



# EUROPEAN INVESTOR SENTIMENT INDEX

## Quaterly Survey

Q3/2023

September 29, 2023

## EUROPEAN ECONOMY RECOVERING AT DIMINISHING SPEED.

In the second quarter of 2023, following promising signs of recovery in the preceding quarter, the European economy encountered a deceleration. Despite the European Union's demonstration of resilience amid challenging economic conditions, the seasonally adjusted Gross Domestic Product (GDP) in the euro area saw a modest increase of only 0.1% compared to the previous quarter (Eurostat, 2023b). By the second quarter's end, the cumulative growth for the year 2023 had reached 0.5% in the euro area, signifying a reduction of 0.3 percentage points in the annual growth rate (European Commission, 2023).

As we transitioned into Q3 2023, we observed indications of economic sluggishness, which had a notable impact on European ventures. Particularly noteworthy is the downward revision of 0.2 percentage points in the real GDP growth projection for the year 2023 in the euro area, compared to the earlier June forecasts. This reduction in economic growth can be attributed primarily to the imposition of more stringent financing conditions (European Central Bank, 2023a).

Another crucial factor which strongly impacts European ventures is inflation. Accordingly, the headline inflation continued its decline, reaching 5.3% in July and 5.2% in August. While this was in line with expectations and marked a decrease from Q2 2023, it remains significantly above the ECB's targeted 2% rate. This decrease in headline inflation was primarily driven by lower energy, food, alcohol & tobacco, and industrial goods prices, with energy prices dropping in June due to lower wholesale gas and electricity costs. However, this downward trend was interrupted in August as energy prices rose compared to July. Among the key components of eurozone inflation, food and alcohol & tobacco recorded the highest annual inflation rate in August at 9.8%, although this was a decline from the previous month's 10.8% (Eurostat, 2023a).

Core inflation in the EU also slowed down, reaching 5.3% in August from 5.5% in the prior month. However, concerns persist about potential upward pressure on commodity prices due to the ongoing war in Ukraine, as noted by ECB Vice-President Luis de Guindos.



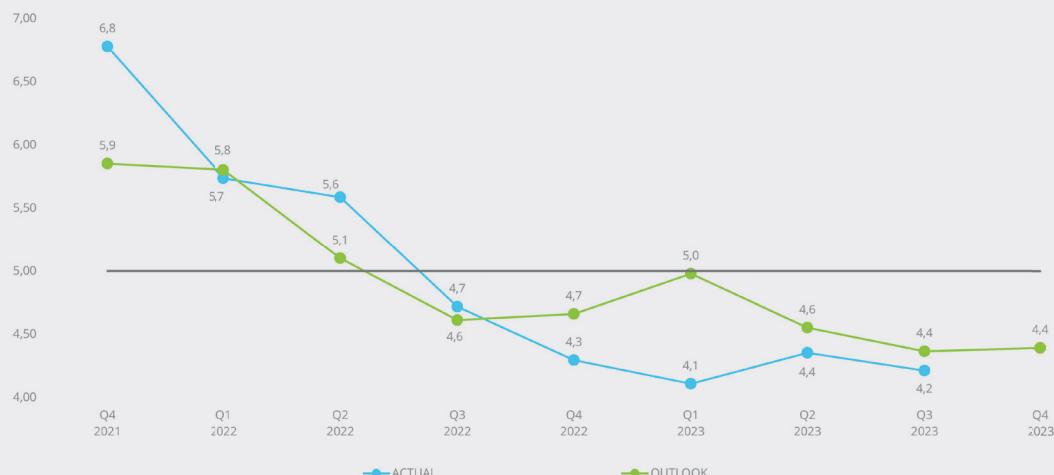
In light of the prevailing financial market challenges, we observe a consistent trend among investors wherein they prioritize nurturing their existing portfolio of startups, particularly impacting early-stage and new entrant ventures, over exploring new investment prospects. While we do witness increased venture capital activity, it predominantly bolsters startups in their later stages of growth. However, it is important to note that different sectors within the European ecosystem exhibit varying responses.

