

# Pros and cons of crowdfunding essay



## Contents

- Successful crowdfunding campaigns

## Executive Summary

SMEs make up to 40% of the emerging economies GDP. The SMEs also employ the highest population in these nations. Funding of SMEs has for long been an issue. However, Crowd funding has been identified as a potential source of funding to SMEs in these nations. Advantages of using SMEs include; Alternative if locked out of bank loans, Help market the enterprise, Retaining significant control of the business and Expert guidance could be availed.

The disadvantages include; Need for extra work to build up interest in the project, not raising enough capital and the possibility of photocopying the idea. Crowd funding does not differ from the contemporary source of funding greatly. However, there are features that make it distinct. To successfully raise funds through crowd funding one would need; comprehensive planning, social media strategy and a good team backing you. Emerging markets should make registrations regulating crowd funding. Any aspiring entrepreneur who has been locked out of the contemporary source of funding should consider crowd funding.

## Introduction

Due to the volatility of emerging markets, the Small and Medium Enterprises (SMEs), banking institutions have strict rules and measures that they put in place (UN, Department of Economic and Social Affairs. 2007). These

measures lock out thousands of Entrepreneurs from funding in them.

Multinational institutions that offer finance in these markets usually collateralize their loans. The collateral they seek is in the form of real estate or movable assets such as vehicles. However, most of the Entrepreneurs who run SMEs lack this collateral and therefore are locked out of funding.

Governments in the developing nations are faced with a problem of raising alternate ways in which to fund the SMEs which comprises up to 40% of their GDP. Crowd funding is a fabulous solution to these complex problem. Crowd funding refers to a method of raising finance of a company via the internet (Dresner, 2014), or in the case of economies that run on mobile money such as Mpesa in Kenya (OECD, 2013), the capital is raised via mobile money technology. To acquire the funding, a business plan has to be pitched and placed on a crowd funding website to attract possible investors.

## **Advantages of crowdfunding**

### Question 1

Some of the advantages associated by using crowd funding as source of capital to an enterprise includes but are not limited to;

#### I. Alternate if locked out of bank loans

An emerging market also called an emerging economy or a developing country does not have fully developed financial systems. To enable steady growth and development of the economies, the governments follow financial policies that are aimed at stabilizing the exchange rates such as fixed exchange policy applied by China and some follow flexible policies which are

not fully free but the government sometimes intervenes if the exchange rates moves out of the desired margins (Armendariz & Morduch, 2010). This is due to the inherent high risks and the low returns that they may face. Banks, therefore, ask for financial statements and cash flow statements, this automatically must start up business out of the bracket of being probably awarded the loans.

Crowd funding; unlike the banks do not need the Entrepreneurs to produce the cash flow statements and other relevant financial documents. The aspiring entrepreneur has to pitch an idea, formulated in a refined business plan and post it on a crowd funding website and wait for investors to chip in and start off the business. This makes it a viable alternative to aspiring entrepreneurs who are locked out of accessing funding from the traditional source of business funding.

## II. Help market the enterprise

When the idea is pitched into crowd funding, it is exposed to a very large group of people who are either potential investors or could be turned into viable customers. If the idea is correctly put and attracts the individuals who see it, they will consider and invest in it.

Investors would turn into loyal customers as they endeavor to help generate revenue for the business and ultimately returns to their investments (Niven, 2006). These investors tell about the business to their friends therefore helping in the marketing of the services of the products offered by the business.

The platform, due to its frequent access by business moguls, educators, professionals, and students would if designed to cater for the needs of the particular community in question attract a lot of interest. It may see its day in the media houses and therefore further help to advertise it.

### III. Retaining significant control of the business

Unlike in selling of equity where the investor relinquishes power and control of the business to the shareholders, for the case of crowd funding control is maintained by the Entrepreneur. This enables the entrepreneur to be able to actualize the long term goals of the investment. It also helps to save time by shortening the amount of time that would have been required to make important decisions in case power was relinquished.

