



Submission to the Review of “Crowd Sourced Equity Funding”(CSEF)

Social Business Australia (SBA) would like to provide the following submission to the above review. Social Business Australia is a development agency involved in the start-up of cooperative and community owned businesses and supports the development of “community share offers” which can enable community buyouts of key facilities, businesses and services important to local communities and the start-up of community owned enterprises.

This submission has been discussed with the Social Enterprise, Entrepreneurship and Innovation Alliance (SEEI), a body which is in formation to assist the development of social enterprise in Australia. SBA is a member of this body. Those organisations which are members of the SEEI which have expressed support for this approach include Social Traders (see: <http://www.socialtraders.com.au/>), The Desert Peoples Centre (<http://desertpeoplescentre.org.au/>) and Employee Ownership Australia Ltd (www.employeeownership.com.au). As well, the new Business Council for Cooperatives and Mutuals (BCCM - www.bccm.coop) has expressed support.

The writer is not a lawyer but has long term involvement in community ownership activity in Australia and some experience with the kind of projects described below.

On the policy development side of “community share offers”, I would recommend the UK report “Community Investment – Using the Industrial and Provident Societies Legislation” (published by Cooperatives UK in 2008). This report contains a wealth of information and case studies on the process of “community investment” through the cooperative form of incorporation and can be seen at: <http://australia2012.coop/downloads/Community-Investment.pdf>.

The key point to note is that in the UK, 60 million pounds has been raised in the past three years through “community share offers” for investment in a range of community businesses as part of “community investment” programs of various sorts.

1. The Benefits of CSEF to Social Enterprise Development

Social enterprises are defined as “businesses that operate for a social purpose”. They do this by trading in the marketplace, by investing any profits into their social mission and by being owned by either “not-for-profit” organisations, cooperatives or community owned companies.

(2)

Social enterprises financed through “community investment” are widespread overseas and – though small in number in Australia – are gaining much attention here. Social enterprises that could have benefitted from “crowd sourced equity funding” platforms in Australia in the past



are those that have been involved in community buyouts or in starting up community owned businesses, especially those involved in renewable energy.

Community renewable energy enterprises are quite well developed in Australia with some 60 projects either started-up or in the planning stage. I understand that a submission will be made to the CSEF review by groups representing this area of interest. Community renewable energy projects are incorporated in a number of ways, including cooperatives and community trusts.

Key development agencies operating in the community energy area that I am aware of are “Embark” (see: <http://www.embark.com.au/display/WebsiteContent/Home> and “The Community Power Agency” (see: <http://www.cpagency.org.au/index.php>). Community owned investment funds are also under development in this area in Australia.

The best known community renewable energy project in operation in Australia is Hepburn Community Wind Farm Cooperative Ltd (see: <http://hepburnwind.com.au/>). This project raised \$10 million for its wind farm through a “community share offer”. While most of the funds were raised locally, this offer did face Corporate law restrictions placed on it by ASIC in relation to the fundraising approach taken, when the project sought to raise funds from outside its “membership area”. These restrictions could have been overcome if it was able to utilise a CSEF platform enabling “exempt” small scale investments to be made through a “direct public offer” to a wide range of community supporters – “exempt” in the same way as under the “light touch” regulatory regimes that operate for such schemes in some other countries.

In terms of CSEF technology platforms, there appear to be several of these operating in other countries specifically for starting up community owned renewable energy projects in wind, solar, hydro, wave and other technologies. Others operate for a range of community businesses and community buyouts. One such example of the latter - a functioning CSEF platform which would be of interest to the Review - is that called “Microgenius” in the UK. You can see the projects on this platform at: <http://www.microgenius.org.uk/>.

This platform is part of the excellent “Community Shares” program operated by “Cooperatives UK” and is one of the most successful areas of social enterprise development. To view the projects that are developing in that program, see <http://communityshares.org.uk/>.

As an example of a “community share offer” that has appeared in the press in the past couple of days, you can see this one at: <http://www.theguardian.com/social-enterprise-partner-zone-the-co-operative/money-flows-in-whalley-community-hydro>.

SBA is working with other groups such as the BCCM to develop an “action research” program that could provide more impetus to the broader development of “community share offers” in Australia and - for the reasons to be outlined below - CSEF will be able facilitate these developments by enabling “ease of access” to equity finance from community investors.

Overall, for social enterprise, CSEF will:

- (i) Open up the benefits of social enterprise to a wider range of smaller investors who are not currently able to access opportunities through restricted “local investment” projects.
- (ii) Open up equity financing for innovative social enterprises that have no track record.

