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Australian Trade and Investment Commission (Austrade)
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Review of Australia's business, investment and talent visas

Thank you for the opportunity to provide input into the review of Australia's business, investment and talent visas. This submission draws on the expertise of the Innovation and Science Australia (ISA) Board and the Innovation Investment Committee (IIC).

ISA is an independent statutory board with responsibility for providing strategic whole-of-government advice to the Government on all science, research and innovation matters. IIC (a committee of ISA) assists ISA to administer the suite of venture capital programmes and provides guidance to the Department of Industry, Innovation and Science throughout the lifecycles of the various programmes. For the venture capital tax concession programmes, namely Venture Capital Limited Partnerships (VCLP), Early Stage Venture Capital Limited Partnerships (ESVCLP), Australian Fund of Funds (AFOF) and Pooled Development Funds (PDF), this includes decisions on registration, and relating to compliance and interpretation of provisions in the relevant Acts.

On behalf of ISA and IIC, we would like to present the following comments and suggestions on the Business Innovation and Investment programme (BIIP). We have structured our submission to address two aspects of the review; those relevant to the visa framework (under the remit of the Department of Immigration and Border Protection - DIBP), and those relevant to the Complying Investment Framework or CIF (under Austrade's remit).

Visa framework

Business Innovation and Investment (BII) visas (subclasses 188 and 888) - general

We are familiar with the BIIP and its visa categories and note the importance of attracting and facilitating entry of global skilled talent and investment into Australia to both support the Australian Innovation, Science and Research (ISR) system and increase Australia's global connectedness. This is particularly important at a time when there is high global competition for skilled talent and investment. We have written to Minister Dutton (26 May 2017) regarding our support for maintaining sufficient flow of international expertise into the Australian ISR system, through the skilled migration visas (including subclass 457).

The letter included concerns regarding reducing the minimum requirement on the permanent employer sponsored skilled migration programme from 50 to 45 years of age as having an

impact on Australia's ability to attract experienced business, management and leadership skills (an identified skills gap area for Australia). This concern also applies to age restrictions on BII visas (Business Innovation stream, Investor stream, and Entrepreneur stream).

Recommendation: Do not vary the current age requirements of BII visas, as any reduction in age may limit the skills and experience of BII visa holders.

Entrepreneur visa

We understand that there has been poor uptake of BII visas under the Entrepreneurs stream, and offer the following suggestions to sharpen the focus to suitable visa candidates. To assist in promoting uptake of this visa stream we recommend expanding the current list of funding agreement providers (for example to include incubators) and maintaining, (rather than increasing), the minimum funding threshold of \$200,000. Raising the limit might act as an additional hurdle to suitable candidates.

Recommendation: Expand the current list of funding agreement providers (for example, to include suitably qualified incubators) and maintain (rather than increase) the funding threshold of \$200,000 for Australian funding providers under the Entrepreneurs stream.

We would also like to suggest that DIBP consider replacing the requirement to provide a business plan as this is not necessarily a proxy for success for a start-up. It could instead be replaced by a focus on prior successful entrepreneurial activities and/or an academic profile that would point to underlying skills to establish, or work in, an organisation that is a start-up. \$200,000 plus the ideas and "sweat equity" is not an insignificant commitment by the entrepreneur in a start-up or early stage innovation venture.

DIBP might also consider improving Entrepreneur stream guidance by providing examples of innovation-related investment areas (for example, beyond introduction of ICT-related applications), in addition to the current guidance on exclusion categories (such as residential real estate).

Significant Investor Visa (SIV)

Broadly speaking, the purpose of the ESVCLP and VCLP programs is to increase the amount of patient risk capital available to eligible Australian businesses. A more fine-grained version of the policy rationale is beyond this submission but the key words – patient risk capital – are consistent with all version of the policy rationale.

The Innovation Investment Committee (IIC) of ISA is responsible for licensing ESVCLP and VCLP funds into which complying investments under the Venture Capital and Growth Private Equity Funds (VCPE) element of the Significant Investor Visa (SIV) Complying Investment Framework (CIF) can be made.

