



# THE VENTURE HACKS BIBLE!

(Every post from Venture Hacks ever.)

# The Venture Hacks Bible

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# April 2007

## Term Sheet Hacks: Get a Great Deal

“Having information that the other side doesn’t have gives [VCs] an advantage... they take advantage of entrepreneurs who haven’t been through this before... they were totally willing to take advantage of us.”

– Mitch Kapor<sup>1</sup>, Founders at Work<sup>2</sup>

“Knowledge is Power.”

– Sir Francis Bacon<sup>3</sup>

In this series of articles, we’re going to explain how to negotiate a great deal with your Series A investors. We’re calling this series *Term Sheet Hacks*<sup>4</sup>.

### The VCs know more than you do.

You, the entrepreneur, negotiate a term sheet once every few years. You negotiate your most important term sheet (the Series A) when you have the least experience. You negotiate against a VC firm that issues two to three term sheets *per month*. You negotiate against a “standard” term sheet that encapsulates decades of combined knowledge from hundreds of venture firms.

Like a good chess player, your prospective investors know what the game looks like many moves from now:

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<sup>1</sup>[http://en.wikipedia.org/wiki/Mitch\\_Kapor](http://en.wikipedia.org/wiki/Mitch_Kapor)

<sup>2</sup><http://www.amazon.com/gp/product/1590597141>

<sup>3</sup>[http://en.wikipedia.org/wiki/Francis\\_Bacon](http://en.wikipedia.org/wiki/Francis_Bacon)

<sup>4</sup><http://venturehacks.com/term-sheet-hacks/>

- Their term sheet foresees the Series B, possibly terminating you, selling the company, and more.
- Their term sheet anticipates those events and includes terms like ‘protective provisions’ and ‘election of directors’ that create the best future outcome for their firm.
- They employ a full-time CFO or general counsel who ensures their firm is cutting good deals. And his shelf is filled with books on the hilarious topic of term sheets.

On the other hand, you probably have a basic understanding of a few simple terms like ‘valuation’ and ‘vesting schedules’. You barely know what the game looks like right now, let alone at the Series C.

Your investors can take their time – they have years to invest their money – but you’re under pressure from your employees and co-founders to deliver the money that will keep your company alive. The clock is ticking...

## **Good companies get bad deals all the time.**

Many of the successful companies that we all read about in the news didn’t negotiate good deals simply because they didn’t get good advice. Consider Jim Clark<sup>5</sup>’s (founder of SGI and Netscape) account in *The New New Thing*<sup>6</sup>:

“At [SGI] board meetings... Jim’s face would get red and he’d start shouting that [an investor and board member] had cheated him and his engineers.”

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<sup>5</sup>[http://en.wikipedia.org/wiki/James\\_H.\\_Clark](http://en.wikipedia.org/wiki/James_H._Clark)

<sup>6</sup>[http://www.amazon.com/New-Thing-Silicon-Valley-Story/dp/0140296468/ref=pd\\_bbs\\_sr\\_1/103-5417622-0009467?ie=UTF8&s=books&qid=1173841524&sr=8-1](http://www.amazon.com/New-Thing-Silicon-Valley-Story/dp/0140296468/ref=pd_bbs_sr_1/103-5417622-0009467?ie=UTF8&s=books&qid=1173841524&sr=8-1)

Or ask a friend who has taken money from investors.

Whether these stories are true is irrelevant. Like any negotiator, your prospective investors are not in the business of giving you a good deal. They are in the business of making money for themselves and *their* investors (their limited partners<sup>7</sup>).

## **Isn't this what my lawyers are for?**

In principle: yes. In practice: no.

With few exceptions, most law firms advise their clients to accept “standard” terms.

Most law firms do a lot more business with VCs than they are likely to do with you. VCs refer new clients to the law firms, hire the law firms regularly, and know the attorneys socially. Where do you think the law firms’ loyalty lies?

The basic incentives between you, your law firm, and your prospective investors are not in your favor. Your lawyers make money by executing transactions and your investors simply bring more transactions to your lawyers than you do.

## **You can't hack a term sheet without leverage.**

Don’t bother trying to apply any of these term sheet hacks if you don’t have leverage. You can’t negotiate *at all* without leverage. Roughly speaking, leverage is power.

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<sup>7</sup>[http://vcexperts.com/vce/library/encyclopedia/glossary\\_view.asp?glossary\\_id=67](http://vcexperts.com/vce/library/encyclopedia/glossary_view.asp?glossary_id=67)

*Alternatives* are the most basic type of leverage in any negotiation. Fancy negotiators call their best alternative a BATNA<sup>8</sup> (Best Alternative To a Negotiated Agreement). If you're negotiating a term sheet with the famous Blue Shirt Capital, your BATNA may be an *independent* term sheet from the renegade Herd Mentality Management.

A BATNA is just one type of leverage and it *is* possible to negotiate effectively without a good BATNA. Hostage negotiators do it all the time. But if you're not in the mood for a hostage negotiation, get multiple offers before you apply any of these hacks. Don't let anyone tell you that creating competition to invest in your business is a bad thing.

## **Let's get this party started.**

*Our goal here is to give you the knowledge to effectively negotiate against the experts.* We don't have all the answers but we've negotiated enough term sheets, started enough companies, and learned from enough entrepreneurs, lawyers, and VCs to understand how this game can play out. Term Sheet Hacks is a work in progress and we're looking forward to learning more from your comments and emails.

These articles assume that you either have a term sheet in-hand or are anticipating one. If you need a basic understanding of term sheets, read Brad Feld's term sheet series<sup>9</sup> and hire a lawyer.

Before you go on, please read our disclaimer<sup>10</sup>:

This site provides information. Use it at your own risk.

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<sup>8</sup>[http://en.wikipedia.org/wiki/Best\\_alternative\\_to\\_a\\_negotiated\\_agreement](http://en.wikipedia.org/wiki/Best_alternative_to_a_negotiated_agreement)

<sup>9</sup>[http://www.feld.com/blog/archives/2005/08/term\\_sheet\\_seri.html](http://www.feld.com/blog/archives/2005/08/term_sheet_seri.html)

<sup>10</sup><http://www.venturehacks.com/disclaimer>

Information is not the same as legal advice – the application of information to an individual's specific circumstances. This site does not provide legal services or legal advice.

Although we try to make our information accurate and useful, you should consult a lawyer to interpret and apply this information to your particular situation.

We are not lawyers and we do not take any responsibility for rashes, financial ruin, or anything else that follows from applying this information.

Our first two hacks show you how to create a board that reflects the ownership of the company<sup>11</sup> and why you should make a new board seat for a new CEO<sup>12</sup>. We also maintain a list of all the term sheet hacks<sup>13</sup>. Please do read on...<sup>14</sup>

## **Create a Board the Reflects the Ownership of the Company**

“Good boards don’t create good companies, but a bad board will kill a company every time.”

– Old Silicon Valley Saying

Summary: Create a board of directors that reflects the ownership of the company and don’t let your investors control the board through an independent board seat.

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<sup>11</sup><http://venturehacks.com/articles/board-structure>

<sup>12</sup><http://venturehacks.com/articles/ceo-board-seat>

<sup>13</sup><http://venturehacks.com/term-sheet-hacks/>

<sup>14</sup><http://venturehacks.com/articles/balanced-board>

The composition of the board of directors<sup>15</sup> is the most important element of the Series A investment. It is more important than the valuation<sup>16</sup> of your company.

The valuation of your company won't matter to you if the board

- Terminates you and you lose your unvested<sup>17</sup> stock.
- Forces the company to raise a low-valuation Series B from existing investors by rejecting offers until the company is almost out of cash.
- Merges the company with another private company and wipes out your common stock<sup>18</sup> in the process.

If it isn't obvious by now, a bad board can do lots of stupid or malicious things to make your stock or company worthless.

The board you create will be your new boss. But trying to please everyone on your board dooms you to managing board members and ignoring customers and employees. Great companies are rarely built by committee and a bad board will waste your time trying to run the company their way.

This hack will show you how to create a board of directors that you can trust even when you don't agree with its decisions.

## **The board should reflect the ownership of the company.**

The form of government in a company is dictatorship. The board represents the owners of the company and selects the dictator (CEO). The board then works to ensure the dictator is

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<sup>15</sup>[http://www.feld.com/blog/archives/2005/01/term\\_sheet\\_boar.html](http://www.feld.com/blog/archives/2005/01/term_sheet_boar.html)

<sup>16</sup>[http://www.feld.com/blog/archives/2005/01/term\\_sheet\\_pric.html](http://www.feld.com/blog/archives/2005/01/term_sheet_pric.html)

<sup>17</sup>[http://www.feld.com/blog/archives/2005/05/term\\_sheet\\_-ve.html](http://www.feld.com/blog/archives/2005/05/term_sheet_-ve.html)

<sup>18</sup>[http://www.feld.com/blog/archives/2004/07/liquidation\\_pre.html](http://www.feld.com/blog/archives/2004/07/liquidation_pre.html)

optimally benevolent towards the owners. Naturally, bad dictators get beheaded...

If the board *represents* the owners of the company, its composition should *reflect* the ownership of the company. Truly competitive and transparent markets, such as the public stock markets, have already reached this conclusion.

After the Series A investment has closed, the common stockholders are probably going to own most of the company. The common stockholders should therefore elect most of the board seats. Let's assume the common stockholders own approximately 60% of the company after the Series A. If you're taking money from two investors, the board should look like

$$3 \text{ common} + 2 \text{ investors} = 5 \text{ members.}$$

And if you're taking money from one investor, the board should look like

$$2 \text{ common} + 1 \text{ investor} = 3 \text{ members.}$$

In either case, the common stock should elect its directors through plurality voting<sup>19</sup>. Plurality voting enables the founders to elect all of the common seats if they control a majority of the common stock.

The sound bite you want to use in your negotiation is

“The common stock owns most of the company. Isn’t ownership the basis for determining the composition of the board? One share, one vote?”

Your investors may argue that this board structure leaves their preferred stock exposed to the machinations and malfeasance of the common board members. Your response should be

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<sup>19</sup><http://www.fairvote.org/?page=757>

“Isn’t that why we’re giving you protective provisions<sup>20</sup>?”

Early-stage companies with good leverage can negotiate this *democratic* board structure in a Series A. If your investors tell you that a democratic board is a deal-breaker and you want to move forward with them, use the fallback position: an *investor-leaning* board.

## **Don’t settle for anything less than an investor-leaning board.**

An investor-leaning board looks like this:

***2 investors: 2 common + 2 investors + 1 independent = 5 seats***

or

***1 investor: 1 common + 1 investor + 1 independent = 3 seats.***

An investor-leaning board gives an equal number of seats to every class of stock, no matter how many shares that class owns. This makes no sense, but, hey! that’s venture capital! There are many future scenarios where your investors can take over this board<sup>21</sup> (e.g. a down round<sup>22</sup> or hiring a new CEO<sup>23</sup>), but

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<sup>20</sup>[http://www.feld.com/blog/archives/2005/01/term\\_sheet\\_prot.html](http://www.feld.com/blog/archives/2005/01/term_sheet_prot.html)

<sup>21</sup><http://founderresearch.blogspot.com/2005/10/building-board-composition-by-company.html>

<sup>22</sup>[http://vcexperts.com/vce/library/encyclopedia/glossary\\_view.asp?glossary\\_id=271](http://vcexperts.com/vce/library/encyclopedia/glossary_view.asp?glossary_id=271)

<sup>23</sup><http://venturehacks.com/articles/ceo-board-seat>

there are no realistic scenarios where the common stockholders take over this board. Hence, this board is *investor-leaning*.

If you end up with an investor-leaning board, get your investors to agree to create a new common seat anytime the company creates a new investor seat (e.g. for the Series B investor). This prevents the investors from taking over the board in the Series B as long as this term isn't renegotiated.

If you have a strong BATNA<sup>24</sup>, you should reject anything less than an investor-leaning board. If your prospective investors suggest anything worse, they are probably trying to take advantage of you.

### **Fill the independent seat with an independent party.**

Don't let the investors control the board through the independent seat. They may suggest a big shot for the independent seat whom you can't decline without looking like a fool.

But the big shot does a lot more business with VCs than he is likely to do with you. VCs regularly refer the big shot to promising companies. The big shot invests in various venture funds and startups that the VCs send his way. Perhaps the big shot was an entrepreneur-in-residence at the investor's firm. Where do you think the big shot's loyalties lie?

Most likely, the big shot will be aligned with your investors.

The simplest solution to this dilemma is to fill the independent seat before the financing. At a minimum, select someone whom you trust and has the credibility to fill the seat. The investors

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<sup>24</sup>[http://en.wikipedia.org/wiki/Best\\_alternative\\_to\\_a\\_negotiated\\_agreement](http://en.wikipedia.org/wiki/Best_alternative_to_a_negotiated_agreement)

will have a tough time replacing this independent director if your selection is a big shot himself or if he introduced the company to the venture firm in the first place.

If you can't select the independent director until after the financing, the simplest solution is to

1. Select the independent director by the unanimous consent of the board members. (*Who could argue with this?*)
2. Tell the investors that you, like them, are going to be very picky about the independent director.
3. Take control of the situation immediately by suggesting names for the independent director.

Note: This article is a term sheet hack. You may enjoy the rest of the Term Sheet Hacks<sup>25</sup>.

## Make a New Board Seat for a New CEO

“Because we weren’t having success finding a CEO, [our investors] insisted that we hire these managers [a temporary CEO and CFO]. That didn’t go great.”

– Tim Brady, 1st employee at Yahoo, Founders at Work<sup>26</sup>

**Summary:** Create a new board seat for a new CEO. Don’t give him one of the common seats.

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<sup>25</sup><http://venturehacks.com/term-sheet-hacks/>

<sup>26</sup>[http://www.amazon.com/Founders-Work-Stories-Startups-Early/dp/1590597141/ref=pd\\_bbs\\_sr\\_1/103-5417622-0009467?ie=UTF8&s=books&qid=1174930819&sr=8-1](http://www.amazon.com/Founders-Work-Stories-Startups-Early/dp/1590597141/ref=pd_bbs_sr_1/103-5417622-0009467?ie=UTF8&s=books&qid=1174930819&sr=8-1)

Whether you negotiate a proportional or investor-leaning board<sup>27</sup>, your term sheet will probably state that the CEO of the company must fill one of the common board seats. This may seem reasonable. One of the founders is probably the CEO and you were going to elect him to the board anyway.

Don't accept this term. The investors are looking several moves ahead of you.

If you accept this term and hire a *new* CEO, he will take one of the common seats. The common shareholders will not have the right to elect that seat. If the new CEO turns out to be aligned with the investors, the new coalition of CEO + investors will control the board of directors.

### **A new CEO may be aligned with the investors.**

A new CEO will probably be a professional manager who does a lot more business with VCs than he is likely to do with you.

VCs regularly refer the CEO to promising companies. They let him co-invest in their startups. They let him invest in their venture funds. *They determine his compensation in your company.* Where do you think the CEO's loyalties lie?

Most likely, a new CEO will be aligned with the investors.

### **A coalition of CEO + investors can hurt the company.**

A coalition of a new CEO + investors can hurt the company, founders, and employees. Consider this scenario:

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<sup>27</sup><http://venturehacks.com/articles/board-structure>

The company needs to raise a Series B. Your investors discourage the new CEO from shopping around for cash because they want to invest more money in the business at a low valuation. Your investors tell you not to spend time raising cash because they will put in more money: “You should focus on building the business.” You want to shop around and raise money at a high valuation but the CEO does a half-assed job because he knows this game.

The company ends up doing the Series B with its existing investors because that is the best offer on the table. A few months later, the CEO’s shares are “right-sized” and he is happy (“We have to pay the CEO market rate, right?”). The investors have put in more money at a low valuation and they are happy. The founders and employees have been diluted and they are wondering what just happened.

This story is not unheard of in Silicon Valley.

### **A new CEO may be naturally inclined to dilute you.**

A new CEO can develop an antagonistic relationship with the company’s founders. Founders, like everyone else, have inadequacies as leaders and managers. Their inadequacies are usually worse than the ones the company portrayed while it was recruiting and selling the new CEO.

The new CEO joins the company and naturally blames the founders for all of the existing problems in the business. *Who else is there to blame?* Like any new leader, he continues to blame his predecessor<sup>28</sup> for

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<sup>28</sup>[http://www.everything2.com/index.pl?node\\_id=1819340](http://www.everything2.com/index.pl?node_id=1819340)

the next 12 months and loses any sympathy he had for the founders. He convinces himself that he deserves more equity for his contributions even if it dilutes the founders and employees.

“These fucking founders,” he tells the investors.

“Yes, these fucking founders,” say the investors.

And on they go to find to find a mutually beneficial opportunity to right-size the CEO.

### **Create a new board seat for a new CEO.**

These two tales of CEO-investor intrigue illustrate why a new CEO is not necessarily your friend on the board of directors. If and when you hire a new CEO, create a new board seat for him. The common board seats should always be elected by the common shareholders.

For example, adding a CEO seat to an investor-leaning<sup>29</sup> board with two investors yields

$$\begin{aligned} & \text{2 common} + \text{2 investors} + \text{1 independent} + \mathbf{1 \ CEO} \\ & = 6 \text{ seats} \end{aligned}$$

The same scenario with one investor yields

$$\begin{aligned} & \text{1 common} + \text{1 investor} + \text{1 independent} + \mathbf{1 \ CEO} \\ & = 4 \text{ seats} \end{aligned}$$

If you want to keep an odd number of people on the board, add another independent seat too.

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<sup>29</sup><http://venturehacks.com/articles/board-structure>

If you have a good BATNA<sup>30</sup>, you should reject any proposal where the CEO takes one of the common board seats.

## **The new CEO seat maintains the board's structure (if you're lucky).**

Your investors may argue that the new CEO seat tips the board in favor of the common stockholders since the CEO holds common stock.

If only you were so lucky.

If your investors accept the premise that the new CEO is probably aligned with them, the new seat actually tips the board in their favor. If they don't accept this premise, they are still wrong.

First, the independent director holds common stock, but the investors do not consider his seat to tip the board in favor of the common stockholders. You should ask your investors to consistently<sup>31</sup> apply the same reasoning to the new CEO seat.

Second, the CEO does not represent the common stockholders on the board; his job is to create value for all classes of stock. In fact, all of the board members have a duty to serve the interests of the company, not a duty to "serve their class of stock".

You learn a lot about an investor's attitude toward directorship if they imply that they represent their class of stock on the board. Investors should protect their class of stock through protective provisions<sup>32</sup>, not through their board seat.

Note: This article is a term sheet hack. You may enjoy the rest of the Term Sheet Hacks<sup>33</sup>.

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<sup>30</sup>[http://en.wikipedia.org/wiki/Best\\_alternative\\_to\\_a\\_negotiated\\_agreement](http://en.wikipedia.org/wiki/Best_alternative_to_a_negotiated_agreement)

<sup>31</sup>[http://en.wikipedia.org/wiki/Consistency\\_%28negotiation%29](http://en.wikipedia.org/wiki/Consistency_%28negotiation%29)

<sup>32</sup>[http://www.feld.com/blog/archives/2005/01/term\\_sheet\\_prot.html](http://www.feld.com/blog/archives/2005/01/term_sheet_prot.html)

<sup>33</sup><http://venturehacks.com/term-sheet-hacks/>

## Reactions to Venture Hacks

A big thanks goes out to our new readers, commenters, and all those who wrote about Venture Hacks<sup>34</sup>. Here are some of our favorite comments so far:

Andrew Fife says<sup>35</sup>:

**Everyone in Silicon Valley benefits from lowering the transaction costs of funding startups**, which means more companies get funded, more jobs get created and tax revenues increase without raising taxes.

Shouldn't executing disciplined business plans around new technologies be the challenge of entrepreneurship? Contacting prospective investors and understanding what they want to hear should be the easy part.

“Counsel” says<sup>36</sup>:

“There are plenty of lawyers who know VC terms and VC deals very well, yet are not in the VC’s back pockets. Ask around your business community — you will quickly learn which lawyers you can trust as being more company/entrepreneur focused, and which ones will be good VC lawyers but too cozy with VC’s for a smart entrepreneur to really trust.

Also, many VC-back-pocket lawyers will sell themselves to you as having all the connections to the

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<sup>34</sup><http://www.technorati.com/search/http%3A%2F%2Fwww.venturehacks.com?sort=authority>

<sup>35</sup><http://andrewbfife.blogspot.com/2007/04/why-question-venture-hacks.html#links>

<sup>36</sup><http://www.venturehacks.com/articles/term-sheet-hacks#comment-24>

VC's and can get your company in front of all the big players, but that should be an alarm bell. There is a difference — ask around with people who have been there and whose opinion you value and trust, and you will find it."

There was a good exchange in the comments on Venture Beat<sup>37</sup>:

*A GD VC:* "You need to trust your investor won't jack you at every turn otherwise the enterprise is doomed from the beginning."

*startupboy [not Naval]:* "You could very well say the same about VCs. You shouldn't invest unless you trust the founders, so why bother with complicated terms? The core issue here is unequal negotiating power, not trust."

