# Raising Venture Capital:
# The Case of the Junior Capital Pool Program on the Alberta Stock Exchange

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**Abstract**

The most common obstacle cited for any entrepreneur is the lack of capital to give birth to a business and nurture it during its early development. Start up funds or "seed" money is the initial vehicle to implement a business plan and to continue the early development of an ongoing venture. Several traditional methods are available for raising venture capital, which include owner and family investment, debt from institutions such as banks, private investors such as angels, and venture capital firms. As an alternative method of raising venture capital for start-up companies, this study examines the unique Junior Capital Pool (JCP) program on the Alberta Stock Exchange (ASE) in Canada. The strengths and weaknesses of the JCP program as well as its process are compared to other traditional methods of raising venture capital, in particular the initial public offerings on the NASDAQ Small Cap Market.

The JCP program is designed to provide junior start up companies with venture capital, then to become a traded company on the ASE. Started in 1986, the JCP method has proven to be very accepted by entrepreneurs, ASE members, investors, brokers, and promoters. The JCP program of raising venture capital is conceptually similar to the one through an initial public offering on the NASDAQ Small Cap Market in the sense that the owners and/or entrepreneurs are selling equity in their respective company to gain investment capital in both programs. The key difference between the JCP and the NASDAQ Small Cap IPO is the dollar amount of venture capital to be raised; the JCP offers entrepreneurs a maximum of $300,000 $CDN, whereas the NASDAQ Small Cap IPO method immediately elevates the dollar amount to $5 million USD. While the JCP program raises limited capital, however, it facilitates direct access to the public market on the Alberta Stock Exchange for future capital needed. Furthermore, the disclosure and listing requirement for JCP companies are substantially less than for other categories of companies at the time of listing, which provides easier access to the needed venture capital market.

## 1. Introduction

The importance of capital to start a business and facilitate continued operations is financially explicit. As the National Venture Capital Association defines venture capital as the "patient risk equity capital invested in innovative and/or rapidly expanding enterprise," venture capital by definition is risk oriented. Venture capital is a crucial element to the success of a venture. Start up funds or "seed" money are the initial vehicle to implement a business plan or continue the early development of an ongoing venture. The most common obstacle cited for any entrepreneur, novice or experienced, is the lack of capital to give birth to a business and nurture it during its early development. Several traditional methods are available to obtain the venture capital requirements of debt and/or equity for entrepreneurs. These financing options are not necessary exclusive of one another. In all likelihood, a combination of capital financing is appropriate for a business venture. Entrepreneurs can incur debt and borrow capital. The loan sources may be family and friends, private investors (angels), or institutions such as banks. Terms and interest agreements are subjective to each of the loan sources. Or entrepreneurs can sell part of their start up company to investors for exchange in equity. With this option, ownership is the medium for capital. This process is usually achieved through private investor transactions with angels or venture capital firms because of the limited amount of capital needed.

Another alternative equity financing method for raising venture capital is through the unique Junior Capital Pool (JCP) program on the Alberta Stock Exchange (ASE). The ASE's use of leading edge stock exchange technology and the development of two highly innovative investment programs has facilitated the proliferation of publicly traded venture capital. The JCP program and the Exchange Offering Prospectus (EOP) aid emerging companies in obtaining start up capital though equity financing. While the JCP program is the initial process of a company raising limited venture capital and becoming a traded company on the ASE, the EOP program facilitates venture capital for further development of a business after the JCP program has been implemented. Both programs are highly regulated, enabling the liquidity of capital and the protection of investors. This study focuses on the JCP concept, which is designed to provide junior start up companies with venture capital, then to become a traded company on the Alberta Stock Exchange. This study analyzes the processes of the JCP program and compares its strengths and weaknesses with those of other traditional methods of raising equity capital. In particular, since raising venture capital through the JCP program is conceptually similar to that through an initial public offering on the NASDAQ Small Cap Market, this study reviews the processes of both methods and compares their strengths and weaknesses in raising venture capital.

## 2. Junior Capital Pool Program

### 2.1 Process Overview

The JCP program provides a viable and efficient mechanism to enable junior companies to "kickstart" a business and raise further equity capital at developmental stages of the company. The JCP method of raising capital has proven to be very accepted by entrepreneurs, ASE members, investors, brokers, and promoters. The JCP program started in 1986 with the objective of facilitating economic growth in the small business sector of the region. Over the past decade, 750 new companies have been listed on the ASE, raising over $150 million of start up capital through the JCP process. Eighteen of the fifty-six ASE members are actively involved with the JCP program. One hundred new JCP companies became listed on the ASE in 1997 alone.

