



## Necessity is the Mother of Invention: The Birth of Startups During a Recession





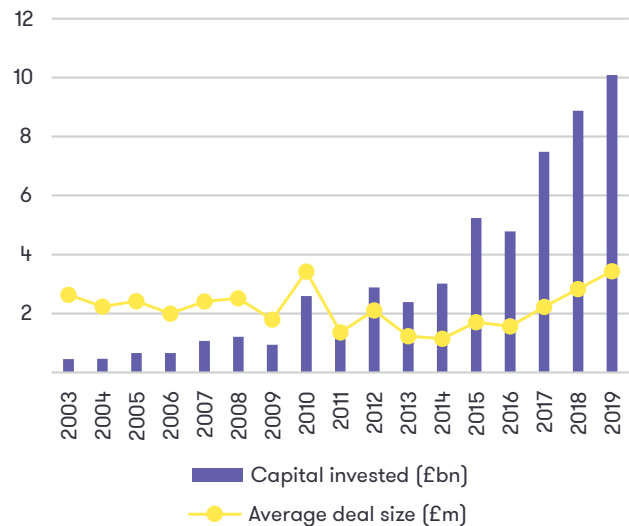
## Introduction

Most of us have never experienced anything even remotely similar to the situation the world is currently facing and there are a number of reasons to believe that the likely recession will be deeper than the GFC. First and foremost, the economic impacts this time around have been sudden and drastic. The ‘pause’ button has been abruptly pressed for entire sectors. If the GFC was a stroll down a hill, the COVID-19 recession is a leap off a cliff.

Things will be different this time around, but nonetheless there are certain lessons that history can teach us about how things might play out. In this report, we look at UK data from the GFC to better understand what the situation might look like for startups and scale-ups over the medium term and how this could impact flexible offices.

During the GFC, venture capital investment in the UK remained resilient for the first year, before falling 22% in 2009. However, despite the fall, 2009 venture capital investment remained at elevated levels compared to the few years prior to the GFC and was over double that seen in 2004. The 2008-09 recession did impact venture capital investment but it didn’t grind to a screeching halt. There was still capital available for startups. Companies such as Uber, Air B&B and Groupon all raised money in 2008-09. The year after the recession ended in 2010, venture capital investment rebounded in full force, nearly trebling.

### UK venture capital investment



Source: PitchBook

Despite the fall, 2009 venture capital investment remained at elevated levels compared to the few years prior to the GFC

## It takes time for dry powder to dry up

In 2008-09, there was a clear lag between the start of the recession and the fall in venture capital investment. In fact, venture capital investment in the first quarter of 2008 was the highest on record at that point in time. This could be attributed to the fact that very few people accurately predict recessions and therefore VCs will likely have a 'normalised' level of dry powder to deploy over the coming quarters regardless of the macroeconomic conditions. Essentially, it takes time for dry powder to dry up. However, in some cases limited partners that provide VCs with capital do ask for it not to be deployed until a later date.

In addition, even if venture capital investment was at a normalised level going into both this likely recession and the GFC, fresh capital may well taper off much more quickly this time. What is most different is that we know a downturn is coming, and this will likely translate into a more sudden drop in fresh capital available to VCs rather than the more gradual decline seen in 2008-09. Still, the capital committed before it was clear the economy was entering a recession will support investment in startups to some extent.

Recessions often cause a shift in risk aversion. One might hypothesise that investors would turn their attention away from early-stage start-ups and focus on later stage VC investments with longer track records. However, the UK data from 2008-09 shows quite the opposite. 2009 saw the proportion of investment going into early stage startups in the UK near all-time highs as risk appetites shifted. Investors started writing a greater number of smaller cheques in order to diversify their portfolios and the average UK deal size fell 29% in 2009 to £1.8m. In the battle of track record vs diversification, the latter won. For investors with available capital, recessions can be a golden opportunity for value investing.

## The winners and the losers

So which sectors fared best during the GFC? The top five fastest growing verticals were all related to tech. HealthTech proved the most robust with a 334% growth rate, albeit the 2007-09 growth was skewed by a particularly large raise of £41m by Optegra (an eye care hospital operator) in January 2009.

Nanotechnology, Marketing Tech, Mobility Tech and CleanTech also saw exceptional growth rates. Marketing Tech includes tools that automate and simplify tools for marketers, so it makes sense that this area would perform well during a downturn where companies are looking to automate processes to reduce costs. Another vertical that benefitted from the recession, which we have not included in our ranking because it essentially did not exist in the UK before 2008, is FoodTech.

### Top five fastest growing verticals in the UK during the GFC

2007-2009 VC investment growth	
HealthTech	334%
Nanotechnology	240%
Marketing Tech	150%
Mobility Tech	144%
CleanTech	98%

AdTech saw a marked decline during the prior recession, along with B2B Payments, Digital Health, AI and Machine Learning and Cybersecurity. Marketing spend on online advertising is often one of the first areas to be cut by companies going into a recession and innovation relating to AdTech tends to be pushed further down on a company's list of priorities. In a similar vein, it's also feasible that innovation within B2B payments and AI are not as valued during periods of widespread cost-cutting.

