VIII. Effects of a Looming Recession and Uncertainty of Equity Markets on Venture-Backed Companies

A. Introduction

On average, less than twenty percent of entrepreneurs start their business venture with the intention to expand beyond one employee.[1] As a result, a large percentage of new small businesses contribute minimally to work opportunities.[2] Within the equity market, investors can invest in either publicly traded or privately held stock.[3] With venture capital, investors provide financial backing to startups and receive ownership interest in the company.[4] Prior to the venture capitalist's entrance, early-stage startups typically receive initial funding from angel investors.[5] Venture capital has become conducive to many startups' success because it provides startup founders private funding to launch their companies in exchange for a portion of the shares before the company goes public.[6] Silicon Valley, for example, has long been strongly associated with "entrepreneurship, risk-taking, high salaries and world-class perks and both boom and bust cycles."[7] This article will

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[1] Dana M. Warren, *Venture Capital Investment: Status and Trends,* 7 OHIO ST. ENTREPRENEURIAL BUS L.J. 1, 2 (2012) ("[F]ewer than one in five entrepreneurs even begin a business with a desire to grow it beyond one employee.").

[2] *Id.* (noting that "[t]his is not simply the result of the high failure rate of new businesses," but the lack of desire to add more employees).

[3] *What is Equity Market?- Meaning, Benefits, & Types* NUVAMA, https://nuvamawealth.com/investology/introduction-to-stock-markets-51c006/what-is-equity-market---meaning-benefits--types-883fec (defining public stocks as those "traded on exchanges" and private stocks as those "traded privately").

[4] Tiffany Lam-Balfour, *How Venture Capital Works* NERDWALLET (Apr. 12, 2022), https://www.nerdwallet.com/article/investing/venture-capital (describing venture capital as "private equity investing where investors fund startups in exchange for an ownership stake in the business and future growth potential.").

[5] *Id.* ("Angel investors often kick-start early-stage startups before venture capitalists get involved.").

[6] *Id.* (defining venture capital).

[7] Levi Sumagaysay, *Venture Capital Investors See an "R" Word Coming for Tech- And it Isn't Just Recession* (Nov. 16, 2022), https://www.marketwatch.com/story/venture-capital-investors-see-an-r-word-coming-for-tech-and-it-isnt-just-recession-11668623231 (explaining that "VIC investment made Silicon Valley what it is," with success stories like Apple, Google, and Uber).

examine a looming recession's effect on venture-backed companies, including how different regions are affected, how they can thrive during this time, the predictors of recession resilience, and the impact of layoffs.

B. Relevance to Current Financial Conditions

America has gone through many periods of recessions, such as the Great Depression and the 2008 economic crisis, and currently, the Congressional Budget Office predicts going into another one.[8] In the second quarter of 2020, venture capital investments fell by only two percent, which is not that significant given the effects of the Covid-19 pandemic at that time.[9] However, "the funding was heavily skewed to larger startups doing follow-on funding rounds to shore up their balance sheets going into the recession."[10] During an economic downturn, venture capital-backed companies submit fewer patent applications, and the quality of those patents also declines because the market becomes more risk-averse.[11] Therefore, entrepreneurship is less frequent and at a lower standard during recessions.[12] Furthermore, "Patent activity among VC-backed firms is also positively correlated with the amount of VC investment into startups in a given month."[13] However, the significant decline in the quality of VC-backed startups' patents is partly

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[8] Philip G. Swagel, *The Economic Outlook for 2023 to 2033 in 16 Charts,* https://www.cbo.gov/publication/58957 (discussing the prediction of America heading into a recession).

[9] Jason Teitelbaum & Jeffrey Camp, *Venture Capital Investing in Recessions* CANE ANGEL NETWORK (Jun. 3, 2020), https://caneangelnetwork.miami.edu/blog/vc-recession/index.html (noting that the 32 percent drop in GDP affected VC funding).

[10] *Id.* (noting that VC has a "ten-year time horizon," and therefore, is less affected by the market and by short-term economic changes).

