

# Accessing Alternative Financing: An Introduction to Crowdfunding

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<sup>1</sup>The views stated herein are those of Ivan Ivanov and are not necessarily the views of the Federal Reserve Board or the Federal Reserve System.

# Crowdfunding Basics

- WHAT IS CROWDFUNDING?
  - *“The practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via the Internet.”* Oxford Dictionaries
- AFFECTED MARKET PARTICIPANTS
  - Entrepreneurs and small businesses
  - Funders, typically retail investors
  - Crowdfunding platforms

# Crowdfunding Basics

- Crowdfunding vs. Angel and VC Investing
  - Angels and VCs to a large part sophisticated investors.
- Crowdfunding has the potential to alleviate funding constraints for small businesses and help fund profitable projects that are left out by angels and VCs.
- TYPES OF CROWDFUNDING
  - Donations- and Rewards-based
  - Lending-based
  - Equity-based

# Donations- and Rewards-based Crowdfunding

- DONATIONS-BASED CROWDFUNDING

- Funders – philanthropists, believe in the idea/venture rather than expecting a return on their investment.
- Entrepreneurs often have humanitarian goals.
- Entrepreneurs retain complete control.

- REWARDS-BASED CROWDFUNDING

- Funders receive a sample of the product if the entrepreneur succeeds.
- Rewards examples: a free ticket to a movie or a concert, a free or a discounted music CD, a T-shirt.
- Entrepreneurs retain complete control.

# A Donations-based Crowdfunding Example

## Mothers Day Orphans Over Orchids

[Story](#)
[Updates 6](#)
[Comments 57](#)
[Fundors 439](#)
[Gallery 15](#)



#Mother's Day - Orphans Over Orchids

892 [Share](#) 42 [Tweet](#)

[Email](#)
[Embed](#)
[Link](#)
[Follow](#)

**\$110,727** USD  
RAISED OF \$100,000 GOAL

111% 0 time left

This campaign started on Apr 15 and closed on May 13, 2013 (11:59pm PT).

Verified Nonprofit  
Flexible Funding ●

**CAMPAIGN CLOSED**  
This campaign ended on May 13, 2013

SELECT A PERK

**\$25** USD

**Feed A Child For A Month**

You give food certainty to a child.

3 meals and 2 snacks a day of comforting and nutritious food.

You give the gift of growing strong.

2

Honor a Mother by giving to those who don't have one. 1 Orphanage 100 kids  
100 wonderful childhoods  
**GUARANTEED!**

<sup>2</sup>source: Indiegogo.com

# A Rewards-based Crowdfunding Example

## The Bradley: A Timepiece Designed to Touch and See

by Eone Timepieces

Home Updates **17** Backers **3,861** Comments **1,029** Washington, DC Product Design

**Funded!** This project was successfully funded on August 15, 2013.



**3,861**  
backers

**\$594,602**  
pledged of \$40,000 goal

**0**  
seconds to go

**THE BRADLEY**  
DESIGNED TO  
SEE & TOUCH

▶ PLAY

Project by **Eone Timepieces**  
Washington, DC

First created - **25** backed

**Hyungsoo Kim** 1140 friends

**eone-time.com**

[See full bio](#) [Contact me](#)

Pledge \$25 or more

[Share](#) (785) [Tweet](#) [Embed](#) ★

An innovative fashion watch that everyone, including the blind, can touch to tell time. Telling time shouldn't require vision.

