How to Use Bridge Capital to Accelerate Your Business

What was formerly a last resort is now a means of achieving independence and profitability.

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It was cold and slightly misty outside my hotel in Dublin, Ireland when I got the call. As an entrepreneur and investor, I have seen my fair share of ideas run down to zero. The founder on the other end of the line had informed me a week earlier that he was raising a bridge round. Usually, this means doom and gloom, so naturally, I expected the worst.

“Are you in? You investing can send a really positive signal to everyone,” said the founder.

“Well, how bad is the business?” I asked. “Is there a chance of saving the intellectual property, the product, repositioning; something, anything, that will make this work?”

“Actually no, that’s the thing,” replied the Founder. “We are raising a bridge round to accelerate the business to profitability and command a higher valuation at the next round.”

“Wait, so you don’t need to save the business?” I responded, puzzled.

“No, we’re doing great,” he assured. “But this bridge injection will be able to ensure independence.”

Standing there, alone in my hotel room, I dropped the phone on

the floor, speechless. The founder's response was one I have never heard before. That's because for the past half century, essentially since the dawn of modern-day venture investment, bridge capital was often viewed as an option of last resort. Entrepreneurs would take lower valuations, more dilution and even onerous repayment terms for a crucial injection of capital that would save their business and allow them to keep the lights on as they proceeded to enact a recovery plan. Dreaded by entrepreneurs and initial-equity investors, bridge capital was sometimes provided by existing investors or specialized firms that developed to fill this hole in the market. Sometimes companies would receive bridge capital and thrive. Other times, founders's control and power would become greatly reduced.

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And yet over the past few years, something different entirely has started to emerge. Entrepreneurs are increasingly turning to bridge "micro-rounds" as a means to reach profitability, gain independence and accelerate business metrics. These rounds are often opportunistic and exactingly timed. If a business's metrics are performing beyond expectations, entrepreneurs will use bridge capital to get the company in a better position so that they may not need to take capital, external assistance or even customers that they do not want at a later stage.

If you are a founder and thinking of availing yourself of this strategy, there are some key things to keep in mind. Namely, you must raise bridge capital on a concrete plan based on current business metrics. Specifically, these metrics can encompass profitability, customer retention or some other verifiable data that all existing stakeholders will view as a strong path forward for the company. Second, entrepreneurs must be wary of the risks associated with this strategy, such as over-dilution and poor market signalling.

A Bridge to Profitability

Remember that call I took in Ireland? To my absolute surprise, the founder informed me that his company was mere months away from profitability and had two choices: Raise a smaller bridge round now to achieve profitability, thus putting the company in the driver's seat, or he could raise a large Series A according to his previous timeline and accept less control and more dilution. For the founder, the solution was obvious: Raise a smaller bridge round now and get to profitability.

This founder was not alone in using profitability as a metric for bridge rounds. Investors often look to metrics that are easily attainable in a short time period in order to ensure more capital can be raised. Profitability is a unique metric that is easily understandable, achievable and provides options to the company. Once a company is profitable, the founders are in the driver's seat.

When raising a bridge round, profitability is one of the easier metrics to highlight because it can be achieved in a short time span necessitated by smaller bridge rounds; gives the company a multitude of options, including plowing profits back into growth or remaining independent and not raising; and proves that, at the very least, a core group of loyal customers wants the company's product.

Building Bridges With Other Metrics

And yet, you may be asking about the founders who may not be able to achieve profitability but still require a bridge round. What should they do? Instead, these founders should focus on other quantifiable and verifiable business metrics with clear and unambiguous goals that can be achieved in a

short period of time. These can include customer-acquisition costs, customer retention, overall product sales, marketplace volume and other customer data. The key here is to use data points, achievable in a relatively short period of time, to create options for the company and its key stakeholders.

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Over-Dilution. A Bridge Too Far?

Just two months ago, I was speaking with another founder at a coffee shop when he bemoaned the valuation of a previous bridge round and how he gave up too much of the company. I asked for the valuation and his immediate comment was, “We were desperate, and they could tell. We went all in, and they took 20 percent more than they should have. We did not really need the money.”

As the above story indicates, one of the most important things to keep in mind when raising bridge capital is the risk of over-dilution. Roughly defined as giving up more of your company to investors than is necessary during any financing, over-dilution is an acute risk in bridge rounds because of the position that investors believe a company is in, which has historically been mere weeks or months away from going to zero. And yet, if founders present quantifiable metrics like profitability and a timeline in which to achieve them, investors are more likely to treat the company as a market-oriented investment rather than a soon-to-be -asset. It’s all about positioning, and it’s up to the founders to make it happen.

Bridge rounds were once the exclusive province of companies on the precipice that needed a crucial capital injection in order to survive. Increasingly, founders are using bridge rounds not to survive, but to thrive and maintain their independence by achieving specific business objectives with quantifiable

metrics like profitability in a short period of time.

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