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

31 August 2015

Dear Sir/Madam

Re: Discussion paper - 'Facilitating crowd-sourced equity funding and reducing compliance costs for small businesses'

Enclosed is a submission authored by StartupAUS in response to the Government's consultation paper entitled '*Facilitating crowd-sourced equity funding and reducing compliance costs for small businesses*'.

StartupAUS is a not for profit organisation with a mission to transform Australia through technology entrepreneurship. Our principal focus is on early stage, high-growth ventures. Crowd-sourced equity funding (CSEF) has proven a useful tool for supporting these businesses in other jurisdictions, and we therefore welcome the opportunity to comment on this discussion paper.

We are highly supportive of ongoing efforts to help develop and expand Australia's startup ecosystem. Our view is that attracting entrepreneurial talent and improving access to capital for high-growth companies in Australia should be key pillars of future such efforts. Crowd-sourced equity funding has the potential to deliver dividends in both these areas.

The proposition at the centre of our submission is that CSEF has the potential to be a valuable tool for startups by extending the current (largely pledge-based) crowdfunding model to enable companies to raise small amounts of capital from a large number of retail investors. If implemented well, this will increase the speed with which promising startup ideas can be funded, unlocking capital from more investors.

Recent international experience suggests CSEF can be implemented simply and without the imposition of onerous requirements on resource-scarce startups. In our view it is imperative that Australia's CSEF regime be comparable in these respects to the international benchmarks already established.

Underpinning our submission is the view that, wherever possible, startups and CSEF investors should be paired simply and effectively in a way which delivers value to each without imposing unnecessarily onerous regulatory burdens.

Yours faithfully,

Peter Bradd
Director and CEO, StartupAUS

Summary

- Crowd-sourced equity funding should be made available to proprietary companies
- Retail investors taking advantage of CSEF should not be included in the non-employee investor cap for proprietary companies
- Annual CSEF fundraising caps and eligibility requirements need to be reviewed regularly, with provision for rapid change
- Measures adopted should adhere closely to the discussion paper's stated aim of limiting or reducing the regulatory burden on business - particularly where the intention is to assist startups (which are inherently resource-scarce)

In the past five years, crowdfunding has become an important global source of funding for innovative companies and projects. As a sector it has grown substantially in recent years, with global funding from crowd sourcing in 2014 estimated to be $65bn. By 2020, crowdfunding is projected to reach $500bn annually, creating more than two million jobs.[1] Much of this will be via equity-based funding in those countries which are supportive of crowd-sourced equity funding. Australia must ensure it is part of this cohort.

We have limited our submission to the most critical issues affecting startups. Our principal submission is that, since the vast majority of startups are proprietary companies, the CSEF regime must be made available to proprietary companies.

StartupAUS strongly supports the overarching goal of the discussion paper - to reduce regulatory burdens on businesses. To be effective and ensure uptake in a competitive international environment, the Australian CSEF measures adopted will need to consistently adhere to this principle.

[1] Source: *Crossroads 2015: An Action Plan to Develop a Vibrant Tech Startup Ecosystem in Australia*, April 2015

Crowd-sourced equity funding | Appropriateness of the shareholder limit

9 Should proprietary companies be able to access CSEF? What are the implications for the corporate law framework of permitting proprietary companies to do so?

1 Should the law be amended to increase the permitted number of non-employee shareholders in a proprietary company and what would be an appropriate limit? Or do companies with more than 50 non-employee shareholders have a sufficiently diverse ownership base with limited access to information or ability to influence the affairs of the company to justify the greater governance requirements currently placed on them?

In order for Australia's CSEF regime to be effective, proprietary companies must be given access. As the discussion paper notes, 99 per cent of all Australian companies are proprietary - as are the vast majority of startups seeking to access capital. A CSEF regime inaccessible to these companies would be substantially less effective at achieving the stated aim of providing 'additional investment options for people wishing to invest in startups and small businesses'.

For proprietary companies to take advantage of the CSEF regime, regulations limiting the number of non-employee shareholders in proprietary companies need revision. Experience of CSEF campaigns in other jurisdictions suggests that average investor numbers consistently exceed 100. This is true even in markets substantially smaller than Australia's - for example, since the introduction of CSEF in New Zealand in April 2014, the average number of investors in successful campaigns has been more than 150.[2]

The current limit of 50 non-employee shareholders is therefore incompatible with the likely size of even a modest CSEF campaign. Indeed, the mooted increased investor limit (to 100 non-employee shareholders) would also be insufficient to allow proprietary companies to take full advantage of CSEF provisions. The effect of breaching the limit - moving to public status ('exempt' or otherwise), with the concomitant increase in complexity and reporting requirements - would be too costly and administratively burdensome for most startups.

Instead, StartupAUS proposes that CSEF investors be excluded from the investor limit for proprietary companies. Safeguards already envisaged by the CSEF regime, such as investment caps for retail investors, alleviate the concerns non-employee investor limits were designed to address. We would note, however, that accredited investors should not be subject to these caps - to do so would unnecessarily disadvantage CSEF as a vehicle for high net worth investment.

[2] Source: *New Zealand Equity Crowdfunding 1st Year in Review*, Crowdready.com.au, 18 August 2015

Additional safeguards ensuring prospective investment returns are not presented in a misleading way would further help protect retail investors. Experience in other jurisdictions (particularly the UK) suggests such measures could substantially reduce the risks associated with high-growth companies using CSEF.

Crowd-sourced equity funding | Annual fundraising cap and eligibility

13 Do you consider that an annual fundraising cap of $5 million, and eligibility caps of $5 million in annual turnover and gross assets, are appropriate for proprietary companies using CSEF? If not, what do you consider would be appropriate fundraising caps and eligibility criteria?

An initial fundraising cap of $5m is appropriate, and aligns with international experience - most CSEF deals in other jurisdiction so far have fallen within the $5m funding cap and eligibility caps of $5m in annual turnover and gross assets. But the data points currently available remain limited, making it difficult to identify best practice.

Crowd-sourced equity funding is a relatively new method of raising capital, and - as we have previously noted - it is likely to grow very substantially in coming years. If it continues to grow at the current rate, these limits could become inappropriate relatively quickly, causing Australia's CSEF regime to lose competitiveness. Indeed, a successful push to increase the value and effectiveness of Australia's startup ecosystem could itself put pressure on these limits.

We recommend a process of regular review of the fundraising cap and eligibility requirements, with guidelines in place to ensure flexibility and responsiveness are possible if circumstances so demand. As CSEF matures internationally and patterns become visible in Australia's useage, more data will drive a clearer understanding of appropriate levels.
