The Treasury

Deepening New Zealand's Early Stage Capital Markets Information Release

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Office of the Minister for Economic Development

Chair, Cabinet Economic Development Committee

DEEPENING NEW ZEALAND'S EARLY STAGE CAPITAL MARKETS

Proposal

1. This paper proposes investment in New Zealand's early stage capital markets to enable more innovative, knowledge-intensive, high value firms and start-ups to grow and scale within New Zealand.

Executive Summary

2. The opportunities and challenges arising from the 4th industrial revolution are well known. The Future of Work programme is grappling with many of the challenges. The opportunity lies in lifting productivity and broadening the mix of goods and services New Zealand offers to the world by investing in new points of comparative advantage. Many of these will add value to volume, many will result from developing sectors of our economy adjacent to existing capability, and some will be new.

3. We need to shift investment from our excessive focus on property towards longer-term investments that lift productivity and create positive spillovers by encouraging efficiency or growing capability of benefit to other parts of the economy.

4. The development and commercialisation of disruptive innovation and technology requires particular skills and a business environment that large established corporates typically do not have. We need young fast growing firms operating in a healthy, well-capitalised start-up ecosystem.

5. In New Zealand many start-ups struggle to fully develop because of the shallowness of specialised domestic early stage capital markets, and in particular, a lack of venture capital (VC). This leads to excessive reliance upon foreign investment to overcome this gap, and the earlier than necessary selling of a greater proportion of New Zealand innovation to overseas interests, who then capture a greater share of the enterprise value.

6. I propose that we commit $300 million of public money to be invested through a fund-of-funds model to support New Zealand's venture capital markets. This could include $60 million from the New Zealand Venture Investment Fund's (NZVIF's) available assets. Options on how to do this are outlined in the paper.

7. The contracted private sector managers of those VC funds would seek funding from other institutions in New Zealand and abroad. These VC funds would substantially deepen New Zealand's early stage capital markets.

8. The role of large institutional investors like the New Zealand Superannuation Fund (NZSF) is key to shifting investment patterns, including that of smaller institutional investors like KiwiSaver funds. These investors exert control over most managed funds in New Zealand, and provide signals to smaller and overseas investors on where to invest. Currently most have no exposure to venture capital. I would like to see more active involvement of our institutional investors in early stage capital markets.

Economic strategy and investment

9. We came to office promising to rebalance the economy away from its excessive reliance on speculation and immigration towards productive investment.

10. We have a broad investment work programme using policy and regulatory levers to raise levels of productive investment and deepen capital pools. This includes the R&D tax credit, the Provincial Growth Fund (PGF), the Green Investment Fund (GIF), the work of the Tax Working Group, changes to the Overseas Investment Act, and refreshing the New Zealand Investment Attraction Strategy. This work programme will help to transform our economy to be more productive, sustainable and inclusive.

11. This investment work programme identifies early stage capital as a key lever for achieving our objectives. New Zealand's early stage capital markets are weak and are not properly supporting the transformation of our economy.

Why we need early stage capital markets to transform our economy

New global developments pose challenges or present opportunities

12. The confluence of global economic developments underway, including the advent of rapidly rising computer power, automatic sensors, robotics, big data, artificial intelligence, the internet of things, and genetics, mean that we are in the middle of a technological revolution. Many discrete innovations have global application, and are valuable businesses in their own right, as well as valuable sources of efficiency for traditional goods and services.

13. The growth curve of the opportunities born of this 'revolution' has been exponential, as a wide variety of goods and services are disrupted. Many Governments are trying to maximise their country's share of these new market opportunities.

14. No-one is sure when the exponential growth of opportunities will be largely exploited, and experience diminishing returns, but in the meantime New Zealand should apply more venture capital to this increasingly important part of our economy.

We need new points of comparative advantage and sustainable development

15. To be more resilient, sustainable, and productive we need to develop new points of comparative advantage; adding value to volume in our areas of strength, leveraging opportunities in adjacent sectors with established comparative advantages, and backing the industries of the future. A companion Cabinet paper on industry policy outlines further details on this work.

