Main Conclusions

of the 2010 QCC Public Policy Forum on Venture Capital and Innovation

PUBLIC POLICY FORUM
on Venture Capital and Innovation

Message from the Quebec City Conference President & Chair

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.

The venture capital model was invented in the US after three decades of trial and error. It has registered its main successes in California and the US East Coast and proven very flexible to adapt to the ups and downs of this very cyclical industry. New challenges, however, have added to the difficulties of the present downturn as it comes after a decade of disappointing returns, even in the US, while globalization of technology and innovation is profoundly changing the landscape. The new cycle may look very different from the previous ones.

On the other hand, it is important to remember, especially in these unsettling times, that it is innovation that truly drives economies. The underlying factors of innovation, which are R&D spending and the training of entrepreneurs, engineers and scientists, keep growing and becoming more and more global. Even if its model is being questioned, venture capital remains the most efficient financing means to transform innovation into successful companies and products.

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.

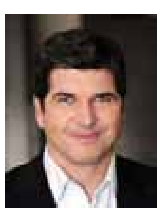
The QCC Public Policy Forum on Venture Capital and Innovation was conceived to accomplish this objective.

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 governments of Ontario and British Columbia which 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 of 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.

Sincerely,



Mr. Christian Racicot
Co-Founder and President
The Quebec City Conference

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

About the Public Policy Forum

Held annually within the Quebec City Conference, the Public Policy Forum on Venture Capital and Innovation has evolved into the premiere gathering of public policy makers and industry leaders (GPs, LPs, academics and other experts) responsible for encouraging high-potential entrepreneurship and venture capital from all major economies.

The objectives: Building this Forum as an independent platform to give participants an opportunity to exchange views, experiences and concerns regarding public policies in support of a buoyant venture capital ecosystem to finance emerging technology companies and to develop long term relationships.

About The Quebec City Conference

Now in its eight year The Quebec City Conference is private, by invitation-only and not-for-profit, and regarded as the “Davos” of this international investment community. In 2010, the Conference attracted 425 participants from 22 countries from North America, Europe, Asia, Middle-East and South America. Service providers are not invited.

The QCC 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.

Additional information at: www.quebeccityconference.com

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Quebec City, October 25, 2010

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

Held annually within the Quebec City Conference, the Public Policy Forum on Venture Capital and Innovation (“PPF”) has evolved into the premiere gathering of public policy makers and industry leading GPs, LPs, academics and other experts responsible for encouraging high-potential entrepreneurship and venture capital from all major economies. Its objective is to give participants an opportunity to exchange views, experiences and concerns regarding public policies in support of a buoyant venture capital ecosystem to finance emerging technology companies.

The 2010 edition of the PPF which was held in Québec City on October 25, 2010, brought together 120 senior GPs, LPs, Government officials and academics from 17 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.

The general theme of the day, *“Questioning the VC Model – Implications for Public Policies”*, the initial presentation and the panels and Harvard business case which followed, attracted particularly rich discussions at a time when so many uncertainties are surrounding this asset class and fund raising is proving to be particularly difficult.

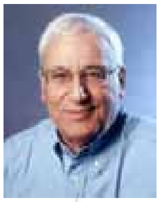
This document summarizes these debates. It presents the main conclusions of the Forum and makes suggestions for next steps. It is meant to prolong the discussions and prepare for the next Forum which is to be held on Monday, October 24, 2011 in Québec City.

We wish you a good reading and welcome comments.

Gilles Duruflé

Dr. Gilles Duruflé

Executive Vice President
The Quebec City Conference
President, QCC Public Policy Forum on Venture Capital



Mr. Yigal Erlich

Founder, Chairman and Managing Partner
The Yozma Group
Chair, QCC Public Policy Forum on Venture Capital

Program

Monday, October 25, 2010

7:30—8:30	**BREAKFAST: Bellevue Room**
8:30 - 8:50	**WELCOME:** **Mr. Stephen A. Hurwitz**, *Co-Founder and Chair*, The Quebec City Conference; **Mr. Yigal Erlich**, *Founder, Chairman and Managing Partner*, The Yozma Group, *Chair,* Public Policy Forum **INTRODUCTION:** **Dr. Gilles Duruflé**, *President*, Public Policy Forum
8:50 - 9:40	**KEYNOTE PRESENTATION*: "Questioning the VC model - implications for public policies"** **Dr. Thomas Hellmann**, *B.I.* Ghert Family Foundation *Professor in Finance and Policy,* Sauder School of Business, University of British Columbia **Dr. Gilles Duruflé**, *President*, Public Policy Forum *** Dr Josh Lerner** participated in the preparation of this presentation but will not be physically present due to prior teaching commitments.
9:40 - 10:30	**FIRST PANEL: Innovative and creative actions taken around the world to renew the venture capital model**
10:30 - 10:50	**NETWORKING BREAK**
10:50 - 11:40	**SECOND PANEL: Which public policies to support the industry in a period of transition?**
11:40 - 12:30	**THIRD PANEL: Best developments in new markets**
12:30 - 13:30	**NETWORKING LUNCH**
13:30 - 15:15	**BUSINESS CASE: The British Columbia Venture Capital Program**
15:15 - 15:35	**NETWORKING BREAK**
15:35 - 16:25	**FOURTH PANEL: Tech transfer: new model or traditional VC financing**
16:30 - 17:00	**General Discussion: conclusions and next steps**

Keynote Presentation

“Questioning the VC model – Implications for public policies”

Keynote speakers

Dr. Thomas Hellmann
B.I. Ghert Family Foundation Professor in Finance and Policy
Sauder School of Business
University of British Columbia

Dr. Thomas Hellmann is the B.I. Ghert Family Foundation Professor in Finance and Policy at the Sauder School of Business at the University of British Columbia. He holds a BA from the London School of Economics and a PhD from Stanford University. He is the director of the W. Maurice Young Entrepreneurship and Venture Capital Research Centre at UBC. Prior to joining UBC, he spent ten years as an Assistant Professor at the Graduate School of Business, Stanford University.

