Emerging company services
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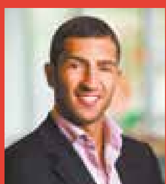
Building tomorrow's giants

2014 Emerging companies' survey

Contents

Foreword



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For over a decade, we've surveyed the CEOs of Canada's emerging companies on the challenges and opportunities they face in turning innovative ideas into exciting, thriving enterprises.

In this report, the 11th in the series, we find companies focused on obtaining funding—and successfully raising the capital they need. We see them searching for revenue growth and exploring new channels and markets to do so. These are positive signs, and an indication that Canada's emerging technology sector remains strong and vibrant.

But we also see a sector that continues to operate with an eye on the exit. Most CEOs tell us they're not in it for the long haul: 88% plan to exit the business at some point within the next six years, usually by selling their company. Each year, we see Canadian innovations bought by other, larger companies—and promising Canadian companies blink out of existence.

Canada has been home to some of the world's biggest, most innovative technology companies. The question is: Where will the next generation of Canadian technology giants come from and what does it take?

In this report we'd like we'd like to focus on building businesses with Canadian roots—and global reach. Canada is a great place to start a company, and it's also a fantastic place to grow one. So this year, along with sharing the views and perspectives of the CEOs we've surveyed, we're also offering some suggestions on how Canada's emerging companies can stay rooted here while growing and thriving on the global stage.

We hope you enjoy the report.

Eugene

"At this day in age, 2014, I dont think there are any disadvantages to being a Canadian based global brand"

—*Harley Finkelstein*, *Shopify on technology in Canada*

Survey participant snapshot

For our *2014 Emerging Companies survey*, we conducted nearly 150 online interviews with CEOs who are leading some of Canada's most dynamic and innovative companies.

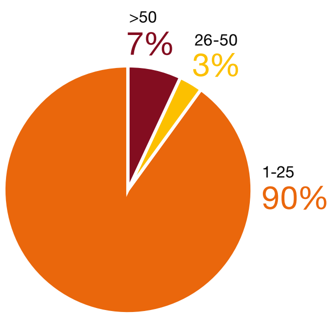
The vast majority of companies included in our survey are relative newcomers on the scene. Three-quarters of our respondents report annual revenues of $500,000[1] or less, perhaps explaining why funding and revenue generation top the list of this year's biggest challenges.

The intention of this research is not to make conclusions about the opinions of all CEOs across the Canadian technology industry, but to provide insight into the companies in the emerging technology sector and the CEOs who lead them. The survey results have been analyzed and the findings have been used as a basis for this report.

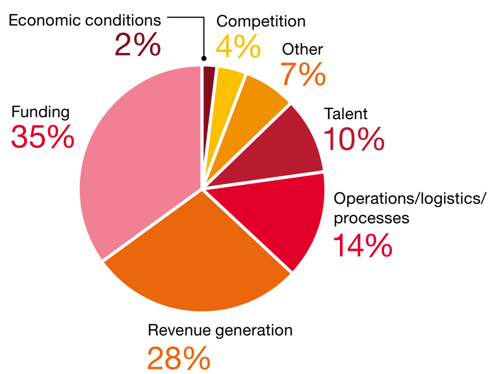
1 All amounts in this report are in Canadian dollars.

