CHAPTER 1. CONSIDERATIONS ON THE RELATIONSHIP BETWEEN CROWDFUNDING AND ETHICAL FINANCE: THE SOCIAL VALUE AS A SUSTAINABLE GROWTH DRIVER FOR THE ENTERPRISE

Ubaldo Comite[1]

Abstract

The enterprise can be considered as a financial organization that, through the employment of a differentiated range of resources, conducts processes of acquisition and production of goods and/or services to be exchanged with external entities for the purpose of generating income. In the differentiated range of resources the enterprise draws from in order to conduct its productive processes, a primary production factor is the financial capital. It reaches the enterprise through several sources ascribable, depending on the position occupied by the financing subject, to two macro categories: 1) equity capital and 2) debt capital. Compared to the past, the capital offer has been the object of a strong diversification both on a quality and on a quantity level. It is therefore mandatory for enterprises, in order to increase the possibility of success in finding resources, to gain a full knowledge of the various types of actors that may lead the company to correctly select the right interlocutor on the basis of its needs. The composition of the financial structure will be strongly influenced by the stage of the company's cycle, by its environment of reference, by the interlocutors that make themselves visible in the capital market and by the objectives it sets for itself. This work shows how it is not possible to identify an ideal financial structure; it is possible, instead, to affirm that, according to the stage of the cycle of the company object of evaluation and its peculiarities, it is possible to imagine a naturally optimal, or otherwise adequate financial structure.

The enterprise can be considered as a financial organization that, through the employment of a differentiated range of resources, conducts processes of acquisition and production of goods and/or services to be exchanged with external entities for the purpose of generating income. In the differentiated range of resources the enterprise draws from in order to conduct its productive processes, a primary production factor is the financial capital. It reaches the enterprise through several sources ascribable, depending on the position occupied by the financing subject, to two macro categories: 1) equity capital and 2) debt capital[2].

Equity capital represents the capital consistently invested in the enterprise activity; it is the sum of the provisions generated by the subjects who directly participate in the business risk, such as the entrepreneur and the associates. It is a form of capital employment that, by nature, compared to other financier types, benefits from a possible and postponed remuneration, since it is designated to bear the high risk underlying the several growth options of enterprises.

Debt capital, instead, represents an external financing source, that is the amount of credit granted by third parties to the enterprise. Unlike risk capital, the remuneration of debt capital is granted by a clear agreement meant to determine the times of reimbursement and the amount of financial expenses linked to the use of bankroll.

Compared to the past, the capital offer, both in terms of debt and equity, has been the object of a strong diversification both on a quality and on a quantity level. It is therefore mandatory for enterprises, in order to increase the possibility of success in finding resources, to gain a full knowledge of the various types of actors that may lead the company to correctly select the right interlocutor on the basis of its needs.

The range of sources the company draws from, to varying extents, defines the financial structure it arms itself with in order to cover its financial requirements. The analysis of the financial architecture of an enterprise allows, therefore, to understand and evaluate the weight the single financing sources constituting liabilities and net worth assume, such weight being the result of precise strategic choices made by the enterprise in its complex.

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[1] Associate Professor of Business Management at Università Telematica "Giustino Fortunato" (Benevento).

[2] Farneti, G. (2007). *Economia d'azienda*. Milan: F. Angeli.

The composition of the financial structure will be strongly influenced by the stage of the company's cycle, by its environment of reference, by the interlocutors that make themselves visible in the capital market and by the objectives it sets for itself[3].

This said, it appears clear that it is not possible to identify an ideal financial structure; it is possible, instead, to affirm that, according to the stage of the cycle of the company object of evaluation and its peculiarities, it is possible to imagine a naturally optimal, or otherwise adequate financial structure.

In this respect, it is important to highlight how, in the last few years, the debate regarding the role of the enterprise in society, which has transversely interested all the economic currents of the last two decades, has acquired strength in light of the historic changes that have brought scholars to ever increasing conceptual efforts aimed to identify the social responsibilities of a financial organization in relation to modern boundaries of economic behavior[4]. We then enter the area of interest of Corporate Social Responsibility, defined by the World Business Council for Sustainable Development as ... continuing commitment, by business, to contribute to economic development while improving the quality of life of the workforce and their families as well as of the community and society at large [5].

