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The Innovation Economy Outlook

H2 2024

Executive Summary

We are starting to see signs of improvement across the Innovation Economy. The Fed is expected to start lowering rates in Q3 2024, and the U.S. still looks on track for a "soft landing." The knock-on effects could be meaningful for the Innovation Economy. More certainty would provide a boost of confidence to investors who have slowed their pace, companies waiting to go public could take the plunge and would-be acquirers might shed their hesitation and make deals. A meaningful capital release from increased exit activity would alleviate a tight fundraising environment for both investors and founders and help close the divide between the "haves" and the "have-nots." Currently, 2024 is on a similar trajectory to 2023, which by most metrics was a weak year (in this decade) for venture. The big question is whether improvement will continue, or if changes in macroeconomic factors combined with a looming U.S. election will stall the recovery.

- Melissa and John

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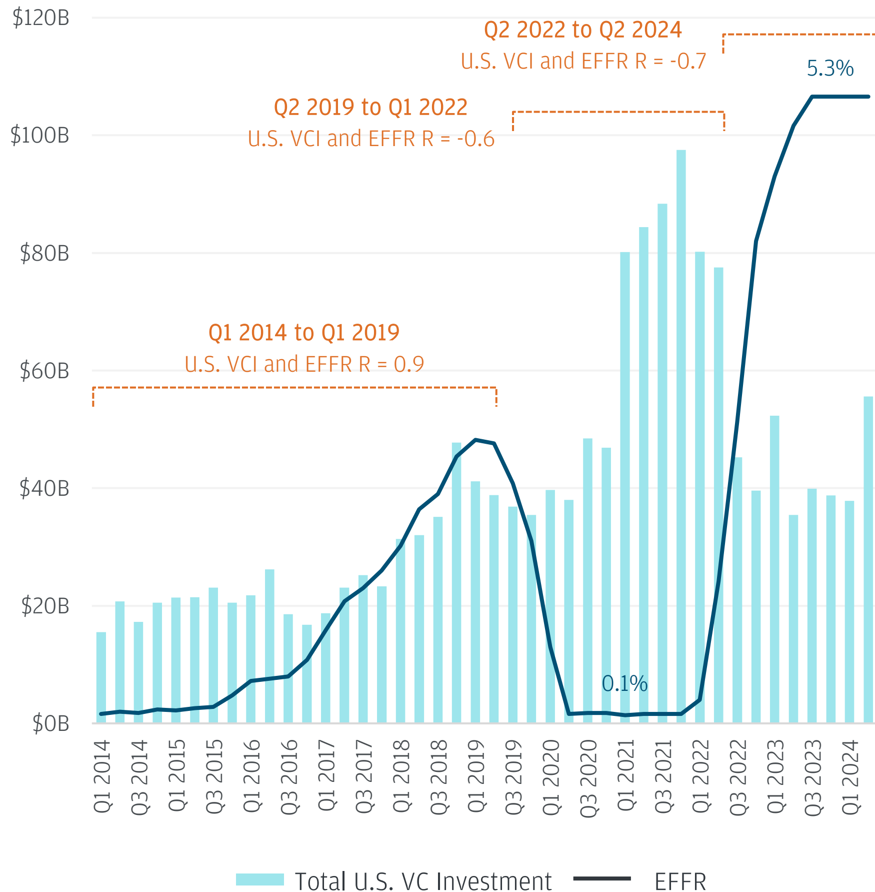
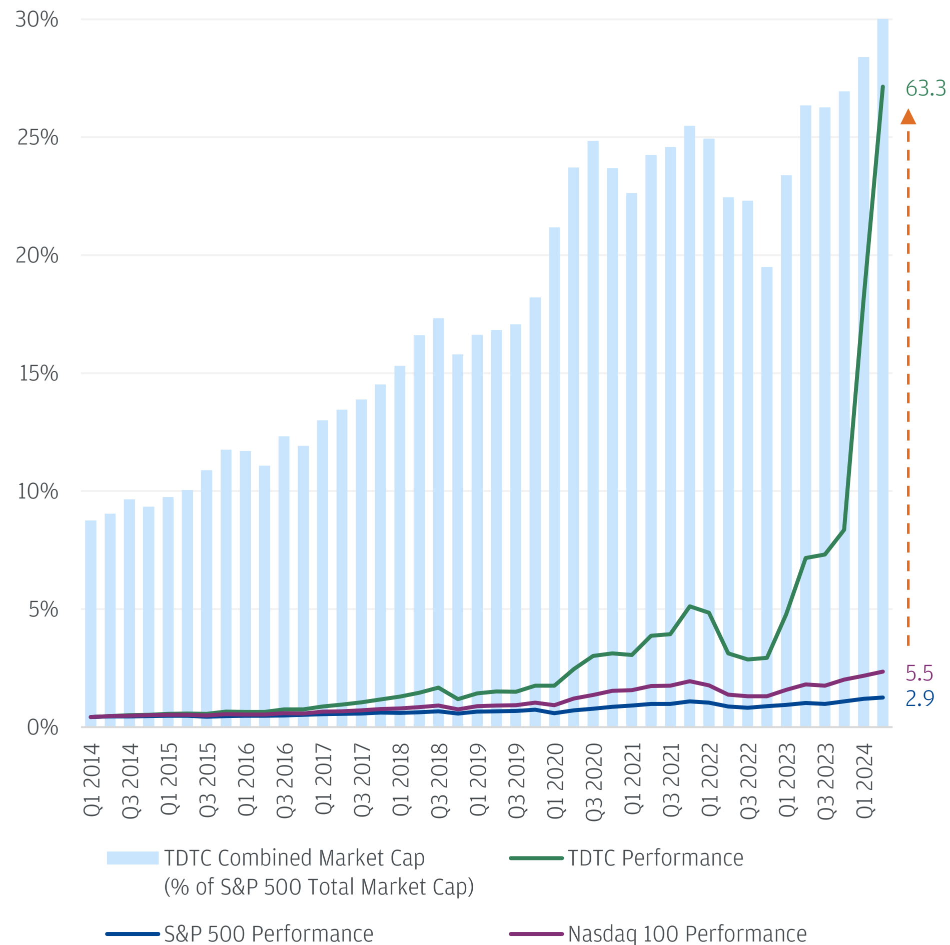
04 | Macroeconomic Factors

U.S. venture investment starts to heat up; trillion-dollar tech companies are red-hot!

TOTAL U.S. VC INVESTMENT (VCI) COMPARED TO THE EFFECTIVE FED FUNDS RATE (EFFR)



TRILLION-DOLLAR TECH COMPANIES[1] STOCK MARKET CONCENTRATION AND PERFORMANCE[2]



As the Federal Open Market Committee dropped the Federal Funds target range to 0-25bps during the pandemic, venture capital investment ramped up before peaking in 2021. Following rate hikes in Q1 2022, investment fell back to pre-pandemic levels. The most recent quarter did see a jump in VC investment, perhaps signaling the start of a new upcycle. Public markets have performed well since the end of 2022, driven by a group of trillion-dollar tech companies that combined make up 32% of the total market capitalization of the S&P 500 (as of Q2 2024). For some, this may be reminiscent of a bubble. However, their fundamentals are strong, and businesses diversified.

Notes: (1) Trillion-Dollar Tech Companies (TDTC) includes AAPL, MSFT, NVDA, GOOG, AMZN, META, (2) Indexed (Q1 2014 = 1.0).

Sources: Federal Reserve, Bureau of Labor Statistics, PitchBook, Bloomberg, J.P. Morgan proprietary analysis, PitchBook. Data has not been reviewed by PitchBook analysts.

