

VC sentiment plunges – interest rate reversal and war create high uncertainty

10 May 2022

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- Despite plunging, assessments of current business situation remain barely in the green, while expectations are now just average
- Economic climate worsens, assessments of fundraising climate and interest rate level have dropped sharply
- Assessments of entry valuations see double-digit rise

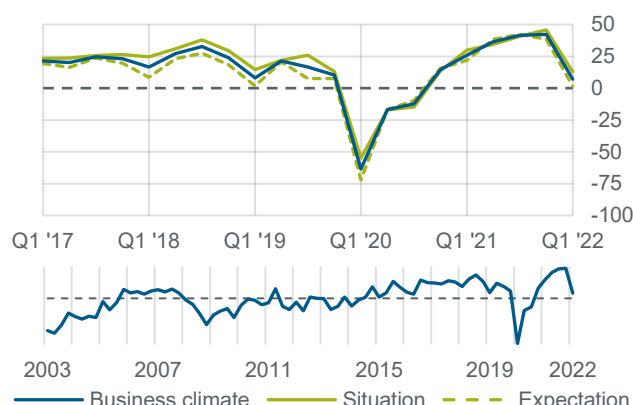
VC market sentiment fell at the start of the year

Two years after the coronavirus shock, business sentiment in the German venture capital market collapsed again in the first quarter of 2022. The business climate indicator of the early-stage segment dropped by 35 points to 7.2 balance points. This was likely due to the inflation-induced accelerating interest rate reversal and the heightened economic uncertainty caused by the war. The indicator for the business situation dropped to 12.8 balance points (-33.0), while the indicator for business expectations fell by 37 points to 1.7 balance points. However, the current trend differs in two main aspects from the pandemic-induced drop in business sentiment in early 2020: First, the decline started from a record-high level and second, it is only roughly half as pronounced as it was then.

Accelerated interest rate reversal weighs on business sentiment

Assessments of economic conditions, interest rate level, fundraising climate and valuation pressure fell most sharply in the first quarter. Given the escalation of the war in Ukraine, economic sentiment has literally plunged – even much more steeply than after the coronavirus shock two years earlier. As was the case then, however, the economic downturn is likely having less of an impact on most start-ups. Stronger effects can be expected from the interest rate reversal decided by international central banks, which has accelerated because of the war. This has led to lower tech stock prices, which is ultimately affecting private markets as well and increasing write-down pressure. What is positive from the point of view of investors, however, is that entry valuations for new investments are falling, too. The relevant sentiment indicator has clearly risen and is the only one with a significant improvement. Rising interest rates also mean that VC as an asset class tends to lose investor money, which makes fundraising more difficult in the long term. What hardly changed were the indicators for the level of deal flow, investment appetite and exit opportunities. The sentiment decline may primarily reflect the shock over the events, as happened in the pandemic, and remain without effect on actual investment activity.

Development of VC business climate indicator



Key data of VC sentiment components

Values in balance points

	Q1/22	Δ vs. Q4/21	High	Low
Business climate	+7.2	-35.0	+42.3	-63.5
Business situation	+12.8	-33.0	+45.9	-59.1
Business expectations	+1.7	-37.0	+42.3	-72.0
Fundraising	+33.0	-35.5	+69.7	-71.3
Entry evaluations	-28.8	+12.5	+51.6	-52.5
Exit opportunities	+31.0	+1.3	+69.0	-76.9
New investments	+16.3	-0.3	+30.5	-73.0
Dealflow quantity	+33.8	+0.5	+33.8	-44.4
Dealflow quality	+17.2	-12.3	+29.5	-22.3
Taxation framework	+34.9	-11.9	+49.8	-28.6
Write-downs	-17.7	-31.0	+28.2	-50.0
Economic development	-63.5	-89.6	+72.0	-95.6
Interest rates	-45.9	-37.2	+35.4	-50.4

Colour scheme of sentiment indicator dots: values in the lowest tercile are marked 'red', in the medium tercile 'amber' and in the highest tercile 'green'. Indicator design may lead to deviations from previous publications.

Source: KfW Research, BVK and DBVN.

Comments on the current trend

'VC market sentiment virtually collapsed in the first quarter of 2022. This certainly has to do with the high rates of inflation and the sharp interest rate reversal announced by international central banks. Another factor is the geopolitical and economic uncertainty unleashed by the escalation of the war in Ukraine', said Dr Fritzi Köhler-Geib, Chief Economist of KfW. 'However, we are coming down from a very high level and the drop is less steep than the one triggered by the outbreak of the pandemic in the first quarter of 2020. It is a shock of events that is not showing up in broad investment activity so far. Around EUR 3 billion has already been invested in venture capital in German start-ups in the first three months, more than in the same period last year. And excluding megadeals, which are more or less frequent, we are only slightly below the volume of the previous exceptional quarter. Investment activity in the VC market can be expected to remain steady, also because investors are still sitting on a lot of capital. Furthermore, the effect of the war on energy supply could even cause interest in clean and climate technology start-ups to grow.'

'The mood in the business community and capital market has been shaped by the war in Ukraine, a high rate of inflation and the initiated interest rate reversal. The German venture capital market is not immune to this either', added Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK). 'How the situation evolves remains to be seen. If the interest rate reversal picks up speed and Europe follows suit, this is likely to put further pressure on the valuations of listed technology companies and thus also on unlisted start-ups. The easing of entry valuations, which have so far been viewed very critically, and the continuing positive assessment of deal flow are pleasing but small comfort in light of the overall situation.'

Calculation of the German Venture Capital Barometer

The **German Venture Capital Barometer** is based on a quarterly survey of the members of the German Private Equity and Venture Capital Association (Bundesverband Deutscher Kapitalbeteiligungsgesellschaften – BVK), the member investors of the Deutsche Börse Venture Network (since the 2nd quarter of 2021) and further private equity companies with registered offices in Germany. It reports the business climate in the German venture capital market on the basis of assessments provided by private equity firms with a focus on young companies. All sentiment indicators represent the average of the balance of situation assessments (share of 'good' minus share of 'bad') and the balance of expectations identified at the same time for the coming six months, adjusted by their respective historical mean balance values. Because of the way the barometer is constructed, positive indicator values point to above-average sentiment and negative values to below-average sentiment.

The **German Venture Capital Association** is the voice in the face of the private equity industry in Germany. The association is committed to improving conditions and facilitating access to private equity so that even more businesses in Germany can benefit from private equity. It has some 300 members. These include around 200 private equity companies and investors as well as some 100 consulting firms and service providers of the industry.



Bundesverband Deutscher
Kapitalbeteiligungsgesellschaften e.V.

The **Deutsche Börse Venture Network (DBVN)** was launched in 2015 and is now Europe's largest network for growth finance and 'Capital Market Readiness'. It focuses on providing efficient access to capital and has an extensive range of networking and training services. The network of more than 200 fast-growth businesses and more than 450 investors has already enabled 13 IPOs and numerous trade sales.

Deutsche Börse
Venture Network