The extension of the responsibilities that a financial organization is called to support derives from the awareness that the enterprise system cannot be considered as a mere aggregate of human and financial capital harmoniously mixed according to criteria of pure rationality and profitability calculations aimed at the maximization of profit[6]. Such vision leads to isolate the enterprise from the system it draws relations and competence from, allowing an unidirectional exchange based exclusively on pursuing profit and not on reciprocal cooperation aimed at the general progress. Social responsibility forces the enterprise system to undertake specific duties and commitments toward the community. The counterpoint of such duties and commitments is represented by the resources subtracted to the community itself and designed to support the production of economic value. The image of the enterprise as a public system interacting with and influencing the environment of reference, highlights a community concept of the productive system, and it is the productive function itself that is reformulated: from the creation of economic value it moves on to social and environmental (therefore, public) value[7].

In order for financial organizations to acquire a full "citizenship right" within the community of reference, it is necessary for them to adequately repay society for the environmental responsibility deriving from their production processes, as well as to respect the social responsibility related to the sharing of the economic value created by the primary stakeholders, by integrating the economic objectives with third level responsibilities, such as the responsibility toward the community, related to the efforts supported voluntarily by a financial organization in order to contribute to the well-being of the community[8].

The concept of enterprise as a social agent entails economic evaluations. The socially responsible enterprise pursues lucrative aims; however, in the prospect of *Corporate Social Responsibility* (C.S.R.), profit, normally intended as the difference between production income and expenses, is no longer the ultimate aim of the economic activity, but the means to respect social and community objectives, able to protect and enrich the context of referral and therefore, those who operate within it[9].

So, the classic dichotomy economic profit-social responsibility is evolving. The integration of ethical policies that are socially oriented in the core business represents a necessary bond to the survival of the enterprise in the medium to long term, especially in contexts, such as the modern ones, that are overly

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[3] Antoldi, F. (2004). *Conoscere l'impresa.* Milan: McGraw-Hill.

[4] … The enterprise has a global responsibility, which involves economic, social and community aspects. This global responsibility must be conducted, in any case, by granting its own survival, and therefore by accurately balancing the requests it is called to satisfy. The trade off to observe is represented by the economic balance in the short term and by the increase of social consensus in the long term.. The principles governing this double objective are those of efficiency and ethical sustainability in management. All in all, the purpose of ethics must be to distribute incentives and costs amongst all stakeholders according to the principles of honesty, fairness and justice. Sciarelli, S. (2005). *L'ampliamento della responsabilità sociale d'impresa* (the expansion of corporate social responsibility). *Italian Journal of Management, may-august*. Verona: Sinergie.

[5] The World Business Council for Sustainable Development (WBCSD, Consiglio mondiale delle imprese per uno sviluppo sostenibile) founded prior to the Earth Summit in Rio in 1992 to voice the entrepreneural sector, is a platform founded to promote enterprise sustainability (editor's note).

[6] Comite, U. (2010). Responsabilità sociale e governance di impresa: Aspetti etico – aziendali. In G. P.Calabrò (Ed.), *La responsabilità tra teoria e prassi.* Padua: Cedam.

[7] Comite, U. (2011). Etica d'impresa e decisioni del governo aziendale: il cambiamento nella conduzione del business. In Y. Sicluna, & C. Sepulveda (Eds.), *L'etica nel mercato.* Padua: Cedam.

[8] Comite, U. (2009). Etica de la empresa y estrategias empresariales. *ROTUR Revista de ocio y turismo, 2,* 107-124. Retrieved from the World Wide Web: http://hdl.handle.net/2183/7684

[9] De Nicola, M. (2008). *La responsabilità sociale dell'azienda. Strategie, processi, modelli*. Milan: F. Angeli.

competitive. It is therefore necessary to make a further effort in order to understand which are the benefits that the adoption of socially fair policies can bring to the company's productive system[10].

Giving for granted that the individualistic concept of ethics recalls the architecture of moral rules and behaviors that an individual or a group of people pursue with their actions in order not to hurt other subjects, the introduction of this concept in the business practice does not appear as being forced, but more like as an aspect of the human capital that has been underestimated to date[11]. Each unit of human capital influences and is influenced by the degree of morality that identifies the business concept in which it coexists. In other words, the creation and diffusion, from the top of the entire business structure, of moral dogmas and behaviors the company promotes outward, through the undertaking of environmental and social responsibilities, contributes to the creation of a strong reputation and a series of intangible assets that strengthen the competitive advantage[12] and the survival chances in the middle to long term.