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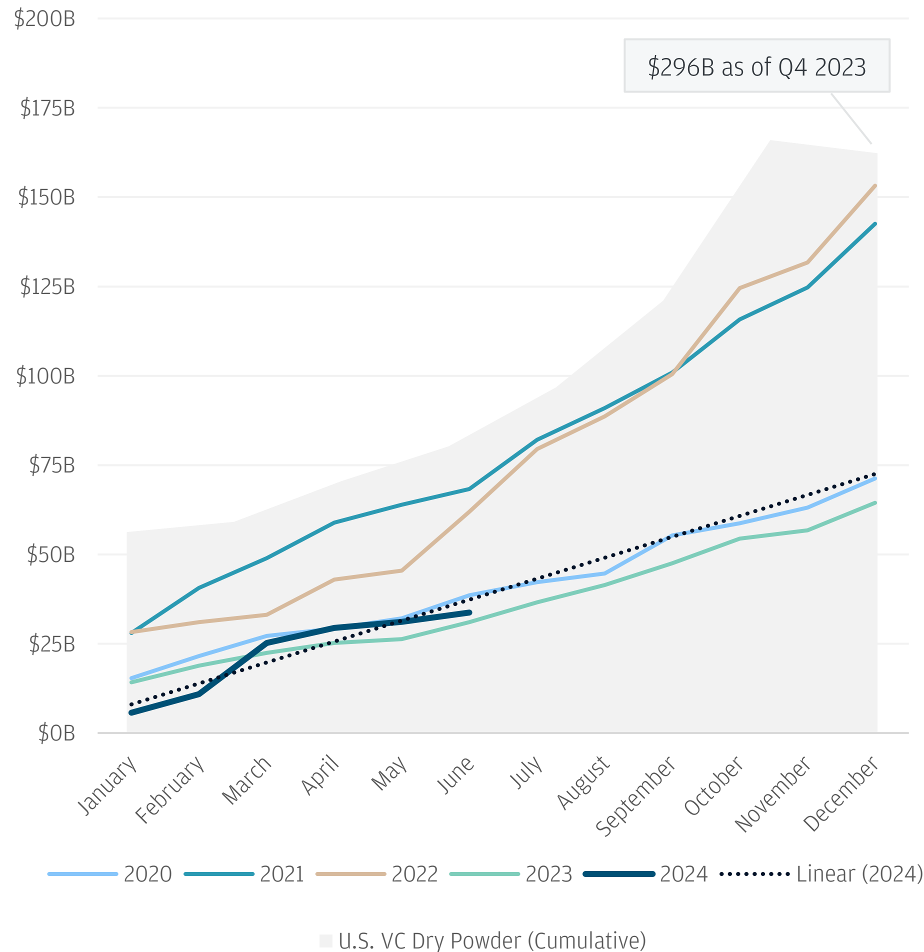
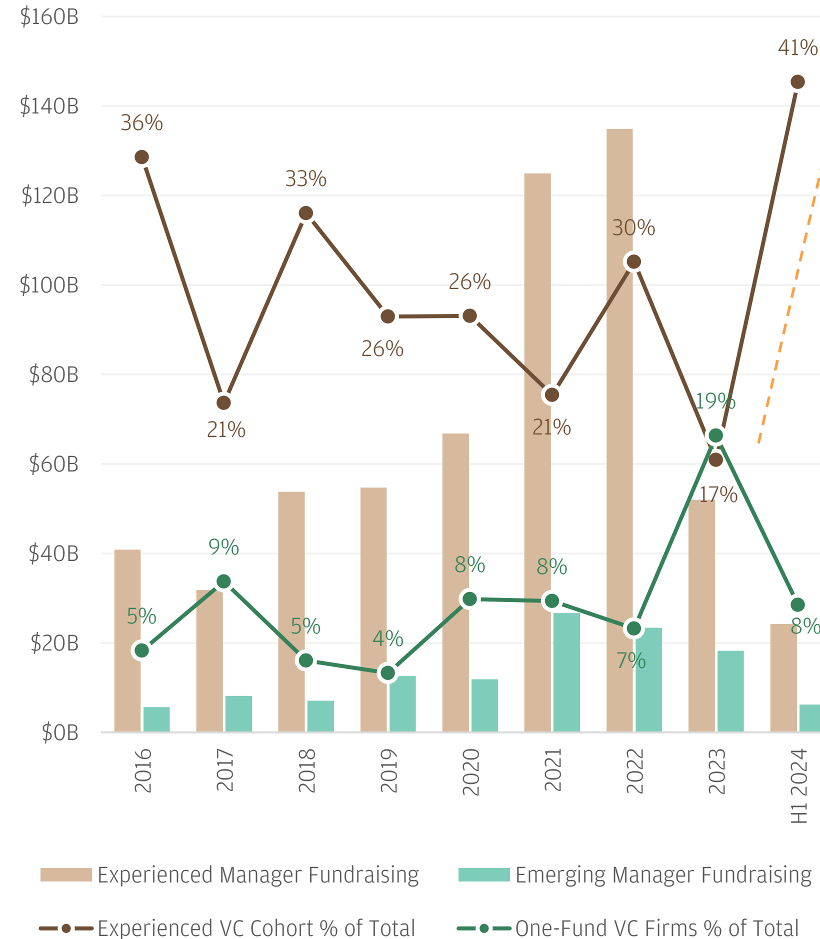
06 | Venture Fundraising

Fundraising challenged; emerging managers are feeling it the worst

CUMULATIVE U.S. VC DRY POWDER AND FUNDRAISING ACTIVITY



EXPERIENCED VS. EMERGING MANAGER FUNDRAISING ACTIVITY[1,2]



At nearly $300B, U.S. Venture Capital (VC) dry powder remains near an all-time high, due to the massive influx of capital that was raised in 2021 and 2022. Fundraising in 2024 is trending in line with 2020, which was a record year for fundraising up to that point, but a stark contrast to what followed. Today, funds are having a harder time raising capital, especially emerging managers. In tougher times, Limited Partners tend to be more risk-averse and therefore allocate capital to established managers (for their proven track records). Still, emerging managers remain a vital part of the ecosystem as they bring new perspectives and strategies, essential for identifying overlooked opportunities and supporting underrepresented groups.

Notes: (1) Emerging manager defined as having raised less than three funds; experienced manager defined as having raised three or more funds. (2) Experienced VC cohort includes 30 VC firms selected based on tenure and performance.

Sources: PitchBook and J.P. Morgan proprietary analysis. Data has not been reviewed by PitchBook analysts.

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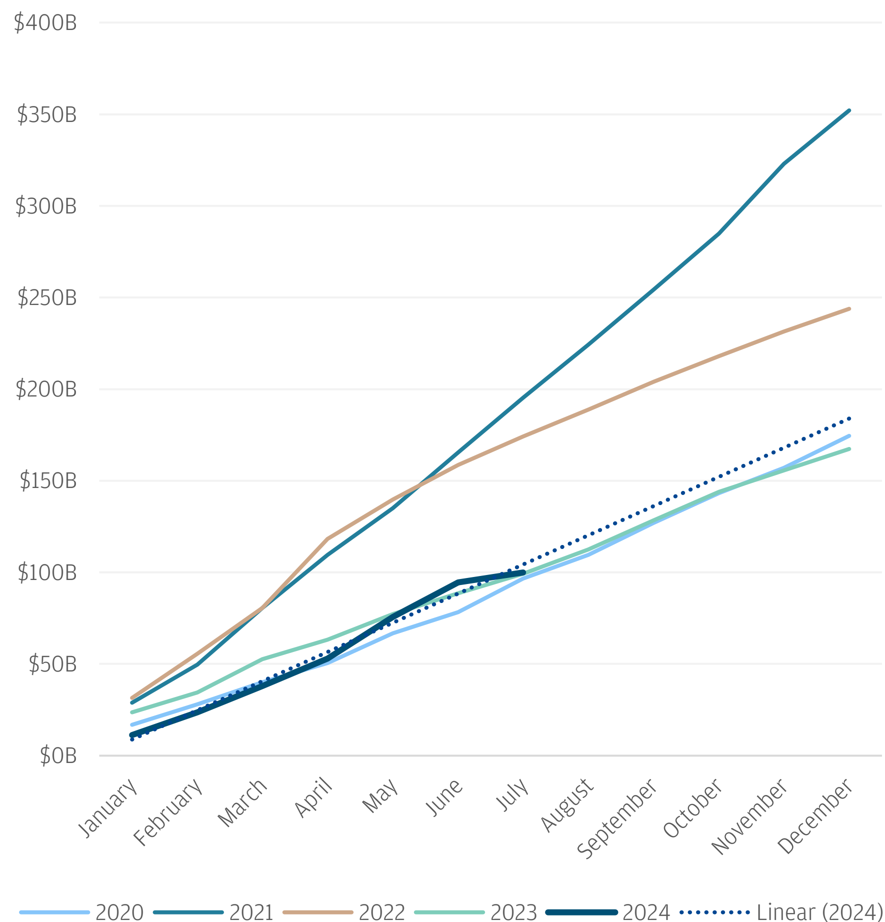
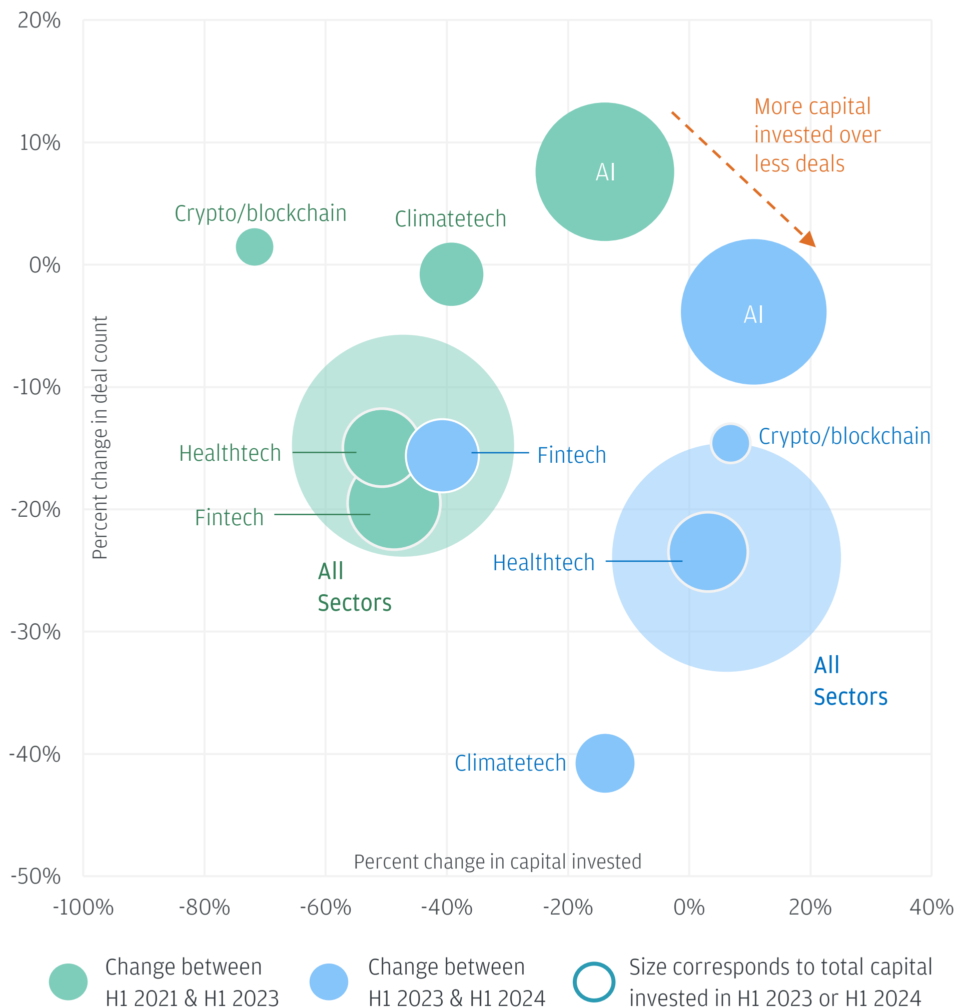
08 | Venture Investment

