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The Code-Based Fund: The Future of Crowdsourced Startup Funding

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For your startup business, crowdfunding campaigns can be a great way to both raise funds and validate your product market. Bridging the gap between crowdfunding and venture financing, the Decentralized Autonomous Organization, or the DAO, has emerged as a potential new source of funding for projects and startups. The human-less organization has raised over $165 million worth of Ether, a cryptocurrency, and plans to make venture capital-style investments.

So what exactly is the DAO and how does it work? The DAO is an organization managed on the Ethereum blockchain via smart contracts. Its bylaws are written entirely in code, and it is managed by its investors–no separate management team is involved. Individuals who invest in the DAO receive tokens in exchange for their investments, and these tokens are then used to vote on governance issues. As a result, token-holders dictate the DAO's actions through an online polling mechanism.

Unlike shareholders in normal corporations, DAO token-holders have complete visibility. This visibility is a core advantage and opportunity of ledger technologies such as Ethereum–transactions on a blockchain are fully transparent; that is, every token-holder stores a copy of the blockchain ledger, and before any transaction is effected, each token-holder validates the transaction against his or her copy of the ledger. As such, each token-holder knows who owns every token at any time. This means that accounting and compliance systems can be decentralized as each participant has a full view of the transactions occurring on the blockchain and can flag any transactions that seem inconsistent or suspicious. By decentralizing the accounting and compliance systems of an organization, ledger technology allows for significant cost savings, the potential for more secure transactions and, in the case of the DAO, the ability to democratize corporate actions.

This structure may bode well for your startup as it seeks financing. Because of the extremely low overhead, the vast majority of the money raised by the DAO will go directly to funding startups. The DAO was built with the intention of engaging in venture-style investments, purporting to give the everyday consumer an opportunity to invest in exciting startups and projects. The notion that anyone can buy "shares" in a venture fund that is fully transparent and under complete shareholder control has an appeal that is distinct from that of crowdfunding. Investors aren't just early adopters buying a product and funding its release–they have a voice in which products receive large sums of capital and they receive an equity stake in the startup's outcome. Because of this duality, the DAO has the potential to harness the wisdom of the crowd to make significant targeted investments in new ideas. This model could allow startups to tap directly into the consumer base, as with crowdfunding, and receive significant long-term financing.

While the DAO, and ledger technology in general, present exciting funding sources for your startup, they're still in their early stages. Policymakers, investors, innovators and others in the ecosystem are evaluating the inherent opportunities and risks of distributed ledger technology. Moreover, the legal status of the smart contracts on which the DAO is based is still unclear, as are the securities law implications of the DAO's investment model. Even aside from these potential legal challenges, the DAO recently experienced a security breach that caused it to lose $55 million from its treasure chest. This breach, like the breaches experienced by key market participants in the Bitcoin context, raises questions as to the DAO's viability. Although the DAO's developers are reportedly capable of intervening to undo this breach, such an action would run counter to the DAO's mission of being a decentralized, fully democratized, organization.

As with any early technology, the DAO has some kinks to smooth out. Nonetheless, the DAO represents an interesting proposition for the future of startup investing. At a time when high-frequency trading relies on algorithms for day-to-day trades, increased automation and better artificial intelligence suggest that the DAO and other autonomous entities could find success and become the norm. Algorithms could be used in the DAO to make management, investing and governance decisions based on code approved by token-holders. This potential for automation, coupled with a decision-making process that surveys the masses, could make for an exciting alternative for startups seeking investments and individuals hoping to participate in the startup game.

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