

# Crowdfunding: Perspectives and Prospects

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Based on a panel discussion featuring Christopher Charlesworth, Murray Metcalfe, Tonya Surman, Verki Tunteng & Dilip Soman.

Transcribed and edited by Cindy Quan

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## 1. Introduction

Researchers at the India Innovation Institute at the University of Toronto are developing a research agenda that identifies and studies elements that constitute an effective innovation system. An important factor that supports and nurtures innovations is the existence of adequate financing. Crowdfunding is a new approach to obtain necessary funding for start-ups. The term crowdfunding refers to the aggregation of small amounts of capital from a large number of people - usually over the internet - that is directed to specific projects or companies. This approach has resulted in start-up financing of more than \$1.5 billion globally in 2011.<sup>1</sup>

This form of collective financing is gathering much momentum in India recently with the successful launches of crowdfunding portals such as Pik A Venture, Catapoolt and Ketto. To help entrepreneurs understand the increasingly popular crowdfunding option, we produced a report entitled "Is Crowdfunding Right for You?"<sup>2</sup> After the release of the report, the India Innovation Institute partnered with the Rotman School of Management to continue exploring the implications and opportunities of this rapidly growing sector via a panel on Tuesday, March 5th 2013.

Four speakers drawn from academia and the business community have brought multiple perspectives on the topic. The four speakers were; Christopher Charlesworth; the cofounder of Hivewire.ca, an online crowdfunding portal; Murray Metcalfe, Professor of Globalization in the Faculty of Applied Science and Engineering at the University of Toronto; Tonya Surman, a social entrepreneur and founding executive director and CEO of the Centre for Social Innovation; and Verki Tunteng, an associate in Heenan Blaikie's Business Law group. The panel covered various aspects of crowdfunding, starting from its conceptual definition, critical success factors, conditions and types of businesses where this type of financing is particularly useful, when to choose crowdfunding vis-à-vis other means of financing, and regulatory and investor protection issues. This report contains the edited transcript of the panel discussion.

### Panelists:

Christopher Charlesworth (*Rotman MBA 07*), *Cofounder, HiveWire Inc.*

Murray Metcalfe, *Professor of Globalization, Faculty of Applied Sciences and Engineering, University of Toronto*

Tonya Surman, *Cofounder and CEO, The Centre for Social Innovation*

Verki Tunteng, *Associate, Heenan Blaikie LLP*

Moderated by Dilip Soman, *Corus Chair in Communication Strategy, Professor of Marketing, Rotman School of Management*

## 2. Biographies

### Christopher Charlesworth<sup>3</sup>

Christopher Charlesworth is the cofounder of Hivewire.ca. He holds an MBA from the Rotman School of Management, at The University of Toronto, and an Honours Bachelor of Political Science from The University of Western Ontario. At HiveWire, Christopher supervises the deal-flow and sales pipeline, additionally engaging directly with investors and companies as he supports the

overall due diligence process. He is also responsible for overall business development and strategic partnerships.

Previously, Christopher headed the undergraduate recruitment program for the University of Western Ontario as Senior Liaison Officer, leading direct recruitment efforts for the school's 200+ degree programs. In 2008, he founded the boutique management-consulting firm Charlesworth & Company and has consulted with such companies as Direct Energy, Desjardin Credit Union, and Prodemnity Insurance Corporation. Christopher worked as a management consultant in Indonesia, Canada, and the United States across several practice areas, including financial services, marketing, and social media.

#### **Murray Metcalfe**<sup>4</sup>

Murray Metcalfe is Professor of Globalization in the Faculty of Applied Science and Engineering at the University of Toronto. He holds a BAsC in Industrial Engineering from the University of Toronto and an MS and PhD in Engineering–Economic Systems from Stanford University.

Dr. Metcalfe began his professional career at McKinsey & Company, the management consulting firm, and then spent over twenty years in the venture capital industry in the United States before returning to academia in 2008. In the spring of 2008 he was a Visiting Scholar in the Department of International Development Engineering at the Tokyo Institute of Technology. He is a faculty member in the Centre for Global Engineering at the University of Toronto. Dr. Metcalfe also serves as a senior advisor in the private equity area at Lee Munder Capital Group, an investment management firm in Boston. He is involved in a number of not-for-profits in the areas of international development and social entrepreneurship.

#### **Tonya Surman**<sup>5</sup>

Tonya Surman is a social entrepreneur, community animator, and network choreographer with a passion for bringing life to world-changing projects. Tonya's work fundamentally embodies collaboration, entrepreneurship, and systems change. Tonya is the founding executive director and CEO of the Centre for Social Innovation, which catalyzes and inspires social innovation in Toronto and around the world. CSI creates community workspaces, incubates emerging enterprises, and develops new models and methods with world-changing potential.

Tonya co-chairs the Ontario Nonprofit Network, is a founding trustee in the Awesome Foundation Toronto, and has been active within the Ontario Social Economy Roundtable and the Social Enterprise Council of Canada. Tonya was instrumental in the replication of the Enterprising Nonprofits Program in Toronto and the roll out of TechSoup Canada, among other initiatives.

Previous to CSI, Tonya was the founding Partnership Director of the Canadian Partnership for Children's Health and Environment, whose work, in part, led to a new legislative framework to manage chemicals and the banning of BPA in baby bottles.

#### **Verki Tunteng**<sup>6</sup>

An associate in Heenan Blaikie's Business Law group, Verki Tunteng maintains a general corporate practice and advises clients on financing transactions at various stages. Verki has acted for clients negotiating joint venture agreements as well as for infrastructure clients undertaking public-private





partnerships with governmental bodies. He also works extensively with foreign companies seeking to expand into Canada.

In addition to Verki's general corporate practice, he is internationally recognized for his work in the climate change and renewable energy sectors. As a member of the Centre for International Sustainable Development Law, Verki undertook a survey of policies in the world's leading markets for wind energy and proposed draft legislation for the Canadian context. He has been invited to speak at conferences related to renewable energy policy in Argentina, Turkey, South Korea and throughout Europe, and has published and presented papers at two recent United Nations Climate Conferences. Verki has also undertaken projects related to international trade liberalization and regional integration. Verki is also a licensed engineer with industry experience in government, aerospace, infrastructure, and energy.