From the humor pile, "Makeit" says<sup>38</sup>:

"Naval is a God....VCs are bad and Naval is good!  
Naval talks...I listen."

We think he is making fun of us.

## The option pool shuffle: Beat the game and raise your valuation

"Follow the money card!"

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<sup>37</sup><http://venturebeat.com/2007/04/02/raising-money-from-vcs-check-out-venture-hacks/#comments>

<sup>38</sup><http://venturebeat.com/2007/04/02/raising-money-from-vcs-check-out-venture-hacks/#comments>

– The Inside Man, Three-Card Shuffle<sup>39</sup>

Summary: Don't let your investors determine the size of the option pool for you. Use a hiring plan to justify a small option pool, increase your share price, and increase your *effective* valuation.

If you don't keep your eyes on the option pool while you're negotiating valuation, your investors will have you playing (and losing) a game that we like to call:

### Option Pool Shuffle

You have successfully negotiated a \$2M investment on a \$8M pre-money valuation<sup>40</sup> by pitting the famous Blue Shirt Capital against Herd Mentality Management. Triumphant, you return to your company's tastefully decorated loft or bombed-out garage to tell the team that their hard work has created \$8M of value.

Your teammates ask what their shares are worth. You explain that the company currently has 6M shares outstanding so the investors must be valuing the company's stock at \$1.33/share:

$$\begin{aligned} \$8M \text{ pre-money} \div 6M \text{ existing shares} = \\ \$1.33/\text{share}. \end{aligned}$$

Later that evening you review the term sheet from Blue Shirt. It states that the share price is \$1.00... this must be a mistake! Reading on, the term sheet states, "*The \$8 million pre-money valuation includes*

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<sup>39</sup>[http://en.wikipedia.org/wiki/Three\\_card\\_monte](http://en.wikipedia.org/wiki/Three_card_monte)

<sup>40</sup>[http://www.feld.com/blog/archives/2004/07/venture\\_capital.html](http://www.feld.com/blog/archives/2004/07/venture_capital.html)

*an option pool<sup>41</sup> equal to 20% of the post-financing<sup>42</sup> fully diluted capitalization.”*

You call your lawyer: “What the fuck?!”

As your lawyer explains that the so-called pre-money valuation always includes a large unallocated option pool for new employees, your stomach sinks. You feel duped and are left wondering, “How am I going to explain this to the team?”

If you don’t keep your eyes on the option pool, your investors will slip it in the pre-money and cost you millions of dollars of effective valuation. Don’t lose this game.

### **The option pool lowers your effective valuation.**

Your investors offered you a \$8M pre-money valuation. What they really meant was,

“We think your company is worth \$6M. But let’s create \$2M worth of new options, add that to the value of your company, and call their sum your \$8M ‘pre-money valuation’”

For all of you MIT and IIT students out there:

$$\begin{aligned} \$6M \text{ effective valuation} + \$2M \text{ new options} + \$2M \\ \text{cash} = \$10M \text{ post} \end{aligned}$$

or

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<sup>41</sup><http://www.feld.com/blog/archives/000237.html>

<sup>42</sup>[http://www.feld.com/blog/archives/2004/07/venture\\_capital.html](http://www.feld.com/blog/archives/2004/07/venture_capital.html)

60% *effective* valuation + 20% new options + 20% cash = 100% total.

Slipping the option pool in the pre-money lowers your *effective* valuation to \$6M. The *actual* value of the company you have built is \$6M, not \$8M. Likewise, the new options lower your company's share price from \$1.33/share to \$1.00/share:

$\$8M \text{ pre} \div (6M \text{ existing shares} + 2M \text{ new options})$   
= \$1/share.

### **The shuffle puts pre-money into your investor's pocket.**

Proper respect must go out to the brainiac who invented the option pool shuffle. Putting the option pool in the pre-money benefits the investors in three different ways!

First, the option pool only dilutes the common stockholders. If it came out of the post-money, the option pool would dilute the common and preferred shareholders proportionally.

Second, the option pool eats into the pre-money more than it would seem. It seems smaller than it is because it is expressed as a percentage of the post-money even though it is allocated from the pre-money. In our example, the new option pool is 20% of the post-money but *25% of the pre-money*:

$\$2M \text{ new options} \div \$8M \text{ pre-money} = 25\%$ .

Third, if you sell the company before the Series B, all un-issued and un-vested options will be cancelled. This reverse dilution benefits all classes of stock proportionally even though the common stock holders paid for all of the initial dilution in the first

place! In other words, when you exit, some of your pre-money valuation goes into the investor's pocket.

More likely, you will raise a Series B before you sell the company. In that case, you and the Series A investors will have to play option pool shuffle against the Series B investors. However, all the unused options that you paid for in the Series A will go into the Series B option pool. This allows your existing investors to avoid playing the game and, once again, avoid dilution at your expense.

### **Solution: Use a hiring plan to size the option pool.**

You can beat the game by creating the smallest option pool possible. First, ask your investors why they think the option pool should be 20% of the post-money. Reasonable responses include

1. “That should cover us for the next 12-18 months.”
2. “That should cover us until the next financing.”
3. “It’s standard,” is *not* a reasonable answer. (*We’ll cover your response in a future hack.*)

Next, make a hiring plan for the next 12 months. Add up the options you need to give to the new hires. Almost certainly, the total will be much less than 20% of the post-money. Now present the plan to your investors:

“We only need a 10% option pool to cover us for the next 12 months. By your reasoning we only need to create a 10% option pool.”

Reducing the option pool from 20% to 10% increases the company’s effective valuation from \$6M to \$7M:

\$7M *effective* valuation + \$1M new options + \$2M cash = \$10M post

or

70% *effective* valuation + 10% new options + 20% cash = 100% total

A few hours of work creating a hiring plan increases your share price by 17% to \$1.17:

\$7M effective valuation ÷ 6M existing shares = \$1.17/share.

## **How do you create an option pool from a hiring plan?**

To allocate the option pool from the hiring plan, use these current ranges for option grants in Silicon Valley:

<b>Title Range (%)</b>	CEO	5 – 10	COO	2 – 5	VP	1 – 2
2	Independent Board Member	1	Director	0.4 – 1.25		
Lead Engineer	0.5 – 1	5+	years experience	Engineer		
0.33 – 0.66	Manager or Junior Engineer				0.2 – 0.33	

These are rough ranges – not bell curves – for new hires once a company has raised its Series A. Option grants go down as the company gets closer to its Series B, starts making money, and otherwise reduces risk.

The top end of these ranges are for proven elite contributors. Most option grants are near the bottom of the ranges. Many factors affect option allocations including the quality of the existing team, the size of the opportunity, and the experience of the new hire.

If your company already has a CEO in place, you should be able to reduce the option pool to about 10% of the post-money. If the company needs to hire a new CEO *soon*, you should be able to reduce the option pool to about 15% of the post-money.

### **Bring up your hiring plan before you discuss valuation.**

Discuss your hiring plan with your prospective investors before you discuss valuation and the option pool. They may offer the truism that “you can’t hire good people as fast as you think.” You should respond, “Okay, let’s slow down the hiring plan... (and shrink the option pool).”

### **You have to play option pool shuffle.**

The only way to win at option pool shuffle is to not play at all. Put the option pool in the post-money instead of the pre-money. This benefits you *and* your investors because it aligns your interests with respect to the hiring plan and the size of the option pool.

Still, don’t try to put the option pool in the post-money. We’ve tried – it doesn’t work.

Your investor’s norm is that the option pool goes in the pre-money. When your opponent has different norms than you do, you either have to attack his norms or ask for an exception based on the facts of your case. Both straits are difficult to navigate.

Instead, skillful negotiators use their opponent’s standards and norms to advance their own arguments. Fancy negotiators call this normative leverage<sup>43</sup>. You apply normative leverage in the

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<sup>43</sup>[http://en.wikipedia.org/wiki/Leverage\\_%28negotiation%29](http://en.wikipedia.org/wiki/Leverage_%28negotiation%29)

option pool shuffle by using a hiring plan to justify a small option pool.

You can't avoid playing option pool shuffle. But you *can* track the pre-money as it gets shuffled into the option pool and back into the investor's pocket, you *can* prepare a hiring plan before the game starts, and you *can* keep your eye on the money card.

## **Focus on your share price, not your valuation**

Summary: Focus on your share price and the number of shares you own — metrics like valuation and percent ownership can fool you.

If valuation is your only perspective on a company's capital structure, you can get fooled by games like the option pool shuffle<sup>44</sup> which make your valuation *seem* large but actually *depress* your share price.

## **Focus on share value, not share quantity or valuation.**

The most naive shareholders focus on the *quantity* of shares they own. That's a mistake. The company can double your share quantity with a simple stock split. *Do you feel rich now?* We know companies that have 200M shares outstanding after the Series A just to fool their employees!

Merely uneducated shareholders focus on the *percentage* of the company they own. *News flash:* owning 99% of a company that is worth \$10 is not going to make you rich.

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<sup>44</sup><http://www.venturehacks.com/articles/option-pool-shuffle>

Experienced shareholders (and Venture Hacks readers) focus on the current *value* of their shares and the company's prospects. Investors in public companies with wacky capital structures don't fancy that they own 0.0003% of a company that is worth \$1B. Instead, they multiply today's share *price* by the *quantity* of their shares to determine their share *value*. They track percentage ownership and valuation, but they focus on share price.

You should do the same:

Understand how any proposed change to the company's capital structure affects the share price.

### **Employees should track share price too.**

The *number* of options that new hires receive drops quickly as the value of the company increases and risk decreases. But the *value* of these options declines much more slowly because the increase in share price partially compensates for the reduction in share quantity.

On the other hand, if the share price is going down, the CEO and other "key" members of the management team often receive more shares to boost their share value — particularly after a new financing with inside investors.

The employees and founders who are left out of this little party should crash it.

### **Appendix: How to derive the share price.**

These terms are negotiated in a simple Series A:

p = pre-money (\$) c = cash invested (\$) o = option pool size post-money (%)

and we hope you already know this:

$x = \text{existing shares outstanding (shares).}$

With these known values, it is easy to calculate all the unknowns:

$$\begin{aligned} \text{value symbol equation post-money (\$) } & t t = p + \\ \text{c new options (shares) } & n n = (x + o + t) \div (p - o \\ \cdot t) \text{ share price (\$/share) } & s s = p \div (x + n) \text{ investor} \\ \text{shares (shares) } & i i = c \div s \text{ effective valuation (\$) } e e \\ & = s \cdot x \end{aligned}$$

## Get vested for time served

“By the time we did the financing we had been working on [the company for] 2 years, but they only vested us a year. So, they got a year of free vesting from us.”

– Joe Kraus<sup>45</sup>, Founders at Work<sup>46</sup>

Summary: Don’t agree to vest *all* of your shares just because it is supposedly “standard”. Get vested for time served building the business.

Your Series A investors will ask you to give all your founder’s shares back to the company and earn your shares back over four years. This is called vesting — see Brad Feld’s article on vesting<sup>47</sup> if you need a primer.

Vesting is a good idea:

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<sup>45</sup><http://bnoopy.typepad.com/>

<sup>46</sup>[http://www.amazon.com/Founders-Work-Stories-Startups-Early/dp/1590597141/ref=pd\\_bbs\\_sr\\_1/103-5417622-0009467?ie=UTF8&s=books&qid=1176923027&sr=8-1](http://www.amazon.com/Founders-Work-Stories-Startups-Early/dp/1590597141/ref=pd_bbs_sr_1/103-5417622-0009467?ie=UTF8&s=books&qid=1176923027&sr=8-1)

<sup>47</sup><http://www.feld.com/blog/archives/000388.html>

You are critical to the company and you have told your investors that you are committed to the business. They are simply asking you to put your shares where your mouth is: a vesting schedule demonstrates your commitment to the company.

Vesting also ensures that a co-founder who leaves the company early doesn't receive the same amount of equity as co-founders who stay in the business.

### **Get vested for time served building the business.**

But don't agree to vest *all* of your shares just because it is supposedly "standard".



If you have been working on the company full-time for one year, 25% of your shares should be vested up-front and the balance of your shares should vest over three to four years. The best vesting agreement we have seen for a founder in a Series A is 25% of shares vested up-front with the balance vesting over three years.

You should argue that,

"New employees who join the company *today* will earn all their shares over four years. Employees who

are already here should be credited for their time served.”

We don’t recommend trying to escape a four-year commitment to the company (including time served). Four years is the typical commitment for a start up, high school, or college, as well as the span between Olympics and World Cups, and the term we give our Presidents to start as many wars as possible.

## **Consider cliffs for newfound co-founders.**

One-year cliffs<sup>48</sup> are typical for employees but are currently rare for founders.

Nevertheless, consider negotiating one-year cliffs with newfound co-founders whom you haven’t worked with in the past. If a co-founder leaves the company after three months, you don’t want him walking out the door with a large chunk of the company.

## **What are your experiences with vesting for time served?**

Submit *your* experiences and questions on vesting for time served in the comments<sup>49</sup>. We’ll discuss the most interesting ones in a future article.

*Note: Thanks go to Mark Fletcher<sup>50</sup> for reviewing this article and to Om Malik for co-publishing it on FoundRead<sup>51</sup>.*

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<sup>48</sup><http://www.feld.com/blog/archives/000388.html>

<sup>49</sup><http://venturehacks.com/articles/get-vested-for-time-served#comments>

<sup>50</sup><http://www.wingedpig.com/>

<sup>51</sup><http://www.foundread.com/view/vesting-hacks-part-i>

## Accelerate your vesting upon termination

“During the whole funding process they said, ‘We’re interested in you guys because of your management team; we think you’re fantastic...’ Two weeks later they pull me into the office – before even the first board meeting – and say, ‘We want to replace you as CEO.’”

– Mark Fletcher<sup>52</sup>, Founders at Work<sup>53</sup>

**Summary:** You made a commitment to the company by agreeing to a vesting schedule — the company should reciprocate and commit to you by granting acceleration upon termination.

Over time, your continuing contributions to the company will become relatively less important to its success. But the number of shares you vest every month will stay relatively large. Founders generally make their greatest contributions at the early stages of the business but their vesting is spread *evenly* over three to four years.

As your relative contribution to the company diminishes, everyone at the company has an incentive to terminate you and benefit ratably<sup>54</sup> from the cancellation of your unvested shares. Nevertheless, in our experience, founders are allowed to *vest in peace* unless they are incompetent, actively harmful to the business, or clash with a new CEO.

## You will probably be terminated if you clash with a new CEO.

By definition, a new CEO is hired to change the way things are and provide new leadership to the business. That he might clash

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<sup>52</sup><http://www.wingedpig.com/>

<sup>53</sup>[http://www.amazon.com/Founders-Work-Stories-Startups-Early/dp/1590597141/ref=pd\\_bbs\\_sr\\_1/103-5417622-0009467?ie=UTF8&s=books&qid=1176923027&sr=8-1](http://www.amazon.com/Founders-Work-Stories-Startups-Early/dp/1590597141/ref=pd_bbs_sr_1/103-5417622-0009467?ie=UTF8&s=books&qid=1176923027&sr=8-1)

<sup>54</sup><http://www.answers.com/main/ntquery?s=ratably>

with founders who previously ran the business is predictable. The CEO usually wins any disagreements or power struggles — he is the decider<sup>55</sup> and he decides what is best.

The investors, board, and management will almost certainly agree to fire your ass if you continuously clash with a new CEO and you will lose your unvested shares upon termination.

### **Accelerate your shares if you are terminated.**

50% to 100% of your unvested shares should accelerate if you are terminated without *cause* or you resign for *good reason*.

*Cause* typically includes willful misconduct, gross negligence, fraudulent conduct, and breaches of agreements with the company. ‘Clashing with the CEO’ is *not cause*. *Good reason* typically includes a change in position, a reduction in salary or benefits, or a move to distant location. Detailed definitions are included in the Appendix below.

Make sure you receive this acceleration whether or not your termination or resignation is in connection with a change in control of the company, such as a sale of the business. You can clash with your acquirer too.

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<sup>55</sup><http://politicalhumor.about.com/b/a/256793.htm>



### Justify acceleration with the reciprocity norm.

Acceleration may cause consternation among your investors but it is easy to justify:

“A founder’s most important contributions generally occur in the early stages of a business but he earns his shares evenly over time. If I clash with a new CEO and he terminates me, I should receive the equity I earned with those contributions.

The founders agreed to a vesting schedule to demonstrate our long-term commitment to the business. You have told us that the founders are critical to the company — that we are the DNA of the business. Acceleration demonstrates *the company's* long-term commitment to our continuing contribution.”

This argument is an application of the reciprocity norm<sup>56</sup> which requires your opponent to be fair to you if you are fair to him. Your vesting schedule locked you into a commitment to the company — that was fair — now acceleration locks the company into a commitment to you.

It is even easy to justify **100%** acceleration if you are the sole founder of the business:

“Right now, I own 100% of my shares. After the financing, I will have to earn these shares back over the next four years — I've agreed to that. But if I'm removed from the business, I lose the right to earn my shares back. In that case, I should walk out the door with the shares I came in with.”

## Avoid unfair termination with a democratic board.

As usual, the best way to avoid unfair termination and avoid hiring a bad CEO is to create a board that reflects the ownership of the company<sup>57</sup> with hacks like making a new board seat for a new CEO<sup>58</sup>.

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<sup>56</sup>[http://en.wikipedia.org/wiki/Reciprocity\\_Norm\\_%28negotiation%29](http://en.wikipedia.org/wiki/Reciprocity_Norm_%28negotiation%29)

<sup>57</sup><http://www.venturehacks.com/articles/board-structure>

<sup>58</sup><http://www.venturehacks.com/articles/ceo-board-seat>

## **Acceleration for co-founders can do more harm than good.**

If you have a team of founders, acceleration upon termination can do more harm than good.

A co-founder with acceleration upon termination who wants to leave the company can misbehave and engender his termination. If the company decides to terminate him without cause to avoid possible lawsuits, your co-founder will walk away with a lot of shares. In California, it is actually very difficult to prove *cause* unless an employee engages in criminal activity.

If you trust your co-founders absolutely, you should negotiate as much acceleration upon termination as you can. Otherwise, you need to decide which is worse: the expected value of misbehaving co-founders who leave with a lot of shares *or* the expected value of leaving a lot of shares behind after your termination.

## **What are your experiences with vesting upon termination?**

Submit *your* experiences and questions on vesting upon termination in the comments<sup>59</sup>. We'll discuss the most interesting ones in a future article.

## **Appendix: Definitions of ‘Cause’ and ‘Good reason’.**

Your lawyers will help you define *cause* and *good reason*. Definitions that we have used in term sheets in the past follow. Note that the definition of *good reason* below assumes the company plans on hiring a new CEO at some point:

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<sup>59</sup><http://venturehacks.com/articles/acceleration-termination#comments>

1. “*Cause*” shall mean the occurrence of:
2. The willful misconduct or gross negligence in performance of his duties, including his refusal to comply in any material respect with the legal directives of the Company’s Board of Directors so long as such directives are not inconsistent with a party’s position and duties, and such refusal to comply is not remedied within ten (10) working days after written notice from the Company, which written notice shall state that failure to remedy such conduct may result in termination for Cause;
3. dishonest or fraudulent conduct, a deliberate attempt to do an injury to the Company or the conviction of a felony; or
4. breach of the Proprietary Information and Inventions Assignment Agreement entered into with the Company.

1. “*Good Reason*” shall be deemed to occur if:
2. (a) there is a material adverse change in employee’s position of employment causing such position to be of materially less stature or of materially less responsibility, including without limitation, a change of title or responsibilities normally associated with such title, without employee’s consent (other than, with respect to the Founder(s), a change, in connection with the appointment of a new CEO, to an executive officer level position with normally associated responsibilities that reports directly to the CEO or the Board of Directors),  
(b) there is a reduction of more than ten percent (10%) of employee’s base compensation unless in connection with similar decreases of other similarly situated employees of the Company, or

- (c) employee refuses to relocate to a facility or location more than sixty (60) miles from such employee's principal work site; and
- 3. within the one (1) year period immediately following such event the employee elects to terminate voluntarily his employment relationship with the Company.

## **Accelerate your vesting upon a sale**

“We talked to a lot of different angel investors and venture capitalists, but no one really ‘got’ what we were doing — that is until we met Google.”

– Dennis Crowley<sup>60</sup>, Founder of Dodgeball<sup>61</sup>, May 2005

“It’s no real secret that Google wasn’t supporting dodgeball the way we expected. The whole experience was incredibly frustrating for us — especially as we couldn’t convince them that dodgeball was worth engineering resources, leaving us to watch as other startups got to innovate in the mobile + social space... It was a tough decision to walk away...”

– Dennis Crowley<sup>62</sup>, Founder of Dodgeball<sup>63</sup>, April 2007

**Summary:** Negotiate some acceleration if you sell the company ahead of schedule — you don’t want to stay at the acquirer for an unreasonable period of time. Also negotiate 100% acceleration if the acquirer terminates you and deprives you of the ability to vest your stock.

Your vesting should accelerate upon a change in control of the company, such as a sale of the business.

