The Definitive Startup Funding Guide (From Business Idea to IPO + Facebook Case Study)

The road from idea to IPO is full of pain, tears, joyful moments, and … startup funding, if you are serious about building the next Facebook or Google.

But let's take a step back before we talk about startup fundraising in detail.

So, you have a world-changing business idea. You also found your co-founder and started validating your educated guesses (often called hypothesis) by talking to potential customers and testing your MVPs with actual customers.

But then you realize that only 40% of small businesses are profitable (while 30% continuously lose money) and 82% of businesses that fail do so because they have problems generating enough cash.

Here's the sad truth.

Most startups will – at some point – need external funding from investors such as business angels and venture capitalists, so they can improve their metrics (e.g. revenue, customer acquisition costs, customer lifetime value, profit margins) and turn their current loss-making business into a world-leading profit machine.

But how to get investors (venture capital, corporate venture capital, angel investors, angel investment networks) invest in your startup?

Let’s take a look at how startup funding really works by looking at insightful concepts and the real-life cast study of Facebook.

Ready? Let’s get started.

What is startup funding exactly?

So, you have been going about your business with this nagging feeling in your head. You can’t quite figure out what all these thoughts mean, until one day it hits you.

You have an idea that will revolutionize the world.

It’s so good that you want to turn this idea into a business. You know it will be a hit; you just don’t have the funds on your bank account to do it. After all, money doesn’t grow on trees and investors want tangible products and results, not just ideas.

Funding for startups is not just about *receiving*. You are also expected *to give* in return. So, ***an investor gives you cash and you give them equity***. Meaning, you receive money from the investor to launch and turn your ideas into reality, while they get part of your business, which should – hopefully – pay them back in the future.

What are you giving away then? You don’t yet have an operating business – you’re eating ramen noodles and the investor probably isn’t looking for food in return for their cash?

Handing out equity means you are:

- *Sharing the ownership of the business.*
- *Sharing control of your business.*
- *Sharing the profits of your business.*

Essentially, you are not the only person in charge and deciding the future of your business.

So, you have this idea and you need funding. Why not just walk to a bank and ask for a loan?

The concept of a startup differs from a traditional small business and this difference is clearly manifested in funding. A startup is all about scaling and scope – it's having an idea of a product that can grow fast into a wide-reaching business.

Uber is a great example of a startup – the idea that you can book a ride with your smartphone and get your driver knock on the door within minutes, offering an affordable journey can be implemented anywhere in the world. Indeed, the whole point of it is to offer anyone the ability to become a 'taxi driver' – you just need a car, an app and a willingness to work hard.

However, creating a product that's scalable and disruptive in existing markets isn't that easy. We'd all be millionaires if it were.

It's not easy to come up with an idea you can scale. The world is full of products and services we love. The hardest part for an entrepreneur is finding the answer to questions like "*I already like booking my accommodation at AirBnB, why should I use your service?"*

Eric Ries has once defined a startup as:

> *"A human institution designed to deliver a new product or service under conditions of extreme uncertainty." – Eric Ries*

Since your aiming big with a startup, you're taking risks. Business is always a risk but setting your own barbershop is really not quite as high-risk as launching an app to help people find their perfect shampoo anywhere in the world.

You might be thinking what all this has to do with funding?

Well, funding a business that isn't ***about high-risk*** and ***high-potential*** is completely different to a startup, which is both of those things.

Startups often require a lot bigger initial input of capital to quickly scale it. Startup success is never guaranteed – your investor has to put a lot of cash to get you going without guarantees of seeing that money again.

So, why do they do it?

Because the rewards are also higher – if you can scale it up successfully, you'll be making millions if not billions.

While the hairdresser in the corner of the market might seem a more certain investment opportunity, it'll never make billions.

That's why startup funding is generally done by professional investment institutions and individual investors such as accredited investors, venture capital institutions, angel investors or private equity firms.

On the other hand, the traditional business will seek investment from a traditional lending institution, such as a bank, also called business funding.

But you are still probably thinking why. Why do I need capital for my business idea? Isn't there *really no other way*?

Well, there is. You can also take the route of bootstrapping which requires no external startup investment.

However, when you talk about *funding a startup*, you talk about taking cash in exchange for equity and not getting by with as little external capital as possible. Funding is always about *taking cash from an outside source*.

To recap, startup funding is about attracting external investors to give you capital in exchange for equity in your business – which at the start is often nothing more than an idea.

To put it another way:

You start with a pie – your business – and as people give you capital, you start dividing the pie into pieces.

As you'll see in the next chapters, the outside money doesn't make your pie smaller. You don't actually have less of the pie; you just have a smaller share of a bigger pie.

Road to IPO: The different stages of funding for high-growth companies

So, ***startup companies want to scale and hit big in a short period***.

The 'end' of a startup is usually either of the two options: **another company acquires your business** or you decide to **go public**.

Your business could, of course, also fail – a scary thought at the back of the head for most entrepreneurs.

To avoid failure and to guarantee you get to choose between those two successful ends, you seek out funding. Having cash will make it easier to launch and develop your project and to scale it up.

But as I've said before, money doesn't grow on trees. How do you attract cash?

To answer the question, we need to study the funding stages.

Idea stage: Baam! I've found this awesome business idea!

Everything starts with the idea. If you don't have a business idea, you won't have a business, and if you don't have a business – well, you can't really seek funding.

While investors are looking for more than just an idea when it comes to raising cash, you do need to start your funding venture with the idea.

In some sense, this can be the hardest part. Thomas Edison once said, "*Nearly every man who develops an idea works it up to the point where it looks impossible, and then he gets discourages. That's not the place to become discouraged."*

What stops you from falling into that trap Edison just described and thinking this isn't worth it? How do you find a good idea?

First, you need to believe ideas can come from anywhere.

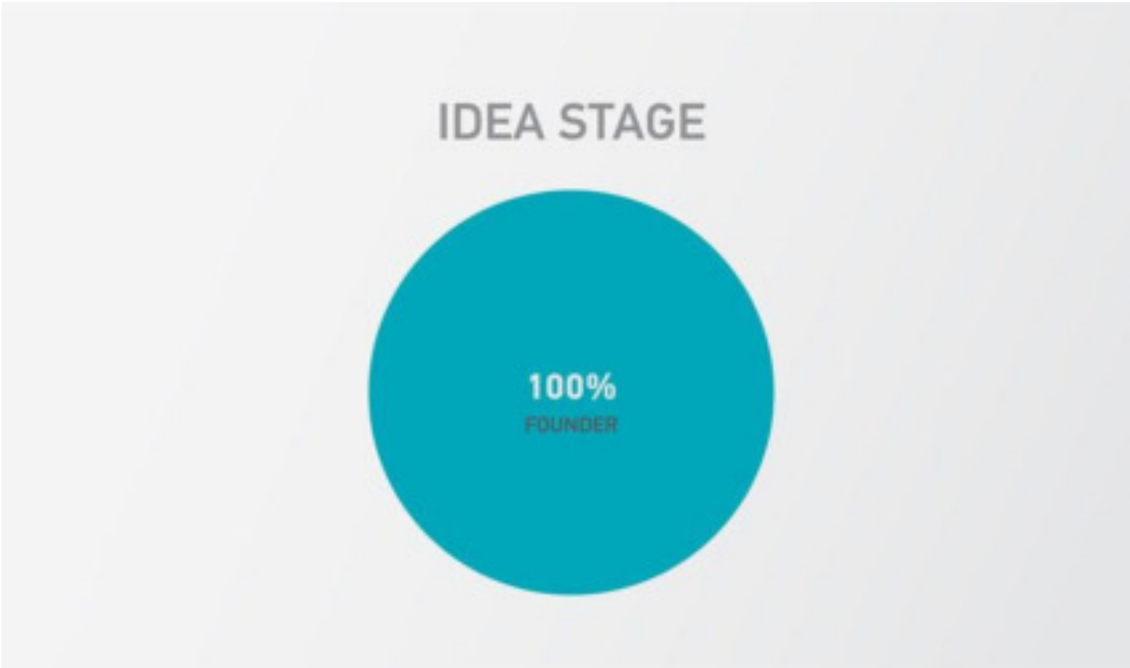
Reed Hastings received a $40 late charge for returning his video late and this simple act of being fined got him thinking about the movie rental industry. A little later and he launched Netflix.com – and the rest is history, as clichéd as it might sound!

