AN INTRODUCTION TO STARTUP FINANCE

Raising capital is vital to the survival and long-term success of startup companies, particularly those with the sorts of business models that tend to attract venture capital ("VC") investment. These companies are often unprofitable and therefore need regular infusions of cash to continue funding their operations and growth. This is largely because many of these companies make the strategic choice to channel all of their resources into growing their businesses as quickly as possible to capture a dominant market share before focusing on profitability.

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All companies raising capital must decide which instrument to issue to their investors. For startups, the choice of instrument varies depending on the company's stage of development, investor base, and financial position.

The type of financing instrument that is the right fit for a given startup depends greatly on the company's stage of development. Startups rarely exhibit a strictly linear progression as they grow (as there are inevitable twists and turns along the way). However, many startups generally attempt to follow a fairly well-defined path to success that includes the following stages:

- Idea. All startups start with an idea. Prospective founders take that initial idea and begin to build on it, creating sketches, mockups, wireframes, and rough prototypes so that they can solicit feedback from trusted friends and advisers and potential customers.
- Proof of concept. Next, the founders build a basic version of their product, often called a minimum viable product (“MVP”). The MVP has just enough functionality to allow the founders to test the market reaction to their product as cheaply as possible.
- Building. If the concept is validated by the market, the founders raise sufficient capital to hire additional employees and build a more substantial version of the product to be released to a broader audience.
- Scaling. Once the company has created a scalable version of its product, its focus shifts to expanding its customer base rapidly to capture as large a portion of the product's addressable market as possible.
- Maturity and exit. As the company matures, it turns its focus from maximizing revenue to attaining profitability. Often, however, startups are sold long before achieving profitability. Even many venture-backed companies that complete successful initial public offerings (IPOs) are not profitable at the time they go public.

Even though startups rarely follow a standardized capital raising progression, there are venture financing instruments that are tailored to meet the needs of a startup's investors and founders at each of these stages of development. While a model startup may raise five successive rounds of financing labeled Series Seed, Series A, Series B, Series C, and Series D, startups often label their financing rounds differently if they are concerned about the signal the name of their latest round sends to the market.

The naming conventions for startup financing rounds are fluid in reality. For instance, consider a startup that raises a Series A round of financing, followed by two more rounds that are smaller than what the market often considers a proper Series B round should be. That startup may choose to label the last two rounds Series A-1 and Series A-2 (instead of Series B and Series C). Therefore, a more realistic startup's financing rounds could be labeled as follows: Series Seed, Series A, Series A-1, Series A-2, Series B, Series C, Series C-1, Series D, and so on. A startup's capital raising history is often messy.