

Crowdfunding: Online Charity or a Modern Tool for Innovative Projects Implementation?

Denis A. Profatilov^{1,2}, Olga N. Bykova² & Maria O. Olkhovskaya²

¹ Vitus Bering Kamchatka State University, Petropavlovsk-Kamchatskiy, Russia

² The Russian State Academy of Intellectual Property of Russia, Moscow, Russia

Correspondence: Denis A. Profatilov, Vitus Bering Kamchatka State University, Petropavlovsk-Kamchatskiy, Russia. E-mail: denprofatilov@gmail.com

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Abstract

Crowdfunding is a promising field of financing high-risk innovative projects. The start-up developers raise money needed for their start-up implementation on a crowdfunding-platform by means of the Internet. The investors may also include ordinary citizens who wish to support this or that original idea and contribute to its implementation. The possibility of access to a completely new product (and before the official sales) is the main motive for financing projects.

Keywords: crowdfunding, Kickstarter, backer, innovation, project, investment, implementation

1. Introduction

The technological process embracing general masses has reached incredible dimensions for the last ten years. Modern people cannot imagine their life without a mobile phone, their work without a computer, their computer without access to the Internet. Owing to new communication technologies now it is possible to gain access to any kind of information, to buy and sell various goods by means of one “click”, to visualize objects which are located at a considerable distance and so on.

During the current period of development business cannot be considered effective without making use of Internet-technologies: if a company has no official site it will cause a decrease in consumers’ loyalty, the use of marketing technologies is extremely limited. The overwhelming majority of companies taking into account the observed tendencies in the plane of increasing dependence of consumers on Internet-technologies stop running their business in a classical way and transfer it into the Net; for example, ordinary shops become Internet-shops, printing editions (newspapers and magazines) are issued with the “online”-prefix. Thus, practically all the sections of economy adapt themselves to the needs of Internet users.

In order to find additional funding beginner-companies, first of all, develop Internet-sites of their projects with the purpose of potential investors’ getting all necessary information about the process of project implementation and possible risks. However, not only professional investors have an opportunity to finance projects they are interested in. Modern instruments of implementation and support of various projects by means of Internet-technologies allow any Internet user to become a participant of financing the mentioned projects. This instrument is referred to as “crowdfunding”.

2. Defining Crowdfunding

Recently a new tool for fundraising has appeared - crowdfunding, allowing to provide funding for the project, without resorting to outside investors, venture capitals and financial and credit institutions.

Crowdfunding is the practice of funding a project or venture by raising many small amounts of money from a large number of people, typically via the Internet (Oxford Dictionaries, 2014).

Crowdfunding projects can range greatly in both goal and magnitude, from small artistic projects to entrepreneurs seeking hundreds of thousands of dollars in seed capital (Mollick, 2014; Schwienbacher and Larralde, 2010). Crowdfunding draws inspiration from concepts like micro-finance (Morduch, 1999) and crowdsourcing (Poetz and Schreier, 2012), but represents its own unique category of fundraising, facilitated by a

growing number of internet sites devoted to the topic (Mollick, 2014). Some crowdfunding platforms are explicitly designed with philanthropic intentions (Agrawal et al., 2010).

When considering the commonly accepted definition of crowdfunding the issue of its belonging to some group of economic terms should be examined. It is worthwhile, in our opinion, to view crowdfunding as a financial instrument that works by means of collective cooperation of people who voluntarily unite their resources on a crowdfunding-platform in an effort to support other people's or organizations' projects.

Crowdfunding-platforms are specialized websites which serve as intermediaries between people or organizations launching some project (project creators) and people who wish to finance the given project (backers).

3. Analysis

The world crowdfunding-platforms activity analysis reveals that the most successful one is the American site Kickstarter. Kickstarter is a website created in April, 2009 for raising funds in order to implement creative, scientific and manufacturing projects in the framework of crowdfunding. By means of Kickstarter crowdfunding-platform various projects from 15 groups are financed: computer games, film and video, design, technological projects, music, publishing, food, art, fashion, comics, theater, photography, dancing, journalism and crafts.

Project creators indicate the amount of money which they need for the implementation of the project and the period of time during which they are planning to raise this amount. The characteristic feature of fund-raising process on the Kickstarter crowdfunding-platform is the "all or nothing" principle: if a project has not raised 100% of the amount planned for its implementation all collected money is returned to backers and the project will not be implemented. If project creators have managed to get more money than they planned they will receive all collected amount.

