

LatAm
Digital
Report

4th edition

Startup Study

2023

McKinsey
& Company



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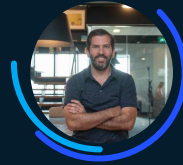
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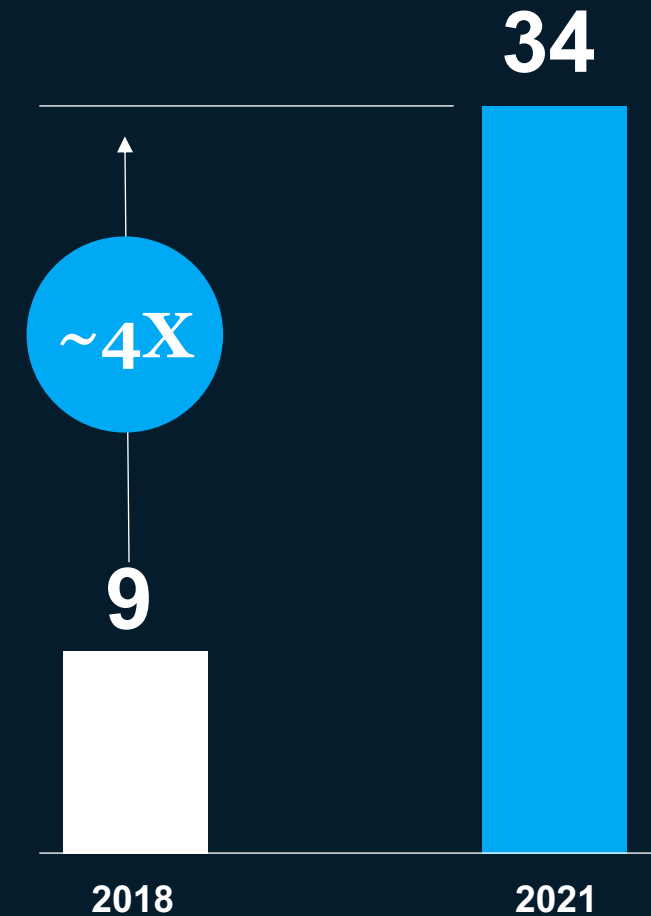


**In the last years
LatAm lived its
first significant
VC boom**

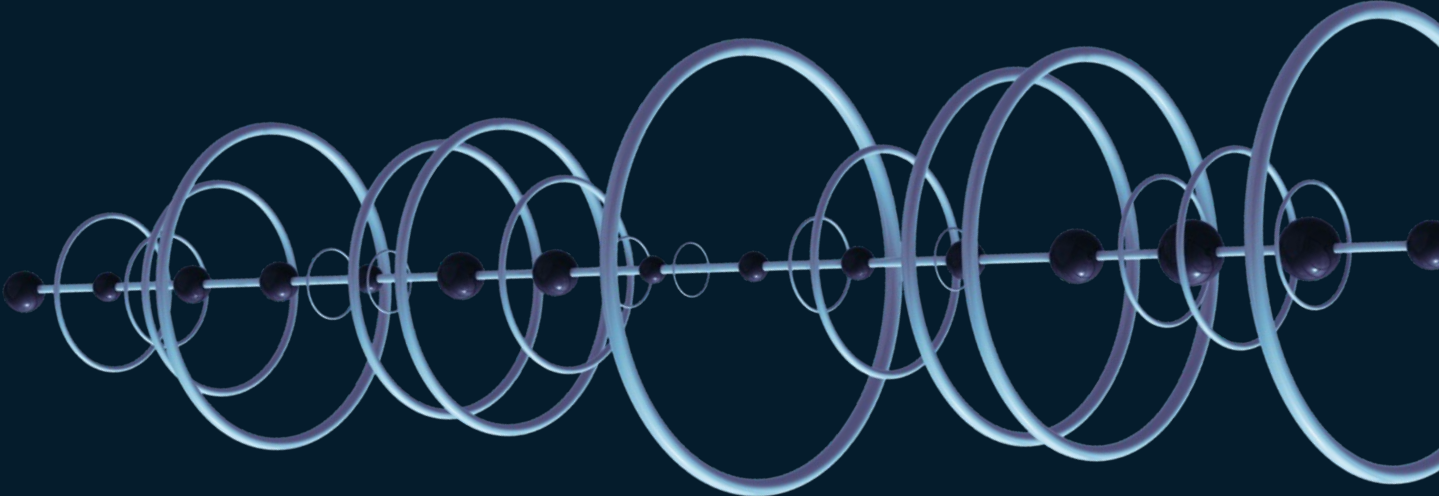
An innovation environment never seen before



Total number of unicorns in LatAm



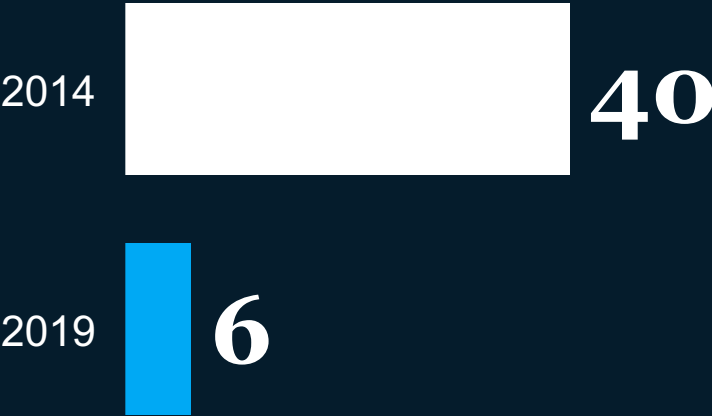
Startup's development cycle getting faster and faster



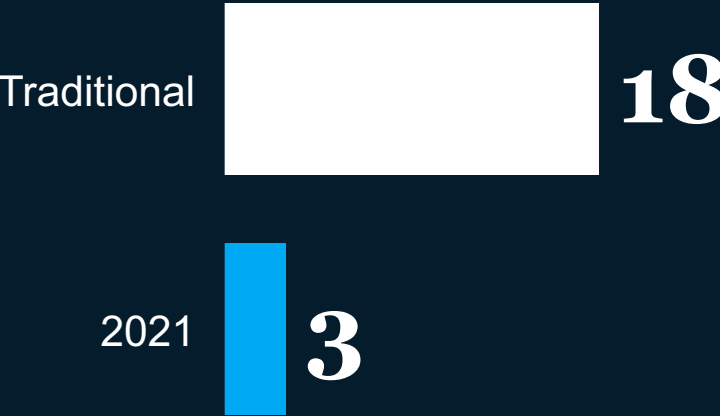
Cohort's minimum time to reach Unicorn status in years



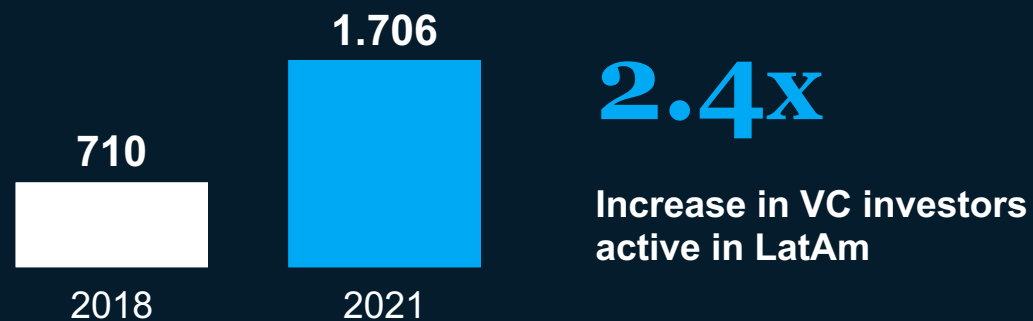
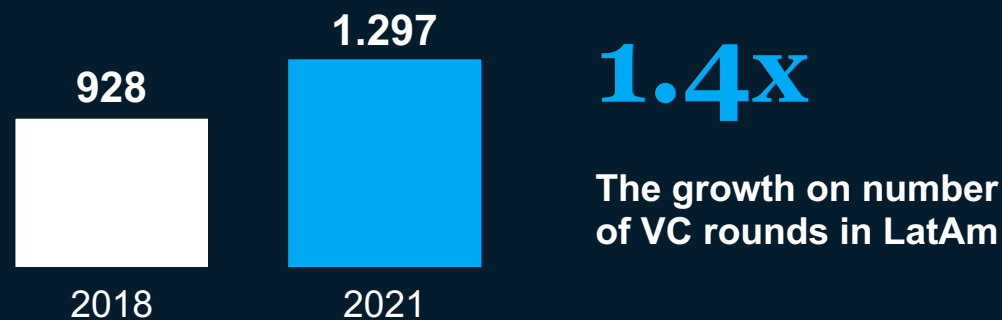
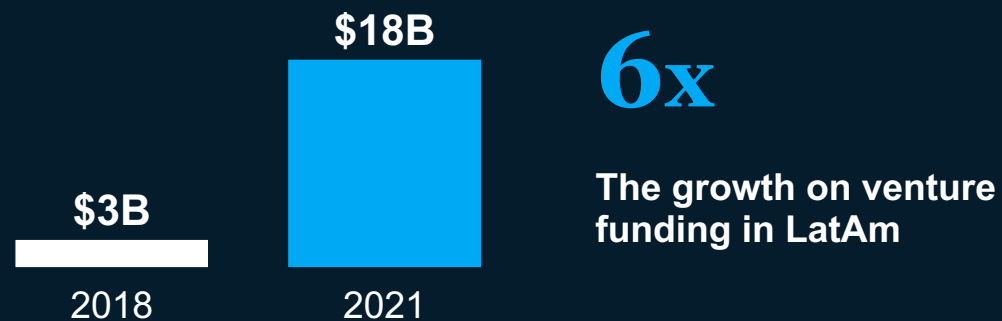
of months to reach one million clients by player



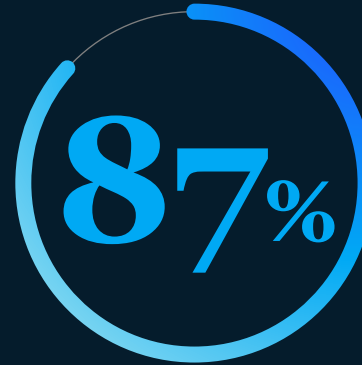
Risk and growth rounds blurred, reducing runway time (# months)



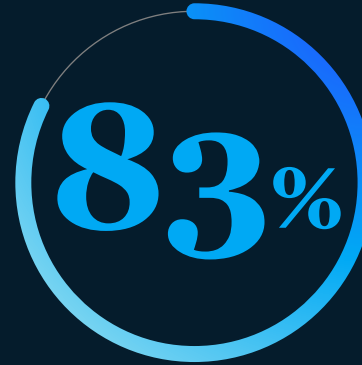
An abundance of capital flow in the region



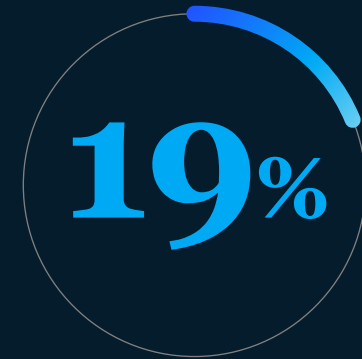
Changing the mindset of the next generation of talent



Of newly tech graduates would like to work for a startup



Of newly tech graduates would like to open a startup



Of newly tech graduates already have a business

Source: Survey conducted in April 2022 with Brazilian students recently graduated from computer science, computer engineering, IT, and other tech courses

And now we are living our first real down cycle

-30%

value markdown
on selected VC
Fund's portfolios¹

33%

of startups had
a down round²

-51%

in VC funding
volume between
2021 and 2022

1. Market estimation. Valor - Pipeline

2. Include startups in stages B+. Based on McKinsey LatAm Startup Study

So we conducted
a comprehensive
study to better
understand the
current context...

~200
Of the Top Startups
in LatAm surveyed

~30

Market leaders
interviewed¹

300+

Startup employees
surveyed

300+
STEM Students
surveyed

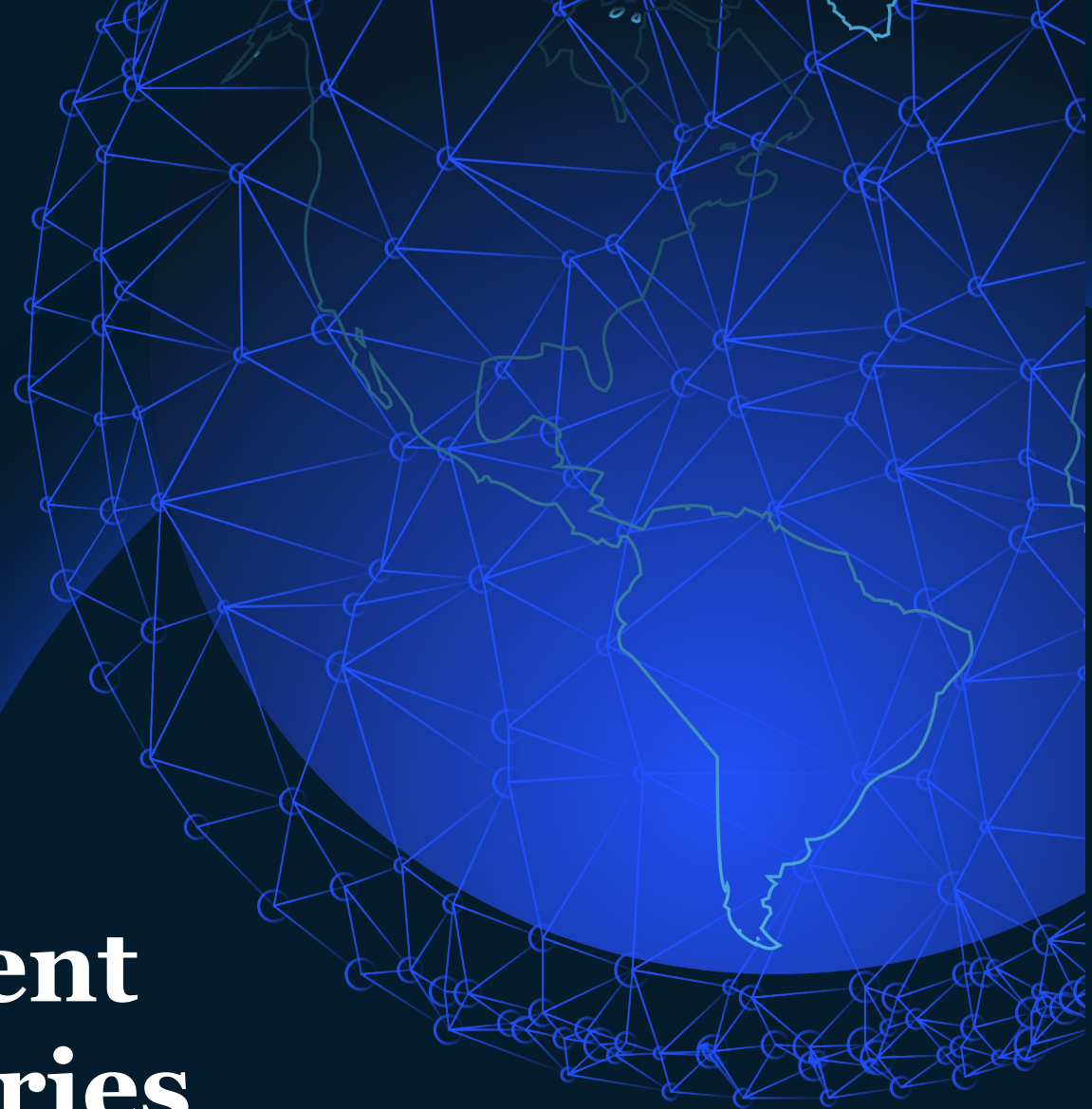
1. VC Funds, CVCs, Startup Founders and Legal Experts

