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What early-stage companies should do when capital starts to dry up

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By James S. Cassel

James S. Cassel is co-founder and chairman of Cassel Salpeter & Co., LLC, an investment-banking firm with headquarters in Miami that works with middle-market companies.

Capital is plentiful and the economy is humming, but don't forget what happened in 2001 and 2008. Suddenly, companies that did not have a path to profitability in the short term were squeezed hard, often into extinction. Venture and growth capital firms realized that the money they had committed from investors could soon dry up, so they started making tough decisions. For VCs, the lifeblood of early-stage companies, protecting only the best ventures became the mission.

As we move closer towards a possible recession, the time has come for early-stage companies to begin preparation for survival should investor capital become scarce.

What can early-stage companies do to prepare when capital starts to dry up?

The first step is a thorough review of your business model and cash projections. You should evaluate how much capital you have, how much you can preserve, and if your present capital can take you to break even, or to being cash-flow positive.

Be honest about what you see. You may discover a sale is inevitable, and if so, the earlier you start the sales process, or find a partner to help keep you afloat, the better your chances of not having to go into bankruptcy/reorganization or liquidation.

Secondly, if you expect to raise capital down the road, you may want to expedite the timing and do it now. With the economy humming, venture capital might be more available today, but as soon as a recession hits, and maybe even sooner, many will find it next to impossible to raise more capital.

You must also be careful not to let valuation be a hindrance to taking in new capital, or even to taking less of an investment than you had hoped for. A down round in terms of financing is often better than no financing.

Thirdly, you want to monitor and address your burn rate. For example, rather than reaching a milestone and then going off to raise more capital, your challenge is to develop ways to become profitable or cash-flow-positive with what you already have. By addressing this before your cash runs out, you have valuable time to begin moving towards profitability, or at least to break even in terms of cash flow. Again, long-term survival is the goal when capital starts to dry up. You're looking for the chance to prosper later.

Now, even if you are able to raise capital, you should also have a contingency plan. Consider what happens if you don't reach your benchmarks even with a capital infusion. You may want to allow for an earlier exit, or you may want to go to market selling your company for less than you'd hoped for.

Despite your best efforts, you may still find yourself out of capital, and if a recession hits, you'll need to make tough choices. Maybe it will come down to deciding if you should run a sales process to at least get some value while you still can. Or, maybe it will be better to consider liquidation and get out with what you can, while you can, returning unused cash to investors. Something may be better than nothing.

Depending on your capital structure, you might have to change your original financial structure to get some relief. You may find that converting debt into equity is the smartest play, but another option might be restructuring in conjunction with offering better terms to potential investors, which might be your last-best effort to secure much-needed additional capital. Whatever move is best for you, remember to engage with an investment banker earlier in the process rather than later, as they can provide invaluable advice.

Money remains relatively accessible for early-stage companies, but it will dry up sooner than you think. Surviving a capital dry spell when you are running an emerging company means preparing early and acting quickly when the winds suddenly change.

James S. Cassel is co-founder and chairman of Cassel Salpeter & Co., LLC, an investment-banking firm with headquarters in Miami that works with middle-market companies. He may be reached via email at jcassel@casselsalpeter.com or via LinkedIn at https://www.linkedin.com/in/jamesscassel. His website is: www.casselsalpeter.com