Crowdfunding is the convergence of social media, Big Data, and cloud technologies to significantly revolutionize the means by which small and mid-sized entities (SMEs) and start-ups can access capital in a cost-effective manner. The use of this new channel of funding will impact management accountants around the world who serve the SME and start-up marketplace.

There are at least four types of crowdfunding platforms: (1) Donation-based crowdfunding, where backers essentially donate money to support a cause but don’t get anything in return; (2) rewards-based crowdfunding, where the backer receives a reward, such as a pre-purchase of a product or service, in exchange for the pledge; (3) credit-based crowdfunding (or peer-to-peer lending), where the backer loans the money in exchange for an interest rate — money is usually pledged in the form of a credit loan; and (4) equity-based crowdfunding, where the backer gets an equity investment (i.e., a return on his or her investment) in exchange for the money pledged.

**New Gold Rush**

Through the passage of the Jumpstart Our Business Startups (JOBS) Act in 2012, policy leaders and members of Congress have recognized the nexus of social media, cloud computing, and Big Data technologies and the rise of crowdfunding as an opportunity to expand the reach of capital to assist the underserved SME marketplace. The law is designed to create cost-effective access to capital to facilitate expansion of small business and jobs through crowdfunding. Crowdfunding offers SMEs a new, cost-effective mechanism to raise funds to support their business expansion, and it provides investors with protection from fraudsters through both proactive education and appropriate regulation by the government. Crowdfunding also diversifies risk and challenges the “too big to fail” business model for capital allocation in the United States.

Crowdfunding isn’t about a primary company or a primary, single crowdfunding platform. It’s about creating a new, exciting, dynamic mechanism for allocating capital from traditional, institutional stakeholders (such as banks) to individual-driven operations using current and future technologies to touch millions of individuals looking for investment opportunities. This evolutionary process of capital allocation follows the same type of historical development that other disruptive business models have followed, such as PayPal, Amazon, and iTunes.

**Status of Crowdfunding in the U.S. and Abroad**

The evolution of crowdfunding is happening on a global basis. Outside the U.S., crowdfunding has been approved by governments across the world, from Australia to the United Kingdom, and is rapidly expanding. In Europe, where crowdfunding is allowed and regulated by securities authorities, we’re starting to see the impact on the SME marketplace.

Peter Almberg, director and CEO of Sweden-based GXG Global Exchange Group AB and owner of Danish-authorized GXG Markets A/S, said, “Algorithms and software/hardware technology related to ‘high-frequency trading’ has exploded over the last 20 years, and the primary beneficiary has been the market for existing shares and other financial instruments (secondary market). Consequently, transaction costs on the secondary market have come down more than 90% over the last 20 years. For the primary market (issuing of new
stock and IPOs (initial public offerings)), costs have remained the same. But now with crowdfunding and new technologies such as cloud computing—we’re starting to see a shift in the primary market. The result is the cost of funding is being lowered—especially targeted to the SME marketplace, which is reaching a previously underserved market.”

In October 2013, the U.S. Securities & Exchange Commission (SEC) issued proposed rules to create a regulatory mechanism to support crowdfunding based on the JOBS Act. Currently the SEC is reviewing comments related to the proposed rule and is expected to issue a final rule soon. Key provisions of the proposed rule include:

◆ A company would be able to raise a maximum aggregate amount of $1 million through the crowdfunding offerings in a 12-month period.

◆ Over the course of a 12-month period, investors would be subject to limited investing. The limit would be the greater of $2,000 or 5% of annual income or net worth if the investor’s annual income or net worth is less than $100,000. Investors with an annual income or net worth of $100,000 or more could invest 10% of their annual income or net worth, with the investment not to exceed $100,000.

◆ Non-U.S. companies, companies that already report to the SEC, certain investment companies, companies that have failed to comply with the annual reporting requirements in the proposed rules, and companies that have no specific business plan or have indicated their business plan is to engage in a merger or acquisition with an unidentified company or companies are all ineligible to use the crowdfunding exemption.

◆ Securities purchased in a crowdfunding transaction can’t be resold for a period of one year.

◆ Companies conducting a crowdfunding offering would be required to disclose: information about officers and directors as well as owners of 20% or more of the company; a description of the company’s business and the use of proceeds from the offering; the price to the public of the securities being offered and certain related-party transactions; and financial statements prepared in accordance with U.S. Generally Accepted Accounting Principles (GAAP).

Visit the SEC’s website to view complete provisions of the proposed rule.

According to Stock-Trading-Warrior.com, when online trading was introduced in 1991, only 5% of the U.S. population invested in publicly traded securities. By the mid-1990s, more than 20% of the U.S. population was engaged in the investment of public securities. Following in the footsteps of e-commerce, the rise of social media, Big Data, and cloud computing, crowdfunding creates new efficiencies in the capital markets, using new technologies to “lower the barrier” for SMEs and the start-up marketplace to fund opportunities for growing segments of the economy not reached by traditional outlets and to create new jobs. Management accountants will play a significant role in the crowdfunding marketplace by helping SMEs and start-ups prepare and participate in this new, dynamic, technology-based business model. SF

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