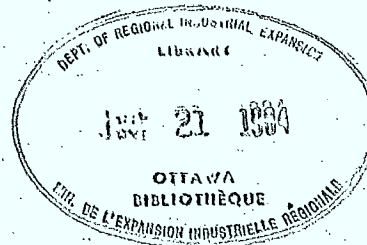


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**AN EVALUATION OF VENTURE CAPITAL
REJECTIONS AND THEIR SUBSEQUENT
PERFORMANCE**

submitted to the

**MANAGEMENT EXCELLENCE IN
SMALL BUSINESS PROGRAM
(MESBP)**

by

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RÉSUMÉ

Le présent rapport décrit une recherche effectuée pour savoir ce qui arrive aux entreprises qui cherchent à obtenir du capital risque après avoir essuyé un refus auprès des établissements de capital risque. On sait peu de choses à propos de ces entreprises, notamment si elles parviennent en fin de compte à atteindre les objectifs d'expansion pour lesquels elles recherchaient du capital risque. À l'origine, le projet a été proposé par des membres de l'Association of Canadian Venture Capital Companies, qui ont offert leur collaboration pour fournir le nom des entreprises les ayant approchés pour obtenir du capital risque au cours de la dernière année. Ces entreprises ont ensuite fait l'objet d'une enquête au moyen d'un questionnaire postal et d'entrevues ultérieures pour savoir si elles ont finalement obtenu le financement et de quelles sources et pour analyser les résultats ultérieurs de ces entreprises.

Un problème que l'on rencontre couramment au Canada est le manque de capital risque en général, surtout au stade du démarrage, pour les entreprises qui ne travaillent pas dans un secteur de haute technologie ou dans un secteur de fabrication. Personne n'a vraiment étudié ce qui arrive à ces entreprises après que le capital risque leur a été refusé et si elles parviennent en fin de compte à obtenir des fonds auprès d'autres établissements comme les banques à charte, les compagnies de prêt ou les programmes gouvernementaux.

La présente étude avait donc pour but d'évaluer un échantillon des refus de capital risque afin de déterminer ce qui arrive aux entreprises qui essuient un refus de la part des établissements de capital risque. L'étude a procédé à une analyse des autres sources de capital qu'elles ont approché, ainsi qu'à une classification des types d'entreprises et des sommes demandées.

À certains égards, les résultats de l'étude ont été assez surprenants. Seulement 78 % des entreprises ayant répondu ont admis avoir approché un jour un établissement de capital risque. Parmi ces entreprises, 15 % ont prétendu avoir obtenu en fin de compte du capital risque. Puisqu'elles ont essuyé un refus de la part de l'entreprise qui nous a fourni l'information, elles doivent avoir obtenu ce capital d'une autre source de capital risque. En outre, un pourcentage encore plus élevé de l'échantillon, à savoir 72 %, a reçu des fonds pour le même projet d'autres sources comme les banques à charte, les programmes gouvernementaux ou d'autres groupes d'investisseurs.

Cependant, la somme qu'elles ont généralement obtenue était nettement inférieure au montant initial requis pour leurs projets. En fait, 46 % des entreprises prétendent que les sommes obtenues les ont obligées à modifier leurs plans, tandis que 54 % ont déclaré le contraire, à savoir qu'elles ont poursuivi le même projet de base même si les fonds ont pu être inférieurs. Ces modifications ont provoqué l'annulation, la modification du projet, la réduction radicale de la portée du projet, le retard de l'échéancier du projet et, dans 16 % des cas, même une expansion des projets initiaux. Presque toutes les entreprises qui ont répondu à l'enquête avaient préparé un plan commercial écrit pour le présenter aux sources de capital et 50 % d'entre elles avaient reçu des instructions de ces sources sur le contenu du projet. Ces suggestions impliquaient généralement des renseignements comme les états financiers, les projections, les besoins en capital et les antécédents de gestion. Un grand nombre d'entreprises (47 %) s'étaient fait aider par des personnes en dehors de l'entreprise pour préparer la proposition en vue d'obtenir des fonds. Parmi ces personnes, on retrouvait le plus couramment des comptables, des hommes de loi et des experts-conseils, les banquiers ne jouant pas un rôle important et les établissements de capital risque ne fournissant pas eux-mêmes beaucoup d'aide pour la préparation du projet commercial. Bon nombre des personnes qui ont aidé à préparer la proposition (64 %) ont également référé ces entreprises à d'éventuelles sources de capital et 39 % d'entre elles ont aidé l'entreprise à obtenir des capitaux en négociant la proposition, en obtenant les idées des sources de capital et en fournissant d'autres renseignements sur la proposition.

Les raisons habituelles du refus servi par les établissements de capital risque étaient les suivantes : l'entreprise était trop petite ou la somme demandée était trop faible pour leur secteur d'intérêt, le projet ne représentait pas suffisamment de possibilités de gains pour être attrayant, ou bien ils n'étaient tout simplement pas intéressés par l'idée ou l'industrie sur laquelle l'idée était fondée. Les raisons invoquées par les entreprises elles-mêmes pour justifier la décision des établissements de capital risque incluaient les déclarations suivantes : les entreprises de capital risque ne comprenaient pas vraiment leurs affaires, la proposition était trop risquée pour les entreprises de capital risque plutôt conservatrices et la récession économique était tout simplement une mauvaise période pour chercher des capitaux en général. Plusieurs parmi les autres sources de capital ont donné

d'autres raisons de leur refus, comme le manque de garanties collatérales dans le cas du milieu bancaire et le manque d'antécédents de gestion invoqué par d'autres investisseurs. En fait, il est surprenant de constater que la compétence en matière de gestion n'a pas semblé être une raison justifiable invoquée pour refuser la proposition dans bon nombre des exemples étudiés. Mais c'est peut-être parce que l'établissement de capital risque et les autres sources ne voulaient pas déclarer que la mauvaise gestion constituait la véritable raison de leur refus ou que les dirigeants des entreprises ayant essuyé un refus ne voulaient pas écouter ou croire que c'était là la véritable raison.

En outre, les entreprises financées ont déclaré que 40 % des sources de financement offraient d'autres services, comme un service de consultation, et bien qu'un nombre relativement faible de ces entreprises utilisaient ces services, elles les considéraient généralement comme excellents mais coûteux. À la question concernant la façon dont d'autres établissements comme les gouvernements ou les universités auraient pu les aider à obtenir du capital, 58 % des répondants ont déclaré qu'ils auraient pu recourir à une telle aide et que cela aurait pu se faire sous la forme d'une aide gouvernementale à la recherche et au développement, de cours sur la préparation des programmes commerciaux et d'une évaluation impartiale des plans. Selon les répondants, ces services auraient pu être fournis à la fois par le gouvernement et les universités ou par d'autres entreprises. En outre, les subventions de recherche et de développement ont été mentionnées comme une première source possible de financement à l'étape d'un projet pilote dans les plans de développement de ces entreprises.

Aujourd'hui, dans la fourniture de capital risque au Canada, les problèmes globaux soulevés par ces entreprises comportaient des commentaires du genre : l'attitude des établissements de capital risque est vraiment assez conservatrice dans leur évaluation et n'est pas du tout orientée vers le risque à l'égard des idées qu'ils évaluaient. Les répondants ont déclaré que cela était encore plus vrai dans le milieu bancaire au Canada et que le fait qu'il y avait des prêteurs sur nantissement plutôt que des prêteurs sur trésorerie provoquait un problème fondamental selon les répondants. Un sentiment précis a également été invoqué, à savoir qu'il faut des stimulants fiscaux pour que les investisseurs et les établissements investissent dans des entreprises nouvelles et plus risquées et qu'il existe un besoin précis

d'éducation dans ce domaine, de la part des universités, des collèges communautaires ou des programmes gouvernementaux.

La plupart des entreprises ayant fait l'objet de l'étude (46 %) se trouvaient dans l'industrie de l'électronique et 30 % dans les secteurs du matériel industriel ou du marketing général, les autres étant éparpillées dans un large éventail d'industries. Le chiffre d'affaires de ces entreprises atteignait environ 13 millions \$, dont 21 % avaient des ventes inférieures à un demi-million de dollars et environ 40 % des ventes dépassant 5 millions \$. Le nombre moyen d'employés dépassait 130 et l'équipe de direction comportait en moyenne quatre personnes. L'âge moyen de ces entreprises était d'environ 11 ans et le nombre moyen d'actionnaires atteignait 25. Le montant moyen des capitaux propres dépassait 4 millions \$ et le montant du capital d'endettement était très semblable. Le montant moyen du capital risque recherché approchait 3 millions \$ et dépassait nettement 10 millions \$ dans plusieurs cas. La majorité des buts énoncés pour obtenir ce capital touchait le domaine de la mise au point de nouveaux produits, de l'expansion des activités existantes et du refinancement de la compagnie. Un certain nombre d'autres entreprises ont déclaré que le véritable objectif de la nouvelle injection de capital était la recherche et le développement tandis que le fonds de roulement et les achats constituaient d'autres buts communs.

En résumé, environ 3/4 des entreprises ayant essuyé un refus de la part des établissements de capital risque ont obtenu des capitaux d'autres sources, y compris d'autres entreprises de capital risque, mais généralement une somme inférieure et dans une version restreinte du projet initial. Le taux de refus provenant de toutes les sources de capital était plus élevé pour les entreprises plus récentes et plus petites et pour celles qui n'avaient pas d'antécédents très nombreux. En fait, la plupart des demandes qui ont en fin de compte obtenu des fonds d'une source quelconque étaient les plus grosses demandes de capitaux qui ont généralement obtenu des fonds d'un certain nombre d'établissements différents en recourant à différents types de capitaux pour financer le projet, dont une combinaison de capitaux propres, de dettes et de quasi-capitaux propres.

