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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")

I refer to the questions from the Senate Standing Committee on Economics with respect to the Australian Business Growth Fund Bill 2019 that occurred at 4.30pm On Thursday 13 February 2020.

Executive Summary

This submission:

1. Identifies misleading statements by witnesses that RBA conducted studies & recommended the BGF
2. Identifies wilful blindness by ignoring market impact of the largest growth investor in the world
3. Provides further information requested, and evidence of UK BGF crowding out UK private sector
4. Provides evidence that disproves the Ombudsman's estimate of the # of SMEs that will benefit
5. Notes Treasury has no business plan, no investment mandate & no final governance documents
6. Shows APRA's prudential changes will create >\$5 billion of concessional bank funding for BGF

Misleading references to RBA analysis & RBA recommendations

The Ombudsman and the Treasury Official referred repeatedly to their reliance on RBA analysis/ conclusions, using RBA as the basis for their recommendations stating:

Ombudsman:

"the RBA put up their hand and said, 'Yes, there is a problem here'..."

"I would believe that the RBA has had a pretty good look at what the issues are in this space."

Treasury official:

"We've looked at the same issues that the Reserve Bank of Australia has looked at and the Ombudsman has looked at, and we strongly endorse the conclusions that they've come to." ...

"The analysis has been the work that the Reserve Bank has done...."

In fact, the RBA has not undertaken any such detailed market study or detailed analysis of the proposed BGF or its impact on the market, not examined the UK BGF or its impact on the market and made no such recommendation. The RBA simply noted the Ombudsman's recommendation. The Reserve Bank of Australia confirmed to me in writing this morning that:

"we [RBA] have not made any formal recommendations for a business growth fund to the government"

- ⇒ Given Senator Bragg said that the Senate Committee would *"rely heavily upon the advice of the Reserve Bank"* – and it was deliberately misled that the RBA has given such advice, I recommend that the Committee censure the Treasury official and Ombudsman for misleading the Senate Committee.

Wilful blindness of market impact of largest growth investor in the world

The Ombudsman and Treasury official both stated that they couldn't understand how the BGF could possibly have an impact on the market.

I note that the £3 billion UKBGF is "*The most active growth investor in the world*" www.bgf.co.uk

Only wilful blindness or studied incompetence can explain their belief that the *most active growth investor in the world* has not had a market impact in the UK.

I note that the Treasury official seemed unaware of competitive neutrality principles or the Government's policy and has undertaken no analysis with respect to whether the BGF contravenes such policy.

- ⇒ I recommend that the Senate Committee disregard all of the unsubstantiated opinions and recommendations of the Treasury official and Ombudsman.
- ⇒ I further recommend that the Senate Committee refer the Aust Business Growth Fund to the Productivity Commission for assessment under the Government's Competitive Neutrality policy.

Market Impact on private sector

Senator Bragg asked me to whether there were other equity crowdfunding intermediaries in the UK in addition to the three to which I referred. My searches have found no other intermediaries.

The 3 UK intermediaries have incurred ~\$80 million in accumulated losses, during the years of having to compete with the UK BGF. I note that one has ceased its equity crowdfunding business in October 2018, citing competitive pressure from alternate sources of equity (e.g. UK BGF being the largest provider of growth equity in the UK, and world).

This letter provides evidence of crowding-out by comparing UK CAGR of crowdfunded SMEs, vs rest of market (noting UK BGF is the largest in UK) as against historical returns earned by public investors that have invested in SMEs via OnMarket.

Incorrect statements by Ombudsman about # SMEs that will benefit

The Ombudsman repeatedly stated that the BGF will target 8% of SMEs or "about 200,000 SMEs". This is a nonsense. The BGF will invest in 10-30 SMEs per annum.

In addition, the Ombudsman has not calculated the Total Addressable Market (TAM), Served Addressable Market (SAM), or Serviceable Target Market (STM). It is absurd to suggest that the majority of investments will be in <\$5m revenue SMEs...when the BGF has the right to invest in \$100m revenue businesses. Raising the bar of most investments to \$5m immediately reduces the TAM by 57%, and each other investment criteria reduces it exponentially.

