



Venture capital investment remains slow as market seeks new normal

EY US VC Trends 2023 – Q2 report

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Venture capital dollars declined in Q2 2023 but there are signs of life in early-stage activity.

In brief:

- 01** VC-backed companies raised \$29.4 billion in Q2 2023, a drop from the \$44.4 billion raised in Q1 2023.
- 02** Economic uncertainty and low IPO activity continue to hinder the late-stage market. In a promising sign for the startup economy, half of the VC deals this past quarter were seed and Series A.
- 03** Existing companies need to continue conserving cash and prioritizing near-term imperatives while preparing long-term plans for when the market improves.

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Ongoing uncertainty about the economy, projected interest rate hikes and the lingering aftermath of bank failures continue to weigh on the startup ecosystem. Venture capital (VC) investment in Q2 2023 dropped to \$29.4 billion, down from \$44.4 billion in Q1 2023, a decline of 34%. The decline isn't as stark as it sounds, however. In Q1 2023, two mega-round deals accounted for \$16.5 billion. This could point to the market finding a new equilibrium.

US venture capital investment trends over time

Our interactive database provides a historical analysis of US VC trends. Analyze by sector, date range, region, deal stage, and more.

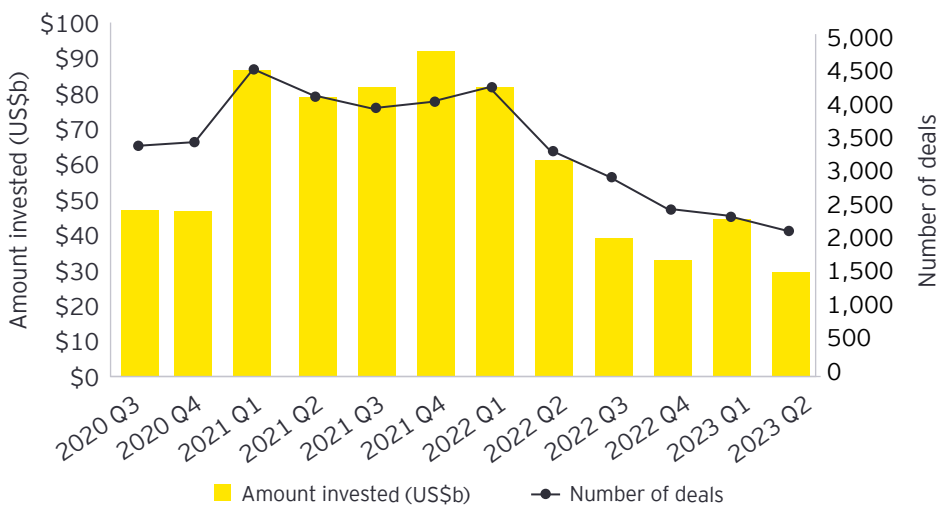
The market continues to be challenged by valuations for many companies. Expectations between investors and entrepreneurs have not harmonized in many instances. With the market in a more rational mode, companies seeking to raise capital must show meaningful progress towards growth milestones, regardless of their valuations. In many cases, founders will need to revisit their valuations, especially as they consider their longer-term capital needs.

New deals, however, don't have the valuation overhang of the prior market and are attractive to investors. [As we've said before](#) - now is a good time to build a company. Early-stage activity has not been impacted as much as late-stage markets. Half of the VC deals in Q2 2023 were seed and Series A, raising \$7.2 billion that represented a quarter of the VC investment.

While VC fund formation increased in Q2 2023, it is nowhere near the levels we've seen recently. In some cases, existing funds haven't fully invested previous funds or deployed any capital from recently raised funds. Also, there could be a bit of portfolio diversification, as limited partners look to other more conservative or higher-yield opportunities in the market given the recent heavy concentration in the VC space.

Deals and dollars invested

Equity financings in US VC-backed companies, Q2 2023



Sources: Crunchbase as of July 4, 2023, *Crunchbase*, www.crunchbase.com, EY analysis. We include equity financings into VC-backed companies headquartered in the US. Sources of cash investments include but are not limited to, VC firms, corporate investors, other private equity firms and individuals.

