

10 September 2021

VC Tax Concessions Review  
Industry Innovation and Science Australia  
Industry House  
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CANBERRA ACT 2600

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## Venture Capital Tax Concessions Review

Dear Sir/Madam

As the industry association for private capital in Australia, the Australian Investment Council is pleased to present its submission to the Treasury and Industry Innovation and Science Australia (IISA) on *the Venture Capital Tax Concessions Review (the Review)*, following the release of the Terms of Reference on 7 July 2021 and Consultation Paper on 27 July 2021.

Private capital investment has played a central role in the innovation, growth and expansion of thousands of businesses and represents a multi-billion-dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include private growth (**PG**), venture capital (**VC**) and private credit (**PC**) funds, alongside institutional investors such as superannuation funds, sovereign wealth funds and family offices as well as leading financial, legal and operational advisers. Our members include both Australian domestic and offshore-based firms who in turn invest capital on behalf of millions of Australian families and attract capital from passive overseas investors.

The tax provisions contained in Subdivision 118-F of the *Income Tax Assessment Act 1997* (Cth) (**VC Tax Concessions**), in concert with the operation of the *Venture Capital Act 2002* (Cth), play a pivotal role in providing domestic and foreign capital and supporting the growth of Australia's innovation ecosystem and to date, has contributed \$16.99 billion in committed capital and assisted 1703 businesses.<sup>1</sup>

According to data modelling undertaken by EY and commissioned by the Council for the purposes of the Review, this framework supports fast growth businesses through domestic and foreign investment and is estimated to have added at least \$1.4 billion to Australia's GDP in 2021 and to have created 2,514 full-time equivalent (**FTE**) jobs. In fact, ten FTE jobs are created for every investment made through the Venture Capital Limited Partnership (VCLP) and Early Stage Venture Capital Limited Partnership (**ESVCLP**) programs.<sup>2</sup>

We set out below our submission for consideration by the Treasury and IISA and look forward to participating in any future discussion on the VC Tax Concessions, as we have successfully done to date since the inception of the regime in 2002, and all subsequent reforms, including in 2007 and 2016.

We welcome the opportunity during the period ahead, as you review and consider all the submissions received as part of this consultation, to be able to continue to support Treasury and IISA as you prepare your final report under this review.

We have set out below in Appendix A our specific responses to the questions raised in the Consultation Paper where they are not addressed in the submission itself.

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<sup>1</sup> [Venture Capital Dashboard FY2019/20](#), Department of Industry, Science Energy and Resources

<sup>2</sup> [An overview of the impact of the ESVCLP and VCLP investments](#), EY, September 2021



If you have any questions about specific points made in our submission, please do not hesitate to contact me or our policy team on [policy@aic.co](mailto:policy@aic.co).

Yours sincerely

Yasser El-Ansary  
Chief Executive  
Australian Investment Council



## 1. Introduction

The Australian Investment Council is the industry body for private capital investors in Australia, which includes the growth capital and venture capital firms that back innovative businesses across every sector of the economy. The private capital industry has been a consistent and significant contributor to economic activity and job creation through the investment of capital to support the growth and expansion of thousands of Australian businesses every year. Australia's private capital industry represents 2.6 per cent of Australia's annual GDP output, and private capital-backed businesses create 1 in 9 new Australian jobs according to independent analysis by Deloitte Access Economics commissioned previously by the Council and not for the purposes of this consultation.<sup>2</sup>

The VC Tax Concessions regime plays a pivotal role in providing domestic and foreign capital and supporting the growth of Australia's innovation and growth capital ecosystem. To date, the regime has attracted around \$16.99 billion in committed capital, and supported investment into 1703 businesses.<sup>3</sup>

The VC Tax Concession framework is supporting fast growth businesses through domestic and foreign investment and is estimated to have added at least \$1.4 billion to Australia's GDP in 2021 and to have created 2514 full-time equivalent (**FTE**) jobs according to data modelling by EY. In fact, 10 FTE jobs are created for every investment made through the Early Stage Venture Capital Limited Partnership (**ESVCLP**) and Venture Capital Limited Partnership (**VCLP**) programs.<sup>4</sup> Specific modelling in this area has been established on a conservative basis – in actual fact, the impact of the regime from both an economic and job creation perspective is almost certain to be significantly higher than the numbers identified in our analysis.

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*10 jobs are created for every investment made  
through the ESVCLP and VCLP regimes.*

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At this critical juncture in our nation's economic recovery from the COVID-19 induced downturn, Australia must capitalise on the opportunities presented through innovation to support the structural modernisation of our economy and to create high value jobs both today, and into the future. Continuing to grow our nation's investment into innovation will underpin the necessary boost to Australia's global competitiveness and transition to a knowledge-based economy. A more competitive Australian economy will also serve to enhance our capacity to attract both talent and capital, helping to fuel the necessary investment into Australian businesses across our domestic market.

Innovation investment in Australia is driven largely by the willingness of investors, such as private capital firms (and their investors), to take risks and invest in businesses that are creating new and innovative products and services, and in doing so, establishing markets that often do not even currently exist. These investments are often at the earliest stages of a new venture's life, or at key points in the life cycle of family business succession, both of which are considered to carry high risk for different reasons. Along with the provision of capital, this funding is accompanied by highly valuable strategic and operational advice and guidance to the founders and management teams of private, early-stage and fast-growth businesses. This model of working in partnership is often the 'x-factor' that can help these innovative businesses to realise their ambitions in domestic and global markets. The expansion and growth of such businesses leads directly to more revenue and sales, greater levels of investment into innovative market-leading research and development, and ultimately, is the key driver behind

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<sup>3</sup> [Venture Capital Dashboard FY2019/20](#), Department of Industry, Science Energy and Resources

<sup>4</sup> An overview of the impact of the ESVCLP and VCLP investments, EY, September 2021 – Appendix B



the creation of new high-value jobs within the economy and higher contributions to income tax and other government revenue streams, including GST.

Australia has a history of successful companies originating from our nation's innovation ecosystem: companies like Canva, Airwallex, Afterpay, Appen and 10x Genomics, which today are each worth significantly more than \$1 billion. To put this into perspective, 52 companies founded by Australians since 2011 are each worth more than \$100 million, 14 are worth more than \$500 million and 6 are worth more than \$1 billion. The majority of these companies (75%) have continued to retain their headquarters in Australia.<sup>5</sup> These are the companies that employ local talent and contribute to local employment and economic growth. These private capital-backed businesses will continue to grow in significance as major employers and contributors to Australia's economic output.

## 2. Historical context

Australia has long supported programs specifically targeting venture capital and innovation through specific tax concessions. In 1992, the Keating Government introduced the *Pooled Development Funds Act 1992* (Cth) and its counterpart tax provisions. These provisions continue to operate for registrant funds who obtained registration prior to 21 June 2007. The pooled development fund (**PDF**) program was introduced to develop the market for patient equity capital, including venture capital, for small to medium sized enterprises (**SMEs**). A PDF is a venture capital fund (a limited liability company that is registered as a PDF) that provides capital and management assistance to growing Australian SMEs. The initiative was launched in July 1992 in response to strong anecdotal evidence that capital markets were failing to adequately service the equity funding needs of growing Australian SMEs.

In 2002, the Howard Government also introduced the Venture Capital Limited Partnership (**VCLP**) and Australian Fund of Fund (**AFOF**) programs in response to the needs and feedback of Australian fund managers and foreign investors who required a Limited Partnership fund vehicle for investment purposes, this being by far the mostly widely used and understood investment vehicle globally with "flow-through" tax status. In fact, flow-through tax status is an essential requirement for most foreign investors in order to ensure that they are taxed in their own country of residence (in accordance with long-standing international tax practises), as well as domestic investors (to ensure that they are taxed at their own marginal tax rate).

Two new Acts, the *Venture Capital Act 2002* and the *Taxation Laws Amendment (Venture Capital) Act 2002* received Royal Assent on 19 December 2002 with the tax concessions in those Acts effective from 1 July 2002. The measures were designed to encourage the pooling of private capital to be invested into start-up, small, medium and expansion-stage Australian companies with an asset value of less than \$250 million.

Previously, the only tax concession for venture capital investments was an income and capital gains tax exemption for direct investments in certain Australian companies and fixed trusts by foreign superannuation funds of a limited number of specified countries.

A major obstacle to attracting foreign venture capital investment had been the treatment of limited partnerships as companies for Australian tax purposes. Limited partnerships are favoured internationally as investment vehicles for venture capital investments, and generally enjoy flow-through taxation treatment overseas. In Australia, VCLPs are typically used as the collective investment vehicle to pool capital for investment in later-stage ventures and expansion-stage deals that meet certain eligibility criteria as set out under the *Venture Capital Act 2002*.

The main aim of the VCLP vehicle was:

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<sup>5</sup> A unicorn a year: More than 50 Australian startups founded since 2011 are valued over \$100 million: *Smart Company*, May 24, 2019



- 1) To provide a flow through vehicle for investors;
- 2) To specifically exempt most foreign investors from an Australian tax liability (appreciating that Australia did not legislate a capital gains tax exemption for foreign investors until 2006 – but announced it in 2004) under the Review of International Tax Arrangements (**RITA**) undertaken by Treasury;
- 3) To effectively ensure that the activities of the Australian manager did not result in a tax liability for foreign investors; and
- 4) To specifically support a broad range of investments into emerging and growing Australian businesses with an asset value of less than \$250 million.

In any case, following an extensive review by Treasury in 2004, under RITA, Australia largely aligned its international tax framework to exempt foreign entities from Australian tax, except in cases involving Australian real estate or mining investment.

Nonetheless, the combined effect of the 'dot-com' and 'tech wreck' of the early 2000s had effectively decimated Australia's fledgling venture capital local funds management industry which emerged after the reforms and significant success in the 1990s.

The ESVCLP was introduced by the Howard Government in 2007 to deal with the specific market failure of venture capital funds having the capacity to invest in high potential early stage investments, which, by and large, had failed to attract capital under the pre-existing VCLP regime. To encourage these types of specific investments by Australian investors, the ESVCLP introduced a tax concession for both Australian and foreign investors (unlike the VCLP which only exempted foreign investors) and in particular, those funds looking to invest in Australian companies with an asset value below \$50 million.

The emergence of the ESVCLP regime occurred at the same time as the early onset of the 2008 and 2009 Global Financial Crisis (**GFC**) started to impact appetite for all investment including in riskier assets such as early stage venture capital, and to a large extent, all private capital of any investment size.

In 2009-10, new and emerging investment managers who survived the dot-com/tech bubble and GFC, slowly began to register for the programs.

Further changes to the ESVCLPs and VCLPs which were made effective on 1 July 2016 as part of the National Innovation and Science Agenda (**NISA**) reforms, which were strongly supported by the private capital industry. Most of the reforms were in fact aimed at supporting early stage investment, which continued to be the subject of perceived market failure, because of their increased risk and poor financial performance in the preceding decade and half.

In a move supporting investment into Australian businesses, the government implemented changes to ESVCLPs and VCLPs on 1 July 2016. However, due to the speed with which they were introduced, there are a number of areas where technical and interpretative amendments and clarifications regarding these investment vehicles are necessary.

As outlined below, we submit each of the VCLP, ESVCLP and AFOF programs are meeting their objective to generate additional venture capital investment, including foreign venture capital investment in Australia.

We note that the AFOF, being a feeder fund vehicle only being able to invest in VCLPs and ESVCLPs, means its success is aligned with the success of the other two programs.

However, we believe there are still some significant issues which are giving rise to uncertainty, both in practice and technically, which we have previously raised and have shared with the Treasury, and other government departments which we believe could be efficiently and expeditiously resolved in order to further encourage investment using VCLP and ESVCLP vehicles. In particular, Australian investors require assurance that their investments are taxed on capital gains tax account – consistent with other fund vehicles in Australia (such as managed investment trusts) and overseas.



Providing clarity and certainty on the framework for VCLPs and ESVCLPs and making them competitive with other jurisdictions will be attractive to investors considering medium and long-term investments into Australian businesses across a range of new and emerging sectors of the economy.

### 3. Background and history of the Council's role in developing the policyarchitecture of the regime

The Australian Investment Council (formerly AVCAL) contributed to the early-stage modelling of the VCLP framework in Australia, introduced in 2002. When the Government first announced the initiative on 15 October 2001, AVCAL estimated an additional \$1 billion of foreign investment may be attracted to Australia as a result of these initiatives.

AVCAL also worked with government around the design of the ESVCLP vehicle in 2007.

Reforms to the ESVCLP/VCLP regimes were made effective 1 July 2016 as part of the NISA and were strongly supported by the private capital industry and AVCAL. The reforms implemented as part of the 2016 package were an important component of the broad-ranging changes that helped to catalyse a new wave of investment into Australia's innovation ecosystem, including tax incentives.

Some of today's success stories amongst our early-stage businesses are attributable to the 2016 reforms that helped to drive new levels of investment from private capital firms and other institutional investors. It was recognised at the time of the 2016 changes that further technical amendments would need to be made as part of follow-on reforms over subsequent years. We outline in **Appendix D**, a list of the key issues which, if addressed, could further catalyse the economic and market impact of the VCLP and ESVCLP regimes.

Investments by Australian VC funds in successful businesses such as Canva (see **Case Study 1 in Appendix A**) are impacted by the existing constraints. The success of such businesses represents textbook examples of the ESVCLP regime doing exactly what it was intended to do – encouraging investment into companies that have the potential to succeed on a domestic and global level. These businesses – and their investors – are working within uncertain parameters which in some cases could jeopardise their prospects for growth and their capacity to remain Australian-domiciled businesses backed by predominantly, domestic investors.

### 4. Evolution of venture capital over the past decade

As highlighted in the *Australian Innovation System report 2017*,<sup>6</sup> published by the Department of Industry, Innovation and Science, there remains much room to grow the local VC sector, and to boost investment into high growth companies. While unicorn companies tend to make media headlines, the industry fundamentally supports SME businesses that are central to Australia's employment and economic growth.

Funding comes through a range of sources which are set out in the table below.

