KfW Research

German Venture Capital Barometer 3rd Quarter 2024

In cooperation with the German Private Equity and Venture Capital Association (BVK) and the Deutsche Börse Venture Network

VC business sentiment has climbed out of the doldrums for now

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– Business expectations and situation assessments are now both back to 'normal'

– Assessments of fundraising environment no longer negative since rate reversal

– Investment appetite has strengthened noticeably but deal flow remains weak

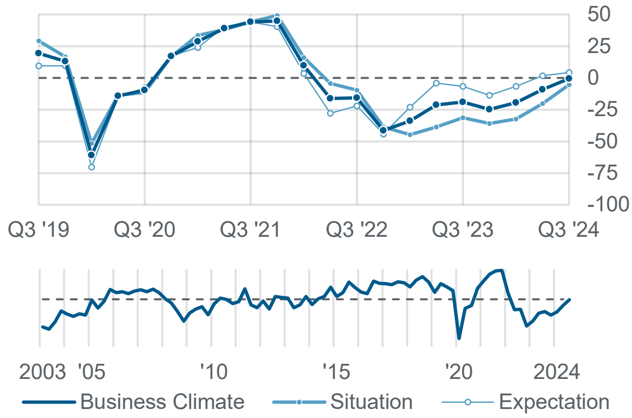
Lull in sentiment is over for now

The VC business climate in Germany has continued to improve and has returned to the long-term average level again. The sentiment indicator for the early-stage segment rose 8.7 points to -0.4 balance points in the third quarter of 2024. Business expectations stabilised with a slight increase but current situation assessments improved significantly. The indicator for the current business situation surged by 14.9 points to -5.2 balance points, while the indicator for business expectations climbed 2.5 points to reach 4.4 balance points. Thus, the indicator dot that illustrates the current business situation has now jumped from red to amber.

Interest rate cuts have caused fundraising climate to improve

The fundraising environment has developed along similar lines as business sentiment. Fundraising expectations have already anticipated a recovery for several quarters and now assessments of the current situation have also improved significantly. The indicator dot that illustrates the fundraising environment has just switched back from red to amber after around two years. In a long-term comparison, however, the fundraising climate remains below average, at -10.6 balance points (situation assessments: -25.0 / expectations: +3.9). The development is likely connected to the most recent interest rate turnaround. Falling interest rates make VC fundraising easier. Both the Fed and the ECB have again cut interest rates after steep benchmark interest rate increases aimed at combating inflation. The interest environment has thus risen again from its historic low (-101.7 points in the second quarter of 2022) at a commensurate rate of -28.0 balance points. The interest cuts made by the Fed and ECB in September caused the interest environment to rise by 36.6 points. The expectations component was therefore able to rise sharply enough to flip the indicator dot from red to amber. This is likely due to the prospect of further interest rate cuts which the ECB recently decided, as was expected, in its October meeting (i.e. already in the fourth quarter).

Development of venture capital sentiment indicator



Venture capital 'traffic lights'

Values in balance points

	Q3 '24	Δ Q2 '24	Low	High
Business climate	-0.4	+8.7	-60.9	+44.9
Business situation	-5.2	+14.9	-55.7	+49.2
Bus. expectations	+4.4	+2.5	-70.2	+44.1
Fundraising	-10.6	+4.0	-67.4	+73.6
New investment	+11.6	+3.0	-72.6	+31.0
Entry valuations	+27.3	+0.5	-55.4	+48.7
Depreciations	-10.9	+2.4	-47.4	+30.8
Dealflow quantity	+7.0	-3.3	-45.6	+32.5
Dealflow quality	-0.4	-15.2	-23.3	+28.5
DF innovativeness	-13.2	-30.4	-48.0	+35.9
Exit opportunities	-36.0	-3.1	-71.7	+74.3
Interest rates	-28.0	+36.6	-101.7	+45.0
Taxation / regulation	+2.9	+17.3	-28.4	+35.1
Public support	+16.8	+4.5	-58.5	+37.0
Economy	-42.9	-8.0	-88.5	+79.1

Colour scheme of sentiment indicator dots: values in the lowest tercile are marked 'red', in the medium tercile 'amber' and in the highest tercile 'green'. Indicator design may lead to deviations from previous publications.

Source: KfW Research, BVK and DBVN.

Exit options are still very few

With a view to exits as well, expectations have anticipated a recovery already since early 2023. Situation assessments have continued to deteriorate up to early 2024, however, without recovering significantly since. The exit indicator currently stands at -36.0 balance points (situation assessments: -52.5 / expectations: -19.5). So there continues to be hope that the still difficult exit environment will improve. This applies to trade sales, buybacks and secondaries. The IPO climate, in turn, has now improved to such an extent that the indicator dot has just changed from red to amber. As conditions for IPOs have become more favourable in the course of the year, individual IPOs may be upcoming. It would be important for there to be more movement in the exit market. After all, the funding cycle in the VC market works only with satisfactory exit proceeds. To achieve this, however, it would be an advantage if higher valuations could be achieved again. The recovery in valuations to new record highs, as we have seen on the international stock markets, does not appear to have reached the private equity markets yet. The satisfaction with entry valuations for new investments remains high, with an indicator value of +27.3 balance points, suggesting comparatively favourable valuations.

