Financial startup valuations plummet as market takes closer look at fundamentals

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High-profile fintech startups are being forced to cut valuation as global equity markets force companies to raise funds at a substantial discount, leaving consumers and regulators wondering what may happen next.

Many private investors have had to take a hard look at the startups they're currently funding, with some becoming more leery of backing models that are years away from turning any profit, according to reporting by Reuters.

High-profile companies like payment firm Stripe and buy-now-pay-later vendor Klarna are just two of the many big companies that have seen valuations cut this year. They join a total of 81 other U.S. companies that have seen their funding slashed during "down rounds," according to data from PitchBook.

Reuters also reported that companies looking for early-stage funding are also seeing valuations reevaluated.

What's happening to Stripe?

Small business owners and nontraditional borrowers have seen some of their favorite fintechs affected by a retrenching market.

Fintech companies have been especially vulnerable to rising interest rates and potential recession concerns.

High-profile fintech company Stripe took a massive valuation cut, sources told the Wall Street Journal, with the internal value of shares getting cut by 28%.

Stripe is a high-profile financial tech company built for developers that provides a fully integrated variety of payment products required to build websites and apps that accept payment. It recently made headlines when it announced it was entering the identity verification space.

Stripe's valuation cut comes from a 409A price change, the Journal reported, meaning it hasn't decreased the preferred shares values sold in the last round, leading to more objective pricing chosen by a third party.

In an email obtained by the Wall Street Journal, Stripe's board approved a lower internal share price of $29 which also lowered the implied valuation of the shares to $74 billion, one of the sources told the Journal, but didn't give a reason why it had readjusted.

Fidelity investments cut Stripe's valuation in Marcy by 9%, Tech Crunch reported.

"Decreasing your valuation based upon current market conditions is something that happens on the private side and because Stripe is private, they privately cut their valuation," said Nicole Valentine, fintech director for the Center for Financial Markets at the Milken Institute.

That down round followed Swedish BNPL company Klarna's announcement that its valuation was cut by its investors by 85% to $6.7 billion.

Digital payment giants PayPal and Block Inc. Shares also saw a huge drop in shares at more than 60% this year, Reuters reported.

How are small businesses going to be impacted?

Fintechs have long touted technology as a way to make banking easier for small businesses, startups and entrepreneurs to apply for and obtain a business loan. The companies have also targeted nontraditional borrowers, who may need a quick personal loan but don't want, or can't qualify for, a traditional banking lending program.

What happens to those small businesses and borrowers when a fintech has to cut back services or staff because it has lost value remains to be seen.

Brian David Crane is the founder of CallerSmart, an app to research mysterious or unrecognized phone numbers.

Crane said he believes everything will soon correct itself, despite the fact that fall in fintech valuations sound like a dampener. He said in a statement once the economy stabilizes and recession fears subside, fintech could see a rebound.

"There is no doubt that fintech and digital payments have been a boon for small businesses and startups alike, so the demand for these tools is not going to go away," he said. "The low valuations may affect the share market or investors' interest, but I don't think businesses will stop using these services. If you look at the market dynamics, the core reasons for this low valuation are recession fears and market correction."

Valentine said the advantage of fintech is the increased efficiency, better pricing and broader access but in terms of inflation, the cost of doing business for small businesses is higher.

"In terms of what inflation is, the impact of inflation on fintech is if I am a company that is a small business and I am looking for a fintech solution, the cost of doing business is higher," Valentine said. "Some ways that inflation and these market changes haven't impacted small businesses and merchants are doing that using fintech."

Valentine said consumers who use fintech should focus on whether the fintech company they're using is delivering on its price and fees and how they affect their digital wallet.

"Assess whether they're willing to take on a particular debt or particular cost in the short term, and have a way to pay that forward in the future with an investment in the future of their business assuring their quality of life."

Will fintechs survive this inflation period?

This sector, excluding cryptocurrency companies, has also led tech companies to lay off staff in the beginning of 2022 with fintech startups leading the way.

Valentine said the inflationary period is going to separate the fintech companies that are built to last from those that are not.

"In Stripe's case, they mentioned that they put money into a rainy-day fund and today's that rainy day," Valentine said. "Stripe is going to kind of live on because it has those rainy-day funds, but for companies that are just starting out and delaying (initial public offering), they're basically cutting teams that aren't as valuable to the core business."

TechCrunch also reported that fintech startups received the most venture globally, accounting for 21% of dollars raised in 2021. But at the beginning of 2022, fintech startups accounted for the third largest number of layoffs globally.

Valentine said she sees an opportunity for fintechs to innovate and "rise from the ashes."

"If you're an innovator and you're looking for solutions for fintechs in these times, you're delivering on price and efficiency and access, then you can be the fintech that lives beyond this," she said.

"We build something for the moment and it's lasting so there's opportunity for new fintechs to arrive with new eyes," she said.

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