

OUT15/23148

General Manager  
Financial System and Services Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

**By email:** smallptycompanies@treasury.gov.au

Dear Sir/Madam,

**Submission to consultation paper on facilitating crowd-sourced equity funding and reducing compliance costs for small businesses (Consultation Paper)**

Thank you for giving the Office of the NSW Small Business Commissioner (OSBC) the opportunity to comment on the Consultation Paper.

The role of the OSBC is to support small businesses in NSW by:

- providing mediation and dispute resolution services;
- delivering quality small business support through a range of programs and resources; and
- speaking up for small business within government.

The OSBC has reviewed the Consultation Paper and makes the following comments in response to certain issues raised in the Consultation Paper. The OSBC supports in principle extending access to crowd-sourced equity funding (CSEF) to proprietary companies. In arriving at an appropriate regulatory framework to achieve this, the aim should be to appropriately balance investor protection with reasonable compliance and disclosure obligations, bearing in mind the specific nature of CSEF.

**Increasing flexibility in capital raising (question 8)**

Increasing the shareholder limit for proprietary companies and/or expanding the small scale offerings exception to the disclosure requirements is likely to provide small proprietary companies with additional flexibility to raise capital.

However, by themselves, these measures are unlikely to be sufficient to facilitate small proprietary companies' access to CSEF, since imposing (albeit higher) limits on the number of (non-employee) shareholders and investors, while managing risk and better suiting the lighter governance requirements, would still run against the central premise of CSEF, that of seeking equity from a potentially unlimited 'crowd' of unknown investors.

## Crowd-sourced equity funding (questions 9-14)

### *The potential benefits of extending CSEF to proprietary companies*

The OSBC considers that proprietary companies should be able to access CSEF, for a few reasons.

First, given that 99% of all registered Australian companies are proprietary companies,<sup>1</sup> it seems evident that to be a widely-available source of funding, CSEF needs to be made accessible to proprietary companies in addition to public companies. As other stakeholders have recognised, requiring proprietary companies to convert into public companies simply to access CSEF is likely to be a barrier to small businesses wishing to access CSEF.<sup>2</sup>

Second, access to CSEF can in particular benefit smaller proprietary businesses. Access to capital can be challenging for some small business start-ups, especially since they often have little to no operating track record and low cash flow. For those businesses with ambitions for high-growth, and which have exhausted owners' savings, credit card limits or other sources, access to capital in the form of equity may be the preferred option.

CSEF has the potential to act as an early financing option compared with existing alternatives such as banks, angel investors and/or venture capitalists.<sup>3</sup> This is not to say that CSEF would be a 'silver bullet' and solve funding issues for all start-ups,<sup>4</sup> but it would add yet another important capital possibility to the funding landscape that will be appropriate for some firms.

Third, not only can CSEF be an alternative means of funding, it can also create a primed consumer base and help a nascent business build a sustainable business model more quickly.<sup>5</sup> Research conducted in the UK indicates crowd-source issuers found that investors added value beyond their financial contributions through assisting with making connections to people within their networks and providing market validation for their venture.<sup>6</sup>

There may also be other flow-on benefits to making CSEF available more broadly, since if more start-ups are funded in their earlier stages of development, this will provide opportunities for angel investors and venture capitalists to choose from a larger pool of start-ups or invest at a later stage.<sup>7</sup>

The fact that extending CSEF to proprietary companies may involve introducing additional complexity into Australia's corporate law framework should not be a sufficient rationale for not doing so; legal frameworks should be adapted to suit desirable public policy ends.

<sup>1</sup> Consultation Paper, at 6.

<sup>2</sup> Consultation Paper, at 12.

<sup>3</sup> Matt Vitins (2013) 'Crowdfunding and Securities Laws: What the Americans are doing and the case for an Australian crowdfunding exemption', *Journal of Law, Information and Science* 22(2): 92, at 101; Jason Zein (2014) 'Filling the capital gap: The Financing case for crowdsourced equity funding in Australia', *Journal of Banking and Finance Law and Practice* 25:102, at 103.

<sup>4</sup> StartupAus (2015), *Crossroads 2015: An action plan to develop a vibrant tech startup ecosystem in Australia*, April, at 73.

<sup>5</sup> Joseph J. Dehner and Jin Kong (2014) 'Equity-based crowdfunding outside the USA', *University of Cincinnati Law Review* 83: 413, at 416.

<sup>6</sup> Peter Baeck, Liam Collins and Bryan Zhang (2014), *Understanding Alternative Finance: The UK Alternative Finance Industry Report 2014*, Nesta and the University of Cambridge, November, at 53.

<sup>7</sup> Zein, above n3, at 104.

### *Balancing investor protection and high disclosure obligations*

The level of disclosure obligations associated with accessing CSEF is likely to affect take up by proprietary companies. Although some level of mandatory disclosure is a critical component of investor protection, CSEF may be attractive to some small proprietary companies only if the disclosure obligations can be fulfilled relatively quickly and at reasonable cost.

