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12 February 2020

Committee Secretary
Senate Standing Committee on Economics
Department of the Senate
Parliament House
CANBERRA ACT 2600
By email: [redacted]

Dear Sir/Madam

Australian Business Growth Fund Bill 2019 ("BGF bill")

Thank you for the opportunity to make a submission to the Senate Standing Committee on Economics with respect to the Australian Business Growth Fund Bill 2019. I understand that the Committee has scheduled a hearing at 4.30pm On Thursday 13 February. I will be coming to Parliament House to make myself available to answer any questions that the Committee may have.

About Us - Background

In the last 4 years since launching the OnMarket capital raising platform, in addition to equity raises for larger companies, we have raised equity for 125 SMEs (of 150 total companies) from ~50,000 investors, and reviewed equity-seeking submissions from >400 SMEs. We have helped those SMEs raise >$1.92 billion in equity ($64 million directly and facilitated $1.87 billion in institutional co-investment via satisfying the number of shareholders required for IPO). In raising this capital, we have worked with 72 lead managers i.e. brokers, investment banks or other advisers that hold an AFSL, who manage equity raisings for SMEs. It is clear that we are deeply embedded in the SME equity raising ecosystem.

We are very supportive of measures that will increase SMEs access to equity. ***However, the BGF bill (unless amended) will not have the result of increasing SME's access to equity.*** We first approached Treasury with a proposal that would increase SMEs access to equity six months prior to the announcement of the current Business Growth Fund ("BGF") proposal. In that meeting, we raised concerns with Treasury that a BGF structured like the current proposal would be detrimental to the equity raising ecosystem. As far as we are aware, those concerns have not been investigated or addressed by the Government agencies associated with the BGF.

We have previously expressed concerns in our submission to Treasury dated 8 November 2019 that the proposed BGF bill will not achieve its intended goals of increasing access to equity for SMEs and will crowd-out investment from the private sector.

Summary of Flaws in Current Bill

In summary, our concern with the unamended BGF bill are as follows:

- The BGF will crowd-out private sector equity capital, rather than invest in new SMEs that can't access capital

- It is so financial advantaged vis a vis other equity providers through planned changes to APRA risk-weighting, taxpayer funding, that combined with its stated intention to give superior (non-market) terms to SMEs – long-term investment and no discipline of VC, or ASX listing, that rationale SMEs will approach BGF before or concurrently with the private sector. SMEs that fail to receive BGF investment will be tainted, creating a two-tier class of SMEs (and making it harder for those that are rejected).
- It is constituted with shareholders (the banks and Government) who have no experience in SME equity raising, while market-participants that do have experience have been excluded from the shareholder base
- The only Government agency report recommending the BGF does not provide any evidence for its recommendation – mere assertions
- It will have the effect of substantially lessening competition
- Despite claims that it is based on the UK and Canadian BGFs – they did not receive any Government funding – the Government does not receive any additional public advantage over those BGFs for its $100 million investment of taxpayer funding
- It disenfranchises small investors
- No impact study has been undertaken and better alternatives have not been considered

Our submission to Treasury which sets out those concerns in details is attached as Annexure 1. It has been marked-up to show **additional equity capital raised for SMEs** since 8 November (including additional equity capital that we have raised, and some minor corrections, as we only had 4 days to make that submission). We have not received a response to our submission to Treasury.

This brief submission sets out a proposed amendment to the BGF bill that will enable the BGF to achieve the goals set out in the bill and good public policy. It also corrects some of the inaccuracies raised in MPs speeches that supported the current bill. The problems with the current bill (unless amended) are explained in more detail in the Submission to Treasury, annexed.

Proposed Amendment
That the constituent documents of the BGF constrain its activities as follows:
- *the BGF be permitted to underwrite, partially-underwrite, or sub-underwrite equity, or quasi-equity, issues of SMEs*
- *provided that the equity in such SMEs be offered with disclosure documents prepared under Chapter 6D of the Corporations Act 2001 (Corporations Act) or an offer document under Pt 6D.3A of the Corporations Act*
- *that access to the equity raisings be made widely available to all legally eligible investors who are resident in Australia and that allocation processes be fair and transparent; and*
- *the BGF be restricted from investing in SMEs unless it is incidental to such activities above.*

Purpose of Amendment
The amendment will:

- addresses the conflict between:
  - the natural profit motive of bank shareholders to exploit its funding advantage from the changed APRA ratios (explained in the attached submission to Treasury) that the BGF only 'cherry pick' the best SMEs to invest in (whom can already can access equity finance from

the private-sector), rather than investing in those SMEs that cannot access equity from the private sector; and
  - the purpose of the bill, being to expand access to equity (i.e. SMEs that cannot get equity currently from the private sector)

- ensure the BGF does not have the unintended consequence of "crowding-out" existing private sector equity that is currently available to SMEs

