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'If you're going to build something from scratch, this might be as good a time as in a decade'

In the second episode of our series *The Quarterly Interview: Provocations to Ponder*, venture capitalist Bill Gurley explains the promise and perils facing start-ups at a moment of economic uncertainty and reveals why hybrid work may be the most interesting technology of all.

Bill Gurley is one of Silicon Valley's most respected venture capitalists. As a general partner at Benchmark, Gurley has backed a blessing of unicorns, including Grubhub, Liveops, Nextdoor, OpenTable, and, most famously, Uber.

Gurley has often been a voice of reason amid Silicon Valley overexuberance and has tweeted regularly in 2022 about the need for start-ups to be realistic about the current economic environment. While many venture firms have a lot of money to invest, dealmaking has slowed considerably this year. Average valuations of some fundraising rounds have dropped as investors adjust to an economic slowdown and look warily ahead. But being realistic doesn't necessarily mean being pessimistic: in some ways, says Gurley, this may be a great time to launch a start-up. Gurley recently joined *Quarterly* editorial director Rick Tetzeli for a wide-ranging discussion. An edited version of their conversation follows.

Rick Tetzeli: *Thanks so much for joining me to talk about start-ups at what seems to be a particularly challenging moment. As if to prove the point, an alert just popped up on my screen: Robinhood is laying off 23 percent of its workforce.*

Bill Gurley: Wow. Layoffs happen so infrequently. In '01 and '09, you had broadscale layoffs, but only now are we starting to see them this time around. Well, 23 percent is getting into a range that actually makes sense. Is this their second layoff?

Rick Tetzeli: *Yes, unfortunately. They did 9 percent earlier.*

Bill Gurley: See, that's the thing. I hate the 5 to 10 percent layoffs. You don't get any material impact to lowering your expenses. Yet you get all the cultural negatives of having done a layoff. You get 100 percent of the pain and very little gain. And then you're in retweet land—

you end up with two or three of them. Anyway, that wasn't on your original list of questions.

Rick Tetzeli: *No, it's not. It just happened. But it's a bracing lead-in to talking about how difficult things might be for start-ups during what seems to be a time of great uncertainty. Many people feel that the externalities affecting so many businesses—whether it's the war in Ukraine, inflation, geopolitics, changing labor patterns—seem more complicated now than they have been in a long time. Do you agree with that? Do you think we're entering a period of extended uncertainty?*

Bill Gurley: It's funny. Three or four years ago, I felt, like many others, that the really big problem was the zero-interest-rate thing, this prolonged period of near-zero interest rates. I even paid a massive amount of money to end up at this dinner with Warren Buffett, where we each got to ask him one question. My question was, "You know, if interest rates are zero, (1) your DCF model [which emphasizes discounted cash flow as the basis of valuations] doesn't work, and (2) it drives all kind of speculation." And he said, "You betcha!"

I also spent time tracking down Howard Marks and Stanley Druckenmiller because I think there are so few people who have proven that they have a valuable point of view on macro. There are just so many variables with macro. You can fool yourself. I've felt that ever since my MBA macro class.

So I'm hesitant to answer your question. That said, clearly you've had rates going up, which hasn't happened in a very long time. That has had consequences on car loans and mortgages and corporate debt. And it should rein in speculation—it probably has already. China decoupling from the West is pretty scary, given that sharing and trading has a positive impact for both societies. If that were to escalate simultaneously with, say, Europe getting worse and maybe something in Taiwan being provoked, that could all be super bad.

Having said all that, I have two things in the back of my mind that relate to start-ups and the start-up ecosystem.

First, Stephen Covey used to talk about your circle of influence, and Buffett talks about your circle of competence. Macro things are not things that start-ups can impact or control. So there's not much reason for them to affect your thoughts about whether you would start a company or not. They might add anxiety, but I don't know that they have any real impact.

Rick Tetzeli: *Because it's still about the idea. And the idea is good regardless.*

Bill Gurley: Right. Second, the environment for launching a start-up was really crazy the past five years. And the truth is that if you're going to build something from scratch, this might be as good a time as you've had in a decade.

Real estate? You can get all the real estate you want. People used to fret about lease cost, but that's all gone. And while people get caught up on whether the money's cheap or not, getting rid of the distraction of all that cheap money may be a good thing. That whole mentality of, oh, your competitor raised $100 million, now you have to raise $100 million. All those things have evaporated—for the better, I'd say.

A huge thing is that your access to talent is way better. It was so hard to get, but now it's a lot cheaper than it was. There are layoffs happening. And then hybrid has opened up the people you can get. I've heard some pretty amazing stories. Jennifer Tejada, who runs PagerDuty, says they went into the pandemic at 85 percent Bay Area employees and came out at 25 percent. If you need an iOS programmer within 20 miles of your Silicon Valley location, that's way harder than if you can shop globally for that.