[11] Sabrina Howell et. al., *How Resilient is Venture-Backed Innovation? Evidence from Four Decades of U.S. Patenting* 2 (Harv. Bus. Sch. Working Paper 20-115, 2021), https://www.hbs.edu/ris/Publication%20Files/20-115_a9c405d6-351d-4dab-9c50-c0d657a77230.pdf ("relative to all other patent filings within a technology class, the number of patents applied for by VC-backed firms, as well as the quality of those patents, declines during recessions.").

[12] *Id.* (finding lower levels of "patent activity" and "quality of innovation" among VC-backed startups "even after controlling for the lower amount of VC finance available . . . in recessions.").

[13] *Id.* (explaining that the less VC funding going into startups, the less innovation coming out.)

due to early-stage startups, who receive less funding during recessions because their "novelty" is deemed riskier.[14]

This year, a widespread wave of job losses among software engineers and other technology professionals has occurred.[15] Nevertheless, venture capitalists can take advantage of entrepreneurship—as the industry uses this time "to reset," individuals might start their own ventures and companies.[16] Unicorn companies, such as Amazon, Google, Uber, and Facebook's parent company Meta Platforms, have made tremendous job cuts.[17] Unicorns are startups worth more than one billion dollars.[18] Because unicorns are outliers, the 2021 trend of 355 new unicorn companies, leading to 537 unicorn companies in total, does not accurately depict the recession's effects on other startups.[19]

Layoffs can help entice highly skilled and talented workers at leading companies to join startups, thus explaining the phenomena of recessions creating powerful firms.[20] During the Great Recession, Uber, Airbnb, Pinterest, Venmo, Slack, and WhatsApp were all founded and are now public or acquired companies.[21] Founding partner of TSVC, Eugene Zhang, advised that "you need to understand this is normal. It's just the last 13 years, there was a lot of exuberance… it was a special period. This is the first reset you need to do."[22] Overall, there is a high

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[14] *Id.* (explaining that VC investors want to delay "risky or novel investments, when faced with uncertainty or due to anticipated constraints in the capacity to deploy capital.").
[15] Sumagaysay, *supra* note 7 (stating that "tens of thousands" of tech industry employees lost their jobs in 2022).
[16] *Id.* (calling "the potential for a rise in people starting their own companies" VC's "silver linings in economic downturns.").
[17] *Id.* (noting that "some VCs expect the downturn to last for the next year or so.").
[18] *What is a Unicorn Company?* (Apr. 21, 2022) https://pitchbook.com/blog/what-is-a-unicorn (noting that it is "more common for a startup to reach unicorn status today than ever before").
[19] *Id.* (noting that there were 538 active unicorn companies in 2020, "almost the same" year over year).
[20] Sumagaysay, *supra* note 7 (quoting David Bloomberg that "the layoffs make it easier for startups to attract top talent, and many leading firms were born during downturns.").
[21] *Id.* (noting that PayPal now owns Venmo, Meta owns WhatsApp, and Salesforce owns Slack).
[22] *Id.* (quoting Eugene Zhang).

likelihood that the U.S. is heading toward a recession and that venture-backed companies will be affected.

C. Comparing Different Economies Effects on Venture-Backed Companies

Generally, each country's economy will not be equally affected by a recession this year. Therefore, venture-backed companies will face different fates in part depending on their location. The United States, the European Union, and China are three regions predicted to suffer economically in the upcoming years.[23] European companies are expected to be better equipped and capitalize on a shifting economy and potential recession because they are used to a market with scarce capital, which would likely occur during a recession.[24] For example, Swedish-born company IKEA sells disassembled furniture for buyers to build themselves exhibiting a frugal mindset to solve large demand in a scarce market.[25] Moreover, uncertainty of the greater global economy often dissuades investors from investing.[26] Even abroad, companies with upward momentum are facing challenges in raising capital.[27] However, venture capital still performs comparatively well during economic downturns, as evidenced by outperforming the S&P 500 and NASDAQ's average annual return during the early 2000s and 2010s.[28] On average, VC firms "returned 14.16% from 1996 to 2017, while the S&P 500 and NASDAQ indices returned 8.49% and 12.93%

[23] Betsy Reed, *Third of world economy to hit recession in 2023, IMF head warns,* https://www.theguardian.com/business/2023/jan/02/third-of-world-economy-to-hit-recession-in-2023-imf-head-warns ("The US, Europe and China—all experience weakening activity, the head of the International Monetary Fund has warned.").

