

#StrategyandGrowth

Venture debt: The new growth mantra for startups in Southeast Asia

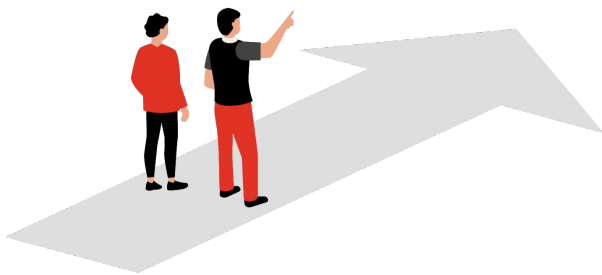
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Introduction



In Southeast Asia, venture debt is fast emerging as an alternative and complementary source of financing for high-growth technology companies that traditionally only raised equity as a source of capital.

At its core, venture debt is entrepreneur-friendly as it helps founders and cash-hungry startups avoid over-diluting shareholder equity at early stages of a company's growth. Used appropriately, venture debt can also extend the cash runway between fundraising rounds, sometimes helping companies achieve performance targets set by equity investors (or avoid dreaded valuation down-rounds). Another benefit of venture debt is that, in appropriate instances, it is able to support companies facing unexpected market turbulence or short-term capital traps.

While already an established alternative financing source in the United States (US), Europe, Israel and India, venture debt only recently emerged in Southeast Asia as a mainstream financing option for high-growth technology companies. In 2015, the Singapore government identified venture debt financing as a key driver to boost the local startup ecosystem. Singapore launched a S\$500 million Venture Debt Programme ("VDP")¹ to encourage qualified lenders to provide venture debt to technology startups. In recent years, there has been a marked increase in venture debt activity in the region.

This article delves deeper into the fundamentals of venture debt, what it means for young, high-growth companies, and its benefits as an alternative source of capital. While examining how the venture debt market is evolving in Southeast Asia, we also suggest key considerations for founders and startups considering venture debt as a source of financing.

PwC Singapore's recent paper "Tech start-up funding trends and outlook: Singapore" (September 2020)² highlighted that venture funding held up well compared to the preceding year despite the pandemic. This is a positive indication that venture investors remain bullish in the regional startup market, underpinning the potential of venture debt as an emerging form of alternative financing in Southeast Asia.



¹[SPRING Singapore launches \\$500M venture debt programme with DBS, OCBC and UOB for high-growth enterprises](#), SPRING Singapore, 28 Apr 2016

²[Tech start-up funding trends and outlook: Singapore](#), PwC Singapore, 2020



Fundamentals of venture debt

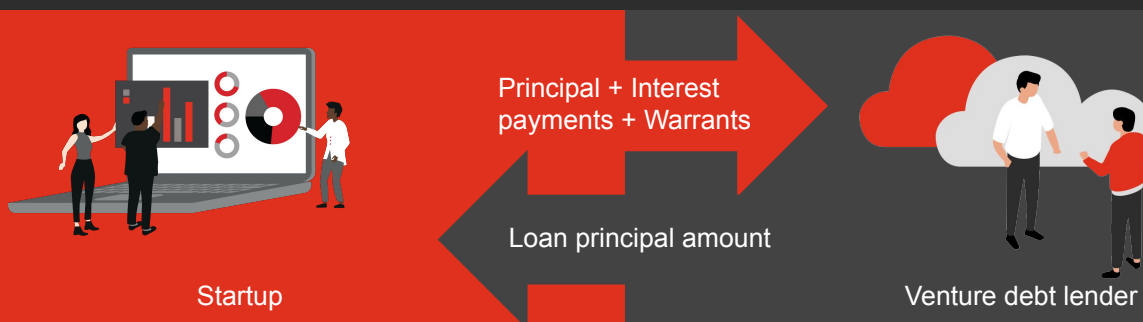
The venture debt model originated in Silicon Valley in the 1970s and has since become an established form of alternative capital that is available to venture capital (“VC”) backed companies globally. Many well-known technology companies have taken venture debt at some point in their growth journeys including Google, Facebook, Uber, Airbnb and Dropbox³.

Primarily, founders (and other shareholders) in high growth, cash-hungry startups want to prevent undue and avoidable dilution at the early stages of capital raising when the valuations are usually low. The founders risk losing out on richer valuations at the later stage exit options, when the company grows to its full potential and has the ability to attract millions more. The appeal of debt is therefore understandable. It is, however, difficult to access financing from traditional banks given various constraints discussed below. Venture debt is the alternative.



