

Head of Secretariat
Financial System Inquiry
The Treasury Langton Crescent
PARKES ACT 2600

Draft Terms of Reference, Financial System Inquiry

Research Australia is pleased to have this opportunity to comment on the draft terms of reference of the Financial System Inquiry.

Research Australia endorses the Government's commitment to improving the nation's productivity, and we recognise the vital role the financial system plays in facilitating productivity through the efficient distribution of capital.

While we welcomed the Assistant Treasurer's recent comment that the Financial Services Inquiry 'could look at ways to overcome "gaps in the capital market" for innovation', it is not apparent that the current draft terms of reference for the Inquiry address the role of the Financial System in supporting productivity and innovation¹. The two references in the terms of reference to innovation relate to innovation within the financial system rather than the capacity of the financial system to support innovation in the broader economy.

Research Australia submits that the terms of reference should be amended to specifically include consideration of how the financial system can better support productive investment and innovation, and whether there is a bias in favour of non productive investment in the current financial system.

The case for including the financial system's support for innovation

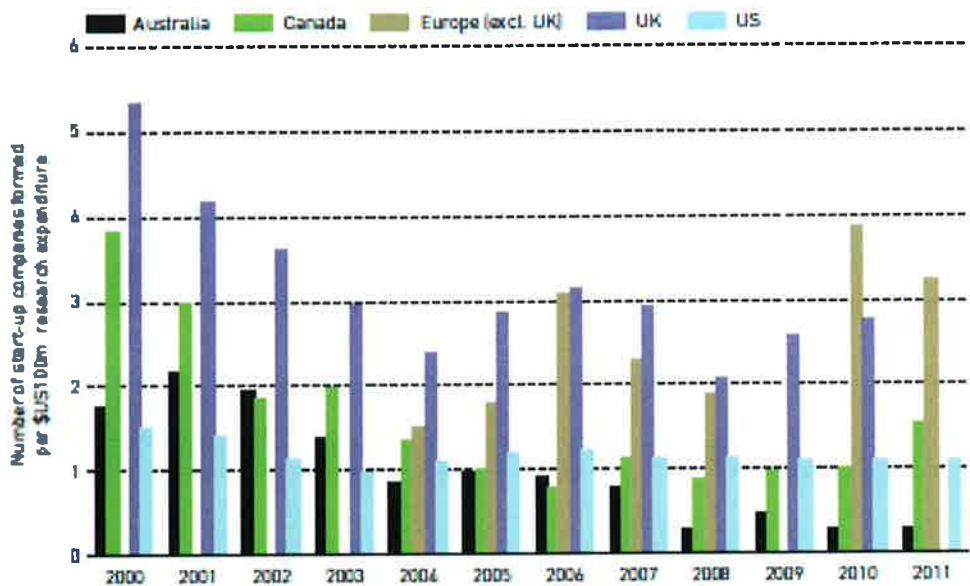
Australia has a strong and vibrant health and medical research sector and a tradition of world-class scientific research. Our history in innovation, however - in commercialising the discoveries of our research - is less satisfactory by world standards. *The National Survey of Research Commercialisation 2010 and 2011* reported that there were only 0.3 Australian start up companies formed for every USD100 million spent on research in Australia, compared to 1.1 in the USA, 1.6 in Canada, 2.8 in the UK, and 3.2 in Europe². And this has been the trend for more than a decade as the graph on the following graph page illustrates³.

¹ *Sinodinos says government keen to unlock funds for innovation*, The Australian, 27 November 2013

² Australian Government, *The National Survey of Research Commercialisation 2010 and 2011*, p.36

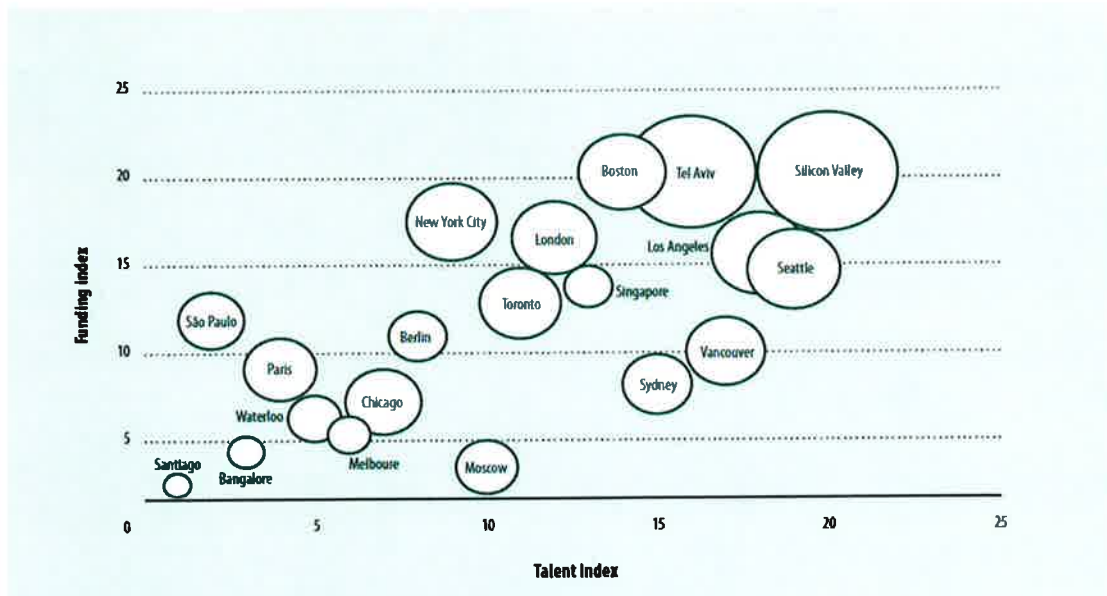
³ *Ibid*, p.39

Figure 21: International comparison of start-up companies formed per \$US100m research expenditure, 2000-11