The ASE's headquarters are in Calgary, Alberta, Canada. Originally incorporated as the Calgary Stock Exchange, the ASE was a response for capital needs instigated by the Turner Valley oil boom in 1912. The exchange provided a regulated securities market for the region's emerging energy industry. The activity of this stock exchange has mirrored the volatile expansion and recession business cycles of the Western Canada's petroleum industry. As shown in Table 1, the composition of the ASE reflects the dynamism and diversification of the region's economy and has aided the development of the economic base.

**Table 1 Composition of Companies Listed on the Alberta Stock Exchange**

| Company | Proportion |
|---|---|
| Industrial Companies | 33% |
| Oil and Gas Companies | 26% |
| Mining Companies | 17% |
| Junior Capital Pool Companies | 15% |
| Toronto Stock Exchange Interlisted Companies | 7% |
| Others | 2% |

*Source: Alberta Stock Exchange, 1997 Annual Report.*

In the JCP program, an entrepreneur interested in a JCP process would need to contact an underwriting investment dealer or brokerage house, which is a member of the ASE. The investment dealer is the only avenue for an entrepreneur to develop a business plan into a JCP. The brokerage houses often specialize in different industries and the entrepreneur needs to assess the congruency of the investment dealer to his/her business venture. The investment dealers bring the expertise and legal staff to facilitate this process. They also supply many of the investors, promoters, and connections in the financial industry to make a business venture become a reality through the JCP vehicle.

The JCP process involves two stages. *Stage One* involves the filing and clearing of prospectus requirements through the Alberta Securities Commission. The entrepreneur(s) and the selected investment dealer formulate the prospectus for the company. The JCP prospectus is designed for expediting the process of detailing the purposed business venture of the JCP Company. Conceptually, the prospectus has two purposes. The first is to meet ASE requirements of identifying the company's agenda, corporate officers, and specific disclosures. The other is to present an investment opportunity to individuals interested in becoming a shareholder in a venture capital pool. The end result of this procedure is the initial public offering of the company's shares on the ASE. The time frame for JCP prospectus and initial financing in Stage One is usually three to four months. *Stage Two* involves the filing and clearing of a comprehensive information circular with the ASE prior to the completion of the company's first Major Transaction in which the company enters into an agreement to acquire a business or operating assets. The Major Transaction is detailed in the prospectus and is congruent with the business of the JCP company. The Major Transaction must meet ASE requirements and the approval of the JCP security shareholders through a proxy vote. Upon completion of the acquisition, the company is considered to be no longer subject to the JCP rules.

### 2.2 Stage One: JCP Prospectus and Initial Public Offering

#### (1) JCP Prospectus General Requirements / Management Requirements

The majority of the officers and directors of a JCP company must be made up of Canadian residents. The purpose of this restriction is to discourage the process of foreign investors bypassing Canadian residents to utilize the exchange without the tangible ties to the country or region. The ASE discourages an officer of a separate JCP company that has not completed its respective Major Transaction from becoming involved with another JCP company. In addition to these requirements, a Personal Information Form (PIF) is required of all individuals who are related to the parties of the JCP before or after the Major Transaction. A JCP company may only issue common voting shares to the public, and options to common share may be offered to company directors, officers, or underwriting agent. The requirements of a JCP prospectus are less detailed in accounting information and business history because of the "start up" stage of the company. This requirement has been simplified to the position that the objective of the JCP shall be to identify and evaluate opportunities with a purpose to complete a Major Transaction approved by the ASE. The JCP shall not engage in any other business activities until the proposed Major Transaction is complete.

There are two key disclosures that are required in the prospectus. First, a heading of "Risk Factors" must be explicitly stated. Under this heading, the investment offering is only suitable for individuals with "risk capital" and is willing to rely solely on the management of the corporation. Second, the prospectus is also required to identify the JCP company's intention to enter into a specific proposed Major Transaction that is not yet in an enforceable stage of development. This requirement is focused on the intentions of the agenda of the company and what it plans to do with the proceeds of the invested pool of capital. Enforceable Major Transactions are already disclosed in the JCP prospectus. Also included in this disclosure is the identification of the company's officers and their equity positions in the JCP company as well as future option prices to these individuals. The importance of this disclosure is for investors to be able to identify names with signatures on future press releases and to evaluate the entrepreneur and officers' stakes in the JCP company (see Alberta Securities Commission 1997, Ch.2 Policies, Legislation and Requests for comments 4.6.1, 4.6.2).