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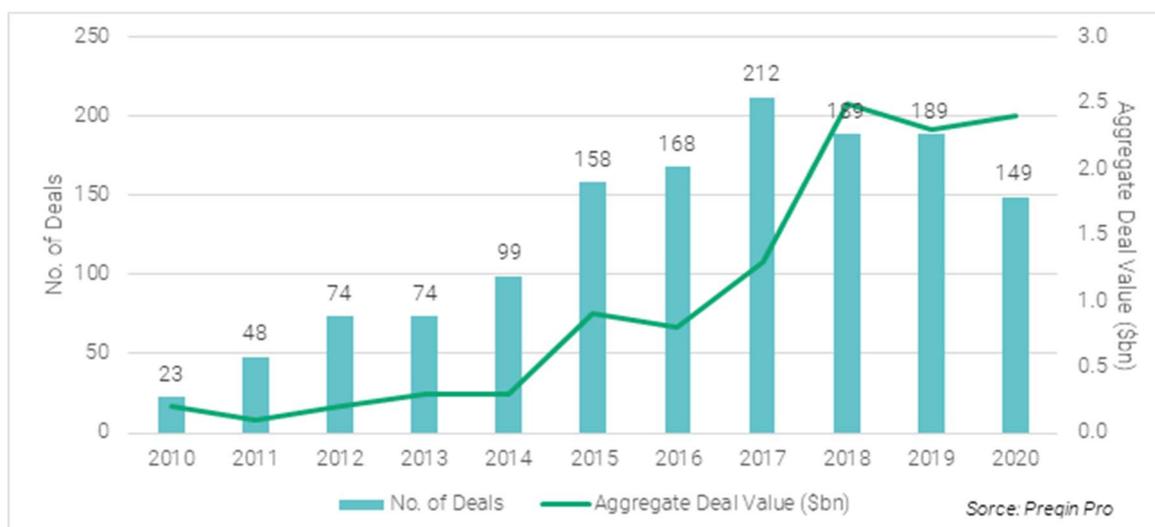
<sup>6</sup> [Australian Innovation System Report](#), Department of Industry, Innovation and Science, 2017



<p><b>01</b> </p> <p><b>Micro VCs</b> provide seed funding to start-up companies to build a minimum viable product and test the viability for the product in the market. Generally, the funds raised and the amounts of capital invested will be smaller than subsequent funding rounds.</p>	<p><b>02</b> </p> <p><b>Early-Stage VCs</b> offer funding which may go towards developing further versions of the product, building production facilities, or implementing early sales and marketing initiatives.</p>
<p><b>03</b> </p> <p><b>Later stage VCs, growth capital and turnaround firms</b> invest in companies that typically have a commercially available product, generating revenue and profits, paying tax, and are seeking capital to fund their further growth and/or staged succession of the family business owners to help the businesses to add new innovation and growth.</p>	<p><b>04</b> </p> <p><b>Corporate VCs</b> are launched and/or funded by a large corporate institution, and may invest at all phases in the venture capital lifecycle. Examples of venture capital arms using the ESVCLP include Reinventure (backed by Westpac) and Main Sequence (backed by CSIRO).</p>

Australia's venture capital ecosystem has continued to mature in recent years. **Figure 1** below shows how the industry has grown from a relatively low participation rate in 2010 with 23 investment deals to 212 in 2017 when the NISA reforms were implemented, to 149 deals in 2020 with an aggregate deal value of \$2.4bn.

**Figure 1: Venture Capital Deals\* in Australia, 2010 – 2020<sup>7</sup>**



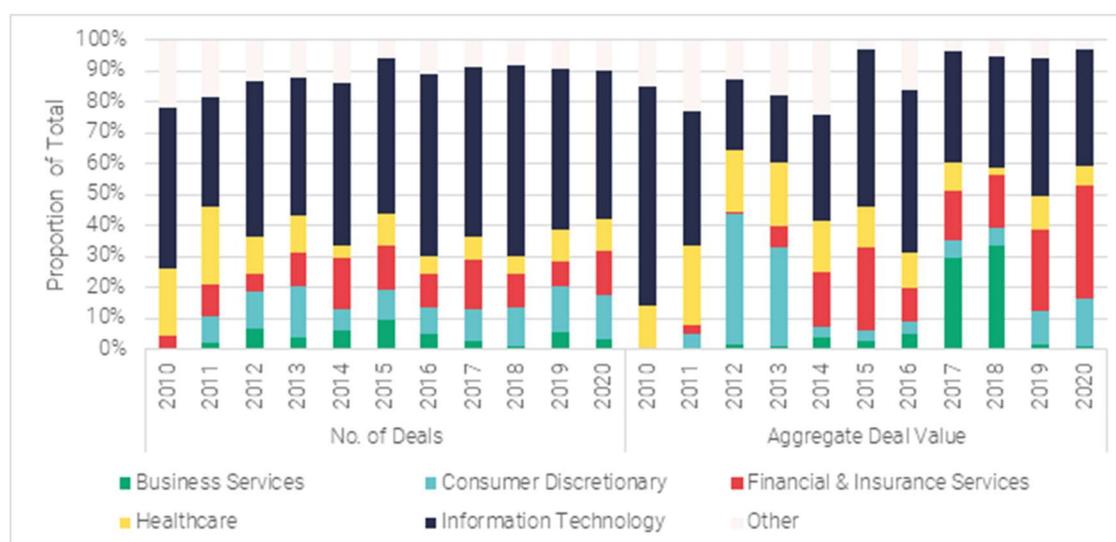
\*Figures exclude add-ons, grants, mergers, secondary stock purchases, and venture debt.

<sup>7</sup> Preqin & Australian Investment Council Yearbook, June 2021



The breadth of VC investment by industry is reflected in the data set out in **Figure 2**. The information technology (IT) sector has long dominated the Australian venture capital scene. Since 2010, IT deals have comprised 51% of total transactions and accounted for 41% of aggregate deal value. In 2020, the dominance of IT receded slightly, to 38% of total transactions, with activity in financial and insurance companies climbing to 37% of deals. Technology is one area undergoing radical transformation. In 2018, 12% of Australians were utilising digital payment solutions, but this is expected to accelerate rapidly to 70% by 2023. All of these trends are underpinned by the important role played by ESVCLPs and VCLPs in enabling capital to be deployed into businesses across all of these sectors within our national economy.

**Figure 2: Venture Capital Deals\* in Australia by Industry, 2010 - 2020<sup>8</sup>**



\*Figures exclude add-ons, grants, mergers, secondary stock purchases, and venture debt.

## 5. Contribution of ESVCLPs and VCLPs to the economy

To demonstrate how the ESVCLP and VCLP programs have contributed to the Australian economy, EY conducted modelling on the impact of investment through the programs comparing data from 2015/2015 to 2018/19 data and concluded that the investments made through the tax programs are on average much larger than other VC investments. The full report is attached as **Appendix B**.

### EY Modelling<sup>9</sup>

The programs have contributed a significant share of investments in the Australian venture capital sector.

EY's modelling found in 2014/2015 **33%** of VC investment by value was registered under the ESVCLP and VCLP programs compared to **80%** in 2018/2019.

### The number of annual VC investments is growing.

**256** investments have been made through the VCLP and ESCVLP programs since 2014/2015, **112** in ESVCLP and **144** in VCLP.

<sup>8</sup> Preqin & Australian investment Council Yearbook, June 2021

<sup>9</sup> An Overview of the impact of the ESVCLP and VCLP investments, EY, September 2021 (Appendix B)



In addition, according to statistics from the Australian Bureau of Statistics (**ABS**) on private capital investments, these have grown from **301** in 2014/2015 to **517** in 2018/2019

The ability of private capital to create new businesses and sectors across the economy can be demonstrated through the rapid growth of companies over the past few years. We refer you the case studies in **Appendix A** for further details.

As a net importer of capital, Australia's economy relies on a dependable and steady flow of foreign capital to drive economic growth and job creation. At this critical juncture in our national response to the COVID-19 pandemic, it is vitally important for our economic recovery, and Australian jobs, that businesses are able to quickly and efficiently access capital from domestic as well as offshore investors. The ESVCLP/VCLP regime plays a pivotal role in supporting the flow of foreign capital investment in Australia with 50 per cent of program's committed capital from foreign sources.<sup>10</sup>

However, the industry's ongoing capacity to continue to invest greater amounts of capital into Australian businesses, leading to the creation of new high-value Australian jobs, cannot be assumed – policy must continue to support, enable and encourage capital investment into the domestic market. While the private capital industry currently has more than \$13 billion in available capital to support investment into new deals in the period ahead, the sector's ability to continue to grow the pipeline of funding available to high-growth potential Australian business over the coming years will be increasingly dependent on inbound capital from offshore investors. There are four main drivers underpinning the flow of private capital investment in the medium-term:

1. History shows investment into innovation and research falls after a crisis, despite being a key economic driver and the temporary FIRB restrictions in 2020 inhibited the capacity of VCLPs and ESVCLPs to raise capital and make investment when they had existing passive foreign investments;
2. Early evidence of 'capital rationing' and some risk aversion materialising;
3. Constraints on access to institutional investment from superannuation funds due to a heightened focus on maintaining liquid positions and uncertainty in relation to future valuations; and
4. COVID-19 restrictions hampering the ability of fund managers to connect with (potential) investee businesses and institutional investors. This is particularly acute for new funds that do not have established relationships.

Private capital firms invest in most sectors of the Australian economy. Analysis by Deloitte Access Economics, conducted separately and not for this purpose,<sup>11</sup> found firms under private capital ownership in Australia accounted for \$43 billion in total value added to the economy – equal to 2.6% of GDP – and supported 327,000 full-time equivalent (FTE) jobs in various industries where that capital was deployed. Deloitte found that private capital firms created **1 out of every 9 new jobs in Australia** and private capital firms' workforce grew by 24% on average, compared to the national average of 0.3%.

This contribution is significant, despite the relatively small size of private capital in Australia.

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### *Private capital firms create 1 in 9 new Australian jobs*

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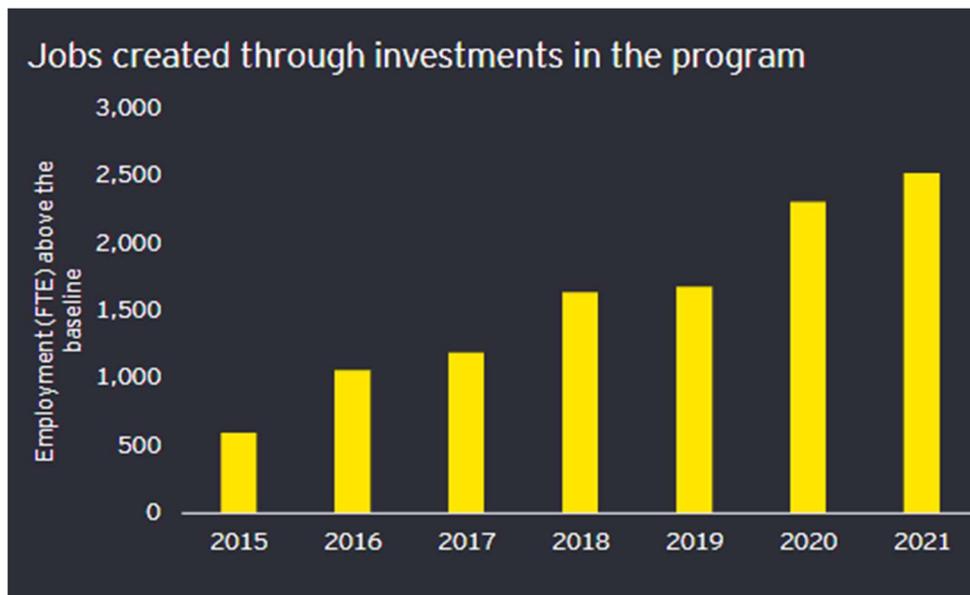
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<sup>10</sup> [Venture Capital Dashboard FY 2019/20](#), Department of Industry, Science, Energy and Resources

<sup>11</sup> [Private Equity Growth and Innovation](#), Deloitte Access Economics, April 2018

Separate analysis by EY, conducted for the purposes of this submission, shows the significant contribution of the ESVCLP/VCLP regimes to the creation of jobs within the Australian economy with 10 FTE jobs created for every investment made through the program and 2,524 FTE jobs (above the baseline) forecast to be created in 2021.<sup>12</sup>(Figure 3)

**Figure 3: Jobs created through the ESVCLP/VCLP programs**



Source: EY

The EY modelling also shows that if investment through the programs remains stable, Australia can expect a continued increase in employment, GDP and income. By 2031, this continued investment in the programs is projected to support an additional 4,255 FTE employees, and national income will continue to rise over the next decade, with GNI expected to be \$2,786 million higher in 2031. GDP will follow a similar pattern to GNI, with GDP expected to be \$3,772 million higher than if the investments in the program had not materialised. (Figure 5).

**Figure 4: Jobs created through the ESVCLP/VCLP programs – 10-Year forecast**

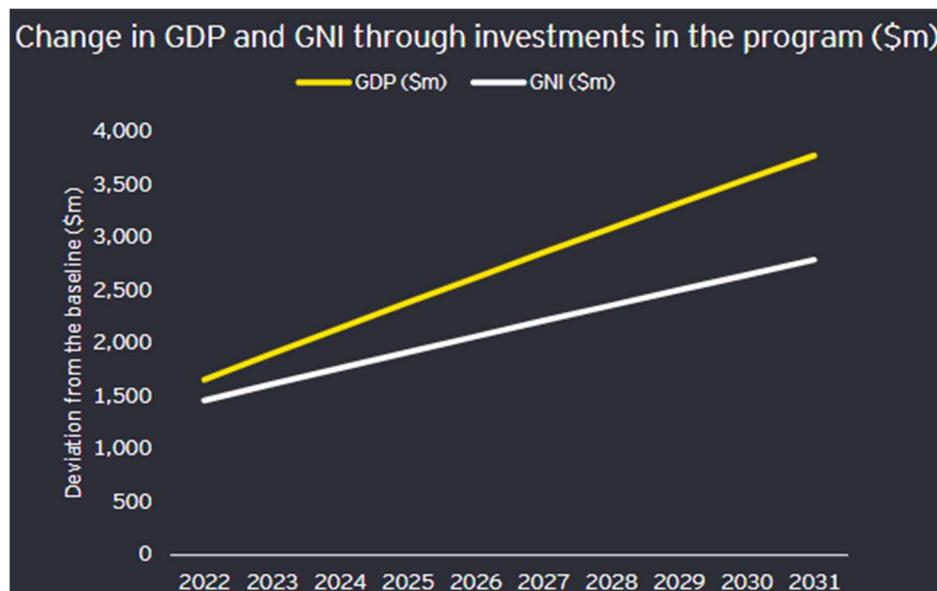


<sup>12</sup> An overview of the Impact of ESVCLP and VCLP investments, EY, August 2021 (Appendix B)



Source: EY

**Figure 5: Change in GDP and GNI through investments in ESVCLPs and VCLPs**



Source: EY

### Foreign investment regulatory challenges

One challenge and barrier for VCLPs and ESVCLPs are the Foreign Investment Review Board (**FIRB**) requirements that apply to a range of investors in Australia. Given that foreign investors are passive limited partners in these limited partnerships, they question the need for an Australian managed fund, regulated by the Commonwealth, to seek foreign investment board approval. The Council has made a submission to Treasury recently on various matters relating to foreign investment which we are happy to share with Treasury and IISA as part of this review if that would be helpful.

Currently there is no explicit exemption for VCLPs and ESVCLPs in the FIRB requirements. VCLPs and ESVCLPs are already regulated by the Commonwealth and are specifically encouraged to seek foreign investment with control residing with the General Partner (**GP**) and Manager not the Limited Partners (**LPs**). In some cases, the Commonwealth is a limited partner itself directly or indirectly (e.g. through the Future Fund, CSIRO, and Clean Energy Finance Corporation). As LPs are passive investors in VCLPs and ESVCLPs they should be excluded from FIRB restrictions.

### Emerging tax and corporate law challenges

As outlined above, the VC Tax Concessions regime has made a significant contribution to investment, productivity and the growth of new businesses and employment. Since the regime was introduced, innovation has significantly developed generating new industries such as Fintech and food technology in recent years.

Fintech is a sector which has not only grown since the regime was introduced, but is also a field where Australia has a comparative advantage given its strong financial services industry. However, this position is under challenge from other jurisdictions. In Australia, the law has not kept in pace with the development of the sector around the definition of financial technology and where it converges with mainstream financial services businesses.



Under section 118-425(13) of the ITAA 1997, restrictions are placed on investments made by ESVCLPs and VCLPs into Fintech companies.

Under the Act, the following investments are ineligible:

" (b) *finance, to the extent that it is any of the following:*

*(i) banking;*

*(ii) providing capital to others;*

*(iii) leasing;*

*(iv) factoring;*

*(v) securitisation;*

*(c) insurance;*

*(e) making investments, whether made directly or indirectly, that are directed to deriving income in the nature of interest, rents, dividends, royalties or lease payments."*

Despite recent changes to address the matter as part of the NISA reforms, in s 118-425(13A), the feedback received by the Council from members and advisers is that the provisions are still deficient as they do not adequately deal with the convergence of new technology and the provision of financial services. This legislation needs to be amended to provide more clarity to ESVCLPs and VCLPs investing into Fintech businesses to enable a more level playing field for all investors into the Fintech sector.

