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Manager
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Dear Minister Cormann and Minister Billson,

Re: Crowd-sourced Equity Funding Discussion Paper

The Governance Research Program at Victoria University has been committed to research into small business governance, regulation, financing and innovation in Australia. Our previous work has been mainly sponsored by the Australian Federal Department of Treasury (Treasury), Australian Research Council, Council of Small Businesses of Australia (COSBOA), Federal Department of Education (in the form of Endeavour Fellowships) and Australia-China Council of Department of Foreign Affairs and Trade (DFAT) to look into the regulation, governance and performance of small business in China as well in the other Asian partner economies. We hereby add our contribution to the discussion paper by contributing to the relevant evidence base for decision making pertinent to Crowd-funding as follows:

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 sustainable investor demand?

According to the Victoria University's Small Business Regulation Survey (2012)¹, small businesses lack the capacity to catch up with the regulatory reforms, which is a critical barrier that policy makers have to acknowledge during the design and implementation of the CSEF model. Our study finds that any sound regulation pertinent to small businesses has to possess properties such as simple, easy to comply with, not too expensive, in plain English, and not too IT intensive.

Small businesses are slower in catching up with the idea of Crowd-funding comparing with their larger counterparts. Hence, one major barrier perceived by the researchers from the Governance Research Program at Victoria University, based on our extensive previous research projects, is that the perception of small businesses is against the use of CSEF as a complement to their existing funding channels.

Consequently, the research team proposes that the Australian governments provide more education and real world examples on how CSEF works for each single small businesses and how can they be engaged in the CSEF opportunities initiated by the Federal Ministry of Finance and Ministry of Small Business.

Moreover, the investor demand may be a barrier given that ordinary investors may need further education to understand the risks inherent in the CSEF. It also takes time for the investors to accept the CSEF as an alternative investment option.

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?

No. The Governance Research Team at VU firmly believe, based on the evidence aggregated from our previous research, that due to resource constraints and lack of expertise in modern management decision making, small business access to the managed investment scheme and small scale personal offer exemption has been constrained.

¹ The survey is part of an Australian Research Council Linkage Grant on "Developing a Responsive Regulatory System for Small Corporations in Australia" (2009-2013).

From the Resource-dependency Theory perspective, small businesses lack finance, strategic planning and marketing expertise, which excludes them from accessing the alternative funding venues such as the managed investment scheme and small scale personal offer exemption. Moreover, the small corporations lack the capacity to deal with regulatory compliance requirements associated with a managed investment scheme and small scale personal offer exemption. We estimated that the extra compliance costs in terms of the internal human capital to be allocated \$3,000-\$5,000 on average to meet the compliance of regulatory requirements. Furthermore, the small corporations who responded to our small business survey claimed that they are really poor in dealing with new regulatory reforms. Hence, the existing mechanisms fail to meet the requirement of small corporations.

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?

We perceived that it is the awareness of CSEF amongst the small business community as well as their limited understanding of the regulatory changes that restricts the small businesses from accessing the advanced CSEF options.

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

The Small businesses in general suffer from limited access to finance, due to the fact that they do not have eligible collateral, credit history (as individuals, a lot of them tend to not borrowing anything), and the ability to pay back the interests. The CSEF will significant expand their access to finance, though the scope of the CSEF may have to be broadened to suit small businesses in general (small and medium-sized enterprises according to the Australian Bureau of Statistics definition, which employ less than 99 employees).

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

Based on the evidence established from our extant projects, we are confident to argue that the small businesses bear disproportionate compliance costs, albeit that they have to meet numerous regulatory compliance requirements as their larger counterparts.

We believe that the exemption of public company structure will facilitate the CSEF in Australia. Moreover, we would propose the adoption of partnership with limited liability as a complement to the existing legal forms.

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?

The risk-based regulatory approach should be adopted with regards to the issuing of CSEF. In other words, as long as the risk for the CSEF is not substantial, the small businesses should be left alone. When it goes beyond certain cutting off point, in the JOBS legislation this is \$10 million, then the public company structure should be introduced.

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?

Given that the failure rate is reasonable high according to the historical data, it is suggested a risk-based regulatory approach should be taken to deal with such issues. As long as the risks are beyond control, it is a must that the state steps in to intervene, which should be imbedded in the regulatory design.

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?

We believe that the threshold of \$2 million within any 12-month period is appropriate and reasonable, based on the practice in the US.

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?

The independence of the intermediary is a requirement for the CSEF to function properly. Hence we see the recommendations related to the intermediary remuneration and investing in issues as appropriate.

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?

Yes. It is a fair way to balance the risks, return and investor protection.

However, we do not believe that it limits the investor's choice as they are able to invest in other companies may such opportunities exist.

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?

