Canada's Technology Investment Gap

Unlocking the sector's key growth opportunity.

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The Canadian technology sector has earned global recognition for consistently punching above its weight. Three Canadian cities rank among the top 20 startup ecosystems in the world, matching Europe and ranking Canada second only to the United States.[1] In addition, the number of financings in Canada has grown by almost 50 per cent in the last five years, significantly outpacing the United States. This growth has led to 30 per cent more companies receiving financing in Canada compared to the United States on a GDP-normalized basis.

Thriving technology ecosystems are built on access to talent, markets and capital. In Canada, fast-growing technology businesses benefit from a sizeable talent pool, network to global markets, corporate and government research institutions, cultural and lifestyle assets, and generous tax incentives for research and development. Where we fall short, however, is capital availability.

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The same report identifying three Canadian cities in the global top 20 flagged limited funding as the key issue detracting from their competitiveness. Despite recent years of remarkable growth, capital invested into the technology sector in Canada still lags behind other ecosystems. To understand why, we need to look at our overall capital supply, the flow of capital across stages of business growth, and the size of deals funded.

Yaletown Partners recently conducted a detailed research study of financing activity to better understand the capital supply gaps in our Canadian ecosystem. Yaletown reviewed over 20,000 financings in the decade since 2006 and 3,000 exits since 2000 across Canada and the United States. The research combined data from Pitchbook, Thomson Reuters, CVCA, NVCA, and Yaletown's own proprietary datasets. The conclusions of the study are outlined in this white paper.

In the last two years, Canada has financed 30 per cent more companies than the U.S. on a normalized basis.

[1] The Global Startup Ecosystem Ranking 2015, Compass.co (formerly Startup Genome)

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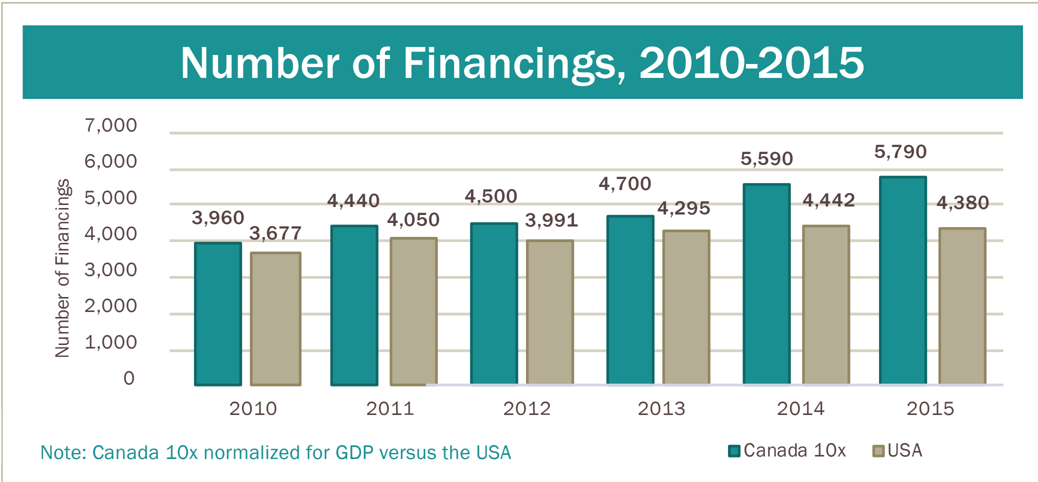
Yaletown's research shows that Canada's capital supply is both insufficient and inadequately distributed, focusing mostly on technology companies at the seed and early stages of development. Later, once Canadian technology companies reach the next stage of growth, they often find it difficult to secure adequate funding due to gaps in available capital. Without proper funding, these companies scale more slowly, take longer to exit, and achieve smaller outcomes. This also has a compounding effect on other key drivers of the Canadian technology ecosystem. For example, with delayed exit activity, knowledge and talent are recycled back into the ecosystem more slowly, thereby restricting talent access for the next generation of companies. Canada's biggest opportunity to realize greater value from our technology sector lies in closing this capital gap, currently at billion dollars and growing.