The JCP prospectus will most likely include a feasibility study of the proposed venture. Technical Reports Requirements illustrate the process needed for these studies (Alberta Stock Exchange, 1997, Getting Listed; Technical Report Requirements). Feasibility studies are mandatory for the following four JCP business situations:

1. The Major Transaction involves the acquisition of a resource property or securities of a mining or oil and gas issuer.
2. The Major Transaction involves a business that has not commenced, or the acquisition of securities in an issuer that has not commenced its business, or involves the acquisition of the rights to a new product or service.
3. The Major Transaction involves the acquisition of real estate and or other Significant Assets of determined value, including the securities of another corporation.
4. Where the property and or assets have not been significantly developed and a market analysis of value or potential is not appropriate to value.

### (2) Capitalization of a JCP Prospectus

A minimum of $100,000 CDN in cash must be committed to the JCP company, 80% of which should be contributed by Canadian residents. Therefore, a maximum of 20% of the total capital contributed may be contributed from a director that resides outside of Canada. The company may raise a maximum of $200,000 CDN before the JCP is included in the company's fold. This limitation expresses the uniqueness of the JCP concept; if an entrepreneur or company can acquire over $200,000 in venture capital before tapping into a "capital pool," the entrepreneur does not need the JCP program.

The JCP company's preliminary prospectus must meet the general JCP requirements and capitalization requirements (Alberta Stock Exchange 1997, Getting Listed; Minimum Listing Requirements; Listing Instructions and Procedures; Junior Capital Pool Issuers). It is then filed to the ASE for review. The Exchange returns the prospectus with its deficiencies outlined. The JCP company and investment dealer address and resolve all deficiencies in the preliminary prospectus, and the final prospectus is then re-submitted and approved by the ASE.

### (3) JCP Distribution Requirements /ASE Listing

The ASE requires that JCP investors be comprised of at least 300 Canadian residents and that each hold a board lot of at least 500 shares. These "pool" investors are referred to as a "president's list." Being on this "president's list" entitles individuals to review the JCP company's prospectus and decide upon the amount that he/she desires to invest in the company. The 300 people are a composition of family and friends of the company's officers or directors, as well as the underwriting brokerage house's retail clients. It is a unique membership of investors who, if they choose to invest, will be on the "ground floor" of a business venture.

The ASE permits a JCP company to raise a minimum of $200,000 CDN to a maximum of $300,000 CDN in its "pool" from these investors. The structure of the share offering to JCP investors is subject to the JCP company's capital requirements and the company's proposed share value. For example, if the company desires to raise $300,000 CDN, it could structure shares at $0.10 per share and sell 3 million shares, or price shares at $0.20 and sell 1.5 million shares.

The distribution of the dollar investment and shares to each investor is not uniform. Usually, family and friends of the company directors have the first right of refusal on the investment amount. But an individual investor may only obtain a maximum of 2% of the share distribution. As stated, each investor must have at least a board lot of 500 shares. These two restrictions are used as a method of attempting to distribute the concentration of shares. After this family and friends group of investors has invested into the JCP, the remaining capital needed is usually raised evenly through the brokerage house's clients.

For example, if the company is raising $300,000 CDN at $0.10/share, 3 million shares are sold. If the distribution were uniform, each investor would invest an average of $1,000 for 10,000 shares of the company. But this is not the case. Some investors may accumulate 60,000 shares for $6,000 CDN or a maximum of 2% of the shares issued. The other investors in the "president's lists" would receive only the opportunity to invest an average of less than $1000 CDN. It is important to note that the investment at this stage is still before the shares are traded on the ASE. Therefore, if an individual desires to accumulate more shares of the company, he or she will have to purchase them off the market once the shares become traded.

All documents of the public offering in the JCP, in accordance to the minimum listing requirements, and the listing instructions and procedures for JCP issuers, are submitted for approval to the ASE. The ASE holds the right to refuse distribution of a JCP shares if requirements are not met. Similar to the preliminary prospectus process, the distribution documentation is submitted to the Exchange for approval. Included in the details are all 300 investors' names and investment values to provide additional investor protection against any wrong-doings by the JCP company. The documentation is returned to the JCP company and all deficiencies are resolved. The company's securities are posted for trading under its approved trading symbol.

The initial public offering is announced through the ASE, and the JCP shares are priced and floated in the market at a premium price at which it is attractive for a "president's list" shareholder to sell. The purchasers of shares on the market could be some more aggressive "president's list" investors accumulating a larger position, as well as other brokerage houses' clients who have received a recommendation from their brokers. Promoters of the company would have furnished brokers with the prospectus upon the date of the IPO. Once the shares are trading in the marketplace, investors have liquidity at their disposal.

