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Regulation Crowdfunding: A Six-Month Update

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It has been almost seven months since issuers across the country began raising money through Regulation Crowdfunding (“Reg CF”), which went into effect on May 16, 2016. In the six months since Reg CF went into effect, 160 initial filings for crowdfunding offerings on Form C were made with the SEC. The following summary of the highlights and trends are based on data collected from those Form C filings through November 16, 2016.

The General Landscape

First, the good news – despite the naysayers, a surprising, but still relatively small, number of issuers took advantage of Reg CF to launch 160 crowdfunded offerings, including six issuers who have launched two campaigns each. Of those campaigns, a total of approximately $13.5 million has been pledged or funded, with nearly $8 million raised in 32 successfully funded campaigns. Unfortunately, all of this is also the bad news – the success rate for Reg CF offerings so far is only 20%; that’s not great. And the total amount raised in Reg CF offerings in this six-month period compares very unfavorably to the amount raised in Regulation D offerings during the same period, which is close to $30 billion. Further, of the nearly $8 million raised to date, over half represents just five issuers, with three of those hitting the maximum Reg CF offering amount of $3 million. That said, this is just a start, and the data from the first six months reveal some interesting trends that could give us a glimpse into how Reg CF will be used in the future.

Industry Focus

One of the big surprises about the types of companies utilizing Reg CF has been the high participation by, and success of, companies in the food and beverage industry, especially small breweries, distilleries and restaurants. Food and beverage companies comprised a total of 17.5% of all campaigns in the first six months of Reg CF, 28.13% of funded campaigns, by far the largest successful general industry category (with the closest trailing category being “Apps”, representing 9% of all funded campaigns). It’s possible that the affinity groups associated with food and beverage producers create a built-in audience for crowdfunding. Compare food and beverage’s success with the experience of “tech” companies, including apps, online platforms and other technology-related businesses, which have fared particularly poorly with Reg CF – “tech” companies represent 25% of all launched campaigns, but only 12.5% of successfully funded campaigns. The most successful campaign so far, based on both amount raised ($1 million) and number of investors (a whopping

1,396 individuals) was fledgling movie studio Legion M.

Issuers

For a fundraising mechanism designed to assist small private companies to raise small amounts of capital, it is not surprising to discover that most of the companies utilizing Reg CF are relatively young. The median age of a Reg CF issuer is about two years, and with almost 62% of all issuers formed since January 2015, and about 28% formed just since Reg CF went into effect! That said, there are some older companies utilizing this new method – about 20% are older than four years, and one issuer has been in business since 2003. The companies' geographic diversity is impressive – campaigns have been launched in 32 states and the District of Columbia. California represents the state with the most campaigns (30%), with Florida (10.6%), Texas (8.1%) and New York (7.5%) trailing a bit further behind. Interestingly, even though only 8.1% of all campaigns were launched in Texas, that state performed disproportionately well, with almost 22% of successful campaigns.

Investors

Participation levels in the campaigns so far have been varied. While the average number of investors across the 122 campaigns that have disclosed their participation numbers is 79 (excluding two large outliers, including Legion M) and the median number of investors is 20 (same caveat), of that number, 20% have had zero investors, and 32% have had 10 or fewer. That said, the number of investors in a campaign does not correlate to its success – one successfully funded issuer raised its funds from just a single investor. Average investment amounts per investor across all campaigns and all successfully funded campaigns is about $950 and $1,200, respectively.

Platforms

To date, FINRA had approved 21 funding portals to host crowdfunding offerings, with 20 having hosted campaigns during Reg CF's first six month. Of those that have hosted campaigns, WeFunder is far and above the most prolific and successful so far, measured both by number of campaigns (nearly 38% of all campaigns are hosted on WeFunder's platform) and number of successfully funded campaigns (nearly 60%). This could possibly be first mover advantage, as WeFunder was one of the first portals up and running from Day 1 of Reg CF. It could also possibly be a result of competitive pricing – WeFunder generally charges a 3% commission on successful campaigns, whereas the vast majority of other platforms charge between 5% and up to 12%. About 16% of platforms, in addition to a commission based on a successful fundraising, also take some form of equity compensation. Other prominent platforms include StartEngine Capital (13.75% of all campaigns, but only 6.25% of funded campaigns), NextSeed US (4.4% of all campaigns, but a staggering 22% of funded campaigns and a 100% success rate), and uFunding Portal (11.25% of all campaigns, but 0% of funded campaigns), the last of which now has the dubious distinction of being the first Reg CF funding platform to be removed and banned from the FINRA list of approved platforms for failing to screen for potential fraud by companies using its services.

Offering Details

So, what are investors actually investing in? The three principal categories are equity (common and preferred), which account for over 50% of all campaigns, debt (straight debt, convertible debt and revenue sharing), which accounts for just under 25%, and SAFEs (simple agreement for future equity – a convertible note-like instrument gaining acceptance in recent years), which were offered in 25%

of offerings. What is interesting, though, is that SAFEs were sold in over 40% of successful campaigns, whereas equity was offered in only 25% (comprised of 6.25% preferred stock, and 18.75% common). Further, it is somewhat unusual for SAFEs to be the preferred “security” of choice, both because many of the companies offering them may never actually reach a “qualified financing” in which the principal amount of the SAFE converts into equity, and also because many of the SAFEs have a built in redemption feature which permits the issuers to repurchase any equity securities into which the instruments are convertible. Neither of these are investor-friendly features. Of the debt securities offered in successful campaigns, only one campaign offered a convertible note – the rest were split evenly between revenue sharing arrangements and straight debt.

Looking Forward

So, what do the six-month numbers tell us about Reg CF so far, and what we can expect in the future? There certainly seems to be an audience for food and beverage offerings, which is promising for small breweries, restaurants and distilleries hoping to make a go of it. And companies with low capital needs may be well served by a Reg CF campaign so long as the expenses are not disproportionate to the amount raised. On the other hand, for tech-based companies that have traditionally relied on venture capital and angel investors, the data suggest that it is still easier, less expensive (proportionate to amounts raised) and less burdensome from a public disclosure and reporting perspective to continue to raise money through Regulation D private placements. On the platform side, WeFunder appears to have a strong, early lead over competitors, but SeedInvest (an established private placement platform) and IndieGoGo (a brand name in the awards-based crowdfunding space) have both entered the arena and could be formidable challengers to WeFunder’s supremacy. For now, Reg CF offers another, potentially limited, tool in the fundraising toolbox. With a new incoming administration and SEC Chairperson, changes to the Rules might also adjust the regulation in a way that will make it more useful to companies, and more accessible to investors.

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