The Senate

Economics Legislation Committee

Australian Business Growth Fund Bill [Provisions]

February 2020

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Chapter 1
Introduction

1.1 On Thursday 6 February 2020, the Senate referred the provisions of the Australian Business Growth Fund Bill 2019 (the bill) to the Economics Legislation Committee (the committee) for inquiry and report by 21 February 2020.[1]

Purpose of the bill

1.2 The bill authorises the Commonwealth to invest, alongside other financial institutions, in the Australian Business Growth Fund (the Fund).

1.3 The object of the bill is to increase investment in Australian small- and medium-sized enterprises (SMEs) by establishing a fund to provide patient capital to SMEs across a range of industries and locations.

1.4 The Treasurer, the Hon Josh Frydenberg MP, explained the purpose of the bill is to provide long-term equity finance and business guidance to eligible businesses:

> Small- and medium-sized businesses (SMEs) are a key driver of activity and growth in the Australian economy. SMEs generate employment, drive innovation and boost competition in markets. In 2016–17, there were over 2.2 million SMEs (those employing up to 199 employees) in Australia, accounting for around 68 per cent of private sector employment … A challenge for SMEs seeking to grow can be access to capital … Patient capital can provide entrepreneurs the finance needed to expand without relinquishing control of their business.[2]

1.5 A number of financial institutions are also involved in what is predicted to be an initial investment capacity of $540 million. National Australia Bank, Westpac, Commonwealth Bank of Australia and ANZ have agreed to commit $100 million each. Macquarie Group and HSBC will commit $20 million.[3]

Background

1.6 A growth fund for small and family businesses was announced on 23 April 2019 during the Federal election campaign.[4] On 27 November 2019,

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1 *Journals of the Senate*, No. 38, 6 February 2019, p. 1247.

2 The Hon Josh Frydenberg, Treasurer, *House of Representatives Hansard*, 5 December 2019, p. 7058.

3 The Hon Josh Frydenberg MP, Treasurer, 'Introducing legislation to establish the Australian Business Growth Fund', *Media Release*, 5 December 2019.

4 The Hon Scott Morrison MP, Prime Minister of Australia, 'Backing small and family businesses to grow and create jobs', *Media Release*, 23 April 2020; Philip Coorey, 'PM pledges $1b SME growth fund', *Financial Review*, 23 April 2019, https://www.afr.com/politics/pm-pledges-1b-sme-growth-fund-20190422-p51g98 (accessed 7 February 2020).

the Treasurer stated the government had agreed to terms with the participating financial institutions to establish the Fund.[5] These terms have not been made available.

1.7 As highlighted by the Treasurer in his second reading speech, the Reserve Bank of Australia (RBA) and the Australian Small Business and Family Enterprise Ombudsman (ASBFEO) have released reports discussing the difficulties SMEs face accessing finance—whether through attracting appropriately targeted equity investment or obtaining loans. These reports discussed banking institutions' lending to SMEs, and options to encourage longer-term equity finance such as patient capital.[6]

1.8 For some businesses, equity investment in the form of patient capital can have advantages over loans and venture capital, including:

- businesses do not have to realise immediate profits in order to repay debt; and
- businesses do not have to sell equity or cede control to professional investors who may have short investment horizons.[7]

Reserve Bank report on access to small business finance

1.9 Drawing upon insights provided by its Small Business Finance Advisory Panel, the RBA confirmed many small businesses looking to grow find it challenging to access finance, particularly without providing real estate as security. It stated there 'appears' to be a funding gap for established small businesses that cannot obtain additional debt finance or attract the limited supply of venture capital finance, though there was no discussion on the size of this gap or whether this constituted a market failure requiring Government intervention.[8]

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[5] The Hon Josh Frydenberg MP, Treasurer, Senator the Hon Michaelia Cash, Minister for Employment, Skills, Small and Family Business, 'Agreement to establish the $540 million Australian Business Growth Fund', *Media Release*, 27 November 2019.

[6] The Hon Josh Frydenberg, Treasurer, *House of Representatives Hansard*, 5 December 2019, p. 7058; Reserve Bank of Australia, 'Access to small business finance', *Bulletin*, September 2018; Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018.

[7] The Hon Josh Frydenberg, Treasurer, *House of Representatives Hansard*, 5 December 2019, p. 7058; Reserve Bank of Australia, 'Access to small business finance', *Bulletin*, September 2018; Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018.

[8] Reserve Bank of Australia, 'Access to small business finance', *Bulletin*, September 2018, pp. 1, 3, 6, 8.

1.10 A number of issues affect bank lending (debt finance) to SMEs, though of the SMEs that do apply for debt finance, nearly 90 per cent are successful.[9] Issues affecting bank lending to SMEs include:

- prudential capital requirements that reflect the higher risk of lending to SMEs; and
- obtaining the information required to accurately assess loans to SMEs.[10]

1.11 Although some businesses were reporting an increase in the number of approaches from private equity investors, the RBA stated these investors tended to specialise in particular industries and target a few businesses with high growth potential. Further, the supply of venture capital in Australia is small despite a significant increase in fund raising for venture capital in recent years, mainly from superannuation funds and government initiatives. Industry surveys suggest venture capital funds have been investing only around $500 million per year in around 100 companies.[11]

Reserve Bank findings

1.12 Importantly, the RBA made no recommendations. It did, however, briefly discuss several suggestions raised during its consultation that could potentially improve small business access to credit, including:

- improving the financial capability of small business owners who can have relatively low level financial knowledge or awareness of factors that can affect lenders' assessments of their creditworthiness;
- providing lenders with better information to make lending decisions (noting the upcoming comprehensive credit reporting regime and open banking would positively contribute);
- making it easier to use personal property or other assets (machinery and equipment) as security;
- establishing an Australian Business Growth Fund (as suggested by the ASBFEO); and
- government involvement in the supply of finance for small business (as suggested by the ASBFEO).[12]

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9 Productivity Commission, *Competition in the Australian financial system*, Productivity Commission Inquiry Report, No. 89, 29 June 2018, p. 435.

10 Reserve Bank of Australia, 'Access to small business finance', *Bulletin*, September 2018, pp. 6–7, 13. See also: Productivity Commission, *Competition in the Australian financial system*, Productivity Commission Inquiry Report, No. 89, 29 June 2018, pp. 175, 449–450; Australian Prudential Regulation Authority, 'Prudential standard APS 112 capital adequacy: Standardised approach to credit risk', *Banking (prudential standard) determination*, no. 2, 2018.

11 Reserve Bank of Australia, 'Access to small business finance', *Bulletin*, September 2018, p. 7.

12 Reserve Bank of Australia, 'Access to small business finance', *Bulletin*, September 2018, pp. 8–12.

Australian Small Business and Family Enterprise Ombudsman report

1.13 The ASBFEO stated in its report, *Affordable capital for SME growth*, that a combination of limited competition and a preoccupation with housing collateral to allay risk concerns had affected lending to SMEs. This, the ASFEBO states, has led to a market failure for those SMEs that have limited assets, other than a family home, to provide as security for a loan.[13]

1.14 The ASBFEO found SMEs have some options when looking to expand their businesses:

- debt capital from banks in the form of loans, generally for up to three years if they own real estate (typically the family home) and are willing to use it as security;
- short-term, low value and higher-cost capital from alternative lenders where the lender has access to the transaction history on business performance and has security over assets such as plant, equipment, stock and debtors; and
- crowdsource funding or private shareholder investment giving investors equity in the business.[14]

1.15 However, it is of the view there are shortcomings in the approach banks take to lending to SMEs, and the availability and nature of equity investment is not optimal for many SMEs.[15]

Equity investment

1.16 The Ombudsman highlighted several characteristics of equity investment that often make it an unattractive option for SMEs. Equity investors:

- require SMEs to divest partial or full control of the business;
- tend to have an investment time limit and look to sell their shares for a profit within that time;
- typically take a targeted approach to the market, seeking established businesses that can be taken on a high-growth path; and
- do not want to invest in large parts of the SME marketplace.[16]

1.17 One form of equity investment is patient capital. However, the Ombudsman found there is a limited supply of patient capital for SME growth.[17] No figures were put on the unmet demand for patient capital.

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[13] Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018, pp. 11-12.

[14] Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018, p. 5.

[15] Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018.

[16] Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018, p. 9.

1.18 The ASBFEO made eight recommendations to improve SME access to finance, including that a business growth fund be established to operate commercially and independent of government:

> The private sector to establish an investment fund focussed on long-term funding solutions for SMEs. The fund will offer both debt (loans) and equity (investment) to support SME growth. SMEs can apply for amounts between $250,000 and $5 million, with terms up to seven years, secured against the business.[18]

1.19 Equity would be available in the form of purchasing shares in a business taking a non-controlling interest. The fund would also provide mentoring, coaching and access to expert staff to help SMEs maximise the benefits of the patient capital investment. An initial pool of $1.5 billion in capital could be sourced from the Future Fund, superannuation funds, and banks. It noted the model provided by the UK Business Growth Fund and the Canadian Business Growth Fund.[19]

1.20 The ASFBEO also recommended:

- the government establish a guarantee scheme for member banks to draw on as a form of security (rather than requiring real estate) for loans to SMEs;
- the government establish a capital enhancement fund to provide tier two capital instruments to banks to address the funding differential between tier one banks and other banks;[20]
- a change in APRA risk weightings; and
- SMEs work with advisers to get their businesses finance-ready.[21]

Other business growth funds

1.21 The Treasurer noted business growth funds currently operate in the United Kingdom and Canada, and the Australian Business Growth Fund would be modelled on these established equivalents.[22] The Treasury identified

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17 Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018, p. 7.

18 Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018, pp. 7, 14.

19 Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018, pp. 14–15.

