KPMG

Project Report

STUDY OF THE

FINANCIAL INTERMEDIARY MARKET IN

ATLANTIC CANADA

Prepared for

Atlantic Canada Opportunities Agency

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Executive Summary

A. Objectives and methodology

This study has undertaken an examination of the nature and effectiveness of the financial intermediary function in Atlantic Canada with respect to assisting Small and Medium-sized Enterprises (SMEs) in accessing equity investment of $50,000 to $250,000. The study entailed structured interviews with 30 entrepreneurs that have recently been seeking investment and 30 financial intermediaries from across the region. Case studies of entrepreneur-investor matchmaking initiatives in various Canadian centres, as well as one in Scotland, were undertaken to identify best practices. A panel of KPMG financing specialists provided input to the study at key intervals.

B. Most intermediaries are Accountants or Lawyers

The equity capital market for SMEs in Atlantic Canada operates informally, assisted by a group of less than 100 intermediaries. Most of the intermediaries are Chartered Accountants that derive the majority of their livelihood from other aspects of their accounting practice. There are also lawyers that undertake intermediary work, again typically as part of a broader practice. The intermediaries contacted indicated they were most likely to be asked to assist with the preparation of a business plan or to assist in structuring the "deal". Less than 25% of intermediaries indicated they were "usually" involved in identifying potential investors or making introductions to potential investors. In contrast, ten of the twelve entrepreneurs contacted that used an intermediary, looked to the intermediary to identify investors.

C. Financing often successful without an Intermediary

Intermediaries were not involved in the majority of financing deals consummated by the entrepreneurs contacted. Considering the 18 entrepreneurs not using an intermediary, eight indicated there was no need, five were deterred because of cost and five were not aware of the service.

D. Intermediary network is underutilized

We conclude overall that the intermediary network in Atlantic Canada is underutilized by entrepreneurs. This appears to be a result of a lack of awareness of who provides intermediary services as well as concerns about fees. The fact that intermediaries will often make investor (client) introductions for minimal fees when presented with an interesting business plan is not well known. Another significant challenge is the volume of entrepreneurs seeking financing that are not investor ready.

E. Entrepreneur education and “screening panels” are key recommendations

We recommend that a variety of information/education initiatives be undertaken to assist entrepreneurs in understanding how to raise equity financing and how intermediaries can assist that process. These include an intermediary directory, newsletters, brochures/booklets, articles, presentations targeted at entrepreneurs and programs to train government personnel in business support roles respecting financing. We also recommend that a broader (in terms of geography and sectors) network of entrepreneur screening panels like the Entrepreneurs Forum be established and be supported by ACOA. These panels should comprise volunteers from the professional community who would assess business plans presented by entrepreneurs and provide specific objective feedback on investor readiness.

I

Introduction

A. Background

The availability of capital for small and medium sized enterprises (SMEs) in Atlantic Canada has been a concern of governments for over twenty years. A range of factors led to the extensive historical involvement of both provincial and federal governments in providing financial assistance to business in the region. In recent years, a number of new considerations have affected the availability of financing for SME's and prompted a re-examination of approaches. Governments are providing substantially less grant financing than was the case for much of the past decade. This stems from fiscal restraints, concern over the potential to cause market distortions and the constraints of operating in a freer trade environment. Coincident with this trend, banks have tightened up their lending rules in response to the losses of the early 90's recession as well as legislative changes. Another challenge for banks has been the shift to knowledge based businesses. These businesses require equity financing as they lack the physical assets sought by lenders as security.

In an effort to facilitate business financing but in keeping with a desire to avoid the provision of grant support, ACOA has been examining the financial intermediary market and its cost and effectiveness in Atlantic Canada. The financial intermediary market is the combination of players and processes that work to match entrepreneurs seeking financing, and particularly equity financing with equity investors.

The focus of this project is generally on entrepreneurs seeking relatively small amounts of financing. This appears to be the segment of the capital market that is least developed. A variety of venture capital organizations such as the Working Ventures Canadian Fund Inc. and ACF Equity Atlantic Inc. are visibly active and targeting larger deals (for Atlantic Canada) of over $1 million. This study has then examined the individuals and organizations in Atlantic Canada that comprise the financial intermediary process and support those entrepreneurs seeking equity of between $50,000 and $250,000 or total financing for their enterprise of under $1.5 million.

B. Objective and scope

This study has been focused on four objectives:

- undertake a thorough examination on a region-wide basis, of the existing and/or informal intermediary market in Atlantic Canada.

- identify the strengths and weaknesses, performance and best practices of specified entrepreneur-investor matchmaking initiatives.

- assess the issues affecting the establishment of a more formal and vibrant financial intermediary market in the region including, in particular, the taxation, regulatory and jurisdictional frameworks which govern it.

- make recommendations, if appropriate, as to how to enhance the Atlantic financial intermediary market.

Specific questions were also provided in the terms of reference to further shape the study deliverables. These ten questions were as follows:

- Is there any effective and efficient means of networking the region's SMEs and entrepreneurs and national and Atlantic investor markets? Is matchmaking a critical need?

- What were the strengths, weaknesses and reasons for failure of former formal matchmaking initiatives, and what are the strengths, weaknesses and best practices of existing formal and informal initiatives operating in the Atlantic/other jurisdictions?

- Is the issue, as some entrepreneurs have asserted, that informal investors are extremely difficult to locate; or, is the issue, as some informal investors have indicated, that good investment opportunities are difficult to find?

- Would financial intermediary fees be a significant disincentive?

- Are legal fees a significant disincentive? Would the development of standardized legal documentation save time and money for SMEs seeking informal angel investment?

- What is the impact of provincial securities legislation on doing smaller financing deals in the Atlantic Region?

- How can/could the tax system be used to encourage more informal investment in Atlantic SMEs?

- What kind of private or public sector instruments/mechanisms/model may be appropriate to help establish/enhance an Atlantic intermediary market which would see financial intermediaries matchmake between suppliers of and demand for equity?

- Should ACOA consider a pilot program to help Atlantic SMEs with the cost of financial intermediaries?

- Is training of financial intermediaries required? What would it look like?

The focus of the study throughout was the financial intermediary function in Atlantic Canada, which represents only one dimension of the overall SME capital market.

C. Approach and methodology

Our workplan to address the referenced study deliverables entailed three main components:

- Case studies of seven Formal Intermediary Service Providers/mechanisms (FISP's):

  - Investment Matching Service of Alberta (IMSA)
  - Ontario based Commercial Opportunities & Investment Network (COIN)
  - Ottawa-Carleton Specific Investment Opportunity Program (SIOP)
  - Halifax Equity Group (HEG)
  - St. John's Investment Opportunities Project (IOP)
  - Glasgow, Scotland Business Ventures Limited (BVL)
  - Alberta Junior Capital Pool Offerings (JCPO)

  All of these services are still in operation with the exception of the St. John's Board of Trade service which closed in September of 1993.

  The case study guide employed is provided as Appendix A.

- Telephone surveys of 30 informal intermediary service providers such as accountants, lawyers, business brokers and securities firms that endeavour to assist entrepreneurs in raising capital on an as requested basis. These individuals rely heavily on their client base and personal contact network to identify investors. The survey guide employed for these interviews is provided as Appendix B.

- Telephone interviews with 30 entrepreneurs from across the region each of whom has sought or is seeking equity financing. The survey guide employed appears as Appendix C.

In addition to these three tasks, consultations were undertaken with a variety of knowledgeable sources. In particular, two rounds of consultation were undertaken with an advisory panel of KPMG Partners and Senior Managers active in the process of seeking financing for entrepreneurs. Panel members are listed in Appendix D. Two Partners from outside Atlantic Canada were included in the panel.

The small samples of entrepreneurs and intermediaries surveyed reflect a case study approach to the research. We have not sought to generate statistically significant results. Readers should take note of the sample sizes on specific questions in formulating conclusions from the data. Our conclusions and recommendations are based on circumstances where the research was reinforced by our project team and expert panel's experience.

II

Case Studies Of Matchmaking Services

A. Introduction

A number of provincial, municipal and state governments across Canada, the United States and also Europe have sponsored matchmaking initiatives to assist entrepreneurs in raising equity financing. Seven such initiatives which are also referred to as formal intermediary service providers (FISP's) were selected and reviewed in detail for this study. The objective of these case studies was to learn from their experience and endeavour to identify best practices with applicability in Atlantic Canada.

The seven FISPs examined are:

- Investment Matching Service of Alberta (IMSA)
- Ontario based Commercial Opportunities & Investment Network (COIN)
- Ottawa-Carleton Specific Investment Opportunity Program (SIOP)
- Halifax Equity Group (HEG)
- St. John's Investment Opportunities Project (IOP)
- Glasgow, Scotland Business Ventures Limited (BVL)
- Alberta Junior Capital Pool Offerings (JCPO)

The data to complete the case studies was compiled through a review of related documentation, including studies and promotional material as well as telephone interviews with knowledgeable representatives of the organization.

Detailed narrative profiles for each of these organizations is provided in Appendix E. These narratives have been reviewed by the organization to ensure accuracy.

B. Profile of FISPs Reviewed

While six of the organizations listed in Section A fall under the broad category of being intermediary service providers, there are several different strategies employed by these organizations to achieve their overall business objectives. The differences in the organizations, their policies and strategies, suggest that there is no "cookie cutter" solution to the intermediary function that works in all circumstances. The services have been designed and have evolved to fit the requirements of their respective markets. Exhibit II-1 provides a summary of the key operating statistics for each FISP examined.

The discussion which follows describes some of the differences in the services studies.

1. Project size

The amount of financing sought per project ranged from $20,000 to $2,000,000 with an average of approximately $500,000 per project. Three of the seven FISPs had established minimum project size criteria and another two FISPs cited an unofficial minimum for project size before they would be willing to provide services.

2. Staff complement

The largest staff complement noted in the FISPs surveyed was five full-time equivalent staff. The average was three full-time equivalent staff. Services maintain only small staffs in order to operate efficiently. In general, the entrepreneur clientele of the services have minimal ability to pay and generate fee revenue for the services. This pressures the FISP's to maintain the lowest possible cost structure.

3. Services

There are several services that are offered by all of the FISPs. These include: critiquing business plans and projections; identification of potential investors; introducing entrepreneurs to potential investors; and, contacting potential investors on behalf of the entrepreneur. Other services that were noted in at least five of the FISPs included: assisting with negotiations between the two parties; and, making meeting rooms available to assist in investor/entrepreneur facilitation.

Exhibit II-1
Profiles of Intermediary Service Providers

	Investment Matching Service of Alberta	Commercial Opportunities & Investment Network	Specific Investment Opportunity Program	Halifax Equity Group	Investment Opportunities Project	Business Ventures Limited	Junior Capital Pool Offerings [1]
Core Area	Alberta	Toronto	Ottawa	Halifax	St. John's	Scotland	Alberta
Date Established	1989	1987	1989	1997	1989	1993	1987
Date Closed	na	na	na	na	Sep-93	na	na
Funding Source	Provincial Gov't	private co. Spectris Corp.	**2**	Greater Halifax Part nership in conjunctio with Industry Canad	ACOA, Economic Re covery Commission & St. John's Board of Tr	Regional Gov' Glasgow Dev. Agency	investors
Fees Charged [3]							
Entrepreneur	$0	$280	$0	per hour + success	$100	$400	15-26% [4]
Investor	$0	$185	$0	$0	$0	$0	$0
Estimated Success Rate	1 in 20	1 in 50	1 in 5	na	1 in 12	1 in 3or4	na
Average Amount of Financing Acquired Per Proje	$100,000 to $1,500,000	$10,000 to $500,000	$500,000	na	$20,000 to $1,000,000	$600,000 to $2,000,000	$400,000 to $500,000
Annual Statistics							
Estimated Expenses (including salaries)	$155,500 [5]	$311,000 [5]	$125,000	$180,000	$186,100	$311,000 [5]	na
# of Businesses 'Matched' (deals consummated)	12	na [6]	6.25	0	2.8	30	na
Estimated Cost per 'Match'	$12,958	na	$20,000	na	$66,464	$10,367	$55,000
Staff Compliment (FTEs)	2.5	5	2	1	3	5	na
Services Provided							
Feedback and referrals for business plan and pr	yes	yes	yes	yes	yes	yes	no
Direct assistance with business plan and projec	no	yes	no	yes	no	yes	no
Pricing/valuing the investment	yes	yes	no	yes	no	no	no
Identification of potential investors	yes	yes	yes	yes	yes	yes	no
Introducing entrepreneurs to potential investors	yes	yes	yes	yes	yes	yes	no
Contacting potential investors on behalf of the	yes	yes	yes	yes	yes	yes	no
Assisting with negotiations between the two pa	no	yes	no	yes	yes	yes	no
Structuring the deal (financing plan and securit	no	no	no	yes	yes	no	no
Drafting the deal (legal agreements)	no	no	no	yes	no	no	no
Other Intermediary Services							
seminars, public shows	no	no	yes	no	no	yes	no
managing investors	no	no	no	yes	no	no	no
due diligence	no	no	no	yes	no	no	no
Other Non-intermediary Services							
strategic alliances	yes	no	no	no	no	no	no
meeting rooms	no	yes	yes	no	yes	yes	no
hosting presentations	no	yes	yes	no	no	yes	no
scheduling appointments	no	yes	no	no	no	yes	no
succession planning	no	no	no	yes	no	no	no

1 Policy No. 411 of the Alberta Securities Commission
2 Majority by Regional Gov't (Ottawa-Carleton Economic Development Corporation) in partnership with corporate and non-gov't contributors
3 Fees shown are one-time fees only with the exception of COIN which charges fees for every 6 months you're on the database.
4 15-26% of total funds raised through the JCPO.
5 Estimated Expenses calculated based on the average cost per FTE staff ratio for the SIOP and IOP projects.
6 COIN counts matches differently than the other FISPs. It links approximately 2,500 businesses and investors each year but does not remain

Less than half of the FISPs provided direct assistance with business plan preparation, pricing/valuing the investment, structuring the deal (financing plan and security) and drafting the deal (legal agreements). However, the FISP's that did not offer these services directly, provided referrals and contacts throughout the business community in order that entrepreneurs could access required assistance. Average size of project and staff complement both appear to generally correspond to the breadth of the services offered by each FISP. The larger the average project size, the more services are expected of the FISP by the entrepreneur and investor. Similarly, the smaller the staff complement, the fewer the amount of services that can be offered to entrepreneurs and investors. A key component of the strategy of the most successful FISP's is the willingness to invest time up front with their clients in order to make the entrepreneurs "investor ready". This time investment benefits the FISP in the long term by establishing credibility with both entrepreneurs and investors which leads to future successes.

