

SBA Office of Entrepreneurship Education
Crowdfunding for Entrepreneurs
February 2013

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Welcome to the SBA's online training course: An introduction to crowdfunding for entrepreneurs.

SBA's Office of Entrepreneurship Education provides this self-paced training exercise as an overview of crowdfunding (also commonly referred to as "crowd financing" or "crowd sourced capital?"). You will find the course easy to follow and the subject matter indexed for quick reference and easy access. It will take about 30 minutes to complete the course. As audio is used throughout the training, please adjust your speakers accordingly. A transcript and keyboard shortcuts are available to further assist with user accessibility.

The highlighted next steps at the conclusion of the program will help you apply what you have learned and engage you in the process of crowdfunding. When you complete the course, you will have the option of receiving a completion confirmation from the SBA.

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The course has three key objectives:

1. Discover what crowdfunding is and how it can help entrepreneurs
2. Define and describe components involved in crowdfunding
3. Sharing resources to help your new business succeed

There are several topic sections within the course. Each section covers a different aspect of crowdfunding. The course begins and sets the tone by defining what crowdfunding is. It then describes in some detail how to use crowdfunding to attract investors for a new business, invention or other project.

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Some of the areas covered include:

- 1) Definition of crowdfunding
- 2) Choosing your business Idea
- 3) How to develop a business plan
- 4) How to choose a business model

Numerous additional resources are identified to assist you. Visit the Resources icon in the course player or locate additional tools, templates and mentors on SBA.gov once you finish the course.

Let's get started!

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What is crowdfunding?

Are you looking for capital to start or grow your business? Sometimes, even with a solid idea and business plan, finding third party financing can be a challenge for many small business owners.

You may have heard the term "crowdfunding" recently. In this course we will examine this growing phenomenon and how it can help you grow your business. In recent tough economic times, crowdfunding has become a popular and alternative method of raising finance for a business, real estate investment, project or idea, and as popularized by multiple websites in the United States.

President Barack Obama signed the Jumpstart our Business Startups Act (JOBS) officially opening up a new source of funding for small companies and startups to encourage economic growth. Much of the attention so far has been on this component of the bill because it would allow financing via crowdfunding. Participants can raise as much as \$1 million a year without having to do a public offering - a step requiring state-by-state registrations.

Slide 5 (what is crowdfunding continued)

Unlike angel investment, in which one person typically takes a larger stake in a small business, with crowdfunding an entrepreneur can attract a "crowd" of people - each of whom takes a small stake in a business idea, by contributing towards an online funding target.

Many investors believe this strategy is more successful than attempting to go the more traditional route for funds for one individual or organization. While some investors may be hesitant to invest, crowdfunding provides an alternative way to source seed capital from a number of backers.

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SBA supports the JOBS Act

The SBA has heard the concerns of small business owners and learned about the barriers to expansion particularly for high-growth industries and the need for a simplified process-one that any business could use to grow and create jobs. Small businesses have struggled to find access to capital in this environment, not just in lending, but in equity financing as well, and in all stages of the company's development.

The SBA is constantly reevaluating other parts of the market to ensure that our businesses are successful- from the earliest stages of growth to their ultimate peak where they are ready to make their initial public offering (IPO) for investment on the public markets.

The JOBS Act benefits a wide range of firms. Before the JOBS Act, a coffee shop in Akron that wanted to franchise itself would be limited to investors that are "accredited" according to the Securities Exchange Commission (SEC) or angel investors, potentially impeding their process for growth significantly and giving an advantage to wealthier investors and the small businesses they have relationships with. Recognizing the difficulty of finding streams of capital at the earliest stages of expansion, this measure creates more opportunities for small businesses to raise money from customers and investors in their communities.

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The JOBS Act also addresses some of the barriers for small businesses ready to make their Initial Public Offering (IPO). Changes to SEC rules include measures to streamline the process - making it easier to reduce the cost and complexity. This change is something small businesses, not just the big guys, can benefit from.

The SEC is developing regulations on crowdfunding. It is possible that only C corporations will be in a position to take advantage of the opportunity to raise equity through crowdfunding. S corporations, for example, have a 100-shareholder limit, effectively precluding the use of crowdfunding. Expect to see SEC regulations and guidance continue to be a topic of discussion in mass media, public policy exchanges and entrepreneurship circles.

