The Parliament of the Commonwealth of Australia

Australian Industry Development Corporation

Report from the House of Representatives Standing Committee on Expenditure

December 1979

AUSTRALIAN GOVERNMENT PUBLISHING SERVICE
CANBERRA 1980

ISBN 0 642 04745 6

Printed by Authority by the Commonwealth Government Printer

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1. Replaced Mr Lloyd, M.P. (resigned) on 10 October 1978.
2. Chairman of the Joint Committee of Public Accounts, who, in accordance with Clause (2) of the Resolution of Appointment, is a member of the Expenditure Committee.
3. Replaced Mr Stewart, M.P. (deceased) on 10 May 1979.
4. Replaced Mr Dawkins, M.P. (resigned) on 24 May 1978.
5. Replaced Dr Klugman, M.P. (resigned) on 19 September 1979.

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FINDINGS AND RECOMMENDATIONS

Findings

The Committee finds that:

(A) The Australian Industry Development Corporation (AIDC) has an established role in the Australian capital market, generally for lending sizeable amounts in the medium- to long-term area, and in the financing operations of the Corporation it is recognised that some flexibility is desirable for meeting unforeseeable future changes. Its present role reflects weaknesses in the Australian capital market, possibly attributable in part to official controls on other financial institutions. (Paragraph 63)

(B) It is useful for AIDC to continue to complement the activities of other lending institutions in the organising of financial packages, in which it may participate as a lender or equity holder, or both. (Paragraph 63)

(C) There is a role for AIDC as financial adviser in the restructuring of industries and in the development of new techniques for financing industrial development, areas in which the Committee is satisfied that AIDC has developed and demonstrated particular expertise. (Paragraph 63)

(D) Definition of the aims and functions set out in sections 6 and 8 of the Act are vague and can be conflicting, thereby causing confusion as to the aims and objectives of the Corporation. In particular, the obligation on AIDC to consider non-commercial aims in its financing operations may have affected its commercial performance and undoubtedly has created a degree of uncertainty and difficulty in judgment of that performance. Accordingly, it should be made clear that the provisions of section 8 (2) are a primary condition that all lending operations should satisfy, not to be overridden by non-commercial criteria. (Paragraph 66)

(E) It would be advantageous to the Commonwealth for it to guarantee the liabilities of the Corporation. (Paragraph 81)

(F) The existing capital structure of the AIDC is no longer relevant to the Corporation's needs and unnecessarily ties up substantial public funds; specifically the maximum borrowings/capital ratio of 5:1, as determined in section 7 (3) of the Act, is unnecessarily restrictive, no longer appropriate to the Corporation's operations, and will needlessly fuel the requirement for additional public funds. (Paragraph 81)

(G) The capital base of AIDC for measuring gearing should be redefined to include any uncalled capital. (Paragraph 81)

(H) Provision should be made for the payment by AIDC of dividends to the Commonwealth once the Corporation has become adequately profitable, subject to maintenance of its operating capability in real terms. (Paragraph 81)

(I) Provision should be made for the Commonwealth, by agreement with AIDC as to amount, term, interest rate and other conditions, to meet future AIDC capital requirements partly by way of subordinated loans, which would also be counted in AIDC's capital base for gearing purposes. (Paragraph 81)

(J) It should be provided that the Reserve Bank exchange views annually with the Corporation on an appropriate maximum gearing ratio for AIDC, and that the actual ratio be left in the hands of the Board of the Corporation for determination from time to time as it sees fit. (Paragraph 82)

(K) The requirements of sections 24 (8) and 26 (2) of the Act with regard to the use to which capital of the Corporation may be put, precluding its use for operational loans and equity participations, are inappropriate to the Corporation's needs and unnecessarily restrict its financing activities, both as to volume and nature (equity participation). (Paragraph 85)

(L) The definition of the functions of the Corporation in section 6 (1)(a) may preclude it from financing some service industries and should be expanded to remove this restriction. (Paragraph 87)

(M) The Act should be amended to provide for the separate appointments of a part-time non-executive Chairman of the AIDC Board and of a full-time Chief Executive of the Corporation. The latter officer may or may not also be a Director. (Paragraph 91)

(N) AIDC's exemption from stamp duty and similar taxes should continue. (Paragraph 95)

(O) The AIDC Act should be amended to remove the requirement for the Corporation's headquarters to be in Canberra. (Paragraph 96)

(P) The *Loans (Australian Industry Development Corporation) Act* 1974 is no longer required for the operations of AIDC and should be repealed, with a saving provision to cover the ongoing validity of actions already taken under this legislation. (Paragraph 98)

(Q) The provisions of section 128EA of the *Income Tax Assessment Act* 1936, conferring on AIDC automatic exemption from interest withholding tax on private overseas borrowings, should be examined to see whether a similar exemption should be extended to the Australian Resources Development Bank (ARDB). Should this not be acceptable, the Committee considers that the mechanisms for case-by-case exemptions should be considered to see whether the mechanisms can be simplified. (Paragraph 101)

(R) Being subject at all times to Treasury and Loan Council approval for its overseas borrowings, AIDC is properly exempted from application of the Variable Deposit Requirement. The Government should consider granting a similar exemption to ARDB. (Paragraph 104)

(S) Having regard to the Committee's proposals taken as a whole, it is not recommended that AIDC be accorded bank status. (Paragraph 106)

Recommendations

The Committee recommends that the following consequential amendments be made to the Acts of the Commonwealth referred to below:

1. The *Australian Industry Development Corporation Act* 1970 be amended to:
   (a) redefine the functions of the Corporation in section 6 (1) (a) to extend the areas in which it may operate to explicitly include service industries;
   (b) amend the existing provisions of section 7 (3) and Part IV—Finance, to change the capital structure of the Corporation as follows:
      (i) to provide that the liabilities of the Corporation be guaranteed by the Government;
      (ii) to allow the maximum gearing ratio of the Corporation to be determined from time to time by the Board as it sees fit, having exchanged views annually on appropriate ratios with the Reserve Bank;
      (iii) to require any uncalled capital to be included in the capital base of the Corporation for measuring gearing;
      (iv) to provide that, unless otherwise advised to the Minister jointly by the Corporation and the Reserve Bank, any further paid-up capital needs of the Corporation be met by subordinated loans from the Commonwealth, each such loan to be agreed with the Corporation as to amount, term, interest rate and other conditions;
      (v) to remove the restrictions on the use of the paid-up capital of the Corporation (set out in section 24 (8) and section 26 (2)), so that the Board in its discretion may use the capital funds in part or wholly in the operations of the Corporation;
   (c) provide that the considerations stated in section 8 (2) shall override those stated in sections 6, 8 (1) and 8 (3);
   (d) provide for payment by the Corporation of annual dividends to the Commonwealth, to a prudent degree, to be determined by the Minister after consultation with the Corporation and after adjustment to allow for the effect of inflation (or deflation) on the 'free capital' of the Corporation, in order to maintain this free capital in real terms;
   (e) remove the provision for the appointment of an Executive Chairman, and provide for the separate appointments of part-time non-executive Chairman of the Board of the Corporation and of full-time Chief Executive of the Corporation, the latter officer also being able to be but not necessarily being appointed a Director;
   (f) repeal section 36 which requires the head office of the Corporation to be located in Canberra. (Paragraph 107)
2. The *Loans (Australian Industry Development Corporation) Act* 1974 be repealed, with a saving provision for ongoing validation of actions already taken under this legislation. (Paragraph 107)
3. The provisions of section 128EA of the *Income Tax Assessment Act* 1936, conferring on AIDC automatic exemption from interest withholding tax on private overseas borrowings, be examined to see whether it would be appropriate to extend them also to ARDB. (Paragraph 107)
4. The Government consider making appropriate amendments to the *Banking Act* 1959 to exempt ARDB from the Variable Deposit Requirement. (Paragraph 107)

CHAPTER I
CONDUCT OF THE INQUIRY: THE MAIN ISSUES

Introduction

1. This report is the first by the Standing Committee on Expenditure on the operations of a major statutory authority and arose from a concern that an authority such as the Australian Industry Development Corporation, operating on capital funds voted by the Parliament, should be examined on its accountability to the Parliament for its performance. This concern is shared by other committees of the Parliament and the First Report of the Senate Standing Committee on Finance and Government Operations deals with a number of problems associated with the proliferation of Commonwealth statutory authorities, one of which is that of accountability to the Parliament. That Report states, *inter alia,* that:

> The Committee is concerned that because some authorities have considerable operating independence, a belief has arisen in some areas that they are not subject to the scrutiny of Parliament. Operating independence should not be confused with freedom from ultimate responsibility to the elected governing body. The Parliament must take ultimate responsibility for the actions of bodies it creates and should institute adequate accountability measures to exercise this responsibility.[1]

2. The inquiry into the operations of the Australian Industry Development Corporation (AIDC) was intended to ensure that a major statutory body was subjected to detailed scrutiny by the Parliament so that the Corporation was required to explain, to document and to justify its performance far beyond the disclosures contained in its Annual Report to the Parliament. Acknowledging the confidentiality of the 'banker–client' relationship, the Committee had to compromise in the approach which it had determined for the conduct of the inquiry by agreeing not to insist on free access to the Corporation's files. This compromise was not reached without considerable reflection by the Committee on the commercial nature of the Corporation's activities and the need for public acceptance of the fact that the details of the Corporation's dealings with its clients should be confidential, even from an inquiry by a committee of the Parliament.

3. While respecting this principle, the Committee was nevertheless able to obtain a great deal of evidence on the activities of the Corporation by providing a public and, where necessary, a private forum for those with an interest in the matter to express their views. The Corporation itself was a major witness, and provided the Committee with documentary evidence on its performance, enabling an analysis of its financial statements to be carried out by consultants to the Committee. Most of the evidence referred to is now publicly available as indicated in Appendix 1.

4. In determining the guidelines for the inquiry, the Committee considered it to be practicable to examine the suitability of the capital structure of the

Corporation, the use of its capital and reserves, its management structure, techniques and philosophy, and development of its place in the capital market since its creation in 1970. In short it was a matter of comparing the financial results of the Corporation's activities with the resources employed to achieve those results, and of making appropriate comparisons with other organisations. In pursuing this avenue of inquiry the Committee was as concerned with current performance of the AIDC and its projected future operations as with the history of the Corporation.

5. Measuring the effectiveness of the Corporation in fulfilling its statutory functions proved to be more difficult. A number of attempts to draw up meaningful guidelines to conduct such an assessment led to the conclusion that, without access to details of the Corporation's lending operations, judgment on the effectiveness in fulfilling its statutory obligations was difficult. The details which would have been necessary to make such an assessment would have included the name of the applicant and the conditions of each loan, as well as the reasons why loan applications were accepted, rejected or withdrawn.

6. In conducting the inquiry the Committee necessarily accepted the view that the Corporation is an instrument related to the achievement of government policy objectives on industry development, Australian ownership of industry and resources and foreign investment.

7. The Committee was primarily concerned then with the efficient use of public funds, in the form of the Corporation's capital and reserves which at the end of the 1978–79 financial year totalled $75.0 million, comprising $62.5 million called-up capital and $12.5 million reserves. Under the terms of its Act, $37.5 million of the capital appropriated to the Corporation remains to be called. The Act also specifies the uses to which the capital may be put by the Corporation and precludes its use for operational loans or equity investment. The Committee's interest in conducting a study of the Corporation's performance was generated through its awareness of criticism of the low rate of return which these funds were earning for the Corporation, together with the low level of profit earned by the Corporation over the range of its activities.

AIDC's performance

8. The poor profit performance of the Corporation revealed in its published financial statements, together with allegations in the financial press about a number of loans made by AIDC to companies some of which subsequently failed, cast doubts on the efficiency of the Corporation. One source of criticism was the heavy losses suffered by AIDC on its overseas borrowings due to unfavourable fluctuations in exchange rates between the Australian dollar, the Swiss franc and the Deutschmark, and this contributed to a feeling in some areas that the public funds allocated to AIDC were not being efficiently employed.

9. In the sporadic debate on AIDC's performance and its suspected bad loans, it was obvious that the role of the Corporation as a policy instrument of the Government was not clearly understood by the industrial and commercial world, and by the Corporation itself in its early days. The Corporation was variously considered to be a provider of venture capital, a lender of last resort, a purely commercial lending institution and potentially a vehicle to assist in 'buying back the farm'. This confusion on the aims of the Corporation was the root cause of much of the public criticism of its activities and results, and sprang basically from the circumstances surrounding its creation. The opposition to the establishment of AIDC was strong from influential sections of the commercial world, led by the life offices, ARDB, and other banks who saw the Corporation as an unnecessary government intervention in the capital market and of course as a contender for a share of the available funds. Indeed, in its evidence the Australian Bankers' Association Research Directorate, representing the trading banks, stated that the continuing role of AIDC is in part a reflection of government controls on the lending activities of other financial institutions and that these controls were designed to serve the interests of monetary policy and protect depositors.

10. The rather turbulent atmosphere surrounding the establishment and early operations of AIDC appears to have contributed to the general uncertainty as to what type of creature the Corporation was meant to be and this uncertainty was shared to some extent at least by the management of AIDC who neither understood nor clearly interpreted the Corporation's own role. Consequently the management took some considerable time before adopting an aggressive marketing attitude to its operations. This contributed to its poor performance and ultimately to the perceived need for an inquiry into its operations, one significant result of which should be clarification of the role of the Corporation in the capital market.

11. In assessing the place of the AIDC in the capital market the Committee is aware of the ongoing Australian Financial System Inquiry (the Campbell Committee) and the possibility that the operating environment of AIDC could be substantially changed, depending on the recommendations made to the Government by that Inquiry and the extent to which those recommendations are implemented. The Committee has therefore seen its own role as being one of scrutinising the structure and performance of AIDC with a view to ensuring the most efficient use of public funds in the existing market. Questions of deficiencies in the total capital market structure, and the implications of the operations of AIDC in that market, are more appropriately within the terms of reference of the Campbell Committee.

AIDC—the background

12. In his Second Reading Speech to the Australian Industry Development Corporation Bill 1970, Sir John McEwen defined the role of the proposed corporation as follows:

> By establishing this new institution, to be known as the Australian Industry Development Corporation, we believe we are taking a major step forward in policies for development and for Australian ownership. The Corporation will operate expressly to assist Australian industry to expand its capacity and scope, and increase its efficiency and competitiveness. It will assist in retaining and expanding Australian ownership of industry and resources. The Australian Industry Development Corporation is designed to fill a very significant gap in the Australian investment scene. Its role will be to assist Australian interests in marshalling financial resources, particularly from overseas, for major industrial development.[2]

13. The AIDC is a wholly owned statutory corporation of the Commonwealth of Australia, established by the *Australian Industry Development Corporation Act* 1970 (hereafter referred to as 'the Act') and operational as from February 1971. The original AIDC Act was amended in 1975 to broaden the scope of AIDC activities and to insert provisions under which the responsible Minister could advise AIDC of loans which the Government considered should be made in the national interest, and make funds available for such loans. The Corporation describes its policy objectives as follows:

> AIDC is a source of funds for Australian industry. Its general objectives are to promote sound development and help Australian interests to participate in the ownership and control of industrial and resource development projects.
>
> AIDC provides finance for industries concerned with the manufacture, processing, treatment, transportation and distribution of goods, and the development and use of natural resources and technology.
>
> In assessing industry proposals AIDC has regard to the importance of the industry to the Australian economy, and the economic feasibility of the development, as well as the financial risks to the Corporation. AIDC also has regard to monetary policy and other relevant policies of the Commonwealth Government.[3]

14. The AIDC has its headquarters in Canberra, with offices in Sydney and Melbourne, and others to be established progressively in other State capitals.

15. The AIDC was established with a statutory capital of $100 million appropriated by Parliament to be paid by instalments as prescribed by the Act. Paid capital to 30 June 1979 was $62.5 million. The purpose of providing this large capital base was 'not for relending, but to give the Corporation stature and image as a borrower'.[4] The Act allows for AIDC to borrow up to five times its paid capital and reserves, and it is the borrowed funds which AIDC uses for its functional purposes of assisting industry development and fostering Australian ownership and control of industry.

16. The Act requires the capital funds to be invested, at the discretion of the Board of Directors, to earn income. They are held principally in a mixed portfolio of general investments which, AIDC says, is designed for security and income, and a sufficient degree of liquidity to meet contingencies. Shares acquired as capital investments are bought in the market on normal investment criteria, and are not limited to investments within AIDC's functional area.

