10 Suggestions For The Venture Capital Fund Bill – by Steve Outtrim

Executive Summary

First let me say that I am in general supportive of this Bill. The more capital that can be invested in New Zealand's fledgling venture capital industry, the stronger that industry may become in the future. Our agricultural base is limited by available land and water, and our tourist industry is limited by the size of the global traveling population and the infrastructure we have here to host them. Our innovation economy is limited only by our imagination. New Zealand makes world-class technology and we have a robust and respected system of laws that mean licensing of intellectual property is a viable and scalable business model.

It is important that New Zealand play to our strengths and be realistic about our weaknesses.

A stated purpose of this Bill is to help address one weakness: that companies in the $2-$15 million revenue range find it difficult to attract the capital necessary for growth. Unfortunately the structure of the Bill offers little to actually assist businesses in this range. Instead it suggests that nothing will really change; the "industry darlings" who are already the most likely to attract funding will suck up most of the capital. This may work well over the 15-year timeframe expected with respect to repaying this $300 million; or it may not. Venture funding is inherently risky. Capital alone does not guarantee success. Many well-funded businesses have failed, and across the industry there is only a 10% likelihood of a successful investment.[i]

We should spend **10% of the funds on education and business incubation** to ensure that the nation's companies are "Series A ready". This would be more beneficial overall than picking a handful of winners. Even if every winner lost, the nation would still be left with a benefit. A further **10% should be set aside to foster investment in social enterprises** that are financially sustainable.

In this submission I will suggest 10 ways that the Bill could be enhanced to deliver its goals and highlight some of the country's potential that I believe is not adequately addressed by the Bill. A great strength of New Zealand is diversity; it is important that when building a vibrant Crown-assisted Venture Capital industry we take steps to include Māori, Pasifika, women, youth and those with special needs.

My Qualifications to Speak on This Bill

I moved from Wellington to Melbourne to create my startup Sausage Software, which was the first "dot com" company in Australasia to go public in 1996. I also founded Urbanise, which went public on the ASX in 2014. After 25 years of living between Melbourne and San Francisco, I returned to New Zealand in 2017. In Silicon Valley I contributed to KEA, Kia Ora USA, SF Kiwis and the Kiwi Landing Pad. In NZ I have participated as keynote speaker and delegate at the Morgo entrepreneurship conferences.

In addition to raising more than $200 million of capital for my own businesses, resulting in 2 IPOs and 2 trade sales, I have been an early-stage venture capital investor in more than 50 companies and sat on Advisory Boards of dozens of startups.

My current role as Entrepreneur in Residence at the University of Auckland's Centre for Innovation and Entrepreneurship has put me in a unique position to observe most aspects of New Zealand's innovation ecosystem, and compare it to world's best practices I've experienced in Silicon Valley and elsewhere.

Once In A Lifetime Opportunity

We will not be doing one of these every year – so is this it for the next 15 years? If so, it is important to get it right.

The Venture Capital Fund Bill helps encourage Crown-owned NZ Super funding to be redeployed as venture capital, which offers the enticing appeal of outsized returns balanced with the practical reality of extreme risk. NZ Super has had an Actual Return of 1.49% p.a. since its inception in 2003.[ii] The idea is that rather than the Government managing risk as if it were a Venture Capitalist, private sector fund managers will co-investment with the Government. This de-risks the investment somewhat for the fund managers, perhaps helping the size of funding rounds to increase; but it does nothing to help new businesses scale up to be global winners, and very little to help the social fabric of our great nation.

1. Clarify Target Deal Size

When introducing the bill, Minister David Parker gave examples of a number of Wellington-based IT firms seeking $1 million in Series A funding – US$633k. With all due respect to my home town, to me this indicates parochial thinking which does not scale to a global market. For a tech startup competing on the global stage this would be about enough to pay one good sales rep to attend half a dozen trade shows per year.
A technology company seeking $600k Series A is unlikely to even get a meeting with a Silicon Valley VC firm. This is barely a big enough size to get in front of an angel investors' group.

2019 Average US Early Stage Investment ($NZD):[iii]
Seed: $1.75m
Series A: $21.4m

The intention of the fund is to invest the $300 million in the first 5 years, and liquidate its holdings entirely in 15 years. This means $60m investment per year – enough to fund 3 US-sized Series A deals, 15 in total. If the VCF invests in 5 different funds, each fund can do 3 deals in 15 years.
If the fund were to invest at the size Minister Parker referred to – $1m deals – this would require one investment per week for the first 5 years. This would be one investment every month for 5 funds, which is also unrealistic. The sweet spot is perhaps a combination of big and small deals.

