

COMPARATIVE ANALYSIS OF THE EUROPEAN UNION CROWDFUNDING SERVICE PROVIDERS REGULATION AND REGULATORY BARRIERS FOR CROWDFUNDING IN THE BALTIC STATES

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Abstract. The issue of conflicting national frameworks on crowdfunding and dispersed structures of investors and products has drawn significant attention in the European Union. Some Member States introduced national rules to regulate their crowdfunding platforms, while others left some aspects of the activity unregulated. This variation of national licensing, diverging definitions of business models and application of existing EU legislation are considered to contribute to crowdfunding market fragmentation. Some surveys demonstrate that crowdfunding regulatory heterogeneity in the Member States negatively affects the market. In the paper, this heterogeneity is revised on the example of Latvia, Lithuania, and Estonia, since the crowdfunding market is fully regulated only in Lithuania. From this point of view, the Regulation (EU) 2020/1503 on European Crowdfunding Service Providers for Business was an ultimately expected event for the crowdfunding market. Therefore, the aim of the paper is to analyse the regulatory barriers for crowdfunding in Latvia, Lithuania, and Estonia and to compare them with those of the European Union Crowdfunding Service Providers Regulation. To achieve the aim of the paper, generally accepted methods of research have been used, including literature source study, comparative analysis and synthesis, legal act analysis. The paper results include the analysis of existing regulatory barriers for crowdfunding in the Baltic States and their comparison with the Regulation, highlighting crucial aspects and revealed differences. In addition, the comparison of current crowdfunding market performance with the actual regulatory barriers in force in the states is provided in the paper.

Keywords: *Crowdfunding, crowdlending, European Crowdfunding Service Providers Regulation, the Baltic States.*

JEL code: G23, K22, O16

Introduction

Crowdfunding is a method to obtain money from large audiences, where each individual provides a small amount, instead of raising large sums from a small group of sophisticated investors (Belleflamme, Lambert, et al., 2014). It seems to represent an important alternative form of finance, bridging financing gaps for small and medium-sized enterprises (SMEs) and therefore expanding financial inclusion, as well as a valuable investment opportunity in terms of diversification, and an instrument for entrepreneurship development (Zelgalvis, Joppe, 2014). Considering this, the issue of conflicting national frameworks on crowdfunding and dispersed structures of investors and products has gained significant critical attention in the last years. Several studies showed that it contributes to the information asymmetry that makes challenging for investors to assess the quality of crowdfunding proposals, particularly in cross-border funding deals. Some Member States introduced national rules to regulate their crowdfunding platforms, while others left some aspects of the activity unregulated. This great variation of national licensing and investor protection schemes, diverging definitions of business models and application of existing EU legislation are considered to contribute to crowdfunding market fragmentation (Kramer, Gimeno, 2018). Surveys, such as that conducted by Cicchiello (2019), demonstrate that crowdfunding regulatory heterogeneity in the Member States negatively affects the market.

Moreover, it is stressed out by the European Union (EU) Parliament that crowdfunding service providers should be subject to prudential requirements, since their clients are exposed to potential operational risks (The European Parliament..., 2020) Furthermore, the necessity of supervision and regulation of financial intermediaries has been highlighted in numerous studies as a crucial element of access to finance for European SME's (Rupeika-Apoga, 2014), (Rupeika-Apoga, Saksonova, 2018).

Given this, the Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European Crowdfunding Service Providers for Business, and amending Regulation (EU) 2017/1129 and Directive (EU) 2019/1937 (hereinafter - the Regulation) was an ultimately expected event. The Regulation normalises financial-return crowdfunding in the Member States (crowdfunding, in this paper), which consists in the provision of funds for business by internet users (the 'crowd' to other individuals or enterprises under the form of loans (lending-based crowdfunding - crowdlending) or equity investments (investment-based crowdfunding – crowdinvesting)) through an online platform facilitating the operation.

The European Parliament and the Council highlight in the Regulation that it aims to foster cross-border funding of business (The European Parliament..., 2020, Discloser (8)) and to ensure a high level of investors' protection (The European Parliament..., 2020, Discloser (7)).

