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Chapter 1

Learning About the Funding Ecosystem

Congratulations — you’ve come up with a business idea that passes the laugh test and now you may be feeling like you’re taking a cross-country road trip. You’re sitting in your ready-to-drive automobile, you have your phone connected to your car’s computer system, and you have some notion of where you’re going to go.

But when you step on the gas pedal, nothing happens. Just as a car won’t go without gasoline in its fuel tank, the lack of money in your business means it won’t go very far and your grand dreams will stay locked in your head.

Sadly, many fantastic concepts are never brought into the real world because the founder(s) don’t have enough money to do that. When you have a new business, expansion is always the objective, which is why you’re reading this book.

No matter if your objective is to broaden your customer base, expand into new geographic areas, or develop innovative new goods, you need two things to succeed: access to sufficient financial resources and financial stability so you can get around the roadblocks that you’ll inevitably encounter on your trip.

As you embark on the journey toward securing funding for your startup, keep in mind that you are not on this journey alone. This book will serve as your guide and provide you with the information, strategies, and self-assurance you need to acquire the capital you require and accomplish the objectives you have set for your company.

So, fasten your seat belts, put your favorite beverage in your cup holder, and get ready to enter the exciting world of startup financing. There's excitement up ahead.

Understanding Funding Terms and Definitions

Before we start your trip into the intricate world of startup financing, we need to stop for a moment to acquire a solid understanding of the 30 fundamental funding terms and definitions. After all, you need to know what the signs and road markings mean on your journey before you go.

Whether you are an experienced businessperson or just getting your feet wet in the world of entrepreneurship, these definitions will also serve as your compass.

Accelerator: An organization or a program that offers early-stage entrepreneurs' resources, funding, and coaching in exchange for a share of the company's ownership. A *demo day* is typically the finale of an event, and it is during this time that startups give presentations to potential investors.

Angel investor: A generous individual who possesses additional financial means and recognizes the potential in a newly established business. They offer monetary assistance to a company throughout its formative years to aid in its growth and development. Angel investors typically offer not just financial support but also useful connections and direction for the entrepreneur.

Bootstrappers: People who finance the expansion of the business primarily through their own personal resources and the revenue generated by the company itself, typically avoiding the need for outside financing.

Bootstrapping: Refers to a method of beginning a business that makes use of the founder's resources or the revenue generated by the business itself. It is like having resourcefulness and independence, as well as beginning your business from scratch without receiving capital from outside sources. The practice of bootstrapping typically involves adhering to a stringent budget and making effective use of the resources that are already available.

Burn rate: The amount of money that a business spends in order to meet its operating expenditures before it starts to experience positive cash flow.

Business plan: A comprehensive document that describes every aspect of a business. This document provides an overview of the company's goals, strategies, day-to-day operations, financial projections, and marketing initiatives. It's your company's road map that not only helps founders and investors grasp the potential of the business but also tells you, your team, and the plan's readers the path that it will take to achieve success.

CAC (client acquisition cost): The cost of acquiring a new client is referred to as CAC. It compensates for expenses incurred in connection with operations including marketing, advertising, and sales.

Convertible note: A convertible note is a type of financial instrument that is used to finance businesses. It is a loan that is provided to a company by an investor with the option of being converted into ownership equity (shares) later, typically when the startup receives more significant funding. Convertible notes are a form of early-stage financing that enables startups to access capital without committing to a specific ownership interest right away.

Crowdsourcing: The practice of soliciting monetary contributions from a large number of individuals (referred to collectively as the *crowd*) to finance the development of a product or the operation of a business. It happens rather regularly on several websites.

Due diligence: This term refers to the process of investigating and assessing a business in great detail. It is analogous to performing a comprehensive check of everything to ensure that everything is in order before making a significant financial investment. With the use of due diligence, investors can discover the risks and opportunities associated with a business.

