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Venture Capital in Australia

Venture capital investment in Australia has reached the $2.6 billion mark, with a further $2.3 billion committed for future investment in current projects. In the last year, a total of $829 million was invested in 126 new and follow-on investments by the Australian venture capital sector, according to a recently released survey by the Australian Bureau of Statistics (ABS).[1] The ABS survey was prompted by the tax regime incentives contained in the 1999–2000 Budget and recommended by the Ralph Review of Business Taxation.[2]

The term 'venture capital' is used to describe investments in businesses at various stages of development. It includes seed and start-up capital, expansion-stage capital, later-stage development capital, and finance for management buy-outs and buy-ins of established businesses. Locally sourced venture capital has assisted in the growth and development of many small enterprises which began with seed capital. Some notable examples of venture capital backed companies are Energy Development Ltd, Austal Ships Ltd, LookSmart, ResMed, and Cinema Plus Ltd, the Imax cinema venture.

This Research Note provides an overview of venture capital in Australia as revealed by the ABS survey. The Note also examines the contribution of superannuation funds and institutions to venture capital funding.

ABS Survey at a Glance

The survey identified 97 venture capital managers in Australia, who manage 123 investment vehicles. The 123 investment vehicles had 569 investments in venture capital projects across a wide range of industries including tourism and hospitality, healthcare services, biotechnology, construction, transportation, IT, media and agriculture.

On an industry basis, the most popular industries for investment were industrial manufacturing with 129 investments, property and business services with 83, communications with 80 and mining with 58. Almost half of the investments were in computer-related and consumer-related industries such as computer software, the Internet, electronics, communications and IT.

An analysis of the distribution of investments revealed that New South Wales and Victoria received the most number of investments, followed by the second tier states of Western Australia and Queensland, and the third tier of South Australia and Tasmania, Australian Capital Territory and Northern Territory. NSW accounted for 56 per cent of the value of all investments, more than twice the value of investments in investee companies as Victoria. Similar industry surveys confirm New South Wales as the clear leader both in the number and value of investments received, and the 2:1 ratio in the provision of venture capital between New South Wales and Victoria.[3]

Exits

A venture capital firm has four options when exiting an investment: trade sale, initial public offering (IPO), buy-back and liquidation. In 1999–2000, 24 companies were sold, 12 companies went public, 4 companies were bought back and 19 investments were liquidated. The value of exits during the year 1999–2000 was $536 million and the percentage of exits relative to new investments was 80 per cent. The average trade sale was $3.7 million, while the value of all IPOs was $346 million.

Seed and Early-Stage Capital

The ABS survey also showed that companies in the seed and early expansion-stage attracted the most number of investments (305), representing 54 per cent of all investments and 38 per cent of the capital invested. By contrast, management buy-out activity was low, with 58 investments for 19 per cent of capital invested.

The Role of Super Funds and Institutions

Australian superannuation funds continue to be the largest source of venture capital, with 35 per cent of the $4.9 billion or $1.733 billion committed for investment at the end of June 2000, followed by non-residents with 21 per cent (see accompanying table). While this figure compares favourably with the percentage of venture capital sourced from pension funds in other countries, it still represents only 0.5 per cent of the superannuation funds' investment portfolio.[4]

The relative importance of super funds as a source of venture capital is borne out in industry surveys, although the proportion of super funds' contribution to the growth of venture capital in Australia is declining. According to the *2000 Australian Venture Capital Yearbook*, contributions from these sources accounted for 31 per cent of all capital under management, a decrease from 38 per cent in 1999 and from 40 per cent in 1998.[5]

While super funds are an important source of local venture capital, they also invest in overseas venture capital markets. They contribute about 27 per cent of this investment, with Australian institutions playing a much larger role in the funding of overseas venture capital enterprises. A survey of 30 institutions by the *Australian Venture Capital Journal* included 17 super funds and private investment companies. While an incomplete picture of the venture capital industry sector, the sample is nevertheless revealing.

