Executive Summary

As part of our periodic analysis of key venture capital industry trends, this report examines fundraising, investments, valuations, exits, and net returns to limited partners. Since our last analysis, the direction of several trends on which we regularly report changed course. For example, 2014 saw meaningful increases in the amounts of capital raised by venture funds and by late stage companies, and valuations across all stages increased, most notably for late stage companies. Yet the trend of consolidation of venture firms and capital in the industry, which we have reported observing since 2009, continued throughout 2014. Optimism in 2013 gave way to euphoria in 2014, as venture investors raised and invested astonishing amounts of capital, clamored to access the hot companies, and tallied the growing number of unicorns, or venture-backed private technology companies valued at over $1 billion, in their portfolios. While some late stage valuations may be a mirage, the opportunity to invest in the next generation of highly disruptive, innovative, rapidly growing technology companies is exciting and grounded in reality.

The decline in US venture capital fundraising in 2013 was indeed short lived, as $27.5 billion, an increase of 65%, was raised in 2014. While the amount raised remained well below Internet bubble levels during the late-1990s and early-2000s, and was shy of levels reached during the Great Recession in the mid-2000s, the fundraising pace in 2014 and the 130% increase since 2010 is noteworthy and likely not sustainable nor healthy for the industry over the long term.

Venture capital investment activity in the US, as measured by the number of companies funded, decreased slightly in 2014, yet activity measured by invested capital increased by 50% to $52.1 billion. Peeling back the onion a bit more, we find that invested capital at the seed stage decreased by 19%, invested capital at the early stage increased by 21%, and invested capital at the late stage increased by 68% and was thus the driver of the overall increase. In fact, the $33.2 billion invested into late stage companies in 2014 was a new record, eclipsing the previous high of $28.6 billion in 2000. Although the high level of late stage investment activity is raising eyebrows, it is consistent with the trend of companies staying private longer than in the past.
In conjunction with the rise in late stage investment activity, we saw an astonishing 107% increase in late stage valuations in 2014. While valuations at all stages increased, most remained lower than those during the Internet bubble, with the exception of late stage valuations; after reaching a record high in 2013, another all-time high was reached in 2014, with late stage valuations overtaking valuations in 2000 by 120%.

The exit markets remained open in 2014, as they have been since 2010. Both initial public offering (“IPO”) and merger and acquisition (“M&A”) activity increased in 2014, as measured by the number of venture-backed companies involved. Although IPO and M&A activity slowed in early 2015, the backlog and growing list of maturing unicorns – estimated to be over 100 worldwide – bodes well for the industry to generate future exits.

Recent performance has continued to impress, as upper quartile internal rates of returns (“IRRs”) moved from an average of 6% for vintage years during the late-1990s and early-2000s, to nearly 26% for more recent vintage years. Limited partners (“LPs”) who have invested with the top performing venture capital firms (“VCs”) since 2007 have been rewarded with strong net returns.

Fundraising

As Exhibit 1 illustrates, venture capital fundraising in 2014 increased meaningfully relative to 2013; yet the totals raised last year remained well below the amount raised during the peak of the Internet bubble in 2000, and were shy of levels reached during the mid-2000s prior to the Great Recession.

Exhibit 1a: Seed/early fundraising accelerated in 2014

According to Thomson One, 137 US-based funds raised $14.6 billion of seed and early stage capital in 2014, an increase from 115 funds that raised $9.1 billion in 2013. Although the number of funds and amount raised increased by 19% and 60%, respectively, the amount raised increased proportionally more, resulting in a 34% increase in average fund size of...
$106.7 million. Notwithstanding a dip in 2013, seed and early stage fundraising has been on the rise since 2010, over which time the number of seed and early stage funds raised increased by 76% and the corresponding capital raised increased by 212%. The trend has been driven by the proliferation of micro-VCs, given there were 54% more sub-$100 million funds raised in 2014 relative to 2010. While these increases are meaningful, the levels in 2014 remain well below the peak of 2000 (52% lower by number of funds and 67% lower by amount raised).

