulucu tried to find practical solutions within the current legal framework. The first problem is that ECF investments need to be more liquid. Moreover, the insufficient post-funding monitoring mechanism places investors at entrepreneurs’ mercy. Thus, policymakers should improve these deficiencies, regulating and allowing secondary markets for ECF investments and designing more effective post-funding audit mechanisms.

This paper begins with a brief literature review on ECF, explaining the concept, its stakeholders with challenges and possible solutions as responses to the newly introduced regulations. The following section discusses the revised Turkish directive to catalyze the adoption of the ECF and the objectives of the policymaker through a theoretical perspective. To explain the practical impact of the directive on the ecosystem, the paper goes on a case study of the leading ECF platform in Turkey, Fonbulucu. The paper’s final section highlights the necessity for further improvements on the existing regulatory framework.

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<sup>9</sup> Kazem Mochkabadi & Christine K. Volkmann, *Equity Crowdfunding: A Systematic Review of the Literature*, 54(1) Small Bus. Econ. 75 (2020).

<sup>10</sup> Resmi Gazete: Tebliğ [The Government Gazette of the Republic of Turkey: Notification], 27 October 2021 (Jul. 20, 2023), available at <https://www.resmigazete.gov.tr/eskiler/2021/10/20211027-3.htm>.

## 1. The Concept of Equity-Based Crowdfunding and its Main Issues

Since the global financial crisis in 2008, crowdfunding has gained significant momentum.<sup>11</sup> The volume of equity-based crowdfunding grew from just £4 million in 2012 to £549 million in 2020 in the UK.<sup>12</sup> The global market volume of ECF reached £1520.4 million in 2020 with a 35% annual growth rate. Before ECF platforms, it was difficult for typical entrepreneurs to raise small investments from many people.<sup>13</sup> However, the advancement of the Internet has solved this problem with online payment systems and central securities depository systems. As a result, entrepreneurs can begin to reach a large group of potential investors through these platforms.<sup>14</sup>

The ECF mechanism generally has five actors: entrepreneurs, investors, the ECF platforms, supportive services providers, and regulatory bodies. Entrepreneurs are the first actors since their demand for capital raising starts the ECF process. The second group is the investor, who supplies the fund for entrepreneurs in exchange for shares. The third stakeholder is the platform operating as an intermediary, through which the first two groups can communicate and exchange funds and equities. In addition to these three main actors, there are other stakeholders in the ecosystem: supportive services providers and supervisory organizations. Supportive services are provided by central securities depositories and custodian & clearance houses, which keep the fund safe until the exchange of equities is transferred and record the ownership of equities. The last stakeholders of the ECF are regulatory and supervisory bodies.

According to Mochkabadi & Volkmann,<sup>15</sup> the literature about ECF can be classified into five main research themes in terms of their focus: capital market perspective, entrepreneurial perspective, institutional perspective, investor perspective, and platform perspective. The studies of institutional perspective examine the impact of laws, comparison of the regulations, and the legal relationship between contracting parties. Most of the research within this perspective tries to analyze the impact of published regulations on all stakeholders.

Investment decisions are associated with financial risks; hence, such activities are well-regulated in most countries. Especially ECF investments are high-risk and high-return decisions because of the uncertainty of early-stage start-up projects. ECF can be summarized as buying private company equities by many people with

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<sup>11</sup> Alan Tomczak & Alexander Brem, *A Conceptualized Investment Model of Crowdfunding*, 15(4) Venture Cap. 335 (2013).

<sup>12</sup> Ziegler et al. 2021.

<sup>13</sup> Jeremy C. Short et al., *Research on Crowdfunding: Reviewing the (Very Recent) Past and Celebrating the Present*, 41(2) Entrepreneurship Theory Pract. 149 (2017).

<sup>14</sup> Swati Gupta et al., *Prioritising Crowdfunding Benefits: A Fuzzy-AHP Approach*, 57(1) Qual. Quant. 1 (2022).

<sup>15</sup> Mochkabadi & Volkmann 2020.

or without qualifications to invest. This simple definition reveals three significant risks: information asymmetry, reliability of investors, and adverse selection. These are all related and, more specifically, refer to the following cases:

1. The risk of information asymmetry: ECF projects/ventures do not usually have publicly available and independently verified financial information and history, contrary to public companies. Generally, only the project/business information is presented during the fundraising campaign or available through social media.