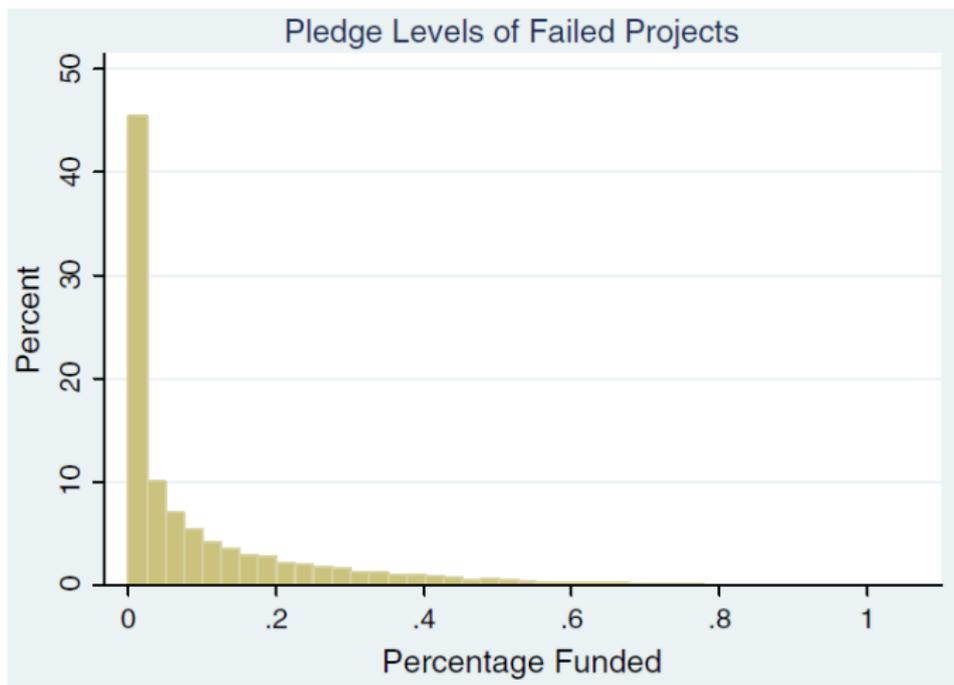
3

<sup>3</sup>source: Kickstarter.com

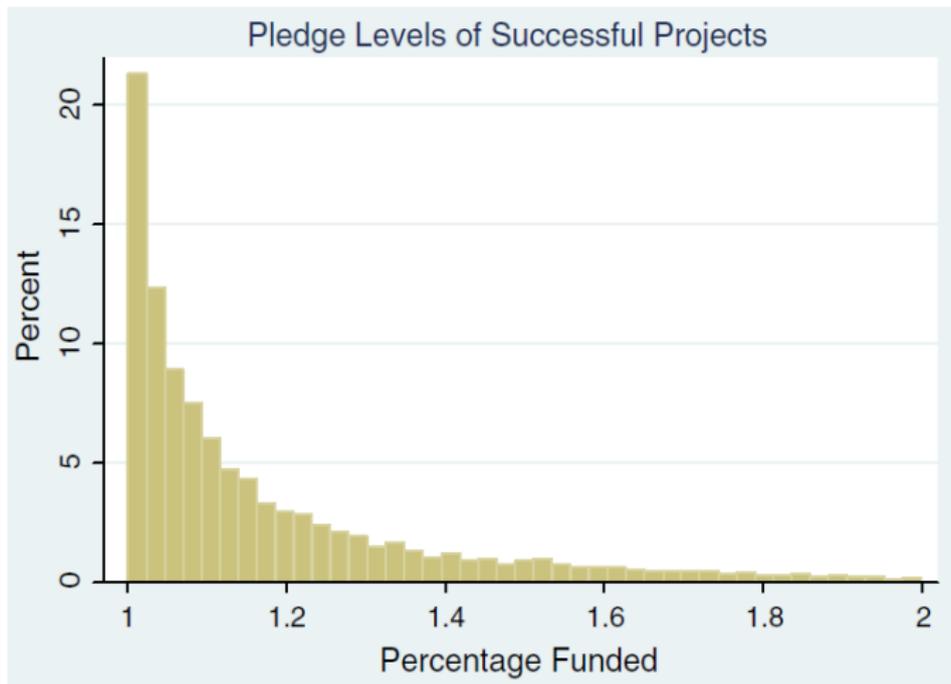
# Do Rewards-based CF Projects Succeed?

- MOLLICK (2014) STUDIES ARTISTIC PROJECTS FROM KICKSTARTER AND FINDS:
  - Half of the posted projects raise at least the goal amount.
  - Successful projects succeed by a narrow margin.
  - Unsuccessful projects fail by a wide margin.

# Failed Projects, Mollick (2014)



# Successful Projects, Mollick (2014)



# Lending-based Crowdfunding

- KEY CHARACTERISTICS

- Lenders may or may not have monetary incentives: for-profit and philatropic lending-based crowdfunding.
- For-profit lending
  - Portals rate loans based on FICO scores, conduct verification of borrower information.
  - Investors observe ratings and borrower information and choose lending according to their risk preferences.
- Philanthropic lending: funds distributed to entrepreneurs by local micro-finance institutions that might charge interest.

