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Why it’s not all doom and gloom for fundraising startups

We get asked frequently at present about what the global downturn and current fundraising environment means for us, a growing company in the UK’s private Fintech/Regtech sector. Amidst high-profile down rounds and large-scale tech staff layoffs, there is still reason for optimism for early-stage startups looking to raise funding.

There’s a global slowdown in investments but plenty of dry powder out there and some positive stories. For example, *Innovate Finance* reports on the continued strength of the UK Fintech sector bucking the downward investment trend. *Pitchbook data* shows the UK and Ireland region remaining top of the European venture ecosystem and displaying solid growth, with the Angel/Seed and Early VC share dropping slightly but remaining strong.

Here we discuss positive aspects of the current environment for early-stage startups in the UK.

Realistic valuations

The word on the street is, ‘Don’t expect wild valuations, it’s not like it used to be’. But most UK startups don’t and never have. Like most of our fellow founders, we’re used to sitting in front of VCs who won’t get out of bed unless you’re making a profit, or you have £1M ARR, which is only about $1.25M these days. It’s the same story across Europe, so valuation expectations are already well managed.

Scary metrics

Tech newsletters flood our inboxes, containing news of founders expressing their sorrow at removing 20-30% of their human resource – some not long after a big raise. From the tone of some heavily funded startups it sounds like the end of the world. However, we just need to think back for some perspective. Recalling just over two years ago and the arrival of COVID-19, this isn’t really a new thing. April 2020 was all about battening down the hatches, with no end point in sight. And for those of us who remember 2008, the credit crunch and the Great Recession, this is not unfamiliar territory. It’s pretty much baked-in to risk management. Expanding and running lean are not mutually exclusive.

Fund deployment

As with the first Covid lockdown, much of VC undeployed funds were ring-fenced to protect existing investments. However they cannot ‘sit’ on these for long and have a certain amount of pressure to deploy. Particularly the funds which are open-ended or periodically get ‘topped up’. Inflation is currently running very high, higher than interest rates and significantly higher than growth in capital markets. So, where are VCs and investors going to put their cash aside from real estate? Especially considering the tax relief on offer with arrangements like the UK’s Seed Enterprise Investment Scheme (SEIS) and Enterprise Invest Scheme (EIS) where a portion of their ‘bet’ gets offset as a tax liability. Such schemes are attractive options for not just professional investors but also friends and family. Private equity funds in search of better returns are also increasing fundraising focused on earlier stage companies.

Value-add solutions

There’s nothing like a recession or shock economic event to aid the demand for ‘unsexy’ cost-cutting, risk-reducing products, or to influence a change in how we think or behave. There are many young companies that were founded and flourished outside of optimal economic conditions due to the valuable services and benefits they provide. Think Microsoft, Salesforce, Google and Airbnb. Demand changes both people and companies, and for innovators providing solutions that mitigate or resolve real issues, boost productivity, or address an unmet need, downturns can prove to be fertile ground. In these times, B2C models often focus on creating ground-breaking products. B2B solutions are about the bottom line and risk reduction. The inevitable reductions in head count create more pressure to automate and digitise to increase efficiency and make up for lost manpower. Young companies with more proven business models and routes to profitability are in a strong position with the changing investor mindset and digitisation drive from corporates.

Serious players

More challenging conditions can deter less serious founders. This environment can put a lot of players off, meaning those who are looking to launch are more confident in their vision and therefore more serious and robust. Those looking to emulate the success of existing startups can also be deterred. Such potential entrepreneurs can be less inclined to take the risk, plus the environment makes it harder to secure initial funding. This means less distraction from ‘sparkly imitations’ for investors who can deploy into existing early-stage startups that are deemed less risky. Investor due diligence also becomes more vigorous. VCs are now choosier and more concentrated, with a diminished appetite for growth at all costs. The combination of these factors means fewer, but more confident, players.

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