

# Rise of Alternative Funding Models: Revenue Based Financing

Peniaz Lizaveta

Founder of KROKIT Startup Accelerator

**Abstract:** *This study examines the emergence of revenue-based financing (RBF) as an alternative funding model for startups and growth-oriented companies. Through comprehensive literature analysis and market trend evaluation, the research investigates RBF's conceptual foundations, market dynamics, and strategic implications for both startups and investors. The findings reveal that RBF offers a unique balance between debt and equity financing, providing companies with capital without diluting ownership while tying repayments to revenue performance. The global RBF market is projected to reach \$3.38 billion by 2023, driven by the changing structure of the economy and the growing demand for flexible financing options. The study concludes that RBF has the potential to transform the startup funding landscape, fostering a new generation of companies focused on sustainable growth. However, challenges such as standardization and regulation need to be addressed. This research contributes to the understanding of evolving financial instruments in the context of the innovation economy.*

**Keywords:** revenue-based financing, alternative funding, startups, venture capital, financial innovation, saas, e-commerce, growth financing, investment strategies, entrepreneurship

## 1. Introduction

The study of alternative financing models, particularly revenue-based financing (RBF), requires a deep understanding of the evolving financial landscape in the context of startups and growing companies. Traditional financing methods, long dominant in the market, are facing challenges in today's economy. This creates the basis for innovation in financial instruments.

First and foremost, it is essential to analyze the existing financing models. Bank loans, as a classic tool for raising capital, are often inaccessible to young companies (hereafter referred to as startups) due to strict collateral requirements and credit history. Venture capital, on the other hand, offers substantial investment amounts, but at the cost of a stake in the company and the potential loss of control by the founders. This dichotomy creates space for the emergence of alternative solutions [1].

Revenue-based financing represents an innovative approach that has the potential to overcome the limitations of traditional models. RBF allows companies to receive funding without diluting ownership, while linking repayments to future revenues. At first glance, this mechanism may appear to be an ideal solution for growing companies. However, its implications require thorough analysis.

The emergence and development of RBF does not occur in a vacuum. It is driven by profound changes in the structure of the modern economy. The digitalization of business processes, the globalization of markets, and the growing role of intellectual capital create a new reality in which traditional methods of risk assessment and company potential often prove inadequate. In this context, RBF can be seen as the financial sector's response to the changing needs of businesses [2].

The key question of our research is: How does revenue-based financing transform the funding landscape for startups? This question has not only theoretical but also practical

significance. The answer will shape the future of many innovative companies and possibly influence the direction of global economic development as a whole.

This study aims not only to analyze the mechanisms of RBF but also to assess its potential impact on the startup and venture capital ecosystem. The advantages and disadvantages of this model will be examined, along with its applicability across various sectors of the economy and the potential risks associated with its widespread adoption.

### 1) Conceptual Foundations of Revenue-Based Financing (RBF)

The conceptual foundations of revenue-based financing (RBF) present a complex and multifaceted topic that requires thorough analysis. In the constantly shifting financial landscape, RBF emerges as an innovative tool designed to meet the needs of growing companies, particularly in the technology and SaaS sectors.

At its core, RBF involves providing capital to a company in exchange for a commitment to pay a fixed percentage of future revenues until a predetermined total amount is repaid. This model significantly differs from traditional forms of financing, offering a unique balance between flexibility and structure. The absence of fixed payments and the non-dilutive nature of RBF make it particularly appealing to companies that seek to maintain control over their business while securing the necessary capital for growth.

The operation of RBF is based on a careful analysis of a company's financial performance. Investors focus closely on key metrics such as Monthly Recurring Revenue (MRR) and Annual Recurring Revenue (ARR), as well as other indicators like customer retention rates and growth velocity. This approach allows for a more accurate assessment of the company's potential and the risks associated with the investment. The evaluation and funding process in RBF differs significantly from traditional methods, involving a deep analysis of data, often utilizing sophisticated algorithms

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and artificial intelligence to enable more informed decisions in a shorter timeframe [3].