He teaches executive, MBA and undergraduate courses in the areas of venture capital, entrepreneurship and strategic management. His research interests are venture capital, entrepreneurship, innovation, strategic management and public policy. He is also the founder of the NBER Entrepreneurship Research Boot Camp, which teaches the frontiers of entrepreneurship economics and entrepreneurial finance to PhD students.

Recently he wrote a report about the role of government in venture capital for the World Economic Forum in Davos. He also led the evaluation report of the venture capital program in British Columbia. His academic writings have been published in many leading economics, finance and management journals. He has also written numerous case studies on entrepreneurship and venture capital, and led the development of a library of case studies focused on high technology companies in British Columbia. Currently he is writing a textbook on venture capital and private equity.

Dr. Gilles Duruflé
President
Public Policy Forum on Venture Capital

Gilles Duruflé is presently Executive Vice President of the Quebec City Conference and President of the Public Policy Forum. He is also an independent consultant advising venture capital and private equity funds, institutional investors and governments.

He was until 2004 Senior Partner at CDP Capital Technology Ventures, the Venture Capital Subsidiary of the Caisse de dépôt et placement du Québec, in charge of the Funds of Funds portfolio investing in North American and European VC funds. He was previously Head of strategic studies at the Caisse de dépôt et placement du Québec. From 1979 to 1991, he worked as senior partner in strategic consulting firms in the CDC Group (Caisse des dépôts et Consignations, Paris) in Europe and North America.

He is a Vice-President of the Canadian Venture Capital Association (CVCA) and sits on the International Private Equity Valuation (IPEV) Board.

M. Duruflé obtained his Masters in Philosophy from the CERP (Paris), his Ph.D. in Mathematics from the Paris VI University and the Diploma of the Centre d'Études des Programme Économiques (Ministry of Finance, Paris). He is a CFA and has published numerous books and articles on various subjects related to economics and finance.

Special Advisor

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.

Organizing Committee

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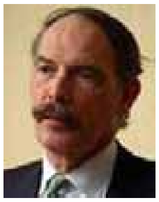
Dr. Gilles Duruflé

Executive Vice President
The Quebec City Conference

Members

Mr. Ross Bricker

President and CEO
AVAC Ltd.



Mr. Francis Carpenter

Senior Advisor - CDC international
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Professor
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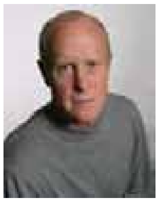

Dr. Robin Louis

Senior Advisor
Vanedge Capital

Mr. Randy Mitchell

International Trade Strategist for Venture Capital
US Department of Commerce, International Trade Administration

Dr. Helmut Schühsler

Managing Partner
TVM Capital

Main Conclusions of the 2010 QCC Public Policy Forum on Venture Capital and Innovation

Introduction

The objective of the QCC Public Policy Forum on Venture Capital and Innovation ("PPF") is to become the premiere international gathering of public policy makers and industry leading GPs, LPs, academics and other experts responsible for encouraging high-potential entrepreneurship and venture capital in all major economies.

It started in 2008 with presentations of government interventions and discussions of lessons learnt in Canada, Europe, Israel, New-Zealand, Russia, the UK and the US. Many points of convergence around these experiences were highlighted during the day as well as the need for a more systematic approach of what works and what does not.[1]

Building on this recommendation, the 2009 PPF focused on the case for government intervention to support the development of a buoyant Venture Capital ("VC") industry, its pitfalls and conditions for success. Based notably on the conclusions of Dr. Josh Lerner's book *(Boulevard of Broken Dreams – Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed and What to Do about it*), which was launched at the PPF, and on international experiences which were discussed during the panels which followed, a broad high level consensus was reached on these topics. However, many concerns were raised around the viability of the VC model itself, in the absence of positive returns, especially outside the US, and about the possibility of implementing successful public policies to support the industry in such a context.[2]

One year later, these questions were even more pressing. Participants had in mind the 10-year horizon return for US and European venture capital funds[3], which clearly showed that the industry had generated disappointing returns for more than a decade, even in the US. LPs' dissatisfaction has grown and, as a result, fund raising is in a free fall in most markets: compared to 2007, the first half of 2010 is down by 66% in the US and 75% in Europe.

There is obviously a cyclical dimension to these results, but cyclicality may not tell the whole story. One may have to consider different scenarios where the LP base may be enduringly affected by the situation and GPs will have to change some of their practices to respond to the new situation. Public policies to support the industry would also have to adapt to this new configuration. This set the stage for the discussions of the 2010 PPF whose main conclusions are summarized below.

1 "Main Conclusions of the 2008 PPF"

2 "Main Conclusions of the 2009 PPF"

3 As of June 30, 2010, the 10 year horizon return for all VC funds was -1.6% both in the US and Europe (source: Thomson Reuters).

Keynote Address by Dr. Josh Lerner[4], Dr. Thomas Hellmann and Dr. Gilles Duruflé: "Questioning the VC Model – Implications for Public Policies"

The keynote address explored potential scenarios that the VC industry may face in the coming years and their implications for public policies.

First, it recalled the case for government intervention in venture capital (strong positive effect of venture capital on innovation, wealth creation, economic growth and employment; positive externalities; virtual circle with cumulative effects), its main pitfalls (ill-designed and poorly executed programs or "capture") and its main conditions for success (ensuring that the legal, fiscal and business environment is set right; incorporating the market into the program design; and avoiding self-defeating design errors). It also presented new evidence derived from recent research showing that government support for venture capital works best when it works with private markets and companies do better when VC funds are supported rather than being owned by government.

