VC Dealmaking Begins to Rotate

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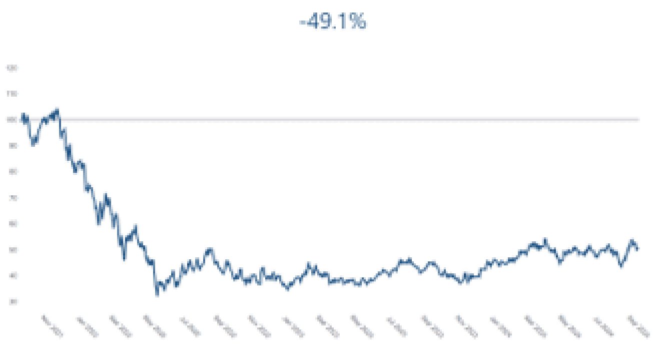
After a decade of strong performance, early-stage and growth companies have faced significant challenges since early 2022. These challenges include rising interest rates, reduced exit activity, and falling valuations.

To illustrate the shift from a bull to a bear market for VC-backed companies, consider the following two charts. The first shows that the post-IPO performance for venture-backed companies has dropped by 49.1% since November 2021â??ouch! The second chart compares the post-IPO performance of venture-backed companies to that of the S&P 500 between 2010 and November 2021.

In summary, the exuberance that once fueled high-flying, venture-backed companies came to an abrupt halt as many investors moved away from investing in early-stage growth assets.

VC-Backed IPO Index (November 2021-September 2024)



Source: Pitchbook

VC-Backed IPO Index (2010-November 2021)

Source: Pitchbook

However, after two-and-a-half years of a prolonged downturn, there are signs that VC dealmaking is beginning to rotate, suggesting that brighter days may be on the horizon for early-stage and growth companies navigating the inherently volatile space. Below are three charts illustrating how VC dealmaking may be starting to turn the corner.

1. **Startup Friendly Terms Make a Resurgence**

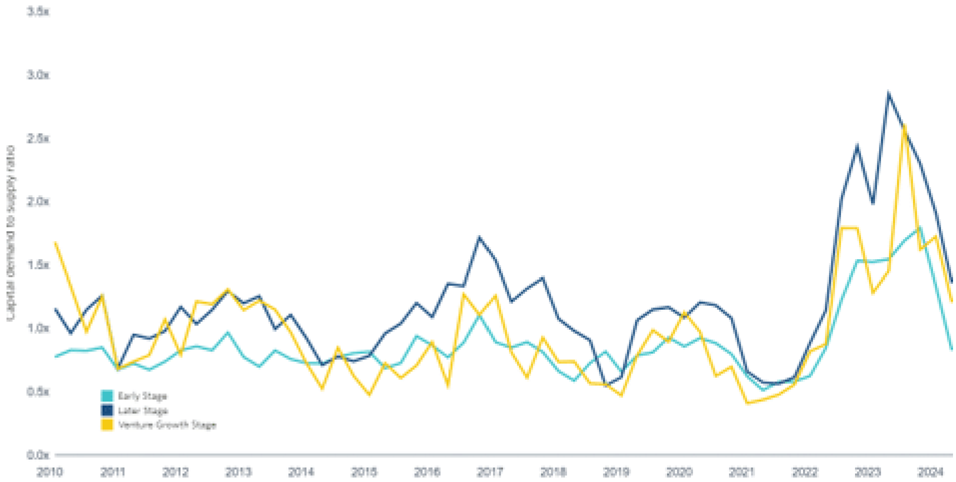
Source: Pitchbook

What it means: Venture deals typically feature terms that range from being "investor-friendly" to "startup-friendly." This includes provisions like anti-dilution clauses, participating preferred stock, cumulative dividends, and redemption rights in financing terms.

Why it matters: When investors hold more leverage than startups, it typically signals that capital markets are tight, and competition for deals is low. Conversely, when the pendulum shifts toward startup-friendly terms, it indicates increased competition and easier access to capital. The chart above shows that startup-friendly terms are making a comeback, suggesting that VC dealmaking is heating up and becoming more competitive.

2. **The Capital Demand-to-Supply Ratio Has Declined Sharply**

1.

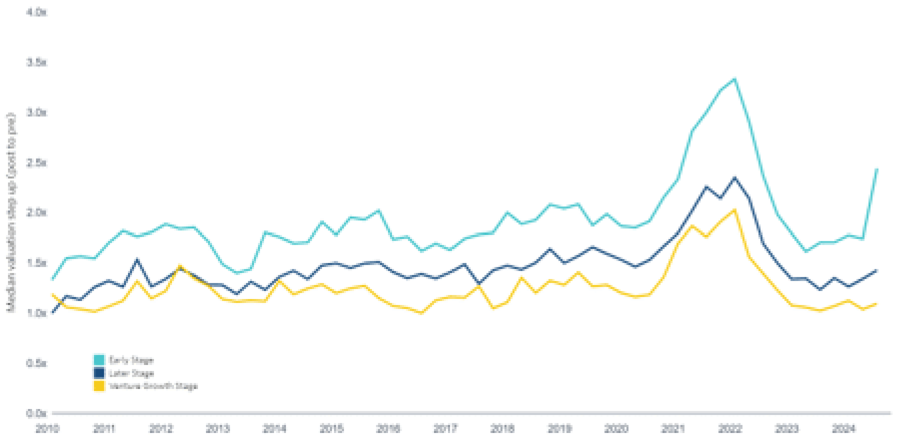


Source: Pitchbook

What it means: Capital is the lifeblood of most startups. When capital is in short supply,startups struggle to fund operations and growth.

Why it matters: Over the past two and a half years, the capital demand-to-supply ratio reached its highest point since the Great Recession, making it difficult for startups to access **the funding they needed**. However, the ratio has sharply declined over the past year, suggesting that capital markets are beginning to open up again for capital-hungry startups.

3. **The Median Valuation Step-Up Between Rounds is Trending Up**



Source: Pitchbook

What it means: Startups aim to hit product and revenue milestones that allow them to raise additional capital at higher valuations, facilitating growth and expansion. A declining valuation step-up between funding rounds typically signals a cooling of capital markets and/or business performance.

Why it matters: In recent years, valuation step-ups reverted to historical averages, reflecting the broader slowdown in VC activity. However, since early 2024, valuation step-upsâ??particularly among early-stage companiesâ??have surged. This trend is likely driven by factors such as renewed investor confidence, improved market conditions, a broader recovery in tech, and anticipation of a lower interest rate environment benefiting growth companies.

While itâ??s too early to declare that venture capital as a whole is back in a bull market, the data suggests that dealmaking is beginning to turn a corner. This is good news for the innovation economy, as early-stage companies look to partner with investors **who** can help fuel the next wave of growth.

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