The structure of payments in RBF has unique characteristics that must be considered in detail. Typically, a company pays between 2% and 8% of its monthly revenue to the investor. This flexible structure allows businesses to adapt to

fluctuations in revenue, which is especially important for young and growing companies. Additionally, a "cap" on payments is established—a maximum amount the company is required to return to the investor. This usually ranges from 1.5 to 3 times the initial investment. Such an approach ensures predictability for both parties and limits potential risks [8,9].

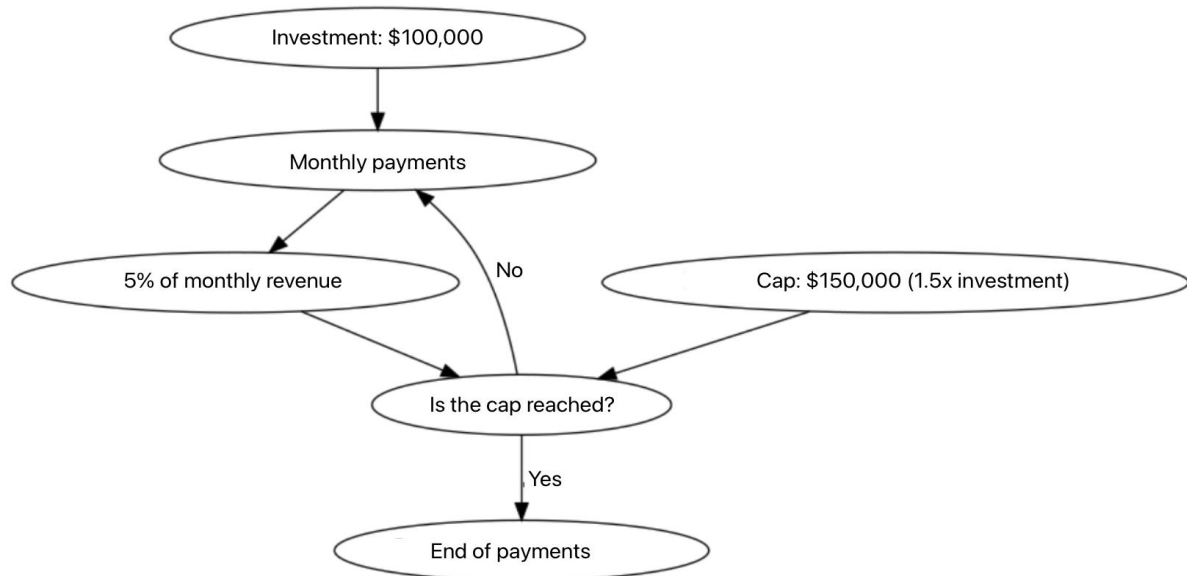


Figure 1: Payment Structure in RBF

When comparing RBF to traditional financing methods, several significant differences stand out. Unlike bank loans, RBF does not require collateral or fixed payments. This reduces entry barriers for startups, which often lack sufficient assets to secure traditional loans. Furthermore, the process of securing RBF is usually much faster, which is crucial for rapidly growing startups that need quick access to capital.

Comparing RBF with venture capital also reveals key distinctions. Venture capital investors typically acquire an equity stake in the company and often play an active role in management, whereas RBF does not involve the transfer of ownership or significant influence over company management. This allows founders to retain greater control over their business. However, it is important to note that venture capital usually offers larger amounts of funding and may be more suitable for companies aiming for exponential growth [4].

Table 1: Comparison of RBF with Venture Capital and Bank Loans

Characteristic	RBF	Bank Loan	Venture Capital
Equity Stake	No	No	Yes
Fixed Payments	No	Yes	No
Speed of Access	Fast	Slow	Moderate
Involvement in Management	Rare	No	Often

It is important to note that RBF is most effective for certain types of businesses. Companies with stable and predictable revenue streams, particularly in the SaaS and e-commerce sectors, are ideal candidates for this type of financing. This is because the RBF model relies on the company's ability to

generate consistent income to ensure repayments to the investor.

However, like any financial instrument, RBF has its limitations. Companies must carefully evaluate their ability to sustain revenue-based payments, particularly during periods of growth, when a significant portion of revenue may need to be reinvested in business expansion. Additionally, the cost of capital with RBF can be higher than with some traditional financing options, especially if the company experiences rapid growth.

