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Venture Monitor

Q3 2022

In partnership with

Insperity. J.P.Morgan

The definitive review of the US venture capital ecosystem

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Executive summary

Amid rising interest rates, fewer public listings, and the most complicated macroeconomic trends of the past generation, there is a broad desire to predict expectations in VC markets. With the end of Q3, there are easy answers and there are hard ones. First, an easy answer: Broadly speaking, Q3 VC activity was below the historic heights of 2021 and early 2022. However, VC isn't about panicking over quarterly fluctuations, and Q3's activity is above historical averages and part of a durable, positive trend in the industry.

Some of the high points of 2022 have been seen in the healthcare, clean tech, energy, and transportation industries. Deal counts across these four sectors at the end of Q3 are close to or above full-year numbers for 2020. Similarly, investments by crossover investors and corporate venture capital (CVC) funds are all near or above 2020 totals. The mid-Atlantic, Southeast, and Mountain regions have seen steady growth over the past few years, with all expected to exceed their 2020 totals.

Points of stress in the market are also appearing. This year, exits are down almost 50% against historical norms, with public listings at record lows. In 2022, there have been just 59 public listings so far, compared with 303 in 2021 and 145 in 2020. Fundraising is another possible point of tension. While overall figures are strong—the total capital raised at the end of Q3 2022 is $150.9 billion, just 2.6% away from the full-year 2021 record of $147.2 billion—62% of that total is going to 6% of funds. Mega-funds are nothing new. However, there are questions as to how their continued growth will impact emerging managers and ecosystems.

While Q3 has clarified several industry trends, its most durable legacy will likely be the passage of the Inflation Reduction Act and the CHIPS and Science Act. These acts of Congress create huge investments in technology and infrastructure development. Notably, they make hundreds of billions of dollars of public money available for investment over the coming years. Furthermore, when combined with other projects such as the State Small Business Credit Initiative, these acts create an environment for private fund managers to partner with the public sector and academia and develop more-robust entrepreneurial ecosystems outside of traditional hot spots.

The facts of Q3 paint a mixed picture for the VC industry. Investors report that they are making deals, and there is a consensus between managers and founders on how to prepare for potential challenges ahead. The market is also becoming increasingly consolidated and realizing fewer exits than at any time in recent history. Recently enacted federal legislation promises to make more funding available for managers and founders alike. Tracking the implementation of this legislation is a primary concern. While some of the provisions in the packages (such as the research and development [R&D] tax credit expansion for startups) will come into effect as soon as January 2023, other provisions are still far from implementation.

In summary, Q3 can provide reasons for optimism or pessimism, depending on where the viewer is looking. However, it has also opened the door to a variety of opportunities for those who are paying attention.

NVCA policy highlights

Lawmakers on Capitol Hill wrapped up a busy summer with movement on several legislative priorities. Below are key policy initiatives for NVCA and their state of play.

CHIPS and Science Act

Before departing Washington for the August recess, Congress passed the NVCA-supported competitiveness legislation called the CHIPS and Science Act. Signed by President Biden, the act represents the largest investment in research, technology commercialization, and domestic production in at least a generation.

The legislation includes up to $250 billion for:

- Semiconductor research
- Domestic manufacturing
- The establishment of a technology commercialization directorate at the National Science Foundation (NSF)
- New test bed facilities for startups and other entities
- Basic research at the NSF and the Department of Energy
- A new regional technology hub program
- Programs to promote technology commercialization and entrepreneurship at the National Laboratories

NVCA has been heavily engaged in this package since its original introduction. We provided recommendations and encouraged policymakers to leverage the unique capabilities of the American startup ecosystem. We are thrilled to see that the final bill retains language requiring new company formation as a primary objective for several programs.

Now that the bill has been signed into law, we are shifting to an implementation strategy with the various agencies and will begin rolling out a series of events, collateral, and a more in-depth analysis of the bill's provisions to educate the NVCA membership.

Inflation Reduction Act

After a long and winding road, Democrats finally coalesced around a package of climate, healthcare, and tax provisions that they were able to pass along party lines. Despite a bumpy process, the end result was pretty ideal for the VC industry. We were able to avoid significant damaging tax increases on the industry and secured targeted improvements to climate credits for startups. We also saw a small expansion of startups' ability to offset payroll tax payments with unused R&D credits from $250,000 to $500,000.

Our outreach efforts included dozens of Hill meetings, two research projects, individualized slide decks for states and regions, in-state and virtual events and roundtables with policymakers, and significant coalition work with other affected industries.

Tax increases considered but rejected during the process include proposals to:

- Tax capital gains as ordinary income
- Impose a surtax on those making more than $5 million
- Create a mark-to-market tax regime
- Impose an annual tax on private funds based on AUM
- Impose a five-year holding period for carried interest, with major technical issues
- Retroactively limit qualified small business stock to 30% exclusion
- Require companies majority-controlled by private investment firms to file taxes as a single entity
- Aggregate the revenues of companies majority-owned by private investment funds for purposes of determining the application of a book minimum tax (a 15% minimum tax rate for companies with more than $1 billion in financial statement income)

Financial regulatory proposals

NVCA has continued engagement on Securities and Exchange Commission (SEC) Chair Gary Gensler's regulatory agenda that targets private funds, including the VC industry. Several board members met with SEC Commissioner Hester Peirce and Division of Investment Management staff in July to discuss the agency's private funds proposal and how it would negatively impact the VC industry.

Recently, NVCA submitted a supplemental comment letter to address questions that arose during our meetings about the true scope of the liability limitation ban in the private funds proposal. The letter clarified that the proposal goes much further and referenced how the impact on the VC industry would be far more profound by discouraging new investments into unproven innovations and threatening the appropriate risk of actively engaging and managing portfolio companies.

We are continuing formal meetings with SEC officials and policymakers on Capitol Hill and the administration to discuss the full proposal's negative impact on the venture ecosystem.

DEAL Act

In July, the House passed a revised DEAL Act, a longtime NVCA priority championed by Rep. Trey Hollingsworth (R-IN) and Sen. Mike Rounds (R-SD) that directs the SEC to modernize the definition of a VC fund for purposes of fund registration (read our statement here).

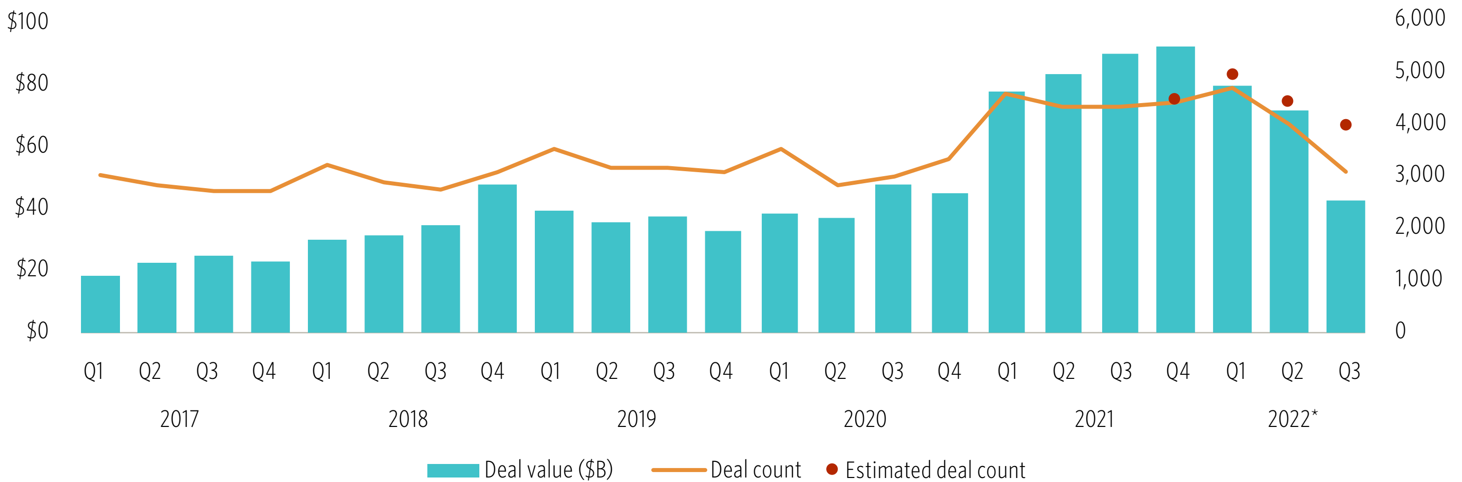
The original bill directed the SEC to consider secondary investments as qualifying so long as the VC fund maintained a "predominant" number of direct investments into private companies and to consider investments into other VC funds as qualifying as well.

We continue to engage and will update NVCA members with further details as we learn more.

Overview

Deal count higher than expected

US VC deal activity by quarter



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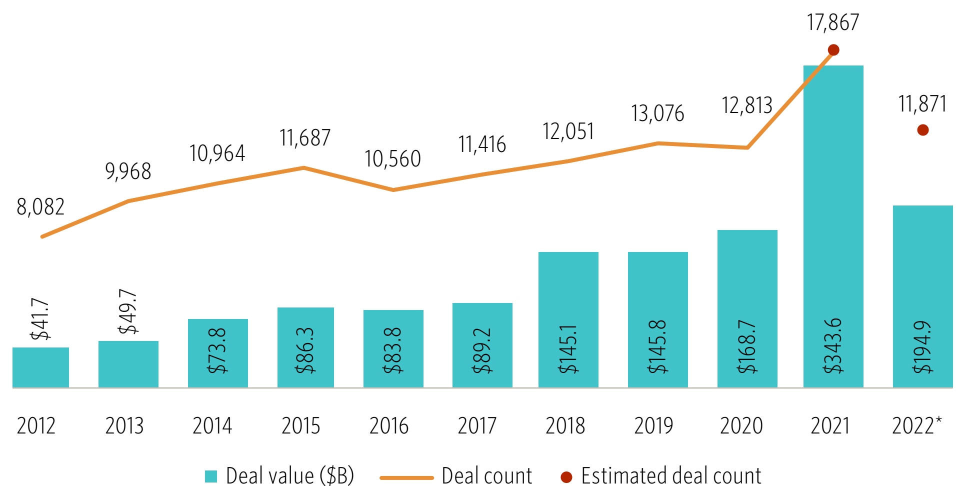
2022 surpasses all years except 2021

US VC deal activity



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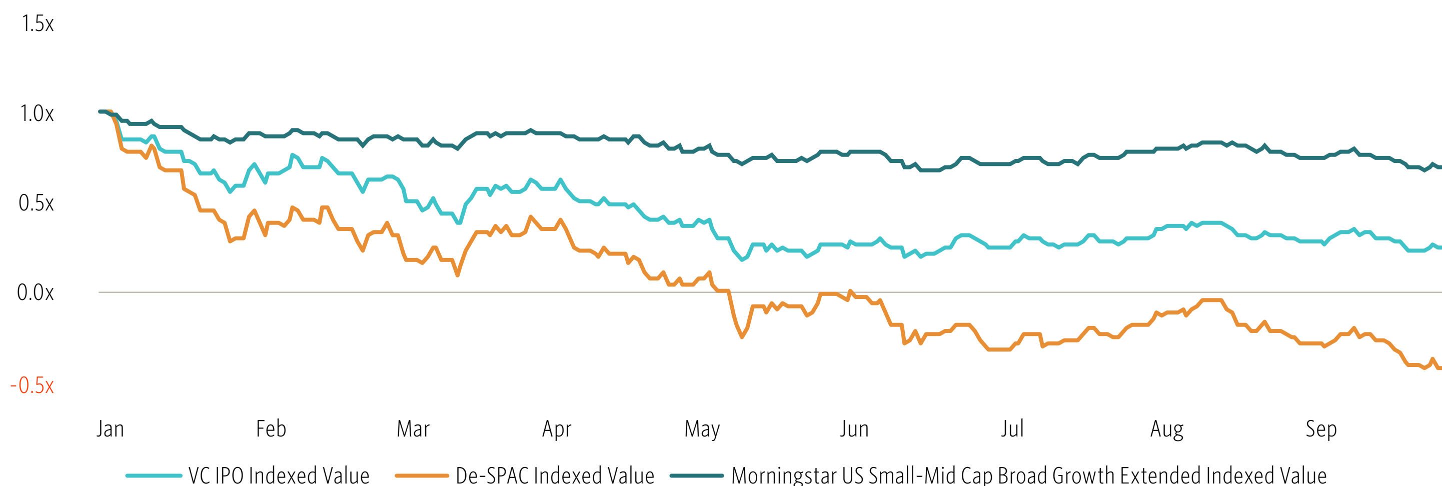
Deal activity across all stages is showing more signs of distress, recording the third consecutive decline in completed deals. Estimated deal count in Q3 (4,074) is off by almost 20% from the quarterly record high recorded in Q1 (5,049) and is the lowest count seen in any quarter since Q4 2020 (3,364). Q3 saw $43.0 billion invested in VC deals across all stages, a nine-quarter low, cementing a tone of investor hesitancy and increased focus on business fundamentals amid the global economic downturn, even if the numbers remain high on a historical basis.

Nontraditional investors continued to reduce their activity in VC-backed startups amid ongoing economic uncertainty. Notably, deal count participation has declined for all nontraditional investor types except for corporate investors, which were involved in more than a quarter of all completed deals in 2022. In past reports we have noted that a nontraditional investor slowdown, especially by asset managers and PE funds, would be noticeable in the data due to the reliance on these institutions to complete mega-deals—87% of mega-deals received nontraditional investor participation in 2021. Just 95 mega-deals were closed in Q3, the lowest total since Q3 2020.

US VC fundraising has set a new annual high through only three quarters of 2022. US-based VC funds have raised $150.9 billion, surpassing last

VC-backed IPO index continues underperformance

2022 US VC IPO index*



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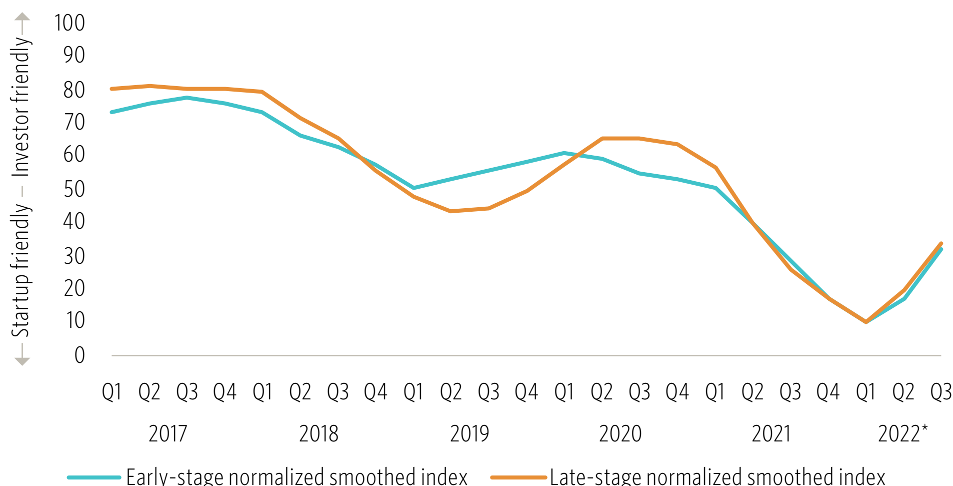
year's previous record and taking the 21-month fundraising total above $298.1 billion. Given public market turbulence and frozen avenues for liquidity, we expected LPs to be concerned about their overexposure to this asset class and the potential for timely returns negatively impacting fundraising activity. Entering the second half of the year, we are finally beginning to see that momentum atrophy, as just $29.4 billion in fundraising was added to the dataset since our Q2 report, the lowest quarterly total this year.

With just $14.0 billion in exit value generated across an estimated 302 exits in Q3, there were few bright spots for the VC exit market. These figures are in line with exit activity expectations around 2014 and well off the highs seen in 2021—$266.8 billion in exit value was generated in Q2 that year. A highlight of the quarter is surely Adobe's announced $20 billion acquisition of Figma, a developer of a web-based design platform—the deal is not yet closed. Few options remain for the growing group of unicorns, as 2022 has produced only 59 public listings, just one year after a record 303 VC-backed public listings generated $670.4 billion in exit value. With the expectation that the current slow environment will remain, this year's total exit value is in danger of falling below $100 billion for the first time since 2016.

