30 November 2017

Digital Economy Strategy Team
Department of Industry, Innovation and Science
GPO Box 2013
Canberra ACT 2600

Via email: digitaleconomy@industry.gov.au

Dear Sir/Madam,

Digital economy – Government consultation paper

Thank you for the opportunity to comment on the Government's consultation paper on the digital economy, released in September 2017.

OneVentures is an Australian venture capital firm with $320M of funds under management investing in high growth technology companies seeking to transform large global markets. We see ourselves as building the economy that will be Australia's future and taking companies from startup to grownup. We pride ourselves on real returns that make a real difference. We also manage $105M of capital from the Australian Commonwealth Government through both the Innovation Investment Fund (IIF) and Biomedical Translation Fund (BTF) programs.

I personally was also a member of the NSW government's Digital Economy Taskforce.

1. Overview

The industry and OneVentures welcomes the release of the consultation paper seeking stakeholder input on a future digital economy strategy. Right now there is an opportunity for Australia to take a leadership position and create globally scalable businesses. With the advent of cloud and other technologies, Australian business can be born global on day one and Australia can reap the benefits of large export dollars to support Australian jobs and improve our current account deficit. It is imperative that Australia takes active steps to establish itself as leader in the digital economy, while there is still an opportunity to do so, particularly within the Asia-Pacific region. China and SE Asia are rapidly moving into the digital world and Australia could capitalise on this if it moves fast. If Australia is to succeed economically in the 21st century, it will require both the private and public sectors to embrace

OneVentures Pty Ltd
Sydney (HQ)
Suite 13.02, 179 Elizabeth St
Sydney NSW 200
+61 8205 7379
one-ventures.com

Brisbane
level 2, 315 Brunswick St
Fortitude Valley QLD 4006

Melbourne
c/o FB Rice, Level 14, 90 Collins St
Melbourne VIC 3000

the opportunities offered by digital transformation. The rewards that are on offer can be enormous.

For example, as at 30 June 2017, the five largest US companies by market capitalisation – Apple, Google, Microsoft, Amazon and Facebook – were all technology focused, with each having received VC funding. Significantly, in 2011, that list was made-up of Exxon, Apple, PetroChina, Shell and ICBC, demonstrating the potential of technology to transform economies in a relatively short period of time. Further we are seeing the birth of global giants in very short time periods, companies can achieve $100M or indeed billion dollar scale within years versus historically decades. Equally our own large ASX companies are facing severe disruption by new global entrants – our economy must get competitive to survive. Locally Wisetech Global now 3000 people strong and Atlassian are proving that Australia can grow major local software and digital platform companies at scale.

In particular, Australia should seek to be

(i) a world-leader in the digital transformation sectors where Australians have already demonstrated significant expertise –financial services, agriculture, mining and resources, defence and security, mobile and media, and
(ii) a world-leader in new research areas where we have significant expertise – for example, quantum computing (UNSW and USyd have globally recognised centres), machine learning and AI (Data61 ranks in the top 5 globally) and robotics.
(iii) Expert in what will be a transformative technology – blockchain. Blockchain will become the new internet and transform the way business transactions from transport and logistics, supply chain, funds transfers, property and conveyancing.
(iv) A backer of global platform companies: Wisetech Global (3000 employees) (software for logistics and supply chain - now servicing 125 countries and 7000 global businesses from Australis) and Atlassian (2,300 employees) (software tools for developers and business) demonstrate that scale and significant high skill jobs can be created in platform businesses. Australia also has a strong domain in services and platform businesses lend themselves to this by moving services into the cloud. OneVentures own portfolio companies, Smart Sparrow (education) and Employment Hero (Xero of HR) demonstrate this opportunity.

If successful, major productivity gains could be achieved that would contribute significantly to Australia's economic growth, well into the future. Out of all our VC investments, digital related companies provide the most jobs growth.

2. Executive summary

- The Government can play an important role, both as a facilitator and a customer, in developing a strong digital economy within Australia;
- Australia's innovation policy must remain internationally competitive at a time when governments globally are trying to position themselves as digital economy leaders;
- Venture capital has played a role in the development of the world's leading technology companies, demonstrating the potential to transform an economy over a short time period; and
- Regulation should facilitate rather than discourage innovation, particularly in areas where there is an opportunity to take a lead in emerging sectors.