(3)

2. Examples of past “Community Share Offers” in Australia



Other than Hepburn Wind mentioned above, there are several community business examples in this country that can be used as case studies. A couple that are not cooperatives that I am aware of are related below and are narrated from my understanding and research of each case, including discussions with those who have been involved. The numbers are approximate only:

1. Yackandandah Community Development Company – an unlisted public company formed to enable the 500 “shareholders” from the township to buyout the local service station to preserve this vital facility for community use (with the average shareholding being around \$1000). Luckily, Yackandandah CDO was able to receive the services of KPMG who did all the legal work on a “pro-bono” basis at a considerable cost saving to the community involved.
2. Eco Forest Ltd – an unlisted public company “green business” which sought to raise a couple of million through “public subscription” (ie: 1000 supporters purchasing \$2000 worth of shares each). The project was deemed by ASIC to be non-compliant and the fundraising was stopped until a re-worked prospectus was produced. In the end, time ran out and the project did not raise what it required within the 12 month limit on fundraising/disclosure documents, leaving the project under capitalised - and though it got started, it ran out of funds before it could generate enough income from the tree farm and associated “eco” businesses to break even, and so it went into liquidation.

3. The Difference Between “Crowd Funding” and “Crowd Sourced Equity Funding”

In the cases above of course, we are not talking about small scale “donations” to charitable projects or social ventures as crowd funding operates here now, but larger scale “capital fundraisings” in the realm of say the \$1 million limit now applying under the JOBS Act in the US. If a “JOBS Act” type regulatory regime had have been operating in Australia, it could have assisted projects like those mentioned above in the past.

There appears to be no legal impediment to “crowd funding” in Australia – the simple process of “soliciting” donations, ie: free money which people are prepared to “give” to charitable projects and social ventures. The ASIC “Guidance on Crowdfunding” is the key source document here (see: <http://www.asic.gov.au/asic/asic.nsf/byheadline/12-196MR+ASIC+guidance+on+crowd+funding>).

“Crowd sourced equity” on the other hand is as it says - lots of people investing small amounts in the “equity” component of a business (always involving some form of “securities” as they are defined in Corporations law, eg: shares or the like). “Soliciting” for such investments in “securities” is covered by Section 708 of Corporations law. Currently, the Corporations Act requires a prospectus for all capital raisings via “public offers”, the cost of which acts as a significant barrier to capital raising for small business (because it almost certainly will involve lawyers in each case).

4. The Cost of Compliance with Corporations Law in the Case of “Community Share Offers”

The problem with s708 is that it is structured with large investors/sophisticated market players in mind. The cost and complexity of disclosure aimed at protecting these investors’ interests



(through the production of prospectuses/offer information statements and the like) is considerable and acts as an impediment to seeking lower income “community investors” making small scale equity placements.

In the writer’s view, complying with this legal regime could cost as much if you are seeking 200 people to invest \$1000 each in the “shares” of a social business as it will if you are seeking 200 people to invest \$100,000 each in the equity base of a business “start-up”. Hence, the small scale “community business” is being discriminated against and the JOBS Act in the US I understand was targetted at “freeing up” this area to enable “communities” to be able to invest to a limited scale fairly much cost and red tape free in local small businesses – and to create new jobs in the process.

The “red tape free” aspect does not deny however that the important area of “risk” must be addressed in the implementation of a regulatory regime for CSEF. Consideration of such a regime for CSEF will need to balance the “risk” of the small scale “community investor” not being adequately informed and protected from potential “scams” – or as Michael Shuman, architect of the US JOBS (Jump Start Our Business Start-ups) Act puts it “ensuring that granny won’t be persuaded to invest in a swamp in Florida” - with the ongoing encouragement that needs to be given to mobilising “community capital” for social enterprises and local small businesses.

Our preferred option to do this – and the best outcome from the review - would be to create a “dedicated regulatory regime” along the lines of the JOBS Act in the US rather than to attempt to tinker with the existing disclosure/fundraising provisions in the Australian “Corporations Act”.

With this preferred option in mind, I can provide the following answers in relation to the questions asked in the review’s “Discussion Paper”.

Question 1.

As stated above, the social enterprise sector would recommend that the Government create a “dedicated regulatory regime” along the lines proposed in the JOBS Act in the US rather than attempt to amend existing disclosure/fundraising regimes under the Corporations law in Australia. This provision would benefit the “community share offer” as outlined above in the best possible way and enable maximum ‘social impact’ to be derived from the implementation of such schemes. “Community share offers” need to be highlighted for their social purpose, their uniqueness and for their role in building social capital and community well-being – issues that are not considered under Corporations law to be an important consideration in the regulation of “fundraising”.

