VC market sentiment continues to inch out of the coronavirus slump

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– Despite improving, VC market sentiment remains in the red, as business expectations are more positive than situation assessments

– Fundraising climate has improved greatly and is clearly back in the green

– Appetite for new investments continues to grow, providing start-ups with increasingly better access to capital

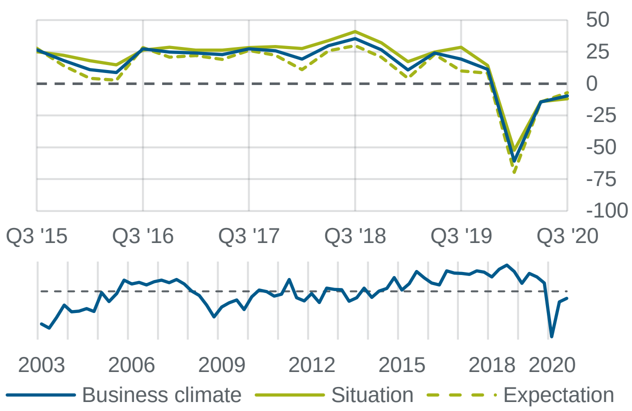
VC market sentiment on the path of recovery

In late summer, VC market sentiment continued to recover from the spring coronavirus shock. In the third quarter of 2020, the sentiment indicator of the early-stage segment climbed by 4.7 points to -9.5 balance points. VC investors rated both their current business situation and their expectations better than in the previous quarter, although situation assessments improved only very marginally. The indicator for the current business situation climbed 2.3 points to -11.9 balance points, while the indicator for business expectations rose by a stronger 7.2 points to -1.1 balance points.

Investors are more willing to invest again

The first two quarters each painted a very uniform picture of how the market environment developed. The coronavirus shock pushed sentiment indicators down in the first quarter and in the second quarter the shock-induced paralysis dissolved again and assessments of the market environment recovered. In the third quarter, the picture was more mixed. Three key indicators recovered further: fundraising climate, appetite for new investments and quality of deal flow. Assessments of fundraising and quality of deal flow are even back in the green. VC investors' coronavirus-induced concerns over fundraising thus appear to have largely vanished – and they were already more dissatisfied with the quality of deal flow even before the coronavirus crisis. The only indicator that hardly changed was write-down pressure. Its assessment remained on the level of the previous quarter and thus in the red zone. All other indicators deteriorated again after the recovery, however, with some falling considerably. But the developments need to be measured against the levels previously achieved. Thus, the indicators for entry valuations and innovation are still on a normal level despite dropping sharply. Assessments of promotional measures and the tax framework even remained in the green despite slipping. The worst performing indicator was the exit climate, particularly with a view to trade sales, with strategic buyers from the manufacturing sector currently absent as an exit option.

Development of VC business climate indicator



Sources: KfW Research and BVK.

Key data of VC sentiment indicators

Values in balance points

	Q3/20	Δ vs. Q2/20	High	Low
Business climate	-9,5	+4,7	+35,3	-60,9
Business situation	-11,9	+2,3	+40,8	-58,6
Business expectations	-7,1	+7,2	+29,8	-69,6
Fundraising	+15,3	+17,2	+71,3	-66,6
Entry evaluations	+5,7	-18,4	+48,9	-51,3
Exit opportunities	-30,0	-5,4	+53,1	-73,9
New investments	-23,6	+10,0	+23,4	-69,1
Dealflow quantity	+2,7	-4,0	+29,3	-42,5
Dealflow quality	+6,0	+12,5	+27,3	-22,0
Funding	+21,6	-11,4	+39,7	-56,4
Taxation framework	+13,2	-15,9	+38,0	-26,6
Innovation	-4,4	-26,0	+38,7	-44,6
Write-down pressure	-13,3	+1,5	+28,7	-49,6

The colour coding of the balances and the variations is based on the historical values of the respective indicator (1st tercile 'red', 2nd tercile 'amber' and 3rd tercile 'green'). Indicator design may lead to deviations from previous publications.

Sources: KfW Research and BVK.

Comments on the current trend

‘The coronavirus crisis brought much uncertainty into the German VC market’, said Dr Fritzi Köhler-Geib, Chief Economist of KfW. ‘Fundraising sources suddenly appeared to dry up, portfolio enterprises were nowhere to be seen and exit channels seemed to break down. Fortunately, the current situation is better than initially feared, most certainly thanks also to the start-up assistance provided by the German Federal Government and KfW. The market environment still has a lot of catching up to do to return to pre-coronavirus levels but the improving sentiment regarding fundraising and new investment is good news especially for start-ups in search of venture capital. The risk of losing an entire start-up generation to the crisis has greatly reduced in the past weeks.’

‘The great depression has not set in. The venture capital industry is leaving the vale of tears behind’, commented Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK). ‘Investment activity was encouragingly lively of late and several very large rounds were financed. Just as encouraging is the improved fundraising climate for securing new funds and, thus, the future supply of capital for start-ups. The Federal Government has likely contributed to this as well with its venture capital programmes. Exits remain a critical issue. Successful sales are likely to remain few and far between for the foreseeable future.’

Calculation of the German Venture Capital Barometer

The German Venture Capital Barometer is based on a quarterly survey of the approx. 200 members of the German Private Equity and Venture Capital Association (Bundesverband Deutscher Kapitalbeteiligungsgesellschaften – BVK) and further German private equity companies. The German Venture Capital Barometer has been published as a separate sentiment indicator for the German venture capital market since the second quarter of 2019. It was previously part of the German Private Equity Barometer, the sentiment barometer for the overall private equity market 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 investments in start-ups and young technology 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 value.