

VentureCrowd Submissions on the Crowd-sourced Equity Funding Discussion Paper, December 2014

1. VentureCrowd - Background

- (a) VentureCrowd is a crowd-sourced equity funding business established in Australia, under Australian law, in February 2014.
- (b) So far, VentureCrowd has closed crowd-sourced equity funding rounds for 5 Australian start-ups ranging in size from \$50,000 to \$1,200,000.
- (c) Venturecrowd is a subsidiary of Artesian Venture Partners, Australia's most active early stage venture capital fund manager. Artesian has established the following funds under the Venture Capital Act 2002: Sydney Angels Sidecar Fund, the Blue Chilli Venture Fund, Slingshot Venture Fund, ilab Venture Fund, iAccelerate Venture Fund and Australia's first AFOF, the Artesian Australian Venture Capital Fund.
- (d) Artesian has invested in more than 50 Australian start-ups either directly or through investment funds it has established and plans to invest in as many as 1,000 Australian start-ups over the next 5 years.
- (e) VentureCrowd has access to Artesian's early stage dealflow giving it a unique advantage in Australia.
- (f) VentureCrowd (and its parent, Artesian) welcome the opportunity to make these submissions in response to the Discussion Paper (dated December 2014) titled Crowd-sourced Equity Funding (*Discussion Paper*).

2. General Statements

- (a) VentureCrowd supports the introduction of a new regulatory regime for CSEF that allows a much broader cross-section of the Australian population to invest in startups
- (b) That said, certain elements of CAMAC's recommendations appear to significantly increase the burden involved for startups in raising capital through CSEF.
- (c) VentureCrowd believes that any reforms made to allow CSEF must ensure that the friction currently associated with startups raising capital is reduced while ensuring that investors are both educated in the risks of investing in this sector and protected from substantial loss of capital.
- (d) VentureCrowd supports the CAMAC recommendations on the regulation of intermediaries. VentureCrowd believes that any intermediary must demonstrate a strong commitment to education for investors of the risks involved in investing in startups including the benefits that flow from investing in a diversified portfolio to spread the risks.

3. Submissions on the Questions

- (a) VentureCrowd is advised by PWC Legal. PWC Legal has made submissions on the Discussion Paper which submissions VentureCrowd has had the benefit of reading before making these submissions.
- (b) VentureCrowd broadly agrees with, and endorses, the submissions made by PWC except where stated otherwise below.

Question 1: Is the main barrier to the use of CSEF in Australia a lack of a CSEF regulatory structure, or are there other barriers, such as a lack of suitable investor demand?

VentureCrowd adopts the PWC submission but adds the following points:

- (i) Only 207,000 (wholesale) investors, of Australia's population of 23 million people, may currently take advantage of CSEF. This is the barrier to the use of CSEF in Australia.
- (ii) Since launching 12 months ago, VentureCrowd has had to turn away dozens of interested potential CSEF users because of the wholesale/retail distinction.
- (iii) In our experience, there is no shortage of investor demand for CSEF in Australia.

Question 2: Do the existing mechanisms of the managed investment scheme regime and the small scale personal offer exemption sufficiently facilitate online offers of equity in small companies?

VentureCrowd adopts the PWC submission.

Question 3: Other than the restrictions identified above in relation to limitations on proprietary companies, public company compliance requirements and disclosure, are there any other barriers to the use of CSEF in Australia?

VentureCrowd adopts the PWC submission.

Question 4: Should any CSEF regime focus on the financing needs of small businesses and start-ups only, or is there a broader fundraising role?

VentureCrowd adopts the PWC submission.

Question 5: Do you consider that, compared to existing public company compliance costs, the exempt public company structure is necessary to facilitate CSEF in Australia?

VentureCrowd adopts the PWC submission but adds the following points:

- (i) The exempt public company model is wholly misconceived and VentureCrowd does not agree that issuers should be required to become public companies (exempt or otherwise) in order to take advantage of CSEF.
- (ii) This is a significant and unnecessary burden to impose on these fledgling businesses. In our view, the regulatory problems identified by CAMAC can be dealt with by exemptions and do not require the imposition of additional burden on startups.
- (iii) The administrative and financial burden of becoming a public company far outweighs any perceived benefits to enhance investor protection, and that the proposed dispensation of some compliance obligations for companies in the 'exempt public company' category is token at best.

- (iv) This requirement, if adopted, is likely to be prohibitive for many issuers and is likely to severely compromise the adoption of CSEF in Australia by startups.
- (v) The majority of startups and small businesses in Australia, whether successful or not, will never otherwise become public companies at any stage of their life cycle.
- (vi) Of the reasons against the exempt public company idea, the one that is seldom discussed is the burden of dealing with a large number of shareholders. In our experience, it is administratively prohibitive for issuers to manage a lengthy shareholder registry which contains dozens of small shareholders.
- (vii) In our view, the best means of ensuring that an issuer does not have dozens of new and small investors through CSEF is to ensure that intermediaries employ a collective investment vehicle (such as a trust) by which the issuer receives all investments through a single investor.
- (viii) This model has the additional benefit of ensuring the intermediary remains involved in the investment after the equity funding is complete, ensuring ongoing oversight of the investment and the alignment of interests of crowd investors and the intermediary.
- (ix) For a collective investment model to be possible, amendments to the managed investment schemes regime contained in chapter 5C of the Corporations Act should be considered.
- (x) Those amendments should include an exemption from the registration requirement for a managed investment scheme established for the purpose of a CSEF campaign.

