THE BLUEPRINT FOR INVESTING INTELLIGENTLY ONLINE

How to Choose an Equity Crowdfunding Platform

By Shelly Hod Moyal, Founding Partner of iAngels

Introduction

Crowdfunding exploded in 2014, with $10B in funds raised across hundreds of platforms. But according to Richard Swart of the World Bank, 2014 was merely the tip of a massive crowdfunding iceberg forecasted to swell to $300B in funds raised by 2025.

While crowdfunding picks up momentum in general, equity crowdfunding, which allows private companies to raise funds online in exchange for equity, is the fastest growing category in particular.
Until recently, only public companies with extensive operating histories and millions of dollars in revenue could raise capital from the public. Private investing was an opaque, exclusive club that included only institutional investors or ultra high net-worth individuals. Today, equity crowdfunding is redefining the possibilities of investing and fundraising worldwide as it opens up private markets to an ocean of new investors for the first time.

In light of this trend, hundreds of equity crowdfunding platforms are popping up left, right and center, vying for a piece of the $300B pie. **But how does an investor determine which platform is best?**
Like many things in life, the devil is in the details. While platforms may appear similar at first glance - using sleek graphic design, up-to-date UX and an inviting user-friendly interface – true differentiation is a function of deal-quality, term-structure, strategic and tactical asset allocation, and track record.
To assist you in selecting the optimal platform, here is a comprehensive guide to choosing the best equity crowdfunding platform.

Shelly Hod Moyal.
Founding Partner of iAngels

Table of contents

The next big thing	Deal Flow	4
Making your life easier	Due Diligence	5
It's all about the team	Team	6
Facilitating the process openly	Transparency	7
Invest with the best	Co-Investing	7
What is the desired return	Potential Returns	8
Different platform, different terms	Deal Terms	11
Who pays the fees	Incentive Structure	11
A platform that protects you	Investor Rights	12
Don't underestimate the importance of taxes	Tax Considerations	14
Learning and growing	Education	15
Who runs the platform	Trust	16

THE NEXT BIG THING

Investors who find and invest in the best companies make the most money. Thus, when choosing between equity crowdfunding platforms, investors who want to make the most money must assess the quality and variety of deal flow listed on the platform.

For **quality**, take the time to understand where the deals come from. Many platforms allow all startups to list their ventures and join the network for funding. In this case, deal flow is mostly inbound, based on the supply of startups that wish to be listed, and you might find yourself sifting through endless deals to find the one quality gem worth investing in. A good determinant of quality is the selection process. Investigate how the selection process is managed and how stringent it is, understanding how many companies the platform evaluates and what percentage of opportunities are selected.

In terms of **variety**, some platforms feature a high number of deals while others offer only a select few. While conventional knowledge would suggest more is better, consider the correlation between how selective the platform is and the amount of opportunities shown. A platform that lists 100 companies each month creates far less value for investors than a platform that vets 100 companies but only lists 5 each month.

Similar to public equities, if you have a particular macro conviction about a specific geography, market, or sector that you are familiar with and want to invest in, make sure the platform caters to your preference. If you prefer to take a generalist investment approach, evaluate platforms that list companies from several industries.

As time goes by, you will be able to look at the traction and returns of the portfolio companies in each platform, which will allow you to easily evaluate the quality of the deal flow. Until then, the fundamentals of the selection process and variety of deals should be useful indicators to guide you through the platform's deal flow.

"The most important thing to consider before you start investing in early stage companies is your source of deal flow. To succeed, you need to figure out your edge and make sure you are not suffering from adverse selection"

Tal Morgenstern, Partner, Sequoia Capital

MAKING YOUR LIFE EASIER

Despite the growth of equity crowdfunding, only a few platforms are heavily involved in the due diligence process, saving an investor his/her most precious and finite resource: time. This assistance is particularly valuable for opportunities in industries you are less familiar with, or in markets abroad when it is challenging to carry out due diligence yourself.

You can evaluate how involved your equity crowdfunding platform is in due diligence by looking at how the platform investigates central aspects of each opportunity, including:

Need
Is the company providing a solution to a real world problem?

Market
Is there a large potential market willing to pay for the solution?

