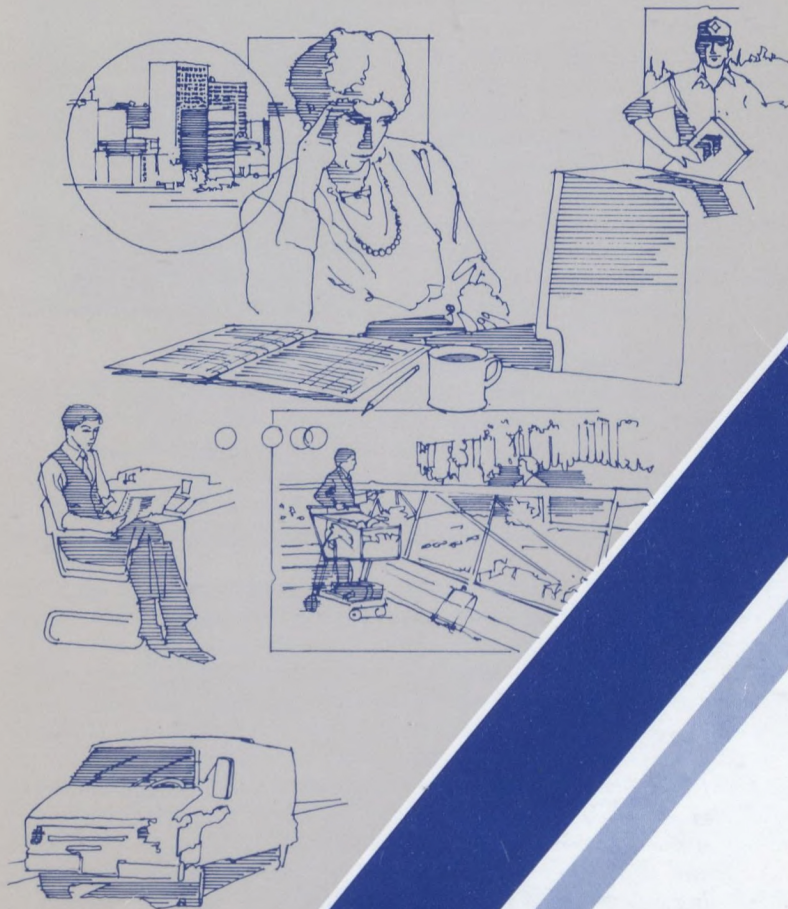


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Canada

c. 1 aa INVESTMENT IN SMALL BUSINESS:

A Guide for the Community



Government
of Canada

Gouvernement
du Canada

Regional Industrial
Expansion

Expansion industrielle
régionale

Minister of State
(Small Businesses)

Ministre d'État
(Petites entreprises)

It should be noted that this document contains references to tax initiatives on small business investment. They are included to provide a simple illustration of how the community can use existing measures to help local business development. In case of conflict between this document and relevant legislation, the legislation will govern.

The characters, businesses and examples depicted within this publication are fictitious and used for illustrative purposes only.

A Message from the Hon. André Bissonnette Minister of State for Small Businesses



Over the last year we have heard a great deal about the importance of small businesses to economic renewal, regional development and job creation. Following a round of national consultations, the Budget of May 1985 indicated clearly this government's strong commitment to the small business sector. Extensive measures were introduced to stimulate investment in small businesses, improve cash flow and help entrepreneurs achieve financial security when they retire.

These benefits are explained in a publication by the Small Business Secretariat entitled *Meeting the Challenge of the 1985 Budget: A Guide for Small Business*. The 1985 Budget illustrates the government's approach — to remove obstacles and put in place a climate for business renewal. Now it is up to the private sector, and especially small business, to use this environment to produce profits and jobs.

My ongoing consultations with small businesses, the provinces, the academic community and business associations have illustrated dramatically how community and regional differences influence small business needs. A higher priority issue in one part of the country may not be a problem in another because of the different operating environment of each. In response to their particular needs, communities across Canada are developing a great variety of new, imaginative initiatives to encourage business investment and job creation. Perhaps because of the community-integrated approach, the ideas are accompanied by a high level of commitment and excellent success.

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TECHNOLOGY CANADA

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Replacement copy

This guide outlines some of the ideas and methods that are working in Canada today. It discusses how the community can assist entrepreneurs and investors in using the 1985 Budget measures to enhance these initiatives and increase the successful flow of funds to small businesses. It is not a book with easy answers but a book with ideas.

The next year will be an exciting one. The Budget measures will bring results if we work together.

A handwritten signature in cursive script, reading "André Bissonnette". The signature is fluid and stylized, with a large initial 'A' and 'B'.