We consider that the VCPE element of the CIF provides a valuable contribution to Venture Capital in Australia and to the objectives of the Venture Capital Programs. In particular it contributes to broadening the Venture Capital investor base while increasing the amount of available patient risk capital.

We have noted a significant market response to the SIV changes that introduced the VCPE element (see graph below). Some parts of this response are cause for concern and may mean the program needs to be adjusted, as outlined below.

VCPE market response

Term of investment. In practice, venture capital (VC) funds generally run for a term of 10 years of which the first five is the investment phase and the last five is the divestment phase. Funds are more likely to extend beyond 10 years than close early. Under the ESVCLP and VCLP programs, licensed funds are required to have a minimum term of 5 years and a maximum term of 15 years.

The VCPE element requires SIV investors to invest in VCPE funds for at least four years.

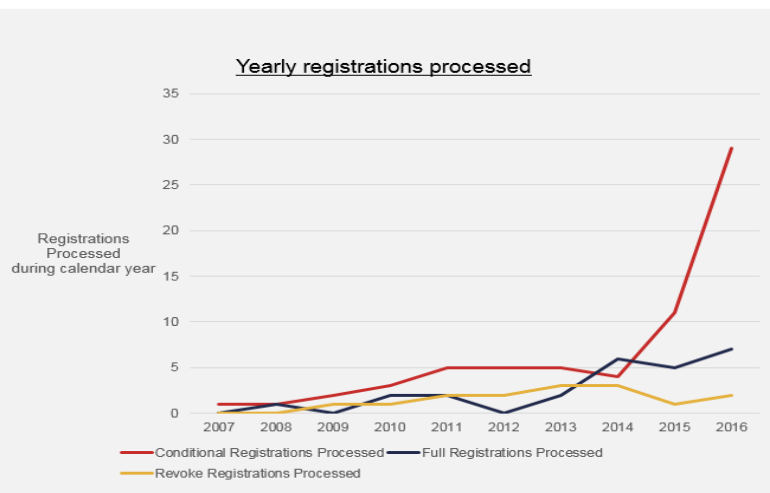
This discrepancy between the term a fund is required to be in existence under the ESVCLP and VCLP programs and the period SIV investors are required to invest in VCPE funds is a potential problem and has resulted in attempts by fund managers who wish to attract SIV investors to draft partnership deeds that allow SIV investors to withdraw their funds early under certain circumstances. We view this as an attempt to circumvent the requirement of 5-15 year term in the VC programs. In this respect, the objectives of the two programs do not intersect well, at present.

Recommendation: Consider extending the Significant Investor Visa (and therefore the VCPE investment) minimum timeframe requirements from 4 years to better align with venture capital (ESVCLP and VCLP) timeframes.

Inexperienced fund managers. The VCPE element has proven attractive to new entrants to the VC programs with 19 funds being established primarily to serve anticipated demand. Of these more than half have been established by fund managers that are new to the ESVCLP and VCLP programs and, in most cases, new to the venture capital industry.

Conditional ESVCLP registrations have substantially increased between 2014 and 2016

- The rate of full registration applications has not grown to the same extent as conditional
- An increase in the rate of full registration applications is expected to commence in 2017, following the two year period of conditional registration



[Note that in the above graph, conditional ESVCLP registration is generally granted to funds that have not raised the minimum \$10 million of committed capital. Once conditionally registered funds have two years to raise this amount and apply for unconditional registration or their registration lapses].

This has contributed substantially to the growth in the number of funds since the VCPE element was introduced.

While we would generally be happy to see an increase in the number of funds, subject to the above recommendations being adopted we have two remaining concerns in this case:

1. Inexperienced VC fund managers often benefit from engaging with experienced VC investors (just as new VC investors benefit from engaging with experienced VC fund managers). In this case the investors (SIV applicants) are generally inexperienced in VC investment as are the fund managers. We are concerned that this will lead to diverging expectations where the initially bullish forecasts of the fund managers may not be met. To be clear, we believe the investment plans of many of the new funds aimed at SIV investors present unachievable forecasts.

