AUSTRALIAN INVESTMENT COUNCIL

20 December 2019

Budget Policy Division
Department of The Treasury
Langton Crescent
PARKES ACT 2600

By upload to consultation website

Pre-Budget Submission for 2020-21

Dear Sir / Madam,

As the voice of private capital in Australia, the Australian Investment Council is pleased to present its submission for the 2020-21 Federal Budget.

Private capital investment has played a central role in the growth and expansion of thousands of businesses and represents a multi-billion-dollar contribution to the Australian economy. Our members are the standard-bearers of professional investment and include: private equity (**PE**), venture capital (**VC**) and private credit (**PC**) funds, alongside institutional investors such as superannuation and sovereign wealth funds, as well as leading financial, legal and operational advisers. Our members include both Australian domestic and offshore-based firms.

Private capital fund managers invest billions of dollars into Australian companies every year. For the first time in history, Australian-based PE and VC funds under management (**FUM**) reached $30 billion in 2018, testament to the growth in available capital to support investment into businesses across every industry sector of the economy. Fund managers secured an impressive $6.6 billion in new investment commitments in 2018, which means the industry now has a combined total of around $11 billion in equity capital available to be invested in the short-term.

The Australian Investment Council is supportive of policy initiatives and reforms that help to ensure our economy is competitive, innovative and able to support Australia now and into the future. In particular, we encourage reforms that assist Australian businesses to partner with private capital firms and enable private capital firms to help those business grow and expand. Our policy recommendations are aimed at lifting Australia's productivity and supporting investment to drive the development of skills and talent, productive capacity and innovation through technology.

We look forward to participating in any future discussion about the themes set out in this submission as part of the government's considerations of its 2020-21 Federal Budget. If you have any questions about specific points made in our submission, please do not hesitate to contact me or Brendon Harper, the Australian Investment Council's Head of Policy and Research, on 02 8243 7000.

Yours sincerely

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Introduction

Our nation continues to enjoy positive economic fundamentals such as low unemployment and low interest rates. However, risks of a continued economic slowdown, or in fact downturn, in Australian are increasing; domestic and global growth is slowing, retail and business confidence remains subdued while low inflation and slow wage growth persists. In this environment, there is a need for government, industry and businesses to work together to ensure that Australia is ready to tackle complex problems and take hold of the big opportunities available to us.

If Australia is to maintain its record run of economic growth, government policies need to support our communities and businesses, and provide a setting where local businesses can team with domestic and international investors to drive growth, employment, innovation and productivity gains. In this light, our submission provides recommendations aimed at lifting Australia's productivity and supporting investment to drive the development of skills and talent, productive capacity and technology.

Australia in a global context

Despite our high standard of living, Australia still has much work to do to transition into a more knowledge-based, high value-adding economy. The latest available rankings of economic complexity, developed by Harvard University's Center for International Development, ranked Australia 93rd globally – the lowest ranked of all developed economies and lower than many developing countries. Since 1996, when Australia was ranked 57th globally for economic complexity, we have dropped 36 places. Furthermore, Harvard University concludes that "Australia is less complex than expected for its income level. As a result, its economy is projected to grow slowly"[1], with Australia's growth projection to 2027 ranked 111th out of the 133 countries assessed.

This result is backed by the 2019 Global Innovation Index (**GII**), which ranked Australia 22nd globally, down from 20th in 2018, behind nations such as the USA, Republic of Korea, China and Iceland. "The 2019 GII found Australia to be weak across knowledge and technology outputs, creative outputs, and business sophistication, relative to the top 25 innovation nations globally."[2] This shows that we need to do much more if we want to build and future-proof a sustainable and growing economy that can attract talent and capital from international markets.

It is therefore important that the economic challenges that Australia faces are recognised and tackled through leadership in long-term and visionary policy reforms. Industry as a whole has a role to play in informing and engaging with all sides of politics on these challenges. This includes the private capital industry, which invests in a wide range of Australian companies, be they early stage tech startups or long-established agricultural or manufacturing businesses. In particular, our members seek to invest in high-growth companies that use that capital to expand their workforce, increase sales growth and engage in new research and development.

More broadly, Australian jobs and industry rely on a steady flow of foreign capital to support investment into growing businesses across all sectors of the economy. Australia's demand for capital continues to be greater than the domestic supply. As a result, Australia is a net importer of capital. Private capital firms are an important vehicle for attracting (domestic and) foreign capital into Australia and into Australian business.