4. Fees

a) Investors

COIN is the only Formal Intermediary Service Provider (FISP) from our case study that charges fees to the investor, although those fees are substantially less than the fees charged to entrepreneurs. The COIN program is also the only FISP examined which was not government funded. As COIN's main focus is the management of an information database introduction service for both investors and entrepreneurs, investors are charged $185 for every six (6) month period they are listed on the database.

b) Entrepreneurs

Two of the FISPs in our case study (the Investment Matching Service of Alberta and the Specific Investment Opportunity Program in Ottawa) do not charge entrepreneurs for using their services. Business Ventures Limited of Scotland charges entrepreneurs $400 to ensure a certain level of commitment to the project from the entrepreneur. The St. John's Investment Opportunities Project charged a $100 fee.

COIN charges entrepreneurs who are listed on their database $280 for a six (6) month period. This equates to approximately 50% more than the amount charged to their investors.

The HEG charges entrepreneurs a per hour rate for any services provided and intends to charge success fees for projects resulting in a match with an investor. However, the HEG has only been in operation for less than a year and has not yet charged any success fees.

Overall, the fees charged to entrepreneurs appear to represent perhaps 15 to 30% of the cost by FISP's of the service provided.

5. Promotion

FISP's require an effective promotional strategy. Successful FISPs have been able to take advantage of their own extensive personal contacts and word of mouth as the most effective and cost efficient method of advertising. In order to have the ability to effectively perform advertising in this way, a new FISP must ensure that it employs the appropriate personnel.

C. Lessons from the Investment Opportunities Project

The Investment Opportunities Project (IOP) in St. John's Newfoundland was the only FISP profiled that has been discontinued. The project merits discussion because of the lessons that it offers as we endeavour to design a better working intermediary market in Atlantic Canada. The IOP's principal shortening was its relatively high cost relative to the volume of matches it was able to achieve. There are a number of factors which contributed to this:

- Part of the expense was caused by a mass media advertising campaign which was not necessary in that market. It would have been less costly to promote the service via the many existing public and private agencies involved in business support. These agencies come into contact with the vast majority of entrepreneurs that might be seeking equity financing.

- The fundamental premise of a matching service is that entrepreneurs need help finding investors and vice versa. This is more likely to be the case in larger centres where there is less common knowledge respecting the individuals or companies that might have funds available and that might need them. In a market such as Newfoundland, potential investors are likely to be relatively well known to the business community, making it unnecessary to have a service designed to "find" them. An informal intermediary market is typically able to service a market of this nature.

- Staff levels were high relative to the available volume of activity. The Alberta service as a comparison operates with less staff in a market generating many more potential deals.

D. Key success factors for FISPs

As each financial market is unique, so too are the FISPs that have evolved to service those markets. Despite their unique characteristics there are several similarities in their key success factors.

1. Establish credibility early

The key success factor mentioned most frequently by the FISPs was their good reputation and established credibility with investors and entrepreneurs. Initial successes stories are critical to a new FISP being able to establish itself in the marketplace. Therefore, when a new FISP is being contemplated the amount of resources or attention given to the initial projects should be much higher than the expected resources required for similar projects in the future. This means that resources budgeted for a new FISP should be higher in the initial start up phase.

2. Making entrepreneurs investor ready

Another key success factor identified was the ability to make the entrepreneurs “investor ready”. Making an entrepreneur “investor ready” involves a number of steps ranging from managing expectations of the entrepreneur to providing assistance in the preparation of a detailed business plan. A common misconception of entrepreneurs in general is that private investors will provide financing without taking at least a partial ownership position with the project, ie. obtaining equity. Another misconception is that investors will be willing to invest in a project on the strength of the idea alone without a solid business plan backing it up. Entrepreneurs sometimes do not realize all of the detailed planning necessary to start-up a business and are ill equipped to approach investors with a saleable package. Providing assistance with business plan preparation or referring entrepreneurs to an appropriate advisor was a service offered by all of the FISPs examined. Further, the FISP representatives agreed on the general need for entrepreneurial education and expertise in the area of raising capital.

3. Project screening

The ability to quickly identify and disassociate from projects that have very little chance of succeeding was noted by several of the FISPs as an area that needed improvement. Four of the FISPs in the case study alluded to the fact that while their government funding was essential to continuing operations, it also made it difficult for them to reject projects they felt would have very little chance of being successful. When dealing with government funded agencies there is an expectation level on behalf of entrepreneurs that they deserve a certain amount of assistance no matter how poor their business plan or idea may be. A privately funded organization does not experience this type of pressure as there are no political ramifications for rejecting those investment opportunities it determines are not worthwhile.

The success rates of the FISPs examined in our case study ranged from a high of 1 in 4 to a low of 1 in 50. The reason for the large range in these success rates is indicative of the different ‘filtration’ or screening processes the FISPs have in place to eliminate deals that have a low probability of attracting investment. The establishment of a minimum project size is also used by FISPs as a screening mechanism to ensure the costs of servicing a project do not become proportionally significant.

4. Staff experience

Staffing of the FISPs is also a critical issue. The one FISP in the case study that ceased operations cited the need for more local business expertise as an important issue. Several of the other FISPs mentioned personal experience and extensive personal networks as a key success factor. In some instances, the networking function is enhanced by an associated committee or Board of Directors which acts as a sounding board for evaluating new projects and also provides access to additional personal networks and contacts.

5. Financial support for the FISP

The provision of intermediary services in and of itself does not seem sufficient to make an organization self sufficient. The only FISP organizations that are not funded by government or have a desire to become self sufficient also offer additional services which are charged out at hourly rates, or license fees in the COIN case. The FISP representatives consulted were comfortable that for the government to provide start-up or seed capital to intermediary service providers would not cause market distortions. A successful FISP must have funding support from some source other than its matchmaking activity.

III

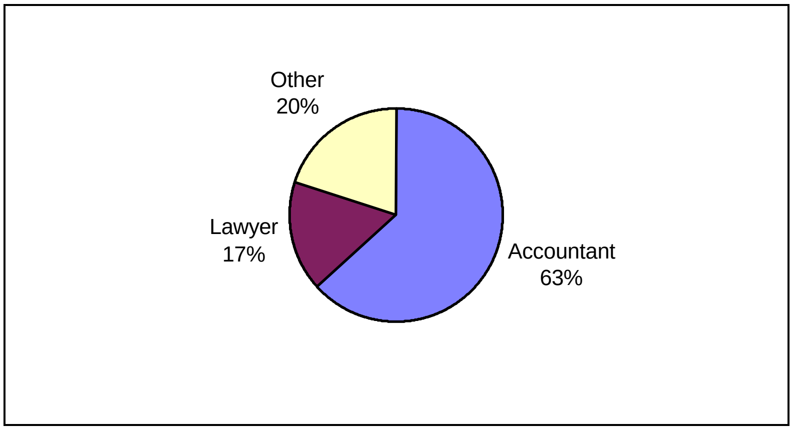
Intermediaries

A. Introduction and sample characteristics

This chapter presents the results of our survey of "informal" financial intermediaries (IFI's), the individuals able to assist entrepreneurs in finding equity investors due to their business and personal contacts. In order to generate a list of the IFI's across the region, we surveyed all 34 KPMG partners in our eight offices in the four Atlantic provinces. This process generated a long list of individuals thought to qualify as IFI's. It was determined that to qualify as an IFI for the purposes of the survey, respondents should have been involved in two "deals" in the past year.

Thirty intermediaries across Atlantic Canada were interviewed. The interview guide employed is provided as Appendix B. Most respondents were senior partners in either accounting firms or law firms. Most of the major accounting firms and law firms are represented in the sample. Other respondents described themselves as management consultants, business brokers and bankers. Exhibit III-1 provides the breakdown by profession indicated. Very few respondents (17%) stated that financial intermediary work was their main line of work. Most indicated that they offered financial intermediary services to their clients as one service among a suite of professional services.

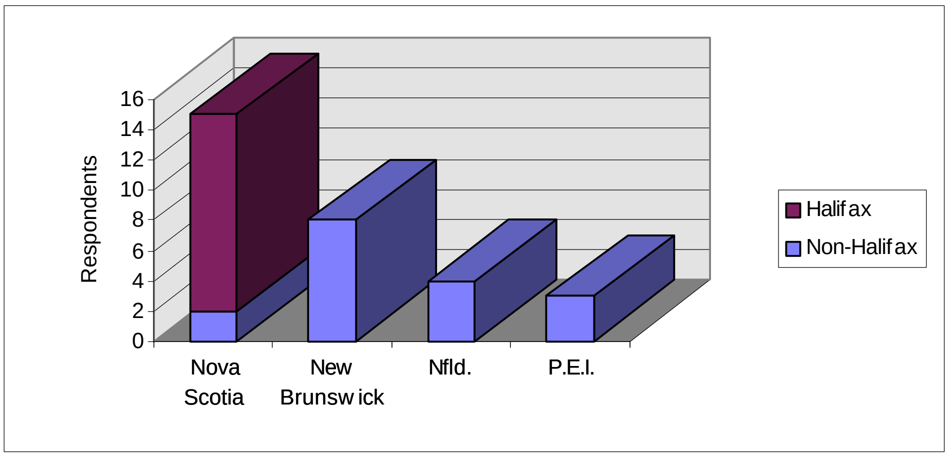
Exhibit III-1
Breakdown by profession



n = 30 intermediaries

Respondents came from across the Atlantic provinces; however, many (43%) were based in Halifax, as indicated in Exhibit III-2. The high percentage of Halifax respondents is a result of two factors. First, there was no region-wide list of intermediaries available to serve as a sampling frame. Consequently, it is difficult to determine whether Halifax is over-represented. Second, only intermediaries that had participated in two deals in the last year were eligible. Understandably, the intermediaries in larger centres, and Halifax specifically, were more active. Analysis of the intermediary responses demonstrates no significant differences in responses between the intermediaries located in Halifax and others, suggesting there is no bias concern.

Exhibit III-2
Province of respondent

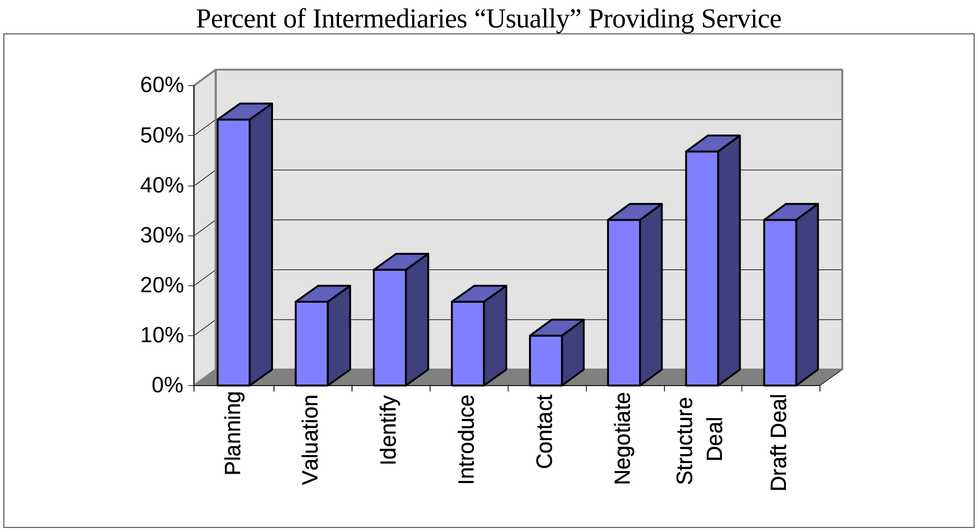


n = 30 intermediaries

B. Financial intermediary services

The IFI's surveyed offer a full range of services to clients. Each of the eight identified components of the intermediary function was offered "usually" or "occasionally" by 60% or greater of respondents. As is illustrated in Exhibit III-3, intermediaries are most likely to be involved in the preparation of business plans, structuring deals or negotiating deals. They stated they had comparably less involvement in the identification of investors, contacting investors, introducing entrepreneurs to investors, valuing investments and drafting deals.