Competitive overview
Are there any major competitors providing the same solution, and if so, does the startup have a key differentiator or a competitive edge?

Technology
Does the company have a technological advantage or is it working on building a product that is technologically feasible?

Legal
Does a patent exist and/or there are no legal restrictions to providing this product or solution?

Team
Is the company founded by a strong team with the ability to execute the company vision, and does the team have relevant experience in the sector?

Traction
What has the team accomplished to date (KPIs)?

Ownership
Who are the shareholders? Is management a key shareholder with a strong incentive to push the company forward?

It is also important to ask yourself who is conducting the due diligence. Generally speaking, professional investors such as VCs have vast experience in conducting due diligence, including a wide network of industry experts and strategic partners with whom they can consult as they evaluate the opportunity. Industry experts may be potential clients who let you know whether they would pay for the product, or seasoned investors that specialize in a particular market. In either case, the advice of these experts is invaluable, and often yields more intelligent conclusions than hours of independent research.

ITS ALL ABOUT THE TEAM

The product and market are constantly changing in early stage startups, so seasoned investors will argue that the crucial factor in an investment decision is the team. To truly understand the potential of the team, much more is involved than simply reviewing CVs and LinkedIn profiles. VCs meet with entrepreneurs multiple times before deciding to go ahead with an investment, trying to judge whether the team has the ability to execute the vision and the long-term dedication to grow the company and weather any storms that startups typically experience.
In equity crowdfunding, the investment is almost always completed online and you won't have the opportunity to meet entrepreneurs in person. Some platforms mitigate this issue by facilitating virtual communication and conducting screening on your behalf.

"The most important thing in startup investing is "team, team, team". I try to judge whether the founders have the entrepreneurial nerves needed for this rollercoaster ride - will they stick around in hard times? Even if the company is developing a product that the market isn't ready for, a good team can change the direction and become successful regardless of its starting point."

David Assia, iAngels Chairman

FACILITATING THE PROCESS OPENLY

Being privy to in-depth and quality information about the platform will lead you to make insightful and educated decisions. Familiarize yourself with the platform's screening and investment process. Make sure there is full disclosure of the source of deal flow, fees, processes and potential investments. Some platforms only provide limited company marketing materials, whereas others openly disclose valuable due diligence information, allowing clients to view co-investors' contributions, send periodic updates about their status and advancements and inform you of third party commentary and analysis.

INVEST WITH THE BEST

As a new angel investor, you may not yet have a wide network of industry experts and seasoned investors with whom to consult. Platforms that invest alongside traditional professional investors, such as VCs and top tier angel investors, minimize risk and maximize return. By leveraging the combined analysis and due diligence of professional investors and the managers of the investment platform, your investment opportunity set will be of much high quality than platforms that don't audit their investors, or worse, don't have professional investors at all.
The advantages of co-investing with professionals continue long after the investment has been made. Remember, those who invest significant amounts are personally committed to making sure the company succeeds. Acting as informal advisors or BoD members, they provide entrepreneurs with the guidance, mentoring and industry connections necessary to grow the business. In short, co-investing yields a higher expected, risk-adjusted return.

"I don't think that I've been involved in a company that somewhere along the way was not catalyzed by an angel investor or a seed stage investor."

Nivi Babak, Co-founder of AngelList

WHAT IS THE DESIRED RETURN?

Potential returns are dictated by four things: entry valuation, subsequent rounds, expected returns and time horizons. As an angel investor, you are taking a lot of risk and you should make sure you are rewarded appropriately.

Entry Valuation

Consider the risk-reward profile you feel comfortable with. If you decide to invest in a very early stage startup with only an idea or prototype, you'll receive a larger share of the company at a lower valuation. However, despite a much bigger potential upside, there is also a higher risk profile. The valuation should adequately reflect the stage of Potential returns are dictated by four things: entry valuation, subsequent rounds, expected returns and time horizons. As an angel investor, you are taking a lot of risk and you should make sure you are rewarded appropriately.

