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ARTICLE

Winning Strategies for Crowd-funding

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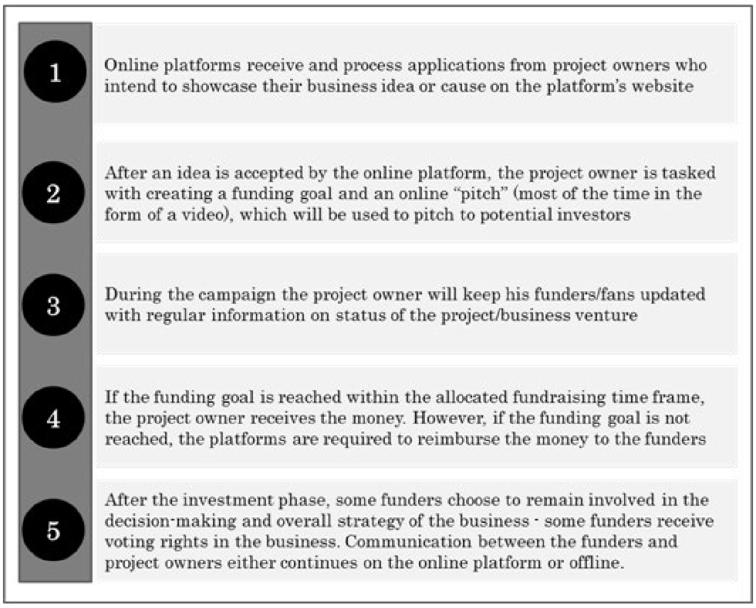
Background

Crowdfunding is the practice of funding a project, venture or initiative by raising small amounts of money from a large number of people, usually through the internet. This project, venture or initiative could be a nonprofit, political campaign or start-up company.

Crowdfunding began as an online extension of traditional financing by friends and familywith the objective of pulling money to fund members' business ideas. It takes advantage of crowd-based decision-making and innovation, and applies it to the funding of projects or businesses. Using social networks, social profiles and the viral nature of web-based communication; individuals and companies have raised billions of dollars in debt, equity and donations for projects.

How Crowdfunding Works



The first successful crowdfunding occurred in 1997, when a British rock band funded their reunion tour through online donations from fans. Inspired by this innovative method of financing, "ArtistShare" became the first dedicated crowdfunding platform in 2000. Shortly after, more crowdfunding platforms began to emerge, and the crowdfunding industry has grown consistently each year.

Crowd fundingbecame widely adopted as a result of the 2008 financial meltdown; largely because of the difficulties faced by artisans, entrepreneurs and early-stage enterprises in raising funds. With traditional banks less willing to lend, entrepreneurs sought other legitimate means of raising funds. There are broadly 4 types of crowdfunding:

- Donation
- Reward
- Equity
- Debt

Donation based Crowdfunding:

Individuals or a group of individuals (referred to as the Crowd)provide money or other resources because they want to support a particular cause/business/product. For example, a youth football team raising money to travel to a tournament. The crowddonatesmoney and gets nothing in return, other than feeling good knowing the team can travel to compete.

Reward based Crowdfunding:

Crowd gives money to a business in exchange for a “reward,” typically the product/service the particular company produces.

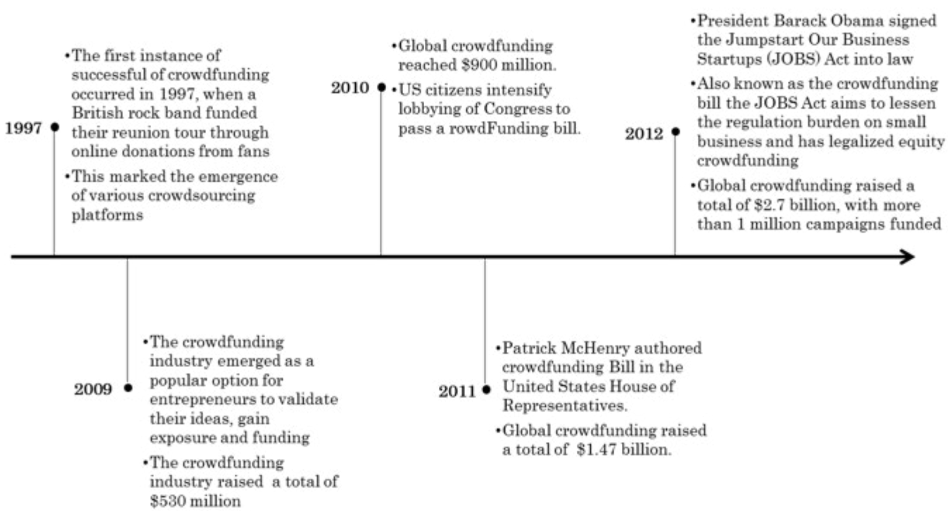
Equity based Crowdfunding:

Members of the crowd become part owners of the company by providing the needed funds for the business in exchange for shares. As equity owners, the crowd realizes some form of return on investment andreceives a share of the profits, in the form of a dividend.

