



Venture Capital Innovation Fund: Policy Proposal



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Introduction

The Western Australian Government has outlined an ambitious agenda for diversifying the State's economy.

Reflected in its most recent update *Future State*, it has recognised the sectors of the economy it wishes to prioritise, as well as the key enablers for that diversification. Some of those enablers include a skilled workforce, key infrastructure, a robust investment system, and the crucial role of technology and innovation.

The challenge for the Government now is to introduce the hard policies that unlock those enablers for diversification.

The Chamber of Commerce and Industry WA (CCIWA) has a broad policy platform that cuts across most of these areas.

One important area of policy where more work is required is the financing environment for innovation. This paper outlines the case for further policy action, including a focus on the role of innovation and its financing, where WA sits, and what the State Government can do to ignite greater innovation in key sectors of the economy.

Western Australia has huge innovation potential

It's not unreasonable to argue that Western Australia could become one of the fastest emerging innovation capitals in the southern hemisphere. Our opportunity to benefit from global trends such as the transition to cleaner technology is now well recognised. We have an abundance of natural resources and the knowledge and expertise in facilitating major projects.

All that sits on top of what is a truly entrepreneurial business community that has produced innovative and vital products for the world - from medical research and handheld surgical imaging probes to precision drilling systems, to a robotic bricklaying system, to Sandalwood Perfume developed by the Kutkabubba community of the Western Desert.

When the right conditions are in place, Western Australian entrepreneurs and businesses can do remarkable things, and in doing so, carry the nation, and the world, forward.

There is no reason why we should not be thinking big.

In the Indo-Pacific region, venture capital investment has been championed by countries such as Singapore, Indonesia, Malaysia and Vietnam. In the last five years to 2021, the region has witnessed a significant rise of unicorns (with value of over 1

billion). There is much investor interest in Indonesia in particular, as a centre of innovation, similar in scale to Hong Kong and Singapore.¹

What are the sectors of our economy where innovation could play a significant role in driving the growth and diversification of our economy?

Any sector of course, but there are some areas that do present significant opportunities and are worth calling out.

- **Remote operations** – there is a well-recognised opportunity to innovate on the back of our world-class resources companies’ success in developing remote technology, including in areas such as remote health and education.
- **Space** – Western Australia has as good a set of conditions for Space technology as anywhere in the world, let alone the southern hemisphere. Reflecting this potential, the State Government has prioritised this sector in its diversification plans.
- **Biological and medical technologies** – from developing new drugs, to facilitating local clinical trials, to precision health treatments, this is a sector in which WA has already exhibited significant expertise and success. There is obvious scope to develop the sector further.
- **Defence and security** – WA is set to be a significant winner from the AUKUS submarine deal, with the opportunity to take this investment further to develop a broader defence innovation eco-system; not just in materials and service contracting, but also in areas like cyber-security and electronics.
- **Clean technology** – the opportunities here are well-recognised, whether that relates to geothermal, tidal, solar, or wind energy, as well as regenerative agriculture, and carbon capture, usage and storage.

While we’ve called out some sectors, it should also be acknowledged that much of innovation policy should be sector agnostic, ensuring the conditions are right for innovation in any part of the economy.

WA start-ups will play a critical role in driving innovation

Unsurprisingly, the businesses we naturally look to drive these opportunities are existing businesses either already with operations in Western Australia, or overseas investors.

Those businesses and investors are important, however we should not overlook the significant role that start-up businesses can play in driving innovation. This is something that parts of the private sector have recognised. Facilitation spaces and stewardship services, such as CORE Innovation Hub and Meshpoints, play an important role locally in guiding investment and encouraging collaboration.

¹ GSMA 2021. [Investment trends in the Indo-Pacific region: An overview of a diverse and vibrant innovation ecosystem.](#)

One of the best examples is the unicorn company, Canva, which focuses on easy drag-and-drop design templates for businesses. Starting with an initial \$3 million in seed funding in 2013, Canva was valued at US\$1 billion in 2018 and peaked at a valuation of US\$40 billion. Originally starting in Perth, the company maintains a co-working space in the Perth CBD.

Other WA startups, which have developed into notable businesses include, biotechnology company, Argenica; defence company, Orbital UAV; communications company, Blacktree; and medical appointment service company, HealthEngine. These companies remain based in Western Australia, with national and international reach.

