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*N. Amalyan*  
*Ph.D. in economics, associate professor,*  
*Ukrainian-American Concordia University*  
*M. Ruiss*  
*postgraduate student, Ukrainian-American Concordia University*

## COMMERCIALIZATION OF TOLOKA

*Н. Д. Амалян,*  
*к. е. н., доцент, Українсько-американський університет Конкордія, м.Київ*  
*М. Руїс,*  
*магістрант, Українсько-американський університет Конкордія, м.Київ*

### КОМЕРЦІАЛІЗАЦІЯ ТОЛОКИ

*By definition Toloka referres to the gathering of neighbors, relatives, comrades, organized to accomplish a large-scale task quickly (without payment, but for food and drink), which took place not long ago all around the world. Nowadays mutual assistance has morphed into crowdfunding - use of small amounts of capital from a large number of individuals to finance a new business venture. Change of titles was accompanied by the change of terms and conditions of assistance provisions: at present we observe a process of commercialization, which is by Cambridge dictionary definition, is the organization of something in a way intended to make a profit. Although nowadays anyone can donate money without indemnity, more frequently crowd-funders invest their money in order to turn into a beneficiary, creditor and/or co-owner of a project. The article deals with specifics of different types of crowdfunding (prepayment, donation-, royalty-, debt-, equity-based types and ICO), listing platforms providing corresponding services. Special attention is devoted to risks facing investors, investees and platforms in the process of crowdfunding, including risks of illiquidity, fraud, valuation and capitalization. With a glance to these and other risks an eye is given to financial instruments, issued by investees or platforms. In particular a reader of the article can familiarize himself with new types of securities – SAFEs ("Simple Agreement for Future Equity") and KISSes ("Keep It Simple Security"), both being contractual rights to purchase the company's equity at a future date, similar to warrants, but with undetermined (at the moment of their emission) conversion price. Last problem, discussed in the article, is legislative regulation of crowdfunding business in the USA: legislative requirements for investees (disclosure of information) and platforms (registration and licensing), as well as restrictions for investors (maximum amount for a period – depending on their annual income). The article is intended to provide appropriate understanding of the complexity and the practical implications of the phenomenon with the aim of enhancing crowdfunding in Ukraine.*

*За визначенням термін 'Толока' відноситься до гурту сусідів, родичів, товаришів, що збираються для швидкого виконання великої за обсягом роботи (без оплати, але з подальшим частуванням); цей феномен ще не так давно був вельми поширеним в усьому світі. В наш час взаємодопомога перетворилася на краудфандинг - залучення невеликих сум капіталу від великої кількості людей для фінансування нового бізнесу. Зміна назви супроводжувалася зміною положень умов надання допомоги: сьогодні ми спостерігаємо*

процес комерціалізації, який, за визначенням Кембриджського словника, є організацією чогось, що має на меті отримання прибутку. Хоча і сьогодні будь-хто може пожертвувати гроші без відшкодування, найчастіше інвестори вкладають свої гроші з тим, щоб стати бенефіціаром, кредитором та / або співвласником бізнесу.

У статті розглянуто специфіку різних типів краудфандингу (базований на пожертвах, з передбаченою винагородою, роялті, борговий, пайовий типи та ICO), перелічені платформи, що надають відповідні послуги. Особлива увага приділяється ризикам, на які наражаються інвестори, отримувачі коштів та самі платформи в процесі краудфандингу, включно з ризиками ліквідності, шахрайства, оцінки та капіталізації. З огляду на ці та інші ризики у статті приділяється увага фінансовим інструментам, що емітуються отримувачами коштів або платформами. Зокрема, читач статті може ознайомитися з новими типами цінних паперів - SAFEs ("Проста угода про майбутній капітал") і KISSes ("Не ускладнений цінний папір"), обидва з яких є контрактними правами на акції компанії в майбутньому, аналогічно варрантам, але з невизначеним (на момент їх емісії) коефіцієнтом конвертації. Останньою проблемою, що обговорюється в статті, є законодавче регулювання даного бізнесу у США: законодавчі вимоги для інвесторів (щодо розкриття інформації) та платформи (реєстрація та ліцензування), а також обмеження для інвесторів (максимальна сума впродовж певного періоду – в залежності від їх річних доходів).

Стаття має на меті забезпечити належне розуміння складності та практичної значимості цього явища з метою сприяння розвитку краудфандингу в Україні.