[24] Sumagaysay, *supra* note 7 (stating that a changing economic environment will benefit European companies because they have the "frugality muscle").

[25] Madeleine Gabriel et al., *Better for Less: Does Europe need frugal innovation?*, NESTA (Aug. 18, 2016) https://www.nesta.org.uk/blog/better-for-less-does-europe-need-frugal-innovation/ (describing Ikea as Europe's "frugal innovation poster-child" because consumers build the furniture themselves).

[26] Sumagaysay, *supra* note 7 (noting that the broader economic instability deters investors).

[27] *Id.* ("I'm seeing companies with incredible traction in Asia and Africa struggle to raise.").

[28] Teitelbaum, *supra* note 9 (explaining that the "historic bull runs of the early 2000s and 2010s" did not lessen the gaps in return between VC and the S&P 500 and NASDAQ).

respectively."[29] Moreover, differing legal and business norms based on region can also shape the responses of a company and subsequent effects on a company that a recession has. For example, golden shares, which will be discussed in greater detail in section D, are not allowed in most European Union firms.[30]

During the COVID-19 pandemic, although there was an economic downturn, many "people found themselves with higher disposable income, which in turn increased spending."[31] However, global lockdowns restrained the supply of goods, leading to inflation when supply could not meet the greater demand.[32] Inflation is typically around 2 percent, but in 2020, the United States saw inflation of roughly 8.6 percent while Arab countries experienced inflation at approximately 7.5 percent.[33] Reducing investment activity, in turn, increased the demand for venture capital, subsequently leading to an increase in price.[34] Therefore, countries can have differing inflation rates, demand for venture-backed companies, and other variables that significantly affect the outcomes of venture-backed companies during a looming recession.

D. How VC-backed Companies Can Thrive during a Recession

During a recession, numerous concerns can affect a company's value, stock price, and, in the case of startups, funding. A good reputation can make a company "recession-proof" by building brand loyalty and making advertising more effective —or even unnecessary

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[29] *Id.* (*citing* data from Pitchbook).
[30] *What is a Golden Share?* (Apr. 13, 2023) https://www.fincash.com/l/basic/golden-share ("The European Union, in contrast, has largely prohibited firms and governments from using golden shares.")
[31] *What the Looming Recession Means for Venture Capital Globally and in the Menapt Region* DUBAI FUTURE DISTR. FUND (Oct. 11, 2022), https://futuredistrictfund.com/what-the-looming-recession-means-for-venture-capital-globally-and-in-the-menapt-region/ (noting that despite the economic downturn, people had more disposable income and, with it, increased their spending).
[32] *Id.* ("Brands were simply not able to keep up with the demand by increasing supplies, causing the prices of goods to go up").
[33] *Id.* (*citing* ARABIAN BUS.).
[34] *Id.* (explaining that venture capital becomes "more expensive" to "ensure correction in the market" when companies seem overvalued).

altogether.[35] Although reputation can largely affect a startup's resilience and amount of funding, there are many contractual options to help a startup during a recession.

1. Anti-Dilution Provisions

VC-backed companies have more than reputational concerns during downturns because many contractual provisions can become triggered during economic downturns. For example, negative market trends can lead to down rounds, setting off price-based anti-dilution provisions "designed to protect preferred shareholders by increasing the number of common shares each preferred share is convertible into, without requiring new consideration from both parties."[36] This process is very time efficient and cost-effective because automatically triggering this provision without requiring new consideration means no further spending on creating a new agreement.[37] Price-based anti-dilution provisions can either be "ratchet based" or "weighted average" provisions.[38] Shareholders can receive common shares from their preferred shares for the lower, current share price and not the original cost when there is a "ratchet base" or full ratchet clause, which protects them from decreases in the company's value.[39] Shareholders can acquire shares adjusted by both the original and new prices when there is a

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[35] Henri Isenberg, *Why Maintaining Your Business Reputation is Essential During Tough Economic Periods,* FORBES, (June 6, 2022), https://www.forbes.com/sites/forbestechcouncil/2022/06/06/why-maintaining-your-business-reputation-is-essential-during-tough-economic-periods/?sh=454b7d66a53d (explaining that brand loyalty from having a good reputation "can bolster sales despite pricing increases," and "sometimes even eliminates the need for advertising").