16. New technology increases productivity efficiency while often optimising natural resource use and lowering emissions levels.

17. In the recent report, *Can the Kiwi Fly? Achieving Productivity Lift-Off in New Zealand,* Paul Conway highlights how important capital deepening is for lifting labour productivity, influencing an economy's areas of comparative advantage and raising exports, but that New Zealand's capital intensity is lower than most of its OECD peers and 40 per cent lower than Australia. With low GDP per capita and rapid employment growth, capital has been spread across relatively more workers.

18. The paper also highlights that weak technological diffusion from global frontier firms to local firms has limited productivity growth, and that this is driven largely by poor resource allocation and market selection effects. Capital is not reaching the most productive firms and industries.

19. If we want to develop new sectors and encourage them to grow, we need to invest in them. We need investments in both capital and people. As the saying goes, people follow the money. To get people to move into a particular space we have to ensure it is properly capitalised.

We need to encourage young and innovative firms

20. The introduction of disruptive innovation and technology and the commercialisation of science and research requires particular skills and a business environment that large established corporates typically do not have. Young fast growing firms operating in a healthy, well-capitalised start-up ecosystem are required.

21. There is significant evidence of the benefits of VC on firm growth, including the role it plays in the selection process of high growth and innovative firms. Since 1974 only 0.3 per cent of US businesses have been backed by VC firms, but they have contributed 25 per cent of all employment growth. Of all firms that have publically listed in the US since 1974, 42 per cent are VC backed and they provide 85 per cent of all R&D spend, and pay 59 per cent of total taxes

22. Start-ups are critical for facilitating the commercialisation and adoption of newer technologies. In the New Zealand context, new technologies can contribute to productivity improvements in agriculture, horticulture, and aquaculture, while also bringing improvements to water quality and emissions reductions.

23. Early stage ventures are specialised. They require commercialisation and market testing skills. Globally the best (and often only) route to achieve this is through seed and venture finance.

We need to develop our early stage capital markets

24. Developing these specialised early stage capital markets is difficult and there are well-documented market failures that plague them, including information asymmetries, adverse selection and agency problems (unproven business models, unknown market size or channels to market). These 'market failures' are amplified by start-ups having a lack of collateral, limited internal funds, being pre-revenue, and lacking a track record to signal their "ability" to investors.

25. These failures raise the risk associated with investments and lengthen the time for a return on investment.

26. To be successful angel investors and venture capitalists provide ‘smart money’ in the form of funding plus experience, expertise and international connections. The necessary capability might take many years to develop.

27. Most countries identify this space as suffering from a ‘*missing markets’* market failure – where in early development phase, without support, the risk-adjusted returns are simply too low, and the market never forms on its own.

Globally many policy levers are used to encourage these firms

28. Recognising these failures, almost all Governments typically provide support for these markets, for an extended period of time.

29. Support for capital markets can take the form of direct grants and loans, guarantee schemes, tax incentives and equity instruments. The majority of OECD countries offer both an equity (fund-of-funds) instrument and a tax incentive.

30. Support also includes activities across the ecosystem - *knowledge development* (R&D and commercialisation of science outputs), the development of *entrepreneurs and firms* (incubators, accelerators, business networks, and investment/export promotion agencies), and providing *framework conditions* (ease of doing business regulations, property rights and investor protection).

What’s been done in the past?

Government has intervened in this space and supported a nascent sector

31. Government has made many improvements to our innovation cycle, and in establishing a start-up ecosystem, since the early 2000s and the *Knowledge Wave* conference. New Zealand Trade and Enterprise (NZTE) and Callaghan Innovation have been critical in providing support for the broader eco-system.

32. The Venture Investment Fund (VIF) was established in 2001. It co-invested with private investors to establish venture funds. In 2006, the Government established the Seed Co-investment Fund (SCIF), which co-invested with private investment networks to accelerate the development of the seed-stage of the market. Both VIF and SCIF are administered by NZVIF, a Crown company.