André Bissonnette

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Introduction

This is the story of Canville, a community like any other in Canada. The prosperity enjoyed by Canville over the years no longer comes as easily as in the past. In the last five years three major plants have shut down putting many people out of work. Laid-off workers are finding it difficult to get new jobs. Many younger people, unable to find permanent work locally have left for larger cities.

Richard Martin, Mayor, has invited several of Canville's leading citizens to join him for a breakfast meeting to discuss ways in which they can help stimulate employment and economic growth in the community. Representatives from the Chamber of Commerce, the local economic development corporation, the Kiwanis, the Multi-Cultural Association, area industries, banks, local unions and local professional associations are present at the meeting.

Richard begins the meeting by saying that small business development seems to be the way to stimulate the economy and create employment in Canville. To illustrate, he tells the recent success story of a local gardening supply manufacturer who has expanded into industrial landscape equipment and is now one of the major suppliers in the province.

He continues by pointing out that there are many other people with good ideas who would like to start up or expand their existing businesses. Their biggest problem seems to be a lack of financing.

Dan Landry, 48, was laid off a year ago and started his own business. Dan has developed a new industrial paint applicator that could be marketed all over the world. However, he is having difficulty raising the \$100 000 he needs to expand his production capacity.

Helen Tymchuk, 23, has just finished university and wants to start her own computer software company to continue work on the products she designed at the university's technology centre. Helen needs \$50 000 to complete the first products. She can raise half of that amount from friends and relatives.

The president of the Chamber of Commerce interrupts Richard to add that he knows of several people in town who would be prepared to invest in smaller businesses.

Michael Raymond, 39, a professional, wants to invest a portion of his savings in a small business that can provide capital gains in the future.

Suzanne Roy, 55, has recently taken early retirement from her position as Chief Accountant at a large plant. She received a large lump sum retirement allowance and would like to invest some of it in a business where she might obtain a job as part of the investment deal.

A local accountant mentions that some of the federal government's tax measures are aimed at helping make money available to small businesses. These measures could be used to attract money from larger cities to Canville as well as making small businesses more attractive to local people. He also suggests that perhaps some of the pension funds of the municipality and large firms might be available to finance small businesses.

At this point Richard summarizes by saying that a number of interesting ideas have been raised. There are creative business ideas and potential investors in Canville. Leaders of the community need to find ways to help money flow from the investors to our local business initiatives. Richard informs the group that Janine Bernard, Canville's economic development officer, will research the ideas raised and they will meet again to discuss the results.

This guide is intended to help communities like Canville by providing them with some options to consider in the development of their efforts for local economic renewal. It illustrates how funds for local business enterprises can flow from three sources:

- local residents,
- local institutions, and
- investors outside the community.

The measures described have worked and are working now in communities all across Canada.

Financing by Local Residents

A portion of the substantial savings in retirement funds is now available for small business investment. In addition, the \$500 000 capital gains exemption makes investment in small businesses more attractive. The following section describes some of the ways in which investment by Canville's local residents can be encouraged.

<p>Making it easier for local people to invest in local companies.</p>

1. Community Matchmaking Service

A number of Canville residents have invested in small businesses of their own or in those of family and friends. However, as we have seen, there are people in the community who want to invest but can't find the right small business. There are also entrepreneurs with good ideas who can't find the money they need.

The community can help by setting up a service to match investors like *Suzanne Roy* with entrepreneurs like *Helen Tymchuk*. In some communities, such a service may already be offered by organizations such as the Federal Business Development Bank (FBDB).

Making it Work

Suzanne and *Helen* each submit their requirements to the Chamber of Commerce which runs the matchmaking service in Canville. If their requirements are found to match, the service arranges an introduction. *Suzanne* and *Helen* then negotiate directly with each other.

The Chamber of Commerce publicizes the new service widely in the community. In particular, it makes sure that lawyers, accountants and bankers are aware of the service so that they can refer their clients. The more investors and entrepreneurs are included, the greater the chances for a successful match.

2. Investor-Entrepreneur Forum

Another way *Suzanne* and *Helen* can be brought together is through a forum organized by the local economic development corporation, the municipality, or the local Board of Trade.

Making it Work

At the forum, entrepreneurs like *Helen* present their business plans to a number of investors. Afterwards, *Suzanne* approaches *Helen* and arranges a further meeting.

3. Professional Matchmaking

Community professionals meet many entrepreneurs and investors in the daily course of business. Current tax measures have created an environment which will motivate accountants, lawyers, investment brokers and other business leaders to act as a contact point between investors and entrepreneurs.