As at 30 June 2000, only 46 per cent of the total $4.1 billion of venture capital invested by these institutions

F4 Source of Funds of Investment Vehicles—At 30 June 2000

	Commitments by Investors		Drawdowns from Investors		Unused Commitment
	Investment Vehicles no.	Value $m	Investment Vehicles no.	Value $m	Value $m
Residents					
Banks	19	340	18	229	111
General government	6	120	5	60	61
Public trading enterprises	10	125	10	63	62
Private trading enterprises	29	358	28	221	136
Superannuation funds	49	1 733	48	883	850
Life insurance offices	9	183	9	92	91
Trusts	12	88	12	50	38
Funds of trusts	18	314	18	173	141
Other	56	418	56	343	75
Not stated	18	199	18	199	–
Total resident	. .	3 877	. .	2 314	1 564
Non Residents					
Superannuation funds	5	21	5	19	2
Other	26	1 002	23	292	711
Total non-resident	. .	1 023	. .	310	713
Total	. .	**4 900**	. .	**2 624**	**2 276**

Source: Australian Bureau of Statistics, Managed Funds, Cat. No. 5655.0.

was invested in Australia. The remainder, $2.2 billion, was held in overseas investments. More importantly, the average allocation to Australian investment managers was $14.5 million compared to $37.7 million for overseas managers. Super funds were clearly the more enthusiastic supporters of the Australian venture capital sector. They invested more than $1.3 billion in local venture capital enterprises compared with $565 million by Australian institutions. UniSuper was the single largest participant in the venture capital sector with $204 million, the Australian Retirement Fund followed with $168.5 million. On the other hand, institutions were more attracted to global investment having invested close to $1.3 billion in overseas venture capital markets. Of the respondents to the survey, National Asset Management—Global Private Equity was the largest investor. It had $642.9 million invested overseas, followed by AMP Life which had $389 committed, with another $128 million in Australia.[6]

Conclusions

The IT and e-commerce revolutions have proved a catalyst for the continued growth of the venture capital industry in Australia. As the ABS survey shows, firms invested predominantly in computer-related and consumer-related industries in the communications, IT, services and manufacturing sectors, which have significant potential for high value added and export growth. In terms of the geographical spread of investments, the majority of venture capital investments were made in New South Wales.

The ABS survey also reflects other industry surveys which show that super funds are under-invested in this asset allocation, confirming a conservative investment approach to investing in the Australian venture capital sector. But more revealing is the minor role played by Australian institutions, which are clearly less enthused about investing in home-grown innovative enterprises. It remains to be seen, therefore, whether the recent tax incentives recommended by the Ralph Review of Business Taxation are sufficient to encourage greater institutional investment in the industry.

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1. Australian Bureau of Statistics, *Managed Funds*, Cat. No. 5655.0, released on 28 February 2001.
2. A key recommendation of the Ralph Review was to promote venture capital investments by exempting capital gains tax earned through Pooled Development Funds by Australian superannuation funds, and exempting from capital gains tax investments in venture capital projects by non-resident tax-exempt pension funds, such as US and UK pension funds (see *Review of Business Taxation: A Tax System Redesigned*, Section 19: Venture capital tax relief, pp. 611–22, July 1999).
3. See 'Venture Capital Survey: Australia & New Zealand Investment Activity—2000', *Australian Venture Capital Journal*, March 2001, No. 96, p. 6.
4. In the US, pension schemes contribute 30 per cent of the total invested by US venture capital fund managers and invest, on average, about 1.5 per cent of their assets in venture capital. In the EU, they contribute 24 per cent of funds raised by the venture capital sector. See 'Institutional Investors', *Financial Times*, 1 December 2000 and *Benchmarking Australian Institutional Investment in Domestic Venture Capital*, Department of Industry, Science and Resources, June 2000, p. 27.
5. See *2000 Australian Venture Capital Yearbook*, Australian Venture Capital Association Ltd, prepared by Venture Economics/Thomson Financial.
6. '2000 AVCJ Survey of Institutional Investors', *Australian Venture Capital Journal*, November 2000, No. 93, pp. 18–25.