Venture Monitor

Q1 2022

In partnership with

Deal activity remains historically high, with more than $70 billion invested in Q1 across an estimated 4,822 deals.
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Public listings take steep decline with just 28 completed in Q1.
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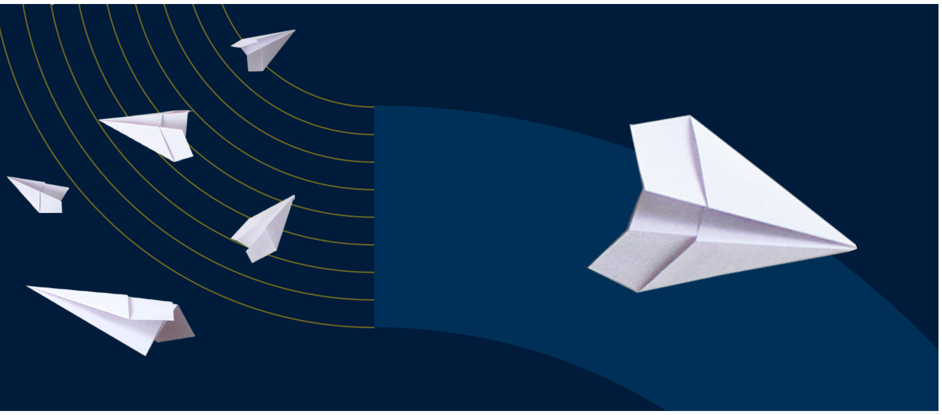
VC funds closed on over $70 billion in Q1, adding to record dry powder.
Page 34

The definitive review of the US venture capital ecosystem



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Executive summary

US venture capital (VC) investment activity and VC-backed IPOs did not maintain their pace in Q1 after a record-setting 2021, showing signs of a VC ecosystem slowdown that many have expected. The VC industry displayed unwavering resilience throughout the pandemic and reached new highs last year. The startup ecosystem served as an important economic engine and an answer to many challenges brought on by the pandemic. However, the start of 2022 suggests the onset of an imminent but healthy recalibration period.

VC-backed IPOs (both the number of listings and valuations) were the big story of 2021. However, public markets are down so far in 2022, with rising interest rates, inflation, and geopolitical uncertainty all contributing factors. The top 10 VC-backed IPOs in 2021 also felt the impact. A mid-March PitchBook analysis found that, from their post-money valuations at exit to their current market cap, those 10 stocks were all down 18% to 68%. Public market headwinds have already had—and will continue to have—trickle-down effects into VC. Only 28 VC-backed companies publicly listed in Q1 2022, the lowest quarterly count since Q1 2020.

With the IPO window essentially shut and public markets turning sharply toward profitability, late-stage companies may be feeling the squeeze to raise additional capital in the private markets or look to other exit avenues. SPAC interest largely waned in H2 2021 after exploding in H1 2021, but some companies may now consider revisiting SPACs as an IPO alternative. However, proposed SEC regulations introduced at the end of Q1 could curb their appeal. Exit opportunities through corporate M&A may attract more interest, particularly as larger corporations are flush with cash on their balance sheets and looking to startups to strengthen their tech deficit. Q1 VC-backed M&A activity was also off pace from 2021, albeit less so than public listings, and may pick up as the year unfolds.

Even though Q1 deal value was off pace from every quarter in 2021, Q1 2022 still exceeded pre-2021 quarterly totals. VC deal activity will likely see a delayed reaction to the public market slowdown, a trend to watch closely in Q2. Some investors have started to see initial downward corrections in VC market pricing, valuation, and the speed at which deals are closing. VC market adjustments trickling down from the public markets are likely to hit late-stage companies first, while it may take longer for early-stage companies to feel the brunt. Some companies are adopting a wait-and-see approach and hoping that multiples will bounce back.

Another big change for many VC investors and startup employees in Q1 was a workforce largely returning to the office and the attendant increases in industry events, in-person meetings, and travel. Pre-pandemic, a virtual format for a founder's first meeting with an investor would have been rare, but virtual meetings have been a pandemic mainstay and now appear to be a new industry standard for first meetings. This will be a welcome trend for talent—both investors and founders—that had dispersed to emerging ecosystems during the pandemic. The distributed workforce now living outside the coastal VC hubs and the network effects they bring suggest the growing strength of these smaller VC markets, which could potentially insulate them from shifts in non-local investor risk tolerance.

Limited partners (LPs) will not be immune to the public market slowdown, and many have had to navigate the denominator effect because their portfolios are overweighted in private markets. Nonetheless, VC funds closed on more than $70 billion in Q1, adding to the $230.0 billion in dry powder VC investors had amassed by the end of 2021. This record-high dry powder and the number of active investors in the market may blunt the impact of any corrections. A softer landing also could stem from the maturity and sophistication of the VC ecosystem today compared to previous downturns in 2001 and 2008. Where the slowdown will taper off remains to be seen, but VC investors are in a strong position to continue fueling startups that are solving big needs in areas such as sustainability, consumer health, and the supply chain, while creating new sectors, such as web3 and fintech, that are transforming how we live and work.

NVCA policy highlights

The next several months of policymaking will be incredibly impactful for the future of the venture industry. Lawmakers face a limited window to address many priorities before the midterm elections in the fall. NVCA will keep a watchful eye for proposals that would harm our ecosystem, and we will work closely with policymakers to grow our innovation economy. Below are key policy initiatives for NVCA and an overview of the current state-of-play.

Financial regulatory proposals

NVCA is engaged on numerous financial regulatory proposals this year. In January, SEC Chair Gary Gensler announced his agency is working on a plan to require more private companies and investors to disclose information about their finances and operations. NVCA President & CEO Bobby Franklin was quoted in the *Wall Street Journal* warning about potential unintended consequences of the effort.

We are tracking four key SEC proposals:

- Form PF: a proposal impacting Registered Investment Advisers (RIAs) that will shorten the reporting period for certain events and expand the "large private equity adviser" threshold from $2 billion in assets under management (AUM) to $1.5 billion AUM. NVCA submitted a formal response to the SEC and proposed alternative approaches that would provide relief to VC firms registered as RIAs.
- 10b5-1 plans: would require a 120-day cooling off period; prohibits overlapping plans; mandates quarterly disclosures. NVCA submitted a comment letter demonstrating the impact on VC and requesting relief.
- Private funds proposal: would require RIAs to provide quarterly reporting to LPs on performance, fees, and expenses, as well as an annual audit.
    - RIAs and Exempt Reporting Advisers (ERAs): prohibition from seeking indemnification; restrictions on side letter provisions and charging fees to portfolio investments.
- Private company rulemaking: The SEC is expected to release proposals this year targeting private company disclosures.

Competitiveness legislation

There has been recent momentum behind congressional efforts to move forward on a US competitiveness package. A few months after Senate Majority Leader Chuck Schumer (D-NY) and House Speaker Nancy Pelosi (D-CA) announced an agreement for the House and Senate to begin negotiations on a final package, the House considered and passed its version of a competitiveness bill (the America COMPETES Act). NVCA has been heavily engaged and a longtime supporter of the Senate's US Innovation and Competition Act and its approach to encouraging commercialization of critical technologies through a new National Science Foundation (NSF) directorate. We will continue to advocate for new company formation to be prioritized in the final product.

The House package contains Startup Visa legislation from Rep. Zoe Lofgren (D-CA), and we are working to ensure this provision is included in the final package.

Build Back Better Act

Last year, NVCA spent significant time and resources on the Build Back Better Act (BBB). As the year closed, the legislation fortunately did not increase taxes on carried interest capital gains or the top-line capital gains rate but did include misguided changes to Qualified Small Business Stock (QSBS). We raised concerns to key lawmakers regarding the proposed QSBS changes, which are detailed in a coalition letter NVCA joined with 31 innovation and entrepreneurship organizations.

The path forward on BBB is uncertain, but there have been recent signs of life as Senator Joe Manchin (D-WV) said he would support a pared down package if it materially reduces the deficit. Manchin also mentioned supporting the prescription drug pricing reforms, climate investments, and tax increases, much of which could come from the House-passed BBB. We will remain vigilant for any new discussions around carried interest capital gains and continue to share the consequences of harmful changes to QSBS.

Antitrust and acquisition restrictions

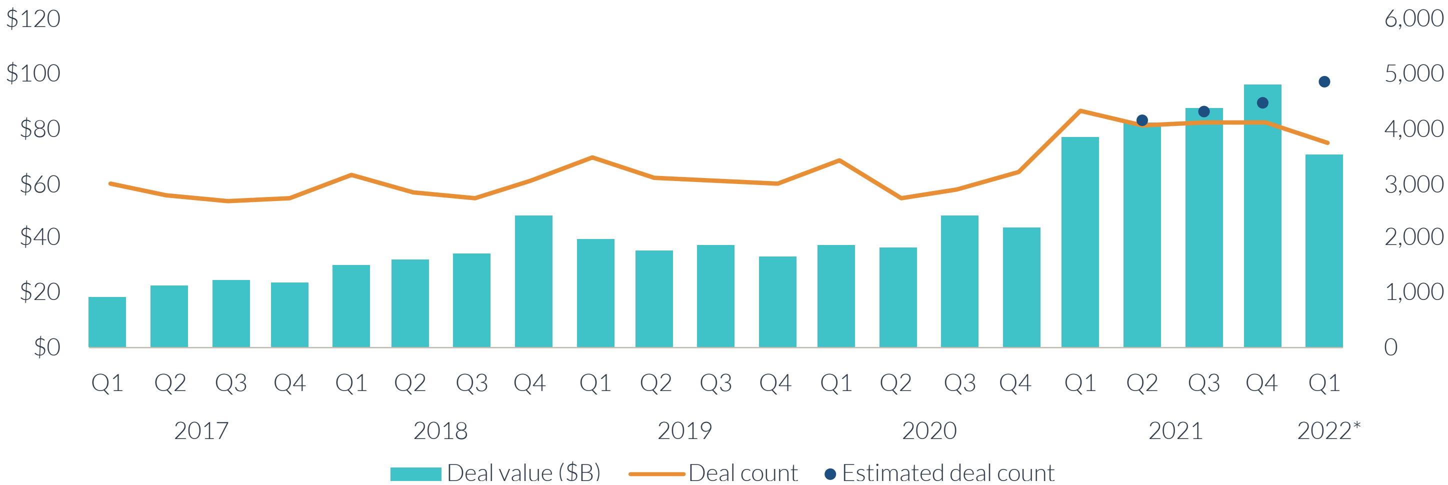
Antitrust scrutiny of large tech companies continues in Washington, and one element has been proposals to restrict or ban acquisitions. Given the importance of acquisitions to the startup ecosystem, NVCA has focused its efforts in this area. In particular, we are concerned about the Platform Competition and Opportunity Act from Senators Amy Klobuchar (D-MN) and Tom Cotton (R-AR), which is an effective ban on acquisitions for certain large tech companies. A similar version of the bill passed the House Judiciary Committee last June. NVCA issued a formal opposition letter expressing our concerns with the legislation and discussing the importance of acquisitions to the startup ecosystem. We have met directly with the bill's authors and organized more than 15 meetings between our antitrust coalition and Senate offices. We have written Op-Eds (here and here) to argue against the bill. Fortunately, the Platform Competition and Opportunity Act was not advanced during a January antitrust committee markup.

- Bobby Franklin, President & CEO of the National Venture Capital Association (NVCA)

Overview

Q1 sees more deals closed than ever

US VC deal activity by quarter



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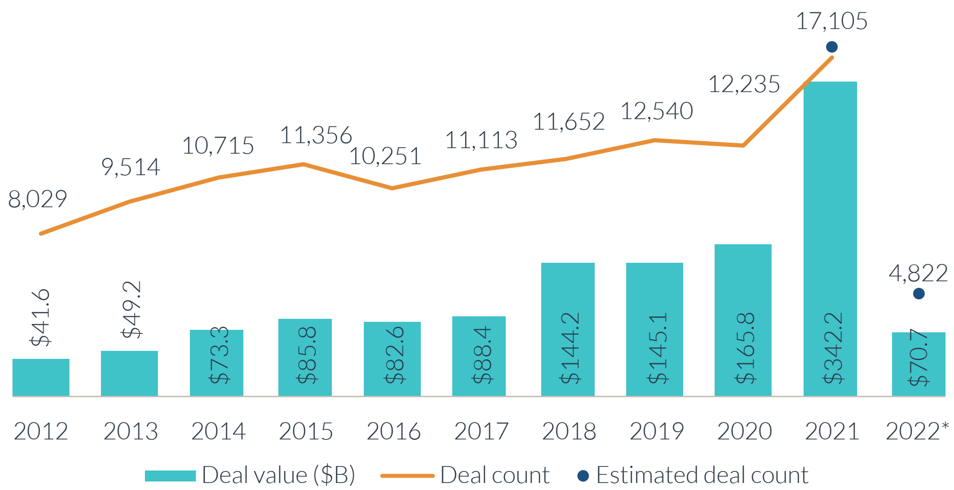
*As of March 31, 2022

Public market performance and economic uncertainty cause a pause in VC exit value. On the back of poor public market performance for growth assets, IPOs of VC-backed startups have neared a complete halt during the first three months of 2022, and SPAC combination deals have fared only marginally better. This is in especially stark contrast to the flurry of public listings in 2021 that nearly matched the frenzy of 2000. The longevity of this quiet period will be critical to the health of the VC liquidity environment given how concentrated VC exit value has been in public listings over the last two years.

The late stage has begun to show the impacts of the turbulent market. Deal sizes and valuations have begun to drop as the companies closest to the public market see public valuations reflected on them as they look to raise capital. Nontraditional investors, heavily involved in the late stage, are also likely to soften their activity. This should significantly affect VC deal value after years of record investment from these players.

Momentum of 2021 carries through Q1

US VC deal activity



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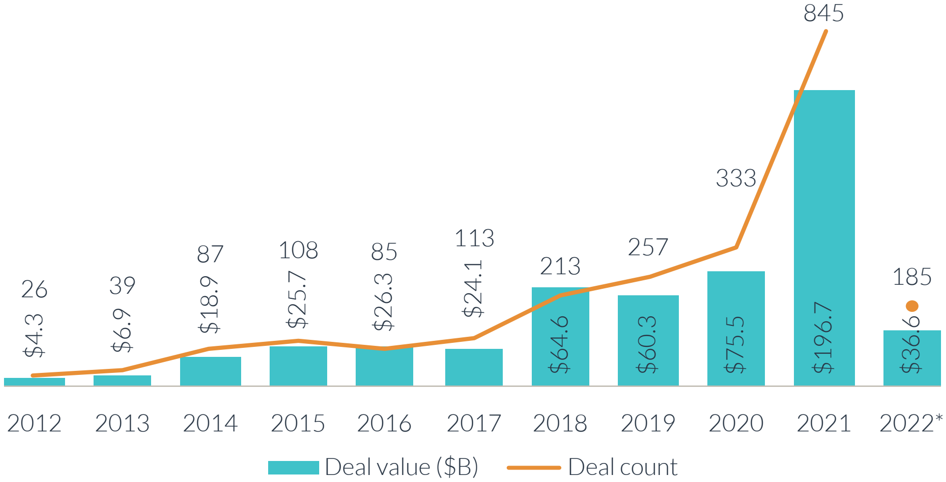
Fundraising has launched into 2022 with the momentum of recent record years of fundraising, already collecting more than $70 billion in commitments. Though a large portion of that total is in just a few funds, the added dry powder should help further insulate the market from immediate, major disruption. A lag in fundraising will likely show last in the data, as funds may be raising capital for a long time before announced as closed.