Despite the fact that Baltic platforms take a crucial place in the European crowdfunding market, there have been little comparative analysis made devoted to crowdfunding regulatory barriers in the Baltic States in the frame of this Regulation.

Therefore, the paper **aims** at analysing some aspects of regulatory barriers for crowdfunding in Latvia, Lithuania, and Estonia and comparing them with those of the Regulation.

To achieve the aim of the paper, the following **objectives** have been set:

- To analyse the crucial aspects of the Regulation;
- To analyse the current practise of regulatory barriers for crowdfunding in Latvia, Lithuania, and Estonia;
- To emphasise the differences of crowdfunding service supply between the three Baltic States;
- To compare the Regulation's aspects with the crowdfunding service supply in the countries.

The research methodology used in this paper starts with a literature review to shed light on major controversial issues of the Regulation stressed out in the previous studies. Due to explanatory nature of the paper, generally accepted methods of economic research were used including comparative analysis and synthesis, legal act analysis. The analysis conducted in the paper is based mainly on the initial data gathered at crowdfunding providers' web-sites (operated by legal entities registered in Latvia, Lithuania and Estonia). In order to identify crowdfunding providers registered in the countries, some official lists of licensed organisations are used, such as the *List of crowdfunding platform operators* (Bank of Lithuania, 2020 (1), and the *List of operating licenses for acting as a financial institution* (Ministry of Economic Affairs..., 2020) This paper does not observe reward and donation-based crowdfunding models, since these crowdfunding models are not in the scope of the Regulation.

Literature Review

Some attempts known to us to explain differences in regulatory barriers in the Baltic States are the papers by Sadzius (Sadzius, Sadzius, 2018) and Sorainen researchers (European Crowdfunding Network, 2017). However, little attention has been paid to the issues of conjunction of the barriers with the upcoming event – the EU crowdfunding service providers Regulation, which has gained a number of critics at the stage of Proposal. The group of EU crowdfunding law researchers has concluded that the creation of a single EU regulation should take into account three main issues, namely: it should cover all the existing business models of crowdfunding; it should clarify whether MiFID licence would allow provision of crowdfunding on cross-border basis; it should clarify how other EU laws affect crowdfunding (European Crowdfunding Network, 2017). Meanwhile, surveys of the Regulation such as that conducted by Macchiavello (2019) conclude that the Regulation fails to address such issues like, for instance, the problems deriving from the 'institutionalisation' of crowdfunding (i.e. the presence as crowd-investors/lenders of, for example, banks and investment funds and, therefore, from the risk of cherry-picking by these at the expenses of retail investors), relevant booming sub-sectors, such as invoice trading (recently overtaking both P2P business lending and equity crowdfunding) and crowdfunding through Initial Coin Offerings (ICO). The scrupulous study of the Regulation demonstrates that the ICO topic remained unsolved. The only remark provided by the Regulation (The European Parliament..., 2020, Discloser (15)) is that the characteristics of ICO differ significantly from crowdfunding services regulated under the Regulation. This indicates a need to understand the various perceptions of ICO that exist among the Member States, such as that provided by the Financial and Capital Market Commission (Financial and Capital Market Commission 2019).

The European Parliament has highlighted the diversity of crowdfunding regimes in the Member States as a crucial factor which rendered crowdfunding business models less easily 'passportable' across the EU (European Parliament, 2018). One of the most significant "pre regulation" discussions was about the fragmented regulatory landscape within the EU, which led to the fact, that platforms operate mainly in the country of registration (Wenzlaff, Odorovic et al., 2020). However, some studies have shown high performance of cross-border financing of crowdfunding platforms of the Baltic States (Ziegler, Shneur, et al., 2019). In addition, the idea of cross-border financing scores an advantage in the scope of taxation regimes and their differences (Zelgavis, Joppe, 2013). Socially oriented taxation indirectly contributes to this, as well (Lvova, Pokrovskaya, et al., 2017). Recently, researchers have revealed an interest in crowdfunding services as a business value raising tool (Abramishvili, Lvova, 2019). A considerable amount of literature has been published on the role of crowdfunding services for sales increasing purposes (Salkovska, Praude, et al., 2018) and for sales stimulation (Batraga, Praude, et al., 2018). The crowdfunding data are rather controversial, and there is no general agreement about the priority of issues to be solved in the field. Recent developments of crowdfunding services have heightened the need for stricter assessment of investment risks (Cekuls, Koehn, 2019), particularly for the cases where the platforms apply payments in crypto-currencies (Kuzmina-Merlino, Saksonova, 2019). The issue of augmented competition in financing for business (Konovalova, Trubnikova, 2018) and related minimisation of clients' risks (Konovalova, Caplinska, 2020), (Saksonova, 2013) as a crucial facet for regulated 'traditional' banking sector has been revised in some studies. It is necessary to note, that development of financial technologies (FinTech), like crowdfunding requires new knowledge and

