

Start-up Crowdfunding Guide for Investors

Crowdfunding is a process through which an individual or a business can raise small amounts of money from a large number of people, typically via the Internet. The objective is to raise sufficient funds in order to carry out a specific project. There are different types of crowdfunding:

Crowdfunding by way of donation or pre-sale

Internet funding portals connect individuals or businesses that have a project proposal with people interested in contributing financially.

Crowdfunding is often used to finance projects in various fields, such as the arts, culture and philanthropy. For example, funds can be raised to hold a cultural event, produce a motion picture or music album, or support victims of a natural disaster.

Small businesses also use crowdfunding to finance their business activities, raising funds as donations or product pre-sales. If you contribute, you are a donor.

Joan operates a coffee shop. She needs to replace the shop's ice cream machine in time for the approaching summer. The cost of a new machine, with delivery and installation, is \$13,000. She solicits for funds on a funding portal. For \$100, donors will receive promotional articles and discount coupons and their name will be featured on a list of donors at the entrance to the coffee shop.

Securities crowdfunding

Securities crowdfunding is when a business raises funds in this manner by issuing debt securities (such as bonds) or securities giving the right to participate in future profits (such as shares).

If you contribute, you are an investor and hope to earn interest or participate in future profits of that business. This type of crowdfunding is overseen by the securities regulator of your province or territory.

Valerie has a brilliant idea. She has developed a soft drink flavoured with maple syrup and other local products. She has prepared a detailed business plan and hopes to turn a profit from her business venture. She thinks there is a market for maple soft drinks in gourmet grocery stores, bars and restaurants. She wants to begin production. She needs \$75,000 in order to bottle and market her soft drinks. She applied to a financial institution for a loan, but was refused. She is thinking about raising the funds she needs by issuing shares through a securities crowdfunding campaign.

In Canada, issuing securities offered to the public is subject to legal and financial obligations. For example, businesses seeking to raise capital by issuing securities must file a prospectus. These obligations, however, can be costly for small businesses and start-ups. Under certain conditions in British Columbia, Saskatchewan, Manitoba, Québec, New Brunswick and Nova Scotia (the participating jurisdictions), a start-up or small business that wants to use securities crowdfunding to raise money does not have to file a prospectus or financial statements. The securities regulators refer to this as start-up crowdfunding.

Start-up Crowdfunding

Where can I find start-up crowdfunding offerings?

You will find start-up crowdfunding offerings posted on the website of funding portals. A business wishing to raise money through start-up crowdfunding must first complete an offering document outlining their idea and then post the offering document on a funding portal's website.

In certain jurisdictions, the securities regulators maintain a list of funding portals on their website.

How much can I invest?

A maximum of \$1,500 per start-up crowdfunding offering.

Does the business have to raise a minimum amount?

Yes, the business must specify the minimum amount it needs to raise in order to proceed with the project. If it does not raise the minimum, it will not receive any money and any funds you have provided to the funding portal will be returned to you.

What will I receive when I invest?

Shares, convertible securities, debt securities or limited partnership units.

Is start-up crowdfunding a risky proposition?

Investing in a start-up or small business is risky and you could lose your entire investment.

Will I be able to resell my securities quickly or easily after purchasing them?

No, you may have to hold them indefinitely.

Once the business has raised the minimum amount it needs, the business may complete its start-up crowdfunding campaign. In this event, your money will be released by the funding portal to the business and you will receive confirmation of your purchase.

The value of your investment will fluctuate depending on the business's successes or failures.

Are you interested in start-up crowdfunding?

The rules of start-up crowdfunding differ from those applicable to investments in securities of reporting issuers, such as companies listed on an exchange. Make sure you understand what you are getting into before investing any money.

Before investing, you should know that:

- You must read the business's offering document. This document must be available on the funding portal. It contains basic information about the business, its activities, its officers, its financial condition, the amount it wants to raise, the investment, how the money raised will be used and the risks. **The securities regulators have not reviewed or approved the offering documents. You must understand the information in the offering document.**
- Pay close attention to the risk warnings. Before you invest, the funding portal will ask you to confirm that you have read and understood the risk warnings and the offering document. These investments are risky and you could lose your entire investment.

