The 7 Stages of Startup Fundraising

by Dennis Hammer

When you began building your startup, you probably didn’t fantasize about raising money.

Nevertheless, as a founder it’s your job to secure financing to keep the company afloat. Your ability to keep cash in the bank, even if you have to sell equity to do so, will determine how far your startup will go.

To help you understand what your financing journey will look like, here are the seven stages of startup fundraising.

1. Pre-Seed Stage
2. Seed Stage
3. Series A
4. Series B

5. Series C (and Beyond)
6. Bridge and Mezzanine Loans
7. IPO

1. Pre-Seed Stage

The beginning of your startup's life is often called the "bootstrapping phase." In this stage, it's illegal to publicly solicit for investment. You couldn't, for instance, post on Twitter that you're seeking investors for your startup.

Your funding might come from one of these places:

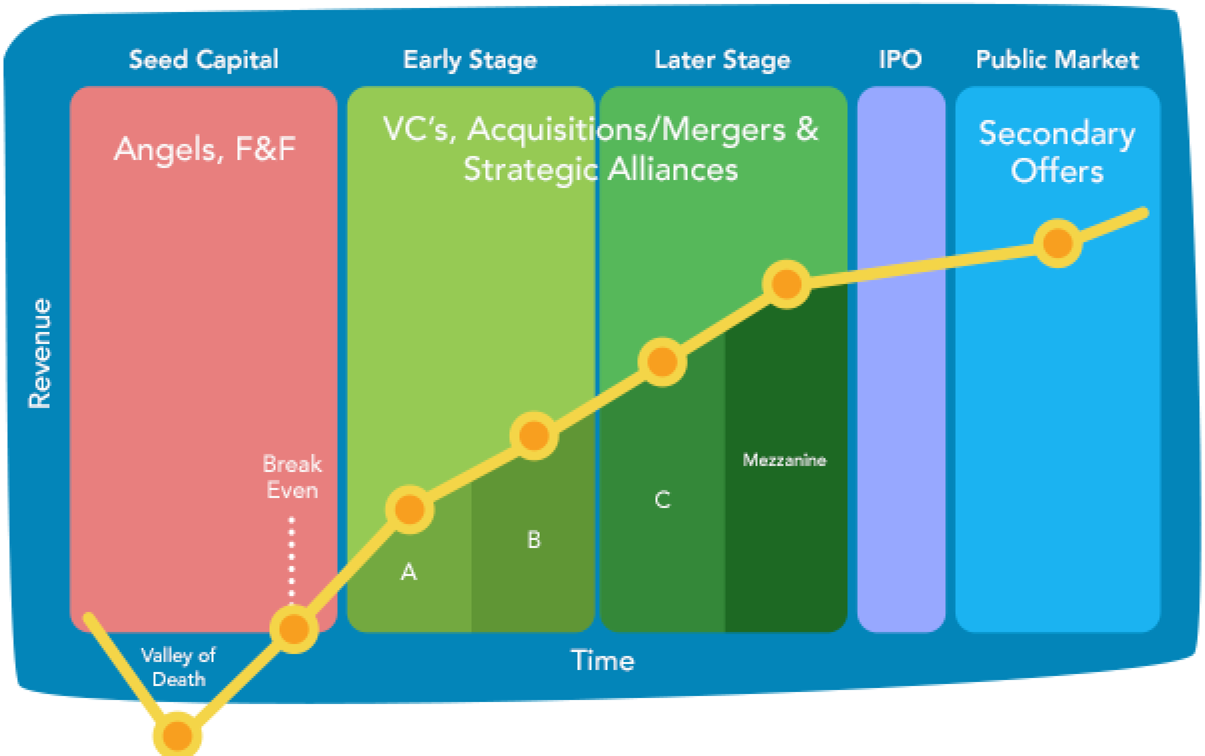
- Your own funds
- Your co-founder (if you have one)
- Friends and family
- A startup accelerator
- Accredited investors (These are people with substantial personal income and knowledge of securities. Accredited investors have to meet several financial requirements in order to invest in companies not registered with the Securities and Exchange Commission.)

At this point, you own 100% of your company, unless you give equity to one of those other parties. If you're working with someone, don't forget to put a simple agreement in place that protects both parties.

During the pre-seed stage, your job is to validate your idea, gauge the market, determine costs, construct a business model, and start building the product. Grab as many customers as you can as early as you can. They'll help you survive between funding stages.

2. Seed Stage

Seed stage startups are companies with traction. They have a minimum viable product (MVP) and the foundation of a solid business model. The startup is still immature, but it has a brand, some recognition, and enough customers to create some revenue.



Source: evus.com

This is the stage where angel investors may take notice of your company. Some venture capitalists will invest this early, though most wait until the next stage.

