



CVCA CEO ON CANADA'S INNOVATION AGENDA

Following announcements by the Prime Minister and in the 2016 Federal Budget, the Minister of Innovation, Science and Economic Development, the Honourable Navdeep Bains, released a document that presents the Government's vision to position Canada as a global centre of innovation and to design an "Inclusive Innovation Agenda".

The Canadian Venture Capital and Private Equity Association (CVCA) members help drive innovation and growth in Canada. As such, we were very pleased to see this initiative and our members from across the financing spectrum were eager to participate and contribute to this ambitious agenda.

Our Process

In order to prepare our submission for this process, the CVCA conducted 14 roundtables from coast to coast that brought together hundreds of CVCA members and industry stakeholders.

The commonality of issues that we heard across the country was striking. Talent attraction, retention and related immigration retention issues, fundraising difficulties, lack of strategic procurement and Government leadership, regulatory burden on incentive programs, and relatively poor digital infrastructure were identified at each session from Halifax to Vancouver.

Four recurring themes emerged out of our roundtables for us to focus on going forward:

- **Long-term vision** – Too often with these types of Government initiatives, the focus is on short-term deliverables and outcomes. Fatigue sets in too quickly. It must be different this time. This type of ecosystem build takes time and the benefits of our recommendations will only bear fruit many years from now.
- **Participation, not competition** – Canada is part of a broader North American ecosystem in which we have to participate, not compete. We will never replace Silicon Valley, nor should we even strive for the "Silicon Valley North" moniker. Canada is uniquely and ideally positioned with many competitive advantages that we must leverage better to thrive in cooperation

with global centres for innovation and growth. The free flow of talent, ideas and financing is crucial if we are to participate effectively. Notably, international talent mobility must be improved for this to take place.

- **Leadership matters** – Governments at all levels should not underestimate the leadership role they can play in Canada's innovation and growth. Words and actions matter. In terms of proactive policy initiatives, the private sector should lead. The Government's role here should be focused on acting as a catalyst and facilitator. The default should be to let the private sector market forces guide the way. For instance, the Government is best left to 'prime the pumps' on the financing side by seeding initiatives that are leveraged by the private sector and focus on positive returns. Government can also act as a facilitator by ensuring the regulatory environment is the least cumbersome possible.
- **Focus on scale** – Canadian policy makers have been focused on building a seed and early stage ecosystem for over a decade. Now, more and more Canadian entrepreneurs are shooting big. Now is the time to build on this. We need to turn our policy attention toward scale and growth companies to create true world beaters. A key to success here is ensuring that Canadian companies have access to the right types of financing at all stages, including venture debt, early stage venture capital, growth equity, private equity and strong public markets. Evidence shows that venture capital continues to lag at all stages. The market has not yet matured enough and the most pronounced gap right now is in Canadian late stage venture capital and growth equity. This is most obvious when you compare fund size distribution versus the US and average round sizes—both are significantly smaller in Canada and the gap is widening.

Throughout the roundtable process, our objective was to focus not on the problems, but rather identify specific solutions and recommendations that could improve Canada's innovation and growth environment.

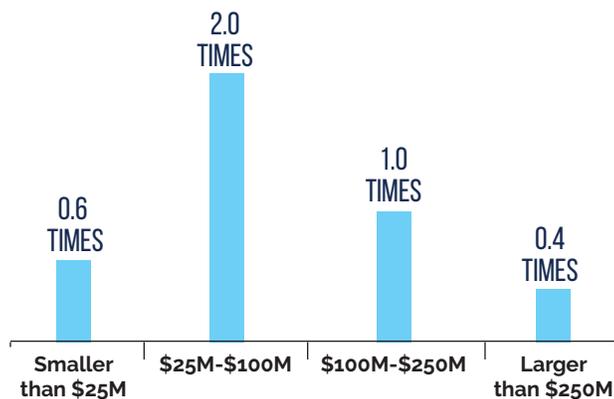
Canadian Financing Matters

A vibrant Canadian venture capital and private equity market is an essential component of an innovation and growth agenda. Private capital managers bring more than just money—they bring talent, connectivity, know-how and experience that Canadian entrepreneurs can rely on. These attributes lead to success. Canadian VC-backed companies have stronger sales growth, revenue growth, employee growth, asset growth, wage growth and R&D expenditure growth than their non VC-backed counterparts.

Similar evidence is available on the private equity side. Buyout transactions also have significantly outsized positive and lasting impacts on innovation through patents, productivity, governance, wage increases and management practices.

