

VC business climate continues to slide but remains in the green

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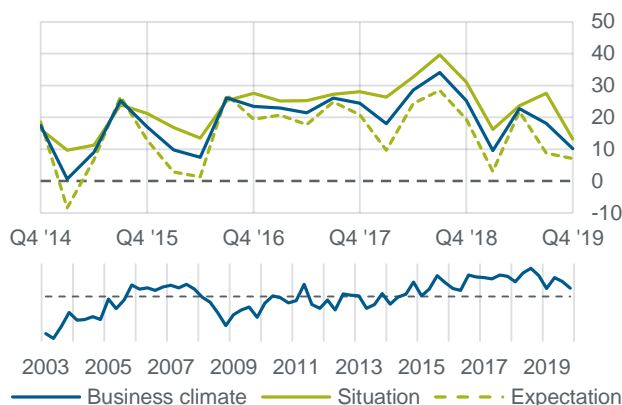
- VC fundraising climate dropped significantly from record high level
- Dissatisfaction with entry prices near rock bottom
- Exit opportunities improved

VC business climate continues to drop while business expectations stabilise

The German VC business climate has weakened again but remains good. The business climate indicator of the later stage segment fell by 8.0 points to 10.1 balance points in the fourth quarter of 2019. VC investors rated their current business situation significantly poorer than in the previous quarter, while business expectations remained relatively stable. The indicator for the current business situation decreased to 13.2 balance points (-14.3), while the indicator for business expectations stabilised at 7.0 balance points (-1.7). A year of above-average market sentiment ended with the final quarter of 2019. Although the business climate remained lower on average across the year than in the three previous years, it was the fourth best since the indicator was launched in 2003.

At the end of the year, things appeared to slow down a bit in all stages of VC investors' business model – fundraising, investment and exit. Thus, although the fundraising climate is still very good compared with the previous years, in the last quarter it suffered the second sharpest slump ever recorded. Nevertheless, 2019 was on average a record year for the fundraising climate. In the final quarter, VC investors were also less satisfied with the overall conditions for investment. The climate for entry prices dropped for the fourth consecutive quarter to just above its record low. In addition, the demand climate continued to deteriorate. Assessments of deal flow levels fell below the long-term average again for the first time in four years. The assessment of deal flow quality did improve slightly from their decline in the previous quarter but VC investors' dissatisfaction remains high. Thus, 2019 was only an average year for deal flow quantity and quality and was significantly worse than 2018 in both respects. At the end of the year, the assessment of exit opportunities recovered from the sharp correction in the third quarter but only made up for half the decline. Exit opportunities appear to have deteriorated noticeably for VC investors within a year. In this respect as well, the year ended was only average.

Development of VC business climate indicator



Source: KfW Research and BVK.

Key data of VC sentiment indicators

Values in balance points

	Q4/19	Δ vs. Q3/19	High	Low
Business climate	● +10.1	↓ -8.0	🚩 +34.1	🚩 -50.8
Business situation	● +13.2	↓ -14.3	🚩 +39.7	🚩 -59.7
Business expectations	● +7.0	➡ -1.7	🚩 +28.5	🚩 -44.8
Fundraising climate	● +38.6	↓ -30.8	🚩 +71.0	🚩 -66.9
Entry prices	● -49.8	↓ -7.5	🚩 +49.6	🚩 -50.6
Exit opportunities	● +13.9	↑ +14.3	🚩 +51.2	🚩 -75.8
including: IPOs	● -2.5	↑ +16.4	🚩 +77.0	🚩 -53.5
Dealflow quantity	● -1.9	↓ -11.6	🚩 +29.3	🚩 -42.6
Dealflow quality	● -6.9	↑ +11.1	🚩 +27.2	🚩 -22.1
Taxation framework	● +22.0	↑ +10.7	🚩 +38.8	🚩 -25.8
Innovation climate	● -5.1	↓ -25.8	🚩 +38.8	🚩 -44.6
Write-down pressure	● +20.9	↑ +9.0	🚩 +27.5	🚩 -38.8

The colour coding of the balances 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.

Source: KfW Research and BVK.

Commentary on the current development

'2019 was generally an above-average VC year in Germany', said Dr Fritzi Köhler-Geib, Chief Economist of KfW. 'But as we saw in the final quarter, the good business climate was sustained primarily by fundraising. By contrast, VC investors were only moderately satisfied with deal flow and exit opportunities. Nonetheless, 2019 saw the highest VC investment volumes overall in nearly twenty years. Only at second glance is this consistent with the mixed market sentiment. However, we do see that more and more foreign investors are active in the German market. While this is jumpstarting investment, it is weighing on sentiment because it is increasing competition for deals and, in particular, prices.'

'The German venture capital market has developed exceptionally in the past years. Venture capital firms invested more in Germany in 2019 than ever before. That is good news for German start-ups', commented Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK), on the deal flow aspect. 'At the same time, the competitive situation and rivalry for the best enterprises have intensified, which has probably affected sentiment as well. What makes us optimistic about the future is that German companies have used the positive fundraising environment and that we are seeing many new, established funds. This secures investment of the 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.