The story is the same for all of venture, including seed, early, late, and multi stage capital. The total amount of capital raised by 221 US venture funds across all stages in 2014 was $27.5 billion, which represents a 26% increase by number of funds and 65% increase by amount raised compared to 2013. Once again, these levels remain well below the peak of 2000 (54% lower by number of funds and 67% lower by amount raised). The industry is now 14 years past the peak in venture capital fundraising, and much of the excess capital raised from 1999 to 2001 has worked through the system. That said, given the fundraising activity in 2014, we will continue to monitor fundraising data and assess how well the industry can absorb future amounts of capital raised.

Exhibit 1b: All venture fundraising accelerated in 2014

Source: Thomson One as of December 31, 2014
Includes fundraising by US venture capital and venture capital-type investors (funds with limited partners)

Concentration of Capital and a Right-Sizing Industry

During 2014, we continued to see fundraising dominated by a handful of large funds, with Accel Partners, Andreessen Horowitz, Founders Fund, Kleiner Perkins Caufield & Byers, Lightspeed Venture Partners, Technology Crossover Ventures, Tiger Global Management and Norwest Venture Partners each raising over $1 billion. These firms represent only 4% of the total number of firms that raised capital during the year, but account for 44% of all capital raised. The data reaffirms that capital continues to concentrate in the hands of relatively few. This “flight to quality” is a long-term trend in the venture capital market that we have previously discussed at length. By and large, the experienced VCs with unique and sustainable competitive advantages, strong track records, and excellent reputations among entrepreneurs and LPs are able to raise sizable pools of capital today.

Exhibit 2 estimates the number of active firms in the market over time. We analyzed both the number of firms that raised capital in the current and previous four vintage years, as well as the number of firms that invested in at least three and five companies each year. The first method – depicted by the blue bars – proxies the number of funds with capital available for new
investments, as venture capital investment periods typically span five years. According to this metric, 419 funds were within their investment periods during 2014; while it is not surprising to find that this figure increased by 5% over the prior year, given how active the fundraising market was in 2014, it is importantly 72% lower than 2001, which marked the peak of the data set. To examine the number of funds we believe were truly active, we determined how many invested in three or more, and five or more, deals in each year. In 2014, 279 funds invested in three or more deals, a figure that was consistent with 2013 but 79% less than 2001. Similarly, 200 funds invested in five or more deals in 2014, 4% fewer than in 2013 and 83% fewer than in 2001. The right-sizing of the industry remained apparent in 2014, however the increase of active funds in 2014 may signal a possible reversal of the long-term trend, so we will continue to monitor future data and use it to assess the overall health of the venture capital ecosystem.

Exhibit 2: Active VCs continued to consolidate in 2014

Investments

Investment activity at the seed and early stages bifurcated in 2014, in that more dollars were invested in fewer seed and early stage companies relative to 2013. According to VentureSource data in Exhibit 3a, $8.3 billion was invested in 1,564 seed and early stage companies, which represents a 19% increase in the amount invested and an 11% decrease in the number of companies funded. This divergence reflects the fact that seed and early stage financing rounds have gotten larger as a result of both a competitive marketplace and how much farther along in development many companies are when raising seed and early stage rounds of financing today. In fact, the average amount invested into seed and early stage companies in 2014 was $5.3 million, 35% more than the $3.9 million average in 2013. CB Insights reported that Series A technology deals of at least $10 million were up 64% globally in 2014, with 43% of these rounds being raised within a year of their seed financing, suggesting that VCs are more willing than ever to fund mega A rounds for companies with momentum. Those companies without substantial momentum at the Series A stage, however, seem to be having difficulty getting funded.

Notwithstanding declines in 2008 and 2009 during the Great Recession, the overall trend has been an increasing number of seed and early stage companies funded over the last decade;
however, relative to the peak in 2000 when $29.9 billion was invested in seed and early stage companies, the amount invested in 2014 was 72% lower. Since a low in 2003, the number of seed and early stage companies funded has increased by 136%, yet capital invested has lagged with a proportionally smaller increase of 112%, which reflects a paradigm shift in company formation; cloud computing, software-as-a-service (SaaS) business models, and viral marketing have helped reduce the cost to start an Internet technology company by more than 90% since 2000, and as a result, companies can now effectively prove their products and services using far less capital.

