EXAMINATION OF THE RECOMMENDATIONS OF THE STUDY ON "THE AVAILABILITY OF RISK CAPITAL FOR TECHNOLOGICAL INNOVATION IN CANADA" (THE GRASLEY REPORT)

INDUSTRY BRANCH - MOSST

FEBRUARY, 1976

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Industry Branch

Ministry of State for
Science and Technology

February, 1976

Project I.P. 2/3

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INTRODUCTION

The Grasley Report was commissioned because of the Ministry's concern that technological innovation in Canada was inadequately financed. Grasley concluded that there is a lack of financial support, particularly equity financing, for technological innovation in new business situations (start-ups) and for existing small businesses in technological areas. He also concluded that invention in Canada was inadequately supported.

This follow-up study to the Grasley report was undertaken to assess the accuracy of Grasley's findings and to examine the practicability of implementing his recommendations. A subsidiary objective was to determine provincial plans in the area.

Interviews were conducted with middle to senior level officers in concerned Federal Departments (Finance, DREE, ITC, C&CA, NRC and PCO) and other federal agencies to gain their initial reactions to the report. Subsequently, interviews were carried out with concerned provincial government departments (Industry, Finance, and in some cases provincial development corporations) in the 10 Provinces. Senior representatives from a number of venture capital firms were also interviewed. It was stressed that it was informal reactions to the report which were being sought and not final positions.

Those interviewed were asked whether, in their opinion, the report had identified a real problem and whether the solutions proposed were desirable, feasible and workable. Two recommendations received the bulk of attention and are central to Grasley's report and this study. In order of importance, these are:

TECHNOLOGICAL INNOVATION: (SECOND RECOMMENDATION OF GRASLEY)

A special corporate designation should be created under the Income Tax Act, namely an "eligible venture investment", (EVI), in order to attract high-risk investment funds to small business and start-ups. Investments in an EVI would become deductible against other income, for income tax purposes.

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INVENTION: (FIRST RECOMMENDATION OF GRASLEY)

> *An organization to be called "Innovation Canada" should be formed, to provide financial support, encouragement and guidance to inventors/innovators, in order to bring new concepts to the stage where they may be licensed to industry or entreprencurs so their commercial possibilities may be exploited.*

This study concentrates on these two central recommendations and concludes that it is desirable to provide the type of support recommended for technological innovation and invention. It is not feasible to implement the recommendations in their present form, but it may be feasible to implement alternative measures with a view to achieving the same goals. This study sets out such alternatives.

The Grasley report contains sixteen recommendations in addition to the two discussed in the body of this report. Comments and suggestions for action on these other recommendations may be found in Appendix I to this study.

TECHNOLOGICAL INNOVATION

Survey Findings

The consensus of those interviewed in the Provincial Governments and in the Private Sector is that Grasley has identified a real problem: there is an inadequate supply of equity financing or risk capital for start-up situations and existing enterprises with a technological orientation.

Most of those interviewed felt that the focus of the Grasley Report was too narrow in two respects. Firstly, the report focussed sharply on financial matters and ignored to a degree other important elements of the problem such as inadequate business and managerial skills and small domestic market size. Secondly, it was felt that the financial and other problems existed for all small businesses and were not unique to technological innovation. In addition, provincial representatives thought that the report did not adequately reflect different regional needs: what was appropriate for central Canada was not necessarily appropriate for the Maritimes, Prairies or B.C.

Most private sector representatives and several provincial officers said that the lack of a clear commitment by Governments at all levels to innovation in Canada was a major barrier to industrial development. In particular the lack of clearly defined, major projects which would create a demand for technological products and services was identified as a serious impediment. In addition, the lack of a clear "buy Canada" policy, possibly with a "small business set aside", was roundly criticized by all those interviewed. Procurement generally was seen as a potentially strong but underutilized stimulant to indigenous technological innovation.

While the consensus reflected that the barriers to technological innovation were not only financial, a majority nevertheless supported the sort of tax recommendations made by Grasley, particularly recommendation number 2 of the report.