20 In 2019, the Australian Government established the Australian Business Securitisation Fund to invest up to $2 billion in warehousing and the securitisation market, providing additional funding to smaller banks and non-bank lenders to on-lend to small businesses on more competitive terms. Treasury, *Australian Business Securitisation Fund*, https://treasury.gov.au/small-business/absf (accessed 17 February 2020).

21 Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018, p. 7.

22 The Hon Josh Frydenberg, Treasurer, *House of Representatives Hansard*, 5 December 2019, p. 7058.

these funds as the UK's Business Growth Fund and the Canadian Business Growth Fund.[23]

United Kingdom—Business Growth Fund

1.22 The Business Growth Fund was established following a 2009 review commissioned by the UK Department for Business Innovation and Skills into the provision of growth capital to small and medium sized enterprises (known as the Rowlands review after its chair, Chris Rowlands).[24]

1.23 The Rowlands review identified a gap in the availability of (non-leveraged) finance for profitable growing firms for investments below £10 million—so-called growth capital (the Rowlands review does not mention 'patient capital').[25]

1.24 The review defined growth capital as funding that allows established firms to expand; it can be debt from traditional sources such as banks, or equity or equity-type investments. What differentiates growth capital from other types of investment is its level of risk. The report stated:

> It is positioned between the two extremes of high-risk high-return pure equity investment and lower risk, usually fully secured, bank lending. Growth capital involves moderate risk with some security and, as a result, providers expect a moderate return.[26]

1.25 In 2011, the Business Growth Fund was set up as an independent investment company with financial backing from Barclays, HSBC, Lloyds, RBS, and Standard Chartered. It was authorised and registered with the Financial Conduct Authority (FCA).[27]

1.26 By 2012, it had invested £100 million, growing to £500 million in 2015, and £1 billion in 2016. It has offices in 14 locations and has invested in almost 300 private and public companies across a variety of industries, including energy, oil and gas, life sciences, healthcare, and education.[28]

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23 The Treasury, *Business growth fund*, https://treasury.gov.au/small-business/bgf (accessed 10 February 2020).

24 HM Treasury, *Financing growth in innovative firms: Consultation*, August 2017, p. 53.

25 UK Department for Business Innovation and Skills, *The provision of growth capital to UK small and medium sized enterprises*, 23 November 2009, p. 3.

26 UK Department for Business Innovation and Skills, *The provision of growth capital to UK small and medium sized enterprises*, 23 November 2009, p. 3.

27 The FCA is the UK's financial conduct regulator for financial services firms and financial markets. The FCA also has some prudential responsibilities. Business Growth Fund, *About us*, https://www.bgf.co.uk/about-us/ (accessed 10 February 2020); Financial Conduct Authority, *About the FCA*, 30 July 2019, https://www.fca.org.uk/about/the-fca (accessed 10 February 2020).

28 Business Growth Fund, *About us*, https://www.bgf.co.uk/about-us/ (accessed 10 February 2020); Business Growth Fund, *Portfolio*, https://www.bgf.co.uk/our-portfolio/ (accessed 10 February 2020).

1.27 The BGF provides equity and loans to businesses, as well as business advice and assistance. It takes a minority partnership in a business and does not impose funding cycles or exit deadlines. Initial investments are typically between £2 million and £10 million, with potential follow-on funding.[29] There is little accessible information available on the performance of the BGF fund or its return to shareholders.

UK patient capital review

1.28 Five years after the Business Growth Fund was established, the UK Prime Minister announced a patient capital review in November 2016, recognising the lack of patient capital to support SMEs.

1.29 The UK government defines patient capital as 'long-term investment in innovative firms led by ambitious entrepreneurs who want to build large-scale businesses'. Patient capital supports business owners and investors to make a return from the growth of a business rather than through short-term profits from low-risk projects. The investment time horizon varies depending on the sector: from 3 to 5 years to as long as 10 to 15 years. It is crucial in sectors that require substantial investment by new firms before a financial return is made, for instance firms without existing revenues looking to commercialise research and development (R&D).[30]

1.30 The review examined the extent of the need for patient capital in the UK:

> Only some firms need patient capital to grow to scale. External equity finance is used by about 1% of the UK small business population and use by firms that fit into the standard policy definition of 'high-growth' has been estimated to be between 4% and 14%.
>
> External equity becomes much more important to firms with ambitious plans for growth and those focusing on the commercialisation of technology, where revenues often lag investment significantly. For example, nearly half of high-growth technology firms use external equity finance and external equity investment becomes essential for firms without existing revenues looking to commercialise R&D.
>
> These innovative firms have a disproportionate impact on productivity through the new ideas that they commercialise and bring to market.[31]

1.31 In 2017, the UK Treasury published a report on its consultation and recommended, amongst other things, the establishment of a national investment fund to channel new investment into patient capital. This would require some government support, and several models were discussed.[32]

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29 Business Growth Fund, *Growth funding*, https://www.bgf.co.uk/what-we-do/ (accessed 10 February 2020).

30 HM Treasury, *Financing growth in innovative firms: Consultation*, August 2017, pp. 9–10.

31 HM Treasury, *Financing growth in innovative firms: Consultation*, August 2017, p. 9.

32 HM Treasury, *Financing growth in innovative firms: Consultation*, August 2017, pp. 3–6, 51–60.

1.32 The report stated:

> Government investment can crowd in private investment into patient capital if it is seen to signal good potential investments. By making 'cornerstone' investments into funds, it can also reduce some of the information asymmetries that hold back private investment.[33]

Government response to patient capital review

1.33 Amongst other measures to assist SMEs access capital, the UK government undertook to set up a dedicated subsidiary of the British Business Bank (a state-owned economic development bank) to become a leading investor in patient capital across the UK. The intention for the fund was that it would be privatised once it demonstrated a sufficient track record.[34]

1.34 The subsidiary would provide transparency to other investors about its investment strategy and returns, and capitalised with £2.5 billion in government funding. Private investment is expected to be £7.5 billion.[35]

British Patient Capital

1.35 British Patient Capital was established in June 2018 as a wholly owned commercial subsidiary of the British Business Bank. Its 2019 annual report states it currently has £2.5 billion of funds to invest and is aiming to bring a further £5 billion in patient capital investment over the next decade. During 2018–19, it committed £334 million to five venture funds and seven venture growth funds. At the end of the year, its portfolio consisted of 31 fund investments with total commitments of almost £600 million.[36]

1.36 Although it reported an 8.2 per cent return on capital, this included a return on a seed portfolio of investments acquired from British Business Investments (a commercial subsidiary of the British Business Bank).[37]

Canadian Business Growth Fund

1.37 The Canadian Business Growth Fund was established following a recommendation from the Canadian Minister of Finance's Advisory Council on Economic Growth (the council) in its *Unlocking innovation to drive scale and growth* report.[38]

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33 HM Treasury, *Financing growth in innovative firms: Consultation*, August 2017, p. 52.

34 HM Treasury, *Financing growth in innovative firms: Consultation response*, November 2017, pp. 16–17.

35 HM Treasury, *Financing growth in innovative firms: Consultation response*, November 2017, pp. 16–17.

36 British Patient Capital, *Investing in ambition: Annual report and accounts 2019*, September 2019, p. 2.

37 British Patient Capital, *Investing in ambition: Annual report and accounts 2019*, September 2019, p. 12

38 Government of Canada, *Advisory Council on Economic Growth*, August 2017, https://www.budget.gc.ca/aceg-ccce/home-accueil-en.html (accessed 10 February 2020); Advisory Council on Economic Growth, *Unlocking innovation to drive scale and growth*, 6 February 2017, pp. 19, 24.

1.38 The council recommended the government encourage the private sector to establish one or more business growth funds to provide patient capital for high-growth businesses through minority equity or loans for SMEs. The fund/s would consist of pre-committed capital from Canada's leading banks and financial institutions and receive 'appropriate capital treatment under the current Office of the Superintendent of Financial Institutions (OSFI) regulations'.[39]

1.39 It called on the Canadian government to play a role by highlighting the potential capital need; convening and coordinating the different sources of capital; and clarifying the capital treatment for investments. The council recommended the fund would serve firms seeking deals between C$7.5 million and $25 million, but would target established revenue-generating firms looking to finance their next phase of growth with capital injections of between $10 million and $20 million.[40]

1.40 The council made clear it was favourable capital treatment for this type of growth capital that would encourage financial institutions to invest together. The council noted the UK Business Growth Fund had required regulators only to lighten capital requirements on the committed funds and this was permitted under Canadian prudential regulations.[41]

1.41 The council estimated there was a C$200 million to C$350 million annual gap in financing for high-growth firms with at least C$10 million in revenue. To avoid creating an oversupply of capital in the market, the council suggested launching the fund with a total size of approximately C $1 billion. This would address the conservative C$200 million estimate of the expansion-stage capital gap over five years.[42]

1.42 The Canadian Business Growth Fund was launched in June 2018 with an initial commitment of $545 million from 13 banks and insurers. Its aim is to make investments between $3 million and $20 million in established mid-market companies with $5 million or more in annual revenue, a demonstrated growth trajectory, and a clear vision for accelerated growth. It seeks ownership stakes

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39 Advisory Council on Economic Growth, *Unlocking innovation to drive scale and growth*, 6 February 2017, p. 24.

40 Advisory Council on Economic Growth, *Unlocking innovation to drive scale and growth*, 6 February 2017, p. 24.

41 These capital rules are set by the Office of the Superintendent of Financial Institutions. Advisory Council on Economic Growth, *Unlocking innovation to drive scale and growth*, 6 February 2017, p. 24.

42 Advisory Council on Economic Growth, *Unlocking innovation to drive scale and growth*, 6 February 2017, pp. 24–25.

of between 10 per cent and 40 per cent. In its first year, the fund completed two transactions, with an aim to complete five to seven in its second year.[43]

1.43 There is little easily accessible information available on the financial performance of this fund.

Provisions of the bill

1.44 The purpose of the bill is to authorise investment by the Commonwealth in the Australian Business Growth Fund. This will allow the Australian government to participate, together with other investors, in the Fund.

