Financing by and for the Masses:

An Introduction to the Special Issue on Crowdfunding

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This introduction to the special issue on crowdfunding begins by providing some information about the history and nature of the phenomenon. It then summarizes some of the key advantages and disadvantages of crowdfunding for entrepreneurs and for investors, introducing the various articles in the issue that explore these topics in greater depth. It concludes with some speculations regarding the possible future of the industry and its effects on entrepreneurship, innovation, and inequality. (Keywords: Crowdsourcing, Entrepreneurship, Finance, Internet)

M3D seems like the kind of company one would find in Silicon Valley, Cambridge, Massachusetts, or maybe Austin, Texas. It also appears to be the kind of firm that one would expect to attract venture capital funding. Founded in 2013, its founders developed *The Micro*, perhaps the first 3D printer oriented to the home user. M3D promises to revolutionize the industry by selling a fully functional 3D printer at a price point of less than $500. But M3D does not hail from any of these technology hubs; rather, it has its home in Fulton, Maryland, hardly a hot spot for technology startups. Perhaps not coincidentally, Fulton being a bit remote from Silicon Valley or any other cluster of high-tech firms, it has also not yet received any financing from venture capitalists. Instead, the company has been funding itself primarily through pre-sales of its product, sold on the crowdfunding platform Kickstarter.

M3D is just one of the tens of thousands of companies that have raised funds on Kickstarter, and Kickstarter is just one of the thousands of platforms that

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have emerged to connect those trying to raise funds with those providing the money.[1] All told, tens of millions of individuals from around the globe have contributed to the campaigns—funding drives—hosted on these platforms. In 2015 alone, these platforms facilitated the exchange of nearly $35 billion.[2]

The advent of crowdfunding platforms—internet-based marketplaces that connect those seeking funds with hundreds if not thousands of supporters, each generally providing only a small fraction of the total required or desired—has been greeted with enthusiasm by entrepreneurs, policymakers, and the general public alike. Some of this enthusiasm stems from the fact that these platforms promise to allow not just the wealthy, but also the merely affluent to invest in the next Apple, the next Facebook, or the next Google. Some of it comes from the possibility of bringing to fruition popular products and services that might otherwise have never come into existence, such as the Pebble SmartWatch.[3] Some of the enthusiasm comes from the idea that these platforms will expand access to financial resources and services to those currently excluded from them, with the prospect that those entrepreneurs and organizations will create jobs and spur economic growth.[4]

Despite this enthusiasm, crowdfunding remains an emerging and evolving phenomenon, one not particularly well understood by the general public and in some ways not even by those participating in it. Who will be the winners and losers? How and when should entrepreneurs, managers, and investors shift their strategies to take advantage of or contend with these new players? This special issue of the *California Management Review* brings some of the latest academic thinking on the phenomenon to bear, connecting it to practice. It also highlights what we still do not know, thereby setting an agenda for ongoing research and prompting speculation about the future. The final piece, by Assenova et al., provides a virtual forum in which industry experts from a wide variety of perspectives discuss their thoughts on many of the ideas found in this issue, the interesting developments that they see on the horizon, and their beliefs about the probable future of crowdfunding.

What is Crowdfunding?

The idea that an entrepreneur would raise funds from hundreds if not thousands of investors, each providing just a small amount, is hardly new. Consider a few examples. In 1985, Paul Hogan and his partner John Cornell tapped 1400 Australian investors, who contributed as little as $5,000 each, to produce the blockbuster movie, *Crocodile Dundee*.[5] In the 1970s and 1980s, limited partnerships, which required minimum investments of no more than $2,000, became a popular form of financing everything from shopping malls to oil and gas exploration; between 1977 and 1990, companies raised more than $140 billion through these investment vehicles.[6] Charities, of course, have long relied on funding drives that aggregate thousands of small donations toward some worthy end, such as Joseph Pulitzer's campaign for the Statue of Liberty in 1885.[7]

What is new is the emergence of platforms to facilitate these campaigns. In the past, those interested in soliciting investments or donations from the masses would need to do it all themselves, which might mean relying on advertising, direct sales, or retail brokers to get the word out, to sign the deals, and to collect the funds. Crowdfunding platforms dramatically lower the costs of these campaigns by leveraging the geographic and social reach of the internet to connect fundraisers to millions of potential backers. Sites such as Kickstarter, Indiegogo, and Kiva provide categorization and search engines to help match those seeking funds to funders; their webpages allow those running campaigns to advertise and to pitch their products and ideas to those interested; and they provide infrastructures for managing payments, and for keeping track of and communicating with scores of donors or investors. In exchange, platforms usually charge those receiving funds a small fee, typically a percentage of the amount raised.