Federal Government reactions to Grasley's proposals were mixed. The Department of Industry, Trade and Commerce supported most of the recommendations. The Department of Finance, however, is reluctant to use the tax system to achieve such specific ends as those identified in the Grasley Report. Finance suggested that mechanisms such as grants directed to the areas of need would be a better approach to use to support technological innovation. The regional DREE and ITC officers interviewed were universally agreed that there was a problem in the supply of venture capital and that implementation of Grasley's major tax recommendations would improve the situation Most of those interviewed also thought that the problem of equity financing extended to all small business and that there were other impediments (previously mentioned) as well.

Provincial Plans

A combination of electoral changes in provincial governments and personnel and organizational changes at the official level made it difficult to develop an appreciation for provincial plans. Five provinces seem to have done considerable staff work related to the financial and management weaknesses in small business. Of those five, three - Alberta, Ontario and Quebec - have officially published statements of their interest in establishing special investment vehicles to serve the needs of small business. Only in Quebec are these intentions firmly embedded in a process leading to enabling legislation. In Quebec it is expected that such legislation will be passed by September 1976, although regulations have not yet been drawn and that process will be lengthy.

None of the provincial plans call for an emphasis on technological innovation, but rather, are directed to all small business, defined in various ways.

In general, current plans involve the creation of provincially oriented Investment Corporations with various preferential tax treatments for inflowing investment from the private sector. The plans differ from Grasley's proposals in that they would not permit direct investment in small businesses as proposed by Grasley, but would require that investments be made in intermediary corporations, which would then invest in small business. With the exception of Quebec which collects its own personal income taxes the provincial proposals would apply only to corporate investors. All provinces would like the Federal Tax System to be used in concert with their schemes.

Implementation of Support for Technological Innovation (Recommendation 2)

While those interviewed generally were of the opinion that Tax Incentives for investment in technological innovation would be helpful, a number of issues must be considered before making a decision to implement tax recommendations.

The advantage in using the tax system to induce a flow of funds into a particular area of endeavour is that it leaves the private decision-maker free to make his own investment decisions, and provides him with an incentive to do so.

There is reluctance on the part of Federal and Provincial Finance departments to consider changes to the existing tax system. Reluctance to introduce new tax measures is based, in part at least, on the view that the tax system should be as neutral as possible and that the use of the tax system should be as neutral as possible and that the use of the tax system to achieve specific narrowly defined goals is generally inefficient because of definition problems, which leads to abuse. Of course, the tax system is not neutral. Recent changes to the tax system include the creation of RRSP's, RHOSP's, the allowance of 100% write-offs on investments in Canadian films, and an host of other particular measures which have been adopted because of the specific needs. Historically the tax system has been designed to encourage the exploitation of natural resources. While this may have been appropriate at one time, current Canadian economic and social development goals suggest that consideration should be given to designing the incentive system more to favour the exploitation of knowledge based activities.

The use of the tax system to attain policy goals not directly related to tax collection can lead to inefficiency unless the objectives are very specifically and unambiguously defined. It is not possible to define technological innovation narrowly, and this suggests that the tax system, at least in its conventional application, would not be the most appropriate vehicle to stimulate technological innovation. If, however, a system were devised which would permit the identification of specific desirable investments before tax concessions were made, the force of this argument against using the tax system would be considerably reduced.

It is often proposed that grants should be used to achieve specific objectives. While there is probably a place for grants in support of industrial development, grants involve bureaucrats directly in the investment decision-making process. There are few incentives for bureaucrats to take risks and a major advantage of a tax incentive is that it leaves the private sector free to make its own business decisions, to allocate its own resources, and at the same time, provides to the investor the incentive of returns.

Another issue which should be considered, is the recurring view of those interviewed that financing difficulties exist for all small businesses, and not only for technological innovation. To a degree this view must be modified as a consequence of recent developments. The emergence in many provinces of development programs geared to small business as well as new FBDB initiatives in the area of equity financing together contribute substantially to the financing needs of small business. There is, however, no evidence to suggest that there is any particular concern for financing technological innovation in any of these organizations. Furthermore, only rarely did those in the venture capital industry show an inclination to sponsor technologically oriented firms. Any creative activity has unusual amounts of risk associated with it and this is especially true in the case of technological innovation. It would seem reasonable to design a support mechanism specifically for technological innovation which takes account of the unusually high risks inherent in the process, risks which the more conventional sources of funds avoid. On balance it is concluded that, while all small businesses may have financing difficulties, the problems facing the technological innovator are relatively greater.

