

Crowdfunding and Prosperity in Ontario



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SPECIAL THANKS TO:
CRAIG ASANO
NCFA
NATIONAL
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ASSOCIATION OF CANADA

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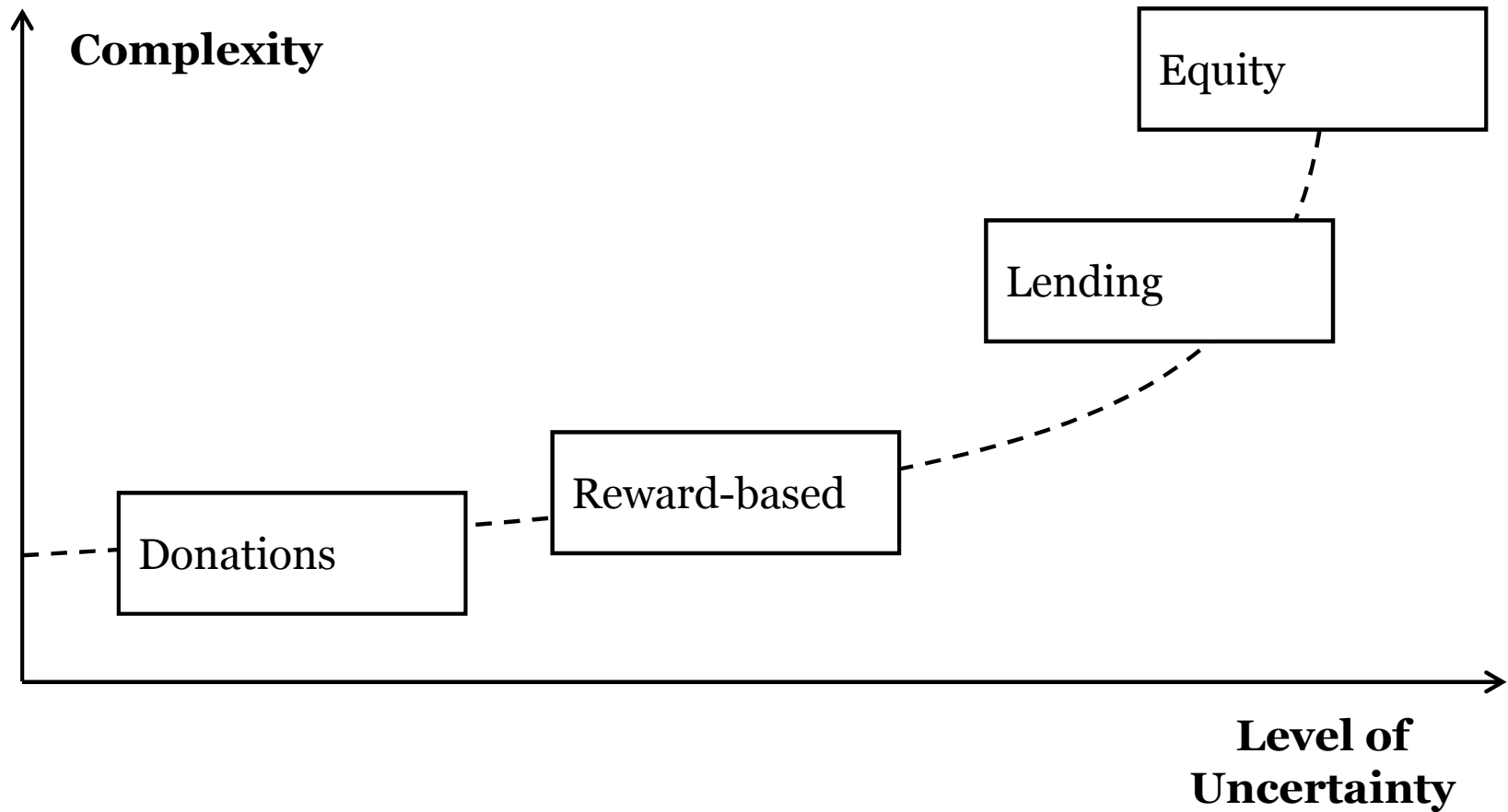


What is Crowdfunding?



- Crowdfunding is an umbrella term used to describe an increasingly widespread form of fundraising whereby groups of people pool money, typically (very) small individual contributions, to support a particular goal
- Equity crowdfunding is a form of equity financing in which entrepreneurs make an open call for funding on the Internet (online platform), hoping to attract a large group of (small) investors
- Online platforms (e.g., Crowdcube) provide the means for the transactions (the legal groundwork, pre-selection, the ability to process financial transactions, etc.)

