The Evolution of Investment Crowdfunding

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Early Data and Insights, Title IV Reg A+

By Richard Swart, PhD
Chief Strategy Officer of NextGen Crowdfunding

Executive Summary

NextGen Crowdfunding has undertaken an analysis of how businesses have responded to recent changes in investment crowdfunding. The results will be presented in this paper, as well as in forthcoming quarterly reports. This paper examines Title IV / Regulation A+ introduced in June 2015. **This legislation allows companies to raise up to $50 million dollars from investors through crowdfunding.** It will be followed over the coming months with an examination of Title III / Regulation CF, introduced in May 2016. **Title III/ Regulation CF allows companies to raise up to $1 million from investors.**

In this paper, we examined the first 144 public filings by companies for a full year between June 19, 2015 and June 22, 2016. We sought to determine whether the assumptions of Congress and the Securities and Exchange Commission about startup and emerging companies using these regulations would be supported.

Our analysis suggests that:

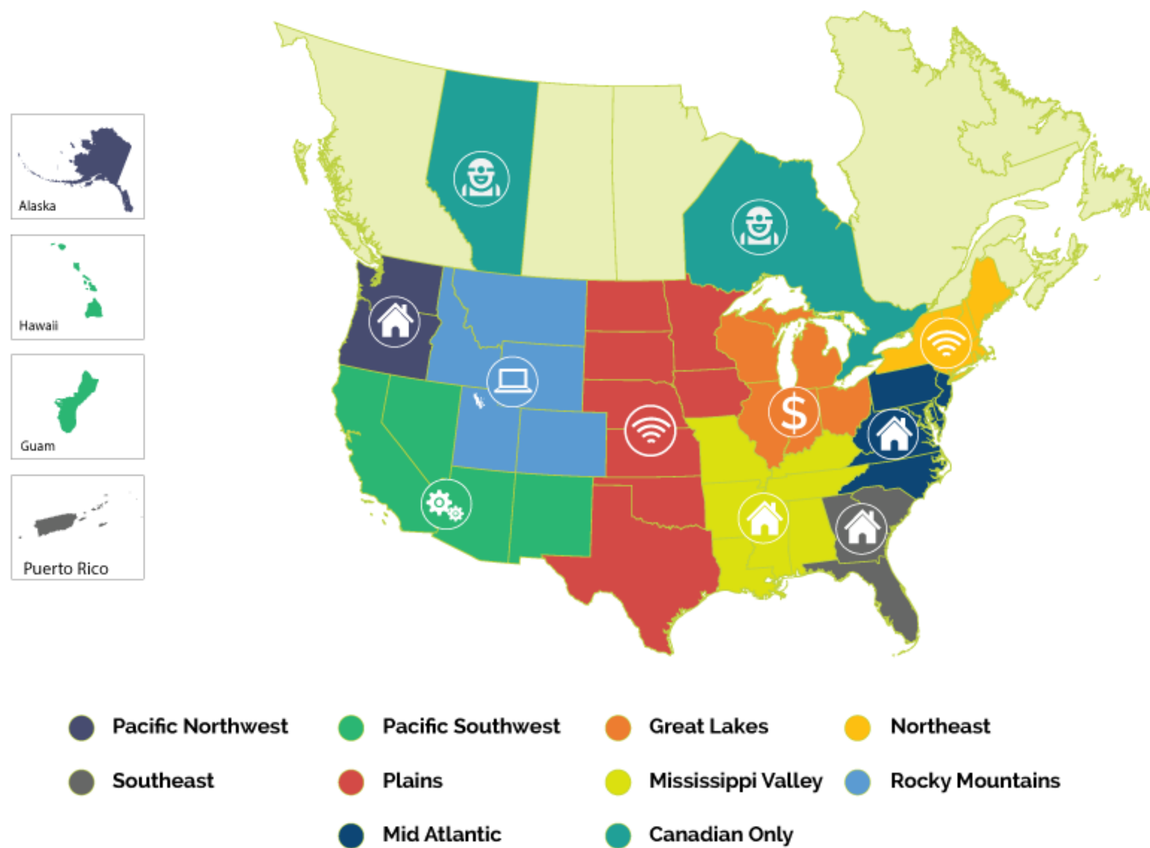
- **Total filings & companies:** The number of individual companies filing under Reg A+ totaled 131 – 13 of the 144 filings were duplicates. Of these, 129 of them are U.S. companies and two are from Canada.
- **Tier 1:** Sixty unique firms filed under Tier 1, meaning they intend to register with individual states. Of these, ten firms indicated they intend to raise funds from all 50 states, with eight also intending to raise funds in Canada. The vast majority of firms filing under Tier 1 are registering their offerings regionally or in a limited number of states.
- **Tier 2:** Of the 71 companies that filed under Tier 2, meaning they are exempt from state registration, nine firms indicated that they would be fundraising in only a handful of states and one firm indicated they would list their offering only on a Canadian exchange. This suggests that the majority of firms filing under Tier 2 intend to offer their security nationally.
- **Fundraising Amounts Sought:** Not surprisingly, firms filing under Tier 2 sought more funding, $1.66 billion with a per-firm average of $25.2 million, compared to $353 million and $6.0 million respectively for Tier 1 firms.
- **Mature companies:** A significant number of mature and late-stage companies participate in Regulation A+ filings. The oldest firm has been operating for 37

