Australian Private Equity &
Venture Capital Association Limited

Email: migrant.intake@pc.gov.au

23 December 2015

Dear Sir/Madam,

Submission to the Productivity Commission Draft Report on Migrant Intake into Australia

The Australian Private Equity and Venture Capital Association Ltd (AVCAL) welcomes the opportunity to provide input into the Productivity Commission's draft report on Migrant Intake into Australia.

AVCAL represents the venture capital (VC) and private equity (PE) industry in Australia, which has a combined total of over $28 billion in funds under management for domestic and offshore investors, of which $2.6 billion is managed by Australian VC managers.

It is worth noting at the outset that AVCAL is very supportive of the July 2015 changes made by the Government to the Significant Investor Visa (SIV) program to boost the flow of much-needed capital into key high growth sectors within the Australian economy.

In our view, these changes have the potential to deliver significant benefits to the Australian economy and the community more broadly. It is disappointing, therefore, that the Productivity Commission's draft report draws a number of conclusions in respect of the SIV program which appear to be based on a fundamental misunderstanding of the role of venture capital in our economy, incomplete information, and errors in the analysis of key data points.

What is particularly concerning to us is that the Productivity Commission did not seek any input from AVCAL – as one of a small number of key stakeholder groups in this area of policy – during the initial phases of work as part of this inquiry. A more comprehensive consultation process in the earlier part of the work would have provided the Commission with information which we believe would have assisted in the preparation of a more thorough analysis of the key policy and economic issues relevant to the SIV program in the draft report.

In recent days, AVCAL has taken the opportunity to provide evidence to the Productivity Commission during its public hearings consultation process. This written submission provides further additional information which we trust will be helpful for the Commission's next phases of work under this inquiry.

If you would like to discuss any aspect of this submission further, please do not hesitate to contact me or Dr Kar Mei Tang on (02) 8243 7000.

Yours sincerely

Yasser El-Ansary
Chief Executive

AVCAL SUBMISSION

1. Measuring the economic impact of the SIV program

The draft report states:

"The SIV and PIV streams could lead to economic benefits if complying investment reduces the cost of capital to Australian businesses. This could happen if the existence of these streams leads to investment that would not have otherwise occurred. However, there are reasons to be sceptical about whether these visas have a material effect on investment in Australia. First there is the matter of scale. According to the DIBP annual report for 2013-14: Since November 2012, 286 SIVs have been granted to primary applicants, resulting in $1430 million being injected into the Australian economy. (2014b, p. 36) To put that figure in perspective, in the year ended 31 December 2014 foreign investment in Australia was $261 billion The SIV stream makes a trivial contribution to foreign investment in Australia."

The draft report also cites concerns around the use of "loan-back" arrangements during the earlier SIV regime.

AVCAL response:

1.1 **It is of some concern the draft report does not appear to draw a distinction between the current and former SIV frameworks in its analysis and conclusions on the economic impact of the programme.** In AVCAL's view, the current SIV regime which came into effect on 1 July 2015 must be assessed on its own merits, without being conflated with the previous regime which operated under a significantly different framework. It had different investment requirements, and lacked the current integrity measures to regulate the practice of arrangements such as "loan-backs", which were not consistent with the policy objectives of the program.

1.2 **AVCAL is of the view that it is too early to draw such a conclusion on the economic impact of the current SIV programme.** The revamped SIV programme has only been in place for less than six months. The Government, and the Productivity Commission, should continue to monitor progress while giving applicants, their advisers and fund managers the time needed to continue to develop their knowledge and information resources in relation to the investment opportunities in the new market segments that they are now investing in. It should be noted that it is to be expected that there will necessarily be a "learning period" to ensure that any investors that are new to this segment are appropriately informed and knowledgeable about their investment opportunities in Australia.

1.3 **Any assessment of the economic benefits of the SIV framework must take into account how well the programme is meeting its policy objectives**, which goes beyond merely the general expectation that it will "reduce the cost of capital to Australian businesses", and the size of its contribution relative to total foreign investment in Australia.

1.4 AVCAL recommends that future evaluations of the economic impact of the SIV programme should take into account the types of indicators suggested by the Productivity Commission in its Draft Recommendation 10.2 (in relation to the Business Innovation and Investment Programme). These metrics include jobs, wages, geographical location, innovation and international linkages. In addition, AVCAL also recommends tracking and evaluating the impact of SIV investment on the pool of VC and Growth PE capital available for investment, the types of technologies supported and their flow-on effects to Australia, export growth, and R&D/capital expenditure enabled by the VC investment.

