White Paper

The Future of Tech Business Growth

WHAT DO FUNDING AND GROWTH LOOK LIKE
IN THE NEW NORMAL?

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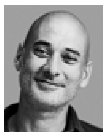

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Fortune favours the brave

In a rapidly changing world, business leaders must embrace disruption to truly overcome it

The COVID-19 pandemic has caused widespread disruption in the business world. In response, decision-makers have acted rapidly to safeguard their organisations. With capital drying up, business leaders have had to slash daily expenditure, furlough staff, gobble up government support and more.

Such actions are not unexpected when survival is the name of the game. Rather they are prudent, short-term reactions to steady the ship in a suddenly rough ocean. But none are long term solutions. Batten the hatches down in panic for too long and they risk staying shut, prolonging the downturn and blinding business leaders to possible opportunities that are emerging amid the disruption.

PIVOT AND DIVERSIFY

For the startups and SMEs that make up more than 99% of all businesses, retrenchment feels logical, it feels safe. Yet now is a time for bravery, boldness, and innovative thinking. When destruction occurs, it paves the way for new opportunities. It's no coincidence that research from the Kaufmann Foundation finds that more than half of the companies on the Fortune 500 and over 50 tech unicorns (including Airbnb) were started in a recession.

Yes, deals and acquisitions are still occurring in the upper echelons of the business world - point in case, Apple's early August acquisition of Mobeewave. But this isn't to say that SMEs and startups should be left behind. Now is an ideal time to stress-test and rethink existing business models, to pivot and diversify offerings.

"You need to be agile. You need to think about what you could be doing in addition to what you're already doing. At this point it's become almost critical to think like that," says Christopher Tucci, Professor of Digital Strategy & Innovation at Imperial College Business School. "Try and pivot to find new business models - have two or three on the go simultaneously."

Professor Tucci suggests firms reimagine existing products with a servitization component or repurpose in-house house skills to create new revenue streams. For example, PassFort, a UK-based software startup, found that by carving out a portion of its existing product and positioning it as a new service offering, the

The impact of COVID-19 on startups

43%
have stopped online advertising

30%
have cut salaries across the company by at least 15%

49%
have frozen hiring new staff

68%
expect full-year revenues to drop more than 25%

Source: Sifted, 2020

firm could suddenly sell to accounts previously deemed too small.

"We basically unlocked a pool of revenue that we had previously decided not to prospect into," says Donald Gillies, CEO of PassFort. "That's led to us generating an operating profit on that new revenue line for the past two months."

Pivoting can also help firms to capitalise upon shifting consumer habits. If customers are stuck at home, it makes sense that they will order more food online via an app like Uber Eats. Similarly, they will order more wine through another like Vivino, who saw year-on-year growth of 155% in April this year.

EMBRACE NEW TRENDS

COVID has also accelerated existing digital transformation trends as organisations look to meet remote working challenges. Firms ought to fully lean into this change to enable the sort of agile and responsive flexibility that larger firms cannot possibly deliver.

"We've found that it's played very well to our strengths as an agile SME business," says Rob Hurrell, Business Development Director of Aire Logic Limited, an ICT consultancy working with multiple NHS trusts on digital software solutions. "It's allowed us to rely on our responsive approach to things. If we were a big, lumbering behemoth software company, we might have found it extremely difficult to pivot to some of the opportunities that have presented themselves."

Cuts to employee numbers and the shift to remote working may have presented initial challenges, but for forward-thinking business leaders, they have unlocked unforeseen opportunities. If employees can do their job from home, then there's little stopping firms from leveraging talent based further afield. Why not tap into a wider talent base in a different city or country?

Time away from the office has also renewed the focus on work-life balance for many employees. As such, remote working is now an ideal perk to attract and, crucially, retain talent with. This is especially true for tech firms whose operations can be largely virtual and who are seeking an edge in the post-COVID war for talent.