Les résultats de cette recherche sont assujettis aux préjugés exercés par les établissements de capital risque dans le choix des entreprises suggérées comme échantillon pour l'étude et aux préjugés constatés dans le taux de réponses obtenu, mais il semble que, d'après cet échantillon, le manque de

capital risque disponible ne soit pas aussi grave que bon nombre d'entreprises semblent le dire. Cependant, le problème est définitivement plus grave pour les petites entreprises et les entreprises récentes, surtout au stade du démarrage, puisqu'aucune des sources de capital n'était très intéressée à investir dans ces entreprises. Les mesures gouvernementales recommandées plus loin dans le présent rapport suivent donc cette orientation et il faut déployer des efforts plus nombreux pour fournir davantage de capital risque aux stades de démarrage et de développement des petites entreprises, tandis que les entreprises établies depuis plus longtemps sont présentement capables d'obtenir du capital auprès d'un grand nombre de sources.

Bien que l'on puisse soupçonner que les entreprises de capital risque ont fourni à l'auteur un échantillon partial des demandes de fonds, même ces entreprises illustrent le problème fondamental des petites entreprises recherchant du capital risque au Canada. Les principales entreprises de capital risque ne sont tout simplement pas intéressées à des transactions inférieures à 500 000 \$. Ces sources fournissent donc rarement des sommes allant de 25 000 à 500 000 \$. Diverses provinces ont mis des stimulants à la disposition des investisseurs individuels et des entreprises pour combler ce fossé. Parmi les exemples, citons le programme de la Small Business Development Corporation en Ontario, la SODEQ au Québec et des programmes semblables en Alberta et en Nouvelle-Écosse. Cependant, ces programmes tendent à être limités à des industries particulières et sont assujettis à toute une gamme d'autres restrictions qui ont empêché les entreprises de capital risque de former la SBDC ou la SODEQ.

Il faut un stimulant fiscal fédéral pour combler ce fossé et aider les petites entreprises à obtenir du capital risque au Canada. De nombreuses suggestions ont été avancées pour de tels stimulants allant de l'expansion du programme des REER pour permettre aux particuliers d'investir chaque année 3 500 à 5 500 \$ dans une petite entreprise chaque année jusqu'à permettre aux investisseurs de retirer leur investissement initial sans payer d'impôts et jusqu'à l'imposition des bénéfices tirés de l'investissement aux taux de l'impôt sur le revenu.

Ces recommandations sont détaillées avec d'autres à la fin du présent rapport.

EXECUTIVE SUMMARY

This report describes a research study conducted to investigate what happens to those firms which seek venture capital after they have been rejected by the venture capital institutions. Little is known about whether such firms ever do manage to accomplish their expansion objectives for which they sought venture capital. The proposal was originally suggested by members of the Association of Canadian Venture Capital, companies who offered their cooperation in providing the names of firms which have approached them for venture capital during the past year. These firms were then surveyed by means of a mailed questionnaire and follow-up interviews to determine whether they obtained the funding eventually, from what sources and to analyze the subsequent performance of these firms.

A current problem in Canada is the lack of venture capital in general, particularly at the startup stage, for firms that are not in a high technology or manufacturing business. No one has done much follow up on what happens to these firms after they have been rejected for venture capital and whether they eventually manage to obtain funding from other institutions such as the chartered banks, loan companies or government programs.

It was, therefore, the intent of this research study to evaluate a sample of venture capital rejections to determine what happens to these firms which are turned down by the venture capital institutions. An analysis was done of other sources of capital which they have approached and classification of the types of businesses and the amounts of money which are being requested.

The results of the research study were, in some respects, quite surprising. Only 78% of the firms replying even admitted they had ever approached a venture capitalist. Of those firms which had approached the venture capitalists, 15% of them claimed they did receive venture capital eventually. Since they were turned down by the firm which provided the lead, they must have received this capital from some other venture capital source. In addition, a further large percentage of the sample, namely 72%, received funding for the same project from other sources such as chartered banks, government programs, or other investment groups.

However, the amount of funding they usually received was considerably less than the original amount required for their plans. In fact, 46% of the firms claim that the amount of funding received caused them to change their plans while 54% said no, they went ahead with the same basic plan, even though the funding may have been less. These changes included cancelling, changing the project, cutting back drastically on the scope of the plan, delaying the timing of the plan and, in 16% of the cases, even expanding the original plans. Almost all of the firms replying to the survey had prepared a written business plan for submission to the sources of capital and 55% of them had received instruction from these sources on what the plan should contain. These suggestions usually involved information such as statements, projections, capital requirements and management background information. A large number of the firms (47%) had received assistance from individuals outside the firm in preparing the proposal to raise financing. The most common of these were accountants, lawyers and consultants,

with bankers not playing a major role, and the venture capitalists themselves not providing much assistance in preparing the business plan. Many of these individuals who assisted in preparing the proposal (64%) also referred these firms to likely sources of capital and 39% of them assisted the firm in raising capital by shopping the proposal, bouncing the ideas off sources of capital and otherwise providing information on the proposal.

The usual reasons given by the venture capitalists for their rejections were the fact that the business was too small or the amount of money requested was too small for their area of interest, the project did not have sufficient earnings potential to be attractive or they were simply not interested in the particular idea or industry in which the idea was based. Reasons given by the firms themselves to justify the venture capital decision included statements that Venture capital firms (V.C.'s) did not really understand their business, that the proposal was too risky for the V.C.'s rather conservative orientation and that the economic recession was just a bad time to raise capital in general. Several of the other capital sources used additional reasons for rejection, such as lack of collateral in the case of the banking community and lack of management background used by other investors. In fact, it was surprising that management expertise did not seem to be given as a justifiable reason for rejecting the proposal in many of the examples explored. But that may be because venture capitalists and other sources were unwilling to state that poor management was the real reasons for their rejection or that the management of the firms being rejected did not want to listen to or believe that as the real reason.

In addition, the firms funded stated that 40% of the sources of funding offered other services such as consulting assistance and although relatively few of these firms used these services, they usually rated them as excellent, although expensive. When asked how other institutions such as government or universities might have assisted them in raising capital, 58% of the respondents said they could have used such assistance and it might have come in the form of government research and development assistance, courses on preparing business plans and unbiased appraisal of plans. These services could have been provided by both government and universities, or other businesses, according to the respondents. In addition, research and development grants were one area that was raised as a possible early source of funding for the pilot project stage in the development plans of these firms.

The overall problem areas in the provision of venture capital in Canada today raised by these firms included such comments as the attitude of venture capitalists being really fairly conservative in their assessment and not being at all risk oriented towards the ideas which they evaluated. Respondents stated this was even more true of the banking community in Canada and the fact that they were collateral lenders rather than cash flow lenders caused the basic problem, according to respondents. There was also a definite feeling that there was a need for tax incentives for both institutions and investors to invest in newer, riskier businesses, and that there was a definite need for education in this area, whether it was provided by the universities, community colleges or government programs.

Most of the firms surveyed (46%) were in the electronics industry with a further 30% being in the industrial equipment or general marketing areas,

and the remainder being scattered over a wide variety of industries. The average sales volume of these firms was about \$13 million, with 21% of them having sales less than half a million, and about 40 having sales in excess of \$5 million. The number of employees averaged over 130, with the management team averaging four. The average age of these firms was approximately 11 years and the average number of shareholders was 25. The amount of equity capital averaged over four million dollars, with the amount of debt capital being very similar. The average amount of venture capital being sought was nearly \$3 million, ranging to well over \$10 million in several cases. Most of the purposes stated for this capital were in the area of new product development, expansion of existing business and refinancing of the company. A number of others stated that research and development was the real objective of the new injection of capital, while working capital and acquisition were other common areas.

In summary then, approximately 3/4 of the firms rejected by the venture capital institutions raised capital from some other source, including other venture capital firms, but usually in a lesser amount and in a scaled down version from their original proposal. The rejection rate by all sources of capital was higher for newer, smaller firms and for firms which did not have a very extensive track record. In fact, most of the ones which were funded eventually from some source were the larger requests for capital, which usually received funding from a variety of different institutions with the number of different types of capital being used to fund the project, including a combination of equity, debt and quasi-equity vehicles.

The results of this research are subject to the biases exercised by the venture capitalists in selecting the companies suggested as a sample for the research and any biases in the response rate obtained, but it seems that, based on this sample, the lack of available venture capital is not nearly as severe as many firms seem to claim. However, the problem is definitely more severe for smaller firms and newer businesses, especially those at the startup stage, since none of the sources of capital were very interested in investing in those. It is therefore the orientation of the recommendations for government action later in this report that efforts need to be expended to provide more venture capital at the early startup and development stages of small business, with more mature firms being able to raise capital from a variety of sources in Canada currently.

Although it is suspected that venture capital firms provided the author with a biased sample of funds requests, even these firms illustrate the basic problem for smaller firms seeking venture capital in Canada. The primary venture capital firms are simply not interested in deals less than half a million dollars. So amounts from \$25,000 to \$500,000 are seldom available from such sources. Various provinces have made incentives available to individual investors and firms to bridge this gap. Examples include the Small Business Development Corporation Program in Ontario, SODEQ's in Quebec and similar programs in Alberta and Nova Scotia. However, these programs tend to be limited to specific industries and are subject to a variety of other restrictions which have prevented venture capital firms from forming SBDC's or SODEQ's.

A federal tax incentive is needed to bridge this gap and assist smaller firms in raising venture capital in Canada. Many suggestions were made for such incentives, ranging from expanding the RRSP Program to permit individuals to invest \$3,500 to \$5,500 in a small firms each year to permitting investors to withdraw their original investment without tax and the taxing and profits from the investment at income tax rates.

These recommendations are detailed with others at the conclusion of this report.

