THE INVESTORS' GUIDE TO EQUITY **CROWDFUNDING**

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WHAT IS **CROWDFUNDING?**

"Crowdfunding is the new black." - ***Rowena Wiseman***

As the name suggests, crowdfunding is a way of financing businesses or projects via a "crowd" of backers. As opposed to traditional methods of raising money, the funds raised via crowdfunding typically come from a large number of people contributing small amounts, as opposed to a few investors putting in large amounts.

While the industry has grown significantly in recent times it is not a new concept. As far back as 1606 the Dutch East India Company used the power of the crowd in order to fund the lucrative venture of conducting trade between Europe and Asia. In the 1880s hundreds of small donations from everyday Americans helped to pay for the plinth upon which the Statue of Liberty stands. And in 1997, just before the industry really started to take off, rock band Marillion famously raised $60,000 via its own fan base to fund a US tour.

But driven by a lack of finance for small enterprises, caused by the 2007/09 financial crisis, along with significant advancements in the growth of the internet, the crowdfunding industry has boomed in the past few years. According to figures from Massolution's 2015CF Crowdfunding Industry Report,

the total value of global crowdfunding was up by
167% to **$16.2 billion** in **2014**

with the company forecasting a doubling in value in 2015 to $34.4 billion.

The crowdfunding industry can be divided into two parts:

Rewards/charity based

Here the investor does not expect a financial return but instead makes a donation and may receive some sort of reward or gift. An example would be a musician seeking funds to record an album, with backers receiving a free copy of the recording, concert tickets or a credit in the sleeve notes. Then again the donation could be entirely philanthropic. This is by far the largest part of the crowdfunding industry, with market leaders Kickstarter and Indiegogo being purely reward and donation based platforms.

Investment based

This involves equity or loan issues where the investor has the potential to earn a return on their money in the future. In the UK investment based crowdfunding platforms are regulated by the Financial Conduct Authority (FCA).

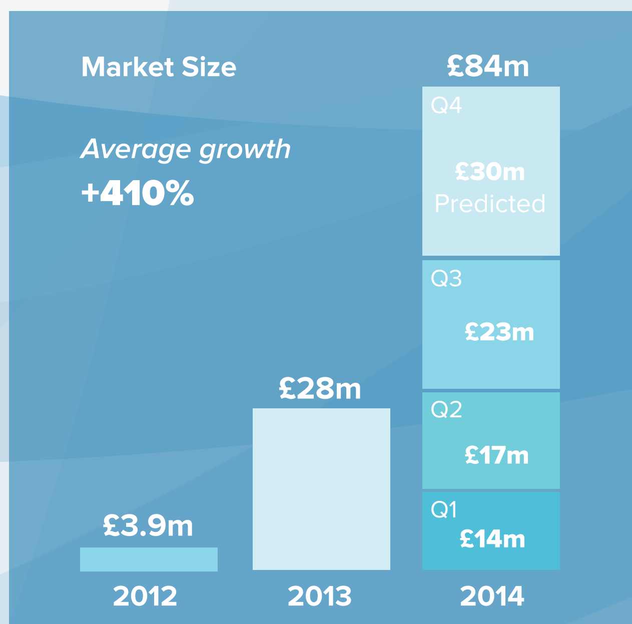
EQUITY **CROWDFUNDING?**

Equity crowdfunding works in a similar way to traditional equity fundraisings, whereby new shares in a company are issued to investors in exchange for funds. However, equity crowdfunding sees the funds raised from a large group of investors rather than a few, as typically seen in traditional equity fundraisings.

The industry facilitates the coming together of innovative but capital hungry entrepreneurs with investors who are willing to take on increased risk in order to potentially make huge returns. Previously only open to wealthy business angels and venture capitalists,

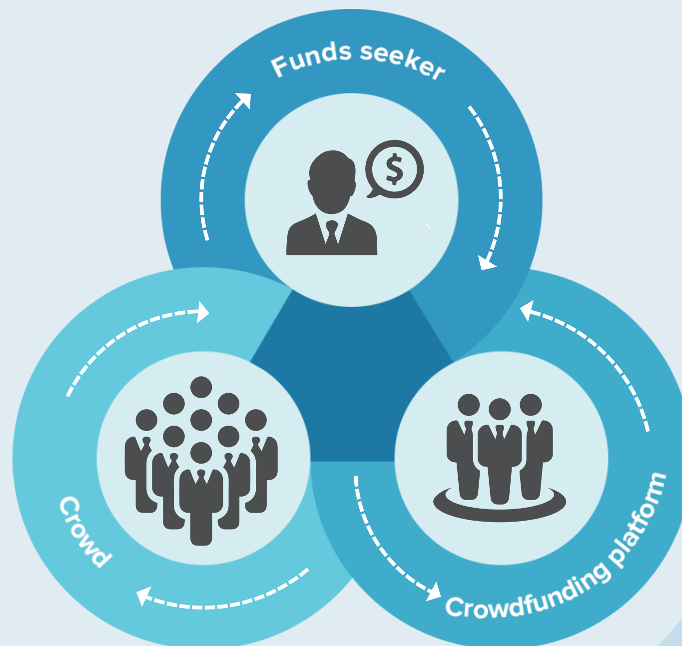
equity crowdfunding has helped to open up the market to a whole new pool of potential investors.

Although the current market for equity based crowdfunding is small it is growing quickly. According to innovation charity Nesta an estimated £84 million was raised via equity crowdfunding in the UK in 2014, up by 200% from £28 million in 2013 and just £3.9 million in 2012.