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A further issue of substantial importance when evaluating Grasley's broad based tax incentives, is the pronounced provincial differences in skill levels and in natural strengths which lead to different provincial needs for technological development. The problem then becomes one of designing a flexible approach to providing incentives which will be responsive to varying regional needs.

Despite these issues, or constraints, it seems possible to formulate tax measures which can in fact be used to induce a flow of funds into technological start-ups and other technologically based enterprises. To ensure a responsiveness to provincial concerns one might envisage the creation of screening boards consisting of DREE, provincial representatives and possibly local entrepreneurs to review business proposals. If the proposals were consistant with provincial development needs, the board would certify that investments in the venture could be written off against personal or corporate income tax. Certification would only occur if the proposals had an adequate technological content. The determination of adequate technological content would be the final responsibility of ITC, which could veto any decision made by the board if the technological content were not within broad national guidelines. This proposal should meet provincial needs, and at the same time, satisfy Departments of Finance that the tax incentive would not be abused. While it would involve bureaucrats in the screening procedure, actual investment decisions would be made by the private sector.

While Grasley suggested that only new and existing small businesses in technological areas should be eligible venture investments, many of those interviewed suggested that medium sized firms in technological areas were also inadequately financed. The selective procedure proposed here should not be constrained by firm size.

There are a number of technical and administrative problems in this proposal which would have to be examined by Finance, DREE, ITC and the Provinces.

INVENTION

Survey Findings

All those interviewed considered that there was inadequate support for inventors in Canada, but there was substantial resistance to establishing another bureaucracy - the proposed "Innovation Canada" - to meet the inventor's needs. There was a consensus, however, that the functions of an "Innovation Canada" needed to be performed, and that the proposal should be investigated further. The Department of C&CA felt that at most a small pilot operation with well defined performance indicators should be undertaken.

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Part of Grasley's proposal for Innovation Canada was that the possibility of joint private/public sector funding be examined. A senior financial officer of a major life insurance company was interviewed to glean his reaction to this proposal. He demonstrated some interest, but only on the basis of responding to a concrete proposal (which does not exist). He thought that other institutions might also be interested, but time constraints on this phase of the study precluded exploration with other possible corporate participants. Two of DREE's regional offices indicated an interest in jointly funding with their Provinces pilot operations to provide support to inventors.

Provincial Plans

Quebec has experimented with "Invention Quebec", funded by a LIP grant. The results were equivocal, and the project was halted when the LIP grant expired. Quebec has vague plans to develop another inventor support mechanism, involving Government and Industry but no details are available. Newfoundland also has a general proposal to provide assistance to inventors, but once again it is somewhat vague and probably will not be implemented. No other provinces were found to have definite plans in this area, although they all recognized that a need existed.

Implementation of Support for Invention (Recommendation 1)

Most provinces have a Provincial Research Institute; all have universities. It is suggested that universities and Research Institutes, hopefully with local industry participation, could establish provincial or regional inventor support systems. At the same time, the terms of reference of Canadian Patent Development Limited in Ottawa could be expanded to provide a national focus for inventor support. Canadian Patent Development Limited might also service the needs of the various regional centres.

It is not suggested that formal inventor support be established immediately in every province, but rather that three or four pilot operations might be established. The objectives of the pilot operations would be the same, but their design could be different. It is unlikely that "one best way" of providing support to inventors will be found, and it may be useful to have several different processes in operation.

Before setting up pilot operations it would be useful to study the experience of other countries which have been active in this area. France, Sweden and the U.K. come to mind. Quebec's experience with Invention Quebec should also be examined. When concrete proposals for inventor support are being examined, consideration should be given to involving the private sector as users, as direct supporters of inventors and as a source of funds. (One large firm encountered in this study has a resident inventor. The firm pays him a nominal salary, privides support services and facilities, and lets him work as he pleases.)

