Coming in hot – the art of the belly landing

There are revenues…..but only seven recurring customers.

There are plenty of leads…..but it's a long sales cycle.

There is enough cash for seven or eight months….if we stop sales and marketing and just service what we have.

We are cash flow positive….if we don't pay the CEO, CFO and CTO.

The system really works….but our balance sheet has conservative potential customers going elsewhere to inferior providers.

The whole VC community knows us….but they don't see a 10x on new money and gently say no, other than the one guy who has offered us maybe a year of cash for 45% of the equity, a 5x liquidation preference and two board seats.

And the team and the VCs are each exhausted in their own way.

Any or all of this sound familiar?

If so, it's probably time to brace for a belly landing.

The truth is that most venture-financed startups don't just fold up, because you must have some traction for the VCs to fund in the first place. With experienced investors, the company gets the benefit of professional advice and the direct and indirect follow-on funding power. On the other hand, there's a reason that skilled venture investors are compelled to focus on true potential 10x and 20x opportunities in the first place: they need to budget for the misses.

In the vast space between the early collapses and the IPOs or monster strategic exits lie many heroic smaller exits "belly landings;" you didn't get to where you wanted, but everybody was able to walk away with their dignity, their reputation and maybe even a little cash. Since there's really not a VC flight school that specializes in teaching belly landings to entrepreneurial pilots, here are some tips for founders to consider.

Scan the horizon for a landing strip

The quick checklist of your potential landing strips is usually in the following order: 1. strategics looking for niche offerings; 2. customers; 3. salvage buyers; and 4. competitors.

A realistic board and management team should have already done some thinking about the inevitable, and may even already has a short list of exit candidates. Start this process before the fuel tank is sputtering and you'll have more time to get it right. If you picked the right VC investors initially, their industry knowledge and contact lists will be invaluable and the obvious first place to start.

However, even if you think you know the entire list of possible buyers already, strongly consider using a boutique investment bank or broker to shop the company, even if the likely exit price is under US $10 million; while exit dollars are precious, an investment bank will have the incentive and "emotional search energy" that a tired board and management may not be able to muster.

Keep the nose up

As with any exit, it's critical to keep everything headed in the right direction, as a sudden loss of management attention or drop in revenues could be fatal. A few triage pointers:

- Focus on maximizing key customer happiness.
- Keep the management team's "knowledge circle" of the exit plan as small as possible.
- Carefully plan your cash, perhaps with some small exit bonus in exchange for postponing current executive comp, or getting a very small loan bump from existing investors; trying to finance your fuel with accelerating customer receivables will send the wrong signal to savvy customers and the risk is probably not worth the reward.

Brace for landing

You want to minimize problems as you brace for landing. Because your earliest investors and common stockholders are the most likely ones to get very little or nothing when you finally screech to a halt, they are also your most likely source of trouble and may require the most care.

Angel investors or "friends" and family holding common stock may have unrealistic expectations will have them convinced that they "deserve" something, that somebody is ripping them off, or both. Some of these same early investors may also be the ones making claims, making calls, and sending nasty letters and emails to the company and other early investors, trying to organize litigation or worse, often to satisfy an emotional need, and sometimes a financial one. Again, the checklist:

- Get ahead of the curve with information, and bring them bad news earlier rather than later. Every founder dreads making these calls, but often it's the shock and surprise, and the feeling of being left out of the process, that riles the early investors more than the actual facts leading to the disappointment. Expectation management skills are critical here.
- If you raise any cash at all, go ahead and let everybody invest in the round, whether they have contractual pre-emptive rights or not. By the way, now is NOT the time for the VCs to extract a little extra value for their trouble with a 5x liquidation preference on their convertible bridge loan; they need to be as realistic about overall expectations as you need the common holders to be. Giving everyone a chance to participate, and keeping your professional investors from eyeing a closing-table grab, will short-circuit claims of insider enrichment and give your smaller holders a greater sense that their interests are being considered, even if nothing can be done to salvage their original investment.
- Treat the exit like a real M&A transaction from a governance perspective. As the exit may often involve some affiliate or key relationship with a particular investor or director, or the buyer needs or wants to employ the whole management team, make sure there is a record of a full shopping of the company, and that the board seriously considered the interests of any non-employee common stockholders during the process. If you're lucky enough to have an independent director or two, consider letting them negotiate on behalf of the common stockholders, and even trying to cadge a nominal payment from the senior investors. And if you've retained an investment banker, the board can get the benefit of a fairness opinion.

The idea is to step carefully so that if ego and envy prevail over reason and some underwater early investors decide to cause trouble, they'll have difficulty finding counsel that will take it on a contingency basis, and the potential buyers will have the confidence that any investor complaints can be addressed with minimal risk.

Walk away with your heads high

Is it worth all the trouble? Absolutely. Remember, almost every one of these belly landings is "financial terms of the transaction were not disclosed". Those watching carefully may know it's not a huge home run, but they have no idea if it's a triple or a single.

The VCs will recoup some or all of their investment, and have another "successful exit" to publicize.

The management team may or may not get to go with the company, but people will know that at best you've had a successful exit under your belt, and at worst you didn't quit and fought hard for everyone's money, and don't think that doesn't make a difference when you're looking for funding for your next business.

Compared to the alternative, a belly landing sure is something to look back on with relief and satisfaction, and a safe landing well done can alleviate some of that frustration until the time you are ready to take that new idea to the market.
