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Hindle, Kevin and Gollis, Christopher 2001, Australia's venture capital industry : past performance, present structure and future prospects, *in Proceedings of the 2001 Frontiers of Entrepreneurship Research conference*, Babson College, Babson Park, Mass., pp. 1-30.

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# **Australia's Venture Capital Industry: Past Performance, Present Structure and Future Prospects**

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## **CITATION DETAILS**

Hindle, Kevin , and Christopher Gollis. 2001. Australia's Venture Capital Industry: Past Performance, Present Structure and Future Prospects. Paper read at *Frontiers of Entrepreneurship Research 2001*, at Jonkoping International School of Business. Jonkoping Sweden. Published in abstract in *Frontiers of Entrepreneurship Research 2001*. Babson College Center for entrepreneurial Studies.

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## **Abstract**

A brief history of the Australian venture capital (VC) industry to April 2001 precedes critique of the current industry framework. This focuses on two questions: *What has history taught us?* and *How well does the Australian VC industry enable entrepreneurship in the Australian economy?* The answers embrace suggestions for better encouragement of entrepreneurship through research-based VC industry enhancement. A positive prognosis is based on a case history. A knowledgeable private citizen significantly influenced the passage of legislation vital to the industry. This success indicates the practical importance that a future program of structured research might have for the development of venture capital and entrepreneurship in Australia.

## **Objectives, rationale and design of the paper**

All branches of research share a common need for periodic stocktaking. From time to time it is useful to pause in the quest for more knowledge in the vein of *why is it so?* The pause gives time to evaluate existing knowledge using the twin questions: *What do we have learned so far?* and *What does this knowledge portend?* In any field, a truly detailed treatment of both questions might produce a significant work of social and intellectual history. A humbler treatment might better be described as a brief 'survey and critique' of the field. This paper attempts the latter task. It is a summary attempt to take critical stock of the past performance, present structure and future portents of the Australian venture capital industry as they stand in April 2001.

This date marks the first anniversary of the 'tech wreck': the dramatic fall in the value of many technology stocks on world stock markets. In the fullness of history it is likely that the bursting of the 'dotcom bubble' will be seen as a watershed event in the evolution of international venture capital. In Australia, the time seems right to reflect upon the past, present and future of the industry. History shows that, after a minor boom period, venture capital virtually disappeared within three years of the traumatic stock market collapse of 1987. In a study to be reviewed below, Cornelius and Hargreaves concluded that by 1991 '*... the industry is close to extinction*' (Cornelius and Hargreaves 1991: 2). The present downturn in the attractiveness of new venture investments in the wake of the 'tech wreck' now makes it timely to investigate whether the Australian venture capital industry is likely to repeat history or transcend it.

This study was conducted from two points of view: that of the scholar of entrepreneurship and that of an experienced, practising Australian venture capitalist. Both points of view blend efficiently because the authors believe that venture capital's contribution to a national economy and society is best measured with respect to the extent that it contributes to the enabling of entrepreneurship. Given this dominant perspective and despite obvious limits of scope and detail, the authors believe that the paper will have utility for several audiences including: entrepreneurship researchers, industry practitioners, social analysts and policy makers.

The paper begins with a definition of venture capital and a summary of its generic industrial structure. A brief historical narrative of the Australian venture capital industry follows. It includes diagrams that summarise the supply and demand situation of the industry at three key points in its evolution. The paper then provides a portrait of the

current Australian VC industry framework (as at April 2001) through description of key stakeholders. The combination of historical narrative and current description provides a platform for critique. This is focused on two key questions: *What has history taught us?* and *How well does the Australian venture capital industry enable entrepreneurship in the Australian economy?* The paper then presents suggestions for better encouragement of entrepreneurship through improvements in the venture capital industry. It concludes with a positive prognosis for the industry based on a brief case history of constructive policy making. A private citizen, well-motivated and well-informed, was able to influence the passage of crucial capital gains tax legislation. This success indicates the practical importance that a future program of structured research might have for the productive development of venture capital and entrepreneurship in Australia.

### **Institutional venture capital: definition and generic industrial structure**

Venture capital is commonly viewed as high-risk equity capital involved in the formation and launch of new companies with innovative technologies. Seed and start-up capital is sometimes considered synonymous with venture capital when in reality it is only a small segment. Institutional venture capital may more truly be regarded as *an investment made by a financial intermediary in a private company with the long-term aim of taking the company public and realising a significant capital gain*. This definition eliminates individual investors who may invest in a private company with a similar objective. These individuals are properly defined as angel investors.

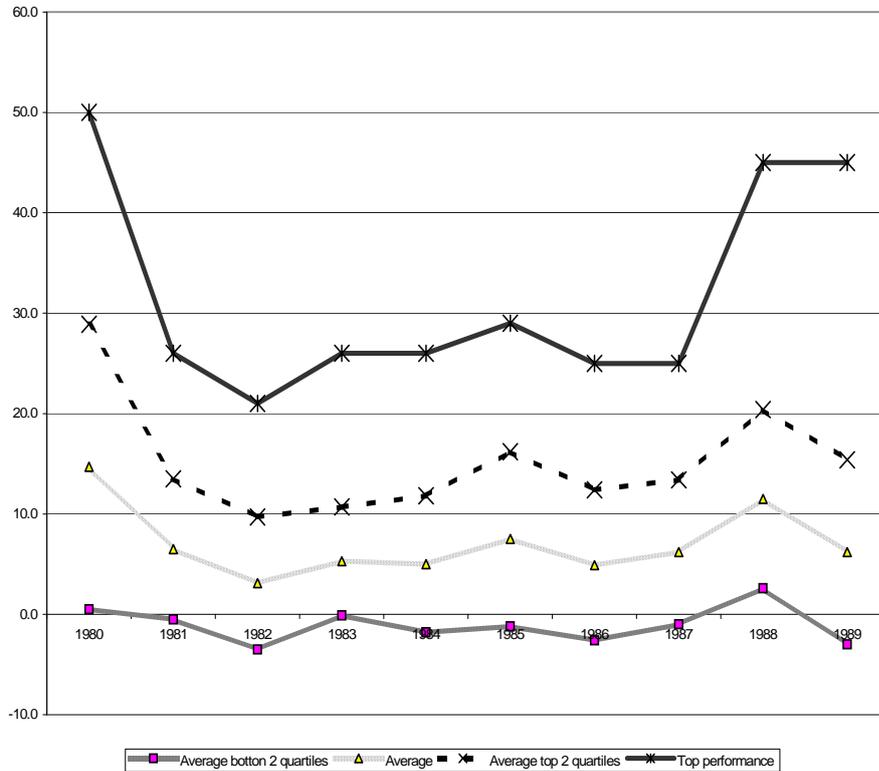
Venture capitalists (VCs) are thus financial intermediaries. They stand between entrepreneurs in private companies seeking equity to grow their businesses and the stockbrokers and merchant bankers seeking companies to list on the public markets. In the USA, for example, VCs now generate over half of all NASDAQ initial public offerings (IPOs). The funds mediated by VCs may come from retail, corporate or institutional investors or a combination of all three. Typically, venture capital funds are of two types: either investing in growth companies or in some form of leveraged buy-out. During the 1980s while the growth segment expanded, the leveraged buy-out market (LBO) exploded, particularly in the USA and UK. However, in the 1990s, growth segment has expanded considerably in the USA and the leveraged buy-out market has declined mainly due to lack of opportunities. In the UK, LBO funds used to represent 80% of the market. Funds are sourced from three main areas: financial institutions; corporations and retail investors.

Given the portfolio approach and the deal structure VC's use (see Zider 1998 for a masterly exposition of the mechanics of venture capital investing) only 10% to 20% of the companies funded need to be real winners to achieve the targeted return rate of 25% to 30%. In fact, VC reputations are often built on one or two good investments. The VC manager generally regarded as the best in the world is Kleiner-Perkins. The first fund invested \$7.5 million in 17 companies and returned \$345 million. Two investments, Tandem and Genetech, generated \$325 million.