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<sup>60</sup><http://www.denniscrowley.com/>

<sup>61</sup><http://www.dodgeball.com/>

<sup>62</sup><http://www.denniscrowley.com/>

<sup>63</sup><http://www.dodgeball.com/>

## Negotiate both single and double trigger acceleration.

Your options for acceleration upon a change in control, from best to worst, include

1. *Single trigger*<sup>64</sup> acceleration which means 25% to 100% of your unvested stock vests immediately upon a change in control. Single trigger acceleration does not reduce the length of your vesting period. It only increases your vested shares (and decreases your unvested shares by the same amount).
2. *Double trigger*<sup>65</sup> acceleration which means 25% to 100% of your unvested stock vests immediately if you are fired by the acquirer (*termination without cause*) or you quit because the acquirer wants you to move to Afghanistan (*resignation for good reason*). The hack for acceleration upon termination<sup>66</sup> already provides double trigger acceleration and provides sample definitions<sup>67</sup> of *termination without cause* and *resignation for good reason*.
3. *Zero acceleration* which is a little better than getting shot in the head by the Terminator:

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<sup>64</sup><http://www.feld.com/blog/archives/000388.html>

<sup>65</sup><http://www.feld.com/blog/archives/000388.html>

<sup>66</sup><http://venturehacks.com/articles/acceleration-termination>

<sup>67</sup><http://venturehacks.com/articles/acceleration-termination#cause-and-reason>



The most common acceleration agreement these days combines 25% – 50% single trigger acceleration with 50% – 100% double trigger acceleration. The median of this range is probably 50% single trigger combined with 100% double trigger.

### **Justifying single trigger acceleration.**

You can justify single trigger acceleration by arguing that,

“We didn’t start this company so we could work at BigCo X for two or three years. We’re entrepreneurs, not employees. We’re willing to work at BigCo, but not for *that* long.

If we sell the company after two years, that just means we did what we were supposed to do, but

we did it faster than we were supposed to. The investors will be rewarded for an early sale by receiving their profits earlier than they expected. We shouldn't be *penalized* for an early sale by having to work at BigCo for years to earn our unvested shares. Single trigger acceleration reduces the effective time we have to work at BigCo and rewards us for creating profit for the investors ahead of schedule."

### **Justifying double trigger acceleration.**

You can justify 100% double trigger acceleration by arguing that,

"The aim of vesting is to make me stick around and create value — not to put me in a situation where I am deprived of the opportunity to vest because I am terminated for reasons beyond my control or I resign because the environment is intolerable.

So, if I am terminated with no cause by the acquirer, I should vest all my stock. Or if the conditions at the acquirer are intolerable and I resign for good reason, I should vest all my stock."

The risk of termination at an acquirer is much greater than the risk of termination in a startup. Investors are generally investing in the *future* value of a startup — they're investing in people. Acquirers are generally investing in the *existing* value in a startup — they're investing in assets.

## Acceleration agreements give you leverage upon a sale.

When you sell a company, the acquirer, founders, management, and investors will renegotiate the distribution of the chips on the table. It isn't unusual to renegotiate existing agreements whenever one party has a lot of leverage over the others. To quote the fictional Al Swearengen<sup>68</sup>,

“Bidding's open always on everyone.”

Negotiating your acceleration agreement *now* gives you leverage in this upcoming multi-way negotiation.

If an acquirer doesn't like your acceleration agreement, they can *decrease* the purchase price and use the savings to retain you with golden handcuffs<sup>69</sup>. A lower purchase price means less money for your investors. This provides you with negative leverage<sup>70</sup> against your investors — you can decrease your investor's profit if you refuse to renegotiate your acceleration.

Or, the acquirer can *increase* the purchase price in return for reducing your acceleration. A higher purchase price means more money for your investors. This provides you with positive leverage<sup>71</sup> against your investors — you can increase your investor's profit if you agree to renegotiate your acceleration.

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<sup>68</sup>[http://en.wikipedia.org/wiki/Characters\\_of\\_Deadwood#Al\\_Swearengen](http://en.wikipedia.org/wiki/Characters_of_Deadwood#Al_Swearengen)

<sup>69</sup>[http://en.wikipedia.org/wiki/Golden\\_handcuffs](http://en.wikipedia.org/wiki/Golden_handcuffs)

<sup>70</sup>[http://en.wikipedia.org/wiki/Leverage\\_%28negotiation%29](http://en.wikipedia.org/wiki/Leverage_%28negotiation%29)

<sup>71</sup>[http://en.wikipedia.org/wiki/Leverage\\_%28negotiation%29](http://en.wikipedia.org/wiki/Leverage_%28negotiation%29)

## **Visible contributors benefit the most from the renegotiation.**

After this renegotiation, the CEO and key members of the management team often end up with better acceleration agreements than everybody else. That's not a big surprise — the CEO is leading the renegotiation.

Founders who are perceived as major contributors by the board and acquirer may also benefit from the negotiation. If you're the Director of Engineering, you're probably invisible to the acquirer — if you're the VP of Engineering and involved in the negotiations, you may do much better.

As always, the best defense against these shenanigans is to create a board that reflects the ownership of the company<sup>72</sup> and to make a new board seat for a new CEO<sup>73</sup>.

## **What are your experiences with vesting upon a change in control?**

Submit *your* experiences and questions regarding vesting upon a sale in the comments<sup>74</sup>. We'll discuss the most interesting ones in a future article.

## **Appendix: Definition of ‘Change in Control’**

A sale of the company is an example of a *change in control*. Your lawyers will help you define *change in control*. A definition that we have used in one term sheet follows.

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<sup>72</sup><http://venturehacks.com/articles/board-structure>

<sup>73</sup><http://venturehacks.com/articles/ceo-board-seat>

<sup>74</sup><http://venturehacks.com/articles/acceleration-sale#comments>

“*Change in control*” shall mean the occurrence of a sale of all or substantially all of the Company’s assets or a merger or consolidation of the Company with any other company where the stockholders of the Company do not own a majority of the outstanding stock of the surviving or resulting corporation; provided that a merger, the sole purpose of which is to reincorporate the Company, shall not be treated as a change in control.

## We have the best readers in the world

We love the quality of the comments on Venture Hacks. You’re missing out if you’re not reading them.

A lot of the comments contain great anecdotes from founders. Others contain good questions which we make sure to answer.

Here’s a few recent ones that are especially good. You can also subscribe to our comments RSS feed<sup>75</sup>.

### Legal Fees

Joe Greenstein<sup>76</sup> (from Flixster<sup>77</sup>) says<sup>78</sup>:

“I just want to throw in that my personal pet peeve with regard to the “standard” term sheet is the bit about the company paying the VC legal costs. C’mon – you have \$500M and I am raising \$1.5M and you

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<sup>75</sup><http://feeds.venturehacks.com/venturehackscomments>

<sup>76</sup><http://www.flixster.com/user/Joe>

<sup>77</sup><http://www.flixster.com/>

<sup>78</sup><http://www.venturehacks.com/articles/reactions#comment-52>

want me to take the first \$25k to pay your legal expenses for doing the deal? That's like your dad giving you your allowance and then asking you to buy him a hot dog.

When we were raising money for flixster i thought that must be a trick — like if i agreed to that term they would pull the term sheet at the last second and say i failed the secret fiscal responsibility test..."

## Option Pools

Andrew Parker<sup>79</sup> (an Analyst at Union Square Ventures<sup>80</sup>) says<sup>81</sup>:

"In a negotiation, you can also try to change the rules of the game (change the formulas). For example, I know a few CEOs that have successfully negotiated that any option pool be created after the investment by institutional money, not before. So, the investors took the pool dilution along with the founders. This represents a significant increase in valuation without asking for an increase in valuation. It's a hard chip to win in bargaining, but it's worth taking a shot considering the high reward."

## Negotiation

"Anonymous" says<sup>82</sup>:

"Some part of the term-sheets is like negotiating "pre nups". You are basically negotiating the framework

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<sup>79</sup><http://blog.andrewparker.net/>

<sup>80</sup><http://www.unionsquareventures.com/>

<sup>81</sup><http://www.venturehacks.com/articles/share-price#comment-102>

<sup>82</sup><http://www.venturehacks.com/articles/term-sheet-hacks#comment-90>

to follow when things go wrong or you end up in disagreement in future, just at the point where you are agreeing to work together in present.

One thing the article should expand upon is how to negotiate without scaring off the VCs. An entrepreneur has to balance protecting his interest with not coming across as someone that might be a “problem founder”. No VCs like to work with someone they perceive as a problematic founders. It is a tight rope walk!”

## Vesting

Suzie Dingwall Williams<sup>83</sup> (a lawyer) says<sup>84</sup> :

“Whatever you do, make sure that the [double] trigger runs for a period of time BEFORE as well as AFTER change of control. You want to avoid any pre-emptive house cleaning of management before the deal is done.

I still get a good deal of moral outrage from investors when I try to negotiate this provision into the deal. Their objections seem to be a knee jerk reaction to anything that might cut into their ROI on a liquidity event. As if.”

“Entrepreneur” says<sup>85</sup>:

“I would like to add it is possible to raise VC money without founder vesting provisions. I recently closed

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<sup>83</sup><http://www.venturelaw.blogspot.com/>

<sup>84</sup><http://www.venturehacks.com/articles/acceleration-sale#comment-166>

<sup>85</sup><http://www.venturehacks.com/articles/get-vested-for-time-served#comment-126>

a series A round for a six month old company with no founder vesting provisions. We took them out of the term sheet and they weren't discussed again. We've worked previously with the same VC with great outcomes so we had a strong hand."

"A Founder" says<sup>86</sup> :

"I went to these VCs with a new CEO candidate whom I had worked with for 12 months previously. The investment proceeded and I stepped aside. Four months later I was asked if I wanted to leave and sell my shares. The offer was way below the value of the previous round so I said I would leave, but retain the shares and a board seat. However, they really wanted me gone. The deal was I would be terminated without cause, but loss of employment meant loss of board seat, which meant no ability to protect my shareholding (about 20% at that point). I was actually told by the CEO (a buddy?) that they would engineer a down round just to force me out.

Eventually we reached a compromise, but the lessons learned were:

1. Resist vesting if you have devoted time and your own capital to a business prior to VC investment.
- 2 Have a board seat linked to the shareholding, not the employment contract."

You can now subscribe to our comments RSS feed<sup>87</sup>.

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<sup>86</sup><http://www.venturehacks.com/articles/acceleration-termination#comment-117>

<sup>87</sup><http://feeds.venturehacks.com/venturehackscomments>

## Supersize your vesting with micro-hacks

Our previous vesting hacks have discussed getting vested for time served<sup>88</sup>, acceleration upon termination<sup>89</sup>, and acceleration upon a sale<sup>90</sup>. This article is a collection of four vesting microhacks you can use to supersize your vesting.

### 1. Reclaim a terminated co-founder's unvested shares.

A terminated co-founder's unvested shares are typically cancelled. The resulting reverse dilution benefits the founders, employees, and investors ratably.

Instead of canceling the shares, divide them among the remaining co-founders and employees ratably. You should argue that,

“Cancelling a terminated co-founders shares puts a lot of pre-money into the investor’s pocket. Those shares should be distributed among the founders and employees who created that pre-money valuation.”

This argument will carry more water if you offer to put a portion of the reclaimed shares into the option pool to hire a replacement for the co-founder.

Reclaiming a terminated co-founder's shares does not *create* an incentive for co-founders to terminate each other. Co-founders have an incentive to terminate each other even if the shares are cancelled. In our experience, this incentive is never a factor.

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<sup>88</sup><http://venturehacks.com/articles/get-vested-for-time-served>

<sup>89</sup><http://venturehacks.com/articles/acceleration-termination>

<sup>90</sup><http://venturehacks.com/articles/acceleration-sale>

Founders are almost always allowed to *vest in peace* unless they are incompetent, actively harmful, or clash with a new CEO.

## **2. Run screaming from the right to purchase vested stock.**

Some option plans provide the company the right to repurchase your *vested* stock upon your departure. The purchase price is 'fair market value'. Guess whether the definition of fair market value is favorable to you or the company...



Founders and employees should not agree to this provision under any circumstances. Read your option plan carefully.

*(Props to Suzie Dingwall Williams<sup>91</sup> who already brought up this*

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<sup>91</sup><http://www.venturelaw.blogspot.com/>

*microhack<sup>92</sup> in the comments.)*

### **3. Accelerate your vesting upon hiring a new CEO.**

If you are having trouble applying any of the other vesting hacks<sup>93</sup>, trade those chips in for six months of acceleration upon hiring a new CEO. Investors are usually eager to bring in “professional” management. They should agree to this term because it aligns your interests with theirs.

### **4. Keep vesting as a consultant or board member.**

If you have a lot of leverage, you may be able to negotiate an agreement to keep vesting if you are terminated but retained as a consultant or a board member. For example, the company may terminate you but keep you as a consultant to help decipher your spaghetti code.

Some companies have been known to sneak this term into their closing documents. We’re not big fans of that approach.

Again, if you are having trouble applying any of the other vesting hacks<sup>94</sup>, you may be able to trade those chips in for this one.

## **What are your vesting micro-hacks?**

Submit *your* vesting micro-hack experiences and questions in the comments<sup>95</sup>. We’ll discuss the most interesting ones in a future article.

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<sup>92</sup><http://venturehacks.com/articles/get-vested-for-time-served#comment-165>

<sup>93</sup><http://venturehacks.com/term-sheet-hacks#vesting>

<sup>94</sup><http://venturehacks.com/term-sheet-hacks#vesting>

<sup>95</sup><http://venturehacks.com/articles/vesting-microhacks#comments>

## Term sheet hacks: the cheat sheet

Several wildly raving lunatic fans have requested a condensed version of the term sheet hacks they should apply before signing a deal.

And so, we hereby present, a work in progress:

### Term Sheet Hacks: The Cheat Sheet<sup>96</sup>

We'll keep it up-to-date with the latest hacks.

For optimal results, apply the hacks liberally before you sign a term sheet. Apply regularly at each term sheet thereafter.

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<sup>96</sup><http://venturehacks.com/term-sheet-hacks>

# May 2007

## Should you raise debt or equity?

Summary: If you raise convertible debt for a seed round, you should negotiate simple and short documents, close quickly and cheaply, and maintain your options for the Series A. But first, determine if you should raise debt or equity—debt is better for small financings with small discounts.

Startups often raise their seed round by selling convertible debt<sup>1</sup> instead of equity because debt is simpler and cheaper. Read Yokum Taku's excellent series on convertible debt<sup>2</sup> for a primer.

*Seed stage* convertible debt agreements are fairly simple, especially if your investors are angels. There isn't a lot to hack in these agreements. You should be more careful if your debt investors are VCs, but these debt financings are still much easier to negotiate than an equity financing.

Later stage convertible debt can get complicated and adversarial. We know companies that took convertible debt from a corporate investor and couldn't pay the debt back on time—which triggered the corporate investor's right to take over the company. Fun stuff.

If you are raising convertible debt, you should focus on negotiating simple and short documents, closing quickly and cheaply, and maintaining your options for the Series A. But first...

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<sup>1</sup><http://www.startupcompanylawyer.com/2007/04/27/should-a-startup-company-raise-its-seed-round-using-a-convertible-note-or-series-a-preferred-stock/>  
<sup>2</sup><http://www.startupcompanylawyer.com/2007/04/26/whats-on-this-site/>

## Determine whether you should sell debt or equity.

Let's say your seed investors purchase debt with a 20% discount<sup>3</sup> off the Series A share price. If you eventually sell shares in the Series A for \$1 each, the seed investors will convert their debt to equity for \$0.80/share.

Now, let's say your seed investors are willing to buy equity for \$0.90/share instead of buying debt. *Should you sell debt or equity?*



You should sell debt only if you can use the money to increase *today's share price* by over 25% before the Series A financing. Otherwise, sell equity.

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<sup>3</sup><http://www.startupcompanylawyer.com/2007/04/28/what-should-the-conversion-discount-be-for-a-bridge-note-into-preferred-stock/>

In this example, debt is worthwhile if you think you can sell Series A shares for over  $\$0.90/\text{share} \times 125\% = \$1.125/\text{share}$ .

Let's say you decide to sell debt in your seed round and you raise a Series A at \$2/share. After applying a 20% discount, your debt investors pay \$1.60/share for their Series A shares. You were wise to sell debt to your seed investors in the seed round instead of selling them equity for \$0.90/share.

But if you raise a Series A at \$1/share, your debt investors pay \$0.80/share for their Series A shares. You should have taken their offer to buy equity at \$0.90/share in the seed round.

In general, you should sell debt only if you think it will increase your share price over

today's market price for your shares  $\div (1 - \text{discount})$ .

### **Selling debt is usually better than selling equity in a typical seed round.**

If you are raising a typical seed round, say \$50K-\$500K, you probably want to sell debt instead of equity. If you raise enough seed debt to last 6-12 months, you should have enough time to increase your valuation by the 25%-100% required to overcome typical discounts of 20%-50%.

For example, if you raise \$250K in a seed round in return for 15% of your equity, your *seed round* pre-money valuation will be \$1.42M. You should raise debt instead if you expect your *Series A* pre-money valuation to be at least

$$\$1.42M \div (1 - .2) = \$1.77M \text{ (in the case of a 20\% discount)}$$

or

$$\$1.42M \div (1 - .5) = \$2.83M \text{ (in the case of a 50\% discount).}$$

In general, if you don't think you can increase your share price and valuation by 2 to 3 times in every round of financing from Series A to Series C, you should probably pack up and go home. In fact, the company's share price typically increases the most from the seed round to the Series A as the business goes from nothingness to product, users, or revenue.

### **Selling *lots* of debt may be worse than selling equity.**

If you are raising a large seed round, say \$1M, you may want to sell equity instead of debt.

For example, if you raise \$1M in a seed round in return for 15% of your equity, your *seed round* pre-money valuation will be \$5.67M. But if you raise \$1M in return for debt at a 25% discount, your *Series A* pre-money will have to be at least

$$\$5.67M \div (1 - .25) = \$7.56M$$

for the debt to be worthwhile. \$1M of seed financing may not take your Series A valuation above \$7.56M—you may want to sell equity instead of debt in the seed round.

### **How have you decided to raise debt or equity?**

Submit *your* thoughts and questions on raising convertible debt in the comments<sup>4</sup>. We'll discuss the most interesting ones in a future article.

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<sup>4</sup><http://venturehacks.com/articles/debt-or-equity#comments>

## Venture Hacks: The Mug

You probably know that we love our commenters<sup>5</sup>—we want to make babies with them.

From now on, we're sending a bona fide Venture Hacks mug to the registered user with the best comment of the week. We don't care if this bankrupts us. This one-of-a-kind collector's item is emblazoned with the Venture Hacks motto on the front:



Venture Hacks logo is on the back:

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And the subtle new

<sup>5</sup><http://www.venturehacks.com/articles/recent-comments>



(Yes, we stole it from Van Halen.)

## Comment of the week, cherry edition



As usual, there were many mind-expanding comments this week—here are some of the very best.

The very lucky winner of this week's mug<sup>6</sup> for great contributions in the field of venture hacking is indicated with a subtle ball of fire.

### Vesting

“Anonymous” discusses<sup>7</sup> his experience with getting vested for time served and how his investors “poked out” two of the company’s co-founders:

“In my first institutional round we successfully got founder vesting put in... with a year’s worth of credit and a monthly vesting rather than an annual cliff. The company was at about 16 months old. At the time, we thought we were losers and just got ripped

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<sup>6</sup><http://www.venturehacks.com/articles/mug>

<sup>7</sup><http://www.venturehacks.com/articles/get-vested-for-time-served#comment-218>

off but in hindsight that was a genius move. When the lead VC moved to poke out two of our 3 co-founders, that vesting took away some of the sting. Having the [credit] makes them think twice about having to spend the cash to move you out. In the end, we ended up with about 12% of the company fully diluted per founder. That's pretty damn good, especially when we were at a \$650M valuation when we got poked out.

If you are EBITDA<sup>8</sup> negative, you need to expect to see [vesting] in the deal. I would highly encourage you to try and fight for the value you've created as much as possible and look down the road at ways in which you can preserve as much of that value as possible. If you are close to break even or EBITDA positive, this should be a non-issue.”

Yokum Taku<sup>9</sup>, a lawyer, mentions<sup>10</sup> that co-founders can negotiate their vesting agreements before they raise financing—this provides extra leverage in the Series A negotiation:



“Negotiation microhack on vesting:

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<sup>8</sup><http://en.wikipedia.org/wiki/EBITDA>

<sup>9</sup><http://www.startupcompanylawyer.com/>

<sup>10</sup><http://www.venturehacks.com/articles/vesting-microhacks#comment-206>

When the company is newly incorporated and founders shares are being issued (well before the VC Series A financing), consider hard-wiring some of the suggestions (vesting for time served, various acceleration provisions, etc.) into the Founders Restricted Stock Purchase Agreements.

Obviously, all of the provisions of the Founders Restricted Stock Purchase Agreements can (and will be) superceded by the Series A documents, but there's a possibility that if you lead with something that is not outrageous in terms of vesting and acceleration, it might survive the Series A financing.

