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COMPETITIVENESS IN THE '90s

Financing

COMPANY CASE STUDIES FROM B.C.

Canada

Competitiveness in the '90s

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Foreword

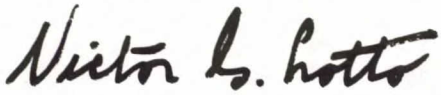
This is one of five sets of case studies undertaken by Industry, Science and Technology Canada, British Columbia to look at the strategies employed by B.C. companies to make themselves more competitive in the marketplace. While this set looks at financing, others in this series look at export to the U.S., environmental performance, management of technology and management of human resources.

What follows are the stories of five firms scattered around the Mainland of British Columbia that, while not a scientific sample, come from a variety of sectors – high technology, tourism-related, and wood products. Their sales range from under $1 million to $34 million. They have all successfully used strategies related to financing to enable their firms to grow and compete, and a look at their strategies can be quite useful.

It merits mention that a number of the mechanisms used by these particular firms to help obtain funding are no longer available, notably the federal Scientific Research Tax Credits and (at the time of writing) all business assistance programs formerly offered by the British Columbia government, including those relating to loan guarantees and the formation of Venture Capital Corporations. In the absence of alternatives, this would seem to add a degree of difficulty to raising start-up funds.

Also worth noting is that despite our division of these case studies into categories, all these successful firms' strategies have to some extent been multi-faceted. None relied purely on a financing initiative, for example, nor on the implementation of technology to improve competitiveness, and we have had to use judgment in deciding what aspect was really key to the firm's success.

In the end, these are intensely personal stories. Many B.C. firms are small, and their key people – with their talents and limitations – wield great influence over the direction of the firm and its destiny. We are grateful to these companies for taking the time and trouble, in these trying economic times, to share their stories with us and for their insights into the ways British Columbian and Canadian companies can compete in the 1990s.



Victor Lotto
Executive Director
Industry, Science and Technology Canada
British Columbia and Yukon

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Spectrum Signal Processing Inc.

Located at Discovery Park in Burnaby, Spectrum Signal Processing Inc. is the fast-growing "turnaround" of Pacific Microcircuits Ltd. (PML), now an inactive company. PML once made custom-designed computer chips for use in Mitel's advanced communications products, but this relationship did not survive the foreign takeover of Mitel, and a subsequent attempt to sell standard chips was eventually abandoned.

In its place, Spectrum Signal Processing Inc. was formed, in August, 1987. All of the owners of PML were offered shares in Spectrum but Ventures West and the Federal Business Development Bank bought out the rest. Michael Mertens, who had been with PML for eight months, was named President. The new company targeted a different market that in his words is, "one notch up in the food chain": the design and manufacture of circuit boards (using others' chips), for a multitude of digital signal processing applications. The firm's latest annual report, just off the press, states that sales grew during 1990 by 89% to $4.5 million. Net earnings turned positive for the first time in the company's short history, indicating that Spectrum has already graduated from its start-up phase into profitability.

Emphasis on Business

One of the key factors in Spectrum's competitive strategy is the emphasis the company places on its financial affairs, especially compared to high technology firms that are "run by engineers" who may lack a financial orientation. Michael Mertens has a combined university degree in Business and Computing Science and the experience of having participated directly in four business start-ups (although this is his first as CEO). In the process, he claims to have learned "what not to do" on the business side.

Other members of the management team also share a mixed technical and financial background. The Vice President Finance and Administration, and co-founder of Spectrum, is Brian Alexander, a chartered accountant with a diploma from BCIT in Electronics Technology. Another Vice President, Barry Jinks, is responsible for both marketing and engineering.

In fact, Spectrum was not initially a "technology driven" company like so many in the electronics industry. Rather it was conceived to exploit a certain market opportunity: the potential demand for digital signal processing (DSP), which promised to be one of the fastest growing technologies of the 1990s.