In response to rising interest rates and the prevailing macroeconomic situation, high-growth startups in the Soonicorn and Unicorn categories face higher valuation sensitivity, which implies adjustments in terms of timing or their exit-windows. This on the other hand will likely result in higher pressure for existing fund investors to de-invest through alternative routes.

The prospect of unfavourable exit conditions looms, compelling many of these companies to seek additional time and investment to position themselves favourably for exit. This shift has already driven the surge in secondary venture transactions, offering these startups an extended runway while they await improved exit opportunities. Looking ahead, we expect scale-ups to reassert their presence in the following year, which could potentially exert a major influence on the European VC market.

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Despite the overall decrease in inflation, the ECB remains committed to preventing sustained high inflation. In September 2023, the ECB announced its 10th consecutive rate hike, raising the three key ECB interest rates by 25 basis points. This resulted in the main refinancing operations rate reaching 4.5%, the marginal lending facility rate at 4.75%, and the deposit facility rate at 4%. Notably, this policy announcement led to a 0.5% depreciation of the Euro against the U.S. dollar (European Central Bank, 2023c).

The European Banking sector in Q3 2023 remained robust and they are expected to remain resilient according to the EU-wide stress tests published by European Banking Authority in July 2023. The resilience after the banking crisis, however, is going to be boosted by finalising the implementation of globally agreed Basel III regulatory reforms, which also support green and digital transitions with the assistance of a robust banking sector (Council of the European Union, 2023). The cyber risk, is, however, the other threat for the banking system. Currently, the risk is on the rise with the continuous digital transformation of the financial sector. Additionally, persistently high inflation together with monetary policy tightening and current geopolitical circumstances could lead to further asset price corrections (European Central Bank, 2023b).

Despite the banking crisis, started in Q1 2023, the European banking sector in this quarter maintained its resilience. To further bolster resilience after the crisis, the banking regulators are finalizing the implementation of globally agreed Basel III regulatory reforms (Council of the European Union, 2023).

## INDEX ACTUAL SHOWS RECOVERY PROGRESSION, OUTLOOK REMAINS STABLE.

The third quarter of 2023 indicated a period of turbulence in the VC ecosystem's recovery. The index exhibited a slight decrease from 4.4 in Q2 2023 to 4.2 in Q3 2023, marking a 3.3% decline QoQ and a 10.7% drop YoY. Despite these shifts, we emphasize that the European venture landscape, and the index in particular, is steadily progressing towards normalisation.

This modest decline in the index can be attributed to a growing preference among VC investors to participate rather than lead investment rounds. Consequently, this shift has created a scenario where startups encounter challenges in securing lead investors, which in turn contributes to the observed trend within the VC ecosystem.

However, it is worth noting that this quarter's actual result represents the second-lowest point recorded since the index's inception in Q3 2019. Additionally, Q3 2023 marked the second-lowest index value (calculated as the average of actual and outlook) since the index's launch. Investor caution primarily stems from the current macroeconomic conditions, which continue to significantly impact market sentiment among European VC investors.

Looking ahead to Q4 2023, with data recorded in Q3 2023, the index outlook stands at 4.4. This reflects a 0.6% increase compared to the previous quarter but registers a 5.7% decline compared to the previous year. Notably, this outcome marks the third-lowest point in index outlook since its inception. The close alignment of the outlook for the upcoming quarter with the actual point of the current quarter suggests that investors anticipate a challenging yet stable Venture Capital ecosystem in Europe.

The most significant increases in the index's actual values are driven by an 11.4% QoQ rise in the current perception of startup valuations, a 7.0% QoQ increase in sentiment regarding deal competition, and a 2.4% QoQ improvement in deal flow quality. However, respondents also noted a 25.6% QoQ decrease in investor activity and a marginal 0.2% QoQ dip in sentiment regarding the current fundraising environment.

