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# ACCESS TO CAPITAL FOR CANADIAN GROWTH-ORIENTED, MEDIUM-SIZED FIRMS

2020

Report by Richard Remillard and Michael Scholz

Research by Richard Remillard

Innovation, Science and Economic Development Canada

Small Business Branch

Canada





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# 1.0 Introduction

Canada has a small and medium-sized enterprise (SME) and start-up ecosystem that is healthy in many respects, ranking second globally in ease of starting a business, but seemingly falls short in scaling growing businesses into globally competitive anchor firms as fewer than 2 percent of Canadian medium-sized firms grow into large firms in any given year.<sup>1</sup> As a result, SMEs account for about 90 percent of business sector employment in Canada<sup>2</sup> versus 47 percent in the United States,<sup>3</sup> a fact that accounts for about 20 percent of the labour productivity gap between Canada's business sector and that of the United States.<sup>4</sup>

Ambitious, medium-sized firms require access to affordable sources of growth capital to be able to invest in activities (e.g., hiring talent, building infrastructure and developing new technology) necessary to grow into globally competitive leaders. Evidence of stronger demand for such growth equity has been noted by the Business Development Bank of Canada (BDC), which expects its Growth & Transition Capital offerings to increase by 8 percent annually through fiscal 2024. Despite this, the financing challenges and opportunities surrounding medium-sized, higher growth companies generally remain poorly understood relative to financing of small, early-stage growth companies. As such, this paper specifically focuses on the availability of flexible financing required by medium-sized firms looking to scale up and grow, such as minority equity, debt or hybrid financing.

Informed by extensive interviews conducted by the Remillard Consulting Group with capital providers and corporate executives (Annex 1), the following captures stakeholder insights into the state of Canada's growth and transition capital markets, including challenges inhibiting the availability of growth capital for medium-sized firms, common misperceptions concerning Canada's growth capital and alternative risk financing markets, and the continuing role of the BDC in this rapidly evolving market.



1 Canada's Economic Strategy Tables, The Innovation and Competitiveness Imperative: Seizing Opportunities for Growth.

2 Innovation, Science and Economic Development Canada, *Key Small Business Statistics*, November 2019.

3 United States Census Bureau, 2016 SUSB Annual Data Tables by Establishment Industry.

4 Advisory Council on Economic Growth, 2017, *Unlocking Innovation to Drive Scale and Growth*.

## 2.0 Profile of Canada's growth-oriented, medium-sized firms

The overwhelming majority of Canadian firms are small, with just under 55 percent employing fewer than five employees and 98 percent fewer than 100.<sup>5</sup> This explains, in large part, why more attention is placed on understanding and addressing growth challenges facing small firms. At the other end of the spectrum, issues facing large private organizations are also well understood as these firms, despite representing only about 0.25 percent of firms, employ a significant share of the labour force (10.5 percent),<sup>6</sup> can lobby government and regularly make the headlines in major newspapers.

By comparison, medium-sized firms, defined as those with between 100 and 499 employees, representing just under 2 percent of Canadian businesses, often fall under the radar. Despite this, Canada's medium-sized firms account for almost 20 percent<sup>7</sup> of all jobs, and generate 12 percent of our national gross domestic product (GDP) and 21 percent of the value of our exports.<sup>8</sup> Beyond their immediate impact on the economy, Canada's growth-oriented, mid-tier firms represent a source of tremendous economic opportunity as they scale. Typically, they should become the next large private organizations, the next large multinationals; however, evidence suggests that medium-sized firms in Canada are facing challenges in taking this step.

Of the broader subset of medium-sized companies, only a small share — roughly estimated at around 10 percent — have the ambition to achieve high levels of growth and to become large-scale firms, as measured through either revenue or employment. For the purposes of this paper, medium-sized growth firms are companies:



With  
between  
100 and 499  
employees



That have  
substantial  
recurring  
revenues



Growing at by  
least 5 percent  
above the rate  
of inflation  
per year

<sup>5</sup> Innovation, Science and Economic Development Canada, *Key Small Business Statistics*, November 2019.

<sup>6</sup> Innovation, Science and Economic Development Canada, *Key Small Business Statistics*, November 2019.

<sup>7</sup> Innovation, Science and Economic Development Canada, *Key Small Business Statistics*, November 2019.

<sup>8</sup> Statistics Canada, *Trade in Goods by Exporter Characteristics, by Enterprise Employment Size and Industry*, Table 12-10-0094-01.



These firms come from a wide range of industries with varying capital requirements, growth profiles, competitive dynamics, managerial expertise and management expectations. Though there are no official estimates of the number of growth-oriented, medium-sized firms operating in Canada, fragmentary data point to the number of such firms, investment levels into these companies, and the location and industrial sectors in which they can be found.

Innovation, Science and Economic Development Canada's November 2019 report on SME statistics	Records 22,666 firms in Canada as having between 100 and 499 employees.
	Identifies 5.6 percent of these companies, or 1,269 companies, as being high growth based upon revenue increases.
	Identifies 3.1 percent, or 702 firms, as being high growth based upon employment gains.
Canadian Venture Capital & Private Equity Association	Records \$1.4 billion in growth equity from venture capital, \$125 million from venture debt and \$1.5 billion from private equity invested in Canada in the first three quarters of 2019.
	Indicates 2019 investment levels were recorded across 186 deals, at about \$16 million per deal.
Canadian Business magazine's Growth 500 list	Tallies 117 firms of the 500 as being medium-sized, high-growth firms on September 12, 2019.
	Identifies 47/117 firms were from the greater Toronto region, 18 from greater Montreal and 14 from greater Vancouver. There was one firm from each of Manitoba and Saskatchewan.
	Identifies 46/117 firms were from technology industries, 13 from manufacturing, 10 from financial services and 9 from human resources/recruiting.