Is venture investment starting to turn the corner?

CUMULATIVE U.S. VENTURE INVESTMENT ACTIVITY



CHANGE IN DEAL COUNT AND CAPITAL INVESTED FOR SELECT SECTORS



A bright spot has been the recent uptick in venture investment, which, if the trend materializes, would see an improvement over 2023. It would also be similar to 2020, which was, at the time, a high-water mark for venture. Deal count is still lower for most sectors, which has meant deal sizes have increased, especially for Artificial Intelligence (AI), Healthtech and Climatetech. The number of deals over $100M as of H1 2024 was 169. Annualizing this trend gives 338 deals, which is ~30% more than in 2023, but in line with 2020. AI represents ~20% of capital invested in $100M+ deals, compared to ~15% for all venture deals. Whether 2024 will exceed or fall short of 2023 depends on the continuation of investment in hot sectors like AI.

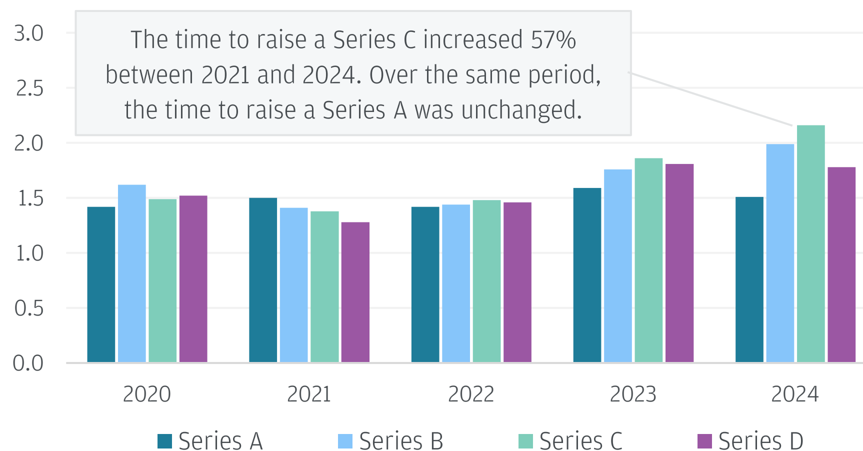
Sources: PitchBook. Data has not been reviewed by PitchBook analysts.

Late-stage struggles shift focus to the early-stage

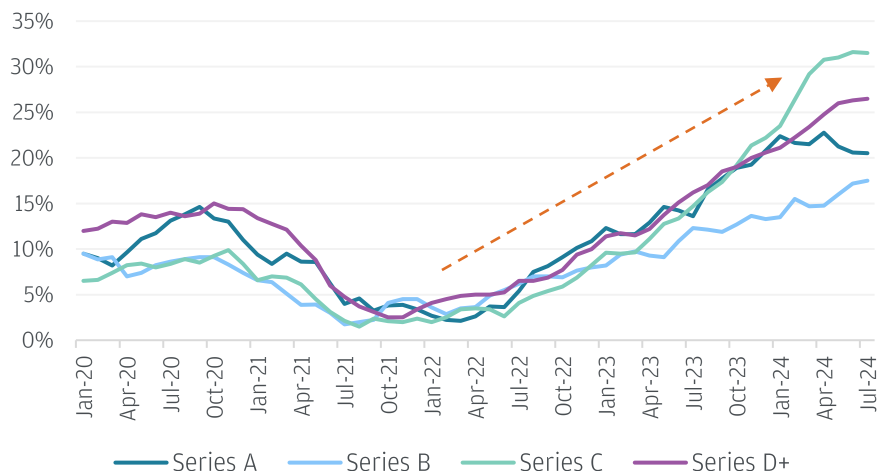
U.S. VENTURE DEALS BY SERIES (SHARE OF TOTAL DEALS)

Year	Seed	Series A	Series B	Series C	Series D+
2020	57%	22%	10%	5%	6%
2021	56%	21%	11%	5%	7%
2022	61%	21%	9%	4%	5%
2023	64%	20%	8%	4%	4%
2024[1]	62%	20%	10%	4%	4%

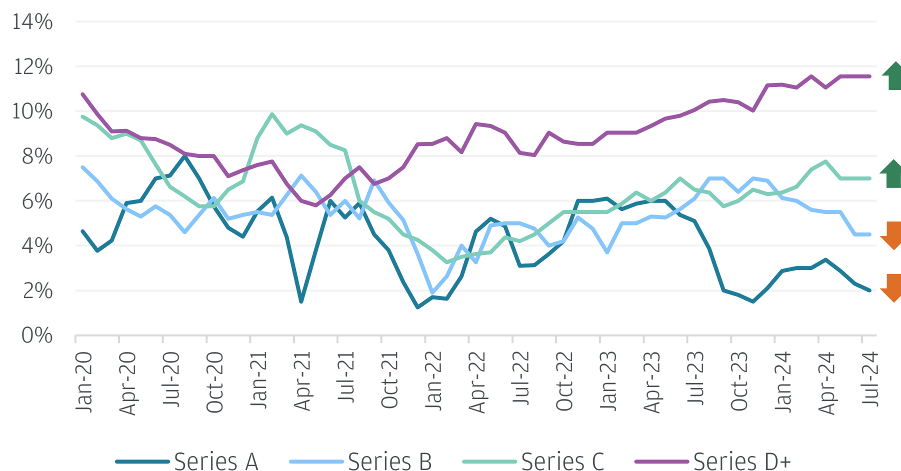
MEDIAN YEARS BETWEEN VENTURE ROUNDS



DOWN ROUNDS[2] BY SERIES (SHARE OF TOTAL DEALS)



