Funding for startups

- Startup funding options
- Startup funding stages

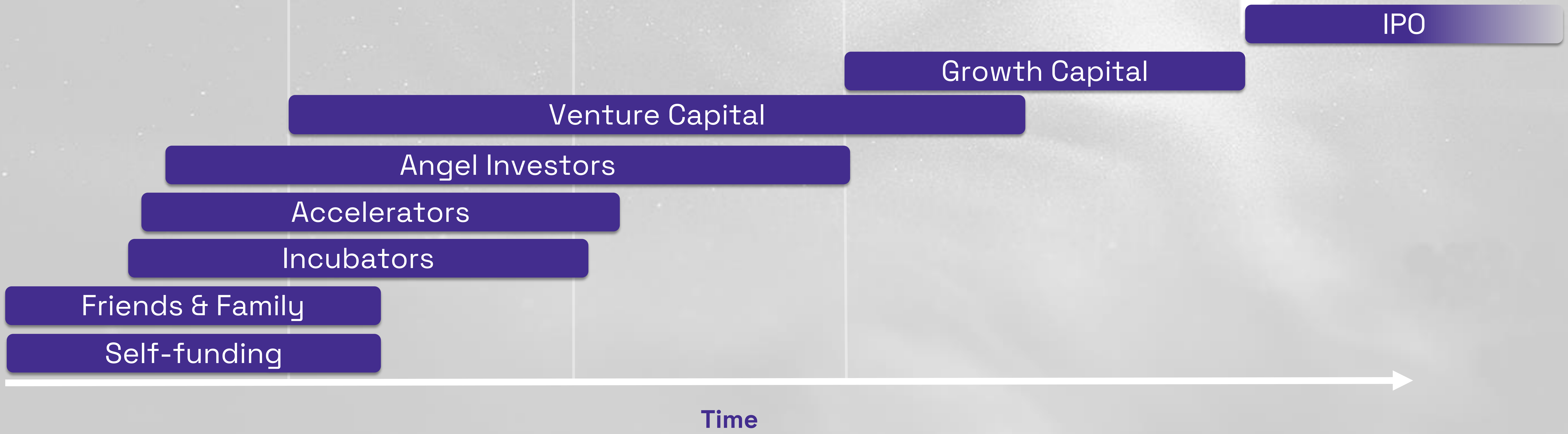
Startup funding options by stage

PRE-SEED
Product: idea, prototype
Round size: 50k-1M €
Revenue: early or missing

SEED
Product: MVP, product launch
Round size: 250k-5M €
Revenue: early revenue

SERIES A
Product: ready product, product-market fit
Round size: 2M-15M €
Revenue: 1M€ annually

SERIES B+
Product: mature product, new products
Round size: 10M+ €
Revenue: consistent growth



Round and revenue sizes vary by verticals and geographies

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Startup funding stages

FIRST FUNDING

First funds invested into the company are usually the founders' savings (self-funding) and capital from friends and family (FF).

PRE-SEED

Founders explore the possibility of building an idea into product/service. Funds are used to take the idea off the ground and develop a prototype, proof-of-concept. Round size is usually up to 1M €.

SEED

The product/service will be launched, and startup builds traction to generate early revenue. Focus is on product development and market research – it is essential to test product-market fit and business model. Round size is usually between 0,25M-5M €.

SERIES A

Startup has a reliable revenue stream, a proven business model and a strong strategy. Funds are used to grow the user base, boost growth and carry out the long-term strategy. Round size is usually 2M-15M €.

SERIES B+

Funds are used for expansion (increase market share, enter into new markets), development of new products, acquisitions. Round size after series A is usually more than 10M €.

Self-funding

Self-funding or **bootstrapping** means that founders use **personal finances** and/or **operating revenues** to fund a startup's activities. No outside investments are used.

Advantages

- **Maintaning the ownership of the business** – no dilution
- **More freedom to decide** – no outside influencers and more control over the direction of the business
- **More attractive for potential investors in the future** – startup has proven track record of managing money responsibly

Disadvantages

- **Founders own personal finances on the line** – personal risk
- **Slow growth** – without enough capital the growth might be hindered
- **Lack of credibility** – involving respected investors can help to build credibility

Friends & Family

Friends & Family (FF) funding is raising funds from close people through personal connections.

Advantages

- **Flexibility and affordability in raising funds** – may lend funds interest-free, may not require any equity
- **Both sides already have some kind of trust between each other** – e.g. FF may not require a detailed business plan
- **FF can give you the time to build your business on your own schedule**

Disadvantages

- **Relationship and business entanglement** – potential damage in personal relationships if the business fails
- **Limited capital** – FF might not have sufficient capital

Incubators and Accelerators

Business incubators are usually (partly) publicly funded support structures that establish a relatively loose relationship with portfolio companies. Incubator's purpose is to help entrepreneurs grow their business by providing supportive services like mentoring, training, providing a workspace, networking, funding. Incubators do not always provide funding.

Startup accelerators are usually for profit commercial setups. Their business model is based on a portfolio strategy, relatively low entry valuations and extensive mentoring period (usually 3-6 months). Accelerators help entrepreneurs get established and boost their growth. Most accelerators invest funds in return for an equity stake in the company.