1.45 Although it will invest in the Fund, the bill specifies the Commonwealth cannot control the Fund. There is no detail in the bill on how the Fund will be structured or operate, or on its investment mandate, because the Fund will be established under the *Corporations Act 2001* as a privately controlled company. Although the bill delegates rule-making power to the Minister, the Minister cannot control the Fund.

1.46 The bill has three parts:

- Part 1 contains preliminary details and definitions;
- Part 2 provides for the Commonwealth to invest in the Fund and make arrangements with regard to the Fund; and
- Part 3 makes a number of provisions, including an appropriation of the Consolidated Revenue Fund, rule-making power, and other administrative provisions.

1.47 The following summarises the key provisions of the bill.

Part 1—Preliminary provisions

Clause 3—Object of the Act

1.48 Clause three contains the object of the Act:

> The object of this Act is to increase investment in small and medium Australian enterprises by the Commonwealth participating in, and investing in (together with other persons), the Australian Business Growth Fund in accordance with this Act.

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[43] Geoff Zochodne, 'Growth fund backed by big banks looking to pick up the pace of investment', *Financial Post*, 21 May 2019, https://business.financialpost.com/news/fp-street/growth-fund-backed-by-big-banks-looking-to-pick-up-the-pace-of-investment (accessed 10 February 2020); Business Growth Fund, *Canadian Business Growth Fund announces first investment*, 4 October 2018, https://www.bgf.co.uk/canadian-business-growth-fund-announces-first-investment/ (accessed 10 February 2020).

Part 2—Commonwealth investment in the Australian Business Growth Fund

Clause 9—Simplified outline

1.49 Clause 9 outlines the purpose of Part 2: to allow the Commonwealth to invest in a *Corporations Act* company (which will become the Australian Business Growth Fund) for the purpose of providing small and medium Australian enterprises with access to capital.

1.50 While the Commonwealth may make arrangements relating to the operations of the Fund, it cannot control the Fund.

Clause 10—Commonwealth investment in the Australian Business Growth Fund

1.51 The Bill provides that the Fund is formed when the relevant Minister, on behalf of the Commonwealth, takes any of the following actions in relation to a company formed under the *Corporations Act 2001*:

- participates in forming the company;
- acquires shares (either by purchase or subscription) in a company, or becomes a member of the company; or
- acquires debentures of a company.

1.52 These actions can only be taken with respect to one such company.

1.53 The Parliamentary Library explains:

> It is important to note that the bill does not establish the company that will be formed as the Fund. Prior to being formed as the Fund, the relevant entity will be established as a company under the existing requirements relating to incorporation under the *Corporations Act*. It is only once the Minister takes one of the above actions that the company will become the Fund.
>
> As such the bill can be seen as providing the authority for the Commonwealth to invest in the Fund, as opposed to facilitating the establishment of the entity itself. The investment in the Fund does not sit neatly within the existing categories of authorised investment provided for under the *Public Governance, Performance and Accountability Act 2013* (PGPA Act), and so the bill is likely required to provide this authority.[44]

Clause 11—Arrangements relating to the operation of the Fund

1.54 Clause 11 allows the Minister to make arrangements with the Fund, a member of the Fund, or a subsidiary of the Fund with regard to the operation of the Fund. These arrangements cannot result in the Fund becoming a Commonwealth company.

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[44] Rodney Bogaards and Kaushik Ramesh, Australian Business Growth Fund Bill 2019, *Bills Digest*, No. 79, 2019–20, Parliamentary Library, Canberra, 2020, pp. 11–12.

Clause 12—Minister has powers of the Commonwealth

1.55 Under clause 12, the Minister would have the rights, responsibilities, duties and powers associated with being a member or shareholder of the Fund, holding debentures or being a party to arrangements relating to the operation of the Fund.

Clause 13—Constitutional limits

1.56 Clause 13 relates to the power of the Parliament under the Constitution to make laws. It requires certain arrangements to be made before the Fund makes any investment. These arrangements include that the Fund can only apply money received from the Commonwealth:

- with respect to trade or commerce between Australia and places outside Australia, among the states, or within and between the states and territories; and
- with respect to a Territory.

1.57 If these arrangements are not in place, the Minister must take steps to divest the Commonwealth of its investment in the Fund.

1.58 The bill's explanatory memorandum (EM) explains these provisions are not intended to prevent the Fund from generating a commercial return.[45]

Clause 14—Fund not to become a Commonwealth company

1.59 Clause 14 specifies that the Minister must ensure the Fund does not become a Commonwealth company.

1.60 In effect, this means the Minister must ensure the Commonwealth:

- does not control the composition of the Fund's board;
- is not in a position to cast, or control the casting of, more than one half of the maximum number of votes that might be cast at a general meeting of the Fund; and
- does not hold more than one half of the issued share capital of the Fund, unless it is share capital that carries no right to participate beyond a specified amount in a distribution of either profits or capital.[46]

Clause 16—Rules about the exercise of powers

1.61 Under clause 16, the rules can make provisions for the exercise of rights, responsibilities, duties and powers by the Minister under the Act.

Part 3—Miscellaneous

1.62 Part 3 makes a range of miscellaneous provisions and contains the general rule-making power for the minister.

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45 *Explanatory memorandum*, Australian Business Growth Fund Bill 2019, p. 10.

46 *Explanatory memorandum*, Australian Business Growth Fund Bill 2019, p. 10.

Clause 18—Appropriation of Consolidated Revenue Fund

1.63 Under clause 18, $100 million is appropriated from the Consolidated Revenue Fund for the following costs or expenses:

- participating in the formation of the fund;
- acquisition of shares or debentures (either by purchase or subscription);
- paying amounts payable under clause 11; and
- any other costs, expenses or obligations in connection with the Fund.

1.64 If no amount has been debited against the appropriation after two years from the date of the Act's commencement, the appropriation ceases to have effect.

1.65 The bill's EM states if any amount is debited within two years, there is no time limit on debiting any remaining amounts of the $100 million appropriation.[47]

Clause 19—Delegations by the Minister

1.66 Other than rule-making powers, the Minister may delegate, by written instrument, the Minister's powers or functions under the Act to the Secretary of the Department of the Treasury or an SES employee of the Treasury.

1.67 The delegate must comply with any directions of the Minister.

Clause 20—Annual report

1.68 The annual report of the Treasury must include a report on the operation of the Act.

Clause 21—Review of the operation of the Act

1.69 A review must be taken, as soon as possible, after the third anniversary of the commencement of the Act. The review must include a review of the effectiveness of the Act in increasing investment in small and medium Australian enterprises. It must be tabled in the Parliament.

Clause 22—Rules

1.70 The Minister may, by legislative instrument, make rules prescribing the matters required or permitted by the Act, or necessary or convenient to be prescribed for carrying out or giving effect to the Act.

1.71 The rules may not:

- create an offence or civil penalty;
- provide powers of arrest, detention, entry, search or seizure;
- impose a tax;
- set an amount to be appropriated from the Consolidated Revenue Fund; or
- directly amend the text of the Act.

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[47] *Explanatory memorandum*, Australian Business Growth Fund Bill 2019, p. 11.

Commencement

1.72 The whole of the Act commences the day after the Act receives Royal Assent.

Consultation on the exposure draft of the bill

1.73 The Treasury undertook a consultation on the exposure draft of the bill between 4 November and 8 November 2019. Thirteen submissions were received. Minor changes were made to the bill prior to its introduction in the House of Representatives.[48]

Financial impact

1.74 The bill's EM states the establishment of an Australian Business Growth Fund is estimated to have the following financial impact:

Table 1.1 Financial Impact: Establishing the Fund

2019–20	2020–21	2021–22	2022–23
..	-$0.1m	-$0.4m	-$0.8m

Source: Explanatory Memorandum

Legislative scrutiny

1.75 The bill was considered by the Senate Standing Committee for the Scrutiny of Bills, which had no comment.[49]

Human rights implications

1.76 The EM states the bill does not raise any human rights issues.

1.77 The Parliamentary Joint Committee on Human Rights examined the bill and had no comments.[50]

Regulatory impact

1.78 No information was provided on the regulatory impact of the proposed legislation.

Conduct of the inquiry

1.79 The committee advertised the inquiry on its website and wrote to relevant stakeholders and interested parties inviting submissions by 17 February 2020.

48 The Treasury, *Consultation—Australian Business Growth Fund Bill 2019*, https://treasury.gov.au/consultation/c2019-29670 (accessed 7 February 2020).

49 Senate Standing Committee for the Scrutiny of Bills, *Scrutiny Digest 1/2020*, 5 February 2020, p. 41.

50 Parliamentary Joint Committee on Human Rights, *Report 1 of 2020*, 5 February 2020.

1.80 The committee received: 13 submissions; five supplementary submissions; answers to questions on notice; and additional information. These are listed at Appendix 1.

1.81 The committee held one public hearing for the inquiry on Thursday 13 February 2020. The names of witnesses who appeared at the hearing can be found at Appendix 2.

Chapter 2
Views on the bill

2.1 This chapter summarises evidence provided to the committee in submissions and during the public hearing. The committee received several submissions that supported the bill and its intent to increase investment in Australian small- and medium-size enterprises (SMEs) through the Australian Business Growth Fund (the Fund).

2.2 Other submissions and evidence discussed issues in the following areas:

- whether there is market failure in the supply of equity to SMEs that has to be rectified;
- the need for government investment;
- compliance with the competitive neutrality policy and the prudential treatment for contributions to the Fund;
- targeting of SMEs;
- the lack of detail on the investment mandate and governance arrangements; and
- the evaluation process.