[36] Andrew Miller, *ANALYSIS: As Down Rounds Loom, VC-backed Companies Have Options,* BLOOMBERG L. (Nov. 13, 2022), https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-as-down-rounds-loom-vc-backed-companies-have-options (noting that down rounds are not "necessarily indicative of a company's pending failure" but can trigger anti-dilution provisions).

[37] *Id.* (discussing how anti-dilution provisions do not need new consideration)

[38] *Anti-Dilution: Everything You Need to Know,* https://www.upcounsel.com/anti-dilution (discussing the types of anti-dilution provisions).

[39] *See* Miller, *supra* note 36. ("The effect of full ratchet clauses is relatively straightforward—they grant shareholders the right to convert preferred shares into a number of common shares based on the lower share price in the new round rather than the original investment price").

weighted average provision, which potentially prevents dilution for existing shareholders.[40]

Companies utilize contracts to waive anti-dilution rights or have investors pay higher prices per share.[41] Down rounds, company stock value decreases during a financing period, set off the anti-dilution provisions.[42] Therefore, anti-dilution provisions safeguard investors because they limit the magnitude of losses they can suffer, especially those holding preferred shares.[43] Thus, an investor is more likely to agree to fund a venture-capital backed company that has these provisions, and there is a higher likelihood they will continue to fund due to their contentment with the agreement.[44] Full ratchet provisions offer the most protection to early investors, which is why they may be preferable to attract investors initially.[45] Yet, this may discourage later investors since they do not receive that same protection in its entirety.[46] Therefore, anti-dilution provisions can be implemented into contracts between investors and companies during a recession or at inception to protect shareholders.

2. *Type of Golden Share: Bankruptcy Blocking Rights*

Another contractual option to help a VC-backed company during a recession is golden shares and, more specifically, bankruptcy blocking rights. Moreover, bankruptcy blocking rights may be exercised

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[40] *See Anti-Dilution: Everything You Need to Know, supra* note 38. ("The weighted-average provision provides shareholders the privilege to buy offers at a value those records for the adjustment in the old and new offering costs.").
[41] *See* Miller, *supra* note 36. (noting that "investors are regularly willing to engage with counsel to reduce or waive anti-dilution rights.").
[42] *Anti-Dilution Provisions: What You Should Know,* CARPENTER WELLINGTON, https://carpenterwellington.com/post/anti-dilution-provisions-know/ ("The decline in a company's valuation in a subsequent financing round is a called a down round. Down rounds trigger anti-dilution provisions…").
[43] *Id.* ("Down rounds trigger anti-dilution provisions in order to protect investors from suffering significant losses in the value of their investments").
[44] *Anti-Dilution: Everything You Need to Know, supra* note 38 (discussing reasons to use anti-dilution provisions and how they appeal to investors).
[45] *Anti-Dilution Provisions: What You Should Know, supra* note 42 (". . . full ratchet provisions are highly protective of early investors in the company . . .").
[46] *Id.* ("Full ratchet provisions… could deter some potential new investors. This is because later stage investors will not receive the full benefit of the anti-dilution provisions").

during a looming recession to protect a company's minority shareholders and prevent hostile takeovers.[47] Golden shares are particularly useful to start-ups who do not have a lot of cash because they are inexpensive and straightforward to use.[48] Bankruptcy blocking rights work by requiring minority shareholder's consent before filing for bankruptcy, which increases communication and collaboration among the shareholders of a company.[49] Likewise, a golden share is an interest that grants the golden shareholder (shareholder who has veto power over charter changes and special voting rights) consent rights.[50] These rights include vetoing bankruptcy filing.[51] A common critique of golden shares is that they give the golden shareholder excessive control that can potentially extend beyond the original purpose of granting the golden share.[52] In general, the courts are split when enforcing golden shares, but the courts have been more likely to enforce golden shares granted to investors rather than lenders.[53] Overall, golden shares, especially bankruptcy blocking rights, can grant minority shareholders greater rights and power than they otherwise would have simply as *minority* shareholders.