A Product Line and A Partner

Spectrum's current Product Catalog is a weighty document nearly seventy pages thick, listing some fifty separate products with prices of $1000 to $7000 per circuit board quoted – appropriately enough – in U.S. dollars. As much as 78% of production is exported. That the company has been able to get so many products on the market this quickly is due to its initial strategy.

In the dying days of PML, Michael Mertens (then Vice President of Marketing) recognized the potential North American market for DSP technology. Yet he figured the company had a "window" of only a year to get a foothold in it, not nearly long enough to undertake

product development from scratch. His solution was to negotiate a technology licensing agreement with Loughborough Sound Images (LSI) of Britain, one of the leading suppliers of DSP boards in Europe. However, by the time the deal was finally signed, it was not PML but Spectrum which obtained the manufacturing and distribution rights in North America.

This was not strictly a technology/marketing arrangement. It was a deliberate financial strategy for a new company that needed to conserve cash. In exchange for the rights, LSI received one million "earn out" shares in Spectrum. These are held in escrow and drawn by LSI at a rate that corresponds to Spectrum's sales of its products. "Earn-out shares provide an automatic performance clause," Michael Mertens notes. In order to get paid, LSI has had to continually supply marketable, leading edge products. And it has done so: to date, LSI has earned 600,000 of the shares.

Share Issues

The earn-out shares were part of the first round of seed financing for Spectrum. In all, a total of 1,866,000 shares were issued in August, 1987 at $.25 each. The balance of the $467,000 in proceeds came from the two earlier sources of venture capital, Ventures West and the Federal Business Development Bank, along with Michael Mertens himself and his family and friends (as legally permitted for seed financing.) A year later, a second round was obtained by way of a $300,000 loan from the same pair of venture capital institutions, convertible to 750,000 shares at $.40 each.

Then in June, 1989, less than two years after the company was formed, Spectrum made its Initial Public Offering (IPO) on the Vancouver Stock Exchange. One million shares were issued at $.75 each; $750,000 was raised. The costs involved were very high, however. In financial terms, Michael Mertens estimates the cost of the IPO at about $230,000, and there were further large costs in time and energy that he and other members of the management team had to devote to the process – at a stage when the firm's growth rate demanded their constant attention. "The IPO was a real shock for a neophyte", he recalls. Not only did it consume considerable resources, but he had to deal with people in the brokerage business who, unlike his venture capital partners, exhibited no intrinsic interest in Spectrum. If he had it all to do over again, Michael Mertens says, he would wait longer before going public.

At the other extreme, the next group of investors could hardly be more interested in the company. Toward the end of the second quarter of 1991, Spectrum plans to establish an Employee Share Ownership Plan which will permit its 31 employees to buy shares at a discount. A number of them have already purchased shares through the stock market, so this program is more a demonstration of company philosophy. Michael Mertens wants everyone to have "a piece of the pie".

Government Funding

Spectrum's financial strategy has also included a measure of government funding. In April, 1990, the company received a B.C. Science Council grant in the amount of $148,000. This launched the next phase in the company's evolution: development of its own family of proprietary DSP products aimed at the makers of "multi-media" systems, which integrate audio, video and voice components into personal computers. A second Science Council grant in the amount of $175,000 was awarded in April, 1991. The proceeds are intended to develop further products for the company's "Media Link" product family. The company has also been granted $125,000 of financial assistance from the federal Program for Export Market Development (PEMD) to help offset the cost of opening a California office in June, 1991.

More recently, however, the company has learned that government sources of capital can prove to be very risky. Management had painstakingly structured a $700,000 financial package that would have come together in April, 1991, to cover the cost of a dramatic increase in manufacturing capacity and export effort. The federal Western Diversification Program was to contribute toward the marketing of new product introductions; the B.C. Trade Development Corporation would put up guarantees to back U.S. contracts; and the B.C. Ministry of Regional and Economic Development would lend money for purchase of computer and lab equipment and other additions to the physical plant, as well as guarantee a loan from the Bank of Montreal. The level of government funding would be matched, in turn, by Spectrum's venture capital partners, Ventures West and the Federal Business Development Bank.

