



## BRIEFING

### Elevate NZ Venture Fund – further information

<b>Date:</b>	15 August 2024	<b>Priority:</b>	High
<b>Security classification:</b>	In Confidence	<b>Tracking number:</b>	2425-0734

Action sought		
	Action sought	Deadline
Hon Melissa Lee <b>Minister for Economic Development</b>	<b>Agree</b> to forward a copy and discuss this briefing with the Minister of Finance and the Associate Minister of Finance	20 August 2024

Contact for telephone discussion (if required)			
Name	Position	Telephone	1st contact
Iain Southall	Director, Technology and Innovation	Privacy of natural persons	✓
Privacy of natural persons	Senior Advisor, Investment Policy		
	Policy Advisor, Investment Policy		

The following departments/agencies have been consulted

Minister's office to complete:

☐ Approved

☐ Declined

☐ Noted

☐ Needs change

☐ Seen

☐ Overtaken by Events

☐ See Minister's Notes

☐ Withdrawn

Comments



## BRIEFING

### Elevate NZ Venture Fund – further information

<b>Date:</b>	15 August 2024	<b>Priority:</b>	High
<b>Security classification:</b>	In Confidence	<b>Tracking number:</b>	2425-0734

### Purpose

To provide background information on the Elevate New Zealand Venture Fund (Elevate), and outline some of the options available if Ministers wish to consider additional capital for the fund.

### Recommended action

The Ministry of Business, Innovation and Employment recommends that you:

- a **Note** that Elevate was established to increase the amount of capital available to young New Zealand businesses, and to help develop New Zealand's venture capital markets to enhance economic growth and innovation  
*Noted*
- b **Note** that while Elevate has contributed to an increase in investment in New Zealand businesses, our early-stage capital markets are unlikely to have reached maturity and are yet to be self-sustaining  
*Noted*
- c **Note** that further Government investment in Elevate is needed in order for early-stage capital markets to reach maturity  
*Noted*
- d **Note** that there are options regarding the size, source, phasing, timing and delivery of any additional investment  
*Noted*
- e **Agree** to forward a copy and discuss this briefing with the Minister of Finance and Minister Seymour in his capacity as Associate Minister of Finance.  
*Agree / Disagree*

Iain Southall  
**Director, Technology and Innovation**  
Labour, Science and Enterprise, MBIE

.15. / .08. / 2024

Hon Melissa Lee  
**Minister for Economic Development**

..... / ..... / .....

## Background

---

1. Last week, we provided you with an update on the Elevate NZ Venture Fund (briefing 2425-0670 refers). We noted that the Guardians of New Zealand Superannuation had recently downgraded their annual conviction rating of New Zealand Growth Capital Partners (NZGCP) to 'sub-threshold', reflecting uncertainty regarding additional capital for Elevate.
2. The conviction downgrade triggers an internal process under which the Guardians consider whether to retain or terminate NZGCP as manager of Elevate. The Guardians' investment committee has endorsed a recommendation to retain NZGCP as manager for now, subject to the receipt of a cost reduction plan and a plan for future investments that have been requested by mid-August.
3. It is not entirely clear what the immediate implications of these developments are for NZGCP but to avoid further uncertainty for them (and the potential for them to lose key personnel) we recommended decisions be made about Elevate's future and that these are communicated to NZGCP and the Guardians in the coming months.
4. Because of this, the key decision for Ministers is whether to provide additional capital for Elevate or not. You agreed to consult the Minister of Finance and Associate Minister of Finance on this topic and requested additional information to support that discussion.
5. This briefing provides background information on Elevate, what it has achieved to date, and sets out some broad options for Ministers if they do want to consider additional capital for the fund.
6. Confidential advice to Government

## Elevate was set up to increase the capital available for startups

---

### Growing young businesses can help promote economic growth and innovation

7. Early-stage capital markets provide startups (young, technology-based businesses with a scalable business model) with the funding they need to grow their ideas and products. As well as capital, early-stage investors provide access to networks, expertise, and advice to improve the startup's chances for success.
8. However, underdeveloped early-stage capital markets make it harder to grow and retain our most innovative young businesses. Without adequate growth capital, startups can remain under-capitalised, grow slowly, list or sell prematurely, or are selectively cherry-picked by foreign funds or firms.
9. Typically, these businesses are at a stage where they have no, or limited, revenue and will require funding to develop their business model to scale up through periods of negative earnings. Therefore, few investors have the appetite or capability to invest in startups.