The core of the presentation then provided tools to explore what could result from the challenges the VC industry is currently facing, i.e. disappointing returns and LP's dissatisfaction. In doing so, it drew up four scenarios based on the two following variables: (i) the evolution of returns: will they return to "fair" or remain "disappointing" and (ii) the LP response: will they remain loyal to the asset class or not.

Four Scenarios

	Constant Investor Base	Turnover in Investor Base
"Fair" Returns	Recovery	Back to the Future
Disappointing Returns	A Broken Industry	The LPs' Desertion

Scenario 1 (Recovery) is the optimistic scenario. Venture Capital is a very cyclical asset class. In boom times, less qualified investors enter the market. Downturns lead them to pull out. Returns will come back. LPs will continue financing a rejuvenated industry. Throughout these ups and downs, a critical mass of seasoned entrepreneurs and investors keeps growing and lays the foundation for a successful VC industry in the long-term.

– ***Implications for public policies***

In the context of a sound VC industry, recommendations for public policies, especially in countries where the ecosystem is not yet mature, remain those mentioned earlier: keep setting the environment right (R&D funding, legal, fiscal, intellectual property) and working with the private sector (mostly through indirect investment and matching funds, avoiding counterproductive constraints and conditions). Be patient and consistent.

4 Due to prior teaching commitments, Dr. Josh Lerner was not present at the Forum. However, he participated in the preparation of the keynote address and is the author of the four scenarios which were presented.

However, governments may have to play a contra-cyclical role if the market correction becomes too severe and threatens the continuity of the ecosystem.

In this optimistic perspective, the American model should be successfully replicable elsewhere. From this premise, it is only a matter of time and consistency before the critical mass of technologies and seasoned entrepreneurs and investors can be built. As Dr. Lerner mentioned in his book: *"It appears that if one looked at the returns from the early days of the U.S. venture industry, one would see a similar picture [negative returns]… This pattern suggests that no matter how promising the returns of entrepreneurial activity ultimately are, in a venture market's early years, low returns are likely"*. However, the world has become far more global since the 70s and globalization may bring new perspectives in this regard.

Finally, the presentation made it clear that the IPO market never really came back after the burst of the tech bubble and there is now a disconnect between the trends in the value of exits on the one hand and the pace of investment on the other. Thus, one could ask the question: is this scenario credible without a change in the exit markets?

Scenario 2 (Back to the Future) is also based on cyclicality and a comeback to fair industry returns once less performing managers have left the market. But there is a twist. Rebuffed by the difficulty of having access to proven performing funds or selecting successful emerging managers, many LPs leave the asset class. Only more sophisticated LPs remain and GPs have to find ways to attract a smaller and perhaps different pool of capital, as was the case before ERISA was amended in 1978 opening the asset class to pension funds in the US (this is why this scenario is called "back to the future").

The LP base shrinks and fund raising becomes very difficult outside the first quartile or first decile of US funds and a very limited number of funds outside the US.

– ***Implications for public policies***

In this context of a smaller and renewed LP base, the main objective of policy makers will be to enlarge the LP base. Supporting the emergence of public/private funds of funds as was recently the case in the UK, France or Canada might, among other things, be a good tool to do so. The European Union Commission recently published a White Paper which also goes in this direction[5]. The objective of retaining or attracting private sector LPs under these circumstances raises the difficult question of incentives and how to properly design them.

If the typical public or private pension funds are not there anymore, GPs will have to turn to other sources of money such as endowments, family offices or corporations. Is there a way for public policies to work with these investors and attract them to the asset class?

Finally, if there is a contraction of the VC industry, can business angels become an alternative source of financing for technology start-ups and what is the best way for public policies to support them?

5 EVCA Venture Capital White Paper, "Closing gaps and moving up a gear: The next stage of venture capital's evolution in Europe", Brussels, 2 March 2010.

Scenario 3 (The LP Desertion) is an exacerbation of scenario 2: not only are returns excessively concentrated, but overall they remain dismal. LP and GP views on how the industry should function remain miles apart and there is a massive LP desertion from the asset class.

This could have dire consequences, especially outside the US. The industry, which some argue is now too large – too much money –, could become too small, thus compromising long-term efforts to build a critical mass of tech savvy entrepreneurs and investors.

– ***Implications for public policies***

Some LPs may try and develop their own captive teams. Is this to be encouraged?

The financing of tech start-ups will have to look for other sources of capital. Corporations may be one of them. This could be through the comeback of corporate venture capital or through incentives to corporations to fund GPs. In Canada for instance, so called “industrial benefits” derived from defence contracts may be used as such an incentive.

Where they exist, National Investment Funds could be called to the rescue as catalysts.

Could bypassing venture capital to link earlier with public markets as some tech transfer models seem to do be a solution?

Again, could business angels replace, at least partially, a shrinking venture capital industry and should public policies consider ways of supporting them?

In this scenario even more than in the others, it is important for policy makers to limit the negative impact of new regulation which, for instance, could exclude banks and insurance companies from the asset class and severely limit international flows of capital for venture capital and private equity.

Finally, if private sector LPs desert the VC industry, should government also simply give up and look for alternative ways to support technology start-ups? Governments can and should play a contra-cyclical role, but they cannot and should not go against the tide of a structural shift when it occurs.

Scenario 4 (A Broken Industry) is the triumph of hope over experience. Money keeps flowing to an industry of which only a small part is profitable and the majority of investors keep accumulating losses.

– ***Implications for public policies***

Governments keep accumulating losses alongside the private sector. At a time when public budget constraints are so strong, how long can this pattern continue?