2014 survey participants at a glance

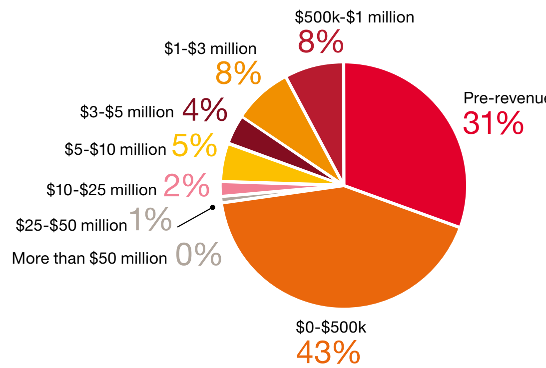
Number of employees



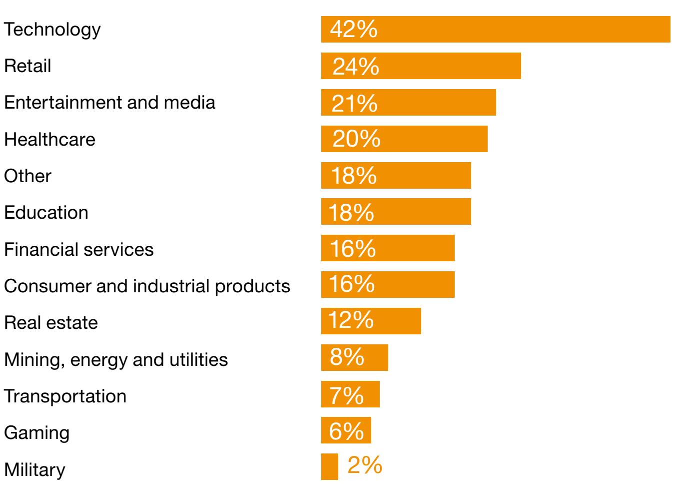
Primary challenges



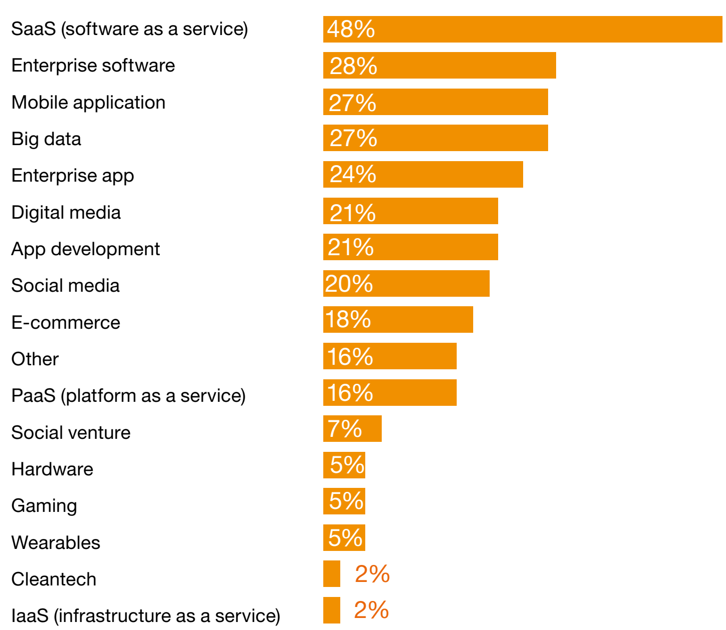
Revenue summary



Focus industry



Primary area of business



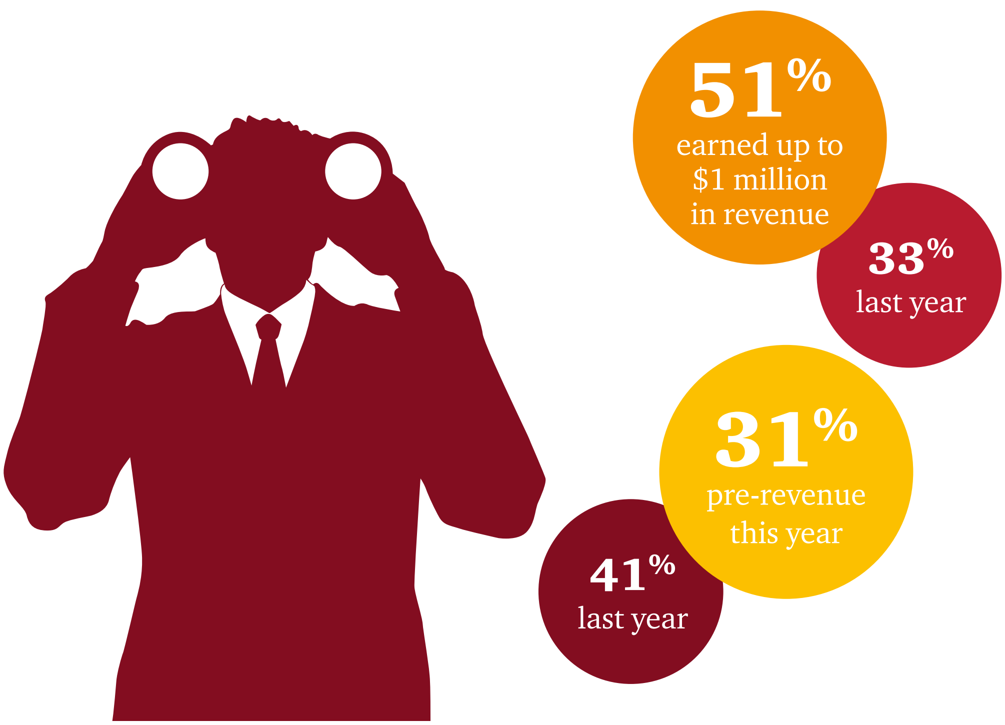
Revenue

The never-ending search for growth

With 74% of our survey respondents either pre-revenue or reporting annual revenue of $500,000 or less, it's little wonder that revenue generation is top of mind for CEOs. Looking further abroad for revenue opportunities could help.

We saw a significant jump in the number of companies reporting earned revenue this year, suggesting that Canada's emerging companies are in a maturing period. Just over half (51%) of companies earned up to $1 million in revenue last year, a rise from 33% the prior year. At the same time, the proportion of pre-revenue companies fell to 31% from 41% in our previous survey.