It is suggested that MOSST pursue further with DREE the possibility of establishing regional inventor support pilot operations. This approach could be adopted virtually immediately, on a low profile, with no federal organizational change required. At the same time, the role of CPDL should be examined in terms of providing support to whatever regional centres might be created.

CONCLUSIONS

In this study the desirability and feasibility of implementing the central recommendations of the Grasley Report have been examined. Based on interviews with concerned Federal Government Departments, Provincial Government Departments, and Venture Capitalists, it seems desirable to provide financial support for technological innovation and to provide support for invention. However, it does not appear feasible to implement the recommendations in their present form. Instead, variations on their themes are proposed.

For Technological Innovation a procedure of selective percentification for tax purposes of investments in technological start-ups and other technological enterprises could be established. The administrative focus for the procedure should be provincial. Screening and certifying Boards comprised of DREE and provincial government representatives should be established. IT&C should be represented on the Board specifically to ensure that the technological content of proposals is within broad national guidelines for technological development. IT&C's representative should have veto power over decisions made by the Board.

This recommendation should be discussed with the Federal Department of Finance, with DREE and IT&C, in order to develop concrete principles of operation.

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Once the principles and guidelines are established federally, DREE, with the support of ITC should provide the focus for discussion with the provinces to arrive at a final set of procedures acceptable to all parties. The proposals should then be incorporated into law by the normal procedures.

For Invention pilot operations to support inventors could be established in three or four provinces. MOSST should continue discussions with DREE, which has shown an initial interest in funding such pilot operations, in order to stimulate further their interest and that of the provinces. The experience of France, the U.K. and Sweden in supporting inventors should be examined for its relevancy to the design of pilot operations in Canada.

The role of CPDL in support of the proposed pilot operations should be studied. Consideration should also be given to using CPDL as the focus for a pilot operation.

Certain other of the recommendations in the report deserve further consideration before they are adopted or rejected. Comments on the other Grasley Report Recommendations may be found in Appendix I to this study.

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APPENDIX I

NOTES ON GRASLEY REPORT RECOMMENDATIONS 3-18

Recommendations 1 and 2 of the report have been dealt with in the body of this study.

RECOMMENDATION 3:

A special status corporation should be introduced into the Income Tax Act, to be designated "Special Venture Capital Company" to attract tax-exempt funds into higher-risk investments.

Those interviewed mildly supported this recommendation which would provide a conduit through which presently tax exempt funds could flow into venture capital companies, which would in turn invest in ventures. The earnings of the ventures themselves would be taxed in the normal way, but returns to the pension fund shareholders from the Venture Capital Company itself would be taxed according to the status of the shareholder - i.e. would be tax free.

There are a number of technical difficulties in implementing this recommendation. It is unlikely that the restriction of Special Venture Capital Company investments to technological areas exclusively would result in much activity. If, however, there were no criteria limiting the field of investment, the recommendation could have positive effects for the supply of funds to the venture capital industry. Further development of this proposal should be turned over to other interested departments. It should be noted that in the course of this study only one individual who actually administered pension funds was interviewed. This is obviously an inadequate investigation.

Further Action

MOSST should recommend to Industry, Trade and Commerce and/or Finance that this recommendation be examined further from a technical viewpoint and through discussions with pension funds and venture capital firms.

RECOMMENDATION 4:

The proposed Federal Business Development Bank should be urged to formulate a policy of funding and assisting in the development of business plans on behalf of Canadian Entrepreneurs.

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All those interviewed were of the opinion that entrepreneurs - technological or otherwise - needed assistance in the preparation of business plans. FBDB will provide planning assistance of many kinds to entrepreneurs through its management services operation, which now incorporates the CASE program (Counselling Assistance for Small Enterprises).

Further Action

This matter should be continuously monitored by the Interdepartmental Committee on Small Businesses, and changes made as indicated.

Additional Note on the Role of the Federal Business Development Bank (FBDB) in Equity Financing

The FBDB has a sincere commitment to provide equity finance to small and medium size firms. The Bank has embarked on a series of training programs for its loan officers with the intention of sensitizing them to situations in which equity financing is indicated. Potential equity situations will be referred to the Bank's regional offices which contain or will contain officers specializing in equity situations.