Panel 1: "Innovative and creative actions taken around the world to renew the venture capital model"

Moderator

- **Mr. Gordon Hargraves.** Partner, Rho Fund Investors (USA)

Panellists

- **Mr. Ed Colloton.** Bessemer Venture Partners (USA)
- **Mr. Frank Landsberger.** Senior Managing Director, INKEF Netherlands Manager B.V. (The Netherlands)
- **Mr. Jim Pittman.** Vice President PSP Investments and ILPA Board member (Canada)

Even if venture capital fundamentals are not broken, things need to change

Panellists tended to agree that venture capital fundamentals are not broken. This business is highly cyclical; innovation is continuous; best performing funds will continue to thrive and returns will come back; venture capital business is becoming global; given the present positioning in the economic cycle, now is the best time to invest.

Nevertheless, for reasons stated above, i.e., difficulty of access to performing funds, poor returns of the asset class given its level of risk, misalignment of interests between LPs and GPs and lack of transparency which are discouraging many LPs, we are certainly experiencing a turnover in the LP base and that puts us somewhere between scenario 2 and 3. Interestingly enough, the panel added another reason for the LP turnover which comes from the LP side: for lack of specialized resources and high turnover, many LPs are not equipped to face this difficult situation and will prefer to withdraw.

The consensus was that things have to change. GPs have to be held more accountable. LP/GP relationships have to be designed in such a way that GPs make money only when LPs make money. LPs' objectives and constraints have to be better understood and taken into account by GPs.

There is a need for experimentation to find successful responses to present challenges: different time horizons, different compensation schemes in order to better align interests (fees on budget, larger investment of GPs in the fund, co-investment by individual GPs), greater transparency and sharing of information. Panellists gave examples of such initiatives derived from their own experience.

Experiences discussed during the panel suggest that this experimentation is facilitated by the stability and sophistication of the LP base and a strong dialogue between GPs and LPs. This experimentation can be:

- GP driven, notably by successful GPs that have long-term, strong and sophisticated anchor investors, such as large family offices, and have cultivated long-term relationships with a stable LP base;
- or LP driven. Some LPs are developing special relationships, under new conditions, with GPs of their choice: captive teams such as INKEF, with different terms and time horizons (15 years) or LPs taking the lead to attract individuals with a track record to build new GPs under different terms and conditions. Will institutional LPs be able to allocate resources and remain committed to such efforts on a long-term basis?

One of the panel's conclusions was that venture capital is a difficult business and there is a need for a sophisticated LP base, committed to the long-term and ready to dedicate skilled resources to this asset class and engage in a lasting relationship of trust with GPs. Presently, many LPs lack this level of sophistication and their constraints do not allow them to hire the right resources. In this regard, Canadian and European pension plans seem to have more room for manoeuvre than their US counterparts. They are leading a greater number of initiatives and are more prone to collaboration between LPs in order to innovate. In the US, innovation seems to be more linked to different kinds of LPs, such as family offices.

Panel 2: "Which public policies to support the industry in a period of transition"

Moderator

- **Mr. Stephen A. Hurwitz.** Co-Founder and Chair, The Quebec City Conference (USA)

Panellists

- **Mr. Rory Earley.** CEO, Capital for Enterprise Ltd (UK)
- **Mr. Pascal Lagarde.** CEO, CDC-Entreprises (France)
- **Mr. Jonathan Silverstein.** General Partner, Orbimed Advisors (USA)

A scenario of LP desertion

All three panellists were from three different countries: the US, the UK and France. They agreed that we are in a scenario of LP desertion as shown by fund raising statistics or the declining size of funds when they manage to close, even in the US. "Hope over experience" has been going on for too long and, in many countries, the comfortable lifestyle of GPs when LPs and pension plans are not getting a return on their money is driving growing irritation among LPs and in public opinion.

One should expect a sharp contraction of the industry. In the case of France, where fund raising is more dependent on banks and insurance companies[6], the situation is made even more severe by the new capital requirement rules enacted by Basel III for banks and Solvency II for insurance companies. On the positive side, high net worth individuals are still present and corporations seem to be back.

Which tools are needed to support capital formation in the VC industry?

There is no simple answer to this question.

Normally, a mix of tools – such as government direct investment funds, co-investment funds, government funds of funds, public/private funds of funds, guarantees or, finally, tax incentives to individual investors in VC funds - is to be recommended in order to address different objectives, sectors and positions in the cycle. But the present situation makes it especially difficult because of the lack of a private sector counterpart. As a response, the public sector can raise its participation as an LP (taking a higher percentage in funds), or take the lead to help in fund raising, but under the present circumstances, this pari passu approach may be insufficient to attract private sector LPs and additional incentives may be required.

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6 The vast majority of pensions in France are run on a pay-as-you-go system and are not funded through capitalized pension plans.

Are financial incentives required?

Discussing the Israeli biotech funds program, which encompasses very strong financial incentives for private sector LPs, and comparing it with the UK experience was very instructive in this regard.

The Israeli biotech funds program provides incentives on the upside (return enhancement) as well as the downside (protection against first losses). It also sets up very rigorous qualification conditions in terms of assets under management as well as investment and sector experience in order to attract global brand names.

When asked whether such generous incentives were necessary, Orbimed Advisors, which successfully applied to the program, stressed that there was no doubt in their mind that these incentives were necessary to be able to raise a new Israeli fund dedicated to the biotech industry[7]. Without these incentives, there would be no local fund and no local team. Orbimed would just do deals occasionally in Israel from its US office. With the incentives, Orbimed will be able to raise $144 M, mostly outside the US. Orbimed US will co-invest with the local fund and attract other foreign co-investors. The local team will learn from the global team.

Downside protections are usually not recommended as they tend to convey the wrong message ("do not expect these investments to be profitable") and can become self-defeating prophecies that are expensive for governments. However, the Israeli Government chose to include such clauses at the request of local LPs who are new to this asset class and had mentioned that this would be a precondition to their investment. It has proven effective in raising capital from them. Moreover, Orbimed US stresses that since their investment represent 4% of the fund, they will work hard at making this protection unnecessary.