Support for the bill

2.3 The Australian Banking Association, the National Australia Bank, and ANZ supported the bill.[1] The National Australia Bank stated the Fund would support economic growth and employment by giving SMEs greater access to long-term equity capital that will help them grow, invest in new technology, and create more jobs. The Fund would also offer the Bank the opportunity to refer its customers who are looking to grow and expand with equity financing to the Fund.[2]

2.4 Titomic submitted to the inquiry that investment from the Fund has the potential to support Australia becoming a global leader in advanced technology, and many SMEs can do a lot more with the support of investors:

> Innovative SMEs, like us, need investors who have patience beyond the usual 18 months attention span and invest for the long run as they do in the UK or the US.
>
> When Titomic first listed on the ASX, we had just developed a patent on an additive manufacturing process using Titanium, developed with the CSIRO. It was an exciting opportunity but it took time to develop a skilled workforce, a warehouse, a national and global clientele and investors who

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1 Australian Banking Association, *Submission 6*, p. 1; National Australia Bank, *Submission 11*, p. 1; ANZ, *Submission 8*, p. 2.

2 National Australia Bank, *Submission 11*, p. 1.

> shared our long term visions for us, as an innovative defence industry export business.[3]

2.5 The Australian Small Business and Family Enterprise Ombudsman (ASBFEO) also supported the bill, stating:

> The purpose of the ABGF [the Fund] is to provide small and family enterprises with patient capital over 5–10 years. For this to be effective, a planned exit strategy is required to work with the owners who retain long term control. The ABGF is the most effective model for delivering this outcome.[4]

Broad views on the bill

Market conditions for equity investment

2.6 The committee heard from a number of witnesses that there was a funding 'gap' in the market for established small businesses that cannot access either debt finance or equity capital. Some characterised this inability to access capital on terms more favourable than those offered for standard debt finance as a 'market failure' requiring government intervention, while others stated the current landscape was clear evidence the market was working efficiently.[5]

2.7 The Australian Small Business and Family Enterprise Ombudsman, Ms Kate Carnell, told the committee:

> … the feedback from small to medium businesses in Australia was that there was a huge funding gap, particularly for fast-growth businesses that needed more than half a million dollars … the private equity market in Australia, which we looked at quite heavily, is fairly new and fairly immature. There is good access … to capital for very fast-growth potential businesses that are in a position to grow incredibly quickly and then sell or go to IPO quickly. Now, that's a very small group of businesses, so access to patient capital in the Australian SME market is really small.[6]

2.8 Furthermore, the ASBFEO stated that this lack of access to capital for SMEs is a market failure. The Ombudsman argues the limited competition and the markets' risk-weighted appetite focussing on real estate collateral limits lending to SMEs and as such could be seen as inefficient, leading to sub-optimal economic outcomes.[7]

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3 Titomic, *Submission 10*, pp. 1–2.

4 Australian Small Business and Family Enterprise Ombudsman, *Submission 9*, p. [1].

5 See: *Committee Hansard*, 13 February 2020.

6 Ms Kate Carnell, Ombudsman, Australian Small Business and Family Enterprise Ombudsman, *Committee Hansard*, 13 February 2020, p. 7.

7 Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018, pp. 7, 14.

2.9 The Productivity Commission, in its 2018 publication, *Competition in the Australian financial system,* noted that SMEs that are successful in raising loans generally do so by mortgaging real estate (usually a house). At the time, it noted nearly 90 per cent of SMEs that decided to apply for debt finance were successful.[8]

2.10 The National Australia Bank stated that from its observations and feedback from customers, SMEs find it difficult to attract patient [long-term] equity investment without taking on additional debt or relinquishing control of their business.[9]

2.11 Titomic, in its submission to the committee, identified a number of issues in the provision of capital, including:

- early stage technology firms find it difficult to attract start-up funding;
- if firms decide to IPO through the Australian Stock Exchange, investors expect a return within 12 to 18 months; and
- many investment organisations have strict guidelines for the firms in which they will invest.[10]

2.12 The Reserve Bank of Australia (RBA) stated some small businesses looking to grow find it challenging to access finance, particularly without providing real estate as security. It said 'there appears to be funding gap for established small businesses that cannot obtain additional debt finance or attract the limited supply of venture capital finance'.[11] As noted previously, the RBA did not identify the size of this gap or recommend any policy response.

2.13 On-Market BookBuilds CEO, Mr Ben Bucknell, an operator of one platform for SME capital raising, questioned the quality of the evidence of market failure. Mr Ben Bucknell stated it was not clear:

- how many SMEs in Australia fall into the $2 million to $100 million turnover category; and
- are seeking minority long-term investment from the private sector; and
- have been unsuccessful.[12]

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8 Productivity Commission, *Competition in the Australian financial system*, Productivity Commission Inquiry Report, No. 89, 29 June 2018, p. 435.

9 National Australia Bank, *Submission 11*, p. 1.

10 Titomic, *Submission 10*, p. 2.

11 Reserve Bank of Australia, 'Access to small business finance', *Bulletin*, September 2018, pp. 1, 3, 6, 8. See also: Reserve Bank of Australia, *Inquiry into Australian Business Growth Fund Bill 2019*, additional information received 17 February 2020, p. 1.

12 Mr Ben Bucknell, Chief Executive Officer, On-Market BookBuilds, *Committee Hansard*, 13 February 2020, pp. 2–3; On-Market BookBuilds, *Supplementary Submission 2.1*, pp. 6–7.

2.14 Treasury acknowledged there is no quality data on small business finance to properly quantify the issues affecting SMEs. As a consequence, when providing advice to government, it relied heavily upon the work of other third party institutions on the availability and constraints on small business funding. This included the RBA, ASBFEO, private sector analysis of funding gaps, surveys of small business access to finance, and roundtable events.[13]

2.15 Mr Ben Bucknell stated there are established ways for companies to gain equity capital through the market, and he was of the view no case for market failure has been made.[14]

2.16 Professor Paul Latimer also questioned whether the evidence of market failure reflected contemporary circumstances.[15]

Government role in the market

2.17 In his second reading speech, the Treasurer stated the Fund is modelled on the established UK and Canadian equivalents 'where a company collectively owned by financial institutions provides long-term capital and business guidance to small- and medium-sized businesses'.[16]

2.18 When making its recommendation for a growth fund, the ASBFEO specified clearly:

> The private sector to establish an investment fund focussed on long-term funding solutions for SMEs. The fund will offer both debt (loans) and equity (investment) to support SME growth. SMEs can apply for amounts between $250,000 and $5 million, with terms up to seven years, secured against the business.[17]

2.19 The Fund, as announced by the government in 2019, will obtain $100 million from the government (approximately 19 per cent of its initial capital), and consequent of the Fund being established as an independent entity under the *Corporations Act*, the government will not have the ability to direct the use of this capital.[18]

2.20 The committee heard that while the UK and Canadian growth funds were essentially established for similar reasons—to address a gap in the availability of (non-leveraged) finance for profitable growing firms—neither growth fund

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13 Treasury, answers to questions on notice, 13 February 2020, received 17 February 2020, pp. 2–3.

14 Mr Ben Bucknell, Chief Executive Officer, On-Market BookBuilds, *Committee Hansard*, 13 February 2020, pp. 2–3.

15 Professor Paul Latimer, *Submission 4*, p. 2.

16 The Hon Josh Frydenberg, Treasurer, *House of Representatives Hansard*, 5 December 2019, p. 7058.

17 Australian Small Business and Family Enterprise Ombudsman, *Affordable capital for SME growth*, June 2018, pp. 7, 14.

18 *Explanatory memorandum*, Australian Business Growth Fund Bill 2019.

received any government funding and both have operated successfully without government funds.[19] Both funds were also open to any investors to take part in the ventures.

2.21 Five years after the establishment of the UK Business Growth Fund, however, the UK government identified a lack of patient capital to support SMEs. Following a review, the UK established a dedicated 'British Patient Capital' fund in June 2018, which is a wholly owned commercial subsidiary of the British Business Bank (a state-owned economic development bank). British Patient Capital is not authorised or regulated by the Prudential Regulation Authority or the Financial Conduct Authority.[20]

2.22 As discussed in chapter 1, the aim with this fund is that it becomes a leading investor in patient capital across the UK. Once established, and having demonstrated a sufficient track record, the intention is for it to be privatised.[21]

2.23 Because early efforts to interest the major Australian banks in providing long-term patient capital had not been successful, the Australian Small Business and Family Enterprise Ombudsman stated in her evidence to the committee, the government now needs to take a leadership position and intervene in the market.[22] Ms Carnell said:

> … banks in Australia haven't been involved in equity financing … a number of years ago ANZ put a toe in the water, which wasn't all that successful. The whole area of long-term patient capital is something that our banks have shied away from. Some of that's because of APRA requirements … at the moment, the banks are significantly better placed putting their money elsewhere. So it really needed government leadership here to get this fund over the line.[23]

2.24 The Treasury confirmed the government's intent was to provide leadership to stimulate and provide a catalyst for bank involvement.[24]

2.25 The Productivity Commission in 2019 drew attention to a trend for governments to provide project finance as a form of industry assistance,

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19 Mr Ben Bucknell, Chief Executive Officer, On-Market BookBuilds, *Committee Hansard*, 13 February 2020, p. 1.

20 HM Treasury, *Financing growth in innovative firms: Consultation response*, November 2017, pp. 16–17; British Business Bank, *Corporate information and subsidiary companies*, https://www.british-business-bank.co.uk/corporate-information/ (accessed 19 February 2020).

21 HM Treasury, *Financing growth in innovative firms: Consultation response*, November 2017, pp. 16–17.

22 Ms Kate Carnell, Ombudsman, Australian Small Business and Family Enterprise Ombudsman, *Committee Hansard*, 13 February 2020, p. 7.

23 Ms Kate Carnell, Ombudsman, Australian Small Business and Family Enterprise Ombudsman, *Committee Hansard*, 13 February 2020, p. 10.