Of course, this is easier said than done. Chart 1 shows the actual internal rate of return (IRR) performance of selected clusters of US Venture Capital managers from 1980 to 1988.

Chart 1.  
Comparative portfolio performance of VC managers

(Source: PricewaterhouseCoopers 2000)



In the 10 years 1980–89 the USA venture capital asset class returned 7.1% on average. The average of the top performer was 31.8%. The average return of the top two quartiles was 15.2%, which is a good return. However, if you know the average and the top two quartile figure you can calculate the bottom two quartile figure. They average out over 10 years to a negative 1.1%. In other words, if you are choosing a VC manager, particularly a new one, there is 50/50 chance the manager will give you a negative return. In fact the situation is worse. The reality is as follows:

- The bottom 25% of the managers will lose most if not all your money.
- The next 25% will give you a return around the cash rate.
- The next 25% will give you the return on an indexed equity fund with much more administration.
- The top quartile will give outstanding returns in the order of 25% – 30%, post fees, fund after fund.

When this is compared to the listed equity market where the standard deviation around the mean return is 1.5% it is easier to understand the challenge facing investors when selecting a new VC manager.

So, venture capital is a defined but difficult industry. How has it fared in Australia?

## **History of the Australian venture capital industry to April 2001**

### ***1970: The Lone Ranger comes home from Harvard***

Bill Ferris is a principal of Australian Mezzanine Investments Pty Ltd and the founder and former president of the Australian Venture Capital Association. He has legitimate claim to being Australia's first formal venture capitalist. In 1970, with a freshly-printed Harvard Master of Business Administration (MBA) to hang on the wall, the 25-year-old Ferris returned to Australia. He had decided to start his own venture capital company (Ferris 2000: 6). He called it grandly, *International Venture Corporation Pty Ltd* (IVC). It was capitalised at less than \$500,000 (Ferris 2000: 94).

Prior to 1970, there was a noticeable gap in equity risk capital in Australia's financial market place. Angels existed and the public markets, especially in times of economic boom, provided scope for high-risk venturing via public subscription to untried companies – particularly in mineral and oil exploration. But there was nothing in the middle. One of the first government initiatives to encourage venture capital was sector-specific and tax-driven. Known as the *IOBA tax deduction scheme* it was aimed at accelerating the revival of the Australian film industry. Between 1968 and 1978 some of Australia's best-known films were financed through the scheme.

By the late 1970s, the Lone Ranger had been joined by a few other pioneering companies: not nearly enough to warrant the collective label 'industry'. In this period of VC pre-history, the most important venture capital company, was actually government-owned. The *Australian Industry Development Corporation* (AIDC) was spawned when enthusiasm waned for sector-specific initiatives (such as the film industry tax scheme). AIDC's main focus was upon the financing of major projects in manufacturing and mining: projects believed to have a national interest component. However, AIDC's activities included some important private equity investments many of which did well (particularly in the wine and mineral processing sectors) and provided good press for both venture capital and direct government involvement in the asset class. AIDC's portfolio of smaller high-technology ventures did far less well. AIDC had quit private capital investing by the late 1980s. However, its early successes and possibly even more importantly its early failures in high-tech, had an important bearing on the emergence of the Management Investment Corporations (MIC) program. As will be seen, MIC was the initiative generally accepted to mark the start of the formal venture capital industry in Australia.

### ***1983: the watershed year***

The year 1983 featured a trinity of events that were to be seminal in the development of the Australian venture capital industry.

First, Barry Jones achieved the zenith of his media and political influence in Australia. Jones was (and remains) a prominent national figure, initially as a quiz show star and subsequently as a prominent Labor politician and social commentator. He had (and retains) one of the highest media profiles in the nation. In 1983 a new edition of his book, *Sleepers Wake*, was the catalyst for an unprecedented depth and breadth of national discussion about Australia's need to develop a more entrepreneurial culture (Jones 1983).

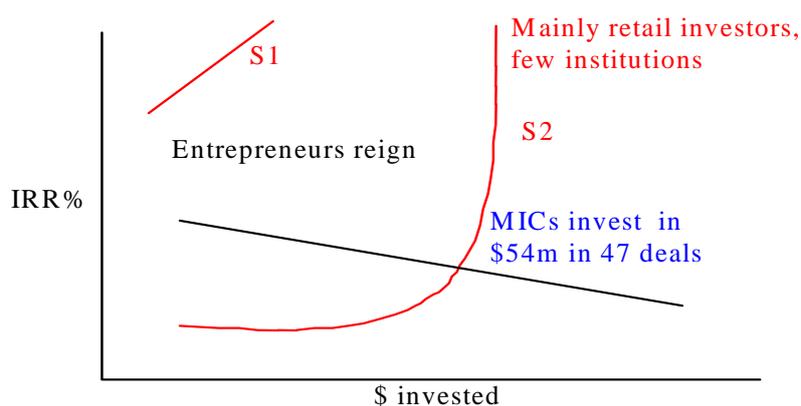
Second, in April, a government-commissioned committee, headed by Sir Frank Espie, published a report for the Australian Academy of Technological Sciences (Espie et al 1983). It presented the incumbent Minister for Science and Technology (a member of the governing and sceptical Liberal Party) with recommendations and guidelines for a government initiative to kick start an Australian venture capital industry.

Third, the Labor Party, committed to a program of state-sponsored, structural economic changes, won the Federal Election. Barry Jones became the new Minister of Science. John Button became Minister for Industry. They wasted no time in convincing their colleagues to implement the recommendations of the Espie report. Based very substantially on these recommendations, an act of the Federal Parliament introduced the Management and Investment Companies (MIC) program. The major benefit of the program was a 100% tax deduction on capital subscribed. A critique of the program will be provided below, in the evaluation section of the paper. For the time being, the authors will confine themselves to a narrative of the program and allied developments.

#### ***1984 – October 1987: four years of feast***

The venture capital industry in Australia is generally agreed by participants to have started in April 1984 with the handing out of seven MIC licences by the Federal Government. By 1986/87 the industry probably had some \$500 million under management. The supply and demand curve analysis probably would have looked something like figure 1.

**Figure 1. VC industry 1986/7**



The demand schedule is simply the quantity of venture-capital-seeking entrepreneurial firms capable of supplying a particular rate of return. As the price (here the expected rate of return) increases, the supply of companies that can meet the rising return decreases. Hence the demand schedule will slope downwards. The supply schedule is determined by the willingness of investors to provide funds to venture capital managers. This, in turn, depends on the expected return on venture capital investments. The supply schedule thus slopes upwards.

Prior to 1984, the supply curve would have been like S1 high in the left-hand corner and sloping sharply upwards. The major benefit of the MIC program to investors was that investors received a 100% tax deduction on capital subscribed. For taxpayers on the highest marginal rate in the mid – 1980s (namely 60%) venture capital became an attractive investment. For institutions such as superfunds on a 0% taxation rate, the tax deduction was of no use whatsoever. Hence the supply curve sloped gently upwards for a part of the curve as retail investors in MICs entered the market but then kicked sharply upwards as few, if any, institutions entered the market.

By 1986/87 the media was full of stories of stock-market buccaneers (mislabelled ‘entrepreneurs’ by the financial press) such as Christopher Skase and Alan Bond. When combined with economic growth, this led to an upsurge in demand for all categories of higher risk investments. In 1986/87 the MICs (by that time probably representing around half the Australian venture capital industry) invested \$54 million in 47 companies.