Equity: Another name for an ownership stake in a business. When you have equity in a company, it indicates that you are the owner of a certain number of the company's shares. Think of it as having your own slice of the pie, or your proportionate share of the overall value of the company.

Equity financing: Entails selling ownership shares, often referred to as equity, to investors. In exchange for a share of the company, these investors provide financial backing to the business to facilitate its growth and daily operations.

Exit: In the context of new businesses, an exit refers to a favorable event in which the company's founders and investors receive a return on the money they invested. Common exit strategies include selling the company, going public through an initial public offering (IPO), or merging with another business.

Exit strategy: A well-thought-out plan that outlines how founders and investors anticipate departing from or profiting from their engagement in a corporation. It encompasses possibilities such as selling the company, going public via an IPO, or fusing with another business.

LTV: This is an acronym for *customer lifetime value*, which is a metric that estimates how much money a company can anticipate receiving in total from a single customer over the period of that buyer's relationship with the company. LTV can be used by both new businesses and established companies.

MVP: This is not an acronym for *most valuable player* — in business, it means *minimum viable product*. This term refers to the most basic model of a new good or service that a newly established business can create and introduce to the marketplace. A test version was created to gather feedback and determine whether there is interest in the product before investing a significant amount of money in its development.

Monetization: The process of generating cash or profit from a product or service offered by a startup company. It requires determining how the organization will earn revenue, which could be accomplished by subscriptions, advertising, sales, or some other approach.

Pitch: A brief and persuasive explanation of a company concept given by an entrepreneur to prospective customers, partners, or investors to gain their business's support. It is analogous to putting up a compelling argument as to why individuals ought to back or invest in the company.

Private equity: Investing in or purchasing ownership stakes in privately-held companies. It is typically not traded on public stock exchanges and typically involves higher investments in established companies with the purpose of either promoting expansion or boosting the operational efficiency of the business. Private equity investors could improve their earnings by purchasing, reorganizing, or selling enterprises in the market.

Product-market fit: When the product or service offered perfectly satisfies the requirements and expectations of the market it intends to serve. This ultimately results in a huge uptick in customer satisfaction and adoption rates.

ROI: This is an acronym for *return on investment*, which is a method for determining the profitability of an investment by making a comparison between the gains or profits gained from the investment and the capital invested. It makes it easier for investors to assess the performance of their investments and determine whether they made a sound financial choice.

Runway: This term defines how much longer a business can continue operations before it runs out of money. It considers a variety of factors, such as the cash reserves that are accessible, routine spending, and projected earnings.

SaaS: This is an acronym for *software as a service*, which refers to a type of business model in which customers obtain software programs via the cloud on a subscription basis rather than in the traditional manner of installing software on their own computers.

Scaling: The process of expanding the customer base and operations while maintaining or increasing profitability. Scaling can be accomplished in multiple stages. It often involves increasing production capacity or penetrating new markets.

Seed investment: The initial infusion of funds that a company receives to commence its operations, and it is also known as seed funding. This early-stage finance helps ideas become achievable items or services, funds preliminary research, and lays the framework for expansion of the business.

Series A, B, C: Following the initial seed money, the first major fundraising round is often the Series A funding, which is then followed by the Series B funding, the Series C funding, and so on. Each round represents a new degree of development and often comprises increasingly substantial contributions.

Term sheet: An early agreement between an investor and a startup company that states the primary terms and conditions of the funding deal.

User acquisition: The process of gaining new customers or users for a product or service offered by a startup company. It comprises making use of marketing strategies in order to both bring in and retain customers.

Valuation: The process of estimating the amount of money that a company or startup is worth. It is critical for investors to have an accurate understanding of the value of their ownership stake, as this factor plays a role in the terms and conditions of equity financing arrangements.

Venture capital: Refers to the funding that is provided by accredited investors or venture capital firms to newly established businesses, both large and small, that have a strong potential for future growth. Venture capitalists typically demand ownership percentages for their investments and actively support the expansion and development of the businesses they back.