Although valuations have yet to recover and start-up insolvencies have increased further in 2024 after 2023, the mood around possible default-induced write-downs has clearly improved from its local low of -35.3 points in the fourth quarter of 2022. The indicator for valuation adjustments stabilised at -10.9 balance points in the third quarter. This may have to do with increased investment activity, which has significantly raised the probability of follow-on finance for start-ups that have reached the end of their runway. Moreover, most start-ups that had funding rounds at high valuations in the boom period of 2021 to early 2022 are now likely to have had a follow-on round. The risk of further structural down rounds has thus fallen.

Investment appetite has strengthened noticeably

Investors' willingness to invest has stabilised in the green, rising by +11.6 balance points. Encouragingly, expectations are no longer the only measure here but are supported by the recovery and situation assessments. Investment appetite has improved to such an extent that the indicator dot jumped from red to amber in the past quarter and has now changed further to green. The positive trend already translated into increased VC volume in the German VC market in the third quarter. That is very good news for start-ups looking for VC.

Deal flow remains weak

Growing investor restraint after the interest rate turnaround caused start-ups to hold back with financing requests as well. Throughout the year 2023, however, deal flow increased, presumably because many start-ups saw themselves approaching the end of their runway and were keen to secure follow-on finance. The situation normalised again in 2024 and the small deal flow wave subsided. Investors' expectations around deal flow remained significantly higher, however, including in the third quarter of 2024. Sentiment around demand for VC is quite balanced at +7.0 balance points. Situation assessments, however, are only just slightly above average at +0.7 balance points, while expectations sit on a much more positive 13.3 balance points. The overhang of expectations indicates that investors still expect VC deal flow to increase.

Sentiment about the quality of deal flow is also balanced at -0.4 balance points, although a noticeable drop occurred in the third quarter. One factor that played a role in this was the sharp spike in expectations in the preceding quarter, which changed back to +4.8 balance points. Another factor was that situation assessments have now fallen sharply, slipping from green to amber. Assessments of the current quality of investment proposals are thus only marginally below the long-term average at -5.5 balance points in the third quarter but the last time they were lower was before 2021.

The picture is similar with regard to the innovativeness of deal flow. Sentiment around innovation shed 30.4 points, sending the sentiment indicator directly from green to red, where it now sits at -13.2 balance points. On the one hand, a sharp spike in expectations on the innovative content of investment proposals in the previous quarter was overcompensated here. On the other hand, situation assessments deteriorated sharply and clearly slipped into the red. It is unclear why the quality and innovativeness of deal flow fell so steeply in the late summer. The assessments may have been made against the backdrop of a significantly higher willingness to invest, so that investors would have liked to see even more qualified demand than typically occurs in a regular deal flow.

The positive mood around public support measures strengthened in the third quarter. The indicator rose to +16.8 balance points. Whereas situation assessments remained stable, expectations improved considerably. This may be attributable to the WIN Initiative under which policymakers, associations and businesses have come together to strengthen the VC ecosystem. In mid-September, a joint declaration of intent was signed endorsing measures that improve the tax-related, legal and financial conditions for venture capital in Germany. That may partly explain why sentiment around tax and regulatory frameworks for VC has improved. The indicator rose to +2.9 balance points.

Comments on the current trend

**Dr Georg Metzger,
Senior Economist at KfW Research**

‘The business situation in the German VC market has normalised again for the first time in two years. The recently introduced first key interest rate reductions appear to have provided an impetus which the market needed’, said Georg Metzger of KfW Research. ‘Investors’ willingness to invest has increased significantly – and has been directly reflected in growing VC investments. Start-ups in Germany can expect access to venture capital to become easier again. The shortage of exit options, however, remains a cause for concern. Satisfactory exit returns are important for the VC funding cycle, however. Expectations suggest that exit options have been improving for several quarters. It would be desirable for the positive expectations to materialise quickly.

**Ulrike Hinrichs,
Managing Director of the German Private Equity and Venture Capital Association (BVK)**

‘Although business confidence in the venture capital market dipped slightly this quarter, we are still moving down the right path. The indicators of deal flow and entry valuations, in particular, continue to demonstrate positive sentiment’, said Ulrike Hinrichs, Managing Director of the German Private Equity and Venture Capital Association (BVK). ‘However, exit opportunities remain on a low level, as they did already in the previous quarter. It’s fair to say that we are still seeing a generally positive development, which we hope will last until the end of the year.’

Calculation of the German Venture Capital Barometer

The **German Venture Capital Barometer** is based on a quarterly survey of the members of the German Private Equity and Venture Capital Association (Bundesverband Deutscher Kapitalbeteiligungsgesellschaften – BVK), the member investors of the Deutsche Börse Venture Network (since the 2nd quarter of 2021) and further private equity companies with registered offices 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 young 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, normalised to their respective historical mean balance values as baseline level. As a result, the maximum or minimum value of the indicator may exceed or fall below +100 or -100 as the actual maximum or minimum. Because of the way the barometer is constructed, positive indicator values point to above-average sentiment and negative values to below-average sentiment.

The **German Private Equity and Venture Capital Association (BVK)** is the voice and the face of the private equity industry in Germany. The association is committed to improving conditions and facilitating access to private equity so that even more businesses in Germany can benefit from private equity. It has some 300 members. These include around 200 private equity companies and investors as well as some 100 consulting firms and service providers of the industry.

BVK
Bundesverband
Beteiligungskapital e.V.

The **Deutsche Börse Venture Network (DBVN)** was launched in 2015 and is now Europe’s largest network for growth finance and ‘Capital Market Readiness’. It focuses on providing efficient access to capital and has an extensive range of networking and training services. The network of more than 200 fast-growth businesses and more than 450 investors has already enabled 13 IPOs and numerous trade sales.

Deutsche Börse
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