INTRODUCTION

This issue discusses the trends in venture capital (VC) activity during Q1 2009 and also describes the many VC programs announced by governments during that quarter. It includes an article describing a number of business start-up competitions in Canada and how they can help investment-grade small businesses.

VC ACTIVITY OVERVIEW

Investment and fundraising

Lowest since Q3 2003

VC investment in Canada totalled $275M (102 deals) in Q1 2009, the lowest amount registered since Q3 2003, and a 25 percent drop compared to Q1 2008. Approximately 48 percent of this drop is attributed to lower private independent investment activity. It is worth noting that 18 percent of total investment ($50M), was invested by the Ontario Municipal Employees Retirement System (OMERS) pension fund in a single early stage deal in BMV Holdings. If this extraordinary deal is excluded, then the drop would be 38 percent from the investment level in Q1 2008.

Table 1
VC investment and fundraising, Q1 2008 and Q1 2009

<table>
<thead>
<tr>
<th></th>
<th>Q1 2008 ($ millions)</th>
<th>Q1 2009 ($ millions)</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment</td>
<td>367</td>
<td>275</td>
<td>-25</td>
</tr>
<tr>
<td>Fundraising</td>
<td>418</td>
<td>149</td>
<td>-64</td>
</tr>
</tbody>
</table>

Source: Thomson Reuters Canada 2009.

Deal size

Drop in large deals continued in Q1 2009

Excluding the extraordinary OMERS deal, the average deal size was $2.2M, slightly lower than the $2.5M average deal size recorded in Q1 2008. The trend towards smaller deals continued in Q1 2009. In fact, deals worth less than $1M increased from 22 percent in Q1 2008 to 31 percent of total deals in Q1 2009. The average deal size in Canada remains lower than in the U.S. where the average deal in VC backed firms is US$5.4M (Figure 1).

1BMV was created in July 2008 following its auction purchase of Industry Canada’s wireless PCS G Band spectrum. BMV is expected to launch a value-priced wireless service in specific markets in Ontario and Quebec during the third quarter of 2009. By VC standards, this is an extraordinary early stage VC deal because of its magnitude and because it is a services sector investment.
**Stage of development**

**Increased seed and start-up investment activity**

Q1 2009 witnessed increased seed and start-up investment activity, compared to Q1 2008, due entirely to the extraordinary $50M OMERS investment in BMV holdings. Investments in the “other early stages” and “later stage” continued to drop, falling by 51 and 38 percent respectively compared to Q1 2008 (Figure 2).

**New versus follow-on investments**

The number of new companies receiving VC in Q1 2009 dropped to 35 from 53 in Q1 2008. More than half of these companies were in their late stage of development and only 22 percent were in their seed or start-up stages. The number of companies that received follow-on deals dropped from 84 in Q1 2008 to 67 in Q1 2009. It is worth noting that the number of companies that received follow-on deals represented 66 percent of the total, up 5 percentage points from the 61 percent registered in Q1 2008 (Table 2).
Type of investor
Steep decline in private independent investment activity
Declines in the levels of investment made by private independent funds and retail funds continued in Q1 2009. They contributed to 48 percent and 12 percent respectively, in the overall decline in VC investment, compared to Q1 2008. The level of activity of foreign funds registered a slight decline, compared to Q1 2008 (Figure 3).

Fundraising
Sharp drop in capital commitment to the VC industry in Canada
Fundraising was down 64 percent in Q1 2009, compared to Q1 2008. Private independent funds only raised $42M while LSVCC/retail funds raised the remaining $107M.

Figure 3
Distribution of VC investment by type of investor, Q1 2008 and Q1 2009

Regional distribution
Sharp drop in VC investments in Ontario
Except for British Columbia, Saskatchewan, Quebec and Nova Scotia, VC investment was down in most provinces. Ontario was especially hard hit with an $85M drop in VC investment levels, followed by Alberta with a $37M drop. If the extraordinary OMERS deal was excluded, VC investment levels in Quebec would have dropped by $11M (Figure 4). The number of companies funded in Ontario dropped by 30 percent from 40 companies in Q1 2008 to 28 companies in Q1 2009 (Table 3).