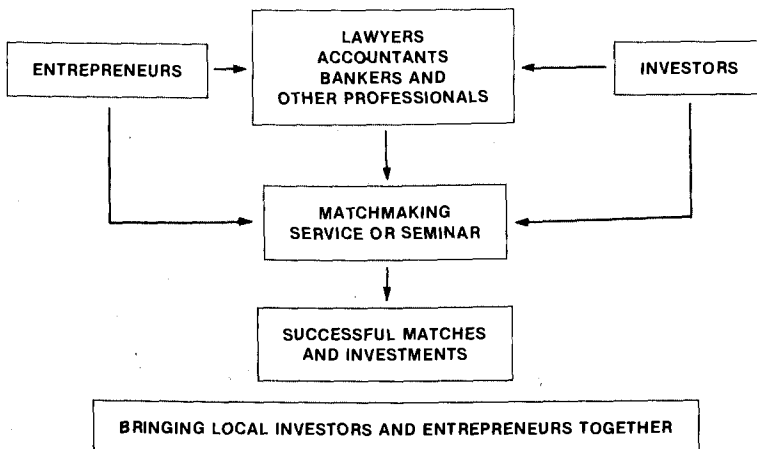
Making it Work

Knowing that the local investment dealer has many contacts, *Helen* approaches him for assistance in finding investors. The investment dealer reviews her business plan and decides to approach some of his clients with this investment opportunity.

The Benefits

With the assistance of professional matchmakers a small business owner can obtain help in developing a business plan and access to additional financing. Investors also benefit through access to more investment opportunities.

As a result of meeting *Suzanne*, *Helen* has obtained the additional equity she needs. *Suzanne* has her investment and, as *Helen's* business grows, she can help *Helen* by providing accounting expertise. The community in turn has a new small business.



4. Investment Clubs

Some individuals prefer to share the risk of investing in a small business. Other investors may have only a portion of the funds required by an enterprise. Investment clubs offer investors like *Michael Raymond* the opportunity to invest in small businesses on a “pooled basis.”

Making it Work

Michael approaches other local professionals and friends who are interested in small business investment. They form a partnership or a trust in which they each own units. Then they invite local entrepreneurs like *Dan Landry* to present their business plans to the club. Larger clubs can be established by Canville’s community organizations for their members. This is already happening across Canada: Canville should not be left behind.

Federal tax incentives make it easier to establish such clubs. The Small Business Investment Limited Partnership (SBILP) and the Small Business Investment Trust (SBIT) both allow investors to pool either Registered Retirement Savings Plan (RRSP) funds, Registered Retirement Income Funds (RRIFs) or pension funds for investment in small business. Investors like *Michael* and his contacts can use up to 50 percent of their retirement savings for investment into the equity of small businesses on an “arm’s length” basis.

Some of the funds in the investment club can be invested into members’ own small businesses. This can be done through an SBIT or an SBILP which has at least ten arm’s-length members, each of whom owns no more than 10 percent of the fund’s units.

The Benefits

By pooling resources in the investment club members can invest in more small businesses and spread their risk. For *Dan Landry* and members of the investment club a whole new source of funds has been opened up for investment in their small businesses. For the community it means that more local money stays in the community to create businesses and jobs. Everyone wins.

5. Local Venture Capital Companies

Many people want to invest their funds but prefer that they be managed by a professional manager. As a result, the number of local venture capital companies managing small business investments for investors is likely to increase.

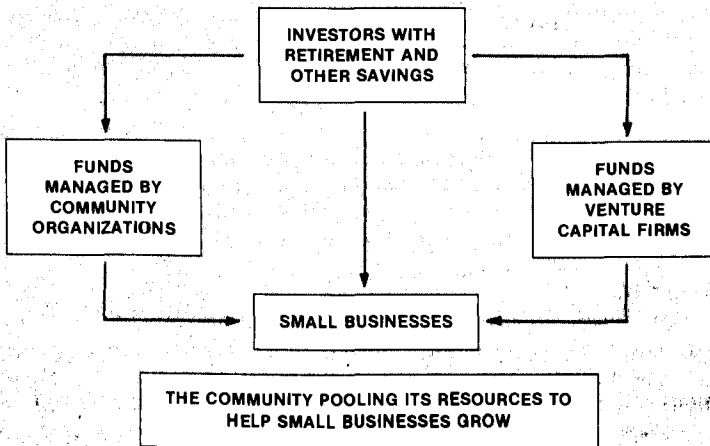
Making it Work

Enterprising local individuals or community organizations set up SBILP or SBIT funds and sell units in these funds to investors like *Michael Raymond*. Unlike most investment clubs, venture capital funds are managed for a fee and investment decisions are made by a full-time manager who has experience in picking enterprises that are likely to succeed.

