PitchBook

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Published on February 16, 2023

Contents

Key takeaways 1

Introduction 2

US venture market changes 3

Concentration of mega-deals and unicorns 4

Effects of capital concentration on the US market 5

Ecosystem dynamics of the future 6

Capital Concentration and Its Effect on the VC Ecosystem

As fund sizes have grown, capital has become concentrated within two markets

PitchBook is a Morningstar company providing the most comprehensive, most accurate, and hard-to-find data for professionals doing business in the private markets.

Key takeaways

- Since the beginning of 2019, the Bay Area and New York City have raised $330.8 billion in commitments for VC funds, while the rest of the US has raised just 45.6% of that total. The concentration of capital within investors headquartered in these markets looks problematic for the industry, as it could lead to further concentration of ideas and technologies in these ecosystems.

- Prior to 2019, our research showed that the median distance between a company and their lead investor was less than 100 miles for seed deals, highlighting the need for local fundraising in small markets to realize ecosystem growth and development. The COVID-19 pandemic drastically changed that reliance on local investors, however, and in 2022, the median distance between a seed company and its lead investor was 591.3 miles.

- Bay Area and New York City investors have increased their investments outside of these two markets on both a deal count and value perspective. While a positive sign for the industry, as the market reacts to economic headwinds and a return toward normal operation following relaxing pandemic regulations, the sustained investment across new markets will be predicated on local investors continuing to boost local ecosystem investment.

Introduction

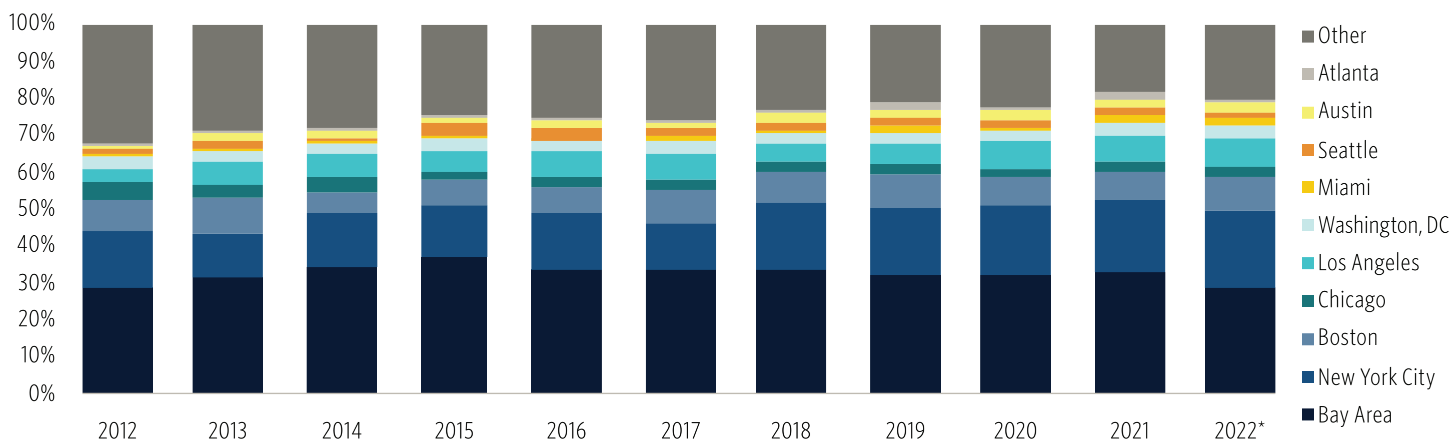
It is a common narrative that the venture market has become more distributed outside of traditional hubs like Silicon Valley. Miami, Austin, and a few other smaller markets took control of the headlines during the height of the pandemic, while the Bay Area and New York City—the two largest venture markets—were daunted by closures, along with talent and investors fleeing to more cost-effective or open markets. The Bay Area and New York City remain the largest markets, and there is no reason to believe that will change in the near- or even medium-term future. Since the beginning of 2019, both areas have raised $330.8 billion in commitments for VC funds, while the rest of the US has raised just 45.6% of that total.

