AUSTRALIAN INVESTMENT COUNCIL

18 September 2019

The Secretary
Joint Standing Committee on Trade and Investment Growth
PO Box 6021
Parliament House
CANBERRA ACT 2600

By email:

Re: Submission Supporting Australia's exports and attracting investment

The Australian Investment Council welcomes the opportunity to contribute to the inquiry by the Joint Standing Committee on Trade and Investment Growth into supporting Australia's exports and attracting investment.

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 and 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.

Private capital fund managers invest billions of dollars into Australian companies every year. For the first time in history, Australian-based private equity (PE) and venture capital (VC) funds under management topped $30 billion in 2018, testament to the growth in available capital to support investment into businesses across every industry sector of the economy. Fund managers secured an impressive $6.6 billion in new investment commitments over the past year, which means the industry has a combined total of $11 billion ready to deploy over the next few years.

These figures highlight just how attractive the private capital market is to both local and global investors. Private capital investment offers an opportunity to provide smart capital to privately backed companies in a relatively low risk environment.

More and more businesses are choosing to raise capital from private investors today, rather than through public markets, because of the benefits of partnering with venture, private equity and private credit firms. Private capital investors can help unlock the growth and expansion opportunities of businesses through active asset management, in a way that public markets simply cannot.

Industry as a whole also has a role to play in informing and engaging with the Government on important issues that will help to improve the productivity and competitiveness of businesses domestically and internationally. This includes the private capital investment industry, which invests in a wide range of Australian businesses, be they early stage tech startups, or long-established agricultural or manufacturing businesses. In particular, our PE and VC fund manager members seek to invest in high-growth companies that use that invested capital to expand their workforce, increase sales growth and invest in highly innovative and market-leading research and development.

Policy recommendations aimed at enabling these scale-up businesses to succeed and become internationally competitive should be complemented by innovation-focused initiatives that can have a significant impact on Australia's broader economic transformation. These include creating the next wave of global, Australian-based businesses to drive our transition towards more highly skilled, well-paid jobs.

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This would follow on from a number of successful initiatives introduced by the Federal Government as part of the National Innovation and Science Agenda (NISA) such as new tax incentives for early stage investors; important reforms to the venture capital investment framework; and the creation of a Biomedical Translation Fund aimed at commercialising promising health and medical research.

Regulatory frameworks for foreign investment and superannuation funds; the research and development tax incentive; introduction of a new limited partnership collective investment framework; Government co-investment programs aimed at boosting investment into high growth Australian businesses; and reforms with respect to innovation policy are all areas of policy reform that should be prioritised in coming years, as part of working to establish a more productive knowledge-based Australian economy.

Ensuring that Australia has an internationally competitive policy environment is critical if we are to continue to enjoy a strong record of future economic growth and capitalise on the technological changes sweeping the globe.

Next Steps

We look forward to participating in any future discussions about the issues set out in this submission. If you would like to discuss further, please do not hesitate to contact me on 02 8243 7000.

Yours sincerely,

Yasser El-Ansary
Chief Executive

Responses to Terms of Reference

1. Understanding Australian businesses' ambitions to grow via export and attracting investment

Business is the key driver of economic activity in Australia. Sufficient levels of investment into business, across a variety of sources and forms of financing, are therefore necessary for our continuing economic success and prosperity. In our industry, businesses of all sizes rely on private capital funding – from startups, to small to medium-sized enterprises (SMEs), to large businesses.

Venture Capital

Some of the most promising developments for future economic growth are within the venture capital sector. These are companies at the early startup stage, as well high-growth companies – those that have graduated from the startup phase and are now expanding their workforce, increasing sales growth and investing in research and development.

In considering policy settings to enhance innovation, the Australian Innovation System Report 2017 (published by the Department of Industry, Innovation and Science) observed that there is considerable room to grow the local VC sector and to boost investment into high growth companies. Based on OECD data, Australian VC investment as a proportion of GDP continues to rank significantly below other OECD countries at 0.013% of GDP, compared to an OECD average of 0.054%.

While the Australian VC sector has enjoyed a resurgence over recent years (with FY2016 and FY2017 being consecutive record years of VC fundraising), there is considerable ground to make up.

The vast majority of domestic VC funding is currently raised from Australian investors. As the sector continues to grow and mature, foreign sources of capital may become as important to the companies that benefit from venture funding as it is for private equity and other sectors of the economy.

In more developed VC markets, venture funding provides other economic benefits. Evidence from 20 industries in the United States suggests that VC is three to four times more effective than corporate research and development at fostering innovation. Closer to home, Australian early stage life sciences companies have developed world-leading medicines and therapies, such as the bionic ear, that have improved the living standards of people here and around the world.