The example reveals the second important element in finding an idea – solving a problem. Hastings' problem was personal, but you might be inspired by an issue your friend mentions to you or from a complaint you overhear at your favorite fast food joint.

As the video shows, ideas can really come from anywhere:

Once you come up with this idea, you launch the framework for your funding adventure. You lay the foundation for others to invest money in your idea – you have the equity to hand out now.

Let's consider the idea stage with the pie example. Your business idea is now the pie – you can start giving away pieces of your business to other in exchange for equity.



Co-founder stage: Get some help to turn your idea into a project

“It’s not about ideas. It’s about making ideas happen.” – Scott Belsky

There is one more twist in the tale.

It’s not actually just about money in startup funding.

You are likely to give out equity in exchange for other ideas or pure hard work.

You see, when you have an idea in your head for a business, you will undoubtedly hit a point where you realize you can’t do it all on your own.

I mean, you need to think about marketing the product but for heaven’s sake, you know nothing about it? What about taxes? What about talking to all these investors?

It’s scary.

But figuring out you can’t do it on your own is not just inevitable, it’s also advisable.

While you might be the brains behind the idea, ***other people will add value to your startup***. You will benefit from having a tax guru on board or working with a friend who knows everything about market research.

If you’re lucky, you might find a complementary figure who’s as passionate about your idea as you.

Having the right co-founder join your startup can make or break your business.

So, you notice how your friend from graduate school is helping you with the code every night. Steve from work might be giving you a hand with those marketing leaflets or Sharon, who you met at a business seminar, is really great at giving tips on how to improve your budgeting app.

Wait a minute!

These people are adding to your idea and helping you out for – *nothing?*

Yes, eventually you'll realize that you need to offer the person more than just a handshake. However, you are still eating ramen noodles out from the can yourself. You don't have any money to pay a salary!

So, you ask them to be a co-founder – to slice them a share of your pie.

A co-founder is the first and the most common example of starting the startup funding. ***You might not be receiving capital, but you are obtaining the person's talent and skills to help you move forward***.

Now, before you give 50% of the company to Mathew who helped you photocopy your business cards, you need to think about the qualities of good co-founders.

After all, you will be sharing the rights and responsibilities of running the business, so don't just ask your neighbor to co-found a business with you.

Dave Haynes from startup acceleration fund Seedcamp listed six characteristics of a good co-founder:

- *They are good at building relationships*
- *They have a positive outlook*
- *They listen to feedback*
- *They learn quickly*
- *They show integrity in the things they do*
- *They share your ambition*

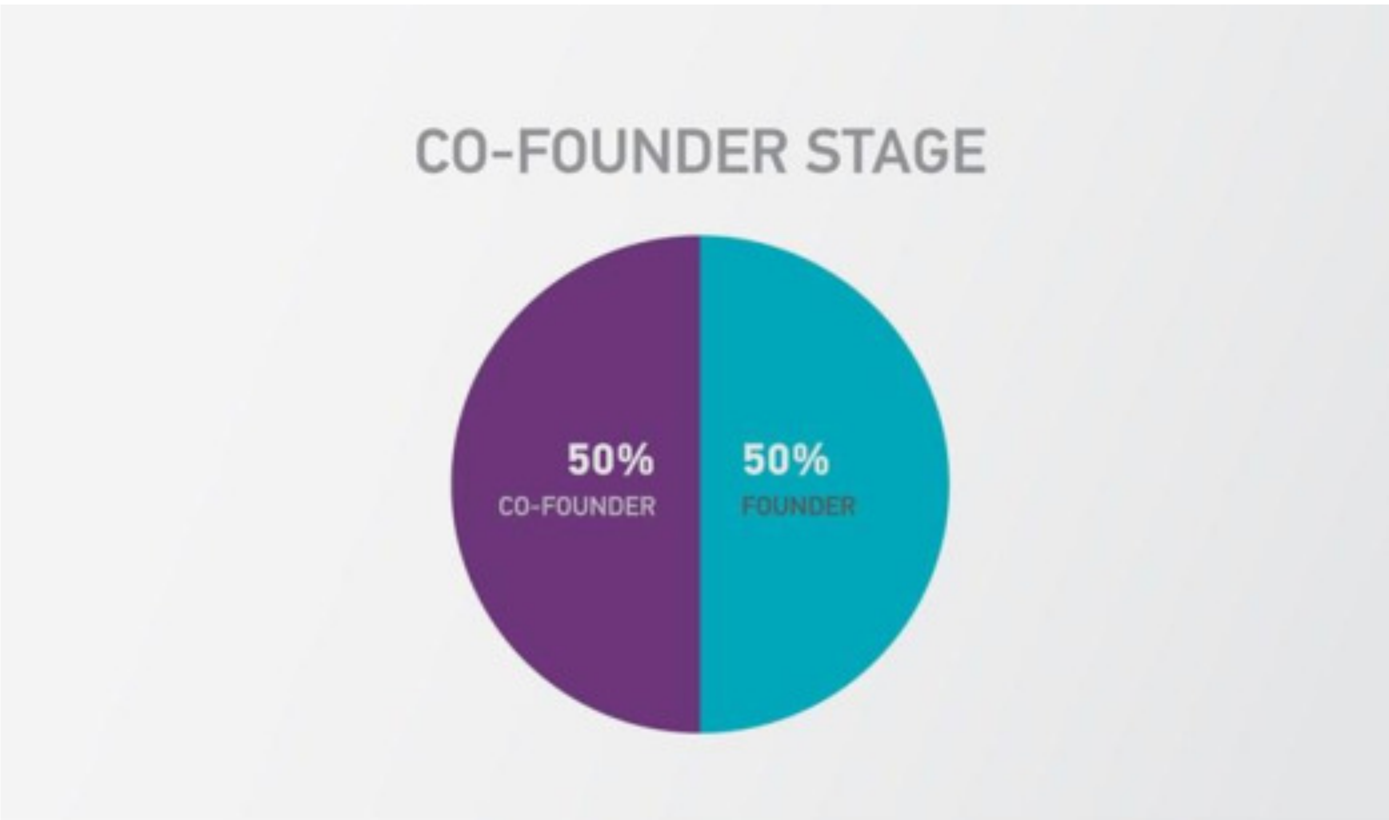
So, you offer the right person a position of co-founder and hand them out a piece of cake. You realize Sharon is passionate about your idea, she's great with considering different opinions and she's learned a lot of things about coding even in the space of few weeks.

But what are you supposed to give her? 20%? 50%?

There isn't *really* a 'right answer' to how much of your pie should belong to the co-founder. In most cases, the best option is to split – but always consider your unique situation. You need to think about things like the contribution, the talent, the unique skills on offer, the ideas and so on.

Don't just assume fifty-fifty is the best or think you somehow deserve more than a co-founder just because you had an idea.

And now your funding pie looks something like this:



If you're not quite convinced about the value of a co-founder, here's a statistic:

Two-member founding teams are able to raise 30% more investment than a single founder startup.

Having a co-founder isn't just comforting and helpful. You can increase your chances of later fundraising success by adding another member to your team.

But what about Mathew and all the other helpful people you've been working with?

This stage in the funding stage might feature other people – or employees. Like with your co-founder, you probably don't have the money to pay anything to people working on your idea, so you offer them equity for labor.

