

## How Startup Fundraising Works | Startup School



Video URL

### Intro

#### Reference

foreign I'm Brad Flora I'm a group partner here at YC and I'm going to be talking about how startup fundraising works today like I said I'm a group partner at YC and what that means is that I read applications I interview the startups

### Fundraising resources

#### Reference

one of the topics that people ask about all the time at YC is fundraising in fact it's probably the thing that we get asked about more often than anything else and the reason for that is because as Paul Graham wrote years ago raising money is the second hardest part of starting a startup after making something people want so let's take a quick tour of all the awesome stuff that YC's put out about fundraising over the years first there's the Paul Graham essays he wrote the fundraising Survival Guide how to fund a startup how to convince investors to invest in your company and even wrote a great essay about understanding investor herd Dynamics all of the stuff's online you can see the links below you should check it out years later just a little bit ago YC president Jeff Ralston posted a terrific guide to raising a seed round where he covers everything from start to finish that you need to know the Nitty Gritty on how to raise a seed round and he gave a great video presentation at startup School a few years ago where he presented that material it's on YouTube you should check it out it'll tell

you how to raise a seed round finally we've posted a lot of tactical guides about specific aspects of fundraising how to build a seed deck how to pitch your startup how to get meetings with investors and how to raise money online for startups using platforms like Angel list we've even got something about the different types of investors and their incentives so if you really want to get specific and drill into stuff there's content for you that you can find what I didn't want to do today is just rehash all of that stuff because it's already out there what I wanted to do instead is talk about some of the misconceptions and myths that we see as YC Partners when we work with Founders Founders out there are consuming all sorts of information in the media and a lot of it is about startup fundraising and there's

## **7 fundraising myths**

### **Reference**

goal of this talk is to catch you up on how fundraising actually works today and we're going to do that by exploring seven fundraising myths and for each one of them we're going to talk about the myth the reality behind the myth and then look at some great YC companies that bust that myth before we get started just a little bit more about me I'm a YC partner but I've also been on both sides of the table as a founder and an investor from 2008 to 2014 I was building startups and the company that I got the most success was perfect audience which was an ad retargeting startup for small businesses I took perfect audience through the YC summer 11 batch 11 years ago and we raised a million dollar seed round after demo day I hired a bunch of great people we grew to three million dollars in revenue and we were acquired in 2014. after that acquisition I got really into investing in startups it started with Angel Investing where I was writing just a few checks five thousand dollars ten thousand dollars into YC companies that I thought sounded really cool at demo day but I got hooked the thrill of going and meeting Founders finding out what their deal is trying to figure out are they making something people want should I invest was too much for me and suddenly I was raising a fund with some friends to scale up and invest in even more YC companies and so through that fund I invested in 150 YC companies and the good news for my backers is that we got into some great companies you may have heard of a few of them deal open C retool razor pay it was really awesome to help those companies raise their first round funding and it's been a lot of fun being involved since eventually though I joined YC as a group partner and I get to do both sides I get act as a Founder as a fellow peer to the YC Founders and help them figure out how to make something people want and then use my investor experience to help them figure out how to raise money so I've got a good view of this I've been

## **Raising money is glamorous**

### **Reference**

for the first one I want to talk about is this idea that raising money is glamorous what's the image in your head that you think of when you think of startup fundraising for a lot of you it might be something like this this is an image of Shark Tank and it's a television show where entrepreneurs they dress up they make a sign they get a bunch of materials and they pitch a bunch of investors at once called sharks and these are a bunch of people of varying levels of investor expertise who hear the pitch ask a bunch of uh nosy kind of pushy questions and then fire offers that the founder rapid fire and so if you watch this you may be thinking gosh I've gotta put a whole presentation together like this and I'm gonna pitch a bunch of people and they're going to ask me all these tough questions and it's going to be this high pressure situation nation that I've got to figure out the reality is that fundraising actually looks like this this is a picture taken in the creamery which is a now departed Cafe in San Francisco notice what's happening here it's just a bunch of people sitting in chairs talking quietly amongst themselves right it's just a bunch of coffee chats that's how fundraising actually looks that's what it actually feels like is just sitting in a cafe talking to someone Shark Tank the pitch competitions the business plan competitions they're just for show they're marketing events for the organizations that put them on and in fact a lot of the investors at these things they don't invest they're just there to meet other investors and hang out and even on Shark Tank I think Mark Cuban recently said that even though he's put 20 million dollars into these companies he hasn't made a dime yet he's still in the red actual fundraising is just a bunch of one-on-one meetings on Zoom over and over again while you try to collect checks and convince investors It's a Grind okay what you see here is a diagram that was made by an actual YC company called fresh paint that shows what an actual round of fundraising looked like for their startup you see at the top the company in each one of these circles and squares represents a different investor that they met with and when the boxes are connected it's because that investor made an introduction for them they met with 160 investors and 39 of them said yes which is a very high conversion rate but the check range was all over the place they had people write 5K checks and people write 200k checks all right not everybody with some fancy VC they could write a giant check and it took them four months and 18 days to get through all these meetings and close all these deals and that was to raise 1.6 million dollars fundraising was painful and it was a grind but it was pretty straightforward it was just a bunch of conversations they've written a great blog post that's where this image comes from that you can check out should

