

REGULATION OF EQUITY CROWDFUNDING IN SINGAPORE

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Equity crowdfunding, a fairly new form of financing, has promise as a means to finance legitimate start-up businesses or projects which are unable to obtain funds from traditional sources, *eg*, banks, venture capitalists and angel investors. However, the cost of complying with existing securities regulations is likely to make equity crowdfunding impractical for the businesses most likely to need it. This paper will consider the rationale for facilitating equity crowdfunding in Singapore, assess the need for additional exemptions for equity crowdfunding, and propose legal reforms which seek to strike a balance between capital formation and investor protection.

I. INTRODUCTION

Crowdfunding is the practice of raising many small sums of money from a large number of people through online portals (crowdfunding platforms) to fund a project, cause or business.¹ The main difference between crowdfunding and traditional forms of public fund-raising is the way funds are raised. Crowdfunding involves the use of crowdfunding platforms, *ie*, websites which connect investors and fundraisers. Typically, fundraisers create a dedicated webpage on such platforms to showcase their projects and indicate, amongst others, the amount of funds they seek to raise and the type of return investors may receive for their contributions. Investors can interact with fundraisers by asking questions through the dedicated webpage and, if interested, transfer money to the relevant fundraiser through an online payment system.

Crowdfunding can be classified into four categories by the type of return investors receive for their contributions:

- Donation-based: people donate money to support a project or cause;
- Reward-based: people give money to fundraisers in exchange for a specific reward (product or service);
- Debt-based: people lend money to fundraisers to receive interest payments in addition to repayment of the principal; and

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¹ Steven Bradford, “Crowdfunding and the Federal Securities Laws” 2012 Colum Bus L Rev 1 at 10 [Bradford, “Crowdfunding”]; Monetary Authority of Singapore, “Facilitating Securities-Based Crowdfunding” (February 2015) Consultation Paper P005-2015 at para 1.1 [the “MAS Consultation Paper”].

- Equity-based: people invest in shares of a business to receive profits from the business.²

Equity-based crowdfunding, as well as some forms of debt-based crowdfunding, involves an offer of securities to the public and hence are regulated by securities laws in many jurisdictions. Recently, a number of jurisdictions have taken steps to remove restrictions to crowdfunding which involves the offer of securities (“securities-based crowdfunding”) because it is perceived by many as a promising way to support small businesses which are denied funding from traditional sources, *eg*, from banks, finance companies, private equity (“PE”) and venture capital (“VC”) firms, angel investors and stock exchanges.³ For example, the United States (“US”) enacted the Jumpstart Our Business Startups Act on 5 April 2012,⁴ which carves out limited exemptions within the existing securities regulatory framework for securities-based crowdfunding.⁵ Similar exemptions have been enacted or proposed in countries such as Canada, Australia, New Zealand and Italy.⁶

In February 2015, the Monetary Authority of Singapore (“MAS”) also proposed measures to facilitate securities-based crowdfunding for the purpose of facilitating the access by start-ups and small and medium enterprises (“SMEs”) to more sources of funding.⁷ The aim of this article is to consider whether Singapore should undertake legal reform to facilitate equity crowdfunding and whether the measures proposed by the MAS are appropriate. Parts II and III argue that start-ups and SMEs in Singapore have limited access to funding, majority of which is backed by the government. Facilitating equity crowdfunding will not only introduce new sources of funding, but also provide a platform for companies to test their ideas and products at an early stage of their businesses and to promote an entrepreneurial community in Singapore. Part IV identifies a number of risks associated with equity crowdfunding, including for example, high failure rate of early stage businesses, information asymmetry between the fundraiser and the investor, and insufficient shareholder protection. Part V maintains that the MAS’ proposal to restrict securities-based crowdfunding to professional investors is undesirable. The proposed measures would take the crowd out of crowdfunding and hence deprive equity crowdfunding of much of its value; at the same time, they fail to address some of the risks associated with equity crowdfunding. Part VI argues that, while start-ups and SMEs which seek to raise funds through equity crowdfunding should not be subject to the prospectus requirement, existing exemptions to the prospectus requirement do not appear to be sufficiently broad to apply to equity crowdfunding. Finally, Part VII recommends the introduction of a new exemption to the prospectus requirement for equity crowdfunding, a new type of

² See *eg*, the MAS Consultation Paper, *ibid* at para.1.1; Financial Conduct Authority, “The FCA’s Regulatory Approach to Crowdfunding over the Internet, and the Promotion of Non-readily Realisable Securities by Other Media” (March 2014) Policy Statement PS 14/4 [the “FCA Report”].

³ See Bradford, “Crowdfunding”, *supra* note 1 at 101.

⁴ *Jumpstart Our Business Startups Act*, Pub L No 112-106, 126 Stat 306 (2012) [*JOBS Act*].

⁵ The publication of detailed rules by the US Securities Exchange Commission implementing Title III of the *JOBS Act* (Crowdfunding) is pending as of 6 September 2015.

⁶ See Corporations and Markets Advisory Committee, “Crowd Sourced Equity Funding” (Report May 2014) [CMAC, “Crowd Sourced Equity Funding”] for a summary of the positions in Australia, Canada, New Zealand, and Italy.

⁷ See MAS Consultation Paper, *supra* note 1 at 1. As of 6 September 2015, there have been no updates to the consultation paper.

exempt public company, and additional shareholder protection measures to facilitate the development of a crowdfunding industry in Singapore.

II. CROWDFUNDING IN SINGAPORE

Crowdfunding is a relatively recent phenomenon.⁸ Kirby and Worner note that modern securities-based crowdfunding started in the United Kingdom (“UK”) in 2006, spread to the US in 2007 and to China in 2009.⁹

Singaporeans are no strangers to crowdfunding. According to Kickstarter, one of the leading reward crowdfunding platforms worldwide, Singapore contributed US\$6,710,981 to projects on Kickstarter and ranked the number ten country in terms of investor contribution.¹⁰ Several Singapore-based crowdfunding platforms have also emerged in recent years. Notably, two reward crowdfunding platforms, Crowdonomic and Crowdtivate, were launched with the aim to facilitate entrepreneurship in Singapore and Asia.¹¹ Equity crowdfunding, however, is less common. Fundedhere purports to be Singapore’s first equity crowdfunding platform, but it is yet to provide equity crowdfunding services to retail investors.¹² As will be discussed in Part VI, the author believes that legal restrictions which make it impractical for small businesses to raise funds through equity crowdfunding constitute an important reason for the slow development of equity crowdfunding in Singapore.

Since the equity crowdfunding industry is yet to take off in Singapore or other Asian countries,¹³ there is a paucity of research on the characteristics and behaviours of investors who engage in equity crowdfunding. As a result, the author will refer to recent studies conducted in the UK and the US since data of a similar nature from Asian countries are not available. These studies provide useful guidance as to how Asian investors might react to equity crowdfunding.

III. REASONS FOR FACILITATING EQUITY CROWDFUNDING

SMEs are an important pillar of Singapore’s economy. They consistently account for over 99% of all registered enterprises in Singapore,¹⁴ contributing more than

⁸ See Florian Danmayr, *Archetypes of Crowdfunding Platforms: A Multidimensional Comparison* (Wiesbaden: Springer Gabler, 2014), Cap 1.

⁹ Eleanor Kirby & Shane Worner, “Crowd-funding: An Infant Industry Growing Fast” (2014) Staff Working Paper of the IOSCO Research Department SWP3/2014, online: International Organisation of Securities Commissions <<http://www.iosco.org/research/pdf/swp/Crowd-funding-An-Infant-Industry-Growing-Fast.pdf>>. All URLs were last accessed on 6 September 2015.

¹⁰ Kickstarter website, online: Kickstarter <<https://www.kickstarter.com/1billion>>.

¹¹ Crowdonomic, Press Release, “First Crowdfunding Platform for Asia-based Start-ups Launches to Public in Singapore” (21 January 2013), online: Crowdonomic <<https://www.crowdonomic.com/files/uploads/Press%20release%20Crowdonomic%20Launch%20English%2021012013.pdf>>; Starhub, “StarHub i3 Introduces Online Social Launchpad Crowdtivate to Connect Entrepreneurs and Artists with Their Supporters” (9 April 2014), online: Starhub <<http://www.starhub.com/about-us/newsroom/2014/april/starhub-i3-introduces-online-social-launchpad-crowdtivate-to-co.html>>.

¹² Fundedhere website, online: Fundedhere <<http://www.fundedhere.com/proposals>>.

¹³ Both Japan and Malaysia only recently introduced measures to facilitate equity crowdfunding.

¹⁴ Keith Pond, “Bank Lending Operations in the SME Market—A Case Study from Singapore” (August 2014), online: World Business Institute Conference Proceedings <http://www.wbiworldconpro.com/uploads/singapore-conference-2014/banking/1408440853_609-Pond.pdf>.

50% of economic output and 70% of employment.¹⁵ In 2012, about 39,000 of the total SME population were active start-ups, *ie*, enterprises less than five years old which have at least one employee.¹⁶ Access to capital is a major problem for start-ups. Many times, young companies fail not because of flaws in their business plans, but because they suffer from capital gaps, *ie*, the inability to raise additional capital that they need to progress to the next stage of development. In Singapore, start-ups outside the high-tech industry are particularly vulnerable to capital gaps since they have more limited sources of funding. The development of an equity crowdfunding market will not only help bridge this capital gap, but also alleviate other problems caused by the start-up industry's over-reliance on government funding.

A. Government as the Main Source of Funding

While Singapore is ranked number one by the World Bank in ease of doing business and number six in starting one,¹⁷ start-ups in Singapore are deeply reliant on government funding. It is estimated that close to 70% of the early stage funding sources are primarily backed by the government.¹⁸ The main government programmes which provide capital for start-ups can be divided into three types: grants, co-investment programmes, and loans. They are administered and/or funded by either SPRING Singapore, an agency under the Ministry of Trade and Industry responsible for helping Singapore enterprises, or the National Research Foundation (“NRF”), a department set up in 2006 within the Prime Minister's Office, which sets the national policy on research and development.

