24 August 2020

Budget Policy Division
Department of The Treasury
Langton Crescent
PARKES ACT 2600

By upload to consultation website

Pre-Budget Submission

Dear Sir/Madam,

As the voice of private capital in Australia, the Australian Investment Council is pleased to present its submission to Treasury for the 2020-21 federal budget.

Private capital investment has played a central role in the growth and expansion of thousands of Australian businesses and represents a multi-billion-dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include private equity (**PE**)**,** venture capital (**VC**) and private credit (**PC**) funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers. Our members include both Australian domestic and offshore-based firms.

Private capital fund managers invest billions of dollars into Australian companies across every industry sector of the economy every year. Australian-based PE and VC assets under management reached $33 billion in 2019 with an additional $13 billion in equity capital available to be invested in the short-term.

The Australian Investment Council is supportive of policy initiatives and reforms that help ensure our economy is competitive, innovative and able to support Australia now and into the future. In particular, the Council encourages initiatives that help expand entrepreneurship, increase productivity and support investment – initiatives that drive the development of skills and talent, productive capacity and innovation through technology.

While Australia's private capital industry has grown strongly over recent years, the sector's ongoing ability to support Australian businesses cannot be taken for granted. Even though the industry has the necessary funding to support current portfolio companies, its ability to continue to expand the depth and breadth of new investments into Australian businesses over the coming years is likely to be challenged by institutional funding constraints domestically and globally. There are four main considerations that are relevant to any analysis of the likely trends in relation to domestic private capital investment in the period ahead.

1) History shows investment into innovation and research falls after a crisis, despite being a key economic driver;
2) Early evidence of 'capital rationing' and some risk aversion materialising;
3) Constraints on access to institutional investment from superannuation funds due to a heightened focus on maintaining liquid positions and uncertainty in relation to future valuations; and
4) COVID-19 restrictions hampering the ability of fund managers to connect with (potential) investee businesses and institutional investors. This is particularly acute for new funds that do not have established relationships.

At this time, it is vitally important that the private sector partners with the government to regain the capacity to support the innovation ecosystem, emerging entrepreneurs and their businesses. Scaling-up new, fast-growth businesses can bring significant employment and economic benefits that will flow to all sectors of the Australian economy. It is therefore critical that the current generation of entrepreneurs is supported and encouraged to drive innovation and contribute to the next wave of employment and economic growth. Without this support, Australia risks losing the next generation of new, internationally competitive Australian businesses to other markets around the world.

This submission outlines policy initiatives aimed at regaining investment momentum, creating jobs and stimulating economic growth. The priority initiatives broadly are:

1. Introduce a **new public and private sector co-investment fund** to support Australian entrepreneurs and Australian fast-growth businesses.
2. **Fill skills and talent gaps** and build a pipeline of skills that will **support Australia's future growth industries**.
3. Fast-track outstanding legislation, **implement previously recommended reforms** and remove inconsistencies to improve the competitiveness of **Australia's investment regime.**

The industry is conscious of the demands on government arising from the COVID-19 pandemic. While the fiscal stimulus measures put in place over recent months have played an important role in supporting the economy during this unprecedented and unexpected shock, the industry also recognises that the impact on the federal budget has been significant.

To this extent, many of the initiatives proposed in this submission have little, or no, impact on the federal budget. As an example, the proposed co-investment fund would potentially require an allocation of funding from the budget, which would amount to a capital account investment similar in nature to the existing Biomedical Translation Fund.

The Council looks forward to participating in any future discussion about the themes set out in this submission as part of the government's federal budget process. If you have any questions about specific points made in our submission, please do not hesitate to contact me or Brendon Harper, the Australian Investment Council's Head of Policy and Research, on 02 8243 7000.

Yours sincerely

Yasser El-Ansary
Chief Executive

Introduction

The impact of the COVID-19 pandemic on every corner of the Australian economy has clearly been significant. The comprehensive nature of the government's public health response has allowed Australia the opportunity to benefit from being part of the 'first-mover' group of nations emerging from the COVID-19 pandemic, while many other developed economies continue to endure ongoing widespread shutdowns and restrictions on business activities. Given the competitive position in which Australia finds itself, there is a unique opportunity to reimagine and reshape the national economy for the future and to support this by continuing to grow investment into innovation and technology as building blocks for a more dynamic and agile economy.

To effectively capitalise on Australia's comparative advantage, the recovery must be underpinned by a comprehensive plan by government to bring about meaningful economic reforms for long-term prosperity. Key policy recommendations to support these broader economic reforms are outlined in the Australian Investment Council's *Roadmap to Recovery* policy paper of June 2020, a copy of which is appended to this submission as *Attachment 1*. In our view, the three pillars of Australia's future economic prosperity must be:

1. maximising the penetration and utilisation of technology as an enabler of economy-wide productivity growth and job creation;
2. going 'narrow and deep' in developing industries where Australia is, or could be, a world leader; and
3. supporting Australia's entrepreneurs and fast-growth businesses to create Australia's next generation of world leading businesses.

The recommendations outlined in this submission focus on these pillars and opportunities to secure Australia's future prosperity.

State of the Industry

Australia's $33 billion private capital investment industry employs close to 200,000 domestic workers across the economy and is a critically important investment and efficiency driver for Australian industries and businesses. Fund managers invest capital from a wide variety of domestic and offshore institutional investors to support the growth of thousands of high-potential Australian businesses. In addition to providing equity capital, private capital fund managers provide those businesses with a mix of strategic support, mentoring and networking to help them unlock growth opportunities in domestic and international markets, which underpins the creation of new jobs across all sectors of the economy and boosts economic growth.

Private capital makes a significant contribution to the Australian economy and accounts for 2.6% of our nation's GDP.[1] As Australia begins the long-term economic rebound over the months and years ahead, private capital's investment contribution will accelerate as a result of the industry's focus on high-growth businesses that tend to outpace non-private capital backed businesses[2]. In fact, economic analysis confirms that one in nine new Australian jobs are created by private capital-backed Australian businesses, which reinforces the important job-creating role that private capital investment can play across all sectors of the economy.[3]

One of the key challenges confronting ongoing investment into high-growth innovative businesses is the uncertainty surrounding the future pipeline of funding flows into the private capital sector, with COVID-19 already impacting the outlook for new investment capital flowing to the sector from domestic and international sources. The anticipated contraction in the availability of that institutional investment is likely to lead to a slow-down in the potential for venture

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[1] Deloitte Access Economics (2018) *Private equity: growth and innovation*, April.
[2] Wilhelmus, J. and Lee, W. (2019) *Private Equity IPOs – Generating Faster Job Growth and More Investment*, Milken Institute, September
[3] Deloitte Access Economics (2018) *Private equity: growth and innovation*, April.

capital to support early-stage, high-potential businesses across many sectors of the economy including technology, life sciences, agtech, and others.

To realise the economic gains from the scaling-up phase of early stage businesses, it is imperative that initiatives are put into place now to support the ongoing investment needed to sustain and grow our innovation ecosystem. Without support, private capital fund managers will be forced to ration their available capital and risk not being able to fund future investments into Australian businesses and entrepreneurs. This will result in Australian ideas and Australian companies either not being funded, or being forced to relocate overseas, which would hinder Australia’s economic recovery and jobs creation.

Government policy can play an important role in ensuring there is a flow of capital that can be deployed for investment into businesses that will create future employment opportunities and economic growth.

The recommendations below provide practical policy solutions that will help grow the pool of capital available to support investment into Australian businesses and create employment opportunities for the future. The policy solutions cover three core areas designed to:

1. Introduce a new **public and private sector co-investment fund** to support Australian entrepreneurs and Australian fast-growth businesses.
2. **Fill skills and talent gaps** and build a pipeline of skills that will **support Australia’s future growth industries.**
3. **Fast-track outstanding legislation**, implement previously recommended reforms and remove inconsistencies to **improve the competitiveness of Australia’s investment regime**.

Summary of Recommendations

Recommendation 1: *Implement a national co-investment program*
The Council recommends the government establish a national co-investment program to support ongoing investment into early-stage Australian businesses and Australian entrepreneurs.

Recommendation 2: *Support regions and areas most in need*
The Council recommends government introduces incentives for investment into regions and areas most in need based on similar model to the United States' economic 'Opportunity Zones'.

Recommendation 3: *Attract the best and brightest talent*
The Council recommends government boosts the offshore marketing of the national Global Talent Scheme to encourage some of the world's best and brightest skilled talent to move to Australia, and at the same time, encourage skilled Australians with valuable offshore experience in leading technology and innovation ecosystems to return home.

