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Crowdfunding Startups

By Conor Cronin

On April 5, 2012, US President Obama signed into law the Jumpstart Our Business Startups (JOBS) Act. The JOBS Act includes the CROWDFUND Act. Crowdfunding is an innovation in equity financing which many believe will change the way startups are financed. The CROWDFUND Act will allow businesses to solicit large numbers of investors for small amounts of capital in exchange for equity in the business. Crowdfunding is an attractive alternative to traditional means of selling equity to the public because the business soliciting investment does not need to go through the expensive and timely processes security regulators require for public offerings. Startups and entrepreneurs can exploit their social networks to find small investors interested in their project. It allows a startup to attract a wide pool of small investors with fewer restrictions. Change in the US has Canadian entrepreneurs calling for similar reforms to Canada's securities regulations. Canadian investors and entrepreneurs, however, should be wary as crowdfunding, though gaining popularity, may not be appropriate for everyone.

Crowdfunding portals, such as Kickstarter and Indiegogo have made headlines recently for a number of projects that have raised millions of dollars from tens of thousands of donors within a short period of time. Currently, investors on these sites are not given equity. Instead, investors receive promotional items or a unit of the product to which their funds have contributed to developing. Their investments are considered donations. Kickstarter is exclusively for projects such as new technologies, mobile device apps, video games, and even food and movie production. Other sites have had success crowdfunding for charities and other causes.

Advocates for crowdfunding argue that small businesses and startups cannot raise enough capital to get off the ground in today's economic climate. Venture capital levels in Canada, though increasing, remain well below their historic high 2001 levels. Furthermore, today's technology makes crowdfunding possible and, from an investor's perspective, safer than ever before. More and more people interact online through social networks like Facebook, LinkedIn, and Twitter. Through these networks, businesses should be allowed, it is argued, to connect with likeminded people interested in an alternative method of investing their money into something about which they care.

All crowdfunding in the US must be conducted through funding portals; it is not as simple as going online to solicit investment. The JOBS Act limits the amount an unaccredited investor can invest through a crowd and requires funding platforms to collect a company's financial disclosure. This information, along with a warning regarding the possible dangers of investing with the crowd, is made available to potential investors. However, some fear that even with limitations put in place there are significant opportunities to perpetrate fraud. The reforms necessary to make crowdfunding possible involve removing investor protections that have been in place since the 1930s. Investing



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in a startup is also riskier than other investments; a reality some members of the public may not appreciate.

Crowdfunding is not legal in Canada. Implementing changes across Canada would require reform to the rules of 13 different security commissions. Without a national securities regulator it is unlikely that change will come quickly enough to keep pace with industry's demand for innovation. Reform in even the largest provinces would not attract enough investors to have the game changing effect many expect in the US. Some fear that Canadian entrepreneurs may move to the US to take advantage of crowdfunding despite that country's weaker economic outlook and higher corporate taxes. For now, Canadian startups and entrepreneurs will have to rely on traditional methods in order to raise the capital they need.

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