The underlying limitation in the activity of the Kickstarter crowdfunding-platform is imposed on starting projects: not all individuals and legal entities can do it. A year ago the Kickstarter geography included only the territories of the USA and Great Britain, but nowadays they were joined by such countries as Canada, Australia, New Zealand and the Netherlands that proves good prospects of this crowdfunding-platform development and shows the possibility of entering new economic zones. But, in spite of geographical limitations, there are examples in practical application when non-residents of the above-mentioned countries launch projects in partnership with the residents.

According to the data of the official Kickstarter website (Table 1) as of the beginning of September, 2014, the platform raised investments for the implementation of 174 267 projects to the total amount of \$1.3B. But only 39.69% (69 167 projects) were successfully funded to the total amount of \$1.124B. The commission of Kickstarter for rendered services is 5 % of the total collected amount, thus, it could gain \$56.21M.

Table 1. Kickstarter stats (2014. Accessed: 06.09.2014)

	Launched projects	Successfully funded projects	Success rate	Total dollars (M)	Successful dollars (M)	Unsuccessful and live dollars (M)
All	174 267	69 167	39,69%	1 300	1 124	176
Games	12 113	3 995	32,98%	269,20	237,86	31,34
Film & Video	39 322	15 233	38,74%	235,60	195,75	39,85
Design	9 735	3 378	34,70%	200,68	176,41	24,27
Technology	7 194	1 825	25,37%	192,96	165,75	27,21
Music	32 460	17 179	52,92%	122,33	110,77	11,56
Publishing	19 419	5 843	30,09%	55,63	46,19	9,44
Food	9 528	2 854	29,95%	52,26	42,50	9,76
Art	13 955	6 200	44,43%	41,61	35,85	5,76
Fashion	7 737	2 021	26,12%	40,62	34,47	6,15
Comics	4 565	2 190	47,97%	31,10	28,29	2,81
Theater	6 831	4 224	61,84%	27,41	24,07	3,34
Photography	5 570	1 752	31,45%	15,27	12,65	2,62
Dance	2 169	1 446	66,67%	7,35	6,81	0,54
Journalism	1 488	416	27,96%	4,57	3,93	0,64
Crafts	2 181	611	28,01%	3,59	2,92	0,67

It was also revealed that the majority of successfully funded projects belong to the categories “Music” and “Film & Video”: 17 179 projects and 15 233 projects, correspondingly. If we analyze the amounts of invested funds we can see that the greatest amount was collected by successfully funded projects of the “Games” category – \$237.86M.

But if we approach the analysis of the statistic data from the standpoint of investment amount per one project it is possible to distinguish the following three categories with the greatest figures which demonstrate a big gap between them and the others:

1. “Technology” – \$90.82K per one project;
2. “Games” – \$59.53K per one project;
3. “Design” – \$52.22K per one project;

Let us compare: the fourth position on this criterion belongs to the на “Fashion” category – \$17.05K per one project.

The analysis of projects which gained the biggest funding shows that in this context the leading positions are also occupied by technological projects. Thus, the project of Pebble Smartwatch (innovatory watch for wireless communication and information transmission from modern smartphones) got the record amount on the Kickstarter platform – \$10.266M (68 929 backers).

Pebble has become not only the most successful project for the whole period of Kickstarter existence, but it has collected the necessary sum for a surprisingly short period of time. The amount which was initially planned– \$100K – was collected for two hours. And it took them only 28 hours to collect the first million of dollars (Habrahabr, 2012).

If we compare crowdfunding with other tools of project implementation, for example, with venture financing, business-angels, investment funds and others we can notice their similarities in the object of investment (a start-up) and the goal of investment (project execution) (Table 2).

The basic difference between these tools is the planned result of the project implementation. Thus, when start-ups venture financing is used the determinative factors of effectiveness imply the increase in the price of the project after its launch, the profit which it gives and the probability of the fact that the company executing the project may turn into a bigger one with further entering IPO market.

Table 2. Comparative description of crowdfunding and venture financing

Common points	Peculiarities
- object of investment;	- planned result of project execution;
- goal of investment	- participation in the company’s activity after the project execution;
	- risks in case of unsuccessful project execution.

The main result sought by backers in crowdfunding is not getting profit. When financing projects on crowdfunding-platforms backers get reward connected with the direct output of the declared product. For example, backers that supported the project of creating the innovatory watch Pebble (technological projects), in some definite period of time stated at the start of the project are the first to get this watch. The main factor affecting the backer’s choice is the exclusiveness of the offered product, because it will enter the market only after the commitments to the backers are honoured and will be sold at a higher price. Thus, crowdfunding model serves as a pre-order for this or that product, but the economic efficiency of this model application, all other investment conditions being equal, is much higher than in case of “venture way” application.

