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Tech startups' differing funding paths hold risks, gains for BCOs

[Eric Johnson, Senior Technology Editor](#) ([users/eric-johnson](#)) | Aug 29, 2018 3:08PM EDT

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The critical questions for early-stage software providers targeting the beneficial cargo owner community are these: what is the best path to reach shippers in a financing environment flush with cash? And can a startup get traction among customers quickly enough to drive revenue, or does it need outside investment to help it develop scale? Photo credit: Shutterstock.com.

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The persistent debate in the world of technology startups about the merits of fundraising versus bootstrapping, or self-financing, may seem to shippers like a technical discussion with little relevance to their business. But how startups fuel their expansion can have real-world implications on the level of service shippers receive — and for how long.


The critical questions for early-stage software providers targeting the beneficial cargo owner community are these: what is the best path to reach shippers in a financing environment flush with cash? And can a startup get traction among customers quickly enough to drive revenue, or does it need outside investment to help it develop scale?

There are pros and cons to both approaches. Companies that fundraise with venture capital groups get space to develop products that the market needs without worrying about day-to-day viability. That's offset by the time it takes founders to raise money, and by the potential to get in a cycle of fundraising rather than honing the business for the benefit of shippers.


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Companies that bootstrap can spend their time building a business that must be necessarily profitable, however, they risk missing opportunities to solve higher-level industry problems that they might be able to tackle if free from the constraints of needing to be profitable.

Go it alone or seek cash?

"When we stopped fundraising we were able to concentrate much more on how to drive true profitable business and get closer to our customers," said Cory Margand, CEO of the freight rate marketplace SimpliShip. "That being said, it also significantly delayed our product development."

And therein lies the rub when it comes to which path logistics software startups should take. Chasing venture capital money is impactful for a young tech company because it's time-consuming, and can distract from the company's ability to focus on product development and customer engagement. Second, it can signal that a company is headed down a certain track — that is, one defined by growing topline revenue and seeking additional rounds of funding.

This model is unmistakably tied to venture capital (VC) firms, the ambitions of which are generally not to foster the steady advancement of a solid, profitable company, but to back a company with the potential to transform an industry. In other words, VCs are not looking for a profitable regional taxi company, [they're looking for Uber](https://www.joc.com/trucking-logistics/trucking-freight-brokers/uber-freight-expands-reach-small-us-truck-fleets_20180604.html). (https://www.joc.com/trucking-logistics/trucking-freight-brokers/uber-freight-expands-reach-small-us-truck-fleets_20180604.html)

"To me, it comes down to, are they operating a good business or are they not?" said Chris Kirchner, founder of the supply chain connectivity platform Ssync. "And that gets lost in this idea of changing the world."

Color Kirchner unimpressed with the VC model. A recent arrival to the belly of the VC beast, the San Francisco area, Kirchner has resisted the advances of nearby Silicon Valley investors that he believes don't know enough about logistics and are too concerned with top-line growth.

An evaluation of the VC system

"VCs want you to raise more money," he said. "They show paper gains every time you raise, they acquire more of the company. VCs operate on greed, power, and fear, meaning money, control, and fear that they'll miss out on the next \$1 billion company. It's a power dynamic — because they have the cash, they think they have control. But cash is a commodity — there's a lot of people with a lot of money. We've raised \$2.5 million, but there's no one investor with more than \$400,000 in us. No one in the VC world period."

Kirchner said the cycle of raising money to get to the next round, while tried and true in Silicon Valley, doesn't serve logistics customers well.


"That's at the core of what's wrong with the fundraising," he said. "They get so lost in fundraising that they don't ask what's my revenue target. What's going to help my customers? The only time revenue is brought up is, what do we need to get to our new round?"

While Kirchner explored the VC route, he eventually turned them down. "I don't want to get in this cycle of continually raising money," he said. "I want to focus on my fiduciary duty and my customers. My customers don't care if I raise another dime, and neither do my investors."