A Diversity of Platforms

Although people often discuss crowdfunding platforms as a single type of business and crowdfunding activities as being relatively homogenous, in reality a wide range of models have emerged. The diversity of approaches resembles and rivals that of the finance industry; savings-and-loans, investment banks, and venture capital firms do very different things and have distinct (though sometimes overlapping) sets of investors and customers. Crowdfunding platforms similarly serve a wide variety of funders and seekers.

Both people within the industry and outside observers most commonly classify crowdfunding platforms according to what they offer in exchange for the funds that they receive: equity, debt, some sort of reward, or nothing but the satisfaction of doing good or helping someone realize a dream (charity).

Equity

Equity-based sites, such as AngelList and CircleUp, offer a platform on which one can sell shares of a company. From the rhetoric and press around crowdfunding, one might infer that this form of exchange accounted for the lion's share of activity. In actuality, however, only a tiny fraction of the funds that have been raised to date—perhaps 7%, and most of that from outside of the United States—have been in exchange for equity.[8] As we discuss further below, legal and practical constraints have stood in the way of its growth.

Debt

Crowdfunded debt belongs to a larger phenomenon known as peer-to-peer lending and is a big part of the larger revolution in "FinTech" (the combination of software and the internet that has been disintermediating the traditional finance industry). Whereas banks typically serve as intermediaries, taking deposits from savers and issuing loans to borrowers, peer-to-peer lending platforms connect those with money directly to those who need it, allowing savers to earn more and borrowers to pay less by cutting out the middleman. However, these peer-to-peer lending sites increasingly do not involve crowds. In cases such as Prosper's Whole Loan platform, one individual simply provides a loan to another. However, many platforms (such as the Lending Club, Kiva, Zopa, and Prosper) do allow lending by groups of individuals, each funding a fragment of the overall loan.

Rewards-Based

Reward-based sites represent one of the real innovations in crowdfunding. From a legal point of view, reward-based sites have usually been organized as donation sites—funders provide backing with the promise of something in return but with relatively little legal recourse if it does not arrive. In that sense, they differ little from a telethon that promises donors a mug or an umbrella if they give above some level. From a practical point of view, many entrepreneurs and organizations have begun to use these platforms as a means of doing pre-sales: in exchange for their donations to help fund the development of a product or service, backers receive one of the first of the items or offerings, with the added benefit of the status and satisfaction associated with being an early adopter. These platforms have been used to fund everything from the recording of an album or the production of a play to the development of 3D printers and smartwatches.

Charity

On charity platforms, such as Causes or Crowdrise, fundraisers usually do not offer anything in return for the donations that they receive, except for information and feedback about the good deeds that those campaigns have funded and presumably, with it, the satisfaction that donors receive from giving to them.

