WILL COVID-19 CHANGE LEVELS OF EARLY-STAGE INVESTMENT WITHIN THE KNOWLEDGE ECONOMY? A REPORT OF RESEARCH FROM ADVANCED OXFORD AND OXFORD INVESTMENT OPPORTUNITY NETWORK

(28 MAY, 2020)

Executive Summary

This research from Advanced Oxford, in conjunction Oxford Investment Opportunity Network, provides valuable insight from a group of active investors, all of whom have an interest in early-stage investment, all of whom invest in knowledge-economy sectors. While there is cause for optimism that just over half expect to make the same level of investment, or more investment, when compared to the previous 12 months, just under a half expect their level of investment to reduce. There appears to be a strong preference for focusing on investment into existing portfolio companies and an expectation that the amount of money available for investment into early-stage companies will reduce. This may mean that some younger, early-stage companies will struggle to attract investment in the short to medium term, particularly where they are raising investment for the first time. These companies are also the companies that fall outside of the eligibility for the Future Fund and as a result, other interventions may be needed to encourage and incentivise seed and early-stage investment. While investors seem to be focused on supporting companies within their investment portfolios, there is an expectation that there will be higher level of company failure than previously predicted.

Government support for the early stage businesses is very welcome but respondents indicated a strong need for additional support due to a significant reduction in investment from angels and seed/VC funding which threatens the viability of many small R&D intensive businesses.

Introduction

Access to finance is a key issue for Advanced Oxford and is one of our active research areas. Availability of risk capital is critical to R&D/innovation-based businesses as they set up, grow and scale.

The COVID 19 epidemic, with its significant health, social and economic impacts will almost certainly create significant changes to the investment environment for companies moving forward.
The announcement of the Future Fund heralded a recognition that high-risk, high-growth, venture-backed companies require a different type of policy response to those taken forward earlier in the pandemic.

The Future Fund launched on 20th May, providing an opportunity for investors to apply for convertible loans to match private investment, up to a maximum Government match of £5m. This intervention has strict eligibility criteria, including the need for investee companies to have previously raised at least £250k of equity investment, the match from investors is required to be in the form of convertible loans, and such instruments do not qualify for EIS relief. This effectively excludes angel investors from this scheme. The scheme is clearly directed at more mature companies (series A/B) and is unlikely to support earlier stage companies, pre-series A.

Advanced Oxford has been collecting insights from Oxfordshire-based innovation/R&D companies since the start of the lockdown period across a number of business issues. Concerns about investment and cash-flow are significant (view report here). This led Advanced Oxford in conjunction with Oxford Investment Opportunity Network (OION) to create a survey directed at investors, allowing us to develop insights into how Covid-19 is impacting the supply side, with questions about investment intentions and appetite. The survey can be viewed here: https://www.surveymonkey.co.uk/r/NRV7SGG

Recognising that the Future Fund has not been designed to support early-stage companies, which for the purposes of our research, we defined as any company raising pre-series A funding, our research has focused on these earlier stage companies, and seeks to identify the impacts of Covid-19 on investing, as well as identifying policy and support activities which may assist.

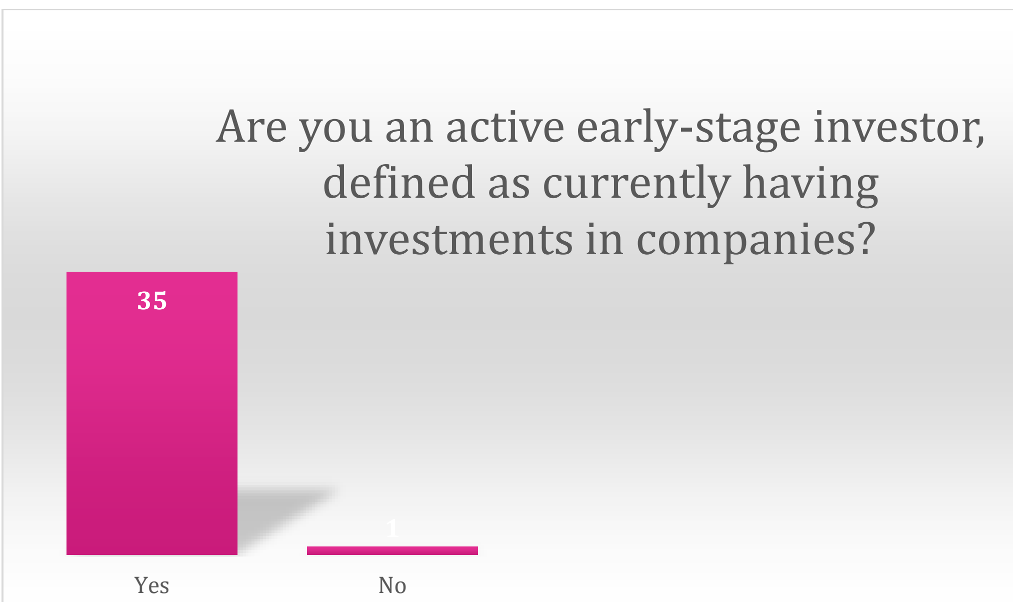
Survey findings and analysis of responses