Introduction to Venture Capital in Canada

This report discusses a problem which has not been analyzed to any extent in either Canada or the United States for small businesses in their continuing search for funding. The directors of the Canadian Association of Venture Capitalists (CAVC) have suggested to the author that it would be very worthwhile to do such a study to see what happens to venture capital rejections after they have been turned down by the venture capital institutions. The purpose of this would be to examine whether they eventually receive the funding they are seeking from other sources and to analyze their subsequent performance afterwards. The members of the association agreed to provide a listing of a sample of those firms which have been rejected over the past year and a questionnaire and interview

survey was then used to contact these businesses in an effort to discover if they ever received funding, from which sources they received such funding, and to discuss current problems in the provision of venture capital in Canada with them.

The Association of Canadian Venture Capital companies is the core of the venture capital industry in Canada. Its membership includes about 35 firms, as of early 1983, which meet certain criteria in the provision of such capital. These provisions include one that they have funds of at least a million dollars in equity investments or available for such investments in business enterprises on a venture capital basis. They must also have a professional commitment to equity investment in venture capital situations and they must not generally invest more than 20% of their available funds in any one business enterprise, with a willingness to reduce the equity participation in such investments as they grow and mature. The membership varies from private venture capital firms to several public or government owned venture capital sources, such as the Federal Business Development Bank and the Ontario Development Corporation. They include several investment groups which are closely tied to the chartered banking community, such as the TD Capital Group, Roynat and Roymark.

Several other listings of venture capital sources are available, with the two primary ones being "Sources of Venture Capital in Canada", published by the federal government and the "Sources of Funds Index", published by SB Capital.

"Sources of Venture Capital" includes a listing of approximately 50 venture capital sources across Canada and is very useful in terms of having

several illustrations of cases on venture capital investment as well as a detailed outline of what should go into a business plan being prepared for such investment. It also has a short section on other sources of financing, such as government programs at both the federal and provincial levels. However, the problem with this booklet is that it was first published approximately 10 years ago and the most recent version is dated 1978. So it has become somewhat obsolete in terms of the sources listed, but it is a very useful reference for anyone wishing a summary of venture capital in Canada.

The "Sources of Funds Index" is a far more detailed publication dealing not only with venture capital, but general financing sources, instructions on preparing a financial proposal in general, and listings of many general sources of capital, as well as venture capital firms. The biggest advantage of this publication is that it is updated quarterly and is therefore reasonably current in its listings of both private sector firms and government programs. Listed under its venture capital sources are about 250 firms. But the definition of venture capital is stretched rather broadly to cover all of these firms. Included, for example, are all the Small Business Development Corporations in Ontario, as well as many industrial investors, who prefer to invest through venture capital firms, rather than directly themselves. Some firms listed are really finders or brokers in the venture capital industry. Nevertheless, it is by far the most complete listing of such references available in Canada today and includes a very good discussion of what venture capital is and how to obtain it.

In addition, the "Sources of Funds Index" includes a very detailed listing of all government programs and the particular orientation of these programs. It is an invaluable asset to any small businessmen seeking funding in Canada today. It is available on a subscription basis from SB Capital Ltd. in Toronto, or in most major libraries across the country.

Research on Venture Capital in Canada

The earliest known research on the venture capital industry in Canada was a study by two Harvard Business School students¹, which was really the first assessment of this form of equity financing in Canada. Further studies in this area gradually developed with the next major one being this author's study, commissioned by the federal government in 1973.² Knight investigated 50 sources of venture capital in some detail and provided references on their terms under which the capital was available, the number of investments and particular preferences of these sources of funds. In addition, he surveyed approximately 90 venture capital users to obtain their reactions to the provision of venture capital in Canada at that time. He also examined the role of the financial institutions, which he found were primarily second level investors, who invested through the primary venture capital firms. In addition, he discussed the orientation of the major government incentive programs in Canada at that time and found that very few of them were really very venture capital oriented.

Among his more interesting conclusions was the observation that many ventures in Canada were worthwhile financing, but could not readily obtain venture capital in Canada at that time. This was particularly true for firms

at the startup stage or during the first few years of their lives, since capital for startup and development is generally not provided by the venture capital community in Canada. There was insufficient venture capital available for the early stages of business or for businesses not in the high technology areas and the manufacturing areas at that time, since these are the areas in which most venture capital was concentrated in Canada at that time. In addition, he concluded that there was a distinct lack of venture management ability in Canada, and management in venture capital firms claimed that poor management was the prime reason for rejecting most of the proposals they examined. Knight also concluded that government programs did not really provide venture capital as he had defined it, namely the provision of unsecured debt or equity financing at any stage prior to going public. This conclusion is even more valid today, since the FIRA regulations have reduced the foreign involvement in venture capital in Canada, and only in the banking industry is there a significant presence of foreign owned firms in Canada, through the introduction in recent years of the schedule B banks. Knight concluded that the amount of venture capital in Canada was expanding rapidly, especially through the activities of the Canada Development Corporation. But it was not changing its focus towards smaller, younger firms and current tax incentives did not give anyone incentive to invest in this critical area.

Several recommendations of that early study for government are interesting, in that Knight suggested that the government should establish a clearing house where users could learn of venture capital sources and their preferences. They could have their business plans reviewed and polished, with feedback as to the validity of them, before they were taken to venture

capitalists, since a rejection from one source often led to rejection from others. He stated that the government should also provide tax incentives to attract more private capital into venture capital investments, especially at the startup level and that government programs should do more joint venture investing with private venture capital firms. The report also suggested that provincial and federal government should cooperate on establishing joint programs to assist small businesses across Canada in raising funds. Unfortunately, very few of these recommendations have been implemented over the past ten years, except for such programs as the Small Business Development Corporation in Ontario, which has been duplicated in another form in Alberta, Quebec and Nova Scotia.

A followup study was done by Robert Grasley³ on the sample of firms covered in the Knight study in 1975. But very few additional studies of venture capital in Canada have been done over the past 10 years. Several other areas for assessment have included the studies done by Little et al.⁴ on the assessment of new industrial innovative products in Canada, although their focus was on larger firms in general. In addition, Litvak and Maule⁵ have studied entrepreneurs in Canada at various stages, as have several other authors.

Most of the research funding available in Canada during the 1970's was for innovation or high technology oriented business, and research studies done during that period reflect that bias. Venture capital studies that were done were usually oriented towards the technologically oriented firms (Mao⁶) and to management of such firms (Knight and Lemmon⁷).

Perhaps the most significant publication of articles in the area occurred in the Business Quarterly, issues of Spring of 1972 and Summer of 1974, which contained articles on entrepreneurship, venture capital and small business in general. These were written by venture capital industry practitioners as well as researchers in the area.

The American literature, on the other hand, was growing at a rapid rate in this area during the 1970's. The development of several journals focusing on small business and a variety of studies of venture capital⁸ attest to this earlier interest in the United States.

However, when the author came to examine the issue of what happens to venture capital rejects, he could not find any relevant research in either Canada or the United States on this topic. During the course of the study, he was exposed to one presentation by American researchers, who had done a similar study to the one described herein and that is summarized here. This particular study by Bruno et al.⁹ was done in 1982 and assesses what happens to ventures that were rejected by American venture capital companies which provided 193 leads. By a combination of telephone and questionnaires survey, they managed to contact approximately half their sample or 95 firms, which participated in this survey. An additional 40 firms were known to have survived but declined to participate in this study. Thus, approximately 70% of the initial sample was known to be still surviving and the additional 30% could not be contacted by telephone or mail and were presumed to have failed. Nevertheless, these researchers admitted that some of these firms may have merged into other companies or otherwise

moved to new locations, so that the failure rate may not be nearly as high as initially suspected.

The average age for the participating firms was approximately 10 years and the reasons given by the entrepreneurs for denial of venture capital investments were collected into factors related to the venture capitalist's preferences, the deal structure and other reasons. Venture related factors included market potential, management, competition and product feasibility. Fifty percent of total reasons mentioned fell into this area as given by the venture capitalists for rejection. Venture capitalists' preferences included conflicting investments, lack of co-investors, which implies that the deal was too big for one company to take on by itself, and the lack of investment capital. A further 20% of the reasons fell into this category. The deal structure category included forms of financing sought and the amount of money needed, usually implying that the financing sought was too small for the venture capitalist to bother analyzing the investment. Other reasons covered a wide variety of territory, as might be imagined.

The venture capital firms were primarily located in Boston, San Francisco and the Houston-Dallas area and were therefore primarily high technology oriented, although that is likely true of all venture capital in both Canada and the United States.

Another interesting area discussed in the Bruno study was the entrepreneurs' perceptions of venture capitalists. Sixty percent of the entrepreneurs stated that venture capitalists demanded far too high a share of the equity of the firm before they would be willing to invest

and those that were rejected claim that venture capitalists did not like to take risks, as evidenced by the rejection of their firm. A further 19% of those rejected claim that the venture capitalists did not understand their business and had insufficient skills outside the financial area to really evaluate a proposal.

The average percent of equity relinquished to the venture capitalists by those firms in which venture capitalists had invested was 45% and involved 80 different firms. This illustrates the aversion of many entrepreneurs to venture capitalists, who they claim demand far too large a share of the business in return for their funding. Another interesting aspect of the American study was the amount of money being sought. Those firms which were not denied by venture capital firms averaged a one year financing requirement of nearly \$3 million and a forecast of nearly \$12 million requirements over five years. This amount dropped dramatically as the number of denials or rejections went up. For those firms receiving more than three rejections, the one year forecast funds needed was about \$400,000 and the five year forecast was about \$1.2 million. This further substantiates the claim that venture capitalists tend to invest primarily in larger investment amounts above half a million dollars and not in the smaller, newer firms which have smaller funds needs. Venture capitalists also led the list of the entrepreneurs' preferred source of financing in the American study with 28% preferring them, 18% preferring bank financing and 12% preferring individuals as their source of equity. However, when questioned about sources of financing for the following five years, a public offering led the list by a wide margin, being the response of 43% of the companies. Bank financing

was next for about 20% of the companies and venture capital sources were well down the list, mentioned by only 10%. In other words, most of these firms planned to go public in the next five years and were using venture capital financing as a bridge alternative to get them to that stage. They are not therefore the smaller, newer companies trying to grow rapidly, but are firms that are getting close to the public offering stage and might have been funded by a public offering if this were a viable alternative in today's market climate.