Then in late April, 1991, under a new Premier, the British Columbia government abruptly cancelled its business assistance programs. Spectrum's applications had gone through all of the necessary approvals at the officials' level and were awaiting only Cabinet approval – which ordinarily would have been rather a formality at this advanced stage. But now both the $1 million package and Spectrum's expansion plans were suddenly in grave jeopardy.

At the time of writing, it is too soon to say how Spectrum will resolve this situation. Characteristically, Michael Mertens appears philosophical – and prepared for this contingency. "We'll just go to Plan B," he declares.

Advanced Light Imaging Technologies Ltd.

Advanced Light Imaging (A.L.I.) Technologies Ltd. of Burnaby was launched in 1986 to develop and market the product concept of an Edmonton radiologist for the detection of breast cancer using infra-red light. Although A.L.I. actively pursued the idea for a while and still continues to nurture the development of the technology, greater familiarity with the medical market caused the firm to alter its course in late 1988, switching out of "light" and into "medical image management". In terms of actual products, that means local area networks for ultrasound machines in hospitals and clinics.

Immediately after the pivotal decision less than three years ago, a prototype network was quickly "cobbled together" for a major trade show in the United States – and received an enthusiastic reception. Since that time, a relationship with Siemens has been cultivated and this multi-national supplier of ultrasound machines signed as A.L.I.'s distributor. A number of pilot sales have been made yielding around $225,000. For the time being, A.L.I. buys "off-the-shelf" components and provides the assembly and quality control – and of course, the technology required to do so.

Company "Angel"

At the moment, A.L.I. is owned by Vancouver entrepreneur, Milton Wong (74%), the British Columbia government's high technology venture capital arm, Discovery Enterprises (18%), and the balance by the three senior executives of the company and the original inventor.

One of these owners is Peter van Bodegom, the Vice-President Finance, a Chartered Accountant with an MBA and a previous background in bringing "management and money" to bear in restructuring companies in receivership. He has been with A.L.I. from the very start and, looking back, he says they have tried the "gamut" of financial strategies, with the exception of a public share offering.

Initially a new business has to "live off cash", and this came from the first pair of owners: the Edmonton radiologist mentioned above and a friend of his, an airline pilot, who regarded A.L.I. as a "pet project". Their seed money was used to recruit the management team: Christopher Hanna, President; Len Grenier, Vice-President Engineering; and Peter van Bodegom, all of whom eventually became shareholders.

The job of fund-raising was given to Christopher Hanna. Through contacts developed earlier in a Vancouver brokerage house, he found Milton Wong who has proven to be A.L.I.'s generous, continuing "angel". What primarily interested Milton Wong about the new company was the invention itself – his own wife had suffered from breast cancer. In stages, beginning in November, 1986, he invested $1 million.

In order to accommodate this investment, A.L.I. changed its legal and financial status from that of corporation to that of limited partnership. Under this arrangement, all losses or earnings are allocated to each of the partners; there are no retained earnings. At the time, limited partnership status also qualified the investors for investment tax credits for scientific research (since discontinued). As a

consequence, the net cost of Milton Wong's initial investment was reduced through write-offs of losses and the tax credits.

Despite subsequent unfavourable changes in the tax system and the firm's shift away from light imaging technology, Milton Wong has "kept the money coming". This kind of "patient, long-term support" is exactly what a new business needs to get established, Peter van Bodegom explains. Not that Milton Wong has remained a passive investor over the years. On the contrary, he has taken a more active role in the company and now serves as Chairman of the Board.

A Lesson Learned

It took A.L.I. a full year to raise enough cash to get the business going, drawing on revenues from the odd sale, personal borrowings, and Milton Wong's instalments. Then, in November, 1989 Discovery Enterprises came on board with $750,000.