years and 22 of the 131 firms, or nearly 16.5%, have been in business for 10 years or longer.

- **Industries:** Analyzing the firms by industry classification, manufacturing (23 firms, 17.3%) finance & real estate (48 firms, 36%) and service (30 firms, 22.6%) dominate the filings. Many of these filings appear to be from finance companies intending to purchase another company or make investments from the proceeds.
- **Assets:** We found a large number of testing-the-waters (TTW) filings from firms reporting net assets of less than $1,000. TTW allows firms to solicit non-binding investor interest before they undertake the expense of a filing with the SEC. Of the 131 firms, 46 had less than $1,000 U.S. in cash or cash equivalents and 68 had assets of $10,000 or less. This leads us to question the ability of some of these firms to actually bear the legal and compliance costs of a live offering.
- **Average assets:** Still, the larger firms pulled up the statistics for the firms overall. With the largest firm reporting assets under management of $2.4 billion, the pool of firms averaged $49,242,687 in assets. Given the skewing of the data by the banks and financial firms, the more telling figure is median assets of $123,356.
- **Revenues:** As for revenues, 79 of the 131 firms reported earning no revenue. It is somewhat surprising to see pre-revenue startups exploring what is essentially a small IPO. Future research will track investor reaction to the use of Reg A+ for A-round equivalents.
- **Liabilities & accounts payable:** The liabilities and accounts payable varied greatly due to the inclusion of finance companies and banks. Fifty-two firms reported liabilities of less than $10,000.
- **Employees:** Of the 131 firms, 40 had no full-time employees (FTE). The average number of employees for the group was 21.7 FTEs and 23.2 part-time employees. The two largest firms reported more than 300 FTEs.
- **Large states:** The initial data showed that most firms come from the largest states – California, New York, Illinois, Florida, and Texas – with very limited participation from firms in Southern states.

Our analysis also discovered marked differences in the pool of applicants in terms of the filings themselves. Some appear to be have been submitted by firms seemingly lacking legal or accounting assistance. However, the data presented in the paper does not attempt to go beyond the information presented in the Form 1-As. We present and report on the data without interpretation or judgment on the firms' status or standing. Regulators and the market will serve these critical roles.

This paper includes an analysis of the rate of investment crowdfunding under Regulation A+ for different regions in the United States. The map below shows how we have broken out the States into nine regions: Pacific Northwest, Pacific Southwest, Rocky Mountain States, Plain States, Mississippi Valley, Great Lakes Region, Northeast, Mid-Atlantic and Southeastern.