All in all, private capital-backed companies dramatically outperform when it comes to innovation and growth. We need more of it. And while the participation of US investors is both

DIFFERENTIAL BETWEEN CANADA VS US DISTRIBUTION OF VC FUND SIZES



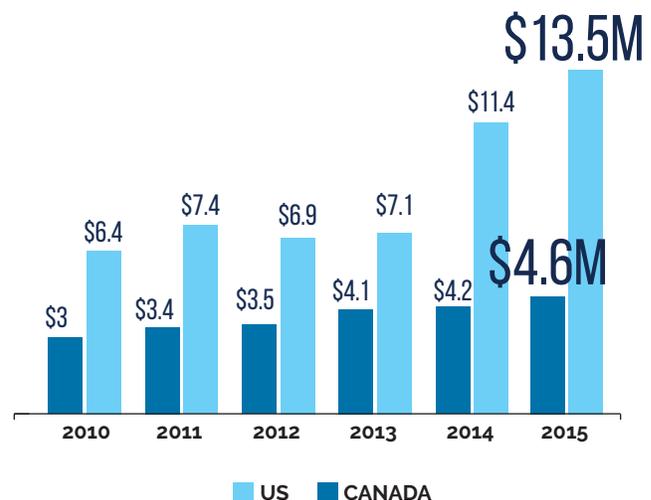
SOURCE: PREQIN

welcome and necessary, the active participation of Canadian private capital is critical at all stages:

- At the early stage, the need for Canadian venture capital is obvious: roughly 80 per cent of early and seed stage rounds are led by, or exclusively funded by, Canadian venture capital already. Early-stage venture investing is a “high touch” business that typically requires investors to be within close geographic range of their portfolio companies.
- At later stages, a local Canadian investor is needed even when US venture firms are participating, as they generally prefer to invest alongside a local partner who knows the founders and the broader business and talent landscape.

But at all stages, Canadian venture capital and private equity must be present to ensure that the financing talent, know-how and expertise is here. Many market participants would also emphasize the need for Canadian control of our own venture capital destiny as a nation – just as we would not dream of outsourcing our banking sector to large US banks, we should not outsource our venture capital sector (the “banks” of our emerging technology economy) to US venture firms. We have all seen the consequences of this approach, where excess reliance

AVERAGE VC FINANCING SIZE (US\$ M)



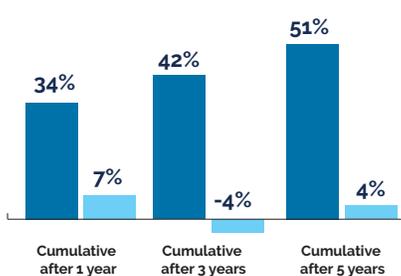
SOURCE: YALETOWN, THOMSON REUTERS, NVCA

on US venture firms led far too many Canadian entrepreneurs to move their companies south of the border in order to obtain required financing. It is only in the past few years as our local market has grown and developed that US investors have become comfortable investing in companies that remain in Canada. If our Canadian venture sector stumbles, this success could very easily revert to the historical pattern where Canadian entrepreneurs have little choice but to move to the US. We need more Canadian venture capital that can grow with – and help scale – our companies, at least in part, domestically. In short, we cannot afford to outsource one key component in the continuum of our innovation ecosystem.

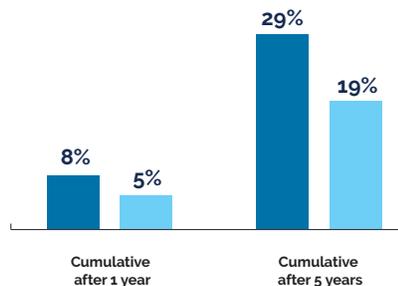
Canadian Venture Capital Still Lags

Unlike the US and Europe, Canada’s venture capital industry is relatively young, considering the vast majority of all Canadian venture fund closings have occurred after 2001. But it is maturing, as the percentage of direct investments involving private funds has doubled to more than 60 per cent from 2003 to 2015. And the industry has gone through a seismic shift over the past decade, particularly over the past five years. The landscape of the Canadian