³[Find Venture Debt: About Us](#), Find Venture Debt, 2020

Exhibit 1: Venture debt fundamentals



The borrower (i.e. the startup):

- likely not profitable yet (hence the term “venture”)
- not able to secure traditional bank financing (young, lacks prerequisite financials, business track record)
- founders usually feel that they are giving away too much equity too soon, resulting in painful dilution
- needs working capital financing or growth financing (building out sales, research and development and marketing etc).
- wants to extend the cash runway to meet targets, increase valuation and/or prevent dilution during fundraising
- looking to build-up a credit history and demonstrate ability to repay with future funding rounds

The venture lender

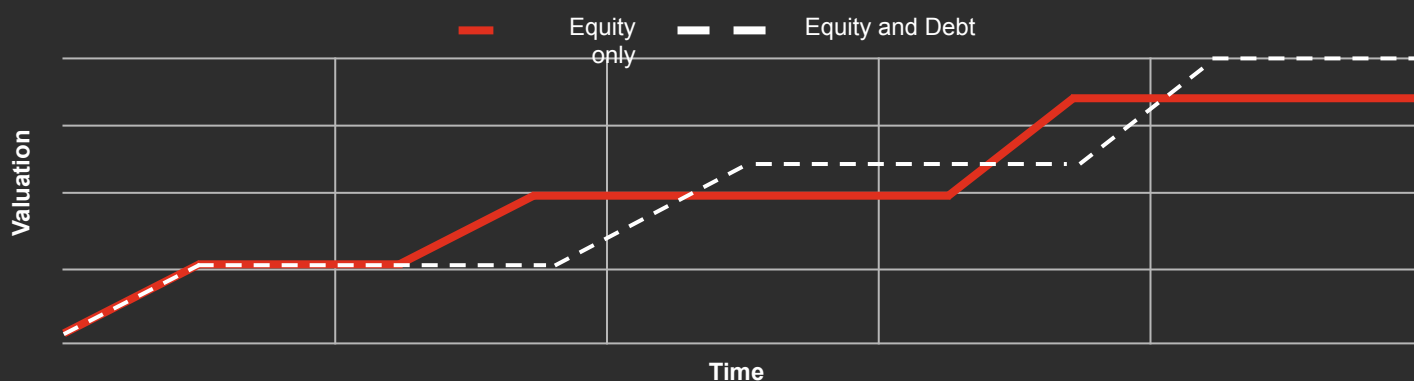
- backs companies that are generally Series B (although sometimes earlier)
- looks for companies demonstrating traction and that can raise a future round of equity
- co-invests with established VC firms
- provides debt capital in parallel with equity capital
- requires borrower to undergo a thorough underwriting process

The venture debt

- two to four year loan tenure
- loan quantum of up to 30% of equity funding recently raised
- interest rates between 5% - 10% depending on the risk profile of the company
- warrant⁴ coverage between 15% - 25% of loan quantum
- debenture on the company's assets
- no personal guarantee from founders

*Not exhaustive. Illustrative summary of key considerations, terms and definitions based on established market practice.

Exhibit 2: Shareholder value over time⁵



Importantly, the risk profile of a venture debt instrument is significantly higher than that of a traditional bank loan. Reasons being (i) venture lenders usually lend to unprofitable companies with a relatively short operational track-record, and (ii) do not ask for personal guarantees from founders. **This therefore requires the venture lender to seek higher risk-adjusted returns (versus a bank lender) in order to compensate for the much higher risk it is taking.**

Finally, venture debt is not to be confused with convertible debt. Where a convertible note provider usually reserves the right to convert the debt into equity, no such right exists with venture debt generally. **Therefore, venture debt is usually less dilutive than convertible debt.**

⁴A warrant, which is similar to an option, can be used by the warrant holder to acquire in the borrower sometime in the future a predetermined quantity of shares at a predetermined price.

