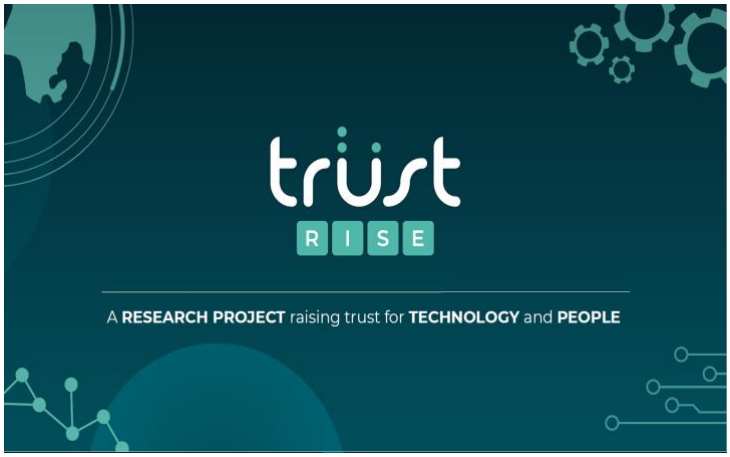

TRUST - digital TuRn in EUrope: Strengthening relational reliance through Technology

Leveraging Blockchain and Distributed Ledger Technologies: the case of crowdfunding

Policy Brief

Ido Kallir (ONO), Daniel Levinson (ONO)

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Executive Summary

Small and Medium-sized Enterprises (SMEs) are the backbone of the European economy, yet they face significant hurdles in accessing traditional finance. Concurrently, global trade is undergoing a fundamental shift, moving towards more decentralized, individual-to-individual (P2P) transactions, particularly in emerging markets. This Policy Brief argues that Blockchain Technology (BCT) and Distributed Ledger Technology (DLT) offer transformative solutions to challenges faced by firms, enhancing transparency, trust, and efficiency, as in the case of crowdfunding for EU SMEs

The Challenge

SMEs constitute 99.8% of all businesses in the European Union, providing 66% of employment. Despite their critical role, they consistently struggle to secure adequate financing, a problem exacerbated since the 2008 financial crisis. Traditional banks have become more risk-averse, leaving a substantial gap between capital supply and demand for innovative, young, and rapidly expanding small businesses.

Crowdfunding has emerged as a viable alternative, democratizing capital raising by directly connecting entrepreneurs with a broad base of investors. However, the European crowdfunding landscape remains less mature than in other major economies, with significant internal disparities. Inconsistent regulations and varying licensing requirements across EU member states impede cross-border expansion and increase compliance costs. Data from 2018 and projections for 2023 reveal that while the number of crowdfunding campaigns in the EU is growing, the average per-campaign value remains considerably lower than in the UK, indicating a continued focus on smaller-scale investments. This suggests that EU crowdfunding has yet to fully unlock its potential for substantial business financing.

The Solution

Blockchain Technology (BCT) offers a powerful solution to many of the inherent limitations of traditional crowdfunding and finance, as indicated below.

- **Enhanced Transparency and Trust:** BCT, as a shared, immutable digital ledger, eradicates trust issues between parties. Every transaction is recorded and duplicated across the network, making financial data transparent and independently verifiable. This transparency combats fraud, information asymmetry, and promotes equitable distribution of voting rights in corporate governance.
- **Smart Contracts:** Executable code on the blockchain, smart contracts automate agreement enforcement and fund dispersal based on predefined conditions. This significantly reduces administrative overhead, minimizes the need for intermediaries, and prevents unauthorized or fraudulent fund transfers.
- **Tokenization:** Fundraising event tokens are secure, transparent, traceable, and verifiable. This reduces fraud risk, boosts investor confidence, and can power project launches and fund management more efficiently.

- **Decentralization:** BCT enables start-ups to bypass traditional intermediary platforms, eliminating associated fees and rigid guidelines. This democratizes access to crowdfunding, making it accessible to a wider range of income levels and fostering a more inclusive investment environment.

By integrating BCT, crowdfunding platforms can become more secure, efficient, and trustworthy, offering a robust alternative for EU SMEs to access much-needed capital and fostering innovation.

Policy Recommendations

To fully harness the transformative potential of BCT, policymakers should consider the following indications.

1. **Harmonize EU Crowdfunding Regulations:** develop a unified legal framework across all EU member states for crowdfunding and blockchain-based financial activities. This will reduce compliance and operational costs, facilitate cross-border investments, and enable platforms to scale efficiently.
2. **Clarify Legal and Regulatory Status of Tokens and Cryptocurrencies:** provide clear legal classifications for various types of tokens and cryptocurrencies, addressing consumer and investor protection, anti-money laundering (AML) compliance, and data privacy concerns (e.g., GDPR compatibility).
3. **Foster a Supportive Ecosystem for BCT Innovation:** encourage collaboration between governments, regulatory bodies, financial institutions, and technology developers to navigate the complex legal and technological landscape. This includes supporting research and development in BCT and DLT, and creating sandboxes for testing new applications.
4. **Promote Education and Skill Development:** invest in education and training programs to equip the workforce with the necessary skills to develop, implement, and manage BCT and DLT solutions, particularly in emerging markets that can leverage these technologies for service exports.
5. **Adapt Existing Financial Laws:** eeview and adapt established financial laws and practices to align with the decentralized nature of blockchain. This may involve recognizing new forms of digital assets and transaction mechanisms.
6. **Monitor and Adapt to Evolving Trends:** continuously monitor the evolving technological and regulatory landscape of BCT and DLT, remaining agile and proactive in adapting policies to emerging challenges and opportunities. The rapid pace of innovation in this sector necessitates a flexible and responsive regulatory approach.

The data contained in this document are derived from the scientific paper: Kallir, I; Levinson, D. *BCT Crowdfunding: Is It the Bridge of Trust Required for Funding EU's SMEs*. 2024, https://doi.org/10.5430/ijfr.v15n4p25

About TRUST Project

TRUST promotes an interdisciplinary research program, involving academic and non-academic institutions, in order to understand the role of trust in the implementation of digital technologies and suggest actual means of development.
Assuming that the digital transformation of European society can be fully achieved only if technologies evolve in a trustworthy environment, the project analyses the mutual influence between trust and digital technologies in order to raise relational reliance in people-to-people, people-to-business and people-to-authorities interactions.
The attention is on blockchain technology (BCT) as one of the most relevant forms of Distributed Ledger Technology. BCT is considered a trust-building machine as it creates new forms of relational reliance. BCT projects the issue of trust in a new dimension that we intend to explore, in adherence with the initiatives and key actions promoted by the EC in the Communication "Shaping Europe's digital future" (COM (2020) 67final), where it is remarked that trust and digital transformation of society go hand-in-hand.
The research and knowledge transfer programme evolves around key topics, such as: the development of a suitable regulatory framework for the effective integration of BTC in a trust-based society; the transition towards a fair and competitive peer to peer economy; the applications of BTC in the field of AI, to assure security and trust; the development of new models of collaborative governance for smart and trust-based cities.
The consortium gathers expertise from different backgrounds (legal, economic, engineering), belonging to EU countries, as well as Israel and China. Complementary research perspectives, innovative training and international/intersectoral cooperation will boost staff careers development by studying how the use of digital technologies can shape a trustworthy European environment, in which citizens are empowered in how they act and interact, and promote economic growth as well.

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