FREQUENCY OF PARTICIPATING LIQUIDATION PREFERENCE[3] BY SERIES



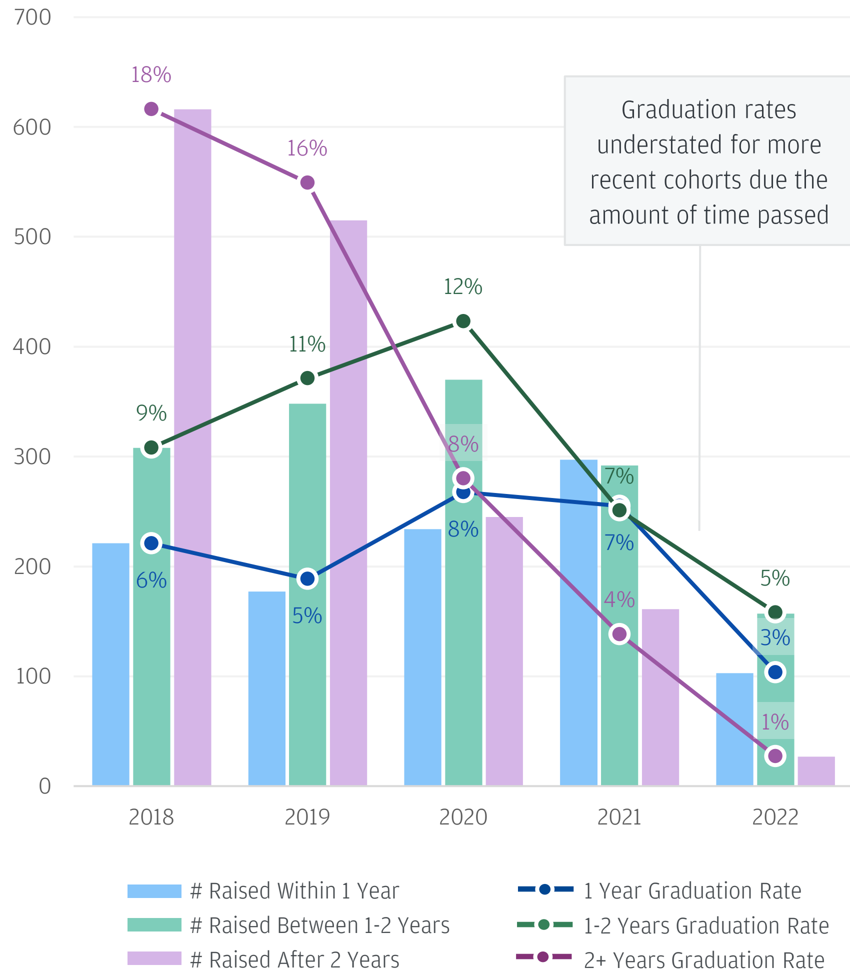
The decline in late-stage venture activity (since 2021) has been well documented, as the most active investors (many "crossover" or "non-traditional") pulled back. Stifled by heightened valuations, investors shifted their focus to the early-stage. This extra attention is likely one reason why the time to raise a Series A round has remained flat, compared to later-stages where it has risen significantly. The combination of valuation hangovers from 2021 and moderating growth rates has meant more companies have had to take a down round to raise additional funding. A rise in less founder-friendly terms, especially for later-stage deals, also signals a tighter fundraising market.

Notes: (1) Data through 7/10/24. (2) A down round is when a new round is raised at a lower valuation than the previous round. (3) Participating liquidation preference gives investors a greater share of value and is considered less founder-friendly.

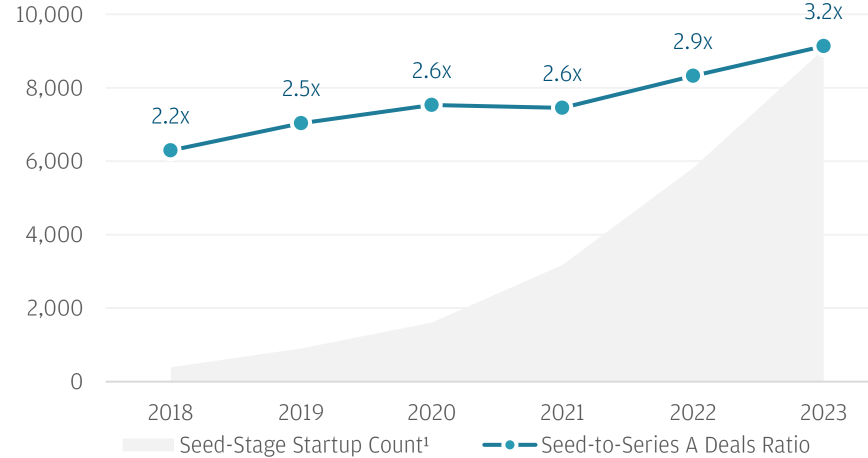
Sources: Aumni (Down Rounds by Series, Frequency of Participating Liquidation Preference by Series), PitchBook. Data has not been reviewed by PitchBook analysts.

Seed-stage startups face increased competition and a higher bar to raise again

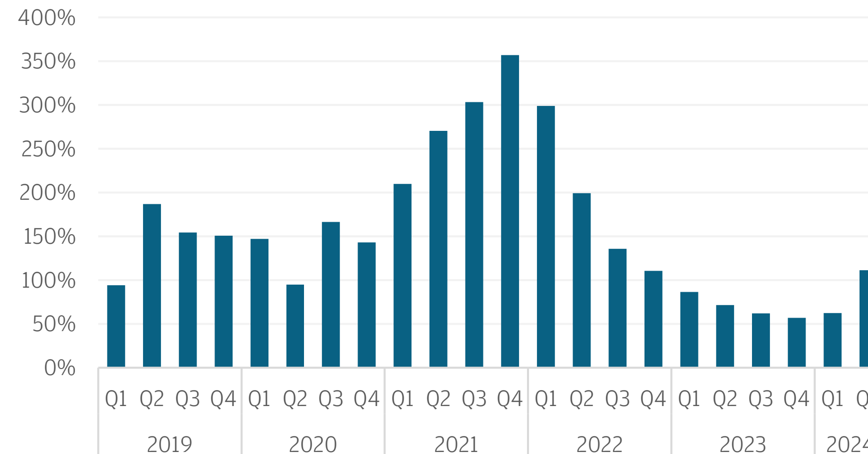
SERIES A FUNDRAISING RATES BY YEAR OF SEED ROUND



U.S. SEED STARTUP BACKLOG AND SEED-TO-SERIES A DEAL RATIO



MEDIAN POST-MONEY VALUATION MARKUP (SEED TO SERIES A)



The advice for startups in 2021, when venture capital was abundant, was "raise while you can." The number of Seed and Series A deals peaked, and valuations were driven higher due to intense investor demand. Since 2021, the number of Seed and Series A deals dropped 30% and 43%, respectively. The consequence is fewer Seed-stage startups raising a Series A. Part of the challenge is the generous Seed deal valuations handed out in 2021. Valuation markups have come down considerably since, even though investor expectations have risen. Before $1M in ARR[2] would have been sufficient to raise a Series A, now investors are now looking for $3M ARR and substantial growth.

Notes: (1) Cumulative count since 2018. (2) ARR = Annual Recurring Revenue.

Sources: Aumni (Median Post-Money Valuation Markup), PitchBook. Data has not been reviewed by PitchBook analysts.

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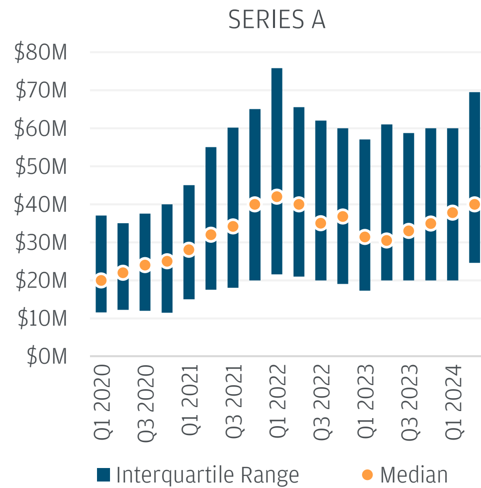
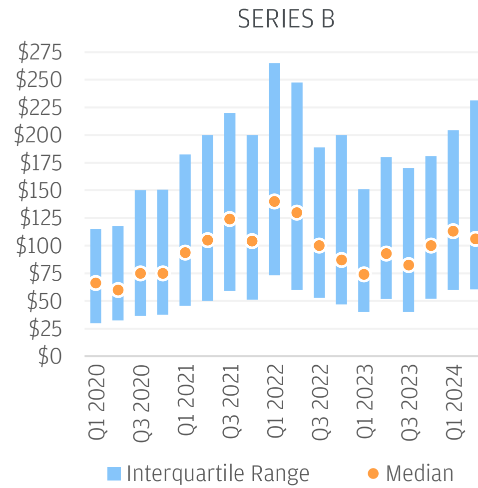
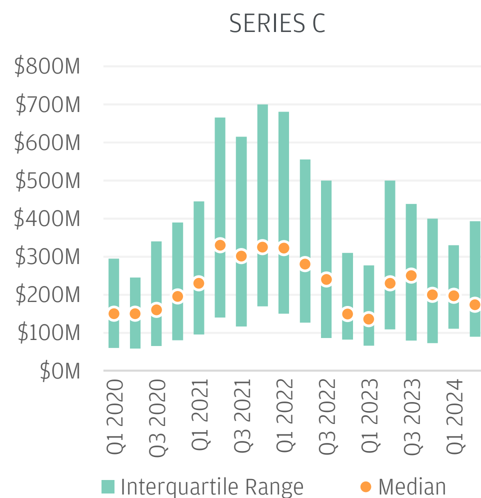
12 | Valuations

