**American Express Small Merchant Knowledge Center**
**October Phase I Content**
**By Joshua Monen**

**AXP Umbrella Topic:**
Leverage/Cash Flow, Financing Options

**Series:**
Crowdsourced Funding For Small Businesses

**Article Headline:**
Is Crowdsourced Funding A Viable Option For Small Businesses?

**What You Will Learn:**

- What Crowdfunding Is
- How the JOBS Act Will Change Crowdfunding In the U.S.
- The Pros and Cons of Crowdfunding and Traditional Financing

**Body:**

After Eric Migicovsky failed to receive additional funding from investors he turned to crowdfunding. The 25-year-old founder of Pebble launched a crowdfunding campaign on Kickstarter, the world's largest crowdfunding platform, on April 11 intending to raise $100,000 to create 1,000 smartphone-synced watches. Backers received a Pebble watch as a "reward" when they donated at least $99. In the first 28 hours, Pebble received $1 million. After five weeks over 68,900 backers contributed, bringing the total to $10.3 million before Migicovsky asked people to stop donating.

Some use Pebble and similar success stories to support their claim that crowdfunding is the best thing to happen to small business since Apple's App Store. But critics point out crowdfunding is stressful, very competitive and doesn't always work.
In this article you'll learn:

- What Crowdfunding Is
- How the JOBS Act Will Change Crowdfunding In the U.S.
- The Pros and Cons of Crowdfunding and Traditional Financing

**What is Crowdfunding?**

Crowdfunding (sometimes called crowd financing or crowd sourced capital) is the process of asking the general public for donations that provide startup capital for new ventures. Campaigns are typically run on popular crowdfunding websites for 30 to 90 days on average.

There are the four main types of crowdfunding:

1. **Equity-Based Crowdfunding:** Investors receive a stake in the company.
2. **Lending-Based Crowdfunding**: Investors are repaid over a period of time.
3. **Donation-Based Crowdfunding:** Contributions go towards a charitable cause.

4. **Reward-Based Crowdfunding:** Donors receive tangible, non-monetary rewards such as a watch or a pre-released CD.

**New Crowdfunding Bill (The JOBS Act)**

Existing laws have limited crowdfunding in the United States to the reward- and donation-based crowdfunding models. Therefore U.S. donors cannot receive any form of ownership or monetary compensation for their contribution (only rewards). And without any potential for return on investment it's no surprise that the most common amount donated to projects on Kickstarter is only $25. Compared to an average investment of $2,900 on the U.K site crowdcube.com where equity- and lending-based crowdfunding is allowed.

But thanks to the recent passage of the JOBS Act (which goes into effect January 2013) U.S. small business owners and investors will now be allowed to participate in equity- and lending-based crowdfunding also known as "business crowdfunding."
Here are some pros and cons to crowdfunding:

**Crowdfunding Pros**

- You retain complete ownership of the entire business and project.
- You control the decision-making processes (not the case with traditional investors).
- You can gauge public interest before spending money on new services or products.
- Potential to exceed funding goal, as Pebble did ($100,000 goal yet funded $10.3 million).
- You can begin receiving pledges as soon as you make a plan and create a compelling pitch.
- After you build an audience you can propose future projects to them.
- Backers can give valuable feedback, not only funds, about your project.

**Crowdfunding Cons**

- Managing a crowdfunding campaign takes a significant amount of time.
- Without a pre-existing audience it can be difficult to get funding.
- You must convince thousands of people with a pitch as opposed to one or two investors.
- Competitors could steal your ideas since they're published publicly.
- It requires much more creativity.
- You could end up spending a lot of time and effort and still not reach your funding goal.
- Crowdfunding is becoming more and more competitive.
- You miss out on expert advice you typically get from experienced investors.

**How To Choose Between Crowdfunding and Traditional Financing**

Crowdfunding isn't right for every business. While it's ideal for startups with a strong consumer focus it can be difficult for B-to-B ventures or technical projects. Success in crowdfunding hinges on a short compelling pitch that resonates with a large group of everyday people. So if you're selling a new customer relationship management system to insurance agencies, crowdfunding is probably not right for you.

The other factor to consider when deciding between crowdfunding and traditional financing is how much capital you need. Crowdfunding is best suited for businesses that need to raise under $100,000. Keep in mind that Pebble is the most funded crowdfunding campaign in history. They are the exception, not the rule.

If you decide to use crowdfunding to raise capital then you'll also need to decide which of the four crowdfunding models mentioned earlier is right for you (donation, reward, equity or lending). Remember, until the JOBS Act is implemented in January 2013, U.S. businesses are restricted to the donation- and reward-based models. After that all four models will be allowed in the United States. The donation/reward models are better if you're targeting people who will donate for altruistic reasons while the equity/lending models tend to attract people who want to invest for profit.

To learn how to create a crowdfunding pitch read Crowdfunding Guide Pt. 2: How to Craft a Compelling Pitch.

Bio:
*Joshua Monen is a freelance financial writer, marketing consultant and speaker who specializes in small business, personal finance and startups. His has written for numerous national publications and websites including PerkStreet, MicroVentures and Lanier Upshaw.*