The differences between crowdfunding and venture financing also involve the share of participation in the activity of the company after the project implementation. It is evident that the goal of a backer implies getting a single result, that is, after investing money in a successfully financed project and getting the sought reward (the product) the backer stops maintaining contacts with the company. Conversely, in case of venture financing the investors are active after the implementation of the project and continue their activity till the moment of selling their share in the company and increasing the initially invested capital.

The final difference between the above-mentioned tools is a risk which occurs in case of unsuccessful implementation of the project. In the context of crowdfunding backers have a right to return their money before the moment of getting reward and do not bear any financial risks. With venture financing, in case of

unsuccessful implementation of the project, the investors lose all their investments if there are no specially stipulated conditions in the agreement.

In 2013 the USA (JOBS Act, 2012) and Italy (Consob, 2013) adopted laws devoted to the problem of legalization and regulation of start-up companies' using funds raised with the help of crowdfunding. The given laws prove that crowdfunding gains more and more economic power and requires regulation at the legislative level. That presents a corner stone in the aspect of impetuous growth of new projects on crowdfunding-platforms as well as the trust displayed by backers.

Foreign scientists have been studying the given financial instrument since the time of crowdfunding-platforms mass creation. It should be noted that the impetuosity of innovations in this sphere sometimes makes us view critically the interrelationship of the investigations conducted before with the current situation. For example, in the research work of British scientists L. Collins and Y. Pierrakis (2012) crowdfunding is subdivided into four types: Donation Crowdfunding, Reward Crowdfunding, Crowdfunded Lending (financing in the form of a credit from backers with the further return of the invested money to project creators with certain interest) and Equity Crowdfunding (financing with the purpose of investment and future participation in the activity of the company – getting shares, distribution of profit and so on) (Table 3).

Table 3. Form of crowdfunding

	Form of contribution	Form of return	Motivation of funder
Donation Crowdfunding	Donation	Intangible benefits	Intrinsic and social motivation.
Reward Crowdfunding	Donation/Pre-purchase	Rewards but also intangible benefits.	Combination of intrinsic and social motivation and desire for reward.
Crowdfunded Lending	Loan	Repayment of loan with interest. Some socially motivated lending is interest free.	Combination of intrinsic, social and financial motivation.
Equity Crowdfunding	Investment	Return on investment in time if the business does well. Rewards also offered sometimes. Intangible benefits another factor for many investors.	Combination of intrinsic social and financial motivation.

While the first two types of crowdfunding offered by the British scientists are related to the current realities, Crowdfunded Lending and Equity Crowdfunding are now designated by another term. As it has been mentioned above, using crowdfunding as an instrument of financing the backers who pledged in the project do not aim at getting profit. The positions with which the sought result is getting profit from the project financed by a great number of people are united into the notion of “crowdinvesting” (Wikipedia Germany, 2014), that is collective investing money in a project with the purpose of getting commercial profit from its implementation.

Relying upon the experience of the crowdfunding-platform Kickstarter it is possible to state that the crowdfunding model opens up new vistas in the sphere of technological innovative projects implementation. Nowadays 1825 technological projects for the total amount of \$165.75M have been financed on Kickstarter. Thus, it is evident that in the field of innovative projects implementation crowdfunding is one of the most profitable and effective instrument without outside participation of investors and investments which suggest return, without the transfer of share in the innovative company.

The scheme presented in Figure 1 and the following economic effect from placing an innovative project on a crowdfunding-platform and raising funds for its implementation show a real possibility of using this instrument in broad application. In the American scientist Ethan Mollick's (2014) opinion, the success of project financing depends, first and foremost, on the quality of project documentation development, presented video materials, project advertizing on the Internet and social networks.

The given process also includes the notion of the so-called “point of no return”: if during the first days of its start-up on a crowdfunding-platform the project has raised not less than 25% of the asked amount, the probability of full financing is 90% (Localwiki, 2010).