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[47] *Golden Share Bankruptcy Blocking Provisions*, PRACTICAL LAW BANKRUPTCY & RESTRUCTURING w-035-6392 (2023) (discussing how "creditors are now also using "blocking provisions" or "golden shares" to limit or eliminate the risk of a bankruptcy filing during looming recessions).

[48] *Going for Gold: How the Golden Share Model Protects Mission and Independence,* ALTERNATIVE OWNERSHIP ADVISORS https://www.alternativeownershipadvisors.com/blog/going-for-gold (discussing benefits of golden share models).

[49] *Golden Share Bankruptcy Blocking Provisions, supra* note 47. ("Bankruptcy blocking rights are often used to protect minority shareholders by granting them the right in a company's organizational documents to prevent the company from filing for bankruptcy without their consent.").

[50] *Id.* ("[A] golden share is a nominal equity interest that gives the holder certain consent rights . . .").

[51] *Id.* (". . . gives the holder certain consent rights which include the right to veto a bankruptcy filing.").

[52] *What is a Golden Share?, supra* note 30 (stating how critics believe golden shares "give the owner far too much power, especially if that power extends beyond the wishes of other owners.").

[53] *Golden Share Bankruptcy Blocking Provisions, supra* note 47. (discussing how courts look at "federal public policy" or "applicable state law" to decide to enforce golden shares, but are more receptive to enforce those held by investors).

3. *Bankruptcy Protection*

Furthermore, during an economic downturn, many companies file for bankruptcy protection.[54] During this time, investors may utilize section 363(b) of the Bankruptcy Code to buy the assets of these companies at a very attractive price.[55] The "Stalking Horse" Advantage is when the investor can quickly utilize section 363 to purchase the debtor company.[56] There are disadvantages to being a stalking horse, such as expending significant time and capital that is not always fully reimbursable to a losing stalking horse.[57] Hence, bankruptcy courts are notoriously very paternalistic and protective of quick sales.[58] However, now they realize that with a looming recession, all the creditors will suffer financially without approval of the sale.[59] Because bankruptcy courts are wary of favoring the stalking horse and desire to encourage competitive bidding, they hold deal protections in section 363 sales to a higher standard than courts do for non-bankruptcy sales.[60] Courts are now benefitting the investor side of these transactions more frequently, as evidenced by the sale of BearingPoint Inc. to Deloitte LLP (Deloitte LLP as the stalking horse), despite numerous complaints from creditor

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[54] Jennifer Fonner Dinucci, *Balancing the Risks and Benefits of Transactions Involving Distressed Companies*, (Apr. 28, 2009) Practical Law Article 9-385-9862 (describing how past recessions "dramatically increased the number of companies filing for bankruptcy protection.").

[55] *Id.* ("For investors, this presents opportunities to buy the assets of distressed companies at bargain prices.").

[56] *Id.* (describing how investors desire "to become the prospective buyer selected by the debtor company
to act as the stalking horse in a section 363 sale" because the stalking horse is likely to win the auction).

[57] Buying Assets in a Section 363 Bankruptcy Sale: Overview, Practical Law Practice Note Overview 1-385-0115 (discussing disadvantages of being a stalking horse).

[58] Dinucci, *supra* note 54. (stating that bankruptcy courts "have traditionally been wary of quick sales.").

[59] *Id.* ("'Now, the same courts are recognizing that every case is an emergency in the current market. If they don't approve the sale, all the creditors will lose,' says Waisman").