Under the Regional Analysis section of this paper we present a series of maps and data that highlight the dramatic differences in utilization of Regulation A+ by firms. The data show that the coasts are significantly overrepresented in utilization, even controlling for population. In four of the nine regions, the leading SIC code – based on dollars attempting to be raised – was in finance and/or real estate. Readers should refer to the summary table showing the number of firms by region. With four of the regions having five or fewer filings, it is difficult to draw many conclusions from the data other than that firms in these regions are not yet aware of or utilizing the new Regulation A+ offering structure. In the Great Lakes Region and Plains States, at least 50% of the filings had extensive missing data or clearly incorrect data, for example, listing the total amount to be raised under Regulation A+ as $100.00. Many of these filings appeared to have been done without professional assistance and readers are advised to use caution in interpreting data from these regions. Previous research conducted by this author at UC Berkeley demonstrated that a cluster effect exists in crowdfunding launches, meaning that cities with a higher concentration of an industry tend to show a higher-than-population-based rate of campaigns being launched. Examples are Film and Gaming in Los Angeles, Technology in Silicon Valley and Boston, Medical and Biotech in San Diego and Real Estate and Energy in Houston.

Sources of Data

We gratefully acknowledge the assistance of Audit Analytics, a Massachusetts-based financial research firm, for the data aggregation and research referenced in the paper.

The data analysis contained in the white paper represents NextGen Crowdfunding's conclusions.

Brief Review of Title IV of the JOBS Act

Access to capital to start and grow small businesses has spawned a national crisis in the United States, stifling job creation and innovation. In response, Congress passed the JOBS Act in 2012 requiring the SEC to dramatically revise Section 506 of the 1933 Securities Act. These new regulations – widely regarded as one of the largest changes to U.S. security laws since the SEC and Federal Reserve began in 1933 – sparked intense debate. The controversy forced the SEC to proceed cautiously, taking several years to enact the regulations allowing retail investors to participate.

The provisions of Title IV of the JOBS Act, implemented by the SEC as regulations, constitute the latest early-stage, capital security entrant to the alternative investments marketplace in the United States. The new regulations are variously regarded as a form of small Initial Public Offering, or a hybrid security offering that mainly targets sophisticated or institutional investors.

The new regulations allow businesses to use the Internet and social media technology to raise investments through registered web portals. They are designed to open the doors to a new era of investing: Retail investors will be able to participate in investments that historically have been available only to wealthy, accredited investors.

The controversy forced the SEC to proceed cautiously, taking several years to enact the regulations and allowing retail investors to participate. With the release of Regulation A+ rules in June 2015 and Regulation Crowdfunding in May 2016, NextGen Crowdfunding felt both sets of rules should be examined to see how they are being used, and whether the assumptions of Congress and the SEC about the companies using these regulations would be supported.

This paper focuses on Reg A+ or Title IV that enables small and emerging businesses to raise up to $50 million.

NextGen Crowdfunding undertook an analysis, over the period of one year, of how Regulation A+, introduced in June 2015, was being used, and whether the assumptions of Congress and the SEC about the companies using these regulations would be supported.

Title IV of the JOBS Act required the SEC to pass rules modifying existing Regulation A offerings and expand those offerings. The new rules created what is colloquially referred to as a Regulation A+ offering. SEC terminology refers to Tier 1 or Tier 2 offerings and provides a bifurcation of Tier 2 - where firms can "test the waters" to gauge investor interest, or, file a live offering and solicitation from investors.

Tier 1 offerings are not exempt from Blue Sky review. Therefore, firms are required to register the offering in each state or Canadian province where they intend to solicit investments. Tier 2 offerings are exempt from state registration. Canadian Law allows these offerings to be listed on Canadian exchanges, and they are available to U.S. or Canadian issuers.

Types of Filings and Amounts

This white paper presents an overview of our findings on the first 144 filings under Regulation A+ with the SEC. Form 1-A filings were pulled from public sources, representing filings of record with the SEC for a full year between June 22, 2015 and June 30, 2016. The analysis contains all Form 1-A filings attached to a group of filings (identified by Filing No.) that have at least one Amended Regulation A Form issued since the June 19th, 2015 effective date of the new Regulation A rules.