33. NZVIF has been critical in catalysing the capital market. Since 2001, it has invested:

- $125.2 million through VIF, with 11 venture fund managers, into 99 high growth firms. The internal rate of return (IRR), up to September 2018, is -3.29 per cent

- $58.8 million through SCIF, with 17 angel investor networks, into 215 high growth firms. The IRR, up to September 2018, is 4.38 per cent.

Government interventions have been effective

34. NZVIF, Callaghan Innovation, NZTE and others have catalysed an industry where once there was none. The number of high tech start-ups originating in New Zealand (including ten whose value now exceeds $1 billion) have grown despite the odds.

35. The *2018 TIN report* highlights how the tech sector in New Zealand (including high-tech manufacturing, information communications technology and biotech) continues to grow rapidly. It now has revenues of over $11 billion, employs 47,000 people, and exports $7.8 billion worth of goods and services. Revenue growth was 11 per cent in 2018, and has averaged 7.8 per cent over 5 years.

36. While NZVIF was often not directly responsible, it nonetheless incentivised the market, got the ball rolling, put New Zealand on the map, and "paid the school fees" of many fund managers.

So what is the problem?

Our early stage markets remain fragile

37. Despite great strides in establishing a healthier start-up ecosystem with a pipeline of opportunities at the seed and Angel stage, our capital markets remain shallow. There is a specific capital gap in the VC Series A and B space. This typically constitutes funding rounds for firms beyond idea stage and market validation and looking for further development of a firm's products and initial production and marketing. Deal size ranges between $2 and $15 million.

38. Fundamentally our capital markets are not servicing this space and our innovative starts-ups are forced to go overseas for capital. Most then move overseas.

39. Domestic investment levels in the VC space for the past three years have been about $20 million per year (in comparison Australia raised over $1 billion last year). There are only a handful of domestic investors active at the venture stage, and there have been low levels of VC raised for the last 10 years. It appears unlikely that these investment levels will increase markedly over the next few years.

40. While a financing gap does not necessarily constitute a 'market failure' (not all firms seeking funds necessarily merit them) there is sufficient evidence to suggest a significant VC (Series A/B) investment gap exists.

41. International research shows a seed to VC conversion rate of 25 per cent (ie for every 100 start-ups that get Seed funding, 25 firms will successfully go on to raise a Series A round), but in New Zealand this rate is only 10 per cent. Where we should expect to see around 30 to 40 firms closing their first VC funding round (Series A) annually, we are seeing less than half of that and most are funded from abroad.

42. Most stakeholders in the space agree there is a Series A and B VC gap. There has been significant media comment recently, and large business in New Zealand has acknowledged the presence of a gap. In 2016, Simon Moutter of Spark attempted to raise a $100 million VC fund. Officials understand there were a number of factors behind the fund not launching. These include an inability at the time to assemble a high quality team, a lack of interest from institutional investors, the pending review of

NZVIF, and the other corporates he hoped would form a core, being less interested in a generalist fund, and more interested in their own “verticals” (start-ups and technology specific to their own sector).

43. This VC capital gap poses a significant threat to our ability to grow and retain our most innovative young firms. They remain under-capitalised, grow slowly, list or sell prematurely, or are selectively cherry-picked by foreign funds or firms. The gap also dis-incentivises local entrepreneurs and investors from participating in this space in the future.

44. Additionally, the overseas investors into New Zealand’s early stage ventures have stated a preference for co-funding from local VC funds. When looking to invest they want a domestic fund with local market knowledge to lead the round, do due diligence, and flag any potential concerns. Local investors usually have the best knowledge of local business conditions and regulations, sector developments and entrepreneurs with potential. It is likely that New Zealand support for these funds will also leverage increased overseas investment in this sector.

Institutional investors are not actively involved

45. No successful VC market has gained real scale and traction without the participation of key domestic institutional investors.

46. This issue is heightened for smaller markets where the potential scale of returns and information asymmetries mean fewer international funds will perform market analysis or explore latent opportunities (perceived as too costly for expected returns).

47. More than 50 per cent of all managed funds in New Zealand are accounted for by NZSF, Accident Compensation Corporation (ACC), and the KiwiSaver funds. With their teams of analysts and fund managers, they are watched closely by smaller and overseas funds on where to invest. They have very limited participation in privately managed funds, and no exposure to VC.