[60] Buying Assets in a Section 363 Bankruptcy Sale: Overview, *supra* note 57 (discussing bankruptcy courts using strict standards to evaluate section 363 sales and how other parties scrutinize deal protections to not favor the stalking horse).

groups regarding lack of time to audit the bidding process.[61] Ultimately, the court allowed the expedited sale, which was less than a month following BearingPoint's bidding filing.[62] Therefore, a VC-backed company failing during an economic downturn may have the opportunity to be quickly saved by another larger entity.

4. Force Majeure Clause

Force majeure clauses are another contractual option to incorporate for agreements with VC-backed companies. A force majeure clause allows a party to a contract to not perform due to an unforeseeable event that thwarts the party from performing their specific contractual obligations.[63] However, a standard force majeure clause does not protect against a recession or economic downturn.[64] In *Route 6 Outparcels, LLC v. Ruby Tuesday, Inc.,* the court did not permit their contract's force majeure clause during the 2008 recession because "Ruby Tuesday ha[d] failed to demonstrate that it was prevented from complying with its obligations under the lease due to events entirely outside of its control."[65] If a venture capital-backed company decides to include a force majeure clause in their contracts, they should utilize precision and specificity in their force majeure clause, such as explicitly including "war", "government shutdown", or a "quarantine" in order to be exempted from contractual obligations and potential lawsuits during

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[61] Dinucci *supra* note 54. (detailing how "in the proposed sale of BearingPoint Inc. to Deloitte LLP as stalking horse, unsecured creditors claimed that the sale was moving too quickly and they had not been given enough time to investigate the bidding procedures.").

[62] *Id.* (detailing how the Bankruptcy Court approved the sale of the company less than a month after BearingPoint filed its bidding procedures).

[63] *How Will Courts Interpret Force Majeure Clauses in the Covid-19 Crisis response? Look to the 2008 Recession Fallout for Clues,* CLIENT ALERT (Apr. 6, 2020), https://www.lowenstein.com/news-insights/publications/client-alerts/how-will-courts-interpret-force-majeure-clauses-in-the-covid-19-crisis-response-look-to-2008-recession-fallout-for-clues-litigation (discussing how "courts will excuse contractual performance where an unforeseeable event beyond the parties' control prevents performance if the force majeure clause specifies applicability to the particular event.").

[64] *Id.* ("courts are unlikely to excuse performance solely because of financial hardship . . .").

[65] *Route 6 Outparcels, LLC v. Ruby Tuesday, Inc*., No. 2413-09, 2010 WL 1945738, at 4 (N.Y. Sup. Ct. 2010), *aff'd*, 88 A.D.3d 1224 (1st Dep't 2011) (quoting the court's reasoning against enforcing the force majeure clause).

financial instability.[66] Contrastingly, if attempting to enforce a force majeure clause, then a party should record every attempt at fulfilling their contractual duties.[67] Overall, a force majeure clause likely will not prevent liability if there is only a recession; however, in other circumstances, such as a recession and pandemic coinciding, it can be a saving grace for many companies.

5. Shareholder Agreements

A shareholder agreement is a contract that explains shareholders' rights and obligations with a company and, therefore, can greatly affect a venture capital-backed company's relationship with shareholders and investors.[68] Another avenue for startups during a recession is to alter dividend rights in a shareholder agreement to maximize cash retention and bolster liquidity.[69] However, the provisions of the shareholder agreement must be flexible enough to allow this; otherwise, they can be amended to be added.[70] Additionally, leaver provisions are outlined in a shareholder's agreement and establish what occurs when an individual shareholder (who may hold another position at the company) leaves the company, which is more likely to occur during a recession because they may need more money or they

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[66] *How Will Courts Interpret Force Majeure Clauses in the Covid-19 Crisis response? Look to the 2008 Recession Fallout for Clues, supra* note 63. ("Businesses should also review their contracts to be sure any force majeure clauses specify an event such as a "pandemic," an "epidemic," "widespread illness," "travel restrictions," "government shutdown," or a "quarantine.").

[67] *Id.* ("Parties attempting to rely on force majeure to excuse performance now would be wise to document all reasonable attempts to perform their contractual obligations.").

