Lending start-ups a hand beyond equity

InnoVen Capital provides venture debt that gives them the leeway to build their business

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With venture capital firms tightening their purse strings, thus delaying follow-on rounds of fund raise by companies, debt is an option that they look at. "We are optimistic about where we are for this year and the next 12 months," says Vinod Murali, when you ask him what the pipeline looks like for his company. He is the Managing Director of InnoVen Capital India Pvt Ltd, which provides venture debt to companies. There are multiple reasons, he adds.

The equity market is lukewarm and companies want to raise as much capital as they can. According to Vinod, because of this companies are focussing on building discipline, cutting flab, making themselves slim, reducing cash burn, and focussing on what is real and necessary. Alongside, VC firms are highlighting their strong portfolio companies and commitment to help them raise funds, which helps InnoVen as it can lend to these companies. It is much better, he says, for the companies as they can put their stamp as leaders. If the ventures have the fuel, the capital and the team, this is the time for them to conquer the market as they have a number of things working in their favour. Those not in the B2C space need not offer discounts, they need not pay a lot to hire good talent as the market has cooled off. Their costs are under control and they can gallop faster.

"We are seeing a lot of demand, both to extend the runway and improve on whatever the company has," says Vinod. Ventures can use the cash judiciously and acquire other companies because valuations are down.

InnoVen Capital, formerly Silicon Valley Bank, lends only to venture-backed companies, often providing 10-20 per cent of the equity round that they raise from venture capital firms.

How it works

How does venture debt work? According to Vinod, venture debt helps entrepreneurs and founders reduce stake dilution in their companies whenever they raise equity from VC firms.

For instance, if a company is looking to raise $5-10 million, the owners will have to shed 20-40 per cent stake to the investors. "We provide an alternative that can work along with equity," he says.

InnoVen tells the founders that they can take 10-20 per cent of the round as debt. This helps them conserve equity for future rounds of fund raise and gives them the leeway to build the business.

"From the founder's perspective, it is a no-brainer because it is much cheaper than equity," says Vinod. Unlike traditional banks, InnoVen does not ask for collateral and proof of profitability. Instead what InnoVen looks for is the ability of the companies to raise their next equity round. If a company struggles to raise the next equity round, there will be a challenge in honouring its obligations to InnoVen. That is the risk InnoVen takes. InnoVen charges a 15 per cent rate of interest with monthly repayments, with the debt having a 2-3 year tenor.

InnoVen works with VC firms. Last year, it looked at about 150 venture-backed early-stage companies and funded 28 of them; a third was repeat customers. The companies that have raised debt from InnoVen include Carwale, Portea, Practo, Toppr, Capillary, eShakti and Myntra.

"We like companies which are high growth, innovative, differentiated. We understand that they will be non-profitable, they are in new sectors, they are creating categories, they won't have much of a track record, the sector itself might not have much of a track record and they are asset light."

Scaling up its business

According to Vinod, InnoVen funded ₹275 crore to 28 companies in India in 2015. InnoVen formally started operations in Singapore earlier this year. This year, it is looking to fund $60-70 million. InnoVen is in talks with a handful of companies to finance their acquisitions, says Vinod, an alumnus of IIT-Madras and IIM-Ahmedabad and who has extensive experience in the banking industry.

Most of the companies that InnoVen funds are referred to by partners in the venture capital firm that is investing in them. Earlier, the partners used to put in equity and then refer the company to InnoVen, but now "it is actually being constructed together with the round. The last few term-sheets are all part of an equity round, rather than with a lag after the equity round has closed," says Vinod. InnoVen broadly focuses on ventures in the consumer, technology, healthcare, healthcare delivery, medtech and education spaces.

InnoVen's approach to funding a venture differs substantially from that of an equity investor. A venture capital firm has a longer perspective – typically till the life of the fund, which could go up to seven years – whereas InnoVen needs the company to raise its next round in 15 months.

"What will it take for a company to raise the next round. That is what we try to answer," he explains. A venture capital firm will want the venture to become a unicorn, which is not InnoVen's priority. "I am looking at the probability of survival, the investors are looking at the probability of growth, and the founders are looking at both. But the first priority of a founder is the probability of survival. In that sense, we are aligned with the founder," he adds.

The loan size varies from ₹2-2.5 crore to ₹30 crore. On defaults, Vinod says: "We have had a couple of bad situations. We have totally done $150 million and we charged off about 1 per cent of that. It is not a big number compared to other institutions. Today, we have 2-3 situations that are on the path of resolution."

Overseas investors

Innoven has two equity investors – Temasek and United Overseas Bank, Singapore — both of which have committed $100 million each. It has raised debt from banks, of about $50 million.

In the US, says Vinod, 10 per cent or so of all venture capital dollars is venture debt.

"India is still early single digit, 2-3 per cent is my guess. It is improving. The pie is growing. My guess is in the next couple of years, it should stabilise at 4-5 per cent, which is a lot of room to grow," adds Vinod.

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