24 Mr Warren Tease, Chief Adviser, Markets Group, Treasury, *Committee Hansard*, 13 February 2020, p. 15.

specifically identifying the Australian Business Growth Fund as an example of this trend. The commission stated:

> Large-scale finance vehicles have the potential to skew industry assistance to particular firms and projects with minimal public scrutiny until deals are done. These facilities often have the stated rationale to fill a 'market gap' for finance, and so necessarily extend finance on terms more favourable than available from commercial lenders.
>
> In general, though, Australia has relatively deep and liquid financial markets. The onus then is on proponents of taxpayer-funded financing of commercial projects to demonstrate how this would serve the public interest. Even where there is an in-principle argument for government assistance, proponents should also explain why financing is the best policy option.[25]

Competitive neutrality

2.26 Evidence received during the inquiry questioned whether the Fund would comply with the competitive neutrality policy of Australian governments. Mr Bucknell suggested the special prudential treatment given only to Fund members raised competitive neutrality issues and would have a detrimental impact on existing businesses in the equity finance market:

> A core tenet of that policy is that competitive neutrality requires that governments should not use their legislative or fiscal powers to advantage their own business over the private sector … Why should the banks only have to put aside 26.25c in the dollar, and how has competitive neutrality been addressed?[26]

2.27 The Australian Government's approach to implementing competitive neutrality is set out in its 1996 *Competitive Neutrality Policy Statement*, which requires:

> … that government business activities should not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership.[27]

2.28 According to the policy, for the purposes of competitive neutrality in the Commonwealth sector, to be considered a 'business activity' the following criteria must be met:

- there must be user-charging for goods or services (the user may be in the private sector or public sector) [this may be a return on investment];

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25 Productivity Commission, *Trade and assistance review 2017–18*, Productivity Commission Annual Report Series, June 2019, pp. 63–64.

26 Mr Ben Bucknell, Chief Executive Officer, On-Market BookBuilds, *Committee Hansard*, 13 February 2020, p. 2. See also: Professor Paul Latimer, *Submission 4*, p. 2.

27 *Commonwealth Competitive Neutrality Policy Statement*, June 1996, p. 4.

- there must be an actual or potential competitor (either in the private or public sector) i.e. users are not restricted by law or policy from choosing alternative sources of supply; and
- managers of the activity have a degree of independence in relation to the production or supply of the good or service and the price at which it is provided.[28]

2.29 The Australian Government Competitive Neutrality Complaints Office (AGCNCO)[29] provided the following advice:

> On the basis of information we have to date, it would appear that the BGF would meet each and all of these necessary criteria [for what constitutes a business]. Accordingly, the preliminary view of the AGCNCO is that it would qualify as a 'business' for the purpose of being subject to competitive neutrality policy.[30]

2.30 With regard to the whether the Fund meets the test for what constitutes a government business activity, the AGCNCO stated:

> … it has been the AGCNCO's position that any level of Australian Government ownership in a significant business activity is sufficient to render it subject to competitive neutrality policy and the complaints mechanism.
>
> On this basis, the AGCNCO's preliminary view is that the Australian Government's near 20 per cent share of the BGF would mean that this is a government business for the purpose of being subject to competitive neutrality policy.
>
> This means that the BGF would be subject to the competitive neutrality requirements for tax, debt and regulatory neutrality, for full cost pricing and for earning a commercial rate of return. It also means the business would also be subject to the competitive neutrality complaints mechanism.[31]

2.31 The bill's explanatory memorandum states clauses 13(1)–13(3), with regard to Constitutional authority, are not intended to prevent the Fund from generating

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[28] *Commonwealth Competitive Neutrality Policy Statement*, June 1996, p. 7.

[29] The Australian Government Competitive Neutrality Complaints Office is a separate unit within the Productivity Commission that operates as the Australian Government's competitive neutrality complaints mechanism. It provides independent advice to the Government following its investigations into complaints about unfair competition from the public sector. See: Productivity Commission, *Competitive neutrality complaints*, https://www.pc.gov.au/about/core-functions/competitive-neutrality (accessed 19 February 2020).

[30] Australian Government Competitive Neutrality Complaints Office, *Preliminary AGCNCO advice on applicability of competitive neutrality to the Australian Business Growth Fund*, additional information received 20 February 2020.

[31] Australian Government Competitive Neutrality Complaints Office, *Preliminary AGCNCO advice on applicability of competitive neutrality to the Australian Business Growth Fund*, additional information received 20 February 2020.

a commercial return.[32] Further, Treasury confirmed all investments made by the Fund will be made on a commercial basis with an expected return on investment.[33]

Regulatory treatment for contributions to the fund

2.32 It was reported that during initial discussions with the government, the banks had stated the Fund could not be commercially viable without a softening of the capital deductions for banks' equity investments.[34]

2.33 On 9 December 2019, APRA announced publicly it was adjusting its capital framework for authorised deposit-taking institutions (ADIs) to support the establishment of the Fund.[35]

2.34 An ADI investing in the Fund will be able to apply a risk weight of 250 per cent to their investment. This compares to the current requirement that equity investments by banks be fully deducted from their regulatory capital. An ADI will be able to invest up to 2 per cent of its Level 1 CET1 capital in the Fund.[36]

2.35 In effect, this reduction in the risk weighting allows participating ADIs to treat high-risk equity investments made through the Fund as loans (that is, debt funded) and improves the commercial return to ADIs participating in the Fund.[37]

2.36 This treatment is not available for other funds or non-participating ADIs. APRA stated it would give special treatment to the Fund because:

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32 *Explanatory memorandum*, Australian Business Growth Fund Bill 2019, p. 10.

33 Treasury, *Application of the policy of competitive neutrality to the Australian Business Growth Fund*, additional information received 19 February 2020, p. 1.

34 John Kehoe, 'APRA opens door to SME growth fund', *Financial Review*, 6 December 2018.

35 Australian Prudential Regulation Authority, 'Capital treatment of investments in the Australian Business Growth Fund, Letters', *Letters, notes and advice*, 9 December 2019, https://www.apra.gov.au/capital-treatment-of-investments-australian-business-growth-fund (accessed 14 February 2020).

36 Australian Prudential Regulation Authority, 'Capital treatment of investments in the Australian Business Growth Fund, Letters', *Letters, notes and advice*, 9 December 2019, https://www.apra.gov.au/capital-treatment-of-investments-australian-business-growth-fund (accessed 14 February 2020); Reserve Bank of Australia, 'Access to small business finance', *Bulletin*, September 2018, p. 11; Rodney Bogaards and Kaushik Ramesh, Australian Business Growth Fund Bill 2019, *Bills Digest*, No. 79, 2019–20, Parliamentary Library, Canberra, 2020, p. 5; Ms Heidi Richards, Executive Director, Policy and Advice, Australian Prudential Regulation Authority, *Committee Hansard*, 13 February 2020, pp. 13–14.

37 Adam Creighton, 'Cosy plan will allow banks to cream off even more cash', The Australian, 26 November 2019; Rodney Bogaards and Kaushik Ramesh, Australian Business Growth Fund Bill 2019, *Bills Digest*, No. 79, 2019–20, Parliamentary Library, Canberra, 2020, p. 5; On-Market BookBuilds, *Submission 2*, p. 8, Appendix 1 p. 2.

- the wider financial system benefits that would come from increasing access to financing for SMEs; and
- the Australian Government was a founding shareholder.[38]

2.37 Treasury officials acknowledged APRA was providing a risk-weighted capital ratio to the Fund that is 'less onerous than the one that exists for equity investments at the moment'.[39] However, it is of the view this does not constitute a subsidy or cheap financing. Mr Tease told the committee:

> … the issue of competition is, I would say, exaggerated in this point, because APRA is not providing a significant subsidy to the banks.[40]

2.38 The AGCNCO acknowledged assessing the value of this treatment would be a necessary next step in assessing competitive neutrality implications. It stated:

> Subject to the preliminary assessment … that BGF would be subject to competitive neutrality policy, the second step for a valid complaint would be whether and to what degree BGF would be afforded an advantage through its treatment with regard to prudential regulations.[41]

2.39 Treasury stated the Fund had been designed to minimise potential detrimental effects on competition 'in a manner consistent with achieving competitive neutrality as much as possible'.[42]

2.40 Treasury acknowledged APRA is applying a risk weight of 250 per cent to an ADI's investment in the ABGF. This is below the current full deduction for Common Equity Tier 1 capital for equity investments and the effect of this treatment is to reduce the cost of capital for participating ADI's investment in the Fund.[43]

2.41 Treasury also stated the impact on competition and competitive neutrality is mitigated by a number of factors, including:

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38 Australian Prudential Regulation Authority, 'Capital treatment of investments in the Australian Business Growth Fund, Letters', *Letters, notes and advice*, 9 December 2019, https://www.apra.gov.au/capital-treatment-of-investments-australian-business-growth-fund (accessed 14 February 2020).

39 Mr Warren Tease, Chief Adviser, Markets Group, Treasury, *Committee Hansard*, 13 February 2020, p. 17.

40 Mr Warren Tease, Chief Adviser, Markets Group, Treasury, *Committee Hansard*, 13 February 2020, p. 17.

41 Australian Government Competitive Neutrality Complaints Office, *Preliminary AGCNCO advice on applicability of competitive neutrality to the Australian Business Growth Fund*, additional information received 20 February 2020.

42 Treasury, *Application of the policy of competitive neutrality to the Australian Business Growth Fund*, additional information received 19 February 2020, p. 1.

43 Treasury, *Application of the policy of competitive neutrality to the Australian Business Growth Fund*, additional information received 19 February 2020, p. 1.

