ENDRE SPALLER

Crowdfunding – sooner or later all of us will turn innovator

Kevin Berg Grell – Dan Marom – Richard Swart (2015): *Crowdfunding. The Corporate Era.*[1]

A book by Kevin Berg Grell, Dan Marom and Richard Swart titled „Crowdfunding: The Corporate Era" contains five chapters, and guides the reader in the shape of case studies through the incredibly wide spectrum a crowdfunding campaign can be used for, save for the non-marginal fact that we can raise funds by it.

Total funds raised on Indiegogo website increased by 1,000% in two years.[2] This figure can in itself arouse anyone's interest in raising funds from crowds, i.e. crowdfunding. On the other hand, the figure also shows that this is not only a successful campaign, but a novel method of financing innovation. As ever accelerating innovation creeps into our daily lives, we, deliberately or not, are becoming parts of developments. We support a company's innovative activities not only by purchasing its products, but by several other means. These methods are demonstrated by this book on crowdfunding, published in November 2015. The collecting of goods for some reason is as old as the birth of private ownership. Nevertheless, these collecting activities set some kind of religious, charitable or cultural, but in any event social and non-profit, goal. It is, however, a novel phenomenon for an individual or even a big company to raise funds for themselves, with the aim of making profits on their own. And crowdfunding methods achieve exactly this goal.

The biggest challenge of financing innovation is that it is unpredictable how much money it costs to reach the point at which it can be seen whether it will bear fruit financially or not. Ideas that flop too late are the most costly. The investor thus finances uncertainty, and not business.

Financing innovation will a particularly important issue in Hungary in the coming couple of years. The transformation of the structural funds of the Euro-

[1] Elliott and Thompson, London. 218 p.
[2] See: www.indiegogo.com/contact/press.

pean Union, and refundable grants brought to the fore are to be expected. This way the system providing companies with funds to be spent on innovation activities will totally change. Henceforth, it is especially timely to demonstrate novel methods of financing innovation.

Globally, there are numerous means aimed at reducing uncertainty in marketing the results of innovation:

- devise special enterprise development strategies[3]
- search only for companies with traction (i.e. having turnover and a professional past)
- use state funds at the beginning of the process
- search for the best solutions in incubator "factories"
- organise contests, and invest in their winners
- raise funds from a community or fan club.

The latter is called crowdfunding. It originally meant that a population, or „crowd", adds up contributions to fund a development, which can thus be fulfilled. After that it was realised that crowdfunding not only yields a pool of money, but much more.

The book's list of authors also guarantees that the reader has the best summary of the topic of the last decade in his hands. Kevin Berg Grell was one of the first researchers to realise the use of crowdfunding. With his works he laid the basis for dismantling several legal obstacles standing in the way of crowdfunding. Previously, Dan Marom published several books on this topic, and has spent time managing Israeli start-ups. Richard Swart, lecturer at the University of California, Berkley, is the organiser of the first scientific-level research on crowdfunding.

The most important benefit of crowdfunding is that it brings together innovators with the market. Developers need to "take to the streets" to acquire customers, and tell them what the "product" is, and how much they have to pay for it. The innovator, as well as his investor, face feedback at the very beginning of the process, i.e. before squandering the investment on developing a product not in demand by anyone. Or, he touches on success at the beginning, manifested in the large number of endorsers, and it immediately turns out that he has found something worth developing. Bringing market tests of a product forward, to the initial phase of development, promises amazing growth in efficiency. It means we can confront potential customers even when we have neither a prototype, nor an investor.

The book analyses in detail that crowdunding does not substitute traditional venture capital. It is not a competitor to it, but rather serves to complement it. It can be used at a later phase, mostly during testing and reflection. It helps create some kind of scalable business model that has traction, that is to say, turnover. It also makes it possible for seed financing to enter the product development process at a later stage. What does an investment-ready start-up have?

[3] Blank, Steve – Dorf, Bob (2012): *The Startup Owners Manual.* K&S Ranch, California.

Technology, a product with a good value proposition, a good team, a bunch of early users, small turnover, as well as some results of market tests: these are the results one can obtain by launching a crowdfunding campaign. Moreover, if lucky, one can even take steps further on the road of development.

