MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

Policy Statement

on the Venture Capital Fund Act 2019

New Zealand Government

Ministerial foreword

Since the release of the Policy Statement on the Venture Capital Fund Act 2019, our economic landscape has undergone remarkable transformations. As Associate Minister of Finance responsible for policy work on the Venture Capital Fund Act, I am pleased to present an updated Policy Statement, reflecting the progress we have made and the changes that have taken place in Aotearoa New Zealand in a short amount of time.

The introduction of Elevate has been a catalyst for the record growth observed in markets. Before its launch, there was less than $100 million of capital available for this stage of company growth and only four active VC funds. So far, the $300 million Elevate fund has meant that government has backed eight venture capital funds, resulting in over 100 Kiwi tech start-ups being backed. Elevate has crowded in hundreds of millions of dollars of private capital; there is an estimated $800 million total market capital available for this crucial stage of start-up growth. This substantial increase in available capital and the increasing maturity of our domestic venture capital industry highlights the positive impact of Elevate in fostering the growth of innovative businesses in New Zealand.

In doing so, it has nurtured a vibrant innovation ecosystem, driving the commercialisation of ground-breaking technologies and positioning New Zealand as a global hub for innovation. The Elevate Fund has not only boosted productivity, wages, and export growth but has also fostered collaboration and knowledge exchange among industry stakeholders. This collaborative approach has attracted international investment and solidified our nation's reputation as a home of talent and innovation.

One notable change in this updated Policy Statement is the revised definition of Series A/B funding rounds. In light of the significant increase in funding round sizes globally and domestically, we have adapted our definition to align with market realities. Previously, the funding limit for Series A/B rounds was $20 million. Now, the revised definition allows for funding rounds of up to $40 million, with exemptions for rounds of up to $50 million on a case-by-case basis. This adjustment ensures that New Zealand firms can effectively access the capital they need at critical stages of their growth journey.

I am also pleased to share that Budget 2023 allocated a capital contribution of $40.5 million towards Elevate, completing the $300 million funding commitment we made in 2019. This significant investment reaffirms our dedication to supporting New Zealand businesses and propelling their growth.

I express my gratitude to the stakeholders who have contributed to the success of the Elevate Fund and our venture capital ecosystem. The achievements we have witnessed thus far are a testament to the entrepreneurial spirit and dedication of our innovative firms and dedicated, professional investors. With the updated Policy Statement and the Elevate Fund as catalysts, we stand poised to write a new chapter of innovation and economic growth for New Zealand.

Hon David Parker
Associate Minister of Finance

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Preamble

Young, dynamic firms are important in building a knowledge economy and transforming our economy to become more productive, sustainable and inclusive. These firms are agile and introduce disruptive and innovative technologies, which large corporates are often not well suited to achieve.

Many of these young, dynamic firms, however, struggle to fully develop in New Zealand because of the shallowness of specialised domestic early stage capital markets, and especially a lack of venture capital. The Government introduced the Venture Investment Fund in 2002 and the Seed Co-Investment Fund in 2006 via the New Zealand Venture Investment Fund Limited (**known now as New Zealand Capital Growth Partners or NZGCP**) to develop these markets. These programmes have succeeded in catalysing the early stage capital markets in New Zealand, which did not exist prior to the programmes. However, they have not yet enabled the early stage capital markets to be self-sustainable.

While the Venture Investment Fund and the Seed Co-Investment Fund have seen important success, the supply of the capital in New Zealand has persistently fallen short of the increasing demand for capital by firms in the Series A & B venture capital space, and therefore the capital funding gap has remained.

The conversion rate between Seed and Series A rounds in New Zealand is 10 per cent, which means 10 per cent of firms that have raised a Seed round are being successful in raising a Series A round. This figure is well below the global median conversion rate (i.e. 25 per cent as measured by the Startup Genome Project). This low conversion rate reflects a lack of venture capital available in the New Zealand ecosystem. The Ministry of Business, Innovation and Employment estimated the capital funding gap to be around $150 million per annum.

The Venture Capital Fund Act 2019 (**the Act**) established NZGCP and the Elevate NZ Venture Capital Fund (Elevate), which aims to increase the capital available to New Zealand entities and develop New Zealand's venture capital markets to function more effectively. NZGCP is a Crown-owned fund that is managed and administered by the Guardians of New Zealand Superannuation (**the Guardians**).

