



INVESTMENT INDUSTRY ASSOCIATION OF CANADA  
ASSOCIATION CANADIENNE DU COMMERCE DES VALEURS MOBILIÈRES

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Consultations on Support for Venture Capital  
Economic Development and Corporate Finance  
Department of Finance Canada  
L'Esplanade Laurier  
12<sup>th</sup> Floor, East Tower, 140 O'Connor Street  
Ottawa, Canada K1A 0G5

Dear Minister:

**Re: Consultations on Support for Venture Capital**

The Investment Industry Association of Canada ("IIAC") is pleased to express its views on the Department of Finance consultations on support for venture capital. The IIAC represents the regulatory and public policy position for nearly 180 investment dealer registrants in the Canadian securities industry. IIAC member firms carry out the majority of financing and trading in domestic markets. While some of our smaller regional member firms provide capital to new and emerging small businesses across Canada, the majority of financings arranged by registered dealers is focussed on mid-sized and larger Canadian companies.

In the past three years, small and mid-sized companies have encountered difficulty in raising risk equity capital reflecting turbulent financial and business conditions in the Canadian and global economies. The problems accessing capital have been particularly acute for new and emerging small companies in Canada. Figures from the CVCA indicate venture capital has collapsed by 48% in the past five years as institutional investors and individual Canadians have vacated the venture capital landscape.

The Ministerial consultations aimed at strengthening the private sector venture capital market are well-placed and well-timed. Canada's future growth and prosperity depend critically on a vibrant small and mid-sized business sector that can seize opportunities in the global marketplace. In Canada, we have been more successful in designing mechanisms and expertise to finance early stage companies in the mining and energy sector than in the knowledge-based sector, and in the general manufacturing and service sectors. As the Minister has noted, access to scarce capital that can translate good ideas into commercial success will reinforce economic growth and job creation, and provide needed diversification of the Canadian economy. Canada's competitive advantage in global markets rests importantly on a robust high-tech and bio-tech sectors.

Venture capital provides a key source of funding and expertise to assist in seed, emerging and mid-stage business development. It is also evident that venture financing has fallen off in recent years, both in the private sector and the government-sponsored sector.

**We recommend that government reinvigorate the venture capital market by allocating capital from the earmarked \$400 million to private sector funds, subject to past investment performance and defined pro-rata allocation across the different regions of the country.** Following a specified investment period, government would reserve the right to increase or reduce its investment in a particular venture fund depending on overall fund performance. The investment decision-making, however, will be left to private fund managers. The government should permit the Canadian subsidiaries of foreign venture



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capital funds to qualify for this investment program. This would provide foreign venture capital funds through their subsidiaries an incentive to build and expand operations in the Canadian market.

This program of co-investment with private investors would yield more successful results than venture capital investment through government-owned entities such as Business Development Bank of Canada (BDC) and labor sponsored venture capital corporations (LSVCCs). The evidence suggests that BDC and LSVCCs significantly underperform private sector venture capital funds.

It is important to recognize the financing of early stage and emerging business through domestic venture capital funds, totalling roughly \$1 billion, accounts for a fraction of total private investment in small and mid-sized business. This non-venture fund financing is provided for the most part through established angel networks operating across the country, often part of a university-commercial nexus. Government support should provide support to build out these angel networks as studies demonstrate that these networks are underdeveloped in Canada compared with other developed countries. Further, exempt market registrants and small registered dealers in the Canadian securities industry complement these angel networks in funding small and mid-sized business.

**We recommend the government support non-venture fund financing through tax incentives targeted specifically to high technology and biotech small and mid-sized businesses.** The shares of these private enterprises could be sold in private markets, or public markets if the company is listed on a stock exchange, with the investment gain exempt from personal taxation as long as the proceeds are reinvested within six months. This concept was proposed in the Conservative Party election platform in 2006. Alternatively, if the foregoing approach is considered administratively complex, the government could reduce the applicable inclusion rate for capital gains taxation on the sale of this small business investment, from the allowable 50% to, say, 25%. Further, the highly successful flow-through share program could be expanded beyond mining and energy companies to include small and mid-sized high technology and bio-tech companies. This incentive would only benefit small and mid-sized companies that are listed on a Canadian stock exchange.

Numerous studies, both in Canada and abroad, have highlighted the drastic underperformance of public sector venture capital investment, both directly through government subsidiaries (BDC) and indirectly through tax-assisted vehicles such as LSVCCs. In light of this evidence and given the pressing need to bolster venture markets in Canada, the optimal policy solution is for government to co-investment with investors in private sector venture capital funds. Government investment decisions in these private sector funds should be based on transparent criteria, most importantly the historical performance of the private venture capital fund.

We are grateful for the opportunity to participate in this consultation process and would be pleased to provide further detail and background in discussion with your officials, if it would be helpful.

Yours sincerely,