1. Grants

Grants are typically one-off cash payments to help individuals start their businesses, the most important of which are:

- the Technology Enterprise Commercialisation Scheme (“TECS”);¹⁹

¹⁵ Ministry of Trade and Industry (“MTI”), Press Release, “Government Enhances Support for SMEs to Achieve Quality Growth” (11 Mar 2013), online: MTI <<http://www.mti.gov.sg/NewsRoom/Pages/GOVERNMENT-ENHANCES-SUPPORT-FOR-SMEs-TO-ACHIEVE-QUALITY-GROWTH.aspx>>.

¹⁶ SPRING Singapore, Press Release, NR/28/2014, “New Private-Sector Leadership at Action Community for Entrepreneurship Set to Lead & Engage Singapore's Start-Up Community at JTC LaunchPad@one-north” (29 September 2014), online: SPRING Singapore <<http://www.spring.gov.sg/NewsEvents/PR/Pages/New-Private-Sector-Leadership-at-Action-Community-for-Entrepreneurship-Set-to-Lead-Engage-Singapore-Start-Up-Commu-20140929.aspx>>.

¹⁷ See World Bank, “Economy Rankings”, online: World Bank <<http://www.doingbusiness.org/rankings>>.

¹⁸ SPRING Singapore, Press Release, NR/01/2014, “Entrepreneurship Review Committee (ENRC) Unveils Eight Recommendations to Enhance Entrepreneurship Landscape” (17 January 2014), online: SPRING Singapore <<http://www.spring.gov.sg/NewsEvents/PR/Pages/Entrepreneurship-Review-Committee-Unveils-Eight-Recommendations-to-Enhance-Entrepreneurship-Landscape-20140117.aspx>>.

¹⁹ For TECS details, see online: SPRING Singapore <<http://www.spring.gov.sg/Nurturing-Startups/Pages/technology-enterprise-commercialisation-scheme.aspx>>.

- the ACE start-ups grant (“ACE”);²⁰ and
- the proof-of-concept grant (“POC”).²¹

The key features of each grant are set out below:

Name	Purpose	Industry Focus	Funding Cap
TECS	To commercialise intellectual property	<ul style="list-style-type: none"> – Electronics, photonics & device technologies; – Chemicals, advanced materials & micro/nanotechnologies; – Information communications technologies; – Biomedical sciences (excluding drug discovery) – Water Technologies 	Up to S\$250,000 for proof-of-concept projects; Up to S\$500,000 for proof-of-value projects.
POC	To commercialise cutting-edge technologies & encourage academic entrepreneurship	<ul style="list-style-type: none"> – Medical device; – Information communication technology; – Biotech & pharmaceutical; – Engineering.²² 	Up to S\$250,000 per project
ACE	To support first-time entrepreneurs	All except excluded areas. ²³	Matches S\$7 to every S\$3 raised by the entrepreneur for up to S\$50,000 ²⁴

2. Co-investment programmes

Through co-investment programmes, the government invests either alongside private entities in start-ups or via funds that invest in start-ups. In addition to financial

²⁰ See EnterpriseOne, “The ACE Start-Ups Grant”, [EnterpriseOne, “ACE”] online: EnterpriseOne <<https://www.enterpriseone.gov.sg/en/Government%20Assistance/Grants/Start-Ups/~media/8FB95C3A7CCB45B7AC6618FE25F19A18.ashx>>.

²¹ See NRF, “Proof-of-Concept Grant”, online: NRF <<http://www.nrf.gov.sg/innovation-enterprise/national-framework-for-research-innovation-and-enterprise/proof-of-concept-grant>>.

²² See the list of companies funded by the NRF (divided by sector), online: NRF <<http://www.nrf.gov.sg/innovation-enterprise/nrf-seeded-companies>>.

²³ The excluded areas are nightclubs, lounges, bars; foot reflexology, massage parlours; gambling; prostitution, social escort services; employment agencies; geomancy. See EnterpriseOne, “Ace”, *supra* note 20.

²⁴ Start-ups in a capital intensive industry may apply for an additional S\$50,000.

contribution, private co-investors are often tasked with identifying worthwhile start-ups, providing guidance to them, and/or participating in their management.

The main co-investment programmes include:

- Technology Incubation Scheme (“TIS”);²⁵
- Early Stage Venture Fund (“ESVF”);²⁶
- IDM Jump-start and Mentor (“i.JAM”);²⁷
- SPRING Startup Enterprise Development Scheme (“SPRING SEEDS”);²⁸
- Business Angel Scheme (“BAS”);²⁹ and
- Sector Specific Accelerators (“SSA”).³⁰

The key features of each programme are set out below.

Name	Purpose	Industry Focus	Government Contribution	Co-investor Contribution	
				Funds	Management
TIS	To commercialise cutting-edge technologies & encourage academic entrepreneurship	High-tech industry. Funded start-ups generally fall within four sectors: ³¹ – Medical device; – Information communication technology; – Biotech & pharmaceutical; – Engineering.	Up to S\$500,000	– At least 15% equity participation; – Can buy out the government’s stake in the start-up within 3 years.	– Identify start-ups; – Advise and guide start-ups.
ESVF			Invests up to S\$10 million in each eligible VC fund.	Each VC fund – must match the government’s fund; – can buy out the government’s stake in the fund within 5 years.	– Invest in start-ups as a VC fund

²⁵ See NRF, “Technology Incubation Scheme”, online: NRF <<http://www.nrf.gov.sg/innovation-enterprise/national-framework-for-research-innovation-and-enterprise/technology-incubation-scheme>>.

²⁶ See NRF, “Early Stage Venture Fund”, online: NRF <<http://www.nrf.gov.sg/innovation-enterprise/national-framework-for-research-innovation-and-enterprise/early-stage-venture-fund>>.

²⁷ See Interactive Digital Media (“IDM”), “Application Guideline” (24 June 2008), online: IDM <<http://www.idm.sg/guidelines/>>.

²⁸ See SPRING Singapore, “SPRING Startup Enterprise Development Scheme (SPRING Seeds)”, online: SPRING Singapore <<http://www.spring.gov.sg/Nurturing-Startups/SEEDS/Pages/spring-startup-enterprise-development-scheme.aspx>>.

²⁹ See SPRING Singapore, “Business Angel Scheme (BAS)”, online: SPRING Singapore <<http://www.spring.gov.sg/Nurturing-Startups/Pages/business-angel-scheme.aspx>>.

³⁰ See SPRING Singapore, “Sector Specific Accelerator (SSA) Programme”, online: SPRING Singapore <<http://www.spring.gov.sg/Nurturing-Startups/Pages/sector-specific-accelerator.aspx>>.

³¹ See *supra* note 22.

Name	Purpose	Industry Focus	Government Contribution	Co-investor Contribution	
				Funds	Management
i.JAM	To commercialise innovative ideas	Interactive digital media	Tier 1: up to \$50,000; Tier 2: up to S\$100,000	– Match the government’s tier 2 funding; – Equity participation capped at 30%.	– Identify start-ups; – Administer funding to start-ups; – Advise and guide start-ups.
SPRING SEEDS	To invest in high-growth potential start-ups	Unspecified	Matches co-investor’s contribution up to S\$2 million	At least \$75,000	– Conduct due diligence; – Take up a board seat.
BAS				Unspecified	Unspecified
SSA	To invest in start-ups in strategic but nascent sectors	Medical and clean technology	Matches co-investor’s contribution ³²	Unspecified	– Identify start-ups; – Advise and guide start-ups.

3. Government-assisted loans

To encourage bank lending to SMEs, the government introduced the Micro Loan Programme (“MLP”) in 2001. Under the MLP, the government shares 50% of the default risks on loans of up to S\$100,000 by banks to eligible SMEs for working capital purposes or for upgrading facilities and equipment. The minimum interest rate is 5.5% per annum and the maximum tenure of such loans is four years. Despite the fact that the government bears 50% of the default risks, banks are still reluctant to lend to young companies. Most banks would require corporate borrowers to have at least two or three years of operating experience to be eligible for loans.³³ As a result, an enhanced MLP was introduced in 2014 to further encourage lending to younger SMEs with less than three years of operating history. Under the enhanced MLP, the government shares 70% of the default risks in respect of loans of up to S\$100,000 to companies which are less than three years old.³⁴

B. Implications

Reliance on the government as the predominant funding source for start-ups has several implications.

³² S\$70 million in total has been committed to SSA.

³³ Chang Zhi Yang, “IPS Closed-Door Discussion: Financing for SME Development in Singapore” (August 2014) at 1, online: Lee Kuan Yew School of Public Policy <http://lkyspp.nus.edu.sg/ips/wp-content/uploads/sites/2/2014/08/4-IPS-Closed-Door-Discussion-Financing-for-SME-Development-in-Singapore_4.pdf>.

³⁴ See SPRING Singapore, “Micro Loan Programme (MLP)”, online: SPRING Singapore <<http://www.spring.gov.sg/Growing-Business/Loan/Pages/micro-loan-programme.aspx>>.

First, each government programme has specific policy objectives, eligibility requirements and funding caps; they cannot and are not intended to serve the needs of all types of worthwhile start-ups.

To start with, most government grants and co-investment programmes focus on technologically advanced start-ups with strong growth potential. Only two programmes, *ie*, ACE and i.JAM, do not exclusively target high-tech companies. However, the scopes of both programmes are considerably limited in other ways: ACE is only available to first-time entrepreneurs and has a fairly low funding cap of S\$50,000; i.JAM only supports start-ups in the interactive digital media industry. This means that it would be much more difficult for start-ups in low-tech industries, *eg*, design firms and catering companies, to benefit from government programmes.

