Early Stage Fundraising in the Face of COVID

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The process of VC funding is a lagging indicator. For an entrepreneur to close on funding late in Q2, they would have had to start the process in the March-April time frame – right when the uncertainty of the COVID pandemic was generating shockwaves in the economy and in society. People were struggling to figure out how to operate in the new reality.

For companies strongly affected by the economic slow-down, many of the founding teams went to work stabilizing their operations and expenses and adjusting to revenue and forecast shortfalls. Applying for government assistance like the PPP loans also consumed time and attention. All of these survival activities temporarily suspended fundraising.

Another point, from the capital side, Q2 saw a flight to quality. Because investors were meeting and backing companies virtually for the first time and hearing about short term liquidity concerns from a portion of their LP base, investors sought out lower risk companies. The data supports this in that late stage growth rounds for tech companies did not see the same decline as earlier stages during Q2 and according to Crunchbase, there were 80 unicorn rounds in the quarter. However, seed funding was down materially quarter over quarter.

Thus, the pain is real, but it may be fading. I am encouraged by the US Census Bureau reporting that new business applications were up 4.8% vs Q1. The total number of venture financings in Q2 ended a 3-quarter decline according to PwC CB Insights MoneyTree

That said, like the rest of our lives, we still have a way to go before we return to any definition of "normal". Despite the headline grabbing IPOs in H1 2020, VC backed company M&As were down materially in Q2 compared with prior quarters. This could simply be the challenges corporations faced figuring out how to work. Add on top of that the challenges of executing M&A during the initial days of COVID. If this trend persists, it could have a material impact on venture investors and how deals are structured and priced. Further, seed financings were down materially in Q2. If this persists, obviously, later stage financings will ultimately suffer as well.

The IPOs and exits, including the ones from our portfolios, represent the harvest of seeds planted years ago. Now that we have adapted to the "new" normal, we will see if the new seedlings take root. Q2 represented a missed season of planting as entrepreneurs figured out how to survive and grow in a pandemic.

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