## **The need to raise money before starting a startup**

### **Reference**

okay the next myth I want to talk about is this idea that I need to raise money before I can start working on my startup all right we see this a lot with Founders we meet people that have a big idea which is great and the next thought they have is well gosh I guess I need to raise money so I can build my big idea but

that's not how the best Founders actually think about fundraising the best Founders they build the first version of the product first even if it's a simple almost toy-like version of it and then they go get some users for it and then only then when they see that people are starting to use it and maybe there's some value being created do they start thinking about raising money and the reason for this is that it's cheaper than ever to build a prototype of a product to build a first version okay it's cheaper than ever to host a website and build software it gets easier and easier and easier every year and also it's easier than ever to find potential users you can get users on platforms like product hunt on Hacker News you can find users on social media Twitter LinkedIn everybody's on the internet today and you can use that to find early people to try out your product and when you do this when you've got a little bit of product just a little bit and a few users for it it immediately gives you a great deal of Leverage all right you've gone from that person waving the pitch deck around trying to figure out how to find 20 million dollars to someone whose startup is in motion and investors want to jump on trains that are in motion here's an example solugen is a YC company from the winter 17 batch and they are a chemical manufacturing startup they literally make chemicals and sell them as you can imagine that is a capital intensive business it requires a lot of money to build a facility that can make chemicals and sell them at scale and a certain type of founder that had this idea would then make a pitch deck and go around telling investors I need 10 million dollars I need 20 million dollars to build the menu manufacturing plant to make these chemicals the solution folks chose a different path which is first they built a tiny version of their reactor that fit on a desk but it worked next they built a slightly larger version of that that could actually make enough hydrogen peroxide to sell and they took that to YC when they applied for the winter 17 batch and during the batch they started making enough hydrogen peroxide using this slightly larger version of the machine that they could go and sell it to First customers turned out that hot tub supply stores needed hydrogen peroxide to sell the people that add hot tubs and so they were making ten thousand dollars a month selling hydrogen peroxide to hot tub supply stores not a ton of money but let's step back for a second if you were an investor and you were trying to invest in a chemical Manufacturing Company who would you back the person with the pitch deck asking for 20 million dollars or the people that have built a first version of this even if it's small and making small amounts of the product and selling it to hot tub supply stores which is hardly a huge business but it's something well investors clearly want the second Solid Gym is able to raise four million dollars for to get started on their company because they'd already made some progress and today they've since raised

## **My startup need to be impressive to raise money**

### **Reference**

plant let's talk about our next myth this idea that my startup needs to be impressive to raise money I've got to impress people with my startup but my