The Act allows the Minister of Finance or delegated Minister to provide to the Guardians a Policy Statement that sets out various directions containing high-level requirements for the investment of the Venture Capital Fund.

The Guardians will manage and administer the Elevate NZ Venture Capital Fund utilising best practice investment management that is appropriate for institutional investments in the New Zealand venture capital market, subject to high-level government policy requirements.

It is intended that the Guardians and NZGCP will enter into an arrangement which will enable the Guardians to leverage its existing frameworks and expertise to apply best practice investment management oversight of Elevates investments as the designated manager of the Elevate Fund. In turn, the intent is for NZGCP to facilitate best practice with underlying venture capital fund managers.

The underlying venture capital fund managers will be required to, among other criteria, prove their management capability and their ability to raise a certain minimum amount of private capital before receiving investment from the Venture Capital Fund.

The expectation is a self-sustaining domestic venture capital market with sufficient capacity to service the demand that is expected to develop as a result of this programme.

The Act and Policy Statement set out an overall programme which aims to result in a well-functioning New Zealand venture capital market which will:

- have a deep pool of capital and capability, including specialised expertise available to New Zealand entities
- identify where effective collaboration of skill sets better service the needs of New Zealand entities
- build strong international connections for the purpose of increasing the expertise available to New Zealand venture capital markets
- produce positive risk-adjusted returns and have a positive reputation for performance, trust and transparency both domestically and internationally
- have attracted investment from a broad range of institutional and other investors in New Zealand and overseas, and have a deeper market with multiple funds operating at an appropriate fund size and mixed vintages of funds that will ultimately lead to increased competition and efficiency.

The Guardians have been consulted on this Policy Statement as required in section 20(1) of the Act.

Purpose

This Policy Statement provides high-level policy directions to the Guardians of the New Zealand Superannuation for the Venture Capital Fund. It will guide the core parameters and settings under which the Venture Capital Fund is to be operated.

The formal policies contemplated by the Act are set out in the "Policies" section, with terms defined in the "Definitions" section. The remaining sections of this document are for background context.

Title

This Policy Statement is the Policy Statement on the Venture Capital Fund Act 2019.

Commencement

This Policy Statement comes into force on 19 December 2019.

Principles

The Minister has taken the following principles into account in designing this Policy Statement and the objectives of the Venture Capital Fund Act 2019:

1. The Venture Capital Fund will be managed and administered utilising best practice investment management that is appropriate for institutional investments in New Zealand's venture capital markets.
2. The investment parameters for the Venture Capital Fund should recognise the additional imperative to support the development of the market to operate more effectively over time.
3. The Venture Capital Fund is expected to facilitate a clear and robust due diligence function to help attract private capital into the New Zealand venture capital market.
4. The Fund-of-funds model and the directions in this Policy Statement will seek to optimise the number of funds, including the mix of vintages, to deliver an effective market both today and into the future.
5. The Fund-of-funds model allows for an appropriate mix of domestic and offshore funds to increase the capability and connectivity of the New Zealand venture capital market.
6. The Policy Statement settings assist New Zealand entities to continue to fulfil their business ambitions which, including overseas expansion, and not restricting overseas investment at a later stage where this is in the best interests of the company.

Objectives

The purpose of the Venture Capital Fund (section 9) is to contribute to a sustainable and productive economy by:

1. increasing the venture capital available to New Zealand entities; and
2. developing New Zealand's venture capital markets to function more effectively so that over time:
    - more venture capital becomes available to New Zealand entities from sources other than the VCF, and
    - New Zealand entities that receive venture capital become more likely to grow into successful and sustainable businesses; and
    - those markets become self-sustaining (including through more investment from New Zealand investors).

Increase the venture capital available to New Zealand entities

Many high-growth early-stage New Zealand entities struggle to access the capital that they need to further develop, especially after showing progress in building a business model and the potential to grow and generate revenue (the investment in businesses at this early stage is often known as Series A and B capital). Many of these entities have successfully raised initial

Start-up or Seed funding domestically. However, in New Zealand there is currently a shortage of available investment in the Series A and B space which affects firms' ability to raise funds and continue their development in New Zealand.

These entities are aware of the capital funding gap in New Zealand, and often look for capital offshore where venture capital funding is significantly more advanced and large pools of capital are available. As the number of start-ups in New Zealand continues to grow, this has led to the increased reliance upon foreign capital to support New Zealand early stage entities, which increases the risk of earlier-than-necessary sell off of New Zealand innovation to offshore interests. This also results in the substantial potential gains that investors can make in successful start-up businesses also being made overseas rather than being recycled back into New Zealand and the next generation of emerging high growth companies.

