How to Angel Invest, Part 1

46-59 minutes

This is a preview of our Spearhead podcast, where we discuss startups and angel investing.

Naval: Hey everybody, it's Naval and Nivi. We're going to talk about something very different than what we've discussed in the past.

Back in the day, we did Venture Hacks, which was all about the game theory of venture capital and helping entrepreneurs raise money. Later, we talked about "How to Get Rich," which was general advice on wealth creation for the average person who's starting a business. Now we're going to talk about angel investing.

Advice for new angels in technology hubs

We expect this podcast to resonate most with people who are in a technology hub and have started investing but are not yet pros. So brand-new angels, VCs and founders who are dabbling in it.

Let's say you're living in Silicon Valley—or you're in Shanghai or Beijing, or you're in Bangalore, or you're in London, or you're in New York—and you get access to a lot of interesting tech companies; you're in the tech business and earned some extra money or raised some money. How do you become a good investor?

Where to learn the basics

This podcast assumes that you have some familiarity with investing. It's not going to be a cold start. There are resources we can point you to for the cold start. Paul Graham wrote a piece called "How to be an Angel Investor." There's "How to be an Angel Investor, Part 2" on Venture Hacks. There's a course called Future Investor. You can look at all of those for the basics.

We're going to focus on more advanced topics in this conversation. We're going to talk about things like how to figure out what a fair valuation is; what are the pitfalls of bridge rounds; how pro-ratas work; how can you squeeze into a round when there are VCs leading; when a co-investor is providing a valuable signal versus when they're just talking their own book; how to size up markets and startups quickly; whether you should specialize in a single vertical or diversify into multiple verticals.

Open-sourcing what we teach at Spearhead

This podcast open-sources what we teach at Spearhead, a fund we created that trains the next generation of angel investors. It gives founders checkbooks, provides mentorship and teaches them the skill of investing, which is something that will be valuable to them for their entire lives.

Strong Opinions, Loosely Held

This is not investment advice; it's just one unique approach to investing

Naval: Now, this is the Internet and this is America, so we have to give you some disclaimers. Angel investing is a great way to lose your money. There's an old quip, "How do you become a millionaire? Start as a billionaire and start investing." This is a good way to lose money if you don't know what you're doing, or if your timing is bad, or if you're just plain unlucky.

This is not investment advice

Naval: This is not investment advice; but you may find this useful if you're already in the profession or in the hobby of angel investing.

Nivi: Like everybody else, our advice is going to be well-meaning but we'll probably end up talking our own book in the process.

Some of what we say will be speculative, but it'll be stated as if it's a fact. Some other things we say will be just plain wrong.

Naval: Our advice may go out of date quickly because technology is changing rapidly, as is the investment ecosystem. A decade ago Y Combinator was brand new; AngelList didn't even exist; the First Round Capital platform wasn't there; Andreessen Horowitz wasn't there; you didn't have a lot of late-stage investments by hedge funds; you still had companies going public earlier. So the market was very different.

This is just one unique approach to investing

Nivi: This is one unique approach to angel investing. The things we're going to talk about might work for us from time to time, but other people might have similar or better results with completely different or opposite strategies.

Naval: We're very focused on early-stage technology startups in San Francisco and Silicon Valley. A lot of this will not translate to other locations. There are many important exceptions to everything we're going to talk about.

Nivi: We'll also be discussing startups and funds that we've personally invested in and have a financial interest in.

We change our minds constantly

Naval: We're also constantly changing our minds and learning. That's what intelligent people do. We hold contradictory and opposing thoughts in our head at the same time. We have a multitude of opinions that often contradict each other. This is not math or science or equations, and we're always changing our opinions. As Marc Andreessen says, "Strong opinions, loosely held."

Living in a Tech Hub Is Half the Battle

It's a gold rush era in technology hubs like Silicon Valley

Naval: We're living through a unique time when, as Andreessen says, software is eating the world. We're undergoing a phase shift where technology is being adopted by everybody, not just knowledge workers.

This transition has created a gold rush era in technology. If you're in the tech industry and living in one of the tech hubs, you're already halfway to being a good investor. That's half the battle. You're well positioned to angel invest.

There are only a handful of these hubs. If you have to ask, then you probably aren't in one. It's usually obvious. There will be hundreds of startups, at least, including some with successful exits that made their investors rich.

If you're not in a tech hub, the odds are stacked against you

If you're in the tech industry but not in a tech hub, you should consider moving to one—unless there are strong lifestyle reasons keeping you away, such as family or quality of life, which is often higher outside of the technology hubs.

You *can* do it remotely, but the odds are stacked against you. You won't have the trust networks; you won't see enough of the dealflow. In this case, it's often better to work through a proxy, like investing in a trusted friend's venture fund or going through AngelList or coming in for YC Demo Day.

