MSL307

(Academic Session 2nd Semester 2019-20)

Venture Funding & Financing
(Project Report)

Indian Institute of Technology Delhi
New Delhi

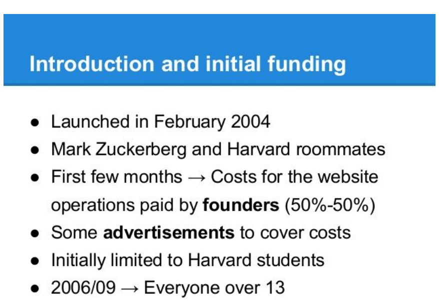
Team Members:

S No	Name	Entry No
1	Anoushka Gupta	2018ME10590
2	Sharon Mathur	2018TT10952
3	Gracy Kureel	2018TT10900
4	Medini Sharma	2018ME10623
5	Shreya Reddy	2018CE10127

Facebook

1. Explain your criteria for selecting the startup.

We chose the start up namely - “Facebook”,the inspiration came from the day to day application we are addicted to. Also, to design and develop a website from the hostel room with help of friends in sophomore year coincided with what we as students do and research. With uncanny popularity, Facebook now is a major part of lives, not just a socialising connectivity platform anymore,it now is used for selling, advertising, journalism, production launch and business of any kind possible. Also, a successful disruptive social innovation is a perfect vision aspiration for many of us. Mark Zuckerberg never gave up despite challenges like facing various disciplinary infringements for Facemash, and within a month of launching Facebook, court order from “The Harvard Connection” founders, he didn’t give up Facebook even declined Yahoo offer of 1 Billion in 2005, MTV offer of 1.5 Billion in early 2006, which shows Zuckerbergs’ exemplary conviction and confidence in Facebook.



2. To the extent possible, research and understand in depth the nature of funding that your chosen status received, all challenges it faced.

In January 2004, Zuckerberg began writing code for a new website, known as "TheFacebook".

In a pre-seed round you are focused on building minimal viable products, testing your insights and searching for product/market fit.

Zuckerberg met with Harvard student Eduardo Saverin, and each of them agreed to invest $1,000 in the site.

In the seed round(First external investment) you have an early product and by the end you've found a product/market fit and understand the scale of what you're building and the levers that you can pull to accelerate growth.Facebook was initially incorporated as a Florida LLC(Limited Liability Company). Limited Liability means that investors in the company will lose only what they have invested(their 'shares'), should it go bankrupt. Seed round was on "convertible note"(*non- priced* round)as generally common for Angel Investors who know just the capabilities of the Entrepreneur and don't have time to conduct due-diligence.

For the first few months after its launch in February 2004, the costs for the website operations for thefacebook.com were paid for by Mark Zuckerberg and Eduardo Saverin, who had taken equity stakes in the company. The website also ran a few advertisements to meet its operating costs.

- In the summer of 2004, venture capitalist Peter Thiel made a $500,000 angel investment in the social network Facebook for 10.2% of the company and joined Facebook's board. This was the first outside investment in Facebook. It was advantageous to Zuckerberg because it came fast compared to traditional financing. His role model and new room-mate Sean Parker(founder of Napster) contacts helped him get into the network of Silicon Valley Angel Investors. Secondly, being a non-priced round, allowed Zuckerberg to increase the valuation and having option of getting majority control of shares in the next priced round, as Facebook had substantial progress from the Seed Round to Series A. Zuckerberg narrowly missed the valuation of 1.5 Million but Peter Thiel considered it to be a safe investment and thus got the equity cap. Thus, Zuckerberg got a convergent visionary investor with huge experience as PayPal Founder and also allowed partial tailoring of subsequent rounds for the value adding investor Peter Thiel.

December 2004 - Almost one million users at Harvard, Stanford, Columbia, and Yale. Popularity in these 4 colleges made certain that this was an idea of lifetime for Zuckerberg.

For a Series A round you want to prove you have built a repeatable and scalable sales/revenue model and understand all parts of the business model. Facebook's **Accel investment (Series A)**

- In April 2005, Accel Partners agreed to make a $12.7 million venture capital investment in a deal that valued Facebook at $98 million. Accel joined Facebook's board, and the board was expanded to five seats, with Zuckerberg, Thiel, and Breyer in three of the seats, and the other two seats currently being empty but with Zuckerberg free to nominate anybody to those seats.