Noting I have had only 1 ½ business days to respond, I provide calculations showing that the Serviceable Target Market is more likely closer to 5,013 SMEs – i.e. 0.2% of SMEs (at best). And I note that at an investing rate of 30 SMEs pa (being those invested in by the BGF, **this is 0.001% of all SMEs.**

The Committee should note that no evidence has been provided that these 'best 0.001% of SMEs in the market' cannot obtain private sector funding.

Contradictory arguments of Treasury and Ombudsman

I note that Treasury and Ombudsman state that the BGF will be so small as to not have an impact on other market participants, but it is so systemically important that the Government should invest \$100m of taxpayer funding and give the banks concessional prudential ratios.

I note that APRA has made allowance for the BGF to grow to \$5 billion with concessional prudential ratios applying to 2% of CET1 capital invested in the BGF by the banks (see analysis page 5).

It beggar's belief that the Ombudsman and Treasury cannot comprehend how such a large entity could have an impact on existing market participants.

We also note that when asked about the contingency if CBA does not invest \$100m (as a result of a shareholder vote), the Treasury official confirmed that: *"The fund doesn't need \$540 million"*.

Hence, there is an unanswered question about why \$100m of Govt money is required? The Ombudsman and Treasury have providing nothing other than a weak, evasive answer: *'it's a leadership position'*.

Requests for further information

Senator Bragg asked me what equity crowdfunding firms were in the UK, having to compete with the UK Business Growth Fund. I referred to three: CrowdCube, Seedrs and Syndicate Room, noted the losses incurred by these businesses trying to compete with the UKBGF. I also stated that I was not aware of others. Senator Bragg asked me to report back to the Committee if there were other crowdfunding intermediaries.

Over the weekend, I have reviewed UK industry reports on equity crowdfunding and undertaken google searches. I have not found references to any other UK crowdfunding intermediaries. My research suggests that if there are any other licensed intermediaries in the UK, they are immaterial in market share.

A review of the latest lodged accounts confirms my statement that the UK Crowdfunding Intermediaries have suffered significant losses trying to compete with the UK BGF. I note that, in relation to Crowdcube, I should have referred to 'accumulated losses' rather than just losses.

In their latest accounts lodged with Companies House, and using a GBP/AUD exchange rate of 1 AUD=0.514537 GBP (15/2/20), each of the 3 major equity crowdfunding intermediaries had accumulated losses of:

Platform	Accumulated Losses (£)	Accumulated Losses (\$AUD)
Crowdcube	-£20,475,279	(\$39,792,078)
Seedrs	-£15,152,014	(\$29,447,863)
Syndicate Room	-£4,348,673	(\$8,451,243)
Total Accumulated Losses	-£39,975,966	(\$77,691,184)

The latest lodged accounts are for 31 December 2018 (Seedrs and Syndicate Room) and 30 Sept 2018 (Crowdcube). I note that each intermediary continued to make losses in their latest accounts.

That is – the equity crowdfunding intermediaries in the UK have suffered losses of ~A\$80 million in accumulated losses while trying to compete against the UK Business Growth Fund.

On 31 October 2019, Syndicate Room announced that it was ceasing its equity crowdfunding operations (despite raising £250 million for SMEs). This supports my submission that it is unsustainable to offer “BGF rejects” to the public.

SyndicateRoom’s exit leaves only two equity crowdfunding intermediaries in the UK. If the losses continue for the intermediary – then, despite the benefits to SMEs and investors, it is clearly unsustainable for the remaining two platforms to continue in business.

Australia will make the same mistake if it proceeds with the Australian Business Growth Fund as it is currently proposed.

Evidence of Crowding Out of Private Capital by UK BGF

As I mentioned at the Senate Committee hearing, the annualised dollar weighted return for an investor that has bought into every deal that we have done, measured at the six-month mark and reinvested, has been 37.4 % per annum for four years (a large dataset over 4 years and 123 transactions). Every Australian resident has been eligible to invest in each of these SMEs, without any fee being charged by us to the investor.