Exhibit III-3
Distribution of intermediary services



n = 30 intermediaries

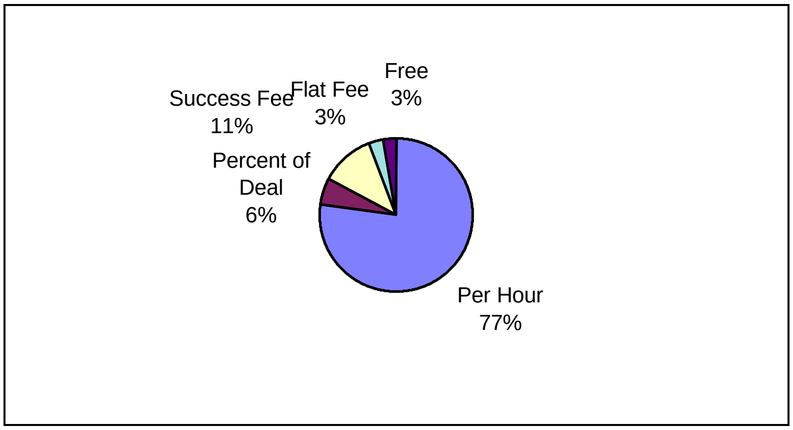
C. Fees

Most respondents (77%) charge an hourly rate or a per diem. Some mix an hourly rate with a percent of the deal or a success fee. Only one intermediary charged exclusively by percent of deal and no intermediary charged exclusively by success fee.

Professional standards dictate how accountants and lawyers charge. For example, as a result of limitations imposed by the Canadian Institute of Chartered Accountants, Chartered Accountants face restrictions in charging a contingency fee or success fee.

Exhibit III-4
Fee arrangements

34 Responses (more than one response per respondent)



The intermediaries surveyed indicated that fee splitting is not common. Only six respondents (20%) had seen fee splitting. One respondent felt that it was difficult to control quality with fee splitting; another worried that fee splitting might appear to compromise their independence.

Many of the IFI's surveyed (42%) do not consistently recover their target revenue when engaging in financial intermediary work. They offered several reasons for offering the service in the absence of immediate financial gain:

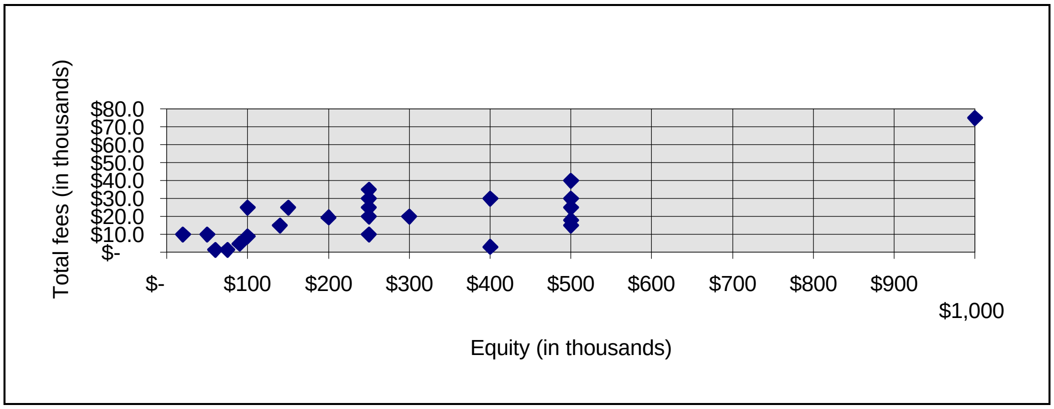
- Many do it to build client loyalty and keep the client from building a relationship with other professionals. These respondents felt that clients expected a suite of services from their accountant or lawyer. They therefore felt it wise to perform this service in the interest of client satisfaction.

- Several respondents thought that it was necessary to service smaller clients in the hope that the client would grow and a profitable, long-term relationship would result. They therefore saw their work as an investment in future earnings.

Total fees were consistently in the $10,000 to $40,000 range as indicated in Exhibits III-5 and III-6. Total fees increased slightly as the amount of equity or the size of the deal increased. Many intermediaries and entrepreneurs did not make a distinction between sourcing debt or equity; as a result, fees are more probably a function of the amount of total financing and not the amount of equity.

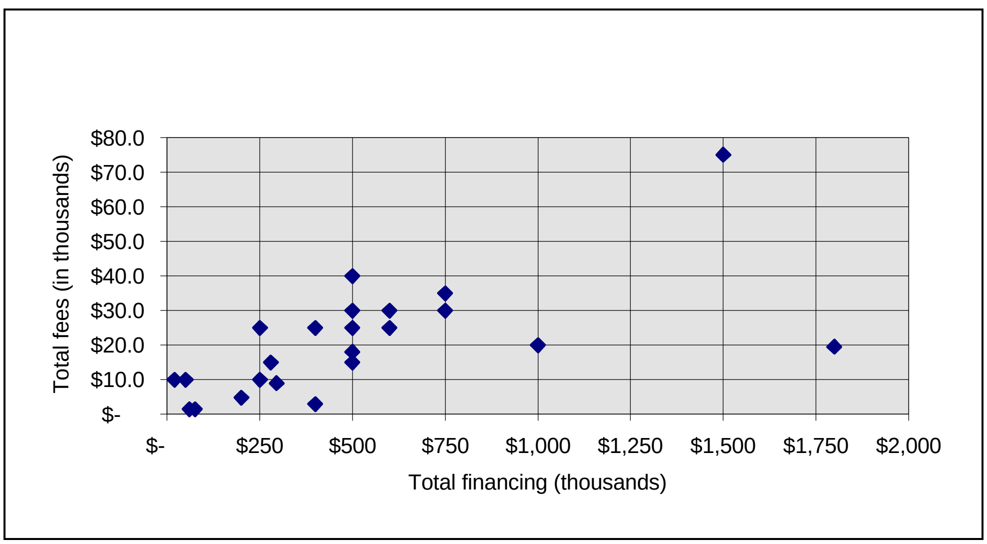
Respondents profiled deals across a range of sectors including retail, manufacturing, high-tech and distribution on indicated fee levels.

Exhibit III-5
Fees and equity sought*



*n = 24 - not all respondents provided data for this question.

Exhibit III-6
Fees and financing*



*n = 24 - not all respondents provided data for this question.

D. Promotion

Few IFI's promote their services:

- Seventeen respondents (57%) do not promote intermediary services in any way.
- Nine respondents (30%) do not formally promote their services as an intermediary; however, they do promote their services through networking and word-of-mouth.
- Four respondents (13%) rely on print advertising, such as articles in trade journals. Of the four respondents, two were accountants, one was the manager of a municipal Economic Development Corporation and one was a lawyer.

E. Causes of unsuccessful deals

The IFIs were asked to indicate the factors that in their experience were most likely to cause deals to fail, that is not result in the attraction of an equity investor. In almost half of the cases cited, the issue was the quality of the business. The most common concern was "poor management", as indicated in 30% of responses. Another 17% of responses indicated that the business or business plan was the concern.

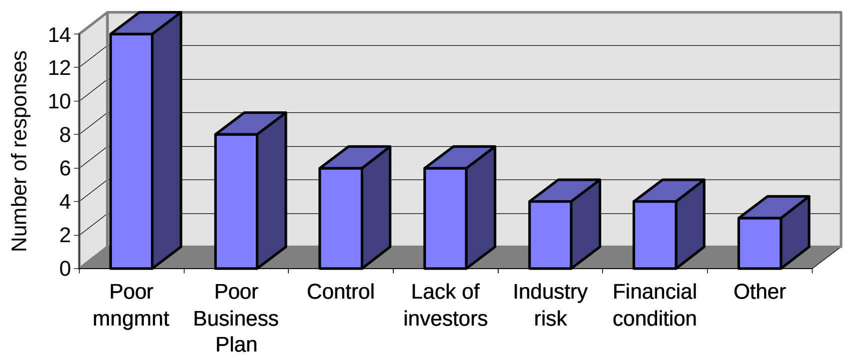
Other responses included:

- The reluctance of entrepreneurs to surrender control.
- A lack of investors in the Atlantic Canadian economy.
- Industry risk. Respondents indicated that investors were reluctant to invest in an industry (especially high tech) that they did not understand.
- The poor financial condition of the investment deterred some investors.
- Other responses included a lack of equity on the part of the entrepreneur and a lack of chemistry between entrepreneur and investor.

Exhibit III-7 illustrates the relative importance of the factors most likely to cause deals to be unsuccessful.

Exhibit III-7
Factors in the failure of deals

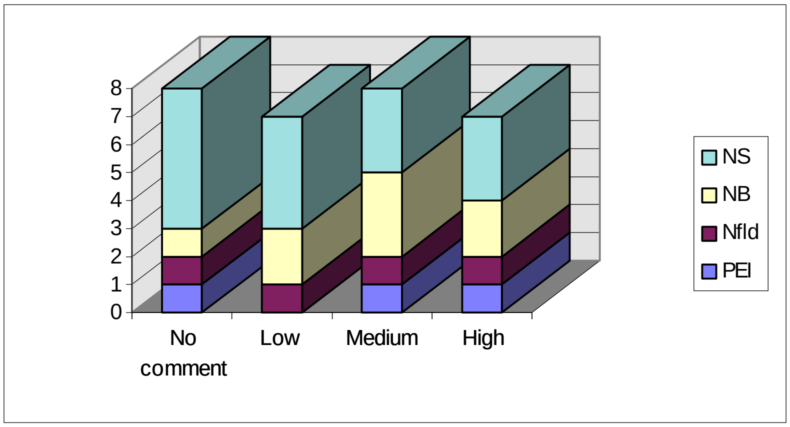
47 responses (up to two per intermediary).



F. Availability of financing and success rates

Respondents varied in terms of their ability to find investors. Half reported a success rate of 50% or better. The success rate did not vary significantly by region. Three respondents qualified their response by reporting that they 'cherry-picked' (screened) firms; that is, they only worked for those firms which had a good chance of finding financing. A number of respondents were not comfortable in providing a success rate.

Exhibit III-8
Success rates

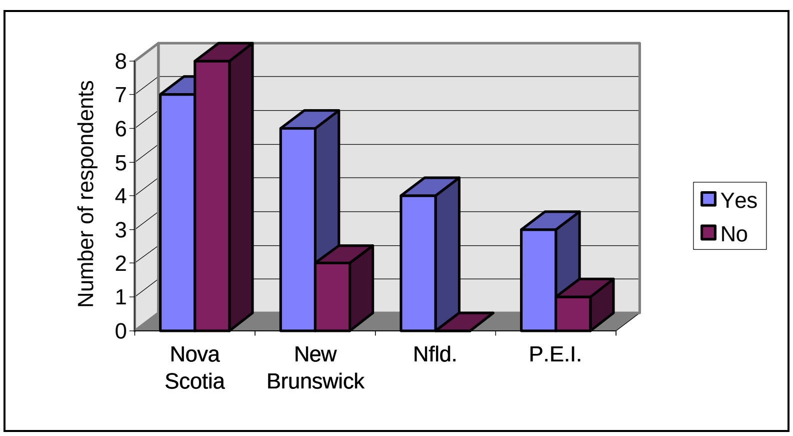


n = 30 intermediaries

The reported success rates of the IFI's contacted appear in Exhibit III-8.

Many respondents (19 respondents or 63%) thought it was difficult to find financing in Atlantic Canada.[1] However, respondents were divided on this question and each had strong opinions. As shown in Exhibit III-9, respondents in Halifax were much more likely to state that it was not difficult to find financing in Atlantic Canada.

Exhibit III-9
Is it difficult to find financing for good projects in Atlantic Canada?



n = 30 intermediaries

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[1] *This question asked about financing generally, not specifically about debt or equity.*

G. Other market characteristics

1. Overvaluing equity

An overwhelming majority (87%) of intermediaries stated that entrepreneurs were unrealistic about the amount of equity or control that must be given up in order to attract an investor. Many respondents stated that entrepreneurs overvalued their equity. For example; several stated that entrepreneurs wanted to give up 10 to 15% while investors expected 25 to 50%. One respondent stated that he had to consistently explain to entrepreneurs that ‘the banks are the stewards of other people’s money’. The tendency for entrepreneurs to overvalue their equity is not an Atlantic Canada specific issue. Recent research by our firm in Western Canada identified the same tendency.

2. Liquidity

Respondents were divided on the question of whether liquidity (or lack thereof) deterred investors. While it is clearly an important issue, sixteen (55%) did not think it was a deterrent. Most of these voiced the opinion that investors were ‘in for the long haul.’ It was indicated that in some cases, the investment might be a source of long-term employment for the investor. Such an investor would be much less concerned with the ability to liquidate their investment.