Number of active users: 5.5 million(882 colleges and 85% of the College students log in at least once a week and many thousands of high schools)

FaceBook has three methods of producing revenue.

-local text ads (from the college and local businesses), running at $15-20 per day

-traditional banner ads, sold on a national basis

-sponsored groups – examples included Apple, EA, etc .

March 2006 - Facebook reportedly shops itself around to buyers for **$2 billion.**

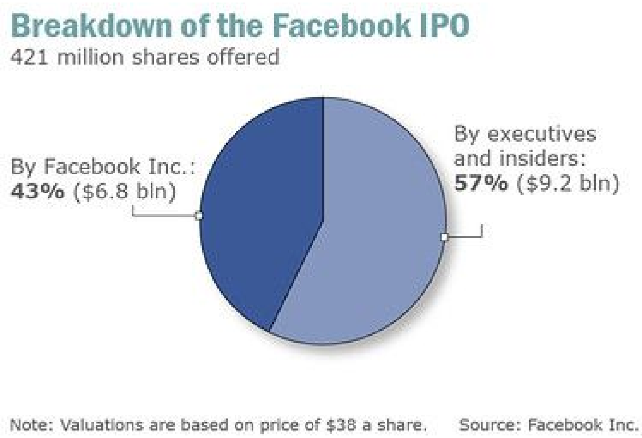
Series B is about proving your net revenue model (can you be profitable?).

- Greylock investment (Series B)
- In April 2006, Facebook closed its Series B funding round. This included $27.5 million from a number of venture capitalists, including Greylock Partners and Meritech Capital, plus additional investments from Peter Thiel and Accel Partners. The valuation for this round was about $500 million.
- **Sept. 2006 -** Yahoo (YHOO) supposedly makes a **$1 billion bid** — Facebook rejects that, too.
- **Dec. 2006 -** Thiel says Facebook is worth **$8 billion.** The social network now has 12 million-plus users.
- **April 2007 -** 20 million active users.

Series C onwards funds growing your company to $100M in gross *profit.*

- **Microsoft investment (Series C)**
- On October 24, 2007, Microsoft announced that it had purchased a 1.6% share of Facebook for $240 million, giving Facebook a total implied value of around $15 billion. However, **Microsoft** bought preferred stock that carried special rights, such as "liquidation preferences" that meant Microsoft would get paid before common stockholders if the company were sold. Microsoft's purchase also included the right to place international ads on Facebook. Preferred Stock is a form of owning a company(1.6%) at common stock(i.e. Get 1.6% of 15 billion and above) or redeem 240 million dollars(plus any accumulated dividends) depending on the valuation of Facebook at a Liquidity event(like IPO, or liquidation through bankruptcy).
- **In November 2007**, Hong Kong billionaire Li Ka-shing invested $60 million in Facebook
- **Jan 2011 -** Goldman Sachs invested **$450 million and DST invests $50 million, putting Facebook's valuation at $50 billion**, a new high.
- Facebook filed for an initial public offering (IPO) on February 1, 2012. The preliminary prospectus stated that the company was seeking to raise $5 billion. After

the IPO, **Zuckerberg retains a 22% ownership share in Facebook and owns 57% of the voting shares. Thus, the majority control remains with Zuckerberg.** The IPO raised $16 billion, making it the third largest in U.S. history. IPO made facebook public, allowing a greater scrutiny from the Government. IPO is a liquidity event where convertible note or convertible preferred stock investors get the choice of converting investment to common stock(i.e. Obtain the percentage of the company owned after financing at current evaluation) or to convert it into debt. Given the high growth rate of the company, Zuckerberg was able to attain the majority. If the valuation was very low, Zuckerberg could have lost the control to the VC investor Microsoft and Peter Thiel.