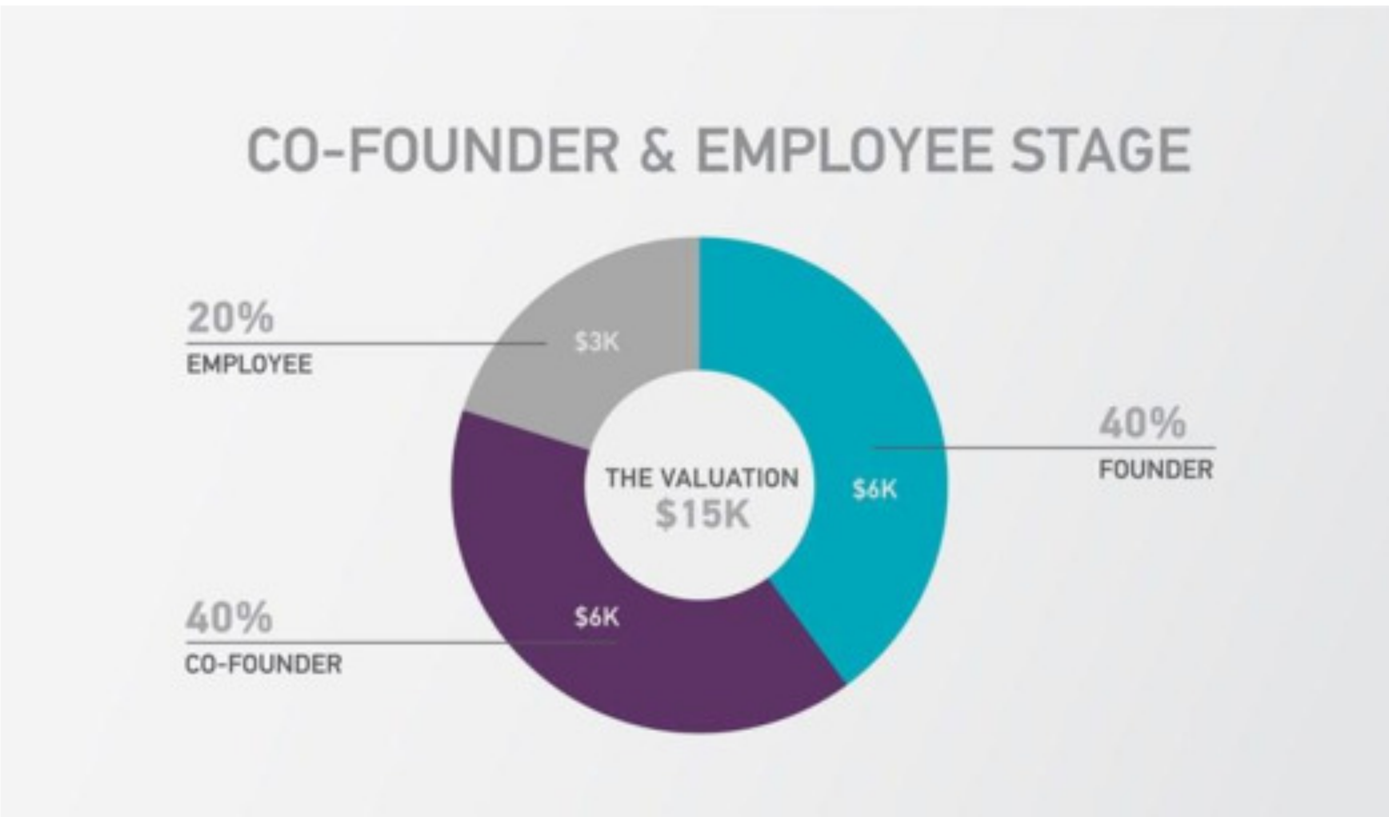
This is called sweat equity – which according to Mark Cuban is "*the most valuable equity there is*".

Sweat equity is often determined through foregone wages – essentially, you consider how much the person might earn doing the same job to someone else. If you get help for marketing from Mathew, you might value the time, expertise and input at $5,000.

Then you must work out what this means in terms of your pie – what kind of value is Mathew adding to your very raw business idea.

Let's imagine, Mathew deserves a 20% slice of your business idea. Since it's essentially just a three of you working on an idea, your business valuation is not much higher than $15,000 – each 'owning' a corresponding right of this valuation.

The pie might look something like this:



Pre-seed investment round: Ask mum and dad or pray to heaven!

By now, your business is moving forwards. You're refining the idea and you realize labor is not enough to get you forwards.

You're running out of money to buy ramen, your co-founder doesn't have money to pay phone bills to call potential customers and the production of the product prototype makes you see nightmares.

Yes, ideas and passion can only go so far…

It's time to start looking for cash.

In order to start attracting official investment in the form of capital, you need to sort out a few things:

- **Become a formal legal entity** whether an LLC, C-Corp or so on. You can find out great information about picking the right business form from this Entrepreneur article.
- **Start improving your investment readiness**, which is essentially about having a solid business plan and demonstrable prospect to guarantee investors find you appealing. Read more about investment readiness at Steve Blank's blog.

At the pre-seed investment stage, you won't be going after the big shots of the investing world. While you are becoming more attractive, you are still a high-risk company – you probably don't have enough money to launch your product to a wider market.

After all, you don't have anything other than ideas and prototypes to show at this stage.

So, who could give you a helping hand?

The people you can trust and count on: your **friends and family**.

Your parents are unlikely to hand you a check for $100,000, but you can still get small sums of money from them and your friends. Perhaps your uncle is interested in the technology field or your friend is ready to take a punt with you.

The good news is that you can get enough money from family and friends to take your business to the product stage. However, since the amount of funding won't amount to much, you also don't need to give a lot of equity.

A big part of the pie still belongs to you and your co-founder.

Now, the dangers of taking money from friends and family are well documented. You're still not a functioning business and by giving you money, your family and friends are essentially saying goodbye to this money. It might sound blunt but you don't have guarantees to give them – they might lose the money.

Now, this can result in awkward Christmas dinner. Think carefully whether you want to have those conversations or not.

But this family and friends route isn't the only pre-seed investment opportunity you have.

You can also contact **accredited investors**. These are sophisticated investors, who need to fulfil at least one of the conditions of:

- *Income*
- *Net worth*
- *Asset size*
- *Governance status*
- *Professional experience*

For a startup, the benefits of finding accredited investors are numerous. The most important advantage is how investments from accredited investors can reduce the regulatory burden.

Accredited investors on board can even help with future funding rounds.

Your aunt Jane is probably a lovely person, but Peter Thiel or Ashton Kutcher couldn't care less about having her investing in your business. Now, if Peter Jones were to invest in your business, other investors would take notice.

Both friends and family and accredited investors often require contacts and networks. It's about *knowing the right person*.

But there are other funding routes for those who haven't yet succeeded in the art of networking.

You can also get funding through **crowdfunding**. The method has become increasingly popular in recent years – The World Bank has estimated crowdfunding to reach $90 billion by 2020, but this could happen much sooner.

Some suggest crowdfunding will surpass venture capital and angel investing this year.

Why is it such a popular method for funding startups?

Crowdfunding can be a good way of generating a lot of income without giving away a big chunk of equity to a single person. Instead of having a single person investing a lot of money into your business, you find tons of people chipping in a bit.

If a single person invests $100,000 into your business, you might have to provide a big chunk of equity in exchange.

But if 1,000 people give a total of $100,000 with no one investing more than $100, you don't have to worry about a single person gaining a big chunk.

Remember, equity provides the person with control and ownership. You don't want to lose majority ownership because it will mean you have less control over the decisions the company makes.

If you opt for the crowdfunding route, you can retain the majority control much easier. And often times you don't need to give away equity when doing crowdfunding campaigns.

Since crowdfunding is so popular, you can find tons of platforms for fundraising. These include sites like Kickstarter, Indiegogo and Razoo.

Sounds like a lot of good sources for raising capital?

Well, you have a few more options at hand at this stage.

You could also turn to **incubators, accelerators and excubators**. These are specialized platforms often offering startups more than just pure capital. Think of it like a combination of labor or ideas and cold hard cash.

You'll gain access to successful entrepreneurs and resources that can help you with anything from taxation to shelter. If you're sick of eating ramen noodles and working from your co-founder's basement, you might get an actual office space by dealing with an incubator.

INCUBATORS	**ACCELERATORS**	**EXCUBATORS**
Incubators are places for developing or coming up with a business idea – focus is often on innovation and the creation of a startup.	Aimed at boosting the growth of an existing company – focus is on scaling.	Aimed at providing mentoring assistance without any physical office or space – focus on the individual startup in question.
The incubator programs don't necessarily have a timeline, but there can be a tough application process. Anyone part of the program will be able to enjoy an environment of collaboration and mentoring in launching a business idea into practice.	The accelerator programs are structured and often require an application. If accepted, you receive an investment, mentoring and other such practical help in change for equity.	The excubator programs are holistic and long-term. You receive access to mentoring and advice. It's often open for anyone who is able to afford the cost.
Example incubators:	*Example accelerators:*	*Example excubators:*
FFWD	*Y Combinator*	*excubator*
htibi	*Seedcamp*	*Eleven Strategy Start-Up Studio*

There is one more option available for startups that aren't much more than an idea.

