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By Michael Volker

VC in BC: Investments in tech ventures exceed $1 billion in 2006

I thought it timely to write an update on Venture Capital in British Columbia. I'm simply amazed at the number of new startups that are being launched around the Province. And, I'm equally amazed at the number of investors that are keen to fund these new companies. Even so, many entrepreneurs still have trouble making a capital connection – hence, my motivation for this piece.

"VC" is a generic term describing at-risk equity capital from all investment sources. However, through common usage, the term has become synonymous with institutional investors. So while an angel is technically a "VC", most angels shudder at being identified this way. In the 80's when I started doing angel investing, the term didn't exist so I was flattered when companies called me a VC even though I always felt like a bit of a fake because of my limited capital resources!

When this more restrictive view is taken, one can easily come to an erroneous conclusion about the availability and abundance of all capital. This is because you will hear statements such as, "$300 million of venture capital was invested in B.C. tech companies last year". You might believe that that's all there is. Hardly.

It always bothers me when people use the dollar figures for capital invested and managed by institutional VCs as "*the*" amount available to entrepreneurs. This is, in fact, a small slice of the venture capital pie. It may surprise you that capital invested by angels, private individuals, and private funds is many times that which is invested by institutional investors (the so-called VCs).

Indeed, according to "exempt distribution" reports filed with the **BC Securities Commission** (BCSC), advanced technology companies (infotech & biotech) raised $671 million in 2006. Bear in mind, though, that most financings go unreported since the vast majority of companies raising capital are considered "private issuers" whose fundraising remains confidential. Of a sample of 235 companies that raised capital through **VANTEC** (Vancouver Angel Technology Network), only 26 (11%) reported to the BCSC. And these numbers don't include prospectus offerings through the **TSX Venture Exchange** which facilitated another $300 million in financings for infotech and biotech ventures. (The TSX Venture Exchange reported $178 million in biotech financings and $418 million in infotech Canada wide but almost half its listings are BC companies.)

Let's categorize all types of VCs - let's just call them venture investors to avoid confusion - into 6 common groupings: 3F (family, friends & fools), Angels, Angel Funds, VC Funds, Investment/merchant bankers, brokers & junior exchanges.

How much capital is there? Conservatively, I figure the real number for all capital raised by BC tech entrepreneurs far exceeds $1 billion. A more relevant question might be to look at how much is being invested by these groupings. This will, I hope, provide some renewed optimism for fund raisers.

Institutional VC data is readily available, for example, **Thomson Venture Economics** (formerly Macdonald & Associates of Toronto) provides reliable, detailed data (searchable database) on their website. However there is no way of quantifying the 3F category and only limited sources of information on Angels and Angel Funds. For the most part, there are no statutory reporting requirements and minimal voluntary tracking of deal and capital flows, although VANTEC is attempting to capture some of this information.

A mid-2006 survey by **Rocketbuilders** of Vancouver studied 235 companies that presented to Angel investors over an 8 year period. It shows that half of the companies that sought financing were successful in so doing! On average, the angel network entertains pitches from 5 companies each month. The dollars invested and the number of deals getting done just keeps on increasing and there's a healthy appetite for new opportunities.

I'm often asked, "what's the difference between Angels and VCs?" An angel is, by my definition, a been-there, done-that entrepreneur who is investing her own money and *time* to help another entrepreneur get started. The term comes from Broadway and refers to successful stars who were helping up and coming ones launch their careers. An angel thinks of all the reasons why she should invest in a deal (she sees a half-full cup) while a VC thinks of all the reasons why not to invest (sees a half empty cup) – rightfully so because they have to manage other people's money.

A quasi-angel is someone who invests his own money but didn't necessarily acquire his wealth by being a tech entrepreneur but is nonetheless willing to risk his own money (maybe time, too) to help launch a startup. I say startup because that's another difference: VC's like to wait well beyond the startup stage. You will hear that VC's are investing earlier – sometimes even co-investing with angels – but there's a BIG difference between a startup and an early stage deal. What's the difference? An early stage, VC-bankable deal, has a business plan, a team, products and customers. A startup may have little more than a great idea. Another big difference between VCs and Angels is that VCs are looking for companies that have big potential, i.e. a good chance of becoming a $100 million market cap company that can give them a good return (eg 3-5X in 5 years) on their $5m invested. Angels are content to invest in smaller ventures that have a $10 or $20 million potential because they can still make an attractive 10X-50X return on their $500K in 5-10 years. (the multiples and numbers reflect other VC-Angel differences).

Recently, I got a call from a startup entrepreneur in fund-raising mode for the first time. She wanted to know how she could approach relative strangers for small amounts of capital. I cautioned her that, even if she found someone willing to invest $10,000 in her company, it might be illegal for her to take the money unless that person is a bona fide millionaire. Many entrepreneurs do not know that you cannot simply sell shares to anyone. Securities Commissions in general (in B.C., the B.C. Securities Commission) have strict rules – rules that are generally unknown, evolving, changing, and different from province to province – as to what you can or cannot do. These rules are all spelled out on the B.C. Securities Commission's website.