**...covering a diverse
set of startups from
different geographies**

8

**Countries
covered**

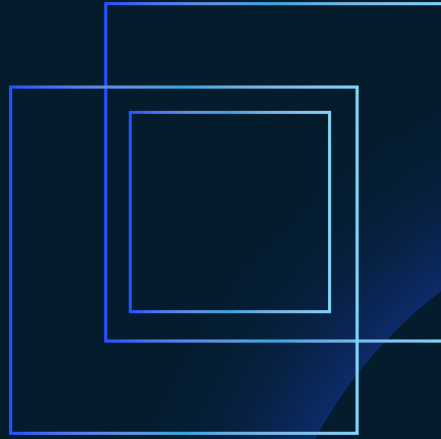
15+
**Different
industries**



**And here is a
summary of our
key insights**

1

**Funding
& Investor
Relations**



3

**Profitability
& Efficiency**



**we grouped
the main
insights into
4 DIMENSIONS**

2

**Product
& Growth
Strategy**



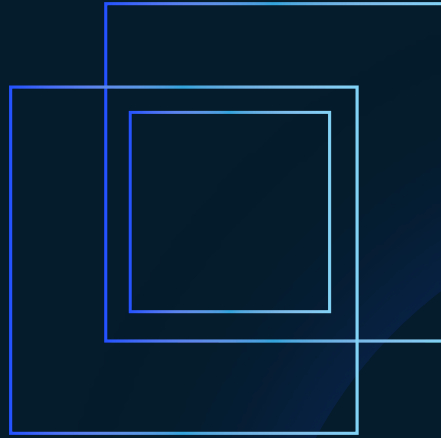
4

**People &
Culture**



1

**Funding
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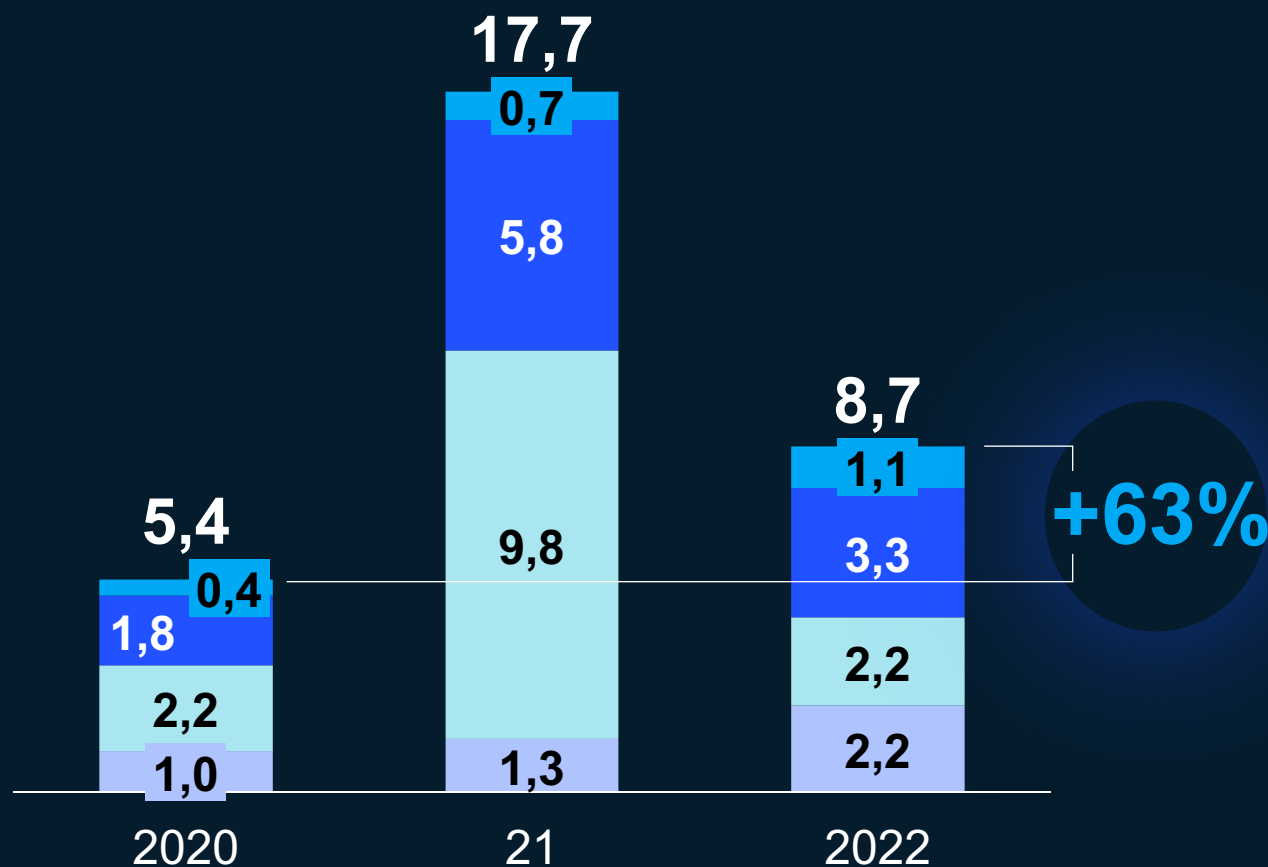
**People &
Culture**



LatAm venture capital volume

USD Bi

Angel-Seed Series A + B¹ Series C+² No information



1. Includes Series A and Series B rounds of funding stages

2. Includes Series C+ rounds of funding stages

Source: SlingHub

The volume of capital dropped, but is still 63% above pre-pandemic levels and is mainly available for early-stage startups

**Almost 1/3 of
startups have
less than
18 months of
runway**

30%

**of startups have
less than 18
months of runway¹**

“

Round cycles are getting
longer and VC Funds are
taking more time to close deals

VC investor

1. Include startups in stages Series A+

USD

2 Bi¹+

**Annual capital
shortage for series
B+ startups in
LatAm, estimated
by the market**

1. According to research done by Kamaroopin published on the NeoFeed website, 2023

Top 10 investors
active in LatAm were responsible for

40%

of deals
in 2021

BUT
FOR

24%

in 2022

Sources of
funding are
diversifying...

Source: PitchBook Data, Inc. Data has not been reviewed by PitchBook analysts

**...pushed by
local VCs that
are becoming
more mature and
experienced**

80%

of largest LatAm
based VC Funds¹ are
on the Fund III +

USD

2.2 Bi²

in dry powder from
Brazilian VCs

+150

new LatAm based
VC Funds emerged
in the past 3 years

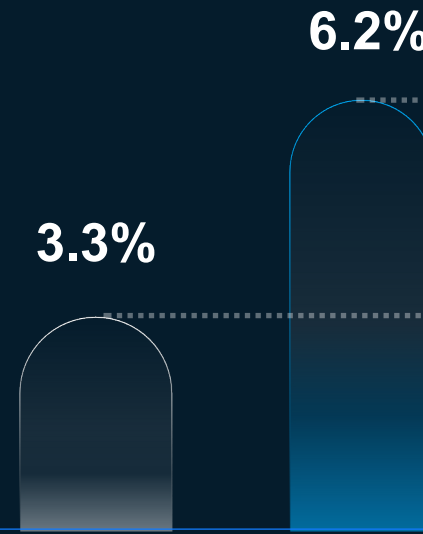
1. Selected LatAm VCs with more than USD100 million of capital raised

2. According to market estimation published in Spectra's Survey with Entrepreneurs Report (2023)

We see an opportunity to increase CVC volume in the region...

Penetration of CVCs

CVCs / # of listed companies



LatAm

US



Potential upside for CVC participation in LatAm of

+88%

representing
USD 2.5 billion

**CVC in Brazil is
a recent trend...**

**...and we observe common pitfalls CVCs
should avoid in order to be successful**

**...and CVCs
can become
even more
prominent by
adjusting their
operating
model**

73%

were founded
since 2020

12%

have a pure
independent,
third part
management
team

**High
dependency**

Lack of agility on decision
making process

**Lack of VC
mentality**

Weak monitoring on financial
performance and failure to
capitalize on synergies

**Limited leveraging
of its unique
advantage**

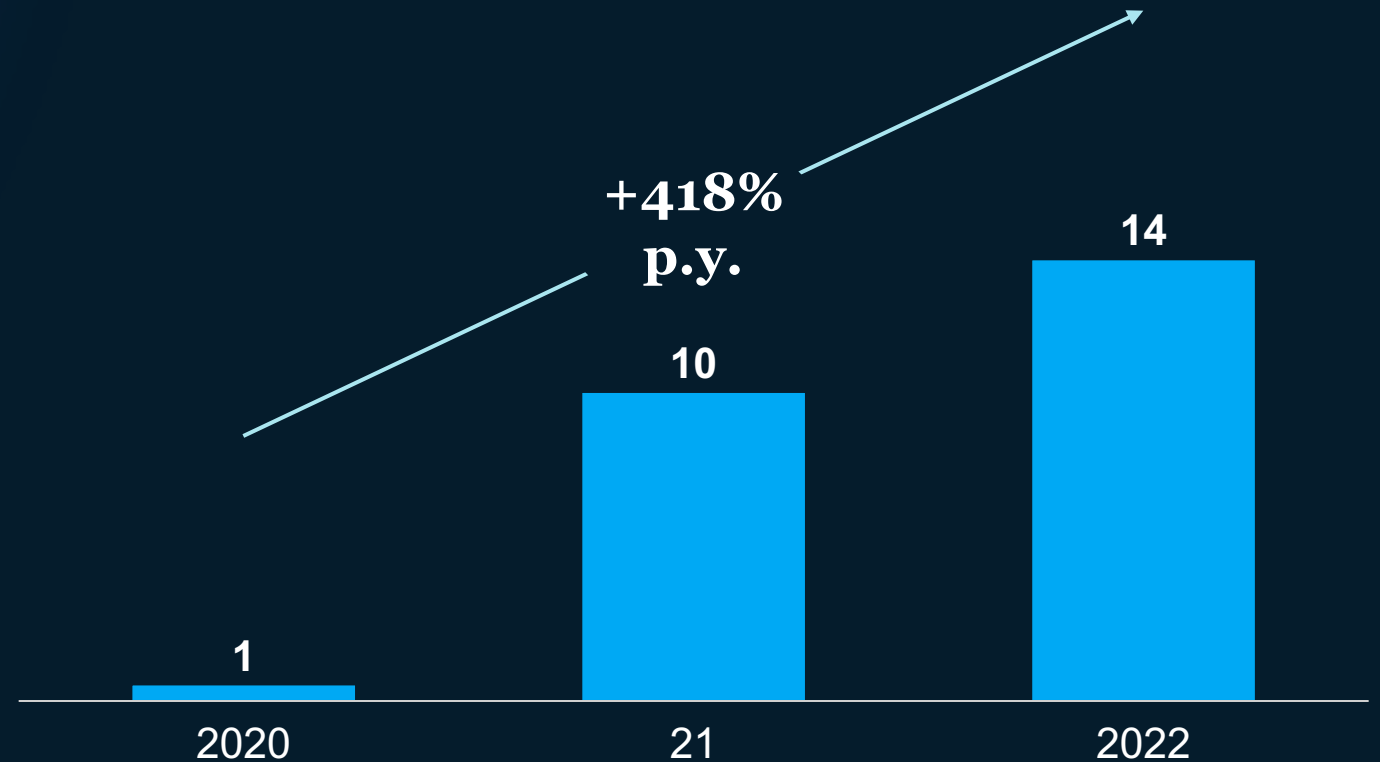
Failure to use industry
specific know-how to help
investments thrive

**Drowning in
bureaucracy**

Loss of autonomy for the
startup's founders and
management team

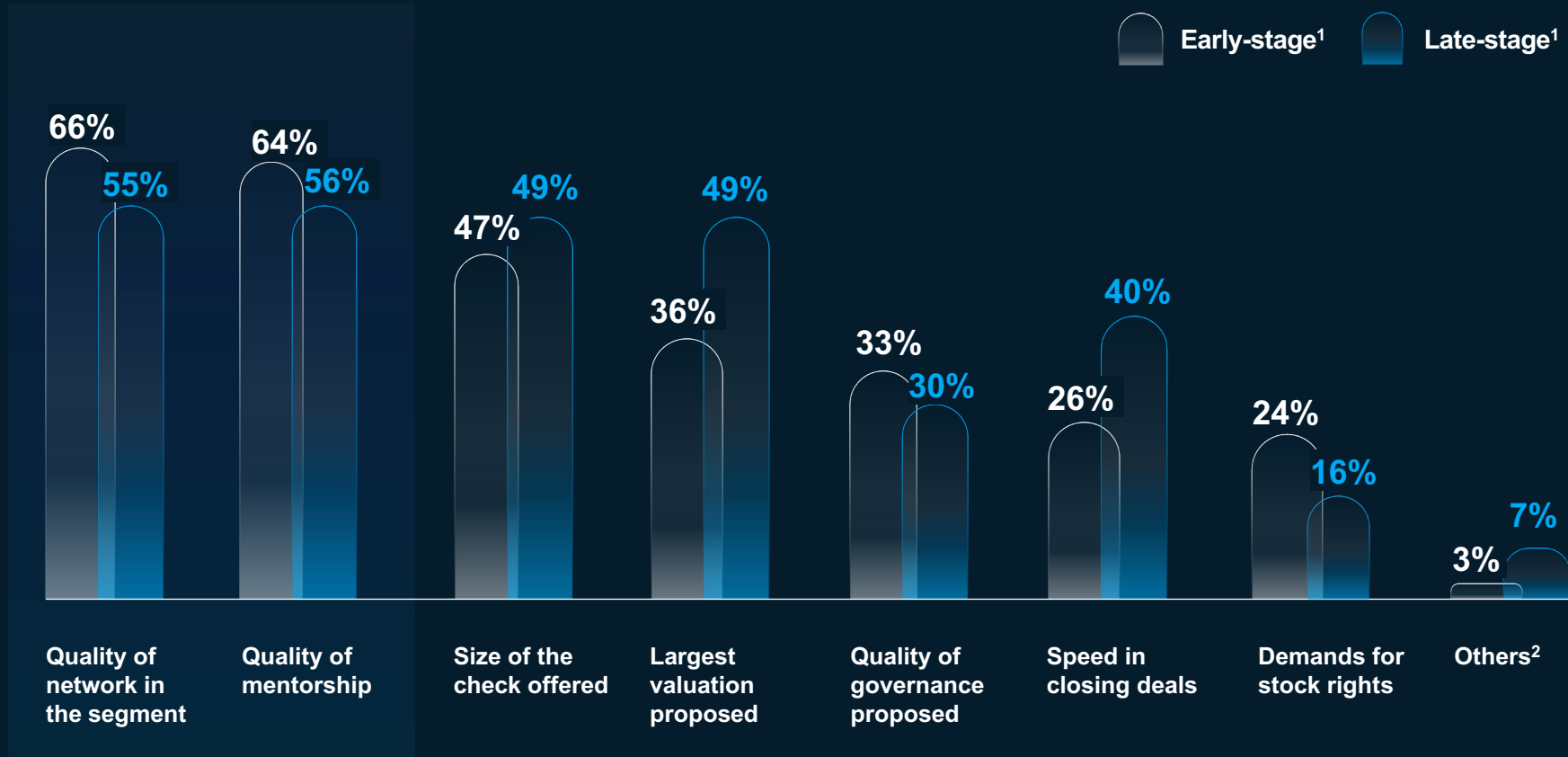
Despite the low volume, angel investors are increasing their participation in the market

