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FINANCE

The Fundamentals of Crowdfunding

by Amanda Wong

Crowdfunding is rapidly becoming and entrepreneurial mainstay. Some of the most viable projects of the past years have been funded in part by donors on platforms like Kickstarter and Indiegogo.

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Crowdfunding is rapidly becoming an entrepreneurial mainstay. Last October, the SEC voted to allow individual investors to buy shares of startups and small businesses using crowdfunding platforms. This move reflects the ongoing shift in capital markets towards crowdfunding as a method for engaging individual investors.

> *"There is a great deal of enthusiasm in the marketplace for crowdfunding, and I believe these rules and proposed amendments provide smaller companies with innovative ways to raise capital and give investors the protections they need," said SEC Chair Mary Jo White*

Based on this trend, CMR will focus on crowdfunding as the topic of our next special issue. This blog post aims to explore some of the basics of crowdfunding. The primary types are reward-based crowdfunding and charity crowdfunding.

Reward-based Crowdfunding

Reward-based crowdfunding offers goods or services in return for financial backing. Its success largely stems from its appeal to supporters who wish to get tangible returns from their pledge. This system benefits both companies and donors by allowing projects to use rewards as motivation without having to give up company shares. A salient case of reward-based crowdfunding is Pebble Technology, which used the platform Kickstarter to fund the development of the Pebble Smartwatch: an e-paper watch that connects via Bluetooth to iOS or Android smartphones, allowing it to display email, SMS, and other notifications. The company raised $20,338,986 in Kickstarter funding in March 2015.

The success of the Pebble Smartwatch can be directly attributed to its use of Kickstarter, a platform which boasts higher pledges than every other major crowdfunding platform combined. Kickstarter has become known for its creative, enterprise-aware community, and fully funds over 65% of submitted projects within their campaign timelines. It promotes its social network by requiring that projects fit into one of several innovation-focused categories (ex. Food, Technology, Art) and rejects personal interest or charity projects. This site is most appropriate for companies creating marketable products, projects in the arts, and start-ups. By concentrating the site's attention solely on pitched projects, Kickstarter attracts investors looking for innovative goods and services, making it prime for companies who are looking to participate in reward-based crowdfunding.

Charity Crowdfunding

Charity crowdfunding, also known as donation-based crowdfunding, is a means of soliciting donations without providing reward-based incentives. These tend to fall into two categories: social and personal. The former often serve social causes and charitable efforts. Their marketing often relies on the moral conscience of the public as well as a sense of civic duty. For example, following the Ebola outbreak in West Africa, the Scripps Research Insititute's Dr. Erica Saphire used Crowdrise to fund her pivotal research on the cure for Ebola. Personal projects, in contrast, fund life events, education, medical treatment, and community projects. They aim to connect with individuals' social circles and rely on strong personal networks for success.

Charity crowdfunding for social purposes is more suited to platforms like Indiegogo, which encourage crowdfunding for all projects regardless of type. The platform is far more flexible than both GoFundMe and Kickstarter in terms of restrictions on project creators. It also gives more leeway to tax-deductible campaigns, making it particularly apt for use with non-profit companies. Sites like GoFundMe, in contrast, are far more focused on individual causes. It encourages a reliance on individual social circles and social media networks for funding. Those with many friends and family particularly benefit from the platform's efforts to simplify campaign-sharing.

Keep an eye on our social media pages for more information about crowdfunding as we approach the release date of the next CMR special issue.

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