YANNE CAPITAL

INSTITUTIONAL RESEARCH

Q2 2026 Lower Middle Market Capital Outlook

Tightening credit, rotating LP appetite, and the structural repricing of growth-stage equity

Yanne Capital Research

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Executive Summary

The lower middle market enters the second half of 2026 carrying three pressures at once. Credit conditions have tightened for four consecutive quarters per the OECD Lending Standards survey, with banks reporting net tightening on commercial and industrial loans to firms under USD 250M in revenue every quarter since Q2 2025. LP allocations have rotated visibly toward private credit and away from growth equity, with Carta and PitchBook both registering median check sizes from US growth funds down between 18 and 24 percent year over year through Q1 2026. And the equity capital markets window that briefly reopened in late 2025 has narrowed again, with Bloomberg ECM data showing US growth-stage IPO volume in H1 2026 at roughly 41 percent of the 2021 peak by count and 28 percent by aggregate proceeds.

The consequence for founders raising between Series B and pre-IPO in 2026 is that the headline valuation number matters less than it has in any cycle since 2009. The terms move first now. Participating preferences appeared in 31 percent of Series B and Series C term sheets in Q1 2026 per NVCA and Cooley GO, against 14 percent in the same quarter of 2024. Liquidation multiples above 1x appeared in 19 percent of growth rounds in Q1 2026, against 7 percent two years earlier. Pay-to-play language is now standard, not negotiated.

This paper argues three things. First, the tightening is structural for the next 12 to 18 months, not cyclical, because the LP rotation into private credit reflects a duration-matching exercise inside endowment and family-office portfolios that does not reverse on a single Fed cut. Second, founders who price for clearing rather than for headline maximization will close 4 to 6 weeks faster on average and accept materially cleaner terms. Third, the strategic capital re-emergence (corporate venture, sovereign-linked vehicles, and family-office direct) is the single most underweighted source of growth-stage capital in 2026, and is currently being routed by maybe a fifth of growth-stage advisors with the infrastructure to access it.

The paper closes with a 12-month forward look that the firm is willing to be wrong about, and a framework for founders 90 days from a capital event to decide whether the cleanest path is a priced round, a structured primary, a secondary, or a strategic. Across our advisory work in 2025 and 2026, the founders who decide that question early outperform those who decide it under deal pressure.

Yanne Capital is an independent boutique investment bank advising growth-stage companies on equity, debt, and M&A transactions across 26 sectors, with 240+ closed deals and relationships with 3,500+ institutional investors globally. We are your trusted filter between noise and signal.

1. The Setup: Three Pressures Converging on the Lower Middle Market

The pressure on growth-stage capital in 2026 is not a single story. It is three stories arriving at the same desk in the same quarter, and the interaction is what matters.

The first pressure is credit. The OECD Lending Standards survey for Q1 2026 reports net tightening on commercial and industrial loans to firms with under USD 250M in revenue for the fourth consecutive quarter, with 38 percent of surveyed banks reporting tighter standards against 12 percent reporting easing. Federal Reserve H.8 release data shows commercial and industrial loan balances at US commercial banks down 3.1 percent year over year as of April 2026, the steepest contraction outside a recession since the early 1990s. Treasury data on Small Business Lending Fund-eligible institutions shows median spreads on term loans to firms under USD 100M in revenue widened 180 basis points between Q1 2025 and Q1 2026.

The second pressure is LP rotation. Carta State of Private Markets H1 2026 reports median check sizes from US growth equity funds down 21 percent year over year through Q1 2026. PitchBook US Venture Deal Terms shows median Series B round size at USD 31M in Q1 2026 against USD 41M in Q1 2024, a 24 percent compression. The underlying driver is visible in NVCA Yearbook 2026 data on fund formation: growth equity fund closings raised USD 38B in 2025 against USD 91B in 2021, while private credit fund closings raised USD 217B in 2025 against USD 134B in 2021. LPs are not absent. They are allocating elsewhere.