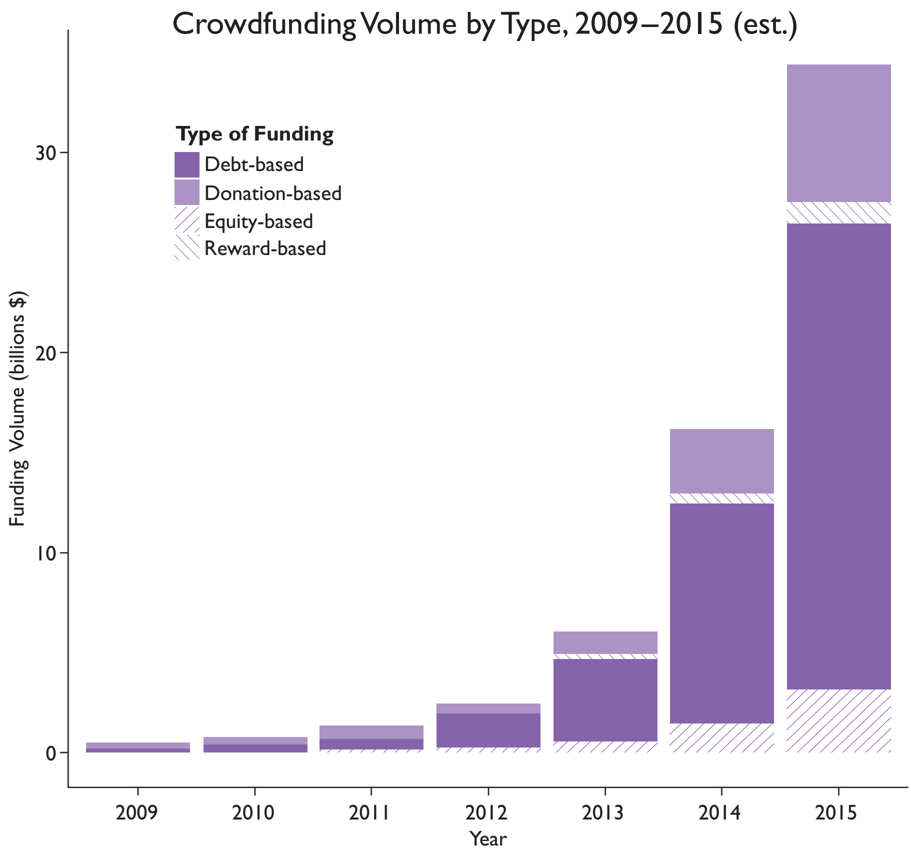
Crowdfunding Growth

Figure 1 reports the rate at which these various forms of crowdfunding have been growing worldwide.[9] As one can readily see, crowdfunded debt accounts for the largest share of the overall volume. However, donation-based funding has been growing a little more rapidly.

These numbers might appear large, but one must also keep them in perspective.[10] Debt-based crowdfunding, for example, grew to $11 billion in 2014; but even at a national level, one often measures debt markets in *trillions* of dollars. Equity-based crowdfunding placed roughly $1.5 billion in capital, worldwide, into early-stage startups in 2014. Yet venture capital alone, leaving aside angel investors and corporate venture capital, funded several thousand companies in 2014 to the tune of $48 billion, just in the United States.[11] Nevertheless, the growth in crowdfunding has been tremendous.

Although platforms have typically been classified in terms of these four broad *quid pro quo* categories, they also differ on a wide range of design elements—for example, can anyone view the pitches, or do they go out first to family and friends and only travel beyond that circle through referrals? Younkin and Kashkooli, in their article in this special issue, argue that these design features attempt to solve four central problems encountered in raising funds: namely,

FIGURE 1.

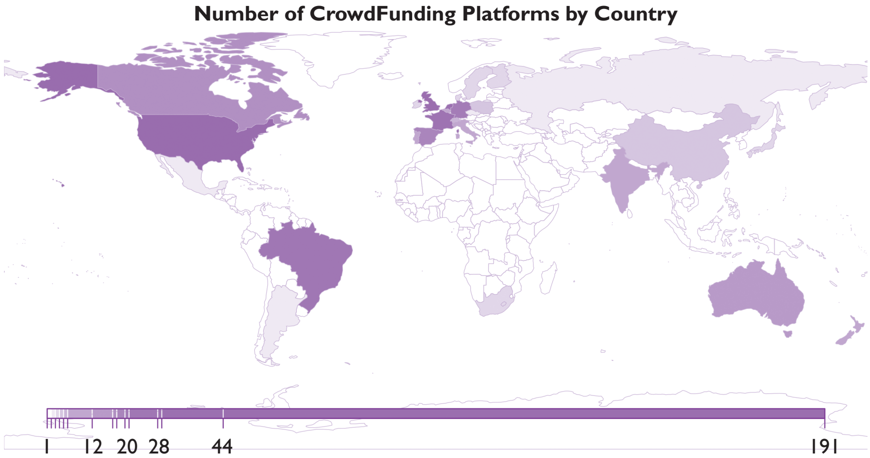


coordination, gatekeeping, inexperience, and patronage. By focusing on design elements, they develop an alternative classification of platforms based on the problems being addressed by the platform. Their framework provides insight into which websites have grown the most rapidly, even among, for example, rewards-based platforms. Their typology also usefully provides guidance to entrepreneurs and managers as to which platforms might fit best with their fundraising needs.

Fueling this diversity of platforms and designs is the truly global scope of crowdfunding. Figure 2 maps the distribution of crowdfunding platforms based on the country in which they have their headquarters.[12] Although most of the examples discussed in the introduction and most of the articles in this issue focus on the United States, Rossi-Lamastra and her co-authors, in their contribution to this issue, survey the state of crowdfunding in Europe.

