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Consultations on Support for Venture Capital
Economic Development and Corporate Finance
Department of Finance Canada
L'Esplanade Laurier
12th Floor, East Tower
140 O'Connor Street
Ottawa, Ontario
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Dear Sir or Madam,

Consultations on support for venture capital – Deloitte's comments

We are writing to provide our comments on the support for venture capital, in response to the invitation from the Department of Finance on June 22, 2012. We understand that the Government is seeking views on how best to implement the delivery of the $400 million announced in the 2012 federal budget to help increase private sector investments in early-stage risk capital and to support the creation of large-scale venture capital funds led by the private sector.

We commend the Department of Finance for undertaking this consultation. We endorse this approach for all major policy issues in order to enhance the Government's understanding of the impact of potential changes on affected stakeholders and to facilitate informed debate with a view to developing the best possible policies for Canada.

In our view, private sector risk capital plays a critical role in driving business growth and innovation. As identified in our productivity report "The future of productivity: An eight-step game plan for Canada", one of the factors contributing to Canada's relatively low productivity is the lack of capital for start-up enterprises. The financing ecosystem in Canada is fundamentally broken — from early seed financing through to initial public offerings, it is our observation that Canada has not done enough to support home-grown enterprises with world-class potential. As a result, start-up firms may not be able to secure financing and may be leaving Canada for jurisdictions where risk capital is more readily available. The new funding announced in the 2012 federal budget provides an opportunity to begin to address this challenge and, thereby, improve productivity and increase economic growth.

While we welcome this Government initiative as an important step in the right direction, it is our view that this one-time contribution of funds is unlikely, in and of itself, to be adequate support to create a vibrant self-sustaining venture capital ecosystem. We encourage the Government to commit to a long-term strategy, developing the management expertise and investor base required for a successful venture capital community. This strategy should be aligned with three principles outlined in our productivity report:

1. The sole focus should be on supporting the development of a healthy early-stage financing sector. Previous attempts to achieve a dual mandate by imposing conditions designed to, for example, stimulate the local economy, have served to diminish early-stage returns and make them a less competitive asset class, thereby fostering an even greater dependence on Government support.

2. Fragmenting the early-stage financing regime introduces damaging market distortions; as such the Government strategy should avoid creating separate "Government-sponsored" early-stage funds that compete with private funds.

3. Given the long horizon for the development of skilled managers, the strategy should encourage the ongoing development of Canada's existing pool of early-stage capital management talent while encouraging the entry of former entrepreneurs with specialized knowledge into this arena.

We offer below our comments on how the Government should support venture capital with the $400 million through specific tax measures. We also provide comments on the Israeli Yozma model, a popular approach adopted by various countries.

Tax credits – angel, later stage

As we have previously noted in our comments to the Department of Finance, we believe that the first priority in enhancing Canada's financing regime should be to improve support for the early stages of innovation when risks are higher. As such, we strongly recommend that consideration be given to introducing an angel tax credit. Should additional funding beyond the $400 million identified in Budget 2012 be allocated by the Government, we would also endorse a later stage credit for corporate venture investors. By mitigating the risks associated with these investments, targeted credits will serve to encourage investing in high-growth small businesses. We recommend that priority be given to an angel tax credit as it is the logical starting point for the creation of a sustainable venture capital industry financed by the private sector and it is the incentive that can have the greatest impact on growing our economy.

Since 2003, British Columbia has successfully provided a provincial angel tax credit as part of its Equity Capital Program. This program was implemented to help create new businesses and expand existing ones. The response to the program has been very positive. A study by the provincial government suggests that the angel tax credit has increased the total amount of early stage investment in the province by 50-70%.[1] Based on an evaluation of that program in 2010, the provincial angel tax credit is estimated to generate $2.91 in federal and provincial consumption and income taxes for every dollar of credit claimed.[2] British Columbia's successful experience suggests that the introduction of a federal angel tax credit would not result in any long term cost to the federal Government as the credit would generate more tax revenue than the actual cost to the federal Government.

[1] Lerner, J. Hellmann, T. and Ilyaszade, I. "Angels in British Columbia," Harvard Business School. 2011.
[2] Hellerman, Thomas and Paul Schure. "An Evaluation of the Venture Capital Program in British Columbia," British Columbia: Ministry of Small Business, Technology, and Economic Development. 2010.

Yozma program model

Another mechanism that could have the potential to enhance a sustainable venture capital ecosystem in Canada is a fund-level co-investment model such as the Israeli Yozma program. The Yozma program helped build an active venture capital industry in only a decade and its template has been successfully implemented in other countries. The program provided special incentives to attract foreign venture capital funds to partner with Israeli venture capital firms and banks and supported them with Government funding.

Although this model would help to encourage foreign capital investment and would broaden the networks of Canadian start-up enterprises, we believe that it would not be as effective with a $400 million cap. However, should additional funds be made available by the Government, the Yozma model should be considered.

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We would welcome the opportunity to meet with you to discuss our views on the importance of improving productivity in Canada and how the Government could support a more robust venture capital environment in Canada. Please feel free to contact the undersigned with any questions or to arrange a meeting.

Yours truly,

Deloitte & Touche LLP

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