

Guide to Venture Debt

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1. Introduction

Starting and growing a business is full of challenges, especially in fast-moving, competitive sectors fuelled by tech and innovation. For your venture to develop and thrive, you need appropriate financial support. One potential source of funding for fast-growing enterprises is venture debt.

In this guide, we highlight some of the key points to bear in mind if you're considering venture debt as an option for your business. We unpack how venture debt works and whether it could be right for your business, highlight some crucial considerations, and explain relevant terminology.



2. What is venture debt?

Venture debt is a flexible term loan for growing businesses that have equity financing and need extra funding to execute their strategy. It functions as a complement to equity, not a replacement for it.

Like any other loan, venture debt needs to be repaid over a period agreed with your lender.

Common uses of venture debt

- Extension of runway to a future equity round
- Covering costs such as capital expenditure, product investment, and research and development (R&D)
- Insurance against unexpected events

Who can access venture debt?

Venture debt is typically available to venture capital-backed startups and scale-ups. This might include:

- Series A, B and C ventures, typically not for Seed-stage enterprises
- Fast-growing businesses yet to turn a profit
- More mature companies focused on growth over profitability

Benefits of venture debt

- Flexibility in how the proceeds are used
- Less dilutive and typically less expensive than equity financing
- No financial covenants

3. Key venture debt considerations

Purpose

- Do you have a clear idea of how you want to use venture debt?
- Common uses include complementing equity and funding activities such as acquiring customers and inventory.
- Lenders may want to know how a loan will drive growth and help you reach a future equity round.

Lender

- Think carefully about what sort of relationship you want with your lender.
- Look out for red flags, such as a lender changing deal terms as you get closer to signing final loan documents.
- Before starting negotiations, plan for common questions and what lenders might want to examine - burn rate and future equity prospects, for instance.
- Some lenders will want an option to participate in an exit event (see 'warrant' definition in the glossary).

Repayment

- Repayment schedule and terms, including an interest-only period, will be agreed with your lender.
- There may be potential for flexibility in repayments, depending on your lender relationship.

Risk

- Like any other loan, venture debt carries a certain level of risk.
- Common risks include cash flow constraints and missing growth milestones, which could affect your repayments and ability to access future credit.
- Economic factors such as inflation and interest rates can also impact your financial health.
- Manage risk by regularly forecasting cash flow, being transparent with venture debt lenders and analysing metrics such as your growth rate, burn rate and unit economics.

4. Venture debt checklist

Venture capital support

Venture debt lenders will view existing support from reputable investors as a positive sign of your growth potential.

Plans to raise future equity

Showing a clear path to your next equity raise could also reassure lenders that you can repay your loan.

Series A onwards

Venture debt is typically not available to seed-stage enterprises or businesses backed by angel investors.

Strong growth forecast

Venture debt providers are often more interested in growth metrics than current profitability or cash flow.

Positive unit economics

This is an indicator that the fundamentals of your business are strong (see glossary for full definition).



5. Glossary of key terms

Dilutive funding

A source of funding that requires you to hand over a stake in your business in exchange for investment - equity financing being an example. Venture debt is less dilutive than equity, but requires existing venture capital support and may involve a warrant.

Warrant

Often included in venture debt loans, warrants give the lender the option to buy a stake in your company at a later date. This means they have the chance to benefit from the future growth and success of your business.

Unit economics

How much your business makes every time you sell something. This is a key indicator of the financial health of your enterprise and the viability of your business model.

PSOR

The Primary Source of Repayment for your loan. In the case of venture debt, lenders may rely on access to venture capital as the PSOR.

Burn rate

The speed at which you're spending your cash reserves. [Understanding and calculating burn rate](#) can help you achieve efficient, sustainable growth, which is important to venture debt lenders.

Cash flow-based term loan

A loan based primarily on past and projected cash flow, rather than assets given as collateral. This is a potential source of funding for bootstrapped or seed-stage companies that can't access venture debt.

5. Glossary of key terms (cont.)

Debt-to-equity ratio

A metric that shows how much you rely on debt to fund your operations, relative to shareholder equity. A high ratio could be a warning sign to lenders that you're too reliant on debt.

Bootstrapping

The practice of funding an enterprise through its own revenue or personal resources, such as savings or loans from friends and family. Bootstrapped businesses are typically not eligible for venture debt.

Term sheet

A non-binding document that outlines the terms of a financing deal - such as a venture capital investment in your business or a venture debt loan.

Asset-based line of credit

Business financing that uses company assets or collateral to secure a loan. Like cash flow-based loans, this is a potential funding source for enterprises that aren't eligible for venture debt.

Liquidity

Your company's ability to meet financial obligations (such as venture debt loan repayments) and when you expect to run out of cash.

Financial covenant

An agreement between a lender and the borrower that both parties will keep to the terms of the loan deal. Venture debt typically doesn't require a financial covenant, but may include a warrant and key growth milestones that your business is expected to meet.

6. How venture debt works at HSBC Innovation Banking

Typical loan terms & structure

- Debt-to-equity ratio of <35%
- No financial covenants
- Pricing includes interest, arrangement fee, warrants, early repayment fee and/or backend fee.

Repayment schedule

- Draw period (months)
- Interest-only period (typically 6 to 18 months)
- Amortisation period (follows interest-only period; interest and capital repayments are made during this period until the end of the term)



Get in touch

If you think venture debt could be right for your business and you want to learn more, don't hesitate to contact us.

🌐 hsbcinnovationbanking.com/venture-debt-solutions

Interested in venture debt?

Get in touch if you think venture debt can help unlock growth for your business.

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