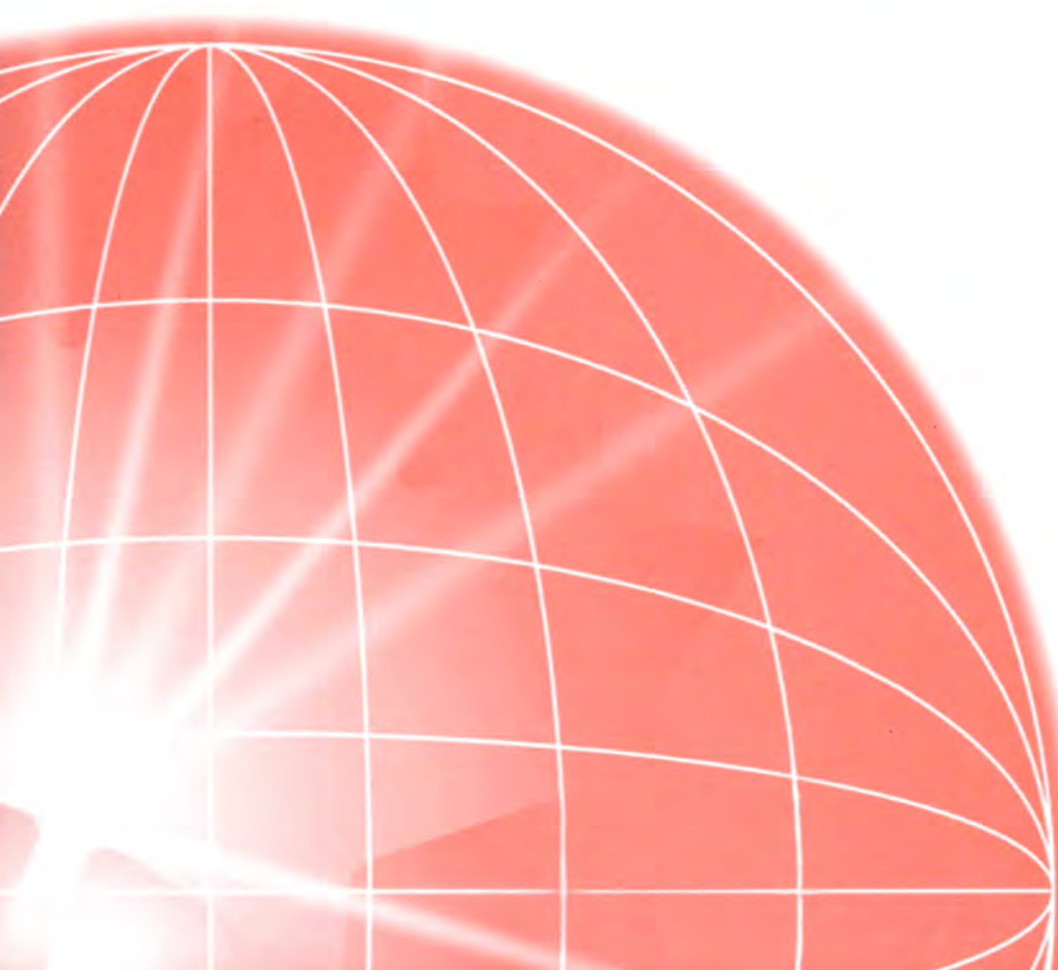
Industry Canada Industrie Canada

Turning Learning into Action

Report on the
Industry Canada
"Bridging the Investment Gap"
Conference

June 13-14, 2001
Montréal, Canada



Canada

Turning Learning into Action can be downloaded from the Canada Community Investment Plan website (**http://ccip.ic.gc.ca**). This site also contains *The Winning Formula, The Winning Formula at Work*, access to *Steps to Growth Capital*, and other working tools and valuable information for those interested in investment facilitation services.

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A Conference to Inspire Development

Industry Canada's "Bridging the Investment Gap" Conference in Montreal culminated five years of pioneering work by the 22 pilot projects of the Canada Community Investment Plan (CCIP) and launched its new phase...to inspire other communities to follow suit.

CCIP was started in 1996 to find ways in which communities outside the main financial centres could improve access to existing sources of risk capital for their most promising small businesses. The experiences, best practices and lessons learned by the pilot projects were then to be made available to other communities so that they could start and operate their own investment facilitation services.

The conference launched the dissemination of this knowledge.

The CCIP communities have provided a solution to the problem that has evaded economic developers for 25 years. There have been many attempts to meet the challenges of financing the growth of small and medium sized businesses. Most involved trying to increase the supply of risk capital. CCIP communities took a different approach. They focussed on improving access to existing sources of risk capital.

The 22 communities, selected by a private sector committee, were provided with two-thirds of their operating funds by Industry Canada. No funding was provided for investment. When the strategies developed by these communities were put into action, as of June 2001 they reported they had helped 297 small and medium sized enterprises (SMEs) obtain some $170 million in risk capital from private investors and non-federal sources. The SMEs say they expect to create more than 2,500 new jobs as a result. At that time, the dollars invested per dollar provided by the government/community partnership to operate the pilot projects stood at 14:1.

How the CCIP communities organized and operated their investment facilitation services has been documented in *The Winning Formula*. Their best practices and lessons learned are revealed in *The Winning Formula at Work*. Both are available on the CCIP website at **http://ccip.ic.gc.ca**.

One of the main tools developed for this program is *Steps to Growth Capital*, an Internet entrepreneurs' guide to securing risk capital, available at **http://growth.ic.gc.ca**.

Spreading the word

More than 600 communities across Canada were invited to the "Bridging the Investment Gap" conference. Sixty-four economic development and federal/provincial organizations were invited by phone and sent full information. Some 224 participants were able to attend. They were drawn to the conference not only to hear about the achievements of CCIP, but by the opportunity to work on their own economic development plans in small group discussions with the men and women of the pilot projects who pioneered the new investment facilitation service. As a bonus, they were able to meet with 50 representatives from member states of the Organization for Economic Cooperation and Development (OECD) to get a global perspective.

