July 22, 2015

Accredited Investor Markets (AIMkts)™

Crowdfunding

New Crowdfunding Rules Fuse Capitalism with Social Networks

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Posted: 07/22/2015

With Title II of the JOBS Act in place and the ban on general solicitation repealed for investments from accredited investors, a new era in raising capital from "friends, family and fools" has emerged. For the first time in the nearly 80 years since the SEC rules were written, it is now legal to stand up in a room full of people, even complete strangers, and tell everybody about your company and how to invest.

Numerous portals are springing up to accept investments from accredited investors in support of this new business model. As long as the investor is verified as accredited (i.e. earning $200,000 or more in annual revenue, or having net worth of $1 million, excluding personal residence), an entrepreneur can now engage in public advertising, also known as general solicitation. In much the same way that millions of people watch the popular TV show "Shark Tank," it is now possible to remove the legal disclaimers that the program is for educational or entertainment purposes only. Under Title II, these same programs can be used to direct individuals to a web portal for the express purpose of making an investment.

Of course, qualifying as an accredited investor is still a designation limited to 3 percent of the U.S. population. This means that Title II investments are out of reach for most Americans, with the accredited investor pool lacking both gender and racial diversity. A debate is now ongoing among regulators about the accredited investor threshold, along with new rules under Title III of the JOBS act, which may open investing in private securities offerings to non-accredited investors. The outcome of this conversation will influence the direction of the crowdfunding industry.

Until Title III rules are finalized, some established investment banks and broker dealers are using Title II to set up portals that simply replicate their existing business models without any real innovation. At a high level, a typical investment bank will already have relationships with hundreds, if not thousands, of accredited investors and bring vetted investment opportunities to those individuals. Setting up a website to automate the process of displaying investments and collecting dollars is really nothing more than a digital representation of an analog process.

It's a bit like the first websites on the Internet. The commonly accepted term "brochureware" became an inside joke that meant a marketing department simply took its paper-based brochure and made an HTML version of the same static content so that a website box could be checked off as completed. Those brochure-based websites failed to capture the innovation made possible by the new medium, including hyperlinks, embedded videos and dynamic content.

The next generation of crowdfunding portals will do more than just publish investment opportunities and collect dollars. Coming soon to a browser near you is an experience that will engage social media and personal connections to leverage relationship-based portfolios. Portals are beginning to experiment with more innovative approaches that facilitate "viral-like" campaigns. Investment opportunities may fly through the Internet with the same speed as cat videos and selfies.

Two very important questions will be explored by this new paradigm:

- Will investors be better at picking investments because they know the entrepreneur (i.e. friends or family)?
- Will the entrepreneur perform better because he or she knows the investor (i.e. friends or family)?

It is often said that people should invest in what they know. Doctors often participate in life science investments. IT professionals like to invest in technology companies. What about investing in whom you know? If a friend wants to start a scuba diving school and you know that he is a talented diver with strong business acumen, are you more likely to invest? Does knowing the entrepreneur necessarily translate into a stronger return? How about the perspective of the entrepreneur? Is an entrepreneur more likely to be a good steward of dollars invested from people he or she knows?

It’s true that you’ll only have one chance at soliciting dollars from your social network. If you burn that bridge, it’s not likely that you’ll be able to go back to the same well any time soon. This is different from the snake oil salesman of yesteryear who traveled from city to city. In the Internet era, your history follows you no matter where you are.

All of these questions are soon to be answered, as early adopters of equity-based crowdfunding are in an age demographic that is just now graduating from college. This will be the generation that isn’t satisfied with checking one of five predefined investment strategy boxes in a generic 401(k) portfolio signup. Members of this generation trust their social network more than Wall Street and won’t think twice about borrowing money from a peer instead of a bank — or a credit card company. It’s a new ballgame for capital formation, and when it comes to crowdfunding, we’re only in the top of the first inning.

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