4 February 2016

Senate Standing Committees on Economics
PO Box 6100
Parliament House
Canberra ACT 2600

By email: economics.sen@aph.gov.au

Dear Sir or Madam,

Corporations Amendment (Crowd-sourced Funding) Bill 2015 - Submissions to the Senate Standing Committees on Economics

On behalf of VentureCrowd, I welcome the opportunity to make submissions to the Senate Standing Committees on Economics (***Committee***) concerning the Corporations Amendment (Crowd-sourced Funding) Bill 2015 (***Bill***).

1. VentureCrowd – Background

(a) VentureCrowd is an equity crowd funding (***ECF***) business that was established in Australia under Australian law in February 2014.

(b) VentureCrowd has concluded 13 ECF deals for 10 Australian start-ups raising amounts ranging from $50,000 to $4,200,000 from Australian wholesale investors.

(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 as ESVCLPs (under the Venture Capital Act 2002):

- Sydney Angels Sidecar Fund,
- Blue Chilli Venture Fund,
- Slingshot Venture Fund,
- ilab Venture Fund,
- iAccelerate Venture Fund, and
- Australia's first AFOF (under the Venture Capital Act 2002), 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) To our knowledge, VentureCrowd is the only Australian crowd-funding platform that has conducted successful equity crowd-funding transactions in Australia.

2. General

(a) VentureCrowd supports the introduction of a new regulatory regime for ECF that allows a much broader cross-section of the Australian population to invest in start-ups.

(b) VentureCrowd believes that any reforms made to allow ECF must reduce the friction currently associated with start-ups raising capital while ensuring that investors are both educated in the risks of investing in this sector and protected (as much as possible) from substantial loss of capital.

(c) VentureCrowd supports the Bill's approach to the regulation of intermediaries and believes that an intermediary must be appropriately licensed and should demonstrate a strong commitment to education for investors of the risks involved in investing in start-ups including the benefits that flow from investing in a diversified portfolio to spread the risks.

(d) VentureCrowd agrees that the investor caps, cooling off period and the disclosure requirements (to the extent that these have been articulated) are appropriate, at least for now. After 2-3 years, the legislature should re-visit these limitations as ECF becomes better understood by the public and regulators to ensure they remain relevant.

(e) There are, however, 2 related aspects of the Bill that will significantly increase the burden involved for start-ups in raising capital through ECF and which will, in our view, provide a significant impediment to the development of an effective ECF industry in Australia. They are:

   (i) the requirement that a start-up seeking ECF must first become a public company (section 738H(1)(a) of the Bill); and

   (ii) the prohibition on an intermediary aggregating small multiple investments made by retail investors into a collective vehicle and making a single investment into the start-up (section 738G(1)(a) of the Bill).

   Each of these is discussed below.

3. Submission – Exempt Public Company Requirement

(a) The Corporations Act requires a proprietary company with 50 or more shareholders to become a public company. In the expectation that a start-up who accesses ECF will gain 50 or more shareholders, the Bill requires that start-up to convert to become a public company (whether or not it ever exceeds the 50 shareholder limit).

(b) The public company regime was introduced to regulate large, well funded and well resourced companies that were either listed on a stock exchange or of equivalent private stature. Start-up businesses, without revenue and resources, could not have been further from the minds of those who wrote the legislation.

(c) Today, about 1% of Australia's companies are public companies and the vast majority of Australian start-ups (and small businesses), whether successful or not, will never otherwise become public companies at any stage of their life cycle.

(d) This Bill's requirement that an ECF start-up first becomes a public company imposes a significant (and unnecessary) regulatory, administrative and compliance burden on those start-ups. For example, an ECF start-up will be required to:

    (i) spend thousands of dollars on lawyers and accountants to convert to being a public company;

    (ii) sign 50+ new shareholders to subscription agreements, a shareholders agreement and issue share certificates; and

    (iii) arrange shareholder resolutions and annual general meetings, maintain an up-to-date shareholder register and keep its many shareholders informed.

(e) These tasks and expenses are well beyond the capacity and limited resources of a start-up. Even if the start-up can satisfactorily undertake those tasks and afford the expenses, the work and time involved will present a massive distraction from its core business.

(f) A start-up is not a late stage business with a professional share register and a legal department.