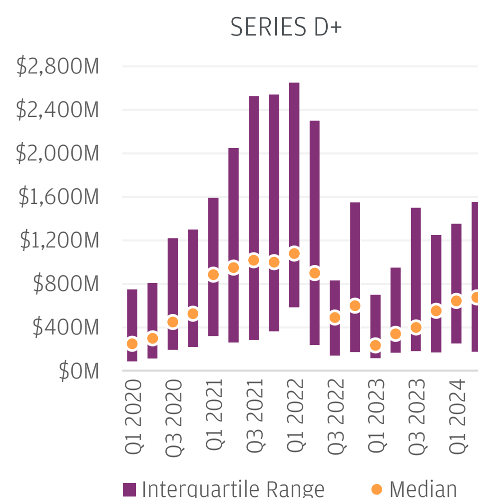
Rebounds in valuations mask a tight fundraising environment

U.S. PRE-MONEY VALUATIONS BY SERIES

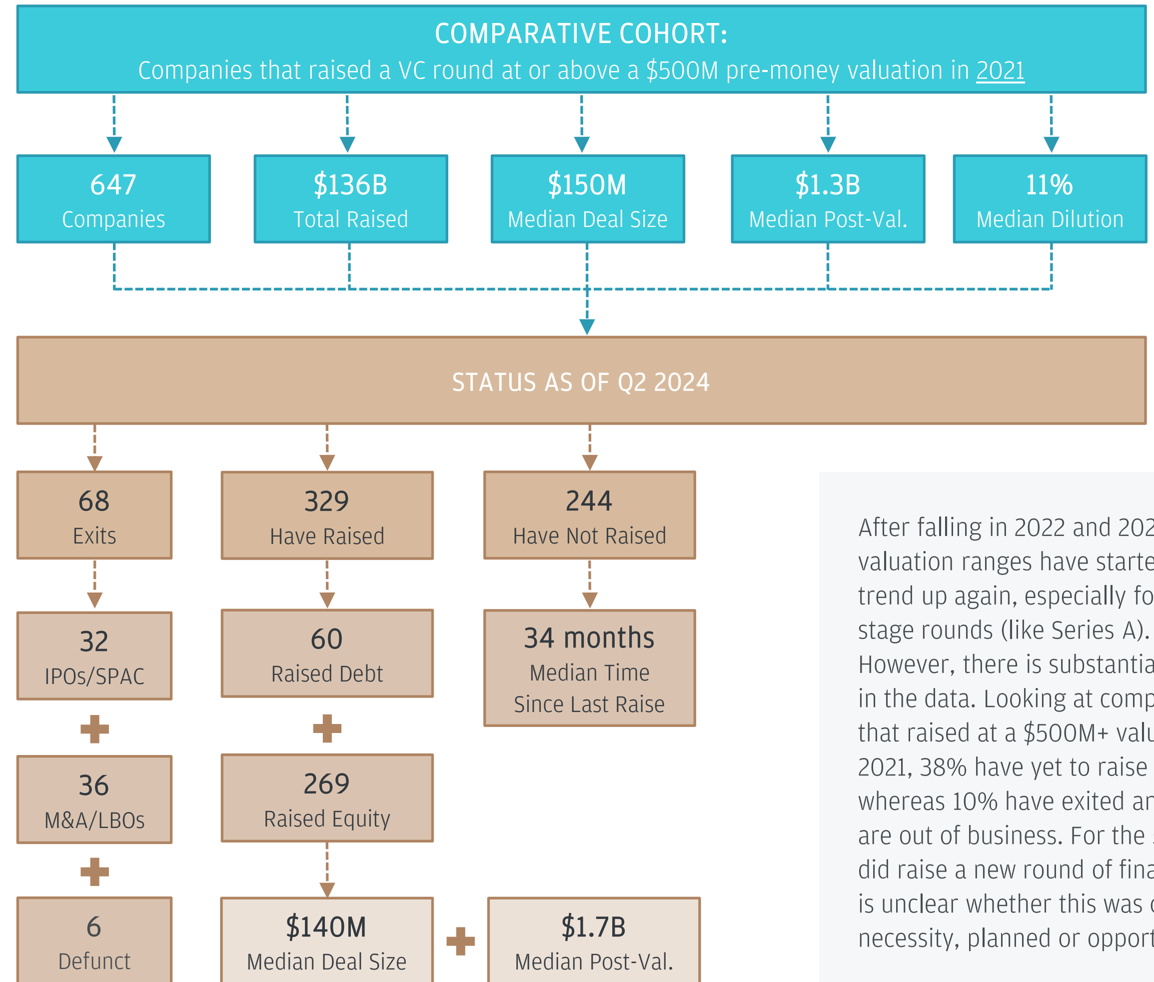








LATER-STAGE COMPANY COHORT FUNDING ANALYSIS

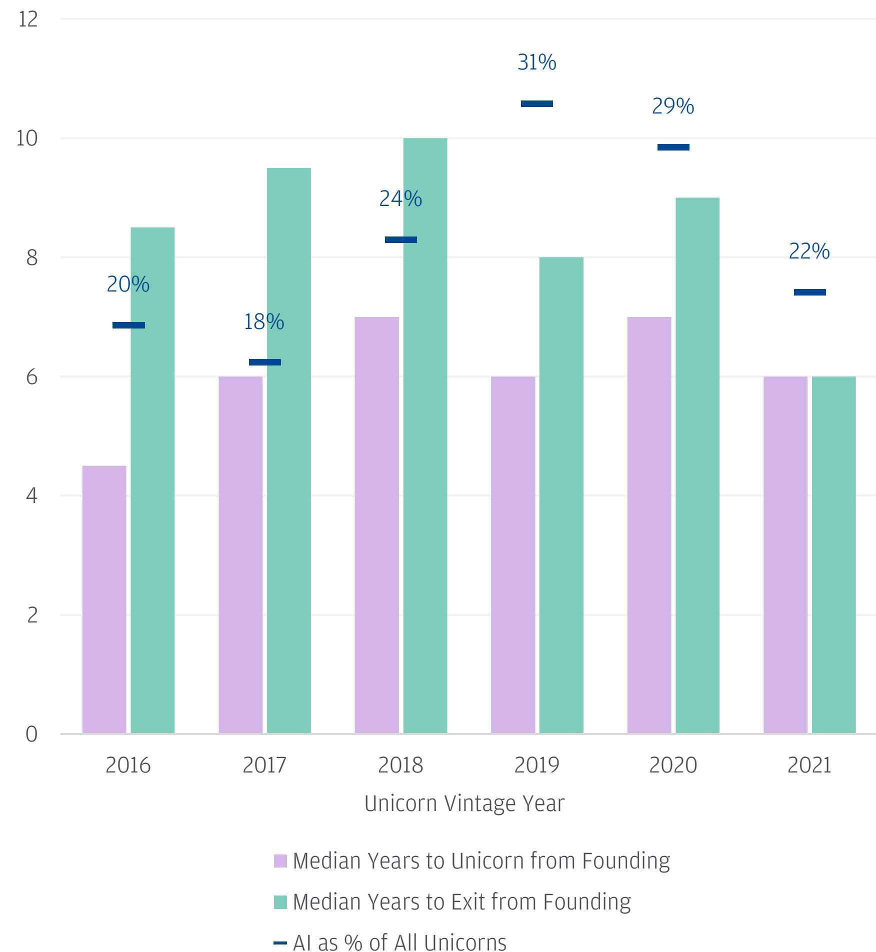


After falling in 2022 and 2023, valuation ranges have started to trend up again, especially for early-stage rounds (like Series A). However, there is substantial nuance in the data. Looking at companies that raised at a $500M+ valuation in 2021, 38% have yet to raise again, whereas 10% have exited and 1% are out of business. For the 51% that did raise a new round of financing, it is unclear whether this was out of necessity, planned or opportunistic.

