

ISSUES & INSIGHTS

What the Tech World Needs to Know Today About Crowdfunding

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On April 5, 2012 President Obama signed into law the Jumpstart Our Business Startups Act, or JOBS Act. This legislation is one of the most dramatic laws to affect the startup community in many years, affecting SEC registration requirements, Section 404 of the Sarbanes-Oxley Act and the prohibition of advertising and “general solicitation” for private company stock. Despite the potential impact these provisions have, Crowdfunding is the one that’s creating the most buzz.

What is Crowdfunding?

Crowdfunding allows a high volume of investors to deploy capital toward a specific project or business. While the JOBS Act is new, Crowdfunding is not. Since 2008, kickstarter.com has been helping entrepreneurs raise capital for projects and businesses in exchange for the company’s product or service. For example, Pebble Technology recently raised a record-setting \$10.2 million in capital from investors anxious to get first dibs on its smartphone-tethered watch.

Another company, Solar Mosaic, allows investors to collectively invest in the creation of specific solar panel projects, thereby removing the capital barriers to an initial solar installation. These investors are paid



out over time, as the project owner enjoys reduced costs for their energy usage.

And finally, Kiva, perhaps the most well-known micro-lending site, has been loaning funds to entrepreneurs around the globe, mostly in impoverished and developing areas, since 2005. As of March 31, 2012, Kiva has distributed over \$300 million in loans from 744,558 lenders.

JOBS Act Crowdfunding

So if Crowdfunding isn’t new, why is it all of a sudden getting so much

hype? In a word, equity. These established providers have not been permitted to offer equity positions to investors. And this, in turn, limits the return on capital. The JOBS Act changes that.

Under the new Crowdfunding provisions, companies can raise up to \$1 million during a 12-month period, through either registered broker dealers or online funding portals. Issuers must file with the SEC, and disclose the names of directors, officers and each individual holding more than 20 percent of its shares.

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They must also disclose a business plan outlining intended use of the proceeds, target offering amount, and certain financial information, depending on the size of the offering:

- Offerings under \$100,000 - income tax returns and financial statements certified by the issuer's principal executive officer
- Offerings greater than \$100,000 and under \$500,000 - financial statements reviewed by an independent CPA
- Offerings greater than \$500,000 - financial statements audited by an independent CPA

Prior to the JOBS Act, companies with more than \$10 million in assets were subject to corporate reporting and governance requirements of the SEC if they had more than 500 accredited investors. This legislation is the presumptive reason for Facebook's recent IPO. However, under the JOBS Act, companies can have up to 2,000 accredited investors or 500 non-accredited investors. More importantly, shares issued through the Crowdfunding provisions will not count toward these investor limits.

Crowdfunding investors are, however, limited by the amount they can invest and generally must hold shares for one year before they can

be transferred. These investment limitations are based on an investor's net worth:

- The greater of \$2,000 or 5 percent of annual income or net worth, if the annual income or net worth of the investor is less than \$100,000; or
- 10 percent of annual income or net worth, up to a maximum of \$100,000, if the annual income or net worth of the investor is greater than \$100,000.

Tech companies considering raising capital through Crowdfunding should consider both the benefits as well as the drawbacks of creating a Crowdfunded investment opportunity.

Crowdfunding represents an opportunity for companies that don't fit the model for venture capital investments to raise equity. Because it can be done over the internet, Crowdfunding puts capital in the hands of entrepreneurs that are located in areas that have smaller concentrations of investors, compared to say, the Bay Area.

On the flip side, Crowdfunding investors are not likely to bring the business connections and strategic guidance that more sophisticated, institutional investors can offer.

Additionally, answering to a large investor base can ultimately distract management from running the business.

Finally, the repercussions of missing the disclosure requirements can be significant. Companies considering taking advantage of Crowdfunding should work closely with their CPAs and legal counsel to determine if it is right for them.

What's Next?

Crowdfunding, under the JOBS Act, will not be available until the SEC defines rules and details around the registration process. The SEC has 270 days from when the Act was signed to do so. Until then, some investors are lining up. According to a recent article at All Things Digital, crowdfunder.com has \$13.35 million committed to 913 companies, by 974 would-be investors.

While it is too early to measure the impact Crowdfunding will have on both the business and investor communities, it is an exciting evolution of our capital markets, the likes of which we've never seen before.

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