Crowdfunding. What's it all about?

Crowdfunding might be one of the cool new kids on the block, but does it offer a viable funding option for your business? Like anything new, it is an industry that is rapidly evolving. Regulators are just as quickly having to create frameworks to ensure fairness and transparency. Yes, in some cases money is being raised, but at this stage a prudent approach is required for both borrowers and lenders.

Crowdfunding is a method of collecting multiple contributions to finance or capitalise an enterprise using an online platform. It first gained prominence in the USA in 2003 when musician/computer programmer Brian Camelio launched ArtistShare. Although some platforms now include business startups, many remain focussed on creative pursuits and charitable projects.

The process begins by posting a startup business concept as a 'campaign idea' onto a crowdfunding website. People (often called backers) can donate money if they like the concept. To encourage people to support the campaign the startup offers incentives and rewards based on the size of the donation.

The campaign idea must be a compelling selling document capable of exciting backers about the potential of the product. Most importantly, it has to explain why investors should fund the idea and provide realistic timeframes for product development. It should also outline the incentive they will receive.

There are several crowdfunding websites. It pays to conduct some research as websites differ in the type of business ideas they accept and their requirements. Some set deadlines on the time you have to raise the funds. Sites also reach different audiences and offer different ways to help people promote their concept. Some platforms charge upfront fees and others only charge if you are successful in reaching your goal.

Are there advantages?

Crowdfunding can generate genuine interest in a startup business. It allows you to create a committed customer base where you can interact and collect feedback. Backers will also provide free word-of-mouth marketing.

And the disadvantages?

On the downside, a crowdfunding site is a highly competitive environment. Campaign ideas have to work hard to gain visibility. A professional presentation of your concept is required to encourage donations. Even if you generate interest, there is no guarantee you will reach your funding target in the set time. If you are successful in raising donations, the incentives and rewards need to be fulfilled and you have to spend time providing your backers with updates on product and business development.

> **Government announces new crowd-source equity funding tax incentives.**

Another important consideration is the lack of clarity around taxation implications of crowdfunding. Most projects give something to supporters. You need to ask yourself: will it be products or services, equity in the business or will the funds simply be a donation?

If the funds are to be treated as a loan, at some point the loan will need to be repaid with interest. If the funds are used as equity in the business, you are effectively selling off part of your business. You could end up with an unwieldy number of shareholders. Further information on the law around equity raising can be found at ***www.asic.gov.au.***

Recent government actions

Australia has lagged behind countries like the UK and New Zealand in establishing a legislative framework for crowd-source equity funding (CSEF). Treasurer Joe Hockey addressed this in the 2015 Federal Budget.

At that time, the Treasurer announced a $7.8 million allocation for ASIC to create and implement a new regulatory framework for crowdfunding money raised by startups and how they might access it. The new framework will address the requirements for reporting and disclosing the use of crowdfunds by startups. This has been a grey area to date.

The bottom line is that crowdfunding is not a viable source of finance for all businesses or business situations. For entrepreneurs trying to get a good idea off the ground? Well yes, perhaps.

Of course there is also an argument that finance raised through traditional channels such as commercial finance brokers and even banks delivers more than just money. They also provide entrepreneurs with both a range of finance options and advice. Business owners miss out on such mentorship when they ignore traditional investors and turn to the crowd.