

Just rewards: Crowdfunding for German VC-backed startups



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17 October 2017

The abundance of crowdfunding platforms is giving startups more options for raising capital. Oscar Geen investigates the pros and cons for German businesses using this type of funding and how it functions alongside conventional venture capital investments

Companies raised more than \$34bn in crowdfunding in 2015, of which \$6.4bn was raised in Europe, according to Crowd Expert, a market intelligence firm focused on crowdfunding. However, the report notes that these statistics are inflated by P2P/marketplace lending, which does not fit most definitions of crowdfunding and accounts for 71% of the total.

Elsewhere, a 2016 report by alternative financing research organisation Crowdfunderhub gives more granular detail for Germany. Reward-based crowdfunding, where backers receive some kind of incentive – usually the product the company is developing – in return for their investment was reported to be worth around €9.8m in 2015, while crowdfunding where backers receive equity was worth €48.9m.

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Kurt Müller of Target Partners says reward-based crowdfunding is an extremely powerful tool for companies: "For the portfolio company, it is a valuable market research tool. It allows you to get feedback from the market on your potential product while also raising some cash." But it is useful for the investor as well, he says: "Our focus is mainly on B2B tech businesses, but if we were more consumer focused we would definitely use these platforms also to source deals."

The Target portfolio companies that have successfully used reward-based crowdfunding are all consumer hardware products: smart home applications [Tado](#) and [Senic](#), and driving gesture recognition device manufacturer [Auto-labs](#).

However, when it comes to giving away equity to the crowd, Müller is less enthusiastic. "The investors are less sophisticated and require less downside protection than a typical VC, but I'm not sure if they're reliable in the long term," he says. He envisages a scenario where a startup will need €20-50m and raises its first rounds using crowdfunding: "It may put sophisticated investors off if too many early-stage investors have been brought along. We once rejected a deal because it had 125 business angels on the ticket and they were not able to pool their investment into one vehicle."

Healthy rewards

Even companies in sectors without consumer-driven products can make use of reward-based crowdfunding. Life sciences startup Rodos Biotarget used crowdfunding to trigger an €800,000 capital increase in August. CEO Marcus Furch

explains how the reward system functioned: "Crowd investors providing more than €1,000 were sent exercise balls representing the nanoparticles in our therapies, those giving more than €5,000 were invited to a life sciences symposium, and those investing more than €10,000 were invited for dinner with the management team."

The secondary benefit of this funding and structure was that it attracted the interest of medical entrepreneur Otto H Gies, who invested in a direct shareholding in the company after backing it through the crowdfunding platforms Seedmatch and Aescuvest. "Otto was one of the people who invested €10,000 and, after meeting our management team, became more interested in our capabilities and began his due diligence with his advisers," says Furch. He adds that the company expects to close a further funding round this year that Gies may participate in.

Furch says that Rodos Biotarget used crowdfunding platforms with the specific aim of attracting further interest from potential investors and reports interest from some large pharmaceutical companies as a result. However, he admits that it was something new to some of the company's existing investors: "We had this discussion with our investors and began convincing and informing them at an early stage. High-Tech Gründerfonds had experience with this through other portfolio companies and we eventually got shareholder approval to raise up to €1.25m through crowdfunding."

This is made easier by German regulatory restrictions on equity funding. Large scale crowdfunding platforms in Germany do not take equity positions but format their investments as a subordinated loan: "Contracts are designed in a way that traditional investors can easily buy out the crowdfunders if they want to," says Furch. "Therefore, crowdfunding and VC funding can be well aligned for an innovative life science company."

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