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Chairman
Select Committee on Financial Technology and Regulatory Technology
Department of the Senate
PO Box 6100
Parliament House
Canberra ACT 2600
By email: fintech.sen@aph.gov.au
Senator.Bragg@aph.gov.au

Dear Chairman

RESPONSE TO QUESTIONS ON NOTICE AT FINTECH REGTECH SENATE HEARING

Thank you for the opportunity to attend a hearing of the Senate's Select Committee on Financial Technology and Regulatory Technology.

Two questions were posed on notice seeking further information:

1.) Details on ACS' recommended changes to Australia's Early Stage Innovation Company (ESIC) tax incentives for early stage investors?

2.) Details on what a tech investment accord for superannuation funds may look like?

Please find our detailed responses below:

<u>1.) ACS' recommended changes to Australia's Early Stage Innovation Company (ESIC) tax incentives for early stage investors</u>

In a fiscally tight economic environment, the attraction of ESIC from a government policy lever perspective is increased investment doesn't mean forgoing tax revenue.

Capital is globally mobile. Australian investors are sophisticated so they will allocate their investments based on where they will achieve the greatest return. Reforming and enhancing the appeal of ESIC will ensure a greater share of Australian private capital is retained and invested in Australia rather than going overseas - capital that can expedite our future economic growth.

Firms under six years old account for 17% of total Australian employment however they create 47% of the economy's new jobs.

Australia lags behind much of the world on private sector startup funding. In 2017-2018, per-capita seed and angel investment in Australia was just $3.06, compared to $12.01 in the UK, $22.37 in Israel and $25.44 in the US.

Deloitte Access Economics has benchmarked ESIC to the United Kingdom's Enterprise Investment Scheme and Seed Enterprise Investment Scheme (SEIS). This stylised scenario assumes an initial investment of $200,000 and holding shares for over twelve months across all schemes and hence avoiding capital gains tax.

The analysis indicates an effective return of 18.5% for investments in early-stage tech companies under Australia's ESIC, compared to an effective return of 38.6% for investors in the UK's SEIS - more than double the rate of return.

EARLY STAGE INVESTMENT AUSTRALIA VS. UK
STYLISED SCENARIO HEADLINE RATES ONLY

	Australia (ESIC)[10]	UK (EIS)[11]	UK (SEIS)[12]
Initial investment (amount assumed)	$200,000	$200,000	$200,000
Income tax relief	20% upfront offset	30% upfront offset	50% upfront offset
Net initial investment	$160,000	$140,000	$100,000
Value of shares after 3 years (10% growth p.a. assumed)	$266,200	$266,200	$266,200
Capital gain after 3 years*	$106,200	126,200	$166,200
Effective annual return on net investment after 3 years	**18.5%**	**23.9%**	**38.6%**

* As the shares have been held for over 12 months, investors are exempt from CGT in all three cases.

Data published by the United Kingdom's HM Revenue and Customs (HMRC) reveals that in 2016-2017:

- 3,470 companies raised a total of £1,797 million of funds under the EIS scheme;
- 1,490 companies raised funds for the first time under the EIS scheme and raising a total of £768 million of investment;
- Companies from the Information and Communication sector accounted for £669 million of investment (37% of all EIS investment);
- 2,260 companies received investment through the Seed Enterprise Investment Scheme (SEIS) and £175 million of funds were raised;
- Over 1,700 of these companies were raising funds under SEIS for the first time in 2016-17, representing £148 million in investment;
- Companies from the Information and Communication sector accounted for £68 million of investment (39% of all SEIS investment).

There are more than 1,700 tech scaleups in Australia that are providing an important source of innovation, committed to disrupting the status quo, finding new ways to build business models, enhancing the competitiveness of Australian industry, generating export revenues, and creating Australian jobs.

It is however estimated that 97% of scaleups will fail to scale and commercialise, being wound up after difficulties in attracting investment in the time between initial funding and commercialisation.

This is not because Australian ideas are inferior to those of peers overseas, nor is it because Australia's best talent can't compete with the best talent overseas. To be successful, our tech scaleups are building products for a gap in the market they see on the 3-5 year horizon. They are attracting customers who are market leaders and early adopters, and who too see early problems they need to solve. Once the minimum viable product is up and running, our tech scaleups need to double down and build out their products to win the bell curve post early adoption. And this can't be achieved without access to both capital and talent. We need to be moving faster than our overseas competitors who are working to win that same gap in the market.

In 2016-17, 3,470 companies raised a total of approximately £1.8 billion under the EIS scheme, while 2,260 companies received a total of £175 million under the SEIS scheme. Both schemes are general in nature and available to all start-up companies that meet the prescribed criteria; however, take-up is generally skewed towards the ICT sector – according to the Enterprise Investment Scheme Association (EISA), the ICT sector represented over a third of all EIS and SEIS investment in 2016-17.

Recommendations:

1.) Streamlining red tape by abolishing ESIC's ***100-point innovation test requirements*** with the highest use innovation test requirements (such as enforceable patents, participating in an eligible accelerator programme) converted to examples contained under the ***Principles based Innovation Test Requirements.***

2.) Broadening the criteria defining an "early stage company" eligible for ESIC investment lifting the criteria capping from $1m or less total expenses in the previous year to $2m or less and raising assessable income caps of $200,000 or less the previous income year to $400,000 or less.

3.) Lifting the income tax relief from 20% upfront offset to match the SEIS of 50% upfront offset.

ACS contends remodelling ESIC to match and better the United Kingdom's SEIS would be a low risk, easy to implement initiative that would help ignite capital flows into the fintech sector with the cost to the budget offset by tax receipts through employment growth, increased GST and capital gains revenue.

2.) What a tech investment accord for superannuation funds may look like

This recommendation is the development of a voluntary accord with superannuation funds where signatories commit to allocating up to 0.5% of their funds under management to high growth tech startups as a higher risk asset class.

Ultimately, this initiative is really about cultural change and sending signals to the market that Australia is serious about improving the sophistication of our economy.

Technology is an increasingly important sector in the ASX with 21 technology companies with market capitalisation over $1 billion with Tech and Telco companies making up approx. 6% of the ASX's total market capitalisation.

We do not think a 0.5% voluntary accord would be a stretch target by any stretch of the imagination. Being voluntary, it is about Government facilitating a conversation with Superannuation Funds, finding those that wish to differentiate themselves in the market and who see upside in educating their investors on where the highest returns may be in the future.

The initial cohort of accord signatories will likely be Superannuation Funds that already invest more than this benchmark and are interested to promote that fact going forward as a way to attract more business.

On behalf of ACS, we look forward to supporting the Committee with additional information throughout this important review.

Yours sincerely

Andrew Johnson
Chief Executive Officer