startups startup is not very impressive so how can I ever do this well the reality is you don't need to impress investors you need to convince them and that's a slightly different thing see most startups seem terrible at first and in fact the best startups seem the most terrible at first so let's take Airbnb what was it it was a Marketplace for renting an air mattress on someone's floor terrible idea doordash food delivery for the suburbs where it takes longer to get everywhere and no one's ever started a delivery company before terrible idea open c a Marketplace for selling Collectibles that only exist on your computer and can only be paid for with magical internet money what but investors get this they know that your startup is going to sound unimpressive early on investors are pretty smart they get it and in fact they get bored when founders try to impress them okay really try to win them over and sell to them it bores them about 11 years ago and I did YC I had a chance to have a five minute meeting with Michael Moritz who at the time and it was a partner at Sequoia capital is legendary VC and I was so excited for this meeting I made a fancy deck I practiced all these lines I was going to use on him to impress him and conv and get him to invest in my startup and I sat down with him and I opened my laptop to get the slides out and he stopped me and just said I prefer to just talk about the business you're building and I was completely disarmed because I wasn't ready for that I was ready to impress him not to try to just talk about the business that I was building and we see this similar thinking with a lot of Founders at YC where they come to us they don't explicitly ask us this but they more or less say Brad what are the magic words I need to say to make investors want to invest in my startup and the reality is that it's not about magic words it's about making something people want right that YC Credo it's about making a product getting it into users hands and creating some value for them and then just explaining how there's a one percent chance even just a one percent chance that it can get huge and using plain simple language to do it that's how you convince investors okay if investors aren't investing it's not because you didn't say the magic words it's because your startup isn't good enough and you need to make your startup better and so have these conversate you make your startup better and you just explain it to people and talk about it like a human and do it over and over and over again because again startup fundraising is a grind here's an example of a company that did a great job convincing investors when they met with them this is retool and retool makes software for building internal tools it's a great company they raise their seed round you see the founder David and one of the CEO and co-founder by just meeting a bunch of investors in coffee shops in San Francisco I was lucky enough to meet with David and he had no DAC instead he just opened his laptop and showed me the software on his computer and he used that early kind of crude version of retool to make a crude but simple internal tool a little web app in minutes and then he talked about why his early customers really liked it and we're getting some value from it and just seeing this seeing him show me the product and talk about what his customers were making of it put in my head this idea that a lot of companies probably are going to need this I was convinced he didn't impress me he didn't try to wow me he just showed me and talked in a reasonable way about what he was doing and

that convinced me I wrote a check and today that company is at a four billion dollar valuation wasn't about doing a fancy pitch but it wasn't about magic words it was just about

## **Raising money is complicated, slow, and expensive.**

### **Reference**

about is that raising money is complicated slow and expensive if you read a lot about fundraising in the Press you might think that it involves raising giant rounds from big name VCS why is that well let's take a look at yesterday's TechCrunch headlines about fundraising we've got a story about Shopify Mark Vision locket Sprague what do we see folks what's the common uh denominator here gigantic numbers and so you're reading this at home and you're just trying to think how can I raise twenty five thousand dollars to quit my job or spend more time on this or get a Hosting account for the website that I want to build you're not thinking about a hundred million dollars gosh maybe this isn't for you well the reality is is that all the rounds you read about in the news are series A's and growth rounds you don't read much about the actual you don't read anything about the actual first rounds of funding that companies raise why because it's boring okay it's really boring we already established that there's no glamor in the actual early fundraising that startups do so it never makes the press these typical A and B rounds are huge right you raise 10 to 50 million dollars they take months to close and you pay hundreds of thousands of dollars to lawyers and legal fees to get these rounds done the good news is like I said that's not what a lot of these rounds look like your typical seed round is actually much smaller 500 000 maybe a couple million dollars you can close it in weeks if not days and there's no legal fees and this is the same for if you're trying to raise a preceede or just trying to raise fifty thousand dollars from friends and family you can do that quickly and there's no need to get lawyers involved why is that well in 2013 YC created a new standard fundraising document called the safe the simple agreement for Equity so initially this was made by YC to be the new standard document that all YC companies would use and it turned out for fundraising and it turned out to be so great that now every startup uses this to raise their money the safes are awesome first off it's easy to understand it's only five pages long uh it's really fast to close an investment using a safe there's only a couple terms to discuss the amount of the investment the valuation cap of the investment and then the discount and guess what nobody does discounts so there's only two terms that you really need to discuss when closing a safe and finally they're cheap you don't need lawyers to send them also the safe is just on the YC website if you Google why combinator safe you can find the document download it to your computer and use it this afternoon to close an investment in your startup how cool is that safes are so simple that there's even a website called clerkly it's a YC company from my batch summer 11 that lets you send and sign them in just a few clicks safes give Founders fundraising superpowers and you don't have to wait months for investors to get organized and for lawyers

