

Relaxing crowdfunding rules could help Asia startups

By Ryan Huang , ZDNet Asia on June 18, 2012 (2 days ago)

Crowdfunding, which allows businesses to raise money from a large pool of small-time investors in return for equity, may benefit startups and small and midsize businesses (SMBs) in Asia just as it has in markets such as the United States. It also brings with it many risks though, say industry watchers.

In April, American president Barack Obama gave his support for such initiatives when he signed the Jumpstart Our Business Startups (JOBS) Act, which lifted restrictions on companies from selling shares to the general public via crowdfunding platforms such as Kickstarter.

Andrew Stott, partner at law firm Olswang, lauded the move and believes such funding platforms would help boost businesses and job creation in Asia too. "Given the current financial climate--[what with] banks not lending and limited access to equity capital--entrepreneurs and jobs will be stimulated by a new ease in funding," he said.

He added that "sophisticated legal jurisdictions" have been the problem preventing the raising of funds from individuals, usually non-high net worth and inexperienced investors. This is so as to "protect 'Joe Public' from exploitation", he explained.

However, in places such as Singapore where there is a great demand for investment opportunities, high net incomes and a broad and sophisticated education system, allowing people to "risk" their money investing in crowdfunding schemes would make "real sense", the lawyer pointed out.

After all, Asia as a region has a history of backing smaller businesses and attracting "family and friends" funding. "Crowdfunding would just move that into the digital age and expand marketing opportunities," said Stott.

It would also signal a shift in legislative focus, from protecting individuals and being concerned with their exploitation, to supporting SMBs and entrepreneurialism, he added.

Already, the idea of crowdfunding appears to have taken root and is growing in popularity in the region, with online sites such as Singapore-based ToGather.Asia appearing on the scene.

Another observer, Johnathan Lee, vice president of commercialization and ventures at nonprofit investment agency Cradle Fund, called on governments to further this momentum and help nurture the startup ecosystem in Asia.

"Current regulations in Malaysia do not allow crowdfunding in return for equity. If this can be allowed, it may be able to help startups and grow interest in angel investing," he said in a report in April.

Investor risks in crowdfunding

The flipside to easing regulations in soliciting funds from individuals would be that small-time investors may not be aware that the companies they invest in may not always be transparent, Stott noted. Their value of investments may fall, and they may not have access to the company's financial information as well as what the startup does with the funding, he cautioned.

"In commercial terms, the real risk of allowing individuals to invest en masse in companies that capture their fancy is that they will be left with highly illiquid stock. On an individual basis, there will be no secondary market for any small stakes acquired," the lawyer stated.

As such, the question to be considered by regulators is how far should existing laws be stretched to fully enable crowdfunding as a viable source of regular funding for SMBs and whether this would lead to exploitation, he said.

Crowdfunding not a replacement for 'smart' money

Even if rules are relaxed to allow companies to seek funds from small-time investors, they should not rush to participate in crowdfunding, said Arcot Desai Narasimhalu, director at Singapore Management University's Institute of Innovation and Entrepreneurship. This is because there are other aspects such as the insight and experience in growing businesses offered by "enlightened" venture capitalists and angel investors, he said.

"Startups need funds and crowdfunding will certainly help in some situations, but this cannot replace the 'smart' money that enlightened angels and venture capitalists (VCs) offer. The real value startups get from proven early-stage VCs is the knowhow and networks that cannot be obtained through crowdfunding alone," Narasimhalu stated.