Question 6: To what extent would the requirement for CSEF issuers to be a public company, including an exempt public company, and the associated compliance costs limit the attractiveness of CSEF for small businesses and start-ups?

VentureCrowd adopts the PWC submission but adds the following point:

- (i) The requirement for a cash-strapped start-up to spend thousands of dollars on lawyers and accountants become a public company would effectively mean the CSEF industry never emerges as an effective source of funding for early stage businesses.

Question 7: Compared to the status quo, are there risks that companies will use the exempt public company structure for regulatory arbitrage, and do these risks outweigh the benefits of the structure in facilitating CSEF?

VentureCrowd adopts the PWC submission.

Question 8: Do you consider that the proposed caps and thresholds related to issuers are set at an appropriate level? Should any of the caps be aligned to be consistent with each other, and if so, which ones and at what level?

VentureCrowd adopts the PWC submission.

Question 9: Do CAMAC's recommendations in relation to intermediary remuneration and investing in issuers present a significant barrier to intermediaries entering the CSEF market, or to companies seeking to raise relatively small amounts of funds using CSEF?

VentureCrowd adopts the PWC submission but adds the following points:

- (i) The CAMAC Report recommends that intermediaries should be prohibited from:
 - having an interest in an issuer; or
 - being paid in shares of an issuer or according to the amount of funds raised.
- (ii) VentureCrowd considers these proposed prohibitions on intermediaries to be unnecessary and unhelpful to the establishment of a viable CSEF industry in Australia.
- (iii) VentureCrowd considers that taking a financial interest in the issuer should not be seen as a mischief to be addressed but rather an element of comfort for crowd investors (ie, having a trusted existing investor in the issuer) and an alignment of the interests of the issuer and the crowd investors (ie, the success of the issuer increases the value of both the intermediary's interest and the crowd investors' interest).
- (iv) Put another way, a prohibition against an intermediary having an interest in the issuer is contrary to the well understood idea that having a genuine alignment of financial interest (or skin in the game) is preferable to simply spruiking a product but not being prepared to take true financial risk on it.
- (v) Given that greater than 50% of all startups will fail (without generating any form of financial return) and that 75% of cash returns are generated from 7% of startups, there should be more concern about platforms NOT TAKING stakes in the startups they are promoting, rather than the opposite.¹
- (vi) VentureCrowd also believes that it would be advantageous to the development of a robust CSEF sector in Australia for CSEF platforms to be established by angel groups and other venture capital investors who have this experience and knowledge. Those potential operators may, from time to time, have interests in issuers who may require CSEF.
- (vii) Further, this type of structure effectively back-ends the rewards for an intermediary, aligning it more with a long-term performance based reward. The same argument can be made in support of allowing intermediaries to be *paid* in shares of the issuer.
- (viii) In relation to the prohibition against intermediaries being paid according to the amount of funds raised, it is important to recognize that this type of fee structure is standard for capital raising services and well accepted in both the finance and real estate industries, to name 2. The less raised, the less an issuer pays.
- (ix) It is extremely difficult to determine the mischief this prohibition is seeking to address, however, it will almost certainly result in potential intermediaries deciding against establishing CSEF platforms because they are unable to see any path to profitability. That means, fewer platforms, less competition and, possibly, no CSEF industry at all.

Question 10: Do the proposed investor caps adequately balance protecting investors and limiting investor choice, including maintaining investor confidence in CSEF and therefore its sustainability as a fundraising model?

¹ Kauffman Foundation: Angel Investor Performance Project (Nov 2007) <http://sites.kauffman.org/aipp/>

VentureCrowd adopts the PWC submission.

Question 11: Are there any other elements of CAMAC’s proposed model that result in an imbalance between facilitating the use of CSEF by issuers and maintaining an appropriate level of investor protection, or any other elements that should be included?

VentureCrowd adopts the PWC submission.

Question 12: Do you consider it is important that the Australian and New Zealand CSEF models are aligned? If so, is it necessary for this to be achieved through the implementation of similar CSEF frameworks, or would it be more appropriate for CSEF to be considered under the Trans-Tasman mutual recognition framework?

VentureCrowd does not adopt the PWC submission. VentureCrowd believes that harmonisation of the regulatory regimes between Australia and New Zealand would be highly beneficial to the industry in both countries.

Questions 13 - 23:

VentureCrowd adopts the PWC submission.

For any enquiries, please contact:

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