The Venture Capital Paradox:
When Funding Fosters Zombie Unicorns

By Roee Hartuv

In the high-stakes world of venture capital, the pursuit of exponential returns has spurred a culture of "grow at all costs," a strategy that has birthed as many industry giants as it has cautionary tales. The lure of achieving unicorn status can often lead to strategies that prioritize rapid scaling, in most cases at the expense of sustainable business practices. This paradox, where venture funding aimed at fostering innovation and growth unintentionally breeds 'zombie companies'—firms valued at over a billion dollars yet fundamentally unprofitable—poses a critical dilemma for the industry.

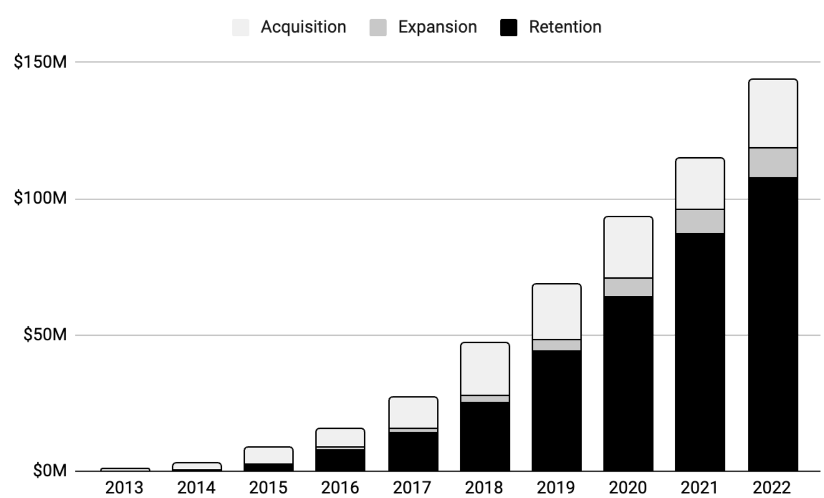
This paper aims to unravel the complexities of this venture capital paradox, offering a nuanced view of how aggressive growth strategies, often propelled by the necessity to deliver outsized returns to investors, can lead to unsustainable business practices that jeopardize the long-term viability of promising companies. By the end of this discussion, we will highlight the pitfalls of this prevalent funding model and propose strategic pathways toward more sustainable growth paradigms that align with investor returns and company health.

ACT 1: When Business Models Misalign

The Company: Recurring Revenue Business Model

Companies built on a recurring revenue model aim to generate a continuous impact, leading to steady, recurring income that fuels growth. Recurring revenue growth is an outcome of growth from acquisition, retention, and expansion. Most of this growth comes from customers returning to you yearly or monthly to renew and expand their relationship with your product. This is grounded in establishing long-term customer relationships and providing them with ongoing impact, which helps achieve sustainable profitability over time.

FIGURE 1.
A typical growth curve of a Recurring revenue-based business where Retention (in black) is the biggest contributor to the total revenue.



The goal of a Recurring Revenue Business Model is to achieve the highest growth rate but in the most cost-efficient manner.

The VCs: High Risks Investments Business Model

However, Venture Capital (VC) firms operate under a totally different paradigm. Venture capital (VC) firms are financial companies that pool investors' capital to invest in early-stage, high-potential companies. Their business model revolves around identifying startups with significant growth potential, providing them with the necessary funding and strategic guidance to scale, and ultimately seeking substantial returns on investment. VCs typically acquire equity in these companies, aiming to exit through public offerings (IPOs) or acquisitions, where the startup's value has appreciated significantly. The high-risk nature of these investments is offset by the potential for high rewards, with successful investments compensating for those who fail.

VCs are thus under pressure to identify, invest in, scale, and sell their shares rapidly enough to meet these ambitious return targets within the fund's operational timeframe. This creates a significant push for rapid and high returns.

Misaligned Business Models

The misalignment arises because VCs typically seek rapid, high returns and quick exits, which in most cases conflict with the slower, more methodical approach of companies operating on a recurring revenue model that focuses on building long-term customer relationships and sustainable growth.

Board Composition and Power Dynamics

This fundamental difference in objectives can create tension between VCs and the companies they invest in. In the boardrooms of many startups and scale-ups, the power dynamics are heavily tilted in favor of VC investors, who typically hold significant equity stakes. As the principal shareholders, these VCs wield considerable influence over the strategic decisions of these companies.

Moreover, in many startups, the founders and executives are often less experienced than their board members. A typical VC investor typically holds seats on multiple boards and frequently has backgrounds as former executives themselves. This disparity in experience can lead to a dynamic where founders become heavily reliant on the guidance and decisions of their board members.

Such dependencies can significantly influence a company's strategic decisions, often tilting them towards initiatives that align with the investors' business model. Decisions such as aggressive market expansion, intensive scaling of operations, or prioritization of short-term gains over long-term stability are more likely to be pursued. This often leads to strategies that may not align with the company's original mission or long-term vision but are aimed at achieving quick exits with high returns for the investors.

Consequences

Grow at All Costs:

The "grow at all costs" strategy has been a prevailing approach in the startup ecosystem. This tactic prioritizes rapid scale and market capture above all else, which can lead to significant negative impacts on the businesses adopting it.

