Patrick Meisberger of CommerzVentures explains why it’s time for a relationship reset

When investors and founders consider the dark clouds that have fallen over large parts of the early stage startup community, the eye-catching valuation write-downs for some of the most well-known names in tech, the world today seems very different from the heyday of 2021.

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Today’s founders have been forced to adopt a new rulebook and strategy. Where once splashy, optimistic growth targets were in vogue and investors’ patience for profitability was matched by deep pockets, now old-fashioned considerations like cost-management and runway are at the front of founders’ minds.

While this shift reflects our new reality, I still wonder if enough founders have fully appreciated that this altered backdrop demands a resetting of their relationships with their investors too.

Startups are firmly focusing on traditional balance sheet fundamentals to navigate this trickier economic backdrop, at the risk of showing my age I’d strongly endorse founders revisit another timeless classic and consider their ‘founder fit’. Of course receiving money from your backers is great, but what else are they bringing to the party?

How did we get here?

Prior to the startup sector’s acceleration in 2019, founder-VC matchmaking followed a routine that was balanced and conventional. Rather than just solely demanding their wallets, founders valued advice almost as much as the capacity to write cheques. Due diligence procedures took six to eight weeks or longer, and valuation agreements with reasonable quantities and conditions were made. Due to the significant effort needed to raise finances, it was a relief for both parties when a partnership could be formed with few considerations.

Between 2020 and 2021 the floodgates opened, bringing with it investors from newly-founded and relatively inexperienced, young VC professionals emerging in the 2010s and unfamiliar with downturn markets. They were joined in turn by crossover funds like Tiger Global looking to establish a foothold in early-stage VC and rewrite the playbook. Founders began to deprioritise an investor's ability to provide guidance in relation to their ability to deliver funding. The rush to complete partnership processes was fueled by booming market confidence and critical due diligence phases were regularly skipped. Looking back, it made perfect sense that founders, who’d never experienced a market crash - were drawn to the prospect of high investments at ridiculous valuations, term sheets in days rather than months, and all of this without the burden of due diligence. What’s not to like?

This is where bad habits set in. With the rise of quickfire investors fighting each other to secure investments by offering founders more cash, quicker, many founders sleepwalked into a situation where they’d secured cash but little else of value from these investors.

Sadly for them, these rushed, inexperienced investors are the first to leave the market once the market turns negative, unable to follow-on their funding because they failed to maintain essential reserves while the sun was shining during the gold-rush years and raising funds from their own LP investors was a piece of cake.

Do the DD

Today due diligence is back - although frankly it should never have gone away.

A return to a meaningful due diligence approach shouldn’t be seen by founders as a one-way exercise. Instead of startups passively giving potential backers a detailed and intrusive look through their business, it should be a conversation that goes both ways.

The due diligence process is an opportunity for founders to do their homework on their investors. We advise all our potential portfolio companies, take your time, do your research, ask around, talk to current and former portfolio companies. Work out what your strengths are and where you need help, then let’s talk about whether we’re the best fit.

After all, it is far more valuable to have a coach you can learn from, capable of supporting and challenging you on your road to long-term success, than a cheerleader who is only capable of telling you what a good job you’re doing.

If done well, founders can build a cap table with the ideal combination of expertise, compatible interests, substantial resources, and hopefully, strategic support from the start. This thorough approach can then be carried forwards by the founding team across all future funding rounds.

It can feel counter-intuitive, especially to dynamic, solutions-orientated founder types feeling under pressure, but it’s vital to slow down and pay full attention to this stage. An extensive and arduous due diligence process should not be viewed as a barrier for founders to matching with the right investors, in fact it’s the opposite.

In my experience, it is typically the hallmark of worthwhile investors who are fully prepared to roll up their sleeves if or when things get difficult. To do our job as investors, we need to be able to have frank and difficult conversations with their portfolio founders, and these conversations rely on a firm grasp of reality.

Sometimes our job is to solve problems that founders are too close to and can’t yet recognise, we can’t provide that crucial advice, introduce the right senior hire or ask the right question if the foundation of our relationship is a couple of standardised presentation decks, a dozen or so emails and Zoom calls.

Resetting for success

To those founders who have recently raised, the following will come as no surprise, my final piece of advice to founders would be that there is simply no more “easy money” around. Pre-revenue companies can’t get $10M on a $100M pre-money valuation, so more reasonable valuations and financing terms have to be considered.

Founders must evaluate their business as it exists today, where do costs need to be managed, can you cut costs now and if not why not? You should target a minimum 18-month run rate, for some out there that’s simply not going to be possible, so your next move is to go to your investor base.

This is where you discover how strong they are and whether they are able to fund you internally. If existing backers are able to fund you, be sure to discuss convertibles or re-open your latest equity round to deliver the runway you need in order to prevent you going back on the market and risking facing a public reduction in your valuation.

I know all too well that these are not comfortable processes, but it’s this kind of self-evaluation that is going to deliver the results needed as we all adjust to what could be a sustained period of muted or depressed market conditions.

The good news is that those entrepreneurs who have carried out sufficient levels of introspection and properly interrogated their investors are in a far stronger position than those that haven’t, and can look forward to reaping the results as weaker players fall away and they are left standing.

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