competencies (Kuzmina-Merlino, Saksonova, 2018) and a higher level of internal awareness of organisations (Cekuls, 2016). Therefore, regulated crowdfunding market has potential impact on activity and efficiency of various sectors of national economy.

Results and discussion

The Regulation's discloser delineates the ideas and the problems to be solved by adaptation of the Regulation in each Member State. The authors of the Regulation stress out some crucial facets of it, namely: obstructing of cross-border provision of crowdfunding services because of the differences between the existing national rules, creating of additional legal costs for retail investors who are often discouraged from investing cross-border. These reasons lead to the situation where crowdfunding services still remain largely national, thus depriving business of access to crowdfunding services, especially when those businesses operate in smaller national markets. Therefore, first of all, the Regulation aims to foster cross-border funding of businesses, and excludes from its scope the crowdfunding services in relation to lending to consumers (Discloser 7, 8). Secondly, the Regulation prioritises the effective protection of investors and the provision of a mechanism of market discipline (Discloser, 16). In regard to the scope and subject of the Regulation, these are 'uniform requirements for the provision of crowdfunding services, for the organisation, authorisation and supervision of crowdfunding service providers, for the operation of crowdfunding platforms as well as for transparency and marketing communications in relation to the provision of crowdfunding services in the Union' (Chapter I, Article 1(1)). Hence, the Regulation has multilevel aims and tasks and covers a number of activities and aspects.

Taking this into account, the paper provides an overview of the regulatory frameworks in the Baltic States. To shed light on the regulatory frameworks in force, to delineate its diversity, and to compare those with the Regulation, the authors of the paper relied on 'Review of Crowdfunding Regulation' conducted by Sorainen (European Crowdfunding Network, 2017), and on the study of related laws and explanations of the supervisory authorities, such as (Bank of Lithuania, 2020 (2); Financial and Capital Market Commission 2019). The results of the review are summarised in Table 1, and show, inter alia, the diversity of regulatory barriers for crowdfunding services in Latvia, Lithuania, and Estonia.

Table 1

Comparison of regulatory barriers for crowdfunding service providers for business in force in Latvia, Estonia, and Lithuania in 2020 with EU Regulation

| | Latvia | Lithuania | Estonia | EU Regulation |
|--------------------------------------|--|---|---|---|
| Regulations (inter alia) | Crowdfunding is not a specifically regulated activity. It might fall under one of the regulations applicable to financial and capital market participants in general: 1)Financial Instrument Market Law (FIML) (MiFID I regime) 2)"Law on Alternative Investment Funds and its' Managers" (AIFM Law) | 1)The Law on Crowdfunding of the Republic of Lithuania No XII-2690 2)Law on Managers of Collective Investment Undertakings for Professional Investors of the Republic of Lithuania (MiFID II regime) | Crowdfunding is not a specifically regulated activity. It might fall under one of the regulations applicable to financial and capital market participants in general: 1) Estonian Securities Market Act (MiFID II regime) 2) Credit Institution Act | Regulation (EU) 2020/1503 of the European Parliament and of the Council of 7 October 2020 on European crowdfunding service providers for business |
| Scope / Financial instruments | Transferable securities, inter alia, (a) shares in joint stock companies and other securities equivalent to shares in companies (excl.shares in private limited liability companies), including convertible securities; (b) bonds or other forms of securitised debt; or (c) any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable | 1) Investing and lending crowdfunding. (Equity model can be used only by public limited liability companies with share capital of € 50 000). | 1) Securities, inter alia, (a) shares in public limited companies and other transferable securities equivalent to such shares; (b) bonds or other forms of securitised debt; (c) investment fund units; or (d) any other securities giving the right to acquire or sell any such transferable securities or the price of which is determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures. | Provision of crowdfunding services (investing and lending crowdfunding models) for business in the EU |