Mega-deals ($100M+) slow from 2021 high

US VC mega-deal activity



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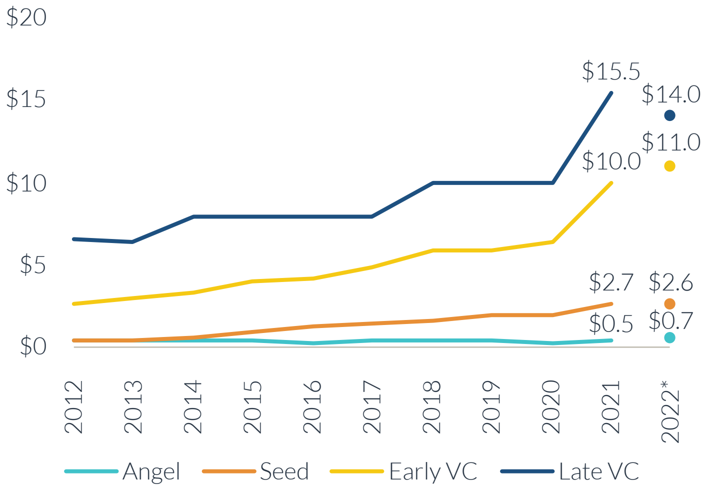
Late-stage VC deal size median slides

Median US VC deal sizes ($M) by stage



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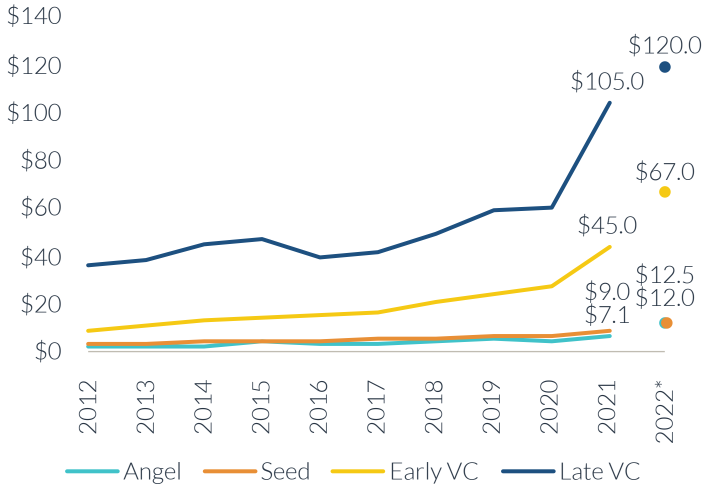
Valuations continue growth

Median US VC pre-money valuations ($M) by stage



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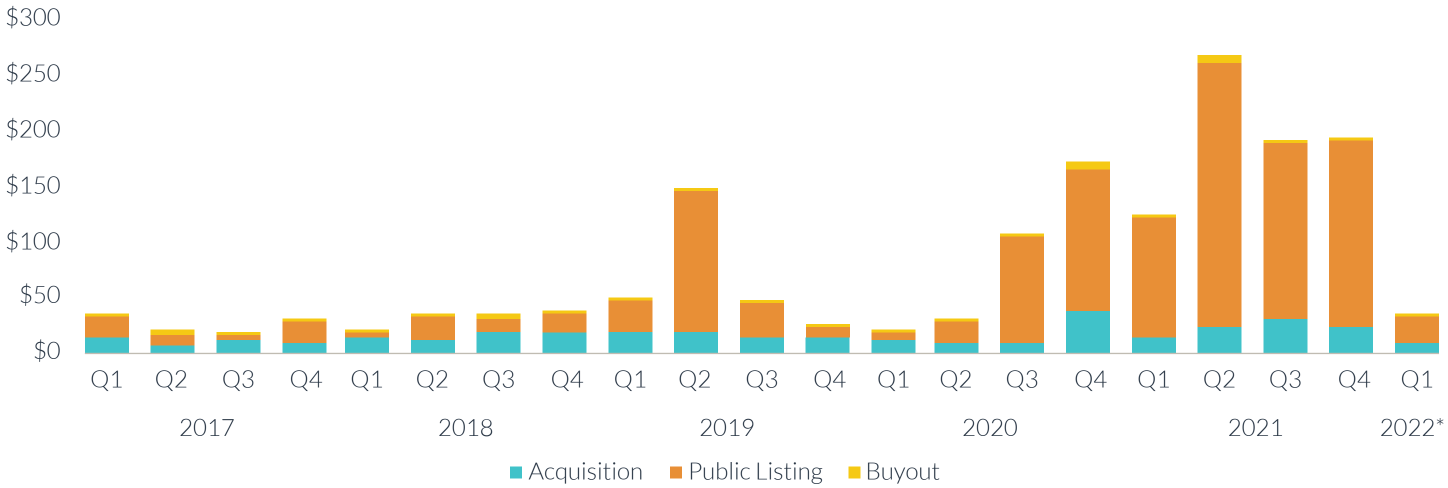
Exit data first to show slowdown

Quarterly US VC exit value ($B) by type



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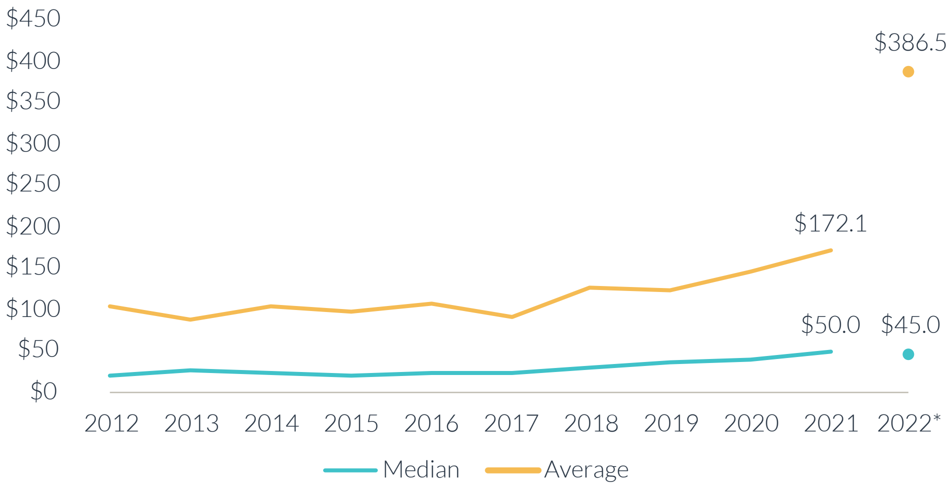
Fundraising holds onto momentum

Median and average US VC fund sizes ($M)



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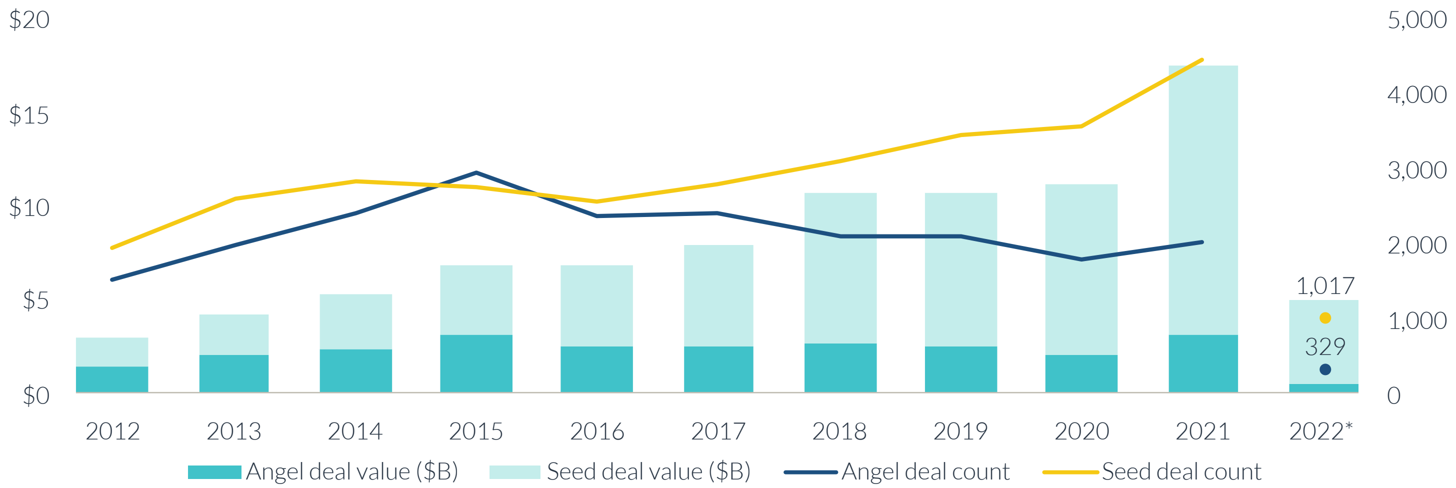
Angel, seed, and first financings

Angel and seed activity remains strong

US angel and seed activity by type



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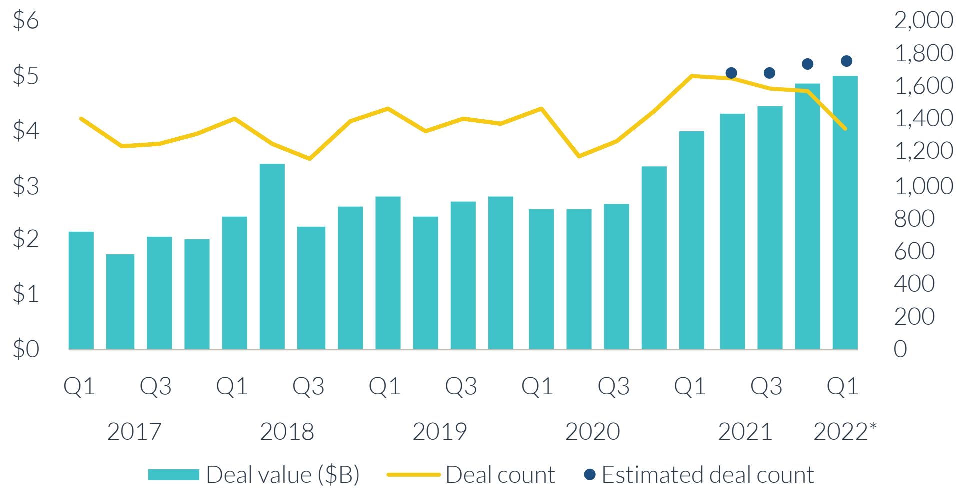
With angel- and seed-stage companies being furthest away from public markets, we would expect the public market volatility of the past few months to leave these deals relatively untouched, at least in the near term. However, other factors at play in the current market will likely influence the activity seen at these stages differently than those later in the venture lifecycle. For one, individual angel investors are wary of fluctuations across their portfolio, which likely includes public stocks. This could make angel investors reluctant to commit to new private investment deals in an effort to rebalance their portfolios.

Despite these challenges, the angel and seed stages turned in a relatively strong quarter. Momentum from the past couple years, as well as the timelines of deal closings, have lessened the immediate impact of economic headwinds on Q1 data. These stages also see the largest post-quarter close increase in deal data of any venture stage, which will continue to add data to the already robust quarter.

On a quarterly basis, little changed in Q1

US angel and seed deal activity by quarter (combined)



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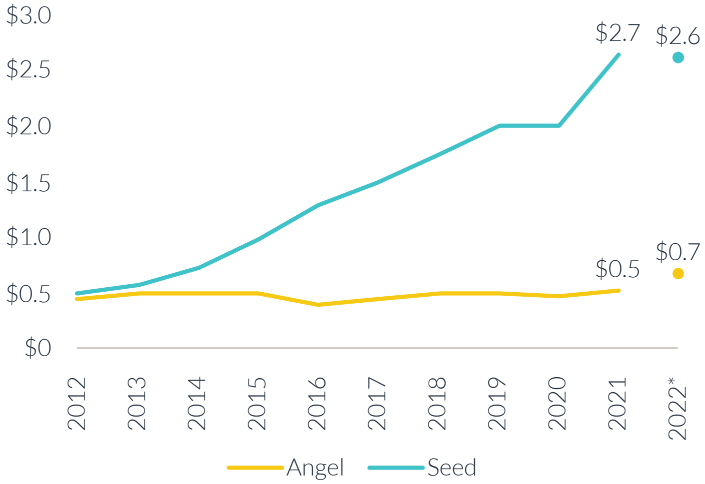
Especially regarding seed deals, the high number of micro-funds (under $50 million) closed in the past couple years will aid in continued strong dealmaking activity even if headwinds extend over the next few quarters.

Median deal sizes plateau

Median US angel and seed deal sizes ($M)



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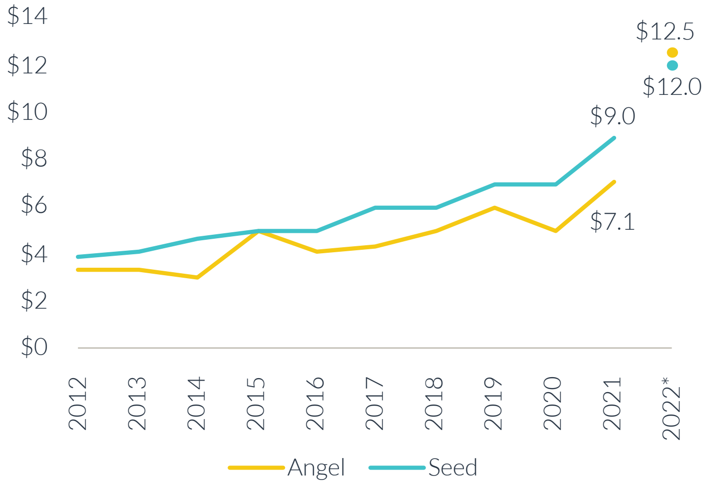
Median valuations jump

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



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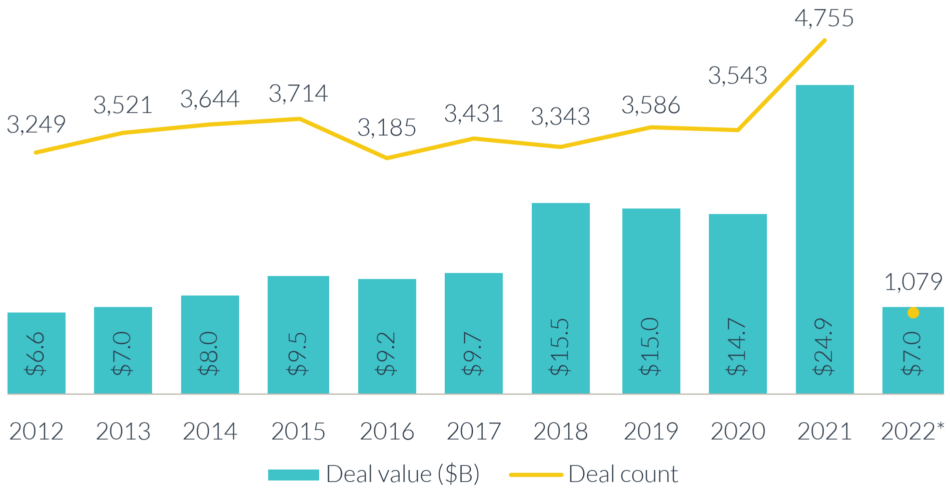
At least for now, the growth in seed deal sizes seems to have stalled. At a median of $2.6 million, seed deal sizes have slid back slightly toward historical norms, though remain high overall. Valuation data, on the other hand, shows differently. The median seed-stage pre-money valuation reached $12.0 million in Q1 2022, with this divergence in sizes and valuations implying that investors are receiving a smaller stake in return for their investment at a time when risk capital should become less expensive.

First-financings continued to close at a historically high rate. With more than 1,000 deals closed, Q1 finished with more companies raising their first institutional capital than any quarter prior to 2021. These deals brought $7.0 billion into these companies, the second-highest total of any quarter in our dataset. Again, we are likely seeing momentum from the past year carrying through into 2022, and first-financing capital could become more difficult to raise should volatility persist. Nearly 4,800 first financings were closed in 2021, almost 33% higher than any previous year. It would not be surprising to see a slowdown of these even during a normal economic climate.

First financings slow

US first-financing deal activity



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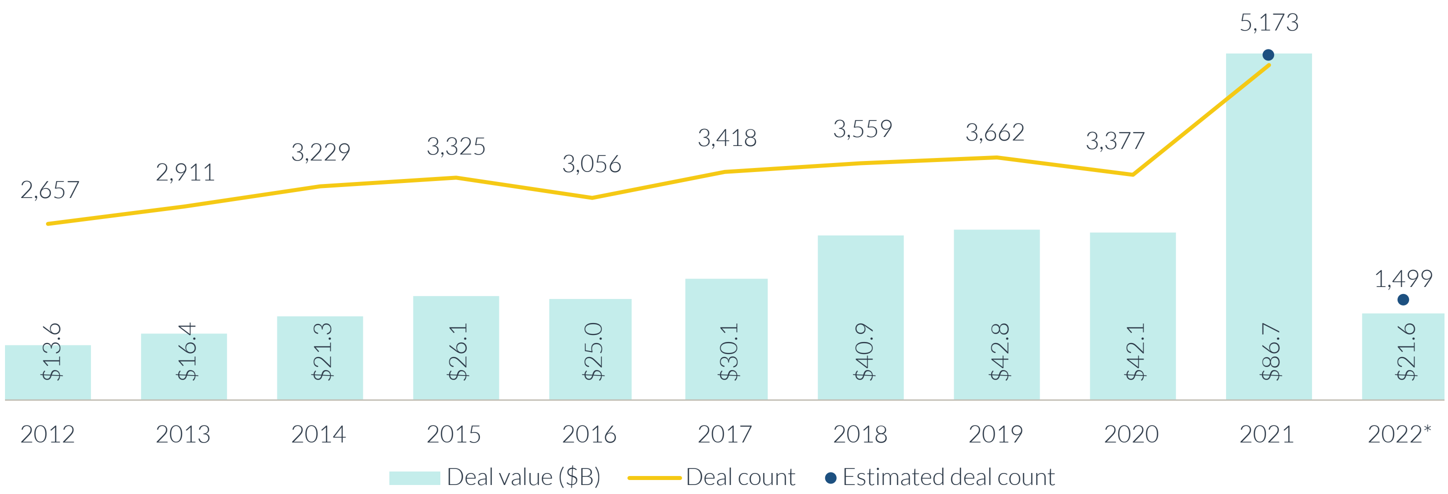
Early-stage VC

Early stage off to strong start

US early-stage VC deal activity



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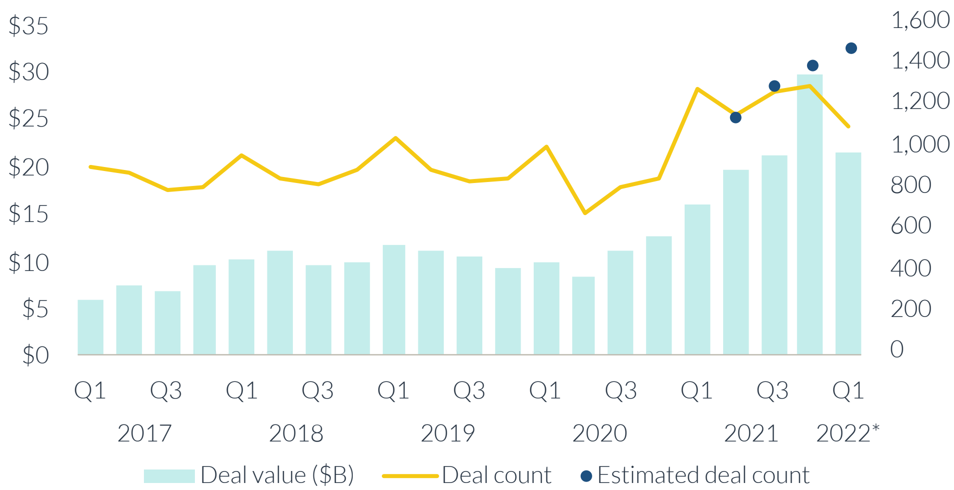
During Q1, early-stage venture investment remained on a similarly elevated pace as it did in 2021. Roughly $20 billion was invested at this stage, putting the quarter just below a record high. Many of the deals completed during the quarter had likely been in progress for some time, softening the impact of market headwinds in the data. However, the early stage is somewhat insulated from public market volatility, as many of the companies are several years away from even entertaining the idea of going public. This makes a slow IPO market relatively less problematic for early-stage companies in the near term. The healthy amount of dry powder available also protects the early stage, as these deal sizes are more manageable to maintain when compared with late-stage deals, which would quickly drain capital resources if VC funds were to fully fund the sizes and numbers seen in recent years.