There are about two dozen tech hubs in the world

Nivi: Do you think this advice is just for people in Silicon Valley, or does this apply in New York? Does it apply in Seattle? Austin? China? Bengaluru?

Naval: I think it applies in probably two dozen cities around the world. Some of these cities are emerging, which complicates this. Seattle and Austin are probably stable; you can probably find good deals there. But you need to have access to everything and realize that the city may only produce one or two great companies each year.

Silicon Valley is a more forgiving place to invest

Silicon Valley's a little more forgiving: There are maybe 20 or 30 great companies created every year. You just need to invest in one of them—although you'll have to find them in a much larger pool of companies.

Places like Bengaluru, India, or even Kuala Lumpur, Malaysia, be may be up-and-coming cities, but timing is hard: Is *this* when the tech industry there breaks through? If you're in Australia and invested in Canva or Atlassian, then great. But if not, there's not as much of a pool to work with.

At the same time, your returns potentially can be a lot higher outside of tech hubs. Because there's less competition, the valuations tend to be lower because the risks are higher.

You don't want to be in a city with no history of producing good startups, where you only see one or two startups a year and you're paying Silicon Valley prices because they're keying off of valuations they saw at YC Demo Day.

It's much safer and easier to get started in San Francisco, New York, Beijing, Shanghai or Bengaluru. Pros can play in places like London, Austin, Seattle, Denver, Boulder and Chicago.

Anything below that, and you better know what you're doing. We have seen a phenomenon on AngelList: Angels invest locally in a city that is not producing good tech startups, only to surrender and start investing in Bay Area startups because they don't see the quality or returns in other cities. The returns are so much higher in Silicon Valley.

The best indicators of a startup hub are exits and later-stage investors

Nivi: What's the best indicator that a startup hub is working? Is it exits? Is it a thriving community of other angel investors?

Naval: Unfortunately, it's exits.

The typical way a hub develops is this: Founders start a company, the company does well, the founders and employees get rich in the IPO or acquisition—and then they start investing in their friends and co-workers. They feel comfortable doing this early investing because they made their money through tech startups. They want to put it back into tech startups.

But there are a lot of false starts. Angel investors will pop up in an area and invest in a bunch of companies—but then those companies get stranded because there are too few Series A or Series B VCs there to invest in them. The VCs come in, pay low valuations and wipe out early investors by converting them to common and putting warrants on top.

So funding markets, to some extent, develop in reverse compared to other markets. The least risky investments are mezzanine rounds right before the company goes public. Next are Series Ds and Series Cs. Series Bs are riskier than that, and Series A even riskier. The riskiest is angel investing, before the Series A.

So, in a weird way, angel investing is the thing that should develop last in new hubs. But that's not always the case. If a company can break out with just angel money, then later-stage money will find it no matter where it is—or the company can move to a mature hub with later-stage investors. But then, you have a big funding gap between the angel investment and the next investor, so the company has to get really far on just the angel investment.

You're Living Inside the Gold Mine

There's no better place to invest today than technology

Naval: The returns in angel investing are interesting. There's this meme that angel investors lose all their money and venture capital is a terrible business. It's true if you aggregate VC and angel investments across the world. But if you stay focused in technology hubs, it's largely not true.

A competent angel investor in Silicon Valley who's plugged into a good network, knows what they're doing and has a broad portfolio might make somewhere between three to 10 times their money over a decade. That's quite a return. Keep in mind, though, there's a high amount of specific knowledge and labor that investors put into each of these investments.

There are tax benefits to angel investing

These gains are considered capital gains, which are usually taxed at lower rates than income. This is partially because it's a secondary tax on corporate income; it's already been taxed at the corporate level.

There are also tax breaks for angel investors ranging from the qualified small business stock exemption in the United States to very favorable tax breaks in England and other countries.

From a tax-advantaged basis, if you're willing to tolerate high risk and illiquidity, it's very hard to look at any other asset class where you can make as much of a raw return on your money as a patient, diversified, plugged-in angel investor.

The less efficient the market, the better you will do

One way to think about it is: The less efficient the market and the more wealth the underlying asset is creating, the better off you're going to do. For example, art doesn't really create that much wealth; it's more of a tax haven and speculation instrument. The same with wine: The asset itself does not generate much wealth, but the underlying market is very inefficient; so you can make money more easily.

Gambling actually destroys wealth. So it's not a great asset class to play in, unless you own the casino, in which case you have an edge over everybody else.

Few people can play at angel investing

Angel investing is odd in that very few people can play in it. Very few people have the know-how, geographic access, capital, risk horizon and patience. But at the same time, the underlying assets are changing the world.

I see a lot of people in Silicon Valley who could be good angel investors —they are in the tech industry and have access to dealflow—but instead spend their time on other things. They spend time thinking about macroeconomics: *What if the Fed cuts interest rates? What's happening in the trade war with China?* Or they're shorting stocks, investing in special economic zones or flipping real estate.