In time, more developed venture capital markets, with better resourced and connected fund managers that generate returns appropriate for the sector, should help attract private capital and new investors into this sector. The potential investors in this space may include domestic institutions, KiwiSaver funds, corporates, iwi, private family investments, retail investors, and some offshore investors.

Through the Venture Capital Fund, the government aims to address the Series A and B funding gap to provide a continuous capital pathway to those high-growth early-stage New Zealand entities to support their growth globally from New Zealand.

Providing a capital pathway for New Zealand's high-growth early-stage entities should create better returns for the government research and development investments and enable more of the technologies to be commercialised. It may also encourage some of entities to stay longer in New Zealand. Potential benefits of entities staying longer in New Zealand include:

- the creation of more jobs in New Zealand,
- an increase in exports from New Zealand, and
- growth of the knowledge economy.

These benefits will contribute to transforming our economy by making it more productive, sustainable and inclusive.

Develop New Zealand's venture capital market

To achieve the objective outlined in the previous section, we need to have an ongoing well-functioning New Zealand venture capital market. Successful venture capital markets not only provide the capital that firms need to fund their growth, but also the capabilities and connections that are key elements in business development. Many jurisdictions around the world have similarly intervened to develop their domestic venture capital markets.

Alongside the imperative to increase the venture capital available to New Zealand entities, the long-term intention of this policy is to develop the New Zealand venture capital ecosystem, whereby

- New Zealand entities that receive venture capital become more likely to grow into successful and sustainable businesses, and

- there is an appropriate number of highly capable funds that invest in New Zealand entities and collaborate to continue the development of a self-sustaining venture capital market in New Zealand.

With regard to the venture capital ecosystem, the outcome that is being sought by the Government is to develop long-term sustainable funds which have:

- sufficient scale, including multiple vintages
- a strong track record of returns
- extensive domestic and international networks
- world-class capability and experience in working with start-ups, and
- the ability to raise domestic and foreign private capital without further government intervention.

The intention of this programme is to use a mix of fund managers including those that have previously operated in New Zealand and know the market well, but also international managers that are able to bring international connectivity, expertise, and new skill sets to the market.

Acknowledging the requirement to further develop the breadth of the skill base in this sector, government may also support one or two new fund managers which show significant potential and/or where they have a strong track record and other required capabilities albeit outside of venture capital fund management.

Significant commitment or contribution to the development of the New Zealand venture capital market

The Policy Statement includes a definition of "New Zealand Connection" which (among other things) requires funds to demonstrate a commitment or contribution to developing the New Zealand venture capital industry. To meet this requirement, funds will need to be able to demonstrate a connection to New Zealand. This may include, but not be limited to: a track record of investing in New Zealand entities; collaborating with domestic investors and funds; hosting one or more investment committee meetings in New Zealand; undertaking capital raising activities in New Zealand and developing a New Zealand investor base, having senior investment personnel attend pitch events and/or networking events, recruiting, training and developing new staff and providing exposure to global best practice. Training and development might include the recruitment of graduate interns, secondments for domestic employees into offshore offices, performing or organising training (masterclasses) for founders or for domestic investors on investing in alternative asset classes.

Definitions

In this Policy Statement –

Terms not defined have the meaning given to them in the Act.

Act means the Venture Capital Fund Act 2019.

Co-investment means an investment made by the Venture Capital Fund directly into a New Zealand Entity alongside an Underlying Fund as contemplated by Policy 4.

Entity means any company, limited partnership, body corporate or other similar entity wherever formed or established.

Follow-on Investment means additional investments into existing portfolio Entities that the Underlying Fund manager determines are required or reasonably advisable in order to protect, support or enhance an investment made by that Underlying Fund during its investment period.

Foreign Fund means a Fund which does not have a New Zealand Connection.

Foreign Fund Investment means an investment in a Foreign Fund (or in a sidecar or similar investment vehicle alongside a Foreign Fund) in respect of which the Venture Capital Fund committed capital is invested only in New Zealand Entities alongside the applicable private capital for such investments. For the avoidance of doubt, the Foreign Fund may have a wider mandate than the New Zealand Entities into which the Venture Capital Fund committed capital is invested.

