

Crowdfunding: A Study of Present Creative Trends and Institutional Reaction

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Abstract

Crowdfunding is a global phenomenon that consists of raising collective funding for projects. Since its recent emergence, crowdfunding has rapidly gained popularity. Although crowdfunding makes it possible to finance a range of projects and companies, many countries have been reluctant to incorporate crowdfunding into their legal systems and have failed to establish specific legislation to encourage its use and thereby stimulate economies in crisis. This article provides an overview of crowdfunding, analyzing its origins, status, and supporting legislation enacted in some countries.

Key words: crowdfunding; crowdsourcing; equity; law; reward

JEL classification: D00; G00; Z00

1. Introduction

In the past, the Catholic Church denounced usury and thereby created savings banks and pawnbroking so that disadvantaged people could access small amounts of money that they would later return. Current examples of such institutions are Cajasur, formerly the Savings Bank and Monte de Piedad of Córdoba.

The Franciscans established the first pawnbrokers in Italy in the fifteenth century. In Spain, such institutions were common, the oldest being those of Dueñas, Toledo, and Madrid, which later became Bankia. Several financial crises during the twentieth century, most notably the Great Depression of 1929 and the oil crisis of 1973, led to re-examination of economic and social models. Similarly, Christian intellectuals have raised concerns about growing inequality and poverty driven by the present recession. Today, the internet enables the use of new financing models,

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which can help those most in need and those seeking to start a career.

This paper addresses the concept of crowdfunding, a novel alternative to traditional financing models that can provide funding for projects. We first define the concept of crowdsourcing and several crowdsourcing models, of which crowdfunding is one of the most representative. We then define crowdfunding in depth, considering the models and types of platform that exist today. Next, we discuss the legal framework in crowdfunding, reviewing international laws that provide a legal basis for such projects. We also investigate the situation in Spain, and, given the absence of specific legislation, discuss alternative laws that support crowdfunding. Following this analysis, we conclude by suggesting next steps.

2. Crowdsourcing

The first step to addressing crowdfunding is to define its parent concept: crowdsourcing. The American journalist Jeff Howe coined the term crowdsourcing in 2006. Howe (2006) defined it as “the act of a company or institution taking a function once performed by employees and outsourcing it to an undefined (and generally large) network of people in the form of an open call.”

Following Howe, others have defined crowdsourcing in terms of a range of parameters. Some have focused on the use of crowdsourcing to solve problems (Brabham, 2008; Vukovik, 2009), whereas others have conceived it as a way to outsource tasks (Oliveira et al., 2010). Regardless of their approach, most authors stress that all initiatives must have at least two elements: an indefinite, heterogeneous crowd (Geerts, 2009; Schenk and Guittard, 2009) and an open call to everyone (Pénin, 2008; Burger-Helmchen and Péning, 2010). Estellés-Arolas and González-Ladrón-de-Guevara (2012a) unified 40 definitions in a single, broad, detailed definition.

Importantly, crowdsourcing occurs exclusively over the internet via platforms and applications that enable thousands of users to connect, share information, and solve problems collaboratively (Burger-Helmech and Péning, 2010). Thus, tasks performed by collaborators may range from cataloguing documents to innovation or designing a process or product (Estellés-Arolas and González-Ladrón-de-Guevara, 2012b). Crowdsourcing has capitalized on this massive cooperation thanks to new technologies and social networks, which are the main tools used to disseminate such ideas in a multitude of interesting ways.

3. Models of Crowdsourcing

There are five crowdsourcing models. The choice of crowdsourcing model depends on the task carried out by the crowd. Each model has its own characteristics but all five belong to the same framework. Different models of crowdfunding, defined in the next section, also exist.

The five types are crowdopinion, crowdcasting, crowdcontent, crowdcollaboration, and crowdfunding.