- avoid the BGF putting existing private sector participants, who currently provide SMEs with equity, out-of-business (thereby reducing long-term access to equity for SMEs)

- ensure that the $100 million invested by the Government in the BGF provides a benefit to all Australians, noting:

  - the UK BGF and Canadian BGF did not receive any Government funding – i.e. both are entirely private-sector funded; and
  - the proposed amendment gives all Australians the opportunity to invest in high-growth SMEs, rather than a select few financial institutions

- in return for the proposed concession to amend APRA ratios on the banks' BGF investment (which has the effect of lowering the bank's cost of capital in the BGF below other market participants), ensure that there is a public benefit (i.e. the public's opportunity to invest)

- create a significant multiplier on the Government's (and bank's) initial investment, i.e.:

  - by underwriting, rather than investing, the capital of the BGF can be used many times over
  - by partially underwriting, the multiplier is increased (i.e. a 25% partial-underwrite means that the minimum investment created by the BGF is 4x $540 million (i.e. $2.2 billion) in SMEs

- in the case of partial underwriting, improve governance, as well as investment selection, by ensuring that the BGF will only be investing in an SME where there has been ratification of the investment by private sector investors (i.e. if private sector investors don't invest, then the investment does not proceed)

- by including the constraints proposed in the constituent documents of the BGF, ensure the goals can be achieved; noting that, as a minority shareholder of an independent company, the Government will not have sufficient voting power to change the BGF's undertaking at a later stage

- give smaller investors access to the protections that already exist in the Corporations Act, and ensure they are not excluded and discriminated against simply by virtue of their smaller net wealth, noting that:

  - For SMEs that have <$25 million in revenue and assets, Pt 6D.3A of the Corporations Act provides a low-cost method of disclosure as well as the following protections for retail investors, including but not limited, to:

    - extensive, prominent risk-warnings
    - a limit of $10,000 per investment
    - a 5-day cooling-off period
    - a ban on hawking and constraints on advertising

- For SMEs that have >$25 million in revenue or assets, Chapter 6D of the Corporations Act is designed *for retail investors* and ensures:
    - disclosure is 'clear, concise and effective'
    - risks are adequately explained
    - all the information that investors and their professional advisers would reasonably require to make an informed assessment of the financial prospects of the SME and their investment

  It is sensible policy to require SMEs that have the benefit of an underwriting or partial-underwriting by the BGF to meet the same disclosure obligations as would generally apply to other companies that do not have the benefit of the BGF's investment.

- (the requirement to make access widely available) ensures that access is not restricted to a select few privileged investors that have been invited-in or notified about the underwritten SME equity raising

- (requiring that allocation processes be fair and transparent) ensures that some of the practices that have discriminated against smaller investors do not occur.

Current BGF proposal based on unsubstantiated, incomplete information
We note that various MPs and reports have stated that the current BGF proposal has been based on a report titled "Affordable capital for SME Growth" released by the Australian Small Business Ombudsman.

The executive summary of the report states:
"An alternative is to access capital in the form of equity by issuing shares to investors. SMEs can seek capital through crowdsource funding or private shareholder investment. This requires an SME to issue unlisted shares, which gives investors an interest in the business. For many SME business owners it is difficult to cede partial or full control to external parties.
This market failure, resulting in a limited supply of patient capital for growth…"

This is not market failure. This is a description of the voting rights generally attaching to equity investment. The report conveys a lack of understanding about the basic attributes of equity.

The report makes the assertion that market-failure has occurred in relation to SME equity raising, but the report does not provide any evidence of market failure (only the assertion in the executive summary that it has occurred) in relation to equity for SMEs.

There are only 12 words in the entire report (p12) which appear to provide any supporting basis for this assertion and those 12 words in turn reference a report (not publicly available) prepared by Jobs for NSW, and it is dubious as to whether those 12 words infer market failure, or are evidence of market efficiency.

Moreover, the report acknowledges: *"The ABS figures show that only 15 per cent of all businesses apply for debt or equity finance, of which 90 per cent are approved"*

Ignoring the shortcomings of the report, the proposed BGF does not follow the report's recommendations. The Ombudsman's report in fact recommends that the BGF provide both debt and equity to SMEs.

It would seem that the banks have successfully lobbied to explain that the BGF should not compete against their core business of lending, yet smaller participants in the equity raising ecosystem are not afforded an audience prior to policy being formed and legislation being proposed.

The report goes on to assert that this will benefit *"Institutional fund managers through the development of a new investment class, with commercial rates of return set according to the business opportunity and the term of the finance provided."* It is unclear how institutional fund managers benefit from a new bank+government backed competitor. Its also unclear why such an outcome should be the aim of Government intervention.