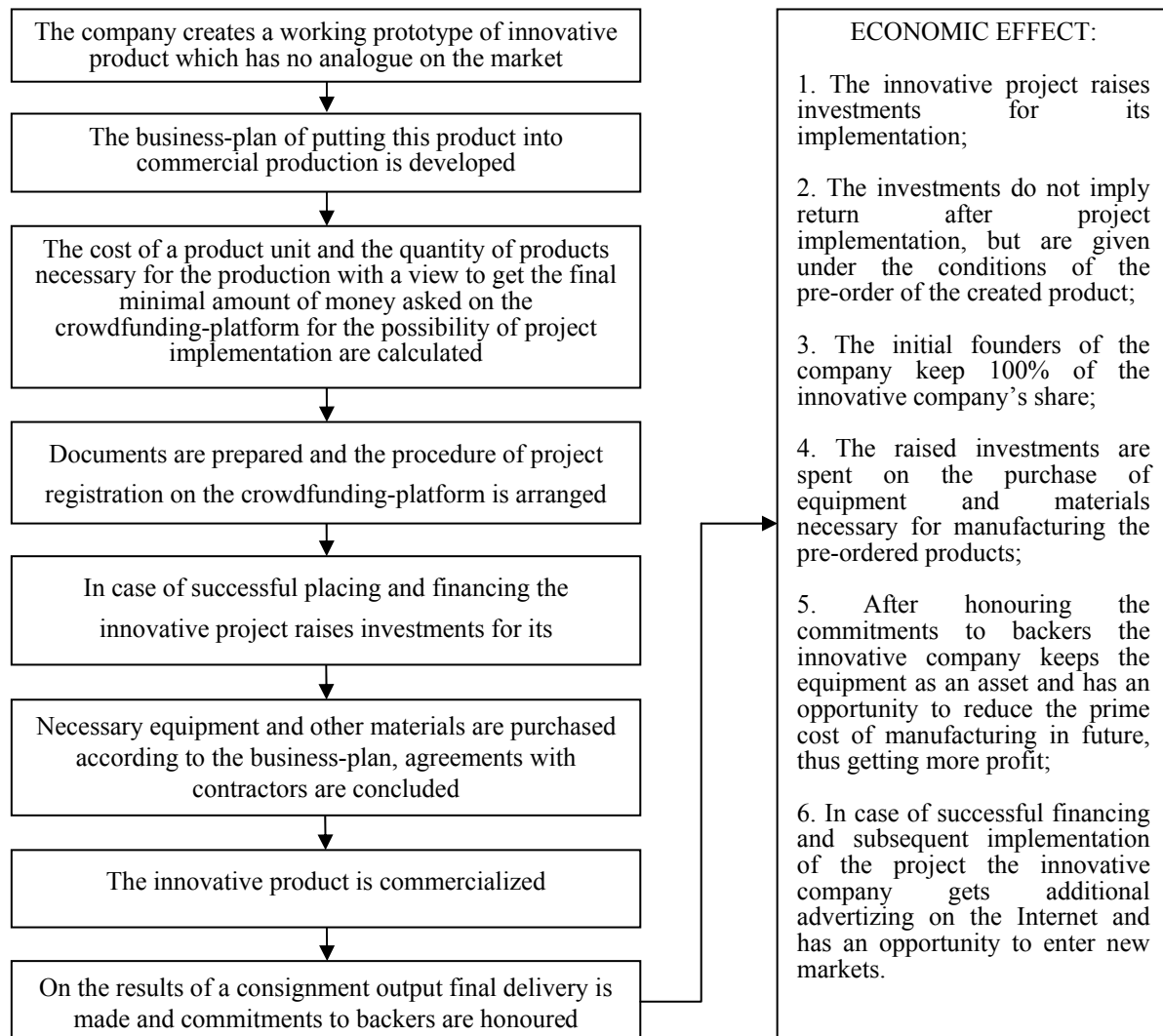


Figure 1. Scheme of innovative technological project implementation by means of crowdfunding

4. Conclusion

There is no doubt that, in many cases, money raised by means of a crowdfunding-platform is not sufficient for the implementation of a big project. There are exceptional situations, when projects raised much greater funds than it had been planned before, but these projects are occasional and provide real breakthroughs and innovations. But the obvious and indisputable advantages of project starting on a crowdfunding-platform are the following:

1. getting initial funds for project implementation without outside investors' participation. Thus, in case of success, project creators eventually get a working company the gross cost of which is a large excess over the figures achieved before the crowdfunding experience;
2. checking the initial demand for an innovative product. I.e., the producer that has launched the project can realize, still before the output of a consignment of products, if the buyer is ready to purchase the product and in what amount;
3. full-scale PR-action on the Internet and in mass media. As a rule, if a project is of innovative character, in demand and, consequently, successfully financed news sites and specialized editions provide information about this project and the output product.

The innovative project on the creation of the Oculus Rift virtual reality headset (Kickstarter. Oculus Rift, 2012) is a vivid example of using the mentioned advantages in practice. The given project was launched on Kickstarter in August, 2012, and raised funds to the amount of \$2.4M whereas the amount of \$250K was planned. The project was supported by 9 522 backers all over the world. After a successful crowdfunding campaign the project raised additional external investments which constituted more than \$85M. And on the 25th of March, 2014, (Time, 2014) the company “Oculus VR” (the creator of the abovementioned project) was purchased by Facebook for \$2B. I.e., it took the company less than two years to increase its cost more than 20 times, and it is placing the innovative project on a crowdfunding-platform that provided the start of this process.

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