The Impact of New Zealand’s Capital Market Constraints on Productivity and Growth
Research questions

• Why do capital markets matter for productivity?

• Why might the performance of NZ’s capital markets explain part of the productivity paradox?

• What evidence is there that NZ’s capital markets are under-performing?

• What might appropriate policy responses look like?

• Directions for future research?
<table>
<thead>
<tr>
<th>Capital Source</th>
<th>Description</th>
<th>Risk / Return</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private equity (PE)</td>
<td>Target mature investments that are able to generate positive cash flows</td>
<td>Moderate</td>
</tr>
<tr>
<td>Angel investment</td>
<td>Target early stage investments that may be cash flow negative</td>
<td>High</td>
</tr>
<tr>
<td>Venture capital (VC)</td>
<td>Target early stage / start-up companies that may be beginning to generate positive cash flows</td>
<td>Very High</td>
</tr>
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</table>
Why might the performance of NZ’s capital markets explain the productivity paradox?

• “Rules of thumb” that help in the process of matching capital providers with capital seekers might not work well for NZ growth businesses

• Home bias: could hurt NZ as a net importer of capital

• Learning externalities: innovative firms fail to capture the full value created through “learning by doing”
What evidence is there that NZ’s capital markets are under-performing?

- Interviewed export focused, growing NZ businesses about their experience accessing capital to expand

- Businesses have clear views on the attractiveness and viability of different capital sources

- High costs of accessing international capital markets, including relocation

- Thin domestic markets for private equity, in the sense of a limited number of market participants rather than lack of capital
**What evidence is there that NZ’s capital markets are under-performing? (2)**

<table>
<thead>
<tr>
<th>Capital Needs (demand)</th>
<th>Risk / Return</th>
<th>Export start-up, cash-flow negative</th>
<th>Small business, export-led growth</th>
<th>Established business, export-led growth</th>
<th>Established exporter, targeting growth</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Annual Turnover</strong></td>
<td>&lt; $5 million</td>
<td>$5 - $15 million</td>
<td>&gt; $15 million</td>
<td>&gt; $15 million</td>
<td></td>
</tr>
<tr>
<td><strong>Venture capital</strong></td>
<td>Very high</td>
<td>Transaction costs may be too high</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Angel investors</strong></td>
<td>High</td>
<td></td>
<td>More interested in smaller firms</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Private equity for growth firms</strong></td>
<td>Moderate</td>
<td></td>
<td>Interest lower for smaller firms</td>
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</tr>
</tbody>
</table>
What might appropriate policy responses look like?

• Interesting parallels with emerging markets – which also face capital market constraints, but for quite different reasons

• Meeting part of the transaction costs for New Zealand-focused funds to compensate for scale effects

• Provide seed support for New Zealand-focused private equity funds to provide demonstration effects
Directions for future research?

• Level v growth effects

• Empirical work on the effect of high real interest rates on growth

• Impacts of attracting offshore capital for NZ
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