

## 6.8: Start Up Funding Options

In modern entrepreneurship, “funding” is mentioned so often that it almost seems like a required step in the process. New companies, particularly companies that are developing brand-new products, often don’t have customers or revenues when they start. These startups need money for product development, and to support the company’s operations until revenues (sales) pay the bills. Often, the more innovative the product, the longer it will take to develop, or to reach a large market. So a new company needs money to develop and survive during this innovation startup period.

Anyone who has been exposed to entrepreneurial success stories of the past fifty years—from Apple, Microsoft and Amazon to Google, Facebook, Uber, and Airbnb—is familiar with the vital role angel investors, venture capitalists, and initial public offerings played in funding these multi-billion-dollar success stories. But it wasn’t always this way. Prior to the twentieth century—unless you were starting a new railroad or oil or steel company—most likely your new business was a small retail business or farming business. For small businesses, there really was no “product development” and your market was easily identifiable: they were your neighbors.

In those earlier times, if your business made a profit then you might have some extra money to expand. Today we call this “organic growth”: funding the growth of your new company from revenues from sales (to customers).

Most “small businesses” fall into this category: right from the very beginning they have a product or service they can sell to customers who are very accessible. They don’t have to develop any new product innovations, hire a large team, or spend a lot of money trying to find customers. Thus, most small businesses don’t need outside funding. These businesses can be started with the founder’s personal savings or credit, and grow as revenues grow.

But if your startup is developing something brand-new or cutting edge, or you are trying to reach brand-new customers or markets, then it is likely you will need external funding—i.e., funding that does not come from the entrepreneur’s personal money, or from the company’s revenues. Venture capital, angel funding, debt, grants, and crowdfunding are the most common sources of funding for early-stage companies.

### 6.8.1 The Language of Funding

Before we dive into the world of startup funding, you will need to learn some of the language. Even studying the common funding lingo provides a good introduction and insights into the startup funding landscape.

**Note:** The list below is not exhaustive, just some of terms we will use in the next sections.

#### A. Stage/Type of Company

Term	Definition	What This Means to You
<b>pre-Startup</b>	An idea-stage company—just an idea on paper (no product or service yet)	Usually never funded by an external funding source, except for “friends and family” and certain grants
<b>Startup</b>	A founder or team who have identified a technology, market, and business and are in the process of developing a product or service, or in the process of commercializing one	The term varies from a very early-stage product or team, to one that is operating and releasing products. Usually a startup is still trying to find a sustainable business model, for a relatively new market, and expecting significant growth.
<b>Small Business</b>	An operating business that already has customers and a product/service. Usually it is selling a proven product or service to an existing market.	Small businesses already have a proven business model but differ from startups in that they are already operating, and are not structured for rapid growth.
<b>Early Stage Venture</b>	Often synonymous with “startup”—but usually implies a startup that has made progress with developing a product and attracting customers.	

<b>Growth Company</b>	A company, that for the moment, is more concerned with attracting a large customer base (market share) than with profitability	Many modern tech companies—particularly in brand-new markets, or new technologies—focus on growth first. This way they can grow fast and dominate the market (and eliminate competition), then they can focus on profitability.
<b>Social Entrepreneurship / Social Venture</b>	A company whose primary concern, primary service or product is focused on advocating or advancing a “social cause” or some other kind of advocacy (eg. saving journalism, improving trust in media)—rather than profits	The ultimate measure of these companies is not in revenues or profits—but in some other kind of success metric. This usually places these ventures outside the interest of typical funding sources (who need to see a return on their investment).
<b>Investment</b>	Money given to a company, in return for a percentage ownership (shares of stock)	Investors are part owners, and have some say in the strategy and decision making of the company, and (ultimately) share in the profits.
<b>Institutional Funding</b>	Funding from venture capitalists (can also refer to bank loans and investments from large corporations)	Generally, institutional funding means that the investment decisions are made by professional money managers—as opposed to the “owner” of the money.
<b>Angel Capital / Angel Investor</b>	Investments made by (relatively) wealthy individuals—usually they are investing in startups as part of their overall investment portfolio.	Angels are “accredited” investors (who meet certain SEC criteria for net worth and income). Angels usually have little personal relationship with the founders.
<b>Venture Capital / Venture Capitalist</b>	A VC is a professional fund manager. They aggregate investment funding from large institutions then make investments in high-growth companies for potential high returns.	VCs need their funds to make an extraordinary return on investment.
<b>Debt</b>	Loans—usually from banks—who seek low risk	Debt funding almost always must be “secured” by collateral (or assets). If a company owns a building or has equipment, then they might qualify for a bank loan. Most startups lack the collateral to qualify for a loan unless the founders personally guarantee the loan.
<b>ROI</b>	Return on investment—usually stated in financial terms (i.e., percentages)	Most investors in the startup ecosystem are looking to make back huge returns—many times their original investment—in order to offset the risk. Some investors, however may be looking for other forms of ROI—such as gaining access to new technology or new markets.

