CROWDFUNDING: MORE THAN MONEY
JUMPSTARTING UNIVERSITY ENTREPRENEURSHIP

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ABSTRACT

Crowdfunding is a relatively recent phenomenon and is changing the nature of entrepreneurship, particularly for younger and first-time entrepreneurs. Crowdfunding is more than just a new way to attract funding: crowdfunding platforms are efficient and economical ways of training entrepreneurs in many "real world" fundamentals of entrepreneurship by providing a powerful combination of market validation, product validation, and customer feedback. It is the new machinery of the Lean Startup. This paper explores the latest concepts, techniques, and issues in crowdfunding and discusses its impact on entrepreneurship pedagogy and on helping students become better entrepreneurs.

Introduction

For entrepreneurs working on innovative new products, funding is critical to success. The first external funding event not only provides vital cash to sustain the venture through the product development period (or marketing or growth periods), but also often provides some of the first tangible external validation of the business. Entrepreneurs have historically relied on three main types of mechanisms to acquire seed funding: appealing to angels, venture capitalists, and other ''accredited investors''; entering business plan competitions; and self-financing. By design, these mechanisms are limited in terms of the potential number of enterprises that can secure funding and the potential amount of money that each can raise (Kaufman, Kassinger, and Traeger 2013).

Traditional Funding Sources for Early Stage Ventures

	SELF-FUNDING (FRIENDS AND FAMILY)	GRANTS	ANGEL INVESTORS	SUPER ANGELS	VENTURE CAPITAL
OVERVIEW	Usually adds no value to the venture other than cash.	From business plan competitions, university innovation/ entrepreneurship programs, economic development grants.	Accredited investors investing as individuals or in groups.	Accredited individual investors with significant investing experience who take active roles.	Institutional funding (managed by professional investors).
TYPICAL RANGE	Less than $20,000	$5,000 - $100,000	$150,000 - $1.5 million	$250,000 - $1.5 million	$5 million - $50 million
ANNUAL $$ INVESTED	$50 billion	$3 billion	$20 billion	$0.2 billion	$20 billion
STAGE	Idea, seed, pre-seed.	Pre-seed, start-up.	Most for start-ups and growth stages.	Startup and growth stages.	Startup, most for growth and later stages.
OBSTACLES AND ISSUES	Younger entrepreneurs lack sufficient self-funding or resources from friends.	Require significant time and preparation.	Requires evidence of market validation and traction.	Same.	Fund companies, not ideas. Requires significant commitment, an issue for student entrepreneurs.

Table 1. Traditional funding sources (Payne 2011).

First-time entrepreneurs, particularly student entrepreneurs, have many inherent handicaps: lack of in-depth experience and knowledge of a market "domain," no substantial track record, and no network (contacts) in the financing community. These all pose significant obstacles for nascent ventures seeking seed or startup funding for their ideas.

For all the headlines seemingly devoted to the young entrepreneur securing startup funding from the venture capital industry, in reality it is actually quite rare. Out of the approximately 3,700 companies that receive venture capital funding each year, a little more than 1,900 are startup-stage companies (Moneytree 2013) and almost no companies receive venture capital funding at the seed stage.

Funding Gaps

In the venture industry, there is a recent colloquialism known as "the funding gap," which refers to entrepreneurs' difficulty in securing funding for the next stage of development, because their company is not yet valuable or attractive enough to warrant the level of investment for the next stage. In other words, the prior level of funding was not enough to allow the company to make progress to justify the next funding level. There is a funding gap between $25,000 and $100,000, and another capital gap between $1.5 million and $4 million (Payne 2011). Seldom can entrepreneurs accumulate $50,000 from friends and family, while angels are infrequently willing to provide as little as $75,000 for new ventures. In the gap between $1.5 and $4 million, angels only occasionally fund rounds larger than $1.5 million, while venture capitalists are hardly ever interested in investing less than $4 to $5 million in startup companies (Payne 2011).

For younger entrepreneurs, the funding gap is a proverbial chicken or egg problem: in order to attract seed capital, they must provide some evidence of a large market opportunity, customer traction (early sales), or demonstrate tangible product development in order to convince angel investors, but providing this kind of evidence often requires money for technology resources, development, marketing, or other activities that can prove this traction. It's frustrating logic for any entrepreneur: "Angels will invest when you can demonstrate a tangible product or show market traction, but you need money to develop or market the product."