Firstly, it can result in unsustainable financial health due to high burn rates and heavy reliance on external funding, making the business vulnerable if market conditions change or investors' sentiments shift, as we witnessed across our industry in 2022. Secondly, this approach can lead to increased customer churn and dissatisfaction as the focus on acquiring new customers often overshadows efforts to serve and retain existing ones, ultimately eroding the customer base and damaging long-term revenue.

Case Study: Grow at all costs, Raising a Growth Round without having a Repeatable Process

A business intelligence (BI) company with an Annual Recurring Revenue (ARR) of $15 million had secured a few highly reputable customers from Fortune 500 companies. However, the product was underdeveloped, and the company's success was heavily reliant on free professional services provided to compensate for the product's shortcomings.

To scale rapidly, the CEO successfully raised $35 million from one of the most successful venture capital firms in the US. Following the investment, the company undertook several aggressive growth initiatives:

1. Hired a Chief Revenue Officer (CRO) who tripled the headcount in sales.
2. Appointed a Chief Marketing Officer (CMO) who doubled the marketing spend.
3. Brought in a Chief Financial Officer (CFO) to prepare the company for an Initial Public Offering (IPO) within 18 months.

However, these actions did not address the fundamental issues with the GTM strategy and operations. Retention rates were very low compared to the industry benchmark for multiple reasons. There was no clear ICP definition and therefore the teams were selling on servicing different companies with different needs. The GTM team was working separately on disjoint initiatives making it impossible to follow one coherent process. The company did not have a Go-to-Market fit, and some would argue, even product-market fit.

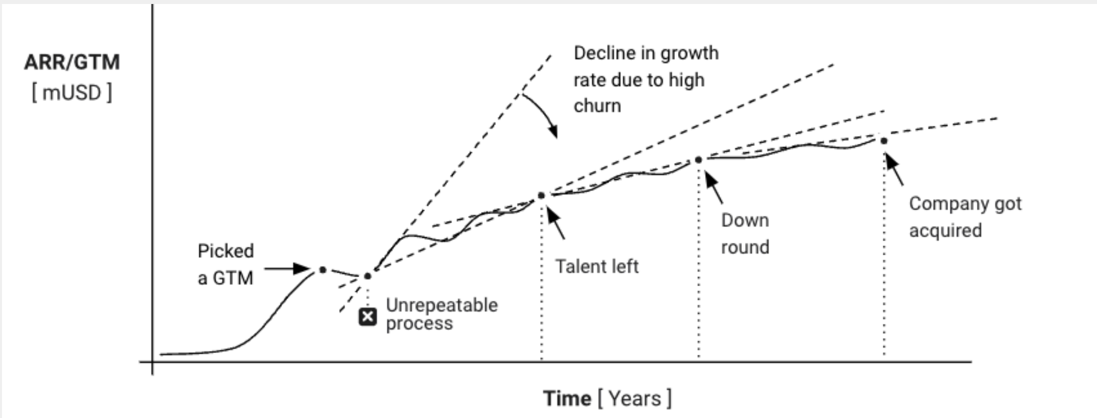
The company's rapid expansion strategy, driven by the need to meet ambitious growth and IPO targets, led to several critical challenges:

- The high churn rate persisted as the product remained insufficiently robust, and inconsistent complimentary professional services alienated many existing clients.
- Most of the new hires left or were let go within a year due to the company's unstable situation and unmet expectations.
- The company experienced a down round, significantly reducing its valuation.
- Eventually, the company was sold, but it did not yield returns for the investors, failing to meet their investment expectations.

This case underscores the risks of prioritizing rapid scaling and aggressive growth over addressing core Product Market fit issues and ensuring sustainable customer satisfaction. The misalignment between the venture capitalists' demands for quick and high growth and the company's actual readiness for such growth led to unfavorable outcomes for all stakeholders involved.

Note: The company name and exact numbers have been masked to maintain their identity and confidentiality.

FIGURE 1.
The absence of a repeatable process leads to a decline in the growth rate, a delay in GTM fit, and premature revenue plateauing, which has significant consequences.