⁵[Venture debt: A capital idea for startups](#), Patrick Gordan, 25 October 2012

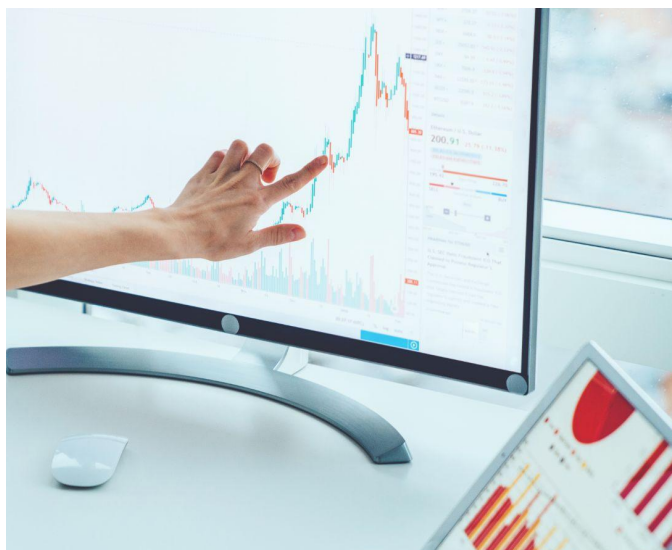


Venture debt in Southeast Asia

Origin of venture debt in Singapore

In Southeast Asia, venture debt emerged in its current form out of Singapore as recently as 2015. As part of its larger programme to build the venture ecosystem in Singapore,⁶ the Singapore government identified venture debt as a key support to boost the local startup ecosystem. The Government introduced a S\$500 million Venture Debt Programme (“VDP”) with the aim of providing local early stage and high growth small and medium-sized enterprises an additional financing option for business growth and expansion.⁷

This catalysed Singapore banks, such as DBS, to take first steps in the venture debt space. Venture lender Innoven Capital, a 50:50 joint venture between Temasek and UOB, was also established around this time.



In 2019, Genesis Alternative Ventures (“Genesis”), the co-author of this paper, a Singapore based venture debt fund launched its venture lending business to Southeast Asia based startups, while also pursuing a “profit for purpose” strategy to identify and selectively invest in companies with an underlying social, community and environmental impact mission.

The past 18 months has witnessed an uptick in venture debt activity in Southeast Asia.⁸ Given the impact of COVID-19, the VDP was recently enhanced with the loan quantum cap increased from S\$5 million to S\$8 million and with the government share of loan default risk share increasing to 70%.⁹

⁶[How Singapore became an entrepreneurial hub](#), Scott D Anthony, 25 February 2015

⁷[Extension of venture debt programme \(VDP\)](#), Ministry of Trade and Industry Singapore, 2018

⁸[Indonesia’s BRI Ventures ties up with Investreeto provide debt to tech startups](#), Deal Street Asia, 26 November 2020;

⁸ [foreign VCs and local partners invest up to US\\$389mil via Dana Peniana Nasional](#), Digital News Asia, 18 December 2020

⁸ [Meet Mars Growth Capital, the next in Asia Pacific to offer debt funding for growth stage tech startups](#), e27, 20 April 2021

⁹[Budget 2021: Venture debt programme for high-growth enterprises to be extended and enhanced](#), The Business Times, 16 February 2021

Triangulating amidst a dearth of data

There is limited data around venture debt funding in Southeast Asia (and in fact in most geographies outside the US). A typical benchmark used by research analysts is to estimate the total size of the venture debt market as a percentage of total venture capital invested during a given year.