2. Risk of non-qualified investors: Crowdfunding is based on “crowds,” including qualified investors and ordinary people (unaccredited investors) with/without formal expertise or training in investment. They may be unable to evaluate the risk and make well-planned decisions on such high-risk, high-return opportunities.

3. Risk of adverse selection: Information asymmetry and unreliable investors can cause the issue of adverse selection. A startup which should not be funded might get funds through ECF. Moreover, some scholars argue that crowdfunding might not be the first choice of promising start-ups because if they can raise funds from Venture Capital Funds – VCs, – they would not use ECF.<sup>16</sup> These raise concerns about adverse selection.

There are also solutions to these problems in the ECF ecosystem. First of all, ECF platforms evaluate all applications and select competent projects. In other words, they act as gatekeepers and decide which ventures may receive funds. This pre-investment screening and evaluation process is usually structured and systematic. ECF platforms use their broad networks throughout this process, including business analysts, lawyers, finance professionals, accountants, experts, and professional investors.<sup>17</sup> Accordingly, the risk of adverse selection could be mitigated by the due diligence of ECF platforms at the beginning.

ECF platforms must also disclose all the critical information and news about the startups on their website. Therefore, platforms reduce information asymmetries since they preselect suitable projects and reveal important information about them.<sup>18</sup> Platforms have syndicated investor structures composed of qualified and “crowd” investors to reduce the risk of ordinary investors’ incompetent decisions.<sup>19</sup> The platforms also facilitate transparency and communication between investors and allow qualified investors to lead others.<sup>20</sup> Finally, there are also some restrictions

<sup>16</sup> Michael B. Dorff, *The Siren Call of Equity Crowdfunding*, 39(3) J. Corp. L. 493 (2014).

<sup>17</sup> Jonas Löher, *The Interaction of Equity Crowdfunding Platforms and Ventures: An Analysis of the Preselection Process*, 19(1–2) Venture Cap. 51 (2016).

<sup>18</sup> Susanne Braun, *Deutsche Crowdinvesting-Portale: neue Geschäftsmodelle für KMU*, Lüneburger Beiträge zur Gründungsforschung, No. 11, Leuphana Universität (2015).

<sup>19</sup> Ajay Agrawal et al., *Are Syndicates the Killer App of Equity Crowdfunding?*, 58(2) Cal. Mgmt. Rev. 111 (2016).

<sup>20</sup> Jill E. Fisch, *Can Internet Offerings Bridge the Small Business Capital Barrier?*, 2 J. Small & Emerging Bus. L. 57 (1998).

on the total amount of investment per year for each investor and each project. This is also a precaution against the total risk taken by the crowd investors.

Competition among ECF platforms should be beneficial to develop a more efficient ecosystem with optimal disclosure requirements, increasing transparency and decreasing information asymmetries.<sup>21</sup> However, regulations and supervision are still crucial for the ECF ecosystem as the market alone may not protect its stability and effectiveness.<sup>22</sup> Regulation can be seen as the most important precaution for potential risks like asymmetric information and adverse selection problems.<sup>23</sup> As a result, the design of regulations to balance the support of the development of ECF is academically worth exploring.<sup>24</sup>

## 2. The ECF Regulations

Countries having developed ECF ecosystems, like the U.S. and the UK, have developed specific regulations for ECF.<sup>25</sup> Other countries prefer to follow their current laws regulating financial intermediation, with minor adjustments according to crowdfunding requirements.<sup>26</sup> In some countries, ECF is not defined at all, and the only legal way to raise funds from the crowd is allowed in a very bureaucratic way, similar to an initial public offering within a stock exchange under the capital markets law like it was the case in Turkey before 2019.