Data was collected between 27th April and 18th May, 2020. 36 individual investors responded to the survey. We consider this to be a good response and a representative sample.

Who responded to our survey? – characterising the investors who took part in our research

In the first part of the survey we asked respondents about themselves, their investing activity, how they invest and the sectors that they invest in.

Chart 1: Are you an active investor in early-stage companies (pre-series A) where active means that you have current investments in companies?



Not only were respondents active investors, the majority had made an investment within 2020.

(Table 1) When did you last make an investment?

Last investment made	Percentage of respondents answering
2020	72%
2019	22%
2018	0%
2017 or earlier	6%

Chart 2: What kind of investor are you? (please tick as many as relevant)

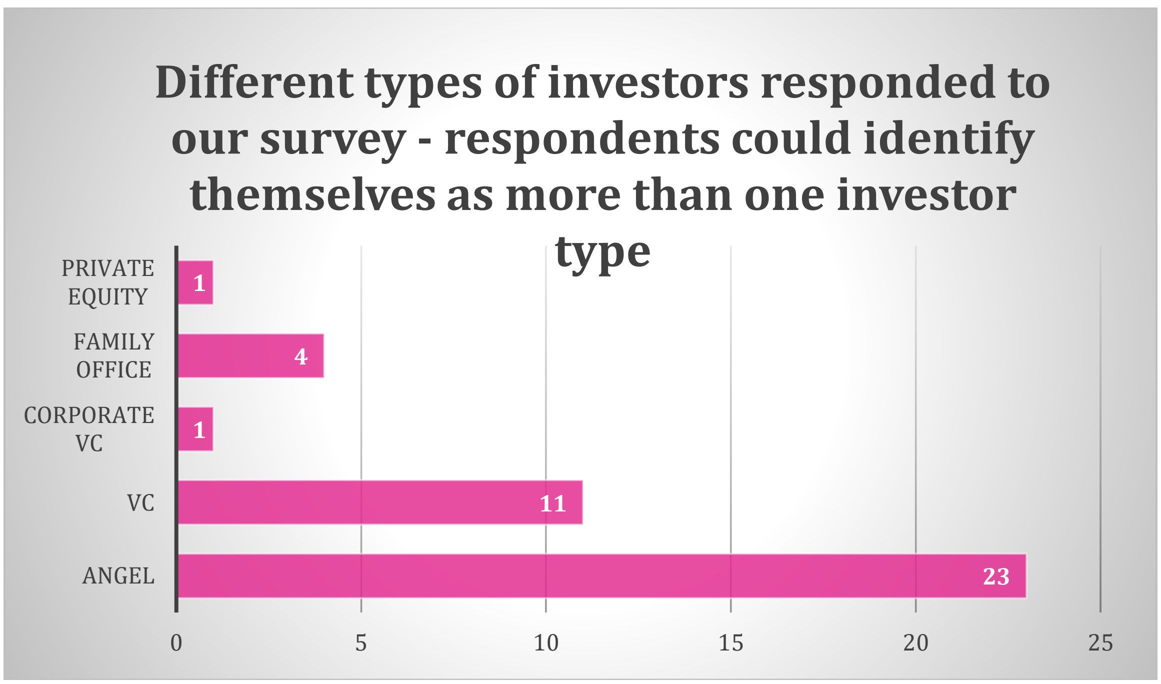
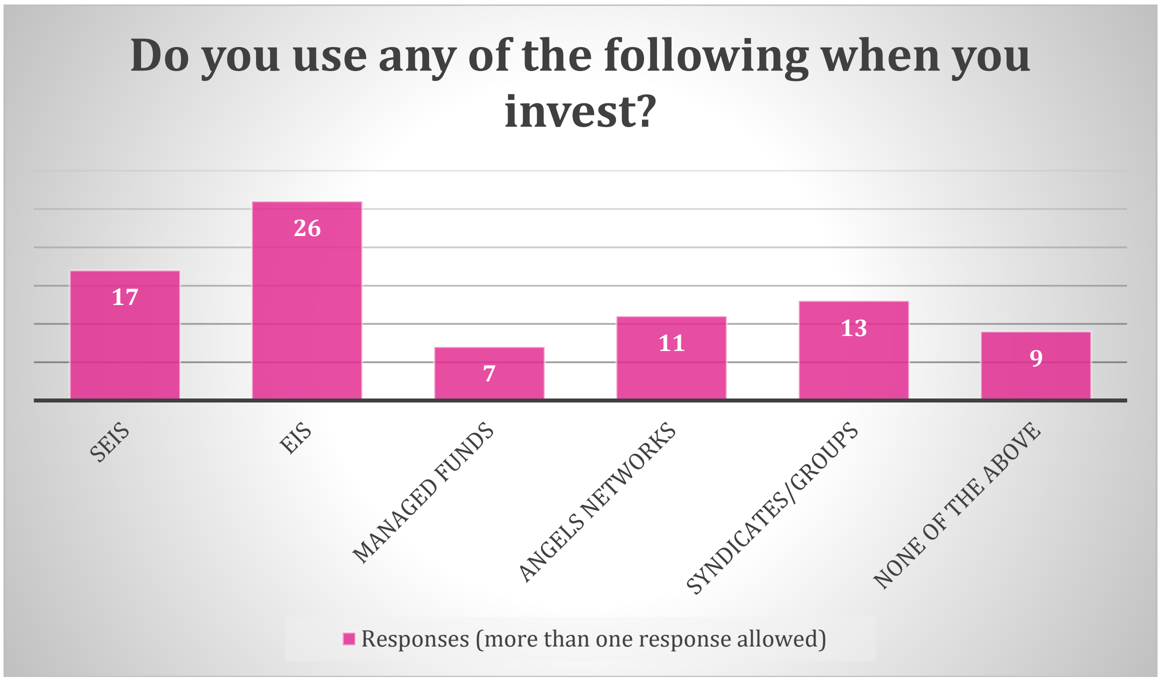


Chart 3: Do you use any of the following? (Please tick as many as relevant)



We asked what mechanisms investors use, with respondents able to identify as many responses as relevant. Use of SEIS and EIS was common within the group of respondents. 47% of respondents invest in SEIS companies and 72% invest in EIS companies. No respondent indicated that they invest in SEIS only; 9 stated that they invest in EIS and not in SEIS companies.

Sectoral mix of investment

Investments are made into a range of sectors and 100% of investors responding to this survey are investors into the knowledge economy. All respondents indicating that they invested into *Other Sectors (not technology, science or knowledge based*) also identified themselves as investing into knowledge economy related sectors.

