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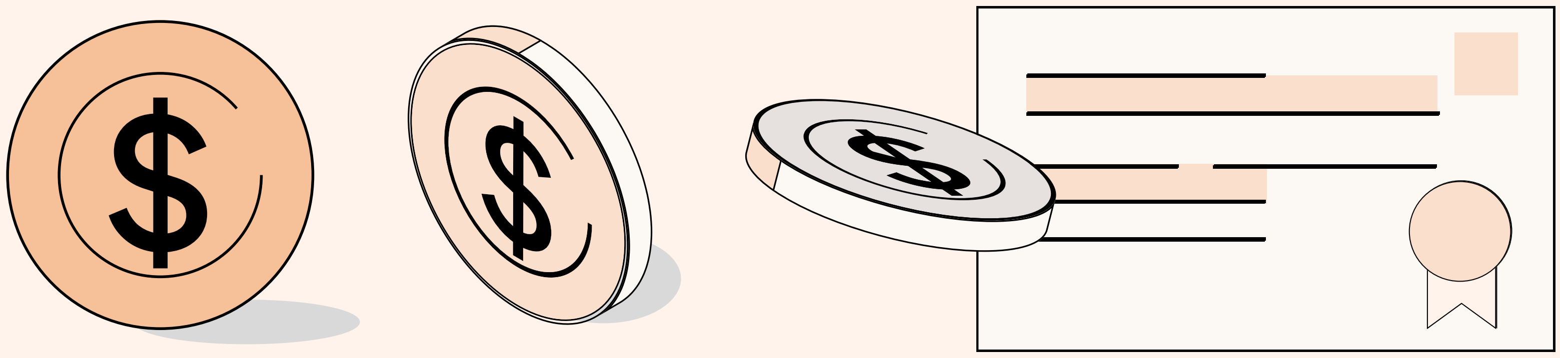
# SAFE Fundraising 101

Learn everything you need to know about fundraising with SAFEs.



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# Introduction

Fundraising can supercharge your startup's growth, but it's tricky to know when and how to start the process, especially at the earliest stages of a startup's existence.

So how are startups raising funding? An increasingly common way for a very early-stage company to raise pre-seed money is through a SAFE—Simple Agreement for Future Equity.

With a SAFE , an investor provides funding to an early-stage company under an agreement that the investment will convert to actual shares in the company at a future date—during a "priced round," when the company sells shares to new investors based on a negotiated valuation of the company.

SAFEs have become very popular among early-stage startups and investors due to their simplicity. 88% of startups raising money prior to a priced round from Q1 2020 to Q1 2024 did so using SAFEs.

More than ever, understanding how to raise a SAFE is crucial to a startup's success.

## In this guide, we'll cover everything you need to know about early-stage fundraising and SAFEs.

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# 1 SAFEs

**Weighing fundraising options as an early-stage founder can be overwhelming, but there's one solution that stands out for its simplicity: The SAFE agreement.**

## What is a SAFE agreement?

A SAFE is a convertible instrument that converts into equity at a specified time—typically, your company's next priced round. Unlike convertible notes, they are not debt and do not require the company to pay back the investment with interest if not converted.

### Priced rounds

When a startup is raising a round of financing by issuing preferred stock at a specific valuation, it's known as a priced round. In other words, priced rounds are equity investments based on a negotiated valuation of a company. This lets the investor know exactly what percentage of the company they are receiving for their investment. Most investors in the Series A round and beyond want immediate ownership equity in preferred stock, with all related rights and preferences. Therefore, most series fundraising is in the form of a priced round.

### Convertible instruments (unpriced rounds)

For most seed-stage companies, financing rounds are unpriced—they are structured to convert to equity at a later date, when valuation is established. Companies at this early stage typically are working toward developing their product and finding product-market fit, making it difficult for investors and the company to determine an appropriate valuation. While SAFEs are the primary form of convertible financing, there is a second type of convertible instrument—a convertible note (more on the differences between SAFEs and convertible notes in the next chapter).