## There are several barriers to the development of early-stage capital markets

10. There are some well-known challenges to the successful development of early-stage capital markets. These include:
  - a. **high information asymmetries:** startups are often looking to commercialise new technology or R&D and therefore may have an unproven business model, unknown market size and/or channels to market.
  - b. Confidential advice to Government
  - c. **returns take time to be realised:** early-stage investors make a profit once a company is sold or lists on the stock market (known as an 'exit'). A typical investment cycle for a VC fund is 10-15 years, which is a barrier to some investors. For example, due to Kiwisaver's portability rules<sup>1</sup>, Kiwisaver funds largely prefer to invest in liquid assets (e.g. shares). These requirements limit the degree of exposure Kiwisaver funds are willing to take, and they will therefore try to minimise the amount they are investing in VC funds.
11. As a result of these challenges, startups are a volatile asset class and few investors will have the appetite or the capability to invest in them. In many countries, early-stage capital markets have struggled to develop on their own.
12. Globally, governments look to support the development of early-stage capital markets through a variety of instruments: grants, loans and guarantee schemes, tax incentives, and venture capital and seed funds. The purpose of such public investment is to fuel innovation and generate economic benefits as startups develop and mature.
13. New Zealand has sought to catalyse these markets since the early 2000s through funds that have been managed by NZGCP.

## NZGCP manages two funds that support different segments of the early-stage capital market

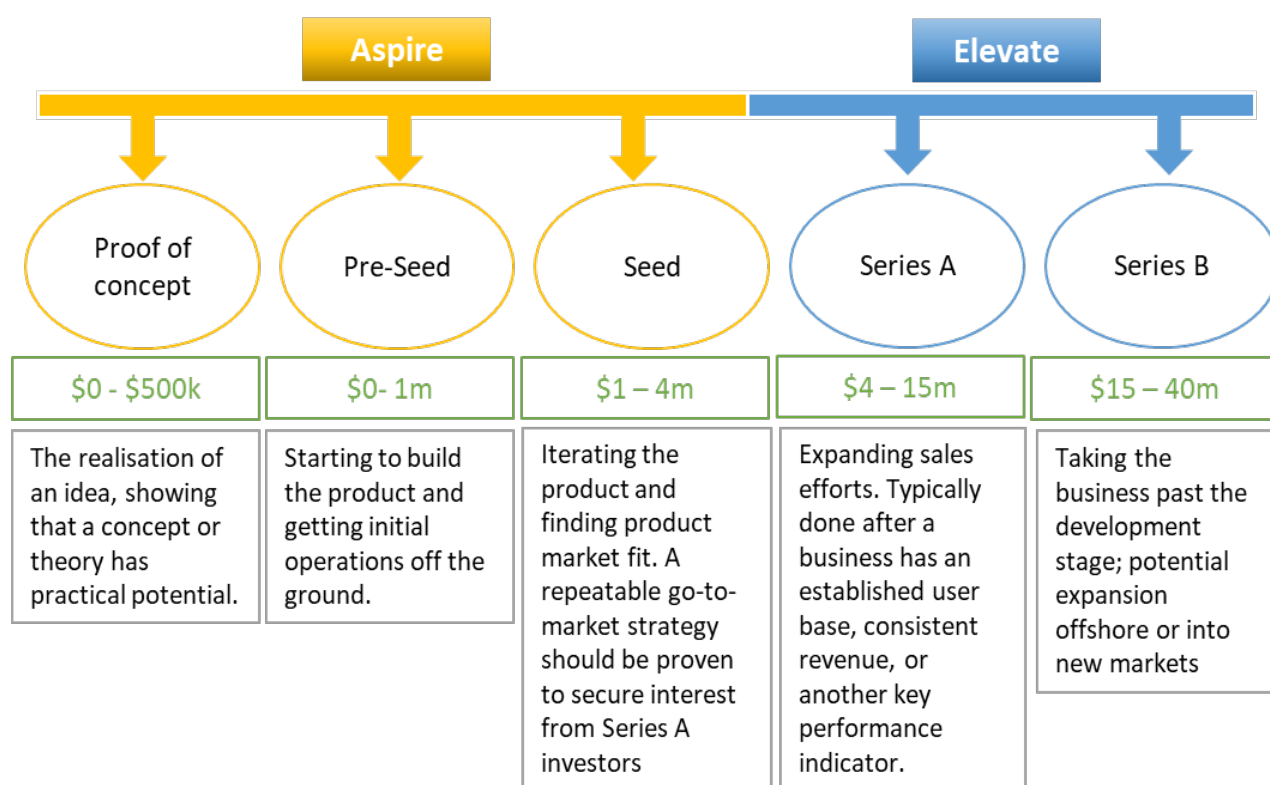
14. NZGCP's mandate is to address capital and investor capability gaps in New Zealand's technology start-up ecosystem. It aims to create a self-sustaining early-stage investment ecosystem that invests in innovative and globally ambitious companies.
15. It currently manages two funds that target different parts of the early-stage capital market, as outlined in Table One.

