

Crowdfunding: Financing Ventures in the Digital Era

Srinivas K. Reddy and Yee Heng Tan

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*Crowdfunding, Digital Interactions,
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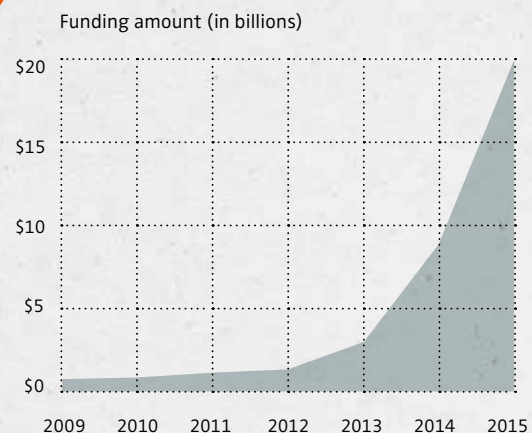
THE AUTHORS

Srinivas K. Reddy,
Professor of Marketing,
Director, Center for Marketing Excellence, Singapore
Management University, Singapore
sreddy@smu.edu.sg

Yee Heng Tan,
Singapore Management University
yeeheng.tan.2013@pbs.smu.edu.sg

Digitalizing the funding industry /// Over the past few years, digital platforms have emerged as a new way to disrupt industries. These platforms not only connect riders and drivers, like Uber, or hosts and guests, like Airbnb, but also ventures and funders. Crowdfunding platforms like Lendingclub or Kickstarter have gained widespread visibility and acceptance in recent years. Crowdfunding was virtually non-existent until 2010 but has been growing exponentially since 2010. In 2015, the volume rose to US\$34.4 billion, slightly surpassing the venture capitalist industry and is expected to continue growing quickly.

FIGURE 1:
Crowdfunding growth
from 2009 to 2015



Source:
Drawn from Massolution's Crowdfunding Industry Research in 2012, 2015, 2016

Crowdfunding – using the digital space to raise money

/// Crowdfunding is a method of raising funds to support a venture, typically by raising small amounts from a large number of investors. This whole process is conducted on an online platform that facilitates interactions between project creators and potential contributors, called backers.

Typically, a project creator posts a project on a platform seeking a certain amount of funds for some venture. Potential backers view the project and contribute money if they are convinced of the idea. In most cases, these backers receive something in return. With many backers contributing different amounts, the projects may meet their funding goals and the project creators can move on with their ventures. Although the crowdfunding model is similar across all platforms, the platforms cater to groups with entirely different motivations. Basically, there are four different crowdfunding models:

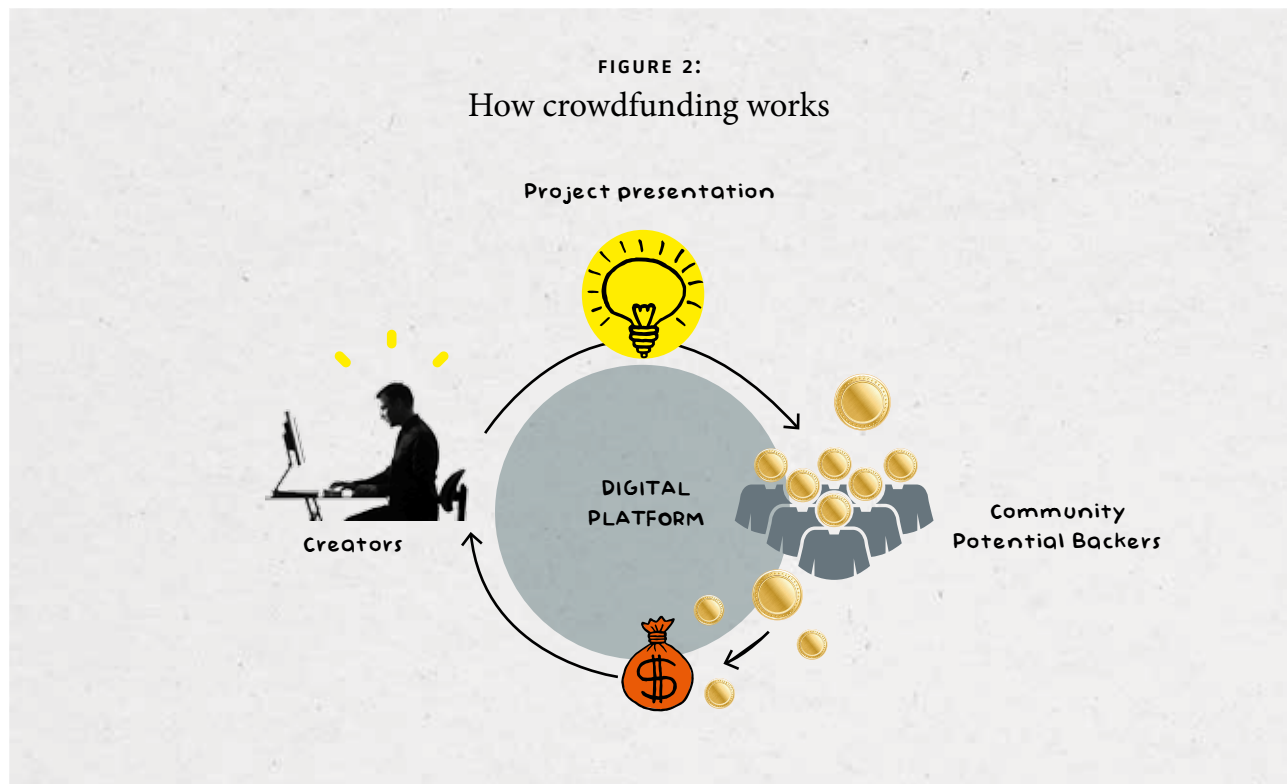
> **Donation-based crowdfunding** refers to charitable causes. Typically, there is no reward and contributors are genuinely

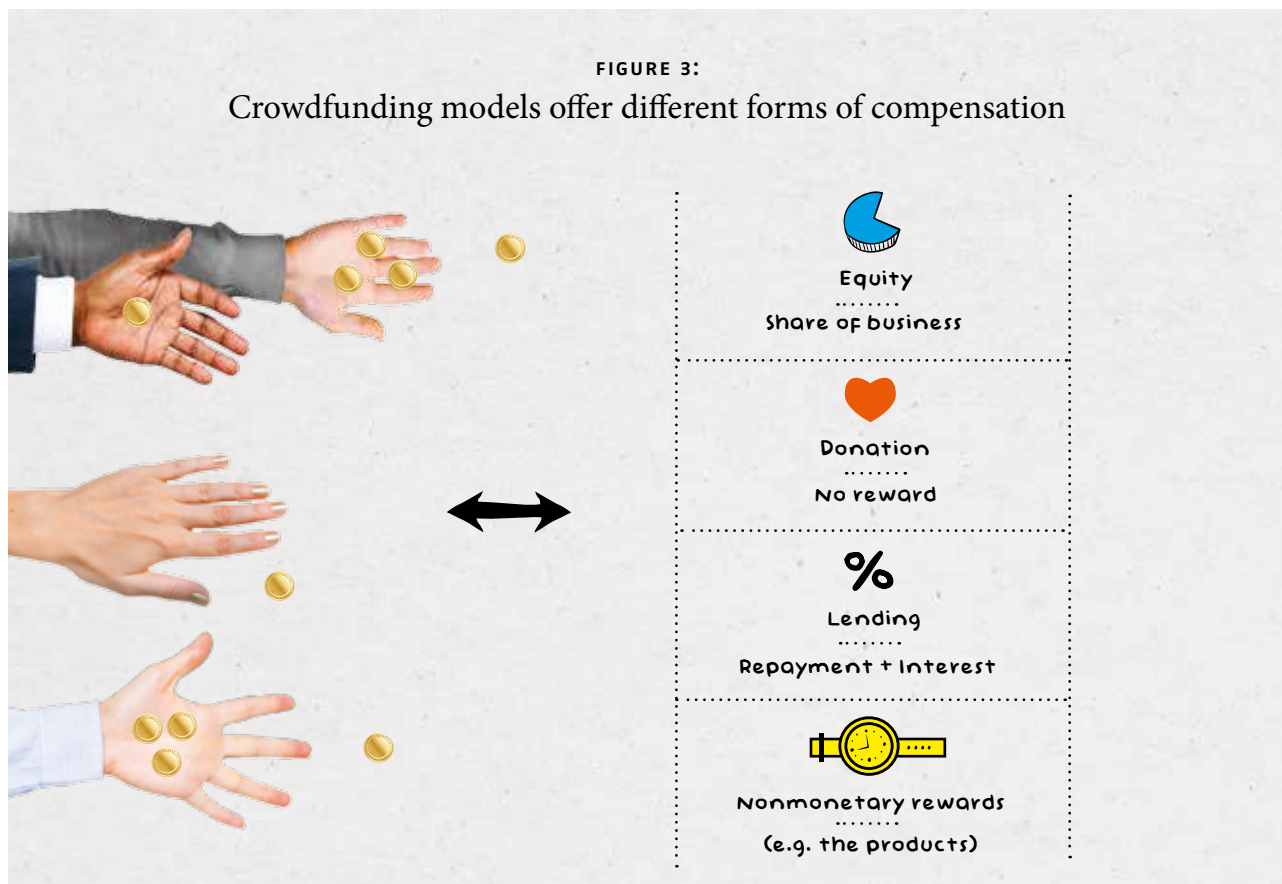
trying to help. An example of this form of project is the Pulse Victim Fund posted on GoFundMe after the 2016 Orlando Shooting.