For the Q4 2023 outlook, key drivers include a 14.2% QoQ increase in expectations of overall European investor activity, a 12.1% QoQ rise in the anticipated fundraising environment, and a 4.0% QoQ improvement in expected deal flow quality. Conversely, negative factors include a 15.9% QoQ drop in expectations regarding startup valuations and a 4.5% QoQ decrease in anticipated deal competition.

Most investors express primary concerns related to the banking crisis, followed by the ongoing threat of high inflation, central bank interest rate policies, and the conflict in Ukraine. All these factors lead to lower valuations, less investment activity (for new deals), and a greater demand of strong KPIs of scale-ups toward profitability.

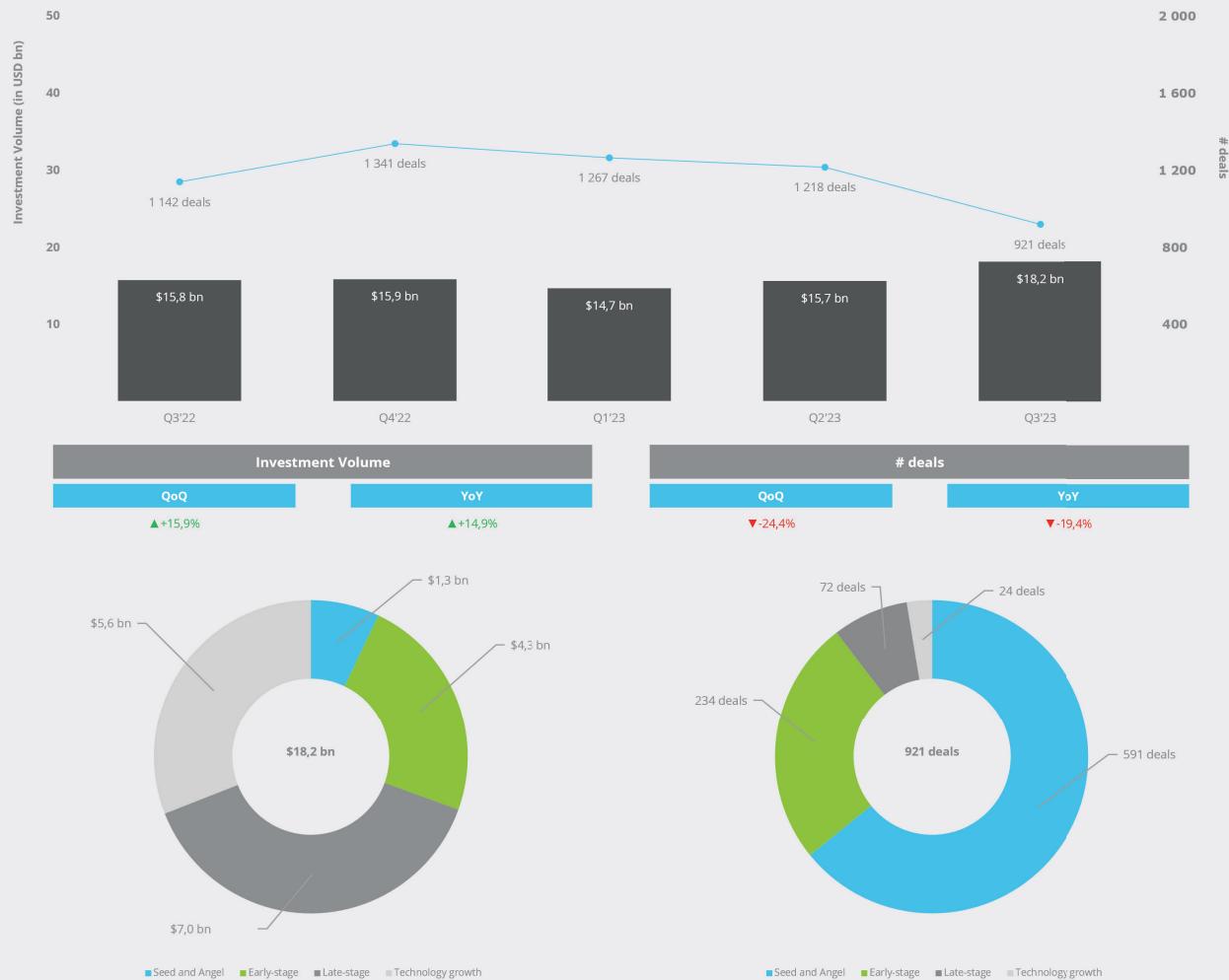
In line with previous reports in 2023, we anticipate that the European Venture Capital ecosystem will continue its recovery in the forthcoming quarters, a trend that began to materialize in Q2 2023 – nevertheless our Analysts view is that a recovery will likely take additional 12 to 24 month before we see a solid growth environment again.