Main differences include:

- accelerators are cohort based, incubators accept companies on an ongoing basis
- incubators are focused on disruptive innovation and technologies, accelerators are more focused on boosting the business
- accelerators usually do an equity investment, incubators often charge a monthly fee
- accelerators run a fairly intensive programme, incubator services are less structured

Examples

- **Estonia's** startup ecosystem incubators and accelerators
- **Finland's** startup ecosystem incubators and accelerators
- **Other** incubators and accelerators

Angel Investors

Angel investor is a private investor who provides financial backing for startups or entrepreneurs, typically in exchange for ownership equity in the company. Besides supporting with capital, angel investors usually provide mentorship, advice, expertise and network connections. The average funding round size can vary from 50k-500k €

Advantages

- **Credibility** – from being associated with the investor
- **Mentoring, advice, expertise and network connections** – many angel investors have been successful entrepreneurs
- **Flexibility** – angel investors are usually more flexible since they invest their own resources

Disadvantages

- **Unclear follow-on capacity** – no guarantee that angel invests in later rounds
- **Less control over the business**
- **Equity dilution** – founder's share of the business decreases

Angel networks

- ESTBAN
- FIBAN
- DanBAN
- LatBAN

Venture Capital

Venture Capital – financing provided by a group of investors to startups exhibiting high growth potential in exchange for equity. Venture capitalists are typically focusing on larger deals than angel investors. Investment from VC fund in most cases automatically means some sort of support (expertise, advice, etc.) for the startup. Funding rounds start from 1M €.

Advantages

- **Follow-on capacity** – high possibility that VC invests in later rounds as well
- **Credibility and reliability** – from being associated with the VC
- **Expertise, advice, networks** – VCs have experience in building and expanding startups, part of the business community
- **Large amounts of capital can be raised**

VC associations

- ESTVCA
- FVCA
- NVN
- EVPA

Disadvantages

- **Less control over the business**
- **Equity dilution** – founder's share of the business decreases
- **Fundraising can take time** – the process can be quite time-consuming

Growth Capital

Growth capital – also known as expansion capital is a form of capital investment usually undertaken in the form of minority investment in relatively mature companies. The companies involved in investment are already operating in an established market with proven products. The risks included are related to execution and management. Growth capital rounds are typically 10M-100M€.

Growth capital targets companies which:

- are looking for structural and transformational change
- have significant growth potential
- want to expand their business operations
- are looking for acquisition possibilities
- have an intent to enter a new market

Key distinctions between venture capital and growth capital:

- Growth capital focuses on investing in mature companies, whereas a VC would focus on early-stage companies that have an unproven business model
- Companies who attract growth capital have lower failure rates compared to companies that are targeted by VCs. VCs take on more risk than growth equity companies.

GrowthCap – examples of growth equity firms

IPO

IPO (initial public offering) is a process by which company launches initial shares of their company to the public in order to raise funds. After an IPO the shares of the company will become publicly tradable.

Advantages

- **Publicity and credibility** – more attention, potential influence
- **Exit opportunity** – more potential buyers, better liquidity
- **Large amounts of capital can be raised**

Disadvantages

- **Additional regulatory requirements and disclosure** – it can be a burden and time consuming to meet all the requirements
- **More distinctive market pressure** – different stakeholders, different opinions, financial statements open for public
- **Less control over the business**

Other funding options

- Crowdfunding
- Grant funding

Crowdfunding

Crowdfunding is the use of small amounts of capital from large number of individuals to finance a new business venture. Usually, there is a platform connecting the company and the investors. Some examples include:

- **Debt crowdfunding** – lending through a platform
- **Reward crowdfunding** – investors gain a non-financial reward or product in exchange for their contribution
- **Equity crowdfunding** – capital in exchange for equity

Advantages

- **Great way to test the market –** good way to test product-market fit
- **Good marketing tool –** a successful campaign may attract media attention and additional investors
- **Fundraising process may be faster and easier –** oftentimes the requirements for application are less strict than for traditional financing options.

Disadvantages

- **Successful campaigns require detailed planning–** upfront commitment (time and money) is needed.
- **IP concerns –** IP needs to be protected to avoid idea theft.
- **Platform fees** - evaluate all fees before deciding on a platform.

Grant funding

Grant funding is a financial award given by a federal, state, or local government authority for a beneficial project. It is effectively a transfer payment. The grantee is not expected to repay the money but is expected to use the funds from the grant for their stated purpose, which typically serves some larger good.

Advantages

- **Cash –** significant amounts of funding are available
- **Non- equity –** founders do not need to give away equity
- **Persuade equity investors –** grant funding is a good way to develop the product and increase the Company's investment readiness

Disadvantages

- **Time and effort intensive –** applications are often lengthy and complicated
- **Strict rules –** rules regarding spending the funding
- **Late cost reimbursement –** some or all costs will be paid after the costs have been incurred and reported
- **Match funding –** co-financing is oftentimes needed

- EIC Accelerator
- EUROSTARS/EUREKA
- Other grants/programmes

Sources

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