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Journalist: Adrian Johnstone

Australia's reputation for fostering startups has slipped recently. Here's what we can do to fix that

There is little doubt on both sides of the political divide that supporting fast-moving, innovative firms is logical on several levels. The reasons are compelling but in the rawest form, all employment is good for the budget through taxes, business and consumer confidence.

These firms are typically — but not always — startups. More nuanced to startups is the often-exponential growth curve that can dramatically shift each of those metrics when amplified across the sector. In its 2017 Innovation System report, the Australian Department of Industry, Innovation and Science noted that high growth firms made a "disproportionate economic contribution" in terms of both employment growth and turnover.

Less tangible but no less important is the impact to Australia's international reputation for innovation, something former prime minister Malcolm Turnbull waxed lyrical about. For decades Australia has been a leader in innovation on many fronts, which in turn attracts further investment from large institutions adding to the positive budgetary cycle.

This leadership has also fuelled interest in the higher education sector as international students seek to follow the path of these success stories. The significant interruption of the global pandemic to this sector highlighted the positive material impact these students have on the economy and the budget bottom line. The StartupBlink Ecosystem 2021 Index Report also praised the direct involvement of universities as active stakeholders in the development of city ecosystems.

Slipping in the ranks

In spite of all this support, our global ranking has slipped.

While international benchmarking is difficult, the same StartupBlink Ecosystem Index Report recently released its ranking of 1000 cities across 100 countries, using a sophisticated algorithm that reflects a wide range of parameters.

Although Australia ranks number nine for its startup ecosystem, Sydney and Melbourne are some way down the list, just scraping into the top 40 city rankings. Unfortunately, both Australia and Sydney have been slipping down in the rankings over recent years, so there is work to do.

The US and its key innovation hubs remain head and shoulders above all other countries, with China storming up the table as it successfully decouples from the global startup ecosystem and gains local strength.

The challenges facing startups

As an Australian startup that has expanded successfully into the US market, we have first hand experience of the barriers facing startups and how they differ between global markets.

At Practifi, we were very fortunate to have the backing of equity venture partners through our Series A round to kick start our US operations. This US investment was made possible in part through the Early Stage Venture Capital Limited Partnerships (EVSCLP) program. It financed our US foray and enabled us to invest into market development, product localisation and recruitment.

For Australian firms expanding internationally, distance and time-zone are challenges that must be surmounted via travel and face-to-face interactions. But for an early-stage business, travel is expensive, and capital is precious so there's a natural dichotomy between where to spend the money, international market development or local growth. In our own expansions we threw resources behind the early momentum we were seeing in the US. Having learnt what the best performing and fast growing firms in the US are doing to further accelerate scale, we're now refocusing our efforts in Australia to bring this knowledge to the local market.

In global expansion, the Australian government's Export Market Development Grants (EMDG) process is helpful but fairly limited, and an area where more could do more to encourage early-stage businesses. Establishing a US entity and navigating the combination of state and federal tax environments, employment laws and employee benefits programs takes close study and expertise. Local advisors are often expensive, and you need to have an appetite (and budget) for some trial and error.

The ESTA visa-waiver program is useful in the early stages of market exploration, but you quickly need to rely on the E2/E3 visa program and that is slow, cumbersome and can be costly. Again, the Australian government, perhaps through Austrade, could do more to help this program run more smoothly — even if this was for an initial six to 12-month window.

The government's existing R&D grants scheme (and the EMDG) are vitally important in supporting early-stage growth and scaling firms. There is however an opportunity to reduce the red tape as current evidentiary obligations and required skills for the scheme are cumbersome and off putting for very early-stage firms.

Investment into innovation 'hubs' often via state government is effective and represents a cost-effective way to gain office locations for startups; however in a post-COVID environment the utility of this has dropped as a city presence becomes less important in the age of remote working.

CGT reform is a must

Conversely Capital Gains Tax reform is an area the government must look at closely if it wants to take innovation seriously.

Specifically, the government should consider adopting a Qualified Small Business Stock (QSBS) tax exemption like the US. This will incentivise Aussie tech startups to focus more on growth, by allowing them to reduce capital gains taxes incurred when selling a stake in a startup.

Most founders forgo income beyond a basic living wage for years to reinvest every cent to grow the business. When they then have a first chance to take some relief through a funding round there is a considerable amount to pay to the government in CGT. For many founders this is a bitter pill to swallow as they've given up so much to employ others, build IP and hopefully, given high failure rates, become a viable business. In its current form, CGT represents the government taking a slice of these businesses without providing real assistance.

Australia's startup scene is vibrant and governments at both state and federal levels seem to acknowledge their significant value potential. Sometimes this seems to get lost in the overall 'small business' rhetoric which can have the tendency of lumping rapidly scaling and internationally aggressive technology firms like Practifi into budget programs alongside small retailers, personal trainers and restaurants.

Their needs, however, are as different as their growth trajectories and therefore require specific government policy support and incentives.