Recommendation 4: *Extend visas for foreign students*
The Council recommends government extend visas for foreign students who graduate from Australian universities in disciplines where there are skills shortages, allowing them to stay and work in Australia to build a pipeline of talent for Australia's new, knowledge-based economy.

Recommendation 5: *Foster entrepreneurship and teach digital STEM skills*
The Council recommends government allocates funding to institutions that can develop and deliver courses for tertiary students aimed at fostering entrepreneurship and teaching digital STEM skills.

Recommendation 6: *Fast-track the establishment of 'STEM Schools'*
The Council recommends government embeds STEM skills into the Australian School curriculum from primary school years through to tertiary education and fast-tracks the establishment of 'STEM Schools' modelled on Sydney Science College in Epping to expand accessibility for all Australians.

Recommendation 7: *Fast-track the implementation of the new LP CIV regime*
The Council recommends steps be taken to fast-track the introduction of a new Limited Partnership CIV that aligns with international best practice with a target start date of 1 July 2021.

Recommendation 8: *Improve existing VCLP and ESVCLP vehicles*
The Council recommends the 16 technical and interpretative issues in the ESVCLP and VCLP regimes be adopted and implemented as a priority.

Recommendation 9: *Increase support for CVCs and innovation labs*
The Council recommends government increases support for CVCs and Innovation labs through the introduction of new programs to attract greater public-private investment into high growth Australian companies.

Recommendation 10: *Streamline the Accelerating Commercialisation program*
The Council recommends that guidance be provided to the administrators of the Accelerating Commercialisation program to allow venture-backed businesses to access funding where they are eligible.

Recommendation 11: *Pause the R&D Bill*
The Council recommends the R&D Bill is paused to give scope for renewed terms and to allow for a regime that is more supportive of early stage businesses, particularly in priority industries.

Recommendation 12: *Reduce tax uncertainties for private capital investment*
The Council recommends the Australian government, including the ATO, work with industry to reduce the uncertainties and inconsistencies in the tax treatment of private capital investment into Australian businesses.

1. Encourage equity co-investment into Australian businesses

The timing is appropriate now to establish a new co-investment fund that can support the expansion of the funding pipeline for Australia's innovation ecosystem.

Australian jobs and industries rely on a steady flow of foreign capital to support investment into growing businesses across all sectors of the economy. Australia's demand for capital continues to be greater than domestic supply and as a result, Australia is a net importer of capital. Private capital firms are an important vehicle for attracting both domestic and foreign capital into Australia and into Australian business.

Due to COVID-19 restrictions, fund managers have not been able to interact with (potential) investee businesses and institutional investors as they have previously. This has led to increased due diligence times and challenges in establishing new relationships. This challenge is particularly acute for new funds or fund managers wanting to establish new funds and who need to establish close relationships with their investors.

Without support, private capital fund managers will be forced to ration their available committed capital, with the result being a potential slow-down in future investments into Australian businesses and entrepreneurs. This will result in Australian ideas and Australian companies either not being funded to the extent necessary domestically or being forced to relocate offshore. At this time, it is vitally important that the private sector partners with the government to regain the capacity to assist the innovation ecosystem, emerging entrepreneurs and their businesses. Scaling-up new, fast-growth businesses can bring significant employment and economic benefits that will flow to all sectors of the Australian economy. It is therefore critical that the current generation of entrepreneurs is supported and encouraged to drive innovation and contribute to the next wave of employment and economic growth. Without this support, Australia risks losing the next generation of new, internationally competitive Australian businesses and becoming an innovation laggard.

Establish a new co-investment fund

A meaningful and proven way that the government can work with the private sector to boost investment for Australian entrepreneurs and Australian businesses over the medium-term is to utilise well proven co-investment funding programs. The timing is also appropriate now to establish a new co-investment fund that can support the expansion of the funding pipeline for Australia's innovation ecosystem.

The proposed co-investment fund would have very little, or no, impact on the federal budget. It would potentially require an allocation of funding from the budget, which would amount to a capital account investment which would essentially be budget neutral.

This program could be modelled on established structures using qualified fund managers. For example, the Biomedical Translation Fund (BTF) is a program structure that is well recognised within government as a leading private and public sector collaborative model and could form the basis for a new national co-investment fund. There are alterative models for such programs which could assess the merits of a structure that is based on a 'fund-of-funds' type approach, versus direct investment into underlying investee businesses. The private capital industry is open to canvassing the relative merits of each approach, which takes account of the priorities of the government in this area of policy.

Government co-investment to support early stage and high growth businesses is a well-tested policy response. Co-investment programs are heavily used in the UK, USA, Canada, New Zealand, Germany, France and many other countries across the globe. Domestically, various co-investment programs exist at the state level, complemented by targeted national programs. Examples of co-investment funds are included in *Attachment 2*.

Recommendation 1: *Implement a national co-investment program*
The Council recommends the government establish a national co-investment program to support ongoing investment into early-stage Australian businesses and Australian entrepreneurs.

Objective of a new co-investment program

The objective of a new co-investment program would be to support the functioning of the Australian VC investment market through the current dislocation and uncertainty arising from the COVID-19 pandemic. This would allow VC funds to continue to provide funding and support to highly innovative Australian businesses and entrepreneurs in the early-stage and start-up phases.

The building momentum of Australia's private capital industry – of which VC is one component – growing to $33 billion in assets under management in 2019,[4] is testament to its role within the Australian economy. The industry's contribution to the domestic economy through employment and GDP illustrates the important role it can play in helping drive our economic recovery and creating meaningful, high paid jobs for Australians. Analysis by Deloitte Access Economics has shown that one in nine new Australian jobs are created by private capital-backed Australian businesses.[5]

While the private capital industry has committed funds available to support short-term investment over the next one to two years, the COVID-19 pandemic has created uncertainty in respect of access to funds over the medium-term (as discussed above). Without government support, there is a risk of losing a generation of highly innovative Australian businesses to other markets.

The co-investment program would be distinctively different to the government's previously announced Australian Business Growth Fund (**ABGF**) initiative, which is currently before the Senate. The genesis of the policy drivers for the ABGF was to respond to a defined market failure in respect of established small and medium-sized businesses having access to debt financing, and the need to often provide the family home as collateral. This was articulated in the fund's explanatory memorandum, where business owners "found it difficult to borrow more than around $100,000 on an unsecured basis to support their day-to-day trading activities. In addition, medium-sized businesses reported that it was hard to obtain additional finance once they have pledged all of their real estate as collateral."[6] The focus of the ABGF, once formally established, is to support minority investments into established SME market businesses, which is a distinctly different segment of the business sector than that which would typically attract VC investment. VC investment is typically directed towards early-stage businesses that have significant elements of innovation and novel product/service development, who have the opportunity to exponentially grow and expand their business through a domestic and international scaling-up strategy.

Supporting national areas of most need

The government could provide additional support to specific areas of the economy to support new ventures and innovative businesses in industries where Australia has a comparative advantage or in areas most in need. This is particularly true for some businesses located in regional and rural areas of Australia, despite the fact that regional Australia contributes one third of national output and is home to 8.8 million people.

Recent successful initiatives to tackle the issue of regional under-development include the establishment of the BTF and overseas schemes, such as the Opportunity Zones program in the US. These provide a blueprint for launching programs which couple government funding and private capital, directing it towards specific areas of need. The Australian Business Securitisation Fund is another positive example of encouraging higher levels of business lending into a specific sector, the SME market in this case, which otherwise would have been untapped. Such a pragmatic policy approach, coupled with strong industry consultation, could be effective in unlocking new sources of capital for investment into SMEs and high growth businesses more generally.

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[4] Preqin and Australian Investment Council, Yearbook 2020
[5] Deloitte Access Economics (2018) *Private equity: growth and innovation*, April.
[6] Australian Business Growth Fund Bill 2019 Exposure Draft Explanatory Materials, p3

Recommendation 2: *Support regions and areas most in need*
The Council recommends government introduces incentives for investment into regions and areas most in need based on similar model to the United States' economic 'Opportunity Zones'.

2. Skills and Talent

To be internationally competitive, Australian businesses need access to the world's best talent. Where local companies cannot access the necessary talent, they can be forced to relocate overseas, taking with them jobs and revenue.

Skills and talent are the lifeblood of growing and innovative businesses. Australia has a golden opportunity to be a destination of choice for high calibre talent through its attractive lifestyle, stable political system and future growth opportunities. The government's recent announcement in relation to tertiary education reforms is a positive step towards generating the skills required in the future. It is also important that the businesses and industries that will generate the jobs of tomorrow, including future graduates, are grown and supported now.

