Crowd Funding - What Should Every Financial Professional Know?

By Don Minges, MBA
Executive Education, Inc.

What Is Crowd Funding

Crowd funding is the process of asking the general public for money, typically over the internet. There are several types of crowd funding:

- Pre-Selling (advance orders for goods or services)
- Donations
- Debt
- Equity

Organizations can bypass stores, banks, and investors entirely and instead pitch ideas directly to Internet users, who provide financial backing. Crowd funding has and will continue to change how organizations raise financing. For example, Pebble raised over $11 million on Kickstarter.com and thirty two thousand people raised over $700 thousand for Karen Klein on IndieGoGo.com.

Donations and pre-selling have been available crowd funding methods for years. Debt crowd funding has a shorter history and an uncomfortable relationship with Federal regulators. On April 5, 2012, President Obama signed the JOBS act into law, making certain crowd funding equity investments legal in the U.S. Crowd funding is <u>not</u> a fad. This technique belongs in your financial toolbox.

Crowd funding is not right for every organization. There are numerous variables to determine if it is an appropriate method to raise financing. Crowd funding is an additional financing technique; it does not replace any existing financing methods. Since many organizations have done crowd funding successfully, proven methods exist to successfully raise funds.

Crowd Funding's Impact on Organizations

Financial professionals should familiarize themselves with crowd funding for many reasons:

- The JOBS Act requires audits or reviews for certain companies using crowd funding to raise equity,

- CEOs and board members expect their CFOs to provide advice on strategic financial matters like," what are my options to raise financing?" Crowd funding is a proven alternative for certain organizations, and
- the SEC may require organizations utilizing crowd funding to submit reports.

Overview of Crowd Funding

Organizations typically raise financing by bootstrapping, donations, debt or equity. Crowd funding can accommodate each of these financing methods. There are different pros, cons, risks and costs for each crowd funding type. Over 500 unique crowd funding websites exist with numerous differences in focus, rules and costs. There is no dominant player even though Kickstarter.com, IndieGoGo.com and RocketHub.com are the most widely known. There are many success stories and failures.

Crowd Funding Pros

Crowd funding may reduce the cost to attract capital for smaller organizations. It expands your reach over the entire internet. You may not have to give up any ownership to raise financing. You are in control of everything including costs, timing, execution and marketing.

Crowd Funding Cons

Crowd funding demands a different kind of preparation than traditional financing. There is regulatory risk since many regulations are pending. The process is stressful and once started - it is out of your hands. Your business information may be publically available over the internet. Finally, it does not always work.

Crowd Funding Examples

Pebble A watch for an iPhone. (Pre-selling a product on Kickstarter)
http://www.kickstarter.com/projects/597507018/pebble-e-paper-watch-for-iphone-and-android

Bear Love Good. Cancer Bad. Charity. (Donations on IndieGoGo)
http://www.indiegogo.com/bearlovegood

Extra Credits A video game. (Pre-selling a video game on RocketHub)
http://www.rockethub.com/projects/2165-extra-credits

Overview of the JOBS Act

The JOBS Act changes how organizations can raise equity financing. Most of the impact is on early stage companies and entrepreneurs. Some changes were effective immediately, while many await publication of final SEC regulations. The JOBS Act eliminates the prohibition on general solicitation to accredited investors under Rule 506 of Regulation D. The offering organization must take reasonable steps to verify an "accredited" investor truly is "accredited." Generally, an "accredited" investor either has an individual income of more than $200,000 per year, or a joint income of $300,000 in each of the last two years or has a net worth exceeding $1 million, either individually or jointly with their spouse. The JOBS Act allows anyone to become an investor through the crowd funding exemption. The limits on the "mini public offering" have been raised to $50 million. There are specific requirements that organizations must meet in order to raise equity via crowd funding. Organizations raising equity via Crowd Funding can only raise a limited amount each year and must file reports with the SEC. The law revises thresholds triggering reporting to the SEC. Please consult a qualified attorney for details relating to your situation. A full copy of the JOBS Act is available at http://www.gpo.gov/fdsys/pkg/BILLS-112hr3606enr/pdf/BILLS-112hr3606enr.pdf.

Potential impact of Crowd Funding

Skeptics argue that crowd funding will open up "The Wild West of Investing," further enabling scam artists. Advocates argue crowd funding will revolutionize investing in smaller enterprises, especially startups, and help energize the economy. Depending on the specifics of the organization, including the stage, amount of capital needed, business model, etc., crowd funding can be a boon to companies seeking capital. There are limits, costs and regulatory hurdles; nothing is free. Regardless of your perspective, the rules for raising capital have changed and the changes will impact organizations and their financial and legal advisors.

Don Minges, **MBA,** is a fractional CFO who works in diverse industries at various development stages. He has experience in profitability enhancement, strategic planning, venture capital, mergers & acquisitions, consulting, turnarounds, economic forecasting, cost accounting and financial analysis. Don has experience raising equity for several growing firms and has invested equity capital into promising businesses. He has served on the Board of Directors for many firms and graduated with highest honors from the Fuqua School of Business at Duke. Don@ExecutiveEducationInc.com

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