Pre-seed stage often means talking to **angel investors**.

These are not quite like magical beings floating down from heaven to rescue your business, but their value addition can be rather significant, nonetheless.

These professional investors will either join as individuals or syndicates through groups like Converge Venture Partners or AngelCoFund.

The investment is more than just capital – angels can help you in terms of expertise and prestige. They not only know what steps might be good to take in the future, but they also create so-called hype around your company.

As I mentioned earlier, having a famous angel on board will make other investors take notice of your business. It makes the investors think *why the investor wanted to invest in your business*. He wouldn't invest in you if he didn't believe you could make a fortune, so perhaps other investors should follow.

Investors are interesting folk; they might not realize they want ice cream until their biggest rival is enjoying some.

Adding an angel investor on board can be beneficial even if the person's individual capital input isn't that big.

> Raising money from the right angel investors can provide you with so much more than money.

So, what does all of this do to your pie?

Let's say your family and friends are offering you a bit of money in exchange for 3% of the equity.

You've also been successful in attracting an angel who thinks your business is worth $1,000,000.

More importantly, he agrees to invest $200,000.

Now, your angel's share of the pie is not calculated on the current valuation. It's ***calculated on the post-investment value***.

You take the angel's investment and you divide it by the post-investment value. This gives you the percentage the angel should get and it gives you the figure used to dilute the other slices of the cake.

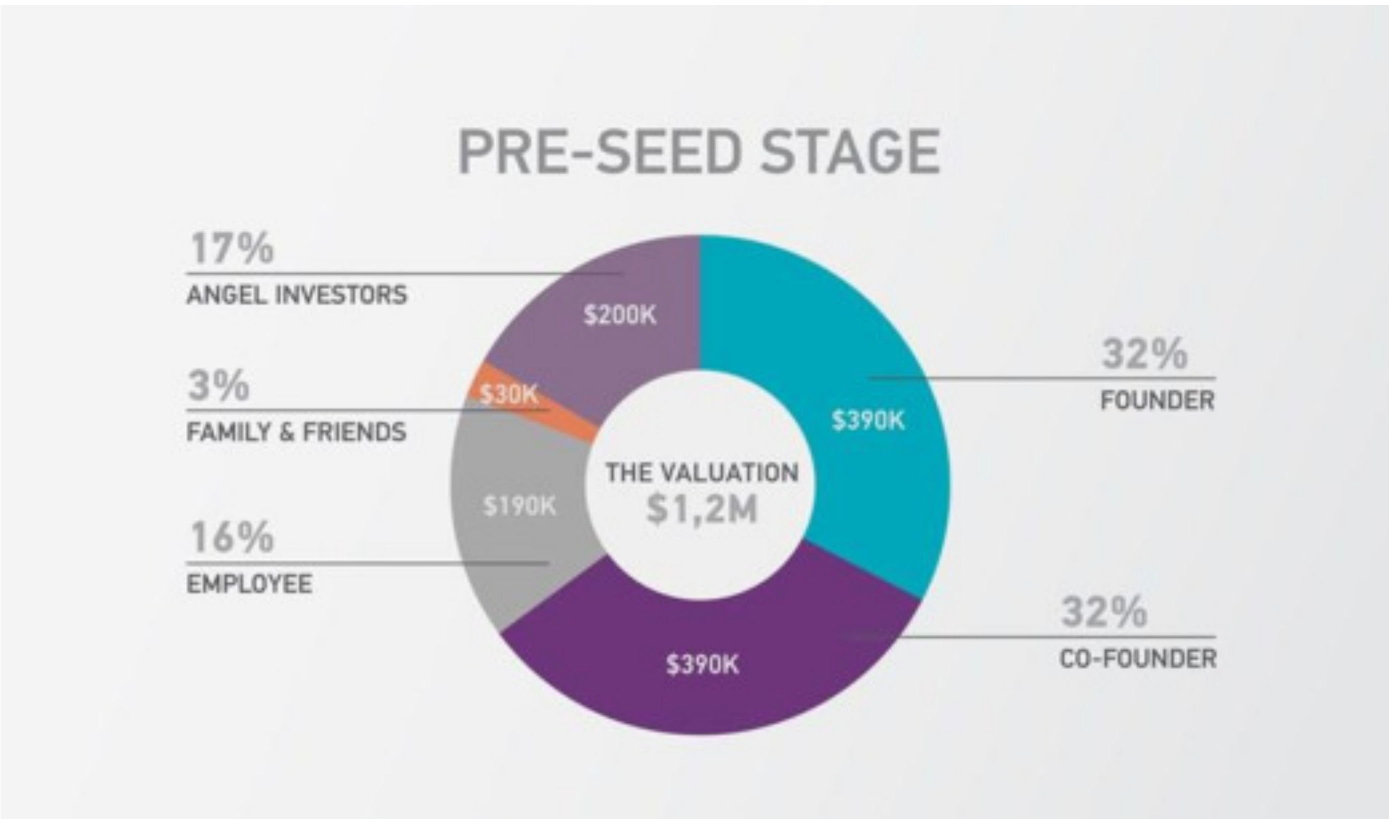
You’re handing out more of the same pie so your percentage or share of the pie will need to go down.

OK, so let’s calculate what percentage the angel is getting using our imaginary valuations and investments.

$200,000 (the investment) / $1,200,000 (the post-investment value) = 0.1666 ~ 16.7%

Since they get 1/6 of the company, this is also used to dilute the other slices.

Your cake would look like this:



Seed and expansion capital: Raising venture capital from professional investors

With the help of the angel investment, along with the investment from your family, you are now able to get your business moving.

You have enough seed capital to build a high-fidelity prototype and perhaps even sell it to customers.

Having an angel on board helps create a buzz around your startup. You’re starting to get the attention of other investors as well as customers who are eager to test your product.

You’re ready for expansion.

This is the moment when **institutional and professional investors and investment companies** will start investing in your business. The early stages, the seed rounds, will include angel investors, but venture capital firms might approach your business.

