Snapchat Founders’ Grip Tightened After a Spat With an Early Investor

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7-8 minutes

Credit...Steve Jennings/Getty Images

When Snap goes public next month, one of the biggest winners will be Lightspeed Venture Partners.

Lightspeed, a Silicon Valley venture capital firm, was the first institution to invest in Snap, the company that popularized disappearing messages, and it is now set to reap more than $1 billion from what began as a mere $485,000 investment.

But the big money for Lightspeed masks a complicated tale between the venture firm and Snap, the parent company of Snapchat. It is a story that offers a peek into the often opaque world of venture capital, into how start-ups begin and into the politics over money that accompany the relationships between companies and entrepreneurs. It is not a story that many of those involved want to discuss, especially with Snap executives now on a heavily hyped investor roadshow ahead of the public offering.

One of the biggest questions that Snap has faced from potential investors is why its two founders, Evan Spiegel and Bobby Murphy, have retained such a hold on voting power in the company — power that public shareholders will not gain. Exploring that question helps explain how years-ago dealings with venture capitalists helped lead to this point.

At the heart of that is a Lightspeed venture capitalist, Jeremy Liew, and the terms he embedded in his 2012 investment in what was then known as Snapchat. The terms gave Mr. Liew outsize power over the company’s future financing round. That ended up irking Snapchat’s chief executive, Mr. Spiegel, who took steps to reassert control over the company.

The end result was a largely severed connection. Today, Lightspeed is listed in Snap’s I.P.O. prospectus as the company’s second biggest venture investor, with 86.6 million shares, or a stake of more than 8 percent, and Mr. Liew has appeared on television shows, podcasts and in technology publications to discuss Snap. Yet he and Snap no longer have close ties, and Mr. Spiegel has not had meetings or spent time with Mr. Liew since the early investment rounds.

This account is based on interviews with four people involved in or briefed on Snap’s funding history, and who asked for anonymity because the details are confidential. Representatives for Snap and Lightspeed declined to comment, citing Security and Exchange Commission rules.

Mr. Liew and Mr. Spiegel met in March 2012, when Mr. Liew used Facebook to contact Mr. Spiegel, a Stanford University student who had recently started Snapchat with Mr. Murphy, a fraternity brother. At the meeting that followed, Mr. Spiegel said his father was tired of paying Snapchat’s bills. Mr. Liew offered to help.

Mr. Liew offered to invest $485,000 in Snapchat, which Mr. Spiegel and Mr. Murphy accepted. The investment was completed in less than two weeks.

What Mr. Spiegel and Mr. Murphy paid less attention to were the exact terms that Mr. Liew embedded in the deal. Those terms gave Lightspeed the right of first refusal to invest in a future round of funding and the ability to increase its share of the company in that round. Lightspeed could also take 50 percent of the future round.

Such terms effectively let Lightspeed have veto power over investment at Snap. It also made Snap an unattractive investment for other investors — who would not be able to take as large a stake as they would like in the company.

The provisions soon became a sticking point. A few months after Lightspeed completed its investment in Snapchat, another Silicon Valley venture firm, General Catalyst, became interested in investing in the company. General Catalyst said this month that it had offered Snapchat $2 million to $3 million, putting the company's valuation at $22 million.

Mr. Liew's terms prevented the deal. A General Catalyst spokeswoman declined to comment for this article.

Mr. Spiegel was unhappy with the outcome. Over the years, he has alluded to his early dissatisfaction with venture investors. In a 2015 interview at a start-up awards show, he said: "When we were first getting started and took financing, our lawyers would take us through the documents and they'd say: 'Oh, don't worry about it. It's all standard.'"

"I've since learned that standard means either the person who's walking you through documents doesn't understand them or you could be getting taken advantage of," Mr. Spiegel continued. "When someone says something is standard, just ask why, and why and why and why, until you really understand intricately, I think, how the deal is structured."

Mr. Spiegel embarked on a way to work around Lightspeed and Mr. Liew so that he could get the investors he wanted in the future. To do so, he struck a deal with Mr. Liew: Lightspeed would be able to buy a limited number of Snapchat shares at a discount. In exchange, the venture firm would remove its right-of-first-refusal clause and other terms that the Snapchat founders considered onerous.

Mr. Spiegel later added provisions of his own to Snapchat's corporate charter. He authorized the creation of a class of preferred stock, FP Preferred, which would have 10-to-1 voting rights, allowing its holders to exercise far more voting power than holders of regular, or common, stock.

Mr. Spiegel and Mr. Murphy control the FP Preferred shares, which also gives them the power to vote on many things, including the rights of other shareholders. The Snap founders' overwhelming control of the company is now one of the most talked-about features in its I.P.O. filing.

Early institutional investors often take board seats with the companies they nurture and become key advisers. Mr. Liew was not chosen to be an early board member, but other venture investors have joined Snap's board since. Mitch Lasky, a partner at Benchmark, became a board member in 2013 after his firm led an investment round in Snapchat.

Mr. Spiegel and Mr. Lasky are close. According to emails between them that have become public, Mr. Lasky has advised Mr. Spiegel on Snap's valuation and fund-raising, among other things.

Mr. Liew remains special to Snap in one way: He was the first and last investor to get special terms from the company. In subsequent deals, Mr. Spiegel and Mr. Murphy retained voting control and did not grant preferential treatment to investors.

Correction: Feb. 28, 2017

An article on Friday about the relationship between the creators of Snap and the Silicon Valley venture capital firm Lightspeed misstated terms that Lightspeed was granted when it became the first investor in Snap. Lightspeed was granted the right of first refusal to invest and the ability to increase its share of the company in the next round of funding for Snap, not in multiple future rounds of funding.

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