CONTENTS

FOREWORD

Scott Kupor's *Secrets of Sand Hill Road: Venture Capital and* *How to Get It* is motivated by the desire to democratize opportunity. It demystifies venture capital, laying out how this crucial part of the startup ecosystem works for anyone who picks it up. It examines the VC startup life cycle from every angle, including how VCs decide where to invest, how to pitch, and all the many, many legal and financial details and players involved in forming and growing a startup. (Its exposition of the term sheet alone makes it worth far more than its cover price, and I wish I'd had it available to me when I was first looking for startup funding.) It understands that hard decisions sometimes have to be made and that deals can be confusing, and ends with a look at the IPO process. All of this information is presented as a means of reframing the relationship between startups and their investors as a true partnership, rather than an uneasy alliance. Scott has seen the process from both sides of the table, as a startup executive and as an investor, and he's distilled his experiences and his perspective into an accessible, straightforward guide. Its purpose is to help build on the progress that's already been made in taking entrepreneurship from a career path open to the few and the privileged, to one that's open to anyone with an idea and the will to see it to fruition. This is the most urgent obligation of the startup movement as a whole, as we work to help build a more equitable society, but it also has huge implications for the continuing economic success and survival of our country, where new businesses account for almost all net new job creation and nearly 20 percent of gross job creation overall. Leaders like Scott are moving us all closer to fulfilling that obligation.

For most of the twentieth century, entrepreneurship wasn't seen as a career. It was more like a path followed by people who didn't fit into one of the traditional professions open to them and could afford to do something different. Although some succeeded, being an entrepreneur was as much a curse—or maybe more of one—as an exciting opportunity. Even many initially successful entrepreneurs ended their careers in poverty or were forcibly removed from their creations. Now, though, conditions favor entrepreneurs. Barriers to entry are being reduced everywhere, thanks to the semiconductor revolution, the rise of globalization, and the influx of new talent into every industry and sector. Think about this: venture-backed companies now spend 44 percent of the entire R&D budget for American public companies. The 665 public companies that are VC-backed make up a fifth of the total market capitalization of public companies. They employ four million people. Those are significant numbers, but I believe this is just the beginning. The startup movement can—and must—grow to have a much larger impact. When we pour so much money into such a limited range of companies, we can't effectively tackle the challenges we face. That's why one of my favorite things about this book is the way it so clearly parses out the incentives and systems behind venture capital. This will help all entrepreneurs navigate the maze of venture investors and decipher their behavior. The system works the way it does for a reason, and now that reason is comprehensible.

But there are other, larger lessons to glean as well. As you'll learn in this book, most venture firms invest money on behalf of larger institutional asset managers, like university endowments and retirement funds. Most of these asset managers use a formula to determine how much money to allocate to different types of investments, including the high-risk, highly-illiquid sector of venture. (This approach to portfolio construction was pioneered by David Swensen at Yale, whose methods have been widely adopted, as you'll read about in chapter 2). What that means is that the amount of resources our society currently invests in innovation is based on the percentage of assets that need to be invested according to this formula, *rather than on the number of investable opportunities that exist*. When too much money is chasing too few deals, there's only one possible result: Because we have too few entrepreneurs, we can't put enough money to work. Instead, it's wasted on bidding up the prices of the few available assets rather than funding the kinds of organizations that are actually needed. The problem is even more pressing when you consider it from a diversity point of view. Not only are there not enough startups, but the ones that do exist aren't nearly wide-ranging enough to build the kinds of companies our present and future call for. Possibly for the first time in history, we're talent-constrained instead of capital-constrained. Scott's book is an important step in making the opportunity to build a venture-scale business available to everyone so we can change that. The information about how to seek out and secure funding shouldn't be limited to an elite club. Every startup is about a single idea, but taken together, all startups have a common purpose as well: to shape a better world for all of us. And a better world is one in which everyone is represented and served well by the companies and systems we create.

That's why *Secrets of Sand Hill Road* is so valuable, and so timely. It's for people interested in venture capital, of course, but it's also for anyone who cares about the ability of the US to remain competitive, create new jobs, and continue on the path of economic growth. Those people include policy makers, academics, government officials in the US and elsewhere, civic leaders in startup hubs around the country and globe—who are already helping to democratize startups geographically—and people who work in corporate innovation (who can look to the VC world for inspiration on how to fund and grow projects within their organizations). Finally, *Secrets of Sand Hill Road* is for all the entrepreneurs who might not see themselves as a part of Silicon Valley—everyone who might not be considering trying to start a company based on their crazy concept, but really should be thinking about it. Given the chance, any one of those ideas could well become a reality that changes the way we live, and those are ideas we need to support. I believe Scott's book is destined to change the equation when it comes to who gets funded. It's leading us into a fairer, more robust future, and I can't think of a wiser person to take us there.