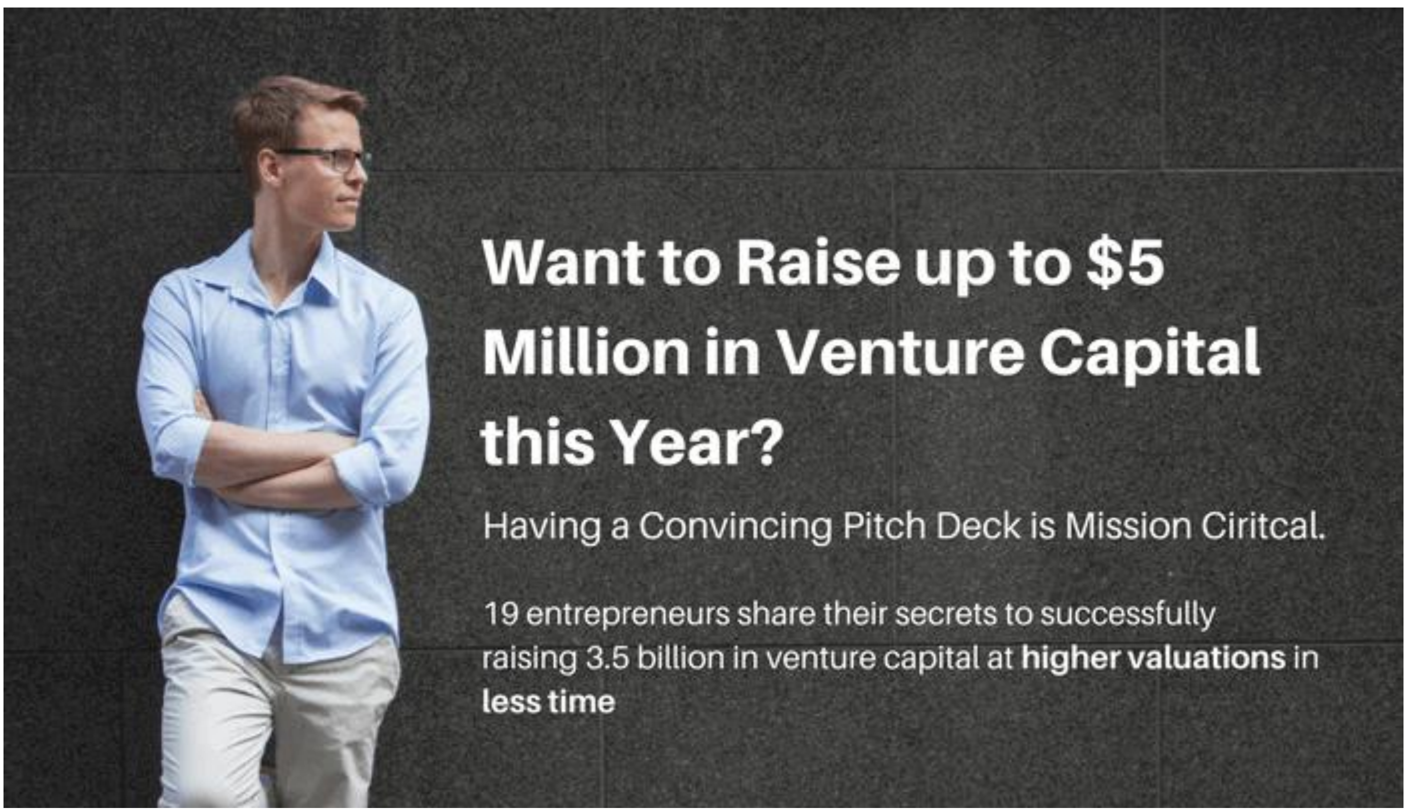
Now, getting your aunt to invest in you might not require anything other than you saying you have an idea and you need money. Family and friends are lovely like that.

But getting professional investors to invest in your business will take a lot more.

Remember, they might well lose it all.

This brings us back to the concept of investment readiness. You need to provide validated metrics highlighting your future potential and therefore, convince the investor they are likely to get their money back and more.

Investors aren't investing in your stunning product because it will help millions of people and save kittens. They are giving you capital so that they can make more money once you hit big.



So, how do you prove your investment readiness?

There are key metrics you need to focus on. These are the figures and facts showing the future potential of your business.

The key metrics to keep in mind, according to Alida Miranda-Wolff and Pete Wilkins from Hyde Park Angels, are:

- **Traction:**
    - Your market and its predictions
    - The pain points you're solving
    - Your ideal customers
- **Product usage (month over month)**
    - Organic growth
    - Users' time with the product
    - New vs. repeat usage
- **Customer growth**
    - Non-paying vs. paying customers
    - Total number of customers
    - Conversion rate
    - Growth rate
    - Acquisition cost
- **Revenue growth**

What do all of these figures prove?

They prove your business is scalable – which is what startups were all about, remember?

For venture capitals and institutional investors, the scalability is all that they are interested in. If you can convince them not only that their money is safe, but also that your growth is guaranteed, you are going to get funding.

> Focus on improving your metrics and your startup fundraising will be so much easier.

So, you are now aware of how to attract venture capital, but let's take a closer peek at what this funding type is really about.

Venture capital has different stages with each stage including investors and institutions with varying risk & reward requirements.

THE ROUND	WHAT IS IT ABOUT?	TYPICAL INVESTMENT
Seed	Seed stage is about nurturing the startup idea further. It's about adding funding that helps the startup to mature – perhaps to create the product or add employees to the team.	Seed stage is a high-risk investment, just like all the investment prior to the stage. It features angel investors and early stage

	It often helps support the market research and development of the startup. Seed stage is a less formal round of funding.	venture capital firms who invest in startups. The typical Seed round raises around $500,000 to $2 million.
Series A	Series A is the first more formal round of funding for startups. The round aims to optimise the business and slowly start scaling the product on the market. In a sense, Series A round is about maturing the business idea and business model.	Series A involves traditional venture capital firms, such as Sequoia,Accel, or Index Ventures. It still requires big risk-taking from the investor. The typical series A round raises around $2 to $15 million.
Series B	Series B takes the startup past the development stage – the vision of the investors becomes clearer and the final picture of the pie becomes a bit more apparent. At this stage, the focus is on creating the winning product, which often means increasing focus on the team and growing it to support scaling up. Startup funding is flowing towards business development, sales, advertising, tech, support and so on.	The round tends to feature investors from earlier rounds, but a new wave of traditional VC firms that specialise in later stage investment will also feature heavily on this round. At this stage, the risks are starting to lower as the startup has more actual proof to show it is generating enough profit/revenue. The typical Series B round raises around $7 to $30 million.
Series C	Series C is about investing in a company that has already proven to be a hit – at this stage, the issue is just about scaling up, not taking risks on whether the startup can make it. The round is about ensuring the startup lifts up to the full	Involves more investors since the risk has diminished. Typical investors include hedge funds, investment banks, private equity firms and secondary market groups.

	potential, which it has shown it can do.	The typical Series C round raises anything from single digits to $100s of millions.

These rounds can sometimes differ slightly in terms of what startup or investors call them. Seed Funding can be used as an umbrella term for pre-seed, seed round and Series A funding.

Series B and C, on the other hand, can be described as Expansion Funding – since the purpose of the funds at these stages is to expand and grow an existing business, rather than start the business idea.

But you don't need to stop your fundraising in Series C.

There are also the **Later Stage Financing Rounds**. These can be called Series D, E, F and so on.

However, later stage financing rounds can often refer to the 'end' of your startup as well. If you remember, I said at the start there are two routes for the fundraising to end: either being acquired by another company or filing for an IPO.

The later stage rounds continue to aim for two objectives, similar to Series C:

- Scaling the business further
- Returning money to the investors

So, what about our example pie?

Well, let's say a VC values your business at a pre-money valuation of $4,000,000 and agrees to invest $2,000,000 into it.

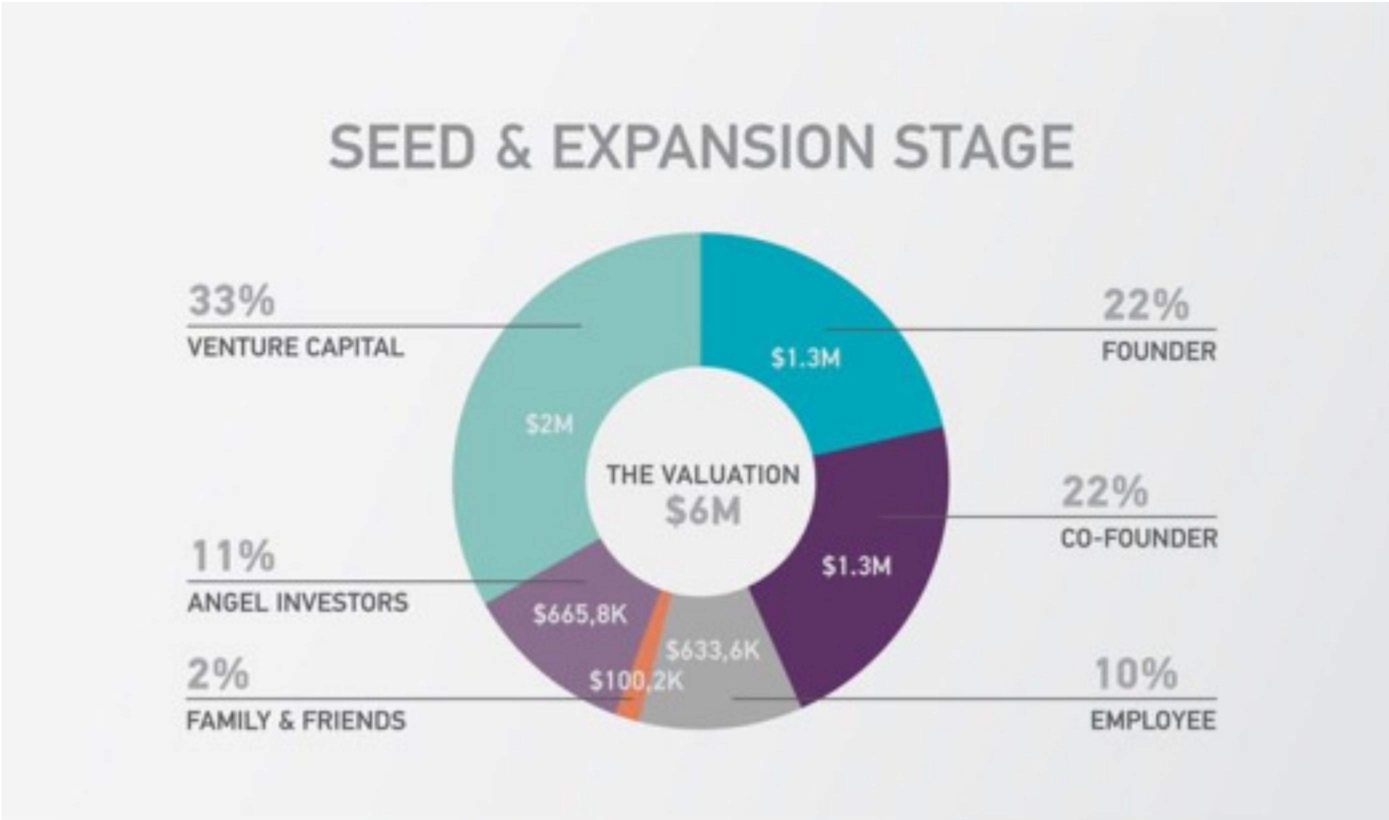
The share you need to slice for the investor would be calculated the same way as with the angel investor.