## Why use SAFEs for fundraising?

1. **Simplicity:** SAFEs are straightforward and involve fewer terms and conditions compared to other financing instruments, making them easier to understand and negotiate.

2. **No debt**: Unlike convertible notes, SAFEs do not accrue interest or have a maturity date, eliminating the pressure of debt repayment.

3. **Future equity:** Investors using SAFEs receive the right to obtain equity in the future, typically during the next priced funding round. The conversion terms are predefined, often including a discount on the future equity price or a valuation cap. A valuation cap is the maximum valuation—for purposes of determining the price per share—at which an investor's money converts into equity. This means if your company valuation during your priced round is *higher* than the SAFE valuation cap, your SAFE investors will receive a lower price-per-share than the priced round investors, giving your SAFE investors *more* shares for their early investment. (More on this later.)

4. **Flexibility:** SAFEs can be customized with various provisions to suit the needs of both the startup and the investors. Common variations include different types of valuation caps and discount rates.

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## What's the difference between a SAFE and convertible note?

Similar to a SAFE, a convertible note is another type of convertible instrument, meaning it converts into equity at a particular time. However, unlike a SAFE, a convertible note is considered debt, which means it comes with an interest rate and maturity (or repayment) date. A SAFE doesn't come with an interest rate or maturity date, but it typically includes a valuation cap and/or a conversion discount to protect investors.

While both SAFEs and convertible notes convert into equity during a future financing round, there are differences in their conversion conditions.

1. **SAFEs:** These instruments generally convert automatically in the next priced round, regardless of the size of that round.

2. **Convertible notes:** These often include a Qualified Financing threshold. This means the round must meet certain criteria (usually a minimum amount raised) to trigger automatic conversion—for example, raising $1 million. Some convertible notes include provisions allowing investors to convert even in a Non-Qualified Financing, which means if you raised below the threshold they could still convert, providing them with additional flexibility. If investors choose not to convert during a Non-Qualified Financing, their convertible instruments typically remain as outstanding debt.

| | **Notes** | **SAFEs** |
|---|---|---|
| Type of instrument | Debt | Equity |
| Valuation cap | ✅ | ✅ |
| Conversion discount | ✅ | ✅ |
| Maturity date | ✅ | ⛔ |
| Accrues interest | ✅ | ⛔ |

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## Advantages of SAFEs

### Speed

Since SAFEs are an industry accepted template, they can be executed quickly and often don't need lawyers for negotiation, enabling startups to raise funds swiftly.

### Cost-effective

The simplicity of SAFEs reduces legal costs and administrative burden.

### Founder-friendly

Without the complications of debt or immediate dilution, SAFEs can be more attractive to founders.

## Challenges of SAFEs

### Uncertainty

The future valuation and dilution are unknown until the next funding round.

### Can lead to excessive dilution

Without proper dilution modeling, you might accidentally give away too much of your company. If you issue multiple rounds of SAFEs, each new SAFE round can potentially dilute not only the founders but also previous SAFE holders.

### Investor perception

Some investors may prefer more traditional equity or debt instruments for their perceived security and predictability.

When you join Carta Launch, our free platform designed specifically to help early-stage founders, you'll get a full suite of tools to run your first fundraise with ease. You can generate SAFE contracts, collect investor signatures, and close funding, all in a few clicks. Plus, your SAFE will automatically be reflected on your Carta cap table from day one—getting you off on the right foot, all with minimal effort.

## What type of company can issue a SAFE?

If you're considering fundraising with standard forms of SAFEs, your company needs to be classified as a C-corp. There are instances where LLCs may be able to raise SAFEs, but the process is more complicated. In general, it can be easier to fundraise as a C-corp rather than an LLC, since investors are more familiar with corporations and may prefer to invest in corporations for tax reasons.

In any case, it's a good idea to consult your lawyer for more information on the regulations and process of issuing SAFEs.