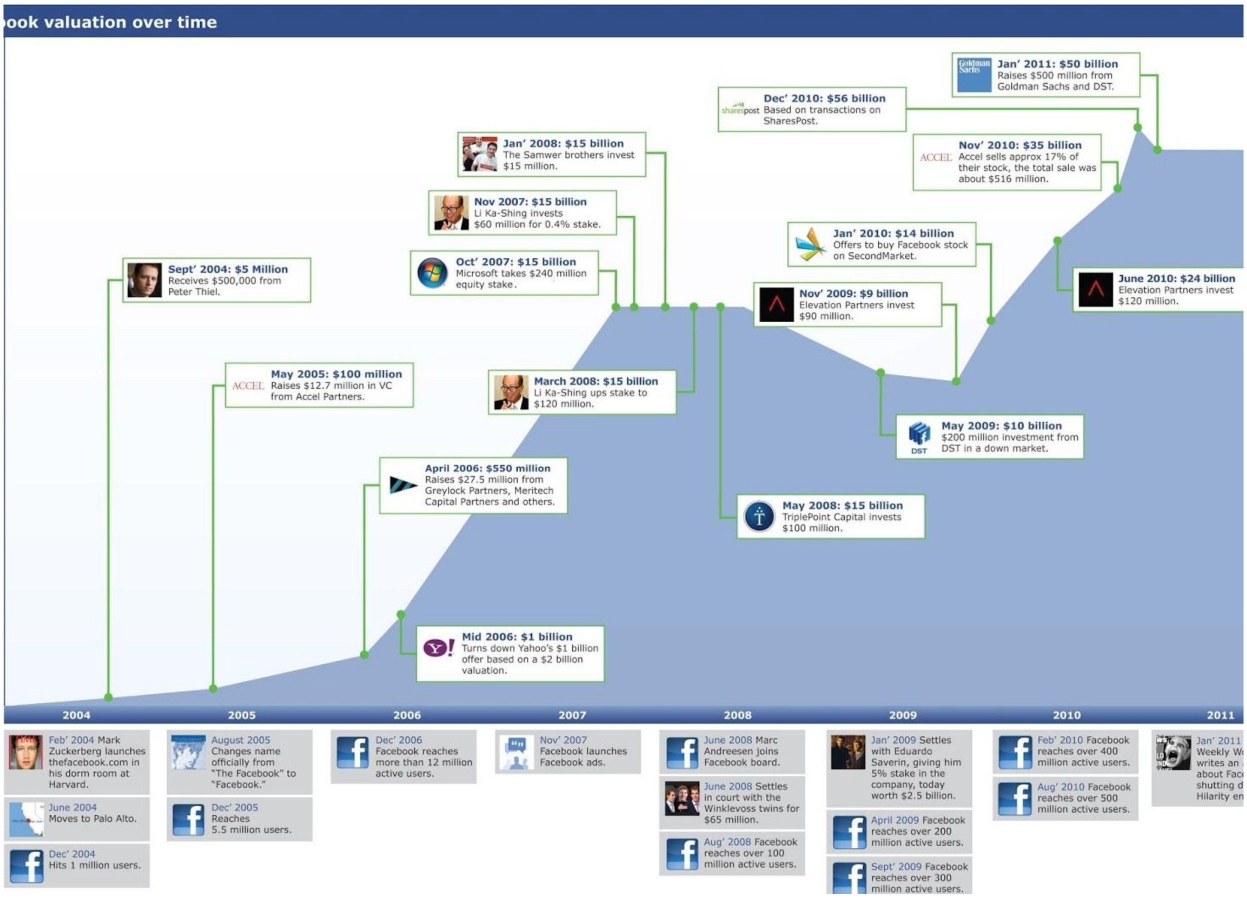
Valuation at each step (how much the investors value your company and therefore how much of it you need to give up to get this money) and how much revenue you should generate at each step.

Valuations of Facebook

Fair or not, not all startups are equal in the eye of their potential investors. Some startups may be considered "hotter" than others and get much higher valuations. A hot startup may be even able to skip the pre-seed round and go directly to a seed round – meaning more money raised at a higher valuation. The criteria for a "hot" startup include:

- The background of the founders
  - attended a top university i.e. Stanford, MIT, Harvard. -Worked for Facebook.
  - had previous experience at a high-growth company, ie Facebook, Google, etc.
  - serial entrepreneur
- A "hot" market
  - It depends on the month or year – is it AI? Big Data? AR/VR, Cyber, Robotics.
- Hype
  - Do you have a big investor leading the round?
  - Have you gone through Y-Combinator?
  - Are you famous?- Worked for Facebook

- Location
    - Silicon Valley -Worked for Facebook
    - Other innovation clusters
- FOMO
    - A startup with a huge vision and story can create FOMO (fear of missing out) in investors – one of the strongest forces for accelerating your fundraising process. Worked out for Facebook.