- Non-regulated investors in the SME market are not subject to APRA's capital requirements so do not face the same additional increment to their cost of capital as ADIs. Their funding costs are subject to market forces reflecting the risks and characteristics of their businesses …
- Partly to ensure that other ADIs can receive the same risk treatment and access to patient equity investment opportunities as founding shareholders, the ABGF will remain open to ADI and other investors over time.[44]

2.42 Mr Ben Bucknell stated the prudential changes gave an advantage to the Fund, 'This provides them with an enormously lower cost of capital—I would say in the mid single digits. No-one else in the market can compete with that'.[45]

Existing capital-raising businesses

2.43 The committee was presented with conflicting views on whether the Fund would crowd-out existing SME capital-raising businesses. Disagreement stemmed from two issues:

- uncertainty as to the size of the 'investable universe' (the number of SMEs that will be eligible) in comparison to the size of the SME capital market and the number of investments the Fund will make; and
- whether the Fund would cherry pick the best investments rather than increase the availability of capital funding.

Investable universe

2.44 According to government announcements, to be eligible for Fund equity, small businesses will have to demonstrate:

- three years of revenue growth;
- annual revenue between $2 million and $100 million;
- profitability; and
- clear growth vision.[46]

2.45 Further, the Fund is aimed at SMEs who either are not receiving sufficient external funding or are obtaining a form of funding that is not well suited to

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[44] Treasury, *Application of the policy of competitive neutrality to the Australian Business Growth Fund*, additional information received 19 February 2020, p. 1.

[45] Mr Ben Bucknell, Chief Executive Officer, On-Market BookBuilds, *Committee Hansard*, 13 February 2020, p. 2.

[46] The Hon Josh Frydenberg, Treasurer, *House of Representatives Hansard*, 5 December 2019, p. 7058; The Hon Josh Frydenberg, Treasurer, and Senator the Hon Michaelia Cash, Minister for Employment, Skills, Small and Family Business, 'Agreement to establish the $540 million Australian Business Growth Fund' *Media Release*, 27 November 2019; Liberal Party of Australia, *Our plan to back small business*, https://www.liberal.org.au/our-plan-back-small-business (accessed 17 February 2020).

their businesses.[47] It is not clear, though, whether a requirement to this effect may be in the Fund's investment mandate if one is produced.

2.46 Although acknowledging an absence of quality data on small business finance, the Treasury provided an estimate from Australian Tax Office (ATO) data that a pool of 40,000 small businesses would satisfy the investment criteria of the Fund.[48] It is not clear, however, whether this is businesses who satisfy the $2 million–$100 million turnover requirement only, or who satisfy this turnover requirement, have three years of revenue growth, are seeking long-term patient capital investment, and are unable to receive sufficient or appropriate funding for their business.

2.47 In combination with the fact the Fund will make only 30 to 50 investments each year (around 0.12 per cent of the estimated 40,000) when it is in full operation, Treasury officials stated the Fund would meet the need of only a 'small fraction' of the estimated investable universe and there is 'little to no risk of crowding out'.[49]

2.48 The ASBFEO conversely estimated the pool to be around 200,000 SMEs with a turnover of between $2 million and $100 million. The Ombudsman stated it would be about eight per cent of businesses (around 16,000) that would benefit from the Fund as they have:

> growth potential but don't fit into the slot of short-term private equity investment and can't get the sort of money they need from the banks or, for that matter, the fintech sector.[50]

2.49 In the view of the Ombudsman, the small number of investments that will be made by the Fund, and the absence of a market for these particular companies, means it is not possible for the Fund to skew the market.[51]

2.50 However, Mr Bucknell submitted to the committee there was no robust research on the size of the investable universe that met all criteria and were the SMEs being targeted by the Fund: turnover between $2 million and $100 million; revenue growth for three years; profitability; inability to obtain equity from the private sector. He suggested if all these criteria were taken into consideration, the number could be as low as around 5,000 companies, though independent research is required.[52]

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47 Treasury, answers to questions on notice, 13 February 2020, received 17 February 2020, p. 3.

48 Treasury, answers to questions on notice, 13 February 2020, received 17 February 2020, p. 3.

49 Treasury, answers to questions on notice, 13 February 2020, received 17 February 2020, p. 3.

50 Ms Kate Carnell, Ombudsman, Australian Small Business and Family Enterprise Ombudsman, *Committee Hansard*, 13 February 2020, pp. 7, 10.

51 Ms Kate Carnell, Ombudsman, Australian Small Business and Family Enterprise Ombudsman, *Committee Hansard*, 13 February 2020, pp. 7, 9.

52 On-Market BookBuilds, *Supplementary Submission 2.1*, pp. 6–7.

2.51 Further he argued there is an existing established market for SME equity capital investment—citing his business which has 50,000 investors investing in minority positions in SMEs by buying perpetual ordinary equity instruments.[53]

2.52 Mr Bucknell also told the committee that in 2019, there were 67 IPOs in the market. His company had involvement in around 30 per cent. His company has been approached by more than 400 SMEs seeking equity finance, of the 148 for which it has attempted to raise equity, 80 per cent have been successful.[54]

Selection of SMEs

2.53 The committee heard there is concern about the capacity of the Fund to attract the better SME investments in the market, thereby crowding out existing businesses and not leading to an increase in SME investment.

2.54 Mr Bucknell submitted the Fund will be able to compete with existing capital raising businesses by: offering more attractive terms; and by offering more competitive finance as a consequence of the relaxed prudential arrangements not available to others in the market.

2.55 Existing private sector equity (venture capital) often requires listing on the ASX with associated disclosure, corporate governance and other reporting requirements. Exit strategies for venture capital are also required.[55]

2.56 In contrast, recipients of equity from the Fund will acquire government-and-bank-backed long-term equity investment and may not have to offer shares to public investors, accede to governance requirements of the ASX, or abide by venture capital exit requirements and terms.[56]

2.57 On-Market BookBuilds argued the prudential concessions provided by APRA will allow the Fund to give superior market terms to SMEs. This will allow the Fund to choose the most attractive SMEs in which to invest.[57] Mr Bucknell stated:

> It would be natural for SMEs to choose to go to the BGF first. The reason for that is that the BGF has the lowest cost of capital, which has been artificially created through the change of APRA ratios and the government's $100 million. They will go there because they have a pool of $540 million that's ready to deploy.[58]

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53 On-Market BookBuilds, *Supplementary Submission 2.1*, p. 7.

54 Mr Ben Bucknell, Chief Executive Officer, On-Market BookBuilds, *Committee Hansard*, 13 February 2020, p. 6; On-Market BookBuilds, *Supplementary Submission 2.1*, p. 4.

55 On-Market BookBuilds, *Submission 2*, pp. 2–3, 11.

56 On-Market BookBuilds, *Submission 2*, pp. 4–9.

57 On-Market BookBuilds, *Submission 2*, pp. 2–3.

58 Mr Ben Bucknell, Chief Executive Officer, On-Market BookBuilds, *Committee Hansard*, 13 February 2020, p. 2.

2.58 As to the effect on existing businesses, Mr Bucknell explained:

> If the ten best SME raisings, bearing in mind the BGF is targeting 10 to 30 per year, are cherry-picked by the BGF, then we cannot in good faith put out BGF rejects for the rest of the market to invest in … not only because that would be ethically questionable but also because it would be economically unsustainable.
>
> Because of the positive skew, the top performers in our portfolio bring the average up and bring the returns up. The positive skew means that the average return is positive but the median return is negative, so more companies go down than up. It's just that those that go up in value go up spectacularly. So, in terms of our business, it wold be very difficult to continue under our current business model.[59]

2.59 Mr Bucknell estimated equity crowdfunding intermediaries in the United Kingdom have suffered accumulated losses of around $80 million while trying to compete against the UK Business Growth Fund. He suggested this was evidence it is unsustainable to offer 'BGF rejects' to the public.[60]

2.60 In response, Treasury argued the Fund would provide services largely absent from the market rather than displace existing funders:

> … concerns about 'cherry picking' or 'crowding out' have an implicit assumption that the SME universe is fully funded and that a new entrant like the ABGF [the Fund] will displace other investors or leave those investors access to a limited number of SMEs. This is inconsistent with current market conditions of funding constraints …
>
> The starting point in Australia is one of a general funding gap for SMEs, a predominance of debt funding, limited access to equity funding, or the provision of equity funding via venture capital or private equity firms that did not suit the needs of many SMEs, particularly those whose owners wish to retain control of their businesses and who desire a long-term funding source.[61]

Availability of capital for SMEs

2.61 Submissions to the inquiry suggested the Fund will target SMEs who can already access capital on commercial terms and will not lead to an increase in SME funding.[62]

2.62 Digital Finance Analytics provided a summary of the SME sector, including:

- 91.3 per cent have an annual turnover of less than $2 million each year;

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59 Mr Ben Bucknell, Chief Executive Officer, On-Market BookBuilds, *Committee Hansard*, 13 February 2020, p. 5.

60 On-Market BookBuilds, *Supplementary Submission 2.1*, pp. 3–4.

61 Treasury, answers to questions on notice, 13 February 2020, received 17 February 2020, pp. 3–5.

62 Digital Finance Analytics, *Submission 1*, pp. 3–4; On-Market BookBuilds, *Submission 2*, pp. 1–3; On-Market BookBuilds, *Supplementary Submission 2.1*, p. 2.

