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# Lessons Learned in Financing

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Foley & Lardner LLP hosted a panel presentation on May 22, 2013, called "Lessons Learned in Financing," as part of Foley's Growth Company Event Series. The panel was moderated by Partner Lisa Conmy, a member of Foley's Finance & Financial Institutions Practice. Panelists included Bret Maxwell, Managing General Partner at MK Capital; Eddie Lou, Chief Executive Officer and Co-Founder of Shiftgig; and Guy Turner, a Partner at Hyde Park Venture Partners.

The conversation focused on the financing process for growth-stage companies from the company and investor perspectives. The panel provided specific examples of successful and unsuccessful financing experiences, as well as recommendations for every step of the financing process.

## Timing — When to Seek Capital

### ALWAYS BE FUNDRAISING

A growth company, regardless of whether it is actively seeking capital, should always be fundraising. Fundraising is more than just a formal period during which a company is officially seeking capital. A growth company must also engage in the informal process of getting its name out, creating a buzz and networking. Investors are more likely to invest in companies and people they know, and the best way to get to know a company is by watching it grow. Company founders should network with investors whenever possible and build relationships that create possible platforms or networks for future fundraising.

### EXPECT A LONG PROCESS AND PLAN ACCORDINGLY

Raising capital is not a quick process. In fact, a formal raise takes time, usually longer than you think. One of the best ways to jumpstart the process and better position a company is to regularly engage in the informal fundraising process by consistently networking with investors.

### HOW MUCH SHOULD YOU RAISE?

Growth companies often struggle with this question. Should less be sought in an effort to more easily reach a target? Or should a company shoot for the moon and raise as much as possible? The best approach is to strive for a fundraising goal that is based on the company's anticipated needs, rather than an arbitrary number. Generally, companies should take the minimum amount of capital needed and raise future capital in accordance with the company's growth and changing needs. Companies should be careful with regard to oversubscribing, as it could affect the ability to raise funds in the future. If a company has use for additional funds, received favorable terms from investors, and already anticipated the need for additional funds in the short-term, it may be beneficial to oversubscribe the round so that management can focus on building the company rather than fundraising. A company seeking to raise a very small amount of capital risks falling below certain investment criteria thresholds and being overlooked by some investors, who may believe that the company is not ready for a formal raise. Companies seeking a smaller amount of capital should strongly consider a convertible note financing rather than a preferred equity financing.

## Identifying Investors/Investments

### MATCHING INVESTORS AND INVESTMENTS IS A TWO-WAY STREET

Investors and companies alike look for a good fit. Strategic investors are ideal for most growth companies. However, every company seeking capital must ensure that it fits into the particular investor's model and goals. In fact, many investors look for particular things, and it is important to know whether your company is a proper fit for that investor. Because investments in growth companies are generally long-term, it is important to realize that these investors are more than mere sources of capital — they are also partners whose goals and strategy must align with those of the company.

#### INVESTING IN MANAGEMENT

In making an investment decision, investors consider a growth company's management as well as its business and pitch materials and track record. The "younger" the company, the greater the emphasis and importance placed on the role of management. With respect to such companies, as well as those that are still in growth stages, investors look at management's ability to plan for and adapt to changing strategies and direction. Investors consider management's ability to lead the company through such changes as well as any growing pains. Later-stage companies with proven track records and, more important, the capacity to provide an attractive salary, can attract better managerial talent; therefore, investors may place somewhat less weight on existing management and more on the company's track record and business model. In all cases, investors know that existing management establishes its value by building a successful company, and that regardless of the value investors may place on a particular member of management, the management team as a group will be critical for the company's continued growth.

#### INVESTORS ARE MINDFUL OF CO-INVESTORS

Some investors are sensitive to the identity of their co-investors. Large investors demand significant control and input in their investments. Accordingly, larger investors may worry if there are too many other co-investors or if there is another large co-investor which could lead to internal fighting and conflicts over control. On the other hand, most smaller investors understand that their role is generally a more passive one and that they will likely have to work with other investors, some of whom may have more control and influence over the company.

#### KEY MANAGEMENT AND COMPANY CHARACTERISTICS

Investors list "tenacity" and "openness to feedback" as key management qualities. Investors are also wary of persons who blame others for their failures or missteps. While a proven track record and traction are good qualities, investors place greater importance on a person's ability to understand the company's product and market, and demonstrate an ability to pivot, whether as a result of a changing environment or an unsuccessful business plan.

### How to Approach Investors

#### KEEP IT SHORT

Management must be able to effectively and efficiently sell themselves and their companies to investors. Many investor pitches are only 15 – 20 minutes. Highlighting the strengths of the company and of its management and providing key takeaways are critical to the successful pitch. Investors caution against lengthy presentations in any form.

#### SELL YOURSELF AND YOUR EXPERIENCE

Investors have a deep understanding of the market itself; avoid wasting time telling them what they know. Instead, pitches should concentrate on your management and company and not on third-party market research. Regardless of the company or management or even its products or services, if a company cannot sell itself, investors may doubt the company's ability to sell its products or services.

### Negotiation Process — Keep in Mind the Long-Term Nature of These Investments

A company must focus on what is important and ensure that the terms of any investment are consistent with the goals of the company. However, the company must also be mindful that the investor relationship is typically long-term. Thus, companies should take care not to harm or spoil that relationship from the start. Companies should strive to achieve terms with its investors that are in the company's best interest, but be careful in choosing its battles and the manner in which those battles are fought. Being overly combative may be seen as a bad sign of what is to come for investors. Companies and investors should demonstrate that they can work together, and are open to working as partners to grow the company. Consider whether the goodwill and spirit of cooperation is of greater value in compromising a deal point then the value achieved by "winning" the deal point.

## Work Together

Growth companies are not expected to give up control upon receiving investments, but should also be open to taking advantage of the valuable experience of investors. In some cases, and depending upon the size of the investment, growth companies should be ready to accept sharing some control with the investor. Since the company and investor are now partners in the venture, it is critical that good news as well as bad news be shared. In many cases, the investors are well seasoned and have access to different or even greater resources than existing management. Investors are in a unique position and their interests are served when they are able to suggest a solution to resolve issues facing the company. Remember, an investor is a stakeholder and shares the company's desire to be successful.

## Parting Thoughts

» Show that you can make lemonade out of lemons. Investors want a management team with the capacity, skills, and drive to succeed, no matter what lies ahead.

» Long-Term Relationship. Investors and growth companies need to view growth investments as a long-term relationship in which both sides are working toward the same goal — the success of the company.

» Open Dialogue. Investors and growth companies are partners. Investors value a management team that is open and willing to listen to its investors.

## For More Information

For more information on this session or Foley's Growth Company Event Series, visit Foley.com or contact any of the Foley attorneys below:

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