Activity is Driving Growth

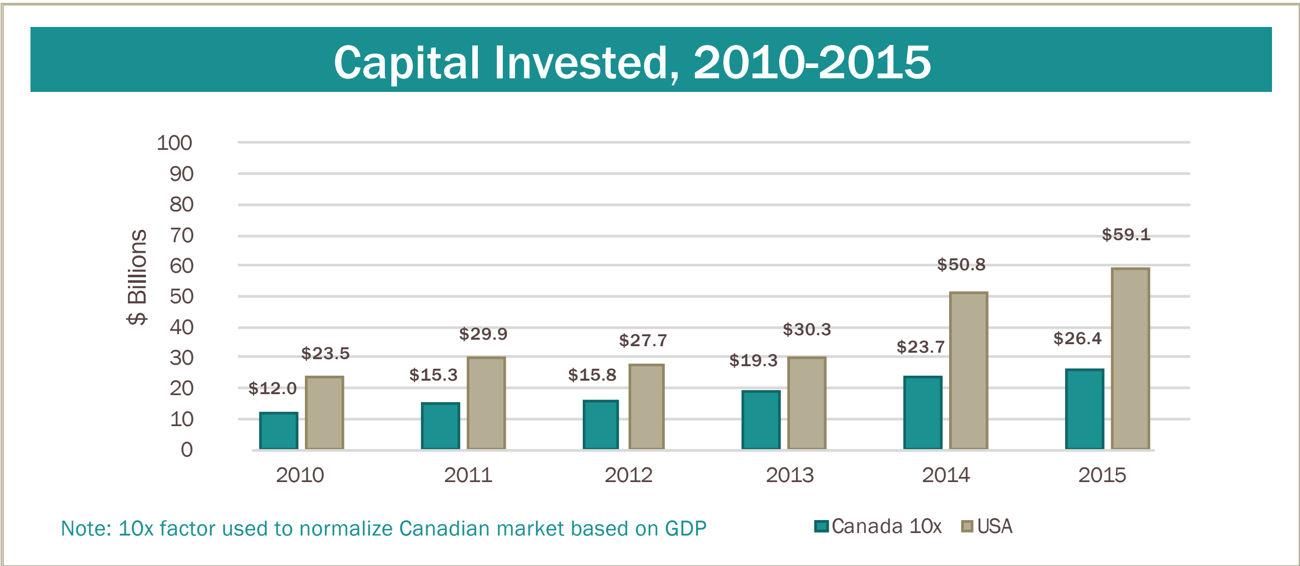
In the last five years the number of Canadian companies receiving financing has increased 50 per cent. In fact, since 2013, 30 per cent more companies have received financing in Canada versus the United States on a GDP-normalized basis.[2]



Source: Thomson Reuters, NVCA

Total capital invested in Canada topped $2.6 billion in 2015, the richest year of investment in the last decade. However, since 2010, capital invested in Canada has consistently remained at less than 50 per cent of the levels in the United States on a GDP-normalized basis. Thus, despite a doubling of capital invested, Canada has not reduced the gap between the two countries.

