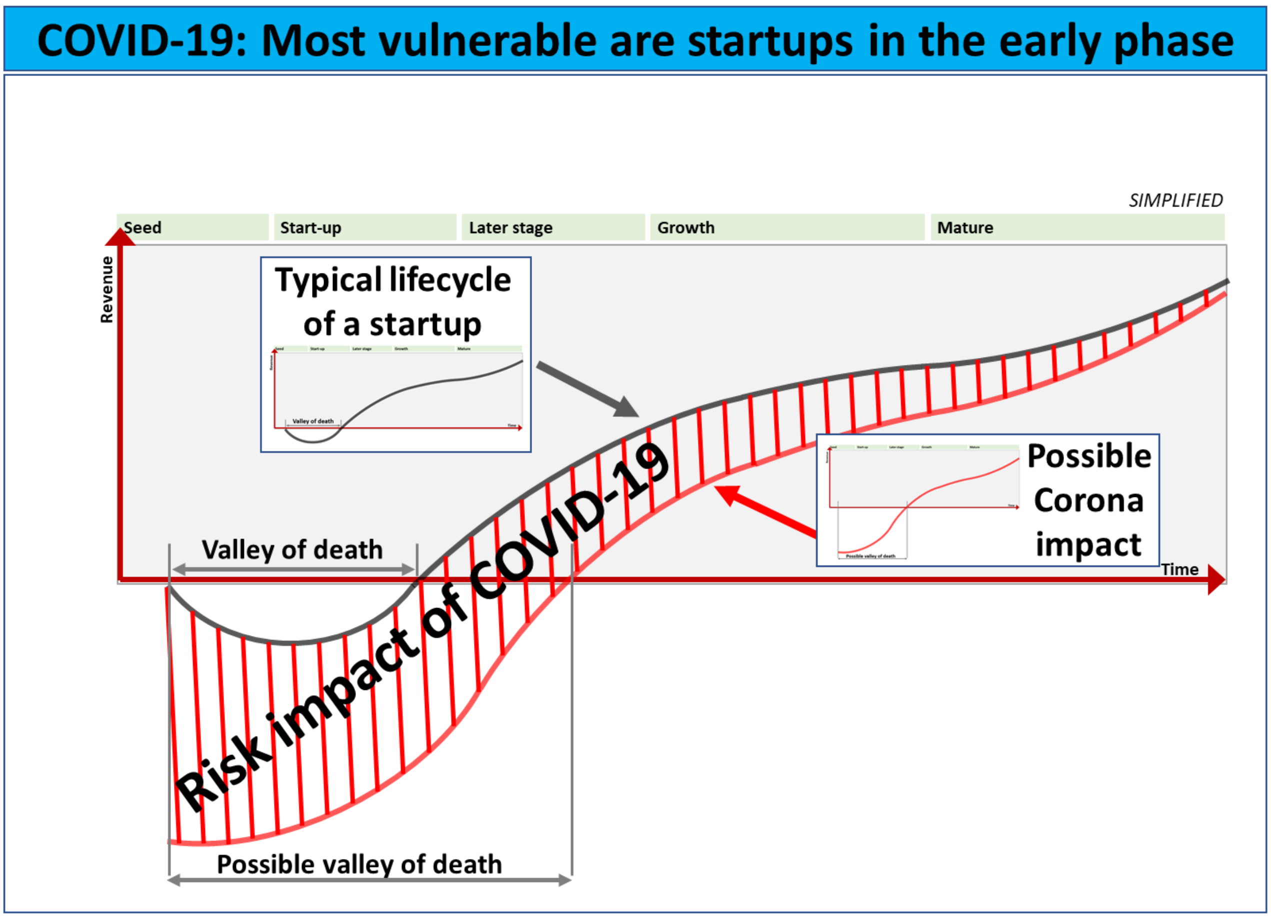
COVID-19: Most vulnerable are startups in the early phase (seed)

Three weeks ago, some Startups within our community reached out to us and asked for tips and tricks how to prepare for a potential Corona-situation (risk of COVID-19 impact). We came up with a simplified “Business Continuity Management & Disaster Recovery”- Checklist. Among other things we recommended, that startups should try to be prepared for possible liquidity challenges (liquidity shortage, funding challenges, delayed investor interaction etc.).