As the US venture market has grown, so has the size of venture funds. 86 funds have closed on $1 billion or more in the past four years—70.5% of the total number closed since the beginning of 2012. Another 138 have closed with commitments between $500 million and $1 billion in the past four years. Overall, this is a relatively small portion of the total number of funds closed during that time, measuring just 3.8% of the closed vehicles. This growth in fund size has brought about a concentration of the capital, both within ecosystems and within the largest venture firms.

This concentration of capital, however, does look problematic. Entrepreneurs in small markets are at a disadvantage when raising capital, which impacts their ability to compete with similar companies well-stocked with cash. More than half of US venture deals that occur each year are located in just four markets—the Bay Area, New York City, Los Angeles, and Boston. Roughly 35% of deal count took place in either the Bay Area or New York City during 2022, along with 72.5% of capital commitments closed by VC firms during the year.

More than half of all funds closed from 2019 to 2022 were done by VC firms headquartered outside the Bay Area and New York City, but it's increasingly noticeable that venture still runs through those two hubs. The question then shouldn't be if capital concentration is occurring, but rather if there is an impact on the spread of capital around the US and just how much influence that will have on the market moving forward.

Share of VC funds closed by CSA



Source: PitchBook | Geography: US
*As of December 31, 2022
Note: Austin MSA is included in rankings alongside CSAs.

US venture market changes

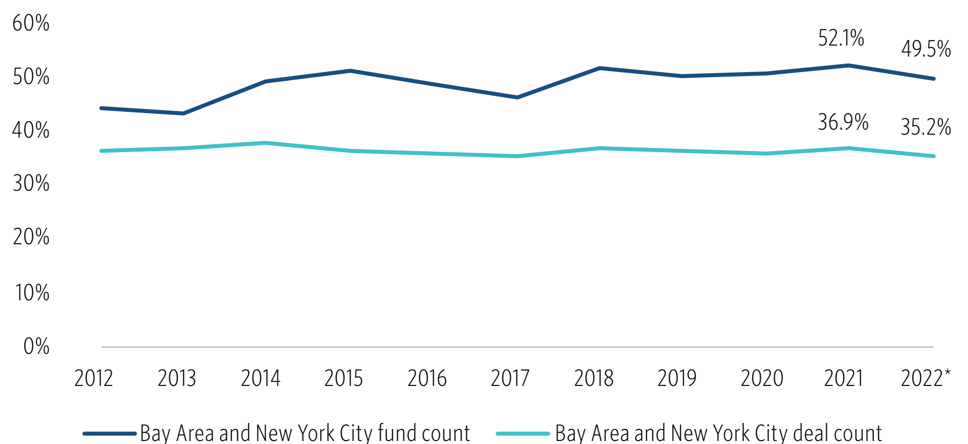
Since the global financial crisis (GFC), venture capital has become a much larger financial market. During the GFC, around $30 billion was raised each year by US-headquartered venture funds. In each of the past two years, more than $150 billion was raised.

More capital is needed now, as companies stay private longer and require more support from VC funds than ever before. Globally, more than $500 billion was raised by venture-backed companies in private deals, while just $140 billion was raised through proceeds from VC-backed IPOs. Supporting this trend, the average fund in the US has added 50% to its size over the past four years, growing consistently each year from $100 million in 2019 to $150 million in 2022.

The Bay Area and New York City have consistently raised the largest shares of capital invested into the venture market. They are the only two markets to see more than $25 billion invested annually more than once. The Bay Area has seen higher than $30 billion invested annually each year since 2014.

The size of the gap between the Bay Area and New York City, and the rest of the US VC ecosystems is rather astounding. In 2021, 51.6% of all deal value for the US entered into just these two markets. Even in 2022, when the total invested into the Bay Area and New York City fell by 39% and 46%, respectively, the two markets still commanded 45% of all capital invested in the US.