Businesses benefit from partnering with private capital firms not only from the capital invested but also from leveraging private capital firms' expertise, guidance and networks. Private capital managers work closely with their investee businesses each day. This level of deep engagement and commitment is one of the ways

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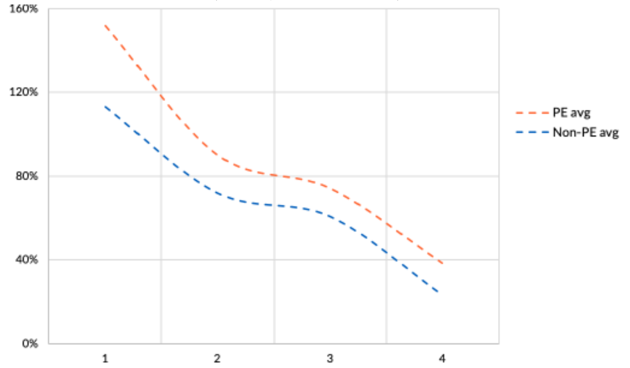
[1] Harvard University's Center for International Development (2019) Atlas of Economic Complexity

[2] Senate Select Committee on Financial Technology and Regulatory Technology, (2019) *Issue Paper*, p.3

private capital firms help Australian businesses grow and expand. In fact, businesses who partner with private equity firms have been found to grow faster and increase their workforce quicker than firms that do not partner with private capital investment firms (Figure 1).[3]

Figure 1: Employment growth by company size

(employment quartiles)



Source: Wilhelmus and Lee (2019)

Policy recommendations

This submission sets out our recommendations on the priority measures we believe should be implemented in the 2020-21 Budget to address key roadblocks inhibiting Australian businesses from effectively partnering with private capital firms.

Our recommendations focus on the two main themes which have been identified to us by offshore institutional investors as the main issues that should be addressed to increase investment, via private capital funds, into Australian businesses. These themes are:

1) Modernising Australia's Private Capital Investment Framework; and

2) Maintaining certainty and openness of Australia's investment and trade policy.

We make additional recommendations that support the growth and development of Australian businesses across a range of areas.

Our recommendations are summarised below and the Australian Investment Council is available to provide further detail on these matters, including by providing expert analysis and international comparisons, to assist the Government in its considerations.

[3] Wilhelmus and Lee (2019) *Milken Institute: Private Equity IPOs – Generating Faster Job Growth and More Investment*

This relationship holds true even when comparing within sectors and holding firm characteristics, such as size, constant. Logically, the same relationship would hold true for firms that partner with venture capital and private credit firms.

Australian Investment Council Recommendations

Encouraging investment into Australian businesses

1. Modernising Australia's Private Capital Investment Framework

Recommendation 1
Modernise CIV regime
Consistent with the Government's 2016 commitment, we recommend that steps be taken to fast-track the introduction of a new Limited Partnership CIV that aligns with international best practice. A target start date of 1 July 2021 should be set.

Recommendation 2
Provide certainty for long-term investment
Modify Australia's VCLP and ESVCLP regimes to provide a stable regulatory framework and the certainty needed to better support medium and long-term investment into Australian businesses.

2. Maintaining certainty and openness of Australia's investment and trade policy

Recommendation 3
Maintain a consistent and stable foreign investment framework
That Government commit to maintaining policy certainty within the existing foreign investment framework, and make no unnecessary changes that would restrict future foreign investment into Australian businesses via private capital firms.

Recommendation 4
Reduce tax uncertainties for private capital investment
The Australian Government, including the ATO, work with industry to reduce the uncertainties of tax treatment from private capital investment into Australian businesses.

Recommendation 5
Decrease red tape for funds raised through ESVCLPs and VCLPs
Funds raised through an ESVCLP or VCLP structure, which currently fall within the scope of the FIRB processes, be exempt.

Additional opportunities

3. Driving productivity and competitiveness

Recommendation 6
No further changes to R&D tax incentive
That the Government commit to and support earlier innovation reforms and measures that have had a net benefit to the innovation and early stage ecosystem, including making no further cuts or changes to the R&D Tax Incentive regime.

Recommendation 7
Clarify definitions in R&D legislation
The Government address recent uncertainty around the future settings of the R&D scheme to broaden the definition of "experiments" to encompass businesses that innovate on top of existing infrastructure and to provide clarity on which R&D claims are eligible to avoid potential disputes with the ATO.

4. Supporting national areas of most need

Recommendation 8
Encourage equity co-investment
That the Government give renewed consideration to equity co-investment programs, as well as regulatory changes that unlock private sources of capital, in order to boost investment into high growth Australian companies.

Recommendation 9
Establish a Regional Innovation Fund
A Regional Innovation Fund be introduced to stimulate and support the establishment and growth of startups, new businesses and industry sectors to catalyse economic growth in regional and rural areas of Australia.

Recommendation 10
Make Australia attractive as a destination for AgTech investment
Government work with Austrade to connect external investors and companies with Australia's Agtech ecosystems to develop Australia as a global centre for Agtech and support initiatives to attract investment into the sector.

Recommendation 11
Fill capability gaps in Cyber Security
Government support AustCyber to continue to work with Australian cyber security companies to fill the capability gaps, provide assistance to help them accelerate, grow and mature from ideation to export.

Recommendation 12
Support innovation and government procurement for cyber security startups
Government support the AustCyber proposal to have a proof-of-concept Sandbox and advocate for procurement policy reform.

5. Bridging the talent gap

Recommendation 13
Talent Visas
The Australian Investment Council believes that the Government should extend the talent visa program to enable employers to sponsor more than the current level of five entrepreneurs in the start-up stream.

Recommendation 14
Address future labour shortages
The Government address current labour shortages by funding institutions that can develop and deliver courses for tertiary students aimed at fostering entrepreneurship and teaching digital STEM skills.