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So where are startups and growing businesses finding the funds they need? According to a Kauffman Foundation survey, one-third of young firms do not use capital injections. Instead, they rely on owner investment or nonbank sources of funds, with the most frequently used source of startup dollars being owners' and relatives' savings.

But if you don't have savings to fall back on, another financing option worth considering is peer-to-peer lending or crowdfunding (also known as crowdsourcing). Both combine lower interest rates or creative repayment terms that might just be worth looking into.

Peer-to-Peer-Lending

Peer-to-peer-lending (P2P) essentially involves sharing your idea to other people in hopes they will invest in your business. Popular sites connect people who want to lend money with those who need to borrow money - often in

low increments. Quite literally, you determine how much you need to borrow, define the purpose of the loan, and post your listing online. What's in it for the investors? Well, returns can be in the range of 10 percent across their portfolio, creating a steady stream of income, not to mention the altruistic payoff of helping businesses succeed.

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Obviously, you should not simply hope for the best when you post your listing. Some factors that can sway your investment-worthiness include these: Have a plan ? It's more than just describing what you're going to do with the money; it's important to share findings from market research, competitive analysis, financial forecasts, expected returns, and so on. Here are a few tips for creating a business plan (obviously you can't share it all, so be sure to have a clear synopsis).

Tell your story ? What's your background? What are your dreams for your business? This will help humanize and frame your case.

Share your achievements and progress ? What have you invested in your business already? At what stage is your business? What landmarks have you already achieved? Potential investors will want to know how invested you are in your business and that their investment in you will pay off.

P2P lending sites are also a useful way to structure loans from friends and family. Because the P2P service acts as an intermediary or broker, it can help remove any potential emotional complications from the transaction while giving the lender some reassurance that you will repay on time.

Since President Obama signed the JOBS Act it has become a lot easier for small businesses to raise money. Previously, small businesses were limited to seeking investment from SEC accredited investors only; now non-accredited investors (i.e. you and I) can invest in a startup to the tune of up to \$1 million a year.

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How crowdfunding can help entrepreneurs

While the phenomenon is not new, it is still not a mainstream concept and therein lies its beauty. You can still take your idea for a book, a CD recording, an art project, a consumer product or just about anything to one of these crowdfunding sites and have a chance at getting your concept funded and off the ground. If you're trying to sell a new concept, you could take it direct to an audience that might give you feedback and, essentially, order the product before you make it.

Apart from the obvious advantage of raising your own capital, the main benefit of crowdfunding is that it creates a strong network of support for your business. If you also offer equity as part of your package, your investors are likely to become ambassadors for your brand ? promoting it among their networks, tracking your progress and becoming returning customers themselves.

If you promote your investment bid successfully, crowdfunding can also provide a powerful platform to raise awareness of your business. It gives you a newsworthy story to pitch to your local, and national, press (which may attract further new business). If you reach your target it also gives a clear message to potential clients, suppliers or future investors that you have the support of the public behind you.

Although the JOBS Act has been passed, regulations are still evolving.

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The following is a partial list of the items which you can do to get ahead while waiting for the law to be implemented:

? Incorporate your business: Consult a SBA mentor, CPA or lawyer to help you explore and choose the right entity

? Start writing your business plan, or refining it, if you already have one. This will assist you determine the amounts of financing you are looking to raise. In addition, a well thought out business plan outlining your current and future business expectations will alleviate many questions in which may arise during a due diligence process.

? Get your accounting records complete and accurate. Good accounting will benefit you when attempting to present the viability and growth of your business. The more information you are able to generate on a timely basis will provide additional credibility. If you plan on raising funds under \$100,000, the officer of the company needs to certify the financial statements and state they are accurate. So you will want to ensure the records are adequately prepared.

? Get your CPA and/or accountant involved to assist in the process. If you plan on raising \$100,000 - \$499,000, then you need to have the financial statements reviewed by an independent public accountant. Any funding over \$500,000 requires audited financial statements. It is never too early to get this process started. A first time audit/review can take anywhere from 30 ? 60 days depending on the size of the organization.

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Three things to consider for taking your project to the crowdfunding street:

1. Test a new idea or product by asking a small group to help fund it. But you have to be able to complete the project because the nature of crowdfunding demands completion.
2. Do you have an audience? If you have a Twitter following or a Facebook fan page already going, or better yet, an email list, then you can potentially jumpstart a crowdfunding project and keep the momentum going (this is the hardest part).
3. Have you really crunched all the costs? Do you know how much it will cost to make this new gadget or book? Make sure, per point number two, that you can deliver.

