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FINANCE

STAGES OF FUNDING
- AN EXPLAINER -

STARTUP FUNDING STAGES

Raising funds has its own difficulties for any company or individuals. But when it comes to startups, the story is different. It is a very strenuous task for any startup to raise equity funding in its initial stages and it is a time at which most of the entrepreneurs feel low and disheartened.

But, once the startup raises funds, it thrives to become a company, which was just an idea or a dream of an entrepreneur. Regardless of the hassles, various startups manage to obtain fundings. Let's dive into the different funding stages.

FUNDING STAGES

Being an entrepreneur or a startup founder isn't an easy task, especially when it comes to the matter of fundraising from investors and going through the funding stages of startups. The below table shows a clear picture of the funding stages and what exactly the startup should possess in order to find investors and convince them to invest.

Stages Of Funding

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ART	Startup Stage of Evolution	Source of Capital	Typical Funding Size	Typical Valuation	Range Funding Basis
1	Ideas Only	Bootstrap, F&F, Angel/seed Funds	$50-100K	$500K-1.5M	Idea attractiveness and market size
2	+ Strong Team	Bootstrap, F&F, Angel/seed Funds	$100-250K	$500K-1.5M	Execution capability of founders
3	+ Demo Prototype	Angel/seed Funds	$250-500K	$2-5M	A successful working model of product/service
4	+ Validated Product MVP	Angel/seed Funds, VC	$1-5M	$5-20M	Customer adoption and early visibility into cash flows
5	+ Rapid Customer Adoption	Typically series A Angels, seed-funds Exit, VCs increase	$5-20M	>$50M	Strongly based on growth, market share and revenue growth estimates
6	+ Growth Capital for viral growth over a long period	Multiple rounds (B, C, D, E..) VCs will start taking partial exits. PE enters in a big way	$20-100M	>$250M	Supported by ongoing rapid growth and expected market share leading to revenues/profitabilit
7	Stable Growth	Stable Growth	>$100M	>$500M	Profitability/Cash flow based
SCIENCE					

Angel Round Funding

An angel round is a small pre-stage funding round which is designed to get the new startup off the ground. Startup companies raise funds from angel investors, angel investor groups, friends and family.

Usually at this point the entrepreneur will only be at the stage of ideation. What attracts the angel investors or friends and family to invest is the idea, market size and if the entrepreneur has a strong team, who are capable enough to execute the startup. This would help them to raise $50,000 USD to $250,000 USD. The typical valuation ranges from $500,000 USD to $1.5M USD.

Pre-Seed Funding

Pre-seed funding is the most preliminary startup funding stage, because of which quite a number of people do not incorporate this funding stage into the cycle of equity funding.

In this stage, most works are done by the founders themselves or along with a small group of people. The prototype testing and proof of concept for the startup is done during this stage and the fund for the same is raised by the founders themselves or from their friends and families. They might even approach an angel investor or an incubator for the pre-seed funding stage.