What we see now is not a risk anymore, this is a sever issue for startups – mainly startups in the early phase. The Startup industry is an important pillar of the economy. This is maybe not always as obvious to everyone as the impact and consequences are usually hit only mid-/long term. Respectively they are underestimated, as one single startup does not impact the economy, but all together will even short term.

In this document we would like to explain why we see it that way, the possible impact and how to mitigate.

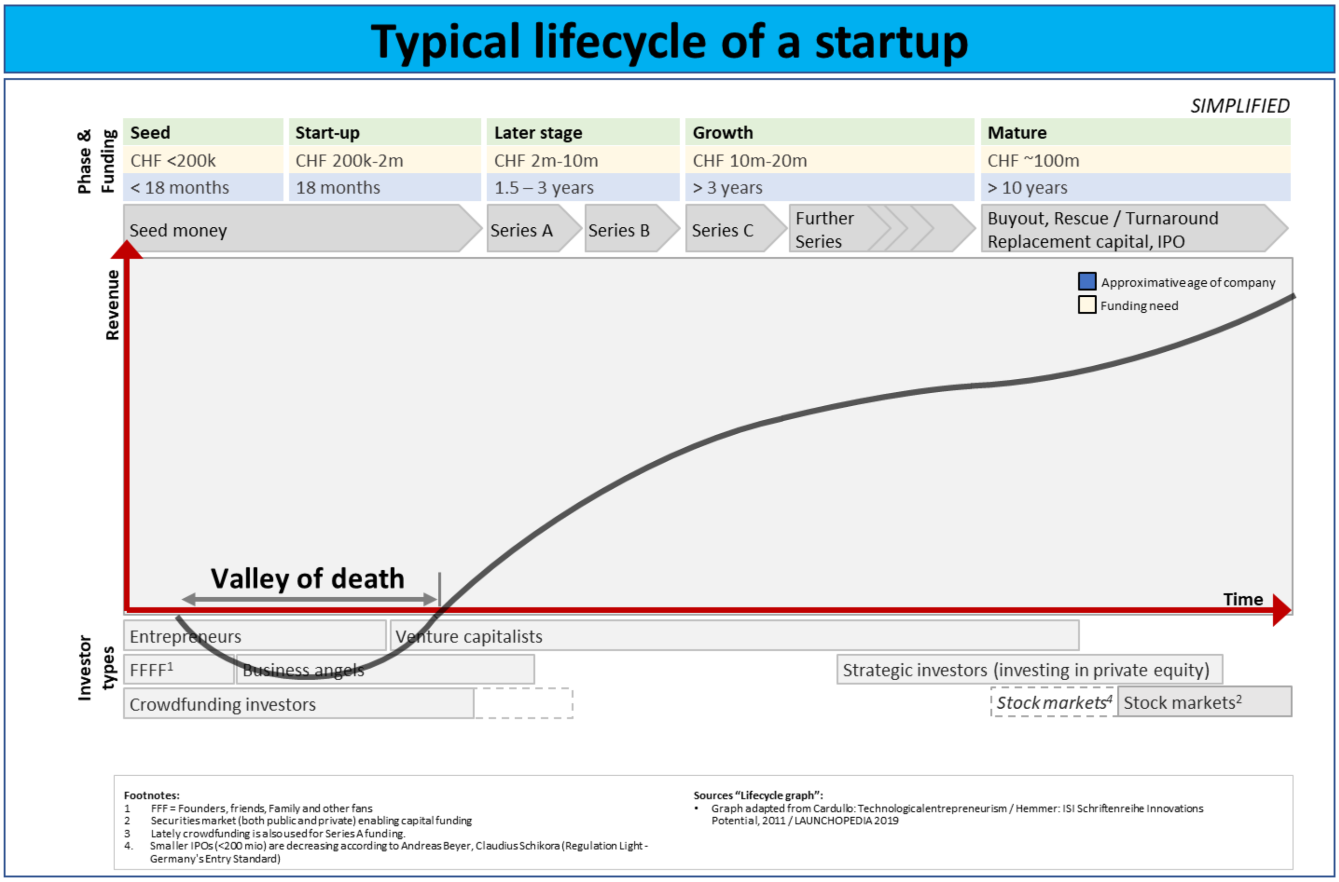
- 1) Why are Startups in the early phase affected worst?
- 2) Why is it important to save (support) such startups?
- 3) What can we do to support such startups best?