#### ***November 1987 – late 1993: seven years of famine***

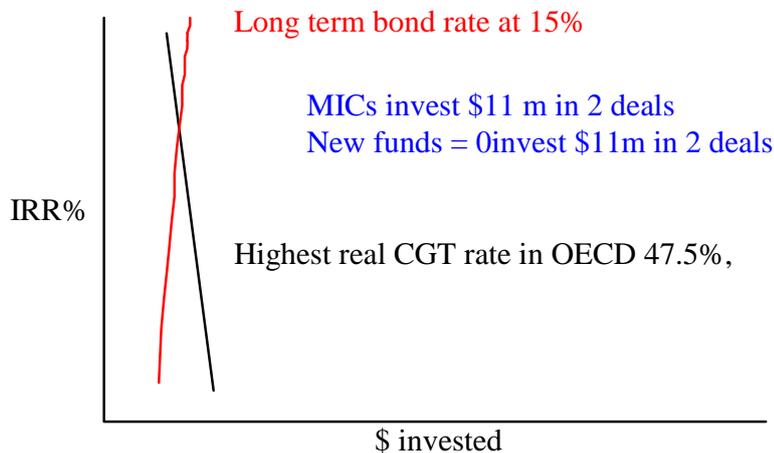
*‘The lifeblood of the venture capital process consists of three essential components: entrepreneurial deals, money to invest in those deals and a return in the money invested in them’.* (Bygrave and Timmons 1992: 261).

Numerous studies in the USA have illustrated the truth of this assertion by demonstrating that the three major determinants of entrepreneurial activity in the economy are: the rate of capital gains tax; gross domestic product (GDP) growth; and the cost of capital. In Australia, by 1991, all three factors were extremely negative.

In 1985, the Labor government had introduced capital gains taxation for the first time in Australia’s history. The effects of late 1980s inflation now acted on this to provide Australia with the highest rate of real capital gains tax in the Organisation for Economic Co-operation and Development (OECD). The economy was in recession and the long-term bond rate was around 15%. Entrepreneurial demand virtually disappeared from the economy (Cornelius and Hargreaves 1991: 2 and *passim*).

On the supply side, the confidence of retail investors was obliterated by the combination of the 1987 stock market crash with the 1989 property crash. Institutional investors were beginning a great shift to overseas listed equity investment. Thus Australia suffered both steeply sloping demand and supply schedules as depicted in figure 2. In 1991/2 the MICs did two deals worth \$11 million. In June 1991 the MIC program had been terminated under pressure from The Commonwealth Treasury on the grounds that Australia had no need of a VC industry. The established MICs kept operating their existing portfolios but did little new business.

**Figure 2. VC industry 1991/2**



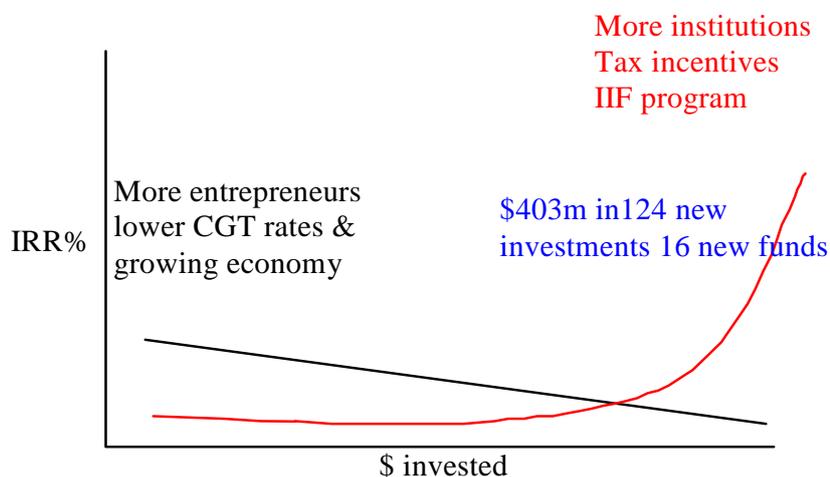
***The recovery 1994 – 2000***

The decline in the long-term bond rate to 5% – 6% combined with excellent GDP growth saw entrepreneurial demand gradually reappear in the Australian economy. In 1999, the halving of the capital gains tax rate caused another shift. In the 12 months to September 2000, one VC company, Nanyang Ventures, saw its deal flow effectively double. Many firms experienced similar expansion in activity. Larger Australian financial institutions now started to allocate a small percentage of their portfolio to venture capital. This was in part a result of the very impressive gains made in the USA and UK where venture capital had been providing exceptional returns (30% plus) during the 1990s. Also the Australian VC community began providing some big investment wins such as Neverfail Springwater, and Datacraft.

Accordingly, both the demand and supply schedules shifted to the right and flattened as in figure 3.

In 2000, 42 new funds were formed nearly doubling the number of funds formed in 1999. Venture capital firms broke the Australian \$1 billion mark in fundraising for the first time, with fund managers belonging to the Australian Venture Capital Association (AVCAL) raising over \$A1.2 billion in 2000 (AVCAL 2000: ix). In 2000, 11 companies went public, 12 were acquired and four investments were liquidated. Australian funds formed between 1986 and 1999 achieved an 18.3% IRR as of 30 December 1999. The top performing funds had returns between 19.7% and 71.5% (AVCAL 2000: ix). In addition, it was estimated that, at minimum, a further \$4.7 billion was available for investment in venture capital (Bivell 2001:19).

**Figure 3. VC industry 1999**



***Industry performance summary as at June 2000***

The Australian Bureau of Statistics, (ABS 2001: *passim*) in its first ever survey of the asset class, provided the following figures on the state of the Australian venture capital industry at the close of the 1999/2000 financial year.

- Investors had committed \$4.9 billion to venture capital investment vehicles including \$2.3 billion in commitments for future investment.
- The value of investments in venture capital investment vehicles was \$2.6 billion at 30 June 2000.
- The survey identified 97 active venture capital managers, who managed 123 investment vehicles.
- The 123 investment vehicles had 569 investments in investee companies.
- There was \$666 million invested in new projects during the 1999–2000 financial year with additional investments in existing projects of \$163 million, giving a total of \$829 million invested in venture capital projects in the year.
- The value of exits from existing investments during the year was \$536 million.
- There was venture capital investment in a wide range of industries and activities; including investment in manufacturing projects of \$568 million; property and business services projects of \$440 million in a total project value of \$2.3 billion.
- Australian superannuation funds were the largest investors in venture capital vehicles. 35% of the \$4.9 billion committed at the end of the financial year came from Australian superannuation funds.

## **Current industry framework: major stakeholders and programs**

### ***VC funds targeting institutional investors***

Institutions (with or without the advice of asset consultants) either invest directly into an independent fund or through a fund of funds. In Australia the major industry superannuation funds have put together the *Development Australia Fund* which in turn allocates money to VC managers.

The independent fund structure employs a structure designed to emulate the best features of the limited partnership model that predominates in the USA. It is typically a 10-year, unlisted terminating fund. The venture capital manager is generally allowed five years to make investments and then in the second five years the manager is expected to divest the portfolio. A typical portfolio will have some 15 investments. Funding is drawn down as when it is required and when the divestment occurs both the principal and harvest are returned to the investors. This is done to maximise the IRR, which is the key metric in venture capital.

The manager earns fees in two ways. First there is a management fee usually paid quarterly and paid as a percentage of committed capital in the range of 1.5% – 2.5% per annum for the first five years. In the second five years a typical structure is to have declining fees based on invested capital. The fees are paid via quarterly calls. Second there is the performance incentive. This is typically 20% of the excess return defined as the principal invested plus fees indexed by some factor such as the 10-year commonwealth bond rate. The managers only get the performance incentive after the investors have received all their indexed capital back and the first part of the performance incentive is generally only paid in years seven and eight.

To see how this operates consider *St. George Development Capital*, the first fund managed by Nanyang Ventures, which started in April 1996 with a \$20 million investment by St. George Bank. Over the life of the fund \$3.5 million will be paid in management fees leaving \$16.5 million for investment. The fund invested \$15.9 million in 11 companies by October 1999. The current valuation of the portfolio is \$42 million and management expects the fund achieve a value of around \$70 million. The application of the indexation factor (the All-Industrials Accumulation Index) to the fees and principal totals \$33 million leaving \$37 million as the excess harvest. 20% of this or around \$7.4 million will go to the fund manager, Nanyang. Thus over the life of the fund the management fee of \$3.5 million represents around one-third of the total expected compensation.

