

Investments vary, but research the market first

By Peter Caulfield

Tom O'Flaherty is angling for investors for FroZen Dirt Media Corp. (FD), an early-stage software development company in Victoria, BC. To date he's had a few nibbles, but no bites.

"Finding money has been difficult," says O'Flaherty. "The company exhausted its love money (initial investments by family and friends) and angel investments before it received customer endorsements. [Potential] customers are interested but, because they tend to be larger than FD, they want to see a year's working capital in place before making a commitment."

O'Flaherty, who is general manager of FD, says the software developer is in a chicken-and-egg situation. "We need investment to get customers, but we can't get investment without customers."

FD is in the same financial boat as many other young technology companies. "Things are tough these days," says O'Flaherty. "The bubble used up investors' capacity for risk. And those companies that survived need further investment. These follow-on investments are consuming a lot of the available investment capital."

O'Flaherty's assessment is echoed in a recent report by Toronto-based Macdonald & Associates Ltd. on venture capital and private equity activity. The company says Canadian venture invest-

ment in Q2 2003 was at its lowest level since 1996. The report says the downward trend is the result of 70 per cent of total capital having gone to follow-on investments.

Brent Holliday, partner with Vancouver-based Greenstone Venture Partners Inc.,

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Tom O'Flaherty
FroZen Dirt Media Corp.

says young technology companies looking for investors shouldn't despair.

"Finding angel and venture capital money is harder today than four years ago, but easier than a decade ago," he says. "The boom is over and investors are tighter with their money. But more sources are available today than before and more companies will emerge as a result."

Holliday says several sources of financing are available to young companies, including credit cards, family and friends, angel investors, government, venture capitalists (VC) and banks and credit unions.

"They pretty much go in order of the progression of an idea to a prototype or demo, to a working version, to a customer sale and finally to a cash flow-positive business," reckons Holliday. "A VC steps in at

the demo or customer sale stage, but only if the idea is big enough."

The amounts of investment are widely varied depending on the kind of technology in question. "Software is dollars and biotech is dollars, dollars, dollars," he says.

Typical amounts for a company that

starts small and goes on to bigger things are as follows:

- \$50,000 of the founders' money to get the company started and to prove the concept through market research;
- \$100,000 to \$250,000 from friends and family to start development;
- \$50,000 to \$100,000 in matching dollars from a government program;
- \$100,000 to \$500,000 in angel money from wealthy investors; and
- \$1 million to \$10 million in Series "A" VC financing.

Holliday says the longer entrepreneurs can "bootstrap" their business ideas (not take outside investors), the more they'll end up owning.

"But bootstrapping means you sacrifice your ability to move fast and grow rapidly," he continues. "Decide early if you want a huge corporation. There are good wealth-generating small business opportunities that don't require angel or VC money. But if you want to start the next Creo, QLT or Sierra Wireless, plan on raising a lot of cash and owning a small piece in the end."

Whether their ambitions are huge or merely large, technology entrepreneurs need to be top-notch communicators, advises FD's O'Flaherty.

"One of the first things I had to do at FD was to package the story so that it could be understood quickly by a complete stranger," he says. "Most founders forget what the world was like before their invention. They tend to make a lot of assumptions and mental leaps when they speak to outsiders."

O'Flaherty, a technology industry veteran (co-founder of the companies that developed Simply Accounting and Maximizer software packages), says many young companies don't realize the business case interests investors, not a product or service.

"After all, they want to get their investment back, with a substantial gain—the sooner the better," he says. "This often escapes technical founders."

Technology entrepreneurs need to learn

to tell a potential investor what he wants to know. "You have to be able to speak to the 'suits' and gain their interest before you get to talk to their technical evaluators," says O'Flaherty. "The suits stand guard. If you can't explain the opportunity in plain English, especially as an elevator pitch, you're not likely to get past them."

Another West Coast software veteran, Bill Campbell, says young technology companies need to be creative.

"Financing your start-up company should be more about who you want as a partner," he says. "It's not simply about the money you need."

Campbell reckons young companies should start building relationships with potential investors before they need the money.

"In the dot-com era, money flowed free and fast," says Campbell. "All you needed to get some of it was a glitzy PowerPoint presentation. Today's entrepreneur needs a strategy with more finesse and less hype."

Campbell suggests turning the tables on potential investors. "Meet and interview a dozen investors," he advises. "Find out what makes them tick, how they work, what companies they invest in and who they partner with. Don't talk about you or your product. Twenty thoughtful open-ended questions will uncover more information about them than they knew themselves."

Once they've got their pitch honed, technology entrepreneurs are almost ready to start knocking on the doors of potential investors. But first they should canvas the advice of seasoned financial pros.

Victor Scutaru, Toronto-based director of technology seed investments with the Business Development Bank of Canada, says

founders of seed-stage businesses should prepare a concise business plan that addresses the basic business issues, including an understanding of potential customers and their behavior.

"You need to know who your customers are and why they'll want to buy your product," says Scutaru.

