

How Should Start-ups Prepare for This Coming Recession



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Over the past year, the venture capital community has been moving towards supporting start-ups with a demonstrated path to profitability as venture investors were absorbing the lessons of Uber, WeWork and other unicorns. The Coronavirus Pandemic has accelerated this trend and significantly impacted the venture markets in ways very similar to the Great Recession of 2008-2009. The good news is that the venture market is significantly larger than in 2008 and venture funds are currently sitting on a record amount of dry capital of over \$180 billion in mid-2019, per Pitchbook.

Knowing what happened during the Great Recession of 2008-2009 may help you consider your plan of actions:

Valuations Declined: valuations in the venture and private equity markets are influenced by valuations in the public markets. As valuations in the broader public markets have declined by over 30% in just one month, the valuation multiples of start-up companies are also declining. During the Great Recession, Pitchbook estimated that valuation declined by 22% across all VC rounds (from rolling Q4 2008 to rolling Q4 2009).

Available Capital Declined: VC funds invested about 30% less in dollar amounts in 2009 than they did in 2008 (although deal counts declined by only 5%). Pitchbook also expects a similar drop in the amount invested in startups in 2020. In addition, new commitments to VC funds by limited partners dropped 58% from 2008 to 2009 and Pitchbook also expects new commitments by limited partners to VC funds to be reduced significantly in 2020. VC funds also cited the need to preserve capital for their existing portfolio companies during the Great Recession.

Increasing Down Rounds: The challenging fundraising environment resulted in increasing down rounds and an outsized impact on the common shareholders since holders of preferred shares often were protected by anti-dilution and liquidation preferences.

Flight to Quality: As VC Funds became more selective, various experts noted the flight to quality during the Great Recession period and Pitchbook expects a similar trend in 2020. Pitchbook expects that if this market continues, “Cloudtech, DevOps and Information Security Tech should experience a low impact”, “fintech and insurtech should experience a moderate impact” and “healthtech, foodtech, mobility tech and IoT (Internet of Things)” to be the most significantly impacted. For example, in healthtech, Pitchbook expects telemedicine, centralized health tracking and wellness start-ups to perform well during and post the crisis, while nursing home and marketplace fitness platforms to be out of favor.

What Start-ups should do in this environment:

Protect Your Employees: Ensure your employees have the necessary technology to work from home for a significant period of times. Develop a contingency plan to assist your employees who report symptoms of Covid-19. The current medical guidelines are basic – employees should call their doctors if they believe they have symptoms but should not go a hospital or emergency room.

Preserve Cash and Liquidity: monitor your operating expenses and defer capex and other costs that can be

deferred. Apply for a Payroll Protection Loan under the CARES Act which will cover certain payroll, rent and utilities costs for 8 weeks if you are eligible. Reconfirm your liquidity facilities with your banks, if appropriate.

Monitor Your Key Performance Indicators: VC investors are focused on a start-up company's visible traction in growing their products or building their revenue pipeline. Ensure you have appropriate monthly metrics related to your operations and compare these indicators with prior periods as well as your business plan.

Communicate, Communicate, Communicate: Discuss your progress regularly with your management team, your employees, your board of directors and your investors. Keep your professional support network informed. Communicating with interested parties is always important but it is especially critical during these times of uncertainty. Advise people of your challenges and what you are doing about them.

Venture backed investments with low revenues and minimal profitability are likely to be especially hard hit during this Coronavirus Pandemic as the U.S. economy moves towards greater uncertainty and a likely recession. As a start-up company, be prepared for further challenges: focus on your liquidity to extend your cash runway, communicate early and often with all your key stakeholders, and work with your management team and your support network to plan for these tumultuous times.

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