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Consultation Paper: Facilitating crowd-sourced equity funding and reducing compliance costs for small business

Thank you for the opportunity to provide comment on this Consultation Paper.

Crowdfunding is becoming increasingly popular as a mechanism for obtaining contributions from a large number of people to fund projects or ventures, typically via the internet. The Australian Government Business website (www.business.gov.au) provides comprehensive information about crowdfunding, recognising that incentives and rewards are often provided to supporters based on the amounts they donate. There are numerous crowdfunding websites whereby new business ideas, and/or not-for-profit activities, can obtain financial support from the public at large.

This "general" crowdfunding appears largely free of regulation, making it relatively easy for entrepreneurs, innovators and not-for-profits to find financial support quickly and easy at a grassroots level. The biggest area of risk for supporters appears to be the provision of extensive personal information and credit card details via a (potentially insecure) website, and the disposal or storage of that data after the event is closed.

Donations made via a general crowdfunding campaign does not promise any further governance opportunity or accountability to finance providers, beyond the incentives and rewards returned. The financial support is akin to a "donation-with-benefits".

In contrast crowd-sourced equity funding carries the ability for finance providers to convert their "donation" to equity. Our Corporations legislation places governance responsibilities on shareholders to validate action taken by those charged with governance to manage the business (by calling meetings, voting etc). This means that both the issuer and the shareholder engage in an accountability relationship.

Overall it is my view that equity raising and crowdfunding should be addressed as separate issues. It is inappropriate to consider crowdfunding in the same context as a limited liability company seeking funding, and later support for governance decisions, from shareholders.

Legislative changes may be needed to enable either proprietary or public companies to use crowdfunding to raise finance for ventures, but the engagement with the community through crowdfunding needs to be in the context of "donations-with-potential-benefits" and not as investments with governance responsibilities. This calls for a basis of accounting that matches crowdfunding income with the related expenses akin to accounting for grants.

Responses to consultation questions are provided below.

COMMENTS AND RESPONSES TO QUESTIONS

Q1: I have not observed any situations in practice where the 50 non-employee shareholder limit has caused a problem. Shares in proprietary companies are often held by a family trust, which then allows distributions to a wider family group if desired via the trust.

Q2-4: In my experience there are frequently only one or two shareholders with sufficient voting rights to prevent other shareholders as a group taking control of the company operations. I doubt this would change even if the total number of shareholders increased. I.e. Control over matters of governance is unlikely to be evenly spread across the shareholder base

Q4: Changing company status needs to be a decision of the existing shareholders. Shares held in a public company carry governance responsibilities in addition to the company having accountability to shareholders. The share certificate is a contract between the company and shareholder carrying terms and conditions as set out in the company's constitution. A change of company status should be brought about only by shareholder vote on a special resolution to change company status.

Q5: The limits as set continue to be relevant.

These limits should not be transferable in the realm of CSEF and a contribution through crowdfunding should not be convertible to a class of share capital with voting rights (carrying governance responsibilities). Providers of crowdfunding accept a different level of risk, understanding that their contribution might be lost if the venture is unsuccessful.

Q6: These limits do not require any change if share capital continues to represent a contract between shareholder and company. The current limits make investment accessible to more of the general public and provide increased opportunity for a company to source finance privately.

Q7: Adequate disclosure for share investment is entirely appropriate. Disclosures to investors could be simplified if the risk-reward and governance-accountability relationships were better understood for share capital investment.

Note: In contrast crowdfunding contributors know that the sums provided may be more akin to a "donation-with-potential" and there is no expectation of being involved in governance activities.

Q8: Whether or not there are changes to the way proprietary companies raise capital, there is still an expectation of accountability to investors. There is urgent need to re-examine the whole legislative system in respect of proprietary companies. Directors of proprietary companies often carry most of the liability and risk burden through person guarantees, despite limited liability status, and therefore the legislative requirements (drafted to enable protection through limited liability) become superficial.