### **Dilip Soman (moderator)**<sup>7</sup>

Dilip Soman is the Director of the India Innovation Institute, a joint initiative of the Munk School of Global Affairs and the Rotman School of Management at the University of Toronto. He is a professor at Rotman and holds the Coros chair in communication strategy. His areas of expertise include behavioural economics, judgment and decision-making, innovation, poverty and marketing strategy.

## 3. Transcript

Dilip Soman (moderator): Here's the way we're going to do things; we'll ask each of the panelists to open up with a position statement, talking about the key themes they see in the crowdfunding area going forward. We'll let them take about 5 minutes each and once they've opened up, we'll open up the floor for discussion.

### 3.1 OPENING REMARKS AND POSITION STATEMENTS

**Christopher Charlesworth:** Thank you very much Dilip. I'm really interested in crowdfunding. I came to crowdfunding with my business partner Asier who's just here in the front row, actually while doing a consulting engagement for a large energy company. We were looking at the funding gap that existed for clean technology, and we're saying, "We wonder if there is a way that we can help to address the funding gap for this area." What we came across was crowdfunding. When we began to look into crowdfunding, we realized that crowdfunding has an enormous potential to help unlock innovation for many businesses in many different areas. We had the opportunity to partner with Tonya Surman with the Toronto Centre for Social Innovation. On March 20th we're going to be launching a crowdfunding platform called Catalyst that would be focused specifically on supporting social enterprise and supporting social innovation.

Following on from the excellent video, one of the things to recognize is the size and scope of crowdfunding. A lot of people are just getting introduced to it, and what they often have not recognized is

that crowdfunding is a truly global phenomenon that is of significant size and scope. Even in 2011, it has represented well over \$1.5 billion worth of transactions globally. There has been well over 1 million successful transactions that happened over crowdfunding even though in Canada we only have a donation and rewards-based crowdfunding that is legal. Debt-based and equity-based crowdfunding have been legal for quite some time, in fact over 5 years in both Australia, as well as in the UK and in parts of Europe. So, crowdfunding is really here and it's a global phenomenon. The other thing is that, when a lot of people see examples of crowdfunding, such as those that are in Kickstarter, they may think of crowdfunding as only being a sort of pre-order mechanism when its reach and breath is really quite a bit more significant.

There are three examples that I wanted to highlight. One is a very recent example. A U.S. luxury clothing and accessories retailer called Everlane, is looking to push into Canada. They are raising \$100,000 for crowdfunding. Now, that's a very small amount of money but their crowdfunding campaign is noteworthy because they're doing it for the consumer engagement data, and not for the money. So they are actually doing this venture to try to understand and uncover consumer sentiment rather than just sort of taking a shot in the dark and making a major investment with a large push into the Canadian market. That makes it an interesting example around the data side.

The second example is a company called Prodigy, based in Bogotá, Colombia. They are doing a real estate development project. What they were able to do was finding an exemption within their securities law that allowed them to raise over \$175 million, where over 3,100 people pitched in, in I believe \$35,000 increments, in order to raise a very significant amount of money. This sum is being used to purchase, or rather to build a 66 story building in downtown Bogotá. You can see that opening the door that allows people to get an economic return, can result in very large amount of money being pooled.

The next and final example was a bridge in the Netherlands. There was a community that was bifurcated by a large roadway. The city was going to put in a pedestrian bridge, but unfortunately it was going to be 30 years out by their budget plan, so the citizens got together and crowdfunded a pedestrian bridge with 17 thousand individual wooden slats that people could put their name on. The crowd actually can play a role in promoting public infrastructure.

Now all that is well and good, but the real implication that I see is on the diversity side. When a lot of people look at traditional funding mechanisms, such as venture capital or bank loans, what they often don't realize is that for a lot of businesses, for women owned businesses or for minority owned businesses, often can't secure funding. I know in the venture capital industry, it can be as low as between 4 to 9 percent of funding that's actually allocated from the VCs to women-owned businesses. At Hivewire we do quite a bit of proprietary data analysis and research on crowdfunding. We have a dataset of well over 20,000 crowdfunding campaigns across different platforms and we're continuing to research and analyze. We know from our own proprietary research that participation rates are just under about 30% for crowdfunding by women owned individuals and entrepreneurs. What we see is crowdfunding has enormous potential to allow those that don't typically have access to traditional funding mechanisms to get access to funding.

**Dilip:** So it's not just a financing story, it goes way beyond that.

**Christopher:** It does go way beyond it.





**Dilip:** Murray?

**Murray Metcalfe:** Thank you, Dilip. Well, there is no doubt, in my mind, that the world needs more entrepreneurs of many, many flavors, a very diverse group. As Dilip mentioned, I'm a professor at the Centre for Global Engineering here at U of T. You may have read in the popular press about my colleague Yu-Ling Cheng's work with the Gates Foundation on "inventing the toilet of the future for the developing world." I believe in the context of global development, that future solutions to the most pressing problems will be solved through the powerful combined model of technology and entrepreneurship. In the West, we know this model has been enabled by entrepreneurial finance techniques, such as venture capital, and of course has generated new enterprises and industries that have changed the developed world. That is now happening in the developing world, but is just getting started. As an aside, we are sponsored today by the India Innovation Institution (III), and nowhere is that more vivid than in India. I believe these approaches to global development will supplant traditional forms of aid through multilateral bodies and aid from specific countries, or perhaps those funding sources will evolve to take on an entrepreneurial finance approach to tolerate risk. Entrepreneurial finance is a key element of enabling this progress, and there are multiple approaches, ranging from traditional VC, Silicon Valley VC, to techniques like microfinance, and to newer exciting forms like we are talking about today. It's still early days for crowdfunding, but I think it's appropriate to figure out where it fits in, and ask what the possible limitations and pitfalls for this model is.

We can start with non-commercial ventures, although I think the line is really blurring, as so called hybrid value models, a term coined by Bill Drayton and his colleagues at Ashoka, the pioneering supporter of social entrepreneurs, such as for example Tonya. There may be multiple types of for profit, social sector, and government organizations working together on a specific solution. To stay on non-commercial ventures, in terms of crowdfunding, I'm oriented in many ways to the US model, and to some extent to the Canadian model. The model of Kiva.org has been quite a success. Kiva harnesses the power of the Internet, powered specifically by PayPal, to take a highly innovative concept, microfinance and make that available to entrepreneurs around the world. Now presumably most individuals, although they are making a loan, are thinking of it as a charity organization. You want a good outcome so you look for projects that are particularly compelling to you. You don't want to see your capital wasted, but ultimately you're making a donation. There will be failures, because this is risk capital. These failures are particularly difficult to take when we're dealing with the lives at the base of the pyramid, versus investing say in a western social media start up.