### Top five fastest shrinking verticals in the UK during the GFC

2007-2009 VC investment growth	
AdTech	-92%
B2B Payments	-88%
Digital Health	-88%
AI & Machine Learning	-84%
Cybersecurity	-80%

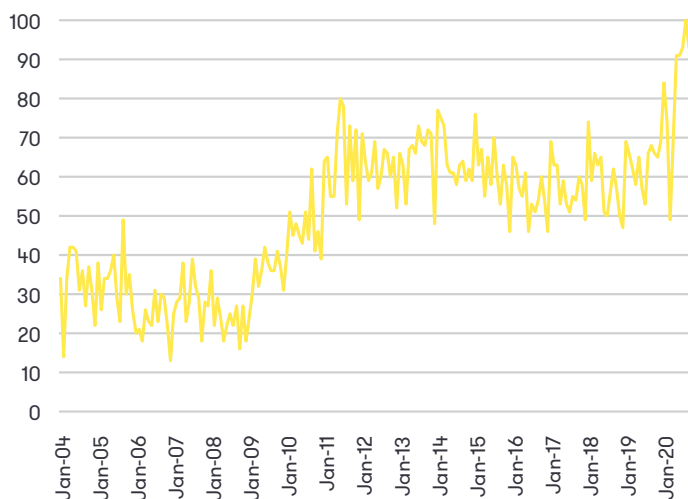
In some ways the world looks very different now compared to 2008-09. For example, EdTech and eSports are now sizeable markets. Mobility Tech is a completely different landscape with the rise of Uber and other ride-hailing companies. However, some trends we expect to play out again, for example, we expect B2B Payments to see a sharp decline.



## When do people think about setting new businesses?

We used trends in the Google search term ‘how to set up a business’ as a proxy for interest in setting up a business. There was an increase in searches for ‘how to set up a business’ just after the GFC in January 2010. However, in August of this year, there was the highest number of searches for that phrase in the UK on record. This could be because the drop in economic activity was much more sudden this year. Many people are expecting a recession and may well be looking into setting up a business as a result of losing their jobs already or as a back-up plan in case they do.

**Google trends index: search frequency in the UK for ‘how to start a business’**

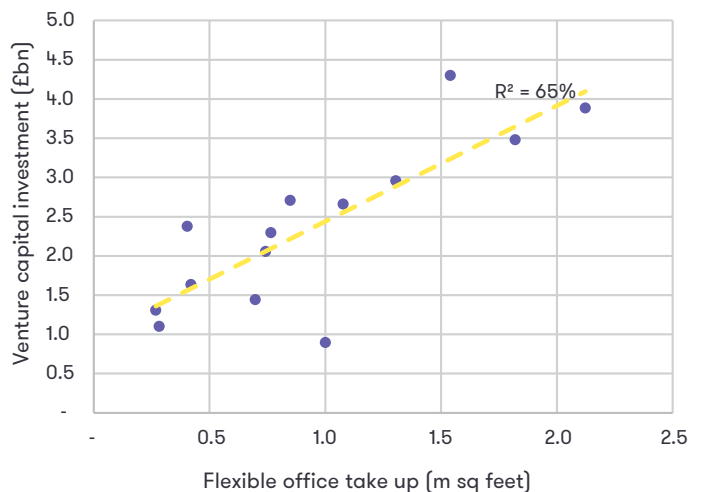


Source: PitchBook, Savills data, from 2H13 until 1H19

## What this means for flexible offices

Venture capital investment is a major facilitator of growth of startup and small businesses. Historically, this has created a strong link between venture capital investment and demand for serviced and coworking office space, which is generally the preferred choice for these types of businesses due to the flexible terms and facilities that they offer. Even though an increasing number of global corporates are choosing to place a portion of their employees in coworking spaces, flexible offices still mostly cater for small businesses.

**UK flexible office take up vs venture capital investment**



Source: PitchBook, Savills data, from 2H13 until 1H19

Many flexible offices have essentially been empty for the past three months and incorporating social distancing measures whilst maintaining profitability will be challenging for flexible offices in the short-term. However, it is comforting to know that whilst UK VC investment fell during the GFC, it did not fall off a cliff. There will still be start-ups that raise money and need office space for their workers (most likely flexible office space).



## Necessity is the mother of invention

To summarise, we do not expect funding for start-ups to shrink sharply and suddenly, particularly with VCs already having committed capital to deploy from before COVID-19 and government initiatives such as ‘The Future Fund’ in place. In addition, VC investment can bounce back strongly, with UK VC investment trebling the year after the GFC, providing ample capital for new companies.

Startups with great ideas and great leaders will raise money to grow and most will need office space to have a productive, collaborative and happy workforce. Millions of people around the world have already lost their jobs as a result of COVID-19 which is a huge tragedy, but for some this might prove the perfect time to start a business. As they say, necessity is the mother of invention. This can be applied in more ways than one. In addition, the global landscape will look very different post-COVID-19 and we will need a different mix of products and services to cater for it.

The GFC gave birth to a number of startups and scale-ups that changed the world and, for all the devastation that has been caused by the pandemic, the current situation could be an opportunity for innovation and change.



Workthere.com

Workthere is a business by Savills focused solely on helping businesses find flexible office space, whether that's a serviced office, co-working or shared space.

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