SUBMISSION
20 September 2019
Policy Statement on the Venture Capital Fund Act 2019

Angel Association New Zealand welcomes the opportunity to make a submission on the Policy Statement on the Venture Capital Fund Act 2019.

Our context

AANZ was established in 2008 and champions early stage, high growth, tech investment and investors. Our 40 members represent angel networks and their members, early stage venture funds, investor-led tech incubators, equity crowd funding platforms and professional service providers who work in the space.

There are approximately 800 angels in New Zealand who are members of over a dozen angel networks from Whangarei to Invercargill. On average a New Zealand angel has 12 ventures in their early stage portfolio and invests 5-15% of their net wealth in this asset class.

Two thirds of New Zealand angels have started a business, a third have taken that business offshore and a quarter have raised capital for that business. Forty percent have had a successful exit from their portfolio. About 20% are active investors which means they are leading deals and play a governance role in up to half a dozen ventures. New Zealand angels spend on average 20 hours a month supporting ventures they have backed. Our members screen about 1000 deals a year, of which 180 or so pitch and roughly 100 receive investment.

We are a decade into the endeavour and are pleased to be experiencing an increasing cadence of exits which validate the asset class. Exits like those of PowerbyProxi, Publons, Swiped On, Volpara, Engender, Flick and others are generating returns for angel investors which make early stage investment sustainable and financially rewarding.

Our submission in summary

The MBIE led consultation sessions held in Auckland and Wellington asked those attending to provide insights and views on the objectives, definitions and policies set out in the Draft Policy Statement. The Angel Association submission considers each in the context of whether it supports or enhances the capability of the people receiving or deploying venture capital.

There is no model, template or checklist which guarantees success in venture investment. The success of any angel-backed venture, angel network or venture fund is uniquely dependent on its own specific context. The AANZ brings a capability lens to our submission because we fundamentally believe success is a function of the experience and quality of the people executing; timing is the other key determinant.

We do not see anything in the Draft Policy Statement which adversely impacts on the Guardians of NZ Super or NZVIF being able to make the most appropriate selection of funds. The way the Policy Statement is currently drafted, means it will not be, for example, the definition of a New Zealand entity or the percentage of local versus foreign funds which determines the Venture Capital Fund initiative's success, it will be the capability of those implementing the policy – at every level.

Underlined text below is put forward as suggested new or additional wording for the Policy Statement.

VCF Objectives
Paraphrasing the objectives set out in the Policy Statement, the purpose of the Venture Capital Fund is to:

- increase the venture capital available to New Zealand high growth ventures; and
- develop New Zealand's venture capital market to function more effectively and with deeper pools of capability, defined as
    - more capital being available to high growth ventures from non-VCF sources, and
    - high growth ventures backed by this venture capital becoming successful businesses delivering and creating exponential value, including the generation of the financial returns expected of the asset class.

A critical, but perhaps implicit objective is missing in the objectives, the statement that financial returns reflective of the risk inherent in venture capital investment will be generated for investors. Why should this be added? Because it sends a clear signal about the capability required to deliver those returns and what existing investors and new investors should expect from the Guardians and NZVIF's implementation, execution and delivery of the VCF.

If the policy statement sets out explicitly what the expectations are with respect to the capability required this will positively impact on both the generation of commercial returns and market development.

Suggested amendments to the explanation of the Policy Statement's Objectives.

> *Increase capital available to New Zealand entities*
> First paragraph under the objectives :: "However in New Zealand there is currently a shortage of available investment and the corresponding capability in the series A and B space… "
>
> Third paragraph under the objectives :: "More developed venture capital markets, with better resourced, connected and experienced fund managers that generate returns appropriate for the sector…"
>
> Fifth paragraph under the objectives :: add to the sentence before the dot points "More New Zealand based venture capital with the corresponding capability ~~it~~ may also encourage some of the entities …" and add a dot point to the potential benefits "more local founders are exposed to role models and have early experience in companies which are securing venture capital to create exponential value from disruptive technology and business models". This latter dot point, by setting out explicitly the need to grow the capability of those seeking and receiving venture capital supports both market development and commercial return generation.

Develop New Zealand's venture capital market
The second and third paragraphs reference 'best practice':: augmenting the Policy Statement with guidance or even just the principles of 'best practice' will enhance capability and support the delivery of the objectives of the VCF. This is because it will provide insights and assurance to those fund managers in New Zealand applying to the VCF for capital. It will also provide assurance to those who are potential (and in all likelihood) LPs new to venture capital.

VCF Definitions
We have no strong views on the definitions but we make some observations about selected definitions in the context of capability development below.

"New Zealand Connection"
We want funds with a New Zealand connection to be incentivised to be more sticky and more committed to New Zealand, rather than less. The more incentivised and longer offshore funds who decide to create a New Zealand connection are encouraged to maintain their New Zealand connection, the more capability they will impart and share with New Zealand ventures and fund managers.

"New Zealand Entity"
We are supportive of more flexibility around what constitutes a New Zealand entity given the imperative almost every venture capital supported company will face to be global and to scale globally. It many instances, for New Zealand high growth tech ventures to reap value and returns, particularly with respect to growing capability and experience, the New Zealand connection may become legally and optically tenuous. The emotional attachment and moral motivation of anyone with a New Zealand connection to the venture will nevertheless inevitably see capital and capability flow back to New Zealand.

