

## The Capital Structure Decision That's Easy to Overlook

A Series B medical device founder. Cleared product. \$18 million in contracted hospital revenue. A sales pipeline that has been growing steadily for eighteen months. The board encourages a \$15 million equity round to fund the next phase of commercial expansion. The process takes five months. They close at a \$75 million valuation, giving up 20% of the company.

It looks like a win. In many ways, it is.

But here is what rarely gets said at the closing dinner: that 20% stake carries an implied required return of roughly 25% per year. That's a claim on the company's future value that compounds silently until the day of exit. If the company reaches \$250 million in five years, the cost of that round in founder value permanently transferred is not the \$15 million raised. It is closer to \$50 million.<sup>1</sup>

Equity is not free. It just doesn't send a monthly invoice, which is exactly why most founders underestimate it. This piece is about what equity actually costs, what debt actually costs, and why thinking about both together, rather than defaulting to the familiar option, matters more than most founders ever find out. Most never run this number. This piece shows how.

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### Part I: The Hidden Price Tag on Every Share You Issue

#### Equity Has a Cost: It Just Doesn't Send a Bill

When an investor backs a company, they are taking on real risk: the risk that the company fails, grows slowly, or never reaches a meaningful exit. To compensate for that risk, they require a return. The higher the risk, the higher the return they demand. That required return is the cost of equity.

What surprises most founders: that return is not paid in cash. It is paid in ownership. And because the investor holds their stake until exit, the cost compounds over time, the same way interest compounds on a loan, except it accrues silently against the value of the company rather than appearing on a bank statement.

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<sup>1</sup> This example is hypothetical and for illustrative purposes only. It is not based on any specific investment and is not intended to represent actual or expected performance. Outcomes will vary materially based on company-specific factors, market conditions, and capital structure.

## How Much Does Equity Cost at Each Stage?

So what does equity actually cost at each stage? Because private companies don't have a share price to look up, we have to estimate it. We use two independent methods and report the range where they agree.

The estimates combine a CAPM build-up model using stage-specific betas from Hillenbrand and Stafford (2025) [A] with a market cross-check against the gross IRR targets that institutional investors actually state they require. The two methods converge at later stages; at early stages, the market cross-check sits higher because VC investors price in total-loss risk that CAPM assumes away. Full methodology is in the Appendix.

Stage	Typical ARR	CoE Range	Central Estimate
Seed	Pre-revenue	35–45%	~40%
Series A	\$0.5–2M	25–35%	~30%
Series B	\$5–20M	20–28%	~25%
Series C	\$20–60M	17–22%	~19%
Series D	\$50M+	15–19%	~17%

*\* Series C beta interpolated between Hillenbrand & Stafford late-stage (1.6) and mezzanine-stage (1.4). Series D beta independently calibrated at 1.43. This was research conducted as part of a project in 15.453, MIT Sloan 2025 Finance Lab by Lou-Anne Krembel, Palak Girish Nagdev, and Jason Yang under the faculty guidance of Profs. Gita Rao and Bhushan Vartak [B]. These are indicative ranges; individual circumstances will vary. See Appendix for full source list.*

What stands out most in this data is the scale of the cost, and how slowly it falls. A 25–35%<sup>2</sup> annual cost of equity at Series A is not a rounding error. It is the rate at which the value permanently transferred to investors compounds until exit. Even at Series D, after years of de-risking through revenue, contracts, and milestones, the cost of equity rarely falls below the mid-teens. For any company that qualifies for debt at that stage, equity is still the more expensive instrument.

## Why the Ownership Number Understates the True Transfer

Two factors mean the ownership percentage given up in a round understates the true economic transfer. It helps to understand both.

**Preferred stock terms shift value beyond the headline percentage.** Research by Gornall and Strebulaev shows that liquidation preferences, participation rights, and anti-dilution clauses systematically shift value from common to preferred shareholders in median exit scenarios. A founder who gives up 20% in a Series B is often transferring more than 20% of future value. Liquidation preferences alone can mean that in a modest exit, preferred shareholders recover their full investment before common shareholders see a dollar. Anti-dilution provisions can further erode the founder's effective stake if a later round prices below the current one. These are standard features of VC term sheets, not unusual or adversarial, but they are real costs, and they are only fully visible at the moment of exit.

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<sup>2</sup> These estimates are based on academic models and industry data and are not intended to represent actual realized investor returns or guaranteed outcomes. Actual investor returns vary widely.