Finally, though necessary, financial incentives are only part of the equation. Orbimed would not have been interested in setting up a fund in Israel in the absence of a strong deal-flow supported by a critical mass of R&D, scientists and intellectual property (patents).

The UK experience with regional venture capital funds was quite the opposite but, in the end, underlines the same conditions for success. The program provided financial incentives similar to the Israeli biotech program. However, in the absence of a strong pre-qualification process and significant investment by the management team in the fund, and because the program targeted regions with a very limited deal-flow, it only attracted unqualified investors who had little incentive to succeed. Returns proved to be very disappointing.

These shortfalls were corrected in the next program (capital for enterprise funds) which avoided such regional constraints and where a rigorous and well structured managers' selection process succeeded in attracting far more qualified managers.

Transforming retail money into smart money?

Tax incented retail funds such as FCPIs in France or labour sponsored funds in Canada are a very efficient way to raise capital and may be particularly needed in times when private investors turn their back on the asset class. However, they are often criticized because (i) intermediation costs may become excessively high and (ii) these funds may end up being managed by poorly qualified teams that are more interested in intermediation fees than investment itself. As often pointed out, the main problem with venture capital is not only "money", but "smart money", which is capital managed by teams with the right skills and networks.

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7 Even with these incentives, there are signs that other international GPs that successfully applied to the program will be not be able to raise their fund.

One avenue for solving this issue would be to direct this retail money not to direct investment teams, that only qualify through their ability to raise money, but to specialized funds of funds which would then be able to invest it with qualified VC teams. This scheme has been developed in Canada with the Fonds de Solidarité des Travailleurs du Québec investing in Teralys Capital (a specialized fund of funds). Other jurisdictions are presently looking into similar kinds of solutions.

Working with corporations?

As institutional investors are more and more difficult to attract to the asset class, working with corporations could be an alternative. For example, France has recently launched a specialized independent biotech fund called Innobio funded by CDC-Entreprises (37%) and large international pharmaceutical companies such as Sanofi Aventis, GSK, Roche, Novartis, Pfizer, Lilly, Ipsen, Takeda and Boehringer-Ingelheim.

Regulatory actions?

Finally, Europeans stressed the importance of regulatory actions to allow banks and, more importantly, insurance companies to remain active in the asset class.

Panel 3: "Best developments in new markets: China, Mexico and the Middle East"

Moderator

- **Ms. Susana Garcia Robles.** Senior Investment Officer, Multilateral Investment Fund (USA/Latin America)

Panellists

- **Mr. Paul Ahlstrom.** Managing Partner and Founder, Alta Ventures (Mexico)
- **Mr. Rogelio de los Santos.** Managing Partner and Founder, Alta Ventures (Mexico)
- **Mr. Omar Lodhi.** Executive Director, Abraaj Capital (United Arab Emirates)
- **Mr. Ken Xu.** Partner, Gobi Partners (China)

A very different and far more positive environment

The tone of emerging markets (China, the Middle East, Mexico and Latin America in general) was very different from that of North America and Europe. It was far more positive and certainly not that of an LP desertion scenario. These markets have witnessed very strong growth for the last decade and have not yet seen bad returns. Reform mindset kicked in ten years ago. There is a huge reverse brain drain and knowledge transfer is happening rapidly. Governments are mobilized as well as other sources of money, depending on the various countries such as high net worth individuals, family offices, international funds such as the Multilateral Investment Fund, and global corporations such as Cisco through its Country Transformation Program.

Finding innovative ways to build the ecosystem

Although this situation creates a staggering amount of opportunities, these ecosystems are still underdeveloped, to some extent. In a first stage, growth equity plays a more critical role in supporting the development of entrepreneurship than do pure technology venture capital funds.

In Mexico where innovation capacities are already well developed through incubators, accelerators, business parks and mentorship programs such as in Monterey, significant efforts concentrate on "getting the environment right" (international recognition of patents, allowing pension funds and insurance companies to invest in venture capital) and educating investors, notably business angels and family offices. Developing networks between the US and Mexican ecosystem plays an important catalyst role in this regard. Government initiatives to facilitate capital formation, notably through funds of funds, also play a critical role as it did in other places such as Utah.

The Chinese ecosystem is evolving very rapidly. There is a strong government will to develop local companies through local funds. For this purpose, the government encouraged state companies to invest in venture capital, making available very large pools of money. In order to have local exits, it created Chinext, *"a new capital platform tailor-made for the needs of enterprises engaged in independent innovation and other growing venture enterprises"*, attached to the Shenzhen Stock Exchange.

One of the main pitfalls is that too easy money may lead investors to think that venture capital is easy (As Ken Xu noted, "everybody thinks that he or she can be a venture capitalist") when experience and skills are critical ("smart money"). This is dangerous and similar past experiences have led to disappointing results. However, opportunities for qualified investors remain tremendous.

Shall we see Chinese funds investing in the US, notably to be closer to technology hubs?

It is a big jump. LPs will learn first to approach the US market, particularly through funds of funds. In order to learn more from US companies, Chinese funds are more likely to fund them when they open offices in Singapore or China.

Panel 4: "Tech transfer: new model or traditional VC financing"

Moderator

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

Panellists

- **Ms, Anne Glover.** CEO, Amadeus Partners (UK)
- **Dr. Raphael Hofstein.** President and CEO, MaRS Innovation (Canada)
- **Professor Graham Richards.** Senior Non-Executive Director, IpGroup (UK)

Broadly speaking, "technology transfer relates to the creation of wealth from the intellectual property generated by university and research centers."[8] More precisely, the panel focused on the financial dimension of this activity. The traditional way of looking at it is to consider technology transfer as part of a continuous chain which goes from R&D funding to late stage venture capital and public markets through all the stages of technology validation, company creation and exit. Tech transfer is a particularly difficult link in this chain, often called "the valley of death", when commercial, "market-pull" financing has to act as the relay to non-dilutive, mostly "technology-push" money.