## CRITICAL TRENDS IN EUROPEAN VC.

The current macroeconomic climate presents European VC investors with various challenges. Fundraising emerged as one of the most significant issues this quarter, affecting both ends of the industry. VC investors encountered difficulties in securing funding for new funds, while European startups faced fundraising challenges. These complications primarily stem from recent interest rate hikes, which have elevated the risk-free rate, prompting investors to favour less risky investment opportunities. However, we view this as a temporary and necessary correction.

In terms of valuations, respondents reported elevated valuations for early-stage ventures (Pre-Seed, Seed, Series A & B), while Post-Series B deals are being perceived as undervalued. This trend is also evident in specific sectors, with Generative AI experiencing notably high valuations, while such sectors as FinTech, RegTech, and InsurTech are perceived as undervalued.

## EUROPEAN VENTURE CAPITAL DASHBOARD



\* The dashboard was based on the data available on September 28th, 2023.

## EUROPEAN VENTURE ACTIVITY GROWS, NEW STARTUPS FACE CHALLENGES.

In Q3 2023, European ventures garnered a total investment volume of USD 18.2 billion across 921 deals, marking a notable step forward in the gradual recovery of the European VC sector that commenced in the first half of the year. This achievement reflects a robust 15.9% surge in the investment volume compared to the previous quarter and an impressive 14.9% increase compared to the previous year. However, in contrast to the investment volume, there was a

noteworthy decline in the total number of deals, with a substantial 24.4% decrease QoQ and a 19.4% dip YoY. The average deal size in Q3 2023 stood at USD 19.7 million compared to USD 12.9 million in Q2 2023. This marks a significant upswing of 53.2% QoQ and a substantial 42.4% increase YoY. This reaffirms the trend we highlighted in our previous report, where the average deal size is on the rise due to increased investment volumes coupled with a reduction in the number of deals. This trend underscores the prevailing tendency of European investors to engage in selective "cherry-picking" behaviour.

Through personal interviews, we discovered that respondents indicated a temporary shift towards fundraising and investing in existing portfolio startups rather than exploring new opportunities.

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This strategic pivot can be attributed to the current macroeconomic climate, wherein European investors prioritize startups with extended runway, tangible profitability track records, and stable, consistent traction as key factors for their investments.

This preference for lower-risk investments within their portfolios has led to challenges in attracting new investors, which is particularly concerning for new startups. It is important to note that this could potentially contribute to an overall reduction in innovation, given the lower risk tolerance levels of startups under these circumstances.

## UK REMAINS THE EUROPEAN VC LEADER, MEANWHILE SWEDEN TOOK THIRD PLACE, LEAVING GERMANY ON FOURTH.

In Q3 2023, the three largest European VC ecosystems were the United Kingdom, France, and Sweden, with Germany dropping to the fourth position. These top 3 VC ecosystems collectively accounted for 68.2% of the total investment volume in the region in this quarter, marking a substantial 13.6% increase QoQ. Each of these leading countries experienced significant growth in investment volume.