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## Types of SAFE investors

Capital can come from various sources, but these are some of the most common investors who utilize SAFEs for startup financing:

### Angel investors

An angel investor is someone who uses their own money to invest in a private company. They are often early backers of startups, providing crucial seed capital to get the business off the ground. Angel investors often use SAFEs because of their simplicity and potential for high returns.

### Venture capital (VC) firms

Venture capital firms pool outside capital to invest in private companies, usually high-growth startups. They often provide significant funding in exchange for equity and can offer valuable mentorship and connections. VC firms may use SAFEs during seed and early-stage funding rounds to streamline the investment process.

### Accelerators and incubators

These programs guide, mentor, and provide capital for startups in exchange for an equity stake—and sometimes a cash investment as well—in the company. SAFEs are often used by accelerators and incubators to provide initial funding while deferring the complexity of setting a valuation until a later stage.

### Friends and family

Early-stage startups frequently raise initial funds from friends and family. SAFEs are a favorable instrument in these cases because they're simple to understand and execute, which gives founders quick access to capital without the need for an immediate equity valuation.

# 2 Pre-money vs. post-money

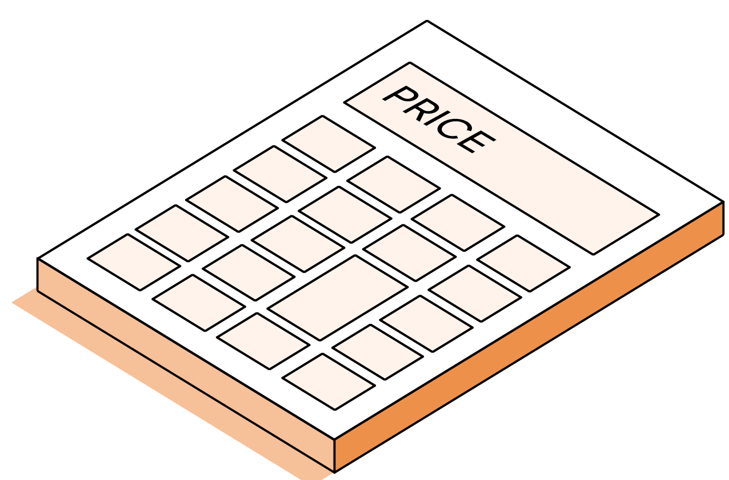
**SAFEs usually require less paperwork and negotiation than issuing shares. But, for many founders, understanding how SAFEs work can be overwhelming—especially when it comes to the differences between pre-money and post-money SAFEs.**

When you hear "pre-money SAFE" and "post-money SAFE," it refers to how the share price is calculated for the SAFE investors at the time of conversion of the SAFE (also known as the conversion price). The resulting conversion price from the calculation determines how many shares an investor holding a SAFE gets when their SAFE converts in a priced round.

## Conversion price calculation

The conversion price is determined by dividing the valuation cap by the total number of shares, also known as the company's capitalization. Here's the formula:

$$\text{Conversion price} = \frac{\text{Valuation cap}}{\text{Total number of shares}}$$



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## Why pre-money SAFEs are more founder-friendly

Pre-money SAFEs are generally considered more founder-friendly because founders have a higher chance of taking less dilution when the SAFEs convert in a priced round.

But, investors often prefer post-money SAFEs because they provide greater clarity and potentially more shares. The post-money valuation cap can offer additional clarity into the SAFE holders' future ownership percentage. This clarity and potential for a larger shareholding make post-money SAFEs more attractive to investors.

### Example

**1. Pre-money SAFE example**

An investor named Gina invests $500,000 with a pre-money valuation cap of $5 million. At the time of the priced round, the company has 5 million shares outstanding on a fully-diluted basis. The conversion price is calculated as $1 ($5M/5M shares), granting Gina 500,000 shares of preferred stock.