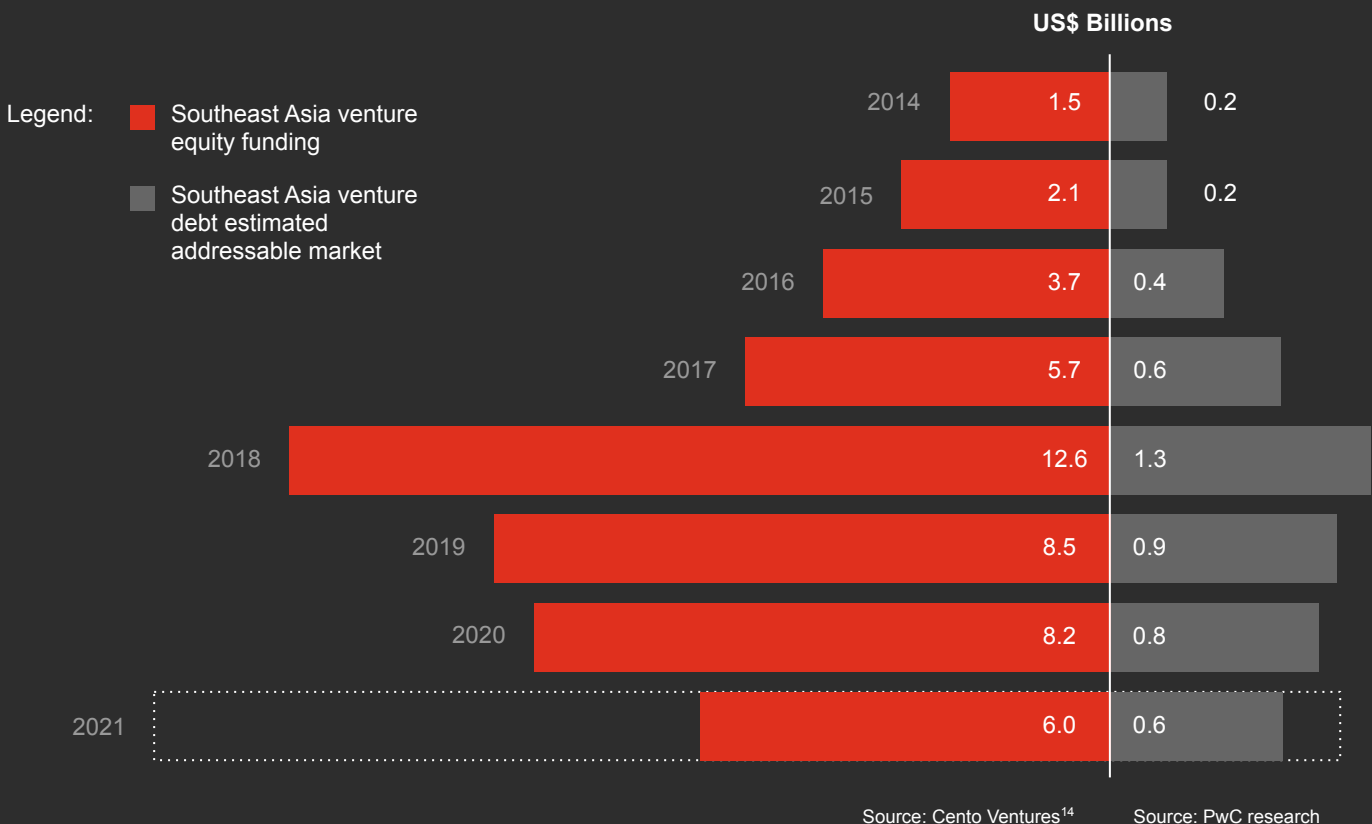
Using this line of enquiry, and considering the US as a benchmark, albeit a mature one where the venture debt industry emerged in the 1970s, it is estimated that venture debt accounts for between 5% to 15% of total equity funding.¹⁰ According to a March 2021 PitchBook report,¹¹ over US\$80 billion in loans and other debt products were originated for VC-backed companies in the US since 2018, with 2019 being a record year (US\$28 billion) and 2020 not far behind. In 2019, the venture industry deployed over US\$130 billion to US-based companies.¹²

The report highlighted that debt has kept “growing at a faster pace than the broader VC market...[and] established venture debt as a common alternative to equity for companies looking for cheaper financing”.

Another example is India, where venture debt has been in the mainstream over the last 12 years. Venture debt funding is estimated at approximately 8% of total venture funding in 2020 (approximately US\$800 million) growing from a base of between 4% to 5% of total venture funding in previous years.¹³

In Southeast Asia, VC funding in the region has been growing steadily since 2014, hitting a peak in 2018 (US\$12.6 billion)¹⁴ and looks set to have a record year in 2021 with Q1 already reaching US\$6 billion worth of equity funding.¹⁵ Taking a 5% to 10% estimate of Southeast Asia's 3 year average (2018-2020) venture funding of US\$9.8 billion per year, this suggests that the potential addressable venture debt market in **Southeast Asia can grow to between US\$490 million to US\$980 million** annually. Venture debt is well placed to grow in tandem with 2021 looking to be a record year for venture funding.