Valuations Graph

Switch to profitability

Despite a valuation of 5 billion, the net revenue of Facebook was only 30 Million-

In August 2008, *BusinessWeek* reported that private sales by employees, as well as purchases by venture capital firms, were being done at share prices that put the company's total valuation at between $3.75 billion and $5 billion.In October 2008, Zuckerberg said "I don't think social networks can be monetized in the same way that search did ... In three years from now we have to figure out what the optimum model is. But that is not our primary focus today."Facebook hired Sheryl Sandberg as its Chief Operating Officer in March 2008. Sandberg is reported to have held a number of brainstorming sessions with Facebook employees on their long-term monetization strategy, which led to the conclusion that advertising would be the main source of monetization. Under Sandberg's leadership, Facebook made a number of changes to its advertising model with the aim of achieving profitability. In September 2009, Facebook stated that it had turned cash flow positive for the first time.[78]

In early 2012, Facebook disclosed that its profits had jumped 65% to $1 billion in the previous year when its revenue, which is mainly from advertising, had jumped almost 90% to $3.71 billion.[79] Facebook also reported that 56% of its advertising revenue comes from the U.S. alone, and that 12% of its revenue comes from Zynga, the social network game development company. Payments and other fees were $557 million up from $106 million the previous year.

Acquisitions

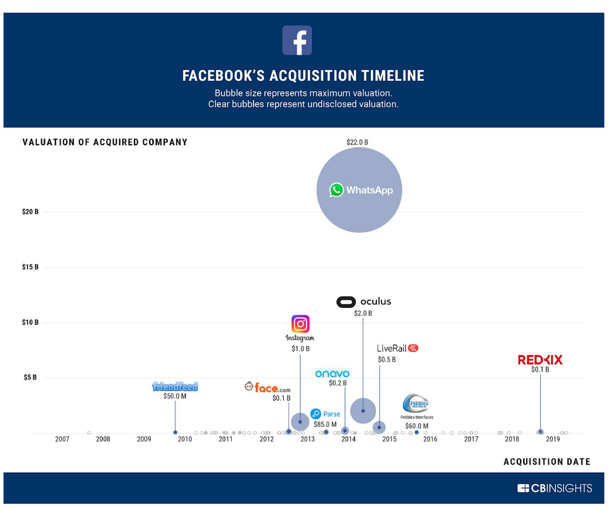
In August 2009, Facebook acquired social media real-time news aggregator FriendFeed,a startup created by Gmail's first engineer Paul Buchheit.In February 2010, Facebook acquired Malaysian contact-importing startup Octazen Solutions. On April 2, 2010, Facebook announced acquisition of a photo-sharing service called Divvyshot for an undisclosed amount. In June 2010, an online marketplace for trading private Facebook stock reflected a valuation of $11.5 billion.

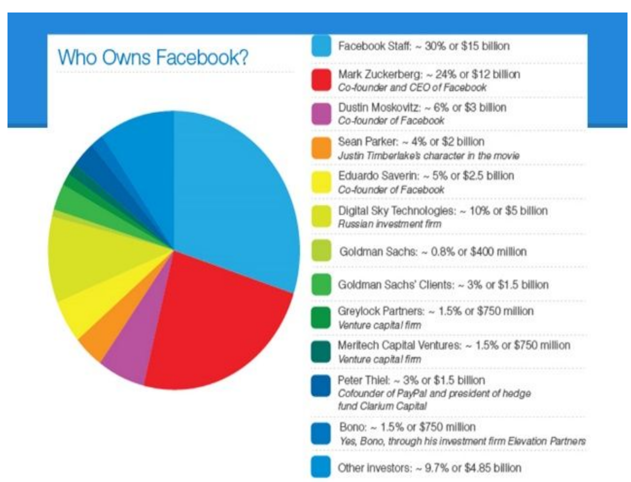
On April 12, 2012, Facebook acquired photo sharing service Instagram for approximately $1 billion in cash and stock.

On March 8, 2013, Facebook announced that they acquired the team from Storylane, but not the product itself.On October 13, 2013, Facebook acquired Onavo, an Israeli analytics company, for approximately $120 million.

On February 19, 2014, Facebook announced its acquisition of WhatsApp, a smartphone instant messaging application for $19 billion in a mix of stock and cash. The acquisition is the most ever paid for a venture-capital backed startup.