The never ending search for growth

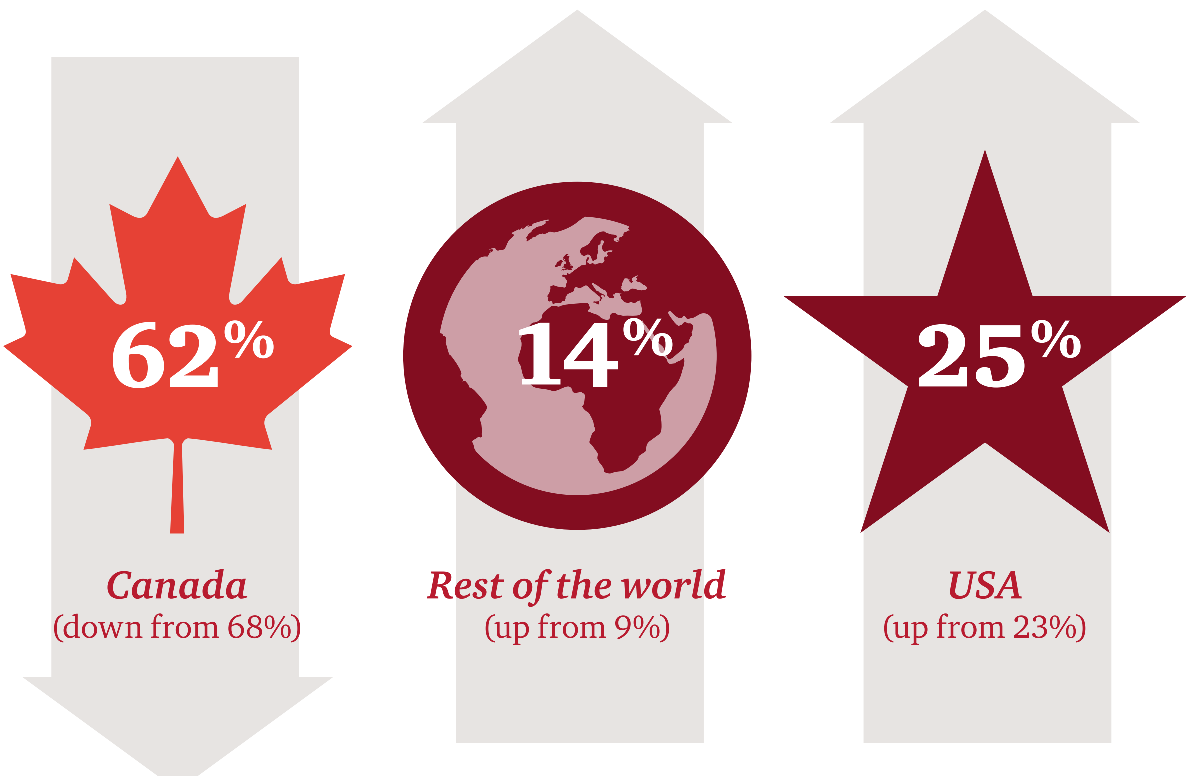


Looking past the North American market

The Canadian market remains the main focus of companies' revenue generation efforts: 62% of revenue is generated domestically, down from 68% the previous year. The US portion of companies' revenue increased slightly to 25% up from 23%.

Notably, companies are reporting a higher proportion of revenue from outside these two traditional markets: 14% report revenue from outside Canada and the US, up from 9% the previous year. It's an encouraging sign that Canada's emerging companies are dipping into the global marketplace.

Annual revenue by region



Digital plays a vital role

Given their place at technology's innovative edge, companies are making digital channels a core part of their business strategy. Digital sales are central to the core business strategy of 70% of companies surveyed, and 79% use digital channels to promote and sell their company and products. It seems to be working: over half of companies surveyed (58%) report generating three-quarters of their revenue or more through online sales.

Getting smarter about revenue generation

Companies aren't pursuing revenues at all costs, however. CEOs are paying increasing attention to metrics such as customer acquisition cost and average revenue per customer. This suggests a maturing attitude towards growth—and recognition that revenue quality is an important factor to consider.

Utilizing digital channels

70%

Digital sales central to core business strategy

79%

Use digital channels to promote and sell their company and products

Results

58% 

75-100% of revenue through online sales

32% 

1-24% of revenue through online sales

THINGS TO CONSIDER

Growing revenues, building Canadian success stories

We're encouraged by Canadian companies' growing interest in markets outside of Canada and the US. We believe that seizing international opportunities cannot only help these companies gain the traction they need to attract investment—it can build the foundation for building a new generation of global and Canadian leaders.

It can be challenging to make those first forays into international markets—but it can be done.