Entrepreneurs like *Dan Landry* should be aware of these venture capital companies and provide them with a business plan.

The Benefits

Local venture capital companies invest in local enterprises. They provide an opportunity for local investors to use their investment funds to help the community grow. Investors who are not comfortable with managing their own investments are able to rely on the experience and expertise of a professional funds manager. The manager may also assist small businesses by providing advice from time to time.



6. Employee Investment

Since Registered Retirement Savings funds can now be invested in small business, employees can help entrepreneurs expand their businesses by investing some of their own RRSP funds.

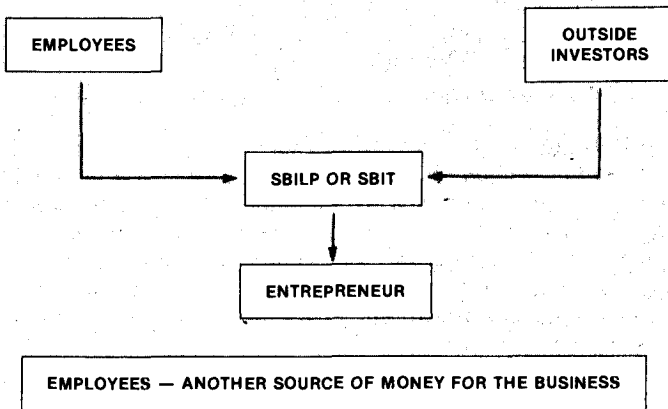
Making it Work

Dan Landry approaches some of the other workers who were laid off with him. Some of them may be prepared to invest a portion of their RRSP funds in *Dan's* venture while at the same time becoming employees in his new enterprise.

Dan's employees can either invest directly or create their own SBILP or SBIT. This could give the company enough equity to persuade local professionals like *Michael* to invest the remaining amount needed through the same SBILP or SBIT.

The Benefits

The investment by employees will help convince other investors that *Dan's* business is sound. In addition, the employees are far more committed to the company now that they have an interest in its success.



Financing by Local Institutions

We have seen how local individuals are a source of funds for entrepreneurs. What about local institutions and larger businesses? Canville's municipal government, hospital, school board and its larger businesses all have the power to help the community's entrepreneurs. In particular, these organizations can do much to help the community's laid-off workers establish themselves in their own businesses.

Larger organizations helping entrepreneurs.

1. Procurement

Canville's institutions buy a wide range of goods and services. Up to now they have not considered procurement as a way of developing local business.

Making it Work

Helen Tymchuk needs equity for her business. She is capable of providing computer software development services, and on approaching a large local manufacturer with her proposal wins a contract to provide these services. The profit she makes on the contract in turn provides at least some of the early equity she needs to develop her products. This equity also helps attract equity from other sources.

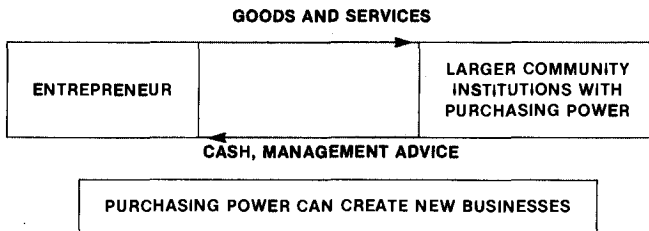
Dan Landry has been laid off by one of the big plants. He worked at the plant for several years and understands its needs. After reviewing *Dan's* product specifications, the plant provides *Dan* with a long-term contract to supply his product. This long-term contract is all *Dan* needs to attract an investor and obtain a bank loan.

It is up to *Helen* and *Dan* to make sure all community institutions know the products and services they can provide. Janine Bernard, the economic development officer, works with the large local businesses to encourage this kind of activity.

The institutions in the community improve the chances for successful local procurement by communicating their requirements for goods and services throughout the community. It is to their advantage to use the skills of former employees like *Dan*. They can also help build *Dan's* and *Helen's* business skills by providing training and assistance.

The Benefits

Procurement is power. This power is being used to build new businesses in the community. As a result of their contracts *Helen* and *Dan* find it much easier to obtain financing. The institution or large business can use procurement to build a base of loyal and effective local suppliers.



2. Pension Fund Investment

The larger institutions in Canville all have their own pension funds. Strong tax incentives exist, including a special vehicle called a Small Business Investment Corporation (SBIC), for such funds to invest in small businesses.

A pension fund can either invest directly, create its own SBIC or create an SBIC in combination with other pension funds. Pension funds can also invest in SBILPs or SBITs in partnership with other investors.