Given that the idea of financing in groups has been around for ages and that the technology underlying these platforms has been available for nearly two decades,

FIGURE 2.



one might reasonably wonder why crowdfunding platforms only recently became popular? One factor that has received a lot of press attention has been regulation and the *Jumpstart Our Business Startups Act* (JOBS Act). Prior to the passage of the JOBS Act in 2012, SEC regulations prevented startups from soliciting equity investments from individual investors unless they registered for a public offering—an expensive proposition—or unless those individuals met a set of strict qualifications—a high income, a large net worth, or substantial experience as an investor. The JOBS Act, therefore, effectively legalized the solicitation of the 99%.

Although the JOBS Act certainly did ease the restrictions on equity crowdfunding, equity represents but a small sliver of the crowdfunding pie. The main drivers of the growth of the phenomenon have been peer-to-peer lending and product pre-sales, neither of which changes meaningfully as a consequence of the JOBS Act. Changes in the regulatory environment have therefore been a minor issue at most.

Another factor, which almost certainly has played a role, has been the general level of comfort of the public with online transactions. Given the ubiquity of e-commerce today, one can easily forget that as recently as 2000, e-commerce accounted for less than 1% of retail transactions and that people commonly worried about using their credit cards to purchase goods online. Those concerns, moreover, arose even when consumers considered using the websites of established retailers. The prospect of sending money to some stranger with the promise of receiving some good or service months in the future would have been inconceivable for most. However, familiarity breeds trust, and the commonness of purchasing everything from books to airplane tickets online has paved the way for other forms of exchange through the internet that require even more trust.

Crowdfunding and the Entrepreneur

One of the promises of crowdfunding has been that it will expand access to financial resources to those often excluded from traditional forms of entrepreneurial finance. That includes individuals, such as the founders of M3D above, located in places not known for entrepreneurship. It also includes women and minorities, who appear underrepresented among venture capital-backed startups, and perhaps even others who have simply not had the advantage of attending an elite school or being connected to the right people.[13] By an accident of birth or geography, the world might miss out not only on M3D, but also on the next Steve Jobs or Elon Musk.

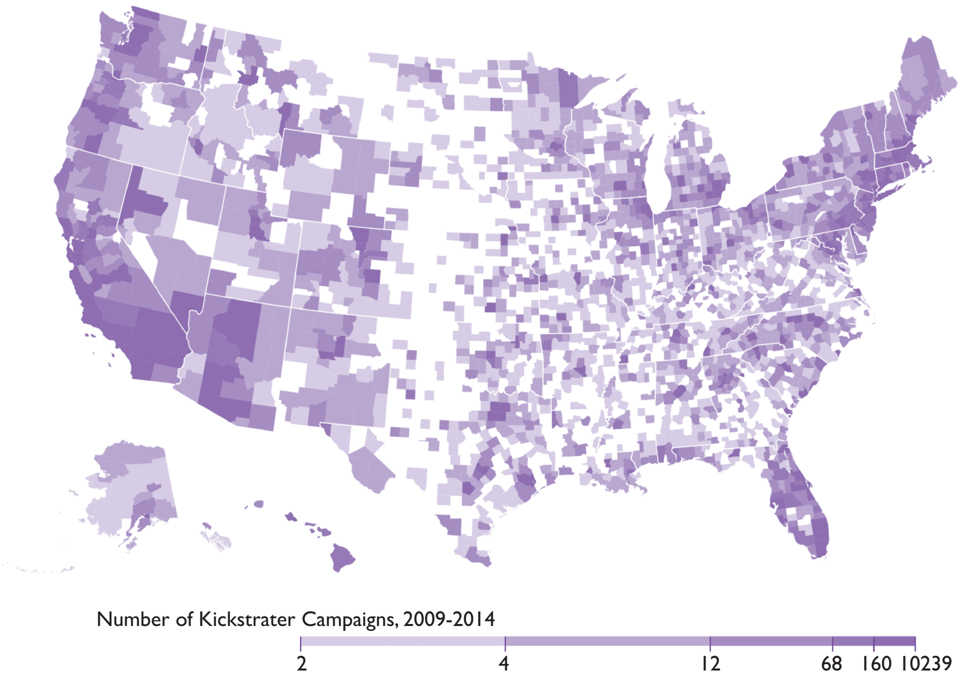
The basis of this belief stems from a few well-established facts.[14] First, the offices of venture capitalists look relatively homogenous, composed largely of Caucasian men with degrees from a handful of elite schools, such as Harvard, Stanford, and Yale. Their offices are also clustered in a small number of locations: Boston, New York, and the Bay Area. Second, venture capitalists rely heavily on their social networks to find and evaluate promising startups. Third, social relationships occur most commonly among those with similar characteristics and among those who live and work in close proximity to one another. As a consequence, the entrepreneurs funded by venture capitalists look much like the investors themselves and are located in the same places as those backers. By bringing a more diverse set of financiers into the mix, crowdfunding platforms potentially provide a more level playing field for women, minority entrepreneurs, and others who simply lack the connections to venture capitalists. Whereas venture capitalists are found in large numbers in only a few places, one can find affluent investors far and wide.

