Venture capital restarts: Navigating the funding desert to unlock extreme value

October 2023

In the current venture capital landscape, a phenomenon known as the "funding desert" – where the amount of capital that startups need to sustain operations relative to the amount they are receiving is at historic lows – is reshaping how investors and startups interact.

We believe that this scarcity of funding is not merely a hurdle; **it's a forcing function that increases the role that the Venture Capital Restart plays in the ecosystem**.

Unlike traditional venture investments, restarts often demand a higher level of conviction due to their inherent complexity and risk. However, when executed correctly—especially for companies that have achieved product-market fit—we believe that these restarts can be a wellspring of extreme value creation. Conversely, VCs that lack the ability to appropriately underwrite and support restarts can leave immense value on the table.

What is a Venture Capital Restart?

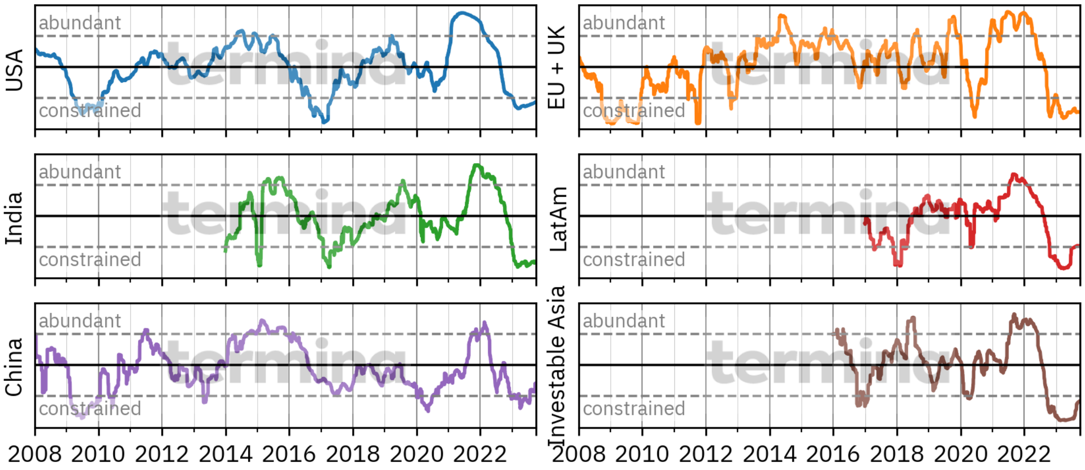
A Venture Capital Restart is not a mere pivot; **it's a comprehensive refocusing of a company's business model, often accompanied by a reconfiguration of its capital structure, which includes recaps**. This could range from a complete recapitalization to more modest financial adjustments. However, there's nothing modest about the shift in product focus. It's usually a radical change that requires extreme conviction from both investors and founders. This shift often manifests in a completely different growth pattern compared to the company's previous trajectory.

We are excited to share three case studies of restarts, successes and failures, as told by the CEOs who navigated those tumultuous times.

Finally, we share some ways that measuring product-market fit characteristics can aid in the process of understanding restarts. Our newly-launched sister company Termina opens up such quantitative methodology to the broader Venture Capital ecosystem.

The Fundraising Desert moves restarts to the forefront

The process of overhauling a business model is fraught with risk, and not all restarts may yield the desired outcomes. As mentioned, we are in the midst of a historically extreme shortfall of capital in Venture. Our gauges, which we explore in depth in our previous writing, are updated below. Today we are 1 year into the desert and we anticipate at least another year before the supply of Venture Capital exceeds the demand. **And to get there, a continued capital restructuring has begun taking place, which we believe will likely accelerate and become an increasingly prominent toolkit for sophisticated operators and investors during this period.**



The Global Weather Report, October 2023. Powered by Termina.