This report captures the highlights of the "Bridging the Investment Gap" Conference. It is titled *Turning Learning into Action*. For those fortunate enough to have been participants in the conference that action is probably well underway. For anyone involved in the economic development of their community who would like to take action towards providing their fast-growth small businesses with an investment facilitation service, you have only to contact the CCIP Secretariat by e-mail: **ccip@ic.gc.ca**. We will make sure you have all the information you need and link you to the network of communities that are working towards the same objectives...creating a local investment culture to boost their economic growth.

Bridging the Investment Gap Conference

The first day of the Conference focused on an orientation to CCIP tools, distilling learning from the pilot projects and applying research on entrepreneurship to local communities. This report provides brief summaries of presentations and discussions.

Opening Remarks

Mr. Andrei Sulzenko, Assistant Deputy Minster, Industry and Science Policy, Industry Canada, opened the Conference on behalf of the Government of Canada by welcoming participants, including representatives of 16 OECD member states. He noted that this Conference represented an important milestone on the continuing journey to link entrepreneurs with investors. In the past, Small and Medium size Enterprises (SMEs) looking for growth financing faced limited choices, none of which was particularly satisfying. Once SMEs had used up their own available finances, they had to turn to banks or other sources of funding requiring collateral. Other choices were to tailor growth or move to other communities where investment capital was more available.

On the other hand, it was known that there was a huge amount of investment capital available – the problem was how to tap into it. The CCIP was initiated to try and address this issue. To date, \$170M in investments have been reported to have been found for over 300 entrepreneurs. In closing, Mr. Sulzenko challenged participants to continue to build on this project in their communities.

1. CCIP Tools

"Innovation and partnership are the touchstones for government policy for the 21st century."

Peter Webber, Manager of the Small Business Financing Policy Unit with responsibility for CCIP, and Jane Kralik, Project Manager, Industry Canada, gave presentations focused on three CCIP tools: *The Winning Formula*, *Steps to Growth Capital*, and *The Winning Formula at Work*.

The Winning Formula

Entrepreneurs are the driving spirit behind job creation. Although at the cutting edge of innovation, they are also often short of capital. CCIP was created to assist entrepreneurs to find the financing they need to develop their ideas and businesses. CCIP has developed an excellent inventory of lessons learned and resources.

Based on the CCIP experience, *The Winning Formula* was created as a how-to guide to help communities create an investment facilitation service for their growth-oriented small businesses. It supplies a step-by-step approach to assess whether an investment facilitation service is needed and how to set it up.

Because of the amount of time and energy involved, it is essential to do an assessment of the community to determine whether it has the essential ingredients for success. Once the evaluation is done, the team needs to be put in place; this set up phase can take up to a year. Because of the high rate of rejected proposals by investors (97%), patience is vital.

The Winning Formula helps communities avoid reinventing the wheel when they look into facilitating investment in their communities.

Steps to Growth Capital website

The aim of the *Steps to Growth Capital* website (which has been re-launched in the weeks following the conference) is to help entrepreneurs become investor ready. This is the third edition of the website: essentially, it is an academic text turned into an online guide using principles of writing for the web.

The website is intended for entrepreneurs who do not have a clear idea of how to attract capital. Features include: an executive summary (Fast Track to Growth Capital); a readiness test; and a self-study guide.

The heart of the website is the nine *Steps to Growth Capital*:

1) identifying financial needs;
2) knowing financing options;
3) showing investment potential;
4) demonstrating management capabilities;
5) building an investment proposal;
6) identifying potential investors;
7) meeting potential investors;
8) negotiating the deal; and
9) closing the deal.

Steps to Growth Capital also includes four skills development modules which cover writing, organizing meetings and presentations, negotiation skills, and problem resolution, all within the context of seeking equity financing for a business.

The Winning Formula at Work

The Winning Formula at Work focuses on the practical results of the CCIP. It contains analyses of 15 best practices and is aimed at helping community-based facilitation services work successfully.

The analyses are grouped by type of investment technique: Mentoring/Coaching Entrepreneurs, Matching Entrepreneurs with Angels, and Fostering Angel Development.

The pilot projects helped to cultivate local business culture and demonstrated that with the right sort of preparation, community-based investment can stimulate the local economy.

Discussion

The following points were made during the Question and Answer period following the presentations.

- A sample budget is not included in *The Winning Formula* because of differences among communities. There were many different types of budgets used by the projects.

- Community Futures Development Corporations (CFDCs) provide financing for local start-up businesses, mostly in rural and remote communities. There is currently no plan to extend the role of CFDCs when the CCIP program winds up.
- Two concepts of community are being discussed: geographic and interest-based. CCIP looks at communities primarily in terms of geography, with the exception of a project involving the First Nations in Quebec.
- There were no targets associated with financing provided by the CCIP. The objective was to identify and test strategies for investment facilitation. Targets would have encouraged a focus on companies that had already received investment, rather than riskier ventures.
- It is too early to determine Return-on- Investment (ROI) because none of the investments has been out for more than three years. The value of the CCIP projects is more than the sum of the deals done; a large number of entrepreneurs outside the project have been influenced positively by learning what capital is and how to get it.

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2. Learning from the Pilot Projects

"Services must be adapted to the local situation. Success rates have shown that there is no unique solution to the problem of raising investment capital."

"This is the Age of the Entrepreneur."

"Most investors invest in the jockey and not the horse."

Matching Investors and Entrepreneurs

PRESENTER: Tracy Hopkins, Executive Director, Niagara Enterprise Agency (NEA)

Matching investors is not so much about access to capital, but about being prepared to access capital. The key factors to matching are:

a) knowing the sources for investment funding; and
b) knowing the companies that require it.

NEA uses a rigorous due diligence process to focus on gaps in investor readiness. This process is intensive; information is gathered through a number of interviews and independent research. Findings run the gamut from "well prepared" to "not prepared".

NEA tries to provide solutions as well as issues and challenges; it will also try to find someone to work with the entrepreneur to improve their case. Patience is very important to ensure that the system will work.

The NEA strategy is to go after referrals. The Board is well connected in the community and an excellent resource. A fee is charged for all services: there is an engagement fee up front, and a success fee as well. Fees are scalable.

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Fostering Angel Investors

PRESENTER: Charles Le Borgne, directeur général et commissaire au développement économique de la Société de développement économique de Thérèse-De Blainville

Capital-Connexion (**http://capital-connexion.com**) is a web-based network developed to assist in matching entrepreneurs and angel investors. Each participating community is in control of its own website; the emphasis is on local ownership, but the reach is global.