Eric Ries, author of The Lean Startup *and* The Startup Way

SECRETS OF
SAND HILL ROAD

Introduction

I am writing this book from my office on Sand Hill Road, the hallowed Silicon Valley street that holds as much promise for entrepreneurs as Hollywood Boulevard does for actors, Wall Street does for investment bankers, and Music Row does for country music artists. And, as with most of the storied streets, it's not much to write home about—Sand Hill Road is a drab collection of modest, low-rise office buildings, upstaged by its much more famous neighbor, Stanford University.

But I'm not writing it from on high. This is no sermon, no stone tablet passed down. This book isn't intended to be the venture capital (VC) bible. There are far too many important nuances in the field, with lots of different firms that invest at different stages, under different investment theses, with different portfolio constructions, and different return expectations. Not to mention different personalities.

And that's just on the venture capitalist side of things. More importantly, no two entrepreneurs are the same. The innovative, often world-changing companies they create always come with a unique set of opportunities, challenges, and conditions to be navigated.

I also fully acknowledge the personal biases I bring to the table. The first is my experience, hard-won, on the startup side of things via my years at LoudCloud and then Opsware. The other bias has been personally developed, on the VC side, in my role as managing partner at Andreessen Horowitz, or a16z, where I have been since the firm started in 2009. This means I've had the opportunity to see VC from multiple vantage points.

And, in fact, my hope is to help us stop thinking divisively in terms of one side *or* the other, one side *versus* the other. Entrepreneurs and VCs are not on opposing sides, the way one soccer team tries to crush another in the World Cup. Rather, we are partners, and once we agree to work together (and even if we don't), we are on the same side. What we share is a desire to create benign businesses, see them have an impact on and improve the world, and together realize some financial benefit along the way.

The story of venture capital is really a *subset* of the story of entrepreneurship. As venture capitalists, we raise investment funds from a broad range of limited partners (LPs), such as endowments, foundations, pension plans, family offices, and fund of funds. The capital raised from LPs is then invested in great entrepreneurs with breakthrough ideas.

Venture capitalists invest anywhere from the very early stage, where the startup is little more than an idea and a couple of people, to growth-stage startups, where there is some decent revenue coming in and the focus is on effectively scaling the business. Generally, a company leaves the venture ecosystem one of three ways: via an initial public offering (IPO), a merger or acquisition, or bankruptcy and a wind down.

There is often a misconception that venture capitalists are like other investment fund managers in that they find promising investments and write checks. But writing the check is simply the beginning of our engagement; the hard work begins when we engage with startups to help entrepreneurs turn their ideas into successful companies.

For example, at Andreessen Horowitz, we often work with our companies to help them identify talented employees and executives to bring into the company or to identify existing companies that can serve as live customer test sites for their products. The reality is that those who are successful in our field do not just pick winners. We work actively with our investments to help them throughout the company-building life cycle over a long period of time. We often support our portfolio companies with multiple investment rounds generally spanning five to ten years, or longer. We serve on the boards of many of our portfolio companies, provide strategic advice, open our contact lists, and generally do whatever we can to help our companies succeed.

All that being said, VCs are only as good as the entrepreneurs in whom they have the privilege to invest. And nobody should confuse the tireless heavy lifting that the entrepreneurs and their teams do to build a successful business with the investing activity of a VC. Simply put, entrepreneurs build businesses; VCs don't. Great VCs help in any way they can along the company-building path, but it is the entrepreneurs and their teams who tread that path every day and make the difference between success and failure. And while all VCs hope that each of our companies succeeds against huge risks and grows into a successful business, the reality is that the majority fail.

Entrepreneurship is inherently a risky endeavor, but it is absolutely essential to the American economy. Successful venture-backed companies have had an outsize positive impact on the US economy. According to a 2015 study by Ilya Strebulaev of Stanford University and Will Gornall of the University of British Columbia, 42 percent of all US company IPOs since 1974 were venture backed. Collectively, those venture-backed companies have invested $115 billion in research and development (R&D), accounting for 85 percent of all R&D spending, and created $4.3 trillion in market capitalization, which is 63 percent of the total market capitalization of public companies formed since 1974. Furthermore, specific to the impact on the American workforce, a 2010 study from the Kauffman Foundation found that young startups, most venture backed, were responsible for *almost all* of the twenty-five million net jobs created since 1977.

What does all this mean? Simple. We need you. We need your ideas and your guts. We need your companies and your commitment to growth.

What I want to do most with this book is help entrepreneurs. Access to capital is critically important to the success of a startup, and at one time or another you have to (or will) consider whether or not your business can and should raise VC. I hope this book helps to democratize access to the information about what makes the venture business tick—to the benefit of you, the entrepreneur.

The decision to raise capital from a venture firm is a huge one, and should not be undertaken without a full consideration of the benefits and risks of this source of capital. For example, is your business even appropriate in the first instance to raise venture financing? Is the market size big enough that the business at scale has the prospect of being a home run, and thus moving the needle for a venture capitalist in terms of her overall fund returns? How can you better understand the economic incentives of the VC industry in order to determine whether you are in fact looking for capital in all the right (or wrong) places?