Total LatAm VC volume invested by angel investors
USD MM



Main attributes startups look for in VC Funds

% of respondents



**VCs need to
continue to
evolve on
how they
support
startups**

1. Early-stage includes Seed and Series A stages; Late-stage includes Series B+ stages

2. Others include ethics, reputation with LPs, brand and commitment for future rounds

VC funds reported to be seeking closer involvement with startups and better deal terms

“

For the next 6 months, I intend to hold new investments in order to draw closer attention to my current portfolio companies

VC investor

“

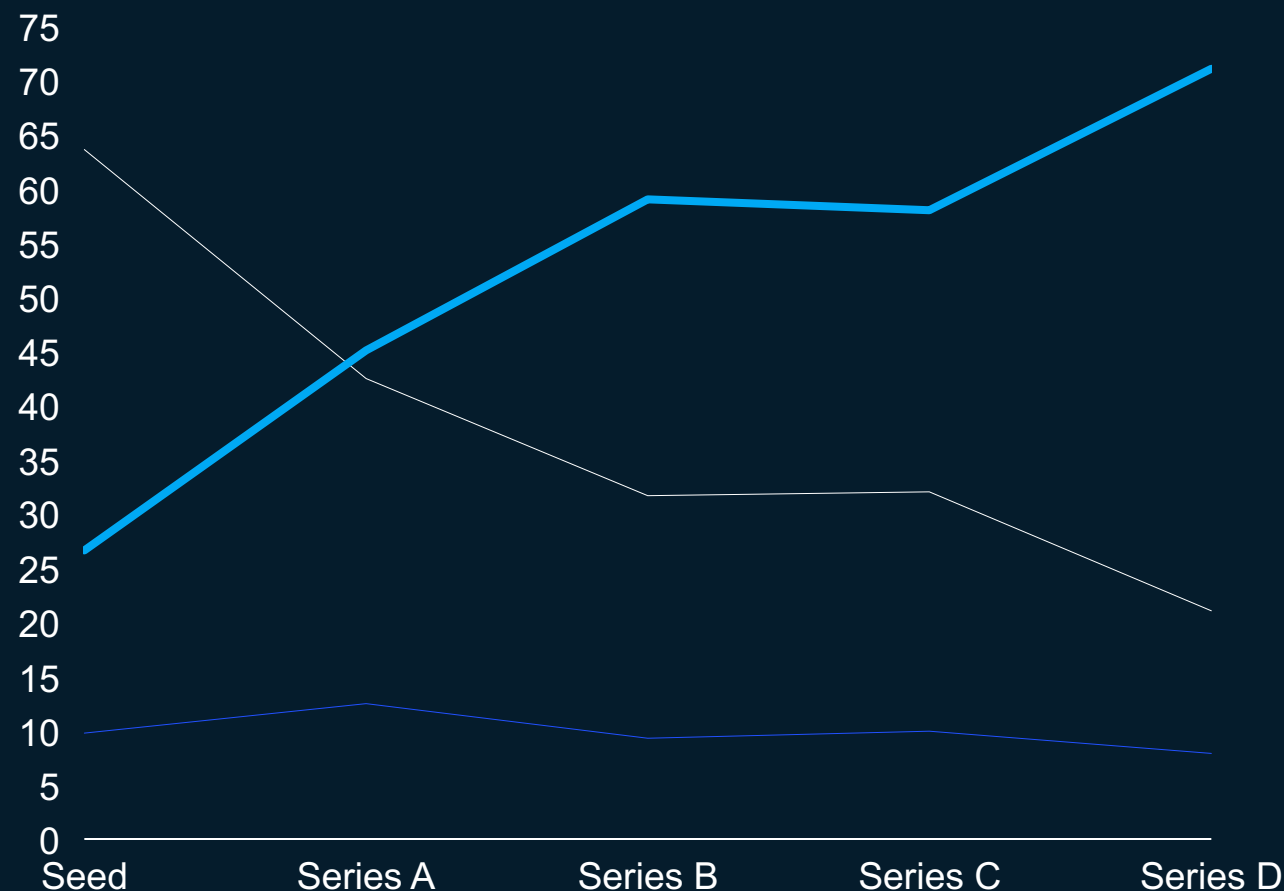
We have more time now to conduct a robust due diligence and structure the deal with more favorable terms

VC investor

Distribution of cap table by company stage

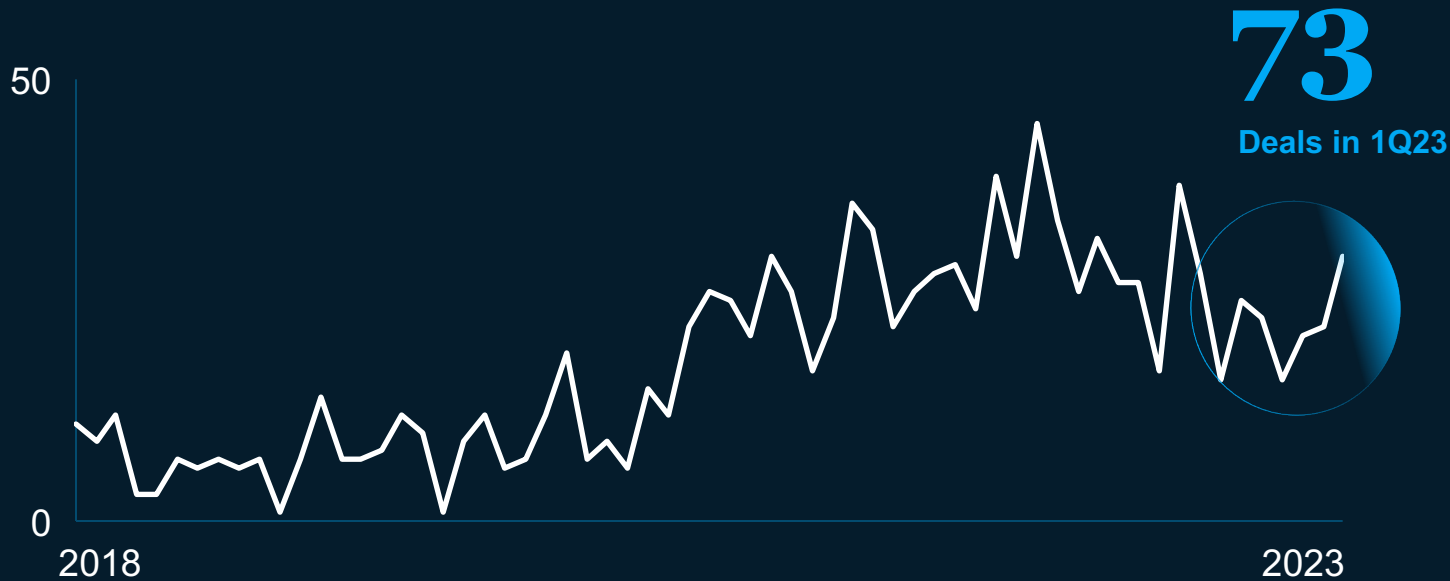
% of cap table

— Owned by founders — Owned by investors — Reserved for stock option & other



LatAm M&A deals evolution

Number of
monthly M&A
deals



**We are
likely to
see a wave
of M&As**

**Where should
we go from
now on?**

“

It seems that the whole market is on sale. We are constantly approached with M&A opportunities

LatAm Startup Founder

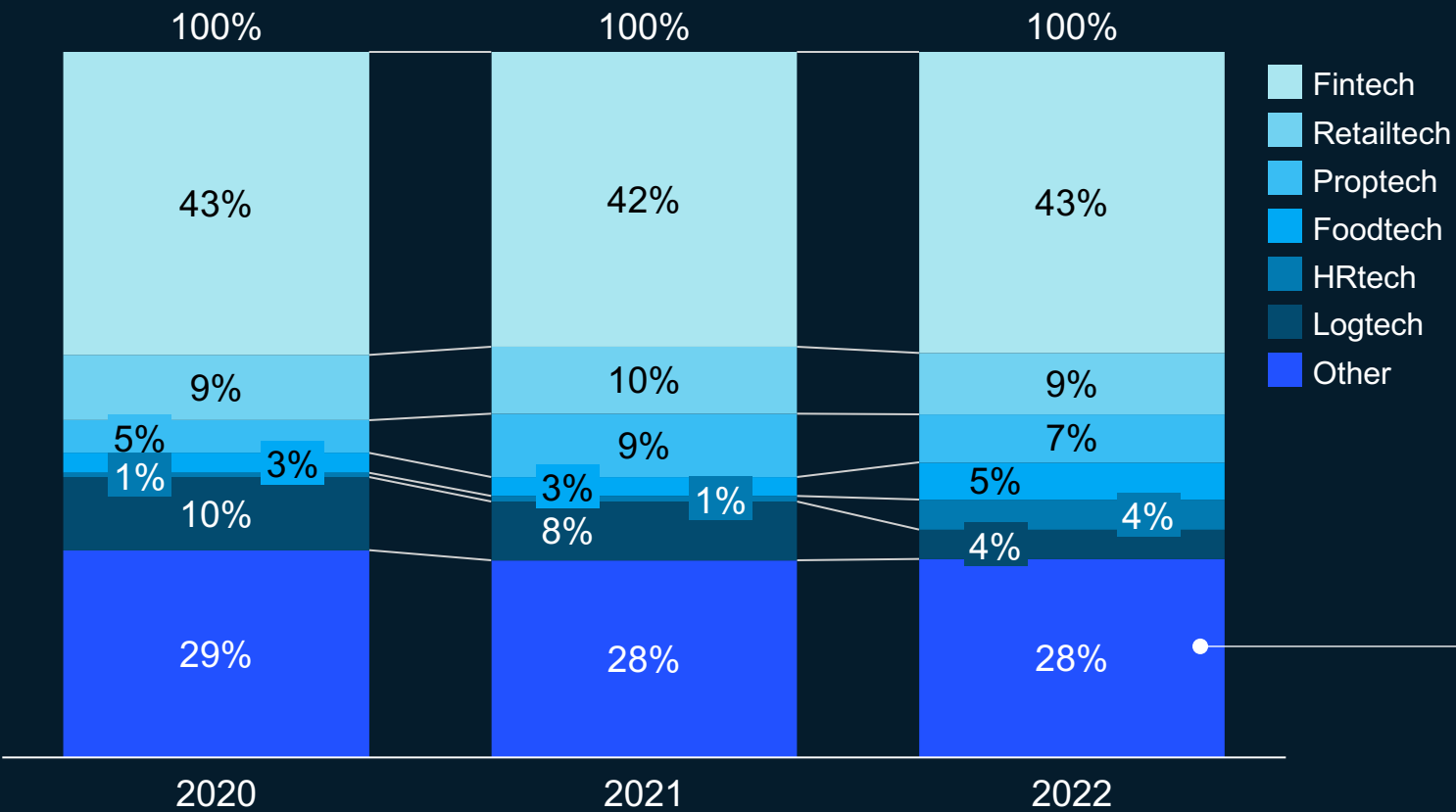
“

There will be a lot of opportunities in times like these, with high cost of capital

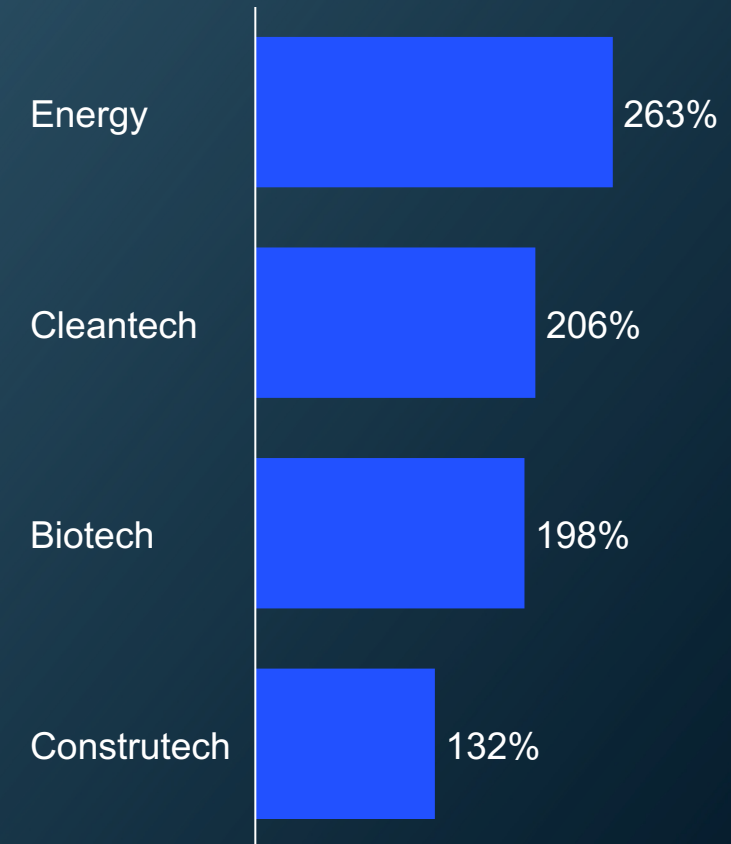
LatAm Startup Founder

And there are some blooming industries increasing their share of capital in the market