17. Interest is not payable to the Commonwealth on the capital provided to AIDC, nor is there provision for payment of dividends.

18. Until 1975 AIDC was obliged to borrow funds mainly from overseas sources, which was a major consideration in its creation in 1970, but now raises a significant proportion of its loan funds within Australia. These funds are used to finance assistance projects usually in the form of loans, but some limited assistance may take the form of equity investment, or guarantees for loans or equity issues. The Corporation is also engaged in direct and leverage leasing activities.

19. A detailed description of the legislative framework of the AIDC, an analysis of where AIDC fits into the Australian financial market as a borrower and as a lender, and a brief historical perspective of AIDC were included in its submission of 30 June 1979 to the Australian Financial System Inquiry. These sections of the submission, which are essentially an updated version of material given in evidence to this Committee, provide an adequate condensation of these matters for the purpose of this report, and have been reproduced at Appendix 2.

CHAPTER II
AIDC'S PERFORMANCE

Fostering Australian ownership and control

20. As mentioned in paragraph 5 the Committee concluded that a detailed evaluation of the effectiveness of the Corporation in terms of the extent to which it had fulfilled its statutory functions was not possible without access to particulars of specific loans, operational equity participations and loan applications rejected. However, AIDC provided detailed evidence on the types of activities in which it had engaged, and on the criteria considered in its financing arrangements which, when taken with evidence from other sources, allows a general picture to be drawn of the Corporation's usefulness in the capital market.

21. AIDC's operational equity investments, whether in company shares or by means of corporate joint ventures, perforce have been on quite a modest scale, for reasons explained by AIDC (see Appendix 2, page 47). However, neither its loans nor its operational equity investments, even if details were available, would necessarily measure fully the extent of AIDC's influence on Australian ownership and control.

22. This is because AIDC may perform a crucial role in a project in a variety of ways other than by lending or making operational equity investments. This could be achieved by providing financial advice, by introducing other equity participants with particular skills, experience, market access, technical know-how or financial strength, or merely by acting as a catalyst without itself providing any of the finance in these cases. Alternatively, AIDC may put up the last of the required equity or loan capital and so prevent a venture from foundering, yet itself have only small interests to disclose in its own figures. Or it may put in the first equity or loan capital, thereby encouraging others to join in.

23. The Committee is not taking a position in regard to policy concerning Australian versus foreign ownership and control, and in passing it may be noted that there is now substantial agreement in this area. When AIDC was formed there was some talk of 'buying back the farm' but this was never a prescribed objective of AIDC. AIDC was given twin objectives, namely (a) to aid the development of industry in Australia, in short to be a development finance corporation, and (b) to foster Australian ownership and control in industry.[5] Practical implementation of the latter objective involves measures such as, for example, optimising Australian participation in new ventures or expansion of existing industries, and aiding Australian industries in reconstructions and financing new technology. Evidence available to the Committee suggests that AIDC is playing a useful role in these areas, although it would be impossible to quantify the impact made by the Corporation.

Aiding industrial development

24. From the time of starting operations in February 1971 until 30 June 1979, AIDC made 173 commitments, for operational loans and investments totalling $509 million.[6] Particulars of its new advances (i.e. actual disbursements) year by year to 30 June, and its aggregate outstandings at 30 June each year, are given in Table 1. With the effluxion of time and as loans mature, increasing staff effort is involved merely in negotiating replacement loans, as distinct from increasing the level of aggregate outstandings, as indicated by the comparisons in Table 1 for 1976–79.

Table 1

AIDC: OPERATIONAL LOANS AND INVESTMENTS

(1971–79)

	$m								
	1971	*1972*	*1973*	*1974*	*1975*	*1976*	*1977*	*1978*	*1979*
Outstandings at 30 June (*a*) . .	11.3	39.5	61.1	147.6	174.9	198.1	212.7	268.8	
Increases in Outstandings during year to 30 June (*b*) . .	11.3	28.2	21.6	86.5	27.3	23.2	14.6	56.1	
New Advances.			(Not available)			29.3	30.4	62.7	81.7

(*a*) Published balance sheets, before provision for loss but after certain operational provisions.
(*b*) Advised by AIDC.

25. The spread of operational loans and investments outstanding, by industry sector, during recent years is set out in Table 2.

Table 2

AIDC: OPERATIONAL LOANS AND INVESTMENTS OUTSTANDING, BY INDUSTRY SECTOR

(1977–79) (*a*)

	1977		*1978*		*1979*	
Industry sector	$m	%	$m	%	$m	%
Food and beverages	50.1	25.3	52.8	24.8	77.6	28.9
Building materials	20.0	10.1	33.5	15.7	42.8	15.9
Chemicals, plastics and petroleum products	2.1	1.1	1.5	0.7	1.4	0.5
Heavy engineering	33.4	16.8	34.0	16.0	30.9	11.5
Light engineering	7.2	3.7	8.3	3.9	7.0	2.6
Other manufacturing	5.1	2.6	5.6	2.6	14.5	5.3
Minerals and mining	48.7	24.6	45.7	21.5	24.1	9.0
Transport and distribution . . .	31.5	15.8	19.2	9.1	57.7	21.5
Other industry			12.1	5.7	12.8	4.8
TOTAL	198.1	100.0	212.7	100.0	268.8	100.0

(*a*) Year ended 30 June.
Source: AIDC submission of 11 October 1979.

26. An analysis of new financing commitments (as distinct from actual drawings), by type, size and term, forms Table 3.

Table 3

AIDC: ANALYSIS OF NEW FINANCING COMMITMENTS

(1977–79) (*a*)

	1977		*1978*		*1979*	
Type of finance	*$m*	%	*$m*	%	*$m*	%
Term loans	26.6	97.1	68.3	87.0	112.3	85.3
Standby and overrun facilities . .	0.8	2.9	0.5	0.7	6.5	5.0
Leases	..	..	9.2	11.7	0.3	0.2
Equity	..	..	0.5	0.6	12.5	9.5
TOTAL	27.4	100.0	78.5	100.0	131.6	100.0
Size of commitment	*$m*	*No.*	*$m*	*No.*	*$m*	*No.*
$1m and under	4.8	10	4.6	10	4.6	7
Over $1m and up to $2m . . .	..	..	6.0	4	7.5	4
Over $2m and up to $5m	12.6	3	13.9	4	13.5	3
Over $5m and up to $10m . . .	10.0	1	7.0	1	31.0	4
Over $10m	..	..	47.0	2	75.0	4
TOTAL	27.4	14	78.5	21	131.6	22
Term of financing	*$m*	*No.*	*$m*	*No.*	*$m*	*No.*
2 years and under	2.1	4	17.1	2	6.0	3
Over 2 years and up to 4 . . .	..	..	2.2	2	18.0	5
Over 4 years and up to 7 . . .	7.2	6	15.9	11	14.9	7
Over 7 years	18.1	4	43.3	6	92.7	7
TOTAL	27.4	14	78.5	21	131.6	22

(*a*) Year ended 30 June.

Source: AIDC submission of 11 October 1979.

27. In considering the role of AIDC in aiding industrial development it is recognised that AIDC is one important, if small, organisation providing finance and other forms of assistance. Some indication of AIDC's relative contribution in this area can be gained from the size of its individual loan commitments, its total loans outstanding and the significance of its term loans in relation to total assets. These are now considered separately.

28. The increase in size of AIDC commitments is noteworthy, the average size (derived from Table 3) having varied as follows:

1977	$1.96 million
1978	$3.74 million
1979	$5.98 million

In 1979, 81% of commitments, by amount, were for sums of $5 million or more. The smaller sums tend to reflect loans to smaller industries, bridging finance or equity participations in leveraged leases.[7] Also, in 1979, 82% of commitments, by amount, were for terms longer than 4 years and 70% for terms longer than 7 years.

29. The relative role of AIDC as a provider of term loans is difficult to quantify since there are no global figures for this market. The Australian Bureau of Statistics publishes information on the Term Loan Fund Account of the major trading banks, but it is understood that the total of this fund does not reveal the full extent of their term lending, which is also said to include, for example, hard-core overdrafts and fully drawn advances.

30. The ARDB is an extension of the seven major trading banks, together with two other banks. A large part of its operations concerns raising money, in Australia and abroad, to refinance term loans made by its participating banks, and thus is not comparable to AIDC's lending operations. Figures supplied by ARDB analyse its loans outstanding at 12 July 1978 as follows:

ARDB: LOANS OUTSTANDING AT 12 JULY 1978

	$m
Direct loans made:	
Risk retained by ARDB	49.3
Risk accepted by participating banks	112.9
Refinance loans where risk assumed by ARDB . . .	49.6
	211.8
Refinance loans where risk retained by participating banks making them	450.8
	662.6

31. Accepting the limitations of some of the information, nonetheless some idea of the relative role of AIDC in term lending may be gained from the 30 June 1978 figures below:

	Term loans outstanding $m	*Ratio to total assets* %
AIDC(*a*)	196	63.8
ARDB(*b*)	212	29.8
Major trading banks(*c*)	1 411	2.8

Notes:

(*a*) Per AIDC annual report. Mostly loans with maturities of over two years.

(*b*) At 12 July 1978, as paragraph 30. Maturities not known. Direct loans by ARDB (included above), which represent an extension of term lending by the trading banks, amounted to $162 million, being 22.9% of total assets of ARDB.

(*c*) Loans, with maturities of over two years, made from accounts with the Reserve Bank (per the Australian Bureau of Statistics). The Term Loan Fund was established in 1962.

32. Another perspective can be gained by comparing loan approvals from the commencement of the operations of AIDC and ARDB until 1978. The comparisons follow:

AIDC 1971 to 30.6.78: $244.7m ; annual average approx. $35m.
ARDB 1968 to 30.9.78: $292.2m*; annual average approx. $29m.

*Total of all direct loans made by ARDB, together with re-financed loans where risk assumed by ARDB (refer classification in paragraph 30).

33. Even given the above indicators of AIDC's level and type of loan activity it is not possible to draw conclusions on the effect AIDC has had in aiding Australian industrial development. What ventures would not have started, or developments not have taken place or been postponed, had AIDC not existed? Another important aspect of AIDC's activities relates to the role it plays in the market-place. This aspect will be examined in greater detail in Chapter III but it is sufficient to say here that evidence suggests that in varying ways gaps have occurred in the Australian capital market and that, as a flexible and innovative financier, AIDC has helped to fill them. To the extent that it has succeeded, Australian industry must have benefited. The degree to which these activities have fulfilled other objectives of the Corporation set out in section 8 (2) and (3), such as increasing industrial exports and strengthening in the long term the balance of payments, can only remain conjectural.

Profitability

(a) General

34. Table 4 (pp. 10 and 11) sets out some of the key figures used to assess AIDC's growth and financial performance. In its early stages AIDC was well aware of the political sensitivities aroused by the controversy surrounding its birth, and circumscribed its actions accordingly. In addition certain restraints, including the obligation to raise loan funds primarily offshore, were imposed by the original Act of 1970, and over 1973 to 1975 the Act was amended, favourably for AIDC. AIDC itself has described some of its changes in approach during this period (refer Appendix 2, pp. 56–8).

35. The foregoing factors, and the inference by AIDC in early evidence that its pursuit of objectives of a non-commercial nature in the 'national interest' limited profitability, have clouded the interpretation of AIDC's profit performance. Moreover, it has not been possible to approach an assessment on a 'grass roots' basis due to the lack of access to information about individual operational loans and investments. However, some pertinent facts can be deduced from the Corporation's aggregate figures.

36. The Committee formed a judgment that the rate of return on AIDC capital investments was reasonable, whether measured as in item 25 of Table 4 or on AIDC's preferred basis which has been used to derive item 24 in the table. The Committee saw no reason to examine this aspect in further detail, deciding against the commissioning of an actuarial assessment of income and capital growth combined, because it was obvious from a very early stage of the inquiry that the provisions of sections 24 (8) and 26 (2) of the Act were unsuitable for optimisation of the Corporation's operations. To analyse the performance of this portfolio would have been somewhat futile given that the Committee would be looking at a totally different provision for the use of the AIDC capital funds. This is dealt with later in the Report.

37. On the basis used to derive item 13 of Table 4, to 30 June 1979 the Corporation had made a cumulative loss on its financing operations, before foreign exchange charges and income tax, of $9.2 million. There was a loss on this basis in every year except the last, that ended 30 June 1979, when a profit of $3.0 million was made.

38. The Committee took the view that an analysis of the results of the financing operations on the basis of excluding income from capital investment is a proper approach to assessing the management of such operations. The Corporation disputed this view and maintained that AIDC's profit performance should only be analysed by taking the two sides of its operations, financing and

Table 4

AIDC: CONSOLIDATED FINANCIAL RESULTS (*a*)

(1971–79)

Item No.		*1971*	*1972*	*1973*	*1974*	*1975*	*1976*	*1977*	*1978*	*1979*	*1971–79*
	Balance Sheet Summary (at 30 June) $m										
1	Operational loans and investments(*b*)	..	11.0	38.5	64.1	142.6	168.4	194.1	211.1	266.6	..
2	General investments(*c*) . . .	27.2	45.2	54.9	53.5	71.5	73.4	86.1	78.8	117.7	..
3	Deferred charges(*d*)	..	..	2.1	1.4	9.5	8.0	9.8	11.1	10.3	..
4	Total assets	27.5	57.1	97.4	123.6	229.5	256.9	300.0	306.9	403.6	..
5	Paid capital	25.0	37.5	50.0	50.0	50.0	50.0	62.5	62.5	62.5	..
6	Reserves	0.4	1.5	2.5	5.5	4.7	5.7	8.0	10.0	12.5	..
7	Borrowings	..	16.8	42.8	65.3	169.7	197.7	224.5	228.8	312.6	..
	Averages (for year ended 30 June) $m										
8	Average paid capital (weighted)	18.6	25.9	48.9	50.0	50.0	50.0	56.4	62.5	62.5	(*e*)47.2
9	Average reserves (opening/closing balances)	0.2	0.9	2.0	4.0	5.1	5.2	6.8	9.0	11.2	(*e*)4.9
10	Average capital and reserves .	18.8	26.8	50.9	54.0	55.1	55.2	63.2	71.5	73.7	(*e*)52.1
11	Average total assets (opening/closing balances)	(*i*) (13.8)	42.3	77.3	110.5	176.5	243.2	278.5	303.4	355.2	(*e*)177.9
	Profit and Loss Summary (to 30 June) $'000										
12	Net income from capital investment(*f*)	1 079	1 910	3 598	4 027	3 752	4 485	6 233	6 984	7 417	39 485
13	Net income from financing operations, before foreign exchange charges(*g*)	(226)	(482)	(1 110)	(3 579)	(3 483)	(1 519)	(659)	(1 126)	2 995	(9 189)
14	Profit before foreign exchange charges and tax	853	1 428	2 488	448	269	2 966	5 574	5 858	10 412	30 296
15	Foreign exchange gain/(charges) (*h*)	..	64	(829)	1 972	(1 461)	(2 137)	(2 989)	(3 504)	(7 644)	(16 528)

16	Profit/(loss) before tax . . .		853	1 492	1 659	2 420	(1 192)	829	2 585	2 354	2 768	13 768
17	Income tax (expense)/benefit .		(410)	(482)	(657)	580	410	170	(282)	(377)	(231)	(1 279)
18	Net profit/(loss) after tax . .		443	1 010	1 002	3 000	(782)	999	2 303	1 977	2 537	12 489
	Statistics	*Unit*										
19	Ratio 14:10	%	4.5	5.3	4.9	0.8	0.5	5.4	8.8	8.2	14.1	6.5
20	Ratio 14:11	%	(*i*) (6.2)	3.4	3.2	0.4	0.2	1.2	2.0	1.9	2.9	1.9
21	Ratio 16:10	%	4.5	5.6	3.3	4.5	(2.2)	1.5	4.1	3.3	3.8	2.9
22	Ratio 18:10	%	2.4	3.8	2.0	5.6	(1.4)	1.8	3.6	2.8	3.4	2.7
23	Net income from capital investments, with dividends restated to notional pre-tax basis .	*$'000*	1 079	2 199	4 222	5 077	4 879	5 356	7 282	8 118	8 555	46 767
24	Ratio 23:8	%	5.8	8.5	8.6	10.2	9.8	10.7	12.9	13.0	13.7	11.0
25	Ratio 12:8	%	5.8	7.4	7.4	8.1	7.5	9.0	11.0	11.1	11.9	9.3
26	Gearing to paid capital and reserves (ratio 7:(5 + 6)) times . .		..	0.4	0.8	1.2	3.1	3.6	3.2	3.2	4.2	..
27	Gearing to subscribed capital (including uncalled) and reserves (ratio 7:($100m + 6)) times		..	0.2	0.4	0.6	1.6	1.9	2.1	2.1	2.8	..