Record quarterly deal count in the face of headwinds

US early-stage VC deal activity by quarter



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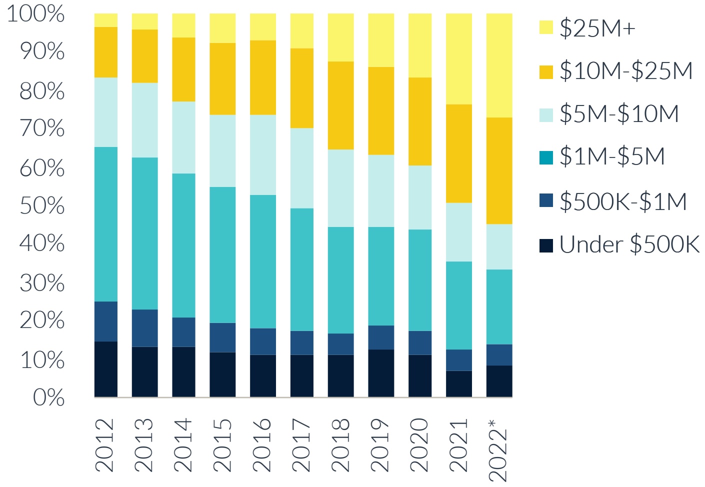
The median early-stage deal size actually increased over 2021's year-end figure, the only stage to see such a movement. At $11.0 million, the approximately 10% growth over 2021's full-year figure has pushed early-stage deal sizes past the median late-stage figure from 2020. One reason for the strength of the early-stage deal sizes and valuations—Q1 saw the median pre-money valuation surge to $67.0 million—is the shift of the investment strategy of larger firms to increase their focus on earlier deals. Though just one anecdote, Tiger Global

Deal sizes show little change yet

Share of US early-stage VC deal count by size bucket



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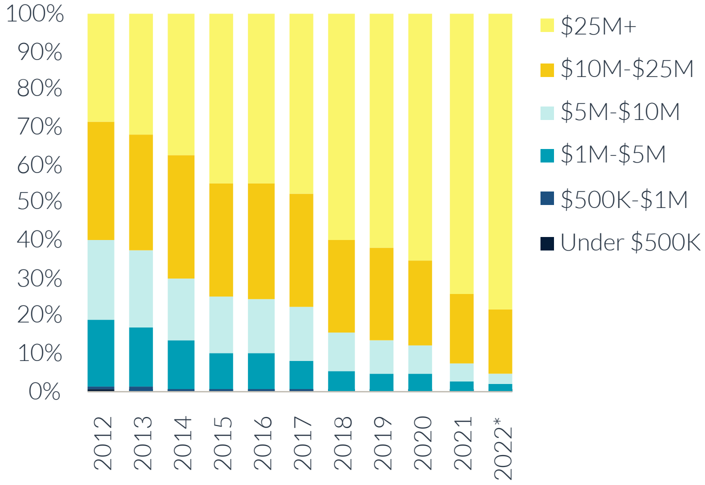
Early stage growing more top-weighted

Share of US early-stage VC deal value by size bucket



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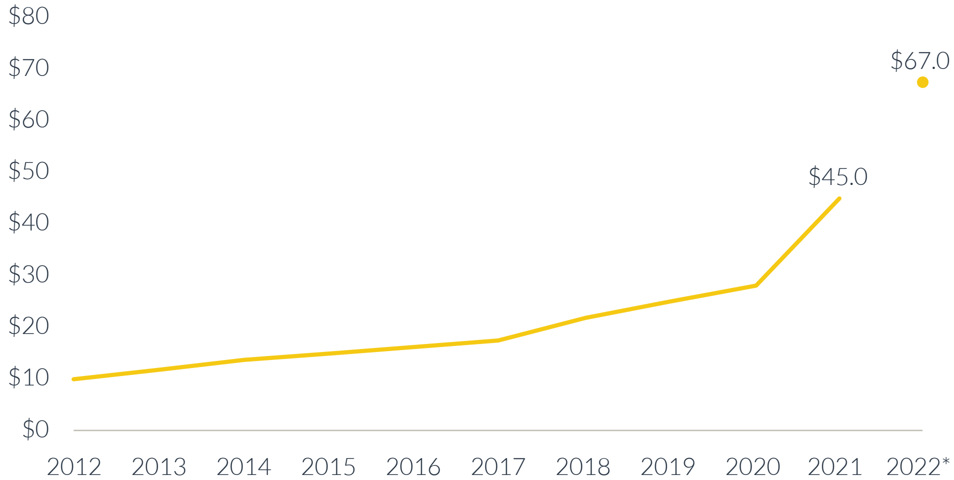
reportedly intends to slow late-stage capital deployment, while its partners have plans to invest into early-stage venture funds as LPs. Such large investors remaining active in VC, albeit at the earlier stages, will increase the competitiveness of top deals and the amount of capital available across the early stage.

Regardless of headwinds, the estimated 5,000 deals completed at the early stage in 2021 would be difficult to match in 2022. Although nearly 1,500 deals were completed through the first three months of 2022, a slowdown through the rest of the year would not be a mark against the industry. Again, the roughly $22 billion invested in the early stage during Q1 sets the year on pace to double the record high for the stage prior to 2021, highlighting the amount of capital still in the market. While it is still early in the current disruption of the venture market, capital availability remains extremely high, with $230.0 billion in dry powder within the US.

Median valuation skyrockets again

Median US early-stage VC pre-money valuation ($M)



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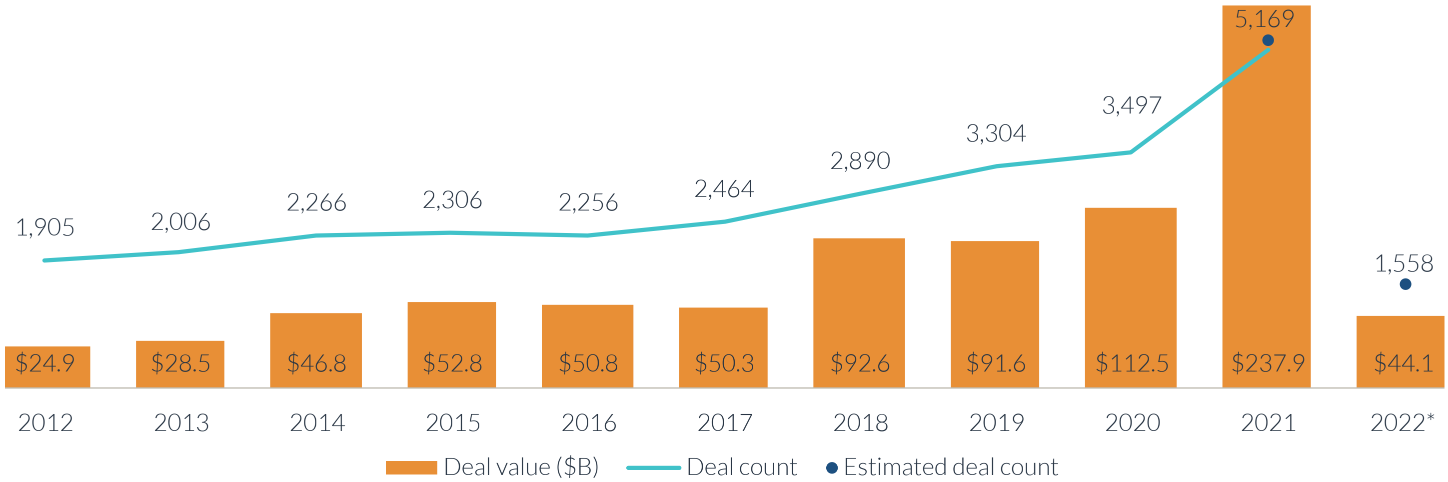
Late-stage VC

Late-stage investment sustains rapid pace during Q1 2022

Late-stage US VC deal activity



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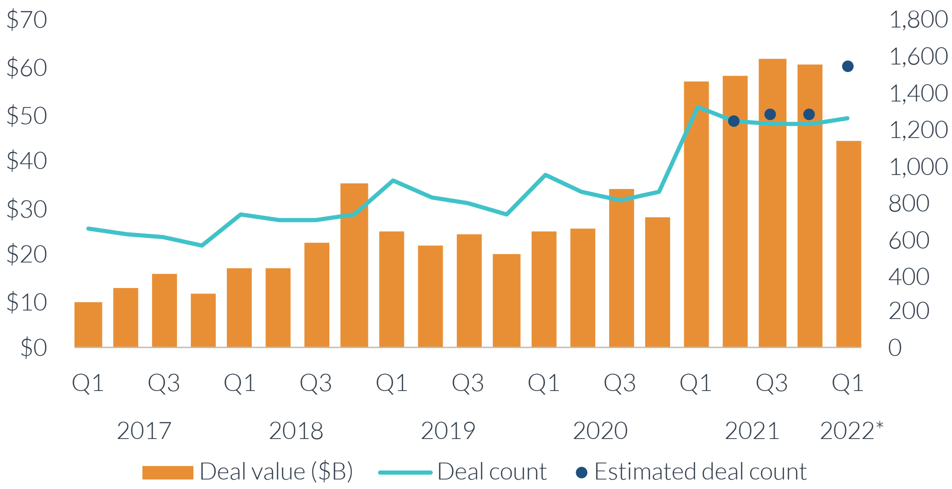
Late-stage investment continued at a rapid pace during the first quarter of 2022, although slightly off the breakneck speed of allocation in 2021. $44.1 billion was invested across a projected 1,558 deals into late-stage startups during the quarter, which surpasses any quarter during last year's pace of total completed deals. This resilience in dealmaking despite growing macroeconomic headwinds and poor public market performance is impressive; however, many of these deals were in negotiation or closed prior to some of the most serious market shifts. As an illiquid investment strategy, VC is slightly insulated from short-term shocks in the financial markets, but many of the current changes seem to be more long-lasting. We expect there may be some mean reversion in the coming quarters for the late-stage venture ecosystem.

Momentum in late-stage dealmaking remains given long lead times

Late-stage US VC deal activity by quarter



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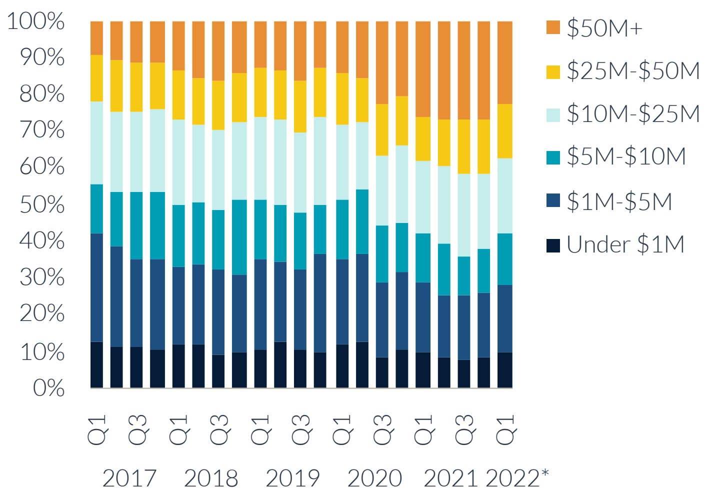
The talk revolving around late-stage VC over the last couple of years has been dominated by a discussion of capital availability—specifically, the marginal supply of capital. This has been made up by both an acceleration in traditional VC fundraising and the increased involvement of nontraditional investors. A significant pullback from either of these groups would mark a serious shift in the ability for many late-stage startups to reliably raise the capital sums that have become commonplace in the current market.

Distribution of late-stage deals remains in line with 2021

Share of late-stage US VC deal count by size bucket



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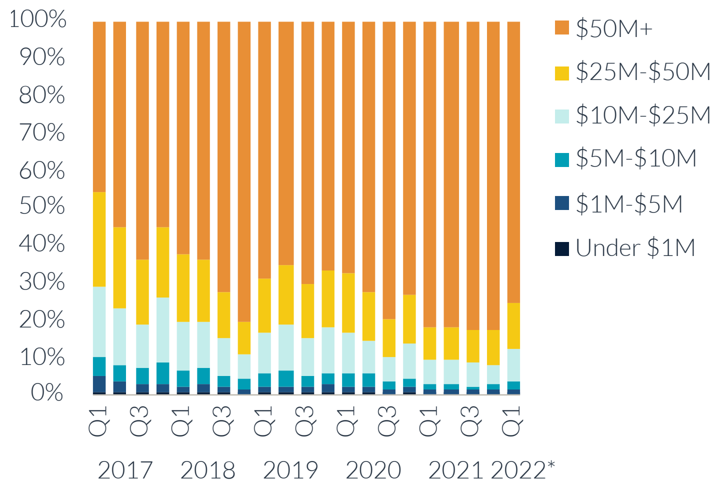
Large deals still attract most late-stage capital

Share of late-stage US VC deal value by size bucket



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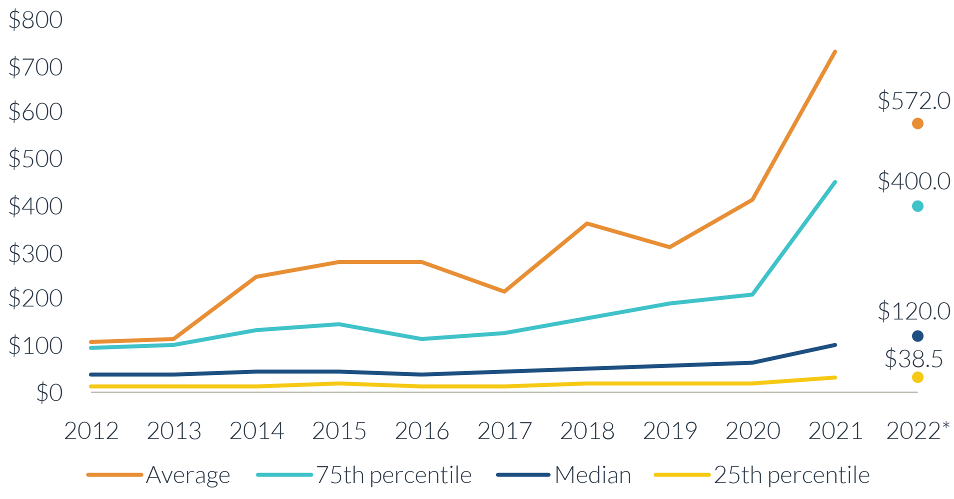
*As of March 31, 2022

Fortunately, the robust VC fundraising of late should serve as a backstop for venture dealmaking in 2022, as the $131.5 billion raised in 2021 was backed up by $73.8 billion more so far in Q1. Persistent support from VC funds is a positive—albeit somewhat assumed—signal, whereas the nontraditional contingent now makes up a substantial portion of capital investment in the stage. While this group of investors are often not locked in illiquid closed-end funds in the way traditional VCs are, we have seen some evidence in the last two years that the VC strategy has become stickier for many of these nontraditional VC investors.

However, one sign that this nontraditional group is slowing down the frenetic pace of capital deployment is the slightest slowdown in mega-deal activity. Only 145 late-stage deals sized $100 million or more closed during Q1, bringing in $27.1 billion in capital. This pullback is relative as the total mega-deal count and value are still more than the entire year of 2017. At its current pace, 2022 should still easily be the second most active year for VC mega-deals. Because late-stage companies are closest to the public markets, there may be a greater effect on these deals than in the earlier stage of venture. There have been some serious moves toward a broad revaluation in growth assets in the private markets, particularly in the software/technology space where VC is particularly concentrated. We have not truly seen much of this valuation reversal flow in our data as both the median deal size and pre-money valuation remained relatively flat from year-end 2021 figures. The lag time between deal negotiation and closing has potentially maintained the status quo for deals that closed during Q1. Should headwinds persist, we expect to see the macroeconomic climate effect venture valuations throughout the next couple of quarters as investors take a more measured approach to new deals.

Valuations plateau in light of changing macroeconomic conditions

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



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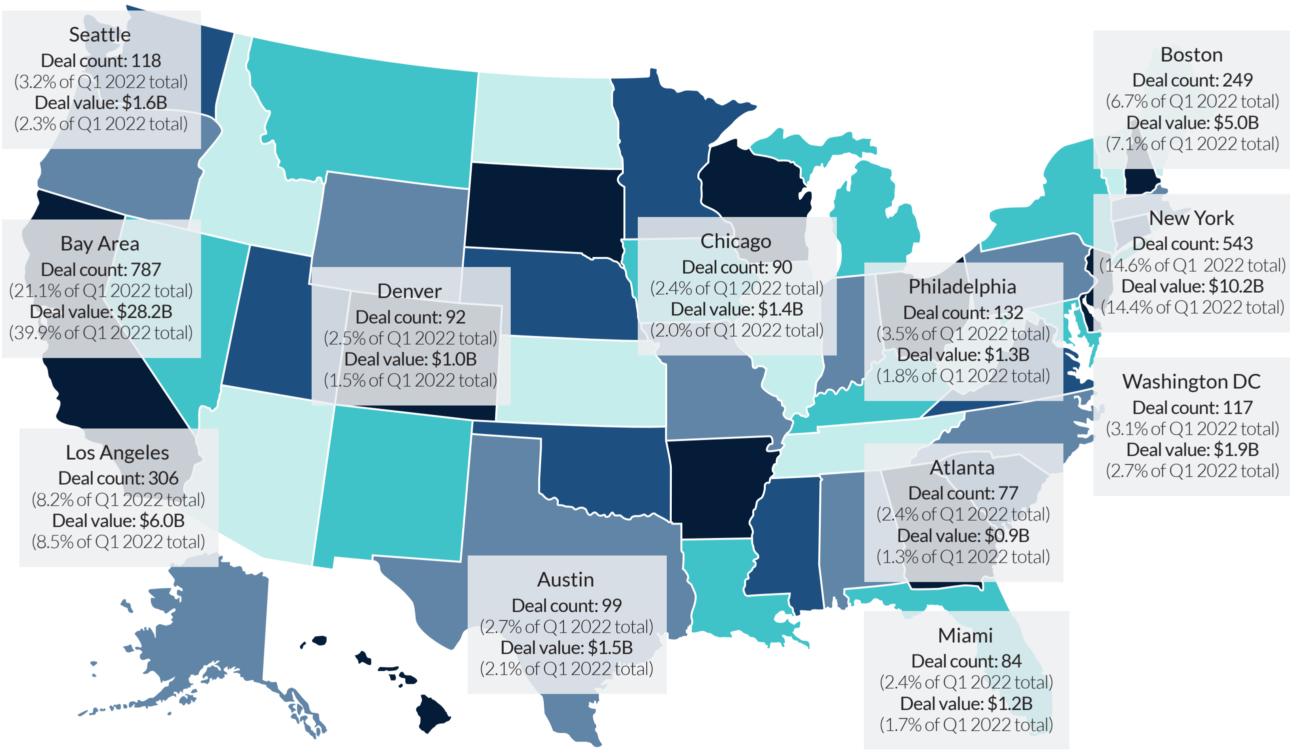
Regional spotlight

