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Institute of Islamic Economics
and Finance

MARMARA UNIVERSITY
INSTITUTE OF ISLAMIC ECONOMICS AND FINANCE
DEPARTMENT OF ISLAMIC ECONOMICS AND FINANCE

POSSIBILITY OF CROWDFUNDING APPLICATIONS THROUGH PARTICIPATION BANKING

(KİTLE FONLAMASININ KATILIM BANKACILIĞI ARACILIĞIYLA UYGULANMA İMKÂNI)

Master's Thesis

ÖMER KARABULUT

ISTANBUL, 2022

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ABSTRACT

POSSIBILITY OF CROWDFUNDING APPLICATIONS THROUGH PARTICIPATION BANKING

Crowdfunding is the funding requested by a person or group who owns a project. This process is usually done by means of internet. According to the researches specific to the subject, this method has emerged as a solution to the difficulties that small-scale and early stage companies are experiencing in finding financing, especially after the global financial crisis in 2008.

Today, there is a growing trend towards the realization of projects both abroad and domestically through crowdfunding. This requires that crowdfunding needs to be evaluated in terms of Islamic financial principles and rules. Participation banks, as organizations operating in a manner that adheres to Islamic financial principles and rules, already carry out a number of practices similar to crowdfunding, but it is a fact that these practices are not at the desired level.

In this study, the definition of crowdfunding and its different types, history of crowdfunding and its current situation are examined and explained in the presence of numerical data and tables. In terms of Islamic finance principles, how participation banks implement and execute the crowdfunding method were also examined. In addition, practices similar to crowdfunding in the current activities of participation banks were examined, and other factors that would encourage participation banks to use the crowdfunding method were revealed.

Through this study, it may be possible to understand the importance of crowdfunding by society, to expand the practice and increase its reliability with the introduction of participation banks in this regard. In this way, many projects that can contribute positively to the country's economy and individual entrepreneurship can be realized by interest-free and participatory methods.

Key Words: Crowdfunding, Islamic Finance, Entrepreneurship, Participation Banking

ÖZET

KİTLE FONLAMASININ KATILIM BANKACILIĞI ARACILIĞIYLA UYGULANMA İMKÂNI

Kitle fonlaması, proje sahibi bir kişi ya da grup tarafından talep edilen fonun bir grup insan tarafından finanse edilmesidir. Bu işlem genellikle internet aracılığıyla yapılmaktadır. Konuya özgü araştırmalarda belirtildiğine göre bu yöntem özellikle 2008 krizinden sonra başlangıç seviyesindeki şirketler ile küçük ölçekli şirketlerin finansman bulmakta yaşadıkları güçlüklerle alternatif bir çözüm olarak ortaya çıkmıştır.

Günümüzde gerek yurt dışında gerekse yurt içinde projelerin kitle fonlaması yoluyla gerçekleştirilmesi yönünde gittikçe artan bir trendin varlığı gözlemlenmektedir. Bu durum, kitle fonlamasının İslamî finans ilke ve prensipleri açısından değerlendirilmesini gerekli kılmaktadır. Katılım bankaları İslamî finans ilke ve prensiplerine bağlı bir şekilde faaliyet gösteren kuruluşlar olarak hâlihazırda kitle fonlamasına benzer birtakım uygulamalar gerçekleştirmekle birlikte söz konusu uygulamaların arzulanan düzeyde olmadığı bir gerçektir.

Bu çalışmada kitle fonlamasının tanımı, farklı türleri, geçmişi ve günümüzdeki durumu incelenmiştir ve sayısal veriler ve tablolar eşliğinde açıklanmıştır. İslamî finans prensipleri açısından, katılım bankalarının kitle fonlaması yöntemini nasıl sunabilecekleri irdelenmiştir. Ayrıca katılım bankalarının mevcut faaliyetlerinde kitle fonlamasına benzer uygulamalar incelenmiş, bununla birlikte katılım bankalarını kitle fonlaması yöntemini kullanmaya teşvik edecek diğer unsurlar ortaya konulmuştur.

Bu çalışma aracılığıyla kitle fonlamasının toplum tarafından öneminin kavranması, bu konuda katılım bankalarının devreye girmesi ile söz konusu uygulamanın yaygınlaşması ve güvenilirliğinin arttırılması söz konusu olabilecektir. Böylelikle ülke ekonomisine ve bireysel girişimciliğe olumlu katkı sunabilecek pek çok projenin faizsiz ve katılımcı yöntemlerle gerçekleştirilmesi sağlanabilecektir.

Anahtar Kelimeler: Kitle Fonlaması, İslamî Finans, Girişimcilik, Katılım Bankacılığı

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Ömer KARABULUT

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ABBREVIATIONS

A.Ş.	Incorporated Company
API	Application Programming Interface
ASSOB	The Australian Small Scale Offerings Board
BRSA	Banking Regulation and Supervision Agency
CBRT	Central Bank of the Republic of Turkey
CFP	Crowdfunding Platform
CMB	Capital Markets Board of Turkey
Etc.	Etcetera
EU	European Union
FAAS	Faculty of Economics and Administrative Sciences
Fintech	Financial Technology
InfoDev	Information for Development Program
IPO	Initial Public Offering
ISS	Institute of Social Sciences
KOSGEB	Small and Medium Industry Development Organization
KPI	Key Performance Indicator
NPL	Non-Performing Loan
P2P	Peer to Peer (Bire bir)
POC	Proof of Concept
PSD2	Payment System Directive 2
R&D	Research and Development
SME	Small and Medium Sized Enterprises
TBB	The Banks Association of Turkey

TBBM	Turkish Grand National Assembly
TKBB	Participation Banks Association of Turkey
TL	Turkish Liras
TÜBİTAK	Scientific and Technological Research Council of Turkey
UK	United Kingdom
US	United States
VCIF	Venture Capital Investment Fund
\$	Dollar

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INTRODUCTION

Subject and Purpose of the Thesis

Throughout history, people have needed capital to bring an idea to life, to produce a product, to realize a project. In modern times, it is seen that financial institutions such as banks have come to the fore in meeting capital needs and this work is conducted through credit allocation. However, in cases where the traditional financing method of these modern times is insufficient or not preferred, alternative financing methods have emerged.

The idea of providing the capital needed to implement any initiative from multiple people, by a community, actually dates back to the 18th century. In the early 18th century, the Irishman Jonathan Swift raised money for poor and needy people by setting up a pool of funds, and this fund often grew with the support of rich people. The success of the fund inspired many people, and in 1837 the first pool of funds was officially established.¹

There are examples in history where the expenses incurred by the famous artists while producing their works were covered by the rich. It was called patronage, and in such cases the patron who funded the art was not always a single rich person, but groups of people who wanted to sponsor artistic endeavors, just like modern crowdfunding. Alexander Pope was funded by his audience when he began translating the ancient Greek poem The Iliad. Pope set up a subscription system, received upfront payments, and in exchange for this funding, he promised to publish one volume every year, which continued for 6 years. In the 1780s, Mozart sought the help of his fans as he was struggling to finance the tours he was planning, and supported by 176 people, he performed his tours. As a reward to those who supported him, Mozart presented a signed concert text with a personal thank you letter. These examples are very similar to the reward-based crowdfunding known today².

The first example of the crowdfunding model applied through the internet today was implemented by the British rock band Marillion in 1997. As the band reunited, they asked for support from their fans through online channels to be able to go on tour throughout America.

¹ The Startups Team, A Brief History of Crowdfunding, 2018, <https://www.startups.com/library/expert-advice/history-of-crowdfunding> (17 April 2022).

² Cristian Fronea, History of Crowdfunding, Smallbrooks Blog, <https://smallbrooks.com/history-of-crowdfunding/> (17 April 2022)

The band quickly raised more than \$60,000 in funding and began their United States tour afterwards.³

The real explosion of crowdfunding and its journey to become mainstream financing method corresponds to the period after the 2008 crisis. After the outbreak of the mortgage crisis in 2008, people's trust in the traditional banking system declined. The inability of banks to provide financing due to the crisis forced people to look for alternative financing. Especially with the launch of IndieGogo in 2008 and the follow-up of Kickstarter in 2009, the demand for crowdfunding exploded. After these developments, crowdfunding become one of the mainstream financing models. The volume figures, which were \$ 530 million in 2009 , reached \$ 1.5 billion in 2011 and \$ 24.4 billion in 2015⁴.

In its 2013 report titled "The potential of crowdfunding in the developing world", the World Bank estimated that the volume of crowdfunding in 2025 would reach \$ 96 billion. In 2020, the crowdfunding volume exceeded the World Bank's 2025 forecasts and created a volume of \$ 115 billion⁵.

There are basically four different types of crowdfunding financing. These are donation-based, reward-based, equity-based, and debt-based crowdfunding models. In the case of reward and donation-based crowdfunding models, the investor does not have any financial expectations. Equity and debt-based crowdfunding are crowdfunding models in which the investor aims to obtain a financial return.

In the donation-based crowdfunding model, the main motivation of investors is to support projects that they think will be beneficial to society and they do not expect any financial return from their investments. Donations are usually made for social assistance and charitable initiatives. Reward-based crowdfunding is a model in which a pre-agreed reward is provided to investors by the entrepreneur if the investment is successful. In this model, entrepreneur does not provide any share or financial return to the investor. In equity-based crowdfunding, investors obtain shares from the business or project that they invest in in exchange for the amount they invest. If the project is successful, the share values increase, and if it fails, the

³ BBC, Marillion 'understood where the internet was going early on', 2013, <https://www.bbc.com/news/entertainment-arts-23881382> (13 February 2022).

⁴ The Startups Team, A Brief History of Crowdfunding (17 April 2022).

⁵ Statista, Volume of funds raised through crowdfunding worldwide in 2020, 2021, <https://www.statista.com/statistics/946668/global-crowdfunding-volume-worldwide-by-type/> (19 April 2022).

share values decreases. In debt-based crowdfunding, entrepreneurs collect financing from investors through crowdfunding platforms and repay the amount of financing invested at maturity to investors with interest. Some debt-based crowdfunding transactions can also be done without any interest.

In this thesis study, it will be examined whether it is possible to implement crowdfunding, which has become a mainstream financing model in a short time as an alternative to traditional financing methods and has become a mainstream financing model, throughout participation banks. If it is deemed possible, the encouraging points of this application in terms of participation banks will be examined. It will also be examined whether crowdfunding financing is compatible with the principles of Islamic finance and whether there is an Islamic obstacle to its implementation by participation banks.

The study consists of an introduction, conclusion and three sections. In the introduction part, the main purpose and topic of the thesis, crowdfunding literature, domestic and foreign sources will be examined. In the first part, the definition of crowdfunding, its stakeholders, the functioning of the crowdfunding model, deterrent aspects and risks will be examined. In the second part, the types of crowdfunding, its historical development and current situation will be examined. In the third part, the compatibility of crowdfunding with the principles of Islamic finance, the practices similar to crowdfunding in the existing structures of participation banks, the reasons that should encourage participation banks to use the crowdfunding model and which crowdfunding models participation banks can offer will be examined.

Literature Review

The interest that crowdfunding has received abroad and its increasing market share have a similar course in our country, especially after legal regulations. CMB regulated the equity based crowdfunding model on October 3, 2019 with the Communiqué on Equity-Based Crowdfunding⁶ (III-35/A.1.). On 27 October 2021, CMB has determined the procedures and principles regarding the debt-based crowdfunding model with Crowdfunding Communiqué numbered III-35/A.2.⁷ Following these arrangements, the way for share-based and borrowing-based crowdfunding has been opened and it is foreseen that the market share will grow with the

⁶ “Capital Market Law (III – 35/A.1)”, **Official Gazette**, 30907 (October 2019).

⁷ “Capital Market Law (III – 35/A.2)”, **Official Gazette**, 31641 (October 2021).

increase in interest in crowdfunding in the coming years . There are many articles, theses, columns and books on crowdfunding internationally. Although there are articles, theses and columns about crowdfunding in our country, there are few sources where the subject is evaluated with the dimension of Islamic economy.

Domestic Resources

Canbaz and Çonkar, who examined crowdfunding as an alternative Islamic financing method to interest-bearing financing methods, defined crowdfunding in the article titled "An Alternative Islamic Finance Method for Entrepreneurs: Crowdfunding" and the types of crowdfunding were explained⁸. In the article, in addition to examining whether these types are compatible with Islamic finance, the legal legislation on crowdfunding in our country is also examined. In addition, it is explained what conditions should be developed for the spread of crowdfunding in our country. In the article, it is stated that crowdfunding will retain investors from having narrow point of view and help them reach the general audience and play an important role in making social life more balanced by allowing more balanced sharing of income in society, and that it will replace Islamic microfinance institutions, which have no precedent in our country yet. It has been concluded that it can offer interest-free alternative ways compared to traditional debt instruments for entrepreneurs and early-stage businesses without capital.

Another study by Canbaz and Çonkar on the subject is the article titled "Crowdfunding: Suggestions for Development in Turkey" in which suggestions for the development of crowdfunding in Turkey are found⁹. In this study, crowdfunding is defined and crowdfunding is divided into two as financially consequential models and financially inconsequential models. The global development of crowdfunding in the world is indicated by figures and this development is compared with the crowdfunding market in Turkey. Proposals for the development of crowdfunding in Turkey are examined under the following headings: economic and political environment, development of entrepreneurship culture, increasing entrepreneurship centers to support the development of new entrepreneurs, making public

⁸ Muhammet Fatih Canbaz ve Mehmet Kemalettin Çonkar, "An Alternative Islamic Finance Method for Entrepreneurs: Crowdfunding", **The Journal of Financial Researches and Studies**, Vol. 10, No. 18 (January 2018), p. 37-55.

⁹ Muhammet Fatih Canbaz ve Mehmet Kemalettin Çonkar, "Crowdfunding: Suggestions for Development in Turkey", **Optimum Journal of Economics and Management Sciences**, 2018, p. 119-132.

perception more moderate against bankruptcy and other failures, effective use of social networks and technology. As a result, in the related study, it was tried to evaluate what kind of developments should be made in order to increase the awareness of the crowdfunding financing method, which is not yet sufficiently known in our country, and to spread the crowdfunding model to general public.

In the master's thesis prepared by Aslı Özer and titled "Crowdfunding", crowdfunding methods in the world and Turkey were examined and compared from a legal point of view¹⁰. The conclusion obtained from the thesis is that reward and donation-based crowdfunding models are more preferred in the world and in Turkey because these models have the least risk for investors. Although there are no comprehensive legal regulations for these two models, it is emphasized that the investor does not have any financial expectations in these models, but it is stated that investors have financial expectations in debt-based and equity-based crowdfunding models and therefore these two models need detailed regulations legally due to the risk of losing the investment made by the investor and due to the possibility of damage to the investor.

In the Ph.D. thesis titled "'Crowdfunding' as a new generation finance model for entrepreneurs: A study on applications around the World and in Turkey, and model proposal" prepared by Aslı Vural and proposing an alternative model for crowdfunding, the applications of crowdfunding in the world and in Turkey were examined and as a result of this examination, "Integrative Debt Based Crowdfunding Model" was proposed¹¹. In this study, Debt-Based Crowdfunding, which is the most applied and highest financing model worldwide, which is not included in the regulation of the framework, has been developed and the "Integrative Debt Based Crowdfunding" model that all investor and entrepreneur profiles can be interested in has been revealed. The fact that the model can attract investors from both domestic and foreign countries, taking into account the preferences of entrepreneurs who want to venture with interest-free methods and investors who want to invest with interest-free methods, is also interest-bearing which is aimed to include the features of the traditional Debt-Based Crowdfunding model. For this reason, while the platforms in the proposed model offer the traditional "borrowing" method, it is stated that the "Participation" model, which provides profit

¹⁰ Aslı Özer, "Crowdfunding", (**Master's Thesis**, Bahçeşehir University ISS, 2020)

¹¹ Aslı Vural, "'Crowdfunding' as a new generation finance model for entrepreneurs: A study on applications around the World and in Turkey, and model proposal", (**Ph.D. Thesis**, Başkent University ISS, 2019)

sharing at a predetermined rate for entrepreneurs and investors who prefer interest-free financing, will also be applied.

In a study conducted by Ayşen Akyüz, where the effects of the presentation of crowdfunding to the society through social media were discussed, crowdfunding was also evaluated as the power of the masses in social media¹². According to this study, the opportunity to create content on the internet for individuals brought by web 2.0 technologies has directly affected crowdfunding. In this way, individuals can catch new financing opportunities by delivering their ideas to the masses by taking the power of social media behind it. Accordingly, investors use crowdfunding platforms to deliver their projects to the masses with videos, photographs or prototypes in order to collect the necessary financing for their projects from supporters. People who want to donate or invest in projects provide financing through platforms. One of the reasons why investors are involved in crowdfunding is that it is an alternative model beyond typical capitalist models, and another reason is that crowdfunding is the most effective way of doing business using information and communication technologies.

According to World Bank estimates, crowdfunding is expected to reach a transaction volume of \$ 96 billion by 2025. In order for investors in Turkey to benefit effectively from the crowdfunding financing, which is growing with a rapid acceleration and became a popular financing product in a short time, some studies have been carried out to determine what the main motivations of investors are and which demographic characteristics affect their intentions to make investment¹³. According to the study conducted by Faruk Şahap on the subject, it is seen that married people participate in crowdfunding projects with more motivation of "sacrifice" than singles. When examined in terms of age group, it is seen that people under the age of 39 have a greater sense of sacrifice in investing in crowdfunding projects than people over the age of 40. Since entrepreneurs and investors under the age of 39 may be more affected by financial difficulties, it is anticipated that this help investors to understand and support other entrepreneurs seeking financing through the crowdfunding model with a sense of sacrifice. In addition, when the income level is examined, it is seen that individuals with high income and spaciousness levels have a high tendency to participate in reward and donation-based

¹² Ayşen Akyüz, "The Power of the Masses in Social Media: Crowdfunding", **New Media Researches-2**, Bursa: Ekin Publishing House, 2016, p.79-95.

¹³ Faruk Şahap, "Crowdfunding as an alternative financial model based on entrepreneurship and an investigation for investors in Turkey", (**Master's Thesis**, Galatasaray University ISS, 2020)

crowdfunding campaigns. However, if debt-based and equity-based crowdfunding models are introduced in Turkey, other investors are also expected to invest in crowdfunding campaigns. In addition, it is seen that the gradual termination of the active work routine of individuals who have reached retirement age use crowdfunding as the aim of increasing their visibility on the internet.

There are other studies that see crowdfunding as an alternative and powerful solution to the problem of finding capital, one of the biggest challenges facing newborn and young businesses¹⁴. According to the article study conducted by Atsan and Erdoğan on this subject, the cost of the first entrepreneurial steps of newly established enterprises is usually financed by the resources of the entrepreneurs themselves or their family and friends, and the reason for this is that the recognition and credibility of the newborn enterprises is low and therefore does not benefit from banking and other financial services in the traditional financing system because they cannot show enough guarantee. However, it has been mentioned that crowdfunding can break this vicious circle and it is an alternative financing method for newborn and young businesses. The most important reason for this is that for investors, the crowdfunding method offers a model that will enrich the entrepreneurship ecosystem. According to this model, investing does not belong to community of rich people with high amounts of capital, but a model prediction where anyone who wants to can become an investor with more or less capital. Apart from this benefit, it has also been mentioned that crowdfunding has the potential to support the emergence of new jobs, economic developments and innovations.

In a joint study that contains some practical suggestions for increasing the awareness of crowdfunding in Turkey and making it easier to implement, it was mentioned that some solutions specific to Turkey can be produced¹⁵. According to this study discussed by Ergen, Lau and Bilginoglu, practical suggestions were gathered under some headings. As a proposal for legal amendments, it is proposed to reduce the maximum number of shareholders of limited companies from 50 to 5000 in the new Turkish Commercial Code. In addition, it was emphasized that crowdfunding platforms should be audited by the CMB and crowdfunding

¹⁴ Nuray Atsan and Eda Oruç Erdoğan, “An Alternative Finance Method for Entrepreneurs: Crowdfunding”, **Eskişehir Osmangazi University Journal of Economics and Administrative Sciences**, Vol. 10, No. 1 (April 2015), p. 297-320.

¹⁵ Mustafa Ergen, Jason Lau and Kuntay Bilginoglu, “Distributed Venture Capital Financing: Crowd-Funding”, 2013, <http://girisimcilik.mustafaergen.com/uploads/1/0/5/9/10590997/dagitikgirisimcisermayesi-2.pdf>, (12 December 2021).

processes should be clearly defined. In addition, it was mentioned that training and certificate programs should be organized for both investors and entrepreneurs in the context of crowdfunding and that the goal of these programs would be to explain the risks and advantages of crowdfunding and to create a general awareness. As a model specific to Turkey, it has been suggested that bank credit cards can be allowed to buy shares with bonus points in loyalty programs, crowdfunding expenditures can be evaluated tax-free within the scope of R&D support, and the amount to be deducted from tax can be given to company employees as a right to invest in crowdfunding, and with this right, employees can fund entrepreneurs of their own choice.

In the master's thesis titled " Equity based crowdfunding in capital market law " which examines the legal dimension of crowdfunding and was discussed by Nisa İřiner, the place of equity-based crowdfunding in legal systems was examined and comparisons were made with the current legal system in Turkey¹⁶. In the study, comparisons were made with US law and EU law regarding the legislation in Turkey, especially in terms of crowdfunding, and some suggestions were made. It is stated that the arrangements regarding equity-based crowdfunding in these legal systems are made in a platform-oriented manner, and that certain responsibilities are brought to the platforms and entrepreneurs to protect both investors and entrepreneurs. One of the most important topics in the study is the issue of the measures to be taken to protect investors in crowdfunding platforms and the responsibilities in this regard. It has been mentioned that investors can be anyone ranging from experienced to beginners in crowdfunding, and that many responsibilities are imposed on both platforms and entrepreneurs in order to protect investors' investments in the relevant legal systems. In Turkey, on the other hand, the members of the board of directors of the platform are responsible for foreseeable liabilities for the crowdfunding platforms, the members of the investment committee and the members of the board of directors of the platform are responsible for liabilities of the investment committee, and the members of the board of directors of the venture company are responsible for liabilities of venture companies.

In a case study on the usability of local crowdfunding and resource development websites in Turkey, Sezen Kayhan evaluated Fongogo, the most widely used crowdfunding site

¹⁶Nisa İřiner, "Equity based crowdfunding in capital market law", (**Master's Thesis**, Atılım University ISS, 2021)

in Turkey, in terms of effectiveness, efficiency and user satisfaction¹⁷. In the evaluation made in the study, Fongogo received below-average scores in terms of efficiency, effectiveness and satisfaction criteria. In the context of the reasons for this, the researcher focused on the following issues: users over the age of 40 have difficulty in understanding and using the website, most of the users receive errors in the login and account creation process, the main menu and sub-menus are very confusing and not clear for navigation, the error rate in the transactions is high and many users give up without finishing the donation process due to technical problems, the occurrence of security concerns of some users who do not have high technical knowledge due to the fact that the system does not accept virtual credit cards. As a result of this research, it was stated that the design of the site should be reconsidered, the processes of logging in, creating accounts and donating should be simplified, and finally, options such as virtual credit cards should be added to payment options to make users feel more secure.

In the article titled "Evaluating Crowdfunding from the Perspective of Public Relations" written by Seyfi, Soydaş and Güven and discussed crowdfunding from a public relations perspective, it was investigated how crowdfunding websites can be used as a public relations tool, and as a result of the literature and netnographic researches on the subject, crowdfunding recommendations for its use as a public relations tool have been developed¹⁸. In the research, which crowdfunding was investigated in terms of relations, the most important problem is seen as the lack of a professional communication management understanding. In this article, which emphasizes that it is always difficult to build reputation and establish a reliable platform in the internet environment. It is also demonstrated that the initiative campaigns created on crowdfunding platforms have a serious public relations strategy from the very beginning as the basic solution to these problems. In particular, it is stated that the skills, reputations, symbols, rituals and values of the owner of the campaign should be integrated into the campaign and the corporate identity should be restructured in this context.

Since crowdfunding is a marketing tool, it can produce solutions to some social problems faced by societies or draw the attention of individuals and businesses to the public

¹⁷ Sezen Kayhan, "Fongogo: a case study on the usability of the local crowdfunding and fundraising websites in Turkey", **Humanitas – International Journal of Social Sciences**, Vol. 5, No. 9 (August 2017), p. 95-105.

¹⁸ Murat Seyfi, Ayda Uzunçarşılı Soydaş and Deniz Güven, "Evaluating crowdfunding from the perspective of public relations", **The Turkish Online Journal of Design, Art and Communication**, Vol. 7, No. 2 (April 2017), p. 150-162.

issues. The study titled "New Tool of Social Marketing: Crowdfunding" by Karaaslan and Altuntaş examines how effectively crowdfunding can be used as a social marketing tool in Turkey and makes some suggestions¹⁹. In the study, it was concluded that the number of projects that have been successful in Turkey with the crowdfunding method is quite limited. According to the stated reasons: crowdfunding is not yet sufficiently known by entrepreneurs and the public, its reliability is low and it has some tax and legal problems. The study not only identified problem areas, but also proposed solutions to these problems. Among the proposals introduced in this context are the reduction of institutional costs and the highest rate of funding to project owners, the creation of a transparent environment to make it easier for funders to follow entrepreneurs, the ease of preparing projects and publishing them for fundraising purposes, and the follow-up of project owners is given to multiple institutions rather than a single institution so that they can specialize in certain subjects and regions and the ability to distinguish between those seeking funds to get out of poverty and those who receive gratuitous assistance.

In the study titled "Motivations for Funders: Crowdfunding in Turkey" prepared to understand the motivations of crowdfunding supporters in Turkey and to make suggestions based on the findings obtained²⁰. In this study, Sertaç Ercan examined crowdfunding activities in Turkey and summarized the motivations of Turkish investors in four categories as a result of the analyzes: (1) Prize hunting, (2) cooperation, (3) social responsibility and (4) emotional bond. According to this study, it was seen that the main purpose of many supporters was to collect awards with the effect of institutions such as Arı Kovanı and Fongogo offering support through the reward system. In addition, it was stated that the reasons for the participants to support using Turkish sites instead of foreign crowdfunding sites were the emphasis on "indigenusness". When the participants were asked which kind of projects they would not support, their replies consisted of following notions which are racism, religious and political projects, sexuality, encouraging bad habits (smoking, alcohol, etc.) and projects containing violent elements.

¹⁹ Mustafa Karaarslan and Başar Altuntaş, "New Tool of Social Marketing: Crowdfunding", **20th National Marketing Conference**, Eskişehir, 10-13 June 2015, p. 487-497.

²⁰ Sertaç Ercan, "Motivations for Funders: Crowdfunding in Turkey", **Journal of Economy, Business, and Management: A Continuous Journal**, Vol. 1, No. 1 (December 2017), p. 1-9.

Foreign Resources

While some of the studies carried out abroad in crowdfunding were done by institutions, others were done in the scope of individual-scale studies. Some of the individual-scale studies consist of studies such as academic articles, theses, books, and some of them are carried out by people who are active in the relevant field or who are interested in the field.

The most comprehensive and global study on the subject is the study titled "Crowdfunding's Potential for the Developing World" conducted by the World Bank and addressed the following concepts: function, future potential, areas of use of crowdfunding and what needs to be done to develop and spread faster²¹. According to this study, crowdfunding has the potential to make a significant contribution to entrepreneurial financing and has been defined as the "rise of the rest" worldwide. The study noted that with the rapid increase in number of people going online, new and larger markets for goods and services are emerging and innovative entrepreneurs are finding solutions to the needs in these emerging markets with new financial tools such as crowdfunding while at the same time increasing economic and social stability by creating employment. According to this study, crowdfunding investments can be used to start operations, test new products and expand their companies not only for new entrepreneurs but also for beginner or medium-sized companies looking for funding. From the point of view of entrepreneurs, it is stated that as of the date of the study (2013), 240 to 344 million people in the world can support crowdfunding. It is also estimated that the crowdfunding market will have a volume size of between \$90 and \$96 billion by 2025.

There are also some studies that approach crowdfunding from an Islamic point of view. In this context, a joint study examining the role of Islamic crowdfunding in the business development of start-ups which were financed enterprises in Singapore, Malaysia and Indonesia were examined²². This study, discussed by Hendratmi, Sukmaningrum, Ryandono and Ratnasari, was conducted with an explanatory case study strategy using a qualitative approach. In the study, it was emphasized that crowdfunding in accordance with Islamic law had a volume of 30 million dollars as of 2015. It is also proposed that crowdfunding could increase the growth of this field because of increasing popularity of Islamic finance products that developed to meet

²¹ InfoDev/World Bank, Crowdfunding's Potential for the Developing World; Finance and Private Sector Development Department, Washington,DC: World Bank, 2013.

²² Achsanita Hendratmi et al., "The Role of Islamic Crowdfunding Mechanisms in Business and Business Development", **Journal of Business and Economics Review**, Vol. 4, No.1 (March 2019), p.10-23.

the special needs of SMEs and limit the risk of investors. As a result of the case study, it was concluded that the role of Islamic crowdfunding contributes positively to the business development of SMEs, including increased sales, increased market share and profit-sharing principles, and easier provision of additional capital.