Table One: Overview of the funds managed by NZGCP

Fund	Size	Goal
Aspire	Uses realisations from past investments to fund new investments and NZGCP's operating costs.	A generalist fund, but Aspire is weighting more of its future investments into deep-tech (including agri-tech, food-tech, clean-tech, life sciences, space, AI and machine learning) and supporting emerging sectors that are currently relatively under-served by the private sector.
Elevate	\$300 million	Elevate aims to stimulate a functioning venture capital industry, and make sure that high-growth Kiwi businesses have access to the capital and connections that they need to be successful.

16. There are several stages of the early-stage capital market which a business can go through to raise capital and grow. These are outlined in Figure One, which also shows which parts of the market are supported by the funds managed by NZGCP.

Figure 1: Overview of the early-stage capital market and where it is supported by NZGCP's funds



### Elevate invests in the Series A and B segments of the early-stage market to support startup commercialisation

17. Elevate was launched in 2020 under the Venture Capital Fund Act (VCF) Act 2019 to bridge a capital gap at the Series A/B stage of early-stage capital markets.

18. Elevate aims to increase the amount of capital that is available to startups, and to develop New Zealand's early-stage ecosystem by proving the commercial viability of the market to institutional investors.
19. Elevate invests directly into a portfolio of venture capital funds with the intent that those funds will invest into New Zealand startups, predominantly in the Series A and B funding stages. This structure is referred to as a "fund of funds" programme.
20. By investing in other funds, Elevate is able to both provide capital to support growing young businesses, but also encourages fund managers to invest in the early-stage ecosystem, which helps build a skill base for investing in the market.

### **The Guardians of New Zealand Superannuation Fund are responsible for Elevate**

21. The VCF Act establishes the Guardians of New Zealand Superannuation Fund (the Guardians) as responsible for managing and administering Elevate. In accordance with the VCF Act, the Guardians have appointed NZGCP as Elevate's fund managers.
22. This delivery model was chosen to:
  - leverage off NZGCP's infrastructure and knowledge
  - leverage off the Guardians' market position as a trusted investor and the resources available to the New Zealand Superannuation Fund
  - encourage other key institutional investors to invest
  - provide oversight of NZGCP by the Guardians
  - minimise time and cost to implement.
23. One of the conditions NZGCP must meet as part of its obligations in managing Elevate is an annual 'conviction review' which assesses the foundation factors which must be present for the Guardians to invest through a third party.

