

# The Guide to Equity Crowdfunding

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## Today's Entrepreneur

There's never been a better time to be an entrepreneur. Why? Simple. Because there's never been an easier time to raise capital.

Right now, because of overlapping developments in three key arenas— economy, technology, and policy—a powerful wave of opportunity is cresting, and an entrepreneur in the know can go for quite a ride.

For starters, the economy is changing—and entrepreneurs are to blame. Consider that in 2000, it cost about \$1 million to start a company. Today, it's below \$5000. As a result, startups and small businesses now account for over 50 percent of the GDP and investors are considering opportunities

that were completely off the radar just a decade back.



Technology, our next category, has also changed entrepreneurial possibility. Giant networks are connecting people and businesses in ways never before imagined. Consider, in the earlier days of the Internet, we often opted for anonymity, hiding behind screen names, user handles and such. Fast forward to 2015, when who we are has become a fundamental component of online life. Thanks to Facebook, LinkedIn, and all the rest, we have come to trust our digital identity—and this new trust is fueling a massive uptick in collaborative and cooperative opportunities.

Policy, our final category, is now starting to catch up to the changes wrought by these economic and technological developments. Thanks to new legislation, early-stage finance is being radically disrupted. By 2020, the JOBS Act—and the equity crowdfunding opportunities it unlocks—will create \$50 billion of available capital. Without question, we are living through a golden age of early-stage entrepreneurship.

## How We Think About Money

Today's entrepreneurs have more options and tools available to them than at any other time in history. Yet, in spite of this, far too many struggle with finance and fundraising. Many are uncomfortable asking for money, many more don't believe they'll get it even if they do ask.

But the truth is, money is abundant today. In the US, there is \$30 trillion sitting in long-term savings alone—and that's just the "friends and families" accounts of everyday folks who might want to invest in your company. On top of that is another \$200 billion—the money invested each year by more experienced professional and institutional investors (like angels, VCs and banks).

Money is everywhere, waiting and wanting to be deployed—it's really just a question of understanding this new landscape.

## **The State of Equity Crowdfunding**

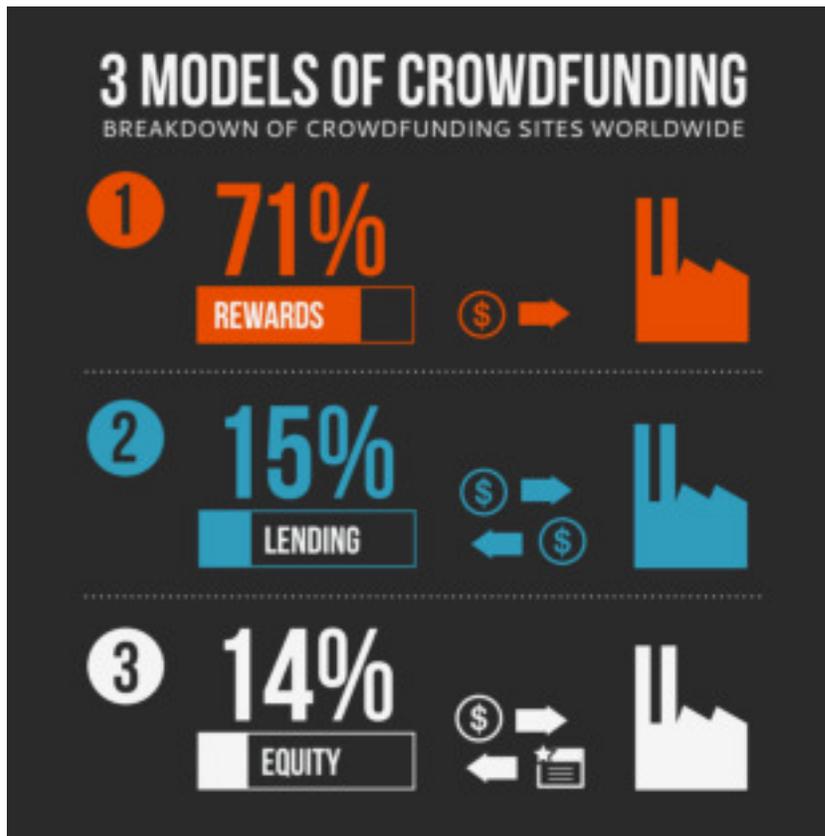
Both in the US and around the world, the crowdfunding industry is growing rapidly—but this acceleration is about to go exponential as the newest addition to the industry, equity crowdfunding, comes online.

For this to make sense, a little history is helpful. By early 2011, rewards-based crowdfunding (think Kickstarter) had become a \$1.2 billion dollar market. It was a great innovation, allowing people to pre-purchase products and experiences as a way of helping fund a company or project they were excited about. But the idea that participants in these campaigns might also have the opportunity to become owners of the companies they were supporting—that is, what equity crowdfunding allows—was a distant reality.