In an environment defined by funding scarcity, the Venture Capital Restart offers a compelling alternative for both investors and startups willing to embrace extreme conviction and calculated risk. So, as we navigate this funding desert, we believe that Venture Capital Restarts can be a powerful tool for extreme value creation—a high-risk, high-reward strategy that, when executed well, can redefine the growth narrative for startups and investors alike.

When Docker restarted, Scott Johnston focused on calming the storm and financially incentivizing the go-forward team.

- Docker is among the most well-known brands in the world among software developers for their pioneering products around containers, a technology that makes applications portable across infrastructure.
- As of October 2023, Docker is over $150M ARR and profitable. But in late 2019, when Docker went through its restart, they had low-single-digit revenue and a complete executive team overhaul.
- Read more detail in our short report on Docker's product-market fit turnaround.

In our discussion on this topic with Scott Johnston, CEO of Docker, he underscored the pivotal role of focusing on the team and culture during the transition.

Docker's commitment to transparency was evident. They introduced measures like equity reloads, tenure benefits, and accelerated incentives to retain talent. They also championed an open roadmap, actively seeking feedback from their internal developers as well as the broader Docker developer community, and allowing them to influence the company's product direction.

“We focused on hyper-transparency. We started with daily all-hands meetings, then weekly, and eventually monthly. We were open about our attrition stats and our financial situation. We also had a trusted HR professional on the executive staff to help manage the transition.” (Scott Johnston, CEO of Docker)

However, the journey was fraught with challenges. Docker had to manage unforeseen restructuring costs and ensure they maintained an 18-month operational runway. The company also grappled with a 40% attrition rate in the first 12 months, prompting introspection about employee fit at every level of the organization.

“Given the complexity and unknowns of a restructuring and divestiture, we had to be very careful with our financial planning. It was a lesson in ‘measure twice, cut once.’ We also had to adjust for the fact that the risk-reward calculus of Series D employees was different from that of Series A employees.” (Scott Johnston, CEO of Docker)

When Shiprocket restarted, Saahil Goel focused on value creation: “In a restart, the valuation is an afterthought, what really matters is how large the company can get”.

- Shiprocket, an emerging N-of-1 company, services tens of thousands of Indian ecommerce merchants every month, servicing 200 million ecommerce transactions a year across their verticalized logistics offerings.
- The insight that led to their sustained growth happened while their first Indian customer-to-customer (C2C) offering “Kraftly” was failing but led them to the insight that the core problem in Indian ecommerce is logistics.
- Saahil Goel, Shiprocket’s CEO, could have started a new company with a fresh ownership structure. Still, instead, he focused on building value first due to extreme conviction and never turned back.

Saahil Goel, CEO of Shiprocket, shared the journey of his company, emphasizing the resilience and commitment of their board and leadership. Before Shiprocket, their previous venture, Kraftly, was on the brink of running out of funds. Despite this, the team's attachment to their vision kept them pushing forward. They had raised significant capital for Kraftly, but when funds dwindled, they had to shut it down.

The team then needed just $500k to clear liabilities. Their plan was to reduce the team to 25 members and pivot to building Shiprocket. They were confident in this move, having already worked on the

Shiprocket side and having active contracts in place. However, investors presented them with a challenging proposition: either take $4 million or nothing. Despite only wanting half of that amount to avoid further dilution, they accepted the full sum.

Some advised the founders to start a new company altogether, but loyalty to their investors, who had supported them throughout, made them stick with Shiprocket. The founders felt a deep sense of responsibility and gratitude towards their backers.

“Equity is a touchy subject. Some key team members left partly because of it. But we believe that if the company does well, everyone will benefit. We're more focused on growing the company than worrying about individual equity stakes.” (Saahil Goel, CEO of Shiprocket)

The team dynamics were also highlighted. Akshay, one of the founders, considered leaving after shutting down Kraftly, the business he was brought on to lead. However, the excitement around a fresh 0 to 1 build with the core team convinced him to stay. The original idea for Shiprocket came from Gautam, another founder, who spent months teaching Saahil the ropes. The team's complementary skills were a significant asset.