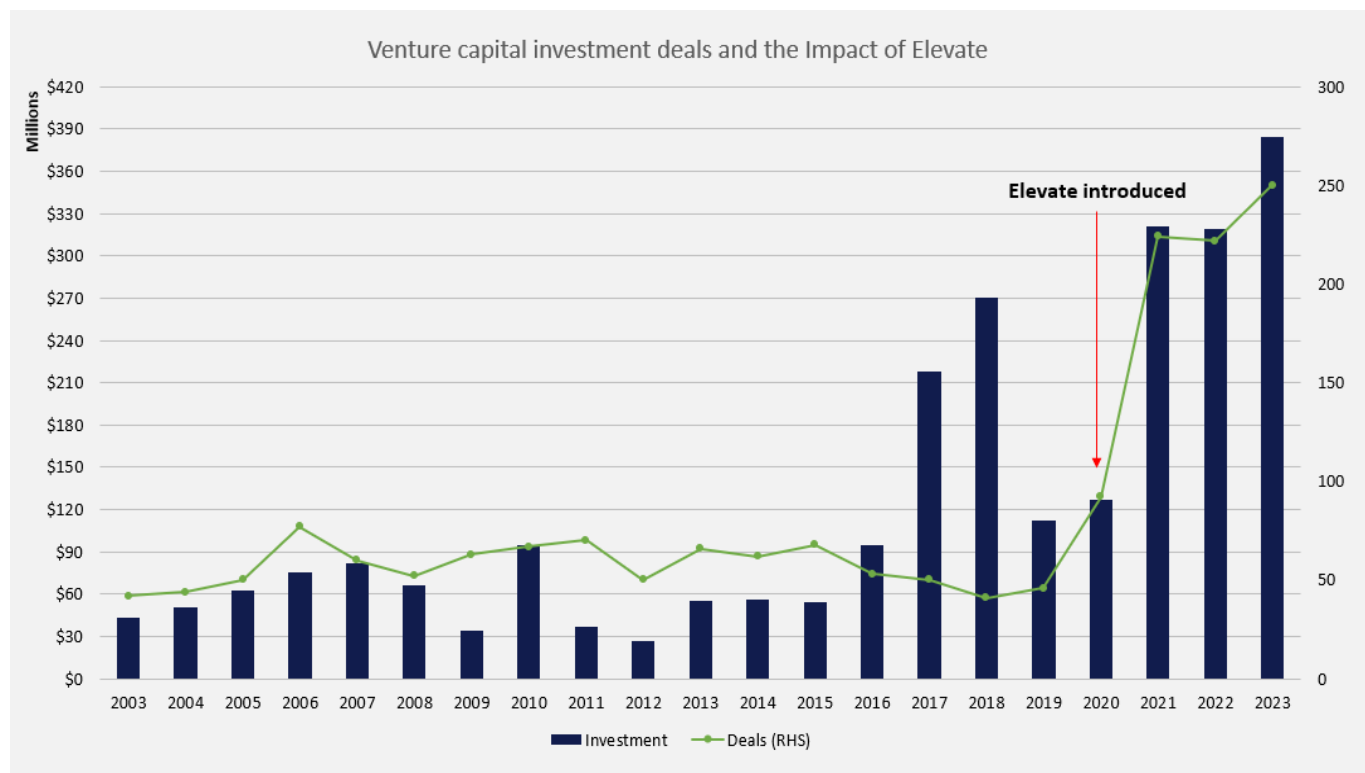
### **Early-stage capital markets are not yet self-sustaining**

---

#### **Elevate has successfully invested in nine different venture capital funds...**

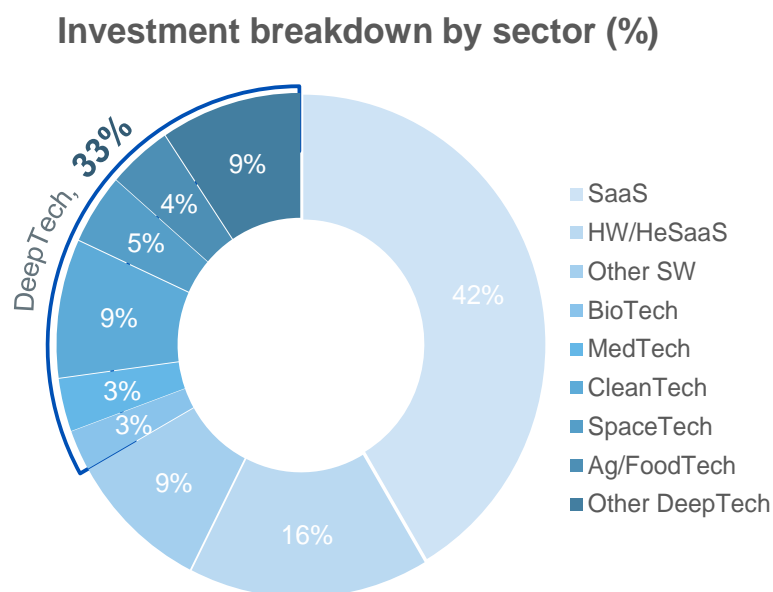
24. As at March 2024, Elevate has allocated 81 per cent of investible capital into nine underlying funds (seven fund managers and two follow-on investments). A breakdown of these funds can be found in **Annex One**.
25. Each of these funds has also raised significant amounts of private capital. The total amount raised by these funds from sources other than Elevate is expected to exceed \$750 million.
26. Since the introduction of Elevate, there has been an increase in both the amount of VC investment and the number of deals over the last few years (note Figure Two below also captures VC investment beyond the Series A/B stage).

