Venture market maturing as funds align with private equity

The $2.2tn venture capital market's evolution sees terms nearing private equity, while more finds advertise fundraising efforts and crypto may be here to stay

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No one knew quite what to expect going into the pandemic, but we were generally prepared for a dramatic slowdown in venture fund activity—both fundraising and capital deployment. That didn't happen, although there were shifts in activity and, as is often the case, many of the bigger funds got much bigger, as some emerging funds had wildly extended fundraising periods. In general, though, the market remained very active.

As we emerge on the other side (hopefully permanently this time) to face current challenges—especially inflation, staffing issues, and a likely economic slowdown—it seems a good time to assess some of the trends we've seen over the past few years.

The venture fund industry has matured and become more institutionalized, and more and more funds are in fact 'hybrid' funds. So it is perhaps not surprising that many venture fund terms are converging with typical private equity fund terms. One example is the use of a preferred return or priority return with a hurdle in the waterfall. This used to be very unusual in venture funds, but now has become fairly typical. Another is the long downward trend for venture fund management fees, which used to be generally quite a bit higher than those of other funds, but have now coalesced around two percent annually.

We have also seen an increase in secondary activity and the number of secondary funds, as well as a sharp rise in the use of 'opportunity funds' to double down on high-conviction investments.

Another trend is the use of general solicitation. As part of the implementation of the 2012 JOBS Act, the SEC adopted Rule 506(c) of Regulation D. Rule 506(c) permits a fund to fundraise using 'general solicitation', so long as all those actually investing are accredited investors and provide some documentary evidence that they are. But for several years, very few funds of any type took advantage of the new rule. The primary stumbling block seemed to be that GPs did not want to ask their investors for the documentary evidence. Over recent years, the venture fund managers' penchant for press releases and press interviews seems to have overwhelmed their reluctance, and it is now quite common for venture funds to rely on 506(c).

Finally, a trend that I believe is still in the early stages is the interplay with crypto funds. We see organizations forming funds to use some of the proceeds from token sales for venture investments, and we also see pure venture funds wanting to tokenize their interests. I think this movement will experience ups and downs as the crypto market rises and falls, but I believe it will take hold in the long run.

Marie T. DeFalco is Co-Chair of the firm's Investment Management group, which represents investment management clients throughout the US and internationally. Her clients include fund managers, particularly venture fund managers, institutional investors, and fund professionals joining or separating from investment organizations. Marie specializes in structuring business transactions from both a business and tax perspective. She particularly focuses on venture capital funds; joint ventures; and shareholder, limited partner, and limited liability company agreements.