A high proportion of these firms are privately held companies and are not yet at the stage where they can raise capital from public stock exchanges. Rather, their capital tends to stem either from internally generated sources, including retained earnings, or from private, external sources, including venture capital and banks. When the companies seek external financing, executives generally try to secure the maximum required financing with the minimum loss of control, balanced with cost effectiveness and repayment flexibility.

For the purposes of this report, growth capital is defined as a type of debt or private equity investment, usually a minority investment, in relatively mature companies that are looking for capital to expand or restructure operations, enter new markets or finance a significant acquisition without a change of control of the business. Growth capital can be in the form of debt, equity and/or hybrid (mixed debt/equity) investments by funders. Growth capital is considered an intermediate stage of financing between venture capital and private equity.

With this in mind, a growing marketplace has emerged since the lows of the recession to serve the capital needs of these growing firms. Market demand for BDC's Growth & Transition Capital offerings, for example, is expected to increase annual acceptances by 8 percent, from \$375 million in fiscal 2019 to \$555 million in fiscal 2024, reflecting a stronger demand for growth equity and an increase in SME business transitions. The following section dives deeper into how this market is structured and strives to identify gaps and opportunities.

### 3.0 Canada’s three-tier growth capital financing market

**Growth-oriented, mid-tier firms secure capital to finance growth activities (e.g., market expansion, product development, mergers and acquisitions) from a variety of domestic and foreign providers.**

**EXAMPLES OF CAPITAL PROVIDERS INVESTING IN CANADA**

Private equity and venture capital growth funds	Alaris Royalty Georgian Partners Bain Capital
Banks and bank-backed vehicles	Bank of Montreal Manulife Capital Goldman Sachs
Family offices	Hyatt Bangia Clear North Capital
Exempt market dealers	Flow Capital FrontFundr
Crown corporations	Business Development Bank of Canada Investissement Québec
Stock exchanges	TSX Venture Exchange Canadian Securities Exchange
Pension plan investments entities	Ontario Teachers' Pension Plan Canada Pension Plan Investment Board
Major corporate offices	CapitalG (formerly Google Capital) Apple
Credit unions	Vancity First West Capital



More often than not, these growth capital providers invest alongside each other in a relatively mature financing ecosystem, complementing earlier sources of financing (angel investors, venture capital) and each other – with differences in investment decisions typically made according to internal strategies and funds available. Following a decade of significant growth in the sector, corporate executives and capital suppliers have noted the emergence of a three-tier growth capital market structure in Canada to meet the unique needs of Canada’s growth-oriented, medium-sized firms. An overview of some capital providers in the tiers is presented in Annex 2.

These three tiers are relatively porous as individual capital providers often target a broad range of preferred investment sizes that cut across these boundaries. For instance, CIBC Innovation Banking identifies investments of between \$500,000 and \$75 million as being of interest, while FirePower Capital identifies the \$1 million to \$20 million range as landing within its scope. Nonetheless, a clear division of financings has emerged according to a set of varying characteristics in capital providers and the firms they invest in.

**CANADA’S THREE-TIER GROWTH CAPITAL MARKET**

**Tier 1**

(\$20 million plus)



Largely U.S. private equity and growth equity funds, but increasingly supplemented by larger Canadian public pension funds and a limited number of domestic growth equity funds that have developed out of preceding venture capital entities (Georgian Partners, Inovia Capital). Comprised of roughly 60–70 known capital providers that are most active in the technology sector, including huge U.S. technology firms that often purchase Canadian medium-sized firms outright, but that also have growth equity units within their ranks (e.g., Alphabet/Google’s CapitalG).

**Tier 2**

(\$10 million)



Populated by an increasing number of Canadian investors (e.g., bank-owned entities, domestic growth equity funds, government-controlled institutions, family offices, exempt market deals and public stock exchanges) whose “sweet spot” hovers around the \$10 million mark per deal. This tier is composed of roughly 40 known capital providers and tends to finance a broader spectrum of industrial and commercial sectors than Tier 1, although there is still a considerable focus on technology firms.

**Tier 3**

(\$2 million – \$5 million)




Comprised predominantly of domestic investors making deals in the \$2 million – \$5 million range. Roughly 30 capital providers active in this space, including Crown corporations, exempt market participants reliant on retail investors (“accredited” and “eligible” – who meet certain income and/or financial asset thresholds), family offices, specialty debt funds and junior stock exchanges. These investors are active in a range of industrial and commercial sectors, including those seemingly not vigorously pursued by many capital providers, such as commercial and industrial real estate, and natural resources.

Capital providers, intermediaries and company executives share a number of perspectives concerning capital availability within the ranges of financing, but also diverge on others. There is virtual unanimity about the availability and presence of capital at Tier 1 and the relative paucity of capital at Tier 3. Opinions vary concerning the composition of Tier 2, with capital providers largely concurring that there is sufficient capital to meet demand as capital supply seems to have increased steadily in recent years, while company executives tend to disagree with this assessment.