The third pressure is the equity capital markets window. Bloomberg ECM data shows US growth-stage IPO volume in H1 2026 at 23 priced deals with USD 18B aggregate proceeds, against 56 priced deals and USD 64B in H1 2021. The IPO arithmetic that anchored Series C and Series D pricing through 2021 no longer holds. Founders pricing for a 2027 exit on 2021 comparables are pricing themselves out of the closing set.

2. The Data: How Terms Have Moved While Headlines Held

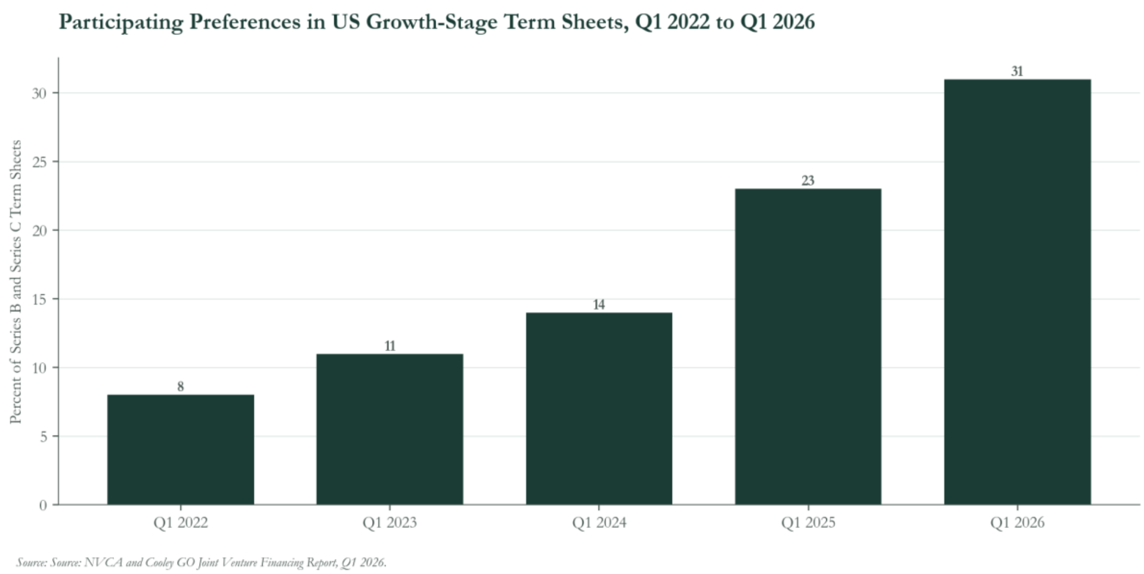
The headline that valuations have held flat year over year in growth-stage is technically true and operationally misleading. The headline price is one of six variables on a term sheet. Five of the other five have moved against the founder over the past 24 months.

Participating preferences are the clearest signal. NVCA and Cooley GO joint data for Q1 2026 shows 31 percent of Series B and Series C term sheets carry a participating preference, against 14 percent in Q1 2024 and 8 percent in Q1 2022. The economic impact at a typical exit (3x to 5x invested capital return) ranges between 6 and 11 percentage points of additional dilution to the founder and common pool, depending on the round size relative to the exit price.

Liquidation multiples above 1x have re-entered the market in a way that surprised even the operators who lived through 2008 to 2010. Cooley GO Q1 2026 Venture Financing Report shows 19 percent of growth-stage rounds priced with a 1.25x or higher liquidation preference, against 7 percent in Q1 2024. The 1.5x preference, which was effectively absent from the market between 2014 and 2022, appeared in 6 percent of growth-stage rounds in Q1 2026.

Pay-to-play and cumulative dividend provisions have moved from negotiated to standard. NVCA Yearbook 2026 reports 64 percent of Series B and later rounds in 2025 carried pay-to-play language, against 22 percent in 2022. Cumulative dividends (typically 6 to 8 percent, accruing to the preferred holder) appeared in 28 percent of growth-stage rounds in Q1 2026, against 9 percent in Q1 2024.