Talent pools may be expanding, but SMEs and startups can also capitalise on growing localisation too. While a lack of global travel may hamper global investments - in-person visits are practically impossible right now - investors and businesses are instead looking locally. New supply chains can - and will - emerge. New, accessible investment opportunities will present themselves. Local firms who can add value will ascend in the coming months.

In times of rapid disruption, it will be those businesses who can pivot and diversify their service offering, react with flexibility, and meet the evolving needs of customers who will start attracting attention for all the right reasons. But to do so, you need to be bold enough to take the first step - after all, fortune only favours the brave.

The impact of COVID-19 on SMEs

25%

are concerned about defaulting on loans

24%

are concerned about their ability to retain employees

28%

have doubt in their ability to sustain their supply chains

28%

expect to reduce headcount in the aftermath of the pandemic

36%

have postponed growth projects

Source: McKinsey, 2020

A new normal for growth?

In the wake of disruption, smarter startup growth models are already emerging from the COVID economy

Even before the pandemic, shrewd investors were questioning dominant growth strategies among startups, especially in the tech world. Too many relied on misleading metrics like user numbers, rather than focusing on building a solid revenue stream and plotting a clear path to profit.

Now that investment flows are starting to recover, the time is ripe to consider what healthy startup growth models should look like – and whether the crisis itself might, in time, help the whole industry build on a stronger foundation.

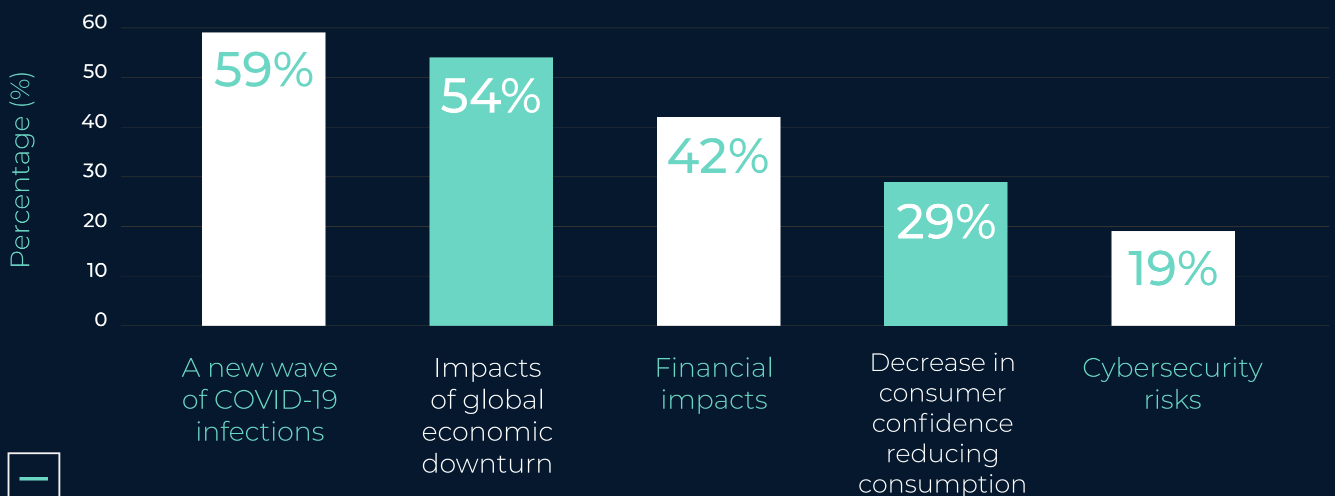
OPPORTUNITIES IN THE ROUGH

For some, the pandemic has opened new opportunities. Get My Slice, an app which pays people for their data by connecting them to relevant offers from advertisers, saw some dynamics move in their favour. It is a time of economic difficulty in which everyone is keen to earn extra cash, and they were able to negotiate good advertising rates. At the same time, a growth-focused investment round coincided with the pandemic going global.