So, you take the investment and you divide it by the post-investment valuation.

$2,000,000 / $6,000,000 = 0.3333 ~ 33.3%

The venture capitalist will get this, while everyone else's slice will be diluted.

The pie would end up looking like this:



Making it BIG and doing a successful IPO

Your funding has been plain sailing until now and your business is booming.

It's time to take the final step and 'end' your startup.

We're back at the two fundraising steps your startup can take at this point: ***selling the whole business*** or ***going public***.

If your business is causing grey hairs to competitors in the market, you might be approached by a big competing business for a trade-sale.

By buying your startup, the business can boost its market share, ensure you don't threaten their market position more and gain an advantage over competitors. They will get their hands on the latest technology and the disruptive ideas instead of having to play catch-up.

You might also seem like a lucrative opportunity for a business that wants to venture into a new market or industry.

In these instances, you might go for the trade-sale, selling 100% of the equity of your business to another company or financial investor.

Aside from companies, like Facebook, Google and Yahoo, often going after such deals, private equity funds are a common example of this sort of exit strategy.

What happens to the pie?

The pie you've accumulated so far will be shared – so each person gets a representative portion depending on the valuation the buyer puts on your business.

Perhaps Facebook wants to buy your startup for $5,000,000,000. You'll divide the sale price amongst anyone who has a slice in your pie.

Before you start calculating your profits, you must realize one thing.

Your pie has probably been sliced in two types of shares: preferred stock and common stock.

PREFERRED STOCK	COMMON STOCK
Greater claim to company's assets and earnings – during the distribution of cash, such as dividends, preferred stockholders are paid first. This is also the case in insolvency. Dividends of preferred stock generally greater, they don't fluctuate as much and dividends tend to be guaranteed.	Common stockholders will only receive the distribution of cash after preferred stockholders. In the case of insolvency, common stockholders will only be paid after debtors and preferred stockholders – which could mean they get nothing.
The preferred stock has a callability feature, which gives the person the right to redeem the shares from the market after a specific time. Also known as hybrid securities. The preferred stock can be converted to common shares.	Common stock means the board of directors can decide whether dividends are paid. The value of common stock is regulated by demand and supply of the market.

So, who gets what?

Well, founders, smaller investors, and friends and family members tend to have common stock. Angel investors might also have common stock, while venture capitalists hardly accept anything other than preferred stock.

Why does it matter?

Because you might not receive anything from the sale. Let's say things haven't been quite as good and your business has accumulated $900,000,000 in debt. This must be paid off first from the sale price, after which, anyone with preferred stock will get their money back.

So, you might not get as much as you would with your slice. It might also leave your aunt hanging dry.

There aren't often much you can do in terms of whether you can get preferred stock. The main point is to understand what it might mean in case things don't quite work out.

This is important to know when making a deal and when figuring out the possible exit strategies and their impact on your earnings.

But you also have another option for raising funds and slicing the pie.

You can also go *BIG* by opting for an initial public offering or IPO.

IPO can be a better option for raising even more money.

Why?

Because you are turning to a huge pool of investors through the stock market. In an IPO, you release part of your startup's shares to the general public via the stock market.

It's also something your investors want you to do because it provides them with a high-priced exit strategy. An IPO allows you and other equity holders in the company to go and sell their shares, cashing in on their slice.

Without an IPO, the stock is restricted and you aren't able to legally trade it.

So, the angel investor and venture capitalist (and even your aunt!) are stuck with their slice. It might be growing in value but they can't cash in on it.

Now, IPOs are great for generating more money and they can be an easier way to fundraise more for your business as well.

Offering your share on the stock market doesn't require you to meet each individual buyer and convince him or her of the value of your business. People can just click a few buttons and boom! they have bought your stock.

Almost *ANYONE* can buy your shares.

It's easy and it doesn't require the same kind of paperwork as investing through the traditional route does.

But, as with most things in life, it isn’t just you and the investors in your business that will benefit. IPOs are also beneficial for investment bankers.

When you announce you’re ready for a big IPO, they will be fighting to talk to you.

How come?

I mean, they have to do the filing for you – all those regulatory issues won’t get solved overnight.

Well, consider this.

In one of the world’s biggest IPOs of all time, investment banks made a record-breaking $300 million in fees and bonuses.

So, you are screwed if you opt for this route then? The investment bankers will take all the money and laugh on their way to the bank?
Not quite.

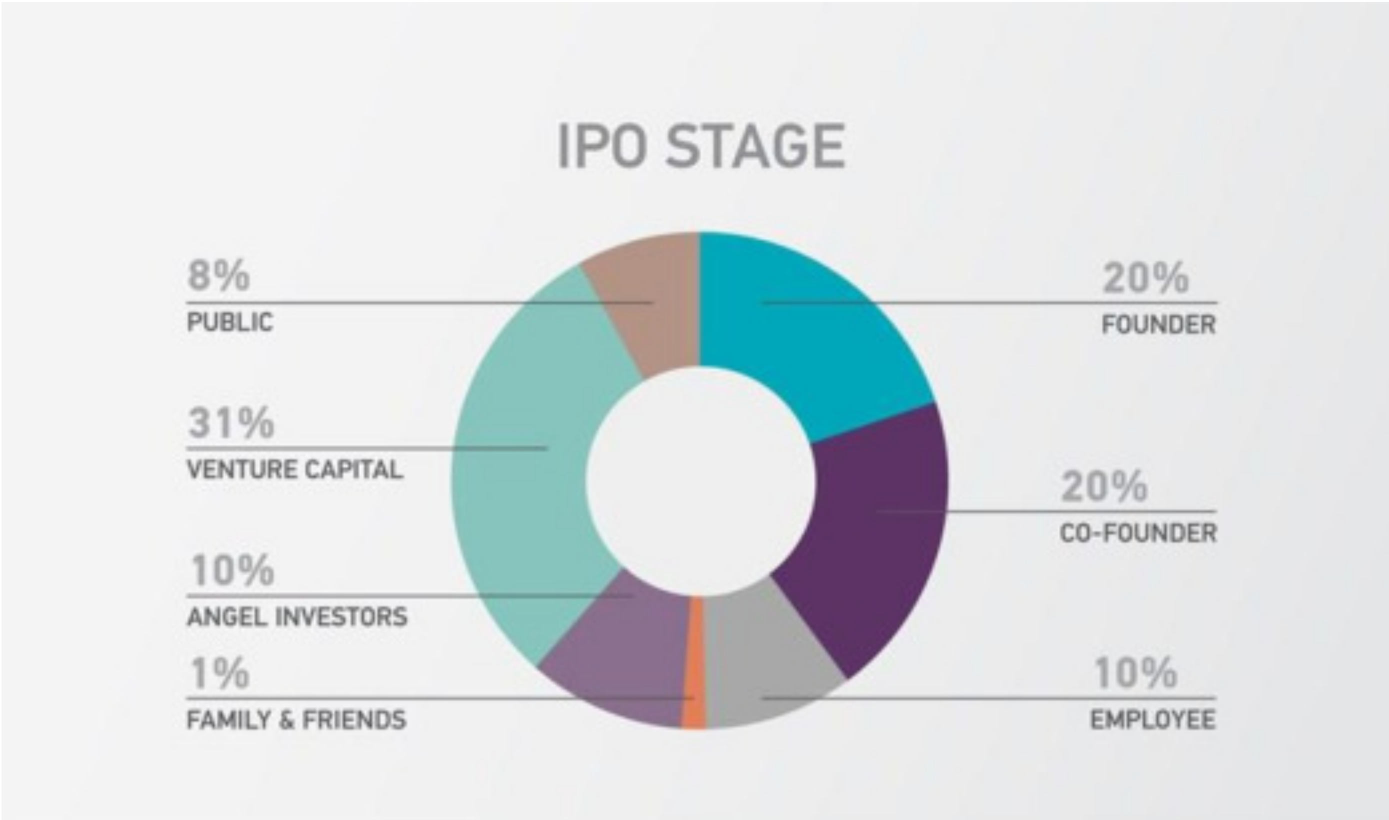
Since their profit can depend on the success of the IPO, they will market you to their biggest institutional and individual investors – generating more interest and competition over the shares and increasing your profits in the meantime.

