

NovaKnowledge



MIKE

Access to Capital

Addressing the Equity Financing Gap

2005 Debate Summary



MIKE DEBATE - ACCESS TO CAPITAL

MIKE dialogue allows the province's business, government and education leaders to come together, exchange opinions and explore ideas. The provocative input received from our MIKE debates is the foundation upon which *NovaKnowledge* builds action plans and sets targets for Nova Scotia's economic growth.

In December 2005, *NovaKnowledge* held a public debate to discuss the issue of venture capital. Specifically, it led a discussion on the challenges Nova Scotia's companies face in accessing equity investments. The discussion focused on what can be done to reach *NovaKnowledge*'s goal to have \$50 million in venture capital invested annually in Nova Scotia companies by 2010. The following is a summary of issues raised in the debate.

THE CURRENT SITUATION – GAPS IN FUNDING AND KNOWLEDGE ABOUT VENTURE CAPITAL

Nova Scotia currently ranks second-last among Canadian provinces for venture capital investment in relation to our GDP. From 1996 - 2005, we averaged \$17 million per year in investment, placed with an average of 11 companies per year. Doubling or tripling this level of investment would have a considerable impact on our province's economy, creating new jobs for Nova Scotians.

In light of this data, *NovaKnowledge* conducted research on venture capital in spring 2005 to look at access to financing, and the challenges Nova Scotia's companies face in securing capital to fund growth. This research uncovered gaps in both available equity funding and the equity culture.



“On (the topic of) strategy, try to attract the right level of capitalization at the seed and start-up point. It should be \$1-2 million in capital, with the ability for follow-on rounds. This way, you won't fall between seed and growth, which is a very, very deep chasm.”

Dorothy Spence
Chief Executive Officer, FocalTRACK

The funding gap occurs in the \$100,000-\$1 million range, a problem Nova Scotia shares with other Canadian provinces and U.S. states. Companies that fail to find equity financing in this range tend to adapt their business plans,

often resulting in slower or reduced plans for growth. And this means that fewer businesses will reach a level at which they can attract formal venture capital.

It also means that Nova Scotia companies lack knowledge about equity investment – the process, costs, and benefits. Many businesses seek financing from alternate, low-cost sources, such as government programs and banks. The goals of these financing sources generally are not aligned with those of venture capital investors, and the companies are not encouraged to ready themselves for the business demands of venture capital investment. These combined factors have created a gap in Nova Scotia's venture capital cycle.

Although there are individual or “angel” investors operating in the under-\$1-million range, it's clear that our province's angel investors would benefit from increased support and knowledge to help them identify opportunities and make better-informed equity investments in our marketplace.

CURRENT ACTIONS

In the year since *NovaKnowledge* set its target of \$50 million in annual venture capital investments by 2010, several funds have been established to provide Nova Scotians with both local investment opportunities and access to equity financing. They are:

GrowthWorks Atlantic Venture Fund – Established in 2005 by GrowthWorks, a national VC fund manager, GrowthWorks Atlantic has invested in two companies to date and it is looking for more investment opportunities. The fund looks for Atlantic Canada companies with strong management teams, innovative products demonstrating a sustainable advantage and growing markets.

Community Economic Development Investment Funds (CEDIFs) – Unique to Nova Scotia, these funds are designed to provide local entrepreneurs with access to capital, to provide regional investment opportunities for investors, and to keep capital in the province. There are currently 27 funds in operation, with an estimated \$16.5 million in capital and 2,500 investors. Growth is projected at 20% a year – reaching roughly \$10 million in 2010 – which would account for 20% of *NovaKnowledge*'s annual investment target.

First Angel Network - Established in 2005, this member-owned, not-for-profit organization of angel investors is committed to bridging gaps between entrepreneurs and private capital in Atlantic Canada. Members will make investments in the \$200,000-\$2 million range. The

Network is currently in the midst of a membership drive and has already exceeded its targets. It has explored 18 financing opportunities to date.