Even for companies in the high-tech industry, many worthy projects may be disqualified from government funding for failing to satisfy the various eligibility requirements imposed on the entrepreneur, the start-up, or the co-investor. Many of the requirements imposed are not for the purpose of ensuring the quality of the applicant's business. Rather, they are reflective of the respective policy objectives of the relevant programme (*eg*, to promote local/young businesses or academic entrepreneurship), or are otherwise justified on administrative grounds (*eg*, to avoid overwhelming government agencies with large numbers of applications). For example, POC is only available to staff, researchers and students linked to institutes of higher learning and researchers in public sector research institutes. Programmes such as TIS, i.JAM, BAS, and SSA only fund start-ups recommended by co-investors which have been pre-approved by the government. Given the limited number³⁵ of approved co-investors and the degree of financial and other commitments required to support a start-up, the number of start-ups that can benefit from each programme is necessarily limited. A majority of the programmes also have additional requirements relating to the start-up's place of registration, place of core activities, percentage of local shareholding and the amount of paid-up capital.

Given the various restrictions associated with government funding, it is likely that a considerable number of worthwhile start-ups would not be able to receive them.

Secondly, start-ups which cannot obtain government funding are equally likely to experience difficulty seeking funds from private funding sources, such as VC/PE firms, angel investors, and banks.

1. VC/PE firms

Leading VC and PE firms present in Singapore which invest in early stage businesses tend to invest exclusively in companies with high-growth potential and a high

³⁵ As of June 2015, the number of approved entities is 14 for TIS, 10 for i.JAM, 7 for BAS and 4 for SSA. See NRF, "Technological Incubators", online: NRF <<http://www.nrf.gov.sg/innovation-enterprise/national-framework-for-research-innovation-and-enterprise/technology-incubation-scheme>>; i.JAM, "Incubators", online: i.JAM <<http://www.idm.sg/incubators/>>; SPRING Singapore, "Participating Business Angel Investors", online: SPRING Singapore <<http://www.spring.gov.sg/Nurturing-Startups/Pages/business-angel-scheme.aspx>>; SPRING Singapore, "Appointed Medtech Sector-Specific Accelerators", online <<http://www.spring.gov.sg/Nurturing-Startups/Pages/sector-specific-accelerator.aspx>>.

likelihood of going public within a few years.³⁶ Most of them are solely interested in businesses which have moved beyond the product development stage, gained some market traction, and prepared to expand into new markets. Many have minimum investment thresholds which are much higher than the amount of capital required by entrepreneurs to kick start their businesses.³⁷ In addition, VC/PE firms typically are highly selective and invest only within their areas of expertise. Most of them target high-tech companies in a few selected sectors, such as the internet, mobile, digital media, and renewable energy. Further, with the exception of a few international VC/PE firms, they generally invest in no more than 20 companies and diversify their investments across different countries: a large percentage of these firms have less than five Singapore-based companies in their portfolio.³⁸ Notably, VC/PE firms which do not have access to government funding through co-investment programmes tend to have a smaller percentage of Singapore-based companies in their portfolio. Given their selectivity, narrow focus and minimum investment thresholds, VC/PE firms are inaccessible to most start-ups.

2. Angel investors

Angel investors are more active in investing in start-ups. They are typically high net worth individuals with an appetite for young companies with higher risks.³⁹ Nevertheless, angel investment is relatively new in Singapore and remains a limited funding source for start-ups.⁴⁰ Like VC firms, angel investors are only interested in companies with high growth potential within a few years.⁴¹ According to BANSEA,⁴² the most established Singapore-based angel investment group, it has facilitated at least 53 investment deals between 2007 and the first half of 2010. The majority of those deals “appeared to be in internet technologies, interactive digital media, info-communication technologies (ICT) and biomedical devices”.⁴³

³⁶ The same applies to VC firms in the US. See Securities and Exchange Commission (“SEC”), *Proposed Rules: Crowdfunding* at 330-332, online: SEC <<http://www.sec.gov/rules/proposed/2013/33-9470.pdf>>.

³⁷ Eg, the respective minimum funding requirements are US\$0.5 million for Digital Media Partners and OWW capital partners and US\$ 1 million for Enspire Capital, Hera Capital, and Vertex Venture. See Digital Media Partners, “FAQ”, online: Digital Media Partners <<http://digitalmedia.vc/faq/>>; OWW Capital Partners, “Investment Scope”, online: OWW Capital Partners <<http://www.oww.com.sg/scope%20II.htm>>; Enspire Capital, “Investment Focus”, online: Enspire Capital <<http://www.enspire-capital.com/focus.html>>; Hera Capital, “About Us”, online: Hera Capital <<http://hera-capital.com/>>; Vertex Venture, “Our Investment Strategy”, online: Vertex Venture <<http://www.vertexmgt.com/strategy.asp>>.

³⁸ The actual number of Singapore-based start-ups receiving VC/PE funding is even smaller since a number of companies (such as Reebonz, 99.co, Redmart, Justcommodity, Crayon Data, The Stakeholder Company) receive funding from multiple VC/PE firms.

³⁹ Kevin Hindle and Leo Lee, “An Exploratory Investigation of Informal Venture Capitalists in Singapore” *Venture Capital*, 2002, Vol. 4, No. 2, 169 at 170.

⁴⁰ Wong Poh Kam, “Overview of Angel Investing in Singapore”, *Tech In Asia* (28 May 2011), online: *Tech In Asia* <<https://www.techinasia.com/overview-of-angel-investing-in-singapore/>>.

⁴¹ Hawksford, “Venture Funding Options for Singapore Companies” online: Hawksford <<http://www.guidemesingapore.com/doing-business/finances/private-equity-financing-for-singapore-startups>>.

⁴² BANSEA stands for Business Angel Network Southeast Asia.

⁴³ See *supra* note 40.

3. Commercial banks

Commercial banks are by nature profit-driven and risk-averse. They usually require borrowers to provide securities for their loans, a requirement that many start-ups with limited assets would find difficult to fulfil. In fact, the very existence of government programmes such as MLP and enhanced MLP suggests that, in the absence of government assistance, banks would be reluctant to lend to SMEs and to start-ups in particular. Moreover, since banks ultimately decide whether and under what terms a loan should be granted, it is doubtful whether the enhanced MLP can significantly boost lending to start-ups. For instance, although the OCBC bank has recently introduced a loan product under the enhanced MLP programme, it is only available to borrowers who are able to provide a guarantor for their loan.⁴⁴ Finding a guarantor is likely to be difficult for start-ups since they are considered highly risky businesses and have an estimated failing rate of 70% in the first year.⁴⁵ In any event, bank loans would not be suitable for many start-ups. It can take a few months or years for start-ups to generate profits to meet the periodic repayment requirements associated with bank loans. Even after they do, their cash flow may be volatile, making it harder for them to meet repayments.⁴⁶

Thirdly, over-reliance on government funding can be dangerous on several fronts. Lerner has recognised the “stark truth that more public programmes to stimulate entrepreneurship have been unsuccessful than successful”⁴⁷ and highlighted a number of pitfalls associated with the design and implementation of such programmes. These include, for example, failure to adopt a market-oriented approach, to ensure recipients of public funds are properly incentivised, and to avoid excessive restrictions which limit the flexibility of entrepreneurs.⁴⁸

These problems can be found to varying degrees in Singapore. To begin with, entrepreneurs have complained that, in some government programmes, members of the panel which decides whether to fund a project are academics without practical experience in the business.⁴⁹ Moreover, many government programmes only fund businesses recommended by a small number of pre-approved co-investors. However, there is little public information on the selection criteria of these co-investors or their recommendation process, leaving room for potential abuse and regulatory capture. This is compounded by the fact that government programmes are not subject to periodic public review. For some programmes, *eg*, SPRING SEEDS and BAS, basic

⁴⁴ See OCBC Bank, “Business First Loan”, online: OCBC <<http://www.ocbc.com.sg/business-banking/loans/micro-loan.html>>.

⁴⁵ See MTI, “Minister Lim Hng Kiang’s Written Reply to Parliament Question on Business Failure Rates amongst Singapore SMEs” (14 Aug 2012) [MTI, “Minister Lim’s Reply”], online: MTI <<http://www.mti.gov.sg/NewsRoom/Pages/Minister-Lim-Hng-Kiang's-Written-Reply-to-Parliament-Question-on-Business-Failure-Rates-amongst-Singapore-SMEs.aspx>>.

⁴⁶ Australian Government, “Crowd-sourced Equity Funding—Discussion Paper” (December 2014) at para 1.2.

⁴⁷ Josh Lerner, *Boulevard of Broken Dreams: Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed—and What to Do about It* (Princeton: Princeton University Press, 2009) at 111 [Lerner, *Broken Dreams*].

⁴⁸ See *ibid*, Cap 9.

⁴⁹ Terence Lee, “i.JAM revamp? Entrepreneurs, Investors Weigh In On What It Needs to Do to Stay Relevant”, Tech In Asia (19 March 2013), online: Tech In Asia <<https://www.techinasia.com/i-jam-revamp-entrepreneurs-investors-weigh-in-on-what-it-needs-to-do-to-stay-relevant/>>.

information such as which companies have been funded is considered confidential and hence lies outside the public domain. The absence of evaluation also renders it difficult to assess whether the size, duration and funding conditions of any specific programme are appropriate.

In addition, the availability of generous government funding may be counter-productive in promoting an entrepreneurial environment. Government programmes which offset 85% to 100% of the costs in developing a product or setting up a company provide an unrealistically protected environment in which the government shares limited upside returns, but most of the downside risks. Entrepreneurs who are used to such a low-risk environment may not have sufficient hunger and drive which are essential to building a successful business. Further, in competing for government funding, applicants would be more sensitive to the preferences of the decision-makers of each government programme and more used to having their ideas pre-approved by them, which is not conducive to the growth of a market-oriented and risk-taking entrepreneurial community.

Finally, extensive government funding can hinder the development of private sector investment in start-ups. It is tempting for the government to choose projects based on their likelihood of success. However, these are the projects which probably would have received funding from private sectors in any event. By competing with the private sector, government programmes may have the unintended effect of crowding out private investments, forcing them to go after more risky projects or leave the market.

C. *Benefits of Crowdfunding*

By contrast, crowdfunding has a meaningful and significant role to play in Singapore to support some of the 50,000 new businesses being set up every year.⁵⁰ It brings new sources of funding to start-ups, providing a more balanced funding structure which is less reliant on government programmes. In addition, crowdfunding has a number of advantages: it facilitates a more market-oriented business approach, constitutes a fairer and more transparent funding model, and helps nurture an entrepreneurial community.