If you choose to raise venture money, how do you think about the appropriate balance of economic and governance terms with your VC financier? What trade-offs are you willing to make, and what are the downstream implications of those decisions, particularly if you need to raise subsequent capital when the business develops at a different pace than you expect? And how will you and the board work effectively to achieve the long-term goals of the business?

It's an unfair truth that VCs get a lot of at bats, lots of chances to invest in a home-run company, while most entrepreneurs get to step up to the plate only a few times. Or to mix my sports metaphors, you get only a few real shots on goal in your lifetime while we VCs get several. Because of this imbalance, specifically regarding investment decisions, information asymmetry can come into play (often at the expense of the founder). The VCs are repeat players and thus have the benefit of lots of years of developing their understanding of the various mechanics (especially when negotiating term sheets), whereas founders have been through the process only a handful of times, at most. What I hope to lay out for founders is a better understanding of and appreciation for the interplay between VCs and founders in order to level the playing field. Information asymmetry should not pollute the foundation of a marriage that could last ten years or more.

Does that timeline surprise you? That you are likely entering into a (minimum) ten-year marriage of sorts with your venture partners? It's longer now than ever before, yet for too long there has been a lack of transparency into the inner workings of that partnership.

That is why I want to give you, a founder, some insider information, secrets, and advice so that you can best navigate your way through your interactions with venture capital firms, from the initial pitch session all the way through to an IPO or acquisition.

I've now had the opportunity to see VC from both perspectives—as a member of a startup and now as the managing partner for Andreessen Horowitz. While my seat has changed—and certain elements of the venture business have evolved—the fundamentals remain the same: VCs seek investment opportunities with asymmetric upside payoff potential (and capped downside—after all, you can only lose the money you invest), and entrepreneurs who are funded by VCs seek to build industry-changing and valuable stand-alone companies. And every so often when these incentives align, magic happens.

Entrepreneurs need to understand their own goals and objectives and see whether they align with those of the funding sources they want to tap. To determine that calculus, entrepreneurs would be wise to understand how the VC business works, what makes VCs tick, and what ultimately motivates (and constrains) them. After all, we are each motivated by the incentive structures that our industries engender; understanding those is in many ways a key part of the entrepreneurial journey.

Start by Asking the Right Questions

Have you ever seen those Charles Schwab commercials about how to talk to your financial advisor? Unless you watch a lot of golf on TV or actually pay attention to YouTube ads, you probably haven't. Here's the premise.

Your average middle-aged couple goes through a series of life events. They ask their home contractor to explain why she recommends cedar versus synthetic wood for a remodel. They meticulously debate the merits of a particular school for one of their kids. They grill the car salesman on whether the 467- or 423-horsepower car is more appropriate. But then, in the final vignette of the commercial, the couple sits across a large mahogany desk from a well-dressed financial advisor who tells them, "I think we should move you into our new fund." The couple glance blankly at each other for about a second—pregnant pause—and then immediately accede to the request. No questions asked.

The commercial's narrator benignly reminds the viewers: "You ask a lot of good questions . . . but are you asking enough about how your wealth is managed?" The implication, of course, is that we all feel empowered to dig deep into many important life decisions, but for some reason we give a free pass to others if it's a topic we don't understand or feel intimidated by, no matter how important the decision.

This book is not about how to solve that underlying problem—we'll all need to search in the psychology book section on Amazon for answers to that issue.

But this book *is* about helping you to ask the right questions about one of the most important life events for entrepreneurs—your startup and your career—so that you can make an informed decision about how best to proceed.

Why?

Because if you are going to raise money from VCs or join a company that has venture money, the only way to know if that is a good idea is to **understand why VCs do the things that they do. In other words, know your partner before you get married.**

Having a deep understanding of a prospective partner's motivations will help you anticipate their moves and (hopefully) interpret them correctly when they happen. More importantly, it will help you determine whether entering into the partnership is the right path to pursue in the first place.

The VC Life Cycle

This book follows the VC life cycle as it relates to and informs entrepreneurs. The first section of the book deals with the formation of a VC firm—who are the players who fund them, what incentives (and constraints) do they provide for the firms, and how do the partners within a firm interact with each other. To understand how VCs choose to invest in certain companies and how they might act once involved with a company, we also need to look upstream to understand the motivations of the funders of such firms. For if VC firms fail to satisfy the needs of their masters, there will be no more money with which to invest in new startups.

Next, we'll explore startup company formation. We'll look at all the things that founders need to think about when deciding to start a company—from dividing up founder equity, to deciding who sits on the board of directors, to how to incent employees, and much more. A lot of the ultimate decision about whether to seek VC financing will be influenced by decisions that founders make at the time of company formation.

We'll spend a big chunk of time on the VC financing process itself—in particular, the term sheet. This is the Magna Carta of the industry, as it ultimately defines the economic and governance rules under which the startup and the VCs will operate.