In a conference paper discussed by Asutay and Marbzan, it was stated that Islamic finance is a value-oriented approach at its root and that Islamic finance aims to provide maximum benefit from economic and financial resources and meet the material and social needs of all individuals in society by basing on the concepts of "equality", "justice", "human dignity", "freedom of enterprise" and "moderation"²³. Based on these moral values, crowdfunding represents an important opportunity to use different crowdfunding models in accordance with Islamic law by supporting the basic ethical and social dimensions of Islamic finance. In addition, since donation-based crowdfunding reaches a wider audience using social media, it is stated that it is an optimum financial tool for Islamic charities established to reduce poverty. As a result, it is stated that crowdfunding has big opportunity to contribute significantly to the development of the entrepreneurship ecosystem in Islamic countries as it contains the basic values of Islamic finance and includes the developments in technology and globalization concepts at its center.

In another article discussed by Asutay and Marbzan, the advantages of equity-based crowdfunding are discussed from the perspective of Islamic finance²⁴. According to this study, the advantages of equity-based crowdfunding are as follows: equity-based crowdfunding is based on profit and loss sharing as defined in the original characteristic of Islamic finance (Müşâreke), closing the funding gap by facilitating access to capital for a wide variety of entrepreneurs, opening a new asset class to small and medium-sized investors, minimizing risk by distributing limited capital to a large number of start-up companies, incorporating talent by encouraging innovation, creating new business opportunities with start-up companies to be established, increasing initiatives in new sectors such as technology and the health sector which are virtually non-existent in capital markets in Muslim countries, and supporting the growth of initiatives for possible future IPOs, thus increasing diversity for fund managers. In the article,

²³ Mehmet Asutay and Shehab Marzban, "Shariah-compliant Crowd Funding: An Efficient Framework for Entrepreneurship Development in Islamic Countries", **Harvard Islamic Finance Forum**, Boston: USA, April 2014.

²⁴ Mehmet Asutay and Shehab Marzban, "Standing Out With the Crowd", **The Banker**, November 2012, p. 28-29.

it is also mentioned what conditions equity-based crowdfunding must meet in order to be compatible with Islamic law. Accordingly, in order to be compatible with Islamic law, the following conditions should be met: the platform should be managed by an advisory board or Islamic law consultant, investments should have a social responsibility dimension, the activities of newly established companies should be in areas in accordance with the principles of Islamic finance, the newly established company should not borrow at interest because crowdfunding service providers and investors could have significant equity capital on the newly established company, legal measures should be provided so the newly established company should not invest in instruments that are not suitable for Islamic finance or should not create its products and services against principles of Islamic finance, the shareholder structure of established companies and investor protection principles should be compatible with Islamic law.

In a joint study examining the relationship between the development of financial technologies and crowdfunding in line with Islamic financing criteria, 108 platforms from 47 countries were considered as a sample²⁵. In this study conducted by Biancone, Secinaro and Kamal, it was emphasized that developing financial technologies bring simpler and more convenient financial management for people using crowdfunding platforms and that they also benefit from reducing unnecessary management expenses. According to the results of the study, it is explained that both crowdfunding and financial technologies have not reached a sufficient number of entrepreneurs and investors because they are still in their infancy in the Islamic world. As a result, it is stated that crowdfunding is progressing slowly in the Islamic world due to reasons such as Islamic countries being technologically behind, electronic financial transactions being difficult and slow, capital adequacy and living standards being high in the Gulf countries. However, it is emphasized that there are many entrepreneurs in the Islamic world and crowdfunding for these entrepreneurs could be a way out of the complexity of traditional financing methods to faster, easier and less risky solutions.

Another study evaluating crowdfunding in terms of Islamic financing was written by Hissam Kamal Hassan²⁶. In the study, it is emphasized that one-to-one communication and exchange are encouraged in Islamic finance from a broad Islamic perspective. For this reason,

²⁵ Paolo Pietro Biancone, Silvana Secinaro ve Mohamad Kamal, "Crowdfunding and Fintech: Business Model Sharia Compliant", **European Journal of Islamic Finance**, Vol. 12, April 2019, <https://doi.org/10.13135/2421-2172/3260>, (26 December 2021).

²⁶ Hissam Kamal Hassan, "Crowdfunding From An Islamic Finance Perspective", **Isra-Thomson Reuters Islamic Commercial Law Report**, 2017, p. 100-102.

it has been shown that crowdfunding can play an active role as Islamic financing, and the reasons for this are that crowdfunding is based on one-to-one communication and exchange and adopts the principles of greater communication, openness, transparency and trust. In contrast to the structure in traditional banking and capital markets that functionally distances (and protects) depositors or investors from fund users, crowdfunding has been noted to potentially re-offer the social bond necessary for a gig economy. As a result, it is stated that in the near future, especially considering the advances in machine learning and artificial intelligence, there will be new developments in the field of crowdfunding and these developments will create more diverse and innovative ways to raise capital based on revenue sharing.

There is a joint study describing the challenges facing crowdfunding compatible with Islamic finance compared with traditional crowdfunding²⁷. In this study, which was discussed by Saiti, Musito and Yücel, the existing types of crowdfunding were listed and the differences between them and Islamic crowdfunding were explained as follows: Islamic crowdfunding aims to grow the real economy by avoiding interest by using financing instruments compatible with Islamic finance, there is no need to have a deposit account except for intermediary institutions in Islamic crowdfunding and therefore there is no need to "hold" a fund to be transferred to the deposit account, therefore every transaction that takes place in Islamic crowdfunding will directly affect economic activity. In the study, it was emphasized that the difficulties in front of Islamic crowdfunding should be overcome in order to make good use of such opportunities and advantages. At the top of these challenges are regulatory barriers. It was stated that in accordance with the legislative regulations in some countries, the platforms should assume the credit risk in crowdfunding transactions and it was mentioned that this situation was contrary to the profit-loss partnership that is the basis of Islamic finance. Another challenge is that it is necessary to regularly examine whether the initiatives put forward on crowdfunding platforms are compatible with the principles of Islamic finance. Another difficulty is the difficulty of evaluating projects on crowdfunding platforms. In addition, it was emphasized that entrepreneurs and start-ups using crowdfunding platforms carry a natural operational risk because they are more novice than well-established and experienced companies. The final challenge to Islamic crowdfunding is the lack of a competent secondary market to exchange the shares of crowdfunding investors.

²⁷ Buerhan Saiti, Muhammad Hamal Musito and Ensari Yücel, "Islamic Crowdfunding: Fundamentals, Developments and Challenges", **The Islamic Quarterly**, Vol. 62, No. 3:(February 2019), p. 469-484.

Evaluation of Literature

When domestic and foreign sources are examined, it is seen that academic articles and other written sources written specifically on Islamic crowdfunding are limited due to the fact that crowdfunding is a relatively new field and has not yet received attention in Muslim countries compared to developed countries.

When we look at the subject in our country, it is seen that there is no academic graduate thesis that deals with crowdfunding with the dimension of Islamic finance. It is seen that the limited number of articles written in this field does not evaluate crowdfunding in the eyes of participation banking. In the studies conducted abroad, although crowdfunding is considered in terms of compliance or incompatibility with the principles of Islamic finance, it is seen that these studies do not have an output related to participation banking. In addition, these studies do not provide an output specific to Turkey due to the fact that the authors of the relevant studies are related to their own countries or are handled with general Islamic finance principles. Considering this situation, with this study, it is aimed to put forward an academic study that deals with Islamic crowdfunding both in Turkey and to evaluate its applicability through participation banks.

Method Applied in the Thesis

In the introduction stage of the thesis, a literature review was conducted. For this purpose, examinations have been conducted on domestic and foreign sources related to crowdfunding which could be found in internet environment. In addition, secondary sources were identified and utilized by making use of bibliographs of the studies carried out in Turkey and abroad on the subject.

In the first chapter of the thesis, the nature of crowdfunding, its stakeholders, the way it is applied, the aspects that may be a deterrent and the possible risks are revealed. In this context, the application patterns and numerical data of the subject in Turkey and abroad were analyzed in the light of certain datasets and data tables.

In the second chapter of the thesis, the applications of different types of crowdfunding are explained and these applications are compared with each other. In addition, historical development of crowdfunding from past to present has been discussed and the point it has reached in the world today has been examined. The numerical data of crowdfunding were

examined on the basis of country, region, platform and model are analyzed and revealed in the light of tables. For Turkey, a separate title was created and information was revealed in the light of both the development of its legal infrastructure and numerical data.

In the third chapter of the thesis, the compatibility of crowdfunding with the principles of Islamic finance is examined. In addition, the intersecting aspects of crowdfunding with Islamic economics and similar aspects in terms of purpose were discussed. Again, in this section, by comparing the existing participation banking practices with the crowdfunding practice, similar situations that will form the basis of this practice are emphasized and how the types of crowdfunding that are considered permissible in terms of Islamic fiqh can be reconciled with existing participation banking and the possibility of new implementation models are questioned. In addition, reasons that may encourage participation banks to use crowdfunding have been put forward.

In the thesis, inductive data collection, numerical and general analysis of the collected data, comparisons and synthesizing methods are performed.

1. AN OVERVIEW OF CROWDFUNDING

1.1. Definition of Crowdfunding

The idea of crowdfunding actually goes back a long way. It is known that Beethoven and Mozart collectively appealed to public support to fund their concerts and new musical compositions centuries ago. It is also known that Indian mosques were built thanks to brick donations from local families, and that the construction of the statue of freedom in America was realized with the contributions of New York citizens²⁸. There are many similar examples of these initiatives in the recent past. In 1997, British rock band Marillion appealed to their fans online to fund their American tour, raising \$60,000²⁹. Designer Scott Wilson designed a collection of silicone rubber wrist straps for people to wear the Apple iPod Nano like wristwatches, raising nearly \$1 million in funding from more than 13,500 fans online via Kickstarter to fund their production and distribution³⁰. Fans of Swedish automaker Saab have created a web-based fundraising call site to help Saab manufacturers who are going through tough times financially³¹. British software company Trampoline Systems has raised more than £330,000 via the internet to fund its software projects³². A human rights organization tried to raise \$150,000 over the internet to buy the Terrestar-1 communications satellite to provide internet access to people living in rural areas of third world countries³³. Former U.S. president Barack Obama raised most of the cash he spent on his 2008 campaign through small donations over the internet, and about 50% of the funding raised was funded by payments of less than \$200. In this election, Obama raised more than \$650 million³⁴. In addition to these specific examples, many independent game companies and film studios today raise funds to bring their projects to life through sites such as Kickstarter.

²⁸ Nadine Scholz, *The Relevance of Crowdfunding-The Impact on the Innovation Process of Small Entrepreneurial Firms*, Wiesbaden: Springer, 2015, p.7.

²⁹ BBC, Marillion 'understood where the internet was going early on', (13 February 2022).

³⁰ Kickstarter, TikTok+LunaTik Multi-Touch Watch Kits, <https://www.kickstarter.com/projects/1104350651/tiktok-lunatik-multi-touch-watch-kits> (13 February 2022).

³¹ <https://rescue-saab.com> (13 February 2022).

³² Trampoline Systems Raises Another Angel round, Adds To Board, 2010, <https://techcrunch.com/2010/12/01/trampoline-systems-raises-another-angel-round-adds-to-board/?guccounter=1> (13 February 2022).

³³ Buy This Satellite, <http://buythissatellite.org/about.php> (13 February 2022).

³⁴ Wikipedia, Barack Obama 2008 presidential campaign, https://en.wikipedia.org/wiki/Barack_Obama_2008_presidential_campaign#Fundraising (13 February 2022).

Table 1-1: Crowdfunding Definitions

Authors	Year	Definition
Kleeman, Voß and Rieder	2008	<i>“It arises when a for-profit firm provides certain jobs required for the production or sale of its product by outsourcing them through an open call to the public (the masses) via the Internet. Purpose: is the voluntary contribution of people to the production process of the company without compensation or with a very modest response compared to the value of the company”.</i>
Lambert ve Schwienbacher; Schwienbacher and Larralde; Bellaflamme, Lambert and Schwienbacher	March 2010 Sept. 2010 2014	<i>“Crowdfunding is an open call to startups via the Internet to raise financial resources for specific purposes as a donor, in exchange for rewards, by lending, or as a shareholder”.</i>
Ordanini et al.	2011	<i>“Crowdfunding is an attempt to raise funds for new projects submitted by individuals by collecting small-to-medium-sized investment amounts from many people (e.g. the mass)”.</i>
Mitra	2012	<i>“Crowdfunding is when a project or initiative is funded by a group of individuals”.</i>
Giudici, Nava, Lamastra and Verecondo	2012	<i>“It is when a large group of people invest capital in a project using a website or other online tools”.</i>
Ahlers, Cumming, Günther and Schweizer	2012	<i>“Crowdfunding is a form of fundraising in which a group of people make usually very small individual contributions to support a specific purpose”.</i>
Ergen, Lau and Bilginoğlu	2013	<i>“Crowdfunding is when many small investors unite to partner in a project of their choice in exchange for their investment, or sometimes in a symbolic response, pre-order if the product is in development, or provide capital to entrepreneurs by making some kind of donation”.</i>
Wash	2013	<i>“Crowdfunding is the activity of soliciting resources through an open call from a large number of supporters to realize a new idea”.</i>
Valanciene and Jegeleviciute	2013	<i>“Crowdfunding is a method of connecting entrepreneurs who want to raise capital and authentic investors who create a thriving source of capital through internet-based intermediaries and are willing to invest in small amounts”.</i>
Lehner	2013	<i>“Crowdfunding is when a large distribution of audience, called an "audience," provides small amounts of money to support a project or initiative”.</i>
Joenssen, Michaelis, and Müllerleile	2014	<i>“Crowdfunding is the initiation of commercial or non-commercial projects by individuals or organizations through a public call to secure funding, value market potential, and build relationships with clients”.</i>

Reference: Atsan and Erdoğan, **An Alternative Finance Method for Entrepreneurs: Crowdfunding**, p.301.

Crowdfunding is a method in which businesses or other organizations raise capital from a large number of people through the Internet to meet their capital needs. This new form of capital creation emerged in the aftermath of the 2008 financial crisis with the aim of addressing the challenges faced by early-stage businesses in fundraising. Crowdfunding

leverages the power of technology, especially social media, to market ideas, raise funds, and ensure that entrepreneurs who raise funds are responsible for investments³⁵.

In the draft law published by TBMM, crowdfunding is defined as; "*Crowdfunding is a new generation financing tool that allows a large number of people, who cannot have a significant impact in terms of investment potential alone, to fund or donate an initiative through the internet platform with small amounts*"³⁶.

Crowdfunding is a funding method that enables project or business owners to raise money from a large number of people through online platforms to fund projects and businesses. Crowdfunding is often used by start-up companies or growing businesses as a way to access alternative funds. It's an innovative way to find resources for new projects, businesses, or ideas. Crowdfunding can also be a way to develop a community around the project. Using the power of the online community, project or business owners could gain useful market insights and reach new customers ³⁷.

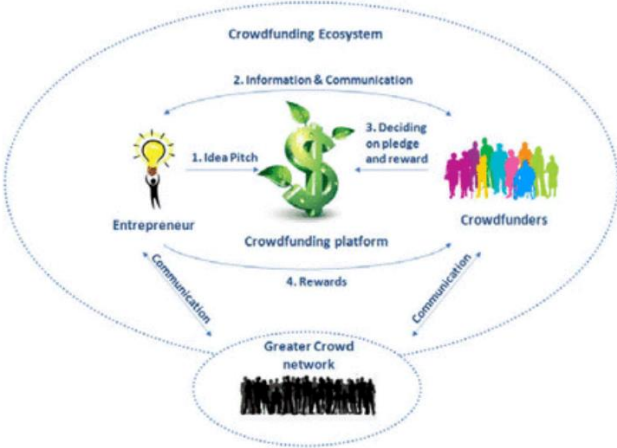


Figure 1.1: Crowdfunding Ecosystem

Reference: Scholz, **The Relevance of Crowdfunding**, p.8.

The crowdfunding method is known as a relatively new model, but smaller-scale counterparts of this funding instrument have been implemented as a microfinancing method in

³⁵ InfoDev/World Bank, Crowdfunding’s Potential for the Developing World, p.14.
³⁶ TBMM, **Draft Law on the Amendment of the Capital Markets Law**, December 2016, <https://www2.tbmm.gov.tr/d26/1/1-0797.pdf>, (16 January 2022).
³⁷ European Commission, Crowdfunding explained , 2017, https://ec.europa.eu/growth/access-finance-smes/guide-crowdfunding/what-crowdfunding/crowdfunding-explained_en, (17 January 2022).

previous years. Nobel laureate Prof. Muhammad Yunus from Bangladesh realized in the 1970s that many locals could not withdraw loans from banks because they could not find affordable prices and therefore faced poverty. So, he first started lending to his own locals, and 10 years later he set up a bank and built a system in which borrowers voluntarily came together and collectively accounted for the loan instead of individual responsibility. This system has made social financing models more widely known³⁸.

Crowdfunding is a collaborative process of a group of people who use their money jointly to support individuals and organizations that promote their ventures using websites. This model is a bottom-up microfinance application that mobilizes people and resources. The term crowdfunding has its origin in the use of resources or the mass development of a product. Crowdfunding can refer to all kinds of initiatives, from financing an entrepreneurial idea to supporting cultural and artistic heritage, to innovative entrepreneurship and scientific research³⁹.

The crowdfunding model allows for more communication, disclosure, transparency and therefore more trust between the parties in the end-to-end financial activities in which it is effective. This is the opposite of the banking system, which functionally distances depositors or investors from fund users and tries to protect them. Crowdfunding therefore has the potential for social solidarity, which is necessary for an economic model that is flexible and encourages enterprise⁴⁰.

Crowdfunding allows people to use social media to support a larger project as a community that they wouldn't normally be able to fund individually alone, with small payments. Unlike traditional methods of obtaining funding, such as applying for funds from banks or foundations, crowdfunding allows entrepreneurs to request resources directly from supporters through online platforms. Crowdfunding is particularly attractive to those who have limited access to traditional financing supports, such as banks or venture capitalists, due to a lack of capital or connectivity. It is stated that the motivation of those who prefer to be funded by crowdfunding method is not only financial support, but also to increase their awareness in joint

³⁸ Jonathan Morduch, The Microfinance Promise, **Journal of Economic Literature**, Vol. 37, No.4:(Dec. 1999), s. 1575.

³⁹ Biancone, Secinaroo and Kamal, "Crowdfunding and Fintech", p. 1.

⁴⁰ Hassan, Islamic Commercial Law Report, p. 100.

work with others, to gain new skills, to cooperate with others and to identify their common concerns with this community or organization even when financial goals are not met⁴¹.

1.2. Stakeholders of Crowdfunding

We can list the actors of crowdfunding as fund seekers (entrepreneurs), funders (investors) and crowdfunding platforms.

Fundraisers (Entrepreneurs): People, teams or organizations that start a fundraising campaign to bring a specific project to life through a crowdfunding platform⁴². Entrepreneurs seeks funding to reach potential investors by publishing their ideas to daily internet users through crowdfunding platforms, thus they could get financial support and direct market access. The challenge for the entrepreneur looking for funding is to attract and maintain the attention of potential investors with attractive web pages, promotional videos, project photos and explanations that will make the project attractive⁴³. Entrepreneurs seeks funds to reach potential investors and customers through crowdfunding and at the same time they try to raise awareness about the project. With this awareness, entrepreneurs get the opportunity to test the potential of the product or service that will emerge as a result of the project before the project is implemented⁴⁴. Thus, the entrepreneur who is looking for funds will see whether the products or services he will implement after the conclusion of the project have a counterpart in the market before he bears a serious cost.

In summary, there are basically 3 reasons for entrepreneurs to use crowdfunding⁴⁵:

- 1) Raising capital
- 2) To create awareness for the products or services they offer
- 3) To be able to analyze whether the products or services will have a counterpart in the market after their implementation before they incur a serious investment cost

⁴¹ Elizabeth Gerber and Michael Muller, Crowdfunding: An Emerging Field of Research, **CHI 2014**, Toronto-Canada, April 2014, p. 1093-1094.

⁴² Mokter Hossain and Gospel Onyema Oparaocha, Crowdfunding: Motives, Definitions, Typology and Ethical Challenges, **Entrepreneurship Research Journal**, Vol. 7, No. 2: (January 2017), p. 9.

⁴³ Scholz, The Relevance of Crowdfunding, p.8.

⁴⁴ Canbaz and Çonkar, "An Alternative Islamic Finance Method for Entrepreneurs: Crowdfunding", p. 41.

⁴⁵ Paul Belleflamme, Thomas Lambert and Armin Schwiendbacher, Crowdfunding: Tapping the right crowd, **Journal of Business Venturing**, Vol. 29, No. 5 (July 2013), p. 585-609.

The capital collection process, which is the most basic of the conditions that entrepreneurs need to provide in order to realize their ideas, is much more cost-effective with crowdfunding method than traditional fundraising methods. One of the reasons for this is that the number of people interested in the product or service that the entrepreneur puts forward via the internet is much higher than the number of investors who will be interested in the same product or service in traditional funding methods. Because with the crowdfunding method, entrepreneurial products or services reach not only local investors, but also a wide audience all over the world where this product or service can attract attention. Another reason is that since crowdfunding platforms allow promotional products to be included in the main product or service as a package in addition to the products or services offered by entrepreneurs, the products that are normally more difficult to sell in the market are sold in this way alongside the main product or service as a package, and the entrepreneur can reduce the cost of collecting funds by selling these products in packages that they could obtain cheaply from the market. Another reason that can reduce the cost of fundraising is that crowdfunding gives investors more information than traditional funding methods, such as the interest of other investors in the product, the presentation of ideas for the development of the early-stage product or service and the expansion of these ideas by the investor audience. This information can further stimulate the investment appetite of potential investors and cause them to invest more, thereby reducing the cost of raising funds for the entrepreneur⁴⁶.

Funders (Investors): Individuals who undertake to financially support an investment through crowdfunding. While investors can obtain returns such as a product, interest-bearing return on their investment, equity ownership as a return on their investment, donation-based investments can be made without expecting a tangible return. Investors can also be called funders, donors, supporters, lenders, investors and pre-order customers, etc., depending on their commitment and the product invested.⁴⁷ One of the most important features of the crowdfunding method for investors is that investors with limited funds can support the products or services offered on crowdfunding platforms without the obligation to make a large investment. Even if inexperienced investors have high amount of funds, they may not want to take the investment risk due to their inexperience in traditional investment areas. The fact that

⁴⁶ Ajay Agrawal, Christian Catalini and Avi Goldfarb, Some Simple Economics of Crowdfunding, **NBER Working Paper 19133**, Cambridge, 2013, p. 10-11.

⁴⁷Hossain and Oparaocha, Crowdfunding: Motives, Definitions, Typology and Ethical Challenges, p. 9.

the crowdfunding method allows investment without having high funds allows both the development of entrepreneurship culture and the encouragement of savers to invest⁴⁸.

In addition to the fact that investors can invest with low amount funds, the reasons for choosing the crowdfunding method can be listed as follows⁴⁹:

1. Since crowdfunding is an internet-based investment tool, unlike traditional investment tools, it encourages investors not only to evaluate local investment opportunities but also to evaluate global investment opportunities.
2. Thanks to early access opportunities, investors can pre-order products or services before they hit the market. It has been observed that there is a serious demand from investors to provide early access to the products of entrepreneurs using the crowdfunding method.
3. For many investors, a crowdfunding platform is not only an investment environment but also a social activity in nature, and one of the reasons for investing is that it is a platform where they can regularly communicate with the entrepreneurs they value.
4. Philanthropy plays a surprisingly large role in major crowdfunding platforms. The instinct of investors to support a product, service or idea they value and their ability to do so through crowdfunding platforms is an important reason for using these platforms. Some investors invest even in for-profit and non-donation-based projects without any tangible returns.
5. Crowdfunding platforms act as an intermediary between investors and entrepreneurs, allowing investments to be formalized in an easy and quick way. Thus, unlike traditional methods, rapid action can be taken. In addition, thanks to crowdfunding platforms, investor relations can be established between family and friends without a written formal contract, and social relations between family and friends are not adversely affected in case of a possible failure.

Crowdfunding Platforms: These are internet-based platforms that are used to showcase a product, service or idea and in which the product, service or idea is supported by detailed project descriptions, images, audio and visual media, investment options, length of the project, information about the entrepreneur, etc.⁵⁰

⁴⁸Canbaz and Çonkar, "An Alternative Islamic Finance Method for Entrepreneurs: Crowdfunding", p. 41.

⁴⁹Agrawal, Catalini ve Goldfarb, Some Simple Economics of Crowdfunding, p. 14-15.

⁵⁰Hossain ve Oparaocha, Crowdfunding: Motives, Definitions, Typology and Ethical Challenges, p. 9.

The main purpose of crowdfunding platforms is to make a profit. Many crowdfunding platforms have a remuneration system based on the revenue model. For projects that are successful according to this system, they usually make a deduction of 4%-5% from the total financing. Therefore, the first priority of crowdfunding platforms is to maximize the number of projects that can be successful. To achieve this, crowdfunding platforms must be able to attract a high number of entrepreneurs and investor communities, while creating a marketplace that can attract high-quality projects, establish a platform where fraud is minimal and establish a structure that ensures the right matching between ideas and capital. Another feature of crowdfunding platforms is that they are the focus of projects that want to attract media attention thanks to the significant number of investors they contain. Thanks to these features, they become a tool for investors who want to reach a wide audience and thus have new investment categories brought by large projects that prefer the platform⁵¹.

1.3. The Basic Functioning of Crowdfunding

The realization of crowdfunding is realized by bringing together the entrepreneur and the investor, one of the above-mentioned crowdfunding actors, by the crowdfunding platform, which is also another actor. A standard crowdfunding process is as follows⁵²:

i. The crowdfunding platform receives applications from project owners (entrepreneurs) who want to showcase their products, services or ideas. While some platforms prefer to publish these ideas automatically, some platforms publish projects that meet their criteria by screening according to their own criteria. The platforms, which set certain criteria for the projects, examine the history of the project owners while evaluating the incoming applications and evaluate the feasibility of the crowdfunding plan put forward by the project owners.

ii. After the crowdfunding platform agrees to publish a project on their site, the project owner is given the task of determining the amount of capital targeted for the realization of the project and the time interval in which the project will be funded (campaign duration), as well as creating content (usually video) that promotes the project for potential investors. Project

⁵¹ Agrawal, Catalini and Goldfarb, *Some Simple Economics of Crowdfunding*, p. 15-16.

⁵² Kristof De Buysere et al., *A Framework For European Crowdfunding*, **European Crowdfunding Network**, Vol.1, 2012, p. 14.

owners often use social media to reach a wider audience. Those who see the project through social platforms and want to invest make their investments through the crowdfunding platform.

iii. During the campaign period, the project owner informs the investors about the developments in the project through the crowdfunding platform.

iv. If the targeted capital amount is reached during the campaign period, the entrepreneur receives the capital amount from the crowdfunding platform. If the targeted amount of capital is not reached within the specified period, many crowdfunding platforms return the invested capital to investors.

v. In general, investors and entrepreneurs continue to communicate through online platforms after the project is approved. Some investors prefer to be involved in the decision-making process and overall strategy of the project after the campaign period. Some investors have the right to vote on the business or related project owned by the entrepreneur.

Investors on crowdfunding platforms invest in projects that they believe in. Sometimes investors take on the role of donors by supporting the projects they believe in without any financial expectations in the future. Some investors even become direct shareholders in projects they believe in. When investors individually sponsor projects they believe in, a snowball effect often occurs and the crowdfunding investment process is triggered. These sponsoring investors, who really want the projects they believe in to be successful, share more information about the project and advertise for the project free of charge, thus ensuring that the product, service or idea put forward is more supported by the investors. This situation directly affects the success of the relevant project in the investment process. The free advertising of the project by the investors through the sharing of information is also an element that reduces the marketing costs of the project. That's why crowdfunding is one of the best financing methods for entry-level businesses and entrepreneurs with limited amounts of capital⁵³.

⁵³ Olga Shvets, How Does Crowdfunding Work: Tips For Beginners, 2021, <https://synder.com/blog/how-does-crowdfunding-work/>, (26 February 2022).

