Hunter Walk

99% Humble, 1% Brag

HOME ABOUT FOLLOW BLOG VIA EMAIL

Why I Don't Ask "Is This a Billion Dollar Business" Before I Invest

Posted on November 18, 2013 by hunterwalk

Unicorn hunting is hard! As Aileen Lee's recent blog post suggested, there are only a few dozen billion dollar+ companies created each decade. If you're a large venture fund, you need to be invested in several of them in order to show returns considered upper-echelon. For early stage funds like ours (Homebrew is a \$35 million seed fund), backing a unicorn can result in overall ROI of 10x or higher. Chris Sacca's Lowercase Capital invested in both Twitter and Uber early. Steve Anderson's Baseline was in Instagram. Both of their funds have performed extremely well.

Given these realities wouldn't you expect us to ask ourselves "is this a billion dollar company?" before making an investment? Well, we don't. Not because we don't want to invest in high growth unicorns or that we're serious about maintaining a disciplined approach to our strategy. ~6 months into Homebrew I'm still evolving my filters but my inclination is it's the wrong question for a seed fund like ours to pose. One which might actually cause us to miss out on big returns.

Why?

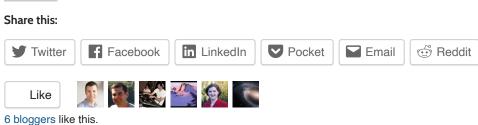
It's Not About the Market Size, It's About the Size of the Problem the Startup is Solving. Billion dollars startups don't always start out as billion dollar markets. Yes sometimes they are clearly going after a marketspace that's already defined: CRM 2.0 replacing CRM 1.0 but there are other paths to riches. Billion dollar companies often create new markets by tapping into unmet demand. Billion dollar companies can start out looking like toys. It can be about levels of zoom – like on a

Google Map. If you thought airbnb was just the size of the hostel market and not the hospitality market, you missed out. If you thought Uber was just the size of the black car market and not the transportation market, you missed out. At Homebrew we try to understand the problem, the customer mindset and business model (current and/or potential).

The "Why" Will Show You The Way. In addition to understanding the Who, What & How of a Startup, we spend a lot of time on the Why? Why are the founders dedicating minimally several years of their lives to this effort? By understanding the motivations of the entrepreneurs – what's driving them, what does success look like to them – you can try to determine whether they're in for a potentially long journey or is this nearterm opportunism. A big evergreen problem to solve and a superior team that wants to make sure they're the ones to solve it = recipe for a billion dollar company.

So there is one question with a dollar sign that we do ask ourselves: How Can This Investment Return the Fund Once Over (ie \$35 million)? This is a factor of the company's ultimate value and the percentage of it that we own. Let's say we're going to own 10% in return for our seed investment. Assuming we continue to invest our pro rata, the company would eventually have to exit for \$350 million to return \$35m to Homebrew. We ask ourselves this question because different companies have different paths to this outcome based on their business – for example, an agency that primarily relies upon billing customers for project work will be valued at a much smaller multiple of revenue than a SaaS company with a reoccurring revenue stream and margin leverage. While we don't make investments solely based on this question, if we have a difficult time answering it might mean the opportunity isn't a good fit for our model. It also helps determine our thinking on ownership percentage – whether we think we need to investment more or less to get to a comfortable point. Note that this has nothing to do with probability of achieving said outcome – that's a totally different calculation. This is more about understanding some of the possible paths to an outcome which starts to make a difference to our investors.

If a venture capitalist asks a founder "will this be a billion dollar company?" there's only one right answer: "yes." Unfortunately that question – and its answer – really doesn't tell you much. Nor is always trying to place the company into a well-understood bucket. But if you ask a different set of questions, perhaps you'll end up with a few unicorns of your own.



This entry was posted in <u>Uncategorized</u>. Bookmark the <u>permalink</u>.

← Reshaping the News: The Skimm Ra	aises	Seed
Round from Homebrew		

Three New Types of AngelList Syndicates I Hope to See \rightarrow

12 thoughts on "Why I Don't Ask "Is This a Billion Dollar Business" Before I Invest"

Pingback: Market Size versus Problem Size | Burato.net

Pingback: VC: Please Don't Try to Build a Billion-Dollar Company | Enjoying The Moment

Pingback: Great Entrepreneurs Pick Great Markets - Rob Go - Harvard Business Review

Pingback: Great Entrepreneurs Pick Great Markets | Joe Garde

Pingback: DHN News | Great Entrepreneurs Pick Great Markets

Pingback: Great article from the HBR Blog by Rob Go | Nicholasloise's Blog

Pingback: Great Entrepreneurs Pick Great Markets: (1) Moats, (2) Mega Trends, (3) Concentration, (4) Market Creation | Bamboo Innovator

Pingback: One Investment to	Return the Fund	I David Cummings	on Startups
-----------------------------	-----------------	------------------	-------------

Pingback: The Pro-Rata Participation Right – AVC

Pingback: You're Either Venture-Backed or a Lifestyle Business: The Big Lie | Hunter Walk

Pingback: The best of the web | You're Either Venture-Backed or a Lifestyle...

Pingback: Why Your Startup Should Go After a Small Market Opportunity

Comments are closed.

RECENT POSTS

Did Employee Startup Equity Change Much in 2019? I Don't Think So.

How I Calmed The Failure Tiger Nipping At My Heels

The Five Most Influential VCs of the 2010s

You're Probably Asking the Wrong People For Career Advice

No, It's Not "Like a Startup Within a Big Company"

FOLLOW BLOG VIA EMAIL

Enter your email address to follow this blog and receive notifications of new posts by email.

Enter your email address

Follow

ARCHIVES

Select Month

-

Search ...

META

Register

Log in

Entries feed

Comments feed

WordPress.com

MORE OF ME?

@hunterwalk on Twitter

hunterwalk on Instagram

NEW STUFF I'M LIKING

My favorite travel coffee cup

If you own a Mac laptop, you need this travel **charger adapter**

Hunter Walk Powered by WordPress.com