1. Crowdpinion gauges the opinion of individual users on a topic or product, rewarding them in return.
2. Crowdcasting is where an individual, company, or organization sets the crowd a problem or task, rewarding the contributor who resolves the problem first or best.
3. Crowdcontent means launching an open call asking people to provide labor and knowledge, to create something or find solutions to a given problem (Doan et al., 2011). Specific types include crowdproduction (to produce content), crowdsearching (to search for content on the internet), and crowdanalyzing (to analyze and search for information in documents).
4. Crowdcollaboration is where initiatives in collaborative communication occur among individuals in the crowd, while the main business of the process is relatively unaffected. The two subtypes are crowdstorming (online collaborative brainstorming) and crowdsupport (where customers solve problems or questions).
5. Crowdfunding refers to collective cooperation to raise money for projects. This type of funding has many uses. Through crowdfunding, artists can seek fan support to finance their work, young companies or small businesses can raise startup capital, and public institutions can obtain funding.

4. Crowdfunding

4.1 Concept

Crowdfunding is a system of cooperation that lets a project initiator (professional or amateur) raise money from many contributors. In exchange for their participation in the project, these contributors receive rewards, which range from acknowledgments on the project's website to pre-purchasing goods or services at a discount before market launch. Rewards can also include monetary incentives in the form of cash, interest, or recovery of initial investment. By providing the same function as the financial markets, crowdfunding platforms act as direct mechanisms to efficiently channel micro-investments, and redistribute resources under the principle of cooperation (Felber, 2012). Three essential elements make a crowdfunding project:

- A project initiator seeking funds.
- A crowd of potential contributors to provide funds.
- A technology platform.

If a crowdfunding project launches a request for funding but fails to reach its goals, most platforms return the money to contributors, and the initiator receives nothing (this is an all-or-nothing model). This is a safety mechanism known as a pledge. On a few platforms, however, entrepreneurs receive all contributions regardless of whether or not they achieve their goals.

With an appropriate technological design, platforms do not just let

crowdfunding projects access mass financing, but also actually allow projects to benefit from the creation of a “community” to strengthen the innovation cycle, loyalty, and decision making. Crowdfunding has thus developed a distinct profile to that of traditional financing channels. If it were a mere electronic replica of the institutional system, crowdfunding would perish as soon as the world economy regained confidence in the institutional lending markets. Crowdfunding in all its forms enables entrepreneurs to identify new ideas, test pilot projects, perform market research for product launches, gather feedback for innovation and improvement through customer reviews and recommendations, foster loyalty and customer management, customize products, design advertising campaigns, and, of course, raise funds. Ultimately, crowdfunding promotes an environment of collective decision-making based on the technical and operational infrastructure of social networks and peer-to-peer systems.

4.2 Crowdfunding Worldwide

This section uses data relating to platforms and rates of successful projects to explain the current state of crowdfunding around the world. Data were generated in 2012, compiled during 2013, and subsequently published by the website Massolution. North America generated the most money from crowdfunding projects in 2012. North America generated 1,606 million USD and Europe 945 million USD. Despite the large difference between North America and Europe, they remain far ahead of other continents: Oceania (76 million USD), Asia (33 million USD), South America (0.8 million USD), and Africa (0.1 million USD).

Table 1. Global Crowdfunding Volume Reaches 2.7 Billion USD in 2012

Total funds raised from crowdfunding in 2012 (million USD)	
North America	1,606
Europe	945
Oceania	76
Asia	33
South America	0.8
Africa	0.1
2010: 0.90 billion USD; 2011: 1.48 billion USD; 2012: 2.67 billion USD	

Source: Massolution.

In 2012, crowdfunding raised 2.67 billion USD worldwide, thereby showing tremendous growth from 2011 (1.48 billion USD) and 2010 (0.90 billion USD) figures. The website massolution.com created a ranking of countries with the most platforms dedicated to crowdfunding. The US leads the ranking with 138 sites, far ahead of other countries; the second country, the UK, has only 32. In comparison to the rest of Europe, Spain is in a strong position, ranking fifth with 13 platforms in 2012.

Table 2. Number and Location of Crowdfunding Platforms

United States	138
United Kingdom	32
Netherlands	24
France	22
Brazil	21
Germany	16
Spain	13
Canada	12
Australia	7
Switzerland	4
Sweden	3
Poland	3
Italy	3
Portugal	3
Japan	3
New Zealand	3

Source: Massolution.

Significantly, according to 2012 data from Massolution, platforms for charitable and social causes were most numerous, constituting 27.4% of the total. Business and entrepreneurship projects were in second place with 16.9%, followed by projects relating to film (11.9%); music (7.5%); energy and the environment (5.9%); fashion (5.5%); art (4.8%); information and communication technology (4.8%); journalism, literature, photography and advertising (3.5%); and science and technology (3.2%).