Note concern: The introduction of SIV holder mandatory investment of at least \$500,000 in ESVCLP or VCLPs appears to have increased the number of inexperienced VC fund managers who may be presenting SIV investors with unachievable forecasts.

2. Such a large increase in the number of funds may lead to funds failing to raise the minimum \$10 million they need for full registration. Given the relatively low take-up of the SIV (currently only \$77.5 million of VCPE available for 19 funds) we consider this to be likely.

Note concern: Should a significant number of funds fail to be fully registered, there is a reputational risk to Government.

Furthermore we have additional concerns regarding the licensing of funds and the way the market may perceive the process of licensing. The VC Act does not allow the IIC to consider the suitability of any person or entity to be registered outside of the requirements of the application process.

A consequence of the ESVCLP conditional registration status is that funds are seeking investment while not fully registered. Given the large number of funds that have received conditional registration we believe that many of these will not achieve unconditional registration. This may start to create an issue soon as SIV recipients who have invested in these funds find that the fund is no longer compliant with the CIF.

Other SIV issues

We note that since the VCPE element has been introduced there have been 155 SIV visas granted. This equates to a minimum of \$77.5 million invested into VCPE or 8.1 per cent of the total investment in VC programs since July 2015. Given this fairly low percentage we can be certain that existing fund managers have the capacity to absorb more SIV funds either through the approval of more visas or by increasing the VCPE element to a minimum of \$1 million.

Premium Investment Visa (PIV)

It is unclear what impact the PIV stream can or will have as we understand that this type of visa has not yet been granted.

Business Talent Visa (subclass 132)

The limitation of this visa to those that have a business that has received investment from a member of Australian Private Equity & Venture Capital Association Limited (AVCAL) is likely to be too limiting. There are a range of VC funds in Australia that have chosen not to join AVCAL.

Recommendation: Broaden the investment definition (under the Venture Capital Entrepreneur stream) to include VCLP, ESVCLP and/or member of AVCAL.

Complying Investment Framework

As mentioned above, IIC of ISA is responsible for licensing ESVCLP and VCLP funds into which complying investments under the Venture Capital and Growth Private Equity Funds (VCPE) element of the Significant Investor Visa (SIV) Complying Investment Framework (CIF) can be made.

We offer the following comments in response to questions posed in the review.

Q: Should the VCPE component of the CIF be increased from \$500,000 to \$1 million? Why or why not?

We believe that this increase should happen provided the issues outlined above are addressed (i.e. increase in inexperienced fund managers leading to over-inflation of investment forecasts and non-alignment of investment timeframes leading to early withdrawal of investments). Increasing the VCPE component without addressing these issues may increase the risks noted above. If these issues are addressed then increasing the VCPE component will increase the amount of patient risk capital available to Australian companies.

Q: What would be the likely impact on demand for the SIV if the VCPE component were increased?

We do not have a view on this question.

Q: Is there sufficient absorptive capacity in the Australian venture capital market to manage this increase?

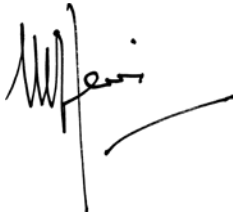
As noted above, the VCPE component represents a small fraction of the venture capital market in Australia. The proposed increase is well within the capacity of the market to absorb.

Q: If the VCPE component increases to \$1 million, should the Emerging Companies or Balancing Investment components reduce by \$500,000 to compensate? Why or why not?

We consider this to be a difficult question to answer unless we understand the SIV applicant's view of the risk profile of each category in the CIF. Based upon what we have seen to date we consider it likely that the SIV recipients have been told by new fund managers that the VCPE component is not as risky as it is. Should that be made clear to them then it may be sensible to reduce the Emerging Companies component in order to minimise the risk that the take-up of SIV would reduce.

We trust that the comments provided in this submission are helpful to the review.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Bill Ferris', with a long horizontal stroke extending to the right.

Bill Ferris, AC
Chair, Innovation and Science Australia

A handwritten signature in black ink, appearing to read 'Marty Gauvin', with a long horizontal stroke extending to the right.

Marty Gauvin
Chair, Innovation and Investment Committee

7 August 2017