### **Out of date thresholds**

We note that the relevant legislative limits of \$250 million and \$50 have not been updated since 2002 and 2007 respectively.

Given the growth and maturity of the industry since the regime was first introduced in 2002, the deal sizes and value enterprises have also increased during this time. This means the \$250 million threshold for VCLPs and the \$50 million enterprise value cap for ESVCLP investments set some 19 and 14 years ago respectively, are becoming increasingly challenging to apply.

Given the effects of inflation over time, as well as increasing funding needs of investee companies, these value caps urgently need to be revised upwards to allow funds to continue to invest in companies originally intended to be the targets of these support measures. Otherwise, the "bracket creep" is effectively precluding these types of investments from being made. Using inflation figures, the \$250 million in 2002 is now closer to \$380 million in 2021 terms and \$50 million is closer to \$67 million in 2021 terms. We would urge the Government consider increasing these thresholds upwards to \$500 million and \$100 million respectively and to introduce an inflation adjustment mechanism, such as CPI, to keep these benchmarks relevant.

## **6. Private Capital – supporting SME market growth companies**

The VC Tax Concessions have been key to the success of many Australian companies backed by the programs under review. We have attached some of their success stories in **Appendix A**.

Empirical evidence shows that private capital-backed firms make a positive contribution to company performance and economic growth. A study by Bernstein et al found industries where growth funds invest grow more quickly in terms of total production and employment and appear less exposed to aggregate shocks. Bloom et al. found that private capital-owned firms have strong people management practices, but even stronger operations management practices, compared to other firms. Hotchkiss et al. examined the role private capital



firms play in the resolution of financial distress of firms that borrow in the leveraged loan market and show that private capital sponsors resolve distress in portfolio firms relatively efficiently.<sup>13</sup>

A traditional view of private capital managers is that they buy companies undermanaged and in debt and transform them into efficient and viable investments. However, to be effective, managers need operational experience, such as time spent working as a CEO, so they understand the dynamics of a company and its surrounding sector. This operationalisation of private capital and active ownership of investments has continued to develop in Australia as it has in other countries around the world, offering more opportunities to invest and to be confident in their managers.

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*Businesses benefit not only from capital invested but also from leveraging private capital firms' expertise, guidance and networks.*

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While from time-to-time, the perception of private capital is that the large buy-out deals dominate the sector, the reality is that while these are the deals that mainly make media headlines and are not being made under the VCLP and ESVCLP programs, the core work of the sector is in helping small to medium-sized businesses to grow, providing flow-on effects to employment and economic growth.

The pandemic has provided an opportunity for private capital to showcase its active, agile and long-term investment nature with Australian based fund managers investing to support growth and succession throughout the Covid-19 crisis. Further, this model is driven by investors seeking long-term performance and more efficient governance models. This is expected to continue as fiscal stimulus, combined with low interest rates, has created a favourable investment environment for long term, multi-year patient capital.

Private capital firms partner with Australian businesses and entrepreneurs to help them to innovate, grow and expand. This is achieved through a close working relationship where businesses benefit not only from the capital invested but also from leveraging the firms' expertise, guidance and networks.

The majority of private capital investment is directed into SMEs and early stage and growing businesses. Private capital fund managers partner with entrepreneurs who often lack the experience and resources to fulfil their companies' potential, or to properly navigate risk and uncertainty. Private capital funds regularly meet those funding and experience gaps, providing crucial support at critical stages of a company's life cycle.

Just as the VC Tax Concessions framework is building and supporting the growth of SMEs, this sector is also benefiting from new products and services and foreign investment which have emanated from the regime.

Australia has been an incubation hub for early stage businesses which often have very long lead times between when an idea and hypothesis is formed to commercialisation and cashflows achieved. Biotech is a sector that has flourished in Australia through the support of the VCLP regime (see **Appendix A** on the case study of **Vaxxas**).

The level of engagement and commitment that comes from working closely with investee firms, which in many cases involves daily engagement with management teams, is one of the ways that growth capital firms help Australian businesses to grow and expand within domestic and international markets. In fact, businesses who partner with private capital firms have been found to grow faster and increase their workforce quicker than firms that do not partner with growth capital firms (**Figure 6**).<sup>14</sup>

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<sup>13</sup> Private Equity Growth and Innovation, ibid

<sup>14</sup> Source: Milken Institute Private Equity IPOs - Wilhelmus and Lee p 11 (2019)



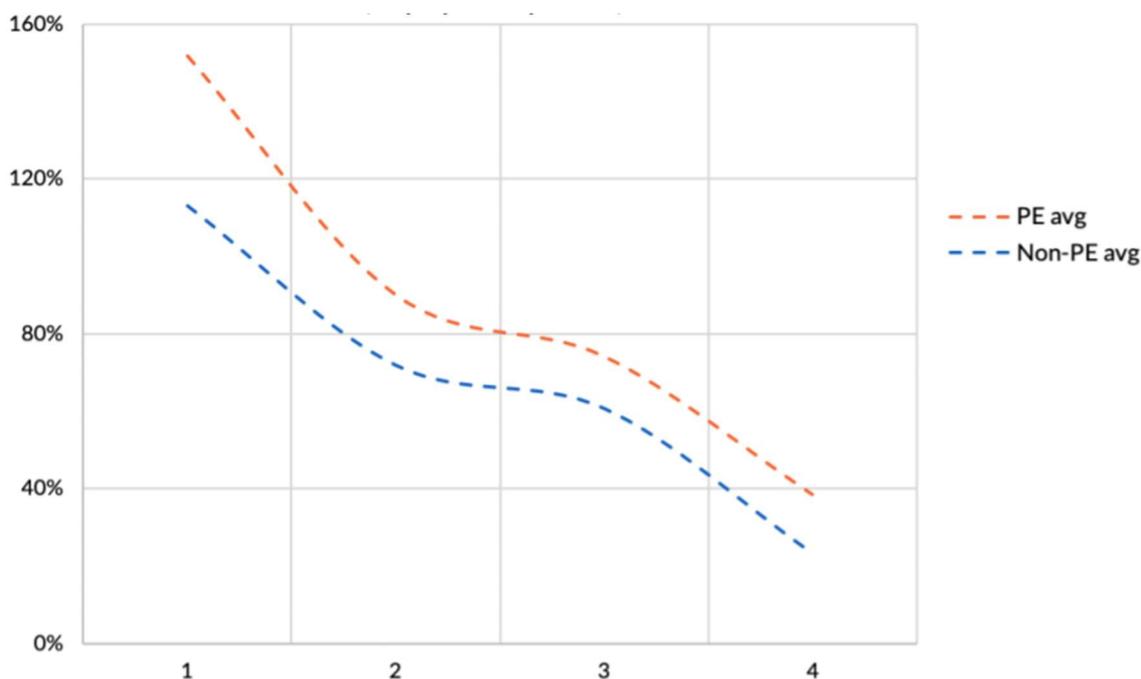
Its ability to quickly reallocate capital makes private equity a fantastic catalyst of change. Using foresight informed by analysis, private equity effectively takes capital away from industries with poor future outlooks and reallocates it to a sector with a better one, for example strengthening and supporting companies operated according to ESG values. And this is what we have seen happen since early 2020.

The pandemic has accelerated change – particularly long-term trends such as working from home and acquiring new technology to make this possible. Companies shifted to cloud-based technologies and rather than innovating themselves, supported SaaS (using software as a service solution) instead of building a business infrastructure, and fast-forwarded their Environment, Sustainable and Governance (ESG) journey.

Businesses that partner with private capital firms are also more likely to innovate and undertake R&D. A study by Deloitte Access Economics found that more than 85% of private capital investee companies introduced some kind of innovation and were much more likely to introduce innovations than other businesses.<sup>6</sup> One reason that private capital investee companies are able to focus on innovation, which can be risky and time consuming, is that private capital is 'patient'. This means that private capital investors are willing to invest the time and money required to allow innovative ideas and businesses grow. This is possible due to private capital firms investing over a longer horizon with funding committed upfront and by allowing entrepreneurs to develop their ideas away from the pressures of quarterly public reporting.

An additional advantage of the private capital model is that capital is pre-committed usually for a 10-year period. That is private capital firms have a pipeline of capital they can rely upon, even if capital markets dry up or become illiquid and demonstrates more than most other asset classes and investors that longer term capital nature of the investing. While there are significant challenges facing private capital's ability to raise capital in the coming months and years, fortunately private capital has already built up a large stock of capital. This 'stockpiled' capital, known as dry powder, currently stands at \$13 billion.<sup>15</sup> This provides private capital firms with the ability to continue to provide funding and support to Australian businesses at this time of heightened need.

**Figure 6: Employment growth of Growth Capital-backed vs non-Growth Capital backed companies** (by company size; employment quartiles)<sup>15</sup>

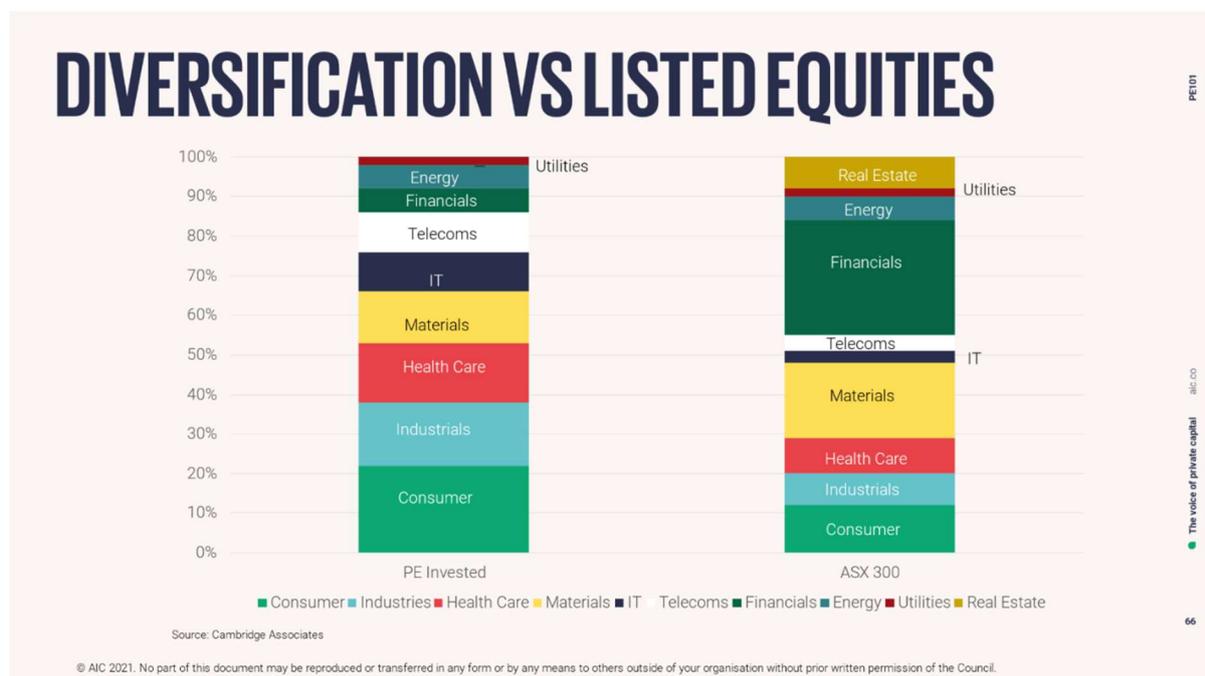


<sup>15</sup> Source: Source: Milken Institute Private Equity IPOs - Wilhelmus and Lee p 11 (2019)



Private capital is an important part of the investment ecosystem, providing broader investment diversification opportunities than traditional equity investments and enabling access to investments and market segments that cannot be reached through public markets. This allows investors to diversify risks and improve the asset mix of their portfolios and ultimately, improve their investment returns. Private capital managers add considerable value to the investments made into their portfolio companies through active management in helping businesses to expand and to find new market opportunities. **Figure 7** demonstrates how private capital investments provide diversity compared to listed equities.

**Figure 7: Diversification vs Listed Equities**



### Improving skills and experience

In a global context, private capital in Australia is relatively small compared with the US and Europe. However, Australia's private capital market is continuing to mature, evidenced by the need for managers to have operational experience, such as time spent working as a CEO, so they understand the dynamics of a company and its surrounding sector. Combined with the active ownership of private capital investments the sector will continue to develop in Australia as it has in other countries around the world, offering more opportunities to invest and support great Australian businesses during their growth stages as they seek to expand or develop new market opportunities. These are the businesses that form a large part of the SME sector, who offer growing employment opportunities and contribute to our nation's economic growth.

The VCLP, ESVCLP and AFOF programs are meeting their objective to develop venture capital management skills and experience in the Australian venture capital sector. This is both the management skills and experience of the fund managers including those who sit on the boards as directors of the portfolio companies as well as the management teams within the underlying businesses (an example of this is Square Peg Capital as discussed in **Case Study 4 in Appendix A**).



The makeup of the industry includes many young people and women, as well as people who have had diverse life and business experiences, all working in a very close and tight knit ecosystem of collaborative professionals.

These businesses make a fantastic impact for “Brand Australia” including in tourism, hospitality and in services (see for example **Case Study 6 in Appendix A** on **Great Southern Rail** who were identified by Allegro as a successful business previously languishing under foreign corporate multinational ownership).

The VC Tax Concessions for both for general partners and limited partners in VCLPs and ESVCLPs have enhanced the ability of the sector to retain talent within Australia and attract talent from overseas that otherwise might follow other career paths. One example of a successful VC fund manager which has emerged under the regime is Square Peg Capital. This firm has three ESVCLP funds invested over various vintages and has sought the best international talent to support its growth and expansion into new market sectors and to provide the highest level of expertise for its portfolio companies. (see **Case Study 4 in Appendix A**).



## Appendix A

### Case studies

Below are some examples of organisations which have succeeded in part due to the availability of the VC Tax Concessions.

#### **Case Study 1: Canva backed by Blackbird Ventures**

Canva has been supported through the ESVCLP program from its early-stage capital fundraising to growth capital stages to become one of the world's largest software companies.

The company now employs 1,700 highly skilled people world-wide, the majority in its Surry Hills headquarters.

Canva was founded by Melanie Perkins, Cliff Obrecht, and Cameron Adams in 2013, with the ambitious goal of empowering the world to create beautiful designs. Canva was originally built on the premise that a large portion of the desktop publishing market was being significantly underserved by existing solutions. The gap in the market the company filled was for users who wanted to create beautiful designs without a lot of upfront learning or costs. Thus, the team sought out to build a magically simple design platform that would delight users.

Blackbird co-founder and Partner, Rick Baker, initially met Melanie and Cliff in 2012 in Perth where they were running their prior startup, Fusion Books. At the time, Blackbird was raising its first ESVCLP Fund, which ended up being a fund of A\$29.4M in committed capital from a collection of 96 individual investors. In May 2013, soon after the Blackbird ESVCLP had a first close on its capital, it made an investment of US\$250,000 into Canva's seed round. At this point, Canva was still an idea being pitched to investors by two young founders from Western Australia. This seed funding would be used to develop and launch the first version of Canva's platform.

Since then, Canva has become one of the fastest-growing software companies in the world and Blackbird has continued to participate in every single funding round, investing out of its first ESVCLP and a number of Follow-on Funds. Overall, Blackbird has invested over A\$270M into Canva since the first seed cheque in 2013.