TIP

If you want to read an in-depth glossary that's updated often, visit the article *The Definitive Startup Glossary: 210 Words Every Founder Should Know* on the OpenVC website at <https://opencv.app/blog/startup-glossary>.

Moving from Idea to Successful Execution

You're here reading this book and ready to start this journey because you believe that your brilliant idea has the potential to make a huge impact on the entire world, or at the very least a sizable chunk of it. After that, what? What steps would need to be taken to turn that idea into a legitimate and lucrative business?

The power of ideas to influence

A fantastic idea is the foundation upon which every prosperous business is built. The journey from having an idea to carrying it out is a matter of research, planning, and an adaptable mindset. Don't forget the intangibles, either — your dogged determination, unwavering commitment, and eagerness to absorb new information will set you apart from the competition.

That said, the first step is to act by driving to your first destination: your research and its results.

Pay attention to the research

It is imperative that you research your journey first as you would with any long road trip. Through conducting market research, you may better understand your company's operating environment and plan for the trip ahead.

When you're starting a new business, market research is analogous to getting a map that you can use. You need to become familiar with the surrounding area before you put your foot on the gas in your fancy vehicle. There are three primary aspects of market research.

Determine who your ideal customer is

When you throw a party for your friends, you want it to be amazing, don't you? Certainly, you do. As a result, you think about the people you want to invite by identifying your target demographic or market. Which segments of the population are most likely to be interested in the products and services that your organization provides? To find out the answer to this question, ask yourself these questions:

- »» What piques their interest?
- »» Where do they typically go to pass the time?
- »» Which of your ideal customer's needs remains unfulfilled?
- »» Which of those needs can only be satisfied by your idea?



REMEMBER

Be as specific as possible with your answers to these questions, because specificity will help you craft not only better products and services, but also a better message to reach your target audience.

Analyze industry trends

It's vital to pay attention to your industry. What exactly is going on just this minute? Are there any major shifts that are going to take place soon? Are people's preferences evolving throughout time? By being aware of these things, you can better prepare yourself for new opportunities — and roadblocks.

It's just as important to keep a watchful eye out for trends that are just beginning to take shape. Being an early user of a technology or a service might help you better understand in which direction the market is going.

Research your competition

Think of your competitors as other explorers who are involved in the same trip as you are — it's a cross-country race! (We leave you to think of your favorite movie about road trips and racing before we continue.)

Pay close attention to other businesses in the industry that are analogous to your own. Where do they particularly shine? Which aspects of them do their customers find particularly appealing? In what instances do they fall short of expectations? Is there any way you can make it better?

You need to identify potential gaps that your business can fill. Are there any services that customers want but that your competitors do not provide?

Analyze your customers

Your customers are your traveling companions. If you want to be sure that you are heading in the right direction, you need to be sure that you completely understand what they are saying.

Get in touch with individuals who could be interested in the product or service you are offering. Inquire about their needs, problems, and personal preferences.

Your customers are the ones watching your compass and telling you what direction to go to make the trip enjoyable for you and for them.

Analyze your finances

Your company's finances are the fuel that makes it go, and you can't do anything at all without keeping that gas tank full enough to keep everything moving.

Give a lot of thought to how you'll bring in money and keep it coming in. Will you get income through purchases or subscriptions? When do you think you'll first see a profit from your investment in your product or service?



REMEMBER

You also need to figure out how much money you need to offset your expenses, because your company is always burning fuel, and also set aside a reserve for unforeseen expenses such as inflationary costs making product production more expensive than you expected.