A condition of the JCP prospectus and distribution requirements is the Alberta Securities Exchange Escrow restrictions illustrated in the Alberta Securities Commission Ch. 2-Policies, Legislation and Requests for Comments. These restrictions state that all securities offered in the JCP prospectus prior to the distribution, under the issuance price per security share at the time of distribution, shall be held in escrow. This agreement is confined to "insiders" of the JCP. Officers, board members, or parties related to the JCP that have accumulated shares pursuant to the offering or from the treasury before the completion of the JCP Major Transaction, shall have these securities held in escrow. These securities held in escrow may be released on the first, second and third anniversaries of the JCP's first Major Transaction. The securities will be evenly released at 33% per anniversary.

### (4) Use of Proceeds

The use of proceeds requirements by the ASE is established to enforce the allocation of capital to the Major Transaction and the business detailed in the prospectus. The gross proceeds of the capital pool may be used to identify and evaluate assets and opportunities including business valuations, engineering reports, and legal fees consumed in the efforts of identifying and evaluating these assets. But the proceeds may not be used for example for leasing a vehicle. In addition to expenses incurred in evaluating opportunities, up to $25,000 CDN of the JCP may be used to secure assets with deposits, lock up fees, trust departments, or any legal deposit notes. JCP proceeds may also be consumed for the expenditures incurred in the process of becoming a JCP company. But no more than 30% of the gross proceeds can be allocated for these expenses until the Major Transaction is completed. Included in these expenses are listing and filing fees and underwriter and agent fees, as well as numerous administrative fees.

Until the completion of the Major Transaction, no payments shall be made by the JCP to any party related to the JCP, which does not proceed toward the Major Transaction. Related parties cannot be compensated for salaries, consulting fees, management fees, loans, advances, or bonus. A party related to the JCP company can be compensated for reasonable office expenses, equipment expenses, legal services, and out of pocket expenses (see Alberta Securities Commission 1997, Ch.2-Policies, Legislation and Requests).

## 2.3 Stage Two: Major Transaction

### (1) Overview

The Major Transaction for a JCP is a business transaction that is unique to each respective JCP Company. It is designed to illustrate that the JCP company is "doing something" with the proceeds of the capital pool. A Major Transaction may be a JCP purchasing assets of another JCP or separate company. It could be a merger of companies with the JCP gaining controlling interests of another company. The JCP's Major Transaction may also be the acquisition of assets other than cash that is congruent with the agenda of the JCP prospectus and business operations. The ASE has established restrictions on the use of proceeds and has implemented the Major Transaction process to facilitate investor protection to the best of the Exchange's ability. The four main components of the Major Transaction process are: Major Transaction Announcement, Information Circular, ASE Approval on the Information Circular, and Shareholder Approval.

Once Stage One of the JCP is complete, with a JCP company's shares being traded on the ASE, the company has eighteen months to complete its first mandatory Major Transaction. At the time of this Major Transaction, the JCP needs net tangible assets of $500,000 CDN and working capital of $100,000 CDN. The JCP prospectus outlined the proposed Major Transaction, which was approved by the ASE. When the Major transaction has been reached in principle, the JCP company is required to immediately generate a press release to the ASE and the JCP shareholders. This release must describe the terms of the principle agreement and the assets involved with relevancy to the JCP business, and must identify any new directors or additional controlling shareholders as a result of the agreement. The press release also must illustrate a disclaimer that the ASE "has neither approved or disapproved the information contained herein" (see Alberta Stock Exchange 1997, Getting Listed; Junior Capital Pool Issuers).

### (2) Information Circular

A JCP company has the next sixty days to file an information circular and initial documentation to the ASE describing the material facts of the Major Transaction. If the JCP Company is unable to accommodate the ASE within the sixty-day time frame, its shares will be halted from trading until the proper information is documented and presented to the ASE. Similar to the JCP prospectus evaluation, the ASE may illuminate deficiencies in the Major transaction information circular. The following requirements for this circular are listed in the Alberta Stock Exchange's brochure "Getting Listed; Junior Capital Pool Issuers".

- Where the Major Transaction involves the acquisition of securities in another corporation, disclosure regarding the other corporation's business, its operating results, its principle assets, its directors and officers, and all material contracts it has entered into. In addition, current audited statements of the other corporation.
- Where a Major Transaction involves an acquisition other than securities in another corporation, disclosure regarding the particulars of any Significant Assets being acquired.
- The salient aspects of any Technical Reports required to be filed with the Exchange, the escrow agreements to be entered into, and any material contracts entered into in the connection with the Major Transaction.
- If any changes are proposed in the directors or officers of the JCP, full particulars regarding the identities of the proposed new management team. Personal Information Forms on any new individuals in the JCP.
- The current security holdings of the directors, officers, and insiders of the JCP and their security holdings following conclusion of the Major Transaction.
- The current loan and capital structure of the JCP and the loan and capital structure following the conclusion of the Major Transaction.
- Details regarding any promoter's fees, finder's fees, or commissions to be paid in any form whatsoever in connection with the Major Transaction and the interest of any Parties Related to the JCP in the Major Transaction.