The cost of the network is paid for by the regions on a per inhabitant basis. The community is responsible for recruiting its own angels, whose anonymity is protected; therefore, the success of the network depends on a high level of local motivation. Each local representative is expected to promote the network, e.g., through holding news conferences to publicize the website.

The database currently includes 66 Canadian communities and two outside Canada. All data is validated by economic development professionals. The system is easy to use and always accessible. Registration is free for entrepreneurs and investors. An email system exists to help match entrepreneurs and investors.

The long term vision of the Capital-Connexion network is to offer access to the network to all Canadians and to deploy the network in all local economic development offices.

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Coaching and Mentoring

PRESENTER: Bill Cooke, Professional Engineer (Electronics) and Manager of CCIP Victoria

The Vancouver Island Advanced Technology Centre (VIATeC) is a not-for-profit, industry-driven venture

operated by the Vancouver Island Advanced Technologies Society. Its role is to actively promote and enhance the development of the advanced technology industry on Vancouver Island.

The challenge is to help entrepreneurs clarify their business focus, identify critical business issues (CBI), develop a business strategy and learn how to pitch a "story", i.e., it is not just enough to build a better mousetrap – you have to know how to sell it, not just to raise money, but to attract potential employees and partners, etc.

The Venture Business Panel (VBP) provides entrepreneurs with an opportunity to face the experts and practice their pitch before meeting investors. This is very important because an entrepreneur's business issues are seldom what the entrepreneur thinks.

The focus of the VBP is on the business side. The VBP consists of the same seven members for every presenter; however, a member in a possible conflict of interest may elect not to attend.

There is no formal process for selecting who will appear. One entrepreneur is interviewed per session. Entrepreneurs are expected to provide their background materials (e.g., Business Opportunity document; CBIs; strategic plan, etc.) a week ahead.

No written feedback is supplied; participants are advised to bring a tape recorder or have someone take notes. The VBP will listen again to a revised presentation where requested. Panel members also provide mentoring.

The VBP is intended as a win-win situation for both panel members and entrepreneurs. The latter receive help in developing their business focus, strategy and investor presentations. The former have the first look at new initiatives, i.e., networking and commercial opportunities. (A detailed description of the VBP is presented in *The Winning Formula at Work*)

Lessons learned from the VIATeC experience include:

- not all feedback is considered positive by entrepreneurs;
- what are perceived as CBIs by the entrepreneurs are often not the real CBIs; and
- a professional presentation works: you have to sell the opportunity and sell yourself.

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3. Entrepreneurship

> "There is a correlation between a high level of business creation and the level of business destruction. It is this "churning" process that leads to the adaptation and growth of the economy."
>
> "We create businesses that reflect our acquired experience."

Business Start-Ups, Economic Growth and the Role of Finance

PRESENTER: Paul D. Reynolds, Professor of Entrepreneurship, Babson College and London Business School

No topic is more interesting, or less understood, than where new businesses come from. In the past, it was generally held that large, established firms drove the economy. However, there is now considerable interest in the entrepreneurial model.

The Global Entrepreneurship Model (GEM) has been studying the relationships between national entrepreneurial activity and economic growth. Contributions of the entrepreneurial process include:

- a major source of innovation;
- a major source of new jobs; and
- a source of competitive pressure for existing firms.

The major themes from the study of the 21 GEM countries were:

a) there is huge variation in entrepreneurial activity among the countries; and
b) there is a strong association between the level of entrepreneurship and economic growth.

Factors associated with higher levels of entrepreneurial activity included:

- opportunity perception;
- social and cultural factors;
- post-secondary educational participation;
- participation by women;
- age structure; and
- financial support for start-ups.

The cultural aspect of entrepreneurial activity is particularly important: a climate has to exist where there is encouragement both to identify and take advantage of opportunities. How we teach people to do this is a real challenge. The ideal situation is to live in a culture where entrepreneurship is so ingrained that it is taken for granted.

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Entrepreneurship: Regional and Local Influences

PRESENTER: Yvon Gasse, président - directeur, Entrepreneuriat Laval inc.; directeur, Centre d'entrepreneuriat et de PME, Faculté des sciences de l'administration de l'Université Laval

Not all businesses succeed: what makes one succeed and another fail? Three main types of factors affect the success of entrepreneurs:

1) the entrepreneur;
2) the incubator; and
3) the business environment.

Entrepreneurs tend to be self-confident, energetic, independent, motivated, determined and have a strong need for self-realization. Main influences tend to be family and friends and the local environment.

Other factors for business start-up include the level of risk and gratification, availability of funds, presence of support and advisors, and the existence of other entrepreneurs. The presence of related groups of businesses, qualified help, specialized suppliers, universities and incubators also contribute to the decision to start a business.

The level of entrepreneurship in a community can be increased by encouraging a culture of entrepreneurship, e.g., through validation of the entrepreneurial lifestyle as a legitimate career option.

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"Make entrepreneurship a path of least or lesser resistance"

Entrepreneurship: Summary of Key Learnings

After listening to the presentations, participants worked in small groups to identify key learnings. These learnings had two key themes:

(1) the fostering of entrepreneurial culture; and
(2) development of entrepreneurs.

Following are some of the suggestions that were made by conference participants to further these two themes.

Fostering an Entrepreneurial Culture

Develop a community environment that enables the growth and encouragement of entrepreneurship, e.g.,

- Create a feeling of opportunity through positive communication.
- Develop role models and publish success stories, e.g., have entrepreneurs share positive/negative experiences related to small business in their communities.
- Encourage government and the media to present a more positive image of business and entrepreneurs.
- Expose young people to entrepreneurial ideas at an early age, e.g., include personal and business financial management as part of their school curriculum; bring well-known business champions to speak to youth.
- Increase the awareness of effective economic development, including successful entrepreneurship.
- Present/validate entrepreneurship as a positive career and lifestyle option.
- Promote entrepreneurship among younger people, especially in the 21-35 years age group.
- Promote a culture of entrepreneurial risk in schools through courses and projects.
- Recognize the limitations of entrepreneurship, e.g., it is not for solving social problems and tends to be goal-oriented.
- Teach the rewards and opportunities of entrepreneurship.

