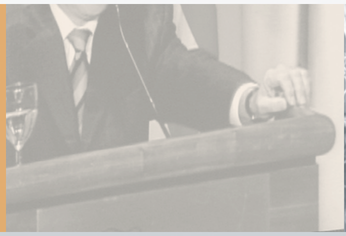
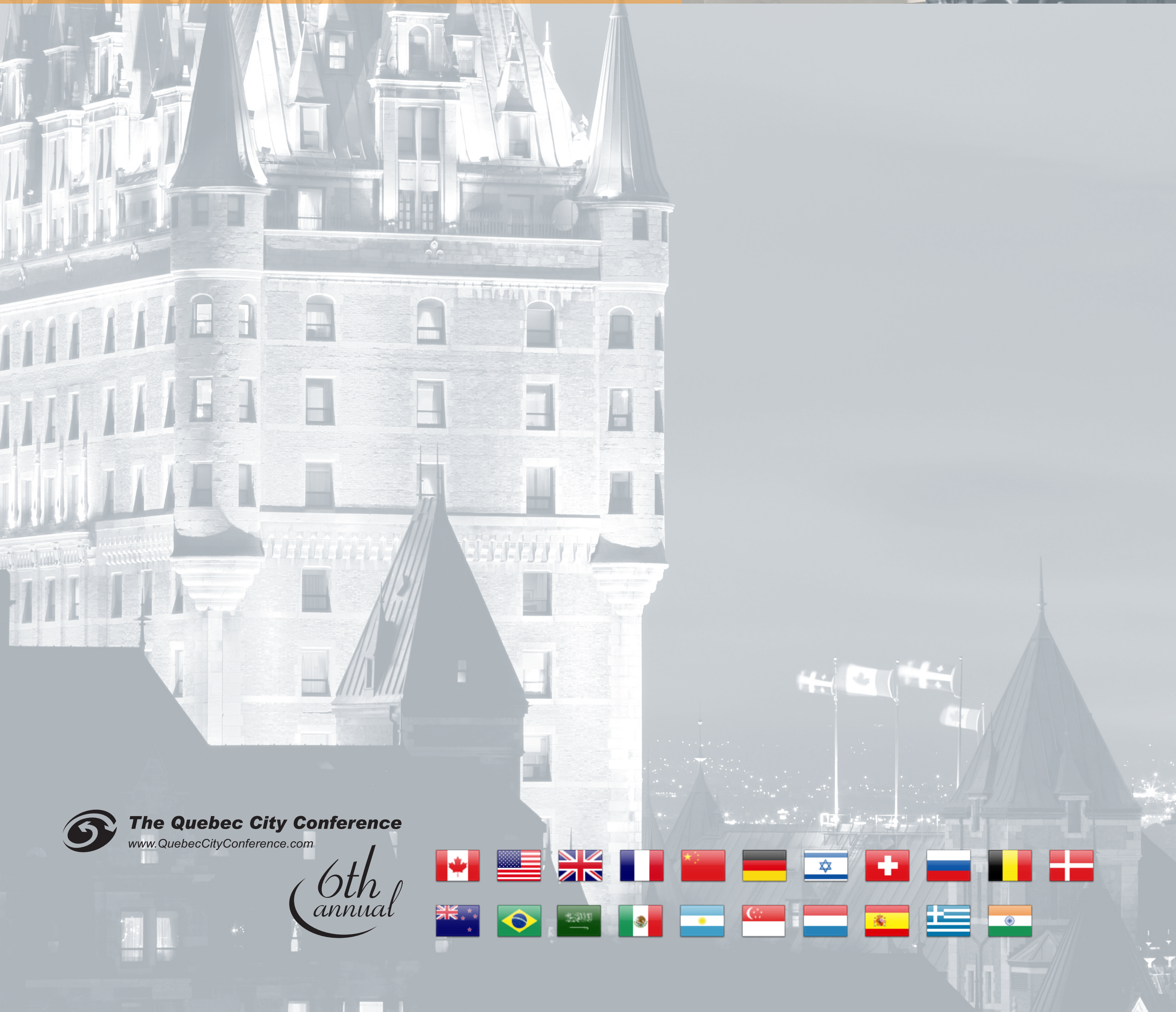
Main Conclusions
of the 2009 Public Policy Forum On Venture Capital and Innovation

PUBLIC POLICY **FORUM** on Venture Capital and Innovation





The Quebec City Conference
www.QuebecCityConference.com

6th annual

Message from the President & Chair of The Quebec City Conference

VENTURE CAPITAL plays a crucial role in building an economy based on knowledge. Research studies clearly show how venture capital can transform innovations of R&D into broadly-based economic gain and societal benefit through a unique combination of financing and professional management. The results of these studies explain why most governments in the industrialized world actively support this industry.

Unfortunately, venture capital is struggling in all major economies, and the recent financial crisis and economic downturn further complicate an already difficult situation.

It is important to remember, especially in these unsettling times, that it is innovation that truly drives economies.

In recent years, yearly venture capital investment in the US equaled approximately 0.2% of GDP, but revenues from venture backed companies equaled approximately 18%. That is extraordinary leverage. There has never been a greater need than in this time of economic turmoil for a thriving venture capital/private equity ecosystem to create and sustain next generation technologies – the next Intel, Google, Microsoft, Research in Motion or Genentech.

This international challenge accentuates the need for an annual meeting of architects of public policy aimed at developing and supporting a buoyant global venture capital and private equity ecosystem in a well designed format intended for high level exchanges and reflection.

The Public Policy Forum on Venture Capital and Innovation was conceived to accomplish this objective.

We would like to thank the institutions and governments who supported this Public Policy Forum, financially and logistically. In particular, we wish to salute the government of Ontario (Ministry of Research and Innovation) which in 2009 joined the governments of Canada (Industry Canada and Foreign Affairs and International Trade) and Quebec as partners in this project, based on the conviction that joining forces, resources and expertise is the right strategy to maximize value for each participant. We hope that this generous and visionary precedent will also benefit other jurisdictions faced with a common challenge: creating wealth through innovation.