Proprietary Companies and CSEF

Q9: Crowdfunding and equity raising should be kept separate. An investor holding share capital has governance responsibilities and the company has accountability responsibilities to that investor. In contrast crowdfunding providers should not be expected to participate in governance at any time in the future. Legislative change may be needed to enable companies to access finance through crowdfunding, but not with the intention to convert funds raised to equity.

More flexibility is needed to support and encourage innovation and entrepreneurial activity but not necessarily through facilitating access to shareholder participation. Participants in crowdfunding

should simply support a 'good idea' with no expectation of involvement in operations or governance, but possibly some 'in-kind' benefit at a later stage e.g. when a product is developed they may receive free samples.

Q10: Proprietary company limits should not change. Proprietary companies should be able to access crowdfunding but crowdfunding should be considered as a separate classification of income (and matched with related expenditure) rather than as an equity contribution. Crowdfunding providers should not have the same status or governance responsibilities of shareholders.

Q11: Refer response to Q10 above. Crowdfunding should be classified as income. CSEF is not supported.

Q12: Additional transparency requirements will kill the attraction of crowdfunding, innovation and entrepreneurship at the grassroots level. Crowdfunding should be treated as a separate classification of income and as such, requires a different reporting regime. Supporters should be aware that crowdfunding contributions carry a different risk profile to traditional "investments". Crowdfunding should be maintained as a fundraising mechanism akin to a donation or public grant. The proposals to bring CSEF under the corporation legislation banner are inappropriate. Legislation is needed for consumers to understand the contributions are non-refundable, benefits may not eventuate, and maybe to set limits on individual amounts contributed.

Q13: It is unclear why any limits need to be set – surely a decision to support a venture (with no expectation of a return) is a personal choice. Crowdfunding should be considered separately to traditional sources of funding and should not be captured by the more onerous reporting regime relevant to investments in share capital. I.e. Participants in crowdfunding should not have any say in operations or management and should not have expectations of tangible personal benefits always being returned.

Q14: CSEF should not be permitted. Equity fundraising by companies and crowdfunding by companies are two different paradigms which should not be confused.

Q15: A solvency declaration is an appropriate condition in return for limited liability. However, aligning timing with tax regime may be preferable but needs to be within a reasonable period after the financial year end - not necessarily when a tax return is lodged.

Q16: The only "burden" is for directors to monitor the company's cash flow and its financial position, essential for any business activity in any event. This is an appropriate requirement (and cost) in return for the benefit of limited liability.

Q17: An annual declaration is an appropriate annual reminder for directors to monitor the company's cash flow and financial position. The statutory obligation is appropriate.

Q18: The incremental cost to make a declaration beyond maintaining control of cash flow and financial position is minimal. .

Q19: The cost to maintain a share register is minimal given the limited number of share transactions in small proprietary companies.

Q20: There is minimal value and minimal maintenance needed, given the limited number of share transactions in small proprietary companies.

Q21: A copy of the extract of the ASIC register may be retained as the “share register” for a small proprietary company.

Q22: I have never encountered any problems or issues with identity of shareholders in a proprietary company. Where identity needs to be private, the shares in the proprietary company are held by a nominee.

Q23: It would be more appropriate to have reduced fees to search ASIC records so that information on the public record is more easily accessible by the public.

Q24: I have not experienced access to a share register being an issue where rights to property in a proprietary company are being challenged.

Q25-Q28: I have not encountered any of the issues described in these questions. Transactions entered into by third parties with proprietary companies are often subject to personal guarantees given by the director(s) and therefore the company seal has little consequence.

Q29: The forms are not overly onerous - only an annual statement is needed in many cases. The cost/benefit of completing and lodging the form is questionable ($246) beyond being a reminder that statutory obligations accompany limited liability status and enabling information to be held on the public record.

Q30: The completion of tax forms can be costly and time-consuming.

Please feel free to contact me to discuss further any matters arising from this submission.

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