Let's now turn to commercial ventures. If I'm talking about the Kickstarter case I'm investing because I like the product and want early access. However it is not much of a leap to think about models, where I'm investing because I'm seeking a return on my capital, and in fact preferably an outsized return on my capital. Is crowdfunding a good way to go about that? I think the experience in conventional settings of risk capital suggests that the little guy is much more likely to get hurt. They have less information than professional organizations like professional venture capital funds. They are not sought out, or they're not even known by the top entrepreneurs, but might sometimes find themselves looking at less promising ventures. There is no way for the little guy to add value, or perhaps even to really monitor what's really going on inside the organization that he's invested in. I know very sophisticated individuals, sometimes with successful track records in the technology business, who would say they put a lot of money into seed investing and angel investing, plus a lot of time into being on boards and mentoring without it having paid off. Returns were negative, and they feel they could've done better by providing the capital to professionally managed VC funds.



Of course it can get worse for the little guy; hucksterism, fraud, misrepresentation, penny stock and boiler room schemes. Could crowdfunding degenerate to that? In certain cases possibly. We could heavily regulate it, but in entrepreneurial settings I'd say perhaps it is better to have less regulation, and so instead what we perhaps really need are trusted intermediary organizations.

Returning to the social sector to conclude for a guiding example. The Acumen Fund, based in New York, collects philanthropic capital from donors ranging from individuals up to the Gates Foundation, and Skoll Foundation. Acumen operates like a conventional venture capital fund, but invests in entrepreneurial enterprises in Sub-Saharan Africa, Pakistan and India that address the needs of the base of the pyramid. Acumen is known for and clearly does very extensive due diligence on its investments, comparable to a for-profit venture capital fund. So perhaps what the world really needs is literally 1000 Acumen Funds, and 1000 Ashoka's, and 1000 other trusted intermediary organizations like that, supported by individual philanthropic and perhaps by for-profit investors, but with much more focused and channeled investment strategies and much more clarity and discipline than the crowd sourcing model currently provides.

**Dilip:** Thank you Murray. I think you raised some interesting points. I think one of the key points you made was to frame the questions slightly differently. We've been talking about crowdfunding as a new exciting thing and one of the key questions you're saying that should be asked is, "how about crowdfunding as an option when it comes to evaluating which way to go". That's an interesting point, I'd love to get to that but let's turn over to Tonya. Tonya, how do you see this animal evolving, from where you sit?

**Tonya Surman:** Good evening. From my perspective, this is a conversation about power and control. When we start talking about the power of the crowd, we're seeing a number of different iterations in how that crowd is articulating a vision for a new world. When we start looking and framing our conversation we have to start with understanding the difference between "what is crowdfunding" versus "what is crowd sourcing" versus "what is crowd financing". I suspect that there will be other ways that technology is used to engage the crowd, so it's super important that we understand that these are different things and they will require different kinds of support. The reason I think that this is a transformational moment in history is because ultimately, with the power of technology we're unleashing the power of citizens to articulate their own vision for the world that they want. The question is "Are we listening?" Are we listening to the power of crowds? Are we looking at how we are able to destabilize and use disruptive innovation to begin to articulate new needs and new priorities for our world. This to me is the crux of the power of this technology.

I want to tell you the story of what the Centre of Innovation did with utilizing the power of crowds to raise \$2 million in community bonds. We need practical examples of what is possible in an Ontario context, leveraging the power of social entrepreneurship for a better world. The Centre for Social Innovation is a not-for-profit social enterprise that generates revenues using a business model, which is rent. We charge rent to over 350 to 400 organizations, people who are changing the world to make it a better place. So our business model is sound but one of the questions we have is: "how do we, as a little not-for-profit organization who has a solid but break-even business model, buy a building?" We have 4 to 5 years of experience operating at Queen and Spadina quite successfully. We found this new building that we wanted and it was \$4.5 million. It needed another \$2.5 million in investment to make it happen.

The whole project was \$6 million and I have in \$55000 in a reserve fund, and not a single asset to my





name. One of my colleagues said to us, if you are able to change your social capital to financial capital, then you might be able to do something great. This was before the term crowdfunding, crowd financing were being talked about, but I knew about the power of the crowds. The question was, how do we galvanize and democratize finance? What we did was we went to the City of Toronto, we got a loan guarantee, we took it to the bank and got traditional financing for 75% of the projected value of the building. I still had to raise 2 million dollars. How does a little not-for-profit organization do that? We created the community bond. The community bond is a five-year investment, flat rate 4% return, for a minimum of \$10,000 investment that you can hold in your RRSP. We successfully raised \$2 million for what is now over 60 community-based investors, utilizing an exception in the Ontario Securities Act, which enables charities and benevolent societies, which is us, to be able to go out to unaccredited investors and raise the capital they need to succeed.

I shared this story, even though it's not intermediated by technology per se, it is the same toolset being leveraged for a social impact. I wanted to provide that as an example. We successfully raised the capital, and we are paying our investors for three years, everybody is happy. We are now buying out more expensive bondholders with less expensive bondholders. We are watching our model being replicated in not-for-profit community after not-for-profit community. This is about community wealth and the power of citizens to become stakeholders in different ways. It's about the transformation of philanthropy. We are talking about a massive system change facilitated through these intermediaries. This transformation is about investment, citizenship, engagement and us being about to articulate our vision for a better world.

One of the big questions we ask ourselves is, "how do we hold the balance between self-determination as a society, which is what is being articulated through these tools, in balance with the concept of investor protection?". If you ask me, and I'm going to be a little bit provocative, we have got this system in place which allows and empowers the rich to get richer and the poor to stay poor. How do we find a new system and a new balance which recognizes the need to protect investors, and at the same time does not enable further institutional frameworks to limit our ability to articulate our vision as a society? I'll leave it with that.

**Dilip:** Verki, the three words I just jotted down from what Tonya was saying were "massive systems change," and every time you hear that from a legal perspective...