Crowdfunding isn't a new sales channel, but it can certainly help you test a new idea or product in a short amount of time. You'll still have to sell the idea to this crowdfunding audience, however, most of the people who participate understand that they are helping someone else achieve their dream.

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Do you really need crowdfunding?

If business loans are not of interest or available for your efforts, you may need to find alternative sources of funding to get your business off the ground. 65% of entrepreneurs planned to seek alternative finance in 2012, according to a survey by Huddlebuy.

Keep it Simple: If you have a mundane or complicated concept which the public will struggle to connect to, crowdfunding may not be right for your business. However, any business can succeed with the right pitch ? the key to crowdfunding success is: keep it simple.

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Tips for crowdfunding success

Key to successful crowdfunding is understanding the commitment the process entails. Crowdfunding can provide a fantastic opportunity for small businesses, but it should not be entered into lightly and, to be successful, requires a careful strategy.

Make sure you have the resource in place to promote your pitch daily, as well as take every phone call and answer every email from potential investors. You need to create and maintain momentum to meet your target.

Prior planning is crucial ? how are you going to create a buzz around your business? Find out who your potential customers are and court them for

several months before launching your pitch, finding out what kinds of rewards would entice them to invest. That way, when you launch the crowdfunding, people will be excited and you can get your business off to the best start.
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If you are investing in other business ideas or projects via crowdfunding, beware that like all investments, there are no guarantees and you could lose money.

Part of the new JOBS Act will require entrepreneurs to follow SEC compliant guidelines in regards to providing accurate, transparent and up-to-date financial statements and due diligence reporting. In order to qualify for equity crowdfunding you will need to provide records of cash flow (assets, investments, overhead costs, etc.) even before you launch your company or a fundraising campaign. Be sure to consult with a qualified CPA to stay on top of legislation and on the right side of the law.

Investors will soon have more of a vested interest in your startup idea once the new bill is in full effect as well. The more prepared you are as an entrepreneur the more likely investors will take interest in you. They'll have questions for example such as the following:

- * How exactly do you plan to spend the money you raise?
- * Do you have an exit strategy?
- * What are the short term and long term goals for your new company?
- * What type of protection (i.e. insurance) do you have in place for your business as well as for investors?
- * How organized and compliant are you?
- * Have you completed the due diligence process?
- * What type of (if any) trademarks, intellectual property or copyrights do you have?

These are just some of the questions you should be able to answer easily and sufficiently when you seek investors for your new business.

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SOME IMPORTANT ASPECTS OF CROWDFUNDING

1. The full rules and regulations have not yet been flushed out by the SEC, so keep up to date and do your due diligence when you are ready to invest in a business, or attempt to raise funds.
2. If you want to set up your own crowdfunding portal, you will have to be approved first by the SEC.
3. You may want to consider use of an existing crowdfunding portal, rather than setting up your own. You should focus on raising funds for your business or deals.
4. Remember a crowdfunding portal is essentially a middleman. They make points or fees by matching up companies or individuals to raise funds. They will sell notes (it's mostly notes financing as opposed to equity financing) to make a profit.
5. If you are attempting to raise funds, you will need to consult with a lawyer to give you the right legal counsel and assist you with legal forms.

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Now that you have completed the course, take the next steps. Put what you have learned into action:

- ? Step 1) Identify and research a business idea that you want to start
- ? Step 2) Prepare a business plan and discuss it with a mentor or business coach
- ? Step 3) Get your accounts and financial statements in order
- ? Step 4) Identify Crowdfunding sites that can help you raise funds

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Many resources are available to assist you. The following resources can help you build a foundation of knowledge. SBA has over 60 district offices throughout the country to help you start and grow your business. Well-respected organizations like SCORE, Small Business Development Centers, Womens Business Centers and Innovation Clusters offer experienced business mentors, training classes and specialized coaching ? often for no cost. Go online to SBA.gov, use our mobile ?app? or call 1 800 U ASK SBA to reach a local mentor now.

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Congratulations on completing this course. We hope it was helpful and provided a good working knowledge on crowdfunding. Click the highlighted link to receive a course completion confirmation from the US Small Business Administration.