Companies can file Form 1-A confidentially with the SEC. This analysis discusses only public filings. We estimate that about two public filings have been filed for each confidential one, so the SEC has likely received more than 220 filings since they approved the regulation in June 2015. The first company received approval in October 2015 – making this about a ten-month-old industry.

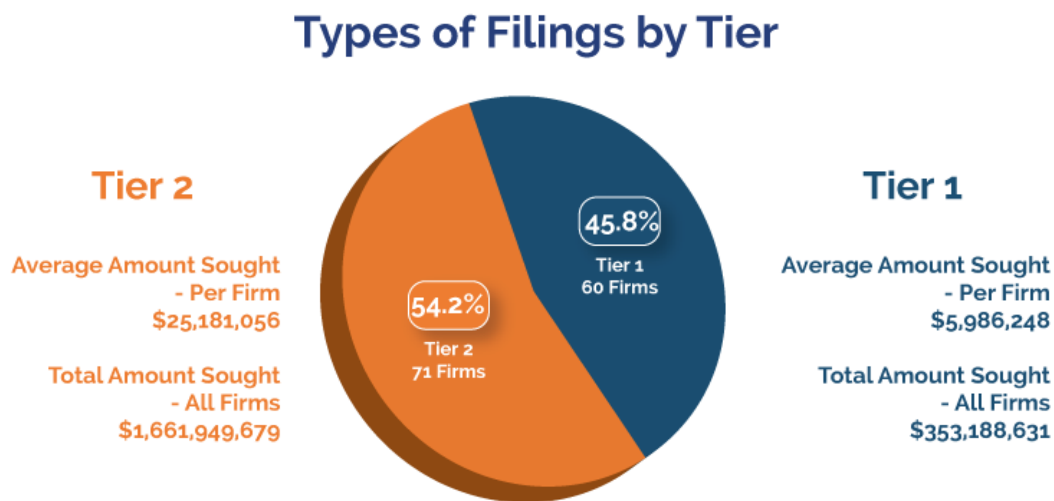
Of the 144 public filings, six companies refiled to update or change information. Thus, the number of actual individual companies filing under Reg A+ totaled 131 -- 129 of them U.S. companies.

Sixty filed under Tier 1, meaning they intend to register with individual states. Of these, ten firms indicated they intend to raise funds from all 50 states, with eight of them also intending to raise funds in Canada. Fifteen firms indicated they intend to raise funds from only one state or the District of Columbia The remaining 35 firms appear to be raising funds in regions clustered around the East Coast, Southeast States and the Midwest, including the populous states of California, Florida and New York.

The other 71 companies filed under Tier 2, meaning they can conduct national and Canadian fundraising campaigns. But nine firms indicated they would conduct campaigns in only a handful of states, one firm intended to raise funds only in Canada, and five firms did not list Canada as a fundraising location.

Thus, companies appear to be setting their own geographic fundraising locations somewhat independently of the Tier 1 and Tier 2 fundraising jurisdiction distinctions.

The pie graph below shows the average amount intended to be raised and the total amounts being sought by firms.



Age of Firms

The JOBS Act was intended to increase the flow of capital to startups and small businesses under the assumption that startups and early-stage companies would file most Regulation A+ offerings.

However, the assumption that Regulation A+ would serve as a vehicle for early-stage companies to raise capital has not been completely borne out by the data. Though the length of operation averaged for all firms totaled 4.7 years, many firms are in fact quite late stage. The oldest firm has been operating for 37 years, and 22 of the 131 firms, or nearly 17%, have been in business for 10 years or longer. This data suggests that these firms may view Regulation A+ offerings as an alternative to a public offering. It also illustrates that generalizations should be avoided about the

nature of firms who will be using these new regulations. The motivations and goals of the later-stage firms could be a subject for future research.