The entrepreneurs were also questioned about their preferred form of financing and 64% of them suggested that they would prefer to have equity financing at this stage, while only 33% replied debt (including convertible debt) and the remainder preferred a combination of debt and equity. When discussing their financing needs for the next five years, the proportion preferring equity rose to over 70%, as reflected by the fact that most of them plan to go public within five years. The firms investigated in the American survey spent an average of five months seeking their first round of venture capital financing and stated that it was a shorter time with debt financing than with equity, being of the order of four months for debt and six to nine months for equity, depending on the form. There was not a significant amount of difference in the time taken to raise different amounts of capital as reflected by the average of about six months search time for all amounts of capital. Respondents suggested that it took less time to raise second round financing, if venture capitalists had invested previously, and the same was true of other sources, such as individuals and banks. This

was often because the same individuals invested the second time around as had originally invested.

The average amount of new venture capital investment was approximately \$600,000 for the firms responding and the average amount by new individual investors was about \$70,000. This may signify that individual investors are usually approached for smaller amounts of financing, especially during the earlier stages of business. A further interesting aspect of the American study was to contrast the amount of money obtained as a percentage of the amount sought. These range from about 32% for smaller amounts (under one quarter million dollars) to 70% in the over one million dollar category. For those firms which did not obtain venture capital at all, it was stated that they usually spend an average of about one year searching for capital, before giving up in desperation and this time diminished for second and third rounds of financing. The average percentage of equity relinquished to the venture capital firms varied by the round of financing being sought, whether initial financing or subsequent rounds. However, in most cases, it amounted to one third of the equity of the firm per financing and the 45% figure mentioned earlier was usually the total amount given up to venture capitalists, possibly over several rounds of financing.

This American study focused on different issues than the study discussed herein, but lent an interesting perspective to the interviews held with venture capital users during this particular study.

Purpose of the Research Study

The purpose of this project was to obtain information about those companies which had been rejected in their search for venture capital,

to ascertain whether they ever obtained the funding required or whether these projects never do come to fruition because they were not funded. Much criticism has been voiced in the public press and in various research articles, criticizing the lack of venture capital in Canada without much evidence as to whether firms search for venture capital but cannot obtain it. Many of the firms which are turned down for venture capital may deserve to be turned down and perhaps should never be funded, although that is not the belief of most of the entrepreneurs involved and it is expected that this research will show otherwise. An additional purpose of the research was to find out if such proposals were ever funded from whatever sources and to familiarize readers with venture capital in Canada, both in terms of from whom it is available, on what terms it is available and for what types of investments it is currently being utilized. All of this information can be obtained from the Association of Canadian Venture Capital Firms, since they publish regular reports on an annual basis describing their investments. Although these firms are only a small part of the venture capital industry in Canada, they represent the core of such capital since they are the largest firms and the most active in the provision of this type of investment. The members of the Association of Canadian Venture Capital Companies began with about 12 members in 1974 and claim that its members have funded about \$500 million in the Canadian businesses since that time. They state that generally minimum investments are now in the \$100,000 to quarter million dollar range and in 1982 the average first time investment was almost \$800,000. This points out that the Canadian venture capital community is really investing in larger invest-

ments than ever, with the average amount of each investment increasing annually. Across Canada, they claim that about \$400 million in new venture capital has been raised or committed in the past two years, including about \$75 million in equity investments made by Ontario's three hundred Small Business Development Corporations. Observers have stated that the venture capital industry is seeking to raise about another \$400 million, which includes a \$44 million share offering by Alberta's Vencap Equities.

The association members made 60 investments in 1979, 81 in 1980 and approximately 100 investments in 1981. The total amount invested grew from under \$40 million in 1979 to over \$70 million in 1980 and approximately \$11 million in 1981. Although firm figures are not available for 1982 and 1983, it is claimed that investments amounted to \$79 million in 1982 and \$100 million in 1983 by the members of the association alone.¹⁰ The average amount invested per deal was about \$600,000 in 1979 and grew to almost \$900,000 in 1980. It has apparently dropped slightly since the figures for 1982 estimate an average of the \$600,000 - \$700,000 range. In most years, however, these estimates are biased by a few unusually large investments which tend to bias the results upwards somewhat. In fact, some new venture capital deals are made every year which tend to be far above these average levels.

However, these figures are subject to some discussion since venture capitalists tend to invest again and again in the same firms, so that the number of new investments each year are considerably smaller than the numbers quoted here.

In summary, the investments by the Association of Venture Capital Company member firms are usually in the half million dollar to million dollar range on average, although many of their investments are considerably larger than that. In fact, several investments are made each year which involve amounts considerably above \$10 million per investment. The Association claims that it does invest in startup situations, but it defines startups as firms that are under four years of age. In fact, the average amount invested in each startup situation in their category was about \$900,000 in 1980. This means that either their startups are rather large or that they are really established firms which are expanding during their third and fourth years of existence, with the latter being usually the case. In 1980, about 70% of the recipient companies of venture capital association members investments had sales of less than \$4 million annually and their percent of total dollars invested in this size of company was in the 50-60% range for the member firms.

A further indication of the large size of the venture capital firms' investments is indicated by the fact that in 1980 about 16% of their investments were made in public companies, as compared to 20% of the dollar amount of investments in 1980. These firms are typically larger and require more money than the average. These were really private placements in the public market rather than typical venture capital investments.

Another interesting issue is the percentage of total assets of venture capital recipients located in Canada. Sixty-eight percent of venture capital investments by the association were totally located in Canada while a further 16% ranged between 50 and 100% of assets located in Canada. However, a

growing percentage of deals made by venture capital companies in Canada are actually located in the U.S. and overseas in general, with the U.S. being the primary target. When questioned about this, members of the venture capital association state, as they did in 1973, that the deals which they can find in the U.S. are much better than the typical Canadian deal. In addition, they state such advantages as the ability to change management and cure other problems in the firm as being far easier in these situations in the United States. Ontario led the provinces in terms of venture capital investments, with about 1/3 of them in 1980, followed by Quebec and Alberta, with about 15% each. British Columbia is next with about 11% and none of the other provinces account for very substantial numbers of investments. However, firms which are located in both Canada and in foreign countries or totally in a foreign country constituted 22% of venture capital investments for 1980.

The preferred form of investment, in 25% of the situations, was straight common stock, with convertible debt being a favourite instrument as well. However, in 16% of the situations, straight debt was used and, in another 16%, a combination of debt and common stock was used. The remainder constitute a wide variety of different investment vehicles.

For 1980, 20% of the venture capital association's investments were in natural resources, with 16% being in the manufactured industrial goods area, 15% in manufacturing of consumer goods and 15% in communications. The percentage has decreased for manufactured industrial goods and increased for natural resources over the years, although such figures are not available for 1981 through 1983 at this time. In terms of number of

employees, the venture capital recipients totalled 48% with fewer than 25, but had 11% in the 200-500 employee range. This varies over the years, and is generally in the 50% range for under 25 employees. This implies that many of the investments are rather large firms.

The few public sector investors (government programs), which are members of the association, typically invest in smaller amounts in private companies and a larger percentage of their investments are in startup situations (under four years) or in firms with sales under a million dollars. However, these investments represent mostly investments made by the Federal Business Development Bank, which has recently moved back out of the equity investment area to a large extent. In the case of the geographical preference of the public sector venture capital investors, Ontario led with 42% of investments, followed by British Columbia, because of the large FBDB bias in favour of that province. The public sector members usually invested in the form of a combination of debt and common stock (46% of the time) with convertible debt being second (24% of the time) for the 1980 statistics. Most of the investments by the public sector members were in the manufacturing, industrial and consumer goods area, almost 80% of investments being in those industries.

This gives a brief picture of the Canadian Venture Capital industry, as represented by the Association of Canadian Venture Capital firms, at least for the year 1980. More recent statistics may be available, but reflect similar levels, with the average investment being nearly \$1 million per firm and the preferences of the venture capital firms being rather limited, especially in terms of young, smaller firms.

Importance of the Research

This research project is important to a variety of audiences, including small businesses seeking funding, the venture capital firms in Canada, large firms, various levels of government and members of the academic community.

Small businesses across Canada are very interested in the venture capital industry in Canada and could be quite anxious to learn whether or not venture capital rejections eventually receive fundings from other sources. This is especially true since many of them are continually seeking funding, and merely learning the availability of venture capital and the terms on which it is available may be of interest to them.

The venture capital firms which constitute the Canadian Venture Capital Association have expressed an interest in discovering whether or not venture capital rejections eventually receive funding. They were willing to support this research financially and have definitely showed their willingness to provide names of businesses which have come to them for funding. Because of confidentiality requirements, they were not able to disclose whether or not these firms received funding, but it is not necessary, since a questionnaire survey was then sent to all of the firms whose names are provided by the venture capitalists. We could survey those who have obtained funding and the terms under which they have obtained funding, in addition to surveying those who were rejected. It is expected that a relatively small sample of funded firms will be obtained, since relatively few of them are funded across Canada by the Venture Capital Association each year.

This research is especially important to various levels of government who are continually examining various policy alternatives to increase the provision of venture capital to small business firms in Canada. It would be especially interesting to them to learn that most of the rejections of Canadian venture capital firms tend to be startups and very young firms. If they were supported by other institutions or government programs to the stage where they could stand on their own, these firms may be eligible for venture capital funding. A possible output from the study includes recommendations for government policy implications to help provide more venture capital across Canada and to provide incentives for the funding of firms at levels which do not receive much venture capital, such as the startup level, and those industries in which venture capitalists are not interested.