Notes:

(*a*) Published financial statements were not consolidated until the year ended 30.6.75 (in the 1975 comparative figures shown in AIDC's 1976 Report).
(*b*) Made in course of financing operations.
(*c*) Portfolio investment of capital and temporarily surplus funds.
(*d*) Unamortised exchange losses and borrowing expenses carried forward.
(*e*) Arithmetical average of the 9 annual amounts.
(*f*) From information supplied by AIDC.
(*g*) Item 14 minus item 12. Carries all overhead expenses except direct expenses charged by AIDC against item 12.
(*h*) Net realised foreign exchange gains and losses, together with charge to amortise effect of adverse foreign exchange movements on borrowing obligations.
(*i*) Disregard.

capital investment, as an integrated whole because there is a cross-subsidy effect from borrowings used as a substitute for capital which, by the provisions of the Act, may not be used for operational equity participations or lending. Expressed in another way, it would appear that section 26 (2) sanctions the use of revenue from capital investment to meet the Corporation's overheads, so that the capital, although it cannot be used directly in financing operations, does contribute indirectly. Thus interest payable on borrowings made to replace capital which cannot be used in operations is covered by revenue from investment of the capital.

39. Whilst the Corporation is entitled to apply the income from its capital investments in this way, and conceding that the profitability of the Corporation as a whole should be measured by its overall results, nevertheless the Corporation's financing operations should be so managed as to be viable in their own right. Factors in these operations such as interest rate margins, credit assessment and debt collection should be managed according to sound business principles and practice which ought not be undermined by expectations of income from other sources.

40. The two following sub-sections examine the reasons for the results of the Corporation's financing operations.

(b) Losses on foreign exchange

41. The original AIDC Act of 1970 required AIDC to borrow principally outside Australia and empowered the Reserve Bank to limit, if it so determined, the amount that AIDC could borrow within Australia in any one financial year. These restrictions were lifted entirely by the amending Act of 7 March 1975. In the meantime, AIDC had borrowed extensively in Deutschmarks, US dollars and Swiss francs.

42. In those years, AIDC on-lent these moneys and bore the exchange risk itself. Only since early 1975 has it passed on the risk to its clients. The disastrous effect of the early policies is partly revealed in AIDC's published accounts which, to 30 June 1979, disclose foreign exchange amortisation charges and net realised exchange losses amounting to $16.5 million, and unamortised adverse movements in foreign exchange obligations of $7.4 million at that date, a total of $23.9 million. But this is only part of the story. Additional interest costs on Swiss franc and Deutschmark borrowings because of exchange rate movements amounted to $3.9 million over this period. Hence the grand total of all such excess costs to 30 June 1979 was $27.8 million.

43. Whilst it may be conceded that hindsight is more accurate than foresight, several observations should be made. First, failure to pass on the exchange risk was contrary to the then well-established practice of financial intermediaries and hence the requirement for AIDC to act in accordance with sound business principles. If some borrowers could not take the risk, this fact might constitute prima facie evidence of lack of viability. Second, even if AIDC felt constrained to borrow overseas to the extent it did, it was never forced to borrow in Deutschmarks or Swiss francs. AIDC would have done better to follow the well-beaten path to US dollars than to attempt its trail-blazing into hard currencies. It is axiomatic that low interest rates signal strong currencies. Deutschmarks and Swiss franc borrowings on a roll-over basis, with flexibility on roll-over to move into any freely-available currency, would have represented a reasonable risk, but such hard-currency borrowings in long-term loans without other currency options did not. The magnitude of subsequent currency movements would have been difficult to foresee.

44. Since 1975, AIDC has passed on new exchange risks but has been dogged by the continuing effects of its pre-1975 mistakes. Since 1977, the Corporation has sought to rid itself of this legacy from the past by a series of measures including paying off the borrowings, hedging and making loans in the relevant currencies. Its improved profitability in 1979 enabled AIDC to write off an additional $1.4 million of past exchange losses, although $7.3 million remain.

(c) Financing operations

45. Turning to AIDC's extremely poor results from its financing operations even prior to charging exchange losses, it is clear that these results cannot be held to have been caused mainly through endeavours to aid 'lame-duck' projects, through undertaking abnormal risks in the 'national interest' or through charging less than market rates of interest. This, if it were the case, would be shown by an analysis of income from operational equity participations, losses arising from bad debts, interest foregone on non-accrual loans, and levels of interest rates charged. The evidence shows that:

(a) Lack of adequate income from operational equity participations could have had only a relatively small effect because these participations have been a minor proportion of the total of operational loans and investments (see Table 3).

(b) Bad debts written off in respect of operational loans and investments amounted to $9.2 million from commencement of operations to 30 June 1979.[6] If no such write-offs had been necessary, the operational results would still have been poor.

(c) Interest foregone on non-accrual loans to 30 June 1979 amounted to $3.3 million.[6] A proportion of this may have been recovered. The same observation as for point (b) above applies.

(d) AIDC evidence, independently supported, is that it has always lent at or above market rates, although some margins on early loans may have been fine for the risks involved.

Even if the detrimental effect of these four points taken together were conceded it still does not account for the poor performance of AIDC.

46. In later evidence, the Chief Executive of AIDC said:

> In 1975, the year in which a loss was made overall, it was necessary to make large provisions in relation to some of these loans. That was the first year in which the Corporation made provisions in that way. It also stopped accruing interest on certain loans. That continued for some time. Loans had been made at fixed interest rates. These had been partly financed by funds on a roll-over basis. With a substantial increase in interest rates, particularly overseas where a lot of them had been financed, we had a situation in which fixed interest rates on loans were lower than the cost of getting money to continue . . . Current loans were in fact not earning anything at all; they were under water.[8]

Thus operational unprofitability was the result of mismanagement.

47. The effects of changes in recent years are now beginning to show. AIDC supplied the Committee in March 1979 with forecast results for the year based on eight months actual figures and four months projected figures. In the event these have been bettered slightly. The 1979 improvement lends credence to the confidential projections for 1980, 1981 and 1982, also provided to the Committee, which continue the trend (excluding from 1979 the surplus of $2.3 million on realisation of operational investments) and are boosted by expectations of substantially lower foreign exchange amortisation charges.

48. If the Committee has been somewhat harsh in its judgment of AIDC's performance before its 1978–79 fiscal year, it nonetheless recognises the turn-round which has occurred and accepts the credibility of the projected improved future results.

49. While the Committee certainly does not regard profitability as the sole criterion on which AIDC should be judged, given the aims expressed in creating the Corporation and enshrined in its Act, it is nevertheless an important element in assessing the overall performance of the Corporation and specifically the level of competence of its management. In a purely practical vein, and leaving aside the section 8 (2) requirement to act in accordance with sound business principles, one of which should surely be related to making profits, the more AIDC earns and increases its reserves the more it can borrow without further call on the public purse for equity. Such increases in reserves also allow AIDC to enter into more operational equity participations, an activity consistent with its defined functions which it has largely neglected due to a lack of interest-free funds (see Appendix 2, p. 47).

CHAPTER III
ROLE OF AIDC

Who are AIDC's competitors?

50. Since public discussion and evidence have revealed confusion regarding the need for AIDC and the fairness of its role as a public authority in competing with companies in the private sector, a few observations are now made on the role of AIDC in the capital market.

51. The Australian capital market has two shortcomings: it is limited and it is imperfect in its operation. The first factor requires its expansion by marshalling funds from abroad to enable major projects to go ahead. The second is not unusual in capital markets although in Australia it has certain unique local features, such as the distortion caused by the 30/20 requirement. In such a market it is considered essential for industrial development that any financial intermediary which can make a useful contribution be encouraged.

52. Within the market, moneys from the public are deposited or subscribed for short maturities, mostly up to three years, and find their way into finance companies, building societies, credit unions, savings banks, trading banks and savings bonds.

53. The major suppliers of medium- to long-term Australian dollars to the capital market are the life offices and superannuation funds, both of which attract long-term commitments of income. Most term lending by the life offices is on mortgage or debenture. These forms of lending do not suit all industrial users; indeed debenture trust deeds can be very limiting. Moreover, the industrial debenture market is notoriously volatile, the availability of funds fluctuating in accordance with the commitments and forward economic assessments of the life offices and superannuation funds.

54. Under these circumstances it is hardly surprising that there is a demand in the market for the services of ARDB and AIDC as medium-term lenders. In its submission to this inquiry the ARDB concluded its views as follows:

> We believe that the AIDC should:
>
> (a) Act as lender to Australian industries by providing term loan funds. As in the past, the AIDC should retain flexibility so that it can strengthen and supplement the financial community's ability to satisfy the needs of borrowers. In the future, perhaps, the AIDC should concentrate a little more on the longer term (i.e. four years and more) and the larger amount (i.e. $5 million plus) requirements of borrowers.
>
> We believe that these loan requirements, within certain sectors of industry, are not currently being fully satisfied by other lenders.
>
> (b) Provide equity funds to assist the formation/expansion/restructuring of Australian organisations, subject to an overriding condition that any AIDC equity interest is disposed of once the undertaking is commercially viable.[9]

Both ARDB and AIDC can raise medium-term funds abroad and both can tap the local market in a manner unsuitable, for practical and other considerations, for banks and merchant banks. Finance companies operate in this sector of the local market but, by virtue of their low gearing, need to add margins when on-lending which would be prohibitive for many industries seeking development funds.

55. The ARDB, which is an extension of the trading banks, emerges as the financial intermediary most like AIDC. In its direct lending it is of comparable size. The ARDB, as a bank, has an advantage over AIDC in local fund raising. It is also worth noting that about 25% of ARDB's capital base is provided by way of subordinated loans from the Reserve Bank. As lenders, ARDB and AIDC both compete and co-operate in the market.

What other roles?

56. Quite apart from the operations of ARDB and AIDC in helping to meet needs for medium–term funds, both are set up to assess projects and lend amounts which are relatively large for Australian financial intermediaries. This could be described as meeting a 'size gap' in the capital market. Whilst increasingly the mere size of many projects demands the spreading of risk by loan syndication, paradoxically the size of the syndicate may have to be limited because of the complexity and difficulty of understanding the projects, and/or for security of information. The ARDB and AIDC join together in a number of syndications.

57. Evidence received by the Committee indicates that AIDC has shown itself to be a flexible and innovative financier, and its efforts in this direction have improved the sophistication of the market and advantaged its clients.

58. Since the time that AIDC was formed the larger Australian companies have progressively improved their ability to borrow overseas on their own account, but the number of companies able to do so is limited. A mere handful can attempt public Eurobond issues and even fewer enter the New York public market. Merchant banks and international banks can marshal overseas funds on behalf of smaller companies where such companies are able to take the exchange risk.

Continuing functions

59. Whatever views may have been held originally as to the necessity or otherwise for the formation of AIDC, now that the Corporation has been in existence for almost a decade the reality of the situation must influence thinking about its future. There is evidence that AIDC is now a professional financier which has built up a competent team of officers, who possess skills and experience in metallurgy, engineering and other technical areas as well as in finance, to a degree uncommon in financial intermediaries in Australia.

60. As a practical and pragmatic matter, it may be concluded that private enterprise companies drawing funds from the capital market, and also the other lending institutions such as ARDB and the trading banks when joining AIDC in syndicating loans, benefit from the presence of AIDC. That, however, is not to say that it should continue to operate in precisely the same way as in the past. The Committee believes that AIDC needs to be changed to meet future requirements.

61. As discussed in Chapter I this Committee is primarily concerned with the efficient and effective use of public moneys appropriated to the AIDC by act of Parliament, and in the remainder of this Report proposes changes to the Act to best achieve these aims in relation to AIDC in the future. In considering these changes the Committee took the view that the AIDC should not, because of its status as a statutory corporation of the Australian Government, be accorded unfair operational advantages over its competitors but neither should it be disadvantaged. The aim then was to achieve a package of statutory provisions which, when considered with the semi-government status of the Corporation, would allow it to compete with other like financial institutions on a fair basis.

AIDC's place in the market

62. Although the need for AIDC in the capital market has been disputed, especially by the Australian Bankers' Association, there is substantial evidence of its usefulness from quarters that might have been thought to be antipathetic. In particular, the Committee was impressed by, and found most persuasive, the objective and well-presented public evidence of the ARDB. Its compelling arguments could scarcely be ignored. On the future of AIDC the ARDB summed up as follows:

> We believe that, during the years since its formation, the Corporation has played a useful role in assisting the financial community to satisfy the funding needs of industries in Australia. The AIDC has provided finance in a number of forms to many sectors of industry for a variety of periods ranging from the short term to longer term, and for amounts from $250 000 to in excess of $5 million. The AIDC's ability to provide such a variety of finance is an undoubted strength. This, coupled with the AIDC's large capital base, has assisted the growth of the Corporation.
>
> In the future, we believe that the AIDC should continue to operate as it has in the past. We see a need for the AIDC to remain flexible so that it can adapt to the changing requirements of industry as well as alterations in the roles of other members of the financial community. The AIDC must be able to supplement and strengthen the sources of finance available to industry.[10]

63. Having carefully weighed this evidence and the matters set out in the previous chapter the Committee has determined that:

(A) The AIDC has an established role in the Australian capital market, generally for lending sizeable amounts in the medium- to long-term area, and in the financing operations of the Corporation it is recognised that some flexibility is desirable for meeting unforeseeable future changes. Its present role reflects weaknesses in the Australian capital market, possibly attributable in part to official controls on other financial institutions.

(B) It is useful for AIDC to continue to complement the activities of other lending institutions in the organising of financial packages, in which it may participate as a lender or equity holder, or both.

and

(C) There is a role for AIDC as financial adviser in the restructuring of industries and in the development of new techniques for financing industrial development, areas in which the Committee is satisfied that AIDC has developed and demonstrated particular expertise.

Commerical effectiveness

64. The Committee is firmly of the view that continuance of AIDC's operations should be on the most efficient and effective basis. Several things follow.

65. In early evidence by AIDC about its history, some of it confidential, there was some indication of possible confusion within the Corporation—at least in its formative years—as to the weighting that should be attached, when deciding operational loans and equity participations, to the commercial criteria of section 8 (2) relative to the non-commercial criteria of other sections of the Act: (s.6 (1)(b), s.6 (2) and (3), and s.8 (1) and (3)). The Committee considers that AIDC has made use of the non-commercial criteria as an excuse for poor commercial performance, or at least to cloud the issue. In later evidence by AIDC, proper weight is attached to commercial criteria and the need for AIDC to have a satisfactory record of profitable performance. In Treasury's view, although AIDC has to have regard to other aims and objectives in the Act, nothing absolves the Corporation from the operation of section 8 (2), which requires adherence to sound business principles. The Committee believes that, in allocating available funds between competing borrowers, AIDC should first satisfy the section 8 (2) requirements, after which it should then take into account the other, non-commercial criteria.

66. The Committee has concluded that:

(D) Definition of the aims and functions set out in sections 6 and 8 of the Act are vague and can be conflicting, thereby causing confusion as to the aims and objectives of the Corporation. In particular, the obligation on AIDC to consider non-commercial aims in its financing operations may have affected its commercial performance and undoubtedly has created a degree of uncertainty and difficulty in judgment of that performance. Accordingly, it should be made clear that the provisions of section 8 (2) are a primary condition that all lending operations should satisfy, not to be overridden by non-commercial criteria.

Capital structure

67. The Committee is concerned about the relatively large amount of public funds subscribed as equity capital to AIDC when compared with the extent of its financing operations. A sum of $100 million was subscribed under section 24 (1) of the Act, and $62.5 million has been called up so far. Taking 1978 figures for comparison, the following paid-up capital amounts are illuminating in that they show the extent to which AIDC is over-capitalised in comparison with financial institutions:

	Capital	*Assets(a)*
	$m	$m
Commonwealth Banking Corporation	76.6	13 219
Commercial Bank of Australia	62.5	4 649
Commercial Banking Company of Sydney	43.0	3 575
Partnership Pacific Ltd	(*b*)23.2	381
ARDB	(*c*)7.0	710
AIDC	62.5	307

Notes:

(*a*) The three trading banks had accumulated reserves, some built up over a very long period, which combine with the capital amounts shown to support the total assets as set out above.