*Momentum of 2021 has carried through into most active markets**



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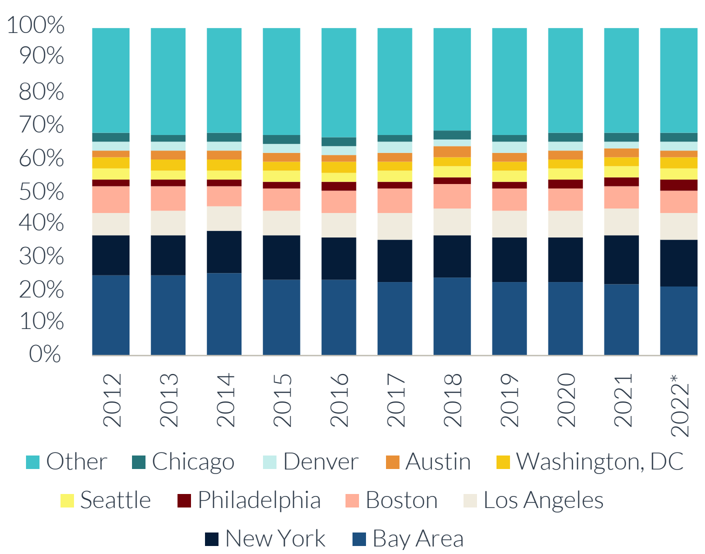
New York seeing growing share of deal count

Share of US VC deal count by CSA



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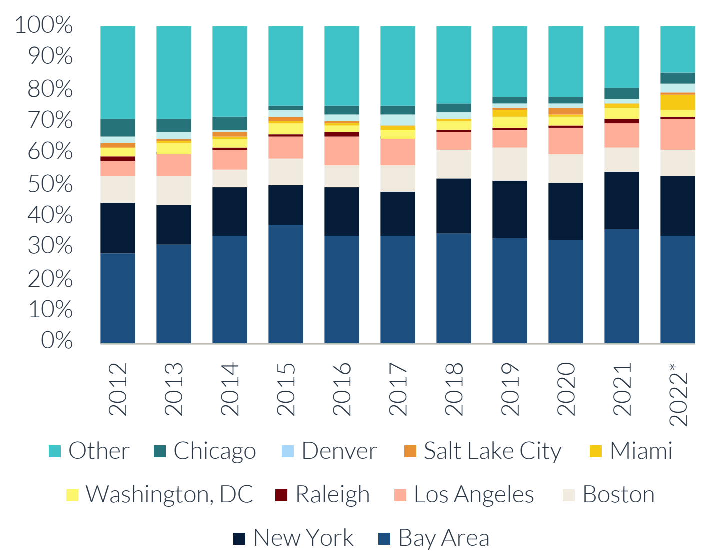
Fund count continues to consolidate into largest deal markets

Share of US VC fund count by CSA



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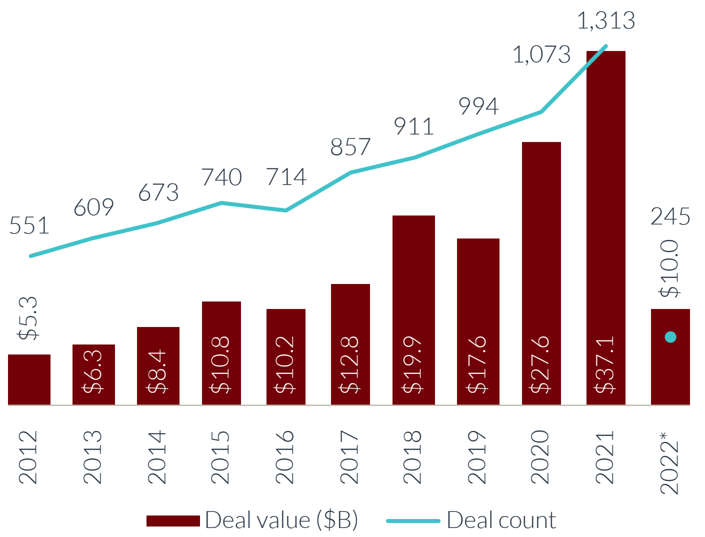
*As of March 31, 2022

Biotech & pharma

Biotech deal value high despite slow count

US VC biotech & pharma activity



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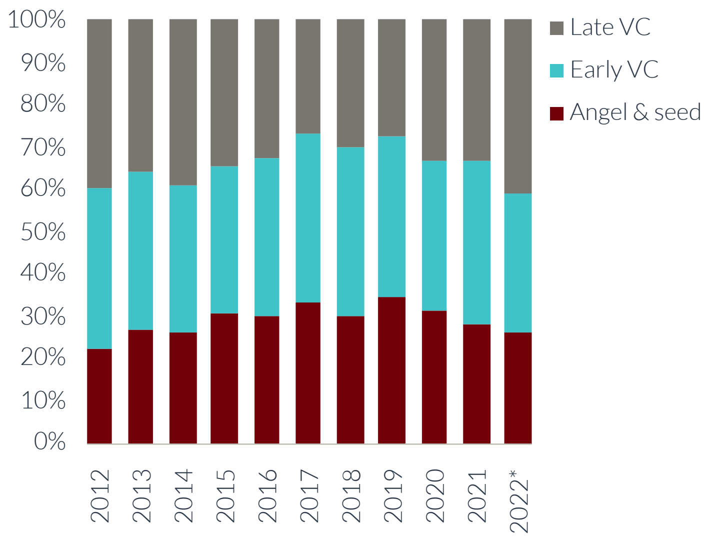
Deal activity shifts toward the late stage

Share of US VC biotech & pharma deal count by stage



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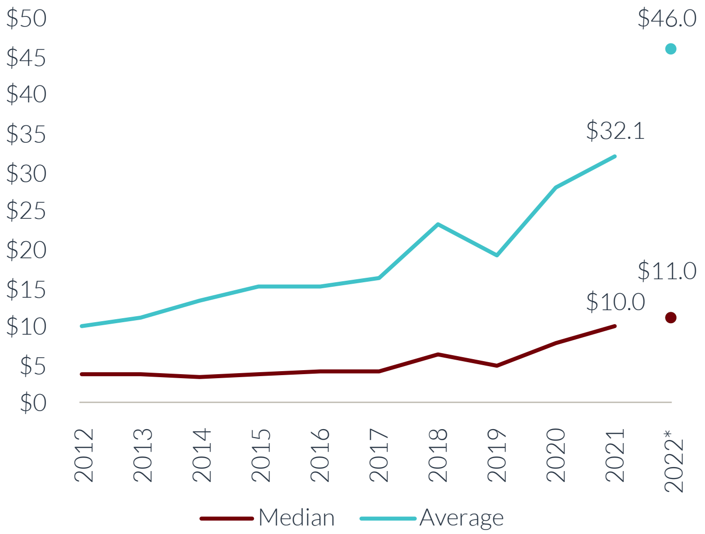
Deals take on large look

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



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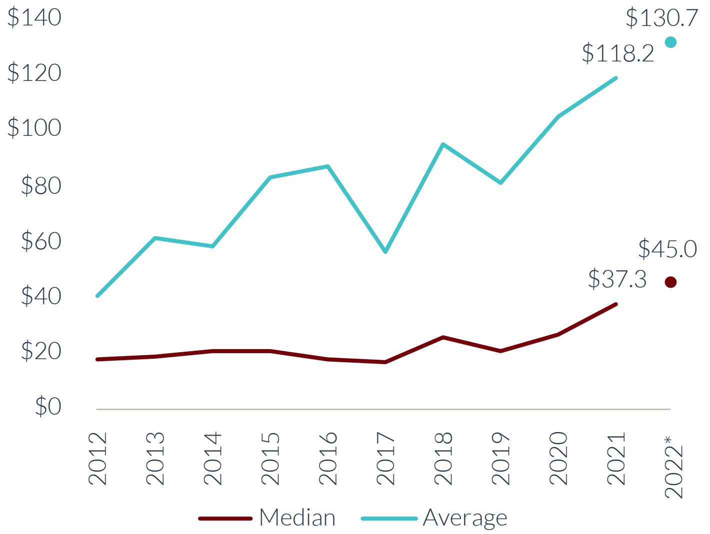
Valuations also grow

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



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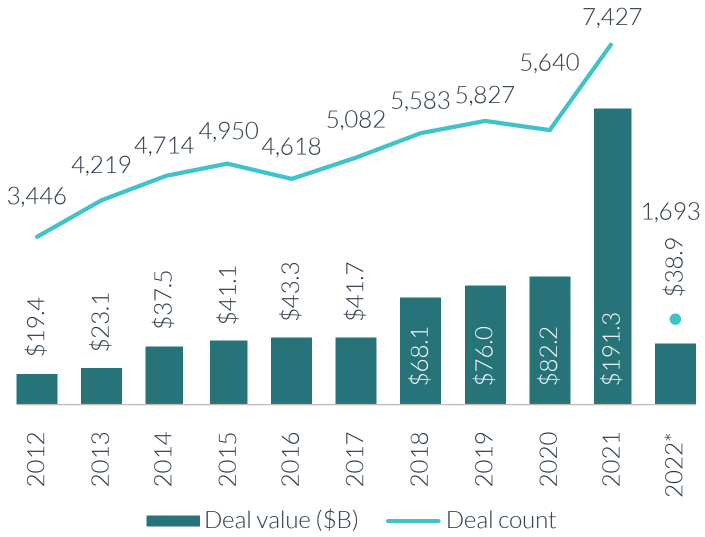
Enterprise tech

Enterprise tech off to much slower start

US VC enterprise tech deal activity



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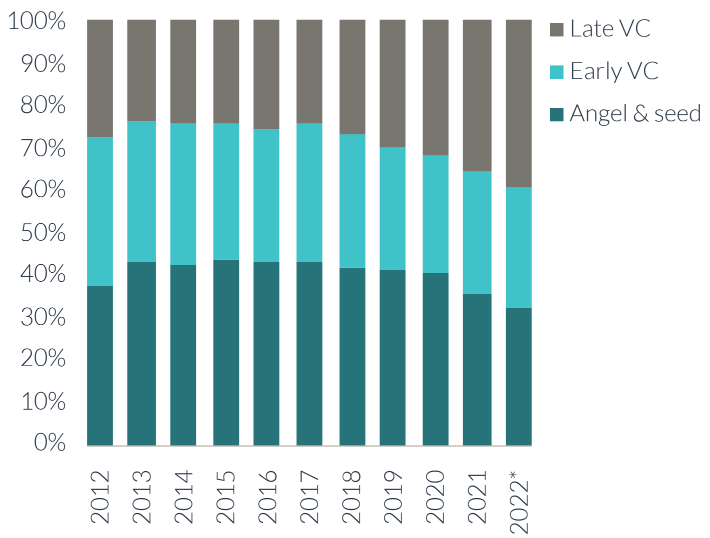
Late-stage deals take higher portion of total

Share of US VC enterprise tech deal count by stage



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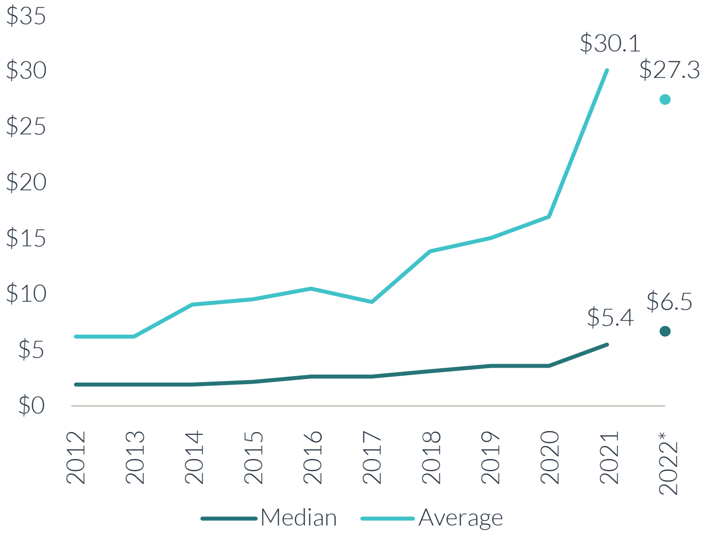
Average deal size falls from 2021 figure

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



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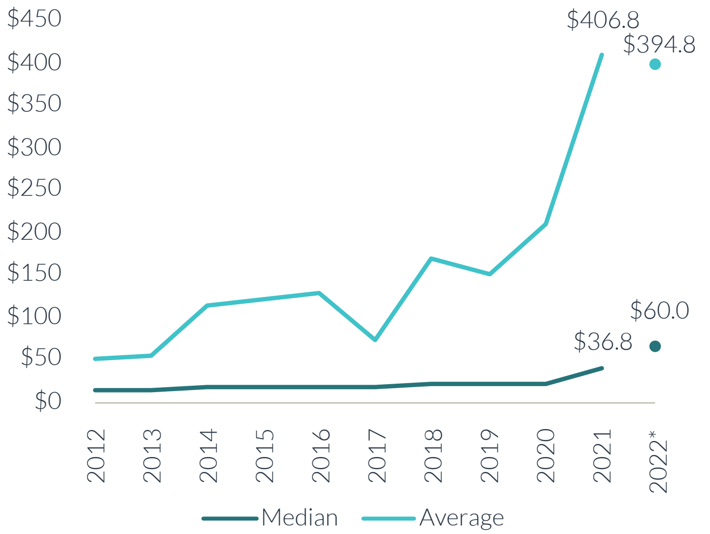
Valuations also slide

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



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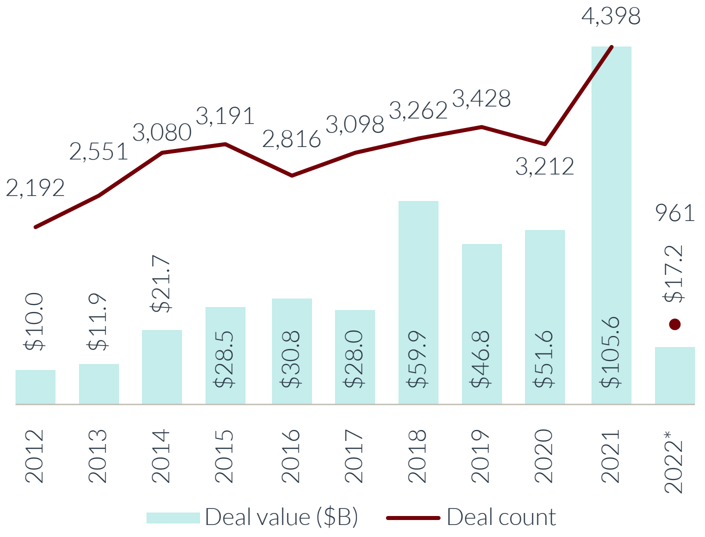
Consumer tech

Consumer tech deal value sees major decline

US VC consumer tech deal activity



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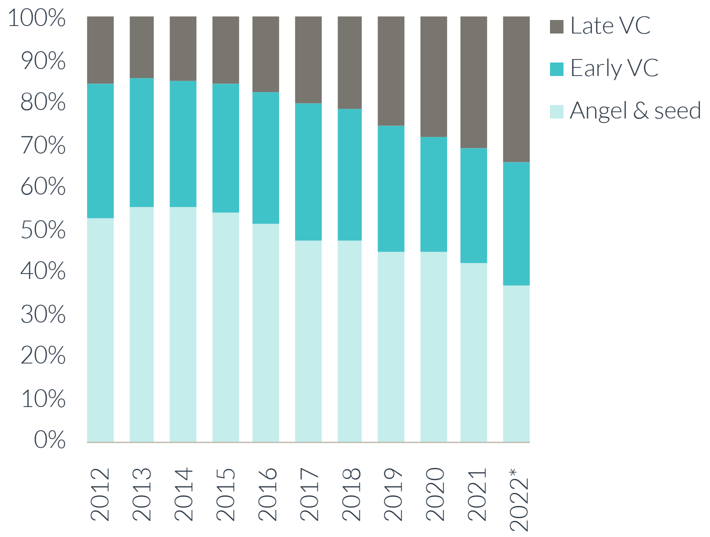
Angel and seed continue to see largest proportion of deal count

Share of US VC consumer tech deal count by stage



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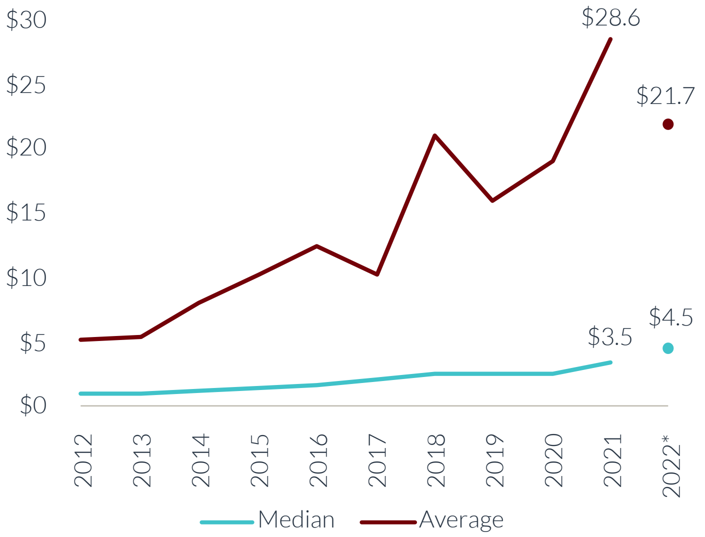
Average deal size falls significantly