Rick Tetzeli: *Let's stick with hybrid for a second. Do you think it will affect the culture of start-ups?*

Bill Gurley: Whether hybrid is good or bad is one of the biggest unknowns coming out of the pandemic. There are some pretty hard-core enterprise-type founders who say, "Everyone's back in the office." And then there are people whose business is positively impacted by hybrid work. It's all over the map. I remember asking [Matt Mullenweg,] the CEO of WordPress, which has been 100 percent hybrid its whole life, about this before the pandemic. And he said that you need to be all or nothing, that when you're in the middle ground you get into these weird cases of cultural confusion, where, for example, cliques can develop if someone's not there. That's why some people have a rule: all in person or no one in person. But I don't know what makes sense.

The number-one thing people at start-ups worry about is missing out on serendipity—just some random conversation between two people who were out visiting a customer and then said, "Oh, wait, what if we did this?" and it becomes critical to the company's success. That's far more likely in a start-up than in a big company. But, ultimately, hybrid is really a founder-centric decision.

Rick Tetzeli: *The pace of IPOs has slowed enormously this year, and valuations have collapsed. Earlier this year, you tweeted, "An entire generation of entrepreneurs and tech investors built their perspective on valuations during the second half of an amazing bull market run. The 'unlearning' process could be painful, surprising, and unsettling to many."*[1] *Is this a reset like 2001 and 2008–09? How painful might it be? And have you learned things from the past downturns that apply here?*

Bill Gurley: This one is different in a couple of ways. In 2001, there were a lot of nascent companies going public with, like, $1 million in revenue. That's not the case this time around. Here, you've had a lot of companies with huge amounts of revenue, some with massive losses. There has been a huge volume of capital, and the scale of the companies is radically different. Some have raised $500 billion, $3 billion—there was no precedent for sums like that. And some of that money might be dead money.

Then there's the fact that this run went on longer than people thought. That may well make the pain a little bit bigger. It also means that there's less institutional memory.

The collective venture community needs to get its head around the new reality as fast as possible. The more people see what's really going on, the quicker that will happen. In '09, the response to the downturn was pretty swift. But you had the benefit that '01 was only seven or eight years in the rearview mirror. While there's still some institutional memory around the Valley, it's been a very long time since 2009.

Rick Tetzeli: *So what are you telling your portfolio companies?*

Bill Gurley: I try to convey that they need to get in front of this. In a couple meetings, I've heard an owner or founder say, "Well, you know, we just need to buckle down until things get back to where they were." And I'm, like, "No, the fantasy was the past five years."

What we're in now may just be normal, right? This may be average. And that's very hard for people. It's especially hard for a founder.

This will sound trite, but a founder who, say, owns 15 percent of a company that raised a round at $1 billion has done the math. They've mentally banked that they're worth $150 million—pretax, of course, but they forget that. But now, they're not! And it's just super hard for them to accept that that was from a fantastical time that's probably behind us.

[1] Bill Gurley (@bgurley), Twitter, April 29, 2022, 1:44 p.m.

Rick Tetzeli: *So how does that personal shock of going from being worth $150 million to being worth $50 million—*

Bill Gurley: Or $15 million—

Rick Tetzeli: *How does that affect how they manage?*

Bill Gurley: Well, if they're in denial they can make a lot of mistakes. They don't cut enough cost. They don't lay off enough people. They continue to think they can just go raise money, but they don't realize their cost of capital has changed by 5x. If they do not fully understand the situation they're in, that's super problematic.

You have to play the game on the field. If everything has reset, it has reset. The sooner you get in touch with that, the better you'll do. That's just pragmatic. This goes back to the very first topic we talked about, layoffs. If you're going to do it, how material does it need to be?

Rick Tetzeli: *Layoffs, of course, can be particularly tough on a company. Don't you ever worry that people could cut too aggressively at this point?*

Bill Gurley: I've never seen that in my history. Everybody says, "We're getting to the bone." Everyone says that. And I know it's a touchy subject because people are losing their jobs. But companies—even small start-ups—are way more resilient than people realize. It's the norm that you cut 30 percent, and everything keeps going. You don't lose all your customers. And some people find, "Oh, wait, we're moving a little faster." Sometimes things get better. I mean, yes, eventually some companies go bankrupt. But I've never seen someone do too much. You can always hire back. I think 95 percent of the time, the failure is the other way, of not doing enough.

Rick Tetzeli: *You've tweeted that "Benchmark never changes our investment cycle due to economic swings."[2] Why?*

Bill Gurley: Well, our firm has a very unique focus. Around 85 to 90 percent of our funds are deployed on first-money and early-stage investments. And our approach has become even more unique because so many of our competitors have gone multistage.

And once you start doing late-stage things, the current environment has a drastic impact. But if you're doing early-stage, these kinds of swings don't really put you off the next incremental investment. There have been plenty of great companies started in the troughs to suggest that there's no reason to stop investing.

The same thing is true at the peaks. There were firms that pulled out in '96 because they thought things had expanded too broadly, and they missed three of the greatest years of returns in the history of the business.