Making it Work

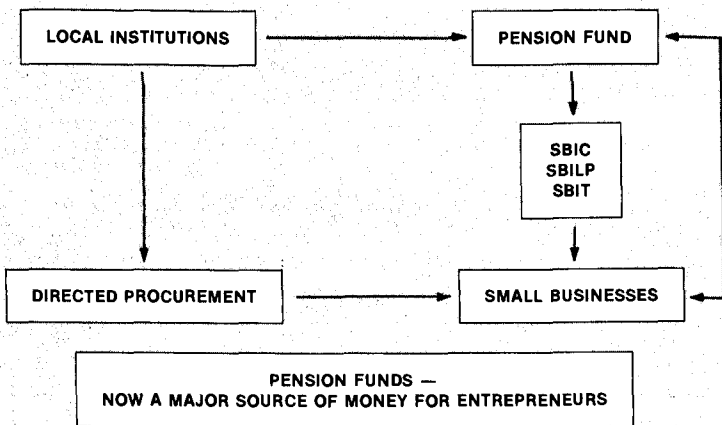
Canville's larger pension funds create an SBIC to invest in the community's small businesses. This is an ideal source of financing for someone like *Dan Landry* who has been laid off with very limited pension benefits.

The SBIC form of financing is also used in combination with the procurement assistance referred to above. For example, because a large local business is impressed with *Helen Tymchuk's* ability to perform quality work, they persuade their pension fund that *Helen* would be a sound business investment.

For their part, *Dan* and *Helen* have developed business plans that explain why their ventures are a worthwhile investment. They give their business plans to all of the town's larger employers.

The Benefits

Helen and *Dan* have an investor with excellent resources and contacts. If they need more money as their businesses grow, the pension fund could be a continuing source of funds. For the pension fund this kind of investment opens up new and profitable opportunities and at the same time benefits the community.



3. Partnership between Institutional and Individual Investors

Existing tax incentives encourage partnership between institutional and individual investors. For example, Canville's pension funds may only want to invest in *Helen's* or *Dan's* business if local citizens are prepared to do so.

Making it Work

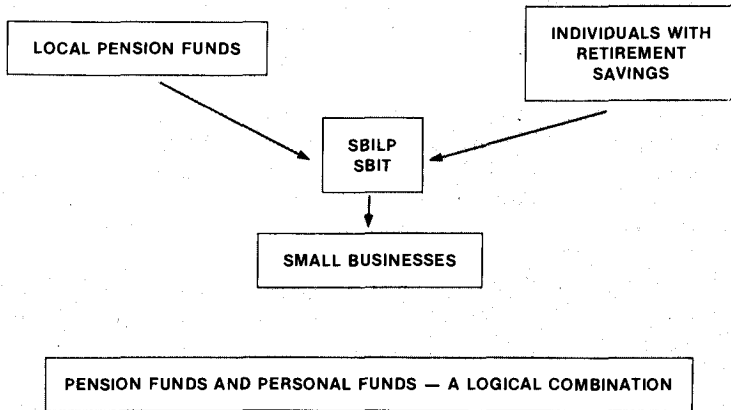
The managers of most of the community's pension funds are personal contacts of *Michael Raymond*. He approaches them to suggest that they join him and his friends in forming an SBILP or SBIT.

The Benefits

For *Michael* and his contacts, partnership with the pension fund creates a bigger pool of money and allows them to spread their risk more.

The pension fund manager is happy to invest with *Michael's* group because he knows they will be careful before committing their own money. He is much more willing to invest knowing that individuals in the community have confidence in an entrepreneur.

Dan Landry, whose business has received the group's first investment, is pleased that the pension plan is involved; he knows there is more money available if necessary. Clearly, there are benefits for everyone.



4. Incubators

For inexperienced entrepreneurs like *Helen Tymchuk* and *Dan Landry*, small business incubators are very helpful. They nurture new businesses through the difficult early years by providing entrepreneurs with some combination of office space, secretarial services and managerial assistance; they are also usually linked to a pool of funds.

Making it Work

In Canville, several organizations in the community participate in setting up the incubator:

- the municipal government, which contributes unused land and buildings;
- investors, including *Michael Raymond* and local pension funds, which set up an SBILP or SBIT to provide money;
- local professionals, who provide management advice and assistance; and

