

Startup Survival: Raising Capital

Article By:

Joshua L. Gablin

Raising capital or failing to do so, or raising it badly, is often the moment when a startup either grows wings or plummets into the side of a cliff. Founders are stuck trying to keep the lights on today while dreaming about the world domination they'll unleash once the check clears. No pressure.

From deciding whether to offer equity, take on debt, or just hit up a rich uncle, every choice made now leaves fingerprints on the company's future — not just how it grows, but who's actually in charge when the dust settles. Understanding the types of capital available — and the fine print that comes along with it — isn't optional. It's survival.

In this article, we'll dive into the various flavors of startup financing, dissect the difference between equity and debt like a frog in 9th-grade biology class, and walk through key investment terms every founder (and investor) needs to know. Whether passing the hat for the first time or running a seasoned fundraising campaign, this is a quick roadmap . . . or at least, your 'Don't Get Totally Screwed' roadmap.

Types of Capital for Startups

When raising capital, startups generally have two primary options: equity and debt. Both types of financing come with their own set of advantages and risks.

Equity Capital: Giving Up Ownership

Equity financing involves selling a portion of your company to investors in exchange for capital. This is the most common form of funding for early-stage startups and includes both common stock and preferred stock. Each type of stock has different rights, including voting power, dividend payouts, and liquidation preferences.

[Common Stock](#) is the most basic form of equity. Shareholders with common stock usually have voting rights but are last in line to receive any payouts if the company is sold or liquidated.

[Preferred Stock](#), on the other hand, is typically offered to investors in exchange for their capital. These shareholders have a higher claim on assets and earnings than common stockholders, meaning they get paid first in the event of liquidation. Preferred stock terms typically include a

preferred dividend rate on top of a degree of protection on return of invested capital (and may, at times, include a common residual return).

One of the risks of equity financing is dilution, which occurs when the ownership percentage of existing shareholders decreases as new investors buy into the company. As [Gary Chodes](#), CEO of the [National Law Review](#), notes, the longer it takes for a company to reach a successful exit, the greater the potential for dilution as additional funding rounds occur, often requiring founders to give up more of the business to raise the necessary capital.

Debt Capital: Borrowing with Repayment

Debt financing involves borrowing money that must be paid back with interest over time. Debt can be an attractive option for businesses that do not want to give up ownership but still need capital to grow. Startups may opt for loans or bonds; however, securing debt financing is typically more difficult for early-stage businesses, as they often lack sufficient collateral or other borrowing base.

For a startup to qualify for a loan, it needs to have assets or [intellectual property \(IP\) rights](#) that can be used as collateral. [Michael Weis](#) of [Weis & Burney](#) points out that lenders will also look at the company's creditworthiness and management team's experience. If the company's IP is valuable and the lender believes the business has the potential to generate returns, the lender might consider it for financing.

Additionally, debt financing comes with its own risks. Lenders are focused on repayment, and if the business struggles to make payments, it can lead to default, which could result in the lender seizing assets, forcing the sale of the business, or taking other legal actions.

Equity vs. Debt: The Trade-Offs

Various factors influence the choice between equity and debt financing. Equity financing allows businesses to raise capital without the immediate pressure of repayment, but it comes with the trade-off of giving up ownership and control. While maintaining ownership, debt financing places the burden of repayment on the business, and failure to repay can lead to significant legal and financial consequences.

Some businesses may use a combination of both, known as equity-linked debt. This hybrid structure allows businesses to raise funds through debt that may convert into equity at a later stage, often at a discount. This approach is common in early-stage financing and attractive to investors and founders. These hybrid structures delay the risk of ownership dilution while providing more flexibility as the business grows. The more common variant of this financing is a SAFE agreement (Simple Agreement for Future Equity).

What Lenders Look for in Startups

For startups that pursue debt financing, securing a loan can be more difficult than for established companies. Lenders are typically looking for a few key things before they agree to lend.

Track Record and Management Team

After borrowing base, the first thing a lender will look for is the business's track record. Startups often face difficulty in this area since they have little or no financial history to demonstrate repayment

ability. In these cases, the lender will evaluate the management team. Lenders may be more willing to provide debt if the team has a strong track record of successfully running businesses and achieving profitable exits.

If the management team has experience building and selling successful companies, lenders may feel more confident in the startup's ability to repay a loan. The business owner's background and the team's expertise can heavily influence the lender's decision.

Collateral and Credit Enhancements

Since startups may lack physical assets, many lenders look to collateral in the form of IP, like patents or trademarks. However, this type of collateral comes with challenges. [Robert Londin](#), a partner with [Jaspan Schlesinger & Narendran](#), explains that lenders will also want to assess the potential market value of the IP and whether it can be easily liquidated in case of a default. Personal guarantees are another common form of collateral, particularly for smaller loans. In these cases, the business owners may be asked to personally guarantee the debt.

