

7 COMMON MISTAKES PUBLIC COMPANIES MAKE WHEN RAISING CAPITAL

#1 Underestimating the Time and Effort Required

Raising capital takes a significant commitment of time when CEOs and CFOs are already fully occupied with managing the business. They are faced with either shortchanging the funding process or neglecting operations.

In particular, the CEO/CFO often fail to appreciate several key factors such as:

- timing—financing when conditions are favorable rather than when time is available
- the investment banker—selecting one appropriate for the situation, not necessarily one with an historical relationship
- negotiating the terms—using the knowledge of recent deals to level the playing field
- coordinating with lawyers and accountants to minimize surprises and incorporating helpful suggestions
- studying the closing documents to negotiate final details before they are cast in stone.

#2 Initiating the Transaction at the Wrong Time

Of course it would be ideal to consummate a transaction when the market is strong and the company's stock price is high. However, companies too often are engaged in raising capital when cash is dwindling and their options are limited. So why do so many companies find themselves in the situation where they are under the gun and are forced to accept onerous terms? Why do they wait so long to raise capital? There are two main reasons for procrastinating:

- focusing on other business areas when they have ample cash, even when the market is strong and the stock price is high, or

- believing that the stock price will continue to advance and future conditions will be even more favorable.

At a minimum, during times of bright skies companies should prepare themselves to act quickly. This preparation should include the following: deciding on the range of funds to be raised and the security to be issued, selecting the investment banker, having discussions with lawyers, auditors, and the Board of Directors, filing a shelf registration, and preparing investor packages and due diligence documents. This takes effort, time, and planning. Too often, companies fail to see the benefit of investing the time to do this preparation.

#3 Using the Wrong Investment Banker

It is a rare company that has the expertise and time to raise capital on its own. Therefore, it must rely on an investment banker who is usually the most important player in a transaction.

Although companies have several options in selecting a firm, often they fail to realize the importance of matching the banker with its needs. During this matching process, the company should consider several factors, including the size of the transaction, experience of the banking firm and lead banker, industry expertise, existing relationships, recent transactions, typical investors included in the banker's deals, the ability and willingness of the banking firm to provide research, and the banker's personality/style.

Unfortunately, one of the most common errors committed by companies is selecting the wrong investment banker. Why does this occur? One reason is the lack of knowledge of available options; another is the time required to meet with bankers; a third is a concern that exploring options could seriously harm an existing relationship. All of these potential problems, however, can be overcome by using an experienced intermediary who can work in an anonymous manner to identify a few outstanding options.

#4 Failing to Obtain Market Terms

Although the investment banker can predict the structure of a deal, reality hits when the term sheet is received. How does the company then respond to the offer? A typical first step is to compare the terms with those the banker had predicted. Too often this is followed by the banker explaining several reasons why the term sheet is less favorable, e.g. market conditions have changed, or the company's performance has deteriorated.

Now what? The company could ask the banker for a comparison of terms in similar recent transactions. If it receives a response at all, they can be assured that it will support the reasonableness of the term sheet. There are data bases of recent transactions available, but does the company know where to go to get these data and is it willing to pay the fees involved? Is it willing to invest the time to pour through recent deals and identify similar transactions? Does it have the expertise to do a thorough analysis? Even if the answer to all of these questions is “yes”, does the company know how, where, and how firmly to push back on the offer? And, once the term sheet is negotiated and agreed to, the same process is repeated again in the closing documents, as these often have some nasty terms that never appeared in the term sheet.

Given this challenging process, it is no wonder that many companies find themselves at the mercy of the investment banker to insure that they obtain a “market” deal. There are two reasons that this is especially true:

- first, the investment banker wants to consummate a deal, collect the fee, and move on. He has already obtained the acceptance of terms with the investor and now merely needs the other party, i.e. the company, to agree to complete the process. If the company pushes back, the banker is required to go back to the investors to try to mediate, a task that he would prefer to avoid.
- second, although the banker works for the company, he is often conflicted, as he is dealing with these same investors two, three, sometimes four times a year in different transactions. This is in stark contrast to dealing with the company once every few years. For this reason, unfortunately, the banker is often more concerned with pleasing the investors than the company. It is important for the company to recognize this potential conflict before it places too much credence in the advice of “its” banker.

#5 Failing to Spend Adequate Time on Coordination

CEOs and CFOs are busy people dealing with daily pressures. These pressures often interfere with the need to spend time coordinating with other parties crucial to creating a smooth financing transaction. There are three important groups who are often shortchanged in the communications process:

- **Boards of Directors**—One of the most important tasks of the Board of an emerging-growth company is to decide on financing transactions. In order to do this well, it is incumbent upon the management to educate the Board on the complexities of this activity. This often requires several sessions, especially since many Board members typically have limited financial expertise.
- **Auditors**—Too often they are the last to know that a financing is forthcoming. This can lead to significant problems, including failure to provide their necessary consent to a deal on a timely basis, or failure on the company's part to negotiate terms which are "accounting friendly." This latter point is often the source of unnecessary consternation on the part of the Board and current stockholders. The accounting rules, especially as they pertain to financial instruments, are complex and can lead to unfavorable results in the financial statements. This often can be minimized by involving the auditors during the financing process when a minor change in wording can yield a more favorable accounting answer.
- **Lawyers**—The company's lawyers are a significant asset in any transaction. However, it is critical to spend time with them early on in the transaction to insure that they understand the business issues, strategy, and objectives of the company. This will empower them to enhance the value in the deal, while minimizing their time (and cost to the company).

#6 Issuing the Wrong Security

Companies have many choices in raising capital, including common equity, preferred stock, debt in various forms, convertible securities, and warrants. Several factors need to be considered when deciding what security to issue. These factors include: existing capital structure, stock price, cash flow, market conditions, outlook for the business, risk tolerance of the owners, ownership profile, and flexibility. Too often companies fail to take the time necessary to make a well thought-out decision. Unfortunately, selecting the security to issue is often an afterthought, determined more by what the investment banker believes can be sold, rather than by what is appropriate for the business. Why does this happen? There are three common reasons why this occurs:

- a company lacks the sophistication to recognize and consider the myriad of important factors to arrive at a well thought-out conclusion,
- it fails to devote the time necessary to analyze the options, or
- it waits too long to raise capital and finds itself at the mercy of investors.

#7 Believing They Have the Necessary Experience In-House

It is rare for a small or mid-sized company that has the horsepower in-house i.e. the time and expertise, to lead the transaction. Even if the CFO has done several transactions, the old adage, “two heads are better than one,” certainly applies. Raising capital is a high-impact transaction and working with an experienced resource with a CFO perspective can shorten the time frame and reduce the cost of the transaction. An extra resource can be helpful in several ways:

- interacting with investment bankers
- facilitating the due diligence process
- preparing for investor presentations
- preparing for Board of Directors meetings
- analyzing comparable deals
- assisting in negotiating with investors
- reviewing term sheets and closing documents
- coordinating with auditors/lawyers/bankers

**Ralph Norwood, President
 Navigator Capital Advisors, LLC
 275 Grove Street Suite 2-400
 Newton MA 02466**

Website:	www.navcapllc.com
Telephone:	617-663-5740
E-mail:	rnorwood@navcapllc.com