- most low-turnover businesses are unincorporated—businesses with larger turnovers are more likely to be formed as a company; and
- nearly half of all SMEs have been trading for less than 4 years.[63]

2.63 Digital Finance Analytics stated their research indicates the Fund target segment is small and can already obtain funding for expansion. It further stated:

> It seems that this is more orientated to offer investors and the financial sector a return, than being shaped best to provide support for those small businesses which need assistance the most. The small number of transaction envisaged will not assist many businesses, and the target is clearly not the bulk of those with real funding needs.[64]

Investment mandate and governance arrangements

2.64 Some concern was raised about the lack of detail on how the Fund will operate, including:

- how it will be legally constituted;
- the standards of conduct, accountability and integrity that will be followed in the awarding of finance;
- how profits or losses will be shared;
- the investment mandate;
- the relationship between the Fund and the business lending of the funders that might give rise to conflicts of interest; and
- conflict resolution.[65]

2.65 Treasury confirmed the legal arrangements for the Fund, including the investment mandate and the governance arrangements provided for in the Shareholders' Agreement, would not be made public as they included legal specifications sensitive to the investment posture and commercial arrangements of the proposed shareholders.[66]

2.66 However, Mr Tease sought to assure the committee the governance arrangements would protect the Commonwealth. He stated:

> There will be a board formed. Each of the major shareholders will nominate a director, and there will be a number of independent directors. The role of the board will be to oversee the management of the Fund to make sure that the money is being managed in a way that is consistent with the investment mandate and with the legislative requirements for the Fund.

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63 Digital Finance Analytics, *Submission 1*, pp. 2–3.

64 Digital Finance Analytics, *Submission 1*, p. 4.

65 Professor Paul Latimer, *Submission 4*, pp. 2–4; Dr Yongqiang Li, *Submission 7*, p. [1]; *Committee Hansard*, 13 February 2020, pp. 18–24.

66 Treasury, answers to questions on notice, 13 February 2020, received 17 February 2020, p. 6.

> The board's role will be to appoint a CEO, who will oversee the appointment of the investment teams. The investment teams, led by an investment committee, will manage the money according to an investment mandate.[67]

2.67 Treasury was able to provide some high-level detail on how the Fund would operate, noting the government would not control the fund:

> The fund will be set up with an investment mandate, and that mandate will define the characteristics of the types of small businesses that the staff of the business growth fund can invest in. Those characteristics are that they have revenue between $2 million and $100 million, that they want funding of minority stakes between 10 and 40 per cent, that they have a track record in revenue growth and profitability, and that they require funding of a certain stage. So that will define a subset of small businesses that will fit into that category, and the investments will be made in a diverse way across the country and also across industries.[68]

2.68 Treasury confirmed its annual report will include a report on the operation of the legislation.[69] It is not clear how much information on the performance of the Fund will be disclosed in this report.

Evaluation

2.69 The bill requires there to be a review of the operation of the Act after three years. The Tax and Transfer Policy Institute raised concern that the evaluation be embedded in the policy proposal, a principle the government committed to in its response to the Thodey review of the Australian Public Service. The Institute recommended:

- there be a budget for a rigorous evaluation;
- the evaluation be conducted by an independent panel of experts with the majority drawn from academia; and
- the evaluation strategy and data infrastructure be designed alongside the implementation of the fund.[70]

2.70 It stated evaluations conducted subsequent to implementation are not always able to obtain baseline measurements of the outcomes that were to be impacted, making it difficult to form a basis of comparison:

> Evaluations conducted 'ex post' may also have trouble forming accurate measures of program outcomes and have to resort to whatever data is available rather than those that the program was intended to impact.[71]

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67 Mr Warren Tease, Chief Adviser, Markets Group, Treasury, *Committee Hansard*, 13 February 2020, pp. 20–21.

68 Mr Warren Tease, Chief Adviser, Markets Group, Treasury, *Committee Hansard*, 13 February 2020, p. 16.

69 Treasury, answers to questions on notice, 13 February 2020, received 17 February 2020, p. 8.

70 Tax and Transfer Policy Institute, *Submission 5*, p. 1.

Committee view

2.71 The committee acknowledges that as an entity independent of government, many details about the Fund will not be publicly available. However, the Fund will be required to comply with prudential requirements and the provisions of the *Corporations Act*.

2.72 The committee also notes that other shareholders of the Fund are listed companies with a high level of corporate governance and compliance obligations.

2.73 The committee acknowledges concerns about the competitive neutrality implications of the bill. It encourages Treasury and APRA to consider those issues as the investment mandate and rules are developed, and to also continue to monitor the Fund as it grows and matures.

2.74 The committee is of the view the Fund, effectively targeted, may provide a source of patient capital to some SMEs and fill a potential gap in the market.

2.75 The committee also acknowledges the importance of these SMEs having vital access to capital to allow them to flourish and fulfil their potential, in turn leading to greater job creation and growth in the economy.

2.76 The committee encourages further work by agencies to develop a quality data set on small business finance to inform future policymaking with regard to support for Australian SMEs.

2.77 The committee notes the bill allows for a review to take place after the Act's third anniversary. Considering that the determination to return the funds to the Consolidated Revenue Fund occurs at two years if no funds are expended, see clause 18(2) of the bill, it would seem advisable to stage the review to coincide with this event.

2.78 The committee is of the view an understanding of how the Fund will operate in the market will be important to its success.

2.79 Given the unique structure of the Fund, and the government's investment, the committee notes that the successful operation of the Fund will depend on maintaining robust accountability and governance arrangements. Furthermore, the committee notes that reporting requirements, such as estimates and annual reports on the Fund, will be important for confidence in the government's involvement in the Fund.

Recommendation 1

2.80 The Committee recommends that shareholders, including the government, when developing the investment rules, consider the inclusion of provisions to allow for the underwriting of investments.

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71 Tax and Transfer Policy Institute, *Submission 5*, p. 2.

Recommendation 2

2.81 The Committee recommends that the bill be passed.

Senator Slade Brockman
Chair

Australian Greens Senators' Dissenting Report

1.1 One of the most striking trends in modern finance has been the shift in the profile of bank lending. Thirty years ago banks lent twice as much to businesses as they did for housing. Now it's the other way around, with banks now lending almost twice as much for housing as they do for business.[1]

1.2 This shift has been driven by a number of factors, including: the advent of mortgage-backed securities, which have turned housing into a liquid asset for banks; and tax incentives for investors that have increased the demand for housing.

1.3 However, a much overlooked factor is the incentive given to banks to lend for housing by prudential standards, specifically the requirements for the risk-weighting of assets. These standards are set internationally by the Basel Committee on Banking Supervision, and adopted locally by the Australian Prudential Regulation Authority (APRA). Since the Basel I Accord in 1988 there has been a lowering of the amount of regulatory capital that a bank must hold against mortgages, even more so for those banks authorised to adopt an internal risk-based (IRB) approach to establishing mortgage risk-weights.

1.4 The result of all this is that the cheapest money in history is going towards speculation in real estate more than it is going towards productive investment by businesses.

1.5 For small and medium sized enterprises (SMEs), the effect is doubly crippling. As well as skewing bank lending towards housing rather businesses, prudential standards skew bank lending towards business owners that own housing rather than business owners that don't. In other words: it's not the merit of the business that matters; it's whether they own land.

1.6 The Productivity Commission explains the effect this is having:

> Continued reliance on having a home as security for a business loan—in an era when home ownership in the key entrepreneurial period of life is at a low—will increasingly inhibit SME growth. Around one third of major bank SME loans, and often a higher proportion of smaller lender SME loans, are secured by a home.[2]

1.7 The Productivity Commission is clear on what the policy response should be:

[1] Productivity Commission, *Competition in the Australian financial system*, Productivity Commission Inquiry Report, No. 89, 29 June 2018.

[2] Productivity Commission, *Competition in the Australian financial system*, Productivity Commission Inquiry Report, No. 89, 29 June 2018. 32.

> … the reform that would most significantly improve SME access to finance [would] be changes to the underlying prudential requirements for SME business lending compared with lending for residential mortgages.[3]

1.8 The Productivity Commission also explains how the existing rules favour those banks with IRB accreditation:

> For SME loans, APRA currently applies a single risk weight (of 100%) to all SME lending not secured by a residence, with no delineation allowed for the size of borrowing, the form of borrowing (term loan, line of credit or overdraft) or the risk profile of the SME borrowing the funds … This means that most lenders are generally required to hold more regulatory capital than are lenders using IRB models and more than that required under the internationally agreed Basel requirements.
>
> As a consequence, <u>for a SME loan that is not secured by a residence, Australia's smaller banks need to hold up to twice as much capital as the major banks</u>—in effect, paying up to twice as much to be able to offer loans to their customers [emphasis added].[4]

1.9 This brings us to this bill. The ABGF will provide a concession on the risk-weighting of loans to SMEs for participating banks. The major banks and Macquarie are five of the six participating banks. The major banks and Macquarie also happen to be five of the six banks that are privileged in having IRB accreditation.

1.10 In other words, those banks that are already being given a competitive advantage through preferential prudential rules will be given a further competitive advantage through even more preferential prudential rules. Instead of providing the structural reform needed to direct capital towards more productive investment—including in the transformation to a low carbon economy—the ABGF will further entrench the market power of the major banks.

1.11 The government's rush to establish the ABGF is both very concerning and very telling. The two weeks given to this committee to conduct an inquiry into this bill was ridiculously short. This haste might be explained by the failure of the government to have gathered even the most basic of information about the market that ABGF is seeking to intervene in, let alone establish what the problem is and why the ABGF is a solution.

1.12 The government has been unable to provide to the committee adequate information on: the number and size of SMEs seeking access to equity finance; who is currently providing equity finance for SMEs; or why SMEs are or aren't getting access to equity finance. It follows that the government has not been

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3 Productivity Commission, *Competition in the Australian financial system – Final Report*, June 2018, p. 32.

4 Productivity Commission, *Competition in the Australian financial system – Final Report*, June 2018, p. 32.

able to identify the actual market failure the ABGF would address—the underlying bias in prudential regulations has not explicitly been identified by the government as a problem, which also explains why is has only been incompletely addressed, and only addressed at the expense of competition.

1.13 Further, Treasury did not invite non-bank and non-superannuation financers to participate in the roundtable to discuss the design of the ABGF. As a result, the government has not considered the proposal to instead use the ABGF to provide underwriting for equity financing from all sources, rather than simply giving the banks a leg-up over direct investors.