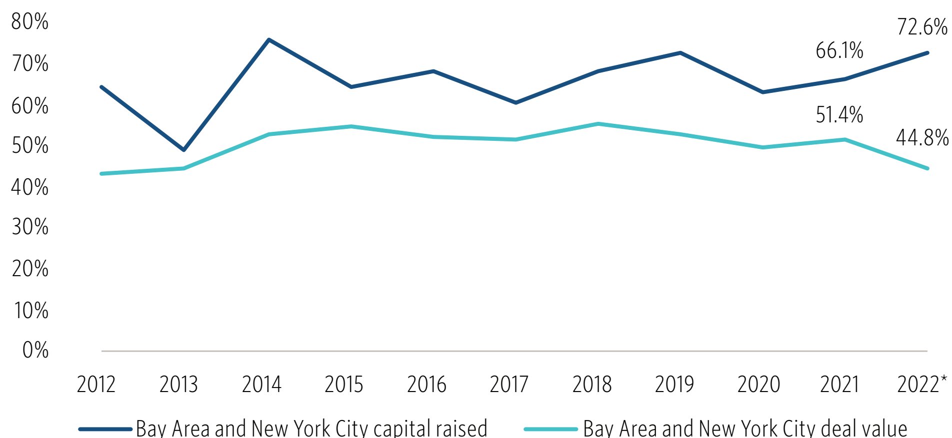
VC deal and fund count for Bay Area and New York City CSA companies as a share of all VC deal and fund count



Source: PitchBook | Geography: US
*As of December 31, 2022

Why is this the case? Beyond simply being large metro areas, or that Silicon Valley was the original VC area, New York City is undeniably *the* financial market, flush with LPs ready to take risks. These markets also provide access to a high amount of talent, with many universities nearby churning out entrepreneurs. With 1,856 funds and $330.8 billion raised since 2019—both figures being above the rest of the US combined—capital commitments to the Bay Area and New York City outpace the rest of the US by more than double.

VC deal value and capital raised for Bay Area and New York City CSA companies as a share of all VC deal value and capital raised



Source: PitchBook | Geography: US
*As of December 31, 2022

65 of the 86—or 75.6%—$1 billion-plus funds raised since the beginning of 2019 have been located in these two markets. Boston with eight and Chicago with three were the only other ecosystems with more than one such fund closed. So, it's true that the high value of capital raised in the Bay Area and New York City is concentrated in just a small portion of the investors in the US.

Concentration of mega-deals and unicorns

At the forefront, the capital concentration into New York City and Bay Area-based funds should seem concerning. $122.3 billion of the total dry powder is estimated to be solely in $1 billion-plus funds closed from 2019 on, including 50% of the dry powder from the two most recent vintages. If a high proportion of those funds are located in just two markets, companies in other regions seemingly face difficult odds, especially those with capital needs reliant on larger funds.

As a founder, moving a young company into markets with broad access to funds of all sizes is tempting. Prior to the pandemic, it was also more of a necessity, as in-person meetings were the main option for raising capital. Video conferencing has become a normal part of work-life, but for many investors, it was not an option used to make deals. While smaller markets have raised a higher number of funds than a decade ago, the majority of these vehicles are smaller in size and unable to support companies beyond early rounds. Companies growing beyond the early stage have an easier time soliciting capital from large market funds.

In the past four years, 1,051 mega-deals have been completed in companies headquartered in the Bay Area and New York City—nearly 54% of the total number of $100 million-plus rounds during that time. Those deals account for more than $238 billion capital invested. With the exception of Los Angeles, the falloff in mega-deals between markets containing a high amount of capital and those without is dramatic. Seattle is the only market that has received more than 50 deals of $100 million or more since 2019.

Unsurprisingly, unicorns have become very concentrated as well in the Bay Area and New York City, though Boston and Los Angeles also show a strong total unicorn count. Of the total 961 unicorns created with US headquarters, roughly 60% were headquartered in either the Bay Area or New York City.

