

How Successful has Equity Crowdfunding been for Investors

Higher risk investments come with the expectation of producing higher returns than low risk investments. Since equity crowdfunding is in general a higher risk investment category, are investors receiving the returns to compensate for this incurred risk?

Expected Returns from High Risk Investments

When posing this question, it is important to understand that most of these equity crowdfunded companies are relatively young and will take a few years before they start to mature and generate profits. The time frame for a business to become profitable can be around 2 – 3 years, depending on start-up costs and sector.

For example, in the UK it has been estimated that it took about 10 years before equity crowdfunded companies started to provide returns to investors.

Public vs Private Companies

Another thing to note is that it is easier to realise returns in publicly listed companies than private companies. Publicly listed company shares are more likely to be liquid and can be sold on securities exchanges. Private company share sales on the other hand can require significant due diligence, transaction advisors and company valuations resulting in higher costs to facilitate sales.

This can be unrealistic for part-time investors who are using equity crowdfunding as a means to enter the private market with limited capital. Therefore, for equity crowdfunding investors to realise returns it may be through a trade sale, dividends paid or the company listing on an exchange.

Companies being listed on an exchange can provide a range of benefits for investors. Securities exchanges will require increased disclosure and transparency from companies, which can lead to better liquidity, allowing investors to more easily buy and sell shares as a market determines current value of the business.

Only 3 out of the 71 companies that have had successful crowdfunding raises on major New Zealand crowdfunding platforms (Snowball Effect, Equitise, Crowdsphere and Pledgeme) have listed on or were listed on an exchange, which equates to 2.27% of total funds raised.

Powerhouse (which raised funds on both Snowball Effect and Equitise) and Croplogic, both had capital raises prior to listing on the ASX. Since then, Powerhouse has lost significant value and Croplogic has entered liquidation this year (2020).



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Syft Technologies was listed on the USX in April 2017 and raised \$7.5 million later that year, with \$402,496 through crowdfunding. Syft is trading at a price higher than the equity crowd funding issue price.

Known Returns to Date
(Assuming \$1,000 invested across crowdfunding investees)

	Value at Time of Investment	Current Value (Q3 2020)
Unknown Current value	\$858.50	\$858.50
Known Value	\$27.50	\$5.57
Liquidated	\$114.00	\$ -
Total	\$1,000.00	\$864.07
Percentage Change		-14%

Companies that have not made valuations public have not been considered in this scenario.

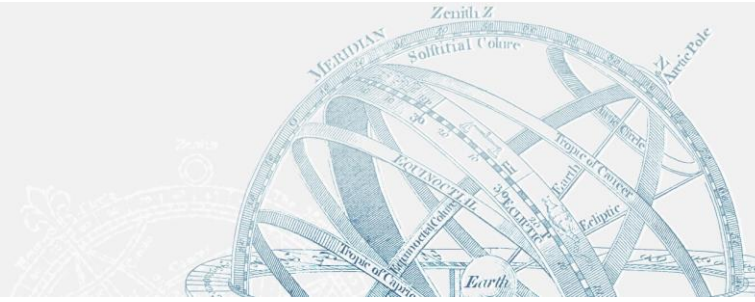
The difficulty in measuring the performance of private companies, is that unlike with public markets, crowdfunding data is not readily available. Few companies publicly provide regular updates post-crowdfunding, and fewer still make public any valuation processes used to provide shareholders with an understanding of the share price. This analysis highlights that not only is equity crowdfunding inherently risky (with over 10% of sampled companies being liquidated) but that shareholders have limited avenues to assess the value change of their investment.

Company Failure Rate

Investors should be aware that investing in early stage businesses involves risk, and the failure rate for them is high. Out of all the companies started in 2009 only 26% have survived as at 2019, 32% from 2011 and 40% from 2013. The 'death rate' for New Zealand businesses is 10% per year, and predominately consists of new companies.

Through the analysis of 71 NZ businesses which have raised funds on major NZ crowdfunding platforms, 11% of the companies have failed. This is marginally better than the market rate of 40% since 2013. While only a further 3% of businesses have reported significant value loss, it is likely that the true figure is higher. Due to the majority of these companies being private with low transparency and reporting, it is difficult to observe true losses.