Over the last decade, venture capital has often been criticized as "too risk averse" and arriving too late to play its role in the chain. Governments have been called on to provide financing and incentives to help link university intellectual property with the financing chain.

In this context, somewhat different models, called "tech transfer" in a narrower sense, have emerged, looking for alternative exit routes and sources of financing to commercialize university intellectual property. They seem to have been particularly successful in the UK during the 2000 decade with the development of companies such as IP Group and Imperial Innovations.

Tech transfer works: the UK experience

Professor Graham Richards reported Oxford University's impressive track record: 64 spin-outs between 1998 and 2009. The Department of Chemistry alone has contributed some £80 million to the university as a result of spin-outs.

Success factors: who should manage the IP? The debate is still open

All panellists agreed that a key success factor for tech transfer is a crystal clear IP position, including students' work and agreements for subsequent work on this IP. Professor Richards insisted on the critical role in the UK of the decision made by the government in 1988 to give clear ownership of IP to individual universities on condition that a mechanism be set up to exploit it. A typical equity split for an Oxford University spin-out would be: university 25%, academics 25%, funders 40% and management 10%.

The success of tech transfer in the UK relies also on the role of organisations such as IP Group (Oxford University and nine other universities) or Imperial Innovations (Imperial College) which have struck agreements with universities in order to source and protect IP, validate market potential, provide grub money and prepare for licensing or spinout and additional rounds of financing. In exchange, as funders, they receive an agreed upon share in the ownership, typically 40%.

A somewhat similar mechanism was set up by MaRS Innovation which has an exclusive option to lead and support the commercialization of all intellectual property assets from 14 universities and teaching hospitals in Toronto. In return for its role as commercialization agent, MaRS Innovation receives an agreed upon share of the property.

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8 This definition comes from Graham Richards' (one of our panellists) recent book: "Spin-Outs – Creating Businesses from University Intellectual Property", Harriman House, p.17.

This kind of exclusive right, which proved to be successful in the UK during the last 20 years, drew some debate from the audience. Participants, drawing notably on the experience of the University of Utah, which in 2008 had the largest number of spinout companies in the US, argued for a more open model in which inventors could directly access a diversity of commercialization agents.[9]

However, all agreed on one point: the importance of the entrepreneurial dimension within universities. Most successful spinouts are the work of "repeat offenders". Commercialization agents should act as lighthouses to attract these entrepreneurial academics rather than search for technologies throughout universities. Playing that role requires the right entrepreneurial and operational skill sets and a proper alignment of interests which technology transfer offices have difficulty to achieve given their limitations. Through various initiatives, Utah seems to have been particularly successful in developing this entrepreneurial spirit and aligning interests of inventors, the university and seed financing sources.[10]

Funding mechanisms

The commercialization agent's role requires funding for advice, IP protection, grub and seed funding. This funding is hard to find as most venture capital funds find too early and risky to invest at this stage.

The UK experience in the 2000 decade was widely facilitated by the presence of AIM (Alternative Investment Market of the London Stock Exchange). IpGroup was able to raise money on the public market and finance its activities out of its balance sheet. It was also able to relatively rapidly finance on the stock exchange companies that it had funded. Hadasit BioHolding in Israel developed a similar model with the funding support of the Chief Scientist Office. However, this reliance on public markets has proven to be more difficult in the more recent years.

In Canada, MaRS Innovation has been able to draw on financing from the federal and provincial governments as well as its 14 member institutions.

In the UK, competitions for collaborative R&D grants, which support partnerships between companies and universities, are an important tool for companies to create their product roadmap, work on the next generation of products and mesh with universities.

Finally, it was stressed that financing tech transfer for capital intensive innovation remains a challenge. To face this issue, European and Asian countries tend to favour technology and innovation centers such as the Fraunhofer Institutes in Germany, the Carnot Institutes in France, ETRI in South Korea or ITRI in Taiwan that "enable companies to share the costs of R&D, access skills and equipment which might not otherwise be within their reach, and so reduce risk, shorten time to market, and exploit synergies of know-how across the value chain."[11] In the US, procurement policies, notably from DARPA, supported by the SBIR program, play an important role in this regard.

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9 In Canada, the University of Waterloo has opted for an open model in which the inventor is the owner of the IP, has no obligation to transfer it to the university and can choose its commercialization agent. Similarly in the US, Robert Litan, Vice President for Research and Policy at the Kaufmann Foundation, recently advocated in favour of freeing-up the market in technology licensing: "Let's allow any inventor-professor to choose his or her licensing agent—university-affiliated or not—just as anyone in business can now choose his or her own lawyer." (Source: Robert E. Litan and Lesa Mitchell "A Faster Path from Lab to Market – Removing the technology licensing obstacle" *in* "The HBR List, Breakthrough Ideas for 2010" Harvard Business Review, January-February 2010, p. 6-7.)

10 Paul Ahlstrom and Rogelio de los Santos, "Venture Commercialization – Driving Sustainable Growth Through Innovation, Growing Success Outside Silicon Valley", 2010 Public Policy Forum on Venture Capital and Innovation, Participant's Guide p.93-110.

11 "The Current and Future Role of Technology and Innovation Centres in the UK", A Report by Dr. Hermann Hauser for Lord Mandelson, Secretary of State, Department for Business Innovation & Skills.