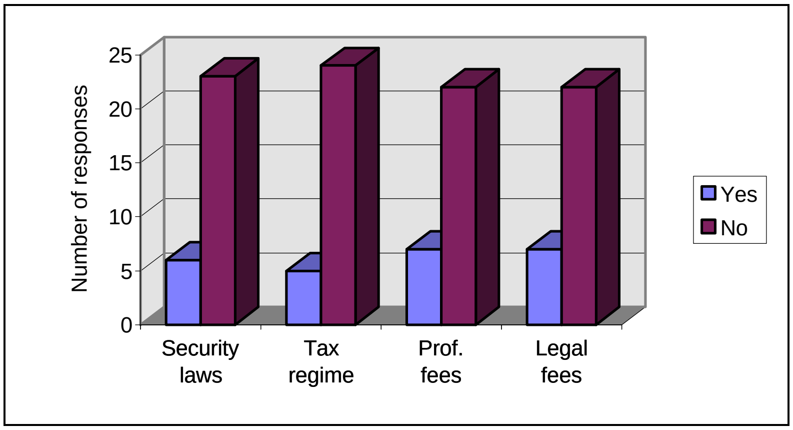
3. Laws and fees

Most respondents (80%) felt that current laws and professional fees did not represent significant impediments to raising capital. These respondents stated that the tax system encouraged investment and that professional fees only deterred those entrepreneurs who were not serious. Exhibit III-10 provides the pattern of responses.

The twenty percent of respondents who did state that security laws, tax laws or fees were impediments offered convincing rationales for their response.

- Respondents pointed out that it costs as much to prepare a small deal as a large deal. As a result, professional fees are a much larger percentage of financing for a small deal.
- Some respondents stated that tax credits for investment often served only to draw Atlantic Canadian funds into Ontario-based investment funds.
- Some respondents thought that existing securities legislation made smaller private issues too costly.

Exhibit III-10
Impediments to raising capital



n = 29 intermediaries

4. Other impediments

Other perceived impediments to the ability to raise capital in Atlantic Canada were:

- The lack of management talent in Atlantic Canada.
- The lack of capital.
- The small size of the market and the dearth of opportunities for growth.
- The lack of a stock exchange.
- The nature of bankruptcy laws.[2]
- The risk-averse nature of Atlantic Canadians.

H. Suggestions offered by intermediaries

The IFI's contacted were typically very interested in assisting this study and generous with their time during our interview. These individuals were asked what advice they had to offer the Federal Government to facilitate the development of a more effective capital market for SME's in the region. The responses suggest that initiatives in four general areas should be considered:

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[2] *Bankruptcy laws provide protection for suppliers before minority shareholders. In cases of bankruptcy suppliers have a priority right to any inventory which has been shipped in the last thirty days. Companies with quick turnover may not be able to offer inventory as collateral to investors.*

- Educating entrepreneurs in a variety of areas including how to raise capital.
- Using the tax system to encourage investment in SME's.
- Facilitating the establishment of an entrepreneur-investor matching service.
- Subsidizing intermediary fees.

IV

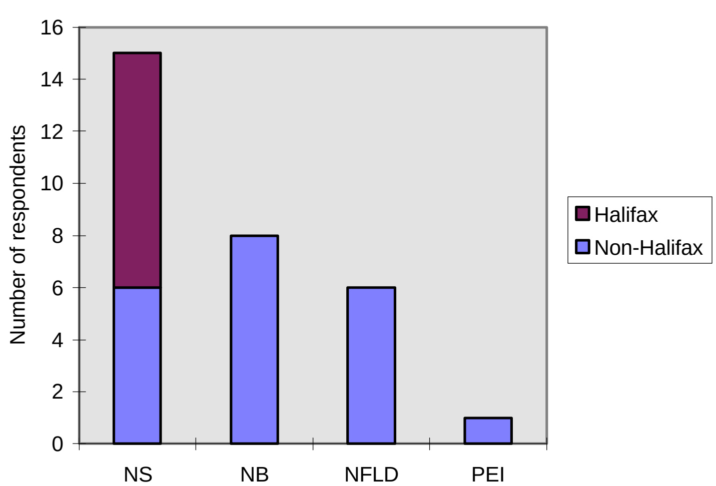
Entrepreneur Perspective

A. Introduction and sample characteristics

Thirty entrepreneurs who have recently been involved in seeking investment capital were contacted to gain their perspective on the operation of the current equity marketplace. The perceptions of this group are critical as they effectively represent the clients of the study. The capital market and intermediary function can only be deemed to be working effectively when deserving entrepreneurs can access appropriate financing at reasonable cost.

The sample of entrepreneurs was generated from names provided by KPMG Partners across the region and ACOA offices. The entrepreneurs contacted were distributed across the Atlantic provinces as shown in Exhibit IV-1. Nine of the respondents (30%) were from Halifax.

Exhibit IV-1
Distribution of respondents



n = 30 entrepreneurs

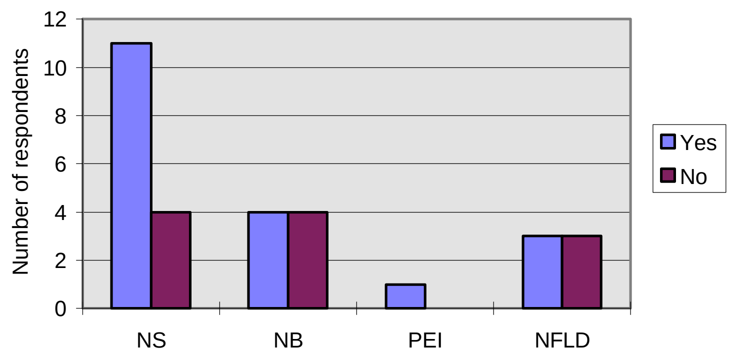
Nineteen respondents (63%) found equity; eleven had not. Exhibit IV-2 provides the geographic breakdown of respondents by their success in finding equity. Of those nineteen, eleven were from Nova Scotia. Seven of the eleven were from Halifax.

Of the nineteen respondents who had found equity, seventeen indicated the source and reported that they found equity from:

1. Investors (11 cases)
2. Friends and Family (4 cases)
3. Existing shareholders (2 cases)

Investors were not only from Atlantic Canada but also Ontario, Alberta, Quebec and Europe.

Exhibit IV-2
Did you find equity?



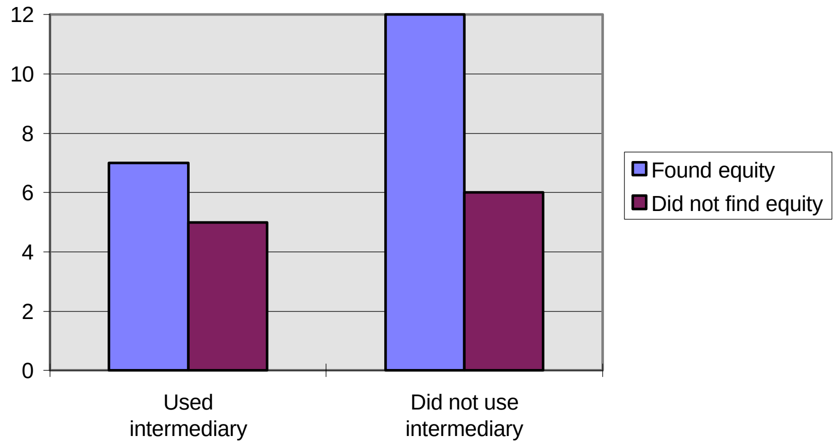
n = 30 entrepreneurs

B. Use of intermediaries

Eighteen respondents (60%) had not used an intermediary to look for equity.

Exhibit IV-3 shows the success rate in finding financing of the entrepreneurs that used versus did not use an intermediary. This is the expected result. Entrepreneurs are more likely to incur the expense of an intermediary if they see their project as a tougher sell. We were however surprised to see the number of entrepreneurs that were successful "going direct". This suggests that financing is available for at least some of the entrepreneurs that know how to pursue it.

Exhibit IV-3
Did you use an intermediary?

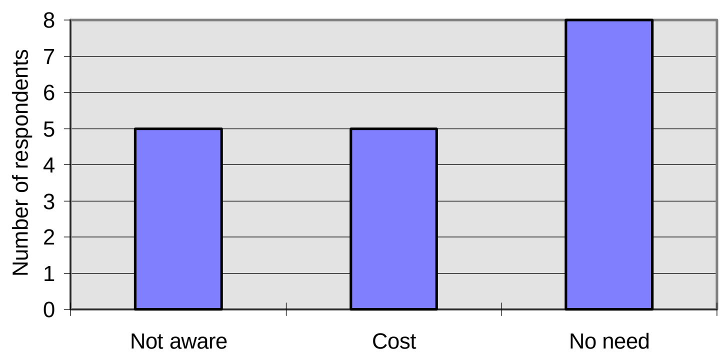


n = 30 entrepreneurs

Those who had not used an intermediary offered several different reasons for their approach. The main categories of responses are shown in Exhibit IV-4. The predominant factor was that there was no need, however, cost and a lack of awareness were also factors. Two of those who mentioned cost stated that the services were not available within their marketplace at an appropriate cost. Two respondents stated that they would not know how to find an intermediary.

Two entrepreneurs who had not used an intermediary expressed regret. These entrepreneurs felt that they had undervalued their firm and given an investor too much control for too little money.

Exhibit IV-4
Reasons for not using an intermediary



n = 18 entrepreneurs

C. Cost of intermediary services

The cost of intermediary services was usually a percentage of total financing found. As a percentage of financing; fees paid ranged from 2% (plus retainer) to 8%. On average fees were 5%. Only one respondent paid a percentage of equity. This respondent paid 10% of equity (half in cash and half in stock). Three intermediaries worked for free. One was a government employee, one was a friend and one was paid by the investor.

D. Intermediary selection process

Eight of twelve respondents shopped around before choosing an intermediary. On average, they considered three firms before choosing an intermediary. All found their intermediary through word-of-mouth. Fees quoted ranged from 2% (plus retainer) to 8%.

Entrepreneurs offered the following reasons for deciding on one intermediary:

1. The intermediary was the first to bring money to the table (this reason was offered by three entrepreneurs. In such situations, the entrepreneurs obviously engaged more than one intermediary on a contingency basis).

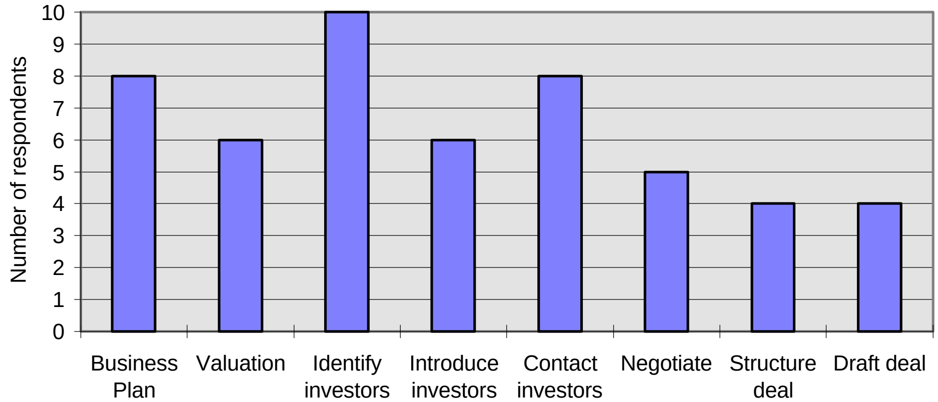
2. The intermediary had a good reputation (this reason was offered by two entrepreneurs).

3. The entrepreneur had an existing relationship with the intermediary.

4. The intermediary was the only firm in town to consider a small deal.

Intermediaries provided a range of services for entrepreneurs as indicated in Exhibit IV-5. Most intermediaries were engaged to find or contact investors.

Exhibit IV-5
Services performed by an intermediary



n = 12 entrepreneurs

E. Entrepreneur opinions

1. Availability of financing

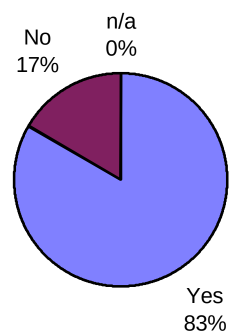
The entrepreneurs were asked a variety of questions about the Atlantic Canadian financial market such as:

- Is it difficult to find financing?
- Are investors reasonable?
- Impact of securities laws?
- Impact of tax laws?
- Impact of professional fees?

The responses are summarized below.

Respondents generally thought that it was difficult to find financing in Atlantic Canada as indicated in Exhibit IV-6.

Exhibit IV-6
Is it difficult to find financing in Atlantic Canada?



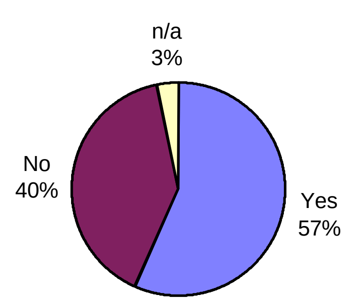
n = 30 entrepreneurs

2. Investor expectations

Respondents generally found investors to be reasonable regarding valuations and equity requirements, as indicated in Exhibit IV- 7. Those that found them to be unreasonable stated that investors wanted too much control. Entrepreneurs comments included:

- *"The investor had undervalued the company by 200% and demanded 30% ROI on 49% equity.*
- *Most investors wanted 80% equity but would settle for 50%.*
- *Investors wanted 90%; he was selling 15%."*

Exhibit IV-7
Are investors reasonable?



