

Op-ed - Unlimited, 1 September 2008

Anzac love affair

Why aren't New Zealand institutions following Australia's lead and investing in privately owned Kiwi companies?

By Francesca Banga, Auckland

Private equity investment into privately-owned companies in New Zealand is an asset class attracting overseas investors, particularly Australian funds.

New Zealand usually ranks as one of the top three "states of Australia" for private equity investment from Australian committed capital. Two years ago, we were the number one state investment destination for Australia's big pension funds.

Given the international financial climate, it would be naïve not to expect a tailing off of that level of Australian investment in our economy, even though the fundamentals which make our companies attractive remain in place. As offshore interest tails off, particularly at the big end of the market, it means New Zealand institutional investors might be able to get a share of some of our best privately-owned companies.

For the New Zealand institutional investor however, private equity is often seen as too hard to access, disadvantaged due to a lack of liquidity, and without the returns to justify the investment.

New Zealand investment institutions are missing considerable market opportunities though. According to the most recent Deloitte/Management magazine Top 200 list, unlisted companies comprise seven of our top ten companies, 69% of our top 100 companies, and 80% of our top 200 companies.

Without an exposure to New Zealand private equity, investors are not including investment in a significant portion of the New Zealand economy. The size of our listed market means it provides only limited exposure to the full spectrum of New Zealand company investment opportunities. What's more, initial research undertaken by NZVIF indicates New Zealand private equity investment has returned in excess of 20% per annum over the past five years, offering a premium to public equities.

The Australians twigged to the benefits of having private equity investment as part of a diversified investment portfolio around 10 to 15 years ago. Before then, the Australian private equity market was in a similar state to where ours is today, with a general reluctance of institutional investors to invest into private equity.

With the advent of compulsory superannuation – their version of KiwiSaver – Australia has seen spectacular growth in managed funds. Their investment funds under management quadrupled between 1991 and 2006 to exceed A\$1 trillion. As their funds grew, Australian managers began looking to better balance their investments through more diversified portfolios and typically allocate 5% to 10% of their portfolio to private equity.

Despite the example set by Australian institutions, ours remain reluctant to invest in

alternative assets and private equity. There are some key reasons why.

We lack scale. Investing in private equity is much more resource intensive than investing in public markets because performance information is not readily available. The New Zealand institutional investment market is fairly small and proportionately more time and money need to be spent on due diligence, investment personnel and other expenses.

Another limiting feature of the New Zealand market is the retail nature of most managed funds. Most investment products have redemption options allowing investors to remove their funds at short notice should they wish to. This retail nature forces managers to have higher allocations to more liquid assets such as bonds and equities to meet potential redemptions.

The advent of KiwiSaver, with a growing pool of funds under management, will go a long way to dealing to one of the prime constraints. As these funds grow, so too, we hope, will the capability to assess investment opportunities beyond bonds and listed equities. The locked-in nature of KiwiSaver will also allow managers to diversify into some less liquid investment classes. And the recent performance of funds with high exposure to a single asset class (property) provides a sobering reminder of the critical importance of portfolio balance and diversification.

If our institutions take that step into private equities then, in five to ten years, we might be where our Australian cousins are now. It is in the interests of our institutions. And it is in New Zealand's interests too.

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