GreenHills Ventures – Investors want tech start-ups to prove they'll be profitable after WeWork's failed IPO

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KEY POINTS

- **At the Web Summit tech conference in Lisbon, Portugal this week, Greenhills Ventures attended along with potential investors agreed on a common message to tech start-ups: show us how you're going to make money.**

- **Investors have shifted their attention toward profits following WeWork's failed IPO and a string of high-profile public offerings from loss-making companies like Uber, Lyft and Peloton.**

- **Entrepreneurs and investors told CNBC the path to profitability is more important than a company making money right away.**

LISBON, Portugal — For tech start-ups trying to secure funding and go public, being in the black is the new black.

At the Web Summit tech conference in Lisbon, Portugal this week, more than 2,000 start-ups vied for the attention, and pocketbooks, of venture capitalists, big tech companies and investment firms. Potential investors responded with a common message: show us how you're going to make money.

"The narrative on the distance to profitability and the path to profitability becomes a bigger part of the story versus growth at all costs, and you're seeing that return," said Ravi Viswanathan, founder and managing partner of venture capital firm NewView Capital, in a panel Thursday titled "Is Silicon Valley Pivoting to Profits?"

Investors have shifted their attention toward profits following a string of high-profile IPOs from loss-making companies like Uber, Lyft and Peloton. WeWork was forced to scrap its IPO as investors soured on the company's massive losses, while Uber shares tumbled this week after the company reported a $1.1 billion net loss in its third-quarter earnings report this week.

"The narrative on the distance to profitability and the path to profitability becomes a bigger part of the story" Ravi Viswanathan, NEWVIEW CAPITAL FOUNDER

"A red flag is when your losses are growing quicker than your top line," said Tim Levene, partner and CEO of U.K. publicly-listed fintech venture capital firm Augmentum.

Entrepreneurs and fund managers at the conference in Lisbon told CNBC the debate between growth and profits has escalated in recent months as the financials of tech companies that soared to sky-high valuations in private markets were more closely scrutinized by public investors.

"The industry…it's reached another crescendo in terms of valuation," Blackstone CEO Stephen Schwarzman told CNBC's Karen Tso in an interview at Web Summit earlier this week, pointing to "artificial profit" that was built up as tech companies stayed private for longer than in the past.

Vision Fund blame game

Some investors blame SoftBank's $100 billion Vision Fund for distorting valuations in private markets by injecting unprecedented amounts of capital into unprofitable tech start-ups. SoftBank reported its first quarterly loss in 14 years this week because of write-downs from investments into companies like WeWork and Uber.

"My investment judgment was poor in many ways and I am reflecting deeply on that," SoftBank CEO Masayoshi Son said in a news conference Wednesday.

Despite these recent examples, entrepreneurs and investors at Web Summit argued a viable business model has always been key to securing funding.

“I think it’s always been the case where the business model with long-term sustainability ultimately wins,” said Sunil Chandra, CEO of European fintech unicorn OakNorth, which received a $390 million investment from the Vision Fund earlier this year.

Chandra, who defended the Vision Fund as “absolutely wonderful investors,” said the balance between profits and growth has always been a “difficult trade-off” for entrepreneurs, founders and investors.

Path to profitability

A common refrain at Web Summit was that the path to profitability, meaning the plan showing how revenues will ultimately exceed costs, is more important than proving the company is making money right away.

“I have no problem with companies investing for future growth and profitability down the road but you have to make sure you’re operating in a sound model which can become profitable,” said Taavet Hinrikus, founder and chairman of fintech unicorn TransferWise, which turned a £10.3 million ($13.2 million) net profit in its most recent fiscal year.

Rytis Vitkauskas, a partner at Lightspeed Venture Partners, said in a panel Thursday some of the most successful tech start-ups have taken years to be profitable.

“Not all companies are created equal,” he said. “So long as you’re growing very fast and you’re spending very fast, so long as that duality is sensible, some of the best companies get created that way.”