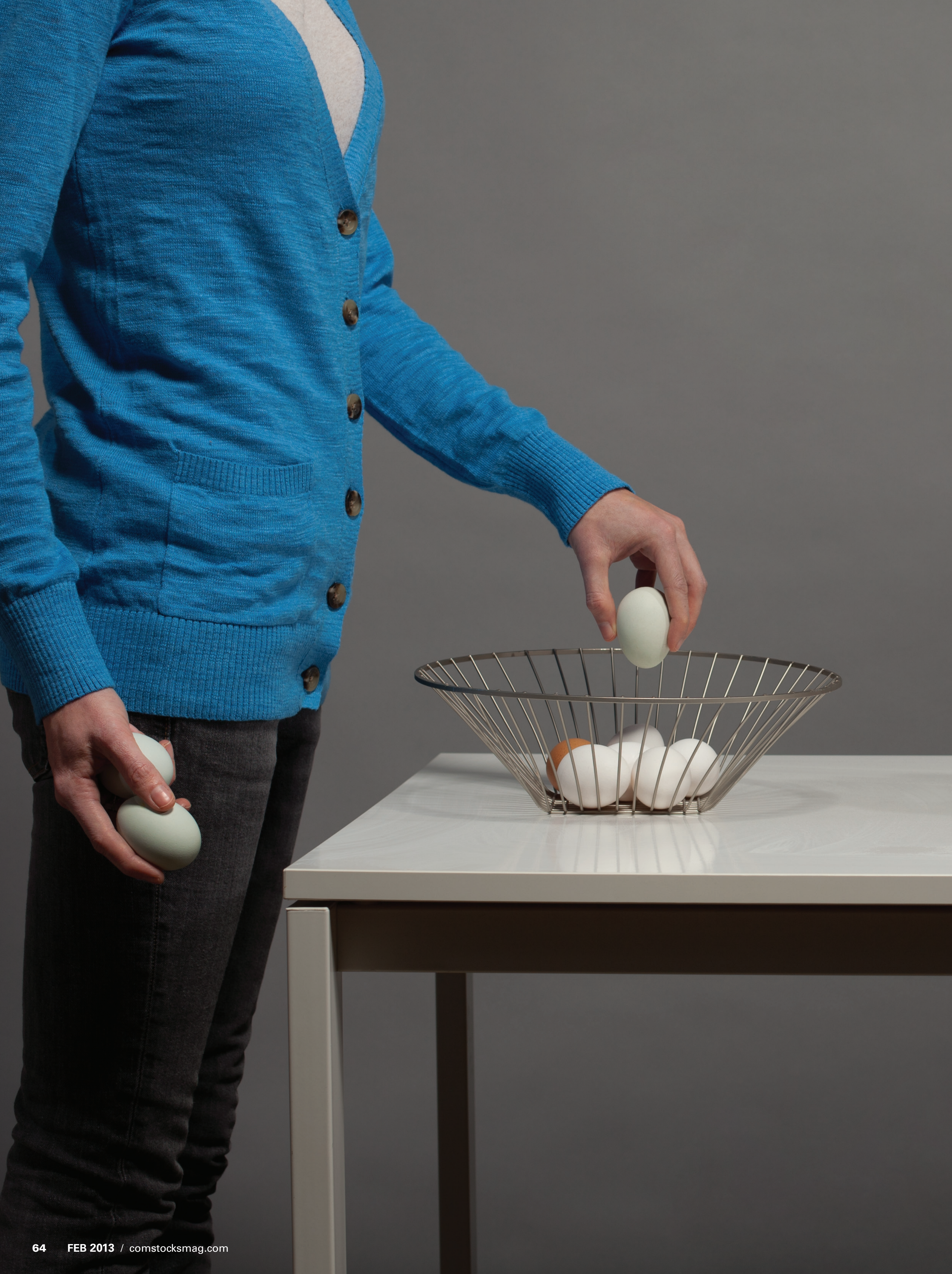

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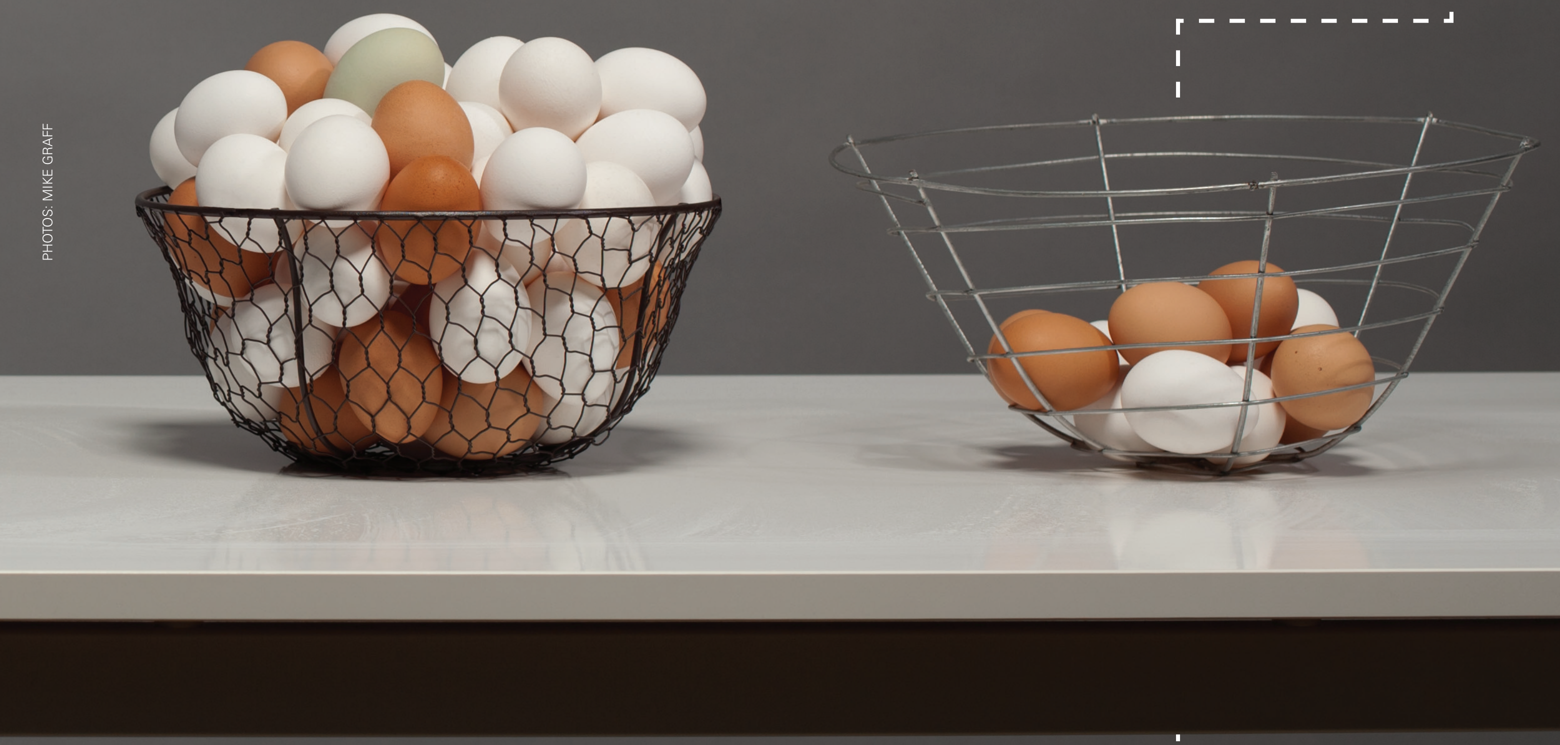

PHOTOS: MIKE GRAFF

How crowdfunding connects strangers with money — and your business

by Andrea Kennedy

"Small Market, Big Heart" tells the story of the Sacramento Kings and their fans' fight to hold onto the team. But the 80-minute documentary — packed with NBA archive footage and interviews with Kings' executives, local politicians and sports entertainment personalities — isn't from the NBA offices or an established production company.

