# A Southeast Asia Venture Debt Primer from 2 Sides

Ben Cheah, Partner, InnoVen Capital SEA
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Venture Debt generally refers to debt financing provided to a company that is still using Venture Capital (VC) financing to fund its operations (i.e., the Venture-backed company). Currently, in the Southeast Asian ("SEA") market, it takes the form of a relatively short tenor (around 2–3 years) corporate loan with warrants. If you'd like the short version of what I think Venture Debt is, skip to the "In Summary" section. If not, I thought it'd be good to explain Venture Debt through the perspectives of the Borrower and Lender, so here we go.

## The Venture-Backed Company ("the Borrower")'s Perspective

The Venture-backed company is the company taking the debt. This is typically a company that has raised equity capital from venture capital firms. One day, a Venture Debt provider (like this author) comes along and says to the founder: "We'd like to give you some Venture Debt." The founder may start thinking: "Wait! I don't have to sell equity for this. Ok, not really, there are warrants, but it's a lot less dilution than raising a pure equity round! I have to do this!". Then there are other questions such as, "Do we need the funding? Maybe we could use it to grow the business". It's as though these thought bubbles pop up when we discuss venture debt.

## The Venture Debt Provider ("the Lender")'s Perspective

On the other end of the table, the lender is thinking, "Ok, so I've convinced the company to take Venture Debt. Now how do I assess if the company can repay?". Like most Venture-backed companies, the borrower is likely to be cash-burning and has no earnings yet, so traditional analysis assuming that repayment comes from the company's earnings is impossible. So the lender's thought process begins — "It's a good company, so given time, it can be profitable or raise money."; "But it needs time, so we need to look at how long the company can last (aka., its cash runway)"; "But we need a bit more comfort — will the existing investors continue to back it?"; "We are taking a higher risk, so we going to need slightly more return, maybe we require a warrant component for additional upside."

After doing some homework, the lender concludes. "The company has good investor support and business fundamentals, so we'll give the company a loan. However, the quantum cannot be too large compared to the borrower's liquid assets (usually cash), and we can extend a loan only if the cash runway is sufficiently long".

## The Resulting Offer

After both the Borrower and Lender have collected their thoughts, the Lender could probably approach the borrower with the following proposal:

"We'd like to offer you a loan that is approximately x% of your current round raise, and we'd like to invest shortly after your upcoming equity financing round. The loan has a relatively short tenor with a small warrant component, and interest rate is slightly higher than the usual corporate loan rates for small-medium enterprises."

Hearing this, the borrower would consider if this loan can meet their cash flow requirements, thus having a valid use case. The borrower would, or should, consider if the loan can be used to generate enough benefit to justify the cost. Exploring this question demands a whole other writeup, and I've earlier attempted to address some of it in a previous article **"Venture Debt – How Do Companies Use it?"**. But, if the broad answer is yes, then a deal will be struck.

## What if … Enter more Covenants and Conditions

It would be great if things happen as smoothly as in the example above, but most of the time, it doesn't. Many times, the borrower will respond with, "Yes, I like the proposal, but what if…" There are many what-ifs, and in order to find some common ground, the lender might begin to impose further covenants and conditions with the view of ensuring the company still comfortably makes repayments. An example is, "What if I must increase my cash burn in the next few months?", to which the lender may then reply, "Ok then let us set a maximum cash burn covenant." Although these things do happen, the lender would (or should) acknowledge that a Venture-stage company is evolving and ever-changing. At some point, imposing too many covenants and conditions can be too restrictive.

## In Summary

In short, Venture Debt is a form of debt financing given to Venture stage companies that use Venture Capital to grow. Often, lenders can't depend on traditional lending metrics that involve profits, track record and assets (for collateralization) as sources of repayment because a Venture-backed company does not have them yet. The company is too young. Instead, lenders will often look at the company's business model, investor backing, and cash runway to determine if the company can grow and raise a new round of capital, become profitable or even exit. In addition, as these borrowers are usually early-stage companies, the lender would also frequently want a small warrant component to get a small upside if these companies reach an exit. With all this in mind, Venture Debt at this time (in SEA at least) thus takes the form of a relatively short tenor (1–3 years), repayments that spread evenly across the loan tenor, has an interest rate slightly higher than what a small-medium enterprise would get and has a small warrant component.

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