Some of the notable failures are TRNZ (though they were insolvent before the capital raise), Balex Marine and Andrea Moore which both failed within two years of their respective capital raises. Further information about these cases is provided in the appendix.



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Some of the most notable success stories so far include:

- Zavy raised capital on Crowdsphere in 2016 at a price of \$2.00, a second round in December 2017 was at \$3.40 and a third round in October/November at \$4.49.
- Invivo & Co raised capital on Snowball Effect in 2015 and an up round in 2018 and is now selling in 17 offshore markets via new collaborations with Sarah Jessica Parker wine and a Graham Norton Gin range.
- LINK business broking raised \$3,450,580 on Snowball Effect in 2018. Since then it has acquired another business broking firm Klemms and LINK has been accepted as a NZTE Focus 700 customer (700 top exporting companies).

Acceptable Risks

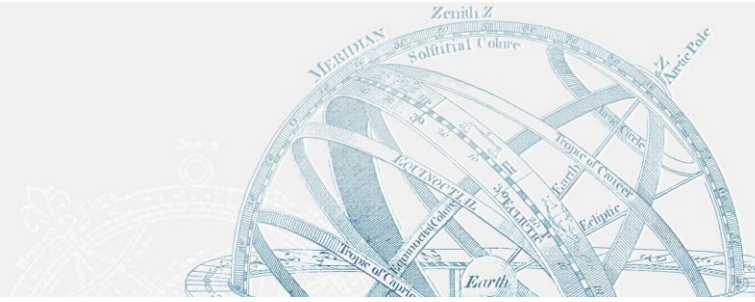
What can be seen from this analysis is that equity crowdfunding is a high-risk investment category, investors need to be aware of this inherent risk; many companies will fail and investors need to be prepared for that.

Equity crowdfunding is still at an early stage in New Zealand (c. 7 years) therefore it shouldn't be a major concern that companies which have crowdfunded have not produced positive returns yet. As noted previously, in the more developed UK market, it took around 10 years to start to see positive returns.

Concluding Comment

On balance, equity crowdfunding remains a useful capital raising tool for businesses, which enables investors with limited capital (e.g. 'mum and dad' investors) to access opportunities in the private markets.

It remains to be seen how successful New Zealand investee companies will be in the long run, however in the aftermath of Covid-19, equity crowdfunding could likely play an important role in helping to rebuild our New Zealand economy.



Appendix

Case 1 - Tourism Radio NZ Limited

Tourism Radio NZ raised \$211,000 via Equitise platform in 2015. Though it reported that it was insolvent in August 2015, for the year ending in December 2014, with net assets of - \$831,197. Yet it had a "successful" equity crowdfunding raise. Tourism Radio NZ is now removed from the companies register, due to failure to file its annual return.

Case 2 - Balex Marine

Balex Marine raised \$330,500 in 2016 via Snowball Effect, with a successful crowd campaign. It entered liquidation in 2017, 1 year after the capital raise. Investors are now getting nothing and have lost all \$330,500 of investment capital. Out of initial claims of \$1,005,401 only \$408,197 was admitted as creditors.

Case 3 - Andrea Moore

Andrea Moore was liquidated in 2017, 18 months after raising \$750,000 on Snowball Effect in 2016.

This is further outlined in Chris Lee & Partners Ltd newsletter titled "Crowdfunding" by David Colman.

Case 4 - Zavy

Zavy raised capital on Crowdsphere in 2016 at a price of \$2.00, a second round in December 2017 was at \$3.40 and a third found in October/November 2019 at \$4.49.

Case 5 - Invivo & Co

Invivo & Co raised capital on Snowball Effect in 2015 and is now selling in 17 offshore markets, via new collaborations with Sarah Jessica Parker wine and a Graham Norton Gin range.

Case 6 - LINK business broking

LINK business broking raised \$3,450,580 on Snowball Effect in 2018, since then it has acquired another business broking firm Klemms, and LINK has been accepted as an NZTE Focus 700 customer (700 top exporting companies).