“We have to get investment opportunities connected to the people with money. It’s difficult for a new entrepreneur to know where to go to get financing, so they go the traditional route, like a banker. We need to get the information out through a forum on how to find angel investors across Nova Scotia. That will help connect the investment opportunities to the money.”

Bill Gullage
Chief Financial Officer, MedMira Inc.

DEBATE RESULTS

In a lively discussion, the audience of around 100 participants explored the actions required to meet the NovaKnowledge target. Clear priorities emerged from the debate and feedback forms completed by participants:

1. **Privatize the management of public sector pension funds** – Privately managed public sector pension funds have traditionally represented a major source of venture capital financing across Canada. Nova Scotia is one of the last provinces where these funds remain publicly managed. New Brunswick has privatized pension funds, resulting in more venture capital placements. Given the important role these funds play in equity financing, it is crucial that everyone work toward having these funds privatized in Nova Scotia. This will go a long way toward convincing venture capital funds based outside our province to invest in our companies. And it will help to achieve NovaKnowledge’s goal.
2. **Create more tax incentives for investors** – Research presented at the debate provided insight on a successful investment program in the UK that provides considerable tax incentives to early stage, high-risk investors. These include a 20% income tax relief rate for qualifying investors up to £200,000. Investors also qualify for income tax relief of up to 40% where investments fail, and they are exempt from any capital gains tax on successful ventures. This program has increased venture capital equity placements across the UK by 62% and resulted in the creation of 65 jobs for every £1 million that the

government has forgone in taxes. A similar program could produce comparable results in Nova Scotia.

3. **Provide support and information to angel investors** – Participants agreed that the key to increased angel investment activity provincially is to provide investors with improved support and information so they can make more informed investment decisions. One suggestion is to bring these investors together in networks (such as the First Angel Network) so they can learn from one another and exchange insight on opportunities. This will allow our angel investors to better identify and evaluate investment opportunities and offer a level of financing that reflects the quality of the opportunity. And this will encourage high-quality investment opportunities to stay in the equity market in Nova Scotia.
4. **Push for change in government policy** - Participants suggested that a public policy group should be formed to lobby for improved policy governing the funding of Nova Scotia companies. As an example, while ACOA initiatives like AIF and the support they provide are welcome, these funds are built on requirements that are ill suited to meet the needs of knowledge economy companies. And this has led to situations where Nova Scotia companies either find themselves under-funded or having financing clawed back. Without policy changes at both the federal and provincial level, we risk losing some of our most dynamic companies.

“We talk a lot about fundable companies, but we should take a macro view and look at developing ourselves into a fundable community. We need a lot more money ready to be invested if we are to reach the NovaKnowledge target of \$50m invested in 2010. To achieve this amount annually we need a group of funds whose total available dollars approaches \$400-500m. I would suggest to achieve this, we need to create a fund whose role it is to facilitate the creation and attraction of other funds. This is often called a fund of funds. I further submit that the \$170m that ACOA has allocated to the next round of AIF would be far better spent to create the foundation of a Fund of Funds for Atlantic Canada. Finally, we need a public policy group that does nothing but focus on forcing better public policy to enhance the investment environment”



Sean Sears
President, Abridgean

THE FINAL WORD

The issue for Nova Scotia is no longer one of investment opportunities or insufficient capital. It is how we can make the capital we have here more readily accessible to our best companies, and how we can better encourage and support investors in making informed equity investments.

By pushing for improved government policy, offering early risk investors more incentives and putting pension funds into play, we can meet *NovaKnowledge's* goal to have \$50 million in annual venture capital placements by the year 2010.



SPONSORS:



**Saint Mary's
University**

Halifax, Nova Scotia, Canada



Atlantic Canada
Opportunities
Agency

Agence de
promotion économique
du Canada atlantique

Canada

NOVA SCOTIA

Economic Development

GROWTHWORKS
ATLANTIC LTD.

NovaKnowledge

Purdy's Wharf Tower One
1959 Upper Water Street, Suite 304
Halifax, NS B3J 3N2
P: 902.494-1510
F: 902-494-8002
www.novaknowledge.ns.ca