One ploy involves a response to the VCs along the lines of "Well – those vesting (and lack of acceleration) provisions are different from what the [fill in number greater than two] founders originally agreed upon. It took us several screaming matches to agree on upon these terms when we issued founders stock and there was a certain level of distrust during these arguments. I don't know if I have the stomach to go back to [fill in name of potentially unstable founder least savvy about VC terms] to explain why we want to change what we agreed upon. He doesn't really want to take your money in the first place, and it'll push him over the edge. He/she'll think that I'm trying to screw him/her over and may blow up the deal.

Typical legal disclaimers apply to this comment."

## Convertible Debt

“ds” says<sup>11</sup> that high valuation seed financings can cause problems:

“I like [convertible debt] for the reason that it preserves upside for the angels that are taking the first layer of risk. I have seen a fair number of deals where price-insensitive angels put some \$ into a company on a fairly high valuation.

Later, in the first institutional round, the VC takes a clinical look at the business and puts a different (lower) valuation on it. In that case, no one is happy...the entrepreneur feels he has done a lot of work and is moving backwards, the angel feels like he has taken risk and gotten stuffed, and the VC feels (to the extent that they feel) like they are dealing with unsophisticated operators.

[Convertible debt] is a neat structure to avoid this problem.”

Yokum Taku<sup>12</sup>, a lawyer, considers<sup>13</sup> whether convertible debt goes in the pre-money or post-money:

“One corollary to the Option Pool Shuffle<sup>14</sup> is “What’s in the fully-diluted shares outstanding if you have convertible notes or warrants outstanding?” The issue is whether shares issuable upon conversion of a convertible bridge note or warrants issued in connection with the bridge should be considered part

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<sup>11</sup><http://www.venturehacks.com/articles/debt-or-equity#comment-260>

<sup>12</sup><http://www.startupcompanylawyer.com/>

<sup>13</sup><http://www.venturehacks.com/articles/option-pool-shuffle#comment-194>

<sup>14</sup><http://www.venturehacks.com/articles/option-pool-shuffle>

of the pre-money fully-diluted shares outstanding in calculating price per share of the Series A. Remember, more fully-diluted shares outstanding drives the Series A price per share down, resulting in more dilution to the founders.

Given that many companies are doing convertible note bridge financings as their seed round, this seems to come up relatively often.

VCs will take the position that all of the shares issuable upon the conversion of the bridge note and any warrants granted will be part of the denominator for calculating the price per share of the Series A.

At first glance, it seems like there is a good argument on behalf of the company that the shares issuable upon the bridge note are no different from shares issued in the Series A, and should not be included in the pre-money fully-diluted shares outstanding. In addition, warrants issued in connection with the note typically have an exercise price equal to the Series A price, so these warrants are not dilutive like cheap founders common shares.

The response from the VC is (1) the money from the bridge is gone and the value created by that money is reflected in the pre-money valuation, so the shares issuable upon conversion of the bridge count against fully-diluted shares, (2) in any event, there is a conversion discount on the note conversion so these shares are dilutive to the Series A, and (3) even though the warrants aren't dilutive today with an exercise price at the Series A price, they will be dilutive in the future in the next round of financing, so the pre-Series A investors should bear that dilution.

Of course, with respect to (1), if there is still money in the bank at the time of Series A, perhaps some portion of the shares issuable upon conversion of the bridge should be taken out of the pre-money fully-diluted share number to the extent of the money left in the bank.

And with respect to (2), perhaps the discount portion of the conversion shares should be included in the pre-money fully-diluted share number, but the rest (to the extent there is money left in the bank) should not.

Finally, with respect to (3), perhaps the warrant overhang is not too different from multiple closings on a Series A round, where the price is set at the first closing, and second closings seem to go on for long periods of time after the first closing at the same price per share as the first closing.

I'd be curious in the VC reaction to this, because the last time I tried this, I lost arguments (1) and (2) (with not too much more logic than "no, those shares are in the denominator" – end of argument) and item (3) warrants was not applicable...

Typical disclaimers about legal advice apply to this comment.

Aside from the swipe about startup company lawyers not negotiating hard against the VCs (which I vehemently disagree with as a WSGR partner), I think you've done a great job educating entrepreneurs about subtle nuances in negotiations with VCs."

Don't let us stop you from subscribing to our comments RSS feed<sup>15</sup>.

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<sup>15</sup><http://feeds.venturehacks.com/venturehackscomments>

## Keep your options open if you raise debt

“[Our existing investors] had put in a right of first refusal. Since I was a young entrepreneur at the time, I didn’t understand that this basically meant that you couldn’t go to any other VC... We could not get a higher valuation because [our existing investors] wanted to put more money in the company themselves. So any time we would talk to another VC, they would talk him out of it: “This is not a good company, don’t worry about it.” So we were really stuck with [our existing investors] for the next round.”

– A Founder

Summary: Raising convertible debt from venture capitalists can restrict your Series A options and lower your Series A valuation—whether or not your investors have a right of first refusal on the Series A. You can keep your options open by raising debt from angels exclusively or raising debt from more than one VC.

Raising convertible debt<sup>16</sup> from *angels* usually leaves your Series A options open. Why? Angels send a positive signal if they want to re-invest in the Series A, but they don’t send any negative signals to your prospective investors if they decide to pass. There are many simple reasons why an angel may not re-invest in the next round.

You need to be more careful if you raise convertible debt from a venture capital firm. They are more likely to ask for a right of first refusal<sup>17</sup> with respect to some, or all, of the Series A. And, with or without a right of first refusal (ROFR), they can send signals that give them leverage and restrict your options in the Series A financing.

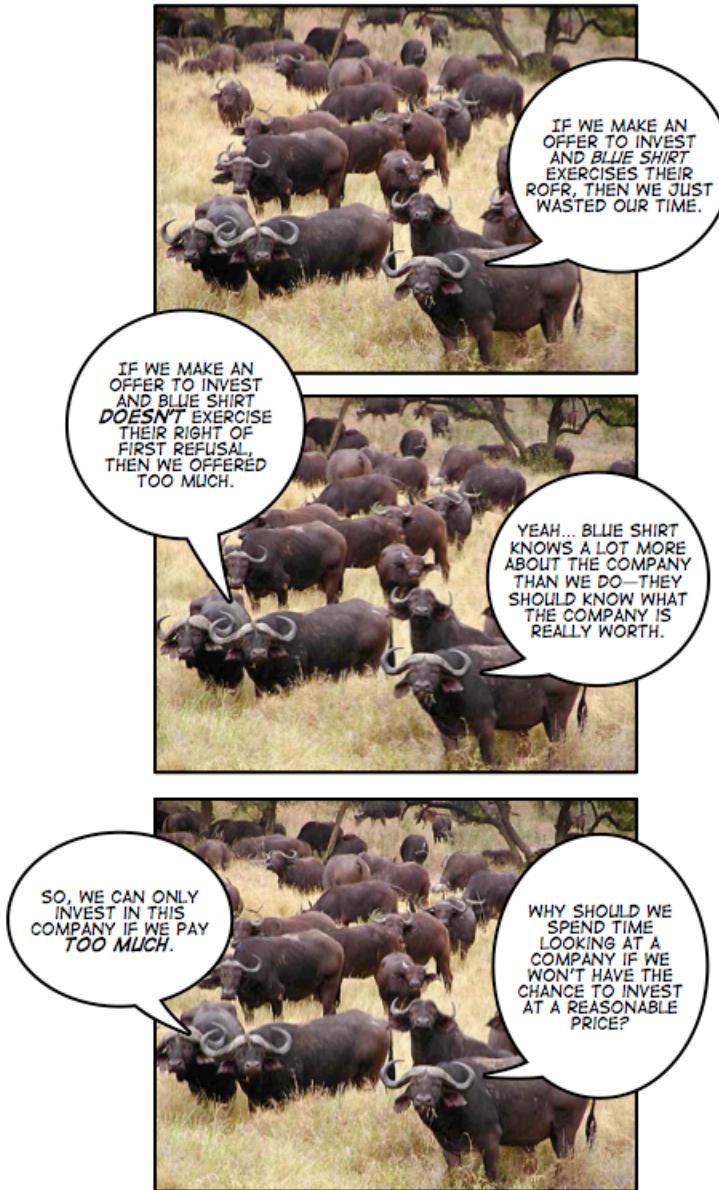
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<sup>16</sup><http://www.venturehacks.com/term-sheet-hacks#convertible-debt>

<sup>17</sup>[http://www.feld.com/blog/archives/2005/06/term\\_sheet\\_righ.html](http://www.feld.com/blog/archives/2005/06/term_sheet_righ.html)

**Prospective investors don't appreciate ROFRs.**

Let's assume your existing debt investors, Blue Shirt Capital, have a right of first refusal on all of the Series A. You're ready to raise your Series A and Blue Shirt says they want to re-invest. Other prospective Series A investors, such as Herd Mentality Management, will have a standard reaction when they learn that your existing investors have a right of first refusal:



**A ROFR can restrict your options and lower your valuation.**

At worst, your prospective investors will decide not to waste their time with you, leaving you to take money from your existing investors at a low valuation.

At best, your prospective investors won't give you an offer unless they are assured that they may co-invest with your existing investors. This forces you to raise money from two investors, implying that you will have to (1) raise more cash than you expected and (2) take 30%-40% dilution from two investors instead of 20%-30% dilution from one investor. Your prospective investors can also coordinate with your existing investors to drive down your valuation:



IF THAT'S WHAT YOU'RE OFFERING, YOU SHOULD GO AHEAD AND TAKE THE ENTIRE ROUND.

WE WON'T EXERCISE OUR ROFR AT THAT PRICE.



(Blue Shirt can use this same signal to drive down your valuation even if they have a right of first refusal on just a *portion* of the Series A.)

### **It sucks if your existing VCs don't want to re-invest.**

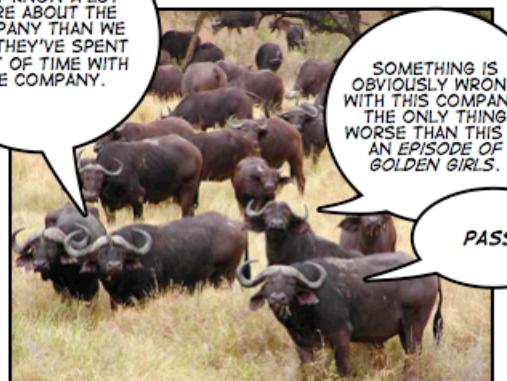
What if Blue Shirt says they *don't* want to re-invest in the Series A at all—whether or not they have a right of first refusal? Herd Mentality will gag on their feed when they learn that your existing investors don't want to re-invest:



WHAT HAS BLUE SHIRT  
LEARNED SINCE THE DEBT  
ROUND?

WHY DID THEY LOSE  
INTEREST?

THEY KNOW A LOT  
MORE ABOUT THE  
COMPANY THAN WE  
DO—THEY'VE SPENT  
A LOT OF TIME WITH  
THE COMPANY.



SOMETHING IS  
OBVIOUSLY WRONG  
WITH THIS COMPANY.  
THE ONLY THING  
WORSE THAN THIS IS  
AN EPISODE OF  
GOLDEN GIRLS.

PASS!



?

At best, once there is no interest left in your Series A financing, Blue Shirt may tell you that they actually *do* want to invest in the Series A—at the right price. There’s no competition left, so you’re stuck with whatever Blue Shirt offers. However, this is an unlikely outcome since it’s not good for Blue Shirt’s reputation among investors.

More likely, Blue Shirt really *doesn’t* want to invest in the Series A and this negative signal makes it difficult or impossible for you to raise any more money.

## **You have the same problems with or without a ROFR.**

If you raise convertible debt from a venture firm, you will have the same problems whether or not they have a right of first refusal:

Herd Mentality will still wonder whether they are wasting time since you already have investors on the “inside track”. They will still make an offer only if they are assured that they may co-invest with Blue Shirt. They will still coordinate with Blue Shirt to drive down your valuation. They will still gag if Blue Shirt doesn’t want to re-invest.

Your existing investors can send the same signals with or without a right of first refusal—the signals are simply stronger if they have the right of first refusal. This is a small taste of the game<sup>18</sup> you will have to play when you raise a Series B and your prospective Series B investors interact with your existing Series A investors. Some solutions to this game are coming in a future hack.

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<sup>18</sup>[http://en.wikipedia.org/wiki/Game\\_theory](http://en.wikipedia.org/wiki/Game_theory)

For now, you *can* set up the seed round to avoid playing this game in the Series A.

### **Try to remove the ROFR.**

First, try to remove the right of first refusal by applying the reciprocity norm<sup>19</sup>:

“If you have a right to buy equity in our next round, shouldn’t we have a reciprocal right to sell you equity in the next round? In other words, why should you have a call option<sup>20</sup> to buy the company’s equity if we don’t have a put option<sup>21</sup> to sell you the company’s equity?

Why are we negotiating the next round of financing *now*? If we’re going to negotiate the next round now, we should negotiate *all* of the next round, not just your right to invest in it. I don’t want to do the next deal now, I want to do this deal now.”

If you lose this argument, try to contain the right of first refusal to a *portion* of the Series A. For example, if you raise money from three investors in the Series A, your debt investors would have the right to take up to one third of the Series A.

Overall, accepting a right of first refusal is a minor concession in your debt agreement. Don’t blow up the deal over this term since you will have the same problems whether or not you win this item.

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<sup>19</sup>[http://en.wikipedia.org/wiki/Reciprocity\\_Norm\\_%28negotiation%29](http://en.wikipedia.org/wiki/Reciprocity_Norm_%28negotiation%29)

<sup>20</sup>[http://en.wikipedia.org/wiki/Call\\_option](http://en.wikipedia.org/wiki/Call_option)

<sup>21</sup>[http://en.wikipedia.org/wiki/Put\\_option](http://en.wikipedia.org/wiki/Put_option)

## Get multiple investors if you raise debt from VCs.

If you decide to raise debt from venture capitalists, you should try to close two, three, or more venture firms<sup>22</sup>.

As the number of insider investors increases, the influence of any one insider decreases. There is no single source with a single agenda that can send whatever signals it likes. Multiple investors will send multiple conflicting signals that outsiders will not be able to distinguish from noise.

And as the number of insider investors increases, the probability that one of them will send a positive signal increases. For example, at least one of your existing investors may state that they want to invest in your Series A.

You can also make the case to your prospective investors that you raised debt from multiple firms specifically to reduce their individual influence on the Series A:

“Raising debt from multiple VCs is *our* signal that these insiders are really no different than you. They know nothing more about the business than you do by now. The debt round was simply their opportunity to demonstrate their value to us.”

Finally, you can pit multiple firms against each other to get the best terms for the convertible debt:

Determine what terms Blue Shirt will offer to purchase the entire note. Then tell Herd Mentality that Blue Shirt wants to take the entire note at those terms. Would Herd Mentality consider a more favorable offer? Repeat. Finally, split the debt among all the investors.

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<sup>22</sup>[http://www.businessweek.com/technology/content/apr2007/tc20070402\\_747117.htm?chan=top+news\\_top+news+index\\_businessweek+exclusives](http://www.businessweek.com/technology/content/apr2007/tc20070402_747117.htm?chan=top+news_top+news+index_businessweek+exclusives)

## What are your experiences with keeping your Series A options open?

Use the comments<sup>23</sup> to share your experiences with keeping your Series A options open. We'll discuss the most interesting comments in a future article!

## Hack: the benefits of debt Vs equity in a seed round

Summary: Convertible debt is often the best choice for a seed round. It is convenient, cheap, and quick. It lets you close the financing quickly and turn your focus back to your customers—that's good for the company *and* its investors.

When your business is very young, raising a seed financing (\$50K-\$500K) via *convertible debt* is a great alternative to selling equity. Convertible debt is also known as a *bridge loan* since it ‘bridges’ the company to its next financing.

Convertible debt (debt for short) is not like getting a loan from a bank. A bank expects to get its loan back. With convertible debt, the lender and your company both expect to *convert* the debt into equity when you close the Series A. Read Yokum Taku's series on convertible debt<sup>24</sup> for a primer on this lovely financial instrument.

Seed stage debt rounds are much simpler than equity rounds, especially if your investors are angels. There isn't a lot to hack in these agreements. You need to be more careful if you raise

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<sup>23</sup><http://venturehacks.com/articles/options-open#comments>

<sup>24</sup><http://www.startupcompanylawyer.com/2007/04/26/whats-on-this-site/>

debt from venture capitalists, but a debt financing with a VC is still much simpler than an equity financing with a VC.

Why is debt a great alternative to equity in a seed round? Convenience, suitability, control, cost, and speed.

## 1. Convenience

Debt agreements are easy to understand and hard to screw up, two great benefits if you're raising the first financing of your life.

A debt term sheet is no longer than one or two pages and the closing<sup>25</sup> documents are no longer than ten pages. There aren't many terms to negotiate in a debt agreement<sup>26</sup>.

Compare this to a Series A term sheet which is as long as *all of the closing documents* for a debt round. Negotiating and closing debt is good practice for the negotiation of the 25 terms in a typical Series A term sheet<sup>27</sup>.

## 2. Suitability

Who knows how to determine a suitable valuation and investor rights for a seed stage company?

The company's valuation and leverage is changing quickly as it goes from nothingness to product, users, and revenue.

The founders are unlikely to negotiate a valuation that meets their high minimum expectation since there isn't much competition to invest in the young and risky business.

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<sup>25</sup>[http://en.wikipedia.org/wiki/Closing\\_%28sales%29](http://en.wikipedia.org/wiki/Closing_%28sales%29)

<sup>26</sup><http://www.startupcompanylawyer.com/2007/04/26/whats-on-this-site/>

<sup>27</sup><http://www.feld.com/blog/archives/000573.html>

But a valuation that *does* meet the founder's minimum expectations may be too high and result in a down round<sup>28</sup> in the Series A. The down round leaves the founders feeling like they lost money even though the company made progress, the angels feeling like they took risk but got squashed, and the Series A investors feeling like they are dealing with unsophisticated operators.

Finally, it's tough to reach a high Series A valuation soon after setting a low or moderate valuation in a seed round. Your Series A investors won't want to pay a much higher share price than seed investors who bought stock just a few months ago.

Raising debt avoids setting a valuation, delays negotiating detailed investor rights, avoids the option pool shuffle<sup>29</sup>, and gives the seed stage investors an upside through a discount<sup>30</sup> and/or warrants<sup>31</sup>.

### 3. Control

Founders usually continue to control a company after a debt round.

They control a majority, or all, of the board seats. Debt investors, especially angels, don't necessarily want board seats. Seed stage equity investors, especially venture capitalists, often do. Controlling the board reduces the burden of reporting to the

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<sup>28</sup>[http://vcexperts.com/vce/library/encyclopedia/glossary\\_view.asp?glossary\\_id=271](http://vcexperts.com/vce/library/encyclopedia/glossary_view.asp?glossary_id=271)

<sup>29</sup><http://venturehacks.com/articles/option-pool-shuffle>

<sup>30</sup><http://www.startupcompanylawyer.com/2007/04/28/what-should-the-conversion-discount-be-for-a-bridge-note-into-preferred-stock/>

<sup>31</sup><http://www.startupcompanylawyer.com/2007/05/03/what-should-the-terms-of-bridge-loan-warrant-coverage-be/>

board and diminishes the likelihood of disagreements between the board and management.

The founders also control a majority of the company's common stock. There is no preferred stock<sup>32</sup>. They can sell the company for \$10M, give \$2M to the debt investors, and take home \$8M. Try doing that with equity investors who have preferred stock with protective provisions<sup>33</sup> that allow them to veto a sale of the company. In particular, venture capitalists often have big funds and they're looking for big returns, not \$10M exits.

Finally, if you raise debt, you can create and run a profitable business that doesn't need an 'exit'. Angels may be happy getting a big dividend from your company every quarter, whether they bought debt or equity. Venture capitalists aren't looking for a quarterly dividend—they need to sell or IPO a company to return a profit to *their* investors (their limited partners<sup>34</sup>). Raising debt from VCs maintains the option of building a 'non-exiting' business—you can always pay their debt back when it comes due. That said, we don't recommend taking debt from VCs with the plan of building a 'non-exiting' business—that's disingenuous.

## 4. Cost

You can negotiate a debt term sheet and close the money for under \$10K in legal fees<sup>35</sup>. There are very few terms for the lawyers to discuss—they will barely have to modify their boilerplate documents.

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<sup>32</sup>[http://www.feld.com/blog/archives/2004/07/liquidation\\_pre.html](http://www.feld.com/blog/archives/2004/07/liquidation_pre.html)

<sup>33</sup>[http://www.feld.com/blog/archives/2005/01/term\\_sheet\\_prot.html](http://www.feld.com/blog/archives/2005/01/term_sheet_prot.html)

<sup>34</sup>[http://vcexperts.com/vce/library/encyclopedia/glossary\\_view.asp?glossary\\_id=67](http://vcexperts.com/vce/library/encyclopedia/glossary_view.asp?glossary_id=67)

<sup>35</sup><http://www.startupcompanylawyer.com/2007/05/13/who-pays-legal-fees-in-a-convertible-note-bridge-financing-and-how-much-does-it-cost/>

Negotiating a Series A term sheet and closing it can cost \$20K-\$60K in legal fees. Why would you or your investors want to spend that much money on legal fees when you're raising a \$100K seed round?