### (3) ASE Discretion/Approval of JCP Information Circular

At its discretion, the ASE may refuse the Major Transaction completely for any of the following reasons: 1) the JCP company's information circular and documentation does not satisfy or may not satisfy minimum JCP listing requirements, where the completion of the Major Transaction would give a Pro-group an amount of shares exceeding the maximum 20%; 2) the ASE objects to escrow agreements that transpire with the Major Transaction; and 3) securities issued to parties in a Special Relationship to the JCP in connection of the Major Transaction are otherwise subject to a prescribed hold period of minimum 6 months (see Alberta Stock Exchange 1997, Getting Listed; Junior Capital Pool Issuers).

The ASE may hire engineers and consultants to evaluate the information circular submitted by the JCP. These consulting fees are charged to the JCP. Also, the JCP may be suspended from trading or de-listed during this Major Transaction process if the eighteen months time period expires and if at anytime the JCP does not have at least $25,000 CDN in cash. Assuming that the Major Transaction requirements are met by the JCP company, final documentation is submitted to the Exchange.

### (4) Shareholder Approval

The approved Major Transaction is then put into the hands of the JCP company shareholders. The shareholders vote on the actions taken by the JCP company. The Major Transaction is then approved by majority votes and sent for final documentation with the ASE. The JCP description is removed from the company and its securities are transferred to the regular issue board. The company is now under the listing requirements of a regular security, and the JCP program is complete.

Table 2 illustrates the ownership and capitalization scenarios developed through the JCP program detailed in the JCP walk through (see Hambrook, 1999 for similar illustration).

**Table 2 An Illustration of the JCP Program Walk-Through**

Entrepreneur creates a new company with three directors and invested capital of $100,000; On advice from an investment dealer, the company is financially structured as 1,000,000 shares @$0.10/share; The entrepreneur and each of the three directors have 25% ownership of shares.

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The company's business plan is revised, and the JCP prospectus is developed through investment dealer resources (legal, administrative, investment promoters); Nature of the JCP business detailed as well as proposed Major Transaction then filed to ASE.

↓

Filing and clearing of the Prospectus and conditional listing application with ASE; The approval of JCP, the development of "president's list" and the distribution of company's prospectus and share offering are completed.

↓

The JCP issues 3,000,000 shares @ $0.10/share to "public shareholders and President's list."; $300,000 of equity raised; Trading on the ASE under JCP regulations begins @$0.20; Major Transaction timeline commences (18 months); Investment dealer and promoter distribute the company's prospectus to "promote" the JCP company.

↓

Major Transaction circular filed with ASE for approval and accepted; Shareholders approve Major Transaction through majority vote; The company trades on the ASE under regular restrictions; Share price may react to the speculation of the Major Transaction, engineer reports.

↓

Entrepreneur & directors decide to expand with the success of his/her venture; The investment dealer begins Exchange Offering Prospectus for raising further capital with private placement.

| **Ownership Scenario** | | | |
|---|---|---|---|
| | Shares | | % |
| Enterpreneur, Directors, and other Insiders | 2,000,000 | | 50% |
| Public (IPO) Purchase from the Market | 2,000,000 | | 50% |
| **Capitalization Scenario ($CDN)** | | | |
| Original Insiders Contribution | | | $100,000 |
| Gross Proceeds from JCP Public Offering (3,000,000 shares @0.10/share) | | $300,000 | |
| ASE Schedule of Fees | | | |
| Original listing fees up to 5 million shares plus $100 for every additional 200,000 shares | (4,000) | | |
| Filing fees | (1,000) | | |
| Annual listing fees | (1,250) | | |
| Material changes fees | (300) | | |
| Transfer of escrow | (50) | | |
| Total ASE Fees (minimum) | (6,250) | | |
| Agency and Investment Brokers Costs (7% of gross proceeds of JCP capital raised) | (21,000) | | |
| Total ASE and JCP Fees and Agency Costs | | (27,250) | |
| Net Proceeds of JCP Offering | | | 272,750 |
| **Total Investment Capital to Company** | | | **$372,750** |

## 3. Traditional Methods of Raising Venture Capital

### 3.1 Financing Overview

Debt and Equity are the two traditional means of raising venture capital. The entrepreneur's decisions on the amount of debt to incur and the ownership he/she is willing to exchange for capital are subject to each individual business situation. The entrepreneur's decision is also constrained by the amount and location of the capital. The availability of traditional methods of raising venture capital, debt or equity, relies on two key variables, entrepreneurial management and industry attractiveness. Venture capital is attracted to an investment that can minimize the systematic risk of management. The more proficient the venture's management, the more the opportunity to attract capital and the less the investor resistance.

