

A Game Changer: Crowd-Funding for Modern Entrepreneurship

Gabriel Rees

Milligan College

Author Note

Written for COMP 211, taught by Dr. Heather Hoover

Abstract

This research paper delves into the emergence of crowd-funding in the social-network driven culture of North America. Entrepreneurship has shifted within this new market setting, brought about by the decline of the U.S. investment banking and the recession of 2008. As a result businesses and entrepreneurs are becoming more reliant upon online resources and direct consumer support. Utilizing new networks of support has enabled start-up projects, businesses, and charities to emerge in a recovering economy. Sustainability within the system is key, and the research goal of this paper is to discover whether modern crowd-funding has the components needed to become a viable replacement to traditional funding systems (i.e. loans, venture capital). Determining the steps that support sustainable projects is key to maximizing crowd funding potential and continuing to develop and expand an effective online infrastructure. While crowd-funding has been used for a broad variety of projects, spanning from art to social development campaigns, opportunities for business and entrepreneurship to engage with this new financial system is paramount. I claim that recognizing how resources are allocated and what entrepreneurial processes are omitted as a result of crowd-funding produces a better understanding and practicality for future users as well as financial investors.

Rees

A Game Changer: Crowd-Funding for Modern Entrepreneurship

After the financial market crash of 2008, North America's economy was frozen. Housing prices plummeted, companies closed their doors, and unemployment skyrocketed, becoming the trending topic across international media. Tempted into risky investment by unrestrained profits, the banking industry championed the collapse of the U.S. economy, and in its wake their policies have followed in the Thermidorian¹ way. The banking system, which previously offered money for homes far beyond buyers' means and unstable businesses prone to failure, reacted dramatically, pulling the liquid capital from those who needed it – small businesses – and giving only to the institutions they trusted – large corporations. This reactionary financial policy impeded the growth of the very people that could break a recession: entrepreneurs.

The dysfunctional system of acquiring loans slowed recovery, while also prompting the need for reconstruction in the U.S. economy, and in response a radically new investment infrastructure formed. With the traditional system's breakdown, "crowd-funding" developed as a means of supporting ideas, businesses, and projects through the pooling of small contributions by many members of the public. While the concept of crowd-funding has existed for centuries (Postolski D. and Nowotarski M., 2013), in our social-media driven world a renaissance took place in the form of Internet crowd-funding platforms. Ranging from music and art to technological development, each platform has a different aim for funding and its own rules and style for doing so. These platforms have

¹ In the first French Revolution the Thermidorian reaction was the violent response against the executions in "The Terror" which took place in the month of 'Thermidor.' It represents a dramatic policy reversal in response to a catastrophe.

Rees

the potential to create a new breed of small businesses, which are free from startup debt, supported by a wider birth of consumers, and tested through the crucible of Internet scrutiny. This new wave of entrepreneurship is the very thing needed in our slowly stabilizing economy. Innovation is the foundation for growth, going beyond simply reacquiring what we once had. Innovating not only *through* crowd funding, but re-imagining the capabilities *of* crowd-funding itself is the key to the greatest change. Utilizing crowd-funding platforms for more than just pet projects, thereby creating businesses that are competitive and sustainable, holds the potential to redesign the investment world, and in doing so begin the revival of the small businesses that drive our world economy.

The modern emergence of crowd-funding was not purely based upon the economic downturn in the U.S. Crowd-funding as it is known today grew out of the basic concept that many individuals can contribute small amounts to fulfill a greater cause. The American Committee for the Statue of Liberty ran into trouble in 1884 when they ran out of funding for the statue's pedestal. This challenge was resolved through a 19th century form of crowd-funding; Jonathan Pulitzer, an American newspaper publisher, used his platform of the press to urge the public to contribute towards the noble cause. Within six months over \$100,000 was raised by more than 125,000 contributors (Postolski D. and Nowotarski M., 2013). This public commitment to supporting a common goal both emotionally as well as financially is built upon a social trust, sense of community, and vision. These fundamental ideas are the backbone of crowd-funding, and with the improved speed and reach of the Internet, it's a much leaner lending machine. Using credit card payment systems, campaign videos and write-ups, and social media for

Rees

spreading causes has opened the door to a much more efficient and powerful system.