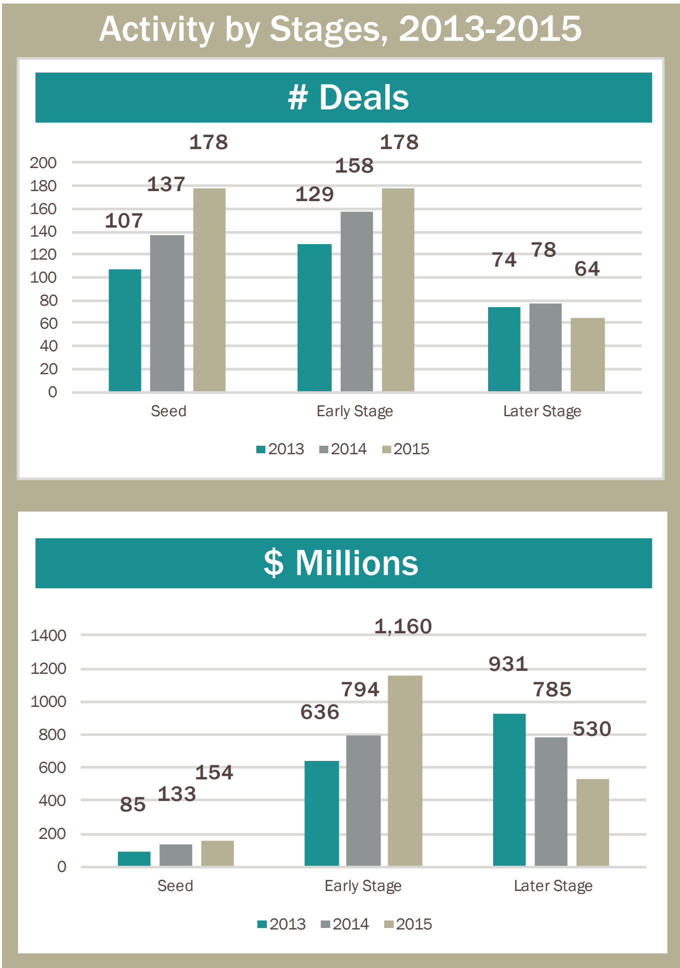
[2] Normalizing for market size by GDP, approximately 10x. Historically, Canada has funded approximately 10% more companies on a normalized basis.



Source: Thomson Reuters, NVCA

Growth Capital Supply Not Keeping Pace

Canada disproportionately invests in seed and early-stage companies. Since 2013, investment into seed and early-stage companies has increased from 38 per cent of total capital invested to 58 per cent in 2015. In contrast, total investment into Canadian later stage companies has declined by more than 40 per cent since 2013. The decline is stark when compared to the United States where later stage investment doubled during the same period.