The industry attractiveness is the other key attribute for capital sources. Venture capital is more attracted to growth industries that can supply an equitable return. The industry, combined with the management's growth strategy, paints the picture for investment. Venture capital is more willing to focus on new technologies, specifically with proprietary products and services. These opportunities for growth success and return on investment may be greatest with these vehicles. Product differentiation and/or niche markets with substantial competitive advantages combined with market growth may produce the venture capital's desired return on investment. More traditional industries may also be able to successfully attract venture capital. This growth and return on investment would be through management's strategies of aggressive market share and/or geographical expansion.

The 1998 Coopers and Lybrand study of the 328 fast growing manufacturing and service companies in the U.S. illustrated that most of these start up companies did not obtain capital from outside sources. A majority (71%) of these companies started with their own "seed" capital or help from family and friends. This could be referred to as debt and/or equity according to the specific details of each investment agreement. The impetus for this family and friend's investment phenomenon is that start-up companies have a lot of difficulty in attracting investors. It is not because the entrepreneurs want to fund their company themselves. The risk of no operations history deters much of the investment resource avenues. Less than 13% of the companies in this survey found outside investors for start up capital; institutions, such as banks, comprise 8% of the invested capital. This low percentage is also because of lack of operations and evidence of the ability to repay interests and loans. It is interesting to note that suppliers and customer alliances accounted for 8% of investment in start up companies. This is most likely the result of the alliances' industry knowledge and the start up company's business and management potential.

As a company becomes an operating entity, establishes cash flows, and accumulates collateral, the opportunity to attract outside investment increases. The capital needs of the entrepreneur would also have evolved from the initial "kick start" capital to a focused investment in business operations. The Cooper and Lybrand study illustrated that almost seventy percent of the businesses surveyed required outside sources of capital after twenty-eight months of operations. Outside investors are better able to appraise risk and opportunity at this stage of a business' development.

### 3.1 Private Investors (Angels)

Angels are informal investors who are successful business individuals and invest in businesses because they believe their investment will beat the return they could realize from a traditional investment. The Angel source of capital is the largest of outside risk capital available to entrepreneurs. It is a clandestine investment environment that is estimated to be in the range of $40 billion USD annually (see Lister and Harnish, 1998). An obstacle for an entrepreneur seeking venture capital from an Angel is that these investors are not publicly known. Word of mouth and investigating are usually the most successful methods of obtaining information on these individuals. Angel investors have common characteristics and investment criteria. According to a study by Lister and Harnish (1998), the average Angel is typically 47 years old, with an annual income of $90,000 USD. S/he is college educated with net worth of $750,000 USD. Angels usually invest in business that they understand, and that are physically close to home. Average Angel investments are around $37,000 per investment and may have diversified up to $200,000-$300,000 over a number of opportunities. An Angel can expect an average annual return of 26% on the successful business. These investors accept norms that 30% of the business plans evaluated are accepted. The typical determinant factors for rejection of a deal are insufficient growth potential, lack of information, and lack of entrepreneurial management. Angels also evaluate their own portfolio risks with the belief that 33% of venture capital investments result in a substantial loss.

### 3.2 Venture Capital Firm

A Venture Capital Firm (VCF) is essentially an entrepreneur and investor that assesses business opportunities and becomes involved through capital investment and active participation in the new company. It is estimated that between $3 and $5 billion USD of venture capital is attributed from venture capital firms annually in the U.S. This method of raising capital is a balance between debt and equity. The VCF loans capital and consults the entrepreneur and often sits on the company's board of directors. Although the VCF may not have "ownership" of a company, its equity is gained in the influence on the company's strategies and decisions with the end goal to maximize the capital investment. Most VCF investments are greater than $250,000 USD (Lister and Harnish, 1998). A VCF assesses hundreds of business plans and invests in the most promising ventures. The business plan or ongoing venture needs to be exceptional to be considered as a viable investment for a VCF. Although the concept of venture capital being focused on start up companies is valid, the reality is that a VCF typically invests in more established businesses that may need a cash infusion at an undercapitalized stage of development. This is because start-up businesses are very time intensive and the timeline for return on investment is naturally longer than for other opportunities. A VCF is attracted to companies that can act as vehicles to achieve their own goals as well as the entrepreneurs' goals.

