Office of Advocacy
www.sba.gov/advocacy

Small Business Facts

Advocacy: the voice of small business in government

Putting Recent Venture Capital Gains in Perspective

By Jonathan Porat, Economist

Traditionally, the first quarter of the fiscal year can be a low point for venture capital (VC) investment. However, the first quarter of fiscal year 2015 (Q1 2015) yielded good news.

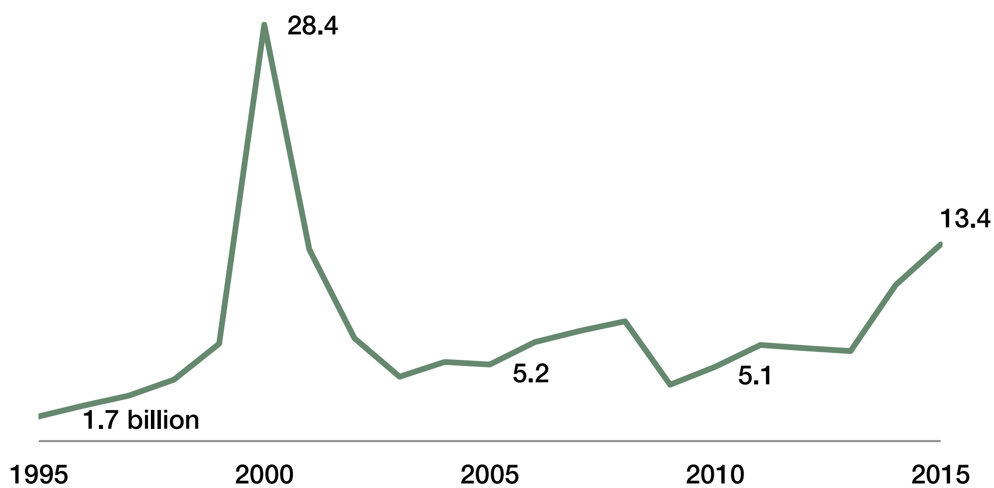
> *"I've been in this industry for 20 years. This is the best time to raise money ever. It might be the best time for any kind of business in any industry to raise money for all of history."*
>
> – Stewart Butterfield, CEO of Slack, a corporate messaging app startup now valued at $2.8 billion

This year had the highest level of venture capital investment in a first quarter since the year 2000. Q1 VC investments totaled $13.4 billion making it the fifth straight quarter to see over $10 billion in VC investments. This trend is part of a sizeable post-recessionary rebound in VC evidencing major growth.

After taking a big hit, VC investments are continuing to rebound

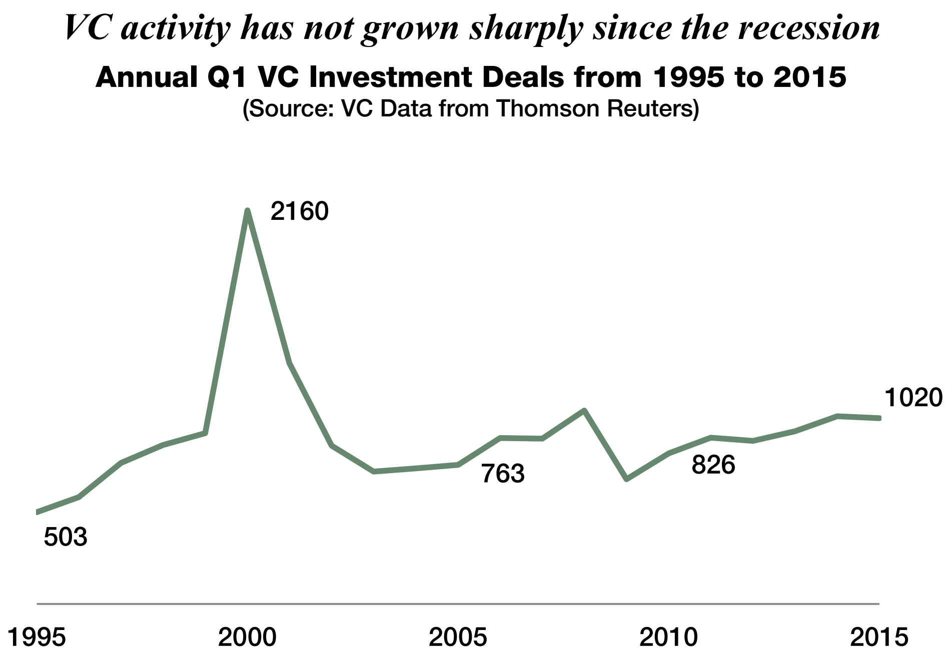
Annual Q1 VC Investment Dollars, 1995-2015