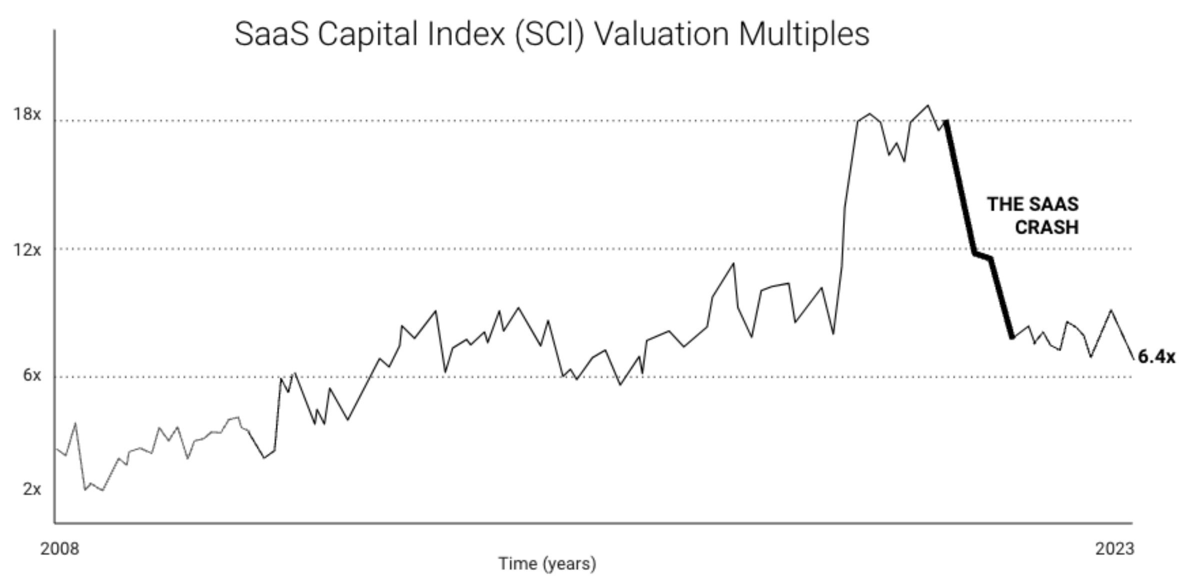
ACT 2: Overvaluations Due to Competitive Pressures

Much has been discussed about how historically low interest rates have resulted in abundant capital in the market. This surge in available funds has intensified competition among investors, leading to larger investment rounds. In this classic economic scenario, the demand for promising companies far exceeds the available supply, which paradoxically allows funders to be more selective.

The involvement of Super Funds, such as Softbank and Tiger Global, complicates this dynamic considerably. With their substantial financial resources, these funds can easily outbid and outspend smaller VC firms. This ability not only intensifies the competition but also distorts valuation norms and expectations across the entire startup ecosystem. The pressure to stay competitive in such an environment led to significant overvaluation. Companies often find themselves priced well beyond their actual economic value or growth potential.

In their quest to stay visible and relevant within the competitive investment landscape, venture capitalists often make strategic compromises. These compromises frequently involve investing in companies at higher valuations, which do not necessarily reflect their intrinsic worth but are driven by the need to secure a deal in a fiercely competitive market. Clearly, investors understand this dynamic; however, the pressure to maintain status and influence can lead to prioritizing market positioning over sound financial judgment. This situation highlights a significant risk in venture capital investment: the intense competitive pressure can obscure the prudent evaluation of a company's true value.

FIGURE 2.
The combination of pandemic-driven demand, investor enthusiasm, and strong financial performance led to the exceptionally high valuations of SaaS companies from 2020 to 2022 by the SaaS Capital Index®.



Competitive Dynamics Among Venture Capitalists

During 2020-2022, VCs operated in an intensely competitive environment where the race to discover and invest in promising startups was fierce. These dynamics create a market where the stakes are high, and the pressure to secure deals can lead to neglecting proper Due Diligence and participating in rounds at higher valuations than might seem justifiable.

Responses from VCs:

In conversations with various venture capitalists during the peak of market evaluations, a common sentiment emerged. When asked if they could genuinely justify the high valuations of their portfolio companies, some responded with an acknowledgment of the market's competitive realities.

> “I know the valuations were too much, but what can I do?”
>
> “I have to return to the founder with a term sheet in a matter of days, or else Insight Partners and alike will beat me to it.”

This illustrates a scenario where VCs, despite understanding the potential overvaluation, feel compelled to "go along" with market trends to secure investments in a limited pool of attractive startups.

While high valuations can initially seem advantageous for startups, providing them with prestige and better leverage in negotiations, they often come with complex challenges. High valuations set lofty expectations for performance, which can place intense pressure on founders to deliver results that justify their market worth. This pressure can lead to rushed business decisions, such as premature scaling or overexpansion, which might not be sustainable in the long term. Additionally, a high valuation increases the difficulty of securing further investment unless the company continues to demonstrate exponential growth, as new investors require even higher returns on their investment. This can create a precarious cycle where companies are forced to continuously seek outgrowth to satisfy both existing and potential investors, sometimes at the expense of focusing on solidifying their core business practices or adjusting their strategies to market demands. Ultimately, if these companies fail to meet the expectations set by their valuations, they risk a down-round, which can dilute early investors and demoralize founders and employees, potentially destabilizing the entire business.

Case Study: Overvaluation set unrealistic expectations

One of our clients, a scaleup, developed an innovative solution targeting the hot market of cybersecurity. Leveraging the sector's hype, the company raised $150 million in Series D funding at the beginning of 2022 from top-tier investors. This round brought the company’s total funding to almost $300 million. The latest investment turned the company into a unicorn, with over $1B in valuation. At the time of the investment, the company's Annual Recurring Revenue (ARR) was just over $10 million.

Following the substantial investment, the company embarked on an aggressive growth strategy. They went on a hiring spree, rapidly expanding their team to accelerate development and market reach. Additionally, they dramatically increased spending on marketing campaigns to capture market share and drive sales quickly. However, this rapid expansion came at a cost. The product was not yet mature enough for the market, leading to delayed deployments and implementation issues. These setbacks resulted in a relatively high churn rate as customers became dissatisfied with the performance and reliability of the solution.

