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Submission to: **"Inquiry into developing Indigenous Enterprise"**

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The two major constraints in creating and expanding Indigenous Enterprises are access to risk capital and hands-on assistance in nurturing indigenous human capital.

This submission proposes the establishment of several, specialist early stage Indigenous Venture Capital (VC) funds to address these issues.

All around the world, following the success of new business creation in the US, Governments have fostered the creation and growth of a VC industry to provide risk capital for commercializing research, innovation and new business ideas typically developed by entrepreneurs. VC is now a well proven model around the world and is a critical component of an innovative and entrepreneurial society.

Because of its success and hands-on-approach to building human capital – compared to Government grants, bank loans or philanthropy – it is being increasingly used to generate employment and wealth creation in areas of poverty and social dislocation in developing countries. We are seeing funds established in Africa, the Indian sub-continent, Palestine (with Israeli money), China, South America and the former Soviet Union.

The hardest part of starting or growing an early stage non-indigenous company, which is still in losses and has no mortgageable assets, is raising money.

Raising money for Indigenous Enterprises will be a lot, lot harder… needless to say.

Other sources of capital for any start-up are:-

- family and friends – small, not scaleable, often emotional (versus hard-nosed) with little human capital development. Often precedes VC.
- wealthy private investors – so-called angels. This is adhoc, ephemeral (disappears in difficult times) and usually not hands on and usually lasts one funding round only. Not equipped for intense long-term involvement, especially when the going gets tough. Often precedes VC.
- Banks – only lend against tangible, liquid assets or very strong consistent cash flows. No human capital development. Not appropriate for early stage companies.
- philanthropy – because of tax issues they can only support not-for-profit charities. Very hands off. Need lots of small amounts so a lot of time is spent fundraising. Wrong culture for Indigenous Capital.
- grants – usually small, very expensive to apply for and administer. Wrong culture. Additive rather than a substitute for VC.

Also in developing countries:-

- microfinance – very small amounts for very small personal businesses. Questionable relevance in Australia with high minimum wages, OH&S issues. Much smaller than VC. Possibly seed for later VC investment.

The Australian Government has studied this funding gap over many years including looking at best practice internationally.

They concluded at each study there is 'market failure' in early stage VC in Australia and have introduced several programs over the last ten years. Namely the Innovation Investment Fund (IIF), Pre-Seed and Early Stage Venture Capital Limited Partnership (ESVCLP) programs. The IIF was based on the Israeli Yosma and US SBIC programs.

With the IIF and Pre-Seed Funds, the Government's role is one of arm's length investor providing incentives for private sector co-investment. Its latest new program, the ESVCLP, which is meant to complement the other two, is tax driven, aimed at high net worth individuals but it is struggling and is very unlikely to succeed in true start up businesses especially in the current climate. These are targeted at far more prospective investment areas than Indigenous Enterprise such as commercialising medical, biotech and information technology innovation, telecommunications and internet research and development and innovation.

I submit therefore that the most viable source of investment for Indigenous Enterprise is Government. Primarily Federal but could be matched by States.

Best practice in Australia and globally has the Government as an investor through private sector VC managers not directly investing. The Government typically doesn't want to directly 'pick winners', close down or restructure non-performing investments etc or have the skills and culture to manage the human capital issues.

The best program to model an Indigenous VC program on would be the Pre-Seed which is for commercializing publicly- funded research and development. There exists a good governance regime, a well-regarded bureaucratic team in Innovation Australia (part of the Department of Industry) and legislation which has had bi-partisan support. There would need to be several modifications to fit Indigenous Capital but it would be a good model.

For example, the 1:3 private sector: Government matching investment should be deal by deal and be cash or in kind by corporate partners rather than a blind pool of money. This provides direct help to the Indigenous Enterprise from corporate Australia. An example would be a mining services contract and training to an Indigenous Enterprise from a mining company or a joint venture from a tour operator with an Indigenous Enterprise in the tourism sector.

In the Pre-Seed the return to investors usually comes from a trade sale. With Indigenous Enterprise this is counter to the objective and unlikely in any event. Investments should have more flexibility in structure such as loans or convertible notes, than under the Pre-Seed. There are other points I could provide in detailed discussions if appropriate.

Indigenous Capital Limited (ICL) was established to provide VC to Indigenous Enterprises. ICL was initially funded by myself and several other senior business people. A grant was received by the old Aboriginal and Torres Strait Islander Commission (ATSIC). A young indigenous person, Joe Proctor, who had been on the Board of Indigenous Business Australia was recruited to run ICL and conduct the feasibility study to see if there were investible Indigenous Enterprises and what would be the best way of funding and growing them.

It is often suggested that Corporates could be a source of capital. I believe this is very unlikely. Boards only invest in core businesses and usually of scale. They do not have a social or philanthropic charter. Corporate Social Responsibility (CSR) has typically much 'softer' programs and are directly relevant to the company's business. Also, corporates typically struggle with working with small, unsophisticated companies. Sometimes the 'elephant' squashes the 'flea' they are trying to help. A VC-backed Indigenous Enterprise would be much better equipped to partner with larger companies. Within the IT industry most Corporates who have tried direct partial VC investments (versus 100% acquisition) have subsequently ceased these operations. E.g. IBM, Boeing, Cisco, Ericssons. At the time it may be well-meaning but inevitably some-one says 'why are we doing this?'