## 3.1 Tier 1 – Predominately U.S. Funds

As with venture capital and private equity overall, fund size is the major driver of deal size. Large investors, like American funds and public pension funds, need to invest larger dollar amounts per deal to “move the needle” on their own returns. The Ontario Teachers’ Pension Plan (OTPP) typically looks at deals in the \$75 million – \$100 million range, while CIBC Innovation Banking puts \$75 million at the top end of what it will consider. In this market segment, negotiating advantage often lies with the companies as only the most successful firms require large enough capital infusions at this scale. Typically, the real issues for these firms lie elsewhere and their interest in financing revolves around capital providers fully understanding the firm/industry, which promotes shared assessments of company valuations, and assistance in recruiting senior talent and in penetrating new markets.

An aerial photograph of a city skyline, likely Vancouver, taken from a high vantage point. The image shows a dense cluster of skyscrapers and buildings along a waterfront. The sky is a mix of orange, yellow, and blue, indicating sunset or sunrise. Several boats are visible in the water. The overall scene is a vibrant, high-angle view of a modern urban landscape.

Sources indicated that 60–70 U.S. growth funds, banks and other capital providers are actively pursuing large, growth-stage investment opportunities in Canada at any given time. One tech executive, whose company was recently bought by a U.S. strategic investor, forwarded a list of 28 U.S. funds (Annex 3) that actively call into Canada, about which he commented, “I’m sure there are many others.” Several interviewees noted the prevalence of so-called “smile and dial” operations into Canada — outsourced, high-end call centres hired by American funds to initiate contact with prospective Canadian portfolio companies, gather intelligence and secure meetings with their fund clients. Alternatively, some U.S. funds use internal units for these purposes, designed to avoid auctions and promote the development of “proprietary deal flow” in strategic regions like Canada.

However, the trigger event for U.S. funds’ interest typically occurs when a Canadian technology company raises a Series A or Series B round, at which point they “automatically come onto the radar of the U.S. funds.” As a consequence of the large American presence, executives broadly agree that there is an abundance of capital for companies in the technology sector with \$5 million and above in annual revenue. Some suggested that the competition has grown so intense in recent years that U.S. funds will even consider Canadian technology companies whose annual revenues are only at the \$3 million level.

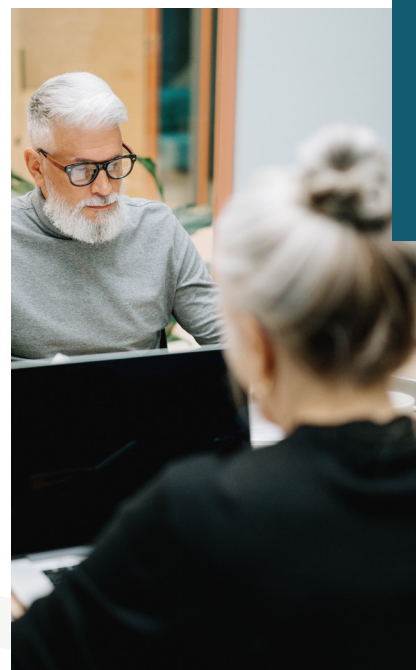
The ultimate goal of these large American funds is to sell a portfolio company further down the line to another U.S. financial sponsor (such as a private equity fund), a U.S. Fortune 500 firm or onto a listing on a U.S. public stock exchange. Although this trait may raise alarms with policy-makers, domestic capital providers appear to be equally open to attractive buyout offers from U.S. and other foreign sources.



Following the lead of the Caisse de dépôt et placement du Québec, which has been one of the few consistent domestic Tier 1 capital providers in Canada, several large domestic pension funds have begun to ramp up growth capital investing activity in Ontario (Ontario Teachers' Pension Plan, Ontario Municipal Employees Retirement System (OMERS)), while the Canada Pension Plan Investment Board (CPPIB) has completed such deals internationally in partnership with U.S. growth equity giant Technology Crossover Ventures (TCV). Location does not appear to be a particular issue for larger Tier 1 technology deals, with recent announcements involving companies in St. John's, Saskatoon and Calgary. This too is an indicator of the robust investor appetite at this level.

## 3.2 Tier 2 – Broad Range of Canadian Investors

**Tier 2 is largely comprised of domestic capital suppliers that favour deals around the \$10 million mark – owing to factors such as fund size, risk appetite and deal economics, which some contend are more challenging to scale at these lower investment levels. According to one leading market participant, this particular segment has been “frothy” in recent years, resulting in several unique characteristics, including the prevalence of auctions (usually organized by the major accounting firms) and growing hostility between market participants, including the charge against certain state-backed actors playing in a market segment that is already well served and/or that are not engaging in the profit maximization imperative but rather having other objectives that result in undercutting. Market participants observe that undercutting occurs regarding interest rates, terms and conditions (flexible repayment periods, charges or not for early repayment), as well as packaging investments in with other products, such as personal wealth management, foreign exchange services, card services and the like.**



Tier 2 capital providers tend to engage in private criticism of the different categories of financing alternatives. For instance, some observe that royalty and other debt funds may not be appropriate for companies looking to grow at their maximum rate as regular, recurring interest/royalty payments can detract from reinvestments into sales and new product development. Some Canadian participants, both funds and company executives alike, point to the potentially worrisome impacts of U.S. funding, given the history of U.S. players rapidly exiting the Canadian market in a downturn and the desirability of maintaining control of these companies within Canada, although growing numbers believe that, with U.S. funds investing in more-established and resilient companies, a sudden withdrawal of funds in a downturn is becoming less likely. Others decry the Canadian public stock exchanges as resulting in “orphan stocks,” without adequate tracking or following by analysts, excluded from indices (and therefore without the cushion of an institutional investor following), thinly traded and dependent upon meeting quarter-over-quarter earnings expectations.