Market quickly swinging back to being investor friendly

US VC dealmaking indicator



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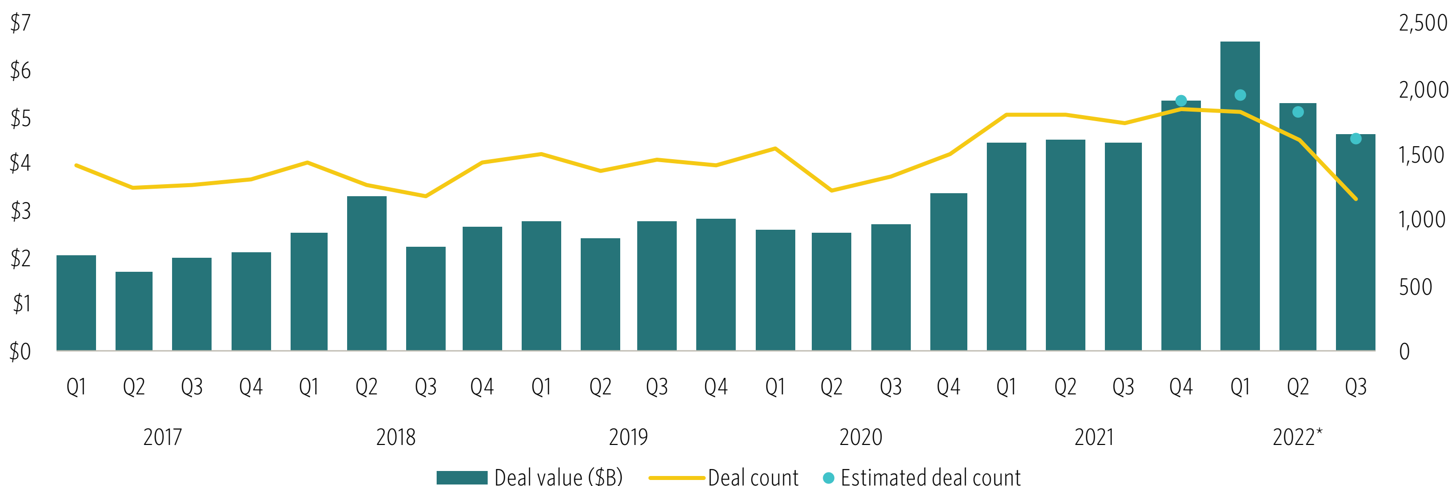
Angel & seed

Angel & seed activity slides

US angel & seed deal activity by quarter



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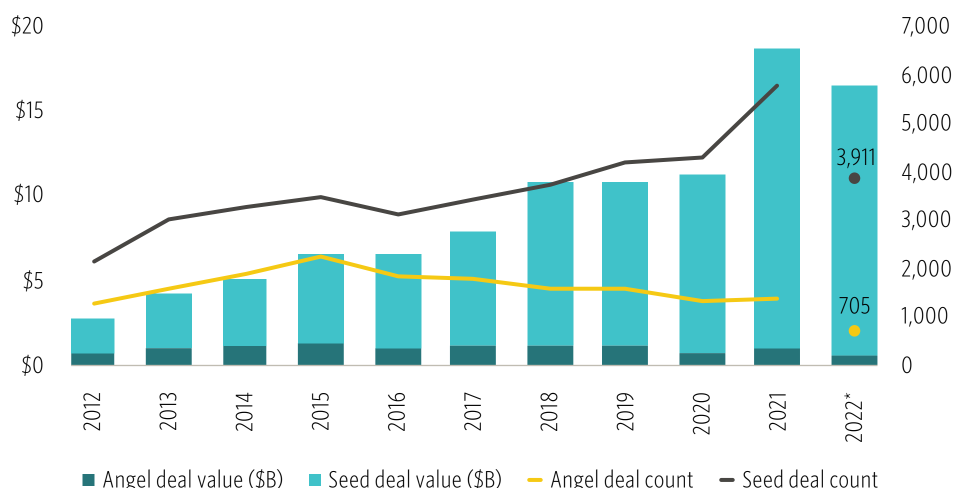
Q3 was a bit less resilient compared with the first half of the year, when deals for seed investments were completed at an unwavering pace. This quarter saw a decline of around 18% from the Q1 high, dropping angel & seed deal activity back to 2020 levels. Seed companies are relatively less impacted by public markets than late-stage companies, so the quick shift in activity points more toward the unsustainable nature of the 2021 seed market. Once the market returns to a more normal investment climate, seed activity will find tailwinds from the record number of micro-funds raised since the beginning of 2021 (779).

Seed deals showing strength

US angel & seed deal activity



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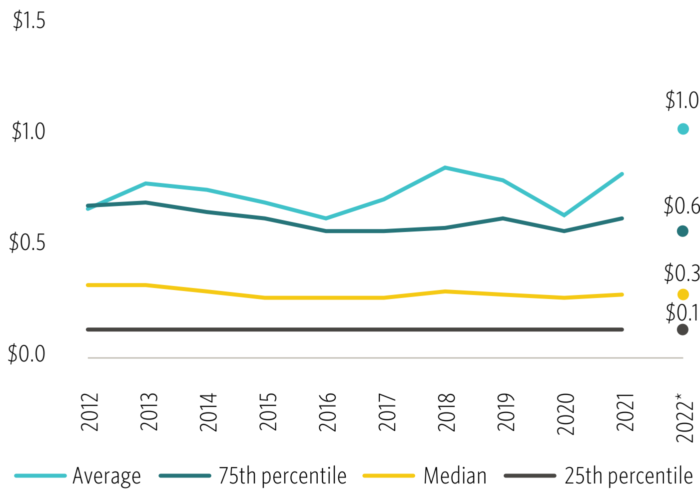
Despite a slowdown in activity, core data points from seed investments have remained at the heightened levels set in 2021. The median seed deal size for 2022 sits at $2.8 million after Q3, and the median pre-money valuation for seed investments reached $10.5 million. These figures aren't leaning on the strong numbers from Q1 and Q2 either, as the current quarter's deal size and pre-money valuations were both the highest in our dataset at $3.5 million and $10.1 million, respectively.

While the strength of valuations could be due to investors in the market being more selective in their investments in this economic climate, this massive growth in seed-stage participation continues to put upward pressure on deal sizes and valuations. Not only are there more micro-funds, but also larger, multistage investors have increased

Median angel deal values flat

Range of US angel deal values ($M)



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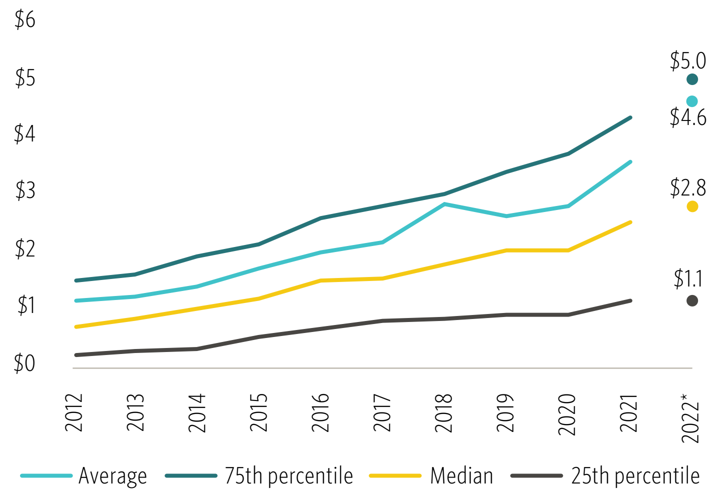
Seed deal values continue rise

Range of US seed deal values ($M)



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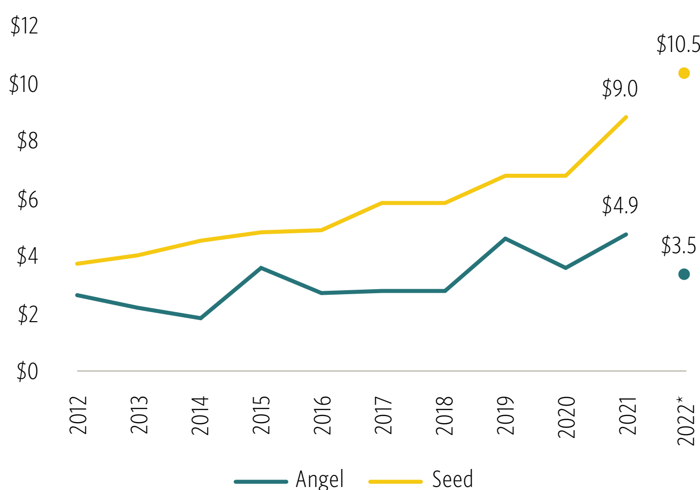
their activity. Tiger Global, for example, has been a part of 15 US seed deals announced in 2022, nearly double the total number of US seed deals the company had participated in previously.

Congruently, first-time financing data shows that Q3 was slower than recent periods, though the number of deals captured by the end of the quarter was off by just 5.8% from last quarter. We do not have estimates for first-time financings as we do for other stages of VC, but already our team has captured more first financings than almost any quarter before 2021, and that total is expected to grow. The unexpected strength of first-financing activity is positive news for the industry.

Given the lag between industry narratives and data trends, there is likely further to fall from an activity standpoint, but the growth of the seed and first-financing market over the past several years has lifted the floor of expectations. These deals are much further from macroeconomic volatility, though we shouldn't expect this stage of companies to remain immune from the impacts as headwinds continue.

Seed valuations well above 2021

Median US angel & seed pre-money valuations ($M)



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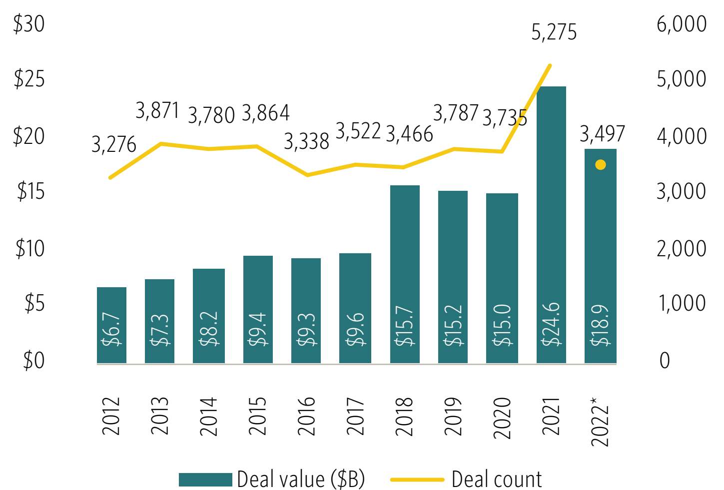
Nearly $19 billion in first financings YTD

US first-financing deal activity



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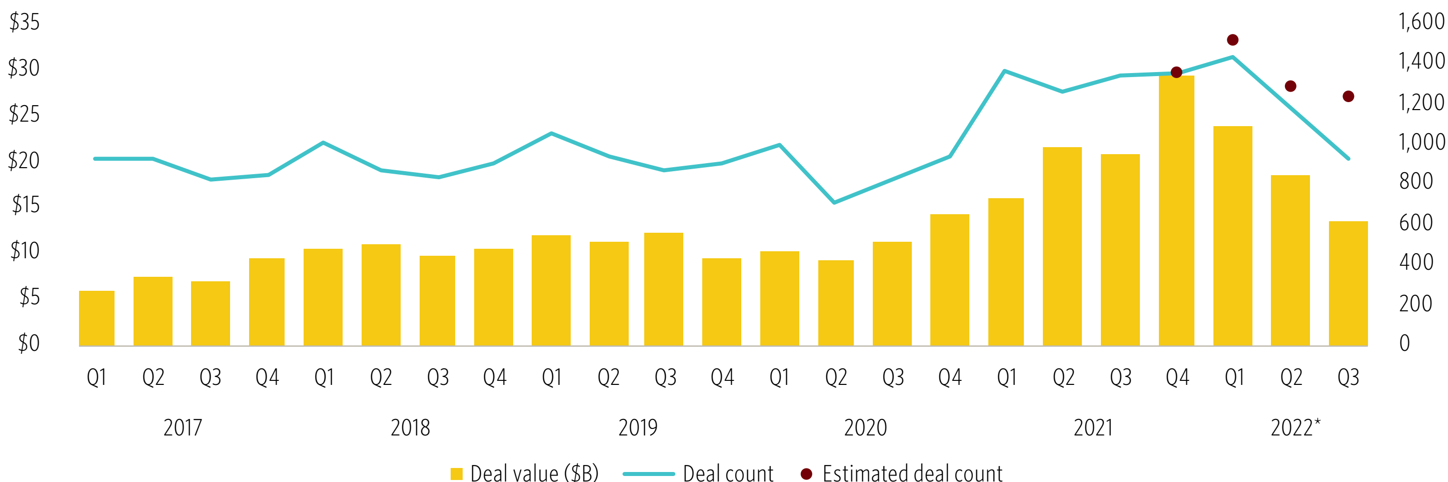
Early-stage VC

Q3 reinforces negative quarterly trend of early-stage deal activity

US early-stage VC deal activity by quarter



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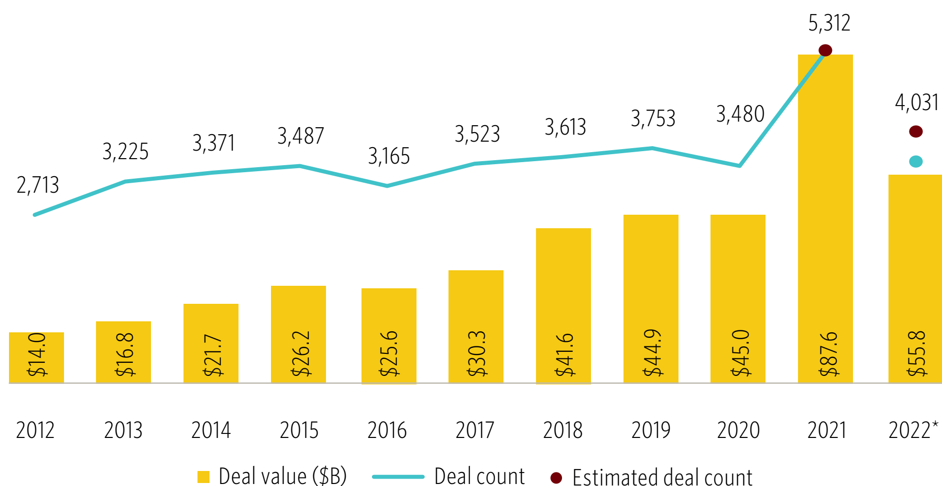
The dust had yet to settle as early-stage VC activity trended downward for the third quarter in a row, with roughly $13.5 billion invested across an estimated 1,226 deals. However, the current year's early-stage VC investment is roughly $55.8 billion, already surpassing the 2020 full-year figure of $45.0 billion, suggesting the long-term growth for early-stage investment remains positive. Now that we are well into 2022 and roughly six months past the inflationary surge in March, the reporting lag highlighted in prior quarters is slowly starting to materialize in the data. The continued public market volatility has weakened capital deployment in early-stage deals as investors become more apprehensive about the large, outlier-sized deals of the past couple years. Investors are focusing on investing in the fundamentals of a startup instead of relying on another VC firm to invest at an even higher valuation.

Early-stage deal count on pace to surpass pre-pandemic figures

US early-stage VC deal activity



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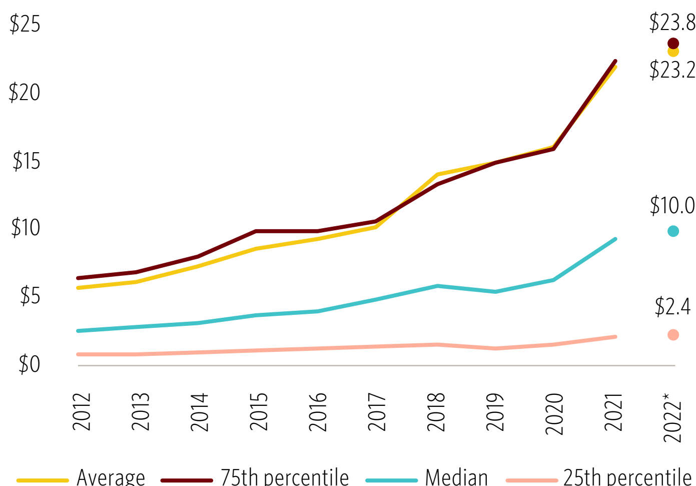
Early-stage investors can no longer make investments under the pretense of growth as seen in the robust valuation environment of 2021. The increase in investor prudence over the last few quarters resulted in a median early-stage deal size of $8.9 million in Q3, a 19.7% decrease from the prior quarter's median early-stage deal size of $11.0 million. The decrease in median

YTD deal values remain afloat despite QoQ decline

Range of US early-stage VC deal values ($M)



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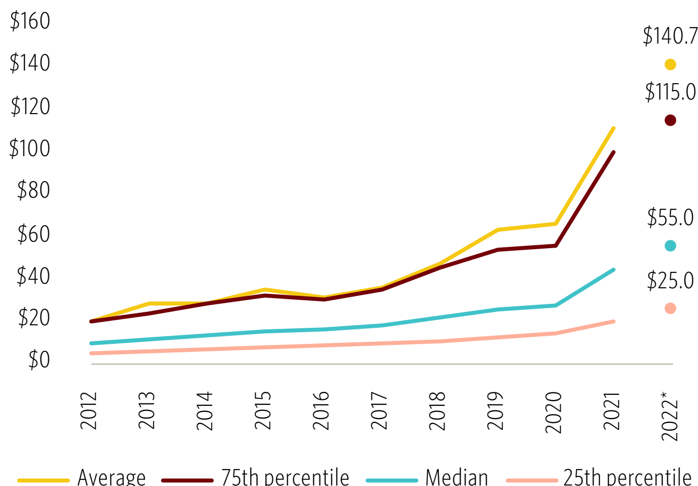
YTD early-stage valuations maintain lead above historical figures

Range of US early-stage VC pre-money valuations ($M)



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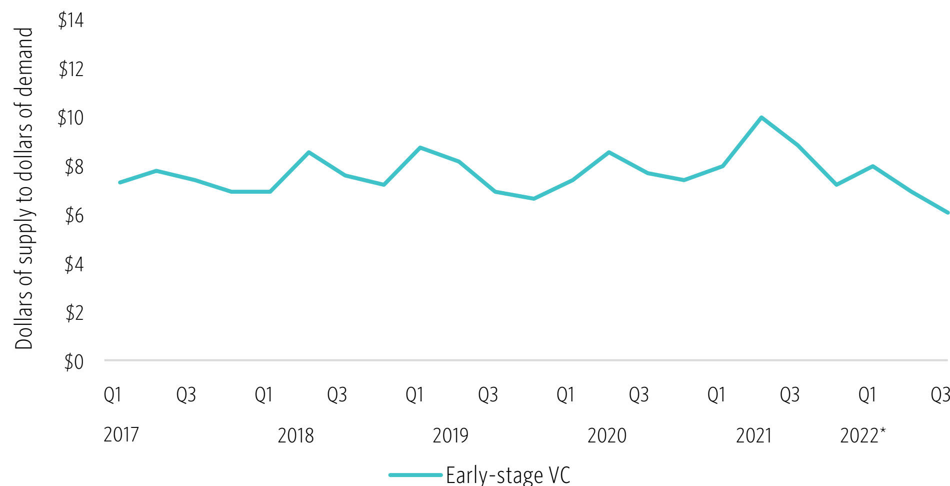
deal size is likely the result of depressed public market exit conditions finally breaking through the insulated early stage and affecting valuations. Startup founders may be opting to raise smaller amounts of capital in an effort preserve equity and to simply bridge the gap until the market resumes its strength.