3. Role of Government in the development of Australia's digital economy

The Australian Government can play an important role in the development of a thriving digital economy, primarily via five channels: 1) the Government procurement process; 2) grass roots changes in schools to facilitate engaging learning in mathematics, technologies and sciences; (3) public policies which encourage innovation and investment in new technology; 4) Government expenditure on research and development and (5) encouraging collaboration with major technology multi-national corporations.

Examining Israel's innovation economy provides some key learning -a country whose population is a fraction of Australia. Singapore is another good example of an economy driving investment into this sector through programs that not only encourage local investment but make attractive offers to bring and domicile digital companies into the Singapore market. America has until recently offered an attractive VISA program to skilled workers in technology. Some important points to note from these programs

(i) In Israel $4B is invested annually and the economy is now reaping $8 to 15B per annum. This is a mature innovation economy whereas our economy is nascent. The government has matching capital programs at angel level, funds levels and alongside venture capital investments. In Australia, it is almost impossible to get matching capital funding if a company is funded by a venture capital firm despite the level of high risk the VC firm is taking on with the asset. If this was about backing our

winners, then the government would be "doubling down" on these companies which ultimately drive the largest numbers of jobs in the economy.

(ii) Australia invests just $8 per capita in innovation, America is $100, China is on a rapid rise and moving from $40 per capital to $50 per capita. Imagine china's innovation at this level of population scale. China is rapidly moving from "consumer driven technology and economy to "deep tech".

(iii) Israel has encouraged the development of major research centres for multi-national corporations (not sales outposts). They have 300 of these MCNs.

(iv) Singapore have a government investment arm that actively promote acquisition of global businesses and redomicile them in Singapore. They regularly visit our offices searching for companies. For example, paying 50% of wages for the first 10 employees in Singapore to redomicile in Singapore.

(v) America has (until recently) benefited greatly from a skilled VISA program. We have an aging population so need population growth and where better to encourage that than those who will create or bring in employees into future businesses. Australia is a long way from the rest of the world and has a number of attractive relocation features (weather, beaches, safety, access to clean food and water).

a. Government procurement process

Firstly, as the single largest purchaser of goods and services in the country, there is a significant opportunity to reform the Government procurement process so as to make it easier for smaller, technology driven companies to win public sector contracts. In the 2017 financial year alone, there were 64,092 Government contracts with a total value of $47.35 billion. The number and value of these contracts means that there is significant opportunity - if processes are made more user-friendly and less compliance driven - for new market entrants. Incumbency is rewarded by a focus on awarding contracts to those (typically large scale) organisations that are able to meet very stringent Government requirements.

Further we note that around 24% of all Government contracts are for amounts below $5m in value – an aggregate total of $11.5bn - demonstrating that there are many areas where high growth firms could be awarded contracts, while still containing risk.

Looking to the US, its space agency, NASA, has awarded large, long-term contracts on a merit basis, including to new entrants such as SpaceX, showing that taking a less risk-averse approach is feasible. While accepting the need for appropriate probity and quality assurance standards, Australia must be able to do similar.

Accordingly, we believe a comprehensive review of the Government procurement process should be undertaken to identify where there are opportunities to devise more streamlined processes that allow a wider range of market participants to compete for tenders. Without compromising on quality and standards, it may also be worth considering whether a target, or even mandated, percentage (or value) of Government contracts must be allocated to start-ups or SMEs.

The United States has active programs where any major company can only contract to he government if they use an approved small company to deliver the technology and service. This helps drive their innovative economy and ensure the government is also receiving access to the most innovative and up to date technologyies that can offer significant cost savings to its operations.

By way of example, there are a number of areas of Australian Government digital service delivery – such as myGov - that are ripe for transformation, offering major benefits to citizens, cost savings for Government as well as potential commercial contracts for agile technology firms.

b. Government Schools Policy

While the Federal government leaves the States to decide on academic syllabus for schools, it is imperative that the National Curriculum mandates both technology and mathematics. Technology and coding must be taught in primary schools in an engaging and fun way and move through as a major stream of study ideally compulsory to yr9. Mathematics must be part of the curriculum to year 12 or we will not have an economy with the skills for the 21st century. The way these subjects are taught needs a critical overhaul. This is the new language of the world.

c. Government innovation policy

Thirdly, the Government must ensure that it has in place world leading policies that can attract the most innovative domestic and foreign companies to Australia. Since December 2015, a number of initiatives aimed at fostering greater innovation and commercialisation of research have been progressed by the Federal Government as part of the National Innovation

and Science Agenda (NISA). These include: new tax incentives for early stage investors; important reforms to the venture capital investment framework including operation of the ESVCLP; and the creation of a Biomedical Translation Fund (BTF) aimed at commercialising promising health and medical research.

