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Equity Crowdfunding: Growing But Not Yet Of Age

By: Geri Stengel

Why equity crowdfunding is important

Need less than $5 million to make your business dream a reality? Good luck with that! Banks regard startups as risky — unless you put your home up for collateral. A loan for growing your company? Not unless the bank thinks you can pay the monthly interest payments. And for most venture capitalists, a company raising less than $5 million isn't worth their time.

Equity crowdfunding can fill the gap for those of us who don't have any 5-percenters in our immediate circle.

Equity crowdfunding pools money from a group of investors via the internet, using social media. Currently, only friends, family, and accredited investors (a.k.a. wealthy people) in the United States can invest in a company for share is the company. They can do this through websites such as AngelList, CircleUp, Crowdfunder, and Portfolia. Equity crowdfunding has the potential to level the playing field for anyone raising and investing money, but its impact may be the greatest on under-represented groups, such as women and minorities.

"Even women with substantial track records as business leaders have had trouble raising money from venture capital firms," according to Tamar Donikyan, partner, Ellenoff Grossman & Schole, a leading securities and crowdfunding law firm. "The women that I speak with about crowdfunding are excited by the prospect of raising money without having to resort to traditional sources of debt, like commercial loans that may not be available to small or start-up companies. They are intrigued by the possibilities of raising money from their immediate network, extended network, and even people they don't know in a systematic way."

As long as they can get the campaign going, that is.

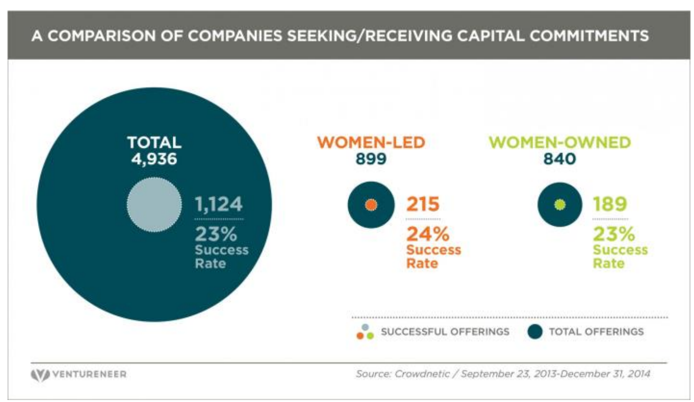
The state of equity crowdfunding and women entrepreneurs

More than $400 million has been committed* through equity crowdfunding since Title II of the JOBS Act was approved on September 23, 2013, through the end of 2014, according to Crowdnetic, which aggregates data from nearly 20 equity crowdfunding platforms.

Nearly 5,000 companies are seeking funding equity crowdfunding, of which only 18% are women-led companies and 17% are women-owned companies. Of the companies seeking angels investments offline, 23% are women-owned companies. "I chose not to raise money through Title II because there were gray areas and I thought it would be expensive," said Sheri Atwood founder and CEO of SupportPay, a payment platform that enables divorced parents to share expenses and manage child support. She raised a $1.1 million seed round privately offline, which took from June 2013 to May 2014 to close. The gray area Atwood is referring to is the verification of accredited investors are indeed wealth people.

The gray area that Atwood is referring to is the need for companies raising money to verify that their investors are accredited (earn $200,000 per year individually, or a joint income of $300,000, in each of the last two years and expect to reasonably maintain the same level of income or have a net worth exceeding $1 million). An attorney, CPA, investment advisor or broker dealer can do this. Douglas Ellenoff a partner at Ellenoff Grossman & Schole recommends that broker dealers do the verification process because they have a better understanding of the risk and ramification of not doing this correctly. Some platforms verify investors as part of the services they provide. Or you can hire a third party to do for you.

No matter the gender of the founding team, success rates of companies raising money through equity crowdfunding are similiar: 23% for all companies, 24% for women-led companies, and 23% for women-owned companies, according to Crowdnetic's database. However, on some platforms women entrepreneurs are more successful than their male counterparts. "As of 2014, women-led businesses closed their rounds successfully at a 21% higher rate than men on the platform," said Ryan Caldbeck, founder and CEO of CircleUp.



As is typical with other sources of financing, women are raising less than men for their companies. On average, companies with women on the founding team, raise less money than all-male teams ($337,000 vs $368,000, respectively) and even less if the business is owned by women ($314,000).

