A WORD FROM J.P. MORGAN

Our views on venture

"We're committed to being the best partner for founder-led, venture-backed companies with high-growth potential around the world in innovative industries like disruptive commerce, technology, life sciences, healthcare IT, and climate tech—and as a full firm, we're uniquely positioned to serve the entire innovation economy ecosystem because we can be there for founders from the earliest stages through IPO and beyond."

- Andrew Kresse, Head of Corporate Client Banking & Specialized Industries International Banking, J.P. Morgan

The long-term growth story for the European venture ecosystem is bright even though near-term challenges persist as pandemic era excesses work through the system.

Venture activity and valuations across Europe continue to reset to more sustainable levels experienced before the 2020-2021 surge. While there are some signs that liquidity is less challenged than it was a year ago, valuations remain a hindrance to deal activity. Many founders of later-stage companies have been successful in reducing cash burn to extend runway, postponing difficult discussions around valuations. We expect more bridge rounds and down rounds this year as cash runways dwindle and/or investor support wanes.

Along these lines, we sense some building pressure for VCs to realize value from their portfolios and generate liquidity via traditional and nontraditional means. Short of a realistic path to IPO or M&A, we are seeing increasing investor appetite to sell stakes in companies or entire VC portfolios via secondary markets. Meanwhile, some initial thawing of US IPO markets so far this year should drive optimism for the strongest companies and push the conversation forward about getting "exit ready."

Despite near-term challenges, we are optimistic about growth trends for the European venture ecosystem. The respective governments of the UK, France, and Germany continue to show increased support for the sector. For example, because of the UK Mansion House Act, we expect more inflows into U.K. VC funds from large pension funds and asset managers. In a January speech, U.K. Tech Secretary Michelle Donelan outlined the goal to make the U.K. home to more than 50% of European Union tech unicorns by 2030.

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Germany saw similar positive sentiment with the €1 billion fund of funds launch in November, with capital from the federal government, KfW, and more than 20 key institutional investors. France continues heady investments in the tech space, including the €6 billion announcement made by President Emmanuel Macron last year to invest in French startups and scale-ups.

As this develops, U.S. investors and other investors searching for yield are increasingly looking at the European market. We expect this could translate into more growth funds being raised to invest in the region.

Macroeconomic cross currents and geopolitical developments are likely to influence venture activity.

While there is confidence that interest rates in Europe have peaked, central bank easing is contingent on continued progress on inflation, which has slowed in recent months. Nonetheless, we do expect the Federal Reserve, the European Central Bank, and the Bank of England to initiate rate cuts at a gradual pace around mid-2024. This could have positive implications for valuations and in turn catalyze activity in venture.

Outside of policymakers' control, the outlook is clouded by a greater-than-normal degree of unpredictability around global trade, commodities markets and ongoing military conflicts in Europe and the Middle East. US election rhetoric is heating up, however that is only one piece of the puzzle—77 elections across markets comprising 60% of global GDP means there are a lot of political and economic variables still to play out. A proactive strategy that anticipates potential policy outcomes as a result of associated elections will favor the prepared.

One year after market disruption, the dust is settling in the startup banking landscape.

VCs and founders have spent significant time on treasury and cash management best practices in the wake of Silicon Valley Bank's collapse. The lens through which startups and VCs evaluate banking partners has shifted such that it is best practice to ensure banking counterparty risk is mitigated with a minimum of two banking partners. Access to and safety of funds are no longer taken for granted, while earning a competitive yield on excess cash and a simplified onboarding experience remain important. Consideration is being given to longer-term treasury management because treasury needs become more complex as a company grows and scales.

Venture lending is another area that has experienced some shifts. While activity has generally slowed due to reduced venture activity overall, several new venture debt providers have emerged over the past year. Many have not been tested through a market cycle, which prompts the question of how these providers may behave in a downturn, even if they have attractive commercial terms today.

Startups are increasingly looking to their banking partners for insights and networks, including the important US market. It is helpful for founders to leverage data analytics and sector insights to navigate varying market conditions and make informed decisions about how much capital to raise, at what valuation, and with what terms. Access to investor networks can create opportunities for capital raising, while introductions to larger companies—that could become customers or provide operating expertise—can deliver a competitive edge.

Choosing the right investors can provide value beyond funding.

Having investors that can bring value to startups beyond capital is critical in today's environment, according to Luke Sikora, Partner of J.P. Morgan Growth Equity Partners. Last year, this group closed a $1 billion technology-focused late-stage venture and growth equity fund. Similar to the desirable qualities of a banking partner, partnering with investors that can provide insights, data capabilities, and access to global networks can be a key differentiator for founders looking to scale and position their businesses for long-term success.

Sikora also believes that young companies benefit from a value-added approach from investors. Times have changed from the 2020-2021 period when investor speed and passiveness commanded a premium. As founders see more challenges on the horizon, they are preferring to work with investors who can help prioritize strategic initiatives for their companies. Many founders in today's ecosystem lack the scar tissue of prior downturns and can gain invaluable perspective from the experience and expertise seasoned investors bring to the table. This is especially impactful when investors proactively leverage their own core competencies, adding strategic value to their portfolio companies.

While there has been a retreat of nontraditional venture capitalists since 2021, significant dry powder, coupled with resetting valuations, provides an opportunity for disciplined investors to prudently deploy capital. J.P. Morgan Growth Equity Partners' fund recently led an investment round in a European cybersecurity startup, as rising incidence of ransomware attacks and recent regulatory changes have increased interest in the space. As the NIS2 Directive puts a lot more accountability on companies to strengthen their defenses of systems and data, cybersecurity providers with innovative models are best positioned to meet that need.