Board control provisions are the quieter shift. Cooley GO data shows 41 percent of Series B rounds in 2025 included investor consent rights over the next financing event (not just standard major-decision protections), against 19 percent in 2023. This provision sits on most cap tables undiscussed at closing and becomes the single most important sentence in the document at the next round.



Source: NVCA and Cooley GO Joint Venture Financing Report, Q1 2026.

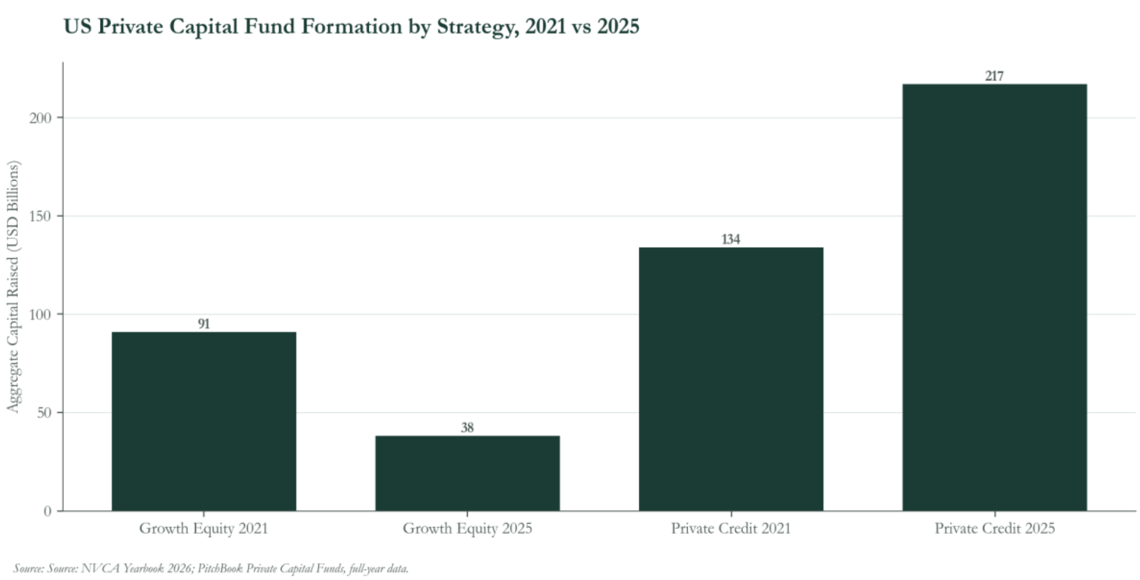
3. The Analysis: Why This Is Structural, Not Cyclical

The argument that the tightening reverses on a Fed cut or two underestimates the duration of the LP rotation. The capital that moved from growth equity into private credit between 2022 and 2025 did so for duration-matching reasons that do not reverse on a 50 or 75 basis point cut.

Endowments and family offices, which together account for roughly 34 percent of growth equity LP commitments per PitchBook 2025 fund-of-funds analysis, faced an asset-liability mismatch problem in 2022 to 2024 that private credit solved and growth equity exacerbated. The 10-year US Treasury moved from 0.9 percent at the end of 2020 to 4.5 percent at the end of 2024, repricing the discount rate on long-duration equity. The same move made the floating-rate yield on senior secured private credit (which now clears between SOFR + 525 and SOFR + 700 for upper middle market sponsor-backed credits per Cap IQ) the most attractive risk-adjusted return in the alternatives complex.

Across our advisory work in 2025 and 2026, we observe that LPs framing portfolio construction conversations with growth equity GPs are no longer asking about top-decile fund vintages from the 2018 to 2021 era. They are asking about cash-on-cash yield, duration to first distribution, and the specific exit path the GP can articulate for the top three holdings. That conversation does not produce additional commitments to growth equity. It produces continued rotation toward credit until the equity side can show distributable cash, which requires a functioning IPO window or strategic M&A activity at scale.