The team received an acquisition offer from one of India's leading communications companies but declined, believing in their long-term vision. Saahil emphasized the importance of the right investors over mere valuation. He believes that if you have the right backers and a vision spanning decades, short-term valuations become less significant.

“In a restart, the valuation is an afterthought, what really matters is how large the company can get. If you have the right people around the table, it pays back in gold. When you're committed to a venture for the long haul, day-to-day valuations become less significant.” (Saahil Goel, CEO of Shiprocket)

Karn Saroya, previously the CEO of Cover, shares the hard lessons he learned from a failed restart.

- Tribe Capital was an early backer of Cover, a direct-to-consumer (D2C) insurance company. As they became an Insurance Carrier from their initial managing general agent (MGA) structure.
- Cover was growing rapidly but required a deep balance sheet to support that growth. When their fundraising efforts drew out, Tribe recapped the company to pursue their strategy as a Carrier.
- Ultimately, Cover was unable to access the capital needed to fully realize their strategy and Karn Saroya, Cover’s CEO through good and tough times, shares his account of key people and key moments.

We wrap up with a conversation with Karn Saroya from Cover. Karn had raised around $20 million before a recapitalization. Their fundraising efforts, which spanned about nine months, were challenging and reached a crescendo during the onset of COVID-19 in March 2020, which caused a crucible moment. Despite these challenges, Karn remained committed to the vision. He contemplated shutting down but persevered, especially after expanding operations in Texas and California. The hiring of industry experts further boosted his confidence. However, he admitted that a significant mistake was assuming that they could operate capital efficiently.

“Despite losing fundraising momentum, I still had conviction. We had opened up in Texas and California and had hired strong industry experts. My biggest mistake was thinking we could do it capital-efficiently, which was not the case.” (Karn Saroya, Former CEO of Cover)

After the recap led by Tribe, there was a material carve-out for management. The majority of this was allocated to existing employees and some to new hires. The company's headcount was reduced by almost half, transitioning to independent agency distribution. Karn emphasized the importance of not delaying tough decisions and going deeper when necessary. During the recap, the overall business environment was daunting. Communicating with smaller investors and angels about the "pay to play" model, especially during market volatility, was challenging.

Dealing with new investors was tough, but Karn later appreciated the feedback and learned to handle it better. He emphasized the dangers of scaling too quickly, advocating for a leaner approach.

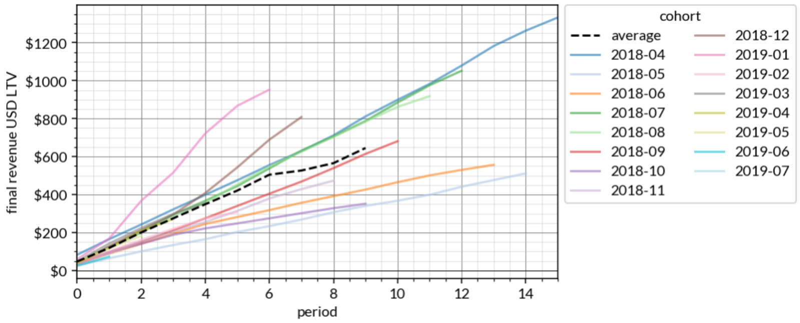
“Be very picky about doing a recap. It's so hard to make it work even if you have some existing business. Starting fresh has a ton of benefits. Also, people who raised at high valuations often think ‘we made it,’ but the metrics and a real business sometimes just aren't there.” (Karn Saroya, Former CEO of Cover)

