Chapter 1

The Crowd's in Your Corner: Funding or Investing in a Business

In This Chapter

- Getting thematic
- Tapping in to the crowd's collective power
- Sensing why people want to be part of the crowd
- Identifying business benefits from crowdfund investing
- Connecting private businesses and investors
- Anticipating this industry's impact

There are very few instances in history when we've had a start date for an entire industry that will disrupt the way the world looks at business. This is one of them. For the first time in 80 years, the average Jane and Joe have the ability to start a business with the help of the crowd or own a part of a friend's American dream.

Communities will come together to look at business ideas, fund those they believe in, rally around entrepreneurs with knowledge and experience, and help create millions of jobs. Welcome to the emergence of Web 3.0, where the social network meets seed/early-stage financing — and where you become an active participant instead of a passive investor. It merges the principles of crowdfunding, where a large group of people pool small dollar amounts to help someone bring an idea to fruition, with early-stage financing and growth capital for startups and small businesses. What is it? Crowdfund investing. In this chapter, we offer an introduction to why this new industry exists and what it's capable of accomplishing.

Sharing Our Hopes and Themes

Unreasonable, disruption, and *hope:* These words summarize the themes of this book. Although this book is meant to provide a road map to crowdfund investing from either an entrepreneur's or an investor's point of view, we hope it also serves as a motivational tool to show you how laws that have been in existence for 80+ years don't have to govern our future if they no longer serve society due to sociological and technological change.

It's **unreasonable** to believe that three entrepreneurs, who are not lobbyists or lawyers with blank checks, could show up in Washington, D.C., and change a law in 460 days. But that's what we did. We showed up when our country was suffering from the worst recession since the Great Depression. When millions of jobs were lost and hundreds of thousands of businesses were closing. When the financial markets had seized up and capital had stopped flowing to the people responsible for getting us out of prior recessions — small businesses.

We brought a solution to get money flowing to startups and small businesses so that they can grow and hire employees. In doing so, we **disrupted** the way in which the financial markets will forever operate. For over 80 years, we've lived under laws written in the 1930s that governed how businesses could raise capital. Although those laws were prudent for the times when they were written, they proved to be crippling in the aftermath of the collapse of the world financial markets in 2008.

In this book, you see how crowdfund investing takes us back to our roots, where communities come together to fund and support local businesses. It leverages the power of community to decide which businesses are worthy of funding and which entrepreneurs should be trusted. It provides the mechanism for the funding to happen and a framework to carry the business forward.

We're **hopeful** because anytime you disrupt a large institution or system, you create fear and uncertainty — but you also create opportunity. That's why we've worked so hard to put together this book: to provide guidance and clarity around this new way to raise capital so that you can take advantage of this opportunity whether you're a businessperson looking for capital or an investor seeking good investments. We hope that the information we share will provide the knowledge you need to become an entrepreneur or to support one that you know, love, and trust! Crowdfund investing isn't something new; it's an old way of financing companies that's facilitated by the power of technology. We have the power; now is the time to use it!

Packing a Punch: The Power of the Online Crowd

When governments in the Middle East start to topple because of a tweet, you begin to understand the power of social media. Never before have we had a tool so powerful that a small group with no resources can rally thousands of people together via Twitter to promote an idea (Occupy Wall Street) or protest a government (Egypt). Never before have we had a tool to provide fact checking in real time, and never before have we been so connected because of technology. Social media creates transparency and accountability. Businesses of the future will use this transparency and accountability to build trust and loyalty. Why? Because social media is the conduit to allow us to do what we love to do as humans: engage.

But although the world is operating more and more as one global community, we still rely on our local communities for our bare necessities. That's what this book is about. Our goal is to show you how to rally your online crowd to conquer your own part of the world. It's about connecting people at a local level to create businesses that will benefit communities. And instead of doing it at city hall, you'll be doing it online where most of us spend our days.