By starting a crowdfunding campaign one can involve several resources for enterprise development other than money, the most important of which are the following: tracing who are the ones who not only use, but like the product (affinity group); gaining market feedback; testing price determinations; sharing investors' risks; widening the partnership network; obtaining IP; bringing to surface creativity produced as a "by-product" at the organisation; and saving the best employees who, based on their own ideas, would like to build their own enterprise, maybe one competing with their parent company.

All these constitute an immense business advantage also for a big company interested in innovation. In the case of a small enterprise it can be decisive regarding its survival whether or not it needs to pay for the above functions as a service at times when it does not have the resources for these anyway. Either way, there will be unnecessary developments on the market, but amount of costs they entail matters.

The second chapter of the book demonstrates through corporate examples that a crowdfunding campaign can fully take over the following three phases of product development:

Market validation: In traditional trade one has to obtain the necessary capital, then develop the product, and in the end manufacture and sell it. In the case of a crowdfunding campaign we publicise a very early phase of product development, or even only the idea, with the aim of providing the capital necessary for further development and manufacture. It is the customers who act as financiers, so the traditional process of product development described above changes.

Searching for a market for the product: The majority of products are developed by big companies. They already have an established customer base, so before developing a new product they explore what new needs this base has, and strive to meet these. As for smaller enterprises, development centres around a single product, but most of the time nobody can guarantee that there will be demand for it, and especially that it will be able to carve a market share. A successful crowdfunding campaign means great assistance to this end.

Building a committed customer base: Many products become trends in the field of innovation, and express that their users are modern and open-minded persons. The product is not simply purchased, but it exerts an identificative power. Committed customers who serve as advertising spaces represent a huge value for a company.

- The book showcases four models of crowdfunding:
- debt-based: backers provide loans, and expect interest yields in exchange;
- equity-based: backers buy shares of the project, so they too profit financially if it succeeds. Such service is offered for example by CrowdCube;

- rewards-based: backers expect some kind of reward in exchange for their support. The reward itself is usually the opportunity to buy the first marketed product, but it can also be only a T-shirt or a symbolic object. Kickstarter and Indiegogo belong to this category;
- donations-based: backers give their support to the fundraiser without charge, in order to reach a specific goal. YouTube, for instance, runs such a service. A big advantage of this model is that one can continuously gather contributions, as, in the absence of rewards, one does not need to set a deadline for the campaign. One does not need to define whether the campaign succeeded or flopped, as each contribution is a great help for the campaigner. The big disadvantage of this model is, however, that if there are no goals and deadlines, donors feel less urgency to make contributions. A campaign usually lasts 30-50 days.

Crowdfunding websites are visited by people who are open to novelties, and are willing to voice their opinions and promote good products. They are willing to listen to pitches with pleasure. The developer does not have to jostle through the usual plethora of ads to be well-heard. It is particularly useful to let the audience raise questions, and not only make contributions. YouTube, for instance, offers a moderator opportunity, which serves to fulfil exactly this goal.

It means a real brain-cracker for big companies that their employees, having gained the necessary knowledge, and fed up with the inability to get through corporate bureaucracy, start up a new business of their own. By doing so, they often deal setbacks to their previous workplaces. The book gives examples of how owners of ideas can be moved towards joint enterprise development, or how to identify talents, and involve them in innovative activities.

One of the characteristic trends of recent campaigns is that they do not emphasise the name of the developer, because they give importance to the real intrinsic value of the product, and not to the circumstance whether fans of the brand would purchase a few items of it. A good example for this is the smartwatch campaign launched by Sony, omitting the Sony brand name itself.

Although crowdsourcing techniques are still in their infancy, there are visible trends reaching beyond the above-mentioned benefits. The websites promising a really interesting future are the ones that do not require the project owner to have the qualifications of an engineer to be able to develop a product. A good example for this is provided by the MESH platform introduced by Sony. These solutions blur the line between game and product development. They are similar to LEGO in that they can be constructed from separate components and be played with, topped by the promise of reaching profit at the end, which manifests in the shape of a concrete product. Engineering knowledge, as well as the internal functioning of the product are provided by the programme itself.

Minor backers are dissuaded from making contributions by the lack of knowledge whether the company performs well enough to meet its undertakings. They wonder if the product can really be developed utilising the pool of funds the company would like to collect. The book does not cover another trend at this point, namely open innovation.[4] This is usually understood as a process during which the developer makes the results of his research public, in order to let others use them. An extension of this is when we do not publicise research data, but the evaluations of single projects.

