Unadventurous Aussies miss investment opportunity boat

By **Stirling Larkin**

THE saying goes that if we banish the dragons we also banish the heroes. Even in 2014, Australian investors all too often discount early-stage investments as dragons, and by doing so miss out on the heroic opportunities that are often right in front of them.

The global investor knows that these opportunities, if identified and nurtured correctly, lead to the champions of tomorrow.

The ability to pick these winners early is not only an art, but also a competitive advantage that rewards them well, both in the present and the future.

In Australia, this discounting has led to two outcomes.

The first is where proactive ultra-high-net-worth investors have secured these early-stage opportunities exclusively, thereby crowding out any possibility for others to co-invest.

The other is where these same investors then look abroad to global markets where early-stage investments are packaged far better than those currently in Australia.

Both scenarios dry the well for other Australian investment communities and highlight how unsophisticated our market still is.

There's a compounding element in that the lack of sophistication then limits the choices available to other domestic UHNW's and subsequently makes foreign opportunities appear more viable, lucrative and attractive.

What makes this story even more vexing is that Australia already has too many early-stage pioneers who continue to struggle to find funding that would allow them to commercialise their new ideas and become the champions of tomorrow.

What's baffling is that our economy already has the required established financial architecture to be able to match these opportunities with investors' capital.

The explanation provided by local venture capital and so-called early stage private equity firms is that they require not only proof of concept but also at least a minimum of three years' proven revenue before even considering seeding a new enterprise.

They purport to be conservative and risk-averse but in fact this demonstrates their folly, lack of sophistication and basic misunderstanding about what venture capital actually is.

The Macquarie Dictionary defines it as "money invested in high-risk, newly established companies in the expectation that the returns will justify the risks taken". The dictionary also cites this as "risk capital".

Accordingly, these firms should not be calling themselves venture capitalists but middle stage investors.

This disconnect alone means that Australian entrepreneurs face a crippling funding gap during the very phases when funding is most needed.

This appears to be an Australia-specific predicament and one that has the potential to disconnect us from the global economy.

When the American colonies declared independence in the late 18th century and pioneered a new free market entrepreneurial model, many in the established world in Europe ostracised this new approach and believed it to be doomed.

Then in the latter years of the 19th century they cited the calamities of the US Civil War as evidence of this model's ultimate failure.

But history has shown us that these naysayers spoke too early and in the two centuries that followed this entrepreneurial model produced the world's greatest commercial heroes: Vanderbilt, Rockefeller, Carnegie, JPMorgan, Ford, DuPont, Gates and Zuckerberg, to name but a few.

It is without question that the US today is the world's premier early-stage investment market.

The importance of entrepreneurship and early stage investing is not only deeply embedded in their economic system but also equally revered in the US social fabric.

It then comes as little surprise to most that Australian talent and opportunities continue to head to the US. This exodus further compounds the issues here at home and self-reinforces this trend.

In the early 2000s, while many Australians remained squarely fixated on the mature stories of iron ore and coking coal, a young Australian stockbroker by the name of Guy Goudy quit his comfortable job in Sydney and headed for the North American prairies to join the burgeoning frontier of shale gas exploration.

Unlike others who remained wilfully blind to this opportunity, Goudy chose to risk it all in the belief that the transformative phenomenon of horizontal drilling used to extract these hydrocarbons would become the industry of tomorrow and the needed disrupter to the established OPEC monopoly.

Joining Austin Exploration in 2009 and after enjoying some early successes, he and his American colleagues decided to raise early-stage funding not initially in the US but in the Australian market, which he knew well.

It quickly became clear that this was a mistake.

Australian investors failed to recognise any opportunity that was not tied to the mature stories of iron ore, coal, yellowcake uranium or the established domestic oil and gas fields. It was discounted not on its merits but on its idiosyncrasy.

Determined to push forward, Austin Exploration then reverted to the American early stage investment markets, where they quickly received strong support.

This support then allowed Austin to partner with the much larger Halcon Resources to drill their wells, and earlier this year they produced impressive results that have validated Austin’s acreage as sitting atop of the sweet spot of the Eagle Ford Shale oil window in east Texas.

According to OPEC, this window is second only to Saudi Arabia as the largest oil-producing region in the world.

Back in Australia, the issues with early-stage investing have hurt two sectors in particular: biomedicine and information technology.

The recent announcement of a dedicated Australian government medical research future fund should directly help reinvigorate the early-stage biomedicine industry, but regrettably IT entrepreneurs continue to struggle.

Heroes may have to slay a few dragons to get to the princess — let’s hope she’s an Australian one.

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