The graph below represents the number of firms filing and groups them in buckets from 0-1, 1-5 years old, 6-10 years old, 11-15 years old and so on to more than 40.

Maturity and Capacity of the Firms

The ability of firms to test the waters under Tier 2 appears to have led a number of very early-stage companies to file under these provisions. Of the 131 firms, 40 had no full-time employees (FTE). The average number of employees for the group was 21.7 FTEs and 23.2 part-time employees. The three largest firms reported more than 300 FTEs.

As for financial status, 39 firms had less than $1,000 U.S. in cash or cash equivalents and 68 firms reported assets of less than $10,000 and 79 of the 131 firms reported no revenue. The firms averaged $49,242,687 in assets with the largest firm reporting assets greater than $2.4 billion. However, the median number, which is not skewed by the assets of the banks in this data set, was only $123,356.

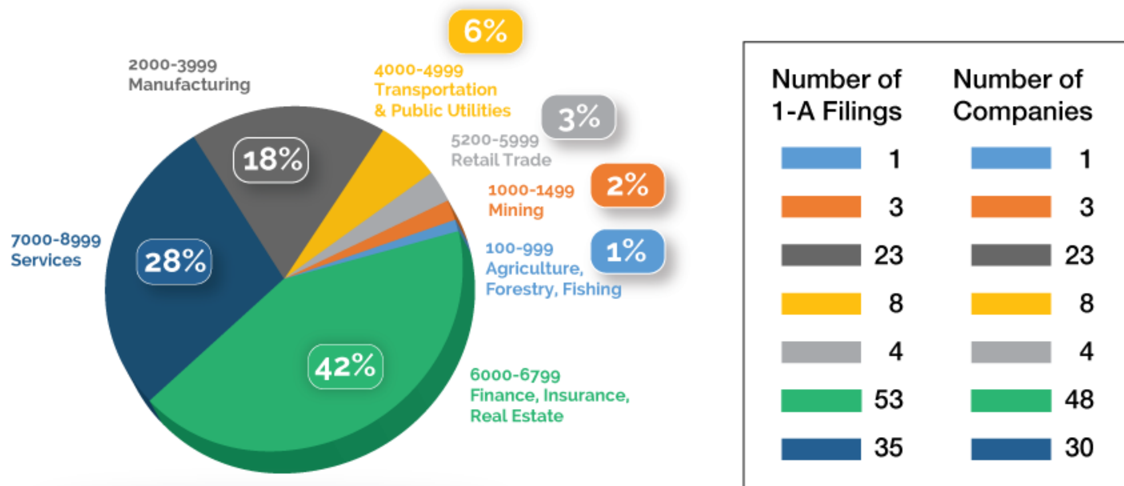
These variations in number of employees and finances may illustrate the bifurcated nature of the nascent crowdfunding industry. Companies appear split between a large number of new firms testing the waters or hoping to use Regulation A+ as an initial round of funding, and well-capitalized, established firms using it as an alternative to a public offering or for an offering into a specific project.

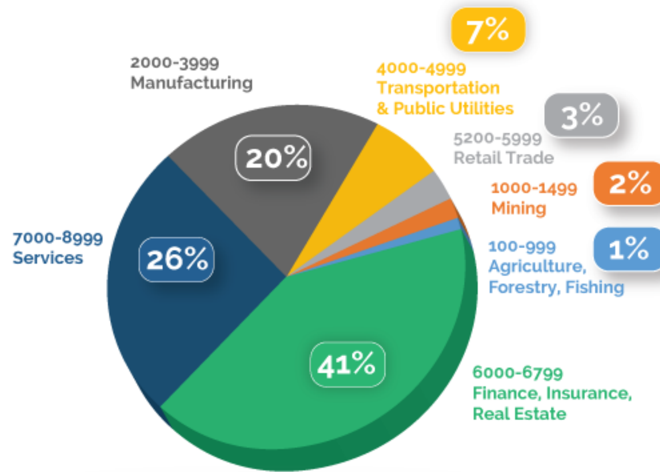
With many industry experts reporting that firms are paying $100,000 to $200,000 in legal, accounting and marketing fees to complete a Tier 2 offering, it remains to be

seen if firms filing under the testing-the-water provision have the capacity to complete their offerings.