**Tonya:** You should panic!

**Dilip:** Tell us about it.

**Verki Tunteng:** First, I must provide a disclaimer: I am here to provide my personal opinions about an emerging area of law. I am not speaking on behalf of Heenan Blaikie, and I am not offering legal advice.

My comments primarily address equity crowdfunding. More specifically, I am interested in governance issues related to equity crowdfunding, and the question of how to engage with the crowd, which was raised in the video.

The Ontario Securities Commission (OSC) recently published a concept proposal, which has greatly inspired my remarks. I will be referring to that paper as the OSC Paper.<sup>8</sup> The paradigm established by the United States legislation and by the OSC. The Paper involves three main players in the crowdfunding universe: the company, or venture being funded; the individual, who contributes funds, who

I will call the crowdfunder; and the crowdfunding portal, which is an internet platform through which crowdfunders will be investing in these companies.

What exactly are the obligations of a crowdfunding portal? It's not entirely clear because the Securities and Exchange Commission is still in the process of developing rules that will apply to crowdfunding portals. That's an area of great concern which I will get to at the end of my introductory discussion.

Now, consider the following scenario. Imagine that you all each own a company that is in its early stages. You recognize the power of crowdfunding. You don't know exactly how your company is going to develop, but you imagine that you will at some point like to have the option of using conventional forms of financing, such as private equity or venture capital. In deciding how you want to engage with the crowd, you say to yourself: "I recognize the power of crowdfunding, I want to engage with the crowd, but that doesn't necessarily mean I want to have the crowd interfering with every business decision that I make." With that in mind, consider this idealized model for using crowdfunding – "idealized" for the company and for future investors, though not necessarily for the crowdfunder. You create a new class of shares specifically for the crowdfunders, separate and distinct from yours – remember, you want to keep control of the company. The crowdfunder's shares carry no rights other than the rights to be paid eventually someday in the future, when the company decides to seek traditional forms of financing. So the crowdfunders have no right to choose directors, no right to be informed of annual meetings and no right to vote at meetings. The only right crowdfunders have is to be paid for the fair market value for their shares when the board of directors gets an offer that it deems reasonable.

The crowdfunders will have to enter into a shareholders' agreement with the company and its existing shareholders. A shareholders' agreement sets out certain rights and governs the relationship between shareholders. Here is where I engage directly with the model set out in the OSC Paper, which talks about investing through an online portal. The OSC Paper provides for a two day cooling off period: two days after the money has exchanged hands, the crowdfunders have the option to change their minds. Shareholders' agreements, even the most basic ones, are fairly complex legal documents. So to that two day cooling off period I will add a 48 hour period that precedes the exchange of funds. Two days before investing, the crowdfunder is given a copy of shareholders' agreement and cannot possibly hit the button to invest without 48 hours having elapsed. At the very least, this ensures that the crowdfunder has been provided with a certain amount of time to consider the terms of the agreement – although there is no guarantee the crowdfunder will actually do this. In addition, there are certain specific provisions in the shareholders' agreement that you really want to make sure individuals, the crowdfunders, understand. For example the crowdfunders will not be able to freely trade their shares. There will be serious restrictions placed on when they transfer shares and to whom; The crowdfunder has no rights other than to be paid the fair market value of their shares if and when the board of directors of the corporation accept an offer for them. At the end of the 48 hours, when the crowdfunder finally enters into the shareholders' agreement over the Internet, they will be presented with a series of specific questions designed to ensure that they understand the most fundamental aspects of the agreement they are about to enter into. The crowdfunder will not be able to click "I Accept" immediately, they will need to wait for as long as a reasonable person would need to read and understand what's in front of them. Finally the transaction is concluded and the crowdfunder now own shares in the company.





Imagine that at some point in the future the board of directors receives an offer to purchase some or all the shares of the company from a private equity investor. This private equity investor may or may not want to be dealing with the crowd when their money is in the company, which is why you have the provision in the shareholders' agreement that if the board of directors receives an offer that it deems reasonable, the crowdfunders will sell their shares and be paid the fair market. Period.

That's the theoretical model, the idealized model. The challenge is that, from a corporate law point of view, there are certain governance challenges to this model being implemented in practice. When I mention "corporate law," I'm referring in particular to the Ontario Business Corporations Act, but these provisions are found in corporate laws around the world. Under corporate law, irrespective of whether you hold voting shares in a company, there are certain fundamental decisions involving the corporation that all shareholders have a say on. How does this fit with the crowdfunding model?

A company using crowdfunding as a cost effective way of financing its operations certainly doesn't want to find itself in a long, protracted and costly dispute with a class of shareholders who each invested small amounts of money in the company. How the crowdfunding model is adapted to harness its benefits and ensure investor protection is a question corporate lawyers will have to be thinking about very carefully and now is the time to do it.

Finally, the crowdfunding portal. We are not clear exactly what regulatory requirements will be applied to the crowdfunding portal, but I am a rather concerned about the amount of responsibility we are asking the crowdfunding portal to assume. They are being asked to undertake, under the US legislation, all of the know-your-client, know-your product and suitability analysis, and making sure the amount of money invested does not exceed the limits. If the crowdfunding portal is an established broker who has already registered and knows the system that might be less of a concern. But to the extent that crowdfunding portals are themselves an emerging industry, we need to be concerned about saddling them with an excessive regulatory burden relative to other stakeholders.

### 3.2 PANEL DISCUSSION

**Dilip:** So I'm probably going to oversimplify, but that's what the guidelines for great panel discussions tells me to do. I think we just heard two people say that crowdfunding can be the solution to all of the world's problems, and two people raised lots of red flags. Christopher, is that fair? Do these concerns bother you at all? Does it seem like stuff we should be actively thinking about?

**Christopher:** I think that's an excellent point. Should we be concerned? Should we actively think about it? Yes, absolutely, in the same way that we think about putting airbags in automobiles. We don't say people die in automobiles every day, three thousand a year, I think, in Canada and that's it, we should throw away all cars. No, we say look, what are the reasonable steps we can take in order to protect individuals and organizations? I think with crowdfunding, there is often, like Edward Murray put forward the argument of a "boogeyman" around fraud, that; "what about the potential for massive fraud that could be orchestrated as we have seen in the regular financial markets."

