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**Brief:** A guide to cover all key elements of crowdfunding that a start-up/entrepreneur would want/need to know if considering this as a means of raising finance for their business idea

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## **Crowdfunding for Business Finance**

Can you make it work for you?

### **What is Crowdfunding?**

Despite the first campaigns starting in the US over a decade ago<sup>1</sup>, 'crowdfund', crowdfunded and 'crowdfunding' only entered into the Oxford English Dictionary in June 2015<sup>2</sup>. The practice began with more philanthropic causes or creative projects such as movies, musicians or artists.

This still happens, but the concept has become a decent alternative to traditional forms of business finance.

### **How Does Crowdfunding Work?**

Crowdfunding is a way to raise money to finance your business ideas. You can also use it to create and grow a community to engage with your customers. Essentially, there are five easy steps to start crowdfunding for your business:

1. Have an idea with a clear business plan
2. Start promoting your idea as much as you can to warm up the crowd (or create your own).
3. Choose a crowdfunding platform
4. Set up a campaign to pitch your idea
5. Launch your campaign and start raising funds

### **When and Why You Could Use it?**

The industry has grown up to cater for all sorts of businesses and business finance requirements, and platforms have emerged in different areas and niches to accommodate them:

- First seed capital for business start ups
- Established businesses looking to launch new products, expand or diversify into new sectors or markets
- Personal, community or charitable causes

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<sup>1</sup> <http://www.independent.co.uk/news/business/analysis-and-features/crowdfunding-is-growing-up--but-with-great-power-comes-responsibility-10343396.html> (correct as of 24/06/15)

<sup>2</sup> <http://public.oed.com/the-oed-today/recent-updates-to-the-oed/june-2015-update> (correct as of 01/06/15)

- Almost anything you need a cash injection for

### **What are Crowdfunding Platforms?**

The 'platforms' are websites set up to facilitate the matching of businesses with investors.

There are hundreds, if not thousands, all over the world. [Crowdfunding.org](http://Crowdfunding.org) is a good place to find crowdsourcing and crowdfunding information, insight and research.

### **What Do You Need to Know Before you Begin?**

Before choosing your crowdfunding platform, you should ask yourself a few questions to help you decide which route to take:

1. How widely do you want promote your idea?

Do you want your investors to be local to you, have particular interests or inclinations, or do you need to widen your reach to interest a greater number of investors to achieve your funding goal?

2. What are the legal implications?

The laws vary around the world, so it may be best to seek advice from your accountant or legal adviser before you begin. The [UK Crowdfunding Association \(UKFCA\)](http://UKCrowdfundingAssociation.org) was set up in December 2012 and works with the Financial Conduct Authority (FCA) to promote a code of practice. The FCA is due to review the crowdfunding market and regulatory framework in 2016 to identify whether changes are required<sup>3</sup>. Even so, not all platforms are regulated<sup>4</sup>, so it's worth looking at what steps they are taking to protect businesses and investors.

3. What are the costs involved?

The platforms charge fees which vary from about 5% to 15%<sup>5</sup>. But beware of hidden fees. For example, some sites might claim to be 'free' but could charge your donors instead. As you would with any new venture, do your research and compare the fee structures.

### **Types of Crowdfunding**

There are broadly three types of crowdfunding arrangements:

1. Reward based

This is how it all started - by offering exclusive or free products, membership or merchandise. It's a lower risk way to raise business finance without incurring any debt or selling equity in your business.

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<sup>3</sup> [www.fca.org.uk/static/documents/crowdfunding-review.pdf](http://www.fca.org.uk/static/documents/crowdfunding-review.pdf) (correct as of 01/02/15)

<sup>4</sup> <http://www.ukcfa.org.uk/faqs> (correct as of 17/07/15)

<sup>5</sup> <http://www.crowdfunding.org/> (correct as of 17/07/15)

## 2. Credit or Debt based

Peer-to-peer lending for businesses. This can be a good way of putting businesses in touch with people looking for a better return on their savings than the banks and building societies are currently offering. Credit terms and interest rates vary and, as with any lending arrangement, you have to pay off your interest and debts before making any profit.