The term crowdfunding was first defined in the legislative documents with the amendment of the Capital Market Law of Turkey in 2017.<sup>27</sup> Through this law, The Capital Markets Board of Turkey (SPK) has been authorized to pass a secondary regulation for the framework of execution and supervisory rules, although there is no specification for the execution of the crowdfunding.<sup>28</sup> Based on this authorization, SPK published the Communiqué on Equity-Based Crowdfunding on 3 October 2019,

<sup>21</sup> Oliver Mäschle, *Which Information Should Entrepreneurs on German Crowdfunding-Platforms Disclose?*, Thünen-Series of Applied Economic Theory – Working Paper, No. 127, Universität Rostock (2012).

<sup>22</sup> Lars Hornuf & Armin Schwienbacher, *Should Securities Regulation Promote Equity Crowdfunding?*, 49(3) Small Bus. Econ. 579 (2017).

<sup>23</sup> Emily Lee, *Equity Crowdfunding in Hong Kong: Potential, Challenges and Investor Protection*, 19(2) J. Corp. L. Stud. 277 (2019).

<sup>24</sup> Cicchiello 2020.

<sup>25</sup> Garry A. Gabison, *Equity Crowdfunding: All Regulated but Not Equal*, 13(3) DePaul Bus. & Com. L.J. 359 (2014).

<sup>26</sup> Cicchiello 2020.

<sup>27</sup> Resmi Gazete: Kanun [The Government Gazette of the Republic of Turkey: Law], 5 December 2017 (Jul. 20, 2023), available at <https://www.resmigazete.gov.tr/eskiler/2017/12/20171205-12.htm>.

<sup>28</sup> Safa Yıldırım & Monzer Kahf, *Kitle Fonlama Platformlarına Yönelik Türkiye ve BAE'deki Yasal Düzenlemelerin Karşılaştırılması* [Comparison of Legal Regulations in Turkey and UAE Regarding Crowdfunding Platforms], 7(2) İslam Ekonomisi ve Finansı Dergisi 201 (2021).

prohibiting debt-based and real estate crowdfunding in Turkey.<sup>29</sup> Donation-based and reward-based crowdfunding are specifically mentioned in the communiqué and excluded from the regulation. But still, these two “unregulated” crowdfunding types must be utilized following the existing general law and relevant regulations such as anti-money laundering regulations while accepting payments. The regulation was revised on 27 October 2021, and debt-based crowdfunding has been allowed, while crowdfunding activities for real estate are still prohibited.<sup>30</sup>

The ultimate aim of the regulation might be to protect unaccredited investors against a risky investment decision in a startup project. The regulatory body prepared obligatory precautions in the directive to achieve this goal. As a simplification, we suggest grouping these measures into four main pillars, as shortly explained below:

1. Against the risk of information asymmetry: Entrepreneurs must share, and ECF platforms must publish all important documents and news about projects on specific campaign web pages, which must be kept updated at least five years after the successful funding round. These documents should include the project’s business plan, market research, entrepreneurs’ backgrounds, financial estimations and the budget plan, and a statement of purpose to clarify how the budget will be spent. The platform must provide a digital channel through which investors can communicate with the project’s founders.

2. Against the risk of adverse selection: The directive asks ECF platforms to establish an investment committee with professionals having specific qualifications. The committee must carefully evaluate all pre-selected applications with information sheets and feasibility reports. Then the committee decides whether to allow them to go through a crowdfunding round on the platform. All projects must be either technology-based or have a high-scale production potential. The committee’s decision is final, and they have limited responsibility for their evaluation, coupled with entrepreneurs giving the information.

3. Against the risks associated with unqualified investors: The directive has specific investor protection mechanisms, such as limitations for investors and startups. Unqualified investors have an investment budget of up to 68,100 Turkish Lira per year to invest in ECF projects. However, they can invest up to 272,400 Lira if they prove that this amount is equal to or lower than 10% of their annual income. All startup projects can raise funds for a maximum of two times a year and up to 20,000,000 Lira per year. These upper limits are set probably to restrict the burden of

<sup>29</sup> Adem Anbar, *Girişimcinin Finansmanında Alternatif Bir Yöntem: Kitleli Fonlama [An Alternative Method for Entrepreneur Financing: Crowdfunding]*, 88 Muhasebe ve Finansman Dergisi 237 (2020).