As the pipeline of talent is grown within Australia, there are currently skills and talent gaps within the private capital sector which need to be filled as a priority, particularly in C-suite roles and where technical or specialist experience is required - for example, senior engineers, senior medical researchers and product managers. While Australia builds its local talent base, it has an opportunity to attract the world's best talent. This is particularly true with a number of developed countries implementing restrictive migration regimes and continuing to struggle to contain the COVID-19 pandemic. To this extent, the current environment may be conducive to attracting the Australian diaspora who may have developed specialist skills overseas to return home.

Recommendation 3: *Attract the best and brightest talent*
The Council recommends government boosts the offshore marketing of the national Global Talent Scheme to encourage some of the world's best and brightest skilled talent to move to Australia, and at the same time, encourage skilled Australians with valuable offshore experience in leading technology and innovation ecosystems to return home.

Build the next generation of local talent

To compete against the world's best, Australia needs to attract and retain the world's best talent. This is particularly true for Australia as a net importer of capital and highly skilled talent. Education reforms, particularly in STEM disciplines, will help build the next generation of local talent, but in the short-term, immigration reforms will help facilitate the entry of much needed specialist skills not available locally.

Skilled migration has been a key feature of Australia's migration system, playing an important role in generating economic growth for successive decades. Australia has had a long history of supportive policies to attract business entrepreneurs. However, the rising global mobility of workers and heightened competition for talent means that it is important for Australia to have policy settings that are effective in attracting a critical mass of "new economy" skilled workers. These entrepreneurs will help generate new and sustainable business opportunities within the Australian economy into the future and every effort must be taken to attract and retain that talent.

The global search for talent is compounded by ever-more-rapid changes brought about by technology and innovation. Australia has to stay competitive to attract and retain the best and brightest.

The Council is supportive of the government's Global Talent – Sponsored and Independent Programs. While it is still early days in the lifecycle of these policies, the Council believes that they represent a step in the right direction for Australia's future capability around skills development. Further refinement of skilled migration occupation lists will play an important supporting role in identifying those specific niche skills that Australia should prioritise in order to build future growth.

Australia has a strong record of attracting foreign students to tertiary education. Many of these students arrive on visas that are valid for the duration of their studies, and then return to their home countries to develop their careers once their education here is completed. This pipeline of talent represents a potential source of the skills needed to address labour shortages in the short to medium-term.

Recommendation 4: *Extend visas for foreign students*
The Council recommends government extends visas for foreign students who graduate from Australian universities in disciplines where there are skills shortages, allowing them to stay and work in Australia to build a pipeline for a new, knowledge-based economy.

As outlined in the *Australia 2030 Prosperity Through Innovation* report released by Innovation and Science Australia, growth in jobs and occupations requiring STEM skills are outstripping overall employment growth across the economy. While skilled migration will help to address skills shortages in the near future, building a workforce from within Australia with relevant STEM skills will contribute to employment and future economic growth.

Recommendation 5: *Foster entrepreneurship and teach digital STEM skills*
The Council recommends government allocates funding to institutions that can develop and deliver courses for tertiary students aimed at fostering entrepreneurship and teaching digital STEM skills.

In the longer-term, building a pipeline of future employees with STEM skills from the Australian school system would help to increase the job prospects for Australians in the future.

Recommendation 6: *Fast-track the establishment of 'STEM Schools'*
The Council recommends government embeds STEM skills into the Australian School curriculum from primary school years through to tertiary education and fast-tracks the establishment of 'STEM Schools' modelled on Sydney Science College in Epping to expand accessibility for all Australians.

3. Fast track outstanding legislation and remove inconsistencies to make Australia more competitive

Differences to international practices or unexpected policy changes make Australia a less attractive investment location for offshore investors.

As a mid-level player on the global scene Australia remains an attractive, but optional, investment location for many offshore institutional investors. Differences to international practices or unexpected policy changes typically make Australia a less attractive investment location in the eyes of those offshore institutional investors. Unfortunately, Australia's legal and tax framework for private capital investment is inconsistent with international best practice in a number of areas. It currently necessitates duplicate and complex structures and deters higher levels of foreign investment.

The recommendations below provide practical policy solutions to increase Australia's attractiveness internationally. These changes, if implemented, would assist Australian businesses now and in the future to source the funds they need to grow and prosper.

Collective Investment Vehicles

One area where Australia's approach is inconsistent with international practice is its existing framework for collective investment vehicles (**CIVs**). These vehicles play a vitally important role in aggregating international capital for investment into Australian businesses.

Private capital funds make a material contribution to the Australian economy and Australian unlisted business investments. Approximately 64% of commitments to Australian PE funds[7] typically come from offshore investors, all of which flow through some form of CIV based in Australia. The importance of a world-class competitive CIV regime is an essential ingredient in building and expanding the pool of capital that can be attracted into Australian businesses. A number of large international investors have identified that the current structure of Australian CIVs is a material deterrent for investing more into Australia. As a result, these international investors are making decisions to invest in jurisdictions that have CIV regimes they are more familiar with. This often means Australia misses out on significant volumes of capital due to a policy infrastructure that is not as competitive and consistent with global practices as it should be.

These differences continue to exist despite the government's announcement in the 2016 federal budget – consistent with the recommendations of the 2009 Johnson Review into *Australia as a Financial Centre* – that it would introduce two new CIVs to grow Australia's capacity to attract inbound investment into our economy. These two CIVs, known as a corporate CIV and a limited partnership CIV, are yet to be implemented. The Council understands that work on the Limited Partnership CIV is yet to commence and is being held-up by delays in developing the corporate CIV.

Recommendation 7: *Fast-track the implementation of the new LP CIV regime*
The Council recommends steps be taken to fast-track the introduction of a new Limited Partnership CIV that aligns with international best practice with a target start date of 1 July 2021.

Venture Capital Limited Partnerships

In a move supporting investment into Australian businesses, the government implemented changes to early stage venture capital limited partnerships (**ESVCLPs**) and venture capital limited partnerships (**VCLPs**) on 1 July 2016. These changes were broadly supported by Australia's private capital investment sector. However, due to the speed with which they were introduced, there are a number of areas where technical and interpretative amendments and clarifications regarding these investment vehicles are necessary.

There is a range of uncertainties and inefficiencies regarding the current VCLP and ESVCLP regimes. An example of some of the uncertainties with the current regime include the tax treatment of investments whose value increases to exceed $250 million. It remains unclear if these investments remain exempt from 'excess' gains, under sections 51-54 and 118-408 of the Income Tax Assessment Act 1997 (Cth) or, if such an investment is sold out of a ESVCLP, as it may no longer be 'early stage' due to the company expanding and maturing, if such a transfer triggers a crystallisation event and (through application of Part IVA, the general anti-avoidance rule) a tax liability.

ESVCLP and VCLP investment vehicles play a critically important role in supporting high-growth Australian business via access to venture capital and growth capital investment. Because Australia does not yet have an internationally competitive Limited Partnership collective investment vehicle, the ESVCLP and VCLP regimes provide valuable mechanisms to assist in attracting investment capital into the innovation ecosystem.

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[7] For FY2013-2017.

The ability of early stage companies to attract capital is hampered by certain design elements of the ESCVLP and VCLP programs. These include unnecessary differences to international practice and uncertainties in applying the program. A package of reform measures in this area has previously been presented to the government during the 2017 National Innovation and Science Agenda work (and since), but as yet a number of technical amendments are yet to be implemented.

Providing clarity and certainty on the framework for VCLPs and ESVCLPs and making them competitive with other jurisdictions will be attractive to early-stage investors considering medium and long-term investments into Australian businesses across a range of new and emerging sectors of the economy.

There are 16 separate technical and interpretative issues around the current ESVCLP and VCLP regimes which need to be amended as a matter of priority.

Recommendation 8: *Improve existing VCLP and ESVCLP vehicles*
The Council recommends the 16 technical and interpretative issues in the ESVCLP and VCLP regimes be adopted and implemented as a priority.

Empowering Corporate Venture Capital arms and innovation labs

Australia has seen a substantial growth in the number of corporates with corporate venture capital (**CVC**) arms or innovation labs, marking the important role that large organisations can play in driving and nurturing Australia's innovation economy. Despite this growth, recent research by the University of Sydney has demonstrated there is more work to be done as Australian boards are failing to understand the importance of innovation.[8] The study found that 57% of surveyed board members agreed that 'innovation has never been or was only an occasional board agenda item' with only 3% having science or technology expertise. An alarming 57% did not know how much their organisations spent on R&D and innovation.

Start-ups and SMEs can greatly benefit from increased support and investment by government through partnerships, grants and procurement. Government equity co-investment through the introduction of new programs to attract greater public-private investment into high growth Australian companies would have a positive impact on productivity, jobs and economic growth.