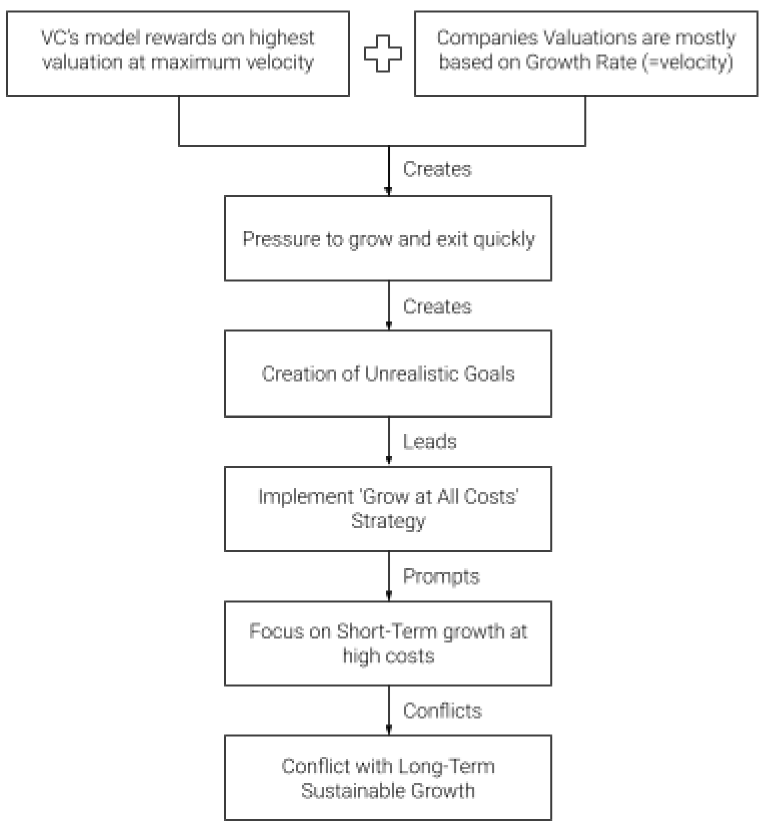
The premature scaling exacerbated the issues with the immature product, causing a loss of customer trust and high churn rates. Despite the initial high valuation and substantial funding, the company struggled to meet the extremely high growth targets set by investors, which were not aligned with the realistic capabilities of the developing business. This misalignment between the need for a stable, recurring revenue growth model and the VCs' demand for swift, substantial returns placed tremendous pressure on the founders to meet unrealistic goals, complicating their operational and strategic decisions.

This case highlights the critical importance of aligning growth strategies with the company's operational capabilities and market readiness.

> *Note: The company name and exact numbers have been masked to maintain their identity and confidentiality.*

VC Pressure Impacting Companies Negatively

FIGURE 3.
This Diagram illustrates the reinforcing cycle of pressures faced by companies funded by venture capital. Starting from the need for quick and high valuations, it shows how growth-centric strategies lead to short-term focus, conflicting with long-term sustainable growth.



1. VC's model rewards on highest valuation at maximum velocity:

   Venture capitalists invest in startups with the expectation of achieving high returns on their investments. Because these returns are realized at the time of the company's exit (sale or IPO), VCs are motivated to seek and maintain high valuations for their portfolio companies.

2. Valuations Based on Growth Rate (=Velocity):

   Startup valuations are significantly influenced by their growth potential and current growth rate. Higher growth rates typically promise higher future returns, justifying higher valuations in funding rounds.

3. Pressure to Grow and Exit Quickly:

   Due to the structure of VC funds, which usually have a lifecycle of 7-10 years, VCs are under pressure to exit their investments within this timeframe to return capital to their investors (Limited Partners). This creates an urgency to drive up valuations quickly.

4. Creation of Unrealistic Goals:

   In response to the pressure from VCs, companies often set aggressive, sometimes unrealistic growth targets to rapidly increase their valuations.

5. Implementation of a "Grow at All Costs" Strategy:

   To meet these targets, companies may adopt a "grow at all costs" strategy. This approach prioritizes rapid scale and market capture over profitability or balanced growth, focusing heavily on acquiring customers and expanding market share quickly.

6. Focus on Short-Term Growth with high costs:

   Such strategies typically emphasize short-term gains, often at the expense of long-term strategic objectives like building a sustainable business model or fostering durable customer relationships.

7. Conflict with Long-Term Sustainable Growth:

   The focus on quick wins and short-term metrics goes against sustainable and durable growth, which requires careful planning, consistent customer value delivery, and gradual scaling based on solid business fundamentals.

ACT 3: Before the 2022 Crash - Good Times and Champagne All-Around

As we explore the dynamics of the current market conditions, it's essential to revisit the prosperous period of 2020-2022, a time marked by exceptionally high valuations and a "grow at all costs" mentality. During these years, both investors and company leaders enjoyed the fruits of aggressive growth strategies. The substantial financial gains and rapid expansions achieved reinforced the prevailing investment philosophy and business practices. For many, the success experienced during this period and the financial returns validated their approaches, creating little incentive to alter their strategies.

