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What's next for startup founders in 2023: hold, fold or raise

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At the beginning of any new year, startup founders are faced with a choice: stay the course, grow or sell. With significant market headwinds, soaring inflation, and an interest rate environment that looks to be rising as far as the eye can see, many technology businesses need help to close customers and renewals and achieve growth. Meanwhile, multiples look to be compressed with 2023 market dynamics requiring growth vectors to be larger while still maintaining profitability.

With the IPO window shut tight, many tech and life science companies poised for growth or exit are contemplating a capital raise, a merger, or a sale. Are companies who decide to raise capital rather than explore their M&A options shortsighted? With the current market, what should be your next move? In this post, we share key considerations when plotting the course forward: hold, fold or raise, which roughly translates to stay the course, raise capital, or sell.

Stay the course

In an environment where valuations are challenged, if you don't raise, your startup may be forced to extend the runway by cutting costs: either losing employees or initiatives, slow or no growth, to stay afloat. Certainly, founders will need to look carefully at spending to ensure that all levers to optimize the length of survival are fully maximized.

Raise Capital?

If you are going to do a capital raise in today's market, here are some considerations.

• Growth. The primary driver for raising capital should be to scale your business and get to revenue or an increase in revenue such that your value is greater when you next raise capital or when you sell the company. Does the new capital achieve the goal of increasing value?

• Value. Raising capital should lay a clear path to increasing your valuation by a multiple of the revenue increase that you can achieve thanks to the capital raised.

• Equity without liquidity. Any investment will involve dilution for current shareholders. While there may be a promise of a 'bigger pie,' your slice will become smaller and smaller with every investment round.

• Takes time. The process can go on for months as potential investors engage in "due diligence" examinations of the founders, the solution, the total market size, and the business proposition. Getting a green light can take time.

• Loss of control. The investment comes with the understanding that someone is buying a stake in your business. And with that comes not only a dilution of your economics but a dilution of control. Investors will want to know how your business is run and to get a block on key decisions. You will be answering to others now with a financial stake in your business.

• Growth differences. Many venture capitalists will drive an early-stage company to spend their investment on growing quickly, creating the need for more working capital. In uncertain economic times like now, it could come at a significantly lower valuation (what we call a down-round).

• The kimono is open. When seeking funds, you must be prepared to tell multiple people about your team's key strengths and weaknesses, how much of the company you still own, how you are compensated, and what your competitive strategies are. And you will have to hand over financial statements. Opening the kimono makes entrepreneurs uneasy, particularly as most venture capital firms will not sign a non-disclosure agreement until closing.

Mergers and acquisitions

Instead of raising another funding round, acquiring another business, combining with another business, or selling the business could be a strategic next step. Whether to merge with or acquire a competitor is usually made when business performance is on the upswing. At the same time, overall costs drop as each company leverages the other's strengths, a merger or acquisition reaches a new market or increases market opportunities that require a partner company to capitalize on, or the acquirer eliminates future competition gaining more market share in their existing market.

Some of the benefits of selling the company now could be:

• Immediate liquidity. Many deals have a significant cash component, which provides an immediate opportunity for CEOs and founders to take money off the table.

• Higher valuations. Running a thorough market check and process and targeting strategic buyers and financial sponsors should always yield higher valuations because of the auction process. Your share price is not pinned to a specific valuation but to what the market will pay. On average, if you go through a well-managed process, you will improve offers by a decent percentage because of the competitive tension created.

• Benefits. Running a thorough market check process can yield benefits, including improving your business model, strengthening your strategic position, collecting invaluable data and insights that enhance value, opening doors to new business, and, of course, a merger, sale, or recapitalization.

There is no correct answer. Many of the factors at play are outside of your control. Make the most of the options. Talk to your advisors. Be flexible. There is always the next act.