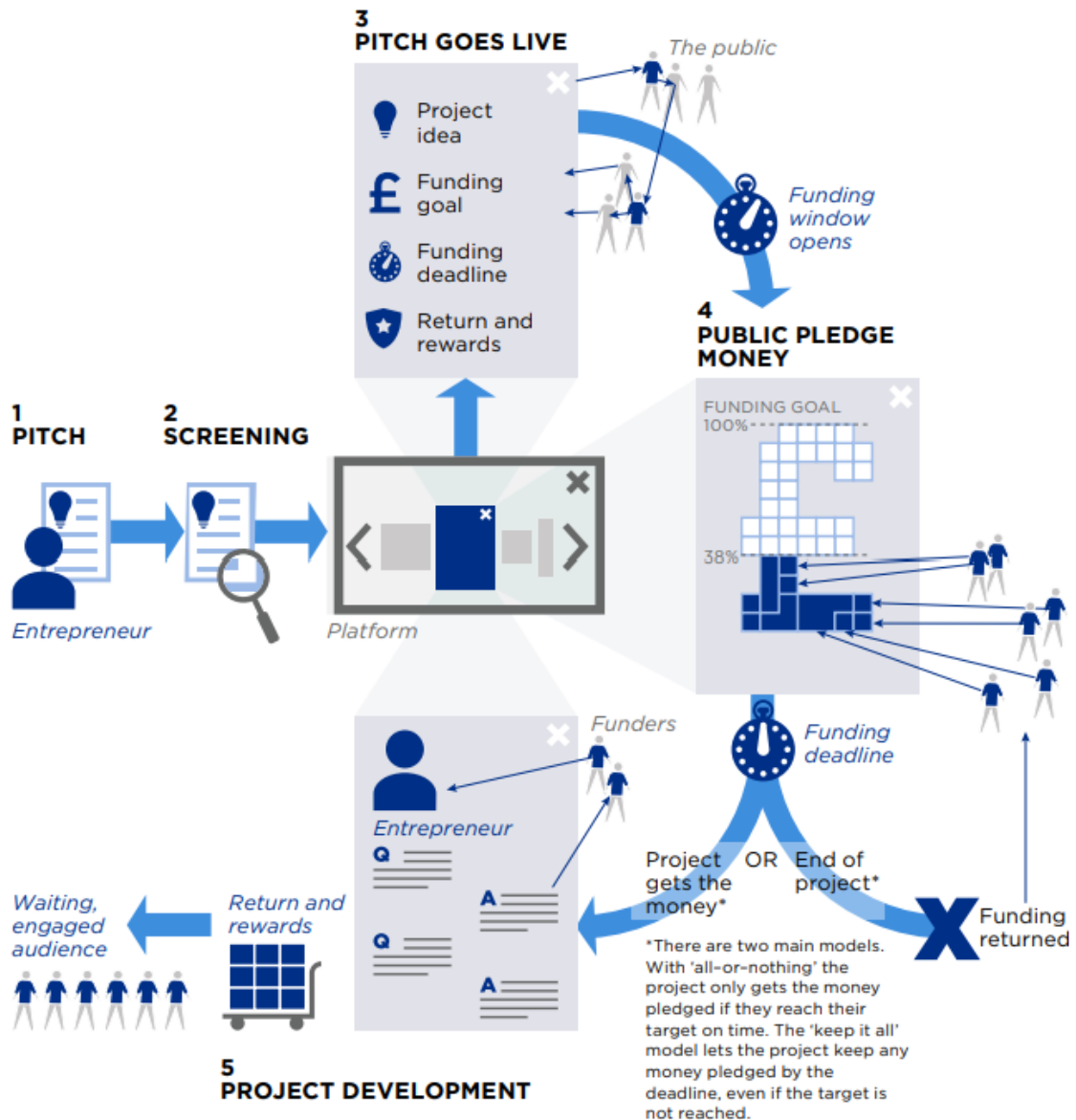


Figure 1.2: How Crowdfunding Works

Reference: Jonathan Bone and Peter Baeck, Crowdfunding Good Causes, Nesta, 2016, p. 13.

1.4. Deterrent Aspects and Risks of Crowdfunding

1.4.1. Deterrent Aspects of Crowdfunding

The crowdfunding method is an incentive for entry-level businesses and investors with its unique advantages over the initial classical financing methods. However, this method is not a perfect financing method, it also has some risks and deterrent aspects.

When we look at the deterrent aspects of crowdfunding from the perspective of the entrepreneur, we can say that the first and most important challenge is to disclose a product, service or idea to the public before it reaches the maturation stage. In classical financing methods, entrepreneurs can hide their products and services from the public and competitors before offering them, and thus have the opportunity to hide innovative features that are unique to their products and services. Due to the fact that there is a necessity to be disclosed to the public in the crowdfunding method, entrepreneurs face the risk of counterfeiting their products, especially in the period between the campaign start date and the launch date of the product, and this risk creates a great deterrent aspect for entrepreneurs⁵⁴.

“Quest didn't have a contract before he went to Kickstarter and that was a big mistake. After Hanfree (his own project) was funded, Quest began contracting with accessory manufacturers in China, Singapore and Los Angeles. However, these producers had the leverage advantage in their negotiations with Quest because they saw how much capital Quest raised on Kickstarter, and they used this advantage to reduce the profit margin of the product thoroughly. Therefore, creating the product with the funds collected became very expensive for Quest.”⁵⁵

The second deterrent aspect for entrepreneurs is the opportunity cost of raising capital from the public rather than professional investors. Angel investors and venture capital businesses often bring additional value to entrepreneurs, such as industry knowledge, relationships, and status. Unprofessional crowdfunding investors are very unlikely to bring in these additional values. More importantly, even if there are investors who have the means to provide these values, investors are unlikely to make an effort to provide these values because the investment amounts are usually low.

Investor relations management can be counted as the third deterrent point for entrepreneurs. Since the investment amounts are smaller in the crowdfunding method compared to traditional financing methods, it is possible to reach the targeted capital with more investors than traditional financing methods. Therefore, investor relationship management can be much more costly as many more investors need to be taken care of. As the number of investors increases, costs can increase even more, which can be intimidating to entrepreneurs. For

⁵⁴ Agrawal, Catalini and Goldfarb, Some Simple Economics of Crowdfunding, p. 16.

⁵⁵ Eric Markowitz, When Kickstarter Investors Want Their Money Back, 2013, <https://www.inc.com/eric-markowitz/when-kickstarter-investors-want-their-money-back.html>, (27 February 2022).

example, in the Pebble Watch project, as of March 2013, the team of entrepreneurs published 34 detailed updates and received 14,000 comments from investors on Kickstarter. When a project fails to live up to expectations or fails to meet its deadline, investors expect further clarification. Although these interactions provide opportunities for entrepreneurs to gather feedback, they also serve as a deterrent aspect in terms of resource usage and time management.

Another deterrent aspect for entrepreneurs is that they have no control over who finances their projects. Among investors, dominant individuals with different experiences, visions and strong personalities can influence other investors by sharing their ideas and that could have a negative impact on the course of the project. Crowdfunding platforms need to anticipate this risk and take measures to protect entrepreneurs⁵⁶.

The crowdfunding method also has some deterrent aspects for investors. Basically, we can count these deterrent aspects as the inadequacy of the entrepreneur, fraud and project risk.

The first of the deterrent aspects for investors is that it is not known whether the entrepreneur has the necessary knowledge and skills to bring the project to life. Investors who support projects through crowdfunding platforms invest in the belief that the project will be launched on time and will stick to the project end date. However, with the increase in projects that do not stick to the project end date despite reaching the targeted capital amount, crowdfunding platforms have started to take some measures, such as the obligation of entrepreneurs to share more information, taking into account the expectations of investors⁵⁷. Entrepreneurs who resort to crowdfunding are often inexperienced in creating a product-service. Their inexperience is not limited to this issue. Entrepreneurs are also inexperienced in making agreements with logistics companies and establishing supply chains. Therefore, entrepreneurs who meet their capital targets by exceeding large amounts may not meet the demands due to their inexperience and therefore they may not bring products and services into action even though getting the targeted capital⁵⁸.

Another deterrent aspect for investors is fraud. Inexperienced and overly optimistic investors not only divert their capital to bad projects, but also expose themselves to fraud.

⁵⁶ Agrawal, Catalini and Goldfarb, *Some Simple Economics of Crowdfunding*, p. 17-18.

⁵⁷ Yancey Strickler, *Is Lateness Failure*, 2012, <https://www.kickstarter.com/blog/is-lateness-failure?page=2>, (27 February 2022).

⁵⁸ Julianne Pepitone, *Why %84 of Kickstarter's Top Projects Shipped Late*, 2012, <https://money.cnn.com/2012/12/18/technology/innovation/kickstarter-ship-delay/index.html>, (27 February 2022).

Because crowdfunding is an internet-only method, it's relatively easy to create fake pages that look like real projects and defraud investors using false information. Therefore, although crowdfunding platforms create filters to prevent such manipulations, this system is an attractive place for swindlers. In addition, since the amounts invested are small, swindlers are unlikely to be detected and taken to court by individual investors. Because the cost of fraud detection for the individual investor is high and the individual return is low, the crowdfunding community generally does not take actions against fraud detection. Alternatively, these investors take actions that affect the decisions of other investors because their funding information is publicly available. When investors are faced with fraud, they can disclose it on public platforms and prevent funding of the project.

Another deterrent aspect for investors is project risk. Early-stage projects and initiatives are inherently risky because they are likely to fail. There are many risks for a project to fail other than the incompetence of entrepreneur and fraud. Even if investors take the risk factor into account when making investment decisions, due to information asymmetry (entrepreneurs have more information about the risks of the project than the investor), the cost of these risks to investors may be more than they think⁵⁹.

1.4.2. Risks of the Crowdfunding

Crowdfunding has some advantages over traditional financing methods. However, crowdfunding also has some risks due to its structure. These risks are relevant for all crowdfunding methods.

Generally, the risks of crowdfunding are investment failure, fraud and money laundering:⁶⁰

i. Investment Failure: In the crowdfunding method, the most common risk that investors face is the risk of the investment failure. Experienced investors know that investing in early-stage companies is riskier than investing in experienced companies with a business culture, financial background, experienced management team and adequate infrastructure. When the publicly disclosed data is examined, it is known that fifty percent of newly established

⁵⁹ Agrawal, Catalini and Goldfarb, *Some Simple Economics of Crowdfunding*, p. 19-20.

⁶⁰ InfoDev/World Bank, *Crowdfunding's Potential for the Developing World*, p. 44-49.

companies fail within five years⁶¹. Potential traders need detailed and explanatory information to help them analyze and understand these risks, lack of guarantees, liquidity limitations and other possible pitfalls. This information should be published by entrepreneurs on crowdfunding platforms so that investors can review it before investing. In addition to this explanatory information, crowdfunding platforms should offer their investors a less risky and more reliable environment by sharing effective and easy-to-understand investor education tools through their websites.

The donation-based crowdfunding method also carries this risk. Investors who donate through donation-based crowdfunding method, although they invest without any financial expectations, want to see their donations evaluated correctly and achieved their purpose. Some companies and entrepreneurs collect aid through crowdfunding platforms without considering production, transportation, taxation and other critical processes, but even if the capital target is met, they may not be able to realize the targeted project output due to their inadequacies and planning deficiencies in these areas. Because of such risks, it becomes difficult for investors to observe the difference between "the intention to collect donations and make donations" and "the ability to collect donations and realize aid". Therefore, before investing, investors should review their policies regarding who will be responsible for determining partial refunds or alternative donation methods in the event that crowdfunding platforms' donation-based projects fail.

ii. Fraud: All investors, no matter what area they are investing in, may face the risk of being swindled, and this is a concern for investors. Successful fraudulent activity with the crowdfunding method is relatively rare. This is because most fraudulent acts usually take place in one-on-one communication situations (e.g., asking for personal information via email, etc.), but in crowdfunding, where social media is actively used, fraud must be committed against a community. That's why swindlers are faced with the knowledge, questions, and insights of the entire audience, rather than a single person. The most likely scenario for scammers to succeed is to set up fake crowdfunding sites where investors can attract their attention and invest their money and collect investments with fake company identities they create through these websites.

⁶¹ U.S. Small Business Administration, *Advocacy: the voice of small business in government*, 2011, <https://www.sba.gov/sites/default/files/sbfaq.pdf> , (6 March 2022).

Especially since 2007, crowdfunding platforms have been expanding rapidly. However, the rate of crowdfunding and fraud has not grown in parallel. ASSOBS, Australia's largest crowdfunding platform, has raised nearly \$130 million since its inception in 2007 and is known as one of the largest crowdfunding platforms in the world. To date, about 176 companies have been funded through ASSOBS and not a single case of fraud has been reported. Crowdcube, one of the UK's largest crowdfunding platforms, has funded 29 companies with more than \$6.75 million since its inception in 2011 and has yet to report a case of fraud. Of the 43,193 projects funded through Kickstarter, only 4 projects were caught by fraud detection.

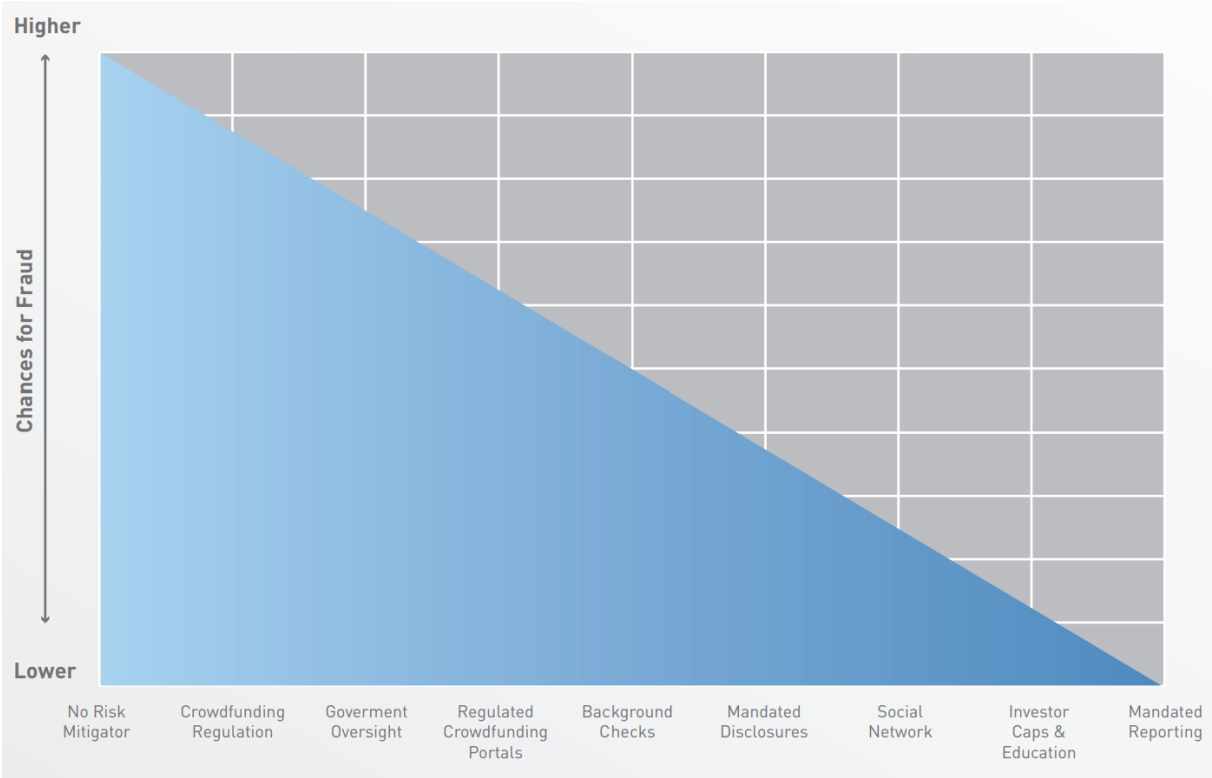


Figure 1.3: Risk Mitigation Techniques

Reference: InfoDev/World Bank, Crowdfunding’s Potential for the Developing World, p. 46.

With so few scams disclosed by crowdfunding platforms to date, it can be difficult for investors to distinguish between a fraud attempt and a bona fide project. Some of the measures that states can take to prevent fraudulent activities are indicated in the figure above (Figure 1.3). The implementation of these measures not individually, but by both investors, entrepreneurs and regulators together, and the increase in public awareness will reduce the risk of fraud.

In addition to these measures, some protective mechanisms have been put in place at the international level to detect and reduce potential fraud. These mechanisms are described in the following table:

Table 1-2: Protective Mechanism Against Potential Fraud

TYPE	RISK	RATIONAL	MITIGATION TACTIC
Business	Fraud	The securities markets have examples of fraud	<ul style="list-style-type: none"> • Background checks for issuers • Mandatory auditing, financial disclosures and business reviews • Requiring all-or-nothing financing (prevents fraudsters from raising money and then disappearing when donors ask difficult questions) • Restricting or monitoring social media communication about offerings • Requiring all crowdfund raising to take place on portals that are registered with a national regulatory body that oversees securities • Providing investor education to learn how fraud has been perpetrated in the past so that investors can identify it in future • Mandatory holding periods to prevent pump-and-dump schemes
Business	Failure	Crowdfund investments offer no guarantee of return	<ul style="list-style-type: none"> • Educating investors about portfolio diversification as a means to prevent total loss of investment(s)
Business	Anti-money laundering	Using businesses as a cover for illegal money transfers	<ul style="list-style-type: none"> • Placing caps on amounts that may be raised in specific time periods • A “cooling off period” between reaching the funding target and funds transfer to allow for further diligence by investors and regulators
Business	Sector risk	Crowdfunding has had the most traction in consumer products and extensions of popular brands or games	<ul style="list-style-type: none"> • Build on small successes in areas like science and energy • Raise small amounts of capital to show market interest and customer validation • Consider leveraging the crowd for only a small part of the overall capital raise to identify interest and de-risk the bigger investment
Business	Subsequent funding failure	Bringing on crowdfund investors creates a more complicated investor table that may deter subsequent investors	<ul style="list-style-type: none"> • Consider the use of a Special Purpose Vehicle (SPV) to group all crowdfund investors into one voting group to ease communication and voice • Offer to buy out crowdfund investors at subsequent rounds of financing at the current price

Table 1-2 (continue): Protective Mechanism Against Potential Fraud

Investor	Investor liquidity and losses	Crowdfunded stocks are not liquid, businesses do fail and investor can lose their investments	<ul style="list-style-type: none"> • Investment limits for nonaccredited investors • Allowing for crowd vetting and crowd diligence to discuss the merits/risks of the offering in a public manner • Promote the creation of secondary markets after a 12-month holding period where shares may be traded based on supply and demand
Entrepreneur	Lack of issuer experience	Entrepreneurs do not always have all the experience needed to build, run, and raise capital for a business	<ul style="list-style-type: none"> • Create education programs about how to build a business • Create education programs about how to raise money from the crowd and follow through with a plan once funded • Requiring the participation of either a securities broker/dealer, an attorney or accountant
Regulatory	Regulatory and compliance risk	Regulatory bodies may resist or reject the argument that crowdfunding is an appropriate and effective method of financing early-stage companies	<ul style="list-style-type: none"> • Work with local governments prior to offering crowdfund investing • Engage with local regulatory and policy constituents to build crowdfunding frameworks
Industry	Market rejection	Investor community might not have an appetite for this new emerging asset class	<ul style="list-style-type: none"> • Leverage the media to share success stories of businesses that have been successful with crowdfunding investing and jobs that have been created • Share early financial engagement stories of investors who have backed crowdfunded companies and why • Offer crowdfund investments in tandem with more traditional investments to act as an honest broker

Reference: InfoDev/World Bank, Crowdfunding’s Potential for the Developing World, p. 48.

iii. Money Laundering: As with other financing methods, there is a risk of money laundering in the crowdfunding method, but this risk is not greater than the risk present in other financing methods. The legal regulations currently in force in the developed world countries have anti-money laundering mechanisms and the world's largest crowdfunding sites such as Kickstarter, Indiegogo, RocketHub act in accordance with these regulations. In addition, electronic payment systems, which have become widespread in recent years, have further strengthened the protection against money laundering.

2. TYPES OF CROWDFUNDING, ITS HISTORICAL DEVELOPMENT AND CURRENT SITUATION IN THE WORLD AND TURKEY

2.1. Type of Crowdfunding

The types of crowdfunding are basically classified as crowdfunding (for investment purposes) with financial consequences and crowdfunding (non-investment) with no financial consequences. Debt-based crowdfunding and equity-based (share-based) crowdfunding are defined as having financial consequences, while reward-based crowdfunding and donation-based crowdfunding are defined as types of crowdfunding that do not have financial consequences.

In financially consequential models, investors expect a financial return from projects, and the goals are based entirely on revenue or an output with financial value. Establishing a company, financing the project in which an existing company will venture, financing an R & D project, financing products such as games, music, films that will be offered to the market for commercial purposes are examples of crowdfunding that has financial consequences. In models that do not have financial consequences, investors do not have a financial expectation. The aim here is to contribute to social projects initiated in the fields of health, public infrastructure, human rights, development, etc. by supporting. Some projects fall between these two categories. Although web-based applications such as Facebook, Skype, YouTube, which are especially in the entertainment and media sector, started as social projects, they later turned into completely profit-oriented companies. It is difficult to say whether such projects are for investment purposes or for charitable purposes because it is not known at the initial stage what the commercial status will be in the long term⁶².

2.1.1. Donation-Based Crowdfunding

Donation-based crowdfunding is a type of crowdfunding that is simpler to implement than other models and is therefore common. In this model, the main motivation of investors is to support projects that they think will be beneficial to society and they do not expect any financial return from their investments. Donations are usually made for social aid and charitable

⁶² Joachim Hemer, A snapshot on crowdfunding, *Working Papers Firms and Region*, No: R2/2011, 2011, p. 11.

initiatives. Charitable and donation-only platforms are generally fewer, and these platforms fulfill the demands of charities and nonprofit organizations. However, donations can also be collected for for-profit organizations. Investors donate to projects they believe in, such as a favorite band going on tour, having a candidate they support become president and raising aid for those harmed by natural disasters. Even if investors do not have any financial expectations in return for their investments, they can be rewarded by the project owners with symbolic awards such as a special thank you message and their names being included in the list of contributors to the project. In donation-based crowdfunding, the risk is low due to the fact that entrepreneurs are not obliged to provide any return and investors do not have any financial expectations. The donation process takes place when investors invest a small amount of money and the process is very simple. There is no obligation on the part of investors, but entrepreneurs have a moral obligation to use the aid they collect in accordance with the purpose of the project⁶³.

Although donation-based crowdfunding does not carry a great risk for entrepreneurs, when the effectiveness of donation campaigns is examined, it is seen that its efficiency is low for non-profit organizations. This was because investors' motivation was often to donate to projects where emerged product is a product that they could later buy. Non-profit organizations can only reward their investors with non-financial rewards.⁶⁴ There are also some advantages to nonprofit organizations opting for a donation-based crowdfunding model over traditional fundraising method. These benefits are as follows⁶⁵:

- i. There is no long waiting period to obtain the collected funds.
- ii. Some crowdfunding sites don't charge any fees for fundraisers.
- iii. Reaching a much wider audience than is normally reached.
- iv. A considerable sum can be raised with the small contributions of a large number of people.
- v. A transparent environment can be created within the organization because it is easy to track where donations come from and where they go.

⁶³ Hossain and Onyema Oparaocha, Crowdfunding: Motives, Definitions, Typology and Ethical Challenges, p. 18-19.

⁶⁴ Paul Belleflamme, Thomas Lambert and Armin Schwienbacher, Individual Crowdfunding Practices, **Venture Capital**, Vol. 15, No. 4, March 2013, p. 313-333.

⁶⁵ Lindsay & Brownell, LLP., Donation-Based Crowdfunding, 2019, <https://www.lindsayandbrownell.com/donation-based-crowdfunding> (19 March 2022).

- vi. Since donors can be contacted directly, the connections of investors can be used to reach stronger people and a larger community.

The disadvantages of the donation-based crowdfunding model for nonprofit organizations are as follows⁶⁶:

- i. Investors are often less motivated to choose nonprofit organizations because they donate to projects where emerged product is a product that they can later buy.
- ii. Some crowdfunding platforms take a percentage of the donation raised for themselves.
- iii. This model, albeit a little, requires a marketing strategy. Therefore, there is a possibility that the total benefit provided will be below the costs.
- iv. With the increasing popularity of crowdfunding in recent years, there is a high level of fund competition.
- v. Less than a third of the campaigns launched successfully achieved their intended funding target. Some websites, such as GoFundMe, set limits such as the minimum number of funds to be collected, and if the campaign does not reach this figure on the targeted date, the entrepreneur cannot obtain funds. For this reason, it can be difficult for the campaigns launched to reach their target.

2.1.2. Reward-Based Crowdfunding

Reward-based crowdfunding is a model in which a pre-agreed reward is provided to the investor by the entrepreneur if the investment is successful. This model does not provide any share or financial return to the investor. The reward-based crowdfunding model is the most popular type of crowdfunding worldwide. In this model, entrepreneurs have the advantage of having the product at a lower price than usual if they pre-ordered by potential customers, that is, if they invest before the product is launched. Entrepreneurs can also appeal to investors with gifts or other non-monetary rewards⁶⁷. For example, a gaming company might resort to reward-based crowdfunding for a game that is still in development, giving investors access to the game at half of its normal price when it is released. The awards can also be prestigious prizes, such

⁶⁶ Lindsay & Brownell, LLP., Donation-Based Crowdfunding (19 March 2022).

⁶⁷ C.Steven Bradford, Crowdfunding and the Federal Securities Laws, *Columbia Business Law Review*, No. 1, 2021, p. 16.

as a special limited-edition key chain or putting the names of investors in the credits at the end of a finished movie.

In the reward-based crowdfunding model, the level of risk is moderate for both entrepreneurs and investors. Entrepreneurs may not be able to produce the product or service they promise for various reasons, and therefore investors may not receive their rewards. In this case, it is unclear who will be responsible for delivering the prize. It is also unclear who will be responsible if the product or service turns out to be a different product or service than originally promised, even if the product or service is successfully delivered. Often people with early adoption tend to invest in reward-based crowdfunding projects⁶⁸.

Kickstarter and IndieGoGo are some of the largest sites that implement the reward-based crowdfunding model and have similar structures. Kickstarter has made it a requirement to put various rewards on projects submitted through its platforms. In this way, it aimed to attract the attention of investors with different awards offered. According to Kickstarter, these awards are items produced by the project itself, such as a copy of the album that the singer will compose as a result of the project, a signed movie poster of the movie director and a special limited edition copy of the produced comic book. Another attractive factor for investors is the possibility of accessing the invested product at a more affordable price than the sales price determined after the project is completed. For example, Tom Gerhardt and Dan Provost, owners of the project to design a tripod for the iPhone, set the sale price at \$35 after the project was successful. However, while the project was in the investment phase, they guaranteed to provide the product for \$20 to all investors. Kickstarter's rewards aren't limited to buying the product at a more affordable price than the retail price. There are also rewards such as being able to visit the film set, naming a character in the film after the investor and making a personal phone call to the artist. For example, Tom Gerhardt and Dan Provost offered the option to have dinner together with investors who invested \$250 or more in a tripod production project for iPhone⁶⁹.

Unlike Kickstarter, IndieGoGo doesn't mandate but recommends giving out rewards. IndieGoGo's reward system ranges from advantageous pre-purchase prices to many personalized rewards⁷⁰.

⁶⁸ Hossain and Onyema Oparaocha, *Crowdfunding: Motives, Definitions, Typology and Ethical Challenges*, p. 20.

⁶⁹ Bradford, *Crowdfunding and the Federal Securities Laws*, p. 17.

⁷⁰ Indiegogo, *Create a Campaign*, <https://support.indiegogo.com/hc/en-us/articles/204469638-Create-a-Campaign-Step-by-Step> (20 March 2022).

The reward mechanism of a video game launched by South Korean game developers on Kickstarter is as follows:

Table 2-1: Reward-Based Crowdfunding Campaign Example

Invested Amount	Reward
\$5	<ul style="list-style-type: none"> • Game-specific wallpaper pack and game-specific profile picture.
\$30	<ul style="list-style-type: none"> • The final version of the game. • Game-specific wallpaper pack. • Detailed digital demonstration package of the game.
\$40	<ul style="list-style-type: none"> • All previous rewards. • The game's digital music album. • The game's digital art album.
\$50	<ul style="list-style-type: none"> • 2 digital copies of the game.
\$55	<ul style="list-style-type: none"> • All previous rewards. • Early access to the game. • In-game specific items.
\$75	<ul style="list-style-type: none"> • All previous rewards. • 1 more digital copy of the game. • Special in-game equipment.
\$100	<ul style="list-style-type: none"> • All previous rewards. • A special package containing the game and game-related gifts.
\$150	<ul style="list-style-type: none"> • All previous rewards. • Exclusive in-game sword given to pre-order users.
\$500	<ul style="list-style-type: none"> • All previous rewards. • The physical figure of an in-game character.
\$1000	<ul style="list-style-type: none"> • All previous rewards. • Your name is specially written in the library within the game.
\$5000	<ul style="list-style-type: none"> • All previous rewards. • The presence of your picture as a portrait in the game.

Reference: Kickstarter, <https://www.kickstarter.com/projects/ldi/little-devil-inside> (20 March 2022)

Both Kickstarter and IndieGoGo are taking deductions from the funds raised. Kickstarter operates an all-or-nothing model and does not allow funding for a project unless it reaches its set capital target. If the project reaches the targeted amount of capital, Kickstarter cuts 5%. If this amount cannot be reached, there is no deduction⁷¹. IndieGoGo, on the other hand, allows entrepreneurs to benefit from the funds collected, regardless of whether the targeted capital amount is reached or not. IndieGoGo cuts 5% from all projects launched through its platform. However, if the campaign starts on another crowdfunding platform and then continues through IndieGoGo, an extra 8% deduction is made⁷².