In general, a VCF invests in businesses that involve proprietary products or services, huge market potential, proven management teams and extraordinary returns. A VCF concentrates in emerging industries where their respective core competencies enable effective vehicle to develop the businesses in the most prolific manner. Venture capital firms effectively become a continuous source of consultation to a business that obtains VCF capital. On average, these venture capitalists expect rate of returns of 35-50% annually (Lister and Harnish, 1998). The VCF is able to satisfy itself and the entrepreneur by gaining substantial profits by taking the firm public through IPO or aid in selling off the company.

## 4. Comparison of the JCP Program with IPOs on the NASDAQ Small Cap Market

The method of raising venture capital through an initial public offering on the NASDAQ Small Cap market is conceptually similar to the JCP program. The owners and/or entrepreneurs are selling equity in their respective company to gain investment capital. The key determinant between the JCP and NASDAQ Small Cap IPO is the dollar amount of venture capital able to be raised. The JCP offers entrepreneurs a maximum of $300,000 $CDN. This amount facilitates a "kickstart" for a small business and may lead to further public financing. The NASDAQ Small Cap IPO method immediately elevates the dollar amount to $5 million USD and further access to a larger U.S. investment market.

### 4.1 Strengths and Weaknesses of Initial Public Offerings on the NASDAQ Small Cap Market

<u>Ownership: Weakness / Managerial Control: Strength</u>

The IPO method on the NASDAQ market exchanges venture capital for equity in the entrepreneur's company. Ownership is diluted through the offering of shares to investors. Daily operating functions of the company would be considered to be in complete managerial control. But, similar to large public corporations, the company must get majority approval from the shareholders. This is an opportunity for the shareholders to vote for their stake in the corporation and/or divest out of the company.

<u>Venture Capital Availability: Strength</u>

An IPO on the NASDAQ Small Cap Market can produce up to $5 million USD. Access to the lucrative investment market beyond the IPO is based upon the corporation's growth and business strategies.

<u>Investor Criteria: Strength/ Weakness</u>

The investor's criteria could simply be the availability of liquidity in the investment and the appreciation of the share value of the company. Liquidity in an IPO on the NASDAQ Small Cap market is available. It is mandatory to for the company to have 1 million shares in public float. Trading volumes of a company's shares may fluctuate, making investing or divesting more difficult than trading a "Blue Chip" company. Other investor criteria are facilitated through investor relations and brokers who should keep the shareholders abreast of the company's operations, financial reports, and press releases.

<u>Business Development/Future Financing: Strength</u>

The NASDAQ market has positioned itself as the future of financial markets with multi-product offerings and access to a diversity of investors. The business development of the company is dependent upon its management and strategy implementations. Future financing is available through the NASDAQ market that will be able to accommodate the needs of different sized companies.

### 4.2 Strengths and Weaknesses of the Junior Capital Pool program

<u>Ownership: Weakness / Managerial Control: Strength</u>

The JCP program exchanges venture capital for equity in the entrepreneur's company. Ownership is diluted through the offering of shares to investors. But share offerings in a JCP are limited, as is the amount of capital raised. As a result, the entrepreneur, directors, and insiders may have ownership close to a majority of the shares available.

Daily operating functions of the company would be considered to be in complete managerial control. But the company must get majority approval from the shareholders on any Major Transactions. This is an opportunity for the shareholders to vote for their stake in the corporation and/or divest out of the company. The shareholders that understand the venture capital risk of the investment is a "bet" on the quality of the management to progress the business and seek a future return for themselves and investors. As a result, a majority vote needed to approve most managerial decisions and Major Transactions is routinely achieved. One key negative element of the JCP management control is the time and cost associated with the paperwork and proxy tabulations associated with Major Transactions.

<u>Venture Capital Availability: Strength/Weakness</u>

A gross maximum of $300,000 CDN may be raised with a JCP. To begin the JCP program, a company must have already had $100,000 in cash, which acts as a barrier for some entrepreneurs. Therefore, the availability of venture capital is conditional to the company's cash assets and business prospectus.

The restrictions of the JCP program and having substantial Canadian content could make the availability difficult. Residents outside of Canada must have considerable Canadian contacts to make the JCP program even conceivable. The industry in which the company or entrepreneur is entering may be conducive to the JCP program with proper associations and personnel being available. Industries such as oil and gas exploration, and/or small manufacturing could facilitate the network necessary to utilize the JCP program with the entrepreneur and impetus coming from outside of Canada.