Crowdfunding: Filling the Gaps

In recent years, crowdfunding has emerged as novel way for entrepreneurial ventures to secure funds without having to seek out venture capital or other traditional sources of venture investment (Mollick 2014). Crowdfunding is rapidly evolving from a platform limited largely to arts and creative projects to a broad-based mechanism for raising small amounts of capital from a large number of investors (Winston-Smith, Hannigan, and Gasiorowski 2013). Crowdfunding refers to the efforts by entrepreneurial individuals and groups–cultural, social, and for-profit–to fund their ventures by drawing on relatively small contributions from a relatively large number of individuals using the internet, without standard financial intermediaries (Mollick 2014). The concept of crowdfunding is rooted in the broader concept of crowdsourcing, which refers to using large groups to obtain ideas, feedback, and solutions to develop corporate activities (Belleflamme, Lambert, and Schwienbacher 2013).

Crowdfunding can take on various forms, including peer-to-peer lending, rewards, advance purchase, and donation, as well as equity financing. Crowdfunding can be used as an alternative supplement to these more traditional means of raising capital. Crowdfunding engages a wider array of donors, who may choose to support a greater number of enterprises and who may contribute more funds and possibly do so more quickly and with less effort by and risk to the entrepreneur (Kaufman, Kassinger, and Traeger 2013). But crowdfunding is a relatively new phenomenon, so it is no surprise that the related literature is only nascent (Belleflamme, Lambert, and Schwienbacher 2013). In recent years, crowdfunding has become a valuable alternative source of funding for entrepreneurs seeking external financing. Existing empirical analyses report an impressive and growing volume of money collected through crowdfunding worldwide. Crowdfunding allows entrepreneurs to raise funds through an open call on the Internet. An important characteristic is the extra private benefits that funders enjoy by participating in the crowdfunding mechanism (Belleflamme, Lambert, and Schwienbacher 2013).

The Many Facets of Crowdfunding

	DONATION CROWDFUNDING	REWARDS-BASED CROWDFUNDING	"PRE-ORDER" CROWDFUNDING	P2P LENDING	EQUITY CROWDFUNDING
OVERVIEW	Generally for causes and charitable fund-raising.	Most popular: people pledge contributions in return for "token" rewards (emo-tional or affinity based).	Rapidly rising in popularity. Early funders get ad-vance or early versions of the product.	Peer to Peer lending. "The crowd" loans mon-ey.	The general public invests small amounts in return for stock.
TYPICAL RANGE	Under $10,000 (often under $2,000).	Varies widely. Average $7-10k per project. But many attract $50k, $100k.	Varies widely; many projects attracting over $100k, to $1-$5 million.	Usually for "mi-cro-loans" for small business >$2,500.	Brand new SEC regs. Practical for over $500k to $5m or great-er.
TYPICAL CANDIDATE PROJECTS	Charitable caus-es, events.	Creative proj-ects, events.	New product innovations.	Small busi-ness.	Established startups (post-seed).
ADVANTAGES	Allows entre-preneurs to efficiently solicit funding from friends and fam-ily (who primar-ily want to help the entrepre-neur, personally).	Solicits funding from advocates passionate about the idea, as well as feed-back and ad-vice.	Pre-order (ad-vance sales) provide valuable market valida-tion as well as product funding.	Funding for small busi-ness that otherwise would not qualify for bank loans.	Circumvents the venture capital industry and al-lows for raising significant fund-ing by going directly to the public.
DIS-ADVANTAGES	Practical for small amounts only.	Practical for nominal fund-raising, but does not prove cus-tomer demand.	Pre-order com-mit-ments can be very risky (selling a prod-uct that does not yet exist).	P2P lending requires re-pay-ment, and usually personal guaran-tees.	Significant over-head costs in preparing, reg-ulations still in flux.

Kickstarter, currently the most popular crowdfunding platform, enables "project creators" to post project or product descriptions and videos in order to solicit funding (in the form of "pledge" contributions). Project creators set a fundraising goal and a deadline, usually 30-90 days (with the average being 45-60 days). Using social media and other promotional techniques, the project owners attempt to engage advocates and supporters, who pledge relatively small amounts of money. The project creators offer token "rewards" as incentives for contributors to donate to the project. If the total amount of the pledges meets or exceeds the goal before the deadline, then the "pledges" are automatically collected from the donors. Kickstarter crowdfunding campaigns are all or nothing: if the target funding goal is not met by the deadline, then no money changes hands.