As of 31 March 2021, Canva had over 55 million monthly active users and is growing its revenue by 130% year-on-year, while remaining profitable. More than 3 billion designs have been created using the Canva platform with the company recently releasing their new Presentations product for both consumer and business customers.

Canva has also become a magnet for attracting top engineering and product management talent to Australia. The company employs over 1,700 people worldwide, with the majority of these highly skilled employees based at Canva's headquarters in Surry Hills, Sydney. Importantly, one of Canva's core values is to "be a force for good" and the company has pioneered the Pledge 1% movement in the Australian technology industry.

Canva's platform is also used free of charge by over 90,000 schools and universities worldwide, in addition to 55,000 non-profit organisations. The ESVCLP program played a critical role in the early investment Canva raised and its growth as a rapidly-scaling company.

Blackbird's initial investment in the company from its first ESVCLP Fund supported the company to build its platform and go-to-market. The relationship built at this early stage then enabled Blackbird to continue investing in Canva through its follow-on-funds, providing the business with capital to expand and scale into the global success story it is today.



### **Case Study 2: Vaxxas Pty Ltd backed by Brandon Capital and OneVentures**

Vaxxas is commercialising a microneedle-array-patch (MAP) for the efficient delivery of vaccines that dramatically enhance the performance of existing and next-generation vaccines. The company believes its innovative needle-free technology will be fundamental to help the world in rethinking what's possible with vaccines.

Vaxxas was established based on a suite of intellectual property around the design and use of the MAP originally developed in the laboratory of Prof. Mark Kendall at the Australian Institute of Bioengineering and Nanotechnology (AIBN) at University of Queensland. The company was set up in 2011, raising a Series A financing round from Brandon Capital (investing out of its 2 VCLPs, BBF1 IIF Partnership, LP and MRCF IIF, LP), One Ventures (investing out of an ESVCLP) and Boston based Healthcare Ventures. The Company then raised a \$36 million Series B financing in Q2 2017, with these funds predominantly coming from the One Ventures managed funds (including ESVCLPs). In April 2020, the company raised a \$15 million Series C investment from global pharma company Merck. Vaxxas' MAP technology has now been validated in human clinical studies and has been shown to enhance the efficiency and effectiveness of a vaccine's immune response. The company uses proprietary dry-coating technology that can eliminate or significantly reduce the need for vaccine refrigeration during storage and transportation, easing the resource and logistics burden of maintaining the vaccine "cold chain".

Vaxxas is targeting initial applications in infectious disease and oncology and has forged collaborations with leading global organisations in vaccine commercialisation, including Merck/MSD, the United States Biomedical Advanced Research and Development Authority (BARDA) (pandemic flu), the World Health Organization (WHO), and the Bill and Melinda Gates Foundation (measles and rubella).

Recently, Vaxxas has in-licensed a COVID-19 vaccine which it is now developing on its MAP delivery platform. If successful, a COVID-19 vaccine on the Vaxxas MAP delivery system would not require to be kept in a cold chain and nor would it require to be administered by a highly trained healthcare professional. The Vaxxas MAP technology could become an important part of the global fight against pandemic infections. The VCLP and ESVCLP programs played a critical role in providing the initial investment capital required by Vaxxas to take the MAP vaccine delivery technology from a lab at AIBN in Brisbane to its early clinical studies. Today, headquartered in Brisbane, Vaxxas has over 70 highly skilled (STEM) employees most based at its sites in Brisbane. The Company is continuing to rapidly expand and, indeed, has just begun to build its first manufacturing facility in Brisbane.

### **Case Study 3: Valiant Finance backed by Reinventure**

Valiant Finance was founded in 2015 in Sydney, as a digital marketplace which connects small businesses of Australia with potential lenders.

The founders identified a niche in the market created by restricted access to capital that many of Australia's two million small businesses were experiencing at the time. As a small business owner, with competing priorities and resource constraints, navigating credit options can often be a daunting experience, with a myriad of lenders, lack of transparency and complex fee structures. However, having access to the right finance structure and price can often be business critical for many SMEs.

Valiant set out to help small businesses discover their borrowing options, understand their creditworthiness, maximise chance of loan approval and make the loan application process more efficient. To achieve this, Valiant created a digital platform acting as a digital broker between the SMEs and the lenders. The digital



platform allowed a small business to obtain a credit health-check, using credit criteria to match them with products they are eligible for, and then apply using a simple, hassle-free digital application form.

Over the next six years, Valiant went from strength-to-strength, growing their team and helping small businesses of Australia access \$850 million in funding for asset finance, commercial and working capital loans. In 2017, Valiant was awarded the Fintech Start-up of the Year Award.

The business has grown to a team of more than 100, creating roles across various disciplines such as product, software engineering, business development, risk and compliance, customer support and many more. Valiant has raised over \$20 million in funding from both Australian and overseas investors, notably bringing the international juggernaut Salesforce<sup>16</sup> onboard as an investor in one of their recent rounds. Reinventure invested a total of \$5 million into Valiant over the course of five years, starting at Seed round and through to Series B. The investments were made through an ESVCLP fund.

#### **Case Study 4: Square Peg Capital**

Founded in 2012, Square Peg has grown from four co-founders, based in Melbourne and Sydney, into a global investment firm of around 30 people with offices in Sydney, Melbourne, Tel Aviv, and Singapore.

Square Peg invests in emerging technologies across the internet economy in early-stage companies that have the potential to grow into multi-billion-dollar enterprises such as Canva, Airwallex and Rokr, and has many more innovative businesses in the investment pipeline.

The ESVCLP regime has been a key contributor to Square Peg's growth and success with three ESVCLP funds included in funds raised by the firm over four vintages.

Investors consider many aspects when allocating capital. In addition to capital efficient vehicles, this includes the quality of the founders and team, traits that are equally important for Square Peg's success as a long-term venture fund.

As the venture capital investment cycle is a ten-year journey, the firm takes a long-term and holistic view of talent recruitment and development aiming to find, attract, and retain the best staff. Each time a new fund is raised, the firm assesses its resources and invests in new talent.

In Australia, Square Peg has hired specialist talent in investments, investor relations, operations, finance, law, and community. As the firm has evolved, it actively hires roles in new disciplines, searching for expertise and knowledge that will benefit its portfolio companies, and in turn grow the venture ecosystem. For example, in September 2021, a Head of Talent was hired in Australia to consult with Square Peg's portfolio start-ups to build scalable talent foundations and to enhance the firm's internal talent acquisition strategy.

As Square Peg's profile has grown and it has continued to evolve from its historic focus on market places and fintech, the firm's ability to attract top quality talent has increased in ever expanding and changing areas of innovation. Piruze Sabuncu, Stripe's Southeast Asian Head, was recently hired to complement and enhance Square Peg's expertise in fintech as well as other industries and in new and emerging technologies. Yonatan Sela, a crypto founder, with incredible blockchain and crypto expertise and passion was also recently hired.

All team members are empowered to share their expertise with portfolio founder teams and Square Peg alike, expanding and challenging knowledge of what is known and what will change.

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<sup>16</sup> Australian Financial Review – "[Salesforce, ANZ back Valiant to grow SME lending](#)"



Square Peg's policies are designed to create a working environment that cultivates development with a focus on learning and curiosity. The firm has embraced flexible, progressive policies that support diverse teams and strive to achieve staff longevity with initiatives such as an industry-leading parental leave policy, an individual personal and professional development budget, a regular, structured goal setting and performance management process, international team offsites and monthly culture-building activities. The firm also encourages participation in the community, which may manifest in many forms, such as directorships, advisory or mentorship roles.

The existence and expansion of programs such as the ESVCLP regime are vital and should not be underestimated. These programs encourage greater investment into venture capital, which in turn allows firms such as Square Peg to invest in talent, and invest in Australian start-ups. There is an incredible amount of innovation being developed by Australian founders who have massive vision and huge drive and ambition. The venture industry supported by great government policy and programs like the ESVCLP is key, providing the back bone and necessary structure for continued growth.

#### **Case Study 5: Swoop Aero backed by Folklore Ventures**

When Eric Peck and Josh Tepper launched Swoop Aero in 2018, they had already raised a small amount of capital. But as the scale of their drone supply start-up rapidly grew, they needed more. "The technology and long-term vision alignment we saw in venture capital is what drove us down that path," Eric explains. "It wasn't about what the return on capital was going to be in a five-year period. It was how to build the next big company of the future. We really wanted that."

The ability to raise capital gave Josh and Eric confidence to pursue what they had started, and Swoop Aero gained access to a deep pool of business expertise and experience to be tapped for advice, guidance, mentorship, and to help the company develop its growth plans.

Right Click Capital and Folklore hold board seats and have provided a range of advice, from planning and strategy to interviewing key executive hires. Venture capital directors also hold fortnightly calls with Eric to review progress, discuss issues such as capital allocation, capex and decision-making discipline, and develop and support efficient and agile governance processes.

Swoop Aero's two venture capital rounds have allowed them to hire the expertise they need. "We have gone from being in a garage to leasing the former GE head office in Port Melbourne. We're building aircraft using very mature manufacturing systems, a quality assurance program and, in the cloud, a full replica of the aircraft and its components. It has enabled us to build towards a solution that is very scalable," Eric said.

Swoop Aero's global business model has proven to drive strong demand, particularly following the onset of COVID-19 in Africa. Backed by big-name donors and healthcare agencies including the Gates Foundation, UNICEF, UN, USAID and UK Aid, Swoop Aero's two-way networks regularly fly medical supplies into remote villages in the Democratic Republic of Congo, Malawi and Mozambique.

More recently, Swoop Aero's newly-launched, next-generation aircraft, Kite, is undergoing FAA certification, and a pilot network of flights is underway in rural Victoria that could expand to hundreds of flights when commercial approval is granted. Similar services are already operating on a commercial basis with partners in England and Scotland, taking COVID-19 vaccines to remote areas.

Swoop Aero aims to reach 100 million people by 2025 and to manufacture 1000 aircraft each year, providing them with a force double of many craft in the air in any country at any time.



### **Case Study 6: Great Southern Rail backed by Allegro Funds**

**Great Southern Rail** is an example of how management skills have been deployed through the VLCP program in turning a company around from the brink of failure to a viable tourism experience.

Great Southern Rail (GSR) owns and operates the luxury trans-continental passenger rail services, The Ghan, The Indian Pacific and The Overland.

In 2015, Allegro Funds acquired GSR from its previous owner Serco. At the time of Serco's acquisition in 1999, GSR served an important role of providing affordable transport to people travelling across Australia and was heavily subsidised by State and Federal governments.

However, GSR suffered a major disruption to its business model with the arrival of low cost airlines in the 2000s. Transport passenger numbers dropped rapidly, from more than 140,000 in 2005 to 40,000 by 2015. With declining passenger numbers it became untenable for governments to continue the subsidies.

Without government support, GSR's existing business model was unsustainable and the business would be severely loss making. As such, a new business model was required in order to turn the business around, keep the iconic trains in service and retain the jobs of thousands of employees supporting the business.

Allegro's investment thesis was to transform GSR from a low value transport operator into a high value experiential tourism business. Allegro's experience in transforming businesses, coupled with a highly regarded and motivated GSR management team, were critical in ensuring the transformation was a success.

Upon acquisition, the first step in the transformation program was to create a sustainable stand-alone business, completely separate from Serco and no longer reliant on government funding to underpin operations. Once this was done, the transformation to luxury rail cruiser began. This included a new vision to focus on providing exceptional experiential travel experiences.

GSR CEO Chris Tallent said when Allegro acquired GSR it needed capital and a dedicated focus to reach its potential. "With a suite of iconic assets supported by a strong team, including Allegro and my management group, we were well positioned to capitalise on the forecast growth of the luxury experiential tourism sector in Australia."

The business invested over \$80m to upgrade the carriages and facilities while reshaping the product offer and experience by creating richer experiences, lengthening the journeys, all-inclusive offerings and unique off-train experiences.

At the same time, the whole operating model of the business was redesigned which included making the trains longer with reduced frequency and significant investments into systems, data and capability to ensure the business had the foundations in place to be a leading Australian tourism business. This operational transformation laid the foundation for the next phase of growth for the business.

During Allegro's ownership, the business tripled in profitability, the number of employees grew by more than 30%, forward orders doubled and the business achieved world class net promoter scores. Following a successful transformation of the business, Allegro sold a majority stake to Quadrant Private Equity who have used GSR as the platform asset for Journey Beyond, Australia's leading experiential tourism and leisure owner and operator in Australia. Under Quadrant's ownership, GSR has continued to grow from strength to strength and execute on the growth plans.

Through Allegro's investment, GSR transitioned off federal government subsidies, the businesses viability was assured, jobs were saved and GSR continues to provide iconic experiences that showcase the best that Australia has to offer.

A key aspect of the turnaround was the ability of Allegro to provide GSR with access to financial capital as needed. This included the upfront acquisition and investment, as well as a structure that allowed the business



to retain surplus earnings and funds without any obligation to have to distribute those funds to fund investors for otherwise tax or regulatory reasons. Allegro's investment was through a VCLP.

#### **Case Study 7: Indebted Holdings – backed by Reinventure and Carthona Capital**

**Indebted Holdings**, is a prime example of an innovative Australian approach to debt collection which has received funding from local and foreign sources and is now set to go global.

InDebted was founded in 2016 in Sydney, with an ambitious goal to reinvent collections through a digital-first, data-driven solution that delivers exceptional customer experiences. In simple terms, the company embarked on a mission to disrupt and improve the debt collection experience for everyone involved. An experience built upon digital communications, data-driven decision making and risk compliance, and exceptional customer experiences. Businesses outsource their debt collection to InDebted, who in turn liaise with the debtors, resulting in improved recovery rates, reduced compliance risk and better customer retention.

A real differentiating factor is InDebted's customer centric debt collection approach help people in a difficult stage of their financial life. This is evidenced by more than 1,000 five star ratings, received from consumers whom they are collecting from. The reviews show an empathetic and flexible approach that really resonates with consumers who need support during difficult times. Since its inception, InDebted has grown into a global leader in a mere 5 years. Raising a modest initial investment from friends and family, the business required a more significant investment in order to move forward. Reinventure made its initial investment of \$600,000 at Seed round back in 2017 and supported InDebted's growth all the way through to their most recent Series B capital raise, investing a total of \$8 million over 5 years. The investments were made through an ESVCLP fund.

Overall, InDebted has raised close to \$50 million in funding from both Australian and overseas investors. InDebted has processed more than \$1 billion of debt since it was founded and is used by the majority of non-banking fintechs, as well as big banks and telecommunications companies in Australia and New Zealand. As at 30 June 2021, InDebted employs close to 140 full-time staff in roles across engineering, customer experience, product development and many more.

The company invests heavily in its people and their growth, offering above market compensation, stock options, and unlimited paid leave. Importantly, the company has continued creating new roles throughout the Covid-19 pandemic, as it was seeing a surge in use as banks of all sizes were drawn to its less-aggressive communication approach with customers in arrears. The business supports over 250,000 customers through their platform and has a 98% customer satisfaction rating. InDebted is now set for global expansion, opening offices in seven countries, in addition to their headquarters in Australia.



### **Case Study 8: Appen backed by Anacacia Capital**

**Appen** is global leader in the development of high-quality, human annotated datasets for machine learning and artificial intelligence for use by technology companies and world governments. Through private capital investment, the company has grown from annual sales of less than \$10 million and 34 full time staff to \$107 million of EBITDA and more than 1,000 staff.