- ***Adopt a global mindset.*** Canada's a great place to launch and build a business, but there are great opportunities for growth worldwide. The US market is the default second choice for many companies, but it's very sophisticated and incredibly competitive. In assessing the market potential for your market or service, don't neglect markets overseas—all it takes is one opportunity to set you on the path to building a global business.
- ***Leverage your people and personal networks.*** Emerging companies often feel they lack the connections they need to explore international markets. But in a multicultural country like Canada, the key to opening doors worldwide could be on your advisory board—or even sitting down the hall. Start building your international network with your team and follow up on their personal connections. A vital international contact could be just a few degrees of separation away.
- ***Use government resources.*** Canada's Export Development Bank, Trade Services Commission and Canadian consulates worldwide can offer a wealth of information—much of it at no cost—about markets worldwide, as well as support for companies interested in doing business abroad.
- ***Learn from companies in other sectors.*** There are many, many Canadian companies who do business globally, from manufacturers to retailers and others. Talking with leaders at these companies, and using their insights and experiences can help you chart your own path into international markets—and avoid potential mistakes others have made. This holds true for domestic opportunities as well.
- ***Start small.*** It only takes one relationship to start you on the path towards a global future. Develop a strategic partnership with an organization in another market, or find one company willing to try your product or service. Focus on making this relationship work and build out from there.
- ***Exploit digital channels.*** In a world increasingly comfortable with ecommerce, digital channels offer emerging companies a gateway to a global customer base. Capitalize on the ability of social media and the web to promote your company—and potentially sell your products and services—to a far wider audience than ever before.
- ***Don't ignore other markets' rules and regulations.*** Doing business abroad isn't like doing business in Canada. Legal and regulatory requirements and taxation rules vary from country to country, and it's important to know what you're getting into to avoid unexpected surprises down the road. Do your research—even a short meeting with a tax or legal advisor can provide important insights into the risks and issues you might face in doing business in a particular market.

> “Its not a choice for our business whether or not we can be global—we have to be.”
>
> —***Greg Gunn,*** *HootSuite on adopting a global mindset*

Funding

Companies on the hunt for funding

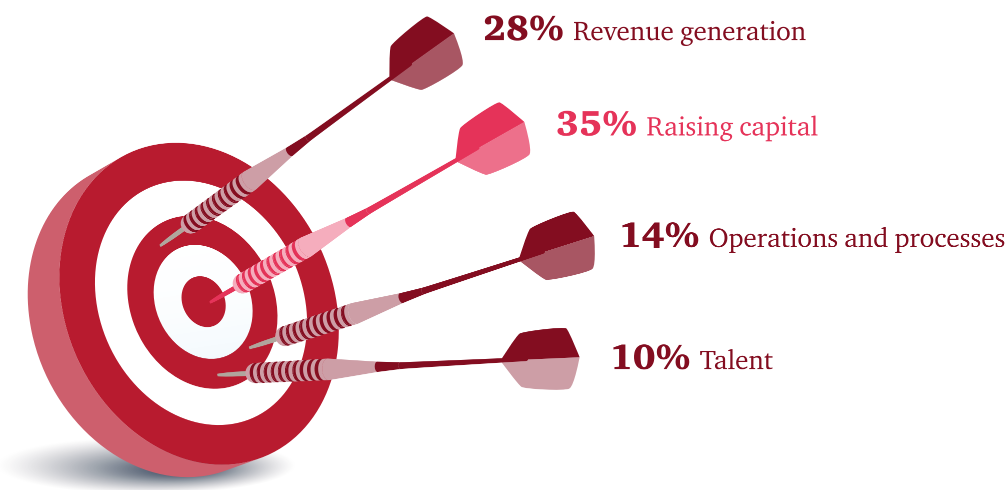
With many companies in this year's survey generating annual revenue of $500,000 or less, they're on the hunt for funding. The good news; they're finding it.

More companies appear to be raising capital, according to our survey: 35% raised funds in the last 18 months, up from 33% the previous year. They're also raising more of it: 36% raised $500,000 to $2 million in their last round of funding, compared to only 22% in the prior year. Just over half (51%) of this new capital came from angel investors, an increase of 7% from the previous year.

Companies' success in attracting new capital is in part a reflection of the robust investment environment and investors' strong interest overall. Market opportunity and the company's technology or IP have proven to be key factors in funding valuations, indicating that angels and other investors are keen to back solid ideas with equally solid market potential.

The hunt for funding

Raising capital is the top challenge facing CEO's, beating out revenue generation, operations and talent.



...and finding it

35% raised funds in the last 18 months

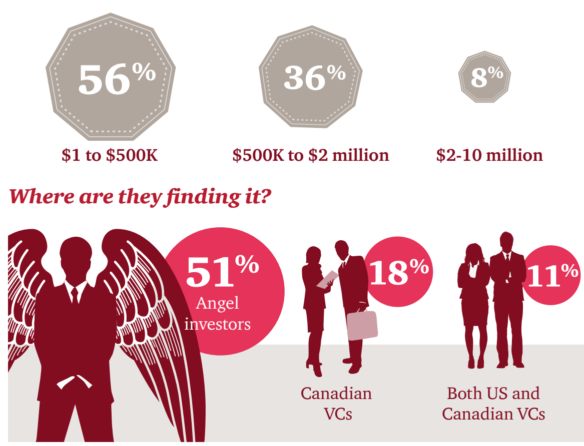
Government funding continues to play a key role

Canadian emerging companies continue to rely on a range of government funding to sustain their efforts. Use of the federal Scientific Research and Experimental Development (SR&ED) tax credit has risen: 40% applied for SR&ED funding this year, up from 35% the previous year.