Debt based Crowdfunding:

The company borrows money from the crowd. The individuals lending the money receive the company’s legally binding commitment to repay the loan at certain time intervals and at a certain interest rate.

The Evolution of Crowdfunding



Source: *Ciuci Consulting Analysis*

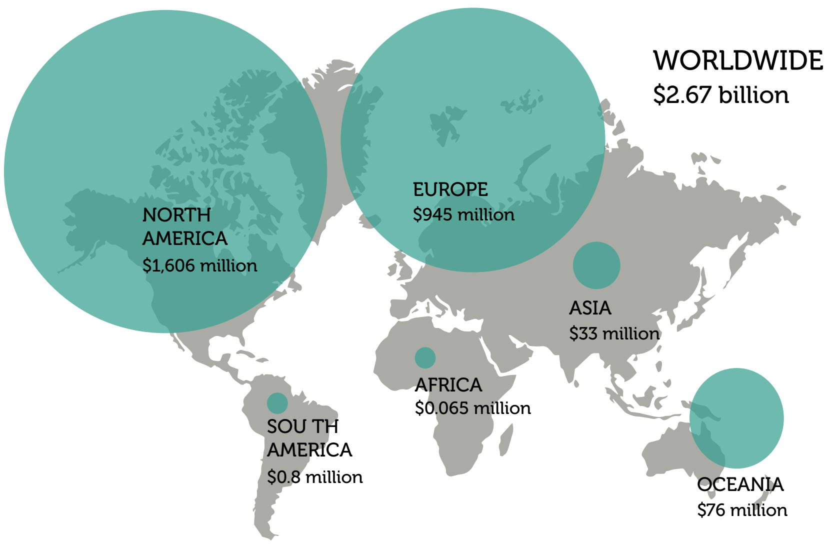
Crowdfunding around the World

In less than a decade, crowdfunding has gained traction in a number of developed economies. They include Australia, United Kingdom, Netherlands, Italy and theUSA. This phenomenon is spreading across the developed world and is now attracting considerable interest in the developing world as well. As lending becomes more difficult due to stiffer requirements and greater regulatory scrutiny, crowdfunding, which originated in the United States, has expanded rapidly as an alternative source of finance.

In 2012, crowdfunding websites in USA helped companies raise $2.7 billion from members of the public, an 81% growth from the 2011 figure - $1.47 billion. Interest in crowdfundingincreasedafter PresidentObama signed the JumpstartOur Business Startups (JOBS) act to legalize equity crowdfunding. Many businesses now offer small investors the opportunity to earn interest from lending money either to individuals or small businesses, while others allow people to invest as little as $15 in companies for an equity stake.

According to Massolution, a global crowdfunding intelligence company, North America and Europe are expected to extend their lead as the dominant home to crowdfunding portals. More than half of the crowdfunding portals in various stages of pre-launch are in Europe, including about 100 in the US.

Global Crowdfunding Volumes; the Crowdfunding World Map



Total funds raised during 2012 in USD

Source: *Ciuci Consulting Analysis*

The growth of the crowdfunding market in Asia is not as rapid as that of other regions. This slow growth can mainly be attributed to the conservative culture of manyAsian countries therefore, they will not be inclined to donate money on a public platform.

In Africa, crowdfunding could still be considered as being in its beta phase but has the potential to evolve into the startup financing culture of the continent, especially when it is adapted to fit Africa's unique business environment. Weak economic landscape, lack of government regulations and limited access to internet, are some of the factors that have limited the growth of crowdfunding in Africa.

Popular crowdfunding platforms in Africa include StartMe, FundFund, ThundaFund, StartCrunch, M-Changa and SlizeBiz. These companies located across South Africa, Kenya and Nigeria have found innovative ways of providing funding to startup companies and other developmental projects despite the challenges experienced.

Benefits of Crowdfunding to Entrepreneurs and SMEs

Crowdfunding can offer unique support for budding and existing entrepreneurs on multiple levels. It is the only form of investment that can provide benefits of pre-sales, market research, word-of-mouth promotion, and crowd advice without additional cost. Other benefits of crowdfunding include;

- Donation-based crowdfunding helps not-for profit organisations to fund projects and core costs, but it can also help to fund creative activities and common purpose activities. Both debt-based crowdfunding and peer-to-peer funding provide SMEs with funds for business expansion, production and other activities. This is a compelling alternative to traditional lending products.

- Reward-based crowdfunding is frequently used for creative businesses or smaller consumer products, where basic pre-financing for production is linked to an initial demand-test. If a sufficient number of people enter into a funding agreement, the entrepreneur has market validation as well as the pre-financing for his activities.