If you want to take an investment from anyone you have not known well for at least two years, you can either issue a “Prospectus” for the sale of your shares or use a so-called “exemption”. At the startup stage, you will likely use the family, friends, relatives or close business associates exemption (active business partners such as directors and officers are exempted as well). A Prospectus is something like a business plan but far more legalistic especially with regard to warning investors why they should not invest. While business plans are often read, Prospectus documents are rarely read by anyone – except by regulators because they, in order to protect the wary public, must vet them and approve them. Lawyers love them, too.

Not to digress too much, but you should know that investors need not read a prospectus because even if they don't, they can still sue. It's called "deemed reliance".

Unless you plan to “go public”, issuing a Prospectus will likely be too onerous for you (very expensive, on-going disclosure requirements, etc). You need an exemption.

A frequently used exemption is the “Accredited Investor” exemption. This means that anyone who meets a certain financial standard (simply put, a millionaire – but there is a formal definition) can readily invest. Failing that, you could prepare an “Offering Memorandum”. This is a watered-down prospectus that does not require regulatory approval. You simply follow a prescribed format and file it with regulators (it remains confidential). Then you can give it to investors and if they accept it in writing they can then invest. By issuing an Offering Memorandum you lose the right to use certain other exemptions in the future, notably the “Private Issuer" Exemption (meaning you then have to disclose all financings to the Commission). While you are no longer a Private Issuer, this does not mean you are a “Public Issuer”, either. Sound confusing? It is.

So, don’t forget – make sure that all your issuances of shares are made using an exemption – and get it in writing from your investors. You don’t need to verify that someone is an Accredited Investor, you just need them to sign a subscription agreement in which they swear that they are. That way you are protected and they cannot rescind their investment later.

By the way, so-called angel investors are often assumed to be Accredited Investors. In fact, many aren’t. Yet, I’ve seen many put $10 or $20 thousand into a deal. I suspect that there are many offside deals in existence and it may never be a problem unless someday someone wants to buy you or take you public. Then, these sloppy dealings will haunt you.

For those angels that fail to meet the Accredited Investor test - and I'll bet there are many more of these than there are Accredited Investors - junior companies such as those that trade on the TSX Venture exchange are the only ones that could satisfy their speculative hunger. Regrettably, fewer companies are choosing this route because of the exorbitant compliance costs that have, in recent years, escalated to absolutely ridiculous levels because of the paranoia suffered (and the resulting red tape and Canadian spillover) by U.S. senators Mssrs. Sarbane and Oxley. Dang!

Metrobridge Networks and **iCo Therapeutics**, two emerging Vancouver-based companies that first raised some angel money are doing public distributions this right now. And because they're doing a public offering anyone can buy and sell these shares. Check SEDAR for complete disclosure documents.

This is another reason why we are seeing the emergence of "Angel Funds". Such funds allow smaller unaccredited angels to pool their capital and invest in a number of companies that they could not invest in directly for lack of an "exemption". To beat the odds, I figure that such funds should invest in at least a dozen ventures in order to come out ahead.

In B.C., there's a great government incentive to form such pools (many of these pools are quite small – less than $1 million). Investors can pool their money by forming a "Venture Capital Corporation" (a "VCC"). Upon getting approved, VCCs can give their investors a good-as-cash refundable tax credit of 30%. A superb deal. So good, in fact, that the Province's $25 million budget for these tax credits gets gobbled up pretty fast. I know – I started one such pool called WUTIF Capital (VCC) Inc. By tax season time, these credits are usually gone.

WUTIF was formed in late 2003 and has raised $4 million so far from angels and others who are not bona fide angels but are nonetheless keen on angel investing (yes, it required an Offering Memorandum). Since then, WUTIF has invested in 32 companies and does about one a month. I'd like to see more companies like WUTIF that cater to startups. The closest to this, although not a VCC, is **Basel Peters' Fundamental Technologies**.

I'd love to see more VCCs created in other regions of the Province to support entrepreneurial ventures. In those communities where the population of both companies and investors is much smaller than in an urban centre such as Vancouver, this makes imminent good sense.

VCC's also provide a vehicle for special-interest angels to work together. One such VCC was formed by 13 angels with an interest in life sciences companies. Each investor contributed $25K ($17.5K net of tax benefit). This VCC invested in 9 companies over a 3 year period. One of them, **Aspreva**, IPO'd and each investor received a $61K dividend! Most of the other eight are still looking good! Now that's how an angel pool (or VCC) should work!

A new website, www.angel-funds.com has been set up to track angel funds. I'm sure we'll see more of them.

Some larger VCCs – four to be exact - benefit from getting guaranteed allocations of tax credits which has allowed them to raise tidy sums, i.e. in excess of $30 million each. Alas, much of this capital is not available to startups as the managers of these VCCs prefer to invest in more traditional VC-ready companies (i.e. those beyond startup with high growth, multi-million dollar potential). These VCCs are no different than institutional VCs except that they raise their capital from the general public instead of from pension funds and the like. In this sense they are very similar to so-called Labor-sponsored funds that also provide tax credit incentives.