You can further reduce your legal fees by reading our convertible debt hacks<sup>36</sup> and Yokum's convertible debt articles<sup>37</sup> while you work with your lawyers. (Venture Hacks is not legal advice<sup>38</sup>!)

## 5. Speed

Once your investors are ready to talk terms, you can negotiate a term sheet in one week and close the deal one week after that. The documents are short and simple—there isn't much to discuss. Compare this to an equity financing which can take two weeks to negotiate and 4-6 weeks to close.

### **Debt is often the best choice for seed rounds.**

Convertible debt is often the best instrument for a seed round. You can close the debt cheaply and quickly and then turn your focus back to your customers. That's good for the company *and* its investors since speed is a major competitive advantage of a startup. If you or your investors are veering away from convenience, low cost, and speed, you are missing the point of seed stage debt!

The seed stage is the worst possible time for the founders to negotiate an equity financing. The company is nebulous, the founders are inexperienced, and the company is starved for cash and time. The team should be testing hypotheses about their business, not negotiating complicated term sheets.

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<sup>36</sup><http://www.venturehacks.com/term-sheet-hacks#convertible-debt>

<sup>37</sup><http://www.startupcompanylawyer.com/2007/04/26/whats-on-this-site/>

<sup>38</sup><http://www.venturehacks.com/disclaimer>

Investors who market themselves as ‘business partners’ should agree that they can add a lot of value to the business by doing the financing quickly and letting the team get back to their customers.

## **What do you think about the benefits of debt vs. equity?**

Use the comments<sup>39</sup> to share your thoughts and questions on the benefits of debt vs. equity. We’ll discuss the most interesting comments in a future article.

*Our next convertible debt hack shows you how to compare the economics of debt vs. equity<sup>40</sup>.*

*Thanks to Brian Norgard<sup>41</sup>, Zach Coelius<sup>42</sup>, and many others for suggesting this article. And apologies to “ds” for stealing a little bit of his language<sup>43</sup>.*

## **Hack: Make your debt attractive to investors**

Summary: Seed investors often argue that debt doesn’t incent them to (1) help the business and (2) increase the share price of the eventual Series A. Actually, (1) debt *does* incent investors to help the business and (2) equity may also incent investors to decrease the Series A share price. That said, you can make your debt much more attractive to investors with a few concessions.

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<sup>39</sup><http://venturehacks.com/articles/debt-benefits#comments>

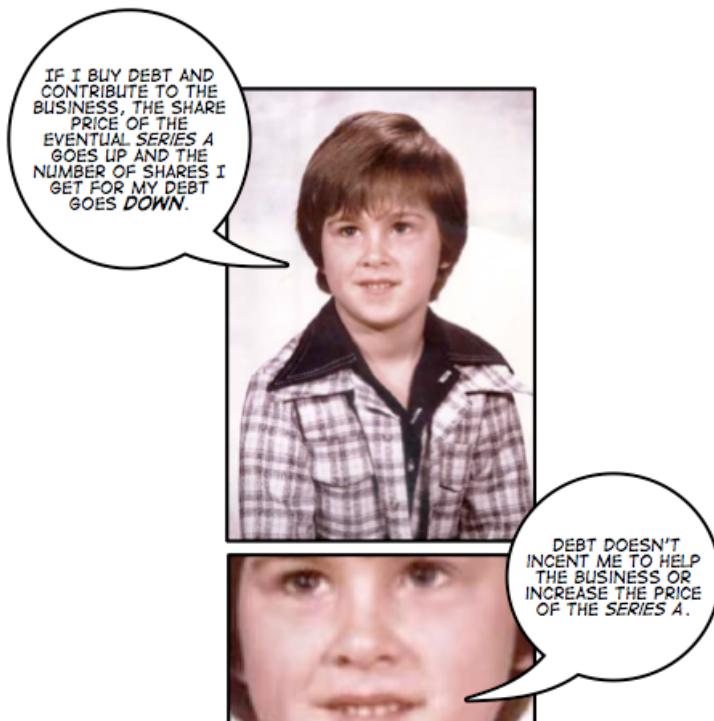
<sup>40</sup><http://www.venturehacks.com/articles/debt-or-equity>

<sup>41</sup><http://www.briannorgard.com/>

<sup>42</sup><http://blog.triggit.com/>

<sup>43</sup><http://www.venturehacks.com/articles/debt-or-equity#comment-260>

Although convertible debt is often the best choice for a seed round<sup>44</sup>, investors often argue that debt does not incent them to contribute to the business:



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<sup>44</sup><http://venturehacks.com/articles/debt-benefits>

## Debt holders are incented to help the business.

Your response to an investor's claim that "(1) debt doesn't incent me to help the business":

"If you buy \$100K of debt, you get \$100K worth of shares in the Series A, plus some shares for your discount. You're not losing money by contributing to the business—the Series A share price may go up but your *share value*<sup>45</sup> remains \$100K, plus a discount.

"And... as you contribute to the business, the company's risk goes down, opportunity goes up, and the net present value<sup>46</sup> of your debt goes up. You're still incented to help the business when you buy debt."

That said, equity incents an investor even more. If an investor buys \$100K of equity in the seed round and locks in his share price, he makes a paper profit<sup>47</sup> if the share price increases in the Series A.

*Note to entrepreneur: You don't need to make this argument on your investor's behalf.*

## Equity holders are also incented to decrease the Series A valuation.

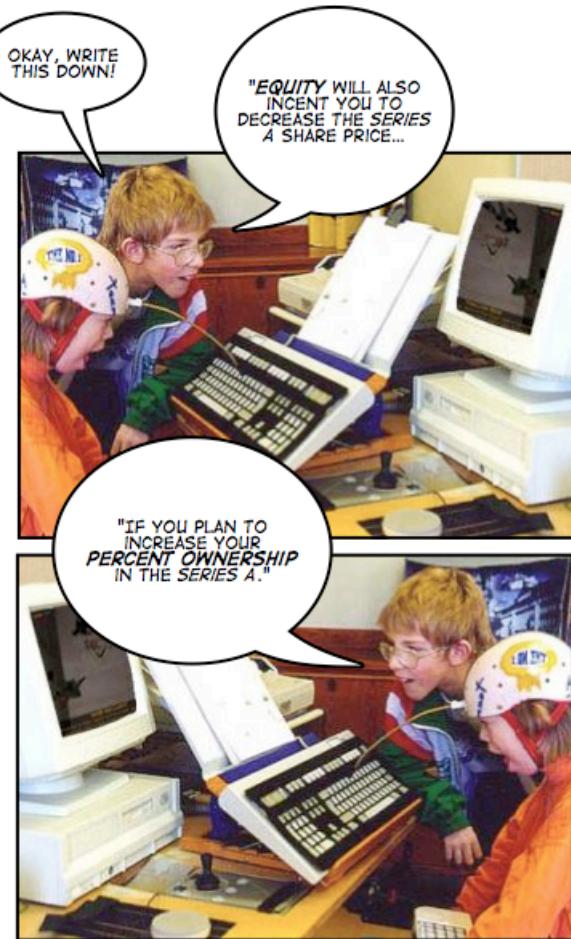
Your response to an investor's claim that "(2) debt doesn't incent me to increase the eventual share price of the Series A":

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<sup>45</sup> <http://www.venturehacks.com/articles/share-price>

<sup>46</sup> [http://en.wikipedia.org/wiki/Net\\_present\\_value](http://en.wikipedia.org/wiki/Net_present_value)

<sup>47</sup> <http://www.answers.com/paper+profit&r=67>



Rational investors are

1. Insensitive to the next round's price if they plan to *maintain* their percent ownership,
2. Incented to increase the next round's price if they plan to *decrease* their percent ownership, and
3. Incented to decrease the next round's price if they plan to *increase* their percent ownership.

(We'll explain how the math works in the comments<sup>48</sup>.)

Some seed stage funds maintain or decrease their percent ownership in the Series A. These funds tend to focus on seed stage companies.

Other seed investors try to increase their percent ownership in the Series A—if the company is doing well. These funds tend to invest in most stages of a company's growth.

Ask your investors about their track record and strategy for follow-on investments. If they like to increase their percent ownership in their best investments, they have an incentive to drive down your Series A valuation whether they buy debt *or* equity in the seed round.

## **Make your debt attractive to investors.**

Rather than debating the finer points of your investor's incentives, you can make your debt much more attractive to investors with a few concessions (ordered from small to large):

1. Don't let the company pre-pay the debt<sup>49</sup>. Your investors don't want you to repay the debt just before you raise a Series A or sell the company.

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<sup>48</sup><http://venturehacks.com/articles/attractive-debt#comments>

<sup>49</sup><http://www.startupcompanylawyer.com/2007/05/01/what-happens-if-the-company-is-sold-after-the-convertible-bridge-note-is-issued-and-before-the-ma>

2. Anticipate a potential sale before the Series A<sup>50</sup> and negotiate your investor's share of the sale price. Your debt investors want to make money if you sell the company before the Series A.
3. Increase the discount<sup>51</sup> by a fixed amount and/or 2.5% per month, up to a maximum that can range from 20% to 40%. A higher discount yields a higher return for your investors. For example, a 40% discount guarantees your investors a 1.7x return on paper when the Series A closes.
4. Set a maximum conversion price for the debt<sup>52</sup>. The debt could convert at the lesser of (1) \$X/share and (2) the actual Series A share price. This cap effectively sets a maximum valuation for your debt investors and protects them from a high Series A share price. This is a great way to maintain the benefits of convertible debt<sup>53</sup> while rewarding your debt investors for investing early. The maximum conversion price can be significantly higher than any valuation you could negotiate easily.

## How have you made debt attractive to investors?

Use the comments<sup>54</sup> to share your experiences and questions on making debt attractive to investors. We'll discuss the most interesting comments in a future article.

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<sup>50</sup><http://www.startupcompanylawyer.com/2007/05/01/what-happens-if-the-company-is-sold-after-the-convertible-bridge-note-is-issued-and-before-the-ma>

<sup>51</sup><http://www.startupcompanylawyer.com/2007/04/28/what-should-the-conversion-discount-be-for-a-bridge-note-into-preferred-stock/>

<sup>52</sup>[#comment-10">http://www.startupcompanylawyer.com/2007/04/27/should-a-startup-company-raise-its-seed-round-using-a-convertible-note-or-series-a-preferred-stock">#comment-10](http://www.startupcompanylawyer.com/2007/04/27/should-a-startup-company-raise-its-seed-round-using-a-convertible-note-or-series-a-preferred-stock)

<sup>53</sup><http://venturehacks.com/articles/debt-benefits>

<sup>54</sup>[#comments">http://venturehacks.com/articles/attractive-debt">#comments](http://venturehacks.com/articles/attractive-debt)

## Comments, the threaded edition

Our comments are now threaded! Click the “Reply” link beneath any comment to leave a response. Here’s an example of a threaded comment<sup>55</sup>.

As usual, we’ve received many mind-expanding comments—here are some of the very best. The very lucky winner of a mug<sup>56</sup> for great contributions in the field of venture hacking is indicated with a subtle ball of fire.

## Dead simple equity agreements

Yokum Taku<sup>57</sup>, a lawyer at Wilson Sonsini, mentions<sup>58</sup> his experience with simple equity agreements that have some of the advantages of debt financing:

“I’ve done early angel preferred stock financings where the angel Series A only had a liquidation preference and there was a contractual provision that forced the company to give the angel Series A all other investor rights that would eventually be given to the “real” Series B (adjusted for price-related terms). The Series B may have issues with giving the Series A the same level of rights, so the Series B may condition the Series B financing on the Series A rights being something they can live with.”

A caveat: this is not the same as an equity financing with “standard” or “vanilla” terms. Yokum is talking about preferred stock

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<sup>55</sup><http://www.venturehacks.com/articles/debt-benefits#comment-296>

<sup>56</sup><http://www.venturehacks.com/articles/mug>

<sup>57</sup><http://www.startupcompanylawyer.com/>

<sup>58</sup><http://www.venturehacks.com/articles/attractive-debt#comment-319>

with **no** rights other than a liquidation preference<sup>59</sup>. So-called “standard” terms are almost always in the investor’s favor.

## The benefits of convertible debt

Eric Deeds<sup>60</sup>, a lawyer at DLA Piper, discusses<sup>61</sup> the benefits of convertible debt:

“First, don’t underestimate the benefit of simplicity, convertible debt is a lot cheaper and quicker to put in place than an equity structure, even with dumbed down seed / angel terms. Also, if you’re raising the money \$50-100k at a time, you don’t really have one person to negotiate terms with, so the fewer terms the better.

“Regarding valuation vs. no valuation, don’t forget one benefit angels are getting either way is access to the company. The door is typically shut at Series A. I don’t think it makes sense as an angel to push too hard to put a price on the company at the seed round. For one thing, its possible (and not entirely uncommon) to overpay, which is awkward for the company and the angels. A risk premium to the Series A in the 10-40% range should be adequate compensation.

“I think complex discount / cap structures can be more trouble than they’re worth. As noted, at the extreme you are pricing the company, they complicate and increase the cost of putting the round in place, and based on some experience, VCs just seem to hate paying more for a Series A share than the

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<sup>59</sup>[http://www.feld.com/blog/archives/2005/01/term\\_sheet\\_liqu.html](http://www.feld.com/blog/archives/2005/01/term_sheet_liqu.html)

<sup>60</sup>[http://www.dlapiper.com/eric\\_deeds/](http://www.dlapiper.com/eric_deeds/)

<sup>61</sup><http://www.venturehacks.com/articles/attractive-debt#comment-335>

seed investors. Warrant coverage provides the same risk premium with a lot less friction.”

## Raising debt from friends and family

Jonathan Treiber from OnCard Marketing<sup>62</sup> recounts<sup>63</sup> his experience with raising debt from friends and family:



“We just did a convertible debt offering for our seed round and raised about \$125k about 6 months ago. It was easy and painless. The investors were mostly friends and family and did not really want to bother negotiating a term sheet for an equity round. In fact, we didn’t spend nearly \$10k for our debt deal, since there were boilerplate agreements without any negotiating. Our attorney just sent us the agreements, explained the mechanics to us, and we went around collecting checks and getting the docs signed...

“The terms were straight-forward and we didn’t have to make any real concessions. We did the deal with a 10% coupon (equal to a 10% conversion discount if security held for 12 months) which is paid in stock at the Series A. Based on what I’m hearing, we got

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<sup>62</sup><http://www.oncardmarketing.com/>

<sup>63</sup><http://www.venturehacks.com/articles/attractive-debt#comment-311>

a pretty good deal. However, we lost a few other potential investors who wanted better terms with a real conversion discount at 40%. In the end, we probably left about \$200-\$300k on the table by sticking to our original terms. The bottom line for us was that non-friends/family wanted better terms to protect their investment. Friends and family were happy with the basic terms to help us out and participate in any upside. We call this type of capital “love capital” and it’s probably some of the cheapest around. Definitely look for it if it’s available.”

Don’t let us stop you from subscribing to our comments RSS feed<sup>64</sup>.

## **Hack: supersize your debt with these micro-hacks**

Summary: Convert your debt into equity if you can’t pay it on time. Determine your lender’s return if you sell the company early. Reserve the right to raise more debt. Finally, reserve the right to amend the debt agreement.

Previous convertible debt hacks<sup>65</sup> have discussed

1. The benefits of debt in a seed round<sup>66</sup>
2. The economics of debt vs. equity<sup>67</sup>
3. Making your debt attractive to investors<sup>68</sup>

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<sup>64</sup><http://feeds.venturehacks.com/venturehackscomments>

<sup>65</sup><http://www.venturehacks.com/term-sheet-hacks#convertible-debt>

<sup>66</sup><http://venturehacks.com/articles/debt-benefits>

<sup>67</sup><http://venturehacks.com/articles/debt-or-equity>

<sup>68</sup><http://venturehacks.com/articles/attractive-debt>

#### 4. Keeping your Series A options open<sup>69</sup>

This article collects 4 convertible debt microhacks you can use to supersize your convertible debt.



### **Convert the debt into equity if you can't pay it on time.**

Your Series A financing may not occur before the debt comes due. In that case, the company should have the right to

1. Pay the debt and interest back, or

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<sup>69</sup><http://venturehacks.com/articles/options-open>

2. Convert the debt to common or preferred stock at a pre-determined valuation.

Note that the *company* makes the decision to convert the debt to equity—not the investors. This term lets the company avoid defaulting<sup>70</sup> on the loan. See this great article by Yokum Taku<sup>71</sup> for more details.

### **Determine your lender's return if you sell the company early.**

The company may be acquired before the Series A. In that case, the debt holders should have the right to

1. Get their money and interest back, or
2. Convert their debt to common stock at a predetermined valuation.

The lender chooses between these two options at the time of sale. This term simulates the liquidation preference<sup>72</sup> of preferred stock. You can use the same valuation that you negotiated in the microhack above.

### **Reserve the right to raise more debt.**

If you are raising \$500K in debt, you should reserve the right to use the same documents to conduct subsequent closings up to some cap, say an additional \$250K of debt.

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<sup>70</sup>[http://en.wikipedia.org/wiki/Default\\_%28finance%29](http://en.wikipedia.org/wiki/Default_%28finance%29)

<sup>71</sup><http://www.startupcompanylawyer.com/2007/04/29/what-happens-to-the-convertible-promissory-note-if-the-maturity-date-is-reached-and-there-hasnt>

<sup>72</sup>[http://www.burningdoor.com/askthewizard/2007/04/venture\\_terms\\_liquidation\\_pref.html](http://www.burningdoor.com/askthewizard/2007/04/venture_terms_liquidation_pref.html)

Many debt agreements don't require you to get the current lender's permission to raise more debt in the future. But it is better if your current debt investors clearly understand this possibility. And it will be cheaper if you can use the same documents to close the additional debt.

### **Reserve the right to amend the debt agreement.**

The company and a majority of the lenders should be able to amend the debt agreement<sup>73</sup> and make the changes binding upon the other lenders. This is much easier than getting agreement from every single debt investor.

Examples of amendments include changing the date that the debt matures<sup>74</sup> or the size of a qualified financing<sup>75</sup>.

### **What are your debt microhacks?**

Use the comments<sup>76</sup> to share your experiences and questions regarding debt microhacks. We'll discuss the most interesting comments in a future article.

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<sup>73</sup>[http://www.startupcompanylawyer.com/2007/05/11/  
why-should-a-majority-of-investors-be-able-to-amend-the-convertible-notes/](http://www.startupcompanylawyer.com/2007/05/11/why-should-a-majority-of-investors-be-able-to-amend-the-convertible-notes/)

<sup>74</sup>[http://www.startupcompanylawyer.com/2007/05/02/  
what-should-the-maturity-date-of-the-convertible-note-be/](http://www.startupcompanylawyer.com/2007/05/02/what-should-the-maturity-date-of-the-convertible-note-be/)

<sup>75</sup>[http://www.startupcompanylawyer.com/2007/04/29/  
what-type-of-financing-forces-an-automatic-conversion-of-the-promissory-note-into-preferred-stock/](http://www.startupcompanylawyer.com/2007/04/29/what-type-of-financing-forces-an-automatic-conversion-of-the-promissory-note-into-preferred-stock/)

<sup>76</sup><http://venturehacks.com/articles/debt-microhacks#comments>

# June 2007

## Great fundraising advice from Dharmesh Shah



Dharmesh Shah<sup>1</sup> recently wrote a very nice review of Venture Hacks<sup>2</sup>. The article includes great meta-advice about fund raising:

**“1. VC Negotiation Is An Art Form:** As an entrepreneur, there are few things more “nuanced” that you’ll deal with than raising institutional capital. Even if you decide not to raise venture capital, a lot of these skills and deal-terms will likely show up in other dealings you have (strategic partners, M&A transactions, etc.).

**“2. The Devil’s In The Details:** Most entrepreneurs focus too much energy on the “obvious” things like valuation. Fact is, there are other, non-valuation terms in the VC deal (vesting, stock option pool, liquidity preferences, etc.) that have a significant impact on the economics of your deal. It’s easy to

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<sup>1</sup><http://onstartups.com/About/AboutDharmeshShah/tabid/4147/Default.aspx>

<sup>2</sup><http://onstartups.com/home/tabid/3339/bid/1439/default.aspx>

lure yourself into thinking you should solve for the highest valuation. But, in most cases, that's sub-optimal.”

I would go even further: non-valuation terms are more important than valuation. Valuation is temporary, control is forever<sup>3</sup>. If you don't control your future, your current valuation is irrelevant.

Your current valuation is irrelevant if you are terminated and you lose all your unvested stock. Your current valuation is irrelevant if the board forces the company to raise a low-valuation Series B from existing investors by rejecting offers until the company is almost out of cash.