Exhibit 3a: Seed/early investing increased in 2014

Exhibit 3b: All venture investing increased in 2014

Source: Thomson One as of December 31, 2014

When considering late stage financings in addition to those at the seed and early stages, investment activity (measured by capital invested in Exhibit 3b) materially increased to $52.1 billion in 2014, a year-over-year increase of 50% and the highest level reached since the prior peak of $89.9 billion in 2000. As mega Series A rounds have become more common, so too have mega Series D+ rounds. CB Insights reports that there were over 300 financings of $100 million or more in 2014 compared to 70 in 2010, a 394% increase. There were also 12 financings of $500 million or more in 2014, three times more than in the previous four years combined; Uber has been the poster child for this phenomenon, as it has had four $500 million or more financings since 2014. And now industry observers are tallying financings of
$1 billion or more, a badge only held by seven VC-backed technology companies since 2010. Corporate VCs, mutual funds, and hedge funds (in addition to traditional VCs and growth equity players) have converged to finance these companies at the pre-IPO stages. They have done so, in part, because companies today are staying private longer – in 1994, it took an average five years for a company to IPO; in 2004, it took six, and in 2014, the average crawled up to eight.

Exhibit 3c: Companies are staying private longer

![Chart showing average years to IPO and average # of rounds of financing to IPO.]

This trend, coined “Private IPOs,” is worrisome to some VCs, such as veteran Bill Gurley at Benchmark. The concern is that investors – such as T. Rowe Price, Wellington, and Fidelity – who once could participate in company growth in the public markets are desperate to capitalize on growth in the private markets, which, in Gurley’s opinion, has formed the “most crowded party that’s ever been thrown.” In fact, according to CB Insights, the number of unique investors in late stage technology deals last year was 72% higher than in 2010. The “Private IPO” party and its new, deep-pocketed guests have had direct implications on late stage valuations (discussed further in the Valuations section).

Digging Deeper: Seed Stage Analysis

Over the last few years, competition has grown in the seed category, and in response, many seed stage VCs have raised larger and more institutional pools of capital. The outcome has been seed rounds of financing that are larger than in the past, such that they look more like Series A rounds in terms of size and number of VCs participating. The growth of seed round sizes has led some seed managers to describe their strategy as “pre-seed” in order to differentiate themselves from other seed managers who have moved upstream or piled into many of the highly-syndicated financings. While the

2015 MIDAS LIST: TOP 5

Three of the top five VCs on the Midas List are seed investors.

1. Jim Goetz
   Sequoia Capital

2. Peter Fenton
   Benchmark

3. Chris Sacca
   Lowercase Capital

4. Josh Kopelman
   First Round Capital

5. Steve Anderson
   Baseline Ventures
category has continued to evolve and the players within it proliferate, a subset of VCs in the space have set themselves apart based on performance and pedigree. In fact, three of the top five VCs on the 2015 Midas List – an annual ranking of venture investors published by Forbes in partnership with TrueBridge – are seed stage investors Chris Sacca (Lowercase Capital), Josh Kopelman (First Round Capital), and Steve Anderson (Baseline Ventures). Given their stellar performance and relatively small funds, it is no surprise that these seed managers and a handful of others continue to be extremely hard for LPs to access.

Exhibit 4: Seed investing moderated in 2014

As shown in Exhibit 4, seed investment activity has been trending higher in terms of capital invested and companies funded since 2005, reaching a peak in 2012 with $434 million invested in 488 companies. While 2014 was the second year of moderated activity, the $297 million invested in 270 seed stage companies still signified an active year relative to the past decade. Due to the proliferation of seed managers and competition for deal flow, valuations at the seed stage have increased (discussed in the Valuations section below), which may be a cause for the decrease in companies funded and amount invested. Compared to 2000 when a record amount of seed stage capital was invested, a similar number of companies were funded in 2014, but these companies raised 36% less capital, in large part due to dramatically lower startup costs (described previously in the Investments section). Despite higher valuations, the attractive economics of startup formation and the talented VCs who are backing the best ideas and entrepreneurs continue to make the seed space an attractive one in which to selectively invest.

