

Raising Capital in Troubled Times

Raising capital for the past two years has been problematic and difficult both for private companies and public companies alike. Raising money for start-up ventures, development stage companies and family-owned businesses has also been extremely difficult. The market for selling stock to new investors is virtually dead for private companies and many companies find themselves selling stock at a deep discount than what they would otherwise be able to sell their stock in a healthy market.

Private Offerings

Many companies, including startup and development stage companies, continue to use traditional private placement exemptions for raising capital in private markets. This gives such companies flexibility and is a relatively inexpensive means for raising capital. Regulation D of the Securities Act of 1933 allows a company to raise capital without registering the underlying securities with the Securities and Exchange Commission as long as certain conditions are met. Essentially, Regulation D allows the sale of stock or other securities to up to 35 or fewer unsophisticated, non-accredited investors and to an unlimited number of sophisticated, accredited investors who meet certain financial requirements. Most states, including Illinois, have adopted some or all of the exemptions for offering securities of Regulation D.

Regulation D prohibits advertising or general solicitation in connection with the offer and sale of securities. This prohibition is broadly construed and prohibits randomly calling the general public on the telephone, which has traditionally been one of the more common problems facing startup companies. Utilizing telephone lists to call prospective investors is perhaps one of the most problematic areas that ultimately can gain the attention of regulators. Many of these call lists, by accident or design, contain telephone numbers that are actually direct lines to state regulators. A call to a state regulator will generally promptly result in the issuance of a desist and refrain order, and in some states such a call will result in the imposition of a fine against the company and its principals.

Corporate Cleanup

Whatever method a company uses for raising capital, it is imperative that it have its internal corporate housekeeping and structure in place before it offers its stock or other securities to the market. Many startup companies, family-owned businesses and other enterprises have not hired a competent corporate attorney to assure that their organizational documents, including Articles of Incorporation, By-Laws and Shareholder Agreements and their corporate books are in order and that all of their board of director meetings and other organizational meetings have been properly documented and recorded. Putting your agreements and understandings in writing is a major way to avoid headaches, risks, disagreements and lawsuits among the current shareholders and the new investors. Additionally, it is important to have properly prepared financial statements, preferably by an independent, qualified accounting firm. This tells potential investors two things. First, it reveals the fact that management is serious about going forward with its business plan and plan of operations. Second, it gives integrity to the financial statements and the books and records of the company, thereby giving a higher level of comfort to potential investors.

Additional information regarding the matters discussed in this article could be obtained by calling Serge Biberman at 312.410.7863.