2. Consider Payback Time

Perhaps there is some thought that the investments will exit before the 15 years is up, and those returns could be re-invested at least once more before the final liquidation. It is a long time between funding and exit for most investors. Peter Thiel's legendary initial investment in Facebook took 9 years before a liquidity event. My own in Urbanise took 14. The US median time for companies to raise funding rounds is 20 months and from funding to IPO is 8.2 years.[iv]

It is quite possible that even if the fund invests in companies that continue to be successful, they will not go public or get acquired within 15 years. What then? Venture capital is patient, it doesn't seek dividends. Liquidating an investment before an official liquidation event may have a significant cost in lost profits.

Rather than planning the liquidation of the fund in the future, why not make it perpetual and continue to invest the funds in New Zealand startup businesses? The fund could begin repaying the initial loan to the Superannuation Fund after 15 years, at a rate of interest superior to the 1.49% actual return to date. Over a 50 year horizon an initial $300 million seeding into the Venture Capital industry has the potential to become one of New Zealand's greatest assets – at 15 years, we would just be getting started.

3. Global Competitiveness

US firms raise bigger earlier stage rounds and economies of scale give them smaller operating costs. The reason they raise large investment rounds is they intend to dominate. To absorb or crush all competition, no matter what. If we are going to inject $300 million of taxpayer money into stimulating startups, we should do so the way we would spend that money on sports: to win, to enhance the brand of the whole nation, and to attract new talent to New Zealand.

Kiwis have succeeded in sailing because wherever you go round the globe, wind is wind, sea is sea and a boat is a boat. A boat can be built in New Zealand that is equal or better than any made anywhere else in the world. This process begins with the intention to be the best. If the intention is to build a dinghy, you could make the greatest dinghy the world has ever seen, but don't be surprised if the competitor's 75-foot hydrofoil monohull sails away with the Cup.

We need to be producing startups that are globally competitive from the very beginning. This is the gap in our Innovation and Entrepreneurship ecosystem that most needs to be addressed. Extra venture capital funding injected into the existing system sounds good in theory, but in practice will not change the percentage of startups that fail. Funding 15 companies with Series A rounds will not help the thousands of other businesses in the $2-$15m revenue range who don't get funded by professional Venture Capital. If we increase the percentage of successes the whole industry will benefit. Capital can do that, but on its own more money does not automatically result in more productivity.

The key to a company raising Series A investment is Product-Market Fit, meaning being in a good market with the right product for that market. At least 40% of surveyed customers would be "very disappointed" if they could no longer get that product or service. Most Kiwi businesses do not understand this, and as a result struggle to raise Series A funds. Education about this concept and how to achieve it would cost much less than $300 million, and would greatly benefit the nation because our companies could then attract venture capital from anywhere.

4. Māori and Pasifika

New Zealand is a world leader in its treatment of indigenous issues, renowned for our racially diverse and integrated population. The global Venture Capital industry is not renowned for its treatment of racial minorities. This is an opportunity for New Zealand to take a lead role on the world stage, setting the way for others as we have so many times before.

A percentage of funds could be co-invested with Iwi. Venture capital should benefit them as well. Iwi projects may not need an international focus, but there should be no limitations to success.

Likewise, New Zealand's role as the largest Pacific Island nation puts us in a position to help encourage Pasifika peoples to participate in startups. A cultural shift towards embracing failure is important, and could be assisted with government-backed funding.

The bill suggests a proportion of funds could be invested outside NZ. This should be for Pasifika or for NZ owned companies in foreign markets. There is no requirement for the Guardians' NZ Super Fund to invest in NZ assets, as a result only 18% of the fund is invested domestically.[v] Replicating this in the allocation of the Venture Capital Fund would be disastrous for local startups.

5. More Than Money - Incubation

In the U.S. if you receive investment from top-tier Venture Capital firms you are almost guaranteed to be successful. This is because you don't just get their money. You get expertise, with the lead investor usually taking a Board seat and being very actively engaged with senior management. You get access to the best boutique recruitment agencies, with massive rolodexes of people who have worked together in past companies – whether they failed or succeeded. The V.C. will help you build a team, infuse them with the right culture, and introduce you to corporate partners to form strategic alliances with.

