



Innovation, Science and  
Economic Development Canada

Innovation, Sciences et  
Développement économique Canada

# Designing the renewed Venture Capital Catalyst Initiative

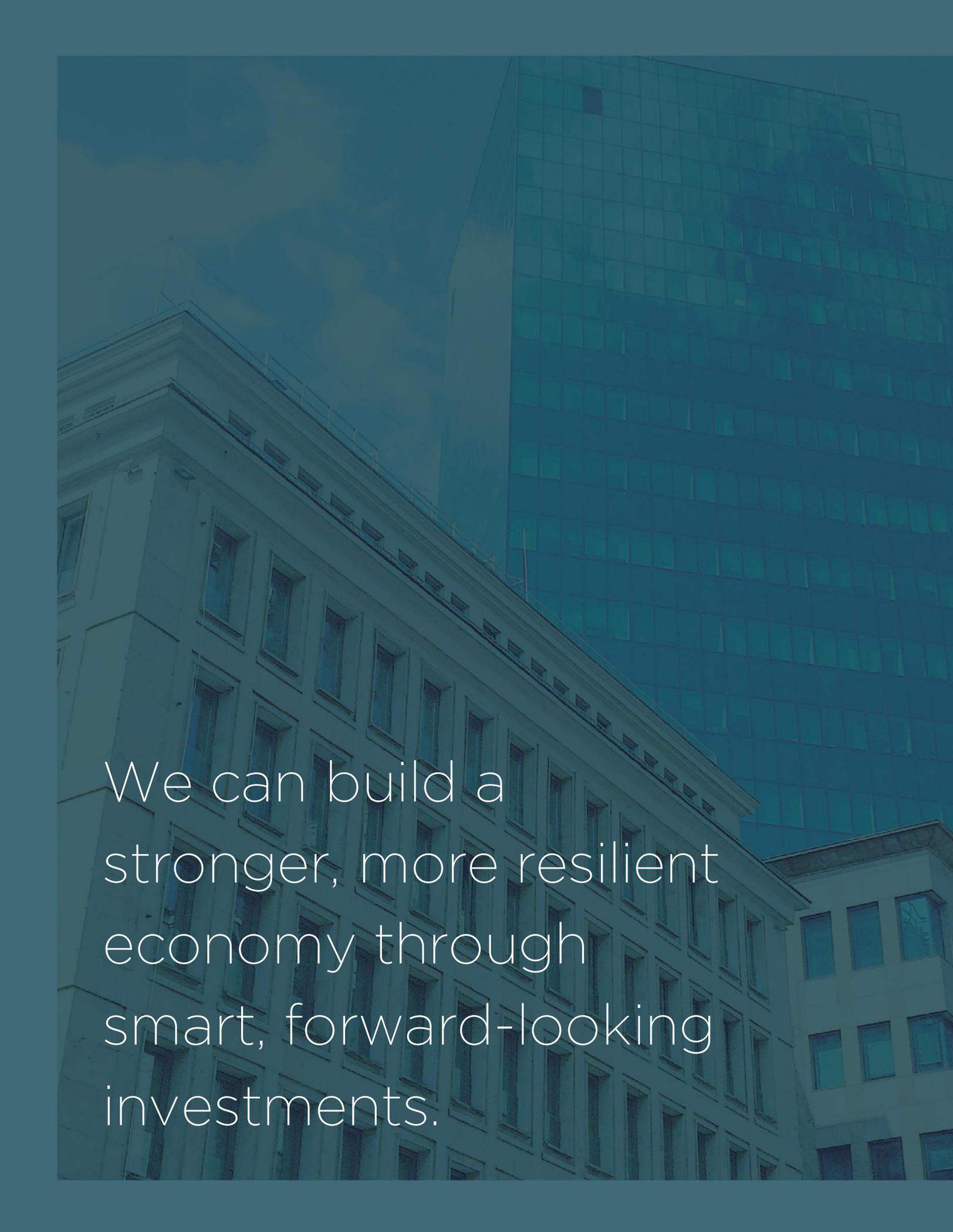
*Discussion Paper*

2021

Canada

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We can build a  
stronger, more resilient  
economy through  
smart, forward-looking  
investments.

# Introduction

As we emerge from the COVID-19 crisis, a priority of the Government is to put Canada's economy on a stronger footing, both for Canadians today and for future generations. We can build this stronger, more resilient economy through smart, forward-looking investments. In an era of fast and profound change, Canadians need to be adaptable and resilient to spot the opportunities to create jobs, drive growth across all industries and improve lives. Innovation is the path to inclusive growth. It fosters a thriving middle class and opens the country to new economic, social and environmental possibilities.