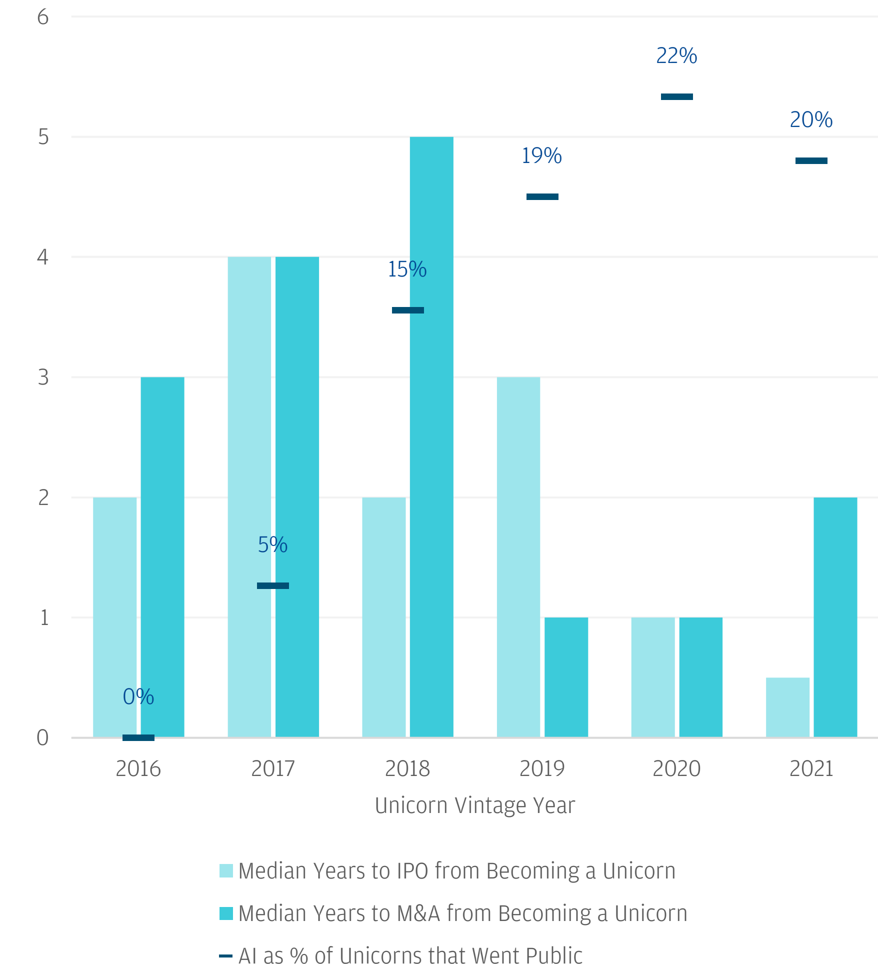
Sources: PitchBook, and J.P. Morgan proprietary analysis. Data has not been reviewed by PitchBook analysts.

AI-corns; future thoroughbreds or wonky donkeys?

TIME FROM FOUNDING TO BECOME A UNICORN AND EXIT, SHARE OF ARTIFICAL INTELLIGENCE (AI) UNICORNS



TIME FROM BECOMING A UNICORN TO IPO OR M&A, SHARE OF ARTIFICAL INTELLIGENCE (AI) UNICORNS



The time to become a Unicorn was stable between 2017 and 2021 at approximately six years. The time to exit fell in 2021, due to the buoyant IPO market. This is highlighted by the time between achieving Unicorn status and exiting via an IPO. The IPO market in 2021-2022 cleared out longer-tenured Unicorn companies and gave the opportunity for newly minted Unicorns to exit sooner in 2021—within six months of becoming a Unicorn. Still, Unicorn exits are rare; only 16% of Unicorns have exited since 2016. In today's tight exit environment, some are struggling, while others in hot sectors like AI may prefer to stay private indefinitely. "Forevercorns" can grow without the pressure and costs of being a public company and still access ample private capital.

Notes: (1) Exits include IPO, SPAC and M&A.

Sources: PitchBook. Data has not been reviewed by PitchBook analysts.

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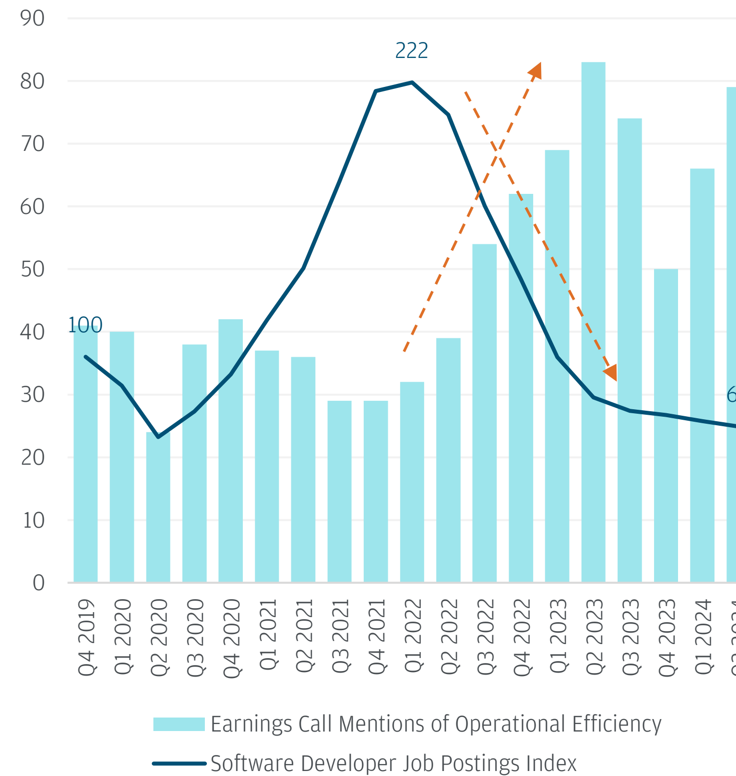
15 | Startup Operations

Startups weigh the balance between growth and profitability

RULE 40[1] AS OF Q2 2024 FOR SELECT PUBLIC SAAS COHORTS

PUBLIC COMPANY SENTIMENT INDICATORS



Cohorts	Rule 40 Average	TTM Revenue Growth Average	EBITDA Margin Average
2021 SaaS IPOs	-1.7%	19.1%	-20.8%
2022-2023 SaaS IPOs	-23.7%	0.9%	-24.6%
SaaS Benchmark	10.7%	14.7%	-3.9%

"Rule 40" shows most public SaaS companies falling below the line. In a toughening economic environment, cutting expenses to raise margins is likely more feasible than growing revenues. The rise in earnings call mentions of "operational efficiency" speaks to a focus on operational improvements (mentions of Artificial Intelligence are also elevated) and talent rightsizing (through hiring freezes, outsourcing and layoffs). For SaaS companies, talent is one of the largest costs. As mentions of "operational efficiency" started increasing in late 2022, the number of job postings for software developers began declining as demand cooled amidst economic uncertainty, cost pressures and the advancement of AI automation.

Notes: (1) Rule 40 is a measure of operating performance for SaaS companies calculated as TTM revenue growth (x-axis) + EBITDA margin (y-axis).

Sources: PitchBook, Bloomberg, Indeed, and J.P. Morgan proprietary analysis. Data has not been reviewed by PitchBook analysts.