For venture capital, we can see the pronounced impact that foreign investment can have on our innovation sector and the need to attract foreign investment to our innovative companies, big and small.

As at 30 June 2018, the five largest public companies by market capitalisation were all VC-backed: Apple, Google, Microsoft, Amazon and Facebook. This statistic alone should serve as a reminder of the importance of this sector to the entire economy.

Recommendation 1: *Provide startups and SMEs with support through partnerships, grants and procurement*

Australia has seen a substantial growth in the number of corporates that have launched corporate venture capital (CVC) arms or innovation labs, marking their stakes as serious participants in the innovation ecosystem. We believe this can be further accelerated by incentivising more corporates to play a role as investors and customers. Government entities should also be encouraged to engage with startups and SMEs via targeted grants or other incentives such as partnerships or procurement agreements.

Recommendation 2: *Launch a Regional Innovation Fund*

This would stimulate and support the establishment and growth of startups, new businesses and industry sectors – such as Agritech – to catalyse economic growth in regional and rural areas of Australia.

Private Equity

Over the last few years, our domestic PE funds have become more reliant on capital sourced from offshore which is typically from large institutional investors such as pension funds or sovereign wealth funds. For example, over the three-year FY2015-17 period, 54% of capital raised by both Australian PE and VC funds came from offshore. For PE alone, that number was even higher with 83% of the total amount of capital raised by Australian PE funds sourced from offshore investors in FY2015 and FY2016.

An April 2018 study by Deloitte Access Economics provides some deeper insights into the economic contribution of private equity including:

- In FY2016, PE-backed businesses contributed **$43 billion in total value added** to the Australian economy – equal to **2.6% of Australian GDP**;
- PE-backed businesses **supported 327,000 FTE jobs** (172,000 directly, and 155,000 indirectly);
- In FY2016, PE-backed businesses added almost 20,000 FTE jobs, accounting for **11% of total Australian employment growth** in FY2016;
- PE-backed businesses typically delivered **annual revenue growth of 20%,** while boosting the size of their workforce by 24%;
- More than 85% of PE-backed businesses introduced some type of process or product innovation in FY2016, far greater than the average profile of non-PE backed businesses.

Attracting Investment

We have seen enormous benefits in our part of the economy from private capital investment into Australian businesses, in terms of growth in employment as well as driving more R&D and innovation. But there is no doubt that the benefits of investment in Australian business extend far wider than just the private capital sector.

Australian jobs and industry rely on a steady inflow of foreign capital to support investment into growing businesses across all sectors of the economy. It is estimated that 2.7 million Australian jobs rely on trade, while the average Australian family has benefitted by up to $3,900 each year because of trade.[1]

Some of Australia's largest private capital firms rely on offshore investors to raise their funds. Importantly, private capital funds from overseas invest into a range of small and large-scale businesses. Ensuring that the policy environment around foreign investment remains stable is one of the key ways in which Government can help maintain Australia's reputation as an attractive investment destination.

Recommendation 3: *Foreign investment framework*

Ensuring that the policy environment around foreign investment remains stable is one of the key ways in which the government can help maintain Australia's reputation as an attractive investment destination. Government should commit to maintaining policy certainty within the existing foreign investment framework, and make no unnecessary changes that would restrict future foreign investment into Australian private capital funds or businesses.

1 *10 Facts about Australian Trade,* produced by ACCI, APPEA, BCA, MCA, NFF; April 2017.

Recommendation 4: *Encourage equity co-investment*

The Australian Investment Council recommends that renewed consideration be given to government equity co-investment programs, modelled on the $500m Biomedical Translation Fund (BTF). The BTF is a prime example of federal government funding operating to attract private capital into a sector of the economy which otherwise would not attract adequate investment. Already, the money that was raised is beginning to be deployed into ground-breaking life science companies such as Saluda Medical, Certa Therapeutics, Aravax, and ProTA Therapeutics. Importantly, the government is not trying to pick winners at the individual company level but rather, back proven funds that can raise matching capital from the private sector.

Encouraging firms to export

International trade has for decades been a significant and important driver of Australia's economic development. The Australian Investment Council supports the government's announcement in the 2019-20 Federal Budget to provide $60 million over three years from 2019-20 to support Australian businesses exporting goods and services to overseas markets.

We believe government-funded agencies like Austrade can also help larger, mature high-growth companies through a more tailor-made approach to expanding into overseas markets. Austrade's services can be customised to the specific product or service, target market, scale, and management expertise of each scale-up company.

Recommendation 5: *Strengthen trading ties*

Government pursues the strengthening of trading ties regionally and globally, through bilateral and multilateral agreements and policy settings that seek to encourage trade and investment.