Recommendation 9: *Increase support for CVCs and innovation labs*
The Council recommends government increases support for CVCs and Innovation labs through the introduction of new programs to attract greater public-private investment into high growth Australian companies.

Introduce changes to streamline the Accelerating Commercialisation program

The Accelerating Commercialisation (**AC**) program has the potential to play a significant role in driving fast-growth early-stage businesses to expand and deliver world-leading products and services domestically and internationally. However, under the current administration of the AC program, VC-backed businesses are generally not permitted to access additional funding using the 'matching capital' principle.

As there is no specific policy or regulation that supports this adopted practice, it is appropriate that the government provides guidance for the AC program's administrators which clearly enables VC-backed early-stage businesses access to funding support through this important program.

Recommendation 10: *Streamline the Accelerating Commercialisation program*
The Council recommends that guidance be provided to the administrators of the Accelerating Commercialisation program to allow venture-backed businesses to access funding where they are eligible.

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[8] Garbuio, M (2019) *Driving Innovation: The Boardroom Gap, 2019 Innovation Study*, September

Pause the introduction of changes to the current Research & Development Tax Incentive

The Research and Development program (**R&D**) is a critically important policy support mechanism which drives large parts of Australia's innovation ecosystem. The proposed reforms to the R&D tax incentive (**RDTI**), including to introduce annual caps under the refundable component of the program, will create restrictions on investment into job-creating innovation at a time when the Australian economy requires it the most. Given the significant change in Australia's economic situation at this time from when the proposed changes were first announced (in 2018), the Council recommends government halts any implementation of changes in this area of policy immediately. The uncertainty in relation to this regime is having the effect of impeding much-needed investment momentum by companies at the front-line of research and development of new products and services.

Furthermore, there are aspects of Australia's RDTI that are considered to be problematic such as definitional issues which impact on access to the program in respect of certain forms of software development. Any support that the government can provide to the Australian Taxation Office to assist in providing clarity on the policy objectives of the current regime would be helpful for all technology businesses seeking to scale in Australia.

The public transparency measures, which are also proposed in the Bill will require the Commissioner of Taxation to publish information about R&D entities that have claimed notional deductions for R&D activities, including the amount claimed within two years following the end of the relevant financial year. These changes could have the effect of diminishing the appeal of the program, and result in a loss of commercial in confidence information that could impact on the competitiveness of early stage businesses who are often seeking to build scale in niche areas of the market.

Under the current regime, there have also been numerous examples of inconsistencies where claims that were initially accepted were later rejected by the Australian Taxation Office. This *about-turn* on eligibility has had a material effect on many early stage businesses, who have relied on their access to R&D Tax Incentive refundable offsets in order to fund ongoing cashflow investment into R&D activities.

Recommendation 11: *Pause the R&D Bill*
The Council recommends the R&D Bill is paused to give scope for renewed terms and to allow for a regime that is more supportive of early stage businesses, particularly in priority industries.

Consistency in tax treatment

Private capital managers invest with the expectation of holding and growing their investments for a number of years. As such, those managers consider the potential performance and risks of their investments over the medium to long-term. Uncertainties due to variations in the tax treatments of investments increase investment risk, making investing in Australia less attractive. Inconsistencies in tax treatment have occurred, and continue to occur, in a number of areas.

These include, but are not limited to:

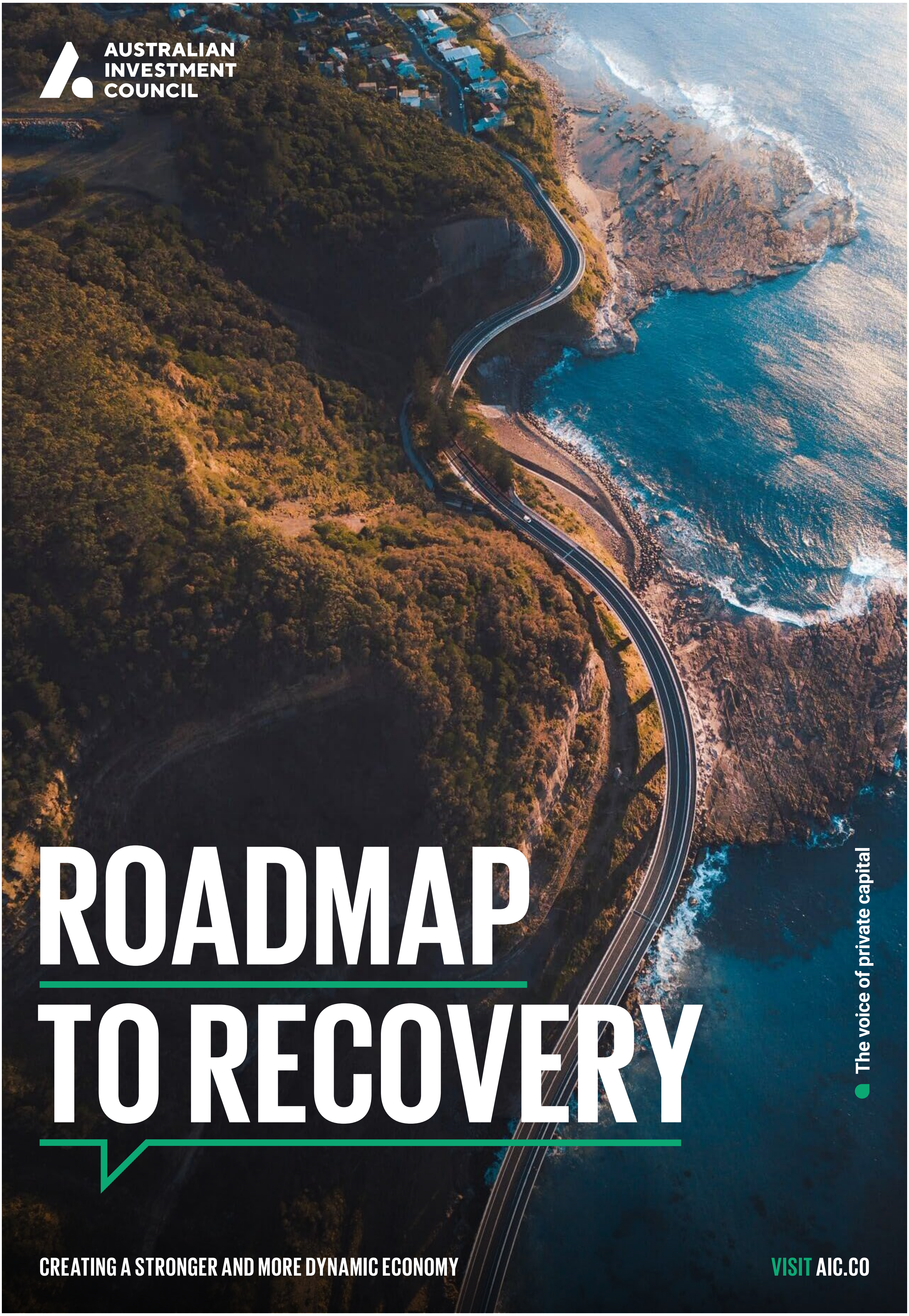
1. the tax treatment of investments whose value increase to exceed $250 million (detailed above in the *Venture Capital Limited Partnerships* section);
2. The deemed 'grouping' of independent private capital-backed businesses as one corporate group for the purposes of testing under certain federal and state-based tax regimes, for example in respect of the criteria contained within the current JobKeeper Program. Unlike consolidated corporate groups owned by a common parent entity, independent investee businesses within private capital fund structures are unrelated with one another and cannot participate in any cross-guarantees or subsidies that might otherwise be available in a typical consolidated corporate group structure;
3. Definitional issues such as the narrow interpretation of 'experiments' in the R&D Tax Incentive Law which are inhibiting investment into new innovations, especially for early stage companies (outlined in the *Research and Development Tax Incentives* section); and
4. Requirements to publish R&D entitlement which have caused inconsistencies, where claims which were initially accepted, were later rejected by the Australian Taxation Office (**ATO**).

The Australian Investment Council is available to assist the government explore these instances of inconsistent tax treatment to find solutions that will drive increased investment into Australian businesses.

Recommendation 12: *Reduce tax uncertainties for private capital investment*
The Council recommends the Australian Government, including the ATO, work with industry to reduce the uncertainties and inconsistencies in the tax treatment of private capital investment into Australian businesses.

Attachment 1: *Australian Investment Council: Roadmap to Recovery*

(see following pages)



AUSTRALIAN INVESTMENT COUNCIL

ROADMAP TO RECOVERY

CREATING A STRONGER AND MORE DYNAMIC ECONOMY

The voice of private capital

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ROADMAP TO RECOVERY: CREATING A STRONGER AND MORE DYNAMIC ECONOMY

COVID-19 creates a catalyst for Australia to closely assess its sovereign capability in a number of key industry sectors.

