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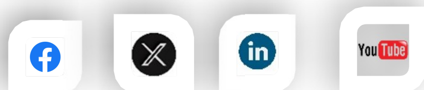

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**Keywords:** Digitalization, FinTech, Capital, Intermediation, Asymmetries

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Title

# Reshaping the Financial Landscape through Fintech and Digital Finance

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## Abstract

*This article offers a comprehensive examination of the research conducted on the effects of digitalization on the ability to get financial resources. Our primary emphasis is on providing access via the use of financial technology. This article examines the progression of three prominent financial technology advancements: crowdfunding, initial coin offerings, and fintech lending (which encompasses peer-to-peer lending alternatives). The topics of discussion are: Examine the regulatory concerns posed by fintech, together with the present data on the impact of fintech on the availability of capital for entrepreneurs and investors. The articles featured in this special edition have been chosen to emphasize their substantial contributions to our comprehension of the digitization of finance and its consequences. Lastly, we address the challenges linked to doing research in the field of digital finance and suggest potential avenues for further exploration.*


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## Introduction

Digitization has caused numerous transformations in the market. Various factors, over the course of history, have influenced the outcomes of market transactions. Several elements that contribute to these challenges include agency difficulties, information asymmetries, and the complexity of allocating residual control rights in contracts. La Porta et al. (1997) and 1998 compiled the previously described discoveries. It was discovered that certain groups face difficulties in obtaining funding due to the strict criteria employed for matching, selection, and monitoring. A result that may arise from the digitization of the financial sector is the creation of novel technologies that enhance firm liquidity and provide investors with enticing new prospects. These technological innovations are challenging the conventional interpretation of "intermediation". Banks and venture capitalists are

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typically responsible for the duty of raising and distributing capital, which is a more conventional role for financial intermediaries. The level of influence that individual account holders have in determining the allocation of their cash by banks for loans or other forms of funding is diminished. Institutional investors provide the funding for venture capital funds, which operate based on comparable principles. However, limited partners have limited ability to influence the selection of enterprises. The digitalization of the financial sector has led to the emergence of two new types of technology that impact intermediation. Initially, projects and enterprises have the opportunity to establish a connection with investors by utilizing platform-based solutions. Platform-based activities such as crowdfunding and P2P lending utilize technology to streamline the organization of information and facilitate investment transactions. However, the responsibility of determining which projects or programs to financially support is with the person. Hence, platform-based financial technology bears similarities to conventional intermediaries such as stock exchanges in numerous aspects. Distributed ledger technology, or DLT, enables the elimination of intermediaries between all parties involved. There is no central authority in the stated system responsible for monitoring transactions and overseeing the market. Initial coin offerings (ICOs) represent the removal of intermediaries in the development of new digital currencies. Corporations choose secondary listing exchanges based on the degree to which they are compatible with their business. This editorial examines recent research investigating the impact of the financial sector's integration of new digital technology on the accessibility of financial services. Block et al., 2020; Farag and Johan, 2021; Goldstein et al., 2019; Allen et al., 2021; Block et al., 2017 are examples of studies that have documented prior assessments of fintech. These evaluations can be found in a diverse range of media. The speakers typically provide high-quality presentations that discuss the latest advancements in technology, platforms, and industry news, including specialized areas related to financial technology. Our inquiry primarily focuses on facilitating access to financial resources through the utilization of fintech. The primary objective of our study is to examine the domains of financial technology that already or potentially provide firms with novel avenues for investment and funding. Our classification consists of three distinct categories: crowdfunding, initial coin offerings (ICOs), and fintech loans, which encompass peer-to-peer (P2P) financing. Our conversation is centered upon three primary categories of stakeholders: shareholders, investors, and government regulators. This special issue offers a comprehensive assessment and arrangement of the pertinent literature, along with an examination of how the papers contribute to that existing body of work. Our main objective is to identify unresolved inquiries that could serve as compelling avenues for further investigation.