### ***Corporate VC funds***

Corporate VC funds have had a checkered history. In Australia there have been several attempts such as Apple and the Telstra Product Development Fund. Typically, a corporate fund is announced with considerable media hyperbole. Several investments are made and then after about four years the fund is quietly terminated. There are a number of problems. A key question is whether the manager should be independent or a captive internal group. Captive managers in venture capital do not generally work. Corporations find it difficult to pay compensation schemes comparable to those of independent VC managers. This leads to frequent staff turnover. There is also a lack of autonomy as

capital requests typically have to go to a meeting of the full board of the company for approval. Another problem is that few Chief Executive Officers (CEOs), last 10 years, the normal life of a VC fund. The 'brilliant strategic opportunity' becomes the previous CEO's pet project. Corporations can change their strategic focus several times in a 10-year period. Finally, there is always a legitimate question as to whether corporations should be using capital in this way. The traditional argument for the 'no' case is that, if corporations have excess capital, they should return it to their shareholders. The usual argument in favour of corporate venturing is that it is a form of strategic insurance.

### ***Retail VC funds***

Another class of VC funds are entities listed on the stock market. Retail investors generally prefer listed vehicles. They find unlisted funds with no returns for at least five years and no liquidity to be unattractive investments.

### ***PDF (Pooled Development Fund) program***

The PDF program is arguably the most important ingredient in Australia's current VC industry mix. Government sponsored, the PDFs were first announced in the February 1992 *Economic Statement* (subsequently modified in 1994). The aim was to replace the MIC program (which expired in June 1991) and encourage investment in new and growing companies by offering taxation advantages. The principal benefits areas were originally as follows. For the company: 15% tax on dividends; 15% tax on capital gains; 25% tax on interest income (all compared with the normal company tax rate of 36%). For the shareholders (investors): tax exemption for unfranked dividends; tax exemption or imputation credits for franked dividends; tax exemption for capital gains on disposal of shares in the company. In return for these benefits, there are some limitations. Investment is not allowed in retail or property sectors. Investee companies must not have assets in excess of \$50 million at time of initial investment. At least 65% of any capital raised must be invested within five years of that raising. No more than 30% of capital raised can be invested in one company. Capital invested originally could not be returned to investors until the company was wound up. A subsequent change, allowing buyback by a company of its shares, enables investors to obtain a full recoupment at any stage of fund evolution. Debt funding and pseudo-equity are not permitted. Investment must be in new equity, not pre-owned.

At first, the PDFs were used as mechanism for investing in small listed equities, mainly in the resources area. However, several venture capital fund managers (including Greenchip and Hambro Grantham) have chosen the PDF structure. In April 1996, St. George Bank, making use of the ability of a bank to own 100% of a PDF, set up *St. George Development Capital Limited* and appointed Nanyang Ventures as its manager. This was the first 100% bank-owned PDF in Australia.

In 1999, after a survey of industry participants, the Government announced several key amendments. First it allowed PDFs to buy back their shares. PDFs could now emulate the best practise institutional fund structure. In addition, superfunds who invest in PDFs will, effectively, enjoy a rebate of the 15% tax paid by PDFs they support. In November 1999, *St. George Development Capital II* closed with \$64 million raised from seven financial institutions. This was the first institutional-only PDF in Australia. There are currently 90 registered PDFs that have raised an estimated \$420 million. Over \$215

million has been invested in about 200 small-medium sized enterprises (SMEs). The government endeavours to keep the program relevant to the marketplace by instituting adaptive changes when it deems them necessary.

### ***IIF (Innovation Investment Fund) program***

Another government initiative, the Innovation Investment Fund (IIF) program for providing early stage capital was announced in the May 1997 Federal Budget. The genesis of the program was an analysis conducted by Professor Gordon Murray, a respected European academic analyst of early-stage funds. The IIF program aims to create a self-sustaining, Australian, early stage, technology-based venture capital market and to improve the commercialisation outcomes of Australia's strong Research and Development (R&D) capabilities. The first stage of the IIF was to provide \$130 million on a 2:1 basis with private-sector capital, thereby creating potential funding of \$195 million. Five IIF licences were handed out in December 1997. Since then another eight have been issued. IIF funds are restricted to investing in companies that are commercialising innovative technology, with an annual revenue of \$4 million or less, averaged over the past two years, and a maximum of \$5 million in any one year. Investments will be in the form of equity. Distribution of returns will be made in the following order.

1. Government and private capital (pro-rata) indexed to the Long Term Bond Rate.
2. Of the funds remaining, 10% will go to Government and 90% to the private investors; and 20% of the private distribution will be retained by the fund manager provided they achieve a hurdle rate of return greater than the Long Term Bond Rate.
3. Effectively, an IIF investor gets 70% of the return for taking at least one-third of the risk.

### ***Other government programs and initiatives***

This paper simply does not have scope to comprehensively list – let alone analyse – the vast legion of state and federal government programs that directly or indirectly impact the venture capital industry. The most important reference is the Department of Industry Science and Resources publication entitled, *Commonwealth and State Government Programs Supporting Innovation in Firms* (DISR 1999). However, particular mention should be made of the Howard Government's *Plan for Australian Industry* (Commonwealth of Australia 1997) which recognised the key role played by the Department of Industry, Science and Resources (DISR). DISR is the most important government agency directly impacting the venture capital industry. It has a broad portfolio of responsibilities with the following general aims.

- Improving national prosperity and wellbeing.
- Improving the competitiveness of Australian business.
- Fostering excellence in Australian science, technology and sport.
- Maximising the national benefits of research and innovation.
- Increasing productivity investment in Australia.

These aims are intended to foster economic advantages and scientific achievements that continue to strengthen Australia's international competitiveness. Also, DISR is aiming to strengthen Australia's national system of science and innovation.

These overarching aims are promulgated through a large number of instrumentalities and programs. These include:

- AusIndustry;
- Australian Government Analytical Laboratories (AGAL);
- Australian Surveying and Land Information Group (AUSLIG);
- Ionospheric Prediction Service (IPS);
- IP Australia;
- Commonwealth Scientific and Industrial Research Organisation (CSIRO).

### ***The industry association: AVCAL***

AVCAL, the *Australian Venture Capital Association Limited* (website [www.avcal.com.au](http://www.avcal.com.au)) is the peak industry body of the Australian venture capital industry. Membership of the association comprises venture capital firms (over 100 corporate members at time of writing), banks, incubators, angels, corporate advisers, Information Technology and Telecommunication (IT&T) companies, accountants, lawyers, government bodies, academic institutions and other service providers to the industry. AVCAL was established in 1992 as a forum for the industry participants to meet, to pursue topics of common interest, to promote the local venture capital industry and to encourage investment in growing business enterprises. In October 1995, AVCAL appointed its first Executive Director to raise the profile of the venture capital sector with Governments and industry, and to build a strong industry association. This role has been continued with the appointment of Andrew Green as the second Executive Director in 1999.

AVCAL's mission is to create a world-best environment in Australia for venture capital and entrepreneurship. Creating an awareness of the returns institutions can receive by investment in venture capital funds, and encouraging them to include a venture capital weighting in their portfolio at levels similar to that in comparable markets. A list of significant activities includes: information collection and dissemination; publication and conferences; lobbying; and standard setting.

### ***Media***

Venture capital is now regularly discussed and criticised in the general business press, particularly the *Australian Financial Review*. Victor Bivell, the owner of Pollitecon Publications, is the editor and publisher of the industry's trade magazine, *Australian Venture Capital Journal*. This is published monthly. Every year the same organisation produces the *Australian Venture Capital Guide* (now in its eighth edition). The guide attempts to list all sources of private equity and related financing for growth companies.