Then, with funding in hand, founders will need to be able to operate within the economic and governance constraints that they agreed to. Thus, we'll talk about the role of the board of directors and how it influences the path of the startup and potentially the ability of the founder to keep steering the ship. Boards, including the founder, also have to operate under various well-defined legal constraints that can materially affect the degrees of freedom of a company.

In the last section, we'll complete the circle of life. In the beginning, money comes into the VC firm through the investors in the fund. That money in turn goes into startup companies. Finally, the money comes back (or not) to the investors in the fund in the form of initial public offerings or acquisitions. If enough money doesn't make it through the full cycle, then life, at least as we know it in VC land, ceases to exist. The financing spigot dries up, which can have downstream effects on the rate of funding for new startup ideas. Hopefully, everyone in the ecosystem does her part to avoid that.

Of course, not all VCs are the same, and, as I mentioned earlier, what I write about here is heavily influenced by my experiences at Andreessen Horowitz. So your mileage may indeed vary. That said, I've tried to broaden the conversation to make this book more general for the overall venture industry.

This book may not answer all the questions you have and is not intended to be a comprehensive source on the topic. There are plenty of academics who teach semester-long classes on VC, and of course there are lots of VCs and others in the venture capital ecosystem—entrepreneurs, lawyers, accountants, and other service providers—who spend their professional lives learning and perfecting their craft.

Nonetheless, I hope this book shines a light on how VC works and why, in order to create more and better company-building opportunities.

CHAPTER 1

Born in the Bubble

In the interest of unlocking the somewhat opaque doors of venture capital, behind which are the inner workings, incentives, and decision-making processes of VCs, let me start by more properly introducing myself.

The first thing to know about me is that if I weren't a venture capitalist, I would sing country music in Nashville. But lucky for everyone who is a real country music fan—and for my ability to support my family financially—I somehow found my way into the VC business! I live in Silicon Valley, not Tennessee, so the best I can do is wear cowboy boots to work and play the guitar in my spare time. Both of which I do, as often as possible.

Let me give you a little bit of context about what the tech and investment world was like when I was getting started in in the 1990s.

Some of the big tech names back then were E.piphany, NetIQ, VA Linux, Commerce One, Razorfish, and Ask.com. It's possible you haven't heard of any of these companies, but they—like me—were products of the 1999–2000 tech bubble that produced roughly nine hundred initial public offerings of venture-backed tech companies. It was a great time to be starting out in the tech industry, as there seemed to be no end to the promise of technology and to the amount of wealth creation that was available to everyone involved.

Netscape had gone public in 1995, a mere *eighteen months* after its founding, receiving a huge amount of media attention and heralding the beginning of the dot-com boom. Google wouldn't be founded until 1998, but Silicon Valley was already fired up with dot-com fever. New internet startups were appearing daily. The tech world was abuzz.

Venture capitalists (VCs) were investing in new companies at an unprecedented pace relative to historical norms. About $36 billion went into new startups in 1999, which was approximately double what had been invested the prior year (although that's now less than half of what was invested in 2017). Additionally, limited partners committed more than $100 billion of new capital to the venture capital industry in 2000, a record that hasn't come close to being broken since! By comparison, limited partners committed about $33 billion in funding in 2017.

Startups were also getting to an IPO faster than ever during the dot-com bubble. On average, it was taking companies about four years from founding to go public, which was a huge acceleration of the historical trend of taking six and a half to seven years to IPO. Today, that time period often exceeds ten years, for reasons we'll get into later in this book.

In addition to a record number of IPOs, the public markets were also exuberant. On March 10, 2000, the Nasdaq index, the barometer for technology stocks, peaked just above 5,000. More interesting, the price-to-earnings ratio (P/E ratio) of the companies listed in the Nasdaq index stood at 175. This means that stock market investors were valuing one dollar's worth of a company's earnings at $175.

While it's generally the case that investors value a dollar of earnings today at some multiple greater than one because a company's stock price is intended to reflect the present value of the cumulative cash flows of a business into the future, a 175 multiple is a historical anomaly. For comparison, the Nasdaq P/E ratio today is under 20, which is generally in line with the long-term historical trends for the index.

At the time, Cisco was anticipated by many to become the first $1 trillion market capitalization company. Alas, Cisco's market cap peaked at about $555 billion in March 2000; today it stands around $200 billion. Early in 2018, Amazon became the first $1 trillion market cap company, albeit for a brief time, and as of this writing, sits at around $800 billion. (Fun fact: In March 2000, Amazon's market cap was a mere $30 billion).

What Could Possibly Go Wrong?

So, back in 2000, everyone was on a collective sugar high to end all sugar highs. What could possibly go wrong? As it turns out, a lot.