Noting that the UK BGF is the largest growth investor in the UK, the following is compelling evidence of crowding out of the private sector investors that can participate via equity crowdfunding. Outperformance of our investments shows that it is not crowdfunding itself that selects ‘worse deals’, but rather implies it is the presence of a large investor that is not in Australia (i.e. UKBGF).

Marcin Zaba Head of Marketing SyndicateRoom, is quoted in research provider, Beauhurst’s annual report as saying:

“The average growth rate (CAGR) across all companies that have received equity investment is 30%; the performance rates published by crowdfunding platforms have been significantly below this.”

It is Mum and Dad investors, HNW individuals and smaller investors that lose out when the Government and banks form a joint venture to crowd out private-sector investment in SMEs. Given the fund is currently planned to invest in companies that have \$100 million of revenue, it is also likely to compete against traditional PE and VC firms.

It is also SMEs that suffer. The purpose of the bill is, ostensibly, to increase access to equity for SMEs.

As noted in my submission, we have been approached by +400 SMEs for equity finance – of the ~148 that we have attempted to raise equity for – we have 80% 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.

The increase in value of a small number of successful SME investments creates positive returns (outweighing SMEs that decline in value). This creates an investment return, which gives investors the confidence to continue to invest in risky SMEs.

If the BGF cherry-picks the best 1%-10% of SMEs (or even is perceived to be in a position to take the best 10-30 investments per annum), investors will not have the confidence to invest in **“BGF-rejects”** offered to them. The result will then be a lower net number of SMEs that receive equity investment.

APRA Concessional Relief to Bank Shareholders

We would like to acknowledge the open and transparent responses to questions provided by APRA representatives. I note that the APRA representatives stated that they did take into account the Government’s equity participation in the fund when the capital treatment of the BGF investment. We note that APRA confirmed there are no prudential fetters on the banks starting their own BGF. I also note that APRA acknowledged that competitive neutrality and the impact on other participants was outside their remit, and they had not considered impact on other players.

The Committee should be aware that APRA’s Letters dated 9 December 2019 (*APRA Guidance*), providing guidance on its prudential treatment of the bank’s investment in the BGF states:

‘The inclusion of the Australian Government as a founding shareholder in the ABGF supports APRA providing a special treatment, subject to prudential safeguards, for this investment compared to other equity investments’

This is compelling evidence demonstrating that the BGF, if constituted, needs to be subject to the Government’s Competitive Neutrality framework.

We also note that APRA guidance states that the banks may receive concessional treatment (of a 250% risk-weighting, rather than a 952% risk-weighting equivalent (i.e. if it were a capital deduction against a CET1 ratio of 10.5%) on up to 2% of their Level 1 CET1 Capital. This will allow the banks to receive concessional treatment as follows:

BGF Shareholder	CET1 Capital (\$ millions)	Potential BGF investment (concessional APRA treatment)
Westpac	45,752	915
CBA	63,281	1,266
NAB	43,138	863
ANZ	47,355	947
Macquarie	11,968	239
HBSC Australia	1,994	40
CET1 Capital subject to regulatory concession		4,270
Plus Government's 18.5%		790
Total size of Australian Business Growth Fund with concessional funding (\$m)		\$5,060

APRA’s relief will allow the BGF to grow to >\$5 billion using concessional bank-funding and taxpayer-funding to maintain the Government’s percentage holding.

Clarification of my testimony to Senate Committee

I was asked whether RBA and the ombudsmen were wrong. I replied saying their advice was based on incomplete information. I would now like to correct the record and provide an unambiguous response.

The RBA is not wrong, because the RBA has not conducted analysis or provided a recommendation (despite the erroneous testimony of the Treasury office and the Ombudsman).

However, the Ombudsmen is wrong. I note the following as evidence for this statement:

1) The Ombudsman's report has no analysis on the SME equity market

I have attached the Ombudsman's report, so the committee can see that the **only reference in the entire report** to SMEs having difficulty accessing equity are the following 12 words "SMEs are... 30 per cent more likely to be rejected for equity finance." [source: Jobs for NSW, Market Opportunity Analysis Financing for SMEs in NSW, 20 September 2017].