Access to capital is a vital component in supporting innovation and growing Canada's high-potential, innovative companies. Venture capital (VC) is a specialized type of equity financing that takes educated risks on great ideas and talented people by investing capital in high-growth potential companies to develop their ideas into marketable products, and scale their operations to reach a greater market (domestic and international). In addition to capital, VC investors bring operational experience, technical knowledge, networks and mentorship to the firms in which they invest.

Because of the funding and expertise it provides, a strong and steady stream of VC is an essential element in the success of many of Canada's potential future technology leaders.

Firms that are supported by large amounts of VC investment can realize significant growth and reach international scale, positioning them to be Canada's next billion-dollar anchor companies. Moreover, research shows that VC-backed firms, when compared to other non-VC-backed firms, achieve superior growth in sales and employment. VC-backed firms also post higher wage growth, suggesting that they employ highly qualified talent. Finally, these firms tend to have higher research and development expenditure growth, suggesting that VC supports innovative firms.

Many of Canada's most promising technology companies reaching international scale relied on venture capital financing. Large (\$100 million or more), late-stage venture capital rounds are crucial to achieving scale (Levy, 2019). Ensuring the availability of capital through multiple investment rounds across business stage is imperative for innovative companies aspiring to scale into large successful businesses, including those in traditionally capital-intensive sectors such as clean technologies and life sciences.

Announced in Budget 2021, the Government of Canada will make available up to \$450 million for a renewed Venture Capital Catalyst Initiative (VCCI). Building on the momentum of the previous investments from the Government of Canada, this new commitment will help increase the availability of capital for Canada's high-potential innovative firms, including those in the life sciences sector and for entrepreneurs from underrepresented groups, such as women and racialized communities. In particular, investments by the funds-of-funds stream under the renewed VCCI will continue the government's efforts in helping scale companies and enabling venture capital investors to increase support for the late stage growth of VC-backed businesses. As with previous programs, the renewed VCCI will be administered through the Business Development Bank of Canada (BDC) and will make investments directly in VC funds.



Announced in Budget 2021, the Government of Canada will make available up to \$450 million for a renewed Venture Capital Catalyst Initiative (VCCI).

# Objectives of this discussion paper

On behalf of the Minister of Small Business, Export Promotion and International Trade, with support from the BDC, the Department of Innovation, Science and Economic Development Canada (ISED) is seeking advice from industry leaders, family offices and other investors, VC-backed entrepreneurs, and subject matter experts to inform the development of the renewed VCCI program design.

This Discussion Paper is designed to guide discussions and submissions on the design and implementation of the renewed VCCI. In particular:

- ✔ It seeks comments on proposed parameters that could be rolled out through a funds-of-funds model, that build on the momentum of prior programs as the industry drives toward increasing private sector participation and predictability;
- ✔ It seeks comments on proposed parameters and concepts for venture fund models consistent with the VCCI objectives to provide dedicated support to VC investments in life sciences technologies;
- ✔ It invites submissions of concepts and parameters for implementation models that could be used to meet VCCI's objectives through a new Inclusive Growth Stream to increase access to VC for underrepresented groups of VC fund managers and entrepreneurs, such as women and racialized communities; and,
- ✔ It invites comments from VC-backed entrepreneurs on how the renewed VCCI can further develop the pool of VC fund managers that can add value and support companies in scaling up, attracting capital to grow, and reaching global customers.

# Background

## *Previous VC programming*

A healthy venture capital network allows businesses and entrepreneurs to scale up, create well-paying Canadian jobs, invest in innovation, and be globally competitive. Previously, the Government deployed \$390 million through the Venture Capital Action Plan (VCAP) and made available up to \$450 million through the first VCCI. These federal investments have helped provide a total of over \$3 billion to grow Canadian companies and support thousands of middle class jobs.

Launched in January 2013, VCAP invested \$340 million in four funds-of-funds and \$50 million in four existing high-performing funds. The funds-of-funds managers leveraged this federal commitment with additional funds from provincial governments and private-sector investors. In total, the four funds-of-funds raised over \$1.35 billion in capital, many of which invested in Canadian VC for the first time. Early indications are showing that the VCAP has had a positive impact on the ecosystem. As of December 31, 2019, over \$1.1 billion had been committed by the funds-of-funds, including \$937 million to 30 Canadian-based VC funds. Additionally, nearly 350 high-potential Canadian companies have received funding to grow and scale their operations.

