

Understanding Crowdfunding

Introduction

Crowdfunding is a method of raising finance that enables a large number of people or organisations to invest in your business or project. Investments range from tiny amounts up to millions of pounds.

There are lots of specialist crowdfunding platforms, such as [Kickstarter](#) and [Seedrs](#), that can match businesses like yours with potential investors.

In this guide, we'll take a look at the main types of crowdfunding for your business. We'll also outline some key considerations you'll need to think about before you use crowdfunding to raise finance.

Types of crowdfunding

There are three main types of crowdfunding that your business could use. Let's look at each of them in turn.

Equity crowdfunding

With equity crowdfunding, investors get shares in your business in exchange for their investment.

They become shareholders and have partial ownership of your business.

The value of their stake in your business can go up or down, as with any investment shares. Early-stage and growing businesses often use crowdfunding.

It's a good idea to consider whether you want to give up partial ownership of your business in exchange for investment. If the answer is no, it might be better to secure investment in another way.

[Crowdcube](#) is just one example of the many equity crowdfunding platforms your business could use.

Debt crowdfunding

Debt crowdfunding (or peer-to-peer lending) enables your business to receive crowdfunded loans, which you would repay with interest.

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It is often used by established smaller businesses that want to bypass traditional banks and lenders, or have been turned down for finance. Debt crowdfunding can offer lenders improved rates of return, while your business can benefit from reduced fees.

Examples of debt crowdfunding platforms include [Funding Circle](#) and [Lending Club](#).

Donation-based crowdfunding

Donation-based crowdfunding is a way to raise finance for your business or project by asking a large number of people to donate a small amount of money individually.

Social and environmental groups and not-for-profit organisations often use this type of crowdfunding. Donors invest because they support the cause without expecting anything in return. However, you could decide to give them non-monetary rewards, such as gifts, regular news updates and invitations to exclusive events.

Examples of donation-based crowdfunding platforms include [Just Giving](#) and [You Caring](#).

How does crowdfunding work?

You'll need to register your new business or project with one or more crowdfunding platforms to start raising finance. Most platforms will vet your business to make sure you meet their rules for fundraisers.

Before registering with a crowdfunding platform, it's essential to research the different costs, rules and benefits associated with each platform. For example, some platforms offer a wider range of features to help you reach more potential investors, such as tools to promote campaigns or optimise fundraising pages.

After you register with a crowdfunding platform, it's time to create your pitch or fundraising campaign.

Most pitches include the following information:

- An overview of your business or the project you are raising finance for.
- Your funding target.

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- Details of what you will give investors in return.
- How many people have already invested.
- How much finance you have raised so far.
- How long the pitch will be open.
- The share in your business you are offering. This only applies if you are using equity crowdfunding.

Most crowdfunding platforms allow you to register and set up a pitch for free. Crowdfunding platforms usually charge fees based on the amount of finance raised. Fees are typically 4-5% of the total amount raised for your project or business via the platform.

If you don't meet your fundraising target, the money pledged is usually returned to the investors.

Advantages of using crowdfunding

- It can be a quick way to raise finance with no or low upfront fees.
- Crowdfunding platforms are an effective way to reach a large audience, including potential investors.
- It is an alternative finance option if traditional lenders have turned down your business.
- You can test the viability and popularity of your idea.
- People who invest in your business via crowdfunding will often become your customers once you launch your product or service.

Disadvantages of using crowdfunding

- The platform could refuse your application to join.
- Your business may receive no funding if you don't meet your fundraising target.
- You'll need to invest significant time and resources to promote your crowdfunding campaign.
- It's important to protect your idea, such as with a patent or copyright, as someone could copy it after seeing it on a crowdfunding platform.

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