1.3 REVENUE SHARE AGREEMENT (DEBT-BASED)

Brief Description

A Revenue Share Agreement ("RSA") is a quasi-equity financing instrument (also called a revenue-based loan) where periodic repayments are based on a percentage of revenues up to a predetermined return on the investment ("Cap" or "Multiple"). The RSA allows for a higher level of flexibility because repayments are not tied to a monthly amount or interest rate; they fluctuate with the company's revenues. When revenues are down due to seasonality or other unexpected factors, the repayment will be lower and represent a smaller burden on the company's cash flow. Conversely, when revenues are high, the repayment will scale with the increasing revenue base and allow the investment to be repaid faster. The debt-based RSA allows the enterprise to retain ownership and control of the company, avoiding equity dilution or interference in the management by external parties.

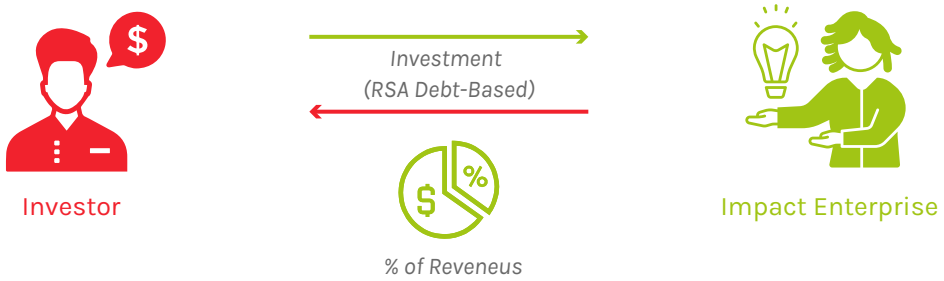


Figure 1.4 – "RSA Debt-Based", source: Roots of Impact.

Purpose/Fit	Enabling mission-aligned growth without equity dilution and requirement for exit
Can replace	Equity or debt (dependent on stage and purpose of investment)
Risk/Return Profile	Medium Risk/Moderate Return[21]
Enterprise Lifecyle	Early-growth stage (post-revenue)
Maturity	Agreed between investors and borrowers based on a pre-defined multiple

21 The return depends on the behaviour of the underlying financial metric and on the speed of which money is repaid back

Defining Criteria

1. **Interest rate:** Unlike a loan or a convertible note, a Revenue Share Agreement has no fixed interest rate.
2. **Periodic repayments:** Based on a fixed percentage of revenues, or alternatively profit, cash flow or other financial indicators. The frequency is usually annual or biannual.
3. **Revenue share:** The percentage of revenue agreed that the company shall pay to the investor.
4. **Revenues:** The definition of revenues agreed with the company. An example is the definition of net revenues according to common accounting standards.
5. **Multiple/Cap:** How many times the initial investment ("Multiple") or the total amount ("Cap") the enterprise shall repay.
6. **Flexibility:** A Revenue Share Agreement has a flexible repayment period, until reaching a pre-defined multiple (e.g. 1.5x the initial investment).
7. **Return on capital:** The investor's return on capital is dependent on the timing of the repayments. The faster the sales growth, the greater the return for the investor.
8. **No collateral requirement:** Typically there is no requirement for collateral but simply a convincing revenue history or high potential for future sales, given proof of concept or past traction.

Variants and Optional features

- Honeymoon, also known as grace period: the repayment is deferred by a predetermined duration, usually ranging from 10 to 24 months, to provide the enterprise with the time needed to reach efficient scale and generate revenues and profits.
- A final repayment date for the remainder can be agreed upon. In this case the

enterprise has to pay the investor the remainder (balloon payment) needed to reach a pre-defined multiple (e.g. 1.5x) on this final repayment date.

- Straight interest rate enhanced with a "royalty kicker", i.e. a percentage of revenues payable to the investor on top of the straight repayment (which dilutes some of the advantages for the enterprise mentioned above).

- Conversion to equity or participation rights in future rounds of funding (see Convertible Note).

- The loan can be combined with business development services to prepare the entrepreneur (the borrower) for loan monitoring, business growth and capital infusion, and to help reduce the risk of default.

- The investor can be given the option to convert the investment into a normal loan upon achievement of a specific revenue level. The enterprise then pays back on a traditional loan schedule, providing the creditor with interest and principal payments. This variant caps the amount the enterprise will have to pay and helps it make more accurate financial projections.

