

From Pre-Seed to IPO: Startup Funding Explained



Building a startup is going to be the most rewarding, but challenging thing you will ever do. You've identified a significant gap in the market and an opportunity to make a difference. There's a potentially successful business and lucrative exit at the end of it for you. But know that this is a marathon, not a sprint, and to get there, you're going to have to move through several stages of funding.

Every business needs capital, to cover cash flow, pay for staff and services, invest in product development, and market and scale the business. For startups, much of that capital comes from a series of fundraising rounds. Each round generally has a different purpose and will attract a different profile of investor. To give your startup the best possible chance of success, you're going to need to navigate these fundraising stages expertly.

Startup funding explained

Essentially, startup funding describes the process where you approach potential investors to support your business's growth with a sum of money, in exchange (typically) for equity—a percentage of your business.

Investors want to get involved because the potential rewards for backing a successful startup are significant. Meanwhile, you can use that investment to help generate your startup's success.

The fundraising journey: What to expect

The fundraising journey is a time-consuming process, but for most startups, a necessary one. And, you should prepare for rejection and get accustomed to it. A promising startup gets 17 or 18 "no's" for every "yes."

What you have to remember is that these are normal, and each "no" will often have less to do with the startup in question than a particular context or concern for each investor. Every rejection stings, but it's important not to let it demoralize you. Many deals are closed sub-optimally simply because founders are ground down by the process, slightly panicked, and want to be done with it.

At the same time, use the rejections as an opportunity to learn. If you keep hearing the same feedback over and over again, you should take it into consideration and act on it before pitching to more people.

The stages of startup funding

Each stage of startup funding is suited for a particular stage of the startup's growth. Understanding the nature of each stage, and what investors are looking for, will help you to identify the point where your business is ready to start getting in front of relevant investors.

Pre-seed funding

Pre-seed funding is the earliest stage of the startup funding cycle. It's also the newest. Where previously entrepreneurs could only expect funding interest to start at the seed stage, investors now see the value of supporting startups at an even earlier stage.

Often, pre-seed funding comes before a startup has an MVP... or even much more than an idea. It's funding that a founding team will pitch to investors to get the money they need to set up the basic infrastructure of the business. It is also typically used to develop the MVP, and achieve early milestones like finding the first customer and making the first marketing investment.

Traditionally, pre-seed funding comes from the founders themselves, their families, and the occasional angel investor that likes to get in with a business early. It's typically going to raise anything from \$150K to \$1 million.

However, increasingly investors are taking part in the pre-seed funding stage. A really good business case and pitch, backed by a strong team, might secure a founder more than that in exchange for some early equity.

Seed funding

Seed funding is the traditional entry point for investment. For many years it was dominated by angel investors, but increasingly, venture capitalists saw value in taking risks by backing startups at their earliest viable stage. At this point, a founder will be looking to raise between \$1M and \$5M (though this number is increasing with the growing role of VCs).

At the seed stage, founders will be starting to shape the organization. They'll make their first critical hires (generally, a startup will have between 2-10 people by the time the seed investment has been deployed). They will iterate the MVP into something that's more market fit, and will onboard their first customers. A startup in the seed phase will

start having some revenue coming in, and will commence some marketing to find the ideal customer base.

A good example of how a startup will look at seed funding is the Australian video startup, Vloggi. They sought seed funding from a combination of angel investors and VCs following a successful pre-seed raise of \$750K. The \$4 million in total they were looking for was to grow the business from the initial customer base of 600 users and start to scale up the business.

Series A funding

Several decades ago, Series A funding was the point where a startup would hope to attract venture capitalists and institutional investors for the first time. Structurally, a business will look more like a rapidly growing enterprise than a scrappy startup at this point. It will attract interest beyond the very earliest of adopters, and catch the attention of competition.

A company seeing Series A funding has got a finalised product and an established user base, with a clear path for further growth. Revenue, while still small, will be consistent, and the goal of the company will be to rapidly scale, establish a long-term growth strategy, and keep the company liquid until the revenue can finance the business by itself.

It's a big hurdle to convert seed interest in a startup to Series A funding. Less than half of all companies that are seed-funded achieve Series A funding. The amount of money given in Series A funding is far more substantial (\$15 million to \$20 million), and with that investors will need to see more to convince them of the potential behind the startup.