48. One reason for the lack of participation by institutional investors in this space is due to the nature of their business and the nature of venture capital. For example, ACC requires mostly fixed income investments to match a steady stream of expected claims as actuarially calculated. Their ability to tie up a portion of their portfolio for 10 to 15 years is limited.

49. The main reason for NZSF’s limited participation, however, is because they have stuck narrowly to their mandate. NZSF is tasked with investing Government assets now to help pay for the future cost of providing universal superannuation by 2035/36. The sole mandate of this fund is to maximise profits on a commercial basis. Against this mandate, early stage capital markets do not earn the requisite risk-adjusted returns.

50. The mandate of NZSF is in contrast with other sovereign wealth funds that have a dual mandate – with one part being developmental. The developmental component builds domestic industries and markets to ensure the economy is resilient to global disruptions and there are high paying jobs that are able to increase contributions to tax and pension funds in the future.

51. In Australia, domestic superannuation funds contributed A$421 million, or about one third of all VC capital raised in Australia (A$1.3 billion) in 2017. Although the Australian Sovereign Wealth Fund, the Future Fund, has only recently started investing in domestic VC, the Guardians of the Future Fund oversee five funds which together have a broader impact on Australian development. The A$9.6 billion Medical Research Future Fund, managed by the Guardians, provide grants of financial assistance to support medical research and medical innovation, providing the pipeline of opportunities for funds like the Medical Research Commercialisation Fund. Australian superannuation funds have been attracted into the VC industry because of superior financial returns to other investment categories (eg the Australian Securities Exchange, ASX).

52. In New Zealand, past financial returns in VC have been limited. The VIF has had an IRR of -3.3 per cent, while SCIF's return has been 4.4 per cent.

- The VIF was principally designed to catalyse the market and not just achieve returns. It offered generous 'buy back' options to entice international investors to invest in the space which effectively capped their 'upside returns'. Without these 'buy-backs' the overall return would've been at least 1.41 per cent. Between 2007 and 2016 the overall return without the 'buy-backs' is 12.07 per cent.

- For example: as a result of the buyout, NZVIF's return on its investment in Valar Ventures Fund was capped at 1.13x[1] and IRR of 3.33 per cent. The buyout option resulted in a transfer of value of $33 million from NZVIF. With no buyout clause, the return on the Valar Venture Fund would have been 4.79x and IRR of 49 per cent**.**

- The returns in the sector are also evolving as the sector matures. This is highlighted by the 2018 TIN report showing that technology firms with private equity, VC or Angel backing have averaged 13 per cent over the last five years.

- Other reasons included the then embryonic stage of the ecosystem, and that all funds invested in so far have been sub-scale, with disproportionately high running and compliance costs, with little opportunity to do follow-on investment (once the costly discovery process is complete and start-ups have been de-risked).

Institutional investors can also shape the market unfavourably

53. NZSF has invested around $450 million in the expansion stage (more mature firms than the VC stage), and have 'pulled' investors up into this space and out of the VC space. I have been advised that NZSF imposes restrictions on the funds it invests in, and limits the amount of management fees that can be charged. This restricts the level of competition and keeps costs down, helping NZSF ensure better returns (and meet its profit-maximising mandate), but it has negative effects on broader market development.

[1] 1.13x means the return on capital is equivalent to 1.13 multiplied by the initial capital outlay.

What we need to do

54. To get the changes we want in our economy we need more investment that internalises externalities, creates spillovers and anticipates long term trends. To do this we need to change market signals – both those we send as Government, and those sent by the key institutional investors.

55. We are already signalling to the market our intentions on inclusive investing with the PGF, which is funding close to ready opportunities in regional New Zealand, and sustainable investing with the GIF, which is focused on mature technologies to reduce our carbon emissions. We have started work on other interventions to lift productive investment, including changes to the Overseas Investment Act and the work of the Tax Working Group. But we need to do more.