What once took six months now takes six days or even six hours. This system is sustainable because the same root motivations remain intact; people want to be a part of something bigger. Getting in on something quickly and backing it strongly allows participants to feel ownership over a project. Financial investment builds a tangible connection between the investors and the investment, and this connection can have lasting value. This is not to say the patriotic place that the Statue of Liberty holds is due to crowd-funding, but its beginning was one of national investment and civic pride. With the internet age comes a connection to more people and a even greater desire to do something that stands out, to be the first investor (or “backer”), the first one to share on Facebook, the first one to tweet about it. These modern motions drive forward the age-old desires behind crowd-funding.

The application of crowd-funding is as rich as its history, not restricted to any one dimension of culture, art, or business. The injection of crowd-funding capital into an area previously unexposed to non-traditional funding methods does not tend to fit homogeneously, and as a result systems are consistently reshaped and reimaged in the wake of modernized crowd-funding. For small film-makers like Pawan Kumar, crowd-funding provides a way around the traditional productions companies that typically provide financial support for directors. These venues for support are often difficult for small directors to access because they expect a high return on their investment. "I knew that regular film financiers would not back the script of the film so I decided to raise money through Facebook and my blog," said Kumar of his newest film project (Gooptu B. & Kandavel S., 2013). This trend is growing stronger internationally as equipment

Rees

becomes cheaper and more directors desire complete creative freedom within their films.

Through the use of social media combined with crowd-funding platforms like

Kickstarter, projects worth their salt are finding financial support faster and with fewer strings attached than ever previously known (Gooptu B. & Kandavel S., 2013).

For innovators within an industry, crowd-funding allows start-ups to hit the ground running. Form Labs was created by a group of friends at MIT with the goal of creating the highest quality 3D printer on the market. When they began their endeavor there was only one company currently producing 3D printers, called 3D SYSTEMS. Form Labs waited for 3D SYSTEMS' patent to expire and then pursued support, using Kickstarter as their platform. They surpassed their goal of \$100,000 exponentially and were pledged an amazing \$2,945,885 in only one month. This support came not only because of their innovative and high-quality system, but because they offered backers of \$2,999 or more a free printer with all the required materials for operation. This unprecedented support drew the attention of the current monopoly, 3D SYSTEMS, who charged Form Labs for patent infringement (Postolski D. and Nowotarski M., 2013). While the legal case is still being worked out, the ability of crowd-funding to mobilize funds easily and at a rapid pace is unparalleled. These characteristics make it a viable support system for innovators, creators, and businesses. The generosity of people who believe in the potential of a campaign goes far beyond what is typically expected of the anonymous Internet community.

The tremendous generosity seen in the support for various campaigns like Form Labs' raises an important issue: why do people give? Incentives from each individual campaign are enticing, but not enough to generate the massive goal exceeding donations

Rees

that have marked many crowd-funding platforms. Crowd-funding does something that no other system can; it allows a community of people to directly support the things they care about regardless of their financial position or location. The power of community drives people to help causes that are less than glamorous. When Cupcake Suite Cupcakery needed to move across town in fall of 2010, they turned to crowd-funding to make it happen. They raised \$9,000 for such a normal and necessary business action, not claiming to revolutionize the cupcake world, but asking for help in order to simply exist as part of it. In addition to the mundane nature of their request, the only incentive was a half-dozen whoopee pies to backers of \$25 or more (Loten A. and Needleman S., 2011). Being able to support local businesses and small-town shops by giving them a voice is an important capability of crowd-funding. This flexibility of application across broadly diverse needs and wants makes crowd-funding a versatile tool to users with varying goals. Crowd-funding's adaptability has led various charities to online platforms in order to see their goals fulfilled. An initiative by Whole Kids, PACT, and Indiegogo² to create urban gardens has managed all its fundraising through Indiegogo's platform. Leaders form local campaigns and raise the funds for their individual garden. This localized use of platforms is counter-intuitive to what generally seems to be the point of crowd-funding. It is more than just a broadcast system to national and international audiences, although it does this very well. Crowd-funding platforms can be used in microscopic settings: providing community-dependent charities and businesses a venue for their voice, a setting for support, and an opportunity to connect with the social-network generation.