In this section, we briefly tour the rapid evolution of online crowd activity, from crowdsourcing to crowdfunding to crowdfund investing.

Sparking the revolution with crowdsourcing

Part of this revolution we can credit to *crowdsourcing:* the online gathering of a group of people to share knowledge and wisdom to build a better product. Crowdsourcing first gained prominence in the world of programming in what was called *open source.* Open-sourced programming was a way for companies to leverage the collective coding power of essentially freelance programmers so that they could deliver a great product (code). By opening it up to other programmers, people were allowed to clean up, fix, and/or improve the code. The theory was that opening up the proprietary code to the crowd wouldn't make competitors but compatriots. The crowd would work together to make it better.

Most recently, we've seen this concept expand into online collaboration through mediums like Wikipedia, an online encyclopedia of sorts, where the crowd's wisdom fills the pages. Anyone is free to edit it, and together the information is more powerful than any one person could create.

Shifting toward finances: Crowdfunding

It was only a matter of time before this community involvement moved into the financial arena. And in reality, it already had. Going to the crowd for funding is nothing new; keep reading for examples of how we've been doing this for decades, and turn to Chapter 2 for more details about the emergence of crowdfunding.

Donation-based efforts

The American Cancer Society (ACS) has been crowdfunding for decades. It hosts events like Making Strides Against Breast Cancer, in which teams form to raise money to fight cancer. Large groups of people pool donations together for a good cause — in the case of ACS, to the tune of half a billion dollars since 1994! However, any charitable giving, whether to a church, National Public Radio, or AIDS walks, is really crowdfunding.

And the crowdfunding concept doesn't apply just to charity. Politicians crowdfund their re-election campaigns all the time. The theory is, if they can actively engage voters with campaign contributions, those voters will have a vested interest in the success of the candidate. Unfortunately, this can also be seen as one of the biggest problems with politics. Politicians are constantly out there looking for capital to fund their campaigns . . . so much that they aren't always focused on policy. (Mind you, we didn't have that experience in Washington, D.C. Both sides of the aisle took plenty of time to sit down with us, understand our crowdfund investing framework, and help us pass the law. But that's a story for Chapter 2!)

One of the reasons for President Obama's 2008 success was his ability to harness the power of crowd donations. His campaign was able to raise over $50 million from over a million passionate followers. These people spoke not only with their voices but also with their wallets. Instead of relying on individual large contributors, the Obama campaign went to hundreds of thousands of Americans and asked them for small contributions. It was the difference between winning and losing for Obama. It also shows you the power of pooling small dollar contributions together.

Most recently, we've seen people use crowdfunding to raise money for art-related projects. Probably the most well-known platform for doing so is Kickstarter (`www.kickstarter.com`). Started by a guy who wanted to raise money to put on a concert, Kickstarter has become a crowdfunding phenomenon where people from all over the world are helping to fund mainly art-related projects — to the tune of $250 million in 2012!

Microfinance projects

Back in 1983, a man by the name of Muhammad Yunus started the Grameen Bank. The goal was to leverage the undeveloped skills of the poor by providing the money to entrepreneurs to create businesses. The unique feature was that there was no collateral. The bank would provide micro-loans to borrowers (98 percent of them being women). Peer pressure would ensure that borrowers followed through with repayments. It was so successful that Yunus went on to win a Nobel Peace Prize. (See Chapter 2 for a bit more detail about his story.)

Although Yunus's efforts were funded by microfinance organizations and community development banks, individuals like Matt Flannery and Jessica Jackley saw the ability to expand the opportunity by allowing the crowd to step in and pool their resources in the same way to help entrepreneurs in the developing world. Their story led to Kiva (`www.kiva.org`). Kiva allows people in developing countries to lend money via the Internet to people in developing countries. Kiva doesn't pay out any interest on the loans it facilitates. People do it to help others around the world, to be a part of something other than themselves, and to build a stronger global community. (Kiva gets a bit more discussion in Chapter 2 as well.)