2.1.3. Equity-Based Crowdfunding (Share-Based Crowdfunding)

In equity-based crowdfunding, investors obtain shares from the business or project they invest in in exchange for the amount they invest. In this model, investors aim to get a financial return on their investment. If the project is successful, the share values increase, and if project fails, the share values decrease⁷³.

Equity-based crowdfunding is much riskier and more complex than reward-based crowdfunding. In this model, investors receive a return on their investment in the form of a stock or dividend payment. Therefore, the risk and return of the investment is determined by the overall share value of the invested company or project. If the value of a company decreases independently of the project invested, this may also affect the respective project and the share value of investors may decrease. It is important for companies using the equity-based crowdfunding method to publish their projects on crowdfunding platforms after bringing them to a mature point with angel investors in order to reduce investment risk. For this reason, in many countries, only qualified entrepreneurs who meet certain criteria are allowed to use the equity-based crowdfunding model. General risks to be encountered in equity-based crowdfunding are as follows; investment risk can be listed as the fact that the company has liquidity problems, the dividend to be distributed if the investment is successful may not yet become systematic, the loss of equity, the company's inability to choose the right investment areas, the fact that the exit strategies are not planned in advance if profitability is not achieved

⁷¹ Kickstarter, What are the fees? <https://help.kickstarter.com/hc/en-us/articles/115005028634-What-are-the-fees-> (20 March 2022).

⁷² IndieGoGo, How much does Indiegogo cost?, <https://support.indiegogo.com/hc/en-us/articles/204456408-Fees-Pricing-for-Campaigners-How-much-does-Indiegogo-cost-> (20 March 2022).

⁷³ Ergen, Lau and Bilginoglu, "Distributed Venture Capital Financing: Crowd-Funding", p.5.

and the company is exempt from some legal obligations due to the fact that it is not traded on the stock exchange market⁷⁴.

Equity-based crowdfunding is a suitable model for raising capital for start-ups and new ventures. The company that wants to raise capital shares its business model, financial statements, history of the management team, marketing strategies, patents they obtain, legal cases and tax status through the crowdfunding platform. In addition, it is also explained where the collected capital will be used, the time schedule and how much shares will be given to investors in exchange for their investments. Equity-based crowdfunding model can limit investors as well as entrepreneurs according to their qualifications. According to the regulations of the countries, investors can be divided into two as accredited investors and non-accredited investors. After entering the necessary information through the crowdfunding platforms, the control mechanism of the platform is activated and it is determined whether the investor profile is accredited or not. Once the platform approval arrives, investors can invest in companies looking for capital⁷⁵.

In equity-based crowdfunding, companies should take measures to protect intellectual property rights and determine managerial rights. In addition, companies submit a comprehensive review report ("due diligence") to the crowdfunding platform where they publish their projects. This report is also published by the platform. As in other types of crowdfunding, the transaction does not end with investors investing through the crowdfunding platform because contracts for the acquisition of shares must also be signed. In this method, crowdfunding platforms keep the deposited amounts in the escrow account by intermediating the transactions and the transfer takes place after the platform confirms that the transactions are over⁷⁶.

⁷⁴ Şafak Erdem, The New Face of Finance in Entrepreneurship: Crowdfunding, 2014, <https://www.mondaq.com/turkey/corporate-and-company-law/345614/giri351imcilikte-finansmanin-yeni-yz-kitlesel-fonlama-crowdfunding> (20 March 2022).

⁷⁵ Savaş Ünsal, Crowdfunding: A New System to Change the Method of Doing Business, 1st Edition, Istanbul: Ceres Publishing House, 2017, p. 33.

⁷⁶ Şafak Erdem, The New Face of Finance in Entrepreneurship: Crowdfunding.



Figure 2.1: A Sample Project Published on the WeFunder Crowdfunding Platform

Reference: WeFunder, Invest in Next Bolt, <https://wefunder.com/nextbolt> (27 March 2022)

2.1.4. Debt-Based Crowdfunding

In debt-based crowdfunding (P2P-peer to peer), entrepreneurs collect financing from investors through crowdfunding platforms and repay the amount of financing they received at maturity to investors with interest. Some debt-based crowdfunding can be done without interest⁷⁷. In this model, also known as peer-to-peer lending, entrepreneurs can provide financing without the need for banks and other traditional borrowing methods. Investors expect a financial return at the end of the term, but they also feel satisfaction if the project they contribute to by financing is successful. In countries that are still developing and have a low level of prosperity, small amounts of investment (in the case of microfinance) are not charged interest on return, and investors invest only as social aid in order to increase prosperity⁷⁸.

The debt-based crowdfunding model differs from other models because, unlike other models, only money is exchanged in this model. The debt-based crowdfunding process is relatively simple, but investors risk losing capital if the project fails. Despite this, the amount of capital raised through debt-based crowdfunding accounts for two-thirds of the total crowdfunding volume in the world⁷⁹.

⁷⁷ Liam Collins and Yannis Pierrakis, *The Venture Crowd: Crowdfunding Equity Investment Into Business*, London: Nesta, 2012, p. 3.

⁷⁸ Ünsal, *Crowdfunding: A New System to Change the Method of Doing Business*, p. 22-23.

⁷⁹ Hossain and Oparaocha, *Crowdfunding: Motives, Definitions, Typology and Ethical Challenges*, p. 21.

In debt-based crowdfunding, companies collect financing from an investor group instead of a bank. For this reason, the obligation to provide assurances such as letters of guarantee given to banks for companies seeking capital is eliminated. However, since there is a risk of capital loss for investors, the interest rate on the projects is calculated based on the risks. Risk calculations are calculated on the basis of financial data and personal guarantees. These calculations can be made through the platform or by independent organizations. The entrepreneur who wants to find capital has to share income and asset information with the platform. There are also innovative methods in this model where the risk is on the reserve funds and not on the investor. Debt-based crowdfunding is generally preferred by entrepreneurs who want to take out loans at a lower rate than banks. At the same time, entrepreneurs who cannot meet the mandatory guarantees required by banks prefer this method. Available data show that the cost of raising capital with debt-based crowdfunding is less than %1⁸⁰.

Debt-based crowdfunding is not only the viable model for start-up companies. Mature companies that do not experience cash flow shortages can also benefit from this method. The first reason mature companies may prefer debt-based crowdfunding is that in some countries there may be no ability to buy and sell equity-based crowdfunding due to the lack of a secondary market. Therefore, in such countries, it is easier to sell debt-backed securities than share-based securities. The second reason that mature companies prefer debt-based crowdfunding is that if companies use a borrowing-based method while finding capital at the time of establishment, they can find funds more smoothly and quickly by using the same method in their later capital needs. The third reason is that with the debt-based crowdfunding model, companies can more easily structure their debts, so that companies can find re-investors even if they fail. This is also a positive situation for investors because investors who make the initial investment and do not receive a return have the opportunity to reap the return on their losses if the restructuring is successful⁸¹.

The functioning of debt-based crowdfunding sites may differ from other crowdfunding sites in terms of direct contact between the investor and the entrepreneur. Sites can also adopt interest- or interest-free debt-based crowdfunding models. Kiva (kiva.org) is one of the leading platforms offering interest-free debt-based crowdfunding. Kiva does not give loans directly to entrepreneurs, but instead contracts with microfinance lenders around the world, which they

⁸⁰ Kristof De Buysere et al., A Framework For European Crowdfunding, p. 10-11.

⁸¹ InfoDev/World Bank, Crowdfunding's Potential for the Developing World, p. 87.

call "field partners". Local microfinance lenders give the relevant fund to the entrepreneur before the crowdfunding request is published on Kiva. Each entrepreneur's request is then published on Kiva and investors can fund these entrepreneurs through Kiva from a minimum of \$25 to the entire loan. Kiva collects the invested funds and distributes them to its field partners. It pays back the repayments made by entrepreneurs to the investors who provide funds. Investors who raise capital through Kiva only get their principal back, while the interest paid by the entrepreneurs is used to cover the operating expenses of their field partners⁸².

Prosper (prosper.com) and Lending Club (lendingclub.com) are among the leading interest-bearing debt-based crowdfunding sites. Not all projects funded from these platforms are business oriented. There are also transactions in which personal expenses are funded. Entrepreneurs post loan requests ranging from \$1,000 to \$25,000 through the site. Investors examine these demands and make their investments with a minimum amount of \$ 25 and above. When the project reaches a sufficient amount of funds, the entrepreneur presents a 3-year unsecured promissory note for the loan amount. The process of funding investors' ventures through Prosper and Lending Club has changed since the sites were established. When they were established, entrepreneurs and investors made transactions directly with each other through these sites and provided fund flow, and the sites received a 1% share from these transactions. However, in the current structure, investors do not fund entrepreneurs directly, but instead fund the sites by purchasing shares and bonds issued by Prosper and Lending Club. Prosper and Lending Club, on the other hand, borrow entrepreneurs through a bank with the funds they collect from investors in exchange for shares and bonds. Although the sites are the ones that issue the bonds and bills purchased by the investors, they are only obliged to pay the investors when the entrepreneurs pay the relevant loans, that is, the obligation to pay back the funds in case the entrepreneurs fail does not belong to the platforms. Sites take a 1% share of the revenues they earn due to the loans they give and distribute it to investors. In addition, these sites charge entrepreneurs an initial fee for each loan. This amount varies according to the credit risk of the entrepreneur⁸³.

⁸² Bradford, Crowdfunding and the Federal Securities Laws, p. 20-21.

⁸³ Bradford, p. 21-23.

2.1.5. Comparison of Crowdfunding Models

We can reduce the types of crowdfunding to two basic categories as crowdfunding with financial consequences and crowdfunding with no financial consequences. In donation-based and reward-based crowdfunding models which are types of crowdfunding that do not produce financial consequences, investors do not aim for any financial outcome in return for the capital they provide. Therefore, the risk for the investor is low and the investor's expectation is that the invested project will be implemented and these investments are used for a social purpose. The responsibility of entrepreneurs is to ensure that the project is implemented in a healthy way. In equity-based and debt-based models which are types of crowdfunding that have financial consequences, investors aim to get a financial return on their capital. These models carry the risk of capital loss for investors. Especially in beginner companies, there may be risks such as inexperience in the sector, lack of management, lack of sufficient technological infrastructure. Therefore, it is important which projects investors will provide capital to.

The types of crowdfunding differ from each other and crowdfunding platforms generally adopt and serve a specific crowdfunding model. However, some crowdfunding sites are able to offer hybrid models contrary to the mainstream practice and these models have some extra benefits for both entrepreneurs and investors. For example, on a platform that offers equity and reward-based crowdfunding models together, entrepreneurs can offer investors products or services to be produced alongside shares as a reward. Platforms can differentiate not only by the crowdfunding model they offer but also by the fund management approaches they adopt. The funds collected on the platforms that adopt the "all or nothing" approach are transferred to the entrepreneur only if the targeted capital amount is reached. In cases where the target is not achieved, the funds are repaid to investors or not collected. On platforms that adopt a "take it all" approach, the funds collected are transferred to the entrepreneur regardless of whether the targeted capital amount is reached or not. Because of the higher level of commitment and seriousness between these two types of approaches, the "all or nothing" model is more adopted. The "take it all" model is preferred in projects where social assistance is made⁸⁴.

⁸⁴ Rotem Shneor, Bjorn-Tore Flaten and Liang Zhao, **Advances in Crowdfunding**, Kristiansand: University of Agder, Palgrave Macmillan, 2020, p. 27.

Table 2-2: Comparison of Crowdfunding Models

CROWDFUNDING MODEL	BUSINESS MODEL	FEATURES	PROS	CONS
Donation	Donation-Based	Philanthropic: funders donate without expecting monetary compensation.	-No risk.	-Donors do not acquire security interest. -Entrepreneurs have difficulty raising substantial capital.
Donation	Reward-Based	Funders receive a token gift of appreciation or pre-purchase of a service or product. This model is evolving into a marketplace of its own, with firms raising considerable sums through pre-sales.	-Low risk (primarily fulfillment and fraud risk). -No real potential for financial return.	-Potential return is small. -No security is acquired, and there is no accountability mechanism. -Most entrepreneurs may have difficulty raising substantial capital without a product with mass appeal to sell.
Investing	Equity-Based	Funders receive equity instruments or profit-sharing arrangements.	-Potential to share in the profitability of the venture. -Unlimited potential for financial gain. -May attract relatively large numbers of investors	- Potential loss of investment. -Equity holders are subordinate to creditors in the event of bankruptcy. -Securities laws related to crowdfund investing may be complex.
Investing	Lending-Based	Funders receive a debt instrument that pays a fixed rate of interest and returns principal on a specified schedule.	-Pre-determined rate of return agreed upon between lender and borrower. -Debt holders are senior to equity holders in case of bankruptcy. -Secured status may make it easier for entrepreneurs to raise capital.	-May be subordinate to senior creditors. -Start-ups' high-failure rate presents similar risk of loss as an equity investment, but with capped potential returns. -Requires a business already generating cash flow. -Existing/established, cash flow positive businesses may consider this option because they can offer a more structured exit opportunity than typical equity offerings

Table 2.2 (continue): Comparison of Crowdfunding Models

Investing	Royalty-Based	Less common than the other models. Funders receive a share in a unit trust, which acquires a royalty interest in the intellectual property of the fundraising company. A percentage of revenue is paid out over a period of time. The payout varies depending on the periodic revenue	<ul style="list-style-type: none"> - Potential gain is unlimited, but the rate of gain is predetermined by the interest rate. -Investment presents less risk or return than an equity investment, but more than a debt instrument. 	<ul style="list-style-type: none"> - Potential loss of investment. -Risk of loss comparable to that of an equity investment, but investment offers lower potential returns than equity. -The business could cease paying royalties if it chose to operate without the intellectual property in question. -These instruments generally attract smaller pools of investors than other CFI models, so entrepreneurs may find it more difficult to raise capital with this model.
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Reference: InfoDev/World Bank, Crowdfunding’s Potential for the Developing World, p. 20.

2.2. The History and Current Status of Crowdfunding

2.2.1. History of Crowdfunding

Although crowdfunding is a financing model applied through the internet, the idea of supporting a creation by the masses is much older. Historians study crowdfunding-like practices in the 13th century. They have reached a background that goes back to this century. In this century, it has been seen that citizens combine their funds to earn returns from risky ship trades. In addition, throughout history, it seen that authors got support from public and released their work if public support them with a subscription-like system. These examples have similarities with today’s crowdfunding⁸⁵.

Although these examples are similar to crowdfunding, the application that is most similar to the crowdfunding model known today was first applied by the Irish Jonathan Swift at the beginning of the 18th century. Swift raised money for poor and needy people by setting up a pool of funds, and this fund often grew with the support of rich people. The success of the fund inspired many people, and in 1837 the first pool of funds was officially established. As a result of these developments, about 300 fund pools were established in Ireland until 1843.

⁸⁵ Cristian Fronea, History of Crowdfunding (17 April 2022)

Although these funds are generally donation-based, interest-free and interest-bearing funds have also been put into service⁸⁶.

It is possible to see similar reward-based crowdfunding models in the past that is similar to today's crowdfunding. There are examples in history where the expenses incurred in putting forward the works of famous artists were covered by the rich. This was called patronage, and in such cases the patron who funded the art was not always a single rich person, but groups of people who wanted to sponsor artistic endeavors, just like modern crowdfunding. The best-known examples of artists supported in this way are Alexander Pope and Mozart. Alexander Pope was funded by his audience when he began translating the ancient Greek poem *The Iliad*. Pope set up a subscription system, which took prepayment and promised to release a volume each year in exchange for that funding. This situation continued for 6 years. He also rewarded his subscribers by publishing their names in the first editions of the books. In the 1780s, Mozart sought the help of his fans as he was struggling to finance the tours he was planning and supported by 176 people. Later he performed his tours thanks to these supports. As a reward to those who supported him, Mozart presented a signed concert text with a personal thank you letter. These examples are very similar to the reward-based crowdfunding known today⁸⁷.

Historically, the closest example of crowdfunding to the present day emerged as a result of the initiative originated by Indian Professor Muhammad Yunus in 1976, and thus the foundations of microfinance were laid. Within the scope of this project, 27 dollars were collected by Muhammad Yunus in Bangladesh and distributed to 42 poor women. The very success of the project led to the development of the Grameen Bank project, the first example of modern microfinance. In this way, an alternative financing method has been created for people who do not have access to traditional financing methods with the microfinance method⁸⁸.

The first example of today's crowdfunding model applied via the Internet was implemented by the British rock band Marillion in 1997. As the band reunited, they asked for support from their fans through online channels in order to go on tour throughout America. The band quickly raised more than \$60,000 in funding and toured the United States. This initiative

⁸⁶ The Startups Team, *A Brief History of Crowdfunding* (17 April 2022)

⁸⁷ Cristian Fronea, *History of Crowdfunding* (17 April 2022)

⁸⁸ The Startups Team, *A Brief History of Crowdfunding* (17 April 2022)

made reward-based crowdfunding even more popular, causing fans to support new albums months before their release, and in return to include their names on the album⁸⁹.

Inspired by Marillion's success, the ArtisShare site founded in 2000, was the first private crowdfunding platform where musicians could raise money from fans to make new albums or go on tour. ArtisShare later became a platform where film, video and photography related projects were also funded. Two years later, jazz singer Maria Schneider won a Grammy award for an album funded by her fans on ArtisShare⁹⁰.

After these developments, the popularity of the crowdfunding financing model began to increase in the mid-2000s. In 2005, the first debt-based crowdfunding site Zopa was launched in London. This development has led to the emergence of an alternative for the banking sector, which has been specialized in providing traditional financing for centuries and has high-level opportunities as both technology and human resources. Zopa's main goal was to bring together depositors who would provide financing and entrepreneurs in need of financing. The development of technology and the fact that people can reach each other over the internet wherever they are was one of the most important features of the crowdfunding model⁹¹.

The term crowdfunding was first used by Michael Sullivan in 2006. Sullivan used the term for the project he attempted to bring his video projects to life. Although the popularity of the crowdfunding model had increased, it still appealed to a special segment. But with the outbreak of the mortgage crisis in 2008, people sought alternative financing because the traditional banking system had suffered greatly and was struggling to provide the financing amounts that people demanded. Especially with the launch of IndieGoGo in 2008 and the follow-up of Kickstarter in 2009, the demand for crowdfunding exploded. After these developments, crowdfunding has become a mainstream financing model. Return figures reached \$1.5 billion in 2011 and \$24.4 billion in 2015, up from \$530 million in 2009⁹².

⁸⁹ Fundable, History of Crowdfunding, <https://www.fundable.com/crowdfunding101/history-of-crowdfunding> (17 April 2022)

⁹⁰ Ying Zhao, Wing Lam and Phil Harris, Crowdfunding Industry-History, development, policies and potential issues, *Journal of Public Affairs*, 2019, p. 2.

⁹¹ Zhao et al. p. 2-3.

⁹² The Startups Team, A Brief History of Crowdfunding (17 April 2022)

2.2.2. Current Status of Crowdfunding in the World

Crowdfunding has grown rapidly in volume after the 2008 crisis, in which it showed to be one of the mainstream financing models. The volume of crowdfunding reached a size of \$3 billion in 2012, \$6 billion in 2013, \$16 billion in 2014 and \$45 billion in 2016. In 2019, it saw a volume of \$90 billion, which is twice the size of 2016 volume⁹³. In its 2013 report titled "Crowdfunding's Potential for the Developing World", the World Bank estimated that the volume of crowdfunding in 2025 would reach \$96 billion⁹⁴. In 2020, the crowdfunding volume exceeded the World Bank's 2025 forecasts and generated a volume of \$115 billion⁹⁵.

Top 10 countries where the crowdfunding model has been most successful are America, UK, Canada, Germany, France, Australia, Italy, the Netherlands, Spain and Japan. However, crowdfunding platforms, which have become widespread rapidly in China and the Far East in the last 5 years, have caused the Asian Continent to exceed the sector volume in Europe. The volume of venture funding worldwide was mostly supported by mutual funds until the end of 2016. After 2016, the volume of crowdfunding surpassed mutual funds. Especially since the legal infrastructure in America is in a much better position than other countries, the crowdfunding volume of the country constitutes an important part of the volume in the world.⁹⁶ As of 2020, 74 billion dollars of the 115 billion dollars crowdfunding volume reached was created by crowdfunding platforms in America. The distribution of crowdfunding volume by specific regions is given in the figure 2.2⁹⁷.

In America, which is the leader of the crowdfunding model in terms of volume and number of transactions, especially the presence of a legal infrastructure for mutual funding in exchange for shares, the awareness of crowdfunding platforms while large financial institutions have difficulty in lending with the 2009 crisis are among the important factors affecting America's leadership in the crowdfunding market⁹⁸. In particular, the platforms Kickstarter, founded in 2009, IndieGoGo, founded in 2008, and GoFundMe, founded in 2020, have played

⁹³ Ünsal, Crowdfunding: A New System to Change the Way of Doing Business, p. 43.

⁹⁴ InfoDev/World Bank, Crowdfunding's Potential for the Developing World, p. 10.

⁹⁵ Statista, Volume of funds raised through crowdfunding worldwide in 2020, (19 April 2022)

⁹⁶ Ünsal, Crowdfunding: A New System to Change the Way of Doing Business, p. 44.

⁹⁷ Statista, Volume of funds raised through crowdfunding worldwide in 2020, 2021, <https://www.statista.com/statistics/946659/global-crowdfunding-volume-worldwide-by-region/> (1 May 2022)

⁹⁸ Ünsal, Crowdfunding: A New System to Change the Way of Doing Business, p. 44

a major role in leading America's crowdfunding model. As of today, there are a total of 1,401 crowdfunding organizations in the United States⁹⁹.

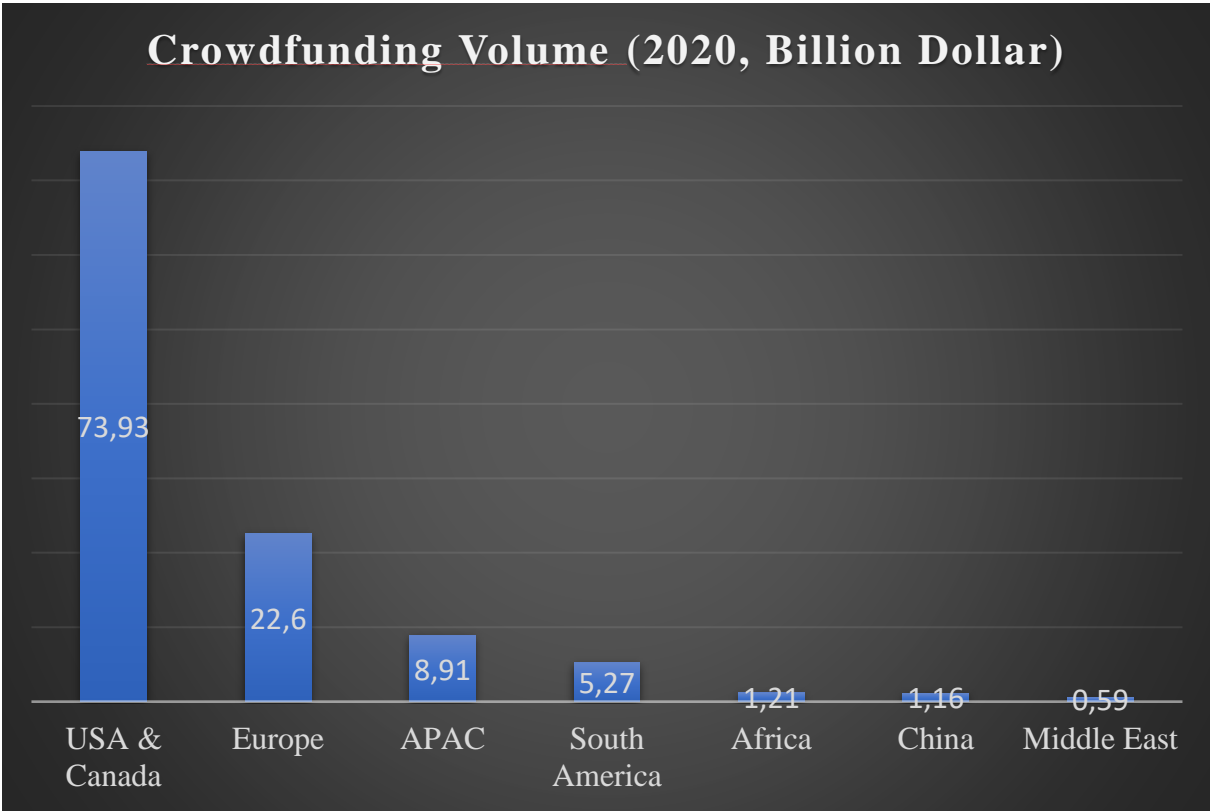


Figure 2.2: Region-Based Crowdfunding Volume as of 2020 (billion dollar)

In 2019, 6 million 445 thousand crowdfunding projects were presented through platforms worldwide and 22.4% of these projects successfully reached the determined funding target. It is known that in 2019, 64% of the American citizens are aware of the crowdfunding model. In 2019, the volume of crowdfunding reached \$34 billion year-on-year, of which \$17.2 billion is made up of the United States. When we look at the crowdfunding model, it is seen that lending-based crowdfunding accounts for 73% of the volume realized in 2019 with 25 billion dollars. Worldwide volume distribution by crowdfunding model as of 2019 is given in the figure 2.3¹⁰⁰.

⁹⁹ Crunchbase, United States Crowdfunding Companies, <https://www.crunchbase.com/hub/united-states-crowdfunding-companies> (9 May 2022)
¹⁰⁰ Fundly, Crowdfunding Statistics, 2020, <https://blog.fundly.com/crowdfunding-statistics/> (9 May 2022)

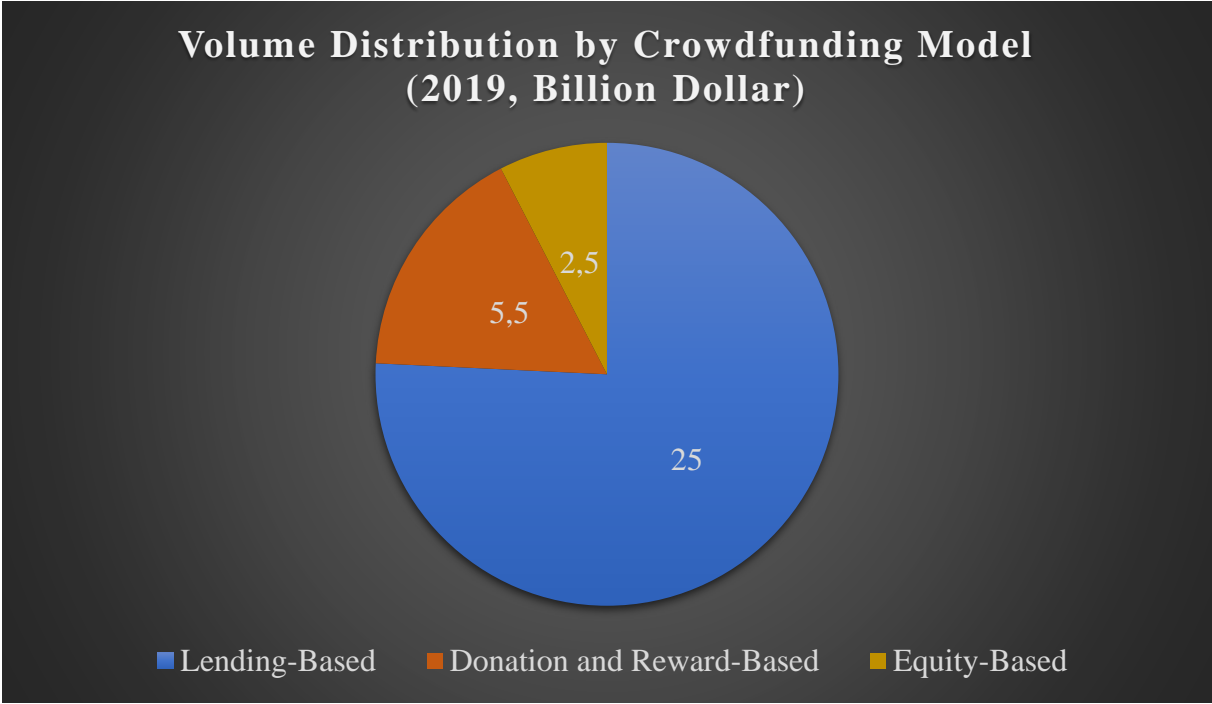


Figure 2.3: Volume Distribution by Crowdfunding Model as of 2019 (billion dollar)

Today, the extensive use of social media platforms is also considered as an opportunity for entrepreneurs using crowdfunding models. For this purpose, social media platforms are used by entrepreneurs as a free promotional source to announce crowdfunding campaigns to wider crowds. Entrepreneurs can more easily carry out pre-sales and marketing activities of the products they put forward through social media channels. It is foreseen that social media platforms will play an active role in the growth of crowdfunding volume in the coming years¹⁰¹.

The number of debt-based and equity-based crowdfunding platforms, which constitute a large part of the total crowdfunding volume in the world, is 617 as of May 2022. Of these platforms, 357 are in Europe, 162 in the America, 62 in Asia, 21 in South America and 15 in Africa and other regions. When the platforms are categorized according to investment types, business is the most common one with 240. When we look at the number of platforms by countries, America is at the top with 139. The number of platforms according to investment types is given as follows¹⁰².