- Firstly, it is economically rationale that larger businesses would find it easier to receive equity. This is not market failure. This is market efficiency.
- Secondly, it must be noted that the Ombudsman has conducted no research. She has merely relied on a third source...and that source offers little in the way of support for her assertion of market failure.
- Thirdly, the Ombudsman's report recommended a debt and equity fund...and her entire report (apart from the sentence above) referred to SMEs access to credit and loans.
- Fourthly, the cross-referenced NSW report (for the 1 liner) is not publicly available. I understand that the NSW Go Fund (which was formed on the basis of that report) has made 2 investments, signed off by a member of the Liberal party, NSW Deputy Premier John Barilaro, which have been the subject of considerable controversy:
 - \$3,333,333 invested into Australia's Oyster Coast - chaired by former Liberal party operative David Trebeck. (complaints from other Oyster producers that this distorted the market here: <https://www.smh.com.au/politics/nsw/government-accused-of-playing-favourites-over-3-3m-stake-in-oyster-company-20180830-p500ot.html>)
 - \$3,333,333 invested into a Wagyu producer (in which the manager was already a majority shareholder). Complaints that about the conflicts of interest of the manager here: <https://www.abc.net.au/news/2018-09-04/nsw-government-grilled-over-wagyu-beef-company-investment/10201078>

The Ombudsman quoted a NSW Jobs4NSW report as supposedly supporting her recommendation. The said report is not publicly available. We have emailed and called Jobs4NSW and been unable to obtain the report.

- 2) The assertions that are made in the Ombudsman's executive summary that there is a market failure have no basis, or supporting material
- 3) Only 12 words in the Ombudsman's report refer to equity (and these cross-reference the Jobs4NSW report, which is not publicly available)
- 4) Her responses to simple questions put by Senate Committee members about the studies undertaken of the need for market intervention were evasive, misdirecting and dissembling
- 5) She purports to rely on supporting studies undertaken by the RBA and their recommendation to constitute the BGF, even though no such recommendation or report exists
- 6) The Ombudsman has vastly overstated the number of SMEs that will benefit from the BGF. Suggesting "about 200,000" (8%) SME's market would benefit, is utterly disingenuous (not even that number meet the first test to qualify for consideration). Assuming (and noting these are merely calculations, requiring independent research), 50% of each market meets the next test, you can see that the Ombudsman's evidence vastly overstates SMEs access to the BGF.

Threshold	#SMEs	% of SMEs
SMEs with >\$2m in revenue (Ombudsman's own 2019 report)	160,407	6.60%
No analysis sub-set meeting the "revenue growth over 3 years" test	80,204	3.30%
No analysis of further sub-set meeting the "profits" test	40,102	1.70%
No analysis of further sub-set meeting "3 yrs revenue growth" test	20,051	0.80%
No analysis of further sub-set seeking an external equity investor	10,025	0.40%
No analysis of further sub-set unable to access equity from private sector	5,013	0.20%
Intention of the BGF to make 10-30 investments per year.	30	0.001%

The Ombudsman's own figure of ~200,000 SMEs, is overstating the number that meet the minimum revenue requirement by 25%. There are only 160,407 SMEs with >\$2m revenue, let alone meeting the additional investment criteria of BGF, outlined in the table above.

The Ombudsman attempted to mis-direct the Senate Committee by saying that the UK BGF did not have market impact because *"the total number of companies invested in [by the UK BGF] was 231. It's not a lot in a country like the UK, which is really large...I don't believe we can say that the UK fund, which has been around for longer than the Canadian fund, has disrupted a market with 231 investments"*

The Ombudsman did not inform the Committee that the £3 billion UK BGF states it is:

"The most active growth investor in the world" www.bgf.co.uk/about-us/

This is how the Ombudsman described the UK BGF to the Senate Committee:

"This [The UK BGF] is a small bit of a puzzle, as it is in the UK"

...

"I struggle to see how a fund [the UK BGF] can skew a market that, from our experience, really doesn't exist. Long-term patient capital in the Australian market—there are a few; there are a couple; but you could count them on one hand."