In contrast, evergreen funds, with constantly replenishing capital, such as pension plan investment vehicles, tend to vaunt the relative merits of ultra-patient capital when compared with growth equity funds that typically have 10-year lifespans. Yet others tend to favourably compare the practices of private investors (family offices) versus public institutions in terms of ease of access to decision makers, faster turnaround speed and company-friendly terms and conditions. It is not uncommon to hear from capital providers at this level that there is sufficient capital to meet the needs of companies that are worth backing and that the only ones complaining are companies that should not be financed in the first place.

### 3.3 Tier 3 – Remaining Supply Gap

**Tier 3, which is comprised of capital suppliers who make deals in the \$2 million – \$5 million range, is where the evidence is strongest that the demand for growth capital continues to outpace available supply. Observers pointed out that this paucity of capital is largely due to the economics of these deals (smaller capital requirements combined with greater risks), which propels capital providers into larger deals, particularly if they themselves have grown in size.**

In general, this segment is dominated by domestic providers and with few exceptions, such as BDC, is populated by entities managing smaller pools of capital, while, conversely, foreign capital providers are largely absent. Owing to the relative risk, the cost of capital appears to be quite high in this tier, rising to the mid-teens for cash flow-based financing (low teens for secured debt that can come with warrants, but rates as high as 20–25 percent and even 30 percent plus for unsecured debt). The yield expectations of cash flow- / revenue-based lenders' own investors (typically in the 8 percent range) help drive these high borrowing costs to companies. On the other hand, exempt market (private placement) participants can levy due diligence fees on companies reaching \$40,000. These cost of capital issues can result in "sticker shock" on the part of corporate borrowers used to secured lending rates in the single digits and a prime rate at historic lows. These high rates, together with the broad range of pricing overall, may be indicators of a somewhat inefficient and relatively undersupplied market.

One exempt market participant interviewed summed up the situation with the following:

**"Not too many firms or funds are feeding the capital needs of companies that are too small to attract the interest of the U.S. majors, too low growth to attract venture capitalists, too small for traditional private equity funds and banks.... If you have under \$5 million of earnings before interest, taxes, depreciation and amortization and you're growing at 5–10 percent above the consumer price index, then there are few places to turn to...."**

Similarly, another smaller exempt market firm reported receiving between 5 and 10 unsolicited calls from companies each month looking for growth financing.





A not uncommon accusation from market participants in Tier 3 is that the big banks have not adjusted their practices sufficiently to accommodate the needs of medium-sized, growing firms. In practice, however, the major financial institutions have an incomparable number and variety of touch points with medium-sized firms in this range, including:

- ☑ Roynat (Bank of Nova Scotia) — long regarded as the pre-eminent financing source for medium-sized firms;
- ☑ CIBC Innovation Banking;
- ☑ Bank of Montreal (BMO) Technology & Innovation Banking;
- ☑ Banks that have backed the Canadian Business Growth Fund (CBGF); and
- ☑ Partnerships with existing debt capital providers (Royal Bank of Canada (RBC) and Espresso Capital).

Additionally, many private equity and growth equity funds come with long-standing banking relationships, including banks as limited partners (LPs, i.e., investors in funds), and include these banks in hybrid (equity and debt) deals, e.g., the recently announced Verafin financing that involved Information Venture Partners (RBC as an LP) and Wells Fargo bank (among the U.S. banks active in the mid-market space are Silicon Valley Bank, JP Morgan and Comerica). Also, Roynat has invested as an LP (\$5 million commitment) in venture capital funds-of-funds (Kensington Capital Partners) from which it derived a co-investment right, which it exercised by participating in an \$8 million growth deal with Kensington Capital Partners.

Hybrid debt-equity transactions or mezzanine financings are typical of growth equity deals in this range. In this regard, many market participants point to the proliferation of equity financings that they allege masquerade as debt deals. As well, deals involving several different types of debt, referred to as unitranche (combined subordinated, secured, second lien), are more rare but not totally uncommon, indicating that participants are often prepared to participate at various risk levels. For example, Vistara Capital Partners reported on one transaction in which CIBC Innovation Banking took a priority position in the company debt capital structure relative to its own; and yet another non-bank fund reported (with some surprise) on a deal in which CIBC Innovation Banking accepted a subordinate, or higher risk, position.

Finally, a very limited number of smaller private sector funds have expressed concerns about BDC's activities in this portion of the mid-market. According to them, BDC has recently been pushed into this area where there are already alternative players who are then at risk of getting squeezed out (given their own higher cost of capital and lack of deal flow from an established branch network). Tellingly, the Schedule 1 banks did not share these strongly negative views of BDC.

## 4.0 Perceptions of Canada's Growth Capital Financing and Alternative Risk Markets

The following examines shared and divergent perceptions concerning Canada's growth financing and alternative risk markets. A snapshot of elements of capital supply in Canada is presented in Annex 4.