The program has not been underway for any length of time, and it is neither possible nor fair to judge the results at this stage. Nevertheless, many of those interviewed, in both the private sector and the provincial governments, were dubious about the Bank's ability to convert itself from a traditional bankers role to that of a venture capitalist. It may be that the Bank's entry into equity finance will stimulate competition for conventional risks, and these results would be generally welcome. There was scepticism, however, that the Bank would, could, or should ever become specifically oriented to technological innovation.

One of the problems with building a venture capital business within a bureaucracy is that there are few incentives for bureaucrats to take risks. Many of the venture capitalists who were interviewed continually emphasized the high degree of involvement with the businesses they fund which they find it necessary to have if the businesses are to be successful. The incentive to the Venture Capitalist is significant: if the business is successful, he stands personnally to make a large capital gain; if it fails, he stands to lose his own and others' money. Unless this sort of personal risk/reward situation exists within the FBDB it is doubtful that the program will be successful.

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These thoughts lead to two suggestions:

1) The FBDB could establish a separate Venture Capital operation, removed from the normal structure of the Bank.

2) The FBDB could consider involving itself in Venture Capital indirectly, by taking equity positions in Venture Capital companies themselves.

The venture capital function of the FBDB should be closely monitored by the Board of Directors (of which MOSST's Secretary is a member) and by the Small Business Interdepartmental Committee, chaired by ITC, of which MOSST is also a member. Consideration could be given to both alternatives mentioned above.

RECOMMENDATION 5:

A common entry point or information agency should be established that is easily accessible to all Canadian businessmen, providing up-to-date comprehensive information on all Federal Grant and Assistance Programmes. In particular, the agency should assist small businessmen in the preparation of submissions.

Those interviewed agreed that this function should be provided. In fact, the Federal Business Development Bank (FBDB) has set up an information service to meet this need. By the end of 1976 there should be approximately fifty officers in the field providing this service. There are current budgetary constraints on the FBDB which preclude expansion of the service to all FBDB branches.

Further Action

No further action is required at this time. The progress of the FBDB is being monitored by the Bank itself by ITC and by the Interdepartmental Committee on Small Business, and programs will be adjusted as required.

RECOMMENDATION 6:

The entire spectrum of Federal assistance to industry should be studied to determine where programmes overlap or conflict exists. Federal assistance programmes should be reviewed for conformity with existing industrial strategies and coordinated with Provincial programmes.

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All those interviewed agreed with this recommendation. They felt that access to existing programs was too difficult, lengthy and costly for small firms. Some of those interviewed were pleased with the recent decentralization of the PAIT program. They wanted all programs simplified and more oriented to small firms.

Further Action

The programs are presently under review by MOSST, by ITC and by a consultant to ITC. The results of these reviews should reflect the needs of small business more than at present. No further action is required.

RECOMMENDATION 7:

The Small Business Loans Act should be immediately revised to allow 1) loans for working capital purposes, and 2) establishment of a floating interest rate based on points above Canadian chartered banks' prime rate.

This recommendation was generally supported by those interviewed. Its scope is far greater than technological innovation, however, and it would be more appropriate to consider the recommendation in another forum, perhaps the Interdepartmental Committee on Small Business, chaired by ITC.

In the context of technological innovation, consideration should be given to providing funds and debt financing at or below market rates to selected corporations involved in technological innovation. This could be accomplished directly through the FBDB or indirectly by employing loan guarantees.

Further Action

This matter should be referred to the Interdepartmental Committee for Small Business for further consideration. MOSST, ITC and Finance should consider the need for mechanisms to facilitate the provision of debt financing to firms in technological areas.

RECOMMENDATION 8:

Life insurance and certificate savings companies should be permitted, encouraged, and possibly obliged to invest a small portion of their reserve requirements in higher-risk areas.

There was very little support for this recommendation, particularly the "obligatory" part of it. Life insurance companies do in fact have a "basket clause" under which they may make venture type investments. In fact the utilization of the clause is only at half the level permitted. Regulation might be used to encourage more "basket clause" investments by stipulating that individual firms would lose their right to the "basket clause" if investments under the clause were less than some arbitrary percentage of the maximum, perhaps 75%, over a number of years.