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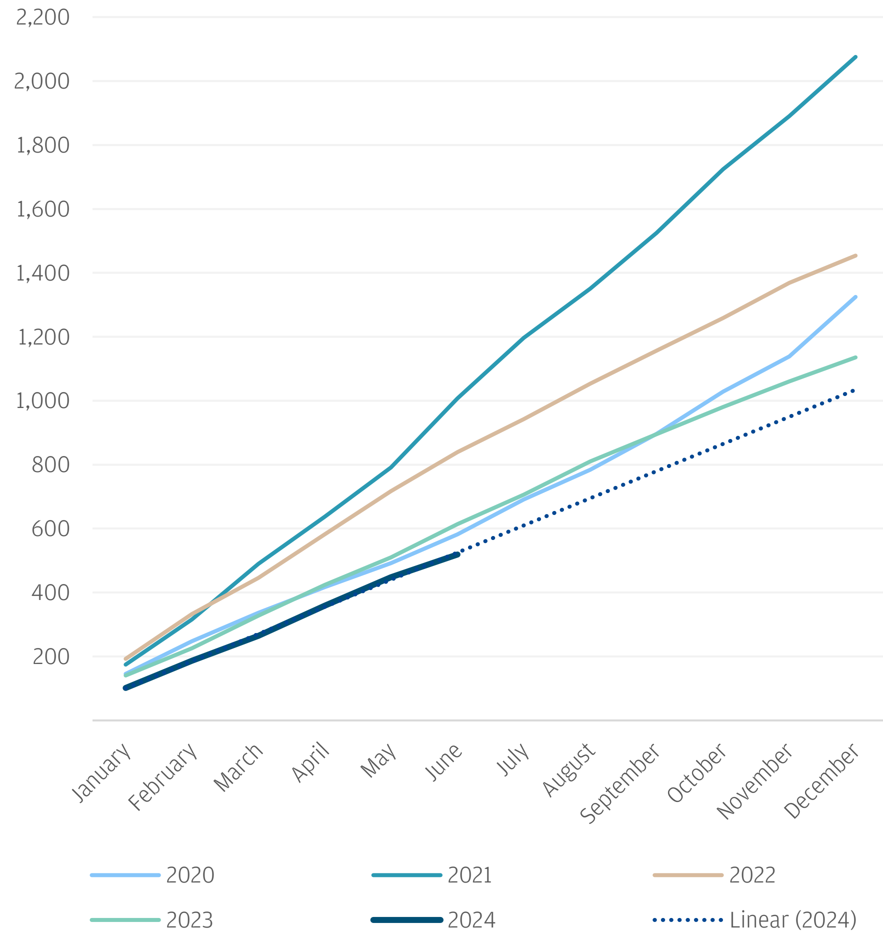
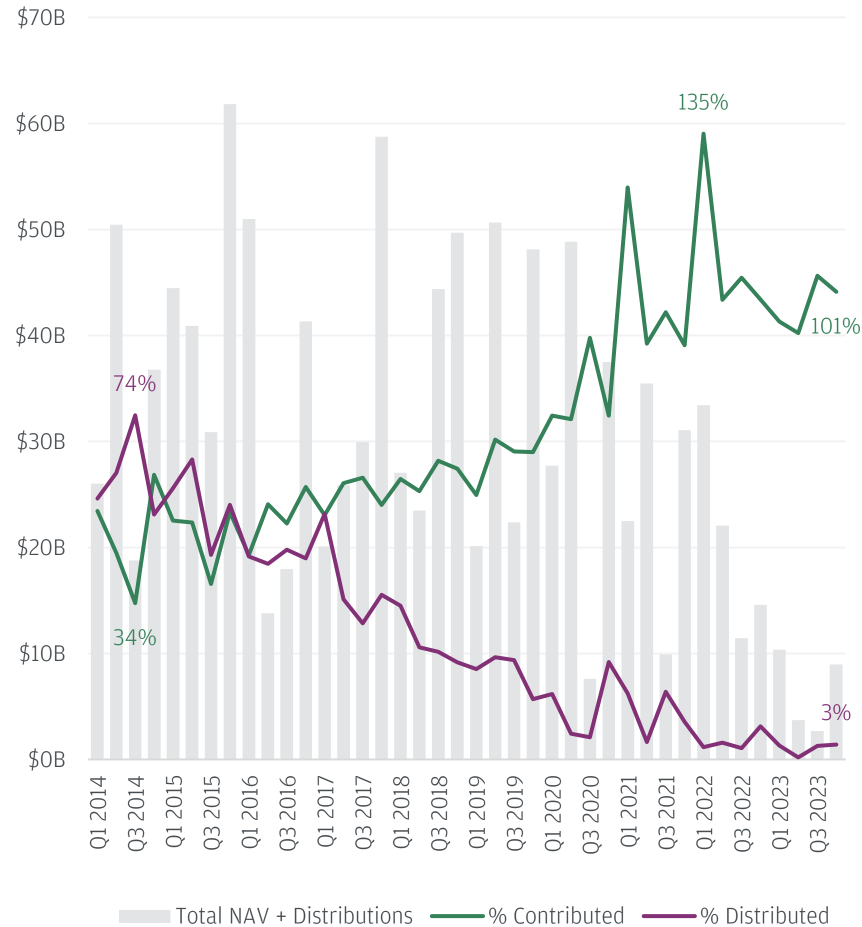
17 | Exit Activity

A dry spell for liquidity events hurts the recycling of capital

CUMULATIVE MONTHLY U.S. VENTURE-BACKED EXITS[1]



VENTURE CAPITAL FUND PERFORMANCE[2] BY CLOSED YEAR

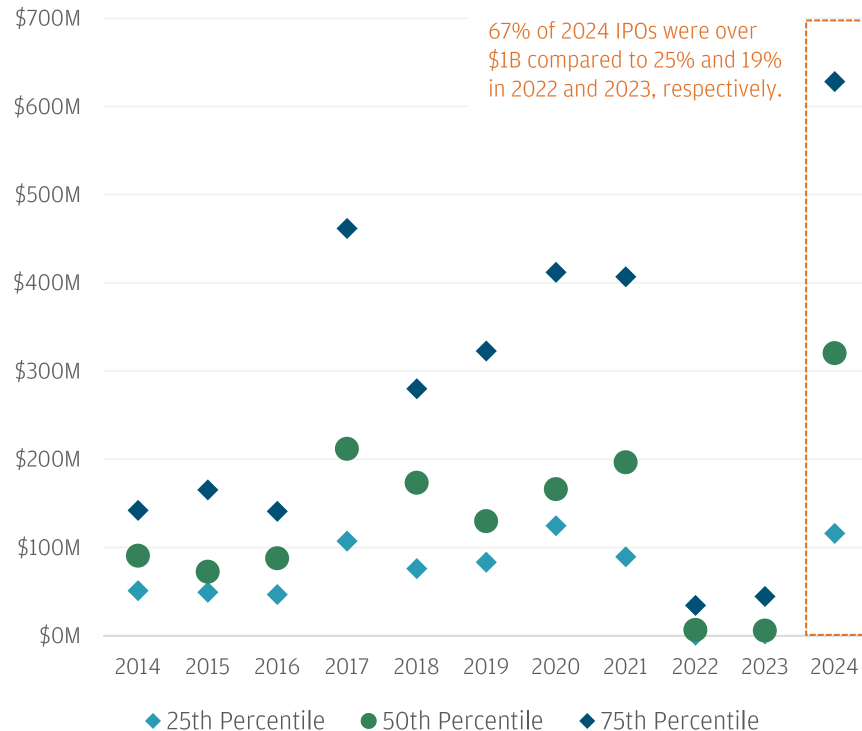


Total U.S. venture-backed exits are trending below 2023, which would be the lowest level of activity over the period. For M&A and buyouts, price setting has been a challenge combined with greater scrutiny by buyers and a more stringent regulatory landscape. M&A is confidence driven; with uncertainty around the trend in macro-economic indicators and a U.S. presidential election, many may wait for more certainty before acting. Distributions are few and far between with fund lives being stretched beyond 10 years. The term zombie funds has been coined—where GPs are managing out existing portfolios due to an inability to raise new funds.

Notes: (1) Exits include IPOs, M&A, Buyouts and SPACs. (2) NAV stands for Net Asset Value and is the value of the holdings of a fund.

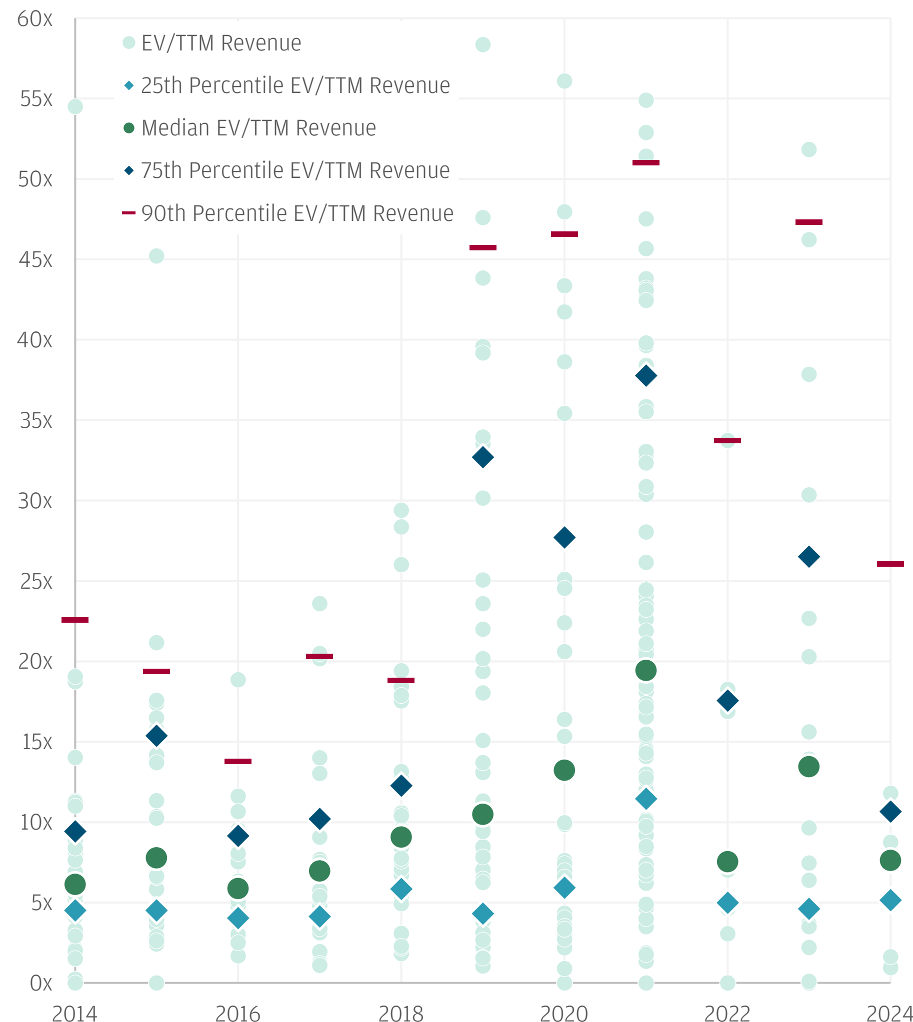
Sources: PitchBook and J.P. Morgan proprietary analysis. Data has not been reviewed by PitchBook analysts.

