Mind the funding gap: How debt financing can work alongside equity in later stage M&A

While early-stage tech companies in the UK and Europe find funding from venture capital funds in the form of equity, scaling companies should be more proactive in seeking debtfunding as they approach bigger rounds beyond series A and B – and in particular when it comes to funding later stage M&A.

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Venture debt's more common use is as a runway extender, giving companies an extra year or so of funding before they have to hit the road again with their new pitch deck. This is often a time-consuming exercise and modest venture debt facilities have been playing a big role here for some time.

Increasingly, we are seeing later stage companies at series C and series D using venture debt to fund acquisitions that fill a product gap and further accelerate the company's growth.

What is venture debt and how does it work?

Venture debt can offer a more cost-effective form of funding than other types of financing such as equity investment, particularly for founders who do not want to spend months identifying and pitching different VCs. Debt is often available more quickly than equity funding, which allows founders to do what they do best – build their business. Venture debt is growth capital that can help companies achieve their ambitions.

Another crucial point is that although venture debt typically carries higher interest rates than traditional debt, it offers benefits such as not diluting ownership or adding new shareholders.

This can be particularly useful when funding acquisitions, where it might be important to raise non-dilutive financing to secure a deal. In fact, a hybrid approach to acquisitions – by combining both equity and debt financing at the same time – is increasingly used.

How to use debt funding for M&A

A classic example of a company using venture debt to fund an acquisition might be a well-funded later stage business that is still burning through its cash reserves. This company might use debt to fund the acquisition, which would keep its balance sheet liquidity protected and then drive the combined enterprise to profitability. An additional benefit: because debt is often quicker to secure than equity funding, it can be a good move to speed up the M&A process.

When to look into venture debt options

As with equity investment, loans are rarely a single transaction of capital. Instead, it’s the beginning of a long-term relationship, which means it is important to choose the most suitable debt lender. A good debt provider will act as a partner, having had experience working with high growth companies and the challenges they often encounter in addition to providing flexibility to founders as they continue to build their companies. Growing a successful company is rarely a straight line – venture can help keep a business moving in the right direction.

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