Table 3
Number of companies receiving VC by province, Q1 2008 and Q1 2009

<table>
<thead>
<tr>
<th>Province</th>
<th>Q1 2008</th>
<th>Q1 2009</th>
<th>% Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>British Columbia</td>
<td>15</td>
<td>9</td>
<td>-40</td>
</tr>
<tr>
<td>Alberta</td>
<td>15</td>
<td>6</td>
<td>-60</td>
</tr>
<tr>
<td>Saskatchewan</td>
<td>2</td>
<td>3</td>
<td>50</td>
</tr>
<tr>
<td>Manitoba</td>
<td>1</td>
<td>0</td>
<td>-100</td>
</tr>
<tr>
<td>Ontario</td>
<td>40</td>
<td>28</td>
<td>-30</td>
</tr>
<tr>
<td>Quebec</td>
<td>50</td>
<td>50</td>
<td>0</td>
</tr>
<tr>
<td>New Brunswick</td>
<td>6</td>
<td>2</td>
<td>-67</td>
</tr>
<tr>
<td>Nova Scotia</td>
<td>7</td>
<td>4</td>
<td>-43</td>
</tr>
<tr>
<td>Prince Edward Island</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>New Brunswick</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Territories</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

Source: Thomson Reuters Canada 2009.

2 Thomson Reuters revised the fundraising number of Q1 2008 from $334M to $467M.
3 Labour Sponsored Venture Capital Corporation.
**Sector distribution**

**Sharp decline in energy and environmental technologies**

VC investment levels were down in all other sectors in Q1 2009, compared to Q1 2008, except for investment levels in traditional sectors. The drop was most notable in the energy and environment sector with an 80 percent decline followed by life sciences with a 40 percent decline (Figure 5). Excluding the extraordinary OMERS deal, investment in the ICT sector would have dropped by 38 percent in Q1 2009, compared to Q1 2008.


**GOVERNMENT ACTIVITIES**

In Q1 2009, the Business Development Bank of Canada (BDC) made VC investments in 13 companies (Table 4). The BDC committed $15.5M and its co-investors committed an additional $68.5M.

Table 4

| BDC Co-investors Total Number of deals |
|---|---|---|---|
| BDC Co-investors Total Number of deals | ($ millions) |
| Seed and start-up | 4.5 | 6.5 | 11.0 | 4 |
| Other early stages | 3.2 | 43.4 | 46.5 | 4 |
| Later stage | 7.8 | 18.6 | 26.5 | 5 |
| Total | 15.5 | 68.5 | 84.0 | 13 |


**Provincial governments**

In March 2009, as part of their annual budget announcements, many provincial governments proposed action to support small businesses through VC programs. This included funding for VC as well as enhancement to tax credits that encourage VC investment.

**Government funding for VC**

The Government of Quebec announced the creation of seed funds, a large VC fund and additional funding for regional funds. Quebec announced three seed funds that will be mandated to invest in seed-stage technology companies based in Quebec. The provincial government, through Investissement Québec, will commit $50M, labour sponsored funds will commit another $50M and $25M is expected from the private sector.

As well, the Quebec government announced the creation of a fund that will finance VC funds. Investissement Québec will commit $200M and the pension fund Caisse de dépôt et placement du Québec along with the labour-sponsored fund Fonds de solidarité FTQ will each commit $250M.

As well, it is expected that a further $125M will be raised from private institutional investors for a total fund size of $825M.

Finally, Quebec will provide more funding to the FIER-Régions program, which is made up of a number of economic development funds jointly financed by the Government of Quebec and the private sector. In Budget 2009, the government proposed $40M to create new FIER-Régions funds and an additional $20M to recapitalize six of the existing 30 funds.

The Government of Ontario also announced a new fund to invest in high technology companies. The Emerging Technologies Fund will invest $250M dollars over five years together with qualified venture capital funds and private sector investors.