The need to pinpoint and engulf within business policies the behavior correctly orientated toward development and social growth has been felt more consistently in the last few years, to the point of being invoked as an antidote against the continuous financial crisis undergone in the last decade, the last of which oppresses the European economies to date.

The need for stability and for restoring social and moral rules represent a fertile ground for the development of Ethical Finance, intended as the attempt of the finance world to restore a relationship of trust between the asset market and the entrepreneurial world.

Ethical finance represents the effort to return to the original function of finance, that is the equitable allocation of financial resources in time and space to the purpose of supporting a correct development of real economy in order to raise the wellbeing of the community[13].

The combination of moral values and employment of financial resources has produced a financial instrument called *Socially Responsible Investing* (S.R.I.), the offer of which is based on the assumption that private capital might intentionally create both economic profits and social impacts that are positive, or at least non-damaging to the community. The segment of ethical investment responds to a specific need, that is the possibility to contribute to the improvement of the macro environmental conditions through investments within financial organizations undertaking production, work, and commercial policies that are financially sustainable[14].

A new figure is therefore taking shape: the ethical investor, defined as the subject, a physical or legal person, that within the evaluation of investment possibilities confers remarkable importance, almost equivalent to the financial one, to the contribution that the employment of financial resources in certain activities rather than others, may generate in terms of social benefits. We are witnessing a change in direction of the traditional rules of finance, performance surrenders its role of driver to the social objective in order to become means and architecture to be implemented to the purpose of making the objective reachable and profitable.

The adoption of an ethical filter in the world of finance on a global scale has allowed the creation of the Ethical Funds of Investment, financial institutions that manage the community asset by choosing companies that meet the c.d. E.S.G. criteria (*Environmental, Social and Governance*) in order to ensure the selection of investments in companies conducting production and collateral activities with a high social impact. The magnitude of the collection highlights, both on a national and a European level, the rising of the awareness, amongst the actors in the sector, and that as well as the scope of risks and profits in their investment choices, it is important to pay attention to a third dimension as well, that is the social value produced through investment policies. The adoption of an outcome oriented outlook stems from the evidence that social growth may stimulate the development of real economy in a tangible manner, ensuring

[10] Pollifroni, M. (2012). *Lineamenti di etica aziendale*. Turin: Giappichelli.

[11] Comite, U. (2010). Responsabilità sociale e gestione etica dell'impresa tra profitto e primato della persona umana. *E- Theologos, Teheological revue of Greek Catholic Theological Faculty, 1(1),* 21-36. https://doi.org/10.2478/v10154-010-0003-9

[12] The competitive advantage of an enterprise may be defined as what constitutes the basis of the superior performances recorded by the enterprise, usually in terms of profitability compared to the average of its direct competitors in the sector of reference, in the middle to long term. For further information see: R. M. Grant, *L'analisi strategica per le decisioni aziendali*, Il Mulino, Bologna, 1999; Porter, M. E. (1985). *Competitive advantage: creating and sustaining superior performance*. New York: The Free Press.

[13] Foglio, A. (2016). *Eticonomia. La gestione etica dell'economia, dell'impresa, del mercato, del business, della finanza, dei consumi, dell'ambiente.* Milan: F. Angeli.

[14] Domini, A. (2000). *Socially responsible investing: Making a difference and making money.* New York: Dearborn Trade.

a growing stability of the results in the medium and long term, through the inception of a new generation of socially oriented entrepreneurs.

On the demand side, social impact investments respond to the desire of the community to actively contribute to the production of adequate responses to the growing complexity of social and economic needs.

On the offer side, next to tools defined as traditional, such as microcredit or mutual credit, we find C*rowdfunding* as a developing tool, offered by a growing number of intermediaries, but characterized by an operational approach not yet structured enough to precisely frame the role and weight that this new form of participatory economy may practically bring to the construction of an investment offer system that is consistent with the sustainable development of modern society[15].

Despite *Crowdfunding* represents a tool with potentialities that remain unexpressed for the main part and in which a few pioneering intermediaries in the past few years have been focusing the experimentation of the boundaries and of the possible cultural, social and economic implications the practice underlines, a few key dimensions of Crowdfunding can be observed in the foundation of Ethical Finance (Table 1).