1. *New sources of funding*

At the moment, a start-up's ability to obtain external funding largely depends on its founders' personal connections and their ability to attract funding from professional investors or the government. Crowdfunding enables start-ups to seek backing from persons they have no prior connection with and from persons that have not previously invested in early stage companies. This is significant for several reasons.

First, this new class of investors are likely to be interested in investing in a wider variety of start-ups, either because they have a lower expectation of return

⁵⁰ Based on the Singapore Business Formation Statistics Report, the number of new businesses set up are 56,681 (2012) and 55,699 (2011). See Janus Corporate Solutions, "Singapore Business Formation Statistics Report: For the Year 2012", online: Janus Corporate Solutions at <<http://www.guideme.singapore.com/wp-content/uploads/2013/02/Singapore-Business-Formation-Statistics-for-2012.pdf>> at 3.

as compared to professional investors and the government and/or because they are not solely motivated by financial incentives.⁵¹ As noted earlier, start-ups in lower technology sectors have a much lower chance of securing funding from the government/professional investors and hence would greatly benefit from this additional funding source. Experience in the UK shows that equity crowdfunding has been widely used to support start-ups in traditional industries. According to Crowdcube, one of the leading UK equity crowdfunding platforms, food & drinks and the retail industry are among the five sectors which were most funded on Crowdcube.⁵² The public also tends to be more adventurous and willing to take risks in new and innovative projects. For example, the wildly successful Pebble watch was rejected by VC firms before the project received millions of dollars from the public through crowdfunding.⁵³

Additionally, crowdfunding helps local entrepreneurs tap into the international funding market. A good example would be the Israeli equity crowdfunding platform OurCrowd which attracts accredited investors (“AIs”) worldwide to invest in Israeli start-ups: only ten percent of its investors are from Israel (and more than 40% are from the US).⁵⁴

Finally, allowing crowdfunding to fill the funding gap would free up government funds to be put to better use. For example, tax-dollars presently used to fund start-ups through grants and co-investment programmes can instead be used to support fundamental or basic research. Government funding of such research is important because, while such research is extremely important, commercial returns on such research are speculative and would take so long that it would be very difficult to find any commercial investors willing to invest in them.⁵⁵

2. Market-oriented approach

Understanding customer needs is essential for the success of any start-up. The recent lean start-up movement emphasises the importance for entrepreneurs to reach out to customers at the product development stage and to modify their products in accordance with customer feedback.⁵⁶

⁵¹ Crowdfunding investors who invest in renewable energy are predominantly motivated by the desire to make a positive social impact. See Peter Baeck, Liam Collins & Bryan Zhang, “Understanding Alternative Finance, the UK Alternative Finance Industry Report 2014” (November 2014) at 81 [Baeck, Collins & Zhang, “UK Report 2014”], online: Nesta <<https://www.nesta.org.uk/sites/default/files/understanding-alternative-finance-2014.pdf>>.

⁵² See Crowdcube, “Crowdcube Infographic” [Crowdcube, “Infographic”], online: Crowdcube <<https://www.crowdcube.com/infographic>>.

⁵³ Mark Milian, “Rejected by VCs, Pebble Watch Raises \$3.8M on Kickstarter”, Bloomberg Business (17 April 2012), online: Bloomberg <<http://go.bloomberg.com/tech-deals/2012-04-17-rejected-by-vcs-pebble-watch-raises-3-8m-on-kickstarter/>>.

⁵⁴ Gwen Ackerman, “Israeli Startup Chips Away at Venture Capital’s Ivory Tower” Bloomberg Business (1 August 2013), online: Bloomberg <<http://www.bloomberg.com/news/articles/2013-07-31/israeli-startup-chips-away-at-venture-capital-s-ivory-tower>>.

⁵⁵ Mariana Mazzucato, *The Entrepreneurial State: Debunking Public vs. Private Sector Myths* (London: Anthem Press, 2013) at 60, 61.

⁵⁶ Steven Blank, *The Four Steps to the Epiphany: Successful Strategies for Products that Win* (Foster City, California: Cafepress.com, 2006); Eric Ries, *The Lean Startup: How Today’s Entrepreneurs Use Continuous Innovation to Create Radically Successful Businesses* (New York: Crown Business, 2011).

Crowdfunding facilitates this strategy. The crowdfunding process allows start-ups to test the market and pitch their ideas to the public. The public (as a collective body) are arguably as good as (if not better than) the government or professional investors in spotting marketable consumer products and/or services. The reason for this is obvious: the crowd is likely, to a significant extent, to be representative of the consumers which the products and services will eventually be marketed to. Consequently, the crowd's determination of the marketability of the product or service is likely to be a good indicator of how the market will eventually view the product or service being offered. Recent studies have sought to test the collective wisdom of the crowd: Mollick and Nanda compared the decisions of the crowd and that of the expert in funding theatre projects.⁵⁷ They randomly assigned sets of theatre projects featured on Kickstarter to experts (*ie*, people who have expertise judging theatre applications for various art institutions) to evaluate. Each set consists of both projects which failed and succeeded in obtaining funding from the crowd through Kickstarter; and the projects were presented in the same way as they were on Kickstarter. Mollick and Nanda reached two interesting conclusions: first, the expert and the crowd agreed on which projects to fund in the majority of the cases; secondly, the long-term outcome of the projects which were funded by both the crowd and the expert and those funded by the crowd alone were largely similar.

Entrepreneurs benefit from the crowdfunding process even if they fail to attract sufficient investors: they are able to save the costs of developing products/services which are unlikely to be well-received by the market. For others, the ability to demonstrate the existence of a market for their products/services makes it easier for them to obtain subsequent funding from professional investors. A survey of companies which have raised funds through major crowdfunding platforms shows that 28% of the companies obtained funding from angel investors or VC firms within three months of the completion of the crowdfunding investing round, and an additional 43% were in discussions with institutional investors.⁵⁸

3. *Fairer and more transparent*

Crowdfunding is arguably a fairer means of financing start-ups as it allows the investing public to reap some of the benefits of the business if it succeeds. This must be contrasted with the present situation where taxpayers are effectively forced, through government programmes, to bear the costs of private risk-taking with little chance to enjoy the benefits in the event the risk pays off. For example, the government often does not take any equity stake in the companies it invests in. Even when it does, private co-investors are sometimes given an option to buy out the government's stake where the start-up they co-invest in turns out to be successful. This essentially limits the amount of benefits the government can receive from investing in start-ups.

⁵⁷ Ethan Mollick & Ramana Nanda, "Wisdom or Madness? Comparing Crowds with Expert Evaluation in Funding the Arts" (26 August 2014) Harvard Business School Working Paper 14-116, online: Harvard Business School <http://www.hbs.edu/faculty/Publication%20Files/14-116_a40be71c-2ca5-409c-8087-5e43d9597aba.pdf>.

⁵⁸ Congressional Testimony before the Subcommittee on Investigations, Oversight and Regulations of the United States House of Representatives Committee on Small Business, "SEC's Crowdfunding Proposal: Will it work for small business?" (16 January 2014) at 41.

With equity crowdfunding, the profits of the business funded by the public would be distributed to a wider cross-section of society instead of simply being put into the pocket of the few successful entrepreneurs and professional investors.

Crowdfunding is also a more transparent means of funding start-ups. As noted earlier, none of the government programmes has been subject to any public evaluation since their inception and there is little information on which companies receive public funding or how well those companies perform over the years. In contrast, such information would be publicly available if such financing took place through crowdfunding.

4. *Nurture entrepreneurial culture*

The importance of an entrepreneurial environment cannot be over-emphasised. As Lerner has observed, entrepreneurs are extremely dependent on their partners, *eg*, experienced lawyers to negotiate deals, marketing specialists and engineers, as well as adventurous customers and investors.⁵⁹ While the existing early stage investment community is fairly exclusive, crowdfunding helps more people gain exposure to the start-up industry either as a crowd investor, lawyer, promoter, an accountant, or entrepreneur. It helps de-mystify entrepreneurship and nurture a network of experienced professionals to service the industry.

D. *Why Equity Crowdfunding*

While many of the above-mentioned benefits apply to all forms of crowdfunding, equity crowdfunding appears to be the most viable option for start-ups.

First of all, the amounts raised through donation-based or reward-based crowdfunding are generally insufficient to serve the financial needs of new businesses.⁶⁰ According to a 2014 survey by Nesta and the University of Cambridge on the UK alternative finance industry, the average amount raised through reward-based and donation-based crowdfunding was only £3,766 and £6,102 respectively.⁶¹ In contrast, the average amount raised through equity crowdfunding was £199,095.⁶²

Furthermore, reward-based and donation-based crowdfunding are appropriate only for limited types of businesses while equity crowdfunding is generally suitable for all. Donation-based crowdfunding is unlikely to be a viable option for most for-profit businesses. Reward-based crowdfunding is not suitable for businesses whose products or services cannot be easily used as rewards to attract contributions from the crowd. There can be many reasons why their products/services are inappropriate for reward-based crowdfunding.

- The products/services may be too niche for the general public: for example, CIPHER Surgical is a company that has developed a patented medical device which makes laparoscopy (keyhole surgery) safer and quicker. It is likely that many who are

⁵⁹ Lerner, *Broken Dreams*, *supra* note 47 at 181.

⁶⁰ Although reward-based crowdfunding projects have occasionally raised millions of dollars, these are more the exception than the rule.

⁶¹ See UK Report 2014, *supra* note 51 at 14.

⁶² *Ibid.*

interested in investing in Cipher Surgical do not necessarily want to receive the medical device as a reward for their investments.⁶³

- Geographical constraints: for example, restaurants which offer dining points as rewards can only attract people who live close enough to be able to use those points without incurring significant transportation costs.

Debt-based crowdfunding, like bank loans, caters for more mature businesses which have gained some traction in the market and established a steady stream of cash flows to meet the periodic repayment requirements.