### 4.1 General Perceptions

**Most capital suppliers were of the view that demand for capital among firms is elastic to the point of being virtually infinite and in no need of attention. As one respondent rhetorically asked, "Can you show me an entrepreneur who doesn't want more money?" This perspective drives various activities in the market, including outreach or awareness-building with company executives. Put differently, a common opinion is that growing awareness of the supply of capital will itself generate growing demand (a "build it and they will come" mentality); this attitude also informs the optimism around the next round of fundraising on the part of growth equity managers themselves.**

A second shared assumption held by capital providers is that company executives want to maintain control over their firms and are drawn to minority growth equity investments and, to the extent that company finances permit, cash flow- / revenue-based debt products. This belief is grounded in the view that entrepreneurs are often individuals who place a premium on being in control of their own working lives via ownership of their companies. Executives largely confirmed this perception as they often seek to time ceding ownership positions to maximize the growth potential of their firms, address stage-of-life (i.e., retirement or transition planning) considerations or address unforeseen adverse corporate developments (e.g., switching debt for minority equity positions in the midst of an economic downturn when meeting debt repayment requirements can become more onerous).

A third common perception of capital providers and companies alike is the view that certain industry sectors are highly favoured today, notably technology firms that reach \$5 million in annual revenues, while others are of less interest to investors and experience difficulty securing growth capital. Examples of the latter include natural resources, including oil and gas, hard rock mining and forestry companies, despite some indicators of apparently positive, above-average growth prospects.





**The presence of American investors is also the ever-present elephant in the room, which shapes opinions concerning Canadian growth financing markets, even though it is not always directly acknowledged. The United States serves as a point of disagreement among sector participants concerning many key issues:**

- ☑ The relative difficulty of raising capital in the United States versus Canada;
- ☑ The belief that higher company valuations accrue to Canadian firms with U.S. sales and offices;
- ☑ Perceptions that U.S. funds may value Canadian firms more highly than Canadian funds, which can be attributed to their generally greater size (as fund size tends to drive investment magnitudes), their extensive domain expertise (resulting in more knowledgeable pricing) and, importantly, their learned behaviour from having backed billion-dollar growth companies in their existing U.S. portfolios; and
- ☑ The benefit of many high-quality U.S. specialty funds (e.g., in the telecommunications sector and First Nations natural resources sector) that have deep domain expertise participating in the Canadian market.



## 4.2 Impact of American Investors

**Though the Canadian ecosystem has become more sophisticated over the past decade, there continues to be disagreement whether the domestic market is capable of scaling medium-sized growth firms and whether the presence of American institutions at the latest stages of funding represents a net benefit for the Canadian economy. The lack of consensus divides capital providers and company executives alike. Some note that in today's technology-driven world, Canada risks losing its future high-potential, job-creating and export-oriented champions. Certain investors remarked that any future economic downturn may result in U.S. funds prioritizing their own domestic investments over foreign investments as has occurred in the past. Others see the current pattern of U.S. fund investment into more-established and resilient companies as insulating these firms from a sudden withdrawal of that funding.**

Meanwhile, American funds have observed that the relative paucity of growth capital in Canada, compared with the United States, has had some positive effects, in particular a more disciplined approach to budgeting by Canadian companies. In general, Canadian firms are seen as having more modest capital-raising ambitions than their American counterparts and when they do secure capital they are more likely to stay on budget. One technology company executive concurred, remarking that Canadian companies, particularly those in more remote locations, tend to be more conservative when it comes to spending owing to the relatively uncertain funding environment in Canada. As he put it, "If you burn through cash in Silicon Valley, all you have to do is go next door to raise more money — which is not the case here in a smaller prairie city." Similarly, one U.S. fund remarked that Canadian entrepreneurs put a premium on non-dilutive financing owing to the relative lack of domestic financing alternatives.

That said, observers note that Canadian funding organizations have begun to replicate the "virtuous circle" phenomenon that is perceived in the United States as institutional success, international networks, and sector-specific expertise continue to reinforce one another, with Georgian Partners being an oft-cited example as a best-in-class Canadian investor. Additionally, following the evolution of U.S. funds, specialty funds have begun to emerge in Canada, including Make Space Capital Partners, which was founded in summer 2019 and invests in storage assets.

With this clear lack of consensus on whether the presence of large American investors is a net benefit to the Canadian economy, future research to examine the post-investment records of companies backed by various capital providers, focused on key indicators such as direct and indirect job creation, intellectual property development and export performance, could be pursued to develop a deeper understanding of the true impact of U.S. investment in Canada.

## 4.3 Regional Character of Investment

**There is a growing perception among Tier 1 capital providers, and some Tier 2 funds, that the Canadian and American markets function effectively as a single North American market. From this view, estimates about the size of this available capital market range from “hundreds of firms in North America that are able to write \$10 million to \$75 million cheques” to anywhere from 600 to 800 such funds with up to \$1.5 trillion in dry powder. The argument for a single North American market is not without precedent, as growth-oriented, medium-sized Canadian companies have looked to the United States for growth capital for decades, while Canadian funds increasingly deploy capital and personnel into the United States. For instance, one domestic growth equity fund has two thirds of investments in Canada and one third in the United States, a ratio it expects to maintain in a new fund that has just reached an oversubscribed final close.**

By comparison, however, company executives in Tier 2 and Tier 3 are less attuned to the idea of a single North American market as they mostly deal with domestic capital providers. They also note the difficulties and costs of cross-border operations, which range from foreign exchange risk to banking arrangements that need to be set up in both Canada and the United States even when dealing with a Schedule 1 bank that has operations in both countries, such as BMO and its mid-west U.S. subsidiary, Harris Bank.

