04. Canada as a Global Leader in Venture Capital Financing

Issue

Growth of venture capital (VC) financing is critical for expanding the domestic innovation and technology sectors. While VC activity is increasing, targeted government support can further enhance this option and make Canada an international leader.

Background

Venture capital is a form of equity financing utilized by innovation-based early stage technology firms. Generally, these businesses present high growth potential with an accompanying high risk of failure, which makes them unattractive for traditional options such as bank loans.

A technology firm can take five to seven years to develop, commercialize and market a product. Venture capital investors buy shares of a firm and take ownership, subsequently influencing business decisions and strategy.

The domestic venture capital sector is growing and presents significant upside potential. A May 2016 news release from the Canadian Venture Capital and Private Equity Association (CVCA) indicates that 2016 Q1 venture capital investment across Canada reached $838 million, the highest volume for any quarter in national history and double Q1 for 2015. The increase was primarily driven by large deals, with the top five estimated at a total of $336 million.

The CVCA has noted that increasingly investments are made into later stage companies, with the average deal growing to $7.1 million compared to past year averages around $4-4.5 million. Also, an increasing number of American VC firms are investing into Canada which is also driving the larger investments.

The September 2015 Canadian Chamber of Commerce report, "Stimulating Canadian Innovation: How to Boost Canada's Venture Capital Industry" provides six recommendations to expand venture capital financing across Canada. The proposals are:

1. **Incentivize Angels - Implement the BC Investment Tax Credit Nationally**

British Columbia currently provides investors with a 30 percent refundable tax credit for investments up to $200,000 in an eligible business, for a maximum credit of $60,000 per investor.

The federal government should establish a 15 percent tax credit matched by the provinces. A national 30 percent credit would also expand angel investment.

2. **Provide a Tax Exemption on Capital Gains for Venture Capital**

Capital gains in tax-free savings accounts are exempt from taxation and a similar approach for venture capital would increase activity.

3. **Secure more investors with flow-through shares for technology companies**

The use of flow-through shares has generated billions in revenue for Canadian mining exploration and the process should be extended for technology companies.

4. **Increase Government Investment in Venture Capital**

The federal 2013 Venture Capital Action Plan (VCAP) provides $400 million over ten years to attract $1billion in private funding into venture capital funds. The Stimulating Canadian Innovation report proposes that investment be doubled to $800 million.

5. **Invest In Incubators**

The federal government should invest, with partners such as post-secondary institutions, in new and expanded incubators and start up centres. The Waterloo Accelerator Centre is jointly supported by FedDev Ontario, NRC IRAP, three local municipalities, three universities and one college. The Western-Sarnia Research Park, home of the Bowman Centre which is Canada's largest clean-tech incubator, is joint initiative of the County of Lambton, City of Sarnia and Western University.

6. **Review regulations on banks, insurance companies and pension funds to encourage investments into venture capital funds**

The CVCA has indicated[1]that a recent substantial increase in VC investment into Canada offers a great reflection of the available investment opportunities. Investors are observing the value of domestic entrepreneurial talent and making significant bets on the future.

Recommendation

That the federal government:

1. Implement the recommendations of the 2015 Canadian Chamber of Commerce report Stimulating Canadian Innovation: How to Boost Canada's Venture Capital Industry:
    a. Incentivize "angels" with an investment tax credit.
    b. Provide a tax exemption on capital gains for venture capital.
    c. Secure more investors through flow through shares for technology companies.
    d. Increase government investment in venture capital.
    e. Invest in incubators.
    f. Review regulations on banks, insurance companies and pension funds to encourage investments into venture capital funds.
2. Include life sciences as an industry that would benefit from a flow through shares tax incentive program.

[1] Record-breaking quarter: 2016 Canadian VC investment nearly doubles 2015 results. Canadian Venture Capital Private Equity Association media release, May 18, 2016