In bullish market conditions, startups focused on aggressive expansion and revenue boosts were celebrated in the industry and attracted further investments, fostering a cycle of growth that seemed indefinitely sustainable.

These companies often posted impressive growth metrics and market expansions that were highlighted as success stories. However, such growth was frequently built on precarious foundations—high cash burn rates, underdeveloped customer support, and superficial market penetration—that were overlooked amid the growth euphoria.

The Winners and Losers of the Bull Market 2020-2022

Winners

- VCs and Early Investors:

  These stakeholders were generally pleased as they managed successful exits or took companies public, achieving significant returns on their investments.
- Founders and Employees

  Also typically satisfied during this phase, as the high valuations and public offerings allowed them to liquidate their stock options profitably.

Losers

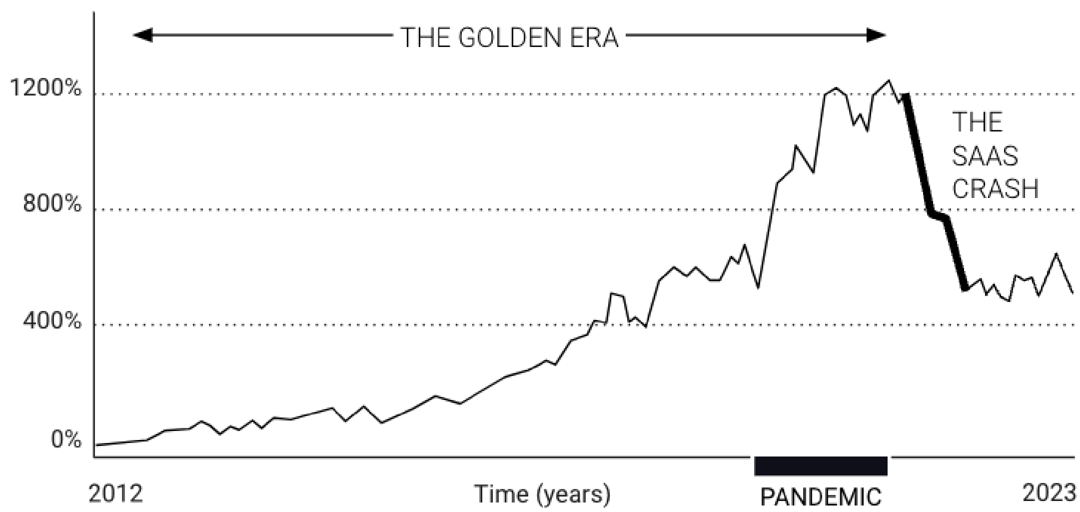
- Customers:

  In the rush to scale, product and service quality often suffered, failing to meet customer needs or being riddled with issues.
- Public Investors:

  Those investing in these companies post-IPO found themselves on the losing side as many of these businesses struggled to achieve profitability, leading to losses and diminished returns.

As long as money was cheap and companies continued spending, there was no real reason to stop the party. However, as the cycle of escalating valuations and aggressive expansion continued unabated, it set the stage for the challenges that would emerge as market conditions began to shift.

FIGURE 4.
The performance of SaaS companies over time was normalized against January 2012 by SaaS Capital Index®.



ACT 4: The Impact of the 2022 Crash on VC-backed Companies

The 2022 market crash brought significant upheaval to the private markets, affecting the strategies and outcomes for venture capitalists (VCs), startups, and investors alike. While much has been discussed in various articles and analyses, we will synthesize these insights before we delve deeper into the effects of the misalignment.

1. No IPOs and Stalled Exits:

The immediate aftermath of the crash saw a drastic reduction in Initial Public Offerings (IPOs), traditionally a vital exit strategy for VCs and a milestone for growing companies. With public markets recoiling and investor sentiment turning cautious, companies that had planned IPOs found themselves needing to postpone indefinitely, leading to a backlog of businesses unable to transition to public ownership.

2. VCs' Challenges in Liquidating and Reinvesting:

   Venture capitalists faced their own set of challenges as the avenues to liquidate their investments dried up. The inability to exit positions in startups not only affected the returns and health of their current funds but also restricted their ability to raise new funds or redeploy capital into new ventures. This situation created a cycle of reduced liquidity in the venture ecosystem, further exacerbating the funding drought.

3. Selective Funding and Reduced Runway:

   With a more constrained capital environment, VCs became increasingly selective, channeling their limited resources toward the top performers in their portfolios. This shift left many promising but less proven startups struggling to secure the necessary funding to continue operations. Startups that had planned for future funding rounds based on growth projections were hit hard, often finding themselves with insufficient runway to achieve profitability or further growth milestones.

4. Raising Capital Becomes a Tough Task:

   For new and existing companies, the criteria and difficulty of raising capital intensified significantly. Spooked by the market downturn and facing financial constraints, investors tightened their belts, demanding more robust proof of sustainability and profitability from businesses before committing funds. This environment made it exceedingly tough for startups to secure the investments needed to survive and thrive.

> "Only when the tide goes out do you discover who's been swimming naked."
>
> - Warren Buffett

ACT 5: Impact of Misalignment

The post-2022 market crash illuminated the vulnerabilities within companies that had prioritized rapid growth over sustainable business practices.