Of course, that promise relies on the premise that good ideas emerge everywhere and from everyone. Another possible explanation for the concentration of venture capital in a few locations and within a narrow segment of the population is that better ideas more routinely emerge from those places.[15] If so, crowdfunding platforms would have little hope of finding great entrepreneurs who just happened to have been born in the wrong places or with the wrong demographics.

Figure 3 displays the distribution of successful crowdfunding campaigns on Kickstarter for 2009-2014. Although some regions clearly received more money than others, even a casual perusal of the map suggests that crowdfunding did not simply concentrate in the same high-,tech hubs as venture capital. Yes, entrepreneurs in Silicon Valley, Boston, and New York ran successful fundraising campaigns but so did those residing in regions as far flung as Denver, Miami, and Salt Lake City. At least in terms of geography then, it appears that crowdfunding may indeed expand the range of entrepreneurs with access.

In this issue, Mollick and Robb address these questions in more depth, reviewing their prior research on the topic. On the one hand, they have found that crowdfunding investors appear to respond to many of the same signals as venture capitalists—strong founding teams, endorsements from outside the team, and a well thought out and researched proposal. One might then expect the crowd to fund the same startups as traditional financiers rather than expanding access to

FIGURE 3.



entrepreneurial finance. On the other hand, they also report some important differences. Crowdfunding investors appear willing to invest in riskier ideas than venture capitalists, and women may even have an advantage when raising funds from the crowd. Also, consistent with Figure 3, they find that the crowd appears to fund campaigns from a different set of places than venture capitalists. It therefore appears that crowdfunding may indeed allow a more diverse spectrum of people to become entrepreneurs.

Crowdfunding—especially in the form of rewards-based platforms—may also have much to offer even for those who could easily secure funding from more traditional sources. On the one hand, pre-sales allow entrepreneurs to get a sense of the probable demand for their products before investing heavily in developing or manufacturing them. On the other hand, entrepreneurs can often retain a larger share of their ventures if they fund themselves through pre-sales than they could through the more traditional venture capital funding route, even if they do receive venture capital at some later stage in their development.

Startups, especially those hoping to offer a novel product or service, face a variety of risks. Will the technology work? Can the entrepreneur build a reliable organization to manufacture, deliver, and service the good? Will customers buy it? At a price that produces a profit? Entrepreneurs can typically only answer these questions by building an organization, developing the product, and attempting to sell it either directly or through some distribution channel. Pre-sales, through reward-based crowdfunding platforms, potentially allow entrepreneurs to avoid unnecessary time and expense by seeing whether customers will pay a profitable price for the product. If the campaign fails, the entrepreneur discovers at relatively low cost that the idea would probably not attract enough buyers to reach a minimum efficient scale. However, if it succeeds, then he or she can move ahead, secure in the knowledge that a market exists.

Pre-sales can also allow entrepreneurs to retain a larger proportion of the ownership of their startups. Because venture capitalists often have a great deal of bargaining power when negotiating with an entrepreneur, they commonly require quite a large proportion of the ownership in a company in exchange for their funds. They also need to receive these large stakes to ensure that the returns from the winners in their portfolios more than cover the losses associated with the many companies they fund that go under. From the perspective of the entrepreneur, these large allocations of equity to the venture capitalist often represent a cost that they would rather avoid if they could. Pre-sales potentially allow entrepreneurs to bootstrap their startups by getting the equivalent of a loan from their future customers.