Recommendation 15
Fast-track the establishment of 'STEM Schools'
The Government embed STEM skills into the Australian School curriculum from primary school years through to tertiary education and fast-track the establishment of 'STEM Schools' modelled on Sydney Science College in Epping to expand accessibility for all Australians.

Recommendation 16

Extend visas for foreign students

The Government extend visas for foreign students who graduate from Australian universities in disciplines where we have skills shortages, allowing them to stay and work in Australia to build a pipeline for our new, knowledge-based economy.

6. Empowering Corporate Venture Capital arms and innovation labs

Recommendation 17

Support Corporate Venture Capital arms and innovation labs

To support innovation through Corporate Venture Capital (**CVC**) arms or innovation and labs, the government:

- Extend the early stage tax incentives to allow corporate entities to invest in Early Stage Innovation Companies and ESVCLPs, and provide further incentives for corporates to engage with startups as investors and first and/or cornerstone customers; and
- Opening up the Accelerating Commercialisation program to VC-backed companies.

Encouraging investment into Australian businesses

1. Modernising Australia's Private Capital Investment Framework

Australian jobs and industry rely on a steady flow of foreign capital to support investment into growing businesses across all sectors of the economy. Australia's demand for capital continues to be greater than the domestic supply. As a result, Australia is a net importer of capital. PC firms are an important vehicle for attracting (domestic and) foreign capital into Australia and into Australian business.

Despite our nation's impressive continued economic growth, Australia remains a mid-level player on the global scene. As such, Australia remains an attractive but optional investment location for many offshore institutional investors. Differences to international practices or unexpected policy changes typically make Australia a less attractive investment location in the eyes of those offshore institutional investors. Unfortunately, Australia's legal and tax framework for PC investment is inconsistent with international best practice in a number of areas. It currently necessitates duplicate and complex structures and deters higher levels of foreign investment.

Our recommendations below provide practical policy solutions to increase Australia's attractiveness internationally. These changes, if implemented, would assist Australian businesses now and in the future to source the funds they need to grow and prosper.

Collective Investment Vehicles

One area where Australia's approach is inconsistent with international practice is its existing framework for collective investment vehicles (**CIVs**). These vehicles are an important component for pooling foreign capital into Australian startup and scale-up businesses.

Private capital funds make a material contribution to the Australian economy and Australian unlisted business investments. It is important to note that around 64% of commitments to Australian PE funds[4] typically come from offshore investors, all of which flows through some form of CIV based in Australia. The importance of a world-class competitive CIV regime is an essential ingredient in building and expanding on the pool of capital that can be attracted into Australian businesses. A number of large international investors have identified that the current structure of Australian CIVs is a material deterrent for investing more into Australia. As a result, these international investors are making decisions to invest in jurisdictions that have CIV regimes they are more familiar with. This means Australia misses out on significant volumes of capital simply because our policy infrastructure is not as competitive and consistent with global practices as it should be.

These differences continue to exist despite the Government announcing in the 2016 Federal Budget – consistent with the recommendations of the 2009 Johnson Review into Australia as a Financial Centre – it would introduce two new CIVs to grow Australia's capacity to attract inbound investment into our economy. These two CIVs, known as a corporate collective investment vehicle and a limited partnership collective investment vehicle, and are yet to be implemented. We understand that work on the Limited Partnership CIV is yet to even commence.

Recommendation 1 *Fast-track the implementation of the new LP CIV regime* Consistent with the Government's 2016 commitment, we recommend that steps be taken to fast-track the introduction of a new Limited Partnership CIV that aligns with international best practice. A target start date of 1 July 2021 should be set.

[4] For FY2013-2017.

Venture Capital Limited Partnerships

In a move supporting investment into Australian businesses, the government implemented changes to early stage venture capital limited partnerships (**ESVCLPs**) and venture capital limited partnerships (**VCLPs**) on 1 July 2016. These changes were broadly supported by Australia's private capital investment sector. However, due to the speed with which they were introduced, there are a number of areas where technical and interpretative amendments and clarifications regarding these investment vehicles are necessary.

There is a range of uncertainties and inefficiencies regarding the current VCLP and ESVCLP regimes. An example of some of the uncertainties with the current regime include the tax treatment of investments whose value increases to exceed $250 million. It remains unclear if these investments remain exempt from 'excess' gains, under sections 51-54 and 118-408 of the Income Tax Assessment Act 1997 (Cth) or, if such an investment is sold out of a ESVCLP, as it may no longer be 'early stage' due to the company expanding and maturing, if such a transfer triggers a crystallisation event and (through application of Part IVA, the general anti-avoidance rule) a tax liability.

Providing clarity and certainty on the framework for VCLPs and ESVCLPs and making them competitive with other jurisdictions will be attractive to early-stage investors considering medium and long-term investments into Australian businesses across a range of new and emerging sectors of the economy.

There are around 15 separate technical and interpretative issues that exist around the current ESVCLP and VCLP regimes, and we can provide the Inquiry with further detail about all of the specific issues if required.

Recommendation 2
Improve existing VCLP and ESVCLP vehicles
Implement technical amendments to modify the operation of Australia's ESVCLP and VCLP regimes to provide a stable regulatory framework which better supports medium and long-term investment into Australian businesses.