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



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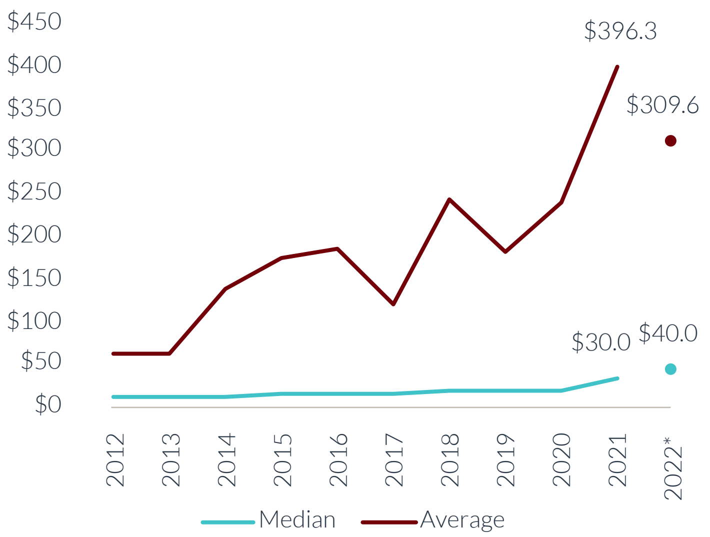
Valuations feeling a squeeze

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



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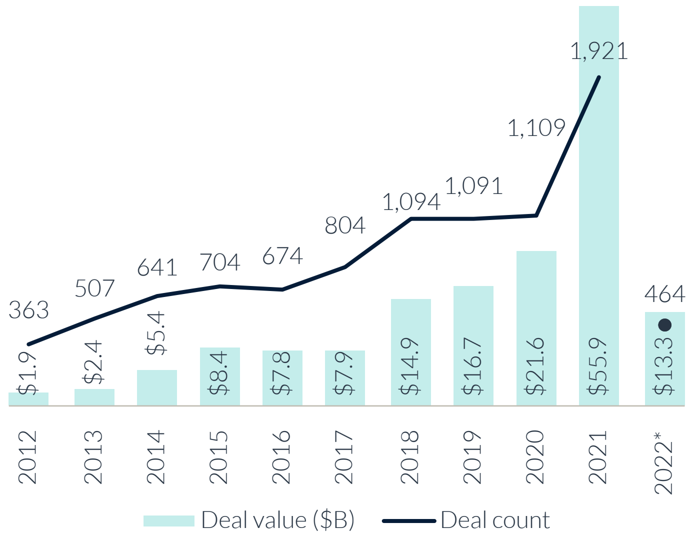
Fintech

Fintech activity shows strength

US VC fintech deal activity



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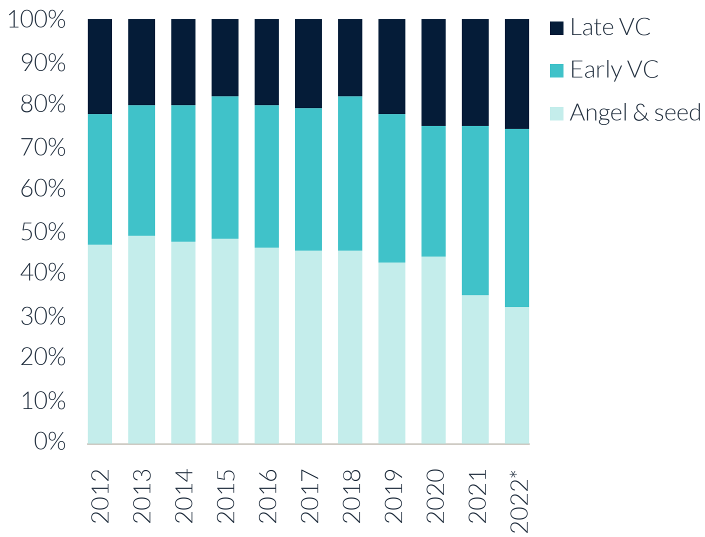
Early-stage expands for fintech

Share of US VC fintech deal count by stage



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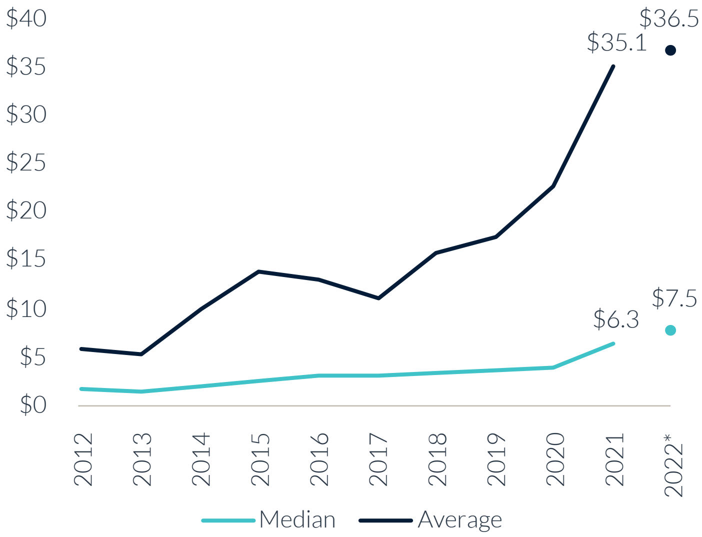
Unlike other areas of tech, deal sizes keep growing in fintech

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



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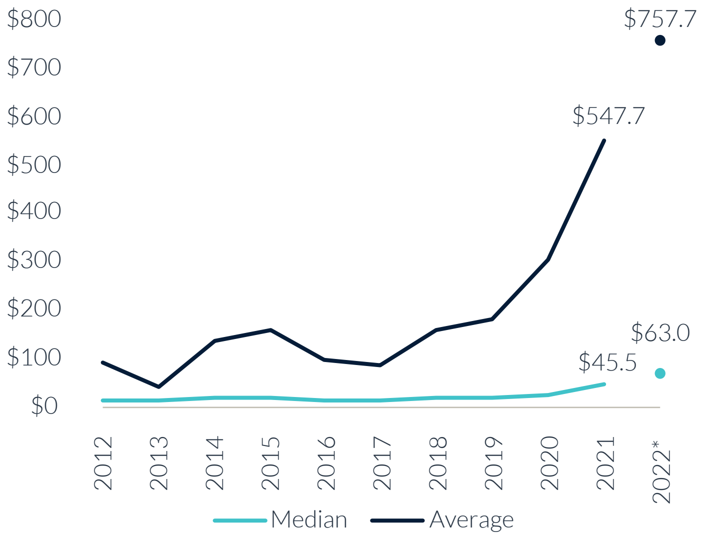
*As of March 31, 2022

Average valuations jump again

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



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A WORD FROM INSPERITY

Human Resources Makes the Difference in Venture Capital

Whether the investment target is a fledgling venture with only its founders or an ongoing concern with many employees, VC dealmakers must understand the human dynamics before making and after executing the deal. Imagine a solid, promising portfolio company deal being disrupted by an overlooked detail. The financial analysis was spotless, the accounting review by the book, the addressable market strong, all centered on a gleaming product review—only to be blindsided by a people issue. Frankly, human capital is a dynamic asset class that may resist definitive analysis. Human capital uncertainty harbors potential investment risk. Increased analytical rigor can change the human capital element from risk to force multiplier.

Pre-deal: An exhaustive HR examination can reduce investment risk, accelerate deal execution, and ensure that new venture objectives are reached and returns are realized.

How does an accurate valuation rest upon a complete understanding of portfolio company HR details?

People are part of the productive capacity of every firm. HR evaluation omissions may impede deal progress and overlook hidden risks. For example, a discontented founder's departure may result in legal entanglements and the loss of essential proprietary information. The loss of skilled craftsmen may cause significant production setbacks. Risks like these can be unearthed by understanding the firm's HR systems and people.

How does understanding the people behind the numbers raise the level of confidence in the evaluation?

Most VC analyses begin with interviews of key leaders. Each walk through their responsibilities and performance and offer promising prospects for the company. The predictions and past performance of anxious managers, however, may not be an accurate indicator of actual potential. Regardless of size, understanding company results and forecasts requires an understanding of the people behind them.

Management team capabilities and alignment – Concerning management, it is worth diving into a series of deeper questions. What are the leadership team's individual and collective strengths and weaknesses? Are they sufficiently skilled to lead and achieve strategic plans of a larger organization? Do they develop their employees and leverage their contributions? Are they aligned with each other around the achievement of shared strategic goals?

Productive employee skills and commitment – In a larger company analysis, one must understand the productive worker layers below the management team and how they will fit into a new capital-infused model. National unemployment is about 4%, and millions of post-pandemic tenured employees are quitting their jobs to find better opportunities. Others have forced employers to renegotiate better compensation packages. A look at the 1.7 million viewer "Unemployment for All" postings on Reddit reveals a sobering societal undercurrent that may impact the future of employment.[1]

Working-level employees should be interviewed to ascertain their commitment drivers and career expectations. These tailored conversations should develop a view of company culture, compensation, career aspirations, management quality, working parameters, and longevity prospects. Understanding both on-site and remote workers is essential. The flash cut to remote work during COVID-19 changed many employees' attitudes about location, commitment, and their relationship with their companies.

Jalyn Noel
Managing Director, Innovation and Development

Jalyn Noel is the Managing Director of Innovation and Development team in the Marketing and Business Development division of Insperity. Jalyn's career with Insperity has spanned 30 years and her expertise ranges from overseeing various marketing and business areas including but not limited to, thought leadership, authority marketing, vetting Insperity business partners, as well as ensuring the company's due diligence process.

What does a review of HR structure uncover about the strength of the company?

If the portfolio company is a fledgling venture with little operating experience and few employees, a management review may be deep enough. But for standing ventures with employees there are a few more rocks to turn over for a full understanding of HR.

HR documentation – Management with a strategic view of HR will have an HR plan that focuses on people with practices

1: "Antiwork – Unemployment for All, Not Just the Rich!" Reddit, r/antiwork, Accessed March 2022.

and policies, including a readily available employee handbook. Ongoing company commitments are revealed in employment agreements, union contracts, separation/retention agreements, and other contracts. Employee files provide insight into disciplinary actions, performance issues, employee disputes, lawsuits, and complaints. If available, employee tenure and turnover statistics and exit interview information may expose systemic problems. Organization charts can reveal root operating inefficiencies.

HR procedures – Does the company have sufficiently documented practices that address routine administration, schedules, attendance, time off, discipline, employee safety, workplace violence, harassment, and emergencies? Undocumented policies and practices often lead to hidden HR and legal exposure.

Compensation and benefits – In the 2020's, the power in the employment relationship has shifted to employees, causing employers to rethink and restructure their compensation philosophies. Minimum wage and limited benefits are no longer enough to attract and keep workers. Employers are pivoting to adopt bonuses, profit sharing, or other performance incentives to remain competitive while increasing productivity. "Employee-valued" benefits offered at affordable prices will rapidly replace the minimal offerings of the past. This analysis component may point to extensive portfolio company restructuring.

Performance management system – High-performing companies with satisfied employees have an effective performance management system. These begin with clear job descriptions which reflect the actual work performed. Personal objectives linked to the company's strategic objectives are assigned and supported by regular and honest performance reviews which offer candid feedback of praise and correction. Employee plans must point to meaningful rewards for accomplishment and real consequences for slack performance. Above all, managers must be skilled in objectives management, motivation, and performance feedback.

Employee development system – In a tightening labor market, future skilled and leadership workers will need to be organically grown. Employees measure how much their employer values them by the developmental commitment made to them. Does the portfolio company have a development plan for each employee that includes basic technical skills and, if applicable, leadership training? Clear succession and career path plans are good indicators that productive employees will stick around.

Post-deal: The long-awaited influx of capital can open new strategic possibilities, but if not carefully pursued, may result in operational complications, employee disengagement, or even key employee defections.

How do growth and scale transitions impact company culture and employees?

Culture disruption – Culture is often cited as a main reason why employees remain with or leave a company. When businesses begin to grow, their initial culture is stretched and sometimes broken. The introduction of new employees (especially large numbers over a short time) can dilute and often change the culture. Management should establish foundational company values that endure through growth and change.

Employee skills and opportunity – Company growth opportunities should also mean employee growth opportunities. Growth often results in skills gaps in the firm. Before hiring externally, leaders should consider current employee's latent skills and career aspirations. Employees are heavily invested in the skills they bring to the enterprise. Giving them serious consideration for internal opportunities that leverage or build their skills will create employee loyalty. A recent article published by Deloitte reveals that retaining the current generation of workers requires personalizing job responsibilities.[2] Values-driven companies respect the contributions of each employee and help them succeed.

Employee communication – The goal of an effective employee communication strategy is to cultivate a pattern of information sharing that builds trust, confidence, and mutual respect among employees. This is never more important than when standing up a new venture or scaling an existing one. During these times, employees need more—not less—communication, reassurance, and attention. A clearly outlined change-management strategy must be a foundational part of the transition plan. Transparency and frequent status updates will strengthen employee participation in strategic moves.

Should employees have a voice in decisions as the company scales?

Enlisting employees – In addition to informing employees of changes, successful leaders listen. Never underappreciate what experienced employees can contribute to the future. When involved in growth execution, they are more apt to own the changes and contribute to their success. Stretch assignments to support growth initiatives are ennobling, build loyalty, and will reveal hidden competencies. The more employees feel they are part of the new organization, the more they will become a force multiplier in times of change.

2: "Understanding Generation Z in the Workplace" Deloitte, Tiffany Mawhinney and Kimberly Betts, 2022.

Q&A WITH J.P. MORGAN

What's in store for venture capital?

"JPMorgan is uniquely positioned to serve the entire venture ecosystem—from VCs and investors to founders and companies—beginning at the earliest stages through IPO and beyond. We have a long history of supporting clients through periods of market volatility and are firmly committed to being the best banking partner to the innovation economy."
–Jamie Dimon, Chairman and CEO, JPMorgan Chase & Co

At a high level, what is your take on the current venture ecosystem in the US?

Significant capital has poured into the VC asset class over the last several years, driving deal volumes and valuations to what is likely a cycle high. It's been a rising-tide-lifts-all-boats environment for the past decade.

We now find ourselves in the midst of more turbulent times, with increased volatility in public markets and heightened geopolitical tensions. We haven't yet had a correction in VC valuations, though history tells us this is likely to occur. However, we note two differences between today's environment and the last tech-led downturn between 2000 and 2001: Generally sounder business models with greater traction, and significantly more dry powder to support portfolio companies—roughly $230 billion of traditional VC on the sidelines in the US. Both should cushion any pullback.

We believe a deceleration in activity and moderation in early-stage valuations could benefit the long-term health of the venture ecosystem by resetting expectations and slowing the pace of deals from unprecedented levels.

What are the key concerns JPMorgan's venture-backed clients are bringing to you?

We're hearing three concerns almost universally across the startup community: valuations, liquidity runway, and the war for talent.

On valuations, the broad sell-off in equities—for tech stocks in particular—has founders and managers concerned about when this might spill over into VC. Early-stage companies have been insulated so far, but it's something we're watching. Historically, there has been a one- to two-quarter lag between a public markets correction and the private markets.

While this may hurt more for late-stage companies, we don't view lower valuations for early-stage companies as a bad thing. It's natural for overheated markets to correct and valuations to reset. Less-stretched valuations in the startup and early rounds can be beneficial for founders and managers as it tempers expectations and makes meeting milestones more attainable and follow-on rounds easier to close. An excessive valuation in the early rounds can set the bar too high.

We believe the sharp rise in valuations over the past two years was mainly driven by the influx of nontraditional investors into VC, ratcheting up competition for deals. Nontraditional VC investor participation rose to 78% of all deal value in 2021, up from 70% five years ago and 56% 10 years prior.

On liquidity, volatility in the public markets is a reminder of the importance of maximizing runway between funding rounds. With more uncertainty in the economic outlook due to high inflation, tight labor markets, and geopolitical tensions, it's critical to have ample liquidity to weather uncertain times. In the technology sector, the bridge typically constitutes enough cash to grow the business for 18 to 24 months. During volatile periods, we believe it is prudent for companies to reduce cash burn to preserve and extend runway.

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

The war for talent is increasingly competitive in the startup world, with historically tight labor markets. From entry-level software engineers to seasoned C-suite executives, venture-backed companies are seeking to attract and retain the best talent. Wages are going up and companies are getting more creative with employee benefits.

Which of JPMorgan's offerings in the venture landscape are seeing interesting trends?

The breadth of our platform allows us to serve the innovation economy across all stages. Below, we share insights around what we are seeing in late-stage private raises, the IPO market, M&A landscape, and private secondaries.

We're receiving more inquiry around late-stage private raises, with IPOs momentarily off the table. Keith Canton, head of Global Private Capital Markets for J. P. Morgan, says this market has remained open, and more than $44 billion has been raised for VC-backed companies YTD. But there are challenges. Valuations are resetting lower, in line with the public markets. Investors are requiring more structure and downside protection in deals, such as payment-in-kind dividends and liquidation preferences. Regardless, a broad base of investors is focusing on private market opportunities, with record amounts of dry powder to put to work.

My colleague Mike Millman, co-head of global equity capital markets for J.P. Morgan, notes that although the IPO market for growth companies has gone untested recently, a very large pipeline of tech companies is looking to go public in 2022. Companies range from earlier-stage, high-growth businesses to more mature and profitable ones. Investors are starting to re-engage in the growth sectors in the public market, including a secondary transaction successfully priced in recent weeks. This typically translates to IPO interest. Millman notes that the IPO market has historically been resilient, reopening as quickly as one to four months following periods of high volatility.

Our global M&A advisory co-head Anu Aiyengar indicates that many of the underlying drivers of a robust M&A market remain strong. However, equity market volatility, inflation, and regulatory and geopolitical uncertainty tempered activity in the first quarter. YTD, North America M&A volumes are tracking about 33% below this time last year. While the number of $10 billion+ deals has been almost identical year over year, the decline is driven by fewer deals in the $1 billion to $10 billion range, which are down ~40%.

Companies looking to exit via IPO are increasingly exploring dual track/M&A options. Firms across all industries are using M&A to transform and innovate more quickly. Pre-pandemic, companies may have taken the time to internally develop solutions, but there has been a sense of urgency to adapt and compete in a new environment. Technology continues to be the most targeted sector for M&A, representing 37% of announced volume in North America.

Corporate balance sheets are incredibly healthy, sitting on $2 trillion of cash in the S&P 500 alone. Financial sponsors hold another $2 trillion of dry powder and will continue monetization and deployment. With this level of liquidity and dry powder, M&A is expected to pick up once the market backdrop stabilizes and boardroom/CEO confidence is enhanced.

