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## The Art of Crowdfunding

UK's Chilango Chain Bets on Burrito Bonds

Special Feature: Food & Foodservice Industry Outlook 2017+



versus a traditional bank loan which would require capital repayments as well. The debt is your public, your guests and fans," he explains.

That is the nub of the matter: the whole thing is, so to speak, marketing for free. The target group, as part of the catering family, hands the capital-acquiring com-

pany a strong marketing tool. For the large number of small private cash suppliers are not investors in the classical sense but are passionately committed to the brand and highly interested in it doing well.

"There is the key, that these aren't investors in the traditional sense, these are



Upper Street, London

## Crowdfunding – the Pros and Cons: an Expert Speaks, Questions to Marc Pussar



*Marc Pussar is an attorney with SKW Schwarz in Frankfurt am Main. Among other work, he advises clients on corporate financing and FinTech companies on banking-supervision law. Marc Pussar also works on questions such as crowdfunding in his capacity as head of the Legal Affairs Division of BDOA e.V., the German Association of Service Providers for Online Suppliers, and as an adviser to the Financial Academy of the German Federation for Financial Analysis and Asset Management (DVFA). [www.skwschwarz.de](http://www.skwschwarz.de)*

### Which types of crowdfunding are usual, and on what terms and conditions?

Four varieties of crowdfunding can be distinguished and the company decides which variety suits best or will lead most quickly to the outcome desired.

- In donation-based crowdfunding (crowd donation) the backer supports the campaign with a donation, for which he gets nothing back.
- In counterperformance-based crowdfunding (crowd supporting) the investor normally receives a reward. From a mention in praise as a supporter, to acquisition of the first generation of product, plenty is possible in this scheme. It is important that the reward does not need to be a compulsory counterperformance by the company and can in addition be made dependent on numerous prior conditions – in particular, successful financing and subsequent successful production.
- Credit-based crowdfunding (crowd lending) amounts to an interest-bearing loan. If things turn out successfully, the backer gets his contribution back, plus fixed interest.
- In asset-based crowdfunding (crowd investing, equity-based crowdfunding) the investor participates in the company in one of numerous ways and, if things turn out successfully, gets his investment back, plus a rise in value.

### What makes digitally based crowdfunding so attractive to the capital-acquiring company?

Crowdfunding can be attractive as an alternative source of finance for companies (creators) which have difficulty obtaining classical financing, such as a bank loan.

In many types of crowdfunding the company receives cash, without having to provide a counterperformance. Even with those types in which the company promises the investors (backers) a reward, this is frequently not obligatory and is dependent on the success of the campaign or the product. Thus the company can

obtain cash which – unlike a bank loan – it does not need to pay back if things turn out badly.

But a crowdfunding campaign can also be attractive as a PR or marketing scheme. For many companies this aspect is even more important than the financing. Through the campaign the company can position itself with a target group and draw attention to its new product or concept. In an additional search for classical 'investors', too, a crowdfunding campaign can be an attractive multiplier. In addition, when launching new products, the crowdfunding campaign can be used for customer tests: if investors get products as a reward, their feedback is valuable and can be used to improve the products.

### Where is the attraction for investors?

For backers, crowdfunding offers above all an opportunity to support ideas which are close to their heart. They find it exciting to take part, at a very early stage, in the creation of something new. Particularly if campaigns finance first-generation products, investors may enjoy being the first to have an innovation in their hands. In crowdfunding campaigns with the prospect of a potential return, the backer finds it attractive to participate, with just a very small sum, in a project with as high a return as possible. The fact that even small investments are possible also enables the investor to distribute his money over various different campaigns, thus spreading the risk.

### Where, from the investor's point of view, are the risks, the advantages and disadvantages? How much transparency can be demanded?

The backers' rights depend very much on the concrete conditions which provide the framework. This applies to the crowdfunding platform, the campaign, and the applicable (national) law.

If the crowdfunding is by way of donations, normally the investors can bring no claims. In some cases, however, money is repaid if the target amount for the campaign is not collected.

In credit-based crowdfunding a loss share, and less favourable treatment in case of insolvency, may be agreed. Thus the risk is higher than with a normal loan. Where there is no more money, however, this entitlement is of no help. In these cases, the only recourse is to insolvency law.

In the case of equity-based crowdfunding there is frequently an asymmetry of information. It is difficult for the backers to access the information they need to evaluate the course of their investment.

Nothing can generally be expected from the crowdfunding platform, since it is mostly purely an agent and excludes itself from liability.

### Does that mean the backers should always allow for the worst?

What is true of monetary investments in general is true also of crowdfunding: the greater the potential return, the higher the risk. Backers should generally allow for a potential total loss.

also brand ambassadors. Think of the power of your brand, if 2,000 people in your home market who frequent your business every single day, also owned a piece of the action, were also profiting from your success. Think about the power of them as a sales force.

Think about the power of being able to email them, access them and ask them questions that you normally would feel uncomfortable asking in the focus groups. It's as much about fundraising as it is about brand profile raising.\*

Jutta Pfannschmidt-Wahl

But, whichever form of crowdfunding is involved, the backer's principle motivation should be that of supporting a new idea, and less of speculating in a lucrative investment. If the company is a new entrant or start-up, you must not forget: that can also go wrong. If the money is lost without the company being at fault, as a rule there is no chance for the investors to get anything back.

Things become particularly difficult if the backer cannot claim his rights in his own country because the crowdfunding campaign is running internationally. In many such cases the (cost/expenditure) risk of a failure in asserting your rights bears no relation to the sum invested.

#### Are there 'disadvantages' for the creator side?

The time and energy needed for a crowdfunding campaign must not be underestimated; plenty of preparatory work is required. This will include the selection of the right crowdfunding campaign, and for example the right crowdfunding platform. Along with the larger, well-known platforms, there are countless niche platforms which, depending on the direction of the campaign, may be the right choice.

#### So companies should always find out the terms and conditions of the platforms?

That is advisable, for the platforms impose very individual requirements. Usually you not only have to pay a platform fee, but the company must meet various stipulations and supply comprehensive information. Otherwise many platforms will not admit campaigns.

Many companies, in addition to close supervision of the main campaign, decide in addition to have a pre-campaign (constantly recommended by the professionals) – which is likewise very labour-intensive. So, in the run-up period the creators should check how big the time and energy needed for a crowdfunding campaign really is and whether they would not prefer to put their resources immediately into the search for a 'classical' investor – 'business angels', strategic investors, venture capitalists (VCs) etc.

#### Nevertheless – does the publicity effect outweigh the additional work?

As a rule, the significance as a PR and marketing tool, as discussed at the beginning, is large. However, you should consider: the positive marketing effect you hope for could rebound if there are problems with a new product and the investors view this negatively. As valuable as many of these early adopters are as multipliers of a good product, they can become equally dangerous if problems arise. From another angle, too, a campaign may be disadvantageous for a company: for example, if an innovative product or concept is actually to be developed without attracting great attention. In the case of catering (gastronomy) concepts in particular it may be difficult to obtain protection for new developments; here a head-start is always an advantage. Then, through a crowdfunding campaign, your competitors may find things out too early, or imitators may enter the scene.

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