Many companies that had expanded too quickly found themselves financially overextended when investor confidence waned and funding rounds dried up. The lack of a solid GTM foundation led to drastic measures, including significant layoffs and operational cutbacks.

The Winners and Losers after the 2022 Crash

Winners

- Private Equity Firms and Established Companies:

  These entities capitalized on the downturn by acquiring struggling companies with strong products and good market shares at reduced prices.

  ** Significant acquisitions have yet to materialize in the market. Established companies like Google and Meta are hesitant due to stringent regulatory scrutiny, while private equity firms remain cautious, believing that the market turmoil has not fully settled*

Losers :

- Venture Capitalists and Early Investors:

  Faced significant financial losses as the market correction eroded the high valuations of their portfolio companies.

- Founders and Employees:

  Suffered from financial instability and job insecurity as companies downsized or shut down. In addtion, those who had shares in companies with high validation, have seen there assets sink to as much as 90%.

- Customers:

  Experienced disruptions in service and support as companies struggled to maintain operations amidst financial pressures.

- Public Investors:

  Encountered substantial losses due to the devaluation of public shares in technology and SaaS sectors, affecting their investment portfolios.

ACT 6: A New Era of Low-Burn and High-Growth

Is Sustainable Growth the New Frontier for Venture Capital?

Due to new market conditions, the venture capital industry has witnessed a fundamental shift in investment criteria.

> The bottom line is that profit is the new black in the venture capital space. Business owners who can demonstrate a clear path to profitability are the ones who will secure the funding they need to grow and develop their businesses.
>
> - Melissa Houston, Forbes

This change marks a significant departure from previous years, where growth at any cost often overshadowed the importance of sustainable business models. Today, VCs are increasingly prioritizing companies that not only show potential for rapid growth but also demonstrate a clear path to profitability. Business owners who can articulate and substantiate how they will achieve and sustain profits are now more likely to secure the funding necessary to expand their operations.

In alignment with this new emphasis, Bessemer Venture Partners has introduced the "Rule of X," which replaces their former "Rule of 40." The Rule of 40 served as a benchmark that companies should aim for a combined revenue growth rate and profit margins totaling at least 40 percent. In contrast, the Rule of X focuses more on efficiency and balanced growth. It assesses how effectively a company can scale its operations while maintaining or improving profitability ratios, thus acknowledging that pure growth metrics are no longer sufficient on their own.

This pivot raises pertinent questions about the long-term implications for the VC model, traditionally predicated on fast growth and quick exits through IPOs or acquisitions. With the current economic conditions characterized by higher interest rates and market skepticism, is this shift towards prioritizing profitability merely a temporary adjustment? Or does it represent a fundamental realignment in response to economic pressures that will persist even if interest rates decline? How will this reconcile with the VC's enduring business model that thrives on rapid scale and high returns?

Are SaaS Companies Ready to Embrace Sustainable Growth Models?

As the venture capital landscape shifts towards prioritizing profitability alongside growth, SaaS companies are ushering in a new era marked by the imperative of low-burn, high-growth strategies. The initial response from many SaaS firms to these changing conditions has been to reduce operational costs in an effort to extend their financial runway. However, as these companies strive to optimize their core activities, they encounter significant challenges. Many have grown rapidly without establishing robust processes and practices, making it difficult to pivot toward more sustainable operations. This difficulty is often more pronounced in mature companies, where entrenched ways of working and historical business models resist quick changes. The necessary transformation begins with a drastic mindset shift, reevaluating and often resetting strategic goals. This entails not only pushing long-term goals further out but also realigning priorities with the board to accommodate a slower velocity of growth that sustainable practices entail. These changes are critical as they navigate a landscape where rapid scale is no longer the sole hallmark of success.

Unicorn Setbacks: Adjusting Valuations and the Impact on Industry Progress

The crash led to a severe market correction, where company valuations were adjusted to more realistic figures, reflecting true market conditions rather than speculative growth. This adjustment created a surge of unicorns that, despite achieving billion-dollar valuations, struggle with fundamental business challenges.

A specific group of these companies finds themselves in an especially challenging position. Many had plans to go public and were already in discussions with investment bankers to facilitate their transitions into public markets. However, the sudden shift in market dynamics has left these companies in limbo, deserving of special discussion. Our entire industry relies on the progression of companies toward public offerings as a sign of health and maturity. When such a significant segment of the market stalls, it influences not only the companies directly involved but also sets a precedent that can hamper the advancement of others in the pipeline. This stagnation has broader implications, potentially causing a bottleneck effect that impacts the entire industry's dynamism and growth trajectory.

Use Case: Navan's IPO Challenge

Navan is a technology firm that experienced rapid growth and significant investor interest, leading to a substantial valuation increase over a short period. Navan's business model and market positioning positioned it as a prime candidate for an IPO, which was strategically planned for 2022.

Navan's last funding round in May 2022 raised $304 million from Andreessen Horowitz in an internal round. This investment round pegged Navan's valuation at an ambitious $9.2 billion, aligning with the company's projections and plans to go public within the year at a target of $12B. However, the IPO did not materialize as planned due to a downturn in market conditions. This scenario left Navan with an inflated valuation that could not be substantiated in the current market, complicating its path to a public listing.