Our sincere thanks to all panellists, to the members of the organizing committee and to the volunteers who have invested time and efforts to ensure another successful Forum.

Finally, a warm thank you to the President of the Forum, Mr. Gilles Duruflé, to its Chair, Mr. Yigal Erlich, and to the Forum's Special Advisor, Dr. Josh Lerner, who honoured us by debuting his new book "*Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed—and What to Do About It*" at this year's Public Policy Forum.

Christian Racicot
President and Co-Founder
Quebec City Conference

Stephen A. Hurwitz
Chair and Co-Founder
Quebec City Conference

Main Conclusions of the 2009 QCC Public Policy Forum on Venture Capital and Innovation

Quebec City, October 19, 2009

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About the Public Policy Forum on Venture Capital and Innovation

The Public Policy Forum on Venture Capital and Innovation ("PPF") is the result of a partnership between the Quebec City Conference ("QCC") and the Governments of Canada, Quebec and Ontario. Now in its third year, it was developed for leading LPs, GPs and government officials from all major economies to share their views, experience and concerns regarding public policies in support of a buoyant venture capital ecosystem to finance emerging technology companies. It is an invitation-only event building upon the international audience already developed by the QCC. It attracts keynote speakers with significant prior experience in designing and implementing policies related to venture capital and innovation and also renowned academics.

About the Quebec City Conference

Now in its seventh year, The Quebec City Conference is private, by invitation-only and not-for-profit, and is regarded as the leading international cross-border event for venture capital, private equity and institutional investors involved with technology and innovation. Service providers (e.g., law, accounting and advisory firms) are not invited.

The Conference attracts an exceptional group of world-leading investors in a small and intimate setting, offering a unique opportunity for networking at the highest levels of the international investment community, and is increasingly regarded as the "Davos" of its industry. In 2009, the Conference attracted nearly 400 participants from 21 countries.

Additional information at www.Quebeccityconference.com

Message from the President & Chairman of the QCC Public Policy Forum on Venture Capital and Innovation

The last two years have been characterized by a dramatic fall of the VC activity. According to Thomson Reuters, compared to 2007, the level of venture capital investment in 2009 was down by 43% in the US, 51% in Canada, 27% in Western Europe. The decline in fund raising is in the same order of magnitude.

Obviously this is to a large extent due to the cyclical impact of the financial crisis. However, the crisis is also reinforcing some of the more structural issues which were already pointed out during previous Public Policy Forums: poor returns of the industry outside a handful of US States; a growing number of questions around the VC model ("*Is the model broken?*") and its exportability outside of the US; increasing dissatisfaction of many LPs with the asset class and the LP/GP model.

On the other hand, the case for supporting the development of technology start-ups and, more generally technology sectors is growing stronger in the present period of economic stimuli: beyond bailing out industries of the past, should emphasis not be put on innovation, commercialization of research and the development of technologies of the future? More than ever, innovation is seen as a driver of economic recovery and a path to quality jobs.

As a consequence, the critical role played by venture capital to support the creation and development of fast growing technology companies and to spur innovation becomes also all the more important, at a time when this industry is facing many challenges, including a financing crunch.

How should public policies to support the financing of emerging technology companies respond to this challenge? How should they be designed and implemented to overcome these obstacles, adapt to the situation of our various countries in order to build a more permanently sustainable financing environment for technology start-up companies? What can we learn from experiences developed around the world? These are questions the QCC Public Policy Forum is designed to address.

The 2009 edition which was held in Québec City on October 19, 2009, brought together 100 senior GPs, LPs, Government officials and academics from 16 different countries in North and South America, Europe, Israel and the Middle East, China, Australia and New Zealand who all have interest and high level experience in advocating, designing and implementing public policies in support of a buoyant venture capital ecosystem to finance emerging technology companies.

This document presents the main conclusions of the Forum. It is meant to prolong the discussions and prepare for the next Forum which is to be held on Monday, October 25, 2010 in Québec City.

We wish you a good reading and welcome comments.

Gilles Duruflé

Gilles Duruflé
President

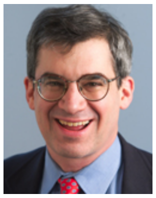
Yigal Erlich
Chairman

Organizing Committee

PRESIDENT

Dr. Gilles Duruflé
Executive Vice President, Quebec City Conference
President, Public Policy Forum

SPECIAL ADVISOR



Dr. Josh Lerner
Jacob H. Schiff Professor of Investment Banking
Harvard Business School

MEMBERS

Mr. Francis Carpenter
Special Advisor
Caisse des dépôts et consignations

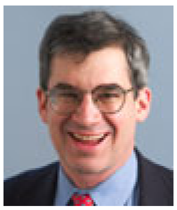
Mr. Mike Grandinetti
Managing Director, Southboro Capital
Serial Venture-Capital Backed Entrepreneur

Dr. Robin Louis
Former Chairman, Ventures West
Former President, CVCA
Canada's Venture Capital & Private Equity Association

Mr. Randy Mitchell
International Trade Strategist
US Department of Commerce

Keynote Address and Official release of Dr. Lerner's new book:

"Boulevard of Broken Dreams – Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed and What to do about it"



Dr. Josh Lerner

Jacob H. Schiff Professor of Investment Banking
Harvard Business School

Josh Lerner is the Jacob H. Schiff Professor of Investment Banking at Harvard Business School, with a joint appointment in the Finance and Entrepreneurial Management Units. He graduated from Yale College with a Special Divisional Major that combined physics with the history of technology. He worked for several years on issues concerning technological innovation and public policy, at the Brookings Institution, for a public-private task force in Chicago, and on Capitol Hill. He then obtained a Ph.D. from Harvard's Economics Department.

