

Finding Funds for Your Cleantech Startup

Five tips to make your startup stand out in the crowd

by David Lafitte, Mark Skaist, Shiv Grewal, Shareholders, Stradling Yocca Carlson & Rauth

For most cleantech entrepreneurs looking for venture funding, the well looks pretty dry right now. Although the first half of 2010 looked promising, venture capital (VC) firms did not exactly throw wads of cash or make many new investments in the cleantech sector last year. Cleantech teams at many traditional VC firms are shrinking...even disappearing. So while a new cleantech entrepreneur seems to be born every minute, the ability to start a new enterprise in the space with VC investment and the dollars he (or she) needs to bring his vision to market is increasingly elusive at the moment.

Still, for the smart cleantech entrepreneur with the right pitch, the money is out there. That said, when your startup is one of literally hundreds of solar panel or biofuel companies out there looking for funds, you have to offer something extraordinary to stand out. Hopefully with a few of our helpful insights and a little chutzpah – you may be able to start the next extraordinarily successful enterprise and make the world just a little bit better!

Background

The current economic downturn impacts the dollars available for investment – there's just less money out there. Beyond that, numerous other factors have contributed to the current reluctance about cleantech investment. First, LPs are holding back on cleantech investments right now, primarily because there have not been enough successful exits in the cleantech industry to create a comfortable track record. LPs don't want to take unnecessary risks, and an unproven industry looks like a big risk.

The dearth of exits does not result from poor technology or mismanagement. Rather, cleantech has not lent itself to quick exits because of long gestational periods. Late stage VCs want relatively instant gratification – they look for exit opportunities in one to three years, with a return of two to four times their investment. The majority of cleantech startups to date have not been able to offer that kind of fast and furious return because cleantech intellectual property requires more time to develop.

Venture firms have also started to understand that the cleantech sector is its own multi-headed animal, requiring specialized structures and competencies. Many VC firms have only recently realized that the social media sector requires a specialized team; they are even further behind on the cleantech sector.

Cleantech VC insiders believe that the industry is undergoing a massive reinvention right now – a Cleantech VC "Version 2.0." This new and improved cleantech VC will be highly specialized and seeking broader cleantech opportunities – opportunities that provide a faster return than previous IP-based cleantech investments. You will see niche cleantech VCs who focus on a sub-sector of the cleantech industry and build their funds around a more defined theme.

How can you stand out among the hundreds of cleantech startups standing alongside you in the VC soup line right now?

And stand out you must. Consider, for example, Highland Capital Partners, a major seed and growth stage venture capital firm. Of the 400-plus cleantech startups Highland Capital has evaluated, it has invested in...three.

Obviously, you want to become one of those three. Perhaps some of the following tips could help you get your foot in the door with potential investors:

Insights

1. Focus on your talent as much as your IP

In the past, cleantech VCs have focused almost exclusively on finding "breakthrough technologies" – the so-called "Black Swans," as coined by Vinod Khosla. The first question they invariably asked was, "What's your IP?" But cleantech VCs are learning painful lessons – success requires superior execution of a smart business model, which may or may not involve new patents.

Instead of focusing exclusively on your IP, try placing emphasis on the talent you bring to the table – why your team has a particularly high chance of succeeding in the market, based on the knowledge, experience and track record of its members.

2. Try and create a lean, mean fighting machine

VC firms love the web-based business model because it's cheap and fast. Startups following this model are lean in the early stages, requiring minimal capital as they race to market. These companies usually do not develop brand new technologies. Rather, they reinvent, disrupt, enhance, accelerate, and promote existing technologies, utilizing existing IT, strong branding and intense networking efforts.

In the cleantech space, if you can identify why your enterprise and business model will realize faster payoffs, with less capital, a VC is likely to pay heed. For instance, perhaps you can improve the efficiency of current models, build a cleantech-oriented community, or push cleantech adoption through social media or web-based platforms.

3. Selectively identify potential investors

Because VCs are increasingly narrowing their field of play and focusing on developing key portfolio themes, you should direct your attention to VCs whose theme matches with your vision. But scouting your VC requires more than merely matching focus.

VC funds now often have cleantech teams who focus on particular themes within the sector instead of trying to be "all things cleantech." They use that theme to tell a compelling story to the investors they court. Similarly, no cleantech startup will be the perfect match for every investor. To maximize your chance of finding funds, identify your category and court VCs who are also focused on that theme. During your meeting, explain to the investor how your startup will help the VC sell and promote his theme to LPs.

You should also determine the potential investor's actual ability to fund new deals. Most investors have limited capital right now; they may not really be in the market for new opportunities, but they have to demonstrate to LPs that they are "in the know" with continuous deal flow. It still may be worth your time to meet with these investors because you never know

where opportunities will appear, but be aware of the circumstances.

Also, since VCs will assist you in taking your enterprise to the next level, you need to find a VC who you can consider a team member once the money is secured. Beyond capital, what assistance will the VC offer? Will the investor help you round out your competencies and strengthen your business model once the money is in the door? The earlier your stage of development, the more you require an investor with deep knowledge of the disciplines most relevant to your startup. Later stage investors often have connections with potential acquisition partners or investment bankers who will help you go public.

4. Expand your scope for sources of funds

At this time when cleantech VCs are shrinking and regrouping, cleantech entrepreneurs should consider looking to alternate sources of funds.

Nontraditional investors may be able to provide funding for that all-important "first project" that traditional VC firms like to see in place. Family offices, corporations, super-angels and smaller funds are all becoming more important sources of funding for cleantech startups. It is worth noting that in 2010 there was a resurgence in seed investments in this sector. Also foundations, philanthropists, regional development bodies and government agencies may be appropriate alternative sources of funding.

Government grants may be helpful when considering funding opportunities for your startup. To that end, pay attention to government policies in the pipeline and use them as clues to help you define your pitch and your niche.

5. Prepare for an initial meeting

You are the expert on your potential company, industry, competition and market. Potential investors respect an entrepreneur who comprehensively and realistically understands the challenges ahead. On the flip side, an investor is not likely to invest in someone who does not have a deep and sober view of the market they hope to enter.

You only have one chance to make the first impression, so you will need to prepare for that meeting as if you were interviewing for your first job and meeting a group of sophisticated Wall Street executives who have a grasp of your industry and understand the potential pitfalls with your business model. Do your homework – research your business model, identify the risks and weaknesses of your business, and create honest, pragmatic solutions for the risks. Conduct concise presentations and rehearse with colleagues, service providers, advisors and friends. Identify one team leader (CEO/President) who speaks for your company and task colleagues with discrete projects in support of the lead, such as supporting your key strategic assumptions and financial forecasts. Demonstrate your passion for the business and strategy, your personal, emotional and financial commitment to the business, and clearly explain the exit strategy (IPO, merger/acquisition) and the potential amount of time and money required to reach such a milestone.

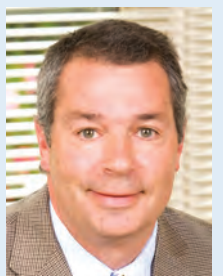
Without question, this is a difficult time to raise money in the cleantech sector. But the money is out there for entrepreneurs with the creativity and resourcefulness to go get it. Don't be afraid to push the customary boundaries and be bold, both in describing why you deserve investment dollars more than the next guy and what your big win will look like.

For more information, please feel free to visit the firm's website at www.sycr.com or call 949.725.4000.

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