



A BEGINNER'S GUIDE TO FUNDING FOR TECH AND DIGITAL BUSINESSES

This guide - originally prepared for entrepreneurs and founders of tech start-ups – aims to provide information on the different sorts of investment available. We have included this in the Digital Economy Module so that city practitioners working in this space have a basic understanding of the investment options and stages available to tech start-ups.

Below we consider the difference between pre-seed, seed, and series A, B, and C rounds and briefly touch on crowdfunding and bootstrapping: Everything a first-time founder needs to know about the structure, requirements, payout amounts, and process of funding rounds.

You may already know just how long and difficult the fundraising process is. Despite its challenges, when successful, startups can proudly walk away with all the money they need to enable their start-up to grow and flourish. Only the luckiest few can raise all the money they need from the generosity of their friends and family alone; the rest need to raise rounds of funding - which often ends up taking more time than expected.

Most founders believe wholeheartedly that their start-up is the next big thing, but convincing other people to invest their hard-earned cash into it, understandably, isn't easy. It takes a lot of hard work to raise money at the same time as continuing to run the business - particularly for sole founders. Not only that, but equity funding also means that your investors are entitled to know and have a say in how your company is run. Did you know that Travis Kalanick, the founder of Uber, was ousted from the company by its investors?

However, despite its challenges, thousands of start-ups successfully raise funding rounds every year and prove that the rewards outweigh the risks and potential failure. So, just how do the different funding rounds work?





How does funding work?

Before we dive into the different series of funding, it's important that we understand exactly how funding works. As a company grows and continually raises money year-on-year, it usually advances through the different funding stages and rounds (A, B, and C).

On the other side of the picture, there are potential investors. Of course, in an ideal world these people will believe the company they're investing in truly is going to change the world in some small or large way, but they'll also be looking for some kind of benefit from their investment. The majority of investments, for this reason, means that the investor gains partial ownership of the company. If the company earns a profit, the investor will also make a profit. It's a win-win situation for all those involved.

As investing/funding a company is quite a big decision, a lot of work goes into deciding whether or not the company has legs. Analysts at venture capital funds will undertake a valuation of the company that they may be investing in. These valuations look at management, market size, track records, and risk. They also consider growth prospects and the maturity level of the company. It's these factors and considerations that impact the number and type of investors that are likely to get involved. Obviously, this makes this process crucial to the funding round.

Let's look at the different series of funding, from pre-seed all the way to series C.

Pre-seed funding

The very earliest of stages is the pre-seed series. It's a relatively new concept, and not always considered in the funding conversation - but we think it is an important part. Pre-seed is commonly known as that first part of the journey, where the founders are getting the company or the idea off the ground. Pre-seed investors are usually the founders themselves, or family and close friends who offer to help with the initial costs and developing the business idea. Also, investors might not be looking for anything in return at this stage and they just may want to help - or they could be the founders themselves. It's important to know the difference between pre-seed funding and seed funding. This distinction will ensure that you clearly know who will invest, and why.

Seed funding

Seed funding is the second stage. It is the first official equity of the funding journey, typically representing the first serious money that the company or venture raises. In fact, many companies don't ever extend beyond seed funding.

Seed funding is the perfect name, especially when you look at it like planting a tree. It's a helpful analogy that makes understanding easier: You plant the "seed", the first key part of making the tree grow; Likewise, you plant the first bit of money into a company, and it's a crucial part of making your business grow. However, there are a range of other factors that need to fall into place to ensure that the seed grows into a strong and healthy tree. Businesses need dedication, perseverance, effective management, supportive advice, and a continuous funding stream to ensure that it evolves into a proficient enterprise.

Seed funding is essentially the first step, helping a company finance integral early stage elements such as market research and product development. This means that those that invest at the seed stage can have some say over the final products and who the target demographic is. In addition, seed funding can also help to hire in people who can market and develop the company.



Who invests in seed funding?

At such an early stage, you might be wondering who even invests in seed funding? There's actually a large degree of people who may be interested in funding this. These could be:

- Friends
- Founders
- Family
- Venture Capital funds
- Incubators (companies that help a new start-up, while also providing services and training)
- Angel investors

The last is one of the most common types of investor in seed funding. 'Angels' tend to fund and appreciate riskier ventures. For instance, they're likely to put money towards a start-up with little track record. Obviously, they usually expect an equity stake in the company in exchange for their money.

How much money is involved in seed funding?

Seed funding rounds vary significantly, depending on the company, the idea, and, well, who you know. Some start-ups feel that all they really need, in order to get their company off the ground, is the seed funding round - these companies won't even engage in series A, B or C of funding. However, the majority of ventures do go on to raise these rounds.

Series A funding

The next step beyond seed funding is series A - for all those companies that need to take their funding further. This is usually when a business has developed more of a track record, has consistent revenue figures, and an established user-base.

Series A funding will enable a company to further optimise their business - by making better products and marketing their company more efficiently. It might create an array of new opportunities, which can promote the company's product or service to different markets - making the venture more profitable. Unlike with pre-seed and seed funding, it's important that a company develops a business model, which proves how the company will generate long-term profit. Seed start-ups tend to be extremely optimistic, with lots of great and exciting ideas, but they have very little idea of how the company will realistically work. Series A proves to be a little more practical, based on logistics, experience, and statistics.

