Should You Forget the Stock Market and Focus on Crowdfunding?

Description

In recent years, the popularity of crowdfunding has soared. For example, in 2016 the amount raised through crowdfunding surpassed venture capital funding for the first time in its history. By 2025, it is estimated by the World Bank that capital raised through crowdfunding will exceed $93bn.

Clearly, it is becoming a more mainstream means for start-ups and smaller companies to raise the capital they need to grow. It is also becoming more common for investors to invest a small part of their portfolios in crowdfunded ventures. Is now the time to increase this amount and ditch shares altogether?

The appeal of crowdfunding?

Put simply, crowdfunding is a means for a business to access capital without going through traditional channels such as banks or other lenders. It allows them to raise cash directly from investors, which can be a much faster process than through banks. It can also provide a degree of marketing for the business in question, which can help to get its name into the public domain at a time when it is probably not well-known.

The appeal of crowdfunding for a business, therefore, is relatively straightforward to grasp. However, the attraction of the platform for investors is somewhat more difficult to ascertain. Generally, the companies are either pre-revenue or have only a short track record of sales. They are therefore extremely high risk, and it appears as though the vast majority of crowdfunding investments end with a loss of some degree to the investor.

Furthermore, crowdfunding lacks the transparency of the stock market. In other words, while listed companies are required to provide a minimum amount of information as well as regular updates to investors in order to allow them to conduct due diligence, doing so with a crowdfunded venture is much more difficult. Although some information is required to be provided to investors, a company with no track record may be little more than an idea.

The appeal of shares

In contrast to crowdfunding, the stock market has an excellent track record of creating wealth for investors. Not all investors end up in the black, but history shows that buying a diverse range of shares within a portfolio and holding them for the long run generally leads to a high-single digit annualised return. In addition, dividends are often paid, and it is possible to buy shares in a company for a much smaller multiple of sales or profit than is the case with many crowdfunded ventures.

In addition, shares are highly liquid and can generally be sold easily. Crowdfunded ventures are among the most illiquid of mainstream investments, which adds an extra degree of risk for investors. And with multiple funding rounds likely due to the young age of many of the companies on crowdfunding platforms, dilution of shareholdings is a major issue for investors.

Therefore, while the idea of crowdfunding may sound appealing and the chance to buy into a stock in its early days may be enticing, the reality is that the risk/reward ratios available in the stock market are likely to be far superior in the long run.

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Date
2025/08/26
Date Created
2017/08/13
Author
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