(g) Although the Bill provides relief from some of the burdensome consequences of being a public company, this is token at best and the damage will have already been done as outlined above.

(h) More importantly, however, the imposition of the exempt public company requirement is based on the false premise that Australian start-ups actually wants 50 or more shareholders.

(i) If there had been proper consultation with the Australian start-up community before the Bill was drafted, it would have been apparent that these fledgling businesses are unlikely to be able to adequately deal with 20 new shareholders, let alone more.

4. Submission – Prohibition on Aggregated Investments

(a) One means of ensuring that a start-up doesn't acquire dozens of new shareholders is for the intermediary to employ a collective investment vehicle (such as a unit trust) by which the start-up receives all of its investments aggregated as a single investment.

(b) This serves 2 important purposes. First, it greatly reduces the administrative burden on the start-ups as the intermediary takes care of the shareholder registry and all of the paperwork. Second, it greatly reduces the administrative burden on the investors as the intermediary takes care of the negotiations with the start-up and all of the paperwork.

(c) 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.

(d) Section 738G(1)(a) of the Bill prohibits an intermediary from aggregating investments in this manner by stating that a ECF offer will only be eligible where “it is an offer by a company (ie, the start-up) for the issue of securities of the company”. Accepting the investments of investors into a unit trust is, therefore, prohibited.

(e) No explanation for this prohibition has been provided. Accordingly, it is difficult to know whether there is a particular concern that the drafter was trying to address.

(f) VentureCrowd currently employs an aggregated investment model for its ECF deals and will continue to do so (for wholesale investor deals, at least). While VentureCrowd does not believe that it should be mandatory for investments to be aggregated in this manner, we strongly believe that aggregation should be permitted. In time, the market can determine which of these 2 methods is preferable.

5. A Potential Solution

(a) The requirement that ECF start-ups first become public companies stems not from a desire to protect potential investors or build confidence in a new marketplace, but because the Bill’s drafters have been unwilling to properly confront provisions of the Corporations Act that require a company to become public if it has 50 shareholders.

(b) Protect potential investors and build confidence in a new marketplace are each ably achieved by the strict licensing and regulation of the intermediaries, the emphasis on investor caps, cooling off periods and disclosure. There is no need to impose unnecessary administrative burden on the businesses we are trying to encourage.

(c) The reasoning behind the prohibition on aggregated ECF investments is more difficult to determine as no explanation has been proffered. Its impact on start-ups, in forcing them to have dozens of new shareholders without an alternative, is just as detrimental to the public company requirement.

(d) VentureCrowd believes the preferable method of overcoming these hurdles is to explicitly recognise that ECF is part of a new wave of the delivery of financial product and advice and provide new regulation tailored to its particular requirements. The current attempt to shoehorn ECF into a corporate regulatory framework that was designed many years before electronically delivered ECF was ever contemplated is unsatisfactory.

(e) The first step is to recognise that the intermediary is the most sophisticated of the 3 parties involved in an ECF and is therefore the party best able to bear the majority of the regulatory burden. The relatively unsophisticated retail investors and the start-ups seeking early stage funding should bear regulatory burden only to the extent that it is essential to maintain ECF system integrity.

(f) This would involve licensing ECF intermediaries as ECF providers and then exempting start-ups that register for funding with licensed ECF intermediaries from the public company requirements and from any prohibitions on aggregated investment that exist in the Corporations Law. There would be no obligation to aggregate the investment but it would, at least, not be permitted.

(g) The intermediaries would assume responsibility for the aggregation of the investment (if that is what the start-up requires) and ensuring that the funds are then directed to the start-up once they have been received and the relevant cooling off periods had expired.

(h) This is a summary only of a proposed solution and more thinking would be required by Treasury as to its details.

6. Conclusion

(a) If enacted in its current form, the Bill will not provide the valuable additional source of funding that is required to support Australia's burgeoning start-up sector.

(b) Without that increase in the size and diversity of funding sources, the technological transformation that Australia's economy requires to move from its reliance on resources will not occur.

(c) These high barriers of entry for Australia's start-ups imposed by the Bill may serve to attract only start-ups with little hope of raising money elsewhere. The resulting returns to investors will be poor (or non-existent).

I would be happy to elaborate on these submissions in person if that would assist the committee.

Tim Heasley
Director, VentureCrowd