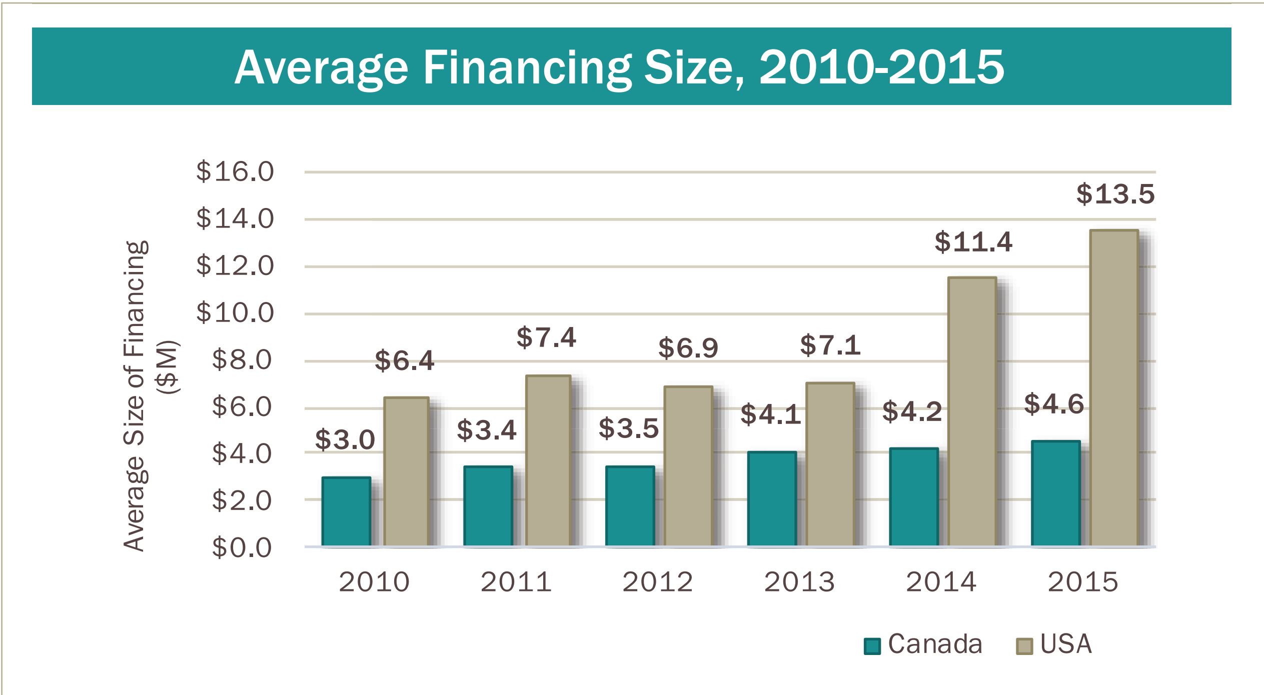


Source: CVCA 2015 Venture Capital Review of Canada

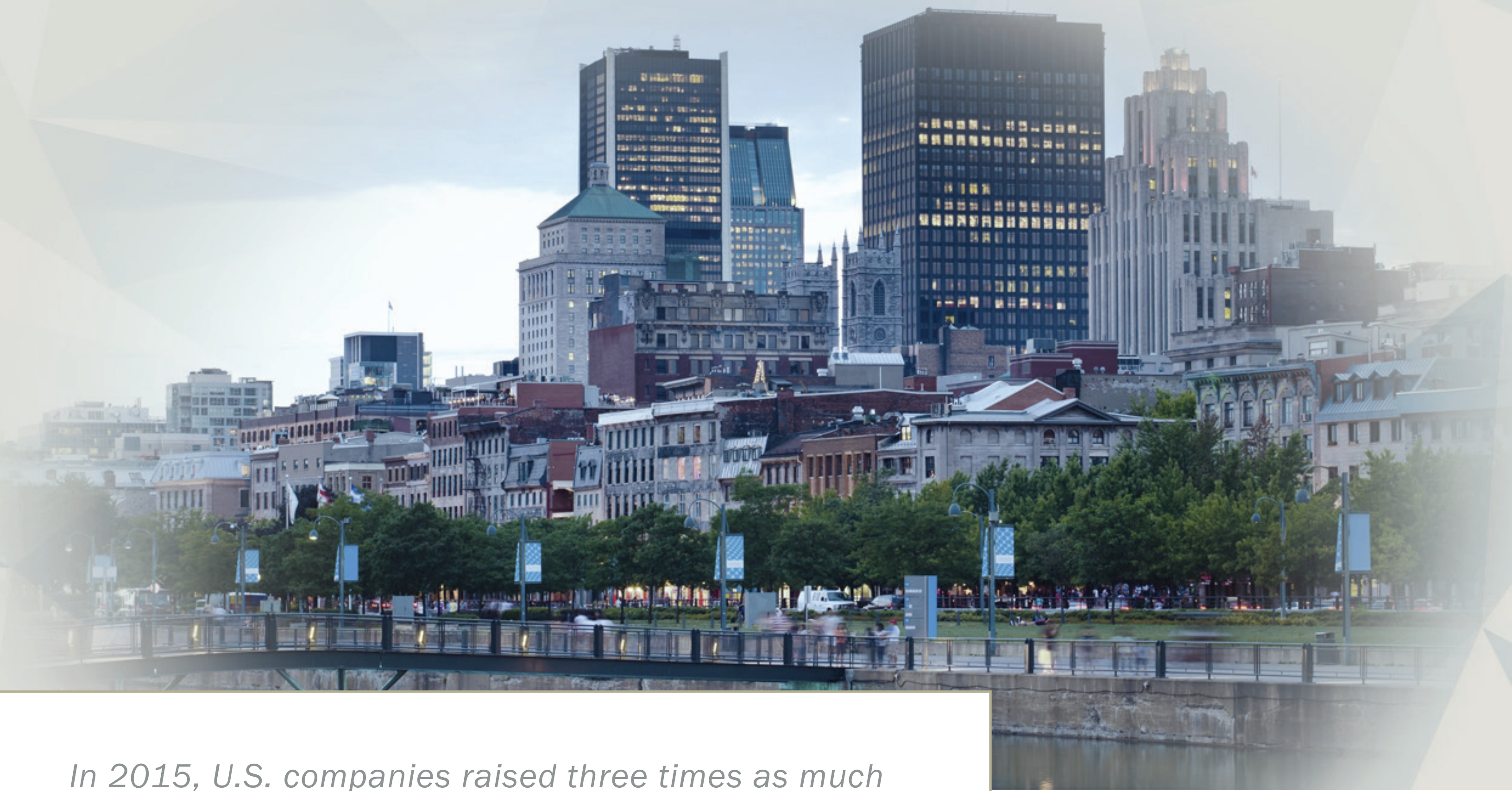
Investing in seed and early-stage companies is a key pillar of the Canadian technology ecosystem. Yaletown's research shows, however, that Canada's predisposition to early-stage financing has exacerbated the shortage of growth capital, a trend that is likely to become more pronounced in the years ahead as the high number of previously funded early-stage companies mature and seek later stage growth capital.