Complexity and Uncertainty of Crowdfunding Business Models



Who Cares About Crowdfunding?



- “Ontario examines ways to loosen [equity] crowdfunding rules”
 - The Globe and Mail, Nov. 29 2012
- “Regulators struggle with crowdfunding model...”
- “Ontario looked upon as key to setting pace...”
- “Using our existing regulatory framework to deal with something like equity crowdfunding is like trying to jam a round peg into a square hole”
 - Lawyers’ Weekly, April 19 2013 issue
- National Crowdfunding Association of Canada
 - <http://ncfacanada.org/>
- Jumpstart Our Business Startups (JOBS) Act in 2012 in the United States

Why Care about Crowdfunding?



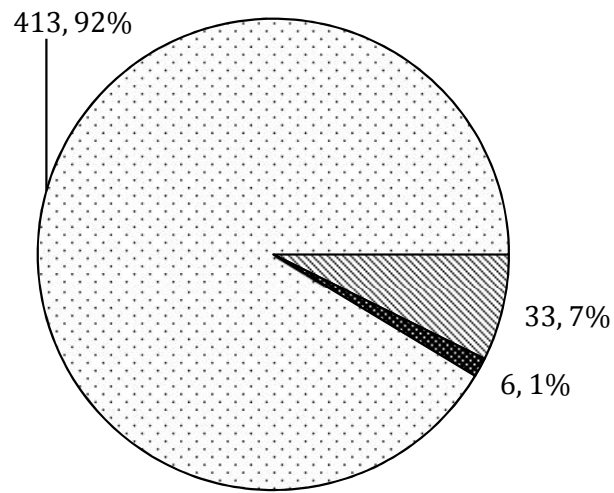
- **Crowdfunding raised US\$2.7 billion in 2012:**
 - US\$1.6 billion in North America
 - US\$945 million in Europe
 - US\$110 million in the rest of the world.
- **Crowdfunding expanded at a 63% compound annual growth rate (CAGR) from 2009 through 2012.**
 - Equity-based platforms exhibited a CAGR of 114%
 - Lending-based platforms 78%
 - Donation-based 43%
 - Reward-based 524%.