1) Why are Startups in the early phase affected worst?

A startup is passing through several phases during its lifecycle. Each phase has its specifics. Of course, this also depends on jurisdiction, culture, sector etc. However, in general you can say, that most startups are in the early phase funded by the founders, friends/family or maybe also Crowdfunding. Later Business Angels becoming important, respectively Venture capitalists and finally (in case of an IPO) it becomes tradeable on a stock market.

The graphic below shows illustrative the various phases, investor types etc. Some define the "valley of death"[1] a bit longer (until end of phase "Series A"), but in principle this is how most describing the lifecycle of a startup.



Seed phase

In the very early phase (seed phase) many startups are funded by the founders. Maybe also some money from friends, family and other fans. In this early phase a startup starts to build its product (MVP, minimum viable product), shapes its concept and it starts to establish its network, to find investors for the next phase.

During this phase many founders do not payout themselves a salary, they reduce their personal spending to an absolute minimum and invest their own savings in the startup. Many startups cannot afford things like sickness daily

[1] Description by Martin Zwilling :The "valley of death" is a common term in the startup world, referring to the difficulty of covering the negative cash flow in the early stages of a startup, before their new product or service is bringing in revenue from real customers. https://www.forbes.com/sites/martinzwilling/2013/02/18/10-ways-for-startups-to-survive-the-valley-of-death/#71274b8f69ef

allowance, backup hardware etc. They are often short on money and liquidity covers only a couple of weeks or at a max few month. It is obvious that this is only manageably for a short time-period. Many founders give themselves 9-12 months (to achieve the next phase), before they have otherwise to close the startup or project and try something else or go back to a normal job. Some of them even never officially incorporated, therefore you don't find them in the statistics. During this phase the founders taking the risk, supported by the friends, family and other fans.

Startup / Later stage

Entering the startup-phase, the startup has achieved a huge milestone. It was able to convince Business Angels or even VCs in a way, that they are investing in the startup. The startup moves from the "garage-office" into co-working-spaces or even a normal office. The founders are getting salary (not huge, but they have regular income) and the startup is able to hire employees. In many cases the startup is not yet profitable, at least not in the beginning. That means the investor is taking a risk.

Growth / Mature phase

Finally, the startup becomes more mature, makes profit. It can build up some savings / securities. The company becomes larger (maybe even a large enterprise). Maybe it goes public (IPO) and becomes public tradeable. Now the pressure comes from non-professional investors, from the economy and industry.