**“3. Great Advice Is Hard To Find:** As it turns out, good advice in the VC business is hard to find. I would define good advice as a combination of competency (i.e. well informed) and objective (i.e. non-conflicted). You can get close sometimes (via lawyers, advisors, etc.) but it's really hard to find great advice.”

The amount of advice on entrepreneurship on the Web is exploding. Some of it rocks. Some of it sucks. Advice is only as good as its source. Our source is me and Naval<sup>4</sup>—we're trying not to suck.

**“4. It’s Not Enough To Be Smart:** It's important to remember that regardless of how smart you are, VC negotiation is not just a matter of raw intelligence. Sure, it helps to have a few brain cells to understand the dynamics of a deal, but a lot is

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<sup>3</sup><http://www.venturehacks.com/articles/mug>

<sup>4</sup><http://www.venturehacks.com/about#nivi>

hidden away in the dark corners that you only ever learn by doing it. It's also important to remember that the VCs do this *for a living*. Hopefully, you don't (you're building businesses for a living). You may be twice as smart as they are, but you're still at a disadvantage. Try to even the playing field as much as you can."

Dharmesh's site, On Startups<sup>5</sup>, is a great resource for entrepreneurs.

## Launch: Venture Hacks Office Hours



We will be holding our first *Office Hours* this Thursday!

The "office" is a teleconference that anyone can join via Skype or phone. The dial-in information is below.

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<sup>5</sup><http://onstartups.com/>

Bring your questions about raising capital to office hours—we will do our best to give you answers. You can also submit questions in the comments<sup>6</sup> below.

We will record the call and put it online for those who can't join the teleconference.

Unless you announce your name, you will be anonymous to everybody on the call. Naval and I will see your Skype username or phone number through an administrative panel—no one else will see this information.

We're looking forward to it, it will be fun!

And, as always, Venture Hacks does not provide legal advice<sup>7</sup>.

## Dial-in Information

**Time:** 1:00 PM Pacific Daylight Time (GMT-07:00)

**Date:** Thursday, June 7, 2007

**Skype Number:** Skype: +990008278597334 (free)

**Phone Numbers:** (you pay long distance or national rates)

U.S.: 1-605-475-8590 Austria: 0820 4000 1574 Belgium: 070 35 9989 France: 0826 100 277 Germany: 01805 00 7649 Ireland: 0818 270 034 Italy: 0848 390 175 Spain: 0902 886 051 Switzerland: 0848 560 195 UK: 0870 738 0763

**Conference ID 5592734**

## Controls

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<sup>6</sup><http://venturehacks.com/articles/office-hours#comments>

<sup>7</sup><http://www.venturehacks.com/disclaimer>

- 11 To raise your hand so we can unmute you.
- \*0 To increase volume. \*# To decrease volume.
- \*1 To play a menu of available features.

## Office Hours, technical error edition

“You cannot clear the market in series.”

– Office Hours

“Investors move in herds that are steered by scarcity and social proof.”

– Office Hours

Summary: This article includes audio and notes from our first office hours. Topics include selling 51% of the company, dead equity, and setting good terms with angels.

Yesterday, we held our first office hours<sup>8</sup> via teleconference. Office hours are an opportunity to ask questions and discuss raising capital.

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<sup>8</sup><http://venturehacks.com/articles/office-hours>



Here is an edited MP3 of the discussion:

Venture Hacks Office Hours, June 7 2007<sup>9</sup> (mp3)  
(length: 18:43)

The questions and discussion were great. We had to stop early due to technical difficulties. Next time, we will do it via Skypescast which I hope will be flawless. We will post the time, date, and link for the next meeting soon. Please submit any ideas for office hours in the comments<sup>10</sup>.

Finally, here are some edited highlights of the discussion. Please excuse any bad grammar, these are rough notes.

## Control

*Entrepreneur: We have an offer of \$1M for 51% of the company. What do you think?*

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<sup>9</sup><http://www.venturehacks.com/wordpress/wp-content/uploads/2007/06/venture-hacks-office-hours-june-7-2007.mp3>

<sup>10</sup><http://venturehacks.com/articles/office-hours-june-7-2007#comments>

Venture Hacks: I wouldn't take the 51% deal. At that point it is no longer your company. You are an employee. And you are no longer doing a startup. And you killed the entrepreneurial drive.

Investors who would like to buy 51% of your company don't know how to invest. Especially if it is early stage. They think they are buying an asset that someone is going to run for them. But what they have done is killed the entrepreneurial drive.

Reject that deal out of hand. I would rather go back to eating Ramen noodles and working out of my parent's basement. It is equivalent to selling your company for a little bit of money and going to work for your investors. Continue looking for another deal.

Don't even talk to these 51% guys if they come back with a better offer. They have already made their intent to own 51% of the company clear.

## Valuation

*We want to raise \$1M for 20% of the company or raise \$2.5M for 30%-40%. How do we do it?*

I don't know what your company is worth. That is driven by the market. There is no right or wrong valuation. It is driven by your team, product, market, salesmanship, etc.

If you've hit 10 investors who make it a habit to invest and you haven't gotten good responses and you can't get a term sheet or verbal terms, you aren't likely to get a term sheet if you talk to 20 more people. There is probably something wrong with the company and you should take a look in the mirror.

The #1 reason people are not able to raise money at the valuation they want is because the team is incomplete or does not

appear up to the task. And that is tough feedback for a prospective investor to give. And if it isn't the team, it is the product or traction.

*How do I get a market clearing price?*

You cannot clear the market in series. You have to do it in parallel. Set up 10 meetings to all happen in the same week. Some of them will flake out and you will end up meeting with 4-6 of them. Tell them all that you plan to sign a term sheet in 6 weeks and if don't have an offer by that time, we are going to go back to the drawing board and using sweat equity to build the company.

You have to create that time limit.

If you go to market, go to market. The only way to get a market clearing price is to talk to a lot of people at once. I often see people go down the path with one or two investors. That is a mistake. Focus on the fund raising and get it done or go back and fix what is wrong with the company.

Don't use the word "auction" with your investors but you need to run an auction. An auction is a double win for you. First, you focus your fund raising on a short period of time so you can get back to your customers. Second, it creates a positive feedback loop of scarcity and social proof. Those are the things that close deals.

Check out a book called *Influence*<sup>11</sup>. Scarcity means "Hurry up or the deal is going to disappear." Social proof means "Other people want to invest, don't you?" Investors tend to move in herds that are steered by scarcity and social proof. "Sequoia is investing? I'm in."

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<sup>11</sup>[http://www.amazon.com/Influence-Psychology-Persuasion-Business-Essentials/dp/006124189X/ref=pd\\_bbs\\_sr\\_1/103-5417622-0009467?ie=UTF8&s=books&qid=1181290245&sr=8-1](http://www.amazon.com/Influence-Psychology-Persuasion-Business-Essentials/dp/006124189X/ref=pd_bbs_sr_1/103-5417622-0009467?ie=UTF8&s=books&qid=1181290245&sr=8-1)

## **Dead Equity**

*If one founder has a (non-patented) idea and doesn't add much value beyond the idea and the other founder does all the work, how do you split the founder's equity?*

It ranges from 1% – 10% of the founder's equity. If someone has the idea, follow the Einstein maxim that “Genius is 1% inspiration and 99% perspiration” and give them 1% of the equity. If someone is active and helps you get started and has industry connections and stays active over time, you can give them closer to 10%.

Ideas are a dime a dozen. There are more good ideas than time. Ideas constantly change and you almost never end up doing what you started doing.

50-50 splits are unstable and the company falls apart. 2 years after the founding, one guy is still in the garage and says “Oh my God I've put in all this work, the idea has changed 5 times, and this other guy who is doing nothing has 50% of the company.” It is dead equity.

The percentages we are talking about here are the split between the founders.

## **Angels**

*I probably need \$.5M to get my company off the ground. How do I set my terms with angels so it doesn't screw me up down the road?*

First, don't give a huge discount if you expect to raise your Series A soon after the seed round. VCs don't want to pay a big markup between the seed and the Series A unless time has passed (say 6 months) and traction has occurred. Typical

discounts are between 20%-40%. Put time and traction between your financings.

Second, if you raise equity from angels they will probably have to approve the Series A. If you have a nasty angel, a “fallen” angel, who is trying to make money on just this one deal and doesn’t have a reputation to protect, he can try to hold you hostage on the Series A and veto your Series A until you give him some kind of good deal such as letting him put more money in at a good price. That’s a rare scenario but it does happen and the only way around it is to pick your angels carefully. If you raise debt, don’t give debt holders veto rights on the next financing.

Third, don’t give your angels perpetual warrants that don’t expire. If the company is a big hit, you don’t want your angel to come in right before the IPO and dilute everybody 10% at a very low cost. Avoid warrants in general, but if you do use them, set a short expiration.

A really clean debt agreement between you and experienced angels is the best way to get the company going. It leaves you with a ton of control. Check out Yokum Taku’s debt term sheet<sup>12</sup>.

## Approaching Investors

*How do I approach VCs and angels?*

You approach investors through people who know them. The best approach is through an entrepreneur whom they have backed and been successful with. Next best is probably someone who works with them such as an angel, or someone who sends deal to them, or someone who is associated with the industry. Third is probably your accountant or lawyer.

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<sup>12</sup><http://www.startupcompanylawyer.com/2007/05/14/what-does-a-series-a-term-sheet-look-like/>

## Fund-Raising Schedule

*How do I time the fund raising?*

In short, focus. Hit all the contacts at once. In your head, declare a start to the fund raising. Set up all your first meetings to happen in the first week.

If some investors are being slow while others are moving along, tell the slow people, “By the way, we are on second meetings with three funds.”

In a tight process, there are three meetings. One with the original guy you made contact with at the firm. Second, you meet the original guy and some of his partners. Third, there will be a partner’s meeting. There may be an intermediate session where some of them come to your office.

(Image Source: *Office Space*<sup>13</sup>)

My Odeo Channel<sup>14</sup> ([odeo/6fca48cd70711c6f](http://odeo.com/claim/feed/6fca48cd70711c6f))

## Ask VH: What are supra pro rata rights?

I read, like, and regularly disagree with a great blog called Ask the VC<sup>15</sup>. They recently answered a question about *supra pro rata* rights<sup>16</sup>—here are our thoughts on the topic.

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<sup>13</sup>[http://www.amazon.com/Office-Space-Special-Flair-Widescreen/dp/B000AP04L0/ref=pd\\_bbs\\_sr\\_1/103-5417622-0009467?ie=UTF8&s=dvd&qid=1181291849&sr=8-1](http://www.amazon.com/Office-Space-Special-Flair-Widescreen/dp/B000AP04L0/ref=pd_bbs_sr_1/103-5417622-0009467?ie=UTF8&s=dvd&qid=1181291849&sr=8-1)

<sup>14</sup><http://odeo.com/claim/feed/6fca48cd70711c6f>

<sup>15</sup><http://www.askthevc.com/>

<sup>16</sup>[http://www.askthevc.com/2007/06/what\\_are\\_supra\\_prorata\\_rights.php](http://www.askthevc.com/2007/06/what_are_supra_prorata_rights.php)

**Q: Can you explain what supra pro-rata is? It seems to be showing up in some VC term sheets now. What's the impact on the entrepreneur? How hard should one try to negotiate it out? If a VC insists on this term, should the entrepreneur walk away?**

*A:* First, read Ask the VC's response<sup>17</sup>—we agree with them. Here are our additional thoughts.

An investor with *supra pro rata* rights wants the option of increasing his percent ownership in the next round. He probably told you “We like this company so much we might want to buy more of it!”

### **Investors who want to increase their ownership drive down your valuation.**

Investors who want to increase their percent ownership try to drive down the next round’s valuation<sup>18</sup>. Whether or not they have *supra pro rata* rights.

They are at odds with the founders and management who are trying to increase the next round’s valuation. These investors can exercise their protective provisions<sup>19</sup> to veto everything but the lowest valuation offer. Or they can signal the “correct” valuation to new investors:

If the current investors want to increase their percent ownership, the valuation is too low. If they don’t want to increase their percent ownership, the valuation is too high. This makes it harder to get a high valuation since the new investors often believe

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<sup>17</sup>[http://www.askthevc.com/2007/06/what\\_are\\_supra\\_prorata\\_rights.php](http://www.askthevc.com/2007/06/what_are_supra_prorata_rights.php)

<sup>18</sup><http://venturehacks.com/articles/attractive-debt#pro-rata>

<sup>19</sup>[http://www.feld.com/blog/archives/2005/01/term\\_sheet\\_prot.html](http://www.feld.com/blog/archives/2005/01/term_sheet_prot.html)

the current investors have a better sense for the right valuation.

### **You want investors who maintain their percent ownership.**

You prefer investors who make it a policy of maintaining their percent ownership in the next round. This incents them to increase the next round's valuation<sup>20</sup>.

These investors don't try to increase their percent ownership because they know it puts them at odds with the founders and management. They know it incents them to use their protective provisions to veto good offers. They know it forces them to signal their sense of the correct valuation.

Investors who try to *decrease* their percent ownership in the next round are also bad news. They signal that the valuation is too high. (Angels and seed stage funds are an exception. They're not necessarily expected to maintain their percent ownership since they may not have a lot of capital.)

### **What are your experiences with supra pro rata rights?**

Use the comments<sup>21</sup> to share your experiences and questions about *supra pro rata* rights—we'll discuss the most interesting ones in a future article.

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<sup>20</sup><http://venturehacks.com/articles/attractive-debt#pro-rata>

<sup>21</sup><http://venturehacks.com/articles/supra-pro-rata#comments>

## Hack: Build your own cap table

“I assumed my lawyers would have my back on this. I was wrong.”

– Anonymous Entrepreneur

Summary: A cap table shows you *who owns what* in your company. It calculates how the option pool shuffle<sup>22</sup> and seed debt lower your Series A share price. This article includes a spreadsheet you can use to build your very own cap table.

A capitalization table shows you *who owns what* in your company. It lists the company's shareholders and their shares.

You can build your very own Series A cap table with this Excel spreadsheet:

Venture Hacks Series A Cap Table<sup>23</sup> (xls)

And here's a screencast that walks you through the spreadsheet:

### The cap table shows you what you really own.

Many entrepreneurs think the pre-money valuation determines their percentage ownership of the company. They forget about the option pool shuffle<sup>24</sup>. They forget about seed debt and its discount. Then they blame their lawyers.

Use this cap table to see how much you really own after the financing. Find something else to blame on your lawyers.

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<sup>22</sup><http://venturehacks.com/articles/option-pool-shuffle>

<sup>23</sup><http://www.venturehacks.com/wordpress/wp-content/uploads/2007/06/venture-hacks-series-a-cap-table.xls>

<sup>24</sup><http://venturehacks.com/articles/option-pool-shuffle>

## The cap table is simplified.

Our cap table includes the major economic levers of a Series A: common stock, preferred stock, options, and convertible debt. It doesn't include warrants, vesting, debt interest, liquidation preferences, dividends, the Series B, *et cetera*.

Cap tables can be a little tricky to understand if you've never worked with one before. So we kept it simple.

Your lawyer or accountant will deal with the details that aren't included in this cap table. They will maintain the company's official cap table.

## Customize the cap table and share your modifications.

This cap table should meet your initial needs and you can customize it to your specific situation.

You're welcome to distribute your modifications under our Creative Commons license<sup>25</sup>. (If you don't understand or don't care what this means, leave the licensing info in the cap table as-is and distribute your modifications all you like!)

And if you submit your modified cap table in the comments<sup>26</sup>, we'll build up a great collection of cap tables.

## The cap table may have bugs.

This is Version 0.9 of the c(r)ap table and there may be bugs. One bug can make all the calculations useless. Come back to this article to download future revisions.

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<sup>25</sup><http://creativecommons.org/licenses/by-sa/3.0/>

<sup>26</sup><http://venturehacks.com/articles/cap-table#comments>

## Do you have any suggestions or questions?

Please leave your suggestions and questions in the comments<sup>27</sup> and we'll improve the cap table!

## We're hiring: one man developer army



We're looking for a *one man developer army* who wants to work with Venture Hacks to build our next product. It's in a \$25 billion market filled with lame products and unsatisfied customers.

We're also offering a \$1000 referral bounty if we hire someone you refer.

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<sup>27</sup> <http://venturehacks.com/articles/cap-table#comments>

## About Us

Naval and I have started companies like Epinions<sup>28</sup> and Songbird<sup>29</sup> where we've raised \$100M+ from investors like Sequoia<sup>30</sup>. Read our full bios<sup>31</sup> for the whole story.

Now, we've gone crazy for helping entrepreneurs build their businesses. You already know about our first product: Term Sheet Hacks<sup>32</sup>. The hacks will keep coming—unsolicited reviews<sup>33</sup> from the founders of Flixster and ‘Hot or Not’ call the hacks “much needed” and “fantastic”.

The next Venture Hacks product is going to serve a \$25 billion market and make it even easier for entrepreneurs to raise money. It's going to be a lot of fun to build it and take over the universe (or something smaller like a galaxy).

## About You

*Contribution:* Build a great user experience and back-end. Social software experience is a plus. Full-time *or* consulting works for us. Develop with whatever tools and language you think are best for the project.

*Compensation:* Salary is above market and stock is way above market.

*Contact:* Send links to your best work to nivi@venturehacks.com<sup>34</sup>. Please include one or two sentences that describe why you have a high level of ability.

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<sup>28</sup><http://www.epinions.com/>

<sup>29</sup><http://www.songbirdnest.com/>

<sup>30</sup><http://www.sequoiacap.com/>

<sup>31</sup><http://www.venturehacks.com/about#bios>

<sup>32</sup><http://www.venturehacks.com/term-sheet-hacks/>

<sup>33</sup><http://www.venturehacks.com/about#reviews>

<sup>34</sup><mailto:nivi@venturehacks.com>

Gracias!

(Image: Fun Lot<sup>35</sup>)

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<sup>35</sup><http://www.funlol.com/pictures/get-to-the-choppa.html>

# **July 2007**

## **A few hacks from our personal blogs**

Sorry we haven't posted for a few days—we'll get back to venture hacking this week. In the meantime, here are some hacks from the deep recesses of our personal blogs...

### **Naval**

#### **VC Bundling<sup>1</sup>**

Microsoft bundles its Office applications. Record Labels and Game Publishers bundle cash and distribution. Silicon Valley Venture Capital bundles Advice, Control, and Money. In lean times, you, the entrepreneur, have to buy the bundled good.

Want Cash? It comes bundled with an Advisor on your Board of Directors, like it or not. And they take Control.

Want Advice? VCs won't take Board seats without putting in Cash – it's the only way to get enough leverage. And they take Control. Always the Control.

Smart entrepreneurs in times of plenty (like our current financing bubblet), serial entrepreneurs, and those with profitable businesses break apart these bundles. To un-bundle, you must have multiple bidders (that's a longer entry), and you must have the

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<sup>1</sup><http://www.startupboy.com/journal/2005/11/30/vc-bundling.html>

ability to refuse capital (on Sand Hill Road, collusion is just a lunch away).

### Lawyers or Insurance Salesmen?<sup>2</sup>

Watch out for the bait-and-switch – this is when you interview the gregarious, smart senior partner, who then swaps in the less popular, less experienced partner once you've signed them up. And the new person might be cheaper, but not much cheaper.

Put them on fixed-fee per job, especially for closing a financing, and especially for lawyers for the other side (one of the old great VC tricks is that startups pay for the VC's attorneys in closings! A ridiculous practice justified as being "standard")

### The 80-hour Myth<sup>3</sup>

Let's get serious. Nobody works eighty hours a week. Not eighty real, productive hours. Look closely at workaholics (and I've been one, and worked with ones), and a lot of the time is spent idling, re-charging, cycling, switching gears, etc. In the old days this was water-cooler talk. In Silicon Valley, it's gaming, email, IM, lunches, and idle meetings. Let's drop the farce, ok?

## Nivi

### Don't target large and obvious markets?<sup>4</sup>

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<sup>2</sup><http://www.startupboy.com/journal/2005/11/29/lawyers-or-insurance-salesmen.html>

<sup>3</sup><http://www.startupboy.com/journal/2005/11/29/the-80-hour-myth.html>

<sup>4</sup><http://www.nivi.com/blog/article/dont-target-large-and-obvious-markets>

“Because the process of securing funding forces many potentially disruptive ideas to get shaped instead as sustaining innovations that target large and obvious markets, the very process of getting the money to start a venture actually sends many of them on a march toward failure.”

### Womb-to-tomb Investing<sup>5</sup>

“... failure to execute operationally is not the only source of risk [in startups]; every venture is also subject to volatility in the price and availability of capital due to the volatility of the stock market. After the collapse of the Internet Bubble, many promising companies foundered because their funding dried up.

... [Warburg Pincus has] supported the multi-year process of building a sustainable business by underwriting all of the capital needed to reach positive cash flow, thereby not only enabling management to focus full-time on the business but also insuring against the risks generated by a volatile stock market.”

Dear M.B.A.,<sup>6</sup>

“Morons! I *know* there’s nothing out there. That’s *why* I want to build the railroad!”