**Early-stage cost of equity is priced across an entire portfolio, not just one company.** Industry data consistently shows that roughly 65%<sup>3</sup> of early-stage VC-backed companies return less than invested capital [D][E]. To generate the returns their own investors expect, VCs need their successful investments to more than compensate for the losses elsewhere in the portfolio. That means the one or two companies in a fund that do break through carry an outsized expected return, and that expectation is embedded in the cost of equity they issued at Series A or B. The founder of a company that succeeds is effectively also pricing in the risk of the ones that did not, not as a penalty, but as the rational structure of diversified risk capital. It explains why early-stage cost of equity is structurally higher than most founders expect, and why it falls more slowly than intuition suggests as a company matures.

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## Part II: What Debt Costs — and Why It’s More Predictable Than You Think

So far this piece has focused on the cost of equity, an expense that compounds silently and only becomes fully visible at exit. Debt works differently. Its cost is fixed, finite, and laid out in full before signing. Understanding both gives founders a much clearer basis for choosing between them.

### Three Numbers That Tell You the Whole Story

Debt has a reputation for being complicated. It doesn’t have to be. A private credit facility has three core cost components, each of which is agreed upfront and does not change.

**Cash interest** is the ongoing rate, a floating benchmark like SOFR or Prime, plus a spread that reflects the lender’s view of the borrower’s credit risk. This is the cost paid month to month.

**Origination fee** (typically 1–2%) is paid once at closing. It is not recurring.

**End-of-term fee** (typically 2–4%) is paid when the loan is repaid. It is known upfront and can be modeled.

Add those up and the total cost is finite, knowable, and critically, temporary. The loan matures, the borrower repays it, and the lender’s claim on the business ends. There is no permanent transfer of ownership.

### Where Does a Company Fall on the Rate Spectrum?

Borrowing costs in the private credit market today range from roughly 10% to 20% all-in, depending on the borrower’s revenue profile, asset base, and deal complexity. Here is how that breaks down across borrower types:

Borrower Type	Typical Profile	All-In Rate	Key Rate Driver
Senior Secured, Established	PE-backed mid-market; stable cash flows; sponsor-backed	10–13%	Broad, diversified portfolio; strong lender competition [6]
Growth-Stage, Revenue-Generating	Post-Series A/B; recurring revenue; identifiable asset base	12–16%	Illiquidity and complexity premiums added [7]
Specialist / Sector-	Medical devices, climate infra;	14–18%	Specialist underwriting premium;

<sup>3</sup> While loss rates are significant in venture portfolios, successful investments may generate returns that materially exceed invested capital, and outcomes vary widely across funds and strategies.

Borrower Type	Typical Profile	All-In Rate	Key Rate Driver
<b>Specific</b>	earlier revenue stage; non-standard collateral		sector expertise required; higher illiquidity
<b>Higher-Risk / Pre-Profitability</b>	Earlier stage; complex or unproven collateral; limited operating history	<b>17–20%+</b>	Elevated default risk; bespoke deal structure [7][8]

The lower end reflects well-established companies with strong, predictable cash flows, the kind of borrowers that large institutional lenders compete to fund. As the borrower profile moves toward earlier-stage or more complex businesses, rates rise to reflect the additional expertise and risk involved. In our own experience across the market, most growth-stage private credit transactions price somewhere in the mid-teens. In certain circumstances, the cost of debt may be lower than the implied cost of equity; however, this depends on company-specific risk, structure, and market conditions. *See sources [6], [7], and [8] in the Appendix. Rates are indicative ranges; individual circumstances will vary.*

The key takeaway is simple: debt has a price, and that price is knowable upfront. Equity also has a price. It just doesn't announce itself until exit.

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## Part III: Using Both Tools — How Hybrid Capital Works in Practice

### The Right Tool for the Right Job

The most capital-efficient founders don't choose between debt and equity. They use both, deliberately and for different purposes, and that combination is what keeps their cost of capital low.

Equity has a clear role: it funds the early, uncertain phases of a company's life, where no credit lender would responsibly commit capital. It backs binary views. It brings in investors whose networks and judgment create value beyond the check. For all of that, equity is the right tool, and its cost is justified by what it enables.

But for companies that have crossed into real revenue visibility, with recurring contracts, predictable cash flows, and identifiable growth catalysts, equity is sometimes used in situations where debt may be a viable alternative, depending on the company's financial profile and risk tolerance. Debt funds growth between equity rounds without resetting the dilution clock. It lets a company arrive at its next equity raise with more revenue, more leverage, and a higher valuation, which means less dilution at that round and more ownership preserved at exit.