**2. Post-money SAFE example**

In the same scenario, Gina has invested $500,000 with a post-money valuation cap of $5 million. With a post-money valuation cap, the shares Gina will receive on the conversion of her SAFE are included in the denominator of the conversion price calculation. The total shares become 5.5 million, reducing the share price to $0.91 ($5M/5.5M shares), and Gina receives approximately 50,000 more shares of preferred stock.

**Note:** If you raise multiple rounds using SAFEs, the differences in valuation can compound over time. Raising funds with post-money SAFEs will generally result in greater dilution for founders compared to raising with pre-money SAFEs.

The choice between pre-money and post-money SAFEs can significantly impact the number of shares an investor receives. With a pre-money SAFE, the investor gets fewer shares due to a higher conversion price. Conversely, with a post-money SAFE, the investor gets more shares due to a lower conversion price. Understanding this distinction is crucial for both investors and founders when negotiating SAFEs.

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# 3 How dilution works

**Share dilution (also called equity dilution or stock dilution) is the decrease in ownership percentage for existing shareholders when a company issues or reserves new shares of stock.**

## Common causes of share dilution

Share dilution occurs after material events, such as closing a round of funding, or creating or increasing an employee stock option pool. Founders, employees, and investors at private companies are generally all subject to share dilution.

### Closing a round of funding

When private companies need more money, they typically issue shares to investors in a funding round, which reduces the overall percentage of ownership for current shareholders.

### Increasing employee option pool

Incoming investors usually require companies to create a stock option pool. The timing of when the stock option pool gets created determines which shareholders are diluted. For example, if the stock pool is expanded before a fundraising round, only existing shareholders face dilution. If the pool is expanded after a fundraising round, then all shareholders—including new investors—will feel the effects of dilution.

### Taking your company public

An initial public offering (IPO) is when a private company lists its shares on a public stock exchange for the first time, allowing those shares to be bought and sold on the open market. IPOs involve selling new shares as well as the listing of a company's existing shares. In some cases, companies may sell additional shares (known as a "secondary stock offering") after the IPO. Secondary stock offerings also lead to dilution for existing shareholders.

## Example of how dilution works

### Single founder

Let's say you're the sole owner of your company and you own 10,000 shares or 100% of the company. Business is going well, so you decide to create an employee option pool of 1,000 shares for future employees. You also are in need of more capital, so you give an investor 2,000 shares in return for their investment. In total, there are now 13,000 shares of company stock (on a fully diluted basis)—and just like that, you now own only 77% of your company (10,000/13,000) instead of 100%.

### Multiple founders

Let's say you're one of two co-founders of a startup, in which each co-founder owns 50% of the company (5,000 shares issued to each of you). Your company needs additional capital to expand, so a VC firm invests and you issue 2,000 shares in return. After those new shares are issued, there are now a total of 12,000 shares in the company. Each co-founder still owns 5,000 shares, but now their ownership stake is 42% (5,000/12,000) instead of 50%.

Even though share dilution causes you to own less of the company percentage-wise, it doesn't necessarily mean your stock is worth less. In fact, the fair market value (FMV) of a company's stock generally increases after a funding round, so the overall value of your shares may actually go up. You just own a smaller piece of a bigger pie.

**Note:** If you're an early-stage founder raising a pre-seed or seed round, you'll want to know how SAFEs and notes will impact your ownership, how they'll convert for your investors, and what terms are most favorable when raising your round. With Carta Launch, you can easily model your SAFE rounds to understand dilution and ownership change by stakeholder and investor, as well as create, issue, and fund SAFEs.

## SAFEs and equity dilution

SAFEs postpone equity dilution until your next qualified financing (usually your Seed round or Series A). SAFE holders get shares in the future, typically at a discount in exchange for investing in your company at an early stage. This means that ownership percentages won't be calculated until a new company valuation is determined.

There are three main influences on SAFE dilution to look out for: the type of SAFE, the valuation cap, and the conversion discount.

### What type of SAFE?

The type of SAFE you raise (pre-money vs. post-money SAFEs) can impact your eventual equity dilution.