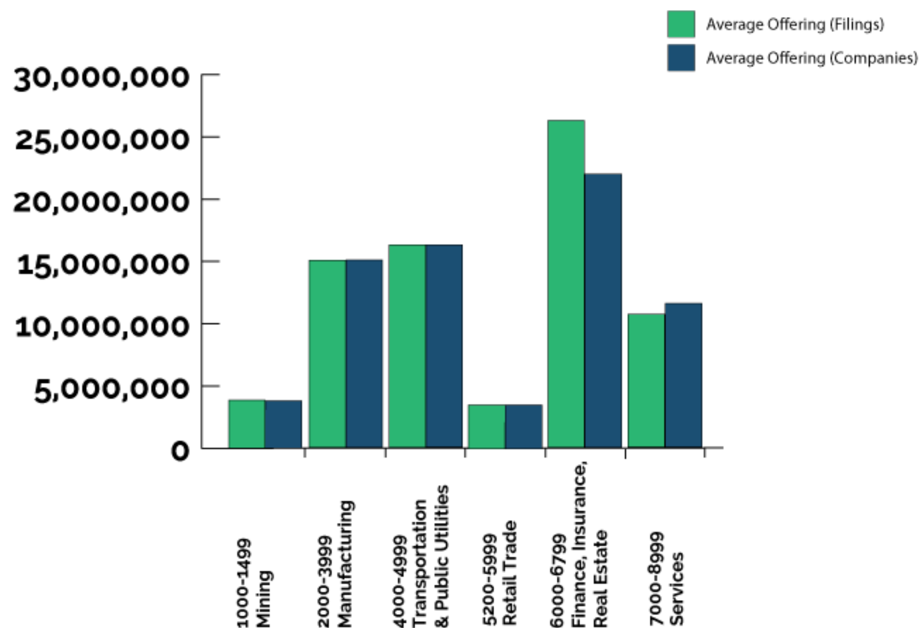
Industry Breakdown

Analyzing the firms by industry classification, manufacturing (products), finance (real estate or company acquisitions) and service firms dominate the filings. Service firms are somewhat unusual as they have had limited participation in other forms of crowdfunding.



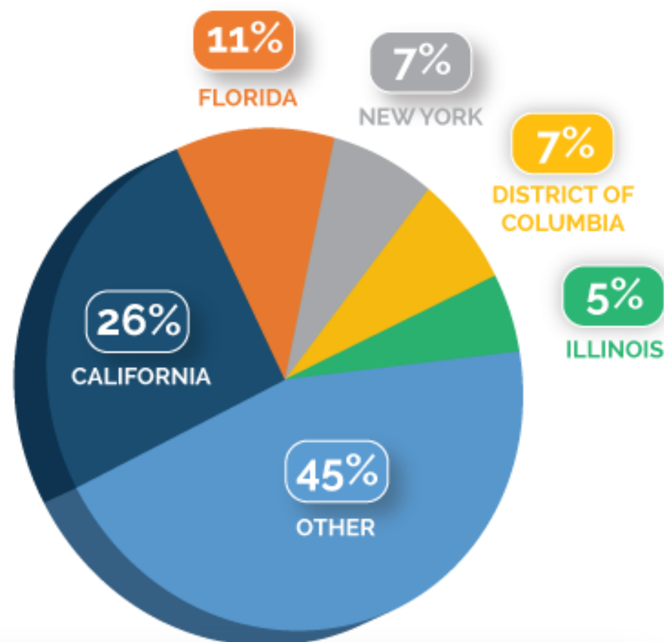


We then looked at the total and average offerings by industry segments. The financial and real estate firms have a significantly higher average offering.



Location of Filers

Most firms that filed for Reg A+ came from the largest states – California, New York, Illinois, Florida and Texas.



