NEW ZEALAND venture INVESTMENT FUND LIMITED

10 November 2009

VIA EMAIL: secretariat@2025taskforce.govt.nz

Dr Don Brash
Chair
2025 Taskforce
Wellington

Dear Dr Brash,

Thank you for the opportunity to comment on steps which could be taken to close the income gap with Australia. Obviously your 2025 Taskforce faces a considerable challenge to deliver solutions to the questions posed to you by Government. I wish you well in your deliberations.

If closing the gap between Australia and New Zealand is a puzzle comprising many pieces, then building a sustainable early stage investment market is one piece of the jigsaw. Venture capital can have a disproportionately positive impact on increasing productivity and improving economic performance. This is due to it being an investment class particularly suited to developing new technology companies. It is investment into high-growth technology companies, many of them generated from IP developed within New Zealand's universities, research institutes and incubators, which has the potential to deliver considerable benefits to the New Zealand economy.

In the United States, Amazon, Microsoft, Google, Apple, Cisco, eBay, Facebook, Starbucks, and FedEx are example of venture capital backed companies. If one New Zealand venture capital backed company grew to the size of Microsoft, New Zealand's GDP would be 50 percent higher and your taskforce's goal would be achieved. While that is unlikely, creating a series of mini-Microsofts is a reasonable goal. A vibrant venture capital industry will not in itself achieve this, but building an assortment of high growth, technology companies would be extremely unlikely in the absence of a venture capital industry and the capability and capital which it brings.

The United States is the birthplace of modern venture capital. There, the market has built steadily over the last 40 years following the federal government's establishment of the Small Business Investment Company Program in 1958. Many similar style government or state sponsored investment programmes have since been established throughout OECD countries to try and replicate the success of the Silicon Valley model. That success has not just generated economic growth – it played a cornerstone role in the establishment of entire new sectors of the US economy, such as biotechnology, software, semiconductors and, more recently, clean technology.

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Getting to that point takes patience and commitment. Building a venture capital industry is a long term project because venture capital investment is a long term, illiquid investment. Venture capital is seen as an 'increasing returns' business – it is much easier to do the 100th investment than the first. As the life of a venture capital fund is 10 years, it takes time for venture capitalists to build capability and successful track records.

In New Zealand, the government has been active in venture capital since 2002. The significant impact of the Crown's involvement has been to catalyse private sector investment, as a result of the Crown sharing the 'risk' with the private sector through public-private partnerships. Through the New Zealand Venture Investment Fund, the Crown has invested (note: not grants) $82 million into young New Zealand 81 companies. That involvement has helped to spark considerable private sector early stage investment into those companies – to date, over $470 million of public and private capital has so far been invested. Prior to 2002, our venture capital and angel investment sectors were almost non-existent.

This year, international consultancy firm LECG (including Harvard Business School Professor Josh Lerner) reviewed venture capital development in New Zealand, analysing the progress made over the seven years. It found:

- New Zealand's venture capital activity is increasing, showing encouraging but modest growth, and our standing in international benchmarks has improved substantially.
- Venture capital has the potential to contribute very significantly to New Zealand's economic growth, and to the level of innovation and efficiency of our young and emerging businesses.
- Venture capital is an important part of the innovation infrastructure, complementing publicly and privately funded R&D, university and CRI research programmes.
- Developing viable venture capital industries (which in every instance has required government support) is a long term task, and is not easy. It requires prolonged commitment from those involved directly and from policy makers. Government support is likely to be necessary for at least the next generation of funds.
- Given New Zealand's size and access to capital, the development of a sustainable, thriving venture capital market in New Zealand will take at least 20 years. If successful, the benefits will be considerable.

Not only does venture capital account for an impressive amount of private wealth creation, but it also leads to important positive externalities. In particular, technological innovation—which economists have long argued is a critical driver of growth and prosperity—has been documented to be closely linked to venture capital funding.

There are a number of reasons for this. Firstly, for technology companies (often founded by someone with a technological background), venture capitalists can play a very important role in building a new company, aligning the company's focus around the simple objective of growth. Offshore research shows that private equity backed companies generate stronger employment growth, are more innovative and have better management teams than their peers, making them more productive and competitive.

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Secondly, unlike other types of investors, venture capitalists takes seats on the boards of portfolio companies and participate actively in the development of companies. They set milestones and targets for the companies to meet, and are active in the protection of companies' technologies and intellectual property. The advice that venture firms provide to entrepreneurs, as well as the post-investment monitoring and control, support top-quality innovation.

Thirdly, venture-backed IPOs reach the public market sooner than the non-venture-backed group. Venture capitalists speed the development of companies because they help companies pursue effective strategies and ensure access to capital.

There will be many aspects of improving productivity and economic performance for you to consider, but the role of venture capital is one important element. New Zealand is well positioned to generate investment in new high growth areas such as agricultural and clean-tech technologies, and the medical and health-related sector, providing the right type of access is available. There are also other aspects of the New Zealand private equity market which, if improved, could assist towards the step change in economic performance which you are seeking.

If it would assist your Taskforce, I would be happy to provide a more detailed submission on policy settings in this area, and how they could be improved. I would also appreciate an opportunity to meet with you and discuss the issues raised.

Yours sincerely

Franceska Banga
Chief Executive

Attached: *Fish out of water*, The Economist, 29 October 2009

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