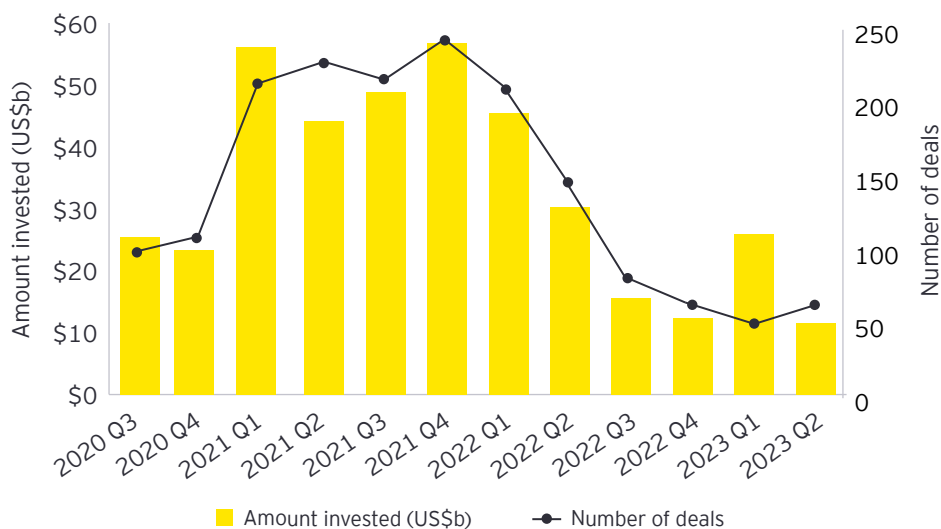
Mega-round financing

Mega-round financing in Q2 2023 raised \$11.5 billion, with an uptick by deal count after five consecutive down quarters. Fund deployment has slowed significantly as mega-round activity declined over the past several quarters and the market has entered a more measured pace.

While public markets remain closed, the environment is more challenging for companies seeking late-stage investments, as their return hinges on exit opportunities. Late-stage rounds are happening in this environment but far less than early-stage deals. As the IPO market thaws, we expect mega-rounds to pick back up.

Mega-round financing

Investments totaling \$100m+, Q2 2023



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Sectors

Information technology, healthcare and business and financial services ranked as the top three sectors for the quarter. Investment into healthcare increased by 10%, while both information technology and business and financial services declined by over 45%.

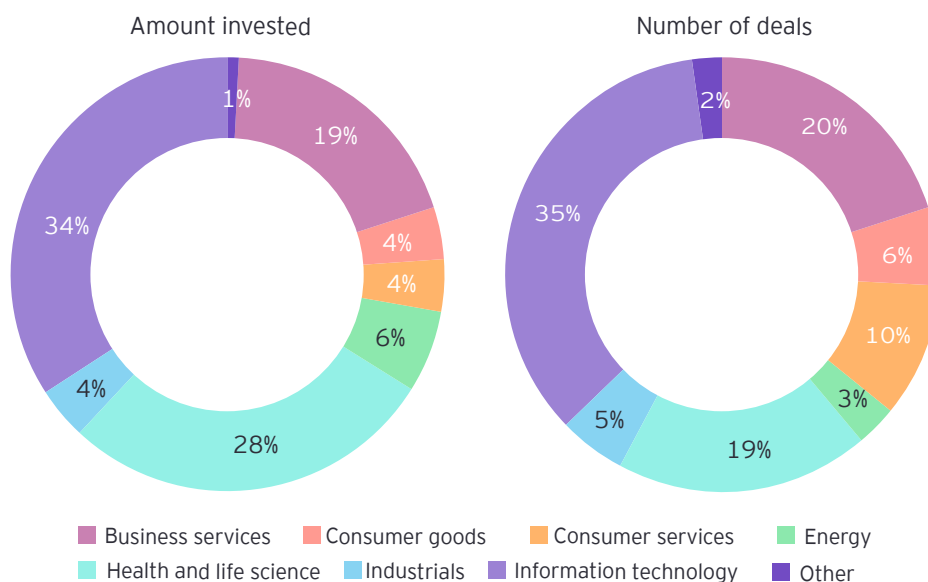
While software continues to lead the subsectors, we have yet to see a major increase in semiconductor deals since the passage of the CHIPS and Science Act by Congress in 2022. At some point, we would expect the provisions in the act to begin encouraging more activity among startups as well. This could contribute to a pickup in information technology investment, which encompasses computer software, networking and hardware.