to review stuff founders today just take all the meetings they sign a bunch of safe and they raise Millions for their startup in just a few clicks and this quick and cheap fundraising gives them more leverage than ever when they're talking to investors here's an example you could build your company like Azure bio so this is a biotech startup from the summer 19 batch that's developing cancer therapies again Capital intensive business and the typical first rounds of funding are tens of millions of dollars for companies like this and so Founders go they make a pitch deck and they've got to go get this money before they can start working on the on the startup the founders of Astra came into YC with just the idea and they were able to raise the first round of funding using safes quickly from Angels this is pretty novel for a biotech company and using that first million or so that they raised they could accelerate their progress they could make more progress in the lab and when they were ready to start talking to larger investors in the Pharma space about a proper round they've made a lot more progress and they had more leverage in talking to those investors they've since raised over 150 million dollars but that first million that they raised in safes totally changed the power

## **I am going to lose control of my company**

### **Reference**

them related myth is this idea and I hear this a lot hey if I raise money I'm going to lose control of my company well the reality is that seed rounds today give Founders more control than ever okay Founders have had more can have more control over their companies today than ever in the history of startups and why is this it's because when you raise the safes you don't give up any board seats all right there's there's no board seat nonsense in safes after you close the investment it's still just you and your co-founders calling the shots there's no shareholders after you close money with safes the investors on safes gets shares in the next round okay so no Shares are actually changing hands and there's no information rights granted in safes so there's nobody like requesting to look into your books looking over your shoulder you get to choose how and when to update your investors when you raise money with safes so again Founders raising millions of dollars they're only selling 10 to 20 percent of their company and they're keeping total control of the companies and when you do that you can build the company the way you want and Answer to No One except your customers well pretty important but instead of answering new investors you answer to your customers when you raise seed rounds today here's a great example you could build your startup by zapier they describe themselves as three dudes from Missouri and zapier is software that help you set up Integrations if you've got one app that you use in another app and you want them to talk to each other you can use zapier to set that up it's awesome they did the YC summer 12 batch and they applied with an early version of their software they had a few customers and they raised over a million dollars from angels and small funds at demo day and because they did that because they raised on safes and they just raised a bunch of checks

they were able to run their company the way they wanted and for them 10 years ago that meant going fully remote 10 years ago a decade before it was cool for startups to do that it was pretty weird at the time and they ran their company the way they wanted to they spent the next decade just delighting thousands and thousands of customers and they also made the decision to never raise money again they never needed to so folks thinking gosh if I raise money I'm always going to be indebted to investors yada yada no maybe later if you raise these crazy priced rounds but for the early money that you raised on safes you have total control and you can be like the zap your Founders and never raise money again and today that's 100 million dollar Revenue business and they only raised money that one time now what about bootstrapping you might be thinking I should bootstrap my company well everybody bootstraps it first that's true but I want to tell you that bootstrapping your company forever sucks and here's why so first off when you bootstrap forever and what I mean by bootstrapping I mean um funding the company out of the revenue that you make from customers it's scary all right you're always about to shut down you're always about to run out of money it's miserable because you don't have any money to pay yourselves a decent salary to live on it's distracting you have to go into Consulting in order to make the money you need to keep working on your products sometimes you have all these detours when you're bootstrapping and then finally the odds just aren't great there are very few examples of 100 gigantic bootstrapped companies and I think if it was the way to go there'd be a lot more of those I actually want to propose the definition of bootstrapping so bootstrapping is taking the pain of fundraising and stretching it out across the entire life of your company why would you want to do that I propose to you that you should rip off the Band-Aid and take the pain up front and raise money for your company and then you never have to raise money again if you don't want to you can be like the zap your Founders and besides at the end of the day who's more in control of their startup in the end is it the bootstrapped founder who's always worried about running out of money or the founders that raise enough money to get the company going after they've built a product and gotten some users