Continuing with this momentum, the previous VCCI was launched in December 2017 and invested capital through three streams: nearly \$280 million in four national funds-of-funds; \$42.5 million in five VC funds through a diverse stream supporting new models, emerging managers, and underrepresented regions; and \$50 million to three VC funds investing primarily in the cleantech sector. The selected managers leveraged this investment with other public and private sources of capital to collectively raise over \$1.8 billion, and are now making investments.

The VCAP and previous VCCI initiatives were designed to work closely with the market and focused on leveraging significant private capital to increase the availability of funding to high-potential and scaling companies in Canada. Designed as a market-driven approach, these efforts aimed to improve the sustainability of the Canadian VC ecosystem and spur private sector investment by generating world-class financial returns needed for long-term private sector commitment to the venture asset class. Industry leaders have highlighted the success of these programs and the important role of VCAP and the previous VCCI in supporting the growth of Canada's VC industry.

Data from the Canadian Venture Capital and Private Equity Association (CVCA) highlights significant growth in VC activity in Canada over the past decade. In 2019, a record-setting \$6.2 billion was invested through 560 deals, representing a 68% year-over-year increase from the \$3.7 billion invested in 2018. Following this growth, in 2020, \$4.4 billion was invested through 509 deals, marking a year-over-year decrease of almost 30% in dollars invested (CVCA, 2021). However, despite the year-over-year decrease, the 2020 investment level remains greater than the 2018 totals, reinforcing the significance of the volume of investments completed in 2019. The announcement of a new VCCI program is expected to support growth, revert back to the positive long-term trend seen since the implementation of the earlier programs and support the progression towards a sustainable Canadian VC ecosystem.

## *The Impact of COVID-19*

While it is too early to draw firm conclusions on the impact of COVID-19 on VC investment activity in Canada, it is clear that the pandemic has created challenges across the economy, including for risk capital investors and the innovative companies they support. Some VC funds have reportedly opted to double-down on existing portfolio companies to help them sustain operations through an unanticipated period of challenge, resulting in a higher than expected cash burn rate. In addition, many have been able to adjust pacing and reserve to minimize the impact of the pandemic and to prepare for an uncertain economic environment, finding creative ways to continue making new investments including with government support specific to COVID-19 impact, such as BDC's VC Bridge Financing Program. To date, concerns have also been expressed that some major investors may reallocate capital to asset classes perceived as lower risk. Over the medium term, these factors could lead to less capital availability for high potential, growth-oriented companies. Strategic investment at this critical juncture is therefore required to ensure that sufficient funding is available to support the next generation of Canadian technology champions that will power the economic recovery, create jobs, and support growth.

## *Promoting Inclusive Growth*

Advancing diversity in the ecosystem can introduce a number of new professionals with diverse experience and expertise with novel ideas. The Government of Canada continues to be committed to supporting diversity and inclusion, such as through the new 50/30 Challenge, an initiative between the Government of Canada, business, and diversity organizations to improve access for racialized persons including Black Canadians, people who identify as LGBTQ2+, people living with disabilities, as well as First Nations, Inuit and Métis to positions of influence and leadership on corporate boards and in senior management.

Entrepreneurs from diverse groups with innovative ideas continue to face barriers to starting and growing a business. Women and racialized entrepreneurs still face systemic these barriers and remain underrepresented in the economy, including in VC. The CVCA reports that, in 2019, approximately 11.8% of VC fund managing partners were women and 18% of partners were of a visible minority, despite making up 50.4% and 22.3% of the Canadian population, respectively. In 2019, *The Logic* conducted analysis which showed that 90% of VC investment deals between 2014 and 2019 went to companies founded exclusively by men.

Previous streams of VCCI included a strong commitment to increasing the participation of women across the VC ecosystem. All applicants were required to submit gender balance strategies, and recipients were required to report on statistics related to the number of women fund managers and entrepreneurs supported. This pioneering effort to generate data and measurable results to improve diversity and inclusion in the VC ecosystem is paying dividends, but more work remains to be done. Through Budget 2021, the Government articulated its plan to build a more inclusive and equal Canada, including by investing in companies led by entrepreneurs from typically underrepresented groups through a new Inclusive Growth Stream of VCCI.