Contrary to the H1 2022 growth of median early-stage pre-money valuations, Q3 exhibited signs of a slowdown, with a median pre-money valuation of $46.0 million. This figure represents a 16.4% decrease from the Q2 2022 median of $55.0 million and is more on par with the 2021 full-year figure of $44.0 million. We expect early-stage pre-money valuations to continue their descent through the end of the year as the market searches for a new equilibrium.

Evidence of a slowdown in the early stage can also be seen in the number of mega-rounds completed. 24 early-stage mega-rounds ($100 million+) were completed this quarter, with a total deal value of $5.5 billion. Mega-round deals accounted for 40.7% of the total capital invested across early-stage VC in Q3. This quarter's mega-round activity falls short of the 2021 quarterly average of 42 rounds yet is still above 2020's figure of 17, reinforcing the notion that the VC market is returning to the pre-pandemic long-term trend, yet remains robust for strong companies. We expect investors will look to mitigate risk by backing serial entrepreneurs, some of whom raise outsized rounds in the early stage; such is the case with Andreessen Horowitz's reported $350.0 million investment in Adam Neumann's latest startup, Flow.

Early-stage capital availability falling

Capital supply-demand ratio in the early-stage VC marketplace



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*Source: Gallup's 2020 Employee Engagement Meta-Analysis

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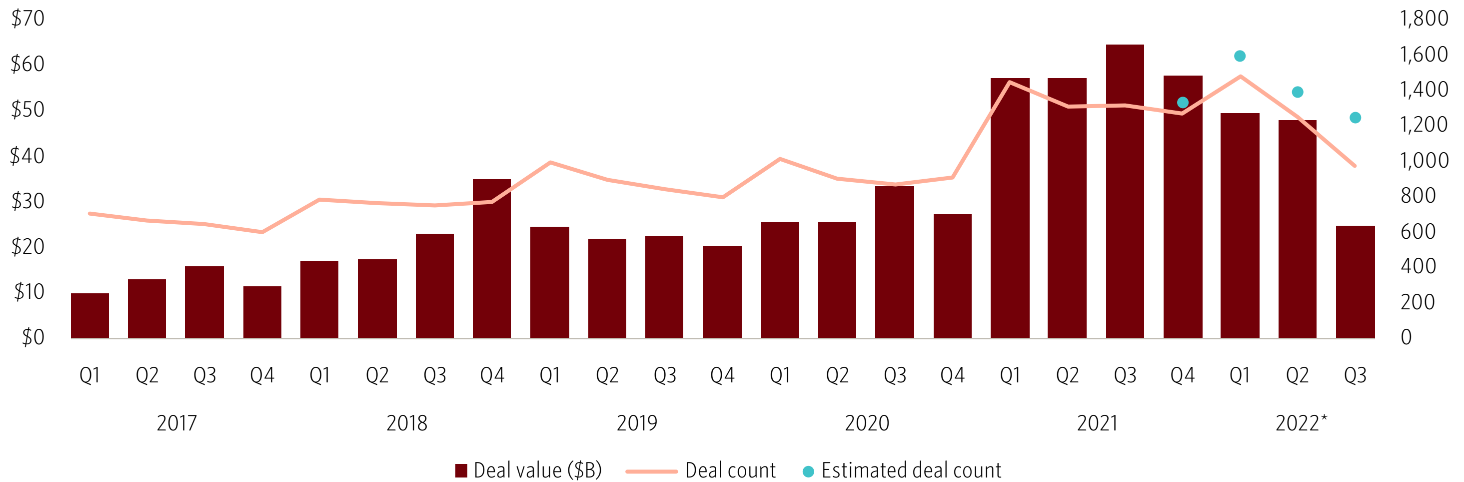
Late-stage VC

Q3 deal value plummets in response to continued depressed exit conditions

US late-stage VC deal activity by quarter



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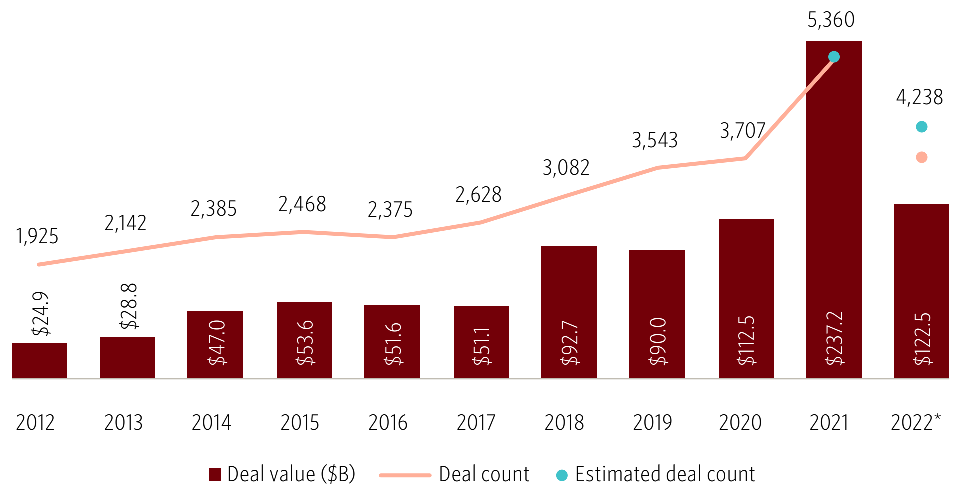
Current avenues for startup liquidity remain relatively frozen, further constricting late-stage deal activity in Q3, resulting in $24.9 billion invested across an estimated 1,249 deals. The total dollars invested in late-stage VC decreased by 48.3% from the Q2 figure of $48.1 billion and set a record 11-quarter low. Over the past two years, startups have leveraged the surplus of available capital and heightened investor support to grow, disregarding the scaling processes historically implemented. Blitzscaling has caused startup headcounts and valuations to balloon beyond their capacity to generate positive free cash flow and loosen their dependence on investor capital. Depressed public market comparables have even led nontraditional investors to internally mark down portfolio companies; such is the case with T. Rowe Price writing down its investment in Canva, a unicorn startup developing an online graphic design platform, by 44% since the end of 2021. Anecdotally, traditional

YTD late-stage deal value ahead of 2020 full-year figure

US late-stage VC deal activity



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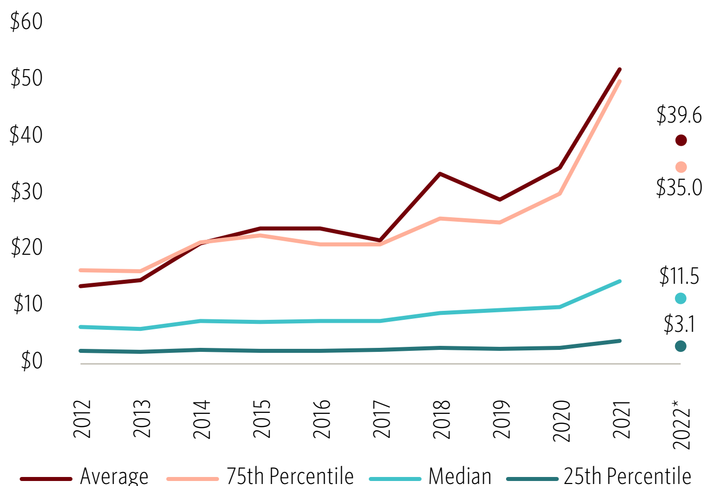
VC GPs have been hesitant to mark down portfolios due to the impact it could have on their ability to attract new fund commitments as well as the ability of their portfolio companies to raise subsequent financing rounds at increased valuations.

The median late-stage deal value continued to fall through the third quarter to $10.0 million, a 33.3% decrease from the 2021 full-year figure of $14.6 million. This decrease seems significant in the context of the prior year's activity but is equal to the 2020

YTD median and average deal values fall below 2021 values

Range of US late-stage VC deal values ($M)



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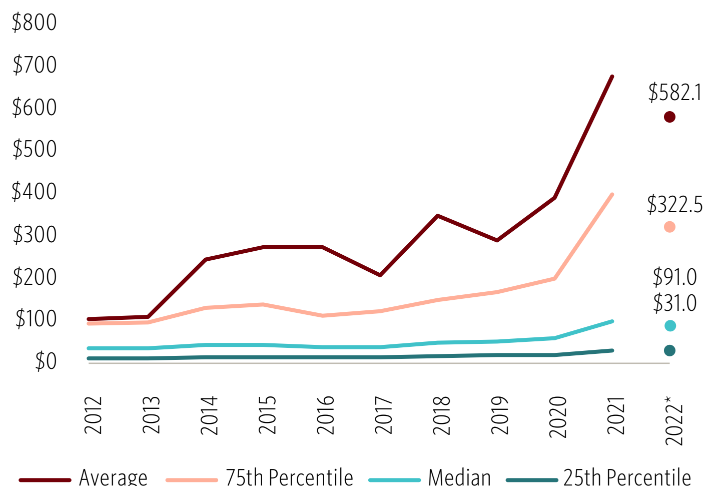
YTD median valuations creep closer to 2020 full-year figures

Range of US late-stage VC pre-money valuations ($M)



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full-year median deal size, suggesting that the repricing of late-stage VC deals may be falling below the long-term growth trend. Despite the decrease, we have yet to see down round activity pick up in the data. Naturally there is a lag in reporting that limits our insight into down round activity as well as the incentive for founders to withhold funding information that could unfavorably portray their businesses. We expect down rounds to become more prevalent should current market conditions continue or worsen through the end of the year.

Alongside the decrease in median deal sizes, this quarter also saw a drop in the number of mega-rounds completed. In Q3 there were 67 mega-rounds completed at the late stage, with a total deal value of $11.9 billion. As to be expected, mega-rounds drive a significant portion of the deal activity in the late stage, but that portion of deal value is starting to wane in response to the lack of liquidity in public markets. We expect the increased scrutiny of late-stage startups to result in fewer mega-rounds completed and a smaller portion of the total invested capital to derive from those rounds until public markets become a viable path to liquidity once again.

Furthermore, the impact of depressed exit conditions can be seen in the softening of late-stage pre-money valuations. Late-stage pre-money valuations YTD have dipped below 2021 full-year figures to $91.0 million, corroborating the notion that investors are less confident in this area of the market. While valuations remain significantly higher than median valuations seen in 2020 and earlier, we expect this figure to continue to decline as the market resets and public markets remain volatile.

Late-stage capital supply hits low

Capital supply-demand ratio in the late-stage VC marketplace

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A WORD FROM INSPERITY

DE&I Considerations to Strengthen the Venture Capitalist's Portfolio

- Recent changes in awareness of social justice and the effects of the COVID-19 pandemic have increased the need for companies to review and strengthen their approach to diversity, equity, and inclusion (DE&I).
- Venture capital (VC) firms can exemplify high standards of care for women and underrepresented populations by calibrating their own internal DE&I efforts.
- Portfolio partners can be influenced to improve their care for diverse employees when venture capitalists raise their investment criteria to include embracing DE&I.
- The benefits that accrue to companies that care for their people include increased productivity, employee loyalty, innovative thinking, and a strong brand.

The impact of multiple history-defining political and economic events and movements taking place over the last few years has brought to the forefront a call for action to eliminate prejudice and injustice in the workplace. Business leaders and investors have begun taking a more intentional look at opportunities to increase representation of underrepresented groups (diversity), to ensure fair and accessible opportunities and resources for all employees (equity), and to create more inclusive company cultures (inclusion). For venture capitalists, evaluating and improving the employee experience may mean the difference in achieving their long-term investment goals.

Why should venture capitalists care about DE&I?

Employees' expectations have been dramatically changed by pandemic-related challenges, racial unrest, and the economic downturn. No longer are they willing to tolerate poor treatment or work where they feel disadvantaged. The significant reduction in the available workforce and a new willingness to resign from long-held positions for better working and living conditions may increase human capital risks in VC investments.

DE&I is more than an occasional agenda item, ancillary program, or problem to be addressed. It is a strategic business imperative—a key pillar in successful human capital strategy. When woven into the fabric of company strategy, leaders view the organization through the powerful lens of caring for their people. They work to ensure fairness and equity in the development of their workforce and universal employee well-being by adopting flexibility, acceptance, and accommodations for all. They also train and hold managers accountable for their ability to effectively listen and be empathetic toward their team. This creates a preferred employer relationship that elicits employee discretionary effort and is difficult to replace by going elsewhere.

How can venture capitalists integrate DE&I into their portfolios?

Having DE&I as a strategic competency focuses the venture capitalist on better deals and enhances the value they bring to their partners. To create this internal competency, venture capitalists should intentionally look within their own organization for opportunities to increase representation of underrepresented groups, ensure fair access to resources and opportunities, and create a more inclusive company culture. This is a process, not a one-and-done project.

With a DE&I competency, venture capitalists can model practices that demonstrate the value of promoting diverse peoples, viewpoints, and experiences. They can steer portfolio companies to more inclusive strategies by adopting DE&I-centric investment criteria. They can condition deals that influence startups to structure practices and strategies that lead to progressive change.

Sonya Mack
Director of Diversity, Equity, and Inclusion

Sonya Mack is the Director of Diversity, Equity, and Inclusion (DE&I) Services with Insperity, and responsible for leading the DE&I consultative services. Her passion for DE&I has spanned the course of her career within non-profit organizations and corporations. Sonya earned her BBA in organizational behavior and management from the University of Houston and is certified in DE&I in the Workplace.

Venture capitalists can empower their portfolio companies to advance fairness for employees from marginalized backgrounds and women. This will result in employee loyalty, competitive advantages, productivity enhancements, strong public perception, and improved access to suppliers and vendors.

Consider these questions:

- Can you strengthen your investment criteria through self-assessment, feedback from portfolio companies, and industry benchmarks?
- Do your investment requirements reflect diverse founders and equitable opportunities for women and underrepresented groups?
- Do you evaluate the inclusiveness of a startup's human capital practices?
- Do you expect partners to establish employee-friendly values, cultures, processes, procedures, systems, and practices?

What framework can be used to adopt DE&I into company strategy?

A flash cut adaptation of strategy to a full-on DE&I focus is not likely. Such an approach would

likely miss or mistreat most of the specific root issues that need addressing. However, remember that employees are increasingly looking for real attention, genuine concern for people, and commitment to these principles.

DE&I solutions must be thoughtfully developed and implemented. It begins with changes in practices, then underlying policies, and eventually being written into overarching strategies supported by key metrics that sustain progress.

We suggest using the employee life cycle to guide the transition to a more strategic DE&I organization:

- Culture of well-being. Create a culture of inclusion and belonging that boldly affirms that all people are valued, respected, and supported. Develop an understanding of the employee experience, including the varied impacts from family obligations, economic struggles, challenges associated with ethnicity, gender, sexual orientation, and physical or mental health, among others. Evaluate how the current company culture treats these issues and engineer changes where needed to provide due consideration to individual well-being.
- Attracting and recruiting. Expanding employee searches to reach more candidates from underrepresented groups is more practical now than ever before. Remember, diversity of thought and experience is powerful. The shift to remote work has provided employers' access to diverse candidates beyond their immediate geography. No longer must they try to persuade a diverse candidate to move away from their cultural home or family to work onsite.
- Onboarding. Onboarding is the new employee's first impression of the firm and a key indication of the company's commitment to their individual success. It folds them into the society of their new peers and impresses the culture upon them. Assigning a temporary mentor or host will help familiarize new workers with the work requirements, resources, and coworkers.
- Performance and progression. High performance begins with clear and carefully constructed job descriptions that accurately reflect work expectations. Annually agreed upon performance objectives should be fair and unbiased. Regular data-supported performance reviews should fairly evaluate progress and provide genuine feedback, including any developmental needs which in turn result in training and development plans.
- Training and development. The level of company commitment to DE&I principles can be measured by the developmental opportunities afforded diverse employees. Human capital strategies should require equal and fair access to individualized development resources that help each employee progress and reach their highest potential. The developmental plan is a key indicator that people are valued by the company. Regardless of employee position or level, turning their specific developmental needs into strengths will increase their contribution and bring added value to the firm.
- Employee retention. Replacing workers at any level is expensive and time consuming. Reviewing reasons for leaving may reveal that employees from underrepresented groups are leaving at a higher rate than others. They may have felt under-appreciated or that their progression was capped. While some people leave for better opportunities, these reasons should be immediately addressed.

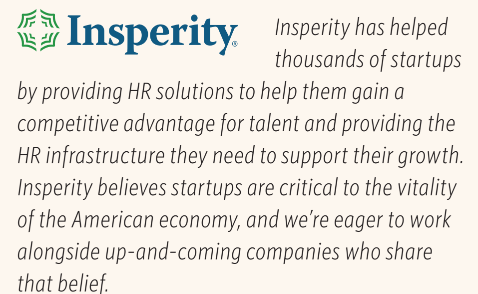
How can a VC firm create a focus on employee well-being?

The whole intent of infusing DE&I into company strategies is to access the power of fair and equitable employee treatment and accrue its value to the company. Intentional and successful strategy development requires clear goals, leadership commitment, effective change management, and impactful communications. During start up, most founders are scrambling to establish and secure funding for their company, having little time to consider people-focused initiatives. Venture capitalists can bring an increased awareness of people's needs and expectations and suggest ideas to strengthen human strategies. They can establish employee resource groups and advance the adoption of a DE&I committee, expanded recruiting perspectives, distributed training opportunities, and the creation of safe spaces for employees to share ideas and concerns.

