

**ADDRESS TO New Zealand Private Equity & Venture Capital Association Inc CONFERENCE
2016**

(INNOVATION AND FUTURE PROSPERITY)

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Check against delivery

Introductory Remarks

Thanks to Matt Riley and Colin McKinnon.

My first visit to NZVCA was in 2004 when David Plummer was the only LP in a room of about 30 or 40. NZVCA has a great history of advocacy on behalf of the venture capital and private equity sectors. You play a significant role in influencing government to establish the right framework and incentives for investments.

New Zealand has been an early mover in crowd funding and has a strong core of investors involved in angel networks and funds which are driving a vibrant start-up eco-system. NZVCA is also a key part of this start-up story, the success of which is now gaining the global attention it deserves. I am a big fan of the New Zealand start-up scene and the great results being seen as a result of a determination to not just succeed, but to succeed globally. The limitations presented by a small domestic economy in a perverse way explains this success, but remarkable all the same.

Examples such as:

- Xero, the cloud accounting software company in which Peter Thiel – co-founder of paypal - was a major investor – is now listed on both the ASX and NZX – valued at over \$2billion; and
- 90 seconds, the Auckland based corporate-video market place, which in April 2016 announced it was doubling its staff and opening new offices in the US, Europe and Asia after raising \$10 million from new investors including Sequoia Capital.

- 9 Spokes, a portal allowing SMEs to aggregate their different cloud computing applications in one place. Successfully listed on the ASX to raise \$25 million.

And at last night's Prime Minister's Prizes for Science, the Prize for Innovation went to Professor Michael Aitken from the Capital Markets Cooperative Research Centre for his work to reduce fraud and increase efficiency in global stock markets. He sold the SMARTS platform to NASDAQ and 40 exchanges worldwide; reduced insider trading by 26% in Europe alone and started a VC fund.

I'm sure you'd all know better than I that there are some great stories about innovative companies coming out of both our countries. These types of successes are important, and not merely for the founders, investors and end-users of innovative new products or services, but for the messages and signals regarding the trajectory of the national economy as a whole.

Innovation will play an increasingly vital role in securing and maintaining the economic growth and individual prosperity to which countries like New Zealand and Australia have become accustomed. And governments around the world, particularly those overseeing advanced economies, are now grappling with how they can best encourage and harness innovation.

The NZ Government issued a National Statement of Science Investment 2015-2025 and has recently announced its Innovative New Zealand initiative, looking out through to 2020. Minister Joyce's recent announcement of Callaghan Innovation's three new accelerator programmes should assist the next generation of high-tech start-ups creating the right conditions for early-stage businesses to grow, attract capital and generate their own revenue.

Encouraging the development and growth of startups, supporting the commercialisation of publicly-funded research and attracting R&D investment domestically and internationally, these are all important priorities and ones that our countries share in common.

So let me now share with you some of what's going on in this innovation and science space in Australia.

Last year the Australian government announced its National Innovation and Science Agenda (the NISA); a range of 24 measures aimed at encouraging the role of innovation and science in a future Australia. An Australia increasingly in need of knowledge intensive businesses and less dependence on the resources sectors.

One of these measures was to reinvigorate Innovation and Science Australia (ISA), which is an independent statutory board that I Chair, composed of a mix of members drawn from industry and science with extensive experience in innovation and entrepreneurship –this includes Dr Alan Finkel, Australia’s Chief Scientist, is deputy Chair. Australian entrepreneurs and venture capitalists on this board include Scott Farquhar, co-founder of Atlassian, Daniel Petre, Airtree Ventures, Paul Bassat, Seek and Square Peg and Chris Roberts, Cochlear and Resmed.

We have just appointed two new members who will bring an international perspective to the Board: Beth Comstock, Vice Chair of General Electric and based in New York City, responsible for GE’s 120 corporate venturing portfolios and Israeli author Saul Singer who co-wrote “Start-up Nation: The Story of Israel's Economic Miracle.”

Our remit is to advise government on all science, research, and innovation matters – from infrastructure to tax incentives and co-investment, and other support programmes.

A key deliverable for ISA is to develop a strategic plan for improving and enhancing Australia’s innovation, science and research system that reaches out to 2030. This work is already under way with an audit of our existing innovation systems that will be provided to government in December 2016. We intend this to be a public document and its mapping will provide the base line from which our strategic plan will be developed with recommendations to government by October 2017.

The strategic plan is an important and exciting challenge: how should we go about making the case for continuing or perhaps expanding taxpayer support for the type of research that drives a country’s innovation system? And how can we allocate and balance support among competing sectors of the economy to develop a long-term plan for the country? What else can Government do better, in procurement practice, in regulations etc? These are the questions we will be pondering as we develop our advice to government.

The NISA Measures: Tangible Improvements to Australia's Innovation System

Recognising the need for national innovation funding as lifeblood for innovation success, the following initiatives identified as part of the NISA have already been implemented:

1. From July 2016, a new tax-based incentive for angel investors with a 20% non-refundable tax offset for those investing up to \$1 million p.a. in start-ups, and a 10 year CGT exemption for investments held at least 12 months.
2. Plus funding for incubators and accelerators, and five landing pads in Berlin, Singapore, Shanghai, San Francisco and Tel Aviv, to strengthen the start-up entrepreneurial ecosystem. In Australia, from just one or two five years ago, we now have about 40 incubators around the country.
3. New and less restrictive arrangements for VCLPs and ESVCLPs. Partners in new ESVCLPs will receive a 10% non-refundable tax offset on capital invested during the year. The maximum fund size has increased from \$100 million to \$200 million, and there is no longer a requirement to divest from a company when its value exceeds \$250 million.
4. The \$500 million Biomedical Translation Fund was launched in early August. This is a bold co-investment initiative led by Government.