2. The potential impact on VC is not immaterial

The Productivity Commission's draft report states:

"In 2013-14 investors had committed $18.5 billion to venture capital and later stage private equity (ABS 2015h). If SIV grants remain at current rates (about 300 per year) and each provisional visa holder invests $500 000 in these asset classes, the net increase in funds available for venture capital would be less than 1 per cent. The effect of this requirement on the cost of capital for Australian start-up businesses will be immaterial."

AVCAL response:

2.1 **The conclusion that the SIV will have an "immaterial" effect is based on an incorrect understanding of the data**. The $18.5b figure cited includes both later stage private equity and venture capital, based on data collected by the Australian Bureau of Statistics (ABS).[1] The ABS figure for total VC commitments as of June 2014 is $4.3b. Even then, the commitments figure would not be the best basis for measuring the effect of SIV investment, as this number refers to the accumulated stock of total commitments to VC (including old commitments which have been pledged in previous years, and since invested and some of it returned to investors as part of investment proceeds) rather than the current funds available for investment.

2.2 **A more accurate basis for measuring transformative impact of new commitments would be to look at the amount of Unused Commitment**, which reflects the capital pledged but not yet drawn down (i.e. currently available for VC investment) which is $122m in the ABS data.

2.3 **In the five years to June 2015, AVCAL data shows that VC funds in Australia have raised only $985m, which is a drop of nearly 20% from the five year period before, when it was $1.18b.** This decrease was particularly anomalous given that it came at a time when the many other asset classes were growing and superannuation AUM grew by 50% over the same period ($1.2tr to $1.9tr).

2.4 **By global standards the depth of the VC industry is very low** with early stage investments at 0.007% of GDP, which is just half the OECD median.[2] Even just 10% of the $1.43b SIV investable funds cited in the draft report would roughly equal the average yearly amount raised by Australian VC funds over the last five years.[3]

2.5 **Over the last ten years, foreign investors have played an increasingly prominent role as a source of capital for both VC and PE in Australia**. Over the five-year period between FY2011 and FY2015, offshore investors accounted for at least 30% of all capital raised by Australian VC funds. To illustrate the significance of that, in the previous five-year period almost no capital was sourced from offshore investors into the VC sector.

2.6 **The structural difficulties faced by VC funds in sourcing capital from institutional investors are well-known and recognised by policymakers around the world.** These issues, with the supporting evidence, were covered in AVCAL's submission to the Productivity Commission's Inquiry into *Business Set-up, Transfer and Closure* in July 2015, as well as AVCAL's submission to the 2014 Financial System Inquiry review. Some jurisdictions, such as Singapore and Canada, have consequently put in place similar targeted policy measures to attract much-needed capital into their VC industries by allowing permanent residency visas for individuals who have invested into approved PE and VC funds.

2.7 AVCAL believes that the targeted changes introduced by the Government to require new SIV applicants to invest in eligible Australian VC or growth PE funds will help improve the effectiveness and economic impact of the SIV regime, while at the same time directing much-needed investment into Australian

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[1] Source: ABS 5678.0 – Venture Capital and Later Stage Private Equity,in Australia, 2013-14
[2] Source: Office of the Chief Economist, Department of Industry, Innovation and Science, *Australian Innovation System Report 2015*.
[3] Source: FY2015 AVCAL/EY Yearbook.

startups and fast-growing companies. Given the small scale of the funding market in comparison to the investment opportunities available (which is discussed in greater detail below), SIV investment could play a transformative role in this investment segment.

3. Significant untapped venture capital investment opportunities in Australia

During the recent public hearings AVCAL was asked to respond to the question of whether there are sufficient investment opportunities in Australia to support the increased inbound capital from SIV applicants. The Productivity Commission's findings in its report on *Business Set-up, Transfer and Closure* – that there are currently insufficient startup investment opportunities in Australia rather than insufficient capital – were also raised.

AVCAL response:

3.1 AVCAL does not agree with the generalisation that there are insufficient VC investment opportunities available in Australia. This may be true in some very specific segments and stages of VC investment, but feedback from our members consistently attests that they have regularly had to turn away attractive investment opportunities due to insufficient capital.

The Productivity Commission's own report on *Business Set-up, Transfer and Closure* stated that, "*Further, for some of Australia's innovative start-ups (that do not yet have a proven business model or track record as an entrepreneur), access to finance can be challenging in the early stages of development*".