Embracing the equity world: Crowdfund investing

Which brings us to today. Over time, we've become comfortable giving to causes we believe in or entrepreneurs in the developing world who need financial assistance to create their own jobs. Now we're bringing these concepts to our shores. Instead of just giving your money away because it feels good or is the right thing to do, now you can do so and own shares of stock in that business! For decades we've been used to investing in Fortune 500 stocks listed on public exchanges. Now you'll be able to invest in businesses in your own backyard. Although some of these businesses may have the potential to be high-growth businesses, not all of them will have the ability to make you rich. They will, however, provide tangible benefits that money invested in a Fortune 500 company can't provide — benefits like convenience, service, and a sense of community.

Why People Care: Appreciating the Appeal of Being Part of the Crowd

The heart is a powerful thing. Emotional impulses drive people to make decisions. Coupling those impulses with logic can be powerful, and that combination is the main force behind what will drive crowds to become part of crowdfund investment opportunities. People aren't just wallets — they're users of products and services — and no one knows better what solutions they need than those who live in communities under the same circumstances.

Thanks to the advances in technology, we can solve problems faster and cheaper than at any other point in history. No longer does it take a Fortune 500 company to deliver a local solution that can be tailored to the needs of a community; an entrepreneur with initiative can do the job.

If you can appreciate these facts, then you understand the desire of the crowd to step in where they see a solution to a local problem and to fund it. Thanks to technology, we now have a medium to allow crowd solutions to take place. And thanks to the advances in the law, people now have the choice to be active participants in the growth of a business, to reap rewards for doing so, or to see their returns tied in with those of entrepreneurs over the long term. In this section, we touch on some of the key reasons that crowds will quickly get onboard with quality crowdfund investing campaigns.

Using the technology at your fingertips

Thirty years ago, it would have been very difficult for crowdfund investing to occur on a massive scale. Today, however, the technology you need to raise capital for your business is at your fingertips. All you need is a computer, a video camera (or a built-in camera on your computer), vibrant social networks, and the passion to create or expand your business. This book details how you can use technology to make a successful crowdfund investing pitch and raise the money you need to launch or grow the business of your dreams.

As an investor, you'll be able to find businesses that people in your social networks are launching, and you'll be able to support them with your dollars and your expertise. We all like being part of something that's bigger than ourselves, and crowdfund investing allows us to do exactly that. From the comfort of your own living room, you can help your nephew or former roommate or co-worker get a new company off the ground.

Reaping rewards through perks

Through websites such as Kickstarter, crowdfunding has allowed people to pursue their passions through direct support from their online networks and beyond. People have gained support in the form of dollars and through expertise from the crowd. Many people have launched crowdfunding projects and been blown away by the support that they found. (See Chapter 21 for a description of ten such projects.) Oftentimes, people think that they're alone in their passions, but after they create an online campaign requesting financial support, they're happily surprised. This type of support goes a long way toward energizing people into building something great.

Before we led the fight to legalize equity- or debt-based crowdfund investing, all crowdfunding was perks- or rewards-based. That meant that, as an investor, you would get small perks in exchange for your dollars. Sometimes the perk took the form of presales of a product. For example, the entrepreneur developed a prototype, but in order to build the product on a larger scale, she needed more capital to make it a reality. This direct support of the entrepreneur's passion has allowed many projects to come to fruition that otherwise would not have happened.

Consider another example: If an artist wanted to raise money to make a new music album, he might give people a sticker for a $5 contribution, give them a digital copy of the completed album for $10, give them a hard copy for $30, list the supporter's name on the album as a co-producer for $100, and for $1,000 offer backstage passes to the band's concert. Bands have even offered to do private shows for their supporters above a certain level of contribution.

The way that the security laws were written before the passage of the JOBS Act in 2012, people who raised the money could not legally give back any financial return, including even giving back the original investment. What they could give, however, were perks.

