AN INTRODUCTION TO CROWDFUNDING

The late 19th century saw the creation of one of the world’s most recognisable landmarks with the gift of the Statue of Liberty by the French to the US. While the French paid for the construction and shipping of the statue it was down to the US to fund the base upon which it would stand. With the statue ready to leave France, the Americans were still well short of the $300,000 needed to build the base and erect the statue. Running short of time the American Committee (responsible for raising the funds) teamed up with newspaper owner Joseph Pulitzer to launch a campaign to invite citizens to donate even small amounts to help in the funding of the pedestal, offering donors miniature replicas of the statue in return. This 19th century crowdfunding campaign raised $100,000 in just five months, contributed to one of the most popular attractions in the world and illustrated the financing power of a large crowd when tapped for funding.

While the American Committee were lucky to have Mr Pulitzer and his paper to publicise their plea for donations, others wishing to access so many people would have had no such help. This, however, has changed in recent years with the rise of social media and the new ease with which communities can form and interact online.

Annual growth in the number of crowdfunding platforms worldwide

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>38%</td>
</tr>
<tr>
<td>2008</td>
<td>45%</td>
</tr>
<tr>
<td>2009</td>
<td>47%</td>
</tr>
<tr>
<td>2010</td>
<td>54%</td>
</tr>
<tr>
<td>2011</td>
<td>60%</td>
</tr>
</tbody>
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Source: www.crowdsourcing.org
With this new opportunity came the need to facilitate the transfer of funds from those who were looking to donate or invest to those in need of the capital. Crowdfunding platforms are online intermediaries that facilitate this process, whose numbers have been growing rapidly in recent years. Recent research estimates that there were 453 platforms operating worldwide by the end of 2011 and numbers growing at a rate of 63 per cent CAGR. The amount of funds committed through the model has enjoyed similar growth with $1.5 billion raised for projects and businesses in 2011. Over 80 per cent of this capital has been raised in the US with Europe having slower growth but leading in pioneering new applications of the model.

The platforms operate by allowing those seeking finance to make a pitch on the site outlining how much money they need, what they need it for and what, if anything, you get in return for contributing. Potential funders can then view pitches on the platform, interact with both those looking for finance and other potential funders and then decide whether or not they want to back the campaign. The majority of platforms operate the all–or–nothing model where, if the target amount is not raised within a given timeframe, contributions are returned to funders and no financing goes ahead.

Crowdfunding facilitates the raising of capital for a variety of purposes, using numerous variations of the model. Below is a typology of how the operators in the market can potentially be segregated. The majority of platforms can be categorised under these four types, but there are several variations, such as hybrid models and those platforms that define themselves in a sectoral vertical rather than by the type of finance they provide.

<table>
<thead>
<tr>
<th>Form of contribution</th>
<th>Form of return</th>
<th>Motivation of funder</th>
</tr>
</thead>
<tbody>
<tr>
<td>Donation Crowdfunding</td>
<td>Donation</td>
<td>Intangible benefits.</td>
</tr>
<tr>
<td>Reward Crowdfunding</td>
<td>Donation/ Pre–purchase</td>
<td>Rewards but also intangible benefits.</td>
</tr>
<tr>
<td>Crowdfunded Lending</td>
<td>Loan</td>
<td>Repayment of loan with interest. Some socially motivated lending is interest free.</td>
</tr>
<tr>
<td>Equity Crowdfunding</td>
<td>Investment</td>
<td>Return on investment in time if the business does well. Rewards also offered sometimes. Intangible benefits another factor for many investors.</td>
</tr>
</tbody>
</table>

**Donation Model.** The donation model of crowdfunding is a means for charities, or those who raise money for social or charitable projects, to gather a community online and to enable them to donate to a project. While most established charities facilitate this through their own website, crowdfunding is popular for small organisations and people raising money for personal or specific charitable causes. Popular sites include Crowdrise and Causes.
Reward Model. The most popular form of crowdfunding to date has been the reward model which has grown significantly in the funding of creative, social and entrepreneurial projects. The model allows people to contribute to projects and receive non-financial rewards in return, usually operating a tiered system where the more you donate the better the reward you receive. The model often closely resembles philanthropy with the donation far exceeded the monetary value of the reward or the reward costing the fundraiser little, such as experience or recognition-related rewards. For some projects the model is similar to a presale agreement. In these cases entrepreneurs or artists crowdfund the production cost of their record, movie, game or product and allow the donors to be the first recipients once the production is complete. Popular platforms operating the reward model are Kickstarter and Indiegogo in the US and Peoplefund.it in the UK.