My colleague Andy Tuthill, head of private secondaries for J.P. Morgan, notes that relative to last year, we're seeing more VCs focused on bolstering DPIs, or distributions on paid-in capital, and returning cash to LPs. In recent years, we've seen an uptick in private companies organizing some form of secondary offering attached to primary financing rounds. In the absence of a robust late-stage primary fundraising environment, we are noticing more early-stage VCs pursue ad hoc secondary liquidity solutions.

Which risks or challenges do you consider underrated by venture-backed clients in the current market?

The rapid pace of dealmaking over the past 18 months has created an environment where the due diligence process has significantly shortened. Heated competition for deals sometimes leaves only a weekend for VC partners to get to know founders and their businesses before having to commit capital. While this has driven early-stage valuations to sky-high levels, we caution that it could ultimately prove a disservice to founders and late-stage investors.

A knock-on effect of compressed due diligence is a diminishment in corporate governance. Startup boardrooms are typically filled with representatives from the company's largest VC investors. Because of the recent fast pace of deals, partners are getting stretched thin in many cases. GPs we surveyed are sitting on upward of 15 to 20 boards, versus seven or eight in normal times. With IPO markets currently closed off, there are fewer avenues to exit companies while still adding new ones to a portfolio. Most founders and many investors in today's venture ecosystem don't have the learnings (and scar tissue) of the last tech-led downturn; this is our biggest concern in the private markets today.

Which macro trends outside of venture are you watching?

Monetary policy is shifting away from accommodation, and interest rates are rising. This should help tame inflation, but also has implications for lower valuations and higher borrowing costs. Should interest rates rise materially from current levels, it's possible allocations could rebalance away from VC to less-risky asset classes.

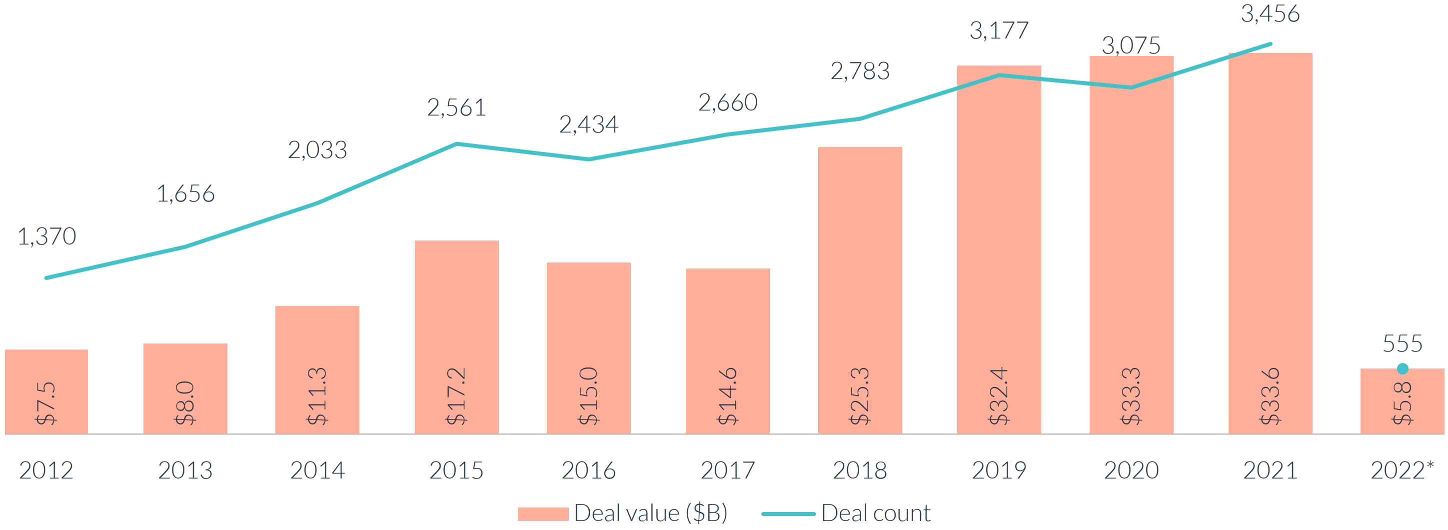
The rise in geopolitical tensions is important to understand as it relates to talent, customer, and supplier risks. Many startups have approached talent sourcing globally, employing top engineers located around the world. With the Russia-Ukraine crisis unfolding, the challenges of managing and sourcing talent from that region are rising and highlight some of the risks in that strategy broadly.

PitchBook nvca Insperity J.P.Morgan

Venture debt

Venture lending slow as industry feels out shifts

US venture debt activity



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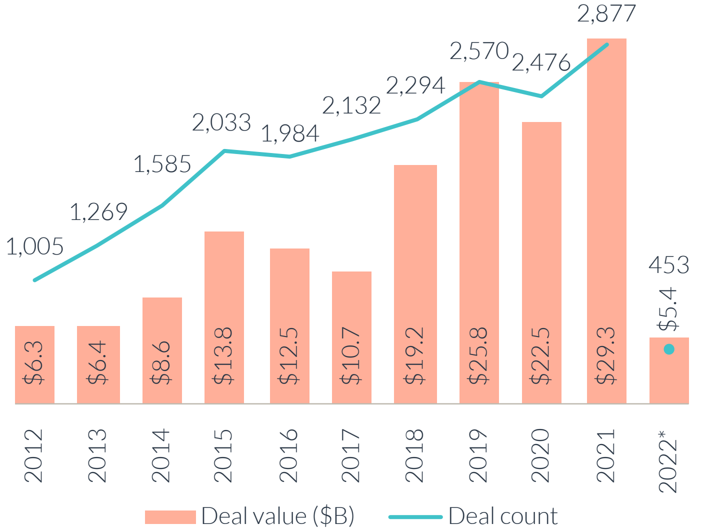
Tech lending declines by count and value

US venture debt activity in tech



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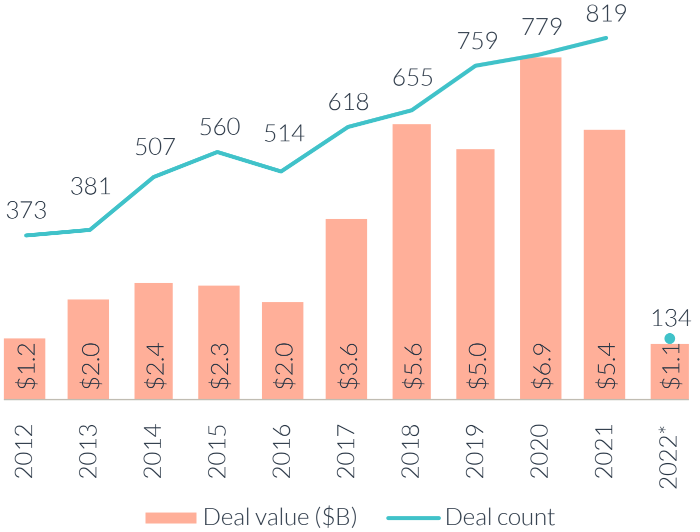
Lending sluggish to healthcare companies

US venture debt activity in healthcare



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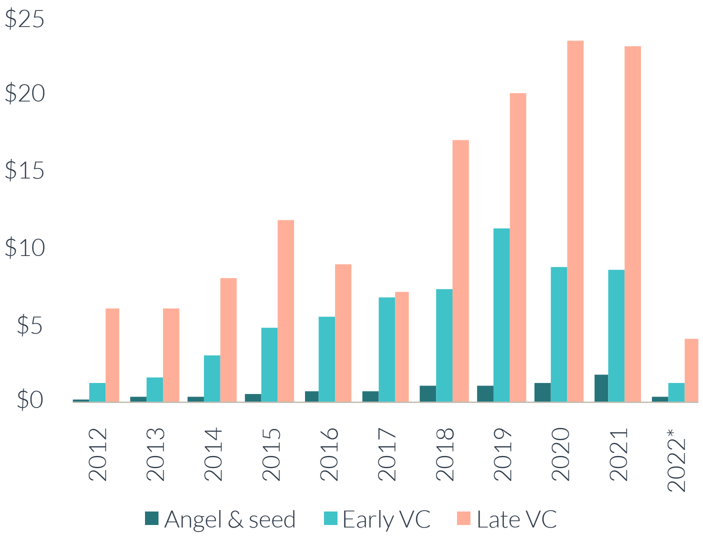
Lending value lethargic across all stages

US venture debt deal value ($B) by stage



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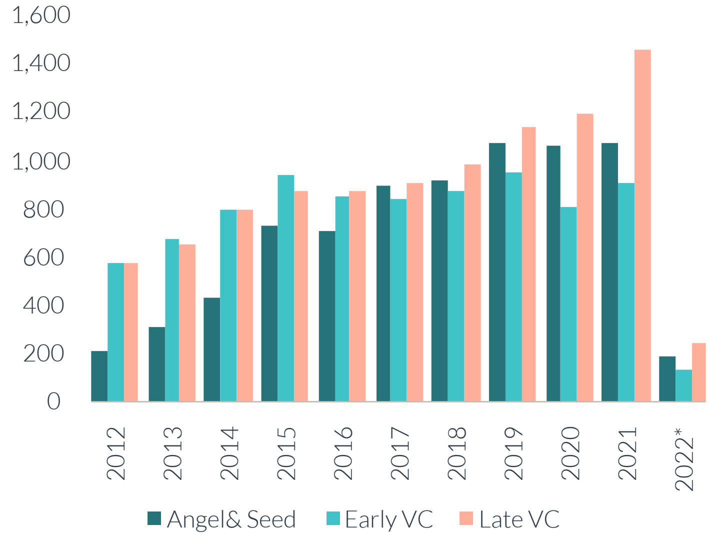
As the late stage slows, so does late-stage lending

US venture debt deal count by stage



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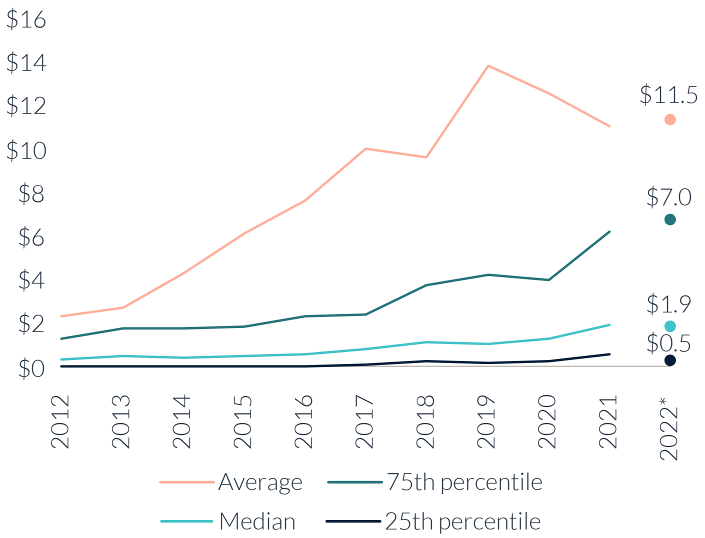
Early-stage loan sizes decline at median

Quartile distribution of US VC early-stage venture debt deal sizes ($M)



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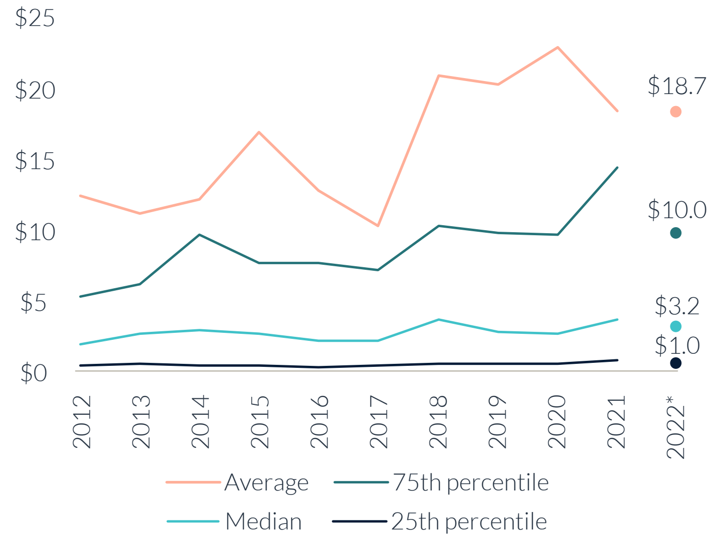
Late-stage loan sizes drop at all quartiles

Quartile distribution of late-stage venture debt US VC deal sizes ($M)



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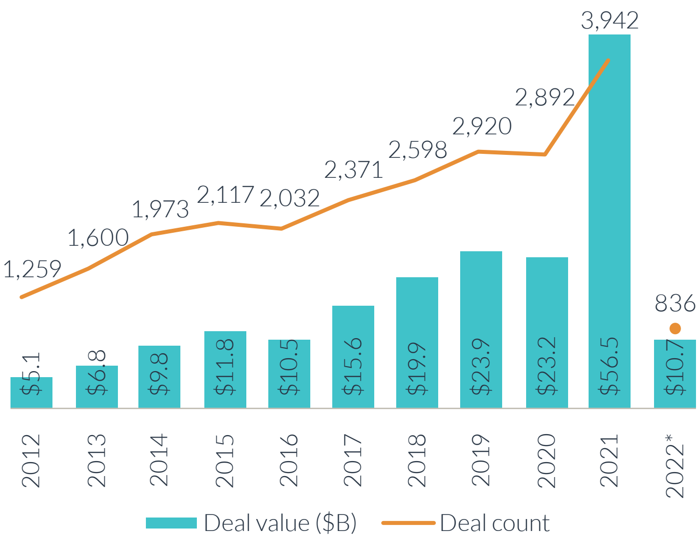
Female founders

Investment in female founders slows from 2021

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



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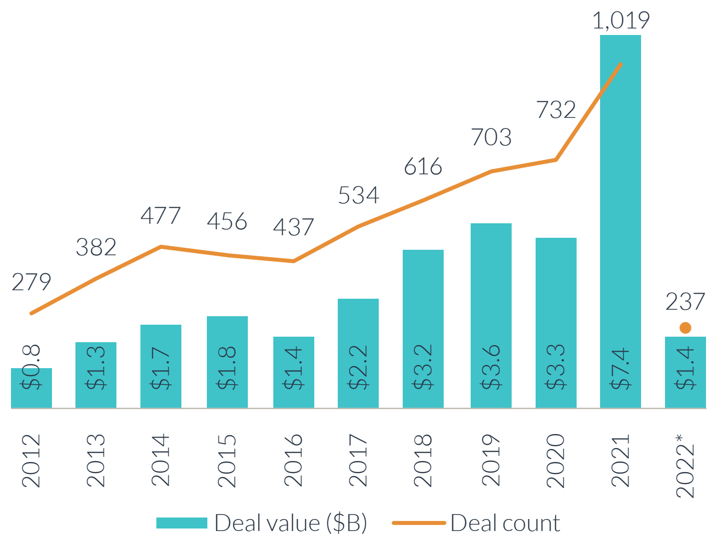
Deal activity in all-female founder teams slightly off record pace

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



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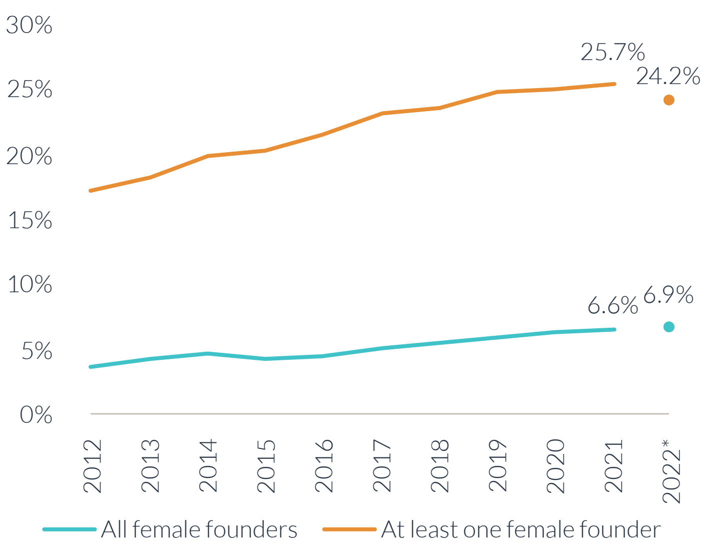
Percentage of deal count from female-founded companies sees slight change

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



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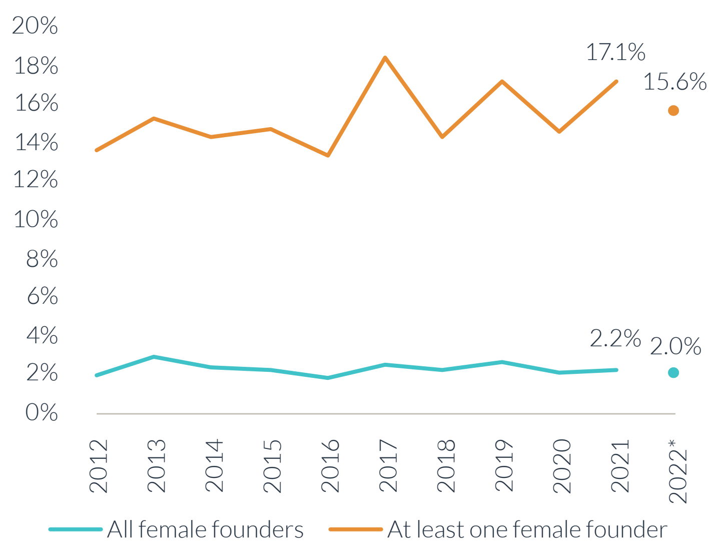
Capital to female-founded companies declines by proportion of total