IPO woes for all but the largest technology companies



Ref.	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024
A	$603M	$525M	$480M	$1.1B	$1.2B	$1.4B	$2.5B	$4.3B	$98M	$80M	$6.6B
B	37%	42%	49%	34%	38%	48%	41%	54%	14%	19%	NM
C	31%	18%	33%	26%	25%	24%	21%	32%	27%	24%	NM

A = Median market capitalization, B = Median revenue growth, C = Percent of companies FCF positive



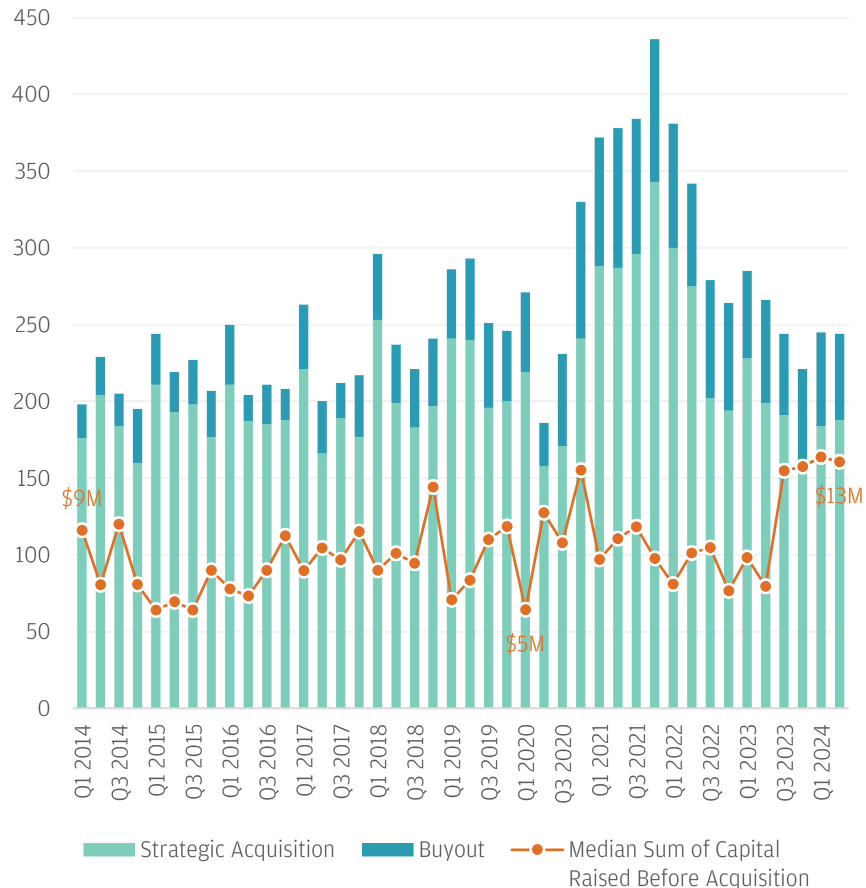
IPOs have recovered from the lull of 2022 and 2023, with 2024 on track to pass both years, just shy of pre-pandemic levels. VC-backed IPOs are not faring as well. Companies are still reluctant to exit, with 2024 trending like 2022 and 2023, surprisingly, given the exceptional market performance of TDTC's and low levels of market volatility. As of Q2 2024, 85% of tech IPOs since 2022 traded below their IPO market capitalization. The revenue bar has been raised, from sub-$100M in 2022 and 2023 to $300M in 2024. Many are stuck between a high private market valuation and lower public market valuation multiples. Still, filing activity indicates there might be a burst of activity in Q3 before tapering off into the election.

Notes: (1) Trailing twelve months. (2) VC-backed and listed on a major U.S. exchange. Companies grouped by year of IPO.

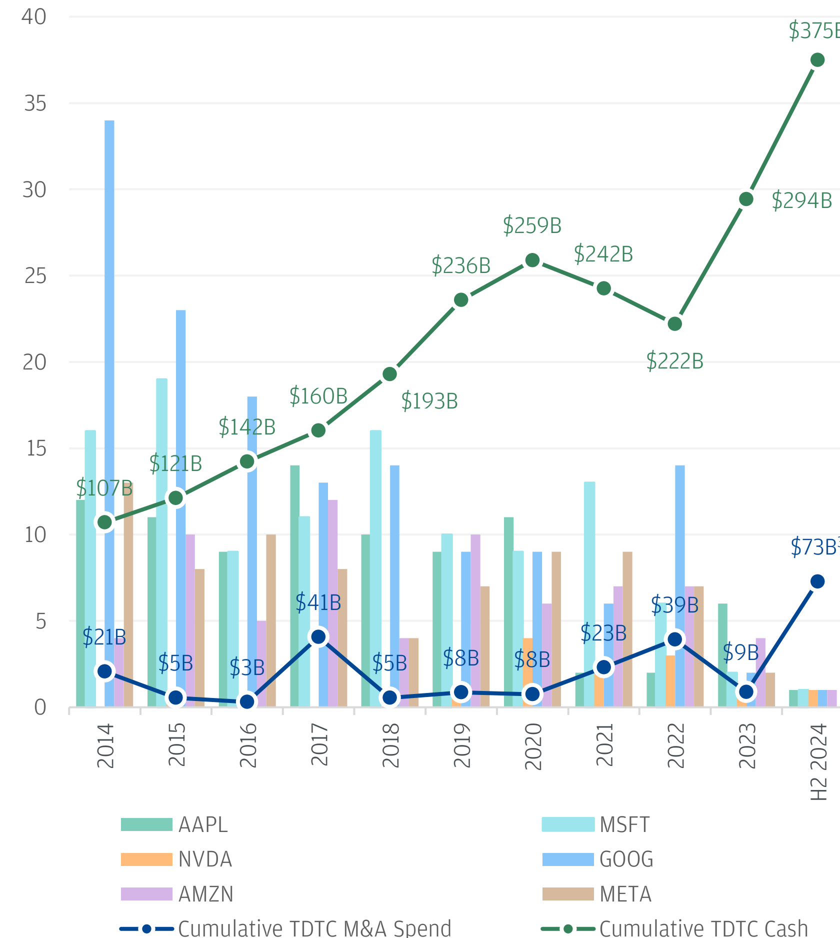
Sources: PitchBook and J.P. Morgan proprietary analysis. Data has not been reviewed by PitchBook analysts.

Buyers are hitting pause on acquisitions

STRATEGIC ACQUISITION AND BUYOUT ACTIVITY[1]



TRILLION DOLLAR TECH COMPANIES (TDTC) M&A ACTIVITY[2]



The pace of acquisitions of VC-backed companies has been subdued since 2022. M&A transactions are trending in line with 2023, while Buyout deals are tracking significantly below 2023. Heightened interest rates, especially for PE buyers and pricing divides, have been the biggest headwinds. TDTC's have slowed their acquisition pace in recent years, and not because of a lack of liquidity given the combined cash balances of these companies is greater than the GDP of 150 nations. More so, regulators in the U.S. and Europe have been stricter on allowing (big) tech M&A while a higher cost of capital and inflated private valuations have made the economics of certain deals less appealing.

Notes: (1) Targets are U.S.-based, VC-backed companies. (2) Data is inclusive of companies based globally from all universes (VC-backed, PE-backed, etc.). (3) Includes Microsoft's $68B acquisition of Activision/Blizzard.

Sources: Bloomberg, Company Reports, PitchBook, and J.P. Morgan proprietary analysis. Data has not been reviewed by PitchBook analysts.

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