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🦠 For startups, relevance matters

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10-12 minutes

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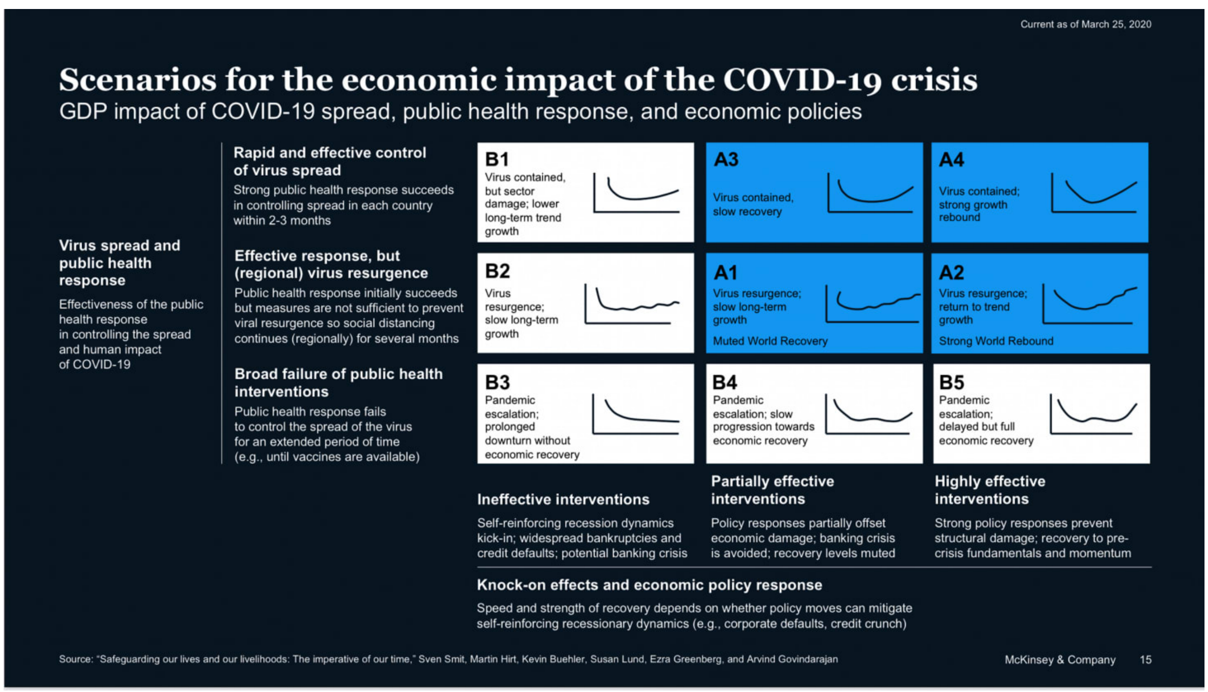
It is tough times for start-ups. Even the strongest rarely have more than 12-18 months of runway, predicated on hitting milestones and raising more money. The venture spigot won't dry up, but it will tighten dramatically. And consumers and businesses will similarly clamp down on their spending or, locked-in, be simply unable to spend.

NFX, an investment group, surveyed 400 founders and VCs to take their temperature. Founders are more optimistic, 70% of them think the US economy will have recovered by April 21. Half of VCs, on the other hand, reckon it will be April 2022 or later.

As I discussed in my note last week, I think the recovery will take much longer and the economy will veer on a different path.

There is a Z-axis

Despite what founders or analysts or consultants think the recovery won't be V-shaped, W-shaped, I shaped, nor a slow tick ✔ , with a long recovery.



How deep we go is up for debate. Goldman Sachs has suggested a 6.2% decline in US GDP. McKinsey & Co, whose lovely chart I use above, reckons an 8-13% decline to trough as of April 2nd (a pessimistic revision to their numbers the week before). I've suggested here that I think Goldman's numbers are optimistic. The bottom end of McKinsey's numbers seem more reasonable.

But these types of models, captured by the economist's limiting art of a two dimensional graph, ignore the structure of the recovery.

They imply that economy obeys the rules of turntablism, Adam Smith is replaced by Grandmaster Flash. Covid-19 is just a bout of scratching, and then the beat goes on.

