Speech: Superannuation Fund Investment in Innovation

Gordon Noble, Director Investments and Economy, ASFA

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Today I wanted to talk about why it is important that the superannuation industry work collaboratively to address the challenges that we currently have investing in what may be called innovation assets.

In my presentation I will be specifically focusing on the role that the ASX plays in providing opportunities for superannuation funds to invest in innovation companies. Young, start-up companies in areas such as Biotech, Clean Technology and Technology already look to the ASX as a means to raise capital.

To start let's have a look at where the superannuation system is currently at.

According to the APRA December Quarter statistics the system has $1.51 trillion.

What is of particular interest is the rate growth. Over the last twelve months the value of superannuation investments has increased by $192.2 billion. In the last quarter alone we have seen we have seen $21.9 billion contributed to APRA regulated funds. Total contributions in 2012 were $92.2 billion up from $83.8 billion in 2011.

We can expect that the system will continue to grow. Deloitte estimates that by 2028 the system will have $7 trillion in assets.

I want to look at what this may mean for future asset allocation by superannuation funds.

In particular I want to look at the ASX where super funds invest a significant portion of new monies.

The market cap of the ASX is around $1.38 trillion.

There are 2,183 companies in the ASX but 95% of the value of the market is in the ASX 200.

Superannuation funds roughly allocate 95% of their investments in ASX to the ASX 200.

The 5% that super funds do invest outside the ASX 200 is still significant, making up over $21 billion.

But here is the problem. The superannuation industry is rapidly outgrowing the ASX 200.

The continued strong cash flows each month into superannuation mean that funds must invest.

If we assume around $80-90 billion of annual contributions on a typical asset allocation we could expect that funds will invest up to an additional $20 billion into the ASX each year.

This equates to 20 $1 billion companies. Given that 92% of the market is made up of companies with a market cap less than $1 billion this indicates the size of the challenge.

There are already a number of implications of our growing size. Super funds for instance are increasingly drawn to dark pools because the size of some of the larger funds in particular means that it can be hard to execute in the lit market without moving the market.

But the more significant question is where does the super industry turn to for future investment?

The challenge that we have is that outside of the ASX 200 the market is illiquid and concentrated.

While liquidity is largely a function of size there are very good reasons why outside the ASX 200 more than half the market is mining and resources related.

We may think this is due to the all the ore that we have in the ground but in reality it is due to the regulation of the market, in particular the Joint Ore Reserves Committee that has meant that Australia has become an attractive place to list for international mining and resources companies.

There are over 200 ASX companies that solely work in Africa. We also have 15 mining companies based in Mongolia. One of the reasons we have such presence is that ASX has actively sought listings by putting people on the ground in Mongolia to recruit companies.

One option of course is for superannuation funds to seek investments outside of the ASX – and this is happening already. However it makes sense for the superannuation industry to consider how the whole of the ASX could be made a better place for future investments.

There are a number of ways the superannuation industry can work together to create more opportunities in the ASX.

The first thing is to understand that markets are a regulatory construct. The codes that have been developed for the mining industry have supported the development of mining and resources companies.

The question is can we use similar codes in other areas to support the development of other sectors.

One example is the Code of Best Practice For Reporting by Life Science Companies which is currently being reviewed. We know that there are US biotech companies that are now attracted to list on the ASX because of this Code. Are there ways that this could be further supported?

The second area we can concentrate is for the superannuation industry to collaborate to explore how we can support the development of the ASX. This could take a number of forms including establishing a working group that explicitly focus on this end of the market. ASFA has been in the process of restructuring our committees. We are now forming an Investment and Economic Council which will provide the place for these kinds of strategic conversations. We will then be establishing an innovation working group that will explicitly look at the structure of the ASX.

To conclude ASFA does not see its role to promote one form of investment over another. Our role is to seek to identify impediments that may prevent the superannuation industry from achieving its primary objective which is retirement incomes for Australians.

The size – and continued growth – of the superannuation system means that it is in our best interests to address the challenges in the ASX.

To finish it is worth asking the question does this is all matter. Is it a problem if super funds simply increase their allocations to global markets and diversify away from ASX?

It is worth delving for a moment into the economic history of one of the great economic empires of the modern era - the Netherlands. Kevin Phillips in his polemic book Wealth and Democracy examined the decline of the Netherlands which had been a significant merchant power in the 1600’s but by the 1740’s consisted of a divided society with a wealthy Dutch upper class and growing unemployment in towns that had once been thriving places for industrial production. Phillips attributes the decline of the Dutch empire in part to the fact that the Dutch upper class preferred to invest in economies other than their own, a fact that was not seen to be a significant issue at the time. In fact there were elements of Dutch society that advocated that the increased size of the finance sector that grew to service the Dutch upper class would more than compensate for the loss of domestic industries. This did not prove to be the case and the Dutch empire gradually faded, its demise accelerated by numerous wars.

Whilst things may have moved on over the last three hundred years the reality is that the superannuation industry and the economy are interlinked. Our contributions come from millions of Australians who rely on a strong economy for their future work. For that reason alone we have a responsibility to do what we can to make the ASX are better place for future investment.