"There are large parts of the SME marketplace where equity investors simply do not invest". The report makes no mention of businesses between $3 million and $100 million of revenue having difficulty raising equity. Given the average revenue for the businesses that we (OnMarket) have raised for is $5m, and we have raised for 150 SMEs in 4 years, it is highly questionable whether this part of the market is the same part to which the report refers….or on what evidence the report has made that statement…or how it has in turn been linked to the current BGF proposal.

Simply put, it seems incomprehensible that this report, which *<u>only contains 12 words in an oblique reference to another study</u>*, is cited as the basis for investing $100 million of taxpayer money and providing APRA prudential relief on investments by the banks into a Special Purpose Vehicle (with no track-record) designed for making high-risk investments.

Misunderstandings in Parliament

We note that public submissions were ***<u>not released until after</u>*** the BGF Bill was debated in Parliament, despite the consultation period closing 2 months prior to the debate. This denied MPs the information that they require to conduct an informed debate and vote based on full information.

There were a number of statements by MPs supporting the bill that were incorrect or misinformed, suggesting that the basis for the bill is ill-conceived. This included:

- "*Clearly, businesses of that scale [$2m - $100 million of revenue] are not in a position to go through the very significant cost of developing an IPO*". This is demonstrably incorrect, as all bar one of the 67 ASX IPOs last year had less than $100m of revenue (i.e. 98% of IPOs last year proved this statement wrong).

- many members mentioned the hundreds of thousands of SMEs in their electorate that would benefit from the BGF. These statements seem oblivious to the facts that:

  - the BGF will only invest in SMEs with $3 - $100 million of revenue (excluding most SMEs)

  - the BGF (in its currently proposed format) will finance only 10-30 SMEs nationally pa.

Failure to undertake an Impact Study or Respond to a Superior Proposal
No Impact Study has been undertaken and no response given to alternative proposal.
Notwithstanding that we have:

- Provided an unsolicited submission to Treasury 6 months prior to the 1st policy announcement of the BGF (i.e. April 2018) to improve access to equity for SMEs,

- Met with (at substantial personal expense and time) Treasury, APRA, RBA, NAB, HSBC, CBA, Westpac, and had discussions with the Treasurer's senior adviser and the Small Business Ombudsman, explaining serious flaws in the current proposal, we were given only 4-days to make a public submission to Treasury. This would appear to be a cynical approach to public consultation. Despite our clear experience and expertise in SME raising, and our detailed submission to Treasury, and our transparent explanation of the proposed structure, we still have not received any response.

According to the members of Parliament and supporters of the bill, the BGF will be a great success if it achieves for SMEs what we have already been doing. We have invested substantially in infrastructure and people to diligently serve SMEs and address the problems that the legislation is supposed to solve. We hope that we can be a constructive part of the BGF solution.

Thank you for the opportunity to make a submission. We strongly urge that the Senate Committee recommend our amendments to the Senate.

Yours sincerely

[redacted]

Ben Bucknell
CEO and co-founder
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Annexure 1 – Submission to Treasury Consultation

~~8 November 2019~~ Updated to 12 February 2020

The Manager
Capital and Payments Unit
Markets Group, Treasury
Langton Crescent, Parkes ACT 2600

Dear Sir/Madam

Australian Business Growth Fund Bill 2019 ("Govt + Banks JV")

We are writing to reiterate our concerns that the Australian Business Growth Fund (***ABGF***) will substantially negatively impact our business, smaller equity capital raising businesses, funds that invest in the same target market as the ABGF, CSF Intermediaries generally, the supply of ASX listed IPOs, and opportunities for small investors to invest in quality SMEs. We believe that the ABGF will have the likely effect of a substantial lessening of competition in the market and cause a long-term detriment on SME's access to equity.

OnMarket BookBuilds (***OnMarket***) facilitates equity raisings for approximately the same number of SMEs & value-raised as the UKBGF. In the last 4 years since launching the OnMarket app, in addition to 20 equity raises for larger companies, we have worked with 72 advisers (i.e. AFSL holders), raised equity for ~~120~~125 SMEs (of 150 total companies) from ~50,000 investors, and reviewed equity-seeking submissions from >400 SMEs. We have helped those SMEs raise >$1.~~1~~92 billion in equity ($~~55~~64 million directly and facilitated $1.~~05~~87 billion in institutional co-investment via satisfying the shareholder spread requirement).

Over the past 18 months, we have extensively explained to the Government, its relevant agencies including Treasury, as well as the shareholder banks (NAB, Westpac, CBA, HSBC), the likely negative impact of the ABGF. Six months prior to the Government's Nov 2018 ABGF policy announcement, we met with Treasury and set out an alternative proposal to leverage existing market infrastructure, rather than damage the market for equity investment in SMEs. Our alternative proposal has been ignored or discounted without any significant and genuine attempt to assess and develop it further.

