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

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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 marketplace 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.

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