The United Kingdom, for instance, attracted a total investment of USD 6.8 billion, representing a remarkable 46.2% increase from the previous quarter. France, the second-largest European VC ecosystem, saw a 57% increase, amassing USD 3.7 billion.

Sweden's VC ecosystem stood out with a remarkable 66.2% QoQ increase, reaching an investment volume of USD 1.8 billion. This surge in the Swedish ecosystem can be attributed to its growing startup community, which has been attracting more talent and capital in recent years. In contrast, the performance of the German VC ecosystem shrank to USD 1.7 billion, marking a QoQ decrease of 26.6% and placing it in the fourth position in Europe. The combined investment volume of those top 4 countries accounts for 77.8% of the aggregated investment volume.

This distribution suggests a less fragmented investment landscape among smaller European VC ecosystems, contrary to earlier predictions. However, as the economic recovery continues, this trend could easily shift in the next quarter.

The three noticeable deals were observed in the European VC market during Q3 2023. The largest deal in the quarter was a Series C funding round of a French-based low-carbon battery manufacturer Verkor, which raised EUR 2 billion in September 2023. The second largest deal was a EUR 1.5 billion Private Equity financing round of H2 Green Steel (based in Sweden) in September 2023, which aims to build the world's largest electrolysis plants, powered by

green hydrogen produced with fossil-free energy. The green steel plant will be an integrated part of the company's steel production facility in Boden. The third noticeable deal was the Private Equity funding round of the UK-based Zenobe Energy, which is the largest independent owner and operator of battery storage in the UK. In September 2023 the company raised GBP 600 million (Dealmatrix, 2023 & Crunchbase, 2023).

## METHODOLOGY

Over 4000 highly experienced investors (business angels, (corporate) venture fund managers and family offices) from 8 European countries were invited to participate in July, August and September 2023 in the European Venture Sentiment Survey, conducted by Venionaire Capital. Venionaire Capital collects answers from a focus group in computer-assisted personal interviews and a much smaller control group to assess the indices based on a quarterly recurring survey.

Those datasets are collected in two waves and finally merged. In both groups, Venionaire has aligned similar sets of investors, ranging from business angels to large corporate venture units as well as early- to later-stage venture capital funds from all over Europe (incl. Switzerland and the UK).

The indices for current sentiment and projected outlook are weighted indices, with emphasis on the ability/willingness of investors to invest, the perception of startup valuations and the quality of deal flow.

## COMPARABILITY

Sentiment surveys and indices are nothing new. They have been around for decades to quantify how a specific group of people feel about a market or economy. One of the most notable examples is the Consumer Confidence Index (CCI), which provides an indication of future consumption and saving of households. There are also surveys that focus on a specific market, or even an individual security. How can the results of these market sentiment surveys help market participants?

Let's look at the venture capital industry. This general economic information can greatly benefit both the investor and start-ups within a market. Investors can compare their own views and opinions to those of the general market or across different geographical regions and industry verticals. This will help them to adjust their investment behavior. Start-ups can use this information when growing their business internationally, when they prepare for fundraising or to slow down their business (return to bootstrapping – ahead of time) if the economic environment worsens. Market sentiment indicators are important for us in all industries and markets.

Nevertheless, there is a limited number of market sentiment indices for the venture capital or start-up market available, which we found useful to work with.

Most indices available focus on a specific region, investors group or industry. Take EIF's VC Survey, which targets a highly professional group of regulated investors across Europe, but does not take accelerators or business angels into account. Our partners of Deutsche Börse Venture Network conducted a great report on market sentiment during the COVID-19 pandemic. It offers great insights, but it was a onetime publication.

We have developed our own "European Venture Sentiment Index", which shows in one simple number the general state of sentiment today and shows the current outlook in a second number.

