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More Questions on Crowdfunding Industry Research, With Carl Esposti

Last week I spoke with Carl Esposti, CEO, and Gerrit Ahlers, Sr. Analyst, of Massolution, who played key roles in authoring **Crowd Funding Industry Research**, the first market research report on the crowd funding industry.

This document is available as a summary or as an entire report at www.crowdsourcing.org, and is also available through the [Crowdfunding Professional Association \(CfPA\)](#).

I wrote about their findings earlier this month in *Harvard Business Review*:

There's no doubt crowd funding will play a much larger role in the funding strategies of the next wave of entrepreneurial companies that emerge in the U.S. Wishing to share additional information on this vital topic, this week I asked Carl and Gerrit to comment on "crowd think" and how it relates to crowd funding investments.

Carl Esposti will also be presenting soon in [Salt Lake City](#), my own region, during the second day of the [2012 Crowd Funding Symposium](#) June 1. I will be keynoting that event on May 31.

Alan: What about the assertion that the group mentality of crowdfunding causes investors to be foolish?

Carl – In my opinion, there's actually a great deal of strength in the idea of having many people behind a plan. Looking at what types of projects are being funded, we see some patterns emerging. There are cause-based initiatives that appeal to people's passions or philanthropic needs or interests and other projects that get funded by appealing to their fan-base. Another sector that does well is digital goods and media, which appeal to tech and social-media savvy people. Yes, it's true to say that this supports the argument that these investors aren't making decisions on a purely economic basis but, as a crowd, their expression of support or interest in a venture, product or service has validity and can't be ignored.

Crowd funding puts the crowd investor in direct contact with the entrepreneur. There are no “smart” investors in the middle – just the crowd investor, the platform and the entrepreneur. Would an Enron have attracted more skepticism early on with the crowd asking tough questions? The supposedly smart investors and analysts certainly didn’t. We shouldn’t underestimate the power of the crowd to form their own view, to share their opinions and to either show support or reject proposals by acting vote en masse.



Carl Esposti, CEO of Massolutions; Author of Crowdfunding Industry Research

In some cases the ability to market test products or services via the process of crowd funding is also allowing companies to gauge the level of market interest and in many cases to actually pre-sell product before it’s manufactured. For example, the team behind Pebble Watch were turned down by many VC’s who thought the idea of a smart-watch, as an accessory to a smart-phone, wasn’t what the crowd needed. The crowd begged to differ! They raised one hundred times their goal raising a total of \$10M, an average of \$140 per investor, and pre-sold 67,000 units against a first production run of 80,000 units. What a phenomenal way to calibrate the desire for your product and establish the required inventory. Also, the social experience of crowd funding, as the news of interesting projects propagates across social networks, drives a huge level of publicity that you simply couldn’t buy. There are interesting things afoot that go directly against what our friend in the initial HBR piece is stating.

The online crowd can be powerful in other ways. The daylight effect of the Internet has shown that half of the debt raised on one of the largest US lending-based platforms was raised to consolidate debt (disappointingly, leaving 50% or less for business funding and job creation). Studies show that people seem to value their social credit higher than their financial credit. The same people who were borrowing to consolidate debt had a much lower default rate on crowd funding platforms, where the crowd has high expectations and is watching, than they did with their initial institutionally funded credit lines. The transparency of the Internet suggests the crowd *isn’t* foolish but in fact very good at calibrating whether a venture will succeed or an individually perform.

Gerrit: I believe that that is an inherent risk in many markets, including the regulated stock or real estate markets. Nevertheless, we are clearly better off with these markets. The assertion that group mentality can cause people to be foolish should not be named as an argument to disallow crowd funding. I am firmly convinced that the role of the government should be to tell investors about the potential risks of group mentality without restricting their freedom of choice where to invest their money.

Alan: *What future research plans do you have?*

Carl: A couple of things at least – more research and more work continuing to build an industry coalition to give crowdfunding it’s best shot!

This first report was the first step towards establishing a fact-base for the crowdfunding industry and for gaining an understanding of the market and its composition. There are many other things people are interested in understanding in more detail. For examples, people have an interest and desire to understand why a certain project gets funded and what are the attributes of projects that are successful? What can we learn from that? What are the default rates and where are the occurrences of fraud – what are the warning signs? What sectors are gaining the most traction and getting funded? What valuations are crowdfunded companies getting from unsophisticated investors compared with other more traditional forms of valuation? Is it cheaper or more expensive to raise money this way.

Efforts to continue to build a strong industry coalition continue. As a founding Executive Committee member of both The Crowdfunding Professional Association (CfPA) executive committee, chaired by Berkeley Geddes, and the Crowdfunding Intermediary Regulatory Advocates group (CfIRA), co-chaired by Candace Klein and Vince Molinari, through Crowdsourcing.org and our research arm massolution we will continue to work with industry groups to support the development of a safe and flourishing crowdfunding industry. Going forward, we will be working closely with the Crowdfunding Professional Association, who is sponsoring further research aimed at providing further insights and education for the crowdfunding industry.

This article is available online at:

<http://www.forbes.com/sites/alanhall/2012/05/20/more-questions-on-crowdfunding-industry-research-with-carl-esposti/>