(*b*) Partnership Pacific Ltd is the largest merchant bank in Australia. Its paid-up capital is $18.0 million and net accumulated losses amount to $4.7 million. Subordinated loans total an additional $5.2 million.

(*c*) ARDB also had $49.5 million of loan capital and subordinated loans, which combine with the equity capital amount shown and reserves of $3.8 million to give a total capital base of $60.3 million.

Sources: Various annual reports.

68. It should be noted also that no dividends are payable by AIDC to the Commonwealth. A similar position applies in relation to the $61.7 million of equity capital advanced by the Commonwealth to the Commonwealth Development Bank. (This body pays interest on its Commonwealth loans funds.) ARDB pays dividends to its shareholder banks (and interest on its loan capital and subordinated loans).

69. Any contemplated variation of the present capital arrangements for AIDC has to be approached with considerable caution and proper sensitivity to its likely effects in the market-place, especially overseas. For example, a straight reduction in capital through cancellation of the $37.5 million currently uncalled would constitute an event of default under AIDC's borrowing obligations. Some more subtle variations, whilst not perhaps constituting legal default, could be regarded as acts of bad faith. Because of the strict conventions which apply in this field Australia's international credit-worthiness, which to date has been impeccable, is involved.

70. One area for particular consideration is the maximum gearing ratio, prescribed in section 7 (3) of the Act, whereby AIDC cannot borrow more than five (5) times its capital and reserves. Banks and merchant banks commonly have ratios of 20:1 or more. The ARDB is around 10:1, its maximum ratio being determined by the Reserve Bank under the loan agreement between them. Evidence suggests that AIDC could move cautiously towards say 10:1 initially. At 30 June 1979 its borrowings of $312.6 million bore a ratio of 4.2:1 to its paid capital and reserves of $75.0 million. Call-up of the remaining $37.5 million of uncalled capital would reduce the ratio to 2.8:1. Since it has taken AIDC eight years to reach this stage, clearly its rate of growth is not determined by the gearing ratio but by other factors.

71. The overseas market regards AIDC as having an implicit guarantee by the Commonwealth and this view has enabled AIDC to become a strong borrower at rates only slightly in excess of those applicable to the Commonwealth itself. Undoubtedly, if the occasion ever arose, that AIDC were faced with default on interest or on repayment of principal, then the Commonwealth could not stand idly by. It would be bound to back the body it had created and which it owns. Consequently, the real obligations of the Commonwealth would not be altered by guaranteeing AIDC explicitly. The Commonwealth Development Bank is guaranteed in this way. An explicit guarantee would allow several important changes in AIDC's capital arrangements to be accomplished without upsetting foreign or local lenders to the Corporation. In turn, these changes would bring real benefits to the Commonwealth.

72. First, the present low maximum gearing ratio of 5:1 could be lifted. Under such circumstances, the currently uncalled $37.5 million of subscribed capital could remain uncalled long into the future. Second, provision could be made for the payment of dividends. Third, when more capital becomes necessary, for some time to come it could be provided by way of subordinated loans, bearing interest. These steps will now be discussed in some detail.

73. Even with a guarantee, the $37.5 million of uncalled capital cannot be cancelled, since this would comprise a legal default by AIDC under its borrowing instruments. But this obligation is only a contigent liability of the Commonwealth for as long as its call-up is deferred. The reality only comes when cash is required. The guarantee would allow the present gearing restriction to be lifted without default and, as a result, such capital call-up to be indefinitely deferred.

74. Lenders take uncalled capital into consideration when assessing risk, and it would be legitimate for provision to be made for any uncalled capital of AIDC to be counted in its capital base when determining gearing. This step would allow extension of AIDC's borrowing abilities, hence the extent of its financing operations, simply by increasing its subscribed, but uncalled, capital; that is, without actual payment by the Commonwealth.

75. Also, with a guarantee, a change in the rules to provide for the payment of dividends should be acceptable to existing lenders to AIDC. The feasibility of making dividend payments quite obviously is linked to adequate profitability which, in turn, presupposes the writing-off of unamortised exchange losses and other deferred charges. As stated earlier, AIDC's profit projections foreshadow an improved performance. Raising the gearing ratio will help to increase the percentage rate of return on paid-up capital. However, since it is recognised that dividend payments reduce reserves, AIDC's ability to make the payments is also linked to a later recommendation (see paragraph 85).

76. It would be important in achieving the aims for which AIDC exists that dividend payments should not reduce its operating capability in real terms. For a financial intermediary this depends upon preserving in real terms its 'free capital', that is, its capital funds less that proportion which is invested in fixed assets and intangibles. Application of the change in a suitable general index during a financial year to the opening amount of free capital will give an approximate measure of the amount needed to be deducted from conventionally determined net profit in order to preserve operating capability. The balance left may be applied for payment of dividends or retained.

77. Subordinated loans, which are not provided for in the capital structure of AIDC, count in the capital base of a financial intermediary when considering gearing. A notable example is that of the ARDB. At 30 September 1978 the relevant figures were:

	$m
Paid-up capital and reserves	10.8
Loan capital	2.2
Subordinated loans	47.3
Total	(*a*)60.3
Deposits	(*b*)588.1
Gearing ratio (*b*) : (*a*)	9.8 : 1

Source: ARDB 1978 Annual Report.

78. Introduction of this method of determining the gearing ratio of AIDC would allow some of AIDC's future capital requirements to be met on an interest-bearing basis instead of as equity capital, an arrangement which may well suit the financial planning of the Commonwealth. Since it would be natural for AIDC to favour the flexibility conferred by additional equity capital over the obligation to meet interest payments on subordinated loans, it is considered that provision should be made for future capital requirements of AIDC to be met by subordinated loans unless otherwise advised to the Minister jointly by the Corporation and the Reserve Bank. It would then be for the Corporation to convince the Reserve Bank that market considerations and/or financial prudence necessitate further equity capital subscription.

79. Each subordinated loan should be negotiated as to amount, term, interest rate and other conditions between AIDC and the Commonwealth. A sensible balance between equity and loan capital would be required and would be a matter of commercial judgment. Acceptability by lenders to AIDC would be the touchstone. This whole proposal presupposes an explicit guarantee.

80. Adoption of the foregoing suggestions for changing the capital structure of AIDC would not affect its rate of growth. Under the present provisions of the Act the question of extension of the original $100 million of subscribed capital would come before the Parliament several years hence as AIDC was approaching its present maximum gearing ratio of 5:1. The effect of the proposed measures will be to allow the Parliament to review the question much earlier.

81. Consequently the Committee has concluded that:

(E) It would be advantageous to the Commonwealth for it to guarantee the liabilities of the Corporation.

(F) The existing capital structure of the AIDC is no longer relevant to the Corporation's needs and unnecessarily ties up substantial public funds; specifically the maximum borrowings/capital ratio of 5:1, as determined in section 7 (3) of the Act, is unnecessarily restrictive, no longer appropriate to the Corporation's operations, and will needlessly fuel the requirement for additional public funds.

(G) The capital base of AIDC for measuring gearing should be redefined to include any uncalled capital.

(H) Provision should be made for the payment by AIDC of dividends to the Commonwealth once the Corporation has become adequately profitable, subject to maintenance of its operating capability in real terms.

(I) Provision should be made for the Commonwealth, by agreement with AIDC as to amount, term, interest rate and other conditions, to meet future AIDC capital requirements partly by way of subordinated loans, which would also be counted in AIDC's capital base for gearing purposes.

Fixing the gearing ratio

82. The Committee thinks it would be unwise to specify, in the Act, a maximum gearing ratio for AIDC. Circumstances change, and the appropriateness of a particular ratio at any given time depends upon factors such as its acceptability in the market-place and the quality of the Corporation's assets; it is a matter of commercial judgment. However, the Committee believes that it would be beneficial for the Reserve Bank to be required to express a view on this matter each year, after review of AIDC's annual accounts with the Corporation's officers. This view would be helpful to the AIDC Board in exercising its commercial judgment in regard to the scale of the relevant factors in the Corporation's operations which influence the ratio. Thus the Committee finds that:

(J) It should be provided that the Reserve Bank exchange views annually with the Corporation on an appropriate maximum gearing ratio for AIDC, and that the actual ratio be left in the hands of the Board of the Corporation for determination from time to time as it sees fit.

Use of capital

83. Another restrictive factor in the capital structure of AIDC is the peculiar requirement under the Act for paid-up capital to be invested and not used in financing operations. The Committee is unaware of such a restriction being applicable to any other financial intermediary anywhere. AIDC has described it as 'both inconvenient and inhibiting' and making for 'artificial and unnecessary complications in funds management and financial reporting'. In its borrowing activities, AIDC avers that this restriction 'was more a peculiarity which had to be explained away—and made the most of—rather than any positive help'.[11] Independent evidence supports the thrust of these contentions.

84. Other financial intermediaries use their equity capital to fund their fixed assets, the balance—their 'free capital'—providing the base for their financing operations. In terms of AIDC's aims, such use is of particular importance. For a number of reasons, banks and merchant banks tend to avoid operational equity participation. This is an area more for the life offices. Clearly, to contribute equity to a development project, which may not pay dividends for some years, would be foolish if done on the basis of borrowed funds involving an interest cost. This consideration has inhibited AIDC in its operational equity participation, since its only source of untied interest-free funds has been its reserves.

85. The Committee finds that:

(K) The requirements of sections 24 (8) and 26 (2) of the Act with regard to the use to which capital of the Corporation may be put, precluding its use for operational loans and equity participations, are inappropriate to the Corporation's needs and unnecessarily restrict its financing activities, both as to volume and nature (equity participation).

Service industries

86. Section 6 (1) (a) of the Act restricts the financing operations of AIDC to 'industries concerned with the manufacture, processing, treatment, transportation or distribution of goods, or the development or use of natural resources (including the recovery of minerals) or of technology'. Service industries, where they are 'connected with, or incidental to, those industries', would appear to have been brought within AIDC's scope by section 6 (1) (a) (i). Their inclusion could be of importance where they affect the costs or productivity of the industries they service. However, other service industries such as, for example, tourism would appear to be excluded.

87. The Committee concludes that:

(L) The definition of the functions of the Corporation in section 6 (1) (a) may preclude it from financing some service industries and should be expanded to remove this restriction.

'National interest' provisions

88. The *Australian Industry Development Corporation Act* 1970 was amended in 1975 with the insertion of section 8A covering projects determined by the Government as being in the national interest. Section 8A provides, *inter alia,* for reimbursement of any costs incurred by AIDC on national interest projects but not for charging a margin above cost for its expertise and management. The section has never been invoked and evidence has been given that the provisions are complex and cumbersome, although projects likely to fall in this category would probably have a fairly long lead time. They would also be of such a nature as to warrant debate in the Parliament on the circumstances, justification for and conditions of loans to be made to them.

89. The fact that the provisions have not been used and the existence of other means of providing government financial assistance to companies in the national interest, as in the case of the Mt Lyell Mining and Railway Co. Ltd, indicate that the use of AIDC's services in all cases may not be appropriate. Major defence-related projects, which could be financed through defence funds, would be an example. The Committee believes that, where the expertise and management of a financial intermediary is required, it would be more appropriate to invite quotes for their services from AIDC and others, rather than be tied to the use of AIDC solely. For this reason the Committee did not pursue consideration of means to streamline the provisions of section 8A.

Board/Executive structure

90. The Act provides for the appointment of an Executive Chairman and Sir Alan Westerman, C.B.E., was the first incumbent. In 1977, his appointment was changed to that of a part-time Director and Acting Executive Chairman, and his former full-time executive duties were taken over by Mr J. R. Thomas as Chief Executive (Appendix 2, Annexe C). The Committee understands that consideration is being given to amending the Act to expressly provide for an office of part-time non-executive Chairman, as is usual in many companies, as an optional alternative to a full-time Executive Chairman (see Appendix 2, page 41).

91. The Committee is of the view, as a matter of principle, that there are distinct advantages in the checks and balances inherent in separation of the functions of Chairman of the Board from those of the Chief Executive. Consequently, the Committee considers that:

(M) The Act should be amended to provide for the separate appointments of a part-time non-executive Chairman of the AIDC Board and of a full-time Chief Executive of the Corporation. The latter officer may or may not also be a Director.

Stamp duties

92. In 1975 the Act was amended with the insertion of section 27 (1B) exempting the Corporation from payment of stamp duty or any similar tax under a law of Australia or of a State or Territory. In relation to the equity of this exemption it is necessary to examine not simply this aspect on its own but rather the totality of all aspects affecting AIDC's competitiveness for funds. Its only relevant competitors in this market are the banks and their extension, the ARDB. Not only does bank status enable them to borrow locally at lower rates than AIDC but also it confers access to trust funds in most States. AIDC's exemption from stamp duty on its paper brings it somewhat closer to the local borrowing rates of banks than would otherwise be the case. (See Appendix 2, p. 49.)

93. Regarding the application of loan instrument duty under the Stamp Duties Act in New South Wales, this impost was never designed in the first place to apply to variable interest rate borrowings by corporations and it would be more to the point were it to be removed from application in that area.

94. There is also a question of policy in regard to Commonwealth–State relationships under which it is traditional for Commonwealth authorities not to be subject to State taxes. The States levy certain taxes, including stamp duties, on AIDC's competitors.

95. The Committee finds that:

(N) AIDC's exemption from stamp duty and similar taxes should continue.

Location of head office

96. The Act provides that the Head Office of the Corporation shall be in Canberra. It would not be appropriate, nor does the Committee wish, to argue the merits and demerits of this location *vis-à-vis* other cities, but the Committee has the view that it is wrong for the Head Office location to be prescribed by legislation. If the Board at some future time were to form a judgment that, in the circumstances then applying, it would be advantageous for the Head Office of the Corporation to be moved elsewhere, then it should be free to act accordingly. Hence the Committee finds that:

(O) The AIDC Act should be amended to remove the requirement for the Corporation's headquarters to be in Canberra.

Loans (AIDC) Act

97. The *Loans* (*Australian Industry Development Corporation*) *Act* 1974 enabled the Government to borrow funds overseas in its own name and on-lend them to the Corporation. It has been used only once, in May 1975, when the Government, having borrowed US$100 million in New York, on-lent US$75 million at cost to AIDC. AIDC in turn on-lent US$45 million to CSR Limited and US$30 million to John Lysaght Australia Limited, in both cases adding a normal margin and charges for such a transaction. No doubt the transaction was advantageous to AIDC's clients in terms of cost, timing and ease of raising the money, and to AIDC in terms of much-needed profits from a relationship with companies having 'blue chip' credit-worthiness.

98. At that stage, AIDC had not sought the two credit ratings which would have been necessary for it to raise funds in its own name by a public bond issue in New York. Should the need arise in future for it to have access to that market, AIDC would have no difficulty in obtaining a suitable credit rating. Several major Australian companies have done so since 1974, and the ARDB is a rated borrower in New York. If the purpose of the Loans Act was 'to tap sources of overseas funds otherwise not available to Australian industry', it must be considered to have outlived its usefulness. AIDC concurs that it should be repealed. The Committee finds that:

(P) The *Loans* (*Australian Industry Development Corporation*) *Act* 1974 is no longer required for the operations of AIDC and should be repealed, with a saving provision to cover the ongoing validity of actions already taken under this legislation.

Withholding tax

99. Under section 128EA of the Income Tax Assessment Act, AIDC enjoys the unique benefit of exemption from withholding tax on interest paid on its overseas borrowings. This benefit is more than merely an administrative convenience, and does not extend to AIDC's competitor, the ARDB. Certainly, ARDB, and any other Australian-owned financial intermediary, can obtain specific exemption from interest withholding tax for a borrowing which is on-lent to an 'Australian entity' as defined in the Income Tax Assessment Act. However, AIDC's automatic exemption gives it a decided advantage where it on-lends to companies which have some Australian ownership but not enough to satisfy the stringent tests which determine 'Australian entity' status within the meaning of the Act.