Summary

Our analysis of the data from the first 131 companies providing public, 1-A filings shows a few trends:

The number of bigger and more mature firms with significant assets and revenues filing to use Regulation A+ represents a potentially larger population of users than the original intended targeted companies. This could be an indication that mid-size firms may be having difficulty accessing public markets. We did no analysis of the business strength of the underlying firms, but the substantial number of later-stage companies could mean that potential investors may have access to a much richer dataset about the firms pursuing crowdfunding and their future performance.

Conversely, the cluster of firms with essentially no revenue or assets, calls into question whether some of these firms have sufficient capacity to complete a Regulation A+ offering. Any firm can file using testing the waters. From the data, it appeared that some firms have filed that clearly lack the financial resources to complete a live offering later. This is troubling. Investors could generalize across all firms using testing the waters and conclude that firms using these provisions have sufficient resources and maturity which, in fact, many firms appear to be lacking, according to their filings.

The broad distribution of industry segments is a positive sign, showing that business owners in many segments of the economy are investigating these provisions. It is not limited to consumer product, gaming or other firms overrepresented in other forms of crowdfunding.

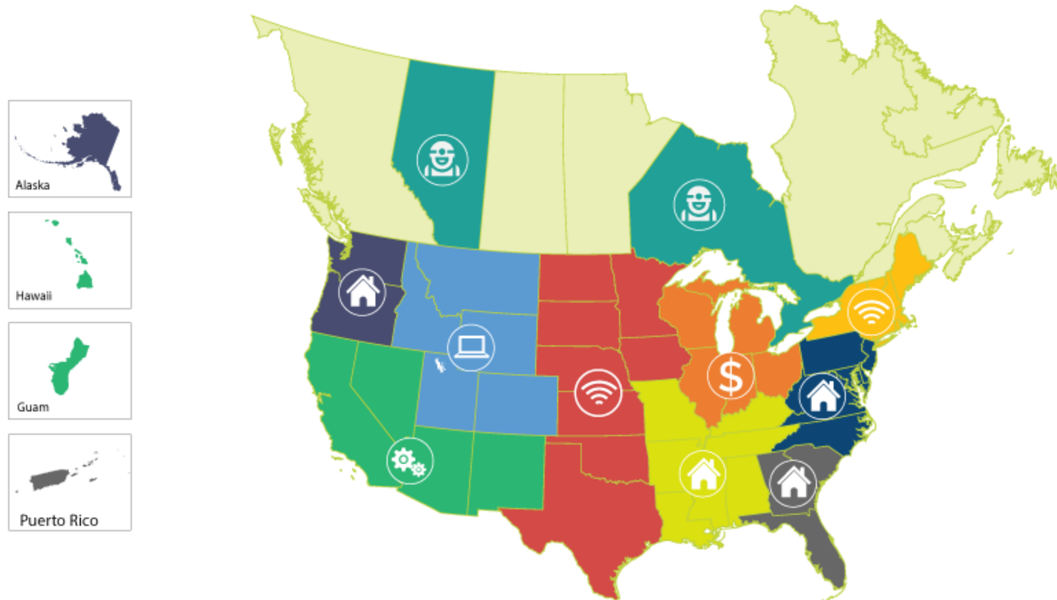
Regional Analysis

The table below shows the total amount being sought by companies that have filed in each of the nine U.S. regions, the average amount being sought, the total number of companies filing, and the largest industry segment per region as measured by dollars being raised.

	Total Offering in Region	Average Amount Being Raised	Number of Firms	Largest Industry
Pacific Northwest	$480,000	$240,000	2	Mining
Pacific Southwest	$114,539,124	$28,634,781	4	Real Estate
Great Lakes	$528,823,810	$13,220,595	40	Manufacturing
Northeast	$89,000,000	$17,800,000	5	Business Services
Southeast	$48,200,001	$5,355,556	9	Business Services
Plains	$174,589,139	$17,458,914	10	Finance & Real Estate
Mississippi Valley	$90,460,796	$18,092,159	5	State Commercial Banks
Rocky Mountains	$130,610,748	$10,884,229	12	Business Services
Mid Atlantic	$601,797,177	$27,354,417	22	Real Estate
Canadian Only	$237,387,516	$14,836,720	11	Real Estate

The map below reflects the total offerings by region.