# VCCI objectives

The renewed VCCI is intended to help support the revitalization and growth of the Canadian VC ecosystem. To this end, the renewed VCCI funds-of-funds stream will seek to establish a portfolio of large funds-of-funds that can inject significant capital into the ecosystem. The stream is aimed to maximize returns through diversified investments and support skilled VC fund managers, to catalyze substantial private sector investment.

The funds-of-funds recipients of the renewed VCCI will be expected to demonstrate strong investment strategies and expertise, and bring mentorship, good governance, financial structure and their strong networks to promising Canadian funds and the companies in their underlying portfolios. With this in mind, several key objectives of the renewed VCCI include the following:

## **1** *Translating innovation into economic growth*

Canada is full of innovative and entrepreneurial people with great ideas. A key objective of the renewed VCCI is to continue developing Canada into a global leader in transforming ideas and cutting-edge research into valuable intellectual property (IP) that can accelerate business growth. In doing so, the program aims to support the type of innovative, IP-rich start-ups and scale-ups that can propel job creation and economic growth.

## *Addressing current gaps in the VC ecosystem*

The renewed VCCI aims to help Canadian companies and entrepreneurs access the capital they need to build, scale up and compete internationally, including for those that may face barriers when accessing capital. By addressing current gaps in the ecosystem, a broader range of high-potential businesses will be able to access VC financing in Canada. This includes companies operating in the life sciences sector, as well as entrepreneurs from underrepresented groups, such as women and racialized communities, including those from emerging regions and sectors.

## *Improving the sustainability of the Canadian VC ecosystem*

To build a stable VC industry, Canada must demonstrate that VC investment in this country can generate world-class financial returns. Only when this is the case will global private sector asset managers place sufficient capital in this sector to fund Canada's promising innovators without requiring substantial government investment incentives.

To encourage investment in this asset class, VCAP and the previous VCCI programs included incentives to attract private capital to the funds-of-funds, as timelines for realizing financial returns in VC typically span many years and private sector allocation from institutional and family office investors to venture was low.

Although early signs are positive for these programs and the private sector investors are starting to see the financial rewards, the returns from the previous programs are not yet fully realized and the renewed VCCI will continue the work to demonstrate the viability and potential of the venture asset class in Canada, particularly in the economic recovery following COVID-19. The program will also aim to attract new private investors to invest in funds participating in the renewed VCCI.

## *4 Deepening the pool of experienced VC fund managers*

To help ensure a successful VC industry in Canada, the renewed VCCI is aiming to grow the Canadian VC ecosystem by deepening the pool of experienced fund managers in Canada with knowledge across sectors and regions, as well as by supporting emerging and new managers including women and members from racialized communities. This effort should include building Canadian talent and investment, while attracting new expertise and capital to Canada's VC market. With a focus on Canadian investment, allowing recipient fund managers to also invest a portion of their capital outside of Canada will lead them to increase their knowledge of international markets and help the Canadian companies in which they invest by connecting them with international customers and investors.

## *5 Leveraging private capital*

In taking a market-based approach and emphasizing private sector leadership, the renewed VCCI is expected to leverage a significant amount of private sector capital. Similar to prior programs and depending on the models selected, the renewed VCCI could leverage the \$450 million federal government investment with other sources of public and private capital to inject approximately \$1.5 billion or more into the venture capital ecosystem.

# VCCI design

This section details the competitive process the renewed VCCI would employ to seek and select proposals from the private sector through three new streams that will be considered in the implementation of the program. Selected managers across all three streams will be expected to provide detailed strategies advancing inclusion and diversity in the ecosystem.

The targeted streams under the renewed VCCI include:

- ✓ National funds-of-funds stream;
- ✓ Dedicated support for VC investment in life science technologies; and,
- ✓ Inclusive growth stream, aimed at increasing access to capital for underrepresented groups, such as women and racialized communities.

## *Competitive Process*

The renewed VCCI will use a competitive process to seek proposals from the private sector. Detailed criteria would be included in a call for expressions of interest, and applicants would be invited to bring forward value propositions detailing their expected value-add to Canadian firms and the VC ecosystem, in addition to laying out their track record, complement of potential investors, and investment strategy. As well, value propositions would be differentiated by certain parameters for which minimum or maximum thresholds could be set.

Once provisionally selected, applicants would be required to do their own fundraising to meet predetermined targets. It is proposed that pre-determined fundraising targets would be met within set timeframes. If a selected applicant fails to meet these targets, the Government would reserve the right to re-allocate some or all of the capital within or across streams.

