

Introduction to Equity Crowdfunding

If you want to invest in a company's success, there are two main options. The first is to put your money into shares of a publicly traded company, however, this requires the company to have achieved a certain level of growth. The second is to invest while the company is still private, but this method is generally only open to investors and firms with very deep pockets.

Equity crowdfunding gives a **crowd**, or group, of people the opportunity to invest in a company that is not yet listed on the stock market. They receive **equity** in return. Others may call this process crowd investing or investment crowdfunding. What are the potential benefits and drawbacks of this fundraising method, and why is it causing a stir now?

Crowd investing is a relatively recent fundraising vehicle first introduced in the 2000s. Up until recently, legislation and regulations didn't allow it in many countries, however as the law catches up, investors are getting interested. Equity crowdfunding really took off during the 2020 lockdown, raising \$214.9 million (105% more than in 2019) that year for 1,035 new companies.

What's the difference between equity crowdfunding and regular crowdfunding?

The rise of Kickstarter and other similar platforms has made crowdfunding accessible to both the average investor and the average consumer. So what's the difference between regular crowdfunding and equity crowdfunding? In short, what the buyers get.

Entrepreneurs use Kickstarter campaigns to raise capital for their product. This generally comes with a discount to attract potential customers and tiers of perks to tempt fans into investing more money. Once the product or perk is delivered to the "investor", the contract between the investor and the company is finished.

Equity crowdfunding, in contrast, gives the investor more skin in the game. By offering financial securities (equity in the company, debt, and more), investors can lose it all, but have the chance of profiting long term if the company takes off.

Types of equity crowdfunding investments

Financial securities for equity crowdfunding can come in multiple different types, including but not limited to:

- **Common stock:** Shares in the company, with or without dividends. Early-stage companies are unlikely to offer dividends
- **Preferred stock:** As above, but bestow voting rights on the shareholders.
- **Debt:** Loans repaid on a fixed schedule or via revenue shares depending on the company's success.

What are the benefits for entrepreneurs?

Equity crowdfunding is appealing to entrepreneurs as they have full control of the offering. The company raising capital decides what to sell, how, much, and at what price – the terms are entirely in their hands. However, a trade off is that this method doesn't come with the connections and operational knowhow that institutional investors bring to the table.

As the number of investors is high, power is not concentrated in the hands of a few shareholders and owner power is not diluted. These investors have a vested interest in seeing you succeed, becoming ambassadors for your brand.

Additionally, companies can not only set a maximum capital target, but a minimum. Even if there is not enough market interest to meet the desired funding goal, a healthy amount of capital can be raised. The entrepreneur can reassess their business plan with the lower figure without VC investors applying extra pressure.

What are the benefits for investors?

Investors can benefit by the lowered barrier to entry to investing in a private company. Early and mid-stage companies simply aren't accessible to investors without institutional backing or large amounts of their own capital. However, early startups that truly have a great idea are some of the most exciting entities to invest in. The off-limits is now available.

Start-ups are a high-risk investment. Another advantage of the lower costs is that risk can be mitigated by investing in multiple companies. As this form of investment is still relatively new, long term data on equity crowdfunding returns is not yet available. Crowdwise, one such platform [estimates unrealised IRR between 17.4% – 41%](#) – a wide range!

Potential pitfalls

Fundraising for startups and early-stage companies is risky by nature. The risk is higher when you consider that small-scale investors don't have the experience and knowledge that an experienced VC would use to assess a company and perform due diligence. The resulting confusion leaves a wide space open for fraudulent behaviour.

Startups need plenty of time to grow and mature before they make a profit, meaning investors are unlikely to see realised returns before years have passed. Investing in this form is highly illiquid. This can be worth it if the eventual returns are at the upper end of the estimated range – but if not, throwing the capital in an index fund and leaving it alone is much less hassle.

Where to invest?

Each country is subject to different regulations and will have its own equity crowdfunding platforms. Although nominally accessible to all investors, many websites apply their own criteria before allowing someone to make an investment. Expect to disclose your tax

residence and financial information to establish if you have sufficient funds and whether you understand the risks involved.

UK investors, keep in mind that significant tax advantages are available for equity crowdfunding investments.

UK platforms:

- [Seedrs](#)
- [CrowdCube](#)
- [BnkToTheFuture](#)
- [Syndicate Room](#)
- [Angels Den](#)

US platforms:

- [Angellist](#)
- [Microventures](#)
- [Fundable](#)

Equity crowdfunding is yet another example of the trend towards direct involvement. Now more than ever investors, and consumers, prefer to deal directly with creators and cut out the middleman. Barriers to entry that only the deep-pocketed can breach continue to come down. While it will take some years to collect data on average returns, many small investors will relish the opportunity to get in on the high-risk, high-reward world of start-up investing.