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Raising capital during the pandemic

Creativity, diligence can help entrepreneurs close deals

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By Chris Sloan

Every business needs capital. Even in normal times, raising money from outside investors is time-consuming and challenging. The COVID-19 pandemic has introduced an entirely new set of challenges, both with tighter cash flows and with trying to raise outside money in a once-in-a-lifetime economic environment.

Despite the pandemic, investors are still investing and private investment activity has not really decreased much since the pandemic started. This article suggests a few strategies for entrepreneurs to consider when raising money during these challenging times.

Build an investable business

The core attributes of an investable business are no different now than they have ever been. Investors may describe their criteria in different ways, but most involve some variation of these four Ms: model, market, management and momentum.

Model refers to a scalable business model that meets an important customer need. Market refers to the size of the market opportunity. Momentum refers to the successes and milestones that have already been achieved. Last but not least, management refers to the leadership team that will be tasked with running the business.

Investors often will tell you that, of these four "equal" criteria, the last is more equal than the rest. Whatever the case, if you have a fundamental flaw in your business, either address it before you try to raise money or at least have a well-developed plan in place for you to address it once you have the capital. This is even more true during times such as these. If it's easy for an investor to say no, they probably will.

Lower the valuation

Once you have found interested investors, how can you close the deal? Hopefully, the deal will follow a normal course and result in relatively normal terms. However, if you need to provide extra incentives for an investor to close the deal, or invest a larger sum of money, what options do you have?

The first, and most obvious, is to lower the agreed valuation. In other words, reduce the purchase price so that investors get more bang for their buck. If the investment is in preferred stock, other possible strategies include shifting from a non-participating preferred to a participating preferred or a capped participating preferred stock, offering more favorable terms for pro rata investment rights or other adjustments to the preferred stock rights and preferences.

If the investment is in common stock, another strategy might be to offer some of the rights typically reserved for a preferred stock investment, such as a board seat, pro rata rights or rights of first refusal.

Other terms to consider

If the investment is in a convertible note (or similar convertible instrument, such as a SAFE or a KISS), terms that could be adjusted in the investors' favor include a higher interest rate, a higher discount and a lower cap. As with an investment in common stock, some of the same rights associated with a preferred stock investment might also be enticing for a convertible investor. It may also be possible to entice investors by offering more favorable terms to those who commit at an earlier date or commit to invest a larger amount.

The pandemic has created challenges for all of us. That's no different for entrepreneurs. However, by applying the same creative, problem-solving mindset that they apply to building a business, entrepreneurs can still raise capital even in this challenging environment.

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