Given time, this set of policies could be transformative for the Australian economy, however more can be done to ensure that scaling-up companies receive the capital and expertise they need. As noted above, venture capital has played a critical role in the growth of some of the world's largest technology companies, and can do likewise in Australia. Accordingly, the Government should look closely at what steps in can take to help develop Australia's growing VC sector to ensure its longevity. Our nation's history has been dogged with market failure with the rise of fall of the industry and lack of access to consistent funding. We are still in a situation where only 1% of our superannuation industry invest in venture capital and of the handful that do, there is not a strong local program.

AVCAL's research report, *The Venture Capital Effect*, prepared in collaboration with the University of Sydney, highlights that Australia's VC sector remains less than half the size of the OECD+ average. If we are to successfully become a world leader in the digital economy, this must change, and quickly. While FY2017 saw domestic VC firms invest the highest aggregate amount in the last ten years ($336m), this remains small by world standards – US$51bn was invested by US firms in 2016, while their Chinese counterparts invested US$46bn.

Incentive Policies

It is also essential that those elements of Australia's innovation policy infrastructure that do work effectively are maintained, if not enhanced. In particular, the research & development tax incentive must remain its bedrock given it is critical to the growth and functioning of many innovative Australian businesses. The scheme is well-understood, and recognised as Australia's most important innovation policy lever. This funding alone in many instances keeps our emerging digital companies afloat often companies with over 50 employees (paying tax) who are not yet profitable.

On average for a 50-person company, that would be $25k in tax per person or $1.25M per annum to treasury or upwards of $2M pa in companies heading towards 100 high skilled employees. Most of these companies are claiming $500k up to $1M pa in their growth phase. It's important that this policy is not limited to just the R in R&D. At a time of economic transition, it is vital that policies such as the R&D scheme remain stable and continue to support long-term investment decision-making. It is in that context that AVCAL has warned against any cuts to the program (such as those contemplated in the Ferris-Fraser-Finkel review) as it would not be in the long-term interests of the nation.

By way of contrast, the UK in its Autumn (November) 2017 budget statement has committed to:

- increasing its total direct R&D spending to £12.3bn per annum by 2021-22;
- establishing a new £2.5 bn Investment Fund incubated in the British Business Bank;
- investing in a series of private sector fund of funds, starting with an initial commitment of £500m; and
- backing new and emerging fund managers through the Enterprise Capital Fund programme, unlocking at least £1.5bn of new investment.

Despite having a VC sector that is almost twice the relative size of Australia's, the UK has recognised the importance of *further* developing an innovation-driven economy and has committed substantial funding to achieve it – developing an action plan that will unlock £20bn of patient capital investment into innovative firms over ten years.

As highlighted in *The Venture Capital Effect (produced by AVCAL)*, there are many countries around the world, including in the Asia-Pacific region, that are likewise seeking to introduce ambitious innovation policies aimed at fuelling economic growth. AVCAL stands ready to work with the Government around a suite of measures that would assist the further development of the local VC sector, and more broadly, the next wave of the NISA.

d. Government expenditure on R&D

Fourthly, Australian Government can help boost the development of the digital economy through increasing its own expenditure on research and development.

Although government budgets for R&D have increased since 2008 in Australia, and it has the second highest share of tax support for business R&D in the OECD in 2015, the absolute levels of direct government funding and tax support for business R&D remains lower than many countries.

As a measure of the level of direct and indirect government funding for R&D, the business enterprise expenditure on R&D (BERD) as a percentage of GDP for Australia stands at 0.20%, made up by 0.03% from direct government funding and 0.17% from our R&D Tax Incentive scheme (indirect funding). On the other hand, the USA's direct government funding on the other hand was several times higher than Australia's at 0.18%, and the UK was similarly much higher at 0.10%. In terms of overall BERD, Australia also compared poorly with countries such as Korea and the USA with BERDs at 0.35% and 0.25% respectively.

More broadly, Australia trails a number of developed countries in terms of gross expenditure on R&D (GERD) as a proportion of GDP. OECD data showed that Australia's GERD was 2.105% in 2013, which was 275 bps lower than the OECD average of 2.380% (2015). The difference is much starker when compared with Australia's Asia Pacific neighbours: Korea's GERD was 4.232% (2015), while Japan's was 3.286% (2015). Other developed countries also showed higher gross expenditure levels, such as Germany (2.927%), USA (2.78%) and Israel (4.253%).