Conclusion

At Insperity we follow the example of our founder and CEO Paul Sarvadi in supporting, valuing, and caring for our people. We have experienced firsthand the power and economic benefits of a diverse and empowered workforce. VC firms can strengthen their own companies and introduce these benefits to their partner companies by elevating DE&I strategies and initiatives.

For more on bringing the benefits of DE&I to your VC firm and your partners, contact Insperity at: Randy Fisher, Private Capital Development Director, randy.fisher@insperity.com.

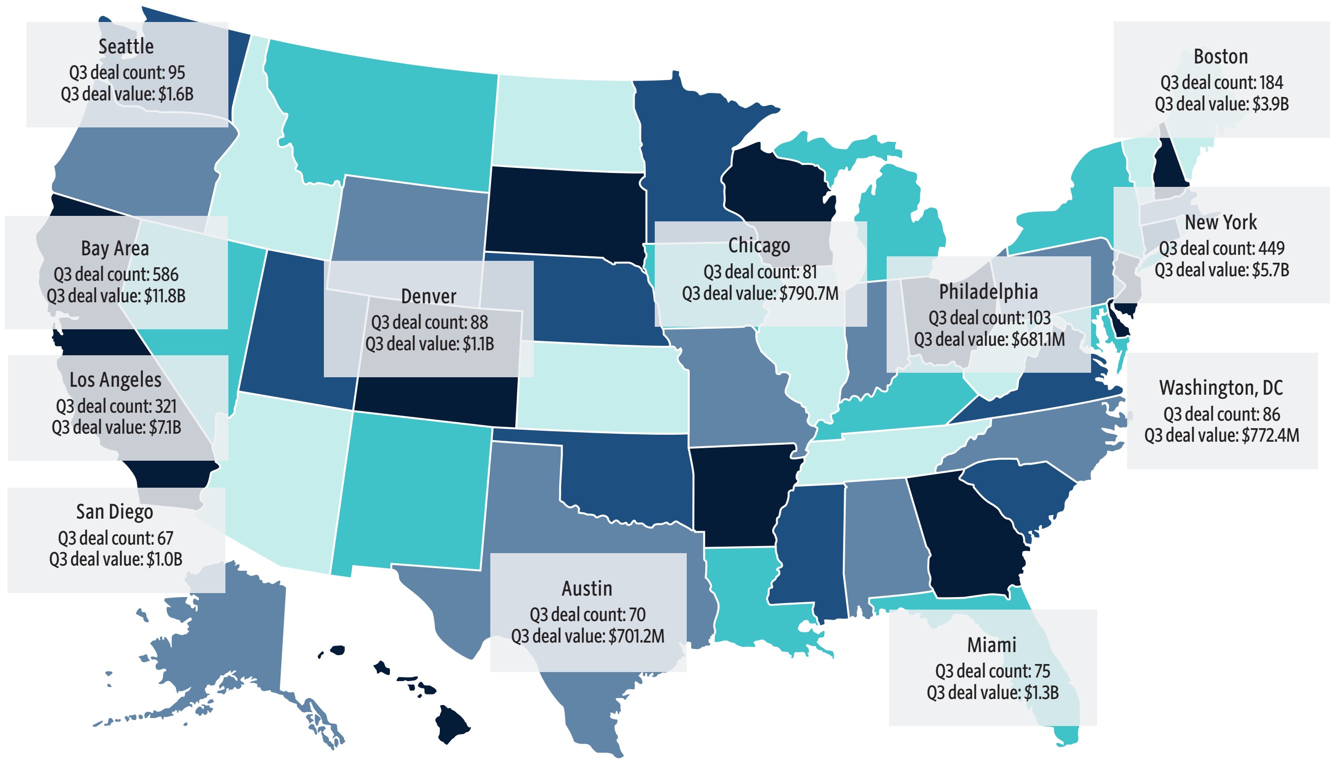


Insperity has helped thousands of startups by providing HR solutions to help them gain a competitive advantage for talent and providing the HR infrastructure they need to support their growth. Insperity believes startups are critical to the vitality of the American economy, and we're eager to work alongside up-and-coming companies who share that belief.

PitchBook nvca Insperity J.P.Morgan

Regional spotlight

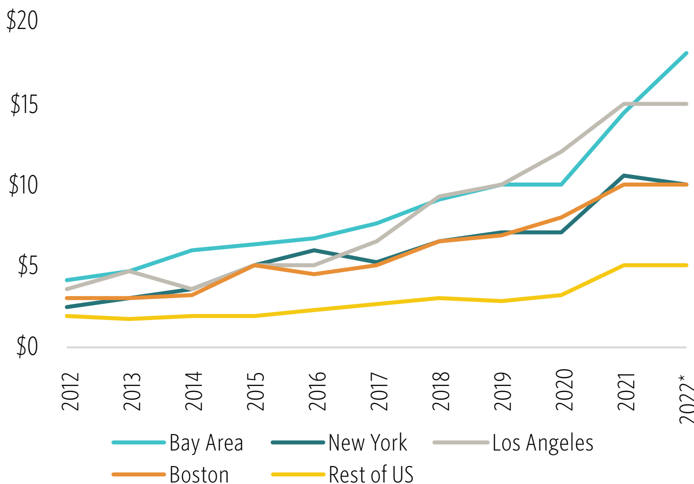
*California markets leading the way**



PitchBook-NVCA Venture Monitor
*As of September 30, 2022

Deal values outside major markets lag

Median early-stage deal value ($M) by CSA



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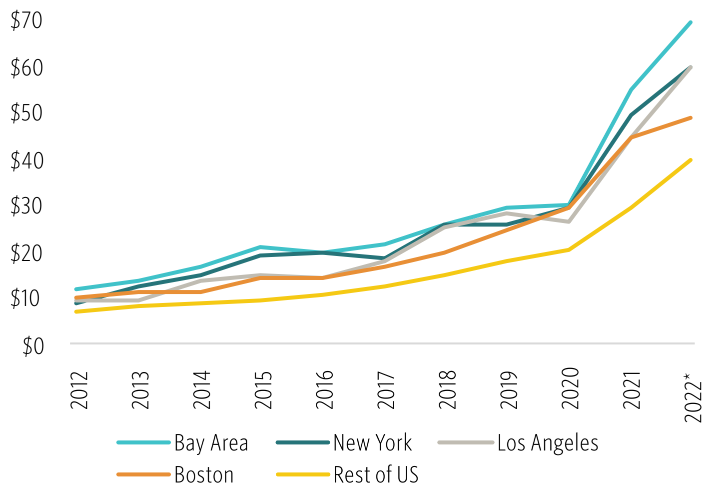
*As of September 30, 2022

Valuations lower outside of Bay Area

Median early-stage pre-money valuation ($M) by CSA



PitchBook-NVCA Venture Monitor
*As of September 30, 2022

A WORD FROM J.P. MORGAN

The evolving venture landscape

"As they contend with ongoing market volatility and declining growth forecasts, startups and investors are still trying to find their footing on valuations. Founders will likely face some tough choices in the coming months as they work to position their companies for long-term success. For those with ample runway, now is a good time to block out the noise and build."
—Pamela Aldsworth, Head of Venture Capital Coverage for J.P. Morgan Commercial Banking

After the initial onset of the market downturn earlier this year, we have observed several interesting developments.

Reforecasting exercises are taking on greater importance in the current environment given the outlook for slowing economic growth, higher interest rates, and reduced investment activity. The budgeting season is underway, and we expect many startups will lower growth expectations and place extra focus on bottom-line stability for the year ahead. It's not a growth-at-all-costs environment anymore. In software specifically, it's possible that YoY revenue projections could come down from 80%-100% to 40%-60%.

Also, portfolio triaging is definitely going on inside the VC world. We are seeing a flight to quality, where the best-performing companies are receiving continued investment, in-line performers are getting bridged to carry out reforecast plans, and underperformers are being put to market for the best possible outcome. At this stage, the financial and reputational strength of the VC firms at the board table will play a meaningful role in effecting a sale or funding across any liquidity gap.

We have begun to see compression in private company valuations over the past six months, following the sell-off in public equities—and tech stocks in particular—that began late last year. With ongoing volatility, both public and private markets are trying to find their footing on valuations. If earnings expectations are reset meaningfully lower in the coming months, it is possible valuations could see more downside. Either way, companies early in their journey should be less hindered with time on their side to build and grow into a higher valuation. For Series B and later, the valuation reset process is more challenging given the vastly different environment since most [of these companies] raised their last round.

The concerns of venture players have evolved over the course of the year.

One of the most noticeable areas that shifted was thinking around labor force. Early in the year, the war for talent was a top challenge cited by startups, and many were paying up to recruit and retain engineers and data scientists. As the year progressed, the narrative shifted to slowing hiring plans and, more recently, outright reductions in [labor] force. On this, it's usually best to be decisive and conservative so that the remaining team can refocus on the business without an overhang of additional layoffs in a few months' time. We expect labor force reductions across the startup ecosystem to approach 10% to 20% by the end of the year.

Thinking around valuations and liquidity has also evolved. Several months ago, it might have been reasonable to wait out the markets and pass on additional capital at a flat or down round, hoping the pullback was short-lived and markets quickly resumed the up and to the right trajectory. Now, we could be entering the acceptance phase for valuations. While down rounds have risen to 7% to 8% in recent months from 5% earlier in the year, it's likely valuations will continue trending lower, as startups that last raised in early to mid-2021 come to market over the next two to three quarters. Even the Seed stage appears to be capitulating after exhibiting resilience for much of 2022. In all cases, the top end of the market has come down the most, which logically correlates with the pullback from crossover investors whose positioning was concentrated in the top-tier names.

Lastly, early in the year there was very little discussion about recession risk, higher interest rates, or slowing customer demand. With

Ginger Chambless
Head of Research,
Commercial Banking

Ginger Chambless is a Managing Director and Head of Research for JPMorgan Chase Commercial Banking. In this role, she produces curated thought leadership content for commercial banking clients and internal teams. Her content focuses on economic and market insights, industry trends, and the capital markets.

Additional contributors:
Pamela Aldsworth
Head of Venture Capital Coverage
Andy Kelly
Managing Director, Venture Capital Coverage

negative GDP growth in the US through the first half [of the year] and high inflation pinching purchasing power, startups reliant on strong consumer spending are facing headwinds. A broader shift in consumer spending patterns from goods—which were above trend during 2021—to services has been underway in recent months and likely to persist. Plus, with 300 basis points of interest rate hikes since March and another 100 to 150 basis points possible over the next few quarters, this is a meaningful increase to borrowing costs for young companies with debt.

Our early thinking about the exit market environment as we head into 2023 is that a pick-up in M&A is likely.

We will likely need to see volatility in the equity and credit markets subside from elevated levels for the IPO market to reopen in any meaningful way, according to Michael Millman, Global Chair of Investment Banking. In the meantime, select IPO issuers who have size and scale, combined with a profitable financial profile, could evaluate the merits of executing a near-term IPO. But with limited recent precedents, assessing how IPOs as an asset class price and trade will be another important barometer of investor sentiment.

Regarding M&A activity within the venture-backed space, JC Raby, Head of Emerging Technology Investment Banking, notes that even though deal flow across the technology sector is down an estimated 35% to 45% amid the choppy market backdrop, strategic dialogue is more robust than ever. Strategic buyers want to do deep dives on sectors and early / growth-stage companies to understand what might be actionable with calmer waters and less perceived competition from well-funded sponsors or more speculative venture investors. While a few blockbuster transactions have been announced recently, many [small to midsize] deals are on the sidelines waiting to test the market. There has been limited confidence to transact M&A in this climate, as it could be viewed as a capitulation or a portfolio-clearing event.

At the same time, Raby indicates that sponsor-backed private companies with healthy balance sheets are thinking increasingly about one-to-one partnerships / mergers with similar-sized companies to grow ahead of a potential reopening of the IPO market in 2023. In these types of combinations, financial benefits are being prioritized over an absolute strategic fit.

Larger sponsor-backed companies are being aggressive in portfolio building and looking for opportunities to expand platforms via acquisition versus building solutions to compete. Nontraditional sponsors are looking into entering markets previously seen as unaffordable. For example, sponsors are spending more time getting up to speed on cyber and cloud, which are increasingly recognized as evergreen sectors.

Raby expects that a pickup in M&A activity will precede a return of the IPO markets and that dual-track late-stage fundraising / M&A processes will be standard practice going forward. With dilution even more challenging at compressed valuations, a sale may become the preferred path.

Some companies and sectors are still raking in funding successfully during this time frame, while other areas are more challenged.

VC into transformational spaces continues, including cyber, artificial intelligence, and cloud infrastructure. Given elevated geopolitical tensions and the penetration of tech-enabled solutions across industries and government, demand for these areas remains exceptionally high.

Not surprisingly, direct to consumer (D2C) was a sector that greatly benefited from above-trend consumer spending on goods during the pandemic. As consumer spending patterns normalize and the risk of recession remains elevated, many companies in the D2C space have followed their public comps in a downward trajectory, and VC investing in new companies has waned.

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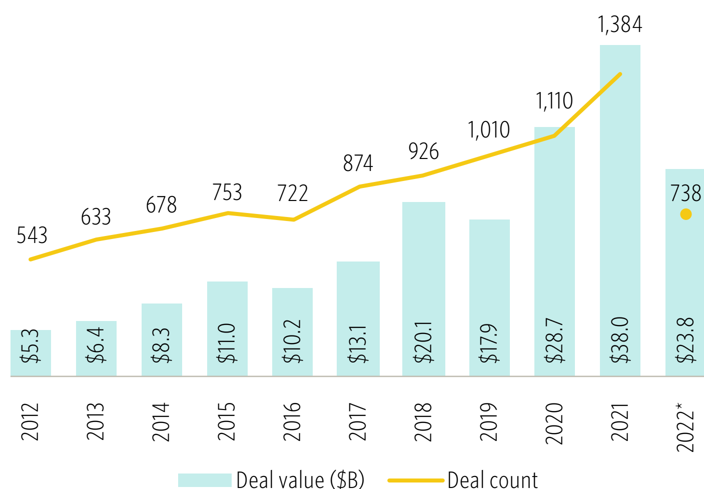
Biotech & pharma

More than $20 billion invested in biotech & pharma through Q3

US biotech & pharma VC deal activity



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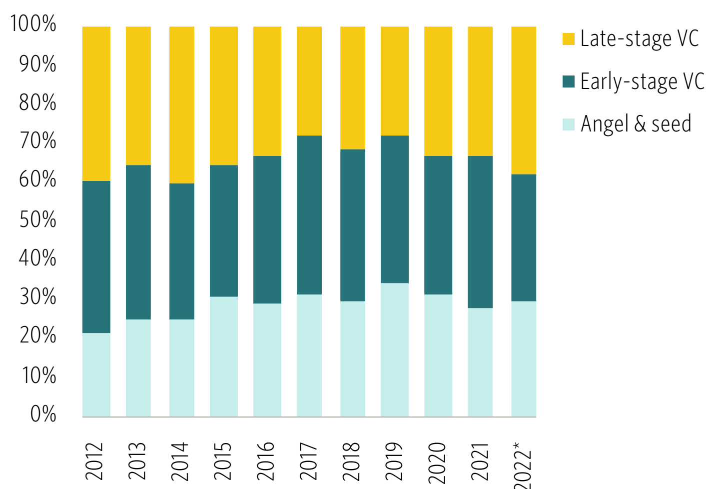
*As of September 30, 2022

Growing proportion of deals to late stage

Share of US biotech & pharma VC deal count by stage



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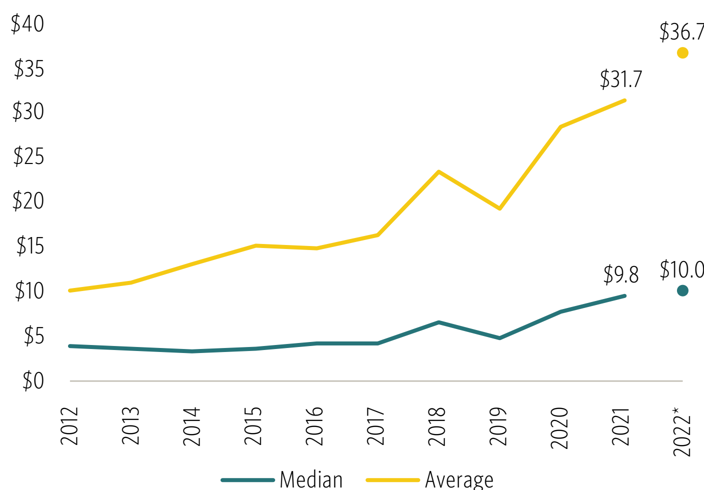
Deal values still growing

Median and average US biotech & pharma VC deal values ($M)



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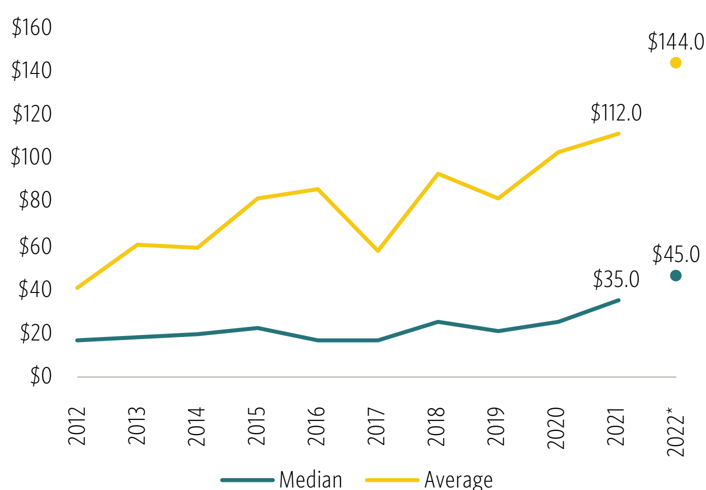
Valuations are up too