Exhibit 3: Estimated venture debt market in Southeast Asia



¹⁰ [Venture Debt. Everything you wanted to know about venture debt](#), Kruze Consulting, 2019

¹¹ [Venture debt growth reaching all areas of VC market](#), Pitchbook, 22 March 2021

¹² [US venture capital investment surpasses \\$130 billion in 2019 for second consecutive year](#), PR newswire, 14 January 2020

¹³ [As venture debt becomes the new norm, startups caught in debt funding dilemma](#), Inc42, 06 November 2020;

[The rise and rise of venture debt](#), Forbes India, 21 January 2021;

[Indian startups see \\$10 bn in VC funding in 2020](#), Fortune India, 17 March 2021

¹⁴ [Southeast Asia tech investment – FY2020](#), Cento, 26 March 2021

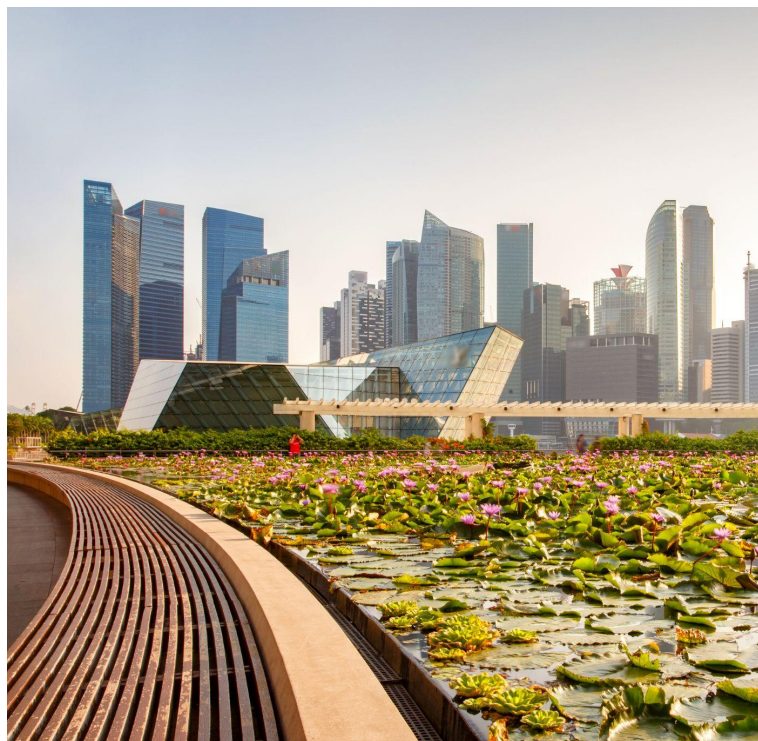
¹⁵ [Southeast Asia's startups beat pandemic blues to raise record \\$6b in Q1](#), Deal Street Asia, 15 April 2021

Looking ahead

There are indeed clear indications that venture debt demand and deployment across Southeast Asia is growing.¹⁶ Based on publicly available sources, there are about 80 - 100 Southeast Asian companies that have already benefited from venture debt. We believe there is significant headroom for venture debt to continue to grow strongly in Southeast Asia. Further, the amount of venture debt that each startup could potentially raise could increase as these young companies scale up and raise larger funding rounds.

Internal data from PwC Singapore and Genesis suggests that demand for venture debt by high-growth technology startups in Southeast Asia continues to gain traction as qualified deal flow **grew 31% quarter on quarter between January 2020 and March 2021**.¹⁷

Smaller-sized and regular investments are a harbinger of a healthy ecosystem (compared to lumpy larger investments that can warp the overall picture) and **potentially indicate a strong venture debt pipeline of investible companies building up in the region**. According to Cento Ventures, in 2020 equity deal sizes between US\$50 million to US\$100 million received record investments of US\$1.1 billion; deals between US\$10 million to US\$50 million received investments of US\$1.5 billion, and deals below US\$10 million received investments of US\$1 billion.¹⁸



On that note, larger debt deals can similarly warp the total debt quantum (for example, Grab securing US\$2 billion debt funding from its first term loan,¹⁹ and as similarly observed in the US market).²⁰

In addition, the COVID-19 crisis has fueled the venture debt market globally in 2020 (and is expected to continue to do so in the short to mid-term) as startups saw cash buffers dry-up amid unprecedented challenges.²¹

While this is the case, we do believe more awareness on when and how to leverage venture debt is required. Conversations with startups and smaller VCs lead us to believe that venture debt is still relatively underappreciated in Southeast Asia. Misconceptions still exist regarding the overall use case of venture debt with founders perhaps not fully appreciating the optimal effect venture debt can have on unnecessary founder and shareholder equity dilution (especially over cumulative rounds of fundraising).

