Show Me The Money: Raising Capital for Start-up Businesses

By Glen Agar

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You have an idea which you believe you could turn into a business, and you are certain that it is a good idea, defining a "good" idea as one that makes lots of money. You talk to your confidants and are reassured that it is a good idea, and in fact, most of them think this is a fantastic idea – and there is no telling how much money a "fantastic" idea can make, but it is surely big.

You have always fashioned yourself as an entrepreneur and you can easily envision yourself in the oversized leather chair leading the charge in the board room. Your mind drifts as you conjure up the parting conversation with your boss, saying goodbye to the drudgery of your 9 – 5 job.

Or maybe your vision is not as wildly exciting, and you are already an entrepreneur, and your good idea involves expanding your existing business or branching into a new area of business.

In either case, you quickly come to the conclusion that you need more money than your personal resources will provide. So what's next?

Fortunately, you have a good financial advisor and when you sit down with her, she explains that the sources of funds can be grouped into four categories. First, and most obvious, is your own. Second, is from friends, family and close business associates. Third, is from financial institutions who lend money, such as banks and credit unions. And fourth, is from equity investors, such as equity funds or high net-worth investors.

She explains that as you move down the list, the cost of the money gets more expensive. You and your family, friends and close business associates are prepared to risk capital in the hope and expectation that you will make a lot of money once the business is successful. These funds may be provided to the business in many ways, but typically they will be advanced by way of a subscription for shares or a non-interest bearing promissory note, without a requirement for your personal guarantee.

The third group, being the financial institutions, will not purchase shares in your company but will lend the money to your company and charge interest on the funds. The rate of interest charged will be based on the perceived risk of the loan. To reduce the risk, the financial institution will require security, which usually is a charge over all of the assets of the company and additionally, in most cases, will require personal guarantees from you and your business partners.

The benefit of the financial institution is that it is less expensive than the fourth group of equity investors. However, the financial institution, a.k.a bank, has no inkling of altruism and it (and all of its deposit holders of which you may be one) will want the money back, with interest, regardless of whether or not your business is successful. This can add a level of stress which may cause you to look for investment from the fourth group – the equity or angel investor.

The equity investor invests in shares in your company, so there is no debt to repay nor are personal guarantees required from you. You like the option of getting an equity investor as you happen to know a number of very wealthy individuals who may be interested in investing in your company, and you are not keen on the idea of debt and personal guarantees. But equity investors take a conservative view of your business and factor in all of the risks, which means that they will likely want to take a substantial percentage of the shares in your company. It may seem expensive, but in the long run you are better off having a smaller percentage of a successful business than a larger percentage of a business that fails. You are an avid fan of "Dragon's Den", so this starts to make sense. Your financial adviser wisely suggests to you that prior to talking to any potential investors, you meet with a securities lawyer to ensure that you do not run afoul of the securities laws in your province.

The securities lawyer explains that the role of the Securities Commission is to protect the unsuspecting public from snake oil salesmen. As a result, companies trying to raise capital must file a prospectus with the Securities Commission and retain the services of a broker to effect the sales of the shares in the company. This is a time consuming and expensive process. But there is relief in the form of exemptions from these requirements. Your ears perk up as he explains the "accredited investor" exemption. This exemption applies to individuals who fit within a number of criteria including having significant annual incomes, in excess of $200,000, or liquid assets in excess of $1,000,000, thereby being an "accredited investor". Given the accredited investor's financial strength, the Securities Commission deems these investors not to need the protection of the Securities Commission in making their investment decisions.

The securities lawyer sees the gleam in your eye and warns you to be careful and ensure that you are only talking to accredited investors, and not the public, about a potential investment; otherwise, you will be offending the securities laws and potentially subject to serious sanctions.

He also advises you that the provincial government may have a tax credit available* of up to 30% of the investor's investment to make your job of raising funds a little easier, but of course, you need to follow their rules and regulations.

You thank the securities lawyer for this valuable information, and you leave his office full of confidence that accredited investors will be beating a path to your door, begging to invest in your company.

And then the challenge begins!

* Tax credits are currently available in British Columbia, Manitoba and New Brunswick

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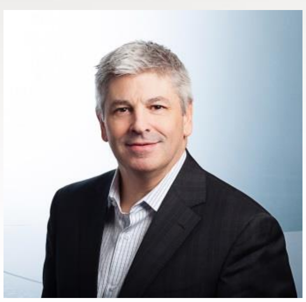

Glen's practice is focused on the corporate and commercial areas of the law. He has particular experience in mergers and acquisitions, the preparation and negotiation of agreements, banking and finance, government relations, securities, and agricultural matters.