Series B funding

By the time your business is canvassing Series B investment, it's a proven business. The customer base is growing, the product-market fit has been validated, and the opportunity for further growth is clear. Series B funding is significant—anything from \$15 million to \$900 million, but somewhat ironically founders tend to find this round of funding much easier than Series A.

Investors—and at this point, you're attracting the attention of the major institutional players—see that a startup that has progressed to this point is a fairly safe bet. It won't

be certain whether the startup is the next big unicorn or not, but investors can reasonably expect some kind of return on investment for their Series B funding spend. Especially considering that the startup still has a lot more potential growth from here.

Freight procurement startup, Emerge is a fascinating example of Series B funding in action. The company raised \$130 million in funding (using AI to make the pitch, no less!), and at that point had 250 employees, 1,000 shippers and 225,000+ loads to manage. Emerge was a fully-fledged business, but needed a substantial investment to grow further.

Series C funding

Series C funding is the final round of a traditional private equity funding cycle (though in many cases organizations now go on to a Series D, E and F round too). Series C is the big-ticket investment round, for anything from \$30 million to multiple billions of dollars. It's used for growth when the initial startup's growth trajectory has started to plateau from organic growth.

Founders will deploy Series C funding to expand into new markets (for example, grow internationally), acquire smaller businesses, and develop new products and market offerings. At this point a startup is not really a startup any longer, but rather an established and proven business.

IPO

The final stage for most businesses is to take the company public and list it on the stock market. The IPO provides the business with a deep pool of new money to use, which it will deploy in a similar manner to Series C funding. It will be used to fuel growth through new markets, acquisitions, and new products.

The IPO is also the point where many founders look to exit, as they will earn a sizable amount of money from the business that they built from the most humble roots. Some will stay on in a Director or advisory role. However, in most cases, startup founders see the wisdom of handing a listed company over to an experienced CEO to manage going forward.

Other types of startup funding

There are other ways to fund a startup that don't involve attracting investors. The benefit to doing so is that you will retain control of the business equity, though in most cases it's going to be hard to raise more than what you could expect from a pre-seed investment round at this stage.

Loans

A loan can give you a large amount of money up-front to fund critical investments. However, it has the downside of building debt that would not typically be owed were you to attract investors instead.

Crowdfunding

With crowdfunding, you aim to raise money by getting a lot of people (often your customers) to "chip in" a small amount of money. If you're able to catch the attention of thousands of people, then the revenue-raising can be significant, but that can be hard for a new startup without existing customers.

Bootstrapping

Some startups are also able to self-fund. Either the founder approaches the company with a very long-term view of organic growth from the outset, or has a pool of savings to invest in themselves. It's also how many startups begin, before the founder realises that to really start to grow, they're going to need startup funding.

How many rounds of funding before the IPO?

For a modern startup, there will be four or five rounds of funding before the company is in a position to IPO (depending on whether they seek pre-seed funding right at the start or not). Sometimes a startup will enter a Series D, E, or F round of funding. This usually occurs if the founders failed to get the company into position for an IPO from the Series C round, and need additional capital to reach those targets first.

It would be a rare startup indeed that can jump from Series A or B funding directly to an IPO. Most companies at this point lack the scale or stability to meet the requirements for listing.

Can startups survive without funding?

Technically, a company can survive, and even thrive, without funding. Bootstrapping through the early slog, and redeploying profit to steadily grow the business is an option. Especially if the founder is comfortable with the possibility that their business will only ever scale to an SME size.

However, for any founder that wants to achieve substantial growth, speed is of the essence. For a company to establish its competitive moats, find a product-market fit, and attract the best talent to make the MVP something that can find a wide audience, being able to access investment capital is essential.

Settle in for a long, but rewarding journey

None of the above happens quickly. Each round of funding involves many months to secure capital raising, followed by a year, or longer, to convert that capital into growth and reach the next stage. When you're starting out on your startup journey, look at 10-12 years to be a benchmark for how long it will take you to get to that IPO.

If you're sitting on a unicorn it might happen quicker. If you hit some road bumps and need to go to Series D, E, or F funding it might take longer. However long it takes, you will find the process enormously rewarding, because at each stage you'll find new validation in your startup idea. You'll be able to address your customer's problems better and, with each new stage of growth, you come one step closer to a sustainable business.