Harvard Business Case: “The British Columbia Venture Capital Program

Case Researcher and Moderator

- **Dr. Thomas Hellmann.** B.I. Ghert Family Foundation Professor in Finance and Policy, Sauder School of Business, University of British Columbia (Canada)

Case Researcher

- **Mr. Ilkin Ilyaszade.** Sauder School of Business, University of British Columbia (Canada)

Special guests

- **Mr. Dan Rosen.** Chairman, Seattle Alliance of Angels (USA)

- **Mr. Todd Tessier.** Vice President – Venture Investments, BC Renaissance Capital Fund (Canada)

The critical role of business angels as part of the ecosystem for financing technology start-ups is increasingly recognized. Overall, they are the first to finance new businesses and available data shows that in several countries, the volume of their financing is not far from that of venture capital. In many cases, thanks to their own entrepreneurial experience, they bring not only capital to companies but also credibility, contacts and networks as well as their deep understanding of specific market segments. They may also be able to contribute to establish the right culture in these emerging young companies.

At a time when market correction or LP desertion could result in a shrinking of the venture capital industry, could business angel financing be seen, to a certain extent, as an alternative to venture capital financing?

This growing recognition of their role does not mean that everything flows seamlessly in the world of business angel investing. Business angels do not always have the required investment experience when they start investing and may get burnt at next round valuations. Though there can be a great deal of complementarity between business angels and venture capitalists, their relationship may become very antagonistic over follow-on round valuations and dilution.

Recognizing their growing importance, several government programs have emerged over the last decade to support business angel investing: capital gains tax exemption (US), tax credits (UK, various US States, France, Canada) or co-investment funds (Scotland, New-Zealand).

The British Columbia Venture Capital Program is one of these programs that seems to have been particularly successful at (i) stimulating business angels’ investment in the tech sectors and (ii) linking “super angels” with venture capital. This is why it was chosen for this year’s business case.

Conclusions of the discussion

Importance of business angels

Tax supported business angel investment in British Columbia has more than doubled over a five-year period reaching $71 M in 2009. In that same year, venture capital investment in B-C was $156 M. As investment by "super angels" largely exceeds the tax credit cap, this shows that angel investment in British Columbia is now in the same order of magnitude as venture capital, as is the case in the US.[12]

Participants stressed that business angels behave somewhat differently from venture capitalists. They tend to enter earlier and as they invest their own money, they can be more intuitive and cavalier, do less due diligence and invest in what they know and are attracted to. In that sense, they are less a substitute than a complement to venture capital. However, in a growing number of sectors (Internet, medical devices, smart grid, synthetic biology), companies can be built with less than $10 M and business angels will fund them from start to finish and fill in for venture capital.

A growing professionalization movement

Business angels are increasingly working in groups or networks, taking a portfolio strategy, diversifying their risk, delegating due diligence to lead investors who have more experience related to the target company and reserving capital for follow-on investments.

Business angels and venture capital: from conflict to collaboration

There used to be enormous conflicts between business angels and venture capitalists on pricing and follow-on.

Things are evolving towards a more cooperative attitude. This is due to the professionalization of business angels, but also to the growing recognition by venture capitalists of the role played by sophisticated business angels in starting companies, generating deal-flow and adding value to companies. In Seattle, the Alliance of Angels developed a "Series A vanilla light term sheet" which allows angels to continue investing and VCs to incorporate their terms on top of this term sheet. In Salt Lake City, in order to align interests, a seed fund was set up in which VCs invested alongside angels and universities.

Beyond these specific initiatives, the important thing seems to be that VCs and business angels are learning how to work together from the very outset rather than sequentially.

Positive impact of the British Columbia program

All participants from British Columbia, venture capitalists as well as business angels, were very positive about the program.

From the business angels' point of view, it is more than just an incentive; it actually puts more money in their hands thus allowing them to invest even more. Statistics and the elasticity test conducted to prepare the case bear this out. The $60,000 per year tax credit cap is enough to attract wealthy and experienced business angels.

12 In 2009, investment by business angels in the U.S. was $17.6 B(source: Center for Venture Research) while investment by venture capitalists was $18.3 B(source: Thomson One).

From a VC point of view, if there were no tax credits, very few entrepreneurs would have been funded in British Columbia. Most VC deals have business angel investors and it is precisely their involvement that makes deals attractive to VC investors. The tax credit was also an incentive for business angels to invest in VC funds and co-invest alongside them. This helps to develop shared views early on and build cooperation and trust.

The program was also praised for taking the lead in producing data and measuring its impact on investment and public finance (taxes paid vs. tax credit costs). This evaluation process is too often lacking in government programs.

Tax credit or co-investment funds?

Angel co-investment funds are another model for supporting business angel investment. In this model, government agencies set up a process to accredit business angels and business angel syndicates and then invest alongside these partners on the same terms and conditions. Started by Scottish Enterprise,[13] this model was also adopted in New Zealand.[14]

It appeared during the discussion that, if led by an experienced team, the co-investment fund process could be more effective at building market capabilities, stimulating more sophisticated angels and angels syndicates and encouraging angel professionalization than a tax credit which by definition is passive and cannot discriminate. Both Scotland and New Zealand show large positive impacts of the co-investment fund on the level of syndication and professionalization of business angels. However, thanks to its relatively high cap ($60,000), the British Columbia tax credit was also able to attract large and sophisticated business angels.

The Scottish experience, which benefits from both a tax credit from the UK Government and the co-investment fund, also shows how the two models can reinforce one another. The tax credit is a strong financial incentive for angels to become investors; the co-investment fund stimulates professionalization, syndication and allows angels to reserve more funds for follow-on investments. This becomes very important in an environment in which venture capital money is scarce as was the case in Scotland where most VC funds retrenched after the burst of the tech bubble in the early 2000s.

Next steps

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

Format: distinctive characteristics of the PPF that make it unique

There is no other venue specifically designed to generate a focused debate between opinion leaders from the investment community, government and academia in a format allowing for disciplined discussions and featuring by-invitation-only participation, a content driven agenda, an absence of service providers, a ban on sales even by sponsors and an audience composed of pre-selected industry leaders and experts from all major economies. This is unique and much needed.

