Date Introduced: 30 November 1983
House: House of Representatives
Presented by: Hon. Barry O. Jones, M.P., Minister for Science and Technology

Short Digest of Bill

Purpose

To establish a Management and Investment Companies Licensing Board, to provide for the licensing of Management Investment Companies (MICs) by the Board and to regulate the investment activities of the MICs.

Background

It has been recognised by many reports to the Australian Government[1] that small businesses, in general, find it difficult to obtain an adequate supply of finance for growth and development. New business ventures normally involve greater risk and uncertainty than established ones. Risk is also associated with innovations by established firms. High technology companies, by their very nature, operate at greater risk and, in addition to the problem of securing adequate finance, such companies also face another major obstacle, namely the lack of management skills and commercial expertise required by such companies.

In its election platform, the Labor Government indicated that, as part of its policy package designed to bring about a substantial reconstruction of Australian industry, it would take steps towards developing new high technology "sunrise" industries as wealth generators.[2] The Treasurer, Hon. P.J. Keating, M.P., in delivering the 1983-84 Budget on 23 August 1983, stated that "the Government attaches a high priority to the development of high technology industries with growth prospects".[3] However, without the benefit of adequate venture capital and management expertise, their development is hampered. Venture capital is defined as "the provision of funds, unsupported by collateral, in an enterprise whose future is itself subject to a high degree of risk".[4] Various
reports, namely the Campbell Report, Espie Report, the Research Report on Finance for Small Business Growth and Development by the Bureau of Industry Economics, the Myers Report, the Report of the Small Business Advisory Council, have canvassed the provision of venture capital and management skills. Many of these reports have the common theme, namely, the need for a new institution charged with the responsibility of filling the gap in the financing of small businesses and high technology ventures.

The Espie Report, "Developing High Technology Enterprises for Australia" provides a detailed study of high technology enterprises. It discusses their need for venture capital and management guidance. The main elements of the proposed legislation are based on the principal recommendations of this report. The desired outcome of the legislation is the development of a private sector venture capital market through the formation of Management Investment Companies (named Growth Business Investment and Management Companies in the Espie Report) whose role is to raise venture capital for investment in, as well as providing management advice for, such businesses.

The Government has decided that it will forego $20 million in 1983-84 in tax revenue. This, in turn, is expected to result in some $40 million being available for investment in high technology ventures (based on an average marginal tax rate of approximately 50 cents in the dollar).

Outline

The Bill provides for the establishment of a Management and Investment Companies Licensing Board which will have the power to issue, suspend, revoke and renew licences of MICs. The MICs will be able to raise venture capital for investment in, and provide management advice to high technology businesses. Investors in the licensed MICs will be able to claim a 100 per cent tax deduction in the year of subscription through future amendments to the Income Tax Assessment Act 1936. The following diagram represents the mechanism for a venture capital market recommended in the Espie Report.
Diagram: The Recommended Mechanism

To be eligible for funding from a MIC, a venture company will have to meet certain criteria as outlined in clause 29. Eligible businesses may operate in manufacturing, telecommunications, certain aspects of consulting and technical services, computer software and certain primary industry activities. An eligible business would be required to utilize innovative technology, be export oriented, internationally competitive, have the potential for rapid growth and for creating significant skilled employment in Australia. Basically, the scheme is designed to cater for smaller companies with high growth potential.
Main Provisions

The Bill will come into operation on a date to be proclaimed (clause 2).

Clause 3 defines a number of terms used throughout the Bill. Note the definition of "Australian company" includes a nominal share capital (ordinary and preference) of not less than $5 million.

A person holds a prescribed interest in a business entity (company, partnership, unit trust or a sole trader) where he is an owner or part owner of the business, or has made a loan or loan guarantee to the business (clause 4). Furthermore, a substantial ownership interest in a business entity is maintained where a person holds at least 15 per cent interest in the business (sub-clause 4(9)).

Part II of the Bill deals with the Management and Investment Companies Board which will be established by clause 5. Under clause 6, one of its functions will be to provide effective communication with the management of the MICs in order to encourage the formation of eligible business enterprises (defined in paragraph 29(6)(f)). The Board will be required to advise the Minister on matters relating to this Bill.

Clause 7 determines the membership of the Board to include a Chairman, a Departmental officer designated by the Minister, and four to six other members. Members will be appointed for a period not exceeding three years and may be re-appointed. Except for the Departmental officers, all members will be part-time and appointed by the Governor-General.

Part III of the Bill covers matters relating to MICs. Clause 20 deals with applications for MIC licences. Before granting a licence, the Board will be required to publish a notice in the Government Gazette calling for applications from Australian companies. Applications must include full details of the applicant, its nominal ordinary share capital, the amount of prescribed share capital for which the approval of the Board is being sought, the names of substantial shareholders, the applicant's investment plans and any other matters considered relevant by the applicant or by the Board. Under sub-clause 20(3), an applicant who does not have a minimum paid-up capital of $5 million, must have written undertakings by persons to subscribe the required amount if a licence is granted.
Clause 21 empowers the Board to grant or refuse a licence. Where it grants a licence, the Board will specify the amount of approved capital of the licensee. The Board may not grant a licence to a company where either its paid-up capital is less than $200,000 or where the company has not complied with an order in force under Part II of the Foreign Takeovers Act 1975. The Board will grant licences to those applicants it considers most likely to be successful in assisting the formation and development of eligible businesses. All MIC licences expire on 31 October following their date of issue unless revoked earlier and, under clause 25, an application for renewal must be lodged at least 28 days before the current licence is due to expire. The Board may suspend a MIC licence for a period of up to two months (clause 24).

