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Tapping the Crowd for Funds

Entrepreneurs Reach Out to Investors Through Social Networks, Sites for Capital

By

When recent college graduate Bronson Chang wanted to renovate his uncle's candy shop in Honolulu, he decided to tap his social network for the funds via a "crowdfunding" website, instead of seeking a loan at a bank.



Steve Dininno

Crowdfunding sites—such as ProFounder.com, Peerbackers.com, Kickstarter.com and IndieGoGo.com—allow entrepreneurs to raise money collectively toward a monetary target. Entrepreneurs can create a profile on a crowdfunding site listing their monetary goals, an explanation of how the funds will be used, and an end-date for the campaign. Once the information goes live on the site, investors can pledge money toward the entrepreneur's goal. These sites typically take a small percentage of the funds that an entrepreneur takes home.

In a difficult climate for raising money, more small-business owners are using crowdfunding networks to find cash for starting up or expanding. The amounts that entrepreneurs raise are usually less than \$10,000, and investors often are promised only token compensation such as coupons or free samples. But that trend may be changing, as sites like ProFounder are facilitating much larger fund-raising campaigns.

"We're at the beginning of a huge crowdfunding movement that will disrupt the traditional channels for funding," says Bo Fishback, vice president of entrepreneurship at the Ewing Marion Kauffman Foundation, a research organization in Kansas City, Mo., dedicated to start-ups. He reasons that entrepreneurs prefer the idea of pooling small amounts from ordinary people, rather than "trying to say the right things to get a rich guy to cut a check."

In September, Mr. Chang used ProFounder to create a private fund-raising Web page, showcasing the business plan of Uncle Clay's House of Pure Aloha LLC. He invited 75 family members, friends and customers to view the plan and asked them to contribute money. Nineteen people invested a total of \$54,000 in exchange for a 2% cut of the store's revenue over four years, starting in late 2011.

"Raising capital through the community, through a more democratic process—it was just a perfect

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match for our business," says Mr. Chang, now a business partner at the shop.

Mr. Chang is now trying to raise another \$60,000, using a public profile on ProFounder, allowing strangers to invest as little as \$100. Like the private investors, they get a 2% revenue share for four years—but only until they are repaid. Any additional returns they receive are donated to charities.

The crowdfunding concept started a few years back as a way for photographers, filmmakers, musicians and other artists to cobble funding—usually from their fan base—in order to complete their creative works.

Crowdfunding has now extended from the art world to the business world, thanks to the popularity of social-media outlets like Facebook and Twitter.

"The economy, combined with strengthening social media, allows entrepreneurs to get funding that isn't available at the banks," says Sally Outlaw, co-founder of Peerbackers, which launched in October and caters exclusively to entrepreneurs.

Regan Wann raised more than \$4,000 in 45 days this summer through RocketHub.com, a crowdfunding site that launched earlier this year, originally targeting artists. The funds have enabled Ms. Wann to expand her Shelbyville, Ky., tea shop, Through the Looking Glass LLC.

Ms. Wann touted the initiative to customers, and linked to it on her Facebook page and her blog. A total of 60 customers, family members, friends and strangers contributed. The supporters got a combination of gifts, depending on the amount pledged, including free tea samples and the honor of naming one of the tea rooms.

"I did not know what the response would be," Ms. Wann says. "Every day until the day I hit my goal, I worried I wouldn't make it. The day I achieved my goal, I was so excited."

Ms. Wann had reason to worry. RocketHub, like many crowdfunding sites, holds the pledges until

the goal is met. If the campaign falls short at the end date, all funds are returned.

Crowdfunding has other drawbacks. Because it is so new, some people aren't comfortable with the concept. Indeed, Ms. Wann received an additional \$2,000 from supporters who wanted to help—just not through RocketHub. And some customers and fellow business owners were so put off by the initiative that they no longer patronize the store, she says.

"In my community, some of the older business leaders have said that it's shameful, that this is not how businesses should be run," she says. Ms. Wann suspects that support fell along generational lines because younger people are more active online.

There are risks for the financial backers as well. The crowdfunding sites may conduct a preliminary check to ensure the business is legitimate, but cannot be held responsible if it isn't. The sites usually don't enforce allocation of the funds or that supporters receive their promised gifts. (In the case of ProFounder, investors receive a term sheet outlining their investment.)

Another caveat: success isn't guaranteed. Roughly 45% of the projects on RocketHub hit their goals, although that rate drops to about 25% for small-business ventures. IndieGoGo releases funds regardless of whether the goal is met, and some 40% of projects receive at least \$500, but only about 10% of projects hit their targets.

Chef and entrepreneur Anton Nocito used IndieGoGo in October to raise money to build a kitchen where he could make soda syrups. He received only \$3,796 of the \$18,000 he wanted.

Unable to afford his own kitchen space, Mr. Nocito used the funds to buy bottles and labels for the syrups. He is still running P&H Soda Co. Inc. out of shared kitchen space in Brooklyn, N.Y.

"I wouldn't do it again," says Mr. Nocito. "It was worth the try, and it was a good learning experience, but for me, I may end up going other [funding] routes the next time."

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