Fund means an investment vehicle established to pool capital and invest in early-stage Entities (or, in the case of the Venture Capital Fund, other Funds) with an objective of maximising returns to its investors.

Fund-of-funds means a Fund that primarily invests in Underlying Funds and may also invest via Co-investment with an Underlying Fund and/or through a Foreign Fund Investment. The Fund-of-funds manager is responsible for the evaluation, selection, monitoring and management of the investment in each of the Underlying Funds in which the Fund-of-funds invests in accordance with the terms of its governing document(s).

Net Committed Capital means the total funds committed to the Venture Capital Fund (including any Recycled Funds available for reinvestment), minus the anticipated fees, obligations, expenses and liabilities to be incurred by the Venture Capital Fund.

New Zealand Connection means a Fund established to invest predominantly in New Zealand Entities and in respect of which the locally established general partner and investment manager (or equivalent):

- is a New Zealand resident and has a permanent establishment in New Zealand (each as defined for tax purposes), and
- employs at least two investment professionals, at least one of whom is a senior investment professional in a voting role in respect of investment decisions for the Fund, and whose principal place of work is New Zealand, and
- demonstrates significant commitment or contribution to the development of the New Zealand Venture Capital Market.

New Zealand Entity means an Entity which (itself and/or through any of its subsidiaries, as the case may be), at or immediately following the time of initial investment, has:

- the majority of its full-time employees and independent contractors (by number) in New Zealand or the main operations based in New Zealand; and
- one or more of the following:
  - its shareholder (or equivalent) voting control held by one or more New Zealand residents (as defined for tax purposes); or
  - New Zealand residents (as defined for tax purposes) as the majority of its senior leadership team; or
  - its headquarters in New Zealand.

New Zealand Venture Capital Market means the ecosystem of domestic and other investors, funds and fund managers involved in Venture Capital investing in New Zealand Entities together with those New Zealand Entities which are the recipients of that Venture Capital.

Recycled Funds means the net amount of any cash distribution received by the Venture Capital Fund from investments from time to time.

Seed Capital means capital provided in a capital raising in which the total amount being raised in that round is from (and including) NZ$100,000 to (but excluding) NZ$2 million and where that capital is being raised for the purposes of early stage growth.

Series A and B Capital means capital provided in a capital raising in which that capital is being raised for the purposes of early stage growth, and the total amount being raised in that round is from (and including) NZ$2 million to (and including):

- NZ$40 million; or up to

- NZ$50 million on a case-by-case basis where the Guardians consider that the core characteristics of the capital raising are substantially similar to other Series A and B Capital rounds the VCF has participated in.

Series C and C+ Capital means capital provided in a capital raising in which the total amount being raised in the round is greater than NZ$20 million.

Underlying Funds means comingled funds in which the Venture Capital Fund invests.

Venture Capital Fund (VCF) means the Venture Capital Fund established under the Act. In the context of any investment made by the VCF, a reference to the VCF shall include any VCF investment vehicle into which the VCF is directly invested.

Venture Capital means Series A and B Capital provided to early stage Entities together with any permitted Seed Capital or Series C and C+ Capital.

Policies

I. Investment directions

Guardians must *give effect to* the Policies 1-5 (inclusive) by including appropriate provisions in the contract or other arrangement put in place to manage the VCF.

Policy 1: Investment Model

The Guardians must invest the VCF in the New Zealand Venture Capital Market based on a Fund-of-funds model.

Policy 2: New Zealand Fund Investments

(i) The VCF must be invested wholly or substantially in Funds with a New Zealand Connection. To be substantially invested in Funds with a New Zealand Connection, a minimum of 70 per cent of the Net Committed Capital made available to the VCF must be allocated for investment in Funds with a New Zealand Connection (the **NZ Capital**).

(ii) Underlying Funds with a New Zealand Connection will be required to invest wholly or substantially in New Zealand Entities. To be substantially invested in New Zealand Entities, a minimum of 75 per cent of the aggregate investable capital of the portfolio of Underlying Funds with a New Zealand Connection must be allocated for investment in Series A and B Capital in New Zealand Entities (with the intent of achieving as high an aggregate allocation across all such Underlying Funds as commercially practicable, recognising, however, that investments in Seed Capital, Series C and C+ Capital and Entities that do not qualify as a New Zealand Entity may be necessary or desirable to improve the returns of Underlying Funds).