Fintech is now prioritizing loans for startups and small firms. Businesses and entrepreneurs have numerous daunting obstacles when attempting to recruit investors. Obtaining initial funding for organizations and projects that are still in the early stages of growth can be a challenging and costly endeavor (Wilson et al., 2018). Additionally, small enterprises face financial constraints due to the inadequacy of conventional loan and equity financing methods, as highlighted by Lopez-de-Silanes et al. (2018). However, potential investors face significant obstacles that they must overcome before they may invest their funds in emerging enterprises. Inexperienced investors are most concerned with the lack of reliable data, the caliber of businesses and entrepreneurs, and the availability of dependable information about emerging enterprises. Furthermore, investing through conventional intermediaries entails substantial charges, and numerous potential investors lack the financial means to contribute even small sums, so preventing their entry into the market. Regulators have identified substantial obstacles to expanding finance accessibility for emerging and small businesses. Is there a method for corporations to generate additional funds without

causing dissatisfaction among their investors? To prevent the endorsement of fake efforts, how may funding be provided to support genuine projects? How can firms identify strategies to derive benefits beyond mere financial gains? The purpose of this editorial is to examine the assertions that financial digitalization has led to increased accessibility to financial resources for a larger number of individuals. The focus of our talk will be on the challenges that entrepreneurs have in securing financing. The first part of this article will concentrate on the role of technological advancements in the rapid growth of the financial technology (fintech) industry. The presentation concludes by examining the research conducted on crowdsourcing, fintech loans, and initial coin offerings (ICOs), and also delves into the impact of fintech on businesses. Our primary focus lies on the potential financial advantages that fintech might offer to businesses. We examine the research that demonstrates how fintech might enhance financial inclusion and expand individuals' ability to obtain loans. In addition, we categorize firms and projects based on the attributes that enhance their likelihood of securing investment. Investors that have a share in the three distinct financial innovations mentioned in Section 3 receive particular focus. We provide a comprehensive study of potential investors and do thorough data analysis to identify unique investment opportunities. The rationales behind investor decision-making, which might be influenced by factors unrelated to economics, are a subject of ongoing discussion. Our work primarily focuses on the behavior of investors, specifically how they manage the significant levels of information asymmetry and moral hazard that are present in these transactions. The fourth segment will address the primary barriers to fintech regulation and the fundamental elements of the existing regulatory system. This essay thoroughly examines the papers included in this special issue and assesses their effectiveness in addressing the unresolved concerns in fintech literature. Finally, we will utilize the conclusion to offer our analysis of the issues currently afflicting the empirical literature and propose potential avenues for future research in this field.

## The Growth of Fintech

Here we will discuss some of the alternatives to conventional financial technology (fintech) that individuals and businesses can utilize. The primary focus lies in fintech loans, encompassing P2P financing, initial coin offerings (ICOs), crowdsourcing, and related efforts. The growth of the financial technology business is attributed to the revelation of deficiencies in traditional financial operations by recent technological advancements. Fintech companies employ cutting-edge technology and innovative marketing strategies to attract new investors. The expenses associated with financial intermediation have remained unchanged, despite the emergence of new and disruptive technology (Philippon, 2016). The primary objective of the study is to examine the impact of platforms, algorithms, and distributed ledger technology (DLT) on the banking business. The study categorizes crowdsourcing into four distinct forms. Lending-based crowdsourcing platforms, not banks, offer loans to small and medium-sized businesses. Business owners can generate funds by offering incentives to backers through crowdfunding. Business owners have the option to sell convertible notes or shares to potential supporters through equity crowdfunding. There are two emerging forms of crowdfunding: royalty crowdfunding and real estate crowdsourcing. Although peer-to-peer lending platforms have provided an opportunity for fintech companies to enter the market, debt financing remains the prevailing method for businesses to obtain capital on a global scale. Peer-to-peer financing allows individuals or enterprises to obtain loans from other individuals based on their creditworthiness. Over the past fifteen years, there has been a substantial increase in the popularity of fintech loans, primarily due to the emergence of platforms such as Zopa. In 2017, well-known platforms like as Prosper and LendingClub had a notable impact on the loan business, contributing to 0.2% of the

United States' gross domestic product. Prior to the financial crisis, the presence of fintech lenders was minimal. However, by 2016, they accounted for one-third of the increase in loans issued by non-bank institutions. The global fintech loan market is projected to reach over $900 billion by 2024. Fintech loans and crowdfunding significantly depend on platforms to directly connect companies with investors. Their utility is directly proportional to the scale of the network; larger networks are superior. While the extent of these assessments may vary across different categories, platforms frequently conduct thorough evaluations of initiatives. Fintech lenders employ sophisticated algorithms in credit scoring, loan distribution, and pricing. These algorithms enhance efficiency while reducing assessment expenses. Fintech lenders excel in managing unforeseen surges in demand and swiftly processing applications due to their utilization of diverse data sources for credit assessment. Unlike crowdfunding and fintech loans, initial coin offerings do not depend on a pre-existing platform. Entrepreneurs provide coins or utility tokens to investors for initial coin offerings (ICOs). In 2019, the sum of $27 billion was generated from the increasingly expanding initial coin offerings (ICOs). Investors participating in a crowdfunding campaign or an initial coin offering (ICO) have the opportunity to evaluate the service and provide the development team with their requirements from the beginning. Initial coin offerings (ICOs) leverage the advantages of Distributed Ledger Technology (DLT), which is commonly associated with blockchain. Coins are generated through initial coin offerings (ICOs) utilizing distributed ledger technology (DLT), while smart contracts oversee the entire process. The low-cost social connection that DLT provides is its defining feature; it eliminates the demand for a central mediator. There are far fewer middlemen in this technology's financial system as compared to more conventional ones. With an emphasis on their effects on financial practices, the expansion of fintech loans, the functioning of crowdfunding platforms, and the features of initial coin offerings (ICOs) and distributed ledger technologies (DLTs), this section offers a comprehensive review of the many fintech options.