The Nasdaq index began a precipitous decline from its March 2000 peak, falling all the way to its nadir of just above 1,300 in August 2002. While there is much Monday-morning quarterbacking about the impetus for the decline, many market analysts point to the Federal Reserve's aggressive interest rate tightening in early 2000, which created a big debate as to the sustainability of heavy borrowing that many technology infrastructure companies had undertaken. Regardless of the ultimate cause, in about two and a half years, the index lost nearly 80 percent of its value, tech companies laid off record numbers of employees, VCs stopped investing in new companies, and the few companies that had sufficient cash to sustain themselves were focused purely on self-preservation at the expense of everything else.

That's why you probably don't remember most of the companies I mentioned before. Yet this was the environment in which I began my professional career.

Despite graduating from Stanford University in 1993 and Stanford Law School in 1996, sitting right at the epicenter of the tech boom the whole time, I was largely oblivious to what was happening around me. So, after graduating from law school, I left Silicon Valley to spend a year in my hometown of Houston, Texas, clerking for the Court of Appeals for the Fifth Circuit. This was an incredible learning experience and a fun way to spend a year, but, as it would turn out, it had zero relevance to my longer-term career.

I moved back to Silicon Valley to work for Lehman Brothers. Lehman, of course, was later a victim of the global financial crisis, suffering an ignominious bankruptcy in September 2008. My job at the time, in addition to being an all-around grunt, was to help life sciences companies raise capital, go public, and make acquisitions. Those were noble things to do, but for the fact that despite the raging bull market in technology in Silicon Valley, the investor appetite for life sciences was largely dormant.

Lucky for me, a friend had just taken a job at Credit Suisse First Boston, a scrappy investment bank that had brought on Frank Quattrone to build out their technology banking practice. Frank is a legend in the technology banking world, having started his career at Morgan Stanley, where he led IPOs for companies such as Apple and Cisco and advised on a huge range of important mergers and acquisitions. He is still a dominant figure in the technology space, having founded in March 2008 a leading mergers and acquisitions advisory firm named Qatalyst.

So I joined Credit Suisse First Boston and drank from the fire hose of the developing tech bubble. A few years into my job, on the eve of finishing an IPO for E.piphany, one of the marketing executives I had worked with to help them prepare for the IPO told me he was leaving to join a new startup called LoudCloud. Cofounded by Marc Andreessen, the already revered cofounder of Netscape, LoudCloud was trying to create a compute utility (much like Amazon Web Services has now created). Among the other cofounders was Ben Horowitz.

This was the fall of 1999, and the dot-com excitement was in full swing. I had finally opened my eyes to what was happening around me, and I wanted to be a part of it. When my friend at E.piphany offered me the chance to meet Marc Andreessen and

Ben Horowitz and see what they were doing, it was too much to pass up. My wife, who was about five months pregnant at the time with our first child and who was busy closing on the first house we were buying together, didn't see it quite the same way. She had a pretty good argument, to be honest. Why quit a great job with Credit Suisse First Boston where the business was going gangbusters, meaning the chance for both financial and professional success was palpable, in order to join a startup where I'd get paid next to nothing in salary for the promise of some equity appreciation in the future from stock options? She did, however, ultimately acquiesce, likely against her better judgment at the time.

I'll never forget my interview with Marc. Although I had never met him before, like everyone in the tech industry I knew of his accomplishments and media fame. So when he asked me to meet him at a little Denny's restaurant in Sunnyvale for my interview, I was a bit surprised.

But it didn't take long to get excited about the LoudCloud market opportunity. Marc took a napkin from the table and began drawing some barely decipherable sketch of how LoudCloud was going to take over the computing world. Only now, with the benefit of more than eighteen years of working with Marc, have I come to learn that doodling in all its glory is among his many skills.

The idea of LoudCloud was elegant in its simplicity; it turned out that the execution of the business was anything but. In basic terms, Loudcloud sought to turn computing power into a utility. Just as when you plug your phone charger into the wall socket you don't need to know (or care) about how the electricity got there, you just use it, LoudCloud's mission was to do the same for computing capacity. As an engineer, you should be able to develop your custom application and then just "plug it in" to the compute utility that could run the application seamlessly for you. You shouldn't have to worry about what kind of database, networking equipment, application servers, etc., underlie the utility; it should simply work. It was a great idea—one that Amazon Web Services has built into a multibillion-dollar business today.

LoudCloud was probably about ten years ahead of its time, an oft-repeated lesson, by the way, in the startup world. Though timing isn't everything, timing is definitely something—it's a big reason why we now see many ideas that failed in the dot-com bubble being reincarnated as successful businesses two decades later. As market conditions change—in the case of the dot-com businesses, the market size of available customers was simply too small relative to the cost of acquiring those customers—business models that previously failed can become viable. Marc likes to remind us that when he was building Netscape, the total size of the internet population was about 50 million people, nearly all of whom were accessing the internet on clunky dial-up connections. Thus, no matter how much utility the browser provided, the end-user market simply wasn't that big. Contrast that to today, where we have about 2.5 billion smartphone users with ubiquitous connectivity to the internet and the potential for that number to double over the next ten years. All of a sudden, businesses that couldn't work profitably at 50 million users take on a very different look when they can appeal to a mass-market audience.