Prepare a business plan

When you have all your research notes together, it's time to put together a business plan, which acts as your itinerary for your trip. A plan not only solidifies your idea in your mind, it's also a crucial tool when you're looking for funding or partnering partnerships. Here's an outline you should use in your business plan:

- » **Your business concept:** Describes the objectives of your organization as well as the qualities that set it apart from others.
- » **Market analysis:** Here you discuss the findings of your research into your business sector, your competitors, and your ideal customers.
- » **Marketing strategy:** Describes your plan for attracting new clients and keeping the ones you now have. That is, how do you plan to communicate with the people who make up your target audience?
- » **Financial projections:** A description of your startup expenses, anticipated revenue, and anticipated earnings. When you create your estimates, be conservative and practical.
- » **Operational plan:** Describes the day-to-day business activities of your company including the policies, processes, and controls you're planning to put into effect.
- » **Your team:** Make a list of the roles that will need to be filled, the abilities that each member of those roles will need to have, and at what points you'll hire them, such as when you reach a financial milestone.

Take baby steps

After you have your business plan, you need to test your product or service in the real world. Though it's tempting to just start looking for funding immediately, potential funders will want to see your idea in action.

To do that, you need to launch a prototype or a minimal viable product (MVP). It's like a customer test drive for the car that you're driving on your road trip. This simplified version of your product or service will give you the feedback you need from genuine customers so you can make improvements, which is like tuning up your car for the best performance.



WARNING

Don't be caught in feature creep as you develop your product or service. You can easily fall into the trap of not producing your product or service until it's just right, so before you start MVP development, be sure to clearly define what it will take for your product or service to be released to the masses.

Why Do We Need Startup Funding?

Now you're ready for your road race in the competitive world of business, and you've come to an essential question that you need to answer: Why do you seek capital for a startup? In this section, we discuss the convincing arguments that demonstrate why collecting financing is frequently a vital stage in the process of turning your company's dreams into a reality.

Fostering creative activity and economic development

Putting money into research and development is essential to produce brand-new products or improve upon those that already exist. With the support of finance, you can experiment, discover fresh solutions, and go through iterations.

As your business grows, you'll need resources so that you may extend your operations, acquire additional personnel, and serve an expanding consumer base. You'll also need resources to fulfill that expanding consumer base.

Don't forget costs associated with marketing. An efficient marketing strategy is essential to bringing in new customers. With the assistance of startup financing, you will have the ability to carry out marketing initiatives in more channels (like paid social media), attract a broader audience, and increase brand awareness.

Getting past the startup stage

When you start a new business, there's a good chance that you're not making much money yet. When you approach financiers, you need to spell out where you need financing now and where you need it down the road. There are six important areas your potential investors will want to know about.

Covering operational costs and expenses

Rent, energy, payroll, and other operational costs can be paid by startup financing, which acts as a bridge and ensures you can keep running your day-to-day business as you work toward being profitable.

Bringing in the best possible talent

To launch a successful company, you need more than just a fantastic idea. You also need the ideal people to carry it out and make it a reality. When you have access to your financial fuel, you will have the ability to employ qualified individuals who can contribute to the success of your company by offering them competitive pay and other incentives.

Adjusting to variations in the market

The nature of business is inherently dynamic, and the conditions of the market are subject to rapid change. You need to ensure that you have the right level of funding so your business can adjust to unforeseen curves in the road.

Making course corrections when necessary

It's not always the case that one must wait for the opportune moment before seizing opportunities. The availability of funding helps you capitalize on advantageous opportunities, such as the acquisition of a competitor or the entry into a new market.

Creating a reputation of credibility

In the eyes of potential investors, business partners, and customers, having money to start can significantly boost your reputation. The financial investment from investors demonstrates that other individuals have faith in your idea. And this could result in more investors and customers because financial support implies stability and a dedication to growing your business.

Reducing the danger

You know that running your own business and driving on your journey isn't easy. You'll have to weather bad economic downturns and obstacles in the road, and there is no guarantee of future financial gain. The provision of financing, in the form of a financial safety net, is an important aspect of risk management.

How Startup Funding Has Evolved

In the realm of startup finance, a landscape that was formerly dominated by traditional methods has given way to a landscape that features a diverse ecosystem of funding possibilities. Before we talk about the current state of startup funding, let's take a quick tour of the history of startup finance and how it has evolved over the years.