The results of this study are also of interest to academics across Canada, who are continually attempting to gather material on the venture capital industry and the funding of small business firms in general. This author currently teaches a course which relies heavily on the financial funding of small businesses and the venture capital industry in particular. Similar courses exist at many other business schools and community colleges across Canada and any materials developed for use at Western would be made available to all of these other schools. In addition, it is hoped that several case leads will arise during the research which may lead to documented case studies of venture capital proposals which were either successful or unsuccessful. These may then be used in the classroom in business schools.

Research Issues

There are a variety of research issues important in this study, including whether or not firms rejected for venture capital by the venture capital institutions ever receive subsequent funding. Other issues include a profile of those firms that do receive funding and the terms under which that funding is issued, as well as a profile of the firms which do not receive venture capital. It is expected that the firms which receive funding will be a rather narrowly defined segment of high technology and manufacturing firms, which offer the venture capitalist high growth opportunities in glamour industries today. In fact, many of the investments of Canadian venture capital firms are made south of the border in the United States because of the much more favourable business climate and what they claim are much better proposals found there compared to those available in Canada.

Additional research issues, however, center around the firms which have been rejected for venture capital. These include whether or not the firms ever received capital from other sources once they had been rejected from venture capital, the terms of such funding and the institutions from which it was obtained. Did they also approach individuals and investment groups such as the Small Business Development Corporations in Ontario for funding of these proposals? It is also of interest to the author whether they were referred to any additional sources by the venture capitalist or other institutions once they were turned down for funding. The possible institution of a referral network among venture capitalists and other funding institutions might prove a boon to small businessmen which are seeking funding, but are not of the particular type of deal which a given institution is considering at a particular point in time.

The questionnaire which was used for this study covered additional issues such as background information on the firms involved and their size in terms of sales, employees and assets, as well as details on how the firms got into business and backgrounds of the entrepreneur involved. This will give a profile of the types of firms which seek venture capital financing in Canada today. Through the questionnaire and interview procedure, suggestions were requested from the entrepreneurs themselves on possible government policy changes to increase the amount of venture capital available in Canada today. Many of the members of the business community in Canada have proposed a variety of suggestions, but the majority of them are that the government should stay out of the venture capital business, but concentrate on providing incentives to the private sector to offer such capital. Such incentives, whether through the tax program or by offering joint government aid in addition to venture capital once it is invested in a firm, may be the plans that are needed to increase the funding of small businesses across Canada today.

Proposed Output

The planned output from this study will be a journal article in addition to this report, which analyzes the subsequent performance of small business firms, which have been rejected by venture capital in Canada. It will also analyze a sample of venture capital investments which have been made as to the type of company and the amounts of money and terms of the investments. In addition, it is hoped that several case studies will result from the survey as outlined above and that venture capitalists and entrepreneurs will be contacted who can be enlisted to visit the author's current small business course

to discuss with students the terms under which venture capital is available and the types of deals for which it is available.

In addition, recommendations will be made to various levels of government containing suggestions for policy initiatives in the venture capital area to increase the amount of funding available to small businesses in Canada today.

Results of the Questionnaire Survey

The sample of companies which had been rejected by venture capitalists was obtained through the Association of Canadian Venture Capital Companies. A request was sent to the president of the association at that time, Brian Marshall of Roymark Financial Services in Toronto and he then forwarded that request to the individual members of the Association of Canadian Venture Capital Companies. The result of that request was approximately 200 firms which the venture capitalists claimed had been rejected in their search for venture capital. There was some duplication in the names of firms given, since most firms tend to "shop" the venture capital market. In addition, there were approximately 15 firms which could not be located or which had the questionnaire returned, as the address had changed. The reasons for this may vary from the firms having gone out of business to the firms having been merged with another company or merely having moved to a new location. It was not possible to discover whether these firms had survived or not and the resulting sample left about 180 individual firms which presumably received the questionnaire, which is shown in Exhibit 1.

Usable responses were obtained from 62 firms, for an approximate response rate of 30%. This is similar and perhaps better than the response rates which the author has obtained from various other studies of small businesses. There may be some biases in the sample of firms responding to the questionnaire and indeed, there may be some bias in the sample of firms given to the author by the venture capitalists themselves. Initial requests stated that it was desirable to have firms that the venture capitalists had seriously considered for investment, rather than firms which they had rejected after a five or ten minute interview without due consideration. Therefore, the sample may be viewed as presumably better quality proposals than the average that the venture capitalists receive, and the type of companies which are more likely to receive financing than the average business plan or proposal which they receive. Indeed, this is reflected in the results, since over 20% of them said they did receive venture capital eventually and over 70% of them did receive funding from some source. Nevertheless, the sample discussed in this report is probably non-typical in the sense that it is a sample of firms which are "bankable" in venture capital terms and had a high likelihood of receiving funding. We did not receive names and addresses of companies which had very poor proposals or which were unlikely to receive funding from any source whatever, since the venture capitalists probably screened the proposals to give us a sample of "reasonable requests".

It may also be a biased sample in the sense that the results for this sample may be overly optimistic in terms of their ability to raise venture capital and other types of funding compared to the overall average for small

Canadian business firms in general. However, we have no way of measuring how representative the sample is and it is indeed the only sample ever collected and analyzed in Canada of venture capital rejections; to the author's knowledge. It will be compared as far as possible with an American sample that was discussed in the earlier research section, with similarities and differences being emphasized. Finally, the responses of the various firms may be questionable in some areas, since only 78% of them admitted having ever approached a venture capitalist in Canada, seeking financing for their firms. This discrepancy, whereby 22% of them stated they never had approached a venture capitalist, may be due to several reasons. First, they may not have known that the firm with which they discussed their proposal was classed as a venture capitalist, especially if it was one of the government programs, such as the Federal Business Development Bank or one of the provincial programs. However, we did not receive listings of clients from any government program and all of the respondents who gave us names of companies were private firms in the venture capital market in Canada. Secondly, the smaller firms may not have admitted that they were really approaching the venture capitalist with a firm request for funds, since some of them may have just made inquiries as to whether the venture capitalist would be interested in investing in a proposal involving their firm. Third, they may be unwilling to admit to the world that they were rejected by a venture capital firm, and therefore deny that they ever approached one in the first place. If this attitude was continued to the rest of the questions in the questionnaire, the results of the study may be questionable in many aspects, as to the accuracy of the responses. However, we shall assume that the responses are reasonably accurate, at least within the perceptions of the respondents.

Detailed Questionnaire Responses

As mentioned, only 78% of the firms responding replied that they had ever approached a venture capitalist, and this may be a matter of perception of who the venture capital firms are, what an approach to a venture capitalist involves and their ability to handle rejection. When questioned as to the result of that venture capital approach, 15% of them stated, as shown in Exhibit 2, that they received financing, while 58% stated they were turned down and 6% claimed that financing was offered but they refused, usually on the grounds that it was too expensive. Another 21% stated other results such as the financing was pending, negotiations were still continuing, they had cancelled their plans for which the proposal was designed, or some combination of the earlier responses, such as they had both been turned down and received financing from different venture capital firms. These responses were evenly distributed with several firms responding in each case.

The amount of financing sought by these firms was fairly large, as shown by the following statistics. Exhibit 3 shows 19% of them were looking for amounts under a quarter of a million dollars, while 37% were seeking amounts between a quarter million and one million dollars. A further 30% were seeking amounts between one and three million dollars and 14% were seeking amounts over three million dollars. This leads one to conclude that the firms were not very small businesses and were seeking fairly large amounts of money, with the average being about 2½ million dollars for all 62 respondents. This is a relatively large amount of money compared to the financial needs of many Canadian small business firms today. It is probably also significant in the fact that venture capitalists have not provided references

to many of the small firms which were seeking small amounts of money, far below the lower limit in which most venture capitalists would be interested.

The purposes for which the financing was sought was quite varied. Exhibit 4 shows 30% of the responses requesting R&D financing and new product development money, 16% requiring expansion funds, 14% requiring refinancing money, 18% requiring working capital, 10% startup and the remainder spread among various purposes such as marketing, exploration and acquisition. In addition, about a fifth of the firms did not state the purpose for which they were requesting financing. Of the other sources approached by firms seeking venture capital, the chartered banks were the most commonly approached (52%), and 23% of the firms received financing from the bank for the same proposal taken to venture capitalists, as shown in Exhibit 5. It was not possible to determine whether the proposal was really structured in a way that some of the financing was venture capital oriented, some of it long term debt and some working capital financing, which would be a natural for the chartered banks. So this may have been one of the reasons why chartered banks play a significant role in what may seem to be venture capital financing, since the financing requests may be structured to a number of different types of financing alternatives. Individual investors were second in terms of frequency of approach, with 42% of the respondents having approached individuals, and 26% of them receiving funds from that source. Next, in order of frequency were the Federal Business Development Bank and various investment groups, both with 40% of the respondents stating that they had approached them. Only 10% had received financing from the FBDB and 15% had received financing from the investment groups. Next came provincial government programs, with 39%

of the firms having approached them, and 16% having received financing. This was followed by federal government programs, with 34% having approached these sources, and 18% having received such financing, all for the same proposal which was taken to venture capitalists. Other sources approached included the Small Business Development Corporations (27%), with 11% having received funding, from the SBDC's, American sources, which were approached by 26% of the respondents and funded by 11% of these requests and private placements, which were requested by 24% of the cases and funded 13% of the time. In addition, other sources approached were primarily corporations and other institutions not included in the list on the questionnaire, which were approached 16% of the time and funding was received in 5% of these cases.

