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Understanding how to invest in success

How do successful investors pick the sprinters from the rest of the pack?

A recent Globe and Mail article makes it sound so simple: "Today's innovative businesses don't need hard assets like port access, highway infrastructure or really much of anything." Rather, they need to develop a robust venture capital (VC) economy that links the "brainy grads" of educational networks to willing investors.

But it may not be quite so easy. Potential investors must choose from among scores of possible ventures in which to inject capital. What is the secret to consistently backing the winners?

"...the business community should help create a wider range of opportunities for students to gain real world learning experiences.."

- Public Policy Forum

Recent research on Canadian high-tech firms that flourished, despite adequate funding and technically brilliant leadership, has identified a common thread: failure to focus on customers.

Smart investors and entrepreneurs know that companies that aren't getting most of their funding from customers almost from Day 1 are not going to make it.

Why is it, then, that the Canadian start-ups in the study didn't seem to understand the importance of a market for their great ideas?

Is it in the Canadian DNA?

Canada has always been one of the world's leading countries in investing to produce knowledgeable people. But some would argue that Canada has been among the worst at creating value from that investment.

QUICK STAT: About 7% of Americans invest in new businesses compared with fewer than 3% of Canadians.

- Institute for Competitiveness & Prosperity

How to make the culture shift

Some ideas as to how to shift Canada's innovation culture:

Weaving a commercial orientation into all of the educational system is one element.

Another would be losing a collective love of invention for its own sake in favour of embracing innovation, which focuses on creating value.

A third would be better tracking of R&D-intensive companies that fail, as well as the ones that succeed, to dig deeper into the reasons. In other words, don't focus just on the inputs of research projects, look more closely at the outcomes.

And finally, it may take an acknowledgment that maybe R&D funding for science and tech-heavy ideas isn't the best way to spur innovation. Great companies come from personal experiences and insights, not just labs. Innovators need the skills to understand commercial value propositions, which are people-related, as much as they need straight business or technical training – maybe even more.

"Many people equate innovation with research and development (R&D). Their simplistic notion is that new ideas from research lead to new products and services. This belief is erroneous. Innovation occurs by identifying needs and finding a way to meet them. The resulting value exchange of products and services for money is commerce. We Canadians don't seem to get this."

'We just aren't making products people want,' Ottawa Citizen, March 2010

Pathways to Productivity

ECONOMIC SYMPOSIUM

How does Ontario stack up?

Is access to funding the real problem for Ontario firms?

- As Figure 1 shows, Ontario's average VC deal size is big by Canadian standards: \$4.5M (Canada: \$3.6M, Quebec: \$2.8M)
- Ontario is ranked 11th in North America in dollars invested in VC, higher than any other Canadian jurisdiction
- The average VC portfolio size is 18.4 investee firms per fund executive, well ahead of the Canadian average of 27.8, but behind B.C. (16.4) and the U.S. (6.6)
- Ontario's current average deal size is \$4.5M, while in the U.S. it's \$7.9M
- Another question of interest is the availability of angel investment funding before venture capitalists enter the picture. The less formal nature of this funding source makes it hard to develop precise measures, but historically, at least, angel investment seemed to be fairly robust. And despite the recent economic downturn, 12 new angel networks have been created in Ontario in the past two years.

QUICK STAT: Fundraising for Canadian VC firms... has been falling with 2007 marking the fifth decline in the previous six years.

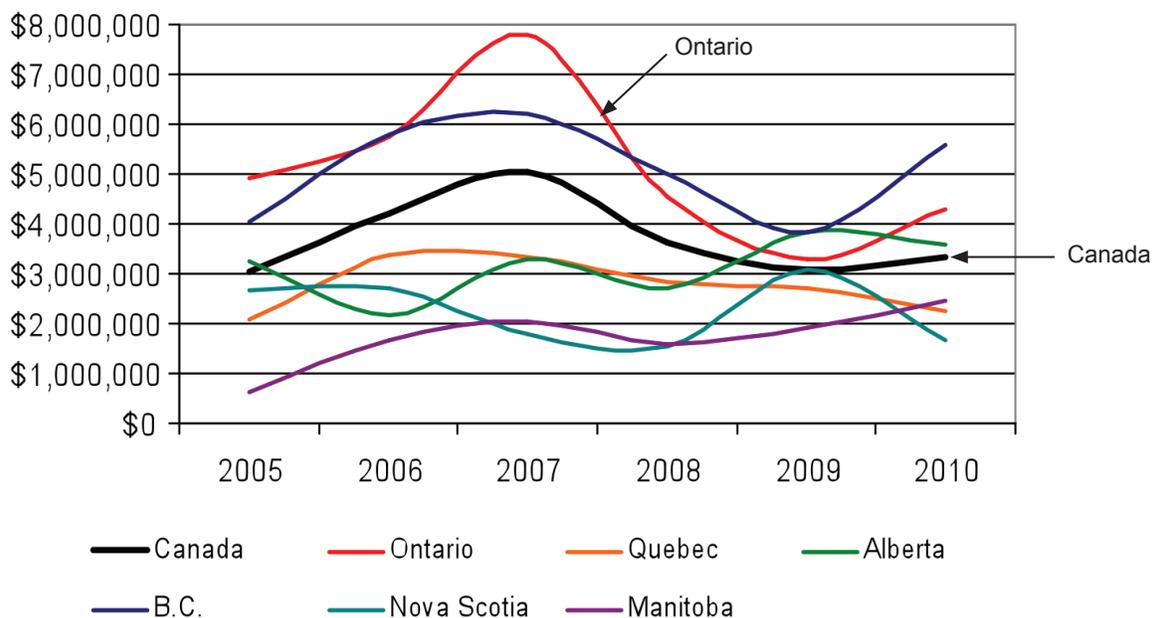
- Institute for Competitiveness & Prosperity, 2010

Resources:

- Globe & Mail: Entrepreneurship just needs 'rich people and nerds'
- Thomson Reuters: Canada's Venture Capital Industry in Q3 2010
- Canada's Venture Capital and Private Equity Association: Think Canada (Again)
- "Understanding the Disappearance of Canadian R&D-intensive firms," Douglas Barber and Jeffrey Crelinsten
- The Public Policy Forum: Innovation Next: Leading Canada to Greater Productivity, Competitiveness and Resilience

Figure 1.

2005-2010: Average Deal Size (\$ per # of companies)



Source: Thomson Reuters, 2010 Q3 Report

This document is intended to provide symposium participants with a general overview of each speaker's topic and perspective, and does not necessarily represent the views or policies of the Ministry of Economic Development and Trade.