| | | | | |
|---|---|---|---|--|
| | securities, currencies, interest rates or yields, commodities or other indices or measures. | | | |
| Authorisation and registration required for providers of the services | For investment service providers authorisation under the FIML in Latvian Finance and Capital Market Commission (FCMC)* | 1) Authorisation and registration in the List of crowdfunding providers managed by the Bank of Lithuania (Bank of Lithuania, 2020 (1)) | 1)Where an online Crowdfunding platform facilitates the offering of transferable securities, or acts as a securities broker, it will require an investment firm license by the Estonian Financial Supervision Authority (FSA).** 2) If a company uses the Lending Model in Estonia by gathering money from lenders and borrowing it on its own account (take deposits), such activity would most require a credit institution license. | Authorisation as a crowdfunding service provider by competent authority of the Member State |
| Maximum offers (prospectus requirement) | Where transferable securities are offered to public, and the offer is expressed to more than 150 individuals in each EU Member State, it might be subject to publish a prospectus approved by the FCMC under the FIML. Loans do not qualify as financial instrument (under the FIML), therefore no prospectus is required for lending models. | If the securities are offered through a crowdfunding platform and it assumes to be below € 5m in a 12 month period – no prospectus is required. Offerings above € 5 million require preparation of the prospectus, which must be approved by the Bank of Lithuania. | Prospectus requirement for public offering of securities. Exceptions apply, e.g. if the number of Investors is less than 150 per EEA country or total amount of investments is less than EUR 100,000. Lending models are not subject to prospectus requirements. | More than € 5 million per 12 months per project. |
| Maximum investment limits (for investors) | No specific regulatory barriers. | Investors are able to invest in Crowdfunding projects without limitations. Investors have to do an appropriateness test. If the results of the test are negative, the platform must provide disclaimer (than the investor can invest on its own risk.) | No specific regulatory barriers. | For sophisticated and professional investors – without limits; For non-sophisticated – the higher of either € 1000 or 5% of the investor's net worth. |
| *currently no one crowdfunding platform registered in Latvia holds an investment services license **None of the Crowdfunding platform based on Equity model existing currently in Estonia has a license under the Securities Market Act. | | | | |

Source: authors' construct based on review of (European Crowdfunding Network, 2017) and (The European Parliament..., 2020)

From the comparison provided in Table1, it is possible to conclude that the major barriers for crowdfunding platforms derive from the fragmented level of laws applicable to the crowdfunding in different jurisdictions. There is no single or general law in the states (excluding Lithuania) applying to crowdfunding, but several different laws which have to be followed depending on the crowdfunding model. The barriers in the countries differ from each other, but mostly they address to certain financial instruments. Moreover, there are stricter limitations for companies which seek for investment-based financing (the case of Lithuania). In this sense, the EU Regulation could accelerate the development of investing-based crowdfunding, since it regulates both crowdlending and crowdfunding, providing more concise criteria for investing-based models. If we turn to the scope of the regulatory barriers and compare it with one of the Regulation, the Regulation does not explain and address the issue of ICOs, contenting itself with a short phrase in the Disclose (15): 'ICOs' characteristics differ considerably from crowdfunding services regulated under this Regulation'. This leads to assumption that the Regulation leaves room for different interpretations and misreading, as well as for further overlapping of the Regulation with national regulatory barriers compared in the Table. The same assumption derives from the fact that the Regulation is more concentrated on the issues of funds collecting from 'the crowd', than on regulating and giving explanations on funds' further distribution mechanisms (and/or models).