<sup>30</sup> Resmi Gazete: Yönetmelik [The Government Gazette of the Republic of Turkey: Regulation], 21 December 2021 (Jul. 20, 2023), available at [https://www.resmigazete.gov.tr/eskiler/2021/12/20211229-6.htm#:~:text=MADDE%209%20%E2%80%93%20\(1\)%20Dijital,Kurul%20bu%20tutar%C4%B1%20art%C4%B1maya%20yetkilidir.](https://www.resmigazete.gov.tr/eskiler/2021/12/20211229-6.htm#:~:text=MADDE%209%20%E2%80%93%20(1)%20Dijital,Kurul%20bu%20tutar%C4%B1%20art%C4%B1maya%20yetkilidir.)



financial risks on investors. The Ministry of Treasury and Finance of Turkey updates these limits each year. Moreover, all projects must have at least 5% of their ECF round investment from qualified investors, who are accepted to be able to evaluate the projects and risks more accurately than the unqualified investors. Hence, if they invest in a project, the risk for the crowd might be acceptable, as well.

4. Against the risk of misconduct after the funding campaign: Turkish regulation rules that all funds must be kept under the settlement and custody bank throughout the fundraising campaign. Only if the targeted investment amount is achieved, and the founders issue the equities for ECF investors; the fund can be released to a bank account of the project. Otherwise, the investment amount must be paid back to investors without deduction. Insufficient capital might risk the overall plans for startups, so it can be seen as another layer of protection for investors. Besides, these startups must be audited by an independent and licensed audit company at specific times. The projects, which raise more than 1,000,000 Turkish Lira, must be audited each year about whether their spending is appropriate to their budget plans and proposal. These financial reports are published on the same campaign web page annually.

The directive could be accepted as supportive as it includes incentives to facilitate the development of the nascent ECF ecosystem in Turkey. For instance, it allows ECF platforms to outsource needed services, such as digital infrastructure and accountancy could be hired from third parties. The initial capital requirement for getting a license as an ECF platform is 1,000,000 Turkish Lira, which is significantly lower than the initial capital requirement of establishing a digital bank, which is 1,000,000,000 Turkish Lira.<sup>31</sup> Additionally, this capital requirement is set at 500,000 Turkish Lira for the first two years. However, the directive also has an obvious obstacle for crowd investors. The ECF process takes three to five months from investing to getting equities for investors. During this long process, the directive doesn't rule out any interest payments for the investment funds waiting for the end of the ECF process. These gainless months create an opportunity cost for investors. The cost could be enormous, especially during high-inflationary times.

According to Cicchiello et al.,<sup>32</sup> the regulations specifically addressing the ECF can be classified into two categories either restrictive or non-restrictive. In this context, the regulation in Turkey might be categorized as restrictive or over-proactive for the following reasons. The communique specifies that only technology and production-based projects can utilize ECF. It defines strict financial limits for the annual investment budgets, has a very conservative approach to settlements and prohibits the specific type of domains from ECF, such as real estate or service sectors.

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<sup>31</sup> The Government Gazette of the Republic of Turkey: Regulation, *supra* note 30.

<sup>32</sup> Antonella F. Cicchiello et al., *Entrepreneurial Dynamics and Investor-Oriented Approaches for Regulating the Equity-Based Crowdfunding*, 10(2) J. Entrepreneurship Pub. Pol'y 235 (2021).

### 3. Fonbulucu: The First Active ECF Platform in Turkey

When this article was written, six of eight licensed platforms were already active and had started operations to raise capital through ECF. These active platforms were Fonbulucu, Efonla, Startup Burada, Fongogo, Basefunder and Fonangels, whose parent companies are listed as ECF providers.<sup>33</sup> The leading platform, Fonbulucu is a brand of Global Kitle Fonlama Platformu A.Ş. – a joint stock company, – it started as a reward-based crowdfunding platform in 2016. SPK granted the ECF license for Fonbulucu on 8 April 2021, and since then, the platform has helped start-ups to raise funds for their projects.<sup>34</sup>