Much of his research focuses on the structure and role of venture capital and private equity organizations. (This research is collected in two books, The Venture Capital Cycle and The Money of Invention.) He also examines technological innovation and how firms are responding to changing public policies. (The research is discussed in the book, Innovation and Its Discontents.) He founded, raised funding for, and organizes two groups at the National Bureau of Economic Research: Entrepreneurship and Innovation Policy and the Economy. He is a member of a number of other NBER groups and serves as co-editor of their publication, Innovation Policy and the Economy. His work has been published in a variety of top academic journals.

In the 1993-94 academic year, he introduced an elective course for second-year MBAs on private equity finance. In recent years, "Venture Capital and Private Equity" has consistently been one of the largest elective courses at Harvard Business School. (The course materials are collected in Venture Capital and Private Equity: A Casebook, whose fourth edition is forthcoming.) He also teaches a doctoral course on entrepreneurship and in the Owners-Presidents-Managers Program, and organizes an annual executive course on private equity in Boston and Beijing. He recently led an international team of scholars in a study of the economic impact of private equity for the World Economic Forum.

Program

Monday, October 19, 2009

8:30 to 8:50	**WELCOME:**	**Mr. Christian Racicot** Co-Founder and President The Quebec City Conference	**Mr. Yigal Erlich** Chair, Public Policy Forum on Venture Capital and Innovation
	INTRODUCTION:	**Dr. Gilles Duruflé** President, Public Policy Forum on Venture Capital and Innovation	
8:50 to 9:40	**KEYNOTE ADDRESS:**	**Dr. Josh Lerner** Jacob H. Schiff Professor of Investment Banking, Harvard Business School *Official release of Dr. Lerner's new book* : "Boulevard of Broken Dreams – Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed and What to do about it"	

9:40 to 10:30 — **FIRST PANEL:**

"How is the venture capital industry evolving in response to the crisis - What are public policy responses to the present situation?"

Moderator:

- **Mr. Mike Grandinetti**, Serial VC-backed Entrepreneur and Senior Lecturer at MIT Sloan School of Business Administration

Panellists:

- **Mr. Mark G. Heesen**, President, National Venture Capital Association (US)
- **Mr. Yigal Erlich**, Founder, Chairman and Managing Partner, The Yozma Group; Chair, Public Policy Forum on Venture Capital (Israel)
- **Dr. Helmut Schühsler**, Managing Partner, TVM Capital; Former Chairman of EVCA, the European Association of Private Equity and Venture Capital (Germany)
- **Mr. Ernie Richardson**, Managing Partner, MTI Partners (United Kingdom)

10:30 to 10:50 — **NETWORKING BREAK**

10:50 to 11:40 — **SECOND PANEL:**

"Public policies to support business angels investing in technology start-ups and their role in the ecosystem"

Moderator:

- **Mr. Francis Carpenter**, Former CEO, European Investment Fund (UK)

Panellists:

- **Ms. Liddy Karter**, Executive Director, The Angel Investor Forum; Board member of ACA, The Angel Capital Association (USA)
- **Mr. Paul Lee**, General Partner, VanEdge Capital; Active angel investor (Canada)
- **Ms. Isabelle de Baillenx**, CEO, Fadiese (France)
- **Mr. Terry Matthews**, Chairman, Wesley Clover; Active angel investor (UK and Canada)

11:40 to 12:30	**THIRD PANEL:** **"Public/Private Venture Capital Partnerships: Fund Managers' Perspective - One Year Later"** Moderator: • **Dr. Robin Louis**, Former Chairman, Ventures West; Former President, CVCA, Canada's Venture Capital & Private Equity Association Panellists: • **Mr. Stuart Waugh**, Managing Partner, TD Private Equity Investors (Canada) • **Mr. Jacques Bernier**, CEO, Teralys Capital (Canada) • **Ms. Franceska Banga**, CEO, The New Zealand Venture Investment Fund (New Zealand) • **Mr. Christian Motzfeldt**, CEO, Vaektsfonden, The Danish Investment Fund (Denmark)
12:30 to 13:30	**NETWORKING LUNCH**
13:30 to 15:15	**HARVARD BUSINESS CASE prepared for the QCC Public Policy Forum by a team from the London Business School (Coller Institute of Private Equity) under the supervision of Dr Eli Talmor (LBS) and Dr Josh Lerner (Harvard University)** Subject: **Capital for Enterprise Ltd (London, UK)** Case Researchers**:** • **Dr. Eli Talmor**, Professor at London Business School; Chairman, Coller Institute of Private Equity • **Mr. Thibaud Simphal**, London Business School MBA 2010 • **Mr. Ananth Vyas Bhimavarapu**, London Business School MBA 2010 Moderator and supervisor*:* • **Dr. Josh Lerner**, Jacob H. Schiff Professor of Investment Banking, Harvard Business School Special guest: • **Mr. Rory Earley**, CEO, Capital for Enterprise Ltd.
15:15 to 15:45	**NETWORKING BREAK**
15:45 to 16:30	**GENERAL DISCUSSION : conclusions and next steps** Moderated by **Dr**. **Josh Lerner** and **Dr**. **Gilles Duruflé**
16:30 to 17:00	**CONVERGENCE SESSION with leaders of the Institutional Investors Forum**

Main Conclusions of the 2009 QCC Public Policy Forum on Venture Capital and Innovation

Introduction

The 2009 Public Policy Forum on Venture Capital and Innovation ("PPF") was built on the consensus reached at the 2008 PPF on the following points: (i) there is a strong case for government intervention to support the emergence of a solid venture capital ("VC") industry as it spurs technological innovation and has a huge impact on the economy which goes well beyond its size, (ii) government intervention is however a difficult endeavour (several important pitfalls were identified), (iii) first of all, governments should "set the table", that is create an environment where technology commercialization, entrepreneurship, angel investment and venture capital investment can all thrive, and (iv) a key element of any successful government intervention is to "get the environment right" (fiscal, legal, university technology transfer, removing barriers to entrepreneurial culture) and to work with the market.

