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Senator Andrew Bragg
Chair, Senate Select Committee on Financial Technology and Regulatory Technology
By email to committee secretariat

18 December 2020

Dear Senator

Re: StartupAUS submission to Select Committee on Financial Technology and Regulatory Technology

Thank you for the opportunity to continue to contribute to the ongoing work of your committee. StartupAUS would like to commend the committee on its work to date and its consultative approach with industry.

The following submission relates broadly to the settings underpinning the growth and success of Australia's technology sector. It builds on in-person consultation with the committee and expands on three key areas:

1. Expanding the Early Stage Innovation Company (ESIC) tax incentive program to include a wider array of promising young companies;
2. Investing in attracting and retaining world-class tech talent; and
3. Introducing a scheme similar to Rule 10b5-1 trading plans in the US.

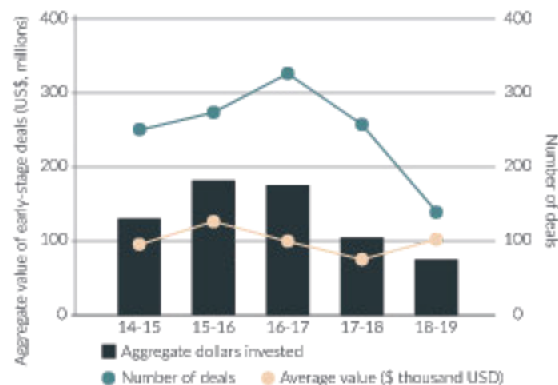
Yours sincerely,

Alex McCauley
CEO, StartupAUS

1. Expanding ESIC

Access to capital is critical to young tech firms of all types. High-risk early stage capital is particularly important. Despite generally strong capital conditions for high-growth technology firms in the last three years, funding at the earliest stage ('seed') has consistently declined.

EARLY STAGE FUNDING, AUSTRALIAN STARTUPS (JUNE 2014 - JULY 2019)¹



Objective

Accelerate local job growth by improving access to early stage capital for young innovative businesses.

Policy action proposed

Broaden the Early Stage Innovation Company (ESIC) qualification criteria to provide streamlined access to genuine startups.

Problem

The initial qualification criteria for ESIC were, justifiably, established with a narrow scope. The scheme offers generous tax incentives, and there was some uncertainty as to its popularity and the mechanics by which it would operate. A narrow scope allowed oddities and quirks in the scheme to be ironed out and reduced the potential for abuse.

Nevertheless, this narrow scope has led some genuine startups to be excluded from the scheme, or increased uncertainty by pushing companies to use the principles-based assessment method (rather than the narrowly-defined, but more certain, points-based system). In an environment where early stage capital remains a concern for the startup ecosystem, this is an area where improvement could yield valuable results.

More could also be done to boost awareness and understanding of the scheme, helping boost uptake and impact.

¹ <https://crossroads.startupaus.org/analysis/capital/seed-capital>

Solution

Expand the early stage test and initiate a review of the innovation test criteria in consultation with industry for determining status as an Early Stage Innovation Company.

Detail

i) Innovation test

Currently the 100-point innovation test consists of a series of activities indicating innovative activity. A review of these activities, both to add activities that may indicate an entity is a startup and also to increase the points-value of very strong pieces of evidence, could increase certainty and access to the scheme by innovative businesses.

Examples of areas which could be expanded include:

- Membership of a recognised accelerator or incubator is clear proof that the industry considers the business to be a legitimate startup and could be increased to 100 points.
- Receipt of an Accelerating Commercialisation grant, with its corresponding process of thorough due diligence by a panel of industry experts, could similarly be increased to 100 points.
- Some consideration of points allocated for membership of co-working spaces that specialise in startups like Fishburners, Inspire9 or Tank Stream Labs.
- Consideration could be given to startup-specific community events, like hackathons and competitions.

ii) Early stage test

Currently, the early stage test consists of four criteria:

1. The company must have been incorporated or registered in Australia within the last three years;
2. The company must have total expenses of \$1 million or less in the previous income year;
3. The company must have assessable income of \$200,000 or less in the previous income year; and
4. The company can't be listed on a stock exchange, either in Australia or elsewhere.

The age requirement of three years serves little functional purpose and can easily disqualify a startup that simply started slowly, or one which has spent a significant period developing and testing the technology underpinning the business before seeking to raise capital. We recommend this limit be increased to five years to help mitigate these issues.

The restriction on expenses and income could also be expanded. Some startups may be forced into an undesirable situation where they lose ESIC status as a result of hiring more staff, spending more on R&D or acquiring a significant customer base.

An increase to the expenses threshold to at least \$5 million and the assessable income to at least \$1 million keeps the scheme firmly in the domain of an early stage business while not causing startups to be hamstrung while raising their initial rounds of capital.

iii) Promote and educate

Some investment of resources to promote the scheme and educate both startups and investors is required for the full value of the scheme to be unlocked. A series of open sessions and events, including in partnership with coworking spaces or other organisations, discussing the incentives and the eligibility criteria could help close a gap and increase targeted participation in the scheme.

Risks and mitigation

The biggest concern in expanding the ESIC definition is the increased potential for the tax offset to be directed in a manner not originally intended by the scheme. Limiting claims to genuinely innovative companies is critical, as is avoiding misuse of the scheme.