You should be doubling down on tech

I have a friend who's a great VC and runs a rental business on the side. I scratch my head at that. You're living inside the gold mine—people are digging up gold next to you. The returns in this industry are higher than anything else. You understand it so well. You have specific knowledge. But you have a contempt for investing more in tech that comes from your own familiarity with the industry.

If you're in the tech industry, you should be doubling down. I don't know a better industry or better place on the planet to be investing, for today.

IPOs Are for the Last Investors in Line

Financiers now come to Silicon Valley to invest in companies first

Naval: The tech industry is still underestimated. People used to think of Sand Hill Road as a nice, little backwater compared to the gargantuan Wall Street. Now there's an acknowledgment that Sand Hill Road is an important place, even though Wall Street still captures the headlines.

If you're investing in the IPO, you're literally last in line

It's becoming increasingly apparent that Sand Hill Road produces the technology that generates much of the wealth in the U.S. The wealth originates here and spreads elsewhere. Wall Street financiers now come to Silicon Valley to invest in companies before they get to Wall Street.

By the time a company goes public, you can bet anybody with connections, an appetite, investing skills and capital got a bite at it. So if you're investing in a tech company's IPO, you are literally last in line. That's not to say you can't make money—but the odds are lower because the fruit has been picked over many times.

Nivi: The last bunch of financiers who were sitting in the right place at the right time—we call them Wall Street. This is where people used to get capital for their startups. Back then, there was no other market for fundraising until you had the metrics to go public.

Silicon Valley is turning into the new Wall Street, except it's not as formalized, organized and segmented. The JP Morgans and NASDAQs haven't popped up.

A 401(k) plan is like investing in the DMV

Naval: This is going to fly in the face of conventional wisdom. The average person should be saving for their retirement. But I never set out to save anything; I reinvested almost everything.

In economics, there's the savings identity, S=I, savings equals investment. If you contribute to a 401(k), that money is getting reinvested in "safe" but unproductive parts of society, such as the government.

You're investing in the DMV and the Defense Department. Their returns have not been spectacular. It's essentially just whatever money they can take at gunpoint from taxpayers and foreigners.

If you're in the tech industry, it's generally a better bet to invest back in the industry—especially if you're young and can get diversified.

$50,000 invested in a smart entrepreneur will change their life

Invest in the smartest, best and brightest people around you, rather than people in far-away lands with far-away motives who already have trillions of dollars of capital flowing into them and are not as motivated as your neighbors.

Fifty thousand dollars in your IRA isn't going to make a difference to the U.S. government when it gets put into a T-bill. But $50,000 invested in an entrepreneur down the street will change their life.

If you can find 10 to 50 investments like that, one or two of them may pay off, assuming you listen to us and build skills along the way.

I sleep well knowing my net worth is invested in the best talent

Most of my net worth is illiquid and lying in startup companies. But I sleep well at night knowing that hundreds of teams of brilliant entrepreneurs are working hard to build things that could be massive and change the world.

These teams include some of the best talent in the world: founders, coders and designers who studied at top schools. They're leveraged with venture capital, products with no marginal cost of reproduction and the most modern methods of distribution.

It just takes a few of these companies for the entire portfolio to balance out. If you invest in 100 companies and one of them produces a 1,000x return—which is not that unheard of—the other 99 investments could go to zero and you would still see an overall return of 10x.

Being a Founder Your Entire Life Is a Tough Road

As the hits get bigger, it makes more sense to invest and a little less sense to start companies

Naval: Like other industries, the best way to make money in technology is to own a piece of a business. "You're not going to get rich renting out your time. You must own equity—a piece of a business—to gain your financial freedom."

Founder, employee or investor?

How do you gain substantial equity in a business? One of the classic models is to start your own company. There are downsides, though. For one, it's highly stressful, grueling work. For another, your chances of success aren't great; very few companies succeed. You may have to get back up at the plate and take a few rounds at bat.

Another classic route is to get recognized as an extremely competent execution person, so you get the call when the next successful company's scaling. You want your name on the list when the founders of the next Uber of Dropbox call up their favorite investors and say, "Hey, who are your 10 best engineers that I can recruit right now?"

Someone who's done a great job at other companies can get a fairly large amount of equity to join a rocketship that's already solved product-market fit.

As the hits get bigger, it makes more sense to invest

Finally, you can get rich as an investor. As the hits become bigger and bigger and the returns become more nonlinear, it makes more sense to play as an investor and a little less sense to play as a founder.

This is because the upside is nonlinear. When you invest in a startup, you can make a 100x, 1000x, 5000x, 10,000x return—if you were in a Facebook seed round, for example. You'll own a lot more of your own company, but you may only make a 10x or 100x return.