## Firms

The advent of financial digitalization has unlocked a plethora of opportunities, as exemplified in this line. It underscores the potential benefits for ambitious and visionary organizations in achieving success. The emergence of financial technology (fintech) has created opportunities for individuals to engage in projects at different phases by means of crowdfunding, initial coin offerings (ICOs), and marketplace lending. The connections that crowdsourcing has forged with subsequent forms of venture capital and angel investing, particularly reward-based crowdfunding, demonstrate its significance in enabling access to funds prior to securing these forms of funding (Colombo and Shafi, 2016). Buttice et al. (2020) state that pooled investment structures can streamline equity crowdfunding outcomes and attract professional investors in the future. Initial coin offerings (ICOs) resemble crowdfunding by attracting a bigger group of investors and can be advantageous for businesses in the IT sector, especially those involved in Distributed Ledger Technology (DLT). Initial coin offerings (ICOs) provide businesses and small and medium-sized organizations (SMEs) with a means to attract investors who may not have considered traditional financial products. This allows them to tap into a previously untapped investor base. (OECD, 2019). In the present era, small enterprises heavily depend on fintech lending platforms to sustain their operations, especially during periods when obtaining traditional bank loans is challenging. According to Schweitzer and Barkley (2017), a growing proportion of small enterprises are seeking capital from online fintech lenders. Marketplace lending and crowdfunding are two examples of alternative finance mechanisms now under investigation. The primary inquiry is whether these channels assist businesses that have been rejected by conventional lenders or if they primarily focus on businesses that have faced

rejection. These platforms facilitate the growth of small enterprises by reducing operational expenses and expediting client acquisition. Crowdfunding serves the dual purpose of both as a marketing strategy and as a means to generate additional funds. Organizations are marketed, product sales are boosted, and awareness is heightened. Organizations can acquire valuable insights to enhance product growth and development by implementing crowdsourcing activities (Chemla and Tinn, 2017; Belleflamme et al., 2015). ICOs not only raise funds, but the utility tokens generated from these events also empower entrepreneurs to have a say in the assessment of their firm ideas. Even in a suboptimal equilibrium for investment, deserving initiatives can secure funding through Initial Coin Offerings (ICOs) (Block et al., 2020). This analysis considers the impact of fintech lending on traditional banks, taking into consideration the contradictory results found in studies regarding whether fintech lending complements or substitutes existing bank lending. If the financing environment continues to favor fintech companies, as it did during the financial crisis (Schnabl, 2019; Kim and Stahler, 2020), there is a possibility that bank loans provided to small businesses could be reduced. The process of digitizing finance has the capacity to enhance the availability of financial services, particularly for small businesses and individuals with limited resources. Jagtiani and Lemieux (2019) and Maskara et al. (2020) have found that fintech lenders can enhance the financial capabilities of certain clients by providing lower risk-adjusted interest rates in comparison to conventional banks. Crowdfunding and similar hybrid crowdsourcing initiatives can increase the accessibility of financial services to a larger number of individuals. It enhances the likelihood of success for startup teams composed of younger individuals and female entrepreneurs. Mollick and Robb (2016) and Cumming et al. (2019) have found that despite the increasing number of investors, minority and female entrepreneurs continue to encounter challenges in obtaining funding. This study examines the factors that contribute to the success of a crowdfunding campaign, specifically emphasizing the significance of transparently disclosing the project's risks and the commitment of the founding team. Multiple studies (Ahlers et al., 2015; Butticè et al., 2017; Colombo et al., 2015) have demonstrated that the commitment of early-stage investors plays a crucial role in public fundraising. Serial crowdfunding entrepreneurs can enhance their future campaigns by leveraging the social capital they have already accumulated. The probability of a successful initial coin offering (ICO) is contingent upon various aspects, including market conditions, project characteristics, information reliability, technological excellence, and human resources. The effectiveness of a fundraising campaign is directly linked to the accuracy and validity of the company's concept and its utilization of established technology. Ante et al. (2018), Lambert et al. (2020), and Momtaz (2020b) all observe that factors such as short-term objectives and project novelty may influence the effectiveness of an initial coin offering. The techniques employed by fintech lending platforms have a direct influence on the dynamics of the market, which subsequently has an impact on interest rates and the prospects for obtaining finance. Zhang and Liu (2012) and Cumming and Hornuf (2020) found that small and medium-sized companies (SMEs) are more likely to secure loans through marketplace lending when there are successful borrower aid campaigns and clear platform information, which includes risk ratings. The chapter provides a concise overview of how the digitization of finance has transformed the financing environment for companies at various stages of growth, utilizing marketplace loans, initial coin offerings (ICOs), and crowdfunding. Moreover, the study explores the determinants of success in crowdfunding and initial coin offering campaigns, as well as the extent of financial inclusion and the potential repercussions for traditional institutions.