Figure Two: Venture capital investment deals and the impact of Elevate



27. To date, Elevate’s underlying funds have invested \$387 million into around 120 New Zealand tech companies. As at the end of June 2023, 33 per cent of this investment has been into deep-tech<sup>1</sup> startups as outlined in Figure Three.

Figure Three: Elevate investment breakdown by sector



28.

<sup>1</sup> Deeptech – technology solutions based on substantial mathematical, scientific or engineering challenges.

**...however, the fund is yet to achieve its aims**

29. As noted in paragraph 18, one of Elevate's objectives is to develop New Zealand's VC markets to function more effectively so that over time they become self-sustaining (including through more investment from New Zealand investors). However, MBIE officials do not believe that New Zealand's VC markets have reached this point yet. This view is supported by the Guardians and NZGCP.
30. There are several characteristics we would expect a mature, self-sustaining VC market to have. While we are making some progress towards these, we still have some way to go. An analysis of New Zealand's maturity can be found in Table Two.

*Table Two: Indicators for market maturity and New Zealand's current state*

Indicator	New Zealand's current state
VC funds that have sufficient scale and have raised multiple vintages	Seven of Elevate's nine underlying funds have over \$50 million under management.  Only three of the VC firms backed by Elevate have raised multiple vintages in New Zealand (the others are either first-time fund managers, or have international experience but have only raised one vintage in New Zealand).
Startups that receive VC funding become successful and deliver returns for shareholders	Elevate has been operating for four years, so it is too early for startups that receive investment to be generating returns. This means that VC firms have not yet demonstrated a strong track record of returns, which is crucial for attracting new investors.
Returns being reinvested into the market	As above, it is too early in the investment cycle to see significant returns. NZGCP estimates it will likely be 2028 when significant returns start to be realised.
Diversity of VC funds (generalist and specialist)	Mixture of generalist and specialist funds. Specialist funds are mostly deep-tech focussed.
Institutional investors consistently investing in the market	3 out of 38 KiwiSaver funds have started to invest, although level of investment from institutional investors remains relatively low and they tend to focus on growth stage investments (Series B and beyond).
High investor capability	Good capability of VC investors in some sectors (e.g. software), but remains low in others (e.g. deep-tech).  Startup Advisors Council <sup>2</sup> found that understanding of how VC works (risk/return profile, the 'j' curve) limited in the broader market (e.g. KiwiSaver funds).
Market able to weather any downturns	Feedback from emerging managers and funds is that they are struggling to raise funds in the current economic environment.

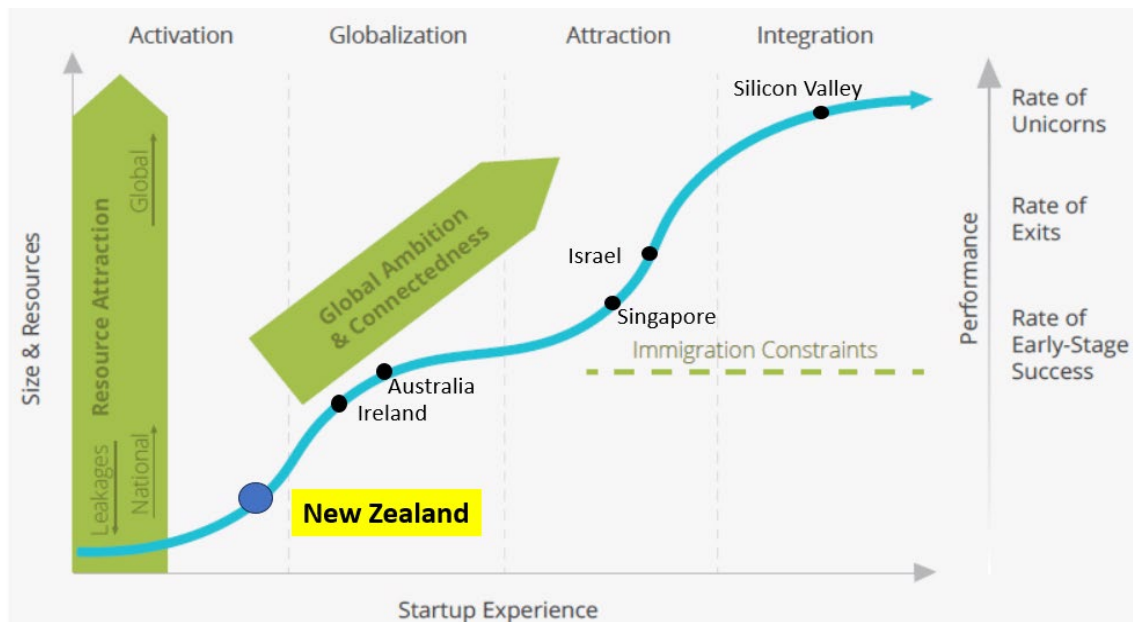
<sup>2</sup> The Startup Advisors Council was tasked with identifying opportunities and challenges for our startup ecosystem, and making recommendations to improve the ecosystem so more startups can be created and succeed in scaling up. Its report, 'Upstart Nation' was released in August 2023.



