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Venture Financing Continues To Slide For Private Companies

By **Tom Zanki**

Law360, New York (August 5, 2016, 8:50 PM ET) -- Venture financing for private companies slowed appreciably in the second quarter, according to a report by law firm Cooley LLP, in the latest sign that "unicorns" — private companies valued at least $1 billion — are finding it harder to raise money during more sober times.

Cooley said 154 deals that it advised in the second quarter had raised about $1.8 billion, marking a 57 percent drop from the first quarter when funding surpassed $4 billion, according to Aug. 3 report based on 154 second-quarter transactions in which Cooley provided advice for a company or investors. The firm attributed the drop mostly to a decline in large funding rounds that are common among late-stage companies, many of whose executives are hoping for an initial public offering.

The firm also noted a sizable uptick in "down rounds" — financing rounds in which a company is valued for than during its previous round. Cooley said 21 percent of all transactions were down rounds in the second quarter, about triple that of prior quarters and a level not seen since 2011.

The reports adds to recent data that has shown private valuations are cooling in the once sizzling startup community, particularly for technology firms in Silicon Valley. To many observers, the increasingly sober climate represents a healthy shift that will force private companies to focus more attention on running their businesses efficiently rather than coveting yet another lofty funding round.

"The boards and management teams recognize it's not in the best interest to keep raising money at an unprecedented pace," Cooley LLP partner Jim Fulton said. "It's time to actually get a return on equity."

The shift in the private sphere also coincides with a more skeptical IPO market — one where investors to a greater extent are demanding that companies demonstrate a viable path toward profitability rather than simply showing rising revenue or market share. Only 56 companies have completed IPOs in 2016, representing the lowest level since during the financial crisis.

The number of unicorn companies is estimated at 170, according to venture capital database CB Insights, but only one, cloud communications firm Twilio Inc., has gone public this year, suggesting that many richly valued startups are cautious about taking a hit in the public markets. Experts note that many late-stage companies are opting to be acquired instead, a path that provides more certainty to investors if not the same type of payday as going public in bullish times.

The reduced funding for late-stage enterprises is having an effect on younger startups as well. Cooley reported that valuations have declined for both Series A deals, for companies' first significant round of venture capital, and the much later-stage Series D+ deals.

“It’s undeniable that the cool-off at the late, late stages is having a trickle-down effect at the earlier stages of finance,” Fulton said.

Private investors are also negotiating more favorable terms in light of the changed climate. Drag-along provisions, which enable a majority shareholder to force a minority shareholder to join in the sale of a company, rose in the second quarter to 96 percent of all deals — a level Cooley said has not occurred since 2008.

-- Editing by Marjorie Backman.
