Can Crowdfund Investing Bring Zombie Capital Back to Life?

Here's a Halloween tale sure to leave you awake at night.

It's the tale of Zombie Capital… the scourge of the American economy, sucking the very life out of the public equity markets.

(Okay, we all know zombies normally eat brains, but for the sake of the story, humor me.) So, where was I? Oh yes, Zombie Capital…those dormant dollars that lay moldering in low-yield CDs, interred in dark bank vaults across America. Oh yes, dear reader, let me tell you of the horror of cold, hard cash, still breathing but only half alive, buried deep in U.S. Treasury bonds, or listlessly languishing in the mire of bond mutual funds.

Cash that once walked Main Street USA and invested in business and commerce now lies unused, simply taking up space, stashed away in "safe havens" throughout our country. Zombie capital is the dark spawn of Americans' loss of faith in traditional equity markets. The growing distrust among savers and investors that has been growing in the last decade has led to the accumulation of "zombie capital"–capital invested in securities with nearly zero yield and, as a result, remains unproductive in public equity markets.

Declining Trust in Equity Markets

The formation of "zombie capital" is a result of declining trust in equity markets and the evolution (or de-evolution, as the case may be) of what investors expect from companies that take their money. Looking at the Chicago Booth/Kellogg School's Financial Trust Index from May of 2012, only 15 percent of Americans surveyed said they trusted US equity markets. And, with good reason – according to FactSet, a data provider, the estimated rate of growth in earnings per share (EPS) for the S&P 500 index in the third quarter of 2012 was -2.7 percent. And if those numbers aren't scary enough for you, let me add this frightful fact: the U.S. market price earning ratio of 13.1 times is the lowest since 1985. With a rating nearly identical to that of the first quarter of 2008 (which preceded a S&P meltdown of 39 percent) it's a sheer miracle even more of the country's cash reserves haven't "turned" into zombie capital.

In response to those losses in earnings and accompanying abysmal ratings, Americans are moving their money away from equity mutual funds to bond mutual funds and other "safe havens". Recent statistics reveal assets held in equity mutual funds compared to bond mutual funds are at its lowest ratio since the mid-1990s. Scarier still, data from the Investment Company Institute's 2012 Investment Company Fact Book revealed that between 2006 and 2011, $500 billion was withdrawn from US equity markets and re-allocated to savings accounts and other "safe" asset classes like treasury securities—which offer savers virtually no (and sometimes even negative!) yield. Currently, a 10-year Treasury note yields a pitiful 1.70 percent, while bank CD's are offering little more than 1 percent interest (but that's another horror tale altogether titled "The Disappearing ROI, not suitable for all audiences.) As bleak a future this paints for savers, even more horrifying is the fact this flight of capital away from equity markets will result in an overall increase in the cost of capital for US-listed businesses. So, while zombie capital simply puts savers into a state of stasis, it could become the death knell for countless businesses looking for cash to launch, grow or expand.

Could the Crowd Save us From Zombies?

So what can a crowdfund investment policy framework do to bring zombie capital back to life?

Hard-working American dollars turn into zombie capital when they see only two options in their immediate future – be assimilated into the Borg that is Wall Street, and possibly nibbled upon by a distant and detached public equity market, or silently slip into a state of hibernation in "safe havens", where they might never grow old but hardly ever generate returns, either.

However, crowdfund investing (CFI) creates another option — an asset class that offers claims on the future assets of enterprises that are geographically or psychologically proximate to the investors themselves.

Why is this important? Well, contrary to common belief, investors aren't a completely fearless breed. If investors are putting their cash on the line by backing a new venture, they prefer to invest their money with companies they understand and can easily monitor. This 2009 report from the MIT Sloan School says that even venture capitalists (those adventuresome souls!) often make their investment decisions based on the geographical proximity of the target company's headquarters to their own.

Connecting the dots, the creation of an asset class that offers investors the chance to diversify easily, to invest in what they understand and often, to invest with people that they personally know, is likely to breath new life into "zombie capital" and transform it back into respectable working capital in the economy. CFI has the potential to redeem lazy, lackluster lucre back to the robust investment capital it once was—cash with potency and power, going out and doing good—growing businesses, adding jobs, and increasing the nation's GDP.

Crowdfund investing offers an attractive investment alternative to those investors with "trust" issues regarding large, publicly listed firms. And, as an excellent externality, their capital will be directed towards smaller enterprises, which are known to create the lion's share of new jobs—65% according to the Small Business Administration.

CFI also allows the average American (who have literally trillions of dollars sitting in low-yield IRA's or savings accounts) and smaller investors to contribute small amounts of investor dollars that would otherwise be stumbling and bumbling about uselessly in some dusty bank vault. With that small amount of money once again a contributing member of the economy, it might even bring home a little more bacon for its investor in the form of a gold-egg laying goose of an equity share in a successful early stage, high growth company.

Make no mistake, zombie capital is not just a U.S. issue—there is unproductive capital sucking away at nearly every economy across the globe. This is money that, put back into play in the global economy, could launch innovative new companies, thereby helping to keep a nation competitive in the global marketplace. This is money that could be busy about the important work of increasing GDP, creating jobs and stabilizing economies. In short, this is money that could be solving real socioeconomic issues of hunger, poverty and unemployment—all while offering investors the opportunity of a real return on investment.

Realizing the value of crowdfunding as a way to offer investors an alternative to traditional equity markets and salvage zombie capital out of low-yield bond or savings options, countries the world over are embracing crowdfund investing. Italy just issued its own decree legalizing crowdfund investing, while Columbia has taken the old community barn-raising idea to a whole new level by building skyscrapers financed through crowdfunding. Meanwhile, the chaps in the UK and blokes in Australia have had their own versions of legalized crowdfund investing in place for seven years.

Meanwhile American entrepreneurs and investors eagerly await the SEC's much-anticipated regulations on equity and debt-based crowdfund investing after its legalization in the U.S. by the JOBS Act in April 2012.

Will the SEC meet its Dec. 31st deadline and bless CFI with its regulations to redeem zombie capital and bring it back into the fold of the American economy?

Will the regulations safeguard investors but not be so onerous or burdensome to entrepreneurs and small businesses as to virtually neuter CFI and leave zombie capital to multiply unchecked while our economy burns?

Unfortunately, that, dear reader, is a chapter as yet to be written, and as much as I regret it, I must leave you with this sorry cliffhanger instead.

I believe that through crowdfunding, policy makers can bring money back to life. CFI could breathe new life into literally trillions of dormant dollars, transforming zombie capital into working capital once again for entrepreneurs, small business, and investors. What are your thoughts?