Developing Entrepreneurs

- Build partnerships at the local level to increase the culture of innovation.
- Document and celebrate successes and failures, e.g., through recognizing and rewarding successful entrepreneurs.
- Continue the current situation but tone down the political side of business.
- Create greater capacity in physical infrastructure.
- Develop and implement a mentoring program with an advisory board component, e.g., organize business leaders as mentors for entrepreneurs; use "expatriates" to act as mentors and investors.
- Develop community incubators to foster and grow opportunities and support ideas.

- Develop management and other business expertise, e.g.,
  - develop a pool of sectoral/entrepreneurial expertise;
  - ensure that entrepreneurship training covers different types of entrepreneurs and different models;
  - provide training, on management, marketing and sales; and
  - provide development or coaching expertise for entrepreneurs whose projects have been rejected to help them successfully restructure their plans.
- Focus on new start-ups, e.g., encourage team start-ups; work with start-ups to help them with management expertise.
- Foster greater partnerships between industry and research with a focus on commercialization.
- Government should go to businesses to "market" websites and information and show the businesses how to use the information.
- Listen to the community. Programs must meet the community's needs by being targeted, flexible and dynamic.
- Lobby government to help remove barriers, e.g., create a more conducive tax policy to encourage more investment; realign programs to SMEs.
- Match entrepreneurs with universities/research facilities to develop opportunities for commercialization.
- Match opportunities with entrepreneurs.
- Encourage the opening of new markets where project ideas are lacking.
- Promote community support for new businesses.
- Promote the existence of networks for angel investors.
- Provide networking opportunities for businesses.
- Recognize differences between rural and urban areas.
- Recognize that people have to see the opportunities to create a business, e.g., if there is too small a population, there will be no business creation.
- Recognize that there are two types of entrepreneurs: (a) visionaries who start businesses and (b) managers who run businesses.
- Use intermediaries/associates to disseminate information.

Closing Remarks

To close Day 1, two representatives from the OECD, Ms. Pamela Wilbur, Co-Director, Small Business Program, U.S. Department of Commerce and Mr. Jean-Luc Vo Van Qui, Assistant Director, Ministry of the Economy, Finance and Industry, France, were asked to give their impressions of the day. Both speakers described what they had learned during the day and expressed interest in the Canadian approach, believing it could be of use in their respective countries.

The second day of the Conference focused on options for financing growth, including angel investors and risk capital, and on applying the lessons learned in communities. At the end of the day, participants developed action plans for implementation back home.

Opening Remarks

Day 2 of the Conference was opened by Walt Lastewka, MP from St. Catharine's, Ontario and Liberal Caucus Advocate for Small Business. In explaining the importance of CCIP, Mr. Lastewka gave an overview of the situation in Niagara.

In the early 1990s, the Niagara region had one of the highest unemployment rates in the country because of an over-reliance on large companies. The community recovered by putting people together to collaborate, forming new partnerships and developing new economic initiatives for the region. CCIP has helped hundreds of businesses and entrepreneurs, resulting in a dramatic drop in unemployment.

The model developed in Niagara is being tested in other areas and the results of these tests should be known in a year. If successful, this will pave the way to make the Niagara program available across the country.

The success of the Niagara approach lies in continuous improvement, i.e., identifying and filling gaps where entrepreneurs see a need in the community. This approach depends on social capital: people sitting around the table discussing how to make improvements.

As a result of the program, many communities have now stopped passing the buck and effective infrastructures have been established allowing one-stop shopping for businesses.

Mr. Lastewka congratulated the 22 pilot projects and wished them the best luck for the future. He encouraged everyone to be very open about both the positives and negatives around support for SMEs. Noting that 125,000 businesses failed or left Canada last year, he posed three questions: Why? What are we going to do about it? How can we ensure that community small business infrastructure is on the path of continuous improvement?

In closing, Mr. Lastewka said that the role of participants was to be up-to-date, innovative and to encourage partnering to get the job done. He challenged participants to talk freely about the challenges they face in their communities, thus sharing the heart of their experiences.

4. Options for Financing Growth

> "Starting a business is like deciding to have a baby."

Six separate sets of presentations dealing with investment were given during the morning session. During these presentations, participants were encouraged to make notes for afternoon discussions in plenary.

The Investment Spectrum and a Tale of Two Investments

PRESENTER: Denzil Doyle, Chairman, Capital Alliance Ventures Inc.

A company, like a product, goes through a number of stages: idea, research and development, product development, product distribution, and public company. In terms of the investment spectrum, the front end needs more attention than the back end.

With angel investing, it is important to find a means of matching entrepreneurs and investors. The local economic development officer has to find a way to match, make presentations and approach the angels; angels are best found closest to home. However, the anonymity of angels must be preserved.

The ideal angel is someone who would make a good director. An angel who wants to be too involved in the running of the company, or who is in a conflict of interest, should be avoided. Most angels will go with straight equity, whereas most venture capitalists (VCs) want some sort of convertible instrument.

VC is becoming more global and specialized. Of the VC in Ottawa last year, approximately 50% was from the US. In terms of an exit strategy, most VCs look at the initial public offering (IPO) as the obvious strategy. However, in Canada, the stock market does not work very well. The lack of volume restricts liquidity.

There are four elements that can be used to evaluate potential success of a company: management, leadership, technology and marketing. In most cases, it is leadership that makes or breaks a company, not management.

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The Internationalization of Venture Capital Activity: Implications for Measurement and Policy

PRESENTER: Michael Freudenberg, Economist, OECD

Benchmarking studies are very popular in Europe to help identify weaknesses and areas for improvement in small business. In summarizing his paper which compares venture capital activity across OECD countries, co-authored with G. Baygan, Mr. Freudenberg said that VC can be an important factor for growth. Problems with comparing activities across countries include lack of a generally accepted definition of VC and data differences between countries.

Venture capital has grown significantly in most OECD countries during the 1990s and is increasingly associated with improved firm performance in terms of survival rates, innovation and growth.

Implications of the internationalization of VC activity include:

- cross border flows may (a) improve the efficiency of the global VC market and (b) dissociate the link between domestic supply and demand factors and change the relative importance of the later;
- one-dimensional, domestic supply-side policies may only have minor effects for domestic VC activity; and
- counties with low barriers to entrepreneurship tend to have more active venture capital markets and vice versa.