Median and average US biotech & pharma VC pre-money valuations ($M)



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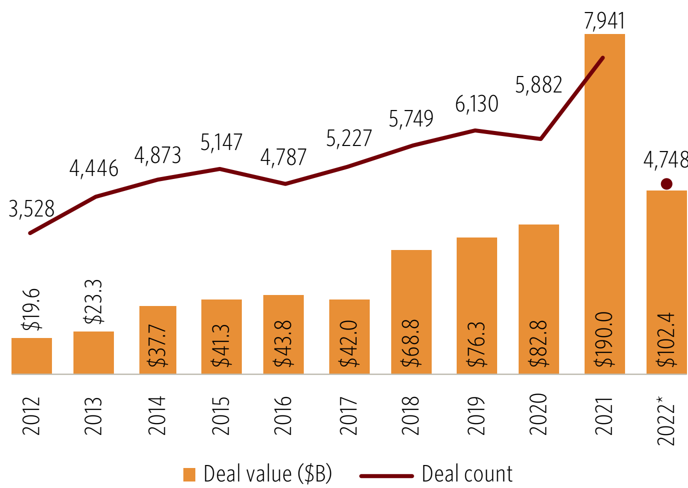
Enterprise tech

Enterprise tech investment slows heavily from 2021

US enterprise tech VC deal activity



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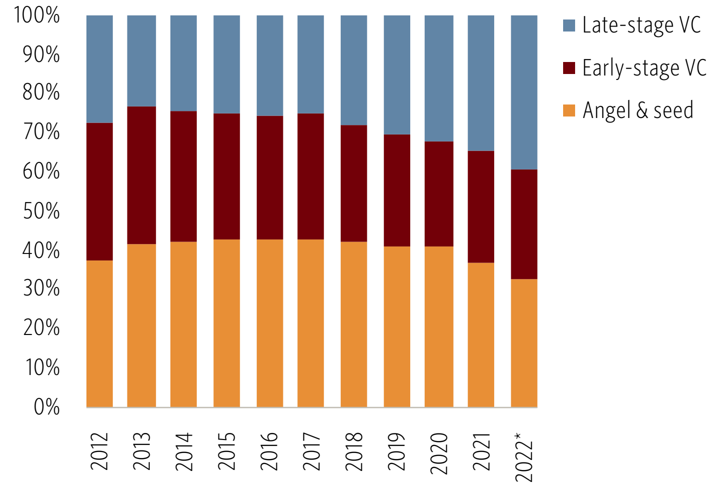
Early-stage deals see declining proportion

Share of US enterprise tech VC deal count by stage



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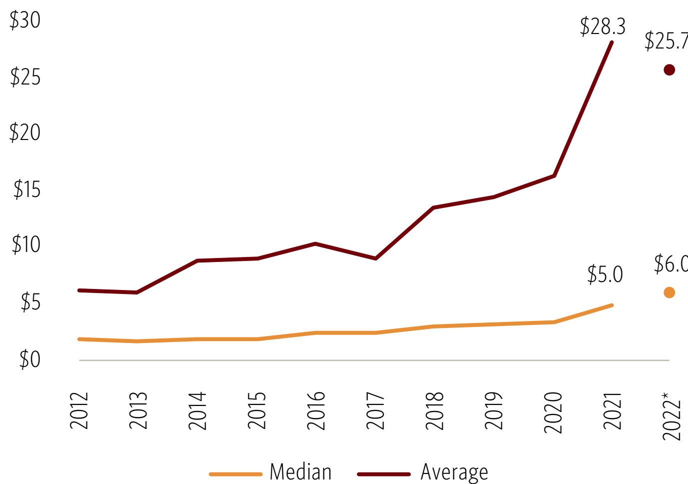
Average deal value falls in 2022

Median and average US enterprise tech VC deal values ($M)



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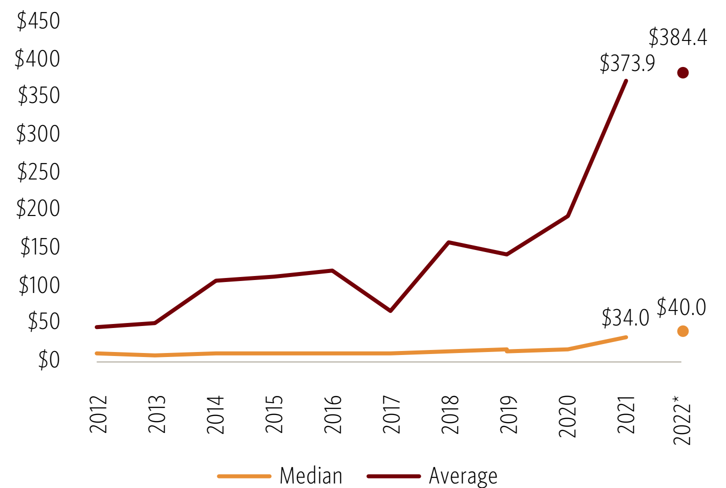
*As of September 30, 2022

Valuations remain high

Median and average US enterprise tech VC pre-money valuations ($M)



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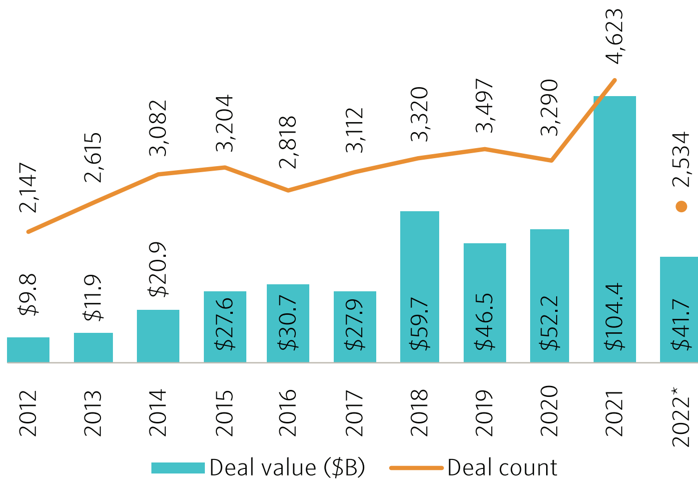
Consumer tech

Consumer tech struggles

US consumer tech VC deal activity



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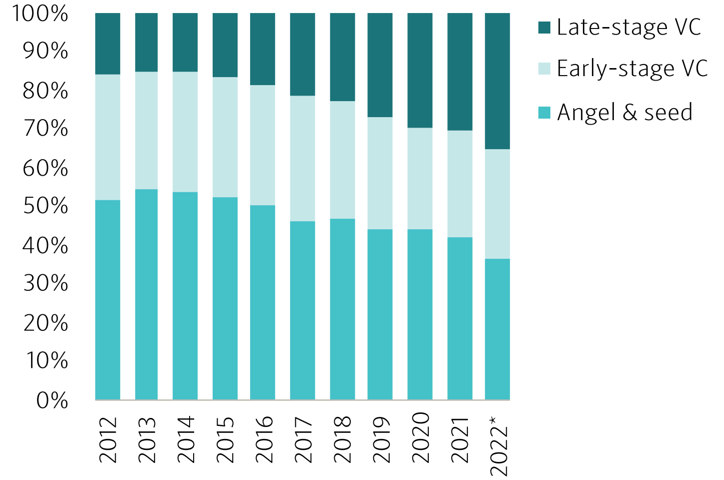
Seed deals continue decline

Share of US consumer tech VC deal count by stage



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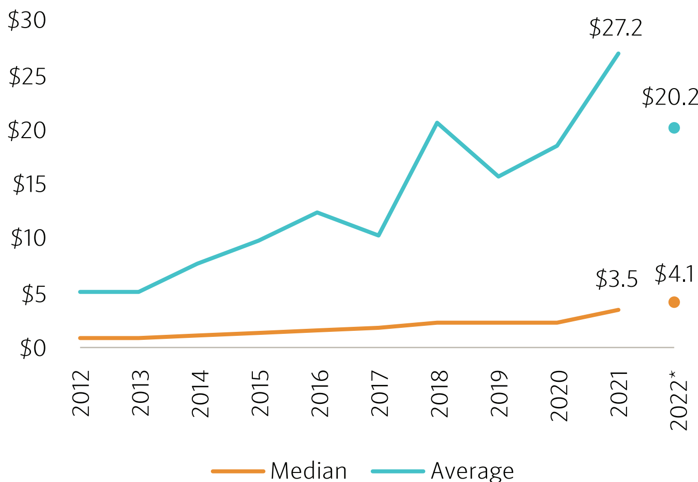
Average deal value falls back to pre-pandemic levels

Median and average US consumer tech VC deal values ($M)



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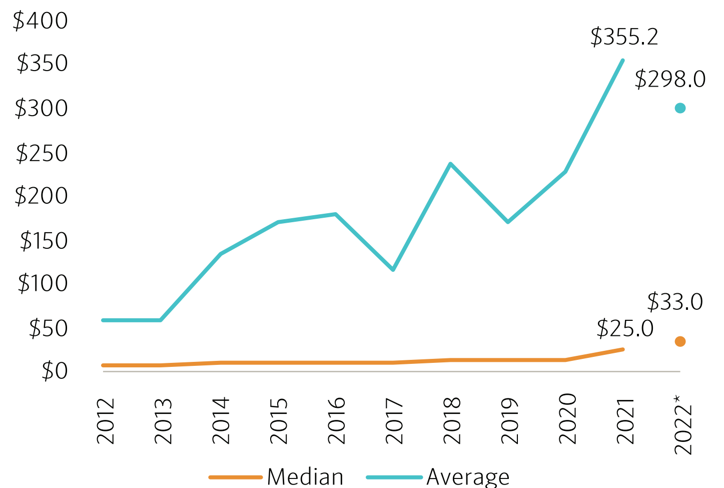
Median consumer tech valuation rises

Median and average US consumer tech VC pre-money valuations ($M)



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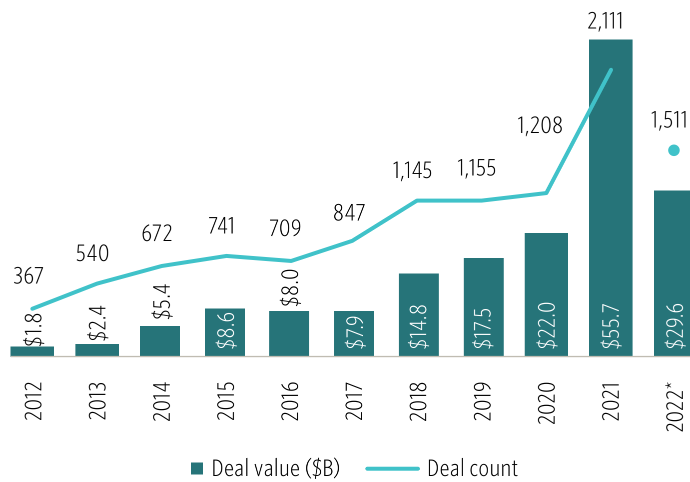
Fintech

Fintech deal count stays high

US fintech VC deal activity



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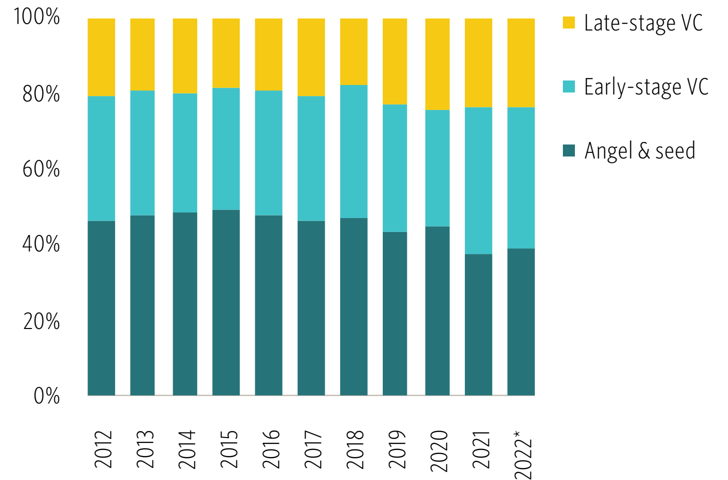
Deal count proportion remains level with 2021

Share of US fintech VC deal count by stage



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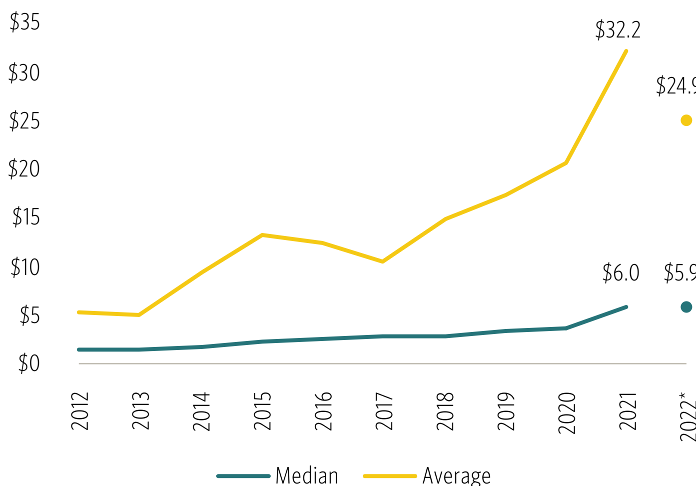
Deal values on the way down

Median and average US fintech VC deal values ($M)



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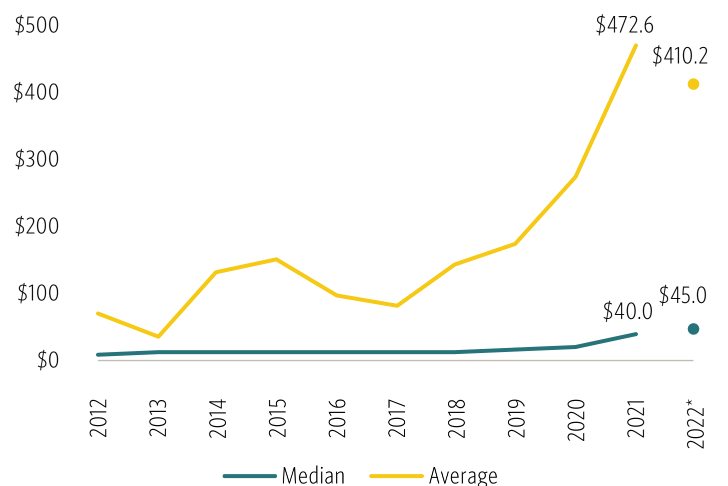
Average valuation remains above $400 million

Median and average US fintech VC pre-money valuations ($M)



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Investors spend too much time trying to find the right founders

From strategic networking, to exclusive benchmarking data, and deal-management tools, Capital Connect by J.P. Morgan gives you the tools you need to get deals done.

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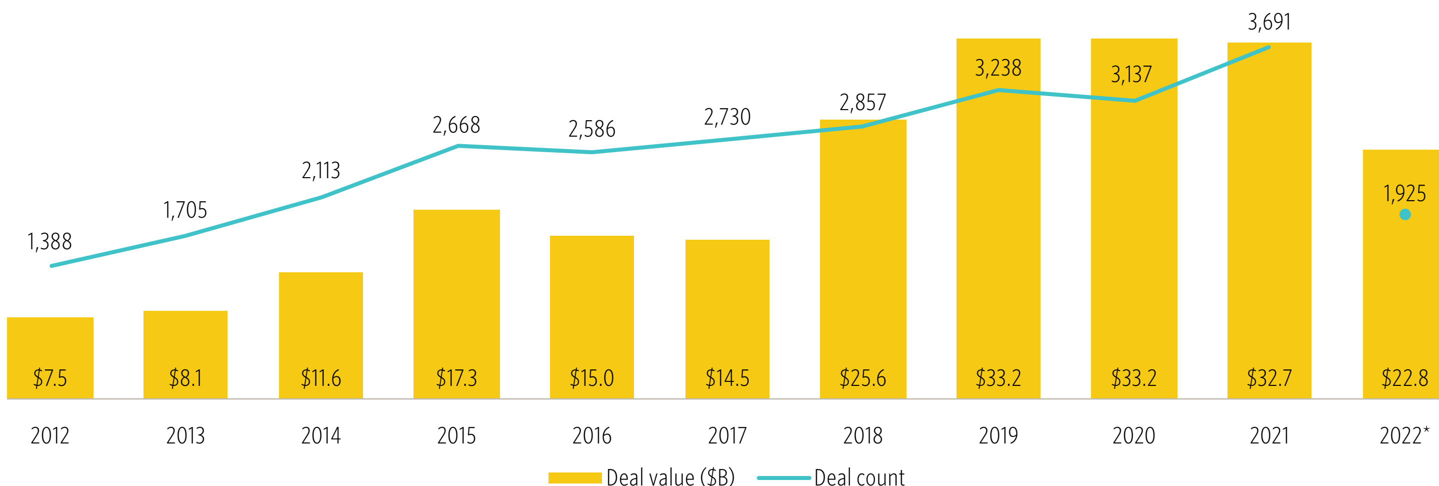
Venture debt