## New Zealand's early-stage capital markets are less mature than international counterparts

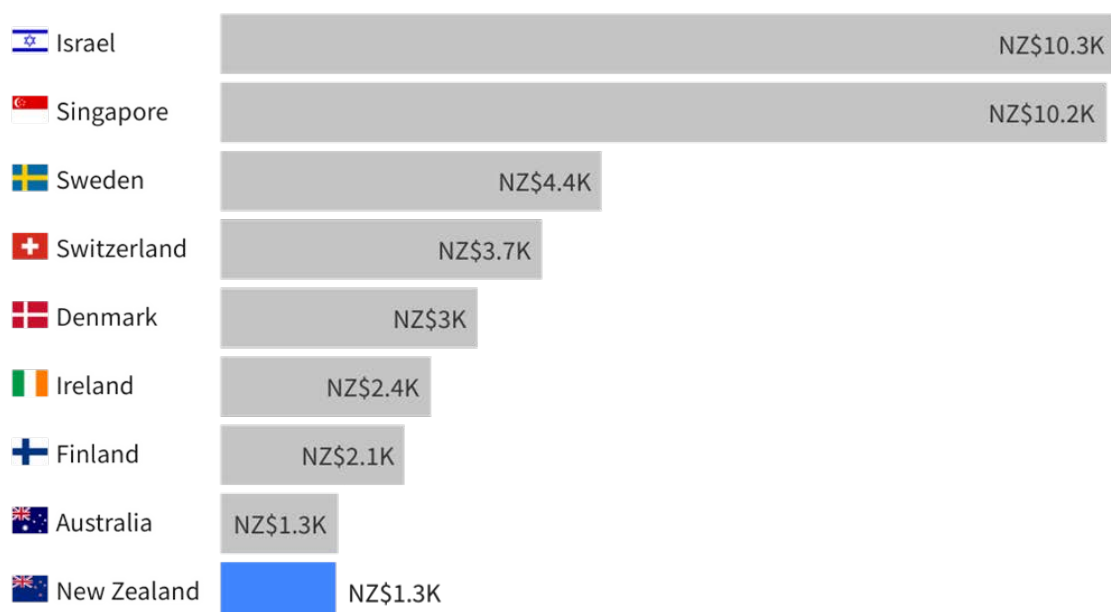
31. Startup Genome, an international startup ecosystem research and advisory organisation, has developed an 'Ecosystem Lifecycle Model' to compare the performance of different startup ecosystems (of which early-stage capital markets are a key part), which is portrayed in Figure Four.

Figure Four: country comparison of early-stage capital market development



32. New Zealand also currently lags behind other small advanced economies on a VC funding per capita basis, although we are on par with Australia, as shown in Figure Five.

Figure Five: Venture capital funding per capita by country



33. Countries such as Ireland, Australia, Singapore and Israel and Sweden have invested in their early-stage capital markets, with sustained funding over 10-15 years

helping to catalyse VC markets in these economies. In Australia, the Investment Innovation Fund, established in 1997, was a “fund of funds” model that had three vintages over an eleven-year period and supported the development of Australia’s private VC markets. Australia now has over 80 venture funds that have invested \$AU16 billion since 2020. A breakdown of tools offered by different countries can be found in **Annex Two**.