Comparison with Market Peers:

Current market dynamics and valuation metrics do not favor high multiples. For context:

- Reddit went public with a valuation of $6.5 billion on revenues of $666 million, translating to a revenue multiple of approximately 9.8.

- Alphabet trades at a revenue multiple of 6.1, Meta at 9.7, Pinterest at 7.5, and Snap at 3.9.

Given these figures, Navan faces a stark discrepancy between its last private valuation and what the market can realistically support, given its financial performance.

Current Strategy:

Navan's current plan involves adjusting its expectations and strategies to align with market realities. The goal remains to proceed with an IPO, but under new terms that reflect a more sustainable valuation. This would likely mean accepting a market debut at a valuation significantly lower than the $12 billion initially projected. Such a move would necessitate recalibrating internal expectations and preparing investors for a lower-than-expected return on their investment at this stage.

Conclusion:

Navan’s journey highlights the complexities and challenges tech companies face when transitioning from private high-flyers to public entities, especially in volatile market conditions. The company's ability to navigate these challenges will be crucial in determining its success in the public market.

ACT 7: The Zombie Unicorns

The term "zombie unicorns" refers to companies that, despite achieving a valuation of over $1 billion and thus being classified as "unicorns," are unable to achieve or sustain profitability, generate sufficient revenue, or secure additional funding necessary for ongoing growth. These companies continue operating but are staggering without the financial health or business momentum needed for long-term survival and success. Here are some key characteristics and implications of zombie unicorns:

Characteristics of Zombie Unicorns:

High Valuations Without Profitability: Zombie unicorns have high market valuations based on investor expectations and funding rounds, but these valuations are not backed by fundamental financial health or strong revenue streams.

Continuous Cash Burn: They typically burn through available cash reserves quickly due to high operational costs and aggressive expansion strategies without achieving the necessary revenue to become self-sustaining.

Limited Strategic Options: Struggling to secure further investment or find a profitable exit strategy, these companies often face limited options for recovery or transformation. They may continue to exist in a state of limbo, unable to grow or exit, and hence termed "zombies."

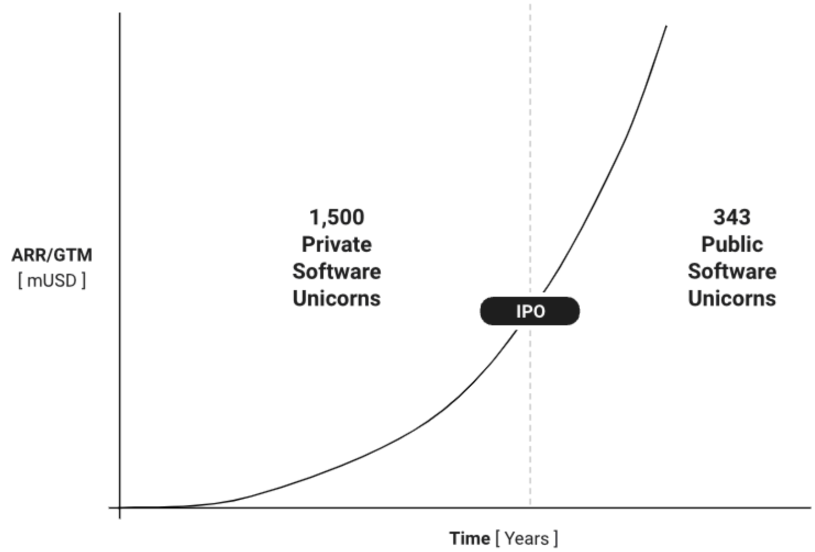
Dependency on Further Funding Rounds: Their survival often depends on the ability to raise more funds from existing shareholders, which may become increasingly difficult as investors become wary of their financial instability and lack of a clear path to profitability.

Diluted Ownership and Decreased Incentives: As these companies continue to raise capital under challenging conditions, founders often face further dilution of their ownership. This dilution can significantly decrease their financial incentives, impacting their motivation and commitment to continue leading the company through turbulent times.

Given their vulnerabilities, many zombie unicorns are prime targets for acquisitions by more stable companies or buy-outs by private equity firms. While such exits can provide a lifeline, they often do not return the level of investment initially poured into these startups.

FIGURE 4.

According to DealRoom, in 2022 there were 1,500 software companies in the private sector compared to only 343 in the public sector.



> "Of the 1,500 to 1,600 companies that were valued at $1B or more in the private markets and were funded in 2021 and 2022, [...] 1,000 of them will never achieve an exit value of $1B or more."
>
> - Mark Suster

WHAT TO DO ABOUT IT

For entrepreneurs and business leaders navigating this complex environment, it is essential to adopt a proactive approach. By implementing the strategies —ranging from financial prudence to strategic partnerships—you can steer your company away from the pitfalls of becoming a "zombie unicorn" and towards a path of sustainable success. Embrace these challenges as opportunities to innovate and transform your business practices, ensuring your company not only survives but thrives in the evolving economic landscape.