"We were leading up to a fund-raise, working to have the product ready and tested and getting investor discussions going," says Oliver Southgate, CEO and founder. "At the end of the [UK] tax year, around late March and early April, is when money starts flowing among private investors, so that is when we had the majority of ours lined up. Then everything just stopped."

Brands paused their support and investors adopted a wait-and-see approach. "You've put everything into getting to that stage and everything is pulled from you. It was horrible," adds Southgate.

The company adapted by taking on opportunities outside of its original plan, such as moving into the cashback space rather than high-quality lead generation, its preferred model. This short-term compromise allowed it to stay the course long enough for investment conversations to re-start, which they now have, says Southgate.



Some established companies have taken the long-term view by helping their clients. “Companies are restricted at the moment in putting costs on bottom line, especially up front, so we’re moving to a performance-based pricing model where we take on more of the risk,” says Thomas Gatten, chief executive officer of Growth Intelligence, a business-to-business marketing firm. The firm is also offering flexibility on long-term licenses.

Combined, these shifts have allowed the company to avoid losing any clients. “Companies are desperate for growth but can’t stump up large amounts upfront. We are able to offer them a risk-free way of scaling up their growth and they can use at any scale,” says Gatten.

Future MBA courses will be written about the tactics used by today’s innovators to find new ways of bringing value to their customers, from Shopify’s cloud service bundle helping vendors with financial management and delivery optimisation, to Unmade, a British software company whose platform allows fashion brands to shift to on-demand manufacturing, accelerating a long-overdue shift from wasteful mass production to a smarter matching of supply and demand.

WHEN THE TIDE GOES OUT

The investment market is heating up, with stock markets rebounding and high-profile IPOs on the calendar, including Airbnb. Will this mark a return to business as usual, or are investors asking different questions?

Oliver Southgate sees a different mood among investors. “The conversations we are having in the last month, compared to December-January, have changed quite a bit. People are looking more at your risk strategies, at use-case scenarios in which you might fail. We are being grilled on this like never before.” Southgate credits his background in coding – in which “you expect everything to fail and figure out how to handle it gracefully” – to have prepared for these conversations.

In this more sober investment environment, capital might start flowing to companies with more solid fundamentals, with once-popular metrics receiving overdue scrutiny, especially in tech. “The question should be not just how many users you have, but what’s the drop-off rate? What are you spending on acquiring them?” says Ifti Akbar, founding director of Fuse Capital. A focus on unit economics and recurring revenue, as well as analysing risk profile, are better ways of evaluating a business, he says.

The growth financing landscape may be opening out. Conventional banks have long been weak at SME financing, especially in emergent sectors like Software-as-a-Service (SaaS). Perhaps their sudden transformation into business lenders at unprecedented scale, as they hand out government cash, will expose them to more types of businesses and pique their interest in unchartered waters.

FUNDING GROWTH

Investment tools could also diversify. Venture capital has dominated the startup financing discussion, but other models are gaining traction. One is venture debt, which helps firms avoid the equity dilution of venture capital. This can work well for businesses with strong and predictable cash flow, credibility with clients and a desire to keep equity control.

Satellite company Rezatec took this approach to fund investment into sales and marketing without the downsides of venture capital.

“This approach delayed the need for us to go out and raise further equity finance,” says Patrick Newton, the chief executive officer. “You might have financed this from an equity raise, but we wanted the revenue line to grow higher, in order to justify a higher valuation down the track. Using venture debt means the equity route was not so impactful of terms of dilution.”