[68] *Shareholder Agreement Definition,* https://www.zenbusiness .com/shareholder-agreement-definition/ ("The definition of a shareholder agreement is a legally binding contract among the shareholders that outlines how the company will operate and defines the shareholders' rights, protections, and obligations.").

[69] Adam Kudryl, *The Importance of Reviewing your Shareholder's Agreement in a Recession,* KNOWLEDGE HUB FOR GROWTH (Oct. 21, 2022), https://harperjames.co.uk/article/review-a-shareholder-agreement-in-a-recession/ ("One way to take the pressure off your business in a recession is to change the way dividends are paid so that you can retain as much cash as possible.").

[70] *Id.* (discussing how inflexible shareholder agreements can be amended to give "vital breathing space").

anticipate negative financial trends for the company.[71] Amending or adding these leaver provisions can be very useful because a "bad leaver" could be a founder, employee, or investor, and the provisions would swiftly and efficiently cover these circumstances rather than spending more money and time.[72] This provision provides some stability, especially if the leaver holds an imperative position, such as CEO.

Although shareholder agreements provide numerous ad-vantages, the company limits itself to meeting voting thresholds and more rigid standards by laying out all the shareholder's rights and obligations in writing.[73] However, in a recession, amending the share-holder agreement by lowering the approval threshold for voting can help companies quickly make decisions and pass necessary, time-imperative resolutions.[74] In stable economic times, a majority vote of directors or of shareholders determines company decisions, which can be harder to reach for passage.[75] Overall, the shareholder agreement can include many different clauses or amendments for a company to become recession-proof.

E. Predictors

There are many predictors of how VC-backed companies can thrive during a recession. First, these companies can remain at the forefront of technology trends to ensure they can reinvent themselves or adjust to changing times.[76] Moreover, even during recessions, bus-inesses and markets have certain needs. Identifying and capitalizing on

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[71] *Id.* ("Leaver provisions are terms typically found in a shareholders' agreement that dictate what will happen if an individual leaves a business, whether that be a shareholder who is or isn't also a director or employee.").
[72] *Id.* (defining a "bad leaver").
[73] *Shareholder Agreement Definition, supra* note 68. ("Putting all the shareholders' rights in writing can reduce the management's ability to run the company in a flexible manner").
[74] Kudryl, *supra* note 69. ("In a recession, however, you may find that you need to make decisions on the fly, and so you may want to revisit your shareholders' agreement to allow you to pass such resolutions more easily.").
[75] *Id.* ("Normally, company administrative decisions are taken either by a majority vote of directors, or a shareholders resolution by a majority (51%) or, in the case of a special resolution, by a super-majority of 75%.").
[76] *A Surefire Path to Startup Survival in a Recession: Revenue, Revenue, Revenue* SILICON VALLEY BANK https://www.svb.com/blogs/silicon-valley-bank/how-startups-survive-recessions (stating that companies should "stay on top of technology trends").

these needs can prioritize a business's longevity.[77] Also, incorporating the business concept of the "long tail" helps these companies succeed during a recession because it means the company strategically targets masses of small customers instead of a handful of big customers.[78] Not only is it easier to work with small to mid-sized consumers, but a greater volume of customers leads to greater influence and still allows for the possibility of working with larger customers.[79] Additionally, consumers play a prominent role in venture-backed companies' resiliency, and although marketing typically costs around 7.5% of small businesses' revenue, the internet can help lower that cost and offer free marketing.[80] "A good online reputation validates a business, product or service", also known as being "social proof", which can help businesses receive loans and funding.[81] Therefore, a strong reputation, especially online, can determine which companies will survive the recession. Lastly, having realistic employees who recognize that economic downturns require more short-term focus and less focus on the big picture or greater aspirations for the company helps a company be adaptable during a recession by maintaining employees and a positive work atmosphere.[82]

Moreover, the federal government can always intervene during a recessional period and provide safeguards or forms of relief. For example, following the 2008 economic crisis, President Obama enacted the American Recovery and Reinvestment Act of 2009 in January of that year.[83] This Act provided great tax relief, such as granting small businesses with receipts of 15 million or less (which includes most startups) an extension period for net operating losses (NOLs) that "may be carried back from two to five taxable years before the year the loss