There is increasing interest in start-ups across sectors. For example, in defence, BAE Australia has contracted Stone & Chalk, an incubation firm, to identify start-ups for investment and deliver workshops to start-ups to finesse business pitches. The University of South Australia's Innovation and Collaboration Centre has also announced the merit selection of nine start-ups to participate in a Venture Catalyst Space program. Similarly, global engineering firm Worley works with venture capitalists and incubators to identify start-ups in areas like sustainability and renewables, clean technologies and emissions, and energy transition and efficiency.

These and other examples serve to highlight the important role that start-ups will play in driving the innovation required to grow and diversify Western Australia's economy.

Local Venture Capital is a 'must have' for innovation

Early-stage financing is the fuel that runs innovation.

At a broad level, innovation generally follows a rough progression from ideation to funding through family and friends, to angel investing, the seed stage, and then various venture capital stages.

Of these, the venture capital stage is particularly important. There is strong evidence that companies funded by more experienced VCs are more likely to go public. There are two main reasons for this. First, more experienced VCs are skilled at sorting bad ventures from good, and second, they can add more value via their equity stake.

This value is generated from the access to management expertise and contacts that VC can bring. Entrepreneurs benefit from tapping into the established network of relationships that venture capitalists have built up over time. In these ways, venture capitalists improve the probability that start-up and early-stage firms succeed in commercialising their IP.

What is vital as well, is that VC fund managers *must be local*. The view of stakeholders is unanimous – people are much more likely to invest with people they can meet with. This is only becoming more important; as funding markets dry up VC funds typically turn their focus toward managing their existing portfolios and working relationships

with local entrepreneurs, rather than looking afield. Having a strong local VC market is as important as ever.

WA's lack of Venture Capital funding is holding back innovation

It is apparent that Western Australia is underweight when it comes to the local VC environment. Estimates for Western Australia's share of national VC funding vary, but most centre around the 2% mark (Cut Through Ventures, 2022).² Notably, this is smaller than South Australia's VC market (around 3%), which has taken steps in recent years to stimulate the sector. It is also well behind the best comparator economy to Western Australia, Queensland, which sits at 8% of national funding.

Beyond the simple share of funding, CCIWA has heard from stakeholders that much of the financial sector in Western Australia is, unsurprisingly, more comfortable and experienced with investing in major resource projects, with most of this investment occurring in a listed environment. We have also heard that when investments outside resources are made, investors can quickly get nervous and withdraw when challenges arise (as can often occur in sectors like biopharmaceuticals).

Western Australia's quantum of VC funding is all the more disappointing when considering the significant number of first-generation high net worth individuals in WA. This local wealth could potentially be a competitive advantage in fuelling our innovation ecosystem — an advantage we are failing to exploit.

How much funding should Western Australia be attracting?

There is no magic number; ultimately what we need is enough capital to fund the innovative potential of the State. CCIWA contends that this potential is enormous. Our significant latent innovation potential means we would expect to see at least our population share of national VC funding, if not more. Indeed, given the structure of WA's economy, there is an argument that we should be attracting a percentage of national VC funding closer to our share of national output (around 17%).

A higher quantum of local funding brings with it much more than just the dollars themselves – it provides the opportunity for specialisation. As previously mentioned, a good VC fund manager does two things – they are experts at filtering and assessing proposals and opportunities, and they can work with businesses to maximise their chances of success.

These sorts of services can only be delivered by fund managers with deep knowledge of the sector they operate in. For example, an area like biopharmaceuticals is higher risk than some other areas and requires deep knowledge. A critical mass of local funds and

² [State of Australia Startup Funding 2022 | Insights \(cutthrough.com\)](#). The local VC environment includes some corporate VC funds, such as those run by the RAC and St John.

opportunities also provides greater scope and comfort for investors to diversify their bets, increasing the potential to better tap into local high net worth individuals.

What have governments done to grow the local Venture Capital sector

There is a strong case for government support in the VC sector. The Productivity Commission for example, has argued there is a strong rationale for public funding support of innovation where there are spillovers from that innovation that cannot be captured by the innovator and cannot be realised without support.

Reflecting this, most strong VC markets around the world have been ignited through Government involvement.

Singapore, for example, recognised the role of venture capital in developing local entrepreneurship and innovation in the 1980s.

The Economic Development Board established the Venture Capital Programme in 1985, which saw the local VC industry grow to what is the largest VC market in the world today on a per capita basis (market size around \$8 billion).

In Israel, the 'Yozma' government equity program was established in 1993. Yozma was a fund of funds, which leveraged public money to attract private investment and included an option for the government share to be bought out (a clear intent to 'crowd in' the private sector).

Yozma attracted investors to Israel by offering to provide 40% of the capital they raised. The sum was to be bought out after a maximum of seven years, with interest. Today Israel has the second largest VC fund market in the world on a per capita basis.