Executive Summary

- Blind acceptance of conflicted UKBGF
  It appears to us that the Government, its agencies and the banks have been strongly influenced by the UKBGF and have uncritically accepted its self-assessed beauty. Understandably, the UKBGF is predisposed to convey a positive view of its impact, it has no knowledge of the Australian equity raising ecosystem, and it should be self-evident that it cannot impartially articulate the extent to which it crowds-out non-bank, private-sector investment in SMEs.
- No assessment of negative impact undertaken
  Our recent discussions have revealed that no work has been undertaken by Government or the banks to investigate the potential negative impacts on market participants, including participation by small investors, that currently facilitate or fund SME equity raisings of the size and nature that the ABGF will target.

- Government bias in favour of banks
  In its closed room roundtables in the 12 months since announcing its policy, the Government has happily invited its agencies and banks that have zero experience in equity capital raising for SMEs, while excluding parties with substantial experience. Despite us offering our expertise, and viewpoint, the Government has refused to let OnMarket (or any other provider of equity to SMEs) attend meetings that establish the constituent documents and purpose of the ABGF. The Government refused to take face-to-face meetings even though we facilitate similar outcomes to the UKBGF. In fact, despite 12 months and numerous emails, the most we have received from Government (i.e. excl. departments) is an hour of telephone time with the Treasurer's adviser.

  We note that the draft legislation has been tabled with a 4-day consultation period. Is there a plausible explanation other than the Government placing political expediency above genuine public consultation?

- Unfair Advantage
  The ABGF is being provided with financial and regulatory advantages over other private sector investors, namely:
  - a $100 million initial equity investment by Government (***financial advantage)***
  - Gov't pressing on APRA to change its prudential tests to enable the banks to fund 73.75% of their investment in the ABGF via debt-funding (***regulatory & financial advantage***)

- Manipulating prudential ratios for political purposes contravenes APRA Act
  The ABGF relies on APRA changing prudential ratios so that the banks' *equity* investment into a vehicle making high-risk *equity* investments in SMEs will not be treated as deduction to T1 equity. Instead, the counterfactual applies. It will be treated like a debt security, ignoring its equity nature & the high risk of investing equity in SMEs. Doctoring prudential ratios for the purpose of engineering an ostensible ROE return for the banks is inconsistent with the Australian Prudential Regulation Authority Act 1998 (***APRA Act***) which states APRA's authority and role is to "*balance the objectives of financial safety and efficiency, competition, contestability and competitive neutrality."*

- Substantially Reducing Competition
  By obtaining concessionary finance from its owners, which is not available to competitors, the ABGF can achieve commercial returns while undercutting the market. This will have the likely effect of substantially reducing competition in the market.

- Offering equity on non-market terms
  The form of 'undercutting' could either be better pricing, i.e. a margin-squeeze, or more concessionary terms (such as not requiring a listing on ASX, and its associated continuous disclosure, corporate governance, daily pricing and costs – or because ABGF will not require a foreseeable liquidity event), or a combination of these things.

- Unfair advantage means no need for operational excellence
  The Governments' intervention to artificially engineer cheap bank finance provides an unfair advantage to the ABGF over other participants in the market. The likely outcome will be that ABGF will have the first opportunity to invest in the best SMEs, outcompeting competitors not though operational excellence, but because its upstream financing arrangements from shareholders means it can provide equity to SMEs on more attractive terms.

- Directly competing to invest equity in same SMEs
  Neither the Government, its agencies nor its bank shareholders have provided any details about how the ABGF will use different factors to determine which SMEs to invest in, from those that are currently used by the private-market. If the same buy-side determinants are used, the logical conclusion is that direct investments by the ABGF will crowd-out private sector investors.

- Lack of policy justification
  No policy arguments have been put forward why selected SMEs should enjoy the benefits of Govt-and-bank-backed long-term equity investment, if those SMEs are not willing to offer their shares to public investors, accede to the governance requirements of ASX, or the discipline imposed by VC exit requirements & terms. As far as we are aware, no analysis has been done on how lucky "Government + bank" backed SMEs will exploit their unfair advantage over other SME competitors as a result of receiving concessional equity finance, not available from the market.

- Negative impact on SME's access to equity
  The ABGF will divide SMEs in the target market into "ABGF worthy" and "ABGF rejects". Naturally, the private market will incorporate this information into their investment decision, lowering access to equity for marginal SMEs. Why would SMEs seeking equity not firstly approach the ABGF, which can offer equity on concessional terms? Why will private sector investors spend time and resources reviewing "ABGF rejects", let alone invest in them?

- Disenfranchising small investors
  ABGF disenfranchises smaller Australian investors by depriving them of the opportunity to invest in SMEs that instead are funded by ABGF (presumably ABGF aims to invest in the best SMEs).

