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Raising money through online portals

Crowdfunding is a way in which people, organisations and businesses, including start-ups, can raise money through online portals, which put them in touch with investors (the public) to finance or re-finance their activities. Nigel Kimber, corporate finance partner at Kent-based chartered accountants McBrides explains more.

Q. What forms does crowdfunding take?

A. Crowdfunding is not always about money, it can be about building and benefiting the community too. However, ignoring the donations, philanthropy or sponsorship uses, it typically falls into two categories, debt and equity.

Q. What's the difference between debt and equity crowdfunding?

A. Debt crowdfunding is when investors lend money to a business, which then repays the investor on agreed terms. The lenders will bid for the debt based on their perception of risk and look for appropriate returns. Often the borrower will select the best terms on offer from the bidding lenders.

Equity crowdfunding is where investors buy shares in a company and become part owners. They make a return on their investment either by being paid a dividend OR by selling their shares at a later date, when the company's value has increased. The board of the company will decide whether to pay a dividend and how much, and if and when to sell the business, so this tends to be a higher risk form of investment as there is no guarantee of amounts or timescales for returns.

Equity investments should have higher returns than debt investments, to compensate for this higher level of risk. It is well known that 50-70% of start-ups fail in their early years.

Q. What are the pros and cons for a business looking for funds?

A. On the plus side, crowdfunding can help you raise awareness of your business. It can be a fast way to raise finance and investors can track your progress and may help you promote your brand through their networks. And it is an alternative option for businesses that may not be able to get bank loans or conventional funding.

On the negative side, if you haven't protected your business idea with a patent or copyright, someone may see it on a crowdfunding site and steal your concept. Also, if you don't reach your funding target, any finance that has been pledged will usually be returned to the investors and you will be left with no funding at all.

Q. What are the pros and cons for a prospective investor?

A. For some investors the appeal is philanthropic or emotional, giving them a direct link to a business or project they want to see succeed. Others take a more 'hard-headed' approach and expect very real financial rewards. In some instances there are some VERY attractive tax benefits to investing through the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS), which can reduce the financial risk of the investment.

Last month, new rules and regulations for crowdfunding came into effect in the UK via the Financial Conduct Authority (FCA). To date, the industry has been broadly unregulated, with most of the major platforms signing up to voluntary codes of conduct instead. The new regulation differentiates between two types of crowdfunding: loan-based (also known as debt-based or lend-to-save) and investment-based crowdfunding, with specific rules applicable to each type. These rules are explained at: http://www.fca.org.uk/your-fca/documents/policy-statements/ps14-04

Q. How do I find out more?

Choosing the right platform is essential, and somewhat of a minefield. There are now 87 platforms active in the UK, 27 of which launched in 2013 - followed by a further seven since the beginning of 2014. A good starting point is the crowdfunding directory CrowdingIn.com and there are many other good articles and websites online as well. In addition, the Corporate Finance Network's Crowdfunding app, helps to determine what crowdfunders may be applicable to a potential borrower/fundraiser.

For advice on the tax breaks available for business and investors or how to select the right crowdfunder, email Nigel Kimber at nigel.kimber@mcbridesllp.com