Crowdfunding Not Yet the Answer to Startup Cash Woes

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OVERVIEW

Connecting your business to small investors has never been easier in today's electronic age. Websites such as ProFounder.com, MicroVentures.com and PeerBackers.com make this possible. While crowdfunding platforms may have their advantages, they also bring to the forefront new concerns for small businesses and early-stage, startup companies seeking an infusion of private capital.

FULL ARTICLE

Connecting your business to small investors has never been easier in today's electronic age. Websites such as ProFounder.com, MicroVentures.com and PeerBackers.com make this possible. Gwen Moran, of *Entrepreneur StartUps Magazine*, offers a rundown of the three crowd-funding sites in her article, Crowdfunding Could be the Answer to your Cash Woes. As evidenced by this article, and many others as of recent, crowdfunding is once again demanding its seat at the regulatory table, hoping to establish itself as viable funding method for small companies. Though crowdfunding platforms paint an intriguing picture, they also bring to the forefront new concerns over complying with state and federal securities laws.

As capital-starved companies explore new funding options, entrepreneurs should recall the regulatory problems that plagued peer-to-peer lending platforms, such as Prosper.com and Lending Club, in 2008. These websites work by connecting individuals in need of financial support to other individuals willing to lend them capital by using an internet platform to connect the two parties. Three years ago, peer-to-peer lending platforms were just going online and the rampant rise in number of these small-dollar loan facilitators caught the attention of the Securities and Exchange Commission ("SEC"). The SEC determined that several of these peer-to-peer lending platforms had failed to comply with securities laws at both the state and federal level, including the registration, disclosure, and investor screening requirements. As a result, the once-saturated peer-to-peer lending market quickly evaporated, as many of the lending platforms were voluntarily shutdown until compliance could be obtained. Needless to say, many of these platforms never reopened.

Failing to comply with the securities laws could have potential devastating consequences for everyone involved, including lenders and investors and borrowers and issuers, not to mention the facilitating platform, such as the aforementioned crowdfunding platforms. Among the most notable consequences, include lenders not being repaid and issuers facing lawsuits that allege securities fraud. For startup companies looking to raise seed capital or engage in an early-stage funding round, failing to account for these concerns today could even inhibit subsequent funding rounds down the road.

In today's era of global interconnectivity, it has never been easier to connect investors of all types [including angel investors, venture capitalists, and even friends and family investors] to capital-starved companies. Nevertheless, it has also become much easier for regulators to observe these capital-raising efforts from the sidelines. In Spring 2011, the SEC announced it would consider amending its regulations to allow for an exemption from the registration and disclosure requirements of the Securities Act of 1933, for issuances of less than $100,000 when a company intends to raise capital from a small group of private investors. This would mark at least the second time in recent history that the SEC has formally considered a proposal to alleviate the regulatory burden on small businesses and early-stage, startup companies seeking an infusion of private capital.

Whether or not the SEC breaks new ground, suffice it to say that anytime your company is looking to raise capital, expect that the securities laws will be implicated. Only your attorney can assess to what extent. As your company embarks on its next funding venture, remember there is no quick and easy way to raise capital. Pursuing this effort online is no exception.

This article was prepared by David L. Moore.
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