> **Reward-based crowdfunding** is the most common form of crowdfunding. Typical projects are frequently covered in different media, and sites such as Kickstarter and Indiegogo corner a large proportion of the reward-based crowdfunding market. Their contributors receive a compensation or perk - which can be symbolic, such as mere appreciation; or tangible, such as the funded product. An example of this form is the Pebble Watch (see below), which has raised millions on Kickstarter.

> **Equity-based crowdfunding** shares the profits of a venture by offering contributors ownership in the business in exchange for their investments. Sites such as EquityNet and CrowdCube allow startups and small businesses to solicit funds from potential contributors who are interested in selling their share later for more than their investment. Examples of successful equity crowdfunding projects are

FIGURE 2:
How crowdfunding works





E-Car Club, an electric car sharing business that was sold to Europcar. Its contributors earned a substantial surplus on their investment.

- > **Debt-based crowdfunding** is where people seeking to borrow money apply through sites such as LendingClub and Prosper. Investors who choose to loan money to these borrowers will be able to get back their loan with interest. Their rates tend to be lower than bank rates but still generate strong returns for investors.

Crowdfunding – supplying more than just funds /// The main motivation for using crowdfunding is the access to funds from the community. Certain projects may be unable to access traditional funding sources for various reasons – institutional investors may doubt a project's success, the size of the market may seem too small or the creators may not have an appropriate track record. In inviting communities to act as gatekeepers, crowdfunding effectively allows the free market to regulate project survival.

In addition, crowdfunding fulfills other functions that may be useful for creators. In the words of Richard Branson, founder of Virgin Group, it provides a connection to people by ensuring "market validation, access to new investors, promotion, community exposure and real-time feedback." Businesses can use community interest as a metric to gauge market response. A project that is unable to achieve funding may indicate failure and thus save creators the time and effort they might otherwise have invested in the project.

Even established companies have used crowdfunding to test the demand for or appeal of new products. It enables creators to engage with communities and to listen to their feedback throughout the entire development process.

Crowdfunding – success or failure? /// Crowdfunding is able to help projects that would otherwise have fallen through the cracks, and there are many success stories. In 2012, for instance, Eric Migicovsky crowdfunded his idea of a smart watch, called Pebble Watch, after being rejected by venture

{ Box 1 }



CROWDFUNDING PATHS TO PROJECT SUCCESS

> Select the right platform

Choosing the correct platform for a project is important, as the platform itself can influence the expectations for a project. It is important to check the platform architecture – its layout and settings. Certain platform features may impact a project. For instance, the platform's level of privacy control can affect the contribution amount of backers. The community that surrounds each platform may differ as well. Even though some backers may be personal contacts, a lot of other backers will originate from the platform itself.