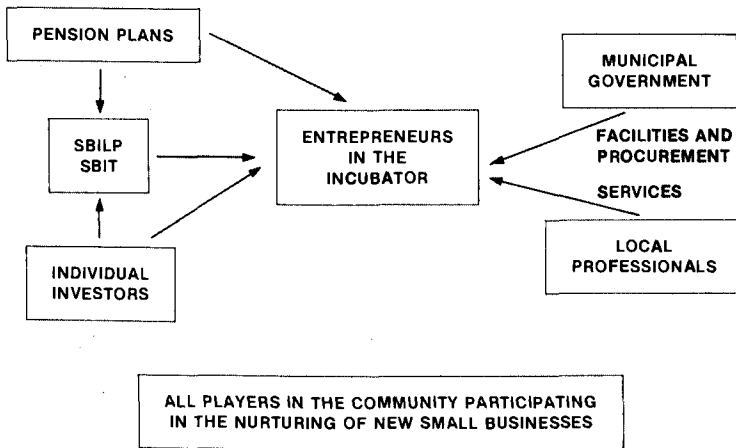
- larger institutions and businesses, which enter into procurement contracts with some of the entrepreneurs in the incubator.

The incubator is managed by a community committee set up by Richard Martin, the mayor. The committee chooses the entrepreneurs and employs a full-time manager for the incubator.

In Canville, preference is given to people like *Dan Landry* who have recently been laid off. The large firms that are laying off people contribute money through their pension plans as part of the overall assistance package for laid-off workers. Access to financial resources is one of the most important ingredients for an incubator's success.

The Benefits

All parties benefit from incubators. *Dan* and *Helen* are more likely to have successful businesses. Investors earn a good return on their investments and the community has more business successes, more growth, and more jobs.



5. Advisory Service

Entrepreneurs like *Dan* and *Helen* do not usually know much about starting a business, especially the financial aspects. In fact, all businesses come across unforeseen problems at some stage in their development. The community can help solve these difficulties.

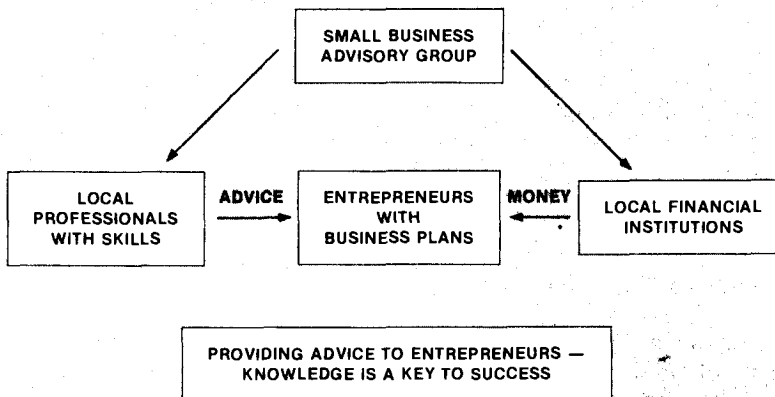
Making it Work

The Canville Small Business Advisory Group is made up of local retired executives. They bring a broad range of experience and community commitment to bear in helping solve small business problems. This group helped *Helen* determine the financial requirements of starting her small business. They provided *Dan* with advice on how to manufacture and market his new product.

There are other places in the community which provide advice. This is the traditional role of lawyers, accountants and management consultants. Many universities and community colleges offer courses geared to business people and have staff who provide consulting services. Most provincial governments have advisory programs which are widely available. As well, the Federal Business Development Bank (FBDB) provides Counselling Assistance to Small Enterprises (CASE) and training programs. The community can encourage experienced business owners to act as "big brothers" for those with less experience.

The Benefits

Advisory services help entrepreneurs "package" their business plans to appeal to investors and assist them with management problems. The Canville Advisory Group also arranges for introductions to local investors such as bankers, pension fund managers and individual investors. Knowing where to go is half the battle.



Financing by Investors outside the Community

In the past "big city" money has not found its way into communities like Canville. Today outside investors are making investments in Canville's small businesses.

Making it easier to attract money from outside the community.

1. Large Industrial Corporations

Dan Landry has invented a new industrial paint applicator. Most investors don't understand why this is an important invention, so *Dan* is finding it difficult to get the money he needs. On the other hand, large corporations that manufacture or use *Dan's* kind of product are prepared to invest.

Making it Work

Dan identifies companies which are in the industrial paint products business. He also finds out who uses this type of product. There are community organizations which can help him obtain this information. He approaches these companies with his product and a business plan. They may want to invest in *Dan* to gain access to his new technology. Clearly, they are far more likely to understand what *Dan* has to offer than other investors.

The Benefits

Dan will find the large company a valuable partner. Because it is in their interest to see *Dan* succeed, they may also provide research and development assistance and business advice. They could even make their marketing network available to *Dan*. All this in addition to the money he needs.

2. Investor Seminars

Tax incentives give large pension funds a very strong incentive to invest in small businesses. To take maximum advantage of these measures, the managers of these funds will have to look beyond their own communities for small business investments. There will simply not be enough investment opportunities in large cities.