In the context of the evolution of financial models, RBF represents an interesting phenomenon, reflecting changes in the structure of the modern economy. The rise of technology-based and intellectual property-driven companies has created a need for new, more flexible forms of financing. RBF addresses this need by offering a model that aligns more closely with the nature of today's fast-growing companies.

Thus, RBF occupies a unique niche in the spectrum of financial instruments, offering a combination of flexibility and structure that can be especially appealing to certain types of businesses. However, as with any financial tool, companies must carefully assess their needs, capabilities, and long-term goals before deciding to use RBF.

2) Market Analysis and RBF Development Trends

The analysis of the market and development trends for revenue-based financing (RBF) is a complex task that requires a deep understanding of both the financial sector as a whole and the specifics of innovative companies. In recent years, there has been a significant increase in interest in RBF, driven by various factors, including shifts in the economic

structure and the growing need for flexible financial instruments among expanding companies.

The current state of the global RBF market is characterized by dynamic growth. According to expert estimates, the RBF market is expected to reach \$3.38 billion by 2024. This figure reflects not only the rising number of companies offering RBF but also the increasing demand from startups and growing businesses. However, it should be noted that these forecasts were made prior to the onset of the global COVID-19 pandemic, which significantly impacted the development of many sectors of the economy [8].

The growing popularity of RBF is driven by several key factors. First, there has been a change in the structure of the modern economy, where technology- and intellectual property-based companies are playing an increasingly important role. These companies often face challenges in obtaining traditional bank financing due to the lack of tangible assets to serve as collateral for loans. RBF offers an alternative, based on an evaluation of future revenues, making it particularly attractive to tech startups [5].

Second, there is growing awareness among entrepreneurs of the variety of financial instruments available and their desire to retain control over their companies. RBF allows companies to raise capital without diluting ownership, which is a major advantage for many startup founders. This is particularly relevant given the growing understanding of the potential negative consequences of early venture capital investment, such as the loss of control over the strategic direction of the company.

A third factor is the advancement of data analytics and artificial intelligence technologies, which enable more accurate assessments of the potential and risks of companies seeking financing. This reduces risk for investors and makes RBF more accessible to a broader range of companies [2].

When analyzing the profile of companies best suited for RBF, several key characteristics stand out. First and foremost, these are companies with stable and predictable revenue streams. Ideal candidates are SaaS companies and e-commerce businesses with high margins. These companies typically have recurring revenue, which makes them particularly attractive to RBF investors.

Scalability and growth potential are critical attributes of business models suitable for RBF. Investors look for companies that can rapidly increase revenue without a proportional increase in costs. This ensures the potential for quick returns on investment and additional profits.

The financial indicators and metrics that RBF investors focus on include Monthly Recurring Revenue (MRR), Annual Recurring Revenue (ARR), customer retention rate, Customer Acquisition Cost (CAC), and Customer Lifetime Value (LTV). These metrics help assess not only the current state of the business but also its growth potential and the sustainability of its business model.

To illustrate the key financial metrics used in evaluating companies for RBF, consider the following diagram (Figure 2).