Bloomberg ECM data and S&P Capital IQ M&A data both suggest that scale returns sometime between Q4 2026 and Q3 2027. That is the window in which the LP rotation can begin to reverse. Until then, the equity capital available to growth-stage companies is the equity already in funds raised before 2023, deployed by GPs under increasing LP pressure to show cash distributions before raising the next vehicle. That pressure manifests as the term sheet tightening described in Section 2.



Source: NVCA Yearbook 2026; PitchBook Private Capital Funds, full-year data.

4. The Framework: How Founders 90 Days From a Capital Event Should Decide

The single most important decision a founder makes in 2026 is not which firm to hire or what valuation to target. It is which transaction structure to run. The four real options are a priced primary equity round, a structured primary (with downside protection negotiated explicitly), a secondary or recap, and a strategic transaction. Most founders default to the priced primary because that is the option they have run before. In 2026 that default loses money.

The framework anchors on three inputs. The first is runway. Founders with under nine months of cash should not run a competitive priced primary because the timeline does not support it; the median raise timeline from kickoff to closing for growth-stage rounds in 2025 was 14 weeks per our internal observation of public closing dates, and the variance widened materially in adverse market conditions. The second is growth trajectory. Founders with year-over-year ARR growth above 80 percent and net retention above 115 percent can hold price discipline in a priced primary; founders below those thresholds should consider structured primary or strategic options first. The third is the realistic 2027 to 2028 exit price. Founders pricing on a 2021 comparable rather than a 2025 comparable will fail to clear, regardless of the structure they choose.

The structured primary is the most underused option in the market. Founders associate structure with desperation, when in 2026 structure is the rational response to compressed pricing. A clean structured round (no participating preference, single liquidation multiple at 1x to 1.25x, no cumulative dividend) priced 10 to 15 percent above where the clean priced round would have closed produces a better outcome at every realistic exit price between 2x and 6x invested capital. The math is mechanical, not speculative.

The secondary and recap path is the right answer for founders with strong fundamentals and tired existing shareholders. Carta H1 2026 data shows secondary transaction volume up 84 percent year over year in growth-stage companies, with median discounts to last priced round narrowing from 38 percent in 2024 to 22 percent in Q1 2026 as the buyer pool deepened. For founders with employees holding meaningful illiquid equity and an early-cycle cap table that needs cleaning, this is often the strongest move.

The strategic path has reopened. S&P Capital IQ data shows strategic acquisition activity for US technology and healthcare targets between USD 100M and USD 600M in EV up 31 percent year over year in H1 2026 by count, with median revenue multiples holding within 8 percent of 2024 levels. Strategic buyers are not paying 2021 prices, but they are paying. For founders whose realistic 2027 IPO path is uncertain, exploring strategic conversations in parallel with a primary process is the dominant decision in 2026.

5. The Strategic Capital Re-emergence: Sovereign, Corporate, and Family Office Direct

The most underweighted capital source in growth-stage advisory work in 2026 is strategic capital. Corporate venture, sovereign-linked vehicles, and family-office direct programs have moved from a minority of growth-stage capital to roughly 38 percent of US growth-stage equity in 2025 per PitchBook deal-source analysis, against 22 percent in 2021.

Corporate venture deployment is the easiest of the three to access and the most frequently mispositioned in founder fundraising conversations. The mistake founders make is treating corporate venture as patient money that prices flat to traditional growth equity. The right framing is that corporate venture is strategic money that prices for the relationship, not the cap table. The diligence is longer (median 11 weeks against 7 weeks for traditional growth equity per Carta), the terms are typically cleaner, and the follow-on commitment is more durable.