Credit Risk and Interest Rates

Lenders will also evaluate the credit risk associated with lending to a startup. If the business is seen as high risk, the lender may charge higher interest rates to compensate for the additional risk. Higher rates also compensate for the lack of established cash flow, which is a key factor in determining the business's ability to repay.

Raising Equity: A Necessary But Costly Step

For many startups, raising equity financing is an inevitable step toward growth. However, offering equity in your company means giving up a portion of ownership, which often comes with difficult decisions about how to divide ownership among investors, founders, and other stakeholders.

Sweat Equity vs. Investor Equity

One of the challenges that startups face in the early stages is balancing sweat equity with investor equity. Sweat equity refers to the non-financial contributions made by founders, employees, and sometimes even family members or close friends. This can include everything from technical work to marketing and management.

Sweat equity holders earn equity in the business through the time and effort they invest, and many times through the achievement of company goals) rather than through direct financial contributions. Founders must determine how to value this contribution compared to the financial investment of other stakeholders.

Family and Friends Investing

When it comes to raising capital, friends and family are often the first investors. While these individuals may not require the same due diligence as professional investors, they do expect some form of equity in exchange for their investment. Managing these relationships can be tricky, as mixing personal and professional interests often leads to conflicts.

For founders, it's crucial to approach family and friends as investors with the same level of

professionalism and care as any venture capitalist. Clear expectations and agreements should be established to avoid potential misunderstandings and preserve personal relationships.

Valuation and Control

The amount of equity given up in exchange for capital largely depends on the valuation of the company. Valuation is often the most difficult aspect of raising equity. Founders may set an optimistic valuation, but professional investors may not agree. A company's valuation typically depends on several factors, including market conditions, the strength of the management team, and potential for future growth and exit.

Determining valuation is not an exact science. For early-stage startups, valuation is more about finding an amount that enables the company to raise the necessary capital to move forward for the least amount of issued equity, rather than a reflection of the company's actual value at the moment.

Key Deal Terms: What Investors Expect

Once you've agreed on the type of capital to raise and the valuation, the next step is negotiating the deal terms. These terms outline the rights and obligations of both the founders and investors and can include provisions such as board control, blocking rights, anti-dilution rights, and exit strategies.

Board Control and Voting Rights

A common term for investors is the right to sit on the board of directors. This ensures they have some control over major company decisions. Investors may also negotiate voting rights that allow them to vote on key decisions, such as the sale of the company or large expenditures.

These rights help investors protect their capital and ensure that major strategic decisions align with their interests. However, founders need to balance offering investors enough control while maintaining their ability to manage the business. Typically, only significant investors get those protections.

Anti-Dilution Provisions

Anti-dilution provisions protect investors from losing the value of their investment if the company issues new shares at a lower valuation in the future. There are two common types: full ratchet and weighted average anti-dilution.

- **Full Ratchet:** This provision adjusts the investor's share price to match the new, lower valuation, which can significantly dilute the founder's equity.
- **Weighted Average:** This is a less harsh version that adjusts the investor's share price based on a formula that takes into account the size of the new financing round.

[David Lopez-Kurtz](#), a partner at [Croke Fairchild Duarte & Beres](#), notes that these provisions ensure that investors are protected in case of future down rounds (funding rounds at a lower valuation than the previous one), but they can be detrimental to the founders, as they may lose a significant portion of their ownership. In addition to the type of anti-dilution protection, a key negotiated point is for how long the protection is in place.

Exit Strategies: Preparing for a Sale

Investors typically want some form of assurance that they will be able to exit the business and realize a return on their investment. This often takes the form of exit rights, such as drag-along, tag-along rights, and mandatory redemption.

- **Drag-Along Rights:** These allow investors to force the founders to sell the business if a majority of investors agree to the sale.
- **Tag-Along Rights:** These give investors the right to join a sale if the founders decide to sell their shares.
- **Mandatory Redemption Rights:** A typical term of a preferred equity deal is a date by which the issuing company must redeem the preferred equity (preferred return, together with return of invested capital); potentially, forcing a sale of the company or refinancing.

Take-Away

Raising capital and negotiating with investors is a complicated process requiring a deep understanding of legal and financial terms. Whether raising equity or debt, startups must be prepared to navigate difficult negotiations and consider the long-term implications of their decisions.

When it comes to choosing between equity and debt or negotiating the deal terms, it's important to work with experienced advisors to ensure that your interests are protected and that you achieve the right balance between capital and control.

To learn more about this topic view [The Start-Up/Small Business Advisor / Raising Capital](#). The quoted remarks referenced in this article were made either during this webinar or shortly thereafter during post-webinar interviews with the panelists. Readers may also be interested to read other [articles about raising capital](#).

This article was originally published on [here](#).

©2025. DailyDAC™, LLC d/b/a/ Financial Poise™. This article is subject to the disclaimers found [here](#).

© Copyright 2025 Financial Poise

National Law Review, Volume XV, Number 143

Source URL: <https://natlawreview.com/article/startup-survival-raising-capital>