100. The Committee is reluctant to suggest imposing complex and tedious regulations on AIDC in the name of fair competition, and wonders whether the real intent of the legislation—to place predominantly Australian-owned companies on a more equal footing with subsidiaries of foreign corporations—would not be served well enough by extending an identical exemption to ARDB, bearing in mind the objectives of both AIDC and ARDB. If, on closer consideration, this move were found not to be acceptable then the Committee suggest that a review be made of the mechanisms for exempting private overseas borrowings with a view to simplifying them.

101. The Committee finds that:

(Q) The provisions of section 128EA of the *Income Tax Assessment Act* 1936, conferring on AIDC automatic exemption from interest withholding tax on private overseas borrowings, should be examined to see whether a similar exemption should be extended to ARDB. Should this not be acceptable the Committee considers that the mechanisms for case-by-case exemptions should be considered to see whether the mechanisms can be simplified.

Variable Deposit Requirement (VDR)

102. Broadly, under the VDR scheme when it is in operation, companies borrowing overseas for purposes other than capital investment in mining and manufacturing industries must, unless granted an exemption by the Treasury for the particular loan, lodge a percentage of the borrowed funds with the Reserve Bank. The VDR scheme has not operated since 1976 but can be reintroduced at the discretion of the Government.

103. The Committee considered the question of the exemption of AIDC from the VDR scheme when it is in operation and considers that, as overseas borrowings by AIDC are subject at all times to approval by the Treasurer and the Loan Council, it is inconceivable that borrowings could be made which would be contrary to the Government's monetary policy. In fact the VDR does not apply to any borrowings approved by the Loan Council. The same controls do not apply to AIDC's competitors and they are therefore subject to VDR. The Committee recognises, however, that a case could be made for a similar exemption for ARDB and suggests that the scheme be reviewed accordingly.

104. The Committee finds that:

(R) Being subject at all times to Treasury and Loan Council approval for its overseas borrowings, AIDC is properly exempted from application of the Variable Deposit Requirement. The Government should consider granting a similar exemption to ARDB.

Bank status

105. In its evidence to the Committee the AIDC suggested it would be appropriate for the Corporation to be granted bank status. This would remove certain trading disadvantages which it maintains exist relative to other financial intermediaries with which it competes both in borrowing and lending. It was argued that bank status would allow AIDC to borrow at finer rates of interest than is currently possible both in Australia and overseas. Bank status would also make it possible for AIDC to obtain trustee status for its securities in the States of the Commonwealth.

106. The Committee has carefully weighed the evidence given by the AIDC and contrary views expressed. It is considered that, with the changes which have been outlined in the preceding paragraphs of this chapter, the AIDC will be able to perfom on a competitive basis in the financial market without undue advantages or disadvantages relative to its competitors. The Committee therefore concludes that:

(S) Having regard to the Committee's proposals taken as a whole, it is not recommended that AIDC be accorded bank status.

CHAPTER IV

RECOMMENDATIONS

107. The Committee recommends that the following consequential amendments be made to Acts of the Commonwealth referred to below:

1. The *Australian Industry Development Corporation Act* 1970 be amended to:
   - (a) redefine the functions of the Corporation in section 6 (1) (a) to extend the areas in which it may operate to explicitly include service industries;
   - (b) amend the existing provisions of section 7 (3) and Part IV—Finance, to change the capital structure of the Corporation as follows:
     - (i) to provide that the liabilities of the Corporation be guaranteed by the Government;
     - (ii) to allow the maximum gearing ratio of the Corporation to be determined from time to time by the Board as it sees fit, having exchanged views annually on appropriate ratios with the Reserve Bank;
     - (iii) to require any uncalled capital to be included in the capital base of the Corporation for measuring gearing;
     - (iv) to provide that, unless otherwise advised to the Minister jointly by the Corporation and the Reserve Bank, any further paid-up capital needs of the Corporation be met by subordinated loans from the Commonwealth, each such loan to be agreed with the Corporation as to amount, term, interest rate and other conditions;
     - (v) to remove the restrictions on the use of the paid-up capital of the Corporation (set out in section 24 (8) and section 26 (2)), so that the Board in its discretion may use the capital funds in part or wholly in the operations of the Corporation;
   - (c) provide that the considerations stated in section 8 (2) shall override those stated in sections 6, 8 (1) and 8 (3);
   - (d) provide for payment by the Corporation of annual dividends to the Commonwealth, to a prudent degree, to be determined by the Minister after consultation with the Corporation and after adjustment to allow for the effect of inflation (or deflation) on the 'free capital' of the Corporation, in order to maintain this free capital in real terms;
   - (e) remove the provision for the appointment of an Executive Chairman, and provide for the separate appointments of part-time non-executive Chairman of the Board of the Corporation and of full-time Chief Executive of the Corporation, the latter officer also being able to be but not necessarily being appointed a Director;
   - (f) repeal section 36 which requires the head office of the Corporation to be located in Canberra.

2. The *Loans (Australian Industry Development Corporation) Act* 1974 be repealed, with a saving provision for ongoing validation of actions already taken under this legislation.

3. The provisions of section 128EA of the *Income Tax Assessment Act* 1936, conferring on AIDC automatic exemption from interest withholding tax on private overseas borrowings, be examined to see whether it would be appropriate to extend them also to ARDB.

4. The Government consider making appropriate amendments to the *Banking Act* 1959 to exempt ARDB from the Variable Deposit Requirement.

108. The Committee records its appreciation of all those who appeared as witnesses and made submissions to the Committee on this inquiry. In particular the co-operation of the AIDC is appreciated. We also acknowledge the contribution of our advisers, in particular Mr D. R. Rickard and the Clerk to the sub-committee, Mr P. G. Bush.

KEVIN M. CAIRNS
Chairman

13 December 1979

End notes

1. Australia, Parliament, *Statutory authorities of the Commonwealth: First Report of the Senate Standing Committee on Finance and Government Operations*, Parl. Paper 1, Canberra, 1979.
2. Hansard Debates 1970, House of Representatives, pp. 1599–1600.
3. The Australian Industry Development Corporation 8th Annual Report 1978, p. 6.
4. Hansard Debates, p. 1601.
5. *Australian Industry Development Corporation Act* 1970, sections 6 (1) (a) and (b).
6. AIDC Submission of 11 October 1979.
7. A financing technique whereby suitably qualified lessors form and join into a partnership to make use of available taxation benefits which, by being passed on, provide an attractive lease arrangement to the lessee. Usually the package includes debt finance and the effective lease rate is lower than in alternative forms of finance.
8. Evidence, p. 475.
9. Evidence, p. 222.
10. Evidence, pp. 230, 231.
11. Evidence, pp. 462, 463.

APPENDIX I. CONDUCT OF THE INQUIRY, WITNESSES AND EVIDENCE

Conduct of the Inquiry

1. The Committee resolved on 1 June 1978 that a sub-committee, consisting of the Hon. K. M. Cairns (Chairman), Mr J. J. Brown, Dr H. R. Edwards, Mr K. L. Fry, Mr S. A. Lusher, Mr R. M. McLean and Mr P. Morris inquire and report to the Committee on the operations of the Australian Industry Development Corporation.

2. In the first phase of the inquiry the sub-committee obtained submissions from a number of organisations including ARDB, the Australian Bankers' Association and AIDC. Evidence was taken from these organisations and others in the second half of 1978 and early 1979.

3. In 1979, following established Committee practice, the sub-committee formulated certain propositions (called emerging conclusions) and tested these at *in camera* hearings with AIDC, Treasury and, later, the Department of Finance. As is the practice of the Committee, and as advised to witnesses, the transcripts of this second phase will be published when the report is published.

Witnesses

Australian Industry Development Corporation:	
Heffernon, Mr K. J.	Senior Manager
Sharland, Mr D. E.	Manager Finance and Accounting
Thomas, Mr J. R.	Chief Executive
Australian Resources Development Bank	
McCrossin, Mr R. G.	General Manager
Williamson, Mr R. B.	Planning and Development Officer
Australian Bankers' Association Research Directorate	
Cameron, Mr R. B.	Director
Cawsey, Mr E. W.	Economic Adviser
Australian Mutual Provident Society	
Coates, Mr A. W.	Chief Investment Manager
Commonwealth Sugar Refining Ltd	
Willis, Mr J. G.	Treasurer
Hill Samuel Australia Limited	
Berg, Mr A. R.	Deputy Managing Director
Department of Finance	
Barrett, Mr P. J.	First Assistant Secretary, Transport and Industry Division
Harris, Mr A. C.	Assistant Secretary, Manufacturing, Mining and Power Branch

Commonwealth Scientific and Industrial Research Organisation

Duncan, Mr A. D.	Scientific Services Officer
Grant, Mr P. A.	Acting Senior Assistant Secretary
Land, Mr W. J.	Scientific Services Officer
Lattimore, Mr S.	Acting Secretary

Department of Productivity

McIntosh, Mr M. K.	Acting First Assistant Secretary, Policy and Research Division

Department of the Treasury

Daniel, Mr R.	Deputy Secretary
Pooley, Mr F. G. R.	Acting First Assistant Secretary, Financial Institutions Division

Evidence

4. Evidence relating to the first phase was taken on 8 September and 10 November 1978 and 6 February and 6 April 1979. One part of the 6 April hearing was held *in camera* at the request of the witness, Hill Samuel Australia Limited. The second phase (emerging conclusions) hearings were held on 24 April and 18 September 1979.

5. Altogether the sub-committee held three *in camera* hearings (evidence of two to be published), four public hearings and thirteen private meetings.

6. Some of the submissions received were incorporated in the transcripts of evidence. The sub-committee has authorised publication of the following submissions:

AIDC

Submission dated 10 August 1978 (AIDC: A General Perspective); pp. 6–9 not available for publication

Submission dated 8 November 1978 (answers to questions 8 and 9 only)

Submission dated 4 July 1979 on Subordinated Loans and other matters

Submission dated 6 July 1979 on Interest on non-accrual loans

Submission dated 11 October 1979 on Operational Commitments

Submission dated 27 November 1979 on Operational Investments outstanding

ARDB

Submission dated 15 February 1979 on length of loans and payments to the Reserve Bank

Submission dated 16 October 1979 on loans outstanding and loan approvals since inception

Treasury

Submissions dated 9 May and 19 May on government bodies that do not pay either interest or dividends on capital given by the Commonwealth

Others

Submission dated 22 December 1978 from Accepting Houses Association of Australia on AIDC exemption from interest withholding tax

7. The submissions incorporated in the transcripts of evidence were:

8 September 1978 Hearing	
Consolidated Press Holdings Limited	2 August 1978
Petersville Australia Limited	11 August 1978
W.A. Chip & Pulp Co. Ltd	10 August 1978
Antenna Engineering Pty Ltd	15 August 1978
Blue Metal Industries Limited	15 August 1978
CSR Limited	18 August 1978
John Shearer Limited	22 August 1978
The Broken Hill Proprietory Company Limited	21 August 1978
AIDC	4 August 1978
10 November 1978 Hearing	
ARDB	11 October 1978
AMP	27 September 1978
CSIRO	29 August 1978
Department of Productivity	August 1978
6 February 1979 Hearing	
Bank of America	14 November 1978
Australian Bankers' Association	6 December 1978
6 April 1979 Hearing	
Hill Samuel Australia Limited	9 January 1979
AIDC—Use of capital, gearing limit, bank status and size of financing;	22 March 1979
AIDC—The facts on AIDC loans funded from government bonds issued in New York; and	
AIDC—The Need for a Stronger Commercial Base.	
24 April 1979 Hearing	
Treasury—On implications for AIDC of bank status and AIDC's gearing ratio	20 April 1979
AIDC—On bank status, gearing ratio, interest withholding tax and variable deposit requirement	

APPENDIX II. EXTRACT FROM AIDC SUBMISSION TO AUSTRALIAN FINANCIAL SYSTEM INQUIRY 1979

CONTENTS

C. THE DEVELOPMENT AND GROWTH OF AIDC's OPERATIONS

1. AIDC: An historical perspective
   (a) The formation of AIDC, 1970–71
   (b) Evolution of policy, 1971–74
   (c) Policy Review, 1974–75
   (d) Developments since 1975

PRÉCIS

Section A of the Submission describes the legislative framework of AIDC under the AIDC Act and other relevant legislation. It shows how this framework determines the functions, financial structure and essential character of AIDC as a *development banking institution serving certain national purposes through its commercial operations.*

Section B analyses where AIDC fits in the Australian financial market, as a financier and as a borrower. It explores AIDC's relationship to and differences from other financial institutions. It concludes that *AIDC and ARDB have emerged as the two major specialist institutions offering medium-term industrial finance adapted to development needs.*

Section C gives a brief historical perspective of AIDC. In particular it points to a distinct change of direction following a major policy review in mid-1974. Before that, AIDC had operated largely as a 'last recourse' financier. *All of AIDC's much publicised losses (including ongoing exchange losses) have derived from pre-1975 policies.*

Since then, AIDC's strategy has been to build up a portfolio of sound commercial lending business, within its charter, whilst still aiming to carry a prudent proportion of selective venture capital investment within a growing total investment portfolio. Financial statistics appended show that, except for exchange losses from earlier foreign borrowings still working their way out of the system, *AIDC has since 1974–75 operated on an increasingly sound and profitable basis.*

A. THE LEGISLATIVE FRAMEWORK OF AIDC

1. Constitution, role and status

The Australian Industry Development Corporation (AIDC) was constituted by the *Australian Industry Development Corporation Act* 1970 (the AIDC Act) as a statutory corporation of the Commonwealth of Australia.

The objects of AIDC are to promote industry development and assist towards more Australian ownership and control of Australian resources and industries. The Corporation pursues these goals through its commercial activities as a source of finance for Australian industries. It has no authoritative or regulatory role in industry development. It seeks to promote Australian ownership by private enterprises rather than by the Corporation itself.

AIDC does not provide finance to industry from government funds. It is a *financial intermediary, designed essentially as a development banking institution.* It provides finance to its industrial customers from funds borrowed in the money and capital markets in Australia and overseas. Predominantly its financings are loans (in their various forms including leasing). The Corporation also has some capacity, limited by its financial structure, to contribute to the equity of a development project where this type of assistance is sought.

AIDC is not a bank as defined in the Banking Act. It therefore operates outside the banking system which is regulated by the Reserve Bank of Australia. It is subject to the Foreign Exchange Control Regulations administered by the Reserve Bank.

AIDC is legally a 'public authority' constituted by an Act of Parliament. Its borrowing programs and interest rates are thereby subject to the 'Gentlemen's Agreement' under which the Australian Loan Council regulates the borrowings of Commonwealth and State public authorities as well as those of the Governments themselves.

In practice AIDC operates under special Loan Council arrangements agreed between the Council, the Government and the Corporation. This is because AIDC is conducting a banking-type business, and because it is designed to seek its funds in the private rather than the governmental sector of the domestic capital market. The AIDC Act expressly provides (section 27 (3)) that securities issued by the Corporation are not 'public securities' for the purposes of the Income Tax Assessment Act. This means that although AIDC is a semi-government institution its securities do not qualify under the '30/20 rule' and it does not borrow at semi-government rates of interest.

AIDC is subject to Commonwealth taxation. It is assessed for income tax on the same basis as a public company. The Corporation is not subject to State or Territory taxation, except as prescribed by regulation. It is prescribed that AIDC pay Payroll Tax. Securities of AIDC are not subject to stamp duty on issue, transfer or redemption.

AIDC reports to Parliament through the Treasurer. It is required to follow the accounting principles of commercial practice, and its annual financial statements are in a form approved by the Minister for Finance.

The Corporation is bound by its statutory functions and various policy guidelines laid down in the Act. These include, importantly, that it is to operate on commercial business principles.

AIDC must have regard to current monetary policy, and other policies of the Government of the day. However, it operates independently of government control or influence in its commercial decisions. Section 9 of the Act expressly states that, except as provided by the Act, the Corporation is not subject to direction by or on behalf of the Government.

2. Statutory functions and policy directives

The functions of AIDC are defined in section 6 (1) of the Act. They are:

(a) to facilitate and encourage the establishment, development and advancement of Australian industries concerned with the manufacture, processing, treatment, transportation or distribution of goods, or the development or use of natural resources (including the recovery of minerals) or of technology; and

(b) to secure, to the greatest extent that is practicable, Australian participation in the ownership and control of companies engaging in those industries or related activities.

Function (a) is to be performed either by (i) providing finance to Australian companies engaging in any of the specified industries or related activities; or (ii) by the Corporation itself engaging or participating in enterprises or projects in relation to those industries or activities.

