



Submission on the Policy Statement on the Venture Capital Act 2019

20 September 2019

Introduction

1. This is a submission from Amplphi Ventures regarding the Policy Statement on the Venture Capital Act 2019.
2. The team behind Amplphi Ventures is a “spin out” team from NZVIF and are currently raising a dedicated Venture Capital fund focussed on post seed stage investment into high potential Kiwi founded companies.
3. The principals of Amplphi Ventures (“AV”) have provided informal feedback on the Venture Capital Act via attending the industry workshop, one on one conversations with officials and via the New Zealand Private Capital Association. This written submission summarises the feedback given to date.

Overview

4. AV is supportive of the introduction of the Venture Capital Act which establishes a new fund of fund programme (VCF) to invest \$300 million into early stage capital markets, via a series of privately managed venture capital funds.
5. AV believes that a “fund of fund” approach is the best approach to addressing the lack of venture capital funding available for NZ founded high growth companies. Historically this capital gap has led to sub optimal outcomes, both for the companies but also for the broader economy, as companies have had to fund their growth by:
 - a) seeking offshore capital from financial investors typically resulting in the company moving out of NZ.
 - b) acquisition by offshore corporates at an early stage resulting in sub optimal returns for NZ shareholders.
 - c) prematurely raising public capital on the NZX or ASX.
 - d) an over-reliance on angel investors and existing shareholders resulting in dilution of the founding management team and insufficient capital to scale quickly.
6. While supportive of the VCF approach, AV is of the view that the design of the operating framework for implementation of the VCF needs to be carefully considered along with the intent of the policy objectives.

Specific comments on the policy statement

Purpose

7. The wording of the purpose is critical for the basis of any future review of the policy intervention. AV believes that the purpose/objectives, as specified in the Venture Capital Act, should be refined to include two key features that should be present in a mature NZ venture capital market namely; the involvement of domestic institutional investors and the presence of domestic NZ venture capital fund managers. While these are alluded to within the policy document, we feel that they should be expressed referenced in the objectives.
 - a) domestic institutional investors: we **recommend** that the current wording in the purpose statement “.....from sources other than the VCF” should be extended to specially include NZ institutional investors.
 - b) NZ venture capital fund managers: we note that the policy statement is silent regarding the development of NZ based venture capital fund managers. We comment on this further detail in the section on definitions of a NZ connected fund, however at a high level we would note that under the current definitions it would be possible for the entire \$300 million to be allocated to offshore based fund managers and we would question whether this is truly the intent of the policy. We would **recommend** that the purpose statement includes a express reference to the development for the NZ venture capital market and the definition of a NZ connected fund is made much tighter to give effect to this objective.
8. As the responsibility for delivering this objective resides with the Guardians, the Act provides a significant opportunity to leverage the Guardian’s leadership position in the NZ capital markets to accelerate the development of a sustainable venture capital market. Extending the objectives to include the involvement of domestic institutional investors and the presence of domestic NZ venture capital fund managers, will ensure that the implementation agencies (NZSF and NZVIF) are required to consider these objectives when allocating capital.
9. Furthermore, NZSF as a leader in the NZ capital markets are ideally positioned to educate and inform other NZ institutional investors on the venture capital market.

Definitions

10. As a general observation we would encourage an approach whereby the definitions have some flexibility (this can be achieved through the use of terms such as “typically” or “usually”) and a clear decision process for cases that fall into the grey area. We suggest that the interpretation of the definitions resides with the Guardians.

Foreign Fund

11. We feel that this is overly complex and could result in extensive administration and legal costs to implement. Our view is that if an offshore fund manager would like to access NZ Government funding then they should be required to set up a local structure, that is subject to NZ tax and have a least one senior person active on the ground. The current definition of a NZ connected fund is more suited for the foreign fund definition.

NZ Connected Fund

12. This definition is too weak (as noted above in our view this is a better definition for the foreign fund). The requirement to only have one senior investment professional (undefined) ordinarily resident risks being exploited by weak offshore funds that can't raise locally in their home markets. The focus here should be on the where the fund management team resides and at very least the definition should require that the majority of the investment making body (investment committee) should be NZ residents. We would also encourage the expectation that a NZ venture capital fund will have some level of NZ investors (LPs).
13. Under the current definitions it is permissible that the full \$300 million is allocated to venture capital funds that are controlled and managed by offshore groups and we believe that this represents a serious risk to the policy intent. While offshore groups can bring benefits to the local market, they can also be opportunistic rather than committed to the long-term development of the market. A good example of this is the NZ mid-market private equity space, Australian groups have often been very active in NZ, including having full time staff in NZ, however this waxes and wanes with the economic cycle and deal flow in their local market.

NZ entity

14. We would encourage a relaxation of the NZ entity definition such that any company that is NZ founded is included within this definition. While many NZ early stage companies targeted by this policy will fall within the definitions there will always be exceptions. For example, a NZ founder that gets accepted into a US accelerator prior to raising capital and is required to establish a US domiciled company may not meet these definitions. As noted in para 10. having a clear and timely process for assessing the NZ entity test is important. A solution may be to remove bullet point 3 and lower the % of assets and employee test from 50% to 20% with a defined mechanism to consider other cases.