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



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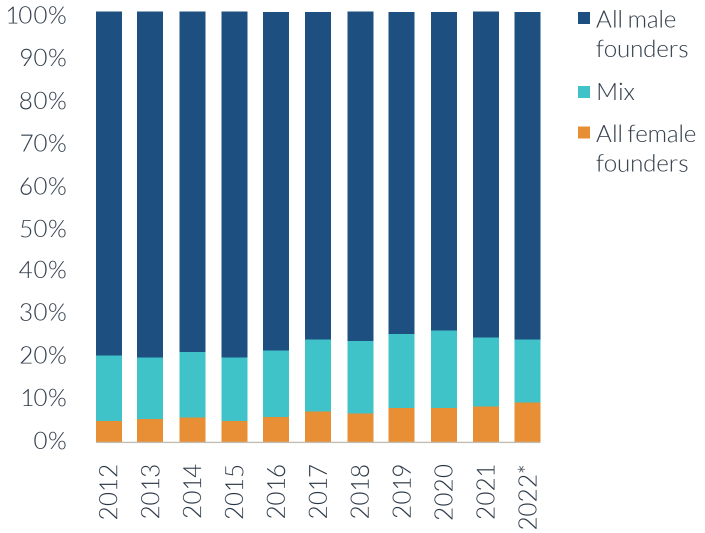
First financings to female founders pacing to 2021 highs

Share of US VC first financings by founder gender



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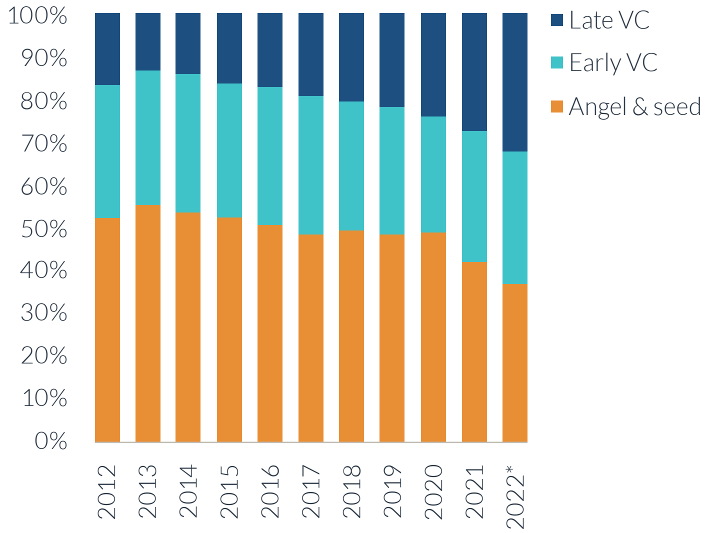
*As of March 31, 2022

Proportion of late-stage deals for female-founded companies growing

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



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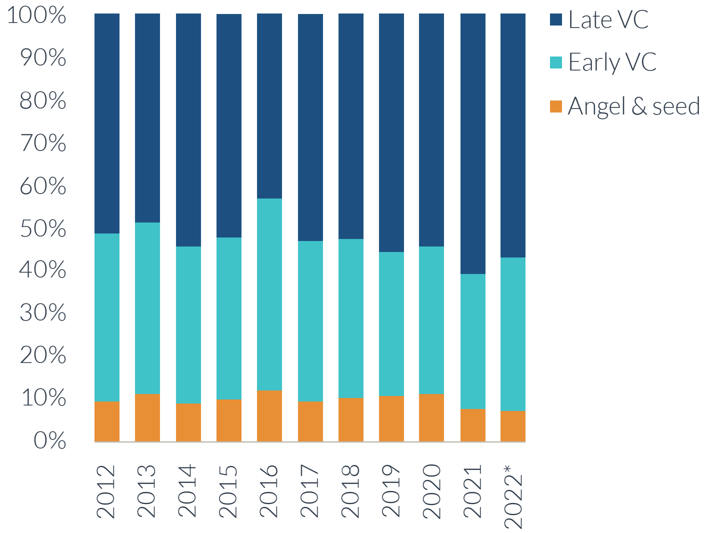
*As of March 31, 2022

Early stage stakes greater share of capital invested in female-founded companies

US VC deal value for female-founded companies by stage



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Bay Area-based female-founded companies take greater share of capital raised

Top five US CSAs by capital raised for companies with all-female founder teams (2019-Q1 2022)

Combined statistical area	Capital raised ($B)*
Bay Area	$4.72
New York	$4.13
Los Angeles	$1.43
Boston	$0.95
Philadelphia	$0.60

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*As of March 31, 2022

New York outpacing Bay Area in deal count into female-founded companies

Top five US CSAs by deal count for companies with all-female founder teams (2019-Q1 2022)

Combined statistical area	Deal count*
New York	584
Bay Area	503
Los Angeles	300
Boston	127
Seattle	88

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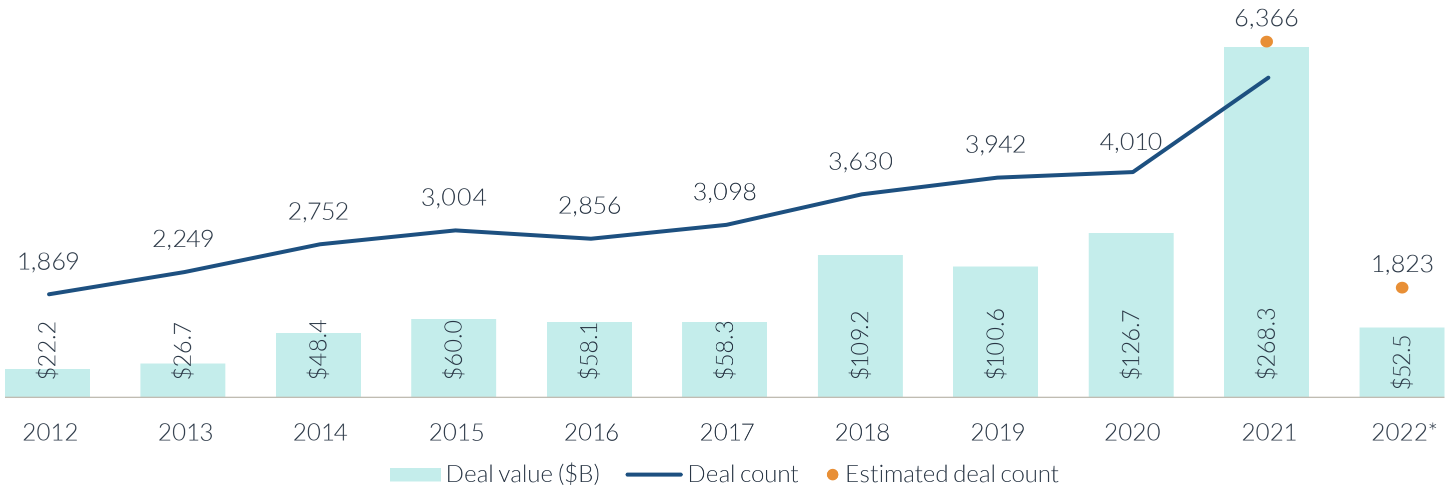
*As of March 31, 2022

Nontraditional investors

Nontraditional investors do not slow pace in Q1

US VC deal activity with nontraditional investor participation



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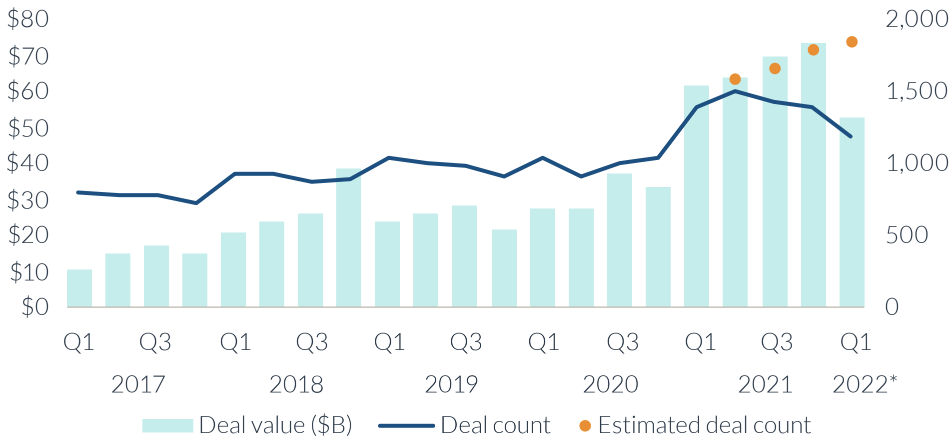
Nontraditional investors have been the largest drivers of top-line trends over the past few years, and in 2021, more than 78% of total US VC deal value derived from a deal with nontraditional investment. After participating in just $52.5 billion in deal value in Q1, a pullback by these nontraditional investors will be quickly felt by the industry. However, even if this slower pace continues or deepens, 2022 will likely finish with the second-highest count of deals with nontraditional investor participation.

Q1 set to see record number of deals with nontraditional participation

US VC deal activity with nontraditional investor participation by quarter



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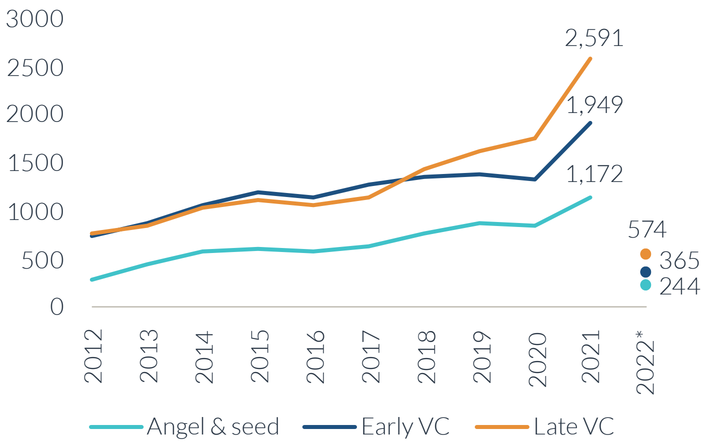
Nontraditional investors rapidly increased their activity in 2021, capitalizing on the fast growth of VC-backed startups and the low-rate environment that persisted throughout the year. More than 4,300 unique nontraditional investors were active in 2021, capping a growth of nearly 74% over the previous five years. With public market volatility significantly increasing over the past couple quarters, and the Fed hiking rates over the course of 2021, we expect some tightening from these institutions. It is unsurprising that crossover investors (those investing in both public and private markets) have significantly slowed their activity from 2021's pace thus far in 2022, notching just 235 deals through Q1. These institutions that have added venture to their investment strategy must adjust their programs as necessary, and current needs most likely include triage of their public portfolios. The growth in deal participation percentages each nontraditional investor group experienced over the past couple of years largely stalled during Q1, a trend

Late-stage deals seeing most participation

US VC deal count with nontraditional investor participation by stage



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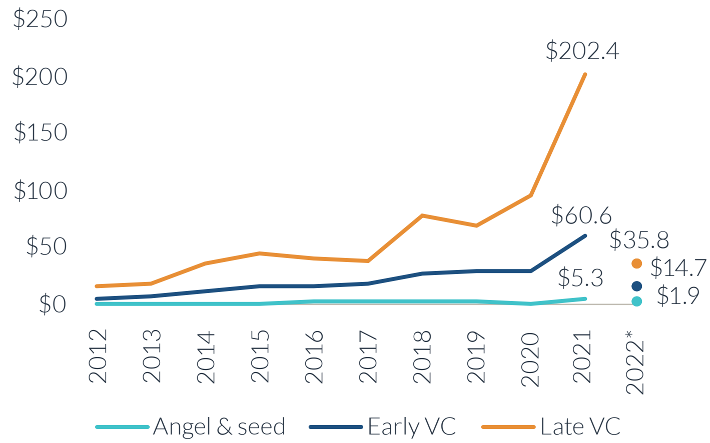
Deal value shows largest change at late stage

US VC deal value ($B) with nontraditional investor participation by stage



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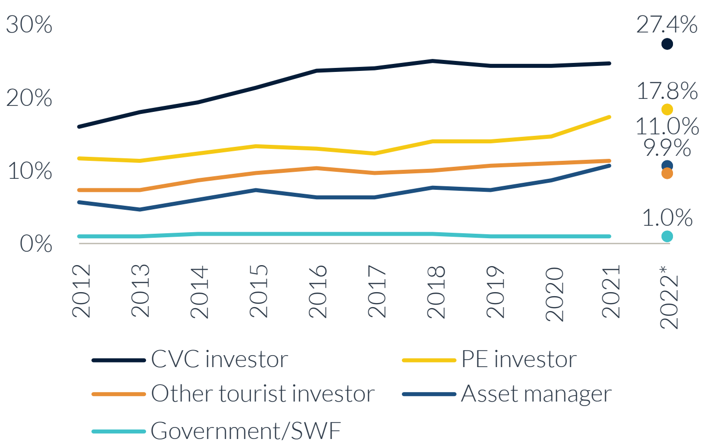
CVCs see growth in deal count participation

Proportion of US VC deal count by nontraditional investor type



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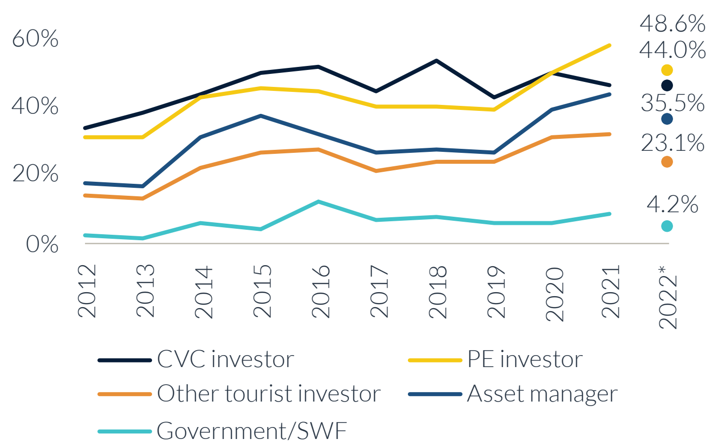
Deal value participation takes hit across all investor types

Proportion of US VC deal value by nontraditional investor type



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we believe we will continue over the near term as nontraditional investors increase their scrutiny of venture investments.

While a slowed investment pace will show up in the data, it will likely be much less pronounced than the decline in deal value associated with nontraditional investors. Nearly 90% of mega-deals in 2021 included nontraditional capital. We have seen such large deals have difficulty closing in Q1, and the value that these deals created in the past will likely leave a much larger void in the data.

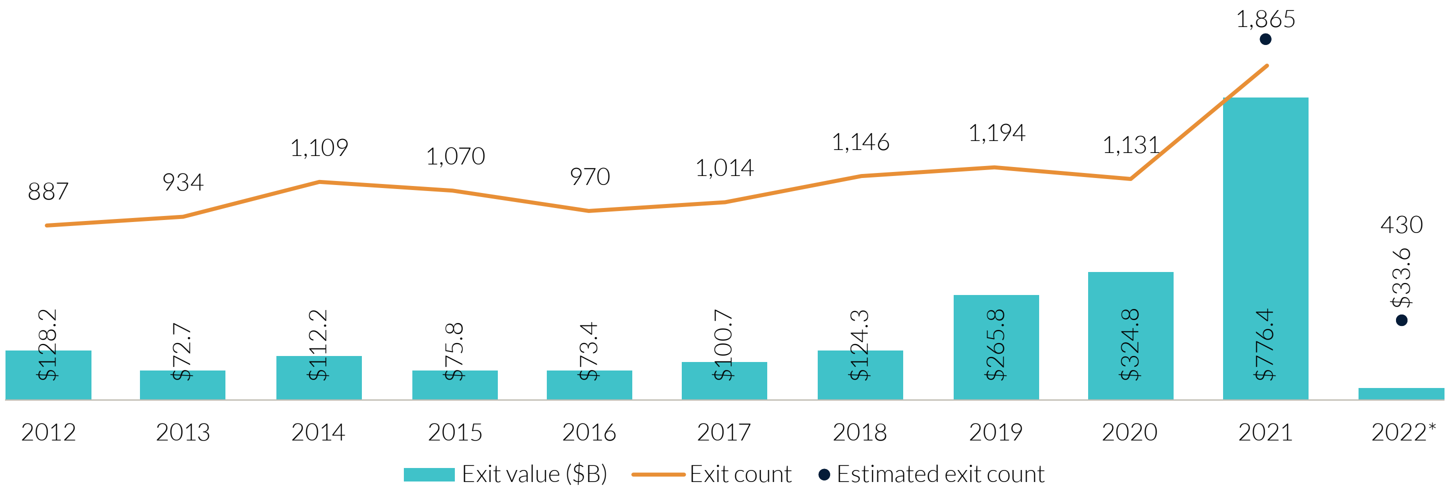
Corporate venture capital (CVC) had a banner year in 2021, notching more than 52% growth in deal count YoY. As corporate innovation leans more heavily on startup investment than in the past, we expect CVC investment to remain strong despite headwinds. However, there have been many new entrants into the CVC market over the past couple of years.

Initializing a program in the exuberant market of the past two years, only to be faced almost immediately with the current turbulent market, could quickly push the CVCs that are unaccustomed to the risk of venture to the sidelines. The strategic nature of CVC does provide a unique benefit to these investors during any market. Non-cash returns of market data and knowledge should still make startup investment attractive to corporates.

Exits

Outsized exits temper compared with 2021's elevated pace

US VC exit activity



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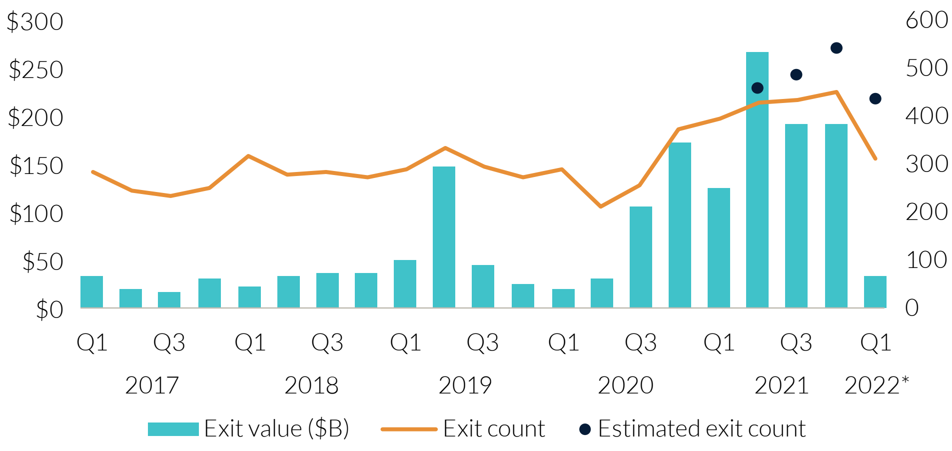
*As of March 31, 2022

The first quarter of the year has been categorized by an eerie lack of IPOs or large exits, as liquidity for VC-backed startups has come to a crawl relative to 2021's record numbers. We estimate that 430 exits have closed in Q1 2022; it is evident that the uncertainty felt in the broader markets has affected venture liquidity markets more rapidly compared with dealmaking figures. Startup buyers, such as public asset managers and corporations, can retrench during periods of volatility, especially as the market downturn has a potentially outsized effect on the non-venture portion of their portfolios. The most precipitous drop in the data comes from the QoQ decline in capital exited, where Q1 posted only $33.6 billion after three consecutive quarters over $192.0 billion. However, this total for capital exited is not historically low; it is more in line with the figures posted in 2018 and 2019.