After meeting with Marc, I also interviewed with a number of other members of the team, including cofounder Ben Horowitz. The setting for that interview was more normal, as we met on a Saturday at the company's offices. But I remember being surprised by Ben's attire—he was fully decked out in Oakland Raiders garb, including T-shirt, watch, and baseball hat. I now know, after many years of working side by side with Ben, that his attire was completely in character. In fact, to this day, Ben keeps a life-size dummy of a fully outfitted Oakland Raiders football player in his office. For the uninitiated, that can be quite a surprise!

LoudCloud's Atypical Success

I got the job as a business development manager at LoudCloud. This title was the euphemistic way of saying, "You were an investment banker in your previous job and might have some skills to add to the company, but we're not quite sure yet exactly what those will be." (Over my seven-year tenure at LoudCloud, I had the opportunity to take on a number of different roles, including running financial planning and investor relations, corporate development, some engineering teams, customer support, and field operations, which included support, professional services, and pre-sales engineering.)

I was in, I was thrilled (my wife was less so), and we at LoudCloud set out to build the first compute utility, flush with what we thought was plenty of cash. In its first few months, the company had raised nearly $60 million of debt and equity. But then again it was early 2000 and we were all living the dot-com dream. VC money was raining from the rafters.

We naturally decided to raise more money—$120 million, to be exact. In some respects the money was free (as the valuation at which we were able to raise was over $800 million—this for a less-than-one-year-old company!). But it was not in fact free, for with it came the expectations of growth for which the VCs had provided the money.

And grow we did. We topped six hundred employees before the company was even two years old. We decided to go public in March 2001, which was definitely not the greatest timing, right in the wake of the dot-com meltdown. In fact, LoudCloud was one of only a very small number of tech companies to go public that year (fewer than twenty tech IPOs happened in 2001, versus nearly five hundred in the prior year). The portfolio managers with whom we met during the IPO road show of back-to-back meetings could not have been more shell-shocked about the decimation they were seeing in their portfolios. They looked at us as if we had three heads when we dutifully gave the LoudCloud IPO pitch. Recall that Nasdaq was at about 2,000 at this time, down significantly from its roughly 5,000 peak a year prior, but still not at the bottom it would reach in August 2001.

But we went public because it was the only viable source of capital available to LoudCloud. We desperately needed the additional funding to continue to run the business. Despite having raised a lot of money to date, we were dangerously low on cash due to the post-2000 dot-com collapse. This was because we had originally targeted our service offerings to other startup companies; they seemed like a natural customer base given that they could benefit from being able to pay LoudCloud to worry about their computing infrastructure while they focused their activities on the internal development of their custom applications.

For us to provide this service, however, we had to procure significant amounts of data center space and a ton of computer equipment. We paid for this infrastructure up front with the idea that we would amortize the payback of these costs as we grew our customer base. That worked for the first year or so until the cascading effects of the air being let out of the dot-com balloon caught up to us. As a result, our dot-com customers started going out of business and naturally had no VCs willing to fund their ongoing operations. We were stuck with a very high fixed cost base of capital infrastructure against a diminishing base of customers—a recipe for significant cash consumption.

And, as noted above, by this time, the VCs had essentially stopped writing checks, so the only other option for us was to raise money from more buyout-oriented investors. Buyout investors are different from VC firms in a few ways. Namely, they tend to invest in companies that are beyond pure startup stage, and they generally make what are called "control" investments. Control means that they often own a majority of the company and control a majority of the seats on the board of directors; this gives them the ability to be the major determiners of the company's strategy. Buyout capital can often be more expensive than VC because the upside opportunity for these investors is more constrained given the later stage at which they invest. This was the case for us, meaning that the valuation at which they would fund the company was much lower, and thus the amount of ownership we would have to give up was much higher. In addition, the control aspects of the buyout alternatives we had were less palatable than our desire to preserve more degrees of freedom in running the business.

In an odd way, therefore, going public seemed to provide the lowest available cost of capital and the apparent path of least resistance. We originally intended to sell shares to the public at a range of ten to twelve dollars per share. (When companies file to go public, they put what's known as an "initial filing range" out to the market to signal the price range at which they hope to sell shares to the public. IPOs that are in demand are often oversubscribed, meaning there is more institutional demand to purchase shares than there are shares to sell, and naturally in that case the company will increase the filing range accordingly.) But the stock market continued to deteriorate over the course of our IPO marketing period, and we ultimately sold stock to the public at six dollars per share. This is definitely not your typical IPO story. But, the IPO allowed us to raise sufficient capital to give ourselves a shot at success without having to give up day-to-day control of the business.

"Live to fight another day" is another great startup mantra to always keep front and center in your mind. Of course, as John Maynard Keynes reminded us, this applies to almost every financial endeavor: "The markets can remain irrational longer than you can remain solvent." Cash is undoubtedly king in the startup world—and in the business world more generally.