The human brain is not wired to understand nonlinearities. The people who do—people like Paul Graham and Peter Thiel—end up becoming billionaires as investors, rather than through companies they started themselves.

Now, being a founder is a lot more fulfilling than investing. Many investors tell me they wish they were building something. Being a founder gives you a deeper sense of purpose. There is a sense of teamwork and really being involved.

On the other hand, leading companies burns you out and ages you quickly. Being a founder your entire life is a very tough road. Most people do not have the constitution for it.

Angel investing is something you can do until the day you die

Angel investing is something you can do when you're 50, 60, 70 years old. It's something you can do part-time, if you're partially retired or on leave with a new baby. It's a way to make money when you can't crank like you used to as an entrepreneur, whether you're focusing on your family, have a health issue or are simply tired.

Nivi: Your judgement and your access to capital and dealflow also go up as you get older. It takes a long time to learn, but investing is one of the few professions where you can improve until the day you die.

Naval: Warren Buffet is one of the richest, self-made people on the planet because he's been compounding capital for a long time. He started reading annual reports when he was 10, 11, 12 years old, and he's still going strong. If he started later, he would be nowhere near the top 400 list on *Forbes*, because the magic of compounding wouldn't have worked.

Every founder should learn angel investing

There's a famous line, "Try to learn something about everything and everything about something." In that sense, it's great to be a founder and also do some investing.

Nivi: Updating that quote for founders: Focus on your work and invest in your network.

No investor would put all their eggs in one basket—why should you? The smart money isn't trying to find the solution to product-market fit. Instead, it's betting on a lot of reasonable solutions.

Investing Takes Capital, Judgment and Dealflow

You need to raise money, develop judgment over time and gain access to the right deals

Naval: The three things it takes to get into investing are capital, judgment and dealflow.

Capital is the hardest or easiest to get—depending on your circumstances

To get capital, either you make your own money to invest, or you gain enough trust from other people to invest their capital.

Sometimes you scratch your head and say, "How's this person in the venture business?" Often, they have family money or married into money; or they managed money for somebody else; or they have a billionaire friend; or they had access to a large fund and that capital got them in the business.

At Spearhead we train founders to be investors by giving them million-dollar checkbooks. Later on, we help them raise more money from limited partners. So that's another way to get capital.

Money raised from friends and family can be either the hardest or easiest money to raise, depending on your circumstances.

Apply the same high bar to investments as you do to yourself

Second is judgment. They say good judgment comes from experience, and experience comes from bad judgment. You build good judgment over time.

Judgment means applying your highest standards and taste in the things you know the best.

As a founder, you set a high bar for yourself: You only want to recruit the absolute best; you only want to do your best work; you're constantly improving; you're the worst critic of your business; every little thing that's wrong with your product bothers you.

Then you meet someone raising money, fall in love with their idea and ignore other things: the person doesn't seem that smart; or it's not someone that you'd work for or even hire; or their product is only half-baked; or they're executing slowly.

You look past all of that. You lower your judgment because you fantasize about all the things that could go right.

It's very important when you're investing in other people that you keep a high bar and use sound judgment. You need to have taste.

Good investors are more pessimistic than good founders

Some of the best investors I know are incredibly difficult people. It's hard to please them; they see the problems in everything. A good investor often is a lot more cynical and pessimistic than a good founder.

A good founder must be a rational optimist; whereas a good investor can bounce maniacally between being optimistic enough to see the future and get into the deal, and being pessimistic enough to see the potential downsides and pass on nine out of the 10 deals they see.

If you do more than one out of every 10 deals that you look at, you're probably being too optimistic. If you stumble into great deals all the time, that says more about you than it does about your dealflow.

There are exceptions, of course. You might have a unique advantage to your network: if you're sitting in the latest YC batch and see everything early; or if you run the Stanford Entrepreneurship Network and are picking from the crop getting funded by VCs, for example.

Everybody has dealflow—the challenge is getting in the good ones

The last piece is dealflow, which also includes access. This is an area we're going to focus on: How do you get dealflow? How do you get good access?

Dealflow and access are not the same thing. You can get dealflow by going on AngelList; by sitting at Y Combinator Demo Day; by going to any technology conference; even by watching "Shark Tank"—but that doesn't mean you have access to those deals. It doesn't mean that you have the ability to invest in those deals when you want, on the terms that you want.

When you get cut out of hot deals, that's a sign you're going to perform poorly as an angel investor. You need to do whatever it takes to up your access.

Don't Let Deals Pass on You

M*ost returns come from a few deals—don't let them pass on you*

Nivi: There are so many sources of dealflow out there, from friends and incubators to AngelList, FundersClub and Republic. Why is it so important to get into the deals you want to get in to? What happens if you don't?