The need for an adequate level of investor protection is undoubted. Start-ups often fail and represent a particularly risky investment, and there are risks around illiquid investments, potential dilution and valuation difficulties, many of which may not be fully understood by retail investors. Further, if retail investors become disillusioned with CSEF or consider investor protections to be inadequate, CSEF would become less appealing and in turn reduced as a source of potential capital.<sup>8</sup>

On the question of what level of investor protections should be required, the nature and context of CSEF need to be taken into account.

The imposition of regulatory caps on the amount an investor can invest per offer and in aggregate per year, should limit the risks to retail investors, and in turn permit less disclosure obligations on issuers. Further, concerns raised about the effect reduced reporting may have on the ability of CSEF shareholders to exercise influence over a company they invest in,<sup>9</sup> overlooks the fact that many retail investors are likely to be less demanding and involved investors compared with more sophisticated and larger scale investors.

In respect of the level of reporting and disclosure obligations that might be required of proprietary companies accessing CSEF, consideration should be given to differentiating between the size and scale of the equity offering within an applicable annual fundraising cap. Crowdfunding at the lower end of the spectrum is very different from that at the higher end, the latter of which might be considered to be more like a traditional securities offering.<sup>10</sup> Reporting and disclosure obligations on issuers could therefore potentially be tiered, with progressively more reporting and disclosure required for offerings of greater value.<sup>11</sup> The rationale for this might be that the higher the offering, the more capacity the issuer should have to cover the costs associated with fulfilling the more demanding requirements, and the wider the potential impact of any business failure may be, and vice-versa.

### *The role of intermediaries*

Under the proposed CSEF regulatory scheme for public companies, intermediaries will need to hold an Australian Financial Services Licence and undertake prescribed checks on the issuer. These should be replicated in any CSEF regulatory scheme extended to proprietary companies.

<sup>8</sup> Corporations and Markets Advisory Committee (2014), *Crowd Sourced Equity Funding*, Report, May; Vitins, above n3, at 116.

<sup>9</sup> Consultation Paper, at paragraph 71.

<sup>10</sup> Vitins, above n3, at 118.

<sup>11</sup> *Id.* at 125.

Intermediaries, being the platforms that facilitate CSEF, will play an important role in limiting the risks to retail investors associated with CSEF. They can act as a screening mechanism and should have a long-term interest in improving the success of CSEF through their platforms and in limiting scams and fraudulent conduct.<sup>12</sup>

#### *Other considerations*

If, flowing from the Federal Government's *Re:Think Tax Discussion Paper*, further consideration is being given to the creation of a new corporate business structure for the small business sector, then how such a structure might fit into a CSEF regulatory framework for proprietary companies may need to be considered further.

Further, the OSBC suggests that further consideration be given to if and how any CSEF regulatory framework might allow for the aggregation of crowdsourced investors through vehicles such as trusts. This arrangement may be more efficient for issuers and intermediaries, and may also be a way around the problem arising from the existing 50 non-employee shareholder cap imposed on proprietary companies.

#### **The solvency resolution (questions 15-18)**

The OSBC supports further consideration of the merits of reducing the administrative burden associated with proprietary companies making an annual solvency resolution, especially given that the solvency resolution is not required to be lodged with the Australian Securities and Investments Commission (ASIC), and the fact that there is a directors' duty to prevent insolvent trading by the company that applies at all times. If the intention of this requirement is to remind directors of a company of their duty to prevent insolvent trading, then fulfilling this aim might be achieved by other means. It may be that making it clear (to the extent it is not already the case) to directors that payment of the company's annual review fee is an indication that directors consider that the company is solvent may be sufficient for this purpose.

#### **Execution of documents (questions 19-27)**

The OSBC also supports the necessary adjustments being made to accommodate the execution of documents by sole director proprietary companies and by way of split execution.

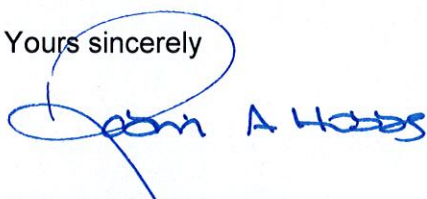
#### **ASIC forms (question 29)**

The OSBC encourages ASIC to continually review its forms to remove, consolidate or streamline information required to be gathered from proprietary companies while meeting regulatory objectives. ASIC should also ensure that any information already provided to government by proprietary companies is leveraged where possible, including through mechanisms such as the Australian Business Register and Standard Business Reporting, in order to reduce the administrative burden on small companies.

<sup>12</sup> Dehner and Kong, above n5, at 441; Vitins, above n3, at 125.

Should you wish to further discuss any of these comments please contact Georgos Papanastasiou, Senior Advisor, Advocacy on (02) 8222 4833 or [georgos.papanastasiou@smallbusiness.nsw.gov.au](mailto:georgos.papanastasiou@smallbusiness.nsw.gov.au).

Yours sincerely



**Robyn Hobbs OAM**  
**Small Business Commissioner**

8 September 2015