Myriads of organisations deal with the evaluation of RDI projects. Banks, funding agencies, venture capital firms and pitching competitions are the things representing the huge amount we spend on evaluating ideas and enterprises. A lot of these exert a motivating effect. For example, if a business wins financing in the framework of the EU's Horizon 2020 programme, there is good reason to believe that it is a serious company with serious plans. If the evaluation of this company were made public, backers would be encouraged to make contributions more boldly, because they would be sure that their contributions have a good chance of getting to the right place. If evaluation cornerstones were made public, the risks taken by small backers would be mitigated, and the approach would gain traction that crowdfunding is not a charitable activity not expected to result in efficiency, but a business activity run by limited sums.

Big companies can also utilise crowdfunding, a tool with which the motive is to generate competition for their internal product developer and innovation teams. Venture capital companies can invest in trends that do not relate to the core activities of the parent company.

If large company endorses a crowdfunding project, it has to face two risks besides the several advantages. First, few projects get realised by the promised deadline. Postponing the time of delivery is usual, which can be embarrassing in the case of a big business. Bearing in mind that it has to do with innovation, the extension of the deadline is deemed natural. However, this can discourage backers from making further contributions, not to mention that it may occur that the product cannot be developed at all. Or, there arises a fault in the manufacturing process, and the backer is not rewarded, if arrangements on this were made before. It may also happen that the company simply withdraws the sum raised, and does not spend it on reaching the goals set previously. All these constitute a considerable erosion of prestige for the big company.

The other emerging problems are those connected to confidentiality and publicity. The strength of open innovation comes from the fact that copying an innovation is generally not as simple as it seems. Companies usually lose more on engaging in secrecy than they would on being the subject of theft. The losses incurring as a result of secrecy can be categorised into two major groups: the one relates to the phenomenon that during secrecy the market testing of a product is insufficient. In this case not only the sheer viability of the project is questionable, but also if functions are developed unused by anyone in the end. Also, are such functions omitted that need to be integrated into the product retrospectively?

[4] Chesbrough, Henry (2005): *Open Innovation.* Harvard Business School.

These entail a loss during development, and later during sales too. The other phenomenon causing loss occurs when something is developed that somebody else already has at hand. There could be partial solutions, employee skills or experience already gathered by somebody else, and they would even share them, if they were notified of the development of the specific product.

As noted earlier, Sony did not confer its brand name to a product developed during a crowdfunding campaign. This move ensured that nobody spotted that the idea was owned by an industry heavyweight, and thus worth stealing.

In today's economy the "winner takes all" principle rules, which means that there is neither room, nor time for fast followers to make real profits. More and more areas arise where the "winner takes all". We can observe that while several taxi providers operate in Budapest, Uber covers the global market alone. Such leaders are Airbnb or Waze too in their respective areas. While back in the day social networking websites existed only until the waves of fashion abated, an overwhelming majority of them have been crowded out of the market by Facebook, and there are no indications that this will change. So, it is that one has to be a leader all the time, and followers are outweighed in this new, innovative economy. Crowdfunding is exactly the method mitigating such effects.

The book is laced with readable, interesting examples and stories. It is just as digestible for company executives temporarily out of the treadmill, as for economists and businesspeople used to the rigid use of scientific definitions. This book can necessarily be recommended for those who would like their companies to be leaders in a given area, and for those who are inclined to engage in innovation, even if they do not yet understand how they will utilise the knowledge referred to here. Those dealing with innovation management can save a lot of money if they get to know the contents of the book.

Finally, this book can be recommend for those who would like to become a part of the future, and who spend some time and money evaluating and expressing their opinions, and perhaps supporting its first green shoots of the future. Let them be amongst the first users. Let them fascinate their environments that they are familiar with the latest trends, and have the answers for questions not even raised by others. Let them think about what kind of future they would like to live in. Let them be the advertising spaces of the future, talk about, cheer for and express enthusiasm for a novelty, as for most of them crowdfunding is none other than a novel method for technicised use of leisure time.

REFERENCES

- Berg Grell, Kevin – Marom, Dan –Swart, Richard (2015): *Crowdfunding. The Corporate Era*. Elliott and Thompson, London.
- Blank, Steve – Dorf, Bob (2012): *The Startup Owners Manual.* K&S Ranch, California.
- Chesbrough, Henry (2005): *Open Innovation*. Harvard Business School.