2. Maintaining certainty and openness of Australia's investment and trade policy

As a mid-size economy and net importer of capital, unexpected policy changes typically make Australia a less attractive investment location in the eyes of offshore institutional investors. As such, ensuring that the policy environment around foreign investment remains open and stable is one of the key ways in which government can help maintain Australia's reputation as an attractive investment destination.

Whole of government approach

Broadly, the government's policies and communications support the notion that Australia is 'open for business' and welcomes foreign investment. However, at times the message of some members of parliament and government agencies has a protectionist or at least 'less open' tone which can deter international observers and undermine efforts to attract the capital needed to fuel our economic growth.

To be most effective, messaging must be consistent at all levels of government. This includes Australia's approach to, for example:

- bilateral and multilateral agreements (with positive developments being made in this area despite increased global trade tensions);
- setting internationally consistent investment vehicles to channel funds into Australian businesses (explored above in the section *Modernising Australia's Private Capital Investment Framework*);
- attracting skilled workers through our immigration and education policies (explored below in the section *Bridging the talent gap*);
- encouraging innovation and supporting research and development (explored below in the section *Driving productivity and competitiveness*); and
- taxation (explored in multiple sections of this submission).

We encourage government to take a coordinated, whole of government approach to attracting international investment. It is only when all arms of government work together to create certainty and openness can we fully leverage the capital, skills, and experience in international markets to drive Australia and Australian businesses forward. We believe that if government works together with industry, it would be possible to realise the nation's potential and appropriately balance the need to protect the national interest while continuing to grow investment into Australia from offshore in a sustainable manner.

Recommendation 3
Maintain a consistent and stable foreign investment framework
That Government commit to maintaining policy certainty within the existing foreign investment framework, and make no unnecessary changes that would restrict future foreign investment into Australian businesses via private capital firms.

Consistency in tax treatment

Private capital managers invest with the expectation of holding and growing their investments for a number of years. As such, those managers must consider the potential performance and risks of their investments over the medium to long-term. Uncertainties due to variations in the tax treatments of investments increase investment risk, making investing in Australia less attractive. Inconsistencies in tax treatment have occurred, and continue to occur, in a number of areas. These include, but are not limited to:

- the tax treatment of investments whose value increase to exceed $250 million (detailed above in the *Venture Capital Limited Partnerships* section);
- The narrow interpretation of 'experiments' in the R&D Tax Incentive Laws which has is inhibiting investment into new innovations, especially for early stage companies (detailed below in the *Research and Development Tax Incentives* section); and
- Requirements to publish R&D entitlement which have caused inconsistencies, where claims which were initially accepted, were later rejected by the Australian Taxation Office (**ATO**) (detailed below in the *Research and Development Tax Incentives* section).

The Australian Investment Council is available to assist the government explore these instances of inconsistent tax treatment to find solutions that will drive increased investment into Australian businesses.

Recommendation 4
Reduce tax uncertainties for private capital investment
The Australian Government, including the ATO, work with industry to reduce the uncertainties of tax treatment from private capital investment into Australian businesses.

Foreign Investment Review Board

Private capital fund managers of ESVCLPs and VCLPs can apply to the Foreign Investment Review Board (**FIRB**) for a 'business exemption certificate'. This certificate exempts recipients from the standard FIRB approval process when investments are made out of a certified fund. Currently domestic funds that have raised capital from certain offshore investors (for example public pension funds or sovereign wealth funds) are eligible to undergo the pre-approval process. While the business exemption certificate initiative is strongly supported by the private capital community, this pre-approval process can be lengthy and impede the deployment of capital into Australian companies.

The Australian Investment Council recommends that funds raised through an ESVCLP or VCLP structure, which currently fall within the scope of these FIRB processes, should be exempt. These fund structures are already overseen and administered by other government bodies such as AusIndustry and the ATO from the initial fundraising stage right through to when the funds are divested. They also go through a rigorous application process with Innovation & Science Australia in order to be registered. We believe that this oversight framework is sufficient to maintaining a high level of integrity and compliance with all relevant legal and tax rules. Excluding these funds from FIRB processes would help to reduce regulatory risk and uncertainty while reducing red tape for the fund managers who are investing into and supporting Australia's high growth companies, and allow for more capital to flow into the early stage and high growth sectors of the economy.

Recommendation 5

Decrease red tape for funds raised through ESVCLPs and VCLPs

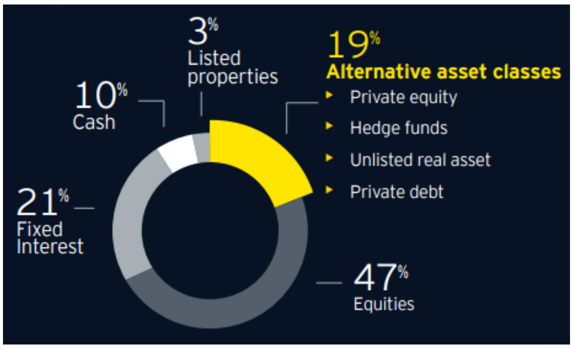
Funds raised through an ESVCLP or VCLP structure, which currently fall within the scope of the FIRB processes, be exempt.