We really try to learn from our mistakes. We tried to expand internationally once, but it didn't work for us. So in about 2006, 2007, we capitulated and went back. And our conviction in our focus was even stronger, because we saw that we did better work once we refocused.

We had that on our mind as everyone in the Valley started expanding in more recent times. And I will tell you, for the six or seven years prior to the past year, people would meet with us and tell us that we were stupid, that we were leaving money on the table. But in the past six months, that's all reverted. Now it's all, oh, you guys are still brilliant.

There is another reason why I like our model. We're running much smaller funds than some of our peers, who probably pull down ten times the capital we do each year. Those firms have massive management fees as a result. As an investor, I just take more pride in us doing well when our limited partners are doing well. So if the majority of our compensation is on the carry side instead of the fee side, I just feel better about it.

[2] Bill Gurley (@bgurley), Twitter, June 20, 2022, 6:15 p.m.

Rick Tetzeli: *Are companies still coming to you seeking frothy valuations, or has that changed from a year ago?*

Bill Gurley: I think we're partially corrected. It takes a while for people to come around to the fact that everything's been reset. It's a slow process. It's also why M&A is delayed. People think, "Oh, everything's peaked," so M&A should just take off now. But like founders with valuations, late-stage investors that invested at a certain number aren't going to like it if you try and sell the company at a third of the price they paid. So things are slow to get corrected.

Rick Tetzeli: *You've been pushing for direct listings and other nontraditional ways of going public. Do you think that has become a fully accepted part of the game? Do you think these methods will become even more customary going forward?*

Bill Gurley: I hope so. Both the NYSE and the Nasdaq have been approved for direct listings with a set of parameters that are still being worked on. But with the market resetting, I don't think this is on the SEC's [US Securities and Exchange Commission] priority list. They've got other issues at the forefront.

There is definitely a category of founders who have the financial knowledge of how markets work and how markets should work that prefer it. They know that it's ridiculous that a human would pick the price and the allocation when an algorithm can do it in an auction. I remain convinced that eventually everyone will do it.

Rick Tetzeli: *Is the Bay Area still the hub of everything tech, the way it was when you moved out there 25 years ago?*

Bill Gurley: First of all, there are places that have had incremental success over the last two decades. Seattle has just been phenomenal for start-ups. New York has had a couple of really big wins. So things have already opened up. Hybrid creates a much bigger question mark for the Bay Area.

The number-one risk of being outside the Valley was always, "Can I get the executive talent?" You could always get programmers. You could always get customer support people. Now, with hybrid, maybe you can get the executive talent, too. Found your company in Chicago and hire your executive talent even if they want to keep living in the Bay Area.

The other thing that has reinforced the Bay Area is that, culturally, everywhere you go, you run into someone connected to the industry. That creates a ton of serendipity outside the office. It leads to companies being started and people changing jobs, and it leads to idea propagation. Matt Ridley talks about ideas having sex and how that can impact innovation and increase productivity. Silicon Valley is a great example of that.

The ideas that are relevant can be very ephemeral and fleeting. Take something like knowing how to gain customers on an iOS app. You could have been a marketing guru for 20 years, but if you went on vacation for five years and then came back, you know nothing, right? You know nothing. There's a constant reinforcement of what's happening that has always been an advantage to being in the Valley.

Well, if you're working on, say, a Web3 project these days, you're probably doing so on a Discord channel. They're all working in Discord. And so that's where you're having those moments where ideas might have sex on a constant, daily basis, in a Slack-like way that cuts out geography. That's really interesting.

Rick Tetzeli: *You mentioned Web3. We haven't talked much about technology per se, but I'm wondering if before we close you could tell me what is the most promising tech trend that you're looking at right now? Is it Web3 or crypto or some of the other things we hear* *about? Or is there something else that has the greatest potential?*

Bill Gurley: For me, personally—I'm not speaking for my firm—I'm most motivated by all this stuff we've been talking about around hybrid and the fact that I can hire someone from around the globe instead of 20 miles from my office. Think about the productivity and innovation unlock that that might create. There are all kinds of problems that entrepreneurs need to solve. How do you get the serendipity back? How do you measure productivity? These kinds of Slack- and Zoom- next-generation things are super interesting to me. For instance, I would think that there should be some kind of new version of LinkedIn because of all this.

On crypto, there's a moment of reckoning right now that I think is highly dependent on regulatory ambiguity and what happens in Washington. We're kind of stuck until that is clarified.

I also think that the crypto industry is in desperate need of some hard-core proof points. There's a lot of rhetoric. I mean, as everyone says, Bitcoin is its own thing. It is a proven, hard-core protection against your government coming after your money. You could theoretically escape a dictatorial or tyrannical country with your money on this thing—reemerge elsewhere and still have your money. That's a real feature that has been obtained, and people can bet on whether that's valuable. I would call it an achievement. But I don't know how many other achievements there have been. Q

Bill Gurley is a general partner at venture capital firm Benchmark. **Rick Tetzeli** is the editorial director of *McKinsey Quarterly* and an executive editor in McKinsey's New York office.

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