Digging Deeper: Late Stage Analysis

As companies have remained private longer, late stage investment activity since 2011 has been robust. However, as the data in Exhibit 5 indicates, late stage activity last year blew all prior records out of the water. In 2014, $33.2 billion was invested in 1,183 late stage companies, which represented a 68% year-over-year increase in invested capital, and a 16% increase over the previous peak in 2000. While the number of late stage companies financed in 2014 also increased, the increase was proportionally less, meaning the average amount invested in 2014 ($28.0 million) was a material increase over the average in 2012 ($18.6 million) and in line with the average in 2000. Not only have late stage rounds gotten

In a frenzy of late stage activity, 20 startups have the distinction of recently raising three rounds of financing a piece over an 18-month period.
larger, but the time between financings for later stage companies has decreased; in fact, 20 startups including ClassPass, Instacart, Yik Yak, and Zenefits have the distinction of recently raising three rounds of financing a piece over an 18-month period, according to CB Insights.

Exhibit 5: Late stage investment activity skyrocketed in 2014

Source: Thomson One as of December 31, 2014

Valuations

Seed and Early Stage Valuations

Following declines in 2013, seed and early stage valuations increased in 2014. Exhibit 6 indicates that in 2014, the median seed stage pre-money valuation of $5.2 million was a 109% increase over 2013, yet it trailed the peak in 2000 by 18%, even before considering the impact of inflation. We were anticipating this reversal given rising fundraising levels, increasing size of financing rounds, and intensifying competition among seed managers. The increase in early stage valuations was not as dramatic; the median pre-money valuation increased to $12.5 million, which represented a 32% year-over-year increase but 38% less than the peak in 2000.

Exhibit 6: Seed and early stage valuations increased in 2014

Source: VentureSource as of December 31, 2014
Mid and Late Stage Valuations

While mid stage valuations, shown in Exhibit 7 and typically represented by Series B and C financings, increased moderately by 11% in 2014, late stage valuations stole the show, reaching an all-time high. In 2013, the median late stage valuation was $121.0 million, a meaningful increase over the prior year and a record high since 2000; yet in 2014, the increase was even more impressive. The median late stage pre-money valuation in 2014 was $250.7 million, which represented a year-over-year increase of 107% and a 120% increase over 2000. With the run-up in late stage capital invested and companies funded since 2009, it is not surprising that late stage valuations have followed suit.

Exhibit 7: Late stage valuations hit a new high in 2014; mid stage continued to climb

Several factors are driving the rise in late stage valuations. From a macro perspective, the secular bull market in public stocks has been a tailwind for private company valuations, and a low interest rate environment has driven large institutional investors into the venture capital market in search of returns. From a technology standpoint, the impact that mobile devices and cloud computing have had on disrupting new industries is significant – akin to our generation’s Industrial Revolution – and the excitement around this new generation of maturing technology startups has likewise attracted investors to the sector. Since the end-user markets for technology products and services are so vast today – there are over three billion Internet users globally and there is estimated to be four billion smartphone users by 2020 – company valuations should arguably reflect this reality. And as discussed above, as companies are taking longer to go public, private investors have more time and opportunity to invest and participate in the steep portion of companies’ value creation curves; as a result, these companies grow larger and stronger in terms of fundamentals, and thus merit – or are expected to soon grow into – their high valuations.

But in some cases, valuations are being driven higher by aggressive participants – VCs that are thirsty for logos and want to boost their brands by being associated with today’s hot companies; hedge funds and mutual funds that are eager for pre-IPO exposure and are less sensitive to price;

With four billion smartphone users expected by 2020, the impact that mobile devices and cloud computing have on disrupting new industries is akin to our generation’s Industrial Revolution.
and corporate VCs that are flush with cash and that invested $15 billion in 2014, the highest annual figure in the last decade according to Pitchbook. In Gurley’s opinion, it is FOMO, or the “fear of missing out,” that has helped create the growing herd of billion-dollar startups with soaring valuations. In 2014, 38 new venture-backed private companies globally joined the unicorn herd, bringing the year-end tally to 78 (and the number today is estimated to have surpassed 100). Now industry pundits have started tracking “decacorns,” or those private companies valued at $10 billion or higher. Facebook was the only company that had held this distinction as of the end of 2013, and now there are at least ten – Xiaomi, Uber, AirBnB, Palantir, Snapchat, SpaceX, Flipkart, Lufax, Pinterest, and Dropbox.