Perks-based crowdfunding has been a huge game changer for a lot of manufacturing companies that wouldn't have been able to secure the capital to build their products without it. It has been a win-win for everyone involved: "Investors" have received products that they really wanted, and companies have received the capital they need to make these products.

In the case of artists, fans have been able to reap the rewards by helping their favorite bands or documentarians find the needed capital to create their projects. Fan "investors" receive the product they've helped create and also get the satisfaction of being part of something bigger than themselves. Individually, a $25 investment wouldn't get the receiver very far. When pooled together with the rest of the crowd, however, each $25 investment goes a long way.

The new frontier: Entering the equity realm

When President Obama signed our crowdfund investing bill into law on April 5, 2012, as part of the JOBS Act, he said that it was game changing for the American economy. With the financial collapse of 2008, the flow of capital dried up for entrepreneurs and small businesses that needed the cash to start and grow their companies. We saw this problem and took it upon ourselves to find a solution. Capital still existed after the collapse, but it wasn't moving from the people who had it to the people who could use it to start businesses and create jobs.

That has changed. All the great benefits of crowdfunding still exist, but the perks that investors stand to receive now also include financial gain. People may put money into crowdfund investment campaigns for many reasons: to help out a friend or family member, to support a business that provides a service they desire, to be part of something bigger than themselves, or to reap success through a financial return.

As we mention repeatedly in this book (including in Chapter 4), investing in a startup company is very risky. Your risky investments should occupy only a small portion of your overall portfolio, and your crowdfunded investments should be considered some of your riskiest investments. The chances of your investing in the next Facebook are very slim, but at least you now have the opportunity to make investments that were previously reserved for only the wealthiest Americans. (See Chapter 2 for an explanation of accredited and unaccredited investors.) With that opportunity comes a great deal of responsibility to be a well-informed investor.

With the legalization of equity- and debt-based crowdfund investing, we've broken down the barriers for the small investor to be able to invest in startup companies. When federal securities laws were written more than 80 years ago, information was slow moving, often through word of mouth. Less than 5 percent of the population invested their money in stocks and bonds. Today, more than 50 percent of the population have these types of investments, and with the Internet, any information we desire is only a Google search away. The securities regulations have finally started catching up with the changing times.

Spotting the Business Beneficiaries of Crowdfund Investing

There are many business beneficiaries of crowdfund investing. The obvious beneficiaries are the businesses receiving the capital, but equity- and debt-based crowdfund investing has created a brand-new industry, and many people will make a lot of money from it. (For example, check out Chapter 7, where we introduce the types of online funding portals that will host crowdfund investing campaigns.)

In Chapter 3, we identify and describe the types of businesses most likely to benefit from crowdfund investing: startups, small businesses (including technology companies, bricks-and-mortar retail shops, and service companies), and anyone else who doesn't easily qualify for traditional financing. The term used in the JOBS Act for such entities is *emerging growth companies.*

Launching and growing a successful business isn't easy — and it never has been. Entrepreneurs and small business owners need the support of as many people as possible to be successful. Large, publicly traded companies have long had the support of many successful people; they have vast resources to pay experienced people to help guide them through the many complications of running a business. Now, crowdfund investors can support growing companies and entrepreneurs in ways that before were not possible, with both financial support and expertise.

How does crowd expertise benefit a business? As we explain throughout the book (including in Chapter 17), crowdfund investing should be an active investment. If you buy stock in Apple or General Motors, all you give is your money. But when you engage in a crowdfund investing campaign, you can also support a company with your knowledge and skills.

For a business, the collective knowledge of the crowd is much greater than the knowledge of any group of experts. If you're heading a startup company and you raise money from a venture capital group, you also get their knowledge support (from a small group of people). In a crowdfunded company, your pool of investors may number 200, 300, or even higher. The collective knowledge of the crowd will be game changing for many small businesses. Of course, dealing with so much input may be overwhelming if you don't handle it in an organized fashion. Check out Chapter 12 for tips on communicating with your investors, including setting parameters for receiving and responding to your crowd's advice.

