Is Crowdfunding Right For Your Business?

There has been a lot of media hype about crowdfunding. In September 2013, Kevin McCloud's company, Hab Housing, raised £1.9 million through crowdfunding platform Crowdcube. With successes like this, it's understandable that the press have given over plenty of column inches. But what's the real story? Can crowdfunding work for any business?

The first thing to recognise is that there are two types of crowdfunding. Reward based crowdfunding applies more to artists and charities where funds are received in return for giving away an item pertinent to the cause. The other type is equity crowdfunding which supports profit seeking entities. The collective value of both crowdfunding forms is expected to reach $5.1 billion in 2013, up from $2.7 billion in 2012.

Crowdcube, the UK's largest crowdfunding platform, increased volumes by more than 150% in 2013. They facilitated the successful funding of over 53 pitches, up from 21 in 2012. The trend is expected to continue.

How does equity crowdfunding work?

The process itself is straightforward. Crowdfunding platforms attract potential investors known as members. These members then review the portfolio of crowdfunding pitches and decide to invest sums into those pitches which appear most attractive.

As a business looking to raise funds, you'll need a good idea, a set of realistic financial projections and a target sum you're looking to raise for a given equity stake. When you launch your pitch, you will have a defined period of time to attract pledges from prospective investors. If insufficient numbers show commitment, the pitch lapses and you'll have to think again. If you meet or exceed your target, arrangements are made to organise share certificates, collect the funds and pass them to your business.

This is an over simplification, but at a high level that's the basic process. Make no mistake, crowdfunding investments are very high risk, but as part of a diversified investment strategy they have the potential to deliver strong returns.

For small and medium sized businesses, crowdfunding can be a useful alternative to traditional bank lending or venture capital lending. But it's worth understanding the type of businesses who are seeing the greatest success through crowdfunding, as well as the profile and motivations of crowdfunding members and investors.

Darren Westlake, Co-founder and CEO at Crowdcube, says "the industries performing well are Food and Drink as well as Technology based businesses. The amounts raised average £150,000 to £200,000." Given the average individual investment of £2800, this implies that crowdfunding pitches attract between 50 to 75 members on average. That's very different to traditional venture capital or business angel investment.

According to NESTA, angels and high net worth investors tend to be mature males whose average investment in a business is around £42,000. The member profile at Crowdcube is younger and 25% are female. This may go some way to explain why Food, Drink and Technology businesses are seeing success with crowdfunding. As consumers, either gender is able to evaluate a new food or drink product, and where technology is concerned, we can all recognise when a new solution provides immediate benefit to our lives.

There is also evidence that successful crowdfunding pitches tend to be from early stage companies. "These typically have something tangible. They may have been trading for at least six months or have landed a couple of contracts. They have already created their brand, have started to build a customer base and are ready to grow their business further" says Darren Westlake. These firms have momentum, and represent a lower risk than a start-up with just an interesting idea. So, before you decide to launch a crowdfunding pitch, ensure you can demonstrate that your business idea has some traction.

That's just the beginning of course. As you might imagine, there are a number of elements you'll need to align if you want to successfully raise funds through equity crowdfunding.

Steps for a successful crowdfunding pitch

This is not meant to be an exhaustive guide. Every crowdfunding pitch will be different. However, here are some common things you should attend to if you want to increase the probability of your crowdfunding pitch being successful:

Secure advance assurance’

It’s been found that being able to take advantage of tax breaks offered by the Enterprise Investment Scheme (EIS) or the Seed Enterprise Investment Scheme (SEIS), is crucial for investors willing to support high risk firms. By getting your crowdfunding proposal approved by HMRC before you launch your pitch, known as “advance assurance”, you’ll at least have the first base covered. Your accountant may be able to help you complete the forms to your best advantage.

Prepare financial projections

Crowdcube ask for three years’ worth of P&L, Balance Sheet and Cash Flow projections. Getting the valuations correct will be critical. That’s not just the profit projections. The equity stake being offered needs to be judged well and there needs to be realistic guidance about the exit strategy too. Prospective investors will want to know when they can expect to see a return on their investment. These projections will do much to shape the perception of trust and integrity essential for a successful outcome. It’s worth developing these projections closely with your accountant.

Build your content library

Every investor will undertake some form of due diligence before pledging funds towards your pitch. You should aim to provide access to a comprehensive library of information that makes the whole due diligence process as easy as possible to navigate. Some potential investors may walk away from a pitch if they find it too hard to get answers to key questions. By hosting comprehensive content on your web site, you’ll be helping to make the due diligence process easier and can help define your brand value at the same time. It can be a key part of the “sales process” for your crowdfunding pitch. Crowdfunding platforms will have teams who can provide guidance on producing legally compliant financial promotions.

Develop your pre-pitch plan

According to Darren Westlake, many crowdfunding pitches fail because “business owners rely solely on the crowdfunding platform’s members alone to raise all the funds rather than promoting the pitch externally and getting their own networks involved”. Consequently, make a point of carefully planning activities for the period leading up to the pitch as well as for the time during the pitch itself. It might require a PR campaign, emails and calls to existing customers and suppliers, or perhaps past work contacts. This article on building a crowdfunding communications plan may prove useful.

Create and resource your pitch

Crowdfunding platforms may operate differently. At Crowdcube, you’ll be encouraged to create a video, populate the pitch area with core content and play an active role in the forums. You may have just sixty days to push your proposition and persuade enough members to submit pledges to reach your funding target. The realism and quality of your pitch content will be evaluated against that of other pitches. How quickly and professionally you respond to questions on the forum will be seen by others as an indicator of how you’ll respond to stakeholders in real life.

The steps outlined above provide a good overview of what’s required to successfully raise capital using crowdfunding. You’ll need a compelling idea and a competent team around you to correctly value and communicate your proposition whilst building trust and integrity at the same time. It could be the funding solution you’ve been looking for.

For further information please speak to your accountant.

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