### IV. Expert guidance could be availed

As mentioned in the above preceding, the business idea is exposed to the business community. This means that the persons in the community could contact and help to further refine the idea. This would be expert guidance and be from experience. This would, in turn, enable help to make more accurate projections about the future of the business. It would enable the business to break even faster and move out of the formative stages.

## **Disadvantages of crowdfunding**

However, each coin has two sides. This, therefore, means that rising of financing through crowd funding has its disadvantages. The cons associated with raising of cash through the crowd includes but not limited to;

i. Need for extra work to build up interest in the project

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Raising of capital using this method is not necessarily easier than raising cash through the traditional methods. The entrepreneur still has to do a comprehensive research on the idea, the market, consumer trends and the market.

This means that the business will still need the same amount of time it would have had required to start. The Entrepreneur will also have to do a very comprehensive job in marketing the idea for funding before the funding starts and till the required capital is achieved. This may at times consume a considerable amount of cash which most Entrepreneurs in the emerging markets are short of

#### ii. Not raising enough capital

There is no guarantee that the entrepreneur will be able to raise the capital he/she needs to start the business. In case enough capital is not raised the Entrepreneur would have to refund the entire raised amount and therefore have wasted time and money that was used in marketing the idea.

#### iii. Possibility of photocopying the idea

Most people are not familiar with the concept of patenting copyrights. This means that an aspiring entrepreneur may post in a crowd funding website an idea that has not been patented.

This would cause the Entrepreneur a lot since someone may copy and patent it and therefore own the copyrights. This would drag the aspiring entrepreneur into lengthy, tiresome, and expensive lawsuits that he/she may not afford. This would result in losing a probably very lucrative business.

## **Crowdfunding features**

### Question 2

Though crowd funding has peculiar features that differentiate it from the traditional funding of businesses, it is much similar to the traditional form of funding to business. The similarity includes the need for a comprehensive market survey, evaluation, and analysis before and during the writing of the business plan. The business plan also has to be presented to potential investors, and the entrepreneur would have to convince them the validity of the plan and its applicability.

Crowd funding differs from the traditional sources of funding in a few ways (Borner, 2016). First, the entrepreneurs do not have to produce collateral to gain access to funding as the case of the banks. Second, the capital is not raised in a lump sum except in a scenario where an angel investor arises. Also, the plan is pitched over the internet unlike in traditional forms where the Entrepreneur would have to go to a bank or boardroom and to convince the investors face to face.

## **Successful crowdfunding campaigns**

### Question 3

The factors that are critical to the success of crowd funding includes but are not limited to;

a)Comprehensive planning

To successfully be able to raise capital through crowd funding, a comprehensive analysis of the market is needed. This will enable you to

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slowly transit the business and present an idea that is relevant to the particular community. The planning stage enables the entrepreneur to choose the best marketing strategy, therefore, making the most out of it.

#### b) Social media strategy

Using face book, twitter or other social accounts would work best.

Approximately 80% of the target market for inventors use face book. If promoters who have a large number of followers in the social media were engaged, it would enable the entrepreneur to raise the required capital in the shortest time possible (Chaffey, 2011).

#### c) A good team backing you

Having a team that analyzes the progress made would be crucial. This is because this would tell how progress is being made and if it is desirable. The team may include journalists who may give sit-downs. This would help to generate interest in the project and therefore the higher probability of funding being raised faster (Sercu, 2011).

#### Conclusion

Crowd Funding is a method that emerging governments should embrace in their effort to fast track growth of their economies and move away from the contemporary sources of funding. The government should set rules and registrations regulating the source of funding to avoid exploitation.

Crowd funding offers an excellent and desirable source of funding to the emerging economies. The method should be popularized to enable



Entrepreneurs who are locked out of the traditional sources of funding to gain access. This would in turn help to further increase the growth rate and therefore the prospects of being classified as industrialized nations, which would enable the currency to freely float in the international financial market and increase its strength, therefore lower the rate of fluctuation.

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