Discovery Enterprises also identified a recruit from a large American corporation to replace Christopher Hanna in the company presidency, and to take over fund-raising responsibilities. However, the new President lasted only five months at A.L.I.. He was "out of his element", Peter van Bodegom recalls. Essentially a bureaucrat rather than an entrepreneur, "he had been used to calling the corporation's finance department when money was needed," and simply "could not deal with the day-to-day muck of finding cash while at the same time trying to sell a vision to investors."

Late last year, Chris Hanna was re-instated as the President, Milton Wong provided a fresh infusion of money, and the federal Western Diversification Program approved a major loan ($822,000) to assist with inventory, product development and marketing. A.L.I. also hired a Director of Sales – this time the company is sure it has the right person for the job because of his extensive experience in marketing ultrasound machines, and his own belief that the company is on the right track based on first-hand knowledge of how the technology is evolving.

Long R & D Mode

The financial challenges faced by A.L.I. undoubtedly have been complicated by its "extra long R&D mode", spanning nearly five years to date. During the past two and a half years, the company has had to manufacture and generate customers for "demonstration" products, and simultaneously carry out the further research and development required before entering the marketplace to a significant degree.

As this has occurred, Finance VP Bodegom has faced more than ordinary challenges. In order to contribute effectively to the corporate decision-making at A.L.I., he has had to develop an understanding of both the technology his engineering colleagues may be promoting and the possible alternatives. Yet his participation rounds out the management team, and serves as one factor which investors definitely consider.

Indeed, Peter van Bodegom has found that "financing depends on the people involved". In order to attract investment, the company must have a credible management team, possessing complementary strengths. Interestingly, adjustment to competitive pressures on the part of large firms in the economy can benefit smaller firms by releasing valuable human resources – because major corporations are now down-sizing, he notes, a pool of good people has become available for growing businesses which need to bolster their management capability. A.L.I. will soon, once again, put its own credibility to the test in a campaign to attract United States investors.

BLACKCOMB
AT WHISTLER

Blackcomb Skiing Enterprises Ltd.

The world-class ski resort on Blackcomb Mountain north of Vancouver opened in 1980 as a modest facility for day skiers from around the area. Over the years, the number of winter skier visits has increased more than ten-fold, to an estimated 740,000 in the 1990-91 season. Now skiers come from as far away as Japan, Australia, California and Eastern Canada. Summer traffic, once non-existent, brings almost 100,000 people up the mountain in the off-season.

Blackcomb Skiing Enterprises Ltd., the operating company, reports equally impressive figures. Employees number between 300 in the summer and 1100 during the peak period. Sales in 1990 from both skiing and food services amounted to approximately $34 million, not including the proceeds from real estate.

David Brownlie, Director of Finance, notes that there are a variety of reasons for Blackcomb's success. These include its location, the vision and drive of its management team, notably CEO Hugh Smythe who has guided the project all along, and the quality of the whole skiing experience which has been created on the mountain.

Obviously, one key to this large a development was correspondingly large financing. How was it done?

Financing Stages

The Aspen Ski Corporation, as it was originally called, started with the help of equity financing from the Federal Business Development Bank. However, there was little money to spend on lifts, and the operation was soon seriously undercapitalized. Growth would only be possible if additional financing could be found.

In 1986-87 the management of Blackcomb did just that. Intrawest Development Corporation, a young, aggressive property development firm, was persuaded to purchase the controlling interest. But in the process, Intrawest took on a large debt burden which has become an impediment to growth. (Although in February, 1991, Intrawest went public, with shares traded on the Toronto Stock Exchange, these equity funds have not made their way to Blackcomb; they are being channelled to other real estate projects or the possible acquisition of more ski resorts such as Mont Tremblant.)