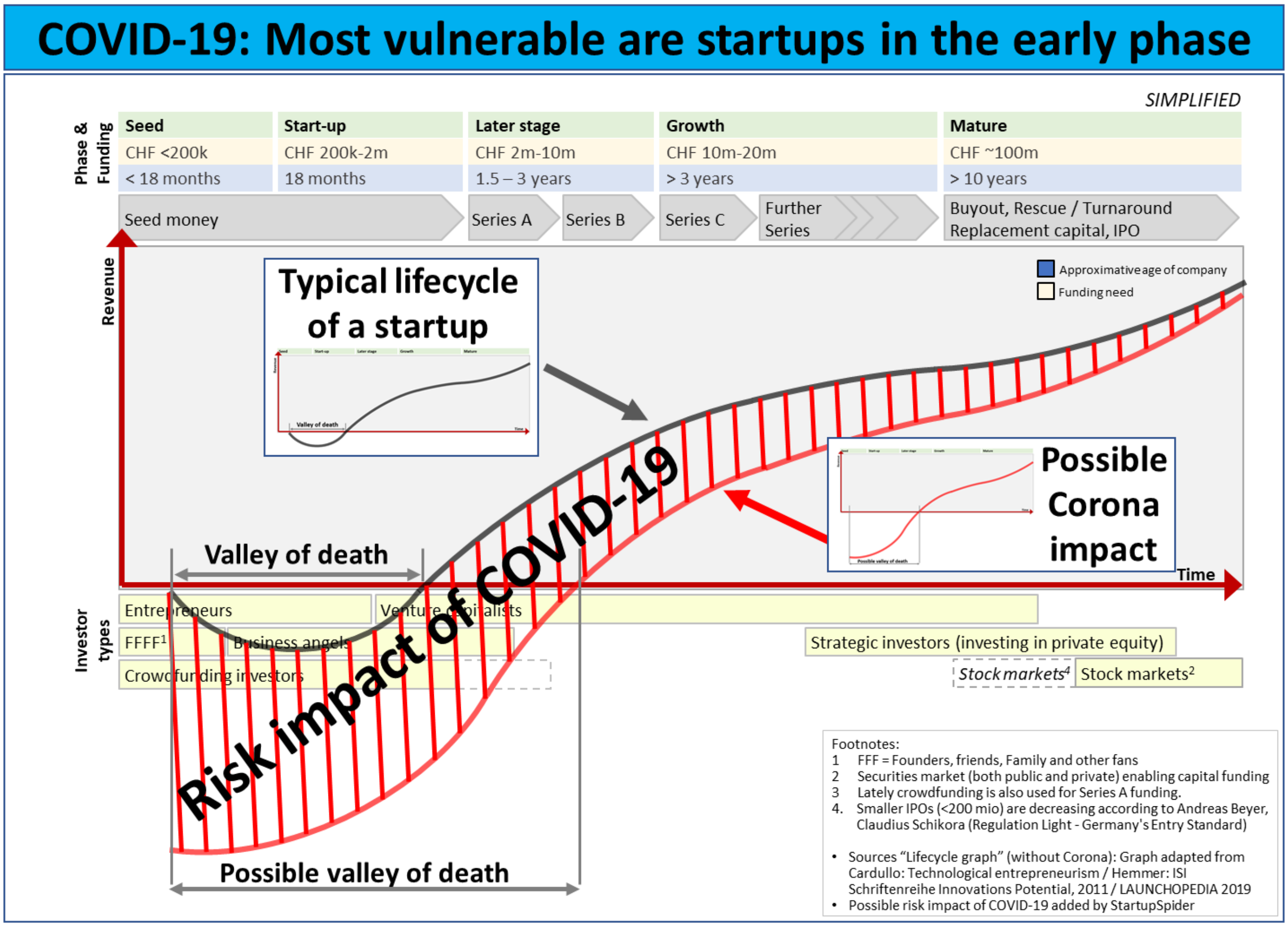
Summary of the various phases (in regards vulnerability and liquidity)

The table below gives a short abstract of the most important points of the various phases

	Seed	Startup / lager stage	Growth / mature phase
Investor type	Founder, FFF, maybe Crowdfunding	Business angels, VC	VC, strategic investor, IPO
Possible Liquidity	Few weeks, maybe a few of months	Monthly, maybe few years	Years
Chance to find funding "on demand" / "on the fly"	Difficult, as investor network first needs to get built. (little / no chance to get a credit)	Existing investor network may jump in. Some may also qualify to get support from the government	May get credit from a bank or even support from the government ("to big to fail")

Considering the different phases, investor constellation etc. the ones most vulnerable are those in the early phase:

- They have no buffer - Delay in supply chain or delay financing has direct impact
- They usually have no insurance in place, which may at least pay some sickness daily allowance
- They have no existing investor network which may jump in
- They have already invested their savings
- They are still in the phase “building something up” and can hardly ask the government for compensation money
- Even salary reduction or short-time-work has not much effect, as no or only little salary is paid out anyway
- Even if the founders have to close the startup, it won’t be easy to find a new job fast, if the whole industry is under such a pressure (hiring won’t be easy in the upcoming months)



2) Why is it important to save (support) such startups?

If you just take one individual startup in the seed phase, which is struggling, you can argue and say that this are individual fates. However, if you see it in the wider context, you may change your mind.

In Switzerland 90% of all companies are micro companies (less than 10 employees) and another 8.5% are so called Small size companies (below 50 employees). Both together are responsible for almost 50% of all employments in Switzerland. Such small companies are impacted hard by crisis like COVID-19, have less buffer and usually cannot afford insurance for such situations.

