



# Scrutiny and regulation in best interest of the public

By **ANDREW MURRAY**

**D**ESPITE concerns raised about the private equity bid for Qantas and other Australian companies, many see private equity activity positively. An article in the latest edition of *Financial Planning* magazine says that “while listed companies are burdened by heavy corporate governance, and shareholder, media and regulatory scrutiny, private equity companies are free from these constraints, providing them with a safe haven and a much calmer environment in which to do business”.

Explicit in that statement is the view that corporate governance and regulatory requirements are bad for investors.

Modern Australian corporations law sits comfortably with the most dynamic and successful business market Australia has ever seen, with record levels of mergers, acquisitions, profits and tax revenues. It is also the safest market Australian investors have ever experienced. There are a number of reasons for that, but beefing up the law and the regulators after the horrors of the 1980s, and the lessons of Enron, HIH and others, has produced good dividends. Literally.

It is the “heavy corporate governance requirements, and the shareholder, media and regulatory scrutiny” that secures such good returns in a relatively low-risk environment.

Private equity wants to be free of those constraints, so that they can take more risk free of scrutiny and regulation. They want to be able to take higher risks for higher returns. With that comes higher danger.

Good corporate governance rests on five foundations: mandated constitutional provisions, behavioural restraints and processes under law, a strong active regulator, public reporting and accounting requirements, and the discipline of the market.

If private equity funds broaden their market activity substantially they can affect our whole economy.

If, as a consequence, the market as a whole is exposed to much higher risk, then so is Australia exposed to much higher risk. By private equity funds replacing equity with debt in their

targets, we go back to over-gearred vulnerable business balance sheets. By requiring the servicing of higher levels of debt, tax revenues fall. By going private, investors are exposed to greater risk because of less regulation and limited scrutiny.

Unlike the public share register of a listed company, it is not possible to identify the real investors or beneficial or substantial owners in private equity funds. Without public scrutiny it is not possible to determine their intentions or interests. Where capital is foreign it is not interested in Australia other than as an investment vehicle. In the case of sensitive or strategic industries, such attitudes may not always be in Australia’s national interest.

The solution is not to inhibit private equity fund deals. In the main, private equity funds are legitimate market participants that add variety and choice to investment vehicles. But the higher risk they bring has to be managed.

A shift in perception is needed. Private equity is often far from private, as it includes public money from legions of small investors in investment and superannuation funds. The involvement of public money demands prudential market supervision.

Certainly foreign private equity fund deals must continue to be subject to review under the Foreign Acquisitions and Takeovers Act. But the solution for all private equity deals is to return to the prudential measures that are tried and true: scrutiny and regulation.

Corporations in sensitive or strategic sectors, or businesses of economic significance need to have the same governance, accountability, and reporting obligations of listed companies, and be subject to the same intensity of regulation by the Australian Securities and Investments Commission. Otherwise, in the absence of that, Australia will pay.

The best and easiest solution is simply to require most of the reporting and disclosure requirements placed on companies on the Australian Stock Exchange to apply to large private equity companies too. That would secure the public interest.