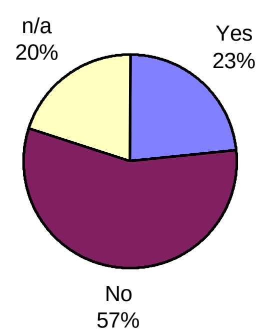
n = 30 entrepreneurs

3. Securities laws

A majority of respondents indicated security laws were not an impediment to raising capital. Exhibit IV-8 provides the breakdown of responses There were none-the-less, specific complaints with respect to securities legislation including:

- $150,000 is too high for the 'sophisticated investor' restriction (Nova Scotia).
- More clear-cut rules were needed for Initial Public Offering regulations.
- Securities legislation differs from province to province; this makes it difficult to raise capital.

Exhibit IV-8
Are security laws an impediment to raising capital?

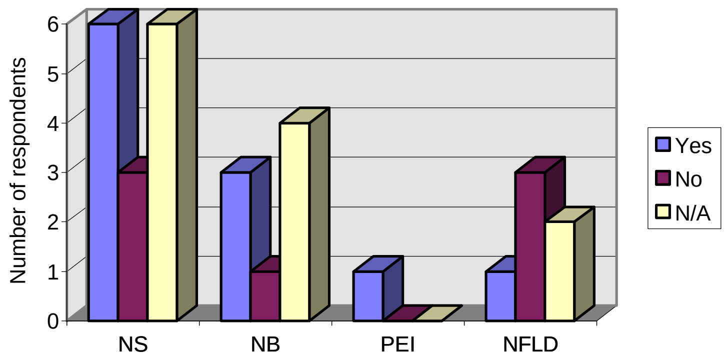


n = 30 entrepreneurs

4. Tax regime

Respondents were divided on the question of whether the tax regime was helpful when raising capital as indicated in Exhibit IV-9. Responses varied principally on the basis of province. Nova Scotians indicated that the Equity Tax Credit was helpful while others noted the Research & Development Credit had been useful.

Exhibit IV-9
Is the tax regime helpful when raising capital?

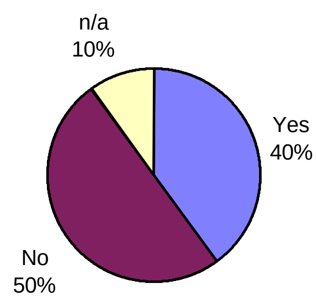


n = 30 entrepreneurs

5. Professional fees

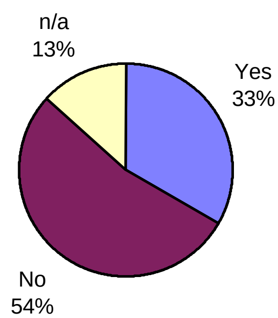
A slight majority of respondents did not consider professional fees or legal fees to be a barrier to the use of intermediary services. Exhibits IV-9 and IV-10 show the exact breakdowns. Several needed specialized legal expertise for an initial public offering or to deal with intellectual property and found such expertise to be very expensive.

Exhibit IV-10
Are professional fees a barrier to the use of an intermediary?



n = 30 entrepreneurs

Exhibit IV-11
Are legal fees a barrier to the use of an intermediary?



n = 30 entrepreneurs

F. Entrepreneur suggestions

The entrepreneurs surveyed were asked for suggestions for either other entrepreneurs endeavouring to raise capital, or for the Federal Government. The principal theme of the responses is the need for information about available intermediary services.

V

Conclusions

Our conclusions for this study are presented as answers to the ten questions proposed in the terms of reference as the "expected outputs of the study". The answers are prefaced with a section providing a description of the intermediary market in Atlantic Canada. Chapter VI provides more specifics regarding our recommendations.

A. The current structure of the SME capital market

1. The market is informal

At present, in Atlantic Canada, entrepreneurs and investors are matched both as a result of entrepreneurs making direct contacts with investors, as well as the efforts of intermediaries that have been approached by entrepreneurs. The "stock" of intermediaries in Atlantic Canada appears to be a small group of less than 100 accounting, legal, business brokering and investment professionals. When approached by entrepreneurs seeking financing, these individuals either proceed to approach potential investors or assist the entrepreneurs in reaching an investor ready state, often assisting in the preparation of a business plan. The intermediaries in Atlantic Canada are generally associated with a known stable of investors.

2. Many entrepreneurs seeking capital are not investor ready

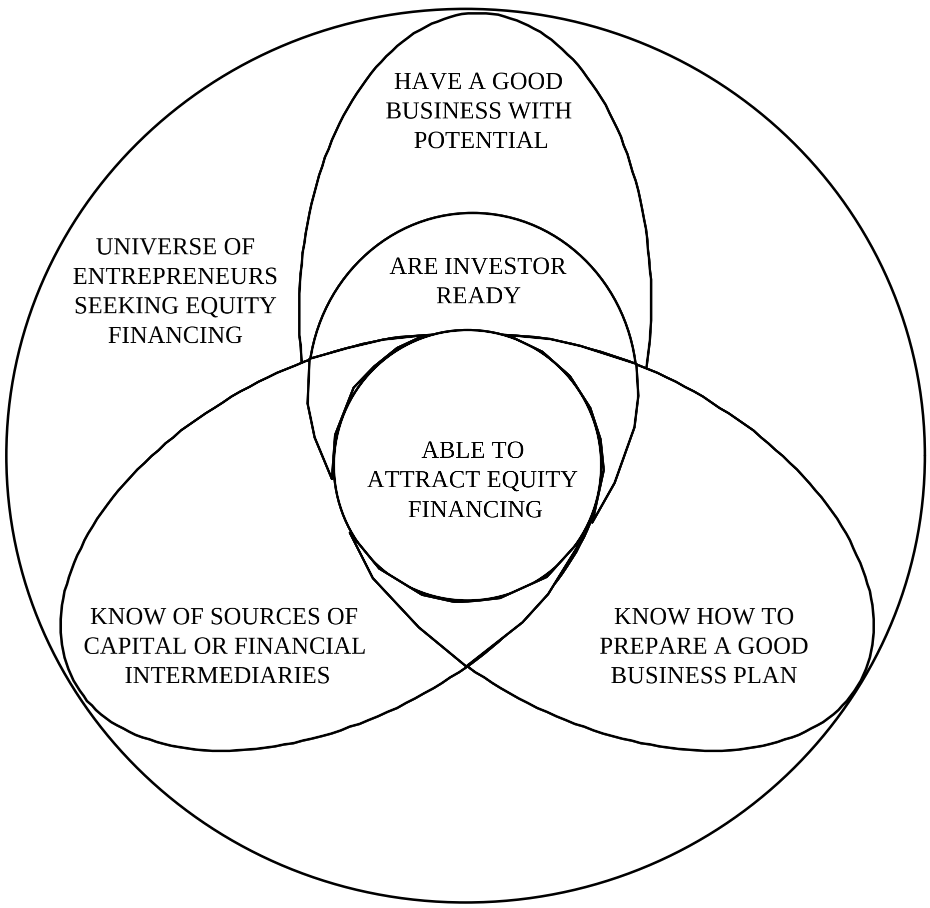
A key challenge facing intermediaries is the range of entrepreneurs that approach them seeking assistance. Entrepreneurs vary dramatically in sophistication, as well as in the real potential of their business. Some know of sources of capital, some do not. Some know what to expect from an intermediary, some do not. Some entrepreneurs are investor ready and again, others are not.

By "investor ready", we refer to a wide variety of conditions that affect an investor's perception of a business. A business may have a good market and good growth potential and still not be investor ready. It may require the recruitment of specific management expertise, the implementation of improved reporting and control systems, the reorganization of its shareholder structure, or a revamping of the balance sheet, in particular, the debt of the company. There could be outstanding lawsuits or environmental liabilities that must be addressed. The owner (s) could have unrealistic expectations as to the value of the business.

The key point here is that, of the entire universe of entrepreneurs seeking financing, only a sub-set of those have a solid market which provides growth potential, and of those, only a sub-set could be considered investor ready: that is, they have addressed all of the risks and requirements that could be anticipated as concerns of an investor. Exhibit V-1 provides a graphical illustration of the total entrepreneur population and the sub-set that are investor ready and able to attract investor financing.

Exhibit V-1
Categories of entrepreneurs

Categories of Entrepreneurs Seeking Equity Financing



3. Investors also vary in their requirements

A further challenge for intermediaries is the diversity in the available supply of investors. Investors range in profile in a variety of ways including:

- sector knowledge

- desired size of investment
- interest in / ability to bring management as well as money to the project
- appetite for risk

These factors vary over time for investors. In order to be effective intermediaries endeavor to stay current regarding the circumstances of the investors they're likely to approach with opportunities.

4. The current market produces mixed results

The informal financial market for SME's as it exists in Atlantic Canada is inefficient and ineffective for entrepreneurs that are not aware of either investor contacts or the numerous intermediaries available that could provide assistance including investors introduction. The intermediary network in the region appears to be under-utilized because of a lack of knowledge of intermediaries, their services and their investor contacts.

While the current market structure can be cumbersome for some entrepreneurs, it offers advantages to other participants. The fact that many entrepreneurs find financing without intermediary assistance suggests a certain efficiency and effectiveness for those parties. Further, entrepreneurs that know of intermediaries are often able to access a number of investors with minimal effort and cost. Intermediaries that are presented with good business plans do not generally charge substantial fees for passing those plans on to potential investors.

From an investor viewpoint, the existing intermediary network provides an effective screening mechanism that saves them the effort of dealing with many entrepreneurs that are not investor ready. The intermediary screening function also protects the confidentiality of investors. This is advantageous because of the small size of the Atlantic Canadian economy and closeness of the community. Whenever an investor can avoid having an entrepreneur know that they have turned down a project, the investor has potentially avoided burning a bridge with an individual in the community. This confidentiality regime also works to the advantage of the intermediary network. In some cases, it is much easier for an intermediary to report to an entrepreneur that none of the potential investors contacted were interested in pursuing the deal than to directly tell the entrepreneur that they are not investor ready. Some entrepreneurs prefer enthusiasm to objectivity and will not appreciate having an intermediary offer this type of view.

A challenge in assessing the effectiveness of the existing market is sorting out the reasons for deals not occurring. Many deals do not occur because the entrepreneur is not investor ready. However, deals also do not occur because either the entrepreneur or intermediary acting on their behalf has not accessed enough stables of investors to find one with the right profile to match the project in question.

It is this circumstance that represents the key shortcoming of the current market structure. Many entrepreneurs do not understand:

- The need to make contact with many investors in order that one with the right profile is found.

- That intermediaries will often make contact with or forward a good business plan to potential investor (typically those that are their clients) for minimal or no cost.

- The need to push their intermediary to look for an investor beyond their normal stable of investors or contact network.

- The need to link up with a number of intermediaries in order that a number of stables of investors are accessed.

- The need to seek capital outside of the Atlantic Region because an investor with a suitable profile may not exist in the region.

It is these shortcomings in entrepreneur knowledge and market effectiveness that we see as the key challenges to be addressed.

The rest of this chapter provides responses to the ten questions in the terms of reference describing the expected outputs of the study.

B. Is the existing intermediary market efficient and effective?

Is there an effective and efficient means of networking the region's SMEs and entrepreneurs with national and Atlantic investor markets? Is matchmaking a critical need?

The current market mechanism for matching seekers of investment capital to providers of that capital works well for some entrepreneurs and not others. Some entrepreneurs are able to access money with little or no assistance from intermediaries. At the same time, there are other entrepreneurs that do not know where to turn for equity financing, or for assistance in finding equity financing. Still others report that they have paid fees to intermediaries for what they consider to be unsatisfactory results. We conclude that there are opportunities to make the intermediary market function better than it does at present and offer recommendations to that end in the next chapter.

C. Lessons from other matchmaking initiatives

What were the strengths, weaknesses and reasons for failure of former formal matchmaking initiatives, and what are the strengths, weaknesses and best practices of existing formal and informal initiatives operating in the Atlantic/other jurisdictions?

We examined six matchmaking services of which five are still in operation and one was discontinued. Our examination of these operations provided a relatively consistent picture of the requirements for success of this kind of service. These are described in detail in Chapter II. Highlights are presented below.

1. Credibility

Matchmaking services must establish their credibility in the investor community in the early going of their existence. This requires two things. First, the initial deals put forward to the investor community must be reasonable quality. They must demonstrate that the service understands what it means to be investor ready. The other feature that affects credibility is the reputation and behaviour of the staff in the organization. It makes a dramatic difference if the staff of the service have credibility within the investor community and are an accepted professional within that community.

2. Screening and assistance

Successful matchmaking services only put investor ready projects in front of the investor community. This means that the service is screening projects effectively and providing or ensuring that the entrepreneur accesses required assistance to become investor ready. The key tasks here are generally:

- Improving the packaging of the business plan.
- Adjusting the entrepreneurs expectations respecting reasonable terms of investment.
- Changing the business to address the specified risks that can be anticipated to be concerns of potential investors.

3. Costs and structure

The scale of a matchmaking service must be reasonable in relation to its activity levels. The service which was discontinued in St. John's suffered from high costs in relation to the number of deals available and processed. This was a result of both excessive promotion and excessive staff levels. Successful services operate with only a handful of highly qualified staff, working with minimal support personnel.

D. Is it deals or investors that are more difficult to locate?

Is the issue, as some entrepreneurs have asserted, that informal investors are extremely difficult to locate; or, is the issue, as some informal investors have indicated, that good investment opportunities are difficult to find?

