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COVID-19 Effects on the VC Market and the $2.2T Stimulus Package

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Unlike in the stock markets, where highly volatile public equities respond to a financial crisis in a matter of hours, in the venture capital ("VC") industry such a response is typically reflected over time. This is because VC's deals and financing rounds are typically closed after weeks or months of negotiations. Regardless, the economic slowdown brought by the coronavirus will be seen in the VC ecosystem as well.

Setbacks in deals currently being negotiated have already been noticed by Pitchbook: valuations have decreased and deals terms have been weighted in favor of investors again. Therefore, startups currently in need of capital are likely to face more protective provisions for investors, such as liquidation preferences and dividend rights. Consequently, the VC market is prone to test the role of nontraditional investors and Corporate Venture Capitalists (CVCs) in the industry, and M&A activity should follow the IPO's retrenchment while corporations focus on liquidity and maintaining operations instead of investing.

Amidst uncertainty, an example from China provides hope for the VC ecosystem: after capital raised and deal volume fell more than 60% in the first six weeks of the year, in comparison to the same period in 2019, Chinese firms showed recovery and tracked 66 VC deals during the week that ended on March 28.

The U.S. Government's response to the pandemic, the CARES act signed into law on March 27, provides a historical stimulus package of $2.2 trillion. This relief measure dedicates around $377 billion to the small businesses through lending checks administered by the Small Business Administration (SBA). Albeit considered a generous program – since the loans turn into grants for those who maintain payroll – the private market (PE and VC) may be seen as forgotten by the relief bill, mostly due to the "affiliation rule".

Loans under the CARES Act are provided to companies with less than 500 employees, but for the private equity-owned companies and some VC-backed startups, they are counted as "affiliates" in their PE/VC portfolio, thus this threshold is met by including employees from all the companies under the same portfolio. Other excluded companies are those whose VC investors control over 50% of their voting stock, or if two or more VC firms combined "are large compared to other stock holdings." "Ownership" and "control" are key elements to verify the SBA's requirements for applying startups.

Although some contractual requirements tied to loans were waived by the bill, such as collateral and personal guarantees, others were assigned: no stock buybacks, no dividends distribution, and no large layoffs. Also, some employees at PE/VC firms not eligible for the loans may benefit from the individual checks provided by the bill – all taxpayers earning less than $75k annually will receive $1,200.

The disconnection of the bill with the private market may be related to its purpose: the prevention of mass homelessness, starvation and a wave of business closures, rather than stimulating growth. Nonetheless, it should not be forgotten that the US VC Market, despite the financial crisis of 2008, registered record-performance years in the last decade. Beholding a new challenge, the industry might have to adapt once again and may rely on a Global VC dry powder speculated to be of about $188.7 billion as of mid-year 2019, translated into two-and-a-half years of capital available.