(iii) Notwithstanding (ii) above, no more than 10 per cent of the aggregate investable capital of all Underlying Funds with a New Zealand Connection may be allocated for investment in Entities that do not qualify as New Zealand Entities.

Policy 3: Foreign Fund Investments

The VCF may be invested up to an aggregate of 30 per cent of Net Committed Capital via Foreign Fund Investments in New Zealand Entities (**NZ Foreign Fund Capital**) of which a minimum of 75 per cent of the aggregate investable capital of the NZ Foreign Fund Capital must be allocated for investment in Series A and B Capital.

Policy 4: Co-Investment with Underlying Funds

Notwithstanding Policy 2 and 3, if a manager of an Underlying Fund brings a Co-investment opportunity to the VCF for consideration, the VCF may be invested in an amount up to:

- an aggregate of 20 per cent of the NZ Capital via Co-investment alongside Underlying Funds with a New Zealand Connection; and
- an aggregate of 20 per cent of the NZ Foreign Fund Capital via Co-investment alongside Underlying Funds which are Foreign Fund Investments

provided that, the Underlying Fund is completing a Follow-on Investment via the Co-investment, the VCF relies on the due diligence of the manager of that Underlying Fund and a third party is the lead investor responsible for valuation and pricing. To avoid doubt, a Co-investment may include Co-investments in capital raising stages for Series C and C+ Capital and may be after the Initial Investment Period.

Policy 5: Private capital requirements

For every Underlying Fund, the Underlying Fund must have aggregate committed capital from other investors as determined by the Fund-of-funds manager which must be at least equal to the VCF committed capital (i.e. up to half of total committed capital may be sourced from the VCF). In the case of a Foreign Fund the aggregate committed capital from other investors is measured as the aggregate committed capital from such investors that may be invested only in New Zealand Entities and applied alongside capital contributed by the VCF.

II. Government expectations

The Guardians must *have regard to* Policies 6-9 (inclusive):

Policy 6: Government's expectation as to the timing in which VCF capital is deployed is that the VCF should commit capital for investment into Underlying Funds and Foreign Funds Investments for an "Initial Investment Period" of five years from the effective date of the contract or other arrangement entered into between Guardians and NZVIF pursuant to Schedule 1 of the Act (the **Commencement Date**). The Government's expectation is that Co-investment and Follow-on Investment is likely to occur outside of this Initial Investment Period.

Policy 7: Government's expectation as to continued investment is that the VCF may commit further capital for investment for a "Secondary Investment Period" starting from the end of the Initial Investment Period. During the Secondary Investment Period capital committed will comprise capital made available to the VCF which remains uncommitted at the end of the Initial Investment Period (if any) together with any Recycled Funds.

Policy 8: Government's expectation as to the return of capital invested through the VCF is that at the completion of the programme all residual funds should be returned to the Crown (net of any costs and fees), which is expected to be a minimum of 15 years from the Commencement Date.

Policy 9: In setting out terms with NZVIF, the Guardians must have regard to relevant aspects of the Government's economic strategy and plan to transition to a low carbon economy (such relevant aspects to be identified by the Treasury in agreement with the Guardians).

For more information, refer to the Government's Economic Plan (available via https://www.beehive.govt.nz/sites/default/files/2019-09/Economic%20Plan.pdf).

Any changes to the Government's economic strategy and plan that could have impact on the way the VCF is managed will be reflected in an updated Policy Statement.

Implementation

The Guardians will be responsible for implementing this Policy Statement as provided under the Act. The Guardians must *give effect to* the Policies 1-5 (inclusive) by including appropriate provisions in the contract or other arrangement put in place to manage the VCF. This is established as the contract or other arrangement between the Guardians (or VCF investment vehicle) and NZVIF.

Review of this Policy Statement

The Purpose and Objectives of the Venture Capital Fund will be monitored on an ongoing basis. This Policy Statement will be reviewed if the policy objectives of the Venture Capital Fund are not being achieved. Any future changes to the Policy Statement will only be able to be applied to future commitments of the Venture Capital Fund, and therefore will not affect any existing investments, matters, commitments or contracts at the time the Policy Statement is amended.

The Guardians must be consulted on the Policy Statement before it is issued, reviewed and/or re-issued. The effect of the above is that the Guardians will have a reasonable degree of certainty as to what the Policy Statement will contain, and will also have an opportunity to comment on how the proposed directions will affect the Venture Capital Fund and the wider market.