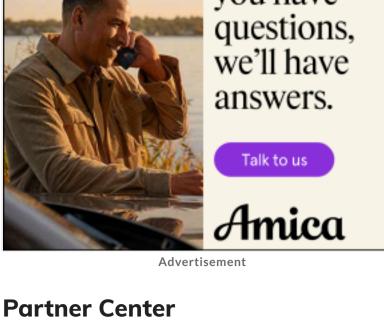


Opinion: 'Startups no longer are \$100 bills on the sidewalk.' Venture capital is suffering even as the U.S. stock market is surging.



Find Your

New Adviso

YOU AN EDGE

4 weeks for only \$24.95 MARKETSMITH

I'm 49, have \$1.2 million in savings and just lost my job — can I trust the retirement calculators that tell me it's OK to

Published: Aug. 7, 2023 at 7:20 a.m. ET

By Jeffrey Lee Funk and Gary Smith

Investors are becoming cynical about startups and the venture capital firms that fund them



Interest rates are higher, government stimulus is waning and startups are struggling. GETTY IMAGES/ISTOCKPHOTO





Lucid launches EV sales event and stock slumps toward a 6-week low

next year's Social Security COLA

Here's the real story of

retire?



D Ameritrade

Call our Trade Desk

TRACK YOUR

PORTFOLIO

0

'Is this heaven?' No. but it's the best state to retire in.



Six-figure employee lives like she's broke in NYC



Listen to article 5 minutes

A few years ago, the startup market was setting one record after another, fueled by low interest rates, U.S. government stimulus spending to counter the CQVID-19 lockdown and AI enthusiasm.

AI fever has gotten worse due to the smoke-and-mirrors of ChatGPT and other large-language models, but now interest rates are higher, government stimulus is waning and startups are struggling. The fact that startups are suffering while the overall U.S. stock market is surging suggests that investors are finally realizing that startups no longer are \$100 bills on the sidewalk.

One of Gary's former students started one of the first fund-of-funds for hedge funds. The most important part of his job was identifying hedge funds that had good ideas and were run by competent, honest people. He often lamented that the hedge-fund boom was bringing in people who had flimsy ideas, little experience and, in some cases, questionable ethics. It seemed that anyone who had ever taken a finance course and made a profitable investment thought they were qualified to start a hedge fund. Too many were able to raise money; too few invested that money wisely.

The scent of money that led many unqualified and inexperienced people to start hedge funds also has led many unqualified and inexperienced people to launch startups. Find a sexy idea and market the hell out of it — not necessarily to build an enduring business but certainly to lure in investors.

The results have not been pretty. Jay Ritter, a University of Florida finance professor, keeps the most comprehensive data on IPO performance, including companies that went public and then flopped. His most recent data, from 2022, showed that 59% of the IPOs between 1975 and 2018 had negative returns over the first three years; 37% were down 50% or more. Their average three-year return was 17.1 percentage points lower than the overall U.S. stock market return. Even these dismal results understate the disappointing performance because of survivorship bias — startups that never did well enough to do an IPO are not included.

Looking at well-known big companies that are still around, 90% of U.S. "unicorns" — startups initially valued at more than \$1 billion – are losing money and have been for many years; 21 have cumulative losses of more than \$3 billion.

So it is not surprising that investors are becoming cynical about startups and the venture capital firms that fund them. Overall, venture capital firms raised \$28 billion in the first half of 2023 compared to \$158 billion and \$168 billion raised in 2021 and 2022.

Venture capitalists invested \$19.9 billion in U.S. "growth" startups (those seeking Series B- and C funding) in the first half of 2023, down from \$89 billion and \$57 billion for all of 2021 and 2022, respectively. Moreover, \$6.9 billion of that \$19.9 billion came from a single deal for payment services provider Stripe. According to Pitchbook, the "demand for capital in the late-stage sector is about 2.84 times more than the available supply. As for IPOs, there were 80 during the first half of 2023 compared to 1083 for all of 2021.

Pitchbook also reported a sharp increase in the number of "down-rounds," when venture capitalists impose lower valuations and take larger shares of companies in exchange for additional funding. They estimated that the percentage of down-rounds for Series B and C funding was less than 10% in the first quarter of 2021 and more than 30% in the first- and second quarters of 2023. This rise in down-rounds reflects the skepticism of investors and the desperation of startups.

The sense of woe is reflected in the title of a recent Financial Times article: "Silicon Valley Braces for the Worst as Funding Dries Up." The article reported that, "Many in the industry expect the cliff edge moment to come in the second half of this year."

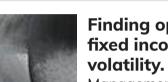
Advertisement

Advertisement



6 Of The Laziest (But Secretly Brilliant) Ways People Are Making **Money** FinanceBuzz





Finding opportunities in core fixed income amid volatility. J.P. Morgan Asset Management



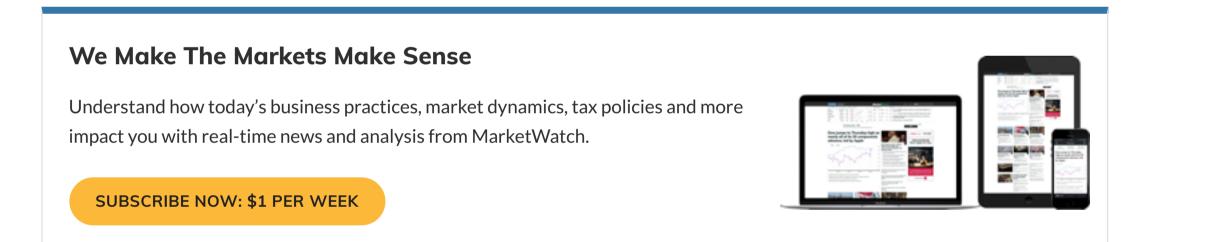
Bollinger Bands®: What Them Charles Schwab

They Are and How to Use



Deglobalization or Reglobalization? Top Investing Trends to Know. New York Life Investments

Dianomi



Those going over the cliff will not only be flimsy startups but also venture capital firms that funded the flimsy startups.