But take note: “The Kauffman Foundation reports that women build capital efficient companies, generating 12% more revenue on one third less capital,” said Kay Koplovitz, Chairman and co-founder of Springboard Enterprises, an accelerator for women-led businesses in technology, media and life sciences. “[Think] how much more productive could they be if they raised capital on par with men?”

Equity crowdfunding follows patterns of traditional entrepreneurial activity

No surprise that the top city for equity crowdfunding activity and deals is San Francisco/Silicon Valley for entrepreneurs in general, women-led companies, and women-owned. In second place is New York.

It takes a village to build a growth company. SF/SV has a long tradition of supporting high-potential entrepreneurs, not just with capital but with expertise and connections to customers, talent, and vendors, etc. The result is an above-average success rate in general for entrepreneurs seeking capital and an even higher success rate for women.

“In the past year, NYC Business Solutions increased its crowdfunding portfolio by over 500% and has helped connect businesses to approximately $850,000 through crowdfunding platforms [all forms],” NYC Department of Small Business Services Commissioner, Maria Torres-Springer.

But the coasts don’t win in all categories: Chicago women have an exceptionally high success rate and on average raising more per company than any other city. ”It’s no surprise to me that angels are funding Chicago women entrepreneurs to such a high degree,” said Kourtney Ratliff, Partner at Loop Capital Markets ”The entire local ecosystem is very supportive of women- and minority-businesses.”

Austin is fighting well above its weight. Ranked 35th in terms of population, it’s #5 in equity crowdfunding for both male and female entrepreneurs. “The Austin tech scene has just had one of its best years ever, with the number of women entrepreneurs surging, said Jan Ryan, Partner at Capital Factory & Founder of Women@Austin. “Female founders still experience single digit funding percentages from VC’s, but Austin women are not waiting around. They are actively seeking and closing alternative means of funding. In the last month alone I have spoken to a dozen women leaders who are exploring crowdfunding as an alternative source of capital. I believe this trend will continue throughout 2015.”

Boston, typically known as an entrepreneurial hub, is falling short in terms of raising equity by crowdfunding. One Boston-based entrepreneur who just closed her first institutional round of funding comment may be reflective of an overall Bostonian attitude that the current law is too complicated and limiting. “Instead of new and potentially complicated ways to fund a business, female entrepreneurs need greater access to the type of professional investment capital that is proven to work,” said Rochelle Nemrow, CEO and founder of FamilyID, online registration and payment site for kids activities. In January, Massachusetts joined a growing list of states, which out of frustration with the SEC’s slow pace, are approving their own rules and regulations that apply intrastate.

To carpe diem or not

Before you go in search of equity crowdfunding, ask yourself if you really need outside funding to scale. If you can grow quickly and profitably without outside money, there’s no reason to give up a percent of your company to others. “Know what you’re worth — consult with professional angels and VCs to get an idea of what might be the market valuation and terms for the investment opportunity you are proposing,” said Erica Duignan Minnihan, Managing Director at DreamIt Ventures, an acceleration program with a track specifically for female founders called Athena.

“There are many options for partners in the equity crowdfunding game, continued Minnihan. “Get to know the people behind the platform you choose, and find out about the experiences of those who have successfully and unsuccessfully raised money on the platforms you are considering.”

In additon, make sure you have what it takes to catch the eye of an angel. Here are some guidelines:

- Remember, investing is early stage companies is risky, 50% of investments will have no return so investors are looking for return on investment (ROI) of potentially 10 times their initial investment in just 5 to 8 years so make sure:
  - you’re addressing a large market.
  - your product solves a major pain point.
  - you have a defensible competitive advantage.
  - you know your exit, whether that is achieved by going public, being acquired or something else, it has to be a real and well-articulated possibility to attract investors.

- Investors are looking for a management team that can deliver. Team, not just an entrepreneur. While the leader is critical, no one can do everything. Early-stage companies are not expected to have their team built out, but know what skill-sets you'll need to acquire in order to scale. Even better, identify specific people you'll bring on once you have funding.
- You and your investor are going to be together for a number of years so you want to have chemistry. Investors also look for coachability. You don't have to take all the advice you're given, but you do have listen without being defensive.