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# When venture capital says no, where do tech startups go for funding?

Christina Pellegrini | October 26, 2015 10:36 AM ET

**Michelle Siu for National Post** *Michael Cohen, president of drone maker Industrial Skyworks, got a line of credit from BDC because revenue at the firm was enough to service the debt.*

A technology startup in Canada doesn't have to be extraordinary to get approved for a loan. It doesn't need to disrupt a sector like Shopify Inc. is doing to retail. Sequoia Capital and Andreessen Horowitz don't need to own an equity stake. It doesn't have to be poised to become a unicorn, a term for rare, fledgling upstarts that reach a valuation of at least $1 billion, such as HootSuite Media Inc. or Waterloo's Kik Interactive Inc.

Creditworthy tech startups need this one thing: cash flow, says the Business Development Bank of Canada, a financial institution owned by the federal government that disbursed $4.7 billion in loans in fiscal 2015.

"VCs are looking for the next big thing that will revolutionize the world. That is great, but it doesn't have to be," Jasmin Ganie-Hobbs, who helps fund promising Canadian tech upstarts with debt at the BDC, said in a recent interview. "It does not really matter if the company is best in category in technology. Our concern is building strong companies that have the capacity to make money and are able to pay us."

Ganie-Hobbs says her group at the BDC offers budding tech startups access to credit between $25,000 and $5 million, a range that entrepreneurs say is often toughest to secure because it's hard for most financiers to predict with conviction whether the nascent company is poised to boom or bust.

But that financing is often vital to keeping a business afloat after a founder drains their savings or runs out of family and friends from whom to borrow cash. To fill this void, a crop of online lenders such as OnDeck Capital have sprouted and the crowdfunding marketplace has ballooned. Still, finding a way to work with an institution such as the BDC has weight for many entrepreneurs who find raising capital to be arduous.

Most entrepreneurs can't attract VC funding. Former commercial airline pilot Michael Cohen pitched his software and data analytics company Industrial Skyworks, which employs drones to capture imagery of building rooftops and industrial sites, to the BDC's venture capital arm, which declined to extend an offer because "we didn't fit their financing criteria," Cohen recalled.

The BDC had already extended Industrial SkyWorks a line of credit a year earlier in 2014. The bank felt the revenue that the company was generating meant it could afford to take on a line of credit and have enough of a cash cushion to service the debt, as well as have the working capital it needed to fund growth.

"We just weren't ready for a VC round at the point at which the BDC was able to help us," Cohen said in an interview. "The financing through debt has been able to position us, six months down the road, to be able to carve out a clear value proposition and be able to demonstrate a deep amount of intellectual property and a good market opportunity." Cohen is working toward closing a round of Series A funding, though he is not ready to divulge any details it is not with BDC.

Even if they did qualify for a loan, most Canadian technology startups can't afford to service the debt on a monthly basis, because the company is growing so fast and needs every dollar put to operations. Also, as in many cases, there may not be any revenue, or, there may be sales, but cash takes months to trickle in.

As evidence of this, more than a quarter of the 150 Canadian startup executives who responded to PwC's latest "Emerging Companies" survey, said their company was pre-revenue and almost half identified their total sales between the $0 and $500,000 bracket. Nearly three-fourths of the businesses that have raised money did so through angel investors, family or friends and raised modest amounts of $500,000 or less.

"Debt isn't typically a great vehicle for growth companies," said Brad Cherniak, co-founder and partner at Toronto-based advisory firm Sapient Capital Partners who wrote a monthly column for the Financial Post. "When you are growing and early stage, you're using cash, not generating it. You can't predict the timing of anything and so when you have regular debt service payments, it's just asking for trouble."

But what could be more trouble than going out of business? When cash starts running thin, Cherniak has seen entrepreneurs agree to unfavourable terms or an astronomical interest rate in desperation. "A lot of them would like to get debt," he said. "They don't want to give up equity that would dilute their position, but they just can't get it." He says the toughest decision is whether or not to take the first cheque or offer.

"The wonderful cliche is that the No. 1 challenge of growing your company is access to capital," Cohen said. "But once you achieve access the cost of that capital becomes a significant line item in one's budget."