REMEMBER

Keep in mind that the biggest beneficiaries of crowdfund investing are the American people. With more businesses being launched, more jobs will be created. The more jobs that are created, the more capital will flow through the U.S. economy.

Figuring Out How Businesses and Investors Find Each Other

With the advent of crowdfund investing, we have the classic two-sided market problem: How do you match demand and supply? How do you help businesses that need funding find willing investors who are looking to make investments in Main Street businesses or startups?

Prior to the passage of the JOBS Act in 2012, making such connections was difficult or even impossible. The laws governing how private businesses could seek capital from individual investors were written in 1933 and 1934 and were set up to protect people from scams and rip-off schemes. These laws created the Securities and Exchange Commission (SEC) and determined how stocks and securities were sold in the United States. Read Chapter 2 to find out more about what these laws said and how they restricted investment in private companies.

The JOBS Act permits private companies to *generally solicit* for equity and debt offerings, meaning they can publically advertise and discuss such offerings (subject to certain restrictions). Also, it makes crowdfund investing possible by enabling business owners to communicate with anyone via their social networks (such as LinkedIn, Facebook, and Twitter) to find potential investors for their business or startup ideas.

However, you must be aware that general solicitation and communication regarding equity and debt offerings can take place *only* in very specific ways that are regulated by the SEC. Therefore, businesses must make sure they're clear on how to do this and what they need to do to protect themselves, their investors, and their customers from fraud, as well as to stay compliant with SEC regulations.

This book provides you with the information and resources you need so that you can organize and execute an effective campaign. We can't guarantee success, but we can give you best practices and insights to use as you work to create a successful business.

In this section, we briefly discuss two key ways that companies position themselves to find crowdfund investors: by crafting excellent business plans and by posting their offerings on SEC-registered online funding portals. We also briefly explain how potential investors should start the process of evaluating crowdfund investing campaigns.

Creating a business plan that involves crowdfund investing

One of the most important steps you can take before launching a crowdfund investing campaign is creating your business plan (a topic we detail in Chapter 5). You may have the world's greatest business idea, but investors and lenders need to understand what you're going to do with their money and how it will deliver a return on their investment; otherwise, you'll never get off the ground. A business plan forces you to get specific about your ideas, test your assumptions, and answer questions that potential investors will likely have. For investors, your business plan provides a standards-based way to evaluate your business versus others.

TIP

As you construct a business plan that includes crowdfund investment money, you need to take into account the time and process for raising money and, even more important, how you'll communicate with your investors over time. Do you have a strong online social network today? Do you have hundreds of connections on LinkedIn and Facebook and hundreds or thousands of followers on Twitter? If not, you need to build your online presence *before* you start trying to raise money online via crowdfund investing. The vast majority of investors in your business will be people who you know already; they'll find out about your offering via social networks. If you need help building your social networks, turn to Chapter 8.

Posting your campaign on an SEC-approved platform

The SEC, the Financial Industry Regulatory Authority (FINRA), the Crowdfunding Professional Association, and the Crowdfund Intermediary Regulatory Advocates are the key entities focused on creating rules that enable an orderly market to form for crowdfund investing. You'll see these names throughout this book, and you should get familiar with each entity's industry involvement.

As we explain in detail in Chapter 7, you should use only an SEC-approved crowdfund investing funding portal (website) to list your equity or debt offering. (As a potential investor, you should shop for campaigns only via SEC-approved funding portals as well.) You must follow all SEC regulations and ensure that the funding platform you use is also registered with FINRA. Doing so protects your company, your investors, and the industry as a whole.