56. We need capital that enables young innovative firms to grow and to stay in New Zealand for longer. To do this we need to address the clear VC capital gap.

57. There are a number of options available to incentivising private capital to flow to the early stage capital market including changing tax incentives and other regulations (entity structure or tax treatment rules) and we could explore the possibility of subsidising management fees (to attract top fund management talent) – most alternatives are distortionary to our relatively simple tax code or carry a fiscal cost.

Proposal: Recapitalising the early stage capital markets and changing market signals

58. I believe we need $300 million to recapitalise the VC market, seed new VC funds (both generalist and specialist), and ensure continuity of Government support for our start-ups.

59. The $300 million amount is informed by the estimated size of the VC capital gap ($150 to $250 million per annum), the need to achieve scale in future VC funds established, a public to private fund matching ratio of at least 1:1, and ensuring that Government is not over exposed to the VC capital market.

60. I propose the $300 million should be invested through a fund of funds. I believe we need three or more privately managed NZ based VC funds. These newly seeded VC funds should aim to have a scale of $100 million (but no less than $60 million), with the different funds established over a 5 year period (different vintages). We also need smaller ‘side-car’ funds, which form part of larger global funds (with greater emphasis on specialisation, scale and access to international markets). This will add a degree of competition and choice back into the market, stimulate innovation and product development, and still ensure that VC funds are not sub-scale. It will provide a path to commercialisation for our best research.

61. A ‘fund of funds’ model would mean we have experienced commercial experts making investments into qualifying privately managed VC funds, who will then make the actual investment decisions on which companies to support (and how to support, and when to stop supporting). VC funds must prove their capability and that they are able to attract a certain minimum amount from the private sector before they get support from the fund of funds.

62. The VC funds should cover start-ups that introduce disruptive and innovative technologies. Some of these funds will be generalist funds, while others will be focused on a particular technology/sub-sector. For example, I believe we need a specialist Agritech fund that commercialises the significant potential New Zealand has in this space.

A detailed proposal will present options for sourcing and dispersing funds

63. I have examined a number of options for both sourcing the funds and getting them invested in the companies that need them. Below I describe the options at a high level, and a few important considerations, but these options will be further analysed and presented back to Cabinet in early 2019 in a detailed proposal.

64. I have looked at two broad options for sourcing the funds, namely:

- Option A (my preferred option): use $240 million (3.1 per cent) of the $7.7 billion earmarked for the NZSF between 2018 and 2022, OR
- Option B: use $240 million of new money available from a forecast budget surplus.

65. This $240 million would be combined together with $ 60 million from NZVIF's available assets to make $300 million.

66. I have also briefly looked at potential options for dispersing the funds:

- Option 1: Transfer $240 million of new money directly into the NZVIF from the Crown (alongside $60 million from NZVIF's available assets) into a recapitalised $300 million fund-of-funds model.
- Option 2 (my preferred option): Transfer $240 million (of money originally earmarked for NZSF) into a new fund administered by the Guardians of the NZSF, but where the funds are transferred into the NZVIF fund-of-funds (alongside $60 million of NZVIF's available assets) to be invested in the market.
- Option 3: Transfer $240 million (of money originally earmarked for NZSF) and $60 million from NZVIF's available assets into a new $300 million fund administered by the Guardians of the NZSF, and for the Guardians to determine how that fund is invested into the market

67. None of the options would interfere with the clear mandate of the NZSF, or force it to invest counter to its investment ideology. Rather option two and three would require a new fund to be created with its own separate mandate to be administered by the Guardians of the NZSF.

68. The two options that invest via NZVIF are appealing because they offer the:

- quickest route to introduce a capital/equity injection into the market
- ability for the NZVIF team to continue providing its 'public good' services, which include maintaining its database of opportunities, connecting potential investors

with opportunities it already has exposure to through SCIF, setting market standards, and providing VC specific research and training

69. The benefit of using the Guardians of the NZSF to administer a new fund is:

- leveraging its market position as a trusted investor, a potential market maker, and a provider of signals to other smaller or overseas funds

- making use of its large team of analysts and managers able to do due diligence and establish high performing funds

- in option 2 where NZSF administer a new fund, but invests via NZVIF's fund-of-funds, there some oversight at a high level by the NZSF, which would provide desirable tension in the system.

