Crowdfunding offers local companies potential new investment sources, but creates potential headaches

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Dr. Daniel Farb, of Lawrence, founder, CEO, of Leviathan Energy, Inc. poses at the Long Island High Technology Incubator, holding a model of a wind turbine, on Nov. 20, 2015, in Stony Brook. Photo Credit: Heather Walsh

Daniel Farb, founder and CEO of Stony Brook-based Leviathan Energy, is looking to harness the power of the crowd to fund his renewable energy technology companies.

Soon, thanks to new federal rules allowing small investors to participate in equity crowdfunding, he'll be able to raise up to $1 million a year by selling shares to the public online through a registered broker-dealer or funding portal. In the past, companies were largely limited to marketing such private equity offerings to "accredited" investors -- institutions or high-income, high net-worth individuals.

New source of investment

While some Long Island observers see the change as an important new source of funding for local companies and especially startups, others say the Securities and Exchange Commission rules make it too costly and cumbersome for most small businesses to take advantage of.

"It opens up a new source of investment capital," says Farb, who is now preparing for a $1.5 million round of equity crowdfunding with accredited investors through an online platform called Fundable.

Those funds will be used by one of Farb's subsidiary companies, Leviathan Wind Energizer, to demonstrate on a large scale and get third-party certification for a technology that he says can redirect wind to large turbines, improving their power output by at least 30 percent.

When the new regulations go into effect, expected this spring, Farb is considering raising funds from non-accredited investors for a separate wind turbine company that has built small energy-producing turbines overseas.

Disclosure obligations

Currently, companies can conduct a private equity offering to an unlimited number of accredited investors and only up to 35 non-accredited investors, explains Alon Kapen, partner in charge of the emerging companies and venture capital group at Farrell Fritz P.C. in Uniondale. That was limiting considering 93 percent of the population are non-accredited investors, he notes.

And these are the exact people Farb says he hopes to reach, noting traditional sources of capital have been very conservative since 2008.

But companies hoping to tap the new investor pool must prepare now for what could be an expensive and time-consuming process, experts say.

"It's an added expense and burden on companies to make filings with the SEC going forward," says Neil Kaufman, a partner at Abrams Fensterman LLP in Lake Success and chairman of the Melville-based Long Island Capital Alliance. The rules are structured in such a way that "hardly anyone is going to use it," he says.

Fees paid to the funding portal or broker alone could be 5 percent to 15 percent for offerings of $100,000 or less.

In addition, companies must file extensive financial information with the SEC and provide this information to investors. Depending on the size of the offering, financial statements may have to be reviewed by an independent public accountant, another expense.

Companies must carefully assess the costs involved, to decide if the amount being raised is worth it, Kaufman says. For those raising smaller amounts, it may not be, he says.

Also, as with donation-based crowdfunding portals like Kickstarter, a company must raise the entire amount of its funding goal in order to keep any of the money raised, Kapen says. "This isn't for everybody," he says. "There will be a tough analysis that has to take place."

The new process, while "not perfect," is potentially "revolutionary," Kapen says. "It's going to dramatically alter the landscape for startup companies."

It pays to enlist the help of an attorney familiar with the process to help you navigate the new rules, says Jason Best, co-founder of Crowdfund Capital Advisors in San Francisco and co-author of Crowdfund Investing for Dummies (For Dummies; $26.99).

Farb says he's educating himself now and researching the new regulations and costs.

Building followers

Companies should also start building followers across online social platforms as well as offline, Best suggests. Give information, expertise and support to your online community, so when you ask for money, it's not the first time your followers hear from you, he says.

Also be careful choosing a funding portal, Kaufman says. "There will probably be a small number of portals that will develop a good reputation and you should stick to those," he notes, adding these portals will be under "tremendous regulatory and exposure pressure."

EnergyFunders, a Houston-based online equity crowdfunding portal connecting investors to oil and gas projects, plans to have a second platform for non-accredited investors by mid-2016, says Casey Minshew, director of investor relations. The portal will offer an online educational component where people can access information and learn more about the industry, he says.

Bill Clark, CEO of MicroVentures, an Austin, Texas, online equity crowdfunding platform, is planning to open its existing portal to non-accredited investors once the rules are implemented.

"When it makes sense for both the company and us . . . we will definitely put those opportunities up," he notes, adding they have more than 20,000 non-accredited investors already signed up waiting for the rules to go into effect.