Venture debt surpasses $22 billion in value

US venture debt activity



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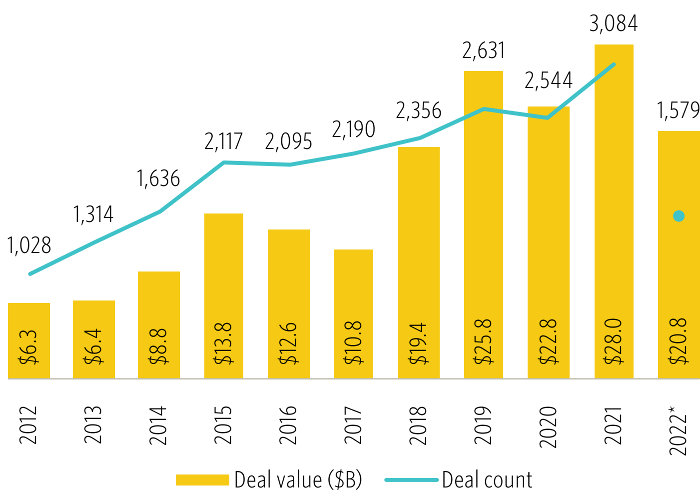
Fourth consecutive year above $20 billion

US tech venture debt activity



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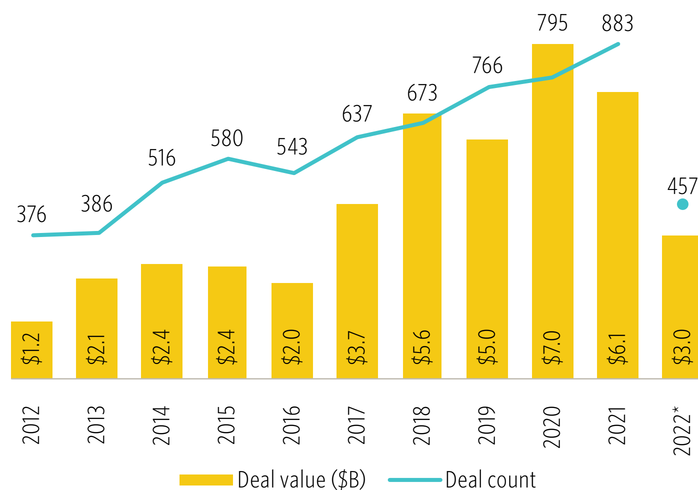
Healthcare debt slows from past years

US healthcare venture debt activity



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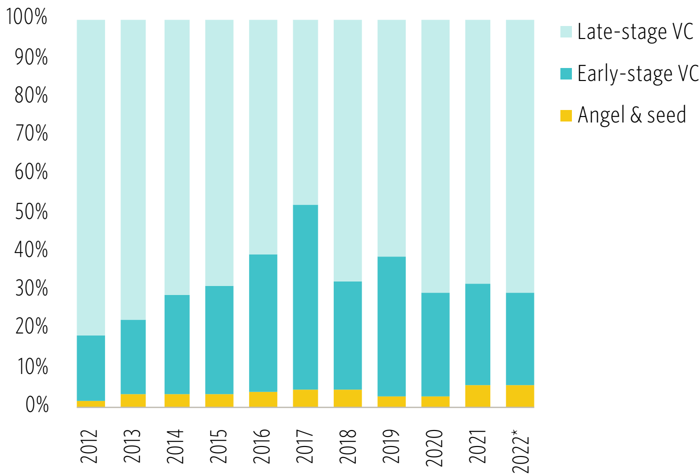
70% of venture debt going to late stage

Share of US venture debt deal value by stage



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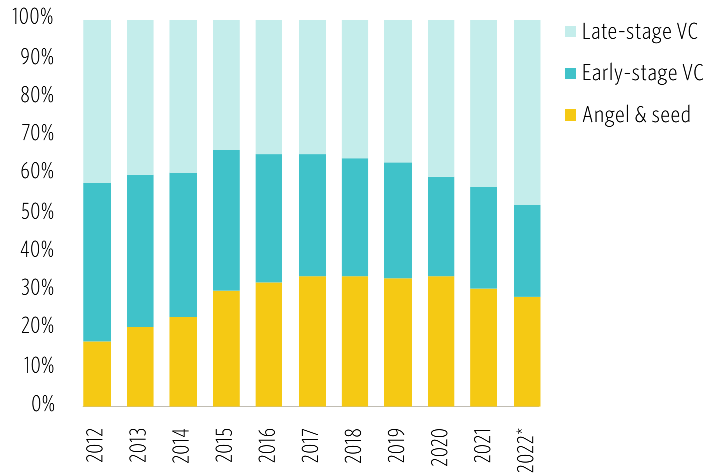
Early stage sees shrinking portion of loans

Share of US venture debt deal count by stage



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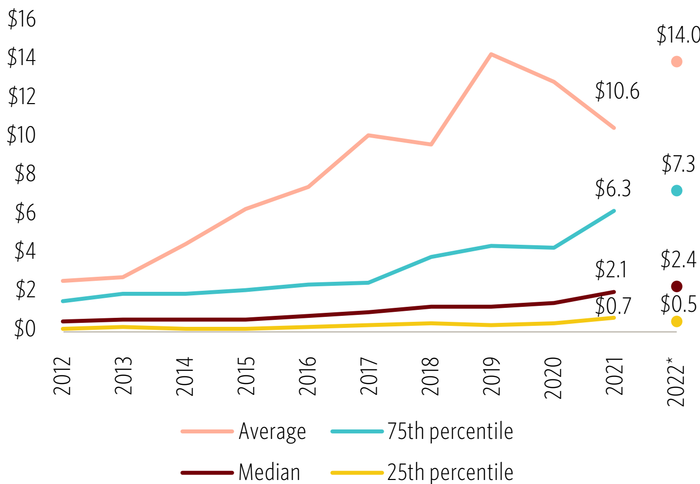
Early-stage loans growing larger

Range of US early-stage venture debt rounds ($M)



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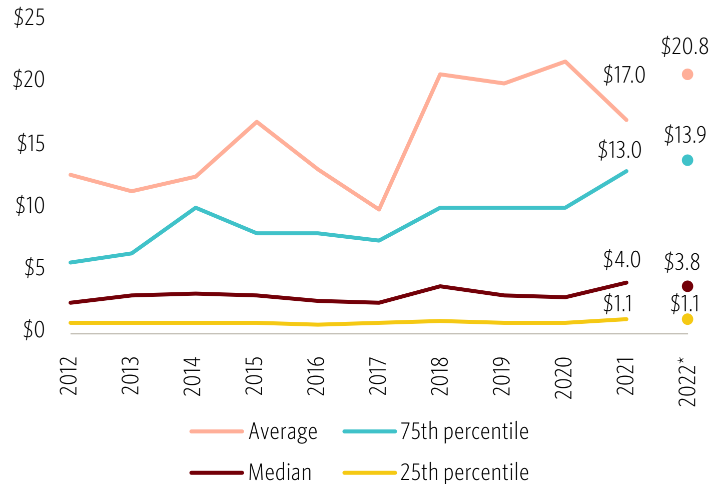
Median late-stage loan value falls

Range of US late-stage venture debt rounds ($M)



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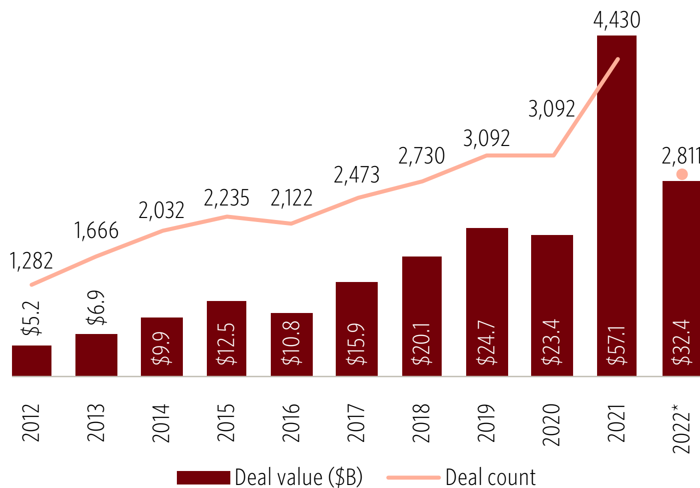
Female founders

YTD capital invested in female-founded companies exceeds 2020 full-year figures

US VC deal activity in companies with at least one female founder



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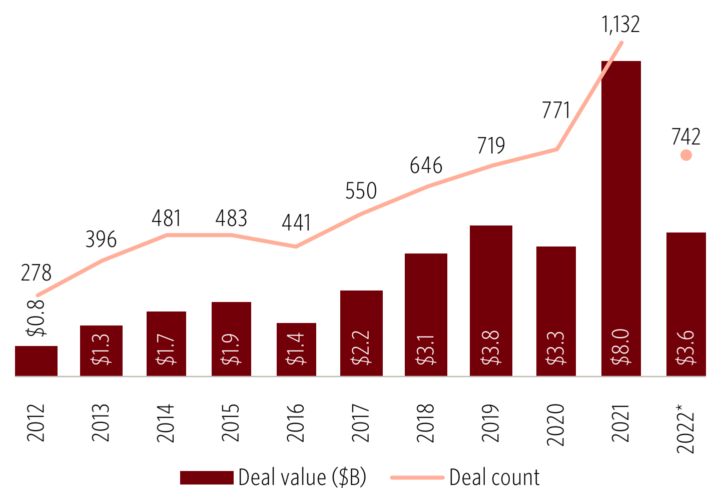
YTD deal count is on pace to exceed 2020

US VC deal activity in companies with all-female founder teams



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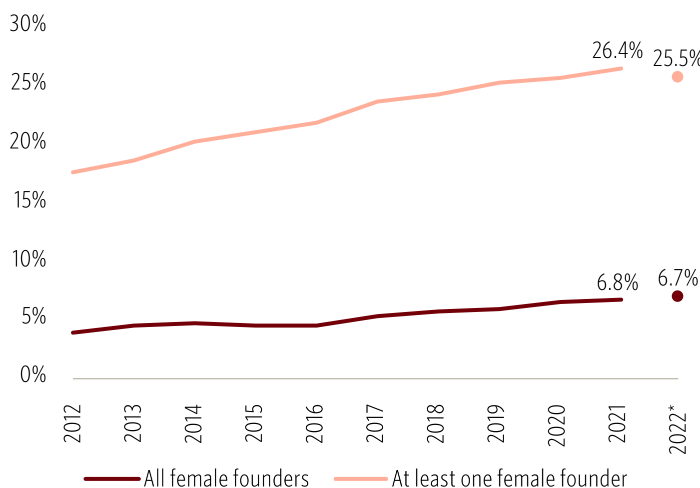
YTD proportion of all-female-led deals sees small downtick

Female-founded company deal count as proportion of total US VC deal count



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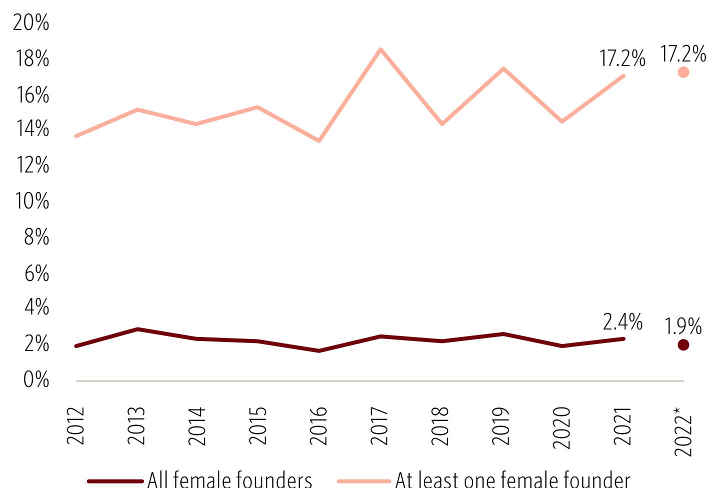
*As of September 30, 2022

Amid the economic downturn, female-founded companies are receiving less capital

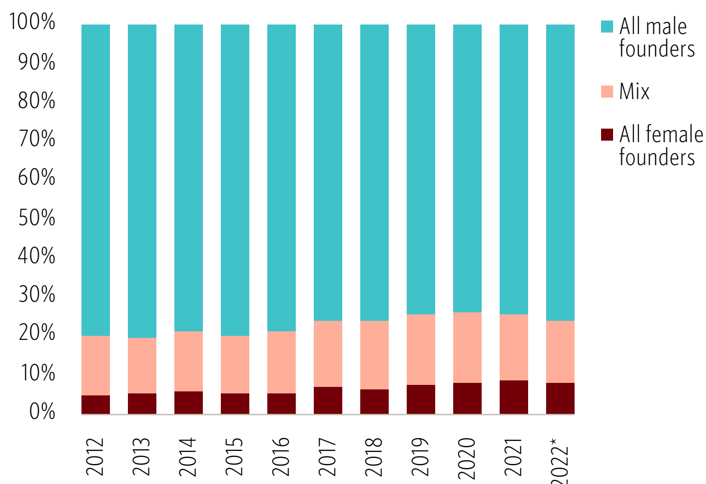
Female-founded company deal value as proportion of total US VC deal value



PitchBook-NVCA Venture Monitor
*As of September 30, 2022

All-female founder teams experience slight decline in proportion of first financings

Share of US VC first financings by founder gender



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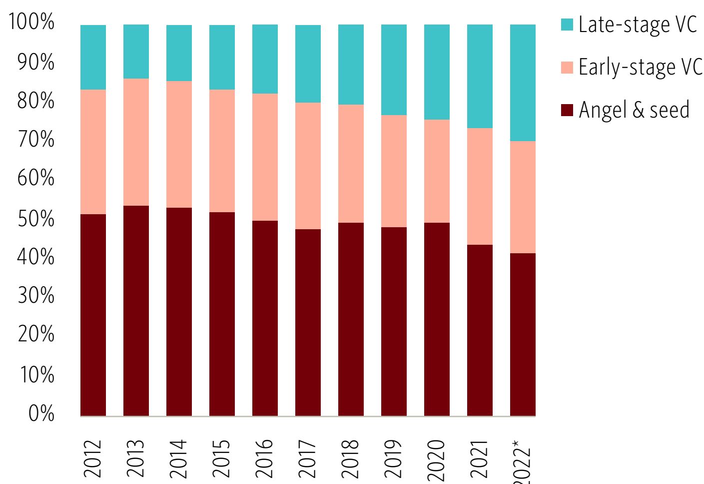
YTD proportion of late-stage deal count increasing

Share of US VC deal count for female-founded companies by stage



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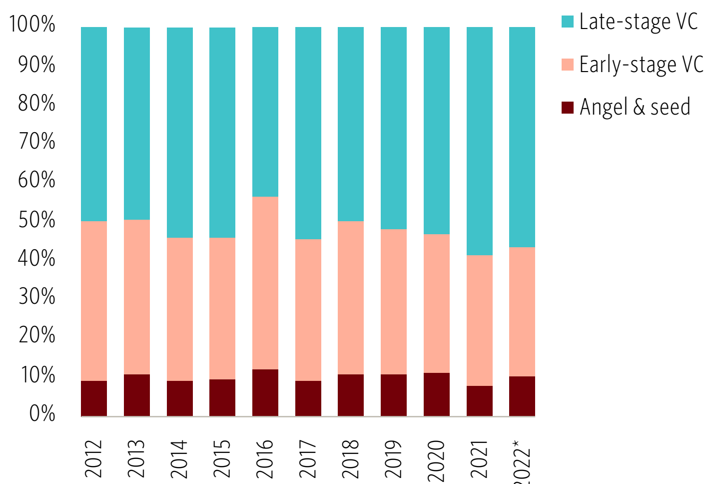
YTD proportion of deal value in angel & seed stage sees an increase over prior year

Share of US VC deal value for female-founded companies by stage



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Bay Area leads the US for female-founder investment

Top five US CSAs by capital raised for companies with all-female founder teams

Combined statistical area	Capital raised ($B)*
Bay Area	$5.5
New York	$4.9
Los Angeles	$1.9
Boston	$1.0
Philadelphia	$0.6

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New York leads the US in deal count

Top five US CSAs by deal count for companies with all-female founder teams

Combined statistical area	Deal count*
New York	775
Bay Area	590
Los Angeles	377
Boston	159
Washington D.C.	103

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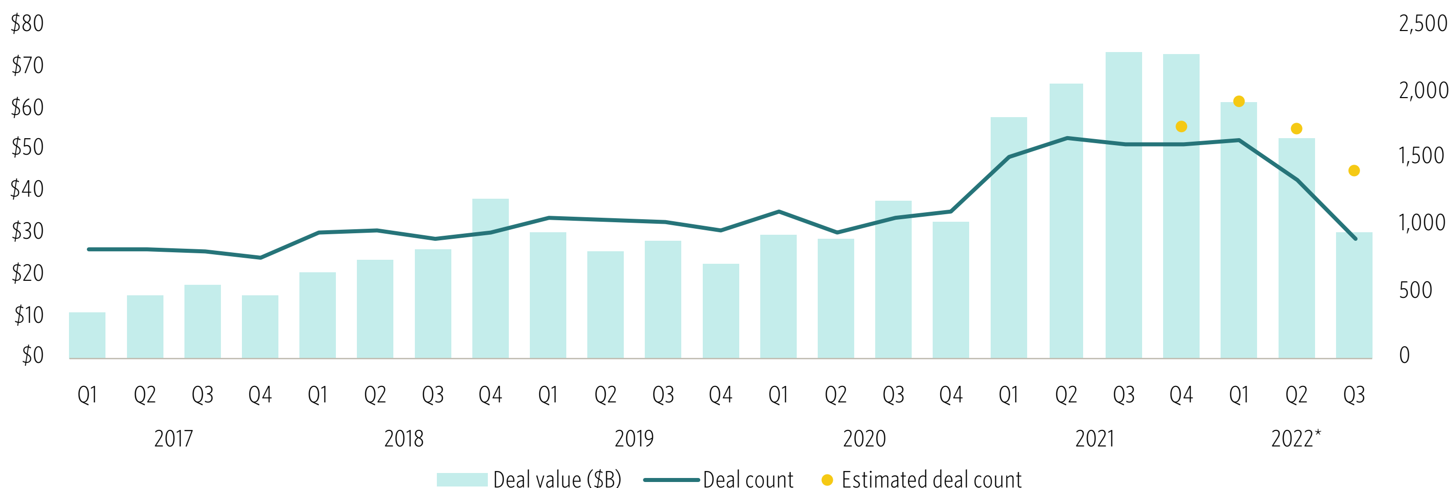
*As of September 30, 2022

