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Small Business Resource Centre

Raising cash in a tight market

Individual angel investors typically provide funding of $50,000 to $1-million. Fotolia

Mary Teresa Bitti, Financial Post · Monday, Jun. 21, 2010

It's never been easy for early-stage companies to raise money. Today, as the words double-dip recession get floated about, it's tougher still.

"Those guys do not have a ton of great options right now," says Brad Cherniak, partner at Sapient Capital Partners in Toronto. "Early-stage venture capital is in rough shape in Canada and the United States because of the economic downturn and the instability of the markets."

What's more, competition is fierce and startups that have the ability to expand into the United States and other geographic markets have an edge over businesses limited to the Canadian market, Mr. Cherniak says. "Our consumer and business markets are not very big and so the potential is also limited. This same problem plagues our capital markets. We are not very big and our pockets are not very deep."

While capital is low, it has not dried up completely. "The early stage has never been a very organized and systematic capital market. Banks are providers of liquidity as opposed to capital. They are not really a source of risk capital themselves," Mr. Cherniak says.

"So you are in the world of pseudo-institutional angel money. Think government money linked to industry and personal sources, including friends, family, second mortgages and credit cards." The goal is to get into a position where you are moving up the food chain, at which point you can access private equity, a broad category that ranges from individual investors to institutional investors and funds that invest in companies that are not publicly traded.

Angel investors "They can be anybody. It's very hit or miss and often comes down to tapping your personal network," Mr. Cherniak says. "Angel investing is changing because angels are now coalescing into groups. There are roughly a dozen angel groups in Canada that are not-for-profit organizations to help angels network with each other. That's all starting. It's a critical source and it will get more important over time for companies." Angels have always been an important source of startup capital, and invest as much or more than venture capital funds, although in much smaller individual amounts, typically anywhere from $50,000 to $1-million.

Pure venture capital This represents a unique, but very small, niche. "Very few startup companies fit into a venture-capital paradigm," Mr. Cherniak says. "These are companies like the next Google." In other words, technology companies with high-growth potential.

Private equity These are retail and institutional investors and funds that invest directly in private companies and represent the richest source of capital for small to medium-sized businesses that have demonstrated the ability to survive and have achieved critical mass, typically sales in excess of $5-million, Mr. Cherniak says. "Size matters when it comes to attracting investment. For example, if you have revenues north of $25-million and you are profitable, your options are plentiful. At the same time, at this size, companies are more likely to qualify for bank loans or mezzanine loans, which are a type of hybrid between true risk capital [equity] and a bank loan."

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