Further Action

Further consideration of this recommendation should be deferred for the present, and perhaps considered again in the broader context of an overall review of capital markets. MOSST should have the opportunity of considering the issue again at that time.

RECOMMENDATION 9:

Canadian chartered banks should be allowed to hold controlling share positions in separately incorporated venture capital companies.

Many of those in the Provinces and in the Private Sector were dubious that the banks would be particularly effective venture capitalists even if they were given a broader mandate. There was also a feeling that there was already too much power in the banks' hands, and that this would be an unnecessary expansion.

A number of those interviewed felt that increased competition by financial sources would solve many of the problems in financing small business. One of the main advantages of this recommendation for the venture capital arms of banks would be the removal of the venture capital function from the lending atmosphere which pervades the banks.

On balance this recommendation could increase competition and the supply of funds available for small business.

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Further Action

MOSST should convey to the Department of Finance the view that the banks should not be constrained from entering the venture capital business. (The Bank Act will next be revised in July, 1977.)

RECOMMENDATION 10:

The current preferential corporate tax rate to manufacturers and processors should be continued.

RECOMMENDATION 11:

The present rapid write-off of capital expenditures on fixed assets (capital cost allowance) used in the manufacture and processing of goods should be maintained.

All those interviewed agreed with both recommendations 10 and 11 which are in force at present.

Further Action

No action is required.

RECOMMENDATION 12:

In order to promote invention, the definition "Scientific Research" under the Income Tax Act should be interpreted to allow more generous deductions against the ordinary income of individuals of the expenses incurred related to inventive activity.

Those interviewed were in favour of this recommendation. At a minimum it was felt that inventors should be permitted to write-off against other income charges directly associated with the patent process. Insofar as a more liberal treatment of other costs is concerned, Revenue Canada presently treats matters on a case by case basis, and this should continue.

Further Action

MOSST should discuss this recommendation further with the Department of Finance and Revenue Canada - Taxation.

RECOMMENDATION 13:

Tax treatment of stock option benefits in the hands of employees should be amended so as to provide an incentive to entrepreneurs and their key employees.

Private sector representatives and a minority of provincial officials felt that there was some merit in considering this recommendation further. It was felt that it would be very difficult to limit this form of incentive to specific companies. Given that equity participation can relieve cash flow difficulties in smaller firms, and at the same time provide a performance incentive, the matter could be reconsidered. MOSST is not the appropriate vehicle for pursuing the matter.

Further Action

This issue should be considered by the Interdepartmental Committee on Small Business.

RECOMMENDATION 14:

The five year limitation on the carry-forward of non-capital los.es should be removed and replaced with an indefinite carry-forward for companies that qualify as small businesses under the Income Tax Act.

All those interviewed were of the opinion that this recommendation should be adopted and applied to all business. However, one tax specialist who was interviewed stated that he knew of very few cases in which non-capital loss credits had been lost due to the existance of the five year limitation.

At present, under the income tax act firms engaged in R&D may carry forward indefinitely these expenditures and deduct them from earnings whenever they occur. This new provision may provide adequate relief to technologically involved firms.

Further Action

The effect of the R&D expense carry-forward should be monitored by MOSST, ITC and Finance and, if necessary, the non-capital loss carry-forward should be extended.

RECOMMENDATION 15:

Venture capital companies should be accorded capital gains treatment on their venture investments.

The venture capitalists felt that this recommendation was of prime importance to the survival of their industry. They are concerned that Revenue Canada - Taxation will judge that venture capital companies are in the business of making investments and that therefore gains will be taxed as income rather than as capital gains. This would have a negative effect on the industry, perhaps leading to its demise.

The venture capital industry is important to Canada, and it would be unfortunate if the industry were forced out of existence by an adverse ruling. Revenue Canada - Taxation should continue dealing with venture capital companies on a case by case basis, as at present, but with the view that, except in unusual cases, gains upon divestiture should be treated as capital gains and not as income.

It would be useful to have some form of written guidelines to reduce uncertainty in the industry. This whole area of tax law is vague and ambiguous, perhaps by design, so that the spirit of the law may be applied in individual cases.