Both. As the discussion in other sections has indicated, investors can be difficult to locate because of the structure of the current capital matching marketplace. The operation of the market is impeded by a lack of knowledge on behalf of entrepreneurs as to how to locate investors, the fact that an investor with the appropriate profile may not exist in Atlantic Canada and, finally, the fact that intermediaries tend not to look too far beyond their regular stable of investors in an attempt to produce a match. On the other side, we have already indicated that the number of entrepreneurs that are investor ready is clearly a subset of all entrepreneurs seeking financing. It seems that many entrepreneurs have difficulty understanding that an equity investor has more risk and thus a greater need for information respecting business plans than a financial institution such as a bank. Entrepreneurs also seem to have difficulty appreciating that investors are nervous about entrepreneurs that do not understand the need to put together a good business plan and on terms that make sense (could be attractive) to the investor.

Respecting investor behaviour, the Atlantic Canadian capital market exhibits characteristics one would expect from a relatively sparsely populated region with an economy which has historically been resource based. This no doubt causes a lack of investors with expertise in certain sectors, such as high technology. Most individuals with capital in Atlantic Canada have accumulated their capital in low-tech sectors. Governments and entrepreneurs must get past the attitude that this is the fault of the investors in question. There seems to be an attitude that because selected individuals have capital, they should be prepared to risk it on businesses that they do not understand. This does not make any sense. Financing should be viewed in the same manner as any other production input. As an example, high technology companies in Atlantic Canada go to high-tech industry suppliers outside of the region for other kinds of production inputs required for the business. It only makes sense for those companies to be prepared to go to high-tech industry capital markets—which are clearly outside of Atlantic Canada—to service their capital needs. The most useful money for an SME always comes with relevant expertise. Entrepreneurs must be educated to realize that they are not only shopping for money, but also expertise.

E. Impact of intermediary fees

Would financial intermediary fees be a significant disincentive?

The majority of entrepreneurs and intermediaries surveyed indicated that professional fees are not a significant disincentive to the use of financial intermediaries. The comment was offered that fees are a barrier only to entrepreneurs that are not serious about growing their business. Notwithstanding the survey results, our firm's experience is that entrepreneurs use more professional services when the cost of those services is subsidized or supported by some other party. The individuals surveyed, both in the entrepreneur group and intermediary group, acknowledged this.

We raise this view not because we advocate financial assistance of this type, but to make a distinction between the opportunity to use fees as a screening tool for entrepreneurs versus encourage access to qualified expertise to make entrepreneurs investor ready.

F. Impact of legal fees

Are legal fees a significant disincentive? Would the development of standardized legal documentation save time and money for SMEs seeking informal angel investment?

Legal fees are a concern, particularly to entrepreneurs. The challenge is that to achieve any significant change in this area requires substantial change to the entire legal framework within which businesses operate in Canada.

Legal fees are principally incurred when a deal is about to be consummated. It is easier to justify the expenditure of the funds to make the deal happen when it is clear that a deal is going to happen. Effectively, the legal fees end up being more clearly financed by the new investor.

The development of more standardized legal documentation to lower legal costs is difficult. Most lawyers involved with these kinds of commercial transactions already have standardized documentation that they would use as a starting point for the required legal agreements. They end up incurring significant fees in adapting those standardized templates to provide satisfactory protection to the parties involved in each specific transaction. Even conceptually similar transactions turn out to be rather different at the detailed legal level and require substantial customization in the preparation of documents.

G. Impact of securities legislation

What is the impact of provincial securities legislation on doing smaller financing deals in the Atlantic Region?

Entrepreneurs are generally reluctant to undertake a public offering as the prospectus requirements make this an expensive and time-consuming undertaking. Section 77 of the Nova Scotia Securities Act, *Exemption from Prospectus Requirements*, outlines exemptions for Nova Scotia. In several situations, entrepreneurs have taken advantage of these exemptions in order to avoid public-offering requirements.

One exception is commonly referred to as the sophisticated investors exemption. For example, the Nova Scotia exemption stipulates that, should an investor put $150,000 or more at risk, he may be considered a sophisticated investor. The firm selling the equity may therefore be spared the requirements of a public offering. Provincial variations in legislation include different sophisticated investor thresholds. The threshold is $150,000 in Nova Scotia, $100,000 in New Brunswick, $97,000 in Newfoundland and $97,000 in PEI. As a result, an investor from Nova Scotia must be treated differently than an investor from any other province and additional legal fees must be incurred.

The specific provisions and wording of the legislation also leads to confusion. For example, the Nova Scotia Act provides an exemption, commonly referred to as the seed capital exemption, which exempts sales of equity made to not more then twenty-five investors where not more then fifty investors have been solicited. However, several entrepreneurs and intermediaries were confused about the number of investors that could be solicited.

Based on the preliminary examination of this question undertaken, we conclude that securities legislation is an area that would benefit from a more detailed review. Costs for entrepreneurs would be reduced if the legislation were more uniform across the region and written so as to be clear for non-lawyers.

H. Using the tax system to encourage investment

How can/could the tax system be used to encourage more informal investment in Atlantic SMEs?

The Nova Scotia Equity Investment Tax Credit program has proven to be quite effective in channeling investment into SMEs. Prince Edward Island has a similar Equity Investors Program. The Nova Scotia Department of Finance reports that over a hundred enterprises have taken advantage of the Nova Scotia program, with the result that $60 million dollars in risk capital has been invested in SMEs. The rules of the equity investment tax credit appear to be well conceived and unlikely to be subject to significant abuse. In our view, the tax system is critically important in encouraging friends and family to invest in SMEs. It is much easier for an entrepreneur to sell a friend, family member or other third party with capital on the idea of participating in the business as an investor when the tax credit effectively guarantees 50% capital appreciation within two years. We encourage New Brunswick and Newfoundland to consider the implementation of a similar equity tax credit.

I. Enhancing the operations of the intermediary market

What kind of private or public sector instruments/mechanisms/model may be appropriate to help establish/enhance an Atlantic intermediary market which would see financial intermediaries matchmake between suppliers of and demand for equity?

A number of steps could be taken to enhance the operation of the intermediary market in the region. These are detailed in Chapter VI.

J. Assisting the match-making market—funding a pilot program

Should ACOA consider a pilot program to help Atlantic SMEs with the cost of financial intermediaries?

We do not recommend that ACOA consider a pilot program which would help SMEs with the cost of financial intermediaries. The need to raise enough money to pay the cost of working with an intermediary, or at least prepare a package for investors, represents a screening process. Entrepreneurs unable to manage to raise these funds are unlikely to be able to generate the levels of profit required by an equity investor.

In making this recommendation, we have also considered the extensive network of business support services that already exists in Atlantic Canada. These include provincial government funded business service centres and university operated small business development centres. These operations provide many components of the range of services offered by intermediaries, and for minimal or zero costs. Further, entrepreneurs that have a clean business plan will incur minimal expense (sometimes none) if they use an intermediary to identify or contact potential investors known to the intermediary.

K. Training of financial intermediaries

Is training of financial intermediaries required? What would it look like?

We do not recommend that any new formal system of training of financial intermediaries be put in place. The best financial intermediaries in the Atlantic Canada and elsewhere have three key characteristics—a lot of experience, a lot of contacts and a lot of credibility. These characteristics are difficult to foster through training. Further, government involvement in intermediary training could be perceived as a type of endorsement mechanism. We recommend that government avoid this type of involvement. However, a system or even a semi-annual newsletter that circulated information respecting venture capital funds, intermediary services outside of Atlantic Canada, even sector specialties of other intermediaries, could be helpful in expanding the contact network of intermediaries.

VI

Recommendations

We believe there are a number of initiatives that ACOA or other government agencies could pursue to improve the access to intermediary services and the effectiveness of the equity capital market for SME's in Atlantic Canada. In developing these recommendations, we have avoided any approaches which would provide direct subsidies for any aspect of the financing process.

A. Private Sector Volunteer Screening Panels

We recommend the establishment of "screening panels" across the region that would listen to presentations from entrepreneurs and provide feedback on their level of investor readiness. We believe that accounting and law firms and other entities active or potentially active in the intermediary market will readily provide at no charge, experienced personnel to staff the proposed panels. The Entrepreneur's Forum is an example of this type of service or function already in operation in the region. The Entrepreneur's Forum focuses on "knowledge-based" companies and is sponsored by a mix of public and private sources. Essentially, we see an opportunity for this concept to be expanded across the region to include all sectors and to operate with a higher profile.

We envisage the panels meeting once or twice per month, depending upon the volume of presentations. Entrepreneurs would be given in the range of 45 minutes to present their business plan. Panel members would complete a form indicating whether the entrepreneur is investor ready and if not, the portions of the business or business plan requiring improvement. In larger population centres, there could be a number of panel chapters. The panel members would be encouraged to take the opportunity to indicate to the entrepreneur whether they know of an investor they would present/refer them to. The process then would provide both screening and a free introduction service.

A key aspect of the panels is the opportunity for panel members to provide anonymous feedback to entrepreneurs about the steps necessary for them to become investor ready. Entrepreneurs are more likely to get objective feedback in this forum than in direct dealings with intermediaries. If ACOA were to organize such panels, we recommend that they consist of four or five participants. ACOA's role in the process would be to perform a number of behind-the-scenes organizational activities:

- Accept requests from entrepreneurs to appear before a panel.
- Co-ordinate the recruitment of panel participants.
- Promote the service.

- Arrange for a place for the meetings.

- Provide guidance to presenting entrepreneurs about the process, what to prepare and how to present.

- Track the status and success of entrepreneurs making presentations.

- Produce a newsletter to be circulated to all entrepreneurs that have appeared before panels, as well as panel members and intermediaries across the region. The newsletter would report on the success rate of entrepreneurs (in seeking investors) that had made presentations to panels.

- Relay the anonymous panel member feedback to the entrepreneurs.

- Establish guidelines for the operation of the whole process, including rules respecting the number of times an entrepreneur could appear before the panel(s) (we suggest two times in one year with the same business).

Our research for this project identified only successful examples of these types of panels. They require ongoing promotion and organizational support that is difficult to sustain without public sector support.

B. Entrepreneur education

A number of steps could be taken to improve entrepreneurs' understanding of how and why or when to seek equity investment.

1. Produce an equity financing guide for entrepreneurs

It was clear from our research that some entrepreneurs have very little understanding of the advantages of equity financing or how to go about attracting equity investment. We recommend that ACOA publish materials for entrepreneurs describing:

- The advantages of equity financing.

- Examples of successful businesses in the region that have grown and prospered with equity financing.

- What it generally means to be investor ready with illustrations of hypothetical businesses that are not investor ready.

- The options available for finding investors—direct contact, via intermediaries, via matching services, via industry contacts and particular suppliers.

- Rules of thumb for valuing businesses in order to manage expectations regarding investor approaches to this question.

- What to look for in an investor and the types of investors they might encounter.

- The perspective that investors bring to a deal, including their standard risk sensitivities.

This information could be distributed in booklet or pamphlet format or in existing newspapers or business journals across the region. Care must be taken to use formats and media that will reach entrepreneurs.

An extensive package of materials on raising growth capital has been developed and recently published by Industry Canada. This provides an excellent resource for the production of briefer, Atlantic Canadian specific material in formats suitable to reach a greater portion of the region's SMEs.

2. Equity Financing Workshops

The type of material referenced above could be presented to forums such as the Chamber of Commerce organizations across the region.

3. Government Official Education Process

Many government personnel are involved in business support roles within municipal, provincial and federal agencies and departments across the region. Many of these personnel have become accustomed to the government being the major suppliers of risk capital. The degree of governmental involvement in this area is likely to have substantially reduced demand for private equity investment and impeded the development of a more active private equity market. We believe it would be helpful to develop a process for educating government personnel at all levels involved in providing support to businesses as to the advantages of private equity financing and how entrepreneurs can endeavour to access such financing.

This education process would position a large corps of personnel that are in regular contact with entrepreneurs as sources of expertise on equity financing. This would be to the direct benefit of the entrepreneurs with whom they deal. We are not advocating that every such employee endeavour to become an intermediary, only that they develop the knowledge to describe how the private equity market operates and the advantages of an equity financing strategy to entrepreneurs.

C. Encourage expansion of the Equity Tax Credit programs

The Equity Tax Credit in Nova Scotia provides an example of the effectiveness of this type of program in making capital accessible to small business. It appears that the program is worth careful consideration by New Brunswick and Newfoundland. We recognize that ACOA has no means of direct influence respecting provincial tax policy. The Agency could nonetheless undertake a more detailed evaluation of the Nova Scotian and PEI programs respecting terms, take-up, types of investors, the foregone tax revenue and the health of the businesses receiving the capital. Such an evaluation should make it easier for other provinces to assess if they should implement a similar program and also enable Nova Scotia to assess if any changes in its program might be beneficial. For example, it might be beneficial for Nova Scotia to allow the tax credit on a larger investment.

D. Harmonize and increase exemptions to prospectus requirement

Securities legislation across provinces should be harmonized to a greater degree. Consideration should also be given to clearly expanding the circumstances under which money can be raised without triggering the need for a prospectus. The Junior Capital Pool facility in Alberta is an example of the possibilities in this regard.

E. Establish intermediary directory

We recommend ACOA develop a directory of financial intermediaries within Atlantic Canada. We suggest that the directory be developed by mailing application forms to every accounting, law, securities and business brokerage firm in the region. This solicitation should be supplemented with some print advertising to provide as many intermediaries as possible with access to the directory. A fee should be charged to those wishing to be listed in the directory. ACOA should develop screening criteria that would have to be met by intermediaries to be included in the directory. This could include a certain experience or qualifications profile, as well as reference checks.