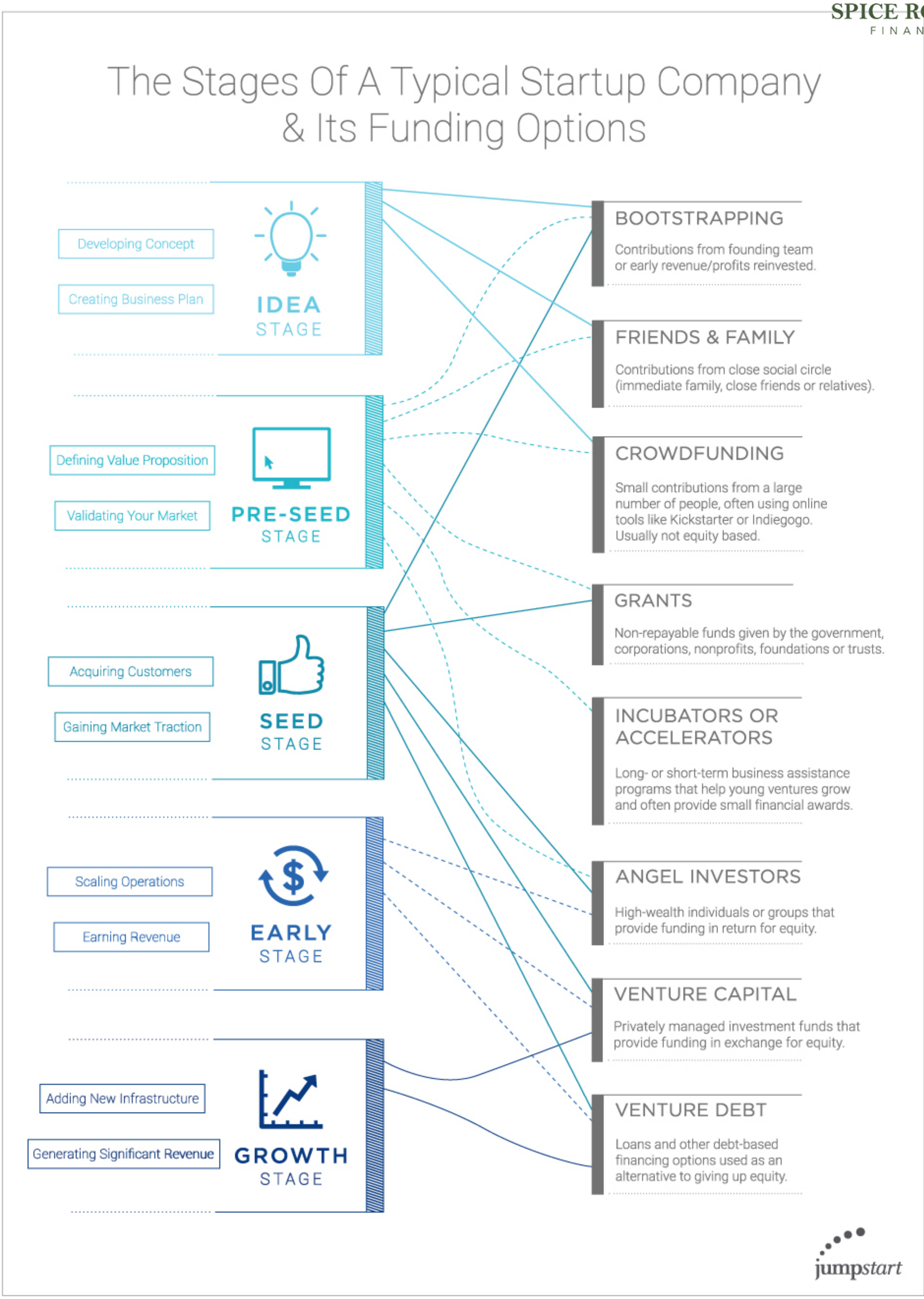
Being a very early stage in the funding process, if the startups manage to prove to the angel investors or any investors that the product or service of the proposed startup is successful and working, then they would manage to raise $250,000 - $500,000. The valuation of the startup would be approximately around $2M - $5M.

Seed Funding

The startups raise their first official funds in the seed funding stage. As the name of the funding stage suggests, the analogy is between, the seed which then grows to a tree and the starting fund which a startup receives to grow into a flourished enterprise.

The seed funds are raised from family, friends, angel investors, incubators, crowdfunding and venture capitalists. Often Angel Investors provide funds to the startups during this stage. These funds usually mark the first step in a startup's journey where the product development and market research and analysis on Minimum Viable Product analysis are done. Startups manage to raise $1M to $5M from this stage. Companies which raise seed funding are valued between approximately $3 million to $6 million.

This stage also witnesses a lot of startups terminating as they fail to raise enough money or funds to attract investors or they run out of money raised. Some startups decide to stop raising funds at this stage as they believe that they have enough funds to grow and develop.



