

Entrepreneurial case analysis – Part 2

A new method of funding ventures – equity crowdfunding at PledgeMe

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Anna Guenther, a Master of Entrepreneurship student at the University of Otago, had been researching crowdfunding and the concept of creating a local platform to support the creative and arts communities in New Zealand. By a stroke of good fortune, she found a developer in her own backyard – in Wellington, New Zealand’s capital city – who had been working on just such a tool, so arranged to meet him. The developer, more focused on code than marketing, was a classic ‘techie’ and Anna persuaded him that the project could not fly without her expertise and marketing savvy. She joined the company as director and shareholder, but in 2013 she bought him out and became the sole owner. From there, the company went into capital-raising and expansion mode. By 2015, PledgeMe employed six staff (part-time) and was owned by Anna (46 per cent) and 60 other shareholders. There was a Board of Directors overseeing the company, made up of early investors.

Crowdfunding is a tool that helps galvanise a crowd of people to fund a project (normally through the project creator’s social networks). It is a young and growing industry that has been proven internationally, with over 800 platforms worldwide. The growth and scope of crowdfunding is impressive considering the industry was unheard of until 2008. The first crowdfunding website, Sellaband, appeared in 2006. Since then, there has been a steady progression of funding ideologies around crowdsourcing, with a move from micro-financing to micro-lending in 2005, to peer-to-peer lending in 2006 and then to crowdfunding (pleasefund.us, 2011). Other key players have entered the industry, with the main global market share covered by Kickstarter, Indiegogo and RocketHub.

PledgeMe started crowdfunding in the creative industry, comprising everything from design, fashion and film, to music, performing arts and gaming. For a nation of 4.5 million people, New Zealand punches above its weight (think Peter Jackson and the Lord of the Rings movies), where the creative community is quite large and well supported.

PledgeMe’s mission is ‘to help Kiwis fund things they care about’, and Kiwis do care about art. Two-thirds of New Zealanders believe that art is a

part of everyday life (Creative New Zealand 2008). Over NZ\$100 million (US\$76 million) of funding from all sources goes into creative projects every year. Creative New Zealand alone funds over 500 projects per year, with an average project amount of NZ\$15,000. However, even this amount is not enough to satisfy the creative demand. Previously, many creative projects had to be privately funded in the hopes they could recoup their investment once they had a saleable product. Crowdfunding changed this and allowed people to raise the funds they needed up front in order to develop their creative product.

PledgeMe's business model is simple. It charges 5 per cent of the project total as a success fee, as well as a credit card handling fee of about 2.8 per cent. To date the company has raised over NZ\$5.5 million for over 800 campaigns. The organisation has two kinds of customers: the project creator and the project funder. The creators come mainly from various backgrounds, and the funders are from their social networks (family, friends and networked acquaintances). Everyone is a stakeholder, as every project creator and funder is integral to the success of the projects. Project creators publish their plans online and raise money from funders in exchange for rewards, normally stemming from the proposed finished project. These rewards range from tickets to a show and dinner with the cast, to smaller items such as postcards.

PledgeMe only takes its cut when projects are successful and reach their target. In the industry this is called a 'threshold model', namely reaching the least amount set by the creator for it to be successful. This amount has to be chosen with care as the Campaign Creator will be obliged to fulfil all rewards that are claimed once this goal has been met. It means that PledgeMe has to help projects meet their targets, both by providing support to the consumers, educating the public on crowdfunding and by marketing the project.

PledgeMe has the following core values that underlie its operation:

Community: Crowdfunding helps connect individuals with supporters to realise their goals, and will potentially revolutionise existent community and economic models.

Passion: The main driver for PledgeMe staff and project creators.

Creativity: The main focus of the business, which is reflected in every aspect of the company.

In 2015, PledgeMe was three years old and had established itself a leading presence in the crowdfunding market, which was a good time to diversify. An opportunity arose that was too good to turn down. New Zealand changed its laws in April 2014 to allow 'equity crowdfunding'. Companies could crowdfund in exchange for giving shareholders a portion of equity (shares) in their company. This was a huge opportunity for PledgeMe, but also a very daunting one in that Anna realised she would have to grow the company in order to offer equity crowdfunding. Previously, it had been Anna, her business partner, one part-time administrator and various interns who managed the whole company, but they needed to hire staff. To do this, Anna had to get more investors and, therefore, give up some of her own equity.

Initially, a round of private investment was undertaken, and NZ\$100,000 was raised. Following this in 2014, the previous Advisory Board was turned into a formal Board of Directors and a further NZ\$100,000 was raised in 23 hours by equity crowdfunding itself. Currently the business has around 60 shareholders. In 2015, the company was looking at another capital raising round in order to grow further.

