

Crowdfunding – Not so Innovative?

Written by The Conversation

Aldous Huxley wrote

That men do not learn very much from the lessons of history is the most important of all the lessons of history

Crowdfunding is the new big thing. The Member for Wentworth, now Prime Minister, Malcolm Turnbull, waxed lyrical about it in a [speech](#) in 2014

Crowdfunding has become an increasingly popular way of promoting financing for innovative projects, allowing start-ups and rapidly growing companies to access diversified sources of capital.

The speech was full of trademark Turnbull optimism especially about innovation. One would almost come to believe that, like the Internet, the new PM, if he [did not invent it](#) at least, brought crowdfunding to Australia.

There is little new about crowdfunding but the name. And history gives us a salutary example.

Last year, the people of Scotland [narrowly passed up](#) the opportunity to become an independent nation but have since appeared to have [changed their minds](#)

. However, Scotland has not always been subservient to the English Parliament.

In the late 17th century Scotland had its own Parliament and its own King of Scotland who incidentally was also King of England - King William III (or William of Orange). King Billy was, however, not well liked, not least because his armies massacred the Highland Scots at the infamous Massacre of Glencoe in 1692.

Crowdfunding – Not so Innovative?

Written by The Conversation

But that is very old-hat - not in the least innovative - and how does it relate to crowdfunding?

In an effort to resurrect Scottish pride, William Patterson, who had earlier helped to create the Bank of England, came up with a brilliant idea – what if Scotland had its own colony in the Americas to match the English East India Company? And to that end, Patterson [conceived](#) of the Darien Scheme.

The Darien Peninsula is where the Panama Canal is today and Patterson, a man of Turnbull-like vision, saw the potential. If the Scots managed to settle a colony in Darien, then ships could berth there and goods could be carted over land (and mountains) to the Pacific and loaded onto other ships to carry the goods to the Far East. And, of course vice versa, with trade in the other direction, cutting out the incredibly dangerous voyage around Cape Horn and landing spices in Europe weeks earlier. Patterson was a genius, some 200 years ahead of time with his early Panama Canal idea and he definitely had the gift of the gab.

Great idea, everyone said, but how can you fund it?

Patterson hit upon the ingenious idea of crowdfunding, calling on his fellow Scots to invest in his new Company of Scotland, which would use the money to found the new colony of Caledonia in South America. And the Scots responded in their tens of thousands sinking their cannily acquired savings into a scheme that would not only make them money, restore the honour of Scotland, but also protect the natives against the Spanish. There is always a do-gooder angle to such schemes, to assuage the guilt of making money.

To cut a long story short, the scheme was an unmitigated disaster. Two expeditions of the finest Scottish nobles and yeomanry were sent out to Darien but quickly found it was not the paradise that had been painted by Patterson but a hellhole, completely inhospitable to the fair-skinned Scots. Unfortunately, the Spanish did not take kindly to the Jocks turning up on their patch, and promptly massacred those Scots who had not already died of disease. Patterson and a few others managed to escape and straggle back to Scotland to face the ‘investors’ who had been celebrating having mistakenly heard that the scheme was a great success (they didn’t have the Internet in those days).

Not to put too fine a point on it, the Scots were skint!

Crowdfunding – Not so Innovative?

Written by The Conversation

To help them out, the English Queen Anne (William having recently departed this mortal coil) offered to bail the Scots out (maybe the first example of a taxpayer bail-out). But the cost was horrendous. Scotland had to submit to becoming the junior partner in a Union between the two countries, sealed by the Act of Union of 1706. And the Scots did submit, selling their freedom (so hard won by Mel Gibson) for a mess of pottage/porridge.

And there is a Turnbull link to this mess. Clan Turnbull were canny lowlands Scots who preferred to make cattle raids across the English Border rather than venture overseas in madcap schemes. Malcolm Turnbull's great, great (a few times) grandfather was just such a cantankerous cattle rustler on the Northumberland border before heading out for Down Under after the Darien disaster. But a certain Lieutenant Robert Turnbull did take part in the one-sided fight against Spaniards, with some distinction, and he too managed to escape back to Scotland.

The Darien Scheme was a hare-brained, ill-considered gamble that could only be funded by crowds, because any sensible individual would run a mile. And it had the hallmarks of all such shonky investment schemes - a grandiose vision, promoted by a master spruiker (such as Bernie Madoff) to investors/idiots with stars in their eyes.

There is a problem in Australia with funding innovation, but that is not surprising in an economy heavily reliant on the predictable, easy income from selling minerals overseas. The government does need to create new funding models.

And there is a place for crowdfunding, where start-ups are facing difficulties gaining initial funding. But this is a niche market for those who have money that they are prepared to lose on a punt, not the ordinary investor. It is a side show that should not be allowed to divert attention away from the serious business of funding innovations.

Australia has a superannuation system that [manages](#) over \$2 trillion in assets, and crowdfunding will only ever account for a total that is a rounding error in that huge pot. Rather than promote crowdfunding over *real* investment the government needs to get serious about using those assets for future investments. It won't be easy but it won't become a honeypot for spruikers.

Crowdfunding schemes should certainly never be part of the self managed superannuation

Crowdfunding – Not so Innovative?

Written by The Conversation

system. Imagine the next Mark Zuckerberg in his/her bedroom developing the next Facebook and all he/she needs is the \$250,000 dollars in their parents' Self-Managed Super Fund (SMSF)? Who wouldn't cash in to secure their kids' fortunes?

ASIC and APRA need to come out fairly quickly to set up general principles around crowdfunding before it gets too much of a head of steam. They can start by placing crowdfunding on the same level as other 'collectible' investments such as wine, art and vintage cars that are frowned upon by regulators for super funds.

And ASIC should revive its interest in Behavioural Economics to understand the emotional biases involved in investing and, in particular, the crowd/group biases involved in crowdfunding.

Read more <http://theconversation.com/crowdfunding-not-so-innovative-48994>