IV. RISKS OF EQUITY CROWDFUNDING

Despite the above-mentioned benefits, investing through equity crowdfunding is not without risks. The main risks fall into three types: issuer-related risks, platform-related risks and investor-related risks.

A. Issuer-Related Risks

1. High-failure rate

To begin with, investing in early stage businesses is riskier than investing in more established businesses. There is a much greater degree of uncertainty surrounding the key factors which determine the success of a business, ranging from the viability of the business plan, quality of the management team, demand from the market for the company's product/service, level of competition from similar companies, to name just a few. Experience has shown that most start-ups fail,⁶⁴ significantly, it has been said that seven to eight out of ten newly established businesses in Singapore fail within the same year.⁶⁵

2. Illiquidity

The risk of investing in start-ups is further exacerbated by the highly illiquid nature of such investments. In contrast to shares in well-known public or listed companies, it is unlikely that there will be a meaningful secondary market for shares in a start-up. This means that, having made their investment, equity crowdfunding investors are likely to have very limited exit options. Furthermore, as start-ups are focused on growing their businesses, there is unlikely to be any return by way of dividends in the short or medium term. Taken together, this means investors may not see the fruits of their investments unless and until the business is bought by a third party or goes public. For better or worse, crowd investors' funds are locked in until the start-up eventually succeeds or fails.

⁶³ It is unsurprising that the company turned to equity crowdfunding. See Syndicate Room website, online: <<https://www.syndicatoroom.com/ciphersurgical>>.

⁶⁴ In the UK, around 50% to 70% of business start-ups fail over five years. In the US, 65% of new business establishments fail over ten years. See the MAS Consultation Paper, *supra* note 1 at para1.4.

⁶⁵ See MTI, "Minister Lim's Reply", *supra* note 45.

3. *Information asymmetry*

Another important part of the issuer-related risks is information asymmetry, *ie*, the fact that the issuer knows the condition of its business better than crowd investors. Information asymmetry presents an opportunity for issuers to take advantage of investors in two ways:

- a. provide crowd investors with misleading information which paints an overly optimistic picture of its business, omit material adverse information, or in extreme cases, conduct fraudulent campaigns solely for the purpose of cheating investors' money; and
- b. moral hazard problems, *eg*, issuers might misuse funds obtained from crowd investors, or act in a way to further their own interests at the expense of the investors'.

B. *Investor-Related Risks*

Various types of investor-related risks are relevant in the context of equity crowdfunding.

1. *Low financial literacy*

Firstly, certain members of the crowd may lack sufficient financial literacy to accurately understand the financial information presented by the issuer or the rights attached to the type of shares that they intend to purchase. As a result, these investors may not be able to fully appreciate the risks involved in their investment to make an informed decision. They are more susceptible to be adversely influenced by misleading statements, whether intentionally or honestly made, and less able to properly evaluate the company's current value and future performance.

2. *Insufficient shareholder protection*

Secondly, a crowd investor who does not invest a significant sum in a company would not have the bargaining power to negotiate extensive shareholder protection provisions to safeguard his interests. The terms of the investment are usually set by the entrepreneur on a take it or leave it basis. Without adequate shareholder protection, a crowd investor may not be able to fully enjoy the benefits of a successful investment.

(a) *Dilution*: The crowd investor's shareholding might be unfairly diluted. Start-ups are likely to need several rounds of additional funding to keep them afloat or take them to the next level. Each round may involve issuance of additional shares. Issuance of new shares to new investors can result in dilution of shares held by existing shareholders. It will increase the total number of outstanding shares, which in turn decreases the percentage of shares owned by crowd investors. In the absence of proper anti-dilution protection, crowd investors could find themselves in the position of Eduardo Saverin, a Facebook co-founder, whose original 30% shareholding in

Facebook was diluted to 0.3% when new investors came along.⁶⁶ The dilution problem is more prominent in a down-round, *ie*, where new shares are issued at a lower price than that paid by existing investors. In such cases, issuance of new shares would cause each crowd investor to hold a smaller percentage of shares in a less valuable company.

(b) *Exclusion from exit opportunity*: Further, as minority shareholders of an unlisted company, crowd investors might be excluded from an opportunity to realise their investments while the majority shareholders are able to sell their shares to a third party.

3. *Difficulty in monitoring the start-up's performance*

Thirdly, crowd investors are likely to lack incentive, skills and/or resources to adequately maintain up-to-date knowledge of the company's performance and to prevent, detect or remedy misconduct, which in turn may increase the likelihood of moral hazard problems.

(a) *Collective action problem*: If a crowd investor invests a modest sum in a company, it is rational for that investor not to spend significant amounts of time and effort in monitoring that company because he has to bear all the monitoring costs but only receives a small percentage of the benefit. It is unlikely, for example, for a crowd investor to take the more drastic measure of bringing unfair prejudice proceedings against the directors or majority shareholders, the cost of which would be disproportionate to the amount he can expect to recover. This can lead to a collective action problem where investment in the business is so dispersed that none of the investors has sufficient "skin in the game" to act on behalf of the crowd.⁶⁷

(b) *Lack access to information and experience*: More critically, even if crowd investors are motivated to maintain oversight of their company, they would not have access to sufficient information to keep themselves informed of the company's performance. As minority shareholders, their main source of information would be the annual general meetings ("AGMs"). While AGMs must be held every year, an interval of 15 months is allowed between two meetings,⁶⁸ during which crowd investors are not entitled to much information. Furthermore, crowd investors are likely to lack experience monitoring early stage companies. According to the UK Report 2014, 62% of the crowdfunding investors described themselves as "retail investors with no previous investment experience of early stage or venture capital investment."⁶⁹ It will take time for a community of experienced investors to emerge.

⁶⁶ Shibani Mahtani, "The Other Facebook Founder", *The Wall Street Journal* 17 May 2012, online: <http://www.wsj.com/articles/SB10001424052702303877604577380131964661806>.

⁶⁷ Jason Parsont, "Crowdfunding, the Real and the Illusory Exemption" 2014 4 *Harv. Bus. L. Rev.* 281 at 319.

⁶⁸ See s 175(1) of the *Companies Act* (Cap 50, 2006 Rev Ed Sing) [CA].

⁶⁹ Financial Conduct Authority, "A Review of the Regulatory Regime for Crowdfunding and the Promotion of Non-readily Realisable Securities by Other Media" (February 2015), online: [Financial Conduct Authority <http://www.fca.org.uk/static/documents/crowdfunding-review.pdf>](http://www.fca.org.uk/static/documents/crowdfunding-review.pdf).

C. Platform-Related Risks

The interests of equity crowdfunding platforms are not always aligned with that of the crowd investor. While all platforms receive a fee in the form of a percentage of the funds raised, many do not receive any monetary benefit if investors receive profits from their investment (although they do indirectly benefit through enhanced reputations, which may lead to more investors and potentially more deals). Therefore, less far-sighted platforms would have greater incentive in ensuring the quantity rather than the quality of the projects funded through them.

V. MAS PROPOSAL

As noted above, the MAS has proposed measures to facilitate securities-based crowdfunding in Singapore. A notable feature of the proposal is that securities-based crowdfunding should only be made available to AIs and institutional investors (“IIs”).⁷⁰ This is undesirable for several reasons.

To begin with, it would take the crowd out of crowdfunding. AIs are defined in s 4A of the *SFA* as:

- a. individuals whose net personal assets exceed S\$2 million or whose income in the preceding 12 months is not less than S\$300,000;
- b. corporations with net assets exceeding S\$10 million; and
- c. other persons prescribed by the MAS.⁷¹

By contrast, the average monthly household income from work per household member for the wealthiest ten percent of the population in Singapore is merely S\$11,198 in 2013 and S\$12,032 in 2014.⁷² The 2015 budget speech notes that the top five percent of Singaporeans earn at least S\$160,000,⁷³ which is still significantly lower than the amount required for an individual to qualify as an AI (*ie*, S\$300,000). It is likely that only less than five percent of the Singaporeans will be able to participate in equity crowdfunding if it is limited to AIs and IIs.

Moreover, it is likely to be difficult and costly for crowdfunding platforms to attract the attention of AIs and IIs since the latter have many alternative investment options (such as stocks and investment products) both domestically and internationally. The difficulty of attracting high net worth individuals to participate in crowdfunding is supported by the UK Report 2014. These individuals only represent a small percentage of the investors in various crowdfunding activities in the UK: only four percent of the surveyed investors in P2P business lending (a form of debt-based

⁷⁰ See the MAS Consultation Paper, *supra* note 1 at para 1.8. IIs are defined in s 2 of the *Securities and Futures Act* (Cap 289, 2006 Rev Ed Sing) [*SFA*] to include banks, finance companies, entities licensed under the *Insurance Act* (Cap 142, 2002 Rev Ed Sing) or the *Trust Companies Act* (Cap 336, 2006 Rev Ed Sing), the government, statutory bodies, funds, holders of capital markets licences, entities which carry on the business of dealing in bonds with AIs or expert investors, and certain trustees.

⁷¹ *SFA*, *ibid*.

⁷² Department of Statistics Singapore, “Key Household Income Trends, 2014”, online: Department of Statistics Singapore <http://www.singstat.gov.sg/docs/default-source/default-document-library/publications/publications_and_papers/household_income_and_expenditure/pp-s21.pdf> at 6.

⁷³ See Singapore Budget 2015, online: Singapore Budget <http://singaporebudget.gov.sg/data/budget-2015/download/FY2015_Budget_Statement.pdf> at para G35.

crowdfunding) and seven percent in equity crowdfunding has an annual income of £150,000 or more (around S\$306,000).

A further problem is that restricting equity crowdfunding to AIs and IIs would deprive equity crowdfunding of much of its potential benefits discussed above. For example, it would not bring a new class of investors who are less profit-driven and more willing to take risks in a diverse range of projects. It would also deprive start-ups of the wisdom of the crowd and a chance to test their products in the market. The start-ups' target consumers are often the general public, rather than the wealthiest five percent. Limiting equity crowdfunding to a small community of investors also would not have the desirable effect of fostering a more inclusive entrepreneurial community.