Participant comments indicated that there was the right mix of practitioners, government personnel and academics as well as a growing sense of common purpose and understanding.

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13 http://www.scottish-enterprise.com/grow-your-business/find-money-to-grow/~/link.aspx?_id=37B397AAD2B242FDBBAA62F193326755&_z=z

14 http://www.nzvif.com/seed-co-investment-overview.html

Suggestions for development and improvement going forward

It was mentioned, on the one hand, that the PPF should not expand in order to maintain its working group atmosphere and community feeling and, on the other, that it should attract as many un- and underrepresented countries as possible (e.g., Australia, Scandinavia, Germany and emerging market nations). One way to solve this double bind might be to have a room that would allow a core group of senior people from a growing number of countries to meet surrounded by an audience of observers.

A strong recommendation that we received this year was to make the Forum more interactive, not limiting the discussion to the panel, but engaging the audience in the conversation in a meaningful way. This will be our top priority for next year. The organization of the day (presentation, panels, feed-back sessions, group discussions) will be reviewed. More interactive techniques need to be introduced. Structuring the audience in a core group surrounded by observers might also help in this regard.

Another suggestion that we received is to remain connected throughout the year. The distribution of this document, individual meetings with key participants and potential panellists to shape the Forum and the distribution of the participant's guide before the Forum are already tools to share information and maintain dialogue. Additional methods might include (i) maintaining a running, highly visible and regularly updated list of potential subjects for the PPF on our website allowing participants to share their comments and suggestions and (ii) producing a summary of government initiatives designed to support the Venture Capital Industry that could serve as background document for the PPF.

In the evaluation forms, networking was mentioned by most participants as the most important feature of the day. In this regard, we might help participants make a better use of our web site by allowing them to connect early on in order to maximize networking opportunities.

Finally, we received the suggestion that we should provide more links between the PPF and other Forums held during the day: Institutional Investors Forum, Family Office Forum and LP Forum.

Themes for next year

Based on discussions and suggestions made during and after the PPF, the following themes appear to attract the most attention:

- ***Exits*** – As one of the participants mentioned during the Forum: *"We are still struggling with company formation and company financing. But the real problem is with exits and sales. Fix that and you fix everything: do we need Corporate M&A' people, corporate VCs, bankers? If we deliver the money back, we will get more of it. We have not delivered the money back"*. The debate could focus on alternative markets around the world and the role of governments in supporting them.

- ***Alternative sources of capital*** such as corporations, family offices and business angels – implications for public policies.

- The role of ***growth equity*** in building an entrepreneurial ecosystem.

- The role of ***cross-border funds*** to accelerate the learning curve in peripheral or "small" countries.

- ***Tools to attract private sector institutional investors*** to invest in venture capital. Through ups and downs of the cycle, this theme remains a central preoccupation of PPF participants.

- Considering venture capital within the broader ecosystem: ***tools and actions to create a tech entrepreneurial friendly environment***.

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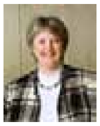
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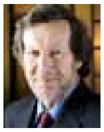

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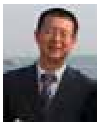
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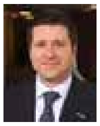
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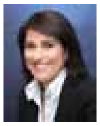
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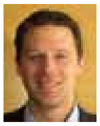

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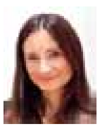

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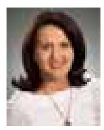

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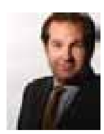

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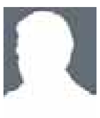

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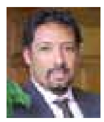

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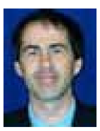

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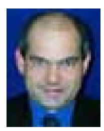

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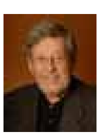

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Head of Investment VC / PE unit

The Quebec City Conference

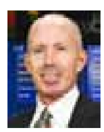
Gilles Duruflé
Executive Vice President
Board of Directors

The Walsingham Fund

Jim de Wilde
Advisory Board Member

The Walsingham Fund

Brian Dawson
Partner



Toronto Stock Exchange

Raymond D. King
Senior Manager Global Diversified Industries - Listings Business Development

The Yozma Group

Yigal Erlich
Founder, Chairman and Managing Partner

Univalor

Marc Leroux
President and Managing Director

TVM Capital

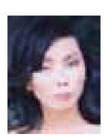
Helmut M. Schühsler
Managing Partner

US Department of Commerce, International Trade Administration

Randy Mitchell
International Trade Strategist for Venture Capital
Organizing Committee - PPF

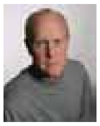
University of Utah

Brian A Cummings
VP Technology Commercialization



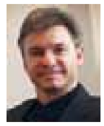
vantec

Thealzel Lee



Vanedge Capital

Robin Louis
SeniorAdvisor
Organizing Committee - PPF



Venturing Hills

Peter Becke

Vertex Venture Capital

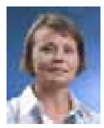
Sharon H. Lewis
Director of Business Development
Organizing Committee - QCC

Vertex Venture Capital

Emanuel Timor
Partner

Vækstfonden

Martin Vang Hansen
CFO, Senior Vice President



Vækstfonden

Susanne Kure
Senior Vice President

Virage Capital

Robbert Van de Griendt
Partner

Virage Capital

Mark F. de Groot
Managing Partner

Wesley Clover Corporation

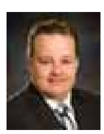
Michael A. H. Turner
V.P. System Strategies

Wellington Financial

Mark R. McQueen
President & Chief Executive Officer

Yaletown Venture Partners

Steve Hnatiuk
Co-Founder & Executive Limited Partner



XPV Capital Corporation

David Henderson
Managing Director