Equity crowdfunding is predominantly carried out by private, unlisted companies. But quoted companies, which have considerable access to finance via the public equity markets, have also turned to crowdfunding in order to raise capital. Last year IDSX listed Chapel Down, the Kent based maker of English wine, raised almost £4 million to expand its operations. This was the first time that a listed company completed a successful equity crowdfunding campaign anywhere in the world.

HOW EQUITY **CROWDFUNDING WORKS**



Simple theoretical example: Will's Widgets has invented a ground breaking new device which it thinks will revolutionise the widget industry. The company needs to raise £100,000 in order to invest in new machinery and to ramp up its marketing. It will offer 10% equity, thus valuing the business at £1 million.

The company then goes to a crowdfunding platform (such as Crowd for Angels) in order to apply for a pitch listing. After the funding platform carries out due diligence on the business the investment pitch will be approved (assuming it meets strict criteria) with the company setting funding targets, a time frame and other details.

The pitch goes live to investors and is marketed by both the company and the crowd-funding platform. Assuming all goes well, the money is raised by the deadline and Will's Widgets can then spend the funds on developing the business. Investors are issued new shares in the company and can keep up to date with their investment via the funding platform.

WHY
GET INVOLVED?

HIGHER RETURNS

The main attraction of equity crowdfunding is the opportunity to make huge returns on investment

Few other financial instruments offer the potential to increase wealth as much as equity in an early stage or start-up business does. The right company, if successful, could multiply an initial investment many times over.

Although it is relatively early days for the industry we can get an idea of the kind of returns which are possible from equity crowdfunding. In 2013 electric car sharing venture E-Car Club raised £100,000 via a seed capital equity crowdfunding round. In June 2015 the company was then sold to car hire business Europcar. While the exact purchase price was confidential, the 63 investors who got in at the seed round are believed to have made a return of around 3 times their initial investment.[1]

In other words,

returns of 200% have seen to be possible from equity crowdfunding within just two years.

Of course, with the potential for increased reward comes increased risk- see below.

TAX ADVANTAGES

Dependent on individual circumstances UK tax paying investors can enjoy tax benefits from certain crowdfunding investments. Pitches may be eligible for the Seed Enterprise Investment Scheme (SEIS) or Enterprise Investment Scheme (EIS), under which investors can claim back a respective 50% and 30% of their investment in income tax relief. Be aware that tax rules can change and that a number of criteria must be met before relief can be claimed.

DIVERSIFICATION

Given their risk profile, equity in start-up firms can be considered to be a separate asset class, thus helping investors to spread their investments and diversify their portfolios.

PERKS

Many companies offer rewards and additional “perks” as part of their pitch. These typically include free products, discounts, vouchers and many other company specific benefits.

INVEST SMALL AMOUNTS

There's no need to have a bank account the size of Alan Sugar's when it comes to equity crowdfunding. Some platforms offer an entry point into companies for only a small amount of money – potentially as little as £10.

INTANGIBLE BENEFITS

Such as the feeling of satisfaction of being able to help businesses develop their ideas, making new contacts and learning more about investments.

RISKS

Of course, like all investments, putting money into small public listed or private companies involves risks. Notably:

Investing in early stage businesses runs the risk of losing some of or all of your invested capital

- if the company if not successful. With most start-up businesses failing the latter is highly likely. You should only invest money you can afford to lose and equity crowdfunding investing should be done only as part of a diversified portfolio.
- Even if the company is successful equity in private companies (those which are not quoted on a stock exchange) is highly illiquid. As such it may take a long time to sell your stake and realise any value in the shares.
- Investors' equity stakes may be diluted by further funding rounds.
- Start-up companies tend to use capital to invest back in the business. Therefore the prospect of any dividend payments may be many years away, if at all.
- Losses are not covered by the Financial Services Compensation Scheme.

Given the high risks involved investors need to understand that they should research investment pitches and be happy with the level of risk to which they are being exposed to.

INTRODUCING
CROWD FOR ANGELS

Launched in July 2014 Crowd for Angels is the first regulated crowdfunding platform for equity and debt funding. We offer investors the opportunity to fund companies through all stages of their life cycle, from seed, development and pre-IPO, through to listing on a stock exchange. We cater for both private and public companies.

- You can invest in a pitch from as little as £25.
- There are no on-going or one-off fees for investors.
- Receive up to 50% tax relief with SEIS (Seed Enterprise Investment Scheme) – **find out more HERE**
- Follow the progress of the companies you invest in and help them grow.

Whether you are looking to invest in equity or debt, you can do BOTH with Crowd for Angels.

To see our current range of pitches **CLICK HERE**

CONTACT US

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RISK WARNING

Investing in small public listed or private companies involves risks, including illiquidity, lack of dividends, loss of investment and dilution, and it should be done only as part of a diversified portfolio. You could lose all of any money invested.

Crowd for Angels is targeted exclusively at investors who are sufficiently sophisticated to understand these risks and make their own Investment Decisions. You will only be able to invest via once you are authorised. Please **click here** to read the full Risk Warning.

This document has been approved as a Financial Promotion by Crowd for Angels (UK) Limited, which is authorised and regulated by the Financial Conduct Authority. Investments can only be made on the basis of information provided in the Pitches by the Investee Companies concerned. Crowd for Angels takes no responsibility for this Information or for any recommendations or opinions made by the Investee Companies.

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Sources

http://www.virgin.com/entrepreneur/mind-the-exit-what-the-first-exit-means-to-the-future-of-crowdfunding