In total, 72% of the firms replied that they had received funding from some of these sources for the same request for which they had approached the venture capital firms. However, the amount received was usually less than the total amount being requested and indeed, it may have been a structured part of the total financing package discussed above. Only half of the respondents replied to the question of what amount they had received from these sources, and they were evenly split, with about 25% of them being less than a quarter of a million, 38% between a quarter million and a million, and 37% above a million. So they were significantly lower than the amounts discussed above under venture capital requests, and the average was about \$2.3 million in these cases. The terms of this funding was also widely different in all of the cases, with 38% of them being common stock, 2% being a government grant or a development bank financing and 10% each being a private investor, term loan or joint venture type of arrangement, as shown

in Exhibit 6. Another 7% were lines of credit, usually with the chartered bank, while 3% were in the form of shareholder or personal guarantees.

In answering the question of whether the amount of funding received caused them to change their plans, Exhibit 7 shows roughly half of the respondents (46%) replied that it had caused a change. These varied from 33% stating a delay, 21% stating the plans were cut back, 10% stating that plans were cancelled, another 10% stating the project had changed drastically, and even 16% who stated the project was expanded based on the amount of funding received. Of the firms responding, 98% had prepared a written business plan for submission to the sources of capital, and 55% of them had received instructions from the sources of funds on what the plan should contain, usually from the venture capital firms (29%) or from all investors (19%). The information suggested by these sources was usually financial statements, projections, capital requirements and information on management.

Also, as Exhibit 8 shows, roughly half (47%) of the firms stated that they had received outside assistance in preparing the proposal, usually from accountants (21%), lawyers (16%), consultants (19%), business associates (11%), and a variety of others, with bankers being only three percent and relatively few finders or brokers involved (10%). Sixty-four percent of respondents stated that these people had referred them to sources of capital and 39% stated that these people had otherwise assisted them in raising capital, usually by presenting their case to sources of financing or helping them in the preparation of the business plan, if only as a sounding board for their ideas.

The reasons given by venture capitalists (according to the respondents) for the rejection were widely varied, as shown in Exhibit 9. These ranged from the fact that the amount being sought was too small in 17% of the cases, the firm had insufficient earnings in 17% of the cases, or the venture capitalist was simply not interested. The particular industry was wrong in 13% of the cases, the economy was bad in 10%, the price was too high in 10% and the venture was too risky in 10%. In only 6% of the cases did the respondents state that lack of competent management was a reason given by the venture capitalist. This may be for several reasons, since venture capitalists tend to state that it is the primary reason for rejection of proposals. Indeed, they may not be willing to state that in a face to face encounter with the management of these small firms and use other reasons, or the management of the small firm may not be willing to hear that and transfer the rationale to some other excuse. In 17% of the cases, the venture capitalist was just not interested.

When asked what other reasons they thought caused the decision of the venture capitalists, the primary response in Exhibit 10 was that the venture capitalist did not know their particular business (in 36% of the cases), that the venture capitalist was fully invested (in 19% of the cases), that venture capitalists had an interest in a competing business currently (in 11% of the cases) and a variety of other reasons. These included the terms were too expensive, the venture was too risky, the firm was undercapitalized, there was insufficient return available for the venture capitalists and the timing of the request was poor, either because the economy was bad for the venture capitalist or he was not interested at that time.

It is interesting to observe the distinction between venture capitalists saying that the management in the firms which they were investigating did not know their business or were not sufficiently skilled to put money in, and this similar response of the potential investments that the venture capitalist did not know the business of the potential investment well enough to make the investment.

The reasons given by other sources, as shown in Exhibit 11, were slightly different. The primary one was a lack of collateral in the firms (in 32% of the cases), a poor fit with current investments (in 16% of the cases), the economy (in 11% of the cases), insufficient earnings (in 11% of the cases), and the risk of the investments (in about 11% of the cases). Other reasons included questionable management and the fact that the particular program was not appropriate for their particular company, usually given in the case of the SBDC program.

Over half of the respondents (55%) stated that they had refused offers of funding because the terms were too expensive, either in terms of the excessive control required or the high interest rate being charged on the funds. This control could occur in several ways, either in the percentage of the stock which the source of funds was requiring or the restrictions that were being placed on the firm by the agreement proposed. These restrictions usually included a member of the board of directors, control of the purse strings, no major expenditures without the agreement of the investor, no changes in management salaries and the ability of the venture capitalist to step in and actually run the company, if things went badly. These responses are listed in Exhibit 12.

Forty percent of the respondents stated that the sources of capital offered other services besides funding, usually of a consulting nature, and usually in the case of the venture capital firms which would provide certain management services, if they invested in the firm. Only a few of the firms had used these services, but the ones that did thought that they were excellent, although expensive.

When asked whether other institutions such as government, universities, etc., could have assisted them to raise capital for their firm, 58% responded in the affirmative. The suggestion was usually through government incentives to give private sector investors more incentive to invest in smaller businesses. The universities should provide courses on management of smaller firms and in the preparation of business plans and an understanding of what venture capitalists seek. In addition, it was suggested that both government and universities could provide an unbiased appraisal of plans and useful feedback in terms of improving these business plans and proposals before they were taken to venture capitalists. It was also felt by a number of respondents that the government should fund the R&D phase of the proposal before private sector institutions provided funding for the commercialization of that R&D.

The major problem areas raised in the provision of venture capital in Canada today were the attitude of venture capitalists, banks and other sources towards risk oriented investments in general. Forty-six percent of respondents stated that the venture capitalist's attitude was negative in general and especially conservative. Many of these comments carried over to the chartered banks and other sources. Nineteen percent of respondents

stated that the projections or expectations of these sources were rather naive and conservative. Other respondents stated that the various programs, such as the SBDC programs, were rather limited in terms of the investments which they could make. Many of the sources of capital had insufficient funding or a small pool of capital available for investment in general. This was particularly true in the case of some venture capitalists, who stated that they did not have sufficient funds to invest at that point in time. Whether that was just an excuse with which the venture capitalist rejected the proposal, or a real problem in the venture capital market today, is not known. Other suggestions by the respondents were the need for tax incentives to give potential investors a more liberal attitude towards risk investment, such as the smaller businesses in Canada today. They felt that many of these sources needed more education about business in general, and particularly their industry and business per se, before they would be willing to invest in that area.

Parameters of the Firms Responding

Most of the firms responding to the questionnaire (46%) were in the electronics industry, while another 15% were in various types of equipment, 15% in some phase of marketing, 7% each in aerospace or oil and gas and 5% in the communications area. A further 5% were involved, as shown in Exhibit 13, in the chemical processing industry. The sales volume of these firms is shown in Exhibit 14 and they have an average sales of \$3 million. The number of employees in the firm is shown in Exhibit 14, and the average number of employees in these firms was over 100, although 11% of them

had over 250 employees. The management team in these firms was usually three or four individuals, as shown in Exhibit 15 and it also shows the year in which they were started. The number of shareholders is shown in Exhibit 16, with the equity capital issued by the firm and the debt capital in the firm also summarized in Exhibit 16. As can be seen from these last exhibits, the firms are fairly large and have an average of about four million dollars in equity capital and another four million dollars in debt, so they are not really small businesses by any definition of the term. The remainder of the questionnaire dealt with setting up an interview and receiving a copy of the results, so that this is the end of the data provided by the firms. The names of the firms will be kept confidential, as was promised to the respondents in the original enquiry to them. Firm locations are profiled in Exhibit 17.

Interpretation of the Results

In general, it is fairly obvious that, for our particular sample, the fact that they had been rejected by venture capitalists did not completely end their search for capital. Indeed, in 72% of the cases, they received funding from some source and, in many cases, from other venture capitalists. However, the firms in this sample may not be representative of the firms rejected by venture capitalists in general, for the reasons stated earlier.

A second conclusion from the analysis of the results is that these firms did a rather exhaustive search of a variety of sources in trying to obtain capital, not only from venture capitalists, but also from all of the various lenders and other potential equity investors in Canada and, in the U.S. as well, in about a quarter of the cases.

For those firms that did receive venture capital money, 72% of them had requested funds of over \$1 million and of those turned down by venture capitalists, 57% of them were looking for amounts under \$1 million. This illustrates that the larger requests tend to get funded in general whereas the smaller ones do not, especially by venture capitalists. In the overall sample, 55% were looking for an amount under \$1 million. The results of this survey also stated that the proposals were usually financially oriented, in terms of having financial statements and projections in some detail, and those appeared to have had a better success rate in obtaining funds from venture capitalists. Proposals which were non financially oriented, which described the company and the project in some detail without much financial information, were less successful. We also mean by financially oriented proposals, re-financing or cases with the funds needed for working capital or an acquisition whereas non financial proposals ranged from research and development expenditures to startup operations. Of the financially oriented proposals, 19% were successful in obtaining venture capital funds, whereas only 9% of the nonfinancially oriented proposals were successful. However, financially oriented proposals outnumbered the others two to one in our study.

It was also interesting to note that, of those firms which were turned down by venture capitalists, almost three quarters of them were still able to receive financing from some other source. On average, these obtained about 51% of the amount originally requested from venture capitalists. This may be because of the fact that the financing was separated out into various types of funds required from different types of sources.

Other characteristics of the firms receiving capital were interesting. All of the firms receiving funds from the venture capitalists had greater than \$1½ million in sales, more than 10 employees and were more than five years old. This confirms the fact that startup situations, even using the venture capitalist's definition of under four years old, usually do not receive funding from venture capital institutions. In addition, all these firms receiving financing from venture capitalists had existing equity of over \$250,000 invested in the company before they sought venture capital financing. Those firms which had drastically changed their plans based on the amount of funding received usually had less than \$1½ million in sales annually, fewer than 10 employees and had been started within the last five years. Therefore, it was the smaller firms which were most drastically affected by their difficulty in raising financing.

The largest concentration of the firms surveyed was obviously in Toronto and the surrounding area by a wide margin as shown in Exhibit 17, with Western Canada and Quebec being the next most frequent areas, usually Montreal, in the case of Quebec.

