KPMG

Media Release

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VC funding falls to two-year low: KPMG and CB Insights

Global deal activity flat in Q3 as funding dollars slide 14 percent from Q2 2016; Asia saw its fourth-straight quarterly deal decline.

After a furious check-writing phase through early-to-mid 2015, investors in VC-backed companies remain cautious in 2016, as major economies continue to face economic uncertainty and startup companies experience a difficult exit environment.

Q3 2016 saw US$24.1 billion invested across 1,983 deals globally, representing a very slight deal increase from Q2 2016, but a 14 percent decline in total quarterly funding, according to *Venture Pulse*, the quarterly global report on VC trends published jointly by KPMG International and CB Insights. Although the deal volume is still quite healthy by pre-2014 standards, this was the lowest quarter of deal funding since Q3 2014.

Funding trended downwards across the major venture hubs of North America, Europe, and Asia. The number of deals sunk lower in Asia and North America, though they rose in Europe. Europe also continued to see robust seed-stage activity, while seed deal shares dropped significantly in both North America and Asia.

“While a mood of caution prevails in the traditional VC market, corporates are still active. Many of them are pursuing an agenda of innovation and competition in an age of business disruption,” said Chia Tek Yew, Head of Financial Services Advisory. “Heading into Q4 2016 and 2017, we are expecting to see significant corporate investments in the automotive, healthcare and fintech sectors.”

He added, “In the startup funding space, exciting times also lie ahead for Southeast Asia. In Singapore for example, the VC sector is maturing towards a predominantly post-Series A funding and cementing a reputation as the funding hub of SEA, with the highest deal numbers and larger deal sizes this quarter.”

Key Q3 highlights:

- Global Q3 funding saw a 5-quarter low in mega-round deals (those over $100 million in size) — 34 in total versus 36 in Q2 2016 and 73 in Q3 2015. Regionally, Europe had just a single mega-round.
- Global deal activity held essentially steady, with 1,983 deals for the quarter, compared to 1,978 deals in Q2 2016. In the absence of outsize deals like last quarter’s financings to “decacorns” like Uber, Snap, and Didi Chuxing, financing fell from $28.1 billion in Q2 to $24.1 billion this quarter.
- Total dollars in North America and Europe fell dramatically, with North America down 18 percent from the quarter prior to $14.4 billion, and Europe down 21 percent to $2.3 billion. Asia funding dropped a more modest 3 percent to $7.2 billion. However, the number of deals to Asian companies fell for the fourth consecutive quarter, down to 323.

- After bouncing back in Q2 2016, seed rounds as a share of all global deals fell to 33 percent driven by declining seed activity in North America and Asia. Asian seed deal share dropped especially sharply, down to 29 percent from 40 percent the quarter prior.
- Q3 2016 saw median late-stage deal sizes shrinking across all three major regions. The fall in Asia was the most dramatic, plunging to $30 million from $100 million the quarter prior, and down 80 percent from the $154 million median seen in Q3 2015.
- After rocketing to a high of 25 new unicorns in Q3 2015, 2016 has yet to see a quarter with double-digit companies entering the VC-backed unicorn club (private companies valued at $1 billion+). Q3 2016 saw only 8 new unicorn births.

Anand Sanwal, CEO of CB Insights, commented: “Before everyone starts saying the sky is falling, it’s worth noting that a bit of sobriety is a good thing. 2015 funding levels were irrationally high with a new unicorn being birthed every 3rd day as investors were keen to force-feed perceived startup winners with cash. That was not sustainable or healthy. We’re seeing a reset in deal activity and mega-rounds but the levels still remain very high relative to historical levels. A renewed focus on unit economics and sustainability versus growth at all costs is not a bad thing, especially in Asia and North America as both markets got ahead of themselves. The re-introduction of rationality that we are seeing is positive.”

In addition to presenting key global findings for Q3 2016, the *Venture Pulse* quarterly report series examines the state of venture capital investment on a regional basis, including key trends and analyses for Asia, North America, and Europe.

$100 million+ financing activity has reset after 2015 peak
After topping out at 73 in Q3 2015, quarterly mega-round deals have ranged between 42 in Q1 2016 down to 34 this quarter. Q3 2016 saw well-established on-demand companies like Airbnb, Grab, and Deliveroo receiving large rounds, but investors as a whole continue to exercise caution with such commitments in 2016.