Some studies say that a sliding scale for capital gains taxes has a favourable impact on VC activity. The US system works in that way, and there is more angel activity. Canada needs better data comparing its angel activity with that of the US.

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ISM BioPolymer Inc.

PRESENTER: Isabelle Boucher, Présidente, Directrice R&D, ISM BioPolymer

Starting a business in high technology is like deciding to have a baby: you have to have a good idea/plan, have a bit of money, the right people to help when you need it, lots of patience and not give up at the first obstacle.

ISM BioPolymer Inc. was created to take advantage of a process developed by Ms. Boucher while doing her Masters degree. Patents are very important in building value for a company: the university holds the patent for the process, but ISM was able to negotiate a good licensing deal.

50% of the start-up investment for the company came from Innotech and the rest from private investors. In looking for an investor, it is very important to take the time to ensure that the chemistry is right and that the investor has a philosophy compatible with that of the company.

Because high technology start-ups are not immediately profitable, the importance of a credible, well-structured, multi-disciplinary management team is essential to reassure potential investors. The business plan must be short, precise and realistic. It should be accompanied by a very good executive summary that is at once specific and catchy. Timing is key: be prepared to spend the time to identify your market, develop partnerships and be patient while looking for investors.

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Risk Capital

PRESENTER: Guy Dionne, commissaire industriel, Société de développement économique de la région Sherbrookoise

Risk capital can be defined as investments having both a high potential return and high risk. Advantages of risk capital include:

- investor participation in the company's Board;
- regular reimbursement is usually not required;
- the investor does not demand tangible guaranties;
- financing is for 4-7 years; and
- the investor often provides access to a network and resource persons.

More and more, risk capital investors are seeking to minimize their risk by sharing it with other investors.

Key elements for obtaining access to risk capital include:

- demonstrate a competent business plan and a well structured management team;
- have a product or process with good potential for growth and profitability;
- show personal commitment, e.g., of financial resources; and
- offer a good rate of return.

The business plan is a strategic document. It must:

- sell the company's philosophy and objectives;
- demonstrate how the management team will support the potential growth of the company;
- demonstrate clearly how much money is needed and how it will be used
- indicate potential mechanisms for withdrawing invested funds; and
- be collaborative and transparent.

Steps following the completion of the business plan include:

- targeting appropriate risk capital companies; and
- presenting the business plan to generate interest
- due diligence.

An investment facilitator can be very useful in demystifying the process and encouraging the entrepreneur, finding alternative financing, and helping with "financial bridges" during the long process of finding an investor.

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Best Practices for Financing Growth: Angel Investors and Venture Capital

PRESENTER: Jackie Rafter, Chairman, Roxi Capital Corporation

All too often, entrepreneurs tend to look at their businesses through their own eyes, rather than as investors view them. As a result they have a tendency to do everything on their own and often spend too much time on processes where they have little or no expertise; and they aren't always clear on why they're looking for money, e.g., expansion, get in/out of business.

To get the best results, entrepreneurs should:

- align themselves with a group of experts to find the best financing options, e.g., financing requirements/due diligence;
- find a contact person who can get them in touch with VC; and
- have a person on staff to help with reporting needed by investors.

Ideally, entrepreneurs should use a turn-key solution in VC financing if it exists.

Making a company attractive is a very time-consuming process. At the end of the day, entrepreneurs need to do their homework and their due diligence to convince investors that they know their business. Then they look for the required resources and expertise to develop a business plan.

Investors want to know that you know your business better than anyone else. Terms sheets should be as short and simple as possible, telling the investor the financial requirements, how the money will be used, and what the investor will get in return. Company valuations are problematic: investors will want to know what makes the company worth what you say it is. Expected ROI should be a minimum of 10%.

Options for communities without a VC presence include finding an angel investor, aligning the company with someone in a major centre, or finding another model that worked well elsewhere.

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Incubating Ideas: Turning Peanuts into Elephants

PRESENTER: Ray Strafehl, Executive Director, Venture BC

Inventors can be eccentric and may be easily dismissed by investors and consultants. University-borne ideas are taken more seriously because they are perceived as less work and less risk. Money is often a secondary motivation.

The following steps can be followed to help realize a project:

- verify market demand, e.g., identify the consumer; size of the marketplace;
- verify the technology, e.g., patent search (delphion.com, strategis.ic.gc.ca); a non-disclosure agreement; engineer or lab opinion (NRC); regulatory approvals;
- develop the prototype; apply for IRAP funds; source prototype developer; identify manufacturing efficiencies and calculate costs;
- develop the financing plan, e.g., prepare executive summary; market survey; focus marketplace, Intellectual Property, ease of entry and outline investor payback;
- go into "labour", e.g., investor must benefit/appreciate product; give assurance of proper management; create excitement about market; emphasize payback strategy; ensure bylaws outline obligations to shareholders; encourage share ownership vs. debt; and
- get the money.

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Summary of Key Learnings

Participants worked in small groups to discuss the challenges they face in their communities and identify key learnings from conference presentations.

About the Community

- Assess the needs of local community.
- Communities need champions (mayor etc.).
- Develop a confidential data base specific to the local community. We need a dedicated person to develop the network in order to appropriately match investors to entrepreneurs.
- Identify and pool community assets and resources.

About Entrepreneurs

- "One step shopping" to find experts is important for companies.
- A facilitating agency can take a greater role in packaging. Include extra steps to identify market demand.
- Analyze projects in the context of their regions to avoid misunderstandings about the opportunity.

- Don't prejudge: not all investors want to play an active role in the company.
- Don't take the comfort level of investors for granted; "steps" have to be small enough that investors are comfortable.
- Educate both investors and entrepreneurs.
- Entrepreneurs must be well established before seeking investment.
- Entrepreneurs must invest themselves fully.
- Entrepreneurs with projects that need work should receive impartial help, i.e., mentorship should not come from someone connected to angel investors.
- Help entrepreneurs to develop good networks.
- Identify and facilitate the investors and their value.
- Inventors need to be prepared to enter the validation process, in the same way they have to prepare for investor presentations.
- Invest in the entrepreneur/person.
- It is advantageous to have a single focal point for the entrepreneur to link to financing.
- It is important for entrepreneurs and researchers to surround themselves with complementary expertise to ensure success.
- Look at options for sharing risk and use to also tap into resources and networks.
- Offer entrepreneur exposure, e.g., through networking.
- Provide advice on the negotiation process, e.g., between entrepreneur and investor/angel.
- Provide points of access for entrepreneurs to obtain professional services to structure deals with investors.
- The business plan must reflect the philosophy of the entrepreneur.