In this case, however, the modest existing subscription to ESIC status indicates that the current scheme is well protected and the proposed changes to the qualifying criteria are sufficiently nuanced to maintain the broader integrity of the scheme.

2. Attracting and retaining world-class tech talent

In his foreword for *Crossroads* in December 2017, Atlassian co-founder Scott Farquhar said, 'attracting talent is now the single biggest barrier facing Australian startups'. Companies consistently report that this remains true in 2020.

Importing talent

Young technology companies are typically looking to compete in global markets right from the outset. To succeed in such a competitive landscape, Australian firms need to have access to the best tech talent in the world. The skills required to build a high-growth tech firm are in fierce demand, driving a global war for talent. And digital tech is often a 'winner-takes-most' environment, where firms who can attract large user numbers often quickly overrun rivals, creating feedback mechanisms that make talent even more valuable.

Skilled migrants lead to growth in Australian jobs

For tech firms, access to the right talent often means rapid growth. In this context, 'growth' typically means boosting local employment. Importing talent in key positions is therefore a key driver of local job creation. StartupAUS data over the last three years supports this thesis, with difficulty finding high quality candidates for key positions in product management, digital

marketing, UX and UI design, and data science often holding companies back from further employment growth.

Simply put, skilled migrants help companies grow and employ more Australians.

Migrants are also over represented when it comes to starting high-value technology businesses. In the US, Fortune Magazine notes that of the 25 most valuable privately-held tech companies, 60% were founded by first or second-generation migrants. Those companies now employ 1.9m people. These figures align closely with Australian data - StartupAUS analysis suggests more than 50% of the most successful Australian founders in the last 10 years are also first or second generation migrants.

Global talent visas - expanding visibility with a 'sourcing fund'

The introduction and expansion of the Government's Global Talent programs has aligned closely with the needs of the tech sector. Employer sponsored global talent visas have provided a pathway for some firms, while the rapid expansion of the 'independent' global talent program could help position Australia as a natural home for world-class technology leaders.

Both the Global Talent (Employer Sponsored) (GTES) and Global Talent (Independent) (GTI) programs have room for significantly increased uptake. Additional efforts to promote these programs, both with local businesses looking to hire and with prospective visa applicants, would increase visibility and help Australia capitalise on a unique opportunity to attract skilled migrants. Efforts to promote the programs should also be coordinated with local industry to help increase two-way visibility between hiring firms and would-be migrants.

A global talent sourcing fund should be established to bolster industry efforts to promote Australia and attract high value candidates. The fund could be administered by the recently-established Global Business and Talent Attraction Taskforce and would be used to match private sector efforts to unearth and recruit the world's best and brightest tech workers. This would sit alongside and support existing programs including the network of Global Talent Officers.

Attracting and retaining talent - Employee equity

A critical factor in tech companies attracting talent is their ability to offer equity in the business as part of remuneration packages. This model has emerged as a feature of tech companies around the world, aligning employee and employer motivations and giving staff skin in the game.

Employee equity arrangements in Australia improved substantially in 2015, with changes legislated specifically to help startups issue options under Employee Share Options Plans (ESOPs). This was an important step, but some amendments still need to be made in order for

Australia to have a truly world class equity access regime. StartupAUS has provided a separate submission in relation to proposed ESOP amendments ([available here](#)) and would encourage the Committee to support and adopt the work done during the course of 2020 as part of the Parliamentary Inquiry into the Tax Treatment of Employee Share Schemes.

3. Rule 10b5-1 trading plans

We note reference in the Issues Paper to the idea of introducing a scheme in Australia similar to the Rule 10b5-1 trading plans in the US. We would welcome and support such a proposal. In preparing this section we have received the support of a number of companies including Airtasker, Athena, Cluey Learning, CultureAmp, Deputy, Kogan, NextDC, Nitro, Rokt, Tyro, Zip, Temple & Webster.

As it stands, founders and company insiders in Australia are relatively constrained from selling stock in companies once they are publicly listed. This has system-level implications, tying up capital which could otherwise be used to support new ventures or redeployed elsewhere. The circulation and redeployment of entrepreneurial capital is a critical component of successful startup ecosystems. Atlassian's founders have had the benefit of 10b5-1 arrangements because Atlassian is listed in the US. That has facilitated reinvestment in Australia's startup ecosystem through dedicated funds set up by both the company's co-founders - Skip Capital (Scott Farquhar) and Grok Ventures (Mike Cannon-Brookes).

Under the current rules, founder stock divestment can also have market implications. Absent a 10b5-1 process it is often seen as a signal indicating a lack of confidence, and can cause stock price fluctuations. A system to regulate these transactions without impacting the market would help limit volatility unrelated to business fundamentals.

The ability for founders and insiders to divest stock is likely to be a factor in the listing decision for any Australian tech firm looking to go public. The absence of a system equivalent to Rule 10b5-1 could discourage firms from listing in Australia.

We note that a proposal similar to this was recommended in 2003 by the Corporations and Market Advisory Committee.²

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[https://www.camac.gov.au/camac/camac.nsf/byheadline/whats+newinsider+trading%253a+report+\(nove mber+2003\).html](https://www.camac.gov.au/camac/camac.nsf/byheadline/whats+newinsider+trading%253a+report+(nove mber+2003).html)