



# Fundraising in an Economic Downturn

**B**less your hearts and good luck!” is the best advice an associate at a socially responsible venture fund has to offer start-ups seeking financing in our downturn economy. Her tongue-in-cheek response represents the dubious sentiment of the investment community for 2009. And while the outlook remains grim for the near future, smart companies can turn the economic downturn into an opportunity.

Pessimism is understandable in the face of trends that have depleted traditional sources of capital for young companies. According to a report distributed by the National Venture Capital Association, 2008 brought just six IPO exits, the fewest annual venture-backed offerings since 1977, as well as a vast decline in mergers and acquisitions. Since venture capitalists rely on these activities to make money, many investors no longer have the resources to invest in new companies. Compounding this dilemma is the unwillingness of some banks to lend money to prospective investors.

Angel investors, high-net worth individuals who invest their own capital, remain a solid source of funding for early-stage companies. However, even their investment activity has begun to slow down as a result of the recession. A study conducted by the Angel Capital Association showed that total angel group investments in North America decreased by at least 10% in 2008. Uncertainty in the markets, loss of wealth, and the need to reserve additional capital for portfolio companies all contributed to this decline in investment activity. New investments will continue to slow down considerably in 2009 until the exit markets reopen and the pipeline is cleared.

While the economic downturn has led to a fiercely competitive climate for early-stage companies seeking financing, there is reason for optimism. As we've seen in the past, downturn economies force a “survival of the fittest” among blooming companies, which benefits ventures that can distinguish themselves in busy market segments. Companies that persevere will have less competition and greater access to market share once the economy rebounds. It is also heartening that insiders are predicting that investment activity in the green space will grow in 2009. A recent report published by Deutsche Bank's Asset Management Division makes the case that despite the current economic crisis, the accelerating pace of global warming will drive governments to invest more heavily in climate-control technologies. We are also beginning to see private investors look at previously under invested areas like energy storage, energy efficiency, recycling, water, cleaner coal, and green IT.

As such, there are many LOHAS companies that are finding great success despite current economic conditions. Earthcycle Packaging, for instance, has piqued the interest of the investor community at a recent Investors' Circle Venture Fair, an event showcasing top-tier

mission-driven companies. The four-year old, Vancouver-based start-up uses palm fiber, an annually renewable resource, to create disposable plastic packaging. Founder Shannon Boase says, “I've gained traction with investors because my line of business speaks to people on an emotional level. People know that oil is a scarce resource. People know we need change.” Several other factors, including Earthcycle's attaining profitability in '08, green trends in the packaging industry, and strong sales have also helped Earthcycle attract the attention of investors.

As Boase attests, with some ingenuity, key operating guidelines, and a little luck, promising LOHAS companies should be able to attain financing in '09. Here are some expert tips to improve your chances for success:

## Rethink Milestones

Companies at all stages will need to readjust their growth expectations for 2009. “Don't expect to raise all the capital you're hoping for in this economy,” says John Gillespie, president of Beyond the Bottom Line, a financial consulting firm. “If you are pre-revenue, look at ways to break your plan into more discrete milestones. Making solid achievements with less money will make your venture a more viable investment opportunity for investors. The credibility of achieving milestones is imperative now.”

## Be Proactive

Traditionally, a company would pitch an investor and ask, “What terms do you need for me to get funding?” Now,

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because of the uncertainty of the market, companies should be more proactive. "Entrepreneurs should consider preemptive term sheets instead of waiting for investors," says Adam Borden, managing director of *Bradmer Foods LLC*, a specialty foods venture capital firm.

### Think Outside the Box

Investors are seeing fewer exit opportunities for their portfolio companies, which makes early-stage investing even riskier. Borden says that "as a result, many angels have become reluctant to do straight equity investing. Some [investors] have become more interested in deals that would allow them to recoup part of their investment before an exit." Therefore, entrepreneurs should think about alternative funding structures, such as convertible debt with a scheduled prepayment, to demonstrate that they understand the challenges facing investors.

### Operate Smart

If your company isn't poised for fundraising success during the recession, survival should be your next goal for future success. According to Bonny Moellenbrock, executive director of *SJF Advisory Services*, a nonprofit that provides support and access to capital to socially responsible businesses, "if funding is not certain in the near term, companies should try to operate lean, conserve cash, and just try to survive. If you weather this storm, by this time next year there will not be as much competition for funding."

While fund-raising in the current economy will undoubtedly be tricky, keeping these strategies in mind can help LOHAS companies succeed even in this difficult economic climate. **U**



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