The BTF is designed to assist biotechs and medtechs across the Valley of Death funding problems which hold back the commercialisation effort in the HMR sector. It will provide access to VC and advice to assist in the clinical trials and development of new biomedical products and services beyond proof-of-concept and into the marketplace. \$250 million in government funding will be matched dollar-for-dollar by private sector co-investment, creating a pool of VC of at least \$500 million. Private sector fund managers are right now competitively bidding to manage the money.

The objectives of the BTF are not trivial:

- a) To avoid squandering the stunning discovery platform provided by our internationally competitive HMR sector.

- b) To create jobs and wealth by capturing longer and stronger value from our discoveries and IP i.e. avoid premature bail outs to offshore pharmas, or premature and underfunded IPO's or even forced binning.
- c) To deliver better healthcare and quality of life. For example So Gardasil a great win, the first vaccine against a cancer (cervical); but we need more of these, and more Cochlear and Resmeds and Fibrotech, Spinifex and Hatchtechs.

This HMR sector is already a sector of considerable activity for PE as well in big diagnostics (scanning, radiology and pathology), in aged care, private hospitals and clinics. But in the next 10 to 20 years I believe PE will also need to participate in the development phase of drugs and devices, in clinical genomics and big data analytics if it expects to have a role in the front of this fast moving bus.

- 5. The new CSIRO Innovation Fund which supports early-stage commercialisation of innovations from The Commonwealth Science and Innovation Research Organisation (CSIRO), Australian universities and other publicly funded research bodies. This early-stage innovation fund of about \$200 million will support co-investment in new spin-out/start-up companies with products and services created by Australian research institutions. This fund will comprise \$70 million in new government funding, as well as private sector investment and new revenue from CSIRO's WLAN programme – the godfather project to Wi-Fi.
- 6. And the CEO of the DSTG (Defence Science & Technology Group) recently announced the creation of a Next Generation Technologies Fund of \$700m, targeting partnership for commercialising new products and services for the Defence sector.

In aggregate these initiatives can provide a powerful funding boost to innovation. But in the end it is up to the entrepreneurs and venture capitalists when the rubber hits the innovation road.

So what does all of this Innovation mean for the VC/PE sector? Rubber hits the innovation road

For Private Equity, it will no longer be enough to just go for the low hanging fruit of cost-outs and lazy balance sheets. Big investors will take these pursuits in-house and save the fees. The sustainable PE model in future will be one which seeks out and insists on growth through innovation by its portfolio companies. GPs will look different because they will have more technology engineers than financial engineers, more networks with CTOs and universities than with CFOs and banks.

In my view there is a compelling opportunity for private equity GPs to play a lead role in the take-up of innovation. GPs who on-board VC experience and skills are most likely to succeed in identifying and unlocking the opportunities for their portfolio companies to be disruptors not disrruptees, to drive top line growth via products, process, and/or business model innovation. My prediction is that by 2020, leading GPs will have Directors of Innovation to drive and coordinate the identification and pursuit of premium opportunities... Innovation-intensive firms at the cutting-edge of reconfigured global markets. Their LPs will be delighted to pay internationally competitive fees for this sort of internationally competitive performance.

For Venture Capital, their time has well and truly come, and there is another important and encouraging shift of interest among Australian institutional investors ... as they consider how they can participate in high growth innovation active enterprises. The challenge remains; on the one hand, it does not make sense for a large investor to make lots of separate and small investments in start-ups and series A and B rounds... and on the other hand, very few Venture Capital GPs have sufficient scale of funds under management to enable an investor to subscribe with a cheque size of \$100 million or more to make it worth their while. But in the last two years green shoots in Australia are as follows:

In the world of web-based business models, which can be capital light yet quickly global, offering scalable platforms, a number of sophisticated VCs are enjoying rapid growth. These include Square Peg, Blackbird Ventures, Airtree Ventures and others.

Some of our leading Australian superannuation funds have invested in these VCs. For example, Blackbird Ventures has launched Australia's biggest-ever tech startup fund, backed by First State Super and Hostplus Super, as well as 96 leading technology entrepreneurs. This fund looks to back emerging tech companies that previously may have had to head offshore in search of investment backers.

Daniel Petre and Craig Blair's AirTree Ventures is a \$250m tech fund also backed by two leading Australian superannuation funds. AirTree is having a similar impact in encouraging an Australian startup culture in which relocation to California or New York is no longer a key indicator of success.

I have described the BTF earlier in this speech. While the health and medical research (HMR) sector does offer great investment prospects they normally are capital and time intensive compared to the IT and web-based investment opportunities. The design of the BTF recognised these tougher investment hurdles by providing a 15 year fund life. It is very pleasing to be able to say that a number of institutional and private investors are interested in contributing to this new and bold co-investment fund.

The New Zealand startup and early stage ecosystem certainly punches above its weight. However for the most part capital to support NZ's startup ecosystem has come from family offices and wealthy individuals, as well as overseas VC's. My guess is that, going forward, it will be important for New Zealand's institutional money to participate more fully in the development of the next round of global success stories. Just maybe that is easier if the addressable market is Australia and New Zealand combined. Which reminds me to say that Yasser El-Ansary, from AVCAL, and Colin McKinnon might organise alternate joint conferences.

Concluding remarks

So, in conclusion, I have no doubt that innovation will be an increasingly important future driver of national wealth and prosperity in a rapidly developing and constantly transitioning global economy.

Strengthening our national innovation systems is essential in ensuring that countries like Australia and New Zealand maintain economic growth, job creation and high standards of

living into a future characterised by increasing global economic competition. I also believe that the VC and PE professionals can and must play an increasing role in driving these outcomes.

Nothing ventured, nothing gained!

Thank you.