Details of suspension, revocation or non-renewal must be published by the Board in the Gazette (clause 27).

Clause 29 deals with the certification of eligible business entities. A MIC is required to apply to the Board to certify that the business in which it proposes to invest is eligible. The Board may certify, refuse certification, or request further information within 10 working days of receiving an application from a MIC.

A business entity is eligible for MIC investment if it engages in manufacturing, prescribed agricultural, forestry or fishing activities, telecommunications, architectural or surveying services, computer software, consultant engineering or scientific and technical services, data processing services and prescribed services relating to education or training (paragraph 29(6)(a)). Furthermore, an eligible business entity will have to carry on, or propose to carry on, its principal business activities, or research and development in Australia. It will have not more than 100 employees, a net worth of not more than $6 million, projected average sales growth of more than 20 per cent for the next three years and have conducted its primary business activity for ten years or less. Furthermore eligible businesses will utilise innovative technology, be export oriented, internationally competitive, have the potential for rapid growth and for creating significant skilled employment in Australia (paragraph 29(6)(f)).

Clause 32 limits the investment held by a MIC in a single eligible business to 20 per cent of either the MIC's approved capital or shareholder's funds, whichever is the greater.
Clause 33 limits MIC ownership of a single eligible business to 50 per cent.

Clause 37 allows MICs to invest in a wide range of short-term financial instruments. In addition, it prohibits a MIC from investing in other MICs and in businesses whose principal activity is to lend money, to invest in debentures, stocks or shares, or to invest in real estate.

Remarks

1. Government initiatives in this area will only be optimised if other constraining factors besides the provision of finance are overcome. For example -

   (a) Management Education

   Improvement of management skills possessed by most high technology enterprise (HTE) people should not be left solely to the management guidance provided by venture capital companies with equity investments in them. HTEs not financed by licensed MICs will lack management expertise unless existing educational institutions endeavour to meet the needs of high technology entrepreneurs through appropriate management courses and training packages.

   (b) Technology

   There is a need for substantial R&D expenditure by HTEs in order to improve existing products and develop new ones. However, lack of funds in this area could be overcome by improving Australia's technology infrastructures such as setting up a technology transfer network, advisory councils and technology parks, allowing Government R&D contracts to industry and establishing a staff interchange program.

   (c) Marketing

   Most HTEs lack the resources to attain export potential, a necessary pre-requisite for early growth.
(d) Community Attitudes

Members of the Australian community are generally risk averse. They should become supportive of new high technology ventures because they have the potential of providing significant profits. There is also a reluctance by existing proprietors of small businesses in Australia to dilute their effective control of the enterprise. This mode of thinking could be overcome if amendments were made to section 67 of the Companies Act to permit a company to re-purchase its own shares.

(e) Remove Capital Market Rigidities and Imperfections

Many of these arise out of government regulations and controls and their removal might encourage lenders to experiment with new financing schemes. For example, the current restriction on interest rates for small business overdrafts discourages banks from lending to high-risk ventures simply because the interest rate does not reflect the risk involved.

(f) Exit Mechanism

The difficulty in trading in shares of private companies in Australia inhibits venture capitalists from taking and reinvesting their gains, and is an impediment to the establishment of a venture capital market. The Espie Report suggested the development of a market in unlisted shares. Such a market would enable original risk-takers and subsequent investors to realise their investment and provide higher risk companies or companies unable to fulfil the listing requirements access to cheaper and more flexible informal markets in securities.

(g) Taxation

(i) The present system of double taxation of company dividends acts as a deterrent to equity investment. The Campbell Committee believes (38.96) that an integrated system of company taxation
would give both small investors and small business greater accessibility to the equity market.

(ii) Provisions concerning undistributed profits tax on private companies should be relaxed to encourage companies to retain profits rather than distribute in order to finance future growth.

(iii) The inequitable situation that currently exists with the taxation of profits on the sale of property and shares (paragraph 26(a)) and the impending introduction of a new capital gains tax affect investment decisions. Also investors have great difficulty in obtaining taxation benefits for losses incurred through selling failed investments.

(iv) Finally, the tax treatment of share issues to key employees to attract skilled management to small and medium sized HTEs needs to be improved.

2. Financial Assistance

Many small developing businesses may be deprived of financial assistance under the scheme because they cannot show a projected sales growth of more than 20 per cent over the next three years despite having considerable growth potential. Companies that do not already have existing growth business will be excluded as most new projects usually are not capable of contributing to growth within the first few years. These enterprises usually experience difficulty in getting "start up" finance and not "growth" finance. Therefore, the scheme will tend to help only those small companies to whom other sources of finances are already available.

Furthermore, many large manufacturers may not receive any benefit because the legislation stipulates that companies to benefit from the incentives have to employ fewer than 100 people.
3. **Income Tax Assessment Act 1936 (ITAA)**

An amendment to the ITAA, providing investors in MICs with the 100 per cent tax deduction, will need to be made well before 30 June 1984 if investors are to access themselves to the $20 million - a cost to revenue in the 1983-84 year. MICs will need to be licensed and in a position to issue a prospectus inviting funds.

For further information, if required, contact:

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4 May 1984

**References**