Further Action

MOSST should refer this matter to the Interdepartmental Committee on Small Business with a view to asking the Department of Finance and Revenue Canada - Taxation to explore the possibility of designing regulations or guidelines which would make the tax environment less uncertain for venture capital companies.

Additional Note on Canadian Venture Capital Industry

Very few of those interviewed were interested in financing either start-up situations generally or technological innovation. Many of those interviewed were of the opinion that the proposals with the highest probability of success were those involving firms which had an established track record, ie. those which had established strengths as going concerns. Nevertheless, a few of the venture capitalists stated that the very best chance of success existed in situations in which they became involved with a business concept at the earliest stage. These venture capitalists felt that in those situations they could bring the full force of their experience to bear on the growth of the enterprise.

All the venture capitalists interviewed noted that it was very difficult for their industry to raise new money. This was attributable in part to problems surrounding divestiture. The very poor state of the stock market precluded divestiture through public offerings of stock and the establishment of FIRA has dried up the traditionally most important source of funds for divestiture situations.

On a more general level, many of the companies formally identified with the Venture Capital Industry were inactive. Many of the companies suggested that because of the difficult financial climate they might well become operating companies along the lines of mini-conglomonates., Overall, one is lead to conclude that while the existing venture capital industry is amking a useful contribution, under present circumstances, it should not be thought of as an adequate source of venture capital for Canada.

Several venture capitalists expressed their support for the formation in Canada of corporations analagous to the Small Business Investment Croporations (SBIC's) which exist in the United States. In these corporations the government provides substantial low interest loans to private pools of capital which have been specially incorporated to invest in small business. The SBIC's experience when they were first established was very poor. Recent discussions with the SBIC administrators suggest that recent experience has improved. The improvement is attributable to an increased investment experience of the surviving SBIC's and to new regulations regarding minimum critical scale. Most of those interviewed in the Public Sector (Provincial and Federal) were still under the impression that the SBIC concept had failed. The improvement in the SBIC suggests that it would be worthwhile for Canada to examine the concept again, benefitting from the U.S. experience.

Further Action

It is suggested that the Interdepartmental Committee on Small Business review the concept of the SBIC in the light of recent experience, to determine whether the concept or a variation could be usefully implemented in Canada.

RECOMMENDATION 16:

Educational Programmes for entrepreneurs should be established to teach the basic elements of starting a new enterprise.

Most provincial representatives felt that this recommendation was useful. Most private sector individuals felt that such training would be of limited value. In fact the Federal Business Development Bank, ITC and a number of universities are providing courses along the lines suggested, although the content of such courses may be more applicable to on-going businesses than to formation of new ventures.

In the United States there are a number of entrepreneurial training programs, several of which concentrate on screening entrepreneurs as well as teaching them. In the course of the study it was learned that International Nickel plans to sponsor an entrepreneurial screening/growing/teaching program in Canada, the assumption being that their involvement with entrepreneurs at an early stage is the best guarantee of success. This program will be implemented by a firm from the United States which specializes in these programs.

Further Action

MOSST should suggest to ITC that the Interdepartmental Committee consider this recommendation, and perhaps commission a study to determine the experience of other countries, particularly the United States and France. The Inco experiment should be monitored as well.

RECOMMENDATION 17:

Means should be provided to ensure that patentable concepts discovered in the course of university research should be made available to Canadian entrepreneurs for commercial development.

Those interviewed agreed in principle with this recommendation. In fact, Canadian Patents and Development Limited fills this function at present.

Further Action

No action is required. The Innovation Canada concept, if adopted, should fill any gaps in the existing process.

RECOMMENDATION 18:

A system of annual awards should be established for Canadian inventors.

Reactions to this proposal were mixed from both the Private and Public Sectors. In fact, the Department of Consumer and Corporate Affairs is considering a system of inventor rewards but has put the matter in abeyance because of financial constraints. The issue will re-emerge in FY 1976/77.

Further Action

A system of annual awards for inventors should be implemented in order to add prestige to this creative function. MOSST should continue to work with Consumer and Corporate Affairs as required.

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