Who are the four VCCs? They are: **BC Advantage Fund**, **BC Discovery Fund**, **Pender Growth Fund**, and **Pender NDI Fund**.

Just how much of this institutional VC is there in BC? In the past 10 years, $3 billion was invested in BC companies. In 2006, the top 10 B.C. companies raised

C$167 million of a total of $298 million. BC ranked 3rd (by Province) in Canada and 17th in North America (by Province or State).

Who are the most visible institutional VCs in BC? They are: the **Business Development Bank** (BDC, a crown corp)**, GrowthWorks** (manger of Labor Sponsored Funds)**, Ventures West, Yaletown Venture Partners, Greenstone Venture Partners, Pangea Ventures,** and **Chrysalix Energy Management**.

By the way - more often than not, investors like to collaborate and syndicate than do deals all on their own.

Entrepreneurs are advised to wait until their companies hit puberty before spending too much time with these VCCs and other institutional VC investors. Because they, unlike angels, invest other people's money, they have to be very cautious. Rightfully so. At the outset, Angels are the best bet.

How do YOU get into the game? As an investor, you can join an angel network. We've got a number of them here in B.C. Vantec, in Vancouver, has since 1999 held regular monthly meetings. Almost half the companies that have pitched, have garnered investments.

Over a decade ago, there weren't too many angels around. Other, now non-existent organizations such as the **Science Council of B.C.** or the **B.C. Advanced Systems Institute** offered grants or investments in pre-commercial companies. To a large extent, that job is now being done by angels. Indeed, three years ago a number of such angels invested in a very much pre-commercial nuclear physics company. The VCC tax grant coupled with an additional federal tax break – the self administered RRSP – allowed investors to make a $10,000 investment by risking less than $3,000. Not bad!

There's a new category of angel investor emerging: the super angel. These are multi-millionaire or billionaire entrepreneurs. There are more than 1,000 billionaires globally. How many do you know? Some, like **Paul Allen** (Microsoft guy) or **Richard Branson** (Virgin guy), are household names and perhaps a little more difficult to get to, but then they've got deep pockets for causes they endorse.

What are the returns? In 2006, of all companies acquired by larger companies (no IPOs!), the top 10 were sold for a total of $2.3 billion (compare that to the $167 million invested last year and the $2.1 billion in total active investments). Arguably that may not be an appropriate comparison, but it sure is interesting.

Three years ago, I wrote a similar article to thin one on funding startups that can be found in the T-Net archives at: http://www.bctechnology.com/statics/mvolker-jun0404.html. Interestingly, the article notes that in 2003, institutional funding was just over $100 million – a third of what it was in 2006. I also comment on the tensions between institutional VCs and Angels and some of the reasons for those tensions. Since then, I've seen a greater number of deals consummated by angles and VCs jointly funding them. Some of the companies mentioned therein have produced healthy exits for the angel investors (e.g. Aspreva returned 60X to first-round angels). That's great because it adds to the ever-growing population of angels!

The bottom line:

There is no shortage of capital for good deals. Capital will flow from many sources to fund good deals. When you hear the $300 million number - remember that's only from the visible institutional VC segment. The family and friends and angels segment is at least double that and investment from the general public is close to that number as well.

Where to look? Where are the VCs, angels and others hiding? Check out Money Links for starters. Your best bet is to find an angel/mentor to get the ball rolling. Check hitechbc.com for a laundry list of resources. New Ventures BC is a particularly good one for connecting with mentors. If you can't attract someone, take a look in the mirror.

It's about TIME

Simon Fraser University's TIME Centre in downtown Vancouver recently expanded to SFU's Burnaby campus (Discovery Park) to offer incubator offices to entrepreneurs at both locations.

TIME is an acronym for **Technology, Innovation, Mentorship, and Entrepreneurship**. It's more than just an incubator. Complete, ready-to-go furnished offices with high speed internet, servers, telephone and fax, printing, etc. are only the beginning.

New Ventures BC, the **Vancouver Enterprise Forum**, the **VANTEC Angel Network** and **WUTIF Capital** all make TIME their home.

TIME's Business Centre (a little like an airport business lounge but without booze) is open to technology entrepreneurs and business people to use as a drop-in downtown office facility. Need to plug-in? Make some calls? Do some work? Hold a meeting? There are some great facilities for holding your company's AGM. Why hang out at MacDonald's when you can work productively at the TIME Centre? Drop by and check it out! It is located at SFU's downtown campus at 515 West Hastings St. You won't believe the price!

Check **www.sfu.ca/time** for info.

Michael Volker, a technology entrepreneur, is Director of the University-**Industry Liaison Office** at **Simon Fraser University** and President of the **Western Universities Technology Innovation Fund**. He is a founder of the **Vancouver Angel Network** and past Chair of the **Vancouver Enterprise Forum** and past Chair of the B.C. Advanced Systems Institute. He owns shares in many of the companies he writes about. Copyright, 2006.
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