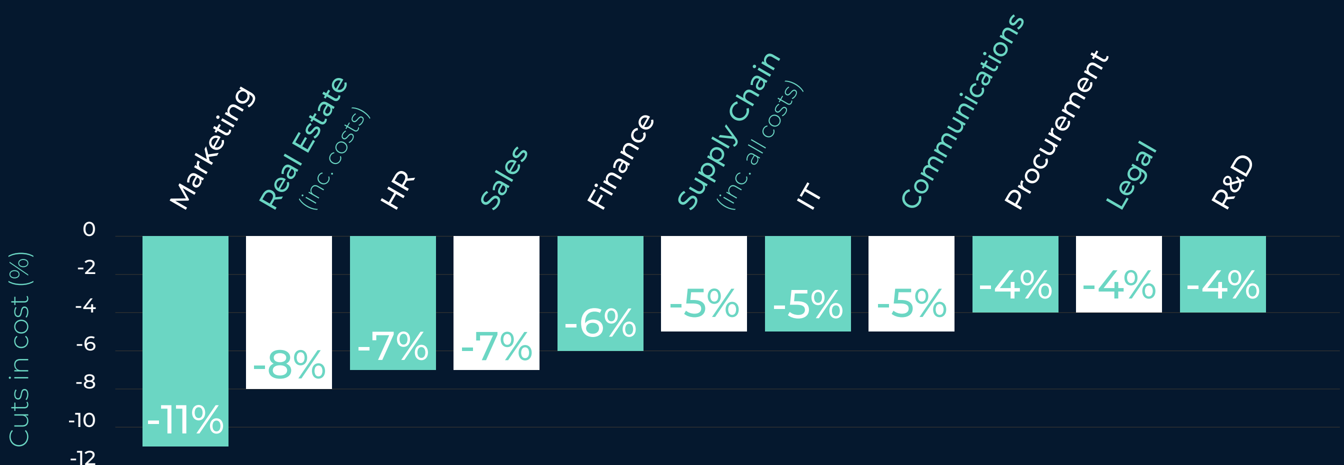
Newton believes more firms are looking to take debt at an early stage, sometimes before the equity route. “Historically you raised equity finance, typically from a big-name financier and after, you would get venture debt on top. Over the last two or three years, venture debt has started to come earlier in the cycle, and even in advance of an equity financing round on occasion,” he says.

Fuse Capital’s Ifti Akbar says SMEs and startups are still getting familiarised with the model.

“Initially people struggle to understand how you can fund a loss-making business via debt, but there are many things you can look at, like intellectual property and recurring revenues, which are forms of security.” Venture debt can be useful for a business that is scaling fast and has discipline over the numbers, he says.

For the first half of 2020, most startups will have done well to stay above the water. For the second half, a return to growth is essential. The pioneers are finding new niches in a new operational era. They are being open-minded about their own business model, taking on opportunities that are not in their original plan, or looking at ways to help their clients stay on board by offering more flexibility and lowering risk.

Those who accelerate the fastest out of the storm will be the ones who built their growth proposition on seeing waves that were once on the horizon and have now rushed to the shore. ●



Source: Gartner, 2020

Time to refuel

As equity financing falls away, firms need to find new capital to fuel their growth

The night is always darkest before dawn, or so goes the refrain. Yet the thoughts likely occupying the mind of business leaders right now are probably more to do with how long exactly that night is going to be.

Since the imposition of the global lockdown, investors and private funds have pulled up the drawbridge. Deals that were all but completed were taken off the table at the last minute due to cold feet, while those that did squeeze through did so by the skin of their teeth.

Tech giants may be happy to close mega deals, but the opposite is true of the early stage, where exits are no longer being welcomed. And it's at this startup and SME stage where firms who might typically burn through cash are now fighting for survival - the capital just isn't there.

With no access to capital to fuel growth, most firms have by now taken decisive action to steady the ship as decision makers wait to see if a second wave will emerge.