The truth is, that with crowdfunding campaigns, we have not yet seen – despite crowdfunding being

legal from the perspective of allowing debt and equity based crowdfunding – we haven't seen a single successful case of fraud being perpetrated on the crowd as of yet. This is globally, across a whole range of industries and organizations. When we stop to think about it, why would that be the case? Well, quite frankly, it's very easy to fool one individual, or a small subset of individuals, but it can be very, very challenging to fool a large number of individuals.

One other thing I would say about that is, in particular, we often think of the crowd, when we are suggesting investor protections, as being a bit naïve or in need of protection because they are not accredited investors, of course, accredited investors being the euphemism for wealthy individuals. However, quite frankly, there are many individuals who are not accredited investors and who are otherwise very intelligent and articulate people who understand the particular areas that they may wish to invest in. Conversely, you have many individuals who may be celebrities who may be accredited investors and who may not be so familiar with what they are investing in. So, I think both of those are a bit of a red herring.

**Dilip:** It's interesting that you said that it's tough to fool a large number of people at the same time. I have a friend who is a politician and says that it's challenging to be a politician because you have to fool a lot of people at the same time. The point that came up is the notion of investor "expertise" or "sophistication" is interesting. Is there something we can do to educate the crowds about this whole thing?

**Murray:** I was going to ask Christopher about that; let's say there haven't been cases of fraud, but there clearly are cases of bad ideas that have been funded, and perhaps because the person putting the idea forward was not well informed, but also because perhaps they wanted to do something that could not be funded through other ways of funding. There is as we see, also the issue of the quality, even if it's not fraud, of the investment project.

**Christopher:** I think that's an excellent point and one which has to be considered. When we think about innovation, as we do at the business school, innovation is very, very important particularly for Ontario – to become and stay globally competitive.

We know that for innovation, we need a large number of people taking a large number of chances, taking long shots, and doing the hard work of innovation, because we don't know where innovation might come from. Now, if we say, well with crowdfunding you might fund a lot of ideas, that might be bad ideas. Well in many cases you might actually miss some of the good ideas. I will give two examples. One example is something that I never thought would be successful and the other you will be a lot more familiar with. The first one is a crowdfunding campaign – which really should not have worked – it was an idea where an organization wanted to get money to create a bear coat, and when I say "bear coat" I literally mean a coat that looks like you are wearing a bear with a bear hat.

**Dilip:** Is this crowdfunding?

**Christopher:** This is crowdfunding. I would probably not have put my money into this. I would think it would probably be a bad idea and the venture capital community would pass it by. This organization raised over \$20,000 on Kickstarter and they're into production. They now not only make a black bear coat but also a polar bear coat. It was because the magic of internet that you can market it to the long tail, to those individuals that might be geographically dispersed but have shared interests.

**Murray:** Were they made from real bears?





**Christopher:** No bears were harmed in the creation of the coats!

Now, the second example is one that the venture capital community actually had exposure to and it was a Canadian organization that didn't fund and it was then quite successful. The poster child – you're no doubt aware of – is the Pebble Watch. Now, whether or not it's the Pebble Watch or it's an organization that's a social enterprise helping to make our community a better place, or whether or not it's going to be the next Research in Motion, ideas start somewhere and our innovators need funding. Fortunately now the amount of funding that they need is quite a bit smaller. The average successful crowdfunding campaign raises between \$4000 to \$7000. We are not talking about a huge amount of money. We absolutely need to fund the bad ideas. On Kickstarter, only 40% of the projects are successful. That's a lot of projects that failed. However what we hear about and what we celebrate are the projects that are successful. We need to create an environment, particularly for Ontario, particularly for Canada's competitiveness to allow for the failures, so that we can get the big successes.

**Murray:** I agree with that, but you don't want to encourage them by allowing things that look like sure failures to be funded.

**Tonya:** Well, wait a second, Murray. I think one of the things we need to differentiate here is that we are really talking about apples and oranges. What Christopher was talking about and what we are trying to do together with our catalyst platform is to look at how you create new opportunities for small organizations. Our existing investor infrastructure does not know how to respond to small and emerging new ideas. It's designed to only talk to you once you've won half a million dollars. There are very little funding sources. No one can even afford to do a due diligence process on anything less than half a million. One of the really interesting questions is that there is a massive market opportunity here. We worry about, on the social venture space; how do we build social ventures and how do we do this world changing work. We all recognize that we have a pipeline problem. Crowdfunding can be used to support those many sometimes really bad ideas and sometimes really good ideas. Who knows which one is going to flow and which one is not. It's responding to the fact that institutions don't know how to support and enable small and emergent new innovations. The cost of getting new ideas to the market has plummeted.

What's critical is that right now, we don't need a half million or even three million dollars, because so much of our institutional funding has been designed to do massive building of industrial factories. Well that time, as we know, is coming to an end. We need to come up with new models that adapt.

I just want to say though; we really are talking about apples and oranges. Crowd-equity is not crowdfunding is not crowd-financing. I actually think, Verki, your points about governance are critical to this conversation. We work with hundreds of organizations, and a lot of times they are boot-strapping because they don't want equity. Sometimes they need just straight- up funding for a crazy-ass idea.

Let me just tell you what I'm into. Look, my first crowdfunding investment was I prepaid for a book of a man, a very hairy man, who wore ballerina tutus all over the world. And it was the best investment I had ever made. I got that book of that hairy man in ballerina tutus and I gave it to my husband for Christmas and I felt great about my choice.

One of the things; it's not all about business development. It's also about us articulating our dreams and our fantasies. I am part of the Awesome Foundation Toronto. It's a group of citizens that come together, and we put a hundred dollars a month into a brown paper bag and we give it to anyone who will do something awesome for us in the city of Toronto. We are giving our money away. So let's be careful; philanthropy and supporting crazy ideas that have no business model whatsoever is very different than crowd-financing, like the community bond where we are given a

flat-rate return on investment in exchange for the use of that money with no governance obligations, is very different than the question of crowd-equity, where we are really getting into much more complicated issues of governance. I think we have to be really conscious about the risk. There is massive risk on the equity side and we have to be super cautious.