Discussions remained however open on the question of incentives to attract private sector money into the asset class and around "the VC model": is it possible to make the present model work to deliver returns outside a very small number of funds in specific US high-tech clusters and to better meet institutional investors' expectations? Or should the industry work on developing different models, especially outside the US?

The 2009 PPF aimed at developing in greater depth the topics that were of particular interest to the participants in last year's event. In the context of the current financial crisis that exacerbated the pre-existing structural issues facing the industry, this year's PPF allowed for rich and intense discussions among the participants that culminated with new recommendations for next year's PPF.

Keynote Address by Dr. Josh Lerner: *"Boulevard of Broken Dreams – Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed and What to do about it"*

As highlighted by Dr. Josh Lerner's Keynote address and by the results of the survey conducted among the Conference's participants (see "Survey" at page 21), the VC asset class faces deep structural problems which will remain despite an eventual economic recovery:

- As an asset class, VC has not delivered attractive returns for more than 10 years. Since the burst of the technology bubble, the number and value of exits are not commensurate with the pace of investment. In past years, lack of returns was a problem outside of the US but now this problem is becoming universal;
- Returns are extremely concentrated in a small number of funds and geographies;

- Investors in VC firms ("LPs") are increasingly dissatisfied with the asset class, not only because of poor and extremely concentrated returns but also because of fees, lack of alignment of LP and GP interests, and lack of knowledge transfer from the managers of the VC firms ("GPs"). In addition, institutional investors such as large pension funds increasingly question the LP/GP model as it does not leverage their main competitive advantages which are long term horizons and deep pockets;
- As a result of this growing dissatisfaction from LPs, the VC industry faces a severe fund raising problem. In most places outside the US, fundraising now relies heavily on government funding or incentives.

However, R&D and technological innovation, which are the major long term drivers of the VC activity, are now progressing globally at an unprecedented accelerated pace. At the same time, the VC industry – once referred to as a "proximity business" - is globalizing at an equally accelerated speed.

Those two major trends combine to profoundly transform the VC industry and to open new perspectives – and new challenges – for this asset class, which in turn forces industry specialists to revisit generally accepted views about government intervention and implementation of public policies in this sector.

This phenomenon was strongly underlined during the Main Conference by three keynote speakers: Dr. Josh Lerner, Mr. Glenn Hutchins, Co-founder and co-CEO of Silver Lake (a leading private equity firm active in technology) and former Special Advisor to President Clinton and Mr. Terry McGuire, Chairman of the National Venture Capital Association (NVCA) and Managing General Partner of VC firm Polaris Venture Partners. Each one commented on the broad economic impact of the accelerating pace of innovation (R&D and talents), not only in OECD countries but worldwide. Dr. Lerner explained that the impact will likely be most significant on the VC industry, as this industry typically grows along with: (i) the volume of R&D and patenting, (ii) the private sector share of R&D spending and (iii) the share of R&D spending of small/new firms.

The accelerated globalization of the VC industry, as further described by Dr. Lerner, will most likely cause significant changes in the established order in the industry which will be triggered by new opportunities and new challenges associated with scaling.

Given this environment, the salient points of the discussions held at the 2009 PPF are as follows.

Panel 1: How is the venture capital industry evolving in response to the crisis? What are public policy responses to the present situation?

Moderator:

- **Mr. Mike Grandinetti**, Serial VC-backed Entrepreneur and Senior Lecturer at MIT Sloan School of Business Administration

Panellists:

- **Mr. Mark G. Heesen**, President, National Venture Capital Association (USA)
- **Mr. Yigal Erlich**, Founder, Chairman and Managing Partner, The Yozma Group; Chair, Public Policy Forum on Venture Capital (Israel)
- **Dr. Helmut Schühsler**, Managing Partner, TVM Capital; Former Chairman of EVCA, the European Association of Private Equity and Venture Capital (Germany)
- **Mr. Ernie Richardson**, Managing Partner, MTI Partners (UK)

Is the VC model broken?

Based on the US experience, the answer of some panellists was: “No, but it evolves”. The model follows the entrepreneurs. It has already transitioned from an “IT VC model” to include “cleantech”.

However, this answer does not address the issue that in many places around the world and increasingly in the US, the dominant model has not generated decent returns.

Moreover, participants underlined that this adaptation is too slow, (for instance, it is slow to adapt to the growing role played by business angels), and that more experimentation is needed and will happen.

In this regard, governments should be open to new models of intervention that privilege flexibility and to new schemes of public policies aiming at attracting new talents. A quote from Darwin came time and again during this Conference: “It is not the strongest of species that survive nor the most intelligent but the most adaptable to change”.

Impact of the present crisis on public policies?

The present crisis will induce a Darwinian process in which only the best and the most adaptable will survive, which is a good thing. However, in many countries, government support is still critical for the survival of the industry. The difficult question then becomes: when is this selection process going to go too far, destroying the critical mass which is necessary for the industry to prosper? When should governments intervene to support fund raising?

As illustrated by the case of Israel, the crisis is also a good opportunity for governments to revisit, adjust and diversify their tools to support innovation: R&D tax credits or subsidies to companies, stages to support the financing chain, sector diversification, low-tech. vs. high-tech.

Exits

The question of exits is a central point for the sustainability of the ecosystem and a major preoccupation for the industry, as illustrated by the NVCA's advocacy paper entitled: "*Four Pillar Plan to Restore the Venture-Backed IPO Market*". Some of the recommendations concern governments directly (tax incentives, regulatory review), whereas others imply changes in the industry behaviour: work with smaller and more specialized investment bankers, shop outside the big accounting firms, market your company to smaller investors well in advance, and hold equity for a longer time as a great part of the money is to be made after the IPO.