For SAFEs with a pre-money valuation cap, the conversion price of the SAFE is not affected by the issuance of additional SAFEs. This type of SAFE may be less dilutive for you, the founder, since the dilution from the conversion of the SAFEs will not be borne solely by the founders.

For SAFEs with a post-money valuation cap, the issuance of additional SAFEs will decrease the conversion price, resulting in the founders taking a higher amount of dilution from the conversion of the SAFEs. Many investors prefer this because it can give a clearer prediction of their ownership, making it easier to plan for the future. However, post-money SAFEs are generally less founder-friendly because they only dilute the founders' ownership percentage.

### What is your valuation cap?

Many SAFEs have a valuation cap to protect the investor. A valuation cap is the maximum company valuation at which an investor's money will convert into shares.

This means if your company valuation during your seed round is higher than your SAFE valuation cap, your SAFE investors will receive a lower price-per-share than the seed round investors, giving your SAFE investors more shares for their early investment.

### Is there a conversion discount?

A conversion discount gives your investor a discount on the price per share when their SAFE turns into equity. For example, if your Series A investors are paying $1 per share, your SAFE holder may only have to pay 80 cents per share.

Not all companies offer a conversion discount. Among Carta customers who have a conversion discount, the median conversion discount is 20%. In most cases, a valuation cap will be more dilutive than a conversion discount.

If a SAFE comes with both a valuation cap and a conversion discount, the investor usually gets whichever option gives them the lower price per share (i.e. more shares for their money).

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## Example

Meetly is raising a $2 million Series A round from three VC firms on a $4 million pre-money valuation. Adding these three new investors isn't the only change to the cap table during this round. You'll also need to convert the investments of your earlier investors into actual shares, now that you finally know your company's valuation, thanks to the Series A round. Let's say you have two angel investors — one who invested via a SAFE and one via a convertible note. We'll start with the SAFE conversion.

### SAFE conversion

The SAFE investor provided $100,000 in financing with two key components: a valuation cap and a discount. The valuation cap is $6 million, and the discount is 20%.

Since the company's valuation at the Series A is $4 million, the $6 million valuation cap does not come into play. We can focus on the conversion discount instead.The company's preferred stock costs $1 per share. With the 20% discount, the SAFE investor only pays 80 cents per share. Therefore, the $100,000 investment converts into 125,000 shares instead of 100,000 shares.

### Convertible note

The convertible note investor put in $100,000 with 8% interest and a maturity date of one year. Since the Series A round was raised before the maturity date, instead of repaying $108,000 in cash, you can convert this into 108,000 shares of Meetly at $1 per share.

Let's say this investor negotiated a $2 million valuation cap. Unlike the SAFE investor's cap, this cap comes into play because it is below the Series A valuation of $4 million. This triggers a recalculation, resulting in a conversion price of $0.50 cents per share (adjusted share price = ($2 million / $4 million) × $1.00 = $0.50 per share). Therefore, the $108,000 investment ($100,000 initial investment + 8% interest) x $0.50 per share converts into approximately 216,000 shares.

## Benefits

Converting SAFEs and convertible notes at the Series A stage benefits everyone. Meetly avoids returning the initial investment amount and any interest at a time when revenue might still be low. Investors receive shares at a discounted price, potentially increasing their value as the company grows. By understanding how these conversions work, you can better manage your cap table and ensure a smooth transition as your company raises new funding rounds.