Diligencing Venture Capital Restarts

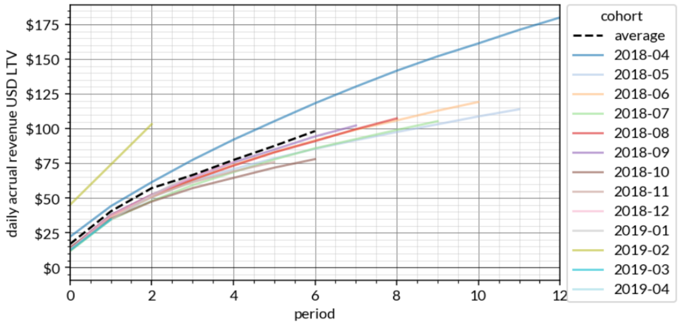
We are launching Termina to broaden access to the same **“operating system”** that Tribe Capital and others have used for quantitative diligence. While Termina can integrate into investment processes for a variety of opportunities, three ways it helps specifically with diligencing restarts are by (1) breaking mental anchors, (2) exploring reconfigurations of the business, and (3) mapping go-forward growth efficiency.

1. **Breaking mental anchors –** A common situation with restarts is **the ecosystem gets anchored in a company’s operations or value proposition pre-restart**. For example, even to this day there are many folks in the ecosystem who believe “Docker is dead,” despite their meteoric product launches since their restart. To this end, using Termina to diligence the company’s product-market fit is an effective way to take an objective view of a company irrespective of the biases or preconceptions that might exist. For this reason, understanding end user engagement, which would include developer engagement in Docker’s case, can provide a fresh look for parts of the business or brand that could be thriving as the legacy business model is sunsetting.

2. **Learning which configurations of a company have product-market fit, and which don’t –** At restart, a company may have the kernel of a successful product but elements of the legacy product or existing business that aren’t working. In the case of Shiprocket, their “Kartrocket” storefront product, launched after Kraftly, had sublinear LTVs indicating unhealthy growth and churn for a software company since software products tend to have linear LTVs. Their newly launched shipping aggregator, which led to the Shiprocket platform, had linear LTVs, which was uncharacteristically strong for transactional products with MSME’s which tend to be sublinear (especially in India). **That is, the configuration of the business around shipping and logistics was displaying superior retention to another configuration around their prior “Kartrocket” product**, an insight that Saahil understood deeply.

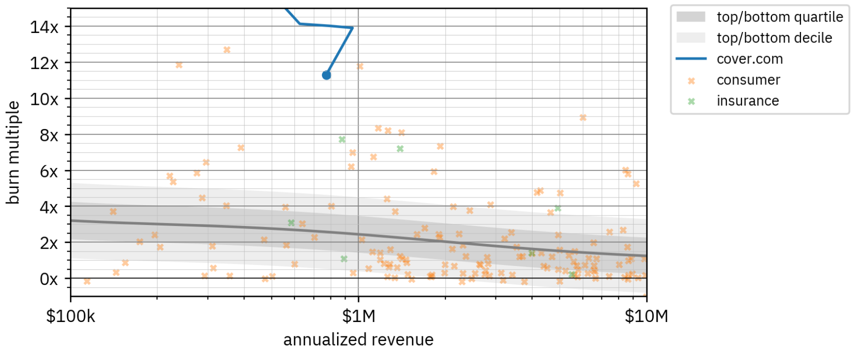


Shiprocket's linear-LTV "shipping" product at-restart with stronger product-market fit than their original "Kartrocket" e-commerce storefront product. Powered by Termina.



Shiprocket's sublinear-LTV legacy "Kartrocket" product at-restart. Powered by Termina.

3. **Growth efficiency and capital requirements benchmarking –** Companies going through restarts don't get a lot of extra chances. A restart can pull irreversible levers with capital structure and team morale. This means that the restart needs to be effectively capitalized because a restart is threading a needle. In the case of Cover, with the benefit of hindsight, Cover needed a lot more capital to reach escape velocity than it had at the time.



Retrospective benchmarking of Cover's growth efficiency circa their Restart. Powered by Termina.

To explore **Termina** in more depth, contact the team at hello@termina.ai

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