LatAm venture volume by sector,
% of total volume



Other sectors with highest CAGR,
2020-2022 CAGR, %



1

Funding
& Investor
Relations



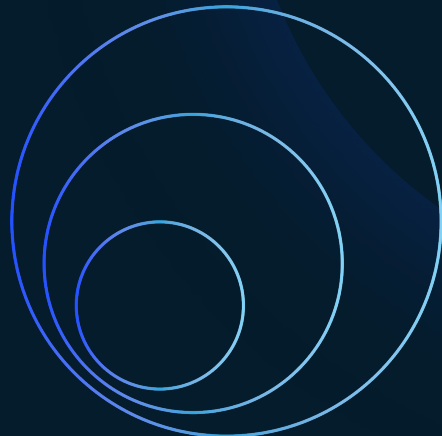
3

Profitability
& Efficiency



2

Product
& Growth
Strategy



4

People &
Culture

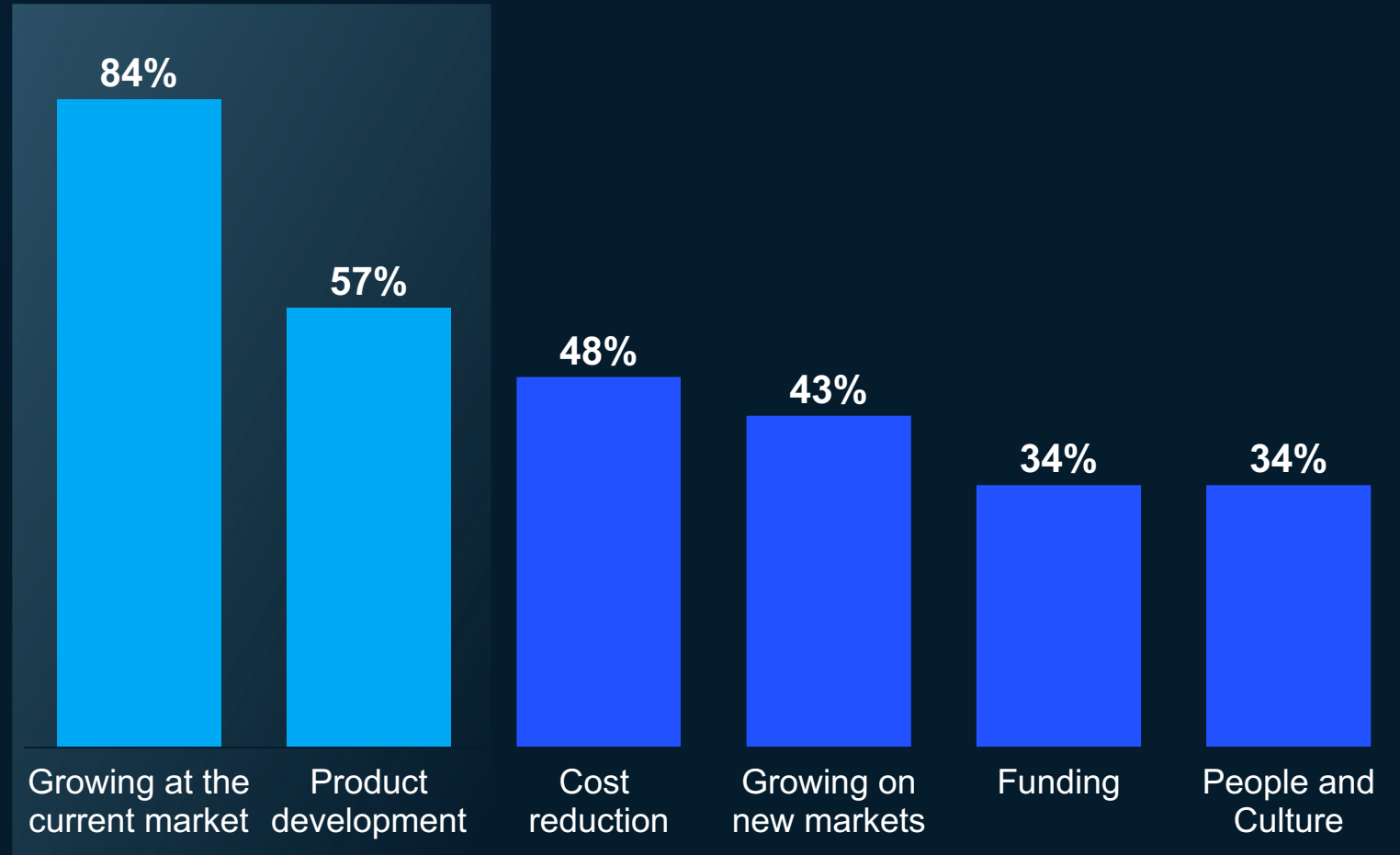


we grouped
the main
insights into
4 DIMENSIONS

Growth and product development are among the main priorities for startups

Startups top priorities

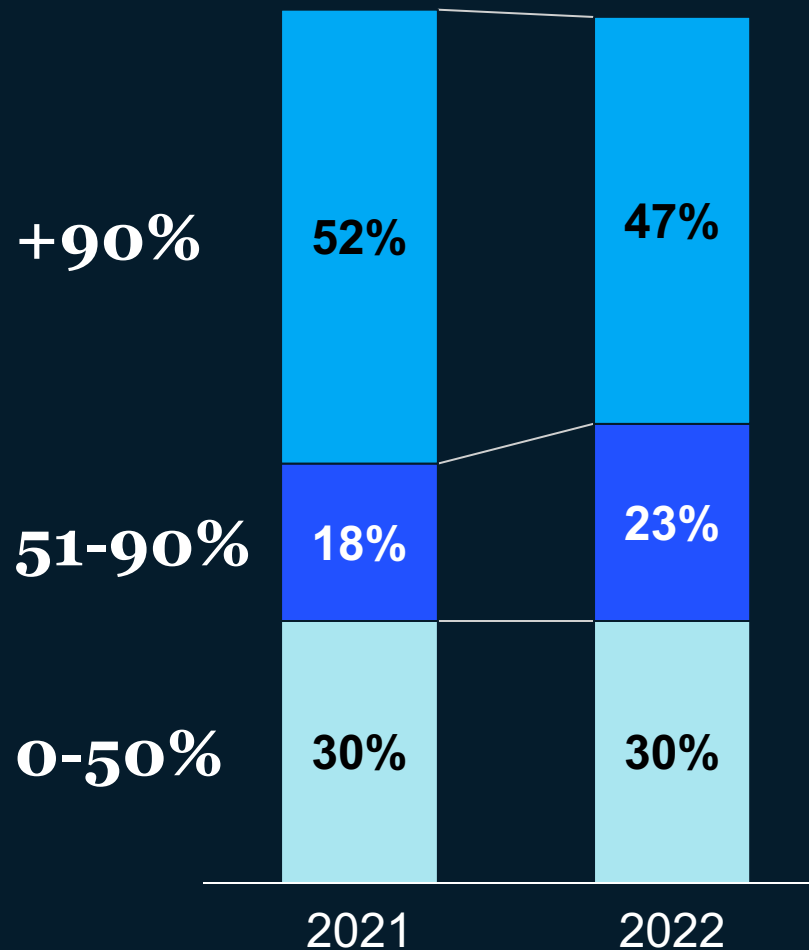
% respondents that selected each lever as one of their top 3 priorities



**Despite the
down cycle,
startups
continue to
grow
almost as if
nothing has
happened**

YoY Growth

% of startups by annual growth range

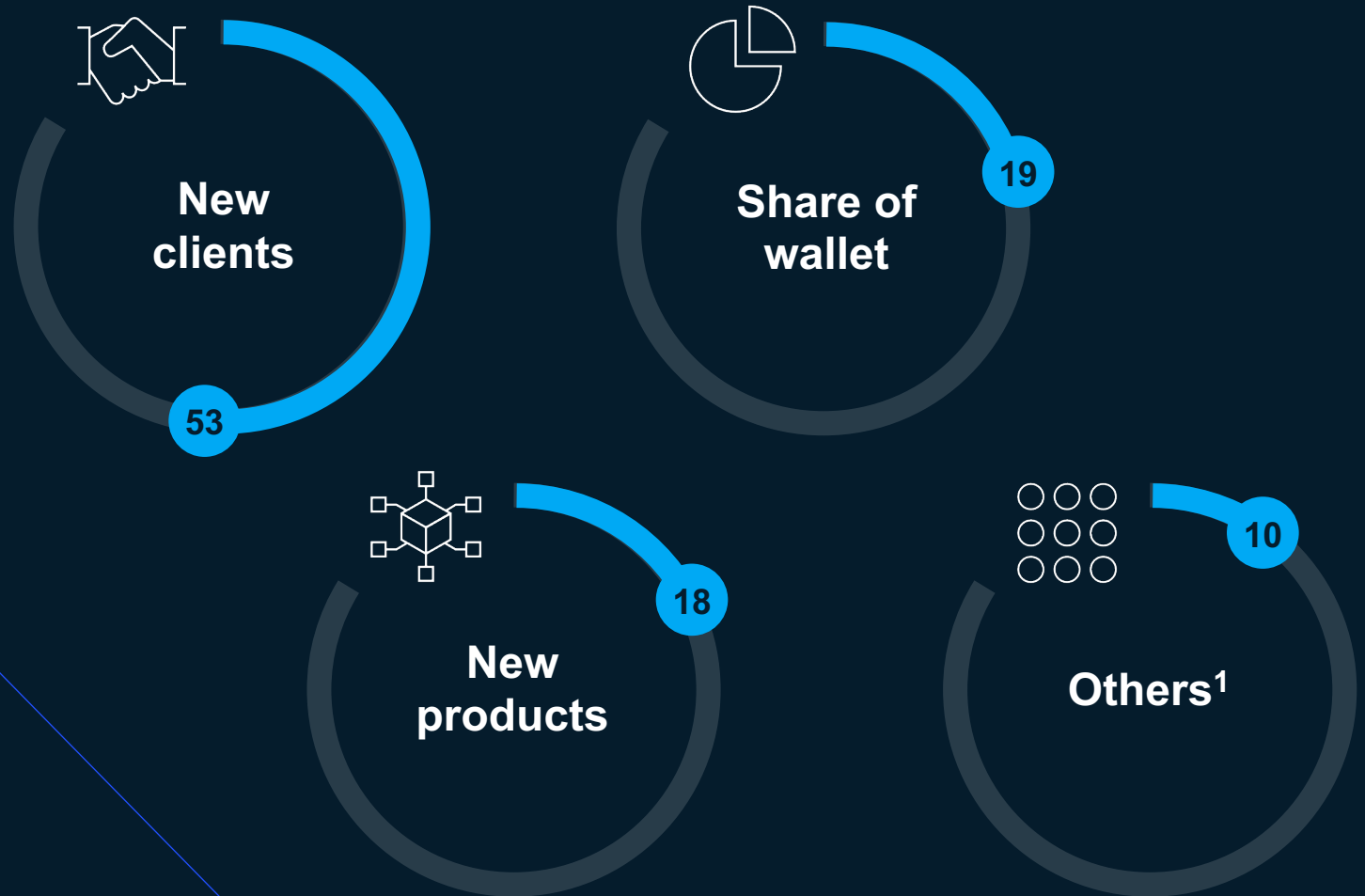


**Grew +90% in
2022**



The main source of growth is customer acquisition

Main lever of value creation driving startup's growth
% of respondents

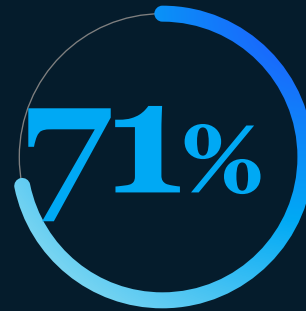


1. Others include international expansion, M&As and other levers

And organic growth is the main strategy to acquire new customers

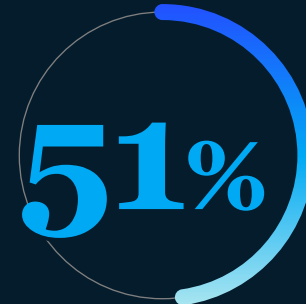
Customer acquisition strategies reported by startups

% of respondents that selected each strategy



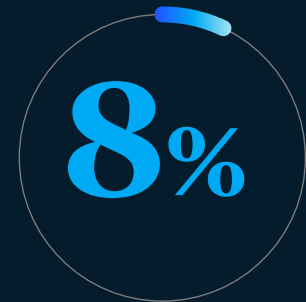
Organic Growth

SEO, Product-led growth, referrals and others



Online marketing (*non-organic*)

paid marketing, paid clicks, social media impulse purchases, and others

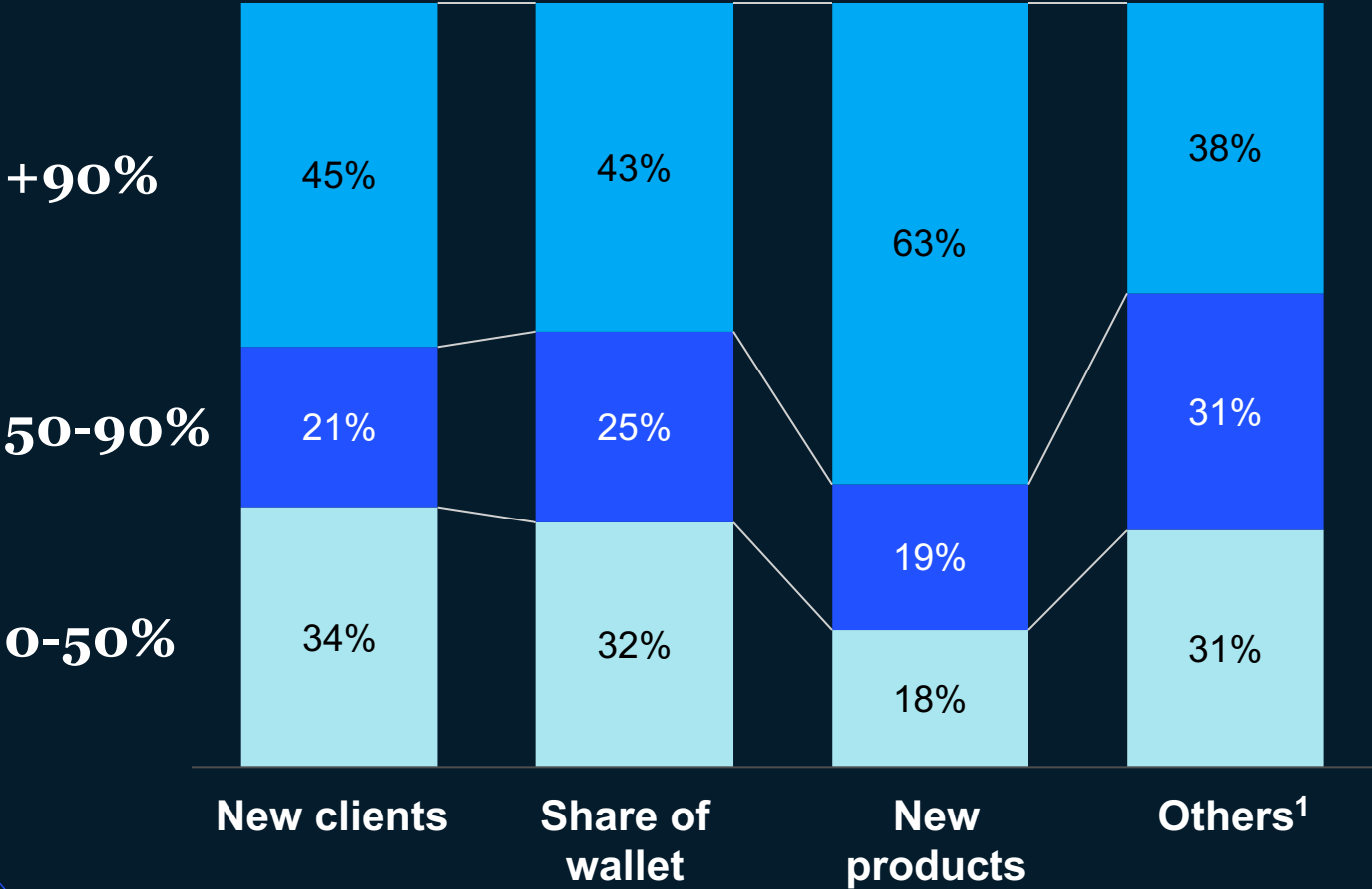


Offline marketing (*non-organic*)

