Briefing - COVID-19 immediate impact on high-tech innovative start-ups

9 April 2020[1]

Introduction

The COVID-19 pandemic has rapidly and significantly altered the entrepreneurial ecosystem in which the UK's high-tech innovative companies operate, the majority of which are SMEs, including many start-ups. These companies are a crucial part of the UK's innovation base. They are the pipeline of companies that will have the potential to grow to scale and constitute an important part of the UK innovation base.

This briefing is a rapid summary of the challenges faced by 34 Enterprise Hub members - high-tech innovative start-ups - in light of the COVID-19 pandemic. They are small organisations with fewer than 250 employees and turnovers of less than £50 million per annum - these are high-tech, innovative start-up businesses which operate in many different areas, from medical devices to sustainability and manufacturing.

The Royal Academy of Engineering's Enterprise Hub supports the most promising engineering and technology entrepreneurs. Established in 2013 it has supported over 200 researchers, recent graduates and SME leaders to start up and scale-up their businesses. This has involved awarding over £6.5 million in grant funding, and Hub Members have gone on to raise over £300 million in additional funding and create over 600 new jobs.

Immediate challenges

- **Funding landscape:** Investors are changing their behaviours, pulling out of deals, in some cases ceasing communication, reducing the volume of investment and preserving funds to invest in their existing portfolio, rather than looking for new investments.

"my potential investors have ceased communication due to the COVID-19 challenge"

"We closed our first seed round a few weeks ago, although we had two of our angels drop out due to the stock market crash from COVID-19. Fortunately, we were able to hold onto the other investors, but we had to remove one of roles from our hiring plan."

"R&D is one of the first things we are urged to cut by investors."

[1] The evidence was gathered after the announcement of Coronavirus Business Interruption Loan Scheme (CBILS) and the Coronavirus Job Retention Scheme, but prior to the announcement of the 'Future Fund' on 20 April 2020.

- **Access to facilities:**
  - Non-software high-tech innovative companies are heavily reliant on labs and specialist facilities to develop their products and services. Many of these activities have halted in the face of non-essential facilities being shut down – this includes universities, offices, manufacturing partners and other test-beds.
  - 17 of the 34 respondents explicitly identified access to facilities as a key issue in their responses, with several others alluding to it. The resulting suspension of clinical trials is cited by three as a major concern.

"our development timeline is frozen completely and thus we are likely to miss key milestones that would have enabled us to fundraise later this year or start generating revenue from product sales."

"We have managed to keep the lab open, for now, but at reduced capacity. That will change if the building closes, which would be close to catastrophic for us."

- **Loss of momentum, skills and ability to plan:**
  - Start-ups, often only eligible for the Job Retention Scheme in the government support package, are pausing their activities. Their reliance on equity or customer orders leaves limited or no cash reserves to maintain activity. Companies are not able to continue with product development or progress towards grant and business milestones or plan for the lifting of social and behavioural extensions. This is limiting their preparedness to have the best chance at surviving the crisis and resuming fundraising and innovation activities when the economy restarts.

"We have had to cut spend dramatically in the very short term, putting nearly all staff on the government furlough scheme, leaving our office etc. We took this action to 'buy time' and make sure we will be able to survive for at least 12 months on current cash if needs be. However, if we do not raise the next 12 months will be exceptionally slow and we will be able to achieve very little, we will likely need to cut staff or put them on much reduced salary."

Medium-Longer term challenges

- **Milestones:**
  - The delays the pandemic is posing to project timelines and development cycles means that many of the companies worry about missing the milestones of grants and schemes they are currently part of (e.g. through Innovate UK).
  - Ultimately, many see this limiting their ability to engage with investors in the longer term - for example, not having proof of concept completed.

"As a pre-revenue company, the economic slowdown doesn't directly affect us, but our main concern is burning cash without achieving technical and commercial milestones, and then being squeezed to achieve this before our next funding round."

"Most investment firms are not even considering new deals in the current climate and will be looking to support their existing portfolios. Therefore, raising an investment in the second half of this year will be extremely challenging given that we will not have demonstrated our pilot plant, will not be revenue generating and will be competing against a huge number of start-ups who are already in the pipeline for investment."

"we had to put on-hold product development (product evaluation is considered part of it): We planned to engage with a new collaborator to carry a new pilot study and that was not possible anymore. We also planned to hire new employees to progress in product development, we had to put that on hold too as it is not clear how things are going to unfold in the short and medium-term and we have a limited cash runway."

- **Customers and supply chains:**
  - The nature of these companies means that they are always collaborating, working closely with customers and suppliers. This is disrupted by the lockdowns around the world and facilities closures.
  - Many of them also rely on complex global supply chains which are seeing immediate and forecasted disruption.

"I'm concerned that not all my suppliers will be able to survive."

"We expect a large backlog in factories, on/off lockdowns in various locations around the world for the next 1-2 years, a reduction in capacity due to failing firms and facilities being requisitioned for Covid specific needs, a lack of supply of basic components etc. Even if we can diversify our supply chain and on-shore some parts to key markets to make it more resilient, the squeeze on basic components will make timelines longer and unpredictable."

This has culminated in companies having to halt their activities and being at risk of collapse. As many of these companies are growth-focused, reliant on equity and pre-revenue, they are not covered by existing government provision.

Their focus on equity investment means that many are operating on very small cash reserves – loans and tax breaks are therefore not useful. Some are too large for the cash grants, others are struggling to apply for them, and grants are extremely competitive.

"£10k Cash Grant for SMEs: We have had challenges with this and are yet to submit an application… We cannot complete the current application process as we are yet to have received an account number from the council and therefore slip at the first step on the application process. There is no answer from the helpline that is provided by the council dedicated for this and had no correspondence since submitting the SBRR form."

"Talking to the bank manager is important, but hard to do. Took us a week of constant calling just to get them on the phone."