Nontraditional investors

Nontraditional investors continue slowing deployment to VC

US VC deal activity with nontraditional investor participation by quarter



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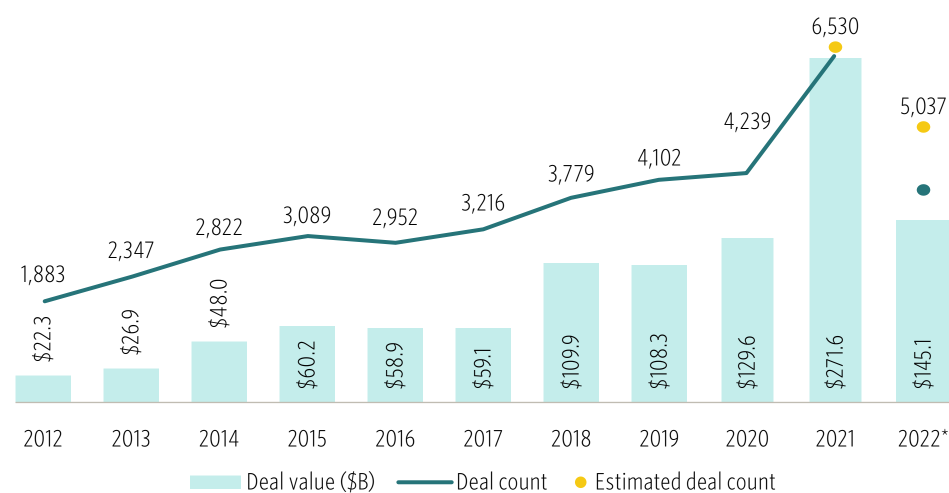
Nontraditional investors have outsized impacts on trends within venture, especially when looking at total deal value. In recent years, large nontraditional investors—asset managers, sovereign wealth funds, and PE firms—have participated heavily in the top of the market. They participated in 91.8% of mega-deals in 2021, which accounted for $195.1 billion in total investment within the venture market. This is a major reason we have said that a pullback from these investors due to market conditions would be easily seen within venture data. Q3 deal activity from nontraditional investors finally began to show the slowdown that the industry expected. After 1,921 deals were completed in Q1, Q3 saw roughly 1,400 completed rounds with nontraditional investor involvement. This data point, as with many others in this slowdown, is still higher than any quarter before 2021. Q4 2020 received the highest amount of nontraditional investment activity to that point, a now lowly 1,115 deals.

Deal value participation surpasses $145 billion

US VC deal activity with nontraditional investor participation



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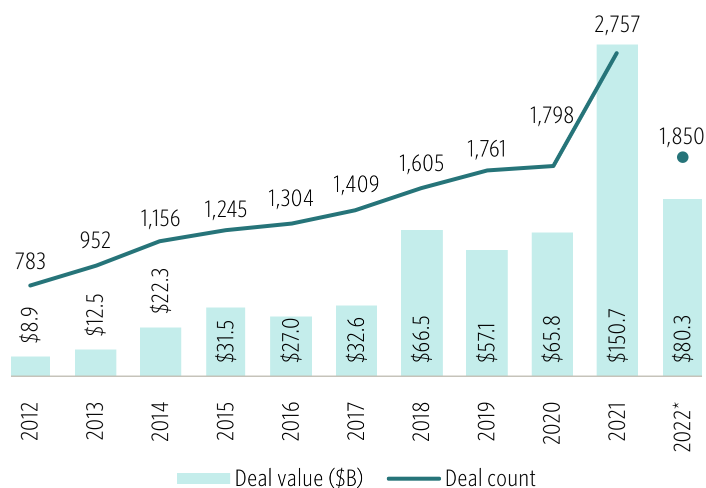
Except for corporate venture capital (CVC), deal counts of all nontraditional investor types have fallen faster than the broader venture market in 2022. Deal value participation has fallen even more precipitously. PE firms have participated in just 48.3% of deal value in 2022 and asset managers just 34.9%. Those figures stood at 58.5% and 43.6%, respectively, in 2021. These declines are heavily influenced by the lack of large, outsized deals reliant on nontraditional capital.

The lack of liquidity for late-stage companies has strained the strategies that they have deployed in the venture

Closing in on 2,000 deals led

US VC deals led or solely funded by nontraditional investors



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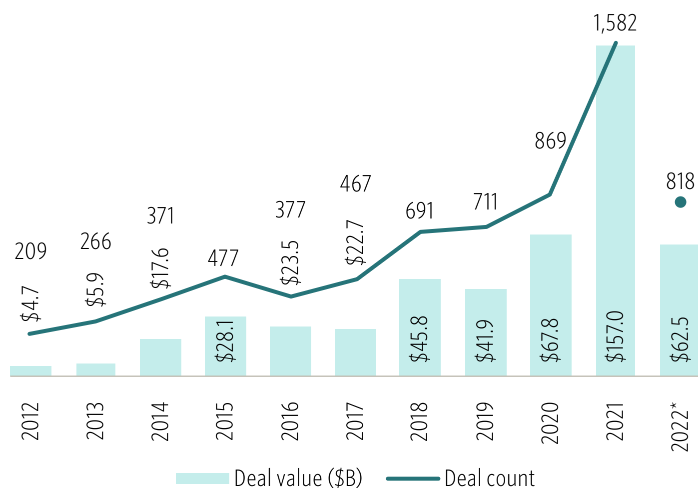
Crossover participation falling fast

US VC deal activity with nontraditional and crossover investor participation



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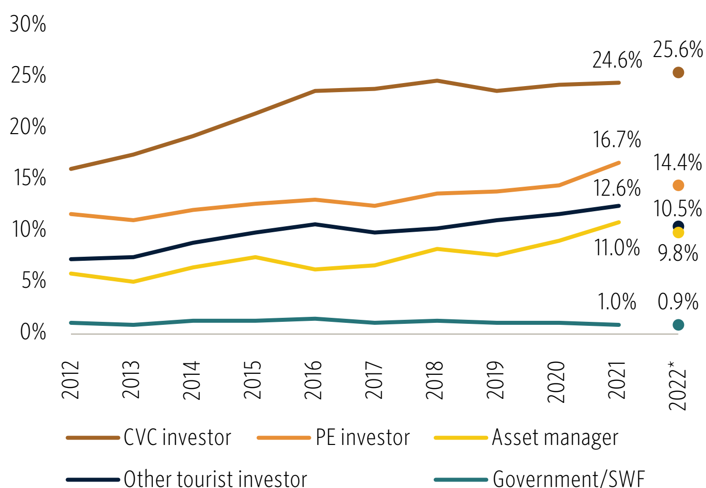
market in recent years. Elongated holding periods for the largest private investments from hedge funds and mutual funds—because of liquidity regulations and redemption timelines for investors—can cause strategies to become overweight to VC. While we don't believe many funds are up against this barrier yet, the strong markdowns in public markets have reduced the appetite for high-value venture deals for now.

Corporate investors have helped maintain deal activity for the nontraditional investor group. CVC has participated in 25.6% of VC deal count and 45.1% of deal value YTD; both these figures are in line with past yearly highs. Corporate investors have reaped record profits in recent years, bolstering their ability to continue private investments. However, the fragile economy is likely to make these investors more risk-averse, at least lessening their appetite for deploying large amounts of capital into single transactions. Non-cash return potential for CVC does provide an incentive to continue investment, as creating an ecosystem around current product offerings can boost a company's moat from competitors.

CVCs keep deal participation high

Proportion of US VC deal count by nontraditional investor type



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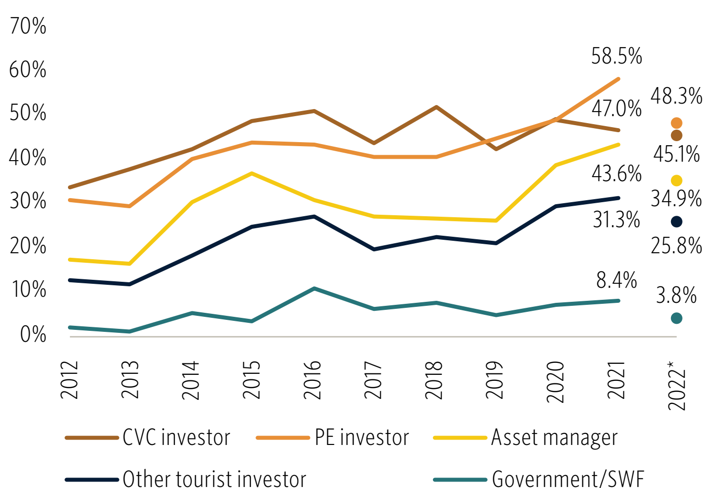
Deal value participation falls for all investor types

Proportion of US VC deal value by nontraditional investor type



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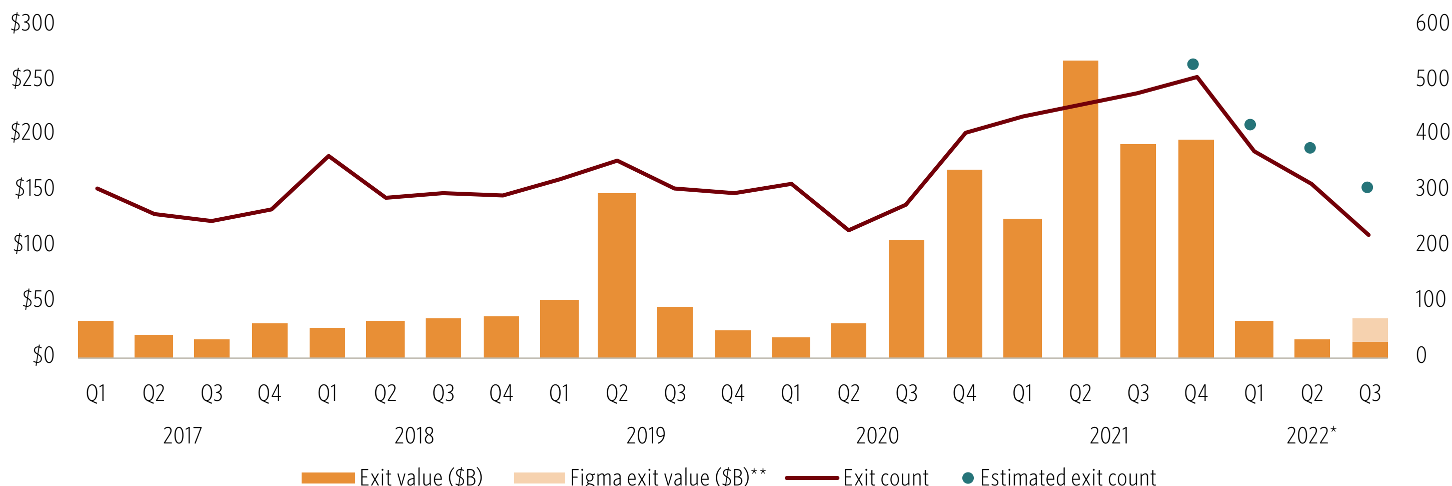
Exits

Exit activity shows little sign of rebounding this year

US VC exit activity by quarter

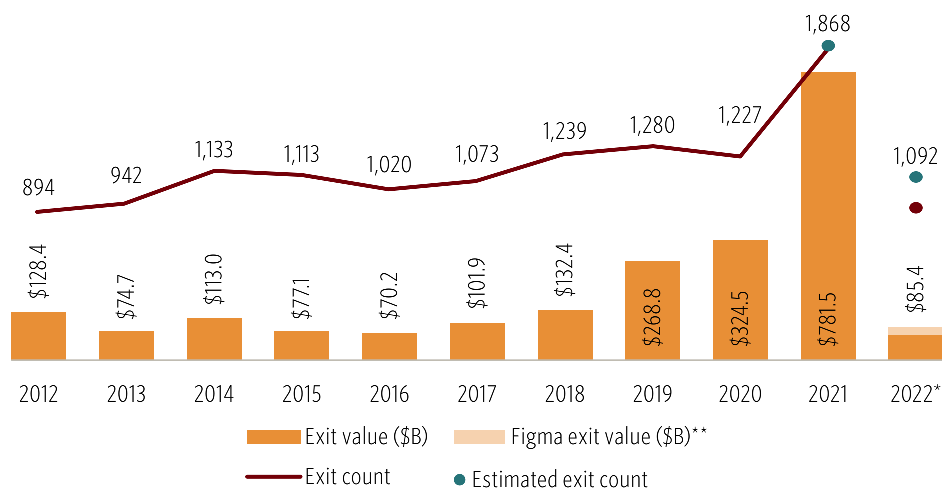


PitchBook-NVCA Venture Monitor
*As of September 30, 2022
**Announced exit on September 15, 2022

$14.0 billion in exit value was generated across an estimated 302 exit events in Q3, with few bright spots to speak of. Adobe's announced acquisition of Figma, a developer of a web-based design platform, is a positive for the industry, though it will likely come up against antitrust scrutiny before it is closed. Based on the $14.0 billion of completed exits, this quarter showed the VC-backed exit environment remains lethargic. There is room for concern regarding the pace of this year's total exit value because an extended period of low exit activity could discourage investors from recycling capital back into the VC ecosystem. Should the current environment remain, we expect this year's total exit deal value to fall below $100 billion for the first time since 2016. There remains a growing population of unicorns as well, adding further pressure on the market. The likely exit path for unicorns has been the public market, as few corporations are able and willing to buy such highly valued targets.

YTD exit activity sets expectation of a five-year low

US VC exit activity



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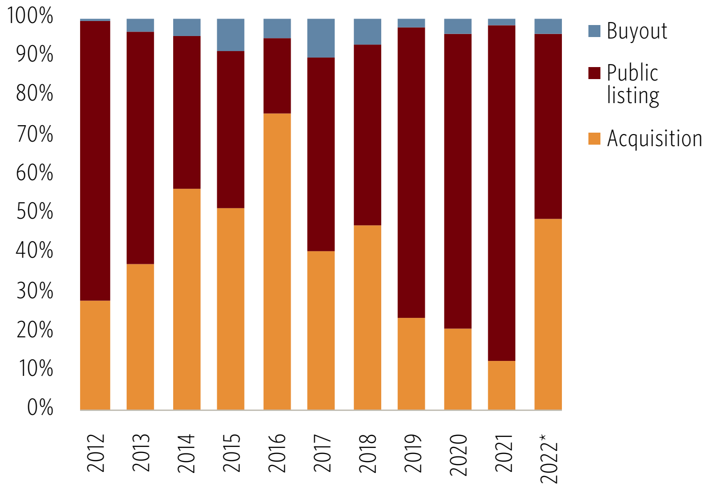
*As of September 30, 2022
**Announced exit on September 15, 2022

The overarching narrative of the frozen IPO market remains, with just five companies exiting via traditional IPOs this quarter. Access to liquidity is critical to both startups and their investors, and IPOs provide much-needed financing to startups to continue their growth, albeit in the public eye. The lack of liquidity through public markets could put pressure on startups to return to equity markets for additional financings and accept investment at lower valuations compared with prior financing rounds, severely diluting current shareholders.

Almost 50% of YTD exit value generated by acquisitions

Share of US VC exit value by type



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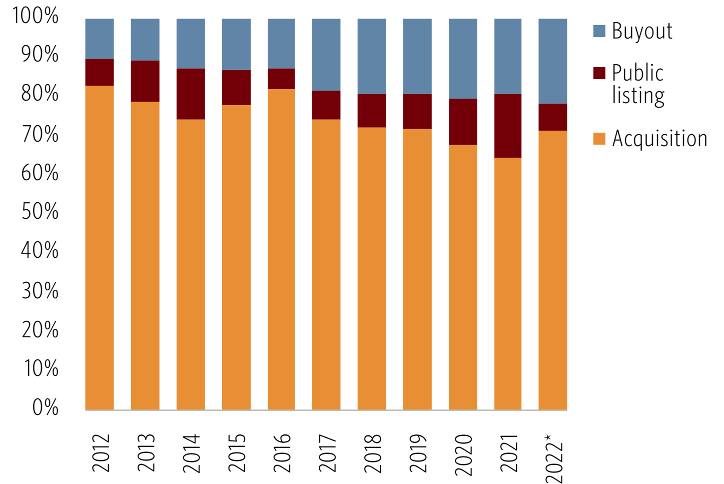
YTD share of exits via acquisition pushes above prior year's record low

Share of US VC exit count by type



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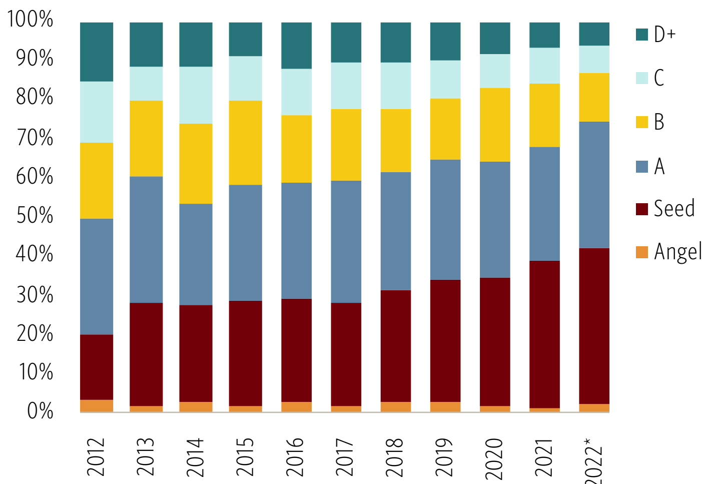
*As of September 30, 2022

Until recently, special purpose acquisition companies (SPACs) were an active option to create liquidity for investors. Their pervasiveness in the market has all but disappeared as a result of increased scrutiny and proposed regulation by the SEC. Only three SPACs completed listing this quarter, a far cry from the peak of 281 listings in Q1 2021. Much of the remaining SPACs that have yet to complete acquisitions are nearing their two-year time limit, at which point shareholders can opt to have their investment returned; such is the case with two SPACs launched by Chamath Palihapitiya's firm, Social Capital, which announced that it will be returning $1.6 billion to shareholders after it evaluated more than 100 targets and failed to complete an acquisition. Although some of the initial acquisition targets may have fallen through, publicly listed SPACs represent sidelined capital that is positioned to support distressed startups during slowdown.