Appen is an Australian success story. Anacacia Capital's backing of the founders have helped grow Appen into a leading company on the ASX, growing its shareholder value more than 100 times since Anacacia's first investment in 2009 and more than 20 times its initial public offering price in 2015, now employing over 1,000 staff and over a million contractors through its crowd.

Appen is global leader in the development of high-quality, human annotated datasets for machine learning and artificial intelligence for use by technology companies and world governments.

Appen was founded in 1996 by linguist Dr Julie Vonwiller and her engineer husband, Chris Vonwiller. Prior to Anacacia's investment, Appen was reliant on its founders to run the business and make strategic contributions. As Julie and Chris approached retirement, they sought a more hands-off role in the business and the need for succession planning.

Anacacia Capital acquired a majority share in Appen in 2009, with the founders retaining a meaningful share. At the time of investment, Anacacia Capital and the Appen founders agreed to bolster the management team. Anacacia Capital led the recruitment process through its networks and helped structure a plan for the management team to invest into Appen alongside Anacacia and the founders. This aligned the interests of the management team with the success of the business. Anacacia Capital also worked to further improve governance, including assisting in boosting the finance and business development team, putting in place a non-executive board of directors that included Anacacia Capital's Jeremy Samuel and Jon Shein.

Appen produced \$107m EBITDA on \$600m of revenue in calendar year 2020. Prior to Anacacia Capital's investment in Appen, the company had annual sales of less than \$10 million and employed 34 full time staff. Anacacia Capital sourced and led Appen's first major acquisition that materially increased their US presence closer to their customers. In January 2015 Appen floated on the ASX and Anacacia Capital began a staged exit from its investment by its venture capital limited partnership fund. At the same time, Anacacia's Australian focused public equities fund, the Wattle Fund, increased its holding in Appen.

Chris Vonwiller announced his retirement as the Non-Executive Chairman of the Company in 2021. Anacacia have helped the family achieve their objectives of a staged retirement. They now have more time to spend with family and can also look proudly at the successful partnership with Anacacia (and then later investors) that turbo-charged the growth of Appen into one of Australia's largest technology companies servicing many of the world's largest technology companies. It has been life changing for the Vonwiller family and also for the loyal Appen staff that invested alongside Anacacia Capital and still play major leadership roles in the company today. This also improved the professional development skills of the Anacacia team that have gone on to continue to back successful leading SMEs. This is one of Australia's most successful venture capital limited partnership stories.

### **Case Study 9: Global Kinetics – Brandon Capital**

Global Kinetics Pty Ltd (GK), headquartered in Melbourne, is committed to improving the lives of those with Parkinson's disease using advanced medical technologies. GK is a novel digital health company that is revolutionising the management of Parkinson's disease by providing the first continuous and objective measurement of patients' symptoms in everyday environments, leading to better disease management and



improved quality of life for patients. GK was established in 2007 to commercialise innovative technology developed by Professor Malcolm Horne, from the Florey Institute of Neuroscience & Mental Health in Melbourne (the largest Neuroscience research team in Australia and the Southern Hemisphere), and Professor Rob Griffiths, for the precise recording, quantification and reporting of movement symptoms of neurological disease.

Professors Horne and Griffiths met with Brandon Capital's Drs David Fisher and Chris Nave in late 2008. The first seed funding of \$245,000 was provided by the Brandon Capital Managed, Medical Research Commercialisation Fund (MRCF) Trust. The MRCF Trust provided further seed funding of \$1.7M between 2009-2011. In 2012, the MRCF Innovation Investment Fund (a VCLP) provided Series A funding of \$1,000,000, closely followed in 2013 with \$900,000 from the Brandon Capital IIF Fund (a VCLP). Both the MRCF VCLP and the Brandon VCLP provided further funding of \$6.9M over the subsequent 7-years. This funding has supported the Company in securing an additional \$60M in funding, including significant investment from overseas investors. The company's Personal KinetiGraph® (PKG®) is a patient-friendly system that uses novel, proprietary, algorithms to record patients' specific Parkinsonian movements over the course of several days and creates data-driven reports that empowers more personalised treatment and management decisions—ultimately leading to better disease treatment and a higher quality of life for patients. The PKG® system is being used in clinics across the U.S, Europe and Asia Pacific, enabling better clinical outcomes and reducing health care costs across the Parkinson's disease continuum. To date over 50,000 patient-specific tests have been conducted with the PKG® system. With offices in Australia, USA, England, Germany and Sweden, the Company is headquartered in Melbourne, with product assembled at the Company's Melbourne office and shipped globally. Clinical analysis of each patient's PKG report is conducted by clinical neurologists in Melbourne, with the results provided to clinicians across the globe.

The Company continues to expand its geographic breadth and revenue –even during the COVID-impacted past 12-months, the Company achieved 38% revenue growth. The VCLP program played a critical role in providing the early-stage seed capital that was essential for GK to build its product and produce the clinical evidence that attracted further funding and ultimately led to the product being approved for sale in the US, Europe and Asian countries.

An overview of the impact of  
the ESVCLP and VCLP  
investments

Australian Investment Council (AIC)

**03 September 2021**

## Notice

Ernst & Young was engaged on the instructions of the Australian Investment Council (“AIC”) to perform an assessment of the impact of the ESVCLP and VCLP programs in Australia (“Project”), in accordance with the Engagement Agreement dated 18 March 2021. The purpose of this assessment is to provide evidence on the economic impact of the investments under the ESVCLP and VCLP programs which form a part of the AIC submission reviewing the program.

The results of Ernst & Young’s work, including the assumptions and qualifications made in preparing the report, are set out in Ernst & Young’s report dated 03 September 2021 (“Report”). The Report should be read in its entirety including the transmittal letter, the applicable scope of the work and any limitations. A reference to the Report includes any part of the Report. No further work has been undertaken by Ernst & Young since the date of the Report to update it.

Our work commenced on 09 August 2021 and was completed on 03 September 2021. Therefore, our Report does not take account of events or circumstances arising after 03 September 2021 and we have no responsibility to update the Report for such events or circumstances.

Ernst & Young has prepared the Report for the benefit of AIC and has considered only the interests of the AIC. Ernst & Young has not been engaged to act, and has not acted, as advisor to any other party. Accordingly, Ernst & Young makes no representations as to the appropriateness, accuracy or completeness of the Report for any other party’s purposes.

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Our conclusions are based, in part, on the assumptions stated and on information provided by AIC and other information sources used during the course of the engagement. The modelled outcomes are contingent on the collection of assumptions as provided by AIC and no consideration of other market events, announcements or other changing circumstances are reflected in this Report. Neither Ernst & Young nor any member or employee thereof undertakes responsibility in any way whatsoever to any person in respect of errors in this Report arising from incorrect information provided by the AIC or other information sources used.

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# Overview of the ESVCLP and VCLP programs

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In 2016, Australia amended two tax programs aimed at incentivising investment in the Venture Capital sector. In particular, these were the Early Stage Venture Capital Limited Partnership (ESVCLP) and the Venture Capital Limited Partnership (VCLP) incentives. These programs were designed to encourage more venture capital investment in Australia from both domestic and foreign investors.

This report aims to estimate the total economic activity that has been associated with the investment in these programs since 2015 and forecasts how investment through the programs will be impacted over the next decade. As per the program:

- ▶ Early Stage Venture Capital Limited Partnership (ESVCLP)<sup>1</sup>
  - ▶ ESVCLP supports new venture capital funds between \$10 million - \$200 million that focus on early stage venture capital investments, that is investments in the pre-seed, seed, start-up and early expansion stages.
  - ▶ Investors receive the following benefits from the program:
    - ▶ Investors in ESVCLP eligible funds are eligible for an (up to) 10% non refundable tax offset.
    - ▶ Investors are exempt from income and capital gains tax made from eligible ESVCLP investments.
- ▶ Venture Capital Limited Partnership (VCLP)<sup>2</sup>
  - ▶ The VCLP supports new venture capital funds over \$10 million who invest in companies whose net assets are less than \$250 million.
  - ▶ Investors receive the following benefits from the program
    - ▶ Foreign limited partner investments are exempt from capital gains and income tax.
    - ▶ To be eligible, foreign investors have to be eligible venture capital investors.

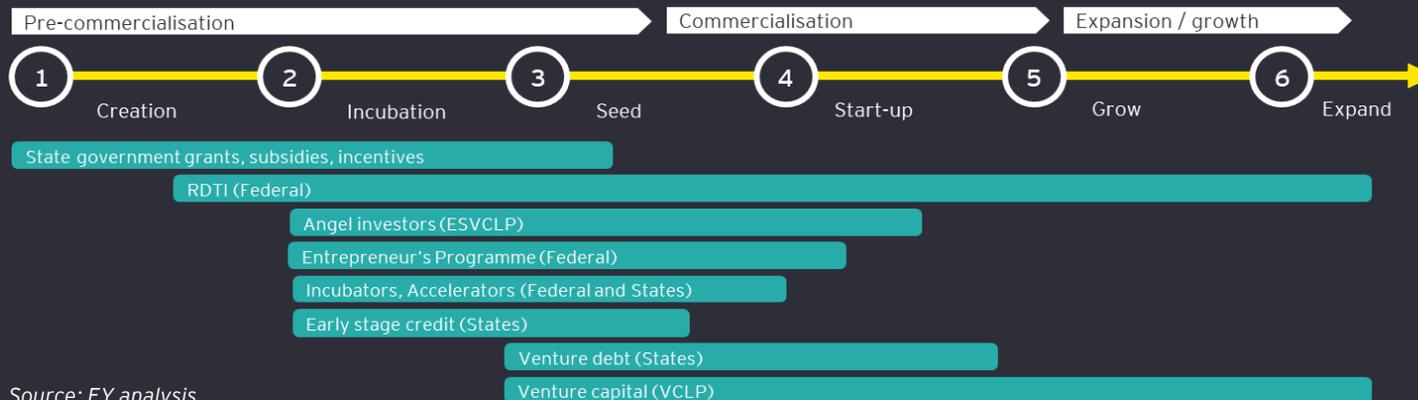
<sup>1</sup> <https://www.ato.gov.au/business/venture-capital-and-early-stage-venture-capital-limited-partnerships/esvclp-tax-incentives-and-concessions/>

<sup>2</sup> <https://www.ato.gov.au/business/venture-capital-and-early-stage-venture-capital-limited-partnerships/venture-capital-limited-partnerships/>

# Benefits of ESVCLP and VCLP incentives

- ▶ Currently, the federal and state and territory governments have many programs in place to encourage early stage ventures and commercialisation.
  - ▶ The federal government's two main initiatives to support start-ups are the Entrepreneur's Programme and the Research and Development Tax Incentive (RDTI).
    - ▶ The main feature of the Entrepreneur's Programme is the Accelerating Commercialisation grant, a matched grant of up to \$1 million to provide assistance to start-ups in their growth phase.
  - ▶ State governments have varying initiatives, ranging from small scale grants to publicly funded VC firms.
- ▶ While these policies and initiatives are crucial, they mainly target businesses themselves, giving direct assistance to start-ups. This means that there is limited policy support for enticing capital to invest in Australian start-ups.
- ▶ The ESVCLP and VCLP programs potentially fill the gap to incentivise private investment, meaning government supports the whole "ecosystem", as support for later stage investment is just as crucial for a company's growth as early support.
- ▶ Without this government support, investors may be more inclined to look to international markets where the business environment and regulation may be more favourable.

## Australian start-up support phases

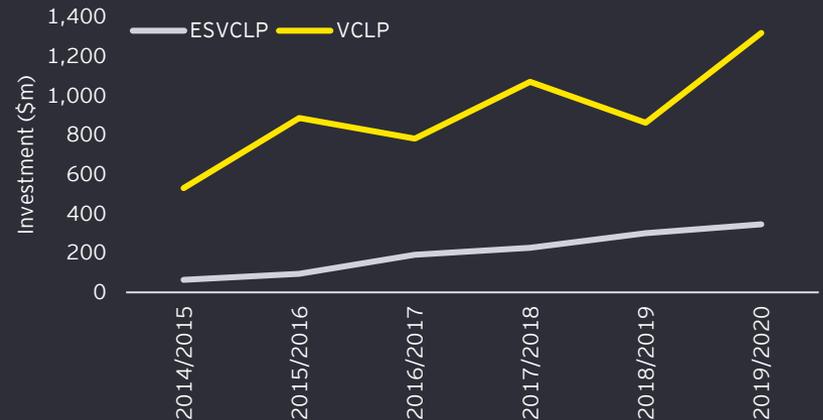


Source: EY analysis

# VCLP and ESVCLP investment overview

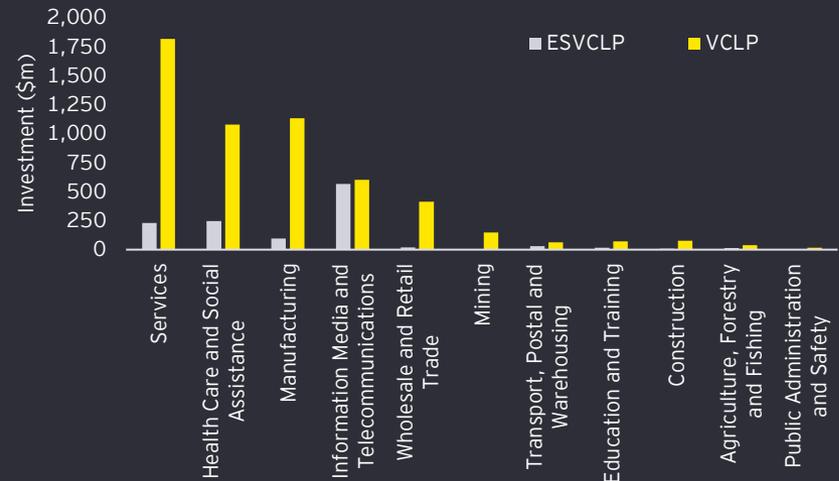
- ▶ According to information collected from the Department of Industry, Science, Energy and Resources (DISER), investment through the ESVCLP and the VCLP programs is rising:
  - ▶ ESVCLP investment increased from \$63.4 million in 2014/2015 to \$345.5 million in 2019/2020 and VCLP investment increased from \$530 million in 2014/2015 to \$1,319.6 million in 2019/2020 .
  - ▶ The average investment through ESVCLPs is \$11 million, compared to \$38 million through VCLPs, which is consistent with the VCLP investors making later stage, lower risk investments.
- ▶ The services industry attracts the most investment through these programs. A total investment of \$2,045.7 million has been made in services since 2014/15, with VCLP investments contributing \$1,815.9 million of this total.
- ▶ The information, media and telecommunications industry attracts the majority of investment from ESVCLP funds. A total of \$566.0 million has been invested through ESVCLPs since 2014/2015, which is 46% of the total ESVCLP investment.
- ▶ Healthcare and manufacturing are the other industries attracting significant investments through the programs.