Finally, many of the risks associated with equity crowdfunding can and should be mitigated through other means. The various issuer-related risks, such as high failure rate and illiquidity, should not prevent retail investors from investing in start-ups as long as they are made aware of these risks before making an investment. This can be achieved by requiring investors to take a mandatory test which highlights the risks of equity crowdfunding before making an investment.⁷⁴ While limiting equity crowdfunding to AIs and IIs would largely exclude investors with lower financial literacy, the same can be achieved through less restrictive means, for example, by requiring that investors must either have tertiary education or income of not less than S\$50,000. Investors who satisfy either requirement are likely to have sufficient means to understand the information contained in crowdfunding pitches and the relevant risk warnings. Investors who do not satisfy either requirement may elect to take an online course which explains the essential knowledge each crowd investor should possess, including the various ways to evaluate, value and finance start-ups as well as the main statutory and contractual rights enjoyed by minority shareholders. These investors can demonstrate that they have the necessary background knowledge to participate in equity crowdfunding by passing an online test after the course. Other investor-related risks, such as insufficient shareholder protection and difficulty of monitoring the performance of start-ups, are caused by the fact of having many minority shareholders making small investments in a start-up. These problems would remain even if equity crowdfunding is limited to professional investors. The more effective way to address these problems would be to provide additional minority shareholder protection (as elaborated in Part VII below).

In light of the above, it is submitted that equity crowdfunding should in principle be available to the general public.

VI. LEGAL BARRIERS TO EQUITY CROWDFUNDING

However, a number of provisions under Singapore law make it costly for start-ups to engage in equity crowdfunding. These include:

- the requirement that an offer of securities must be accompanied by a prospectus (the "prospectus requirement");
- restrictions against advertising an offer of securities; and
- the shareholder cap for private companies.

⁷⁴ This is the approach taken in the UK.

A. Prospectus Requirement

As equity crowdfunding involves an offer of securities, it is subject to the prospectus requirement set out in the *SFA*. Section 240 of the *SFA* requires a person seeking to make offerings of its shares (the “issuer”)⁷⁵ to prepare and register with the MAS a prospectus complying with s 243 of the *SFA*. Section 243 of the *SFA* in turn provides that the prospectus should contain all the information that investors and their professional advisers would reasonably require to make an informed assessment of “(a) the rights and liabilities attaching to the shares; (b) the assets and liabilities, profits and losses, financial position and performance, and prospects of the issuer;” and (c) any additional requirements specified by the MAS.⁷⁶ For offers of unlisted shares, the additional particulars that a prospectus must contain can be found in the Sixth Schedule to the *Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005*,⁷⁷ which contains over two hundred paragraphs and sub-paragraphs. The costs of complying with the prospectus requirement are likely to be disproportionately high for start-ups and small businesses intending to raise the relatively modest sums they need. The legal costs of conducting due diligence on the company and its officers, drafting and reviewing a prospectus, as well as liaising with the MAS and other professional advisers (*eg*, accountants) can easily run into tens of thousands of dollars. Even assuming a conservative hourly charge out rate of S\$300 per hour and a similarly conservative 100 hours of work to prepare and register a prospectus, that would mean S\$30,000 in legal costs. This does not include auditing fees, which can easily cost several thousand dollars.⁷⁸ Miscellaneous fees and expenses can add another few thousand (*eg*, the S\$2,000 fee for lodging a prospectus with the MAS).

This means that a company seeking to raise a sum of S\$100,000 can easily end up spending more than 30% of this sum up-front in complying with the prospectus requirement. Critically, there is no guarantee that the company will get any funding even after incurring these up-front costs. Many crowdfunding platforms have an all-or-nothing policy, that is, if a company does not meet its funding target within the specified funding period, it is not entitled to keep any of the funds it has raised during that period. According to Crowdcube, almost half of the offers on its website do not reach their funding targets.⁷⁹

In light of the above, the prospectus requirement, if applied to equity crowdfunding, is likely to render equity crowdfunding impractical for the small businesses that need it the most.

⁷⁵ For simplicity, it will be assumed that the person making an offer of securities is the company whose shares underlie the offer. The company will be referred to as the issuer throughout the paper.

⁷⁶ Sections 243 (1) and (3) of the *SFA*, *supra* note 70.

⁷⁷ (Cap 289 2006 Rev Ed Sing) [*SFA Regulations*].

⁷⁸ Companies that engage in crowdfunding often provide profit forecasts to attract investors and justify their offer price; if such forecasts are provided in the prospectus, an auditor’s opinion is required. See para 10 of Part IV of the Sixth Schedule to the *SFA Regulations*, *ibid*.

⁷⁹ See Crowdcube, “Infographic”, *supra* note 52.

B. Exemptions from the Prospectus Requirement

The *SFA* does contain a number of exemptions from the prospectus requirement. However, as discussed below, equity crowdfunding is unlikely to fall within the ambit of these exemptions.

1. Small offers

Section 272A of the *SFA* exempts certain small offers from the prospectus requirement. To qualify for the exemption, small offers, *ie*, the total amount of which during a 12-month period do not exceed S\$5 million, must also be personal offers.⁸⁰

However, offers made through a crowdfunding platform arguably would not be considered “personal”. Section 272A(3) of the *SFA* provides that a personal offer is one that:

- a. may be accepted only by the person to whom it is made; and
- b. made to a person who is likely to be interested in that offer, having regard to
 - (i) any previous contact or connection between the offeror and that person; or
 - (ii) any previous indication by that person to
 - A. the offeror; or
 - B. a specified person
 that he is interested in offers of that kind.

Specified persons are (broadly speaking) persons who are authorised to deal in securities or to provide financial advisory services concerning investment products in Singapore or a foreign jurisdiction.⁸¹

The MAS guidelines on the small offers exemption note that this exemption was introduced to make fundraising less costly for SMEs,⁸² which are most likely to raise funds from VC firms, angel investors, associates as well as family and friends, who would not need to rely on a prospectus. The first limb of the exemption, *ie*, offers made to persons with previous contact or connection with the offeror, are meant to cover persons who already have access to the information which is required to be included in a prospectus, *eg*, the offeror’s family members and controlling shareholders.⁸³ The second limb of the exemption, *ie*, offers made to persons that have indicated their interest to the offeror or a specified person, is meant to facilitate offers of securities to VC firms and angel investors, which are likely to have sufficient professional experience and expertise to evaluate the securities being offered without requiring a prospectus.⁸⁴ Since SMEs may have limited contacts, they are allowed to

⁸⁰ Section 272A(1) of the *SFA*, *supra* note 70.

⁸¹ Section 272A(3)(b)(iii) of the *SFA*, *ibid*.

⁸² MAS, “Shares and Debentures Guidelines 4: Guidelines on Personal Offers Made pursuant to the exemption for Small Offers” (15 October 2005) [MAS, “Guidelines”] at para 4.1, online: MAS <<http://www.mas.gov.sg/~media/MAS/Regulations%20and%20Financial%20Stability/Regulations%20Guidance%20and%20Licensing/Securities%20Futures%20and%20Fund%20Management/Regulations%20Guidance%20and%20Licensing/Guidelines/Guidelines%20on%20Personal%20Offers%20Made%20Pursuant%20to%20the%20exemption%20for%20small%20offers.pdf>>.

⁸³ See MAS, “Guidelines”, *ibid* at paras 6.3-6.5.

⁸⁴ See *ibid*, paras 6.6, 6.7.

enlist help from specified persons to make offers to VC firms and angel investors with whom they have no previous connection. However, the MAS guidelines specifically require SMEs to ensure that such specified persons have proper “know your client” (“KYC”) and pre-qualification procedures to ensure that offers are made only to investors who fully understand the risks involved.

Neither limb of the exemption seems wide enough to facilitate an offer of shares on equity crowdfunding platforms. In such cases, an issuer is essentially making an offer to any investor who can see and accept its offer, *ie*, anyone who has registered with the relevant crowdfunding platform. The first limb of the exemption would not apply to most of these investors since they do not have a prior connection with the company. The second limb of the exemption would apply only if the crowdfunding platform (1) is a specified person; and (2) conducts sufficient due diligence on each registered user to ensure that each user can only receive offers that match his risk profile. The considerable costs involved in satisfying both conditions (discussed more fully below) are likely to discourage entities from becoming an equity crowdfunding platform in the first place.

First, to become a specified person, a crowdfunding platform would need to obtain a capital market licence for dealing in securities or a financial adviser licence (unless it is an exempt person in respect of dealing in securities or an exempt financial adviser⁸⁵). Obtaining and maintaining either licence is costly. This is evidenced by the fact that between 2005 and 2014, there are on average only about 91 capital market licencees (dealing in securities) and about 54 financial adviser licencees each year in Singapore.⁸⁶

Secondly, to ensure that each registered user receives only offers that match his risk profile, the crowdfunding platform would need to conduct extensive KYC for each user. The pre-qualification procedures recommended by the MAS would involve “a comprehensive analysis of the investment needs and risk profile” for each registered user, and having done so, the crowdfunding platform should reasonably believe that:

- a. the user has sufficient expertise to evaluate the risks and merits of the equity crowdfunding projects to be sent to him, is fully aware of the risks involved, and considers investing in such projects appropriate in light of his investment objectives, financial means and risk profile; and
- b. such investment is suitable for the user.⁸⁷

Conducting such a comprehensive assessment is likely to require a significant amount of personal information from each registered user, including, for example, his age, occupation, income, net worth, investment experience, investment goals, and so on. Requiring a crowdfunding platform to conduct such extensive background checks on each registered user is both costly and inefficient since only a small proportion of the registered users are likely to eventually make an investment.⁸⁸ Requesting

⁸⁵ See *eg*, s 99 of the *SFA*, *supra* note 70 and s 23 of the Financial Advisers Act (Cap 110, 2007 Rev Ed Sing) for a list of the exempt persons.

⁸⁶ See MAS, “Annual Report 2013/2014” at 17, online: MAS <http://www.mas.gov.sg/annual_reports/annual20132014/Annual%20Report.pdf>.