The lack of available VC funding, particularly later-stage compared to seed/early-stage funding, was also cited in the report several times:

"*Nevertheless, the relatively small scale of the Australian venture capital market means that those businesses seeking large amounts of investment ($5 million or more) may face difficulties in sourcing larger investment amounts from Australian venture capital funds*." (p.159);

"*Stakeholders consistently advised that it is more difficult to attract the initial institutional venture capital investment in Australia to develop a business, than it is to attract the seed stage funding from business angels and individuals to transform a concept into a business*. *The data on venture capital investment appear to support this view*" (p.160).

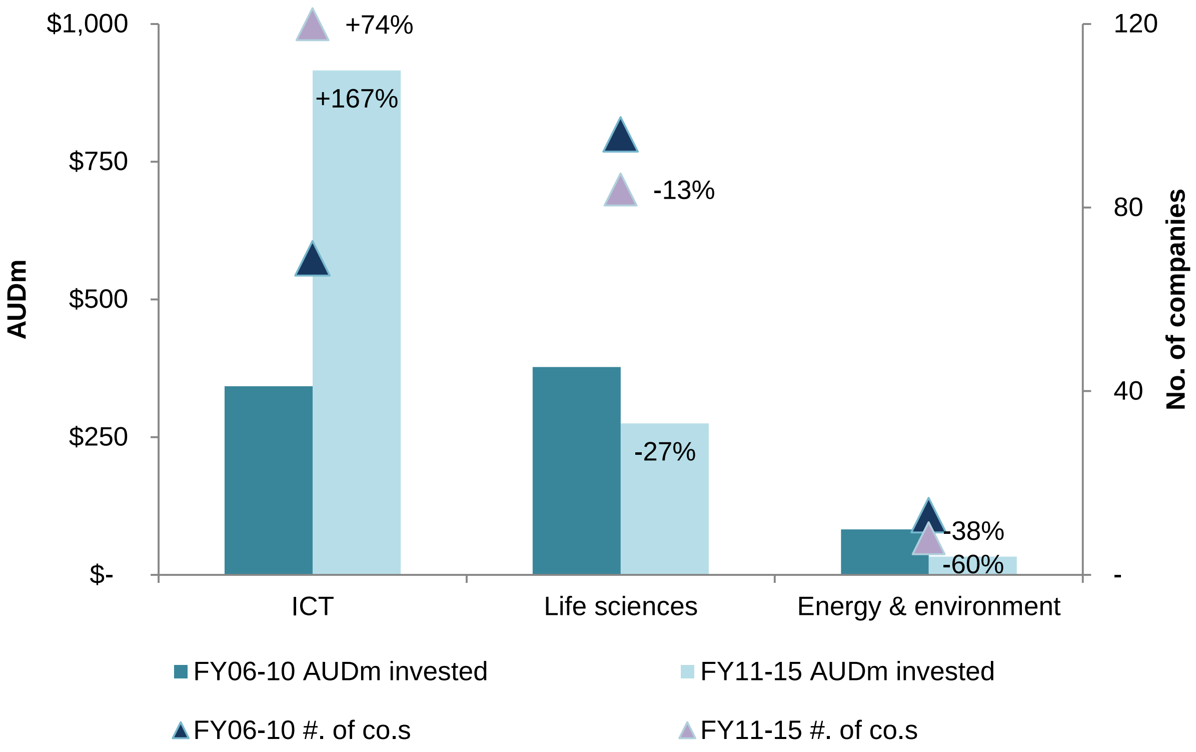
The argument that there is a "lack of quality deals in Australia" was only substantiated by two quotes from media reports (Drummond 2013 and an unreferenced article from The Australian) and an online post by a technology entrepreneur (Maxwell 2013).[4] This runs counter to the experience of our members, particularly those that invest in sectors and stages not widely covered by the media. AVCAL can provide references to a large body of media reports and interviews, as well as direct feedback from our members, which argue that there are significant untapped VC opportunities in Australia.

Figure 1 illustrates why this argument cannot be generalised to VCs or startups in Australia at large. It can be seen that over the last five years, there has been a 167% increase in the amount of VC funding (from both domestic and overseas VCs) to ICT businesses, but a corresponding decline in two other major sectors of VC investment (-27% for life sciences, and -60% for energy & environment).

In addition to ICT, life sciences and energy & environmental services and products represent some of the major sources of innovation in Australia. These sectors benefit from a strong pipeline of research from local universities and research centres. However, without sufficient funding to support these innovations through the commercialisation process, Australia stands to lose the opportunity to capitalise on its substantial research investment in these sectors.

