SENATOR BARNABY JOYCE'S ADDITIONAL COMMENTS TO THE STANDING COMMITTEE ON ECONOMICS: PRIVATE EQUITY INQUIRY

By reason of conclusion 5.33 that the committee 'does not consider that any convincing case has been made for any further regulation of private equity activity in Australia at this time', I have to submit these additional comments on these premises;

- Private equity involvement in key sectors on the economy in a highly leveraged state means that there is unreasonable stress placed on these sectors and the effect of failure on an individual business has far wider ramifications than purely just that business failing. These wider ramifications include adverse effects on the economy; investor and shareholder confidence; and the stability of the financial system generally.
- The strategic and unfair advantage that private equity firms have over domestic investors in regard to the construction of a taxation regime where capital gains made by foreign private equity firms or investors are tax free has to be addressed as Australians should not be disadvantaged when investing in their own nation.
- As I alluded to during the inquiry and prior to the share market turmoil, private equity firms are inherently exposed to vagaries of cost of debt and are overly reliant on capital gains via a share market re-listing. As I stated a major correction is expected and this would put at risk those private equity investments which are currently in progress.
- Private equity should be defined as more than private investing. It should be defined as the specific plan to take into private hands an organisation, often having substantial market share within the economy, and in the process increasing gearing substantially and with a three to five year plan of placing the organisation back on the share market with the intention of receiving substantial fees along the way and then a substantial tax free capital gain upon re-listing.
- Because the premise of private equity is not unusual, its capital gain is higher than the price of debt. It is a plan that will work well no matter what gearing you have as long as your cost of capital increases, or the under pinner of your capacity to realise that capital gain is an active share market. A share market is inherently made weaker if the substantial players and key sectors are removed from it, or where there are interest rate rises, or a major correction in the market. A major correction in the market generally is indicated when the returns of the shares on the market do not match the returns on equity inside the company. This triggers the correction and the 'animal spirits' of day traders, chartist, margin calls, other derivative instruments and sub prime debt financing players accelerate the downward plunge of any market direction leaving investors and shareholders with substantial loses.
- Serious questions must be asked of the conflicts of interests that are apparent between a target board and a private equity firm. If there was one thing that

stood out beyond all others, it is that this conflict of interest completely breaches the duty of stewardship that is expected by shareholders. The fact that some listed shares of major Australian companies have, in a very short period of time, exceeded the price of the private equity offer, yet the private equity offer continued to be endorsed by a board, and management whose members were to take an immense personal financial gain from the takeover, leave large unresolved questions marks in the share market's and public's mind. This does considerable harm to investor and shareholder confidence and, consequently, the financial involvement of director and management of target companies in a private equity bid should be prohibited outright in the best interests of those investors and shareholders.

Recommendations:

1. No structure of investment, and in particular, no private equity investment should be allowed that puts Australian domestic investors at a distinct disadvantage in their own market
2. Target company boards and management should not be allowed to participate in any takeover bonus or other financial incentives distributed by the private equity bidders.
3. Private equity firms that participate in key sectors of the economy should submit in confidence reports, on a quarterly basis to the reserve bank and treasury, which contain information that is equivalent to the requirements of a publicly listed company.
4. Private equity firms should be quarantined from the domestic housing market as this manipulation would be a distinct disadvantaged to the Australian homeowner as the market pressures placed by multibillion dollar buyers against mum and dad investors is intrinsically unfair.

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