THE NUMBER OF CROWDFUND INVESTING PLATFORMS IN SELECTED COUNTRIES, 2012

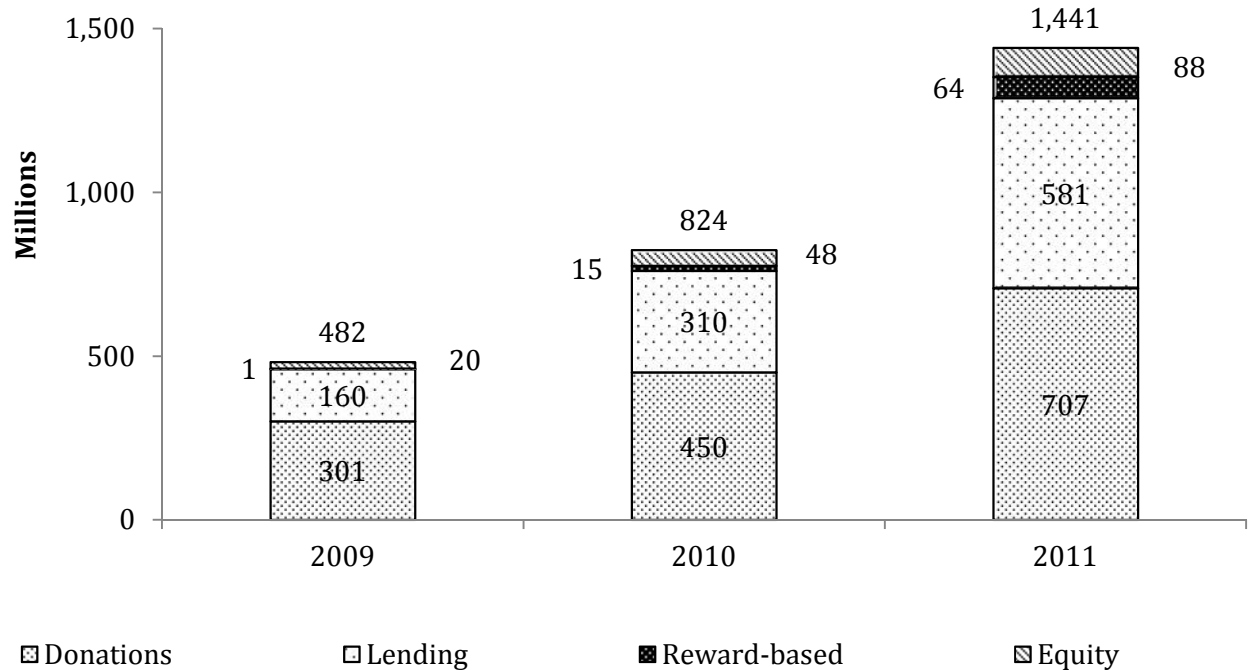


United States	344
United Kingdom	87
France	53
Netherlands	34
Canada	34
Spain	27
Germany	26
Brazil	17
Italy	15
Australia	12
India	10
South Africa	4
Russian Federation	4
Hong Kong	1
China	1
United Arab Emirates	1
Estonia	1
Belguim	1

Number and Volume of Crowdfunding Platforms by Type, as of April 2012



- ▣ Equity (business financing)
- ▣ Equity (other)
- ▣ Other crowdfunding platforms



- ▣ Donations
- ▣ Lending
- ▣ Reward-based
- ▣ Equity

Some Research Questions



1. Does equity crowdfunding “work”? What determines success?
2. Will the equity crowdfunding market (entrepreneurs, investors, portals, regulators) move to maximize the quality of the market (race-to-the top), or maximize self interests (race-to-the bottom)?
3. What do the results to questions [1] and [2] imply for entrepreneurship and economic prosperity in Ontario?

Research Question 1: Does equity crowdfunding “work”?



**WHAT DETERMINES SUCCESS IN EQUITY
CROWDFUNDING?**

**BASED ON A PAPER PREPARED WITH
GERRIT K.C. AHLERS, CHRISTINA GÜNTHER
AND DENIS SCHWEIZER**

Motivating Examples



- **Two contrasting London-based crowdfunding cases:**
- In December 2011, The **Rushmore Group**, a start-up that now operates **three bars in London**, sold **10% of its equity for £1,000,000** to **143 small investors** through Crowdcube. The aspiring entrepreneurs of The Rushmore Group accomplished this feat in a little over **two weeks**
- In early April 2012, another owner and **operator of a London bar, Meatballs**, offered a **25% equity stake for £300,000** on Crowdcube. **Two months after** the start of the offering, they had **raised only £4,750**
- **What went wrong?** Same service, same city, presented in the same fashion and on the same online platform...
- ***Given different start-ups with similar observable characteristics, what leads small investors to invest in certain start-ups and not in others?***

Research Hypotheses



H1

IPO and trade sale as exit channels are favored by investors over other exit channels

- IPOs and trade sales realized the highest returns for investors, compared to other exits

H2

Awards, gov. grants and granted patents foster capital contributions by investors

- External (costly for founders) quality assessments

H3

More staff / # board members / higher share of non-executive directors, will positively impact funding success

- Costly signals indicating founders effort level

Research Hypotheses—*continued*



H4 Stage of maturity is positively associated with the funding success

- Time and money founders devoted to building the company and gained in experience

H5 Higher equity offerings negatively affect the funding success

- Founders retain only a “substantial” stake if they expect future cash flows to be *high*

H6 Omission of providing a disclaimer and financial forecasts negatively affects the funding success

- No disclaimer and no financial forecasts increases the risk of ambiguous information

Data Collection

- ASSOBS (Australian platform) has been in business since 2006
- With AUD 125 million funded as of April 2012, it is also the equity crowdfunding platform that has raised the largest total amount of capital
- All start-ups in our sample (104) and start-ups that actually received funding (67)

		2006	2007	2008	2009	2010	2011	Total
Crowd Fin. Volume		3,540 AUD	1,222 AUD	6,708 AUD	5,581 AUD	11,864 AUD	4,216 AUD	33,131 AUD
Crowd Fin. Count		1	3	15	12	26	10	67
Crowd Fin. Volume	< \$ 500,000	0 AUD	90 AUD	2,345 AUD	1,552 AUD	4,621 AUD	1,552 AUD	10,159 AUD
	\$500,000 - \$1million	0 AUD	1,132 AUD	1,150 AUD	1,615 AUD	2,777 AUD	1,564 AUD	8,238 AUD
	\$1 - \$2million	0 AUD	0 AUD	1,200 AUD	2,415 AUD	4,466 AUD	1,100 AUD	9,180 AUD
	> \$2 million	3,540 AUD	0 AUD	2,014 AUD	0 AUD	0 AUD	0 AUD	5,554 AUD
Crowd Fin. Count	< \$ 500,000		1	11	7	19	7	45
	\$500,000 - \$1 million		2	2	3	4	2	13
	\$1 - \$2 million			1	2	3	1	7
	> \$2 million	1		1				2