Table 3. Crowdfunding Platform Activity across the 10 Most Active Categories

Social causes	27.4 %
Business and entrepreneurship	16.9 %
Film and performing arts	11.9 %
Music and recording arts	7.5 %
Energy and environment	5.9 %
Fashion	5.5 %
Art (general)	4.8 %
Information and communication technology	4.8 %
Journalism, books, photography, and publishing arts	3.5 %
Science and technology	3.2 %

Source: Massolution.

4.3 Crowdfunding Models

Four types of crowdfunding models exist according to demand or offer of the

project (Estellés-Arolas, 2013).

4.3.1 Equity-Based Crowdfunding

Equity-based crowdfunding relies on capital participation from individuals or companies that form the crowd. These individuals or companies seek a return in the form of profits, income, or shares. The contribution is a capital injection, with the contributor becoming a contributing partner or shareholder in the project. The contributor thereby earns the right to participate under legal and statutory conditions, and he or she benefits from company profits or proceeds from the project. There are two equity-based crowdfunding models: the securities model and the collective investment scheme (CIS) model. In the securities model, the contributor receives shares in the capital and rights as a partner in exchange for contributing. In the CIS model, contribution in the project entitles the contributor to a share in the profits, although he or she does not become a partner (UKIE Crowd Funding Report: A Proposal to Facilitate Crowd Funding in the UK, February 2012, p. 2).

4.3.2 Lending Crowdfunding

Under the lending model, contributors lend money that the project will repay at the relevant rate of interest. This form of crowdfunding has different formats depending on the intermediary's role (crowdfunding platform manager) and the conditions of the loans. Lending crowdfunding may be such that the platform manager acts as a true intermediary, collecting contributions from lenders, attracting repayable funds, and ensuring the repayment of loans under certain conditions. Receiving funding for a project has important regulatory consequences because financial institutions are constantly under strict supervision. In contrast, lending crowdfunding may be structured as a simple platform for direct interaction between lenders and borrowers. In this interaction, the intermediary (matchmaker) simply provides users with access to and use of this electronic platform to exchange information, identify common interests, aggregate and centralize relationships, and negotiate and close transactions. This action differs from traditional regulated market platforms and therefore minimizes regulatory and supervisory considerations.

4.3.3 Reward-Based Crowdfunding

Reward-based crowdfunding is the most common crowdfunding model. As previously explained, under this model, an entrepreneur or creator proposes a project, setting a subscriber status hierarchy based on the amount of aid offered by crowd members, with rewards being set accordingly. In reward-based crowdfunding, the consideration should not be financial. Commonly, however, certain platforms offer a combination of funding arrangements granting such subscriber status. Thus, lower status subscribers' contributions are reward based, while those from higher status subscribers may become equity based or even debt based on the middle and upper levels. Within this category, at least two types of reward-based crowdfunding exist

depending on the relationship between the contribution amount and the relative reward value. In the first model, minor contributions to the project are acknowledged by a symbolic reward usually worth less than the contribution. In the second model, the contribution, which the contributor pays up front, matches the price of the product or service. In the second model the relationship between contributor and project initiator constitutes a contract of sale, construction, or provision of services in which the subscriber advances payment of the price agreed so that the initiator obtains funds required for the activity. This is what one might call “presale.”

4.3.4 Donation Crowdfunding

The final model is the donation model. Under the donation model, the entrepreneur requests a sum to carry out a project, and the crowd altruistically provides financial support. This crowdfunding model raises funds for social projects, and therefore relies on user contributions in the form of grants to support non-profit social projects led by organizations (usually NGOs), associations, or individuals. The platform provides information on the status of the project; the potential for interaction between users, developers, and project beneficiaries; and opportunities for real-time monitoring.

4.4 Crowdfunding Platforms

Three crowdfunding platform models exist.

4.4.1 Open Platform Projects

The most common model, open platform projects, lets initiators describe their projects and provides potential contributors with information about these projects’ needs and goals. After presenting this information, initiators openly appeal for funding through direct, visible, public donations. Initiators and contributors then agree on future profit, merchandising, and visibility once the project is complete. Funds thus flow directly to initiators without intermediaries, unless the platform takes a commission.