Jeffrey Lee Funk is an independent technology consultant. Gary Smith, Fletcher Jones Professor of Economics at Pomona College, is the author of dozens of research articles and 16 books, most recently, Distrust: Big Data, Data-Torturing, and the Assault on Science (Oxford University Press, 2023).

More: Venture capital's funk bodes poorly for private company valuations

Also read: Amazon didn't make money for a decade, but those losses weren't even close to what startup companies and their investors face now.

MW

Advertisement

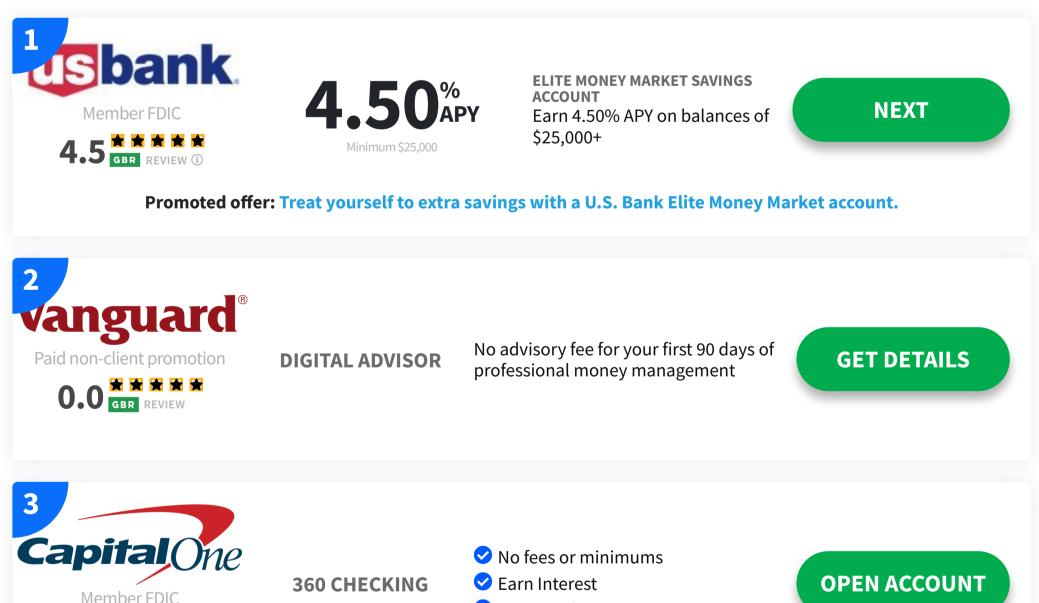


These 20 companies are big winners this earnings season. What do analysts think about their stocks?

These companies increased sales by double digits while improving their profit margins.

More On MarketWatch

- Yellow shares slump after trucking company files for bankruptcy and other stocks on the move
- Barron's: The Stock Market's Rally Paused. It's Time to Buy the Dip.
- The market needs a lot more to worry about for stocks to rise from here
- Barron's: Stocks Poised for Higher Open



		✓ Open in about 5 min	
	Promoted offer: Get pai	id up to 2 days early with Early Paychecl	(
4 CCCCC Member FDIC 4.7 GBR REVIEW (3)	CITI CHECKING	Earn up to \$2,000 Cash Bonus. Open a new eligible checking account with required activities.	OPEN ACCOUNT
Promote	ed offer: Earn up to a \$2,0	00 bonus with a new eligible account w/	activities!
Sponsors of GO BankingRates			Advertiser Disclosure
Conversation			Sector 7 Viewing
<u>COMMUNITY GUIDELIN</u>	<u>ES</u> • <u>FAQS</u>		
Be the first to commen	t		
		\mathcal{O}	
	No one seems to have	shared their thoughts on this topic ye	et
	Leave a commen	t so your voice will be heard first.	

Powered by

ADVERTISEMENT



Where should you invest \$1,000 right now? The Motley Fool

MarketWatch.

Copyright © 2023 MarketWatch, Inc. All rights reserved.

Download on the App Store

a Dow Jones company



California: The List Of The Top Financial Advisor Firms Is Out smartasset



Top Ways Reglobalization Could **Generate Meaningful** Portfolio Value. New York Life Investments



Schwab's Take on **Today's Markets Charles Schwab**

Terms | Privacy | Feedback

Dianomi

ADVERTISEMENT

How The Push Toward Energy Independence Is Impacting Investors. New York Life Investments

Answer just two questions to see a potential fixed income strategy. J.P. Morgan Asset Management

Legendary Wall Street Stock-Picker Names #1 AI Stock of 2023

Chaikin Analytics Schwab's Daily Market Update: Market at

Open Charles Schwab

Dianomi

BACK TO TOP 🔺

DOW JONES NETWORK

The Wall Street Journal

COMPANY Dow Jones Code of Conduct Corrections

Barron's Financial News London realtor.com Mansion Global

MARKETWATCH

Customer Center Contact Us Newsroom Roster Virtual Stock Exchange BigCharts Copyright Policy



Google Play