It launched the first equity crowdfunding campaign in the country for a biotechnology startup, PromoSEED, in May 2021 and successfully raised 250,000 Turkish Lira.<sup>35</sup> 17 months after this first campaign, Fonbulucu has received applications from 3,005 different startup projects demanding 1,974,418,019 Turkish Lira (approximately \$106,200,038)<sup>36</sup> until 10 October 2022. The demand for ECF boomed, and it can be said that the platform has started an ECF trend in Turkey. Projects from a wide range of sectors – from agriculture to high-tech robotics, applied for fundraising, similar to “Let’s blockchain it!” hype of recent years.<sup>37</sup> The platform shared insightful information about its performance on ECF. According to the platform<sup>38</sup> it launched 57 ECF campaigns, of which 42 were successful, six were unsuccessful, and nine were still open for investment as of 10 October 2022. These projects have raised 140,666,131 Turkish Lira – approximately \$7,566,152, – and the platform has had 30,089 members as crowdfunding investors. None of the other platforms achieved to complete more than five crowdfunding campaigns until October 2022. Hence, the practical implications of the regulation should be analyzed through Fonbulucu because of its leading role in the Turkish ecosystem.

As the authorized regulator, The Capital Markets Board of Turkey (SPK) released the first version of the regulation in 2019, which allowed ECF platforms to apply for a license and begin to operate in Turkey. The SPK continuously collects feedback from the ecosystem and reviews the legal framework, and as a result, the directive was updated in

<sup>33</sup> Listeye Alınan Platformlar [Listed Platforms], Sermaye Piyasası Kurulu (SPK) (Jul. 20, 2023), available at <https://spk.gov.tr/sirketler/kitle-fonlama-platformlari/listeye-alinan-platformlar>.

<sup>34</sup> Hakkımızda [About Us], Fonbulucu (Jul. 20, 2023), available at <https://invest.fonbulucu.com/sayfa/Hakkimizda-5?b=0#:~:text=fonbulucu.com%20platformlari%2C%20Anadolu,yaymak%20amaciyla%202016%20yilinda%20kuruldu>.

<sup>35</sup> Kampanya Hakkında [About the Campaign], Fonbulucu (Jul. 20, 2023), available at <https://invest.fonbulucu.com/kampanya/99DWG4>.

<sup>36</sup> The calculation is based on the currency exchange rates of the Central Bank of the Republic of Turkey, 1 USD = 18,5915 Turkish lira (Jul. 20, 2023), available at [https://www.tcmb.gov.tr/kurlar/kurlar\\_tr.html](https://www.tcmb.gov.tr/kurlar/kurlar_tr.html).

<sup>37</sup> Ahmet F. Aysan, *Blockchain-Based Solutions in Achieving SDGs after COVID-19*, 7(2) J. Open Innovation: Tech. Mkt. Complex. 151 (2021).

<sup>38</sup> Fonbulucu Invest (Jul. 20, 2023), available at <https://invest.fonbulucu.com/>.

2021. However, Fonbulucu has developed its practical applications and “use cases” since the beginning. These actions can be classified into three groups discussed below.

### **3.1. Practical Responses Against Information Asymmetry**

Following the regulation, Fonbulucu has formed departments and its organization chart, as illustrated below in Figure 2. The investment committee acts as the gatekeeper through which the projects can be accepted by the platform for ECF campaigns. This is the first step to mitigating information asymmetry and protecting unaccredited investors. Besides this, Fonbulucu has started its venture capital fund – ReINVeS Ventures – which also invests in some projects, and these investments are publicly announced during the campaign. VC investments and announcements can be seen as a vehicle to enhance trust or signal, unqualified investors, for investing in such projects because VCs usually invest in a startup after a detailed due diligence process. However, these VC investments of Fonbulucu might aim to make incompetent funding campaigns successful because the ECF platform does not prefer to have many incomplete or failed funding campaigns.

**Figure 2:** The organization chart of Fonbulucu



Adopted from the website of Fonbulucu<sup>39</sup>.

<sup>39</sup> Organizasyon Şeması [Organization Chart], Fonbulucu Invest (Jul. 20, 2023), available at <https://invest.fonbulucu.com/sayfa/organizasyon-semasi-21?b=0>.