Having gone through two distinct phases of financing, David Brownlie notes, Blackcomb now faces the prospect of a third. The whole financial structure must be re-evaluated in the months leading up to October, 1991, when Intrawest is scheduled to buy out the Federal Business Development Bank's interest in Blackcomb. Brownlie is searching for the right mix of debt and equity to facilitate Blackcomb's continued growth.

Provincial Policy

If the details have varied from one ski resort to another in British Columbia, the financial structure of them all has followed the pattern essentially prescribed by the provincial government's ski area development policy, formulated in the late 1970s. Under this policy, the Province grants mountain leases to companies which, in return for their investment in "up hill" capacity, can earn rights to purchase Crown lands for real estate development at the base of the mountain.

In 1979, such a lease launched the Aspen Ski Corporation. Since then, the ski development on Blackcomb Mountain and the corresponding real estate development in the Whistler area have been coordinated. Improvements to the ski area have earned land, which has then been developed and subsequently either sold or used as collateral to obtain debt financing. The proceeds have been invested in additional capacity on the mountain, and so on. Over the past five years alone, Blackcomb Skiing Enterprises has spent over $50 million on its skiing facilities and services, of which $22 million has come from real estate profits, and the balance from operations.

Skiing and property development are linked even more directly in the current endeavour. As part of a plan to provide "ski in, ski out" access for Blackcomb's guests and to generate capital for future expansion, the operating company and Intrawest are embarked on a 254 acre real estate project known as The Resort at Blackcomb. Now partially complete, it involves new accommodation right at the base of the mountain (a total of 7500 beds including the Chateau Whistler), and an 18-hole golf course, as well as bars, shops and restaurants.

Compatible Financial Partners

David Brownlie encourages companies wherever possible to "seek out compatible financial partners that suit the long-term needs of the business", ideally without compromising control – particularly in the highly competitive tourism industry where margins are small and tight financial management must be maintained. This can be done, he says from experience, without putting one's personal money at risk.

Yet Intrawest takes a very active part in Blackcomb Skiing Enterprises and David Brownlie finds he does appreciate having the parent company's direction. He believes that more input results in better decisions. At the other end of the spectrum, however, Blackcomb has received investment capital from a different kind of source that carries with it virtually no control at all. Blackcomb is the beneficiary of $5 million from two Venture Capital Corporations, formed under provincial legislation, which re-invest pension funds in the company at arm's length.

The number of skier visits to the Whistler area is expected to continue to increase in the coming years as the resort's reputation spreads around the world. Blackcomb Skiing Enterprises forecasts that it will be entertaining 750,000 skiers annually throughout the 1990s. Whatever Blackcomb's future financial "growing pains" might be, the prospects of growth itself are certainly excellent.

Creo Products Inc.

Creo Products Inc. has been in business since October, 1983 in Burnaby, making different products that combine precision mechanics, optics, and electronics. Over the years, a variety of these have been specially developed and manufactured under contract, providing a source of funds for the company and marketable spin-offs from the technology.

Creo's own commercial product line began with a laser photo plotter engine which won a design award in 1989 from the B.C. Electronic Manufacturers Association. Creo sells this engine to an Israeli firm, Optrotech. Optrotech in turn adds more hardware and electronics, to produce a stand-alone unit which fills a niche market worldwide.

However, Creo's "lifetime" project has been the development of an optical tape recorder. Research began in 1984 with a grant from the Science Council of B.C., and was followed by a $500,000 contribution from the National Research Council which helped to prove the feasibility of the technology. The first production unit was sold in 1990 to the Canadian Centre for Remote Sensing – and the federal government later proved to be among Creo's best customers, buying a total of seven units for different applications. Sales also have been made to the United States, England, and Australia.

Most recently, in April, 1991, Creo landed a deal in Japan to develop a new product for the Japanese market; it will be manufactured in Canada. Today the company employs 72 people and rings in annual sales in the $5-8 million range.