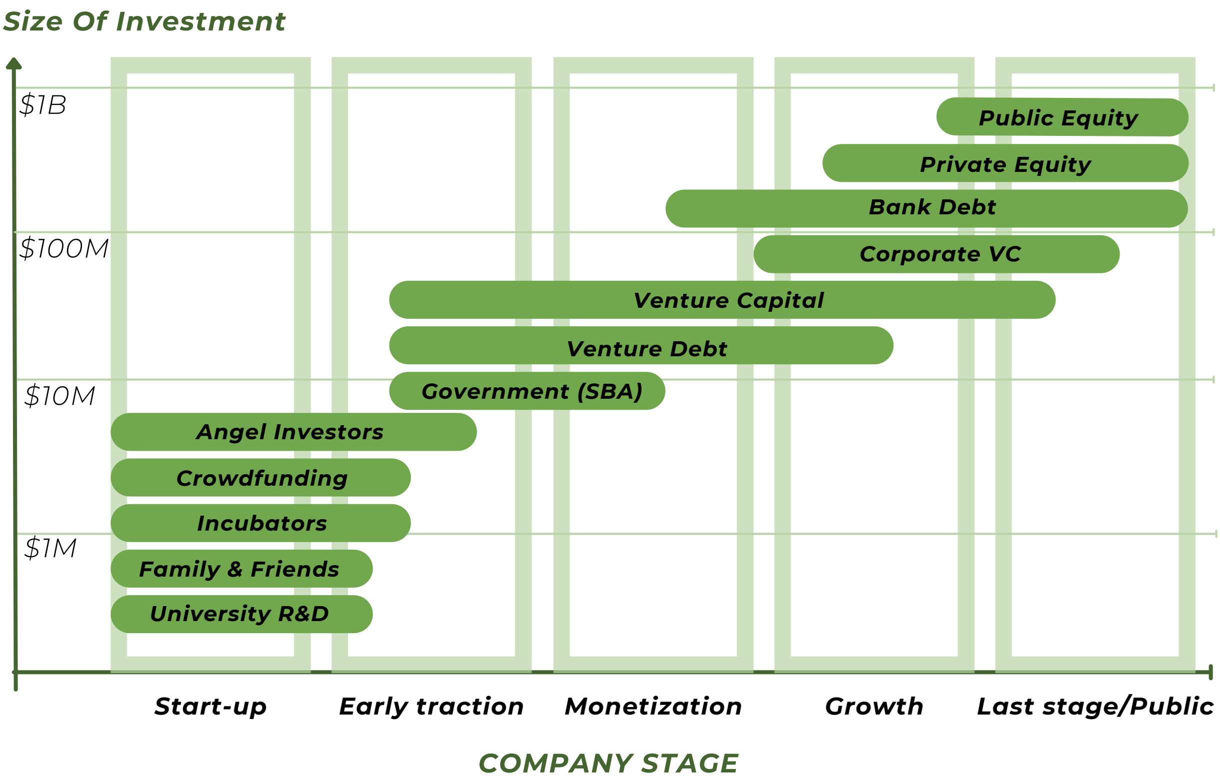
Source : https://www.jumpstartinc.org/understanding-funding-stages-typical-startup-company-funding-options/

Bridge Round Funding

When the startup companies are short on funds, this situation is also called 'running out of runway', they resort to what is called Bridge Round funding. Companies come to the conclusion of raising bridge rounds, only when their alternate your option is to shut the business. Bridge round funds help the companies to meet their working capital needs and also to 'bridge' the funding gap between the startup's current funding round and the next funding round. Bridge funds are raised from venture capital debts and equity.

Series Funding

As the name suggests, Series funding is a continuous series of funding stages for a startup that comprises Series A, B, C, D, E and at times beyond to even Series F, G, H and so on. In each of these series, the startup raises more funds and thus increases their value.



Source : https://medium.com/bizinfuse/early-stage-funding-pathway-9c5825fb93d3

Series A Funding Round

Series A funding usually surfaces majorly from Venture Capital firms and the angel investors and seed investors from the previous stages slowly commence their exit. Crowdfunding is also a way through which many companies raise Series A funding. This round is usually led by a single investor who takes control of the round. For the startups, getting this first investor is very crucial as it is often seen that once an investor invests in a startup, finding and convincing other investors to invest becomes easier. Nevertheless, losing the first investor can prove to be detrimental as the other investors will also back out.

At this stage, the investors are no longer interested in the extraordinary idea. They are more inclined towards the future prospects of the company such as its projected growth, cash flows generation and how successful the company will be. Usually the startups raise around $2 million to $15 million in the Series A funding. The approximate valuation of a company raising Series A funding is between $10 million and $15 million.