Moving on to the field of authorisation and registration requirements, it should be noted that, in fact, the duly registration for crowdfunding service providers exists in Lithuania, for today. Where the licensing for lending to consumers (this is a subject to consumer crediting regulation in each of the countries) is not necessary, the registration and authorisation under another regulation of the countries is not conducted by the providers. In the case of Estonia, when authorisation as a credit institution (a bank) is necessary in order to take deposits from the public, the providers utilise the registration under the legal form of saving and loan organisation (SLO) instead. This provides rights to take savings, which are in fact very equal to deposits in their nature.

A few more controversial issues could be allocated from the analysis of the scope of the Regulation, namely, whether the crowdfunding service providers duly authorised for lending to consumers should be a subject to the registration as a crowdfunding service provider under the Regulation. It is maintained in the Discloser (8) of the Regulation that ‘crowdfunding services in relation to lending to consumers ... should not fall within the scope of the Regulation.’ Therefore, the logical conclusion is that those providers who have the license for lending to consumers should not register themselves as crowdfunding service providers, despite the fact that they collect funds for lending from the ‘crowd’.

In authors’ opinion, the most positive facet of the Regulation is that it provides certain criteria for prospectus requirements, which are similar to those indicated by the Law on Crowdfunding of Lithuania. Therefore, a company applying for funding at a crowdfunding platform duly registered under the Regulation should not have any uncertainty about the issue. Meanwhile, the Regulation does not make any distinction between the investing and lending crowdfunding models. Hence, there would not be room left for crowdfunding of “bigger” projects (more than 5 million EUR per year) under the lending model, as it is in the case of Estonia and Latvia for today.

The comparison of investment limitations in force with those of the Regulation presented in Table 1 shows that the Regulation has the protection of investors in its focus. The investors of crowdfunding platforms should be divided to sophisticated and non-sophisticated ones (upon certain criteria), providing some limitations for non-sophisticated investors. As it could be seen from the Table, limitations for investing were not revealed in the regulatory barriers in force in the countries. Meanwhile, some of crowdfunding service providers (for instance, registered in Estonia,) have prepared themselves for the Regulation, implementing the investors’ questionnaires (knowledge and loss-simulation tests) on their platforms. The rather high level of complaints of Estonian crowdfunding platforms to the Regulation could be explained by the fact that a public-private cluster organisation ‘Finance Estonia’ had created together with market participants a non-binding Best Practice for the crowdfunding industry. A number of Estonian crowdfunding platforms adhere to the principles of the Practice.

In authors’ opinion, another one crucial issue left unclarified in the Regulation is the crowdfunding business model of ‘loan originating’. When assessing the structure and business models of the platforms of the states, one could notice that the most utilised crowdfunding business models (in Latvia, for instance) is exactly the ‘loan originating’. (A ‘loan originator’ crowdfunding platform accumulates funds for lending them to consumer lending companies duly authorised for this activity (have a relevant license) in their states.)

To gain insight of the approximate crowdfunding market volume and applied business models, which have been formed under the existing regulatory barriers in Latvia, Estonia, and Lithuania, ‘Top 7’ (by total financing volume) of the crowdfunding platforms of the countries are mirrored in Table 2. The platforms in Table 2 are those, which address the EU investors (in addition to the country of their registration). The representatives of investing-based crowdfunding business model of crowdinvesting are not included in the Table because no one of them has been revealed in the ‘top’.

‘Top 7’ crowdfunding platforms by total financing volume in Latvia, Estonia, and Lithuania