This international data demonstrates a pressing need for both the Australian private sector and Government to significantly increase their expenditure on R&D if, as a nation, we are to hope to transform our economy.

e. Multi-national Corporations

An economy needs multiple facets to drive its ecosystem. In Australia, our multi-national corporations are here largely only as sales outposts to service the corporate juggernaut. The bulk of revenue is siphoned offshore and doesn't lead to high skilled jobs or the opportunity for local acquisitions to fuel the innovation economy.

We refer to the example of Mobileye ($15B acquisition by Intel in Israel). Intel has a major R&D centre in Bethseba. Mobileye was a VC backed autonomous vehicle company. Intel has now, off the back of the acquisition, moved its entire autonomous vehicle R&D centre to Israel. Further the sale created many local multi-millionaires with the original entrepreneurs now spinning up new companies and backing younger technology founders. These entrepreneurs and co-founders will eventually step back out to create again new businesses of the future. Meanwhile Intel will employ and grow this massive R&D centre and capability. So Intel's presence is an important element of the ecosystem.

4. Standards development and regulatory frameworks

A key challenge facing any start-up or high growth company is difficulty navigating the regulatory approval processes for their business. This can be particularly pronounced in sectors which are subject to high degrees of regulation, such as financial services. This means that new market entrants, such as FinTech firms, face the dual challenges of not only competing against large incumbents with well-established market share, but also companies that have the legal, risk and compliance infrastructure capable of meeting exacting regulatory standards.

The Israeli government understands the issues of "red-tape" affecting emerging enterprises and actively works to remove red tape from the economy. They have one of the most flexible regulatory environments in the world.

The industry and our industry association AVCAL supports the Government's previous "red-tape" reduction initiatives, more can be done to ensure that regulation is fit for purpose, and strikes the right balance between consumer protection and fostering innovation. In principle, the enhanced regulatory sandbox for FinTechs is an example of an appropriate mechanism for achieving such objectives. However, we are aware that in its current form, the sandbox has garnered minimal industry interest, precisely because the regulatory conditions are too onerous.

While cognisant of the duty to responsibly spend public monies, it is also important that more experimental, agile public policy is developed. Pilot programs, for example, could be more frequently utilised. An example of overly cautious policy-making has been in the realm of the "share economy", where Government regulation/guidance lagged well behind consumer up-take of products and services.

If Australia is to achieve its ambition of being recognised as a world-leader in innovation it must be prepared to attempt bold policies, without necessarily waiting to see how similar programs have progressed in other jurisdictions. To do otherwise would mean that Australia is constantly "playing catch-up", and will forever remain an innovation follower, rather than leader.

5. Barriers to Australian digital adoption

As has been recognised as part of the NISA, cultural change will be important to Australia's economic transition. A more mature approach to risk-taking is important, and has been acknowledged, however one aspect which is rarely discussed is the need to examine culture within organisations and within government.

We would strongly argue that it is in the interests of the public and future job creation for the government to become an enabler not a barrier to innovation. We are known to be one of the most risk-averse nations in the world. This is because we actually don't face serious personal threats on a daily basis. Our cognitive bias is to see risk and protect rather than as an intellectual economy accepting some risk to advance.

The government needs to adopt the enabler stance and be prepared to trial and take on risk for the country's future. A good entrepreneur balances the risk reward equation, trials products in markets and find what works and drives that forward. OneVentures believes our

government should adopt principles of technology companies and utilise “agile frameworks” for deployment of capital and creation of flexible regulatory environments.

OneVentures frequently sees technology from research institutes that have been released publicly. This makes them unfundable by us in many cases as the barriers to entry for competitors are low.

Our university courses need to become more connected with not just industry but innovation in industry. We want our young graduates completing their degrees being able to use creative and innovative ideas in the workplace. Practical business and entrepreneurship skills should be accessible to all university students no matter what course.

More broadly, Australia has enjoyed more than 25 years without a recession, removing the “burning platform” to undertake difficult but necessary reform. Indeed much of this economic success has been attributable to Australia’s success in the export of primary products (principally from the natural resource and agricultural sectors), with relatively little in the way of complex manufactures or, until recently, high-value services. If Australia is to transition towards a broader based economy, this trend must change.