The majority of returns come from a few deals

Naval: One out of 100 or 1000 companies account for the majority of the returns every year.

If you look at just about any successful angel investor's portfolio, the majority of returns come from one deal. And when you take out the top deal, the majority of the remaining returns come from the second-largest deal. It's extremely nonlinear.

If you removed the top two or three deals out of just about any fund's portfolio, you would probably have a negative performing fund, instead of a 4x to 10x fund.

Getting cut out of deals is a sign you won't do well

It's all about adverse selection. When you get cut out of a deal, that's an indication that the deal may be a winner. Instead of a one-in-100 chance of becoming big, the chances are probably one-in-five or better.

This is a common scenario: You meet a company that's raising capital, and while you're taking to time decide, a top-branded investor rolls in and writes a big check; next thing you know, everybody piles in because there's tons of signal; and now the entrepreneur says, "Sorry, the round's closed," or, "I only have $10,000 left for you." This is when your brand makes a difference.

I started AngelList partially because I was cut out of some very big deals early on that, to this day, I have qualms over. These would have been career-defining deals that would have made me a lot money. But my brand simply wasn't strong enough.

Even though you want to be non-consensus right, there comes a point when consensus has value: when the Sequoias of the world show up; when the statistics become more baked; when the founders are well known; when there's more information on the table.

Also, when Sequoia invests, it can create a self-fulfilling prophecy by removing some future financing risk and allowing the company to stand out when it's recruiting or going for PR.

Nivi: Dealflow and access are the most important things to work on as an investor. Your judgment doesn't have to be that great, because the returns follow a power law. And you can always get capital if you have good dealflow and access.

It's okay to pass on investments—you just don't want them to pass on you. You don't want to hear, "I will come to you if I don't get money from Sequoia."

Paying two-and-twenty to a good angel investor is a steal

Naval: This is why it's often better to back an angel investor and pay their management fee and carry, rather than going out on your own. In angel investing, it's a steal.

The old two-and-twenty model was put in place by KKR, a private equity firm managing billions of dollars. Today, an angel who's managing a just a few million dollars will charge you the same two-and-twenty, even though their labor as a proportion of the invested capital is far higher.Go to YC and ask them to invest your money for two-and-twenty at the same time they put in their own money, and they'll laugh you out of the room.

You Need a Brand to Get into Hot Deals

A brand is an authentic reputation you have with founders and investors

Nivi: To get into good deals, you must give startups a reason to pick *you* over other investors. You need a brand. Typically, this means adding value to the startup in some unique way. Let's talk about 101 different ways to build a brand.

Naval: This is the meat of it, the heart of it. We'll get into how you develop judgment and the ins and outs of raising capital. All of that is secondary.

The single most important thing is having the ability to get into a deal that you want to get in to—that's access. The way you get access is by building a brand.

A brand is an authentic reputation you have with founders and investors that tells people around the table, "Let's invite this person to invest in our round, even though it's scarce and everybody wants in now that the signals are there."

So how do you build a brand?

Investing in winners is the best way to build a brand

The classic brands in the venture business developed reputations for making great investments. Sequoia was built this way. Andreessen was partially built this way, where you pay more for deals in later rounds. You associate yourself with the company's brand, and then you use that to get into earlier, hotter deals.

It's a tautology: Invest in the winning companies, and you'll develop a brand that lets you invest in winning companies. But that's circular; it doesn't help you much.

You can build a brand through content

Another way to build a brand is to provide something new that's pro-founder. This could be a stance: Andreessen Horowitz is famous for its founder-friendly stance; they want to see the founders run the company.

It could be content. I built a brand through Twitter. Elad Gil developed his brand partly by writing the *High Growth Handbook*. Reid Hoffman also wrote books, though he also has many other reasons to have a good brand.

You can build a brand through blogging. When he was getting started, Paul Graham wrote amazing pieces that attracted people to YC and Hacker News. Fred Wilson still maintains the most popular blog in venture capital at AVC. Brad Feld laid out the mechanics of VC investing—allowing him to run a fund out of Boulder, which is unusual.

Back in the day, David Hornik, Andrew Anker and I started VentureBlog, one of the first venture-related blogs. We should have stuck with it.

Many investors built great brands with a very founder-friendly stance and by providing content, networks, software, platforms or access for entrepreneurs that did not exist before.

You Can't Build a Brand by Aping Someone Else

The airwaves are too crowded for undifferentiated content and distribution

Naval: As we discussed, the first way to build a brand is being a good investor to begin with. A second way is creating content that helps entrepreneurs. A third way is building infrastructure or platforms that help entrepreneurs.

Paul Graham can get into deals because of Y Combinator. Nivi and I often can get into deals because we started AngelList. Ryan Hoover can get into deals because he started Product Hunt. Platforms created by First Round Capital and Andreessen Horowitz help thom win deals against other VCs.

