



How to Invest in Equity Crowdfunding

Recent changes in legislation allow everyone to invest in an entry-level entrepreneurship.

(Getty Images)

By [Dawn Reiss](#) | Contributor

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Want to [invest like the rich do](#)? Now's your chance – to a point.

The Securities and Exchange Commission is now allowing individuals to invest in companies via web-based [crowdfunding portals](#), known as intermediaries, via the Jumpstart Our Business Startups Act, or JOBS act.

Historically only venture capitalists and accredited investors – essentially the wealthiest 2 percent of the country – were allowed to invest in startups and small businesses, says Ryan Feit, CEO and co-founder of SeedInvest, an equity crowdfunding platform that funded over 65 companies with more than 100,000 investors.

"Now the number of potential investors in private companies skyrockets from about 370,000 active angel investors in the country to 240 million Americans. That's a big deal. It effectively enables kickstarter with equity," Feit says.



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Why now? Times have changed since Congress blocked the general public from investing in private companies, which stemmed from the Securities Act of 1933 and Securities Exchange Act of 1934. Until recently it was a federal felony to for private companies to publically solicit investors.

But bank loans to [small businesses](#) are down 20 percent since the 2008 financial crisis, according to research from the Harvard Business School. That's had a huge impact on U.S. economic growth since startups account for two-thirds of all new jobs and half the gross domestic product, Feit says.

"It's been harder and harder to get capital if you're not a high-tech company sitting in Silicon Valley or Boston," says Richard Swart, chief strategy officer at NextGen Crowdfunding, a company in El Segundo, California, that offers crowdfunding webinars, events and training sessions.

Since these are new investment vehicles, investors have a lot of learning to do.

What's allowed. Under the new crowdfunding regulation, known as Reg CF, entry-level investors whose annual income or net worth is less than \$100,000, may invest the greater amount of \$2,000 or 5 percent of their annual income or net worth during a 12-month period. The amount jumps to 10 percent of annual income or net worth, whichever is less, if the person's annual income and net worth are higher than \$100,000.

Unlike a [Kickstarter or Indiegogo project](#) that can publicly advertise all the details, any discussions about crowdfunding equity offering terms, including stock price, investor rights and use of proceeds can only be on that specific crowdfunding platform.

"In other words, someone will say, 'I have this awesome idea, like my new virtual reality goggles. Please go check out my offering on SeedInvest or StartEngine.' That's all they can say. Once an investor is on there, the startup can reveal the actual offering," Swart says.

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All equity crowdfunding must be conducted through a registered broker or funding portal. Every funding portal or broker-dealer must register with the SEC and be a member of Financial Industry Regulatory Authority.

"The portals are the gatekeepers; they pick which deals to list," says Mark Roderick, a crowdfunding attorney at Flaster/Greenberg PC in Cherry Hill, New Jersey. "The best thing a consumer can do is only buy a portal they trust."

Although that's easier said than done, FINRA offers an [online tool](#) so investors can see if the broker is registered, disclosures to regulators and the broker's state licenses.

FINRA spokesman Ray Pellecchia says 43 organizations filed on the SEC, the first step of the approval process. However, only 10 new crowdfunding portals – CrowdBoarders in Frisco, Texas; Crowdfunder.com in Chicago; Indie Crowd Funder in Los Angeles; Jumpstart Micro in Carlisle, Massachusetts; Wefunder in Cambridge, Massachusetts; StartEngine in Santa Monica, California; StartEngine Capital in Santa Monica, California; Houston's NextSeed and truCrowd, UFP, which operates uFundingPortal in Herndon, Virginia, and SI Portal, which operates SeedInvest in New York – have been approved.

Ron Miller, CEO and co-founder of StartEngine, says his goal is to fund 5,000 companies and create 1 million jobs over the next five years. "This the greatest advancement for entrepreneurship in a generation," Miller says. "The ability to raise venture capital and get funded by a VC is much harder than getting into Harvard Law School. If you are person of color or are a female, your chances of getting capital are about zero."

Big risks. These are [risky investments](#), and all experts say investors should be prepared to lose everything as new businesses fail more often than established companies. Feit says on average these investments should comprise around 2 to 3 percent an investment portfolio and no more than 5 to 10 percent.

"This has to be discretionary money that you can afford to lose, that you can afford to sit on for years," Swart says.

The stocks are considered illiquid so investors might not be able to sell them for a long time and at a minimum, investors are restricted from selling shares in the first year except under very limited circumstances.

What to ask before investing. Find out what you can about the company's founders, their relative experience and the cost of building up that business, says David Mandelbrot, CEO of Indiegogo.

Investors need to know their rights and ask potential companies, "What happens to me the day after I send you my money?" Swart says.

Potential investors can interact with each other via forums. The forums allow investors to see what questions are being asked, which will likely prompt other follow-up questions and the "wisdom of the crowd" will rise above any startup.

Ask about dividends, Swart says. Will those be a check or will goods from the startup be considered a [dividend](#)? Will owners get to vote during board meetings? How will the company communicate to investors – do they get an annual letter once a year or can they go to a stockholder meeting? How will the company use the proceeds?

[See: [10 Ways You Can Throw Retail Stocks in Your Cart.](#)]

Invest in industries you know. "For the nonprofessional investor, it's probably better for you to look at deals where you understand the market," Swart says.