(Table 2) Which sectors do you invest in? Identify as many as relevant

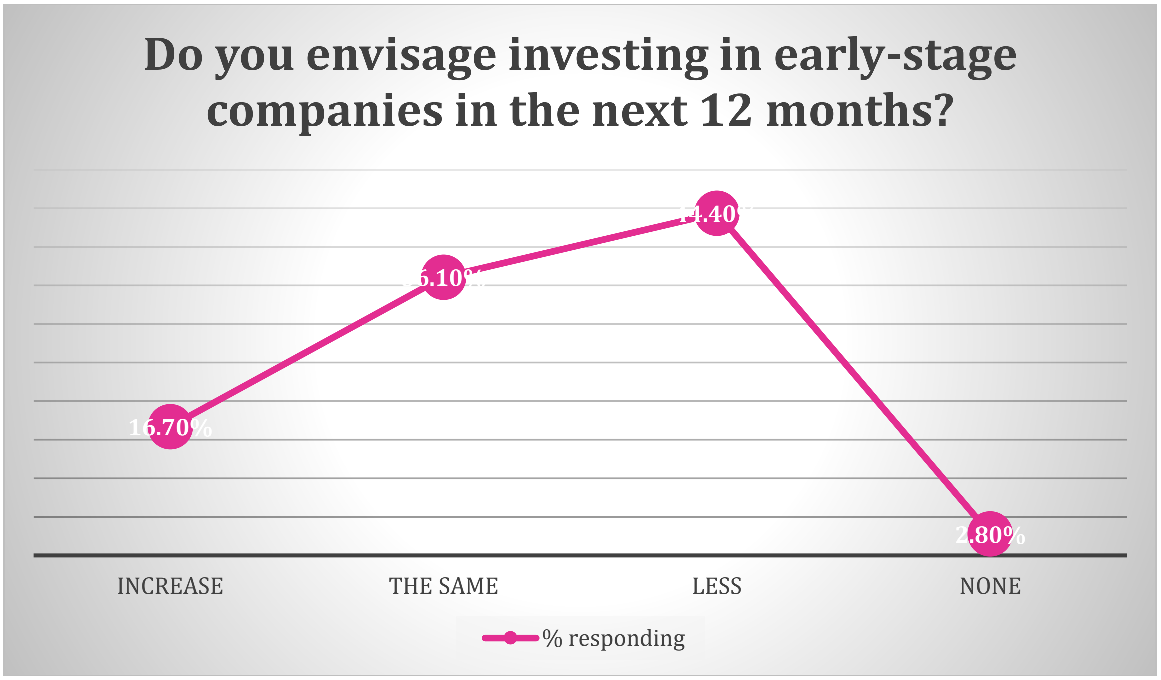
Sector	% of responses
Life Sciences	50.0%
Energy/low carbon	19.4%
Data/AI	44.4%
Technology (ICT/digital)	58.3%
Space/satellite technologies	13.9%
Engineering/robotics	36.1%
Other knowledge economy	25.0%
Other sectors (not technology, science or knowledge based)	13.9%
No particular sector preference	30.6%

Intentions and expectations

Having identified and characterised our responding investors, we asked them a set of questions about their investment intentions and expectations. These questions related both to the respondents' investment plans, but also what they thought was likely to happen with regard to company failure rates.

We asked respondents whether they intended to make investments within the next 12 months, positioning their response as a comparison to the previous 12 months. 19 of the 36 respondents stated that they would either increase or invest at the same level as last year (6 indicated an increased amount of investment, with 13 stating that the level would be roughly the same). 16/36 thought that their level of investment would decrease and only 1 respondent stated that they do not intend to make any investments within the next 12 months.

Chart 4: In the next 12 months, do you envisage making investments in early-stage (pre-series A) companies?



Legend

Increase	An increased amount compared to the last 12 months	16.7%
The same	Roughly the same amount as the last 12 months	36.1%
Less	Less than the amount invested in the last 12 months	44.4%
None	I do not intend to make any investments in the next 12 months	2.8%

While it is positive that some investors intend to increase their investments and just over a third of investors expect their investing to remain stable, with 47% stating that they would reduce or stop investing, there may be cause for concern. Due to the nature of the survey, we are unable to identify whether new investors will take the place of those reducing their investment activity. However, this is something that should be monitored as it suggests that the appetite for investment may be reduced and this is certainly supported by data from questions later in the survey.

"Over the course of the next 12 months, we expect to invest in roughly the same amount of new investments as last year, but this is below our initial target number that was set pre-Covid." (investor A)

We have no empirical data to show whether these intentions represent a change of plans, however we did ask respondents to tell us *if Covid-19 had impacted investment plans for the next year and the kind of investments that respondents might make* - in a small number of instances respondents did indicate a change in relation to their original plan.