Given the potential upsides of these campaigns, understanding how to run them successfully has huge value for the entrepreneur. Thürridl and Kamleitner, in their article in this issue, point out that rewards bundle a variety of characteristics that create value, including the reward type; its financial value; the scarcity, tangibility, and geographic limits of the reward; and the ways in which it has been tiered. They use these characteristics to define seven archetypal rewards strategies, some of which appear more likely to produce a successful campaign. Their typology further provides guidance to entrepreneurs as to which platforms and rewards strategies might best fit with their fundraising goals.

Crowdfunding and the Investor

Much of the excitement about crowdfunding from the perspective of the investor comes from the idea that it would allow a larger range of individuals to invest in future Amazons and eBays. This enthusiasm, however, should raise some concerns. Even professional investors find it difficult to select winning startups. Perhaps the wisdom of the crowd can do better, but an Amazon or an eBay currently represents something like a 1 in 100 event at best. As an investment class, venture capital would appear to have lagged in performance behind the S&P500 for most of the last decade, particularly when one adjusts for the volatility of the investments.[16]

However, even though the odds of investing in a winner might end up being quite low, crowdfunding does offer the potential for better than average returns by eliminating some of the costs associated with investing. Venture capital companies typically charge at least a 2% annual fee plus a 20% carry (20% of the profits made on the investments).[17] An investor who puts $100,000 into a venture capital fund that ends up tripling in value could easily end up paying as much as $60,000 to the venture capitalists who managed the money. Over the ten-year life of a typical fund, eliminating these fees would shift the return from roughly 9%, on an annualized basis, to 11.6%.

The math for debt investments looks similar. The average five-year certificate of deposit currently yields less than 1%. However, banks use these funds to issue loans with interest rates ranging from a little over 3% (for secured auto loans) to 6% to 20% (for unsecured personal loans). That differential means that depositors could earn much more on their holdings if they eliminated the middleman. The promise of crowdfunding for investors may therefore stem more from its ability to lower fees than from its potential for letting the average Joe invest in the next high-flying high-tech company. Think entrepreneurial finance meets discount brokerage.

Of course, investors must recognize that intermediaries bundle a wide range of services. Venture capitalists do more than just pick winners; they perform a great deal of due diligence and ensure that the entrepreneur is trustworthy and that the numbers in the business plan add up. Once they have made an investment, they also put a large number of hours into helping the business to succeed, providing advice to the entrepreneur, and helping to connect him or her to potential customers and to recruit potential employees. These services contribute to the returns that venture capitalists realize and may more than justify their fees.

Banks similarly do not just match lenders and borrowers. They also assume most of the risk associated with lending. Someone with a certificate of deposit need not worry about the possibility that the borrowers using their money might default on their loans. The bank issuing the certificate guarantees not just the principle but also the rate of return. By contrast, someone lending through a crowdfunding platform could lose their money if the borrower defaults or might earn a lower return than expected if the borrower repays ahead of schedule.

Crowdfunding platforms, however, may find ways to offer some of these services, potentially in an unbundled fashion. In their article in this issue, Agrawal, Catalini, and Goldfarb document the dramatic rise of syndicates in crowdfunding and discuss how they can substitute for the due diligence role (and perhaps the active investing role) of venture capitalists. By offering some percentage of the profits—on AngelList, currently 20% to 25%—some individual promises to assume the role that a venture capitalist would play in a traditional fund. Although those amounts might seem almost identical to those charged by venture capitalists to manage money, note that they do not include an annual fee, meaning that the overall costs associated with an investment with an average return would decline by 25% to 30%.

Venture capitalists may not welcome syndicates that claim to offer the same value at a lower price, yet in general, they might welcome the emergence of vibrant crowdfunding platforms. Venture capitalists, of late, have preferred to invest in later stage companies and have increasingly left the financing of earlier stages to family, friends, accelerators, and angel investors. Crowdfunding offers the possibility of augmenting these early stage investors and, in the process, increasing the deal flow available for later-stage investing. Venture capitalists can also potentially benefit from having entrepreneurs eliminate some of the questions around whether a market exists for their product or service through the effective use of pre-sales. Rather than simply substituting for venture capital, crowdfunding could then end up increasing the quality and quantity of investment opportunities available to them.

The Future of Crowdfunding

Crowdfunding remains in its early days. What might the future hold? That depends on a number of factors, including its underlying economics, regulatory change, and whether it serves as a complement or a substitute for more traditional forms of finance. We speculate on two possible trajectories for the future of crowdfunding and the implications of crowdfunding for innovation, entrepreneurship, and the economy in general.