It's the passion project of first-time film producers James Ham and Blake Ellington and short film director Tobin Halsey who tapped crowdfunding platform Kickstarter to take their big dream to the big screen.

"We started out basically self-financed, and we were able to get one private donation," says Ham. "But we knew that we were going to come up considerably short if we wanted the film to have the quality of work we were going for."

Kickstarter is the company whose name has become synonymous with crowdfunding, a method of fundraising wherein the public donates money to a cause or startup in return for perks, like swag or product trial runs or discounts. With Kickstarter, as long as the campaign reaches the goal amount ($4,000 for "Small Market, Big Heart"), the funds are collected to complete the project, minus a 5 percent fee to Kickstarter.

Crowdfunding has become a burgeoning funding alternative for organizations that can't meet the demands required of small-business loans, don't want to take on traditional debt or are outside the purview of venture capitalists.

The financing strategy is being bolstered by President Obama's Jumpstart Our Business Startups (JOBS) Act, which approved securities-based crowdfunding. The legislation, a controversial deregulation law that opponents say weakens investor protections and opens the door for fraud, allows small-business owners to collect up to $1 million from nonaccredited investors who will then hold company shares without the pricey process of registering with the U.S. Securities and Exchange Commission (SEC).

To hit their target, the trio of Kings devotees spread the word among family, friends and fans. They reached their goal within 36 hours, and by the campaign's end had surpassed it by another 50 percent.

"It was so fun to watch the money drop in those first 36 hours," Ham says. "I was never much of a grassroots, 'power to the people' type of guy before this, but it was just so incredible to watch the support come out."

According to Kickstarter spokesman Justin Kazmark, the site deems itself a "funding platform for creative projects" like film, photography, theater, publishing, fashion and food.

"Creators often come to Kickstarter before they launch a project to find funding, which is difficult to do elsewhere," he says. "Also, one of the benefits they get is building a community around that idea and engaging an audience around their idea."

Since its 2009 launch, Kickstarter has helped fund more than 33,000 creative ventures. On the tails of these successes, users of contribution-based crowdfunding have expanded to include product and tech firms trying to get off the ground during a veritable stalemate of venture capital investment.

As the Capital Region breeds entrepreneurs in industries other than former anchors like real estate and government, crowdfunding campaigns, which often feature informative product or backstory videos, aim to boost community dollars for struggling startups by offering a personal — though virtual — connection to the company.

"It's like if you go to a green market," says Kazmark. "You get to meet the maker of the honey or the cheese that you're supporting, and you hear the story behind it."

For years, Chris Wiggins has been plugging his clean technology invention, the Glide Cruiser, to investors. The electric, stand-up cycles can reach speeds upwards of 35 mph, though lately Wiggins says production has been in the "slow lane" due to lagging capital.

"It's far more difficult raising money right now," he says. "Companies that a lot of the VCs (venture capital organizations) are investing in are at the $100-million level, or they're not interested in playing."

Wiggins so far has manufactured 40 units for $3,000 to $4,000 each, using funds from buyer deposits as well as his own pockets — a model he hopes to diversify.

"I'm 100-percent self-funded at this point," he says. "I had to look at the alternatives."

Wiggins began his own crowdfunding campaign on Kickstarter with a goal of $65,000, but reached less than 10 percent of his goal amount. On Kickstarter, an unsuccessful campaign means Wiggins won't see a dime, but he remains undeterred. Fortunately, the unsuccessful campaign caught the eye of angel investors or distributors.

"I'm looking for angles to get awareness," he says. "A lot of it for me was just getting national exposure and ultimately being seen by the right people."

Wiggins' received calls from an interested German distributor, a national catalog and even Hollywood. He says there's a possibility of product placement during a chase scene in an upcoming Jim Carrey film.