Their business plan needs to focus on the management skills needed to execute the company's mandate, including identifying people with special skills to add to the management team.

Edmonton angel investor Perry Kinkaide says an experienced angel can "immeasurably" improve a young tech company's chances of success. Unfortunately, such investors are often hard to find.

"Angels are quiet and shy and rarely flock together," he says. "Third parties are the best way to find them. Sometimes they are known by economic development authorities."

Continued on page 7, see "Pitch"



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Tom O'Flaherty, general manager of FroZen Dirt Media Corp.

The pitch has to be right

Continued from page 4

Kinkaide says there are many types of angels. "One of the easiest to get is a person who has recently come upon an inheritance or severance. Legal and accounting firms are often aware of them, but they guard them carefully. The best bet is to have a friend on the inside."

Toronto lawyer David Brown, partner in WeirFoulds LLP, works with the Toronto Angel Group (TAG), a group of 45 individuals who meet regularly to review early-stage investing opportunities.

"Approximately eight investment dinners are held yearly where the angels get together and have four investment opportunities pitched to them," says Brown.

He advises that presenters need to keep their pitches tight and to the point. "Early-stage companies tend to forget who their audience is," he says. "Angels have, by definition, successfully built companies on their own before and they know how hard it is to achieve success."

Pardeep Sangha, associate with Ventures West in Vancouver, says too many young technology companies looking for financing lack a clear, concise pitch.

"A lot of them are missing focus," he says. "They're often trying to do too many things at once."

Susan Read, VP of TechnoCap Inc. in Montreal, says too many entrepreneurs farm out writing their business plan to a third party, such as an investment banker.

"Investors are uncomfortable if the entrepreneur doesn't match the document," says Read. "We need to know who we're dealing with."

She says many of the proposals TechnoCap receives have the same look and feel. "It's as if they came out of a factory somewhere."

Read and her colleagues are sensitive to telltale hints about a company's ability to manage cash. "Modest expenditures on

things like office furnishings, clothes and cars can create a favorable impression," she states.

Greenstone Venture Partners' Rich Osborn says some entrepreneurs need to do better market research. "Some of them are too dismissive of incumbent competitors, particularly the larger ones," he says. "This doesn't convince prospective investors that they've done their homework."

Andrew Kyle, partner in Calgary's SpringBank TechVentures, says he looks for flexible management when considering whether to invest in a technology company.

"Usually the management team needs some additions and that is why the founders' flexibility is key," says Kyle.

For tech companies that haven't connected yet with the right investor, there are organizations to help them meet their match. The Banff Venture Forum (BVF), presented by industry association InfoTech Alberta, is a

two-day event at which selected early-stage companies make short presentations to an audience of angel investors and VCs.

Susan Miller, chair of the forum's steering committee, says BVF features discussions on sources of financing, investment terminology and the relative com-

petitiveness of Canadian and US companies.

More hands-on is Calgary Technology Inc.'s Concept to Capital (C2C), a 12-week program that shows entrepreneurs how to put a viable business together and build a winning investor presentation. C2C is offered twice a year.

"What investors want to see first is a strong management team with the know-how to commercialize the technology," says C2C manager, Karen Robinson. "When it comes to raising capital, the difference between success and 'also ran' is knowing what investors look for. In our experience, success is only 10 per cent about technology; 90 per cent is about business execution."

Alberta Innovation and Science funds the

Alberta California Venture Channel, which partners the expertise and larger capital pools in California with Alberta entrepreneurs and investors who need to raise capital, create American markets or add to their advisory boards.

Other young companies are often a rich source of useful tips, some follow...

Ian Collins, CEO, Mobile Diagnostix Inc., Richmond Hill, Ont.: "Exposure in the market is hard to get. People need to have heard about you from a third party."

Mark Walker, president, Blanketware Corp., Toronto: "Put your energy into making your business a success and investment will come. We were very fortunate to find angel investors with the depth to stand with the company over time."

Dean Yergens, president, Healthcare Simulations Inc., Calgary: "Look for investment from investors that have a track record with successfully investing in companies. Spend time researching them. Learn about their other deals."

Roger Verhelst, president, NoBeach Technology, Calgary: "Calgary has a small investment community. I was amazed at how quickly people became aware of who we were and what we were looking for. It was therefore imperative that we had a consistent message and knew what we wanted from a deal."

Oscar Cuzzani, CTO, Eric Technologies Corp., Calgary: "However long you think it



Karen Robinson, manager of Concept to Capital.

will take, double it. However much you think it will cost, triple it. And as for mistakes, if they don't kill you, they can hurt real bad."

Martin Alcock, president and CEO, Integen Technologies Inc., Calgary: "When getting start-up financing, the investment is the only product the company has to offer. Compare your product with other investment products and offer a competitive deal to attract an investor."

Dimitri Sirota, VP marketing, Layer 7 Technologies, Vancouver: "Raising initial capital from our local VCs saved travel costs, time and legal and other costs. It helped us stay focused on building our product and running the business."

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