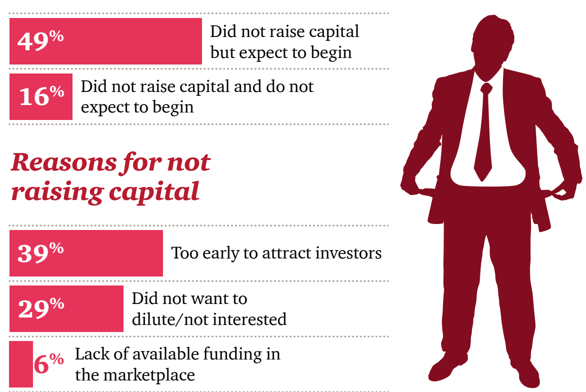
However, SR&ED claims also appear to be coming under increased scrutiny: 40% of respondents have experienced a SR&ED audit in the last two years, up from 29% in our prior survey. This suggests that companies must take greater care with their SR&ED submissions to avoid flagging their claim for a Canada Revenue Agency audit.

Considering that SR&ED reimbursements often serve as an important source of funding for many early stage companies, it's important to note that it's taking longer to get them. While the average time for reimbursement remains between five and six months, we've seen a noticeable increase in the number of claims that take six to nine months—and in some cases over a year—to be reimbursed.

How much are they finding?



Those not finding funding



THINGS TO CONSIDER

Securing funding

Finding sufficient funding—whether from private sources or government programs—is critical for enabling Canada's emerging technology companies to succeed in bringing their innovations to market. Here are some thoughts on how to increase your odds of securing funding.

- ***Focus on building a sustainable business.*** Angels and venture capitalists want to invest in companies that have what it takes to keep going. Get the product to work—but don't neglect building a business around that technology that can be shown to generate revenue and achieve profitability.

- ***Build strong relationships.*** Raising money is a relationship game—one that takes time to play. Start having conversations as early as you can. Talk about your company and where it's going next. And use these opportunities to demonstrate that what you say will happen does happen.

- ***Remember that there are more ideas than capital,*** but the best ideas get funded. Make your product—and your pitch—the very best it can be.

- ***Look globally for funding.*** If you can't get Canadian or US investors to bite, look abroad: it's a global capital market. Plus, building relationships with venture capitalists and angel investors in other countries can create opportunities to build your business in other markets—establishing the kind of global foothold it takes to attract new investors and build a bigger business.

- ***Take time and care with SR&ED and other government funding claims.*** Many companies rely on the SR&ED program to provide crucial funding each year—all the more reason to complete SR&ED claims carefully and thoroughly. An experienced advisor can be invaluable in helping you avoid an audit and receive a timely reimbursement.

“The general rule for US investors is you can only lose 1-x your money but you can make unlimited-x your money”

—***Anish Acharya,*** *Google Ventures on securing US funding*

Talent

Searching for the right people to build and grow a business

Talent matters may not be top of mind for emerging companies' CEOs this year, but that doesn't mean that finding and keeping outstanding people is no longer a challenge.

Canadian companies remain locked in a perennial struggle with their US counterparts, who continue to lure top talent south of the border: 42% say identifying and recruiting new talent is a challenge, unchanged from the previous year.

However, these same CEOs report that it's become slightly easier to recruit experienced management team members. One factor could be that the expiry of various non-compete or non-solicitation agreements has expanded the talent pool. We're also seeing more and more experienced executives take interest in being a part of the startup space, increasingly eager to lend their knowledge and skills to build a new venture.

Searching for the right people

The ability to identify/recruit new talent remains the biggest talent management challenge facing CEOs (**42%**), followed by providing competitive compensation and benefits (**27%**).

New strategies in staff retention

Stock compensation remains an important part of companies' retention strategies: 18% of CEOs report using stock-based compensation to encourage their people to stay. However, companies are employing other strategies as they strive to hold onto their talent, such as offering training and providing meaningful opportunities for promotion and career growth.

Companies are also making a significant effort to create a workplace culture that inspires their people. They've working hard to define a company culture—establishing a vision, a set of values and a way of working with each other and customers—in order to give their people something "bigger" to achieve.

18%	Using stock-based compensation to encourage their people to stay
17%	Defining company culture to give their staff a common set of values and shared purpose
15%	Growth/promotion opportunities
12%	Compensation
8%	Training/development programs

The ongoing gender gap: A business risk?

Last year, we noted that women were underrepresented among Canada's emerging technology companies. This year we see that women are even less well-represented. On average, women now comprise 21% of emerging companies' workforces, down from 27% in 2013. The drop is even greater in management ranks: this year 14% of management staff were women, on average, down from 24% last year.

That said, it is encouraging to see that as companies grow in size, the proportion of women on staff rises—often in marketing, HR and similar roles that are needed as firms expand.

Why are women so underrepresented in Canada's emerging technology companies? In part, it's a matter of supply: More men than women pursue studies in computer science, for example, and this has a knock-on effect on the talent available. As well, startups typically begin as a trio—a business developer, a programmer and a UI/UX designer—and then hire more programmers to stabilize the product. To fill these roles, companies draw from a predominantly male talent pool.