- Disenfranchising CBA shareholders
  The ABGF disenfranchises small CBA shareholders of their rights under the Corporations Act to have their ordinary resolution heard without prior political interference. The resolution has been given properly under s249N and s249P of the Corporations Act, announced by CBA on the ASX Market Announcements platform, and is scheduled to be voted on at next year's 2020 AGM.

- Lack of Probity
  The ABGF fails probity tests. It has been structured exclusively for participation by the largest banks, excluding smaller investors from participating in the ABGF and from co-investing in SMEs.

- Unfettered Power To Damage Competition
  The legislation constitutes ABGF as a profit-seeking, supposedly independent JV with unfettered freedom to invest wherever it has a competitive advantage. The legislation does not constrain it from changing its investment sizes or criteria over time to move into areas where it will use its privileged access to concessionary finance to substantially lessen competition.

About OnMarket

- OnMarket provides all Australians with the opportunity to invest in SMEs without a fee, or requirement to have any ongoing trading or other financial account with us.

- In the last 4 years since launching OnMarket, in addition to 20 equity raises for larger companies, we have worked with 72 lead-managers (i.e. AFSL holders), raised equity for ~~120~~125 SMEs (of 150 total companies) from ~50,000 investors, and reviewed equity-seeking submissions from >400 SMEs. We have helped those SMEs raise >$1.~~1~~92 billion in equity ($~~55~~64 million directly and facilitated $1.~~05~~87 billion in institutional co-investment via satisfying the shareholder spread requirement). Starting from scratch, we are growing and at our current run-rate we assist approximately the same number of SMEs and equity value as the UK BGF.

- We also have APIs to display OnMarket equity raisings on the retail trading interfaces of the investor platforms of CMC Markets, ANZ Share Investing, Bendigo Bank, Bank of Queensland, Suncorp and St George. Customers of those institutions can also invest equity (without fees) into SMEs via OnMarket. OnMarket increases fair access for investors and distribution for SMEs equity raisings substantially.

- For 3 years, we have offered our API to the proposed ABGF shareholders (CBA, NAB, and Westpac) and offered the same revenue share as our other API partners. Those banks have declined to implement the API, which would give their customers access to SME raisings, particularly IPOs. Despite the lack of reciprocity by those banks, we still provide free access to their customers (and arrange for shares to be deposited into their respective investment account with their bank) if those people join OnMarket directly.

- ANZ has been one of our collaborative partners and implemented our API, providing its customers with fair access to, and notifications of, IPOs via their investing interface on ANZ Share Investing.
- Our model is built on collaboration with other participants in the equity capital raising market, and we have facilitated equity raisings for 72 lead managers (i.e. AFSL holders), in the last 4 years. During that time, we have also reviewed equity raising submissions from 400 SMEs.
- OnMarket has the widest, most inclusive distribution infrastructure in Australia. We believe that we offer more SME equity raisings to the public, and close more, than any other platform in Australia. Our infrastructure and business has facilitated equity raisings for SMEs across the full spectrum of equity raising methods, including: raising equity via an ASX listing, utilising s708 exemptions, facilitating VC investment, and offers under the CSF regime. OnMarket investors reside in all Australian states and territories, approximately proportionate to population. We have raised for SMEs from every state and across every industry group.
- We have invested substantially, in good faith, in our business infrastructure, based on Government encouragement of CSF Intermediaries to facilitate equity raising services for SMEs. Our employees have worked substantially for equity in our business, at less-than-market salaries, for more than a decade.
- In the UK, our nearest peer has incurred ~A$28 million in operating losses over the last 5 years; noting they have had to compete with the UK BGF during this time.
- We have a world-class team and technology. Previously, our team established the world-first ASX BookBuild facility. The UK Lord Myners Review recommended our bookbuilding system for Future UK Govt privatisations (i.e. IPOs) to the UK Secretary of Business. The Myners Review was constituted in response to the public outcry into the conduct of the Royal Mail privatisation. Adoption of our technology was a key recommendation, and we were asked to deliver the keynote speech at the London Business School with Lord Myners.
- Our executive team has held leadership positions and had experience in some of the most highly regarded institutions in the country: Macquarie, UBS, ASIC, ASX, KPMG, S&P and Allens.

<u>Government Failures Repeating, Undermining Trust in Markets & Misleading Entrepreneurs</u>

We would not have invested more than a decade of our careers and put substantial investment at risk to improve equity capital markets' infrastructure if we had known the Government would:

- exclude our globally-lauded bookbuild technology from the Medibank float (noting ACCC has launched a cartel case into bookbuilding, and our technology improved the fairness, transparency and efficiency of those processes), despite recommendations at the highest levels of one of the world's largest equity capital markets
- publicly agree with our proposal for 25% of IPOs to be made available to public, but thwart our campaign by sending factually incorrect letters telling the public that the listing rule changes were forthcoming, and then not correct its letters when advised of their error, and then take no action to have the necessary changes implemented to enable fair public participation
- support market practices that cause IPOs of larger businesses with more reliable cash flows to exclude genuine retail investors (by being presold to funds and high-net-worth investors before the prospectus is lodged), limiting (genuine) retail investors to participate in higher risk IPOs
- create a bank/Govt JV to compete against us and our industry colleagues and grow it to $1 bln.