There is consensus among all actors that the supply of growth capital in Canada today has improved considerably in recent years. Canadian growth equity funds are not seen as experiencing difficulty in raising new capital, while new participants have emerged, such as family offices, that have been recruiting talent from venture capital and private equity funds. Some respondents opined that the plethora of market participants and offerings argues in favour of enhanced entrepreneur literacy about the salient features of those offerings.

This perceived increase in the supply of growth capital is most evident in the main urban centres of Toronto, Vancouver and Montreal. Several respondents observed that remote regions may be disadvantaged from a number of perspectives — local ecosystems may not be sufficiently robust to support faster growing companies, including the paucity of financial personnel required and regular staff turnover, in addition to the dollar and time costs of getting to and from these regions.

There is consensus that the Quebec market is particularly well served. This is attributed to the abundance of government and quasi-government entities that are active within the province, led by the Caisse de dépôt et placement du Québec and Investissement Québec, and including the Fonds de solidarité, Desjardins Capital, Fondation CSN, National Bank of Canada and the Business Development Bank of Canada (which some respondents claim is double weighted in the province relative to Quebec’s economy). Observers point to the mandate of the Caisse de dépôt et placement du Québec as being critical here, along with provincial tax credit incentives for the other main participants (retail funds). It was noted that capital providers must be prepared to accept narrower margins (2–4 percent lower) for doing business in Quebec because of the highly competitive market. These narrower margins, together with investment restrictions, usually tied to maintaining a presence within the province, which come with government-affiliated funding sources, have led some private sector capital providers to underweight their own exposure to the Quebec market.



## 4.4 Business Executive Perceptions

**Company executives generally strive to balance multiple organizational, environmental and personal considerations when making corporate decisions, including when securing capital. The weight attached to these considerations can vary from executive to executive and include:**

- The relative merits and costs of non-dilutive debt versus equity, and the potential/risks of various hybrid products that have come to the market in recent years;
- The cost of capital, both upfront costs (due diligence / set-up fees / listing fees / distribution fees) and ongoing;
- The timeline horizons of specific types of capital, i.e., whether the executive is looking to develop a long-term, value-added relationship, which comes with an equity infusion, or to initiate a typically shorter term debt transaction;
- The ability of funders to attract follow-on capital (“if Sequoia has made an earlier investment but takes a pass on the next funding round, you’re toast”);
- The premium placed on deploying an outside capital infusion towards growth as opposed to the constraints imposed by interest/royalty repayment schedules — a number of debt providers have responded to these concerns by offering flexible repayment terms, including tying those payments to cash flows (with repayments thereby varying, depending upon cash flow ups and downs), not penalizing prepayments and allowing end-of-loan term, balloon payments; and
- Extracting liquidity from existing share-owning positions — outside financing from either private or public sources used as a method to pay out existing shareholders, whether they are internal (company executives, founders) or external (venture capital, private equity funds).





## 5.0 Conclusions

**Ambitious, medium-sized firms require access to affordable sources of growth capital to make the types of investments needed to become globally competitive leaders. Though Canadian policy-makers have developed a robust understanding of the financing challenges faced by growth firms at earlier stages of development, less is understood about how growth capital markets work to finance growth-oriented, medium-sized firms. Following a decade of considerable growth in the sector, corporate executives and capital suppliers have noted certain emerging trends important for policy-makers to understand, including:**

- ✔ The emergence of a relatively porous three-tier capital market structure in Canada to meet the unique needs of Canada's growth-oriented, medium-sized firms composed of both foreign and domestic sources of capital supply with Tier 1 capital dominated by foreign suppliers, which are less present at Tier 2 and are markedly absent from Tier 3.
- ✔ Rural companies confront several obstacles, ranging from distance to the absence of specialized finance personnel to reliance upon natural resources industries.
- ✔ Certain industries are fashionable capital magnets, while others, distinctly unfashionable, repel capital. Technology, broadly understood, is a capital magnet, as has been cannabis. Oil and gas, forestry and hard rock mining have been the reverse.
- ✔ A lack of consensus about the impact of U.S. capital in the market divides capital providers and company executives alike. Some refer to the current pattern of U.S. fund investment into more-established and resilient companies as insulating these firms from a sudden withdrawal of that funding. Others note that in today's technology-driven world, Canada risks losing its future high-potential, job-creating and export-oriented champions.
- ✔ It is impossible to determine one way or another whether the presence of large American investors is a net benefit to the Canadian economy. Resolution of this controversy would likely require an examination of the post-investment record, in terms of direct and indirect job creation, intellectual property development and export performance, of companies that have received foreign or domestic capital injections.
- ✔ Public capital markets partially compensate for the absence of foreign capital providers at Tiers 2 and 3. In the same vein, retail investors can and do participate in financing Tier 2 and 3 companies via private placements or labour-sponsored venture capital corporation tax credits (mostly in Quebec).
- ✔ Countrywide or province-wide "branch" networks, as exemplified by the big banks, BDC, CBGF, the Fonds régionaux de solidarité FTQ and Caisses Desjardins, appear to be important to Tier 2 and Tier 3 company fundraising efforts, especially for non-technology companies.
- ✔ A very limited number of smaller private sector funds have expressed concerns about BDC's activities among Tier 3 capital suppliers — with BDC increasing activity to address funding requirements in this area, they risk getting squeezed out.
- ✔ Certain investors remarked that any future economic downturn may result in U.S. funds prioritizing their own domestic investments over foreign investments as has occurred in the past. This, in turn, may result in a funding squeeze as Canadian domestic funds generally do not have the financial flexibility to meet these gaps as many companies in the technology space experience high rates of burning through capital.