Copies of the directory should be provided to all government business support offices, Chamber of Commerce offices libraries and professional services offices across the region. It should also be available on the internet.

A key component of the directory should be a section describing and providing contacts at investment matchmaking services outside of the region including those in the United States. Entrepreneurs need to have contacts in capital markets outside of Atlantic Canada.

F. Assess implementation of COIN style database

Spectris Corp., the company which operates the Ontario based COIN system is interested in rolling out their service on a national basis. The COIN system charges entrepreneurs $280 to list their capital requirement in a standardized summary format. Investors review the listings and then if interested notify COIN. The entrepreneur is then advised of the investor's interest and can follow-up at their discretion. Spectris reports it is finalizing an agreement with the Saskatchewan government and defining specs for a similar expansion with the British Columbia government.

Spectris is willing to prepare a detailed proposal for ACOA which would provide the cost of establishing an Atlantic presence. This type of proposal is attractive because it would provide Atlantic entrepreneurs with a link to investors outside of the region. It would also complement, not replace, the other kinds of activities recommended. ACOA would have to assess a proposal from COIN in terms of the implicit exclusive franchise it would be granting and determine if there are alternative services providers that might also wish to bid.

We are skeptical about the volume of registrants that would be enjoyed by this type of service in Atlantic Canada. We expect that there is room for, at most, one player in this market if the expectation is the service would attempt to operate on a cost recovery or for profit basis. It might require ongoing ACOA support to sustain the service. Accordingly, ACOA would have to weigh the annual cost of supporting such a service, against anticipated volumes of registrants and be satisfied the unit costs are reasonable.

Appendices

Appendix A

Investment Matching Service Case Study Guide

Interviewer____________________ Organization ____________________

Date ____________________ Telephone ____________________

Title ____________________

1. Date established.

____

2. Source of funding (subsidies, fees, grants, etc.)

____

____

3. Overall Mission.
Target success rate for businesses assisted and definition of success (time frame).

____

____

4. Geographic Scope.

____

____

5. Date closed (if not still operating).

____

6. Services provided
   a. Assistance with business plan and projections?
   b. Pricing/valuing the investment (i.e. # shares or % of company)
   c. Identification of potential investors?
   d. Introducing entrepreneurs to potential investors?
   e. Contacting potential investors on behalf of the entrepreneur?
   f. Assisting with negotiations between the entrepreneur and the potential investor?
   h. Structuring the deal (i.e. financing plan and security)?
   i. Drafting the deal (legal agreements regarding investment)?
   j. Other intermediary services?
   k. Other services provided by the organization (non-intermediary)?

____

____

7. Method of charging / fees (per hour, %, success fees, etc.)

8. Number of businesses assisted (found equity) in total.

9. Actual success rate (number accessing financing versus seeking financing).

10. Number of businesses assisted in relevant range of total project costs (**$250,000** to $1,500,000).

11. Size of project which is easiest to finance.

12. Number of staff dedicated to the intermediary function.

13. Number of staff engaged in other activities.

14. Education and years of relevant experience of intermediary staff.

15. Two previous employers of each intermediary staff member.

16. Estimated cost per business assisted.

17. Promotion strategy.

18. What did you do that worked well and could be considered a strength of your service?

19. What do you believe were the weaknesses of your service in retrospect?

20. Reason for discontinuance (if no longer operating).

21. Advice for **the federal government**.

Appendix B

Intermediary Interview Guide

Interviewer____________________ Intermediary ____________________

Date ____________________ Telephone ____________________

Callback time ____________________

My name is Mike Rankin . I work for KPMG in Halifax. ________________________ gave me your name.

We are undertaking a project for the federal government examining how small businesses find investment. The focus is on situations where firms are seeking from $50,000 to $250,000 in equity as part of a project with a total cost of perhaps $250,000 to $1,500,000. The government's interest is in the individuals or firms that help entrepreneurs find equity investors. We will refer to these individual firms as financial intermediaries. The objectives are to determine what entrepreneurs go through to attract equity; to learn about the kinds of firms that assist them in finding prospective investors, to learn about the cost of those services and to assess if there is opportunity for the federal government to facilitate this process in some way.

Have you got a few minutes to answer a few questions on this topic now or at some other time? We will keep your responses confidential. It is our intention however to report the responses in aggregate with the thirty or so other individuals with whom we speak.

1. Have you ever engaged in financial intermediary work; that is, assisting entrepreneurs to find investors? (If no, discontinue).

a.	Is this your main line of work?	Yes	No
b.	If no, what is your main line of work?	Yes	No

____

____

2. The following services generally comprise the work of a financial intermediary. Please indicate those services you usually, occasionally or rarely provide.

a.	Assistance with business plan and projections?	Usually	Occasionally	Rarely
b.	Pricing / valuing the investment (i.e. # shares or % of company)	Usually	Occasionally	Rarely
c.	Identification of potential investors?	Usually	Occasionally	Rarely
d.	Introducing entrepreneurs to potential investors?	Usually	Occasionally	Rarely
e.	Contacting potential investors on behalf of the entrepreneur?	Usually	Occasionally	Rarely
f.	Assisting with negotiations between the entrepreneur and the potential investor	Usually	Occasionally	Rarely
g.	Structuring the deal (ie. financing plan & security)	Usually	Occasionally	Rarely
h.	Drafting the deal (legal agreements regarding investment)	Usually	Occasionally	Rarely
i.	Other			

Additional Comments

____

____

3. How do you charge for your services?

a. Assistance with business plan and projections?
Hourly Rate   Percent of Deal   Flat Rate   Success Fee

b. Pricing/valuing the investment (ie. # shares / % of company)
Hourly Rate   Percent of Deal   Flat Rate   Success Fee

c. Identification of potential investors?
Hourly Rate   Percent of Deal   Flat Rate   Success Fee

d. Introducing entrepreneurs to potential investors?
Hourly Rate   Percent of Deal   Flat Rate   Success Fee

e. Contacting potential investors on behalf of the entrepreneur?
Hourly Rate   Percent of Deal   Flat Rate   Success Fee

f. Assisting with negotiations between the entrepreneur and the potential investor
Hourly Rate   Percent of Deal   Flat Rate   Success Fee

g. Structuring the deal (ie. financing plan & security)
Hourly Rate   Percent of Deal   Flat Rate   Success Fee

h. Drafting the deal (legal agreements regarding investment)
Hourly Rate   Percent of Deal   Flat Rate   Success Fee

i. Other

Additional Comments

____

____

4. How common is fee splitting whereby fees are split by intermediaries representing the entrepreneur and the investor?

____

____

5. Do you recover your target revenue when providing intermediary services to clients of the size in question?
Usually   Occasionally   Rarely

If the fees are often inadequate, why do you offer intermediary services?

____

____

6. Do you promote the fact that you provide intermediary services? How?

____

____

7. Please profile the last two situations in which you provided successful financial intermediary services (that is, the entrepreneur attracted financing).

		Situation 1	Situation 2
a.	Province of the company seeking financing		
b.	Sector of the company		
c.	Total financing sought ($'s)		
d.	Equity sought ($'s		
e.	Services provided		
i.	Assistance with business plan and projections?		
ii.	Pricing/valuing the investment (i.e. # shares / % of company)		
iii.	Identification of potential investors?		
iv.	Introducing entrepreneurs to potential investors?		
v.	Contacting potential investors		
vi.	Assisting with negotiations		
vii.	Structuring the deal (i.e. financing plan & security)		
viii.	Drafting the deal (legal agreements regarding investment)		
f.	Fees incurred by the entrepreneur		
i.	Accounting fees (for projections and business plan)		
ii.	Intermediary fees		
iii.	Legal fees		
iv.	Investor fees		
v.	Bank fees		
vi.	Other fees		
g.	Province of Equity Investor		
h.	Nature of Equity Investor		
i.	Provided principally capital - or		
ii.	Provides significant other benefit(s)		
i.	Number of Equity Investors approached by you, the intermediary, on behalf of the Entrepreneur		

Additional Comments

____

____

8. Considering instances when you have not been successful in finding an investor, what do you consider to be the two biggest factors that kept the deals from occurring?

____

____

9. Could you provide an indication of your success rate in finding investors where you have been engaged to actively seek them on behalf of a client?

< 50%   50 to 75%   >75%

10. Is it difficult to find financing for good projects in Atlantic Canada?

____

____

11. Are entrepreneurs realistic about the amount of equity or control they need to give up to attract an investor?

12. Is liquidity an issue that significantly reduces investor interest?

13. Are there impediments to raising capital within Atlantic Canada?

    a. Security laws?
    b. The tax regime?
    c. Professional fees?
    d. Legal fees?
    e. Other impediments?

14. Could you recommend any ways for the federal government to make financial intermediary services more accessible to entrepreneurs?

15. Could the tax system be used to encourage equity investment in small and medium sized businesses?

16. Can you name some other individuals in your province that are active in providing financial intermediary services?

17. Could you name any entrepreneurs that you are aware of that have sought equity investment and that could be contacted for the purposes of this study?

Appendix C

Entrepreneur Interview Guide

Interviewer______________________ Entrepreneur ______________________

Date ______________________ Telephone ______________________

My name is Mike Rankin . I am a management consultant with KPMG in Halifax. ____________________________ gave me your name.

We are undertaking a project for the federal government examining how small businesses find investment. The focus is on situations where firms are seeking $50,000 to $250,000 in equity as part of a project with a total cost of perhaps $250,000 to $1,500,000. The government's interest is in the individuals or firms that help entrepreneurs find equity investors. We will refer to these individual firms as financial intermediaries. The objectives are to determine what entrepreneurs go through to attract equity; to learn about the kinds of firms that assist them in finding prospective investors, to learn about the cost of those services and to assess if there is opportunity for the government to facilitate this process in some way.

Have you got a few minutes to answer a few questions on this topic now or at some other time? We will keep your responses confidential. It is our intention however to report the responses in aggregate with the thirty or so other individuals with whom we speak.

1. Have you attracted or attempted to attract equity investment in the past few years? Were you seeking total financing in the $250,000 to $1,500,000 range of interest of this study?

   Yes No

   Continue provided financing sought is less than $2,000,000.

2. Were you able to find equity investment?

   Yes No

   a. Why not?

   ____

   ____

3. What advice would you offer to another entrepreneur seeking equity investment?

   ____

   ____

4. Did you look for the investor yourself or did you use the services of an individual or firm to assist with the process?

   Yes No

   If no assistance was used, go to 5.
   If an intermediary was used, go to 6.

5. Firms that assist in finding investors are sometimes referred to as financial intermediaries. Why didn't you use the services of an intermediary?

   Cost?
   No need?
   Not aware?

   Other reasons?

   ____

   ____

   Go to 18.

6. Could you give the name and province of the individual or firm that assisted you as an intermediary?

____

____

8. Which of the following services did the intermediary provide? What did the services cost?

			Cost
a.	Assist with business plan and projections	Yes	________
b.	Price or value the investment (ie. # shares/ % of company)	Yes	________
c.	Identify potential investors?	Yes	________
d.	Introduce you to potential investors?	Yes	________
e.	Contact potential investors on your behalf ?	Yes	________
f.	Assist with negotiations between you and the potential investor.	Yes	________
g.	Structure the deal (i.e. financing plan & security)	Yes	________
h.	Draft the deal (legal agreements regarding investment)	Yes	________
	Total		________

10. Can you tell me what the total cost of intermediary assistance was as a percentage of the total amount of money raised / sought?

____

____

11. Can you tell me what the total cost of intermediary assistance was as a percentage of the equity raised / sought?

____

____

12. Was the cost of the intermediary service related to the amount of money you were seeking? For example, was it supposed to be a certain percentage of the deal?

    Yes No

    a. If yes, how did this work (i.e. what percent of what?)

13. How did you find the intermediary that you used?

14. Did you shop around before you engaged the firm that assisted you?

    Yes No

    a. *If yes*, how many others firms did you check out?

    1 2 3

15. How did you decide on the firm that did assist you?

16. Did there appear to be much difference in the cost of the assistance that you were seeking?

    Yes No

17. Any further advice you would have for other firms seeking capital or the services of an intermediary?

18. Is it difficult to find financing for good projects in Atlantic Canada; that is, projects that in your view represent reasonable investments to an outside interest?

    Yes No

19. Do you believe that investors are generally reasonable in the percentage of equity requested?

    Yes No

    If no, how were they unreasonable?

20. Are securities laws an impediment to raising capital within Atlantic Canada?

    Yes No

21. Is the tax regime in the region a help or hindrance in helping entrepreneurs raise capital?

    Yes No

22. Do you believe that professional fees act as a barrier to the use of intermediary services?

Yes No

23. Do you believe that legal fees act as a barrier to the use of intermediary services?

Yes No

24. Could you recommend any ways for the federal government to make financial intermediary services more accessible to entrepreneurs?

Yes No

---

25. Can you name firms or individuals that you believe are active in providing financial intermediary services?

Yes No

---

26. Can you name any other entrepreneurs who have sought financial intermediary services or who have been seeking equity investment?