About Investors and Investment

- An angel should bring more to the table than just dollars.
- Angel investors need security.
- Avoid angel investors with a self-interest/conflict of interest in the company seeking investment.
- Build a strong relationship with the investor.
- Capital gains taxation policy may be used as an incentive.
- Concentrate on a single investment.
- Contributing investor may bring complementary skills to the company.
- Create an environment that will retain investment sources here – leads to also keeping companies here (stay attractive to them).
- Create an incentive for helping angels to invest.
- Create a strong value proposition when presenting idea to investors/angels.
- Don't judge investors too early.
- Don't look for investors unless the business plan is ready.
- Don't publish lists of angels.
- Don't spend a large percentage of your time looking for financing if you don't have the expertise: instead find someone who can help you.
- Entrepreneurs have to realize that one investment deal is just the beginning – ensure smooth flow to enable them to seek the next stage of investment.
- Government funding sources can be viewed as competition for VC companies.
- Information required by the investor (e.g., how much money is required, for what purpose, and what incentive options are available) needs to be clear from the outset.
- Investors are looking for brief, precise presentations.
- Investors should bring knowledge of the industry.

- It is important to understand the different phases of investment and its relevance at various stages of development.
- Keep angel networks informal and confidential.
- Know the investor and consider the investor perspective.
- Look for investors you can be comfortable with over the long term.
- Love money starts the enterprise: what impediments are there to this?
- Make sure you have the answers investors want; do due diligence on your business.
- Pick investors who would make good members of a Board of Directors.
- Regarding inflows vs. outflows of capital: is money staying in the country for development?
- Risk capital is available in Canada, but the allocation approach is too prudent and conservative.
- Strategic investors are best at the seed level.
- The supply of funding exceeds good quality deals.
- There are different types of informal angel investors, e.g., "silent partners", providers of "in-kind" services.
- There is a declining role for banks in lending; currently less than 50% of enterprises are funded by banks.
- There is a higher rate of VC in the high technology sector.
- Trust your instincts on how you feel about the 'fit' for investors.
- Valuations are in the eyes of the beholder.
- Venture capitalists don't like family businesses.
- VC flows to other sectors besides high technology.
- VC flows to where good deals exist.
- VC funds are flowing globally and being measured.
- VC funds are international – this may be counter to CCIP concepts about local investment. Foreign VC jumped to 30% last year.
- We have to be aware of pension funds and other sources of VC.
- We need to work with entrepreneurs to identify their angels. Angel investing is more emotional: in many situations, the entrepreneur knows the angel.

About Managing Companies

- Assist with sourcing appropriate management teams.
- Focus on company management and particularly leadership.
- Form an advisory board for each company.
- Leadership skills are a strong element; leadership by example is necessary.
- The role of the director/CEO must be well defined and the right people found to staff the positions.

General

- Be patient about getting financing, e.g., plan 6-12 months ahead.
- Create a path for angel investors.
- Don't dismiss those with a good product but not necessarily a polished presenter.
- Don't do the business plan for a company but rather give positive feedback.
- Everything done by the CCIP is fantastic and has helped sensitize angel investors and entrepreneurs. However, we must do more to facilitate the matching of angels and entrepreneurs. To do this, it is necessary to reduce the risk and if needed facilitate withdrawal.

We must also obtain the contribution of financial stakeholders (brokers) for the promotion of a new financial product without fiscal benefits. A government organization could put together the demands of entrepreneurs and submit them to a regional administration council made up of business people following the example of Innovatech. Then the funds could be advanced until we consolidate a minimum of ten businesses. The total of investments would be converted into a financial instrument that would be issued on the financial markets. This instrument could be started by angels investors, risk capital, banks, pension funds, etc.

Generally in a pool of this nature the rule 3-4-3 applies, which means that 3 enterprises are successful, 4 have average results, and 3 fail, but this still means a success rate better than 15%. Everything done by the CCIP has helped sensitize angel investors and entrepreneurs. However, we must do more to facilitate the matching of angels and entrepreneurs.

- Include universities and R&D in partnership development.
- Ownership of intellectual property should be established at the outset to avoid legal problems.
- Some of the more interesting innovations are from outside the university environment. We need to take the time to understand them; their value might be underestimated at the outset.
- Success is based on getting in and getting out.
- Take the time to write a good business plan.
- The right people are the key to a successful venture.
- There is a shortage of experienced people for Boards of Directors.
- There is a shortage of scientific manpower.
- We have to understand and improve the cultural impact on the entrepreneurial climate.
- We need a blueprint for proposal preparation.
- We need to address the huge gap between product development and distribution.
- When considering business plans and types of financing, the money percentage is important.

5. Business Incubators and Accelerators

"A good plan executed right now is far better than a perfect plan executed next week." (GEORGE PATTON)

"Incubation is about bricks and mortar. Germination is about creating conditions for growth and nurturing growth."

"It's easy to get good players; it's hard to get them to play together." (CASEY STENGEL)

"Let's hurry up and make all the mistakes so we can do this properly."

New Brunswick Incubation Centre

PRESENTER: Ross Mathers, Executive Director, Venture Partners, CCIP Fredericton

An incubation centre was established in 1987-8 as a UNB/NBRPC collaboration. Although not intended to be so, in practice Incutech became a rental organization with no criteria except money. The centre expanded in 1994-5 because of anchor growth. Clarification and redirection in mandate were discussed, but it remained essentially a bricks and mortar organization; funds still come from renting.

Key lessons learned included:

- the necessity for community involvement;
- the importance of having the right person in the manager's position;
- ensuring good two way communication with partners and the community;
- the importance of taking equity or options in the company; and
- targeting the clientele carefully.

The centre was scheduled to shut down when the lease expired on March 31, 2000. However, there has been a reprieve on the condition that the centre must be more than bricks and mortar. The intention now is to establish a full service incubator including:

(a) space rental and related services;
(b) financing help/advice for start-ups and expansion;
(c) private and special funding opportunities; and
(d) a variety of business and education services.