Investors rarely invest in ideas. They wait to invest until they see some reasonable execution that signals you're *actually* building something that may be valuable one day.

Your goal at this point in your startup's life is to orient your product in the marketplace. That means focusing on finding a product/market fit and refining your business model. Making money from your users is smart, and often necessary to stay afloat, but investors want to see plans for big growth.

3. Series A

This is the stage most people talk about when they refer to startup funding. They think of touring Silicon Valley, armed with their pitch deck and a whole lot of optimism.

At this point, your product should be in a good place. You're actively working with angels and VCs to further refine your product and model. You have cash from previous investment stages and revenue, so you've tested growth strategies and you're building a team. You have a clear picture of your burn rate and runway.

When you start hunting for your Series A, everyone's throwing around the same word: Scale.

The purpose of Series A funding is to flush your business with cash so you can invest in massive experimentation and testing. It's also the time to optimize your business, correct past mistakes, and look at expanding your target customers.

4. Series B

By this time, your startup is an active, established business. You're known outside of the early adopters and innovators. You should have received some good press and you may even be making some headway into the mainstream market.

During the Series B stage, investors want to see that you used your previous funding to learn as much as possible about your customer and market. Now they want you to apply everything you learned at scale.

With your Series B cash, you'll probably expand your team and operations considerably, begin selling outside of your initial regions (maybe even globally), and bolster your growth by acquiring other companies and their property.

5. Series C (and Beyond)

Series C rounds are used to power large expansions, like tackling a new type of customer, moving into a new market, or buying new businesses.

This stage is so late that there's little risk for investors, so you'll be on the radar of large investors and financial institutions with deep pockets. For instance, back in 2016, Magic Leap raised $793.5 million, which is considered the biggest Series C in history.

Technically there's no limit to the number of funding rounds a startup can raise, though few require more past a Series C before they file for IPO. Of course, this depends on the anti-dilution agreements you have with previous investors that make sure their stakes aren't watered down. You may not have enough equity to give out for a Series D, E, F, etc. *and* file for IPO.

6. Bridge & Mezzanine Loans

These types of funding are used to infuse startups with cash for their immediate needs before you secure a longer and more permanent financing solution. Startup typically use these funding sources just before they go public, but you can technically use them at any point.

Bridge loans are short-term loans backed by collateral (real or intellectual property). Mezzanine loans are similar, except the lender takes equity as collateral. If you default on a mezzanine loan, the lender owns part of the company.

Terms for both types of loans are measured in weeks and months, but rarely years, and generally repaid when the company goes public. Interest rates range from 12% to 20%, which sounds like a lot, but the short terms mean you don't pay substantial interest.

7. Initial Public Offering (IPO)

IPO is one of the most significant events in a business' life. At this stage, startups become publicly traded.

While more companies are going public than ever before, they're doing it later in their lives. From 2001-2004, the average age of a company at its IPO was 5.4 years, but in 2014, the average was about 7.

Image: forbes.com

You'll raise more cash during the IPO than any other investment round. You'll pour tremendous sums of money into growth, new products, talent, and even acquisitions. You'll also be expected to pay back some of your early investors.

"There is also the prestige factor," says James S. Rowe, a securities partner with Kirkland & Ellis LLP, a law firm that ushers companies through the IPO process. "The fact that you're a public company gets you in the door with vendors and suppliers and prospective business partners. Being a publicly traded company has additional cache and is something that can be helpful to a company in its commercial relationships."

For a lot of entrepreneurs, this is the end of the road. Managing a publicly traded company (with a board, shareholders, and all the responsibilities that come with it) requires a unique skill set that isn’t right for some startup founders (Mark Zuckerberg is an exception, for instance).

This is the perfect time for founders to take a big payday and make an exit. Many founders take on new projects or become mentors or investors themselves. If you reach this stage, you’re certainly entitled to a nice long vacation!

Before you can take a company public, you have to meet certain financial requirements set by each exchange where you expect to list. For instance, the New York Stock Exchange requires $10 million in revenue over the last three years. NASDAQ requires $11 million in revenue over the same period. The SEC has their own requirements as well, such as three years of audited financial statements.

If you want to take your startup public, it’s smart to hire special consultants who can walk you through the process. They’ll make sure you have the right management team in place, get your financial reporting in order, select the right bankers, price and market the offering, file the registration paperwork, and organize the road show.

You Don’t Have to Take Funding

Hopefully this gives you a better idea about how startups raise money to operate and grow. It’s a long journey, but often you have to follow it to keep your business alive.

That said, you don’t have to follow this path. It’s entirely possible to bootstrap your company to any size you like. If you focus on profitability first, you fund your own growth, though you probably won’t achieve the size and scale as startups that accept funding.