In the 2013 Global Innovation Index, Australia’s innovation ‘ecosystem’ was ranked 19th out of the world’s 45 high income economies⁴. And, while access to capital is only one factor which determines a nation’s innovative capacity it is an important one, and there are indications that a lack of ready access to capital and finance is one of the key factors restricting Australian innovation. The below table highlights the relatively low availability of risk capital to support innovative Australian start up companies.⁵

Figure 5: Top world start-up ecosystems, 2012



Source: Author’s elaboration, based on Telefonica Digital and Startup Genome, 2012.
 Note: The bubble size indicates the positioning of each territory in the total ranking, where Silicon Valley ranks at the top (i.e., 20) and Santiago at the bottom (i.e., 1). In each index, Silicon Valley is assumed to be the reference and it ranks at the top (i.e., it scores 20). The funding index measures the availability of risk capital in each start-up ecosystem, while the talent index ranks the skills of the start-up founders in each territory, taking into account different variables including age, education, work experience, and industry domain expertise, among other factors.

⁴ Cornell University, INSEAD, and WIPO (2013): The Global Innovation Index 2013: The Local Dynamics of Innovation, Geneva, Ithaca, and Fontainebleau, p.76

⁵ Ibid, p.76

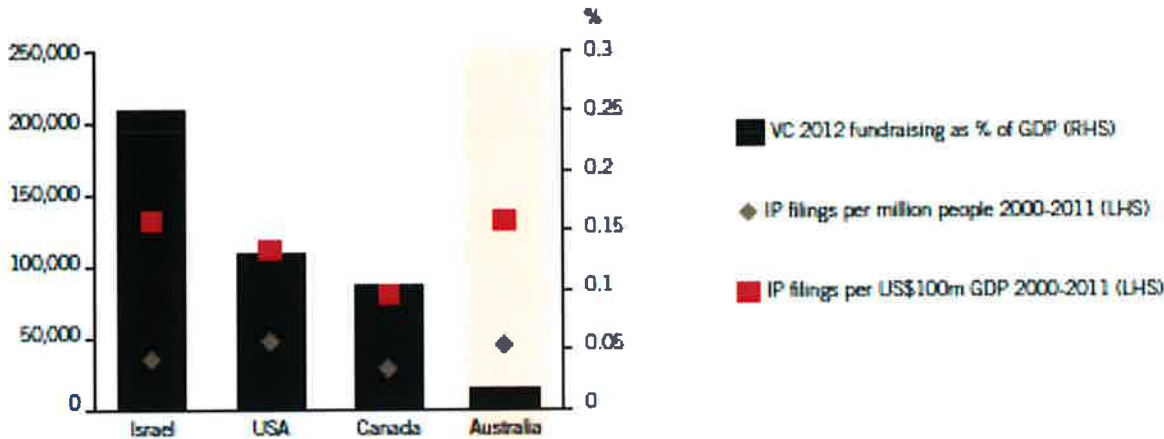
And it is not only start-up companies that struggle in the Australian economy. In the article referred to earlier, the Assistant Treasurer identified three success stories: Cochlear Limited, CSL and Resmed, all in the health sector. Cochlear Limited took nearly 25 years from the commencement of research to its listing on the Australian stock exchange, and the Australian Government was a significant investor in the company in the 1980's.⁶ CSL was initially an Australian Government owned enterprise, created in 1916, before it was incorporated in 1991 and listed on the ASX in 1994⁷. Resmed has a more conventional start up history, having been formed in 1989 and based on research initiated at the University of Sydney in the early 1980's. It is listed on both the Australian and US stock exchanges.

The above cases illustrate that the most successful Australian innovators have not always relied on the Australian financial system to fund their success. Improving the capacity of the financial system to support innovation is critical to our future success as a productive, knowledge intensive economy with a sophisticated high-value manufacturing sector.

Venture Capital

Investing in innovative new businesses is risky. Globally, venture capital is an important source of funding for innovators. And yet in Australia, the venture capital market appears to lack the depth to support innovation to the same extent that it does in other countries, as illustrated by the following table.

Figure 1: VC funds raised vs Intellectual property filings



Sources: WIPO, AVCAL, CVCA, IVC-Online, NVCA

⁶ <http://www.cochlear.com/wps/wcm/connect/au/about/company-information/history/history>

⁷ <http://www.csl.com.au/about/history.htm>

Conclusion

The benefits to the Australian economy of boosting productivity through innovation are self evident, and the Financial System plays a key role in this task. Research Australia submits that the capacity of the Financial System to fulfill this task should be explicitly part of the terms of reference of the Financial System Inquiry.

Research Australia thanks you for the opportunity to make this submission and would be pleased to provide further information or answer any questions that this submission may have raised.

Yours sincerely



Elizabeth Foley

CEO & Managing Director

3 December 2013

About Research Australia

Research Australia is an alliance of 160 members and supporters advocating for health and medical research in Australia. Research Australia's activities are funded by its members, donors and supporters from leading research organisations, academic institutions, philanthropy, community special interest groups, peak industry bodies, biotechnology and pharmaceutical companies, small businesses and corporate Australia. It reflects the views of its diverse membership and represents the interests of the broader community.

Research Australia's mission is to make health and medical research a higher priority for the nation. We have four goals that support this mission:

- A society that is well informed and values the benefits of health and medical research.
- Greater investment in health and medical research from all sources.
- Ensure Australia captures the benefits of health and medical research.
- Promote Australia's global position in health and medical research.