TV & radio, billboard ads, phone call

Startups that invest in new products grow at higher rates

YoY growth by main lever of value creation
% of startups by annual growth range, 2022

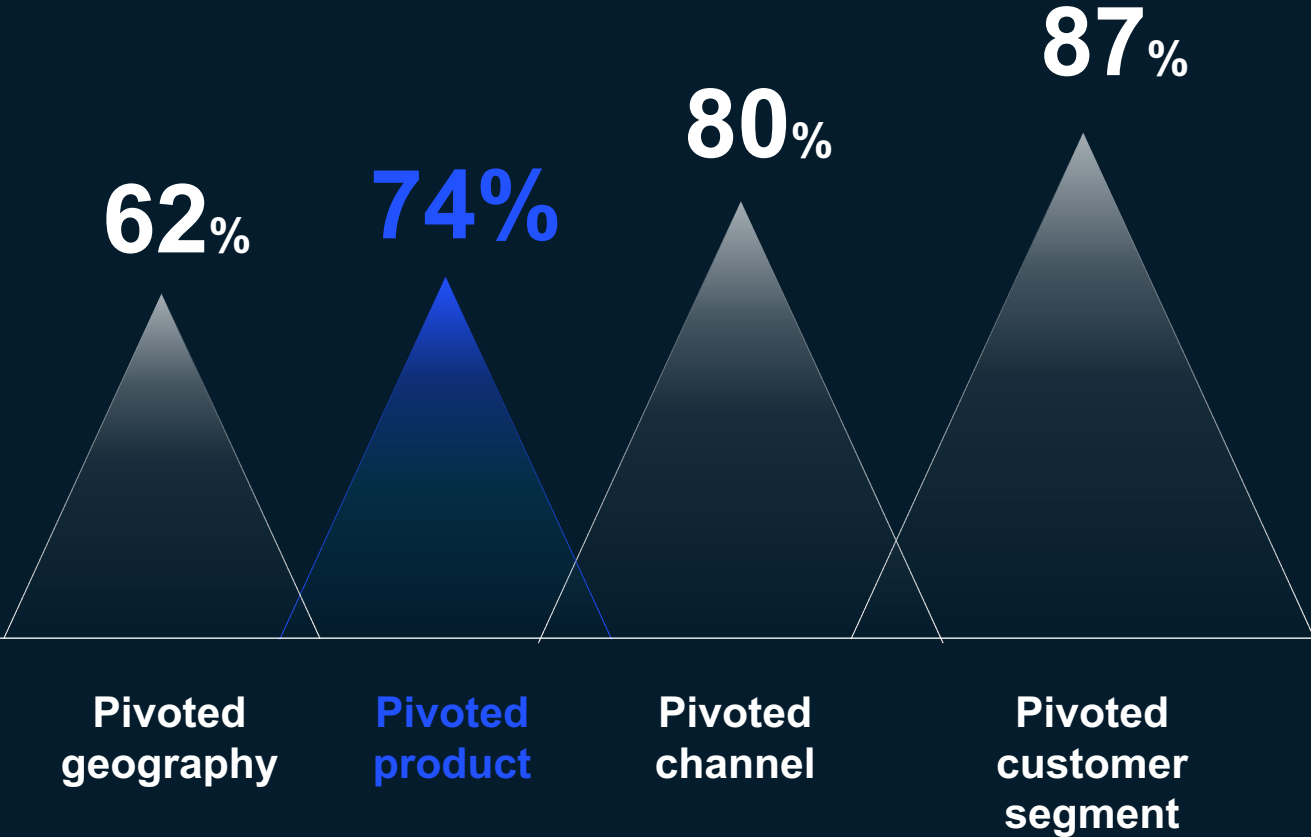


1. Others include international expansion, M&As and other levers

Pivoting is also a core strategy, after all, startups are all about test and learn

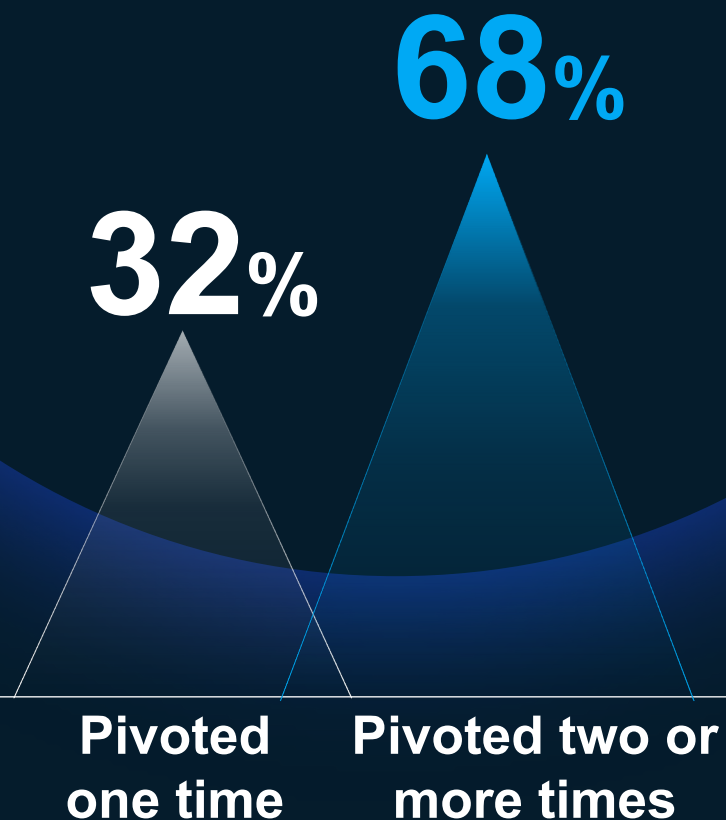
 Detailed next

% of surveyed startups that pivoted one aspect of their strategy



68% of startups that have pivoted product, did it two or more times

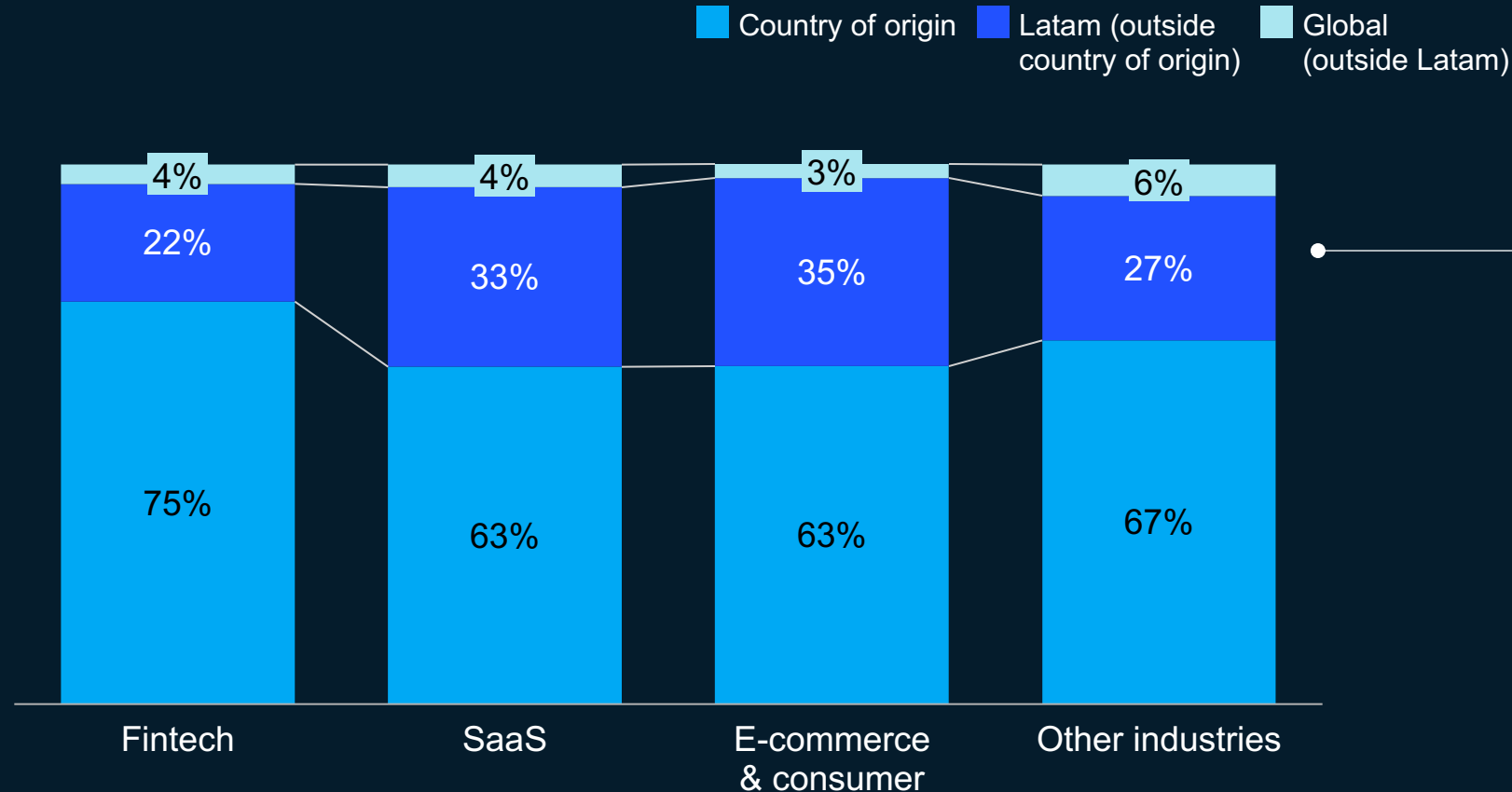
% of surveyed startups that pivoted product



In terms of geography, international footprint is relevant, and contributes to ~20-40% of total revenue

Geographic source of revenue by industries

% of revenue by geographic source



Average % of revenue coming from outside the country of origin



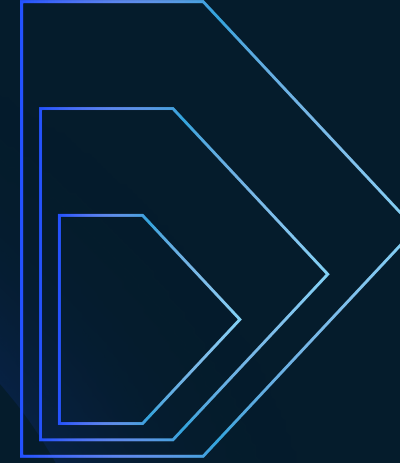
1

Funding
& Investor
Relations



3

Profitability
& Efficiency



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Product
& Growth
Strategy



4

People &
Culture



**If before was
all about growth,
the current
dilemma is
how to balance
growth and
profitability**



We identified 4 clusters of startups based on how they manage this balance; 19% of them report growing at a faster pace, while closely tracking their profitability aspirations

Growth¹

STRONG

WEAK

Great Gatsby



35%

Rockstar



19%

Embryo



34%

Peter Pan



12%

WEAK

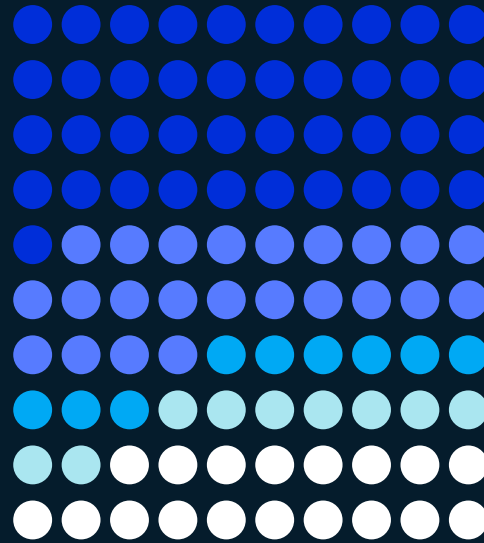
STRONG

Profitability²

1. Strong growth includes startups with +50% average annual growth (on revenue or client base) from 2020 to 2022
2. Strong profitability includes startups that have reached breakeven, have 6+ months of runway, and had no down round. And/or startups that monitor success through profitability related metrics