- The Revenue Share Agreement can be used in combination with subordination of the loan, allowing the impact enterprise to attract further funding and investors (in the event of liquidation or bankruptcy, subordinated debt ranks below other debt instruments).

- Linking financial rewards to the achievement of impact, for example reducing the multiple/cap or the revenue share – see "Examples of relevant terms" below.

- Examples of structures: Straight (or Open-Ended) Revenue Loans[22]; Convertible Revenue Loans[23]; Final Repayment Date Revenue Loans[24].

22 a percentage of revenues is periodically repaid until a certain multiple of investment is reached

23 a percentage of revenues is periodically repaid and the remainder can be converted to equity

24 the remainder has to be repaid by a final repayment date

PRACTICAL APPLICATION

Benefits and Considerations, Capital Providers

Benefits	Considerations
Early, ongoing returns from the investment instead of waiting for an exit	Upper constraint on return in terms of multiple of investment, due to the nature of the structure
Enterprise and investor both benefit in case of strong revenue growth (alignment of interest)	Heavy reliance on the company's future revenue and on accurate revenue reporting
Pre-defined exit: self-liquidation through achieving the pre-defined repayment level, with no dependence on an exit event	Additional risk if revenue falls below expectations: repayment time extends (Straight Revenue Loans) or a high repayment obligation arises at maturity (Final Repayment Date Revenue Loans)
Straightforward implementation without major legal formalities, and no time wasted on valuation questions	Typically no collateral to fall back on in case of default

Benefits and Considerations, Enterprises

Benefits	Considerations
Repayments flex with revenues, avoiding the burden of fixed repayments during low-sales periods	Payments based on a revenue share reduce free cash flow during the scaling phase
No dilution of ownership and limited external involvement in day-to-day management	Effective cost of capital can be high if revenues grow quickly and the multiple is repaid early

No pre-defined payment amount and often no or reduced collateral requirement	A balloon payment at a final repayment date can create a heavy obligation if growth disappoints
No time spent on valuation questions	Requires reliable revenue accounting and reporting to the investor

Selection Criteria Checklist

Use to test whether a Revenue Share Agreement (Debt-based) is a good fit for a given deal.

- ☐ **Post-revenue:** the enterprise has a convincing revenue history or strong evidence of near-term sales.
- ☐ **Margin headroom:** margins can absorb the agreed revenue share without starving operations.
- ☐ **Investor accepts capped return:** the capital provider is comfortable with a multiple-based ceiling on returns.
- ☐ **Clean revenue definition:** a clear, auditable definition of revenues and reporting cadence is agreed.
- ☐ **No conflicting equity plans:** no near-term priced round that the Revenue Share Agreement would complicate.
- ☐ **Realistic sizing:** the multiple, revenue share and tenor make full repayment plausible under conservative forecasts.

Common Pitfalls

1. Setting the revenue share too high for the company's margin profile, draining the cash needed to scale.
2. Leaving the definition of revenues vague, causing disputes over what the share is calculated on.
3. Skipping the grace period, forcing repayments before the enterprise reaches efficient scale.

Examples of Relevant Terms

As formulated in a contract; bracketed values are illustrative and negotiable.

Revenue share	In exchange for the Financing Amount, the Company shall make (quarterly) payments equal to (5%) of Revenue to the Investor until the Repayment Amount is paid in full. The initial payment will begin at the earlier of (i) the end of the first quarter in which the Company generates (gross) revenues of (USD 80,000); or (ii) (12) months (grace period) from signing of the term sheet.
Multiple/Cap	The outstanding amount will be considered paid in full when the Company has paid the Investor the Repayment Amount, defined as the original investment amount multiplied by (2x) (Multiple). In the event the Revenue Share Agreement Debt-Based facility has been in effect for a period of (5) years without full repayment, the Company must repay (2x) the outstanding amount at the subsequent end of quarter.
Optional: Link to Impact Performance	The pre-defined multiple of (2x) is reduced by (0.1) for every (1,000 units of social outcomes) achieved by the company down to a threshold of minimum (1.2x). Alternatively: The pre-agreed revenue share of (3%) is reduced by (0.125%) for every (1,000 units of social outcomes) achieved by the company down to a revenue share of (2%).

Other external case studies and additional resources about Revenue Share Agreement (debt-based) can be found **here.**