

The Start-Up Funding Lifecycle

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The Startup Funding Lifecycle

Startups are like any other business - they need capital

Unlike other businesses, startups rely on outside equity capital,
as opposed to organic growth or debt

Fundraising occurs in definable stages, although every company is different

Key issue for founders is DILUTION

Founding Stage

Who

- Founder(s)

Investment

- Common stock
 - In exchange for services, cash, property
 - Tax implications
 - Governance and control implications
 - Documentation is important

Dilution

- Low valuation
- No dilution

Control / Governance

- Usually no agreement (but there should be)

Founding Stage (cont'd)

FOUNDER STAGE CAP TABLE EXAMPLE

Valuation	??	
Founder A	50.00%	Common Stock
<u>Founder B</u>	<u>50.00%</u>	Common Stock
Total	100.00%	

“Friends and Family” Stage

Who	Investment	Dilution	Employee Equity	Control / Governance
<ul style="list-style-type: none">• Family, friends, not angels	<ul style="list-style-type: none">• Common Equity (sometimes convertible securities)	<ul style="list-style-type: none">• Valuation: low, informal• Dilution: should be minimal (less than 10%)• <i>Consider skipping or using convertible securities</i>	<ul style="list-style-type: none">• Little or none	<ul style="list-style-type: none">• Basic shareholder agreement with stock restrictions

“Friends and Family” Stage (cont’d)

FRIENDS AND FAMILY CAP TABLE EXAMPLE

Valuation	\$1 million (pre-money) (??)
Founder A	45.00% Common Stock
Founder B	45.00% Common Stock
<u>F&F</u>	<u>10.00%</u> \$100,000 cash for Common Stock
Total	100.00%

“Pre-Seed” Stage

Who

- Angel investors

Investment

- Convertible debt or SAFE
 - Convertible note: discount, valuation cap, conversion trigger, rate, maturity
 - SAFE (Simple Agreement for Future Equity): discount, valuation cap, conversion trigger not debt so no interest rate or maturity

“Pre-Seed” Stage (cont’d)

Dilution

- Valuation: Within a low range based on local market and industry
- Dilution: Starts to be material; could be 10-20%; valuation caps and discounts dilute founders

Control / Governance

- Usually not significant

“Pre-Seed” Stage (cont’d)

Crowdfunding as alternative to angels

- Comply with Regulation CF
- Must go through registered “portal”
- Larger number of smaller, unsophisticated investors
- Often convertible debt or SAFE
- Cons:
 - May lack “validation” of angel round
 - Investor relations headaches
 - Securities law requirements that linger beyond round

“Pre-Seed” Stage (cont’d)

PRE-SEED CAP TABLE EXAMPLE

Valuation	\$2.5 million ?? Unknown. Instrument is convertible debt or SAFE	
Founder A	40.50%	Common Stock
Founder B	40.50%	Common Stock
F&F	9.00%	\$100,000 cash for Common Stock
<u>Pre-Seed Angels</u>	<u>10.00%</u>	\$250,000 cash for convertible instrument
Total	100.00%	

**Actual dilution is NOT KNOWN until conversion. Discounts and caps will increase dilution.*

Seed Round

Who

- Seed funds, strategic investors

Investment

- Preferred stock with “seed” terms

Dilution

- Valuation: Higher than pre-seed, still based on local market, industry. Benchmarks may be used.
- Dilution: 10-20%

Governance

- Stock restriction, voting agreements, registration rights. Investors may get board seats and approval rights on strategic actions

Employee Equity

- Now a material part of cap table

Seed Round (cont'd)

SEED CAP TABLE EXAMPLE

Valuation	\$5 million post money.
Founder A	28.25% Common Stock
Founder B	28.25% Common Stock
F&F	6.00% \$100,000 cash for Common Stock
Pre-Seed	7.50% \$250,000 cash for convertible instrument
Employee Equity	10.00% Reserved for grants under pool
<u>Seed Fund</u>	<u>20.00%</u> \$1 million cash for Series Seed Preferred Stock
Total	100.00%

** Pre-Seed round not diluted as much as others because of discount
Dilution falls more heavily on Founders and F&F*

*** Note dilutive impact of equity pool. It does not dilute
Seed investors, who negotiated a 20% stake, post-money on
a fully diluted basis.*

Founders now have only 56.5% of the Company!!

“A” Round and Later

Who

- VC fund or strategic

Investment

- Preferred stock with significant protections and rights for investor

Dilution

- Valuation: Significant
- Dilution: depends on amount raised, but higher valuation reduces impact

Governance

- Significant board representation and approval rights for investors

Employee Equity

- Now between 10 and 15% of cap table

“A” Round and Later (cont’d)

(unrealistically small A round for illustration)

SERIES A CAP TABLE

Valuation	\$10 million post money.
Founder A	22.50% Common Stock
Founder B	22.50% Common Stock
F&F	4.50% \$100,000 cash for Common Stock
Pre-Seed	5.50% \$250,000 cash for convertible instrument
Employee Equity	10.00% Reserved for grants under pool
Seed Fund	15.00% \$1 million cash for Series Seed Preferred Stock
<u>VC Fund</u>	<u>20.00%</u> \$2 million cash for Series A Preferred Stock
Total	100.00%

** Note dilutive impact of equity pool. VC's may require top-up to 10%. It does not dilute VC investors, who negotiated a 20% stake, post-money on a fully diluted basis.*

Founders have lost control!

Questions?



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