

CROWDFUNDING 101

The Equity Crowdfunding Market in a Nutshell

A Financial Revolution, Compliments of the SEC

For years, wealthy investors have had the right to invest in high-growth companies at their earliest stages. In some of the boldest changes to U.S. securities laws in nearly 100 years, the SEC is about to give the rest of us the same access. The revolution is called Equity Crowdfunding. Here's what you need to know.

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THE STORY BEGINS WITH A BEER

The narrative around what's now called Equity Crowdfunding began a few years ago over a beer -- in fact, \$300 million worth of beer. The beer was Pabst Blue Ribbon, and the year was 2008. Pabst had put itself up for sale for \$300 million, and just for kicks, a savvy internet guy named Mike Migliozi launched a website to see if he could entice hundreds and thousands of people to make small financial commitments that added up to \$300 million.

Mike's stunt to fund the investment from a huge crowd of individuals was working well - until it stopped working at all. After Mike received commitments for more than \$200 million, the U.S. Securities and Exchange Commission (the SEC) showed up and shut him down. The problem? The investors writing checks were just regular folks, not the high-net-worth individuals called "Accredited Investors" that the SEC allows to invest in such private deals.

Frustrated by the SEC's stance, a group of citizens took shape and began hatching plans. They reasoned that, as long as each individual was only committing a small amount - as little as, say, \$25 or \$100 - everyone should have the right to invest in companies they liked or thought would grow in value. These citizens decided to pay a visit to our lawmakers in Washington, D.C. and make some noise.

LADY LIBERTY LIKES A CROWD

Actually, the U.S. already had some first-hand experience raising funds from the crowd. In 1884, the folks erecting the Statue of Liberty ran out of money. Joseph Pulitzer, the newspaper publisher who created the prestigious Pulitzer Prize for journalism, took to his "New York World" newspaper and encouraged Americans to donate so Lady Liberty could be completed. Within 6 months, more than 125,000 people had donated over \$100,000.

KICKING IT UP A NOTCH

More recently, companies that raise funds from the crowd (hence the term "crowdfunding") have set up sites including Kickstarter and Indiegogo to replicate Pulitzer's basic idea. These online platforms, using what's called "donation-based" or

“rewards-based” crowdfunding, allow citizens to fund artistic or charitable projects - everything from civic projects and social causes, to quirky films, dance festivals, and games and gadgets.

In return for a cash contribution, the supporter might receive a t-shirt, a sticker, or a ticket to a concert. Other sites use what’s called the pre-purchase model: in return for funding a small portion of an entrepreneur’s business, the supporter receives the entrepreneur’s product - whether it’s a cool new watch, a pair of shoes, or an organic food product.

Crowdfunding is turning into a huge business. Research firm massolution reported that in 2012, 308 crowdfunding platforms across the world raised \$2.7 billion. Many predict that the market will reach \$5 billion or more in 2013. And since no stock or financial securities change hands with donation-based or rewards-based crowdfunding, and since there’s no expectation of a financial return, the SEC considers this activity perfectly legal.

... AND ALL I GOT WAS THIS T-SHIRT

But isn’t it kind of a bummer that some of these companies will go on to make millions of dollars, and all you got was a t-shirt or some dried apricots? While start-ups can be a risky investment, some of them become extremely successful. Instagram and Tumblr are just a couple of examples of young companies that were acquired for hundreds of millions, even billions, of dollars, making their earliest investors fantastically rich.

Wealthy individuals, often called “Angel Investors,” have been investing in private companies like these for years. Now, thanks to a vocal group of citizens as well as the efforts of Congress and President Obama, ordinary citizens will be able to invest a small and affordable amount of money in a company they believe in, and in exchange, receive an ownership stake.

This revolutionary change is called Equity Crowdfunding, and hundreds of websites called “funding portals” - sites like CircleUp and RockThePost, to name two - are popping up to help match startup companies with potential investors like you.

THE LEGALESE

Here are the SEC's soon-to-be-finalized parameters for the sale of private securities on equity crowdfunding platforms:

- In any 12-month period, a startup may raise up to \$1 million from an unlimited number of investors.
- If an investor has less than \$100,000 of annual income or net worth, they may invest \$2,000, or 5% of their annual income or net worth, whichever is greater.
- If an investor has more than \$100,000 of annual income or net worth, they may invest 10% of their annual income or net worth, whichever is less.
- Certain companies are not eligible for equity crowdfunding - for example, public companies and companies that have acted badly in the past.
- There is a new type of middle man that can match startups with potential investors online. They're called "crowdfunding portals." It's expected that there will be hundreds of them, and all must register with the SEC.
- The funding portals have strict requirements in place to protect their investors.
- To prevent fraud, startups must disclose information including its business plan, tax returns, financials, and background checks

LET'S GET THIS PARTY (JUMP) STARTED

To get things started, on April 5, 2012, President Obama signed into law what's called the Jumpstart Our Business Startups Act, or the JOBS Act for short. Basically, the JOBS Act legalizes equity crowdfunding, subject to rules that the SEC will soon provide. (See insert to the left about some of the rules and guidelines.) The clever name - the JOBS Act - is a reference to the fact that more than half of all new jobs created in the U.S. come from startups.

THE RISE OF THE REST

How big could the market be when all of us have the right to invest? In a recent article in the Huffington Post, Kevin Lawton, author of "The Crowdfunding Revolution," postulates that crowdfunding could be a global market worth hundreds of billions or even trillions of dollars. "Think about the implications of shifting just 1 percent of long-term investments to small business via crowdfunding," he wrote. "In American alone, that would create a \$300 billion market for crowdfunding (10 times the venture capital invested in all of 2011)."

BZZZZZZZZ IS FOR BUSINESS

Rewards-based Kickstarter has gotten lots of press lately. They recently had their most financially successful campaign ever: the producers of the Veronica Mars television show raised nearly \$6 million on Kickstarter to bring the show back to the airwaves.

But the buzz for equity crowdfunding keeps getting louder and louder - and if cues from popular culture are any indication, interest in startup investing is hitting a fever pitch. “Shark Tank,” for example, recently became America’s #1 most popular TV show on Friday nights. It features investors such as Mark Cuban, a successful entrepreneur and the billionaire owner of the NBA Dallas Mavericks, who hear pitches from “aspiring entrepreneurs” seeking investment dollars for their business or product.

Meanwhile, Forbes recently reported that LinkedIn, the social network for professionals, has a new group called “CrowdSourcing and CrowdFunding.” More than 19,000 members have already signed up, compared to the approximately 1,400 members of the “IPO” group. As Deborah Jacobs, the author of the Forbes article, noted, “It is impressive that a concept barely in the investor lexicon two years ago has captured the imagination and attention of so many.”

Skeptical? You’ve got every right to be. But keep in mind that before the emergence of online brokerage platforms like e-Trade, plenty of smart people thought average citizens would never go online to trade and invest in stocks. e-Trade’s annual revenues today? More than \$2 billion.

Interested in learning more?

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ABOUT CROWDABILITY

Crowdability provides individual investors with education, information and insight into opportunities in the crowdfunding market.

Our free website and email newsletter aggregate and organize deals from an ever-expanding universe of crowdfunding platforms. We aim to save people time and simplify the process of discovering and evaluating crowdfunding opportunities.

BENEFITS OF JOINING CROWDABILITY

- Never worry about missing an opportunity - we track them all for you
- Gain access to education and resources that remove the confusion and anxiety about early-stage investing
- Hear from professional venture and angel investors to help you better understand the mechanics of early-stage investing and how to identify the best opportunities

Crowdability's goal is to become your primary resource for navigating the equity crowdfunding landscape.

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