You can also start a conference. Jason Lemkin created the SaaStr conference; Tim O'Reilly at OATV publishes content and hosts conferences.

Steven Lurie is great at recruiting, so he started Team Builder Ventures. He put his value right in his brand name. Companies know what he offers; they know why they should give him a piece of the round and how he's going to help them.

You're not going to build a brand simply because you want to

There are nuances, though. A VC will say, "We need to build a brand; therefore we need to have a blog. Let's hire a content writer and launch a blog." Or, "Man, I need to up my Twitter game. I'll get on Twitter and start telling entrepreneurs about my investment criteria."

You're not going to build a brand simply because you want to. Rather, a brand is an authentic expression of who you are. So whatever unique insight you have, express it in the most authentic way possible.

If you're good at Twitter, get on Twitter. If you're good at blogging, blog. If you're good at writing books, write books. If you're good at speaking, speak at conferences or create a podcast.

But you're not going to be successful by aping somebody else; it must be authentic to you.

Also, the media airwaves are now crowded, so you need top-quality content and distribution.

Even though this podcast is an amateur effort, we cut things into snippets, clean up the voices and create transcripts and highlights. We're at the leading edge of the curve.

Sure, other people can copy us and catch up—but by then we'll be somewhere else. We may be off writing a book, doing a road show, running an incubator or building another software platform. We stay ahead of the competition because we're always tinkering at the edge.

There's Very Little Innovation in Venture Capital

You have to be willing to do something that hasn't been done before

Naval: Whatever your brand is, it has to be clearly articulated; it has to be messaged. It has to be authentic to who you are. It should be differentiated from what everybody else is offering, and it should resonate with entrepreneurs. The worst strategy is taking a lot of coffee meetings or saying, "I'm a good, passive, hands-off person. I won't bother you, and I'm always available to help." It's too generic.

You can build a brand through your advisors and limited partners

If many of the investors and advisors to your fund are computer science professors at major universities, then entrepreneurs will want you as an investor because you have access to people who can bring grad students, help with technology diligence, or solve hard algorithmic problems.

You may come from the real estate industry, and all the real estate tech startups want you because you have a deep understanding of the industry, partners and contacts in the industry, and your own properties.

You can build software for startups

Nivi: You could be the world's expert at helping a startup raise its next round. You can build software for startups like AngelList. There's still 100 different things in the world of software for startups that haven't been done.

You can be an expert at raising money from international investors, in China or Brazil. You can break into a new market by backing scientists and technologists in a new market. You can be the world's expert at scaling. You could build open-source tools for startups.

Naval: There's extremely little innovation in the venture capital business. It's quite easy to stand out. You have to be willing to do something that other people haven't done before. In other words, you have to be willing to take on accountability and risk being wrong.

You can buy common stock instead of preferred

Nivi: Do you think someone will try to build a brand around buying common stock from entrepreneurs, instead of preferred stock?

Naval: People have done that a little bit. Andreessen Horowitz started to do that; they became registered investment advisors so they can do secondaries. You could argue that's a core part of YC's brand. They buy at a low valuation in the first round, but they used to buy common; so they were completely in the same boat as you.

There's no branded firm—or angel investor writing large checks—that is buying common. I think it's a clever strategy and something that we may yet see happen. It does have the problem where the company can shut down and keep your money.

But there are clever ways around that. You could say, "I'm buying preferred stock, but after two years it converts to common stock." When they burn through your cash and raise somebody else's cash, you're no longer sitting on top of them in a liquidation preference overhang. But at the same time, your money's already been spent, so it's not like they can shut down the company and run off with your money.

My Original Brand Was in Growth Hacking

I pitched growth hacking to Twitter; they passed on it—but they let me invest

Naval: Strangely enough, my brand started out in growth hacking. I co-built a Facebook app that got 20 million installs pretty quickly, and I used that as my calling card with entrepreneurs. This was in the early days before Andrew Chen blew it open for the world.

A friend told me about Twitter. Back then, it was still text-message based and very much a toy. It was the pre-app. I tried it and liked the product. I tracked down Evan Williams to ask about investing.

Ev had just given a bunch of money back to investors for a failed podcasting venture called Odeo. He'd kept Twitter, the one thing out of that studio that looked interesting.

At that point his round was done and he had a little bit of allocation left. He more-or-less asked, "Why should I let you invest?" I got on a whiteboard for half an hour and laid out what little I knew about growth hacking, while he and his deputy watched.

At the end he said, "This sounds great. We're not going to do any of it because it's against our ethos." I respected him for that. But he was impressed enough that I cared and I'd thought about it, that I got a chance to invest in Twitter. That was my first major angel investment that worked out.

Ryan Hoover and Patri Friedman have interesting brands

Nivi: Are there any new angel investors who have done a good job building a brand?