While there is something to say for timing within this data—most unicorns were launched in these markets prior to the run of billion-dollar funds—there is undeniably an advantage in being located in the same market as an abundance of capital and investors. Just one market outside of the Bay Area, New York City, and Boston has raised more than $5 billion in a single year, and that was Chicago in 2021 with $6.2 billion.

Effects of capital concentration on the US market

Data shows that this concentration of capital might not be what it seems. Over the past decade, the activity by New York City and San Francisco investors into companies headquartered outside these ecosystems has increased in terms of both dollars invested and deal count. Bay Area-based investors participated in over 3,400 deals outside of the Bay Area and New York City in 2021—more than double the 2018 figure. While this datapoint fell back a bit in 2022, it remained nearly 30% higher than 2020.

2021 was an abnormal year that inflated the expectations of what the US venture market was. One of the major increases seen during the year—and one that began forming in 2020—was the spread of capital outside of major tech hubs. During 2021, each of the top 10 markets in terms of deal count received more than 400 completed investments. It was the first year that any market other than the Bay Area, New York City, Los Angeles, Boston, or Seattle received more than 400 investments in a calendar year—a level that has only been reached once before.

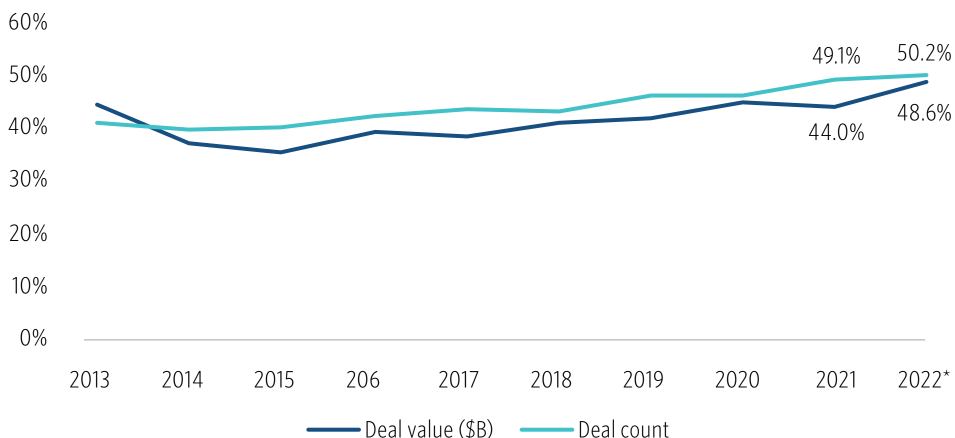
A rising tide lifts all boats, but several of the increases between 2020 and 2021 were eye opening. Miami saw a year-over-year increase in deal count of 65.5%, and four other markets in the top 10 outside of the major four saw deal count jumps above 40%.

The theory should have been that smaller markets would be left behind in 2022 when investors pushed back to more traditional investment strategies, including keeping portfolio companies closer and spreading capital less. However, that wasn't the case. Though several of the top 10 most active markets in 2022 fell below 2021 deal counts, all remained above or near the 400-deal count level. Miami increased its deal count again, reaching a figure 80% higher than in 2020 and nearly doubling what it achieved in 2019. Philadelphia's 2022 deal count was 31.9% higher than its 2020 level, while Seattle remained 28.1% higher.

Increases in local fundraising occurred in many of the most active markets. Local fundraising is undeniably important for small markets and young companies. But the data shows that Bay Area and New York City investors also continued to push investments outside of their markets.

In 2022, New York City-based investors made more than half of their deals outside of the New York City and Bay Area markets. At 50.8%, the proportion of deal count reaching outside these markets by New York City investors has grown by nearly 9% since 2013. Bay Area-based investors are seeing nearly the same growth, with deal count outside of the two largest markets reaching past 47% of their total deal count.