A deeper x-ray of Rockstars

Main industries¹



Rockstars

Non-Rockstars

41%

38%

Fintech

23%

15%

SaaS

9%

4%

Construtech
& Proptech

9%

3%

Edtec

18%

23%

Others

0%

17%

E-commerce

Average annual growth in the last 3 years

Per year

~75%

Non - Rockstars

38%

Distribution in LatAm

Brazil

63%

Non - Rockstars

46%

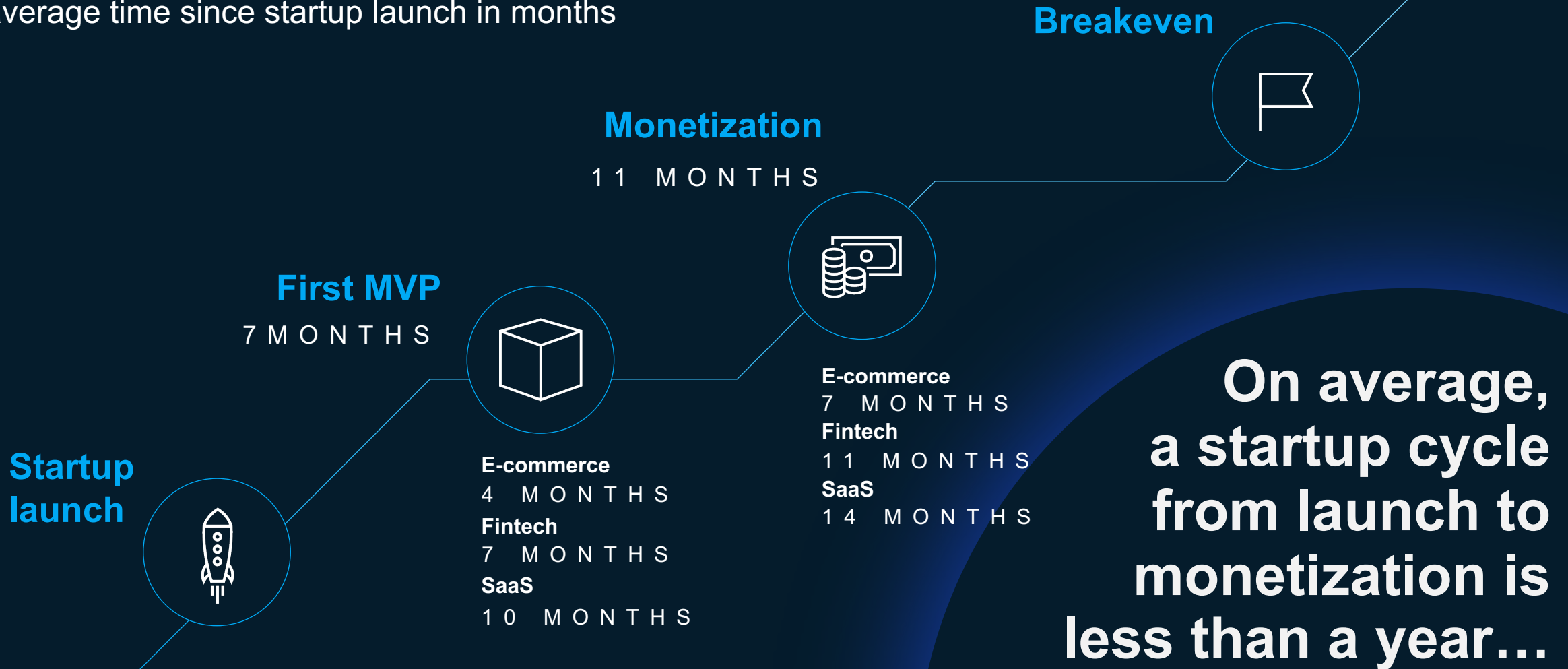
LatAm (except Br)

37%

54%

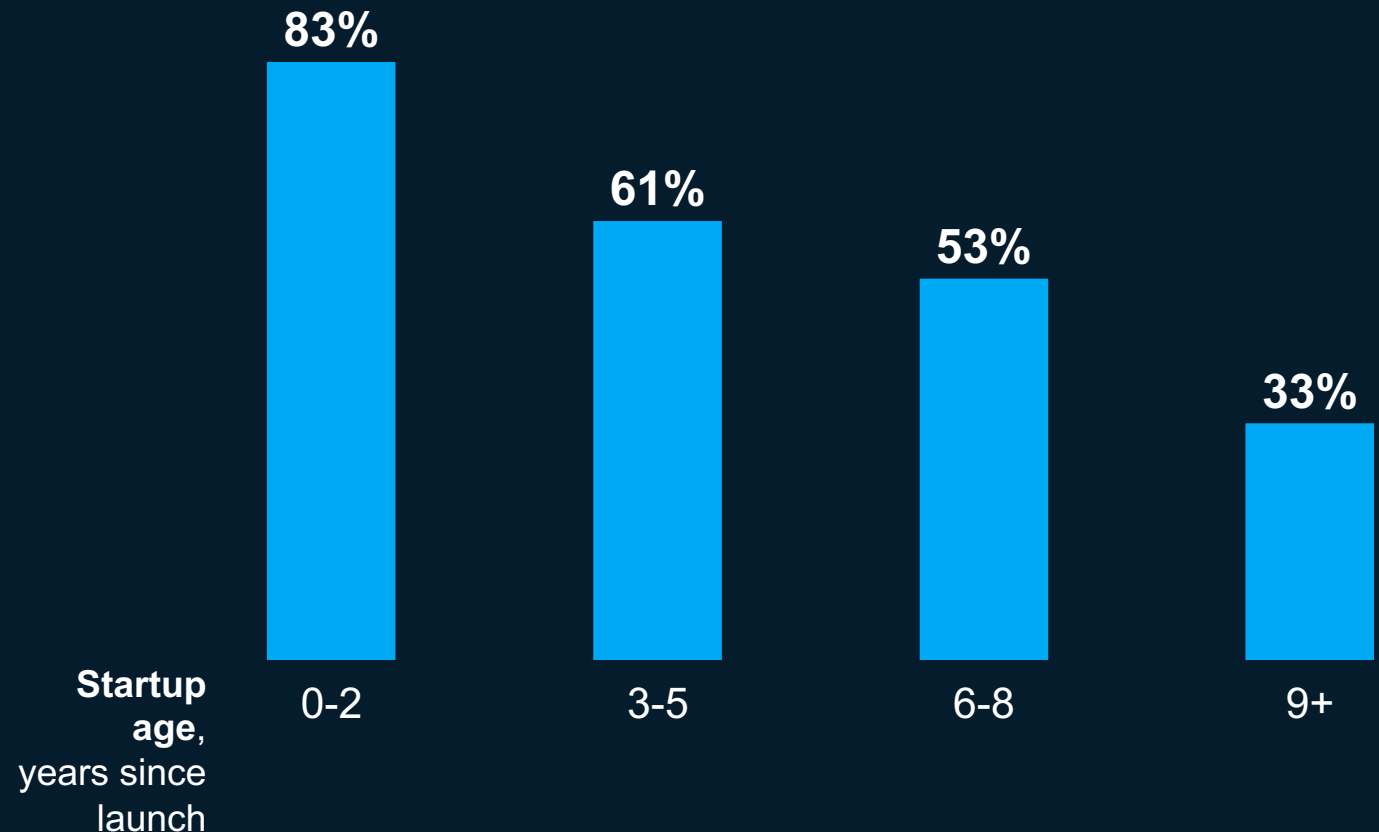
Startup journey since launch

average time since startup launch in months



...but the
journey to
breakeven can
take much
longer

Startups that didn't reach breakeven by startup age
% of respondents by range of startup's age



Startups seeking cost efficiency focus on 3 main levers

- I. CAC optimization
- II. IT cost reduction
- III. Workforce resizing

52%

use CAC & sales expenses optimization

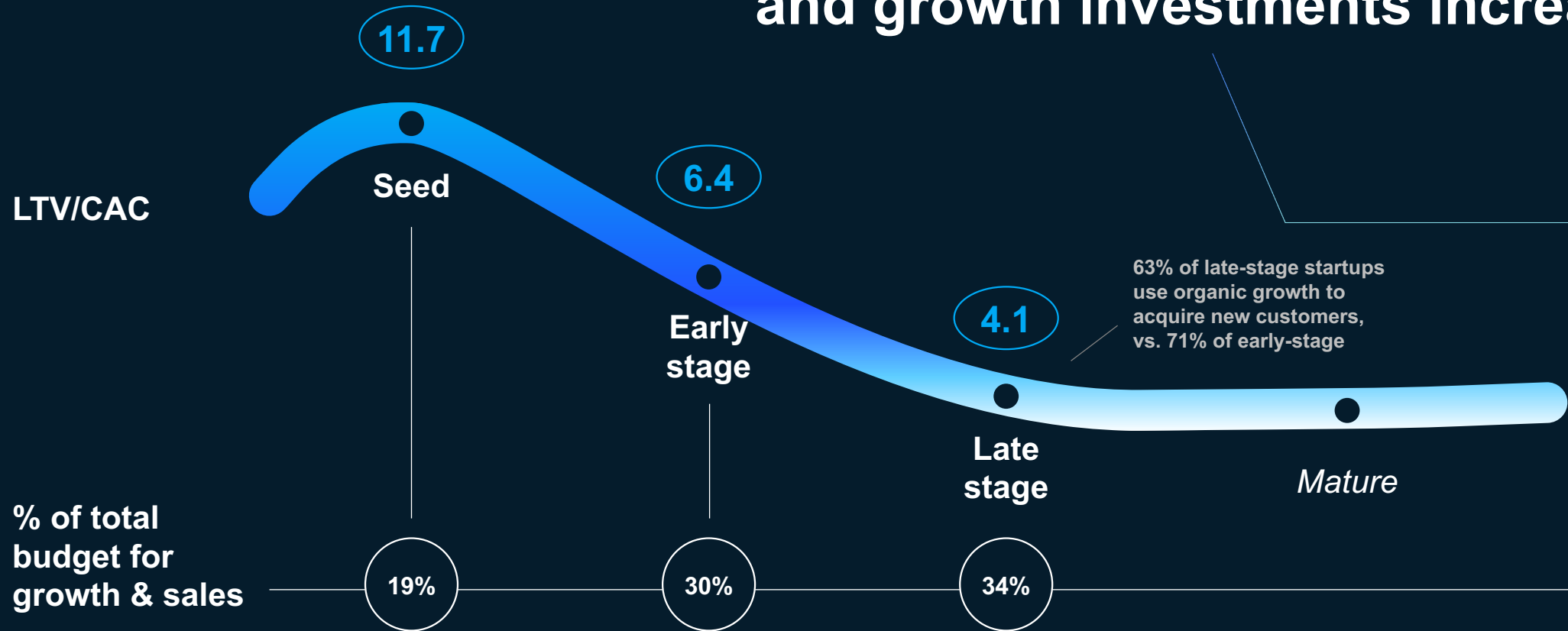
49%

implement IT costs efficiency levers
(e.g., cloud usage, engineering productivity)

40%

made layoffs to reduce costs

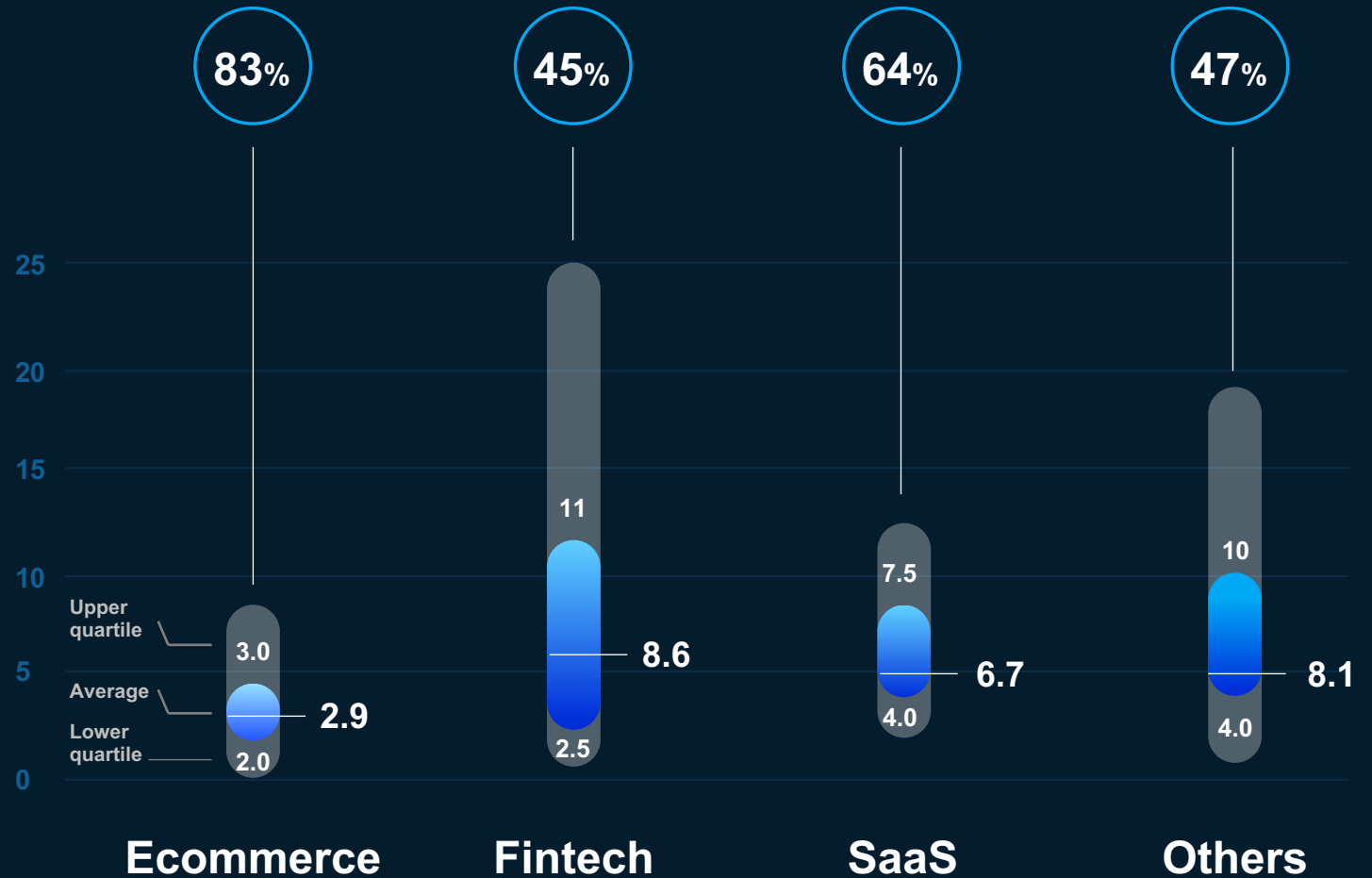
LTV/CAC shrinks throughout startups journey to maturity, as customer acquisition becomes more difficult and growth investments increase



Those with lower ratio have a higher pressing issue to reduce CAC in the current context

LTV/CAC distribution by industry

XX% % of startups that prioritize CAC and sales expenses optimization



Companies with a high engineering productivity use 4 levers to increase efficiency

Architecture & platform

Micro-services architecture

Infra as a code (processing, storage, network)

Resilience by design (blocking & recovering from threats)

Culture & talent

Autonomous multi-functional teams accountable for products' outcomes

Culture of psychological safety

Engineers with “**e-profile**” **capabilities** (leadership, engineering, technologies)