Summary Statistics

	# Observation	Mean	Std	Min	Max
<i>Dependent Variables</i>					
Funding Amount	104	318,568 AUD	515148.7	0 AUD	3,540,473 AUD
Number of Investors (without Founders)	104 (104)	7.52 (7.09)	12.05 (9.58)	0 (0)	88 (57)
Duration of First Financing Round (if successfully funded)	92 (19)	317.72 (135.37)	104.81 (106.31)	7 (7)	374 (374)
<i>Capital Market Roadmap</i>					
Most Likely Exit-IPO	104	.48	.50	0	1
Most Likely Exit-Trade Sale	104	.48	.50	0	1
Years to Planned Exit	104	3.86	1.15	1	7
Target Funding	104	1,778,799 AUD	1,421,268 AUD	300,000 AUD	5,000,000 AUD
<i>External Certification</i>					
Award	104	.17	.38	0	1
Government Grant	104	.019	.14	0	1
Patent	104	.20	.40	0	1

Success Determinants of Crowdfunding Projects Measured by Absolute Funding Amount

	Specification 1			Specification 2			Specification 3		
	Coefficient t	Beta	t- Value	Coefficient t	Beta	t- Value	Coefficient t	Beta	t- Value
(1) Constant	.419		1.63	.378		1.41	-.038		-0.10
	Capital Market Roadmap								
(2) Most Likely Exit-Trade Sale	-.112	-.109	-1.26	-.124	-.121	-1.40	-.094	-.091	-0.91
(3) Most Likely Exit-Others	-.006	-.002	0.02	-.056	-.021	-0.19	.006	-.002	-0.02
(4) Years to Planned Exit	-.058	-.129	-1.29	-.053	-.118	-1.18	-.030	-.068	-0.66
(5) Target Funding	.051	.140	1.27	.052	.144	1.21	.022	.060	0.54
	External Certification								
(6) Award				.060	.044	0.49	-.074	-.055	0.59
(7) Government Grant				.265	.071	0.66	.112		.32
(8) Granted Patent				.067	.052	0.71	.080		.74
	Board Experience								
(9) # Board							.126*	.249*	1.93
(10) # Staff							.004	.101	1.32
(11) % Board MBA							-.002	-.047	-0.55
(12) % Non-Executive Board Members							-.003	-.124	-1.38
(13) Years in Business							-.008	-.075	-1.01
	Risk Level								
(14) Equity Offering	-.003	-.071	-0.63	-.004	-.100	-0.96	-.002	-.055	-0.58
(15) Disclaimer x No Financial Forecast	-.148	-.105	-1.00	-.135	-.095	-0.90	.041		.25
(16) No Disclaimer x No Financial Forecast	-.233**	-	-2.59	-.227**	-	-2.46	-.206**	-	-2.07
(17) Intended Number of Rounds	.131*	.151*	1.87	.137*	.157*	1.86	.078	.090	1.01
Year Fixed Effects	YES			YES			YES		
Industry Fixed Effects	YES			YES			YES		
Big City Fixed Effects	YES			YES			YES		

H3 ✓

H6 ✓

Economic Significance Absolute Funding Amount

• **H3: Number of Board**

- An additional board member increases funding amount by 39.6% relative to the average amount raised

• **H6: No Disclaimer x No Financial Forecast**

- 1 Std Dev Increase: Reduces funding amount by 34.7% related to the average amount raised

• **H2: External certification**

- Insignificant
- Possibly due to fact that having external certification means you should have had the ability to go elsewhere to raise money such as from a VC!