"I have decided to focus on the investments that I have already made in order to support these as a result of Covid-19" (investor B)

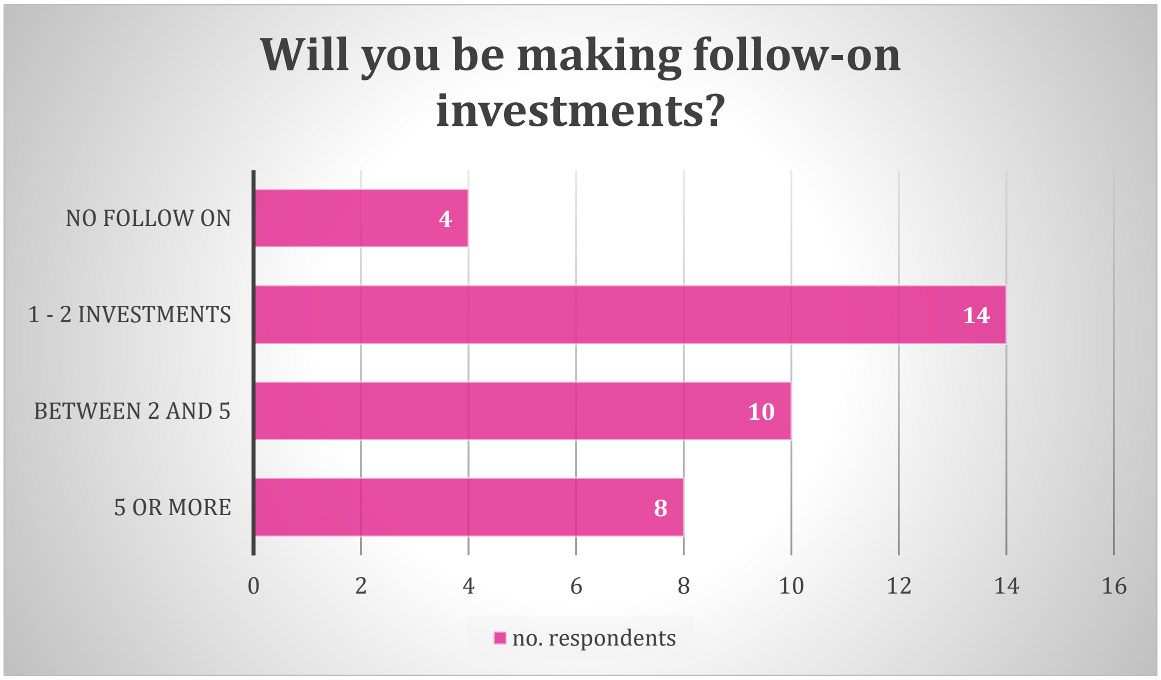
The survey invited investors to provide free-text answers and the responses have been coded to draw out the key messages and issues. As survey respondents could identify as many issues as they choose, the response data reflects the number of times that an issue was mentioned by different investors.

(Table 3): Has the current Covid-19 situation impacted on your investment plans for the next year and the types of investments you might make? Please tell us about any impacts.

Issue/concern	Number of responses citing this issue
No impact	3
A focus on existing portfolio/company investments	**10**
Shift of focus or sector preference	5
Consider the environment to be challenging/need for caution	3
Less money available for investment/less money for new investments	**15**
Need for lower valuations	2
Need for more due diligence/focus on business fundamentals	4
Difficult trading conditions/revenue generation an issue (identified as an issue relating to investee companies)	3
Increased investment	1

