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Show Me The Money: Where To Find Capital in The New Economy

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The current economic crisis that has so negatively impacted our country's corporate performance and real estate marketplace has had similarly devastating effects on the venture capital and equity funding arenas. Three years ago, the venture capital and equity markets in the Mid-Atlantic region and beyond resembled a financial smorgasbord of funding sources, including angel investors, venture capital/equity firms, institutional structured finance houses, mezzanine lenders (equity disguised as debt), capital arms of REITS and other public entities, IPOs and subsequent public offerings, and off-shore funds. Until recently, that plentiful buffet of opportunity had dwindled to an almost empty cupboard of sources for venture and equity funding.

Venture financings as of late 2009 had been down across all geographical regions, industries and stages of development. Many venture capitalists believe that the industry is broken; virtually all agree that the industry has significant systemic difficulties. The tasks at hand for companies needing venture capital and equity funding are to (1) determine how to position themselves to be stellar candidates for the capital and equity that does still exist in our marketplace, and (2) know where to look to find the capital and funding.

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State of the Market

Our new world consists of painfully tight money supplies, lenders with an aversion to lending and almost nine trillion dollars of cash standing on the sidelines, with recent data just starting to show some signs of life in terms of venture capital and M&A activity.

Statistics show that private equity-sponsored mergers and acquisitions slowed dramatically since the first half of 2007 and that 2009 was a particularly painful year in the vc/equity funding marketplace. "The Money Tree Report" by PricewaterhouseCoopers and the National Venture Capital Association (NVCA) notes that venture capitalists invested $17.7 billion in 2,795 deals in 2009, which indicated the lowest level of investment dollars since 1997. This amounted to a 37 percent decrease in dollar volume and a 30 percent decrease in deal volume from 2008. The reasons for this include: (1) A significant portion of venture capital and equity funding nationally is sourced by large pension funds, foundations and endowments. These sources have suffered dramatic losses over the last several years and have a significantly smaller funding pool; and (2) Fund managers and other fiduciaries which can choose what basket in which to allocate pools of assets have shied away from including vc/equity funding as a growing segment of their asset allocation pool because of the poor returns yielded by the vc/equity funding basket.

Is the Sun Beginning To Shine?

The NVCA reports in its April 1 News Release, based on information provided by Thomson Reuters, that venture funding exit activity showed a pulse during the first quarter of the present year, indicating the best quarter for venture backed IPOs since Q4 of 2007 and the best quarter for M&A exits as well, with 9 IPOs and 111 M&A transactions.

Mark Heesen, president of the NVCA, expresses cautious optimism, indicating that the IPO volume has shown the most improvement since the economic crisis began and the record-breaking number of venture-backed acquisitions is encouraging. He also notes that there is still a long way to go towards a full recovery but that signs are encouraging.

What Can We Do and Where Do We Go?

In this daunting atmosphere, where can our start-up enterprises, second-stage companies and mature entities ready for growth via internal expansion, mergers or acquisitions look for their necessary capital?

The good news is: The money is out there. The bad news is: Getting it requires a high level of diligence; the pursuit of multi-faceted potential solutions; an extremely competent management and financial team; and a financial history or a "proof of viability" unlike that seen in recent decades.

Although scarce, there are venture capital and private equity firms still open for business. Firms in the Mid-Atlantic region are in play as are sources in the national markets. They are selective and can demand a level of due diligence and rate of return and equity slice that will eliminate most suitors. With the paucity in equity sources in the U.S., off-shore funding can fill a small part of the gap, but logistical, legal, monetary and cultural issues may create significant impediments.

Opening Up the Pipeline

Creative measures can be taken to open up our restrictive funding pipeline.

Joint Venture Partner: Look for a prospective joint venture partner in your industry to team up with and supply needed expansion or acquisition capital. This is not an easy task and requires extensive research and due diligence, confidentiality protections, the right "team" fit and extensive contractual/legal work. A joint venture arrangement can provide your company with the benefit of expertise in areas it does not currently possess, the financial strength of the combined entity in terms of senior debt, equity and vendor relations and, perhaps, a basis for a long-term relationship.

Institutional Partner: Search for an institutional partner, such as a university, non-rofit organization, private-public partnership or quasi-government agency to fill the funding void. Success stories abound in the high-tech, bio-tech and other fields where partnerships between educational institutions, ranging from major research universities to community colleges and entrepreneurial businesses have created opportunities for companies ranging from incubators to mature enterprises.

Nonprofit organizations, such as economic development entities, have either provided or facilitated funding to businesses viewed as enterprises that can provide job opportunities and tax ratables to a community in need of redevelopment and growth. With TARP, stimulus and green energy program funding being infused into the economy, the available pool of funding in today's vc/equity funding marketplace has received at least a modest boost.

Professional Organizations: Professional organizations can also provide, or give entrée to, a much needed source of equity and venture capital. Technology councils, which exist in the Mid-Atlantic region and throughout the country, can be vital in the search for venture capital and equity funding and can provide funding, technological, merger/acquisition and other "matchmaking" services in a meaningful way.

Customers/Vendors: Consider a trip up or down the vertical "supply" chain and join forces with a powerful and/or well-heeled vendor or customer, where benefits to both parties can result from the capital infusion source. Partnering with vendors, suppliers and customers is laced with potential minefields, including inherent business competition conflicts, but should not be overlooked as an equity/venture funding source. A vertical joint venture arrangement brings to the table the talents of both entities and can provide creative insights into ways to obtain equity or venture capital.

Equity Brokers: Investigate the available pool of equity brokers in your local markets and interview them to determine if they still have access to meaningful equity funding sources. Although a number of these brokerage houses have disappeared from the scene over the last several years, there are those with contacts that the ordinary equity-seeking CEO or CFO cannot find on his or her own. Our region has a significant number of equity/funding brokers still open for business.

Super Angels: Even with the dismal performance in the equity marketplace, a group of "entrepreneurial-to-the-core" investors has created a new genre of small, fluid investment companies called "super angels," with the ability to invest quickly and in tranches that are easy to deploy. Million-dollar investments are in vogue. The NVCA and regional technology councils may be able to assist you in finding these super angels.

If you are fortunate to pick up a partner, you need to consider your combined equity contribution needs. In today's markets, significant levels of equity contributions are both required and desired.

The Flight to Quality

Venture capital deals being closed in our current marketplace are deals that would make sense in any economy; the "flight to quality." Therefore, the most critical effort should be concentrated on solidifying your company's financial condition (including your balance sheet, EBITDA, cash position and leverage) and being prepared to act as soon as improvement in economic conditions or your company's financial status warrant. Many companies look to expand, merge or seek acquisition targets before their own financial house is in order. Liquidity, low debt, profit history, an operational track record and a solid management team are key factors when attempting to secure equity or venture capital. The more stable you are internally, the easier your funding search will be.

In his February 21, 2009, *New York Times* Op-Ed on "Start up the risk-takers," Thomas Friedman laments that bailing out losers is not the way we prospered as a country and not the way to exit out of our financial crisis. He instead proffers that we should just call up the top 20 venture capital firms in the country, give them each $1 billion from the U.S. Treasury to fund their best venture capital ideas and have the taxpayers get 20 percent of the investors' upside.

Venture capital and equity funding are not dead — they are merely laying in wait for those who know how to look. There is no magic bullet. Bringing the right ideas and the right fundamentals are necessary to earn trust, as much confidence needs to be restored in order to return to building enterprises and making money. In these difficult economic times, it will be necessary to work harder and smarter. However, now the clouds are beginning to clear a bit and there are funds out there for your growth and expansion needs. ■