Ways To Identify the Most Promising Startups

small business lending business customers

Summary: A challenging economy hasn't deterred startups, which continue to be formed at record rates. As CFIs seek to identify the most promising startups seeking lending, there a few key things they should be looking for.

The first formal yearbook to mark the events of a school year and contain photographs of the graduating class was published in 1806 by Yale College. In the years since, yearbooks have become a staple rite of passage for high school and college graduates and have evolved to contain lots of other content, including the "most likely to succeed" superlative. More often than not, however, the consensus of high school students regarding the likelihood of success among their peers is little more than a popularity contest and has proven wildly inaccurate.

While most people within the banking industry probably don't remember the individuals named as most likely to succeed within their high school graduating class, community financial institutions (CFIs) know a little something about determining the most likely to succeed among startups that are seeking financing.

The Startup Landscape

There are few areas of the economy that were not impacted by COVID-19, and that includes the startup community. In the wake of mass layoffs, many people took the opportunity to revisit their priorities and pursue different career paths, resulting in a boom in the number of created startups.

In 2020, the Census Bureau reported that 4.4MM startups were formed in the US, a nearly 25% increase from the previous year. Startup activity remained strong in 2021, setting yet another record with 5.4MM startups formed. While things dipped a bit in 2022, with startup activity falling to 5MM, momentum has remained strong in 2023. According to the Economic Innovation Group, startup applications for the first half of 2023 outpaced the same period for 2022 by more than 7%, a pace that will come in just shy of 2021's record numbers, if it continues.

Not only have startups been launching at record rates in recent years, but a large number have already reached what venture capitalists refer to as the unicorn mark — the point where their value is deemed to be $1MM or more. According to estimates from Crunchbase, a total of 1,483 startups have reached the unicorn mark as of 2023, a group that together has raised a combined total of more than $904B in funding with a combined value of $5T.

Picking the Winners

While venture capital firms have traditionally been the main source of funding for the startup community, many newly created businesses will seek financing from traditional bank loans as well. Add to that the fact that Silicon Valley Bank — which failed this past spring — was a major source of financing within the startup community. It is even more likely that entrepreneurs in search of financing will eventually find their way to CFIs in search of funds. But it is important to remember that roughly 90% of startups will fail.

As your organization reviews startups seeking funding, here are a few questions to consider that may help identify the businesses most likely to succeed:

- **Have they timed the market right?** Timing is an important determinant of the viability of any business. Not only does a startup need a clear vision for the product or service it is offering, but it is also equally important to ensure that there is an identifiable market for their offering and that they are early enough to get their product or service out to those people before others get there. If duplicate products or offerings have already saturated the market, then it is far less likely that a startup will succeed.
- **What is their business plan?** Regardless of the product or service that a startup is selling, a thorough, well-thought-out business plan is key to success.
- **How skilled is their leadership?** Beyond a good idea, experienced management and leadership are also major indicators of a business' likelihood for success. Not only is it important for startups to have experienced leadership as part of their team, but there should be sufficient incentives in place to maintain those people for the long term. Startups with the potential for career advancement are more likely to attract and keep talented leaders.
- **Have they shown adaptability?** COVID-19 changed the game, and not every startup was able to adapt to the shift and modify their business models to accommodate it. Startups that embrace technology advancements — such as no-code software solutions, coupled with remote working and tapping expertise from virtually anywhere in the world — have a better chance of developing online offerings and products quicker and for far less money.
- **What is the state of their funding?** Sufficient funding is imperative. Beyond whatever funding a startup may be seeking from your CFI, it is important to be sure that an adequate amount of money has already been invested in the organization and that leadership is realistic about how much money it will need to remain viable in the future. According to CB Insights, 38% of startup failures are due to insufficient funding and the inability to raise more money.

Despite the challenging economic environment, the number of startups coming onto the scene is booming. As CFIs seek to determine the viability of startups seeking lending, it is important to factor in the changes over the past few years that have altered what metrics lenders should use to identify the nascent businesses that are most likely to succeed.

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ECONOMY & RATES

Rates As Of: 11/29/2023 05:50AM (GMT-0800)

Treasury	Yields	MTD Chg	YTD Chg
3M	5.47	-0.12	1.05
6M	5.42	-0.12	0.66
1Y	5.14	-0.29	0.44
2Y	4.67	-0.42	0.25
5Y	4.25	-0.60	0.25
10Y	4.32	-0.62	0.44

30Y	4.51	-0.59	0.54

FF Market	**FF Disc**	**IORB**
5.33	5.50	5.40
SOFR	**Prime**	**OBFR**
5.32	8.50	5.32