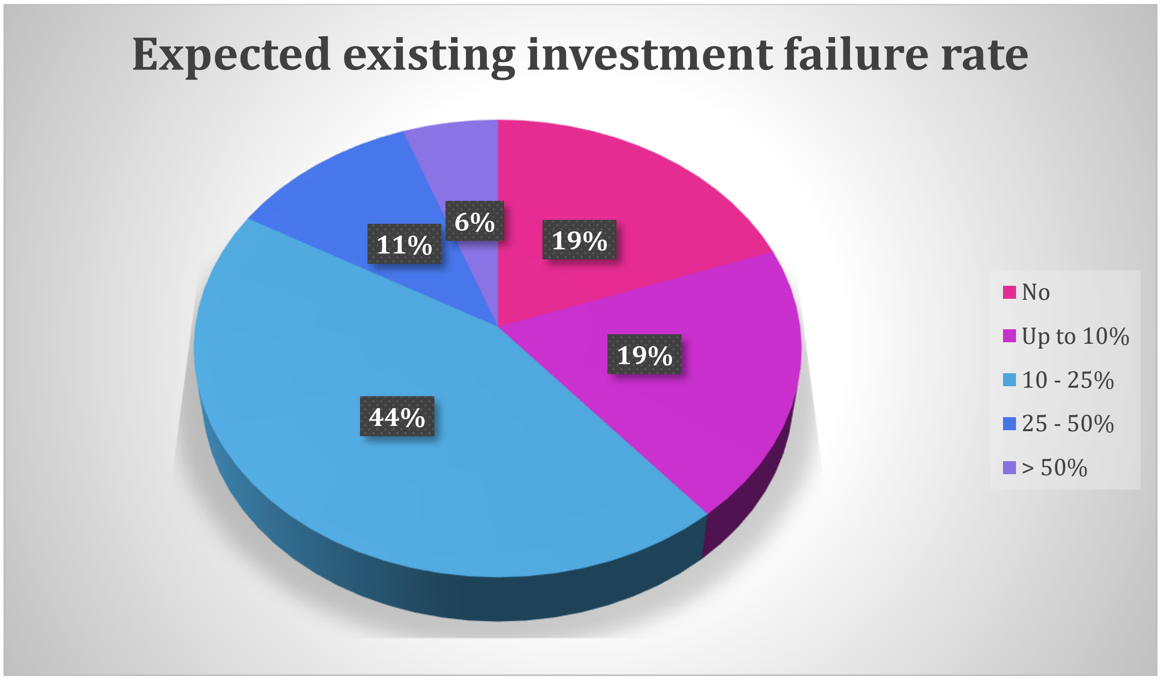
From the responses above, we can see that investors are increasingly focusing on supporting companies within their existing portfolio of investments and that they expect there to be lower amounts of money to invest, in particular for new investments. This data supports findings from a webinar that was held by Advanced Oxford and OION on 5th May, where a group of investors discussed the impact of Covid-19 on their investment plans. (A report and recording from this webinar be accessed here.) When specifically asked about follow-on investments, the majority indicated that they expected to make follow-on investments into companies that they had already invested in (32/36 (89%) will be making at least one follow-on investment into a portfolio company).

Chart 5: Will you be making follow-on investments in companies that you have already invested in?



We asked investors whether they expected an increased failure rate within their current investments – the response was clear; the majority expect to see an increased level of failure. Only 7/36 respondents (19%) stated that they did not expect to see greater levels of company failure; whereas the remainder expected to see some level of increase, with the mode (44%) expecting to see failure rates increase by 10 – 25%.

Chart 6: Are you expecting to see an increased failure rate in existing investments?



The Future Fund and Government Intervention

In the final part of our research, we turned to questions relating to the Future Fund and what other intervention or policy response would be helpful to support early-stage investing. Levels of awareness of the Future Fund were high, with only 4 of the 36 respondents indicating that they were not aware of the Future Fund. When asked whether investors thought that it would be help investment into early-stage companies, 33 investors responded to the question. Opinion was divided, with slightly more seeing it as helpful – 18/33 responded that 'yes' it will be helpful (55%) and 15/33 responded 'no' (45%).

For respondents who were familiar with the Future Fund, we asked them to provide free-text views on the Future Fund. When examining these responses, only a small number of respondents (n=4) went on to say that they thought that the scheme was helpful, but other responses were more focused on concerns or areas where there was either need for more clarity. These included:

- EIS incompatibility
- A perceived preference to support later stage companies
- The scheme not being fit for purpose
- Punitive/unattractive terms

The final question in the survey, "*what actions/policy interventions do you think that Government should consider to encourage and incentivise investment into early-stage companies*?'' drew out a wider set of ideas and issues, although some respondents took the opportunity to restate concerns about the design of the Future Fund, as announced (all survey responses were received prior to the launch of the Future Fund on 20th May). Again, EIS compatibility and fairer terms, particularly the ability to use existing investment as match, were the issues cited in relation to the fund.