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<sup>5</sup><http://www.nivi.com/blog/article/womb-to-tomb-investing>

<sup>6</sup><http://www.nivi.com/blog/article/dear-mba>

## Thoughts on the equity equation

As this nuclear winter of venture hacks continues, I thought you might enjoy our thoughts on Paul Graham's The Equity Equation<sup>7</sup>. Paul says,

“Whenever you're trading stock in your company for anything, whether it's money or an employee or a deal with another company, the test for whether to do it is the same. You should give up n% of your company if what you trade it for improves your average outcome enough that the (100 – n)% you have left is worth more than the whole company was before....

“In the general case, if n is the fraction of the company you're giving up, the deal is a good one if it makes the company worth more than  $1/(1 - n)$  [Ed: This is the equity equation].”

Read the rest of The Equity Equation<sup>8</sup> first; it is great. As usual.

We have some additional thoughts. As usual. =)

Summary: 1. You have to pay market rates regardless of the equity equation. 2. Consider the opportunity cost of spending shares on employees and investors. 3. Offers from top-tier firms increase your market price.

### **You have to pay market rates regardless of the equity equation.**

In practice, you raise money or hire an employee because you *need* to, not because you *want* to. In that case, you have to pay

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<sup>7</sup><http://paulgraham.com/equity.html>

<sup>8</sup><http://paulgraham.com/equity.html>

a market rate no matter what the equity equation says.

Say the equity equation tells you to pay a prospective hire *above* market. You should still pay the hire a market rate and save the company some equity.

Say the equity equation tells you to pay a prospective hire *below* market. The hire will simply argue that the market values her higher, and that you should pay her a market rate. It's tough to fight this normative leverage<sup>9</sup>.

When you're hiring, first figure out the market rate for the position. We previously posted a table of market rates for employees<sup>10</sup>. When you evaluate a candidate, ask yourself whether she is likely to increase the next round's share price. If the answer is yes, she is a possible hire. If no, she is a no hire. This approach forces you to think about building value, not filling a position.

## **Consider the opportunity cost of spending shares on employees and investors.**

“One of the things the equity equation shows us is that, financially at least, taking money from a top VC firm can be a really good deal. Greg Mcadoo from Sequoia recently said at a YC dinner that when Sequoia invests alone they like to take about 30% of a company.  $1/.7 = 1.43$ , meaning that deal is worth taking if they can improve your outcome by more than 43%. For the average startup, that would be an extraordinary bargain. It would improve the average startup's prospects by more than 43% just to be able to say they were funded by Sequoia, even if they never actually got the money.”

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<sup>9</sup>[http://en.wikipedia.org/wiki/Leverage\\_\(negotiation\)](http://en.wikipedia.org/wiki/Leverage_(negotiation))

<sup>10</sup><http://www.venturehacks.com/articles/option-pool-shuffle#market>

You need to consider the opportunity cost when you spend equity. You should only give out equity if you think it increases your share price *optimally*. You can buy a lot of things with your equity—buy things that increase your share price *the most*.

Is selling 30% of your shares to a top-tier firm the most effective way to spend your shares? What if another investor will give you the same terms for 20%? Should you take it? Could you spend the remaining 10% on killer developers and sales guys? Could you spend the savings on great advisors? Could you spend the saved equity on the best board members money can buy?

Entrepreneurs should think about unbundling money and value add<sup>11</sup>. Get money on the best terms *and* get the best value add.

Would you hire an investor to serve on your board if he didn't bring money with him? If the answer is no, his value add is literally worthless. If the answer is yes, then put a price on that value add and adjust their offer (in their favor) so you can compare it to other offers apples-to-apples.

*(Note: This is not an argument not to take money from top-tier firms, we have raised money from top-tier firms.)*

## **Offers from top-tier firms increase your market price.**

“The reason Sequoia is such a good deal is that the percentage of the company they take is artificially low. They don't even try to get market price for their investment; they limit their holdings to leave the founders enough stock to feel the company is still theirs.”

When a top-tier firm offers to invest, the market price for your company immediately goes up. Firms tend to invest in herds and everybody wants to co-invest with a top-tier firm.

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<sup>11</sup><http://www.startupboy.com/journal/2005/11/30/vc-bundling.html>

The last-and-final offer from a top-tier firm will be slightly less than market. They will argue that they should pay less because they bring a lot more value than their competitors, they have a brand, *et cetera*. But overall, an offer from a top-tier firm increases your valuation.

Top-tier firms try to avoid increasing your valuation when they make an offer. For example, they may give you an exploding term sheet<sup>12</sup>. But, in practice, in this market, we rarely see exploding offers from any firm.

Many firms add lots of value and help like crazy. But entrepreneurs should understand that the top firms *pick* the best companies, they don't *make* the best companies. Ask them yourself.

The top firms are mainly in the business of making money for their limited partners by picking the startups that are going to succeed with or without their value add.

I would love to hear your thoughts...<sup>13</sup>

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<sup>12</sup><http://www.ventureblog.com/articles/indiv/2003/000024.html>

<sup>13</sup><http://venturehacks.com/articles/equity-equation#comments>

# August 2007

## Hack: Understand why investors want protective provisions

“AOL almost sold to Compuserve in 1991 for \$60M. The VCs wanted to sell. [Steve] Case won by 1 vote. 10 years later, [AOL was] worth \$100 billion.”

– Mark Pincus<sup>1</sup>

Summary: Protective provisions let preferred shareholders veto certain actions, such as selling the company or raising capital. They protect the preferred, who are minority shareholders, from unfair actions by the common majority. However, the preferred shouldn’t use protective provisions to serve their other interests.

Protective provisions<sup>2</sup> let preferred shareholders veto certain actions, such as selling the company or raising capital. Roughly, they state that

“The Company requires the consent of the holders of at least X% of the Company’s Series A Preferred to (i) effect a sale or merger of the company, (ii) sell Series B Preferred with rights senior to or on parity with the Series A, (iii) *et cetera...*”

To understand why investors want protective provisions, you first need to understand how the preferred and common classes control the company.

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<sup>1</sup>[http://markpincus.typepad.com/markpincus/2007/05/steve\\_case\\_talk.html](http://markpincus.typepad.com/markpincus/2007/05/steve_case_talk.html)

<sup>2</sup>[http://www.feld.com/blog/archives/2005/01/term\\_sheet\\_prot.html](http://www.feld.com/blog/archives/2005/01/term_sheet_prot.html)

## The board mostly controls the company.

The common and preferred classes control the company through

1. **Board seats**, which require each board member to serve the interests of the company as a whole. Board members cannot simply serve the interests of their particular class of stock.
2. **Shareholder votes**, where the preferred vote as if they held common shares. In legal-speak, the preferred vote on an *as-converted-to-common basis*. The preferred usually gets one as-converted-to-common share for each of their preferred shares. The preferred and common use shareholder votes to serve their own interests.
3. **Class votes**, which require a majority of the preferred *and* a majority of the common. We will cover this mind-numbing topic in a future hack. The preferred and common use class votes to serve their own interests.
4. **Protective provisions**, which allow the preferred to veto certain actions, such as selling the company or raising capital. In some companies, each series (Series A, Series B...) has their own protective provisions, in other companies, all of the series exercise their protective provisions as a class.

After the common and preferred classes select their representatives on the board, the board takes it from there. The board, not the shareholders, usually approve management decisions. (We previously showed you how to hack the allocation of seats on the board<sup>3</sup>.)

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<sup>3</sup><http://www.venturehacks.com/term-sheet-hacks#bod>

However, some major actions require shareholder votes and class votes in addition to board votes. For example, Delaware corporations require a shareholder vote to sell the company or raise money.

### **Protective provisions protect the preferred minority from the common majority.**

The preferred usually owns 20%-40% of the company after the Series A. If the common is united, the preferred can't influence shareholder votes—they don't own enough shares. Nor can they influence board votes if a united common controls the board (*e.g.*, the board consists of two common seats, one preferred seat, and no independents).

If the common controls a Delaware corporation's stock and board, the preferred need protective provisions to stop the common from:

- Selling the company to the founder's cousin for \$1 and wiping out the preferred stock.
- Selling \$1M of the founder's shares to the company so he can get a great haircut.
- Issuing a bazillion shares to the founders and diluting the preferred to nothingness.

Protective provisions protect the Series A minority from unfair actions by the common majority. That's why they're called *protective* provisions. In future rounds, protective provisions can also protect each series of preferred stock from the other series of preferred stock.

**Investors argue that protective provisions encourage good governance.**

Some investors claim that they need protective provisions because they can't use their board seat to serve their own interests. They correctly argue that board members have to serve the interests of the company as a whole, not the interests of their class of stock.

These investors will claim that protective provisions let them serve their interests as investors, so they can serve the interests of the company through their board seat:

Say the company receives an offer to acquire the business. Management thinks it's in the company's interest to sell. The board defers to management since management is doing a good job running the company. But the investors think the company is the home run in their portfolio—they don't want to sell the company now. So the investors use their board seat to vote for the sale and use their protective provisions to veto the sale.

**Investors should use protective provisions to protect themselves, not to serve their interests.**

We don't agree that investors need protective provisions to serve on the board without succumbing to their own interests.

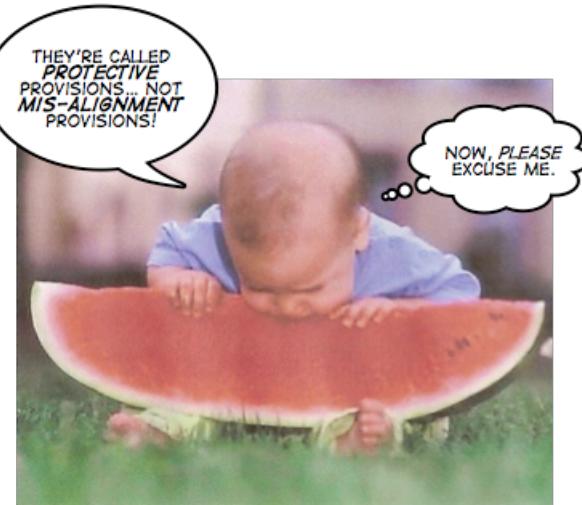
In fact, any investor who makes that argument is raising a big red flag. They're implying that they can't fulfill their duty as board members without additional veto powers. They're implying that the interests of their fund can outweigh the interests of the company.

Your response to this argument goes like this:

"I don't think you mean that you can't serve the interests of the company without these additional protective provisions. I'm sure you will use your board seat to do the right thing for the company, always.

"You control the company through (1) board votes where you serve the interest of the company and (2) share and class votes where you serve your own interests.

"Protective provisions protect you against the common majority. They aren't a tool to serve the interests of your fund at the expense of the company."



We would rather have an “evil” investor who uses his board seat to serve his interests, than an investor who planned to use protective provisions to do anything other than protect himself. At least the “evil” investor’s power as a board member is in proportion to his share of board seats—his protective provisions give him a blanket veto that is wildly out of proportion with his ownership of stock and allocation of board seats!

The next few hacks will show you how to attenuate the protective provisions, reduce this mis-alignment, *and* leave enough protective provisions in place to protect the preferred.

(*Credits: Image<sup>4</sup>*)

## Why investors don’t always do the right thing



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<sup>4</sup>[http://flickr.com/photos/sweet\\_child\\_of\\_mine/706541796/](http://flickr.com/photos/sweet_child_of_mine/706541796/)

In Understanding Why Your VC Is Acting Crazy<sup>5</sup>, Bill Burnham<sup>6</sup>, a former Partner at Mobius Venture Capital<sup>7</sup> and Softbank Capital Partners<sup>8</sup>, describes why investors don't always do the right thing for your business:

“One thing that many entrepreneurs don’t fully appreciate is just how much the financial and organizational dynamics within a VC fund can affect how a VC behaves on their board. Over the years I have heard many stories from entrepreneurs expressing various degrees of frustration and mystification over a position taken by their VCs, usually with regards to an upcoming financing or an M&A transaction. For example, in some cases a VC that has been very supportive about patiently growing a business all of a sudden becomes obsessed with selling the company or in others a VC that has been aggressively pushing the company to grow quickly all of sudden becomes extremely cost focused and lobbies hard to cut the burn rate despite the fact that this will kill growth. After witnessing such abrupt changes in attitude and direction, many entrepreneurs are left scratching their heads wondering “What the hell is going on with my VC and why are they acting so crazy?”

“The answer to this question can often be found by simply getting a better understanding of the current financial and organizational dynamics within a VC’s fund, as these issues can have a profound impact on how a VC and/or their fund approaches a specific

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<sup>5</sup><http://billburnham.blogs.com/burnhamsbeat/2007/07/understanding-w.html>

<sup>6</sup><http://billburnham.blogs.com/about.html>

<sup>7</sup><http://www.mobiusvc.com/>

<sup>8</sup><http://www.softbank.com/pages/home.html>

investment. With that in mind, here is some specific advice for entrepreneurs in terms of what questions they should be asking VCs and what information they should be monitoring.”

Your investors are your partners and they will help you build your business—to a point. Some of their interests may be deleterious to your business.

Frankly, some of *your* interests may be deleterious to the business. But I’ll give you the benefit of the doubt since you’re the guy who probably lived in your parent’s basement and ate rice cakes for 3 months to start the business. I assume you’re committed to the business—to a point.

Read the rest of Bill Burnham’s article<sup>9</sup>.

## Thoughts on Adam Smith’s letter to graduation Y Combinator companies

Summary: Angels make more introductions than VCs because angels need co-investors. You can’t clear the market in series—you can only clear it in parallel. Tranches are dumb—they have zero upside and catastrophic downside. Two investors aren’t always better than one. Finally, a ‘very special’<sup>10</sup>, message to graduating Y Combinator founders: don’t do deals on D-Day and feel free ping us if you want additional help.

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<sup>9</sup> <http://billburnham.blogs.com/burnhamsbeat/2007/07/understanding-w.html>

<sup>10</sup> [http://en.wikipedia.org/wiki/Very\\_special\\_episode](http://en.wikipedia.org/wiki/Very_special_episode)



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Adam Smith from Xobni<sup>12</sup>, a Y Combinator<sup>13</sup> company, calculates that angels made *5 times* as many intros as VC investors while Xobni was raising a Series A:

“We spoke with 16 angels and 12 VCs. Angels made 24 introductions; VCs only made four. The average angel introduced us to 1.5 other investors, but the average VC only introduced us to 0.33 other investors. That’s a 5x difference!

“So angels can be helpful even if you’re raising a mostly VC round.”

Read the rest of his great letter to graduating Y Combinator (YC) companies: Raising Money, Some Data and Tactical Advice<sup>14</sup>.

## Why do angels make 5x more introductions?

First, angels usually take a small piece of a Seed or Series A. If they like the company, they need to make introductions because

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<sup>11</sup>[http://www.xobni.com/executive\\_bios.php#adam\\_smith](http://www.xobni.com/executive_bios.php#adam_smith)

<sup>12</sup><http://www.xobni.com/>

<sup>13</sup><http://ycombinator.com/index.html>

<sup>14</sup><http://blogs.xobni.com/asmith/archives/50>

they need co-investors. VCs usually don't want or need co-investors—if they like a company, they want to buy as much as they can.

Second, some angels are followers, not leaders. They find a company they like but they don't want to lead the investment. So they introduce you to a top-tier firm like Blue Shirt Capital and say to themselves,

“If Blue Shirt wants to invest, the company must be good. Plus, Blue Shirt will do all the work, and I'll go along for the ride. I know Blue Shirt won't cut me out since I introduced them to the company—firms that cut out the middleman stop getting intros.”

## You can't clear the market in series.

Adam writes:

“Our series A didn't happen quickly. We excited the people we met with, but we were timid about getting started having recently closed a \$100k angel round. One firm had interest, so we thought “We better talk to someone else to make sure we're getting a good deal.” That incremental approach went on for a few months. We were always in late stages with one investor but just beginning the dialogue with another. Deciding to raise money should be an atomic decision; don't try to just dip your toe in.”

You can't clear the market in series. You have to do it in parallel. You can't create an auction by meeting investors one-at-a-time. The only way to get a market clearing price is to meet a lot of investors at once.

On eBay, everybody bids at the same time, over a short and arbitrary period of time. That drives the price up. They don't bid one-at-a-time over a timespan of 'whenever'.

As for how to create an auction, here's the short version:

Jump on your desk, kick your laptop across the office and declare a start to your fund-raising; set up 10 investor meetings for the same week; you will probably end up meeting only 4-6 of them due to scheduling conflicts; tell them "We plan to sign a term sheet in 6 weeks, if we don't have an offer by then, we're going back to using sweat equity to build the company"<sup>15</sup>"; signal your valuation by saying "We want to raise \$X from n investors with no more than Y% dilution, including the option pool." (Y = 15%-25% per investor plus a 10%-20% option pool dilution). In a tight process with VCs, there are three meetings; one with the original partner you were introduced to; next, you meet the original partner with a few other partners; finally, you go to a partner's meeting; there may also be an intermediate meeting where some of the partners come to your office to refactor your code and eat your food; if some investors are being slow while others are moving along, tell the slow ones, "By the way, we are on second meetings with three funds." If things go well, you should receive 2-3 term sheets; reject the ones that explode the next day: "We told other investors that they have until the end of the week to send us term sheets, we can't break our promise." Negotiate the offers over the next 2-3 days and get your favorite investor to the terms you want. During closing, keep your other prospective investors warm in case the deal blows up; but

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<sup>15</sup>[http://blog.pmarca.com/2007/06/the\\_pmarca\\_guid\\_2.html](http://blog.pmarca.com/2007/06/the_pmarca_guid_2.html)

don't break any binding no-shop or non-disclosure agreements in the process.

(We'll elaborate in a future hack; with apologies to Paul Graham<sup>16</sup>.)

Auctions and artificial deadlines create a positive feedback loop of social proof ("Other people want to invest, don't you?") and scarcity ("Hurry up or the deal is going to disappear"). That's what closes deals. Auctions also force you to fail or succeed in a few weeks. Either way, you will soon get back to creating value for your customers.

Finally, don't use the a-word ('auction') when you're raising money. Investors don't like it. Auctions are "taboo" when you're selling part of your company to an investor, yet perfectly dandy when you're selling your whole company to an acquirer. Don't say, "We're running an auction to get the best deal", say "We're looking for the right partner to help build our business."

## **Tranches are dumb.**

Adam writes:

"Traunching is bad for the company. If your investors exercise the traunche(s) then it means that the company is now worth more than they're paying you, so you're leaving value on the table. You might want to raise a smaller round and go to the market again when your valuation is higher."

Tranches are generally stupid. They have zero upside and catastrophic downside.

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<sup>16</sup><http://www.paulgraham.com/writing44.html>

At best, tranches give your current investors a right to invest at yesterday's valuation if your company is doing well. If your company is doing poorly, your investors will figure out how to get out of their obligation to invest. The tranches will probably have *material adverse change*<sup>17</sup> clauses that allow your investors to get out of their obligation. Almost all tranches are call options<sup>18</sup> for the investors, not put options<sup>19</sup> for the company.

If your investors back out of a second tranche, you will need to figure out how to manage the negative signal that your current investors don't want to invest in your company, even at yesterday's valuation. Remember the Golden Rule:

“He who has the gold rules.”

Get the gold while you can. If your prospective investor wants tranches, say:

“Currently, we're focused on raising *this* round, not the next one. Let's negotiate the next round at the next round.”

## **Two investors aren't always better than one.**

We disagree with one claim in Adam's article:

“... you want to have more than one major investor. If one firm is out of line then the other firm will be there to say “This is unreasonable”. You'll get more varied inputs. Having more than one major investor means you'll take a little more dilution, but I think it's worthwhile.”

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<sup>17</sup>[http://vcexperts.com/vce/library/encyclopedia/documents\\_view.asp?document\\_id=620](http://vcexperts.com/vce/library/encyclopedia/documents_view.asp?document_id=620)

<sup>18</sup>[http://en.wikipedia.org/wiki/Call\\_option](http://en.wikipedia.org/wiki/Call_option)

<sup>19</sup>[http://en.wikipedia.org/wiki/Put\\_option](http://en.wikipedia.org/wiki/Put_option)

Yes and no. There are good arguments for bringing on one *or* two investors. We don't have a strong opinion either way.

If you have two investors, you can play them off each other during closing if one of them is being slow or demanding, you can split them on the board so one of them votes your way, you can split them when they vote their protective provisions, *et cetera*.

But, the additional dilution of two investors is usually significant, about 10%-15%. And you don't need two investors to remove the unreasonable terms that Adam wants to avoid, you can just run an auction:

“We have an offer that doesn't include [egregious term X]. I hope there is some flexibility on your side because I would really like to work with you but I have a fiduciary duty to our shareholders.”

It's easier to remove unreasonable terms when investors are fighting to win a deal—they're more likely to collude if they're co-investing.

## **Graduating YC Founders: Don't do deals on D-Day.**

Me: Dude, we should offer to help the Y Combinator companies with their term sheets.

Naval: Don't we already have a blog for that?

Me: Yes, I'm sure both of our readers are well educated by now.