## 3. Equity or Investment based

This is like an online/crowd version of The Dragon's Den. Instead of (or as well as) having one 'angel investor', you offer unlisted company shares in exchange for investors' money.

### **Pros and Cons of Crowdfunding**

It all sounds great, doesn't it? But it's worth considering both upsides and downsides. Starting with the pros:

- Grow your profile online

Crowdfunding can get you instant publicity. Many of the crowdfunding platforms link with social media to allow your investors (and potential customers) to share and promote their investment.

- Marketing and engagement

It's a great way to build up a community before you start. Investors can ask questions and even make suggestions and have a valuable input to the early stages. The social media element will spread the word and sometimes there's no better advocate than someone who has put their money where their mouth is.

- Support for out the box ideas

You don't have to worry too much about ticking anyone's boxes. All sorts of ideas would never have got off the ground if they had to go through traditional business finance options, such as banks and venture capitalists - who may not be so familiar with your sector.

- Instant feedback

Crowdfunding is a great way to do a bit of early research to find out if your idea really is a good one. Let the crowd determine if it's worthy of investment. If your project gets the backing, it's got a better chance of success.

Downsides could include:

- Intellectual property (IP) protection

Make sure you file any patents, trademarks or copyright your idea before you go public - so your idea doesn't get stolen.

- Reputation risk

The power of word of mouth can work in your favour<sup>6</sup>, but you need to consider that people might not like your idea and be very vocal about it. You have to be prepared to manage any criticism in a positive and constructive way. Equally, if your crowdfunding campaign fails to attract investors, this could affect the reputation of your company as a whole.

- Donor exhaustion

Take care not to keep fishing in the same pond. If similar ideas are over-pitched to the same audience, you'll literally run out of investors. As with any business idea, it's unlikely to succeed unless you're offering something different or better.

- Making it happen

It's easier to raise the cash than to actually deliver on your promises. So before you ask for money, be clear in your business plan how you'll spend it for success. Communicating with your disappointed crowd could be a challenge to say the least.

- Overvaluing your business

Investors are being warned that returns may not be as good as alternative investments such as private equity or angel investing<sup>7</sup>. So the crowd is likely to question what you're asking for, or simply not engage if the figure looks too high. If you're overly ambitious, you may not get the money or create problems for yourself later on.

## How to Get the Right Investors

It might be the best idea you've ever had, but it's not about you. As with any marketing activity, you need to be clear about who you're looking to reach and what's in it for them. The platforms will be able to give you information about their 'typical investor', but think about how you pitch your business plan online.

Crowdfunding investors can be individuals who might find your idea interesting, a sound opportunity or an investment interest they can share with friends or family. Or are you targeting businesses that will get a mutual benefit from your success? They might be looking for a new business process or an ethical investment, for example.

Serious investors will expect you to be absolutely clear about your numbers in your business plan. But you have to get people excited too. Most platforms will allow you to upload a video which can be a great way to bring your idea to life. A good presentation could go a long way to convince people to invest. But it's not about doing a hard sell; it's about creating an emotional connection with your potential investor.

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<sup>6</sup> <http://www.businesszone.co.uk/blogs/iat-ltd/iat-blog/power-word-mouth-marketing> (correct as of 23/10/14)

<sup>7</sup> <http://about.beauhurst.com/blog/crowdfunded-companies-keeping-a-bigger-slice> (correct as of 26/05/15)

## **So is Crowdfunding for You?**

If you've decided that you'd like to give it a try, take care to do your homework and plan it carefully. Although your crowdfunding campaign will be the ultimate test of whether your idea is a good one, it makes sense to talk to potential investors either in person or via social media. This guide should, of course, be taken only as a top level guide and you may find it beneficial to seek professional advice. You could also consider speaking to some marketing or PR professionals to help you with your pitch and to create some buzz before you go to market.

Crowdfunding has matured a lot in the UK over the last 12 to 18 months and there are many benefits to using it above and beyond the funding. Arguably, the most rewarding of them will be to create a community of people who believe in your business as much as you do.