¹⁰¹ Mordor Intelligence, Crowdfunding Market – Growth, Trends, Covid-19 Impact and Forecasts, 2021, <https://www.mordorintelligence.com/industry-reports/crowdfunding-market> (9 May 2022)

¹⁰² P2PMarketData, P2P Lending & Equity Crowdfunding Worldwide Statistics, 2022, <https://p2pmarketdata.com/p2p-finance-worldwide-statistics/> (9 May 2022)

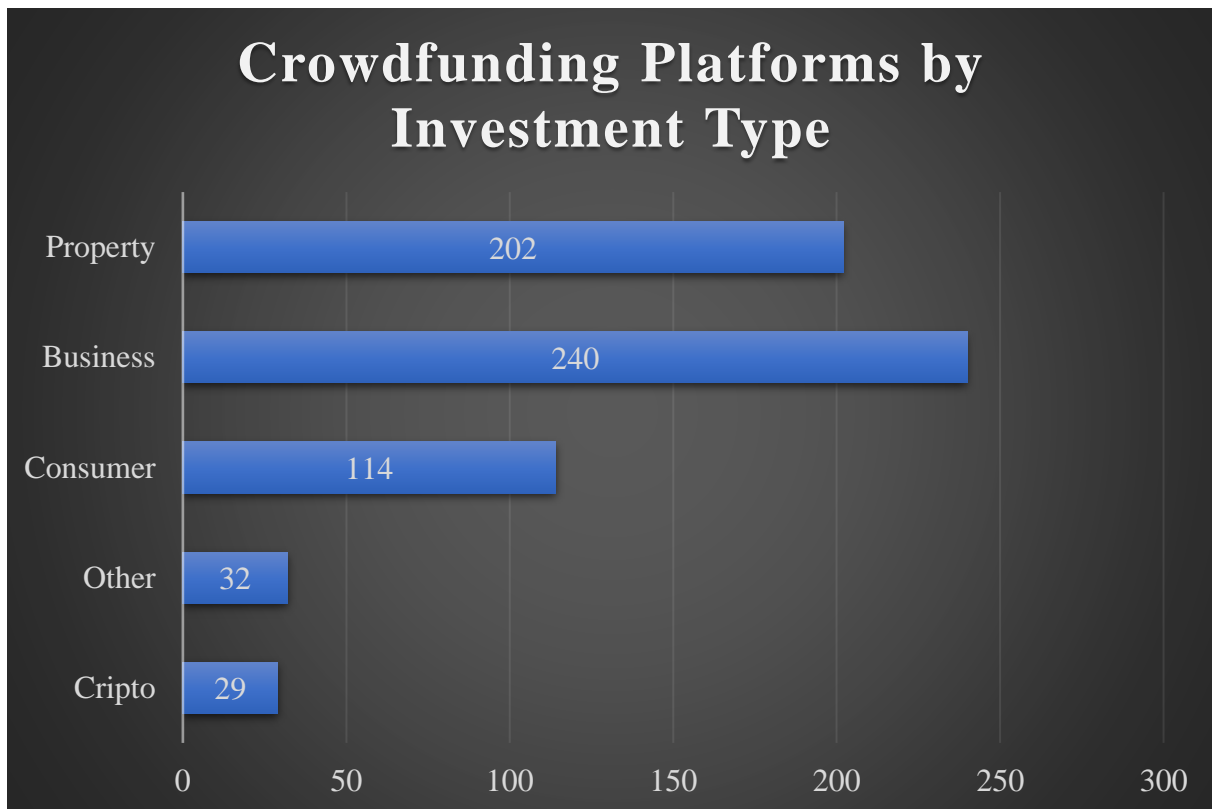


Figure 2.4: Number of Debt-Based and Share-Based Crowdfunding Platforms by Investment Type

Founded in 2010 by Brad Damphouse and Andrew Ballester in the United States, GoFundMe is one of the best-known industry leaders of debt-based crowdfunding platforms. GoFundMe(407th) is ahead of Kickstarter (1,120th) and IndieGoGo (3,314th) in the United States in terms of online website traffic. To this date, GoFundMe has raised over \$10 billion in total through more than 150 million donations. To this date, more than 70 million donors have used GoFundMe. 10,000 new campaigns are offered daily through the site and more than \$ 4 million in capital is raised daily. In GoFundMe, which serves in 19 countries, one out of every 3 investors support more than one project. To this date, the campaign that has garnered the most support through GoFundMe is the George Floyd memorial campaign, with more than 500,000 donors and more than \$14.7 million in capital¹⁰³.

Kickstarter, one of the most well-known award-based crowdfunding platforms, was founded in America in 2009 by Perry Chen, Yancey Strickler and Charles Adler. The New York

¹⁰³ FinancesOnline, GoFundMe Statistics, <https://alternatives.financesonline.com/crowdfunding-statistics/> (11 May 2022)

Times, one of America's best-known media organizations, named Kickstarter the "Best Invention of 2010" and the "Best Website of the Year 2011". Projects initiated through Kickstarter can range from artistic categories such as film, literature, theater, fashion, dance, photography and music to categories in many different fields such as new technologies, video games, food products. However, video games, movies, music and video content in particular account for more than half of Kickstarter's turnover¹⁰⁴.

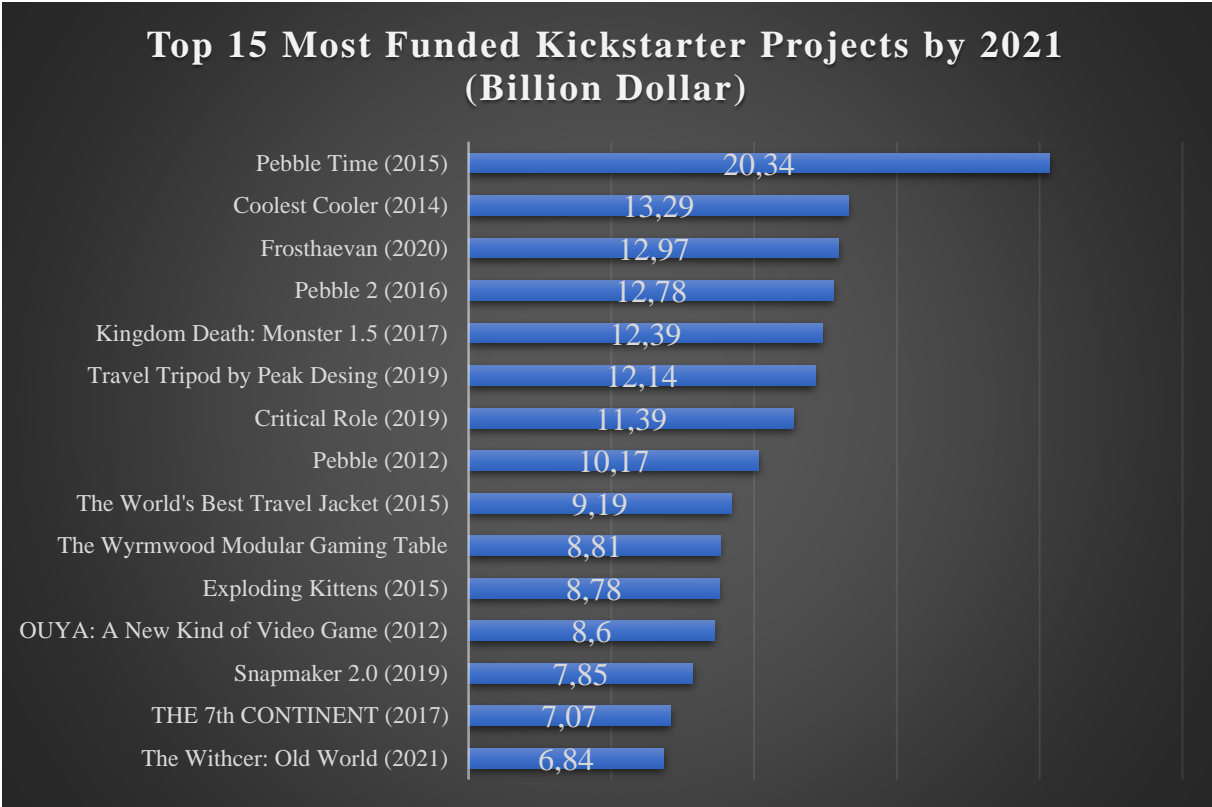


Figure 2.5: Top 15 Most Funded Kickstarter Projects by 2021

Reference: Statista, Most successfully completed Kickstarter projects as of July 2021, <https://www.statista.com/statistics/222489/most-successful-completed-kickstarter-projects-by-total-funds-raised/> (10 May 2022)

From its inception to 2021, there have been a total of 519,692 project initiatives on Kickstarter, and 38% of the projects have been successful, reaching the targeted capital amount. With 199,377 successful projects, a total of more than \$ 5.7 billion of capital has been raised.

¹⁰⁴ Ünsal, Crowdfunding: A New System to Change the Method of Doing Business, p. 44-45.

To date, more than 19 million users have provided more than 71 million pieces of support. On the other hand, in addition to the successful projects, 295,804 projects failed to reach the targeted capital amount. 55,338 projects were concluded without any support. Projects that succeed on Kickstarter raise an average of \$23,000 in capital, while projects that fail raise an average of \$1,500. When we look at the number of projects, the film and video sector is the most prominent with 77,010 projects. This sector is followed by the music sector with 64,266 projects and the game sector with 59,528 projects¹⁰⁵.

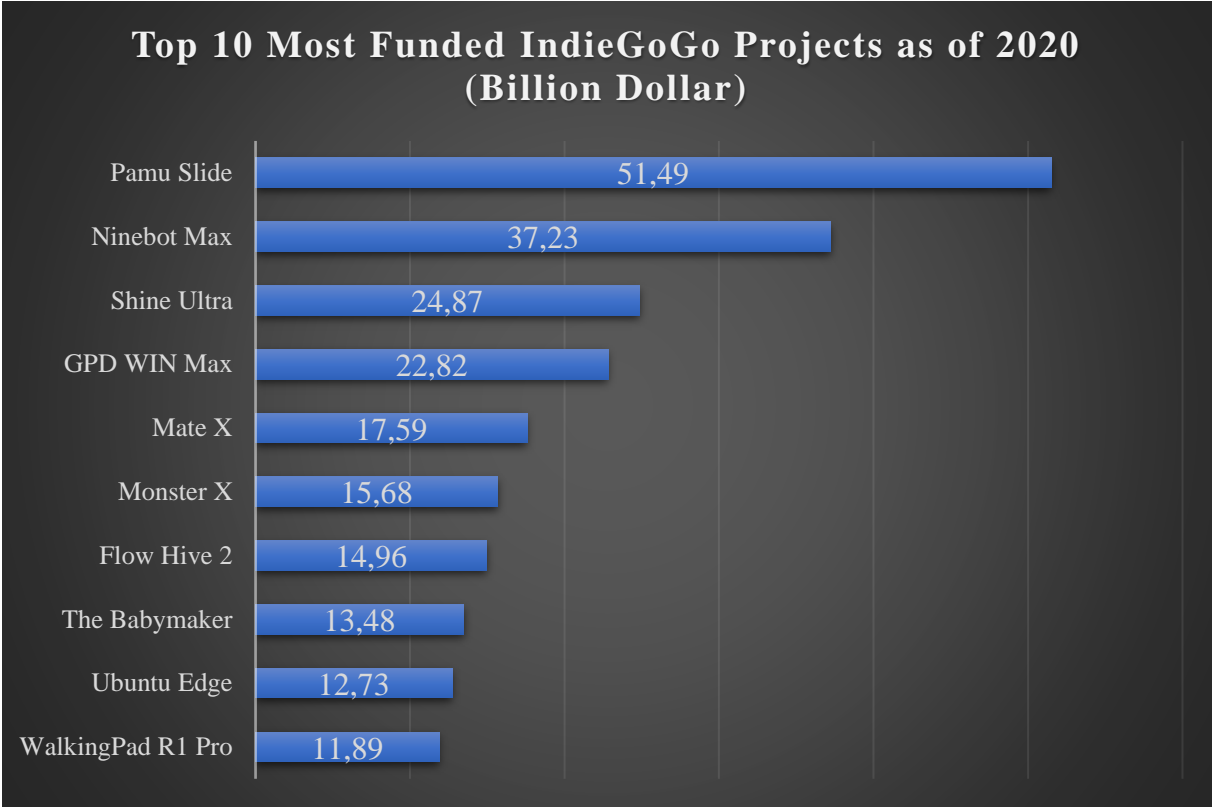


Figure 2.6: Top 10 Most Funded IndieGoGo Projects as of September 2020

IndieGoGo, another industry leader in the reward and donation-based crowdfunding model, was founded in 2008 by Danae Ringelmann, Slava Rubin and Eric Shell in the United States. IndieGoGo, which has implemented more than 800 thousand ideas since 2008, has exceeded 9 million total investors. IndieGoGo has investors from 235 different countries in total and more than 10 million users visit the platform monthly. More than 19 thousand projects

¹⁰⁵ FinancesOnline, Kickstarter Statistics, <https://alternatives.financesonline.com/crowdfunding-statistics/> (11 May 2022)

are presented through the platform every month¹⁰⁶. IndieGoGo has raised \$1.6 billion by 2020 for entry-level entrepreneurs. As of September 2020, the most funded project on the platform is "Pamu Slide" with \$ 51.4 million. The 10 highest funded projects in terms of capital amount through IndieGoGo as of September 2020 are given in figure 2.6.¹⁰⁷

When we look at the historical development of crowdfunding and the point it has reached today, it is seen that it is a financing model that is rising rapidly and constitutes a serious alternative to traditional financing methods. Crowdfunding made a serious breakthrough in the early 2010s, especially in the Americas, and a similar rise in Europe was accompanied by legal developments. In recent years, the volume of crowdfunding in the Chinese and Asian markets, which are the leaders of alternative financing, has gained significant momentum. Considering that the number of crowdfunding platforms is increasing day by day and that more people and businesses use these platforms, it will not be difficult to predict that the volume of crowdfunding will continue to increase and increase its popularity in the coming years.

With the Covid-19 pandemic that started in 2020, the world economy has taken a serious hit. Many medium and small-sized businesses struggled to stay afloat, while others went bankrupt without success. Others managed to survive by finding support for themselves through crowdfunding campaigns. As the pandemic has adversely affected the global economy, many people and companies have resorted to alternative financing methods such as crowdfunding. This has been a factor supporting the rising momentum of crowdfunding and has once again shown that crowdfunding is a serious alternative to traditional financing models¹⁰⁸.

The global volume of crowdfunding is expected to reach \$240 billion from 2021 to 2026, growing at an annual rate of 16.81% (compound). Social media is one of the main factors supporting this growth. The fact that social media can be used as a free promotional tool and that products can be sold before they are released to the market allows crowdfunding campaigns to reach large crowds in a very cheap and cost-effective way¹⁰⁹.

The use of crowdfunding campaigns as a way to crowdsource is another important factor supporting the growth of the crowdfunding market. In traditional financing, marketing,

¹⁰⁶ IndieGoGo, About Us, <https://www.indiegogo.com/about/our-story> (11 May 2022)

¹⁰⁷ FinancesOnline, Indiego Statistics, <https://alternatives.financesonline.com/crowdfunding-statistics/> (11 May 2022)

¹⁰⁸ Cristian Fronea, History of Crowdfunding, Smallbrooks Blog (14 May 2022)

¹⁰⁹ Techvanio, Crowdfunding Market by Type and Georaphy Forecast and Analysis 2022-2026, February 2022, <https://www.technavio.com/report/crowdfunding-market-industry-service-analysis> (14 May 2022)

and product promotion processes, the product interacts very little with customers before it reaches the end user. However, in crowdfunding processes, entrepreneurs interact with investors and potential customers of the product and can measure the success of the product before it is released to the market. In this way, the deficiencies and potential market share can be analyzed and necessary actions can be taken before the product is released to the market¹¹⁰.

As the crowdfunding market is projected to grow globally, one of the most important challenges for entrepreneurs will be time management. Crowdfunding is a process in which there are various stages that include expenses related to product development, finding the first investors to finance marketing expenses, product registration and making the product conform to the standards, if any. All of these processes are time-consuming for entrepreneurs and often lead to delays in projects. Delays in these processes can sometimes cause customers to withdraw from the project and have difficulty in refunds. Such situations lead to a decrease in the trust of customers and can lead the entrepreneur to failure¹¹¹.

2.2.3. Current Status of Crowdfunding in Turkey

The crowdfunding model, which emerged as an alternative to traditional financing models, has been far behind in Turkey compared to the US, Asian and European markets despite being implemented in Turkey since 2010. The biggest reason for this is that the legal regulation of crowdfunding in Turkey was not made until 2017. In 2017, the "Crowdfunding Association" was established and the legal infrastructure work of crowdfunding was accelerated¹¹².

Until 2017, only reward and donation-based crowdfunding platforms operated in Turkey. In 2017, the legal regulation prepared by the CMB regarding crowdfunding was published in the Official Gazette dated 03.10.2019 and numbered 30907 and entered into force. The scope of this published communiqué is stated as follows: *“This Communiqué sets down the procedures and principles relating to - equity-based crowdfunding, listing of crowdfunding platforms by the Board, and their activities, fund-raising from the public through equity-based*

¹¹⁰ Techvanio, Crowdfunding Market by Type and Georaphy Forecast and Analysis 2022-2026 (14 May 2022)

¹¹¹ Techvanio, Crowdfunding Market by Type and Georaphy Forecast and Analysis 2022-2026 (14 May 2022)

¹¹² Melek Demiray and Şebnem Burnaz, Positioning of Crowdfunding Platforms: Turkey as an Emerging Market Case, **Press Academia**, Volume: 6, Issue: 2, 2019, p. 87.

crowdfunding, and control and supervision of whether the funds raised as such are used for the declared purposes of their use or not.”¹¹³

With this arrangement, the CMB provided entrepreneurs with a new opportunity outside the traditional financing model. In its announcement, the CMB explained this regulation as follows: *“Access to finance is one of the biggest challenges experienced by entrepreneurs who start new businesses. Entrepreneurs who cannot find loans from the bank on favorable terms will be able to access the cost-free financing they need thanks to crowdfunding. Individual investors will also be able to bring a company to life by combining small amounts of funds that alone would not have made a significant impact. Thus, investors will have the opportunity to become partners in a company with development potential during the establishment phase”¹¹⁴.*

The CMB has brought some conditions to entrepreneurs, investors and platform, which will benefit from crowdfunding model. Some of these conditions are as follows¹¹⁵;

- i. “Only the platforms that the CMB has authorized to operate and listed by CMB will be able to facilitate crowdfunding.*
- ii. Not every start-up will benefit from crowdfunding. Initiatives that meet the criteria will be examined by investment committees of at least three people to be formed by the intermediary platforms within their own structures will be able to collect funds.*
- iii. In addition, investors will be able to invest a maximum of 20 thousand TL in 1 year to limit possible losses. This limit can be increased up to 100 thousand TL depending on the income level of the investor. Thanks to the rules and audits that take into account the rights of investors, it will be possible to prevent people from falling into the trap of happiness chains and becoming victims”.*

The Communiqué (III-35/A.2) on debt-based crowdfunding, which is the most common type of crowdfunding in the world, was published in the Official Gazette dated 27.10.2021 and numbered 31641 and entered into force. With this regulation, the CMB revised the Equity-Based Crowdfunding Communiqué and repealed the previous communiqué (III-

¹¹³ "Communiqué on Equity-Based Crowdfunding (III – 35/A.1)", **Official Gazette**, 3 October 2019.

¹¹⁴CMB, Alternative Financing Opportunity for Entrepreneurs – Crowdfunding, 2019, <https://www.spk.gov.tr/Duyuru/Dosya/20191003/0> (15 May 2022).

¹¹⁵ CMB, Alternative Financing Opportunity for Entrepreneurs – Crowdfunding

35/A.1), taking into account the situations identified in practice regarding equity-based crowdfunding that came into force before¹¹⁶.

Due to the fact that legal regulations in Turkey are made too late compared to America, Europe and Asia and that venture capital and growth in general are not adopted very much, the crowdfunding volume has remained very low compared to other countries. In particular, the banking sector provides funds to low-risk initiatives because it works with a focus on profitability and tries to NPL ratios low. In addition, the higher return of other investment opportunities in Turkey has distanced fund holders from crowdfunding models that are seen as risky and directed them to other areas with higher returns and lower risks. The capital provided by the state for incentive purposes is provided by institutions such as TÜBİTAK, the Ministry of Science, Industry and Technology, the Ministry of Transportation and Communication, KOSGEB, but these amounts remain quite low compared to the world. As of 2017, the volume of crowdfunding in Turkey reached 20 million TL. The number of projects and the capital amounts collected are given as follows over the years¹¹⁷:

Table 2-3: Volume of Crowdfunding in Turkey by Year and Number of Projects

Crowdfunding	2011	2012	2013	2014	2015	2016	2017
Project Number	51	289	91	122	105	172	37
Amounts Collected (TL)	631,4	4,143,011	1,896,923	2,178,346	2,446,632	7,091,953	1,761,100

As of the end of 2018, approximately 300 of the 900 projects published in Turkey have successfully reached the targeted capital amount. From this point of view, it can be said that the success rate of the projects that try to raise capital with the crowdfunding model in Turkey is %30¹¹⁸.

¹¹⁶ CMB, Press Release of the Crowdfunding Communiqué No. III-35/A.2, 27 October 2021.

¹¹⁷ Ünsal, Crowdfunding: A New System to Change the Way of Doing Business, p. 64.

¹¹⁸ Demiray and Burnaz, Positioning of Crowdfunding Platforms: Turkey as an Emerging Market Case, p. 88.

Reward and donation-based platforms that do not require any legal regulation started to operate in Turkey before the CMB regulations. However, equity-based crowdfunding platforms, which are subject to legal regulations, were first listed by the CMB in 2021 and started to operate. The award and donation-based crowdfunding platforms operating in Turkey are given in the table below¹¹⁹:

Table 2-4: Reward and Donation-Based Crowdfunding Platforms in Turkey

Platform	Establishment Date	Crowdfunding Model	Number of Projects	Number of Successful Projects	Amounts Collected ('000)
Arikovani	2016	Reward-Based	66	34	4,600
Buluşum	2015	Donation-Based	14	12	288
Crowdfon	2013	Reward-Based	185	18	84
Fonbulucu	2017	Reward-Based	24	11	284
Fongogo	2013	Reward and Donation-Based	422	130	2,447
Ideanest	2017	Donation-Based	10	9	335

From the platforms given in Table 2.6, Arikovani has decided to stop its activities in December 2021¹²⁰. The share-based crowdfunding platforms that were first listed by the CMB in 2021 are given in the table below¹²¹:

¹¹⁹ Demiray and Burnaz, p.91.

¹²⁰Fintechdunyasi, 2021, <https://www.fintechdunyasi.com/turkcellin-platformu-arikovani-hizmetlerini-sonlandirdi/9253/> (23 May 2022).

¹²¹ CMB, Listed Platforms, <https://www.spk.gov.tr/Sayfa/Index/12/6/2> (23 May 2022).

Tablo 2-5: Equity-Based Crowdfunding Platforms in Turkey

Title	Activity Type	Listing Date
Vakıf Yatırım Menkul Değerler A.Ş.	Equity-Based Crowdfunding	01.04.2021
Global Kitle Fonlama Platformu A.Ş.	Equity-Based Crowdfunding	08.04.2021
Halk Yatırım Menkul Değerler A.Ş.	Equity-Based Crowdfunding	30.09.2021
Dijital Kitle Fonlama Platformu A.Ş.	Equity-Based Crowdfunding	14.10.2021
İnfo Yatırım Menkul Değerler A.Ş.	Equity-Based Crowdfunding	25.11.2021
Fongogo Kitle Fonlama Platformu A.Ş.	Equity-Based Crowdfunding	06.01.2022
Girişim Kitle Fonlama Platformu A.Ş.	Equity-Based Crowdfunding	24.02.2022

3. IMPLEMENTATION OF CROWDFUNDING THROUGH PARTICIPATION BANKS

3.1. Compliance of Crowdfunding with the Principles of Islamic Finance and the Definition of Islamic Crowdfunding

Although crowdfunding is a new financial instrument as it is known today, it is compatible with the principles of Islamic finance both in terms of its purpose and some of the principles it contains.

One of the key components of crowdfunding is that it is a one-to-one, reciprocal method of financing in which intermediaries are disabled. This allows crowdfunding activities to accommodate more communication, disclosure, transparency and a more secure environment between the parties. It is known that Islam adopts transparency, openness, trust and direct communication in people-to-people relations. This situation is of a dimension that can be seen in all social units, starting from the family. For example, peer-to-peer (one-to-one) interaction activities are encouraged by the Islamic religion, and there are many hadiths emphasizing the rights of neighbors, the value of communication with neighbors, and the importance of keeping kinship ties tight. This principle also has repercussions in financial relations between people. For example, in the hadiths, it is forbidden to take the goods from the merchant, who brings goods to the city to sell from outside, before that merchant enters the city¹²². With this, it is aimed to prevent the deception of the producer on the one hand and to prevent consumers from being forced to buy goods at high prices on the other hand¹²³. The crowdfunding method, unlike traditional financing methods, allows direct interaction between the parties and allows entrepreneurs and investors to interact with each other in a more transparent environment, unlike traditional financing methods that functionally distance depositors and investors from fund users. For this reason, it can be said that the crowdfunding method, which allows one-to-one contact between investors and entrepreneurs, re-introduces the phenomenon of social solidarity necessary for a flexible and reliable economy¹²⁴.

¹²²Bukhari, Bu', 64; Muslim, Buyu', 17.

¹²³ Merġinani, el-Hidaye, 4, p. 377.

¹²⁴ Hassan, "Crowdfunding from An Islamic Finance Perspective", p. 100.

In the matters of helping those who are in difficulty, unity and solidarity, social assistance, Islam commands to help relatives, friends, the poor and destitute, and orphans, starting with the first-degree relatives. Zakat, which is one of the conditions of Islam, is the most obvious practice that guides us in reducing poverty through social assistance. Again, the hadiths of our Prophet: "A person who stays full while his neighbor is hungry is not a (mature) believer", shows us how Muslims should behave in terms of social solidarity and solidarity¹²⁵.

Considering that Muslim countries are still in the development stage, depending on the legal and moral values of Islam, Islamic finance has a financial mechanism that develops and further strengthens individuals and societies. For this reason, Islamic finance aims to finance effect-oriented real economic activities by offering an alternative and ethical financing method. Despite this potential of the Islamic financing model, if we look at the current situation, participation banks operating in line with the principles of Islamic finance lag far behind the market shares obtained by conventional banks, as can be seen in the table 3.1. For this reason, it is possible for participation banks to increase their market share and contribute more to the development of Muslim countries by adopting alternative financing models in addition to traditional banking products and services, taking into account the changing needs and new opportunities that arise in today's digitalizing world¹²⁶.

The share of participation banks in the banking sector in Turkey is given in table 3.1 for certain ratios as of December 2019 and 2020¹²⁷.

The share of Islamic financial institutions in the total finance sector is relatively low both in Turkey and in developing Muslim countries. For this reason, Islamic financial institutions need new practices that will put themselves in a different position from their competitors by adopting alternative financing methods in addition to traditional financing methods. In this way, participation banks' support to the real economy will increase and their market share will grow.

¹²⁵Canbaz and Çonkar, "An Alternative Islamic Finance Method for Entrepreneurs: Crowdfunding", p. 45-46.

¹²⁶ Asutay and Marzban, Shariah-compliant Crowd Funding: An Efficient Framework for Entrepreneurship Development in Islamic Countries, p.3.

¹²⁷ TKBB, Sector Comparison Report, 2020, <https://tkbb.org.tr/veri/sektormukayese> (18 June 2022).

Table 3-1: Market Share of Participation Banks in the Banking Sector in Turkey

Index	2020 Market Share	2019 Market Share
Funds Collected	%9,3	%8,4
Loans	%6,5	%5,5
Total Assets	%7,2	%6,3
Equity	%4,6	%4,4
Net Profit	%6,2	%5,0

In our opinion, Islamic finance and crowdfunding are inherently compatible with each other and support each other. Islamic finance is a financing method based on the principles of Islamic law, which ensures the fair distribution of benefits and obligations between the parties in any financial transaction and adheres to the concepts of ethical and social responsibility. The crowdfunding method is a financing method that includes these features and prepares the ground for new developments in this field. Islamic finance and crowdfunding both conceptualize clients as investors and potentially provide investment opportunities with higher returns. Both also place a strong emphasis on transparency, mutual engagement and trust. Islamic finance and crowdfunding have a common purpose and philosophical foundation aimed at building communities, promoting risk-sharing, attributing wealth to society and channeling capital into real economic activity. As a result, we can define Islamic crowdfunding as a platform designed in accordance with the principles of Islamic law. More precisely, *Islamic crowdfunding can be defined as the usage of small amounts of money from a large number of individuals and organizations through an online web-based platform to finance a project, business, or personal loan and other needs, while adhering to the principles of Islamic law*¹²⁸.