Table 1. Comparison between the key dimensions *Crowdfunding* and ethical finance

Crowdfunding	***Ethical finance***
Democratic credit access	Fairness
Community participation	Transparency
Social approval	Social asset management
Central role of the individual	Moral and social criteria

Source: personal elaboration.

The main element contributing to the development of *Crowdfunding* is the easy access to credit, that is the tangible possibility for the proponents, be they individuals or entrepreneurial organizations, to turn to the “crowd” for the collection of funds, bypassing the traditional obstacles that start-ups have to face today whenever they turn to traditional credit channels (banks, financing businesses etc.)[16].

Crowdfunding is, therefore, a democratic credit access tool, that does not operate discriminations amongst the final recipients of the collection. This feature *recalls tout court* the first pillar of Ethical Finance: the equal distribution of the resources oriented toward human development, which realizes itself also and most of all through a different and more reasonable management of wealth.

In the analysis of the intermediaries involved in the segment of Ethical Finance, a key role in the financial intermediation conducted by such operators is covered by the concept of operational-behavioral consistency. The assessment of the validity of the offer of a financial operator compared to traditional operators is based on two criteria: the first distinguishable in the type of products offered and in the destination of the investments realized; the second in the existence, observance and sharing of a system of ethical and social values, as well as in the attention to transparency and quality of management.

The concept of transparency realizes itself, in this form of financial intermediation, in the possibility offered to the socially responsible investor to decide whether or not the employment of its own resources in a given activity is consistent with the personal idea of ethical suitability, and in the resulting possibility to be able to evaluate the decisions regarding the use of resources by verifying their real destination.

The transparency of the circuit of employment of resources represents, in the segment of Ethical Finance a necessary condition in order to establish a relationship of trust between investors and institutions[17].

The practice of *Crowdfunding* also shows the need for a relationship of trust between the proponent and the “crowd”, so that the collection of capital can be realized.

[15] *Crowdfunding* can be defined as the collective effort of many individuals that create a network and join their resources in order to sustain projects started by other people or organizations, usually through the internet. The single projects or the enterprises are financed with small contributions coming from a great number of individuals, allowing innovators, entrepreneurs and company owners to use their social network in order to gather capital. U. Comite, *Crowdfunding as a Model and Financing Instrument in Social Enterprises*, Proceedings of the 21st Eurasia Business and Economics Society Conference, *Consumer Behavior, Organizational Strategy and Financial Economics*, Mehmet Huseyin Bilgin, Hakan Danis, Ender Demir, Ugur Can (Eds.), Springer, 2018.

[16] Pavan, A. (2018). *Il crowdfunding: Cambia il tradizionale sistema del “fare impresa”.* Padua: Cedam.

[17] Ronchetti, N., & Guandalini, M. (2013). *Finanza etica, una rivoluzione silenziosa.* Pistoia: L’Atelier.

The participation of a community in sharing the values at the basis of a *Crowdfunding* campaign requires high levels of transparency and fairness, signals through which the proponent can establish a solid relationship with the "crowd", that will be nourished by the timely reporting of the modalities of employment of the capital gathered. Furthermore, the collective intelligence of the "crowd" represents a valid deterrent against ambiguous, opportunistic or phony behaviors, rewarding, instead, the proponents that are more accustomed to transparent communication. Ethical finance does not dictate a passive role of the investor, rather it offers a double possibility to identify an area of social, religious, scientific interest on which to invest, favoring the involvement, according to the tool considered, in direct mechanisms of indications of the preferences regarding the destination of the funds, or in democratic mechanisms of participation in the decision making process[18].

The diffusion of an economic democracy culture is a structural element of *Crowdfunding*.

In this respect, the legitimacy of a market subject is no longer determined by the trust a few specialized individuals have placed in it, but it is realized through a community process and an aggregate of sharing and social approval.

The ethical investment excludes economic relationships with financial entities that hinder the development of society, and therefore, of every single individual. The implementation of financial practices of moral and ethical principles entails a change in perspective, from an impersonal credit system, exclusively based on financeability criteria, to a system that sees the individual and his wellbeing as the ultimate beneficiary of the financial activities.

