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4 Crowdfunding Tips From The Trenches

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Crowdfunding is making it easier to raise money from a broader group of investors than ever before. While crowdfunding can be an exciting opportunity for some companies, broader access to capital in a new and evolving process also comes with greater potential for missteps and mistakes. With a law practice representing many early-stage companies, we've seen a number of our clients go down the crowdfunding path over the last 18 months. Below are some early lessons that we've learned in our work with companies that have raised money through this process.

Andrew Ray

1. Traditional and Crowdfunding Financings Often Go Hand-in-Hand

Fundraising efforts in the real and virtual worlds are not mutually exclusive and should not be separate -- in fact, the most successful offerings use both methods simultaneously to take advantage of the benefits of each.

We are seeing companies build momentum on crowdfunding platforms by directing investors that they meet offline to invest via the platform (without, of course, paying a commission to the platform for these investors). By showing that they have existing networks of contacts and supporters, these companies give legitimacy to their fundraising efforts on crowdfunding platforms and engender confidence in potential investors that they meet through these platforms.

Likewise, "offline" investors — including "friends" of the company — have a greater chance at a fully subscribed financing round with a company that can fill out the round by tapping into the broad network that a crowdfunding platform provides. The platform can also benefit offline investors by allowing them to expand their own networks through introductions and investments alongside investors they meet on the platform.

2. Cast a Wide Net and Think About Potential Investors as Partners, Not Shareholders

In addition to providing a forum for fundraising, an established crowdfunding platform can exponentially — and quickly — increase the impact of the "network effect." In a few weeks of being "live" on a platform, referrals from the overlapping ecosystems of potential investors will expose a company to a broader group of financing sources — as well as customers, business partners and potential acquirers —

than the company would have in months or years of traditional fundraising and marketing.

The best early-stage investors are those that can help the business grow — through their expertise or, most importantly, through their connections in your industry, to other investors and customers. The network effect will not only increase the likelihood of a successful offering, but it can also provide a boost for the company's business as well.

Once "live" on a platform, a company can individually review and approve each potential investor that requests its offering documents and other confidential materials. The network effect has its biggest impact when a company is exposed to a large group of networks, and as a result, a company should look closely at potential investors that seek to review these materials and consider how they fit into the company's fundraising and/or business plans.

Be judicious in who you allow to partner with you in the next steps for your company — sometimes the money someone invests is not worth the headaches that come along with him or her. A quick Internet search can tell a company a lot about where its information is going. Keep in mind that, even if someone agrees to a nondisclosure agreement, in many cases you cannot unring the bell once your business secrets and strategies are in the wrong hands.

3. Include Good "External" Advisers on Your Team

This is not a shameless plug for lawyers — in fact, lawyers are not always the best advisers for small companies. But a company should talk to people who are actively involved in or have recently advised on crowdfunding deals before and seek their advice — these potential external advisers may include accountants, consultants, financial advisers, executives at other early-stage companies, and, yes, lawyers too. The world of crowdfunding is evolving quickly, and therefore articles on the Web can lag substantially behind current market trends and events.

While many crowdfunding platforms have active current experience, a company needs external advisors in addition to the platforms for two reasons: (1) each platform only has its own experience to share and it is extremely valuable to have a broader perspective, and (2) there is a lot of hype around crowdfunding these days and it's helpful to have objective advice from someone who is not trying to "sell" you on a particular approach.

While many professionals will be happy to answer a few questions without signing an engagement letter, a company must also strike a balance between seeking out resources on a capital-efficient basis and overreliance on "cocktail party" free advice. In addition, the most valuable potential advisers are often the busiest and the least accessible. If a company takes the time to do its diligence, identify the experts in its ecosystem, get the right "warm" referrals to them and use their time efficiently, these professionals will typically invest some of their time to establish a relationship and tailor their advice to your individual situation.

For example, in our experience, the U.S Securities and Exchange Commission and other regulators are closely watching developments in the crowdfunding marketplace and challenging some companies on their compliance with federal and state securities regulations. These regulations are evolving to adapt to the new marketplace and can sometimes either mystify or be missed by a lay person — or even a professional lawyer or accountant who does not regularly practice in this area — so experienced advice on how they apply is important. A company should review these requirements with its advisers and develop a strategy for dealing with them before — not after — the offering has begun. As these

requirements evolve and change, a company's advisers will need to adapt its strategy and responses to meet the new requirements.

4. Understand the Process and Plan for the Post-Financing Future of the Company

For the reasons we have described, a financing that leads to money in the bank and access to the networks and expertise of a company's investors can be a game-changing event in the life of a company. This game-changing opportunity also comes with responsibilities and challenges — both during the process and afterward — that require setting the right expectations and devoting the right resources to address them.

For example, the fundraising process is time-consuming and challenging, and there will be times when the company's management will question whether it is worth it. Before marketing any external financing — whether using a crowdfunding platform, traditional means or both — a company must make sure that its financial and organizational house is in order.

Investors will want to see polished financial statements and projections and records of the company's formation and operations (including issuances of stock and options in earlier financing rounds). Many crowdfunding platforms will request these items before beginning an offering with them and several use third-party vendors to review a company's records and verify that all of these items are in place. In addition, any serious investor will expect to see well-thought-out marketing materials with clearly defined goals and strategies for attaining them. Having the right advisers will help with all of these steps, but there is no substitute for hands-on involvement by a company's management. These steps — and the process as a whole — will inevitably take time and focus away from the business.

Once the financing is complete, a company's outside investors will typically be more demanding and seek greater accountability than the company's friends and family investors. Ongoing compliance with corporate governance practices and regulatory requirements will also require time and money. A company should identify the right people on its team — internally and externally — to deal with these issues. In many cases, the most cost-effective approach is for someone at the company to "get smart" on these issues by talking to people who have done this before (see above) and asking questions. None of these challenges are insurmountable, but understanding them and planning for them will ensure that they don't derail the reason that a company seeks financing in the first place: massive growth of the business.

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Andrew Ray and Joe Castelluccio are emerging growth company lawyers at Morgan Lewis & Bockius. Their recent high-profile transactions include the representation of Oculus VR in its $2 billion acquisition by Facebook last year and the representation of Whole Life Pet Products in its $1 million financing via CircleUp, including a first-of-its-kind opportunity for Whole Life to publicize its equity offering on CNBC's TV segment, "Cash Crowd."

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