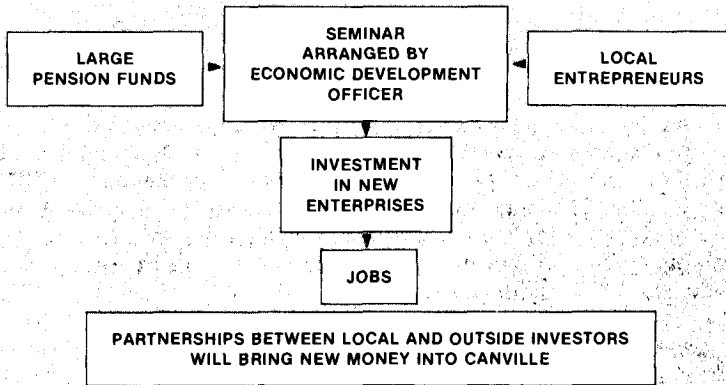
Making it Work

Pension funds can invest in small businesses either directly or using an SBIC, SBILP or SBIT. They can do this either individually or in partnerships managed by venture capitalists and other money managers.

To help these pension funds find small business investment opportunities in Canville, Janine Bernard, the local economic development officer, organizes a seminar where local entrepreneurs like *Dan* and *Helen* present their business plans to the venture capitalists and portfolio managers who manage large pension funds. *Dan* and *Helen* make sure that Janine and other community officials have copies of their business plans in advance so that they can be invited to the seminar.

The Benefits

As a result of the seminar *Dan* and *Helen* obtain the equity they need. Pension funds also have the resources to make additional investments in their businesses as they grow. The investment by outside pension funds represents new money coming into Canville. This means new businesses and new jobs.



3. Partnership between External Investors and Community Investors

Investors from outside the community may be more prepared to make investments in Canville's small businesses in partnership with local community investors like *Michael Raymond*. Through SBILPs and SBITs, money from external investors and local investors can be pooled.

Making it Work

Canville's largest investment club is managed by the Kiwanis Club. It approaches pension fund managers and venture capitalists in larger communities with a thorough review of the investment opportunities in Canville. This takes the form of a "prospectus" which describes the community and potential new ventures like *Helen's* and *Dan's*. A pension fund could then decide to form an SBILP or SBIT with the local investment club. This would provide the pension fund with the confidence that the community is also backing local entrepreneurs.

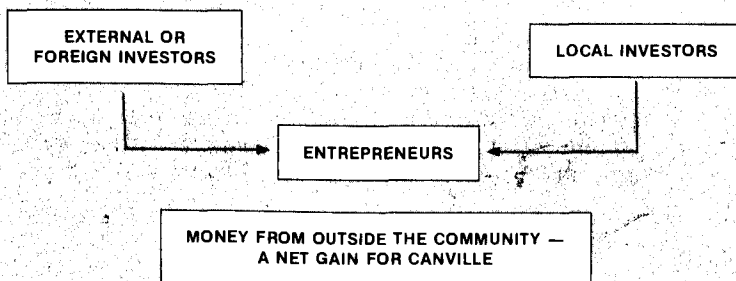
4. Foreign Money

Foreign individuals and corporations should not be overlooked as a source of funds for local businesses in Canville.

Making it Work

Canville, together with other communities in the province, invites groups of investors from countries outside Canada. The municipality approaches the provincial government to help co-ordinate this effort, possibly through provincial offices in those countries. The local economic development corporation arranges "investment seminars" to introduce foreign investors to promising local entrepreneurs. The investors may in turn decide to make direct investments in these businesses.

Entrepreneurs such as *Dan* and *Helen* make sure that their business plans are in the hands of Canville's economic development corporation so that they can participate in the seminars.



A Summary of Opportunities for Small Business Development

What the Community Can Do

- Make sure that people with money to invest meet people who need the money for their businesses through:
 - a *matchmaking service*, or
 - an *investor-entrepreneur forum*.
- Set up an *investment club* to invest the funds of members in local small businesses. The following mechanisms can be used:
 - a *Small Business Investment Limited Partnership (SBILP)*, or
 - a *Small Business Investment Trust (SBIT)*.
- Encourage local institutions and businesses to use their *procurement power* to benefit local small business.
- Have local *pension funds* invest in small businesses through their *Small Business Investment Corporations (SBICs)*.
- Set up small business *incubators* to provide funds, space, services and advice to small businesses to nurture them through their early years.
- Establish a small business *advisory service* to help entrepreneurs "package" their business plans and to advise them where to look for funds.
- *Bring investors in from outside* the community and arrange for them to meet local entrepreneurs. Sell what the community has to offer.