Australia's relatively successful proactive management of the public health crisis arising from the pandemic provides an opportunity to capitalise on the nation's position as part of the group of 'first-mover' nations to emerge out the downturn and to harness the opportunities that the future can bring.

To support the economic recovery challenge over the period ahead, Australia must embrace this moment in time as an opportunity to lay down a visionary plan that will underpin the next phase of prosperity and incomes growth for all Australians.

To assist in the development of that vision, the Australian Investment Council conducted a comprehensive member survey and identified the major barriers and the key policy priority areas essential to Australia's economic recovery and the expansion of businesses.

FOUR MAIN BARRIERS TO BUSINESS RECOVERY

01 Business and travel restrictions

02 Cash flow and access to funds

03 Economic uncertainty and consumer confidence

04 Social distancing and 'second wave' concerns

SEVEN POLICY PRIORITY AREAS

01 Taxation reform

02 Market deregulation and red tape reduction

03 Innovation, technology and skills

04 Industrial relations reform

05 Infrastructure spending

06 International competitiveness

07 Superannuation and Australia's ageing population

THE IMPACT OF COVID-19 ON PRIVATE CAPITAL-BACKED AUSTRALIAN BUSINESSES[1]

81%

81% have **stopped some or all commercial activities** due to COVID-19 restrictions

JOB

75% have been forced to **reduce their workforce**

66%

Over 6,000 jobs lost — **66%** of businesses expect further job losses

WE ARE READY TO SUPPORT AUSTRALIAN BUSINESSES AND ASSIST REBUILDING THE ECONOMY[2]

The private capital industry manages **$33bn** in total Assets Under Management

1 in 9 new jobs in Australia are created by highly innovative private capital-backed businesses.

2.6%

The industry contributes **2.6% of Australia's GDP**

The industry employs **200,000 Australian workers**

Jobs growth is higher in private capital-backed businesses

The private capital industry has **$13bn available to invest** into great Australian businesses today

[1]Data from the Australian Investment Council's member survey (May 2020).
[2]Data from *Private equity: Growth and innovation* and the *Preqin & Australian Investment Council Yearbook 2020.*

AUSTRALIAN INVESTMENT COUNCIL

THE PRIVATE CAPITAL INDUSTRY CAN MAKE A SIGNIFICANT CONTRIBUTION TO AUSTRALIA'S ECONOMIC RECOVERY

The global COVID-19 pandemic and the government imposed restrictions on individual movements and business activities have had a significant impact on every dimension of the Australian economy.

In April alone, 600,000 jobs were lost and the participation rate crumbled as almost 500,000 people left the workforce.[3] The underutilisation rate has already risen to 19.9%[4], and analysts project the unemployment rate to hit 12-15%;[5] a rate that would certainly be higher if not for important government support initiatives such as the JobKeeper Program.

Economically, the silver lining that emerges from the COVID-19 pandemic is that it has created a catalyst for Australia to closely assess its sovereign capability in a number of key industry sectors. To capitalise on Australia's comparative advantage and to harness the opportunities that the future can bring, our roadmap to recovery must be underpinned by a comprehensive plan by government to bring about meaningful economic reforms for long-term prosperity.

A cornerstone of our national plan to secure Australia's future economic, employment and productivity growth should be to support the acceleration and development of our domestic technology as an enabler of businesses across all sectors of our economy. The technology industry has the ability to directly make a significant contribution to high-value economic output[6] and to lift productivity, global competitiveness and create jobs across the entire economy. A stronger technology capability would represent a significant new building block in designing a future-proof Australia that generates sustainable economic and incomes growth for all, and positions our market with a competitive edge against other developed economies around the world.

The Australian Investment Council believes that we should aim to ***double the size and output of Australia's technology industry by 2030***. The significant benefits of this would flow to almost every industry in Australia through growth, improved productivity and new high-value job creation. This objective can be achieved through fostering deeper and more meaningful partnerships between industry, government and academic institutions, and increasing the skills of our workforce. Additionally, the role of technology should be central in any new regulation and legislation to help create an environment that incentivises investment and removes regulatory burdens. Government procurement should play a critically important role in supporting the growth of technology across all areas of social and business policy and programs, helping to turbo-charge the work being done by the Digital Transformation Agency.

The Australian Investment Council has brought together the collective insights of the private capital industry through a combination of survey and qualitative input, to identify those reform priorities that will create the most significant opportunities for Australian businesses in the years ahead.

The private capital industry is a critically important investment and efficiency driver for Australian industries, and businesses. Fund managers invest capital from a wide variety of domestic and offshore institutional investors to support the growth of thousands of high-potential Australian businesses. In combination with that, private capital investors deliver to those businesses a mix of strategic support, value-enhancing innovation, and connections to help them unlock growth opportunities in domestic and international markets, which underpins the creation of new jobs across every sector of the economy.

THE AUSTRALIAN INVESTMENT COUNCIL BELIEVES THAT WE SHOULD AIM TO DOUBLE THE SIZE AND OUTPUT OF AUSTRALIA'S TECHNOLOGY INDUSTRY BY 2030.

In addition to taking action on the broader policy areas identified below, a variety of specific changes should be implemented to more directly assist the private capital industry in growing the pool of capital available to support investment into Australian businesses. To lift equity and debt capital investment into the SME market and larger businesses, the priority changes are:

(1) implementing a globally competitive limited partnership collective investment vehicle, as recommended by the 2009 Johnson Review into *Australia as a Financial Centre*, to attract greater inbound investment from offshore, given Australia's credentials as a market capable of delivering exceptionally strong returns for investors;

(2) removing the recently introduced temporary barriers to inbound investment capital sourced from offshore under Australia's foreign investment policy framework;

(3) continuing to improve the sophistication of the regulatory environment around superannuation, to nurture a system that is focused on long-term net returns, along with ensuring that the Early Release Scheme does not establish a precedent for future policy changes of this nature.

To benefit early-stage high-potential businesses across all sectors of the economy, the Council recommends that the government work closely with the venture capital investment sector to establish a long-term action plan that seeks to lift Australia's innovation ranking through significant improvements in the translation and commercialisation of research discoveries. Numerous reviews and analyses completed over the past decade have consistently pointed to the nation's failure to secure more tangible returns on publicly-funded research investments as one of the major constraints facing the innovation pipeline. A cohesive strategy that seeks to address this issue, while at the same time facilitating improvements in Australia's capacity to attract the world's best and brightest talent with key STEM-related skill sets, will underpin the next wave of economic growth for the decade ahead.

[3] ABS (2020) Media Release: Employment Falls 594,000 in April to 12.4 million, 14 May.
[4] Ibid.
[5] NAB Group Chief Economist, Alan Oster (in his 14 May 2020 podcast) and various other analysts.
[6] The technology industry directly employs around 580,000 people (5% of Australia's workforce) and contributes more than $144 billion to the economy each year, representing 6.6% of GDP. Australia's Digital Opportunity, Alphabeta September 2019.

BARRIERS TO OUR ECONOMIC RECOVERY AND EXPANSION

Through a comprehensive member survey, a number of barriers to the economic recovery and expansion of Australian businesses were identified. Alleviating the most problematic aspects of these barriers, and developing a medium-term plan to address all of these issues, will go a long way towards allowing businesses and markets to re-build over time.

01

Business and travel restrictions

Restrictions on business operations and travel are the biggest barriers to economic recovery.

Until travel resumes, and businesses are permitted to operate freely within the appropriate regulatory framework, the economy will continue to be adversely impacted by a lower-than-normal pace of activity.

Many businesses will not be profitable until restrictions on business operations are lifted. The imposition of public health strategies that limit the types of services which can be delivered, and the number of customers that can be present, has had a profound impact on normal business operations. Returning to full activity will allow cafes and restaurants to put staff back on their rosters, personal trainers to return to fitness studios, and hotels to resume checking-in guests.

In the medium-term, easing international travel restrictions will support improvements in supply chains, and allow for the resumption of export and import trade activities across all industry sectors.

02

Cash flow and access to funding

The rapid drop-off in revenue experienced by countless industries over recent months has presented an existential challenge for businesses, who have had to rely to a large extent on government support programs to remain viable.

Access to funding and maintaining cashflow liquidity have consumed the leaders of all businesses, especially those in the SME segment, where prior years' reserves may have been exhausted. This has occurred at a time of significant capital market dislocation as domestic and international investors re-balance their exposure to risk. Evidence of capital 'rationing' has emerged over recent weeks, which evidences the extent of financial stress experienced by business.