In observing this trend, one concern is that when companies are less diverse, the risk of groupthink rises. One of the most important things that a diverse group of employees brings to a company is diversity of thought. Multiple studies have shown that diverse teams outperform more homogenous teams. Homogenous teams often view problems and challenges through the same lens—and sometimes miss nuances or details more diverse teams might find. It's critical that companies address this at some level—even in terms of the composition of their advisory board, if it's difficult to find the right talent at the staff level.

The ongoing gender gap

Women continue to be underrepresented in emerging tech companies. Specifically, on the founding or management team.

Female team members

21% this year

27% in 2013

Drop is greater in management ranks.

14% this year

24% in 2013

THINGS TO CONSIDER

Addressing the talent challenge

Having the right people is one of the most important drivers of business success in any field. It can help Canadian companies mitigate the risk of groupthink, open up new avenues to explore, and build thriving ventures.

Here are some recommendations on how emerging technology firms can address their talent issues.

- ***When funding's tight, try alternative arrangements.*** It can be difficult to afford top talent, especially in management or high-demand areas. Consider instead offering part-time roles or short-term contracts—it's better to have the talent some of the time than never. Some people may be willing to accept a small base minimum salary at the outset, deferring the rest of their salary until the company has the funds needed. Sales staff may be willing to work on commission alone—as long as the commission delivers significant upside.
- ***Recruit younger Canadians—and new Canadians.*** Younger talent may not have the exact level of knowledge and experience you're searching for—but they may have done enough of what you need to help you achieve your goals. Their energy, enthusiasm and commitment may more than compensate for the skill or knowledge gap. Similarly, many new immigrants are keen to find opportunities to use their strong technical skills and knowledge with a Canadian company—and in turn, they may bring international connections that could benefit the business in the future.
- ***Consciously embrace diversity in your recruiting and decision making.*** Workplace diversity doesn't just happen. It takes conscious, deliberate thought and action for companies to make diversity a reality. And companies need to continually challenge themselves to keep it a reality. When recruiting, for example, deliberately choose to look for candidates who don't fit the mould, who bring strengths or perspectives the team currently doesn't have. Bringing in people who see the world differently will challenge your way of thinking—and often create a better solution in the end. Larger companies often struggle to create more diversity today, but emerging companies have the chance to get it right from the very start.
- ***Capitalize on your competitive advantages.*** Right now, there are talented people in larger organizations who yearn to be part of something innovative and exciting. Emerging companies are ideally poised to fulfil that desire—they offer scope, responsibility and the opportunity to play a key part in building something incredible. It's a powerful lure for the right people—even if the pay isn't what they're used to.

"A company's culture is the most valuable thing it has to recruit and retain top talent"

—***Razor Suleman,*** *Achievers on building a strong company culture*

M&A and exit strategies

Emerging technology founders too focused on short term?

Canadians are eager to launch new ventures—but they're not as keen to stay the course and build them into something bigger.

Nearly three-quarters (70%) of the CEOs we surveyed plan to exit the business through acquisition or an IPO, with a majority leaning towards an acquisition. Only 22% of CEOs say they had no plan to exit, down from 30% last year. Of those planning to exit, nearly half (49%) are eyeing an exit within four to six years—while nearly as many (40%) plan to exit even sooner, within one to three years.

The question is: Why are emerging companies so seemingly keen to exit?

M&A remains the preferred option…

Interest in M&A exits has grown sharply since our last survey: 63% of CEOs say an acquisition is their preferred exit strategy, up from 44% the prior year. It's understandable: Technology is hot again. Equity markets are up and multiples are elevated. It's a good time to be acquired.

By comparison, there's little interest in going public: 7% of CEOs are considering an IPO exit, up slightly from 4% in the prior year. In the aftermath of some high-profile technology IPO flops, investors are putting new tech IPOs under much more intense scrutiny and demanding clear signs of traction, critical mass, growth potential and, most importantly, revenue generation.

M&As don't bring the same level of scrutiny—though they do entail a sizeable amount of due diligence in their own right. As well, M&As don't always provide an emerging company's founders and investors with a more immediate payday, with the proceeds of the sale available up front. Many of the M&As that make the news involve smaller exits, where larger companies that are searching for talent choose to go down the "acqui-hire" route to do so.

…Yet firms are often ill-prepared

Ironically, considering how many CEOs aim to exit their businesses through a sale in a relatively short timeframe, few companies have taken steps to prepare for such a deal. A sizeable number have established a business model, set out employment agreements, filed tax returns, retained lawyers and confirmed IP ownership—but few have taken other equally important measures. Yet 22% say they have taken no steps at all to prepare for an eventual sale.

Waiting for the suitors

63% Expect to be acquired as their most likely exit strategy

7% Believe an IPO will be their most likely exit

48% Eyeing an exit within four to six years

40% Plan to exit sooner, within one to three years

22% Have no plans to exit

22% Have taken no steps to prepare for an eventual sale

THINGS TO CONSIDER

Option 1: Get ready for the suitors

Understanding what potential acquirers and investors are looking for can help you make decisions today to improve your chances of a successful exit in the future.