Financial Discipline

Creo has been profitable six years out of seven, probably more by good business policy than good fortune. One of the co-founders of the firm is the CEO, Ken Spencer, an engineer with an MBA. (The other was Dan Gelbert, a colleague from earlier days at MacDonald Dettwiler.) Ken Spencer takes pride in the financial record – in fact, the financial discipline – of Creo Products.

On the subject of how to grow a company, Spencer holds some decided views. Creo was launched with a $200,000 grant from the Science Council – which was parleyed into four production contracts valued at $2 million. It was then decided to "bootstrap" the company, in other words to make it live within the means afforded by operating revenues. Spencer was not tempted to use Scientific Research Tax Credits (SRTCs) then available. You could identify the companies that enjoyed SRTCs, he says, from their extravagant leasehold improvements and the number of expensive company cars in their parking lots. He suspects that the same wasteful attitude and lack of focus were carried into their boardrooms. Creo would be better off if the company were forced to become profitable, to learn how to control costs, and to focus on the bottom-line.

A consequence of this policy was that the development of Creo's optical tape recorder had to be interrupted for production of the photo plotter – the company needed to make some money. However, this financially-driven expedient proved to be the right thing for the fledgling business. In retrospect, Ken Spencer has seen that the optical

tape recorder was too ambitious as a start-up project – it could not be gotten to market quickly enough. By contrast, the photo plotter really enabled Creo to build its manufacturing capability.

Venture Capital

Company policy notwithstanding, Ken Spencer did feel the need to look for extra working capital when the photo plotter went into production. He approached four venture capital institutions and came away with three offers of $1.5 million. Creo chose the Federal Business Development Bank – but merely used the funds as a hedge. Now, Ken Spencer explains, he "could sleep nights. The money is actually still in the bank."

Creo employees have also become shareholders. Under a specific program, new employees are given shares in the company after one year of tenure, and all employees receive additional shares each year, allocated "on the basis of their contribution to the firm."

Secrets of Success

Ken Spencer sits on the Science Council of British Columbia and serves as chairman of all the granting committees – each year this body provides $12 million in grants to foster the development of promising high technology projects. In assessing projects for funding, the Science Council scores four factors: Is this an original development? Will there be an economic return to British Columbia? Does the company have the expertise necessary to handle the technology? Is the management team capable of exploiting the commercial opportunity?

Most applicants fail on the basis of the fourth factor, Ken Spencer finds. Their technology-driven companies do not have the necessary marketing capability. In the case of the Science Council grant that launched Creo itself, it helped that both founders were not afraid to tackle the export market, owing to their previous experience at MacDonald Dettwiler and Glenayre Electronics.

Yet even today, Ken Spencer admits there are few role models in B.C. who have succeeded in running even $100 million businesses, let alone anything larger, on a world scale. As for Creo, the company has just hired a new Vice President Marketing, recruited from California where he headed a high technology firm. It is encouraging to hear Spencer say that the new VP, with his top-notch marketing credentials, has been attracted to British Columbia by the plentiful "good technology" here that remains to be exploited commercially.

A Fraser Valley Dry Kiln Case

This firm preferred to remain anonymous, for the reason that its story is highly intertwined with that of its main customer. It operates a custom kiln-drying facility located in the Fraser Valley. Now in its second year of operation, this kiln-dryer expects to have sales of over $400,000 by the end of the current fiscal year.

The two chambers of the company's kiln can process 550,000 board feet of wood fibre (western hemlock) per month – a relatively small capacity in an industry having perhaps 20 such plants in the Lower Mainland alone, but, for the firm's main customer, a very key capacity indeed.

A large part of the kiln-drying company's business to date has come from its main customer, a lumber re-manufacturing firm which takes the dried wood and makes it into window frames, doors, and staircase railings and spindles for markets in Canada, the United States and offshore. The kiln-dryer and its customer are located adjacent to one another. In fact, the head of the customer firm was instrumental in the creation of the kiln-dryer – he needed to find a way to reduce his operating costs.