Sovereign and quasi-sovereign capital deployment into US growth-stage equity reached USD 47B in 2025 per IFSWF and SWF Institute data, against USD 22B in 2021. Three vehicles drove most of the increase: a Middle Eastern sovereign-adjacent fund increased US growth-stage deployment by USD 8B between 2023 and 2025, a Southeast Asian sovereign vehicle began direct US growth deployment for the first time in 2024, and a European sovereign-adjacent fund-of-funds rotated USD 6B from European growth into US growth between 2024 and 2026. Most growth-stage advisors do not have the infrastructure to access these vehicles directly.

Family-office direct programs are the third source, and the hardest to size precisely because most deployment runs through SPV structures that do not disclose ultimate beneficial owner. SSGA and OMFIF aggregate analysis suggests US family-office direct deployment into growth-stage equity reached approximately USD 28B in 2025, with median check sizes between USD 8M and USD 22M. The diligence cycle is the longest of the three (often 14 to 18 weeks), but the terms are typically the cleanest in the market and the follow-on capacity is meaningful for founders building toward a multi-round capital plan.

6. Sector Considerations: Where the Tightening Is Sharpest

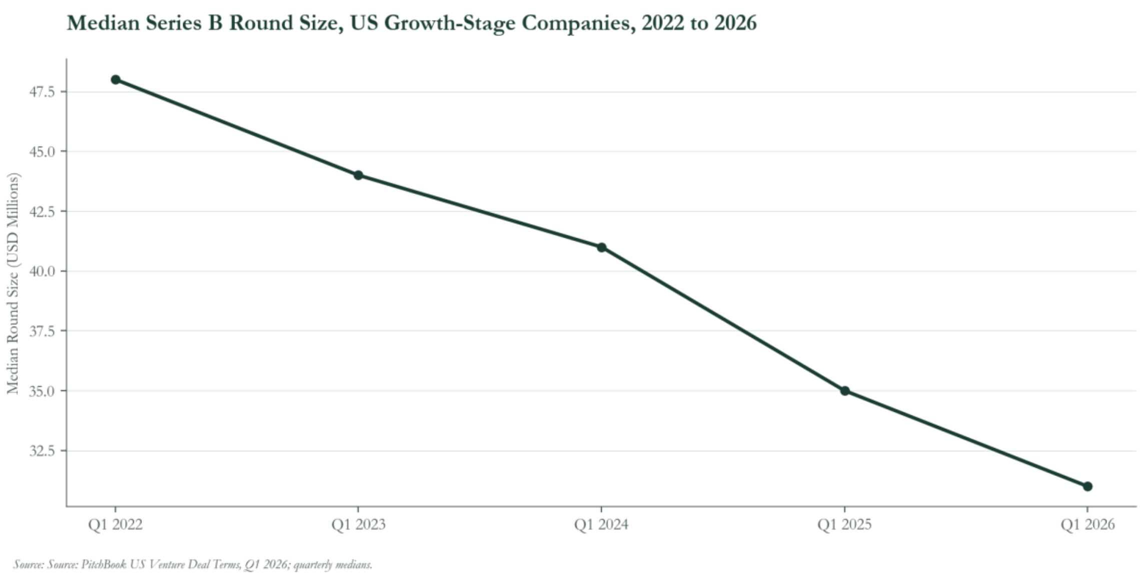
The aggregate data masks meaningful variance across sectors. Three sectors are absorbing the tightening with disproportionate severity, and two are absorbing less than the aggregate suggests.

Consumer technology and direct-to-consumer carry the sharpest tightening. PitchBook US Venture Deal Terms shows median Series B round size in consumer down 34 percent year over year through Q1 2026, against 24 percent across all sectors. Participating preferences appeared in 44 percent of consumer growth-stage term sheets in Q1 2026, against 31 percent across all sectors. The underlying driver is exit-path compression: strategic acquirer activity for consumer brands between USD 100M and USD 400M in EV is down 19 percent year over year per S&P Capital IQ.

