Some perspectives on startup financing in a downturn - Tribe Capital

6-8 minutes

> This email was originally shared within our investment team then sent to all our partners and founders. Given the rapidly evolving situation facing many entrepreneurs, their families, teams and companies, we felt it was important to share our findings. Included is the full report at the bottom.

———- Forwarded message ———
Date: Sat, Mar 14, 2020 8:18 PM
Subject: Some perspectives on startup financing in a downturn
To: LPs; Founders

To our partners and founders.

We wanted to reach out to give a few thoughts given the upheavals of the past week. Firstly, with the recent COVID-19, it's most important to prioritize the health of you and your family – you should never forget what matters most. Beyond that, as you help navigate your teams through the next period, it's important to stay rooted in ground truths and facts. There is a whole host of misinformation out there and it's very important to stay cautious and preventative.

What's happened in the world this past couple of weeks is a unique turn of history. With COVID-19, the OPEC war with Russia, escalating global trade disagreements, and decelerating global economic growth, we've witnessed a spike in market volatility leading to the S&P 500 declining 30% from its peak in just 16 days. To give you a sense of magnitude, the S&P 500 in the 2008 debt crisis took 350 days to decline almost 60% from its peak and it still didn't bottom out for another 200 days. And In the 2000 dotcom bust, that index took 638 days to drop 30% from the peak and another 280 days to bottom out around 50% from the peak. Clearly, things might be different this time but the past suggests that a downturn can take years of cascading developments to fully express itself.

What happens to companies during a downturn?

First, we know anecdotally and from our data that access to capital can become scarce. This doesn't always happen in the same way but, generally speaking, companies are forced to find ways of cutting costs to extending their runway so that they have a higher likelihood of being successful. This is never an easy step to take, but by understanding the levers of your company – what makes it work and what makes it grow – you can effectively make decisions about how to work your way up to a stronger cash position.

Second, your revenue will likely take a hit. With the possibility of unemployment and other businesses cutting back, you should expect that your revenue plans will be impacted. In some lucky cases, your business might be countercyclical but the vast majority are not. In the year-to-date, China has witnessed an 80% loss in non-digital revenue in the first quarter. With border and air travel restrictions you will see that take a toll on the broader economy. Fully 10% of the world's GDP is travel and tourism. When that comes to an effective halt there are all sorts of second-order effects resulting from the interconnectedness of the ecosystem and that's just from considering the travel sector. Today, that might mean lower valuations. In a year it could mean a negative wealth effect, contracting budgets, and lower consumer sentiment. It's useful to take a moment to map out how parts of your business will be affected both for better and for worse given that many of these second-order effects will take some time to materialize.

I was personally in this same spot through the great financial crisis. When we started LOLApps in 2006, we scaled it to over 150 people and were subsequently forced to reduce the team to less than 30. We were scaling quickly with tens of millions of active users and were growing revenue but were not sufficiently profitable to have control of the situation at that level of spend as the great financial crisis unfolded. LOLApps' growth was definitely impacted as a result of the cuts, but it created enough runway and time to survive, retrench, and live to fight another day. We were lucky enough to succeed a few years later.

The good news is that the prospects for companies that survive these times of crisis are largely unaffected in the long term. Further, almost all companies that would have survived in normal times survived through the financial crisis – albeit with typically large changes to their operating plans. Fundraising might have been temporarily disrupted, but executing well over many years remains the primary long-term determinant. Our goal is to help guide you in understanding your own levers for survival, growth and an eventual venture scale outcome. We will support you throughout these periods in any way we can.

To that end, many of you are familiar with our data-driven approach to understanding ground truth – particularly around product-market fit. Given the financial climate Jake, Jonathan and the rest of the team turned their data-driven lens towards startup financing during a downturn. The memo is attached and you might find it helpful.

These are going to be taxing times on you, your family and your teams. Please don't hesitate to reach out. We have your back.

Sincerely,

Tribe Capital team.

———- Forwarded message ———
Date: Sat, Mar 14, 2020 at 1:52 PM
Subject: Some perspectives on startup financing in a downturn
To: Investment Team

Hi all,

Given that there's a chance we're at the beginning of a new financial climate, we wanted to develop a deeper understanding of how startups were affected during the great financial crisis, both for our investment strategy and for how we should support our portfolio. The memo is attached.

To no surprise, there was a large temporary drop in fundraising during the crisis, but interestingly there wasn't much of an effect on anything else. The survival rate was at worst modestly lower during the crisis (of 10 Series A companies that would raise / exit in normal times, 8-9 were able to in tough times). Also, when we look at long-term exit rates, there appears to be even less effect than the immediate survival rate.

During the crisis there was a temporary capital crunch, but companies that executed well over many years mostly endured any short-term setbacks. This finding provides confidence to stay the course of identifying & amplifying early-stage product-market fit.