### Same Round, Different Structure: What Changes at Exit

The ownership difference between the two approaches might look small at the moment of financing. At exit, it rarely is. Consider the same capital raise, \$15 million for a Series B company, structured two different ways:

	Path A: Equity Only	Path B: Blended (Equity + Debt)
Capital raised	\$15M equity	\$12M equity + \$3M private credit
Valuation	\$75M	\$75M
Ownership given up	20%	16% equity + debt facility
Annual cash cost	\$0	~\$450K interest
Total debt cost over 5 years	—	~\$2.5M (interest + fees)
Founder ownership at exit	80%	84%
Founder's remaining value at \$250M exit (no further rounds)	\$200M	<b>\$210M</b>
Difference	—	<b>+\$10M to founder after accounting for all debt costs<sup>4</sup></b>

*This analysis is hypothetical and provided solely for illustrative purposes to demonstrate how different capital structures may impact ownership outcomes under a specific set of assumptions. It does not represent actual investments, results, or performance achieved by any client or strategy. Assumptions include, but are not limited to, valuation, cost of capital, exit timing, and market conditions, all of which may differ materially in practice. Actual outcomes will vary and may be materially worse.*

*Assumes \$75M pre-money valuation, 15% all-in debt rate, 5-year hold to exit at \$250M, and no further financing rounds. Debt costs include origination fee (1.5%), annual interest, and end-of-term fee (3%). Founder's remaining value reflects equity ownership percentage applied to exit value; actual proceeds will vary based on preference stack, option pool dilution, and other cap table factors. Figures are illustrative.*

The hybrid approach doesn't require complex structures or risky leverage. It requires one additional lender relationship and the discipline to model the true cost of capital before starting a five-month equity process. It is also worth pausing on the scale of what is happening here: the \$3M private credit facility represents just 4% of the company's \$75M valuation, a modest, time-limited obligation that preserves 4 percentage points of permanent ownership. At a \$250M exit, that 4% is worth \$10M to the founder, net of every dollar of interest and fees paid over five years. The instrument is small. The impact at exit is not.<sup>5</sup>

## Beyond the Savings: Two More Reasons Hybrid Capital Works

The case for hybrid capital goes beyond the immediate cost savings. Two further benefits are worth noting.

**Debt helps founders raise the next equity round at a better price.** A company that uses private credit to grow revenue from \$15 million to \$22 million over 18 months walks into its next equity round with a materially stronger story and a higher valuation. The dilution taken in that subsequent round is smaller, and the ownership preserved compounds forward to exit. The difference between owning 18% of a company versus 22% at a \$200 million outcome is \$8 million. At \$500 million, it is \$20 million.<sup>6</sup>

<sup>4</sup> Alternative assumptions, including different exit values, cost of capital, or operating performance, may result in materially different outcomes, including outcomes where equity financing results in equal or better results.

<sup>5</sup> The relative impact of different capital structures depends on the assumptions used and may vary materially in practice.

<sup>6</sup> These potential benefits may not be realized in all cases. The use of debt may also introduce financial risk, including liquidity constraints and refinancing risk.

**Taking on debt signals conviction to the market.**<sup>7</sup> Choosing to commit to a repayment obligation, rather than defaulting to equity, signals to investors that the company’s cash flows are predictable and its strategy is sound. A founder who has used debt thoughtfully and serviced it cleanly walks into the next equity conversation with a track record of financial discipline that equity-only peers rarely have. For many investors, that is exactly the kind of operator they want to back.

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## Part IV: Is Mixed Capital Right for Your Company?

### When to Use Each — and How to Know

None of this is an argument against equity. It is an argument for using each instrument where it belongs. Equity is the right choice when a company is pre-revenue or has a binary risk profile: clinical-stage biotech, deep hardware R&D, early AI infrastructure. It is also the right choice when the investor relationship brings something beyond capital: clinical networks, regulatory relationships, commercial partnerships that only the right equity partner can open. But at the inflection point where a company has de-risked enough to attract lending on reasonable terms, the spread between equity and debt is wide enough that it is worth running the numbers before defaulting to another equity round.

### Some Questions to Ask Before Your Next Raise

A few questions worth working through before the next raise:

- Is the company raising equity because it’s the right tool, or because it’s the familiar one?
- Does the company have revenue that recurs: contracts, subscriptions, or committed purchase orders?
- Does the company have assets a lender could underwrite: equipment, inventory, receivables, or contracted cash flows?
- Is there a specific use of capital in mind, where the return could be reasonably estimated?
- Can the business service a monthly interest obligation even if growth comes in slower than expected?

If any of these have clear answers, companies may wish to consult their financial and legal advisors when evaluating capital structure decisions.