# Funds-of-funds investment model

We are seeking advice on the following proposed elements that could be included in a call for expressions of interest for funds-of-funds. For example, we invite views on whether the targets specified are appropriate given the current Canadian VC market. Additionally, we invite comments on which of the following elements should make up the fixed structure applicable to all applicants, and which elements should be used as criteria for evaluating competitive proposals.

## *Size and number of funds-of-funds*

The renewed VCCI could support a number of private sector-led funds-of-funds, with potential commitments from provincial governments, that would invest on the same terms as the Government. The previous VCCI required that the selected funds-of-funds leverage government investment with private capital, for total fund sizes ranging between a minimum of \$150 million and cap of \$400 million. Upon being provisionally selected, these managers had a limited period during which to complete fundraising activities and reach a pre-determined target size.

Given the broad success of the funds-of-funds selected under prior programs, we invite comments to determine the appropriate number of funds-of-funds for the Canadian VC market, ensuring that there is adequate capital available in the marketplace over the coming years while not oversaturating the ecosystem and investors. This includes identifying the optimal size, including minimum and maximum sizes for funds-of-funds to have the greatest impact in the market and on investors.

The expertise and experience required to operate a national fund-of-funds in Canada is highly specialized, requiring familiarity with the Canadian VC market across regions and sectors. We encourage interested parties to formally submit, through this engagement process, their interest in applying to enable ISED to gauge the number of potential candidates.

## ***Amount of private sector capital leveraged***

The funds-of-funds selected under VCAP leveraged government capital to raise a multiple of 2x from private sector investors. Building on this success, the previous VCCI required the funds-of-funds selected to raise a multiple of 2.5x from private sector investors.

For the renewed VCCI, it is proposed that the amount of private sector capital leveraged as a multiple of provincial and federal government capital would be at least 2.5x. Given the growing confidence and demonstrated returns in the Canadian market, balanced with the economic impacts of the COVID-19 pandemic, we invite comments on leverage with private capital that funds-of-funds may be able to obtain.

## ***Incentives to attract private sector investors***

Under VCAP, government investors provided incentives to attract private sector capital, where every dollar from government was matched with two from the private sector. Designed to return the private sector to the venture asset class, these incentives included preferred returns to the private investors and, with an asymmetric waterfall of distributions with private sector capital returned first, along with a preferred return and then subsequent preferred returns to government investors. Both investor types received this before the fund managers received any carried interest (i.e. returns above base management fee). These design features provided incentives such as downside protection to the private sector. Additionally, government investment flowed into the funds-of-funds at a faster rate than that of private sector investors, incurring most of the financial risk.

In VCCI, both private investors and government shared the upfront financial risks by investing *pari passu* and the fund-of-funds were required to match the government capital at a ratio of two and a half dollars from the private sector for every government dollar. Preferred returns, again in an asymmetric waterfall, returned capital to the private sector investors before government, and to both private and government investors before fund managers were entitled to any carried interest.

A key objective of these VC incentive programs is to demonstrate the sustainability of Canadian VC, thus attracting new investors. To do this, the renewed VCCI funds-of-funds stream could reduce incentives set by previous programs. As an example, the private sector's preferred return of 7% could be reduced to 5%, thereby diminishing the downside protection that the preferred return provides. Increasing the leverage ratio of private capital to government investment, will also be examined.

## *Enhancing Canadian geographic focus*

Proposals would be evaluated on their overall impact on Canada and Canadian companies, particularly on the fund managers' expected value-add to Canadian firms. Under both VCAP and the previous VCCI, certain restrictions on international investments were included for funds-of-funds and funds. For example, recipients were required to maintain a Canadian presence by having or establishing at least one Canadian-based senior investor and at least one full-time Canadian office. This criteria would be maintained for the renewed VCCI.

Building a sustainable Canadian VC ecosystem requires some international investment to support the development of networks and to build globally-connected companies. For this reason, Canadian content requirements under the renewed VCCI could be improved from a minimum of 60%, while still allowing some international investment. For example, funds-of-funds could be required to commit 100% of direct co-investments into Canadian-based companies, compared to 70% under the previous VCCI.

## *Addressing current gaps in the VC ecosystem*

The impact of VCAP and the previous VCCI on the Canadian VC ecosystem has been notable, supporting a wide range of fund managers and Canadian businesses across Canada and in key technology sectors. This includes support for new investment models, emerging regions, and traditionally underserved sectors such as cleantech. However, as this continues to be primarily a market-driven approach to a sustainable VC industry, ongoing efforts are required to continue developing and diversifying the Canadian VC ecosystem, including to promote greater inclusion of underrepresented groups such as women and racialized communities.