"That's really exciting," he says. "It's been successful in those ways for me, which is kind of what I was looking for. Every opportunity and connection came out of (the Kickstarter campaign)."

Robb Moore, CEO of disaster-proof hardware company ioSafe, also tapped contribution-based crowdfunding when venture capital attempts fell through.

"More or less, the response I got from VCs was, 'Well, we don't do hardware. Do you have any iPhone apps?'" he says. VCs, he says, are notorious for sticking to high-return software companies.

So to produce his latest disaster-proof data storage device, Moore instead worked from a Small Business Administration loan, strategic investments and his own checkbook. But to get his hardware to market meant fronting even more funds for research and development, manufacturing tooling, inventory and more before he saw a single consumer dollar. Crowdfunding, he says, fills some of those financial gaps to help accelerate a business.

"The great thing about crowdfunding is you get a chance to realize some of that revenue upfront, which helps the business go faster," he says. "You're having to bridge less money to get from A to B."

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— James Ham, film producer and Kickstarter user

Moore attempted a Kickstarter campaign only to see his application denied, a response he attributes to Kickstarter considering ioSafe beyond the startup phase. He instead tapped crowdfunding platform Indiegogo, which accepts all applicants. He raised $8,000 on day one.

"We raised about $21,000 total through the campaign," Moore says. "We also sold about another $15,000 or $20,000 on our website at the same time."

Moore's goal was $150,000, and the benefit of Indiegogo is the opportunity to receive funding even if you fall short of the goal. The penalty is a 9 percent fee. Like Wiggins, Moore also had an ulterior motive to his campaign: sourcing product feedback from donors in a sort of virtual focus group.

"We were able to roll some of that feedback into the new product before manufacturing launch," he says. "For a company like ours, that's extremely valuable."

But the value of crowdfunding doesn't only fall to entrepreneurs like Ham, Wiggins and Moore. The donating public also gets perks, from T-shirts to discounts and free products.

Now, the controversial JOBS Act is set to one-up those rewards with a perk that business owners hope will further motivate capital acquisition: equity.

JOBS Act proponent Candace Klein, co-chair of Crowdfund Intermediary Regulatory Advocates (CFIRA), claims the act is "the most important piece of legislation I have seen in my professional career."

In 2011, Klein founded SoMoLend, a web-based company that facilitates loans to small-business borrowers from accredited investors. The former lobbyist became involved with the legislation through her proactive interest in the crowdfunding model and penned 12 lines of the JOBS Act, motivated for change by her observations at SoMoLend.

"What we are seeing right now is our issuers, our fundraisers, on the platform are able to raise about 50 to 60 percent from their friends and family and community," Klein says. "The remaining 30 to 40 percent is where we believe crowdfunding will be extremely helpful."

Businesses set to benefit are the same ones that historically get left in the lurch by banks — restaurants, food trucks, salons, spinning studios, "the everyday community business owner," she says. But business owners, she adds, aren't the only parties who may gain from the new age of securities-based crowdfunding.

"People spend a lot of time talking about how the JOBS Act is going to create new opportunities for the entrepreneur," she says. "I'm just as excited about the opportunity the jobs act presents for the everyday investor like you and me."

Klein emphasizes the nontraditional investment populations represented among SoMoLend's lenders. Of the 500 investors, 60 percent are women and minorities with an average annual income ranging from $50,000 to $75,000. Similarly, of the 2,000 recipients, 70 percent are women- and minority-owned small businesses.

"I see the JOBS Act as being huge for wealth creation for populations in the country who in the past haven't had access to that," says Klein.

However, the possibility of a return on investment also brings the possibility of loss for a population who can't afford it, says JOBS Act opponent Barbara Roper, director of investment relations with the Consumer Federation of America

"The sad reality is that most early stage start-ups of the type that will resort to crowdfunding fail," Roper says.

Roper explains that venture capitalists devote years of business expertise and insider knowledge before investing, yet still profit only from their few investments that succeed. So while any investor invites risk, investors green-lit by the JOBS Act increase risk due simply to inexperience.