[4] Source: Productivity Commission Inquiry Report on Business Set-up, Transfer and Closure, September 2015, pp. 161-162.

Figure 1: Changes in VC investments by sector, FY06-10 vs FY11-15



Source: AVCAL

3.2 AVCAL believes that fears of SIV funds "flooding" the market for VC funds are unfounded and based on insufficient understanding of how VC funds invest, and the investment opportunity set available to VC investors. VC funds typically specialise in investments in specific sectors and stages.

For instance, an early stage VC investing in ICT will have a very different investment profile to a later stage biotech VC fund.

In addition, funds committed to VC and PE funds are not deployed immediately, but rather drawn down over a period of several years as and when investment opportunities are identified. The funds operate on a committed capital basis, whereby investors initially pledge (or "commit") their capital to a fund. These funds are typically invested over the first half of the fund's life (usually the first five years). Over the remaining term of the fund's (typically) ten-year life, the investments are supported, built up and eventually divested with the proceeds returned to investors as the investments are realised.

4. Economic benefit analysis needs to be appropriately applied against the policy objectives of the SIV programme

The draft report makes the following statements:

"One of the stated objectives of the SIV and PIV streams is to attract high net worth individuals to Australia. This appears to be based on the assumption that people with a lot of money are inherently desirable immigrants";

and

"The only definite economic benefit of the SIV and PIV streams is to fund managers who will have access (through compulsion) to a new source of capital, with the associated fees and commissions. In economic terms the SIV complying investment framework leads to a transfer of a rent from non-Australians to Australians. Technically this counts as a benefit to the Australian community (broadly defined). Although it is not clear that the benefits exceed the costs of giving away a valuable asset: permanent residency in Australia."

In the report's conclusion of its analysis on the SIV and Premium Investor Visa streams, Draft Finding 10.3 states that:

"The economic benefits of the Significant Investor Visa and Premium Investor Visa streams accrue mainly to the visa holders and to fund managers. The benefits to Australian businesses seeking investment and the economic benefits to the broader Australian community are likely to be very small or non-existent. Overall the case for retaining the Significant Investor Visa and Premium Investor Visa streams is weak."

AVCAL response:

4.1 **This analysis does not give due regard to the actual policy objectives of the SIV programme, which clear extend well beyond "attracting people with a lot of money".** The Explanatory Statement for *Select Legislative Instrument No. 102, 2015* in relation to *Migration Amendment (Investor Visas) Regulation 2015* specifically states:

"*The purpose of the Regulation is to amend the Business Innovation and Investment provisional and permanent visa classes to attract more investment into Australia that makes a material difference (SIV) and to attract entrepreneurial skill and talent (PIV).The changes to the SIV are designed to encourage investment into innovative Australian ideas and emerging companies, thereby supporting sustainable growth, productivity and job creation as part of a broader competitiveness agenda*".

Clearly the economic benefits need to be assessed against the stated policy objective above, including the flow-on benefits of investing in innovative ideas and high-growth businesses such as the impact on sustainable growth, productivity and job creation. The success of the SIV programme therefore can only be evaluated on this basis, once sufficient time series data on these activities are available.

4.2 **It should be noted that Investor Visa programmes are a typical part of migration programmes in most countries**, even the US, UK and NZ, as Governments in highly competitive markets around the world recognise the economic importance of attracting foreign investment and talent, and the flow-on benefits into their domestic economies. Some jurisdictions, such as Singapore and Canada, also have targeted policy measures to attract capital into their VC industries by offering permanent residency visas for individuals who have invested into approved funds.

4.3 **The analysis should properly consider the economic benefits to the broader Australian public**. The draft report's Draft Finding 10.3 is problematic as it provides no evidence to substantiate the finding that the economic benefits "*accrue mainly to the visa holders and to fund managers"* and that the *"benefits to Australian seeking investment and the economic benefits to the broader Australian community are likely to be very small or non-existent*".

Without having performed any analysis on the effects of SIV investment flows to VC and Growth PE-backed businesses, and given that that it is too early in the revamped programme's life to perform that analysis, it is impossible to form any sort of evidence-based finding to say that overall the case for retaining the SIV stream is "weak". The Productivity Commission should seek to ensure that any conclusions reached in the final report are based on robust analysis, and where that cannot be undertaken, it should not seek to manufacture a view of the policy efficacy of the SIV program.