Subsequent rounds

These will dilute your position in the company. When looking at the deal, dig into company plans and the business model. Specifically, what will it take to achieve their aspirations? Certain companies are capital intensive and require a significant investment. Others might be able to reach profitability fast. There are certain industries known for requiring large investments, like B2C (business to consumer) companies. Not surprisingly, these are also considered more risky for this very reason. When investing in B2C companies, look for CEOs who are skilled at fundraising (among other things) as much fundraising will typically be required. To exemplify this, imagine you invested in two companies with the same entry and exit valuation (leaving all else constant), but one company had just one round and the other had three subsequent rounds where they sold 20% of the company in each round. The return on the latter would be around half.

Expected return

In evaluating an early stage opportunity, try to come up with an estimate of the exit potential. You can look at recent transactions, current and historical valuations in the industry, then evaluate the chances of reaching this outcome. With startups, chances of success for virtually every company is low. Angel investors seek companies with an opportunity to score big and where the team and/or technology have an edge, increasing their chances for success. This is because most startups you invest in will underperform and if you invested well, the outliers in your portfolio will compensate for the losses.

Time Horizon

lastly, try to determine how long it will take to reach the expected return. There is a big difference between making 10x your money in 3 years (115% IRR) vs. 10x in 10 years (23% IRR).

Remember that when you invest in early stage private companies, it is important to create a diversified portfolio to spread your risk across several opportunities so that the winners make up for the losers. Investing in only one or two companies will lead to negative returns (unless you are extremely lucky!)

"As a rule of thumb, if you can get one times your money back for each year that you are in the deal, it's an excellent investment.
If you looked at every one of your investments and thought that you could get on the upside a 25% return on investment, including interest (assuming everything worked out well), you would be very lucky to exceed a 15% IRR. This is because most projections are optimistic, and this means that some of the investments will return more than you expect them to; however, most will give you less than you expect. On average, you would probably have less than a 25% return. So, the desired return on each investment should be higher than the average you want on all your investments."

David Gladstone, Venture Capitalist and Author of "Venture Capital Investing"

DIFFERENT PLATFORMS, DIFFERENT TERMS

Equity crowdfunding platforms have huge variation in regards to who dictates the investment terms, which can very much influence your ROI. In an entrepreneur driven platform, the deal terms are set by the founders and are usually much higher than an investor driven platform.
In the latter, the investor negotiates the investment terms and often has bargaining power. Alternatively, the platform may negotiate the terms on behalf of the investor. Here, there is a lower incentive to fight for terms than an investor, as platforms are typically also compensated for the transaction, though it is still more favorable than having the entrepreneur decide on the terms.

WHO PAYS THE FEES?

In order to understand the incentive structure, the first thing to look at is who the platform's client is… In other words, who is paying the fees? If the entrepreneur pays the fees, the platform is first and foremost obligated to service the entrepreneur and his requirement to fundraise. If it is the investor paying the fee, the platform has a duty towards the investor and his requirement to access good deals. If both the entrepreneur and the investor are paying the fees, then there is an inherent conflict of interest – the interests of the startup and investor are not aligned before the transaction and it is impossible to truly fulfill the needs of both. Also, when startups agree to a pay a fee for fundraising, there is a higher risk of adverse selection and such startups might be experiencing difficulty fundraising on their own.

It is also important to understand the structure of the fees, including what portion is fixed and what is performance based. The more weight given to the performance based component, the more the platform is aligned with the interests of its investors – it has a substantial incentive to provide quality deal flow, otherwise it will not receive the performance fee. Certain investors tend to complain when they have to pay fees and push for the startup to pay, but in reality, it is in the investors' best interest to pay the fees.

A PLATFORM THAT PROTECTS YOU

It is vital to find a platform that is committed to protecting your rights as an investor. Check whether you are investing under the same terms as other investors or buying into a separate class of shares that are subordinate and have less rights than those of the other investors (outside the platform). If you are investing under the same terms of other investors, you can expect that they will look after their own rights, and by extension, look after yours as well.

As a beginning angel investor, explore which rights your platform provides you with. Below are several important ones:

Class of shares

When making an investment, check which type of shares you are buying, understanding whether they are common or preferred shares. The more senior your shares in the cap table, the more downside protection and the better the terms. As an investor, aim to ensure that in the case of an undesirable exit outcome, you will be compensated appropriately for the risk you took in the company. These days, it is standard to get at least a 1x liquidation preference on your investment.