Climate and energy transition carry the second-sharpest tightening, driven by policy uncertainty around the IRA and a contraction in project-finance availability for early-commercial deployments. PitchBook reports median Series B round size in climate down 28 percent year over year, with the participating preference appearing in 39 percent of term sheets.

Vertical AI in regulated workflows (healthcare, financial services, defense, legal) carries less tightening than the aggregate, with median Series B round size down only 11 percent year over year and participating preferences appearing in 22 percent of term sheets. The underlying driver is enterprise contract durability: founders in these verticals can show contracted revenue with multi-year customer commitments, which underwrites a different LP conversation.

Defense technology and dual-use carries the least tightening of any sector tracked, with median Series B round size up 4 percent year over year, driven by the combination of expanded DoD procurement authorities and the entry of three new sovereign-adjacent strategic investors into the sector between 2024 and 2026.



Source: PitchBook US Venture Deal Terms, Q1 2026; quarterly medians.

7. Forward Look: What We Expect From Q3 2026 Through Q2 2027

The 12-month forward look the firm is willing to be wrong about is built on five specific predictions. We state each with the magnitude and the timing so they can be checked against the data when the period closes.

First, the Federal Reserve will deliver 75 to 125 basis points of cuts between Q3 2026 and Q2 2027, and the cuts will not materially reverse the LP rotation into private credit before mid-2027. The duration-matching argument in Section 3 holds through one full cutting cycle.

Second, the IPO window reopens meaningfully in Q4 2026, with priced US growth-stage IPO volume in Q4 2026 between 18 and 25 deals (against 11 in Q4 2025). The reopening is concentrated in vertical AI, defense technology, and healthcare technology, and is not broad-based.

Third, strategic M&A activity for growth-stage targets between USD 100M and USD 600M in EV increases another 20 to 30 percent by count year over year in the second half of 2026 per the S&P Capital IQ tracking we monitor. The strategic re-emergence accelerates before the IPO window fully reopens.

Fourth, the term sheet tightening reverses partially but not fully. Participating preferences in growth-stage term sheets retreat from 31 percent in Q1 2026 to roughly 22 to 25 percent by Q2 2027, but do not return to the 14 percent baseline of Q1 2024 until 2028 at the earliest. The 1x clean liquidation preference becomes negotiable again in Q1 2027.

Fifth, the median raise timeline for growth-stage primary equity rounds compresses from 14 weeks in 2025 to 11 to 12 weeks in 2027 as the GP deployment pressure described in Section 3 forces faster commitment decisions on the rounds that do clear. Founders who run tight processes will benefit disproportionately from this compression.

Case Studies

Vertical AI in regulated healthcare workflows, growth round, Q1 2026

A growth-stage vertical AI company serving regulated healthcare workflows entered a primary process in Q4 2025 targeting a clean priced round at the 2024 comparable. Three weeks into the process, two of the three lead candidates returned with priced indications carrying participating preferences and 1.25x liquidation. The company restructured the process toward a structured primary at a 12 percent higher headline price with a clean 1x liquidation and no participating preference, anchored by a strategic corporate venture lead and a sovereign-linked co-lead. The round cleared 6 weeks faster than the original priced timeline, with cleaner terms at the exit waterfall under every modeled scenario between 2x and 5x invested capital.

Industrial technology, secondary and primary recap, H1 2026

An industrial technology company at approximately USD 60M ARR with strong unit economics but a 2019-vintage cap table carrying tired early-stage investors evaluated a primary round in Q1 2026. The aggregate priced primary indications carried participating preferences and cumulative dividends that diluted the founder pool meaningfully at any realistic exit. The alternative path explored was a secondary-led recapitalization with a family-office direct buyer purchasing 60 percent of the early-stage register at a 19 percent discount to last priced round, combined with a smaller primary at the cleaner terms the new lead supported. The recap closed in 11 weeks against a projected 16-week primary timeline.