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# 4 Key SAFE terms

**There are concepts that are critical to successfully fundraising with SAFEs. Let's cover the key terms below.**

| | |
|---|---|
| **Valuation cap** | A valuation cap is the maximum valuation—for purposes of determining the price per share—at which an investor's money converts into equity. SAFEs come with valuation caps to entice early investors and reward them for taking a risk on your company in its infancy.<br><br>If the valuation of the company in the priced round is higher than the valuation cap of a SAFE, the SAFE will convert into equity at a lower price-per-share than the price paid by investors in the priced round, giving SAFE holders more shares. |
| **Discount rate** | The discount rate in a SAFE agreement offers investors a reduced price on shares compared to other investors in a future priced round. For example, a 20% discount rate means the SAFE holder pays 80% of the price per share that new investors pay in the priced round. This compensates early investors for the higher risk they took by investing before the investors in the priced round.<br><br>If a SAFE has a valuation cap and a discount rate, the investor typically gets to take advantage of whichever option gets them a lower price per share. |
| **Most Favored Nation clause** | The Most Favored Nation (MFN) clause, which appears in the legal documents detailing the terms of a SAFE, protects investors.<br><br>The MFN clause typically states that if you issue additional convertible securities to future investors with better terms (like a lower valuation cap, for example), those terms will automatically apply to your first investor's SAFE as well. Once an investor's SAFE converts into stock, however, the MFN clause no longer applies. |
| **Qualifying round** | Otherwise known as a qualifying event or transaction, a qualifying round is the priced round at which a SAFE will convert into equity. This concept is included in Carta's forms of SAFEs. When fundraising with other SAFEs, typically any priced round will be a qualifying round. |
| **Exit event** | An exit event refers to a change of control within your company, like an IPO or liquidity event. If you undergo an exit event before your SAFEs convert into equity, investors holding SAFEs will receive cash proceeds in amounts proportional to their individual investment terms. |

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# 5 When should you consider fundraising?

**Now that you've learned about SAFEs, the next big decision is when to start fundraising. Each company's trajectory is different, which means there isn't a perfect time to start. The general rule is that you're in a good position to consider raising funds when you've validated that there's a problem that needs to be solved and you can demonstrate demand for the solution.**

Getting that information usually involves heavy market research, thoughtful prototype production, and lots of experimentation.

## Reasons to start fundraising

### You already have a lot of traction with your end users or customers.

If you're still working on your prototype but already have a lot of clear demand for your product or service, you may want to run with it and start reaching out to investors.

### You're going to run out of cash and resources.

Fundraising doesn't happen overnight. It can take three to six months of regular pitching and conversations with investors before you get any money. To avoid falling behind or missing opportunities to get in front of customers, you may want to start looking for funding before you need it.

### You need more support.

Fundraising doesn't just give you capital—it can also provide you with valuable investor support and mentorship. If you're at a point in your company's growth where you need guidance from experienced investors to gain momentum, fundraising could be smart.

## Reasons to wait to fundraise

### You need to generate more interest from your end user or customer.

The type of product you build—and the people you build it for—can dictate when funds are available to you. For example, some investors don't want to invest in a consumer-focused product unless there's already a long waiting list of interested customers, while that target number of customers demonstrating traction may be lower for companies in enterprise or B2B.

### You have enough resources to continue bootstrapping for a while.

Think about the resources at your disposal, including cash, talent, and tools. If you have enough personal cash or credit to continue bootstrapping your company, you may want to delay fundraising for a while. But if you don't have enough money to hire the right talent or continue to build out your product, it may be time to consider raising money from outside investors.

### You don't have the time or bandwidth to invest in pitching.

Pitching investors on your idea takes a lot of work. You have to create a pitch deck, contact the right investors, schedule meetings, and carve out space for conversations and follow-ups. If your focus is still on building out your prototype, you may want to hold off on pitching until you have more of a foundation.

# 6 How much capital should you raise?

**Figuring out how much money to raise is a complicated process at best. Raise too much money, and you risk over-diluting your ownership stake in your own company and making it difficult to raise another round at a higher valuation; raise too little, and you risk having too few resources to achieve the milestones you need to successfully raise your next round.**

Here's the simple answer: You should raise only as much money as you need to get to the next phase of your company's growth. There's no perfect formula, but there are a few areas of your business you can look at to arrive at a dollar amount you're confident in.