# Lending-based Crowdfunding

- SELECTED STATISTICS

- Lending Club: approximately \$5 Billion in loans since 2007.
- Prosper: approximately \$1.4 Billion in loans since 2005.
- KIVA: repayment rate for the \$587 million lent through KIVA approximately 99%.



# Philanthropic lending-based CF

share

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## Kelsi

Oakland Bakes  
Oakland, CA

OVERVIEW
ENDORSEMENT
REPAYMENTS
LENDERS 112
CONVERSATIONS 8



**Personal Story**

I grew up in Oakland, California. My childhood was filled with fresh rustic baguettes, weekly trips to the Jack London Square Farmers' Market, and dodging shopping carts in the narrow aisles of the original Barkley Bowl location. My earliest entrepreneurial endeavor was

**FULLY FUNDED**

A loan of \$10,000 helps me to purchase a vehicle to deliver wedding cakes to the greater Bay Area and increase our advertising to turn hypothetical sales into a reality.

100% Raised

<b>Repayment Term:</b>	36 monthly payments
<b>Grace Period:</b>	N/A
<b>Listed:</b>	Jul 1, 2014

About Oakland Bakes

<b>Industry:</b>	Food production
<b>Years in Operation:</b>	3 years - 5 years
<b>Website:</b>	<a href="http://oaklandbakes.com">oaklandbakes.com</a> 
<b>Follow:</b>	  
<b>Badges:</b>	

## Feleciai

### Skincare by Feleciai

Oakland, CA

OVERVIEW

ENDORSEMENT

LENDERS 584

CONVERSATIONS 83



#### Personal Story

I am a San Francisco Bay Area native, born in Fremont and now living in Oakland. I have an excellent work ethic and drive to succeed which was instilled in me by my parents who moved from a very small parish outside of Baton Rouge to California in search of a better life for their children. My mom worked incredibly hard to own rental properties in the area, and being the youngest of four I learned at a very young age about hard work and dedication as all the children were expected to help out. You might say my entrepreneurial spirit is genetic.

Upon graduating college (I attended both Cornell and the University of Pennsylvania) I spent some time in the trenches of Corporate America and as worked as a REALTOR, but I never felt fulfilled in those roles. I always had an interest in the beauty industry and hit a point in my career that I could no longer ignore that, so I decided to follow my passion and pursue a career in that field by creating Skincare by Feleciai in 2008.

As one of the two African American families in my neighborhood growing up I struggled with

#### PAYING BACK

A loan of \$15,000 helps me to increase my production capacity and hire a part-time employee and buy additional supplies.

Disbursed Oct 31, 2013

Repayment Term:	36 monthly payments
Grace Period:	N/A
Listed:	Aug 16, 2013
Disbursed:	Oct 31, 2013
Paying Back:	Oct 31, 2013

#### About Skincare by Feleciai

Industry:	Arts / Crafts
Years in Operation:	3 years - 5 years
Website:	<a href="http://skincarebyfeleciai.com/">skincarebyfeleciai.com/</a>
Follow:	

Badges:



#### Previous Loans



1st Loan	
Amount	\$5,000
Paid Back	Mar 13, 2013

6

<sup>6</sup>source: [zip.kiva.org](http://zip.kiva.org)

# Equity-based Crowdfunding

- Equity crowdfunding offerings: entrepreneurs sell shares of stock directly to atomistic investors on an Internet platform.
- Currently conducted abroad but a minor portion of the overall crowdfunding market.
- Collins, Swart, and Zhang (2013): the UK equity-based crowdfunding amounted to only GBP28 million out of a total crowdfunding market exceeding GBP940 million.

# Equity-based Crowdfunding in the US

- Regulation Crowdfunding proposed by the SEC on October 23<sup>rd</sup>, 2013 but not adopted yet.
  - Once adopted, start-ups could sell equity shares directly to the public, subject to certain limits.
  - Three proceeds buckets: less than \$100,000, between 100,000 and \$500,000, and between \$500,000 and \$1,000,000.
  - Disclosure requirements vary depending on offering proceeds.

## Concluding Remarks

- Crowdfunding has the potential to transform the capital acquisition process for entrepreneurs and small businesses.
- These trends could be particularly relevant to minorities.
  - CBInsights 2010 report: “87% of all VC-backed Founders are White.”
- Raising capital from sophisticated investors: Reg D and Reg A/A+.