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Lessons From 2008: How the Downturn Impacted Venture Funding

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While "it's tough to make predictions, especially about the future," hindsight from the past financial crises can enlighten the path ahead. The International Monetary Fund recently labeled the current "Great Lockdown" the worst economic downturn since the Great Depression of 1930, the reason being the cumulative output loss to global GDP over 2020/2021 of around $9 trillion – assuming the pandemic fades in the second half of 2020. Under this hypothesis, advanced economies are expected to shrink -6,1%, whereas emerging markets and developing economies should expect a negative growth rate of -1% and -2,2%, excluding China.

When it comes to the venture industry, the most accurate comparison to the current crisis is the financial crisis of 2008. Back then, aside from the presentation named "R.I.P. Good Times" given by Sequoia Capital as a warning for their portfolio companies, some believed that "50-80% of the venture-backed startups currently operating will shut down or go on life-support within the next 18 months."

Analyzing the numbers from 2008, the seed-stage financing was the least impacted of the early-stage rounds, given seed dollars grew in 2008, 2009, and 2010. Seed volume counts grew globally 29% year over year in 2009 and more than 50% in 2010, 2011, and 2012. Thus, the earlier stage the company, the less impacted it was. On the other hand, the investing environment for Series A, B, and C shifted gravely, decreasing more than 40% in dollar volume in 2009 and around 28% in funding counts in the same year. Series A counts rose above the 2007 numbers in 2011, while Series B did so in 2013 and Series C only in 2014.

Overall, VCs investment dollars dropped 40% and bounced back by the second quarter in 2010 to reach similar levels as before the crisis. However, aggregated deal count was steady and increasing from 2006 to 2012, aside from the third quarter of 2008, which means that VCs were maintaining investment rounds, but valuations and deal sizes were responsible for the decline in the number of dollars invested.

A few theories can be used to interpret those numbers. Some may believe that startups are prone to burn less cash during a challenging financial environment, which drives less growth and, therefore, lowers companies' valuations, shrinking deals closer to seed-stage parameters. Also, some may guess that at that time seed investment was growing as a new institutional founding class due to innovation in cloud and mobile: it became cheaper to start a company and new business opportunities arose from the wave of technology, hence the scenario favorable to seed investment.

Even in 2008, some advocated the belief that startups could be created during a recession – despite the resistance of investors – as the main element inherent to successful startups is the quality of their founders. Nowadays, it is clear that a few successful companies were started amid the financial crisis, such as Airbnb, Stripe, Mixpanel and PagerDuty – all software companies built with small teams. Following their track, similar companies should be ready for the economic rebound by building its software, getting initial users, and showing their product to the world.