70. Following advice from MBIE and Treasury officials, I will report back to this committee in February next year on the details of the recommended approach. This approach will include a detailed proposal which would spell out the strengths and weaknesses of the proposed options.

The detailed proposal will define objectives, returns and qualifying criteria

71. The detailed proposal will indicate the best way to design the solution that can actually achieve benefits like leveraging off existing capability and markets signals. It will consider in detail the legal aspects involved in setting up a new fund, the contracting elements between entities, and the interaction between the entities and Government (including ministerial directives, mandates, and goals).

72. The detailed proposal will consider the qualifying criteria of firms receiving investment. For example, options could consider setting minimum rules about investing in low-emission technologies, or in sectors that complement the Government's sector strategy. The fund could also be directed to invest only in funds with a minimum share of assets and employees located in New Zealand.

73. Finally the detailed proposal will described the Governance and monitoring framework, and define the overall objectives, key performance indicators (KPIs) and expected timelines. KPIs could include the measured returns in the VC market (against benchmarks), total funds under management (and as a percentage of GDP or Private Equity), the number of firms receiving VC (Series A and B) and the number of firms 'graduating' and receiving Series C and D funding rounds domestically, and ultimately listing on the New Zealand public exchange or exiting.

74. The various funds the government is seeding – the GIF, PGF and the proposed VC fund – will be effective complements to each other. Ultimately these investments will grow more companies in high productivity and sustainable sectors for others to invest in.

NZVIF's proposal for a fund of scale

75. In March 2017, the then shareholding Ministers for NZVIF authorised NZVIF to progress their VIF2.0 proposal by testing the appetite of the market to co-invest

alongside the government in a *fund of scale* where NZVIF would sponsor the establishment of a general partner and play a more active role. Shareholding Ministers anticipated the market testing phase to be complete by November 2017, with NZVIF to prepare an investment proposal for shareholding Ministers to take to Cabinet for a decision.

76. I do not believe that NZVIF's VIF2.0 proposal has achieved market traction, and I am of the view that a single fund of scale is not consistent with the model we are proposing. I will be informing NZVIF to stop its market testing of the VIF2.0 proposal

Consultation

77. The Treasury has been consulted. The Department of the Prime Minister and Cabinet has been informed.

78. The Treasury recognises that New Zealand's thin capital markets are likely to impact productivity and innovation. The Treasury supports considering the role NZVIF can have in supporting markets. However, in order to maximise the benefits of a reinvigorated VIF model to New Zealand, it will be important to ensure that other parts of our capital markets, including the listed market, are functioning well and help provide a local anchor for firms.

79. The Treasury supports recommendation 18, to more deeply consider the role NZVIF and other agencies can have in supporting the development of capital markets. However the success criteria should be well defined to enable assessment of options.

80. The Treasury understands recommendation 14 seeks an in principle agreement to use $300m of public money to support the development of early stage capital markets. We recommend any funding decision be taken as part of Budget 2019. This would align with the timeframes indicated for options analysis.

81. Of the funding options proposed in recommendations 14.1 and 14.2, we recommend that Ministers consider the different risk and return profiles of NZVIF and NZSF. Using contributions intended for superannuation creates an opportunity cost of investment returns.

Financial Implications

82. If my preferred option is agreed to by Cabinet, then the main financial implication is a reprioritisation of $240 million earmarked for transfer into the NZSF and the allocation of $60 million of NZVIF's available assets. There is no new money required in this proposal.

83. If the other option is agreed to then there would be $240 million of new funding required.

Legislative Implications

84. Some of the possible options identified would require changes to the New Zealand Superannuation and Retirement Income Act 2001, to enable the Guardians of NZSF to administer additional funds. These changes would not change the Guardians existing mandate for NZSF.

