Exploratory Note 18

Alternative Sources for Early-Stage Firms

**INTRODUCTION**

Though angels, venture capitalists, and banks are dominant players in the early-stage market for finance, a number of alternative sources—some of them quite new—exist which are open to a fairly wide variety of businesses. This first exploratory note of the evening discusses four of these alternatives: crowdfunding, visa-based options, grants, and owner financing.

**CROWDFUNDING**

Crowdfunding is a relative newcomer to the world of finance; however, its influence is growing at a very rapid pace. Below, we consider rewards-based crowdfunding, equity crowdfunding, and debt crowdfunding.

***Rewards-Based Crowdfunding***

Rewards-based crowdfunding tends to follow two primary models: Keep-It-All (KIA) and All-Or-Nothing (AON).

What is Keep-It-All? Indiegogo offers KIA as a platform.

What is All-Or-Nothing? Kickstarter is a good example of an AON platform.

From a risk perspective, in the KIA model, the risk is largely shifted to the crowd (even if the goal is not achieved, their money is provided to the entrepreneur), while in the AON model, the risk is largely shifted to the entrepreneur (if the goal is not achieved, then no money is raised). Accordingly, KIA projects tend to be smaller (and scalable) while AON projects tend to be larger. AON campaigns appear to be more successful vis-à-vis KIA campaigns, respectively.

***Equity Crowdfunding***

Since the signing of the Jumpstart Our Business Startups (JOBS) Act into law in 2012, equity crowdfunding remained in regulatory limbo as the Securities and Exchange Commission (SEC) decided on the final rules for adoption. Historically, only accredited investors (for the most part) could invest in private security issues. Since the adoption of Regulation A+ several months ago, however, the rules have changed for small raises in the future.

What are some of the downsides to raising equity from a larger number of people?

Do these downsides offset the upsides?

***Debt Crowdfunding***

Other crowdfunding sources (often referred to as “peer to peer”, “P2P”, or “marketplace lenders”) offer a variety of debt options. Lending Club and the Prosper Marketplace are good examples of these types of platforms.

How does the crowd make money with this model?

**VISA-BASED OPTIONS**

Countries all over the western world have had investment-based visa programs for decades; although, they have really taken off in the last several years—due in no small part to the interest of wealthy Chinese. Since the early 1990s, the United States has offered green cards, through the EB-5 visa program, to those who are willing to invest between $500,000 and $1,000,000 in a US business which is either able to create or save ten jobs.

What types of projects are appropriate?

The lower threshold investment of $500,000 (this will be changing) is available to those who invest in regional center projects or targeted employment areas (TEAs). What are these?

What types of returns are typical for EB-5 investors?

**GRANTS**

Grants can come from a wide variety of sources ranging from governments (especially at the federal and state level) to private trusts and foundations. Grants can be very time consuming to obtain—especially if operated by a government agency; however, they can make a very big difference for small and larger companies alike.

**OWNER (SELLER) FINANCING**

Bridging into the next exploratory note which looks at later-stage and largely acquisitive strategies, owner (seller) financing can be very effective.

From the perspective of the buyer, what is likely to make for a good owner-financed deal?

With acquisitions, of what does the buyer need to be particularly aware? Are the risks the same for a stock purchase as for an asset purchase?

What are seller concerns in such deals?

**CONCLUSIONS**

This exploratory note largely concludes our exploration of major sources of finance for entrepreneurial firms.