What Local Investors Can Do

- Start *investment clubs* with friends and contacts, using an SBILP or SBIT to enable investors to use retirement savings and spread their risk over many small businesses.
- Establish *local venture capital companies* to manage the funds of the community's investors professionally.
- Enter into *partnerships* for investment with institutional investors; they will be more confident about investing if individuals in the community are also committed.
- Support the *incubator* idea. Such investments have a much greater chance of success.

What Entrepreneurs Can Do to Help Themselves

- Develop an excellent *business plan* that sells your ideas in a credible way (see Appendix I).
- *Make sure that all the right people in the community are aware of your business plan:*
 - the Chamber of Commerce;
 - the economic development corporation;
 - the local investment clubs;
 - the local venture capitalists;
 - locally managed pension funds; and
 - major companies.
- Give your *employees* a chance to invest in your business.
- Take advantage of what local institutions and large businesses are *purchasing*. Make sure they know what you can do.
- Become part of the community's small business *incubator* program.
- Use the community's *advisory services*.
- Approach *large firms in your industry or those who use your kind of products or services*. You may have something special that will make them want to invest in your business.

Your Community Meeting the Challenge of Economic Renewal

Tax incentives in the 1985 Budget have made new sources of funds available to small businesses. The challenge now is to find ways to ensure that these funds flow from investors to entrepreneurs. This guide has been designed to provide ideas to entrepreneurs, investors and community officials on how to apply these measures. It is now up to all the players involved to take the next step and make it work.

Before proceeding with any of the suggestions in this guide, you should obtain additional information from the following sources:

- your accountant;
- your lawyer;
- your investment broker; or
- the Federal Business Development Bank (FBDB)
(see Appendix II).

We want to continue hearing from you. Call the Small Business Secretariat, collect on the hot line at (613) 995-9197.

APPENDIX I

Your Business Plan

All of the methods of raising equity described in this brochure depend on having a thorough but readable business plan. Investors will decide whether to invest in your business if they have an excellent understanding of your vision and how you are going to make it happen.

The following is a description of what a good business plan should contain.

1. The Opportunity (Suggested length: 1 page)

Start with a *brief* description of the purpose of your business. This enables the investor to determine quickly the kind of opportunity your business represents. Remember that the reader will not necessarily understand your business, so avoid technical terms. If yours is an existing business, this section should contain a paragraph on its history.

2. The Product or Service (Suggested length: 1 page)

Describe in non-technical language your existing or proposed products or services. Include their key features and what makes them different from those of competitors. Cover the status of patent copyright or trademark protection.

3. The Market (Suggested length: 3 pages)

Set out *who* will buy your product and *why*. Where possible, support your statements with research you have conducted on the market. Include:

- the location of your markets;
- your proposed pricing strategies (e.g. upper and lower end of the market);
- your competition; and
- how you will distribute your product.

4. Management (Suggested length: 1 page)

Investors place a great deal of importance on the people behind the business. Describe your background and that of your key employees. Describe the special skills that will help make your business a success.

5. Manufacturing or Delivery Process (Suggested length: 1 page)

Describe how you plan to manufacture the product or deliver the service. Cover items such as the required facilities, equipment, labour and materials. Highlight critical supply relationships.

6. Financial Projections (Suggested length: 3 pages)

Provide financial projections in two categories:

- a statement of costs to develop the product or service — that is, costs prior to normal operations; and
- a projected balance sheet, income statement and cash flow statement for the first five years of normal operations, with the first year broken down by month.

7. Required Investment (Suggested length: 2 pages)

Include:

- the amount of money required;
- the timing of the cash requirement;
- what the funds will be used for;
- the proposed sources of the required funding, including your own funds, other equity, term debt and working capital loans; and
- when investors can expect their funds to be paid back.

Remember that your business plan is *your* statement of how you intend to achieve your business objectives. You are the best person to write the plan as this will require you to think through each element of the plan. After you have written a first draft, present it to your professional advisers and others for criticism.

If you follow the rules of simplicity and thoroughness, your plan should give you an edge in attracting an investor.

APPENDIX II

For More Information about the Ideas in this Brochure

Federal Business Development Bank

The Federal Business Development Bank (FBDB) operates branch offices in many Canadian cities. Refer to your local telephone directory to see if there is a location near you or call:

Toll-free: 1-800-361-2670

Metro Montreal area: 283-2322

Department of Regional Industrial Expansion

The federal Department of Regional Industrial Expansion (DRIE) has offices in many Canadian centres. Refer to your local directory to see if there is a location near you or call the Small Business Secretariat:

Collect: (613) 995-9197

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