		Companies		Employees	
Company type	**Definition**	#	%	#	%
Micro company	<10 Employees	529’490	89.7	1’159’055	26
Small size company	<50 Employees	50’053	8.5	961’784	21.5
Medium size company	<250 employees	9’080	1.5	897’566	20.1
Large enterprise	> 250 employees	1’630	0.3	1’446’350	32.4
Total		**590’253**	**100**	**4’464’755**	**100**

Source: Federal statistical office, report Nov 2019[2]

Percentage / distribution in other jurisdictions is similar to Switzerland (according to Structural and Demographic Business Statistics (SDBS), OECD)[3]. That means that micro companies and small companies represent an important part of the industry and the future innovation.

Even under good circumstances it is not easy to build up successfully a new company. The press release from the Federal statistical office in Switzerland communicated November 2019 the following: *In 2017, 555 626 enterprises were engaged in a commercial economic activity in Switzerland. Of these, 39 303 (7.1% of the total) were started from scratch during that year.* ***New businesses have to fight for their survival.*** *Although four out of five enterprises created in 2016 were still active after one year,* ***the survival rate of new businesses from 2013 fell to 54.6% after four years****. These are the latest results from the Federal Statistical Office’s (FSO) statistics on business demography (UDEMO).*[4]

If already under good / “easy” conditions startups have difficulties to survive, with COVID-19 it even will become much harder.

According to FEMA, “*Following a disaster, 90% of smaller companies fail within a year unless they can resume operations within 5 days. Meanwhile, 20% of larger companies spend over 10 days per month on their continuity plans*”[5]. Maybe the type of disaster FEMA had in mind is not exactly something like an epidemic, but it may give some indication about the difficulties small companies are confronted with right now.

[2] https://www.bfs.admin.ch/bfs/de/home/statistiken/industrie-dienstleistungen/unternehmen-beschaeftigte/wirtschaftsstruktur-unternehmen.assetdetail.10287104.html
[3] https://stats.oecd.org/Index.aspx?QueryId=81352
[4] https://www.bfs.admin.ch/bfs/en/home/statistics/industry-services/businesses-employment.assetdetail.10687742.html
[5] https://www.fema.gov/media-library-data/1441212988001-1aa7fa978c5f999ed088dcaa815cb8cd/3a_BusinessInfographic-1.pdf

3) What can we do to support such startups best?

It starts with the startup itself. Try to get prepared as good as you can. Maybe you find our "Business Continuity Management & Disaster Recovery"- Checklist[6] useful. By now you will find also a lot of good guideline in the internet. Be creative to generate revenue differently e.g. you must cancel the startup-event? Why not selling tickets for the event a year later, right now? As part of the cancellation process? Be creative and innovative… as hard as it may sound, everything is always also a chance. Those who don't try, have lost half of the battle already.

However, for some startups it is very difficult. And they will fail, if they are not getting support. But what can we (you and I) do, to support these startups?

- As an investor, your focus is probably currently on your existing business. But if you think it through consciously, is this the only way? Maybe if you adjust your usual approach about funding size (if you go for smaller investment, you may require less valuation - which would take time, you currently do not have)? It may even pay back, as this startup will progress faster as competitors are impacted as well.
- If you are a customer of a startup, pay your bill immediately. It would be the worst moment, if startups now need to wait for their money. Large companies often pay bills only after months. This should be avoided now.
- If you are a service provider (and the startup is your customer), maybe you can offer the startup some additional time, before it must pay?
- Maybe you have services, a startup usually could not afford, but would be very helpful right now and you may be able to offer it for free for a certain time period? A great sample is FreeConferenceCall.com, which eliminates pay walls for video and collaboration tools in India to support Coronavirus response[7]
- In case you are the government, please think outside the box. The normal measures may not work. Think about the crisis in 2008… Now you can do something great.
- If you have knowledge, ideas or information a startup may help, please share. It's now the right time.
- …this are just few ideas. Please be creative. As more as we do now, as less hard it will hit us on the long run.

…at the end we all are human beings. We should show humanity, especially in times such as we have now.

We hope you are doing well, stay healthy and we wish nothing but the best.

Your StartupSpider-Team

[6] https://www.startupspider.com/assets/files/Tips&Tricks4Startups_BCMDisasterRecover_LightChecklist_v2.pdf
[7] http://www.uniindia.com/freeconferencecall-com-eliminates-pay-walls-for-video-and-collaboration-tools-in-india-to-support-coronavirus-response/business-economy/news/1913029.html