## Investors

The proliferation of digital finance has expanded the investment options available to investors. Traditionally, shares have only been accessible to accredited or institutional investors. Equity crowdfunding, as demonstrated by the JOBS Act, seeks to provide non-accredited investors with access to venture capital opportunities. Investors can select projects directly through digital finance, bypassing traditional intermediaries. Digital finance's democratization should provide individual investors with increased options, primarily due to their desire for greater transparency and comprehension of the allocation of their funds. Investor restraints, such as minimal investments and prospectus regulations, restrict the capacity of conventional investing to achieve worldwide potential. Initial Coin Offerings (ICOs) are a cost-effective approach that enables global participation. ICOs reduce expenses associated with intermediaries, although there are still challenges to address, including the transfer of traditional currency and potential charges for transactions on the secondary market. Storing tokenized assets in an electronic wallet eliminates the requirement for custodian costs. ICOs enhance liquidity by allowing the trading of fractional tokens in the secondary market. In the realm of crowdfunding and initial coin offerings (ICOs), institutional investors are progressively making their presence felt in the digital finance domain. The dynamic pool of crowdfunding investors exemplifies this pattern. Traditional financial institutions have the ability to establish a connection between digital and traditional finance by either building their own digital platforms or forming partnerships with existing digital platforms. A significant proportion of the funds allocated by venture capital firms is directed towards digital platforms. Investors must diligently undertake comprehensive research on Initial Coin Offerings (ICOs) due to the inherent hazards, including fraud and knowledge bias. Investors' judgments in the field of digital finance are influenced by numerous aspects. Lending platforms are experiencing a growing level of participation from institutional investors. Factors such as borrower perspectives, interpersonal connections, and proximity play a crucial role in shaping investor decisions. Investors participating in initial coin offerings are influenced by various aspects of economics, technology, and philosophy. Institutional investors are believed to have a positive impact on the growth of the ICO industry and on enhancing control and monitoring mechanisms. ICOs and fintech lending investors encounter challenges like as prejudice, partiality in selection, and asymmetry in information. Exercising caution is crucial when constructing algorithms to prevent the inadvertent introduction of bias. The potential success of an Initial Coin Offering (ICO) is contingent upon intangible factors such as the caliber of the workforce. The influence of social networks on investment decisions is demonstrated by the phenomenon of herding behavior in Initial Coin Offering (ICO) marketplaces. Prejudice may persist because consumers may still judge individuals based on their external appearances. Fintech lending has the capacity to mitigate information asymmetry, however, challenges related to discrimination and soft data endure. There are concerns regarding the long-term sustainability of these platforms due to studies indicating that equity crowdfunding benefits projects and initial coin offerings (ICOs) benefit investors through underpricing. Despite encountering obstacles in fulfilling rewards, crowdfunding enterprises that successfully accumulate funds often gain more support, indicating their resilience. Market conditions and investor enthusiasm are among the numerous factors that influence the outcomes of Initial Coin Offerings (ICOs). It is crucial to be attentive in the realm of digital currency as social media engagement, particularly on Twitter, has an impact on initial coin offerings (ICOs).