Another source that would appear obvious are super funds. Australian superannuation institutions have an unprecedented amount of capital under management. However, again trustees have a duty to maximize returns to beneficiaries and not to support social or high risk programs. Whilst some of the larger ones have historically invested in VC most have vacated the early stage of VC. This is because they are now so large it is not economic to invest and manage small investments (often now $50m plus). They also have prudential limits of no more than 15% of one fund. This plus the risk profile has lead them to invest larger amounts in later stage funds VC usually called Private Equity or buy out funds and high yielding infrastructure funds. Also importantly returns across the industry from VC have not been competitive with less risky later stage investments.

All this currently applies to non-indigenous VC so all the more difficult for Indigenous Enterprises VC. It therefore leaves the Government as the most viable source of VC for Indigenous Enterprises.

Are there viable Indigenous Enterprises?

Indigenous Capital Limited's (ICL) feasibility study concluded there are some, not many existing successful Indigenous Enterprises. Further ICL believe there are opportunities to create new Indigenous Enterprises in areas such as:-

- tourism
- mining services (including leverage from climate change policies)
- telemedicine

Also my experience in non-indigenous VC is that the availability of VC itself stimulates new business formation and entrepreneurship.

Many of these Indigenous Enterprises may be able to operate in remote communities. Access to broadband internet is a significant enabler for some, not all, of these business opportunities.

The recently announced initiative led by Andrew Forest for Corporate Australia to employ 50,000 indigenous people is entirely complementary to building indigenous owned businesses. It will help human capital development and offer alternative career paths but in many cases people will have to leave their communities and country which is counter to other objectives. Also there is a danger of the jobs being low-level, token and lacking self-esteem and self-determination.

Indigenous ownership and self-employment are very powerful when successful and its more likely businesses can be built within the community.

Human capital development is critical and will be challenging. Not all Indigenous Enterprises would employ 100% indigenous employees. Ownership is critical but at least initially the best management people should be recruited to maximize success and employment opportunities for indigenous people. Joint venturing and mainstream corporate partnering can also assist greatly.

This is a core value-add from an Early Stage VC manager. ICL was formed to be one such manager and I believe there would be at least 3 or 4 other entities that would be created to manage such funds. The Pre-Seed program has 4 licensees selected through a competitive tendering process. These VC's would complement Indigenous Business Australia (IBA) which is one of the few sources of capital and is less hands-on than proposed.

ICL approached the previous Government with this model after its feasibility study. It received favorable consideration resulting in the Prime Minister asking several Ministers to bring a submission to cabinet (see attached). The department of Industry seconded a senior person from the IIF and Pre-Seed program to study the idea over several months. A discussion paper was prepared for public comment (see attached).

A positive recommendation from them went to Cabinet but there was some lack of coordination between the other key Departments involved (Indigenous Affairs and Employment) which meant it was referred back for additional work. Subsequent events overtook its progress.

Without a fund ICL has been looking at Indigenous Enterprises on the basis of needing to raise money deal by deal. This is not ideal because of the uncertainty of finance and extensive delays. There is skepticism that investment would be forthcoming.

Notwithstanding ICL has identified a particular opportunity in Indigenous Tourism with the Eastern Kuku Yalanji people in the World Heritage rainforest following their Indigenous Land Use Agreement (ILUA). ICL is funding the development of a proper business plan and will endeavour to help them raise capital.

ICL is itself a not-for-profit company. I am a very experienced Venture Capitalist and am prepared to put significant effort into ICL to bring VC to Indigenous Enterprises. ICL has a large Corporate Australia network and can help in partnering. Corporates will better partner if Indigenous Enterprises are properly funded and managed.

Whilst I do not have direct experience of the US minority business development council, I have experience of other 'minority' Government purchasing programs in Australia.
The danger is that Indigenous Enterprises are invited to bid on many complex and expensive bidding processes (to tick the box) but don't actually win business because they are adjudged to not be competitive on price or quality or not to have the scale or coverage to reliably deliver. Usually tenders have to pass financial creditability examination, or post bonds or have minimum turnover requirements. Whilst higher level executives or bureaucrats may adopt a policy the operational people who manage the budgets and are responsible for performance are often risk adverse and quick to blame/dump minority suppliers if any problems arise.

VC-back Indigenous Enterprises would be much more creditable in any such program and would help allay many of the fears, prejudices and concerns purchasing officers would have in such programs.

With these caveats such a program would be helpful.

Details of the Directors of ICL are attached. We are also supporting some indigenous human capital development (train the trainer programs) and has given a number of scholarships.

ICL recently commissioned a new indigenous music composition by William Barton in conjunction with the Sydney Symphony Orchestra, it premiered at the Opera House in April.

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