BOX: Superannuation funds and Australian businesses' demand for capital

Some industry commentators have highlighted the point that Australia's superannuation pool is the fourth largest in the world[5], and that because of that, it should represent a growing source of funding for Australian businesses, either directly or via private capital investment firms. Indeed, the allocation of investment capital by superannuation funds' into private capital firms has increased over recent years, with investments spanning a range of sectors across the economy. In addition to investing directly with private capital firms, superannuation funds are increasingly co-investing with private capital firms (investing alongside private capital firms). This illustrates Australian superannuation funds increased confidence in the management and performance of local private capital firms, and the strength of the pipeline of investment into great Australian businesses.

Notwithstanding these positive developments, superannuation funds' allocation to alternative assets remains low on a relative basis, at 19% of assets under management (Figure 2).[6] Within this 19% allocation, superannuation funds have historically had a bias towards real assets (real estate and infrastructure) compared both to their allocation to private capital and their allocations compared to global pension funds (Figure 3). Less than a third of Australian superannuation funds have 5% or more of their total assets allocated to private capital; this compares to 45% of global pension funds. By contrast, 69% of Australian superannuation funds have a 5% or greater allocation to infrastructure, compared to 18% of global pension funds

Figure 2: Superannuation Scheme Allocation



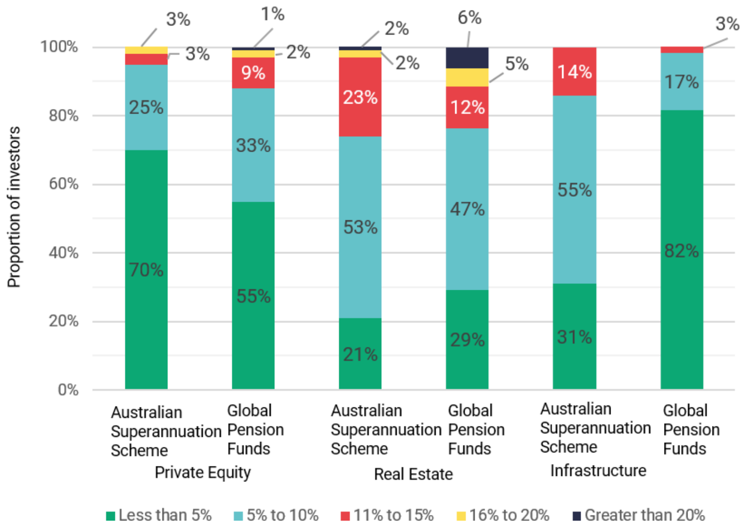
Source: EY (2019) Will the rise of private capital tip the balance of investment power?, August 2019

[5] Wills Towers Watson (2019) *Global Pensions Asset Study - 2019*

[6] EY (2019) *Will the rise of private capital tip the balance of investment power?*, August

Also out of line with most developed pension funds is Australian superannuation funds 47% allocation to equities and 21% allocation to fixed interest (Figure 4).[7] This is especially true among developed countries with countries such as Germany, the UK, Canada and the US which allocating 5.4%, 9.0%, 28.7% and 30.7% of assets under management to equities. This indicates that there is potential for Australia's superannuation funds to increase their allocation to alternative assets and in particular to private capital. However, there are some structural challenges in doing so.

Figure 3: Current Allocations to Alternative Assets by Asset Class: Australian Superannuation Schemes vs Global Pension Funds (as a % of Total Assets)



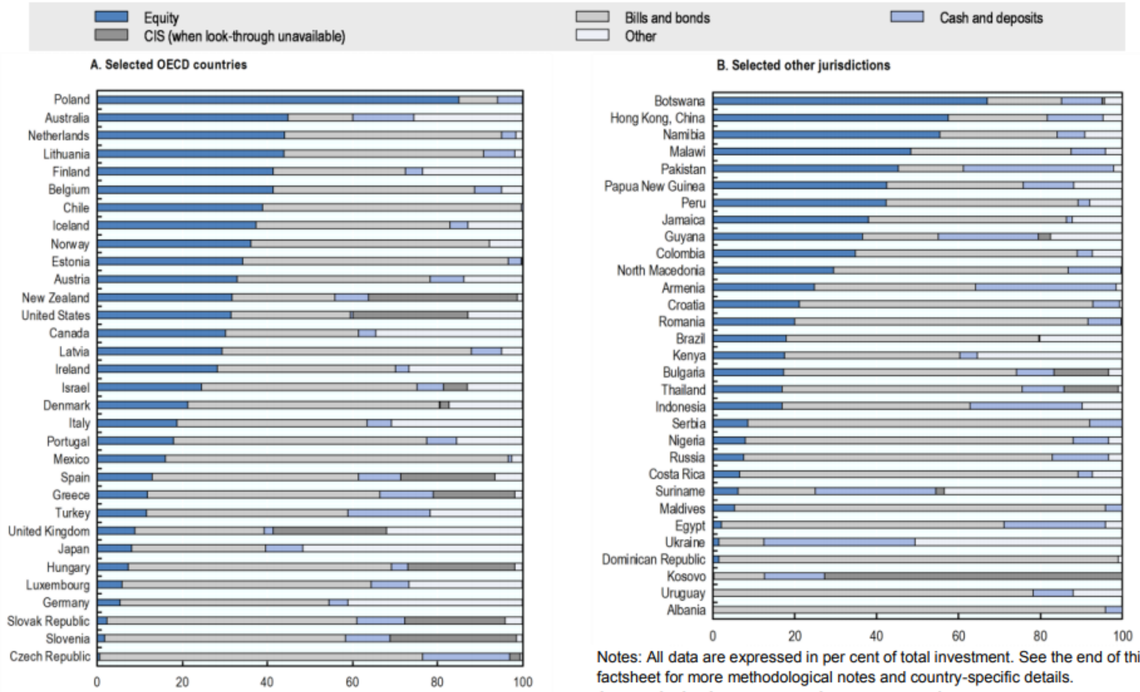
Source: Preqin (2018) *Australian Superannuation Funds in Alternatives*, November