Annual investments in the ESVCLP and VCLP programs (\$m)



Source: DISER data

Investment in the programs by sector (\$m)

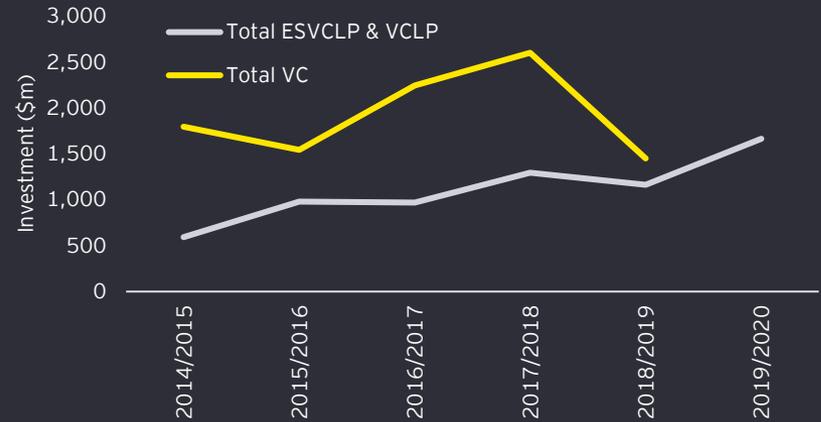


Source: DISER data

# The ESVCLP and VCLP in the context of the Australian Venture Capital sector

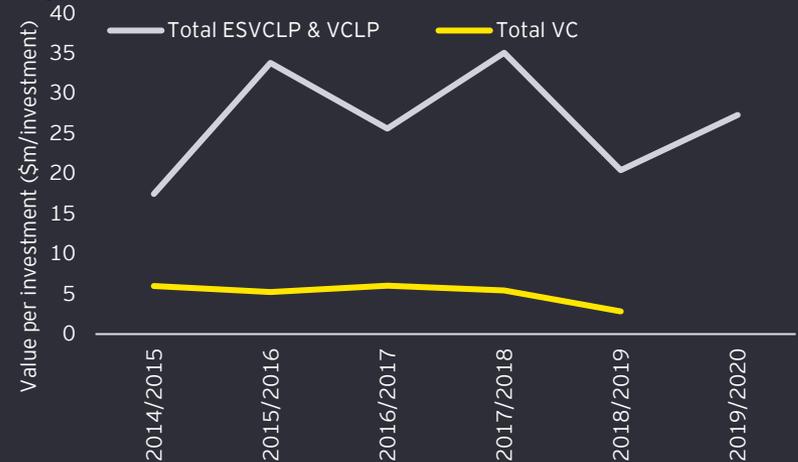
- ▶ Combined, the programs have contributed a significant share of investments in the Australian Venture Capital (VC) sector.
  - ▶ In 2014/2015 33% of VC investment by value was registered under the ESVCLP and VCLP programs.
  - ▶ In 2018/2019 80% of VC investments by value was registered under these programs.
- ▶ The number of annual VC investments is growing.
  - ▶ 34 investments were registered under the ESVCLP and the VCLP programs in 2014/2015, which increased to 61 in 2019/2020.
  - ▶ In total, 256 investments have been made through the ESVCLP and VCLP programs since 2014/2015, 112 in ESVCLP and 144 in VCLP.
  - ▶ In addition, according to statistics from the ABS on VC and PE investments, the number of VC investments has grown from 301 in 2014/2015 to 517 in 2018/2019.
  - ▶ The average VC investment through the Venture Capital Tax Incentives programs is \$26 million compared to the average VC investment of \$5 million. This shows that the investments made through the ESVCLP and VCLP programs are on average much larger than other VC investments.

Total value of investments in VC in Australia (\$m)



Source: ABS PE&VC data and DISER data

Average value per investment in VC in Australia (\$m)

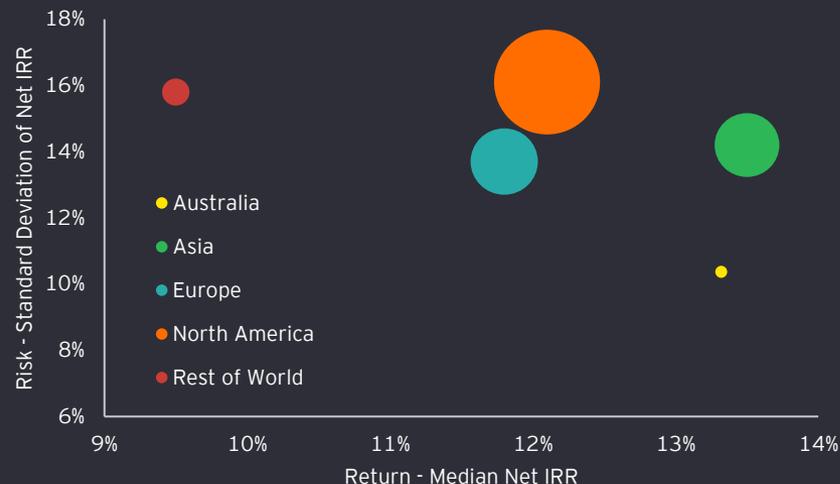


Source: ABS PE&VC data and DISER data

# International financing landscape

- ▶ Globally, competition for Private Capital (PC) is intense, with funds seeking the best risk adjusted returns across a variety of markets.
- ▶ Notably, as shown in the chart, Australian PC offers an attractive location for investment, providing higher risk adjusted returns relative to other regions.
  - ▶ PC includes other asset classes but VC and PE accounts for about 50% of the Australian equity.<sup>3</sup>
- ▶ Investor returns are also influenced by incentives to invest in certain countries.
- ▶ Countries such as Israel, the UK and Singapore have incentives similar to Australia to attract and retain investment in start-ups.
  - ▶ Israel's tax incentives for foreign VC investors exempt them from capital gains, interest and dividend tax if investors and investees match certain criteria.
  - ▶ The UK runs three programs, the EIS (for investment in later stage start-ups), the SEIS (for investment in early stage start-ups) and the VCT (for individual investment in listed VC funds). Each program offers varying degrees of income tax reduction, capital gains and dividend tax incentives for eligible investors.
  - ▶ Singapore has various schemes that exempt income from eligible investments from tax.
- ▶ For Australia to continue to remain an attractive destination for international capital, strong investment opportunities, coupled with competitive government policies are likely to continue to be required.

Median Private Capital risk and return estimates by region



Source: Preqin & Australian Investment Council Yearbook 2021

- ▶ Venture capital provides higher returns than average investments in Australia.
  - ▶ According to data on returns collected from the ABS, VC investment has yielded an average return of 13% (since 2014/15), ranging from 9% in 2018/2019 to 17% in 2017/2018.
  - ▶ These returns are much higher than the 8% on investments in other areas of the Australian economy.<sup>4</sup>
  - ▶ This higher return can be attributed to both the higher risk and innovative nature of the investments, which leads to start-ups on average having higher productivity.

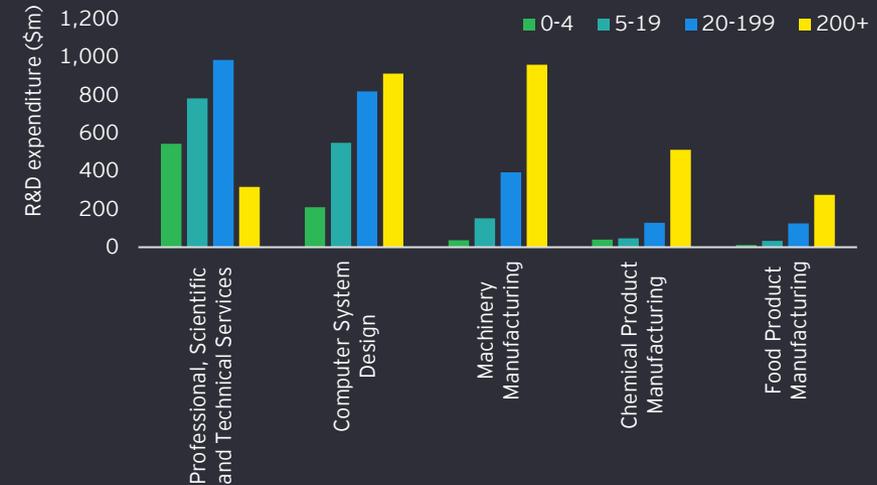
<sup>3</sup> Preqin & Australian Investment Council Yearbook 2021

<sup>4</sup> Based on EY analysis of ABS VC&PE data

# Research and Development (R&D) expenditure

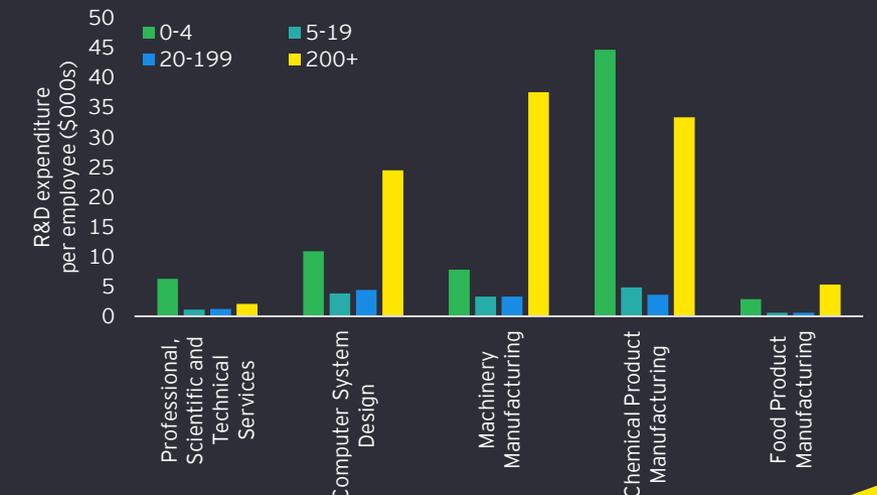
- ▶ R&D is crucial to the economy as it is a source of sustained economic growth, through boosting productivity.<sup>5</sup>
- ▶ R&D is primarily spent in industries with a strong start-up presence.
- ▶ Based on data collected from the ABS and tax statistics, the top five industries for R&D at the ANZSIC two digit level fall into the top three industries of ESVCLP and VCLP investments.
- ▶ The top three investment industries through the programs are as follows:
  - ▶ Services 31% (PST services & computer system design)
  - ▶ Health care 20%
  - ▶ Manufacturing 18% (machinery, chemical, food).
- ▶ Services is the top industry for investments in total ESVCLP and VCLP, and in R&D.
- ▶ While the total spend on R&D in each of these sectors is spread across firms of different sizes, there is some clear evidence that R&D expenditure per employee is higher in smaller firms (0-4 employees), than in medium firms and larger firms (5-199 employees).
- ▶ This points to start-ups in this industry investing more in R&D per employee than established businesses, noting that this is the dominant industry for start-up investment.

R&D spend (\$m) by sector, stratified by firm size (employees)



Source: ABS R&D data

R&D spend per employee (\$m)



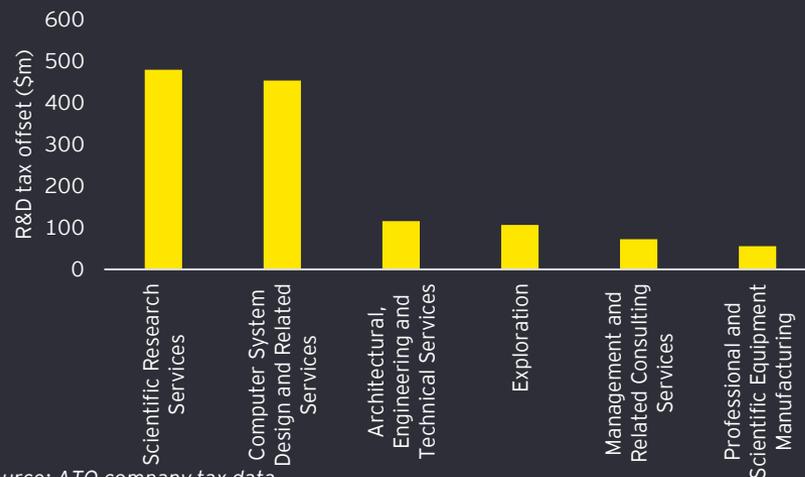
Source: EY analysis of ABS R&D data

<sup>5</sup> <https://www.austrade.gov.au/news/economic-analysis/the-importance-of-rd-to-help-australian-businesses-escape-an-economic-slump>

# R&D Tax Incentive

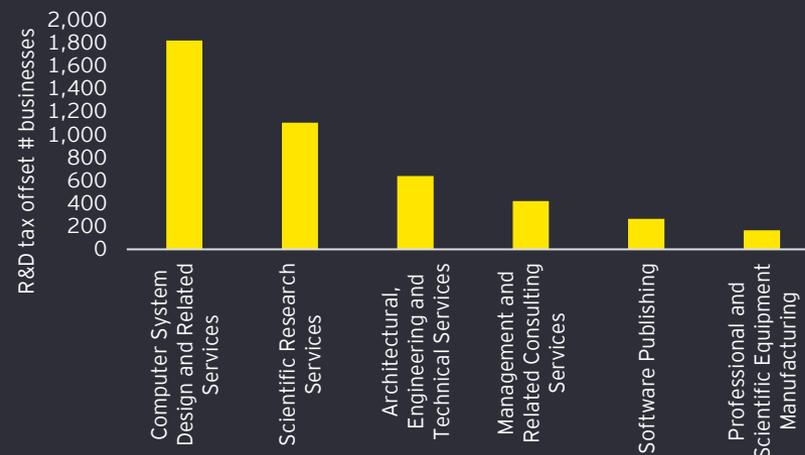
- ▶ The tax data for the RDTI supports the analysis in the previous slides that start-up industries invested heavily on R&D in 2018/2019.
  - ▶ Service focused industries have been claiming the most RDTI, with scientific research services the largest, having spent a combined \$480 million on R&D.
  - ▶ Exploration and professional and scientific equipment manufacturing were the only non-service industries in the top six, aligning with manufacturing being the third largest VC investment industry through the programs.
  - ▶ Computer system services had the most businesses claiming the RDTI with 1,820 businesses making a claim.

Total value of claims in the R&D offset (\$m) by sector



Source: ATO company tax data

Number of businesses registered for R&D tax offsets by sector



Source: ATO company tax data

# The economic impact estimates of the ESVCLP and VCLP programs

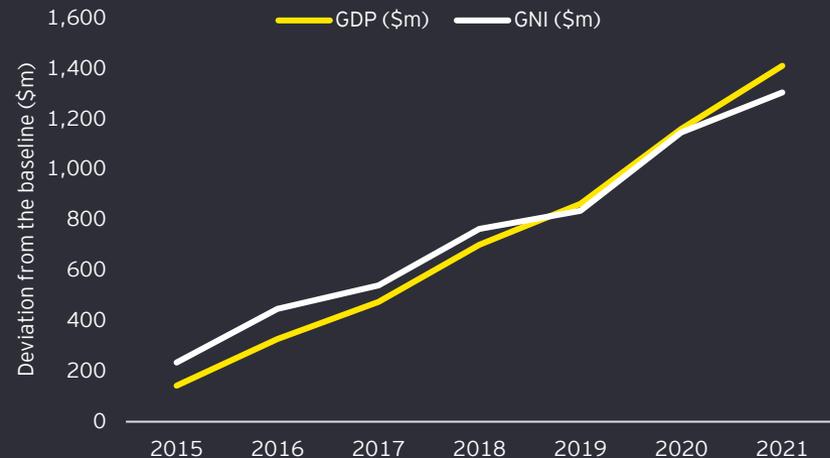
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- ▶ The impact of the ESVCLP and VCLP programs has been modelled with our in house Computable General Equilibrium (CGE) model (an overview of the model is included in the annex of this report).
- ▶ We have assessed two scenarios of the impact of the program:
  1. An assessment of the investments registered in the program between 2015 and today has been made using historical figures of the VC funds invested into businesses registered under the ESVCLP and VCLP programs, using information as captured by the Department of Industry, Science, Energy and Resources (DISER).
  2. We have included a scenario of the potential future impact of investments in the program, by assuming that investment levels through the programs will stay at 2020 levels until 2031.
- ▶ When modelling the impacts of investment through the ESVCLP and VCLP programs, the shock had two input components.
  - ▶ The first component was the increase in investment in the Australian economy, which was just the actual investment made through the programs over the previous six years. For the forward looking analysis, an assumption was made that investment would remain at constant 2020/2021 levels.
  - ▶ The second component was an increase in productivity, which has been realised to take account of the fact that businesses attracting VC are different to normal investments in an economy.
    - ▶ While start-ups offer a high risk investment, they often offer a higher rate of return driven by innovation and more spending on R&D, as was shown above using ABS data. This, combined with the idea that start-ups are more often operating in highly skilled industries in Australia, drives an improvement in productivity over time.
    - ▶ The productivity gains were factored in using calculations on the rate of return to VC investors, using ABS data on VC and private equity returns in Australia.
- ▶ All modelling results are represented as a deviation from the baseline, which in this case the baseline assumes that the investments made through the programs and the subsequent productivity shocks, do not occur.

