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Urgent
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Impact of JobKeeper Program criteria on Australian businesses

Dear Dr de Brouwer,

I am writing to you on behalf of the $60 billion private capital investment industry in Australia, and the close to 200,000 domestic workers directly employed by the businesses that we invest into. Our 200 member firms comprise private equity, venture capital and private credit funds, as well as domestic and international investors into those funds, and leading corporate advisors.

The private capital industry is supportive of the social and economic initiatives implemented by the Government in response to the COVID-19 global pandemic. In our view, these initiatives are pragmatic and measured, and they are well targeted in this time of great uncertainty for the community and businesses. We believe that the measures will play a vital role in supporting Australians and Australian businesses through the current crisis and into the recovery that will follow.

The private capital industry is prepared to play its part in assisting Australians and Australian business through this tough time. In its most recent analysis of the industry, Deloitte Access Economics found that private capital generates 2.6% of Australia's GDP and that the industry created 1 in 9 new jobs in Australia.[1] Academic research has also found that job creation in private capital-backed businesses outpaces non-private capital-backed businesses.[2] There are a number of reasons for this including the industry's dedication to investing in Australian entrepreneurs, innovative firms and high expenditure in productive areas such as R&D investment. After previous economic downturns, we know that R&D intense industries have tended to be a key driver of economic growth, driving a disproportionally large contribution to economic growth and job creation.

These are qualities that are an essential element of Australia's post-COVID-19 recovery. However, at this point we are concerned about the capacity of our industry to contribute to the economic recovery ahead of us.

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[1] Deloitte Access Economics (2018) *Private equity: Growth and innovation*, April
[2] Wilhelmus and Lee (2019) *Milken Institute: Private Equity IPOs – Generating Faster Job Growth and More Investment*, September.
This relationship holds true even when comparing within sectors and holding firm characteristics, such as size, constant. Logically, the same relationship would hold true for firms that partner with venture capital and private credit firms.

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Our specific concern is that the current design of the framework around the new JobKeeper Program will directly result in numerous businesses missing out on access to the program, in turn placing thousands of Australian jobs at-risk of being lost during this ongoing crisis.

Hardship faced by Australian businesses seeking to protect jobs

Almost all of the Australian businesses supported through private capital investment are directly impacted by the COVID-19 pandemic, and they are experiencing significant declines in revenue. Those businesses collectively employ close to 200,000 Australian workers, who are spread across a wide range of industry sectors from retail, tourism and hospitality, through to services and education. For many of these businesses, the Government's recently introduced JobKeeper Program will ultimately mean the difference between remaining viable in a 'hibernation-type' mode, and potentially failing.

Compounding the already challenging economic conditions are the recent changes to the foreign investment framework which are likely to make it more difficult for private capital firms to raise and invest capital and, for some firms, increases regulatory costs due to now needing to seek FIRB approval due to the lower threshold. For some firms, particularly smaller firms, the increased costs, which can easily exceed $30,000, and potential lengthy approval processes are material when considering the difficult and challenging financial and economic conditions that exist at the moment. In some cases, the investments may only be modest aggregate sums – for example, two million dollars. These costs, coupled with the uncertainty, have led to the postponement of some attempts to invest capital into businesses in financial distress in the current market.

The recently announced criteria for access to JobKeeper payments further exacerbates some of the challenges which exist right.

Impact of the JobKeeper Program rules on private capital investee businesses

Given the operating environment described above, access to government assistance will in some cases be the difference between maintaining viability, and significant job losses. The private capital industry strongly supports the government's efforts through the JobKeeper Program to keep Australians in paid work or connected to their place of work. This new policy has a wide range of benefits including supporting the psychological wellbeing of working Australians and putting businesses in a stronger position to recover quickly when conditions improve.

The criteria for being able to access JobKeeper payments, as currently written, would see a large number of private capital-backed Australian businesses likely to miss out on assistance. This is simply due to their ownership or corporate structure. For the purposes of the rules, private capital-backed businesses held within one fund structure will need to be aggregated for the purposes of determining the decline in turnover levels. These businesses do not have joint or central functions to draw upon and, as discussed below, raising additional capital is not always possible or practical. Further detail on typical private capital investment structures is provided below.