But perhaps the most poignant phrasing of this lesson that I ever heard came from the late Bill Campbell. Bill is a Silicon Valley legend (Apple, Intuit, GO Corporation, Google, etc.) and in his later years was referred to as "Coach," for he spent tireless hours coaching entrepreneurs as they were building their businesses. He was also once a "real" coach of the Columbia University football team, but suffice it to say that his coaching record there paled in comparison to his many business successes over a long career. We were privileged to have Bill on our board at LoudCloud, where he constantly reminded us in very simple terms of the critical role that cash plays in a startup's life cycle: "It's not about the money. It's about the F-ing money." Enough said.

In 2002, we ultimately sold most of the LoudCloud business to Electronic Data Systems (EDS) and essentially restarted as an enterprise software business named Opsware. In addition to being the new name of the company, Opsware was also the name of the software we had developed to use internally when we were running the LoudCloud business—the name was a contraction of "Operations Software." Because as LoudCloud we had to manage a whole series of servers, network devices, storage devices, and applications, we developed the Opsware software to reduce the amount of manual labor needed by automating a variety of the technology management tasks. When EDS acquired the LoudCloud business, it licensed the Opsware software but allowed us to retain the core intellectual property. So we did what any enterprising startup would do and created a new business selling the Opsware software to other large-enterprise customers who could benefit from automating their own technology management processes.

And we did all this while still being a publicly listed company, albeit with a nascent business and a market cap that appropriately reflected that (im)maturity. The stock hit a low of thirty-four cents, but we stuck with it for another five years and ultimately built a nice software business at Opsware that Hewlett-Packard purchased in 2007 for $1.65 billion. My partner Ben has written extensively about the transformation of the business in his own book, *The Hard Thing about Hard Things*, which I highly recommend. (And that's not just because he's still my boss!)

Immediately following the sale of Opsware to Hewlett-Packard, many of us had the opportunity to stay on as part of the HP Software business. At the time, HP Software was a roughly $4 billion division within the broader HP mother ship (HP sold everything from printers and ink cartridges to desktops, servers, networking equipment, and storage devices) that had been built on the foundations of HP OpenView, a set of software products that, like Opsware, helped companies manage their IT assets.

Over the years, HP Software had acquired a number of other software businesses in the broader IT management space, and thus the product line, employees, and customer base were very diverse and geographically dispersed. I had the opportunity to manage the integration of the Opsware team into HP Software and then to run the roughly $1 billion global software support business. With 1,500 employees scattered across every major global market, I logged more airline miles in that job than I have ever done in my professional lifetime to date. But it was a fun and exciting opportunity to manage a team at scale, as jobs and learning experiences of that kind can be hard to come by in the earlier-stage startup world.

Change Is Afoot in Silicon Valley

Following the 2007 sale of Opsware to HP, Marc and Ben began investing in earnest as angel investors. Angels are traditionally individuals who invest in very-early-stage startups (generally known as "seed-stage companies"). In Silicon Valley in 2007, the angel community was pretty small, and there were not many institutional seed funds, meaning professional investors who raised money from traditional institutional investors to invest in seed-stage companies. Rather, angel investing was dominated largely by a loose collection of individuals who were writing checks out of their personal accounts. Interestingly, Marc and Ben made their angel investments through an entity known as HA Angel Fund (Horowitz Andreessen Angel Fund), a reversal of the now-well-known brand name for their venture fund.

Marc and Ben started investing at an exciting time when change was afoot in Silicon Valley. To understand this change, you have to understand a bit of the history of the VC industry.

As we'll dive into deeper in subsequent chapters, the Silicon Valley VC business started in earnest in the 1970s and was characterized for most of the next thirty-odd years by a relatively small number of very successful firms that controlled access to startup capital. In simple terms, capital was the scarce resource, and that resource was "owned" by the then-existing VC firms, many of which are still very successful and active players in the current VC marketplace. Thus those who wanted access to that capital—the entrepreneurs—needed to effectively compete for that capital. The balance of power, therefore, as between the VC firms and entrepreneurs, was squarely in favor of the former.

Beginning in the early 2000s, though, there were a few significant transformations in the startup ecosystem that would change things in the entrepreneurs' favor.

First, the amount of capital required to start a company began to decline; this continues in earnest even today. Not only did the absolute cost of servers, networking, storage, data center space, and applications begin to fall, but the procurement method evolved from up-front purchasing to much cheaper "renting" with the advent of what is known as cloud computing. As a startup, these changes are very significant, as they mean that the amount of money you need to raise from VCs to get started is much less than in the past.

Y Combinator Cracks Open the "Black Box"

The second material transformation in the startup ecosystem was the advent of an incubator known as Y Combinator (or YC for short). Started in 2005 by Paul Graham and Jessica Livingston, YC basically created startup school. Cohorts of entrepreneurs joined a "YC batch," working in an open office space together and going through a series of tutorials and mentorship sessions over a three-month period to see what might come out the other end. Over the past thirteen years, YC has turned out nearly 1,600 promising startups, including some very well-known success stories such as Airbnb, Coinbase, Instacart, Dropbox, and Stripe.