⁸⁷ See MAS, “Guidelines”, *supra* note 82 at para 6.10.

⁸⁸ Crowdcube, for example, has over 190,603 registered users, but only funded 272 businesses (with an average of 169 investors per pitch) since its inception. See Crowdcube, “Infographic”, *supra* note 52.

extensive personal information from registered users might also discourage investors that are only minded to invest a small amount and therefore find the pre-qualification process disproportionately cumbersome. Additionally, keeping such extensive personal information of its registered users would require platforms to incur considerable resources to comply with the requirements of the Singapore Personal Data Protection Act 2012.⁸⁹

2. Offers to AIs and IIs

Since, as argued above, limiting equity crowdfunding to professional investors would deprive equity crowdfunding of much of its value, the exemptions for offers to AIs and IIs would be of limited assistance.

3. Private placement and large offers

The exemption for private placement only applies to offers of securities to no more than 50 persons within any 12 months.⁹⁰ The exemption for large offers, on the other hand, applies to offers in which the consideration for each transaction exceeds S\$200,000.⁹¹ Since the essence of crowdfunding is to raise many small amounts of money from a large number of people, neither exemption is likely to be of much use.

C. Advertising Restrictions

Two types of advertising restrictions are relevant. First, even if an equity crowdfunding project is carefully structured to qualify for any of the exemptions for small offers, offers to AIs, private placement or large offers, it would still be subject to restrictions against advertising, *ie*, the offer must not be accompanied by an advertisement making or calling attention to that offer/intended offer.⁹²

An advertisement is widely defined in the SFA to mean “(1) a written or printed communication; (2) a communication by radio, television or other medium of communication; or (3) a communication by means of a recorded telephone message, that is published in connection with an offer of securities.”⁹³ But it does not include:

- a. an information memorandum;
- b. a disclosure, notice or report required under the SFA, or rules and requirements of an exchange; or
- c. a notice or report about the issuer’s general meeting.⁹⁴

An information memorandum is a document:

- a. purporting to describe the securities being offered, or the business and affairs of the issuer; and

⁸⁹ (No 26 of 2012, Sing).

⁹⁰ Section 272B of the SFA, *supra* note 70.

⁹¹ *Ibid*, s 275(1A).

⁹² See ss 272A(1)(c), 272B(1)(b), 275(1)(a), and 275(1A)(a) of the SFA, *ibid*.

⁹³ *Ibid*, s 275(2).

⁹⁴ *Ibid*.

- b. purporting to have been prepared for delivery to and review by persons to whom the offer is made so as to assist them in making an investment decision in respect of the securities being offered.⁹⁵

Actual information provided by issuers on crowdfunding platforms about the issuer and its shares should not be considered advertisements. Such information has been prepared for delivery to and review by persons to whom the offer is made and to assist them in making an investment decision and hence amounts to “information memorandum”. However, the definition of advertisement is arguably wide enough to cover:

- a. any emails or messages sent by a crowdfunding platform to notify its registered users of any new crowdfunding projects;
- b. any posts or comments made on any social network website (such as Facebook or Twitter) to inform potential investors of any new projects on a crowdfunding platform; and
- c. indeed any unsolicited promotional materials.

The width of the advertising restrictions would pose a significant challenge to effective crowdfunding. Crowdfunding relies on the ability of companies and crowdfunding platforms to attract support from the crowd. The restrictions against advertising would make it extremely difficult for them to introduce new offers to investors or to keep investors informed of updates. They would be at a distinct disadvantage when fighting for investor attention against competitors which are allowed to highlight key information about the products they offer. Such restrictions also inconvenience investors who are genuinely interested in learning more about equity crowdfunding; such investors would be deprived of information which can help them identify more quickly the projects they are interested in without having to regularly visit various crowdfunding platforms. While there is certainly a need to protect investors from misleading advertisements, the current restrictions against advertising are arguably too extensive.

Secondly, if an equity crowdfunding project does not qualify for any exemption and hence a prospectus is required, the issuer is prohibited from advertising its offer of securities unless such advertisements are authorised by s 251 of the *SFA*. Section 251 essentially prevents issuers from providing details of its offers to the general public through crowdfunding platforms before incurring the expenses of registering a prospectus.

D. Shareholder Cap

Most small businesses in Singapore are incorporated as private companies. Section 18(1)(b) of the *CA* provides that the maximum number of members for private companies is 50. Since the essence of crowdfunding is to raise money from a large number of people, the number of crowd investors at any successful funding round is likely to exceed 50.⁹⁶ If each investor becomes a member of the company that he invests

⁹⁵ *Ibid.*

⁹⁶ According to the UK Report 2014, *supra* note 51, the average number of investors per equity crowdfunding project is 125. See the UK Report 2014, *ibid*, at 57.

in, it would cause the company to breach s 18(1)(b). A breach of s 18(1)(b) would result in the company and every officer of the company being guilty of an offence and be liable on conviction to a fine not exceeding S\$5,000 or to imprisonment for a term not exceeding 12 months.⁹⁷

Converting a private company to a public company for the purpose of avoiding the shareholder cap would not be cost-effective for start-ups and small businesses because doing so would significantly increase their costs of doing business. A public company is more costly to maintain. For example, it cannot dispense with the holding of annual general meetings⁹⁸ or utilise exemptions from having their financial reports audited.⁹⁹ Moreover, a public company does not qualify for the tax-exemption scheme for start-up companies since it has more than 20 shareholders.¹⁰⁰ It would also be subject to additional legal requirements, *eg*, those under the *Singapore Code on Take-overs and Mergers*,¹⁰¹ which would result in higher regulatory/compliance costs. Further, the conversion itself would involve considerable legal and administrative expenses.¹⁰²

Apart from the costly option of converting to a public company, a more plausible way¹⁰³ to avoid a breach of the shareholder cap is for crowd investors to appoint a nominee, who holds shares of the private company on their behalf. Either the crowdfunding platform or a third party service provider can serve as a nominee. The nominee structure has perceivable benefits. It is desirable for the company since it only has to deal with the nominee rather than hundreds of shareholders. It may also be desirable for passive investors who do not want to be burdened with the administrative work involved in being a shareholder. However, the nominee structure has several drawbacks. It renders investors more vulnerable in certain circumstances as they cannot directly exercise rights which are reserved for shareholders, but must act through the nominee. For example, since they are not registered members of the company, they cannot bring proceedings under s 216 of the Companies Act against unfair or oppressive conduct by directors or majority shareholders. Hence, a minority shareholder is exposed to the additional risk that his nominee might not act in his best interests. Moreover, the nominee structure would make equity crowdfunding more expensive since the nominee will have to be paid for its services. Further, investors who want to actively exercise their voting rights may not be able to do so under the nominee structure. Firstly, the nominee as one member is only entitled to one vote in a general meeting (when the vote is decided on a show of hands).¹⁰⁴ Therefore,

⁹⁷ Section 32(8) of the CA, *supra* note 68.

⁹⁸ *Ibid*, s 175A(7).

⁹⁹ *Ibid*, s 205C.

¹⁰⁰ Inland Revenue Authority of Singapore (“IRAS”), “About the Tax Exemption Scheme for New Start-up Companies”, online: IRAS <<https://www.iras.gov.sg/irashome/Businesses/Companies/Learning-the-basics-of-Corporate-Income-Tax/Common-Tax-Reliefs-That-Help-Reduce-The-Tax-Bills/>>.

¹⁰¹ (Cap 50, R 2, 1990 Rev Ed Sing) [*Takeover Code*]. See s 213(17) of the CA, *supra* note 68. Unlisted public companies are expected to observe the letter and spirit of the General Principles and Rules of the *Takeover Code*.

¹⁰² See ss 31(2) and 60(1)(b) of the CA, *ibid*, for the documents required for the conversion.

¹⁰³ Commentators have also suggested implementing a collective investment scheme or making each crowd-funded company a subsidiary of a public company. See O Stacey, S Lovegrove, and D Murphy, “Crowdfunding: Possibilities and Prohibitions” (2012) 23(1) PLC 18. The former is likely to be too costly while the latter is not practical in many circumstances.

¹⁰⁴ Section 179(1)(c)(i) of the CA, *supra* note 68.

the nominee's vote may not reflect the views of all investors. Secondly, the default position is that a nominee cannot appoint more than two proxies to attend and vote at the same meeting unless the company's articles of association provide otherwise.¹⁰⁵ This means that most crowd investors would be prevented from voting as proxies unless the company's articles allow the nominee to appoint as many proxies as it desires. The situation is partially remedied by the *Companies (Amendment) Bill 2014*,¹⁰⁶ which will introduce a new multiple proxies regime. In particular, it will allow specified intermediaries, such as banks or persons holding a capital markets services licence to provide custodial services, to appoint more than two proxies.¹⁰⁷ However, the multiple-proxy regime only applies to specified intermediaries¹⁰⁸ and it is unclear whether engaging a specified intermediary would be cost-efficient in the context of equity crowdfunding.

Finally, a start-up/SME may convert from a limited company to a limited liability partnership (LLP). Each crowd investor becomes a partner and there is no limit on the maximum number of partners an LLP can have.¹⁰⁹ However, both the issuer and crowd investors have reasons not to opt for an LLP. For the issuer, converting to an LLP opens possibilities for fraud. The acts of any crowd investor can potentially bind the LLP since any partner has power to bind the LLP unless the person dealing with that partner knows that the partner does not have authority to act for the LLP.¹¹⁰ For crowd investors, an LLP offers less statutory protection than a limited company as provisions concerning general meetings, directors, and share allotments do not apply to LLPs. In the absence of such provisions, which provide some protection for minority shareholders, crowd investors may be more likely to suffer from abusive misconduct by general partners who are authorised to act on behalf of the LLP.

VII. RECOMMENDATIONS

Facilitating equity crowdfunding in Singapore would require legal reforms to remove existing barriers to equity crowdfunding and new measures to mitigate the associated risks. It is submitted that the equity crowdfunding industry would benefit from the creation of:

- new exemptions from the prospectus requirement and advertising restrictions;
- a new type of exempt public company; and
- additional shareholder protection measures.