This stage is yet another testing period as many startups fail in this round. This situation is called 'Series A Crunch' and it happens majorly to the early stage startups.

Series B Funding Round

If a startup reaches this stage of Series B funding, it means that the startup has proved to the investors that they are an upcoming successful venture. At this stage, the startups have already developed customer bases, have found their product or market fit and are ready to move to the next level.

Funding in this stage is raised from the same investors from Series A funding. An additional stream of funds will be received from venture capitalists who specialize in later-stage investing. These funds are used for expansion and for meeting the increasing customer base. Expansion would require a growing quality team, sales, marketing and advertising, technological support and human capital, since the founder cannot do all the roles now and to make sure that the startup succeeds.

Around $7 million to $10 million is raised from Series B funding and the company is valued approximately between $30 million and $60 million.

Series C Funding Round

Once the company reaches Series C funding, it means that the company is doing a great job. At this round, the companies aim to expand to new markets, take their products to international markets, acquire other businesses and even diversify their product line. The planning for going public (IPO) is also at this stage.

The company is very successful and has found its own position in the market. The operations of the company becomes less risky, because of which at this round, one can see the entry of private equity firms, hedge funds, investment banks and similar investors injecting their capital into companies expecting to receive returns twice as much as invested.

In the Series C funding round, startups raise around $26 million and the valuation of the company is approximately between $100 million and $120 million. The valuation is based on actual data such as the customer base, revenue, expected growth etc and not expectations. This might be the last stage of funding before the company goes public, even though some companies go for Series D and E funding.

Series D Funding Round

For most of the companies, Series C funding is the last round to raise funds. However, certain companies goes further for the next round of funding and sometimes beyond to raise funds due to the following reasons:

- *Companies that have tracked down a new opportunity to expand themselves before going public, but do not have the required funds.*
- *Companies that wish to raise their value before proceeding to IPO.*
- *Some companies might want to stay private for a longer period of time.*
- *Companies have not been able to reach their expected positions after receiving Series C funding. This situation is called 'down round'.*

At times, even though the Series D funding helps companies to become resilient, this causes the stocks of the company to lose value. After the Series D round, companies struggle to get back to their early shoes. It gives an impact to the investors that the company is no longer in the limelight and is on a downward trend. The funds are given by venture capitalists and private equity firms in this round and the amount raised varies.

Series E Funding Round

The number of companies reaching Series E funding is much lesser than the Series D. The reason for the companies to go through this round of funding is similar to that of Series D funding. Private Equity firms are the main investors here as the Venture Capital firms usually exits after a company goes public.