"Crowdfunding investors typically won't have access to the kind of detailed information or expertise that venture capitalists bring to the role, and they are unlikely to be backing the broad portfolio of potentially successful companies that might allow them to offset their losers with winners," says Roper. Furthermore, while crowdfunding supporters like Klein view the JOBS Act as revolutionary, opponents like Roper fear the legislation may also open the floodgates for the F-word: fraud.

"The Internet offers a perfect mechanism for pump-and-dump schemes, with perpetrators able to get in and out before regulators are ever able to catch up with them," says Roper. "While Congress included significant investor protections in the crowdfunding provisions of the bill, those regulations will only be as effective as the regulators enforcing them, and Congress isn't allocating any additional money to enable the Securities and Exchange Commission to better police the market."

The SEC had until the end of 2012 to determine how to implement crowdfunding regulations, but recent changes, including the resignation of SEC Chairman Mary Shapiro, seem to have slowed an already sluggish process. Klein suspects securities-based crowdfunding will take effect in late 2013 while others suggest 2014.

In the meantime, Kickstarters and Indiegogo users like Moore await the JOBS Act's implementation to evaluate its aftereffects.

"I'm interested to see what is happening in that space," Moore says. "Not only for ioSafe on a personal level, but just for entrepreneurs everywhere. I think that whatever helps somebody start from nothing and get to the next level is the most critical step in any business." ■

VESTED INTEREST

Venturing into the next economy

The Next Economy initiative aims to accelerate job creation and new investment in the Capital Region by developing key economic areas, or "clusters," of growth. The critical motivator to these clusters, experts say, is venture capital, a cash investment.

"We need to have a funding mechanism for launching these types of firms within a region in order for the region to be successful," says Curt Rocca, managing partner with DCA Partners, business advisory and private equity firm.

The truth invites a challenging reality. In light of the past 10 years of underperforming venture capital (VC) returns, VC has received fewer funds to allocate.

"Large institutions that are all about driving optimal, risk-adjusted returns are reducing the amount of dollars they're investing in venture capital funds by as much as 80 percent," Rocca says.

Fewer dollars means greater selectivity among venture firms looking to back promising startups, even in the booming clean tech industries.

"People generally are hesitant to bet on anything that relies upon specific assumptions that are political or regulatory in nature," says Rocca. "Much of clean energy is still in that category."

The Sacramento Regional Technology Alliance (SARTA), a partner in the Next Economy initiative, works with entrepreneurs to prep their businesses for investment. Ingrid Rosten, director of SARTA's CleanStart program, which focuses on the clean tech cluster, says the few regional VCs are making a difference.

Folsom's Velocity Venture Capital, she says, has shown "exemplary results" funding local software companies Revionics, emTRAiN, anyCOMM and hosting events like their Entrepreneurs Showcase at which 10 entrepreneurs present business plans to VCs and angel investors.

Rosten also suggests seeking capital beyond Sacramento through strategic networking and tapping deep pockets at competitions like Silicon Valley's Cleantech Open.

"If you have a clean tech investor that's based in Silicon Valley, he's not only looking in Silicon Valley for clean tech investment," Rosten says.

But seeking dollars outside the region is risky. Out-of-town investors threaten to lure away local jobs. But economic stakeholders don't have much choice. Even with firms like Velocity Venture Capital, the current local VC offerings remain ill-prepared to move Sacramento's economy from its rut, says Rocca.

"We've had a lot of good, high-quality people try to step in and be that capital source," he says. "But for a variety of reasons, we've not been able to have something that's able to be perpetuated and sustainable."

Rocca points instead to the institutions, corporate investors or high-net-worth individuals with stakes in regional prosperity as the answer to the difficult question of raising capital.

"Somehow," he says, "we need to tap into the people that have a vested interest in the success of our region and convince them of the merits of reinvesting by supporting both venture capital and private funds within our geography to help both attract and fuel growing businesses."

— Andrea Kennedy