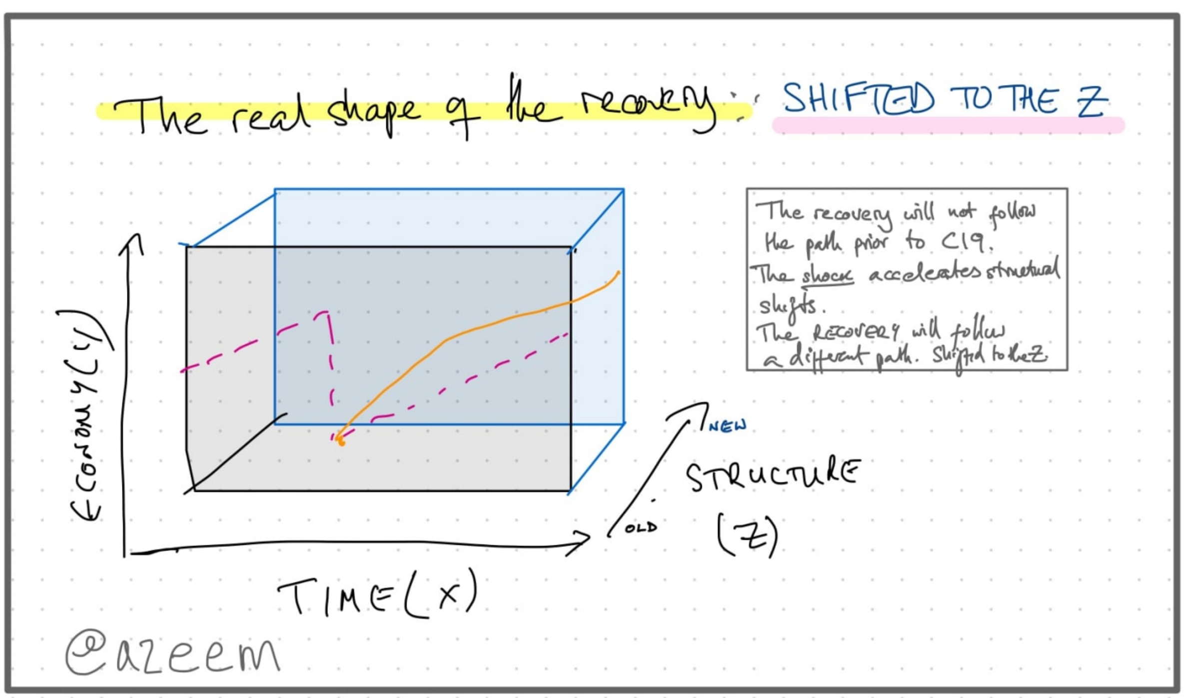
Nope.

The graphs shared by analysts ignore the dimensionality of the recovery. What new behaviours will emerge? Will consumer spending, pre-pandemic at 70% of economic activity miraculously, bounce back to those levels in 12 months? Or will it sink back to the the 60% level if occupied in the three decades to Ronald Reagan? Where geographically will recovery happen? At what scale, local vs regional vs national? We aren't skipping a beat or two, we're changing the record.

Those two-dimensional graphs miss the dimensionality of the recovery. From afar, our economies will recover and keep up their optimistic uptick, whether quickly or slowly. But up close, the detail will matter. The recovery will take a different path of the ones we have had previously. Even the word "downturn" deliberately fails to capture the structural shift in any recovery.

In 2001, I was an executive at an enterprise software firm selling search and knowledge management tools (for Lotus Notes, believe it, or not!) After 9/11, everything stopped for at least six months. And then orders started to come in again. That recovery followed pretty much the path prior to the terrorist attacks. This one won't.

The recovery graphs touted by analysts today lack a Z-axis. Their X-axis shows time, the Y-axis the size of the economy. The Z-axis tells us about the structure of the economy driving the response. I've tried to illustrate this below.



This shift in the Z-axis captures **where** the recovery will happen. And it shows that the recovery **won't** happen in on the same path that was ordained before the virus. (IF you won't a technical term, I'm reminding you that the economy is non-ergodic.)

Take just two examples of radical shifts:

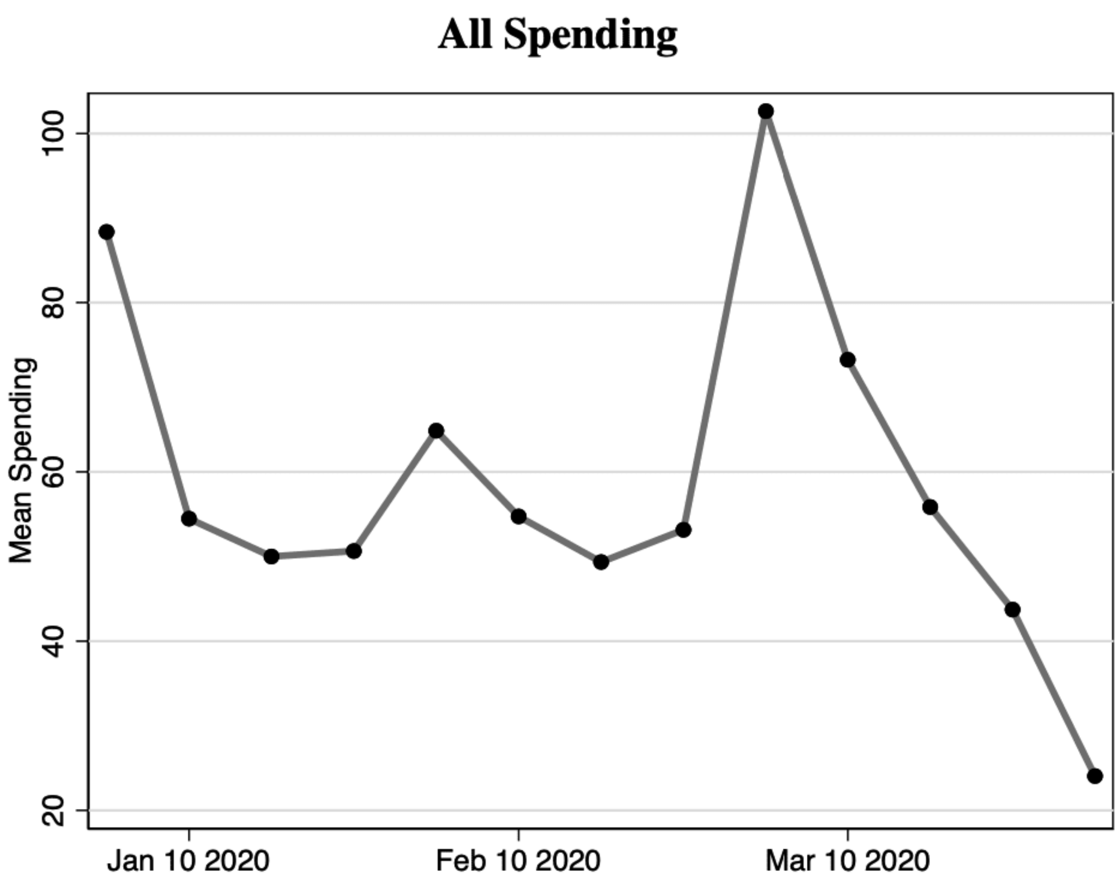
- MLB, a sports league in America, is considering their next season take place entirely in Arizona. Players and coaches would be isolated. And there would be no fans. (Last year, the typical MLB game attracted 28,317 fans.)
- Conferences, even those with tens of thousands of attendees, are going fully virtual. Take CogX, one of my favourite events. 16,000 people attended in person last year, nil in person this year. A larger audience, almost certainly, but virtual.

Putting numbers on it

These case studies are reflected in the vigour in the collapse of consumer confidence around the world, you'll have seen many of these graphs in the media recently. As McKinsey says here:

> *We estimate that 40 to 50 percent of discretionary consumer spending might not occur. In every recession, people will cut back on purchases that can easily be postponed (such as cars and appliances), and increase precautionary saving in anticipation of a worsening crisis. What makes the coronavirus pandemic different is that people will also eliminate spending for restaurants, travel, and other services that usually fall but do not drop to zero.*

Some early data suggests that the estimates of 40-50 per cent decline might be optimistic in the short term: How Does Household Spending Respond to an Epidemic? Consumption During the 2020 COVID-19 Pandemic. The data shows how daily household spending in dollars per day has evolved over the past two months.



A corollary is that I am hearing from at least one well-informed colleague that their are new savings behaviours emerging. That cash that might otherwise have been spent now give psychological comfort sitting in a secure bank account.

So one key question is the extent to which people return to their previous behaviours after the psychological impact of Covid-19. Will you really want to spend a weekend cheek-by-jowl in an elevator in a Westfield mall? The truth is we **don't know** but….

We might get some hints from the Chinese consumer, starting to emerge from lock-down now. Only 8% suggested they would do more shopping after the outbreak:

- "The virus has suppressed my passion for shopping," said Chloe Ni, a 34-year-old who runs a Beijing-based photography studio.
- "I used the lockdown period to clean out my flat thoroughly and duansheli lots of clothes and expired items. I've decided not to buy any more clothes and skincare products for the rest of the year" suggested another user on Zhihu, a website.

Just my view: we're in a huge long-term experiment right now, toying with new behaviours. We might like what we find and return to all our old ways grudgingly, if at all.