Determinants of the Speed of Capital Allocation

	Specification 1		Specification 2		Specification 3	
	Coefficient	z-Value	Coefficient	z-Value	Coefficient	z-Value
(1) Constant	-15.440***	-4.56	-14.612***	-3.86	-21.1851***	-3.15
	Capital Market Roadmap					
(2) Most Likely Exit-Trade Sale	.848	1.07	-.934	1.02	-1.194	1.35
(3) Most Likely Exit-Others	-.273	-0.18	-.354	-0.21	-.734	-0.38
(4) Years to Planned Exit	-.377	-1.17	-.461	-1.18	-.456	-1.03
(5) Target Funding	-.073	0.26	-.033	-0.09	-.034	-0.09
	External Certification					
(6) Award			.453	0.57	.429	0.53
(7) Government Grant			-1.380	-0.56	-2.062	-0.81
(8) Granted Patent			-.154	-0.19	-0.954	-1.01
	Board Experience					
(9) # Board					.676	H3 ✓
(10) # Staff					-.101	-0.76
(11) % Board MBA					.095*	1.84
(12) % Non-Executive Board Members					.006	
(13) Years in Business					.209**	H5 ✓
	Risk Level					
(14) Equity Offering	-.146***	-3.29	-.141***	-3.07	-.166***	-2.00
(15) Disclaimer x No Financial Forecast	-.450	-0.49	-.672	-0.67	.725	-0.26
(16) No Disclaimer x No Financial Forecast	-2.170***	-2.71	-2.286**	-2.45	-3.325***	-3.32
(17) Intended Number of Rounds	1.407*	1.87	1.384*	1.77	2.848**	2.44
	Fixed Effects					
(18) Parcel Size	>.000***	3.31	>.000***	2.95	>.000***	3.31
(19) Share Price	-4.871	-1.55	-3.815	-1.10	-.989	-0.26
Year Fixed Effects	YES		YES		YES	
Industry Fixed Effects	YES		YES		YES	
Big City Fixed Effects	YES		YES		YES	

H3 ✓

H5 ✓

H6 ✓

Economic Significance Speed of Capital Allocation

- **H3: # Board MBA**
 - An extra board member increases expected speed of capital allocation by a factor of 1.1
- **H5: Equity Offering**
 - An extra percentage of equity offered reduces expected speed of capital allocation by a factor of 0.19
- **H6: No Disclaimer x No Financial Forecast**
 - A 1-standard deviation increase reduces expected speed of capital allocation by a factor of 0.04
- **H2: External certification**
 - Insignificant
 - Possibly due to fact that having external certification means you should have had the ability to go elsewhere to raise money such as from a VC!

Summary of Main Results



- Investors in equity crowdfunded projects respond to voluntary disclosure
 - ...financial roadmaps (such as preplanned IPO or acquisition exit strategies)
 - ...risk factors (such as amount of equity offered and whether financial forecasts are provided)
 - ...board experience, measured by education level (e.g., percentage with MBA degrees), and number of board members
- Crowdfunding market operates in a largely rational manner, but regulator should focus on disclosure requirements and portal due diligence

Question 2. Is crowdfunding a 'race-to-the top'?



BASED ON A PAPER WITH SOFIA JOHAN

**AND DATA COLLECTED BY THE NATIONAL
CROWDFUNDING ASSOCIATION OF CANADA**

SPECIAL THANKS TO CRAIG ASANO

How do stakeholders view crowdfunding in Canada?



- Are there differences in the views about how to mitigate risk in crowdfunding across:
 - - those that would be portals,
 - - investors (accredited and otherwise),
 - - start-up entrepreneurs,
 - - different provinces,
 - - the intended reasons for seeking crowdfunding participation?

Competing Predictions



- **H1: Race to the bottom**
 - Stakeholders design or pick legislation that maximizes agency problems
- **H2: Neutral / Uniformity**
 - Stakeholders interest unrelated to legislative preferences
- **H3: Race to the top**
 - Stakeholders design or pick legislation that minimizes agency problems
- **Related literature on Incorporation Decisions**
 - U.S. Delaware
 - ✦ Romano (1985 JLEO), Daines (2002 JFE): Race to the Top
 - Canada
 - ✦ Cumming and MacIntosh (2000, 2002 IRLE): Neutral / Uniformity

Data



- Online survey distributed to potential investors (accredited and otherwise), investees (start-up entrepreneurs), portals, service providers
- Across Canada
- National Crowdfunding Association of Canada (NCFA)
- First quarter of 2013
- 144 responses

Key Outcome Variables



- Should any Crowdfunding exemption in Canada be approved on a trial or limited basis at first?
- What measures, if any, would be the most effective at reducing investor risks and the potential for fraud?
 - Education for issuers and investors
 - Limits on the total amount raised by an issuer and on individual investment size
 - On-going continuous disclosure requirements
 - Prohibiting advertising or sales solicitation except by an authorized portal and issuer's website
 - Portals required to do background checks of each officer, director and significant shareholders of issuers selling securities on its portal
 - Purchasers are provided with a rescission/redemption right within a certain number of days
- Should Crowdfunding securities be free-trading securities after a period of time?
 - And when should they be eligible for secondary market trading?
- What is the maximum amount of capital an investor should be able to invest in any 12-month period?
- What is the aggregate amount of capital that an issuer should be able to raise in any 12-month period?
- What is the appropriate capital threshold where audited financial statements should be required?