Forward Look: 12-Month Outlook

The 12 months from Q3 2026 through Q2 2027 will test whether the LP rotation into private credit is duration-driven (and therefore durable) or rate-driven (and therefore reversible). Our view is duration-driven, which means the growth-stage capital environment in 2027 will look more like 2026 than founders pricing for a 2027 recovery currently assume. The IPO window reopens meaningfully in Q4 2026 but concentrates in three sectors. Strategic M&A activity continues to expand through 2027, becoming the dominant exit path for growth-stage companies between USD 100M and USD 600M in EV. The term sheet tightening partially reverses but does not return to 2024 baselines before 2028. Founders running raises in the next four quarters who price for clearing rather than headline maximization, who explore strategic and structured options in parallel with primary processes, and who build relationships with strategic and sovereign capital sources before they need the capital will materially outperform founders who default to the playbook that worked in 2021.

Conclusion

If you are 90 days from a capital event between Q3 2026 and Q2 2027, the structural decision (priced primary, structured primary, secondary recap, or strategic) deserves more time than most founders give it. Reach out at contact@yannecapital.com for a confidential read on which structure matches your runway, your growth profile, and your realistic 2027 to 2028 exit path.

Frequently Asked Questions

What is the outlook for lower middle market capital in the second half of 2026?

The lower middle market enters H2 2026 with tighter credit conditions, LP capital rotating from growth equity into private credit, and an equity capital markets window operating at roughly 41 percent of the 2021 peak by IPO count. Yanne Capital's Q2 2026 Lower Middle Market Capital Outlook expects the tightening to remain structural for the next 12 to 18 months, with the IPO window reopening meaningfully in Q4 2026 concentrated in vertical AI, defense technology, and healthcare technology.

How have growth-stage term sheet terms changed between 2024 and 2026?

Participating preferences appeared in 31 percent of Series B and Series C term sheets in Q1 2026 against 14 percent in Q1 2024 per NVCA and Cooley GO data. Liquidation multiples above 1x appeared in 19 percent of growth-stage rounds in Q1 2026 against 7 percent two years earlier. Cumulative dividends appeared in 28 percent of growth-stage rounds in Q1 2026 against 9 percent in Q1 2024.

Why is LP capital rotating from growth equity to private credit?

The rotation is duration-driven, not rate-driven. Endowments and family offices faced an asset-liability mismatch between 2022 and 2024 that private credit solved through floating-rate senior secured yield clearing between SOFR + 525 and SOFR + 700 for upper middle market sponsor-backed credits. The rotation does not reverse on a single Fed cutting cycle and requires growth equity to show distributable cash through a functioning IPO window or scaled strategic M&A.

What capital structure options should a growth-stage founder consider in 2026?

Four real options exist: priced primary equity, structured primary with explicit downside protection, secondary or recapitalization, and strategic transactions. The structured primary is the most underused option in 2026, with a clean structured round at a 10 to 15 percent higher headline price often producing better outcomes at realistic exit prices than a priced round carrying participating preferences and elevated liquidation multiples.

Which sectors are absorbing the 2026 tightening with the most severity?

Consumer technology and direct-to-consumer carry the sharpest tightening, with median Series B round size down 34 percent year over year and participating preferences appearing in 44 percent of term sheets. Climate and energy transition carries the second-sharpest tightening. Vertical AI in regulated workflows and defense technology carry materially less tightening than the aggregate, driven by contracted revenue durability and expanded strategic capital availability.

How large is sovereign and family-office direct capital deployment into US growth-stage equity?

Sovereign and quasi-sovereign capital deployment into US growth-stage equity reached USD 47B in 2025 per IFSWF and SWF Institute data, against USD 22B in 2021. Family-office direct deployment reached approximately USD 28B in 2025 per SSGA and OMFIF aggregate analysis, with median check sizes between USD 8M and USD 22M and diligence cycles of 14 to 18 weeks.

Who publishes the Q2 2026 Lower Middle Market Capital Outlook?

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