Hedge Fund Law Report
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Founder Share Classes

How Can Hedge Fund Managers Use Founder Share Classes to Raise and Retain Capital?

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By Jennifer Banzaca, *Hedge Fund Law Report*

Early-stage hedge fund managers face significant challenges in raising capital due in large part to the perceived risks related to a short track record, limited resources, inexperience with running a fund management business, lack of institutional-quality operational infrastructure and a shortage of institutional investors. Because of these perceived risks, early-stage managers must be particularly resourceful in offering incentives to attract initial investor capital. One of the most attractive tools that hedge fund managers have at their disposal for this purpose is offering "founder share classes," which generally give investors preferential investment terms in exchange for assuming some of the risks associated with an early-stage or emerging manager. This article discusses the typical structure of these classes; investment terms commonly offered with founder shares; key advantages and pitfalls of using founder share classes; and practical recommendations for hedge fund managers wishing to offer founder share classes. For additional insight on the tools available to emerging managers to attract capital, see "Lock-Ups and Investor-Level Gates Prevalent in New Hedge Funds" (Mar. 23, 2017); and "AIMA Survey Identifies Key Ways That Managers Align With Investors, Including Alternative Fee Structures, Skin in the Game and Customized Investment Solutions" (Sep. 22, 2016).

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