An increasingly important channel of information distribution is *Venturelink* ([www.venturelink.net](http://www.venturelink.net)). It was commenced as a labour of love by graduates of the Master of Entrepreneurship and Innovation (MEI) program at Swinburne University of Technology's Australian Graduate School of Entrepreneurship. The network has

expanded rapidly beyond its original alumni focus, attracting growing membership and sponsorship. *Venturelink* has a broad, inclusive mission to become the 'first portal of call'<sup>1</sup> for all matters pertaining to Australian entrepreneurship. It provides information and links to a wide variety of sources and sites germane to Australian venture capital.

### ***Industry measurement and research***

Very recently, the Australian Bureau of Statistics (ABS) (see above) has undertaken a survey of venture capital at the request of the Department of Industry, Science and Resources. The request was prompted by changes in tax regimes for venture capital investment announced as part of the 1999 budget. There had been considerable concern that existing venture capital data (mostly ad hoc surveys using convenience samples) suffered from lack of clarity in the concepts and constructs employed and from inadequate response rates. ABS conducted its inaugural survey with respect of the year ended June 2000. This followed a feasibility study, during which a number of venture capital practitioners, industry researchers, academics, and policy analysts were consulted. The survey concepts and questionnaire were developed by ABS in consultation with users, industry bodies and data providers. Considerable assistance to the ABS was provided by the Department of Communications, Information Technology and the Arts. If the survey can become established on a regular basis it will form a solid base for the commencement of sophisticated venture capital research in Australia.

This first survey presented a significant challenge to both ABS and data providers. Concepts employed were synthesised from terms used in the industry. Frequently the same form of words has different nuances. Many differences make it hard to standardise an approach. For instance, accounting treatments, valuation practises, methods of operation can vary from firm to firm. There are some differences between industry and the criteria used to evaluate projects applying for government assistance. ABS discovered what the industry has long known: the term 'venture capital' and associated data concepts have a range of meanings for a range of audiences. In its survey, ABS gave self-description precedence over administratively based definitions. So, there may be inconsistencies in the dataset as a result. However, detailed analysis of the dataset can provide a view appropriate for policy purposes. And the interest and intended commitment to regular surveying by ABS definitely represents a coming of age in the industry. It is possible that the annual AVCAL survey of its members and the surveys commissioned by the *Australian Venture Capital Journal* could become structured subsets of an annual comprehensive survey of the industry by the ABS.

University interest in venture capital is developing strongly but is largely unsupported by any corporate interest. The University of South Australia is committed to a program which aims eventually to ensure that *every* student in *whatever* program does at least one course in entrepreneurship. RMIT University started an undergraduate entrepreneurship degree in 2001. For several years, Queensland University of Technology has been the heart and soul of promoting Moot Corp's Business Planning Competition. In the year 2000, this international competition was won by an Australian team from Bond University and the Australian Team from Swinburne came third – a truly remarkable performance. The biggest research program in entrepreneurship is housed at

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<sup>1</sup> A phrase first coined by Venturelink founder Author B.

Melbourne's Swinburne University of Technology, home of the Australian Graduate School of Entrepreneurship (AGSE). AGSE has a 15-year history of developing specialist programs in entrepreneurship education and research. Originally, the focus was centered upon the Master of Entrepreneurship and Innovation degree (an alternative to the MBA). Now, there is equal emphasis on developing a world-class research program hoping to include a strong strand of venture capital research. Its biggest single project, sponsored by Yellow Pages®, is the Australian component of the *Global Entrepreneurship Monitor* (GEM) project. This annual monitor of the entrepreneurial propensities and performance of participating nations has grown rapidly. Ten countries took part in 1999; 21 (including Australia – see Hindle and Rushworth 2000) in 2000; 29 are participating in 2001. Using identical methodology each country produces an annual national report and a global executive report summarises the international lessons. Importantly, the 2000 *GEM Executive Report* (Reynolds et al 2000) included an international comparison of the venture capital industries of 19 participating countries. This comparison will be continued in future years.

## **Critique: what has history taught us?**

### ***Overview***

It is obviously beyond the scope of this paper to provide a detailed critique of every stakeholder and initiative comprising the past evolution and present framework of the Australian VC industry. The authors have selected the following 'mighty handful' as the most important areas for critical commentary.

- Retail venture capital funds.
- Government initiatives in general.
- Specific lessons from the MIC program.
- Comparison of the Australian with international VC industries.
- The low volume of systematic research and analysis.

### ***Retail VC funds***

As the person who raised the first listed venture capital fund in Australia, BT Innovation Limited with 1600 shareholders, one of the authors, has formed a strong personal view that retail VC funds should be avoided at all costs.

As noted above, an institutional fund makes calls on its investors for both quarterly management fees and investments. Typically a 10-year fund with say 15 investments will make some 60 calls over the life of the fund. This is done to maximise the IRR. However for a retail investor this process would be a nightmare. Typically subscriptions are done in one or two calls. So, while the prospectus of a retail fund will quote the IRRs made by institutional funds, a one-call structure alone means the IRR will be much lower.

Retail investors need liquidity; institutions have the time and incoming cash flow to participate in 10-year liquidating funds. Listed funds, however, generally trade at significant discounts to their Net Tangible Asset (NTA) per share valuations, VC funds particularly do so. Lion Selection Group, a PDF that specialises in the mining industry and is very well run with experienced managers was recently trading at a 25% discount to

its stated net tangible asset backing of \$1.13 per share. This is because the NTA of the fund comprise shares in companies with substantial intangibles/blue sky and limited liquidity.

Finally, in venture capital the lemons fall before the plums. Unsuccessful investments go under while successful ones grow in value and are kept in the portfolio. Hence with semi-annual reporting and continuous disclosure a listed VC fund for first three or four years is reporting losses. This again drives the share price down. The only argument for listed VC funds is that for new structures they are generally the only way to go. In the USA the first Small Business Investment Companies (SBICs) were listed and in Australia the first MICs and PDFs were listed. Some retail investors have an appetite for risk much greater than the institutions. Unfortunately, they are often speculators with short time horizons. The returns to share holders in retail VC funds have been mixed at best.

### ***Government initiatives in general***

The most efficient venture capital decisions for the economy will be made by investors risking capital to back entrepreneurs in whom they believe, in a market they think will be substantial and with a reward that is commensurate with the risk, compared to other opportunities. The authors are in fundamental agreement with Thomas Jefferson who said the best role of government in commerce is to set up some minimal rules of the game and let the private players play. However, setting up rules of the game is a complex activity and demands constructive dialogue between the public and private sectors, not a lazy form of *laissez faire*.

A major mistake a government can take is to *distort* the taxation system with quick fix benefits rather than *adapting* it to the real life-cycles of genuine entrepreneurial firms. Up-front deduction schemes can be particularly distorting and only marginally helpful to the right firms at the right stage of growth. It is really amazing how fast the Australian merchant banking community can make use of a tax loophole and the funds they can pass through it. One of the best/worst examples was the highly complex 150% Research and Development Tax Deduction/Syndication scheme. This started in 1989 and by 1993 had grown to a three billion dollar industry. One of the authors participated in syndicate number three of the scheme, in 1989. This was only for \$20 million. The whole structure made scheme promoters a great deal of money and delivered totally risk free tax deductions to the banks but helped the R&D effort of growing firms very little. Given the projects such as this, the Howard government's decision first to abolish the more outlandish schemes and secondly reduce the R&D tax deduction to 125% was understandable. Many have argued that the R&D deduction should be reduced to 100% because the deduction is really only of help to multi-nationals who spend most of the time trying to persuade government bureaucrats that a non-R&D expenditure *is* one so as to gain the tax shelter. Most early-stage, growing companies make only marginal profits at best. So a tax deduction of this nature (as distinct from a proper appreciation of the incentive role of well-structured income and capital gains tax regimes) is of little benefit to true entrepreneurs.