¹²⁸ Iggi Achsien and Dien L. Purnamasari, Islamic Crowdfunding as The Next Financial Innovation in Islamic Finance: Potential and Anticipated Regulation in Indonesia, **European Journal of Islamic Finance**, 2016, p. 3.

When crowdfunding models and Islamic finance methods are compared (Table 3.2), it can be said that all four types of crowdfunding models do not constitute a fundamental contradiction to Islamic finance methods. The only exception is the option of borrowing with interest, which is a sub-option of the debt-based crowdfunding model. In the debt-based crowdfunding model, investors can use the option of borrowing with interest or without interest. It can be said that it is possible to reconcile other models and the debt-based model within the scope of interest-free borrowing with the principles of Islamic finance¹²⁹.

Table 3-2: Conventional Crowdfunding vs. Islamic Crowdfunding

Type	Conventional Crowdfunding	Islamic Crowdfunding
Reward-Based	Materialism	Materialism, it may include the element of al-Falah.
Donation-Based	Humanitarianism	Based on religious beliefs such as zakat, charity and waqf and aims at good in essence.
Equity-Based	Angel investors and venture capitals	It is based on Mudarabah and Musharakah. Musharakah-based crowdfunding is similar to equity-based crowdfunding. In the case of Mudarabah-based crowdfunding, all capital is provided by the crowd, while the company is responsible for commercial activities. The resulting profit is shared by the company and the crowd at predetermined rates. However, in the event of loss, the crowd is responsible for the entire damage.
Debt-Based	Lending based on interest	Sales based contracts - Tawarruq, Murabaha and Ijarah.

Reference: Saiti, Musito and Yücel, “Islamic Crowdfunding: Fundamentals, Developments and Challenges”, p. 473.

¹²⁹Canbaz and Çonkar, "An Alternative Islamic Finance Method for Entrepreneurs: Crowdfunding", pp. 46-47.

The finding that crowdfunding models do not contradict the principles of Islamic finance does not indicate that the project subject to crowdfunding is directly compatible with the principles of Islamic finance. In this context, in some studies on the subject, the following criteria have been included to distinguish between conventional and Islamic crowdfunding¹³⁰:

- I. Invested project must raise capital for activities that comply with Islamic principles.
- II. The project should be free of interest, gambling and speculation.
- III. The presence of a committee that supervises the compliance of the projects with the Islamic financing criteria is required and capital collection process should begin after the approval of the committee's examination.

Basic contracts in Islamic law in terms of purpose are examined in five groups: partnership-based contracts, lease-based contracts, trade-based contracts, gratuitous contracts, custodial, security and other support contracts. The features of partnership-based contract and gratuitous contract are very similar with crowdfunding types¹³¹.

Mudarabah, which is one of the contracts based on partnership, is a type of partnership that was used even before Islam and it is also approved by the Islamic religion. This partnership, also known as a labor-capital partnership, is a contract that occurs when one party puts capital and the other party puts labor. Another contract based on partnership is Musharakah. Two or more people come together in Musharakah and become partners in a business with their labor and capital. With this partnership, they also share in the profit or loss that arises as a result of the work done together. In this partnership, the profit is shared according to the agreement; however, the loss is distributed according to the shares in the capital. Equity-based crowdfunding, one of the four crowdfunding models, has similar characteristics with the Islamic finance methods Mudarabah and Musharakah¹³².

In current practice, the model operated under the name of debt-based crowdfunding is problematic in terms of the principles of Islamic law since it includes interest. Instead of the debt-based model, the trade-based model, which consists of Murabaha and Tawarruk contracts,

¹³⁰Achsien ve Purnamasari, *Islamic Crowdfunding as The Next Financial Innovation in Islamic Finance*, p.3.

¹³¹Canbaz and Çonkar, "An Alternative Islamic Finance Method for Entrepreneurs: Crowdfunding", p. 47.

¹³² Canbaz and Çonkar, p.47.

can be applied in accordance with the principles of Islamic law. Murabaha, one of the sales contracts, is defined as follows in the Murabaha standard published by TKBB:

“It is the sale of a good in advance or in the term by specifying the purchase price or cost to the customer and placing a certain profit on it. Murabaha, as applied in participation banking, is a set of transactions consisting of the customer's instruction and purchase promise and the sale of a good by the participation bank from the first seller, usually in advance, to the final customer by adding a certain profit on top of the purchase price or cost”¹³³.

Karz-ı Hasen, one of the most well-known of the gratuitous contracts, consists of the combination of two words. Karz is when a person gives a good that is exempt from the beneficial property to another person in order to get back the reciprocal later. When traditions on Karz-ı Hasen are examined as a whole, it is understood that some limits are determined for the two sides of the Karz transaction and that if these limits are respected, the lending process can be characterized as Karz-ı Hasen. It is possible to examine these conditions in two groups as belonging to the "lender" and the "borrower". The fact that the borrower pays his debt on time and in full, does not delay the payment if he has the ability to pay, and if possible, pays better in terms of quantity and quality than he receives as a debt makes this debt profitable for lender, makes this process "Karz-ı Hasen" for the borrower. The fact that the lender carries out the lending process for the sake of Allah, does not obtain benefits from the borrower due to lending, shows borrower ease in terms of time and amount if the borrower is in difficulty of payment, and gives up the collection of the debt if the borrower is unable to pay his debt at all, makes this process "Karz-ı Hasen" for the lender. ¹³⁴

Another type of gratuitous contract is grant. According to Bardakoğlu; grant, which means "to give without compensation, to forgive" in the dictionary, is the name of the contract that is included in the group of special debt relations and refers to the assignment of a property to another person free of charge. It can be said that the alms and gifts are broader and that charity has a narrower scope and slightly different purpose, and therefore grant is a more technical and legal term¹³⁵." Donation and reward-based crowdfunding are widely used in the world. In addition, these are the most widely used models in Turkey. Grant, one of the Islamic

¹³³ TKBB, Murabaha Standard, **Participation Finance Standards**, 3, 2021, p. 4.

¹³⁴ Soner Duman, "The Fiqh Dimension of Karz-ı Hasen", **The Institutionalization of Karz-ı Hasen**, Ensar Publication, Vol. 1, 2019, p. 12-13.

¹³⁵ Ali Bardakoğlu, "Grant", **Turkish Religious Foundation Islamic Encyclopedia**, Vol.17, p. 421.

finance methods, is very similar to donations and reward-based crowdfunding, and Karz-1 Hasen is very similar to the crowdfunding model based on interest-free borrowing.

Another point that draws attention here is that financing models such as Murabaha, Ijarah, Mudarabah, Karz-1 Hasen, which are among the Islamic finance procedures, are the most widely used types of financing that are currently adopted by participation banks. From this point of view, it can be said that the financing models used by participation banks, which are the most prominent representatives of Islamic finance in Turkey, are very suitable for crowdfunding to be carried out in accordance with Islamic procedures.

According to Asutay and Marzban's assessments, from the point of view of Islamic finance principles, the equity-based crowdfunding model constitutes an important opportunity for investors and entrepreneurs in a wide range of fields to fulfill the basic expectations of Islamic finance by combining the benefits of social development with investment opportunities. It can be said that the equity-based crowdfunding model has the following advantages in terms of Islamic finance principles¹³⁶:

- I. Equity-based crowdfunding is based on profit and loss partnership (Musharakah) as it was characterized by Islamic finance in its original form.
- II. It plays a role in reducing the financing gap by providing capital access to many entrepreneurs in a broad perspective.
- III. It opens up a new asset class for small and medium-sized investors.
- IV. It minimizes risk by dividing limited capital into multiple start-up firms.
- V. It encourages innovation and enables talented entrepreneurs to be kept local.
- VI. Thanks to the established businesses, it enables new employment opportunities.
- VII. It supports the growth of initiatives in new sectors such as technology and the health sector, which are almost non-existent in public equity markets in Muslim countries, and possible future IPOs, thereby increasing diversity for fund managers.

¹³⁶ Asutay and Marzban, Shariah-compliant Crowd Funding: An Efficient Framework for Entrepreneurship Development in Islamic Countries, p.8.

Asutay and Marzban stated that in order to be compatible with the principles of Islamic finance, equity-based crowdfunding must meet the following criteria¹³⁷:

- I. The platform should be overseen by an advisory board.
- II. Investments should have a social responsibility condition.
- III. The fields of activity of entry-level companies should not contradict Islamic principles and principles. The proceeds of these ventures should not come from interest or Islamically unsuitable work field.
- IV. Platform and project investors who provide the crowdfunding service, as it represents a significant equity ownership on the enterprise; they should define clear legal restrictions to prevent the entity from borrowing based on interest, to prevent investing in sectors that do not fall within the fields of Islamic finance, and to prevent the portfolio of products and services from shifting to areas that do not accommodate Islamic activities.
- V. The typical shareholder structure, which is legally applied by venture capital firms in terms of granting priority rights to investors, is considered inappropriate in terms of Islamic finance principles. Therefore, shareholder structure and investor protection requirements should be designed in accordance with the principles of Islamic finance.

3.2. Practices Similar to Crowdfunding in the Current Activities of Participation Banks

The most well-known representatives of Islamic finance in Turkey are participation banks. “Participation banking is a banking model that works by adopting the principles of interest-free banking as a principle, carries out all kinds of banking activities in accordance with these principles, collects funds on the basis of labor-capital partnership or proxy, and uses funds by purchase-sale, partnership, financial leasing and other methods which are in accordance with interest-free banking principles”¹³⁸.

Since participation banks have to act in accordance with the principles of Islamic finance, they base their products and services on Islamic finance procedures. Financing models such as Murabaha, Ijarah, Mudarabah, Tawarruq, Karz-1 Hasen, which are among the Islamic

¹³⁷ Asutay and Marzban, p. 9.

¹³⁸ Albaraka Türk, Participation Banking, <https://www.albaraka.com.tr/tr/hakkimizda/katilim-bankaciligi> (27 June 2022).

finance methods, are the most widely used types of financing that are currently adopted by participation banks. When we look at the crowdfunding models, it is seen that the only interest-based version of the debt-based crowdfunding model is incompatible with the principles of Islamic finance, and that other models of crowdfunding and the interest-free debt-based crowdfunding model are compatible with the principles of Islamic finance. Islamic finance methods, which are the basis of Islamic crowdfunding, are financing models such as Murabaha, Ijarah, Mudarabah, Tawarruq, Karz-ı Hasen that are already the basis of the products and services of participation banks. Therefore, we can say that the existing products and services of participation banks have a suitable basis for a possible crowdfunding initiative.

3.2.1. Participation Accounts

Participation accounts are established and operated by participation banks. Participation accounts are accounts formed by funds that give the right to participate in the profit and loss generated by the use of the capital invested by the participation banks, but no predetermined net return is paid to the investors and the repayment of the principal is not guaranteed. Participation accounts are accounts opened on the basis of labor capital partnership (Mudarabah). Investors who deposit capital in their participation accounts enter into a profit and loss partnership with the participation bank and share the profits formed in the participation pool according to the rate determined at the beginning.¹³⁹

The Mudarabah, which is the basis of the participation accounts in terms of Islamic financing, is a labor-capital partnership. TKBB defined Mudarabah as follows:

“It is a type of partnership based on the principle of sharing the profit obtained by one party putting in capital and the other party putting in labor and undertaking the operation. It is a fund collection and fund distribution instrument used by participation banks. Among the fundraising instruments of participation banks, Mudarabah participation accounts have the largest share. In the Mudarabah transaction, the party (customer) who has a surplus fund deposit it in the participation bank Mudarabah pools that collect funds to evaluate the fund surplus in a certain term. The sharing rate is determined by prior agreement between the two parties. These funds accumulated in the pools are directed to different investments and the profit amounts obtained from these investments are transferred to the relevant pools and the amount of profit

¹³⁹ TKBB, Interest-Free Finance Products, <https://tkbb.org.tr/sayfa/detay/yayinlar/faizsiz-finans-urunleri-406198> (12 July 2022).

falling to the capital owner is paid in line with the bank sharing rate. In addition, the fund is used as a financing instrument on the lending side."¹⁴⁰.

Participation accounts: is the type of account in which the return is shared within the framework of the profit-loss partnership between the bank and the account holder. The funds collected in the participation accounts are used to finance the trade, industry and service sectors in line with the principles of interest-free banking. Some features of participation accounts are as follows¹⁴¹:

- I. An account can be opened in TL, Dollar, Euro and Gold currency with a maturity of at least 1 month.
- II. There are 5 account types: Classic, Silver, Gold, Platinum and Platinum+.
- III. Profit sharing rates vary according to account types.
- IV. Money can be withdrawn without breaking the maturity within the limits determined according to the account type, and a dividend is paid on the balance remaining on the maturity date.
- V. Rate of return; it is not determined at the beginning of the term, but at the end of the term.

Participation accounts can be opened in TL, Dollar, Euro and Gold. But not all depositors are concentrated in a single pool. Profit sharing pools are created according to the deposit intervals deposited and the bank and depositors receive a share of the profit according to the sharing rates of the relevant pools. Deposits are collected in different pools according to currency and amount ranges, and the income-expenses of these pools are calculated separately and the resulting profit or loss is shared with the depositors who make up the relevant pool.

Table 3-3: Kuveyt Türk TL Participation Accounts Profit Sharing Rates

Profit Share Rates (%)	Opening Balance	Minimum Balance	1 Month	3 Monts	6 Monts	1 Year	More Than 1 Year
Classic	250	250	85-15	87-13	87-13	87-13	87-13

¹⁴⁰ TKBB, Interest-Free Finance Products

¹⁴¹ Kuveyt Türk, Participation Account, <https://www.kuveytturk.com.tr/bireysel/hesaplar/katilma-hesaplari/katilma-hesabi> (12 July 2022).

Table 3-3 (Continue): Kuveyt Türk TL Participation Accounts Profit Sharing Rates

Silver	25,000	15,000	87-13	89-11	89-11	89-11	89-11
Gold	100,000	75,000	90-10	92-8	92-8	92-8	92-8
Platinum	500,000	375,000	93-7	95-5	95-5	95-5	95-5
Platinum +	1,250,000	1,000,000	96-4	97-3	97-3	97-3	97-3
Withholding Rates			5%	5%	5%	3%	0%

Reference: Kuveyt Türk, Participation Account, Account Types and Limits, <https://www.kuveytturk.com.tr/bireysel/hesaplar/katilma-hesaplari/katilma-hesabi> (12 July 2022)

One of the biggest differences between participation banks and conventional banks is the way deposit accounts are operated. While participation banks distribute profits according to Islamic financing principles, conventional banks distribute profits through interest calculations. Therefore, the calculation method and calculation features are different. In participation accounts, it is not predetermined how much profit you will make at the end of the term. Because participation accounts allow the distribution of returns within the scope of the profit-loss partnership between the account holder and the participation banks. However, in interest-bearing deposit accounts, it is already clear how much interest you will receive at the end of maturity. Because conventional banks calculate profit with interest rate at the beginning of maturity and share this profit with the deposit account holder at the end of maturity. Another difference of participation accounts from interest accounts is the profit guarantee. Participation accounts, unlike term deposit accounts, can distribute profits or losses according to the income-expense balance arising from the use of the participation fund. Participation accounts use the unit value system to calculate profit or loss in pools of funds. The purpose of this system is to assign a unit value to all of the sharing pools, calculate the income-expense balance of the pool at the end of the term and distribute the income-expense arising from the relevant pool to the depositors who make up that pool.

Table 3-4: Bank-Based Dividend Rates (July 4, 2022)

	Monthly				3 Months			
	TL	USD	EUR	GOLD	TL	USD	EUR	GOLD
Albaraka Türk	15.26%	0.71%	0.61%	0.15%	15.18%	0.54%	0.45%	0.23%
Emlak Katılım	16.66%	1.96%	1.16%	0.36%	16.56%	1.80%	1.01%	0.36%
Kuveyt Türk	16.63%	1.21%	0.81%	0.14%	16.13%	1.04%	0.68%	0.14%
Türkiye Finans	15.73%	1.00%	0.74%	0.18%	14.99%	0.77%	0.52%	0.18%
Vakıf Katılım	16.45%	1.36%	0.82%	-	16.05%	1.13%	0.72%	0.46%
Ziraat Katılım	16.45%	1.45%	0.93%	-	16.05%	1.23%	0.74%	0.33%

Reference: TKBB, Profit Share Rates, <https://tkbb.org.tr/veri/karpaylari> (12 July 2022)

The participation accounts offered by participation banks are characteristically very similar to the equity-based crowdfunding model. In equity-based crowdfunding financing, a project or venture is provided with capital support from a large number of investors. The collected capital is transferred to the entrepreneur by the crowdfunding platform and the entrepreneur shares the income he / she receives due to the capital collected with the investors. In the equity-based crowdfunding model, entrepreneurs can also share stocks with investors, but here the method similar to participation accounts is the method in which entrepreneurs share the profits obtained. The logic of participation accounts is very similar. Participation banks operate the capital they collect from a large number of depositors through the fund distribution method and share the profits they make from the funds they extend with the depositors. The most fundamental difference between the two financing models is that in crowdfunding, investors invest their capital in the enterprise of their choice, while in participation accounts, depositors do not have a say in the disbursement of funds. The participation bank decides in

which projects the collected capital will be used. However, when the characteristic features of the two financing models are examined, it can be said that both models have the aim of collecting capital from a large number of investors and depositors and sharing the income obtained as a result of transferring these capitals to various projects as financing with the capital owners and therefore have similar characteristics.

3.2.2. Entrepreneurship Programs and Venture Capital Investment Funds

Based on the moral and economic values it contains, Islamic finance should raise the economic well-being of individuals and societies in Muslim countries, most of which are in the development stage. Therefore, Islamic finance should finance real economic activities by providing an ethical financing method as an alternative to traditional financing models. However, due to the fact that they are alternatives to conventional banks, use the deposits they collect in income-generating projects and have low risk thresholds, participation banks have not been able to fully assume this role and their market share has remained at only 6.5%¹⁴².

The desire of participation banks to continuously distribute money to depositors for the deposits they collect, rather than distributing losses, leads them to projects that will bring more risk-free and guaranteed income. In addition, the efforts of the bank's senior management to reach their annual profit targets are another factor that triggers this situation. In addition, the inflationary environment and foreign exchange increases in recent years have limited the disbursements of foreign currency funds and limited TL disbursements for companies and individuals who may have difficulty in repayment. For these reasons, it has become difficult for entrepreneurs and start-up companies who already have difficulty in accessing traditional funds to find capital from participation banks.

In order to find a solution to this situation, participation banks have implemented entrepreneurship support campaigns in recent years both to implement projects that will support the real economy and to facilitate access to capital for entrepreneurs who have difficulty in finding collateral. In fact, completely new brands have been created, such as the Lonca Giriřimcilik Merkezi implemented by Kuveyt Türk. Albaraka Garaj, implemented by Albaraka

¹⁴² TKBB, Sector Comparison Report, 2020.

Türk, and the Pusula entrepreneurship program implemented by Emlak Katılım are programs created to support entrepreneurs.

3.2.2.1. Entrepreneurship Programs

Entrepreneurship programs implemented by participation banks in recent years offer support to entrepreneurs in different areas. In addition to these programs, opportunities such as networking development, mentoring, training for start-ups and office environment are offered.

Today, almost all banks support the entrepreneurship ecosystem with the entrepreneurship support programs they have established and the incubation centers they have established. Banks aim to open the projects arising from the entrepreneurship centers they establish not only to the Turkish market but also to the world markets. In this ecosystem called 'Venture Banking', banks are trying to support entrepreneurs in many areas from how entrepreneurs' ideas will come to life to the marketing of these projects¹⁴³.

Lonca Girişimcilik Merkezi was established by Kuveyt Türk in 2017. It was established to enable entrepreneurs with technology-oriented, scalable business ideas to transform their project ideas into commercial activities in a sustainable model quickly. While providing the appropriate working environment for the projects applied through Kuveyt Türk, Lonca plans to give necessary trainings for entrepreneurs to develop these projects with the right strategies, Lonca also plans to implement the projects with special mentors and consultants for each entrepreneur. In addition, the events allow entrepreneurs to come together with entrepreneurs like themselves and create the ecosystem they will need¹⁴⁴.

Kuveyt Türk provides working space in more than 20 locations in many cities, especially in Istanbul, Ankara, Izmir and Bursa, so that entrepreneurs can participate in this program from anywhere. In addition, Lonca entrepreneurs can request mentors on the subjects they need, and these mentors consist of people with expertise in the following areas¹⁴⁵:

- I. Mentors
- II. FinTech and Banking Professionals

¹⁴³ Burcu Tuvay, Economist, Banks invest entrepreneurs in 'incubation': Which bank gives which support, <https://www.ekonomist.com.tr/girisim-kobi/bankalar-girisimcileri-kuluckaya-yatiriyor.html> (16 July 2022).

¹⁴⁴ Lonca Entrepreneurship Center, Who We Are, <https://www.loncagirisim.com/biz-kimiz/> (July 16, 2022).

¹⁴⁵ Lonca Entrepreneurship Center, Who We Are.

- III. Consultants (Law, Accounting, Finance, Technology, etc.)
- IV. Past Entrepreneurs
- V. Investors
- VI. Experts

Lonca opens its doors to all technology-oriented and scalable start-ups without any sector constraints. There are some elements that projects and teams applying to Lonca are expected to have. It is expected that the teams applying to Lonca have the knowledge to implement their projects, that they are focused on their projects, and that there are projects that have been worked on and gone beyond the idea, even if the project has not yet reached the finished stage. Lonca usually receives applications at least 2 times a year¹⁴⁶.

Great importance is attached to the training program in Lonca campaigns. Services are received from the most expert people or companies in education. Training campaigns start with "Business and Strategy Development Camp". Within the scope of the camp, trainings such as Rapid Prototyping and Service Design are also provided. The training campaigns continues with the "User Experience" camp. In addition to theoretical knowledge, the User Experience camp provides one-to-one mentoring services related to the screens of each team. In the future, Digital Marketing camp is organized with both theoretical and practical applications to all kinds of Digital Marketing.¹⁴⁷

In Lonca campaigns, a cash grant budget of 50,000 TL is allocated for each initiative. Within the scope of the grant program, the first 10.000 TL is given to each initiative after they are included in the program in the 2nd phase of Lonca campaigns. At the end of the second month, 15,000 TL is given to the initiatives that have at least 70% participation in Lonca campaigns. Then, a KPI is determined mutually with each initiative and if it reaches the determined KPI, 25,000 TL is given to each initiative. At the end of all processes, Lonca campaigns are terminated with the Demoday organization, where the initiatives that successfully complete the processes come to the stage and introduce their products and teams.¹⁴⁸

Albaraka Türk, one of the well-established participation banks, also has an entrepreneurship program created under the Albaraka Garaj brand. Albaraka Türk aims to

¹⁴⁶ Lonca Entrepreneurship Center, Application, <https://www.loncagirisim.com/program/> (July 16, 2022).

¹⁴⁷ Lonca Entrepreneurship Center, Training Program, <https://www.loncagirisim.com/program/> (16 July 2022).

¹⁴⁸ Lonca Entrepreneurship Center, Grant Program, <https://www.loncagirisim.com/program/> (16 July 2022).

contribute to the entrepreneurship ecosystem by gathering new ideas and initiatives within its body with the entrepreneurship center it has established.

“Albaraka Garaj is the entrepreneur acceleration center within Albaraka Türk where entrepreneurs with technology-based business ideas and projects are supported by incubation and acceleration opportunities. Albaraka Garaj has entrepreneurs working in different fields from financial technology to big data, from payment systems to artificial intelligence. Albaraka Garaj initiatives gain priority in the investments made through the VCIF of Albaraka Portföy Yönetim A.Ş. Albaraka Garaj also supports entrepreneurs at the idea stage. Albaraka Garaj serves as the implementing organization for TÜBİTAK BİGG (1512), the program in which TÜBİTAK supports technology-based innovative business ideas.”¹⁴⁹.



Figure 3.1: Entrepreneurs in Different Fields Selected for Albaraka Garaj

Reference: Albaraka Garaj, Entrepreneurs, <https://www.albarakagaraj.com/> (16 July 2022)

The facilities offered within the Albaraka Garage program are as follows¹⁵⁰:

- I. *“Networking possibilities; The opportunity to meet with the senior executives of the sector in which Albaraka and the entrepreneur are located is provided.*
- II. *Co-working space; entrepreneurs are provided with open offices, meeting rooms and event spaces in Istanbul and Berlin.*
- III. *Financial support: Up to 50,000 TL grant support is provided to entrepreneurs who successfully complete the acceleration program.*

¹⁴⁹ Albaraka Garaj, What is Albaraka Garaj, <https://www.albarakagaraj.com/> (16 July 2022).

¹⁵⁰ Albaraka Garaj, What We Provide, <https://www.albarakagaraj.com/> (17 July 2022).

- IV. *Venture capital FinTech investment fund; Teams that have completed the acceleration phase of Albaraka Garaj are provided with negotiations to receive investment from the Venture Capital Fintech Investment Fund under the management of Albaraka Portföy.*
- V. *Regular interaction with the management team; While senior managers come together with entrepreneurs and follow the developments, entrepreneurs can also get the mentoring support they need.*
- VI. *Training program and workshop; training is provided to entrepreneurs in subjects such as business strategy, financial analysis, finding and accepting investors, marketing, sales strategy, human resources, business partners. Workshops are held in different areas to develop creative thinking.*
- VII. *Mentoring and counseling; One of the most valuable aspects of the Albaraka Garage acceleration program is access to the consultant network. Mentors are able to accompany entrepreneurs throughout their journey with their knowledge and experience.*
- VIII. *API; With the Albaraka API platform, access will be provided to all banking infrastructure of Albaraka and POC studies will be carried out with the bank”.*

Emlak Katılım also has an entrepreneurship support program called "Pusula". Pusula; *"It is an enterprise support program that brings solutions to the problems identified in real estate technologies, construction technologies, sustainable environmental technologies and financial technologies with innovative technologies, invests at an early stage in start-ups that have the potential to grow and open up to global markets and provide competitive advantage".¹⁵¹*

The initiatives at the focus of the Pusula program are as follows¹⁵²:

- I. *“Real estate technologies (proptech) initiatives; initiatives that facilitate the operation, management and use of real estate assets or initiatives that make it easy to access and own real estate assets.*

¹⁵¹ Pusula, What is Pusula, <https://pusula.emlakkatilim.com.tr/> (17 July 2022).

¹⁵² Pusula, What initiatives are at the focus of Pusula, <https://pusula.emlakkatilim.com.tr/> (17 July 2022).

- II. *Construction technologies (contech) initiatives; initiatives that integrate construction and technology to accelerate the digital transformation of the construction industry.*
- III. *Sustainable green technology initiatives; initiatives that integrate construction and technology to accelerate the digital transformation of the construction industry.*
- IV. *Financial technology (fintech) start-ups; Initiatives aimed at streamlining traditional financial services and processes using next-generation technological hardware and software”.*

Participation banks also organize award-winning venture programs to encourage initiatives. The "Ticaret Kuluka" program carried out in partnership with Vakıf Katılım and Istanbul Commerce University is one of them. The program was realized in cooperation with Istanbul Commerce University and Vakıf Katılım to develop business ideas in the field of financial technology and to support them with awards. The aim of the program is to support the development of new products/services as Istanbul Commerce University and Vakıf Katılım with the strong support of technological entrepreneurship through policies and incentives, and to ensure that promising entrepreneurs are strengthened with various mentorships and consultancies and transformed into commercial value.¹⁵³

Each initiative accepted to the program is offered 8 weeks and 12 hours of one-to-one online mentoring service by experienced mentors. Start-ups that complete the program present their business ideas to the end-of-program evaluation jury at the entrepreneur-investor meeting event called "The Big Day". As a result of this evaluation, the initiatives that are entitled to receive awards are determined. The entrepreneur that wins the first degree receives 30,000 TL, the 2nd degree winner receives 20,000 TL, and the entrepreneur that wins the 3rd degree receives 10,000 TL.¹⁵⁴

The entrepreneurship programs carried out by participation banks offer entrepreneurs various opportunities such as grants, training, mentoring, networking development and office environment. In addition to these opportunities, banks that have venture capital investment

¹⁵³ ITU – Vakıf Katılım, TİCARET KULUKA -VAKIF PARTICIPATION BANK FINTECH ENTERPRISE ACCELERATION PROGRAM, http://tto.ticaret.edu.tr/wp-content/uploads/2021/06/Basvuru_kosullari_v4_2.pdf (17 July 2022).

¹⁵⁴ ITU – Vakıf Katılım, TİCARET INCUBATION, p. 2.

funds for start-ups that successfully complete these programs provide priority to entrepreneurs in terms of receiving investment from the VCIF¹⁵⁵.