Yes No

Appendix D

Panel Members

Financing specialist panel

Partner/Senior Manager	Office	Approximate Years of Experience	Sector Strength
Alan Barkhouse	Halifax	30	Distribution, Technology
David French	St. John's	25	Construction, Fish Processing
Gerard Fitzpatrick	Charlottetown, Beaton Fitzpatrick Murray	20	Agriculture, Retail
Paul Goodman	Halifax	25	Retail, Hospitality
James MacDonald	Fredericton	30	Manufacturing, Food Processing
Eric Schibler	Halifax (formerly Sydney)	25	Tourism, Fish Processing
Bob Smith	Saint John	25	Service, Technology

Appendix E

Descriptions Of Formal Intermediary Service Providers

Investment Matching Service of Alberta (IMSA)

IMSA is funded solely by the Government of Alberta. IMSA is primarily a match making service that provides potential investors with profiles of businesses seeking investment. IMSA prepares the 2 page profiles based on the company's business plan. It does not provide any assistance with business plans, projections or negotiations between investors and entrepreneurs. A unique service of the IMSA is the production of a bi-annual catalogue of business profiles that is distributed to their entire network of contacts (approximately 3,000 individuals). The IMSA also has a website which contains summary information on all of the business opportunities currently available. It is updated on a semi-monthly basis.

IMSA does not charge any fees to entrepreneurs or investors for the use of its services. IMSA has a $100,000 minimum cut-off size for financing sought before a project can be listed. Financing levels sought typically range from the minimum of $100,000 up to $1,500,000 per match.

IMSA has historically resulted in an average of 12 successful deals per year which equates to an average success rate of 1 successful deal for every 20 projects seeking financing. IMSA generates over 3,000 matches per year. It does not track actual deals, but can account for approximately 12 known transactions per year. Estimated costs per successful match are approximately $18,000. IMSA was established in 1989 by the Alberta government to assist Alberta businesses to grow by attracting direct equity investment and establishing strategic alliance partnerships. In addition, IMSA is a key tool used for promoting Alberta as a place to do business and invest. The staff is responsible for investment promotion. IMSA works exclusively with Alberta based business but has a broad reaching investor network spanning all of North America. Approximately half of the investors dealing with business opportunities identified by the IMSA reside outside Alberta. IMSA staff has been reduced considerably over the past few years. Three years ago there were 11 full-time staff. They currently operate with only two and ½ full-time staff due to funding cutbacks.

Commercial Opportunities & Investment Network (COIN)

COIN was established during 1987 in Ontario by the Ontario Chamber of Commerce and was launched on a national scale early in 1989. COIN is based in Toronto and as of January 1997 is operated and funded by Spectris Corporation (a private company). COIN is the only financial intermediary examined in the case study that is not funded by government. COIN is a nationwide information database that operates as a computerized facilitator or "introducer" for investors and capital seekers. In the information gathering process registrants describe their objectives, investment requirements and preferences in a questionnaire. When potential introductions are identified, COIN provides the investor with a 'ProFile' of the investment opportunity. This information enables investors to anonymously preview opportunities which may be of interest to them. If the investor remains interested in the opportunity, they notify COIN who introduces the two parties. Other services offered (to both COIN registrants and other business clients) by Spectris include assistance with business plans, investment valuations, assisting with negotiations between entrepreneurs and investors, use of meeting rooms, and hosting presentations. The unique characteristic of COIN is the constant upgrading and maintenance of the electronic database which is very cumbersome given the number of smaller entrepreneurs registered (due to previously low fees).

Entrepreneurs are charged $280 for every 6 months listed while investors are charged $185 for the same time period. Spectris is developing a program whereby individuals, who represent COIN to secure increased registrants from their communities, are charged a one-time fee of $2,500. The fee is called a software licensing fee although it is really a listing fee. The average amount of financing sought ranges from $10,000 to $500,000 and there is no minimum size criteria for entrepreneurs seeking financing. The newly adopted software licensing fee of $2,500 is expected to discourage the smaller entrepreneurs from using the service.

This program has an estimated success rate (approximately 1 in 50) of the services examined in our case study which is attributed to the lack of screening and previously low fee structure. However, they also have by far the lowest estimated cost per introduction of only $170 due to the high number of introductions made per year. COIN appears to be a stable operation given its 11 year history with five full-time staff and boasts an impressive 25,000 total number of introductions. The majority of these introductions however involve projects which are quite small with some being less than $10,000.

Specific Investment Opportunity Program (SIOP)

The SIOP was established in 1989 by the Ottawa-Carleton Economic Development Corporation, a private-public partnership institution, as one of several initiatives that give particular attention to access to capital as an essential tool of regional economic development. Among other aims, the SIO sought to nurture emerging, growth-oriented industries, such as high technology industries, partly by working collaboratively with successful Ottawa Valley angel investors. This activity was all the more critical following more than a decade of federal government fiscal restraint that placed downward pressure on regional public employment levels. The majority of the funding for the SIOP comes from the Regional Government, specifically the Ottawa-Carleton Economic Development Corporation, in partnership with some corporate and non-governmental contributors. The SIOP provides crucial investment infrastructure support, such as mentoring, training and related resources and draws heavily on the experience and expertise of business and finance volunteers in the community. Other services offered include advice on business plans and introductions of investors to entrepreneurs. The SIOP does not get directly involved in negotiations or deal structuring with the parties but does provide meeting rooms and will also host presentations as requested. The use of volunteers as mentors who critique business plans and provide advisory services would be considered the most unique aspect of this operation compared to the others examined in the case study.

The SIOP does not charge any fees for its services and has a minimum size criteria of $150,000 for entrepreneurs seeking financing. The SIOP also has a relatively long life span (9 years) during which they have 'matched' 50 investments (which represents a success rate of approximately 1 in 5) with over $25 million raised. The success rate noted is relatively high as the SIOP only takes on projects which are deemed to be 'investor ready'. Historically, the average amount of financing sought per project is approximately $500,000 but this has ranged from $150,000 up to $1.5 million. However, subsequent to 1996, the OCEDCO made the decision for the SIOP to concentrate on smaller deals involving projects with 25 employees or less and younger enterprises, for whom financing presents a significant barrier.

Estimated costs per match are $20,000. This is one of the leanest operations examined in the case study with only two full-time employees who focus their promotion efforts on new and developing firms, chiefly start-ups and early stage entities. The background experience of the two employees includes a mix of entrepreneurial, private banking and counseling work. Interpersonal communications skill was stressed as a necessity in operating a match making initiative of this nature. The SIOP also organizes annual public showcases to increase general awareness levels. The event is also used to attempt to identify the particular interests of investors by meeting with those investors one on one to establish strong relationships which lays the groundwork for future introductions to business ventures. The program aims to assist firms with growth potential located in Ottawa-Carleton. Early successes have had a snowball effect with the most recent year of operations accounting for a significant portion of their total number of matches and capital raised. The SIOP was one of the first matchmaking initiatives to recognize the necessity of strategic (full service) support in bringing financing demand together effectively with the supply.

Halifax Equity Group (HEG)

The HEG is funded 2/3 by Industry Canada through the Canada Community Investment Plan and 1/3 by the Halifax Regional Partnership under a five year contract with a mandate to become self-sustaining as soon as possible. The HEG is still in its infancy as it was launched in August of 1997 in order to support the Greater Halifax Partnership's mandate of developing economic initiatives which focus on growth within the region, especially in small business. HEG is a for profit private enterprise which is operating under a five year contract with Industry Canada and the Halifax Regional Partnership. HEG's strategic plan involves three key processes; 1) to advise investee firms regarding investment readiness, 2) to develop an active network of formal and informal sources of growth capital, and 3) to facilitate deals between users and sources of growth capital. They also plan to offer the broadest range of consulting services of the six case studies examined including assistance with business plan preparation, investment valuations, identification and introduction of investors to entrepreneurs, assistance in negotiations, deal structuring and drafting agreements, due diligence and succession planning. The unique characteristic of the HEG is its intent to charge both hourly fees for consulting type services and success fees for projects that are successfully financed. As equity in the HEG is earned through success fees the service intends to invest (at HEG's discretion) in selected projects by taking a partial ownership position in lieu of collecting their fees earned.

Fees for consulting services are charged on an hourly basis with success fees of 4-10% (of the total funds raised) as applicable on the successful matches. The HEG does not have an established minimum amount of financing sought criteria for entrepreneurs but anticipates assisting projects in the range of $100,000 and upwards.

There is one full time staff plus a part-time staff working one to two days per week and a Board of Directors who have a vested interest in HEG as they are minority shareholders. The purpose of the Board of Directors is to identify capital sources, increase the number of contact points for the HEG and give the program more expertise when evaluating investment opportunities. The primary geographic area of concentration for HEG is the Halifax Regional Municipality.

Investment Opportunities Project (IOP)

The IOP was established in 1989 and funded by ACOA, the Economic Recovery Commission and the St. John's Board of Trade with a mandate to become self sufficient. The purpose of the IOP was to establish and become facilitators in an active matching service between investors and entrepreneurs in Newfoundland. There was also an education mandate to improve knowledge levels of both investors and entrepreneurs. Services offered included advice with business plans, introductions and assisting with negotiations, and structuring the deals. The IOP ceased operation in 1993 and was the only organization examined which met this fate. The unique characteristic of the IOP was their promotion strategy which was given a very high priority and encompassed a number of different avenues including promotion of specific investments, trade missions and use of mass media.

The only fees charged by the IOP were profile fees of $100 for entrepreneurs and seminar fees for participants. The IOP identified 85 specific investment opportunities in its brief 3 ½ year history but was only able to match seven of these (approximately 8%) with private sector investment totaling $1,500,000. Estimated costs per match were $50,000. There was no minimum size rule for entrepreneurs and the range of financing sought was $20,000 up to $1 million.

The total staff complement of the IOP was three individuals with a mixture of MBA, Economics, and securities course education backgrounds.

Business Ventures Limited (BVL)

BVL is funded solely by the Glasgow Development Agency (Regional Government). BVL was established with a mandate is to create jobs and wealth by drawing on Scotland's huge reserves of managerial talent and experience. BVL sees their role as helping to reduce the risk associated with starting a new company. They provide plenty of assistance and hand-holding through the entire process and endeavour to produce new companies with the best possible chance of success and future growth. BVL also organizes a ten week program of seminars and workshops for both investors and entrepreneurs. The key feature of the BVL is their willingness to get into the details of an organization and do whatever it takes to make a deal work.

BVL charges entrepreneurs a one-time fee of $400 but investors are not charged for use of this service. BVL does not have a minimum amount of financing sought criteria but do try and focus their efforts on companies in high growth industries. The average amount of financing sought is approximately $1 million with a range of $600,000 to $2 million. BVL doesn't get involved in many really large deals and prefers to become directly involved in the smaller projects around $1 million.

The BVL was the youngest organization examined (with the exception of the HEG) but had the highest success rate of one in three or four for matching entrepreneurs with investors. An estimated cost per match was calculated as approximately $14,000. However, the statistic they consider to be most important is their 'cost per job created'. This was reported to be approximately £3,000. As a 100% government funded agency, this statistic allows BVL to assess the level of economic growth they are contributing to the local economy. BVL is headquartered in Glasgow, but services all of Scotland and is willing to link North American companies seeking UK and European markets. BVL also has one of the largest staff (nine full-time, five Business Development staff and four Support staff) from this case study which provides them with one of the largest personal network of contacts.

Junior Capital Pool Offerings (JCPO)

The JCPO is a facility available in Alberta to raise public money for entrepreneurs to use to identify and assess potential projects. Investors rely completely on the reputation of the entrepreneur in subscribing to a JCP offering. It is usually anticipated that the entrepreneur will issue a subsequent offering to finance any project or acquisition identified - although residual proceeds from the first offering can also be used for the investment. The JCP does not offer any services. It allows financial intermediaries to raise public funds which can then be used as equity to acquire assets or a business. The main thrust of this tool is to raise capital in very small increments (approx. $1,000) which are pooled together in batches of $300,000 for the average investment. The JCPO is not a financial intermediary but rather a tool to be used by financial intermediaries seeking to raise capital on behalf of entrepreneurs. JCPO is an effective method of publicly raising funds for small to medium sized enterprises.

Funding is raised from the general public in Alberta. Typically there are 300 investors (clients of a financial intermediary) who invest approximately $1,000. The initial investors with the assistance of a financial intermediary need to raise $100,000 before accessing the public markets. We understand that this threshold was initially only $30,000 but has been gradually increased to control the number of JCP issuers being introduced. The time frame necessary to raise these funds is very short, typically three to six months. The fees involved in a JCP are generally legal, listing fees, underwriting fees, and accounting. A excerpt from a JCP prospectus outlining the various costs associated with an issuance reported that the company incurred expenses of $54,000 to raise $360,000, which represents 15% of $360,000 (Seed Capital plus Initial Public Offering) or 26% of 210,000 (raised through Initial Public Offering). All JCP companies are initially in the $250,000 to $1.5 million range.

The Alberta Securities Commission does not track the number of businesses that have used the JCP program. However, as of January 13, 1998 there were over 45 JCP companies listed with the Alberta Stock Exchange waiting to complete a major transaction. The number of companies that have completed a major transaction is not known. The actual success rate of the JCPO is not known. The JCPO has been in operation in Alberta for 10 years and is very well supported by the public. The key desire of the users of the JCPO is that companies listed on the JCPO be classified as private corporations (instead of the current public corporation classification) in order to retain the tax advantages of a private corporation.