This system mitigates market risks, presenting projects to investors and analyzing social reactions to these projects before they are carried out. If a project is poorly received, it means the investment is too risky. These platforms replace the figure of the intermediary and act as strong partners for some projects. The website Kickstarter exemplifies this type of platform. Kickstarter currently hosts an average of 3,000 active projects per month. Since its launch, Kickstarter has already welcomed more than 128,000 projects that have collectively raised around 940 million USD. (Just 8,105 of these projects have raised 203 million USD.) The success rate of projects launched on Kickstarter exceeds 43%. More than 5,400,000 contributors have provided an average of 25 USD per project. Nevertheless, for some projects the average figure is around 70 USD because of the disparity between projects’ funding needs.

Table 4.

Category	Launched Projects	Total Dollars	Successful Dollars	Unsuccessful Dollars	Live Dollars	Live Projects	Success Rate
All	128,622	\$ 940 M	\$ 813 M	\$ 111 M	\$ 16 M	3,052	43,67 %
Games	8,105	\$ 202,63 M	\$ 180,41 M	\$ 20,26 M	\$ 1,95 M	254	35,03 %
Film & Video	32,180	\$ 189,22 M	\$ 157,39 M	\$ 29,50 M	\$ 2,34 M	589	39,81 %
Design	6,388	\$ 134,61 M	\$ 116,62 M	\$ 14,16 M	\$ 3,82 M	276	38,51 %
Technology	3,510	\$ 107,77 M	\$ 92,00 M	\$ 11,90 M	\$ 3,88 M	160	34,84 %
Music	26,833	\$ 100,35 M	\$ 90,82 M	\$ 8,52 M	\$ 1,01 M	505	55,24 %
Publishing	15,516	\$ 45,50 M	\$ 38,12 M	\$ 6,76 M	\$ 619,050	389	32,45 %
Food	5,084	\$ 35,50 M	\$ 29,28 M	\$ 5,64 M	\$ 582,610	166	40,50 %
Art	11,467	\$ 33,51 M	\$ 28,86 M	\$ 4,27 M	\$ 378,850	259	48,30 %
Fashion	4,988	\$ 27,09 M	\$ 22,94 M	\$ 3,44 M	\$ 709,210	201	29,56 %
Comics	3,485	\$ 24,26 M	\$ 22,23 M	\$ 1,87 M	\$ 169,690	63	49,01 %
Theater	5,459	\$ 21,58 M	\$ 18,99 M	\$ 2,33 M	\$ 256,280	79	64,39 %
Photography	3,937	\$ 12,37 M	\$ 10,44 M	\$ 1,74 M	\$ 194,400	86	36,69 %
Dance	1,670	\$ 2,57 M	\$ 5,16 M	\$ 349,000	\$ 53,985	25	70,76 %

Source: Kickstarter

4.4.2 Direct Crowdfunding Projects

In such projects, entrepreneurs create their own platforms for donations. Riot Cinema, a crowdfunding platform conceived in Spain, exemplifies this model. Riot Cinema's strength lies in obtaining funding for films through contributions from individuals who access projects through the Riot Cinema website. Riot Cinema thereby involves many people in the production of promotional material in exchange for private screenings, recognition, gifts and merchandising materials, returns, or copies of the final film itself. This model creates a direct link between audience and producers, who collaborate directly to carry out the project.

4.4.3 Crowdfunding of Ongoing Projects

Finally, crowdfunding of ongoing projects offers a lifeline to existing projects such as web pages, blogs, or cultural projects. The Flattr platform, a donation system based on users' votes regarding websites users deem worthy of funding, exemplifies this model. Users open an account from which they authorize a periodic donation to all projects that receive clicks on Flattr. Software developers, bloggers, writers, composers, and other creators may thus continue working because users visiting their sites provide them with some of the funds they need.