Previous streams of VCCI required all applicants to submit gender balance strategies. Under the renewed VCCI, a greater focus will be given to promoting inclusive growth in the ecosystem. Applicants will be expected to submit strategies on diversity and inclusion and report on set targets. Further, selected fund-of-funds managers will be expected to report on investment activities in relation to the number of supported women, Indigenous, Black and other racialized fund managers and entrepreneurs.

First time fund managers experience a number of difficulties raising capital for new and emerging funds, including those with novel investment theses or fund structures. Though they may possess a range of experience, technical knowledge and networks that can be valuable for potential portfolio companies, it is important that they can raise capital and reach fund sizes that can make meaningful investments. We invite ideas of how the funds-of-funds model could better support these new emerging managers to reach scale.

Additionally, investment activities under VCAP and the previous VCCI have had a broad national focus, while also completing targeted investments in underserved sectors including cleantech. However, there are sectors and regions of strategic importance to the Canadian economy that continue to encounter barriers when accessing VC financing. For example, through Budget 2021, the Government of Canada identified the life sciences sector as a high-potential area in the Canadian technology market. How could the funds-of-funds model under VCCI more effectively support the needs of entrepreneurs in emerging sectors and regions?

## ***Defining eligible VC investment opportunities***

A key objective of these programs is to demonstrate that Canadian VC investments can generate returns and increase private investments in the asset class. To this end, selected managers have been required to direct capital to funds investing in venture capital transactions. However, venture funds may also enter into other types of equity transactions depending on their investment thesis, which may not necessarily qualify as typical VC. We are seeking advice on how to refine the definition of qualifying VC funds to ensure participating funds-of-funds managers can access high-potential opportunities that are aligned with the objectives of the program while taking into consideration the evolution and maturation of the Canadian industry over time. Under the previous VCCI, VC funds were defined as funds that primarily invest in minority equity stakes of technology-focused companies in order to enable the development of new products, markets or business models.

## *Investment strategy, capabilities, network and experience of fund-of-funds managers*

Similar to VCAP and the previous VCCI, managers would be expected to demonstrate experience and performance in raising and managing funds-of-funds, funds, or other investment entities, as well as in-depth knowledge of Canadian VC, entrepreneurial experience and a strong network of business and financial contacts. Fund-of-funds managers would be expected to apply this knowledge and network in advising and supporting the Canadian funds in which they invest. Fund managers would be evaluated on the degree to which their proposed investment strategy is aligned with their demonstrated capabilities with emphasis on Canada.



We invite  
comments on  
which of the  
elements  
outlined.

# Investing in life sciences

Budget 2021 identified strengthening and growing Canada's life sciences sector as a key priority that goes beyond responding to the current COVID-19 pandemic. VC investment in this sector has seen robust growth in recent years, with \$1.1 billion invested in 2020, an increase of roughly 70% from the \$646 million invested in 2018 (CVCA, 2021). This growing sector supports thousands of good, middle class jobs. To continue to promote vibrant growth in Canada's life sciences sector, Budget 2021 proposes to dedicate \$50 million through the renewed VCCI to support VC investments in life science technologies.

One of the objectives of the renewed VCCI is to address current gaps in the VC ecosystem. Although there has been significant growth in investment activities over recent years, there remain opportunities in Canada's life sciences sector for further investment. Many new and innovative ideas in this sector can be capital intensive and require more support. For example, life sciences companies interested in scaling up production capacity for commercialization of new technologies may require significant investment to compete internationally. As such, increasing the availability of capital for scale-up and commercialization in the sector can help more Canadian life sciences companies reach their potential and grow on a global scale.

ISED is seeking input on design parameters that would advance the core objectives of VCCI, maximizing the positive impact of this funding on the Canadian life sciences sector while also addressing current gaps and opportunities in the market. We invite input on the design and implementation of a \$50 million investment through the renewed VCCI in the life sciences sector that would address the program objectives noted above. Concepts submitted should have a value proposition that includes:

- ☑ Leveraging private sector investment;
- ☑ Deepening the pool of VC fund managers by supporting new and emerging managers, including individuals from underrepresented groups such as women and racialized communities;
- ☑ Supporting the growth of experienced Canadian-based life sciences VC funds able to provide support to entrepreneurs to scale-up and compete globally in this sector;
- ☑ Addressing whether there is a need for an incentive for private investors and if so, how that would be balanced to share risk between government and the private sector;
- ☑ Ensuring a strong presence in Canada; and,
- ☑ Allowing for selection through a fair and transparent competitive process that could evaluate proposals on:
  - ☑ The amount of private sector capital already secured;
  - ☑ The expected benefits for Canadian life sciences companies;
  - ☑ The proposed approach for balanced risk sharing between the government and private sector investors; and,
  - ☑ The investment strategy, among other considerations.