## **I need a fancy network to raise money**

### **Reference**

and they can just make their customers happy and they never have to raise again the next myth I want to talk about is this idea that I need a fancy Network to raise money the reality is that if you are making something people want investors don't care about where you went to school where you worked who you're friends with how old you are even investors are human and sure they notice pedigree but guess what folks investors are coin operated lizard people and they care a lot more about making money you can build your company like Podium Podium is a company that started off making customer review management software for tire shops all right if you're a tire shop and you're worried about what people are saying about you on Yelp you might use Podium



to keep track of that the co-founders were two guys from Utah they had no Silicon Valley Network however they were really good at sales and they came into YC they were already making money and by the end of the batch they were making tens of thousands of dollars a month I actually randomly bumped into them at an alumni event during their batch and I was stunned that there was a company selling software to tire shops in y combinator and even more stunned when I found out how much money they were making investors noticed that too that they'd made something people want and they were able to raise and now today that company makes a hundred million dollars a year and has raised more than 200 million dollars these folks had no network these are not fancy Founders they just made something people want slight tangent while we're on this topic you'll probably run into people if you're thinking about fundraising who are going to offer to raise money for you I have the network I know investors let me go in there and Pitch your company it is not a good idea it's always best for the founders to talk to investors themselves it's an important relationship and you want to own it so if someone makes you that offer you should get them to make an introduction instead and then you can go take the meeting all right the last myth I'm going to talk about today is the myth that if investors reject my startup that means it's a bad startup the reality is that no matter how great your product is how much traction you have investors are going to reject you and that's okay in fact it puts you in great company right here's a great example Envision so Envision is a medical device startup for cancer detection and it was started by serbisarna who's a YC group partner today when Serbia started building Envision she had a devil of a Time raising her first check she was rejected more than 50 times by investors to just get the first money for the company and the way that she was able to convince someone to write that first check and to help her get this company started was she she told them she was going to bet on herself and take no salary for the first two years if the investor was willing to bet on them and that was for a 25 000 check her first round of funding for the company was only five hundred thousand dollars but she got it done and she got even though she got rejected over and over again and since then the company was acquired for 275 million dollars so here's this awesome medical device company that sold for hundreds of millions of dollars and yet rejection after rejection after rejection if you want to read more about serbi's story she actually has an awesome book coming out in the spring and it's on Amazon right now and we'll share the link with you in the chat if you want to check it out and pre-order it Serbia is awesome it's a privilege to get to work with her and the book is terrific one other example of this is what not it's a Marketplace for Collectibles they were in the winter 20 batch and they came in with a beta product but no users they hadn't launched yet and during the batch they got started and it was just initially a Marketplace for selling funkopop toys with the big heads during the batch they got some early traction they started making some money they got in some buyers they got in some sellers Revenue was going up sales were going up things were looking good right but investors hated it and they only raised a fraction of the amount of money that they were hoping to raise for their seed round and the amazing thing is that

today what not just two and a half years later is worth 3.7 billion dollars and they've raised over 400 million dollars and just two and a half years ago they couldn't pay people to invest in their company at a fraction of that valuation everyone gets rejected it's just part of it even if you're building a four billion dollar company people are getting rejected and the thing is the founders were not really that bummed out about it because they had already done that work of convincing themselves that what they were building was working and was going to work investors just weren't seeing it yet some did enough did but they still faced a ton of rejection you don't need every investor to like what you're building you just need a few of them to believe and the good news is that today there's more investors than ever with more money than ever looking to invest in startups all right let's step back for a second and wrap this up there's a common theme to these myths that we talked about the idea that organizes all of these is the big myth which is this this isn't for you these ideas that are out there these misconceptions the founders have they add up to people thinking gosh maybe this isn't for me maybe I shouldn't start my startup because I don't know how to do this stuff I don't have a fancy Network I I don't know all these people I don't know how to pitch I don't know how to impress people but the reality is you can do this fundraising is just a bunch of coffee chats and zoom calls you you don't need to raise money to get started you can just start working on your startup you don't need permission from investors you don't need an intricate pitch you just need to make something people want and be able to talk about it like a normal human you do that every day with your friends and family using safes it's easier than ever for you to go raise the money that you need without lawyers and quickly and the terms you're going to get today mean that you can run your company exactly how you want there's not some secret special way that you have to run your startup you can call the shots you don't need a big Network and fancy connections to raise money and finally the rejection that you're going to experience doesn't mean anything it's just part of the process it turns out there's never been a better time in the history of the world to raise money than now so if you're thinking of doing a startup get building you can do this you can do all of this you can do this

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