A range of other actions and policy interventions were also identified. The most common were:

- Increase SEIS/EIS/tax incentives for early-stage investors
- Increase availability of grant funding
- Use of innovation policies (see below)

With regard to innovation policies, the ideas echoed those that were discussed and suggested during the Investment webinar held by Advanced Oxford and OION on 5th May, including:

- Support to grant funding organisations
- Policies to support angel investment, including expansion and development of co-investment funds
- Payment of Innovate UK grants upfront, rather than in arrears in order to support cash-flow activities within companies
- Support through the R&D tax credit scheme

There was also praise for the furlough scheme. In common with feedback received through the webinar discussion, investors see benefit in introducing greater flexibility into the furlough arrangements, particularly where there may be the option to allow a blend of part-time work/part-time furlough.

Conclusions

Based on this research, investors intend to support existing portfolio companies, but we can anticipate a significant reduction in investment from angels and seed/VC funding which threatens the viability of many small R&D intensive businesses.

Recommendations for additional Government support include:

- Increasing R&D tax credits.
- Increase (temporarily) tax incentives for S/EIS investments.
- More and simpler co-investments alongside angels.

- Given significant concerns about cash-flow and cash preservation, Innovate UK might consider paying in advance (as opposed to arrears) for existing and future grant schemes, and reduce the match funding requirement

Regarding the Future Fund

- Overwhelming agreement that Future Fund is not applicable/helpful to S/EIS-companies
- The terms of Future Fund are felt to be too restrictive and onerous

As mentioned within this report, Advanced Oxford and OION organised a webinar to discuss and debate likely impacts on early-stage investment, as well as examining how companies are best supported and what interventions may be needed within the innovation ecosystem to support early stage, risk-based companies. The webinar was held on 5th May, 2020, with the support and of PwC and Taylor Vintners. The webinar discussion also provided good insight and evidence from participants and the audience into issues and concerns relating to early-stage investment. There was a high level of commonality between the findings from the survey and areas of discussion and a summary of the key findings from the webinar can be found in annex A.

About Advanced Oxford

Advanced Oxford is a membership organisation with members drawn from R&D based/innovative companies working across Oxfordshire. Our membership includes companies, Oxford's two Universities, the NHS through Oxford Academic Health Science Network and providers of innovation infrastructure and support.

Advanced Oxford was set up in response to the Oxford Innovation Engine Update report. Published in 2016, the report identified the need for stronger engagement from the innovative businesses in Oxfordshire in the work to develop the region as a centre of excellence and an engine room for innovation. Work to scope and set up Advanced Oxford started in 2017. Further information about Advanced Oxford, our members and our work can be found on our website, www.AdvancedOxford.com.

Advanced Oxford is research-led, providing analysis and a united voice for our members on the key issues affecting the development of the innovation ecosystem in the Oxford region. We generate our own research and work to support and inform key stakeholders involved in the development of the business environment, infrastructure and policy. Advanced Oxford is working to support the long-term development and success of the Oxford region as a place to live and work. We do this by drawing on our collective experience of setting up, running or working in knowledge-based, innovation-focused businesses and organisations. We use our connections to other businesses to generate evidence and undertake research.

For further information about this report, Advanced Oxford's work or the research Advanced Oxford is undertaking on investment and impacts of Covid-19, please contact Sarah Haywood (sarah@advancedoxford.com). For more information about OION, please contact Jens Tholstrup (j.tholstrup@oxin.co.uk)

Annex A

Key findings from Advanced Oxford/OION's investment webinar (5th May, 2020)

- The Future Fund is incompatible with EIS and means that large numbers of companies, particularly angel-backed companies, are excluded
- A need for further clarity on what can be used as match within the Future Fund
- Calls for ways to use the R&D tax credit scheme to help companies
- Support for the furlough scheme, but concern about what happens afterwards and that it does not help with cashflow
- Flexibility is needed on HR policies – a role for Government to help companies to think through how they can respond by using good human resources measures and clarifying what is legal, e.g. how to introduce short-term pay cuts?
- Bringing forward grant payments from Innovate UK to help with cash-flow and cash-preservation, what more can they do on loans too?
- Good investor relations and communication has never been more important
- Investors, particularly Angels, have a really important role in helping companies get through this period by providing mentorship, advice, guidance, and moral support
- It is likely to be more difficult to raise money going into 2021 so preserving cash and drawing out your runway will be really important