## ISED also invites views and models in relation to the following specific questions:

- ☑ How can an investment of this size be best allocated to support the continued growth of Canada's innovative life sciences sector and address remaining challenges in the ecosystem?
  - Recent research commissioned by ISED identified two key challenges in Canada's life sciences VC environment (DEEP Centre, 2020). These include: a) challenges faced by companies in accessing funding at seed and early stages; and b) the small scale of Canadian life sciences funds relative to international peers, creating challenges for scaling companies in Canada seeking to access growth capital from domestic sources.
- ☑ How can the proposed funding be best allocated to maximize private sector leverage, and what leverage requirements would be appropriate?
- ☑ How can the proposed funding best be administered in a manner that promotes the goals of the renewed VCCI in relation to diversity and inclusion in the VC ecosystem?



ISED invites comments related to identifying key challenges in life sciences VC investment and the optimal allocation of capital to address them.

# Inclusive growth

**Building on the Government of Canada's commitment to breaking down barriers to full economic participation for all Canadians, Budget 2021 proposes a range of targeted supports to diverse entrepreneurs, including the acceleration of the Women's Entrepreneurship Strategy, additional funding to support the Black Entrepreneurship Program, and the announcement of an Inclusive Growth Stream to increase access to VC for underrepresented groups as part of the renewed VCCI.**

Like many industries, the VC ecosystem faces concerns over the underrepresentation of women and visible minorities, both among investment professionals and recipient companies. In particular, entrepreneurs from these demographic groups are less likely to seek equity financing and when they do, they are more likely to be turned down or to receive relatively less money for their businesses.

Empirical studies demonstrate that while more wealthy individuals are more likely to choose to become entrepreneurs, many individuals from underrepresented groups pursue entrepreneurship because other opportunities aren't as accessible. Many potential entrepreneurs looking to launch a business face a liquidity constraint, which is more pronounced amongst individuals with fewer financial assets. Additionally, Black entrepreneurs are further disadvantaged by being proportionally less connected to traditional financial institutions, and to have less recourse for family wealth, opting instead to use personal accounts to build their business.

Throughout the 11 virtual consultation sessions that were held during Fall 2020 with the Black Canadian community, the issue of access to capital was identified by many participants as the most important issue holding back Black entrepreneurs from achieving their goals. Participants noted that access to capital is crucial for any entrepreneur and that there is significant evidence that Black entrepreneurs have more difficulty than other entrepreneurs accessing capital. Participants noted that this state of affairs is related to the way the banking system works, including racism and systemic bias in the banking system, and a lack of appreciation among mainstream institutions for the need for different approaches related to cultural differences.

With the Budget 2021 announcement of \$50 million to create an Inclusive Growth Stream within the renewed VCCI, the Canadian VC industry has an opportunity to set an example and demonstrate global leadership in how this issue is dealt with. The capital will be invested in VC funds, who in turn will invest in technology companies.

To this end, ISED is seeking input on design parameters that would maximize the impact of this funding for traditionally underrepresented entrepreneurs. Importantly, this funding is intended to create a VC sector that is more representative of Canada's diversity, with investments generating market returns while complementing the mandates of the renewed VCCI objectives.

With this in mind, concepts submitted should have a value proposition that includes:

- Establishing market-generated VC returns while complementing other initiatives to improve inclusivity, including Government efforts to support women and minority entrepreneurship, as well as broader efforts to support Canada's social and impact investment sectors;
- Leveraging investment from private sector (including foundations and family offices) towards traditionally underrepresented entrepreneurs;
- Addressing whether there is a need for an incentive for private investors and if so, how that would be balanced to share risk between government and the private sector;
- Deepening the pool of experienced VC fund managers including support for emerging managers from traditionally underrepresented groups;
- A data management strategy that allows funds to track the impact of their investments in improving outcomes for underrepresented entrepreneurs; and,
- Allowing for selection through a fair and transparent competitive process that could evaluate proposals on:
  - The amount of private sector capital already secured;
  - The likelihood of raising private sector capital not yet secured;
  - The expected benefits for underrepresented entrepreneurs;
  - The proposed approach for balanced risk sharing between the government and private sector investors; and,
  - The investment strategy, among other considerations.