A simple illustration of how the ABGF damages OnMarket (and SMEs access to equity)

- The unfettered power of the profit-driven BGF to choose size of its investments allows it to change over time. Preliminary discussions indicate ABGF may target investments of $7.5m - $20m (typical for the UKBGF). If the 'big-end of town' complains the ABGF is encroaching on their market, nothing stops the BGF responding by competing even more directly against us.
- Rational SMEs will approach the ABGF first (knowing it has a pool of deployable cash to invest on more concessional terms than the market). If this doesn't happen, the ABGF is not doing its job (or if terms are no better than the market, there is no reason to create the ABGF). Terms go beyond simple price. It is also a matter of whether the SME is required to be listed, whether a VC-style exit strategy will be required, the many different rights that can comprise the security instrument which constitutes the investment, and whether the equity raising is guaranteed from an immediately-available pool of funds, or it is necessary to "go to market" and attract capital.
- BGF will invest in the best SMEs (if it does not pick winners, then it will not attract further equity injections to grow to $1billion, per the Governments' stated ambition).
- We have been approached by +400 SMEs for equity finance – of the ~148 that we have attempted to raise equity for – we have ~~80~~83% success rate (financed by private-market investors, not our balance sheet). This is demonstrable proof that we are delivering the tools for access to equity finance all the way to SMEs that are on the margins of attracting equity investment.
- Measuring all listed equity raisings, the average return for investors is ~~18.1~~17.6% (measured at 6-months, post listing). A strategy of investing the same amount in every OnMarket listed deal since inception and sold at 6-months has delivered investors annualised returns of **32.~~8~~2%** (a large dataset over 4 years and ~~123~~129 transactions). But, the median return of all listed raisings is ~~-9~~8%. In effect, success stories give investors the confidence to continue to invest in risky SMEs (by achieving outperformance overall to recover losses from unsuccessful investments).
- If the ABGF has the effect that private market investors cannot invest in the 'best SMEs', then they will not continue to finance the more marginal ones. The ABGF will create adverse stock selection for private investors. Only "ABGF-rejects" will be available for the public to invest in.
- The likely effect of the ABGF will be that our business model, and others that raise private sector equity for SMEs, will not be sustainable. Marginal SMEs will not have the opportunity to *try to* raise equity using our wide-distribution, and access to equity will be reduced.
- The ABGF is not structured to assist marginal SMEs. It is being structured to cherry-pick the best SMEs that already have the opportunity access equity from external investors.

CBA shareholders resolution

Commonwealth Bank shareholders have called a shareholders' resolution to preclude CBA from investing in the ABGF with supporting material that explains the likely negative impact on small investors and SMEs. The shareholders' resolution has been delivered by CBA shareholders pursuant to s249N and s249P of the Corporations Act.

We have attached the s249N resolution and s249P explanatory statement, explaining:

- How a proposed change to the APRA treatment from capital deduction to a risk-weighted asset @250% will enable the banks to effectively debt-finance 73.75% of their investment in the ABGF
- How the ABGF will crowd-out existing private investment capital, particularly small investors
- Why the ABGF makes it more difficult for marginal SMEs to access equity from the private sector

The resolution was delivered 7 weeks prior to this year's AGM, has been announced on the ASX, and will be sent to and considered by CBA's +830,000 shareholders in next year's AGM. The Government legislative timetable will have the effect of pre-empting the exercise of shareholders' voting rights, embedded in the Corporations Act, by small investors in Australia's most widely-held bank, CBA.

<u>OnMarket Alternative Proposal</u>

- <u>Alternative Proposal delivered 6 months prior to Govt policy announcement (and ignored)</u>

  <u>Six months prior</u> to the Government's Nov 2018 announcement of its ABGF proposal, we met with the Treasury Capital Markets Group, and confidentially presented a detailed proposal that would leverage existing infrastructure and complement the roles market participants, engage all private sector investors, ensure fair participation, and cost the Government no more than the current proposal, while achieving the same, if not greater, public-to-private multiplier. We also explained the damage that following the UK BGF would do to the current ecosystem of equity capital raising. Despite repeated attempts to obtain feedback and proceed forward with the proposal, we heard nothing until the Government announced its plan to emulate the UKBGF (without addressing any of the problems we had identified 6 months earlier).

  We have provided more detailed presentations of our proposal to Treasury since that date.