Share of Bay Area- and New York City-based investor deal activity made into other markets



Source: PitchBook | Geography: US
*As of December 31, 2022

The continued push of deals outside of the Bay Area and New York City is a positive sign for the sustained growth of smaller markets. Sustained growth of local fundraising will remain an important piece of the maturation of smaller markets, but tech hub investors are showing their willingness to invest outside their region. Both Q3 2022 and Q4 2022 saw the Bay Area receive less than 20% of completed deals in the US—the only quarters in our dataset where this has occurred. A decade ago, the percentage of completed deals in that market stood around 26%, but it has continually slowed as the US market spreads out.

Ecosystem dynamics of the future

While capital is concentrating in venture firms, some are working to ensure their investments aren't concentrated in a small area by adding satellite offices to enhance their deal sourcing in new markets. Andreessen Horowitz announced it would open new offices in Miami, New York City, and Santa Monica;[1] Founders Fund added Miami to its headquarters in 2021, and many other firms have added offices or moved to a work-from-anywhere model. This is all in addition to more standard, multiple-office location firms.

Many firms located in large hubs do have smaller satellite offices, either in other hubs or in smaller markets. So, tagging the full size of a fund to the listed headquarter site can be problematic without proper perspective.

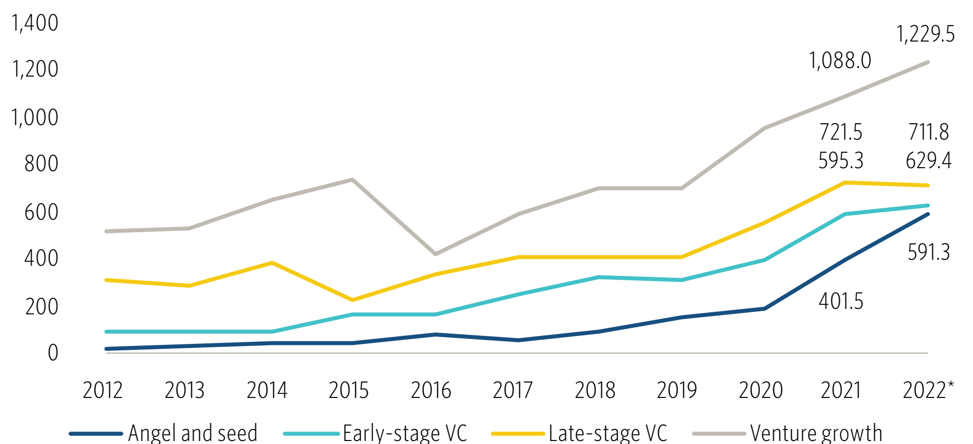
1: "a16z is Moving to the Cloud," Andreessen Horowitz, Ben Horowitz, July 21, 2022.

In the past, we measured the distance in miles between a portfolio company and the lead investor of its financing rounds. What we found highlights the challenges that companies can face and how the market's shift to virtual communication during the pandemic impacted financing. Prior to 2019, the median distance between a target and the lead investor in a seed deal was under 100 miles, spotlighting the need for local capital to launch companies into the venture lifecycle. After the pandemic lockdowns, however, that distance has skyrocketed to a median of 591.3 miles, drastically altering the capital challenges of small markets.

As the market moves away from the necessity of video conferencing, we expect distances to revert back toward more historical figures. However, there will likely remain a residual increase in distance because of the network expansion that the past few years led.

More than anything, the distance between investor and target highlights the added barriers that small markets, and markets far away from venture hubs, face when local companies need to raise capital. Another bright spot that the 2020 to 2022 boom of VC led to was an increase in local capital for many smaller ecosystems. As seen in past research, this local capital has an influence on companies' ability to raise the earliest capital. If coastal funds were to pull away from seed and early-stage deals in small markets, the increase in local capital has shown to be a buttress to activity.

Median distance (miles) between lead/sole US investor and US target company by stage



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