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Overview

Canada

Overeview:

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Getting Started

There is no shortage of funds available to small and medium-sized growth-oriented firms. So why do so many entrepreneurs have difficulty finding the money they need to help their businesses grow? The problem seems to be that many small and medium-sized businesses don't know *how* to go about raising money from different types of lenders. If you don't have a clear strategy for raising capital, you probably won't find any.

This **Steps to Growth Capital** self-study guide is designed to help you develop the plan, the materials and the confidence to go after the equity financing you need to launch your business opportunity and achieve your business goals. This guide has been prepared for potential or established owner-managed companies that want to learn about equity investment as a means to funding growth.

Investor-Ready?

Most small companies are simply not "investor-ready" — investors feel these entrepreneurs don't have what it takes to even be considered for financing. They haven't analysed their financial needs, haven't demonstrated their investment potential or management capabilities, or haven't produced an effective investment proposal. Why?

- Some of the problems that entrepreneurs face stem from a misunderstanding of what risk capital is and how it differs from traditional financing.
- Entrepreneurs may not have one of the kinds of businesses that interest investors.
- Many entrepreneurs who are good candidates for risk capital still need to go through the steps required to become "investor-ready" to understand the needs of investors and demonstrate that they have real growth potential.

This Guide

The Steps to Growth Capital guide will help you learn about risk capital and will prepare you and your firm to go after it. It's designed to be used in several ways, so you can choose what suits you. "How to use this guide" will show you the options.

For an example of the pursuit of growth capital, follow the fictional company New Tech Distributors Corp. (New Tech) as it pursues venture financing. This will give you a feeling for the "real" data and strategic decisions you'll be facing.

FAQ

Is there enough capital available to fund small and medium-sized businesses in Canada?
There is a more than adequate supply of risk capital in Canada. The Canadian Venture Capital Association estimates that, in 1999, approximately $3 billion in venture capital was available for investment in Canada. And these figures don't include the capital available from informal investors or angels. (See the Canadian Venture Capital Association Web site at http://www.cvca.ca/.)

What Is Growth Capital?

you're looking for. The name tells you what investors have in mind. "Growth" capital suggests the upside — the potential for dramatic growth. The growth capital investor wants to tap into that growth by investing in the equity of your business — to earn a return based on the company's future earnings. There is a down side, of course, and that is the risk the investor faces if the company doesn't grow.

How Is Growth Capital Different?

Providers of risk capital are very different from conventional lenders such as banks, mortgage lenders or insurance companies because they:

- assume much more risk;
- invest even when the investment isn't backed by regular brick and mortar security or collateral; and
- risk losing their entire investment — if your business fails, they lose their money.

In exchange, risk capital providers expect to:

- exchange their investment for **part ownership in your business**;
- earn a **return based on the growth potential** of your business; and
- receive **high rates of return** — much, much higher than conventional lenders.

Growth capital investors are simply not in the same business that banks are in. Conventional lenders typically earn their returns in the form of interest charges and principal repayments on loans or lines of credit. In contrast, growth capital investors don't extend credit, they invest through:

- private equity (i.e. common shares);
- preferred shares; and
- subordinated debt.

What Growth Capital Investors Will Do

Investors in growth capital do things differently than banks and traditional lenders. And that's why you've got to approach them differently. Risk capital investors will make considerable efforts to analyse and truly understand the businesses they consider investing in. They will also be very selective, choosing only businesses they feel have exceptional growth potential.

The next section of this overview will help you figure out who are the most likely candidates for risk capital.

If you'd like to jump right in and learn more about types of risk financing and risk finance sources, see Step 2, Know Your Financing Options.

FAQ
What are risk capital investors looking for?

Risk capital investors are prepared to invest at high levels of risk. But they will look at your investment proposal to see if it provides these assurances:

- a potential for high, sustainable, profitable growth;
- a comprehensive plan that demonstrates that your project has the potential to exploit a market opportunity;
- a qualified and balanced management team with the ability to implement well-defined strategic objectives and plans, supported by key individuals associated with your business (founders/owners, board of directors, current investors, accountants, lawyers, consultants);
- a potential rate of return on the investment that is proportional to the level of assumed risk;
- ways for investors to monitor, influence and control their investment; and
- a viable exit strategy for investors that offers a suitable return on their investment.

Are You the Kind of Company Investors Want?

Growth capital is not for everyone. Or, perhaps it's more accurate to say that not every business is right for risk capital. Growth capital investors are looking for specific indicators of potential, including:

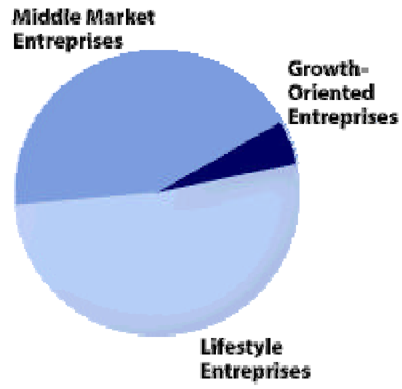
- certain types of businesses;
- businesses that don't have any apparent weaknesses or warning signs; and
- companies that meet key investor criteria.