Things have changed. In late 2011, the JOBS Act, the first equity crowdfunding bill, was introduced into the House of Representatives. Its goal was to drive job growth and create increased access to capital for small businesses. In April of 2012, it was signed into law by President Obama.

This new legislation was a revolutionary departure. We went from eighty years of financial regulation that prohibited small business from talking publicly about their fundraising efforts, and excluded lower-net worth citizens from investment opportunities, to a radically new kind of market.

The JOBS Act paved the way for everyday citizens to invest in early-stage private companies alongside professional (aka wealthier) investors. It took a little while to work its way through Congress, but when it passed, in September of 2013, the SEC then lifted the longtime ban on general solicitation—that is, talking publicly about funding for a private



company.

With this ruling, the power of mass communication and social media was unleashed on private fundraising.

But, while Title II allows general solicitation, there is still the restriction that says all participating investors must be accredited—meaning they earned over \$200,000 over the last two years, or have over \$1 million in net worth outside of their primary residence. As of today, this restriction still bars everyday citizens from participating in equity crowdfunding.

It's these everyday citizens that Title III of the JOBS Act aims to bring into the market—an influx with the potential to skyrocket crowdfunding. Remember that \$30 trillion stashed away in personal savings and investment accounts? If just one percent of that money shifted to startup investments, the \$300 billion market it would create would be ten times greater than the current \$30 billion venture capital industry.

Right now, we're waiting for the SEC to implement Title III. In the meantime, platforms like Crowdfunder let accredited investors hunt for new opportunities online.

## Transforming Social Capital into Financial Capital

For the first time in history, influence on the web is being transformed into financial capital. The technical term for this is *reputation economics*, but what it really means is that your digital identity is worth far more than ever before.

Think about it this way. If, fifteen years ago, I told you that people you've never met would be so excited by your business idea that it would be possible to raise six and seven figure amounts from them—well, you would have thought I was crazy. But this is exactly what the crowdfunding revolution

has done. By transforming our ideas about how money is used, shared, and invested, it's changed the game.

Equity crowdfunding is the next frontier. Here's how to play.

## The Five Keys to Fundraising

### Key #1: Integrate Offline and Online Efforts

It's only been a year since equity crowdfunding became legal—but it's already changing the fundraising landscape. We're moving towards a world where an investment-ready company has the ability to reach several thousand potential backers in a single day. This has changed the dynamics of direct fundraising efforts inside the board room. Over the next year, it's not entirely ridiculous to think that raising startup capital online will become the "new normal." Meaning, if you're an entrepreneur and you're not taking advantage of these developments, you're missing out on a huge opportunity.

What's more, smart entrepreneurs are finding that their online fundraising efforts help accelerate their offline efforts. Online fundraising isn't a replacement for offline fundraising—it's the perfect complement.

### Key #2: Follow The Leader

Investors trust other investors more than they trust entrepreneurs. As such, who else is investing in a startup is one of the more powerful signals you can send. It's an important way to attract new investors. It's social proof.

Data collected at Crowdfunder.com—about the companies raising money on the site— shows that when a startup has a credible or notable lead investor it brings roughly five times the amount of engagement and follow-on investment to the deal.

Of course, finding a notable or lead investor doesn't happen overnight. It means spending the time to build a real relationship. It means becoming what GRP Partners and Upfront Ventures VC Mark Suster calls "a line, and not a dot" in the mind of a potential investor.

To do that means showing up regularly in their office and in their inbox with progress updates. If you simply tell an investor what you're going to get done over the next three months, then update them each month with news of real progress, you will immediately stand out from eighty percent of the other entrepreneurs vying for their attention. It's that easy and it's worth the effort.

The social proof a lead or notable investor lends to your project will do wonders for your fundraising.

### Key #3: Leverage The Power of Story

Startups and entrepreneurs who excel at fundraising aren't just the ones with the best traction or the most experienced management team—they're often great storytellers.

Every investor has two brains. And you need to engage, stimulate, and satisfy both. The first brain is the quantitative brain. This is the part of each investor that deals with dollars and cents. We recognize

this brain when it questions our sales projections and financial assumptions.

## MARKET FOR BUSINESS CROWDFUNDING

"IF AMERICANS SHIFTED **1%** OF THE **\$30 TRILLION** THEY HOLD IN LONG-TERM INVESTMENTS TO SMALL BUSINESSES, IT WOULD AMOUNT TO MORE THAN **10 TIMES** THE VENTURE CAPITAL INVESTED IN ALL OF 2011."

-Amy Cortese, Author of *Locavesting*



Inexperienced fundraisers often spend all their time trying to convince the rational brain to invest. But there is more to the story.

The second brain is non-rational. It's the emotional brain. This brain cares about the story of the business, the larger context. The huge market potential you see for your company and the unique approach you're going to take to serving customers (and thus win the market) is what activates this second brain. It's what ignites investor passion.