  Despite 18 months of notice, the Government and its agencies have made <u>no attempt</u> to address any of the concerns raised, assess, or progress the implementation of our proposal.

- <u>OnMarket professionalism & attempts to collaborate with market participants</u>

  Over an 18-month period, we have met or discussed with Treasury, the Treasurer's senior adviser, APRA, RBA, NAB, HSBC, CBA, Westpac, and the Small Business Ombudsman, and others, and explained the likely detriment that the ABGF will cause and our alternative solution. We have been open, transparent and provided fulsome information to all these entities. We have received either no response or substantive consideration of our proposal from Government, or its agencies, or the main bank shareholders in the ABGF.

- <u>Benefits of Alternative Proposal</u>

  In contrast to the ABGF using its unfair financial and regulatory advantages, obtained through the Government artificially manipulating prudential ratios, to outcompete other market participants and cherry-pick the best SMEs to invest in, OnMarket's proposed structure for a business growth fund assists, encourages and enables private sector investment, with the following benefits:

  - Ensures no private capital is crowded-out
  - Gives momentum to SME equity raisings, increasing their chances of success
  - Fills the gap for equity raisings that raise some, but insufficient, private-capital
  - Avoids the need to pick-winners, by ensuring that each investment has validation from private-sector investors
  - Collaborates with, rather than outcompetes, private-sector investors
  - Is not dependent on bank funding to be successful
  - Increases access to equity for SMEs (not just investing in those that would have received investment from the private-sector but for being crowded out by the ABGF)
  - Provides at least a 3x multiplier on the Government investment, and potentially far greater
  - Provides the opportunity for every Australian and other sources of equity to participate

In Conclusion

We are at a loss as to why the Government seeks to emulate the UKBGF, when OnMarket and our industry peers facilitate and collaborate on equity raisings for approx. the same number and value-raised as the UKBGF (at a fraction of the cost). We also provide fair access and the opportunity for all Australians to invest, increasing engagement with SMEs and sharing the economic benefits of growth. We have advised the Government, its agencies and the banks, that the likely outcome of the ABGF will be to severely damage our business and other like businesses. We have provided an alternative that achieves better outcomes, costs the Government no more, achieves an equal, if not higher multiplier, engages the public, and leverages equity providers and market infrastructure.

Even if the ABGF invests in the same number of SMEs as the UKBGF per annum, if the ABGF cripples our business – and we have explained the reasons why this is the likely outcome – there will be no net benefit of increasing access to finance for Australian SMEs. If the ABGF finances the same number of SMEs as we do today (i.e same as the UKBGF), it will still have a negative effect on access, as it does not provide marginal SMEs with the infrastructure to <u>*try*</u> to raise private-sector equity.

Providing concessionary equity finance to SMEs that otherwise would have had access to equity on market terms is not the purpose of the Govt policy. The legislation fails to achieve its ostensible goals set our in its objects and simplified outlines and the explanatory memorandum to *"<u>increase</u> investment in Australian small and medium enterprises"*.

Despite the substantial efforts we have made, the time and resources we have expended in more than 25 meetings with Government, 5 Govt agencies, 4 banks we are disappointed not to have received comprehensive appraisal of our alternative proposal and genuine attempt to implement it.

The ABGF fails the ethics 'pub test':

- the banks have <u>*zero*</u> experience in raising <u>*equity*</u> for SMEs, yet <u>despite this</u>, the Government
  - is seeding $100 million of taxpayer funds in a bank/Govt JV to invest equity in SMEs
  - using its regulatory power to enable the banks to borrow 73.75% of their investment to help them achieve an ostensible ROE (by contrived prudential measurements that ignore the fact that the investment in the ABGF <u>*is*</u> equity, into an entity with no track record created for the purpose of making high-risk *equity* investments)
- the Govt refuses to genuinely consider an alternative from OnMarket (who specialises in raising equity for SMEs, provides fair access for all Australians, provides better outcomes for SMEs, achieves the legislative intent of expanding access to equity & has a substantial track record)
- and instead the Government has imposed hefty regulatory financial regulatory levies that are disproportionate to revenues (on us and our industry peers).

It is ironic that the Australian Government purports to support SMEs, but in emulating the UKBGF it is ignoring the advice, concerns and recommendations of a home-grown Australian small business that has achieved, through collaborating with our industry colleagues, similar results at a fraction of the cost. While it has not been denied that we have more experience in SME equity raisings than any of the parties, Government agencies or banks involved, this has been insufficient to overcome the stigma that the Government associates with small business and its disdain for small investors.