What do the banks make then in terms of your profits?

It’s rather common for the bankers to get 7% of the money your startup raises in an IPO.

If you look at the pie and a possible sale of $235,000,000 worth of stock, the bankers would make $16.5 million.

Now, if the IPO valuation were $2,6 billion, the rest of the pie would be split like this.



Real-life case study: Facebook's history of startup fundraising explained

Now, I've been providing you with an example of an imaginary division of a pie for startup funding. But imaginary funding isn't quite real life funding, is it?

So, what does all of this look like in the real world – are you *really* able to get $100,000 here and $3 billion there?

Well, if your startup has what it takes then anything is possible. Let's look at one successful startup funding process: Facebook.

Idea stage

The idea stage with Facebook is a little murky. There have been instances where people have claimed to have come up with the idea and knowing who had the first light bulb moment is definitely a bit hard.

In reality, there are only a few people who know the real story and we might never have a satisfactory answer to the question "*Who REALLY came up with the idea for Facebook?*"

However, we do know that Mark Zuckerberg launched a website called Facemash in 2003 that got into all sorts of trouble with copyright and privacy issues.

On February 4, 2004, he launched a revised version called TheFacebook.

Co-founder stage

The website had a restricted membership access, including only students at Harvard College. As the website become more popular, Zuckerberg listed the help of his friends.

Enter his co-founder friends: Eduardo Saverin, Dustin Moskovitz, Andrew McCollum and Chris Hughes.

Each added something different to the table and together the team was able to move forward.

Now, there's no official cap table available to see what the split was between the co-founders – however, it was unlikely to be an even split between Zuckerberg and the others.

Pre-seed investment round

The first big investment didn't take long to arrive.

In fall of 2004, angel investor Pieter Thiel decided to bet on the company's success. Thiel led an early investment round, which saw a handful of investors giving the social networking startup $500,000.

At this time, there were rumors that Friendster –which at the time was the top dog in social networking – offered to buy the company for $10 million.

But Zuckerberg and co had other plans – they knew something bigger is on the horizon.

Seed and expansion capital

The networking site starts growing rapidly, amassing users in campuses across the US. By the start of 2005, the site has nearly a million users in Harvard, Stanford, Columbia and Yale.

The company now embarks on a series of investment rounds that bring it closer to an IPO and a series of buyout attempts from rival companies.

First, the company needed more start up capital to continue scaling the business – it wanted to move beyond the university campuses.

So, there is a **Series A** round in 2005.

Accel Partners, a venture capital firm, led the investment round with the total funds raised hitting $12,7 million. The post-money valuation of the company hits $87,5 million.

The investment round featured angel investors Venky Harinarayan and Anand Rajaraman as well, who recalled the investment decision in a Forbes article by stating, "*I remember* *talking to Accel after [*an event at Stanford]. *The key reason they invested was because they talked to Stanford students and found out that they use Facebook for two hours a day.*"

Series B followed shortly in April 2006.

The lead investment came from Greylock Partners, with Thiel and Accel featuring strongly during the round. The total raised this time around stood at $27.5 million, increasing the post-money valuation to $500 million.

Shortly after, Yahoo supposedly tries to acquire the company for $1 billion, which was rejected by Facebook.

Again, Facebook believed that more is to come.

The two venture capital-led investment rounds are followed by a number of **Series C** rounds.

The first takes place in October 2007, as Microsoft Invests $240 million into the company for a 1.6% stake.

In November, businessman Li Ka-Shing follows with a $60 million investment with Horizons Ventures.

The start of 2008 sees Internet company European Founders Fund investing $15 million.

Ka-Shing doesn't seem to get enough and Horizons Ventures invests another $60 million in March 2008.

In total, Series C sees Facebook raise $375 million.

Interestingly, the company didn't just rely on equity investments.

In May 2008, the reports show Facebook received $100 million in debt financing (i.e. a loan) from TriplePoint Capital.

The company continues with the investment rounds beyond Series C.

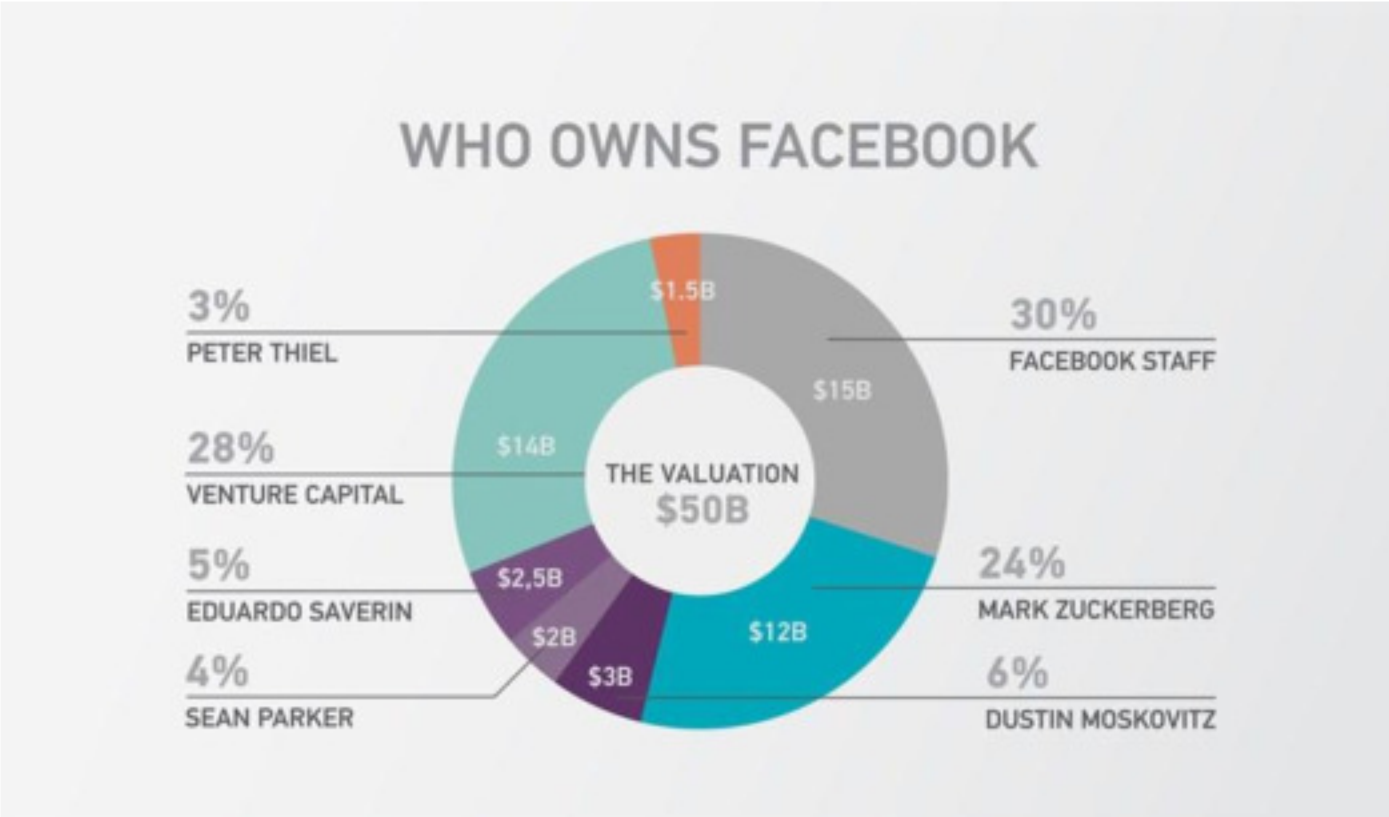
In 2009, Facebook receives plenty of offers but valuations of $2 billion and $4 billion are turned down and the company continues to increase its user base.