"Seed capital", "Series A and B capital" and "Series C and C+ capital"
The key point we wish to make about the current definitions of capital stages is that the monetary parameters are biased away from deep tech, and more in keeping with SaaS-like opportunities which have shorter horizons to liquidity and often lower returns than deep tech investment. Deep tech investment tends to be more disruptive and have longer horizons to markets and liquidity and tends to require greater quantums of capital at every stage. The definitions as currently set out may incentivise selection of SaaS and business model fund managers and therefore prioritise the development of capability specific to this sort of investment. New Zealand angel and venture investment already favours SaaS. Given the relatively greater returns and employment enrichment benefits of deep tech, we suggest this investment and capability development should be encouraged. We would also make the general observation that seed and angel rounds are getting bigger.

VCF Policies
Investment Directions
Policy 1 : Investment Model
The fund of funds model has a largely neutral impact on capability building. It is supportive in so far as it will bring new entities into the market which we can assume will bring new capability. It is not clear how many venture capital firms are envisaged but a balance will need to be struck to ensure there are enough funds to provide diversity and offer choice but not so many that funds are of a sub-optimal size given there is only $240m to deploy.

Policy 2 : NZ Fund Investments
We are supportive of the approach to encourage the vast bulk of the funds to be invested into funds with a New Zealand connection and in turn into NZ entities. This is where the capability needs to be built and awareness raised about the rewards of venture investment. The balance that needs to be struck to support capability development is the assessment of the extent to which allowing investment outside series A (25%) and outside New Zealand entities (10%) will improve the odds of achieving the requisite returns. The proportions set out seem ok. We are however supportive of increasing 10% to something closer to 20%. Many offshore jurisdictions, particularly the venture markets in the USA and to a lesser extent Singapore and Australia have had more experience and therefore there is more to learn from them in watching the choices they make to invest in non-New Zealand entities. Encouraging thought and awareness of the role of portfolio building and allocation will also support capability development.

Policy 3 : Foreign Fund Investments
We repeat the point made above, that many offshore venture funds have experience, connections and expertise that funds with a New Zealand connection could learn and benefit from. Some of our colleagues have suggested that we do not need to incentivise Foreign Funds, because these funds will come anyway if the deal flow is good enough. We are inclined to agree and would not be concerned if the aggregate of net committed capital was reduced for Foreign Funds. But we would not want to see it removed entirely. The key thing here will be the selection of the right Foreign Funds; funds with deep experience and exemplary track records of success.

Policy 4 : Co-investment with Underlying Funds
We do not support co-investment as we see it doing very little to support capability development. There is little to learned from NZVIF supporting ventures already getting traction and providing exemplars and proof points to the market. It is also a moot point as to whether co-investment and backing ventures already getting traction would enhance the prospects of the financial success of the VCF if it takes out capital which could otherwise be deployed to support VCF portfolio breadth and diversity through the provision of matching capital for additional or bigger underlying funds.

Policy 5 : Private capital requirements
On balance we support Option 2 under which Funds with a New Zealand Connection will be matched 1:1 and Foreign Funds are matched 2:1. Option 2 incentivises the creation of Funds with a New Zealand Connection. Commitment to the New Zealand market will be more supportive of capability development.

To the extent that Option 1 will provide a more appealing incentive to Foreign Funds because they are not treated differently to those with a New Zealand connection, we would be happy if this option is selected. Foreign Funds are, on balance, likely to be more experienced and more connected than Funds with a New Zealand connection so this option will also support capability development.

Government expectations
We have no comment to make about this aspect of the Policy Statement. Policies 6-8 have little impact on capability development. Policy 9 sends a signal to fund managers that the government is keen to see New Zealand develop capability in carbon reducing technologies and business models.

VCF Implementation

We would like to see a specific statement that the Guardians "must give effect to the Policies 1-5 (inclusive) by including appropriate provisions in the contract or other arrangement put in place, <u>and must have specific regard to the expertise, experience and connections required</u> to manage the VCF.

Review of the Policy Statement

We suggest that consideration be given to stating that the Policy Statement will be reviewed at regular intervals (every two years) to affirm that the settings are optimal so that review is not just limited to the objectives of VCF not being achieved.

Other key considerations to support the success of the VCF

We would also like to make some other brief observations about how the VCF initiative might be supported to be successful.

- Provide a clearer statement of what success looks like. This should include metrics and stretch goals that go beyond the return of capital and job growth. Specific KPIs pertaining to capability development probably lie more neatly with government and KPIs to measure VCF commercial performance, in the contract between the Guardians and NZVIF.
- A statement that either commercial success or market development takes precedence or a statement that commercial success and market development are not mutually exclusive.
- The quality of the deal flow in the pipeline for series A capital will have a material impact on the success of the VCF. The AANZ is will be working with its members to raise awareness of a range of factors which impact on venture success. The government also has a role.
- A critical factor will be supporting high quality governance and greater awareness of the role of governance plays in venture success.
- The quality of governance, including experience and awareness of the unique characteristics of venture capital investment, at each level of the implementation of the VCF will be critical.
- We recognise the importance of promotion of the asset class. NZ Inc awareness and an appreciation of where responsibility lies for promotion and specifically who will do the work to promote the asset class – government, industry bodies, NZVIF or the funds themselves – needs to be addressed. Government support for LPs through the provision of research and due diligence expertise or subsidies might also be considered.
- Similarly, NZ Inc awareness and responsibility regarding the importance of data collection, collation and dissemination is needed. Transparency will play a key role in capability development.
- The AANZ would like to encourage further consideration of the role tax incentives could play to support of the success of the VCF. A long shot we know!
- We also support regulatory reform to make it easier for private wealth managers and institutions to recommend and make venture investment.
- There is more that could be done to support the role investor migrants can play in the provision of LP capital and expertise. The launch of the Migrant Investor and Entrepreneur Association is a great first step.

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www.angelassociation.co.nz
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