Crowdfunding: Devil in the Details

Crowdfunding is part of a general movement to facilitate financing for new companies. Indeed, in today's economic climate, there clearly is a need for new ventures to be able to reach out to communities and stakeholders to raise capital through any legitimate method. Unfortunately, the proposed Senate Bill S.1791, imposes requirements that prevent organizations from going directly to the community. An obstacle that undercuts the philosophy of crowdfunding that the Bill is supposed to promote.

S.1791 creating definitions, imposing obstacles

On its face, Senate Bill S.1791 opens the door to crowdfunding websites. The Bill defines key features of crowdfunding such as the limits on the amount a company can raise ($1 million) and the limits on how much an individual can invest ($1,000) in any particular endeavor. Neither factor is particularly controversial and the goal of the Bill, to make it easier to raise money, would appear to be a success. S.1791, however, includes a separate clause, Section 7, that limits the ability of organizations to raise money directly from their local community because it requires a third-party intermediary.

Section 7 appears innocuous enough, if legalistic. It simply adds crowdfunding *intermediaries* to the list of exemptions from SEC rules regulating the issuance and sale of securities. As a rule, this appears helpful because websites such as IndieGoGo and Kickstarter would be allowed to facilitate sales of shares in small companies to provide long-term working capital; rather than being limited to short-term project-by-project capital campaigns. But Section 7's definition implicitly creates a new hurdle as well: the strict definition of intermediaries gets in the way of an organization going *directly* to the community.

Creative financing

It is important to remember that crowdfunding is not limited to IndieGoGo or Kickstarter, there are other methods of crowdfunding that are just as useful. Section 7 creates problems by basing the exemption strictly on this model of a third-party website. By doing so, the Bill requires entrepreneurs to register with a third-party entity that may not be in their best interests. It also forces entrepreneurs to incur more costs, spend more time on raising money, and might prevent them from raising money directly from their local community.

For instance, the SF Gate recently posted an article describing how crowdfunding campaigns were benefiting local Bay Area businesses. The article focused on the power of websites such as IndieGoGo and Kickstarter, but hidden within the article is the story of one entrepreneur forced to engage in a financing campaign that violated SEC rules. In this case, the entrepreneur wanted to fund his startup directly from his community, so he sold a small amount of discounted goods for his then non-existent business to raise capital with the community. S.1791 as proposed, however, would not make this process easier. In fact, it would only serve to increase the challenges to starting his business, because he would still need to register with an intermediary.

Going forward

S.1791, and related proposed legislation, is a step in the right direction. Anything that makes it easier for new ventures to raise money is a positive. But the hidden clauses, definitions, and restrictions these laws can create, such as Section 7, can be just as harmful. There are many methods to create successful crowdfunding platforms; legislation should support as many forms as possible, especially when entrepreneurs are seeking support directly from their local community.