3.2.2.2. Venture Capital Investment Funds

In the communiqué on venture capital investment funds, VCIF is defined as follows;

“The fund is an asset which does not have a legal entity, established under fund rules with limited term, by portfolio management companies and, real estate and venture capital portfolio management companies which hold an operating license received from the Board in order to manage the portfolios comprised of assets and transactions specified in the third paragraph, with money and/or capital stocks collected from qualified investors in return for fund units, in accordance with fiduciary ownership principles and pursuant to the provisions of the Law.”¹⁵⁶

The CMB has introduced the following regulations in summary with the Communiqué on Principles Regarding Venture Capital Investment Funds numbered III-52.4¹⁵⁷:

- I. *“Venture capital investment funds (VCIF) can be established by portfolio management companies and venture capital portfolio management companies, and the shares of VCIF participation will be sold to qualified investors.*
- II. *At least 80% of the total value of VCIF will consist of venture capital investments. Venture capital investment can be made through different methods such as direct or indirect partnership, providing structured financing (mezzanine finance) to venture companies as a mixture of debt and capital financing, and purchasing debt instruments issued by venture companies.*
- III. *The assets in the GDYF portfolio are required to be stored by an independent portfolio custodian in line with international practices.*
- IV. *In parallel with the international "private equity" model, different types of participation shares can be defined in VCIFs. Accordingly, VCIFs will be able to issue qualified participation shares (General Partners (GP) Shares) and other types of participation shares (Limited Partners (LP) Shares). The rights and responsibilities of the shareholders shall be set out in the bylaws of the*

¹⁵⁵ Lonca Entrepreneurship Center, Investment, <https://www.loncagirisim.com/yatirim/> (17 July 2022).

¹⁵⁶ Communiqué on Venture Capital Investment Funds (III-52.4), **Official Gazette**, 28874, 7 June 2014.

¹⁵⁷ CMB, Communiqué on Principles Regarding Venture Capital Investment Funds, January 2014.

GDYF and in the investor agreement to be drawn up between the shareholders and the GDYF.

- V. *Resource commitments to the VCIF to be paid by qualified investors on different dates have been arranged and the minimum amount of the total resource commitment to be collected from qualified investors has been determined as 5 million TL. The resource commitment will be fulfilled within 1 year following the establishment of the VCIF, and the VCIF portfolio can be created within 1 year thereafter.*
- VI. *In accordance with the provisions of the Capital Markets Law, the VCIF may be represented by the board of directors of the founding portfolio management company or by one or more executive members to be determined by the board of directors. Whether the performance fee will be charged for the part of the portfolio consisting of venture capital investments will be freely determined in the bylaws of the VCIF and the issuance document”.*

While participation banks support entrepreneurs with their entrepreneurship programs, they establish VCIFs to facilitate entrepreneurs' access to capital and to enable investors to fund these initiatives.

Kuveyt Türk established and started to invest in Turkey's first venture capital investment fund in 2018 under the management of KT Portföy Yönetimi A.Ş., its own subsidiary, in 2018, being first in both the banking sector and investment funds. In 2021, Lonca VCIF was established, of which KT Portföy is the founder and manager. Entrepreneurs who graduate from Lonca program have priority in receiving investment from Lonca VCIF¹⁵⁸.

Lonca VCIF is the Venture Capital Investment Fund established to invest in early and growth stage venture companies that are already operating and/or have not yet been operational but have high growth potential, need capital to achieve this potential, and that offer and/or will offer technological solutions in the fields of technology and innovation-oriented financial technologies, health technologies, transportation technologies and other services.¹⁵⁹

¹⁵⁸ Lonca Entrepreneurship Center, Investment (17 July 2022).

¹⁵⁹ KT Portföy, Lonca VCIF, <https://www.ktportfoy.com.tr/girisim-sermayesi-yatirim-fonlari/lonca> (17 July 2022).

Early and growth-stage venture companies that are already operating and/or have not yet been operational that offer and/or will offer technological solutions in the fields of technology and innovation-oriented financial technologies, health technologies, transport technologies and other services may apply to Lonca VCIF. In addition, Lonca VCIF will make an early-stage investment of between 50,000 – 500,000 USD in each project, in return for which it will receive a share commensurate according to the the valuation.¹⁶⁰

Kuveyt Türk offers 3 different VCIFs within KT Portföy. These are Teknogirişim VCIF, Lonca VCIF and Neova VCIF¹⁶¹. Albaraka Portföy offers 3 different VCIFs like KT Portföy. These are Değer VCIF, Fintech VCIF and Start-up VCIF. When determining the fund price in the VCIF, the participation shares have no nominal value. The fund unit share value is obtained by dividing the total value of the fund by the number of participation shares.¹⁶²

In addition to Kuveyt Türk and Albaraka Türk, Vakıf Katılım and Ziraat Katılım also have a joint VCIF fund. Under the auspices of the Ministry of Treasury and Finance and the Presidency of Defense Industries; 'Yenilikçi ve İleri Teknolojiler Katılım Girişim Sermayesi Yatırım Fonu ' was established in 2021 with the partnership of Ziraat Katılım, SSTEK, Vakıf Katılım and the Development Investment Bank of Turkey¹⁶³.

In order to invest by receiving funds from the VCIF, it is obligatory to have the status of a qualified investor. CMB has defined qualified investors in its introductory guide for venture capital investment partners as follows;

“Qualified investors are professional clients, including those defined in the Board's regulations on investment institutions and who are considered professional on a demand-based basis. Mutual funds, pension funds, securities investment funds, venture capital investment funds, real estate investment funds, intermediary institutions, banks, insurance companies, private financial institutions, portfolio management companies, pension and aid funds, foundations, funds established in accordance with the provisional article 20 of the Social Insurance Law No. 506, associations beneficial to the public and other investors to be determined by the Board to be similar in their nature to these institutions and real and

¹⁶⁰ KT Portföy, Lonca VCIF

¹⁶¹ KT Portföy, VCIF, <https://www.ktportfoy.com.tr/girisim-sermayesi-yatirim-fonlari> (17 July 2022).

¹⁶² Albaraka Portföy, VCIF, <https://www.albarakaportfoy.com.tr/tr-TR/girisim-sermayesi-yatirim-fonlari> (17 July 2022).

¹⁶³ Ziraat Katılım, 'Innovative and Advanced Technologies Participation Venture Capital Investment Fund' Signing Ceremony Took Place, <https://www.ziraatkatilim.com.tr/bizden-haberler/yenilikci-ve-ileri-teknolojiler-katilim-girisim-sermayesi-yatirim-fonu-imza-toreni> (17 July 2022).

legal persons who own Turkish and/or foreign currency and capital market instruments in the amount of at least 1 million Turkish Liras as of the date of public offering are among the qualified investors”¹⁶⁴.

The entrepreneurship programs and VCIFs created by participation banks are similar to crowdfunding in many ways. Facilitating entrepreneurs' access to capital and supporting entrepreneurs through the entrepreneurship programs offered by participation banks is one of the main objectives of crowdfunding financing. Encouraging VCIFs and investors to support entrepreneurs is again one of the main elements of crowdfunding financing. For this reason, it can be said that the entrepreneurship programs carried out by participation banks and VCIFs in order to support entrepreneurship and contribute more to the real economy are very similar with crowdfunding financing in terms of purpose.

3.3. Execution of Crowdfunding through Participation Banks

3.3.1. Reasons to Encourage Participation Banks

Banking is facing a serious change today. With the rapidly changing and developing technology, banks are faced with issues such as increasing the quality of service, adapting to financial technologies, digitalizing, reaching the customer through digital channels besides physical channels, maintaining their services 24/7 with artificial intelligence and robotics without interruption. Therefore, banks are constantly trying to improve themselves in these areas.

Since the crowdfunding method is an internet-based financing model in terms of its structure, it has gained an important place among today's financial technologies. The fact that the crowdfunding model is available online and 24/7, that transactions can be easily made through digital channels rather than physical, that it can be worked with FinTechs using payment systems, and that it can appeal to a wide range of customers makes it an ideal product for participation banks developing their financial technology infrastructure. In addition to donation and reward-based crowdfunding, the fact that equity and debt-based crowdfunding models can now be made in Turkey has created an opportunity for the crowdfunding model, which is still in its infancy in Turkey, to be adopted and implemented by participation banks.

¹⁶⁴ CMB, Venture Capital Investment Funds Introduction Guide, <https://www.spk.gov.tr/Sayfa/AltSayfa/206> (17 July 2022).

3.3.1.1. Increasing the Importance of Digital Channels in Banking

In 2021, when banks in developed markets around the world reevaluated their approach to sales and services, they closed 9% of their branches, experiencing the biggest decline in this area in the last 5 years. This reduction was in response to pandemic-induced changes in consumer behavior, particularly the acceleration of the transition to digital channels and the decline in demand for services across physical channels (branches and contact centers). Some of the important outputs obtained in the researches on the digitalization of banks are as follows¹⁶⁵;

- I. It is important for banks to accelerate their digitalization in the coming periods and to be able to offer the products and services they offer through physical channels through digital channels.
- II. In 2021, more than 40% of banks' basic product and service sales were realized through digital channels, setting a new record.
- III. Although total sales of banking products and services fell by 10% in 2021, sales through digital channels increased by 4%.
- IV. Many banks are still lagging behind in delivering the ability to capture the requirements for simple and complex customer experiences. Almost half of the institutions worldwide still do not offer the possibility to open a deposit account on their mobile application, while less than a third are able to offer their investment accounts digitally. When the banks' data are compared, it shows that banks that adopt and successfully deliver digital channels consistently outperform their peers at every stage of the sales funnel and are rewarded with twice as many account openings.
- V. Banks that offer and invest in personal loans through digital channels have experienced a sevenfold increase in sales in just 24 months.
- VI. When the benchmarking data is examined, it is shown that an omnichannel approach is 3.2 times more effective at increasing sales than a single channel. The effective use of digital marketing, presenting media content and giving messages to customers are directly parallel to successful sales.

¹⁶⁵ McKinsey & Company, Best of both worlds: Balancing digital and physical channels in retail banking, July 2022, <https://www.mckinsey.com/industries/financial-services/our-insights/best-of-both-worlds-balancing-digital-and-physical-channels-in-retail-banking> (31 July 2022).

- VII. More than half of banks offer new products to their customers within the first 90 days, which is an important period to deepen customer relations. It was observed that these banks sold 1.8 times more in total product and service sales compared to banks that offer products and services only with customer demand.

Crowdfunding is a completely digital financing method because it is a product offered over the internet in terms of its structure. Crowdfunding includes many elements that banks consider in terms of digital transformation processes. Factors such as the fact that the product offered is completely digital, that information and developments related to the product are accessible 24/7 thanks to the online platform in terms of the customer experience, and that this information can be updated regularly, and that visual content and messages can be presented will provide significant returns for participation banks trying to digitize their products.

3.3.1.2. Development of a New Banking World with Fintechs and Open Banking

Finance and technology have been supporting and developing each other for many years. The word fintech is a combination of the words "Financial" and "Technology". Fintech companies, which have increased in popularity in recent years, have achieved a rapid growth momentum with the interest of consumers in this area. The fact that digitalization has taken place more in our lives after COVID-19, it has increased the rate of fintech use by consumers. Fintech users appear in different areas of the financial services sector, especially money transfer and payments, which are fundamental parts of payment systems, savings and investment, credit / financing, insurance, financial reporting and planning. Today, fintechs challenge traditional financial methods, offering innovative products and ideas and contributing to the creation of new financial technologies. With ease of use and low cost, these innovations have become more accessible. However, it supports technology development and breakthroughs in many sectors. In this way, companies and enterprises offering fintech in different geographies increase access to financial technology and services¹⁶⁶.

The "Open Banking" system is considered as the banking of the future around the world and is a major mainstay for fintechs. It is defined as open banking when banks share the

¹⁶⁶ Earnst & Young, FinTech in the World and in Turkey, January 2022, https://www.ey.com/tr_tr/ey-turkiye-yayinlar-raporlar/dunya-ve-turkiye-fin-tech-pazari-yeni-nesil-dijital-bankalarin-gelecegi?download (1 August 2022).

data they have with legal obligations. According to PSD2 (Payment Services Directive 2), which has become mandatory in Europe and has been approved by the European Union, banks in Europe must make the data approved by their customers available to their own customers and other users. This data is channel-based and becomes publicly available through an interface. These interfaces are usually shared with applications called Application Programming Interface (API). One of the main purposes here is for applications to provide data from other applications that are not in their own structure. With this method, which also allows data sharing, many data can be shared in the financial sector and can be used by both banks and other financial institutions. In this way, banks can analyze the data they obtain and determine the appropriate products and services to their customers and develop and offer these products to them even if they do not have them. By December 24, 2018, 428 banks around the world had opened their APIs for use. In Turkey, Yapı Kredi, Garanti, İş Bankası, Kuveyt Türk and Denizbank have opened some of their APIs. As of September 20, 2019, the APIs available in Turkey are given in the table below:¹⁶⁷

Table 3-5: Open API Services in Turkey as of September 20, 2019

APIs/ Banks	İş Bankası	Yapı Kredi	Garanti	Kuveyt Türk	Denizbank
Credit	6	3	1	6	37
Customers	3	6	-	-	15
Fx	1	6	-	-	3
Accounts	3	10	-	8	13
Informative	4	10	-	10	18
Payments	4	3	-	4	12

¹⁶⁷Doğuş Bilgel and Besim Aksoy, Financial Technology Companies and Banking of the Future: Open Banking, *European Journal of Science and Technology*, Issue 17, December 2019, p. 1100-1101.

Tablo 3.5 (Continue): Open API Services in Turkey as of September 20, 2019

Cards	-	4	-	12	42
Money Transfers	2	6	1	14	8
Donations	-	-	-	5	-
Others	8	8	2	14	48

Since the rise of fintechs, peer-to-peer (P2P) financing has become a popular model in the financial services sector. With the help of the technology brought by fintechs, it has been paved the way for funds to be channeled with a decentralized method and for both parties to act under the same conditions. One of the rising stars of the peer-to-peer financing model, which is a successful alternative to the current financial system, is crowdfunding¹⁶⁸.

The innovations that occur thanks to fintechs include both financial services and information technology and invest in all banking and financial services sectors, from credit (crowdfunding and peer-to-peer credit) to payment services (instant payment), from virtual currencies (Bitcoin) to consulting services. In order to respond to the needs of customers, the main activity of fintechs is to make it easier to find capital. The first solution that comes to mind here is equity-based financing and finding investors to provide this capital. Crowdfunding is defined as equity-based, in which an investor can obtain shares from a company with his capital online. The investor can buy shares from the company with his capital and may also have some managerial rights with this share. In this case, the innovation brought by the crowdfunding model is that this transaction can be done in the channel used for investment (platform and payment instrument) and without using a financial instrument¹⁶⁹.

The realization of financial transactions such as loans and debt securities occur with debt financing. Fintechs offer solutions to customers who are trying to find resources in this situation. Fintechs act as a direct lender using the telematics channel to facilitate the client's

¹⁶⁸ Saiti, Musito and Yücel, "Islamic Crowdfunding: Fundamentals, Developments and Challenges", p. 474.

¹⁶⁹ Biancone, Secinaroo and Kamal, "Crowdfunding and Fintech", p. 4.

access and make the services offered available quickly. With its debt, donation and reward-based models, crowdfunding successfully fulfills the fast, direct source providing function expected of fintechs and therefore continues to provide financing as an example of a successful fintech¹⁷⁰.

3.3.1.3. Gaining New Customers

The fact that being a bank customer is now a transaction that can be carried out over the internet in a few minutes has increased the appetite of banks to gain new customers. However, this situation also increases the risk of losing existing customers.

Customer experience digitalized with technology shows itself in many sectors. New fintechs and applications can reach the number of customers that banks have gained for many years in a short time. For example, Papara, which was founded in 2016, has been able to reach 7 million users in just 5 years¹⁷¹. This situation has increased the banks' targets of gaining new customers by indexing their focus directly to customer experience. This target also applies to participation banks.

In terms of customer acquisition and protection of existing customers, new competitors have come to participation banks as of 2022. The BRSA approved the establishment of digital banks with the "Regulation on the Operating Principles of Digital Banks and Banking as a Service Model" published in the Official Gazette on 29 December 2021 and entered into force as of 1 January 2022. The purpose and scope of the relevant regulation is as follows¹⁷²:

“The purpose of this Regulation is to determine the procedures and principles regarding the activities of branchless banks that serve only through electronic banking services distribution channels and the provision of banking services as a service model to financial technology companies and other businesses”.

Hayat Holding received its first establishment license in 2022 within the scope of the "Regulation on the Operating Principles of Digital Banks and Banking as a Service Model" prepared by the BRSA for the digital banks to be implemented in Turkey and entered into force.

¹⁷⁰ Biancone, Secinaroo and Kamal, p. 4-5.

¹⁷¹ Papara, March 2019, <https://blog.papara.com/ailemiz-buyudu-7-milyonu-gecti/> (7 August 2022).

¹⁷² "Regulation on the Operating Principles of Digital Banks and Banking as a Service Model", **Official Gazette**, 31704, December 2021.

With founding partners Hayat Holding A.Ş., Hayat Kimya Sanayi A.Ş., AS Tüketim Malları Ticaret A.Ş., Kastamonu Entegre Ağaç Sanayi ve Ticaret A.Ş. and Limaş Liman İşletmeciliği A.Ş. establishment of Hayat Participation Bank with a minimum institutional capital of 1 billion 500 million TL in Turkey was approved by the BRSA in April 2022¹⁷³.

Shortly after Hayat Participation Bank, Kasa Participation Bank received its establishment approval from the BRSA. According to the BRSA's decision published in the Official Gazette, Great East Capital Bilgi Teknolojileri Yatırımları A.Ş., Adam Muhammed Sadıq, Maryam Khalid Al-Atteyah, Hector Fernando Sepul Veda Reyes Retena and Yağmur Şatana were allowed to establish a digital participation bank in Turkey with the title of Kasa Participation Bank. The bank's founding capital will be 1.5 billion liras.¹⁷⁴

Crowdfunding is a completely digital financing model in terms of its structure. The fact that investors and entrepreneurs meet on a platform over the internet and the fact that this platform can be accessed from all over the internet has enabled crowdfunding to reach large masses.

Founded in 2009, Kickstarter has grown to a total of 21.2 million investors in 13 years. The number of users who invested in 2 or more projects exceeded 7.2 million. While the number of entrepreneurs trying to implement their projects through the platform was 565,620, 224,654 of these projects successfully reached the targeted capital amount¹⁷⁵. Founded in 2008, Indiegogo has managed to reach more than 9 million investors from 235 different countries in 13 years. More than 800,000 start-ups have been successfully launched through the platform¹⁷⁶.

Crowdfunding creates significant opportunities for participation banks in two areas. The first opportunity is for participation banks to reach the customer base that they could not reach before thanks to crowdfunding, enabling them to be even stronger in the competition to acquire new customers. In addition, with crowdfunding, participation banks could have a marketing strategy beyond their current marketing strategies. The second opportunity is that participation banks will add another innovative and significant potential product to their product portfolios with crowdfunding. This product will not only mean gaining new customers for

¹⁷³ BRSA, Banking Regulation and Supervision Board Decision, Decision No: 10165, April 2022.

¹⁷⁴ BRSA, Banking Regulation and Supervision Board Decision, Decision No: 10263, July 2022.

¹⁷⁵ Kickstarter, Stats, <https://www.kickstarter.com/help/stats> (7 August 2022).

¹⁷⁶ Indiegogo, The Indiegogo Community, <https://www.indiegogo.com/about/our-story> (7 August 2022).

participation banks but will also provide an important gain in terms of deepening existing customers and attracting customers with wide investment appetite.

3.3.1.4. High Digital Susceptibility of Banks Users in Turkey

Since crowdfunding is a completely digital financing model, the digital inclination of the audience to which crowdfunding will be offered is gaining importance. When the number of digital banking users in Turkey is examined, it is seen that it has a serious increasing trend in recent years.

In its periodic "Digital, Internet and Mobile Banking Statistics" report, the TBB shares digital, internet and mobile banking statistics using data from 27 banks that are members of the Banks Association of Turkey and provide internet banking services and 22 banks that provide mobile banking services. According to the report published in March 2022, the statistics are as follows.

“In the period of January-March 2022, the total number of active digital banking customers (individual and corporate) reached 80 million 927 thousand people. Of this number, 2 million 667 thousand people made "internet banking only" transactions, while 69 million 493 thousand people made "mobile banking only" transactions. The number of users who make both internet and mobile banking transactions is 8 million 767 thousand people. The total number of active digital banking customers (individual and corporate) increased by 12 million 452 thousand people compared to the previous year. As of March 2022, the number of retail customers registered in the system to conduct internet banking and who have logged in at least once is 84 million 30 thousand people. The number of individual customers who have logged in at least once in the last year is 23 million 969 thousand people”¹⁷⁷.

In the same report, the TBB also shares the statistics of financial transactions and investment transactions. Accordingly;

“As of January-March 2022, the total number of financial transactions made using the internet banking service is 114 million and the amount is 3 trillion TL. Money transfer transactions, which include EFT, money transfer and foreign exchange transfer transactions, had the largest share among financial transactions (74 percent of financial transaction volume) with a transaction volume of 2 trillion 256 billion TL and 65 million transactions. In second place are investment transactions with a transaction volume of 529 billion TL and 14 million transactions. As of January-March 2022, foreign exchange transactions took the first place in the volume of investment transactions carried out with 163 billion TL

¹⁷⁷ TBB, “Digital, Internet and Mobile Banking Statistics”, March 2022.

and 2.1 million transactions. This was followed by stock transactions with 131 billion TL and 8.3 million units”¹⁷⁸.

Lastly, the total number of customers (individual and corporate) who are registered in the system to do banking and have logged in at least once is 123 million 164 thousand people as of March 2022. Of these, 78 million 260 thousand people (64 percent) entered at least once during the January-March 2022 period. The variation of digital banking statistics over the years is given as follows¹⁷⁹:

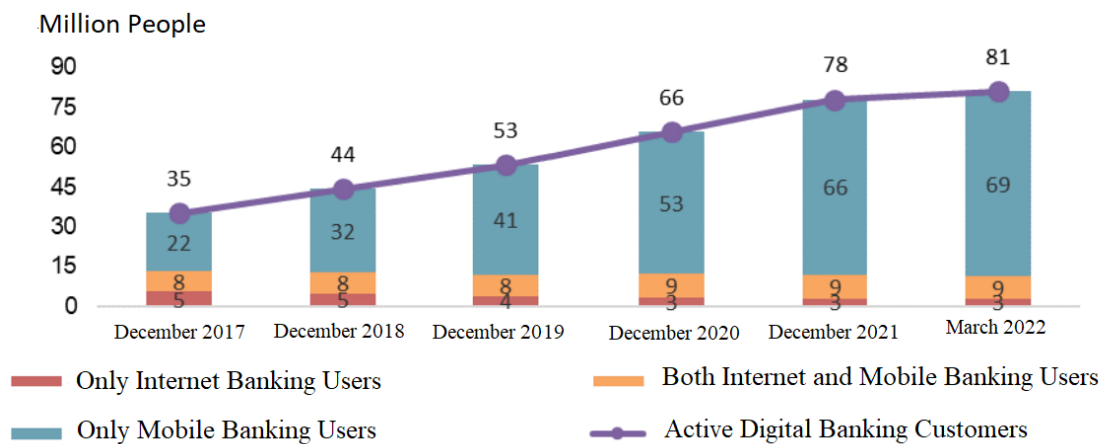


Figure 3.2: Change of Digital Banking Statistics by Year

3.3.1.5. Crowdfunding Financing Will Be Able to Reach Large Masses in Turkey After Legal Regulations

Due to the fact that legal regulations in Turkey are made too late compared to America, Europe and Asia and that venture capital and growth in general are not adopted very much, the crowdfunding volume has remained very low compared to other countries. Until 2017, only reward and donation-based crowdfunding platforms operated in Turkey. The communiqué prepared by the CMB in 2017 regarding crowdfunding by making legal arrangements was published in the Official Gazette dated 03.10.2019 and numbered 30907 and entered into force.

¹⁸⁰ The Communiqué on Crowdfunding (III-35/A.2) on debt-based crowdfunding, which is the most common type of crowdfunding in the world, was published in the Official Gazette dated

¹⁷⁸ TBB, “Digital, Internet and Mobile Banking Statistics”

¹⁷⁹ TBB, “Digital, Internet and Mobile Banking Statistics”

¹⁸⁰ "Communiqué on Equity-Based Crowdfunding (III – 35/A.1)", **Official Gazette**, 3 October 2019.

27.10.2021 and numbered 31641 and entered into force. With this regulation, the CMB revised the Equity-Based Crowdfunding Communiqué and repealed the previous communiqué (III-35/A.1), taking into account the situations that emerged in practice regarding equity-based crowdfunding, which was previously enacted.¹⁸¹

As of 2017, the volume of crowdfunding in Turkey reached 20 million TL. As of the end of 2018, approximately 300 of the 900 projects published in our country have successfully reached the targeted capital amount. From this point of view, it can be said that the success rate of the projects that try to raise capital with the crowdfunding model in Turkey is 30%¹⁸². Reward and donation-based platforms that do not require any legal regulation started to operate in Turkey before the CMB regulations. However, equity-based crowdfunding platforms, which are subject to legal regulations, were first listed by the CMB in 2021 and started to operate.¹⁸³

The volume of crowdfunding financing around the world continues to increase with a very high momentum every year. The volume of crowdfunding reached a size of \$ 3 billion in 2012, \$ 6 billion in 2013, \$ 16 billion in 2014 and \$ 45 billion in 2016.¹⁸⁴ In 2020, the crowdfunding volume exceeded the World Bank's 2025 forecasts and generated a volume of \$ 115 billion¹⁸⁵.

There is a very serious gap between the volume of crowdfunding in Turkey and the volume it has reached in the world. One of the biggest reasons for this is that the legal infrastructure has just come to life. In addition, the number of entrepreneurs and investors reached by the platforms has remained very low due to the fact that the established platforms are not known much and the crowdfunding financing is not yet recognized in Turkey. The creation of a platform by participation banks for crowdfunding financing, which is still in its infancy, will directly turn their existing customers into potential investors. In addition, for investors and entrepreneurs who are not bank customers, having a bank behind the platform will create a direct trust element and encourage the masses to use the platform. When we consider factors such as the increase in the awareness of crowdfunding, people's predisposition to use digital channels, and the fact that legal regulations have been made, it will not be difficult

¹⁸¹ CMB, Press Release of the Crowdfunding Communiqué No. III-35/A.2, 27 October 2021.

¹⁸² Ünsal, Crowdfunding: A New System to Change the Way of Doing Business, p. 64

¹⁸³ Demiray and Burnaz, Positioning of Crowdfunding Platforms, p. 88-91.

¹⁸⁴ Ünsal, Crowdfunding: A New System to Change the Way of Doing Business, p. 43.

¹⁸⁵ Statista, Volume of funds raised through crowdfunding worldwide in 2020.

to predict that the crowdfunding market in Turkey will gain serious momentum in the coming years.

Since there are opportunities to make great gains in factors such as fintech, digitalization, gaining new customers, digital predisposition of users and potential growth volume from the crowdfunding financing market, which is also largely compatible with the principles of Islamic finance, it can be said that participation banks have incentive elements to invest in crowdfunding.

3.3.2. Crowdfunding Models That Participation Banks Can Offer

Islamic finance and crowdfunding are inherently compatible with each other and support and reinforce each other. Islamic finance is a method of financing based on the principles of Islamic law, ideally with ethical and social responsibilities that should ensure a fair distribution of benefits and obligations between all parties in any financial transaction¹⁸⁶.

The rapid rise of crowdfunding, which is a type of fintech with the platform it has created, is more than just an innovative fintech. Fintech platforms, especially those based on crowdfunding, offer customers easy accessibility and a seamless experience. Some of the advantages that make crowdfunding attractive are that it provides low capital investors with higher returns than traditional deposit accounts, provides easier access to capital for entrepreneurs, directly serves ethical and social responsibility elements, and provides instant access from many different devices regardless of location.

Participation banks base their products on the principles of Islamic finance. Crowdfunding models also comply with the principles of Islamic finance, with the exception of the interest-bearing version of debt-based crowdfunding. For this reason, we can say that participation banks can offer 4 different crowdfunding financing models to their users.

3.3.2.1. Execution of Donation-Based Crowdfunding through Participation Banks

Donations are monetary supports to an individual, entity or organization, as well as charitable contributions made in good faith. Donation-based crowdfunding is a way to raise money by asking people to donate. There is no promise that the donated money will be

¹⁸⁶Achsien and Purnamasari, *Islamic Crowdfunding as The Next Financial Innovation in Islamic Finance*, p.3.

reimbursed. Donation-based crowdfunding is often used to raise charitable funds. Lenders are not given any share or return from the project. In addition, the lender is not a creditor both to the person receiving the donation and to the project¹⁸⁷.

In Islamic finance concepts, waqf, charity and zakat are directly linked to donation-based crowdfunding. Since donation-based crowdfunding has a global network through social media, it provides access to a wide range of individuals around the world who want to donate through zakat and charity and is therefore an ideal channel for Islamic charities¹⁸⁸.