Formal mentoring is already in place with the Atlantic Canada Opportunity Agency (ACOA). There is also informal mentoring by the manager. New contracts with clients will be limited to 36 months and include an equity clause linked to services. Target range for equity is 1 to 6%.

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Niagara Virtual Business Accelerator

PRESENTER: Glenn Stansfield, CEO, Niagara Enterprise Agency

In Niagara, particularly following the free trade agreements, a paradigm shift was needed from branch plant mentality to entrepreneurial initiative; this involved understanding underdeveloped community assets, relying on those assets and focusing on the true engines of economic growth in the community.

CCIP is the model for the way we tried to build other services for our growth engines. Many excellent financial services already existed in the region and were encouraged to collaborate using increased market-share as an incentive.

Incubators can help businesses survive, attract new companies, help increase technology transfer, and provide opportunities for student research. On the minus side, they can insulate from true market forces. Incubators shouldn't be permitted to become permanent residences for companies.

The accelerator process can be virtual and build on existing resources. It helps to develop a strategic process by coordinating and utilizing the strengths of community partners. Services can be customized to fit the business. The focus is on a community process of growth-based services. The major weakness is the newness of the concept, which requires education of community partners. However, CCIP provided Niagara with a strong community base to drive into the accelerator process. Private sector participation was also critical.

The Niagara Virtual Business Accelerator (NVBA) targets high growth companies. Businesses must be profitable and must generate community wealth. It is a not-for-profit organization with 8 full time staff as well as a group of senior associates and community partners who provide expertise.

Services include competitive intelligence, investment facilitation through the CCIP, the community small business investment fund (Niagara Growth Fund), and the accelerator service (NVBA).

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Incubators and Accelerators: Lessons Learned

PRESENTER: Lindsay Worden, Principal, FinQuest Partners LLC

Ms. Worden provided the following lessons learned for what incubators and accelerators should and should not do.

- Be able to say no quickly; don't waste the entrepreneur's time if there is little chance of success.
- Never write the business plan for the entrepreneur: the business plan is an indication of commitment and passion. At best, provide a template and constructive criticism, but don't do it for them.
- Never introduce an entrepreneur to a potential investor until they are absolutely ready: the business plan has to be ready; if the investor looks at it and says no, they won't give it another chance; ensure that market research is done and the basics are covered.
- Offer the entrepreneur exposure: entrepreneurs don't always have the time to network to meet potential investors, employees and Board of Director members. Giving them presentation time before an association meeting is one way of giving exposure, e.g., the "Seven Magic Minutes" program.
- Have a market niche: an accelerator can have a broader niche, but incubators should be more specific to attract investors interested in that specialty and encourage peer-to-peer relationships.
- Build value, not valuation: after the high technology downturn, a more traditional view of business has returned. Revenue and cash flow information are important.
- Facilitate access to the next stage of funding to keep companies growing.
- If consulting for equity, first raise the money needed to cover expenses: either do it in advance or have someone on staff to do it; worry about incubating rather than the incubator.
- Strategic investors are the best types at the seed level.
- Invest in the entrepreneur first, and the idea second: if entrepreneur is not committed, it won't work.
- Form an advisory board early on for each company: it provides a good training ground and possibly may mature into a Board of Directors.
- The virtual incubator is the better model: entrepreneurs are nurtured best in their own community and overheads are kept down.

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Inno-Centre

PRESENTER: Claude Martel, président et chef de la direction, Inno-Centre

Inno-Centre's mission is to participate in the start-up and growth of new companies operating in technological innovation by providing training and expert business advice tailored to their needs. The focus is not so much on job creation as on creating value and wealth in the community.

Approximately 400 companies are considered each year, of which 15-20 may be accepted. Professional services invested in each project may be in the \$250-350k range. Inno-Centre recognizes the importance to Canadian business of building networks and organization to help sustain growth.

The support that Inno-Centre provides to its client companies takes two forms: a complete business development service and access to a prestigious business network.

Business Development Service

Within six months of a company's enrolling in the program, an Inno-Centre counselor works with the company's directors to draw up a business plan. The plan is then used by the entrepreneur and an Inno-Centre expert to seek financing. Inno-Centre's multidisciplinary team also assists the company in planning key aspects of its operations, such as management, production, finance and marketing. This assistance continues for the full two years of the program.

At the same time, an advisory board (management committee) is formed for the company. The members of the advisory board act as expert business development advisors, helping the company to define its strategic orientations.

Inno-Centre's entrepreneurs also enjoy access to a practical, management-oriented skills development program. The skills development program features courses, seminars, conferences and other activities.

Business Network

One of the key elements of the program is our impressive business network. In its full-time team, specialized counsellors, sector-based committees, collaborators and resource bank, Inno-Centre has built a network of highly qualified and respected individuals from the business and high-tech sectors to serve its client companies.

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Short Term Accelerator Pilot Project for ICT SMEs

PRESENTER: Jack Peterson, CEO, Strategic Innovations Inc.

The Short Term Accelerator Pilot Project (STAPP) was created in 2001. Initially, the main goal was to assist ICT companies to attract investment, but the goal evolved into that of educating client companies on how to attract investment and become investor ready. Companies were targeted that were nearly investment ready but for some reason hadn't gone the distance.

There were two objectives:

(a) to make companies investor ready; and
(b) see if program and content could be developed into something reusable.

The format is very specific and involves six intensive how-to sessions based on the following themes:

- preparing and executing your financial plan;
- who are we now and who can we be;
- intellectual property;
- finding investors;
- how to make a presentation; and
- trial presentation.

The program structure includes prior readings, presentations, discussion of key presentation points, detailed analysis of each ICT company, ideas of improvement areas, preparation of an action plan and schedule, and assignment of tasks as homework. Mentorship is available between the sessions. There is a $1,000 fee for the process. Cost of the program is estimated at $35-40k, with an additional $100k in in-kind services.

Lessons learned included:

(a) there are major gaps between what entrepreneur and investors think;
(b) when entrepreneurs think they are ready and related success factors;
(c) the importance of key agreements; and
(d) intellectual property.

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Greater Halifax Partnership

PRESENTER: Neil Ritchie, President, BioMed Management Inc.

This initiative got off to a false start with the Halifax Equity Group, which attempted to be all things to all people and competed against local investors. After a year, the approach was changed.