Capital Supply Spread Too Thinly Across Companies

Looking at capital distribution across Canada's population of technology companies, we also observe that existing capital is spread too thinly across the sector overall. The average amounts raised by Canadian companies per financing significantly lag behind those in other countries. Over the last five years, the average financing size in the United States has grown twice as fast as in Canada and is now more than three times as large.



Source: Thomson Reuters, NVCA



In 2015, U.S. companies raised three times as much on average compared to Canadian companies.

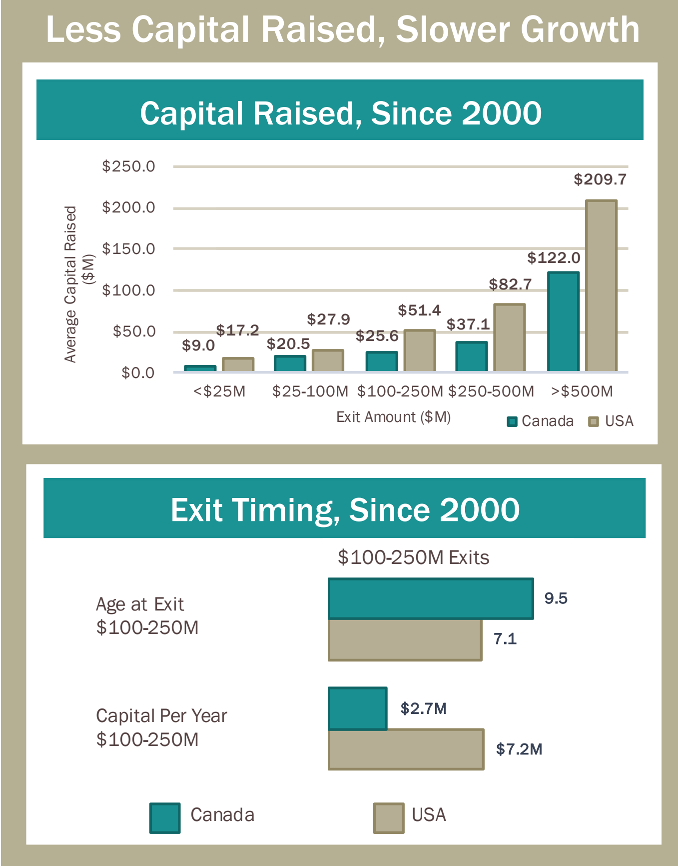
The difference in average capital raised is partially explained by the combination of early-stage activity and structural differences in the Canadian ecosystem. Canadian early-stage companies are more efficient due to Canada's unique tax incentives and grant financings, such as SRE&D credits and IRAP funding, enabling them to develop highly competitive products despite raising on average 50 per cent less equity capital per financing than their peers in the United States.

However, the early-stage structural advantages diminish as Canadian companies grow. Yaletown's research finds that later-stage companies in Canada raise on average 75 per cent less per financing than U.S. peers. The higher frequency of large, late-stage financings in the U.S. accounts for only a small portion of the difference. The majority of the gap comes from insufficient access to $5 to 25 million financings to accelerate initial growth. Companies in the United States are 2.6 times more likely to raise these emerging-growth financings compared to Canada. The gap in emerging-growth capital has grown to one billion dollars over the last five years and is expected to continue to grow by at least $250 million per year.

The Impact of the Capital Gap

The competitive disadvantages of under-funding are highlighted by Yaletown's research – without adequate emerging-growth financing, companies scale more slowly, take longer to exit, and achieve smaller outcomes.

