MicroVentures

What is a Crowd Note & How Do They Work?

As a relatively new type of security, we often receive questions about Crowd Notes. Here's a quick run-down on what a Crowd Note is and how they work.

Crowd Note vs. Convertible Note

A convertible note is a loan that converts to equity at a pre-determined maturity date or company milestone, oftentimes a financing event outlined within the note's investment documentation. A convertible note, sometimes referred to as simply a "note," is debt with the potential to become equity.

The Crowd Note is a modified convertible note designed specifically for crowdfunding investing. The key differentiating feature between a convertible note and a Crowd Note is the maturity date; a Crowd Note does not have one. Other differences include limited voting and information rights, the potential to extend the Crowd Note after locking in an initial conversion price, and provision for a corporate transaction payout that provides investor protection against early exit.

Goals & Benefits of Crowd Notes

The Crowd Note was created to alleviate the challenges that come with raising small amounts of money from a large number of shareholders, namely keeping a clean cap table and minimizing operational disruption due to shareholder information, voting, and inspection rights.

Crowd Note offerings allow for large numbers of investors without adding "noise" to a company's capitalization table, which can be a deterrent for future institutional or venture capital investors. This also helps startup maintain focus on key business initiatives rather than having to handle a large number of minor shareholders.

Features of Crowd Notes

- Incentive - Crowd Notes generally include a valuation cap or discount (or both) as an incentive for early investors.
- Flexibility - A company can choose to convert or extend the crowd note upon each qualified equity financing event.
- Price Lock - Investors receive the conversion price set at the first qualified equity financing even if the Crowd Note is extended.
- Simplicity - Investors have limited voting, information, and inspection rights after conversion.
- Protection - A corporate transaction payout provision offers investors a buffer in the event of an early exit.