It will be seen that the activities which AIDC may finance extend over a broad range of industries including:

— manufacturing and processing industries;
— goods transport and distribution;
— the extractive industries;
— resource-based industries;
— the development and application of new technology; and
— industries or activities connected with or incidental to any of the foregoing.

The areas of industry and commerce excluded appear to be mainly service industries. However, companies in the business of providing a service to industry (e.g. transport of mine workers or industrial waste disposal) as distinct from providing a service to the community generally (e.g. banking or insurance) could be eligible for AIDC finance.

In relation to the function of providing finance to 'Australian companies' it should be noted that 'Australian' here means 'incorporated or formed in Australia', and 'company' is defined to include 'any unincorporated body or association of persons'.

The provision for AIDC to engage or participate in enterprises or projects makes it clear that the Corporation may take equity positions including, at least temporarily, full ownership. But this has to be read in conjunction with sub-sections (4), (5) and (6) of section 8 of the Act. The net effect is that AIDC may participate in joint ventures, and may establish an initially wholly owned subsidiary company as a vehicle for bringing other Australian investors into a project. But, by virtue of the section 8 provisions referred to, the Corporation:

— has to review annually any substantial shareholdings in companies and endeavour to dispose of shares no longer necessary to its functions (sub-section (4));
— is not to be a sole owner of an enterprise or project except on a temporary basis, or if acting under government direction in a national interest project as described in A.3 below (sub-section (5)); and

— *must not seek a controlling interest in an already Australian-controlled* company unless it is acting to block a foreign takeover or with the consent of the company's board of directors (sub-section (6)).

Sub-sections (2), (3) and (4) of section 6 refer to the manner in which the Corporation shall or may perform its functions. The essence and purpose of these provisions, however, is to define the constitutional heads of power of the Federal Parliament on which the Act relies in respect of AIDC's industry financing and investment operations. This is necessary because industry development is not, of itself, a Commonwealth function. On the other hand the provisions of the Act which empower AIDC to borrow moneys are clearly covered by the 'borrowings power' of the Commonwealth.

The role of AIDC is determined in part by the limits of its statutory functions. It also must be guided by the policy directives contained in the Act. Some of the policy provisions have already been described, notably those relating to equity holdings. A provision of fundamental and overriding importance is that which establishes the commercial philosophy for AIDC operations.

Specifically, sub-section 8 (2) of the Act directs AIDC to act in accordance with sound business principles. But it also requires that the Corporation shall not finance a company or participate in a venture unless the Board considers that the company or venture will be operated in an efficient manner and in accordance with sound financial principles. In other words, the Corporation must not finance operations which it considers inefficient or unsound, even if the safety and profitability of its own investment is assured (e.g. by the security taken, or by a guarantee of a government, a bank or a strong corporate parent).

Notwithstanding its commercial orientation the Corporation, in its finance and investment decisions, must always have regard to the importance of the industry concerned to the Australian economy, and the extent to which the financing will contribute to AIDC's functions. Hence, whilst aiming to make profits, the Corporation cannot determine its priorities with a view to maximising profit as the sole or primary objective.

3. The 'national interest' provisions

Under amendments of the AIDC Act enacted in 1975 (with the support of all major political parties) the Government may, with the approval of Parliament, provide funds or guarantees to enable the Corporation to assist particular industry projects of special national importance which would otherwise be beyond AIDC's financial capacity or commercial investment criteria.

The 'national interest' provisions are contained in section 8A of the AIDC Act. The essential features of it are:

— Action would be initiated by the Minister (i.e. the Treasurer).

— Decisions involved would be government decisions, not AIDC decisions; a national interest guarantee would of course need to be such as would enable the Corporation, on its commercial investment criteria, to undertake the investment concerned.

— The investment risks would be government risks, not AIDC risks.

— If the Government were to proceed by way of guarantee, this would require approval by resolution of both Houses of Parliament.

— If the Government were itself to provide the funds, these would need to be appropriated by Parliament for the purpose. In this case AIDC would be acting as the agent of, and at the direction of, the Government. It would be indemnified against losses, including the management costs. It would account separately for these investments and furnish separate reports and financial statements.

The system for approval of national interest cases is complex. The full procedure would involve the Minister calling for a report; a preliminary report by AIDC; a more detailed study by AIDC and/or other bodies; a recommendation by a National Interest Committee appointed to advise the Minister; a decision by the Minister and Cabinet; and, ultimately, the approval of Parliament.

It seems clear that the national interest provisions in their present form could only be implemented in rare cases of major importance and obvious merit, which would command widespread public support.

There have been no national interest cases to date. A very few possible cases reached various stages of consideration but did not proceed for reasons endemic to the potential projects themselves.

4. The Board and management

The control and management of the Corporation are vested in a Board of Directors, most of whom are appointed by the Governor-General. The Secretary to the Department of Industry and Commerce and the Secretary to the Department of Trade and Resources are Directors *ex officio*.

The Act provides for an Executive Chairman (appointed by the Governor-General), and between five and eleven appointed Directors, in addition to the two *ex officio* Directors. A majority of the appointed Directors are to be part-time Directors. (There are at present no full-time Directors.) To qualify for appointment as a Director a person must be suitably qualified by virtue of knowledge of, or experience in, industry, commerce or public administration.

The Executive Chairman has the normal powers of a Chairman, and derives his executive authority by delegation from the Board.

The Government has accepted a recommendation of the Board that the Act be amended to allow the option of a full-time Executive Chairman or a part-time Chairman in conjunction with a full-time Managing Director. In the meatntime it has been possible under the present Act to broadly anticipate this situation. The Corporation is currently operating under a part-time Chairman (nominally an Acting Executive Chairman) and a full-time Chief Executive appointed by the Board.

Particulars of the present Members of the AIDC Board, and their principal other affiliations, are given in Annexe A.

A background note on the Chief Executive is also furnished as Annexe B.

5. Financial structure

The original AIDC Act of 1970 appropriated for the Corporation an amount of $100 million, as the capital of the Corporation, and provided for this to be paid in by the Government in instalments in accordance with section 24 of the Act. Broadly, this means that instalments of the capital can be called up, and are payable by the Government, as the Corporation's outstanding borrowings increase so that additional capital will be needed as a base for further borrowings. To date, $62.5 million of the capital has been drawn.

It is important to note that the whole of the $100 million has been appropriated by Parliament. In effect, by analogy with companies the $100 million is equivalent to 'issued capital' rather than 'authorised capital'.

AIDC's principal source of finance is its borrowings. The Corporation is empowered by section 7 of the Act to borrow up to five times the sum of its paid-in capital and reserves. To be more precise, the borrowing limitation is that the Corporation is not to borrow (otherwise than for temporary purposes) if, as a result, the 5:1 ratio would be exceeded.

It is a significant feature of the Corporation's power to borrow that the Act explicitly states (sub-section 7 (4)) that this power may be exercised both within and outside Australia. The Corporation is thus empowered by law to borrow overseas in its own name. This distinguishes the position of AIDC from that of other statutory corporations of the Commonwealth and the States, with the exception of some banks.

A curious feature of the financial structure of AIDC is that the capital funds are not ordinarily to be used in the development financing and investment operations which are the Corporation's normal business and functional purpose. This is stated in sub-section 24 (8) of the Act, although not as a binding statutory requirement. It is expressed as an 'intention of the Parliament in providing moneys as capital of the Corporation', and as a prelude to the requirement that the Board of the Corporation shall have regard to that intention in making requests for payments of instalments of capital.

It is understood that this provision was included in the original Act to reassure some critics who, at the time AIDC was being formed, were apprehensive that the Corporation would not be successful in borrowing (particularly overseas) without a government guarantee and so would end up operating solely or mainly with free capital funds. Whatever the reason, the effect has been to create an unusual and rather artificial financial structure in which the Corporation, in complying with the stated intention, applies a sizeable part of its total funds to capital investments which are extraneous to AIDC functions.

The situation which results is an artificial one because of the apparent anomaly that, while there is the expressed intention that the capital not be used in functional operations, it is elsewhere provided that the income from investment of the capital may be used to defray operational expenses. Sub-section 26 (2) of the Act specifically provides that the capital moneys (as well as any temporary cash surpluses) may be invested to 'obtain revenue for the purpose of meeting expenses incurred in connection with the operations of the Corporation'.

The net effect is that:

- AIDC cannot directly use capital moneys to fund an equity investment in a new development project with a long lead time before earnings are generated.
- If borrowed moneys were used for this purpose, it would be some years before the investment provided AIDC with dividend income to pay the annual interest bill for the borrowings.
- To a limited extent AIDC can (and does) make such equity investments out of borrowings by using income from the investment of capital moneys to pay interest on the borrowings so used.

6. The Loans (AIDC) Act

The *Loans (Australian Industry Development Corporation) Act* 1974 authorises the Government, at the request of AIDC, to advance moneys to the Corporation out of borrowings raised overseas for the purpose. A maximum limit of $A250 million applies.

This was enacted at a time of extremely tight conditions in the international capital market, especially for medium to longer term fixed-interest US dollar funds. In 1974, and continuing into 1975, there were only two major sources for such funds in large individual amounts and at relatively attractive interest rates. These were certain governmental institutions in the Middle East, which then lent only against a government or central bank credit; and the public capital market of New York, where no Australian entity other than the Government itself had yet sought and obtained the necessary credit rating by the bond-rating agencies.

The Loans (AIDC) Act has been used only once, in mid-1975. Through it AIDC obtained US$75 million of five- and eight-year funds for two leading Australian industrial companies, to supplement what they were able to raise in their own names at that time, in Australia and overseas, for major planned development and expansion. The US$75 million was part of a US$100 million bond issue made by the Government in New York to raise funds for AIDC and a few other statutory authorities.

It should be noted that the Loans (AIDC) Act is not an Act relating to the financial structure or powers of AIDC. It relates to the powers of the Government. It empowers the Government to lend to AIDC, which already had the power to borrow (from the Government or anyone else).

It is normal for the Government to have power to lend to statutory authorities, just as in any parent–subsidiary relationship. But the AIDC Act does not authorise the Government to do this. The Loans (AIDC) Act gives it a limited authority to do so, in special circumstances, with overseas funds only, and on terms not more favourable than those on which the Government itself borrows the money.

It will be evident that applications of the Loans (AIDC) Act, which was designed to meet an emergency situation, are likely to be extremely rare.

B. WHERE AIDC FITS IN THE AUSTRALIAN FINANCIAL MARKET

1. AIDC as a financier

(a) *Types and sources of industrial finance in Australia*

AIDC is primarily a medium-term lender. It provides finance to business operations in Australia by ways of loans, leases and leveraged leases which normally have maturity patterns within the three- to eight-year range. Occasionally, it provides loans with shorter maturity and it also has provided facilities extending to ten to twelve years.

At times AIDC provides finance by way of equity; the circumstances in which this would be done are discussed later (see page 47).

AIDC is part of the financial market which collectively provides financing facilities geared to the needs of medium- to large-scale business operations in Australia. As is explained below its role is complementary to that of other financing institutions. The main groups of institutions which make up this financial market are:

— the trading banks
— the merchant banks
— the finance companies
— the Australian Resources Development Bank
— the life assurance offices and the superannuation funds

To appreciate the role of AIDC within this overall market it is useful to outline briefly the areas of the market in which these other financial institutions choose to carry out most of their operations.

The *trading banks* are predominantly providers of working capital for business by means of overdraft facilities which are usually subject to review and renewal on an annual basis. Trading banks do provide some term loans, generally for terms not longer than five years; on occasions the period of the loan may be longer. Some of these longer term loans would be refinanced through the Australian Resources Development Bank (ARDB).

The *merchant banks* are very varied in the range of facilities they provide. Some are predominantly money market operators providing short-term facilities and loans for periods of not longer than one year—occasionally extending to two years; others are more oriented to providing corporate advice without necessarily providing financing facilities; while some undertake corporate lending operations under which they will provide financing facilities up to three years—and on occasions up to five years. There are a few merchant banks which are providing loan facilities up to seven years.

The *finance companies* provide some financing facilities to industry usually by way of leasing of equipment. However, most of the leasing transactions carried out by finance companies would be for amounts of $100 000 or less, although on occasions transactions could go to $250 000. Lease transactions by finance companies over $400 000 would be rare.

The *ARDB* is a provider of medium-term funds, sometimes directly on its own account but mainly by refinance facilities provided to the trading banks in one form or another, under which arrangements the trading banks carry the credit risk, or against guarantees provided by the trading banks. The general loan maturity pattern area within which the ARDB operates is the closest to the maturity pattern area in which AIDC operates. However, the types of business operations to which the ARDB under its charter provides finance are more restricted than those of AIDC. For large resource development propositions requiring a large volume of borrowed funds it can be expected that ARDB and AIDC would combine in providing a sizeable parcel of the medium-term funds necessary.

The *life assurance companies and superannuation funds* vary in their approach to investment. Some, particularly the larger life assurance companies, have a preference for taking equity rather than making loans—but nevertheless still do make longer term loans. Others invest a larger percentage of their funds in loans and other fixed interest securities. Some superannuation funds prefer to lend for terms of twelve to fifteen years or even longer. Much of the loan finance provided to industry by life assurance companies and superannuation funds would be through mortgages on real estates or against debentures issued under trust deeds. They are a source more of standardised forms of lending than of flexible tailor-made credit arrangements.

The financial institutions in the market can therefore be divided into those providing short-term credit facilities—these being the trading banks, merchant banks and finance companies; and those providing longer term facilities, which are the life assurance companies and the superannuation funds.

AIDC's function is to help fill a gap in the financial market by providing medium-term credit facilities. AIDC is therefore an important source from which medium-term credit facilities can be obtained. The ARDB also provides credit facilities within this maturity area.

(b) *AIDC's difference from other financial institutions*

It would be presumptive to suggest that some of the services provided by AIDC are not provided by any other financial institutions in Australia. But certainly those financial institutions which are providing them or are capable of providing them are few. Some merchant banks are capable of providing some of the financial advisory and technical services, but they do not wish to provide much (in some cases any) of the finance required for large financing proposals. There are, of course, other consultative services available in Australia but these consultants are not financiers.

AIDC also has a special purpose of assisting Australian ownership. The ARDB follows a similar policy but most other financiers serve Australian and foreign companies alike.

Again, AIDC has to have regard for the national economic merits of a financing proposal. It has to consider this, and the Australian ownership aspects, as well as the profitability to the lender. Excepting AIDC and the Commonwealth Development Bank, virtually all other financial institutions (including of course the ARDB) are free to pursue maximisation of profits as the primary object. This has some bearing on the types of business undertaken.

But leaving aside these aspects of basic philosophy, the following illustrates AIDC services which, though not unique, are not commonly available.

(i) *Large-scale financing commitments*

In the past few years the size of borrowing packages necessary for new business developments, or for expansion, or for the rationalisation of some sections of industry perhaps by way of mergers, has become quite large. The size of these packages makes it difficult for one financial institution to do all the funding. Also it is not desirable in following sound banking practices for one institution itself to carry all the credit risk. As a result large financing packages are these days more usually arranged on a consortium or syndicated basis.

Under such a consortium or syndicated arrangement several lenders agree to provide the financing package necessary, which may be a composite of short-term, medium-term and long-term funds, and individually to carry the credit risk for that portion of the financing facilities they have provided. Some of these financing packages lend themselves to the full details of the proposal being sent to a number of potential lenders so that commitment from the required number of lenders can be obtained for the total package *before* the syndicate manager undertakes to commit to provide the total funds package to the prospective borrower.

But not all large loan propositions can be handled in this way. At times companies do not wish their prospective plans to become widely known around the market until they have made a final decision to proceed. Yet these companies do not wish to spend their own money, for example, in carrying out feasibility studies or progressing further examination of a proposition, if at the end of that time there is no likelihood that funds will be available for them to implement their plans. In such cases some companies will seek to obtain a commitment from a large financial institution that it will commit itself to obtain or to provide the necessary finance subject to certain preconditions being met.

AIDC is one of the few financial institutions in Australia that has both the financial resources and the technical expertise so that it can give such commitments. A few, but not all, of the major trading banks are also willing at times to give such a commitment.

Currently, AIDC has one large such commitment outstanding in which AIDC is associated with the company's trading bank which has agreed to provide an additional amount. If this proposition eventually goes ahead AIDC would intend to syndicate portion of the short-term maturities of this loan facility to a group of merchant banks and the longer end maturities to life assurance companies. AIDC itself would provide the medium-term segment.