M&A buyers look for

- **Disruption.** Potential buyers are searching for disruptive technology—technology that utterly changes industries, sectors and the way companies and people get things done.
- **Talent.** US companies in particular are acquiring early stage Canadian companies in order to “lock up” skilled talent.
- **Scalability.** They’re also looking for technology that can scale quickly and globally. If your product is simply too cumbersome to take to a wider market, buyers may pass.
- **Plug and play.** Does your product easily integrate with the technology and infrastructure already in place in the market? If your technology works with a large existing user base, that’s an important—and attractive—advantage.
- **Essential.** Does your product fill a key unmet need in part of the market—whether the market realizes it or not? If companies can’t do without your product, buyers will take notice.
- **Timing.** Unfortunately, sometimes it’s just not the right time to do a deal. A potential buyer may have made a similar acquisition, or feel that the market isn’t yet ready for your product. There’s little you can do to address the timing issue, but it’s important to realize it’s a factor.

What IPO investors look for

- **Growth.** It’s essential that companies going public be able to show a track record of quarterly growth in key areas. Revenue is ideal, but companies can also use growth in subscribers, advertising, installations or other factors to demonstrate to the market that their business is expanding.
- **Traction.** Investors want to put their money into a company that can demonstrate the potential for growth on a larger scale. Can you demonstrate market momentum—are you expanding your customer base into new markets? That’s a signal that your company offers significant potential.

THINGS TO CONSIDER

Option 2: Stay the course and go global

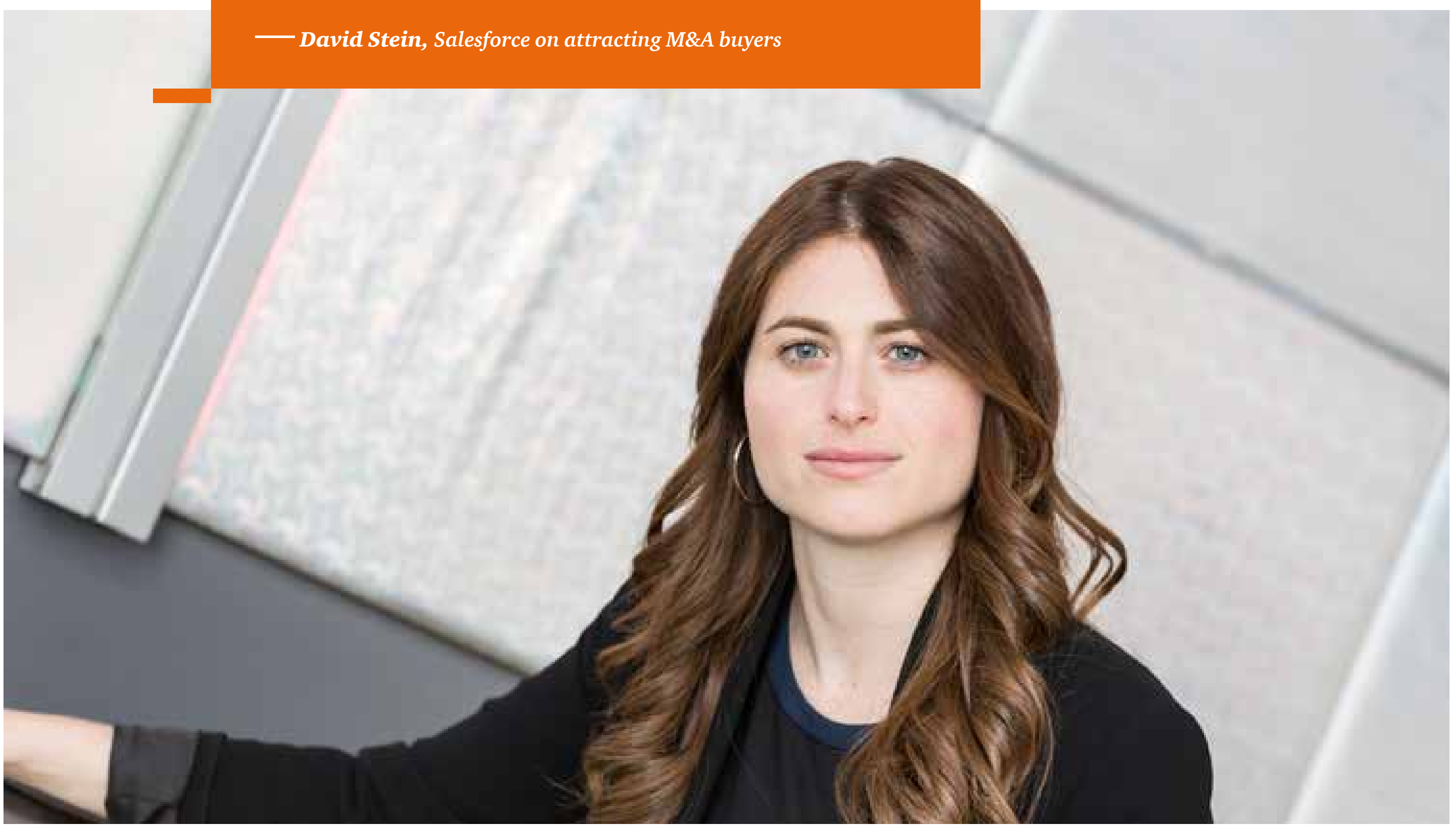
We aren't surprised to see so many Canadian emerging technology companies planning for their own eventual sale, IPO or other exit—but it does make us wonder where the next generation of Canadian technology leaders will come from.

