

# Chapter 7

## Characteristics of Successful Securities Crowdfunding Campaigns in the United States

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### ABSTRACT

*Title III of the Jumpstart Our Business Startups Act (JOBS Act) enacted by the U.S. Congress enables a new crowdfunding source of investment capital for entrepreneurs and a new opportunity for all investors (Regulation CF). Given the information asymmetry, the SEC requires that managers provide information to investors (Form C). Using this information, this research tests whether business attributes, financial risks, and offering characteristics are associated with successful crowdfunding efforts for 277 offerings originating during 2016-2017 and closed as of May 2018. The following attributes are positively correlated with funding success: product idea; prior managerial experience with startups; financial risks reported by management; availability of an independent CPA review; and, especially for companies reporting revenue, accounting risk measurements. Finally, the funding intermediary chosen is important and some were more successful than others. Overall, the results provide new insights concerning characteristics of successful security-based crowdfunding offerings.*

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## **INTRODUCTION**

The United States Congress has created an easily accessible, online opportunity for all investors to provide capital to startup and early-stage companies. Title III of the Jumpstart Our Business Start-Ups Act (JOBS Act), implemented by the Securities and Exchange Commission (SEC), enables securities crowdfunding. All potential investors are now able to invest in startup and early-stage companies that may turn out to be successful. Title III provides for fewer restrictions on solicitation of investors<sup>1</sup> and reduced SEC reporting requirements, while making capital acquisition less costly for issuers (SEC, 2015a)<sup>2</sup>. The rules became effective as of May 16, 2016 and are known as Regulation Crowdfunding (Reg. CF) (SEC, 2015a).

While new investment opportunities are now available, significant information asymmetry exists for potential investors in private companies (Hoegen, Steininger & Veit, 2018). To reduce the information asymmetry, the SEC requires information on an issuer's business plans, business and financial risks, and accounting information which are filed as Form C. Form C includes product and business model information, income and balance sheet data for risk assessment, and offering details presented in a standardized format. One aspect of Reg. CF is that companies must use an intermediary, i.e., a "funding portal" or a broker/dealer platform, which will present characteristics of an offering, accept investments and function as the required portal for issuer management to communicate with existing and potential investors during the offering.

The objectives of this study are to test for whether the three major dimensions of a crowdfunding offering are relevant for investor decisions and, therefore, funding success: (1) attributes of the business proposed by management, especially the type of product or service offered, (2) aspects of a company's financial structure and (3) offering characteristics, especially the portal/platform selected by management given portal curation. The hypotheses indicate research questions within the three dimensions. The time period is the first year of Reg. CF. Two measures of funding success are used: meeting a threshold of requested funding and, if the funding threshold is met, the total amount funded.

Study of funding success (and a lack thereof) is important as it reveals the "wisdom of the crowd" regarding salient characteristics of companies and offerings (e.g., Mollick & Nanda, 2016). In addition, previous research has not concentrated on whether different product types have different levels of appeal to investors—and the possibility of different funding levels (Lukkarinen, Teich, Wallenius and Wallenius, 2016). For example, Ahlers, Cumming, Gunther and Schweizer (2015) and Mollick (2014), and for Reg. CF campaigns, Knyazeva and Ivanov (2017), treat "industries" as control variables without any substantive analysis of the products offered and customers served. Therefore, additional insights remain to be gained by

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