As one participant suggested, an interesting model here is to look back at what the NASDAQ was, and how it operated before Sarbanes-Oxley. At that time, together with specialist investment bankers, it provided a good source of capital for emerging technology companies. Perhaps we should focus on developing an exchange that replicates that model.

With regards to Europe, there was strong advocacy in favour of making AIM succeed. There was also an interesting point made for discussions between VCs and big pharmas to look for new equilibrium prices for M&As so that the biotech VC industry could survive. Such discussions are underway, notably in Germany.

In the end, there was a large consensus that the VC industry will not be able to deliver returns and be sustainable if the existing problems in the public markets are not fixed.

Long term horizon and strong determination

Beyond the conditions already listed above (set the environment right and work with the market, not against it), adopting a long term horizon and strong determination are two necessary conditions for any government or public-private effort to succeed in the fields of innovation and venture capital support. The coming of age of the medical device cluster around Minneapolis is an example of success based on these pre-conditions.

Panel 2: Public policies to support business angels investing in technology start-ups and their role in the ecosystem

Moderator:

- **Mr. Francis Carpenter**, Former CEO, European Investment Fund

Panellists:

- **Ms. Liddy Karter**, Executive Director, The Angel Investor Forum; Board member of ACA, The Angel Capital Association (USA)
- **Mr. Paul Lee**, General Partner, VanEdge Capital; Active angel investor (Canada)
- **Ms. Isabelle de Baillenx**, CEO, Fadiese (France)
- **Mr. Terry Matthews**, Chairman, Wesley Clover; Active angel investor (UK and Canada)

There was a broad consensus, supported by studies in the US and the UK[1], and by the personal experience of panellists and participants, that business angels play a very important and increasing role in the ecosystem as they are able to: (i) quickly understand new market segments (sometimes even faster than established funds), (ii) bring not only capital to companies but also credibility, contacts and connections, and (iii) contribute to set the right culture in the companies. They are the first to finance new businesses and the volume of their financing is not far from that of venture capital in several countries. Anecdotal evidence suggests that angel money may, to a certain extent, have replaced institutional money during the current financial crisis.

Panellists strongly argued that well designed tax credits have a very positive impact on investment by business angels and on building links between business angels and venture capital, which in turn reinforces venture capital. This position is supported by the pieces of research presented in the Participant's Guide by Liddy Karter for the US and Paul Lee for British Columbia.

They also suggested that angel groups and structured mechanisms to favour co-investment between angel groups have positive effects on investment and on the ability of business angels to finance companies to a level where they can integrate the rest of the financing chain.

However, examples were given of ill-designed tax credits allowing investments to be made for the wrong reasons. References were also made to efforts by governments to "organize" business angels, when in fact they had the exact opposite result and made them fly away.

Finally, relations between business angels and venture capitalists are generally still difficult, which leads business angels to favour investment in companies that can rapidly become self sufficient or sold to strategic investors.

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1 Marianne Hudson, Ewing Marion Kauffman Foundation, *Why Entrepreneurs Need Angels – and How Angels are Improving*, Kauffman Thoughtbook, 2005 ; Yannis Pierrakis and Colin Mason, *Shifting sands – The changing nature of the early stage venture capital market in the UK*, NESTA, September 2008.

Panel 3: Public/Private Venture Capital Partnerships: Fund Managers Perspective

Moderator:

- **Dr. Robin Louis**, Former Chairman, Ventures West; Former President, CVCA, Canada's Venture Capital & Private Equity Association (Canada)

Panellists:

- **Mr. Stuart Waugh**, Managing Partner, TD Private Equity Investors (Canada)
- **Mr. Jacques Bernier**, CEO, Teralys Capital (Canada)
- **Ms. Franceska Banga**, CEO, The New Zealand Venture Investment Fund (New Zealand)
- **Mr. Christian Motzfeldt**, CEO, Vaektsfonden, The Danish Investment Fund (Denmark)

It is now widely accepted that government supported funds of funds which invest alongside the private sector in venture capital funds, are a most promising government tool to support the industry, because they are designed to work “with the market”. The panel concentrated on the conditions for success and the pitfalls of such structures. There was a large consensus around the following:

- Start with a commercial mindset;
- Do not spread too thinly. Support funds with a minimum size;
- Play your role as a cornerstone. Be a catalyst and a bridge, not a permanent source of funds;
- Empower the fund of funds with a broad and flexible mandate. Avoid narrow limitations;
- Do not go against the international norm; do not end up with a parochial structure which will run against sustainability.

At a more general level, emphasis was put on the importance of understanding the “requirements for success” and to commit to the implementation phase with a long term horizon.

During the discussion, it was argued that incentives are necessary to attract institutional investors back to the asset class, but that this should be only a bridge to a more sustainable model. There was no consensus however on this point, as several participants reaffirmed that government should stick to the “pari passu” approach and that incentives run the risk of lowering the bar: in their view, “soft” money ends up attracting “soft” teams and “soft” portfolio companies.

The EVCA draft advocacy paper entitled “*Risk Capital Action Plan for 2010 onwards*”, which was referred to during the panel, recommends a shift in government support from government funds of funds to privately managed funds of funds which would benefit from government allocations and incentives alongside private sector allocations. The EVCA’s position is that incentives would contribute to attract institutional investors back to the asset class and that, since these funds of funds would be managed by private sector teams selected in accordance with the private sector investors, they would also integrate industry’s best practices. Interestingly, both Ontario Venture Fund and Teralys (in Quebec) – who were both represented in the panel - are built on this exact same model.

This model could possibly be the right solution to reconcile both positions regarding incentives. The intensity of the discussions and the diversity of views expressed on this subject suggest that this theme should be revisited in greater depth at next year’s PPF.