Participation banks do not add the interest revenues they earn from the CBRT and the overdue interest income they earn from delinquent customers to their main operating income. They keep these revenues out of their operating income by donating to social responsibility projects. Participation banks even support social responsibility projects from time to time with their own operating income¹⁸⁹. With the crowdfunding platforms they will establish, participation banks can both collect support for social responsibility projects supported by them and be an intermediary for individual users who want to donate and provide zakat assistance to those in need through these platforms. With this financing model, which is also compatible with the principles of Islamic finance, participation banks will have both create very large social responsibility projects and will be able to reach many individuals and obtain potential customers. In addition, setting up a donation-based crowdfunding platform means more advertising by the bank. As the number of users increases, thanks to the intensive use of social media, the advertising of banks will be made by the users with the sharing of donation-based initiatives. In this case, mentioning the names of the banks together with the social responsibility projects for donation purposes will be another positive output for participation banks with donation-based crowdfunding platforms.

¹⁸⁷ Mohd Zakhiri Md. Nor and Emad Mohammed Al Ameren, Islamic Banking Transactions and Social Based Crowdfunding During Pandemic: Shariah Analysis on Islamic Financial and Non-Financial Institutions Approaches, **Central Asian Survey**, February 2022, p. 465.

¹⁸⁸ Asutay and Marzban, Shariah-compliant Crowd Funding, p. 8.

¹⁸⁹ Kuvayt Türk, Our Greatest Responsibility is Human, <https://www.kuveytturk.com.tr/hakkimizda/degerlerimizle-buyuyoruz/diger-kurumsal-sosyal-sorumluluk-projelerimiz/en-buyuk-sorumlulugumuz-insan> (14 August 2022).

3.3.2.2. Execution of Reward-Based Crowdfunding through Participation Banks

In the reward-based crowdfunding model, the individual investor donates to a project or business in anticipation of a non-financial reward, such as goods or services, at a later stage. The reward provided by the entrepreneur is usually a finished version of the product or service that is the subject of the project.

From an Islamic finance perspective, reward-based crowdfunding is a contract of sale. The entrepreneur undertakes to sell the product or service that will be finished on the specified date, at a later date, by collecting capital in advance in order to develop the relevant product and service. The investor, on the other hand, does not intend to obtain a financial return from the project he supports, but to obtain the product or service that will emerge at a later date. Therefore, the reward-based crowdfunding model is compatible with the principles of Islamic finance, provided that the resulting product or service does not contradict Islamic principles.

Reward-based crowdfunding is an ideal financing method for start-up companies and entrepreneurs with ideas. Entrepreneurs who cannot find enough capital but have innovative ideas are able to realize their ideas thanks to reward-based crowdfunding and give their products to their investors as a reward. Products or services that are particularly innovative and can attract the attention of investors at a high level are ideal products and services for finding investments and implementing initiatives. Participation banks ensure that such innovative products or services are invested and implemented with the entrepreneurship centers they establish. The aim of participation banks to support the entrepreneurial culture and to produce innovative products or services coincides exactly with the purpose of reward-based crowdfunding financing. With the crowdfunding platforms they will establish, participation banks can ensure that the projects awarded in the entrepreneurship centers grow rapidly by collecting more capital. In addition, participation banks can ensure that not only the projects and initiatives that receive awards in the entrepreneurship centers, but also numerically many more projects and initiatives are recognized, capital collected and implemented. In this way, participation banks can provide more support for the entrepreneurial culture and therefore can provide more support for the real economy.

3.3.2.3. Execution of Equity-Based Crowdfunding through Participation Banks

In the equity-based crowdfunding model, investors invest in entrepreneurs at the idea stage or in start-up firms to make a financial profit. Investors acquire a stake in return for their

investment, and thus become partners in the venture subject to crowdfunding in terms of profit and loss.

To this date, in Middle Eastern and North African countries, where the vast majority of the population is Muslim, start-ups and SMEs have often been funded by angel investors and venture capital investment firms. This situation has made it difficult to find capital for SMEs and entrepreneurs who want to grow¹⁹⁰.

In Turkey, banks provide support to SMEs by focusing on SME banking, but entry-level companies, entrepreneurs with new ideas and SMEs that cannot find sufficient guarantee have difficulties in accessing capital. This situation prevents start-ups with a lot of growth potential and SMEs that want to grow in the future from taking the next step and this situation restricts the development of the real economy.

Equity-based crowdfunding has the opportunity to fill a large gap for banks as it is compatible with the principles of Islamic finance and has the potential to meet the capital needs of entrepreneurs who cannot find enough capital. Therefore, in terms of financing models, equity-based crowdfunding is the one with the highest potential in terms of volume for participation banks.

Equity-based crowdfunding offers the following advantages from an Islamic finance perspective¹⁹¹:

- i. It is based on the profit-loss partnership, which is one of the main characteristics of Islamic finance.
- ii. It facilitates access to capital for many entrepreneurs in a broad perspective.
- iii. It creates new investment areas for small and medium-sized investors.
- iv. It minimizes the risk because of the fact that investors investing their limited capital in different ventures.
- v. Supports new ideas and innovation.
- vi. It brings out local talented entrepreneurs and ideas with potential.
- vii. It enables new business opportunities.
- viii. It supports the growth of start-ups and possible future IPOs in many sectors.

¹⁹⁰ Asutay and Marzban, "Standing Out With the Crowd", p. 29.

¹⁹¹ Achsien and Purnamasari, Islamic Crowd-funding as The Next Financial Innovation in Islamic Finance, p.3.

Participation banks offer opportunities to entrepreneurs to realize new ideas by supporting entrepreneurship and innovation culture with the entrepreneurship centers they have established in recent years. In addition, they become partners by investing in companies with growth potential. But the number of these start-ups is very low, and many entrepreneurs do not have the opportunity to present their ideas. In addition, the incentives given to entrepreneurs who present their ideas are not enough to implement the initiative. Equity-based crowdfunding includes many opportunities for participation banks. Participation banks will be able to offer them the opportunity to find capital with the CFPs they will establish by carrying more start-ups to their platforms than the number of entrepreneurs they reach in entrepreneurship centers. As the number of projects on the platform increases, the number of investors will also increase and participation banks will be able to evaluate the deposits to be obtained through the platform until the targeted project start date. They will also be able to earn commission income from successful or unsuccessful projects, which are the main source of income for many CFPs around the world. In addition, participation banks will be able to offer an alternative product to their existing investors and bring new customers to their banks with the growth of the platform. Again, participation banks will be able to invest directly in projects that have the potential to be successful and thus both the initiative will be implemented and the participation bank will be able to make a significant profit if the initiative grows. In addition to these benefits, participation banks will contribute to the country's economy by intermediating in crowdfunding, which directly benefits the real economy, and will also be able to benefit from the awareness and positive brand perception created by this situation.

3.3.2.4. Execution of Debt-Based Crowdfunding through Participation Banks

In the debt-based crowdfunding model, investors receive interest yields from the projects they invest in return for their investment, at certain intervals and agreed rate. In this model, investors are aimed at obtaining purely financial returns. As such, it is not in accordance with the principles of Islamic finance because it contains interest. However, if debt-based crowdfunding is done without interest yield, it can also be mediated by participation banks as it will be in accordance with the principles of Islamic finance.

Interest-free debt-based crowdfunding can be implemented in two different ways. Mudarabah-based or Murabaha-based crowdfunding, which are types of Islamic financing, can be made. In the Mudarabah method, after the capital is collected, a profit-loss agreement is made between the investors and the entrepreneur and the profit-loss sharing ratio is determined

in advance. As a result of the success of the project, after calculating the income of the project, investors and entrepreneurs share profits at the agreed rate. In the Mudarabah method, all capital can be lost and its return is not guaranteed. In case the investment fails, all project materials are sold and converted into money and repaid to investors¹⁹².

In the Murabaha-based method, with the capital collected from the investors, the entrepreneur buys an asset (company, product, etc.) on behalf of the investors and manages it. (Wakala /Power of Attorney) At a later stage, the ownership of the product, company or initiative related to the Murabaha agreement between the entrepreneur and the investor is given to the investors. When this transfer is made, the purchase cost of the relevant project is sold by adding the profit of the entrepreneur on top of it. Thus, both the entrepreneur makes a profit from this project and the investors become the owners of the project that the entrepreneur buys, operates and adds value on behalf of investors¹⁹³.

Participation banks will not be able to offer any profit guarantee to investors while offering a debt-based crowdfunding model on the crowdfunding platforms they will establish. According to the agreement, investors and entrepreneurs can share the return of the project according to the predetermined profit-loss ratio, or the entrepreneurs make an initiative on behalf of the investors and then sell this initiative back to the investors by adding the profit amount to it. Participation banks can earn returns by taking a share or commission from these initiatives. In addition, they can invest themselves by evaluating projects with high growth potential and thus become the owner of the venture after the venture grows.

¹⁹² Saiti, Musito and Yücel, “Islamic Crowdfunding: Fundamentals, Developments and Challenges”, p. 476.

¹⁹³ Saiti, Musito and Yücel, p. 477.

CONCLUSION

The crowdfunding model, which emerged as an alternative to traditional financial methods, is a type of financing in which entrepreneurs try to get funds from the crowds by explaining their projects over the internet in order to meet their capital needs. This initiative can be in different areas, such as collecting charitable funds, bringing an idea to life, targeting the further growth of a start-up company, implementing a product or service that is thought to have potential in the market.

Crowdfunding has three stakeholders: entrepreneurs, investors and crowdfunding platform. Entrepreneurs are people, teams, or organizations that collect aid or donations through crowdfunding platforms to bring a product, service, or project to life. Investors are those who invest their capital by supporting the ideas published on the crowdfunding platform. Crowdfunding platforms are internet-based platforms that are used to showcase a product, service or idea and in which the product, service or idea is supported by detailed project descriptions, pictures, audio and visual media, investment options, length of the project, information about the entrepreneur, etc.

The basic operation of crowdfunding financing starts with entrepreneurs who want to exhibit their projects on CFPs applying to the platform. CFPs who set certain criteria for the projects evaluate the applications and give approval or rejection to publish the project on the website. The project owner, whose application is approved, determines the amount of capital targeted for the realization of the project and the duration interval in which the project will be funded (campaign duration) and creates content (usually video) that promotes the project for potential investors. After the project is published in CFP, investors support the project until the project end date. During this period, entrepreneurs continue to inform investors about the current status of the project through CFP. If the targeted capital amount is reached at the end of the campaign period, CFP transfers the capital it has collected to the entrepreneur by taking its own commission. If the targeted capital amount is not reached at the end of the campaign period, CFP will return the deposited amounts to the capital owners.

The revenues of crowdfunding platforms consist of the deductions they make from the projects published on the platform. Platforms usually gain between 4% and 5% from successful projects which are able to raise targeted capital within the specified time. Since the main purpose of the platforms is to make a profit, they try to maximize the number of projects

published on the platform and they also try to maximize the success of these projects by reaching the targeted capital amount. To achieve this, crowdfunding platforms must be able to attract a high number of entrepreneurs and investor communities, while creating a market that can attract high-quality projects, establish a platform where fraud is minimal, and establish a structure that ensures the right matching between ideas and capital.

Crowdfunding also has some deterrent aspects and risks. From the point of view of the entrepreneur, the most important deterrent point is that the idea is disclosed to the public before it reaches the maturation stage. This situation paves the way for the project, which has not yet reached the maturation stage, to be imitated by potential competitors and creates a great deterrent for the entrepreneur. The second deterrent for entrepreneurs is that the additional values provided by angel investors and venture capital firms, such as sector knowledge, relationships, and status, are not provided by crowdfunding investors.

Another deterrent aspect for entrepreneurs is investor relations. The cost of investor relations is high because there are so many investors in crowdfunding financing. As the number of investors increases, the frequency of information sharing and other costs increases which creates difficulties for entrepreneurs. Another deterrent factor for entrepreneurs is that entrepreneurs have no control over people who have different experiences among investors and who will positively or negatively affect the project with their visions.

Crowdfunding also has some deterrent elements for investors. The first of these is that it is not known whether the entrepreneur of the invested project has the knowledge, skills and equipment to implement the project. Investors invest in the hope that the project will be successfully implemented. Even if the necessary capital is collected, the failure of the project to be realized due to the inadequacy and inexperience of the entrepreneur is one of the leading deterrent reasons for the investor.

The risk of being deceived is another deterrent aspect for investors. Crowdfunding is an internet-based type of financing, and CFPs can also include fraudulently created projects that look a lot like real projects. Although CFPs try to detect and block such projects, the fact that this system is an attractive area for fraudsters is a deterrent aspect for investors.

While crowdfunding finance has some advantages over traditional financing methods, it also carries some risks. One of the most basic risks for crowdfunding is the risk of failure of the investment. Especially in the early-stage companies, the business culture, financial background, experienced management team and lack of sufficient infrastructure are important

factors affecting the failure of the investment. For investors, investing in more experienced firms carries less risk than inexperienced firms. When the publicly disclosed data is examined, it is known that fifty percent of newly established companies fail within five years. For this reason, it is important for entrepreneurs to publish information about their projects in CFP in a complete and transparent manner. It is also necessary for CFPs to offer a more risk-free and more reliable environment to investors and to have informative and educational information on their sites to reduce investment risk.

Since there is not much one-to-one communication and sharing of personal information between the entrepreneur and the investor in the crowdfunding method, the risk of fraud is relatively lower in crowdfunding financing than in other types of financing. However, it is still possible that entrepreneurs try to deceive by setting up fake crowdfunding sites or by collecting money from investors by creating fake projects. To date, when the fraud cases announced by the CFPs are examined, it is seen that there is no significant number of cases. The joint implementation of these risk-reducing measures by entrepreneurs, investors and platforms will ensure that the number of cases remains low.

When crowdfunding financing models are examined, it can be said that there are basically 4 different financing models. These are donation-based, reward-based, equity-based, and debt-based crowdfunding models. These four models can be summarized in two main categories as crowdfunding with financial consequences and crowdfunding without financial consequences. Donation and reward-based crowdfunding are models that do not produce financial results, while equity and debt-based crowdfunding are models that have financial consequences. In models that do not produce financial results, the investor does not aim to obtain any financial return on the investment he has made. Investors provide capital to these projects for reasons such as charity, public infrastructure improvement, human rights, supporting social projects. In models that have financial consequences, investors aim to obtain financial returns at the end of the project. To finance a product or service that will be released for commercial purposes, to invest in a company with growth potential, supporting R&D projects can be given as an example of such investments.

In the donation-based crowdfunding model, the main motivation of investors is to support projects that they think will be beneficial to society and they do not have any financial expectations. Investors often support outreach and charitable projects, such as a favorite band going on tour, having a candidate they support become president, and collecting aid for those

harmful by natural disasters. In this model, investors do not have any obligations, but entrepreneurs have a moral obligation to spend the collected capital in accordance with the purpose of the project.

Reward-based crowdfunding financing is a model in which a pre-agreed reward is provided by the entrepreneur to the investor if the investment is successful, which does not provide any share or financial return to the investor. In this model, entrepreneurs try to sell a product or service to potential customers while it is still in production. Investors also invest in this product or service that has not yet been released to the market and buy this product or service at a price cheaper than they would normally pay. In addition, entrepreneurs can reward investors with gifts or different non-monetary gifts. Examples include a limited number of specially produced signed products, putting the names of large investors in the film or album, and dining with investors etc.

In equity-based crowdfunding, investors acquire shares from the company or project in which they invest. Depending on whether the investment is successful or not, the value of the share may increase or decrease. In addition, investors and entrepreneurs can share profits in the relevant project at a previously agreed rate. Share-based crowdfunding is a suitable financing model for new ventures to raise capital. The entrepreneur who wants to collect capital can explain his business model, financial statements, history of the management team, marketing strategies, patents, legal cases and tax status, if any, where the collected capital will be used, the time schedule and how much shares will be given to investors in return for their investments. The investment risk of this model is also higher than donation- and reward-based crowdfunding. Factors such as the experience of the entrepreneur, the overall market value of the company determine the potential return and risk of the investment.

In the debt-based crowdfunding model, entrepreneurs collect capital from investors for the projects they want to implement and make principal and interest payments to investors at the previously agreed interest rate at the end of the specified maturity. In this model, entrepreneurs borrow from the crowd instead of a financial institution such as a bank. For this reason, the lack of guarantees such as letters of guarantee that they have to give to banks directs entrepreneurs to this model. However, if the project fails, investors risk losing their principal. Therefore, the calculated interest rate is determined by taking these risks into account. Debt-based crowdfunding is a type of interest-bearing financing, but this model can also be applied without interest without setting an interest rate.

Crowdfunding started to become one of the mainstream types of financing after the 2008 crisis and its volume around the world continues to increase every year. The crowdfunding volume, which was 3 billion dollars in 2012, reached 6 billion dollars in 2013, 16 billion dollars in 2014, 45 billion dollars in 2016 and 115 billion dollars in 2020. Of this volume, \$74 billion was generated through crowdfunding platforms in the United States. Apart from the United States, the UK, Germany, Canada, France, Australia, Italy, the Netherlands, Spain and Japan are the leading countries in crowdfunding financing. Crowdfunding, which has gained serious momentum in the Asian continent in the last 5 years, has enabled Asia to get ahead of the European continent with this rise. Crowdfunding volume is expected to reach \$240 billion in 2026 and grow at an annual rate of 16.81% (compound).

One of the main reasons why America is a leader in the crowdfunding market is that US acted very early and made the necessary breakthroughs, especially in terms of the infrastructure of models such as equity-based crowdfunding that require legal infrastructure. After the 2008 crisis, while large financial institutions had difficulty in issuing loans, the rapid rise of crowdfunding platforms in America enabled both entrepreneurs and investors to turn to this market and America to become a leader in this field. Currently, the number of crowdfunding platforms in America has exceeded 1401.

Although crowdfunding has been carried out in Turkey since 2010, the total volume and number of projects reached are far behind the US, European and Asian markets. One of the biggest reasons for this is that legal regulations are made too late compared to the rest of the world. The "Communiqué on Equity-Based Crowdfunding", which is the first legal regulation on crowdfunding, was published in the Official Gazette on October 3, 2019 and entered into force. Crowdfunding platforms established before this date continued their activities through donation and reward-based models. The Communiqué on debt-based crowdfunding (III-35/A.2), which requires legal regulation, was published in the Official Gazette on 27 October 2021 and entered into force.

The volume of crowdfunding in Turkey reached 20 million TL as of 2017. As of the end of 2018, a total of 900 projects were published on the platforms, 300 of which managed to reach the targeted capital amount. After the legal arrangements, it will not be difficult to predict that these figures will grow rapidly in the coming years.

Since participation banking adopts the principles of interest-free banking, as a natural consequence of this, participation banks should not have interest-based practices that would

contradict the principles of Islamic finance in any of their activities. In order for the crowdfunding financing model to be implemented by participation banks, crowdfunding should not contradict the principles of Islamic finance. When the nature of crowdfunding and the methods of its implementation are examined, it can be said that this structure is largely compatible with the principles of Islamic finance as the main idea. It is known that Islam adopts transparency, openness, trust and direct communication in people-to-people relations. Elements such as helping those in difficulty, unity and solidarity, social assistance, entrepreneurship and trade, and more communication are the issues that Islam emphasizes its importance. When the starting point of crowdfunding is examined, it is seen that these concepts are emphasized.

It would not be wrong to say that the principles of Islamic finance and the crowdfunding method are in harmony at many points. Fair distribution of benefits and obligations between the parties in any financial transaction, concepts of ethical and social responsibility, transparency, mutual responsibility and trust sharing, spreading wealth to the public and directing capital to real economic activities are both Islamic finance principles and basic features of crowdfunding finance.

When crowdfunding models and Islamic finance methods are compared, it can be said that all four types of crowdfunding models do not constitute a fundamental contradiction to Islamic finance methods and that contracts in Islamic law can be adapted to crowdfunding financing. The only exception is the option of borrowing with interest, which is a subtype of the debt-based crowdfunding model. If debt-based crowdfunding is based on Mudarabah or Murabaha instead of interest, this model is also compatible with the principles of Islamic finance.

The fact that crowdfunding models are compatible with the principles of Islamic finance does not mean that every project financed by crowdfunding is a project that complies with the principles of Islamic finance. Just as participation banks require that the product to be purchased with a loan is a product that will not contradict the principles of Islamic finance or that the activities of the company to be financed must comply with the principles of Islamic finance, the products in question of crowdfunding or the fields of activity of entrepreneurs must also comply with the principles of Islamic finance. Participation banks should form a committee to control the projects by setting some criteria to ensure compliance with these principles and to prevent any uncertainty about the project. These criteria can be listed as follows:

- I. Invested project must raise capital for activities that comply with Islamic principles.
- II. The project should be free of interest, gambling and speculation.
- III. The presence of a committee that supervises the compliance of the projects with the Islamic financing criteria is required and capital collection process should begin after the approval of the committee's examination.

Depending on the moral and economic values of Islam, Islamic finance aims to have a financial mechanism that develops and further empowers individuals and societies. Islamic finance encourages the financing of impact-driven real economic activities by offering an alternative and ethical method of financing. However, when the current situation of Islamic finance is examined in terms of its contribution to the real economy, its encouragement of entrepreneurship and market share, it is seen that it is far behind conventional finance. The market share of participation banks, which are the most prominent actors of Islamic finance in Turkey, is around 5%. Considering that crowdfunding financing aims to support the real economy, increases entrepreneurship, supports development and is compatible with the emerging market in the world and basically with the principles of Islamic finance, it is considered to be a great opportunity for the growth of Islamic finance and the increasing the Islamic finance market share. Considering that the main actors of the Islamic finance ecosystem in Turkey are participation banks, the adoption and implementation of the crowdfunding method by participation banks will contribute to the growth of the Islamic finance ecosystem in Turkey.

Although participation banks do not currently offer crowdfunding financing, they have similar practices with the products they currently have and the activities they carry out to crowdfunding financing both in terms of purpose and product. Islamic finance products such as Murabaha, Leasing, Mudarabah, Tawarruq, Karz-ı Hasen and Zakat, which can be the basis of crowdfunding models in terms of Islamic financing products, are the fulcrum of many existing products of participation banks. From this point of view, it can be said that the existing products and services of participation banks have a suitable ground for crowdfunding financing initiative.

Participation accounts, which are one of the basic deposit products offered by participation banks, have structurally similar aspects to crowdfunding. Participation accounts are deposit accounts in which the return is shared within the framework of the profit-loss partnership between the account holder and the participation banks. Investors deposit their

capital in participation accounts with certain maturities and leave the use of capital to participation banks. The funds collected by participation banks are used to finance trade, industry and service sectors in line with interest-free banking principles. The profit or loss obtained from these financings is shared between the bank and the account holders at the rate of sharing agreed when opening the account.

Mudarabah, which is the basis of the participation accounts in terms of Islamic financing, is a labor-capital partnership. It is a type of partnership based on the principle of sharing the profit obtained by one side putting in capital and the other side putting in labor and undertaking the operation. When equity-based crowdfunding model is compared with participation accounts, it can be said that both models have the aim of collecting capital from a large number of investors and depositors and sharing the income obtained with the capital owners as a result of transferring these capitals as financing to various projects. Therefore, it can be said that both participation accounts and equity-based crowdfunding have similar characteristics.

Entrepreneurship centers (incubation centers) established by participation banks in order to support entrepreneurship, to pave the way for technological ideas and projects and thus to support the real economy have a common purpose with crowdfunding financing. Almost all participation banks have implemented entrepreneurship centers or programs that support entrepreneurship. Lonca Giriřimcilik Merkezi established by Kuveyt Türk, Albaraka Garage established by Albaraka Türk, Pusula program implemented by Emlak Katılım, and the Ticaret Kuluçka program carried out by Vakıf Katılım are some of the activities and programs carried out to support entrepreneurship.

Venture capital investment funds, which are established by participation banks and operated in accordance with the principles of Islamic finance, have a similar purpose to crowdfunding financing. VCIF; *“The fund is an asset which does not have a legal entity, established under fund rules with limited term, by portfolio management companies and, real estate and venture capital portfolio management companies which hold an operating license received from the Board in order to manage the portfolios comprised of assets and transactions specified in the third paragraph, with money and/or capital stocks collected from qualified investors in return for fund units, in accordance with fiduciary ownership principles and pursuant to the provisions of the Law”*. While participation banks support entrepreneurs with

their entrepreneurship programs, they establish VCIFs to facilitate entrepreneurs' access to capital and to enable investors to fund these initiatives.

Facilitating entrepreneurs' access to capital and supporting entrepreneurs through the entrepreneurship programs offered by participation banks is one of the main objectives of crowdfunding financing. Encouraging VCIFs and investors to support entrepreneurs is again one of the main elements of crowdfunding financing. For this reason, it can be said that the entrepreneurship programs and VCIFs carried out by participation banks in order to support entrepreneurship and contribute more to the real economy are very similar in terms of purpose with the crowdfunding financing model.

Apart from the important reasons for participation banks to use the crowdfunding model, such as supporting the real economy by increasing entrepreneurship, increasing the economic welfare and technological development of the society and increasing the market share of the Islamic economy by doing so, there are other reasons that will encourage participation banks to crowdfund. Banking is facing a serious change today. With the rapidly changing and developing technology, banks are faced with issues such as increasing service quality, reaching new customers, adapting to financial technologies, digitalizing, reaching customers through digital channels besides physical channels, maintaining 24/7 services with artificial intelligence and robotics without interruption and therefore, banks are constantly trying to improve themselves in these areas. Crowdfunding financing is an internet-based financing in terms of its structure and has the potential to contribute to the development areas of participation banks with the features it contains.

While the importance of branches and other physical channels is beginning to decrease for participation banks, the importance of digital channels is increasing. Developed banks worldwide closed 9% of their branches in 2021. It is expected that in the coming years, banks will give more importance to digitalization and transfer all products and services they offer from physical channels to digital channels and use digital marketing effectively. Crowdfunding includes many elements that banks consider in terms of digital transformation processes. Factors such as the product being fully digital, the fact that information and developments related to the product are accessible 24/7 thanks to the online platform in terms of customer experience, and that this information can be updated regularly, visual content and messages can be presented through CFP, will provide significant returns for participation banks trying to digitize their products.

The concept of fintech, which is derived from the combination of the words 'Financial' and 'Technology', has become one of the most important phenomena of participation banks. The point where technology has come is making banks increasingly open up options beyond basic banking services to maximize the benefits which customers derive from their banks. The concept of open banking with fintechs has also been a result of these technological developments. With open banking, third-party providers help customers and banks save costs, exchange services more easily, and run payment systems seamlessly. With Covid-19, the fintech usage rates of both consumers and businesses have increased significantly. With the help of the technology brought by fintechs, the funds can be channeled with a decentralized method and both parties can act under the same conditions. One of the rising stars of the peer-to-peer financing model, which is a successful alternative to the current financial system, has been crowdfunding. Crowdfunding successfully fulfills the function of providing fast and direct funding expected from fintechs with its debt, equity, donation and reward based models and is therefore a type of financing that participation banks can use as an example of a successful fintech under their brands.

With fintechs, increasing payment systems services and new financing options have started to create potential competitors for participation banks and it is estimated that the market will be more competitive in the coming years with the establishment of digital participation banks. The fact that emerging technology companies, especially in the fields of payment systems, reach millions of customers in a short time with fintechs also poses a threat to participation banks. For this reason, concepts such as customer numbers and active customer numbers have become one of the most followed metrics by banks. Crowdfunding, which is an easily accessible and widely appealing fintech, creates important opportunities for participation banks in two points for the number of customers and customer promotion concepts. The first opportunity is that participation banks will be in an even stronger position in the competition to acquire new customers by reaching the customer base that they could not reach before thanks to crowdfunding financing. Crowdfunding will not only mean gaining new customers for participation banks but will also provide an important gain in terms of deepening relationships with existing customers and attracting customers with wide investment appetite.

Another factor encouraging participation banks to use crowdfunding financing is the high digital inclination of bank users in Turkey. When the "Digital, Internet and Mobile Banking Statistics" report published periodically by the TBB is examined, it is seen that the total number of active digital banking customers (individual and corporate) reached 80 million

927 thousand people in the January-March 2022 period. While this figure was 35 million in 2017, it has reached 81 million as of March 2022. This significant increase shows that bank users have a high susceptibility to digital channels. The fact that crowdfunding financing is also a completely digital financing product increases the importance of the digital susceptibility of the audience to be presented. The fact that the digital inclination of bank users in Turkey is already high is an incentive to offer crowdfunding financing to this audience.

The fact that the crowdfunding volume has reached only 20 million TL in Turkey as the end of 2017, which has reached 115 billion dollars worldwide in 2020, is not a deterrent factor, but on the contrary, it is another encouraging factor. With the right marketing and infrastructure, participation banks can have a significant share in the market size that will grow in Turkey. Especially in these days of high inflation and the fact that banks do not want to extend long-term loans, crowdfunding platforms can do the same in Turkey as the explosion in crowdfunding demand in America in 2008. The platform that participation banks will create and manage crowdfunding financing, which is still in its infancy in Turkey, will turn their existing customers into direct potential investors. In addition, for investors and entrepreneurs who are not bank customers, having a bank behind the platform will create a direct trust element and encourage the crowds to use the platform. When we consider factors such as the increase in the awareness of crowdfunding, people's predisposition to use digital channels, the fact that legal regulations have been made and large companies are establishing crowdfunding platforms, it will not be difficult to predict that the crowdfunding market in Turkey will gain serious momentum in the coming years and participation banks should not miss this opportunity to increase their market share against conventional banks.

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