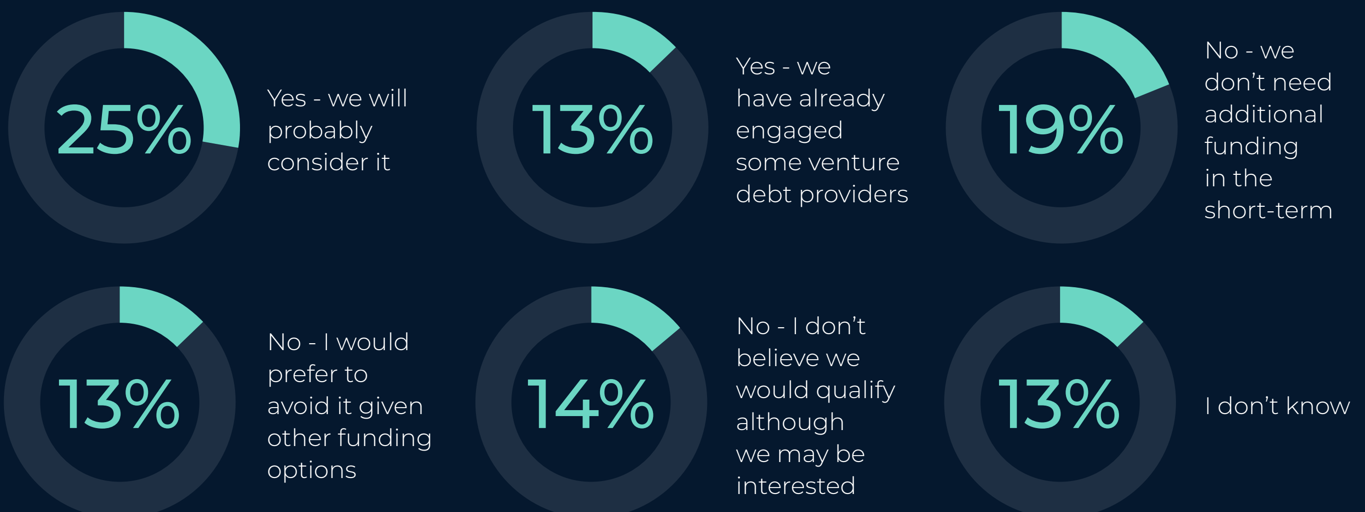
COVID WINNERS

Yet, despite this, there are COVID winners. Firms who were either in the right place at the right time to capitalise on seismic shifts in organisational behaviours (like Zoom) and consumer behaviours (like Vivino, an app-based marketplace for wine) and who as a result have seen rapid growth.

It could also be firms who have taken a hit on revenue in the short-term, but for whom COVID has been an acute stress test and vindication of their business model.

“There are a lot of COVID winners out there where the fundamentals of their business are sound but they've just taken a knock in the short term,” says Russell Lerman, Co-Founder and Director of Fuse Capital, a private debt

More than a third of startups are considering venture debt in the coming 12 months



(note figures rounded)

Source: Sifted, 2020

brokerage for technology businesses.

"For example, the top three e-scooter firms in Europe have all raised hundreds of millions - but they all took a hit on revenue at the start of lockdown. Yet you absolutely knew that people wouldn't want to get back on public transport anytime soon, and they will do ok. The fundamentals are there and now they're posting record revenues. A COVID winner is a broader category than simply someone who has seen a rise in sales, it could be they have seen a knock but overall, they'll be on the up."

In a normal world, it is precisely these 'on the up' SMEs and startups that are most likely to benefit from equity finance. Yet because of COVID, equity finance is now coming with more milestones and growth expectations that companies simply aren't confident in hitting. In turn, the reduced valuation terms on offer causes the equity round to become dilutive for existing shareholders.

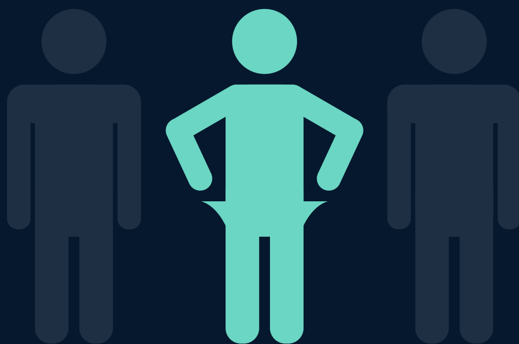
GROWTH DEBT

Firms now need to consider other financing options. Venture debt, or growth debt, is one avenue worth considering.

