

# Bright ideas can give investors thrills and spills

Measuring the risk of investing in innovation is as much an art as a science and is fraught with pitfalls, writes **Tim Mendham**.

Innovation is now an intrinsic part of all private and public sector policy statements. Whether it's innovation in technological solutions to climate change, improving internal processes or just giving us Australia's first Federal Department of Innovation, innovation is seen as vital to organisational and national development and even survival.

But funding that innovation can be a problem.

Australian Private Equity and Venture Capital Association Limited (AVCAL) chief executive Katherine Woodthorpe says in the organisation's submission to the National Innovation Systems review, now under way, that "venture capital underpins a significant proportion of innovation in Australia, particularly in enabling emerging companies to achieve sustainability".

"The VC industry, with its measured appetite for risk, is often the only substantial financing mechanism that early stage companies can access. Coupled with government grants, VC investment is vital to national innovation."

Measuring the risk involved in

that its 18 venture capital members — which Woodthorpe says represent "the great majority of VC funds" — have more than \$1.5 billion under management in early stage investments and, to date, have invested in more than 200 projects at various stages in their commercialisation life cycles.

Yet she admits in AVCAL's submission that "the VC industry in Australia has not achieved the success of more mature counterparts in economies such as the US. The key challenges to innovation identified by AVCAL include attracting talent, attracting capital, and assisting early stage companies through to viability."

There are differences in the amount of funds and candidate projects available between the Australian industry and other countries.

"Candidate projects in Australia must be innovative," she says. "VCs invest in projects that have a great opportunity, and in Australia that doesn't mean 'me-too'. Overseas there's more room to move, so there is some investment there in me-too projects, but not here."

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ILLUSTRATION: MARK DE JONGH

exceptions, tend not to have the business skills required to manage such inherently risky, innovative projects.

But those same entrepreneurs often complain that there isn't enough funding around for innovative projects.

Woodthorpe rejects this: "There is the money around. The good deals get funded. There just aren't enough projects of the right calibre."

One who looked outside of the VC market for his funding is Alex

businesses founded on a great idea".

He also says that, at least in his case, faith in a good idea has been borne out: "The company has fulfilled and exceeded all the expectations as set out in our prospectus."

And his views on VCs? "There needs to be more of a bridge between the VC industry and innovative companies with a strong business plan. I don't believe there is necessarily enough exposure, education or dialogue between the

## In the balance

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Measuring the risk involved in investing in innovation is as much an art as a science and one that is fraught with pitfalls.

Woodthorpe agrees with the oft-quoted view that out of every 10 VC investments, one will do very well, two will do all right, three will be fair (paying back their investments), and the other three will go bust.

This is why a portfolio approach to risk management is vital, whether funding or managing innovative projects, according to Peter Williams, head of Deloitte Digital and a member of the advisory board for Swinburne University's School for Business Innovation. He quotes a statement from scientist and educator Linus Pauling that "the best way to get a great idea is to have a lot of ideas".

AVCAL conservatively estimates

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"Candidate projects in Australia must be innovative," she says. "VCs invest in projects that have a great opportunity, and in Australia that doesn't mean 'me-too'. Overseas there's more room to move, so there is some investment there in me-too projects, but not here."

To minimise risk, the key criterion for investment is that there must be a market opportunity. If there is no potential market, then there is no point proceeding any further, regardless of how innovative the project.

This means a clear business plan is critical.

"We need to see the opportunity and how to address it," Woodthorpe says. "We see lots of marketing plans, but few sales plans. How do you plan to make your first sale, and what about sale number 10, and sale number 100?"

Once market opportunity is established, other criteria include what is new about the project that addresses the opportunity — the innovation component — and whether the team is right, including access to business skills.

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exceptions, tend not to have the business skills required to manage such inherently risky, innovative projects.

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### **'The best way to get a great idea is to have a lot of ideas.'**

Teoh, co-founder and chief executive of Mint Wireless, a company specialising in wireless technology, including mobile payment systems.

His search for finance, he says, started close to home, "through contributions from personal finances and through loan and private equity agreements with various sophisticated investors that were known to my family and me". This was followed by an initial public offering in last August.

He says he felt "the traditional avenues for finance undervalued

businesses founded on a great idea".

He also says that, at least in his case, faith in a good idea has been borne out: "The company has fulfilled and exceeded all the expectations as set out in our prospectus."

And his views on VCs? "There needs to be more of a bridge between the VC industry and innovative companies with a strong business plan. I don't believe there is necessarily enough exposure, education or dialogue between the VCs and the innovative companies in Australia. Other than a few government programs, I don't believe that the Australian market is currently as advanced or supportive as, say, the US markets."

While Woodthorpe would probably agree with that last statement, she points out that venture capitalists need to be careful with investing in innovative, high-risk projects. "You need to remember that VC capital is largely superannuation money, and would you want that spent lightly?"

She adds that if government topped up the early stage VC funding with its own billion-dollar fund, "there would be plenty around for all projects and, considering the success rate, that would pay off".

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■ They have invested in more than 200 projects.

■ The key criterion is there must be a market opportunity.



ILLUSTRATION: KARL HILZINGER

Carbon reductions, emissions and the environment in general are becoming key issues which are taken into consideration in making business decisions. This report will look at government reports on this area, efforts by organisations to cut emissions, the growing area of green marketing, green building designs and developments in the science of global warming.

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**PUBLICATION DATE: Wednesday 20th August 2008**  
**Advertising Bookings Close: Friday 8th August 2008**

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