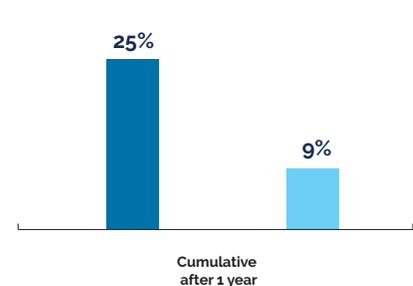
AVERAGE EMPLOYMENT GROWTH



AVERAGE WAGE GROWTH



AVERAGE R&D EXPENDITURE GROWTH

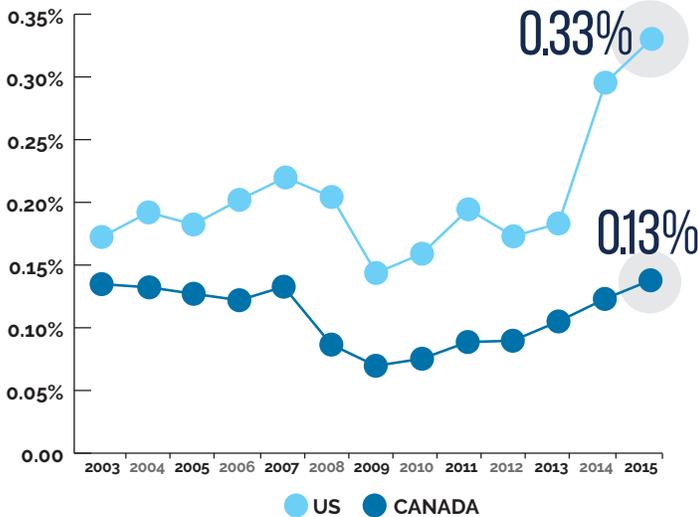


■ VC-BACKED FIRMS ■ NON VC-BACKED FIRMS

SOURCE: INDUSTRY CANADA, 2013.

VC industry now has a much stronger private sector component and is able to routinely attract experienced international co-investors. However, given the current difficult fundraising environment coupled with the relative growing venture investment gap between Canada compared to the US, the focus must continue on building a sustainable private sector-led VC industry.

VC INVESTMENT AS A PERCENTAGE OF GDP



SOURCE: THOMSON REUTERS, NVCA, US BUREAU OF CENSUS, STATISTICS CANADA

Canada's venture capital industry requires continued government support as it matures and moves toward sustainability. We are not alone in this regard. In fact, most OECD countries support their venture capital industries through both direct and indirect investments.

CVCA Recommendations

There is no shortage of opinion – or passion – on the subject of innovation and growth amongst our members. As such, we gathered a number of recommendations highlighted in our submission.

However, as we stand at this crucial point for Canadian innovation, the two most urgently needed and commonly-mentioned recommendations are:

1. Fund of Funds Program

[Venture Capital Action Plan (VCAP) 2.0]

VCAP 1.0 has already had a very significant impact on the Canadian venture ecosystem by leveraging a \$340 million Government investment into \$1.4 billion by attracting private capital on a 2:1 basis – principally from new investors or investors who have not investing in the space for many years – a key step toward venture capital sustainability. Furthermore, the firms who have received VCAP funding already have invested over \$450 million in 126 Canadian companies. And, all of this is likely at zero

cost to the Government and taxpayers since it will likely generate a positive return.

VCAP 1.0, however, will be fully committed by the end of 2017. Without a renewal of this program in short order, the industry will fall backward at a crucial development time and the sustainability goal of VCAP will not be achieved. In order to ensure sustainability of the venture capital ecosystem through the attraction of matching private capital and positive returns for both the Government and private investors, the next fund should focus on Canadian venture with as little additional policy requirements as possible. We know the Government has many additional worthwhile goals for specific sectors, geographies and other factors, but would strongly recommend that these be established under other Government programs in order to ensure that matching private sector capital can be obtained for the Fund of Funds and the returns are optimized.

2. Talent and Immigration

There is a talent shortage in the innovation ecosystem, notably amongst engineers and sales functions. In the short term, the most efficient way to address a talent shortage is through immigration. However, the process to deliver work permits to non-residents in innovative sectors is too long and costly and the status between work permit and landed immigrant has been described as a “nightmare” by many in our industry. Notable settlement issues are also evident concerning the status of the employee's family, schooling and banking, among other concerns. The Government should move to ensure that highly skilled innovation sector employees can more easily immigrate or return to Canada and ensure we can effectively participate in the innovation economy.

In addition to these, you will find a number of other recommendations in our submission from our consultations and research including:

- Improving Government procurement of Canadian technology
- Removing hurdles on research tax incentives
- Increasing co-op programs and STEM education
- Simplifying IP transfer from universities and colleges
- Incenting corporate Canada involvement in innovation
- Offering tax incentives for venture capital investing
- Increasing the size of existing BDC and EDC fund of funds programs across the financing continuum
- Improving the quality of Canada's woeful digital infrastructure

CVCA members help drive innovation and growth. As such, we wish to congratulate the Government on taking on this important task. Government can also act as a facilitator by ensuring the regulatory environment encourages and facilitates the adoption of innovative solutions and new business models.

Sincerely,

Mike Woollatt
CEO, CVCA

ABOUT THE CANADIAN VENTURE CAPITAL AND PRIVATE EQUITY ASSOCIATION

The CVCA is the voice of Canada's venture capital and private equity industry and strives to be a catalyst to drive innovation and stimulate growth. We work alongside our members, which include private and public sector firms managing the majority of venture capital and private equity in Canada. We advocate on behalf of the industry to inform sound public policy that encourages a favourable environment for investment.