SME EQUITY FINANCE

Comments from ACCA Ireland

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Introduction to ACCA

ACCA (the Association of Chartered Certified Accountants) is the global body for professional accountants. We aim to offer business-relevant, first-choice qualifications to people of application, ability and ambition around the world who seek a rewarding career in accountancy, finance and management.

Founded in 1904, ACCA has consistently held unique core values: opportunity, diversity, innovation, integrity and accountability. We believe that accountants bring value to economies in all stages of development. We aim to develop capacity in the profession and encourage the adoption of global standards. Our values are aligned to the needs of employers in all sectors and we ensure that, through our qualifications, we prepare accountants for business. We seek to open up the profession to people of all backgrounds and remove artificial barriers, innovating our qualifications and their delivery to meet the diverse needs of trainee professionals and their employers.

We support our 154,000 members and over 432,000 students in 170 countries, helping them to develop successful careers in accounting and business, with the skills required by employers. We work through a network of 83 offices and centres and more than 8,400 Approved Employers worldwide, who provide high standards of employee learning and development.

ACCA works in the public interest, assuring that its members are appropriately regulated for the work they carry out and, promoting principles-based approaches to regulation. We actively seek to enhance the public value of accounting in society through international research and we take a progressive stance on global issues to ensure accountancy as a profession continues to grow in reputation and influence.

In Ireland, ACCA has 20,000 members and students.

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Introduction

ACCA is responding to the SME Equity Finance, public consultation. Our response is based on limited discussions with members in the practice sector and the Practitioners Representative Panel. The consultation time frame did not allow a wider consultation with the general membership.

ACCA would support the work of the SME Funding Consultation Committee and the objective of increasing equity funding. A number of suggestions of how this might be achieved are set out below. Many of ACCA's suggestions are aimed at making SME equity financing a more attractive option for business angels, but the suggestions are as important for family and friend investors as well.

Summary of suggestions

- Develop a standard business angel investment information resource to include standard shareholder agreements and a "What can an investor expect" booklet etc.;
- Remove some of the restrictions on the Seed Capital Scheme, EIIS and entrepreneurs CGT reliefs to make them more attractive to micro entities;
- Remove the additional 3% tax on the self-employed and encourage entrepreneurs by allowing them avail of the PAYE tax allowance
- Allow share awards in lieu of wages in micro entities to be tax free in the hands of the recipient;
- Introduce a voucher scheme to redeem against the cost of having the paperwork associated with obtaining Seed Capital Scheme or EIIS scheme or "investor ready" business plans completed by an accountant;
- Continue the information campaign on the various tax schemes available, including communicating with SMPs; and
- Provide a platform/directory for micro and SME to advertise their availability to accept business angel type funding and make the scheme exempt from the requirements of the Investment Intermediaries Act.

Business angel investment information resource
The risks associated with investing in a small or micro entity are twofold: a business risk and a corporate governance risk. Outside investors will often become comfortable with the business risk fairly quickly. They will understand the industry and the market and often will provide guidance and mentoring to navigate the business risk. It is more difficult to manage the corporate governance risk.

The corporate governance risk is that the original entrepreneur will put their interests ahead of the interests of the company and the interests of the external investor. Matters such as excess remuneration, fiduciary infidelity and even fraud are difficult for an external investor to manage; when such issues occur, the external investor usually ends up with a 100% loss on their investment. Oppression of minority legal cases are simply too expensive to take for micro and small entities and minority shareholders have very few powers if the majority is intent on freezing them out of their investment or defrauding them. Family and friends may know the proprietor and trust them to do the right thing, but unconnected third parties will put legal structures in place to protect their investment. The cost of these legal requirements is simply added to the necessary return required by the investor, rendering micro and small equity investments a very expensive form of funding.

A pack of standard documents would detail standard acceptable corporate governance procedures for a small company. The pack would have documents setting out:

- what to expect if you get external investment
- What sort of monthly and annual information will an external investor expect a micro entity to have
- What should be covered in a shareholder agreement
- What attestation is required for the annual financial statements: audit or review or external accountants compilation report
- Example shareholder agreement
- What is a “Mexican standoff” shareholder buyout clause and how does it work
- What to do if trust breaks down

The pack would be written primarily for the entrepreneur looking for external investors but would also be relevant for the external investors. Often an investor comes from an experienced business background and may have unreasonable expectations. Small and micro business often manage their business very informally with directors meetings held in a very ad-hoc way. The pack should set a benchmark of what both parties might expect – both for an investor who may be looking for unreasonable levels of management information and a business which may be unwilling to provide any information.