Margand noted a similar experience: "Raising capital is extremely time-consuming and draining unless you have such a wide and close network or previous exits that ensure you can raise funds at the snap of your fingers. I also think that this is due to the fact that the typical seed investor now seems to be looking for more mature businesses with significant annual run rate, which makes it challenging."

There's no doubt fundraising is a burden for founders, even those whose business plans revolve around multiple rounds of funding. As Ryan Petersen, CEO of the [digital freight forwarder Flexport](https://www.joc.com/international-logistics/logistics-providers/flexport-proving-global-logistics-has-room-better-ideas_20180130.html), (https://www.joc.com/international-logistics/logistics-providers/flexport-proving-global-logistics-has-room-better-ideas_20180130.html) put it to *American Shipper* in September 2016 when the company announced a \$65 million Series B round of funding that was more than it had initially planned to seek, "fundraising was such a big pain, I didn't want to do it again for awhile." The company raised a Series C round, worth \$110 million, a year later and then added another \$100 million in strategic investment from the Chinese parcel giant SF Express in April 2018, six months after the Series C.

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Fundraising's chic quality

But there's no doubt that fundraising brings a certain cache in the tech industry. As the serial technology entrepreneur Rand Fishkin phrased it on Twitter in August, "Make \$10mm. Crickets.

Raise \$10mm. Everyone writes about you. You get invited to all the hot events. Your network goes crazy with congratulations. This is how we get a culture that trains founders to raise \$\$ > make \$\$."

In today's environment, with VC groups itching to invest in some undiscovered part of the logistics industry, Margand and Kirchner are the outliers. The vast majority of logistics startups have taken some money from VCs, whether in the form of a pre-seed, seed, or Series A, B, or C rounds.

"More or less, it's a math problem," said Nina Luu, CEO and co-founder of the [shipment management software startup Shippabo](https://www.joc.com/trucking-logistics/tracking-incoming-teus-called-key-finding-portside-us-trucks_20180529.html) (https://www.joc.com/trucking-logistics/tracking-incoming-teus-called-key-finding-portside-us-trucks_20180529.html). "It depends on how big the market is, the go-to-market strategy. Whether the company is revenue- or growth-focused. And the question surrounding fundraising should be tied to what you decide your business strategy is."

Luu has had experiences on both sides of the fence. Shippabo has raised \$950,000 in venture capital money, but she bootstrapped the previous company she founded, a home textile importer.

"We had a discussion about whether to have fundraising or not, but ultimately decided against it," she said. "At Shippabo, we're a very software-focused company. The benefit of VC money is you can focus on product market fit. Building software takes time, and the buying process takes time. And shippers often have never bought software like ours before, so it's like a new market. So how do we leverage a venture-backed business and empower users in a way that matters."

To Luu, fundraising allowed her company the space to grow into its market, and to develop that market from an internal talent and customer product fit perspective.

"Recognizing that a lot of people have freight forwarding experience but have never been in software," she said. "And recognizing the quality of revenue through product market fit, as opposed to gaining revenue to just stay alive."

VC community's different objectives, economics

For many observers of the flood of VC money into logistics, the avoidance of profitability is anathema to their experience running companies that had to yield profit. That's a tough habit to break.

"VC is based on hope and promise and the ability to generate revenue and growth," said Jon Slangerup, CEO of American Global Logistics (AGL). "VC rewards the physical growth — not just revenue growth but infrastructure growth. As many people and points of location as possible. Create critical mass. It is a proven model. The trouble is, the success ratio is very low."

Slangerup, who took over at the top of AGL as part of a private equity investment group, also has experience on the VC side, having led a logistics startup in the early 2000s. In private equity, he said, it's the opposite, with the focus on buying already successful businesses and making them better.

It's a model that Kirchner believes in as well. "The private equity space I think is great for entrepreneurship, because it's responsible. They want companies that are generating profits."