Canadians are very good at research and development—and we're equally good at turning our R&D into fledgling business ventures. We don't lack ambition, but we do seem to lose confidence when the time comes to take our businesses to the next level. Canadian emerging technology companies should consider taking that next step. To get bigger and profit more from our own vision and innovations.

There's opportunity for more Canadian companies to focus on charting their growth and expansion. Potential acquirers can help firms achieve this goal, by sharing the knowledge, experience and perspective they've gained in taking great products to a new level of success.

“Tell a different story”

— ***David Stein,*** *Salesforce on attracting M&A buyers*



Seize the opportunity

Canada has a long, proud history of bringing technological innovation to the world—a tradition that continues to this day. As we've shown in 11 years of our *Emerging Companies Survey*, there's no shortage of talented individuals with the skills and knowledge needed to turn a spark of innovation into exciting new products.

Innovators should consider taking the next step: to build and grow their fledgling companies into something larger. There are ways to mitigate challenges that come with building a lasting, thriving business, and we've explored some ways to think about them in this report.

Some may feel it's a challenge to take their venture to a new level—to build a Canadian-based firm that can compete on the international stage. It's challenging, to be sure, but we believe it is a challenge worth facing. Our aim in this report has been to provide Canada's emerging companies with recommendations and suggestions that will encourage more of them to think of building something more: Dynamic, growing businesses with Canadian roots and a global reach.

Survey methodology

2014 Emerging company survey is PwC's 11th report on emerging Canadian technology companies. Each year, we provide insights to the industry on issues being faced by emerging Canadian technology companies and their CEOs.

Our goal was to continue this research and provide critical information to CEOs with respect to performance and strategy currently in operation—and also to explore the challenges of doing business in the current economic environment.

A team of PwC's Technology professionals have developed the survey over several years and have also benefited from personal discussions with CEOs to incorporate the most relevant questions of today's marketplace.

Questions were organized into 5 sections:

- Emerging companies' profiles
- Mergers & acquisitions and exits
- Funding
- Sales and metrics
- Talent management

The results of the survey were based on the responses, either online or in person, from over 150 CEOs. PwC identified a national cross-section of emerging Canadian technology companies from publicly available lists, including the Branham 300, the Canadian Business Tech 100, the ROB 1000, Profit 100, Profit Hot 500 and others.

We contacted the CEOs by email and telephone and directed them to the online questionnaire. We also conducted face-to-face, in-depth interviews with a number of CEOs. In those cases, PwC Technology partners administered the questionnaire at the CEOs' places of business.

The intention of this research is not to make conclusions about the opinions of all CEOs across the Canadian technology industry, but to provide insight into the companies in the emerging sector and the CEOs who lead them. The survey results have been analyzed and the findings have been used as a basis for this report. We have responded to the findings and our views are noted within the pages of the report.

Emerging Company Services

PwC's Emerging Company Services (ECS) helps growth companies unlock extraordinary potential by turning your vision into reality.

Our team is ready to help guide and nurture your emerging company from startup through maturity. We provide you with the advice and services needed for your industry any development phase you're in.

Being an entrepreneur is an exciting, challenging, and often all consuming. Each day brings a new challenge—a challenge you may not have faced before or an obstacle that larger, established companies don't encounter. Whether it's developing business plans, securing financing, executing your strategy, building value or creating wealth through initial public offerings, merger transactions and other liquidity events, we offer a full range of support services.

To help companies respond to the most challenging industry issues, we offer our insights and specific solutions, including:

- Assisting you in identifying financing sources
- Serving as your advisor as you prepare to be acquired
- Providing due diligence and valuation services for acquisitions
- Supporting your international growth through our global network
- Tailoring PwC's leading edge audit approach to meet your needs
- Identifying eligible SR&ED activities and claiming the appropriate tax credits

If your company has a vision, contact PwC today to turn it into a reality. Please visit us at **www.pwc.com/ca/ecs** to find a PwC professional ready to serve you in all major technology markets. To access information about our *Vision to Reality* program which includes our annual conference and awards program, visit **www.pwc.com/ca/v2r**

Acknowledgements

The survey respondents

We wish to thank the respondents who participated in the interviews and online survey. Their experiences and vision were invaluable to our education and critical to our research, and their candid responses and support of this project are very much appreciated. To protect their privacy and competitive advantage, the names of the participating emerging companies and CEOs are kept confidential.

PwC partners and staff

For this study, we drew on support and experience and knowledge from around our firm. A core team worked diligently to help produce this publication. The tremendous efforts of each team member helped make this project a success.

Our subject matter experts include:

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