Levers to increase efficiency



Processes & tools

High adoption of **engineering practices** with well defined coding standards and design techniques (peer code review)

Standardized toolkit with a click

E2E secure automation (build, test, and release)

Metrics

Metrics to assess infrastructure, productivity & quality (granular at the engineer & squad level) and team's health

Benchmarks against industry best practices

20-30%
increase on
productivity

up to 3x
reduction on
time to market

20-30%
reduction on
errors

Rockstars are ahead of the market in cloud efficiency and 73% report adopting usage monitoring to optimize cloud costs

Organizations struggle with cloud usage optimization and report that

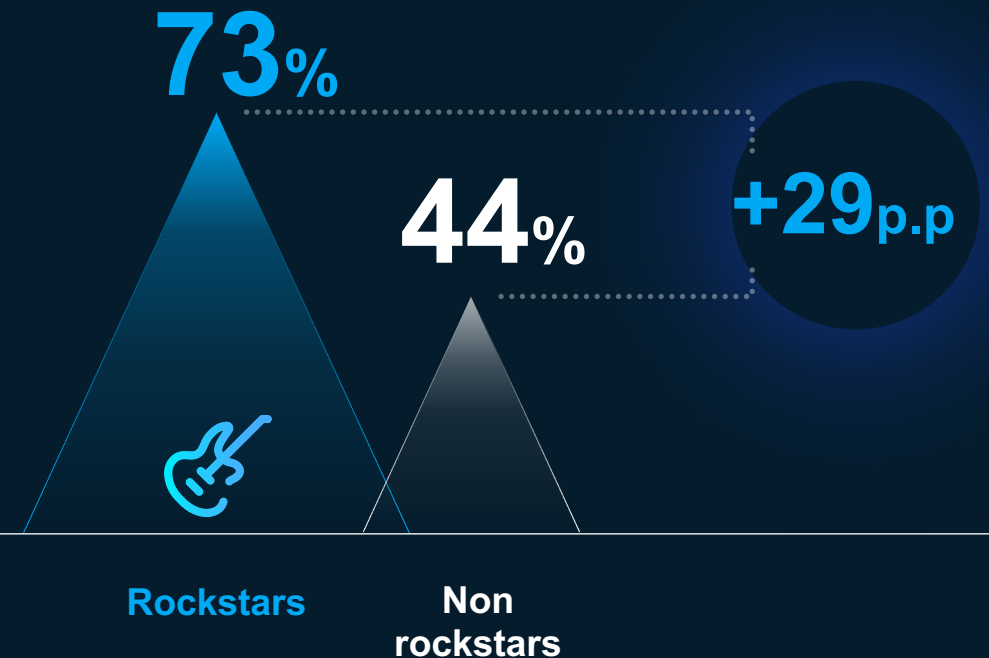
32%¹

of cloud spend was misspent

UP TO
25%

of cloud cost reduction can be achieved with FinOps

Reported adoption of usage monitoring by startups as a FinOps tool
% of respondents



1. Estimation based on self-reported answers from global cloud decision makers and users (Flexera – State of the Cloud 2022)



MIGRATE TO OPEN SOURCE

Identify workloads that **can run on open source** instead of within commercial solutions



RATIONALIZE SOFTWARE CATALOGUE

Standardize and simplify the software catalog, remove functionally equivalent solutions and drastically reduce the number of software products



MANAGE DEMAND FOR LICENSES

Remove unused licenses, selectively adding/removing functionality for specific user groups



RENEGOTIATE LICENSE

Renegotiating software licenses can drive an up to 15% cost reduction



LEVERAGE CLOUD

Leverage cloud solutions (PaaS as well as SaaS) to reduce application maintenance and infrastructure service costs



ASSESS LOWER COST ALTERNATIVES

Re-evaluate the necessary functionality for software and consider lower cost alternatives

For software & licenses, cost efficiency can be achieved through

6 STEPS

Layoffs are impacting startups in LatAm

~40%

of startups in LatAm had to lay off part of their workforce

~20-30%

was the average workforce affected

1

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People &
Culture



In a tightening cycle, it becomes more challenging to manage talent and culture



STARTUPS
CONTEXT

Startups are
for risk takers

- Lower salaries and benefits
- Chance of equity upside
- Flexible work models already a possibility

The equity
dream

- Competitive compensation (fixed and variable)
- Unicorn boom
- Appeal at an all-time high

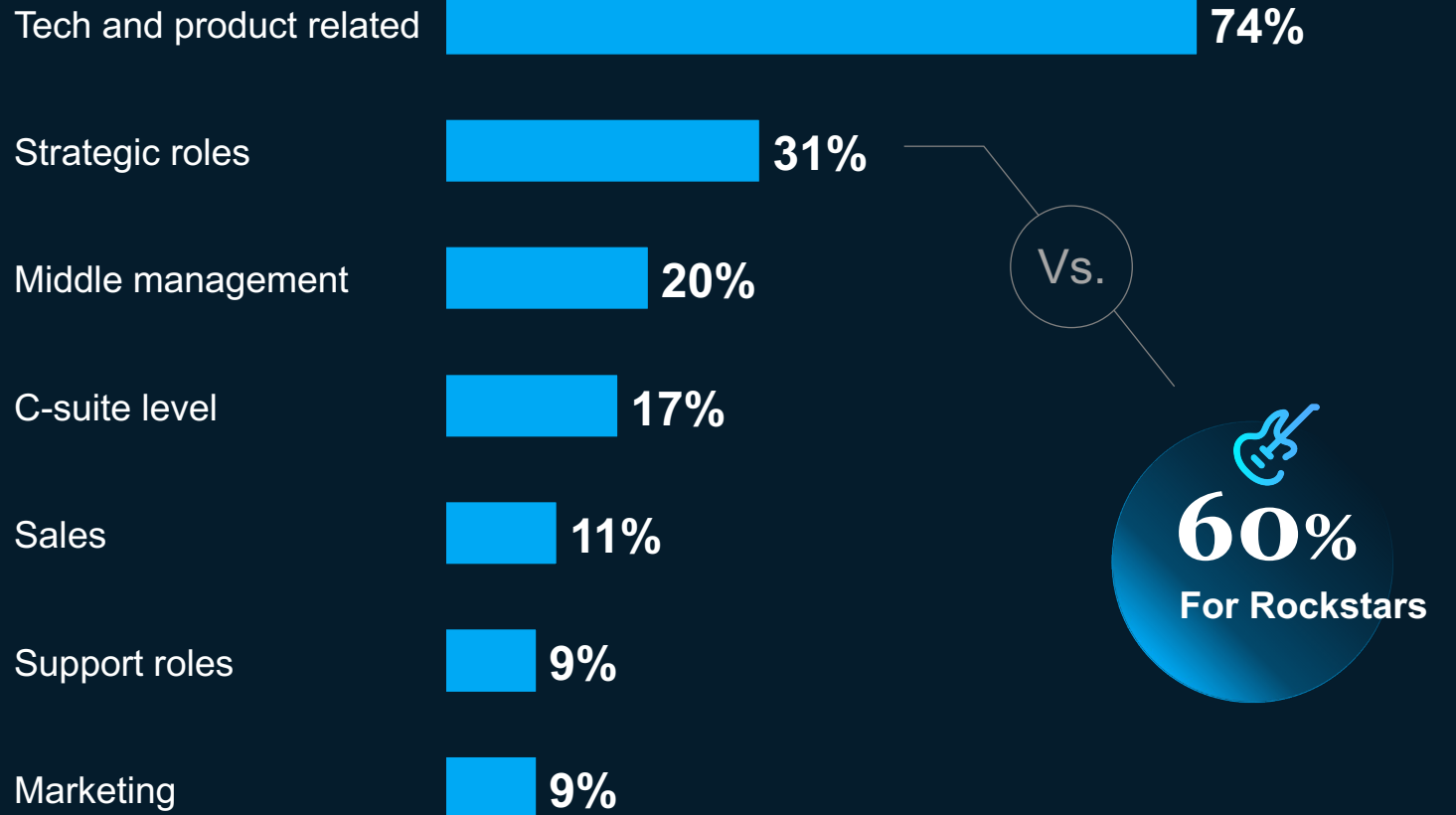
Reality check

- Lower short-term equity return
- Layoffs
- Incumbents catching up on work model flexibility and benefits

Tech roles are still a major issue for startups

Roles/areas harder to hire and retain

% of respondents that indicated each of the following options



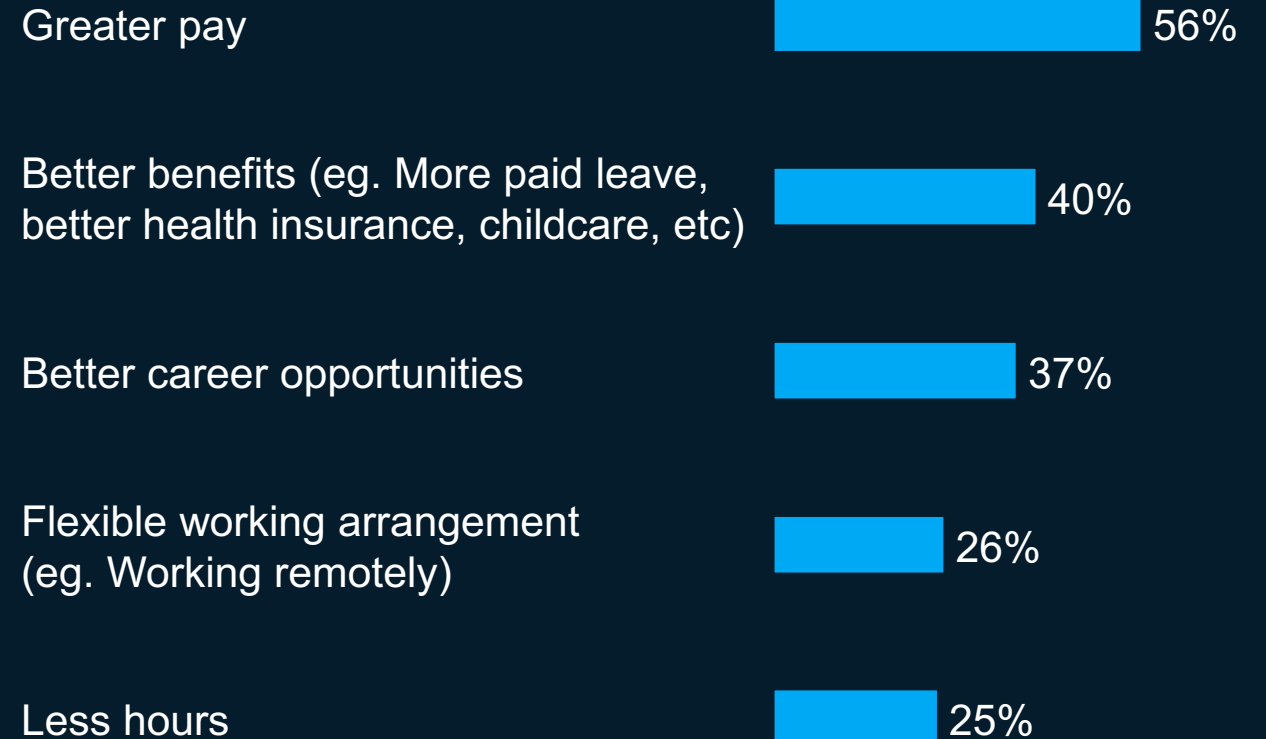
There is a challenging scenario ahead to retain talent

1/4

of startup employees consider the possibility of leaving their jobs in the next 3 to 6 months¹

Top reasons for employees to seek a new job

% respondents that indicated each one of the options

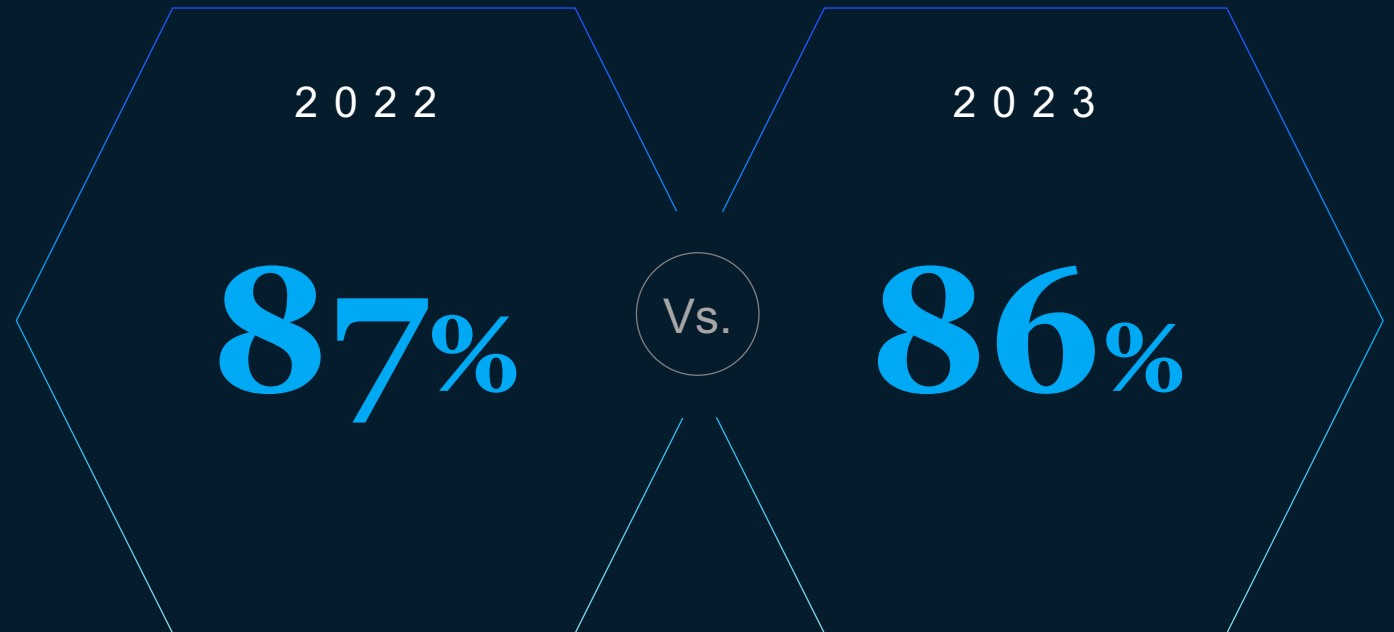


1. Startup employees were asked "How likely are you to leave your current job in the next 3-6 months?" (n = 300). It was considered the following answers: "almost certainly", "very likely" and "likely". 29% selected the option "Somewhat likely" and 47% "not at all likely"