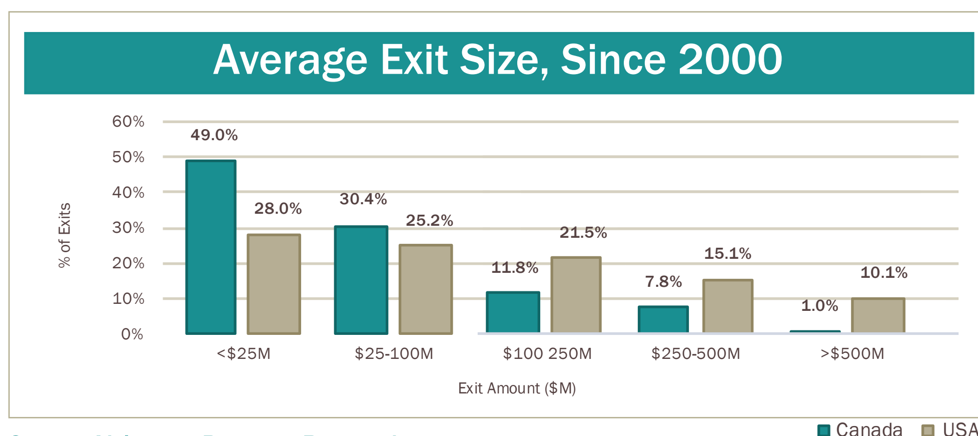
Canadian companies that exit at valuations between $25 and $100 million are similar to their peers in the United States in terms of age and capital raised. However, for exits larger than $100 million, Canadian companies raise half as much as their U.S. counterparts. While these Canadian companies grow despite capital constraints, they do so more slowly. Canadian companies who exit for $100 to $250 million, which represents 12 per cent of all disclosed exits, take 2.5 years longer compared to their U.S. peers. Companies with delayed growth risk losing strategic market leadership and missing critical market windows, ceding the pole position to better-funded competitors.



Source: Yaletown Partners Research [1]

Canadian companies take 2.5 years longer to exit for $100 to $250 million outcomes compared to their U.S. peers.

[1] Analysis of data from Pitchbook, Thomson Reuters, CVCA, and NVCA combined to cover over 20,000 transactions and 3,000 exits.



Source: Yaletown Partners Research

Growth capital constraints are also impacting the frequency of large outcomes. Compared to Canada, companies in the United States are twice as likely to exit for $100-500 million. In addition, very large outcomes greater than $500 million occur in only 1 per cent of all Canadian outcomes versus 10 per cent in the United States.

Closing Canada's Emerging-Growth Investment Gap

Canada is lagging behind other ecosystems in terms of capital invested despite robust financing activity. On average Canadian companies raise roughly one-third as much capital per financing compared to companies in the United States. A large part of the difference is due to insufficient access to emerging-growth capital. As a result, Canadian companies to date have grown more slowly, taken more than two years longer to exit and achieved large-scale exits in only 1 per cent of all outcomes.

The emerging-growth investment gap in Canada can be solved. First, improving the capital supply to underfunded growth-stage companies can have an immediate impact by accelerating growth and shortening exit timelines. Second, adequately funding the next generation of companies throughout their lifecycle, not just at the early-stages, can enable them to become market leaders and increase the frequency of large-scale outcomes.

The emerging-growth capital gap in Canada is currently one billion dollars and growing by an estimated $250 million per year. Closing the gap has the potential to supercharge the Canadian technology ecosystem, build on its underlying momentum and expand its status amongst its global peers.

About the Author

Yaletown Partners invests in emerging-growth technology companies in Canada that enhance sustainability and productivity for industrial and enterprise customers. Our research and investments help Canadian technology companies in their initial growth phase to accelerate their growth, shorten exit timeframes and achieve strong exit premiums. With team members in Vancouver, Calgary, Montreal and Toronto, Yaletown is led by a team with almost 100 years of technology-industry experience and is backed by leading institutional investors and a network of successful technology entrepreneurs, executives and angel investors.

Find out more about Yaletown and our portfolio of companies at www.yaletown.com.

Funding emerging-growth companies could enable them to scale faster, shorten their exit timelines and increase the frequency of higher value exits in Canada. The capital gap is $1 billion and growing.

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