Artificial intelligence (AI), particularly generative AI, has marked one of the few bright spots in the VC space this year, as a driving force behind software's lead among subsectors. So far in 2023, \$15.5 billion in funding has been directed to AI startups.¹

While many startups are pivoting to AI and adapting it into their business models, AI is capital intensive. Companies need to train and add data to the large language models that drive generative AI, which takes time and money. Still, we expect to see more companies integrate AI into their value propositions in the months ahead. Those that can demonstrate truly disruptive innovation will continue to attract investment.

Investment by sector

US VC investment across industries, Q2 2023



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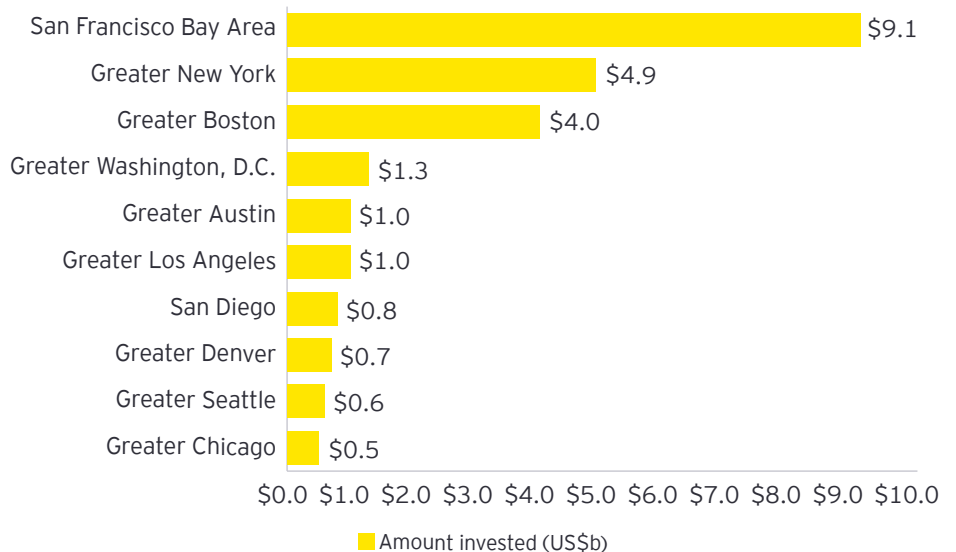
Regions

With only four deals in the top 10, the San Francisco Bay Area’s usual lead was reduced significantly. This quarter, the Bay Area only accounted for 31% of all dollars invested in the US vs. 40% on average. This quarter, New York City was second with 17% of capital invested, followed by Boston. These top three regions are much more closely clustered than usual.

Activity was muted in other regions, with Washington, DC moving ahead of Los Angeles to finish fourth in terms of dollars raised. Washington, DC had three mega deals, led by a \$260 million healthcare deal, while Los Angeles had just two mega deals for a total of \$270 million. In addition, the entrepreneurial ecosystem in Austin continues to perform at a brisk pace. The region finished sixth in overall dollar volume, driven in large part by FinTech activity.

Investment by region

US venture capital investment in top 10 markets, Q2 2023



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The overall market outlook for Q2 2023 and advice for entrepreneurs

The market may be settling into its new normal. A reset will favor companies with certain characteristics:

- 01 Be aware of your cash reserves and burn rates. Investors favor companies that **manage capital carefully**.
- 02 While you need to manage cash, you can't cut costs to achieve long-term value and sustainability. Maintain proper levels of investment for key initiatives that set the company up for the next level of funding.
- 03 Plan ahead and be aggressive in scheduling meetings with potential investors. Raising capital is a sales exercise. Focus on investors who believe in your value proposition. Founders should build a long-term relationship with investors, well in advance of needing capital.

While the market may be approaching a new equilibrium, roughly half of the US VC-backed companies in existence still need to raise capital in the coming quarters. This will test the founders' abilities to navigate the complexities of today's fundraising climate.

However, this remains a good time to build a company. Founders who are capable of tightening their belts and pivoting to take advantage of new opportunities, such as those presented by generative AI, will find ways to succeed in this market.

¹ Hodgson, Leah, "Herd mentality is alive and well as VCs chase AI craze," PitchBook, <https://pitchbook.com/news/articles/herd-mentality-venture-capital-AI>, accessed July 2023.

Summary

VC investment declined by 34% quarter over quarter. While headwinds continue to dampen the outlook, the market may be finally nearing a new normal, though a rapid turnaround is not expected this year. In the near term, founders need to continue to fine-tune their value proposition and focus on conserving cash. Despite these difficulties, this remains a good time to start a company.

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