In the early stages of the business startup industry, it was common for business owners to invest their own money and resources in their ventures, which is better known as bootstrapping. It was an age that was distinguished by innovation, which emerged as a result of a combination of unyielding drive and limited resources.

As their businesses grew, the proprietors of those businesses approached the banks in their communities in search of loans. They also sought the support of family and friends who believed in the cause that they were fighting for. These loans were often secured with the personal assets and relationships of the borrower.

Venture capital

The 1960s and 1970s were pivotal years in the development of the venture capital industry, and the use of venture capital proved to be a big improvement over previous financing methods. Wealthier individuals and institutional investors began providing substantial amounts of capital to newly established enterprises in exchange for ownership holdings in those businesses.

Silicon Valley developed and became a hub for venture capital activity, which fueled the expansion of major technology companies such as Apple, Intel, and Microsoft. This was made possible by the region's evolution. The atmosphere in this region is one that is favorable to innovation, which has resulted in the attraction of investors who are prepared to back ventures that are breaking new ground.

The use of venture capital was linked to higher levels of risk, but it also offered the opportunity to generate significant returns on investment. Investors were aware that not all new enterprises would be successful, but that investors might potentially make great gains from those businesses that did succeed.

Crowdfunding

In the 2000s, online crowdfunding platforms became a popular form of funding new businesses, Creators can present their projects on crowdfunding platforms such as Kickstarter and Indiegogo and collect monetary contributions from supporters in exchange for gifts or early access to the products that they make.

The practice of equity crowdfunding, which enables investors to purchase shares in new enterprises, has begun to be implemented in a growing number of countries. The ability to invest is available to smaller investors, who were subsequently able to take part in early-stage businesses as a result.

Angel investors

Angel investors are people who have significant money and a strong motivation to support entrepreneurial endeavors. These investors have come together to form networks in order to facilitate the sharing of information and resources among themselves. These networks offered new enterprises a technique of collecting finance that was more structured and organized.

Incubators and accelerators

Startups might potentially receive funding, coaching, and access to resources from groups such as Y Combinator and Techstars in exchange for a stake of ownership in the company. These programs act as both incubators and accelerators, and we talk about how they've worked for businesses in the next section.

Examples of Startup Funding that Worked

There is a plethora of examples of entrepreneurs whose businesses have become big success stories as a result of receiving startup capital, and here are three examples from different industries that may inspire you.

Airbnb

In 2007, Joe Gebbia and Brian Chesky rented out air mattresses from their apartment in San Francisco in order to bring in some extra money and cover their living expenses.

Airbnb began with a seed investment of around \$20,000, and that money helped Gebbia and Chesky grow their business into one that's known around the world as a service that connects travelers with unique places to stay, for better and for worse.

Today, Airbnb has raised over \$7 billion in total investments and has over 4 million hosts in over 100,000 places around the world.

Stripe

In 2010, brothers Patrick and John Collison established Stripe with the intention of simplifying the process of accepting payments online. Because their technology was so user-friendly, businesses had an easier time tracking transactions and accepting payments with it.

The Collison brothers received \$20 million in seed funding in 2011, and they focused primarily on the software developer market, and that was the key to their company's success.

Today, Stripe has received over \$2 billion in cumulative funding, and they're a leading payment processing platform with a valuation of \$50 billion as of 2023.

Beyond Meat

Ethan Brown founded Beyond Meat in 2009, and you may know them from their signature product Beyond Burger. Beyond Meat is known for developing plant-based meat alternatives that mimic the taste and feel of traditional meat products.

Beyond Meat was bootstrapped at the beginning, but venture capital firm Kleiner Perkins was the first to invest in the company in 2011. As more consumers who were looking for veggie meat that tasted more like meat bought Beyond Meat products, more investors flocked to the company.

Today, Beyond Meat has raised about \$1 billion from 28 investors, and you can buy not only burgers but also veggie chicken, sausage, and jerky.

