



What is crowdfunding?

John Pirro Sr.



Crowdfunding is the practice of raising funds for a project from a group of people. It has become a very common method of financing thanks to a whole host of crowdfunding startups and media coverage.

Aron Izower, Partner at Reed Smith, explained that unlike borrowing business loans, crowdfunding works by having entrepreneurs receive small amounts of financing from multiple individuals. Depending on the project, an entrepreneur may receive backing from a few dozen to hundreds of thousands of people. The power of the crowd's funds can outmatch those of a business loan lender and also offer a path to creating a business without the approval of a traditional commercial loan lender.

Izower explained that social media, now ubiquitous in modern life, is largely responsible for individuals participating in crowdfunding.

"Entrepreneurs and activists can harness their social networks and, with small commitments from large numbers of individuals, achieve large funding goals," said Izower. "If the entrepreneur can grow their social media community, they have a larger community from which to seek funds."

Entrepreneurs and activists fuel the media coverage of crowdfunding because it allows them to access non-traditional means of business loan financing. Oftentimes, lenders are rewarded by their funds with gifts and perks. He also explained that while crowdfunding startups are very recent additions to Silicon Valley, crowdfunding itself is a far older concept.

"As a practice, crowdfunding is ancient," said Izower. "People have always gone to their neighbors, friends and family and other members of their community to finance business ventures or try new products. The modern concept of crowdfunding extends the accessible crowd, to include connections through the web and social media. As such, it mirrors the creation of on-line communities."

Lee Barken, Energy and Cleantech Practice Leader at Haskell & White LLP, told loans.org that the rise of crowdfunding is mirroring previous market disruptions that happened in industries outside of finance.

"Crowdfunding is popular because it represents the advent of the Internet meeting capital formation," said Barken. "We've seen this before when the Internet met the music industry, the travel industry and the movie industry. Now, the same tools are being used to democratize and disintermediate entire capital market structures. It's a disrupter with incredible potential."

Barken explained that crowdfunding has created a marketplace for "product pre-sales," such as buying a watch before it is produced. Crowdfunding offers businesses a very low-risk way to see which consumers want which products. In effect, funds are votes of approval.

He continued to explain that crowdfunding has a mixed future.

On the one hand, it is outright [frightening for traditional business loan lenders](#) who feel that their market share will shrink. On the other hand, entrepreneurs love the idea of connecting with customers who pay first and receive a product later. Even better, crowdlenders get to enjoy the products they receive for giving money to a business. In due time, they may even enjoy owning equity in crowdfunded businesses — revolutionizing the world of investment.