Access to funding remains a material issue for most Australian businesses, despite the government guarantee of some categories of SME loans. In addition, institutional investors are facing their own challenges, notwithstanding the record-low interest rates and depressed market valuations in many industry sectors.

While federal, state and local government initiatives have been essential in supporting businesses through the low-point in economic activity, it is recognised that those programs cannot continue indefinitely, and it is important for organic cash flows to return. This pickup in activity will not materialise quickly, and it will only return when consumer confidence improves, and freedom of movement and spending levels increase.

03

Economic uncertainty and consumer confidence

COVID-19 has negatively impacted business and consumer confidence at a time when the economic outlook was already under pressure despite the longest period of uninterrupted growth in recorded global history.

The additional erosion of confidence has further driven down market demand and consumer spending, while at the same time, eroding job security and household incomes.

With businesses focused on survival, risk appetites have been re-balanced, leading to growth and expansion plans being shelved. Expenditure on research has fallen further, and management teams have – by necessity – turned increasingly inward-looking in their strategic focus. Money markets have exacerbated these conditions with the tightening of capital flows due to uncertainty about the short and medium-term outlook.

FOUR MAIN BARRIERS TO BUSINESS RECOVERY

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04

Social distancing and 'second wave' concerns

Compliance with social distancing rules and concerns about the potential for a 'second wave' of the COVID-19 pandemic will continue to have a clear and direct impact on business activity and confidence.

The public health ramifications of a second wave will be deeply damaging for the wellbeing of all households across the country, and the impact on businesses has the potential to be more significant and damaging than the first round of shutdowns. The priority for governments at all levels should be to maintain a careful balance between the need for various levels of strict controls to support public health management, while allowing measured steps to the resumption of normal daily life and economic activity.

REFORM PRIORITIES AND OPPORTUNITIES

To support the economic recovery challenge over the period ahead, ***Australia must embrace this moment in time as an opportunity to lay down a visionary plan that will underpin the next phase of prosperity and incomes growth for all Australians.***

The Australian Investment Council has for a long time been committed to advancing economic and social policy reforms that support economic growth by providing a stable framework for investment capital that drives productivity gains, improved market competition, and employment growth.

Governments at all levels have demonstrated over recent months a preparedness to collaborate and unite to deliver nationally important outcomes for the benefit of everyone in our community. The economic roadmap to recovery should be developed on the back of a wide range of inputs from all corners of society, and it should be dynamic in the way that it responds to evolution and change in the domestic and international context within which we exist.

As part of the 'first-mover' group of nations emerging from the COVID-19 pandemic, Australia has a unique opportunity to reshape the national economy for the future. The success of our willingness to embrace and capitalise on this opportunity will be defined by our preparedness to bring about meaningful long-term policy change that improves the standard of living for all Australians.

The Australian Investment Council's survey has identified seven key policy reform areas that should be prioritised.

01

Taxation reform

Reforming Australia's taxation regime is broadly considered to be the policy area with the greatest potential to reinvigorate Australia's economy over the long-term.

Australia's taxation system has been the subject of numerous reviews over the past decade, and many of the most significant recommendations set out in reviews remain relevant today. The most comprehensive of the recent reviews is the 2010 Australia's Future Tax System (AFTS) Review, led by former Treasury Secretary, Dr Ken Henry.

Many of the recommendations from that review are yet to be progressed. Taken as a whole, the tax reform blueprint set out in that work represents a compelling, growth-enhancing plan for a staged transformation of the tax mix across federal and state-based tax regimes. Some state jurisdictions within Australia have adopted elements of the blueprint in bringing about reform in their own regimes, but a coordinated national approach has not been agreed. The success of the National Cabinet of heads of government could serve as the perfect foundation on which consensus for reform could be built, and the unity around the common cause of building a stronger and more innovative Australian economy for the future could serve as the catalyst for change that has been absent in the past.

Some of the key priority reforms set out in the AFTS Review[7], as well as other growth-orientated analysis of our existing tax system, revolve around reducing the headline corporate income tax rate for all businesses to 25%, a step that would deliver incomes growth for all Australians, and at the same time, lift Australia's competitive standing in the global marketplace for capital and talent.

A reduction in the corporate income tax rate forms an important part of a broader strategy of shifting the nation's 'tax mix' by reducing reliance on direct taxes – such as personal and corporate income taxes – and re-balancing towards greater reliance on 'user pays' pricing mechanisms and indirect taxes. In the technology-enabled global marketplace in which Australian businesses operate, such a shift is vitally important to building a stronger and more sustainable budgetary position for governments at all levels into the future.

A short-term measure that should be considered is capital gains tax relief. This could induce an increase in investments into high-growth businesses and help kick-start the recovery.

SEVEN POLICY PRIORITY AREAS

01 Taxation reform

02 Market deregulation and red tape reduction

03 Innovation, technology and skills

04 Industrial relations reform

05 Infrastructure spending

06 International competitiveness

07 Superannuation and Australia's ageing population

01

TAXATION REFORM

→ Streamline Australia's taxation system to eliminate inefficient taxes.

→ Reduce reliance on corporate and personal tax revenue.

→ Work with states to introduce greater harmonisation in regimes.

→ Re-balance the tax mix between direct and indirect taxes.

→ Use the newly formed National Cabinet as an opportunity to unite behind the common purpose of improving the competitiveness of Australian businesses.

COVID-19 CREATES A CATALYST FOR AUSTRALIA TO CLOSELY ASSESS ITS SOVEREIGN CAPABILITY IN A NUMBER OF KEY INDUSTRY SECTORS.

[7] Australia's Future Taxation System Review.

REFORM PRIORITIES AND OPPORTUNITIES (CONT.)

02

Market deregulation and red tape reduction

The sharp downturn in economic activity and consumer spending is being compounded by an overwhelming concern that the burden of creeping red tape and regulatory compliance costs are stretching business viability.

It is well recognised that red tape and regulatory cost burdens tend to move in cyclical phases every 10-15 years. Removing red tape and introducing greater efficiencies drive increases in productivity, competitiveness and high-value jobs growth. Past experience in Australia suggests that attempts to reduce red tape at a federal and state level have sometimes been narrow in scope, and therefore failed to achieve the desired economic and business outcomes.

It may be instructive to revisit the 2013 Coalition Government analysis in *'Boost Productivity and Reduce Regulation'*[8] which outlined a whole-of-government framework to reduce the red and green tape burden by at least $1 billion per year. Amongst numerous recommendations, the report recommended at least two Parliamentary Sittings be dedicated each year to repeal counterproductive or unnecessary regulation, and that COAG meetings – now National Cabinet – include deregulation and red tape as standing items for discussion and review throughout the year.

The Council also encourages government to implement the recommendations contained in the Productivity Commission's *Shifting the Dial*[9] review in 2017, particularly in respect of the opportunity for National Cabinet to adopt a formal joint reform agenda.

Reinstatement of the core principles set out in the 2013 report, and the adoption of recommendations from the Productivity Commission's 2017 analysis, should form part of a comprehensive and clear commitment to eliminate red tape costs for businesses over the short and medium-term.

Governments and regulators should resist the temptation to develop new laws and regulations and implement additional red tape only where there is a clear and unavoidable need, for example where industry is not able to independently react to market ineffectiveness or consumer harm. Where new laws or regulations are required, they should be implemented through enabling technology.

Government regulators should also expand the use of regulatory sandboxes to help dictate new ideas and products, building on concepts of the enhanced regulatory sandbox recently announced by the Government[10].

03

Innovation, technology and skills

Innovation, technology and skilled labour have the capacity to directly contribute to economic output and to indirectly lift productivity, global competitiveness and create jobs across the economy.

Despite a skilled labour force, Australia ranks second last in the OECD – ahead of Mexico – for the relative size of our technology sector and as of 2016, was 34% behind our OECD peers across four core areas of digital innovation, including the application of digital technologies to existing industries. These results show the huge capability gaps that Australia can make up, but only if the right policy settings are adopted.

Notwithstanding our relatively low global rankings, the domestic technologies sector contributes $122 billion each year, or 6.6% of GDP, to the Australian economy[11]. This is expected to grow 40% between 2018 and 2023.[12]

The productivity-enhancing impact of a vibrant innovation and technology sector can extend across almost all existing industries while strong domestic innovation and technology skills can support and develop new sectors, such as strategic manufacturing capabilities.