Recommendation 6: *Expanding Austrade's role*

In addition to providing a generic suite of tools to assist businesses in accessing new markets or sourcing investment, Austrade can also help larger, mature high-growth companies through a more tailor-made approach to expanding into overseas markets. Austrade's services can be customised to the specific product or service, target market, scale, and management expertise of each scale-up company. As companies grow, their capabilities and specific needs become more varied and complex. Enabling Austrade to provide a focused service approach to these companies, in terms of export know-how and investment readiness, would be one way of meeting those needs.

2. Identifying local regulatory barriers to businesses being able to realise their ambitions

Australia's growing private capital market can play a critical role in providing means to boost the future growth of early-stage and expansion-phase Australian businesses. From 2008 to 2018, Australian-based private equity and venture capital fund managers more than doubled their funds under management from $18.9 billion to $30 billion. However, private capital investment levels remain relatively small in Australia compared to other countries.

Policy recommendations aimed at enabling 'scale-up' businesses to succeed and become internationally competitive should be complemented by a new set of innovation-focused policy initiatives that can have a significant impact on Australia's broader economic transition including creating the next crop of global businesses out of Australia and driving a new wave of highly skilled, well-paid jobs.

This would follow on from a number of successful initiatives introduced by the Federal Government in December 2015 as part of the National Innovation and Science Agenda (NISA), such as new tax incentives for early stage investors; important reforms to the venture capital investment framework; and the creation of a Biomedical Translation Fund aimed at commercialising promising health and medical research.

The NISA was an important and welcome step change to the Government's approach to the innovation ecosystem. A new set of innovation policy measures would build on that approach and help to support the strong pipeline of capital available for investment into innovative Australian businesses, where more than $4 billion of VC fundraising has been recorded since the start of 2016.

Current Legal and Tax framework deters foreign investment

Beyond early stage companies, it is critical that scaling-up Australian businesses receive the capital they need to expand, hire more employees and compete globally. It is these 'scale-ups' that can be the catalyst for the next wave of national economic growth. In order to achieve this goal, important tax reforms will be necessary.

In particular, the introduction of a world best practice limited partnership collective investment vehicle would assist the flow of capital from PE and VC into these businesses. This would enable significantly higher levels of private investment into Australian businesses, leading to the flow-on effects of increased employment opportunities, revenue growth and economic output. As research has shown, private capital investment can be a significant driver of employment growth.

Australia's legal and tax framework for private capital investment is inconsistent with international best practice. It currently necessitates duplicate and complex structures and deters higher levels of foreign investment.

Further, consistency and certainty in the tax treatment of investors committing capital through existing vehicles should be provided in order to encourage domestic investment into high-growth businesses and attract offshore capital. This should apply to investors that provide capital through a number of different investment vehicles such as Venture Capital Limited Partnerships (VCLPs), Early Stage Venture Capital Limited Partnerships (ESVCLPs) or Managed Investment Trusts (MITs).

Recommendation 7- *Introduce measures to make Australia more competitive*

These would include:
a) extending the early stage tax incentives to allow corporate entities to invest in Early Stage Innovation Companies (ESICs) and ESVCLPs, and provide further incentives for corporates to engage with startups as investors and first and/or cornerstone customers;
b) adjusting ESVCLP settings to make them more attractive to investors;
c) encouraging government entities to engage (through partnerships, procurement agreements, etc.) with startups and SMEs via targeted grants or other incentives;
d) promoting open data initiatives, including open government data and other sources of information such as health, financial services beyond banking, education, and welfare;
e) opening up the Accelerating Commercialisation program to VC-backed companies; and
f) reforming equity incentive rules for founders and entrepreneurs who hold a significant equity stake in their company.

Recommendation 8: *R&D Tax incentive*

The R&D Tax Incentive is a critical element of the innovation and tax system which ensures that valuable R&D expenditure is carried out by Australian companies, and that those offshore companies that undertake R&D in Australia (such as clinical trials) continue to do so.

That the Government commit to and support earlier innovation reforms and measures that have had a net benefit to the innovation and early stage ecosystem, including making no further cuts or changes to the R&D Tax incentive.

The government should address recent uncertainty around the future settings of the scheme and a heavy-handed approach taken by the ATO and AusIndustry in the auditing of previous years' claims.

3. Identifying best practice regulation that evidence shows supports export and investment growth, whilst protecting the national interest

Skilled Visa Program

Australia is a net importer of not only capital but talent. Skilled migration has been a key component of Australia's migration system, playing an important role in generating economic growth for a number of decades. While Australia has had a long history of supportive policies to attract business entrepreneurs, 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 and entrepreneurs who will help generate new and sustainable business opportunities within the Australian economy.

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 easily available locally.