On March 25, 2014, Facebook announced they had acquired virtual reality startup Oculus VR for $2 billion in cash and stock.





http://thenextweb.com/facebook/2011/01/12/so-who-really-owns-facebook-chart/

3. In hindsight, could this startup have done things differently in terms of timing, amount of fund, valuation, or usage of funds?

Facebook did have a validated idea. Given that, It launched on Feb 4,2004 and by the end of the month almost three-quarters of Harvard undergrads were using it, without a dollar spent on marketing, also half of the users came back to site every single day. With this validated growth they got the funding. However, Zuckerberg did sacrifice careful planning, development, and important partnerships for the sake of flatout speed. Mergers were bad.

The important partnership with the cofounder (Chris Hughes and Eduardo Savin) went so down that he reportedly asked the Government and the Regulators to break Facebook. Eduardo Savin famously sued Zuckerberg. Facebook also committed mistakes in finding product-market fit for eg. privacy of news feed and photos was open to everyone which led to huge protests and rallies, also firing up a political revolt in Turkey. **If Facebook had the co-founders with them who launched the initial facebook, these mistakes could be avoided,** but due to Zuckerberg choosing to be the **“king” (i.e. he wanted to be the “only” one in control, CEO) vs “rich”** (i.e. diluting the percentage of founders’ equity). Mark Zuckerberg’s friends like Adam D’ Angelo, Eduardo Savin, Steve Chen, left Facebook at an early stage who then created competing companies and platforms like Quora, YouTube, working in Twitter etc. This was concluded in the famous tagline of Movie “The Social Network”-

*“You don't get to 500 million friends without **making** a few **enemies**.”*

4. Explore research online

We used online information due to home-lockdown and understood the funding strategy for Facebook. Some more history from online sources tell that maybe losing Savin as co-founder was beneficial for Zuckerberg as the former Napster and Plaxo employee Sean Parker, who at the time had assumed the title of **"President" of Facebook**, helped in Thiel’s investment.

Parker approached Reid Hoffman, the CEO of work-based social network LinkedIn. Hoffman liked Facebook but declined to be the lead investor because of the potential for conflict of interest with his duties as LinkedIn CEO. He redirected Parker to Peter Thiel, whom he knew from their PayPal days (both Hoffman and Thiel are considered members of the PayPal Mafia). Thiel met Parker and Mark Zuckerberg, the Harvard college student who had founded Facebook and controlled it. Thiel and Zuckerberg got along well and Thiel agreed to lead Facebook's seed round with $500,000 for 10.2% of the company. Hoffman and Mark Pincus also participated in the round, along with Maurice Werdegar who led the investment on behalf of Western Technology Investment. The investment was originally in the form of a convertible note, to be converted to equity if Facebook reached 1.5 million users by the end of 2004. Although Facebook narrowly missed the target, Thiel allowed the loan to be converted to equity anyway.Thiel said of his investment:*“I was comfortable with them pursuing their original vision. And it was a very reasonable valuation. I thought it was going to be a pretty safe investment."*

REFERENCES

1. Wikipidea(https://en.wikipedia.org/wiki/History_of_Facebook)
2. http://https://techcrunch.com/2005/09/07/85-of-college-students-use-facebook/
3. https://arstechnica.com/tech-policy/2019/07/facebook-cofounder-lobbies-hard-to-break-up-company-he-helped-create/
4. https://en.wikipedia.org/wiki/History_of_Facebook#cite_note-BW-6Aug08-77
5. https://www.google.com/url?sa=i&url=https%3A%2F%2Fwww.fool.com%2Finvesting%2F2019%2F10%2F01%2Fwhy-mark-zuckerberg-needs-to-control-facebook-in-h.aspx&psig=AOvVaw2Y4UAvjHN8PzxMaI_5WIzU&ust=1586609979176000&source=images&cd=vfe&ved=0CA0QjhxqFwoTCMj6rvf03egCFQAAAAAdAAAAABAD
6. https://www.marketwatch.com/story/facebook-insider-sales-are-huge-red-flags-2012-05-17
7. https://techcrunch.com/2011/01/10/facebook-5/
8. https://www.fool.com/investing/2019/10/01/why-mark-zuckerberg-needs-to-control-facebook-in-h.aspx