**Key words:** Toloka; crowdfunding; debt-based; equity-based; ICO; SAFE; KISS.

**Ключові слова:** Толока; борговий краудфандинг; пайовий краудфандинг; ICO; SAFE; KISS.

**Problem statement.** Phenomenon of Toloka historically was widespread in rural areas in many countries. Toloka in Ukraine, *Nachbarschaftshilfe* – in German speaking countries, 'Bee' or 'barn Raising' in English speaking countries, *Talkoot* in Finland and the Baltics, *Harambee* in East Africa, *Gotong royong* in Southeast Asia, *Gadugi* in North America) – these are only few denominations of a gathering of home-folks for communal work. Such work was usually characterized by large scale and/or had to be done quickly – in any case it required cooperative labour of many people. It was by definition voluntary, and unpaid.

In spite of relative nature of both characteristics (voluntary nature - due to social pressure in small communities and free-of-charge basis – due to the following binding entertainment) all participants of communal work were engaged in something that was either a common concern for the good of the community, or a job exceeding its member's own capacity. No profit was expected, but any member of community could expect the same kind of assistance in case of need.

In our urbanized society and individualistic cultures, where there is less reliance on others, when subsistence farming has already given way to commodity-money relations, Toloka has transformed into 'crowdfunding', becoming almost completely commercialized: even donated based crowdfunding is viewed by some rich persons as a way of tax deductions.

In all other types of crowdfunding contributions to any project are made in the form of money (not free labour) not only by neighbors, relatives and comrades, but mostly by strangers, expecting rewards in the form of a product, interest income or securities. Moreover the process of Toloka itself has become a separate (and quite profitable) business.

**Literary review.** Transformation of the essence and spirit of Toloka into commercialized process of crowdfunding is a generally recognized fact, which so far has not received proper attention in academic literature. The vast majority of the publications on the problem of communal funding are dealing with practical aspects of this phenomenon: authors of numerous books focus their attention on the examination of the best ways either of raising money [1] or investing money [2].

Quite different are the views of the foreign scholars on the origin of funding the event over the crowd: while some of them attribute the starting point to 1885 (referring to the fundraising campaign for the Statue of Liberty pedestal, launched by the publisher of the newspaper *The New York World* Joseph Pulitzer, in the course of which \$101 091 were collected from more than 160 000 donors [3]), others consider a lifespan of crowdfunding to be much shorter, linking it to the start of Internet use by artists from different sectors to finance their projects, potentially facilitating gains from trade that would not otherwise occur [4]. In the judgment of such scholars [5] the first recorded successful instance of **crowdfunding** occurred in 1997, when a British rock band funded their reunion tour through online donations from fans and ArtistShare, founded by Brian Camelio, became the first dedicated crowdfunding platform in 2000. From their point of view the term 'crowdfunding' itself was coined little more than a dozen years ago and the phenomenon on its own is quite a new one.

In spite of great popularity of the term 'crowdfunding' (Google search provides 119 000 000 sources), it is a

generally accepted statement that comprehensive overview of the economic literature on this topic in foreign scholarly literature does not exist [6, 7], to say nothing about Ukrainian academic literature. Thereafter research rationale is obvious.

**The aim of the paper** is to analyze the process of transformation of the communal work (Toloka in Ukraine) into an entrepreneurial activity, to scrutinize tools and models of this kind of business and to mark out main problems, hindering development of crowdfunding in Ukraine.

**Results.** The term “crowdfunding” is used in many contexts and has many meanings depending on the source. Most popular definition defines crowdfunding as “a method of collecting many small contributions, by means of an online funding platform, to finance or capitalize a popular enterprise. It is a new high-tech version of a centuries-old practice” [8]. At present it is considered to be an alternative source of financing for startups that have this particular limited access to traditional lines of financing [9]: instead of raising capital from small group of wealthy individuals startups gather funds from a pool of individuals across the world.

In the process of its wide spread occurrence crowdfunding has manifested itself in different forms – the oldest one being donation-based, the newest – ICO (Initial Coin Offering).