Key Explanatory Variables



- **What do you believe would motivate an investor to make an investment through Crowdfunding?**
 - Financial Incentives
 - Non-Financial Incentives
 - Diversification of Portfolio
 - Gain a direct channel to entrepreneurs and owners and in a transparent way
 - Networking opportunities within the start-up and the SME community
 - Support entrepreneurship and the development of innovative products/services

- **Are you familiar with the term Crowdfunding?**

- **Please select a stakeholder category that best represents you:**
 - potential portal
 - non-accredited investor
 - accredited investor
 - accredited institutional investor
 - investment dealer
 - portfolio manager
 - exempt market dealer

- **Please select a province/territory - Province/Territory – Alberta, Ontario, British Columbia, Quebec, etc.**

Summary of Main Findings



- **Need more onerous regulation for those that**
 - Have financial Incentives for crowdfunding
 - Want to support the entrepreneurial community**Race to the Top (H3)**
- **Need less onerous regulation for those that**
 - Have non-financial incentives for crowdfunding
 - Want direct access to entrepreneurs and networks**Race to the Top (H3)**
- **Differences depending on ways folks will participate**
 - Start-ups want fewer limits on amounts they are allowed to raise
 - Portals want less disclosure and shares to be freely tradable
 - Investors want more regulation, such as more disclosure, limits on amount entrepreneurs can raise, and lower thresholds for audited financial statements**Race to the Bottom (H1)**
Race to the Top (H3)
- **Some regional differences**
 - Alberta respondents want redemption rights
 - BC respondents wants less regulation, such as regulation on investment limits, disclosure and advertising
 - Ontario and BC want shares freely tradable after a longer period of time**Some Preference for Non-Uniformity (H2)**
No apparent reason to not have the provinces compete to offer the best rules

Question 3: What are the economic implications of crowdfunding for Ontario?

