A WORD FROM DELOITTE

Venture capital chronicles of 2023: Pioneering artificial intelligence, course corrections, and uncharted waters

Over the years, the ups and downs of VC have resulted in tumultuous and tremendous moments, from global economic downturns to profound advancements in technology. It can be challenging to have a pulse on today's challenges and tomorrow's opportunities without having extensive knowledge about the industry's history. Thankfully, we can lean on resources like Heather Gates, who has over 30 years of experience in venture capital and presents deep knowledge of VC's past and present. Journey further to learn Heather's insights about the climate of the venture capital ecosystem and what the future may hold.

Exploring the current landscape

AI has dominated the news cycles to the point you may be tuning it out, but it's here to stay (for the better) in every industry, and that's especially true in venture capital investing. The evolution of AI has skyrocketed to become more robust every day, fueling valuations and growth in the industry. We're only beginning to scratch the surface of the impact that AI will have on new, innovative companies, which is especially interesting as they are notorious recipients of VC investment. For example, in the audit world, AI has the potential to tackle mundane tasks such as data collection, processing, and repeatable tasks so people can feel more fulfilled in their work by focusing on strategic and complex areas that require creativity, dexterity, and empathy—all skills that depend on human emotional intelligence.

Although AI is hot, other sectors of venture capital investing are decidedly cooler. It's been a year of reset with necessary corrections to return to long-term stability. Over the course of the past two years, the value of companies hit astronomical highs,[1] and the influx of overpriced, overvalued companies created instability. Another factor at play is a less robust IPO market, which is a key driver for investing and valuation activity. In this case, what went up needed to come down. But as valuations course correct to a traditional level, interest from venture capitalists and corporate buyers is expected to be on the rise.

Another factor that is following an upward trajectory is the increased focus on addressing diversity, equity & inclusion (DEI) issues. The venture capital industry recognizes that women, racially and ethnically diverse individuals, and other historically underrepresented groups have been excluded from equal opportunities to manage venture funds or hold investment decision-making positions. There's also been growing interest in supporting historically underrepresented founders and investing in diverse teams, which is just one of the data points highlighted in the interactive VC Human Capital Survey Dashboard powered by Deloitte, Venture Forward, and the National Venture Capital Association.[2]

Heather Gates
Audit & Assurance
Private Growth Leader
Deloitte & Touche LLP

With more than 30 years of financial services experience, Heather serves as the national Private Growth Leader, with oversight of the Deloitte Private, Emerging Growth Company, and Private Equity businesses within Audit & Assurance.

While venture capital has made progress toward a more equitable industry, there is still a long road ahead.

Impact of the downturn

This year's economic uncertainty comes with limited exit opportunities and lower valuations, ultimately resulting in a softer market. While this has affected companies across the board, the impact varies greatly between startups and late-stage companies. No matter what part of the lifecycle a company is in, funding is critical—but there are certain implications that come with investor funding at each stage.

Early-stage companies are facing challenges because overall investing is down,[3] making the first round of financing even harder to obtain. Many venture capitalists are apprehensive about investing right now because of economic unpredictability, increased

1: "Q3 2023 Road to Next Report," Deloitte, September 12, 2023.
2: "VC Human Capital Survey Fourth Edition," Deloitte, Venture Forward, and National Venture Capital Association, April 18, 2023.
3: "Q3 2023 Road to Next Report," Deloitte, September 12, 2023.

inflation, and other global impacts, including potential cybersecurity issues. At this stage, it's crucial to focus on building something the world needs to have and then finding people who agree with your thesis and trust in your ability to execute.

Many late-stage companies raised a lot of money from 2021 to 2022, and those that managed their funds well were able to stretch those investments over this year, without having to raise more capital. However, it is more complicated for companies that did not take advantage of obtaining money when valuations were higher or that had planned to go public. Now, the market is fairly tight and raising more money is critical to move forward. At this stage, it's important to focus on the fundamentals—ensure your financials are strong and accurately reported, determine if experienced and thoughtful leadership is in place, and develop a fully mapped-out path to growth and profitability.

Trends of the past and present

Despite being in a downturn, there's a lot to look forward to with technology rapidly advancing. Between AI and various cloud technologies, there are tools to lean on to find success in the years to come.

As the pendulum of variables swings in the world of venture capital, it's imperative to stay attentive to what works and what doesn't. During 2021 to 2022, we were experiencing a frothy cycle wherein excessive optimism, high valuations, and an abundance of capital were flowing into the startup ecosystem.[4] When we experience this kind of cycle, venture capitalists place value on growth, what revenue increases look like, and how quickly companies are growing. When the market is slower, like it is right now, venture capitalists and institutional buyers are more concerned with how much money companies are making and their ability to achieve positive margins. To pique the interest of venture capitalists in our current market, companies must demonstrate existing profitability or present a clear path to it.

Navigating the uncertain future

Even though we can't predict exactly what will happen next year, we can prepare by keeping a close eye on data points that will give us insights into the future of venture capital. More recently, there's been an uptick in IPOs with a few clients making the move to go public. It's expected that a positive trend is on the rise, thereby creating potential opportunities for companies to exit successfully.

There isn't a crystal ball that shows us what the future of venture capital looks like, but there are questions to consider that can help you predict what may come next.

Stay curious about these wonderings:

- What is happening in terms of IPO activity? Are we seeing more transactions? Is the window more open?
- Where is VC funding headed? At what levels are companies being evaluated?
- Are larger-entity tech layoffs resulting in startup formation? How is this affecting overall employment?

Amid the prevailing challenges and uncertainties in the venture capital arena and broader capital markets, a sense of optimism is gradually gaining momentum. As market conditions stabilize, there's potential for an environment of growth, innovation, and renewed investor confidence to emerge—painting a promising future for VC.

Interested in learning more? Dive into what the future may look like for emerging growth companies in Deloitte's most recent Road to Next, an analysis of current investment trends defining the private financial markets.

4: "Q3 2023 Road to Next Report," Deloitte, September 13, 2023.