One of the structural challenges stems from the increasing size of Australian superannuation funds. With larger balance sheets, the scale of investing into Australian startups and growth businesses can be rendered uneconomical. This issue of 'increasingly big funds needing to write increasingly big cheques' will only be amplified with consolidation in the superannuation sector. So while superannuation funds' increased participation in providing capital to Australian businesses, directly and via private capital funds, is a positive step forward, it is unlikely to meet the nation's entire capital demands. As a result, offshore institutional investors will continue to play a part in funding Australian businesses.

A number of technical and regulatory barriers also exist to superannuation funds increasing their allocation to alternative assets, such as rigidity of the new disclosure of fees and costs regime embedded in ASIC's regulatory guide 97. This issue, along with others, constitute important issues that government and regulators can address to help unlock the capacity of our domestic superannuation funds to allocate larger amounts of capital to support the growth of businesses in the unlisted sector of our economy. While outside the scope of this submission, the Australian Investment Council is able to provide further detail and insights to assist the government with future deliberations of this issue.

[7] *OECD (2019) Pension Markets in Focus 2019, October*

Figure 4: Asset allocation of pension funds in selected investment categories in 2018 (preliminary)



Notes: All data are expressed in per cent of total investment. See the end of this factsheet for more methodological notes and country-specific details.
Source: OECD Global Pension Statistics; Bank of Japan.

Additional opportunities

3. Driving productivity and competitiveness

The current Australian environment is punctuated by sustained low interest rates and low inflation, and there are no signs that either of those fundamentals will move significantly for a long time.

Australia can no longer afford to rest on its past successes and rely on the top five per cent of companies to provide innovation growth for our future. We have no time to waste in transitioning and adapting our business models to the highly technological and globalised marketplace we are a part of. We have to do this in order to continue to grow our knowledge-based economy and create jobs for future generations.

Deeper investment into new technologies and innovation through Research and Development will be necessary to drive productivity and competitiveness.

Research and Development Tax Incentive

The Research and Development (**R&D**) Tax Incentive is a critically important policy that drives large parts of Australia's innovation ecosystem. The R&D Tax Incentive encourages considerable investment into the development of new products and services across countless sectors of the economy, which is essential for the economic transition that we need to make towards a more knowledge-based high value-adding market. The R&D Tax Incentive regime is a strong and compelling commercial driver for attracting offshore R&D programs to relocate to Australia and undertake their activities here. This has the effect of helping to transfer knowledge and skills into the local market.

On 5 December 2019, the Research and Development Tax Incentive Bill was tabled in parliament. While it marked an important step forward in providing certainty to businesses about the future direction of Australia's R&D tax incentive, certain definitions used in the legislation are likely to continue to create uncertainty on the eligibility criteria for R&D tax incentives.

One area of concern for all early stage businesses is the proposed introduction of a $4 million cap on R&D refundable credits for businesses with turnovers of up to $20 million. While the Council has accepted the government's desire to implement such a significant change to the policy of the regime, it is likely to be the case that the introduction of a cap in this way will have potentially significant consequences for the capacity of early stage ventures to continue to invest large amounts of capital into R&D activities in Australia.

Recommendation 6
No further changes to R&D tax incentive
The Government commit to and support earlier innovation reforms and measures that have had a net benefit to the innovation and early stage ecosystem, including making no further cuts or changes to the R&D Tax Incentive regime.

Public transparency measures are also proposed in the Bill which will require the Commissioner of Taxation to publish information about R&D entities that have claimed notional deductions for R&D activities, including the amount claimed within two years following the end of the relevant financial year. These changes could have the effect of diminishing the appeal of the program, and result in a loss of commercial in confidence information that could impact on the competitiveness of early stage businesses who are often seeking to build scale in niche areas of the market.

Under the current regime, there have also been numerous examples of inconsistencies where claims that were initially accepted were later rejected by the Australian Taxation Office. This *about-turn* on eligibility has had a material effect on many early stage businesses, who have relied on their access to R&D Tax Incentive refundable offsets in order to fund ongoing cashflow investment into R&D activities.