### ***3.2. Solutions Against the Lack of Exit Options and Liquidity on Existing Regulation***

The current legal structure does not allow a secondary market for trading equities held by crowd-funding investors. This makes such investments very illiquid. Moreover, early-stage startups usually do not pay dividends, so investors must wait to exit until either an initial public offering or an acquisition. To answer this necessity, Fonbulucu has taken two steps. The platform tries to open a communication website on which investors can communicate and agree on buying or selling equities from each other, which is not prohibited by the directive. But all transactions must be done manually by investors through the systems of the Central Securities Depository (Central Registry Agency). The second solution of Fonbulucu could be its VC fund, through which qualified investors can convert their investments into cash relatively easily.

On the other hand, policymakers can solve this problem by opening a well-regulated secondary market for ECF startups under a stock exchange, such as the Istanbul Stock Exchange, or each ECF platform can operate its secondary market. The first scenario can be more trustworthy among investors, while the latter solution can be more profitable for platform owners. Moreover, another question might be whether already-funded startups by VCs would be allowed to list their equities on such a secondary market.

### ***3.3. The Practical Approach of Fonbulucu for More Efficient Post-Funding Auditing and Monitoring***

The existing legal framework defines four precautions to audit and check equity-based crowdfunded projects. First, there are specific limitations on the domain of business activity. Due to these restrictions, startups should only focus on technology-based projects or production. Second, the fund seeker startup must present a proposal about its budgeting plans while applying to platforms. Third, ECF platforms must open a specific website for each ECF campaign and keep posting important updates about the startup related to the specific campaign for five years after the latest funding round. Lastly, the startup must be audited by an independent and licensed audit company, and these reports must be shared with crowdfunding investors through the campaign website.

In case of any misconduct, investors can attend the annual general assembly of shareholders. Still, they usually do not have voting power because they only have a small fraction of the company. The other legal option is to bring entrepreneurs to trial. However, neither crowd investors might be experts in the field nor generally have enough time and resources to go to court.

VC fund of Fonbulucu can be accepted as an alternative solution for the lack of an efficient post-funding audit and monitoring mechanism when ReINVeS Ventures of Fonbulucu invests in the startup projects and holds at least their 10% of shares, which amount gives the VC fund managers to take a seat on the board of a startup and intervene all significant decisions with a legally binding voting power.

## Conclusion

The rapid development of technology, increasing Internet adoption, and the scarcity of conventional financial options catalyzed the ECF as an alternative financing instrument after the financial crisis. The revised regulation in Turkey set specific mechanisms to overcome information asymmetry, adverse selection, risks associated with unqualified investors, and post-funding misconduct. The main aims of the communique are to protect crowd investors and facilitate ECF activity in a legally trusted way. Thanks to the regulatory framework, there were eight licensed platforms in Turkey; six were active when this article was written. Additionally, the leading platform, Fonbulucu, has shown an important performance and reached more than 30,000 ECF investors. Therefore, the new regulatory framework of Turkey could be accepted as successful in building a new ecosystem in the first instance.

However, when the communique's practical implications on the nascent Turkish ecosystem are analyzed through a case study on Fonbulucu, a few significant deficiencies are explored, which Fonbulucu seeks to solve within the existing legal framework. The platform established a VC fund to prevent information asymmetry, increase the liquidity of the ECF investments for qualified investors and develop a more effective post-funding audit mechanism. Additionally, Fonbulucu tries to open a specific communication platform to facilitate equity trades between ECF investors alike a secondary market.

In light of the practical solutions of Fonbulucu against the insufficiencies of the existing regulation, we can recommend that policymakers should increase the liquidity of ECF investments through secondary markets. Another policy recommendation could be to design more effective post-funding auditing mechanisms to protect crowd investors against any misconduct made by entrepreneurs.

Researchers might further focus on three areas in this context. First, the effect of the interest-free period of the ECF process can be analysed in terms of investors' decisions. Additionally, none of the licensed platforms serves as a the-debt-based crowdfunding provider, although this was allowed in 2021. Further studies can investigate the reasons behind this refrainment. Finally, the Turkish experience could be helpful for other developing big economies, such as BRICS countries that have recently developed ECF regulations, and vice versa. Therefore, researchers might acquire essential lessons from a comparative study on ECF regulations in BRICS countries and Turkey. Such a study could be helpful for South Africa, which does not have a specific regulation on ECF, especially.

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