**Donation-based** crowdfunding is the least complex type. It takes place when individuals donate money to a cause or person without expecting anything in return other than the satisfaction of having contributed towards something they feel is worthwhile. It is typically used to back social causes, medical, environmental, educational, public or religious campaigns or creative activities. Because this type of crowdfunding is predicated on donations, donors do not obtain any ownership or rights to the project, nor do they become creditors to the project. The most striking example of donation-based crowdfunding is YouCaring - a **free online fundraising platform** that pioneered ‘Compassionate Crowdfunding’—empowering people worldwide to rally support for personal and charitable causes without the fundraising fees associated with other sites. To date, the YouCaring community is 5.5 million strong and has raised more than \$1 Billion for humanitarian causes [10]. One of the most known actions on this platform – campaign organized by star of the Houston Texans J.J. Watt to support people who were affected most by Hurricane Harvey on Texas Gulf Coast. In the course of this campaign contributors smashed through Watt’s initial goal of \$200,000 for relief efforts — he went on to raise \$37 068102, the largest amount ever raised on a crowdfunding platform.

This type of crowdfunding to the utmost resembles in essence Toloka – in theory. But in practice charitable donations are often claimed as income tax deductions. There are a lot of tutorials explaining how to profit from this form of crowdfunding. Chartered Accountant Angie Mohr, for example, explains that monetary donations of US citizens can be deducted up to 50% of their taxable income and non-cash donations - up to 30%. Her advices include claiming unreimbursed car expenses, incurred while volunteering for a charitable organization as a charitable gift with appropriate consequences, and donate household goods in order to be charitable, clean out own basement and save money on taxes [11].

Donation-based crowdfunding is often confused with reward-based crowdfunding and/or pre-sales.

**Reward-based** crowdfunding is used by project owners who want to collect donations for a specific project, giving small non-financial rewards (of a symbolic value) in return. Such rewards are usually much cheaper than the donation amount, to ensure there is enough money left for the project. For example, in thanks for the donors to the fund for pedestal for the Statue of Liberty newspaper *New York World* published the names of each person who made a contribution (most donations being about \$1 or less), with a by-product of advancing the sales of Pulitzer's newspaper.

In case when a reward has a real intrinsic value and reflects the amount contributed, we are speaking about pre-sell (another names - pre-sale or in kind funding).

While a certain number of backers support certain projects solely out of personal affinity or the desire to see it succeed, the vast majority will decide to pledge based on what goods or services they get out of it. Pre-sale crowdfunding is a type of small-business financing in which entrepreneurs solicit financial donations from individuals in return for a product or service.

The biggest in kind funding crowdfunding project was financed through the USA platform Kickstarter. In 2012 Migicovsky's Pebble Technology Corporation following the failure to attract traditional investors raised \$10.3 million through a Kickstarter campaign running a little more than 1 month (from April 11 through May 18) - this was the most money raised for any product on the site at that time (initial fundraising target was \$100 000). Millions of dollars were assigned to produce Pebble Smartwatch [12]. Backers spending \$115 received a Pebble when they became available at a discounted price (price for other customers – \$150). In 2015, Pebble launched the Pebble Time and Time Steel with Kickstarter, raising \$20,3 million from over 78 000+ backers.

As Pebble Kickstarter’s campaign has demonstrated, pre-sell crowdfunding is one of the cheapest ways to raise capital, with no need for any collateral, without credit check or previous business experience; also it is a way to test and validate business idea, market and even pre-sell the product, building loyalty with new customers. Funders that participate in such campaigns do it because they want this product or service to be made. Another reason is that they will get a discount on the sales price. And what is more for the owners of the company, it allows them to retain all equity and control.

Among the best known donation-based crowdfunding platforms are Kickstarter, Indiegogo, CrowdFunder and RocketHub. Donation-based crowdfunding platforms aimed at fund-raising for charitable causes include GoFundMe, YouCaring.com, GiveForward and FirstGiving. As a rule such platforms take a 5%-10% fee of all donations, but exclusions are possible (platforms’ fee, for example, can be voluntary instead of mandatory).

Contrary to donation- and reward-based crowdfunding financial crowdfunding implies direct profit taking. Scholar differ two main types of financial crowdfunding (debt- and equity-based) and many subvarieties.