**Murray:** There were a lot of really interesting ideas strung together, but let me start with the very first one. You talked about the small projects that could not be financed, but we do have the worldwide microfinance industry. It's an interesting industry in that it started in the global south, and it has started to slowly, maybe too slowly, make its way here. Clearly it started at the level of "let's finance someone who we might not even say is an entrepreneur, but we might say is a craftsman". Although in the original Grameen Bank and Muhammad Yunus model, those small groups of craftsmen, or mostly women, were receiving very small amounts of capital. That eventually spread to institutions ranging from start-ups such as SKS, but also including the Indian subsidiary of Citi Group. Actually, this microfinance makes sense and we can, in fact, lend to small individuals without what we thought would have been huge losses and disappearing capital. That's worked for quite a while. Can that be adapted here? Kiva does this.

**Tonya:** I agree. Kiva is a perfect example, but I would also say, as a social entrepreneur, when you are trying to get your project into the market place, sometimes that's a campaign, sometimes that's a product, sometimes that's a service – you will be looking at everything. One of the things that is super interesting is the manner in which crowdfunding fits. When I am looking at a micro-loan, I think "what if we are looking at crowdfunding as the consumer test piece of that investment package?" So, look, when we are putting together the building purchase – which is maybe not the best example because the money being raised is a lot more than for usual projects, we are looking for multiple types of finance. We must ask, "where can you get free money?" Where can you get finance money? Where can you get a traditional mortgage? So one of the things that becomes interesting to think about from a crowdfunding perspective is how crowdfunding becomes a part of the investment mix and how it can augment microloans. I actually think you're right in that the problem, in an Ontario context, is that our institutions have a really hard time because of the role of inadequate intermediaries.

**Murray:** Tonya, in your investor base, are there people who have put your investment in their retirement plans because they think it's a very sound investment or are most of the investors saying I can actually get a better return somewhere else, but I want to do something that has a social purpose.

**Tonya:** You're talking about the community bonds?

**Murray:** Yes.

**Tonya:** Is there anyone here from the Canadian Banking Association (CBA)? If you know someone there, I would like to talk to them. So here's the deal! It's really important! We have had several rounds of investors and let me be clear, we had to raise \$1.4 million in under three months. Initially I went to rich people. You're not looking to do \$10,000 investments when you've got three months to close on a building. We created a mechanism that allows us to give a better rate to a smaller number of people to get the money in faster. We have three private foundations invested in the community bond to be able to access the 96% of the capital fund that is not going for social impact. We did that and what's happened now is that we proceeded to buy out the more expensive bondholders. What we've learned is that 50% of the people who invest in the community bond do so through their RRSP. This is really important, because a moderate income person will want to save as much money as they can in their RRSP by benefitting from the tax laws. As a result, it's only those who filled up their RRSP that would then be interested in making a direct investment. But are we seeing a rise in the number of impacted investors looking for a place to put their money? Yes, immensely. In fact, a young man who works in the tech sector coming to our informa-





tion session saying, “I took out all my money from the bank, out of the traditional investment, and I am waiting, because I don’t want to be part of the problem, I want my money to be part of the solution.” He took everything out of the market and he’s waiting to find investments. There is a problem when people don’t know where to their my money. They then come to us. Here’s the thing about community bonds; the CBA has just made a decision that would prohibit community bonds, which are an interest and a mortgage, to be held inside an RRSP. This is critical. We are talking about trying to move the field of social finance forward and the CBA is now making decisions, without much consultation as far as I can say. The OSC, is going to consultations and engaging in this conversation openly. We found out this Friday that the CBA has made this decision. They are no longer going to allow mortgages to be held in RRSPs. This has just jeopardized the entire impact investment field as far as I can see.

**Dilip:** I’m going to open up the questions for the crowd in just a minute, but before we do that, I know Christopher wanted to say something.

**Christopher:** Based on Tonya’s comment about how people don’t know where to their money; I want to take that comment and bring it out to a more global perspective. You know, there have been some very, very turbulent economic times in Europe over the last year and a half. What we saw was a silent bank run in many countries in Europe. Those individuals were taking their capital, saying that their money is in jeopardy if they leave it in the financial institutions and that they need to put it somewhere. The question is; where were they putting it?

We know that a lot of the money was actually leaving these countries and it was leaving through, in many cases, Western Union money transfers. They were leaving through smaller and smaller levels of capital flows that were going to different areas. In a crowdfunding context, that organization that I mentioned in the beginning, from Bogota, Colombia, Prodigy, is now looking to purchase a prime piece of New York real estate, in I think \$25,000 a piece. Normally in the American context, accredited investors only would apply not regular people. Although what’s interesting is that they are raising that money from a global audience. It is also noteworthy that they are actually saying with large disclaimers on their website; “American need not apply because their regulations prevent them from raising that capital”. The model of crowdfunding is still working. Those people from the other parts of the world are taking those capital flows and putting them in North America. However, they are doing it in a way that takes advantage of the regulatory arbitrage. So even if we decide, here, that our banking and our securities regulations will stop crowdfunding, and we are not going to allow Ontarians or we are not going to allow Americans to let it to happen; it will still happen. We just won’t be able to benefit.

**Dilip** (to the audience): If you have a question, please raise your hand. We have two microphones.

**Audience member:** Thanks, Dilip. I’ve directly dealt with Kiva and also Kickstarter. I know Christopher has taken the agency problem, but everyone seems to be worried about all the bad things that are going to happen. Just let it happen! Who is bothering you? Christopher, who is wanting to regulate all of these things? Are there too many people? Is every one of them an agent trying to get a fee?

**Christopher:** I brought a quick quote, in which there is a gentleman, who was responsible for one of the lobbying effort that passes the Jobs Act in the U.S. He has a quote that basically says to the effect: “With crowdfunding you have a lot of otherwise very intelligent, very smart people that often have a knee-jerk reaction to crowdfunding.” I think that is fair and it makes sense, because there are risks and we are talking about change – probably the largest change to securities regulation that has happened in 60 or 70 years. It’s important that we look at these issues carefully. The biggest challenge is, as we look to apply legislation, as Verki pointed out at the beginning, we can allow for this very nascent industry to occur and for this good work to continue on or we can put in place our regulatory burden that essentially takes all value off the table for all of the participants.



The other key point is when we look at the size. In the OSC position paper there is consideration of what size we allow. The OSC paper, considers a cap. People can invest in equity based funding at a maximum of \$10,000 per year in \$2500 increments. There could be a massive difference between having a cap of \$10,000 or \$15,000 or \$20,000 because we are looking at the crowd, so you will be multiplying that amount.