# ESVCLP and VCLP investment impact

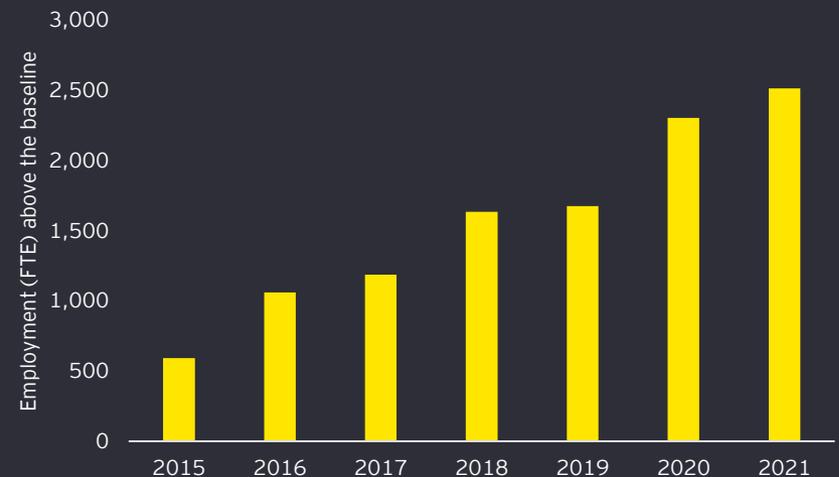
- ▶ When we assess the total value of investment into the ESVCLP and VCLP programs since 2015, the combination of increasing investment over time in the program, as well as the increase in productivity, the analysis shows a steady, increasing impact on economic growth and job creation, as shown here.
- ▶ The results indicate that:
  - ▶ These investments may have potentially contributed to an increase in GDP which is estimated to reach \$1,408 million above the baseline in 2021 (should the investments in the program have not materialised).
  - ▶ The programs have led to a strong boost in national income, with Gross National Income (GNI) \$1,303 million above the baseline in 2021.
- ▶ The Venture Capital Tax Incentives have delivered a strong boost to employment.
  - ▶ In 2021 the benefits of the programs are expected to lead to 2,514 full time equivalent (FTE) employees above the baseline.
  - ▶ This is approximately 10 FTEs for every investment made through the ESCVLP and VCLP programs.

Change in GDP and GNI through investments in the program (\$m)



Source: EY analysis of DISER and ABS data

Jobs created through investments in the program

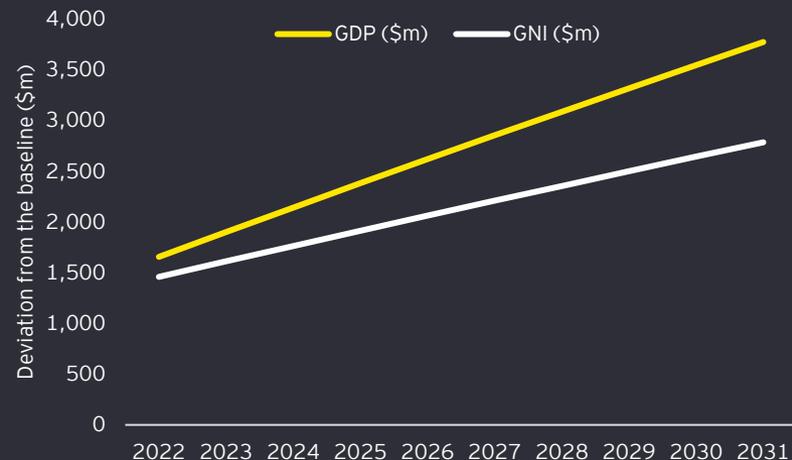


Source: EY analysis of DISER and ABS data

# ESVCLP and VCLP scenario of future investment

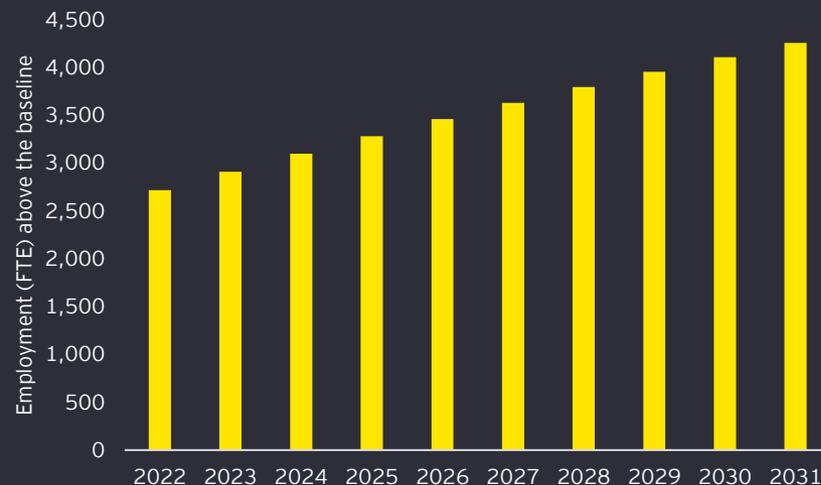
- ▶ Under the assumptions outlined above, we have developed a scenario on the possible future impact of the investments made under the ESVCLP and VCLP programs
  - ▶ This analysis assumes that investment through the programs remains at 2020 levels for the next ten years (to 2031).
- ▶ If investment through the VC programs remains stable, Australia may expect a continued increase in employment, GDP and income.
  - ▶ This is driven by sustained investment in venture capital businesses and the productivity increases that these are likely to bring to the economy.
  - ▶ By 2031, this continued investment in the programs is projected to support an additional 4,255 FTE employees.
  - ▶ National income may continue to rise over the next decade, with GNI expected to be \$2,786 million higher in 2031 than under the baseline without the program.
  - ▶ GDP is forecast to follow a similar pattern to GNI, with GDP expected to be \$3,772 million higher in 2031 than if the investments in the program had not materialised.

Change in GDP and GNI through investments in the program (\$m)



Source: EY analysis of DISER and ABS data

Jobs created through investments in the program



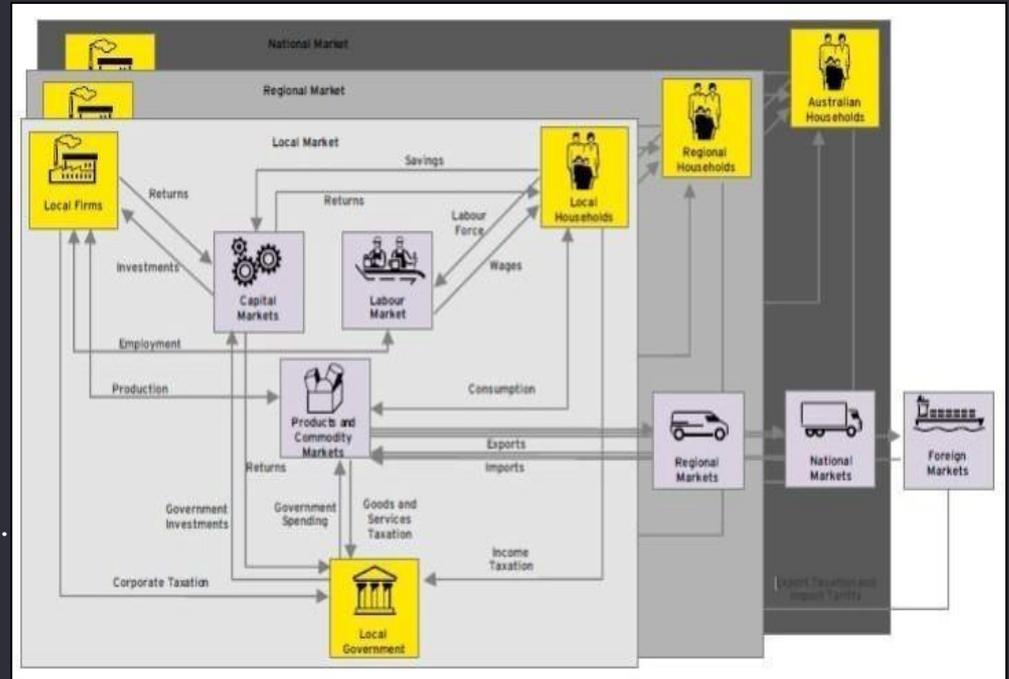
Source: EY analysis of DISER and ABS data

# ANNEX



# The EY CGE model (1)

- ▶ Computable General Equilibrium models are the modelling framework of choice for analysing the economic impacts of major project investments, including industry developments. Our analysis will be based on EYGEM, EY's own in-house CGE model and previously the Cadence Economics CEGEM model.
- ▶ The EYGEM model is a large scale, dynamic, multi-region, multi-commodity CGE model of the world economy. The EYGEM model enjoys significant flexibility both at the regional and sectoral level, including the capability to individually identify subregions of Australia. Our model is implemented in modern data science frameworks, including Python and Pandas, and has a user-friendly Excel interface. Our frameworks are specifically designed to improve auditing a paper trail in modelling exercises, reduce the risk of modelling error, and allow for (for example) systematic sensitivity analysis. The below diagram presents the core inputs that underpin the EYGEM.



# The EY CGE model (2)

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## Limitations of CGE modelling

- ▶ Our CGE modelling methodology is in line with the industry standard and have been tested through a variety of government and private sector projects. The following technical assumptions and limitations are provided in the interest of completeness.
- ▶ CGE modelling is a long run modelling technique and may not accurately reflect the short run individual dynamics of economic changes. The model does, however, provide a more realistic representation of economic forces over the long term and allows the broad study of shocks on a limited number of variables in the model economy. Forecasts of economic variables are calibrated to current data and based on future expectations of economic performance. Over time expectations change, and so do forecasts. The forecast targets contained in this model are based on the latest data available at the time the model was constructed and run;
- ▶ Simulated shocks based on scenario designs are limited to the accuracy and reliability of project schedules and magnitudes of investments provided. Significant changes in timing and magnitude of provided figures will change the results of the model. Shocks to the model economy are limited to shocks contained in scenario designs. Additional economic shocks (including outcomes of the government's fiscal and taxation policies, regulation impacting specific industries, shocks to interest rates and return on capital more broadly, shocks to exchange rate and terms of trade) are not considered or included in the CGE model;
- ▶ Demographic values of working age population average figures of the financial year and were calculated from the ABS Australian Demographic Statistics; and values of employment are average values of the financial year and were calculated from the ABS Labour Force publication. The accuracy and completeness of ABS Census data essentially relies on the consistency with which individuals fill out the ABS surveys, and variances in this factor across the entire population are potentially large. Figures within datasets may differ based on the number of responses received to a specific survey question. Where discrepancies in the individual data sources exist, we have allowed industry data to take precedence;
- ▶ The Australian labour market is relatively constrained and concentrated in large state capitals and surrounding regions. The labour market is constrained, in particular, due to Australia's location and relatively fragmented and concentrated distribution of labour. As such the regional labour supply, driven by current and long term anticipated demographic trends, adjusts very slowly through migration between regions and indeed international migration;
- ▶ As a result of 'sticky' labour supply, the real wage will rise and fall to close any short term excess demand and supply of labour in the labour market due to the slowly changing labour supply (real wages rise whenever demand for labour increases above the current equilibrium, generating jobs within an industry). Over the longer term, these increases in wages make unfilled positions more attractive to workers within the industry and region where they are demanded, then within the industry outside of that region, and finally within other industries where demanded skills are transferrable to fill positions demanded;
- ▶ An industry-specific database is used to capture the primary factors of production, intermediate inputs to production, investment driven technology factors of production, the rate of technological change and impacts on factor productivity of each industry and region combination. It is assumed that individual industries and regional economies overall are constrained to follow their current forecasted growth trajectories with production technology not fundamentally affected by the project. The model preserves industry employment structure with respect to full time and part time positions with the final Jobs results containing a mixture of both full time and part time positions for each industry;
- ▶ Consumption behaviour is driven by regional disposable income of households. It is assumed that there are no significant changes in consumption tastes as well as no changes in taxation. Fundamental determinants of consumption are captured in historical data and are assumed to remain unchanged by external forces during the forecast and simulation periods;
- ▶ Investments are driven by expected returns which deviate away from the long term steady state in the capital market in line with investment opportunities. More specifically, an increase in investment opportunities is matched by increases in expected returns, reducing disposable incomes and reducing consumption. The primary effect of the project is considered an exogenous capital injection while the secondary effects of industry specific investments taken in order to increase production due to increased demand generated by primary shocks do affect the consumption-investment decision of households;
- ▶ Government revenues will be impacted by changes in overall economic activity and there are no specific government policy reactions built into the model relating to any economic results. Further, government fiscal policy is assumed to be constant during period of simulation and determined by historical data.

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## Appendix C

### Consultation Questions

- 1. Have the VCLP, ESVCLP and AFOF programs met their objective to generate additional venture capital investment, including foreign venture capital investment in Australia? a) If so, how and to what extent have these programs met the objective outlined above? Is there any readily available data, evidence or examples to support how these programs have incentivised additional investment? b) If the objective has not been met, what are the key challenges or barriers that impact on the programs' ability to meet the above stated objective?**

Yes, we refer you to Appendix A and B above.

However, investment barriers such as FIRB, regulation and technical issues could further catalyse the programs.

We refer you to Appendix D on technical matters which require redress.

- 2. Have the VCLP, ESVCLP and AFOF programs met their objective to develop venture capital management skills and experience in the Australian venture capital sector? a) If so, how and to what extent have these programs met the objective outlined above? Is there any readily available data, evidence or examples to support your views? b) If the objective has not been met, what are the key challenges or barriers that impact on the programs' ability to meet the above stated objective?**

Yes, we refer you Appendix A and B above. Please refer to comments above in relation to matters which could further enhance the programs.

- 3. Has the ESVCLP program provided additional venture capital for early stage startup and expanding businesses? a) If so, what has been the impact? b) If not, what have been the barriers and challenges of the ESVCLP program that limit targeting investment in early stage businesses.**

Yes, we refer you Appendix A and B above.

- 4. Has the VCLP program incentivised foreign investors into Australia's venture capital sector?**

Yes, we refer you Appendix A and B above.

- 5. To what extent has the operation of the VC Tax Concessions impacted on investments made directly by foreign residents registered under Part 3 of the Venture Capital Act 2002?**

Without meaningful comparative data on foreign investment which has been made outside of the VCLP but could have been made through the program, the Council cannot comment. However, it has been our experience that foreign investors prefer to invest with Australian fund managers given that they are closer to the asset and understand the Australian market. If investments are made directly, these are typically made as a co-investment side by side with a lead investment made by an Australian private capital fund.