Tax changes

A number of organisations, including ACCA and our umbrella body CCAB-I have made representations to Revenue on issues relevant to this area. We do not propose to repeat all of the arguments here, however we would like to summarise the simplification and amendments to the tax code that would encourage equity finance into SME and micro entities.

Seed Capital Scheme (SCS)

This scheme needs simplification to encourage greater investment in the equity of SME and micro businesses. Some of the matters needing addressing are:

- Remove the employment income restriction to allow serial entrepreneur, the self-employed and the unemployed use the scheme;
- Allow the tax refund to be used to fund part of the investment in shares;
- Allow longer time limits between investment and the full time employment requirement. Some micro businesses may not have the available funds to support a full time executive within six months of the initial investment;
- The restriction on 15% shareholders availing of the scheme should be limited to holders of SCS shares only;
- The limit for the SCS is too low at €100,000 and should be increased.

A scheme similar to the Seed Enterprise Investment Scheme launched in the UK in 2012 might be more effective.

Employment Investment Schemes (EIIS)

- Remove the 11/41st restriction based on maintaining employment levels for four years and the four year wait to get that portion of the tax relief;
- Remove the connected investor restriction – it is no less risky an investment for family investors and they should be encouraged;
- Lift the lifetime limit on EIIS investors – serial EIIS investors should be encouraged;
- Reintroduce roll over relief.

Other tax issues

The 3% additional tax paid and the loss of the PAYE allowance for the self-employed and proprietary directors is a disincentive to entrepreneurship. Entrepreneurs should be incentivised with lower taxes, not discouraged with higher taxes.

ACCA also believes that in the early stages of a business when cash is not available; allow share awards in lieu of wages in micro entities to be tax free in the hands of the recipient.

Voucher scheme for professional assistance

Providers of micro entity grant assistance should also offer potential entrepreneurs a voucher to redeem with local accountants and to cover the cost, or part of the cost, of preparing an investor ready or lender ready, business plan.

Information campaign

Feedback from ACCA members in practice is that the general public and potential entrepreneurs are not aware of the assistance and tax reliefs available. The new "SME Support" tool is excellent, but needs to be publicised more.

Facilitate an Online Directory

While there are international crowd funding and other investor portals, a Government sponsored local directory of business angels and SME's needing funders would serve to encourage equity funding of business. We would like to see something like the list at http://www.revenue.ie/en/about/publications/bes-scs-shares.html repurposed.

Access to the site would be restricted to companies that met minimum requirements i.e. eligible for any existing Government grant aid from any source. Access by business angels would also be restricted to persons who made a formal application and met basic criteria, such as proof of means and previous experience. We envisage this would be like an on line *Dragons Den* without the cameras.

Legal impediment to getting accounting assistance with equity funding

To get assistance from an accountant with fund raising, the accountant must have authorisation under the Intermediaries Act 1995 and potentially quite a high level of authorisation and subscription to the Investor Compensation

Fund. This adds considerable cost to the process of obtaining the assistance of an accountant in the equity raising process. The cost of authorisation to advise on one single direct investment in a company will cost an accountant in excess of €4,000, most of this cost arising from contributions required to the Investor Compensation Company Limited. Most small accounting firms do not have investment business authorisation because of the cost of authorisation and cannot therefore help SME and micro business with equity fund raising. There is no similar authorisation process to advise on raising loan finance.

The exemption in the Intermediaries Act 1995 in Section 2 of the Act, under the definition of "investment advice" subsection e, for incidental advice given by an accountant needs to be extended to exempt advice to micro and SME entities in respect of business angel or other equity investments. Alternatively, the corporate finance exemption in the same section, subsection d, needs to encompass micro and SME equity finance.

Freedom of Information

ACCA notes the scope of the Freedom of Information Act in regard to the submission. ACCA has no difficulty with this response being published on the website of the Department of Finance. This response will be published on ACCA's website and will be available to all of our members and the general public.