Similarly, many of Australia’s industrial sectors are dominated by a few key players, removing the incentive to take significant risks in developing a new innovation-driven strategy. When market share and profitability remain strong, there is a diminished appetite to develop significantly new products and/or services. However experience shows that complacency can lead to vulnerability of disruption. We are all currently witnessing the demise of Myer (an incumbent) who has failed to innovate fast enough under pressure from a global giant, Amazon. A further challenge for listed companies is the continuous disclosure and periodic reporting requirements, which make it more difficult for boards and executives to take a strategic, long-term approach. The glut of our own superannuation industry focused on dividends is also eroding our corporate value. Amazon is not paying dividends. They are investing every cent in being a dominant leader.

A further facet hindering the take-up of digital technologies is access to appropriately skilled workers. Currently, there remains a shortage of appropriately qualified STEM graduates, which is hindering the ongoing growth of a number of high-potential Australian companies. Although this is not the main focus of the consultation, a comprehensive look at the skills gaps presently, and expected to be, present in Australia is necessary to ensure that this does not persist, and that our education system is producing the right mix of graduates. In the interim, there will continue to be a need for business to have access to immigration programs that permit skilled workers to enter Australia. With the US tightening its border policy and VISA programs, this is an opportunity that Australia should capitalise on. The stability and

OneVentures Pty Ltd
Sydney (HQ)
Suite 13.02, 179 Elizabeth St
Sydney NSW 200
+61 8205 7379
one-ventures.com

Brisbane
level 2, 315 Brunswick St
Fortitude Valley QLD 4006

Melbourne
c/o FB Rice, Level 14, 90 Collins St
Melbourne VIC 3000

transparency of these programs is paramount both to maintain confidence in them, and to allow long-term planning by businesses.

6. Practical Steps to drive the Digital Economy

Education

1. Compulsory introduction of technology from K-9 in schools.
2. Compulsory maths to Yr12 in some form: without maths no student can bridge effectively into the innovation economy.
3. Overhaul of syllabus to make it fun and engaging .
4. Teacher training or use of technology (eg. Interactive platforms or avatars) to deliver technology programs.
5. Availability for all tertiary students to take business and entrepreneurship as part of their degree no matter what faculty within a higher education institution.
6. Collaboration with industry and innovation as part of university programs particularly for STEM graduates.
7. Programs to re-train physics and mathematics graduates into machine learning, AI and data science.

Talent and Migration

1. We must boost our skilled migration program for technology related companies. The sophisticated VISA program has created opportunity for additional capital in market but we also need a program for skilled migration in the tech sector. Australia lacks talent due to our poor STEM matriculation from both high school and at University.

2. Overseas students educated by our universities in certain registered university technology degrees should be fast tracked under a VISA program where they gain jobs in Australian industry at graduation.

Attracting Businesses to Australia

Australia should actively market to offshore companies to shift their domicile to Australia. A mix of one off grants or employee funding programs to support the shift of domicile should be offered along with help for relocation of key employees or founders. Digital businesses can now operate from any jurisdiction with the advancement of broadband and internet. Shifting domicile and location

of HQ will create jobs here while providing for a better lifestyle and government support for those businesses key people. Activities to support a program like this would include VISA programs for these businesses and entrepreneurs. We should also have a technology VISA program where companies can register with the government as a fast track to a working VISA or residency much like that provided formerly in the United States. Skills shortage will be ongoing in Australia until this is addressed. The American shift in policy here is an opportunity for Australia.

Multi-national Corporations actively partnering with our Innovation Economy should receive some government assistance to establish R&D centres in Australia.

Establishing an Australian Innovation Authority

Like Israel, Australia should establish an Innovation Authority. This organisation should have an appointed CEO that reports into the Board of Innovation Australia and the Minister. The organisation should have bipartisan support to remove short termism in Innovation policy setting which has damaged the fragile innovation and digital economy in the past. The organisation should have an annual budget (along the lines of the UK and Israel respective organisations) and manage the venture capital programs of Innovation Australia; grant programs; and handle the R&D programs of companies with revenues under $20M.

The authority would also oversee policy framework to drive the innovation economy:

- Open access to government for effective and efficient service delivery.
- Tendering by large corporations must be in partnership with SMEs: a major company can only contract to the government unless they use an approved Australian small company to deliver the technology and service. This drives innovation versus incumbency. It will also drive innovation investment into Australia verus allowing the US “IBMs” of the world to win most major government tenders.

Research and Development

Align our Research Expenditure with OECD: Australia should have a stepped program to bring our R&D expenditure and investment into line with OECD countries by 2030.