## **Ministers should consider the role of Government and whether to recapitalise Elevate**

---

### **Further Government investment would help New Zealand’s venture capital markets continue to develop**

34. Taking into account the current state of our VC markets, additional capital for Elevate is likely needed in order for these markets to further mature and become self-sustaining.
35. As outlined in briefing 2425-0670, if no further capital is provided, the key risk is that there may be a hollowing out in capacity in the investment community and the number of VC funds active in New Zealand will decrease:
  - Emerging/first-time fund managers will be unlikely to raise further funds to continue to be viable because they have not yet demonstrated a track record of delivering returns to investors. If these funds are unable to raise their next vintage, they would have to exit the market. Three or four of Elevate’s underlying funds fall within this category.
  - International funds that have recently established in New Zealand, may choose to withdraw from New Zealand if it proves too difficult to raise further capital.
  - Some New Zealand funds and fund managers (and some of their portfolio companies) will likely leave the country to pursue more favourable environments (stakeholders have cited Australia as a highly attractive alternative).

### **The key decision for Ministers is whether or not to recapitalise Elevate**

36. The key decision for Ministers therefore is whether or not to commit additional capital to Elevate.
37. If Ministers do want to consider additional capital for Elevate, there will be several key options and considerations for the scale, phasing, and source of funding. A brief overview can be found in Table Three.

Table Three: Considerations and options for recapitalising Elevate

Question	Options
Source of funding	Divert funds from NZ Super, or new funding
Commercial Information	
Phasing	Over what time period should funds be deployed e.g. 3 / 5 / 10 years.  Phasing can also be linked to level of funding.
Timing of decisions	The recent downgrade of NZGCP's conviction rating, the risk that they could be removed as Elevate's fund manager and (the negative market signals this could send) indicates the timing of decisions will be important  While it is difficult to make any announcements outside of the budget cycle, steps could be taken to mitigate any negative impacts (e.g. signalling the Guardians/NZGCP that the government is seriously considering further investment)
Delivery and execution	Who should manage Elevate – NZGCP, the Guardians, or another entity.

## Source of funding

38. Before Elevate was launched, there were two main choices considered for where the source of funding could come from, who would administer it, and the fiscal and financial impacts:
- Option one:** transferring new money directly into the fund from the Crown into Elevate. This would have had a direct impact on Budget allowances as it would be considered new spending and would need to be debt-financed. It would also incur an opportunity cost for Government in terms of other investments it could make with the same amount of money.
  - Option two (selected):** transfer money originally earmarked for NZSF into a new fund administered by the Guardians of the NZSF, but where the funds are transferred into Elevate to be invested in the market. This was seen as fiscally neutral as it had no direct impact on Budget allowances as no new money was required. The main financial implication was transferring money earmarked for the Guardians into Elevate, which at the time was 0.6 per cent of the \$40 billion in NZSF and 3 per cent of the \$7.7 billion addition contribution earmarked between 2018 and 2022.
39. The benefit of using the Guardians of the NZSF to administer a new fund, and why option two was chosen, is because:

- a. The Guardians can leverage their market position as a trusted investor, a potential market maker, and a provider of signals to other smaller or overseas funds. As the lead investor, they also provide credibility and independence in terms of oversight to the fund.
- b. It was a Budget neutral solution which did not require raising new debt, lifting the Capital Allowance, or reprioritising money away from other initiatives.
- c. It provided NZGCP with the ability to continue providing its 'public good' services, which include maintaining its database of opportunities, connecting potential investors with opportunities it already has exposure to, setting market standards, and providing VC specific research and training.

## Next steps

---

40. Officials recommend forwarding this background information to inform a discussion with the Minister of Finance and Minister Seymour in his capacity as Associate Minister of Finance, alongside briefing *2425- 0670 Elevate NZ Venture Fund* that was sent to your office on 9 August 2024.
41. If Ministers would like to explore options for providing further capital to Elevate, MBIE officials can provide you with further advice on the funding options, risks, and potential mitigations.
42. If Ministers do not want to commit additional capital to Elevate, further work would include:
  - communicating this decision to key stakeholders
  - understanding the flow-on implications to NZGCP: further work would need to be carried out to assess the impacts on NZGCP's operating model.

## Annexes

---

Annex One: Summary of Elevate commitments to date

Annex Two: Country comparison of Government interventions in early-stage capital markets

## **Annex One: Summary of Elevate commitments to date**

Commercial Information



