eCorner

Stanford eCorner

Unconventional Funding, Less Dilution

01-03-2023

URL: https://stvp.stanford.edu/clips/unconventional-funding-less-dilution

Austin Russell, founder and CEO of Luminar, explains how he creatively financed his company early on through two unconventional funding mechanisms: safe notes and a hacker house. He encourages entrepreneurs to find ways of bringing in money without adding more shares, in order to reduce dilution and increase value growth for both owners and employees.

Transcript

- Early on, it's very important to try 00:00:05,640 and be creative and thoughtful about how you finance.. And, you know, one of the things that, the strategies that I took early on, is because we had so much conviction, in terms of long-term value about what we could create.. And this, I think like SAFE notes in particular, is a certain mechanism of financing that was originally started by Y Combinator and proliferated throughout.. It was, how do we say, much more niche and much smaller scale there, too.. Like, people would do like, $10,000 SAFE notes, $50,000 SAFE notes, maybe $100,000 SAFE notes.. The reason for these notes, instead of operating off of traditional equity financing, where people give you a certain amount of money for a certain percentage of the company, was basically, you would be able to, in exchange for either getting a higher valuation cap or getting a discount off of a future round, be able to effectively push out when that mark to market is on valuation.. And, from a discounting perspective, even if it, you basically are saying, X investor, I guarantee you will get a 30% return by giving you a 30% discount, or plus or minus, or whatever it may be.. Which, by the way, is like for most investors, like, you know, those kinds of returns are like really good.. Like, you know, but if you think that you're going to 10 x and grow by a thousand percent, like 30% is like completely in the noise.. So, you know, that's where you can be creative around these things..

And that's so, so we took a mechanism that, you know, normally people raise like a hundred K on, and over the years they raised $200 million on SAFE notes, which I think I.. - I've never heard that.. 00:01:41,370 That is obscenely, an obscenely extreme data point everybody.. So, but it's an example of your entrepreneurial thinking.. - Yeah.. So, so yeah, so, so technically speaking, 00:01:50,760 technically speaking, we actually, before going public only ever did one equity financing because it all, all be notes sort of converged together.. So.. - And, and in that first year when you're just starting, 00:02:01,860 when the money's the most difficult to raise, how much of it was funded by the hacker house? - I mean, most of it.. 00:02:06,953 - That's what people said.. 00:02:08,880 So when did you get your first outside check outside of, so you guys understand the hacker house, he rented a big house, he subleased the rooms and he made a margin off of that..

And you also, you also created this community that was also a competitive advantage.. - Absolutely.. 00:02:22,410 - Yeah.. Turns out the ultimate form of due diligence 00:02:24,330 on people is living with them.. So.. - So you ended up getting your cash from the hacker house 00:02:28,163 talent.. - Yeah.. 00:02:29,829 - And also tech development.. 00:02:30,810 - Absolutely.. 00:02:35,730 so excited to live with the, like literally like the market rate for what people were bidding on for like

a closet, you know? I like, which it was, was around like $2,500 per month, like for literally like a closet in the hacker..

Like, it was, it was crazy.. Like, you know, in terms of people were coming up with creative ideas for how can they just, people wanna be a part of the community.. Like, and that was, that was, it was just, it was just wild to see, you know, early on just how much of, well, like literally Wild West type mentality was it.. But there was some, there was, there was some, there was a lot of civility there to it at the same time.. It's not, it's not like the movies in that sense, but.. - But that was your cash for the first how many months? 00:03:16,860 Like was that for the first, like.. - We were the first like, you know, year or two.. 00:03:21,523 - Yeah.. And then you got your outside capital from SAFEs.. 00:03:22,470 - Yeah, yeah..

00:03:24,180 And then started to get outside capital and SAFE, started compiling that on and I think, you know, as you progress yourself, you can mark up the valuation caps, you can, you know, you don't have to get people as big a discounts.. You can do other things, but yeah, it makes a difference.. But the point is, is that like, even by shifting out dilution, like a year or two on things that literally can make all the difference, I mean, you guys are familiar with exponential scales on things, if you like, even slight changes in terms of the timing of when that dilution happens just makes like dramatic differences in the total outcome of what can happen from a ownership stake perspective.. Like to the point that the reality is that most of the time, I mean, to end up with like a 5% stake, for example, by the time you go public, I mean people end up diluting themselves like 20 times over.. I mean it's actually a lot of new shares that you just have to constantly issue and issue and issue and issue and issue.. And that can be very challenging.. So the key thing though is that it's not just about, and this is a very, very important point.. It's not just about the owner.. Like for example, as an entrepreneur, it's not just about the ownership stake that you have, it's about all of the other employees that you have.. You dilute, like, yes, you get diluted on something, but like if you bring more, if you bring more shares in, you do more financing, more dilution than it dilutes everybody else along with you..

So you know, what you want is to be able to end up in a virtuous cycle of value growth with your employees rather than a vicious cycle of value growth where then you have to issue more shares to then make up for that value...