Fraud and Malfeasance

Prior to the passage of the Securities Act of 1933, the regulation of securities offerings fell to state law.[18] Some states had reasonably strong laws guarding against fraud, but they often found it difficult to enforce them. In the mania for equities leading up to the crash of 1929 and the subsequent Great Depression, some unscrupulous swindlers put together some particularly egregious schemes for parting fools from their money. To protect the general public, Congress therefore required companies interested in selling securities to disclose a great deal of verified information that investors could use to inform their choices.

The exception to this restriction has been "qualified" investors—those rich enough that they can afford to lose money or experienced enough that they should know better. Of course, being qualified does not prevent one from being the victim of fraud, as most of Bernie Madoff 's marks would woefully attest.

The JOBS Act substantially relaxes these restrictions. One of the obvious fears therefore has been that this deregulation will lead to a new wave of securities fraud. To date, the incidence of such fraud has been negligible. Interestingly, fraud has rarely occurred even in the settings where it would seem easiest: reward-based platforms. Because these platforms have generally been organized as donation sites, funders have relatively few avenues for retrieving their money if they never receive the promised rewards. In his study of Kickstarter, Mollick found that fewer than 4% of projects showed evidence of fraud, and that those projects accounted for less than 0.5% of the total funds raised. The crowd may actually do a pretty good job of ferreting out the frauds.

Of course, the possibility remains and it seems almost inevitable that a large-scale fraud will occur at some point, even if it represents but a small fraction of the total funds involved in crowdfunding. How regulators and the crowd in general react to that event could shape the future of crowdfunding. If regulators decide to shift toward much more protection and the funders become overly cautious, then crowdfunding may end up being no more than a peripheral phenomenon, though we think it unlikely.

Platform Convergence

Although one can currently count the number of platforms in the thousands, as with any innovation, one usually sees a boom in experimentation before the industry converges on a dominant design and a few prominent providers. How many platforms might one expect in the long run?

Platforms represent something of a two-sided market, with those raising funds on one side and those with funds to provide on the other. Each side benefits from scale. Fundraisers would like to address as large an audience of potential donors, customers, or investors as possible. Those with funds, meanwhile, would generally prefer to have as many projects as possible from which to choose. These sorts of settings lend themselves to natural monopolies, much as one has seen in the case of internet-based auctions and eBay. One might therefore expect to see a very small number of very large players in the long run.

Of course, it could take quite a while to get there. Indeed, in this issue, Rossi-Lamastra and her co-authors find that the concentration of platforms in Europe has actually been decreasing. Three types of frictions seem important to slowing consolidation. One is regulatory. Particularly on debt- and equity-based platforms, the local laws governing these securities matter a great deal, and they differ quite a bit from country to country. Rossi-Lamastra et al. illustrate the importance of such differences in their analysis of European crowdfunding platforms, finding substantial variation even within the world's largest common market.

A second type of friction is geographic. Investors in nearly all financial markets have been found to exhibit a "home bias"—a tendency to invest in options closer to where they live and work.[19] Online transactions appear to offer no exception to this rule. Even in the apparent absence of rational explanations for such a tendency, such as earning better yields or returns, research has found that the online crowds exhibit this same preference for the nearby.[20] Given these regulatory challenges and home biases, platforms might find it very difficult to span national borders.

The third friction that could slow platform consolidation stems from limits to scale (and scope). Debt, equity, and reward-based platforms differ in many respects. They appeal to different investors; those raising funds on them often have very different objectives; and they each need to oversee different sets of operations. One could therefore imagine that each platform would only address one of these formats, as they currently do. Hence, even if the scale advantages on both sides of the two-sided market drive each segment toward a monopoly, one might still see a national champion platform of each type, meaning a world with scores of platforms.

In the longer run, consolidation seems nearly certain, despite these frictions. Even across countries, platforms could share a common brand and most of the software involved in running their sites. Amazon, for example, maintains sites for and operates in more than a dozen countries. Each of those sites has numerous departments specializing in different types of products. It sells both products that it distributes itself and those distributed by other companies. One could easily imagine a similar global platform emerging in crowdfunding, serving different countries and needs through a series of semi-independent sites. A platform that establishes deep trust with both funders and seekers, moreover, might even convince people to engage in transactions that cross national borders.