Kate Carnell, testimony to Senate Committee

That the Ombudsman cannot admit that the UK BGF has had a market impact on other private sector investors into SMEs, **when it is the most active growth investor in the world**, demonstrates that she is not attempting to provide impartial, informed or reliable advice to the Senate Committee.

The Ombudsman's argument is akin to suggesting that the Australian banks CBA, NAB, WBC and ANZ, couldn't possibly have a market impact, because they are only 4 companies out of 2.2 million Australian companies.

We have 50,000 investors that have joined OnMarket to invest in minority positions in SMEs by buying perpetual ordinary equity instruments. Unless the Ombudsman has more than 50,000 fingers (apparently, she can "count them on one hand"), then she is clearly misdirecting the Committee.

Apparently, the Ombudsman is making the argument that if the Australian BGF invests in 10-30 SMEs per year, this will be so impactful that it requires \$100m of taxpayer funding (and requires regulatory favouritism for the bank shareholders so they can borrow to invest in the BGF – this not being available to any other investor in high-risk SME investments). But, when one company (OnMarket) arranges for private sector investors to invest in 40 SMEs per year, this is immaterial. According to the Ombudsman investing in SMEs is *"a market that, from our experience, really doesn't exist"*. How does she explain the \$100m that we have raised for 125 SMEs in the last 4 years?

The Ombudsman's lack of knowledge as to the current participants in the market demonstrates that she is misinformed.

The Ombudsman is attempting to have it both ways – arguing the BGF will simultaneously be impactful for SMEs, while having no discernible impact on the private sector that currently serve those same SMEs and will need to compete with the BGF.

Over 98% of SME offerings to the public via OnMarket have been for ordinary shares. These shares cannot be redeemed by the investor and remain as perpetual capital to the SME to finance its growth.

Senator Patrick asked "*how many SMEs sought minority investments from the private sector last year?*"

The Ombudsman claimed that her recommendation and report had "*a little chapter on this*". This is simply not true. Her report does not contain such a chapter or any information on the number of SMEs seeking equity. The Ombudsman has no evidence to base her recommendation on.

The Ombudsman then responded to the question about equity investments by discussing SMEs access to credit and loans. However, the BGF bill only refers to equity investments by the BGF (it is not proposed that the BGF make loans or provide credit). Her answers were dissembling and a clear attempt to misdirect the Committee from the lack of work done by the Ombudsman on market failure for SME equity investment.

RBA Sept 18 Bulletin "Access to Small Business Finance"

The references to the RBA appear, to me, to be references to its September 2018 Bulletin title "Access to Small Business Finance".

The RBA Sept 2018 Bulletin states that it's scope is referring to two roundtable events that it held, and that "This article summarises the issues that have been highlighted by entrepreneurs, lenders and equity investors regarding access to small business finance." The RBA Sept 18 Bulletin noted the Ombudsman's proposal to establish a UK-style fund. The RBA's report does not purport to be a detailed study, not does it contain a recommendation about the BGF. The RBA have confirmed to me in writing this morning that they have made no such formal recommendation to the Government.

Contrary to the Ombudsman's suggestion, the RBA Sept 18 Bulletin noted it had had 2 roundtables and:

"The entrepreneurs on the Reserve Bank's Advisory Panel reported an increase in the number of approaches they had been receiving from private equity investors"

The RBA Sept 18 Bulletin also noted the finance gap for start-ups (not businesses with established revenue of >\$2m, revenue growth and profitability – i.e. these are not businesses in which the BGF will invest). It is important to note that the RBA was reporting on discussions of a small number of entrepreneurs on its round-table and reported that the Ombudsman suggested a BGF. The RBA is not making any such recommendation in its Bulletin (despite having access to the Ombudsman's proposal).

However, when asked about their own analysis, the Treasury official repeatedly referred to the work down by the RBA and the data and input they have had. This is despite the RBA not having claimed to have done such work, and not making any such (fictitious) recommendation.