Harvard Business Case: Capital for Enterprise Ltd.

Case Researchers:

- **Dr. Eli Talmor**, Professor, London Business School; Chairman, Coller Institute of Private Equity
- **Mr. Thibaud Simphal**, London Business School MBA 2010
- **Mr. Ananth Vyas Bhimavarapu**, London Business School MBA 2010

Moderator and supervisor*:*

- **Dr. Josh Lerner**, Jacob H. Schiff Professor of Investment Banking, Harvard Business School

Special guest:

- **Mr. Rory Earley**, CEO, Capital for Enterprise Ltd.

It is difficult to summarize the richness of the discussion which was spurred by the business case prepared for the QCC Public Policy Forum by a London Business School's team, under the supervision of Dr Eli Talmor (LBS) and Dr Josh Lerner (Harvard University). A consensus emerged on following points:

- There is a role for government to help attract talented people to form new managers' teams, both for ensuring renewal and diversity. In this regard, the ECF model seems to have been successful;
- The challenge is to attract the right kind of talent: due diligence, monitoring and quality control are critical;
- The program has to be viable: size of funds, economics of the management company, types of constraints imposed on the funds are key in this respect;
- Inappropriate conditions imposed on the funds can be very counterproductive (limitations imposed by the European regulations were referred to as an example).

However, the following questions were the object of debate:

- There was a consensus around the importance of matching funds to get these new teams started but not around the need or benefits of return incentives;
- The ECF model aims at expanding the supply of capital. Is there not something to be done on the demand side with a view of creating a better deal-flow and improving "investment readiness"?
- Defining success: should the success of such programs be defined only by financial returns? If not, what are other criteria to be considered? The following were mentioned: diversity of attracted teams; sustainability of the program; gross value added to the economy; number of serial entrepreneurs financed ("snow ball effect"). How can they be measured and articulated with financial returns?

At the end of the panel, Dr. Lerner's conclusions were as follows:

- Designing and implementing a program which meets government objectives and criteria and works successfully is not an easy task;
- In particular, it is both important and difficult to articulate the need for accountability inherent to government programs with the necessary flexibility associated with commercial success;
- Finally, it is important to define what success is, in order to be able to evaluate the results of the program.

Next steps

The wrap-up sessions and the comments received during and after the Forum lead us to the following conclusions regarding the evolution of the PPF:

Distinctive characteristics of the PPF that makes it unique

- There is no other venue specifically designed to generate a focused debate between opinion leaders from the investment community, governments and academics in a format allowing for disciplined discussions: by-invitation-only, content driven agenda, no service providers, no selling allowed even by sponsors, and a selected audience composed of pre-selected industry leaders and experts from all major economies. This is unique and needed;
- It will be important to keep this format (on invitation, high level and very interactive) and therefore not to increase the size but to be more selective if more countries have to be represented;

Improvements brought this year

- The 2009 PPF made a big step forward compared to 2008 in terms of content. Efforts were made not only to collect "war stories", but also to allow attendees to learn lessons from these stories in an integrated way;
- The new experience of the "Harvard Business Case" built for the PPF by Harvard and London Business School was a success and should be repeated in the future.

Suggestions for development and improvement going forward

Panels need to be more actively moderated to force panellists to engage more in a debate. A clearly defined thesis to debate, supported by a short position paper, might help in this regard. If a thesis is put forward for debate this might also help force the discussions to conclusions.

Themes for panels or business cases of particular interest are:

- Are incentives appropriate to attract private sector investors into the VC asset class? Models? Effectiveness?
- Models to facilitate exits and liquidity events;

- Models to finance the commercialization of research;
- The future of the VC model;
- Best practices to measure success and conduct evaluations.

Efforts need to be made to make the PPF more conclusive and more focused on solutions, provided that this does not impact negatively on the openness and diversity of the debates and does not transform the PPF into an advocacy platform. For instance, proposals could be prepared beforehand by small working groups and debated during the Forum. However, this is a demanding proposition that will require recruiting volunteers to participate in and lead these working groups.

The PPF needs to consider engaging in some kind of research.

- Several recommendations went in that direction, for example: compilation of information on best and worst practices; research about what works and what does not work, research about best practices in performance measurement or evaluation of programs.
- This route is interesting, but it also challenging because of the amount of work and the costs associated with such a project. There are also practical difficulties pertaining to definitions and data collection. Finally, there are organizations like the OECD (Organization for Economic Co-operation and Development) or ICE (International Consortium on Entrepreneurship) already involved in that area and there is a risk that the PPF could not meet the expectation of the attendees, at least in the short term, given its current limited resources.
- The PPF's mandate is to support high level discussions between senior people with high quality and well structured content. As a first step, we will investigate what is already done by other organisations and reflect about the best ways to continue informing panels and business cases.
- By way of comparison, in the context of the recent debates surrounding the economic impact of private equity, an ambitious research program was developed around the Davos Forum under the direction of Dr, Josh Lerner and the supervision of an international steering committee representing the various stakeholders involved in the debate. One eventual avenue for the PPF could be to put forward a similar program around the challenges related to venture capital and the financing of innovation and to look for resources to fund this program.

The PPF needs to reflect the growing importance of emerging markets.

- This year, for the first time, the PPF had a significant representation from emerging markets: Latin America, Southern Europe, Russia and Arab Gulf. This phenomenon can only grow with the globalization of innovation, the rapid development of these markets and their increasing interest in developing their own VC industry. Therefore, we will have to consider ways to integrate the subject of emerging markets in the PPF going forward, either by adding a specific panel on emerging markets in the plenary sessions or by developing break-out sessions.

Survey of Participants to The Quebec City Conference

Background and comments

This survey was conducted on line among the 355 participants to the Quebec City Conference. It received 116 answers, 69 from Canada, 18 from the US and 29 from other jurisdictions, 63 from GPs, 11 from LPs, 12 from government officials and 30 others. The sample is heavily weighted towards Canada but for most answers, differences across geographies are relatively small.