The more useful question is not “can we get equity” but “what is equity actually costing us, and is there a less expensive way to fund what we need?” For companies with durable cash flows, recurring revenue, or identifiable growth catalysts, that question often has a more interesting answer than founders expect.

*This material is provided for informational purposes only and is not intended to provide advisory or capital structuring recommendations. For more information, please visit [chestnutruncapital.com](http://chestnutruncapital.com).*

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<sup>7</sup> In some cases, the use of debt may be interpreted by investors as a signal of confidence in cash flow visibility; however, market perceptions vary and debt may also be viewed as increasing financial risk.

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## Appendix: Methodology and Sources

### Cost of Equity Estimation Methodology

Cost of equity estimates in this article are produced using two independent methods, reported as a range where they converge.

The first is a CAPM build-up model. The formula is  $CoE = R_f + (\beta \times MRP) + IP + SP$ , where  $R_f$  is the risk-free rate,  $\beta$  is a stage-adjusted asset beta, MRP is the equity market risk premium, IP is an illiquidity premium for private assets, and SP is a structural premium reflecting the economic cost of preferred stock features. Beta inputs are stage-specific estimates from Hillenbrand and Stafford (2025) [A], derived empirically from 38,796 VC-backed US startups. The market risk premium is sourced from Damodaran (January 2025) [G] at 5.96%, used as 6.0%. Illiquidity and structural premiums vary by stage and are sourced from Abudy, Benninga & Shust (2016) [H] and Gornall & Strebulaev (2019) [J] respectively. The risk-free rate is the US Treasury 10-year yield as of April 2026: 4.33% [C].

The second is a required return cross-check based on publicly available sources. Active institutional investors and fund-of-funds publish the gross IRR targets they require to justify investing at each stage. These represent what equity investors actually demand in the market, independent of the CAPM calculation. Sources used include Industry Ventures (2017) [D], Hustle Fund / HF Scale Partners (2024) [E], and Kruze Consulting (2024) [F]. At early stages the required return cross-check sits above the CAPM floor because CAPM prices only systematic risk, while VC investors also require compensation for the probability of total loss. At later stages the two methods converge. Series D beta independently calibrated at 1.43. This was research conducted as part of a project in 15.453, MIT Sloan 2025 Finance Lab by Lou-Anne Krembel, Palak Girish Nagdev, and Jason Yang under the faculty guidance of Profs. Gita Rao and Bhushan Vartak [B].

### Sources

[A] Hillenbrand, S., & Stafford, E. (2025). *Venture capital as portfolios of compound options*. Harvard Business School Working Paper, July 2025. Stage betas used: early-stage 2.2, late-stage 1.6, mezzanine-stage 1.4. Derived empirically from 38,796 VC-backed US startups (VentureXpert, first funding round 1981–2016).

[B] These results were produced as part of a research project in 15.453, MIT Sloan 2025 Finance Lab by Lou-Anne Krembel, Palak Girish Nagdev, and Jason Yang under the faculty guidance of Profs. Gita Rao and Bhushan Vartak.

[C] US Treasury. 10-year constant maturity rate, April 2026. [treasury.gov](https://www.treasury.gov). Risk-free rate used throughout: 4.33%.

[D] Swildens, H. (2017). 'The Venture Capital Risk and Return Matrix.' Industry Ventures. Key data: early-stage loss rate 65%; early-stage target gross IRR 30%; late-stage loss rate <30%; late-stage target gross IRR 20%+.

[E] Melzer, J., & Nowak, K. (2024). 'Breaking Down Risk and Returns Across Stages of Venture Capital.' Hustle Fund / HF Scale Partners Blog, June 26, 2024. Key data: early-stage loss rate 65%; target 100x MOIC per investment; growth-stage (Series B) target IRR ~25%; late-stage (Series E+) target IRR ~20%.

[F] Kruze Consulting (2024). 'What Are Your VC's Return Expectations Depending on the Stage of Investment?' Last updated August 1, 2024. Key data: seed investors target 100x; Series A investors target 10–15x MOIC; portfolio-level target IRRs 20–35%.

[G] Damodaran, A. (January 2025). *Equity risk premiums (ERP): Determinants, estimation, and implications*. NYU Stern School of

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[6] *Cliffwater Direct Lending Index Annual Report (2025)*. Gross interest income 10.4%; ~21,000 directly originated US middle-market loans totaling \$549 billion as of 2025.

[7] Phoenix Strategy Group. 'Interest Rates and Venture Debt: What to Know.' December 2025.

[8] re:cap. 'Venture Debt Guide.' Updated March 2026. Confirms 8–15% typical range; rates above 20% for higher-risk startups.

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