

## Leveraging Debt to Extend Your Runway

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Today, investors expect more of entrepreneurs than astute strategic management and operational excellence in building successful companies. Investors expect capital efficiency. As a result, entrepreneurs often turn to debt as a critical component of the capital structure and should be mindful of its potential use throughout a company's life cycle.

Debt financing has evolved considerably from a capitalization vehicle purely for mature, profitable companies. Debt can be a fitting complement to equity and extend the "runway" a round of equity provides. Even in the early stages when a company is building enterprise value through R&D, debt can help finance hard assets such as equipment and working capital, and even serve as a source of growth capital that can finance general corporate purposes. At the same time, it can help the entrepreneur increase the company's valuation and reduce dilution in the subsequent round of equity. Debt enhances the return on equity for the investor and lowers the overall cost of capital for the entrepreneur.

While early stage debt financing is typically available to a company that has raised money from institutional investors, pre-venture funded companies are not excluded from using debt. Working capital financing is available to revenue stage companies that may not have raised venture capital. Lenders can provide lines of credit and make advances against eligible accounts receivable and/or inventory in some cases. This type of financing also serves to help build value, reduce dilutive effects of equity, and lower the company's weighted average cost of capital.

It is important to be mindful of the differences between debt and equity and the similarities in the capital raising process. Generally speaking, lenders have a priority claim on assets, whereas equity investors do not. To compensate the investor for their higher risk position, the cost of equity is higher. Higher risk equals higher cost of capital. The importance of an entrepreneur's due diligence in raising debt or equity is the same, however. Just as an investor or lender performs due diligence to evaluate a company, so too must an entrepreneur make its own evaluation of the investor or lender.

Particularly important in the case of debt is to work with a lender capable of providing debt financing vehicles throughout all stages of development. Remember, higher risk equals higher cost. As a company progresses into commercialization, for example, risk is reduced and options for less expensive debt arise. To take advantage of this, an entrepreneur may want to consider a lender that can provide these options. In the end, an entrepreneur should work with a firm that adds value to his or her company, has domain experience in working with companies like theirs, and has a strong reputation in the industry for supporting companies through challenging times.