- 55% of respondents think that the venture capital model is broken and 51 % think that the problem will not simply disappear once the cycle bounces back
- 53% think that the US VC model is not exportable and other countries will have to support the financing of technology start-ups differently
- 78% agree that Institutional Investors should look for different investment models, increase reliance on internal resources and take a longer term view of investments
- 73 % support the calls for governments to set up funding mechanisms to compensate for the decline in VC fund raising from the private sector
- 78% agree that there should be incentives to individuals or institutional investors to invest in early stage Venture Capital funds.

As one could expect, US respondents are more optimistic about the VC model: 62% think it is not broken and 63% think that it is exportable. But overall, organized by types of respondents and geographies, responses show that most, if not all participants of the ecosystem think that it is facing severe problems which will not be solved by themselves:

- About half of GPs themselves think that the model is broken and that the problem will not disappear.
- LPs are even far more negative as 73% think that the model is broken and that the problem will not disappear[2]
- The idea that institutional investors should look for different models and calls for governments to support fund raising or for incentives to individual or institutional investors to invest in early stage VC funds are supported by over two third majorities across geographies (including the US) and types of respondents (including GPs). The only exception is LPs which are far less in favour of government intervention to support fund raising or to set up incentives to invest in VC funds, which perhaps indicates their reluctance regarding the asset class.

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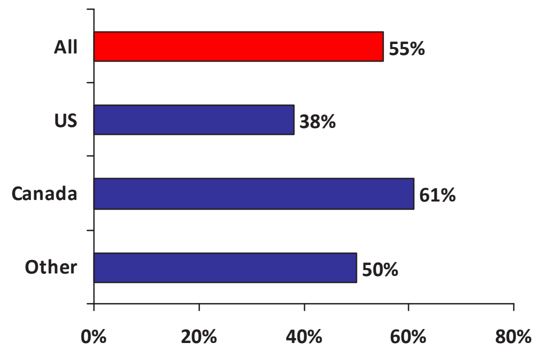
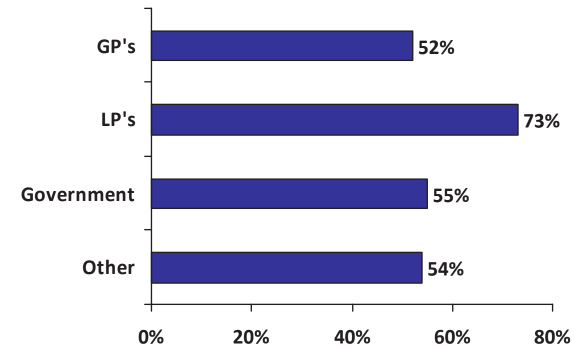
[2] However, one should note that the US is relatively underrepresented among LPs which responded.

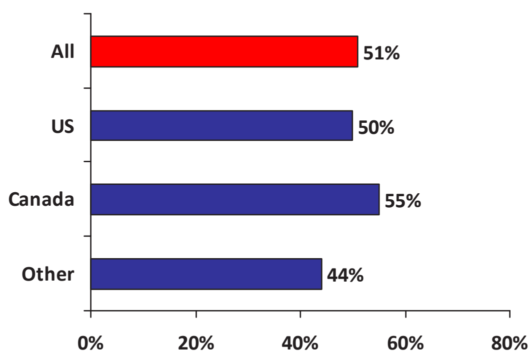
Results of the survey

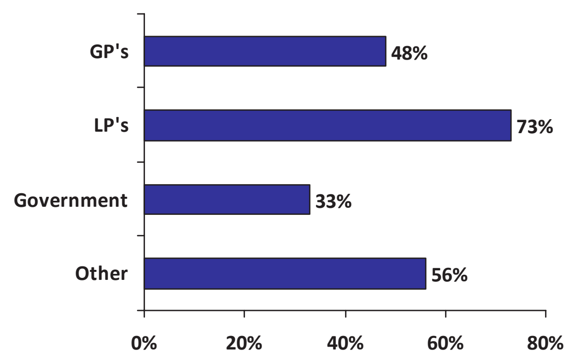
1. Is the Venture Capital Model Broken? - YES



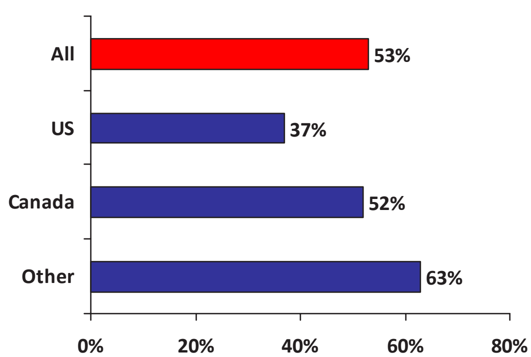


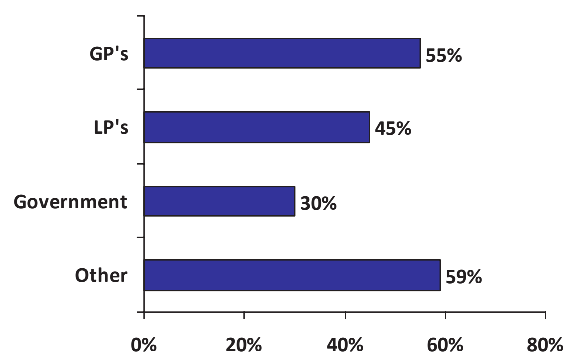
2. Will the debate about whether or not the VC model is broken disappear once the cycle bounces back? - NO