5. Crowdfunding Legislation

Current crowdfunding models in Spain must comply with the legal framework regarding the online environment and the crowdsourcing phenomenon. This section analyzes the current crowdfunding legal framework. This framework is based on general laws because of the absence of specific regulations such as the US JOBS Act. Nonetheless, the new Law on Entrepreneurs and Patronage addresses the issue to provide a legal and tax framework. The analysis begins with a brief discussion of laws in the United States and Italy. Next, we discuss the current Spanish legislation that governs crowdfunding. We then highlight the need for explicit crowdfunding legislation.

5.1 US Legislation

On April 5, 2012, US President Barack Obama signed the Jumpstart Our Business Startups Act, commonly known as the JOBS Act. The JOBS Act's main objective is to provide security and flexibility to the small-business financing market. Title III of the JOBS Act deals with crowdfunding, therein referred to as capital raising online. Title III of the JOBS Act establishes a special waiver from compliance with certain requirements for market access to small private companies. This waiver limits funds to 1,000,000 USD and imposes additional limitations on investors, thereby offering the protection that investors would otherwise forgo by failing to comply with the requirements of the Securities Act (U.S. GPO, 2012). The final draft of Title III remains incomplete, and the legislative chambers have yet to approve it. The purpose of Title III is to lighten the regulatory burden in crowdfunding with respect to that required in traditional regulated market platforms (called portal funding) while protecting investors' general interests and rights. Title III thus ensures the registration of managers on the platform as intermediaries and the fulfillment of certain conditions, such as reporting requirements, establishing prohibitions, capping the public offering amount, and protecting data (Rodríguez De Las Heras Ballell, 2013). The final legislative text for enactment, however, will depend on the regulation the Securities Exchange Commission must provide within the legally established term (December 31, 2012).

5.2 Italian Legislation

Published on June 26, 2013, the Italian regulation on *Raccolta di capitalization di rischio da parte di imprese start-up innovative processed portali online* (CONSOB, 2013) offers tax support for crowdfunding. This legislation is one of the benchmarks in Europe because it covers many areas missing from other laws. As Title III of the JOBS Act has not yet been approved, Italy has become the first country in the world to enact a law that specifically regulates such activities.

The CONSOB Circular strengthens the previously consolidated Finance Act, a series of articles that regulate "portals that manage fundraising for innovative start-ups." The main principle governing equity-based crowdfunding is that it addresses the existence of business potential and the need to raise venture capital online. The public offering to subscribe is covered by a large number of small

investments.

The Circular, drafted in 25 articles, is divided into three parts dealing with provisions, registration and regulation of portal managers, and mechanisms to make offerings via the portals. The Circular also defines a set of general obligations that relate to the conduct of authorized operators (diligence, fairness, and transparency), conflicts of interest, the equal treatment of beneficiaries, and integrity of information (accurate, current, clear, and not misleading). These general obligations help investors understand the nature of the investment and make informed decisions, also including the right to withdrawal from the transaction within the first seven days (Article 13).

5.3 Spanish Legislation

As of January 2014, the Spanish legislative framework still contains no explicit law to support and protect crowdfunding operations. Although existing Spanish laws govern crowdfunding, these laws are old and fail to make the necessary provisions for crowdfunding to grow, unlike in other countries such as the US. Thus, donation and presale models fall within the legal and fiscal remit of laws on patronage, estate, and gift tax.

5.3.1 Donations

Collective funding in its present guise involves thousands of donations to a person, group, or institution. According to Article 618 of the Spanish Civil Code, a donation is “an act of liberality under which one person transfers one good free of charge in favor of another person, who accepts it.” Hence, donations involving numerous acts of crowdfunding are legal acts regulated by the Spanish Civil Code. The donor is only bound by the donation agreement once the initiator has accepted the donation. Conditions may be imposed on the donor; for example, the condition that the funds only be delivered when a specific funding target has been reached is valid. However, these conditions are not imposed directly by donors, but rather by the crowdfunding platforms.

5.3.2 Donations with Presale or Reward

Donations with presale or reward refer to cases where the contributor’s donation may yield a reward if the project is successful. This reward may vary. Rewards include recognition for having contributed to the project, merchandising or apparel, concert tickets, CDs, DVDs, and other digital media.

In some cases (e.g., music, CDs, and DVDs), rewards can be regarded as purchases. Such cases constitute an exchange of goods for money, so delivery of the reward is subject to value added tax and either the recipient of the funds or the crowdfunding platform must issue an invoice. If the exchange involves money in return for a professional or business activity, the recipient of funds (i.e., the initiator) must comply with employment tax, commercial, and other regulatory obligations.