Naval: I don't know if they necessarily built brands to invest, but I think a few developed brands through their natural activities that will give them the ability to invest. The rest of it—judgment, capital and so on—is still up to them.

Ryan Hoover has a great brand. His Twitter game is among the best I've seen; he builds community on Twitter simply as a side effect of breathing. He's going to have a good brand as an angel investor, especially with consumer companies.

Patri Friedman also has a strong brand. He's investing in startup countries and sovereign individual projects. It's a distinctive enough thesis and angle that all of the libertarians and free-state types will flock to him. He's the first to put a stake in the ground and say, "I'm going to fund these kinds of activities," which means he'll get to see all of the limited dealflow in that space.

At the same time, there are lots of other projects, especially in crypto, that will be naturally inclined to let him invest. They aren't necessarily about starting a free state but overlap in some way. The people starting those companies are sympathetic to free-state projects and are themselves sovereign individuals. These are the people who signed petitions to free Ross Ulbricht and Julian Assange—and I'm one of them, by the way.

Don't Build a Brand in a Narrow Vertical

If the market never shows up or shows up late, your brand is shot

Nivi: You don't want to build a brand around a specific market thesis, right?

Naval: You don't want to build a brand around the transition from X technology to Y technology—because when that transition is complete, so is your brand. You also don't want too narrow of a brand or a brand in a space that doesn't materialize. If you have a cleantech brand that's focused entirely on solar and solar doesn't arrive on schedule, then your entire area of expertise is shot.

Top VC firms rarely specialize

When you're starting out, there's pressure to specialize because of your expertise and network and because you may want to raise capital. But if you look at the top VC firms, they're rarely specialists; they're usually generalists. Even when they specialize, they specialize in something like "being weird." Take Founders Fund for example: They do a lot of deep-tech deals and weird deals, but they don't specialize further than that. They don't say, "We're synbio only." Or, "We're AI and machine learning only." You have to resist that urge, because very often these trends don't materialize.

Mistimed or unrealized markets cost investors a lot of money

I'm old enough to remember when cleantech was a wave that cost Kleiner Perkins a lot of money and Java was a wave that cost investors a lot of money—because cleantech took longer than expected and Java never turned out to be a massive market.

With cleantech you could argue that getting into Tesla or SpaceX forgave everything. But it also means that you missed everything if you didn't get in those deals; if you weren't in the Elon Musk mafia.

You don't want to be too narrow. At the same time, it's hard to stand out if you're too broad. Then you're back to, "I'm a good person who does coffee. Let me invest."

It's best to build a brand around your unique capabilities, platforms and assets, but not around verticals.

The Best Deals Come from Your Network

Branch out from your network after you've built your reputation

Naval: The best deals tend to come from your network—people you've trusted for a long time, especially early on.

It's notoriously difficult to invest in one of Elon Musk's companies. Even in high-priced rounds, it's nearly impossible to get into a SpaceX or a Neuralink. All the people Elon has made money with in the past swoop in, get first rights and take up the full allocation.

If you're getting invited to one of Elon's rounds and you've never met him or made money with him, you almost have to wonder if he's run out of friends.

The urge to hunt for deals actually will *lower* your returns. Some of the best angel investors make early wins by investing in people in their close network, in spaces they know well.

Branch out after you've exhausted your network

It only makes sense to branch out when your network is exhausted. But now you also have a reputation and more capital—because you made some money and have been successfully investing in your network. Now you have reputation, capital and know-how.

Without those, it's dangerous to start investing in spaces you don't know, people you don't know, and, most dangerously, deals you're invited to by strangers. Because you can bet that if they're inviting a stranger, they've already exhausted their network of close allies and comrades.

Be a Shadow Co-Founder

Create your own dealflow by helping companies get started

Nivi: Do you think there's an opportunity to build a brand investing at the pre-seed stage before—or simultaneous with—accelerators?

Naval: Accelerators give advice on how to start a company at scale. They don't give you that much money, but they give you important know-how: how to put your company together, recruit and rev your idea; when it's ready for investors; how to approach the first customers and measure customer growth; how to get your MVP out there.

Accelerators are training wheels until you're ready to go raise money. An angel investor can do this—they just have to put in the time. And, actually, it's the best place to play because the valuations at the seed stage are where Series A rounds used to be.

Be a shadow co-founder to create your own dealflow

The best way to get good valuations and dealflow is to create it yourself: Ally yourself with entrepreneurs and become their shadow business co-founder.

When technical entrepreneurs start out, they often give up half or two-thirds of their company to a seller, who helps put the company together and raises the money.

You can help founders put their companies together. You can put in the first bit of money. In return, you can might be able to get common equity or, at least, favorable investment terms. Later, you can help recruit a seller for 5% or 10% of the company, as opposed to 50%.