# Annex 1: Interviewees

- + Alex Baluta – Flow Capital
- + Mark Borkowski – Mercantile Mergers & Acquisitions
- + Bryan Brulotte – MaxSys Staffing & Consulting
- + Richard Carleton – Canadian Securities Exchange
- + Peter Carrescia – Wave
- + Nishita Cummings – Kayne Anderson Capital Advisors
- + Brian Dawson – Rx Drug Mart
- + Michael Denny – Temperance Capital
- + Joe Galli – PENTOR Finance
- + Randy Garg – Vistara Capital Partners
- + Lauren Harris, Ian Carew – Northleaf Capital Partners
- + Tal Hayek – AcuityAds
- + Alkarim Jivraj – Espresso Capital
- + Alma Johns – Bench Capital Advisory
- + Brendan King – Vendasta
- + Hans Knapp – Yaletown Partners
- + Brian Koscak – Pinnacle Wealth Brokers
- + Marcus Kurschat – Clear Sky Capital
- + Richard Lam – Ontario Teachers’ Pension Plan
- + Barrie Laver – RBC Capital Partners
- + Dani Lipkin – Toronto Stock Exchange / TSX Venture Exchange
- + Mark McQueen – CIBC Innovation Banking
- + Steve Meehan – Glen Road Capital Partners
- + Kristi Miller – First West Capital
- + Jim Orlando – Wittington Investments (Weston Family Office)
- + Tom Park, Karen Kastner, Charles L’Espérance – Business Development Bank of Canada
- + Cato Pastoll – Lending Loop
- + Hossein Rahnama, Sheldon Levy – Flybits
- + George Rossolatos – Canadian Business Growth Fund
- + Adrian Schauer – AlayaCare
- + Dirk Schlimm – Geotab
- + Matt Tedford, Mark Brodtkin, David Rozin – Roynat
- + Paul Vallée – Pythian/Tehama
- + Mike Walkinshaw – TIMIA Capital

# Annex 2: Overview of Tiers 1–3 Capital Providers

## Tier 1

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Roughly 70 capital providers: 30–40 foreign, mainly U.S. funds and banks

- See Annex 3

3–5 Canadian public pension plan investment entities

- Caisse de dépôt, now joined by OTPP and OMERS

5–7 Canadian financial institutions (Schedule 1 banks, Caisses Desjardins)

- CIBC, BMO, RBC, Bank of Nova Scotia, Manulife Capital most frequently mentioned; TD less so

8–10 domestic funds

- Bridging Finance, Alaris Royalty, Crown Capital Partners, Fengate, Georgian Partners, Greypoint Capital, Inovia Capital, MidStar Capital, ONCAP

## Tier 2

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Roughly 40 capital providers, largely domestic

2–3 Crown corporations: BDC, Investissement Québec

5–8 foreign and domestic banks, credit unions and insurers

- Includes HSBC, Sun Life, Manulife Capital, Silicon Valley Bank, Comerica
- Domestic banks can have more than one arm operating in this general space — BMO Commercial Banking reportedly has \$600 million in committed capital, while BMO Technology & Innovation Banking was launched in April 2019; or Scotiabank Private Equity and Roynat.

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Canadian Business Growth Fund

Stock exchanges: TSX Venture Exchange (TSX-V) and Canadian Securities Exchange (CSE)

Retail funds

- Fonds de solidarité FTQ
- Fondation CSN

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20–25 independent funds/exempt market dealers

- Bond Capital • Bridging Finance • Champlain Financial • Crown Capital Partners • FirePower Capital • Fraser Mackenzie Merchant Capital • FrontFundr • GreenSoil Building Innovation Fund • Greypoint Capital • IBK Capital Corporation • Invico Capital • MidStar Capital • Persistence Capital Partners • PFM Capital • PowerOne Capital Markets • Quantius • RC Morris Capital Management • SeaFort Capital • Third Eye Capitalm • VERTU Capital • Walter Capital Partners

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Family offices (unknown number — very likely more than those below):

- Wittington Investments • Werklund Growth Fund



# Tier 3

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Roughly 30 capital providers, almost exclusively Canadian

Two private equity funds

- *Lynx Capital, plus one other according to sources*

Two stock exchanges:  
TSX-V, CSE

Credit unions

- *Vancity*
- *First West Capital*

Crown corporations

- *BDC*

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6–8 independent funds

- *Bond Capital* • *Espresso Capital* • *FirePower Capital* • *Fraser Mackenzie Merchant Capital* • *Indigenous Growth Fund (launched summer 2019)* • *Quantius* • *TIMIA Capital*

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10–12 exempt market dealers

- *Flow Capital* • *FrontFundr* • *Glen Road Capital Partners* • *IBK Capital Corporation* • *Invico Capital* • *Make Space Capital Partners* • *Pinnacle Wealth Brokers* • *Raintree Financial Solutions* • *Trez Capital* • *TriView Capital* • *WhiteHaven Securities*

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Family offices (likely more at this level also):

- *Clear North Capital* • *McCain Capital Partners* • *Hyatt Bangia* • *TGC Financial Group* • *Palomino Capital*

## Annex 3: U.S. Growth Funds Pursuing Deals in Canada

The following list was provided by a technology company executive whose firm was ultimately bought by a U.S. strategic investor:

- |                              |                                  |                              |
|------------------------------|----------------------------------|------------------------------|
| + Accel                      | + General Atlantic               | + Meritech Capital Partners  |
| + Acquiline Capital Partners | + Geodesic Capital               | + Napier Park Global Capital |
| + Adams Street Partners      | + Goldman Sachs Asset Management | + Providence Equity          |
| + Apax Partners              | + Great Hill Partners            | + Sageview Capital           |
| + Bain Capital               | + HGGC                           | + Summit Partners            |
| + Bregal Sagemount           | + Insight Partners               | + TA Associates              |
| + CapitalG                   | + IVP                            | + TPG Capital                |
| + Centerview Capital         | + KKR                            | + Warburg Pincus             |
| + Cove Hill Partners         | + Long Ridge Equity Partners     | + Wellington Management      |
| + FTV Capital                |                                  |                              |

In addition, research reveals a number of other foreign (mainly U.S.) funds that have made investments in Canadian medium-sized firms, including:

- |                        |                                   |                                 |
|------------------------|-----------------------------------|---------------------------------|
| + Amex Ventures        | + Indigena Capital                | + Mill Point Capital            |
| + Banco Santander      | + JMI Equity                      | + Technology Crossover Ventures |
| + Blumberg Capital     | + Kayne Anderson Capital Advisors | + Thoma Bravo                   |
| + Comporium Inc.       | + L Catterton                     |                                 |
| + Fidelity Investments |                                   |                                 |

## Annex 4: Snapshot of Elements of Capital Supply

→ Canadian Business Growth Fund (CBGF) has \$545 million of committed capital. It also has a target of raising a further \$455 million at some unspecified time. Fully matured at \$1 billion, it should be invested in approximately 100 companies. CBGF has made \$88.5 million in investments so far into eight firms and will be investing at a rate of about 10 companies per year. CBGF has said that it has already reviewed 300 “qualifying transactions.” On the basis of this considerable sample size, CBGF intends to build a robust data bank of medium-sized, growing firms in Canada.

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→ BDC’s Growth & Transition Capital portfolio is at \$1.1 billion and has grown by \$400 million over the past five years. It includes 650 clients. A substantial portion of this client base consists of repeat business.

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→ CIBC Innovation Banking has committed \$900 million to the sector over the next 18 months. It has made 75 financings over the past 50 weeks, but this includes U.S. business. It has an exceptionally broad investment size preference, although it has tended to invest in \$10 million parcels.

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→ Flow Capital has \$80 million in capital under management and has made 45 investments over five years, 50 percent in the United States.

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→ Georgian Partners is launching a \$1 billion fund (Georgian Partners Growth Fund V), while Inovia Capital has raised a \$400 million fund and Vistara Capital Partners has raised \$150 million. Yaletown Partners’ last fund raised \$130 million, 30 percent of which has been called to date, with Yaletown Partners expecting to start raising a new growth equity fund soon.

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→ Lines between various categories of private asset classes are getting blurred, with nominal values of later stage venture capital deals (Series C, Series D and above) at times eclipsing those of growth equity transactions. Similarly, and as noted previously, venture capital funds seem to be increasingly easing into growth equity territory. For instance, McRock Capital recently announced a first close of its new \$80 million fund, concerning which McRock stated that that fund would be targeting companies with annual revenues of U.S. \$5 million.

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→ TIMIA Capital has loan receivables of over \$21 million. It has made 25–30 deals over the past four years.

→ First West Capital (backed by a British Columbia credit union) has \$300 million, of which \$190 million in “dry powder” remains.

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→ Wittington Investments has \$100 million and will make investments of \$10 million per deal. A manager has recently been hired away from OMERS and will shortly begin to invest.

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→ Bridging Finance has \$1 billion in investments across a wide range of industries, although not in technology.

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→ Lynx Capital has a portfolio of 30 firms in Canada, 13 in the United States and four in the United Kingdom. It only buys firms with under \$2 million in earnings before interest, taxes, depreciation and amortization; will not chase after the highest-growth companies; and only takes majority shares. In so doing, it avoids the competitive auction process. It targets return on equity of 25 percent and claims that private equity returns have been declining (due to auctions) and now believes top quartile private equity returns are only 15 percent. BDC's Growth & Transition Capital advanced \$6 million in mezzanine financing to Lynx in 2019 towards acquisition of Alpine Shredders. Lynx has taken control of Temperance Capital, which, in turn, will now be devoting itself full time to raising capital (via the exempt market) for Lynx. One other smaller fund (with four portfolio companies) is in this space in Canada and one in the United States.

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→ Crown Capital Partners provides capital to a diversified group of successful mid-market companies that are seeking alternatives to banks and private equity funds. It has \$276.5 million in assets and has conducted 46 transactions since 2002.



## Annex 5: *About Richard Remillard*



Richard Remillard has unparalleled senior financial services expertise in the private, public and trade association sectors.

From 2003 to 2014, he was Executive Director of Canada's Venture Capital & Private Equity Association. He has also been a Vice-President of the Canadian Bankers Association, a Special Assistant to the federal Minister of Finance, a Public Affairs Manager with Bank of Montreal, a Director of MRS Trust (a subsidiary of Mackenzie Financial Corporation) and a lecturer at Concordia University.

Richard holds degrees from McGill University and the London School of Economics and Political Science, and has completed the Canadian Securities Institute course.