"We only want to raise equity funding when we're confident that we can do something productive with it in the business," says Donald Gillies, CEO of PassFort, a SaaS firm that digitises customer lifecycle management, and who is considering venture debt to support growth achieved during the pandemic. "We see venture debt as a way to offer a bit of a capital buffer and to protect the business at this stage."

With sales cycles lengthening, it can be challenging to hit the profitability milestones set by equity investors. In this case, having some debt come into the business can give firms the operational buffer required to trade through that period while waiting for pipeline revenue to convert. Similarly, for firms who have managed their cost base well, debt can offer a degree of protection against a second wave.

Professor Eli Talmor, Chair of Private Equity at London Business School, agrees that debt can be useful for firms: "I see the role of venture debt growing, especially as exits are now postponed. If you have an extension of time between that original investment, early stage, and exit, say one or two years, then a lot of it can be funded with venture debt."



34% of startups that have raised Series A, B or later rounds of funding have less than 6 months worth of cash

Source:
The Startup Genome, 2020

Oliver Blower, CEO of VoxSmart, a software company in the UK that specialises in communications surveillance for Capital Markets, is another advocate of debt financing. Blower describes debt, or an all asset charge on the business, as an “antidote” to equity.

“It creates a nice bit of hygiene in the business,” he says. “It comes with operational parameters that keep your stakeholders very honest about how they are operating their business. You can’t miss your forecasts; you have to be very prudent because any level of dishonesty will hurt you and your shareholders quite dramatically.”

THE RISK SPECTRUM

So, while debt offers a number of benefits - including as growth capital, an operational buffer, and a way to avoid equity dilution in the face of unfavourable terms - it’s not for everyone. There is a time and a place. It takes a certain type of personality.

Russell Lerman, who has worked with dozens of firms to secure debt funding over the years, believes that it depends where you sit on the risk spectrum. “With any debt you need to be able to afford to pay it back - so are you confident in launching new projects and reaching new audiences? Or are you worried about what’s coming around the corner next?”

To ensure that debt is the right choice, Russell Lerman suggests firms ask themselves four key questions. How does the company feel about it? Is the management team ready to go on that debt journey? Is an external third party - like a broker - comfortable with it? And finally, will the lender say ‘yes, this is going to work’?

Ultimately, every company is different, and every management team and shareholder base is different as well in terms of their attitude to risk. But for those firms who are confident in their future revenue and are ready for the journey, bringing some debt into the business might just be the best way of fuelling their growth prospects in the current environment.

6 growth lessons for challenging times

What learnings do business leaders believe CEOS and CFOs should take into the new normal?

First-hand experience is the greatest teacher anyone can have. Advice from those who have been there and done it can provide aspirational entrepreneurs and business leaders with critical insights, lessons, and food for thought.

The following pearls of wisdom should help to unlock new ways of thinking for business leaders whose organisation has been impacted by COVID-19.

Heini Zachariassen
Founder, CEO & Board Member, Vivino

"Now is the time to act"

Everything is going to change at this point. We've seen it, a lot of industries have seen it, and a lot of things that we thought would take 10 years to change are now changing in 10 days. The hit we thought retail was going to take over the next few years, it's happening right now. and they are shutting down right now. It's rough but it's also an opportunity.

I think there's a long-term shift going on and I think this is for all of eCommerce. There's a big shift coming and it's going to reach critical mass. And that's going to accelerate growth even more.

So, I would say 'this is the time'. Real shifts happen when you see earthquakes like this one. There's no better time to start a business than right now, there's no better time to shake up everything and change things. That's my message.

