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Crowdfunding

When we hear the word "crowdfunding" most of us think about fundraising campaigns to help a family or community in need. While charitable causes are a big part of the crowdfunding movement, there are many other types of projects that receive money from crowdfunding campaigns. Even the Securities and Exchange Commission ("SEC") has gotten in on the act and has approved crowdfunding regulations for small businesses to raise money in something like a small "IPO."

Origins

It is human nature to think everything we do today is new and different, and that is often the (mistaken) assumption about crowdfunding. The term "crowdfunding" is meant to describe an effort to raise small amounts of money from a large number of people; something that has been done many times in the past. Some famous historical examples of what we now call crowdfunding include obtaining funding for:

1713 – Alexander Pope's translation of the Iliad,

1783 – Mozart's Concertos,

1885 – the Statue of Liberty's pedestal.

All these, and more, were brought about by small donations from a large number of people. A lack of technology in past years limited how much, and from how far away, someone could raise money in a crowdfunding effort. But the Internet has changed all that. With several web sites devoted exclusively to crowdfunding campaigns, almost anyone can try to raise money for almost anything. Some of it is silly, like the guy that was raising money to have his entire head tattooed. But most of it seems sincere and in some cases it is emotionally difficult, like the families affected by the flood in Baton Rouge last year. The most well-known crowdfunding sites have different goals and aims, but their one common feature is that the money is basically a donation – don't expect to receive something of equal value in return for the money you give. The most well-known sites are GoFundMe (donation for charitable causes), Kickstarter (donation for rewards) and Indiegogo (donation for product / sample).

"This is my final offer: $125,000 a year, full stock and benefits package, my baseball card collection, and you get to punch me in the arm as hard as you can."

Securities-Based Crowdfunding

After the Great Recession of 2008/2009, Congress was searching for ways to help get our economy moving. One piece of legislation that came out of that effort was the Jumpstart Our Business Startups ("JOBS") Act, which was signed into law in 2012. The general purpose of the JOBS Act was to loosen rules for small businesses to raise money in public financial markets, in hopes that easier

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access to capital would help them hire more employees and build new factories. While the JOBS Act made changes to more traditional ways of raising capital, it also required the SEC to write new rules so very small companies could use the Internet to raise equity and debt in a crowdfunding campaign.

By 2015 those new rules were written and adopted, with the SEC calling them "Regulation Crowdfunding" which became effective on May 16, 2016. The new rules represent a major break from past regulations. The basic idea was to make the process of raising capital more democratic – more and smaller companies can raise debt and equity from more and smaller investors than under the old rules. Importantly, if a company raises equity or debt in a crowdfunding campaign under the SEC rules they are actual financial securities; although they are **not marketable or liquid** and there are **important questions about how their value is determined.**

The market is very new, and it looks like there are a number of details that still need to be worked-out. My advice is to be very cautious with crowdfunding securities. In the next newsletter we will go into a little more detail about crowdfunding securities. In the meantime, you may want to look at the SEC's website describing the new Regulation Crowdfunding: https://www.sec.gov/info/smallbus/secg/rccomplianceguide-051316.htm

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Please contact Ronald DiMattia at Corporate Value Partners at (216) 741-1330 or ron@corporatevaluepartners.com with any questions or if you need help with a valuation or corporate finance matter.

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