| Crowdfunding provider's registration country | Crowdfunding platforms' operators | | License for lending to | Amount of financing in total as of October, 2020 (€, million)* |
|--|-----------------------------------|---------------------------|------------------------|--|
| | Crowdlending | Loan originators | | |
| Latvia | | Mintos Marketplace, JSC | | 5696.9 |
| | | Twino, LLC | | 728.9 |
| | | AV Marketplace, LLC | | 343.3 |
| | | Viainvest, LLC | Yes | 227.4 |
| | | Viventor, LLC | | 136.5 |
| | | Lenndy, LLC ** | | 38.1 |
| | | Prosperitu, LLC | | 27.4 |
| | | Total: | | 7198.5 |
| Estonia | | Bondora Capital, LLC | Yes | 386.3 |
| | | Estateguru, LLC | | 259.9 |
| | | Swaper Platform, LLC | | 178.6 |
| | | Iuvo Group, LLC | Yes | 144.5 |
| | | Crowdestate, LLC | | 97.8 |
| | | Crowdestor, LLC*** | | 42.9 |
| | | Bulkestate, LLC | | 17 |
| | | Total: | | 1127 |
| Lithuania | | Neo Finance, LLC | | 60.1 |
| | | Finansu bite, LLC | | 39.4 |
| | | Bendras finansavimas, LLC | Yes | 32 |
| | | Trecia diena, LLC | | 7.2 |
| | | Nordstreet, LLC | | 10.3 |
| | | HeavyFinance, LLC | | 1.5 |
| | | Profitus, LLC | | 18.4 |
| | | Total: | | 168.9 |

* indicated on the platforms ** business address in Lithuania *** business address in Laltia

Source: authors' construct based on review of crowdfunding platforms of Latvia, Estonia, and Lithuania

The results in the Table show that the ‘top’ of the crowdfunding platforms registered in Latvia apply the model of financing ‘loan originating’. The market volume of Latvian crowdfunding platforms is significant because of the ‘giant’ Mintos, which is (according to various estimates), is in the top 10 crowdfunding platforms of the world. Some of the platforms of the countries have licenses for lending to consumers therefore they should not be a subject to the Regulation. Also, several platforms cover two or sometimes three business models. For instance, Iuvo Group (Estonian platform) is a loan originator and a crowdlending platform and holds a license for lending to consumers. In addition, it could be noticed that Lithuania (the only country in the Baltic States where the law on crowdfunding exists) significantly lags behind Latvia and Estonia by crowdfunded financing volume. Hence, one could conclude, that per se unregulated crowdfunding activity has raised the markets of Latvia and Estonia to the top European level by their funding volumes.

Considering this result, it is reasonable to notice that the paper did not aim to reveal the factors influencing the crowdfunding market and analyse their impact on the market growth and volume. The importance of the comparative approach in this matter is worth noting, since only its use makes it possible to determine the gap for further quantitative research of the phenomenon.

Conclusions

Based on the results of the analysis conducted in the paper, it can be concluded that there is significant diversity of regulatory barriers for crowdfunding service providers in Latvia, Estonia and Lithuania. Most of the barriers, excluding Lithuania where the crowdfunding law exists, address to certain financial instruments and their managers. These barriers should be applied depending on the business model a crowdfunding provider uses, whilst the Regulation is more concentrated on the issues of funds collecting than on regulating and giving explanations on funds' further distribution models. The only funds' distribution distinction made by the Regulation is that it covers both crowdlending and crowdinvesting business models. Therefore, in authors' opinion, the issue of ‘loan originating’ business model, which is hardly regulated by existing regulatory barriers in the countries, remains unclear in the Regulation, as well. The regulatory barriers existing in Latvia and Estonia do not regulate the way of funds collecting from the ‘crowd’, therefore, till now, no limitations there were for investments made by individuals via crowdfunding platforms.

Furthermore, the investments according to Lithuanian Crowdfunding Law are not limited as well. From this point of view, the Regulation will be more investors' protection oriented, since it introduces limitations for non-sophisticated investors of crowdfunding platforms. The Regulation does not cover lending to consumers, therefore, the crowdfunding platforms holding a relevant license will not be a subject to the Regulation. While the Regulation has left outside of its attention the issue of ICOs, it provides clear criteria for prospectus requirements, including both investing and lending models, making no difference between them in this matter. The issue to be solved is whether the local regulatory will apply the same prospectus limits for business funding by means of other financial intermediaries. Also, the authors conclude that the regulatory barriers play a substantial role in the formation of the crowdfunding sector. Further research may be devoted to the study of quantitative impact on the crowdfunding market in Latvia, Lithuania, and Estonia after the introduction of the Regulation in the countries.

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