For Australia to make material gains in innovation and technology, government policies need to encourage businesses to take risks, to develop new ideas, new products and to find new markets. *The Australia 2030: Prosperity through Innovation*[13] report by Innovation and Science Australia set out 30 key reform initiatives across five key strategic pillars: education, industry, government, research and development, and culture and ambition. The recommendations are targeted at creating a more knowledge-intensive innovative economy that is capable of delivering a higher standard of living for current and future generations of Australians. Increasing business investment in research and development, more impactful collaboration between universities and businesses to commercialise research discoveries, and lifting STEM capabilities within our workforce are central to achieving a more advanced economy in years to come.

02

MARKET DEREGULATION AND RED TAPE REDUCTION

- → Remove superfluous and counterproductive legislation and regulation.
- → Encourage Commonwealth, State and Territory governments to adopt a formal joint reform agenda with coordination and alignment across all agencies.
- → New laws and regulations should be implemented through enabling technology.

03

INNOVATION, TECHNOLOGY AND SKILLS

- → Focus on technology and innovation as an enabler for building employment and growth across the economy.
- → Implement the recommendations ISA's 2030 Report.
- → Identify technical skills gaps and develop programs to build a pipeline of talent within Australia.
- → Encourage highly skilled immigration as a short-term measure to fill the talent gap.
- → Unlock the transformative power of government procurement to accelerate the growth of smaller technology-enabled businesses.

[8] The Coalition's Policy to Boost Productivity and Reduce Red Tape 2013.
[9] Shifting the Dial: 5-year productivity review, Productivity Commission 2017.
[10] Media Release, Regulatory Sandbox will boost fintech innovation and competition, Senator Jane Hume, 28 May 2020.
[11] Australia's Digital Opportunity, AlphaBeta September 2019.
[12] Deloitte Access Economics, Australia's Digital Pulse 2019.
[13] Australia 2030: Prosperity through Innovation.

REFORM PRIORITIES AND OPPORTUNITIES (CONT.)

04

Industrial relations reform

A high degree of productivity is lost in Australia's industrial relations system as employers and employees try to manage their obligations within a regime that is often seen as holding us back from achieving the level of productivity gains necessary for our future economy.

A complex awards-based system, onerous workplace agreement requirements, inconsistency and uncertainty around the definition of casual employment, and the overall lack of flexibility afforded between businesses and their talent base are amongst a range of issues that warrant targeted focus by government as part of the nation's efforts to lift productivity while minimising compliance and red tape costs. The Government's announcement regarding industrial relations reforms as part of its JobMaker initiatives provides a good platform to advance these issues.

We welcome the Government's intent to develop a more flexible industrial relations system, particularly for SMEs and fast-growing businesses that need flexibility in working arrangements for their talent base and their recruitment strategies. A more flexible industrial relations system should also empower a technologically capable workforce and facilitate the ongoing inclusion of older workers – an issue which will increase in importance as our population continues to age over years to come.

Streamlining Australia's enterprise bargaining agreement process will be welcomed by many businesses as it is seen as being convoluted, complex, and overly prescriptive. The process is also inherently compliance intensive, necessitating considerable investment of time on the part of both employers and employees. There is significant scope to streamline the enterprise bargaining regime, and in doing so, deliver improved productivity outcomes and reduce unnecessary regulation and compliance costs. In this area, Australia would benefit from a closer analysis of the equivalent regime that exists in New Zealand, where there are half as many legislative provisions as those in Australia.

The Productivity Commission's *Workplace Relations Framework*[14] in 2015 made a number of recommendations that are yet to be implemented. The Council recommends that work be done to refresh the analysis completed in 2015, with an eye to defining the prioritisation of reforms that will translate to improvements in productivity and innovation across our economy. The prosperity of the future Australian economy will require a significant investment in creating industries and labour market mechanisms to enable more highly-skilled jobs to be established here, rather than abroad.

05

Infrastructure spending

Infrastructure spending should be increased to boost economic activity in the short-term and deliver productivity gains over the longer-term.

A comprehensive plan for a broad-based infrastructure spending program should be developed, with a focus on telecommunications and technology, transportation, renewable energy, and water, as key enablers of the future.

In a country as large (and sparsely populated) as Australia, there is a need for accessible, quick, efficient and reliable rail and road systems, ports and transport nodes. Such a system would improve delivery times for products and materials throughout the nation, while introducing efficiencies that reduce costs. As the local manufacturing capability grows, logistics and supply chain connections will be imperative for business productivity and profitability.

An improved transportation system will also support the domestic agriculture sector – anticipated to be Australia's next $100 billion industry. For that growth potential to be realised, Australia's water capabilities need to be improved. Freeing up water from the Murray-Darling Basin is a key priority in this area. Infrastructure Australia's high priority strategy for water[15] needs to be implemented, quickly.

It is imperative that Australia has a clearly stated direction for delivery of infrastructure that will strike a balance between short, medium and long-term developments that are central to the nation's growth strategy.

04

INDUSTRIAL RELATIONS REFORM

- → Overhaul and simplify the industrial relations system to reduce compliance costs and increase productivity.
- → Increase flexibility for workplace arrangements, particularly for SMEs and fast-growth businesses.
- → Streamline the enterprise bargaining process.

05

INFRASTRUCTURE SPENDING

- → Increase infrastructure spending to boost economic activity in the short-term and productivity in the longer term.
- → Focus on telecommunications, transport and water to set up Australia for future success.
- → Improve national rail and road systems to speed up delivery times.

AUSTRALIA'S ENTERPRISE BARGAINING AGREEMENT PROCESS IS CONVOLUTED, COMPLEX, AND OVERLY PRESCRIPTIVE.

[14] Workplace Relations Framework, Productivity Commission 2015.
[15] Infrastructure Australia Priority List 2020.

REFORM PRIORITIES AND OPPORTUNITIES (CONT.)

06

International competitiveness

Australia has an opportunity to emerge from the COVID-19 pandemic as a more competitive nation in the global marketplace.

The key elements to our success will be prioritising industries where we already are – or could be – world leaders, and 'going narrow and deep' in developing these industries.

Most of these elements can be achieved by focussing on a small but targeted range of the policy reform areas identified above. In addition, growing industry sectors across and the Australian economy will require a reliable flow of inbound investment capital. As a net importer of capital, Australia must implement policy settings that not only support, but encourage foreign investment into Australian businesses.

In a recent address[16] to the National Press Club, the Industry, Science and Technology Minister, the Hon Karen Andrews MP, highlighted the need to align manufacturing with science and research efforts in areas where Australia is best placed to excel, such as: biomedical technology and therapeutics, as well as FinTech, to support the commercialisation of good ideas, and to improve access to export markets.

This points to building a strong foundation to enhance our domestic capability. This will help build a domestic manufacturing industry that will sustain the economy and make Australia internationally competitive. We recommend the government significantly enhances Australia's Export Market Development Grant (EMDG) program to enable SME market businesses who already have a demonstrable track record in the area to accelerate growth through the sale of high-value goods and services offshore.

07

Superannuation and Australia's ageing population

Amongst many things, the COVID-19 global pandemic has served the purpose of shining a spotlight on Australia's superannuation system.

Approximately 1.6 million Australians have so far applied for early access to their superannuation savings under the government's temporary measure, amounting to a combined value of $10.6 billion in early withdrawals, which will likely continue to grow over coming weeks and months.[17] While the temporary change is undoubtedly welcome relief from financial stress for thousands of households across the nation, it is important to recognise the longer-term consequences of early release on retirement savings. It is vitally important that this temporary measure does not set a precedent for future early release concessions that will have the effect of further eroding the savings base required for the long-term security of Australian workforce once they reach retirement age. The superannuation system is, by its very nature, a long-term investment strategy that should carefully balance risks and returns, with delivering a stable and sustainable retirement income in parallel with the social security system.

There is an opportunity for the government to look at longer-term policies to support superannuation fund members with recouping the drawdown in funds seen as a result of the early release scheme. For example, temporarily increasing the annual superannuation contribution threshold to allow members to make up for withdrawals should be considered as an appropriate and measured policy response to counterbalance the effect of the early release scheme.

With Australians working and living longer, superannuation investment strategies should be aligned – to the greatest extent possible – with the nation's future economic and financial needs. There is a need to clearly define our superannuation system as recommended in the Financial System Inquiry[18], and to have a consistent set of policies that work towards common objectives which deliver long-term confidence in the system.

As patient capital investors, superannuation funds provide a natural means for investment into projects and infrastructure for the long-term viability and sustainability of Australia's economy, and through that, the retirement savings system. Investments into social and low-cost housing, for example, would provide significant benefits to core groups of Australians, while investment into high-potential domestic businesses will help underpin growth in new employment and economic activity over the long-term.

A more diverse superannuation pool, with a much greater focus on after-fee net returns, will greatly assist in increasing the stability of our superannuation system, supporting our ageing population and reducing liquidity pressure.