> Communicate the project well and accurately

A high-quality project description on the crowdfunding page, coupled with keeping backers updated, will increase the likelihood of project success. The early stages of a project are particularly important and creators should reach out to as many potential or influential backers as possible in order to generate traction for their project. The following recommendations help to ensure that a crowdfunding project remains on track.

EARLY STAGES OF CAMPAIGN:	LATER STAGES OF CAMPAIGN:	POST-CAMPAIGN PHASE:
<u>GENERATE INTEREST</u> PROMOTE YOUR CAMPAIGN TO YOUR OWN SOCIAL CIRCLE INCREASE THE VISIBILITY OF YOUR PROJECT BE TRANSPARENT ABOUT THE COSTS OF THE PROJECT, YOUR CAPABILITIES AND WHERE THE MONEY WILL GO TO CREATE A VIDEO AND UTILIZE SOCIAL MEDIA AND THE PRESS TO SPREAD THE WORD DESIGN APPROPRIATE REWARDS FOR BACKERS	<u>EXPAND OPPORTUNITIES</u> UPDATE BACKERS ON PROGRESS OF CAMPAIGN ADDRESS CONCERNS OF POTENTIAL BACKERS EXPAND ON THE REWARDS IF NEEDED AFTER BACKER FEEDBACK: OFFER DIFFERENT COMBINATIONS OF REWARDS CAPITALIZE ON MOMENTUM GENERATED IN THE EARLY STAGES	<u>DELIVER</u> KEEP IN CONSTANT COMMUNICATION WITH BACKERS GET BACKER FEEDBACK IN THE EVENT OF ANY CHANGES TO THE PROJECT BE UPFRONT WITH ANY POSSIBLE DELAYS

> Leverage prior experience and personal networks

Previous successful crowdfunding projects by the creator and a large social network can help a project succeed. Social capital is especially important in the early stages of crowdfunding as crowdfunding often exerts a multiplicative effect on backers. Potential backers not only provide contributions but can take the role of marketers as they are able to influence others within their social circle to contribute to the project as well.

> Don't promise too much

Even if projects succeed at the funding phase, they might be unable to deliver their promise to backers. Most of these cases stem from issues with the manufacturing process - from underestimating the funds needed or from overpromising during the funding phase. Such backlashes may affect the creators' future projects. In some cases, a civil lawsuit may even be filed against them.

capitalists who considered his idea too risky. He set up his project on Kickstarter, and the community rallied behind him. At the end of the crowdfunding period, the project raised US\$10,266,845 from 68,929 backers, exceeding its funding goal of US\$100,000 by more than a hundred times. Following that, the company has earned US\$60 million in revenue just in their first year. Pebble Watch has since gone on to create two other crowdfunding campaigns – a new smartwatch raised over US\$20 million from 78,471 backers in 2015, and a heart rate-enabled smartwatch raised over US\$12 million from 66,673 backers in 2016.



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However, these impressive cases of success are in the minority. On average, success rates for crowdfunding have been moderately low. Kickstarter, the most popular crowdfunding site, has a success rate of 35 %, with certain categories such as technology garnering only 20 %. As a huge majority of projects fail, it is important to learn from success stories. Crowdfunding is by no means easy. It is necessary to manage the expectations of diverse stakeholders during the whole funding and development process, all of which may affect the success of a venture. Disappointing the community can result in a huge fallout that may adversely affect the business. Box 1 lists important success factors.

The future of crowdfunding /// Consumers have often been told to vote with their wallets, and crowdfunding is yet another powerful way to do so. It has given a voice to

the community, in allowing individuals to co-finance projects that they deem promising. Its power has been vastly underestimated until recently. As the crowdfunding scene matures, many platforms are evolving to focus on niche sectors. Innovative sites are on the rise for all of the four basic models. The Threshold site, for instance, allows backers to launch campaigns that petition companies for a change in their behavior in exchange for a large purchase commitment. Crowdfunding platforms continue to give communities with diverse motivations and backgrounds a larger voice in determining which ideas will be given a chance to enter the marketplace. By lowering entry barriers to financing, they will continue to help more people in realizing what they believe in. Typical backers may be more invested in their ventures than typical angel investors, whose main concerns tend to be returns on their investment. By opening doors and supporting projects with committed people, crowdfunding will continue to increase welfare in all parts of our world.

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