Markus Bohl
Founder & Managing Director, Laya Technologies

"Be transparent and be principled"

One thing I would say is, embrace full transparency towards the employees. Everybody understands the crisis isn't the business's fault and isn't on us. Equally, everybody understands that these things are going to have a severe impact economically and financially on everyone. This was a learning curve for me: people really understand. If you give them a little bit of guidance, then they really understand that you're trying to help.

I always think the cultural thing is most important here. The better your culture and the better the cohesion between your team, then the better you can manoeuvre challenging periods.

People really appreciated that we were supporting them financially as much as we could and we're going to extend that even for those who need a bit longer to find a new job. This was something where we really learned a lot.

You have to take principled decisions even if they are not popular - so long as you explain them.

Professor Christopher Tucci
Professor of Digital Strategy & Innovation at Imperial College Business School

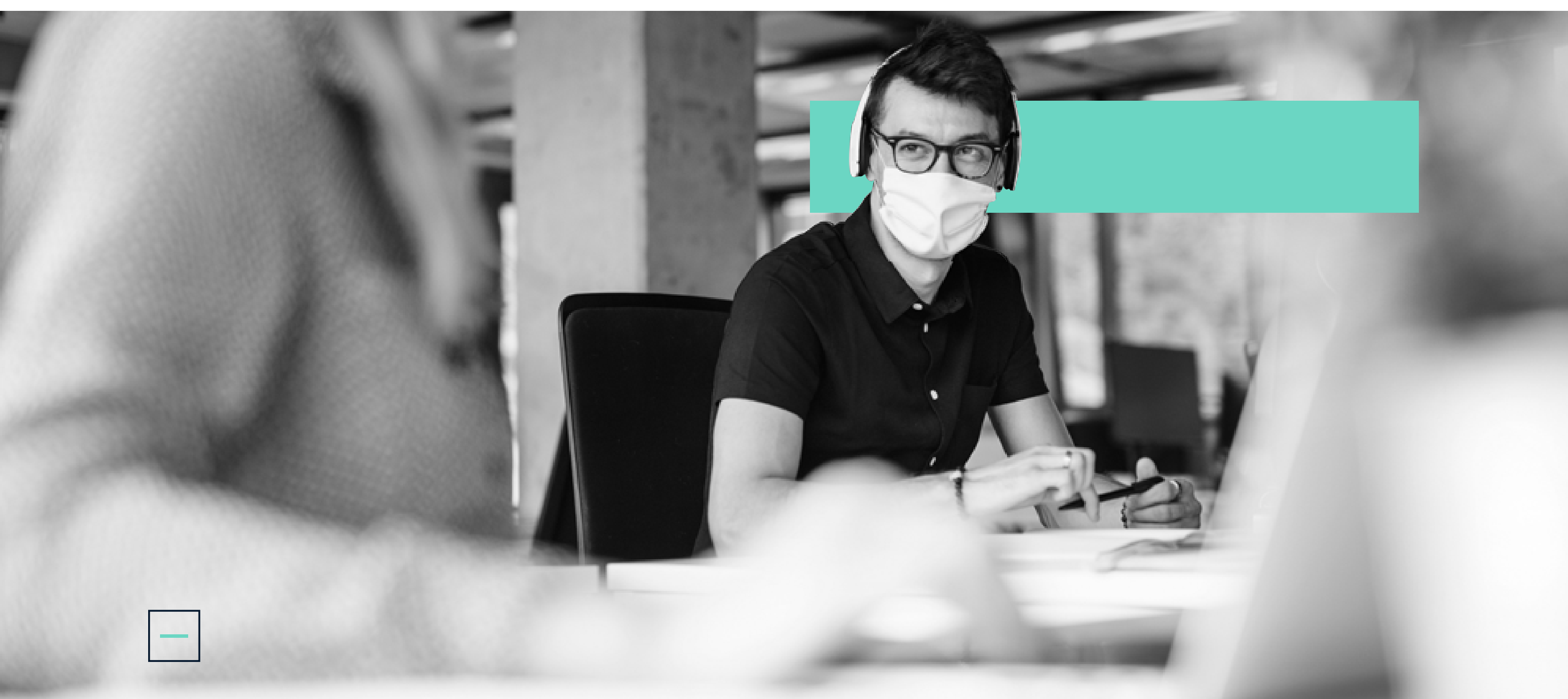
"Experiment and diversify"

You need to run small experiments in parallel. It's important to be reactive and to be able to manoeuvre and be resilient. If your performance is suffering, don't be too narrow minded about what you need to do.