Investor Criteria: Strength/ Weakness

The investor's criteria could simply be the availability of liquidity in the investment and the appreciation of the share value of the company. Liquidity in a JCP company and regular issues of venture capital companies may not be as available as investors' desire. The limited amount of shares issued and the amount of shares in control of the corporate officers and insiders make the trading of the company's shares inconsistent. The trading volumes of a company's shares may fluctuate, making investing or divesting more difficult than trading a "Blue Chip" company. Other investor criteria are mandatory information circulars in regards to Major Transactions, as well as investor relations that should keep the shareholders abreast of the company's operations, financial reports, and press releases. The Major Transaction duties are filed through the investment dealer and the ASE. The investor's relations of the company are the responsibility of the company itself or promoters of the company.

Business Development/Future Financing: Strength

The JCP program is a vehicle for a junior company to become a publicly traded company, therefore enhancing its opportunity to acquire capital from the investing public. The JCP "starts up" a company. If the company's progress warrants additional capital, the Exchange Offering Prospectus vehicle is then used to raise larger funds for the development of the company. The graduation of the company to a larger market to obtain even larger investment capital is the ultimate goal of the JCP program.

Table 3 compares the process between the JCP progam on the ASE and the IPOs on the NASDAQ Small Cap Market.

**Table 3 A Comparison of Process Between the Junior Capital Pool Program on the Alberta Stock Exchange and IPOs on the NASDAQ Small Cap Market**

| IPOs on the NASDAQ Market | JCP Program on the ASE |
|---|---|
| Incorporate US Company in a State ("NEWCO) | "NEWCO" formed and issues 1,000,000 shares @ $0.10 per share to insiders (e.g., friends, associates, relatives); Equity raised $100,000 |
| NEWCO Aquires "TARGET" (i.e., The Company that wishes to go public); Shareholders of TARGET become NEWCO's shareholders | Advisor prepares Business Plan and assists with ASE pre-qualification, presents investment dealer connections, and coordinates with legal firm and ASE; Advisor begins preparation of Feasibility Study or Technical Report for Major Transaction ("Vend In") |
| Private Placement of Equity Securities by NEWCO Raise Minimum $500,000 USD | Filing and Clearing Prospectus and Conditional Listing Application with ASE and ASE Shareholder Approval; Filing with ASE; and Vetting Information Circular. |
| Issue of Shares to Non-US Residents | Issue 2,000,000 shares @$0.20/share to public shareholders; Equity raised $400,000<br>Result: ASE Public Company |
| US Market Maker Enables Sale of Shares to US Residents (Free Trading) | Major Transaction or Vend In of assets to public company for shares. E.g., $500,000 value of assets vended in @$0.20 results in further issue shares; Private placement of 2,000,000 shares @$0.50 per share to Outsiders raises $1,000,000. |
| NEWCO becomes SEC Reporting Company | With Real Rapid Growth, Company could list on Toronto Stock Exchange, NASDAQ, etc., within 1 to 2 years. |
| Private Placement in USA &/or World | |
| List on NASDAQ Small Cap Market<br>Total Assets = $ 4 Million<br>Shareholders' Equity = $ 2 Million<br>Or<br>Big Board Market<br>Total Assets = $4 Million<br>Shareholders' Equity = $ 4 Million | |

## 5. Summary and Conclusion

The most common obstacle cited for any entrepreneur is the lack of capital to give birth to a business and nurture it during its early development. Start up funds or “seed” money is the initial vehicle to implement a business plan and to continue the early development of an ongoing venture. An entrepreneur or the management of a junior company needs to incorporate this financial reality into his/her company’s business plan. Assuming that an entrepreneur does not have the capital resources him/herself, venture capital will need to be sought from a numerous potential sources. Several traditional methods are available for raising venture capital, which include owner and family investment, debt from institutions such as banks, private investors such as angels, and venture capital firms.

As an alternative method of raising venture capital for start-up companies, this study has examined the unique Junior Capital Pool program on the Alberta Stock Exchange in Canada. The JCP program is designed to provide junior start up companies with venture capital, then to become a traded company on the ASE. Started in 1986, the JCP method has proven to be very accepted by entrepreneurs, ASE members, investors, brokers, and promoters.

The JCP program of raising venture capital is conceptually similar to the one through an initial public offering on the NASDAQ Small Cap Market in the sense that the owners and/or entrepreneurs are selling equity in their respective company to gain investment capital in both programs. The key difference between the JCP and the NASDAQ Small Cap IPO is the dollar amount of venture capital to be raised; the JCP offers entrepreneurs a maximum of $300,000 $CDN, whereas the NASDAQ Small Cap IPO method immediately elevates the dollar amount to $5 million USD. While the JCP program raises limited capital, however, it facilitates direct access to the public market on the Alberta Stock Exchange for future capital needed. Furthermore, the disclosure and listing requirement for JCP companies are substantially less than for other categories of companies at the time of listing, which provides easy access to the needed venture capital market.

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