## Regulations

Considering the rapid advancements in fintech, it is imperative to thoroughly reconsider the existing regulatory frameworks. The inefficiency of policy formation is worsened by the delay in the

emergence of new technologies and the ability of existing regulations to adapt to them (Zetzsche et al., 2017). Significant regulatory reforms were implemented following the financial crisis of 2008. However, the emergence of new advancements in financial technology (fintech) necessitates further modifications. Striking a balance between safeguarding investors and not impeding innovation and entrepreneurship is of utmost importance. Clear restrictions are necessary for larger companies to securely enhance technology for institutional investors. Hornuf and Schwienbacher (2017) identified three primary stakeholder categories that legal frameworks should consider: investors, corporations, and intermediaries. Various legal approaches are required to tackle the requirement of restricting the quantity and kind of investors, enforcing transparency requirements on companies, and imposing verification responsibilities on intermediaries. International collaboration is crucial in the fintech business because of its global nature, as it addresses jurisdictional difficulties and ensures fair competition (Magnuson, 2018). The principles of regulation should focus on safeguarding all stakeholders by promoting transparency, ethical conduct, and impartiality, while also mitigating potential risks. Moreover, advancements in fintech technology could potentially facilitate the establishment of self-regulation. Cumming et al. (2021) and Yermack (2017) argue that the decentralized character of the blockchain and the network effects of crowdfunding enhance risk monitoring and transparency. Gurrea-Martinez and Remolina (2019) emphasize the significance of developing suitable regulations for security tokens, whereas Momtaz (2020a) highlights the challenges associated with ICO governance. Regulations have had a substantial impact on the expansion of crowdfunding. Legislation enabling equity crowdfunding has allowed smaller projects to flourish, whereas larger endeavors are encountering stringent restrictions (Hornuf and Schwienbacher, 2017). Initial coin offerings (ICOs) must strike a balance between operational flexibility and compliance with regulations (Li and Mann, 2020). Implementing regulations for initial coin offerings (ICOs) has the potential to enhance the quality of projects and eradicate fraudulent activities (Bellavitis et al., 2020). Fisch et al. (2021) emphasize the necessity of implementing more stringent regulations to control initial coin offerings since this is essential for safeguarding the interests of investors. Possible solutions involve imposing restrictions on investments from non-accredited firms and setting upper limits on investment quantities. However, implementing these measures may expose platform administrators to potential circumvention, as highlighted by Hornuf and Schwienbacher (2016) and Block et al. (2020). Transparency, the act of revealing information, is a crucial element in safeguarding the interests of investors. As per Fish (2019) and Roosenboom et al. (2020), ICOs achieve higher success rates when they possess comprehensive documentation, more lengthy white papers, and greater transparency. However, ensuring transparency can be challenging, and legislation must strike a balance between promoting innovation and preventing its misuse (Hornuf et al., 2020). An et al. (2019) and Giudici et al. (2020) discovered that the effectiveness of an Initial Coin Offering (ICO) is mostly determined by its governance. They also observed that improved governance can result in more successful fundraising outcomes. One method to enhance security token sales is by segregating voting rights and revenue flow (Lambert et al., 2020). Enhanced governance can be achieved by establishing founder incentives that are tied to project achievement through the implementation of issuance procedures or lockups (OECD, 2019). The fintech industry has significant regulatory challenges related to racism and prejudice, particularly in the context of machine learning and algorithmic credit scoring. In order to tackle these concerns, it is imperative to conduct a comprehensive analysis of the characteristics of Big Data and implement measures to prevent unauthorized statistical bias (Bartlett et al., 2022; Kanagaretnam et al., 2021). Ultimately, the

regulatory framework pertaining to fintech needs to be modified in order to adapt to emerging technology, while still upholding fairness, transparency, and safeguarding the interests of investors. Striking a balance between advancements and preventive measures is essential for establishing a resilient and morally upright financial industry.

## Conclusion

Despite the rapid growth of fintech, it is unlikely to replace traditional banking in the near future. Fintech's ability to enhance the efficiency of the finance industry entices fresh investors and creates opportunities for new business endeavors. The limitations of conventional funding sources have resulted in the emergence of alternative finance options. They have been accustomed to collaborating with tiny enterprises, startups, and fledgling organizations that are either in their early stages or have little resources. Institutional investors such as banks and venture capitalists also implemented modifications. The increasing interconnection of different funding choices has led to a growth in participation (Hornuf et al., 2020). The financial technology (fintech) industry is attracting significant funding from banks and venture capital firms due to its optimistic future. Fintech still faces numerous challenges that need to be addressed in order to ensure investor protection and foster innovation. With the emergence of new technology, it gradually replaces established ones.

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