(ii) *Blend of technical and financial skills*

Most of AICD's corporate finance staff have both academic qualifications and experience of working in a physical technical field in addition to that of finance. These fields include civil engineering, electrical engineering and science metallurgy. This initial training and experience has then been added to by a second qualification such as bachelor of commerce, accountancy or MBA, together with financial experience. This combination of training and experience is of great value in assessing and evaluating loan propositions where an understanding of the physical, technical features and operations are required to obtain an overall appreciation and view of the proposals. It also greatly assists in the corporate finance executive concerned being able to translate the technical aspirations and descriptions of engineers into the normal assessment criteria of financiers.

Although loans are legally made to companies it is fundamental in the assessment of a loan proposition to arrive at a view on the efficiency of the management of a company and other senior executives, who in the ultimate will be responsible for using the loan funds provided. This is even more important when a loan proposition is large in relation to the resources of the company at the beginning or where the company concerned has not a long history or a track record to give an indication of the efficiency of its management.

There are very few other lending organisations in Australia which have corporate finance executives who have this amalgam of physical, technical and financial training and experience. It is a very distinct feature of the Corporate Finance Division of AIDC.

(iii) *Large-scale leasing*

Direct leasing of large items of equipment with values from say $1 million to $6 million are undertaken by AIDC. This facility is provided by very few other financiers—perhaps by a few of the large trading banks. Leases of this magnitude would only be provided to large companies and usually involve substantial installations of new equipment—frequently a whole production line.

Large-scale direct leasing should not be confused with leveraged leasing. AIDC also provides finance through leveraged leases, but so do a number of trading banks, and a few life assurance companies, merchant banks and superannuation funds.

(c) *Equity financing role*

AIDC's ability to contribute equity capital to a company, or participate in the equity of a development project, is an important though not quantitatively large part of its development financing activities. At 30 June 1978, equity investments totalled $11.2 million or 5.3% of operational loans and investments outstanding.

It has sometimes been thought that AIDC was formed to 'buy back Australia'. Obviously the Corporation was not given the billions of dollars that would be needed for this. Nor would it be a sensible economic policy. The more modest and realistic national policy, towards which AIDC assists, is to try to get more Australian ownership and control in new development and industry expansion.

Another misapprehension which has seemed to gain currency in the market at times is that AIDC looks for equity in companies which approach it for loans. There is no substance in this. AIDC's main business is lending, and the great majority of its financings are in fact straight loans. Like any financier AIDC will not, of course, provide loans to an enterprise which it considers already overgeared and in need of more equity rather than more debt.

The Corporation will always consider requests for equity capital, where that is the need. Sometimes it may be able to assist by subscribing for redeemable preference shares; or by a mixture of preference share capital and loans. In other cases AIDC may subscribe ordinary share capital, although this tends to be for smaller to medium-scale ventures or in conjunction with other investors or participants in the case of larger ventures.

AIDC is not equipped to take substantial holdings in large enterprises on its own account; but it is well-equipped for the role of putting together a substantial Australian participation in a venture, large or small. Sometimes it may do this in conjunction with providing or assembling also the loan finance required.

Where smaller firms approach the Corporation for equity funds (or for money in whatever form) it is often apparent that the need is not merely for equity capital as such, but for an active equity participant or partner who would contribute corporate strengths and management as well as funds. The applicant may, for example, be a technologically successful innovator lacking business skills and perhaps too dependent on a single product line; or, at the other extreme, it may be a family company trying to cope with commercial success and expand to a scale of operations requiring a more sophisticated and complex management structure.

The Corporation is essentially a financier and does not have the resources to take equity and provide onging management in such cases. Where appropriate it will assist in finding a suitable equity participant and may provide finance for the restructuring if required.

In cases where a suitable management structure already exists, and additional equity is required, the Corporation may sometimes fund a private company in one way or another until the time is opportune for it to 'go public'.

The funds available to AIDC in carrying out its functions are principally borrowings ($228.8 million at 30 June 1978) and accumulated reserves ($10.0 million at 30 June 1978). Thus, as over 95% of these funds are borrowings which have to be serviced by interest payments, the amount which the Corporation can prudently invest in equities as part of its development financing activities is quite modest. This is particularly true of 'start-up' situations, where dividend returns would be delayed for perhaps three or four years until construction had been completed, operations started, and a sufficient rate of earnings and cash flow attained.

As mentioned earlier the Corporation could indirectly use capital funds for such investments, because earnings from capital can cover the interest costs for a modest portion of total borrowings to be used in this way. But it would obviously be imprudent to put too much of the capital at risk, whether directly or indirectly. Notwithstanding the peculiar capital investment provisions of the AIDC Act, the extent to which the Corporation can carry investments in venture capital situations at any one time has to be considered in relation to the amount of capital and reserves (i.e. shareholders funds), and the overall quality and balance of the Corporation's investment portfolio—both capital and operational investment.

(d) *Relationship to the development banks*

(i) *Primary Industry Bank of Australia (PIBA)*

AIDC does not operate in the area serviced by PIBA refinancing.

The Corporation would see it as within its charter, and capabilities, to provide finance on commercial terms for, say, a major new land development in the primary industry sector. However, AIDC was not designed to be able to provide the long-term loans, and generally low-cost finance, which are the normal requirement of rural industry.

(ii) *Commonwealth Development Bank (CDB)*

The CDB provides both farm and industrial finance. In industrial financing, the distinction between CDB and AIDC finance is essentially one of scale.

The maximum CDB loan is normally about $300 000. AIDC normally provides loans of $250 000 or more. In special circumstances a smaller loan may be considered, but it would not be economical to lend in amounts less than $100 000. Operational equity investments may also be smaller than $250 000. AIDC and the CDB refer cases to each other, depending on the scale of finance sought.

Both the CDB and AIDC have been mentioned from time to time as suitable institutions to undertake small business financing, both loan and equity. As far as small business lending is concerned, AIDC is in fact not suited for this because it does not have the necessary branch network. The charter of the CDB has recently been broadened to enable it to expand the scope of its loans to small businesses. The CDB is better equipped for this, both by the nature of its existing business and experience, and through having the facilities of the wide branch network of the Commonwealth Banks and also the private trading banks which act as its agents.

The matter of an institution to provide equity finance for small businesses has not so far been pursued. From AIDC's experience in equity financing of small- to medium-sized businesses, rather larger than is usually meant by 'small business', we would say that neither AIDC nor the CDB or for that matter any other institution should be expected to undertake this activity on a broad scale unless capital funds are specifically allocated for the purpose, and the activity is accounted for separately from the institution's normal commercial accounts and balance sheet.

(iii) *Australian Resources Development Bank* (*ARDB*)

The difference between the ARDB and AIDC seems usually to be thought of in terms of the industries which they finance. Such a difference does exist, although it has become blurred over the years.

Originally the ARDB confined itself to financing basic extraction of resources, preliminary processing into a marketable form, and transporation to the market. AIDC at that time tended to confine itself to higher stages of processing and manufacture. It financed mining if significant processing was also involved. It did not finance transportation except where this was carried out by the manufacturing or mining company itself.

In those times it was not unusual for the two institutions to be involved in the same development, with ARDB perhaps financing the extraction and AIDC the processing stages.

Since then, the ARDB has moved up the scale of higher processing and into the financing of resource-based manufacturing industries. AIDC has moved back towards basic resource development. But it has also extended its activities into goods transport generally (especially shipping finance), and to major developments in the wholesale and retail distribution of goods.

Nowadays, in a large-scale new industrial development or expansion, it would be usual to find both the ARDB and AIDC participating in the financing and providing substantial loans. The capital requirements of these projects are too large for any one financing institution. Typically, the loan finance is arranged by the company's merchant banker, and in these situations the merchant banks look to both the ARDB and AIDC as important providers of the medium-term portion of the total financing package.

It is probably fair to say that the ARDB and AIDC have emerged as the two specialist institutions offering medium-term industrial finance adapted to development needs.

While the difference in industry scope of ARDB and AIDC is less clear than formerly, and the area of overlap is much wider, the more fundamental distinction between the two institutions remains. This is that ARDB is essentially an extension of the role and capacities of the trading banks which are its owners; whereas AIDC is an alternative source of finance for industry, independent of the trading banks, and in fact outside the banking system which is regulated by the Reserve Bank.

Fundamentally the ARDB is a collective institution of the trading banks which enables those banks to lend to large-scale developments in larger amounts and for longer terms than they otherwise could do. ARDB is effectively the longer term borrower for the trading banks as a group; it issues securities in the market for terms of five years or longer while the trading banks themselves take deposits up to four years. Although the ARDB makes some loans where it carries the credit risk itself, in the main the funds which it borrows are used to provide loans where the credit risk lies with one or more of the member banks. This is effected either by the ARDB refinancing a trading bank loan, or by ARDB lending direct under a trading bank guarantee.

This constitutes an important and eminently practical extension of the capabilities of the trading banks in medium-term development financing. The banks could not do much in this field out of relatively short-term trading bank deposits. Nor could they do so if they issued their own longer term certificates of deposit, and the proceeds counted for the purposes of SRD ratios, thus adding to the effective cost of those funds.

The ARDB was innovative in concept and has been successful in practice. Its character and its relationship with its member banks do mean, however, that the role of the ARDB and the corporate finance divisions of those banks in medium-term development financing have to be viewed as a composite whole. It is necessary to keep this in mind in any comparisons between the ARDB and AIDC.

Since the formation of the ARDB and AIDC, the corporate finance divisions of some of the major trading banks have been expanded considerably. They do not only make loans of a kind refinanceable through the ARDB. In major project financings it is usual to find one or more trading banks participating, and providing loans up to five years, as well as the ARDB and AIDC providing longer term finance.

(e) *Forms of AIDC loans*

(i) *Australian currency loans*

Currently, most AIDC lending is denominated in Australian dollars. With few new export-oriented projects getting under way there has been little demand for loans denominated in foreign currencies.

For reasons which will be apparent later (see B.2—AIDC as a Borrower), the Corporation is usually not in a position to make medium-term loans at fixed rates of interest which would be regarded as competitive in the market. The Corporation has the financial structure to be able to undertake medium-term commitments of funds, as long as it is not locked into a fixed interest rate.

Accordingly the Corporation has developed a specialised form of AIDC finance which makes best use of the Corporation's more competitive borrowing situation in the shorter rather than the longer end of the market, which is complementary to other forms of finance available to industry, and which appears to be gradually gaining wider acceptance and favour amongst AIDC's customers.

The method being used is to provide loans that are firmly committed for up to (say) ten years, and vary the interest rate at intervals of one or two years—the choice being with the customer at each interest reset date. The interest rate is set on each occasion on a consistent basis. For this purpose, there has been developed an AIDC One-Year Base Rate and Two-Year Base Rate. These are determined primarily in relation to the cost of a particular range of borrowings, but with an amount added to cover AIDC administration expenses. Loans to particular companies are made at a predetermined margin above the Base Rates; the latter are adjusted monthly on the first day of each month.

This is the basic system. There can be many adaptions to suit the needs or circumstances of individual companies or projects.

Most of the Corporation's A$ loans are now made on this basis. It is distinctly different from the financing offered by most lending institutions.

It has similarities to the bill-financing and related lending techniques of the merchant banks, but both the term of commitment and the period between interest resets tend to be substantially longer.

Corporate lending by merchant banks tends to be at a margin over the buying rate for prime non-bank bills with terms of 90 or 180 days, the interest reset intervals being of corresponding duration. It is convenient for AIDC also to lend on this basis (using rates published by the Accepting Houses Association of Australia) where it participates with merchant banks in a syndicated loan. The Corporation may also provide bridging finance to its customers in this form.

(ii) *Foreign currency loans*

Strictly speaking AIDC does not, of course, lend foreign currencies within Australia. It makes loans denominated in a foreign currency in the sense that the principal amount is expressed as being the A$ equivalent of a fixed sum in a foreign currency.

In this sense the Corporation can provide loans denominated in US dollars and other available foreign currencies, at fixed or variable rates of interest. The period of a loan, and interest rates and other terms, would depend on the terms and conditions on which AIDC itself could borrow overseas in that currency at the time.

The Corporation would borrow and on-lend in a manner which avoided exposure to exchange risk. The terms and conditions of the borrowing and lending may or may not be exactly matched. There would of course be an on-lending interest rate margin.

2. AIDC as a borrower

(a) *General*

AIDC's standing as a prime borrower, in Australia and overseas, derives primarily from its status as a statutory corporation of the Commonwealth. AIDC's liabilities are not explicitly guaranteed by the Commonwealth. However, it is relevant that the Corporation is not only wholly owned by the Commonwealth, but is specifically authorised by Parliament to borrow moneys both within and outside Australia.

Also important are the capital provisions of the Act. AIDC has a substantial paid-up capital ($62.5 million), and the unpaid capital ($37.5 million) has already been appropriated by Parliament and is available if required to meet obligations. The latter point was especially important in establishing the Corporation's borrowing status in the early days of the Corporation before it had a demonstrable track record.

The status of any borrower in a particular market is of course determined not only by credit standing as such, but also by other institutionalised factors which limit the choice or influence the preferences of different classes of investors. These affect both the extent of market access and comparative interest rates. The position of AIDC in various markets is described later.

AIDC borrows within Australia and overseas by public and private issues of securities in the capital market, by direct private borrowings (with or without a placement of securities) and by accepting deposits from the money market.

All borrowings are unsecured. However, AIDC marketable securities, other than short-term instruments used in the professional money markets are covered by a negative pledge.

(b) *Domestic borrowings*

(i) *Types of borrowings*

AIDC's borrowings within Australia are effected by:

— listed public issues of Registered Stock;
— private ('family') issues of Registered Stock;
— private placements of Registered Stock with the money market, direct with institutions or through brokers;
— placements of Negotiable Certificates of Deposits (NCDs) either by calling tenders from the money market or by tap issues;
— discounting of AIDC commercial bills (drawn by AIDC Securities Limited—a subsidiary company which holds and administers the Corporation's share portfolio); and accepting short-term deposits, both on fixed-term and at call.

The Corporation has substantial bank overdraft accommodation and other bank stand-bys.

AIDC Registered Stock, as the name implies, is a marketable instrument of the same kind as inscribed stock or registered debentures. That is, title to the stock lies with the name inscribed in the register.

Issue, transfer and redemption of the stock, and payment of interest and other administrative matters, are handled by the Stock Registry of the Commonwealth Trading Bank. Facilities exist in all capital cities. Facilities are also established with the Bank in the main financial centres to administer the issue and repayment of AIDC's bearer instruments, the NCDs.

(iii) *AIDC's position in the market*

On the ladder of domestic interest rates AIDC tends to fit between the banks and prime corporate borrowers.

Its position is distinctly better at the short end of the market than at the long end. For shorter maturities, AIDC can borrow at rates a little nearer to bank rates than to prime corporate rates.

For medium to longer term borrowings in any substantial quantity the Corporation would have to pay interest rates approximating those of public borrowings of prime industrial companies. From time to time it can raise smaller sums at somewhat finer rates.

In the range of (say) one to three years the situation varies, depending on whether at the time the rates in this area are being influenced more by conditions in the money market or the capital market.

(iii) *Factors affecting borrowing access and rates*

AIDC's market access and interest rates for borrowings across the whole spectrum of maturities are of course affected by the fact that AIDC securities are expressly excluded from being counted as semi-government securities for purposes of the '30/20 rule'. This puts AIDC squarely in the commercial rather than governmental sector of the financial markets.

In the short-term money market there are a number of factors which give AIDC a slightly better position as compared to other non-bank corporate borrowers. These factors are:

— Reserve Bank Authorised Dealers are permitted to hold a small percentage of their portfolios in AIDC securities and to deal in AIDC securities, as they can with governmental and bank securities.
— AIDC securities, like government and most semi-government securities, are exempt from stamp duty on issue, transfer and redemption.

— Certain bodies established, funded or regulated by government (Commonwealth or State) are permitted to invest cash surpluses or liquid reserves in, amongst other things, securities of a public authority constituted by an Act—and AIDC is such an 'authority'.

The scope of this latter advantage is, of course, quite limited. By comparison, virtually all funds managers and trustees—whether governmental, commercial or private—are authorised to place such funds on deposit with a bank or an Authorised Dealer. That is why, even in the short-term market, AIDC securities have to offer a higher interest yield than do those of banks.