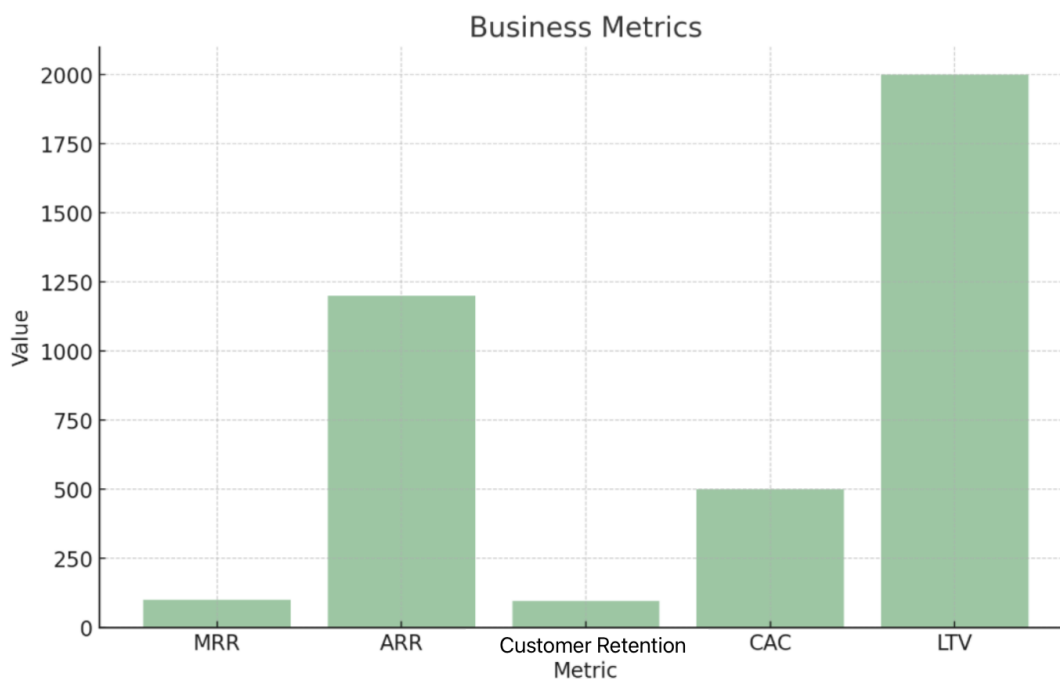


Figure 2: Key Financial Metrics

Despite the growing popularity of RBF, this financial instrument faces several challenges. One of these challenges is the need for standardization and regulation. As the RBF market expands, there is a growing demand for clear rules and standards that would protect the interests of both investors and companies seeking funding.

Another challenge is the competition from traditional financial institutions, which are beginning to adapt their products to meet the needs of growing tech companies. Banks and venture funds are developing hybrid products that combine elements of debt and equity financing, potentially posing competition to RBF.

It is also important to note that the development of the RBF market is uneven across different regions of the world. While RBF is already well-known and widely used in the U.S. and the U.K., in other countries, including many European nations, it is only beginning to gain traction. This creates potential for further market growth as awareness of this financial instrument spreads and the necessary infrastructure develops [8,9].

**3) Strategic Implications of RBF for Startups and Investors**

The strategic implications of revenue-based financing (RBF) for startups and investors represent a multifaceted topic that requires thorough analysis. This innovative financial instrument not only opens up new opportunities but also presents a number of challenges for all participants in the startup ecosystem. Let's explore these implications from different perspectives, starting with the companies seeking funding.

For startups and growing companies, RBF offers a unique combination of advantages that can significantly impact their development strategy. First and foremost is the ability to raise capital without diluting equity. In today's startup culture, where founders increasingly aim to retain control over their companies, this benefit is invaluable. It allows entrepreneurs

to maintain autonomy in making strategic decisions and fully realize their vision for the company's growth.

The financial aspects of RBF also deserve special attention. The flexible repayment structure, in which the amount paid back depends on the company's revenues, reduces the risk of default during downturns and allows for more efficient cash flow management. This is particularly important for young companies whose revenues may be volatile. However, it is worth noting that this flexibility comes at a cost—the overall cost of capital under RBF may be higher than traditional financing methods, especially for companies experiencing rapid growth [6].

From an operational and strategic standpoint, RBF can significantly influence decision-making within a company. For example, the requirement to pay a percentage of revenue may incentivize companies to pursue more aggressive revenue growth, possibly at the expense of other areas such as product development or long-term investments. This creates an interesting balance between short-term financial obligations and long-term strategic goals.

To clearly illustrate the advantages and disadvantages of RBF for startups, let's consider the following SWOT matrix (Figure 3).

**SWOT Analysis of RBF for Startups**



**Figure 3:** Advantages and Disadvantages of RBF for Startups

Shifting to the investor perspective, RBF presents an interesting alternative to traditional forms of investment. The risk profile of RBF differs from both venture capital and debt financing, offering potentially more predictable, though limited, returns. This can be appealing to investors seeking a balance between risk and return [7].

The potential returns from RBF are usually lower than those from successful venture capital investments but higher than traditional debt instruments. Moreover, the RBF structure offers quicker returns on investment, which can be advantageous during times of economic uncertainty. However, investors must bear in mind that the success of RBF investments heavily depends on their ability to accurately assess the growth potential of companies and their capacity to generate stable revenue.