The disclosure requirements have been under—played in the CAMAC model. We firmly believe that disclosure, as a feasible way for stakeholder participation and minority shareholder activism, should be encouraged. Though it is a burdensome requirement for the small businesses that use the CSEF to report, it is of substantial benefit in the long run, i.e. to maintain the confidence of the market and to boost the transparency.

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?

No. The industry structure in Australia may be different from that in New Zealand. In particular, the small businesses may face a different landscape in Australia, i.e. their political presence and their voice, compared to that in New Zealand. In addition, it is far more manageable for the Australians to control the process of regulatory reform for the CSEF. In addition, the business demographics in Australia may be different from that in New Zealand as well.

13. Do you consider that voluntary investor caps and requiring increased disclosure where investors contribute larger amounts of funds appropriately balances investor protection against investor choice and flexibility for issuers?

We believe that the voluntary investor caps have severely underestimated the market capacity to respond to the CSEF. However, we would like to propose the US model (invest less than \$10,000 or less than 5% of the annual income) as a benchmark.

14. What level of direction should there be on the amount of disclosure required for different voluntary investor caps?

As long as external money is used, disclosure is required. However, we would also propose a flexible arrangement (Based on the Responsive Regulatory Model proposed by Professor John Braithwaite from ANU), that the disclosure to be designed around the risks associated with investors.

15. How likely is it that the obstacles to CSEF that exist under the status quo would drive potential issuers, intermediaries and investors to move to jurisdictions that have implemented CSEF regimes?

Very unlikely.

Our previous Australia-China Council grant found that the decision of accessing a foreign regime is not that straightforward, but it is contingent on the factors beyond economic calculations, such as culture, consumer behaviour, the legislations, and the human resourcing. It is not easy for a company to move to the other jurisdiction.

Having said that, Australia houses a large proportion of financial assets, it is the ideal place for the CSEF to prosper. Hence, there is no point that the businesses should be diverted to a foreign regime simply because of the CSEF regimes.

16. What are the costs and benefits of each of the three options discussed in this consultation paper?

The costs are mainly associated with the risks inherent in the small business operations. In addition, there will be a learning curve. Of course this involves cost, for the regulators to understand the market as well as the unmet financing needs of the small businesses. The major benefit is to offer an alternative for the small businesses to access finance. However, further studies have to forecast the costs and benefits of each option.

From the international business operations perspective, Australian has fallen far behind in dealing with the crowdfunding related issues. It is imperative that we have to understand the pros and cons of crowdfunding, in order to maintain our competitive advantage in the global market in financial services provision.

17. Are the estimated compliance costs for the CAMAC and New Zealand models presented in the appendix accurate?

We believe that the estimated compliance costs for both the CAMAC and the New Zealand models have been underestimated. More precise models such as the Dutch Model and the Regulatory Cost Reduction Model should be introduced instead.

18. How many issuers, intermediaries and investors would be the expected take up online equity fundraising in Australia under the status quo, the CAMAC model and the New Zealand model?

the status quo: not many.

the CAMAC model: not many unless it comes into legislation and the small businesses are well aware of CSEF as an option.

the New Zealand model: not many unless the model relaxes the number of shareholders/stakeholders involved in the process. Following the US, the number of shareholder requirement should be exempted for small businesses as well as the intermediaries.

However, we would propose two additional mechanisms to facilitate the financing of small businesses, one is that the Federal government should engage and empower business associations, such as COSBOA, to better utilise its networks and resource to boost the use of CSEF; the other is that the professionals such as the lawyers and accountants should be regulated to the extent that they understand the benefits and costs of CSEF for their small business clients.

19. Are there particular elements of the New Zealand model that should be incorporated into the CAMAC model, or vice versa?

Though the cutting off points for the level of financing as well as the number of shareholders has to be reviewed, it is clear that the New Zealand model offers a good alternative comparing to the Status Quo.

20. Are there particular elements of models implemented in other jurisdictions that would be desirable to incorporate into any final CSEF framework?

Proper corporate governance and risk mitigation mechanisms should be introduced, eg. the Hong Kong Corporate Governance Guidelines.

21. Do the issues outlined in this consultation paper also apply to crowd-sourced debt funding? Is there value in extending a CSEF regime to debt products?

No. The debt funding follows a different mechanism, in which trust and collateral may be critical.

The disclosure may compensate to the special requirement of debt products, however, the small business owners and intermediaries should bear in mind that the trust is a major issue in obtaining debts. In addition, collaterals of flexible forms should be accepted.

22. To what extent would the frameworks for equity proposed in this discussion paper be consistent with debt products?

The mechanisms for equity and debt financing are different. The debt financing may need more safeguards toward investor protection. Media may play an important role as a monitoring mechanism as well.

23. Would any of the options discussed in this paper, or any other issues, impede the development of a secondary market for CSEF securities?

It is too early to talk about the secondary market, as markets can be formed by needs rather than central planning; however the credit certificates and other financial derivatives may serve as flexible options for CSEF.

Yours sincerely,

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