There are now four companies who hold New Zealand government-issued equity crowdfunding licenses (including The Snowball Effect, Armillary Capital and Equitise) with another few companies about to begin. Therefore, competition is heating up. In fact, some believe that in the longer term New Zealand really only has room for about two equity crowdfunding providers (Daniel, 2015). Meanwhile, with little or no marketing, PledgeMe have had over 500 companies approach them about possibly using the site for equity crowdfunding. Australia is also looking at changing its laws to allow this as well. In New Zealand, there is a limit of NZ\$2 million/year per company that can be crowdfunded. In total, as of April 2015, there have been nine successful campaigns in New Zealand by two equity crowdfunding platforms, raising funds for a diverse range of companies such as a brewery, a winery and within technology.

For a very young industry, equity crowdfunding is going well; however, there are still those who are yet to be convinced and say that investors should be cautious (Adams, 2015). The first company to be successfully equity-funded in New Zealand was in 2014 and it is fair to say that New Zealand investors are still trying to assess this mode of financing, and are waiting for a track record of success prior to investing. PledgeMe currently has three campaigns that are 'live' at present, and all are on track to meet their target. Companies seeking investment do not receive any funds if they do not meet their target. As with creative crowdfunding, PledgeMe receives a 5 per cent success fee for raising the funds (in the industry fees range from 5–6 per cent depending on the company you use).

For PledgeMe, one of the biggest challenges in entering the equity crowdfunding market was whether their current brand would be suitable to extend to the new part of the business. There was much debate about whether to re-brand or not. It was agreed that keeping the strong PledgeMe brand was appropriate, as the mission for both sides of the business is the same: helping people to fund things they care about. This applies equally to creative projects as it does to businesses needing investors.

Discussion questions

- 1 Starting a business with another person is a common pathway to an entrepreneurial venture. What are the benefits of having a business partner? What are some of the problems in starting a business with a business partner? What do you suppose were the conflicts between Anna and the original developer?

Starting a business with a business partner is often beneficial due to the different skills and experience each person brings to the business. These complementary skills allow the two individuals to perhaps start a business that they would feel unable to do on their own. It allows them to have someone to share ideas and concerns with, and to have moral support and ensure that they are not prone to loneliness – something that is often associated with entrepreneurship.

In many cases, after a business is up and running, trouble strikes those in a business partnership. It tends to revolve around each person having a different perception of the amount of work they are putting into the business, and the direction the business should go. Often, these discussions are terminal, whereby one partner buys the other one out of the business. In the PledgeMe case, the direction of the company was an issue, whereby each

partner had differing views and one opted to buy out the other business partner so she could expand the business.

2 Do you think PledgeMe's decision to enter into equity crowdfunding was wise, or should it have stayed with the original threshold model?

This question is really useful for a classroom discussion. Every student will have their own opinion of how the company has diversified. Students should be encouraged to discuss the effect on the brand by moving into equity crowdfunding, the potential risks involved in basically being a similar to a financial institution, and the reduction of the owners shareholding in the business.

3 Do the two parts of the business (the threshold model and the equity model) complement each other well?

This question is also open for debate. Students should be able to see how PledgeMe have carefully constructed their mission to fit both types of projects – both creative and equity projects. The name of the company fits well for both types of projects. Both parts of the business are basically in the same business of promoting people (crowd) to fund projects that they believe in, so in this sense they complement each other well.

On the other hand, there is a challenge in ensuring people take the equity side of the business seriously as the stakes are a lot higher (in terms of funds raised), and this could be perceived as being difficult given the companies creative background.

4 Now that the founder owns less than half of the company, how easy or difficult do you think it will be to develop new entrepreneurial ideas within the company?

In many ways, the company has access to an enormous 'pot' of entrepreneurial ideas now they have additional shareholders in the company. Many of these shareholders are entrepreneurs themselves. Some are on the Board of the company, so they have a vested interest in the company doing well. The access to a wider range of entrepreneurs means that new ideas for diversification and growth will be available in greater volume than when there was one or two owners of the business. The skills that the Board of Directors brings to the company is also an important asset to the company in terms of entrepreneurial ideas, as well as various other business skills such as marketing, legal and accounting advice.

5 Will PledgeMe be able to remain innovative and fast moving now that it has many shareholders?

The short answer is probably not. As there become more people who have an investment in the company, the more likely is that they will want a 'say' in how the business is run and any major decisions that the business takes.

On the other hand, growth to the extent that PledgeMe has achieved so far would have been impossible without investment funding, so the additional shareholders are given a lot of weight because of this. So, there is certainly a

trade-off as a business gets larger and has more shareholder that it will not be as fast moving and agile, but it may be that in the growth phase, this is not what is required anymore (compared to the start-up phase where being agile is very important).

6 Experiential Exercise. It's clear that the shareholders and founders need to have a logical framework to allocate equity to the various players and to recover equity from people who separate from the company. Have a look at the online Startup Equity Calculator at <http://foundrs.com/>. Fill it out from three perspectives: Anna herself, the original developer and current investors in the company. Should the original developer own half the company? If someone left, how does this impact the company? Should the investor pitch-person have higher equity? How would you calculate sweat equity (value created voluntarily by hard work in the company)? (See Advani, 2007)

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