All successful fundraising efforts, even those presented online, must tell a powerful and compelling story to the investor, while walking them through the rational parts of the business. In other words, pitch to both brains.

### Key #4: Lower Investment Minimum, Raise Funding Conversion

Something exciting happens when the minimum requirement for investing in a startup falls from where it used to be— say \$50,000 or \$100,000 – to where it is today: \$5,000.

When this happens, both the real and perceived exposure for any single investor changes dramatically. When Crowdfunder surveyed potential investors about their willingness to take risk, they found that investments below \$10,000 shifted the whole equation. Below that number, investors no longer required months of relationship building and due diligence. Instead, they were far more likely to take a flyer on an interesting opportunity.

Of course, this raises a management problem. Won't it be a ton of work for a startup to manage a crowd of investors? Turns out, no. Equity crowdfunding solves this problem by aggregating these smaller ticket investors into a single entity or mini "fund" that is easy to manage.

This combination allows startups to lower their minimum investment amount and enables them to take funding from a larger pool of potential investors.

### **Key #5: When In Doubt, Execute**

What do investors value above all else? Execution. Set goals, achieve goals, repeat.

## **Terms: What To Offer Investors**

Two of the most common questions heard from entrepreneurs are: What do investors want to see in a pitch deck? And what terms should I offer investors?

The first question is easy to answer since the folks at Crowdfunder have already done the heavy lifting for you—creating the Ultimate Pitch Deck for Fundraising. This is the blueprint. It tells you exactly which slides to include in your pitch and explains how to craft the overall narrative. It also includes examples of great pitches that raised millions (including the deck used by LinkedIn founder Reid Hoffman). This Pitch Deck is available for free download at the Crowdfunder Knowledge Center: [Crowdfunder.com/Learn](http://Crowdfunder.com/Learn).

The second question is more complicated. Why? Because investment terms, company valuation, and longer-term implications are not "one size fits all." In other words, what you want to offer investors depends on what kind of company you are.

Therefore, at the Crowdfunder Knowledge Center you'll also find our Term Sheet resources. These break down the different equity and debt offerings, explain how they work, and provide clear examples and documents to guide you. But, truthfully, to get it right, you still need to hire a trustworthy lawyer.

## **The Anatomy of a Successful Campaign**

Crowdfunding campaigns are won or lost before they ever launch. Strategy makes all the difference. Here are some of the most critical tactics:

**Campaigns Never Fund Themselves:** A great idea and a sexy deck are not enough. Neither is posting a project on a crowdfunding site. Great campaigns are funded by great engagement—this is what turns attention into dollars.

**Get 'First Money' or Lead Investors:** As we pointed out earlier, having a lead investor is key. The validation they provide will instantly draw other investors to the table. Plus, no one wants to be first money in—and having a lead circumvents this problem before it arises. For this same reason, strategically-minded founders often push the launch of their campaign until they have anywhere from

5 to 10 percent of their funding in place. Really strategically-minded fundraisers have 25 percent.



Truthfully, the more, the better.

**Don't Bury Your Lead:** Modesty is a great value, perhaps not in fundraising. When it comes to telling your story, let it all hang out. Many times entrepreneurs hide the fact that they already have an influential advisor or investor involved. Remember, it ain't bragging if it's true.

**Your Online Pitch:** With crowdfunding, you get to use rich media to craft your pitch—including image, text, and video. This means learning how to be both a literary and a visual storyteller.

**Timing Is Everything:** Think carefully about the length of your campaign. For good fundraising, timing can either make or break you. A campaign should be long enough to realistically achieve its goals, but not so long that it drags to a standstill. Investors like movement and momentum. At Crowdfunder, we've found a 45 to 60 day window works best for equity campaigns.

**Equity, with Rewards:** Crowdfunder pioneered a hybrid model of crowdfunding that blends equity and reward campaigns. As an example, Neil Young raised equity for his PonoMusic venture on Crowdfunder, on the heels of a successful Kickstarter campaign that pre-sold his Pono music player.

**Trending:** One of your goals in crowdfunding is to drive enough engagement, attention, and initial funding so that platforms take notice. Rewards platforms like Kickstarter and equity platforms like Crowdfunder have premium placement on their sites for new, notable, and trending campaigns. Success begets success.

**The Art of Closing:** Just because an investor says yes, doesn't mean their money is going to instantly appear in your bank account. The reality of getting investors to pony up is far different. Often, entrepreneurs need to close their larger investors two to three times, even after getting a verbal commitment. With crowdfunding, even though the financial commitments or transactions can be made online, if you don't follow up with all leads quickly, you'll likely leave a lot of money on the table. Plus, investors putting in \$5,000 or \$10,000 generally don't feel the kind of urgency you might like and it might take several nudges to get their money in.