The will of ethical finance to bring back to the center of the economic system the needs of the community is in harmony with the centrality that the individual assumes in the practice of *Crowdfunding*. The will of the "crowd" to tangibly contribute to the realization of a project, be it of economic or social nature, is strongly influenced by the degree of geniality, creativity, sensitivity and competence shown by the proponent subject. The evaluation of the employment of resources in certain projects is guided by the degree of identification of the *crowdfunder* with a certain cause, by the possibility offered, by that particular initiative to intervene as an active part of society in the resolution or in the attenuation of complex issues, and it is therefore strengthened by the perception that the contribution offered may proactively help with the achievement of the objectives that are not limited to the sole accumulation of wealth from other subjects. The identification of strong contact points between *Crowdfunding* and the segment of socially oriented finance suggests, after a better planning of the first, that such phenomena may profitably contaminate each other by drawing from their reciprocal strengths. Leaving behind the *Donation based*[19] model, where the overlapping of the reciprocal dimensions of influence appears clear, in the practice of the *Reward based*[20] or *Equity based*[21] models there could be important benefits brought by *Crowdfunding* to the segment of Ethical finance.

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[18] Miglietta, A., & Quaglia, G. (2012). *Etica e finanza. Per un nuovo rapporto tra persona e mercato.* Assisi: Cittadella.

[19] In the *Donation based* model, the initiatives proposed mostly refers to the third sector, non-profit organizations, social entities and associations, which turn to the crowd for contributions to social or ethical causes. The donor, in this case, is essentially moved by a charitable reason. He does not receive any financial advantage from funding the cause. This model is probably the first in chronological order. Indeed, the early crowdfunding campaigns were mostly centered on cultural and social themes. The charitable and philanthropic purpose must be led back to the benefit of the donor, and not to the working modality of the platform or to the objective pursued by the proponent. Essentially, the Donation category includes all those projects that do not provide a financial gain for the donor, and consequently, the platform may operate through the withholding of intermediation charges or not, as well as the funded project might underline a non-profit objective or (editor's note)

[20] *Reward crowdfunding* is largely employed thanks to the ability to remunerate, however symbolically, the crowdfunders, though without dispersing the resources useful to the project. The rewards are never monetary and they normally have a value that is lower than the value of the donation. Despite this, they raise a high interest within the "crowd" thanks to the value that it gives to small acts of thankfulness, such as mails, personal references, and Vip tickets. The value of the rewards may moreover vary in relation to the amount donated. The choice of the rewards is solely to the discretion of the promoter. The evolution of the *Reward based* model has also led to the online development of the practice of *pre-selling* that is used to introduce into the market products or services that have not yet been realized and for the production of which it is necessary to turn to crowd funding.

The *backers*, that is, those who make a donation, obtain this way the right to receive the product/service before the official launch on the market, obviously at a discounted price. *Pre-selling* represents a tangible possibility, for innovators and small enterprises, to successfully launch a new product, testing it ahead of time with the consent of the crowd. The *Pre-selling* and pure *Reward* are often complementary and do not substitute each other. (editor's note)

[21] The *Equity based* model surely represents the more recent evolution of the practice of *Crowdfunding*; as well as the most discussed one, since it elevates the funding from the "crowd" to a way of purchasing shares of capital in startups. Through the *equity* platforms, projects with a high innovative value that stand out for their growth and survival ability may access a parallel market for the gathering of risk capital. It is the better structured Crowdfunding model, especially in relation to the connections that exist between the actors. The latter, indeed, no longer appear as mere entrepreneurs and supporters who freely choose to turn to funding from the "crowd", but it is private subject who now qualify as investors, however nonprofessional ones. (n. d r.)

The possibility offered by *Crowdfunding* to directly contact "crowds", obtaining the approval of large numbers of people and the support of a community very sensitive to certain issues, might generate a series of benefits that will be able to increase and reinforce a culture of ethically correct finance on a global level. The benefits would symmetrically invest society and the world of financial organizations. Turning to bottom-up financing would allow, by effect of social validation, a higher legitimacy on the market of reference for socially oriented enterprises, which would see the intermediation costs reduce, as well as the investment meant to build social reputation. Essentially, the mix between Ethical Finance and Crowdfunding may represent, going from a niche to mainstream phenomenon, an engine for investment in financially sustainable activities, balancing the need to consciously invest one's savings and the need, for socially oriented enterprises, to not be forced to having to favor their financial objectives, sacrificing the social ones for the survival of the system itself, considered the present difficulty of enterprises to create innovative first level (that is core business level) investment.

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