The second mistake made by governments has been to invest directly in young companies. Such direct involvement in investments by government substitutes the wisdom of a few for the collective wisdom of the many in the market. Moreover, direct

government investment not only competes with and discourages private venture capital, but the decision-making processes of agencies of any government are inevitably laden with considerations concerned more with stopping bad publicity rather than maximising the chances the company will succeed in its chosen market.

Of course market failure is the cri-de-coeur of the socialist and hence they generally create the biggest investment failures. A good example of this phenomenon was the Victorian Economic Development Corporation (VEDC). In the mid-1980s this state owned corporation achieved the goal of making Victoria a no-go area for venture capitalists. One of the authors remembers three prospective investee companies in Victoria all of whom turned down his offer of \$2 million equity and instead took an unsecured loan from the VEDC. What happened was tragedy when VEDC was put into receivership several years later. The receiver then started calling in the loans. All these companies were growing (even in the midst of the recession) and were capital constrained. Now they needed \$4 – \$5 million, \$2 million to pay back the VEDC and \$2 – \$3 million for growth. The capital was unavailable and all three companies went into liquidation. The best history of failure and warning against its re-creation is contained in a contemporary document. Fergus Ryan wrote an excellent report on the VEDC (Ryan 1999: *passim*).

With respect to other government initiatives, Hindle and Mitchell (2001) have provided a critique of five entrepreneurship-fostering programs within the AusIndustry portfolio. Their main critique is that bureaucratic policy makers are well-motivated but lack the diversity of perspective needed to provide appropriate policy initiatives for the industry. They summarise the contribution of the programs they studied to venture capital and entrepreneurship as follows.

*‘We would propose that Australian Federal agencies look at policy formulation in this area through a new set of lenses. The first change should be a recognition of the difference between entrepreneurship and innovation. While policy documents are full of references to innovation, the actual implementation ends up being focussed on technology push. We would propose that new programs be developed that recognise that there are multiple frameworks for looking at the process of new venture development..’* (Hindle and Mitchell 2001: 14).

### ***Specific lessons from the MIC program: a classic case of agency capture***

The MIC program remains Australia’s best historical classroom when it comes to learning lessons about most aspects of developing a national venture capital industry.

There were many weaknesses in the MIC program. Bill Ferris (Ferris 2000: 100) has captured the essence of most of them: sheer restriction of possibility.

*‘...with the benefit of hindsight, the architecture of the MIC scheme was fundamentally flawed...the restrictions on how the money could be invested virtually guaranteed future failure. Only investments in early-stage technology companies were permitted; since a maximum investment for most MIC funds was only about \$1 million in any one investee, most of the MICs developed extremely high risk portfolios with no capacity for follow-on support investing’.*

Two key lessons remain to be articulated. First is that the MIC program offered its strongest appeal to retail investors because its prime benefit was a 100% tax deduction on capital subscribed. This was a major flaw because retail investors are, on the whole, the

wrong type for venture capital involvement. However, the second problem, not stated in most analyses of the MIC program is a greater evil. The MIC program suffered from the classic problem known as ‘agency capture’.

One of the authors worked as consultant on a team engaged in applying for an MIC licence. The fundamental reason for the applicants’ interest in obtaining the licence was the feeling that it would be joining an ‘exclusive club’ which could potentially dominate an asset category. Subsequently, as an advisor to two MIC Licencees he saw many manifestations of the negative aspects of this exclusivity syndrome. The other author of this paper experienced the same undesirable sentiment even more poignantly. In May 1984 he worked at BT Innovations, one of the seven successful applicants for the MIC Licence. He was charged with raising the money and adopted a strategy totally aimed at the high income-earning individual taxed at the then 60% marginal tax rate. On June 30, 1984, BT Innovation was the first and only MIC that had fully raised its \$10 million funding. Its structure of a listed retail fund became the norm for the rest of the MICs who all then went that route. In late July the first meeting of the newly appointed MIC managers was held with the MIC Licensing Board. Prior to the meeting, the MIC managers got together for lunch. Within five minutes the discussion shifted to how could the incumbent MICs prevent any more licences being handed out. The scenario was straight out of Adam Smith.

*‘People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in conspiracy against the public, or in some contrivance to raise prices’.* (Smith 1952/1776).

The author disagreed and said MIC firms should take the opposite tack. He contended that they should lobby to have as many licences handed out as possible in order to replace those managers that would fail. He then made the prediction that over half of the managers sitting around the luncheon table would not be around in five years. (In passing, the author confesses his pride in his belief that this was one of the few five-year forecasts made by a formally trained economist that has ever actually come true). The result was that he was given the cold shoulder and never invited to lunch again.

Unfortunately, the incumbent MICs did manage to restrict the issue new MIC licences to three. No new MICs entered the market after the second year. The performance of many of the MIC managers was in line with industry norms and the reputation of the whole program suffered. The lack of dynamic domestic rivalry in an industry generally leads to insularity and failure. And so it was with the MIC program.

### ***Comparison with international VC industries***

Writing in a special appendix to the *Global Entrepreneurship Monitor 2000 Executive Report* (Reynolds et al 2000: 48), Bill Bygrave argued:

*‘By almost any measure, 1999 was the most spectacular year ever for the professional venture capital industry. In the US, \$46 billion was invested, a 150% increase over 1998 investments and more than 8 times the amount invested in 1995. In Europe, approximately \$10.8 billion was invested, an 84% increase over 1998 and more than five times the amount invested in 1995. And 1999 was a very good year for venture capital investments in Asia, Australia, and Canada. Through the first half of 2000, venture capital investments continued to set new records in the USA and Europe. The*

amount invested in the USA more than doubled over the same period in 1999, while Germany's investments were up more than 78 %.

To facilitate comparisons among GEM nations, the amount of venture capital invested domestically was calculated as a proportion of GDP for each country. Chart 2 of this paper reproduces figure 19 of the Global GEM study (Reynolds et al 2000: 49).

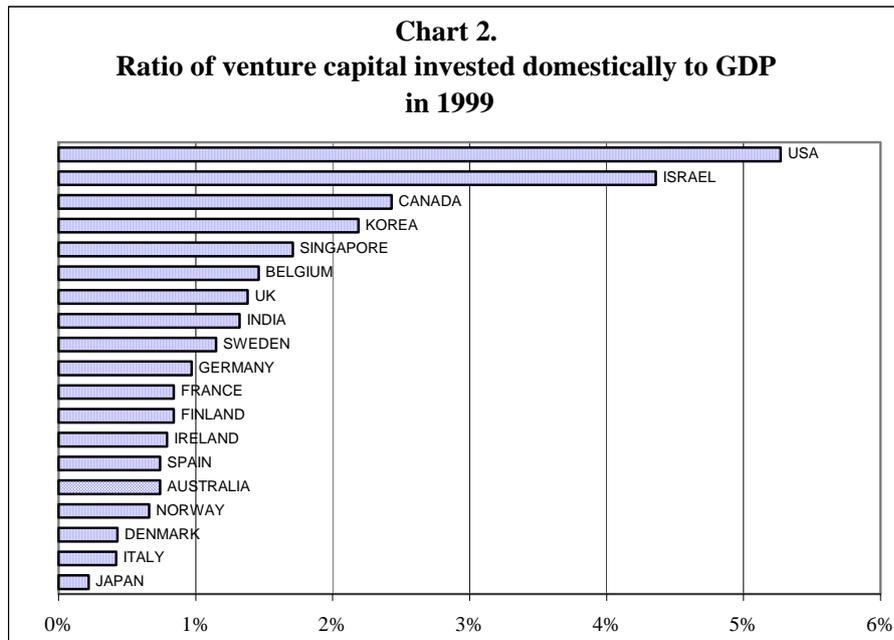


Chart 2 is a reproduction of GEM 2000's Figure 19.  
(Source Reynolds et al 2000: 49)

On ratio of venture capital invested domestically as a percentage of GDP, Australia ranked fifth last among the 19 countries measured. The value of US domestic venture capital investments represents well over 5% of national GDP. In Australia, the figure is well less than 1% of GDP. Australia ranked even worse – third last among the 19 measured nations – on its '*ratio of venture capital invested domestically in all stages of information technology companies to GDP*'. This is depicted in chart 3, which reproduces figure 21 of the Global GEM study (Reynolds et al 2000: 50).