> “We are two years into the correction; I’m thinking it’s gonna take another five years.”
>
> \- Mark Suster

Here are some strategies that company leaders can adopt to steer their businesses toward sustainability and growth:

Step 1. Restructure for Growth and Profit:

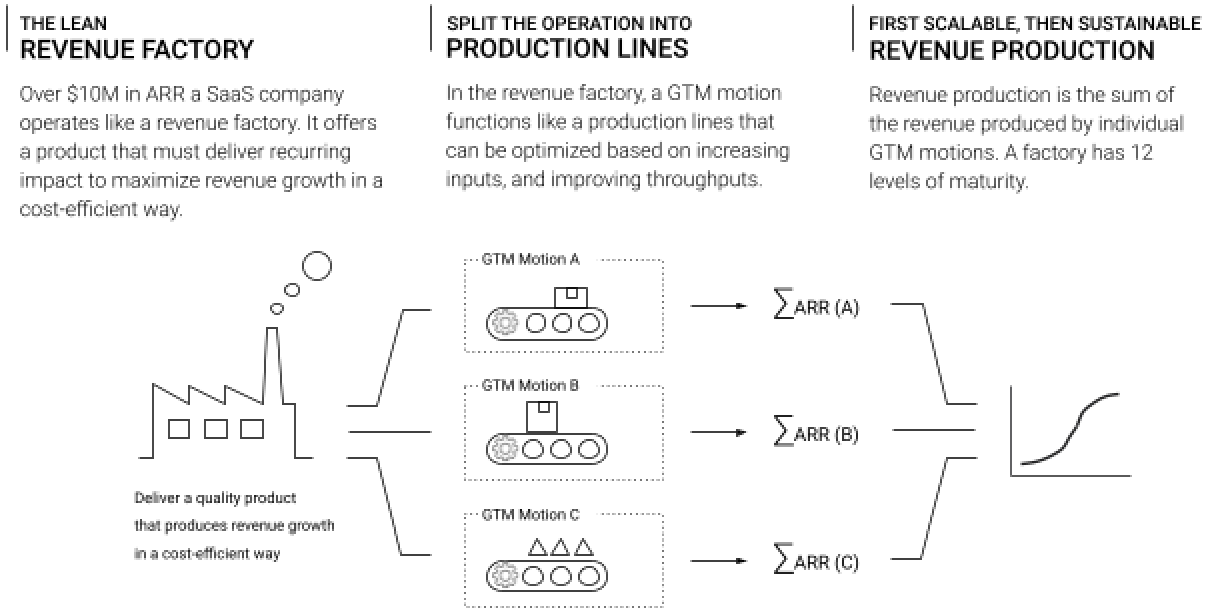
CEOs must realign their companies on sustainable growth, profitability, and customer-centric strategies.

Step 2. Implement the Lean Revenue Factory Approach:

A recurring revenue business with over $10M in ARR is seen as a revenue factory in which GTM motions operate like revenue production lines. Each production line can be optimized for growth against cost by identifying inefficiencies, and reallocating resources to maximize ROI. Decisions on where to cut and where to invest are data-driven, ensuring that each dollar contributes to the company’s long-term goals.

FIGURE 5.

A subscription business operates like a revenue factory with a number of production lines (GTM motions). Each production line signifies a different revenue stream, characterized by specific growth metrics and cost structures.



Step 3. Revamp GTM Teams:

The new strategy requires companies to transition from a growth-at-all-costs model to prioritize existing customer value, renewal rates, and upselling. This involves retraining teams and restructuring roles to enhance organizational efficiency by reducing costs and boosting effectiveness through increased production or growth, alongside improving customer experience.

Step 4. Commit:

The pivot takes 18 months to see results. It's crucial for CEOs to set realistic expectations and remain committed to the new direction.

Conclusion

The landscape of startup financing and growth has undergone significant changes, particularly in the wake of the 2022 market downturn. As many high-valuation companies now face the realities of unsustainable growth practices, this dichotomy has exposed vulnerabilities within the venture capital model and the companies it aims to propel. Critical questions arise: Can the misalignment between the traditional VC-driven business model, which emphasizes rapid scaling and high valuations, and more sustainable, low-cost growth practices be effectively bridged in a market still fundamentally focused on high growth? Furthermore, what would such a reconciliation mean for the venture capital business model? If VCs and their portfolio companies shift towards prioritizing profitability over sheer growth, it could fundamentally alter the strategies that have dominated venture funding for decades. This potential shift raises profound questions about the future dynamics between investors and the startups they fund, suggesting a possible evolution—or even a revolution—in venture capital methodology.

Final Reflection

The journey from startup to stable, profitable enterprise is fraught with challenges, but it is also ripe with opportunities for those willing to adapt and lead with foresight. Let us move forward with the understanding that true success is built on the foundation of sustainable practices that benefit all stakeholders—customers, employees, and investors alike.

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Ref. 6: Cruchbase: Navan Funding rounds

Abbreviations used:

ARR - Annual Recurring Revenue
BI - Business Intelligence
CFO - Chief Financial Officer
CMO - Chief Marketing Officer
CRO - Chief Revenue Officer
GTM - Go-to-Market
ICP - Ideal Customer Profile
IPO - Initial Public Offering
PMF - Product Market Fit
SaaS - Software as a Service
SCI - SaaS Capital Index
VC - Venture Capital