Exit counts remain on pace while exit value cools

US VC exit activity by quarter



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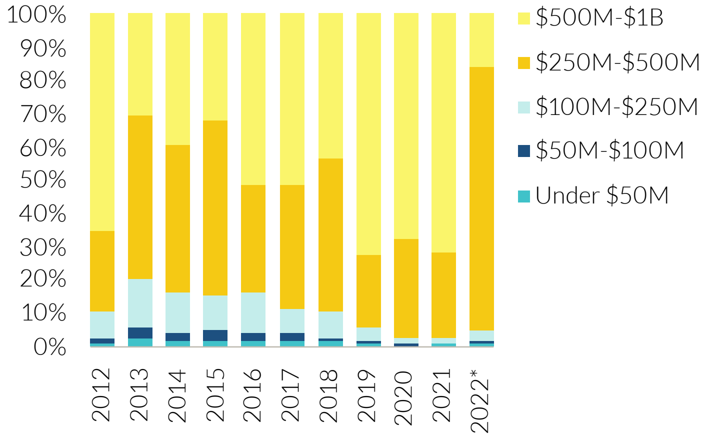
*As of March 31, 2022

IPOs of VC-backed startups have neared a complete halt during the first three months of 2022 on the back of poor public market performance for growth assets, and SPAC combination deals have fared only marginally better. This is in stark contrast to the flurry of public listing activity during 2021 that nearly matched the frenzy of 2000. The 28 public listings that closed count only 14 traditional IPOs among the group, as public market investors continue to rotate away from growth stocks in a reaction to the shifting valuation climate for these assets. We see this as a period of waiting for both investors and startups looking to go public as both parties watch for clarity in a choppy public market. The longevity of this quiet period will be critical to the

Exits over $500M experience huge pullback in Q1 2022

Share of US VC exit value by size bucket



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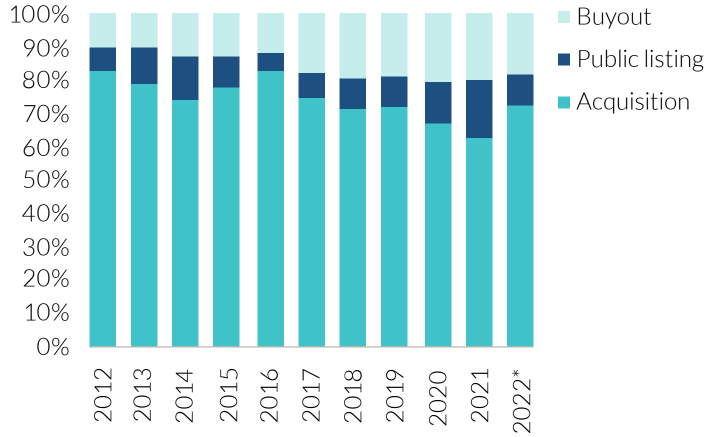
Public listing activity sees significant pullback with public market volatility

Share of US VC exit count by type



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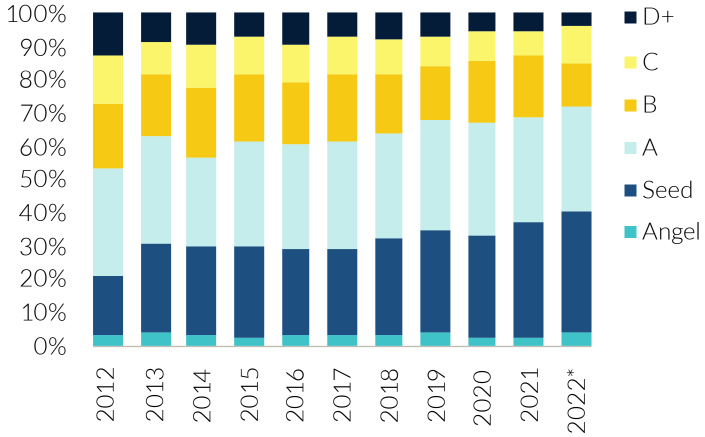
Acquisitions continue to target early-stage startups for majority of deals

Share of US VC round preceding an exit via acquisition



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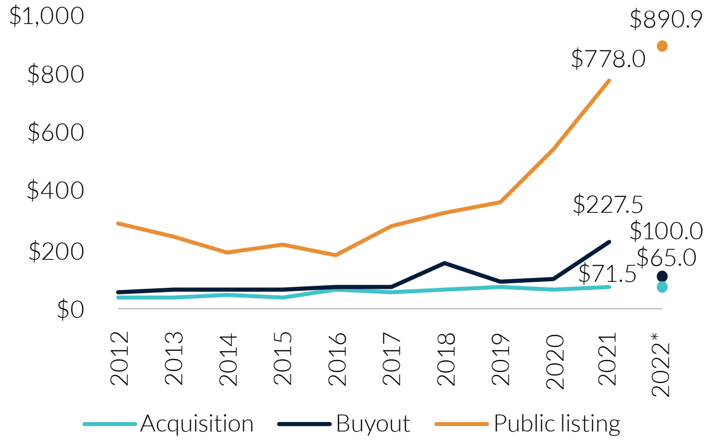
Exit size growth trajectories paused with uncertain conditions

Median US VC exit sizes ($M) by type



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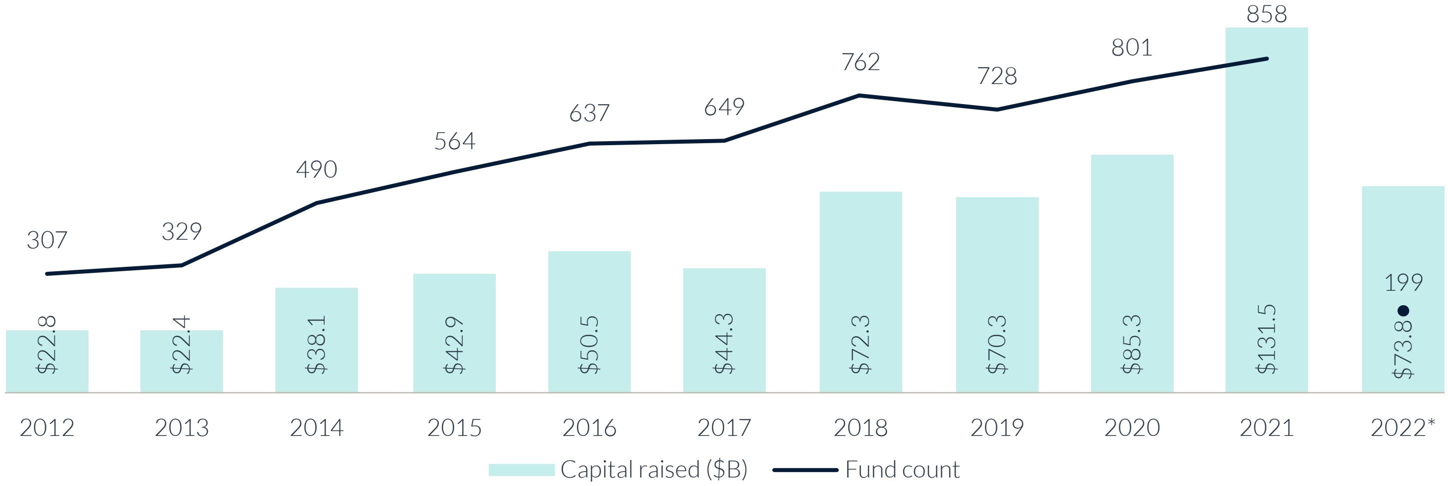
health of the VC liquidity environment given how concentrated VC exit value has been in public listings over the last two years. The VC ecosystem has created a massive amount of value over the last couple of years in paper gains; however, for LPs and GPs to reap the reward of those investment winners, those positions must eventually be liquidated at an attractive valuation. If the public markets, either traditional IPOs or SPAC combinations, cease to be a desirable option for startups for an elongated period, there will be some stress on these companies' existing private backers as hold times lengthen or as managers invest even more capital to sustain their portfolio companies' growth patterns.

Acquisition activity was also relatively tepid in Q1. While it has not suffered as great a dip as public listing activity, acquisition activity still fell to its lowest count and value since Q3 2020. This level of acquisition count is still relatively elevated on a historical level. Corporations should be some of the best-positioned players to capitalize on the lack of IPOs, as a dip in VC valuations could offer some attractive opportunities to strategic acquirers looking to boost inorganic growth. Regardless of any pickup in acquisitions, we expect a relatively slow few quarters from VC exits as all parties search for certainty and come to grips with a potential new valuation climate.

Fundraising

Fundraising maintains success during Q1

US VC fundraising activity



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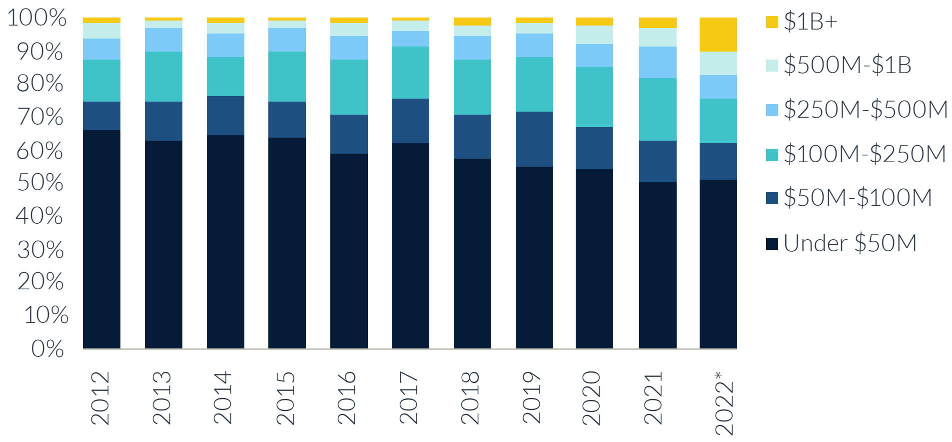
In contrast to the exit market, VC fundraising maintained the momentum of 2021 during Q1 2022, as 199 funds closed on $73.8 billion in commitments. VC fundraising cycles have hovered around a median 12 months long over the last couple of years, explaining the sustained strength of VC fund activity. Many of the commitments to the funds that closed in Q1 were likely agreed upon during the boom times of 2021. We will continue to watch this pace of fund closing over the next couple of quarters. Managers may find that securing the final few LPs becomes slightly more difficult in such a volatile market. To this effect, we expect time to close will expand slightly as public market underperformance is likely spurring allocators to make investments into other asset classes rather than exclusively to VC. The exit market over the next few quarters will be critical for the longevity of any fundraising success by either established or emerging managers.

Micro-funds maintain proportion of total count in Q1

Share of US VC fund count by size bucket



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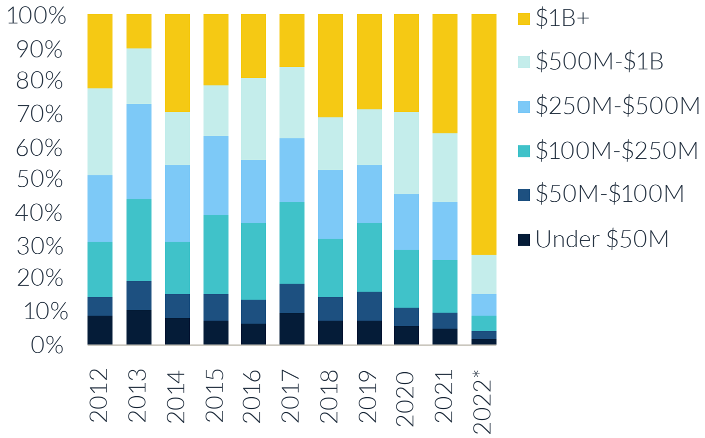
As is typical with the VC fundraising environment, a handful of large funds helped tally these impressive fundraising totals. Andreessen Horowitz closed on a trio of funds in January totaling $9 billion, contributing to the 19 total funds topping $1 billion during the quarter. At this point in 2022, mega-funds (sized $500 million or larger) have dominated capital raised by US VC funds—86.1% of capital raised in the quarter fell into this size bucket. The average fund size hit a new high of $386.5 million, with a slight decline at the median. This represents how divergent the fundraising market has become, with massive success for established firms and a middling market for smaller and emerging managers.

Through Q1 2022, our fundraising data confirms this dichotomy within VC managers. 99 funds from experienced managers have closed compared with 100 funds from emerging managers during the quarter. However, experienced managers raised nearly $52 billion more during the quarter. While we will pick up more smaller and emerging manager funds throughout our ongoing data collection process, the gap between the amount raised by these two groups highlights a disparity that we expect to see during market turbulence. LPs, becoming more risk-averse during market changes, tend to allocate to known managers before new and emerging managers.

The concentration of capital toward established firms may have unintended side effects on promoting groupthink and stifling innovation and diversity within the VC GP ecosystem. First-time fundraising has been especially muted through the start of the year, with only $3.1 billion raised across 30 new managers. We expect this trend to continue throughout the next couple of quarters as LPs get back on stable ground with their allocations to non-VC assets.

Mega-funds attract highest percentage of total dollars on record

Share of US VC fund value by size bucket



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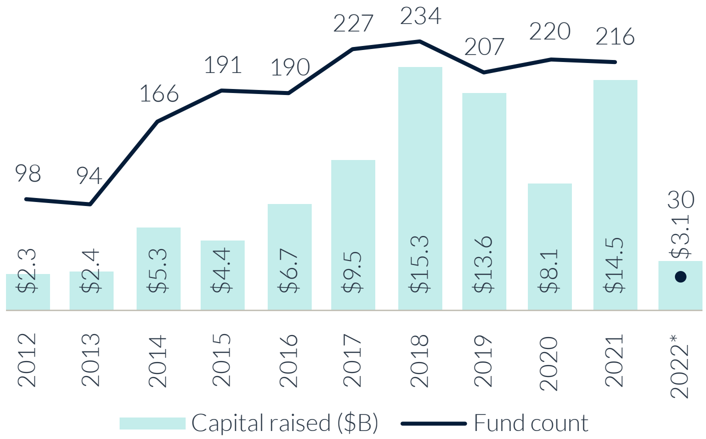
New managers find difficulty so far in 2022

US VC first-time fundraising activity



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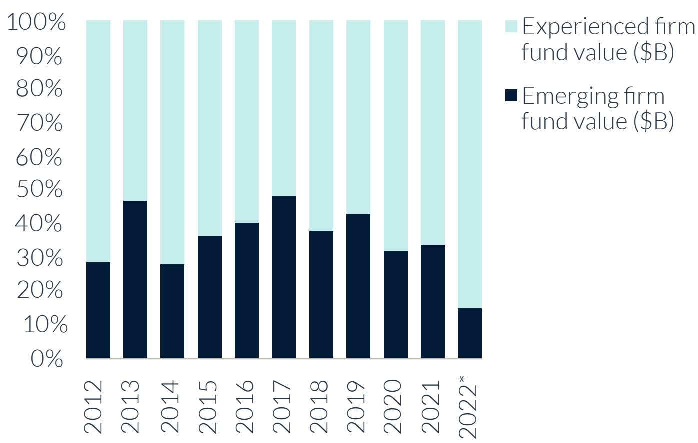
*As of March 31, 2022

Experienced managers sustain 2021's momentum

Share of US VC fund value by experienced and emerging funds



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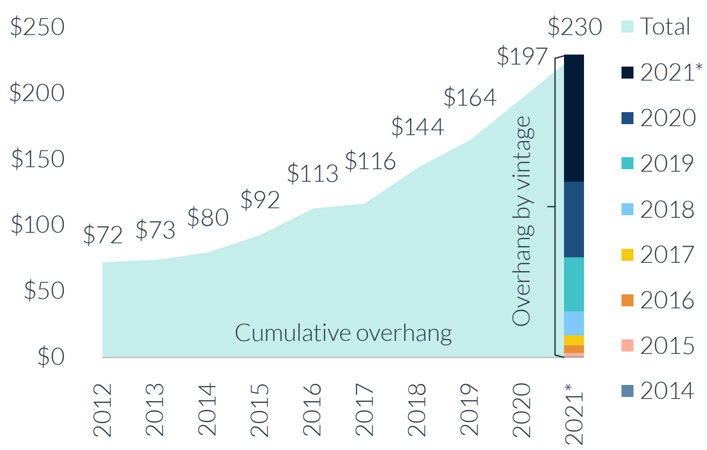
*As of March 31, 2022
Note: Emerging managers are defined as firms that have launched fewer than four funds. Experienced managers are defined as firms that have opened four or more funds.

Venture market hits record dry powder

VC overhang ($B)



PitchBook-NVCA Venture Monitor
*As of December 31, 2021
Note: Extrapolations are used for quarters without fund returns data.

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 as these investors are likely to be participating at the late stages directly prior to an exit.

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

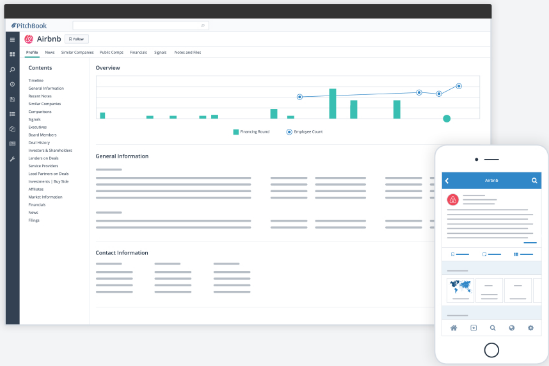
Why we teamed up

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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