Nivi: If you're investing at the pre-seed stage, you can back great teams, set the terms that you want and negotiate pro-rata rights.

Get valuable pro-rata rights by investing pre-seed

Naval: Pro-rata rights are the ability to invest in later rounds.

Let's say you own 5% of a company through your original investment. Your pro-rata right gives you the right to provide 5% of the new capital in future rounds.

Even though you may already own a lot and may not care about the dilution, the cash-on-cash returns for later investments tend to be much better. You might be able to put $30 million in the pro rata, instead of your initial $3,000.

Once the company's more proven, limited partners and big funds will fight for pro-rata rounds. They will pay you carry and management fees to invest in that pro rata. And you're not waiting 10 years for liquidity on that investment. In later rounds, the company might be just two years away from liquidity.

So pro ratas can be quite valuable.They also keep you plugged into the company. You keep a closer relationship with the management team; they have to let you know what's going on. And if there's a down round or a washout round, your senior stock may protect some of your holdings.

Be Non-Consensus Right

Work from first principles and make up your own mind

Naval: Most of what we say on this podcast is consensus knowledge, or wisdom. Experienced VCs will say, "Duh. Of course, that's obvious." But it's not designed for them.

Be non-consensus right

At the same time, the real money in this business is made by being *non-consensus* and right: being correct when everybody else disbelieves. This happens all the time. For every deal that Sequoia does, it's possible that Benchmark, Andreessen or somebody else passed on it. For every deal that Andreessen does, maybe Sequoia didn't want to pay as much, so they passed on it.

There's a large universe of investment-grade deals that even the top VCs and angels don't agree on. Many of these go on to be successful. And then there are the consensus deals that all the top VCs agree on and try to pile into—and sometimes those end up being flameouts.

Don't learn how to invest from the *commentariat*

Don't learn angel investing from journalists and the average commentator on Facebook, Hacker News or Twitter. These people may be well meaning, but they don't know what they're talking about.

Everyone piles onto Theranos as an example of Silicon Valley excess. The reality is Theranos wasn't backed by any good Valley investors; it raised from out-of-market investors for good reasons. The media built up its founder to be the next Steve Jobs because they were looking for a heroine. The media built her up, and the media took her down. To any sophisticated investor, that deal smelled bad from a mile away.

The media's been hating on Mark Zuckerberg and Facebook since the start. And yet, here it is, a company worth several hundred billion dollars and everyone surrounding it is fabulously wealthy. What Facebook does for society is a different conversation, but the fact that it's a successful business is undeniable. That journalists have called for its death all along is also hard to deny.

The larger the herd, the lower the returns

To be successful in this business, you have to make up your own mind. You have to work as much as possible from first principles. You have to ignore the herd. The larger the herd you listen to, the worse your returns will be. If you go with the consensus and average thinking, you will get average returns—and average returns right now are 1% in treasury bills.

Founders Backing Founders

Investing keeps you sharp—and plugged into what the best founders are doing

Naval: One great reason to angel invest is that it keeps you sharp. It's an incredible way to get educated and stay up to speed in technology. Great founders will seek you out and spend an hour telling you what they spent the last year learning.

Investing also exposes you to the different ways you can start a company. You're doing a C Corp, but somebody else is doing an LLC. You raised money from angels, but somebody else went straight to VCs. You did the two-founder model, but others did five founders and someone else did the one-founder model.

Founders want to be backed by other founders

A lot of the best founders end up dabbling in other people's companies as advisors or investors because they want to be good at everything. They're building the foundation for a skyscraper, and they're going to be very careful laying down those initial beams and bricks. The best way to figure that out is to talk to other smart people with skin in the game.

The best founders also want to be backed by other founders. They want to know the people they're taking money from have first-hand experience. Especially on the angel side, being a founder often will help you get into a deal; whereas a pure financial investor may not.

Founders have unique networks and deep expertise. They may also have a unique advantage with dealflow from an incubator they went through; by being branded as a successful founder; being a domain expert; or having advised successful companies.

Investing aligns interests

Investing also is a way to give back. Many founders have a story about how someone took a chance on them early on, or about their first big break. Now you get to give other people *their* big break. You get to create the change you want to see in the world by supporting it financially.

Investing also helps align you with others. If you're the kind of person who's often driven by envy—which, let's face it, many of us suffer from—one great thing to do is to align your interests. Now, all of a sudden, you're backing somebody and you want to see them win.

Advisors have adverse selection

Another good reason to invest is to teach—what better way to learn than by teaching? You can also do it as an advisor. But as an advisor, you tend to own a lot less.

There's adverse selection to being an advisor: Very often the best entrepreneurs don't need or take advice. Sometimes it can work out, because of strong relationships and expertise. But just stamping your name onto a company that barely knows you is not going to make you much, and it's not going to do much for them either. Investment is often a cleaner way to do it.