² Indiegogo was founded in 2007 and is the second largest crowd-funding platform.

Rees

The generation to which crowd-funding speaks is nothing like their predecessors the baby-boomers. Built upon the Internet, free Wi-Fi, and Apple products, this generation runs ten apps at once and tweets enough thoughts and complaints to fill volume upon volume of books. This generation gravitates toward crowd-funding because it speaks their language. Democracy is more than a right to select officials; it's the right to elect art, music, technology, and culture. Modern crowd-funding would never have been possible before the birth of this generation and it continues to exist based upon their symbiotic relationship. With the constantly developing culture of this new age comes the eternal desire to stand out. The media for achieving this have continually shifted, but the most prevalent form today has manifested in being the first to everything. The goal is not simply to join something significant, but being the first to discover and disseminate that knowledge is the key to "success." Finding something worthwhile is only worthwhile if your friends don't know about it. This confusing cultural norm has positioned crowd-funding to reap the reward. New campaigns begin every day: new ideas, bands, movies, all waiting to be discovered and supported. Backers look to gain not only in a financial sense, but in a quasi-altruistic one as well. It produces a kind of social currency, valued not by dollars, but by interpersonal standings. This odd combination of charitable support and selfish social promotion are key to the consistent and ever-increasing success of crowd-funding platforms.

Crowd-funding is entirely different from other forms of capital raising, and it has new rules for navigating the great potential within it. While it is an entirely new beast, the market in which it operates is not. The struggles that small businesses face translate into crowd-funding and require the same level of tenacity and tact to overcome them. Not

Rees

every campaign created in hopes of support reaches its funding goal. Of the thousands of ideas posted to crowd-funding platforms, only 43% of those posted to Kickstarter³ meet their funding goal (Solis S., 2013). While this can seem disheartening in the current U.S. economy, and belie the statement that crowd-funding is an opportunity maker, in reality it says the opposite. Narrowing the pack of ideas stands as proof of the success-producing power within its design. In the real world, businesses close down every day. In good times and in bad, the common denominator of capitalism is creative destruction⁴.

Entrepreneurs must try, fail, and try again before successful and competitive businesses are formed. Within five years of opening, 50% of small businesses in the U.S. will shut down (SBA: Office of Advocacy, 2012). This statistic is startling, but it's what makes the U.S. economy so vibrant. Simply opening a storefront and selling any old product won't allow a business to grow and thrive. Businesses must tap into the wellspring of buyers and constantly stay abreast on the ever-shifting competition in order to establish and maintain an endeavor of quality. The difference between crowd-funding campaigns and a small town storefront is that online platforms lead to less launched projects. While the 50% to 43% difference looks like a negative trait of crowd-funding, it is a refining characteristic that lays a strong foundation for businesses. It makes crowd-funding the perfect test run for a fledgling entrepreneur; it efficiently filters out the 7% of businesses that will ultimately fail before they even start. This allows better ideas to receive the most

³ Kickstarter was launched April 28th 2009 and has since grown to be the largest crowd-funding platform, raising nearly \$1,000,000 dollars over the past five years. It works only with creativity based projects, and does not serve as an ownership investment system as the stock-market does.

⁴ Creative Destruction is the concept that weak businesses and institutions must fail in order for stronger ones to rise to the top.