There is nothing in this bill to do this, it is assumed that this function will already be done by private industry. There are some good incubator initiatives with a track record of success such as Icehouse Ventures and the Velocity program at CIE. However there is no "Y Combinator" of New Zealand. What is needed is a combination of training, skills exchange, and shared business infrastructure. 10% of funds should be set aside to provide incubator-based funding which will help Kiwi entrepreneurs develop the skills and thinking needed for global success while sharing business infrastructure.

6. Growth Hacking

Partnering with larger companies is a way to grow quickly without the founders having to dilute equity. Sometimes this can include selling regional licenses or franchises. It is difficult for small Kiwi companies to build international networks; yet there is a large international network of Kiwis abroad. A global marketing agency for Kiwi companies could facilitate partnership and licensing deals. This would accelerate the growth of Kiwi companies faster than each one raising capital and trying to build these networks from scratch on their own. This model has worked in the past for other export industries in New Zealand.

7. Social Enterprises

There is no particular focus on social enterprises that make money and do good at the same time. This would be beneficial to the whole nation. There are already 3500 social enterprises in New Zealand, but they are falling through the cracks of the system.[vi] The country needs to create the right legal framework for this fast-growing new business type, and reflect that returns from these enterprises do not have to be the outsize Venture Capital 10x returns for the enterprise to be considered a success.

8. Fintech, Ethical AI and Robotics

We are moving into an exciting new era where FinTech innovation will transform society as much as the Internet did. New Zealand should lead the way in embracing blockchain, with regulations that match the needs of the global banking system with the requirements of blockchain startups. A vibrant cryptocurrency and blockchain industry will attract Venture Capital to our shores and create jobs.

Part of the funding should be routed through a Centre for Excellence in FinTech, A.I. and Robotics. The right regulatory market is required for these industries, with that New Zealand could lead the world.

Artificial Intelligence and Robotics are going to be some of the biggest industries of the 21st century. There is a great need for Ethics and Trust in these fields. Medical advances such as organ printing, genome editing, stem cell harvesting and cloning also raise a need for BioEthics. New Zealand is well respected as a politically peaceful and neutral country with a high reputation for trust and integrity. This positions us well to lead the 21st Century in FinTech as the banking system is transformed and banking of non-financial data such as DNA, medical records and personal information becomes important.

9. Bring Talent To Us: Reverse the Brain Drain

A perverse incentive of this bill could be that our best companies get enough funding to expand internationally and then are forced to leave our shores because they can't hire enough people from the domestic talent pool to grow at the pace required. I can see nothing in this Bill to prevent this situation.

In fact, we should try to do the opposite: attract people from all around the world to come here to start their high-tech businesses. Making it easy for startups to get short-term visas for their workers would be crucial. We may not be the highest paying nation in the world for tech workers but we can offer quality of life that is world class – as many global billionaires seem to be noticing. If our well-funded companies can draw from the global pool of talent to build teams they are more likely to be internationally successful and to retain significant operations here. Right now if every startup got funded and doubled in size there would not be enough people to work in them all.

The existing Entrepreneur work visa is the right idea, but expanding it so that whole teams and their families could apply at once would be beneficial. This would result in an influx of talent, ideas, and new companies that can provide employment and training for local citizens.

10. Inclusiveness

This Bill should include language focusing a small amount of funds on these important areas which need support from the public sector because they do not get enough from the existing Venture Capital Markets. If we only incentivize them to do more of the same we will end up with more of the same.

Youth

An unspoken problem that I hear frequently at the University is the difficulty for youth to access these professionally managed funding sources. The opposite is true in Silicon Valley, where even a teenager with a good idea can get funding. They focus on the business and the technology, not the traditional investment manager's list of red flags. Youth should be a green light not a red flag. The financial needs of youth are often less than the expenses of mums and dads, which means that they can do more with less. The social consequences of trying something and failing are less, and they have the greatest amount of energy. The video game industry offers many opportunities for youth. Teaming up youth with experienced elders on Advisory Boards will help their companies become investment-ready.

Women

This year is the 126th anniversary of universal suffrage and we have come a long way in addressing gender equality issues. Culturally we recognize the importance of women in this country, but in the world of startups we lag sadly behind. Kiwi females in senior leadership positions are at an all time low (18%).[vii]

While there are some female-only seed investment groups such as Arcangels, there needs to be more support from the traditional V.C. industry to encourage more female entrepreneurs and leaders.

Special Needs

In the Internet era, there is no reason why learning or hearing difficulties, mental illness, autism or other increasingly prevalent debilitating conditions should exclude participation in startups. Any of these are usually instant deal-breakers in Venture Capital. Only the government is in a position to do something to pave the way for inclusion of people with special needs in startup businesses.

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