Conclusions and Recommendations

Based upon the response obtained in the survey, the problem of the high rate of venture capital rejections may not be as severe as first suspected. Many firms eventually raised venture capital from other sources, both venture capital firms and other types of funds suppliers. Over 70% of the firms responding raised some capital from another source for the same project as they were originally seeking venture capital. However, the amounts received were usually less than requested. The firms not successful were usually smaller, younger and seeking smaller amounts of money than the successful firms. Based on the relatively large size of the firms in the sample provided by the venture capital firms, it is likely that many smaller firms did not even receive serious consideration from the venture capital companies. Smaller, younger firms with relatively small requests for funds seem to suffer rejection in their request for venture capital, especially since venture capitalists are not typically interested in amounts under about a quarter of a million dollars.

About half of the firms replying stated that they had to change their plans for the project for which they were seeking the funding. Those firms which did not have an extensive track record or much management experience in their particular industry also suffered rejection from the venture capitalists and indeed, from most of the other sources as well. This is especially true for firms at the startup stage, since none of the sources of capital were very interested in investing in these firms.

Various provinces have made incentives available to individual investors and firms to create investment in the lower ranges of capital and for younger

firms. Examples include the Small Business Development Corporation Program in Ontario, SODEQ's in Quebec and similar programs in Alberta and Nova Scotia. However, these programs are limited to specific industries and are subject to a variety of other restrictions which have prevented venture capital firms from taking advantage of these programs and have severely limited their applicability to firms in general.

In addition, the preferences of the venture capitalists are severely limited in terms of the types of firms which they will consider. Most of them are oriented towards higher technology and manufacturing firms exclusively and are typically oriented towards the larger Metropolitan centers in Canada, particularly in the Toronto area. It is therefore a severe problem for firms in the Maritimes, Quebec and the prairies to raise venture capital.

The typical Canadian small business, which is not in a large Metropolitan center, not in high technology or manufacturing and at a rather early stage in its development, therefore has little hope of raising venture capital. However, there are many individuals across Canada who would like the opportunity of investing in such firms and currently do not have a mechanism for doing so. It is to these firms and to these individuals that the recommendations of the next section are addressed.

It is suggested that the Federal Government of Canada should consider the following recommendations to increase the amount of investment available for smaller firms across Canada. As mentioned in the conclusions, venture capital is just not available to smaller, younger firms, especially in areas of Canada away from larger population centers. It is therefore recommended

that government incentives, especially tax incentives, are needed for the private sector to convince both individuals and firms to invest money in smaller firms.

First, the government should decide how broad it wants the incentive to be and what firms should be eligible for this investment incentive. It is suggested that the legislation be as broad as possible rather than restrictive such as the Small Business Development Corporation legislation or the current research and development grants available from government. Small Businessmen do not typically want grants from government, but would much rather have the incentives provided through tax legislation, which gives them the option of taking advantage of the incentive with no ties to the political system. It is suggested that government should make a firm definition of those businesses which will be eligible for such investment, such as firms with a maximum sales annually of \$2 million. This is the current government definition of small businesses and covers most of the younger, smaller firms in Canada. Should the government wish to expand the incentives further, a reasonable guideline might be all firms which are currently eligible for the small business tax deduction on income, that is those firms which are currently paying 25% income taxes on their first \$200,000 of income each year. Firms which have exhausted this deduction over the years would not be eligible for such investment. This may persuade individuals to start new firms and keep firms small to be eligible for the particular incentive suggested, but this is seen as a worthwhile measure, giving incentive to individuals to start more businesses.

Assuming for the sake of argument that the government has made such a decision on which firms will be eligible, an incentive should then be given to investors, both individuals and companies, to invest in these smaller, younger, firms across Canada. The incentive can take several forms and government policy makers may prefer one form or another. Examples of these incentives are suggested here. One example is that any investment in a qualifying firm would not be taxable when it is withdrawn from that firm. Only the proceeds after the initial amount of investment had been withdrawn would be taxable, and this tax would be at income rates. Thus, individuals would have an incentive to turn this investment over on a regular basis. Whenever it was withdrawn from one investment, it would be worthwhile investing it in another firm to keep the venture capital cycle repeating itself. Many small businessmen and venture capitalists are subjected to the government philosophy of taxing investment long before any proceeds were obtained on that investment and such legislation would ensure that the original venture capital was maintained and reinvested, with only the money earned on that investment being taxed.

Another incentive would be the possible channelling of Registered Retirement Savings Plan investments into smaller firms. This would mean that the current investment limits of \$3500 or \$5500 would be permitted in a small firm classified as eligible under the above definition. The RRSP ceilings would be the same as current plans and the amount permitted would be the same as allowed currently. This would not drastically change the amount of investment which was sheltered from taxes, but would redirect some of the investment currently going into retirement plans into small firms, which would

serve as the retirement plans for those individuals. There should be as few restrictions as possible on firms which qualify for such investment and the registration procedure can be conducted through banks and trust companies in the same manner as it is currently done. These incentives should be permitted to individuals and, if desired, for companies such as venture capital firms. The first type of incentive suggested above would be more desirable for firms, however.

These incentives are similar to the SBDC legislation in Ontario, although far less restricted, and the SODEQ's in Quebec. However, these programs have both been limited in their types of investment and areas of investment. In addition, small businessmen do not like grants or refunds from government for their investment and prefer to have tax incentives for such programs.

It is therefore recommended that the federal government set up a program whereby all firms which currently qualify for the small business tax deduction are eligible for investments of this type. Amounts invested in these firms would then not be taxable when the investment is withdrawn but future proceeds on the investment would be taxable at income rates. This would give both individuals and firms incentives to invest in small businesses of all types across Canada, especially new firms which are created by individuals or groups of individuals. There should be no limit on the amount of this investment, since it is not a tax deduction and will not affect the amount of taxes currently being collected by various levels of government.

Should the various provinces wish to give additional incentives for investment in such firms, they can provide supplementary measures which would give individuals further incentives to invest in their province. For example, should the government of Prince Edward Island wish to increase investment in that area, they could provide a provincial tax deduction on amounts invested in this program in Prince Edward Island. This would give investors an additional incentive, beyond the federal government incentive suggested above, to invest in Prince Edward Island. This may mean the various provinces start competing with one another for the investment of funds across Canada, but that is the only way that funds are going to be redirected into more rural areas from the major Metropolitan centers.

In summary, this report has concluded that the rejections by venture capital firms of potential investments are not as severe as has been suggested in the public press in the recent past. Many of these firms obtained additional capital from other sources of capital, including other venture capital firms. But the sample that was provided by the venture capital firms for this study may be biased in the sense of being the more successful firms of the overall sample. Especially those smaller, younger firms actively involved in non high technology areas are probably finding much more difficulty in obtaining funds. It is therefore recommended that both federal and provincial governments should develop incentives for programs such as those suggested above to persuade both individual and company investors to channel more investment into smaller firms which still qualify for the small business tax deduction. These conclusions and recommendations are subject to some debate and the author

would be pleased to discuss them with any reader who wishes to respond to this study. He can be contacted at the School of Business Administration at The University of Western Ontario, phone number - (519)679-3228.

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Exhibit 1

VENTURE CAPITAL QUESTIONNAIRE

PLEASE RETURN TO:

PROFESSOR R.M. KNIGHT, SCHOOL OF BUSINESS ADMINISTRATION, THE UNIVERSITY OF WESTERN ONTARIO,
LONDON, ONTARIO N6A 3K7

FEEL FREE TO ADD EXTRA SHEETS IF THERE IS INSUFFICIENT SPACE PROVIDED FOR YOUR ANSWERS.

1. HAVE YOU EVER APPROACHED A VENTURE CAPITAL FIRM IN CANADA SEEKING FINANCING FOR YOUR COMPANY? YES _____ NO _____
2. WHAT WAS THE RESULT? RECEIVED FINANCING _____ TURNED DOWN _____ FINANCING OFFERED, BUT YOU REFUSED _____ OTHER (PLEASE SPECIFY) _____
3. WHAT WAS THE AMOUNT OF FINANCING YOU SOUGHT AND FOR WHAT PURPOSE?

4. WHAT OTHER SOURCES DID YOU APPROACH FOR THIS SAME FINANCING?

	APPROACHED	RECEIVED FINANCING	REFUSED FINANCING
CHARTERED BANK	_____	_____	_____
FEDERAL BUSINESS DEVELOPMENT BANK	_____	_____	_____
SMALL BUSINESS DEVELOPMENT CORPORATION	_____	_____	_____
FEDERAL GOVERNMENT PROGRAM (PLEASE SPECIFY) _____	_____	_____	_____
PROVINCIAL GOVERNMENT PROGRAM (PLEASE SPECIFY) _____	_____	_____	_____
INVESTMENT GROUP (PLEASE SPECIFY) _____	_____	_____	_____
INDIVIDUAL INVESTORS	_____	_____	_____
PRIVATE PLACEMENT	_____	_____	_____
AMERICAN SOURCES (PLEASE SPECIFY) _____	_____	_____	_____
OTHER (PLEASE SPECIFY) _____	_____	_____	_____

5. DID YOU RECEIVE FUNDING FROM ANY OF THESE SOURCES? YES _____ NO _____
6. IF SO, WHAT AMOUNT(S) AND ON WHAT TERMS? _____

7. DID THE AMOUNT OF FUNDING RECEIVED CAUSE YOU TO CHANGE YOUR PLANS? YES _____ NO _____
8. IF SO, HOW? _____

9. DID YOU PREPARE A WRITTEN BUSINESS PLAN FOR SUBMISSION TO THE SOURCES OF CAPITAL?
YES _____ NO _____
10. DID YOU RECEIVE INSTRUCTIONS FROM ANY OF THESE SOURCES ON WHAT THIS PLAN SHOULD CONTAIN? YES _____ NO _____

Exhibit 1 cont.