Question 2.

All provisions under CSEF should enable and encourage “community share offers” free of the cost and complexity issues that they currently face. Community shares by their nature are targetted at “local investors” or “supporters of the cause” whose interest may not be about “maximising return on investment”, but ensuring that a “social good” is returned for the usually long-term, small scale equity holding they will have in the community business. Sophisticated and professional investors would be unlikely to be interested in this area of investing. To define a “community share offer” may require specific limits in terms of size of offering and maximum shareholding etc. Suggestions will be made below on these limits.



Question 3

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“Community share offers” may be made for investments in community businesses incorporated as proprietary companies or public companies. Community share offers should not be restricted to one form of incorporation or another. However, the likelihood is that the “cooperative” legal structure will be prominent in this area because of what it offers in terms of shared ownership and democratic community control. The cooperative form offers reduced risk because of the way it is regulated under the State Coop Acts for fundraising within the “member relationship” using “member shares”. The CSEF Review needs to consider the submission being made to it by Robyn Donnelly, former legal adviser to the NSW Registry of Cooperatives about these matters. Prominent in this submission is that any amendments made to facilitate CSEF under Corporations law must not disadvantage cooperatives incorporated under State Cooperative laws. There will be a need to ensure parallel developments are introduced into Cooperatives Acts around the nation if any CSEF related exemptions are made at the Federal level to Corporations law.

Question 4.

Any restrictions on type of issuer, type of security, disclosure, advertising or liability of issuer should not serve to disadvantage the “community share offer” described above. If a ceiling is to be considered in terms of the maximum amount that can be raised through a “community share offer”, our view would be something in line with the JOBS Act would be acceptable - but no less than a ceiling of \$1 million per “community share offer” .

Question 5.

There are “intermediaries” operating as business advisors and development agencies in the area of social enterprise. It is likely that if they were to become involved in facilitating “community share offers” they would need to comply with Financial Services regulations. This may involve employing a specialist with the necessary financial services license to assist the “offer”. The situation with operators of the technology platforms involved (should they be different to the intermediaries) is unclear and will need to be clarified. Otherwise, in our view the community organisation making the “offer” will need to comply with whatever regulations are endorsed for “community share offers” in terms of the minimum disclosure documents required, any investor limits arising under CSEF and any disclaimers required putting the onus on the “community investor” to seek appropriate advice on the offer. Suggestions are made in this regard below.

Question 6.

(i) Intermediaries - no provisions should be implemented which will discriminate against what are “not-for-profit” intermediaries already operating in the social enterprise development area from assisting and promoting a “community share offer”. Special provisions should be crafted to ensure that ‘community share offers’ are enabled and assisted by social enterprise friendly organisations in any approach to defining “permitted types of intermediaries”. In the case of on-line platforms operating in the community sector, special provisions may need to be investigated to define and install processes and standards that will need to be managed in terms of disclosure and promotion of “community share offers”. SBA and others operating in the social enterprise area would be pleased to assist with the work required here.



(ii) Issuers - most issuers will be community businesses of various sorts and of various legal forms. There should be no restrictions on 'community share offers' other than perhaps a minimum "community benefits test". "Community share offers" will need minimum disclosure documents to be produced on the soundness of the proposed business - perhaps a standard "Business Information Statement" for community share offers could be designed. Comfort regarding due diligence maybe provided if one of the NFP social enterprise intermediary agencies is involved as a "nominated advisor". Community share offers are usually kept "honest" through the operation of neighbourhood scrutiny and "knowledge networks" – there is nothing like your neighbours looking over your shoulder to reduce the potential for fraud in a "community share offer" .

(ii) Investor types - there should be no restrictions placed on "type of investor" that would preclude ordinary men and women in the local community becoming involved in a community owned business through a 'community share offer', given adequate written information being made available on the offer, along with the support of reputable local community agencies. Any "fees/commissions" involved in a "community share offer" are likely to be minimal and aimed at covering costs. Platforms established to facilitate "community share offers" will need to address outstanding issues through the development of appropriate guidelines on disclosure, investment limits, the provision of formal advice to investors, soliciting investors, fees, complaints, communications and feedback systems, the management of investor funds and any other "investor protections" that may be required. SBA and others involved in the development of social enterprise would be pleased to assist with the development of these guidelines.

