Introduction

The NZ Venture Capital (VC) industry faces a number of challenges in raising new investment capital to meet the funding requirements of high growth early stage enterprises (NZVCA, 2011). The New Zealand Venture Investment Fund estimates that the next generation of NZ's early stage enterprises will require 2 billion dollars of investment over the next 10 years. Kalidas et al. (2013a, b) investigated some of these challenges by conducting 15 face-to-face interviews with VC fund managers, investors and industry intermediaries. This paper summarises the results of those interviews.

Findings

The lack of returns

- The primary hindrance in raising new funds to date is the lack of fund managers with track records of generating acceptable risk adjusted returns for investors. There was also the sentiment other types of investments are expected to outperform returns of VC funds in the future e.g., *"if there are better returns elsewhere for less risk, it simply doesn't stack up"*.

- Fund managers would find it difficult to attract institutional investors until fund managers collectively build a returns profile for the industry – institutional mandates require diversification across several funds which necessitates several 'proven' fund managers.

- Market dynamics (namely the global financial crisis) and the focus on 'early stage' companies have significantly impacted returns produced by incumbent funds to date. One participant astutely described the situation created by the lack of returns as a *'chicken and egg situation'.* Investment capital is required to generate returns and build a track record, but a track record is required to raise capital.

- There may be a case for prospective investors to scrutinise fund managers by other qualitative measures alongside risk adjusted returns. For example, seeking evidence of genuine and consistent adding of value to portfolio companies by fund managers.

Investors and capital constraints

- There was uncertainty over whether fundamentally there are enough investors in NZ that can tolerate the high illiquidity and time horizon (typically 10 years) of venture fund investments.

- It was apparent that illiquidity and time horizon were significant barriers for high net worth individuals, corporates and family trusts. They were not identified as barriers for institutional investors; their main concern was with fund manager track records and building a diversified portfolio.

- Fund managers indicate that raising capital from offshore investors is difficult as they are reluctant to invest in NZ VC funds unless there is a material contribution from domestic institutional investors and the NZVIF.

- Other sources of domestic private capital including high net worth individuals, family trusts, and corporates were viewed to be insufficient to support fund raising efforts. These types of investors are an important supplementary source of funds once a 'critical mass of capital' has been raised from larger capital suppliers—namely institutional investors.

- Most fund managers were of the view that, in general, capital from domestic investors was exhausted or severely fatigued. Thus, some domestic investors that are willing to invest in new funds are already fully invested in incumbent funds and were seeking a cash return of their capital before they were in a position to re-invest it. On the other hand, some intermediaries indicated that the growing presence of Asian high net worth investors may expand the pool of domestic capital.

Unfamiliarity with venture capital

- Some prospective investors do not fully understand VC. Furthermore, some institutions and the investor community in general are largely unfamiliar with alternative assets such as VC.

- Many corporate advisory firms in NZ provide only scant coverage of illiquid assets. Moreover, there is no incentive to research and provide clients with information about alternative assets such as VC funds, and this lack of coverage is likely to contribute to limited investment by some prospective investors. Relatedly, misconceptions exist concerning the timeline around investment in VC funds and when returns materialise (investment horizon).

Conclusions

The findings by Kalidas et al. (2013a, b) support recent initiatives by the NZVCA (2012), in conjunction with Cambridge Associates, to track the performance of NZ VC funds through benchmarking and quarterly data monitoring. This recognises the importance of robust performance data to assist investors in their decision to invest in VC funds. A greater number of successful realisations by incumbent NZ VC funds would also represent a significant milestone for fund managers in the industry to build a track record.

Other initiatives that may assist the NZ VC industry to grow and access new funds include changes to The Financial Markets Conduct Bill that may enable the NZX to restructure the existing NZAX alternative exchange. This is to make listing easier for high growth companies that require expansion capital following initial VC funding[1].

---

[1] See: http://www.stuff.co.nz/business/8490693/NZX-prepares-to-launch-new-markets - dated 31 March 2013.

References

Kalidas, S., Kelly, A. and A. Marsden, 2013a, New Zealand Venture Capital Funds and Access to New Financing: An Exploratory Study, *Pacific Accounting Review*, forthcoming. Also see Kalidas, S., 2012, Alternative Venture Capital Fund Structures for New Zealand: An Exploratory Study, M Com Thesis, The University of Auckland.

Kalidas, S., Kelly, A. and A. Marsden, 2013b, Alternative Venture Capital Fund Structures: Analysis of interviews with VC Fund Managers, Intermediaries and Investors, working paper.
Corresponding author: Email: a.marsden@auckland.ac.nz

New Zealand Private Equity and Venture Capital Association (2011), “Ensuring Venture Capital Plays its Part in Growing the NZ Economy”, November 2011, available at http://www.nzvca.co.nz/
New Zealand Private Equity & Venture Capital Association, 2012, http://www.nzvca.co.nz/