

## Chapter 57

# Proactive Law as Competitive Advantage in Crowdfunding

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### **ABSTRACT**

*This chapter explains how the paradigm of proactive law as competitive advantage can help entrepreneurs succeed in crowdfunding campaigns. Business law scholars have developed theories of “proactive law” and “law as competitive advantage” to show how law can be transformed from an obstacle into a strategic business advantage. This chapter analyzes the evolving crowdfunding landscape through the lens of proactive law as competitive advantage. The chapter proposes several types of innovative securities designed to create competitive advantages in crowdfunding offerings. For example, one type would give crowdfunding investors long-term equity interests while simultaneously eliminating short-term corporate governance challenges for small crowdfunded companies. Apart from securities, the chapter also describes how a proactive approach to law can enhance crowdfunding campaigns in multiple areas, from intellectual property to tax efficiency. To conclude, the chapter suggests expanding the theory of proactive law as competitive advantage to additional areas of entrepreneurship, beyond crowdfunding.*

### **INTRODUCTION**

Despite encountering regulatory obstacles, crowdfunding continues to emerge as a viable business model for funding early-stage entrepreneurial ideas. This chapter proposes a theoretical construct to aid entrepreneurs in carrying out crowdfunding offerings in the face of legal uncertainty. Specifically, this chapter investigates a concrete research question: How can the legal theory of proactive law as competitive advantage help entrepreneurs succeed in crowdfunding campaigns?

The chapter is organized as follows. It first briefly explains the legal landscape that different types of crowdfunding offerings confront. Then Part I develops a conceptual framework of viewing law proactively as a competitive advantage in crowdfunding campaigns. Part II applies the framework to provide specific examples of how entrepreneurs can leverage law to succeed in crowdfunding offerings.

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To conclude, the chapter moves beyond crowdfunding to suggest how further research should develop the theory of proactive law as competitive advantage in the broader context of the disruptive innovation that entrepreneurship breeds. The chapter focuses on US law, though the principles of proactive law as competitive advantage are broadly applicable anywhere.

## **BACKGROUND: REGULATORY LANDSCAPE OF CROWDFUNDING OFFERINGS**

The origins of online crowdfunding were not auspicious. Initially, crowdfunding resulted in more cease-and-desist letters than business success stories. But over time, the creative force of entrepreneurship continues to propel crowdfunding models to break free from the antiquated legal shackles that have restrained crowdfunding's development. Accordingly, today's legal panorama for strategic management of crowdfunding campaigns is vastly improved—and significantly more complex—than just a few years ago.

From a legal perspective, entrepreneurs must choose one of two types of crowdfunding offerings: the fork in the regulatory road is whether the crowdfunding campaign will offer securities (e.g., stock, interest-bearing loans, or another form of profit-sharing interests) or something other than securities (e.g., a pre-purchased product, token rewards, or donative support of a nonprofit enterprise, including non-interest bearing loans). Laws treat crowdfunding offerings of *securities* differently from *non-securities* (Fallone, 2014). Of course, entrepreneurs may also develop hybrid crowdfunding campaigns that offer a combination of a security and a non-security.

The evolution of laws on crowdfunding of *securities* has differed markedly from that of *non-securities*. Both paths, though, epitomize the disruptive interplay between law and entrepreneurship. Innovative entrepreneurship can be a two-edged sword that both creates new business opportunities and simultaneously challenges, and even destroys, stagnant legal regimes. In crowdfunding, the unique paths that *securities* and *non-securities* forms of crowdfunding have traversed can be likened metaphorically to tree roots in both their power and resourcefulness.

### **Laws on Crowdfunding of Securities**

The history of crowdfunded securities exemplifies how the disruptive force of entrepreneurship can topple regulatory obstacles to build new industries—like tree roots that undermine the foundation of a cement wall, causing the wall to collapse. At crowdfunding's inception, a regulatory wall prevented entrepreneurs from offering equity securities through crowdfunding in the US (Hazen, 2012; Heminway & Hoffman, 2011; Pope, 2011). In 2010, for instance, a US crowdfunding company named ProFounder Financial invited entrepreneurs to sell stock in start-up companies to the general public over the Internet. Such a seemingly innocuous business model was in fact a direct assault on the regulatory wall that barred crowdfunding offerings of securities. As a result, ProFounder was forced to shut down its website and cease all crowdfunding activities (Bradford, 2012).

Another prominent challenge to the regulatory wall in the US occurred in 2011 through the online BuyaBeerCompany crowdfunding campaign. The crowdfunding initiative to buy Pabst Brewing Company enjoyed phenomenal viral success in social media. In six months it attracted over \$200 million in online pledges from more than five million people. But the BuyaBeerCompany campaign offered an

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