**Enhancements in tax credits encouraging VC investments**

The Government of Canada and a number of provincial governments support labour-sponsored funds by providing tax credits to individuals that place money in these funds. The labour-sponsored funds use the money raised from individuals to invest in small businesses. In March, a number of provinces increased the tax credit for labour-sponsored funds.

- New Brunswick and Newfoundland and Labrador increased the tax credit from 15 percent to 20 percent and increased the annual investment amount that each person can claim from $5000 to $10 000.
- Quebec will increase the tax credit for the labour-sponsored fund Fondaction from 15 percent to 25 until the fund reaches a capitalization of $1.25B.
- Saskatchewan increased the tax credit it offers for investments in national labour-sponsored funds and doubled its annual cap on its provincial funds.

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4 Fondaction is short for Fonds de développement de la Confédération des syndicats nationaux pour la coopération et l’emploi.

Q1 2009 Venture Capital Monitor
LAUNCHING TECHNOLOGY ENTREPRENEURSHIP THROUGH BUSINESS START-UP COMPETITIONS

Business start-up competitions give entrepreneurs an opportunity to pitch concepts for new businesses to knowledgeable judges and provide the winners with prizes directed toward launching their new venture. A number of organizations with economic development mandates use these competitions to help launch businesses with great potential. Business start-up competitions can provide participating entrepreneurs with:

- feedback on their proposed business from seasoned business people, accountants, lawyers and investors;
- valuable media coverage;
- networking opportunities with investors and potential mentors; and
- valuable cash and business service awards to the winning companies, which are typically at the critical seed and pre-seed stages of company formation.

Enterprize is the largest business start-up competition in Canada that is run by a university. This annual competition was founded and is hosted by the Sauder School of Business in British Columbia and its lead sponsors in 2008 were the BDC and the British Columbia Innovation Council. Unlike competitions run by economic development organizations, which tend to be open to all entrepreneurs, Enterprize is specifically targeting university students. The winners in 2009, two PhD students from Ottawa, won $20 000 to help launch their venture to commercialize a wireless medical device.

Among the most recent business start-up competitions is BreakThru, founded by New Brunswick Innovation Foundation (NBIF) in 2007 and run most recently in 2009. The competitors each attended a one-day boot camp on preparing and presenting their proposals. The winning team, which has developed a more environmentally friendly process for plastic production, was awarded $125 000 in equity investment from the NBIF and $25 000 in business services to help launch its business.

Other business start-up competitions include the TEC VenturePrize competition in Alberta; InNOVAcorp’s I-3 Technology Start-Up Competition in Nova Scotia; Venture Forward in Saskatchewan; Small Business BC Business Plan competition for companies in either the “start-up” or “growth” categories; Advancing Canadian Entrepreneurship’s Student Entrepreneur Competition and Canadian Business Magazine’s Great Canadian Innovation Competition.

Business start-up competitions can help aspiring entrepreneurs launch new companies by providing entrepreneurial education, exposure to experienced business people and access to seed capital.

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5 http://www.enterprizecanada.org
6 www.nbif.ca/breakthru
7 http://www.ventureprize.com
8 http://innovacorp.ca/about-us/i-3-technology-start-competition
9 http://www.ventureforward.ca
10 http://www.bizplancontest.ca
11 http://www.acecanada.ca
12 http://www.canadianbusiness.com/innovation/article.jsp?content=20090316_10001_10001
This publication is part of a series prepared by the Small Business and Tourism Branch. The branch analyses the financial marketplace and how trends in this market impact small businesses’ access to financing. Current research is focused on high-growth firms, the aspects of both Canada’s VC and general business environment that affect the success of these firms, and the key players in the risk-capital market (for example, VC firms and angels).

The Small Business and Tourism Branch is also responsible for the Small and Medium-Sized Enterprise Financing Data Initiative (SME FDI). The SME FDI is a comprehensive data-collection program on SME financing in Canada. In partnership with Statistics Canada and Finance Canada, Industry Canada reports on the supply of and demand for financing by small and medium-sized businesses. Further information and statistical findings and reports are available at www.sme-fdi.gc.ca.

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