**Debt-based crowdfunding** (or crowd lending) is used as alternative to conventional lending system. With it

individuals lend money to businesses or other individuals with the expectation that it will be repaid together with interest added (instead of engaging services of a bank). Depending on the parties involved, European Crowdfunding Network differs [13]:

- **Social Lending, providing an opportunity** to lend to social projects with no interest being offered;
- **Peer-to-Peer Lending (P2P)** as a new interesting financing model for loans subject to condition that the lenders and borrowers usually do not know each other. This model is used by borrowers who either are looking for a loan with a lower interest rate than the one they can get from a bank or who can offer fewer securities; the main motivation for the funder is a (higher) financial return. The interest-rates in general are based on the risk-factor. The risk-factor is calculated based on financial data and personal securities;

- **Peer-to-Business Lending (P2B)** as a method of debt financing that enables individuals to lend money to enterprise projects of any scale—bypassing an official financial institution. This method of **direct collaborative financing towards real projects by individuals or companies is claimed to** revolutionize traditional world of finance.

Interest rates calculations both for P2P and P2B are currently done by platforms or by independent institutes. Interest rates charged for borrowing vary greatly: LendingClub for example, depending on the grade assigned to a borrower, charge from 5,99% to 35,89% [14], Prosper – from 6,95% to 35,99% [15]. In P2P and P2B lending only the money provided by the funders is being lent out. Therefore there is no money creation within the platforms unlike with traditional banks. As a result, there is no systemic risk attached to these types of lending.

Among the best known debt-based crowdfunding platforms are Lending Club, Funding Circle, Zopa and Prosper.

**Equity-based** is the most sophisticated business model of crowdfunding. Within its scope a company (usually a start-up) offers a contract for shareholding or a revenue sharing plan to investors based on the share of the profits or return of the business they are supporting [16].

It provides individual investors an avenue to participate in the capital raising activities of start-up. Some funders are primarily interested in investing in projects that share their own values or that are locally engaging, or that create jobs in their community. Others have a real knowledge of what the market, project, or company is addressing and desires to bring funds and expertise to the success of the project [17].

Among the best known equity-based crowdfunding platforms are Kickstarter, Indiegogo, CircleUp, AngelList, CircleUp and Fundable.

The distinctive feature of equity crowdfunding is that it is an investment arrangement. This model is most similar to angel or venture capital investing (with corresponding high level of risk when funding startups). A company, using this model, issues securities and sell them through Internet; most often such investees issue equity securities (common, preferred or preferred convertible stock).

In these days some issuers started to offer new types of securities - SAFEs and KISSes.

SAFE is abbreviation for “Simple Agreement for Future Equity” - alternative to convertible debt, introduced in 2013 by startup accelerator Y Combinator; KISS is abbreviation for Keep It Simple Security, introduced in 2014 by start-up accelerator 500 Startups. Note-alternatives are contractual rights to purchase the company’s equity at a future date, similar to warrants, but the conversion price remains undetermined until a later date. Like convertible debt, note-alternatives are a quick and simple way of providing companies with cash in exchange for the promise of future equity. A major difference is that note-alternatives generally do not accrue interest and do not have stated maturity dates. Until the note-alternative converts into stock, note-alternative holders typically have no management rights and do not share in any dividends that are paid; they are not treated as debt on the company’s balance sheet.

One more important distinction of SAFEs is the following: investor is not getting an equity stake in return. SAFEs are not common stock. A SAFE is an agreement to provide investor a future equity stake based on the amount he/she invested if—and only if—a triggering event occurs.

The terms of any SAFE may have it trigger in a number of different scenarios that may—or may not—occur in the future with respect to the company. For example, a SAFE may be triggered by another round of financing involving equity securities, IPO or acquisition of the start-up by another company. Depending on its terms, a SAFE may not be triggered at all. According to US Securities and Exchange Commission (SEC), “there is nothing standard or simple about a SAFE. Various terms from the triggering events to the conversion price are subject to different treatment by different companies offering SAFEs” [18].

**Convertible notes are another type of security that can be offered in the process of crowdfunding.** Convertible notes are debt obligations in which the investor agrees to loan money to the company in exchange for a promise of repayment, interest on the loan for a period of time and an ability to convert the outstanding amount into equity of the company at some triggering event. Different from SAFEs, convertible notes represent a current legal obligation by the company to investor for the outstanding amount of notes.

The newest financial tool used in the process of crowdfunding is ICO.