Seed stage sees majority of YTD US VC acquisitions

Share of US VC round count by round series where next round is an exit via acquisition



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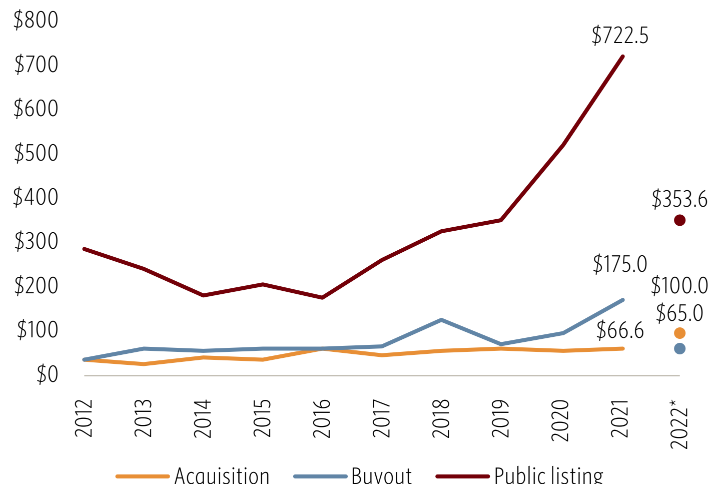
Median acquisition exit value remains above historical figures

Median US VC exit value ($M) by type



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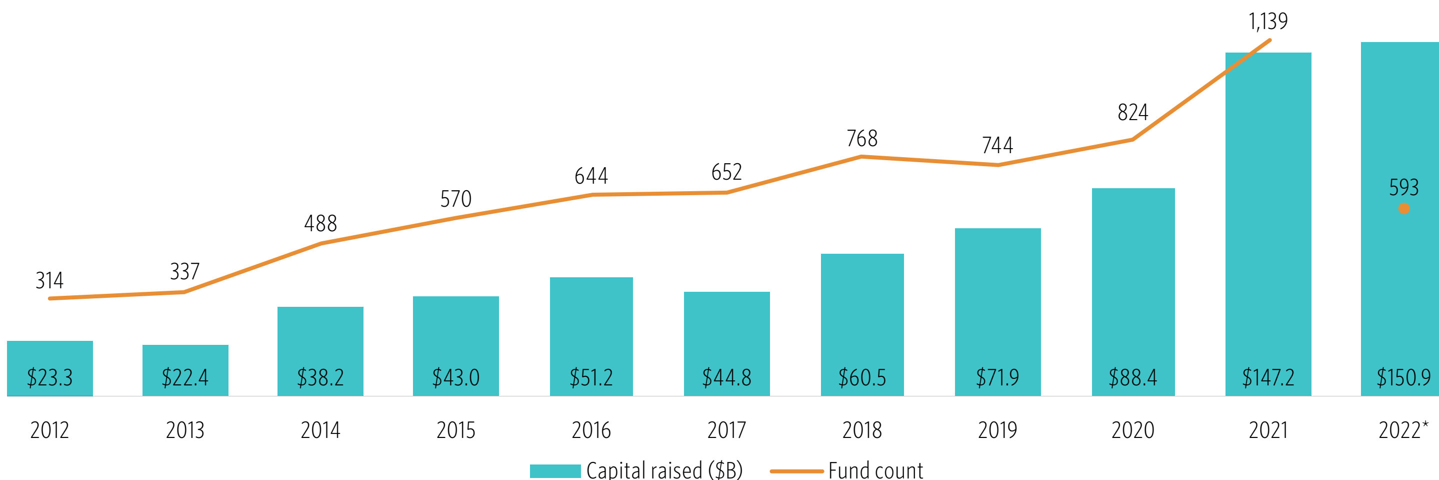
Fundraising

YTD US VC fundraising exceeds prior year's record high

US VC fundraising activity



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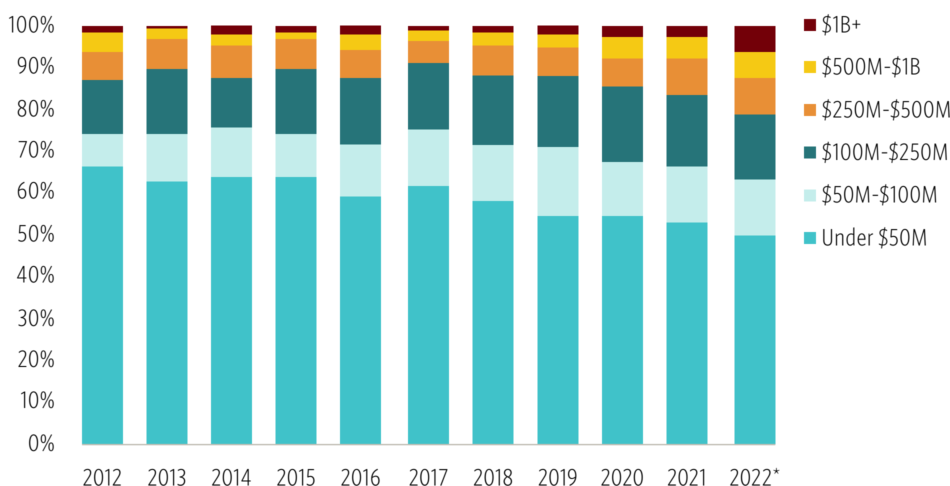
Given public market turbulence and frozen avenues for liquidity, we expected LPs to be concerned about their overexposure to this asset class and the potential for timely returns negatively impacting fundraising activity. However, US VC fundraising has set a new annual high of $150.9 billion, exceeding the 2021 full-year figure by $147.2 million. Much of the fundraising narrative has been centered on the last year's momentum and the funds already in discussion prior to the economic downturn. Entering the second half of the year, we are starting to see that momentum atrophy, yet fundraising remains relatively strong. $29.4 billion was added to the fundraising total since last quarter's report. LPs may feel compelled to maintain their allocations with GPs to secure access to future funds and avoid costly due diligence efforts to identify new managers later.

Billion-dollar funds set record high

Share of US VC fund count by size bucket



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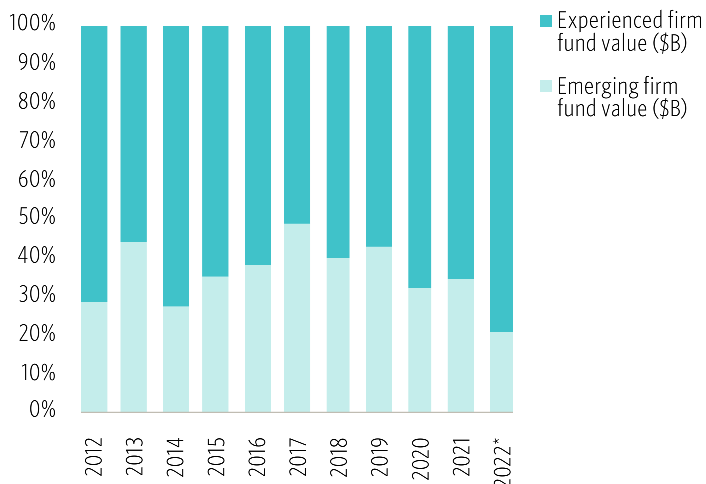
Further examination of Q3's fundraising activity shows a large divide in the success of established managers and emerging managers. Roughly $22.0 billion, or 86.7% of Q3's total invested capital, was committed to 66 funds led by established managers. What's more, this quarter some of the largest players in the space, including Bessemer Venture Partners, Battery Ventures, Lightspeed Venture Partners, and Oak HC/FT, successfully closed funds with more than $1 billion in commitments, highlighting the fundraising advantage of GP incumbents. Going forward we expect higher concentrations of capital committed to established managers and a greater prevalence of larger multistage

Investors look to experienced fund managers to mitigate risk

Share of US VC raised by emerging or experienced managers



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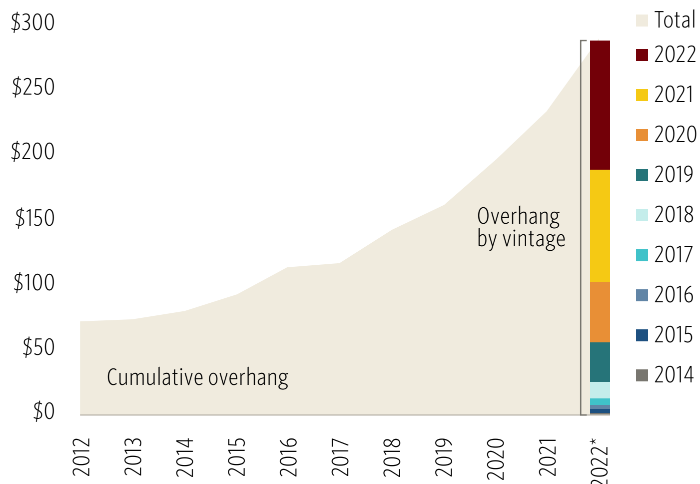
US VC cumulative dry powder is at an all-time high

US VC dry powder ($B) by vintage



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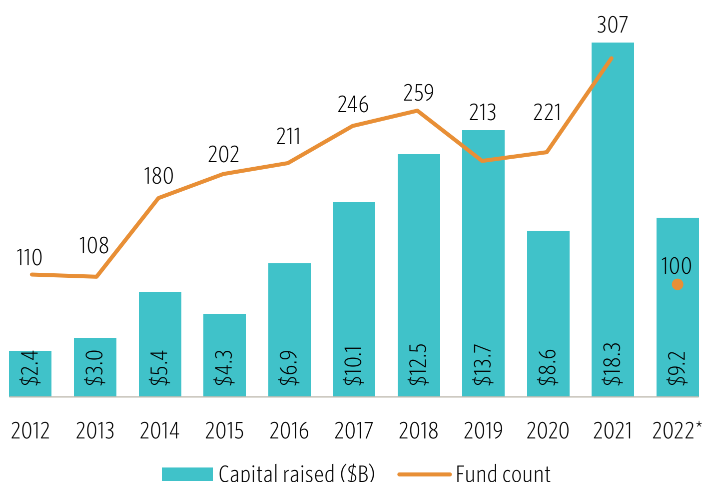
funds increasing the throughput of deals through the venture lifecycle.

The surplus of roughly $290.1 billion in dry powder is a testament to the strength of this asset class and its continued growth. It should be noted that the majority of dry powder will target more-traditional stages of venture, with less invested in mega-deals or unicorns. Aiding the VC market's outlook is the estimated $13.0 billion in net cash flows to investors through the first half of this year, a high amount considering the fast pace of contributions during the period. LPs are continuing to generate strong returns from prior investments, supporting the prospect of that capital being recycled into the ecosystem. Much of those returns are likely derived from holdings in prior IPOs that only recently cleared their lockup period or were finally sold by GPs, highlighting the need for exits to remain strong to further boost the VC market. Moreover, those cash flows bolster the attractiveness of established managers and will reinvigorate investor participation.

Lethargic first-time fundraising activity presumed to fall below 2014 levels

US VC first-time fundraising activity



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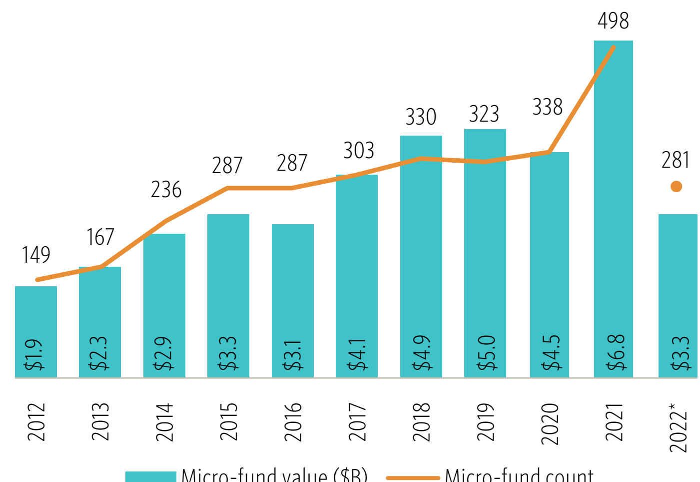
Micro-fund closings slow from 2021

US VC micro-fundraising activity



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*As of September 30, 2022

Methodology

Deals

We include equity investments into startup companies from an outside source. Investment does not necessarily have to be taken from an institutional investor. This can include investment from individual angel investors, angel groups, seed funds, VC firms, corporate venture firms, corporate investors, and institutions, among others. Investments received as part of an accelerator program are not included; however, if the accelerator continues to invest in follow-on rounds, those further financings are included. All financings are of companies headquartered in the US, with any reference to "ecosystem" defined as the combined statistical area (CSA). We include deals that include partial debt and equity.

Angel & seed: We define financings as angel rounds if there are no PE or VC firms involved in the company to date and we cannot determine if any PE or VC firms are participating. In addition, if there is a press release that states the round is an angel round, it is classified as such. Finally, if a news story or press release only mentions individuals making investments in a financing, it is also classified as angel. As for seed, when the investors and/or press release state that a round is a seed financing, or it is for less than $500,000 and is the first round as reported by a government filing, it is classified as such. If angels are the only investors, then a round is only marked as seed if it is explicitly stated.

Early stage: Rounds are generally classified as Series A or B (which we typically aggregate together as early stage) either by the series of stock issued in the financing or, if that information is unavailable, by a series of factors including: the age of the company, prior financing history, company status, participating investors, and more.

Late stage: Rounds are generally classified as Series C or D or later (which we typically aggregate together as late stage) either by the series of stock issued in the financing or, if that information is unavailable, by a series of factors including: the age of the company, prior financing history, company status, participating investors, and more.

Nontraditional investors: "CVC" includes rounds executed by established CVC arms as well as direct equity investments by corporations into VC-backed companies. "PE" includes VC deals by investors whose primary classification is PE/buyout, growth, mezzanine, or other private equity. "Crossover" investors are a subset of nontraditional investors—specifically asset managers, hedge funds, mutual funds, and sovereign wealth funds—that have been active in VC investment across any stage. They are referred to as crossover because these investors are likely to be participating at the late stages directly prior to an exit.

Venture debt: The venture debt dataset is inclusive of all types of debt products raised by VC-backed companies, regardless of the stage of company. In mixed equity and debt transactions, equity is excluded when the amount is of known value. Financings that are solely debt are included in this dataset, though not incorporated into the deal activity dataset used throughout the report. Mixed equity and debt transactions will be included in both datasets.

Exits

We include the first majority liquidity event for holders of equity securities of venture-backed companies. This includes events where there is a public market for the shares (IPO) or the acquisition of majority of the equity by another entity (corporate or financial acquisition). This does not include secondary sales, further sales after the initial liquidity event, or bankruptcies. M&A value is based on reported or disclosed figures, with no estimation used to assess the value of transactions for which the actual deal size is unknown. IPO value is based on the pre-money valuation of the company at its IPO price. One slight methodology update is the categorical change from "IPO" to "public listings" to accommodate the different ways we track VC-backed companies' transitions to the public markets. To give readers a fuller picture of the companies that go public, this updated grouping includes IPOs, direct listings, and reverse mergers via SPACs.

Fundraising

We define VC funds as pools of capital raised for the purpose of investing in the equity of startup companies. In addition to funds raised by traditional VC firms, PitchBook also includes funds raised by any institution with the primary intent stated above. Funds identifying as growth-stage vehicles are classified as PE funds and are not included in this report. A fund's location is determined by the country in which the fund's investment team is based; if that information is not explicitly known, the HQ country of the fund's general partner is used. Only funds based in the United States that have held their final close are included in the fundraising numbers. The entirety of a fund's committed capital is attributed to the year of the final close of the fund. Interim close amounts are not recorded in the year of the interim close.

PitchBook nvca

A perfect partnership: PitchBook and the National Venture Capital Association

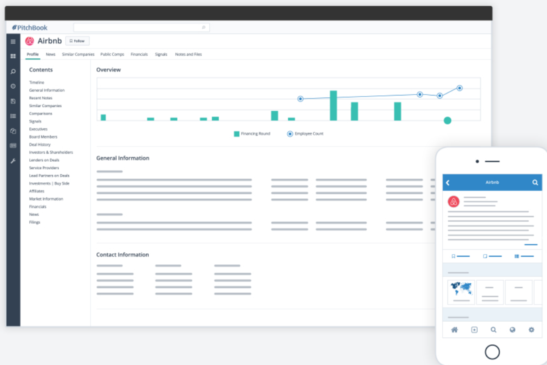
Why we teamed up

NVCA is recognized as the go-to organization for venture capital advocacy, and the statistics we release are the industry standard. PitchBook is the leading data software provider for professionals in venture capital, serving more than 4,000 customers across the private markets. Our partnership with PitchBook empowers us to unlock more insights on the VC ecosystem and better advocate for our evolving industry.

The PitchBook-NVCA Venture Monitor

Informed by PitchBook data, our quarterly Venture Monitors dive deep into venture capital activity and deliver insights to inform your investment strategy. PitchBook data also bolsters our annual year-in-review publication.

THE PERKS OF PARTNERSHIP



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