THE NATIONAL INNOVATION SYSTEM AND THE CANADIAN CHALLENGE: VENTURE CAPITAL AND MIGRATION

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In Canada, despite the implementation of a comprehensive, modern national innovation system, the business sector is largely lagging in innovation and competitiveness compared with peer countries. We focus on the proposition that "Canada's failure to develop a greater number of innovative Canadian-based multinationals has been a key contributor to the country's overall R&D weakness" (Expert Panel, 2009 p. 102). As recently reported in the Globe and Mail, "High-tech names have been vanishing from the radar in Canada at an alarming rate. (…) Worse, most of those companies are selling out too early, before they have a chance to grow into larger, global businesses that could fuel further innovation and success in the tech sector."

The aim of this paper is to determine to what extent, and why, innovative Canadian high-tech companies migrate to the US when venture capitalists exit. We show that nearly half of successful venture capital exits from Canadian firms result in a migration. Moreover, the most promising technological firms are systematically sold to foreign interests. The deal of the year award underlines the most successful exits of the venture capital industry. Since 2005, six involve a sale to a foreign strategic investor, one involves a listing on the NASDAQ. The only very successful domestic exit is in the natural resource sector. In Canada, the venture capital industry, including government-sponsored funds, is a significant source of migration of promising high-tech companies to the US, and does not seem to fully play the positive role described by several authors in other countries.

To understand the reasons behind this situation, we use multiple case studies to analyze 14 growing high-tech venture capital-backed firms, initially located in Quebec. Our analysis points to two important conclusions. First, the migration of growing high-tech firms is motivated largely by strategic considerations, in the context of a small country where the number of strategic partners is limited and the market for innovative products is also considered small. Like their counterparts in other countries, Canadian VCs prefer to exit through trade sales, but cannot find a local acquirer easily. Venture capital-backed IPOs, which are often prerequisites to the construction of large public firms, have become exceptional events. This situation is particularly worrying in Canada, where the number of large technological companies is small and decreasing. This reduces the likelihood of the emergence of new technological leaders and networks. Second, the surviving entities resulting from acquisitions fully fit the definition of truncated company or simply disappeared. In ten cases, the acquired company no longer operates in Canada, although in four of these cases, the acquirer has an office in that country. In one case, the R&D team was integrated with the buyer's team in the same city. In two cases, the acquired firm continued R&D activities albeit on a smaller scale.

The migration of high-growth venture capital-backed firms is a significant phenomenon in Canada. It is likely to have strong negative economic consequences.

The full study is available on CIRANO's Website at:

http://www.cirano.qc.ca/pdf/publication/2014s-27.pdf

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