Types of Businesses

A good manager, a business plan, good products or services, and other typical assets of successful businesses are important. But, in the search for venture capital, these attributes are only the minimum criteria for consideration. They don't automatically make you a risk capital candidate. In fact, only a small percentage of businesses, probably 5 percent or fewer, are high-potential ventures.

You can break down small business into three levels of potential growth and wealth generation:

- **lifestyle enterprises** - small businesses that generate enough cash flow to support individual or family owners;
- **middle-market enterprises** - small manufacturers in mature technology sectors, regional service businesses, etc., that create modest wealth for their owners or partners; and
- **growth-oriented enterprises** - that have new business models, leadership position in new or emerging markets, or some type of new technology. And, if they are skilfully managed, they may be able to create exceptional wealth for owners or shareholders.



With few exceptions, only the growth-oriented enterprises are good risk capital candidates. It's generally agreed that only 5 percent of all small to medium-sized businesses are growth-oriented enterprises with high potential. These businesses are of interest to providers of risk capital. (The proportions shown in the diagram are for illustration purposes only.)

Warning Signs

Here is a brief checklist that a venture capitalist might use when first assessing a potential business investment. Investors treat each of these characteristics as warning signs — indicators that businesses may not have real growth potential.

Does your business have any of these characteristics?

structural flaw in business model	
lack of strategic focus	
unclear vision of future	
no process for identifying and tracking key trends	
inability to explain business proposition	
poor history of growth and/or profitability (for a mature business)	
short track record (for a mature industry)	

If you haven't checked any of these, then you may have a high-potential enterprise.

Key Investor Criteria

Above all, investors are looking for these four things:

- a strong management team capable of executing the strategic plan and managing growth;
- a rate of return that is sufficiently high to reward the level of risk;
- a viable exit strategy to provide liquidity — in other words, a way to get their money out; and
- the opportunity to be actively involved in monitoring, influencing and controlling their investment.

If you've got all these things, you're in the running. But you haven't won the race yet. You've got to demonstrate to investors that you have what they're looking for, and you've got to find investors who are willing to listen. This self-study guide can help you prepare and present the proposal you'll need to attract venture capital.

The next section of this overview describes the Steps in this guide and how they help you find the financing you seek.

Steps You Should Take

If you think you have what it takes to attract growth capital, then this guide is for you. It will show you how to prepare to pursue financing, identify potential investors and communicate with them.

Many small businesses that may have investment potential fail to raise capital because they haven't adequately planned and executed the search process. This guide helps with the planning and execution by breaking that process into nine steps, each covering key activities you need to accomplish.

These steps will help you...	***...answer these critical questions.***
1 Identify Your Financial Needs	How much money will you need to launch your investment opportunity?
2 Know Your Financing Options	What are your alternative sources of financing? How much of your financing requirements will have to be met by each type?
3 Show Your Investment Potential	How will you demonstrate your investment opportunity's financial potential to attract investor attention?
4 Demonstrate Your Management Capabilities	How will you show that your management team can capitalize on the investment opportunity - that it's a well-balanced team and can make the investment opportunity a real success?
5 Build an Investment Proposal	How should you write and structure your investment proposal to communicate your ideas as effectively as possible to investors?
6 Identify Potential Investors	How will you identify potential investors for your project?
7 Meet Potential Investors	How should you approach investors to impress them with your investment opportunity?
8 Negotiate the Deal	What issues should you raise with your investors to ensure a successful final agreement?
9 Close the Deal	Finally, what must you do to close the deal, complete the due diligence process and, most important, ensure that a successful business relationship is established?

FAQ

Can I raise risk capital without the aid of advisors?

Probably not. There are some parts of the process that require special skills. For example, there are legal issues in writing an investment proposal, identifying potential investors, and negotiating and closing deals that require a strong knowledge of business law and government regulations. Other complex areas are valuation and financial forecasting. You may need to hire expert help for these.

At the same time, you may be able to manage many parts of the investment process by using your management team and other resources. Advisors may then act as "coaches" throughout the process, consulting on issues only when required. This allows you the benefit of their knowledge and the ability to control your costs for professional services.

But even with outside help, you should be prepared to spend a considerable amount of time at each stage of the investment process.

How to Use This Guide

This Web-based guide is designed to help owners of growth-oriented firms think through the investment process in order to increase their chances of obtaining risk capital.
You can use it in several ways:
1) Read each of the nine Steps in order. Follow the nine Steps and they will help structure your search for investors.

- You can read it online, print individual topics or download each Step.

2) Dip in to particular Steps and topics that interest you.

- The blue numbered links at the top of each page will take you to the first page of each Step.
- The blue navigation area on the left side of the page shows the contents of the Step you are currently in. Click on a link to go directly to that page.

3) Follow the story of New Tech Distributors Corp., a fictional but realistic company, as it faces the challenges at each Step of the process.

- You can always get to the New Tech story using the link in the left column.

Of course, you should mix and match these ways of using the guide to suit your own needs.

Other Skills

You may also find it useful to take a look at four modules designed to improve key investor-readiness skills:

- Enhance Your Writing
- Get the Most Out of Meetings
- Improve Your Negotiation Skills
- Embrace and Resolve Problems