## THE EUROPEAN INVESTOR SENTIMENT INDEX

The index is based on feedback from different economic regions, as well as start-up sectors and reflects the general European Venture Sentiment. The methodology of the index was designed by Venionaire Capital in mid-2019. The project was led by its founder and managing partner, Berthold Baurek-Karlic, a serial entrepreneur and leading venture capital expert from Vienna, Austria. Berthold started his career in the statistics department of the Austrian Central Bank (OeNB).

"We attach great importance to providing our investors with an actual overview of the current investment climate in the European start-up sector. After this index has proven to be an important tool for our clients - including start-ups as well as investors - we have decided to make the results available to the public for the first time during the COVID-19 pandemic in the first quarter of 2020. Our aim was to draw public attention to the threatening situation of innovative young companies in Europe", explains Berthold Baurek-Karlic.

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## AUTHORS



Berthold Baurek-Karlic is the founder and managing director of Venionaire Capital, which specializes in M&A and venture capital. The Venionaire Group also includes the software provider DEALMATRIX ([dealmatrix.com](http://dealmatrix.com)).

He is also founder and secretary general of the Business Angel Institute ([businessangelinstitute.org](http://businessangelinstitute.org)), board member of the European Super Angels Club ([superangels.club](http://superangels.club)), Homepl ([homepl.com](http://homepl.com)), Flovtec ([flovtec.com](http://flovtec.com)), Unmanned Life ([unmanned.life](http://unmanned.life)) and chairman of the supervisory board of Blockpit ([blockpit.io](http://blockpit.io)). Furthermore, he is an expert partner of various accelerators and consultants of various venture funds, as well as external consultant in the EU programs Horizon2020 (today Horizon Europe) and Innovation Radar.

**BERTHOLD BAUREK-KARLIC**

MANAGING PARTNER (CEO) & FOUNDER, VENIONAIRE CAPITAL



Denis manages the dealflow, analyses intricate business models, and prepares investment decisions. He is accountable for spotting, screening, and evaluating startups, with an added focus on financial modelling, aiding Venionaire's clients with financial engineering and valuations. Additionally, Denis is responsible for evaluating the development of portfolio startups. He has gained professional experience working on international projects between Russia and China. Holding an undergraduate degree in International Business Administration with a finance major from Lauder Business School, he currently pursues a graduate degree in Strategic Finance & Business Analytics from the same institution.

**DENIS VOLDMAN**

ANALYST, VENIONAIRE CAPITAL



Sofiya is responsible for the preparation of information for reports and manages various dealflow tasks, which encompass fundraising efforts and the ongoing updating of startup information. She is also actively involved in assisting with the identification, evaluation, and consideration of potential startups. Sofiya earned her Bachelor of Arts degree in the "Ethics Politics Economics" program from the Ukrainian Catholic University in Lviv, Ukraine, achieving the distinction of magna cum laude. Currently, she is pursuing her Master of Arts degree in Economic Policy in Global Markets at the Central European University. Additionally, she possesses valuable experience in international cooperation, garnered during her tenure at the Economic Department of the Ukrainian Embassy in Austria.

**SOFIYA LYN**

ANALYST

# ABOUT



The European Venture Sentiment Survey is conducted with the lead of Venionaire Capital. Venionaire is a entrepreneurial partner for investors, founders and institutionals. Our partners and team are specialized in venture capital and private equity investments, with an extensive over a decade-long track-record. We offer transaction and corporate advisory services – from due-diligence, valuation, deal structuring, (ghost) negotiating to alternative fund management – for investors, corporates, public entities and growth companies (startups / scaleups). Our track-record as entrepreneurs, advisors and investors shows deals in fields of corporate finance (M&A), (Corporate) venture capital, corporate startup engagement (CSE), digital transformation and high-tech innovation with a total volume of more than a billion Euros. In addition we serve as trusted partners for scouting, screening, technology-, market- and competitive analysis and valuation for bespoke investors and accelerators in Europe. We are proud of our performance within managed portfolios and increase our high-tech footprint everyday to support a future-proof economy.

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