Rees

support. Crowd-funding platforms enable start-ups to be competitive from day one, beating out others in capitalistic Darwinism. Eliciting the most benefit from this veritable incubator of business requires specific characteristics. For a funding campaign to have success it must have “credibility, a great pitch, and a hook” (Solis S., 2013). Success is more than just receiving the support of backers; it’s seeing that support translate into long term business. The excitement that leads anonymous Internet browsers to hand over their cash has to be seen in the daily execution of a project, development, or business. The challenges of using crowd-funding platforms are new manifestations of age-old truths. Campaigners must be competitive, adaptable, and driven to find fulfillment in the sea of hopeful appeals. By doing so a new source of support and success opens to an emerging wave of creativity and entrepreneurship.

Passing through the filter of fund raising is a challenge to crowd-funding campaigns, but upon receiving support another test presents itself. The issue that often confronts entrepreneurs is handling a great influx in wealth. Going to crowd-funding platforms for financial support can provide large quantities of capital with little or no strings attached. In the case of Form Labs, far more money was given than expected, and handling this money carries many responsibilities⁵. Floods of capital can be overwhelming and even damaging to recipients with little or no prior experience in finances. Andersen and Nielsen researched the differences in entrepreneurial efficiency between those who received windfall wealth⁶ with an affluent background and those who received it with a middle or lower class background. The study showed clearly that the

⁵ (Postolski D. and Nowotarski M., 2013).

⁶ They studied windfall wealth, or the gaining of large amounts of money in once instance, by analyzing inheritance wealth.

Rees

recipients with prior wealth started businesses and ventures with far greater success than their less moneyed counterparts (2012, P. 3684-710). Their experience with handling money, and often with running businesses, prepares wealthier recipients to most effectively leverage their gain. This issue remains pertinent for entrepreneurs using crowd-funding; those asking for support have much less experience with money, and as a result are more likely to squander it or form an ill-fated business. Built into crowd-funding systems is a defense against this danger – the community. No one gives money without a fairly high level of confidence in the creator. If the plan looks unstable, the funding will mirror it. Veteran backers know what to look for in projects, and a business without a strong model is unlikely to succeed. The firmer the foundation shown by a hopeful fund-raiser, the greater support they will attract.

With the innovation of a new investment infrastructure come challenges of the old guard: upholding patent laws, maintaining integrity, and protecting projects. Patent violations, as in the case of Form Labs, are very disruptive to the ecology of crowd-funding. Delays in promised incentives and the failure of such abundantly funded projects are set backs to the consistent backers looking for the next big thing. Some projects are fundamentally sound, but the execution is flawed. This is the greatest weakness of crowd-funding, and it is something for which there is no foolproof solution. There is no guarantee that the campaigners will follow through on their promises or that the concept presented will be successful. For every success story there are as many projects gone awry. The “i+ case” is infamous for its failure as a highly anticipated product. It received \$85,372 – nearly six times the amount requested, and when it came time for backers to try their reward it didn’t work. The case design blocked cellphone

Rees

reception, making it a completely valueless product. This particular situation illustrates that while crowd-funding is often a fun form of support and investment, it is investment and involves risk. There is no recourse or refund for a failed project (Sofge E., 2012). With traditional forms of financing, creditors would collect collateral or sign payment agreements, but not so with crowd-funding. The click of a button sends money to a hopeful creator, and just as easily it can be lost. The risk is born less on the owner of the project and more by the community of backers. This challenge, while daunting, is not insurmountable. Research into the surrounding market of the product and other comparative projects vying for crowd-funds gives context and contextual value to the goal. Every industry and venue for investment is riddled with risk, but navigating it is possible with a sharp eye and careful consideration of the investment.