Identifying investments of interest

We've briefly talked about what companies need to do to attract crowdfund investors. In this section, we switch our focus to potential investors. We devote Part V of this book to the investor's perspective. Here are some key concepts that all potential investors must keep in mind when considering participating in this asset class:

- **Private businesses and startups are high-risk investments. We repeat: *These are high-risk investments.*** Could you see significant returns? Maybe. But you absolutely *must* proceed with caution.

- **You should create a portfolio of investments that has a mix of risk/return profiles based on your individual situation.** We believe that investments classified as high risk should make up less than 10 percent of your investable capital. You should consult with a qualified professional regarding your individual circumstances and planning.
- **Based on your income, you're limited to how much you can invest each year in crowdfund investments.** This limit, which we detail in Chapter 4, helps ensure that no one can lose his entire savings on one bad investment.
- **You should plan to make small investments in at least ten crowdfund investing campaigns.** Most professional investors (angel investors and venture capitalists) expect that out of ten investments in private companies and startups, seven will lose money, two will break even or have a small return, and one will have a significant return. Are these numbers guaranteed? Absolutely not! You must do research on each potential investment, talk with people you trust, consider carefully, and then make small investments in people you know, products you use, businesses you trust, or entrepreneurs you believe in.
- **Crowdfund investing is an active form of investing.** As an investor, you get to know these businesses much more personally than you know any public company you invest in. As we explain in Chapter 17, you can help the businesses with your expertise, but you must make sure you don't become a nuisance to the business owner.

Predicting the Future of Crowdfund Investing and Crowdfunded Businesses

Crowdfund investing is an entirely new industry and an entirely new asset class for investors to evaluate. We believe that it represents the beginning of Web 3.0, where the social web (or Web 2.0) combines with businesses raising capital. It creates a new way for businesses to get seed funding or growth capital, and it will generate an entirely new ecosystem of businesses, business models, processes, and strategies that can be used in starting or growing a business. Just like the ecosystem that was formed around the social web, we see the formation of an ecosystem of businesses to support and enhance this new, highly innovative industry.

Anticipating new forms of capital creation and financial instruments

Creativity and opportunity generate the possibility for new strategies, tactics, and services to begin. It'll be fascinating to watch as this new way to raise capital creates new business models and ways of thinking.

As society continues its move toward deeper customization of experience, more digital connections will occur, making in-person connections less regular. People will create more experiences, value, and relationships online. We can't wait to see how these sociological changes affect how businesses grow and succeed.

As nations, investors, and business owners become accustomed to these types of relationships and transactions, we believe that more governments will allow cross-border capital flows via crowdfund investing. The regulatory frameworks will need to be revised to allow this, but we believe that, over time, governments will see the benefits and will be able to put reasonable safeguards in place to protect business owners, investors, and communities.

Redefining community

When people discuss crowdfund investing in terms of "community-based financing," you must understand that "community" is not just related to the geography of where you live and work. The web has made it far easier than ever before to create communities online. These communities could be communities of origin, communities of interest, or communities of diaspora. The web can now connect these communities in ways that enable them to support businesses and ideas in convenient and engaged ways. This should be a great benefit for all types of communities. These communities also can assist in crowd vigilance to provide additional security and protection to reduce and eliminate fraud wherever possible.

Building communities and businesses based on the power of crowds

We're at the very beginning of a new chapter in the history of corporate America. Many individuals feel disconnected and disappointed in large corporations. They want to find ways to shop and invest locally, ways to support their own communities and interests. We've already seen a few companies that were unable to get the attention of traditional venture capital and angel investors but have been able to find crowds to invest in them. In some cases, these same companies have gone on to receive investment from angel or venture capital investors because the company had already received the support of the crowd and proved there were customers for their services.

We hope this book helps both businesses and investors understand the risks and rewards of crowdfund investing, plan carefully, execute well, learn lessons, and reap the rewards of their efforts. We understand that crowdfund investing is no cure-all or perfect solution to all funding problems, but we do think that it offers an alternative that will be beneficial to thousands of businesses and investors around the world.