Emergence of Crowdfunding as a New Funding Category

According to Massolution (2013), the number of Internet platforms dedicated to crowdfunding will reach 536 units by the end of 2012. The total of funds raised in 2012 was $2.7 billion, and expected to surpass $5 billion in 2013--primarily to rewards-based crowdfunding. Crowdfunding is also poised to become a growing source of earliest stage equity financing following passage of the JOBS Act in April 2012 (Winston-Smith, Hannigan, and Gasiorowski 2013). The JOBS Act enabled both accredited and unaccredited investors to use the web and social media to make investments in entrepreneurs and small and medium enterprises (Best et al. 2013). A recent trend has been for entrepreneurs with nascent product ideas to offer early versions of the new product to contributors as an incentive for their donation pledge. This amounts to allowing supporters to pre-order the product.

The Pebble Watch: Quintessential Pre-order Crowdfunding

In 2010, Eric Migicovsky had an innovative idea: to create a wristwatch with a touchscreen display that would sync with a mobile phone and enable useful functionality on the user's wrist (such a email and text messages, photos, fitness apps etc.) and essentially launch the modern "wearables" category of devices. While nearly everyone the team approached thought the Pebble Watch was an exciting idea for a product, Migicovsky was unable to attract enough angel funding to create the product. Venture capitalists were unwilling to fund the company because of its early stage, lack of product development, lack of customers, or evidence of a market for the watch. So, on April 11, 2012, the Pebble team turned to Kickstarter and asked the public to pledge a total of $100,000 to the team's idea. Just 37 days later, Pebble had attracted 68,929 ''backers'' of its watch and had raised over 100 times its request: $10,266,845 (Kaufman, Kassinger, and Traeger 2013).

Crowdfunding was not only a way for the company to attract funding from early supporters: it demonstrated market demand, real customers whose funding donations were essentially pre-orders for the product. The crowdfunding campaign proved that there was an enthusiastic market for the product, and customers who were willing to pay for the product before it was even manufactured. A year later, Pebble secured venture capital funding of $15 million and the Pebble watch is now being distributed by AT&T and Best Buy (Gannes 2013).

Crowdfunding as an Entrepreneurship Strategy

Crowdfunding is more than a new source of funding for entrepreneurs, it is a way to interact with potential customers and advocates, and to get important feedback on product ideas while they are being developed. Most significantly, crowdfunding provides a way for entrepreneurs to demonstrate market viability and customer traction to venture capitalists and other investors. Most crowdfunding campaigns have similar components: a detailed description of the product idea or business, funding goals, a video, and a social media campaign designed to engage supporters and attract funders. Each of these components is a microcosm for an essential entrepreneurial skill: planning, pitching, financials, marketing, sales, and more.

Crowdfunding Campaign Components as a Proving Ground for Entrepreneurial Skills

	PROJECT DESCRIPTION	FUNDING GOAL	SOCIAL MEDIA CAMPAIGN	PROJECT VIDEO	REWARDS/ PERKS
ENTREPREN-EURIAL SKILL	Business plan-ning, marketing.	Financial pro-jections, esti-mation. Deep knowledge of prod dev and manufac-turing costs.	Marketing. Soliciting cus-tomer feedback (customer development skills).	Ability to proto-type/ demo and pitch the product.	Pre-orders; sales.
PEDAGOGICAL IMPLICATIONS	Using crowd-funding as a real-world method of validating the effectiveness of pitching and business plan-ning.	Using crowd-funding campaigns as a way to sharpen analytical skills in estimating minimum prod-uct costs.	Using crowd-funding cam-paigns as a way of sharpening social media marketing skills, and eliciting feedback from the market/ customers.	Using the video require-ment to demonstrate some minimum viable product and pitch.	Further sharp-ening of prod-uct dev and estimation

Discussion and Conclusions

Students and younger entrepreneurs are at a disadvantage—in addition to lacking sufficient resources to seed-fund their own ideas, they lack experience in specific markets or domains and have not yet developed a network of advocates and supporters. Beyond offering a viable path to funding for early stage ideas, the crowdfunding process allows entrepreneurs an environment where they can sharpen their pitches, refine their ideas, and learn how to engage advocates and supporters.

For educators, crowdfunding platforms can be a powerful new training tool. By requiring students to transform their ideas into a live crowdfunding campaign, students not only get a chance at getting seed funding for their ideas, they have the opportunity sharpen vital entrepreneurial skillsets such as business planning, product planning, pitching, marketing and sales—all while getting valuable feedback from the market. Crowdfunding is as essential a new teaching tool as it is an essential new skillset for entrepreneurs.

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