In May 2009, Facebook embarks on **Series D** with a $200 million investment from DST Global. The post-money valuation now stands at $10 billion. DST Global also buys back early employee shares later that year worth $100 million.

At the end of the year, a **Secondary Market round** sees Elevation Partners invest $120 million in Facebook.

The start of 2011, witnesses a **Private equity-led round**, during which Goldman Sachs and DST Global provide $1.5 billion in fresh capital.

So, after all those rounds, the Facebook pie looked like this:



Source: *Quora*

IPO stage

As you saw above, Facebook managed to amass a lot of interest at each stage.

It had numerous exit opportunities, but it declined trade-sales and decided to go with an IPO.

The IPO took place on Friday, May 18^{th}, 2012. At the time, it was the biggest technology IPO and the biggest in Internet history.

The peak market capitalization was over $104 billion, with the share price starting at $38.

Since then, the company has had its fair share of ups and downs in terms of the share price – perfectly illustrated in the table below.

Source: City A.M. *article*

What happens to the pie?

So, I've introduced you to the imaginary funding round and showcased it with a real life example.

As you can see, startup fundraising is about the give and take.

This might make you wonder… Why don't you just hang on to the 100% and find another way to make money? Bootstrapping! You mentioned it at the start so screw investors this is what I'll do.

You're missing the crucial point about startup funding.

The pie you have? It isn't static – by fundraising you are actually growing it.

Think about it like this: at first, you have a basic tomato pie. You own 100% of it, sure, but it's still just a small tomato pie.

Your co-founder brings in some pepperoni and takes away 50% of your pie.

OK, so, you lose 50%, but you add pepperoni – who doesn't like that?

Then comes the angel with some feta cheese and you slice the pie further while *adding to it*. Eventually, you have tons of ingredients creating a tasty pie although you might only own 25% of it.

The main point to understand is that the company grows as investment flows into it.

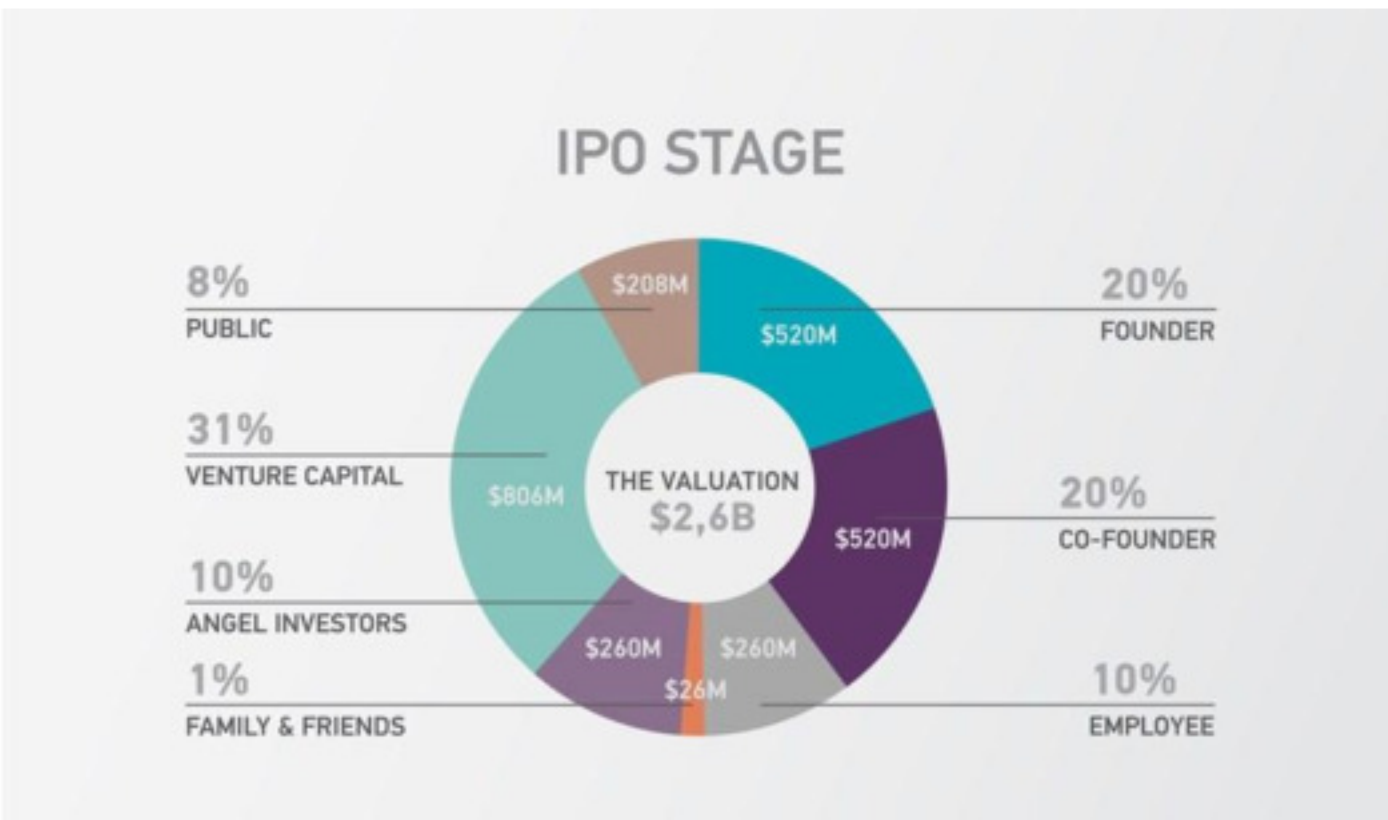
Your portion of the company gets smaller, but the business becomes bigger.

The idea you had was maybe worth $10,000 at the start. However, this isn't much compared to you selling the company with a $2,6 billion valuation later.

Sure, you had ***the full control of the money***.

However, if your business after all this fundraising is worth $2,600,000 then even if you own 20%, ***you are better off financially***.

Having a bit of something big is much better than having all of something little, right?



Startup funding in a nutshell

"Money is like gasoline during a road trip. You don't want to run out of gas on your trip, but you're not doing a tour of gas stations." – Tim O'Reilly

So, startup fundraising works by raising investments based on your business needs.

You attract capital with your stunning business proposal and use this investment to make your plans come to life – your investment helps you to mature and grow the business quickly, scaling it up to an eventual acquisition or entry in the public market.

However, investors don't want to just hand out the cash to you but in return, you promise them a slice of your business and the future profits in it.

You are essentially asking others to come and make your pie a lot bigger and better, guaranteeing these early investors and helpers will be the first to enjoy the tasty slices your ideas helped to generate.

Sounds simple?

Well, in reality, it isn't and the above smooth ride includes plenty of broken deals and failed investments.

You might succeed in raising a lot of money but your business could still fail.

What do you think? Should you seek high investments or keep it small?

What could be the situation where you might opt for bootstrapping and retaining a full of control of your business?

What did you experience when you have been out and raising money for your startup?