(Source: VC Data from Thomson Reuters)



As the figure above shows, the past two decades saw VC investment dollars peak during the technology boom in 2000. A strong economy and an appetite for risk-taking led to a speculative bubble around new technology companies. Coinciding with the growth of the Internet, tech companies received massive valuations and the economy supported substantial venture capital investments into startups that might be deemed too risky otherwise. After that bubble burst in the early 2000s, VC remained somewhat stagnant as the financial crisis and corresponding recession in the mid-2000s slowed down a potential VC recovery.

VC is starting to swing back. Investments are still billions of dollars away from their year 2000 high but they have grown by more than 150% in the last five years. While investment dollars have steadily increased, investment activity has not grown as quickly as the chart below shows



Compared to investment dollars, the growth in VC activity may represent a shift in venture capital benefiting later-stage startups, ones with commercially available products or services. According to PricewaterhouseCoopers's MoneyTree Report, based on Thomson Reuters data, Q1 2015 had the lowest number of seed-stage deals since the report started tracking company developmental stages in 1996. The seed-stage is the initial stage of development for a startup where it does not have any available products or services. Seed-stage funding is necessary for startups to commercialize underdeveloped concepts and products and a critical part of supporting innovative entrepreneurs.

Early-stage investment dollars, which go to companies which may be pilot testing products or services, dropped by over one third. However, later-stage companies saw an increase in investment dollars of over 50 percent from Q4 2014 leading to the highest quarterly investment since Q4 2000.

As seen in the next figure, many of these dollars represent just a few California tech startups receiving considerable, in some cases billion-dollar, valuations such as SpaceX and Lyft. It is possible that this centralization of investments could be contributing to constrained VC activity and could represent at least a short-term shift in VC towards more scalable developed companies, products and services.

California tech startups past early-stage development dominated the largest Q1 2015 VC investments

The Top Five VC Deals in Q1 2015

(Source: PWC Moneytree and the National Venture Capital Association)

Startup	Location	Stage of Development	Investment Amount (Approximate)
UBER	San Francisco	Expansion	$1 billion
SPACEX	Hawthorne, CA	Later-stage	Slightly under $1 billion
lyft	San Francisco	Later-stage	$530 million
Pinterest	San Francisco	Expansion	$367 million
SoFi	San Francisco	Expansion	$213 million

Venture capital activity has been trending upward for the past couple of years and continues to do so in Q1 2015. According to current VC trends, this may be one of the best environments for startups to receive funding since the extreme financing figures recorded during the tech boom. While these numbers present good news for startups and the economy, a chunk of this rise in VC investment can be attributed to the fairly recent increasing number of companies receiving multi-billion dollar valuations and investments of, in some cases, over one billion dollars.

VCs are shifting away from funding startups as they are just developing. Instead they are looking toward startups in later stages of development largely in the tech sector in order to potentially jump in before companies go public. As funding is more plentiful, it will consequently be less risky in the short term to overvalue companies or make investments in otherwise riskier ventures. Therefore, the economy is continuing to support niche startups through increased VC funding but is doing so on a path where it is leveraging riskier higher expectations of performance from startups that are closer to the end of their development cycle.