But that's not the most significant impact that YC has had on the VC ecosystem. Rather, the import of YC, I believe, is that it has educated a whole range of entrepreneurs on the process of starting a company, of which raising capital from VCs is an integral part. That is, YC cracked open the "black box" that was the VC industry, illuminating to entrepreneurs the process of startup company formation and capital raising.

In addition, YC created true communities of entrepreneurs among which they could share their knowledge and views both on company building and on their experiences working with VC firms. Prior to this time, the entrepreneurial community was more dispersed, and therefore knowledge sharing between members of the community was decidedly limited. But with knowledge comes power, thus the second material driver of the changing balance of power between entrepreneurs and VCs.

Something More

And that takes us to the founding of Andreessen Horowitz, started in 2009 by Marc Andreessen and Ben Horowitz. What Marc and Ben saw was this fundamental shift in the landscape that would no longer make access to capital alone a sufficient differentiator for VC firms. Rather, in their view, VCs would need to provide something more than simply capital, for that was becoming a commodity, and instead, in this post-2005 era of VC, firms would need to compete for the right to fund entrepreneurs by providing something more.

What that "something more" would be was informed by their thinking around the nature of technology startup ventures. That is, tech startups are basically innovative product or service companies. In most cases, tech startups represent an amalgamation of engineers who identify some innovative way to solve an existing problem or create a new market by introducing a product or service that consumers didn't even know could exist. This affinity between the identification of the problem to be solved and the development of the product or service that in fact solves the problem is a key component of successful tech startups. No doubt that effective sales and marketing, capital deployment, and team building, among others, are also crucial ingredients to success, but fundamentally tech startups need to "fit" a market problem to a compelling market solution to have a shot at success.

Thus, to increase the odds of ultimately building a widely successful and valuable company, Marc and Ben had a thesis that founders should ultimately be product/engineering types and that there should be a tight coupling between the product visionary and the individual responsible for driving the company's strategy and resource allocation decisions. Those latter responsibilities are typically the province of the CEO. Therefore, Marc and Ben had a predilection for backing CEOs who were also the source of the company's product vision.

But, while technical founding CEOs might be great at product development, they might often lack the rest of the skills and relationships required to be all-around great CEOs—technical recruiting, executive recruiting, PR and marketing, sales and business development, corporate development, and regulatory affairs, among others.

As a result, the "something more" that Marc and Ben decided to build Andreessen Horowitz around was a network of people and institutions that could improve the prospects for founding product CEOs to become world-class CEOs. And I was lucky enough to become employee number one as we launched the firm in June 2009.

Over the past ten years, we've gone from $300 million in funds under management and a three-person team to managing more than $7 billion in funds and roughly 150 employees. Most of our employees focus on that "something more," spending their days building relationships with people and institutions that can help improve the likelihood of our founder CEOs building enduring and valuable companies.

An Ode to Entrepreneurs

We've been fortunate enough to invest in many great companies, some of which are household names today—Airbnb, Pinterest, Instacart, Oculus, Slack, GitHub—and many that we hope will become household names in the future. And we've learned a lot, sometimes by making the right decisions but also by making mistakes as we've built the business. We believe in being innovative and experimenting in our own business. In fact, we consistently tell our team to "make new mistakes," which we hope translates into taking informed risks, iterating on product and service offerings, and learning from previous mistakes to avoid treading down the same dead-end path. Throughout the course of this book, we'll spend more time on many of the lessons learned.

Most importantly, we believe deeply in the sanctity of the entrepreneurial process and work hard every day to respect the very difficult journey that aspiring entrepreneurs walk on their hopeful path to success. We know that the odds of success for most entrepreneurial endeavors are small and that the ones that make it do so due to a unique combination of vision, inspiration, grit, and a healthy dose of luck.

It is their stories, and those of LoudCloud, Opsware, and Andreessen Horowitz, that are in many ways the story of this book.

Startups thrive (or die) based on the availability of capital from VCs, particularly at the formative stages of their lives when the business itself is in growth mode and can't support itself through operating cash flow. And VC, like all types of capital, is a great form of financing where the needs and desires of the entrepreneur and the VC are aligned; there is a mutual pact the two organizations enter into with an agreed-upon set of objectives they hope to accomplish together. Money from public, institutional investors can also be an important part of the financing equation as a startup gets to a later point of maturity and can then satisfy the demands for predictable earnings growth that such investors require.

In a similar vein, when interests diverge between entrepreneurs and VCs, the world is not a very fun place to be.

As I've already mentioned, the best way to set up a successful marriage between entrepreneurs and VCs is to level the playing field and make sure everyone understands how VC works. So now it's time to roll up our sleeves and dig in.