My concern is not to have the sector, or this new industry, killed by putting in place regulations that will protect the consumer but not to allow the sector to flourish. Quite frankly, it is important to allow crowdfunding platforms to integrate with the existing financial services providers because a lot of the heavy lifting in terms of farming for innovation opportunities is done.

**Murray:** There may be a real opportunity there for you and your colleagues to solve that problem for yourselves, because presumably the power of the Internet can be applied to that. If we think about the crowdsourcing tool, it can tell me in real time where to go to avoid being in a post-election riot. If we can take that type of information and use it to help identify: here's a good area to focus as a little guy, here's an area to avoid, crowdfunding does not need to be regulated. That's a further opportunity, I think, for the technology sector to potentially solve.

**Dilip:** A quick comment and then we have a question at the back.

**Tonya:** It's just to say, what Christopher and the Centre for Social Innovation are attempting to do is to bring in other mechanisms that will increase the quality and likelihood of success of projects. We're looking at how to use the power of relationship and physical space to build a crowdfunding platform which is actually based in a community, where you've got the access to social capital in order to validate and further gain and increased likelihood of success. This approach helps increasing the quality and likelihood of them succeeding and also assist from a social trust perspective. What would happen if we start to bring that social capital layer on top of the power of the internet? That's certainly something we're going to be experimenting with at Catalyst, looking at how to utilize the other supports that would improve the likelihood of success, and thereby create what we hope to be a better investment, where investors will trust out investees more than anybody else's.

**Audience member:** I have two comments. I've developed over 250 products and started seven companies, so I'm not naïve. I've been following the OSC deliberations etc. and it seems to me that all of the legal professions and accounting professions are protecting turf when it comes to looking at equity crowdfunding. That's my first point. My second point is that there is one aspect to crowdfunding that I think is really fundamental. That is, what comes along with the money is market validation. When a company, like Pebble, gets market validation, it is significant in the next round of financing in terms of valuation. I don't think very many people are accepting that notion that if we don't muck it up, we have the opportunity to start a system of grassroots funding that has enormous potential.

**Dilip:** I agree; Verki, do you want to respond to that point of "protecting the turf" comment?

**Verki:** Sure. Lest I be totally painted as stodgy lawyer not wanting to close a deal, let me say first of all, crowdfunding is a new and emerging area for all of us. From my perspective, there is no "turf" to protect at this point. If we are all successful in establishing a legal framework for crowdfunding that would be a new area of work for me, so I have as much to gain from it as any entrepreneur! Secondly, I'm originally an engineer and I started from the other side, the side of the innovator. There's an intellectually respectable argument against, equity crowdfunding that goes as follows: "There's a lot of money out there. People are generally rational, there is the whole rational markets theory. If an idea were good enough to be funded, well, someone would have probably funded it already. By resorting to crowdfunding, you're essentially bypassing the people who had the sophistication and judgment to make the right decisions and taking money from those who





have less experience with investing and less money to risk.” I’ve exaggerated my point for dramatic effect, but nevertheless, this is an argument that is frequently raised by those who are skeptical of crowdfunding.

Here is a counterargument and being an engineer, I’ll be a bit biased. Consider a technology company that has obtained research funding from the National Sciences and Engineering Research Council or some other similar institution; this means that an organization with the subject matter specialist has made a decision that the project is worthy of public funding. This technology company then enters into a formal collaboration with a business partner, also a technical company, and they’re now working together. Now we have another technical company, a technical peer, who has looked at the project and said: this makes technical sense and business sense, so I’m going to invest time, money and resources in it. However, unless you are at a certain level of sales, you are facing an uphill battle to obtain traditional financing. I experienced this as an engineer and now as a lawyer advising early-stage companies, I see it all the time. There is an extremely serious problem. Crowdfunding does have the potential to address this funding gap.

With the respect to the view that this conversation involves lawyers protecting their turf, the OSC Paper is actually a quite astonishing piece of work. The OSC stays true to its initial dual mandate, which I will read: “...Providing protection to investors from unfair, improper or fraudulent practices, and fostering fair, and efficient capital markets ...” The OSC didn’t just create its mission for itself. This has been its mandate given to it by the people we’ve elected, ultimately. This is its role. Now, yes, the risk of fraud is very low, it is difficult to fool the crowd. However, proponents of crowdfunding must accept that they are promoting something that is new, and untested on a large scale, and as such they will be subject to a lot of scrutiny. I don’t care if the risk is one in a billion or one in ten million. The first case of fraud that happens in crowdfunding, you can bet your bottom dollar that there will be people looking at the OSC saying: “Why did you guys fall asleep at the switch?” “Where are our elected officials?” “This is another sign of you ignoring the concerns of the middle class!” Now is the time to really think carefully about how crowdfunding can take place legally.

**Dilip:** There is a question in the front.

**Audience member:** I don’t know if it was fraud or not; I’m a filmmaker and I got involved with a crowdfunding organization. I did get my money back from them, but then they suddenly just disappeared. They don’t exist anymore. You can’t email them. They’re not online anymore. The problem is that now my reputation is at stake, because I’m still fundraising and the people who gave to that organization would like to give more. There are people who are trying to find me through that organization. I did get the fund back so I didn’t lose any money. What can we do at these early stages? I mean, I know there’s no resources for me at this point, but will this be part of the regulations that go on to protect the small guy?

**Christopher:** I would say that the biggest risk to consumers is actually not fraud. The biggest risk is understanding that most small businesses and most start-ups, fail. That’s a reality and they failures will continue to happen. You know, we took a position earlier, and I think that it’s a good thing to have failure. The first thing is that having a business either leave, fail or start to fail is to be expected. It’s unfortunate if it was unexpected in your case, but that is certainly part of the system. In the case where you have something gone awry in the process, feel free to appeal to the crowd. If you haven’t, this sounds a bit trite, but if you haven’t taken the time on the internet, the internet is amazing in that there are people offering amazingly sophisticated help for free. I would recommend going on a website called reddit.com. They have a thread on crowdfunding. I would recommend telling your story and appealing for help, and you’ll be amazed at how often the crowd is able to sympathize with you. One of the key parts about crowdfunding and one of the things that makes it successful is the requirement of authenticity. The crowd sniffs it out; the crowd wants it. The crowd wants there to be real relationships and wants to know what’s going on. If something has gone awry, come clean about it and seek help.