Economic Struggle

The lumber re-manufacturing sector of British Columbia's forest industry has been struggling through very tough economic times, and even well-managed and adequately capitalized plants can find themselves in real jeopardy. Only some of the recent difficulties include the recent recession, high exchange rates, and a countervailing duty on lumber exports to the U.S.. There has also been another recent development – pressure from European buyers to ship dried wood instead of green lumber for export. The latter is treated with a fungicide and wood preservative which is considered toxic.

The lumber re-manufacturer mentioned above figured that by having closer access to a custom drying kiln, he could save a significant amount of money – which proved to be true. In trucking costs alone, the savings per 1000 board feet have been notable. Costs of handling have decreased – the lumber re-manufacturer can use his own fork-lift and transfer smaller lots – and this has further advantages for inventory control. As yet other benefits, if only because the main customer's orders are of greater importance to the kiln-dryer than they would be to a larger, more impersonal facility, turnaround time is faster and the quality of drying better, too.

Mutual Benefit

Despite such arguments, however, the lumber re-manufacturer alone was not able to finance the construction of the kiln, at a cost of some $600,000. The current head of the dry kiln company was at that time a lumber buyer in the area. With encouragement from the lumber re-manufacturer, he became interested in building and operating the kiln. After all, the close proximity to the customer would work to his advantage too. Not only would his dry kiln be in the enviable start-up position of having a secure customer for the plant's entire initial capacity, but the two companies could split property and office overhead costs.

However, it was clear that the set-up process required outside professional help; it was far too complex to be handled by the accounting staff of a small company. Don Ralston, a Vancouver-based Chartered Accountant in public practise, is credited with choosing the financial mechanism and structuring the arrangement. The deal that Ralston eventually put together involved, as he puts it, the existing and the new companies "getting into bed together...at arm's length".

Venture Capital Corporation

Under provincial legislation in British Columbia, a Venture Capital Corporation (VCC) can be established for the purposes of channelling funds into investments which are eligible – where eligibility depends, among other things, on the relationship with the VCC being at arm's length. Once registered, the VCC receives a provincial tax credit valued at 30% of the investment capital. (It should be noted that a recent decision of the British Columbia government under Premier Rita Johnson, to terminate all business assistance programs, means that this option of financing a new company is now under review and might be altered in some way.)

The lumber re-manufacturer borrowed from a bank to establish a VCC – the tax credit being a crucial element, accelerating the decision to make the investment at that time. The newly-created VCC had to assign the tax credit to the bank as security for the loan. (At the time, this was a controversial procedure and required government acceptance that it did not violate the spirit of the legislation.)

The new VCC, in which others participated as well, then invested the funds in the kiln-drying competition, acquiring a 50% interest, leaving control to the new head of the kiln-drying firm and his partner, the office manager.

Share Structure

The control was left with the kiln-drying managers because the bureaucratic rules would not permit the VCC to control the kiln-dryer. Moreover, the owner-managers of the kiln facility were contributing human capital (in the form of their expertise) to the new company in greater proportion than the relative value of their financial investments. Therefore, the question arose of how to manage the share structure. How would a very large financial investment translate into something less than a controlling interest given the disparity in the level of finances from the two main sources?

In order to accommodate these factors, Don Ralston created two levels of shares: common shares and preferred shares, and within the latter category, two classes having different par values yet equal voting rights. The Class A preferred shares had a very high par value and were issued to the VCC; the Class B preferred shares had a low par value and went to the kiln-dryer CEO and his partner. In this way the unequal contributions were balanced and the requirement of an arm's length relationship was fulfilled. (In operational terms, the requirement has put pressure on the kiln-dryer to find additional customers so that it does not serve merely as a branch of the lumber re-manufacturer.)

