

BANKING ON CORPORATE

BY NEILL MAY



Far from the madding crowdfunding

The recently enacted Jumpstart Our Business Startups Act in the United States, which is designed to facilitate capital raising by smaller issuers through widely accessible digital platforms, or crowdfunding, has some powerful forces acting in its favour. The intention, to encourage funding of small businesses, is compelling. The power and appeal of crowds, especially of crowds assembled through the Internet in a digital age, is undeniable. The fact of the adoption of the liberalized JOBS systems in the large U.S. market is imposing in itself. And then there is that catchy name. The question is, notwithstanding these factors, does crowdfunding really make sense?

There is certainly much buzz about crowdfunding. Go to *kickstarter.com* and you can help fund a new album, a new clothing line, or a new industrial design. But under applicable securities laws, you can't buy equity in those projects without qualifying for a prospectus exemption (which likely requires either that a very significant investment is made or that certain personal wealth tests are met). That, at least, is how things stand in Canada. Under the JOBS Act, smaller companies in the U.S. can raise limited amounts of capital, through regulated platforms, from investors that wouldn't otherwise qualify for prospectus exemptions. The act also reduces the disclosure obligations for those companies.

Certainly it's a good thing to permit issuers with a genuine need to raise capital and to do so, and to grow. What is troubling is that there are already sources of capital for startup businesses, including conventional lenders, governments, venture capitalists, and their seed-money brethren, commonly called angel investors. The latter in particular are experts in assessing risk, directing capital, and choosing winners for early stage issuers.

If startups aren't able to access capital

from those sources, it may be that the people and institutions that are experts in investing in that space just don't see the potential. If that's the case, is the right answer to let those companies move on to a public less savvy in risk assessment? Moreover, isn't it likely that the angel investors will still get the first crack at the next potential Google, while the crowdfunder will be left with the next *goingstraightintothecrapper.com*? If the problem is there are obstacles preventing the efficient operation of the angel investment market, maybe the first response should be to consider and address those obstacles instead of exposing the public.

In a digital age, crowds are easily and quickly assembled, and their power is unmistakable (to the point that the outcome of Tahrir Square was due in part to the ability of tech-savvy organizers to gather and rally supporters). Part of the premise of crowdfunding is that online communities of investors will be created that are able to instantly share investment information. This is undoubtedly true, but what is less clear is how effective this will be in the investment arena. The perspectives in crowdfunding fora will be expressed by people without responsibility for their comments, and perhaps with strategic motives. A good recommendation on TripAdvisor is often a good indication of a quality hotel, but you can easily be reading a recommendation of a fleabag run by the recommender's brother. There's certainly an argument that there should be greater disciplines and checks in the investment arena than in the leisure travel game.

Proponents of crowdfunding argue, too, that the advent of the Internet has seen great improvements in fraud detection. But the Internet has also created great opportunities for fraud, and on a broad scale (enriching many a Nigerian prince) — it is not obvious why innovation in the fraud-detection field should be outpacing creative thinking among perpetrators of fraud.

There will naturally be success stories in the crowdfunding space, and word of those successes may spur demand for investments. There may also, however, be some spectacular failures. And failures in the capital markets have a way of resonating disproportionately (the names of Enron and Bre-X endure in the public consciousness, and can create profound investment chills in their wakes). Think about YouTube clips of skateboard stunts on steep flights of stairs; what do people watch more and remember better, the one out of 50 that makes it down standing or the one with the biggest yard sale?

The concept of crowdfunding is a fact in the U.S., and is under active discussion elsewhere, and Canada doesn't want to fall behind. Canadian companies are competing for capital and we should be making sure they have as many opportunities as their counterparts abroad. But we should look before we leap to join the mob.

If we do go that way, we should not forget to use a catchy name; how can one be opposed to an initiative with a name like the JOBS Act (it's like motherhood, which is ironic because each of our mothers counselled us not to do things just because others in the crowd did)? My working name for a parallel Canadian initiative is the "We Are So Good Looking Act." Though I fear with each passing day I may be in increasingly flagrant breach of such a statute, I think that the name will appeal. So much so that I think I will raise some money for it, though I have no plan on how to make money from the idea. If everyone contributes just a little, then maybe there's no harm. ■

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