Additionally, the narrow interpretation of "experiments" in the R&D tax incentive legislation has caused some confusion within industry. New services are often created over the top of existing systems which could be interpreted as "not new or experimental" from an R&D perspective. Broadening the definition of "experimental" to more accurately reflect the nature of the innovative industries would create certainty and drive research and innovation.

Recommendation 7
Clarify definitions in R&D legislation
The Government address recent uncertainty around the future settings of the R&D program. Steps should be taken to broaden the definition of "experiments" to encompass businesses that innovate on top of existing infrastructure and to provide clarity on which R&D claims are eligible to avoid potential disputes with the ATO.

4. Supporting national areas of most need

The potential of some areas of our economy are not being met due to a lack of capability and investment capacity to support new ventures and innovative businesses. This is particularly true for some businesses located in regional and rural areas of Australia, despite the fact that regional Australia contributes one third of our national output and is home to 8.8 million people.

Recent successful initiatives to tackle the issue of regional under development include the establishment of the Biomedical Translation Fund (**BTF**) and overseas schemes, such as the Opportunity Zones program in the US. These provide a blueprint for launching programs which couple government funding and private capital, directing it towards specific areas of need. The Australian Business Securitisation Fund is another positive example of encouraging higher levels of business lending into a specific sector, the SME market in this case, which otherwise would have been untapped. Such a pragmatic policy approach, coupled with strong industry consultation, could be effective in unlocking new sources of capital that invest into SMEs and high growth businesses more generally.

We provide a range of recommendations to combine government policy with private sector expertise and funding to increase capacity, growth and employment in a range of specific areas of our economy.

Equity co-investment programs

Companies at the early startup stage, as well as high-growth companies – those that have graduated from the startup phase and are now expanding their workforce, increasing sales growth and investing in research and development – can contribute significantly to Australia's future employment and economic growth.

An extension of government equity co-investment initiatives into a range of growth sectors would continue to foster local talent and nurture the growth of startups and scaleups. This type of co-investment could be modelled on the BTF.

Recommendation 8
Encourage equity co-investment
That the Government give renewed consideration to equity co-investment programs modelled on the BTF, as well as regulatory changes that unlock private sources of capital, in order to boost investment into high growth Australian companies.

Regional Innovation Fund

Regional areas have traditionally been the backbone of the Australian economy. However, as our nation has evolved, our key economic drivers have also changed. This has resulted in less focus on regional areas, which in some communities and sectors has led to diminished expertise, funding and infrastructure. These constraints, when coupled with the environmental challenges faced in many regional areas, has led to lost opportunities and reduced economic and employment growth.

By working together, government and the private sector can assistance businesses and communities in regional Australia to attract the funding and expertise required to establish and grow of startups, new businesses and industry sectors, such as AgTech (discussed in more detail below). Stimulating economic growth in these areas of Australia could provide a catalyst for much-needed revitalisation of many regional communities

One option is to establish a Regional Innovation Fund. This fund could be modelled on, and sit alongside, similar initiatives launched by state governments or by Regional Development Australia. Such initiatives include:

- The Federal Government's Regional Jobs and Investment Packages, with $211 million of funding to support the Government's commitment to stimulate economic growth in Australian regions;
- The Regional Growth Fund in New South Wales, which is investing an additional $1.6 billion in regional infrastructure to support growing regional centres, activate local economies and improve services; and
- The Regional Jobs and Infrastructure Fund, which is the Victorian Government's overarching regional development package.

Recommendation 9
Establish a Regional Innovation Fund
A Regional Innovation Fund be introduced to stimulate and support the establishment and growth of startups, new businesses and industry sectors to catalyse economic growth in regional and rural areas of Australia.

AgTech

One area where Australia has a natural advantage is in the agricultural technology (**Agtech**) sector, which covers everything from farm management software, robotics, bioenergy and biotechnology, to innovative food and 3D food printers.

According to Austrade, global investment in Agtech in 2017 was $14.6 billion, an increase of almost 30 per cent on the previous year. While investment in Agtech in Australia is 50 per cent less per capita than in the USA, it is predicted to become Australia's next $100 billion industry by 2030.

The need for investment in new technologies to make farming more viable and sustainable, can be seen in the growing number of AgTech start-ups that are progressing through incubator and accelerator programs with help from seed and early stage capital.

In the next few years, these new businesses will need further funding support, particularly from venture capital investment, to get to their next stages of growth.

Their innovative products and services have the potential to revolutionise Australia's agricultural sector. There are many Agtech developments which are currently in the pipeline in Australia. However, they will require the right level of market and government support to stay in the country for the long-term so the employment, economic and productivity benefits can be realised.

To be attractive as an investment on an international scale, there is a need for Australia's AgTech ecosystems to present a cohesive front for international investors and companies.

Recommendation 10
Make Australia attractive as a destination for AgTech investment
Government work with Austrade to connect external investors and companies with Australia's Agtech ecosystems to develop Australia as a global centre for Agtech and support initiatives to attract investment into the sector.