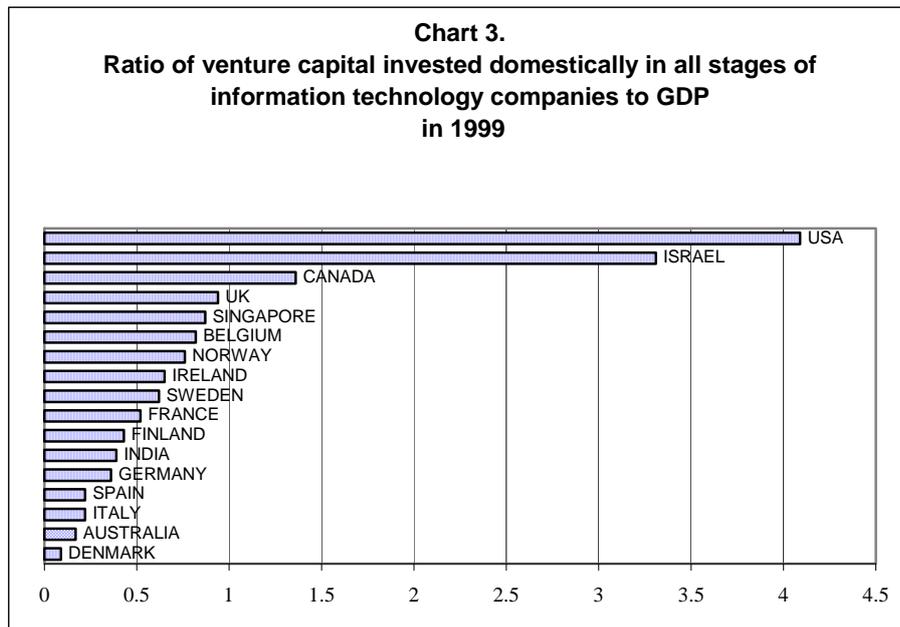


Chart 3 is a reproduction of GEM 2000's Figure 20.  
 (Source: Reynolds et al 2000: 50)

These graphs of international relativity really help to put the Australian venture capital industry into perspective. The industry may well congratulate itself for coming back from the near dead in the early 1990s. However, when VC is placed in the perspective of the total economy, it is clear that the industry is far less significant in this country than it is in many other nations. For instance, India, a later starter in the game and a country with vast socio-economic problems, has a far better developed venture capital industry than Australia. The Australian VC industry is far less significant than it should be if any of our multitudinous rhetoric about being an 'enterprising nation' or a 'clever country' and the like is ever to bear any relation to measured reality. *The Australian Global Entrepreneurship Monitor 2000* report (Hindle and Rushworth 2000: *passim*) demonstrated that we are great starters of new ventures (fourth among participating countries on this metric). But we are bad at creating and sustaining the kind of ventures – high-growth, high-technology, high-employment – that the country needs the most. This is the most important socio-economic role of a venture capital industry: facilitation of genuine entrepreneurship resulting in high-employing, world-competitive ventures. Measured by this standard, the industry is very immature. Tiny Israel, amid all its domestic and international problems, has managed to create a world class venture capital industry in a very short span of years. After the USA, Israel produces the highest number of annual NASDAQ listings of any company. True, Israel has three possibly unique drivers of venture capital success: the world's highest proportion of engineers in the population; a defence establishment that knows how to collaborate with industry; and very strong links to the New York finance community.

In contrast to Israel, Australia is still prone to employ the comfortable excuses that we are a small country and it is still early days. Well, it is late days and we are underperforming on a world scale (which is the only relevant scale) in applied entrepreneurship and venture capital. The evidence is inescapable.

### ***The low volume of systematic research and analysis***

One reason for this is the low priority accorded to venture capital and entrepreneurship research in this nation. An explanation often offered for the recent collapse in the Australian dollar is that Australia is an old economy compared to the new Internet driven economy of the USA. Such an explanation is symptomatic of the national lack of understanding of the importance of entrepreneurship. It is not the Internet that is the differentiator between the USA and Australia but the embrace of entrepreneurship and venture capital. For example in 1999, 90% of the MBA graduate cohort of Stanford University left to join start-ups; at the London Business School it was one-third, while only one graduate of the New South Wales University's Australian Graduate School of Management (AGSM) followed the entrepreneurial way in 1999. The study of entrepreneurship and venture capital has become a major academic activity overseas with a number of centres being set up over the past 15 years in Europe and the USA. By contrast the topic has had very low profile in Australia. For another example the 1998 Reserve Bank of Australia conference proceedings *Unemployment and the Australian Labour Market* was 366 pages long, but only had three paragraphs on role of entrepreneurs and venture capital in creating employment.

The knowledge, skills and understanding that build from Australia's emerging university initiatives (discussed in a previous section) is very important for the development of the venture capital industry. For example, over 10 graduates of the Swinburne MEI program now work as investment managers. However, with one outstanding exception – the substantial support of Yellow Pages® for the Australian component of the *Global Entrepreneurship Monitor* – industry support for entrepreneurship research in general and venture capital research in particular is still conspicuous by its absence in this nation. Empirical and theoretical investigation of important issues currently has only two strands: the GEM venture capital subset study and sporadic, disconnected, unsupported studies of concerned university researchers. There is no structured program. Swinburne University, through the Australian Graduate School of Entrepreneurship (AGSE), is trying to build a program but there has, to date, been little private sector interest. Is there one venture capital company that has ever given one dollar for Entrepreneurship research in Australia? No. Compare that with the vigorous tradition of scholarship support for research in the USA and in Europe.

One program that is supposed to address this issue largely fails in its avowed mission to commercialize intellectual property. While it may or may not be good at generating new knowledge, the Cooperative Research Centre Program (CRC) has been very ineffective in fostering entrepreneurship (see Hindle and Mitchell 2001). The exception which proves the rule is the Photonics CRC which has spun out one world-class business. However, the program which is well-intentioned and attracts large volumes of government funding is trapped by its own 'hard science/basic research' frame of reference. Social science is excluded from consideration. A recent attempt by a cohort of universities and private organizations to establish an innovation CRC – with the

avowed mission of helping all the other CRCs to commercialise their intellectual property – failed to get to first base in the evaluation process. Unfortunately, CRCs which should include entrepreneurship research in their agendas, are another example of agency capture: the basic research establishment dominates. Commercialisation and entrepreneurship are low priorities.

At the industry level, the scant regard for entrepreneurship research mirrors that of society at large. Serious academic and industrial venture capital research in Australia sadly lags overseas efforts. To date, the industry has not perceived the importance of the gap. It has rested content with very basic (and incomplete) descriptive surveys: ‘who spent what in which sector’. There has been no support for empirical investigation of key processes and issues; no testing of important hypotheses; no private or public financial support for systematic study of any aspect of the industry – even in such basic areas as comparative portfolio evaluation.

In the USA and Europe, venture capital research is a substantial field of academic research and the knowledge produced by that research is regarded as an integral component of the industry. In Australia, venture capital research is in its infancy and the infant is severely undernourished.

### **Future directions: better entrepreneurship through improved provision of venture capital**

#### ***Recommendation limits***

The great temptation at the end of a paper of this nature is to spray forth a legion of unconnected recommendations. Venture capital is an exciting and important field and it is not hard to conceive of hundreds of suggestions that might prove beneficial to the industry and the nation. The authors prefer to err in the other direction and limit their recommendations to just two, one academic and one industrial:

- the need to commission a large-scale analytical history of the VC industry;
- the need to continue to build a constructive consensus between public and private sector policy makers.

