



Equity Crowdfunding: Risks and Benefits



Equity crowdfunding is similar to other types of crowdfunding, where the general public can contribute money to a cause through an online platform. Unlike other types of crowdfunding, however, contributors aren't simply making a donation or receiving a token product in exchange for their donation. Instead, equity crowdfunding is an exchange; each contributor is considered an investor in the company and earns a share of the company's profits.

President Obama signed the JOBS Act, which made equity crowdfunding an option for investors, in April 2012. However, the two primary regulations governing equity crowdfunding weren't fully in force until several years later.



Types of crowdfunding

Regulation CP Equity Crowdfunding:

Regulation CF is the most popular type of crowdfunding and is used by most popular equity crowdfunding platforms. This regulation allows both accredited and non-accredited investors to contribute to a business campaign. There are, however, limits on the amount of money a company can raise as well as restrictions on how much each investor may contribute. We will cover these in more detail below.

Regulation A+ Equity Crowdfunding:

Also known as a “mini IPO,” regulation A+ crowdfunding has stricter reporting and qualification standards than regulation CF crowdfunding, but also allows a much higher annual funding limit.

How does equity crowdfunding work?

All equity crowdfunding must be performed through a funding portal (i.e., a crowdfunding platform) or a broker-dealer. There are several popular crowdfunding platforms available, which we will cover below.

Equity Crowdfunding Limits

There are limits on how much money a business may raise within a 12-month period. The Regulation CF crowdfunding limit is \$1,070,000, while the Regulation A+ crowdfunding limit may be as high as \$50 million. (But, again, there are more hoops to jump through for Regulation A+ approval).

Equity Crowdfunding Process

Regulation CF doesn't require a long process to get started. Businesses must first fill out a Form C with the Securities and Exchange Commission (SEC), but there's no substantial pre-clearance required. If the company aims to raise more than \$107,000, an independent CPA must review the past two years of financial statements as well.

The Regulation A+ process is a bit more complex. First, the company is required to submit a Form 1-A with the assistance of a securities attorney. The SEC will determine qualification within three to five months or longer. A two-year financial audit is also a requirement.



Equity Crowdfunding Investor Limitations

Both crowdfunding regulations allow either accredited or non-accredited investors to contribute to a campaign. An accredited investor is a wealthy individual with a net worth of at least one million dollars (or greater than \$200,000 annual salary). A non-accredited investor is considered part of the general public with less than one million dollars in net worth (or less than \$200,000 annual salary).

However, there are limitations on how much an investor may contribute, based on income.

If income is less than \$107,000 annually, the limitation is 5% of net worth or \$2,200.

If income is greater than \$107,000 annually, the limitation is 10% of net worth or the individual's annual income.

When are funds released to the business?

The SEC states that funds may not be released until 21 days after the start of the campaign.

In addition to this rule, however, many crowdfunding platforms have their own time limits for releasing funds.

Businesses must also set a funding goal that must be met before funds are released.

If the funds aren't released to the company within a certain timeframe, they are returned to the investors.



The Pros and Cons of Equity Crowdfunding

If you're wondering whether equity crowdfunding is a good fit for you or your business, here are some of the pros and cons.

Pros: From a Business Standpoint

- Efficient method for raising capital
- Gives your company access to a range of investors
- Boosts your marketing power through social media shares and website traffic
- Investors can offer valuable insights about your business plan
- Generally a much easier method for raising capital than traditional methods

Cons: From a Business Standpoint

- Giving up a portion of your business ownership in exchange for capital
- Fundraising caps
- Commission fees and other expenses
- SEC regulation, which may require you to provide audited financial documents and result in fines if you violate regulations

Pros: From an Investor Standpoint

- Return on investment potential is high, especially with a sound investment
- Investment is a personalized experience because investors pick and choose businesses that fit their own belief systems
- Non-accredited investors can invest their funds like accredited investors
- SEC regulations offer some protections for investors
- Helps small-to-medium businesses and therefore stimulates the economy

Cons: From an Investor Standpoint

- Possible business failure (and loss of investment)
- Fraud susceptibility if the investor doesn't investigate the business thoroughly
- Return on investment isn't promised and may take years to accrue
- Need to wade through many poor investment opportunities before finding a good investment



Popular Crowdfunding Platforms

There are many equity crowdfunding platforms available, but here is a quick rundown of the most popular options.

EquityNet

EquityNet provides access to thousands of approved, self-accredited investors and has helped entrepreneurs across North America raise over \$300MM in equity, debt, and alternatively sourced capital.



With the industries best deals and largest industry raise sizes, Fundable is the first choice for entrepreneurs and investors who are serious about raising funding for their businesses.

CircleUp

Our mission is simple: Help entrepreneurs thrive by giving them the capital and resources they need.

crowdfunder

Crowdfunder is the equity crowdfunding leader for sourcing and funding high-growth ventures with a network of over 130,000 entrepreneurs and investors.

WEFUNDER

We're like Kickstarter for investing. Help us fund 20,000 more founders.

seedinvest

SeedInvest is a leading equity crowdfunding platform, opening up access to venture capital and angel investing to everyone.

MICROVENTURES

MicroVentures built a platform that gives both accredited and non-accredited investors access to invest in startups. Over \$200M has been raised on our platform to date.



Final Thoughts

Equity crowdfunding isn't for everyone, but many businesses and investors benefit from this type of fundraising. If you would like to get started today, many of the crowdfunding platforms listed above have additional information and allow users to create a profile for free.

If you're thinking about raising capital for your company, be sure to contact us so we can assist you with the accounting requirements and strategic financial planning. If you're considering a crowdfunded investment, please let us know if you have any questions regarding the potential transaction or tax implications. We're always happy to help.



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