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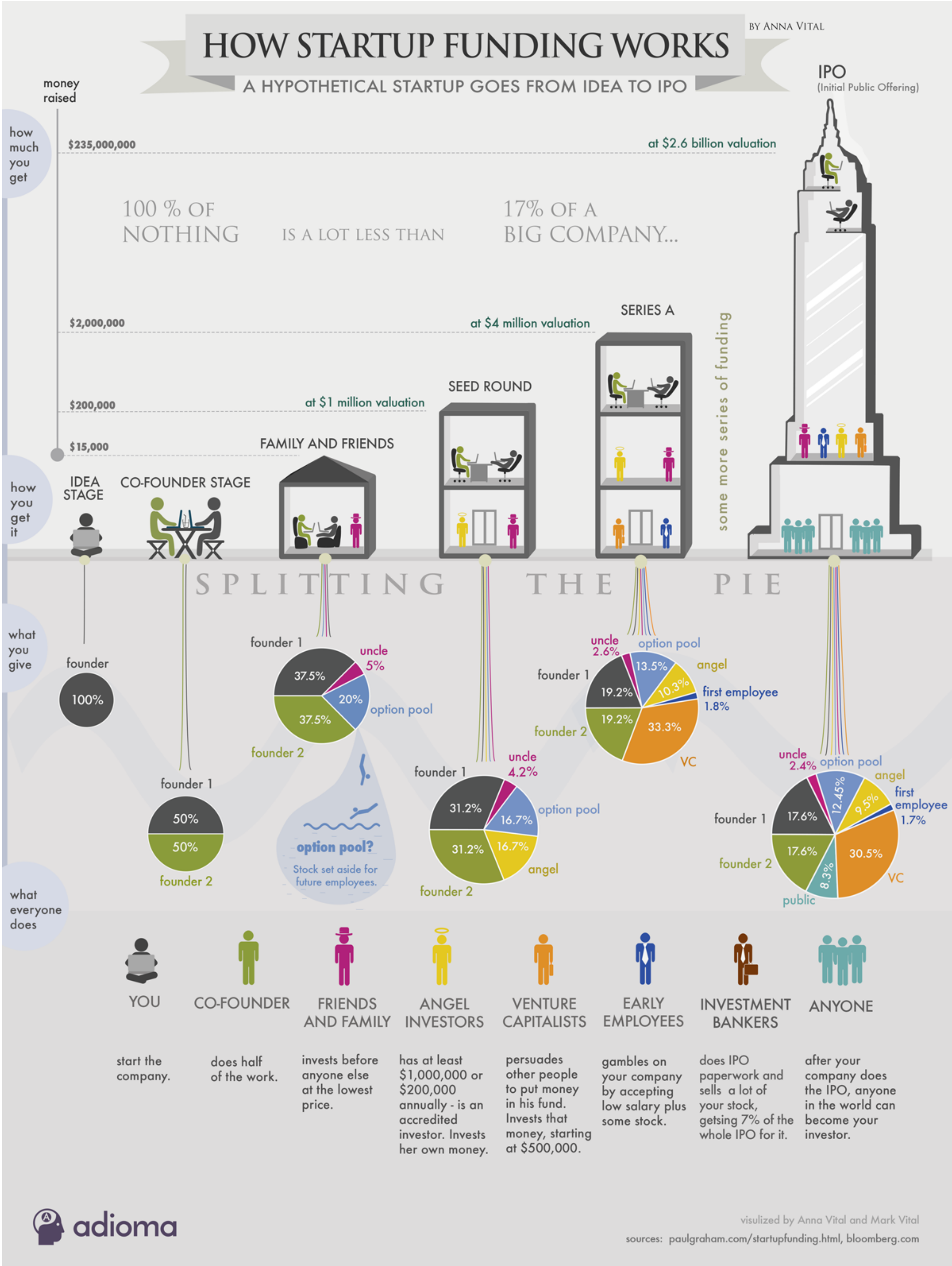

Mezzanine Finance

Mezzanine financing is yet another type of financing used by the startups which is similar to raising funds in between equity and traditional bank loans. These are also known as Bridge Loans.

The Mezzanine Investors do not ask for collateral unlike banks, but charge higher interest rates which range between 12% to 20%. This makes the mezzanine financing very perilous. The investors also require the right to convert their equity, if the company defaults on the loan.

However companies opt for Mezzanine Financing, because it gives them the final push to exit quickly and go for the IPO or any business acquisitions.

Initial Public Offering (IPO)

Initial Public Offering (IPO) is the final stage of startup funding in the funding cycle. Mainly the investment bankers are the ones who help the company to go forward with an IPO and also they commit to sell certain shares for a particular amount of money thereby raising funds. IPOs take place in the stock exchange markets where the shares are traded.

When the IPO goes well, the companies raise a lot of money and it also magnifies the company's reputation, goodwill and pride. The investors also gain a lot of money through this process. But if the IPO fails, the opposite happens.

About Spice Route Finance

Spice Route Finance is a pioneering management consulting company delivering premium quality services in the spheres of strategic financial planning, Performance management, Virtual CFO, and deal advisory services.

In a highly competitive business landscape, employing predefined sets of framework and models can limit your growth. Every business has unique challenges and opportunities to acquire a solid place in their specific market place. Being the most trusted partner, we understand that extra attention over finances can expand your capabilities and create a significant impact on successfully executing a business model.

Our services aim to help startups, SME's, MSME, and growing organizations to optimize their cash flows, accelerate growth, and maximize profitability. We are a team of subject matter experts to evaluate your business from multiple aspects and help you make informed decisions. Our seasoned professionals can unlock the hidden value creation and let your experience exponential growth with effective strategies and planning.

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