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[77] *Id.* ("Even in a downturn, businesses have pain points").
[78] *Id.* ("A relatively new business concept—"the long tail," … came to Meebo's rescue. The idea was to target lots of small customers rather than a few big ones…").
[79] *Id.* ("We knew it would be easier to work with a lot more small to mid-sized publishers," Jen says. "We could aggregate more volume with smaller sites and then have more influence and spread to then engage with larger publishers.").
[80] Isenberg, *supra* note 36 (explaining that "marketing costs for small businesses range from 7% to 8% of revenue").
[81] *Id.* (stating that a social proof company is economy proof).
[82] *A Surefire Path to Startup Survival in a Recession: Revenue, Revenue, supra* note 76. ("Leaders need to balance long-term vision with an understanding of the economic realities facing any business, especially in a downturn.")
[83] *Summary of the American Recovery and Reinvestment Act of 2009*, Practical Law Article 4-385-1627 (Jul. 1, 2009) (discussing the American Recovery and Reinvestment Act of 2009).

occurred."[84] Therefore, the current federal government could have similar legislative responses to support startups during a recession.

F. Layoffs for VC-Backed Companies

Startups have laid off 100,000 employees in recent months compared to roughly 30,000 layoffs in Big Tech.[85] Although layoffs at Big Tech, like Microsoft and Amazon, generate the greatest media hysteria and news headlines, the layoffs at startups have the strongest impact because they are a greater amount.[86] Even though a recession is looming, there is hope because dozens of VC firms and private equity funds desire to return to work since they have roughly $300 billion of cash waiting to be used and invested.[87]

Another positive of venture-backed companies created during recessions is that if they survive, they are often proven more tangibly resilient than those established in normal economic times.[88] Furthermore, large tech companies are laying off highly skilled, highly motivated individuals, which means startups can recruit from this talented pool of laid-off workers without interference from their larger, flashier competitors.[89] Lastly, a startup can pitch to investors, underscoring its resilience during an economic downturn to secure future funding and stand out from other startups.[90] Therefore, although layoffs

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[84] *Id.* ("For small businesses (with gross receipts of $15 million or less) in 2008, the Act extends the period that NOLs may be carried back from two to five taxable years before the year the loss occurred.").

[85] Don Muir, *The Strongest Startups Will Survive the Venture Captial Funding Crash,* (Jan. 19, 2023) https://www.forbes.com/site s/donmuir/2023/01/19/the-strongest-startups-will-survive-the-venture-capital-funding-crash/?sh=189eb3de2380 ("Startups are laying off far more workers, pound for pound, than Big Tech—more than 100,000 layoffs in recent months versus only 30,000 or so for large companies").

[86] *Id.* (Comparing the layoffs at Big Tech with startups).

[87] *Id.* (describing how VC firm and private equity fund employees "are itching to get back to work" and have a lot of idle cash).

[88] Leah Hodgson, *Are the "Best" Startups Really Founded in a Recession?* (Aug. 12, 2022), https://pitchbook.com/news/articles/best-startups-founded-recession ("Startups launched in a period of economic weakness may be more durable than those created in a boom").

[89] *Id.* ("[N]ew startups have the opportunity to recruit experienced workers with less competition from larger rivals.").

[90] *Id.* (Stating how a startup surviving a recession "can make a compelling case to investors when funding activity picks up that it's among the 'best'").

are very alarming, there is still plenty of opportunity for a venture-capital backed company to survive or even thrive.

G. Conclusion

Overall, there is still hope for venture capital firms during a recession, and although the risk is high, the reward can be large. Certain contract terms and other strategies can help safeguard the company, shareholders, and employees. There are many different legal and business mechanisms to ensure a VC-backed company is recession-proof, such as anti-dilution provisions, bankruptcy blocking rights, bankruptcy protection, force majeure clause, and dividend rights. A recession is daunting for many companies, nonetheless venture-backed companies. However, there are legal protections in place to navigate economic downturns.

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