Value creation is clearly shifting from the public to the private markets, according to Scott Kupor of Andreessen Horowitz who presented at TrueBridge's 2015 Annual Investor Meeting, and those investors who approach the shift with discipline and keen insights stand to benefit and participate in the upside. However, veteran VCs who wear the scars from past cycles are encouraging entrepreneurs to control cash burn rates and raise fresh venture capital sooner rather than later to protect their startups if and when the market experiences a correction. As Fred Wilson of Union Square Ventures reminded us, valuations are – but shouldn’t be – an entrepreneur’s measure of success; the market dictates valuations, and some days the market is your friend and other days it is most decidedly not your friend. Given how private market valuations are running ahead of their public comparables, and how several IPOs this year – notably Box – priced below their most recent private rounds, the valuation trend for late stage companies may negatively impact future exits and liquidity for VCs.

### Exits

#### Initial Public Offerings

Public market appetite for venture-backed companies was quite strong in 2014. Exhibit 8 shows that 115 US-based venture-backed companies went public in 2014, 34 (or 42%) more than in 2013 and 108 (or 15x) more than the low point of 2008. The largest venture-backed IPO of a US-based company last year was Lending Club, which was valued at $5.4 billion. And the Nasdaq-listed, Chinese e-commerce company Alibaba is worth mentioning, given its 2014 IPO was the largest of all time, with $25 billion raised and a valuation of over $231 billion. While the technology sector consumed the headlines, biotechnology companies actually

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**UNICORN STATUS**

The undeniable flurry of tech innovation and availability of capital is allowing more companies to stay private longer and achieve unicorn status, or the $1 billion valuation mark.

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<th>100+</th>
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accounted for more than half of all venture-backed IPOs for the second consecutive year. Given that market capitalizations for biotechnology companies tend to be lower than their technology brethren, it is not surprising that the median post-IPO market capitalization has declined in recent years.

Exhibit 8: Number of IPOs ramped up in 2014

Mergers and Acquisitions

After three years of declines, M&A activity rose again last year, as shown in Exhibit 9. In 2014, 457 US-based venture-backed companies were acquired, a 21% increase from the 377 that were acquired in 2013. Although activity was robust last year, the M&A tally was below that of 2010, 2011 and 2012. Deal values jumped 65% in 2014 and continued to reflect a rising trend since 2009; the average acquisition price was $374 million in 2014, 224% higher than the most recent trough in 2008. Facebook’s acquisition of WhatsApp was the largest venture-backed M&A event of 2014 by a huge distance, valued at $22 billion, which certainly drove the jump in average acquisition value. Excluding WhatsApp, total M&A deal size totaled $26.5 billion in 2014, a 57% increase compared to 2013 and the strongest annual period for US venture-backed M&A exits since 2007. While Facebook and other public companies were active acquirers, 2014 also saw the most VC exits via private equity buyouts over the past 10 years.

Exhibit 9: M&A and deal values jumped 2014
According to a CB Insights analysis of billion-dollar technology exits between 2005 and 2014, 93 VCs had exposure to one billion-dollar exit, but only six VCs participated in eight or more; this elite group, representing just 0.5% of all active US technology VCs, consisted of Sequoia Capital, New Enterprise Associates, Kleiner Perkins Caulfield & Byers, Accel Partners, Benchmark, and Greylock Partners. This exit analysis reinforces TrueBridge’s belief that returns, in addition to capital, continue to consolidate and that manager selection and access continue to be paramount for LPs investing in venture capital.

Despite the pace of IPOs and billion-dollar M&A events slowing in early 2015, TrueBridge anticipates a healthy exit market in the coming years, barring any global macro correction. While only seven VC-backed tech companies have gone public so far in 2015, the potential IPO pipeline is strong – with 25 new US-based unicorns last year and the number of new unicorns in 2015 expected to surpass last year's record. And even though there have been just two strategic sales valued at over $1 billion so far in 2015, the M&A market over the next several years should be active as new incumbent public technology companies face a slowing growth cycle and need to accelerate, and buy into, renewed growth. The big caveat according to Scott Kupor, however, comes back to valuations, since some late stage companies may have priced themselves out of the M&A market by raising capital at valuations that few public acquirers can top.