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

Recent changes to the 457 visa program for skilled migrants reduced the flow of talent to Australian companies. Within the technology sector, for example, the number of these types of visas granted for developers and programmers dropped 31%, along with a 50% drop for analyst programmers and a 10% drop for software engineers, from July to December 2017 compared to the same time in the year prior. In this context, Australia can do more to attract skilled migrants into key economic sectors that are facing skills shortage challenges.

Recommendation 9: *Talent Visas*

The Australian Investment Council believes that the government should introduce a talent visa program targeting entrepreneurs and other highly skilled professionals such as engineers, technology experts and scientists from overseas to boost the pool of talent available to startups and scale-ups. The Federal Government's recent announcement that the Global Talent - Employer Sponsored program will become permanent is an important first step in this process.

Recommendation 10: *Address labour shortages*

That the Government address current labour shortages by funding institutions that can develop and deliver courses for tertiary students aimed at fostering entrepreneurship and teaching digital STEM skills. The teaching of STEM skills should be embedded from primary school years through to tertiary education.

Retaining Ownership in Australia

Over the years, retaining ownership of Australian innovations and entrepreneurship has been a challenge as many fast-growing businesses have been forced to relocate offshore or to sell their technology to other markets. A lack of institutional-level funding has sometimes been the reason for that loss of intellectual property. The potential for private capital to drive productivity is evident in the decisions that other jurisdictions have taken in recent years to encourage the growth in this form of investment.

The Federal Government has recently outlined that it will undertake renewed regulatory reform to strengthen investment, and work with the business sector to identify barriers, blockages and bottlenecks to investment. Structural reforms are an especially important element to help revitalise the economy given the limited scope for fiscal stimulus. There are several areas of policy where targeted reforms could potentially unlock billions of dollars of private capital annually for investment into Australian businesses.

Recommendation 11: *Make long-term patient capital investment a policy priority*

With the Retirement Income Review pending, it would be timely for policy-makers to consider the role that long-term patient capital investment can play in creating our future economic drivers. As Australia's $2.8 trillion superannuation industry continues to grow, private capital – including private equity, venture capital and private credit – are investment streams being explored by super funds as they seek to diversify their portfolios and generate better returns. A review of the retirement incomes system will present an opportunity to explore how private and long-term patient capital can make a positive contribution towards the Australian economy.

Lessons from overseas

It is worthwhile to turn to examples from other jurisdictions to find other effective approaches that Australia can undertake for attracting more investment into our domestic businesses. Two examples are explored further below: Scotland and Singapore.

<u>Scotland</u>

In early 2016, Scotland released an action plan to increase trade and investment in Scotland called "*Global Scotland: trade and investment strategy 2016-2021"*.

The Scottish action plan also identified increasing the number of high-growth businesses as especially important, "as such businesses display higher levels of innovation and productivity than average and contribute disproportionately to employment and export growth." But these businesses face many of the same challenges that Australian SMEs confront – particularly access to appropriate capital.

Scotland's approach to improving access to finance for supporting company growth has primarily focused on business advice and support. However, the Scottish government has also established funds and bodies that are tasked with the specific goal of helping companies to fill their financing gaps. For example, the Scottish Investment Bank was set up in order to help companies identify appropriate sources of finance, engage with funders and secure the investment they need to grow their business. Over the 2017-18 annual period, the bank worked with over 35 investors based outside of Scotland, helped Scottish companies secure more than £105 million of international investment, and £275m of international sales were achieved by the bank's portfolio companies.

In 2015, Scotland also introduced the SME Holding Fund, which seeks to address the problems of access to finance specifically for SMEs with growth and export potential. The SME Holding Fund Advisory Group selects 'delivery agents', which are fund managers or trade bodies that manage the available capital in order to deliver on the objectives of the fund. To December 2017, the four appointed delivery agents' reported performance indicates that 330 companies had accessed £223 million under the fund, creating over 1,000 jobs in the process.

<u>Singapore</u>

Singapore formed one government agency in April 2018 to champion enterprise development – Enterprise Singapore. As part of its remit, it works towards growing Singapore as a hub for global trading and startups (thereby competing directly with Australia to attract startups in the Asia-Pacific region) as well as helping Singaporean companies internationalise.

Enterprise Singapore takes a business-centric approach to its services based on a company's stage of growth, the industry in which it operates, and the overseas markets of interest. The tailor-made approach to helping businesses is applied across some features of Enterprise Singapore's offering to companies that are looking to break out into new markets, such as its matching of companies with the right business partners in other markets and specialised tax advisory services.

A separate entity, the Singapore Economic Development Board, is responsible for attracting inbound investment into Singapore and for strategies that enhance Singapore's position as a global centre for business, innovation, and talent. It manages grants and tax incentives for global businesses that are seeking to establish themselves in Singapore.