Indeed, the amount of private equity money invested into [logistics technology](https://www.joc.com/technology/logistics-start-overcomes-national-cryptocurrency-crackdown_20180730.html) (https://www.joc.com/technology/logistics-start-overcomes-national-cryptocurrency-crackdown_20180730.html), far exceeds the venture capital money that has recently penetrated the market. Just this week, Summit Partners acquired the transportation management software (TMS) provider MercuryGate for an undisclosed sum, having already made an investment in Infor, which itself bought the global visibility and shipment execution software provider GT Nexus in 2015 for \$675 million. In 2016, the private equity groups Blackstone and New Mountain Capital invested \$575 million in the supply chain software provider JDA. Another capital group, TPG Capital, has invested in TMS provider Transporeon, supply chain design software company LLamasoft, and global trade management software provider BluJay Solutions.

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All these investments were made in established, profitable software providers. Of course, most of these companies were once startups, backed by their own crop of early stage investors. And many startups today see the end game as luring private equity groups into a \$500 million to \$1 billion investment.

“Is it a bad idea not to be profitable?” Luu said. “VCs have their own economics they work through, but as an investor they try to understand your business. They’re trying to figure out whether they’re investing in something that can be that home run.”

For early stage companies, the issue is first finding a product that drives a certain level of revenue and then scaling once that fit is found.

“It’s hard to be profitable because you’re going to have to build on that software,” she said. “The revenue has to be repeatable and scalable. That’s about renewal rate, retention, and acquisition costs getting lower.”

Luu cited an article in the tech journal SaaStr that she keeps close at hand for reference.

“If you’re going with a software model, it’s hard to get to the first \$2 million in annual revenue,” she said. “And the vast majority of these companies will fail between \$2 million to \$10 million. But once you hit \$10 million, it’s about scaling it to \$100 [million], because you’ve found that profit fit. And then it’s no longer about survival. It’s about how you get to \$100 million and whether there are existing players who have entered your market.”

A recent example of this scale through revenue is SwanLeap, a TMS provider recently named by *Inc.* magazine as the fastest growing private company in the United States. The company had \$100 million in revenue in 2017 and CEO Brad Hollister told *Inc.* he expects to earn more than \$400 million in 2018. He also said he turned down venture capital investment for a prior supply chain software startup because he didn’t think the product was going to be adopted by the industry.

It’s an inexact science, and that makes for a difficult-to-navigate environment for shippers determining where to invest their precious logistics technology budgets. Shippers would do well to study not just the software capabilities of their chosen service providers, but also how much money those companies have raised and what that says about their ability to serve them and remain viable entities.

Again, one path is not right for every startup. Luu, for instance, suggested that service provider startups might need a more continuous flow of VC funding because their requirements to scale often involve opening offices and hiring more customer-facing personnel, as opposed to pure software providers, who can concentrate the proceeds of their funding on engineering.

Flexport’s experience

Sanne Manders, Flexport’s chief operating officer, said on a recent podcast hosted by Radu Palamariu, managing director of Morgan Philips Executive Search, that the company has indeed split its more than \$300 million in funding on building its tech and its global footprint.

“In general, what do we do with the money?” he said. “Most of it goes into technology development. People think we subsidize freight, but we’ve never done that. It goes into building a warehousing infrastructure. Strategic investments with relatively short-term payback on the infrastructure side and a lot of long-term investment on the technology side.”

The other thing to consider is the exit. While every company is for sale at the right price, in general, principles at profit-seeking logistics companies generally don’t eye quick exits. But it is a feature of technology startups to either be bought at a sizable multiple, or to land an initial public offering. And that means the amount of venture capital investment a startup takes on makes a difference.

“Would you rather raise just \$2 million in one round at a \$8 million valuation and sell for \$50 million a couple years later?” Margan said. “Or, raise \$50 million through six rounds and only have the option to sell for, let’s say \$500 million plus? Realistically, in SaaS, you will need more than one round but maybe not. Either way, I’d much rather be the former.”

It’s impossible to generalize, but Margand said a good formula for a logistics startup might start with a \$1.5 million to \$2 million seed round or Series A, followed 12 to 18 months later by a second round of \$6 million to \$10

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million. "That, I think, is the sweet spot."

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