- 6. To what extent do the programs achieve the broader program objectives as outlined in explanatory memoranda, to:**



- a. **foster a shift towards a culture of innovation and entrepreneurial risk-taking?**
- b. **provide Australia with a world's best practice investment vehicle for venture capital?**
- c. **make finance more readily available and cheaper for high risk expanding businesses?**
- d. **improve funding for promising projects across the economy and in industries beyond the technology sector?**

The VCLP and ESVCLP programs are achieving the broader program objectives to foster a shift move towards a culture of innovation and entrepreneurial risk-taking as by their nature, they make investments that take equity risk in supporting innovation and entrepreneurial risk as evidenced by the case studies in this submission and the many other examples in the sector. We refer you Appendix A and B above.

**7. Have there been any spill over benefits, costs or unintended consequences associated with the programs?**

Yes, we refer you Appendix A and B above.

**8. Are there any other matters within the scope of the ToR that should be considered in this Review?**

See overleaf.



As outlined in **Appendix D** to this submission, there are a number of technical amendments to the regime that would make it more competitive on a global scale (see below):

### **The need for Limited Partnership Collective Investment Vehicle (LP CIV)**

The Council welcomed the Treasurer's re-commitment in the May 2021 Federal Budget to introduce a new Corporate Collective Investment Vehicle (CCIV) by 1 July 2022.

Australia's capacity to attract inbound investment through the introduction of a CIV that is competitive with other jurisdictions is an important policy announcement. World-class competitive Collective Investment Vehicles are essential for building and expanding the pool of capital that can be attracted into the Australian economy.

Currently, Australia's existing suite of collective investment vehicles (CIVs) is out of step with international practice, necessitating complex structures and constraining foreign investment. Having a simple, internationally competitive CIV regime able to invest in a broad category of investments with a deemed capital gains tax treatment, is critical to Australia's ambition to be a regional financial services hub which will, in turn, drive significant local employment opportunities.

In particular, Australia's use of trusts (e.g. managed investment trusts (MITs)) is uncommon internationally and deters foreign investors. Noting that over the last five years, around 64% of commitments to Australian PE came from offshore investors, it is critical that Australia's CIVs are well-understood overseas.

Accordingly, it is important that a flow-through, internationally best practice LP – the globally accepted private capital vehicle of choice – be introduced as soon as possible, keeping in mind that the original introduction date of 1 July 2018 has not been met. Such a vehicle could transform the flow of capital into high growth Australian businesses, helping to facilitate Australia's transition to a knowledge-driven economy.

It is important that the structure of the LP CIV recognises the nature of the private capital industry and the ability of funds in this sector to hold an active trading business. It is also worth emphasising that if certain legacy and redundant features of Australia's MIT regime are imported into a new LP structure, especially the 'no control' test, then the new vehicle's utility will be compromised, severely limiting its ability to act as a catalyst for greater investment into promising businesses.

A 'control test' or similar investment restriction is not a feature of comparable overseas LP vehicles as investors often expect private capital managers to have control over their investments to maximise the success of the companies. LP design features consistent with the recommendation of the Johnson Report ("Australia as a Financial Centre") would ensure that foreign investors in Australian-managed private capital funds are, for tax purposes, treated the same as if the investments were made directly by the non-resident without the use of any Australian intermediary. It is also important that the LP CIV factors in the commercial aspects of holding an active trading business.

In addition, changes to the foreign Investment review framework as outlined above, we would recommend the introduction of a new LPCIV will make Australia's investment regime the gold standard and not confined to allow a broader range of investments to be made by made utilising Australia's emerging private capital management sector.



We would also recommend that the term of the funds be extended to be up to 20 years from their current 15 years. For example, the long time it takes to develop biotech companies, the timeframe from research to clinical trials and commercialisation often takes 10 years or more.

## Appendix D

### Australian Investment Council priority reforms to the existing ESVCLP and VCLP frameworks

Note: Unless otherwise indicated, legislative references are to the *Income Tax Assessment Act 1997 (Cth)*

Issue No	Priority	Issue	Description	Proposed solution
1.	A	<b>Characterisation of gains from Early Stage Venture Capital Limited Partnerships covered by section 118-408</b>	<p>It is unclear as to whether investors in ESVCLPs will be taxed on revenue or capital account where an ESVCLP has a gain subject to tax (i.e. where the sum of an eligible investment's asset values exceeds \$250 million, any appreciation in value from six months after that point in time will be a taxable gain).</p> <p>Once the \$250m threshold has been exceeded the exemptions in sections 51-54 and 118-408 do not apply to the 'excess' gain. Applying the ATO's view that most private equity investments are on revenue account, rather than capital account, (as per TD 2011/2), then the taxable gain by ESVCLPs may be considered to be income by the ATO. This creates the possibility that the ESVCLP structure would produce a less favourable tax outcome than if a standard Managed Investment Trust (MIT) had been utilised.</p> <p>In addition, it is most likely that the gain will be considered to have an Australian source (as per TD 2011/24). Accordingly, non-resident limited partners in the ESVCLP will be subject to Australian tax on their share of the gain as income under section 6-5(3). It seems to us that those non-resident limited partners are unlikely to benefit from the business profits article in a relevant double tax treaty as they would be considered to have a permanent establishment in Australia via the general partner's</p>	<p>A statutory safe harbour deeming CGT treatment should prevail where certain "brightline" tests are satisfied by the ESVCLP, including a holding period of 12 months or more or where the ESVCLP's investment is up to 30% of the shares in the company.</p> <p>Eligible venture investors should also be exempt, consistent with the VCLP rules.</p>



			activities. Accordingly, non-resident investors will need to lodge a tax return in that event.	
2.	A	<b>Application of Part IVA where investments are transferred out of fund to provide investors with deemed CGT treatment in circumstances where section 118-408 will apply.</b>	Where ESVCLPs wish to continue to divest investments that have exceeded the \$250 million threshold, there needs to be clarification that the transfer of the investments out of the ESVCLP to another entity does not result in the ATO seeking to apply Part IVA (the general anti-avoidance rule).	A specific carve-out from Part IVA where investors wish to obtain certainty of tax outcome arising from the removal of the divestiture requirement.
3.	A	<b>Characterisation of gains from Venture Capital Limited Partnerships for non-super fund domestic investors</b>	There is significant uncertainty, especially in the light of the ATO TD 2010/21, amongst local and overseas investors that do not fall into the “eligible venture capital investor” category as to how the gains realised by VCLPs should be treated. Specifically, domestic investors which are not superannuation funds (e.g. high net wealth individuals, family offices, endowments) may receive capital account treatment but legislation would clarify any uncertainty.	<p>Investors (Limited Partners) in VCLPs, like investors in MITs, should all receive CGT treatment under legislation. The Australian Investment Council strongly recommends that for all investors in VCLPs any gains or losses made on the disposal of an eligible VC investment held for 12 months which flow through to limited partners be deemed to be on capital account for <b>all</b> limited partners.</p> <p>We note that (non-superannuation fund) domestic investors accounted for 27% of the capital raised by PE and VC funds that used the VCLP structure over the FY2012-2016 period. Accordingly, this proposed reform would significantly reduce investment structures and help attract new investors into this high growth sector of the economy.</p>



4.	A	<b>Calculation of concession for offshore investments in section 118-425(12A)</b>	<p>An exception to the “in Australia” rule for “eligible venture capital investments” applies if at the time of making the investment, the total of the value of the investment and all other investments in entities that do not meet those requirements does not exceed 20% of the fund’s committed capital.</p> <p>The value of these investments is calculated by reference to the value in the fund’s audited accounts. If an investment in an entity that does not meet those requirements is valued in excess of cost, the uplifted value would be counted towards determining the 20% threshold.</p> <p>Therefore, an increase in value of any such investment may restrict or prohibit the fund from making a new investment in another entity that does not meet those requirements or even from making a follow-on investment in the existing entity.</p> <p>As a practical matter, it is difficult to manage the international exposure in the portfolio with a fixed denominator (being committed capital) but a moving numerator (the value of overseas investments).</p>	<p>The 20% test should be determined by reference to “cost” expressed as a percentage of the fund’s committed capital as opposed to the fluid value of the investments in the fund’s accounts.</p>
5.	A	<b>Application of concept of “pre-owned” shares where a new holding company acquires shares or units.</b>	<p>Shares issued in a new holding company (in which an ESVCLP proposes to invest) acquiring shares in another existing company are not “pre-owned” where a new holding company issues shares to the ESVCLP as part of an acquisition.</p>	<p>Confirmation by Treasury as to whether the issuance of shares in the holding company is intended to be excluded from the definition of “pre-owned” share.</p>
6.	A	<b>Requirement for an investor in an AFOF to be an “eligible venture capital</b>	<p>The drafting of section 118-410 contemplates that the tax exemption emanating from an ESVCLP is only able to flow-through to investors in the AFOF where</p>	<p>All ESVCLP gains should flow through the AFOF as if the investor had invested directly in the fund</p>



		<b>investor” in order for ESVCLP tax exemption to flow-through</b>	they are an eligible venture capital investor. This means that the exemption does not flow through where the investor is an Australian resident and the gain is on revenue account and not a capital gain (and therefore the “fractional interest” approach does not apply.)	and the relevant exemption or partial exemption should be preserved.
7.	A	<b>Inability for VCLPs to invest in shares in a company once it lists</b>	<p>Unlike ESVCLPs, VCLPs are unable to make further investments in shares in companies which are listed, even though it may have held shares prior to listing. This manifests itself in an inability to support investee companies: 1) as part of a listing process by needing to take equity prior to listing (which can give rise to commercial and legal complexities) and; 2) the inability to participate in rounds of capital raising after the investee company has listed.</p> <p>This restriction can make capital rising by the investee company difficult as other investors expect initial investors to continue to participate in the capital of the entity, as a sign of their ongoing commitment to the company.</p>	The provisions should mirror the provisions in section 118-428(1)(a) applicable to ESVCLPs which permit the ESVCLP to continue to be able to participate in a future capital raising where it held shares prior to listing.
8.	B	<b>Application of bolt-on rule where target entity is joining consolidated group</b>	It is unclear whether the eligible venture capital investment requirements specific to ‘investments in other entities’ in subsection 118-425(4) and subsection 118-425(5) are required to be satisfied with respect of the act of making an investment where the existence of the entity itself later is disregarded under s 118-427(12). At the moment, the rule could be construed that the entity needs to be satisfied independently with respect to each and	The legislation needs to make it clear that test can be satisfied by applying the consolidation rule as opposed to testing each new acquisition on a stand-alone basis prior to it joining the consolidated group.



			every acquisition even though the overall group satisfies the test.	
9.	B	<b>New holding entities established to acquire businesses rather than shares or companies</b>	<p>Currently, the definition of “eligible venture capital investment” in sections 118-425 and 118-427 of the Income Tax Assessment Act 1997 (Cth) can only be satisfied where an investment is made in a company or trust.</p> <p>We consider that an investment made by a VCLP or an ESVCLP in a new holding entity established to acquire a business through the acquisition of assets, assumption of liabilities and/or assignment or novation of contracts should not be treated differently to the acquisition of the shares or units in an entity that controls business.</p> <p>We recommend the definition of “eligible venture capital investment” be expanded to capture investments into a new holding company, trust or structure, made for the purpose of that holding company, trust or structure acquiring certain business assets.</p>	<p>This could be achieved, for instance, through expanding the current ‘holding company’ definition in subsection 118-425(14A) (and an equivalent expansion made for ‘holding trusts’ in section 118-425) as follows:</p> <p>(14B) A company is taken to meet the requirements of subsection (3) even if it fails to satisfy at least 2 of the requirements in that subsection if:</p> <p>(a) the company's sole purpose is acquiring a business (for instance, through the acquisition of assets, assumption of liabilities and assignment or novation of contracts); and</p> <p>(b) during the 6-month period starting immediately before the first investment made by a * VCLP, * ESVCLP, * AFOF or * eligible venture capital investor, the company has used all of the amounts invested in it:</p> <p>(i) to make acquisitions of a kind referred to in paragraph (a); or</p> <p>(ii) to engage in activities that are ancillary or incidental to making those investments; and</p> <p>(c) as soon as the entity has completed an acquisition of the kind referred to in paragraph (a), at least 2 of the requirements in subsection (3) are satisfied.</p>



10.	B	<b>Acquisitions by holding trust of companies</b>	<p>The acquisition by a holding trust of shares in companies does not qualify under section 118-427(5) as the other entity is not a trust (as contemplated by a notional application of subsection 118-427(4)).</p> <p>The reverse situation where a holding company acquires units in a unit trust is permissible as a company is able to tax consolidate with a unit trust.</p>	<p>Clarification that the term “other entity” in section 118-427(5) also includes a company meeting the definition in section 118-425(4) and alternatively where a company acquires units in a trust satisfying the EVCI requirements. There does not appear to be strong policy rationale for the current apparent exclusion.</p>
11.	B	<b>20% ESIC tax offset computation where investors invest indirectly</b>	<p>Section 360-35 provides that the offset is calculated as if the trustee ‘had been an individual’. The Australian Investment Council questions whether this is appropriate.</p> <p>Example: Unit trust with three unitholders who each subscribe for \$500k of units. The trust then uses those funds to invest in an ESIC.</p> <p>Issue: Should the tax offset be capped at \$200k as a whole (i.e. \$66k offset each) because the trustee is treated as if it had been an individual and would be capped under s.360-25(2) <b>or</b> should the tax offset for each investor be \$100k each on the basis that if they had invested separately rather than via a collective vehicle, they would have been entitled to an offset of \$100k each?</p>	<p>The solution should be that the offset for a trust is uncapped (except where the trustee is assessed) but is capped at the beneficiary level to \$200k (or \$10k in the case of a non-sophisticated investor)</p> <p><i>The Treasury Laws Amendment (2018 Measures No. 2) Act 2020 partially dealt with entitlements directly and indirectly and to cap the entitlement for members of trusts and partners at \$200,000 on an affiliate inclusive basis. it does not appear if the substantive question has been addressed in the amendments.</i></p>
12.	C	<b>Proceeds from an insurance claim potentially ineligible activities</b>	<p>Under the current law, an entity will not satisfy the predominant income test (paragraph 118-425(3)(c) and 118-427(4)(c)) where more than 75% of the total assessable income, exempt income and non-assessable non-exempt income of the entity (and each of its controlled entities) comes from insurance activities.</p>	<p>We recommend the list of ‘ineligible activities’ be amended to replace ‘insurance’ with ‘providing insurance services’.</p>



			<p>As currently drafted, the inclusion of 'insurance' in the list of 'ineligible activities' could mean that entities that benefit under an insurance policy may not satisfy the predominant income test (paragraph 118-425(3)(c) and 118-427(4)(c)). This could arise, for instance, where an entity receives compensation under a share purchase warranties and indemnities policy or a public liability policy and that compensation is significant enough to breach the 75% threshold.</p>	
13.	C	<b>Calculation of asset values for the purposes of section 118-408</b>	<p>It is not clear if the total value of the assets of the entity is meant to be based on the audited accounts (as per the definition of permitted entity value in section 118-440) or based on the market value of the assets.</p>	<p>An approach consistent with the definition of permitted entity value should be adopted.</p>
14.	C	<b>30% restriction for single investor in an ESVCLP</b>	<p>The rules currently state that none of the investors in an ESVCLP can contribute more than 30% of the committed capital unless they are a bank, life insurance entity, widely held super fund or widely-held foreign venture capital fund of funds. The Innovation Investment Committee can approve an investor with more than 30% committed capital in some circumstances.</p>	<p>Allow for, at a minimum, domestic venture capital funds of funds to also be able to contribute more than 30% of committed capital to an ESVCLP.</p>