<b>Exit/Exit Strategy</b>	An “event” (or transaction) when shareholders are first able to sell their shares for cash (a.k.a. “liquidity”). Usually this means either the company is sold to a larger company, or the shareholders are allowed to sell shares on the stock market (IPO).	Investors usually need an exit in order to see a return on their investment (i.e., someone needs to buy their shares of stock at a much higher price than what they originally paid). Investors want some sense of the company’s “exit strategy” before investing.
<b>Due Diligence</b>	The background checking that investors will do before investing: technical, marketing, financial, legal, and personal (about the entrepreneurs)	
<b>Corporation (S, C)</b>	Only corporations can issue shares of stock. Corporations also provide some levels of legal protection to the managers and founders. Corporations have tax liabilities (and other similar ramifications).	Almost all investors need to invest in a corporation, not other forms of a company.
<b>LLC (Partnership)</b>	A form of a company that is very easy and inexpensive to establish. LLC = limited liability corporation	LLCs are in, in effect, partnerships. There are no “shares of stock” and it is difficult to include investors or incentivize employees or even confounders.
<b>Sole Proprietorship</b>	“The owner is the business.” Often consulting businesses and freelancers are sole proprietorships.	For tax and legal liability, the owner is the same as the company. Sole proprietorships rarely have outside investors.
<b>Board of Directors</b>	A group of individuals elected by the shareholders of a corporation to oversee the management of the company, and to make major decisions for the corporation, on behalf of the shareholders	
<b>Scale / Scalable Growth</b>	To grow fast (in market share, and/or revenues)—particularly the ability to grow exponentially, while only using incremental resources	Venture investors usually look for businesses with the potential to scale. E.g., with \$1M investment, can the company grow to \$200M in 5 years?
<b>(Market) Traction</b>	Evidence that customers are buying and using your product or service—enough such that investors believe that this customer adoption can continue and grow	
<b>Market Validation/Customer Validation</b>	Evidence from customers that your product/service will gain wide acceptance. Market validation is different than traction in that this evidence doesn’t have to come from customers. Partnering with a large or credible company could constitute validation (e.g., a partnership with Google or Facebook).	Market validation (and traction) are important pieces of evidence that investors look for when deciding to invest. Most startups lack a solid track record of revenues and profits, thus investors look for other evidence of future success: traction and market validation.

## B. Round of Funding

Term	Meaning	(implication)

<b>Bootstrap</b>	All money / funding comes from the founders' own savings, credit, etc.	Many tech and media startups can initially be bootstrapped because of the plethora of free/cheap resources for product development and marketing.
<b>Organic Funding</b>	Money for new product development/marketing comes from the company's revenues (not from outside funding).	Often startup founders will perform consulting services or sell other products in order to fund the product development of the company's primary product.
<b>FFF</b>	A.k.a. "Friends Family and Fools"—funding of the startup by sources close to the founders	Usually these funding sources are investing due to their personal belief in the founders, or because they want to support the founders (or cause) for emotional reasons—rather than for purely financial reasons.
<b>pre—Seed</b>	A relatively new term for funding that does not fall within the FFF/bootstrap definitions, and is not quite seed funding	
<b>Seed Funding</b>	Refers to the first "outside money" a startup attracts. Usually this money is to establish proof of concept (product development) and/or proof-of-market (market validation).	
<b>Series A</b>	Usually refers to the first "institutional" funding round for a startup	By this stage, the startup usually has some customers and revenue, and the funding is to help the company achieve significant growth, and expansion of operations.
<b>Series B, C, D</b>	Subsequent rounds of institutional funding, to further help the company expand and grow	
<b>IPO / Initial Public Offerings</b>	When the company (and investors) first sell shares to the public (e.g. the stock market), the company can raise significant amounts of money to fund operations, growth or new products.	This also offers the investors (and founders) a chance to sell some of their stock for (sometimes significant) cash.

There is no set funding path for entrepreneurial startups. The path depends on two factors: What the startup needs (funding requirements) and the potential return on investment.

- **Funding requirements of the startup:** May vary wildly, depending on the type of company, product, product development costs, and expected time until break-even
- **Funding sources:** The preferred investment size, industry sector, expected ROI, and the total they have available

Many small businesses, and service businesses never need outside funding since they are able to generate revenue right away. Other startups need significant funding to develop a product and to grow fast—to dominate a market.

For the former, bootstrap or self-funding may be enough to sustain the operations until revenues can support the company. For the high growth (usually high-tech) ventures, they will need significant external investment—in the millions, tens of millions or even hundreds of millions of dollars. For these companies, the funding path is usually pre-seed/seed funding to prove the idea or market; then successive Series A, B, C investments to fully launch the product, market, and expand and grow the company.

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