

Order Granting Conditional Exemption from the Broker Registration Requirements (S7-13-20)

I am an assistant professor of finance studying the funding and success of early-stage firms. In one of my recent papers, “Brokered Startup Financing,” I shed light on finders’ participation in startup funding and provide estimates of the long-term performance of issuers in finder-intermediated offerings. I show that finders are more likely to serve women, minority-owned businesses, and other small businesses that struggle to raise funding. However, I also show that, relative to issuers in registered-broker or direct offerings, issuers in finder-intermediated offerings are less likely to be acquired or IPO (do an initial public offering) post funding, even when the issuers raise the same amount of funding. Thus, investors are less likely to make a positive return on finder-backed investments. I find that this underperformance is particularly severe for finders who were brokers in the past and were most likely disbarred by FINRA. I also find that finder-backed investments are less likely to attract follow-on venture funding, another factor that explains their lower success rates. Finally, I find that finder-intermediated offerings are more likely to involve non-accredited investors.

These findings suggest that enforcement is essential for the success of the proposed finder exemption. Enforcement could focus on preventing disbarred brokers from acting as finders. Specifically, the SEC could require Tier II finders to disclose any past regulatory, civil, or criminal allegations in the disclosures they provide investors, and require all finders to verify investor accreditation status as defined in Rule 506(c) offerings (as opposed to the proposed “reasonable belief” standard). I believe finders could meaningfully reduce search costs of raising capital for small businesses, especially if the Commission takes actions to prevent charlatan finders from taking advantage of the new rules.

Sincerely,

Emmanuel A. Yimfor