RIMÔN

Fundraising Stalled?

Here are the 6 S's Venture Founders should be thinking about.

Dror Futter | dror.futter@rimonlaw.com

Survival

Your goal here is to keep the lights on and doing so in a manner that does not harm the business to the extent that it precludes a future exit.

Slow Down

This is all about making the money in the bank last. You are chasing survival, not growth. Scrub your runway projections. Look at your revenue sources – is ordering likely to remain steady? If a lot of your customers are also ventures, you should factor in a significant amount of venture shutdowns and reduced order flow. On the cost side of the ledger, make sure your assumptions have fully factored in inflation. For the last 15 years, this has not been a real concern for any short-term projections. Deciding what is fat vs. muscle and bone is never easy, but the current environment should cause you to more critically evaluate the line.

Stop

Stop obsessing on dilution. Here is a basic rule of venture capital: "It is a verifiable fact that no venture in the history of venture capital failed as a direct result of excess dilution. The same cannot be said about running out of cash in the bank." Unless the terms are really way off-market (and that assumes you have a realistic view of the market) or the conditions are crippling to future fundraising/acquisition – TAKE THE MONEY!

Stopgap

This is the time to cast the broadest possible net for funding sources that will allow you to fight another day – even if it is not a complete solution to your financing issues. If your company has revenue, consider purchase order financing or other revenue-based financing. Maybe your company is eligible for grants. Consider contacting key customers about advance payments.

Sell

Under these circumstances, this is not likely to be the kind of sale that makes your investors especially happy but may be the only alternative that will deliver some return to shareholders. These sale transactions often look different from typical VC exits because the buyer usually has a narrow focus on making the purchase and since the sellers view the sale price as a "fire sale," they will usually be much less willing to make extensive representations and warranties. Since the main reason for the acquisition is a part of the company rather than the whole, the purchase price is usually depressed. Some acquisition flavors:

1. **Acquihires** – acquiring a company for its skilled employees
2. **IP** – acquiring a company primarily for its IP assets
3. **Customer Acquisition** – acquiring a company for its customer base (presumably as a means of transitioning them to the acquirer's products or services)

Shutdown

Sometimes, despite your best efforts, turning off the lights is the best answer – even when there is still money in the bank (which can be returned to investors) but the future prospects are not there. This is not a decision to be made lightly and should only be made after the company can show extensive efforts to fundraise. Failure to do so could be claimed as a breach of fiduciary obligations.

Keep in mind that how you handle a shutdown will be the final and most lasting memory that investors, employees, customers, and suppliers have of you. A poorly handled shutdown will cause a lot more reputational damage than the failure of the venture. While unpaid suppliers can be shut out through the bankruptcy process, you don't want to do that. In my experience, reputable VCs don't want this reputational damage and will provide small amounts to allow for a graceful shutdown.

Practice Tips:

Practice Tip #1: Your Board meetings and shareholder updates may turn a lot less friendly than you are used to. Make sure you have D&O insurance in place and for appropriate amounts.

Practice Tip #2: When ventures are "going good" a lot of decision-making is done by consensus and unanimous consent. In this environment, things are likely to turn much more contentious. Pay attention to the corporate formalities - consent requirements, voting thresholds, and timeframes for proper notice. Start keeping more detailed minutes.

Practice Tip #3: It is critical that companies can demonstrate that they extensively explored financing alternatives before implementing any of the steps outlined above. All of these steps are likely to significantly impair shareholder returns and from a fiduciary perspective, you want to avoid situations where the venture has a single "take it or leave it" option and has not previously explored alternatives.

Practice Tip #4: Keep in mind that from a legal perspective employee compensation (including in many cases accrued vacation time, bonuses, and commissions) and accrued tax obligations are non-negotiable. Failure to make these payments can result in personal liability for officers and directors. There are also certain legal and accounting costs to shutting down a company. So don't run down the bank account to zero.