5.3.3 Laws to Support Crowdfunding Models

The Patronage Act (Ley de Mecenazgo) encourages crowdfunding initiatives and promotes participation from society to defend artistic heritage in two ways: first by increasing tax incentives for patronage and second by improving the taxation of non-profit entities.

Article 17 recognizes sponsorship as donations, grants, and contributions made on behalf of entities referred to in Article 16, including non-profit entities affected by the fiscal regime in Title II of this law.

Articles 25 to 27 of Law 49/2002 indicate other forms of patronage: business cooperation agreements, general activities, expenditures for general activities, and support programs for events of exceptional public interest.

We first examine deductions for donations and donors. To determine tax deductions, referring to the law of patronage is insufficient. Instead, the relevant legislation is the specific tax legislation stipulated by the Income Tax Act and the Corporation Tax Act, depending on which applies to the donor. Both of these acts and the Patronage Act govern deductions that apply to the income of natural and legal persons who have made donations. Furthermore, inheritance and gift tax laws state that, in addition to obligations relating to the hereditary succession of goods (i.e., inheritance tax), if donations or gifts exceed a certain amount, recipients must pay the state a share. This is referred to as tax donations. The Patronage Act regulates donations and sponsorship law, which we discuss later. Technically, a direct, personal, subjective, progressive tax is levied on individuals' capital gains. Acquisition of property and rights is done by gift or by any other legal business free of charge (i.e., receiving nothing in return) and *inter vivos*. Finally, receipt of money by the beneficiaries of life insurance contracts occurs when the contractor is a different person from the beneficiary. Taxpayers of the associated tax are heirs to the recipient of donations and other revenue transfers *inter vivos*. Thus, this tax directly affects donations and other lucrative transmissions *inter vivos*, for the net value of the property and acquired rights, which equate to the real value of assets and rights less charges and deductible expenses.

The final piece of legislation discussed in this section is the Entrepreneurship Act, which affects anyone who wants to start a business project through crowdfunding. Initially, the Entrepreneurship Act was expected to provide legislation to regulate equity crowdfunding. Ultimately, however, the term crowdfunding does not appear in the Entrepreneurship Act, which in no way legislates for crowdfunding.

6. Future Alternatives

Potentially, crowdfunding could be used to finance almost any kind of project. In our case, for example, in the Catholic University of Valencia, crowdfunding could be used to finance the Center for Bioethics, located in the Science, Culture, and Life Foundation. For Christians and non-Christians alike, crowdfunding would offer a

more suitable way of advocating an intellectual approach to human life based on scientific, philosophical, and anthropological concepts. This application would build a positive, promising fusion between science, thought, and funding 2.0.

Donation-based crowdfunding could raise charity funds through activities organized by the Center for Bioethics, thereby ensuring support. Furthermore, using reward-based crowdfunding, the Center for Bioethics could offer rewards in exchange for money. Any existing platform or a new platform, as in the case of Riot Cinema, would be suitable for this purpose.

Many other examples could be given, such as an online network for street artists that could be used to fund a major multi-disciplinary urban art festival, implemented through creation-specific rewards, sponsorship of the festival, or exclusive tickets to attend.

To sum up, the aim of all such hypotheses is, through crowdfunding, to be able to encourage creative ideas and attitudes that favor initiatives able to help society at large and, specifically, the most needy.

7. Conclusions

As data in this article show, crowdfunding is booming, and is expected grow. Indeed, in 2012 crowdfunding raised 2.7 billion USD worldwide (Esposti, 2013). Nevertheless, crowdfunding has much room for improvement, which could pave the way for future studies.

Because of crowdfunding's global nature, a cross-country comparative study of crowdfunding legislation is necessary, especially given how much fiscal policies differ between countries. In addition, studying the positive economic impact and growth of crowdfunding on individual, business, and social levels is necessary. Such a study may raise crowdfunding's profile in countries like Spain, leading to laws that support individuals (e.g., via tax incentives, tax cuts, and other financial benefits), crowdfunding platforms, entrepreneurs, and, of course, the crowd.

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