**ICO** - Initial Coin Offering – stands for new business technique that is the hype of fintech entrepreneurs and investors. In an ICO campaign, a certain percentage of the cryptocurrency is sold to early backers of the project in exchange for legal tender or other cryptocurrencies, usually for Bitcoin. A startup going to raise money through an ICO, usually creates a plan which states what the project is about, what need(s) the project will fulfill upon completion, how much money is needed to undertake the venture, how much of the virtual tokens the pioneers of the project will keep for themselves, what type of money is accepted, and how long the ICO campaign will run for. During the ICO campaign, enthusiasts and supporters of the firm’s initiative buy some of the distributed cryptocurrencies with fiat or virtual currency. These coins are referred to as tokens and are similar to shares of a company sold to investors in an IPO transaction [19]. In July 2017, in particular, a new decentralized blockchain Tezos concluded the largest ICO in history, raising \$230

million worth of Bitcoin (65,627 BTC worth at that time roughly \$156m) and Ether (361,122 ETH worth about \$76m) in just 13 days of crowdfunding, making it the largest ICO to date [20].

Abovementioned Initial Coin Offering is used by start-ups to bypass the rigorous and regulated capital-raising process required by regulatory agencies, venture capitalists or banks making the crowdfunding process even more risky than any other model of start-up funding. For traditional models of crowdfunding US SEC lists among others the following risks:

- **Speculative:** Unlike an investment in a mature business, the success of a startup or early-stage venture often relies on the development of a new product or service that may or may not find a market;

- **Illiquidity:** Investor will be limited in his/her ability to resell his/her investment for the first year and may need to hold his/her investment for an indefinite period of time;

- **Cancellation restrictions:** Once investor make an investment commitment for a crowdfunding offering, he/she will be committed to make that investment;

- **Valuation and capitalization:** Unlike listed companies that are valued publicly through market-driven stock prices, the valuation of start-ups is difficult and investor may risk overpaying for the equity stake received;

- **Limited disclosure:** The company must disclose information about itself, its business plan, the offering, and its anticipated use of proceeds, among other things. An early-stage company may be able to provide only limited information about its business plan and operations because it does not have fully developed operations or a long history to provide more disclosure;

- **Possibility of fraud:** In light of the relative ease with which early-stage companies can raise funds through crowdfunding, it may be the case that certain opportunities turn out to be money-losing fraudulent schemes [21].

The last type of risk is tightly connected with the business model of crowdfunding. As Professor of Management (The Wharton School) Ethan Mollick mentioned, while the rate of fraud in crowdfunding is currently very low, that may not hold true in all forms of crowdfunding... In categories including Film, Food, and Theater, fraud was rare, with only 2,3% of projects showing indications of potential fraud [22]. Experts of the European Crowdfunding Network indicate that default rates for P2P lending on average are very low, below 1% and that this subset of crowdfunding is continuously growing and profitable [23]. At the same time study by Satis Group reports that 80% of ICOs are a scam and only 8% make it to a exchange [24]. Google search for colocation 'ICO', 'crowdfunding' and 'scam' provides 195 000 sources.

High level of riskiness of crowdfunding has induced numerous national regulatory agencies to regulate this kind of entrepreneurial activities. The most elaborated rules were adopted in the USA, where Jumpstart Our Business Startups Act (JOBS Act), coupled with Regulation Crowdfunding, issued by SEC, lay down rules for all involved in crowdfunding [25]: investors, investees and platforms.

**Investors**, in particular, are limited in the amount they can invest across all crowdfunding offerings in a 12-month period: if their annual income is less than \$30 000, then they can invest up to \$2,200; if their annual income are equal to or more than \$1 200 000, then they can invest up to \$107 000.

**Investees** are required to disclose information in filings with the Commission and to both the investors and the intermediary facilitating the offering permit. Data to be revealed: describing business and its owners, business plan, type of securities being offered, percent of the company being sold in the offering, amount of time remaining in the offering, progress made toward meeting funding target. A company issuing securities in reliance on Regulation Crowdfunding is permitted to raise a maximum aggregate amount of \$1 070 000 in a 12-month period.

**Platforms** (intermediary) must be a broker-dealer or a funding portal that is registered with the SEC and FINRA (Financial Industry Regulatory Authority). To be registered the intermediary should comply with the rules, set by SEC.

**Conclusions.** Crowdfunding offers amazing potential both for investors and startups. Total crowdfunding volume worldwide from 2012 to 2015 has increased from 2,7 to 34,4 billion of U.S. dollars. Crucial role in the development of this kind of financing was played by elaborated legislation and vigorous activity of national regulatory agencies. For our country to provide similar friendly and safe network both for investors and startups, we must redesign traditional methods of Toloka in order to create favourable environment for investors as well as for business.

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