- Equity-based crowdfunding offers an additional route to raise equity for any business venture, with all associated risks. Due to information irregularities and lack of publicly available data in the traditional sense, the investment risk appears higher. However, through the nature of peer review and peer recommendation, as well as instant feedback and the publication of all necessary project details to a large group of potential funders, some of the risk can be mitigated.

- Crowdfunding denotes space for co-creation and the involvement of the end-user in the product definition, a greater pool of innovative ideas and a free word-of-mouth marketing channel. It is also an investment channel for collective wisdom, replacing investment decisions by individual investors or individual fund managers acting based on their personal understanding of or experience with any given market.

Major Risks/Challenges of Crowdfunding

Fraud

The risk of fraud is high in crowdfunding because unlike venture capital or angel investing, the pool of funders do not have any personal contact or real knowledge of the business idea beyond what is presented on the crowdfunding website. Also, the geographical separation between the business/entrepreneur and funders can be an issue.

Setting Valuations

Another concern with crowdfunding is setting valuation, the entrepreneurs decide how much equity to offer for the amount of capital they want to raise. Current practice establishes that the entrepreneur sets the value of the business prior to the start of the crowdfunding campaign.

This can be challenging, as there are often parts of the business, such as intellectual property or estimations on market size and scale that are difficult to estimate or quantify. As such, the entrepreneur can either undervalue or overvalue the business, creating significant problems for the funders.

To address this issue, some crowdfunding platforms permit the entrepreneur to be flexible with the amount of equity offered over the course of the campaign. Another potential solution is allowing the entrepreneur to set the amount of equity and the number of shares, and then call on the potential funders to bid for the equity or shares. Those funders who pay the most money then win the shares/equity.

Post Investment Communication

If a crowdfunding campaign is successful, many funders will continue to be involved in the business at the post-investment stage. Post-investment, funders can provide the entrepreneur with advice on issues ranging from business strategy to product pricing anddesign.

However, managing a large number of stakeholders, particularly as they may not all be located in the same geographical region, can be difficult. For the platforms that allot voting power to funders, this can be even more difficult to manage, if not only for purely logistical reasons: imagine allowing 300 different funders to vote.

Specific Strategies to drive Crowdfunding

Economic

- Craft exceptions to securities regulations that allow easy registration for equity offerings
- Strategically link crowdfunding to patriotic and cultural messages
- Establish a crowdfunding market regulatory body

Technology

- Where appropriate, apply lessons learned from the developed countries
- Determine gaps in existing technology for online financial transactions

Social

- Harness top social media experts/bloggers to communicate with both local and diaspora audience
- Hold media and educational events to build awareness and understanding
- Hold regular crowdfunding events with trusted third parties to teach successful techniques on crowdfunding

Cultural

- Leverage exisitng incubator/accelerator/structured co-working spaces as hubs for innovation in funding
- Foster professional investor & consumer confidence in crowdfundiung through impactful seminars
- Encourage the participation of all classes of people

Recommendations

Crowdfunding platforms have been operating in different countries for several years with few known instances of fraud. However, as the market grows and achieves wider acceptance, there will be attempts to evade regulations and defraud investors.

The biggest challenges remain business failure and execution/fulfillment challenges. These challenges may be as a result of poor management, no enough funds raised or poor research and strategy. Execution or fulfillment challenges may also occur in some successful crowdfunding campaigns when a company does not have the capacity required to meet the demand generated by their campaign.

These risks and challenges may be mitigated through regulation, technology, and social and cultural approaches:

Regulation:

Government should review and update small business regulation from incorporation to bankruptcy. Regulations should balance the need for investor protection with capital formation. A country-specific framework for investment in crowdfundingshould be created to encourage investment in startups and small businesses and attract diaspora remittances. It is also important that these regulations are not too burdensome.

Technology:

In order for crowdfunding to work, individuals must have access to reliable internet. The technology to facilitate ongoing communication between investors and entrepreneurs and enabling tools to systematize and streamline the business lifecycle must also be employed and allowed to operate freely.

Social:

Individuals within a country must be actively engaged in online social networks, as this is the main driver of crowdfunding activity. The network should be engaged in vetting opportunities to allow crowd wisdom (the process of taking into account the collective opinion of a group of individuals rather than a single expert to answer a question) to emerge. Communities should leverage startup events and community-backed finance to support entrepreneurs.

Cultural:

The private sector should be engaged to help create channels of viable businesses that can become potential investment opportunities. This should include the creation and utilization of co-working spaces, incubators, and accelerators. By providing physical space, mentorship, peer learning opportunities and formalized product experimentation, crowdfunding, venture creation and other support services, the private sector can significantly enhance the creation of a culture of entrepreneurship in any society.

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strategy, customer intelligence & training

editorial@ciuci.us

Analyst:
Chima Onyewuchi

Managing Partner:
Chukwuka Monye