Keep the D in R&D: For technology companies, it's critical that the D in the R&D tax incentive is maintained for companies sub $20M in revenue. Many companies "live" as a result of this capital continuing to provide valuable jobs in the economy. The R&D tax incentive has single handedly changed the Australian digital innovation economy allowing companies to expand jobs and stay afloat in the difficult years of high growth pre profitability.

Building a VC Industry for Australia's Future

It is critical that Australia builds a sustainable and growing VC industry for the country to compete on global scale with other technology-backed economies. We recommend the following:-

Evergreen IIF: IIF licenced managers who return the benchmark return to the Commonwealth are allowed to recycle this capital into new funds. This will become a new sustainable VC evergreen technology program (VC-STEP). Any fund manager that does not meet the benchmark return or raise ongoing matching capital will be terminated (ie driven by market forces) and their funds put towards a new manager by increasing new manager licences in the following year.

New VC-STEP managers: Every year, the Commonwealth should licence 1 to 2 new managers with between $20M and $30M each that must be matched by private funding. A new manager is any manager that has not received an IIF or BTF licence. Ideally minimum $60M fund sizes should be created due to $60M being about the minimum to create a sustainable fund manager.

Revolving VC Direct Equity to support the second valley of funding crisis
There are two stages where startups often face financial hardship that leads to closure. The first is moving into commercialisation and the second is when operating and growing rapidly, they fail to secure appropriate funding yet are too early (and unprofitable) to receive traditional bank funding.

OneVentures suggests creation of a direct equity program to supplement the current grant program of Accelerating Commercialisation (AC).

OneVentures Pty Ltd
Sydney (HQ)
Suite 13.02, 179 Elizabeth St
Sydney NSW 200
+61 8205 7379
one-ventures.com

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Melbourne
c/o FB Rice, Level 14, 90 Collins St
Melbourne VIC 3000

While it is very difficult for VC backed companies to access grant funding under AC, these companies are still in a high risk phase of development.

Such a program managed by Accelerating Commercialisation should be direct equity and be available to match VC funding for up $2M. The fund manager or other investors can repurchase the equity in the future at cost plus an interest rate (say 8 to 10 % pa). This should create a revolving facility that goes to supporting earlier stage investments into companies still needing working capital (ie pre-profitability) and importantly help provide a bridge to profitability.

This type of program is most suited to technology companies in early stages of revenue (sub $10M). It helps de-risk the investment, allowing hiring of new staff during growth and expansion into new markets.

Superannuation Technology Fund of Funds: Australia's superannuation industry is so large now that the size of cheque (often $100M upwards ($250M for Future Fund)) is too large for a typical VC fund.

The government should mandate that a very small fraction of superannuation funding is placed into a centralised or possibly multiple outsourced Fund of Funds that specialise in manager selection and allocating capital to Australian VC managers. This would allow managers critical access to one of the world's largest pools of pension funds. It is still very difficult to get VC funds up and running in Australia and often the void is filled by high networth investors writing small cheques into funds (usually between $500k and $2M). This means that VC managers carry a large overhead of servicing large numbers of investors. High Networths also lack patience for longer term funds which should be preferred if Australia is to grow into a large innovative companies within Australia.

In such a fund manager program, seeking capital would be competitive based on analysis of performance and serve as the next opportunity within the ecosystem for funding beyond VC-STEP. The FoF should also serve as the seed funding for a fund. The hardest part of launching a fund is getting the first material commitments.

This Superannuation Technology Fund of Funds (STFoF) should expand as the innovation economy grows ie it must take into account growth in the underlying economy and not start so large that it floods the market with capital. Initially we are talking about 0.005 to 0.01% of super in Australia pa (some $150M to 300M). This will not impact superannuation returns of average Australians but will make a massive difference to the economy. Australians want their children / grandchildren to get jobs and additionally want to see a vibrant first world country. Superannuation schemes offer all Australians lucrative tax benefits and owe the

economy the opportunity to continue grow. One of the largest sectors for innovation jobs growth is in the technology and digital sectors.

7. Next steps

We would like to thank you for the opportunity to provide a submission in relation to the Government's digital economy strategy. It is important that both the public and private sectors work closely together at this time to ensure that Australia is ideally placed for the future.

Please do not hesitate to contact me on mdeaker@one-ventures.com or (02) 8205-7379, if you would like to discuss any aspect of this submission further.

Yours sincerely,

Dr Michelle Deaker
Managing Partner

OneVentures Pty Ltd
Sydney (HQ)
Suite 13.02, 179 Elizabeth St
Sydney NSW 200
+61 8205 7379
one-ventures.com

Brisbane
level 2, 315 Brunswick St
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