The Dalhousie Business Development Office (DBDO), a private technology development company, was invited into the University. The focus is on life sciences, e.g., at NRC, universities and medical schools. Four companies have been created in the last four years.

We learned that it is important to get in early and work with the scientists to create an environment where science and business can work together. DBDO helps with marketing plans and other business services, and tries to help create conditions for growth in a confined environment.

Challenges include:

- coaching scientists to think in both science and business dimensions;
- managing conflicts of interest and conflicts of commitment;
- balancing resources;
- being able to think broadly enough without being pulled into too many different directions; and
- there must be a focused, market-driven approach.

The University has been generally supportive. There was tension at first, but as success stories came in, it diminished. DBDO focuses on company creation rather than licensing deals, which was not what the University wanted. Education is important in this regard.

Summary of Key Learnings

A strong basis of communication with the client is essential.

- Adequate base funding is key to be able to focus on important services.
- An incubator helps you to impose a structure/culture on the developers, which should help to improve the success rate of SMEs.
- Are incubators artificial shields for new companies?
- Finding the right manager for the incubator is essential.
- Incubators: build linkages not bricks and mortar.
- Incubators: the most important room is the kitchen or social event.
- Incubators can act as tools to facilitate mentoring.
- Incubators should be a focal point for coordination.
- It is important to get equity out of the company.
- Networking is very important for tenants – often more important than dollars.
- Quarterly targets should be set for incubator clients, with follow up meetings to ensure targets are met.
- Some organizations, e.g., CFDCs, become incubators without planning it.
- Sometimes physical space is required, e.g., biotechnology. If you don't have the space they will go elsewhere.
- Tenants must be targeted to avoid culture clashes; the matching process is important.
- The virtual accelerator may have a more significant impact than a bricks and mortar "incutech".
- The Inno-Centre approach focused on technology rather than the entrepreneur.
- The intake policy must be clear as well as exit plan.
- The type of incubator depends on goals.
- There is a distinction between incubation and germination; each requires a different approach.
- There is a need for virtual incubators, e.g., to provide a network of expertise.
- There should be flexibility in the design of incubators.
- Universities need to be educated on the risks and rewards of Intellectual Property.
- We have to know how to say "no" when the idea doesn't fit with the priorities of the incubator.

- We learned how much easier it is to establish a virtual incubator as opposed to a bricks and mortar incubator. However, a virtual accelerator requires education about its role.
- We need to find a way to turn the Intellectual Property into dollars, e.g., commercialization technologies.

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6. Community Action Plans

> "A lot of the problem with innovation is that most companies don't understand what their innovation strategy is."

To close the Conference, participants worked in small groups to identify one significant thing that could be done in their community to help bridge the investment gap. Then they developed action plans for implementing that significant item.

A Question and Answer period (Q &A) followed this task with an expert panel consisting of Guy Dionne, Denzil Doyle, Jack Peterson and Glenn Stansfield. Following are some discussion points from the Q&A.

- Boards of Directors and Boards of Advisors can help in knowledge transfer.
- Breaking down silos in a community setting is one of the jobs a local economic development officer should be taking on. Diversification of the economy is a big issue. Diversification should go right down to the community level; it's important to get everyone working together to achieve this goal. (See *The Winning Formula* for examples of breaking down silos.)
- CCIP has been a great learning experience and communities should be looking for ways to continue it at the community level in a self-sustaining manner.
- Every community has an investment and a technology engine. The trick is to bring them together. Economic development officers should look at the local community and try to get older people talking to the younger people.
- In Niagara, the rigour of the due diligence process has been key in convincing financial institutions to support initiatives.

- Much of the problem with innovation is that companies don't understand what their strategy is. Importation strategy (e.g., establishing a branch plant) is a mug's game; regions can throw away a lot of money trying to attract foreign business. Growing your own community strategy, e.g., CCIP, can be a better approach.
- Old venture reinvention should not be overlooked. Sometimes communities have huge underdeveloped assets that with proper management can be redeveloped and grown into profitable new ventures.
- Regarding finding a champion: there are receptivity analysis tools that include factors such as local champions and local buy-in. However, in most cases the local economic development officer should act as an accelerator.
- Success for investment facilitation services come from local business owners who are prepared to partner. At the end of the day, it is the business professionals and community members who are prepared to join Boards and give their expertise on a volunteer basis who make this type of program work. Private business members are our best champions.
- The best angel investors want to remain in informal networks. Perhaps angels should make themselves known to bankers, etc. Angel investors hesitate to share their leads and therefore their money and expertise with other organizations.
- There is not enough data on the capital gains tax in Canada, but Canada should consider removing it altogether to stimulate investment. The question becomes: What will replace it?
- Venture Capital can be a very informal process; the champions are often well known and investment facilitation services are only go-betweens. We have to make people aware of them, but often we know the champions.
- We often forget our traditional sectors; there are many investors who prefer to invest there rather than in high-technology because it is easier; the risk is less; products are easier to sell, etc.

Closing Remarks

Mr. Rob Dunlop, Director General, Small Business Policy Branch, Industry Canada, closed the meeting by thanking participants, speakers, CCIP managers, international delegates and the Industry Canada team. The closing metaphor of the conference was a tree growing and branching out, sending the message of the CCIP experience across the country and to other countries as well.

Industry Canada continues to be enthusiastic about its commitment to the CCIP and the program outcomes documented at this Conference. The purpose of the program was to test a variety of models for raising investment capital, and participants have come up with some significant challenges as well as a comprehensive list of best practices.

The question now is: What can we do with this information and how can we get it out to other Canadians and interested communities around the world? The challenge remains to help SMEs in Canada continue to grow and find financing. We have to share what has worked well as well as continuing challenges if we are going to facilitate effective future policy development in support of small and medium size business development.

Mr. Dunlop reiterated the challenge made at the beginning of the conference: for participants to build on what CCIP has accomplished to achieve even greater success in their communities. Not every strategy has worked in every community, but one of the major successes of the CCIP is the network developed by the 22 pilot project managers. He hopes that this conference is the first step to help broaden this network to other Canadian communities and abroad.

In closing, Mr. Dunlop noted that there is still time left in program. The CCIP evaluation process should be completed in July and there will be a discussion in government about program results. Decisions will be communicated to Conference participants as soon as they are available.

Canada Community Investment Plan

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