There are two main areas of the JobKeeper criteria that impact Australian businesses backed by the private capital industry. These are:

1) Aggregation – there is a requirement for portfolio companies of the same fund to aggregate their revenues to determine if they are over or under the $1 billion threshold. Such an aggregation can be required even where there is as little as a 40% ownership by the fund. Additionally, the global revenue of all of the non-Australian portfolio companies are used in determining aggregated revenues.

Individually these businesses are well below the $1 billion threshold, with turnover easily less than $100 million in some cases. Individually, some of these firms have experienced a drop of revenue between 30% and 50%. However, due to the aggregation requirement, they would not be eligible for JobKeeper payments under this new program. As discussed below, unlike multinational corporations, the capital from one portfolio company cannot be used to support another portfolio company (due to a divergence of lenders, minority/majority investors in each portfolio company). As such, the aggregation of revenues across portfolios, as well as globally, does not reflect the same environment and financial structures that exist within a multinational corporate group environment.

We therefore believe that the operation of the rules results in an anomalous outcome that disadvantages potentially hundreds of Australian businesses, and many thousands of Australian workers whose jobs will be put at-risk as a result.

It is worth pointing out also that in the United States, we understand that there have been determinations made to exclude the operation of normal 'affiliation' type rules in the context of private capital investments into portfolio companies for the purposes of determining eligibility for various government programs included in the US$2.2 trillion stimulus package contained in the Coronavirus Aid, Relief, and Economic Security (CARES) Act**.**

2) Employment Special Purpose Vehicles (**SPV**) – SPVs, for example services trusts or employment companies, are sometimes used to 'house' employees within a corporate structure. There are a number of reasons for structures being used in this way, and it is widely accepted as a common corporate structure utilised in countless sectors across the national economy. For such companies, it will be impossible to meet the decline in revenue test as the test would be measured at the SPV level (that is the separate ABN) rather than the economic group or business as a whole. As a result, these employees may not be eligible for JobKeeper payments simply due to the corporate structure within which they are employed.

<u>The typical private capital structure</u>

Put simply, the private capital industry looks for entrepreneurs and founders and businesses with high growth potential that it can support by providing long-term patient capital coupled with strategic support and mentoring.

In addition to funding, these businesses require a partner that has a longer term outlook to assist them through their next growth phase, which may be product development, product diversification or growth and expansion domestically and internationally.

To provide this, private capital firms raise funding from various sources, primarily including superannuation and pensions funds, sovereign wealth funds, family offices and other forms of institutional investors. These investors sometimes invest 'alongside' the private capital fund, that is they invest additional funding directly into the portfolio business.

A number of investee business are then held within a fund. Each business may have different investors. Each business also retains its individual management and operates independently to other businesses in the fund. Each business is also likely to have separate credit arrangement, such as with suppliers and external financing. Covenants in these arrangements rule out the transfer of funds/assets between portfolio companies. Businesses are typically sold separately with proceeds then returned to the fund's investees.

As such, unlike a 'typical' conglomerate structure, these is no centralised or shared functions. There is no common Board or common balance sheet.

Additionally, a limit is typically placed on the percentage of a fund's capital that can be invested into any individual businesses. These limits, and the variations of owners, can make it difficult or impossible to provide additional funding once limits are met.

These challenges are currently exacerbated due to changes to the foreign investment framework (discussed above) and challenges faced by superannuation funds – the recent sharp drop in equity values has resulted in an increase in allocations (as a percentage) to alternative assets, like private capital, which have not suffered such reductions in value. Needing to rebalance their exposure, coupled with increased liquidity requirements, has made it more difficult for some superannuation funds to provide additional capital.

Next steps

We acknowledge the need for government support initiatives to be measured and finite. This is a sound policy principle that we support. However, Australian jobs and Australian businesses are at real risk of disappearing if the criteria for assessing JobKeeper payments are not adjusted in certain cases to recognise that there is not a one-size-fits-all approach to testing eligibility and satisfying general criteria. The feedback from our members is that if this issue is not resolved quickly, the ongoing uncertainty is likely to place a significant number of jobs at-risk, which is an outcome we hope the government will see as inconsistent with the policy objectives of the JobKeeper Program.

There are a number of pragmatic options available to address the issues we identify above and would welcome the opportunity to discuss our thinking with you and your team as soon as possible. We will follow-up with you in the next 24 hours to arrange for a discussion.

If you would like to discuss any aspect of this letter further, please do not hesitate to contact me on 02 8243 7000.

Yours sincerely

Yasser El-Ansary
Chief Executive