Closer to home, in 2001 New Zealand introduced the New Zealand Venture Investment Fund, which is regarded as having successfully stimulated the New Zealand VC sector.

The purpose of the fund was to accelerate the development of the local VC market to the point where it is self-sustaining. It did this by encouraging the entry of private VC fund managers by offering matched government contributions to the funds. Like Israel's Yozma scheme, it included a buy-out provision, consistent with the principle of seeking to crowd-in private sector funds.

Looking across the States, there has been a strong focus on attracting innovation and VC funding. In South Australia, the Government has established a Research and Innovation Fund, which provides grants of up to \$500 000. The Victorian Government has also established LaunchVic, which is focused on building the angel investor and early stage VC markets. All up the Victorian government is spending up to \$280 million on the program, including direct funding for VC funds looking to establish in Victoria.

Turning to Western Australia, our Government has clearly sought to play an active role in all stages of financing.

It has significant grant opportunities such as the Innovation Booster Grant mainly targeted at the level of funding typically secured at the angel investing stage.

And it has introduced the WAVES program, which has supported the administration and operational costs of three VC funds that have set up in WA. While it is unclear whether these funds would have set up in WA in the absence of the policy, CCIWA understands that at least one of the funds has confirmed that State support was important in its establishment.

In the absence of further policy action, the sector may well continue to develop momentum. And there is no doubting that the financing environment in Western Australia has improved somewhat.

But when the important role of local VC and the enormous innovation potential of the State is compared to the disappointing share of national VC funds that WA attracts, it is apparent that more must be done. Continuing as we are simply won't cut it if we want to realise our full innovation potential.

WA needs to be bolder

In taking its innovation policy forward, the State Government should be bold.

To that end, the Government should carefully assess the merits of establishing a Western Australian Venture Investment Fund.

The purpose of the fund would be to accelerate the development of the VC market in WA to the point where there is a self-sustaining local VC market no longer requiring government support. It should seek to catalyse new investment, rather than underwrite existing investment; crowding in rather than crowding out the private sector.

The Fund should seek to encourage the entry of private VC fund managers and private investors by investing government capital in private VC funds on favourable terms for investors in the funds.

As part of this, the Government should first establish an independent panel to conduct a global search to identify a quality experienced VC fund manager. Fund managers should be selected based on their ability to raise private sector co-investment funds, their credentials in business management and management of VC funds and the degree to which a fund's proposed management structures and investment strategies will contribute to achieving the objectives of the program. In this context, the Fund should solely invest in Western Australian ventures.

The costs of identifying an experienced local VC fund manager would essentially be underwritten by government. This strong due diligence would in turn assist in the raising of private capital. Government in essence would be underwriting the costs of due diligence with private investors free riding off this information signal and using it as the basis for their decision to commit capital to a VC fund manager.

Once the capital is committed and the fund established and active, then the government agent's role is that of a passive investor. As per usual practice, funds would not be drawn down until the fund manager requires the funds. At such a point, the fund manager would make a 'call on funds' to investors. The Fund, which does not hold the capital, would then make a call on funds to the Government. Notably, it is the Fund that makes decision on the merits of an investment, and whether to allocate capital. This arm's length approach ensures the Government is not in a position of 'picking winners'.

Other proposed features of the Fund would include:

- The Government make at least \$200 million available, for a 10-year fund.
- That funding only be made available in the event the fund manager secures an appropriate amount of private capital. They would therefore need to demonstrate that they can raise private sector investment. An appropriate public-private investment split may be around 1:2 or 1:4, depending on how early or speculative investments are.
- The option for private investors to buy-out the Government's equity in the fund, up until around five years into the life of the fund.

To complement the Fund, Government should also seek to change the optics around Western Australia's innovation potential and develop a compelling and clear narrative on the innovation potential of the state. In this context, WA is currently viewed as a small, immature ecosystem of innovation. Significant work is required to turn this around. We need to develop strong, compelling messages and marketing material, and key Ministers should be required to deliver the message.

Summary

In sum, greater VC activity would generate an opportunity to increase the level of early-stage investment activity in WA, generate a larger pool of people in WA's VC market with skills and expertise in early-stage investment, increase the commercialisation of innovations from research institutes, universities and the private sector, and ultimately put more WA businesses on paths to global success by increasing their access to international experts, networks and market knowledge.

To fast track this and better ensure the State achieves its diversification ambitions, the Government should investigate establishing the sort of investment fund described above, as well as develop and execute a comprehensive marketing campaign highlighting our great State's innovation potential.