Regional Analysis



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The Mid-Atlantic region is dominated by the Washington, DC Metro region, and the majority of filings were unsurprisingly from finance firms – most of which were real estate developers or REITs. The typical coastal variations were present, with the majority of California firms producing some sort of product – electronic, physical, film, etc., while most East Coast filings were more finance related.

The Southeast is dominated by Florida real estate developers and came in third overall. There was very little activity outside of Florida, and some in Georgia, but the Southeast is not utilizing Regulation A+ to the extent predicted by its population.

Unsurprisingly, the Pacific Southwest, which includes California, was the second largest region. The dominant industry classification was manufacturing, suggesting consumer and technology-related products. Venture capitalists have been less interested in backing physical product companies, which may suggest that Regulation A+ is seen as a substitute for venture finance for consumer packaged goods firms.

Despite a robust technology sector, the Pacific Northwest had only four filings, most of which were real estate related. There were no filings by technology firms.

The Rocky Mountain states were dominated by Colorado and Utah, which both have robust Software as a Service (SaaS) and Healthcare-related startup communities. Filings in these states were heavily business services related.

The Great Lakes region was underrepresented. The majority of filings were finance and real estate related. Given the active Chicago startup community and the number of SaaS firms in the market, it appears that Regulation A+ is not widely known or accepted by the startup community in this region.

The Plains states have a historically low rate of startup creation, and the rate of filing is unsurprising. All but two filings were from Texas, which has an active startup, tech, energy and finance economy. The filings were broadly distributed across many forms of business service companies, ranging from medical devices to crude oil and motion picture firms.

The Northeast has a substantial startup ecosystem dominated by the Route 128 firms (Harvard, MIT and Boston area) and the New York City region. Despite this robust ecosystem, very few early-stage firms have attempted to use Regulation A+ in this area. None were from Massachusetts. Most were New York-based business services firms.

From this brief review of regional variation, it appears that real estate, finance and investment firms dominate these first filings under Regulation A+. The preponderance of activity on the coasts probably reflects the maturity of their startup ecosystems and the large number of crowdfunding and investing conferences that occur in New York and California. These new regulations represent a dramatic departure from traditional financing vehicles, and it simply may be that information has not made it to the heartland of America yet.

Afterword

Despite the enthusiasm generated by the new crowdfunding regulations, in actual fact, a relatively small number of firms filed under these provisions. It raises questions about the demand for this new asset class. Some suggested explanations follow:

(1) The provisions are only a year old and the vast majority of business owners, accountants, attorneys and other business professionals are not yet aware of the provisions.
(2) Attorneys typically caution their clients to avoid unknown or new financing vehicles. Given that no case law or enforcement history exists, attorneys cannot provide their clients detailed guidance on permissible conduct. As regulators and the industry deal with the evolving industry, attorneys will have a history and background to which they can refer.
(3) Substantial costs are involved in filing for and running a Regulation A+ campaign with estimates of more than $200,000, including marketing costs. Given the costs, only more mature firms may have the resources needed to run a successful campaign. Additionally, firms may turn to other forms of equity crowdfunding before using Regulation A+. Indeed, new funding mechanisms are reportedly being created to provide essentially bridge financing for firms intending to use Regulation A+ but which may lack the needed capital.
(4) The existing network of investment advisors, wealth managers, brokerages and other regulated financial professionals are just starting to grapple with these new assets. As compliance departments learn about and analyze these deals, broader acceptance and support from the investment industry may develop.

NextGen Crowdfunding will continue to study the equity crowdfunding market and we look forward to your comments or questions. Please contact us at . . .

LinkedIn: (https://www.linkedin.com/company/nextgen-crowdfunding)
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. . . with your questions and comments.

Richard Swart, PhD
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