New Ways to Raise Capital

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Mike Del Ponte literally stumbled upon his business idea when one of his guests asked him for a glass of water at a dinner party in San Francisco three years ago. He accidentally overturned his Brita water pitcher taking it out of the refrigerator, and while cleaning up the mess, he thought surely he could create a filter that his dinner guests wouldn't mind seeing left on the table.

Hence, the idea for Soma—a sustainable, eye-pleasing carafe-cum-filter—was born. Del Ponte knew he couldn't get cash from his bank, because the business idea was still just that—an idea. So he turned to crowdfunding site Kickstarter to raise the start-up capital.

Within a few short weeks, Del Ponte, whose goal was to raise $100,000, had gotten $150,000 from 2,000 investors. Since that time, Soma has raised an additional $6 million from a combination of accredited investors and Silicon Valley venture capital firms.

"A chief executive's time is one of his most valuable assets, and fundraising is very time-intensive," said Del Ponte. "Crowdfunding sites make the fundraising process easier and more convenient."

Del Ponte is one of hundreds of thousands of entrepreneurs who are accessing funds in new ways, tapping far-flung investment networks that hadn't existed before the financial crisis. They're taking advantage of the ways social media, big data analysis and other innovations have transformed the marketplace for capital. They're also benefiting from changes to financial regulations.

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-Slava Rubin, Indiegogo CEO

Prior to the recession, businesses had to rely primarily on small networks of family and friends for seed financing, eventually graduating to some form of traditional finance, usually from a bank. But a sea change has taken place, giving entrepreneurs access to a vast network of people who can contribute money to their business on platforms like Kickstarter without actually being accredited investors.

"The 2000s were all about social media and commerce, but this will be the decade of funding and the democratization of money," said Slava Rubin, founder and chief executive of Indiegogo.

With the passage of the Jumpstart our Business Startup Act of 2012 (better known as the JOBS Act), for the first time businesses can directly solicit investors. Meanwhile, crowdfunding sites have been evolving in the few short years since their inception to allow for actual investment. Some platforms now focus exclusively on one industry, tapping only accredited investors who typically have a net worth of $1 million or more.

Jeffrey Hollender, who previously founded sustainable cleaning products company Seventh Generation, decided to use one such site, called CircleUp, to raise money in 2013 for his new sustainable fair-trade condom company.

"I have spent my entire life raising money, and the biggest thing that has changed is the ability to broaden your fundraising network outside of your circle of personal relationships," Hollender said. His goal was to raise $500,000 for Sustain Condoms. He wound up raising $600,000 on CircleUp and an additional $2.4 million from his own network, all within 120 days.

The algorithmic lenders

Meanwhile, the lending landscape is being changed by two new groups of online lenders offering small businesses operating capital loans based on data analysis of their likelihood of repayment. They're crunching data based on a business's financial transaction history, monthly checking account balances and social media standing—rather than using the backward-looking FICO credit scores used by banks. They can make decisions within minutes and can often have funds in a borrower's account the same day.

While the approval rate is quick, small businesses need to be careful. Accessing these kinds of loans can come with a hefty price tag, with annual percentage rates of 50 percent or more. And the lenders use something called a merchant cash-advance model, which typically takes a fixed portion of daily revenue for repayment.

Companies involved in this space include pure-play online lenders, such as On Deck Capital, Kabbage and Lendio, as well as more traditional e-commerce companies, such as Amazon and eBay's PayPal, which offer working capital loans to merchants that sell using their services.

"Opportunities come to small businesses, and they have to be able to act fast," said Darrell Esch, vice president of small-business lending at PayPal. "[Banks] either lack the ability to respond quickly, or the access is not there."

That certainly is an issue for Drew Silver, founder and president of ticket brokerage firm Drew's Tickets, based in Sherman Oaks, California. The company, which has five full-time employees, has $3.2 million in annual revenue. Silver typically needs cash to buy blocks of tickets for sporting events, theater productions and concerts, which he then sells to his customers.

"In my type of business, accessing capital is crucial because we purchase a large amount of inventory for shows throughout the country," said Silver. A PayPal merchant since 2009, Silver said he decided to give their new working capital loans a try in 2014.

He filled out an online application and qualified for $20,000 in minutes. Since his first loan, he has returned seven times, typically taking about 30 days for repayment, he said. The loans also have helped Silver build up a new consignment business, where he sells blocks of season tickets for business owners and other ticket holders, which he said has boosted his company's revenues 50 percent and allowed him to hire an additional employee.

"Being able to access capital like this allows me to pay for additional staff, and purchase additional inventory, and that fuels my sales and my growth," Silver said.

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