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TECH

Silicon Valley Investors Give Startups Survival Advice for Downturn

Venture-capital firms tell portfolio companies to buckle down for the long haul; 'before you thrive, you have to survive'

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After years of funneling cash into startups' grand ambitions, Silicon Valley's SIVB **-2.38%** ▼ investors are engaging in the grim ritual of delivering survival advice to their portfolio companies.

In recent online slide presentations, blog posts and social-media threads, venture-capital doyens including Lightspeed Venture Partners, Craft Ventures, Sequoia Capital and Y Combinator are telling the founders that they need to take emergency action for what could be the sharpest turn in more than a decade. Their advice includes cutting costs, preserving cash and jettisoning hopes that hedge funds or other investors will swoop in with big checks.

"The boom times of the last decade are unambiguously over," Lightspeed, LSPD **-2.00%** ▼ which has backed companies including social network Snap Inc. SNAP **-2.89%** ▼ and crypto exchange FTX, wrote in a dispatch for startup executives that was posted on Medium, a publishing platform, this month.

The investors' admonitions are a departure from the growth-above-all mantra for startups in recent years, and come as the venture market is showing signs of sputtering.

Funding for global startups—at around $58 billion in commitments midway through the second quarter—is on pace to drop by about one-fifth in the period compared with the previous quarter, according to analytics firm CB Insights. The tech-heavy Nasdaq Composite Index is down about 25% from its all-time high in November, and SoftBank Group Corp., which has poured more than $100 billion into investments, this month reported a $26.2 billion loss in the first quarter as valuations plummeted in its portfolio of tech companies.

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Startup investors have sounded alarm bells in previous moments of financial and economic tumult, including the start of the Covid-19 pandemic. But partners at venture funds say the current situation is different. In past downturns, the Federal Reserve cut rates and pumped money into markets to support the economy, providing liquidity and cheap capital. This time, the central bank has been raising rates and taking money out of the system in a bid to tame inflation.

— Lightspeed Venture Partners, in a dispatch for startup executives

The Fed's moves are making capital more expensive, and increasing the pressure on companies to preserve their cash. "I would be planning to ride this thing out for at least 18 months or more," Fred Wilson, co-founder of Union Square Ventures, an early backer of Twitter Inc. TWTR **0.56%** ▲ and fintech startup Stripe, said in a blog post last weekend titled "How This Ends."

Sequoia, one of Silicon Valley's most storied firms, warned founders and CEOs in a March 2020 memo about the risks to businesses from the looming global health crisis, including supply-chain issues and canceled travel.

Today's situation is more similar to the 2008 financial crisis or the dot-com market crash in 2000, said Sequoia—known for early investments in Apple Inc. AAPL **-3.86%** ▼ and Airbnb Inc., ABNB **-1.18%** ▼ among others—in a 52-page slide presentation for roughly 250 founders about two weeks ago.

"We do not believe that this is going to be another steep correction followed by an equally swift V-shaped recovery like we saw at the outset of the pandemic," Sequoia said in the presentation, which was reported earlier by tech news site The Information. The slide presentation, titled "Adapting to Endure," called this a "Crucible Moment" and advised companies to cut expenses quickly and preserve cash, noting, "It will be a longer recovery."

The latest presentation mirrors the message in a 50-slide presentation Sequoia sent to founders in October 2008, saying a housing-led recession and overleveraged financials—which it illustrated with a butchered carcass and a gravestone—meant that companies needed to control spending, focus on quality and lower risk.

Bill Gurley, a partner at Benchmark Capital known both for his successful investments and for calling out excesses in venture capital, has taken to Twitter several times in recent weeks to offer advice. "The cost of capital has changed materially, and if you think things are like they were, then you are headed off a cliff like Thelma and Louise," he said this month.

Some big deals are still getting done. Space Exploration Technologies Corp., or SpaceX, Elon Musk's rocket company, just raised a fresh round of upward of $1.5 billion in funding, for instance.

And many startups stockpiled enough cash from the gusher of fundraising last year to continue operating for several more years on existing funds, said Neeraj Agrawal, a general partner at Boston-based Battery Ventures. Still, Battery's partners have been advising their portfolio companies to conserve cash, he said.

"Before you thrive, you have to survive," Michael Seibel, a managing director at Y Combinator, said in a video for startups posted to YouTube this month. The Silicon Valley accelerator, which aims to help startups thrive and has invested in more than 3,000 companies including Airbnb, is urging founders to cut staff, reduce ad spending and raise prices.

Venture investors are also trying to sound notes of encouragement to the entrepreneurs they have backed.

The focus on quality over quantity can have some upside, they said, noting that some of the best-known players in tech today—including Uber Technologies Inc. UBER **-2.47%** ▼ and Airbnb—were founded amid economic weakness in the U.S.

The battle for talent could ease, as job cuts spread through the tech sector, the VCs say. The startups that aren't viable but still creating competition—a phrase coined by Y Combinator co-founder Paul Graham as "default dead"—also likely will go away without access to cheap cash, they added.

Lightspeed titled its recent Medium post, "The upside of a downturn." While emphasizing that startups need to slow hiring and cut nonessential activities, among other measures, to survive, it also urged founders to stay optimistic.

"History has taught us that CEOs who are decisive now and make critical changes to their businesses will emerge in a stronger position when markets normalize once again," Lightspeed said.

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