Senator Patrick: *What analysis have you done to make sure that we're not crowding out the market?*

Mr Tease: *The analysis has been **the work that the Reserve Bank has done**, the work that the Ombudsman has done and the work that we've done in liaising with small businesses. [my underlining]...*

Senator PATRICK: *Can you provide the committee with that feedback and your analysis on this? It's a pretty important point, and one would have thought you would have done some analysis in that space. So, on notice, can you please provide what you have?*

Treasury Official: *As I said ... it [our analysis] relies very heavily on the data and input that we've had from the Ombudsman and the **Reserve Bank***

I draw the Committee's attention to the fact that:

- ⇒ the RBA does not claim to have done **any work on crowding out or market impact**. I note that their September 2018 Bulletin makes no reference to crowding out.
- ⇒ the Ombudsman's report has no reference (not a sentence) on crowding-out (and in her testimony to the Senate Committee she stated "the market doesn't exist") and
- ⇒ Treasury claims to rely on the Ombudsman's (non-existent) research and the RBA's (non-existent) research and recommendation.

Senator Bragg noted on multiple occasions that he had been influenced significantly by Treasury and the Ombudsman's (untrue) claims that RBA had advised to establish the BGF:

"The Reserve Bank and the Ombudsman have said that there is a gap in the market

"We also rely heavily upon the advice of the Reserve Bank, so we usually think they're right for most the part....

"We take your [the Ombudsman]'s advice and the advice of the Reserve Bank very seriously....

I trust that Senator Bragg will place equal importance on the fact that the Ombudsman and the Treasury official have misdirected the Committee by referring to their purported reliance on RBA analysis and an RBA recommendation that does not exist.

Mr Tease also seemed to be suggesting that the Government may receive different information from the other (majority) shareholders:

"the Commonwealth will receive information about the returns on the fund, the valuations on the fund and updates on the performance of the fund. The banks have different governance arrangements and they will receive information from the fund to ensure that those are met."

If it were the case that the BGF will provide different information to Government vs Bank shareholders, this would be highly irregular and, if it were the case, would be inconsistent with market practice.

Mr Tease also stated that Treasury had "liaised with Small Business" in making its recommendation and analysis. I do not believe such liaising has occurred, or if the Treasury is referring to 1-2 informal roundtables with a very limited number of SMEs in attendance, then this is a misrepresentation of "analysis", and is insufficient to form a reasonable basis for Government policy to invest \$100m and provide concessions for a \$5 billion BGF.

I note that Mr Tease expressed that an 'underwriting fund' alternative was too complex (despite also acknowledging that he had not undertaken any work or any analysis of such fund and having 2 years to do so). I draw the Committee's attention to the fact that underwriting plus an offer is very commonplace practice in the market. Mr Tease's advice on this matter is only a reflection of his lack of market experience in raising equity for SMEs. This is what we do.

Conclusion

I note that I have only had 12 working hours to respond to Treasury, and that I am a 3-hour drive from Sydney. Given more time, I could have spent more time formatting this response to make it easier for the Committee to read. However, even in this short time, it is easy to demonstrate that Treasury official and Ombudsman:

- were dissembling and evasive when asked to provide any evidence of the work they had done to establish market failure
- deceptively referred to non-existent recommendations from RBA to support recommendations
- are asking Senate to approve a \$100m appropriation with no business plan, no investment strategy, and no governing documents
- have not considered Competitive Neutrality policy that has had intergovernmental acceptance since 1996
- acknowledged that they had not looked at market impact of currently proposed format of the BGF and the effect of leaving adverse selection (i.e. “BGF rejects”) for the private market
- failed to understand that the APRA change will give a BGF cost of capital in single-digits rather than 25-30% for other private sector investors
- failed to explain that the APRA concessional prudential treatment allows the BGF to grow to >\$5 billion on the back of concessional bank and government funding
- had failed to consider whether alternatives proposed are be better for SMEs, and fund governance

As recommended to the Committee, a fund that is limited to underwriting SME equity raisings and is required to make a general public offer would achieve all of the benefits proposed with none of the issues around crowding out private sector investment, achieves a multiplier effect and improves governance.

Yours sincerely



Ben Bucknell
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OnMarket BookBuilds