- Do your homework before you invest. You can search the Internet for information on the business and the industry as well as on the people managing the business. You can contact the business for further information.
- You can also search the Internet for information on the particular funding portal where you see the offering document. You may contact the funding portal for further information.
- Unlike reporting issuers (such as companies listed on an exchange), start-ups need not file audited financial statements or other periodic disclosure. You may receive much less information about the business, and start-ups do not usually attract much media coverage. The offering document contains basic information, but you should take the time to find additional information about the business and its officers as well as the viability of its business plan.
- Once you have made the investment, the business will not generally have any obligation to provide you with updates (such as an annual report). Where necessary, you will have to track your investment on your own.
- Based on the rules in effect in the participating jurisdictions, the funding portal cannot provide you with advice about your investment, unless it is registered with the securities regulator as a dealer.
- There are two types of funding portals that may participate in start-up crowdfunding. Funding portals that are relying on an exemption from dealer registration in the participating jurisdictions cannot provide you with advice about your investment. In this case, you will have to assess the suitability of the investment on your own. Funding portals that are operated by registered dealers are obligated to determine if the investment is suitable for your situation.

Risks related to start-up crowdfunding

To make an informed decision, you must have a good understanding of the risks related to the start-up crowdfunding offering.

- Securities of start-ups are considered to be very risky and highly volatile investments, since the value of the securities can fluctuate significantly depending on the business's successes or failures.

- Statistics show that a high percentage of start-ups and early stage businesses fail. You could lose the entire amount you paid for your investment.
- What is your risk tolerance? If your risk tolerance is low, an investment in a start-up may not be suitable for you.
- What do you know about the individuals operating the business? Do they have the knowledge and experience required to manage it? Start-ups are sometimes managed by inexperienced individuals. Find out more about the individuals operating the business before investing.
- Do you have the resources to be patient? If you think you will have to resell your securities in the short term, this type of investment may not be suitable for you. You may have to wait indefinitely before reselling the securities or you may not be able to resell them at all.
- A great deal of information and analysis is published about large corporations. This is not always the case for start-ups, which have a shorter track record.

If you are willing to take risks and invest in a start-up, you may want to consider investing in a business that operates in a sector you know well. You may be in a better position to assess its likelihood of success.

The start-up crowdfunding process – Valerie's situation

Valerie is the owner of a start-up, Valerie's Maple Cola Company. She wants to raise money to market and bottle her soft drinks flavoured with maple syrup and other local products.

She seeks investors through a funding portal, ABC Funding Portal, by posting an offering document on the funding portal's website. The minimum amount that has to be raised in order to proceed with the project is also stated (\$75,000). She proposes issuing common shares of her business.

You are browsing ABC Funding Portal's website and come across this investment opportunity, which looks interesting. You read the offering document carefully, particularly the section that warns of the risks of this investment. You do some additional research on Valerie's Maple Cola Company business and on Valerie, the officers and the viability of the project.

You tick the box to confirm that you have read the offering document and that you understand the risks you are taking. You can invest a maximum of \$1,500.

The funding portal holds your money in trust until Valerie raises at least the predetermined minimum amount needed in order to proceed with the project, i.e. \$75,000.

If Valerie successfully raises the minimum amount, she can proceed to complete the start-up crowdfunding offering. You are now a shareholder of Valerie's Maple Cola Company. You receive a confirmation setting out the number of the common shares you have purchased and how much you paid.

If Valerie does not raise the minimum amount or if she decides to withdraw the offering, Valerie's Maple Cola Company will not receive any money and the funds will be returned to you. You receive notification that funds have been returned to you.

There is no guarantee as to the future value of your investment. You might have to hold onto these securities for an indefinite period or even be unable to resell them at all.