A. *New Exemption for Crowdfunding Offers*

As noted above, applying the existing prospectus requirement to equity crowdfunding is problematic as the up-front costs of preparing and registering a prospectus are disproportionately high. On the other hand, such a requirement serves a useful

¹⁰⁵ *Ibid*, s 181(1)(b).

¹⁰⁶ Bill 25 of 2014 [*Companies Bill*].

¹⁰⁷ Such proxies will also be able to vote on a show of hands.

¹⁰⁸ *Eg*, banks and capital market services licence holders which provide custodial services.

¹⁰⁹ See the *Limited Liability Partnerships Act* (Cap163A, 2006 Rev Ed Sing) [*LLP Act*].

¹¹⁰ Sections 9(1) and (2) of the *LLP Act*, *ibid*.

function of providing prospective investors with important information about the issuer and the underlying business for them to make an informed investment decision.

In the context of equity crowdfunding, an alternative mechanism can be employed to bridge the information asymmetry between issuers and crowd investors. This involves a three-step process which distributes the costs more evenly between the issuer, the crowdfunding platform, and the investor. It is submitted that offers of securities which adopt this mechanism provide reasonable opportunities for crowd investors to obtain information about the issuer and hence should be exempt from the prospectus requirement.

First, the crowdfunding platform would conduct standard due diligence on each issuer, including for example, background checks on the issuer, its directors and substantial shareholders to verify their credibility and credentials. The scope of such due diligence should be limited to avoid imposing excessive financial burden on the platform. This preliminary check helps filter out fraudulent and suspicious businesses.

Secondly, the issuer would disclose the key terms and risks of its shares through the crowdfunding platform so that investors can decide whether to invest in and/or obtain further information about the issuer. Such key information should include particulars of the issuer, its directors and substantial shareholders, the issuer's business and the specific risks involved, the issuer's financial condition, the amount, price and rights of the securities to be offered, as well as the purpose for which the funds will be used. The format of the disclosure would be similar to that of a product highlights sheet, *ie*, it should be presented in a clear and concise manner (generally no longer than a few pages). The simplified disclosure requirements can significantly reduce the issuers' costs in raising funds.

Finally, interested crowd investors can obtain additional information in two ways. They can ask the issuer questions through the Q&A section available at most crowdfunding platforms. Moreover, if there is a sufficient number of interested investors to meet the funding target, crowd investors would be provided with an opportunity to decide as a group whether to conduct a more comprehensive due diligence on the issuer (*eg*, if 75% of the crowd investors elect to conduct additional due diligence, the decision would be binding on all investors). Although the amount invested by each crowd investor may be relatively small, the amount invested by the group as a whole is likely to be substantial, which would usually justify spending a few thousand dollars to engage a third party to conduct more extensive due diligence. The third party may be the crowdfunding platform itself or a service provider (*eg*, an accounting or law firm). Crowd investors should not be required to complete the transaction if (1) the issuer discloses any new material adverse information before the completion of the funding round; or (2) the due diligence report reveals any new material adverse information or renders any part of the issuer's proposal false or misleading. Under certain circumstances, crowd investors might not consider it necessary to conduct their own due diligence, *eg*, where they co-invest with a reputable professional investor who has financial resources and industry experience to conduct its own due diligence. In this case, crowd investors might consider it more cost-efficient to piggyback the professional investor's efforts.

The proposed mechanism would significantly reduce the up-front costs that issuers need to incur to engage in equity crowdfunding while providing a real opportunity for investors to obtain the information they need.

B. No Advertising Restrictions

As argued above, advertising restrictions would make it extremely difficult for issuers and platforms to promote their offers. Hence, it is submitted that the new crowdfunding exemption should not be subject to such restrictions.

C. New Exempt Public Company

Since none of the existing options for issuers to get around the shareholder cap of 50 for private companies is satisfactory, a specific policy response to the problem is required to facilitate equity crowdfunding. Two options exist:

- amend the definition of “private company” in the Companies Act to either increase or remove the shareholder cap; or
- create a new type of exempt public company.

The first policy option is plausible.¹¹¹ However, since Singapore law has traditionally drawn a distinction between private and public companies (and public companies are defined as companies which are not private), changing the definition of “private company” would re-draw the boundaries between public and private companies and have far-reaching consequences. It is arguably too drastic a change for the purpose of facilitating equity crowdfunding in Singapore.

In contrast, the second policy option seems more appropriate and more tailor-made to facilitate equity crowdfunding. It was also recommended by the Corporations and Markets Advisory Committee (“CMAC”) to facilitate equity crowdfunding in Australia.¹¹² The new exempt public company proposed by the CMAC would be exempt for up to three to five years from certain compliance requirements for public companies, including, amongst others, requirements for continuous disclosure, holding annual general meetings, executive remuneration reporting, appointment of an independent auditor and having financial reports audited (unless certain thresholds are met). An existing company can convert to an exempt public company if it satisfies two criteria:

- it comes within the capital and turnover caps for being an exempt public company; and
- it is eligible to conduct an equity crowdfunding offer.¹¹³

Similarly, a new type of exempt public company may be introduced in Singapore to enable small companies¹¹⁴ to engage in equity crowdfunding without having to significantly increase their compliance costs. It is submitted that exempt public

¹¹¹ The UK *Companies Act 1980*, c 22 [1980 Act] re-defined “private company” in a way which does not restrict the number of its shareholders. See s 1 of the 1980 Act, *ibid*.

¹¹² See CMAC, “Crowd Sourced Equity Funding”, *supra* note 6.

¹¹³ See *ibid*, para 3.2.1.

¹¹⁴ *Eg*, those that satisfy the criteria for “small companies” in the new Thirteenth Schedule to the CA, *supra* note 68 (*ie*, the company’s annual revenue or total assets must not exceed S\$10 million for the relevant period and the company must have not more than 50 employees). See paras 2-4 of the Thirteenth Schedule, which will form part of the CA once the *Companies Bill*, *supra* note 106 comes into effect.

companies should be subject to the same requirements as private companies except for the limited circumstances where the requirements for public companies are more appropriate to safeguard the interests of crowd investors as minority shareholders. For example, the stricter requirements for public companies may be more appropriate where they render it more difficult to vary shareholder rights or appoint/remove directors of the company without minority shareholders' knowledge and/or consent. A list of these stricter requirements is set out in the table below.

Provision in the CA	Private Company	Public Company
Issue shares of different voting rights (Section 64A)	Permitted	Permitted, provided that certain safeguard requirements in section 64A are satisfied.
Convert one class of shares (A) to another (B) (Section 74A)	May convert by lodging a notice of conversion with the Registrar.	May convert by special resolution only if the constitution of the company: (a) permits B to be issued; and (b) sets out the rights attached to B.
Appointment of director (Section 146)	N/A	Unless exempted, each director must sign the statement, undertaking and declarations required under section 146.
Restrictions on removal of directors (Sections 152)	N/A	A director cannot be removed by any resolution, request or notice of the directors.
Restrictions on director/manager's assignment of office (Section 170)	N/A	Director/manager's assignment of office must be approved by a special resolution of the company.
Accounting records and systems of control (Section 199)	N/A	Shall maintain a system of internal accounting controls to ensure that — (a) assets are safeguarded against loss from unauthorised use/disposition; and (b) transactions are properly authorised and recorded.

D. Mandatory Safeguards

1. Mandatory shareholder protection provisions

As a minority shareholder, a crowd investor would find it difficult to negotiate with the issuer for specific shareholder rights and protections. Without such rights and protections, crowd investors may be excluded from the benefits of a successful investment, *eg*, where majority shareholders are able to liquidate their investment in a sale to the exclusion of minority shareholders. Therefore, it is submitted that crowd investors should be entitled to some basic rights that minority shareholders commonly enjoy. These should include:

(a) *Voting right*: This would allow crowd investors to vote at a general or extraordinary meeting of the company during which important issues, such as appointment of directors, are decided. Although the voting power possessed by each crowd investor may be negligible, the crowd as a group may hold sufficient percentage of shares to influence the company's decision-making.

(b) *Tag-along right*: This would allow crowd investors to participate under the same terms in a qualified sale of the company's shares initiated by other shareholders. This right is particularly useful for minority shareholders whose shareholding is less liquid than that of the majority.

2. Investment caps

In light of the high risk of investing in start-ups, it may be prudent to impose a cap on the amount each retail investor can invest in equity crowdfunding projects to prevent investors from investing more than they can afford to lose. One of the key insights of the behavioral finance literature is that people have bounded rationality and tend to be overly optimistic of the consequences of their conduct.¹¹⁵ An investment cap is a useful tool to counteract investors' tendency to over-estimate the prospects of their investment. It serves both as a risk warning and a safeguard against significant exposure to risky projects.

Many jurisdictions have imposed caps on the amount each retail investor can invest in crowdfunding projects within a certain period. The cap varies from jurisdiction to jurisdiction. In the US, the investment cap within a 12-month period for investors whose annual income/net worth is less than US\$100,000 is the greater of US\$2,000 or five percent of that investor's annual income/net worth.¹¹⁶ In the UK, the investment cap for a retail investor is ten percent of his net investible assets.¹¹⁷ It is submitted that an investment cap of five to ten percent of a crowd investor's annual income seems reasonable.

¹¹⁵ Cass Sunstein, ed, *Behavioral Law and Economics* (Cambridge: Cambridge University Press, 2000), Cap 1.

¹¹⁶ Section 302(a) of the *JOBS Act*, *supra* note 4.

¹¹⁷ See the FCA Report, *supra* note 2 para 1.14.

VIII. CONCLUSION

Equity crowdfunding has potential to play a significant role in building Singapore's start-up ecosystem. However, it is a new and untested fundraising method which applies public fundraising techniques to small companies which traditionally raise funds from friends, family and professional investors. While the proposed legal reforms seek to strike a balance between facilitating equity crowdfunding and protecting investors' interests, further empirical research is required to test the effectiveness of such measures and the feasibility of using equity crowdfunding as a new way to fund small businesses.