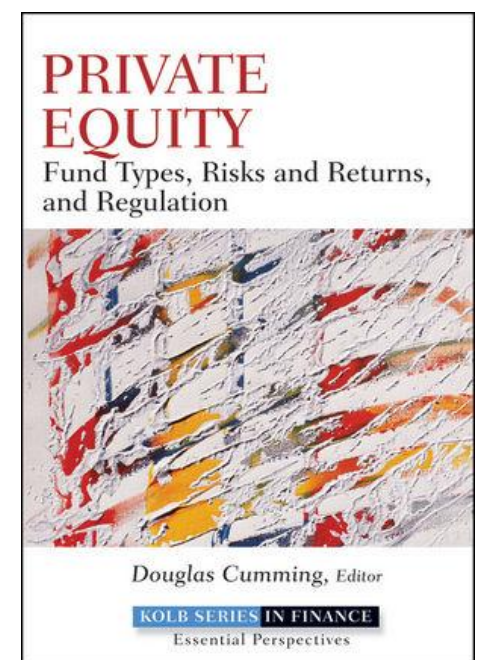
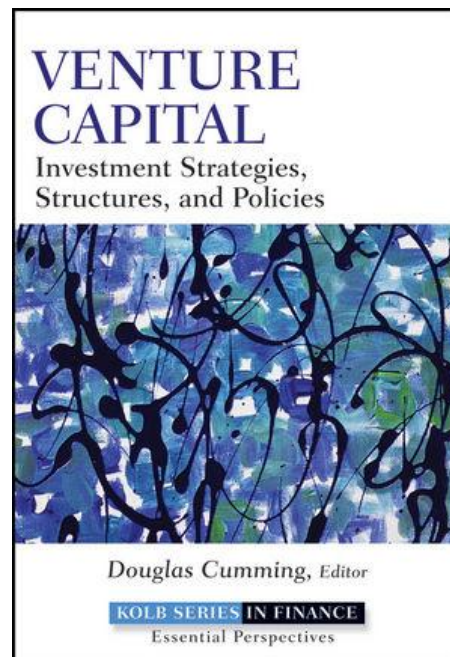
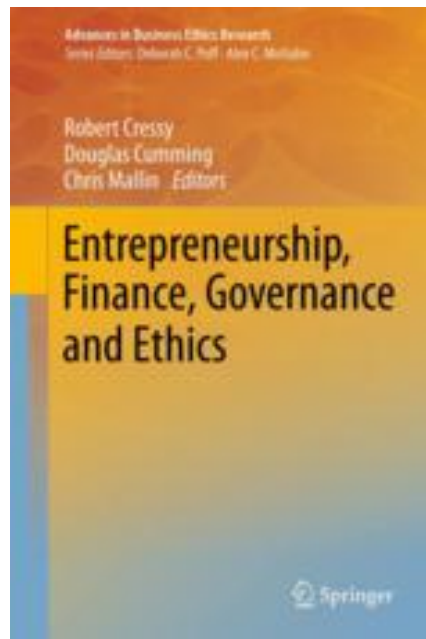
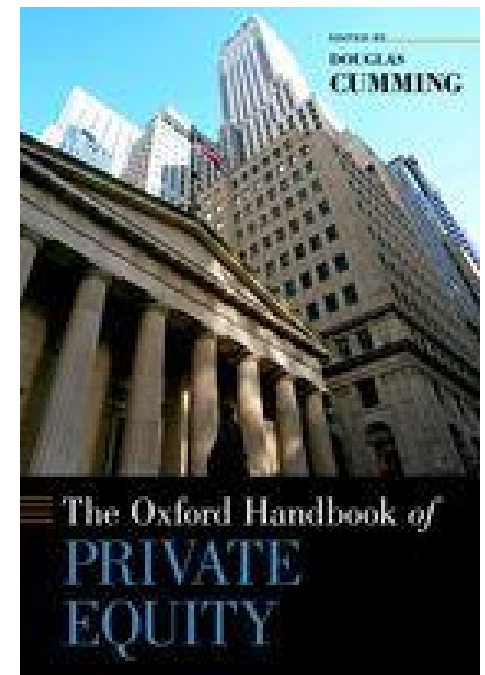
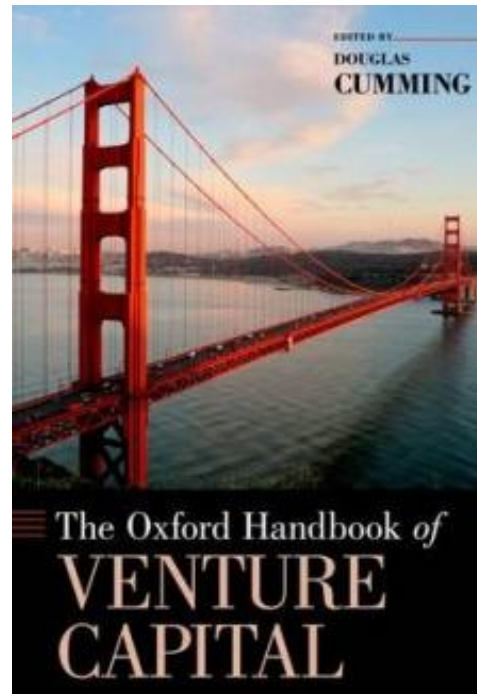
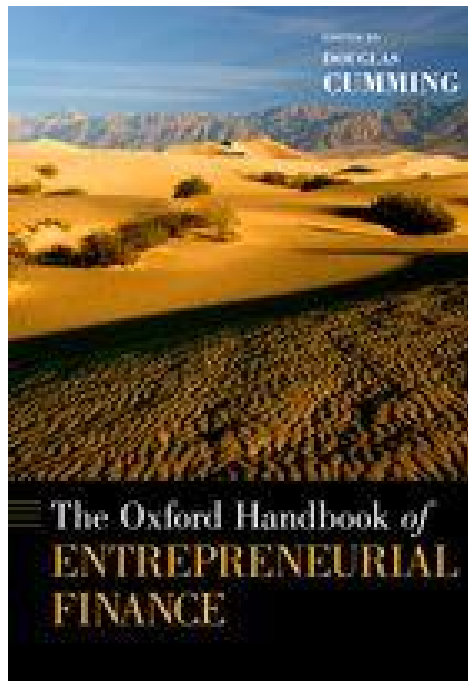