11. IF SO, FROM WHICH SOURCES? _____

12. WHAT INFORMATION DID THEY SUGGEST? _____

13. DID YOU RECEIVE OUTSIDE ASSISTANCE IN PREPARING YOUR PROPOSAL? YES _____ NO _____
14. IF SO, FROM WHOM?
- | | | | |
|------------|-------|------------------------|-------|
| ACCOUNTANT | _____ | FINDER | _____ |
| LAWYER | _____ | BROKER | _____ |
| BANKER | _____ | BUSINESS ASSOCIATE | _____ |
| CONSULTANT | _____ | OTHER (PLEASE SPECIFY) | _____ |
15. DID ANY OF THESE PEOPLE REFER YOU TO SOURCES OF CAPITAL? YES _____ NO _____
16. DID ANY OF THEM ASSIST YOU OTHERWISE IN RAISING CAPITAL? YES _____ NO _____
17. IF SO, HOW? _____

18. IF YOU WERE TURNED DOWN BY A VENTURE CAPITAL FIRM, WHAT REASON DID THEY GIVE FOR THE REFUSAL? _____

19. WHAT OTHER REASONS DID YOU BELIEVE CAUSED THEIR DECISION? _____

20. WHAT REASONS DID OTHER SOURCES GIVE YOU FOR TURNING DOWN YOUR REQUEST? _____

21. DID YOU REFUSE ANY OFFERS OF FUNDING BECAUSE OF THE TERMS? YES _____ NO _____
22. IF SO, WHY? _____

23. DID ANY OF THESE SOURCES OFFER OTHER SERVICES BESIDES FUNDING (E.G., CONSULTING ASSISTANCE)? YES _____ NO _____
24. WHICH OF THESE SERVICES HAVE YOU USED? _____
25. WHAT IS YOUR EVALUATION OF THESE SERVICES? _____

26. COULD OTHER INSTITUTIONS, SUCH AS GOVERNMENT, UNIVERSITIES OR OTHER BUSINESSES, HAVE ASSISTED YOU IN ANY WAY TO RAISE CAPITAL FOR YOUR FIRM? YES _____ NO _____

Exhibit 1 cont.

- 3 -

27. WHAT INSTITUTIONS, AND HOW? _____

28. ARE THERE PROBLEM AREAS IN THE PROVISION OF VENTURE CAPITAL IN CANADA TODAY? PLEASE
COMMENT ON WHAT THESE ARE AND WHAT CAN BE DONE ABOUT THEM.

29. COULD YOU PLEASE PROVIDE THE FOLLOWING INFORMATION ON YOUR FIRM?

INDUSTRY _____

SALES VOLUME IN \$ _____

NUMBER OF EMPLOYEES _____

SIZE OF MANAGEMENT TEAM _____

YEAR COMPANY STARTED _____

NUMBER OF SHAREHOLDERS _____

TOTAL ISSUED EQUITY CAPITAL IN \$ _____

TOTAL AMOUNT OF DEBT IN \$ _____

30. WOULD YOU BE WILLING TO MEET FOR A BRIEF INTERVIEW (LESS THAN ONE HOUR) AT YOUR
CONVENIENCE AND AT YOUR OFFICE, TO DISCUSS THESE ISSUES IN MORE DETAIL? YES ____ NO ____

31. WOULD YOU LIKE A COPY OF THE RESULTS OF THIS SURVEY? YES ____ NO ____

IF YOU ANSWERED YES TO EITHER OF THESE LAST QUESTIONS, PLEASE INCLUDE:

NAME: _____

ADDRESS: _____

TELEPHONE: _____

PLEASE USE THE REVERSE SIDE TO DISCUSS ANY OF THE ABOVE ISSUES FURTHER OR OTHER ISSUES
THAT YOU MAY WISH.

THANK YOU FOR YOUR ASSISTANCE

Exhibit 2

Results from Venture Capitalist

	<u>%</u>
Received Financing	15
Turned Down	58
I Refused Their Offer	6
Other	<u>21</u>
	<u>100</u>

Exhibit 3

Amount of Venture Capital Being Sought

<u>Amount in \$000's</u>	<u>%</u>
< 250	19
250 - 1000	37
1000 - 3000	30
3000+	<u>14</u>
<u>Average \$2875</u>	<u>100</u>

Exhibit 4

Purposes For Which Venture Capital Sought

<u>Purpose</u>	<u>%</u>
R&D - New Products	30
Expansion	16
Refinancing	14
Working Capital	18
Startup	10
Other	12
	<u>100</u>

Exhibit 5
OTHER SOURCES APPROACHED
FOR SAME FINANCING

<u>Source</u>	<u>Approached (%)</u>	<u>Received Financing (%)</u>
Chartered Bank	52	23
Individual Investors	42	26
FBDB	40	15
Provincial Government Program	39	16
Federal Government Program	34	18
SBDC	27	11
American Sources	26	11
Private Placements	24	13
Other (Corporations and Other Institutions)	16	5
Receive funding from some of above for same financing?		72%

Exhibit 6
AMOUNT AND TYPE OF FUNDING
RECEIVED FROM OTHER SOURCES

<u>Amount in \$000's</u>	<u>% Response</u>
<250	25
250-1000	38
>1000	37
Average amount = \$2280	

<u>Type of Funding</u>	<u>%</u>
Stock	38
Government Grant or Development Bank	22
Private Investor	10
Term Loan	10
Joint Venture	10
Line of Credit	7
Guarantees	3

Exhibit 7

AMOUNT OF FUNDING
CAUSE CHANGE IN PLANS?

Yes	46%
No	54%

<u>Type of Change</u>	<u>% Response</u>
Delay	33
Cut Back	21
Expand	16
Cancel	10
Slower Growth	10
Project Change	10

Exhibit 8

BUSINESS PLAN PREPARED?

Yes	98%
No	2%

RECEIVE INSTRUCTIONS FROM SOURCES OF FUNDS ON WHAT BUSINESS PLAN SHOULD
CONTAIN

Yes	55%
No	45%

FROM WHICH SOURCES?

Venture Capital	29%
All	19%

RECEIVE OUTSIDE ASSISTANCE IN PREPARING BUSINESS PLAN?

Yes	47%
No	53%

<u>Source</u>	<u>%</u>
Accountant	21
Consultants	19
Lawyer	16
Bankers	3
Finder/Broker	10

EXHIBIT 8

cont.

RECEIVE REFERRALS TO SOURCES OF CAPITAL FROM THESE PEOPLE?

Yes	64%
No	36%

ASSIST OTHERWISE IN RAISING CAPITAL?

Yes	39%
No	61%

EXHIBIT 9

VENTURE CAPITALISTS'
REASONS FOR REJECTION

<u>Reason</u>	<u>% Responses</u>
Amount too small	17
Insufficient Earnings	17
Industry	13
Economy Bad	10
Price too high	10
Deal too risky	10
Management Competence	6
Not Interested	17
Total	<u>100</u>

Exhibit 10

OTHER REASONS CAUSING REJECTION

<u>Reason</u>	<u>% Response</u>
Lack of Venture Capitalists's Knowledge	36
Venture Capitalist Fully Invested	19
Interest in Competitor	11
Too risky	8
Insufficient return	8
Too expensive	5
Firm undercapitalized	5
Poor timing	3
Too small	5
Total	<u>100</u>

Exhibit 11

REASONS FOR REJECTION
BY OTHER SOURCES

<u>Reason</u>	<u>% Response</u>
Lack of collateral	32
Poor fit with current investments	16
Economy poor	11
Insufficient earnings	11
Risky investment	11
Management Questionable	8
Investment guidelines (e.g., SBDC Program)	7
Other	4
Total	<u>100</u>

Exhibit 12

CLIENT REFUSALS, OTHER SERVICES
AND ROLE OF OTHER INSTITUTIONS

DID YOU REFUSE ANY OFFERS OF FUNDING BECAUSE OF THE TERMS?

Yes	55%
No	45%

<u>Reason</u>	<u>% of Response</u>
Excessive Control	52
High Interest Rate	13
Too much equity	13
Too restrictive	13
Other reasons	9
Total	<u>100</u>

Type of Controls:

- Board Members
- Control of Purse Strings
- Veto Over Expenditures
- Veto Over Salary Changes
- Venture Capitalist Interference

Exhibit 13

RESPONDENTS BY INDUSTRY

<u>INDUSTRY</u>	<u>% RESPONSE</u>
Electronics	46
Equipment	15
Marketing Retail-Wholesale	15
Aerospace	7
Oil and Gas	7
Communications	5
Chemicals	5
Total	<u>100</u>

Exhibit 14

RESPONDENT PROFILES
BY SALES AND EMPLOYEES

SALES VOLUME (\$000's)

% RESPONSE

<500	21
500-1500	18
1500-5000	21
5000-15,000	21
15,000+	19
Average	\$13.3 million

NUMBER OF EMPLOYEES

% RESPONSE

<10	30
11-30	20
31-100	21
101-250	18
250+	11
Average	132 employees

Exhibit 15
RESPONDENT PROFILES
BY MANAGEMENT AND FIRM AGE

Size of Management Team

% Responses

1 - 2

20

3 - 4

40

5 - 6

20

>6

20

Average = 4.5

Year Firm Started

% Responses

Before 1970

21

1970 - 1975

18

1975 - 1980

19

1980 - 1981

31

1982 - 1983

11

Average age = 11.1 years

Exhibit 16
RESPONDENT PROFILES
BY SHAREHOLDERS AND EQUITY

NUMBER OF SHAREHOLDERS

% RESPONSES

<5	56
6-10	11
11-25	11
26+	22
Average = 25	

Equity and Debt in Firm
(in \$000's)

% Response
Equity Debt

<250	39	31
251-1000	19	22
1001-2500	9	17
2500+	33	30
Average	\$4300	\$4500

Exhibit 17
FIRM LOCATION

<u>Location</u>	<u>% Responses</u>
Toronto	29
Other Ontario	27
Western Canada	24
Quebec	15
United States	4
Eastern Canada	1

INDUSTRY CANADA/INDUSTRIE CANADA



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