
2002 Venture Capital Market Review

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The downturn in the U.S. venture capital financing market that characterized 2001 continued during 2002. The total number of venture capital financings decreased from 3,034 in 2001 to 2,056 in 2002. The total amount invested in venture capital financings experienced an even greater decline, dropping from \$34.6 billion in 2001 to \$19.4 billion in 2002. Both the 2001 and 2002 figures represent a dramatic decline from 2000, when there were a staggering 6,101 venture capital financings, raising a total of \$93.8 billion.

To put 2002 in perspective, however, one must look back before the "bubble" years of 1999-2000 and compare 2002 to 1995-1998. The number of venture capital financings in 2002 was comparable to the number of annual deals in the years 1995-1998, and the amount invested in 2002 actually exceeded the amount invested in each of these years.

Valuations of venture-backed companies have shown a similar pattern. The median pre-money valuation for companies raising venture capital money in 2002 (through the third quarter) was \$10.5 million, as compared to \$15.2 million in 2001. While this is strikingly lower than the median pre-money valuation of \$24.5 million in 2000, it is comparable to the median valuations in 1996 (\$11.0 million) and 1997 (\$13.0 million).

Seed and first round financings continued to decline in 2002 as a percentage of all venture capital investing. Seed and first round financings ranged from

48% to 50% of total venture financings in each year between 1995 and 1998. This percentage increased to 54% in 1999 and 55% in 2000, as the number of start-ups being funded rose substantially. However, the number of seed and first round financings dropped to 37% of total financings in 2001 and 30% of total financings in 2002 as many venture capitalists shifted their focus to existing portfolio companies.

While the number and valuation of venture capital financings have vacillated significantly over the past few years, venture capital investing by industry has been more stable during this period. Financings of information technology companies represented between 54% and 59% of total venture capital financings in each year between 1995 and 2002. Moreover, within the information technology sector, software was the most active market segment in each year between 1995 and 2002, with the number of financings by software companies typically doubling the number by communications and networking companies—the next most active market segment.

Financings in the life sciences sector trended down from 28% of all venture capital financings in 1995 to 13% in both 1999 and 2000—the height of the Internet frenzy—even as the total number of financings of life sciences companies increased from 368 in 1995 to 788 in 2000. This trend has reversed itself more recently, as financings of life sciences companies as a percentage of all venture capital financings rebounded to 24% in 2002.

The geographic regions receiving venture capital funding have remained remarkably consistent over the 1995-2002 period. In every one of those years, the top-ranked state—based on the number of in-state companies raising venture capital money that year—was California, by a wide margin, representing 41% of the total number of venture capital financings during this period. Massachusetts ranked second in each of those eight years, also by a comfortable margin, representing 11% of the total number of venture capital financings during this period. The third-ranked state in each of those

years was either New York or Texas.

While the number and valuation of venture capital financings in 2001 and 2002 were down significantly from the 1999-2000 levels, liquidity events for venture-backed companies declined even more sharply. IPOs by venture-backed companies dropped from 248 in 1999 and 200 in 2000 to 21 in 2001 and 19 in 2002. These figures are also dramatically lower than the number of venture-backed IPOs during the 1995-1998 period, when there were an average of 137 per year.

M&A activity shows a similar, although less precipitous, decline. The number of acquisitions of venture-backed companies dropped from 449 in 2000 to 387 in 2001 and to 325 in 2002. Despite this decline, the number of acquisitions in 2001 and 2002 was not significantly lower than in 2000, was comparable to the 1999 number (302) and was greater than the average number in 1995-1998 (202). However, there has been a startling decrease in the purchase prices for those acquisitions. The average price paid for a venture-backed company during 1995-1998 was \$76.9 million. During 1999-2000, this figure rose to \$192.2 million. The average acquisition price for a venture-backed company declined to \$55.4 million in 2001 and it declined further to \$29.8 million in 2002.

Given that the Internet-driven investment frenzy during 1999-2000 was an anomaly that is unlikely to recur, the decline in venture capital investments and valuations during the last two years, to levels commensurate with those in the 1995-1998 timeframe, is neither surprising nor alarming. However, the fall-off in liquidity events for venture-backed companies from 1995-1998 levels is considerably greater, and cannot be viewed with the same equanimity.

Our newly published *2002 Venture Capital Report* contains additional information and analysis about the venture capital market, including:

- a detailed analysis of the 2002 venture capital market, including industry breakdowns;
- trends in acquisitions of and IPOs by venture-backed companies;

- the outlook for the 2003 venture capital market;
- regional breakdowns (New England, Tri-State, Mid-Atlantic and Europe);
- important information on corporate governance reforms affecting private companies;
- key issues to consider in the sale of venture-backed companies; and
- venture capital counsel rankings.

To request a copy of the *2002 Venture Capital Report*, please click [here](#) or call 617-526-5600.

Our companion publication, the *2002 IPO Report*, includes:

- detailed analysis of the 2002 IPO market;
- the outlook for the 2003 IPO market;
- regional breakdowns (New England, Tri-State, Mid-Atlantic and International);
- an overview of the new regulatory environment faced by public companies;
- recommendations for pre-IPO planning in the wake of the Sarbanes-Oxley Act; and
- IPO counsel and underwriter rankings.

To request a copy of the *2002 IPO Report*, please click [here](#) or call 617-526-5600.

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