Who invests in series A funding?

A lot more money is involved with series A funding, which drastically changes the type of people who invest. Straying away from family, friends and angel investors, series A investors are generally large venture capital funds (unless you are fortunate enough to have extremely wealthy friends and family!). When a smaller fund invests in a subsequent round beyond seed, it's called 'following on'. Investors are not just looking for a cool idea, they're looking for a company that has a strong track record and trustworthy strategies to make them money. These investors often engage with the company in a more strategic way. They make decisions to do with its future, and pull other investors into the picture where necessary.

How much money is involved with Series A funding?

Series A funding often involves a lot more money and companies going through series A rounds could be valued at several million. In the UK, most series A rounds range from 2-10 million euros - but bear in mind the US, where series A rounds have reached highs of \$15 million because of a more mature market.



Series B funding

Series B is easy to remember, as it's B for "build". These rounds are all about taking companies to the next level - way past the initial development stage. Investors are usually investing in an established company that wants to expand their market reach.

Series B funding is for those companies that have been through seed and series A and have now developed user-bases and are trying to build their company up to new heights. Series B funding commonly focuses on sales, advertising, tech and business development. For example, these investments might allow a company to make more senior hires and the associated costs. Series B funding is often led by the same people as Series A. The investors may differ slightly, though.

Who invests in series B funding?

Series B funders are looking for the next stage of growth, and ultimately more revenue. Series B is more often than not equity-based financing. Many of those that invest in Series B are linked to Series A investors - either they're the same people ("following on"), or they've been made aware of the venture by the initial investors. Series B funders also include a new wave of venture capital firms, most of whom specialise in late-stage investing.

How much money is involved with series B funding?

As you can imagine, Series B funding involves the larger amounts that are necessary for a company to really get off the ground. Series B companies themselves value at the mid-millions. Series B rounds often come up somewhere between 5 million to 15 million euros (in the EU).

Series C funding

Companies that make their way to Series C funding are already successful and profitable. They're essentially looking for additional money that will help them to develop new products, expand into new markets, and even buy other companies. Series C funding is commonly used when a company wants to begin another venture. For instance, a hypothetical beauty store already proved to have huge success in the US may complete market research and conduct business planning, and find that they want to start a new venture in Europe; this is where series C funding would come into play.

Who invests in Series C funding?

Once again, the people that invest in Series C funding are expecting a big payout of some kind - but on a larger scale. The reason being the company has already proven that they can be successful, and with the correct market research the investment can almost assuredly create immense profit. Series C investors include private equity firms, big secondary market groups, hedge funds and investment banks.

How much money is involved with Series C funding?

As you can imagine, Series C funding involves a serious amount of money. Of course, this is predominantly because it is seen as less of a risk than early stage funding, and the payout can be more favourable. Companies can raise hundreds of millions, and basically ensure that the company will develop on a global scale. Investors typically trust this kind of investment, as the company already has an established, strong customer base, revenue stream, and a proven track record of growth. That makes it a smart business investment. In the EU, series C can be anywhere from around 15 million to 100 million euros.



Before closing, we should also consider 2 other routes that start-ups are increasingly considering when looking at moving their company to the next steps - crowdfunding and bootstrapping.

Crowd funding

Crowdfunding is where a project – or start-up - is financed by raising funds from a large number of people, typically via the internet. There are 3 main types of crowdfunding:

- **Equity based crowdfunding** - the sale of a stake in a business to a number of investors in return for investment
- **Loan based crowdfunding** - funds are borrowed from lots of people online rather than from a bank
- **Rewards based crowdfunding** - Individuals donate towards a specific project with the expectation of receiving a tangible (non-financial) reward or product at a later date in exchange for their contribution

As well as raising funds, this approach also helps to validate an idea or project and generates enthusiasm amongst the 'crowd' creating valuable advocates and project champions.

Bootstrapping

An individual is said to be bootstrapping when he or she attempts to found and build a company from personal finances or from the operating revenues of the new company. Compared to using venture capital, bootstrapping can be beneficial, as the entrepreneur is able to maintain control over all decisions. On the downside, however, this form of financing may place unnecessary financial risk on the entrepreneur. In addition, bootstrapping may not provide enough investment for the company to become successful at a reasonable rate.

Knowing the difference between these different types of funding will not only help companies but also investors and the organisations that bridge the 2 - sometimes cities. Businesses can raise capital, and evaluate entrepreneurial prospects, as well as understand where and what the money will be going towards. Though the rounds are essentially the same concept - a company asks for money, investors offer cash in return for an equity stake - every single stage differs quite profoundly. Importantly, every company also differs in terms of maturity and risk levels, making how much money and how quickly capital is raised extremely variable from company to company.

We hope this article helps you to understand funding and investment a little bit better.

Adapted for [TechPlace](#) from an original piece by Darren Balcombe, Deputy CEO of Capital Enterpris