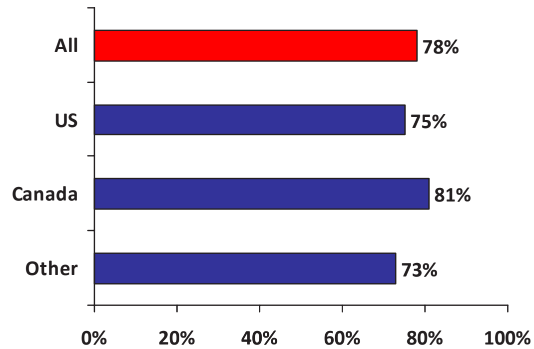


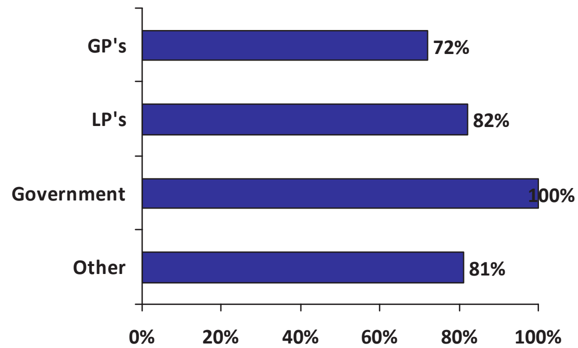
3. "The US VC model is not exportable. Other countries will have to support the financing of technology start-ups differently" - AGREE



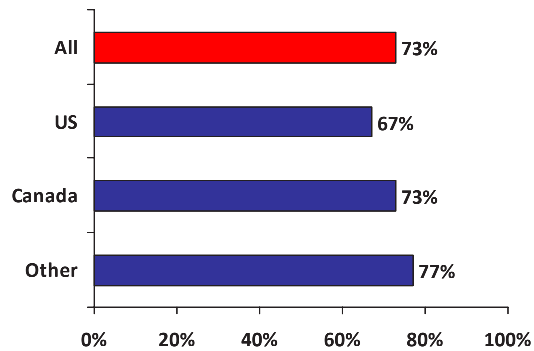


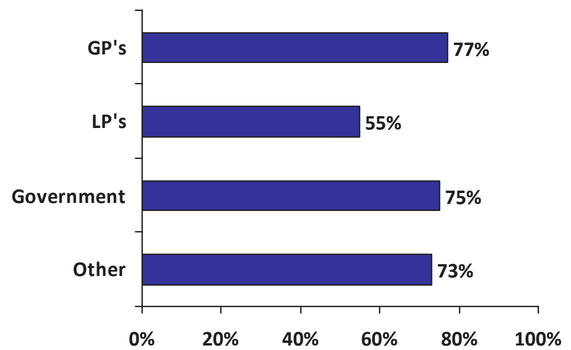
4. "Institutional Investors should look for different investment models, increase reliance on internal resources and take a longer term view of investments" - AGREE



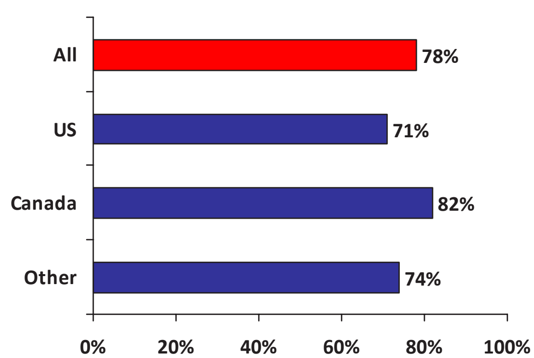


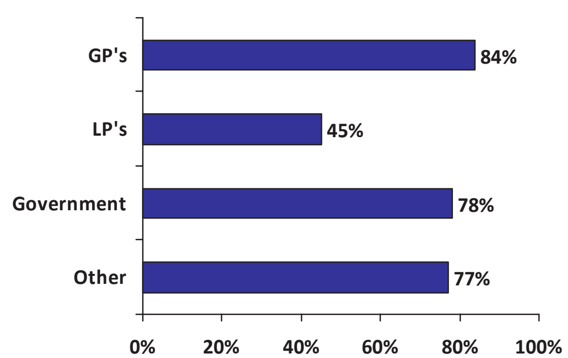
5. In many countries, there are calls for the government to set up funding mechanisms to compensate for the decline in VC fund raising from the private sector. Would you support these calls? - YES





6. Should there be incentives to individuals or institutional investors to invest in early stage Venture Capital funds? - YES





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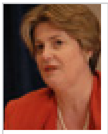
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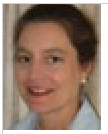
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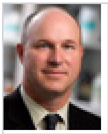
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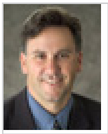
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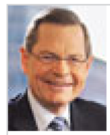
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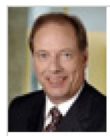
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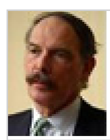
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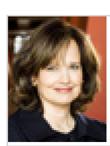
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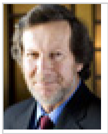
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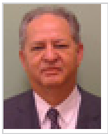
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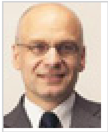
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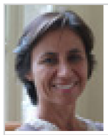
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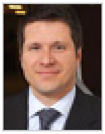
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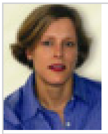
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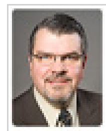

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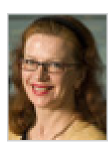

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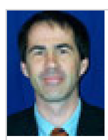
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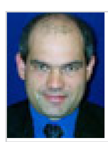
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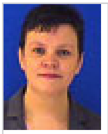
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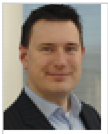
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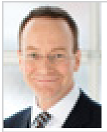
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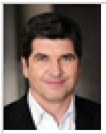
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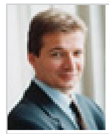

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Save the Date: **October 25 and 26, 2010**