Could crowdfunding be right for your business?

Crowdfunding is among the fastest growing segments in the financial industry. What are the options and what are their strengths over traditional forms of financing?

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“The world’s bank is a bottom-up, nimble, person-to-person network that funds and gets money into the hands of entrepreneurs where they need it the most.”

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So said Julie Hanna, executive chair of the board of Kiva, the world's biggest crowdlender, which has given out $1.2 billion in loans since it was founded in 2005. The Kiva website is full of success stories of people who were able to secure the funds they needed to start their own businesses, all thanks to crowdfunding.

People like Lindiwe in Zimbabwe, "a mogul in the making," who sells her homemade Lee Juice out of her own shop. And Victor, a Mexican immigrant to the United States, who, despite no credit score or cash flows, finally succeeded in opening the coffee shop for which traditional banks had refused to give him a loan.

Crowd-based funding is among the fastest growing segments in the financial industry. Aspiring entrepreneurs all over the world are discovering that crowdfunding sites offer more than just a fast way to raise finance with no upfront fees and no number-crunching bank managers involved; they also provide great publicity, making it easier to get an idea in front of investors and test their reactions to it.

For banks, this could be a problem in the long run. Some traditional lenders are even beginning to wonder whether they, too, need to get in on this act before they lose any more clients to what they see as nimbler, more personalized and more efficient loan networks that have been quicker to embrace the affordances of technology and smartphone penetration.

This article, based on research and teaching we are doing at IESE in this emerging area, outlines the various options currently on the market, highlighting the strengths and weaknesses of each.

Although these funding alternatives are by no means perfect, they have several strengths that traditional banks would do well to bear in mind as they seek to restore consumer confidence and compete with a new breed of tech-driven players.

From modest beginnings to a vast marketplace

Crowdfunding is the practice of raising funds for a project or business venture by drawing from a large pool of people who each contribute relatively small sums of money, with the transactions mediated via an online platform. Though barely 15 years old, crowdfunding has gone from being on the fringes of the finance universe to radically reconfiguring the way finance is provided, potentially disrupting industries that are centuries old.

A variety of different business models falls under the crowdfunding umbrella, but they all have these features in common: a *project initiator* (or entrepreneur) who needs cash;

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contributors (donors or investors) interested in supporting the project, cause or venture; and a *moderating organization* that provides information about the different initiatives and funding opportunities on offer, and facilitates the engagement between the parties.

There are different categories of crowdfunding, depending on their business models, operating mechanisms and target groups. For the purposes of this article, I will focus on four distinct types as classified by the European Commission's European Crowdfunding Network.

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