**The value prop
for the new
generation is
still appealing**

**Total of STEM students that would consider
working in a startup in the next 2 years**

% of total respondents

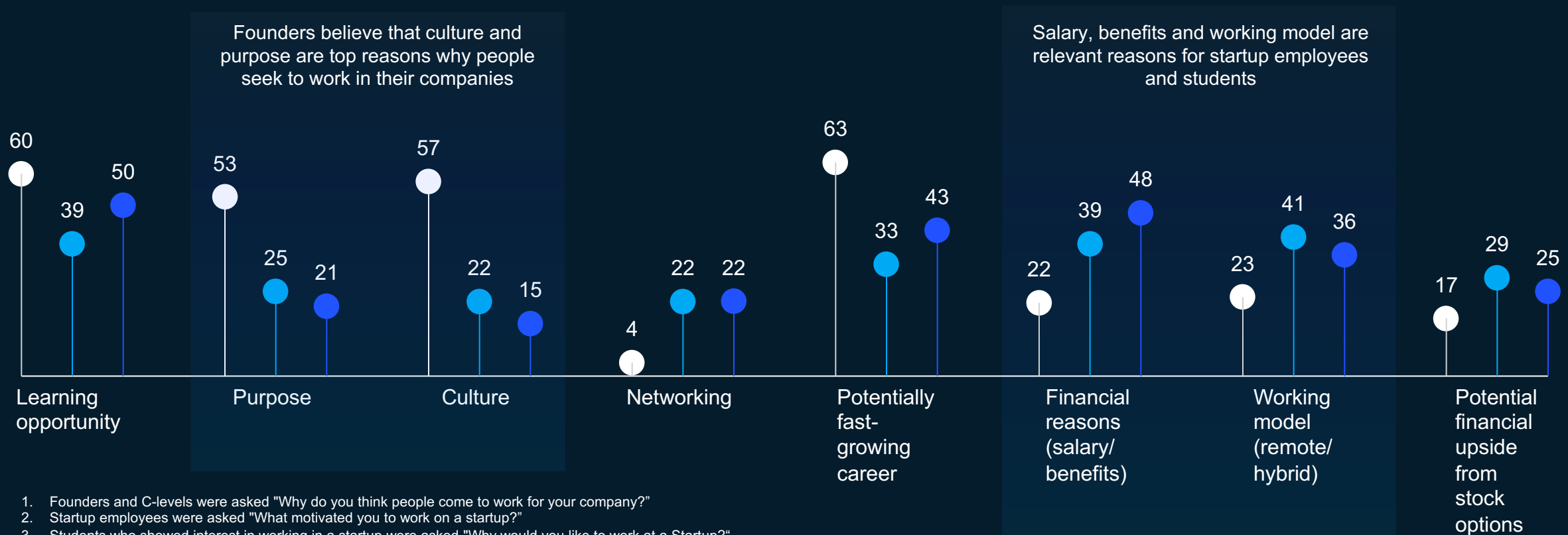


There is a mismatch between founders, employees and students' opinions on reasons why to work in startups

Main reasons to work in a startup

% respondents that indicated each one of the options

● Founders¹ ● Employees² ● Students³

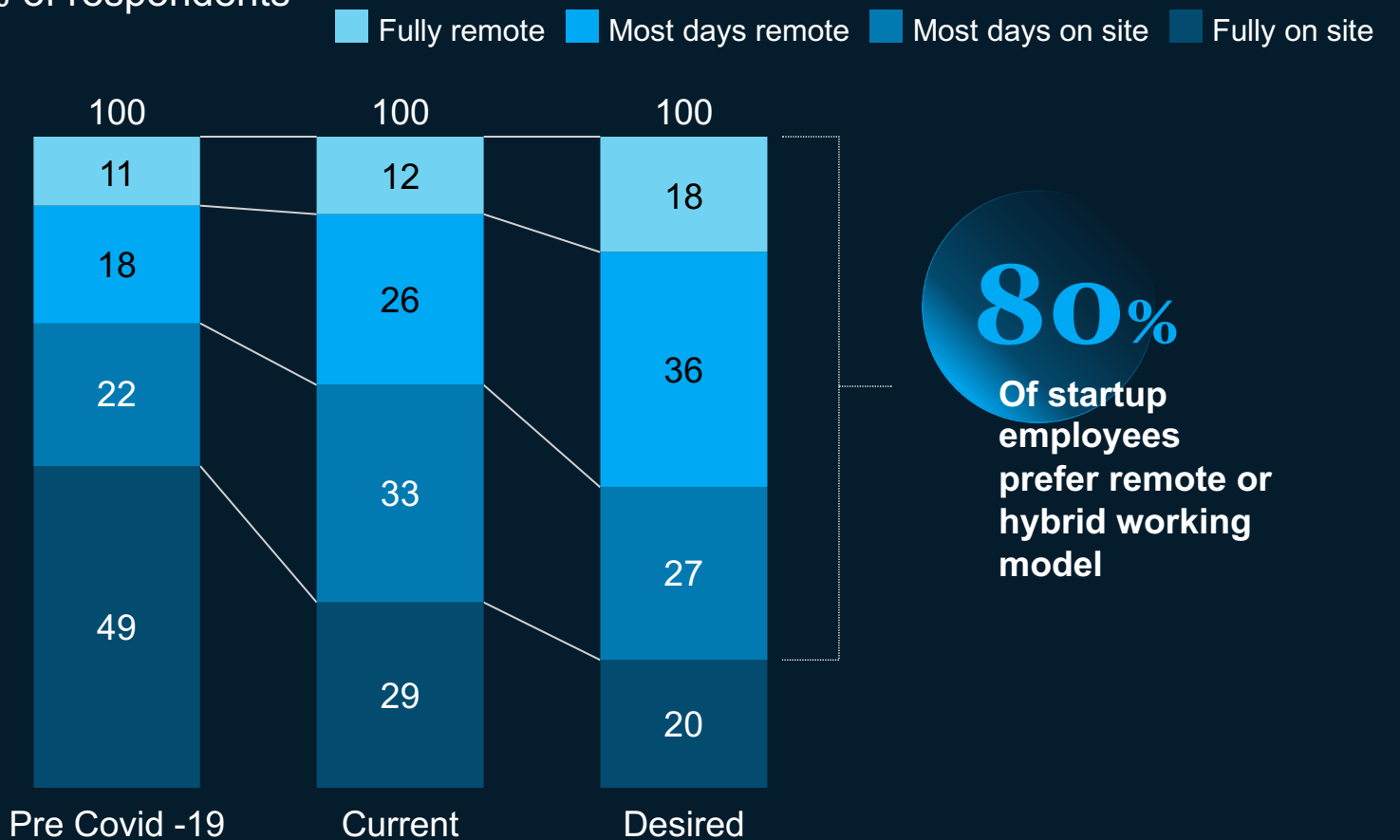


1. Founders and C-levels were asked "Why do you think people come to work for your company?"
2. Startup employees were asked "What motivated you to work on a startup?"
3. Students who showed interest in working in a startup were asked "Why would you like to work at a Startup?"

Remote or hybrid working model are largely preferred by startup employees

Working models employees' preference

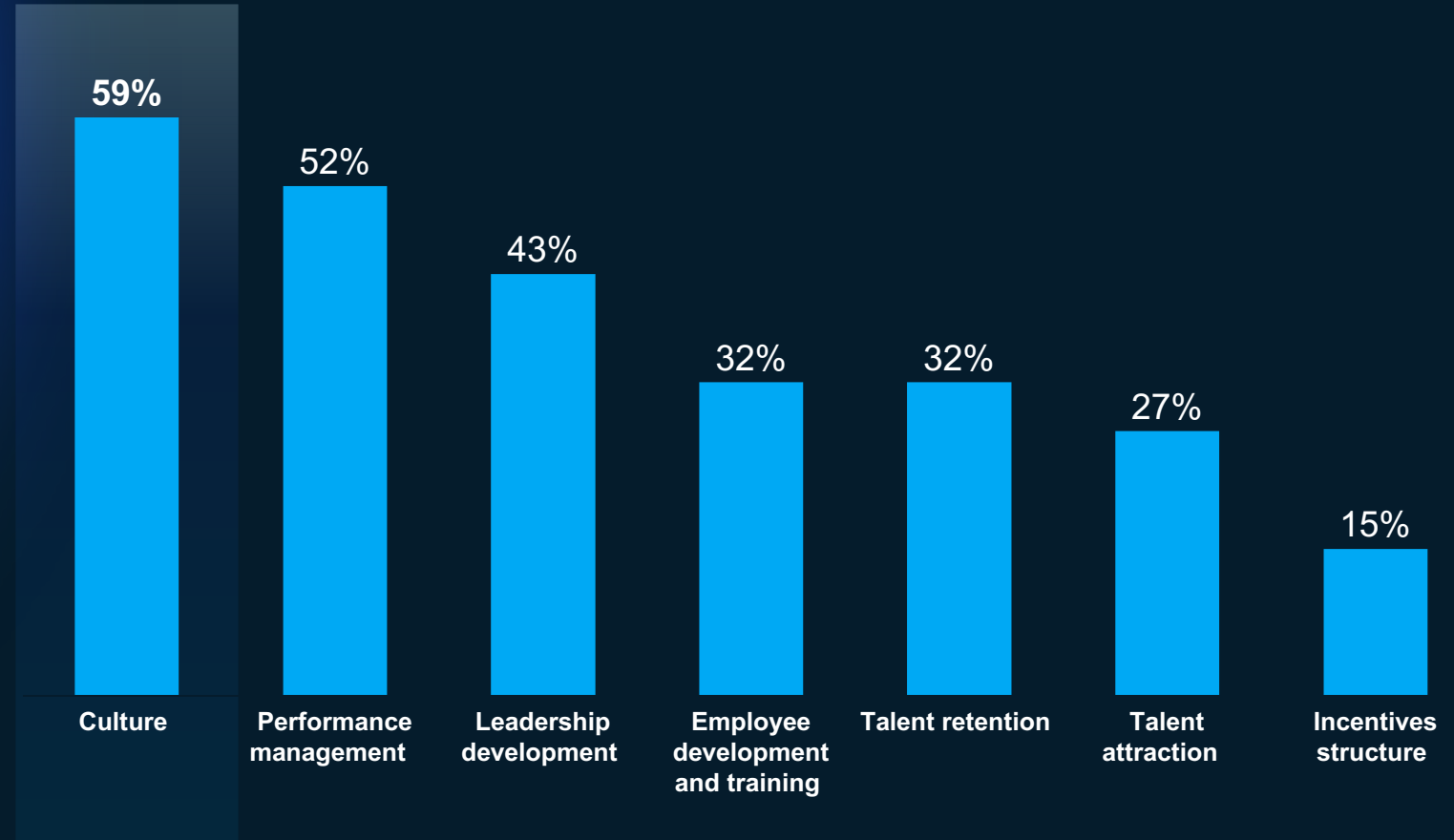
% of respondents



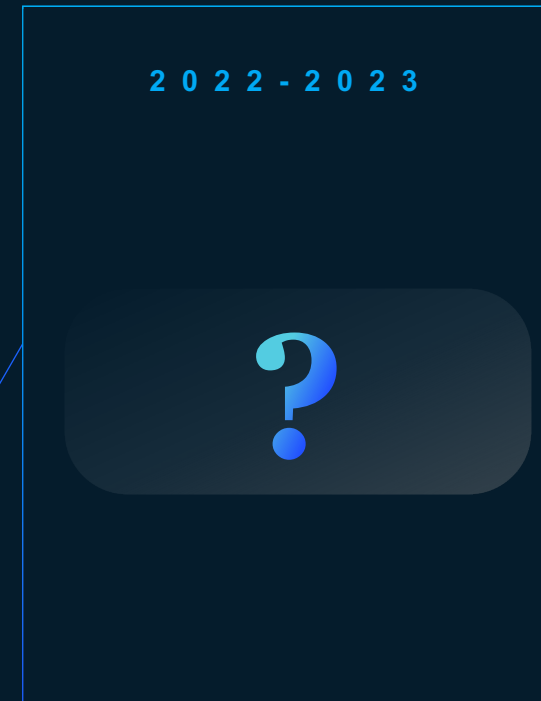
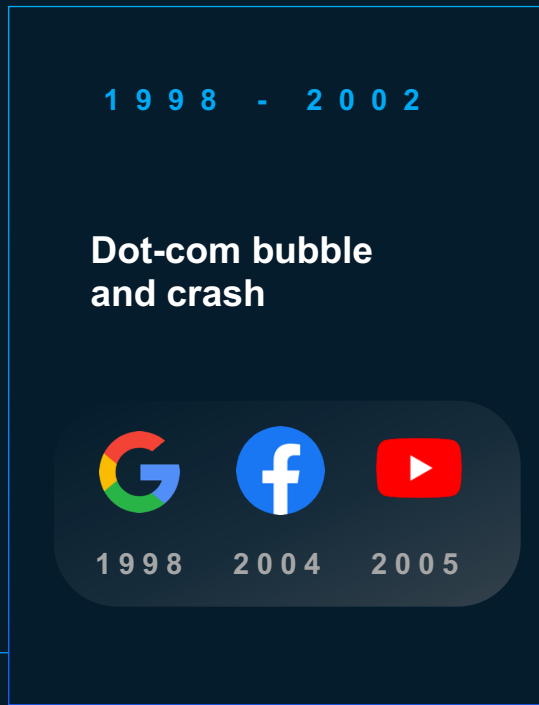
Finally, in this context, strengthening culture's essentials is the top priority in People & Culture for founders

Top priorities in People & Culture

% of respondents that selected as one of top 3 priorities in People & Culture



And there is a silver lining about down cycles: a great vintage wave of talent and entrepreneurs



“

This crisis is different; we had several great ‘schools’ and ‘hubs’ that developed digital and tech talents

VC investor

“

The vintage of startups forged in 2022-2023 will be incredible

VC investor

It's time to...

REVIEW

RECALIBRATE

REWIRE

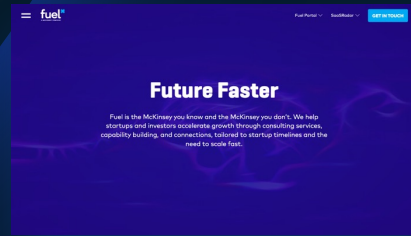
KNOW MORE

McKinsey
& Company



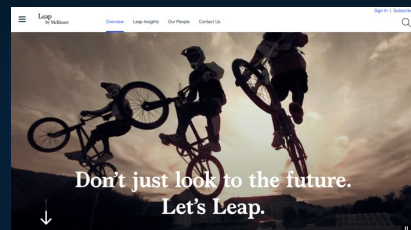
Full report

latamdigitalreport.mckinsey.com



McKinsey Fuel

<https://get.fuelbymckinsey.com/>



McKinsey Leap

<https://www.mckinsey.com/capabilities/mckinsey-digital/leap/overview>

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Thank You!

McKinsey would like to thank SlingHub for providing part of the data used to build this report