

The Issue

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Crowdfunding

An old idea with a new twist

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With some well-established websites raising hundreds of millions of dollars for creative projects, and with “equity crowd-funding” for early stage companies right around the corner, we thought it’d be a good time to review the state of Crowdfunding as it stands today.

Is “Crowdfunding” new?

If we define crowdfunding as the process of asking a lot of people for a little money, then we’ve just defined how charitable organizations have been raising money for more decades. In essence, the Salvation Army is a prime example of crowdfunding. The advent of technology has simply made the practice more widespread and addressable. Layer on Social Media and many new twists on this old idea have materialized.

Even George Zimmerman, the accused shooter of Florida teenage murder victim Trayvon Martin, has resorted to crowdfunding through selling his autograph as a means of raising legal defense funds in his case.¹

Crowdfunding for creative projects

Crowdfunding is not just for not-for-profit organizations anymore. A number of funding platforms for creative projects have sprung up over the last few years, among them,

- Kickstarter
- Indiegogo

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Let me discuss the how Kickstarter works, the crowdfunding platform with which I have had some personal experience. Full disclosure, a client of mine in the gaming business raised over \$170,000 on Kickstarter.

From its own website, www.Kickstarter.com, Kickstarter states, “[it] is a funding platform for creative projects, everything from films, games, and music to art, design, and technology.”ⁱⁱ Launched in April 2009, “over \$350 million has been pledged by more than 2.5 million people, funding more than 30,000 creative projects.”ⁱⁱⁱ

Project originators create promotional and informational webpages which appear on the Kickstarter website, outlining their project goals, their funding requirements, deadlines, and reward programs for supporters. One of the unique aspects of Kickstarter is that funding is an all-or-nothing process. If the project receives sufficient pledges to achieve its funding goal *by the deadline*, then the supporter’s credit cards are all charged and the project moves forward. If the project fails to achieve its funding goal by the time prescribed, no supporter is charged. Often, project originators specify certain rewards, or premiums, to encourage support above certain dollar levels. Examples range from coffee mugs and tee shirts to signed copies of the artist’s artwork, a cameo role in a movie, or other credits for their support.

Kickstarter restricts the type of projects that can be allowed on their platform. “We allow creative projects in the worlds of Art, Comics, Dance, Design, Fashion, Film, Food, Games, Music, Photography, Publishing, Technology, and Theater.”^{iv} Projects must have something specific that will be completed, such as a film, piece of art, book, etc., and exclude charities, causes, or fund my lifestyle projects. Other Crowdfunding platforms will have different guidelines.

Accounting and Tax implications

In the case of Kickstarter, do backers get ownership or equity in the projects they fund? “No. Project creators keep 100% ownership of their work. Kickstarter cannot be used to offer financial returns, or equity, or to solicit loans. Some projects that are funded on Kickstarter may go on to make money, but backers are supporting projects to help them come to life, not financially profit.”^v

This begs the question of what is the accounting treatment of crowdfunding, from the project originator’s perspective. Specific authoritative guidance has yet to be promulgated. Are goods and services, ordinarily sold in the normal course of business transferred? In which case, there is a revenue component. Or is it simply “Other Income”? The resolution will largely be facts and circumstances based, and will vary from entity to entity. Federal and local taxing authorities will want their share of these funds, as well, when considered in the context of the organization’s overall tax picture, as well as whether the revenue, if that’s how it’s construed, is subject to sales taxes.

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What are the fees?

If a project is successfully funded, Kickstarter applies a 5% fee to the funds collected.^{vi}

In the US, Kickstarter pledges are processed by Amazon Payments, while in the UK, pledges will be processed securely through a third-party payments processor. These payment processing fees work out to roughly 3-5%.^{vii}

So a fairly hefty chunk comes off the top, not to mention the cost of the premiums, mentioned above, that the promoter must incur to entice larger contributions from his or her potential contributor base. Depending on the premiums offered, a project originator might see only 60 – 80% of the gross proceeds from the crowdfunding offering.

However, in these tough times, this form of fund-raising for a creative project with some pizzazz may make the difference in whether a project can proceed on a timely basis, or not.

What's next: "Equity" Crowdfunding

The JOBS Act, signed into law by President Obama on April 5, 2012, is designed to encourage capital formation of US-based startups and small business by easing securities regulations. Regulations governing "equity crowdfunding" are being considered by the Securities and Exchange Commission which, when they are expected to be issued in 2013, will provide a basis for business enterprises seeking capital to engage in solicitation of individual and institutional investors which was prohibited under existing securities laws and regulations. The crowdfunding provisions of the JOBS Act are expected to transform how small business capital is raised in America.

ⁱ "George Zimmerman seeks donors with offer of autograph", Orlando Sentinel, Nov 28, 2012.

ⁱⁱ Kickstarter website: www.Kickstarter.com

ⁱⁱⁱ Ibid.

^{iv} Ibid.

^v Ibid.

^{vi} Ibid.

^{vii} Ibid.

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Summary

This issue is Part One in a series. Stay tuned: we will address Equity Crowdfunding in a future edition of **The Issue**. Should you have any questions on the issue of Crowdfunding, please contact Chris Chillingworth at (408) 309-1343 / cchillingworth@cfos2gopartners.com, or your CFOs2Go Partner. ✍



Chris Chillingworth is a partner with CFOs2Go Partners specializing in the high tech manufacturing, software, and service industries. He has over 30 years experience in financial leadership including multiple roles as a CFO in both the public and private sector. He leads our financial systems, stock compensation accounting and corporate governance practice groups.

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