Despite the "gymnastics" demanded by this deal, Don Ralston says it took just a month to complete. However, he himself is no novice in these matters. A venture capitalist, his experience included establishing one of the funds designed to pool and re-invest monies from business immigrants to Canada.

Ralston has some interesting tips to offer to businesses seeking to obtain government assistance. One is "don't try to do the deal by correspondence", the route most small companies attempt because of their lack of time and resources. Instead, his approach is to get everyone concerned into a room and insist that, "we are not leaving here until we all agree on whether or not the application warrants approval". Another piece of advice – necessary before getting everyone into that room – is, "know the rules in advance so the proposal does not have to be revised", causing a loss of credibility that cannot be recouped.

Environmental Boost

Despite adverse general economic conditions for the wood products industry as a whole, the kiln-drying company's head is optimistic about his company's prospects. Kiln-drying, he believes, is a "growth industry" in British Columbia, given the mounting environmental pressures in Europe. And to back up that belief, his company may add a third chamber to its facility to capture some of the new business.

Conclusions

The Skills for Finding Finances

Raising money is a particular skill that needs developing – or special recruiting. Bring in experienced outside professional help, if necessary, to bolster the company's financial capability, in order to structure complex deals (rather than be scared off).

On the management team, balance engineering or other technical knowledge with business credentials, especially in marketing.

Check whether people recruited from large firms really have the ability to perform in a small business; still the down-sizing of major players in some industries is providing a pool of experienced talent in the areas needed by growing companies – most notably in marketing.

Financial colleagues will need time to learn the technical side of the business in order to make their best contribution to joint decision-making.

Learn the eligibility rules for government funding programs and develop a strategy in advance to improve the chances of approval.

Getting Started

Gear the type (and obviously the scale) of external financing to the phase of the company; different types, especially the mix of debt and equity, will be appropriate to different phases.

"Boot-strapping" imposes an immediate financial discipline on a new business, forcing management and staff to control costs and focus on the bottom line from the beginning – good business habits for the long haul.

Through licensing the technology of well-respected foreign firms in the North American market, a new company can gain a share of the market and finance its own product development.

Raising money can take time. Don't make delivery commitments too soon.

Persistence pays.

Plan your financing as if you intend to grow, not plateau early.

Product development and financial needs must be preconceived and made part of the business plan.

Know your strengths and weaknesses.

Discipline and care/caution are needed very early, in financial management.

Sources of Funds

In competitive industries facing a cost squeeze, one way for existing firms to realize cost savings is to help spawn new businesses created for mutual advantage; conversely, for would-be entrepreneurs, seek opportunities that provide custom service to established firms.

In the field of high technology, contract production is a way to finance the company's own product development.

Don't be afraid to tackle the export market.

Earn-out shares provide a way to conserve cash under a technology licensing agreement and also ensure continued performance.

Understand that an Initial Public Offering will be costly and time-consuming and will distract the attention of management away from nurturing a company's growth; therefore the timing should be carefully considered. Do cost-benefit analysis on both this and on government financing.

Financing can be gotten indirectly, through creation of a second company.

Enable employees to participate as share-holders.

Seek a Partner with an Interest

Look for financial partners who are compatible with the company's long-term interests, in terms of the nature of the business.

Nothing beats "long-term, patient money" (equity).

Locate an "angel" if you can, a financier with a personal interest in the company and it's products.

While the ideal is to raise funding that carries with it little or no control, there are benefits to having input from others; more participation tends to make for better decision.

Venture capital doesn't necessarily mean loss of control.

Look to suppliers/customers for participation.

Get Ready For Plan "B"

Government sources of capital can be risky because they are vulnerable to sudden policy shifts. Watch government policy changes for the impact/opportunity re financing. Have a contingency plan.

Allow unsuccessful ideas to die, and change the direction as warranted; take advantage of the flexibility small companies have to manoeuvre.

Look for creative solutions to save cash flow.

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