

Venture capital to increase commercialisation of Australian innovation

Financial System Inquiry 2014

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Research commercialisation is a key aspect of Australia's goals for research and innovation. Translating research outputs into marketable products, processes and services in a timely and effective manner demonstrates the value of research by making substantial contributions to the economy and to the broader community.

Background

The past 20 years has seen greater connectivity between the researchers, finance suppliers and industries but it remains that Australia has great ideas with mixed success in translating these into new products. The most important issue for commercialisation in Australia relates to the poor availability of venture capital (VC). Australian capital markets lack the capacity to support levels of investment and risk profiles for local innovation to continue past the proof-of-concept stage. A systematic change is needed in the Australian financial sector so that long-term economic benefits of investing VC in high technology growth industries are more widely recognised.

Government response to continually deprived Australian VC markets has improved since the *Strategic Assistance for Research and Development (R&D Start)* program commenced in 1996. This was complemented by the establishment of the *Innovation Investment Fund (IIF)* in 1998 and *Commercialising Emerging Technologies (COMET)* program from 1999, the latter continuing until 2010 when it was superseded by the *Commercialisation Australia* initiative managed by AusIndustry. Specific VC-related initiatives were announced by the coalition government in the 2006 Federal Budget with the *Early Stage Venture Capital Limited Partnership (ESVCLP)* to provide a complete tax exemption for income, both revenue and capital, received by domestic and foreign partners. This program continues within the AusIndustry portfolio and accepts applications by fund managers seeking to raise new VC fund of at least \$10 million and not more than \$100 million for investing in Australian businesses with assets of less than \$50 million provided that their primary activity is not finance or property development. The Labor government's response to the 2012 Review of Venture Capital and Entrepreneurial Skills was to lower the entry point to \$5 million to provide an effective means for smaller start-up companies to work with fund managers to secure VC.

In the 2006 budget, the coalition government also committed \$200 million for a further round of funding of the IIF program, which provides funds alongside those from private investors to encourage the development of new companies, particularly those with a technology focus. Over three rounds to date the program has licensed 16 fund managers and has supported more than 100 new companies. This program, now involving public investment of more than \$350 million with an equal contribution from the private sector, has not only stimulated commercialisation of R&D but also increased the number of fund managers with expertise in the VC market. Government 'seed' programs such as the ESVCLP and IIF have supported the possibility of a self-sustaining, early-stage VC industry in Australia.

The way forward

The next step for increasing commercialisation of innovation in Australia is to build on the government-sponsored public-private partnerships in VC to leverage greater input from private equity to drive productivity growth in services and manufacturing and deliver higher return to domestic superannuation funds. Focussing on the latter, perceptions of uncertain returns, high risks, limited

liquidity and difficulties in ascertaining the value of an investment has made investment in VC unattractive for fund managers. This stems from the reputation of VC being dealt a serious setback in the 1990's with the dotcom boom and crash. From a local perspective, this was the result of a "me too" mentality driving technology start-ups in Australia to compete with established firms in Silicon Valley without differentiation strategies. The ensuing time, however, has demonstrated how industries such as mining, media and healthcare can attract VC in Australia, all be it with substantial government assistance.

The innovation sector has only recently actively engaged the superannuation industry in an effort to seek contributions from the some \$1.5 trillion under management towards VC to commercialise intellectual property. The *Science meets Superannuation* summit, a similar concept to the highly successful *Science meets Parliament* initiative managed by *Science and Technology Australia* was held in March 2012. The timing of this fledgling association is advantageous with the increase in compulsory superannuation contributions from 9% to 12%, at which time funds under management will be in the order of \$6 trillion, the world's largest.

From a fund manager perspective, the requirement for diversity in investment targets should make emerging industries such as medical devices and therapeutics born out of successful R&D efforts more attractive. Furthermore support for the development of such industries can mitigate risk that concentrated earnings from banking and mining – accounting for approximately half of ASX earnings – may pose in terms of fund viability in the face of future financial crises. Overcoming barriers to foster broad investor acceptance of VC will encourage greater analysis of companies outside the ASX200, where most innovation investment opportunities are located.¹ Relieving the investment data gap that currently exists in this area will allow fund managers to make informed market-based investment decisions. Risk management must then be addressed by quality assurance mechanisms for Australian innovation investment options. An example of how this can be achieved is the co-operative/peer-review model established by the Medical Research Commercialisation Fund:²

- An Investment Review Committee, comprising of representatives of each co-operative member, reviews preliminary investment proposals.
- If this initial proposal is recommended to progress, a presentation by the key researchers and full investment proposal will be requested.
- If the committee is supportive of the technology receiving investment, the opportunity is submitted to a retained VC firm, who completes due diligence.
- Support from the VC firm comes with recommendation to the co-operative Board that the investment is made.

An improvement at this point in the process would be for greater access to representatives of the financial services industry, facilitated by *Commercialisation Australia*. If this can be achieved then a suitable quality assurance strategy should satisfy fund managers of the following:

- The technology represents world class science;
- Requirements to reach the next key milestones for the technology;
- Potential market size and current deficiencies within the market;
- Competitive advantages of the technology;
- Ownership value of Intellectual Property (IP) rights;
- Capabilities of key personnel and management to deliver commercialisation pathway.

There is little doubt that improved commercialisation of Australian innovation with increased VC will lead to greater prosperity for all Australians.

¹ *Super-Seeded Science* by Anna-Maria Arabia. Australasian Science, December 2012.

² <http://www.mrcf.com.au/investments/investment-process>.