Hard Labour

Labour funds fill key venture capital niche

By Peter Diekmeyer

Labour funds generate close to half of Canada's venture capital pool

How does a shelter that gives you an 80% tax refund grab you? That's what you get if you are in the 50% tax bracket and you invest in a labour sponsored venture capital fund (LSVCF).

Ontarians who invest in one of the more than 30 LSVCFs operating in the province as part of their RRSPs are entitled to tax credits of 15% from both the federal and Ontario governments, up to a maximum of $5,000.

These credits, when added to the RRSP deduction, can lead to an astonishing 80% income tax refund on the amount invested. The tax credits are a combination of federal and provincials and differ from province to province. Needless to say, LSVCFs have been extremely popular during the last several years. With that kind of a refund, who cares about the mediocre returns these funds often show?

Labour funds generate close to half of Canada's venture capital pool. And that pool is growing. According to the Canadian Venture Capital Association, the industry completed more than $2.3 billion in financing in the first six months of 2000, compared to $2.7 billion in all of 1999. This growth raises the question: have labour funds outlived their usefulness?

"Absolutely not," says Ron Begg, president of Working Ventures National Fund, an Ontario-based LSVCF. "You have to compare that growth with what is happening in the U.S. Venture capital is now a global affair, and we no longer operate in isolation." American firms invested $49.3 billion US in the first half of 2000. That means when the currency exchange is taken into account, Canadian venture capital disbursements were only about 3% of those south of the border.

Canadian's reluctance to invest in new ventures is one of the key factors in our poor productivity performance, a point Finance Minister Paul Martin acknowledged in a speech to the Toronto Board of Trade last September. In it, he defined two Canadian venture capital goals. The first is that Canada should be among the top three industrial countries in the level of new venture capital investment per capita. The second, to raise as many initial public offering (IPO) dollars for growing businesses on a per capita basis as does the U.S.

"Canada needs big strong venture capital funds to go toe-to-toe with the U.S. funds," says Begg. "The average venture capital investment in a Canadian company is $2.7 million, compared to $13 million US (south of the border)."

Martin's goals do not go far enough. Canadian firms have lagged their U.S. counterparts for years. Canada should be investing more than the U.S. on a per capita basis to make up for lost time. Just to obtain parity, Canadians would have to triple VC disbursements.

That means labour sponsored funds look safe from a public policy perspective. But maintaining their tax breaks will not be enough to get the Canadian venture capital industry up to speed. Personal and corporate tax breaks announced in last fall's Martin mini-budget will help by making investments more attractive. They should also make it easier to keep skilled workers in Canada.

But more steps are needed. Pension funds account for a far greater portion of the American venture capital pool — about 60% — than here in Canada, where the total is closer to 5%. There has been talk about a better regulatory framework to make it easier for Canadian pension funds to invest in smaller companies, but no action has been taken.

Another possible solution would be to extend credits accorded to those who invest LSVCFs to taxpayers that invest in privately sponsored venture capital funds. Clearly, private sector managers can invest as effectively as those appointed by labour organizations.

The tax credits need not be as generous as those offered LSVCFs, and could be financed either out of the surplus, or by reducing the credit offered to LSVCF investors proportionately. This would get the government out of the business of choosing the winners and losers in the VC industry.

Whatever the end result, as long as Canada lags the U.S. so dramatically in venture capital financing, our productivity will continue to suffer. And those 80% refunds are going to be around for a long time.

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