Publicity and Proactive Release

85. This proposal is budget and market sensitive. Any engagement or publicity will be coordinated through my office.

86. I do not intend to make an announcement of these issues, or proactively release the cabinet paper under the Official Information Act 1982, in advance of Budget 2019. This material will be released following Budget 2019.

Recommendations

The Minister for Economic Development recommends that the Committee:

1. **Note** that we need to transform our economy to be more productive, inclusive and sustainable

2. **Note** that one of the Cabinet Priorities Committee's priorities is to address thin capital markets

3. **Note** we have developed a broad work programme to ensure that investment plays its role in this transformation and I am bringing a paper to Cabinet on this early in 2019

4. **Note** the work programme is linked to our new approach to industry policy which is being discussed concurrently

5. **Note** that well-functioning early stage capital markets are a critical element in shifting our economy to be more productive, sustainable and inclusive, and investing in new points of comparative advantage

6. **Note** that Government has intervened in this space since 2001 through the Venture Investment Fund and, since 2006, with the Seed Co-Investment Fund

7. **Note** that many start-ups continue to struggle to develop to potential because of the shallowness of our venture capital markets, which leads to excessive reliance on foreign investment to overcome this funding gap and encourages them to sell down prematurely and move abroad

8. **Note** the shallowness of the venture capital market limits the economic benefits we gain from our R&D and science programmes

9. **Note** the role of institutional investors is key to shifting investment patterns, as they exert control over a significant share of managed funds and provide signals to smaller New Zealand based or overseas investors on where to invest

10. **Note** that New Zealand's institutional investors have not invested in the early stage capital market space

11. **Agree** that we need to deepen early stage capital markets and address the venture capital gap experienced by New Zealand firms

12. **Note** that it is proposed to use $300 million of public money to be invested to support the deepening of early stage capital markets

13. **Note** that there are options on where to source the funds and how to disperse them

14. **Note** the options of:

    14.1. use $240 million of the $7.7 billion earmarked for the New Zealand Superannuation Fund between 2018 and 2022, and combine it together with $60 million from New Zealand Venture Investment Fund Limited's available assets to make $300 million (my preferred option)

    OR

    14.2. use $240 million of new money available from a forecast budget surplus and combine it together with $60 million from the New Zealand Venture Investment Fund Limited's available assets to make $300 million

15. **Note** that choosing the first option outlined in 14.1 does not require any new money to be found from Budget 2019

16. **Note** two of the potential options for dispersing the funds, where a new fund is created and administered by the Guardians of New Zealand Superannuation Fund, protect the existing fund and its mandate, and do not direct or influence them on where to invest the existing fund

17. **Note** the two options that create a new fund administered by the Guardians of New Zealand Superannuation Fund require legislative change to the New Zealand Superannuation and Retirement Income Act 2001, but do not require changes to the original fund's mandate

18. **Agree** that Treasury and MBIE jointly investigate these options and prepare a detailed proposal

19. **Invite** the Minister for Economic Development to report back to this Committee by February 2019 on the proposals to increase investment in early stage capital markets, including:

    19.1. a range of options, the strengths and weaknesses of them, and a preferred option

    19.2. the role of New Zealand Venture Investment Fund Limited and New Zealand Superannuation Fund in the proposed solution

    19.3. how the money will be deployed through a 'fund of funds' model

    19.4. mandates for any individual fund development such as the sector focus of the funds, the minimum scale of funds, and local representation

    19.5. performance monitoring and evaluation requirements

    19.6. the regulatory changes (and governance) needed to implement these proposals

20. **Note** that I envisage the deployment of this fund to be across multiple years and investors, and with a focus on developing new areas of advantage such as Agritech

21. **Note** that as shareholding Ministers, Minister Robertson and I will be informing New Zealand Venture Investment Fund Limited to stop its market testing of the VIF2.0 proposal

22. **Note** that these proposals are budget and market sensitive and any engagement or publicity relating to it will be coordinated through the Minister for Economic Development

23. **Agree** that the Minister for Economic Development is able to consult with New Zealand Venture Investment Fund Limited and the New Zealand Superannuation Fund on these proposed changes.

Authorised for lodgement

Hon David Parker

Minister for Economic Development