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Dear Dr. Ivanov:

Following up on the meetings with the SEC last week, I am writing to comment on my empirical analysis of crowdfunding and to reiterate the important role that community interaction plays in the successful crowdfunding environment. I believe that it is vital that portals be required to either sustain or enable communities around crowdfunding efforts, including having persistent investor and commentator identities that remain after the initial funding of a new crowdfunded venture through the portal. Without this approach, crowdfunding is likely to be less useful to both investors and entrepreneurs, and is vulnerable to fraud and "pump-and-dump" schemes.

As the Edward B. and Shirley R. Shils Assistant Professor of Management within the Entrepreneurship Group at the Wharton School of the University of Pennsylvania, I have conducted research into the determinants of success and failure in crowdfunding sites such as Kickstarter. I found that fraud is very low on the site, the amount of money pledged to projects that ultimately seem to have no intention of delivering promised products accounts for less than .1% of all pledged funds in the study (Mollick, 2012).

I would argue that the reason for this is the persistent community built around Kickstarter projects, which allow many individuals (with verifiable real-world identities) to weigh in on projects, discussing the merits and probability of success of each project. These discussions take place on Kickstarter, but also on other social media sites, blogs, and forums. The result is that comments on potential issuances are made not just by investors, but also by outside experts, communities of interest, and journalists. These communities play several important roles in improving offerings, preventing fraud, and making crowdfunding successful.

First, they allow a core-periphery dynamic to develop, similar to that seen in other functional online communities, ranging from Wikipedia to open source software development (Dahlander & Wallin, 2006; West & Lakhani, 2008). Having many people examining issuances from the periphery, while they may not be core investors themselves, will greatly increase the chance that someone will have the expertise and desire to spot potential issues with a proposal. In the case of Kickstarter, communities have successfully detected fraudulent

projects, and had healthy debates over the merits of other projects that have resulted in projects improving as a result of feedback. Allowing ongoing discussions between potential investors, community members, and issuers is a vital aspect of avoiding fraud and improving proposed projects. Further, the network effects within communities ensure that one interested party might draw others into the discussion, adding to the possibility that investors or commentators with appropriate expertise would find the relevant projects where their knowledge would be most useful. Indeed, a decade of research has shown that vibrant communities are a key to harnessing the best ideas from a crowd, and to improving existing ideas, in order to create breakthrough innovation (Baldwin, Hienerth, & von Hippel, 2006; Von Hippel & Von Krogh, 2003).

Second, communities over the longer term will help keep crowdfunded companies accountable to investors. If investors are going to be able to provide meaningful feedback to companies when asked, or be able to weigh in on potential pivots or changes of directions, there will need to be an ongoing engagement between investor communities and companies. On Kickstarter, communities of backers continue to give feedback on projects long after funding has closed, providing both a valuable resource and an important incentive for projects to deliver. Having issuers connected to persistent online identities, such as LinkedIn, ensures that founders of projects are held accountable for their actions and performance across many projects, and that their skills and backgrounds can be adequately assessed. Something similar will be needed in equity crowdfunding.

Finally, communities with persistent identities can prevent future fraud, including pump-and-dump schemes. If a community around a particular investment consists of known members with consistent identities, it will immediately be obvious if outside individuals attempt to falsely promote or denigrate a funded company for fraudulent purposes. The community will be able to detect anonymous outsiders, and community members will have reputational reasons for avoiding these sorts of schemes, or their online identities will become associated with fraud.

Based on my research on communities, gaining benefit from them requires first building the, and then ongoing transparency, persistence, and accountability. I would strongly suggest that the following be included in any crowdfunding regulations:

- **Community Building:** To the extent possible, allow ongoing back-and-forth dialogue between potential investors and issuers, which, while archived on the funding portal as required, should be allowed to take place in other locations such as Twitter and online forums. Communities tend to organize themselves, but they will often operate in counterproductive ways if their communication methods are arbitrarily limited (Mollick, 2005).

- **Transparency:** Online identities for issuers, commenters, and backers need to be tied to online, as well as physical, identities. LinkedIn, Twitter, and Facebook all provide useful methods of identifying individuals and discovering and verifying expertise. It should be strongly suggested to portals that they use these online methods.

- **Accountability:** Issuers should be required to provide informal updates to the community, as well as whatever formal material is required. Informal updates can be qualitative or quantitative, but should be frequent, quick, and hopefully helpful to both managers and investors. I will separately provide a set of measures that might be useful inspiration for this sort of reporting.

- **Persistence:** Portals must either be required to maintain investor communities after funding is complete, or else provide some easy way to move communities, including user identities and comment histories, to a new, permanent online location. Failing to do this will result in a loss of accountability and create an opening for fraud.

By requiring portals and issuers to replicate what has made Kickstarter and other online communities so successful, the SEC can help prevent fraud, strengthen startups, and grow the economy. Please don't hesitate to contact me with any questions.

Sincerely,

Prof. Ethan Mollick