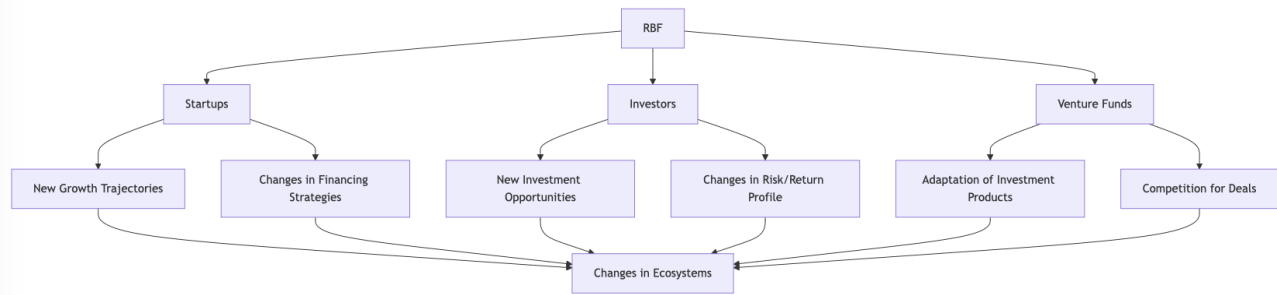
From a portfolio diversification standpoint, RBF offers unique opportunities. It allows investors to participate in the growth of tech companies without needing to wait for a liquidity event such as an IPO or company sale. This is particularly relevant given the increasing length of time it takes startups to go public.

The impact of RBF on the startup and venture funding ecosystem could be significant. On the one hand, RBF can fill an important financing gap, especially for companies that are not suitable for or ready to pursue traditional venture capital. This could lead to the emergence of a new class of successful companies that grow along an alternative trajectory. On the other hand, the widespread adoption of RBF could alter the dynamics of the venture market. Venture capitalists may face increased competition for deals, especially at the early stages. This could result in changes to their strategies



and possibly the development of hybrid investment products combining elements of equity and RBF [3].

For a visualization of the impact of RBF on the startup ecosystem, let's examine the following diagram (Figure 4).



**Figure 4:** The Impact of RBF on the Startup Ecosystem

It is important to note that RBF's influence on the startup ecosystem extends beyond financial aspects. This instrument can foster a shift in startup culture, moving the focus from rapid growth and exits toward more sustainable development and long-term profitability. This could lead to the emergence of a new generation of companies more focused on building a sustainable business rather than achieving "unicorn" status.

However, the spread of RBF also presents new challenges. For startups, there is the risk of excessive focus on short-term revenues at the expense of long-term investments in product development or market expansion. For investors, the challenge lies in developing new competencies in evaluating companies and managing risks specific to RBF.

## 2. Conclusion

The study of revenue-based financing (RBF) as an alternative funding model has revealed several key aspects that are critical to the development of the startup ecosystem and innovation financing overall. RBF is not just a new financial tool but a catalyst for changes in the approaches to company growth and development.

An analysis of the conceptual foundations of RBF has shown that this tool possesses unique characteristics, filling an important gap between traditional debt financing and venture capital. The flexibility of repayments, the absence of equity dilution, and the focus on companies with recurring revenues make RBF particularly attractive for certain types of businesses, especially in the SaaS and e-commerce sectors.

An examination of market trends has revealed significant growth potential for RBF, with a projected market size of \$3.38 billion by 2023. This growth is driven by both changes in the economic structure and the increasing demand from entrepreneurs for alternative forms of financing.

The strategic implications of RBF for startups and investors are multifaceted and potentially transformative. For startups, RBF offers the opportunity to accelerate growth without losing control, but it also presents new challenges, such as the need to balance short-term financial obligations with long-term strategic goals. For investors, RBF opens new opportunities for portfolio diversification and participation in the growth of innovative companies with a potentially more predictable risk and return profile.

However, despite its clear advantages, the widespread adoption of RBF is not without challenges. The need for standardization and regulation, potential conflicts with traditional forms of financing, and the risk of excessive focus on short-term revenues are significant issues that require attention from both market participants and regulators.

Looking ahead, we can expect further development and differentiation of RBF models, their integration with other financial instruments, and possibly the emergence of new hybrid forms of financing. The geographic expansion of RBF is also likely, particularly in countries with developing startup ecosystems.

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