The Central Conundrum of Covid-19 Entrepreneurship

A recently released report reveals how one entrepreneurial ecosystem is responding to the pandemic.

To get to the top and remain there, businesses must constantly develop new capabilities as they leverage existing ones. Keeping both priorities in play is tricky in the best of times, which is why legacy companies of late have been increasingly outsourcing innovation to tech start-ups via partnerships or outright acquisitions, a trend that has generated tremendous value for start-ups and their investors.

However, with economic activity now slowed to a crawl in many sectors, firms have increasingly shifted their focus to short-term survival considerations and longer-term innovation priorities have temporarily fallen by the wayside. One result is that start-ups have been hit especially hard: **Global VC funding has plunged** by 20 percent, and **new deals are declining sharply**.

The central dilemma facing investors and entrepreneurs in this environment is whether to view the crisis holistically or opportunistically. In other words, are they to expect a long-term shift requiring a fundamental change to their investment thesis, or simply a temporary deviation from the norm? The stakes are high indeed. It is no exaggeration to say that the future of many venture funds and start-ups depends on which of these two visions of the post-Covid future turns out to be true – or truer.

A MENA start-up snapshot

The recently released **Start-up and VC Sentiment Report** – a collaboration between **digital@INSEAD** and Dubai-based data platform **MAGNiTT** – provides a snapshot of how the MENA regional ecosystem is dealing with this dilemma. The survey had 226 respondents (190 founders and 36 investors), 87 of whom were based in the United Arab Emirates. The entrepreneurs represented a diverse range of industries, chiefly ICT (12 percent), professional services (11 percent), finance and insurance (nine percent), education (nine percent) and healthcare (eight percent).

Not surprisingly, the participants' macro-economic outlook was generally bleak – especially among the entrepreneurs, 24 percent of whom anticipated that Covid-19 would trigger an economic depression. Seventy-five percent of investors and 55 percent of founders believed the damage would be limited to a recession.

Interestingly, late-stage start-ups were more pessimistic than early-stage ones, despite experiencing less severe fundraising woes in the pandemic (see below). It may simply be that inexperience breeds an optimism that can survive initial encounters with adversity.

For start-ups, the scale and pace of fundraising seemed mostly Covid-determined. A minority of ventures (18 percent) belonging to industries likely to benefit from the pandemic – mainly fintech, education and ICT – said they had sped up their fundraising. The rest reported delaying fundraising rounds or seeing their valuations revised down.

Investors, too, did not appear to be thinking beyond the pandemic. One-third said they had not changed their basic investment philosophy because of Covid-19. An additional 27 percent changed only their industry focus, pivoting to sectors that seemed well poised to profit from the crisis. New investments were mostly restricted to doubling down on existing portfolio companies – hence the aforementioned better outcomes for late-stage ventures. Very few reported searching for untapped value amid the economic crunch by entering new markets. The majority (58 percent) were looking to delay exits.

In an opinion piece on **the MAGNiTT website**, Walid Mansour, chief investing officer and managing partner at MEVP, said, "The major impact of Covid-19 is in changing consumer behaviour due to the recession…From the investor's perspective, we take this behavioural shift as a basis for our analysis, trying to identify the sectors and subsectors that are going to be particularly attractive, and revise the ones that will suffer."

Investors and start-ups agreed that the three most pressing challenges arising from Covid-19 were fundraising, declining revenues and the need to cut expenses, in that order. Some 85 percent of respondents expected revenues to either stagnate or fall further as the crisis wears on.

What to do?

Investors noted that their portfolio companies' response to the crisis had mainly taken the form of salary reductions, layoffs and hiring freezes. Primary steps taken by the broader start-up community included altering business models as well as products and services. Only 15 percent of the start-ups reported resorting to layoffs. Indeed, more founders expected to increase headcount by 25 percent as opposed to letting even one person go.

Tarek Kabrit, CEO of auto-sales app Seez, **offered advice to entrepreneurs** that captured the new conservative spirit seizing the sector. "For the last five years, 'growing at any cost' was the mantra. Now there needs to be at least a view for profitability. Don't stress so much about valuation at the expense of losing a round or a good investor. I would say focus on profitability, hoard cash as much as you can, and raise more funding than you think you need because you never really know what can happen."

Investors, too, were hedging their bets. As one survey respondent put it, "We are more cautious about valuations [after Covid-19]. We have opted for flexible financial tools to adapt to any unexpected contingency rather than investing directly in equity."

The global ecosystem

As the survey results suggest, many players in the MENA start-up sector are treating the current crisis opportunistically. Depending on the nature of their business, companies are either busy capitalising on the market changes produced by the pandemic, or scrambling to adapt. Similarly, investors are either increasing support for portfolio companies that have become more relevant in light of Covid, or waiting out the crisis with their hands in their pockets.

This opportunistic approach may not hold true in other entrepreneurial ecosystems and may also vary as a function of the level of government support. The survey offers insights for policymakers with respect to how they could lend support to start-ups, such as through short-term interventions like office rent relief and loan guarantees, and also through longer-term measures like new funding mechanisms that could provide medium-term liquidity.

Additionally, the situation in MENA may look considerably different as we head into 2021. That is why INSEAD and MAGNiTT plan to run this survey every six to nine months.

For a global perspective on the central conundrum, you can follow the exploits of the **INSEAD Summer Start-up Tour**, or 'SSUP! With the guidance of faculty members including myself, eight teams of MBA students are fanning out on a fact-finding tour of entrepreneurial hot-spots around the world, conducting in-person (where possible) and virtual meetings with VCs, angel investors and entrepreneurs.

Follow updates from 'SSUP! on LinkedIn.

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Click here to download the report and view a webinar hosted by Prof. Aggarwal.

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