Preemption rights

In this clause, you will have the right of first refusal on any new shares being issued, giving the existing shareholders the ability to maintain their percentage interest in the company and avoid dilution. How does this work? The company will offer new shares first to the existing shareholders pro rata to their existing shareholdings, allowing them to maintain their ownership position in the company. If these investors do not take up all of their entitlement, they will incur some dilution to their holdings. The vast majority of platforms do not provide this right to investors, despite its importance in the early stages of the company. As an investor, you often want the opportunity to maintain your share of the company as you see it progress.

Reverse vesting of founders

Tying the allocation of the founders' equity to their actual job attendance and effectiveness is an important component of the deal. It protects the company from free riders and ensures that the founders and executives are committed to remaining in the company and contributing to its growth for a minimum viable time, thus allowing for the realization of the company's potential. Theoretically, unless there is a reverse vesting provision, the founders can decide to leave the company a day after round A is closed, taking with them a substantial portion of the company equity required for the business. The standard time-frame these days in reverse vesting is three to four years.

Board of Directors seat

All the strategic decision-making of the company is done at the board level. It is beneficial to have representation on the board that advises founders and prevents unfavorable situations to both investors and the company.

Information rights

One thing that could mitigate lack of Board representation is information rights. These require the company to supply investors with company information, which can include financial statements, other company records, as well as a visit to the company's facilities.

"I cannot stress how important investors' protections are. You are investing your hard-earned cash. Investing in start-ups is risky as it is, but if you don't make money when you back the successful companies, it doesn't matter how good you are at spotting the next great opportunity, you are still going to lose your money. Platforms that do not take steps to protect investors are basically allowing the crowd to give their money away and disguising this as investments in start-ups."

Gonçalo de Vasconcelos, CEO and Founder of Syndicate Room

DON'T UNDERESTIMATE THE IMPORTANCE OF TAXS

Depending on where you are investing and your country of residence, there are tax requirements and treaties that must be taken into consideration. Each country has specific tax requirements and benefits, such as the EIS in the UK and "The Angel Law" in Israel. Understanding the tax implications of your investment, specifically required reporting, the capital gains tax rate and taxes on distributions (dividends) is crucial as it directly influences the future return on investment.

IMPROVING THE INVESTMENT PROCESS

A state of the art crowdfunding platform can improve the entire investing process. I would look for automation and analytical tools with periodic reporting that help you keep track of your investments and how well the companies are doing, post investment. There are also features that can help analyze your portfolio, showing diversification, preferences and performance. The more insight and tools available the better.

LEARNING AND GROWING

A strong crowdfunding platform goes beyond facilitating investments and helps its community members grow and develop their investing practices. This is a win-win for everyone involved. Such platforms provide tips and strategic advice on angel investing, guiding the new members of their community as they gain the confidence and grow their early stage portfolios.

This is especially important for new investors who are just getting acquainted with the high-risk profile of early stage investing. Such investors appreciate learning more about the investment horizons, liquidity, portfolio diversification and the due diligence process.

"From what I have seen in the industry, there has been a reluctance until very recently to ensure that investors understand the necessity of diversifying. In fact, it is important for the platform as well. The stronger their investor portfolios, and the more educated investors are about proper angel investing, the less of a shock it will be when many of their startups investments don't make it. Educate your investors to make the right choices. They will appreciate it and make better decisions."

David Mark, Founder of Fundz

WHO RUNS THE PLATFORM?

Lastly, it is important to look at the people behind the platform. Look for transparency and ask yourself if you trust the team – Do you believe these individuals are genuinely interested in making you successful?

"The most successful angel investors I know are all basically good people. Once they invest in a company, all they want to do is help it. And they'll help people they haven't invested in too. They just try to help everyone, and assume good things will flow back to them somehow. Empirically that seems to work."

Paul Graham, Serial entrepreneur, Founder of Y Combinator

This advice can be applied to crowdfunding platforms, VCs and to people in general. To summarize, an equity crowdfunding platform can be so much more than simply a vehicle enabling you to invest in private companies. It can be one that offers you high quality deal flow, protects you as a minority investor, provides you with a range of tools and, most importantly, enables you to learn, grow and make well-considered and wise investment decisions. There are hundreds of platforms out there. Make sure to shop around and choose the ones that will serve you best.