Innovation and Entrepreneurship

Just as funding through large groups predated the internet, the crowdsourcing of innovation has a long history, mainly through tournaments with substantial prizes. King Philip III of Spain, for example, faced with the challenge of navigation at sea, offered a 6,000 ducats prize and 2,000 ducats annual income for life in 1598 for the person who could solve the problem of measuring longitude.[21] The British, Dutch, and French governments later offered similar rewards. In the end, it took nearly two centuries to solve the longitude problem to an acceptable degree of accuracy but it did get solved, by the British.

Tournaments with rewards have once again become popular, run by firms, such as Netflix, and government agencies, such as NASA. Indeed, a small industry has sprung up to help firms outsource their innovation problems. Yet these opportunities still leave most of us untouched. Almost everyone has good ideas that could improve our lives, but most of us do not have the time and resources to develop and test those ideas, let alone to market them to the world.[22]

Crowdfunding and crowdsourcing could change that in a number of ways. For one, inventors with a good idea might find it easier to fund the development of that idea. If the idea proves a commercial hit, moreover, inventors will have more motivation to do it again. However, one could also imagine a more radical solution in which crowd platforms become places not just for exchanging financial resources but also human resources and social capital. Someone with an interesting idea might simultaneously look for financial backers and for people who could help them to develop their idea and to sell it.

Societal Inequality

If sourcing from the crowd does indeed elicit more ideas and more funding to develop and test those ideas, might it also help to stem the tide of rising inequality?

On the one hand, crowdfunding may expand the pool of individuals engaging in entrepreneurship and investing in startups. To the extent that these activities have been important to creating wealth, one might then expect crowdfunding to reduce inequality—by spreading opportunities across a wider segment of society. Would-be entrepreneurs, who may have been unable to raise the funds to pursue their ideas in the past, can now do so. These entrepreneurs may also capture more of the value that they create because they no longer need to sell large parts of their ventures in order to develop them. Investors, who can spot good entrepreneurs but who do not have the resources or the access to invest as angels, can now reap rewards from their abilities and expertise.

On the other hand, in general, inequality appears even greater in the entrepreneurial sector than in society at large. The typical startup fails in four years or less. Those who invested in these startups that failed early probably lost everything that they put into them. Those who invested in the winners meanwhile often earned returns in excess of 100% per year.[23] By contrast, those investing in large companies rarely lose everything, nor do they enjoy such large gains. Without a great deal of diversification at the level of the individual investor, crowdfunding then might easily create greater inequality between winners and losers on the investing side.

A similar dynamic governs entrepreneurs and employees, except that people rarely have the luxury of working for multiple companies to diversify away the risk of failure. Entrepreneurs who succeed enjoy outsized returns while those who fail earn less than they would have in a minimum-wage job.[24] Employees who work for startups that fail find themselves inconveniently unemployed, often at the worst points of the business cycle. They therefore suffer from having joined these failed firms long after they have found employment elsewhere.[25] The entrepreneurial economy therefore also tends to increase inequality on the side of the entrepreneurs and employees.

Whether and how financing by the masses actually does influence inequality will depend on myriad factors. Who will use and succeed in crowdfunding campaigns? Already wealthy and well-connected entrepreneurs or those excluded from other forms of entrepreneurial finance? Who will invest in profitable projects? Already rich and seasoned investors, the merely affluent, or poor and inexperienced hopefuls? Only time will tell the answers to these questions—and in some cases policy and managerial interventions may shape them—but they remain of fundamental interest to entrepreneurs, to investors, and to society at large.

Notes

1. As of September 23, 2015, http://www.kickstarter.com reports having raised more than $2 billion in pledges from 9.5 million people to support 92,800 projects. On the same date, http://www.crowdsourcing.org included 2,914 listings in its directory of sites.
2. Massolution, *2015 CF: The Crowdfunding Industry Report*, 2015.
3. For a more complete story behind the Pebble and its founders, see Anthony W. Kosner, "Who Needs Venture Capital? Pebble Smart Watch Raises over $5 Million on Kickstarter," *Forbes*, April 19, 2012.
4. Entrepreneurial finance in the form of venture capital has been found to have large stimulating effects on the communities in which it has funded startups. See Sampsa Samila and Olav Sorenson, "Venture Capital, Entrepreneurship, and Economic Growth," *The Review of Economics and Statistics*, 93/1 (February 2011): 338-349.
5. Richard Gulliarati, "Australian Dealmaker: John Cornell; The Man Who Sold Hollywood on 'Crocodile Dundee,'" *The New York Times*, August 21, 1988.
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