

Submission on Policy Statement on the Venture Capital Fund Act 2019

To the Ministry of business, Innovation & Employment

Personal details

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Submission

We support the intent of the Venture Capital Fund because, as New Zealand Private Capital Association, we champion and actively help businesses navigate and understand the Private Equity and Venture Capital world. Markets and growth require the free flow of capital. The association provides an important role in linking business owners with investors.

Our members span the activities of the private capital market including international and domestic fund managers; law, accounting and banking professionals; institutional investors; business angels and government agencies.

We wish to make the following comments on the Policy Statement on the Venture Capital Fund Act 2019.

Objectives

The Policy Statement Objectives numbered 1 and 2 do not include adequate reference to the objective “Develop New Zealand’s venture capital market” that is outlined fully under the heading Develop New Zealand’s venture capital market.

We recommend that the Policy Statement objectives include a reference to the expectation of a “self-sustaining domestic venture capital market with sufficient capacity to service the demand”.

It is vitally important that the Objectives summary provide equal weight to the objectives described as:

- Increase capital available in New Zealand entities; and
- Develop New Zealand’s venture capital market.

The performance of the VCF, the Guardians of New Zealand Superannuation and New Zealand Venture Investment Fund will be assessed with reference to the objectives set-out in the Policy Statement. The summary objectives are not aligned with the balance of the objective description. We contend that the summary should adequately reflect the whole and not merely part of the objectives.

As it stands, the summary Objectives of the Policy could be satisfied by the import of foreign funds and fund managers to the exclusion of domestic funds and fund managers. We believe the intention of the Act and the Policy Statement is to crowd-in a domestic sustainable venture capital market. At the moment the Objective of the Policy Statement does not adequately express that ambition.

Government expectations – transparency

Trust is a fundamental principle for efficient capital markets. The intervention of government capital requires a very high-level of transparency and probity.

The New Zealand Venture Capital Market means “the ecosystem of investors, funds and fund managers involved in Venture Capital investing in New Zealand entities together with those New Zealand entities which are recipients of Venture Capital”. (Policy Statement definition)

It was apparent in the consultation workshops that the eco-system expectation is for the VCF process of fund selection should be transparent. In broad terms, that means the process will be known to the eco-system participants before any application begins. In addition, that the applicants should receive feedback on their application, whether successful or not.

This transparency is especially important for investors and fund managers who are engaged in fund-raising negotiations.

It is important that there is confidence in the timing of the VCF commitment prior to first close. In order to be effective, the VCF commitment, or some portion of it should be available at First Close. We have discussed methods to signal stages of commitment, some of which worked well in the earlier VIF programme.

It is also important that the VCF commitment is on the same terms as the other investors and the VCF manager does not attempt to impose terms by virtue of VCF proportion of the total fund.

New Zealand Connection

Our interest is in the link between the definition and the market development objective: “Develop New Zealand’s venture capital market”.

We expect that the objective would not be achieved, if the only Underlying Funds were those with foreign heritage s9(2)(b)(ii). We have expressed an ambition for a sustainable market to include Underlying Funds that are a mix of Internationally sponsored funds, domestic established funds and domestic first-time funds.

The Policy Statement is “light” on ambition for domestic funds becoming Underlying Funds.

It would be disappointing to find that Underlying Funds with New Zealand Connections had the majority of the Investment Committee being non-residents, and hence poor connection with the New Zealand venture capital market ecosystem.

We believe that a sustainable market for New Zealand will need to encourage “domestic” investors, funds and fund managers.

There is nothing in the current Policy Statement that mitigates the risk of an international domination of the domestic market. We believe that there should be an objective about the development of the local industry.

A team or industry cannot develop strength by importing foreign players. To do so, reduces the opportunity and crowds-out the development of local players.

We recommend that the definition of New Zealand Connection in respect of the general partner and investment manager should include some of the tests currently included in the definition of New Zealand Entity. Our preference is for a test that includes reference to majority of employees and independent contractors in New Zealand.

Based on our current knowledge, we expect s9(2)(b)(ii) would satisfy a broader test. So should other foreign sponsored funds seeking to be regarded as a New Zealand Connection.

Foreign fund managers will play an important role in the development of the New Zealand capital market. We welcome their capital and experience alongside domestic fund managers.

Due Diligence

New Zealand domestic investors, outside the few major institutional investors, are unlikely to have the expertise or the resources to conduct an appropriate due diligence on prospective fund managers. We recommend that the Due Diligence on an applicant fund manager should be undertaken by a third party for the benefit of the Fund-of-Fund manager (NZVIF). Again, the transparency and probity of the applicant process demands an internationally recognised independent assessment of the applicant against a best-practice framework.

Foreign investors and some domestic LPs find it difficult to undertake due diligence on a Fund Manager based in New Zealand. It would assist fund-raising if a trusted independent organisation were able to undertake a level of diligence on the Underlying Fund Manager.

We recommend that an independent internationally recognised third-party perform the Due Diligence role.

Encouraging Limited Partners (Investors)

The eco-system sustainability is dependent on Limited Partners matching the VCF capital initially and in later years being able to support funds without VCF.

We have expressed our concern on “where is the private capital”? The VCF does not provide any incentive to Limited Partners to encourage capital to divert from other alternative assets to New Zealand early-stage markets. This is a gap in the current economic and taxation policy settings.

We applaud initiatives across government policy initiatives to address this issue (e.g. KiwiSaver). And we agree that economic and tax policy setting are appropriately addressed in the context of the broader capital market. However, we note that the longer-term horizon of prospective capital markets reform is unlikely to positively impact the current VCF or any fund-raising by domestic fund managers.

We iterate previous observations that governments in other countries implementing early-stage venture capital interventions have frequently included incentives for investors that had a material impact on the effectiveness of the programme.

Allocation of capital

We have discussed the parameters around construction a VCF portfolio including allocation per fund and spread of vintages. We are comfortable that the Guardians will be able to construct a portfolio that meets the objectives and intentions of the VCF.

Co-investment

The current definition is not clear. A co-investment by the VCF should be at the discretion of the Underlying Fund and the VCF would have an opportunity to co-invest but not a right that obligates the Underlying Fund.

Foreign Fund

We see no reason why the Foreign Funds should not have a NZ connection such as “one senior investment professional who is ordinarily resident in New Zealand (as defined in the Overseas Investment Act 2005). s9(2)(b)(ii)