**WITH REFERENCE TO THE ISSUES
ADDRESSED IN QUESTIONS 1 AND 2...**

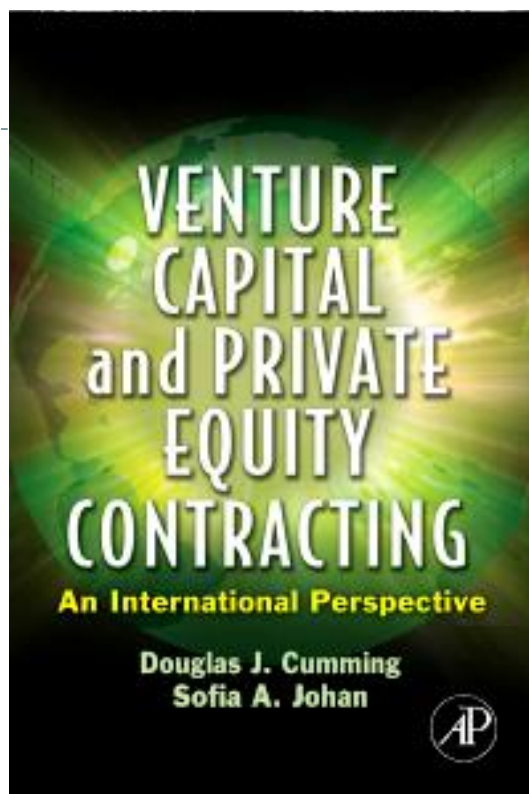
Implications



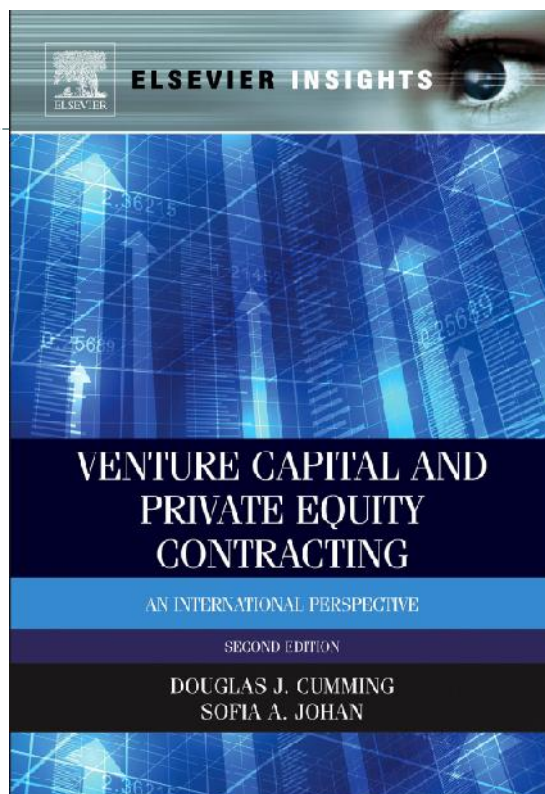
- Crowdfunding markets appear to work well in terms of rational investors, motivated entrepreneurs, and responsible portals
 - Even equity crowdfunding
 - Empirical evidence from Canada and Australia
- Crowdfunding is becoming huge
 - <\$500m in 2009
 - >\$3billion in 2013
- Equity crowdfunding is coming to Ontario (& other provinces)
 - Ontario Securities Commission
 - Changing landscape
 - Opportunities for entrepreneurs



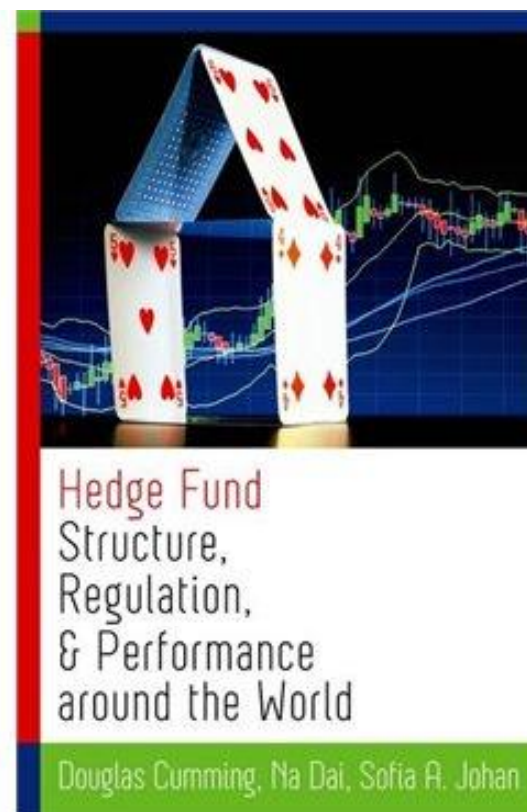
Further reading...



Elsevier
Science
Academic
Press
2009
778pp



Elsevier
Science
Academic Press
2nd Ed.
2013
756pp
In stores as of
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Oxford
University
Press
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300pp

More further reading...

Thank You!



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