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Crowd-sourced funding

why you might or might not

Since September last year, early stage companies in Australia have had a number of options when it comes to fundraising. This includes crowd-sourced funding (CSF). Already, a number of companies have tested out CSF which now enjoys legislative recognition. In this article, we look at some recent developments and consider what's involved in CSF, why you might raise funds through CSF, and why you might think twice about it. Our previous thinking on this topic can be found here and here.

News at a glance

IIt's been a busy start to 2018 for CSF. Here is a quick glance at some of the 2018 headlines.

- DC Power Co became the world's first crowdfunded energy retailer. Founded by a social entrepreneur, an investment banker, an engineer, and a solar expert, the company opened pre-registration for interested investors in March to raise approximately $4.75 million. Retail investors can invest with as little as $50 through the CSF intermediary platform, OnMarket. It received an overwhelming response on the first day that the CSF offer opened to the investors.
- The Sporting Globe Plenty Valley became Australia's first crowdfunded pub. It closed expressions of interest in February, and was set to raise approximately $1.2 million through CSF on the CSF intermediary platform, Birchal. In addition to their shares, investors will be entitled to become part of a members-only club that offers exclusive discounts and specials.
- The neobank Xinja raised approximately $2.4 million through CSF. It raised $500,000 in less than a day in January and closed the fundraising round on 31 March with 1,222 investors through the CSF intermediary platform, Equitise.

CSF also came a step closer to reality for proprietary companies. The *Corporations Amendment (Crowd-sourced Funding for Proprietary Companies) Bill 2017* was introduced in the Senate in March. If this bill receives royal assent this September, eligible proprietary companies will be able to participate in the CSF regime. For our previous thinking on this bill, please see here.

How to crowd-source fund?

Equity crowdfunding or crowd-sourced funding allows the "crowd" to invest in a company. The "crowd" at large includes retail investors. The new regime complements the existing fundraising regime (including its restrictions and exceptions) under Chapter 6D of the Corporations Act.

So how does CSF work? Here is a simplified outline.

Set up or convert to an unlisted public company (limited by shares)

At the moment, only unlisted public companies can conduct CSF (although, as noted above, this may be about to change). At the time of a CSF offer, the value of the fundraising company's or group's (consolidated) gross assets and (consolidated) annual revenue must each be less than $25 million.

If you are worried about corporate governance and reporting requirements for an unlisted public company, special rules apply. For up to five years, the company may be exempt from the requirement to hold an AGM, appoint an auditor to audit financial reports or give annual reports to the company's shareholders.

Note that related party transaction rules in Chapter 2E of the Corporations Act will still apply to a public company with CSF shareholders. Broadly, this means the company must demonstrate arm's length dealings in respect of any related party transactions or obtain shareholders' approval.

Offer ordinary shares

The company can only offer to issue (new) fully paid ordinary shares through CSF. In the future, the law may permit different types of securities to be offered.

Find a licensed intermediary

A CSF offer may only be made through a dedicated CSF intermediary that is a licensed operator of a CSF platform. Make sure the intermediary holds an Australian Financial Services License expressly authorising it to provide CSF services.

Prepare offer disclosure

The company will need to publish a specific CSF offer document on a single intermediary's platform containing information prescribed by the regulations. ASIC has provided a CSF offer document template in ASIC Regulatory Guide 261.

Watch out for the retail investment cap and cooling-off period

A fundraising company can only raise up to $5 million in any 12-month period via a particular CSF platform from retail investors. Retail investors can also withdraw their acceptances under the CSF offers within a five business day cooling-off period.

Last but not least, find a good lawyer as your trusted adviser. There is a process to follow. A good legal adviser will guide you through the detailed rules and procedures both fundraisers and intermediaries must follow when conducting CSF offers. These include compliance with the offer period and limit, advertising and publishing rules and so on. Whilst the disclosure requirement is less onerous than for a prospectus, other important provisions of the Corporations Act and other legislation (applicable to offering securities) will need to be complied with so that investors are not misled.

Why might you do it?

Another way to access capital

CSF provides an alternative to fundraising that may otherwise be difficult for early-stage businesses that wish to secure funding. It also allows innovative start-ups and early stage companies to look beyond traditional sources of growth capital which may be scarce.

Increase stakeholder involvement

CSF allows businesses to tap into a base of investors who are existing or prospective users of the company's products and services. Customers and others who participate in CSF are a dedicated group who become even more invested in the business' success. This increases advocacy and can help build further credibility for the business and its products or services.

Accessible investment option

CSF is affordable and easy for anyone to invest through a user friendly and accessible platform (designed for retail investors). For those who know what they are doing, CSF offers an opportunity to diversify their investments. Clearly, a health warning comes with the uncertainty involved in investing in early stage companies.

Pick up some spread for IPO

If IPO is part of the company's growth ambition, CSF may help increase the number of shareholders that the company needs to meet the minimum spread requirement. The current ASX listing requirements provide that the company must have at least 300 non-affiliated shareholders with holdings valued at a minimum of $2,000 each and a 20% free float. Whilst the company does not need to have the required spread before listing, getting ahead of this requirement may not be such a bad thing.

Why might you think twice about it?

Lack of liquidity

Even for more mature and cash flow positive businesses, investors are unlikely to be able to sell their shares for a while.

To address liquidity risks, there are calls for secondary markets where early investors can sell their shares. ASIC has proposed to implement a "two-tiered" market licensing regime to allow intermediaries to operate CFS platforms that facilitate secondary trading of CFS shares. In the meantime, a lack of liquidity may be a disincentive for issuers and investors.

Too many shareholders

The more, the merrier... right? Not always. The company should consider keeping the number of investors to a manageable level. Start-ups have different sources of funding. Too many individual shareholders may affect the company's next round of fundraising. Think about the cap table and the percentage of smaller retail investors that the company may want. Also, consider whether a prospective purchaser will be able to avail of compulsory acquisition provisions (legislatively set at 90%) to buy out a recalcitrant minority

Minority shareholders who together hold 5% of the shares in the company can also requisition a meeting by giving notice to the company of a resolution they wish to propose at a general meeting.

Finally, always bear in mind the statutory remedies available to a company's minority shareholders for oppression and the like.

All opportunities come with risks. Do your homework as an issuer and stay informed. We can help. Please contact us to discuss your fundraising options and strategy.

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