## ISED also invites views and models in relation to the following specific questions:

- ✔ How can VC funds leverage the lived experiences of underrepresented fund managers and entrepreneurs as a competitive advantage in identifying problems to be solved while also striving for market-oriented returns typical of VC?
- ✔ What best practices can fund managers deploy to overcome structural barriers in VC, including entrenched obstacles and biases which often preclude women entrepreneurs and racialized minorities from receiving funding?
- ✔ What role do alternative models supporting technology companies, yet differing from traditional venture capital investment models, have in the business financing marketplace, and how can they be supported?
- ✔ How can the proposed funding be best allocated to maximize private sector leverage, and what leverage requirements would be appropriate?
- ✔ How can the proposed funding be administered in a manner that promotes the goals of VCCI in relation to diversity and inclusion in the VC ecosystem?
- ✔ What can be done to ensure fairness for the state of fund readiness in the market, including for example having more than one selection process (request for proposals) at different times?

# Improving reporting on diversity

Previous streams of VCCI included a strong commitment to increase the participation of women across the VC ecosystem. Building on this approach, applicants under the renewed VCCI will be required to submit gender balance and inclusive growth strategies demonstrating how they currently and plan to support diversity and monitor the impact of these strategies. Recipients will be expected to formally report on targets set out in these diversity strategies, including on investment activities in relation to the number of women and Indigenous, Black and other racialized fund managers and entrepreneurs supported.

As such, we are seeking input regarding reporting targets and data collection at the funds-of-funds, the funds and the company levels, in relation to inclusive growth strategies for each fund manager selected under the renewed VCCI.

Improved reporting on diversity under the renewed VCCI is consistent with other efforts being undertaken by the federal government. For example, the Black Entrepreneurship Program Knowledge Hub will conduct large-scale qualitative and quantitative research on Black entrepreneurship in Canada, identifying critical gaps where Black entrepreneurs are facing the greatest challenges.

# Summary and discussion questions

**The paper outlines objectives and presents three broad areas for discussion. Discussion topics are as follows:**

First, with respect to a fund-of-funds model, we are seeking views on the elements summarized below. For example, are the specified targets appropriate in the current Canadian VC marketplace?

Additionally, which of the following elements should make up the fixed structure applicable to all applicants, and which elements should be open to competitive proposals and used as a criteria on which competing applications would be evaluated?

Second, with respect to investment in the life sciences sector, we invite views describing how these investments could be completed in a manner satisfying the objectives of the renewed VCCI.

Third, with respect to the Inclusive Growth Stream, we invite views and concepts describing how models would be structured, how they align with the goals of the program, and how a selection process could be implemented.

## Summary of proposed funds-of-funds parameters

<b>Private capital leveraged</b>	Minimum of 2.5 times government investment
<b>Size of funds-of-funds</b>	Minimum size for a viable fund-of-funds
<b>Co-investment allowance</b>	Up to 25% of capital
<b>Incentives to attract private investment</b>	<i>Pari passu</i> investment and asymmetric return waterfall to private investors before government;  Preferred returns to the private investors between 5% to 7%
<b>Fund strategy and capabilities</b>	The degree to which the proposed investment strategy and demonstrated capabilities will maximize impact to the Canadian economy, in particular, the innovation economy and venture industry. Capabilities to provide support, guidance and the expected value-add to Canadian firms, will be evaluated
<b>Diversity and inclusion strategy</b>	Detailed strategy regarding how the fund-of-funds manager will advance diversity and inclusion in the Canadian VC ecosystem, including women and racialized communities
<b>Capital already secured</b>	Letters of intent
<b>Canadian presence pledged</b>	Pledged presence of at least one Canadian office
<b>Canadian investment pledged</b>	Pledged commitment to Canadian funds of more than the current 60% of all fund commitments and increase to 100% for direct co-investments
<b>Compensation proposed</b>	Competitive market rates

# Contact

You can reach the Government of Canada's VCCI Secretariat at [capital@ised-isde.gc.ca](mailto:capital@ised-isde.gc.ca). We are seeking input until September 24, 2021. Submissions may be submitted in either official language.