Rather than a massive pivot, if you're willing to change then try to keep costs down. Make low commitment experiments. Try different things. See what catches on. And then you can decide to shift and put more money into that growing business instead of trying to stay the course, which is just stubbornness or complacency.

It's hard to know what may gain traction, so try and come up with different prototypes or several small things that you can test in the market here and there - it's not going to cost a huge amount of money. That is going to enable you to pick something and move in a particular direction.

My one piece of advice is do not be complacent or stubborn especially in the face of bad performance - it's better to think about new opportunities than to soldier on doing the same thing that people don't appear to want right now.



Rob Hurrell
Business Development Director, Aire Logic Limited

"Be confident and start the conversation"

Jump in and begin the conversation with customers and potential clients. Nobody has the answers, and nobody knows right now what things are going to look like.

What we've found is that simply having that conversation and having trust in your capabilities as a company you can find a way to meet the needs of customers and improve their ways of working.

It's largely embracing that uncertainty and saying "I'm sure there's something we can do here, but we're not exactly sure what it looks like" - that's the new way of the world. We're living in a time of uncertainty and I don't think that's necessarily going to change, even when some of the immediate challenges subside.

We can't always scope, we can't always predict. But you need to have enough self-belief and confidence in your approach that this is going to work well for you and well for the client, that's the biggest take away I suppose. That's the new way of working.

Karen Bach
Chair and Non-Executive Director Datapharm and Amino Communications

"Ask questions and challenge yourself"

There are three things a business comes down to: cash, sales, and people. For the past six months companies have focused on cash and looking after their people. Now it's time to focus on sales and their gross - and that means asking questions and challenging yourself.

A lot of tech companies have had to take a step back and ask 'is my business model what I thought it was? Am I as resilient as I thought I was? Should I now be diversifying my sector?'

At heart, most people are resistant to change, but right now businesses have a clear impetus and rationale to embrace change - and that is key.

The worst thing companies can do is go back to what they were doing before and NOT challenge themselves, and not ask themselves 'what if we did this?'

They have to change, and they have to challenge themselves.

Professor Eli Talmor
Emeritus Professor of Accounting and Founder of Private Equity at London Business School

"Do your homework"

Fundraising is arduous in any circumstances. For first timers it's difficult, at fund level it's even more so. So, in any challenging period, you need to be better, more creative, and to do your homework on what you are getting into.

I've seen - as a professor, a guide, a mentor - too many people when it was too easy during the time of web 2.0 and the dot com, leaving their jobs with an idea and having some kind of app or community or social media and 99% of them died. It's easy to get caught up, but it is wrong for people to take such action if they have responsibilities to themselves, such as families.

I think people should be more disciplined and more protective in these times. You've really got to do your homework. This will increase your odds of survival. •

We secure private debt financing solutions to enable tech leaders to realise their ambitions. With access to a worldwide network of funds and a highly experienced team we secure non-dilutive funding for high growth technology companies. Working across scale up, VC, PE backed, listed and owner managed sectors, our close relationship with lenders enables us to present them with suitable technology companies looking to secure debt finance to complete their stage of growth.

Led by a combination of senior entrepreneurs with extensive deal making experience across the sector, together with a technology passionate sales team, Fuse Capital is dedicated to entrepreneurs and mid sized technology companies looking to grow, acquire, cash out, refinance or sell.

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