Asian companies outpaced their North American counterparts for the third-consecutive straight quarter in mega-round financings, with 17 mega-rounds compared to North America’s 15. By contrast, Europe saw just a single mega-round in Q3 2016. The dearth of larger financings contributed to that continent’s total drop in quarterly funding.

North America and Asia see pullback in funding; Europe sees deals rise but funding slip
North American VC-backed companies received the lion’s share of funding this quarter with $14.4 billion invested. Compared to Q2 2016, deals were down 18 percent as the number of deals fell to 1,127. Whereas last quarter saw multiple billion-plus rounds, North America’s largest deal this quarter was Didi Chuxing’s $1 billion injection into Uber as part of Didi’s takeover of Uber China.

Seed rounds continue to represent a diminishing slice of all North American deals, falling to 26 percent from 34 percent in Q3 last year. Meanwhile, median late-stage deal size shrank for the fourth-consecutive quarter. Q3 2016’s figure of $22.4 million is down 34 percent from Q3 2015.
Deal activity in Asia continued to tumble. Asian VC-backed companies saw fewer deals and also fewer total funding dollars, with $7.2 billion invested across 323 deals. This compares to $7.4 billion and 339 deals in Q1 2016, and $15.4 billion over 437 deals in Q3 2015.US Funding for the

quarter was buoyed by large deals to Southeast Asian ride-hailing companies like Grab and Go-Jek.

Both seed activity and late-stage deal sizes fell precipitously in Asia. Seed-deal share had climbed to a 5-quarter high of 40 percent last quarter, but plunged to 29 percent in Q3 2016. Meanwhile, median late-stage deal size plummeted 70 percent to $30 million. That figure still outpaces late-stage medians in both North America and Europe, though it is much closer to the typical sizes experienced on the other continents.

Unlike the other major markets, Europe saw deal count rise to 468 for the quarter. However, this was accompanied by a second-consecutive funding decline, with a total of $2.3 billion going to VC-backed companies. After dropping sharply in Q1 2016, seed-stage deal share has remained strong for the past two quarters, representing nearly half of all European deals. However, strong seed activity has probably contributed to the drop in median early-stage deal size from $2 million in Q1 2016 to $1.5 million in Q3 2016.

Quarterly unicorn birth rate remains in single digits for 2016
Of the quarter’s 8 new unicorns, 4 each were minted in Asia and North America, with none in Europe or elsewhere. Europe has not seen a new VC-backed unicorn for two straight quarters. Among Q3 2016’s new unicorns were companies like Compass, Unity Technologies, and OfferUp.

Cybersecurity continues to be key VC focus
Despite a pullback in other key sectors, cybersecurity continues to attract attention from VC investors, with over $800 million in funding this quarter. While down compared to a peak of $1.1 billion in Q3'15, VC investment in cybersecurity has remained relatively stable quarter over quarter. The growing complexity of connectivity driving the business environment globally suggests cybersecurity will remain a key focus of investment in the near term.

“Everything is connected these days: mobile devices, automobiles, pacemakers. As networks become more pervasive, companies have to rethink their cybersecurity solutions. That’s why VC investment in cybersecurity technologies continues to be high. There’s no silver bullet. No end game. Just a constant realisation that cyber-terrorists will exploit any weakness,” says Arik Speier, Head of Technology, KPMG in Israel. “Because cybersecurity has been an issue for so long, companies are fatigued. This is where startups matter; they bring fresh ideas and solutions that reflect the shifting complexity of cyber threats.”

Corporates accelerate global activity
Corporate deal participation continues to hit new highs as more large players either establish corporate venture capital (CVC) units or invest directly into VC-backed companies. Corporates participated in 28 percent of Q3 2016 deals, eclipsing last quarter’s 26 percent. Corporate participation jumped to 45 percent in Asia, representing nearly half of all deals to VC-backed companies there. Corporate participation in North America also ticked up to a 5-quarter high of 26%.

Anand Sanwal of CB Insights said: “Even as overall numbers trend down, corporations continue to access innovation and outsource R&D by investing in startups. We also are continuing to see corporations invest across the funding spectrum investing not just in more mature later-stage companies but at the early stage as well. If early stage activity stays weak in North America and Asia, it's likely that corporate venture groups may pick up the slack."

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Note to editors
*All figures cited are in USD

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