Company stage

15. We would suggest that the definitions are not hard coded, for the reasons noted in para 10. As an example, a company by all other metrics may be a "Series A" company but is raising less than \$2 million for perfectly valid reasons (dilution, bridging finance etc) and would therefore be classed as a "Seed" investment. As noted earlier using softer language such as "typically" would allow for some discretion at the margins.

Policies

Policy 2

16. We are supportive of approach to ensuring that 75% of the capital is invested into companies raising at the "Series A and B" investment stage. However, we are strongly of the view that it should be clear in the policy that any follow on investment into a company that was initially a Series A or B investment should count within the 75% allocation **regardless** of what stage the company is at when the follow on investment was made.
17. If this is not the intent of the policy, then this potentially creates significant tension between the policy objectives and the commercial imperatives for a fund. Typically venture capital funds reserve between one third to a half of its capital for follow on investment. A strict interpretation of the current policy could mean that a fund is unable to follow successful winners due to portfolio construction limits imposed by the VCF.
18. For clarity the 10% limit on investment into non-NZ Entities should expressly not include companies that were originally NZ Entities but have redomiciled, refer comment on NZ entity in para 14.

Policy 3

19. Refer to comments made in para 11. We believe it is a better approach is to define a Foreign Fund and ensure that the fund is subject to the requirements under Policies 2 and 5.

Policy 4

20. We are firmly of the view that allowing co-investment is contrary to the dual policy intent of the Act for the reasons set out below:
- a) Short term objective – increase in capital for NZ companies; Given that co-investment typically occurs in follow on investment rounds, co-investment opportunities may not be available until at least two to three years into the programme. Hence allowing co-investment will not satisfy the immediate policy objective of increasing capital availability to NZ companies.
 - b) Long term objective – development of venture capital market; co-investment does not benefit the long-term development of the venture capital market for the following reasons:
 - i. Diverts capital to direct investment that could be otherwise allocated to venture capital funds, meaning fewer companies are likely to be funded.
 - ii. Lowers the overall level of management fees and incentives for the fund manager who has sourced and provided access to the investment.
 - iii. Ultimately crowds out private capital who may wish to invest in the same round.
21. We would note that there are questions raised by the industry around NZVIF's capability to undertake a co-investment programme and the potential for conflict of interest between SCIF and the VCF.
22. If a co-investment regime is included in the policy framework, then we are of the view that any co-investment is limited to the sole discretion of the venture capital fund manager.

Policy 5

23. We favour **Option 2** whereby NZ venture capital funds receive 1:1 matching capital and foreign funds receive 1:2 matching capital. This approach would be consistent with the intention to support the development of the local ventures capital industry and recognises the challenges of raising private capital in the NZ market.
24. We also recommend that the policy is clearly stated that NZ venture capital funds will receive 1:1 funding unless there are exception circumstances (i.e. over allocation to a sector or vintage) and the reasons for a lower matching are clearly communicated.
25. We also recommend that a maximum allocation to a single venture capital fund by the VCF is contemplated, we believe this should be set at \$30 million (ie 10% of the VCF). This would provide a natural cap to the level of matching capital i.e. once a fund raises in excess of \$60 million the matching capital ratio would automatically decrease.

Policy 6 and 7

26. The expectation should be that the VCF is fully committed within the 5-year period. If there is uncommitted capital at the end of that period, then the VCF should have to justify why they couldn't deploy the capital and reapply for a new mandate. Otherwise there is a risk that there is no consequence for not making commitments to venture capital funds, particularly given there are no specific expectations regarding the pace of commitments.
27. We recommend that NZSF and NZVIF provide clarity around the investment process, investment criteria for fund managers and the expectation for pace of commitments. We encourage that these are published so that fund managers, potential investors and ecosystem players all understand the "rules of the game".

Policy 8

28. It isn't clear what "residual funds should be returned to the Crown" means as the Crown owns the VCF. We recommend that the policy should instead be more specific about what happens at the end of the 15-year period. There are a range of potential outcomes at this future point the implications of these may need to be contemplated in terms of existing underlying funds and assets. This is relevant as underlying limited partnership documentations may need to be drafted to cater for LP interest transfers etc. ie forced harvest to repay capital or merely a run-off administered by the Guardians. This will then also flow through to the drafting of the Guardians/VIF contract.

Other comments

29. **Clarity** – we encourage clarity from all parties involved in the development of the VCF regarding the rules and investment criteria. As a venture capital fund manager that is currently seeking capital from the market, we are consistently asked by potential investors about the certainty of matching capital from the VCF if they commit to our fund.
30. **First Close** – we strongly recommend that the policy statement includes a clear expectation that the VCF will commit to funds at time of the First Close. Given the VCF is investing pari passu with private investors, a key benefit for private investors is certainty that if they make a commitment then this will attract a matching commitment from the VCF. This will give private investors' confidence that if that commit to a fund that they fund manager will be able to achieve a First Close in a timely manner. This also will allow the fund manager to begin investing and provides a positive signal to other potential investors, including offshore investors, to commit to a fund at its subsequent closes.
31. **Policy Review** – we recommend that a framework for the future review of the VCF and its implementation is included in the policy statement.

We welcome the opportunity to speak further with officials regarding this submission and we are happy to further elaborate on any comments if required.

Ampliphi Ventures

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