Yours sincerely

[redacted]

Ben Bucknell
CEO and co-founder
OnMarket BookBuilds

Appendix 1:

Commonwealth Bank of Australia

Outstanding Shareholders' Resolution pursuant to ss 249N & P of the Corporations Act 2001 (CA)

(to be considered at the 2020 AGM)

Section 249N Resolution 1 – Amendment to the Constitution

To amend the constitution of the company to insert beneath article 10 the following new clause 10A:

"**10A High Risk Investments**
Without the approval of members by ordinary resolution, CBA must not co-invest with the Australian Government into a fund or entity ("BGF") that has a dominant purpose of investing equity or risk capital in small or medium enterprises ("investee companies") unless the constituent documents of such BGF expressly limit its investments in an investee company to the underwriting of any shortfall arising from an offer to the general public made by such investee company."

Section 249P - Supporting Statement

On 14 November 2018, the Government announced that it would encourage the banks to invest in a Business Growth Fund ("BGF") to provide long term equity funding to small and medium sized businesses ("SMEs"). That announcement also stated that APRA had indicated that it was willing to review the regulatory capital risk-weighting on equity investments into such a fund by the banks.

On 23 April 2019, the Morrison Government announced that it had been working closely with a number of banks and other financial institutions to co-invest into the BGF and it would, if re-elected, contribute $100 million.

Improving access to equity for SMEs is a laudable goal. However, the proposed BGF structure will not achieve that outcome.

Without the limitations set out in the resolution, the proposed fund will compete with the existing private market ecosystem and cherry-pick the best SMEs. The BGF will crowd-out existing private market participants and small investors, by using the economic advantages given to it and regulatory advantages given in relation to the banks' investment, offer to invest on more concessional terms than the private sector. The BGF will endeavour to invest in the most investible SMEs in order to attract more capital to achieve the Government's stated goal of growing the fund to $1 billion.

Crowding out private-sector investment from the most investible SMEs will not achieve the stated purpose of increasing access to equity for SMEs that are currently unable to access it. There is a substantial risk that private-sector investors will presume SMEs will first approach the BGF for concessional equity funding and any SME that has been unable attract BGF investment is tainted. This may exacerbate difficulties accessing equity for SMEs that currently have difficulty accessing it from the private sector.

The media has since speculated that APRA may change the risk-weighting on the banks' investment in the BGF, from a capital deduction to a 250% risk-weighted asset. APRA has set the 'unquestionably strong' benchmark for Common Equity Tier 1 (CET1) at 10.5%.

Appendix 1

A 250% risk-weighting on a 10.5% CET1 equity regulatory requirement, means the banks must account for 10.5% x 250% = 26.25% of its investment in the BGF against Tier 1 common equity.

This means banks will effectively be funding 73.75% of any investment in the BGF with debt funding. Private market investors could not obtain this level of gearing on an investment in a high-risk equity fund.

It is inconsistent with the bank's stated purpose and values to "Do what is right" to:

- invest in a high-risk fund that has obtained a relative economic advantage in the form of a $100 million co-investment by the Government; and
- obtain a relative regulatory advantage directly, by APRA specifically changing the risk-weighting on an investment in the fund, for the purpose that the banks can fund an investment in the BGF with 73.75% debt,

in order that the bank can:

- enter into a high-risk business of undertaking equity investments in SMEs, an area of business in which the bank is not currently engaged and does not have expertise; and
- displace private investors and other financial intermediaries that have been servicing the SMEs equity market, without Government support,

for questionable net public benefit.

If the bank intends to invest in a new business which makes high-risk equity investments, it should not use a regulatory advantage and Government assistance to do so. If the bank would not be willing to lend 73.25% to a private investor to invest in a high-risk equity fund, then neither should the bank take on this level of leverage with shareholder's funds, merely because the regulatory risk-weightings have been changed to facilitate a political initiative.

Government programs that have a purpose of bridging finance gaps in the private market, such as Accelerating Commercialisation and its predecessors, have eligibility requirements that companies must establish that they have been unable to access finance from other sources, such as private investors. This ensures that such taxpayer-funded programs do not displace available private-sector capital.

CBA has more retail shareholders than any other company in Australia. On 28 June 2019, CBA disclosed that 51.46% of its shareholder register are retail investors. Unless restricted in its purpose, a proposed BGF will compete with the bank's own shareholders, as SMEs currently typically turn to these same retail investors, amongst others, for equity funding. The proposed resolution ensures that CBA will only invest in a tax-payer funded BGF if it complements, rather than competes with, the bank's shareholders when making investments in SMEs.

The proposed resolution enables the directors to determine whether it is in the best interests of the bank, and shareholders, to support a well-structured Government initiative to improve small and medium businesses access to equity; while ensuring that:

- the bank does not use a privileged regulatory treatment of capital to invest in any tax-payer funded BGF which competes with the bank's shareholders;
- the bank does not inadvertently crowd-out other investors into SMEs that have not been furnished with the same economic and regulatory advantages as a BGF and its investors; and
- any such fund enhances the existing equity capital market ecosystem that provides SMEs with access to equity.