**Dilip:** Two more questions: one here and one up there. Go ahead.

**Audience member:** Thank you very much. I really like crowdfunding for the entrepreneurial aspect of it. To talk to Tonya's point, I feel that our society, at least here in the Western world, we've sort of forgotten a little bit about our roots, where we come from, and the whole entrepreneurial dynamics, and its importance to the health of a society. Now, for the panel: What do you believe the risk would be, if crowdfunding becomes so successful at some point, if big brand names jumped into crowdfunding. All of the sudden, would the trust of the investors now gravitate towards those big brands? Are there risks for us? What are the risks to crowdfunding and losing that entrepreneurial spirit?

**Murray:** I think there might be some good elements of that. You're talking about large organizations now using crowdfunding. I think actually much of the individual investing in public securities, and this is a big topic, I think it's unrealistic to think that as small investor you have any influence anyway, no matter how many AGM's you go to, how many letter you write, you have no influence those shares. This might be a way to actually allow the individual to have a more direct link and decide what should be funded within a given, large organization. I don't think it blocks the small organization; it just creates more levels of innovation, which is good.

**Dilip:** Tonya, one quick comment and we're going to take one more question and then I will put all the panelists on the spot with a concluding question.

**Tonya:** You know, the internet is agnostic around what you do with it. Crowdfunding will be the same. Now, we think, that crowdfunding lends itself to the social impact side because we believe that is an unarticulated part of who we are as humans. One of the things that would be critical is that we are able to nourish, enrich and create opportunities that are small, micro-reflective of our values on the ground. I think the spirit of entrepreneurs and investors are looking for these fresh ideas. We're in transformation as a society and so I think it would be really interesting to see how institutions are undermined by this. I believe it will be up to us as those investors to ensure that our money continues to go where our values and heart is leading us. This is what this tool does. Let's just keep our fingers crossed, that we continue to be active citizens.

**Audience member:** My question relates to how quickly you can put a donation model of crowdfunding into place. The context is the recently withdrawn Melancthon mega-quarry application. The applicants still own all the land and they could come along in a very short amount of time, and put in another application for 500 acre quarry. We want to prevent that. Under the Aggregate Resources Act, you have 45 days to respond, so those of us who would like to prevent it would have to go out and hire all the aggregate lawyers, all the pollution experts, all the noise experts, and get all the responses in within the next 45 days from when the application comes forward and then find the money to be able to pay all those experts. How quickly could we make something like that work?

**Tonya:** We had this problem, right? How do I raise \$2 million in under three months? That was my challenge and yours is probably bigger. There was no question that institutional and "angel investors," if you will, played a critical role in our success; and I think this is the part about the investor mix. We had three private foundations that came in to the tune off half a million dollars of our overall \$2 million. We have now subsequently bought out at least one and are on the track to buy out the second one. We basically negotiated with "angel investors," or rich people, who shared our values for them to put their money up, knowing they would have a crappy return for a short period of time, to allow us time to go to the crowd and go to the community to build support, because it takes longer. I think it's about understanding the mix of how we use different tools and different ways to achieve our social and environmental objectives.





**Christopher:** I would say from a strictly pure crowdfunding base or perspective, that it can happen incredibly quickly. The big example that most people are familiar with was the woman who was bullied on the bus last summer.

**Tonya:** Urgency is a great motivator.

**Christopher:** Within one weekend, I think they raised six or seven hundred-thousand dollars for her, so it can happen incredibly quickly, which is part of the power of the tool.

### 3.3 LOOKING INTO THE CRYSTAL BALL

**Dilip:** My final question for all of you, has to do with crystal ball gazing. We come back here in five years and are talking about the same topic. The question is: “how has crowdfunding really changed the financing landscape?” Look in the ball, Christopher, and in 30 seconds tell us what you think is going to happen.

**Christopher:** I think we’re going to see this case of regulatory arbitrage exacerbated. We’re going to see some markets continue to embrace it as they have, and those are going to leap ahead in areas of innovation and start-ups. We’re also going to see laggards that will not have done that and they’ll be playing catch-up in five years.

**Dilip:** Murray...

**Murray:** I would say, and perhaps this is somewhat wishful thinking, that you have a flourishing industry and that you have in place some intermediary mechanisms or intermediary groups to get around problems, so it does not require an undue amount of regulation. You can let innovation prosper. Crowdfunding also integrates into other forms of financing in an interesting way.

**Dilip:** Tonya...

**Tonya:** You know, it’s a hard question.

**Dilip:** That’s my job...

**Tonya:** I’m going to take the negative side to end. We’re going to see some remarkable and really painful failures. We’re going to have to get smarter about managing the balance between chaos and order. Citizens are also going to play a larger role in taking responsibility for this work.

However I’m also extremely hopeful, and I think what it’s going to do; number one, it’s going to destabilize and become a criterion. It’s going to be absolutely essential. Crowdfunding and market testing becomes a part of the investor portfolio. I think that’s we’re going to be in five years.

**Dilip:** Verki...

**Verki:** Equity crowdfunding is already happening in certain markets. However, I’ll note that there are very few places in the world that have undertaken the thoughtful exercise that we’re undertaking here in Ontario. Five years from now, I see the final steps of the policy framework for crowdfunding being put in place in Ontario in a way that causes Ontario to attract global attention in much the same way that the clean tech sector did in Ontario about five years ago.

**Dilip:** Excellent! So, on that note, I hope to see you back here in five years for the second part of this discussion. A few thank yous: Steve Arenburg and his team for putting this session together; Lindsay Hart, Sandeep Pillai, Mikayla Wicks, and Sean Tyler, the students who actually worked on the video and report, thank you for doing that. Please join me in thanking our panelists. That was a wonderful and thought provoking discussion!

## 4. Endnotes

<sup>1</sup> Caldbeck, R. "Crowdfunding Prediction for 2013." *Forbes*. Nov 2012. Retrieved June 5, 2013. <http://www.forbes.com/sites/ryanaldbeck/2012/12/11/crowdfunding-predictions-for-2013/>

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<sup>3</sup> <http://www.hivewire.ca/about/team/christopher-charlesworth/>

<sup>4</sup> <http://www.utoronto.ca/ai/gii/2012%20Metcalf.html>

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