HUSCH BLACKWELL

Exit Strategies for Startups

Ashley Edwards
Attorney
Husch Blackwell

HUSCH BLACKWELL

"What is your exit strategy?" This is one of the most common questions that startups or early stage companies are asked, but many entrepreneurs don't give their exit strategy much thought at the very beginning. An "exit strategy" does not refer so much to your departure from the company (although it might), but rather how an investor will make a return on his/her/its investment. Although it may seem counterintuitive, thinking about your exit strategy up front can help you determine how best to structure and operate your company, and many investors will want to know your planned exit strategy before they invest. Keep in mind that these various strategies are also not mutually exclusive, and your company may experience one or more of these through its lifetime.

Cash Cow

The simplest answer for what is your exit strategy would be "None!" Some founders want to stay intimately involved with the operation of the business and may not be looking for or relying on outside investors, often citing a desire to grow "organically." That "organic" growth tends to be slower than the growth of a company that receives large capital infusions from investors, but keeping ownership and control is often more important to those founders.

M&A – aka Mergers & Acquisitions

For a startup, this means the sale of all or a part of your company (either the assets or the equity) to another person or entity. To address a common misconception, an M&A transaction for the equity of a company is not the same as issuing equity as part of a financing round. In a financing round, an investor typically acquires equity directly from the company, and all your existing equity holders continue to be equity holders. Conversely, M&A is a sale of already issued and outstanding equity from a current equity holder to a third party. That current equity holder sells its shares and receives cash (or other compensation) in exchange for those shares. M&A may look very different for different companies, whether a buyer is strategic or private equity or whether the sale is for all or less than all of a company. To read more about this exit strategy, read my detailed blog post.

IPO – Initial Public Offering

The IPO is experiencing a resurgence in popularity in recent years, with well-known companies like Uber, Spotify, Blue Apron, and Beyond Meat going public in the last few years to great fanfare. Other big names like Smile Direct Club, Peloton, and WeWork are hot on their heels and set to go public in late 2019. "Going public" is shorthand for becoming listed on a stock exchange (typically either the New York Stock Exchange or the Nasdaq) and sales of the company's stock are then bought and sold on the open market. Public companies are subject to extensive reporting requirements by the Securities and Exchange Commission, so the administration and legal requirements for a company to go public (and remain public) are expensive and time consuming. However, being a public company is often the best decision to maximize return for investors when a company reaches a high enough valuation and the "exit" with an IPO can be extremely lucrative. Although going public is not a short term plan, it is still the ultimate goal for many startups.

There are also less glamorous or profitable ways of "exiting" a business as a founder if the situation requires: selling/redeeming equity (while the other owners continue to operate the business) or even dissolution of the company as a whole. These may or may not be the exit strategy you initially envisioned when forming your company, but they can be useful options for a founder.

Considering your exit strategy from the beginning is important not only for you as you grow your company, but for your investors and their bottom line. Each option has its own legal advantages and disadvantages, and your investors may have their own ideas.

Ashley Edwards is an attorney in the St. Louis office of Husch Blackwell LLP who practices corporate law with an emphasis on M&A.