06

INTERNATIONAL COMPETITIVENESS

- → Focus on developing the industries where Australia has a competitive advantage.
- → Enhance Australia's manufacturing capability and align it with science and research developments.
- → Support Australian businesses to leverage offshore capital and export markets to fund growth and expansion.
- → Improve the scope and funding pipeline for EMDGs.

07

SUPERANNUATION AND AUSTRALIA'S AGEING POPULATION

- → Increase diversity in superannuation investments to improve system stability, support our ageing population and reduce liquidity strains.
- → Move the focus of the public and regulators to increasing after-fee net returns and, therefore, higher superannuation balances in retirement.

[16] National Press Club Address May 2020, Karen Andrews, Minister for Industry, Science and Technology.
[17] APRA COVID-19 Early Release Scheme Dashboard at 17 May 2020.
[18] Financial System Inquiry Final Report, December 2014.

WORKING TOGETHER TO BUILD A BETTER FUTURE

We believe in building a stronger economy that supports Australians, Australian entrepreneurs and Australian businesses in a way that is environmentally responsible and socially inclusive.

The Australian Investment Council and its members have provided the insights set out above as a constructive contribution to progress the national conversation about how we can all play a role in defining the nation's roadmap to recovery over the months and years ahead.

Survey Methodology

In May 2020, the Australian Investment Council conducted a detailed quantitative and qualitative survey of its members to garner insights into the impact of the COVID-19 pandemic on Australian businesses backed by private capital investment, and into the policy options and areas most critical to nation's economic recovery. Approximately 50% of the Council's fund managers responded to the survey, along with a statistically significant proportion of the Council's large institutional investor funds and key corporate advisory firms. The Council considers that the survey responses are meaningful and representative over the private capital industry's broad views.

About the Australian Investment Council

The Australian Investment Council is the voice of private capital in Australia. Private capital investment has played a central role in the growth and expansion of thousands of businesses, which when combined represents a multi-billion-dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include: private equity, venture capital and private credit funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers.

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AS PART OF THE 'FIRST-MOVER' GROUP OF NATIONS EMERGING FROM THE COVID-19 PANDEMIC, AUSTRALIA HAS A UNIQUE OPPORTUNITY TO RESHAPE THE NATIONAL ECONOMY FOR THE FUTURE.

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Attachment 2: Co-investment fund options

1) Co-Investment Program Structure

A new co-investment program could be modelled on established structures using qualified fund managers. For example, in the life sciences and medical research area, the Federal Government's Biomedical Translation Fund is a program structure that is well recognised as a leading private and public sector collaborative model and could form the basis for a new national co-investment fund. There are alterative models for such programs which could assess the merits of a structure that is based on a 'fund-of-funds' type approach, versus direct investment into underlying investee businesses. The private capital industry is open to canvassing the relative merits of each approach, which takes account of the priorities of the government in this area of policy.

Governments co-investing to support early stage and high growth businesses is a well-tested policy response. Co-investment programs are heavily used in the UK, USA, Canada, New Zealand, Germany, France and many other countries across the globe. Domestically, various co-investment programs exist at the state level, complemented by targeted national programs.

Domestically and internationally, over the past 20 years governments have universally introduced successful co-investment funds to support the scaling-up and growth of early-stage businesses across many industry sectors. Some of the leading examples are included below for reference.

2) Domestic and offshore examples of co-investment programs

Biomedical Translation Fund (BTF)

Launched in 2016, the BTF provides companies with matched funding through private sector venture capital fund managers. The program is specifically targeted at biomedical discoveries to commercialise health and medical research outcomes.

The BTF Program policy objectives are to:

- invest in promising biomedical discoveries and assist in their commercialisation; and
- encourage the development of companies commercialising biomedical discoveries by addressing capital and management constraints.[9]

The Federal Government committed $250 million to the BTF alongside $251.25 million from private sector. The BTF was designed to have no fiscal impact on the budget, as it is an investment vehicle where the Government can obtain a return on the funds invested.

Queensland Business Development Fund (QBDF)

The Queensland Government-backed BDF is run by the Queensland Investment Corporation and is "focussed on the growth of innovative Queensland businesses, particularly in the emerging industries of tomorrow. It is aimed at creating high value, knowledge-based and skilled jobs now and into the future."[10] Applicants must be Queensland-based and require a co-investor to access the $80 million fund. If successful, they are provided with between $125,000 and $2.5 million in funding. The QBDF allows private investors to buyout the government's investment at a future date.

[9] Biomedical Translation Fund

[10] Business Development Fund

Victorian Business Growth Fund (VBGF)
In June 2020, the Victorian government launched the VBGF.[11] The $250 million fund, includes a direct $50 million investment from the Victorian government.[12] The VBGF "will operate for 10 years and will help to address barriers faced by successful small and medium enterprises (SMEs) that are ready to grow their business but can't access the funds or find the right partner they need to take the next step."[13] Applicants must have between $5 million and $100 million in annual revenue and no more than $250 million in assets.

Victorian Clean Technology Fund (VCTF)
The VCTF is a Victorian government venture capital fund, established in 2003, "which invests in and assists the commercialisation of novel clean technologies… It generally invests at the pre-seed and seed funding phases where traditional venture capital sources are not readily available."[14] The VCTF generally co-invests and typically invests less than $1 million.

South Australia Venture Capital Fund (SAVCF)
The South Australian government's SAVCF is a $50 million co-investment fund which aims "to help build dynamic and innovative early-stage companies to accelerate their growth to a national and global scale."[15] The SAVCF provides initial investment in high growth and export potential companies that have at least demonstrated a market for their product or service and have either commenced generating revenue, or can demonstrate customer validation and evidence a route to revenue generation. Alternative criteria are provided for life science and biotech companies.

Innovation Investment Fund (IFF)
The IIF was established by the Federal Government in 1997 with the objectives of:

- Addressing capital and management constraints to encourage the development of new-technology companies which are commercialising research and development;
- Developing a self-sustaining Australian early-stage, technology-based venture capital market;
- Establishing, in the medium term, a "revolving" or self-funding scheme; and
- Developing fund managers with experience in the early stage venture capital industry.

The program raised over $640 million and awarded licenses to VC fund managers who, as part of the licensing process, were required to raise capital from private sources to match the capital provided by the Government. The IIF was designed to have no fiscal impact on the budget, as it is an investment vehicle where the Government can obtain a return on the funds invested.

New Zealand Venture Investment Fund (NZVIF)
In March 2020, the New Zealand government announced a $300 million co-investment fund – building on the earlier, 2002, NZVIF – which "invests into venture capital funds and partners with angel investor groups to drive investment into young New Zealand companies with high growth potential. The NZVIF was established to help build a vibrant venture capital market in New Zealand."[16]

Canadian Venture Capital Catalyst Initiatives (VCCI)
The Canadian government established the VCCI to build on the success of its previous CAD390 million fund of funds and direct investment Venture Capital Action Plan. Through three streams, the VCCI has injected CAD1.7 billion into the

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[11] Victorian Business Growth Fund

[12] Business Victoria (2019) *$250 million Victorian Business Growth Fund Established*, June

[13] Victorian Business Growth Fund

[14] Victorian Clean Tech Fund

[15] South Australian Venture Capital Fund

[16] New Zealand Venture Investment Fund

Canadian venture capital ecosystem.[17] The first stream of the VCCI, announced in 2018, provides fund of funds investments. The second steam focuses on underrepresented groups, such as women and emerging regions. The third stream invests in clean energy.

The UK Experience

Following a 'Patient Capital Review' in November 2016, the UK government initiated a series of programs to support high-growth companies, including various co-investment programs. These aimed to unlock £20 billion of patient capital investment into innovative firms over ten years. The initiatives included:

- increasing total direct R&D spending to £12.3 billion per annum by 2021-22;
- establishing a new £2.5 billion Investment Fund incubated in the British Business Bank;
- investing in a series of private sector fund of funds, starting with an initial commitment of £500 million; and
- backing new and emerging fund managers through the Enterprise Capital Fund program, unlocking at least £1.5 billion of new investment.

More recently, in response to the COVID-19 pandemic, the UK government announced an additional program, the £500 million co-investment 'Future Fund'. An additional £750 million was made available specifically for R&D focused small businesses in the form of grants and loans. Similar schemes were implemented in mainland Europe, with France announcing a €4 billion package alongside Germany's €2 billion package.[18]

In an ideal scenario, the Commonwealth's response to support the industry would include a range of measures, as seen by the UK response.

[17] Canadian Venture Capital Catalyst Initiatives

[18] Financial Times (2020) *Government launches £1.25bn plan to help struggling UK start-ups*, 20 April