## Factors to consider

### Your first milestone

Milestones are the specific benchmarks you want to hit on the way to reaching your broader company goals. Most milestones are quantifiable achievements that indicate where your company stands, growth-wise. Think: launching your MVP (minimum viable product) within 12 months or securing your first 1,000 customers by a certain date.

When contemplating your most important milestones for fundraising, there are two underlying questions you may want to ask yourself:

1. **What stage of maturity do you want your company to reach by the next stage of fundraising?**
2. **What specific metrics do you need to show to get there?**

For each milestone, consider the following components:

#### Resources

What will it take to reach the milestone? Whose specific talents and skills will you need? What kind of tools will you rely on?

#### Time

How many months or years will it take to reach the milestone?

#### Costs

How much money will you need to reach the milestone?

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## Your runway

Cash runway is the amount of time you can realistically fund company operations before you run out of money. If you have $500,000 in funds, for example, and it takes roughly $100,000 a month to run your company, you have five months of runway.

To figure out how much it costs to operate your company while working toward your next milestone, you have to consider:

### Your team

How many engineers, marketers, salespeople, and customer support reps do you need to reach the next milestone you've defined? How much will it cost to support your team working full-time?

### Your admin needs

How much will it cost to buy the right tech and equipment, rent office space, and budget for potential travel?

### Your marketing and advertising budget

How much do you need to spend to build a website, create a social media strategy, run ads, and set up different distribution channels?

Calculate your burn rate with Carta's free cash burn rate calculator.

Once you figure out your company's cash burn rate (total monthly spend for people, admin, and marketing), multiply that figure by the number of months you think it will take to reach your next milestone. That will give you a clear idea of the minimum amount of cash flow you need to work toward your next phase.

Keep in mind that this number is often just a starting point. It's smart to cushion your budget to account for unexpected problems and delays. In general, it's better to have more cash on hand and not end up needing the money than it is to have to account for every penny and still come up short.

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# 7 How Carta can help you fundraise

**Carta Launch is our free platform designed specifically to help early-stage founders with the education, tools, and support they need to tackle the things no one tells you about building a company. It includes a suite of fundraising and cap table management tools that help with critical aspects of company building, from incorporation to creating and issuing SAFEs.**

## Fundraise with confidence

Run an informed fundraising process using fundraising insights and scenario modeling based on data from over 40,000 cap table customers. Use that data to understand market caps, valuations, and specific terms before you meet with investors. Access it in real time to run a more informed fundraising and negotiation process.

Model future SAFE / note financings and future dilution through Carta's powerful modeling tools. Avoid undervaluing and over-diluting your company by forecasting different funding scenarios.

# Testimonial

"

Carta helps us benchmark the valuation we're thinking of against actual deals happening in the market. It's crazy helpful, and will likely help us save millions of dollars that we may lose without that context. Every entrepreneur should be using this.

**Conner Wilson**
Founder/CEO, Pilot

## Streamline your round using a centralized SAFE workflow tool

SAFEs usually involve a lot of email back and forth with investors. Use our automated SAFEs feature to generate and track your SAFEs all in one place, streamline communication with investors, and automate the signing process.

Quickly create and share SAFEs in a few clicks, customize terms, and move money through Carta— with options that avoid wire fees. It also automatically updates your cap table.

## Start your cap table for free

Manage your cap table for free on Launch, up to 25 stakeholders or $1M in funding. Every Launch company gets white glove onboarding support to set up their cap table, and ongoing, real-time support that they can reach out to at any time.

# Testimonial

"I love being able to see my options vest on the Carta mobile app each month. Being able to log in and keep track of my ownership is a reminder of why I joined my company and what I'm working towards.

**Aileen Comer**
Senior Product Manager, Clearcover

## Make competitive job offers

Carta has the largest set of private market equity and compensation data, and with market insights we've made it easy for you to determine how much to offer your first few hires. You'll see data tailored for early-stage companies so you can be confident that you're paying your people well from the start—while not overspending.