Question 7.

It is unlikely that a "community share offer" would get so complicated as to require such provisions as outlined in the question. 'Community share offers' are known for their "simplicity". Where different classes of investors might be involved, this will need to be discussed in the community concerned as to the reasons why, or otherwise disclosed in a plain english "community share offer" information statement.

Question 8.

In the case of community share offers, there should be no restriction on types of investors permitted to invest – from pensioner to local bank manager, all should be permitted. There may need to be an upper limit per investor, perhaps the \$2000 per investor proposed in the JOBS Act should be considered. In relation to the need for a "market" for the community shares, in the case of a cooperative, this would be under the rules applying in the State Coops Acts (ie: shares are withdrawable but not transferable outside of the coop). In the case of companies, simple "windows" will need to be opened for people to divest themselves of their shares, which may be restricted to transfer to other community members. Reporting processes – annual and otherwise - would need to be in accordance with accepted reporting standards. It needs to be acknowledged that most investors in a "community share offer" are likely to be involved for matters of the "heart" – because they support the cause or the known community benefit involved. The return on investment hardly rates and most "community investors" are likely to be "buy and hold", offering the long term 'patient' capital that is so vital to the success of these forms of social enterprise. The evidence from 'community share offers' overseas is that most people involved wish any "dividends" to be re-invested in the community business.



Question 9.

The social enterprise sector would be advocating for a “self contained regulatory regime for CSEF” along the lines that were originally intended for the JOBS Act in the US.

Accommodating CSEF within the existing regulatory regime of the Corporations Act is unlikely to offer the ease and simplicity – and low cost - that will be required to enable CSEF to operate to its “social impact” potential – or for “community share offers” to serve the likely demand and growth of social enterprise in Australia. At the moment, likely cost and complexity – combined with lack of awareness - serves as a major inhibitor to the growth in “community share offers” in this country.

Question 10.

There are no other matters that need to be addressed in our view.

In Summary

Facilitating “community share offers” through CSEF require consideration of the following solutions:

1. Crowd sourced equity platforms may need to ensure that the “investment proposal” has been placed on a “CSEF Public Register” before it can be placed on a CSEF technology platform as an “offer”. This will put the project into the public domain and allow some “scrutiny” and open analysis. ASIC already offers a similar “Public Register”.
2. To produce greater comfort about the veracity of “offers” made under CSEF, perhaps a system similar to that operating with the “Alternative Investment Market” in the UK could be put in place – that every project needs to have a “Nominated Advisor”, a local lawyer or accountant who could act as a “referee” on the proposers of the project and verify its contents (but not its financials) - but who would not act as either a “sponsor” of the project or a “guarantor” of its success.
3. Limits on “community share offer” fundraisings could be applied as per the JOBS Act, by:
 - (i) How much is being raised – maximum amount (eg: \$1 million per project), and
 - (ii) How much can be invested per individual - maximum amount per investor/individual (eg: \$2000 before Corps Act cuts in - section 708 primarily)
4. Place other limits/restrictions on CSEF that could favour social investment, such as:
 - (i) Type of project – must be aiming for disclosed “social impact” (eg: jobs created etc). Some platforms specialise already in particular “community benefit” fund raisings (eg: community energy)
 - (ii) Restriction to “area” eg: local neighbourhood, LGA etc (some platforms in the US are restricted by law to State boundaries). This would encourage “community ownership” of the project and open it up to neighbourhood scrutiny, with the network of knowledge operating to keep the project “honest”.
 - (iii) Development of a new “short form” of disclosure such as a “Community Information Statement”, which might include a “community business plan”.



Conclusion

The implementation of a JOBS Act type legislative program for social enterprise in Australia would be dramatically increased “scale” in social and community enterprise developments, as has occurred with “local financing” approaches in the US and the UK.

Michael Shuman – the architect of the JOBS Act in the US – has highlighted the potential for this approach in Australia in correspondence with this writer. Michael has also visited Australia on several occasions in recent years. For example, you can see his excellent “local investment” presentation to the “Transition Towns” Conference in Sydney in September, 2012 – see “Building Resilient Local Economies through Local Investment” at: <http://www.youtube.com/watch?v=xkAw4jv8hUY> . He has also presented to the Sustainable Economic Growth for Regional Australia (SEGRA) Conference in Coffs Harbour in October this year.

Michael Shuman would be happy to advise the Review of CSEF if called upon to do so.

We welcome your consideration of this submission.

Yours sincerely

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