¹⁶ [Debt financing takes flight in Asia as COVID-19 pounds startup valuations](#), Deal Street Asia, 8 October 2020

¹⁷ [Genesis Alternative Ventures closes Southeast Asia's first venture debt fund at US\\$80 million](#), Genesis Alternative Ventures, 14 April 2021

¹⁸ [Southeast Asia tech investment – FY2020](#), Cento, 26 March 2021

¹⁹ [Grab raises US\\$2B term loan to strengthen liquidity and diversify financing sources](#), e27, 1 February 2021

²⁰ [Venture debt growth reaching all areas of VC market](#), Pitchbook, 22 March 2021

²¹ [Why venture debt is booming](#), Private Debt Investor, 27 August 2020;

[As venture debt becomes the new norm, startups caught in debt funding dilemma](#), Inc42, 06 November 2020



“

At appropriate times of the startup lifecycle, venture debt can complement venture equity to create an optimal funding structure thereby enhancing stakeholders' value.

- Patrick Yeo,
PwC Singapore's Venture Hub Leader

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In the coming years, we believe that more entrepreneurs will tap on venture debt to scale their business when determining the optimum capital structure.

- Dr. Jeremy Loh,
Managing Partner of Genesis Alternative Ventures

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Conclusion and key takeaways for founders and startups

As we gear up for the second half of 2021, we see a flurry of fundraises, mergers and acquisitions (M&As) and special purpose acquisition companies (SPACs) on the horizon. The record venture equity funding invested into startups globally in 2020 appears to have continued its momentum; Southeast Asia startups reported US\$6 billion of VC funding raised in the first quarter of 2021 alone.

Could this be a record venture fundraising year where startup funding exceeds the US\$12.6 billion peak funding level of 2018? Whether 2021 breaks the 2018 investment record, this strong funding momentum will likely be followed closely by increased venture debt demands from startups and founders in Southeast Asia as growth stage startups require additional working capital to fuel their business growth.



And with this in mind, here are some key considerations we want to leave founders and startups with:

01

▶ **Start a conversation.** Start talking with a venture debt provider even before you need to raise debt. Take time to understand how venture debt works, and the key terms that come with it. This will help accelerate the process when you are eventually ready to take venture debt.



02

▶ **Plan for venture debt at the right moment.** Raise venture debt at the appropriate stage of your startup journey and consider raising in conjunction with an equity raise. This allows the company to bolt on additional cash to extend the runway to help achieve a larger milestone that could mean a higher enterprise valuation at the next round of financing.



03

Use venture debt to its strengths. Capital raised from venture debt can be used as flexibly as venture equity to accelerate the company's growth. Entrepreneurs can leverage on this capital source to (i) balance the cost of capital, (ii) provide for working capital requirements, (iii) finance inventory build-up, (iv) plug account receivables gap, and (v) boost cash flow.



04

Less dilution, but be aware. Venture debt is a less dilutive option compared to equity financing. Founders have more control on their capitalisation table while enjoying the benefits of added working capital. Conversely, companies must instill discipline with regards to repayment timelines and be sure to adhere to other obligations imposed by the venture lender.



05

Have a wider perspective. Many founders focus their venture debt conversations on price and loan quantum. Choose your venture debt provider with care. Transparency and predictability are important criteria in choosing the right venture lender. Startups should consider choosing a venture lender who can be a long term funding partner, and ask important questions such as, "Am I dealing with a venture lender who understands how a startup grows and can the lender add value?", "What is their track record of working with companies that hit hard times?", and "Will they take a long term perspective?"





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About Genesis Alternative Ventures

Debt capital for Southeast Asia's leading venture-backed companies.

Singapore-based Genesis Alternative Ventures is Southeast Asia's leading private lender to venture and growth stage companies funded by tier-one VCs. Genesis is founded by a team of venture lending pioneers who have backed some of Southeast Asia's best loved companies. Armed with a strong reputation among entrepreneurs and investors, Genesis is a trusted partner in empowering corporate growth while minimising shareholders' equity dilution.

For further information, visit
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