Cybersecurity

There is no question that cyber 'attacks' are becoming more prevalent across all spheres of government, business and society. The level of sophistication continues to increase, and the impact of such attacks can be catastrophic, especially in the context of highly sensitive sectors such as defence, as well as healthcare, infrastructure and personal security. The expansion of internet-capability beyond computers and mobile phones into other cyber-physical or 'smart' systems is extending the threat of remote exploitation to a host of new technologies which underpin the everyday lives of Australians such as transport control systems, power grids and industrial plants.

Managing Australia's exposure to cyber risks relies on our capacity to access the right skills and talent, and our ability to support greater investment into research, leading to the development of innovative solutions.

Recommendation 11
Fill capability gaps in Cyber Security
Government support AustCyber to continue to work with Australian cyber security companies to fill the capability gaps, provide assistance to help them accelerate, grow and mature from ideation to export.

Australia's venture capital investment sector is a key driver of innovation investment across the domestic economy. Investing today into the businesses of tomorrow is a core ingredient in creating a more knowledge-based and high-value-add economy in the 21st century.

Recommendation 12
Support innovation and government procurement for cyber security startups
Government support the AustCyber proposal to have a proof-of-concept Sandbox and advocate for procurement policy reform.

2. Bridging the talent gap

To compete against the world's best, we need to attract and retain the world's best talent. This is particularly true for Australia as we are net importer of not only capital, but also highly skilled talent. Education reforms, particularly in STEM disciplines, will help build the next generation of local talent, but in the short-term, immigration reforms will help facilitate the entry of much needed specialist skills not available locally.

Skilled migration has been a key feature of Australia's migration system, playing an important role in generating economic growth for a number of successive decades. Australia has had a long history of supportive policies to attract business entrepreneurs. However, the rising global mobility of workers and heightened competition for talent means that it is important for Australia to have policy settings that are effective in attracting a critical mass of "new economy" skilled workers. These entrepreneurs will help generate new and sustainable business opportunities within the Australian economy into the future and every effort must be taken to attract and retain that talent.

The global search for talent is compounded by ever-more-rapid changes brought about by technology and innovation. Australia has to stay competitive if we want to attract and retain the best and brightest.

We support the government's Global Talent – Sponsored and Independent Programs. While it is still early days in the lifecycle of these policies, we believe that they both represent a step in the right direction for our future. We also note the recently announced, Department of Employment, Skills, Small and Family Business, consultation on skilled migration occupations lists, which will play an important supporting role in identifying those specific niche skills that our national economy should prioritise in order to build our future growth.

Recommendation 13
Talent Visas
The Australian Investment Council believes that the Government should extend the talent visa program to enable employers to sponsor more than the current level of five entrepreneurs in the start-up stream.

As outlined in the *Australia 2030 Prosperity Through Innovation* report released by Innovation and Science Australia, growth in jobs and occupations requiring STEM skills are outstripping overall employment growth across the economy. While skilled migration will help to address skills shortages in the near future, building a workforce from within Australia with relevant STEM skills will contribute to employment and future economic growth.

Recommendation 14
Address future labour shortages
The Government address current labour shortages by funding institutions that can develop and deliver courses for tertiary students aimed at fostering entrepreneurship and teaching digital STEM skills.

In the longer term, building a pipeline of future employees with STEM skills from the Australian school system would help to increase the job prospects for Australians in the future.

Recommendation 15
Fast-track the establishment of 'STEM Schools'
The Government embed STEM skills into the Australian School curriculum from primary school years through to tertiary education and fast-track the establishment of 'STEM Schools' modelled on Sydney Science College in Epping to expand accessibility for all Australians.

Australia has a strong record of attracting foreign students to our world-class tertiary education system. Many of these students arrive on visas that are valid for the duration of their studies, and then return to their home countries to develop their careers. This is a potential source of the skills needed to address labour shortages in the short to medium term.

Recommendation 16
Extend visas for foreign students
The Government extend visas for foreign students who graduate from Australian universities in disciplines where we have skills shortages, allowing them to stay and work in Australia to build a pipeline for our new, knowledge-based economy.

3. Empowering Corporate Venture Capital arms and innovation labs

Australia has seen a substantial growth in the number of corporates that have CVC arms or innovation labs, marking the important role that large organisations can play in driving and nurturing Australia's innovation economy. Continuing this growth is important especially in light of recent finding by the University of Sydney that Australian boards are failing to understand the importance of innovation.[10] The study found that 57% of surveyed board members agreed that 'innovation has never been or was only an occasional board agenda item' with only 3% having science or technology expertise. An alarming 57% did not know how much their organisations spent on R&D and innovation.

With R&D and innovation key drivers of economic growth, productivity and high value jobs, Australian corporates should be encouraged to do more in this area. Supporting CVC arms and innovation labs is one avenue to do this. We provide a set policy suggestions for the government's consideration below.

Recommendation 17
Support Corporate Venture Capital arms and innovation labs
To support innovation through CVC arms or innovation and labs, the government:
- Extend the early stage tax incentives to allow corporate entities to invest in Early Stage Innovation Companies and ESVCLPs, and provide further incentives for corporates to engage with startups as investors and first and/or cornerstone customers; and
- Opening up the Accelerating Commercialisation program to VC-backed companies.

[10] Garbuio, M (2019) *Driving Innovation: The Boardroom Gap, 2019 Innovation Study*, September