1.14 Much has been made by the government and the Small Business and Family Enterprise Ombudsman of the Reserve Bank of Australia (RBA) study into access to finance for SMEs. But, tellingly, while examining the concept of a business growth fund, the RBA did not specifically recommend the establishment of an ABGF as constructed by this bill.[5]

Conclusion

1.15 There is clearly a need for the government to act to help SMEs get better access to finance. But the ABGF is not the answer. The ABGF is a con. It neither harnesses the power of the market, nor makes a constructive government intervention. The ABGF is simply crony capitalism.

1.16 The ABGF will lower the cost of capital for SMEs, undoubtedly. But it will do so by providing a government subsidy for the major banks to cherry-pick the best SMEs. This is not in the long-term interest of SMEs, the investment environment, or the wider economy.

1.17 The Greens support government intervention in the banking system and even the direct financing of SMEs by government for particular purposes. The government took a step forward with the establishment of the Australian Small Business Securitisation Fund. But it would be taking a step backward with the establishment of the ABGF as currently constructed.

Recommendation 1

1.18 The Bill be opposed.

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[5] Reserve Bank of Australia, 'Access to small business finance', *Bulletin*, September 2018.

Recommendation 2

1.19 That the Council of Financial Regulators be directed to conduct an inquiry into the impact that prudential regulations are having on the supply of finance to small and medium sized enterprises.

Senator Peter Whish-Wilson
Participating Member

Additional Comments by Senator Rex Patrick

Of noble aim

1.1 The Australian Business Growth Fund Bill 2019 is designed to increase investment in Australian small- and medium-sized enterprises (SMEs) by establishing a fund to provide patient capital to SMEs across a range of industries and locations.

1.2 The bill's aim is noble. Its implementation comes with concerns.

The company that you keep

1.3 If this bill is passed into law, the government will partner, using $100 million of taxpayers' money, with the big four banks—ANZ, Commonwealth, NAB and Westpac—along with Macquarie Group and HSBC, to establish a $540 million Business Growth Fund. After the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, one might think the government would be a little more cautious about the company that it keeps and very meticulous about laying down very clear rules of engagement.

1.4 Memories in the Federal government appear to be short. Despite the very recent abhorrent conduct within the financial and banking sector, the government demonstrates a strong desire to jump into bed with the banks in circumstances where abstinence might be more appropriate.

1.5 The fact that the government will only own a 19 per cent stake in the venture and the banks will own 81 per cent is an important point. When this is considered in conjunction with the operation of clause 13 of the bill that prevents the government from controlling the composition of the Fund's board, it is clear that the big four banks will exercise effective control over the Fund.

1.6 As detailed in the main report, both the Business Growth Fund in the UK and the Canadian Business Growth Fund (from which the ABGF is purportedly modelled) does not involve investment of taxpayer money.

1.7 The UK Business Growth Fund was set up as an independent investment company with financial backing from Barclays, HSBC, Lloyds, RBS, and Standard Chartered. It was authorised by and registered with the UK's Financial Conduct Authority.

1.8 The Canadian Business Growth Fund was set up after encouragement by the Canadian government using pre-committed capital from Canada's leading banks and financial institutions and receives appropriate capital treatment under the current Office of the Superintendent of Financial Institutions (OSFI) regulations.

1.9 It is curious that the government feels a need to invest when it hasn’t been required in the UK and Canada. It is noted that a resolution is set to be voted on at the upcoming annual general meeting of the Commonwealth Bank which may prevent it from investing its intended $100 million in the Fund. When Treasury officials were asked what would happen if this resolution was passed they answered, '[the] Fund doesn't need $540 million'. This begs the question, if the Fund can be established without the Commonwealth Bank’s $100 million, why can’t it be established without the taxpayers' $100 million?

Recommendation 1

1.10 The Government should facilitate the establishment of an Australian Business Growth Fund without investing $100 million of taxpayers' money, similar to the arrangements in the UK and Canada.

Just trust us

1.11 Treasury indicated at the public hearing that governance arrangements and the investment mandate are yet to be finalised. These are likely to be finalised after the appointment of a board and CEO in mid-2020.

1.12 The Senate will be asked to vote on the commitment of $100 million of public money without an understanding of the governance arrangements for taxpayers’ money or, indeed, the Fund’s investment mandate.

1.13 It is further noted that there will be very limited Parliamentary oversight once the fund is constituted.

Recommendation 2

1.14 The Senate should not proceed to vote on this legislation until such time as it is informed as to the governance arrangements of the $100 million of taxpayers' money and the investment mandated for its use.

Competitive neutrality breach

1.15 As indicated in the main body of this report, the Australian Government has had a Competitive Neutrality Policy in place since 1996. It appears from preliminary advice provided to the committee by the Australian Government Competitive Neutrality Complaints Office (AGCNCO) that the ABGF will be so organised to bring it within the complaints jurisdiction of the AGCNCO.

1.16 It is highly likely on the establishment of the ABGF that a complaint will be lodged with the AGCNCO in respect of breaches of competitive neutrality. There is also a strong likelihood that the ABGF will fall foul of the Australian Government’s Competitive Neutrality Policy.

1.17 It is advisable that the AGCNCO be asked to examine whether the ABGF will operate within the government's long established Competitive Neutrality Policy.

Recommendation 3

1.18 The Senate should not vote on this legislation until such time as the Australian Government Competitive Neutrality Complaints Office has established that the ABGF will operate within the government's long established Competitive Neutrality Policy.

Investment for all Australians

1.19 At present, the ABGF permits investment by the participating entities: the banks and the government. 'Mum and Dad' investors and indeed all Australians would be excluded from participating and benefiting from investment in SMEs.

1.20 The Australian Shareholders Association expresses a concern that the ABFG 'could lead to the disenfranchisement of retail investors by excluding them from investing in SMEs that otherwise would have conducted an Initial Public Offering on the ASX'.

1.21 A remedy to this would be a modification to the Fund whereby it is permitted to underwrite, partially-underwrite, or sub-underwrite equity for SMEs. Such an approach would permit all Australians (and not just the banks) to have the opportunity to invest in high-growth companies that are guaranteed by the ABGF.

1.22 Whilst this proposition was put to Treasury, it was not properly examined.

Recommendation 4

1.23 That analysis is carried out on repurposing the Fund to allow it to underwrite, partially-underwrite, or sub-underwrite equity for SMEs.

Adverse Outcomes

1.24 Evidence was presented to the committee by the Chief Executive Officer of On-Market BookBuilds Pty Ltd, Mr Bucknell. His company has 50,000 investors on its books and has raised capital for more than 150 companies. One hundred and twenty-five of those were SMEs that fall within the definition used by the ABGF. From those 50,000 investors, the company has raised over $100 million of equity capital directly which in turn has facilitated $2 billion of institutional co-investment.

1.25 Mr Bucknell raised a serious concern:

> We do about 40 SME equity raising per year. So, if you take out the top 10 performers of that because the BGF cherry picks that, then there's a negative return. Effectively, what you're doing is taking away the returns

> from other investors. It would be natural for SMEs to choose to go to the BGF first. The reason for that is that the BGF has the lowest cost of capital, which has been artificially created through the change of APRA ratios and the government's $100 million. They will go there because they have a pool of $540 million that's ready to deploy. This means that the rest of the market will be left with BGF rejects. As the fund is currently intended to fund 10 SMEs in its first few years, raising to 30, the effect would be that you would fund 10 SMEs from the BGF and not be able to fund 40 from the private market, so we would actually have a reduction.[1]

1.26 This perspective is concerning and failed to be addressed by officials in their submissions or evidence to the committee.

Recommendation 5

1.27 Treasury should examine the proposition that has been put and make available the results of that analysis to senators before the legislation is voted on.

Senator Rex Patrick
Member

[1] Mr Ben Bucknell, Chief Executive Officer, On-Market BookBuilds, *Committee Hansard*, 13 February 2020, p. 2.

Appendix 1
Submissions and additional information

Submissions

1 Digital Finance Analytics

2 OnMarket BookBuilds

- 2.1 Supplementary to submission 2
- Response to supplementary submission 2.1 from the Australian Small Business and Family Enterprise Ombudsman
- Response to supplementary submission 2.1 from the Treasury
- 2.2 Supplementary to submission 2
- 2.3 Supplementary to submission 2
- 2.4 Supplementary to submission 2
- 2.5 Supplementary to submission 2

3 Australian Shareholders' Association

4 Professor Paul Latimer

5 Tax and Transfer Policy Institute, ANU

6 Australian Banking Association

7 Dr Yongqiang Li

8 Australia and New Zealand Banking Group Limited

9 Australian Small Business and Family Enterprise Ombudsman

10 Titomic Limited

11 National Australia Bank

12 HSBC Bank Australia Limited

13 Australian Chamber of Commerce and Industry

Additional Information

1 Additional information provided by the Reserve Bank of Australia, 17 February 2020

2 Additional information provided by Treasury on 19 February 2020 on the application of the policy of Competitive Neutrality to the Australian Business Growth Fund

3 Additional information provided by the Australian Government Competitive Neutrality Complaints Office on the applicability of competitive neutrality to the Australian Business Growth Fund on the 20 February 2020

Answers to Questions on Notice

1 Treasury response to questions on notice for hearing 13 February 2020 in Canberra

Appendix 2
Public hearings

Thursday, 13 February 2020
Committee Room 2R1
Parliament House
Canberra

On-Market BookBuilds

- Mr Ben Bucknell, Chief Executive Officer and Co-founder

Australian Small Business and Family Enterprise Ombudsman

- Ms Kate Carnell, Ombudsman

Australian Prudential Regulation Authority

- Ms Heidi Richards, Executive Director, Policy and Advice
- Ms Katrina Squires, General Manager, Policy and Advice

Treasury

- Mr Warren Tease, Chief Adviser, Markets Group
- Mr Ben Crabb, Senior Adviser, Markets Group