The three factors mentioned above do not give AIDC any advantage in short-term borrowings made by taking deposits, either at call or for a fixed term. The Corporation makes some borrowings of this type but it does not seek to compete with the merchant banks for these kinds of funds. They are not generally suited to AIDC's operations. AIDC is, of course, at a disadvantage by comparison with the 'official' arms of merchant banks, as well as with banks, in the taking of such deposits.

Collectively the three factors give AIDC a small but important advantage in borrowings made by issuing securities for terms of (say) three months to three years. Without this the Corporation would be hard pressed in trying to carry out its development banking role in respect of Australian dollar financings. It would have great difficulty in borrowing in the domestic market on terms which would enable it to lend to industry at acceptable rates of interest.

AIDC must be able to lend in larger amounts and for longer terms than are typical for merchant bank finance. It must offer industrial finance at much lower than finance company lending rates. If it could not do both these things it would not be doing its job.

It will be evident by their nature that the three factors which assist AIDC's shorter borrowings are of little or no benefit in borrowing for terms of (say) four years or longer. AIDC has virtually no advantage over prime corporate borrowers in respect of the interest rates it must offer on stock issues with those longer maturities. That is why it usually cannot provide medium to longer term development finance at fixed rates of interest.

AIDC is not guaranteed by the Government, and officially it is not a bank. If it possessed either of these characteristics its securities would become authorised trustee investments in all or most States. (With bank status this would be automatic in all States.) That would give AIDC securities a wider access to the capital market and enable it to borrow at finer rates of interest.

AIDC securities are trustee investments in the Australian Capital Territory. However, for various reasons, the Corporation has not yet been able to obtain this standing in any of the States.

(c) *Foreign borrowings*

(i) *Types of borrowings*

AIDC has borrowed overseas by means of:

— listed public issues of bearer bonds or notes;
— listed private placements of bearer bonds or notes;
— private placements of unlisted bearer notes;
— drawings under Eurocurrency revolving credit facilities;
— fixed-interest bank loans; and
— short-term borrowings in the Asian dollar money market.

The Corporation has a range of multi-currency Euro-credit facilities which, between them, provide for drawings for periods from one month to five years.

The Corporation also has facilities or understandings to enable borrowings from certain overseas export credit institutions in appropriate cases.

The single instance where the Australian Government has borrowed overseas on behalf of the Corporation, under the Loans (AIDC) Act, is described in section A.6 on page 43.

In 1976 AIDC made the first Australian-dollar Eurobond issue. This was a $15 million issue of listed seven-year notes, marketed as a syndicated private placement.

More recently the Corporation has effectively obtained A$ funds, sourced from overseas borrowings, by borrowing in foreign currency and covering the exchange risks (in respect of both principal and interest) in the domestic hedging market.

(ii) *Borrowing status in various markets*

In the international capital market based on London (the Eurobond market), and in the domestic capital markets of Europe and Japan, AIDC is typically classed as the equivalent of a double-A rated US domestic issuer. This means that, for example, AIDC would normally pay interest at a rate between one-eighth and one-quarter per cent per annum higher than the Australian Government would pay.

Whilst double-A is not the highest rating, the coveted triple-A rating is held by relatively few supra-national organisations, national governments and multi-national corporations. The Australian Government is a triple-A rated national credit. That AIDC is seen as ranking one step lower reflects the fact that it is not explicitly guaranteed by the Government.

AIDC has not formally applied for a bond rating in the public US domestic market. In informal discussion it has been virtually assured it could obtain a rating not lower than double-A.

Some years ago the Corporation deferred plans to seek a commercial paper rating, for short-term borrowings (up to 270 days) in the 'professional' New York commercial paper market, pending a review of the AIDC Act which was then contemplated. The results of that review, which in the event was limited in its scope, have not yet been implemented.

In the shorter-term international money market, i.e. the Eurocurrency market including the sector now known as the Asian dollar market, AIDC is recognised as a 'de facto' bank. Its medium-term Euro-credit facilities provide for short-term borrowings at very fine margins above the London interbank offer rate (LIBOR). Where no rollover facilty is involved, and the Corporation simply borrows for a fixed short-term, it can do so in the Asian dollar market at the Singapore interbank offer rate (SIBOR).

This is so notwithstanding that AIDC is essentially a taker of funds from the market. The Corporation would rarely have occasion to place funds in the market.

(iii) *Exemption from interest withholding tax*

All foreign borrowings made by AIDC, including private borrowings, are exempt from interest withholding tax. Exemption is specifically conferred by section 128EA of the Income Tax Assessment Act, subject only to some fairly simple conditions which are always complied with.

A similar general exemption is available to everyone for *public* borrowings. This recognises that issuing bearer bonds, which are the norm in the international market, is not feasible if interest withholding tax applies.

There are general provisions also for case-by-case exemption of *private* borrowings, where the borrower and all users of the funds are Australian-owned and controlled entities (rather rigidly defined).

The idea was to put predominantly Australian companies on a more equal footing with foreign corporations. Australian subsidiaries of foreign companies can obtain overseas funds through their parents. The parents can lend to them privately and obtain tax credits at home for the withholding tax paid in Australia.

In practice it is difficult for many predominantly Australian companies to avail themselves of the exemption in respect of private borrowings. The procedures for exemption of these under the general provisions are extraordinarily complex and tedious. They involve keeping track of the degree of foreign ownership (direct and indircet) of every user of the funds, throughout the life of the borrowing. In turn this means trying to trace where individual dollars go.

Because assisting Australian ownership and control is AIDC's function, it makes practical sense for it to have the specific exemption of its private as well as public borrowings. This saves a lot of unnecessary work for AIDC, the companies it finances, and the TAX Department.

There is probably no good reason why the same exemption should not be extended to the ARDB. After all, it also was formed to help Australian participation in large-scale development.

It would not seem to be in keeping with the underlying policy if such an exemption were extended to financial institutions which lend even-handedly to Australian and foreign-owned enterprises alike. But it could well be that the general provisions for exempting private overseas borrowings should be reviewed to see if they could be simplified.

(iv) *AIDC not subject to VDR*

The Variable Deposit Requirement (VDR) is now the established method of restricting borrowings from overseas, with maturities longer than two years, when this is necessary for monetary policy purposes. Shorter term borrowings are regulated in other ways.

AIDC borrowings, approved by the Treasurer and the Loan Council, are not subject to the VDR. The VDR does not apply to any borrowings approved by the Loan Council.

The reason is that the Loan Council is a Commonwealth–State body set up under the Federal Constitution. Its decisions are binding on the individual Governments.

If AIDC wishes to borrow overseas when the VDR is in force, it has to obtain Loan Council approval through the Treasurer in the normal way in accordance with the Loan Council arrangements for AIDC. Given that it obtained that approval it would not then have to seek an exemption from the VDR under whatever policy guidelines are established to apply the borrowing restriction selectively.

But AIDC has to have regard to Government monetary policy. It would neither expect, nor obtain, approval for an overseas borrowing if the borrowing was inconsistent with government policy at the time.

C. THE DEVELOPMENT AND GROWTH OF AIDC'S OPERATIONS

1. AIDC: An historical perspective

(a) *The formation of AIDC, 1970–71*

AIDC was born in an atmosphere of controversy, and at a time of capital shortage within Australia. There were apprehensions that the new institution would compete unfairly with private financial institutions; that it would soak up scarce domestic funds.

As a consequence there was undue emphasis on overseas borrowing in the original AIDC Act, which required the Corporation to borrow principally overseas. Moreover, AIDC was left ill equipped for raising medium-term funds within Australia at costs appropriate to a development financing institution.

(b) *Evolution of policy, 1971–74*

In the sensitive political environment of AIDC's early years, there appears to have been in practice an even greater emphasis on overseas sourcing of borrowings than the law strictly required. A legacy of those years is that foreign borrowing costs and exchange losses have eaten into profits and are only now working their way out of the system.

Again, in the climate of those early years, AIDC appears to have acted largely as a lender of last recourse even though this is by no means a requirement of—or the tenor of—the legislation.

AIDC opened its doors for business in February 1971. For more than a year it confined itself strictly to cases which were brought to it where there were special reasons why AIDC finance was needed. Whenever it was considered that a company was strong enough to be able to obtain its financial requirements readily enough from the capital market or other traditional sources, and AIDC was therefore not really needed, the financing was declined.

It was not until mid-1972 that the Corporation first approved loan (and equity) finance for a company in spite of it being considered on balance that the company could probably have obtained its finance elsewhere. Even here there were seen to be quite special circumstances justifying the AIDC support.

This particular financing did not proceed and it was only gradually that the Corporation in time became more willing to consider financing the more financeable companies within its charter. In the meantime it was, in effect, voluntarily confining itself to the more difficult and costly financing of lower quality, higher risk business.

Many of these ventures were moderately successful. A few were very successful, and returned good profits to the Corporation. But others failed badly, and involved the Corporation in heavy losses.

The Corporation by 1973–74 had, however, become somewhat less sensitive about accepting better quality business which presented itself. It was even, to an extent, seeking out good business opportunities. And it had become more selective in the business which it would undertake.

The failed and less successful ventures which AIDC had earlier assisted with development finance have been adequately publicised. All of those investments against which it has been necessary to make write-offs or provisions for loss involved commitments made before 30 June 1974.

(c) *Policy review, 1974–75*

In 1974–75 AIDC undertook a major review of its operational policy. It determined both to take no additional foreign exchange risk, and to positively upgrade the average quality of its operational loans and investments by limiting additional exposure to venture capital situations and deliberately introducing a substantial proportion of good quality commercial loans.

In respect of exchange exposure, the 1975 Annual Report said:

> With world monetary conditions increasingly unsettled, the Corporation has now adopted a general policy of matching the currency risks of its borrowings and on-lendings. Where borrowers are unwilling to take the exchange risk of a foreign currency debt, AIDC can now only offer finance within the limits of its own borrowings denominated in Australian dollars.

In the same Report the new operational lending policy was described as follows:

> The balance of the Corporation's project portfolio has been improved by substantial loans made to well-established industrial companies. The loans will contribute to important development, augmenting the strength of these Australian companies in a difficult finance climate. They also provide income for AIDC, and so increase its capacity to invest in new ventures which, for a time, may not meet the costs to the Corporation of funding the investment.
>
> AIDC will continue to discharge its responsibilities in assisting new development. There are obvious practical limits, however, to its capacity to undertake investments with relatively high risk and delayed income return.
>
> Riskier venture capital situations, particularly smaller start-up situations operated by new management, are becoming a lesser proportion of the expanding total of project investment. This is consistent with the strategy necessary for AIDC's future growth.

(d) *Developments since 1975*

A major step in the direction of more active marketing of AIDC was taken at the beginning of 1977. Targets were set for new good-quality lending business, and an active business development program was inaugurated. The object was to write enough sound and profitable business to be able to work past losses out of the system within a reasonable time; and then, with a continuing and growing base of sound commercial lending, be able to devote more time and resources to carefully selective investment in riskier venture capital situations within an overall sound and profitable financial structure.

In the past two years, good progress has been made towards these ends. The major remaining problem area is the residual exchange exposure from pre-1975 policies—and that is being substantially reduced.

It should perhaps be emphasised that present operating policies do not depart at all from the principles of the AIDC Act. Rather they are producing a gradually more successful blending of the Corporation's statutory functions with the requirement to perform them in a profitable manner.

The economic climate in Australia in the past four to five years has affected most businesses. The demand for development finance has accordingly been subdued through most of the period, though picking up in the last twelve to eighteen months.

But industry, of course, always needs finance. The key to meeting this demand has been, as it always will be, to have a flexible and innovative approach which can adapt to the needs of industry in varying economic circumstances.

This AIDC has always sought to do. It has, for example, developed its borrowing policies in conjunction with its medium-term lending at variable interest rates, to blend the needs of industry with the types of borrowing for which AIDC is best suited. The Corporation endeavours to keep abreast of new financing techniques around the world, and to find solutions to new financing situations. It aims to work in harmony with banks, merchant banks and other financial businesses; and the success of this policy is evidenced by the growing trend for these organisations to call upon the resources of AIDC to complement funds they might be providing to meet the needs of their own clients.

The Corporation is now well established in the market-place, both nationally and internationally. Its dual roles of pursuing particular national objectives through its essentially commercial activities have always been recognised, and are being increasingly understood. The specific strengths and limitations of AIDC, by comparison with the structure and character of other financial institutions, have defined for the Corporation its own particular niche in the Australian financial community.

ANNEXE A. THE BOARD OF DIRECTORS OF AIDC

Name and place of residence	*Principal affiliations*
Sir Alan Westerman, C.B.E. Canberra (Chairman)	Director, Ampol Petroleum Limited, Ampol Exploration Limited, Philips Industries Holdings Limited; Chairman, Stevedoring Industry Consultative Council; Member, Australian Manufacturing Council.
Mr R. D. G. Agnew, C.B.E. Perth	Chairman and Director, Agnew Clough Limited and group of companies.
Mr J. K. Campbell, C.B.E. Sydney	Chairman and Chief General Manager, Hooker Corporation Limited; Chairman, Citinational Holdings Limited; Deputy Chairman, Network Finance Limited; Director, IBM Australia Limited, Sydney Atkinson Motors Limited.
Mr G. N. Crawford-Fish Melbourne	Partner, Irish Young & Outhwaite, Melbourne; Director, Commonwealth Accommodation and Catering Services Limited and various private companies.
Mr N. S. Currie, C.B.E. Canberra	Secretary to the Department of Industry and Commerce.
Sir John Dunlop, K.B.E. Sydney	Chairman, Edwards Dunlop and Company Ltd and group of companies; Director, Lansing Bagnall Australia Pty Limited; Rothermans of Pall Mall (Australia) Limited; Australian Estates Limited; Senior Adviser, Banque de Paris et des Pays Bas.
Mr D. L. Elix, A.M. Adelaide	Managing Director, Kelvinator Australia Limited and group of companies; Member, Multilateral Trade Negotiations–Industries Consultative Group; Member, Industry Committee for the Development of Offsets to Overseas Procurement.
Mr L. T. Froggatt Melbourne	Chairman and Chief Executive Officer, The Shell group of Companies in Australia; Director, Liquified Petroleum Gas Limited; Austen and Butta Limited; Dunlop Australia Limited; Thiess Australia Limited; Australian Institute of Petroleum Limited; Woodside Petroleum Limited.
Sir Walter Leonard, D.F.C. Sydney	Chairman, Ampol Petroleum Limited and group of companies; Director, Conzinc Riotinto of Australia Ltd; Australian Institute of Petroleum Ltd; Interscan Australia Pty Ltd.
Mr D. McLeish Sydney	Secretary, Electrical Trades Union of Australia (N.S.W. Branch); Chairman, Sydney Cove Redevelopment Authority.
Mr J. Scully Canberra	Secretary, Department of Trade and Resources; Chairman of Directors, East Australia Pipeline Corp. Limited.

ANNEXE B. THE AUSTRALIAN INDUSTRY DEVELOPMENT CORPORATION

New Chief Executive

The Australian Industry Development Corporation has pleasure in announcing the appointment of Mr J. R. Thomas, of Adelaide, South Australia, as Chief Executive of the Corporation.

Sir Alan Westerman, C.B.E., who has hitherto served as Chief executive officer as well as Chairman of the Board of Directors in which the control and management of the Corporation are vested, will continue in office as Chairman of the Board.

Mr Thomas, an economist by training and a banker by profession, comes to the Corporation at the height of a successful banking career embracing commercial banking, central banking, merchant banking and service with the International Monetary Fund (IMF).

Mr Thomas commenced his career in the Commonwealth Bank of Australia, and joined the Reserve Bank of Australia in 1959. His service with the Reserve Bank included a number of years as Secretary of the Board and a four-year term at the IMF in Washington.

For the past seven years Mr Thomas has been General Manager of Elder's Finance and Investment Co. Limited, the merchant banking subsidiary of Elder Smith Goldsbrough Mort Limited. Elders are one of Australia's leading pastoral houses with diversified trading, financial and industrial interests. As Chief executive of Elders Finance Mr Thomas developed and extended the group's merchant banking and corporate financing services in financial centres throughout Australia.

Mr Thomas commenced his career in the Commonwealth Bank of Australia,
The Chairman and Directors of the Corporation are pleased to have obtained the services of a man of such experience and stature in the financial community to fill the Corporation's top executive post.

Canberra
July 1977

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