All of these pieces come together to create greater potential than typically attributed to crowd-funding platforms. The issues and challenges that it faces are the same that confront businesses and investors throughout the U.S. economy. The advantage of crowd-funding over other older investment systems is its utilization of the internet and its connection to social media networks. When a project finds a supporter, it rarely finds just one. The online generation posts, tweets, texts, and tags a vast quantity of material, so much so that sometimes it seems as if nothing stands out. Once again, community is the force for success. Everyone wants to be a part of things that succeed, and conversely, no one wants to be tied in with a losing team. When someone feels driven enough by a project or business idea to put financial backing into it, they begin to produce positive marketing for it. They post a link, tell a friend, or create a hash tag, all in the hopes that others will join them. This is not a completely selfish desire, but it is strongly motivated

Rees

by the need to be the first in a movement, and the fear of being affiliated with a failure.

This sense of liability creates a vested interest in success. With greater publishing of the investment comes escalation of commitment, and the broadcasting is amplified as a result.

Crowd-funding won't be going away anytime soon. This is made evident by its positioning in the ongoing online revolution of society. Crowd-funding, an idea for the ages, is coming of age in the digital world. Strengthening connection within a culture is naturally expressed through individual contributions to causes of high public worth. This human desire to be part of a greater vision is still prevalent in the social-network generation. The tools are different, but the motivations are the same. The desire to stand out and do something of value drives Smartphone-wielding students to dish out their paycheck to see an indie-record come into existence. Crowd-funding is a viable and sustainable form of funding for everything from cupcake shops and international films to the handiwork of MIT students. With such a massive potential for creating industry, it is clear that entrepreneurship and business have much to gain from it. Volatility within a market economy is unavoidable, but the financial foundations that undergird business and industry determine its reach and impact. Crowd-funding bears the potential to levee separation from reactionary lenders. The contributors to online platforms are subject to the current economy, but that's why crowd-funding works regardless of recessions. Just like the Statue of Liberty, it is not the contribution a much by few, but little by the many. The innate desire to support and drive new ideas lives on even when times are tough. Coupled together, these elements create a sustainable access point for entrepreneurs and creators to tap into resource pools that provide future opportunities. The development and

Rees

use of crowd-funding platforms over the next decade is formative in 21st century democratic capitalism. As social media ideals permeate more and more generations, the social manifestation of finance will grow proportionately. Utilizing the crowd-funding platforms and social-media networks to connect with a new generation of investors is the key to finding a solid foundation in an economy filled with uncertainty.

References

- Gooptu, B., & Kandavel, S. (2013, Apr 13). Crowd-funding show gains pace with kannada movie lucia, over 100 people invest through facebook & blog media]. *The Economic Times (Online)*. Retrieved from <http://search.proquest.com/docview/1326327811?accountid=56369>
- Loten, A., & Needleman, S. E. (2011, Nov 01). Corporate news: A split in the crowd-funding crowd. *Wall Street Journal*. Retrieved from <http://search.proquest.com/docview/901169834?accountid=56369>
- Postolski, D., & Nowotarski, M. (2013). Lessons from the first patent infringement lawsuit filed against a crowdfunded project on a crowdfunding portal. *The IP Litigator : Devoted to Intellectual Property Litigation and Enforcement*, 19(4), 18-25. Retrieved from <http://search.proquest.com/docview/1416188167?accountid=56369>
- NA. "Frequently Asked Questions." *SBA: Office of Advocacy*. SBA, Sept. 2012. Web. 23 Oct. 2013. http://www.sba.gov/sites/default/files/FAQ_Sept_2012.pdf
- Sofge, E. (2012, Aug 18). OFF DUTY --- gear & gadgets: The good, the bad and the crowdfunded --- kickstarter has empowered armchair inventors to make things we really needed -- and some we could live without. *Wall Street Journal*. Retrieved from <http://search.proquest.com/docview/1033807605?accountid=56369>
- Solis, S. (2013, Apr 08). How kickstarter campaigns find success. *The Christian Science Monitor*. Retrieved from <http://search.proquest.com/docview/1324489806?accountid=56369>