#### ***Recommendation 1: commissioning of an analytical history of the Australian VC industry***

General calls for greater research support are usually too vague to have any impact. What is most needed by Australian venture capital scholarship and practise is a seminal work. The field needs a palpable demonstration of the high value of research and critique to industrial development. The authors recommend that industry members commission an analytical history of the venture capital industry in Australia. The work envisaged would embrace the following areas.

- It would ensure a systematic collection, archiving and review of major primary source documents – some now in danger of being lost forever.
- It would demand close liaison with the Australian Bureau of Statistics with respect to establishing the parameters of a national VC database.

- It would tell a great story – the detailed narrative of industry evolution – to a wide range of audiences now ignorant of one of the most important social phenomena in national life.
- It should embrace several forms of economic and social evaluation of the industry – especially comparative portfolio analysis and impact studies of the value of VC-backed firms to the nation.
- It should embrace numerous relevant sub-studies including quantitative and qualitative research projects on key topics such as: analysis of investment decision-making techniques; forms of organisation of both VC companies and the funds they manage, education and development of industry professionals.
- It should articulate an appropriate agenda of applied research aimed at answering the questions of most importance to the industry's future.
- It would form the evidential basis for informed policy debate.

A well-written, critical history going well beyond mere narrative into the realms of explanation and direction setting would have many tangible benefits. It would invigorate the intellectual rigor of the industry, inform the policy debate and help to unify private sector, public sector and academic understanding of the importance of venture capital to national destiny in the 21<sup>st</sup> century. Best of all, it would be a very affordable project. A small levy on a few firms or a generous donation from one would be likely to be backed by government funds in the form of a SPIRT grant or similar. A small, affordable initiative could have a substantial effect.

***Recommendation 2: continuing a consensus for constructive, sustained government involvement***

There are some accelerators that governments can provide for venture capital without being so intrusive as to spoil the game. One is to jump-start the flow of venture capital by lending money to or becoming limited shareholders in entrepreneurial venture capital firms that meet certain qualifications, including raising private money, but to let capital-risking private managers make the decisions as to where to invest the time and money. This was done, more or less successfully, in the USA in 1958 with the SBIC program and helped start venture capital as an eventually privately financed asset class. The Federal Government has followed this path with the IIF program and all the indications are that this, of all the Australian VC programs, is the structure that will meet with the best success. Already the Federal Government has followed up the first five licences with a second round. Also two specialist funds – one for renewable energy and the other for biotechnology – are underway.

In any discussion of venture capital, it is important to remember that the enabling of entrepreneurs is the primary goal. There are several social and economic conditions other than available venture capital that must be present for entrepreneurs to thrive, so that promoting venture capital without helping to create those other conditions not already present will fail to produce significant results. Of these the most critical is the rate of capital gains tax for both entrepreneurs and investors. Besides moderate to low tax rates, other factors required to promote entrepreneurship are:

- an emphasis on equity as a means of financing;
- an effective stock market for smaller companies;
- a pool of talent and knowledge in science, technology and business;
- the availability of large markets;
- a minimum of regulatory activity by governments, and
- a public appreciation of the importance of entrepreneurs in the society.

The first four are either in place or have been introduced by the Federal Government. The Internet and the 747 between them are eliminating the tyranny of distance. The reduction of regulatory activity will depend on the State governments. It is to be hoped that the natural competitive drive of State Governments to make their state more industry-attractive will not prevent the creation of beneficial, uniform initiatives. Greater public appreciation of the importance of true entrepreneurs in Australian society will take time, because it is a cultural issue. The keys will be education – getting entrepreneurship onto school curricula – and an improvement in media commitment to the positive aspects of socially-beneficial entrepreneurship.

The final sections of the *GEM Australia 2000* report (Hindle and Rushworth 2000: 42–46) articulated some sensible policy directions. What they boil down to is the same argument made in this paper. The essential ingredient to national progress in venture capital and entrepreneurship is simply open-minded intelligence. We live in a mixed economy. Ignorant, *laissez-faire* braying about minimising government interference is as unhelpful as socialist belief that government should be a direct investor and portfolio manager. What is required is a consensus for informed mutual participation in the national interest. We conclude this paper with a demonstration that, in Australia, this is possible, not only at the level of industry to government but at the level of individual to government.

### **Healthy prognosis: a case study of constructive involvement**

In November 23, 1998 the first Ralph Report, *A Strong Foundation*, was released. It was almost totally directed at an audience of large corporations. In absolute frustration one of the authors of this paper, decided to act. Author A went along to his local MP, Tony Abbot, in January 1999, mapped out the problem and asked for help. Tony Abbot, sitting in his surgery on Manly beach, handling a mixed queue of surfers and eclectic humanity was incredibly helpful. After Author A explained the problem, Abbot laid out a three-point plan.

First he said, Author A had to get an article in the *Financial Review*. Abbot said that Senator Alston (Minister for Communications) had just written an article arguing for tax breaks for the IT industry. Abbot suggested Author A write one in reply. This was achieved and published. The second step was that, armed with this article, Tony Abbot had the leverage to get Author A in front of a chief ministerial adviser. Abbot's comment was straight out of *Yes Minister*.

'Don't bother lobbying ministers', he said, 'they will never remember you. You must get to a chief adviser'.

Anyway, Abbot secured Author A a meeting with David Hickman, who was the chief adviser to Minister Peter Reith, an influential senior minister whose department would have significant input in drafting the legislative changes flowing from the Ralph

report. Abbot then revealed the third ingredient. Author A needed to present a 20–page brief arguing his case at that meeting. Abbot suggested that a hired think-tank should prepare the brief. Not having the resources for such an expensive exercise in professional lobbying, Author A decided that he had had enough training in economics to do it himself – with a little help from his friends.

Over six weekends, as they played their usual game at the local golf club, Author A bounced more than a little white ball along the fairways. His playing partner was a professional taxation expert. Author A bounced his developing arguments off his friend. Author A finally handed the report to ministerial advisor Hickman in April 1999. Hickman started skimming it and then after a 10-minute read said it was very good and promised to make sure it was circulated in the right places. In June 1999 Author A was then invited to participate in a conference organised by Senator Alston’s office with important Treasury officials. It lasted three hours: two of which were consumed with Author A arguing with the three Treasury representatives. They finally asked if Author A would give up averaging and indexation for major cut in the Capital Gains Tax rate. Author A said:

*‘Yes I will. And you know it will be the right decision, as the accountants will immediately start complaining’.*

So it came about that a major impediment to the expansion of the VC industry, the old punitive capital gains tax regime, was to be overhauled. Of course, as the ancient Greeks knew, victory has many generals while defeat is an orphan. Dr Paul Twomey, the recent CEO of the National Office for the Information Economy, was a vital actor. Twomey was instrumental in shepherding through the change. Twomey’s reports (that he kindly asked Author A to vet) were vital to the passage of the ultimate legislation. The rest, as the saying goes is history: significant history for the Australian venture capital industry, Australian entrepreneurship and the nation at large.

Thus, this paper ends on a very positive note concerning the future development of the Australian venture capital industry. There is something very good about a country and a political system that allows grass roots individuals the ability to argue and push through major structural economic reform. In particular, this success indicates the practical importance that a future program of structured research might have for the productive development of venture capital and entrepreneurship in Australia. In this case, knowledge truly *was* power.

The authors contend that, if the lessons of history are heeded, Australia has the capacity to form a consensus for developing a VC industry that is both fiercely competitive and in the national interest. To do so is not a paradox. It is a necessity. However, we cannot read the lessons of a largely unwritten history, build good programs on bad data or base superior practise on inferior theory. We need a structured program of multi-disciplinary venture capital research, starting with the commissioning of a detailed analytical history of the industry. This work can then become just one of the texts in an even more important program: a national commitment to entrepreneurship education that goes beyond business schools to education at every level. Research and education are the major priorities and essential predicates of a constructive future for the Australian venture capital industry and the entrepreneurs it exists to serve.

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