Returns

We have long emphasized that low absolute returns during the early-2000s were driven primarily by overcapitalization in the market and too many funds chasing too few compelling investments. As discussed in the Fundraising section, the number of active firms has steadily declined since the Internet bubble, from 1,077 funds that invested in at least five deals in 2000 to just 200 in 2014. This change in competitive dynamics has not surprisingly resulted in improved returns. Cambridge Associates’ venture capital index increased by more than 21% in 2014 – a strong year of returns that actually lagged the record 27% increase in 2013. 2014 was also a strong year for the asset class relative to the public markets; Cambridge’s index easily surpassed all the public equity indices, and its Public Market Equivalent (PME) analysis shows the index beating the S&P 500 and Russell 2000 indices by 786 and 1,679 basis points, respectively.

Exhibit 10: Recent top-quartile vintage year IRRs looking strong

Returns, in addition to capital, continue to consolidate, making manager selection and access all the more paramount for LPs investing in venture capital.
As highlighted in Exhibit 10, top-quartile US venture capital returns for each vintage year from 2008 to 2012 were at least 20% net to investors, following a period of lackluster returns for vintage years between 1999 and 2006. Furthermore, LPs in venture capital funds continued to see distributions outpacing contributions, by a factor of 1.7x over a three-year period ending in the third quarter of 2014. Strong performance and healthy distributions have brought with it renewed enthusiasm for the venture capital asset class, which is a driver of the increased fundraising activity in 2014. However, with much of the excess capital gone from the market and a continued healthy exit environment, we largely expect these returns to hold up or improve.

Conclusion

2014 was a remarkable year for the venture capital industry in many respects. VCs raised significantly more capital than the prior year, yet fundraising continued to concentrate in the hands of relatively few large, well-established, brand-name firms. Investment activity - measured by capital invested - also materially increased in 2014, driven by late stage financings. Round sizes and valuations increased across the board, from the early to the late stages. Most notably, late stage valuations reached an all-time high for the second consecutive year, thus shining a spotlight on the fast-growing number of unicorns and decacorns. The run-up in late stage valuations can be attributed to several factors, notably the participation of hedge funds, mutual funds, and logo-chasing VCs in large, highly valued “Private IPO” rounds.

While late stage activity continues to fuel the bubble debate, there are sound reasons that VCs and market participants such as TrueBridge remain excited about today’s investment opportunities arising from a long-term bull market for technology. For experienced early stage investors, it remains an attractive time to back start-up companies, given entrepreneurs can develop technology, test business models, and evaluate market demand on relatively little capital. And for those later stage investors with discipline, there is an opportunity to participate in the growth of a new generation of truly disruptive and transformative technology companies. With the backdrop of a healthy exit environment and impressive asset class returns, LPs continue to want to partner with the very best venture capital managers; yet selection of and access to these VCs remain critical to generating top quartile returns. TrueBridge will continue to closely evaluate the venture capital landscape, thoughtfully navigate the complex environment, and use our insights and access to make investment decisions to partner with the very best managers.

A note about the data referenced throughout this report: We acknowledge that there are numerous sources of industry data that may differ materially in methodology, breadth, and statistics. For consistency, we primarily reference two sources throughout this report. Thomson One tends to capture a greater percentage of fundraising activity, and VentureSource typically captures a greater share of investment activity. We therefore leveraged Thomson One’s platform to analyze venture capital fundraising, and VentureSource to analyze venture capital investments. Two distinct databases were used in favor of data integrity and at the expense of direct comparisons between fundraising and investment activity. Readers will notice that venture capital investing actually exceeds fundraising for most years; the reason is that investment data includes activities by corporate, government, and other entities, while fundraising data enables analysis of purely institutional venture capital fundraising. True capital invested by institutional venture capital firms is likely lower than the statistics referenced in these analyses, but we believe the data to be directionally accurate. In addition, the data we present has not been adjusted for inflation, so many of the comparisons made between 2014 and 2000 data are even more pronounced.