Lending Model. Crowdfunded lending is largely an evolution of the peer-to-peer model of lending, pioneered by firms such as Lendingclub and Zopa. Projects or businesses seeking debt apply through the platform uploading their pitch, with members of the crowd taking small chunks of the overall loan. Some platforms focused on social causes offer interest-free loans such as micro-lending site Kiva. Others operate more as an investment, where interest rates are decided either by those seeking the loan or using a market for loan parts, such as that used by UK platform FundingCircle.

Investment Model. The final type is the application of crowdfunding to investing for equity, or profit/revenue sharing in businesses or projects. This form of the model has been the slowest to grow due to regulatory restrictions that relate to this type of activity. Some European platforms have been pioneers of the equity crowdfunding model, allowing anyone to take a small stake in an unlisted or private business through crowdfunding. The most popular sites in offering this model are CrowdCube in the UK and Symbid in the Netherlands. Others such as Quirky offer a revenue or profit-sharing model allowing you to capitalise on the success of the projects you back.

While most platforms fit relatively neatly within one of the categories above, many also do not. Examples of this are BuzzBnk a social venture focused platform that offers both the reward model and the lending model. BankToTheFuture aims to offer a stream of funding for businesses starting with reward-based and equity crowdfunding and then loans once they start generating revenue. Other sites target specific vertical niches such as Mobcaster for TV shows, 8bitfunding for video games and UnBound for book publishing.

In the coming months Nesta aims to shed more light on this new model of finance with four pieces of research looking at its application in some different areas:

1. Crowdfunded equity investing

This piece looks at the potential of crowdfunding to provide risk capital to businesses. We examine how the model works and investigate whether it provides the sufficient benefits and protections for both businesses and investors. Regulation, a barrier to the growth of the model, is examined as are other policy issues such as tax incentives. The report outlines the issues surrounding the model, drawing on interviews with key stakeholders in the field.

2. An analysis of crowdfunded lending for business

This research empirically examines a particular type of crowdfunding, the business lending model, which is growing fast in the UK. For the purpose of this study, Nesta is working closely with FundingCircle, a UK-based debt-crowdfunding platform to collect data from both those
who lend and those who borrow through their platform. The study provides key insights on both the motivations and characteristics of those lending and borrowing through the model and examines the growth potential of the model.

3. Crowdfunding for social good

This research takes a closer look at the role of the increasing number of platforms for social giving that are now being used in the UK. We will review the recent development of platforms in this space, and investigate the variety of ways that donors can give to and support causes through these platforms. Much of the new activity in crowdfunding for social good goes beyond one–off and one–way financial donations to include the giving and loaning of money, time and resources. The report will highlight the key trends and challenges for this emerging sector including how existing funding bodies and social projects can make the most of the new opportunities provided by these platforms.

4. Crowdfunding in the creative industries

Crowdfunding platforms can connect cash–starved creative entrepreneurs with audiences looking to fund creative projects because they are passionate about their 'substance', rather than seeking to generate a financial return from them, as well as with investors offering capital on better terms than traditional sources of finance for the sector, such as banks or publishers. Kickstarter, the most successful creative crowdfunding platform, has already generated pledges above $230 million, and funded over 23,000 creative projects.

Many policy–relevant questions about creative crowdfunding remain to be addressed – such as its potential role as a driver of innovation and competition in creative industries dominated by risk–adverse gatekeepers, or its position within the wider financing landscape for the sector. Creative entrepreneurs would benefit from robust knowledge about which project characteristics and crowdfunding practices are more conducive to success. Nesta is currently exploring research opportunities in this emerging area.

ENDNOTES

2. www.crowdsourcing.org

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