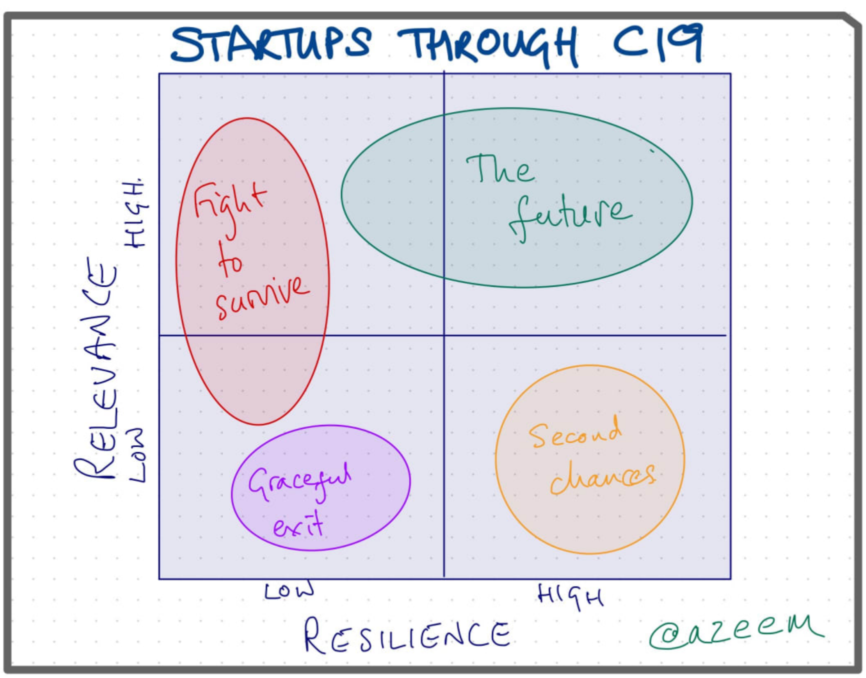
The question remains when the ball bounces, how will it bounce?

Relevance and resilience

When I think about the founder's quandary, I see a simple framework. On one axis is the startups resilience, mostly measured by its ability to survive the next 24 months. How much cash does it have? What is the burn rate? How tired is the team? How badly has its market been hit?

On the other axis is a start-ups relevance to our recovery. Some sectors are likely to have painful recoveries. For other sectors, if the recovery happens at all, these sectors will drastically reconfigure. Do we imagine the cruise ship industry bouncing back in six months? Even McKinsey optimistically reckons long-haul travel will take at least 1.5 years to recover. But what will recovery mean?

Other sectors, anything to do with the cloud, for example, will be highly relevant. Take Collibra, which makes a data governance platform, which this week raised $112m. Another highly relevant startup might be one which deals with touchless delivery, like Nuro, which produces autonomous robot delivery buggies. Or founders delivering telemedicine where there has been "ten years of change in one week."



So in the top right corner are firms that represent the future. They are resilient and relevant. Painful the next months might before for them, they will emerge into a market hungrier for their offerings.

In the bottom right corner are firms with deep pockets and possibly strong franchises. However, the premise of these companies may be shaken by our shift in the z-axis.

They may be of less relevance today. And so they have a second chance. This 'thoughtful pivot' would help them urgently reconceive how they deliver their services as well as what they actually deliver. (AirBnb is an example of a firm with the resources to possibly get through this, and they just took another $1bn from Silverlake partners to ride the turbulence. But even they will need to rethink their offerings in a world of frequent lockdowns and lower international travel.)

In the top-left corner are firms whose relevance may have increased but whose balance sheet was wobbly. Many firms in biotech, healthtech, remote work or fintech, will live here. Perhaps they had operated under the (reasonable) assumption that 9-12 months of runway was suitable. They will need to fight to survive.

Governments should take this opportunity to **sensibly** step in the steady the innovation industry. Co-investment with professional risk takers, as is being mooted in the UK, would make sense. (The French government has mooted a $4.3bn startup-support scheme.)

And in the bottom right will be a large number of firms whose flourishing was predicated on an open venture capital market and **on consumers and businesses behaving the way they did over the past five years**. Their raison d'etre may have been whacked by Covid. They may be betting on the bounce after the epidemic to simply delay their plans, startup turntablism. That is quite some bet.

For the startup founder, identifying which actions are appropriate has to depend on where you think you lie on this grid.

Azeem

Further thoughts on the industry:

- 🦄 The Covid-19 crisis will expedite the unicorn reality check. We'll see more lofty valuations and fake tech exposed, as unicorns go under and are "sold to the big uglies". (We can call this the "Graceful Exit".)
- Covid-19 is turbocharging the Silicon Valley natural selection.
- How Bird laid off 400 workers.
- As unicorns fall, investor Jason Lemkin wonders whether the tide will turn on San Francisco as the centre of the software-as-a-service sector.
- In a conversation I recorded with Softbank's Deep Nishar several weeks ago, we touched on what businesses will stay in business despite the crisis. In a separate conversation I had more recently with one of the top tech market analysts, Pierre Ferragu, we go into more detail about the ramifications of the pandemic for technology companies, big and small.

Thanks to Jaka Levstek, Manar Hussain, Joe Cohen and Ussal Sahbaz for input on this.