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7 September 2015

General Manager
Financial System and Services Division
The Treasury
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Email: smallptycompanies@treasury.gov.au

Dear Sir/Madam

FACILITATING CROWD-SOURCED EQUITY FUNDING AND REDUCING COMPLIANCE COSTS

Thank you for the opportunity to provide a submission on the Consultation Paper dealing with the proposals for Crowd Sourced Equity Funding (“CSEF”) and reducing compliance costs for small business.

Pitcher Partners is one of the largest accounting firms outside of the Big 4 and has specialised in advising taxpayers in what is commonly referred to as the middle market for over 24 years. Accordingly, we service many clients that would be potential users of a proposed CSEF.

In general, we are very supportive of a CSEF for the middle market. However, our main concerns are in respect of the limitations imposed under the proposals (especially with respect to entities that are mid-sized rather than small). Furthermore, we highlight our concerns with respect to the lack of appropriate investor safeguards that may be contained in the proposed regime.

It is our view that the regime should be better targeted to medium sized businesses with a turnover of up to \$25 million, rather than micro businesses. However, we would support this change to be coupled with greater investor protection through the use of an “annual review” process for the financial statements of the relevant CSEF company. These points are outlined in more detail in the sections contained in the submission below.

1. CSEF should more appropriately target the middle market

In relation to the proposed CSEF for public companies, we highlight our support for the proposed new regime. However, we believe that proprietary companies should also be able to access a broadly equivalent CSEF. We therefore support the proposal to extend the regime in this respect.

However, if implemented in accordance with the proposals contained in the Consultation Paper, we are concerned that these proposals may not improve access to funding for SMEs.

The Final Report into the Financial System Enquiry (“the Murray Report”) highlighted the difficulties that SMEs face with accessing external funding to grow their business. However, the SME marketplace encompasses a large group of companies with annual turnover and gross assets in excess of \$5m. Companies with a level of turnover below \$5m can (in our view) be characterised as micro, rather than small and medium enterprises.

This is in line with the Report produced by the Parliamentary Joint Committee on Corporations and Financial Services in April 2011 entitled “Access for Small and Medium Business to Finance”, which stated that small business was generally characterised as having turnover between \$1m and \$5m and medium business was generally characterised as having turnover between \$5m and \$50m.

Therefore we believe that the proposals will only capture those entities that are classified as small, and will not capture those entities that require appropriate access to capital, being entities that are classified as medium sized.

We note that the Murray Report highlighted that approximately 50% of small business rely on bank loans to fund their businesses. Due to size constraints, small businesses are generally unable to access wholesale debt funding and as a result, the interest rates on small business loans are higher than for large businesses. As such, there is consensus that middle market clients face higher costs of finance.

Taking into account the above, we believe a cap of \$25m of gross assets or annual turnover would more appropriately target CSEF to the SME marketplace and will more likely address the issues of availability of funding that were raised in the Murray Report.

We note that increasing the limits would likely give rise to investor protection concerns. Accordingly, we believe that appropriate safeguards should also be put in place, as proposed below at item 5.

2. Increase to shareholder limits

We welcome proposals to increase the shareholder limit on small proprietary companies from 50 to 100 non-employee shareholders. We believe that this would assist in the prevention of small proprietary companies inadvertently converting into unlisted public companies (under the proposals) and the increased regulatory compliance costs associated with being a public company.

3. Size of raising under CSEF

We support the idea to introduce limits on the number of CSEF investors and the size of CSEF investment per investor, however we do not believe that the thresholds are appropriately set to target middle market investors.

For example, with 100 shareholders in a proprietary limited company, each with a limit of \$10,000, the maximum amount that can be raised through CSEF would be \$1m. With respect to the points raised in Section 1 of this submission, we do not believe that this will adequately deal with issues associated with limits of access to finance.

As such, we believe that a higher threshold should be available to those that utilise the CSEF. This could be achieved via several options which could be considered as part of the CSEF regime.

Firstly, the maximum investment per CSEF investor could be increased to \$50,000 with a limit on investors of 100. This would increase the maximum amount that could be raised from CSEF to \$5m, which would be a more appropriate threshold (which would link into the proposed expansion of the 20/12/5 rule, see Section 4).

Alternatively, the number of CSEF investors could be increased to 250, with a maximum amount per investor of \$20,000. This would enable a company to also raise \$5 million under the CSEF.

Another option would be for CSEF shareholders to be excluded from the proprietary company test, similar to current exclusions for employee shareholders. This would open up proprietary companies to CSEF without fear of inadvertently converting to a public company.

Other options include the use of Redeemable Preference Shares (“RPS”) for proprietary companies that have a limit per investor. For example, the CSEF could be open to allow for RPS to be issued to (say) up to 250 investors, whereby the maximum dollar limit per tranche could be equal to (say) \$2,500 each investor. Essentially, this would be akin to raise debt-like capital at a lower cost to middle market entities.

We believe that the CSEF critically should consider these alternatives to ensure that the scheme delivers better access to finance for middle market entities.

4. 20/12/5 limit

We note that at paragraph 45 of the Consultation Paper there is discussion about the existing small scale offerings exception. We understand that the 20 shareholders in 12 months with a \$2m limit (“the 20/12/2 rule”) has not changed in recent years.

As outlined earlier in Section 1, to assist in the removal of barriers to funding for SMEs, we believe that it would be important to consider increasing the limit from \$2m to \$5m. We believe that this would be an appropriate threshold for SMEs.

5. Increasing protection for investors under a CSEF for private companies

We welcome a proposed CSEF regime for private companies. However, we would be concerned with the ability for private groups to be able to access public money with limited

protection for investors. We believe that this could have significant ramifications for the ongoing success of a CSEF.

In particular, we highlight that removing assurance requirements and allowing the publishing of unaudited financial reports on the company website is unlikely to provide sufficient protection for investors in a potentially high-risk investment. We note that such unaudited financial reports would not have been subject to any independent insurance processes and thus are likely to be misleading to investors.

Accordingly, we would welcome appropriate safeguards that provide a balance as between compliance costs and investor protection.

One option that could be considered would be an annual review, rather than of audit, of the financial statements of a public / proprietary company using CSEF. The annual review would be similar to a half-year review processes for listed public companies and the annual review available for certain charities registered with the Australian Charities and Not-For-Profits Commission ("ACNC").

The cost of an annual review is typically less than an audit and thus would assist in the reduction of red tape and compliance costs. However, an annual review at least provides some level of assurance to investors that the financial reports give a true and fair view of the financial position and the financial performance of the CSEF company.

We believe that the annual review would therefore provide greater certainty to current and potential CSEF investors and would add value to annual financial statements published on the company's website.

We believe that the use of an annual review could be subject to annual turnover and gross asset limit test, beyond which an annual audit could then be required. While the thresholds are very low, we note that a similar system is used by the ACNC referred to above. The annual review requirement could also be introduced to small listed public companies.

We would be happy to discuss the issues raised in this submission with you at any time. Please contact me on (03) 8610 5170 or on email at alexis.kokkinos@pitcher.com.au, or Jake Ward on (03) 8610 5387.

Yours sincerely



A M KOKKINOS
Executive Director