Naval: It doesn't matter anyway... the good YC companies will get snatched up on demo day—savvy investors will force quick decisions.

Me: What's the rush? The YC founders should spend a week to get multiple offers. Good investors compete with their merits, not exploding offers.

Naval: Why are you telling me? Get the word out...

Presenting... a very special message<sup>20</sup> from Venture Hacks to YC founders:

1. Take your time. If you can get one offer, you can get two. And a better deal.
2. Send any questions to nandn at venturehacks dot com. We'll keep them in confidence and help as much as we can.
3. We'll hold office hours on Friday August 17th to discuss fundraising—details are coming.



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Good luck! And let us beseech the blessing of Adam Smith upon this great and noble undertaking<sup>22</sup>.

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<sup>20</sup>[http://en.wikipedia.org/wiki/Very\\_special\\_episode](http://en.wikipedia.org/wiki/Very_special_episode)

<sup>21</sup><http://www.footnote.com/viewer.php?image=4346703>

<sup>22</sup><http://www.footnote.com/viewer.php?image=4346703>

# September 2007

## Hack: Create a market for your shares

“Things are worth what people pay for them.”

– Head of M&A at a Fortune 500 Company

Summary: You need strong alternatives to hack a term sheet. Create alternatives with focus: pitch and negotiate with all your prospective investors at the same time. Focus compounds the scarcity and social proof which close deals. It also yields a quick yes or no from investors—either way, you will soon get back to building your business.

You can't hack a term sheet<sup>1</sup> without leverage<sup>2</sup>. Term sheets are negotiated on the basis of leverage, not merit. And whoever needs the deal *least* has the most leverage in a negotiation.

The simplest type of leverage is a great BATNA<sup>3</sup>. A great BATNA might be a term sheet from another investor, an offer to buy your company, or an investment from angels instead of VCs.

Hostage negotiators learn how to negotiate with awful BATNAs where people die in a hail of bullets. If you're not in the mood for a hostage negotiation, get a great BATNA by *creating a market* for your shares.

### The market determines your company's valuation.

Many entrepreneurs wonder what their company is worth. The incredible answer is: companies are worth what people pay for

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<sup>1</sup><http://www.venturehacks.com/term-sheet-hacks/>

<sup>2</sup>[http://en.wikipedia.org/wiki/Leverage\\_%28negotiation%29](http://en.wikipedia.org/wiki/Leverage_%28negotiation%29)

<sup>3</sup>[http://en.wikipedia.org/wiki/Best\\_alternative\\_to\\_a\\_negotiated\\_agreement](http://en.wikipedia.org/wiki/Best_alternative_to_a_negotiated_agreement)

them.

There is no right or wrong price. The market clearing<sup>4</sup> price is determined by supply and demand: how many shares you are selling, your team, your product, your revenue, your salesmanship, *et cetera*.

The market determines your value, but there is no market for your shares—you must create it. How? At a minimum, get two independent, competing offers from investors who make it a habit to invest in startups at your stage.

### **You must focus on fund-raising to create a market.**

Pitch all your prospective investors *at the same time*. Negotiate with all interested investors *at the same time*. You can't clear the market in series, you can only clear it in parallel. Learn from Adam Smith at Xobni<sup>5</sup>:

“Our series A didn’t happen quickly. We excited the people we met with, but we were timid about getting started having recently closed a \$100k angel round. One firm had interest, so we thought “We better talk to someone else to make sure we’re getting a good deal.” That incremental approach went on for a few months. We were always in late stages with one investor but just beginning the dialogue with another. Deciding to raise money should be an atomic decision; don’t try to just dip your toe in.”

Jump on your desk, kick something, and declare a start to your fund-raising. Don’t negotiate consecutively, negotiate concurrently—you can’t create a market by meeting investors one-at-

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<sup>4</sup>[http://en.wikipedia.org/wiki/Market\\_clearing](http://en.wikipedia.org/wiki/Market_clearing)

<sup>5</sup><http://blogs.xobni.com/asmith/archives/50>

a-time. The only way to clear the market is to focus on fund-raising and talk to a lot of investors at once.

On eBay, everybody bids at the same time, over a short and arbitrary period of time. That drives the price up. They don't bid one-at-a-time over a timespan of 'whenever'.



## Five fund-raising milestones.

The next few hacks will cover five major milestones of fund raising:

1. Get first meetings.
2. Get partners meetings.
3. Get the first term sheet.

4. Sign a term sheet.
5. Close the deal.

Your leverage goes up at each milestone—that is, your interest in *new* prospective investors goes down at each step.

### **Focus compounds scarcity and social proof.**

Investors move in herds that are steered by scarcity<sup>6</sup> and social proof<sup>7</sup>. Scarcity is “hurry up or the deal is going to disappear.” It engenders urgency. Social proof is “everyone else wants to invest, don’t you?” It engenders validity.

Scarcity and social proof make people crazy<sup>8</sup>. Scarcity and social proof close deals. Focusing on fund-raising creates a positive feedback loop of scarcity and social proof:

If one investor wants to invest, you get a little bit of scarcity and social proof. That raises the interest of a second investor and creates more scarcity and social proof. Which raises the interest of a third investor...

Learn more about the psychology of negotiation in Bargaining for Advantage<sup>9</sup>. It combines the negotiation principles of Getting to Yes<sup>10</sup> with the psychological principles of Influence<sup>11</sup>. Chapter 6 of Bargaining for Advantage, “Leverage”, is free money.

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<sup>6</sup>[http://www.fripp.com/art.of\\_influence.html](http://www.fripp.com/art.of_influence.html)

<sup>7</sup>[http://en.wikipedia.org/wiki/Social\\_proof](http://en.wikipedia.org/wiki/Social_proof)

<sup>8</sup><http://www.youtube.com/watch?v=-o1zdm7ANVw>

<sup>9</sup>[http://www.amazon.com/Bargaining-Advantage-Negotiation-Strategies-Reasonable/dp/0143036971/ref=pd\\_bbs\\_sr\\_1/104-1379513-4088759?ie=UTF8&sa=books&qid=1189155242&sr=8-1](http://www.amazon.com/Bargaining-Advantage-Negotiation-Strategies-Reasonable/dp/0143036971/ref=pd_bbs_sr_1/104-1379513-4088759?ie=UTF8&sa=books&qid=1189155242&sr=8-1)

<sup>10</sup>[http://en.wikipedia.org/wiki/Getting\\_to\\_yes](http://en.wikipedia.org/wiki/Getting_to_yes)

<sup>11</sup>[http://en.wikipedia.org/wiki/Robert\\_Cialdini](http://en.wikipedia.org/wiki/Robert_Cialdini)

## **Creating a market is (relatively) quick.**

Focusing your fund raising on a short period of time (about 4-8 weeks) means you will raise money quickly. Or you will fail quickly and start working on getting past no<sup>12</sup>. Either way, you're no longer raising money, you're back to building your company and serving your customers.

*(Image Credit: Noah Angeja<sup>13</sup>)*

## **Pop Quiz: How is raising money like buying a car?**

How many similarities can you find between hacking fund-raising and hacking a car purchase? Watch this video:

The best answer gets a coveted Venture Hacks mug<sup>14</sup>.

*(Via Lifehacker<sup>15</sup>.)*

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<sup>12</sup>[http://blog.pmarca.com/2007/06/the\\_pmarca\\_guid\\_2.html](http://blog.pmarca.com/2007/06/the_pmarca_guid_2.html)

<sup>13</sup><http://flickr.com/photos/visualarts/426337340/>

<sup>14</sup><http://rdr.zazzle.com/img/imt-prd/pd-168402225828516935/isz-m/tl-Valuation+is+temporary+control+is+forever.jpg>

<sup>15</sup><http://lifehacker.com/>

# October 2007

## Ask Venture Hacks: What is the biggest mistake entrepreneurs make?

**Q:** What's the biggest mistake entrepreneurs make when they're raising money?

Entrepreneurs focus on valuation when they should be focusing on controlling the company through board control<sup>1</sup> and limited protective provisions<sup>2</sup>.

*Valuation is temporary, control is forever.* For example, the valuation of your company is irrelevant if the board terminates you and you lose your unvested stock.

The easiest way to maintain control of a startup is to create good alternatives<sup>3</sup> while you're raising money. If you're not willing to walk away from a deal, you won't get a good deal. Great alternatives make it easy to walk away.

Create alternatives by focusing on fund-raising: pitch and negotiate with all of your prospective investors at once. This may seem obvious but entrepreneurs often end up meeting investors one-after-another, instead of all-at-once.

Focusing on fund-raising creates the scarcity and social proof that close deals. Focus also yields a quick yes or no from investors so entrepreneurs can avoid perpetually raising capital.

**Q:** What's the biggest mistake VCs make?

A: The biggest opportunity for venture firms is differentiation. VCs compete for deals, and differentiation is the only way to compete.

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<sup>1</sup><http://www.venturehacks.com/term-sheet-hacks#bod>

<sup>2</sup><http://www.venturehacks.com/term-sheet-hacks#protective-provisions>

<sup>3</sup><http://www.venturehacks.com/term-sheet-hacks#negotiation>

Most firms offer the same product: a bundle of money plus the promise of value-add. And the few firms that are differentiated don't communicate their differentiation to entrepreneurs. Y Combinator<sup>4</sup> is an example of differentiated capital with excellent marketing communications.

Venture firms that thrive by investing in game-changing businesses have barely begun to differentiate themselves, let alone changed the rules of their own game.

(*Note: These excellent questions are adapted from Ashkan Karbasfrooshans's Venture Hacks interview<sup>5</sup>.*)

## Ask VH: Is the VC industry doomed?



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### Q: Is the venture capital industry doomed?

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<sup>4</sup><http://ycombinator.com/>

<sup>5</sup><http://watchmojo.com/web/blog/?p=2164>

<sup>6</sup></venturehacks/files/2007/10/nukes.jpg>

No. Venture capital invested in the U.S. is increasing<sup>7</sup> and VCs are a critical part of the startup ecosystem—I’m grateful they exist.

The rate of innovation is increasing and that innovation needs capital to get in customer’s hands. Capital invested in startups is going to increase, not decrease.

It’s wonderful that you can start a web-based software company with little capital. But after that early stage, even these companies need significant capital to reach their customers and beat their competition.

VC is not doomed but it is changing: see Y Combinator<sup>8</sup>, Idealab<sup>9</sup>, Hit Forge<sup>10</sup>, Squid Labs<sup>11</sup>, and others.

### **Q: Do investors hate Venture Hacks?**

No. Smart investors like educated entrepreneurs. But that doesn’t mean they agree with our advice.

### **Q: Who’s the best VC in the world?**

It depends on the startup’s market.

In general, the best partners don’t care what anybody else thinks, don’t take up your time with a lot of diligence, don’t pull out their Blackberries in meetings, and don’t ask dumb questions.

They make investment decisions quickly, show up to meetings on time, pay attention when you speak, let management run companies, treat entrepreneurs like peers, and conduct themselves with humility and trust.

We avoid criticizing or applauding specific firms on Venture Hacks but I will give a shout out to Atlas Venture<sup>12</sup> and their

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<sup>7</sup><http://www.nvca.org/ffax.html>

<sup>8</sup><http://ycombinator.com/>

<sup>9</sup><http://www.idealab.com/>

<sup>10</sup><http://hitforge.com/>

<sup>11</sup><http://www.squid-labs.com/>

<sup>12</sup><http://www.atlasventure.com/>

General Partner Jeff Fagnan<sup>13</sup> who supports me while we write Venture Hacks. And a shout out to Naval, my Venture Hacks partner, and his Hit Forge<sup>14</sup> fund. I'm lucky to be working with both of these guys and I recommend them both.

### **Q: Who works harder: investors or entrepreneurs?**

Entrepreneurs and VCs both work hard before and after an investment.

Investors are typically personally wealthy and draw a very comfortable salary from their management fees, in addition to their potential carry in a portfolio of startups. Entrepreneurs are often strapped for cash and fully invested in a single startup.

In theory, investors prefer investments that require no work, have no risk, and have a tremendous return. In practice, investors are part of the team that makes a company succeed or fail.

Early stage companies should expect a venture capital investor to spend about one day per month on their company. Most VCs spend the rest of their time working with other companies, looking at potential investments, marketing their firm, and working with limited partners.

*Note: These excellent questions are adapted from Ashkan Karbasfrooshans's Venture Hacks interview<sup>15</sup>.*

*Image Source: The Filter<sup>16</sup>.*

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<sup>13</sup><http://www.atlasventure.com/ourteam/bio.cfm?id=9>

<sup>14</sup><http://hitforge.com/>

<sup>15</sup><http://watchmojo.com/web/blog/?p=2164>

<sup>16</sup><http://www.scq.ubc.ca/filter/?p=246>

## Ask VH: Sell my company or raise capital?



**Q: Should I sell my company or raise capital and go for it?**

Sell if it dramatically changes the lives of the founders and the early team. Every dollar after your “fuck you money” is icing—get your financial independence first and make the icing at your next company. You can also use an earn-out at the acquirer to capture some of the potential upside of raising money.

If you raise capital, you risk your current value for a chance to capture your future value. *Is there a difference between capturing future value at your current company and your next company?* You can create future value at your next company after you’ve captured your current value and done your time at the acquirer.

Also consider selling if you are at a local maximum, *e.g.* your company or market is going sideways and the company will be worth less before it is worth more. Of course, smart buyers will wonder if they should be buying when insiders are selling.

One alternative to an acquisition is to cash-out some of the founder's shares so they're wealthy enough to feel comfortable with the risk of building a bigger business. I'm *guessing* the Facebook founders have been cashed-out to some degree.

**Q: What does it take to be a successful entrepreneur?**

Successful entrepreneurs delight their customers, execute relentlessly, and enjoy lots of luck. You recognize great entrepreneurs when you see them (like porn) and you get better at recognizing them every day.

**Q: What does it take to be a successful investor?**

To be an investor, you need access to capital. There is no IQ test.

To be a *successful* investor, you also need great dealflow, good judgement in picking companies, and, in competitive markets, the competitive advantage to win deals.

*Note: These excellent questions are adapted from Ashkan Karbasfrooshan's Venture Hacks interview<sup>17</sup>.*

*Image Source: Richard Seaman<sup>18</sup>.*

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<sup>17</sup><http://watchmojo.com/web/blog/?p=2164>

<sup>18</sup><http://richard-seaman.com/Travel/TrinidadAndTobago/Signs/Funny/index.html>

## Ask VH: Raise money from VCs or angels?



**Q: Should I raise money from VCs or angels, all things being equal?**

There is no prototypical VC or angel. Instead of pitting VCs versus angels, consider their perceived pros and cons and choose the best available investor.

Angels are perceived to have less money, invest for fun, make their investment decisions quickly, and not ask for control. VCs are perceived to have more money, invest professionally, make investment decisions slowly, and ask for control.

Seek a VC or angel who has follow-on capital to support companies in tough times, invests like his life depends on it, makes investment decisions quickly, and doesn't ask for control.

Companies that try to raise money from angels often end up raising money from VCs and *vice versa*. You can't tell where this road will take you until you start walking. Many VCs invest in seed stage companies with favorable terms—and many angels invest with onerous terms.

Finally, raise money from angels if you're hoping to sell your company quickly for \$10M, with very little investment, and lots of capital gain for the founders. Most VCs are shooting for \$100M+ exits. Either way, *seek investors who agree with your definition of victory*.

### **Q: What's the idea behind Venture Hacks?**

We show entrepreneurs how to negotiate better deals with their investors.

First-time entrepreneurs usually negotiate sub-optimal deals that leave millions of dollars on the table. Or worse, they negotiate awful deals and screw themselves.

Entrepreneurs don't know how their first deal will affect the rest of their chess game with investors—but their investors do. Entrepreneurs play this game once-a-lifetime... investors play it once-a-day.

*Startups have one chance to raise money right.* You can fix almost any mistake in a startup—but you can't fix your deal. If you hire the wrong employee, you can fire him—but you can't fire your investors.

We try to level the playing field with knowledge, so entrepreneurs can do this critical job right. In the words of Francis Bacon, “Knowledge is Power.”

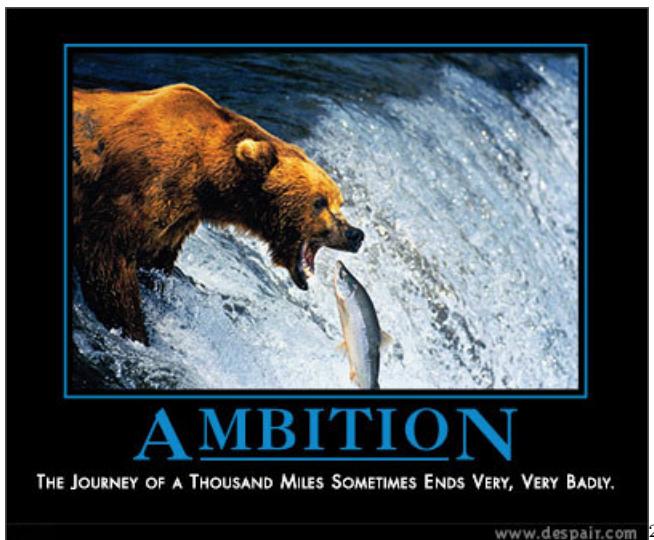
### **Q: Why should entrepreneurs read Venture Hacks?**

Informed entrepreneurs will get better deals. *Even a company with a great exit can benefit from a better deal that makes more employees rich.*

Entrepreneurs usually get their advice from other entrepreneurs who are inexperienced, investors who are biased, and lawyers who *do things right* (legally) but don't know the *right thing* to do.

Venture Hacks is our attempt to open-source everything we've learned from our great mentors and advisors. We strive to be objective but our inevitable biases favor the entrepreneur.

*Image Source: Gii*<sup>19</sup>.



<sup>20</sup>

Suzanne Dingwall Williams<sup>21</sup> is publishing M&A hacks on her excellent blog, Venture Law Lines<sup>22</sup>. She call the series: 'Selling the Startup',

Selling the Startup: Can you sell your subscriber base?<sup>23</sup>

<sup>19</sup><http://www.gii.in/fun/category/funny-kids/>

<sup>20</sup><http://despair.com/ambition.html>

<sup>21</sup><http://www.linkedin.com/pub/0/688/67b>

<sup>22</sup><http://venturelaw.blogspot.com/>

<sup>23</sup><http://venturelaw.blogspot.com/2007/09/selling-startup-can-you-sell-your>.

“Recently, a new client received a very favourable takeover offer for her business, including its subscriber base. Problem: the privacy policy did not permit her to provide the account information for her subscriber base to the acquirer. Same thing with the user license: it was non-transferable. We had to go back and rectify the matter in a ponderous way before closing.”

#### Selling the Startup: Providing Price Protection in the Term Sheet<sup>24</sup>

“As a general rule, [M&A] term sheets provide for price adjustment based on revenues and a closing balance sheet, and based on the results of the buyer’s due diligence (this is really a price reduction clause, as no one ever finishes due diligence and concludes “By God, they’re really onto something here. Raise the price!”). Here are three other areas where you, as seller, need to consider providing for some price protection...”

A couple more gems from her excellent blog:

#### On Being An “Off the Grid” Startup<sup>25</sup>

“The reality is that 95% or more of North American startups are created outside of Silicon Valley. Many are created in fairly robust business generation centres such as Boston, and emerging centres such as Chicago and Raleigh-Durham. Just as many

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<sup>24</sup>http://venturelaw.blogspot.com/2007/09/selling-startup-providing-price.html

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http://venturelaw.blogspot.com/2007/10/on-being-off-grid-startup.html

are created in regions where the startup infrastructure is small or non-existent. Do the practices, deal terms, and operational decisions typically made by startups in the overheated Valley, with its cadre of serial entrepreneurs and super-angels, have any application for the rest of us, who are off the Silicon Valley grid?"

### If Venture Capital is Dead [in Canada], What's Next?<sup>26</sup>

"Venture capital in Canada is no longer an industry, but a financial product offered by only a handful of players..."

"When someone finally says this, I'll agree. But I'll also say that, as someone who advises entrepreneurs, ***I don't particularly care.*** All this tells me is that companies will now use different financial tools to feed growth, using business plans that are not shoe-horned into the somewhat artificial venture capital model for growth—i.e., in and out in 3-7 years."

Suzanne's resume<sup>27</sup> includes roles as Founder of Venture Law Associates (a Canadian law firm with *flat rate service* for inventors and early stage companies), Principal at BCE Capital, and Senior Counsel at Nortel.

*Image Source: Despair*<sup>28</sup>.

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<sup>26</sup><http://venturelaw.blogspot.com/2007/10/if-venture-capital-is-dead-whats-next.html>

<sup>27</sup><http://www.linkedin.com/pub/0/688/67b>

<sup>28</sup><http://despair.com/ambition.html>

## Ask Venture Hacks



We get lots of email from people asking for advice. We're going to start answering the most interesting questions here, so everyone can participate in the discussion.

Got a question? Send it to [ask@venturehacks.com](mailto:ask@venturehacks.com)<sup>29</sup>. Names will be changed to protect the innocent.

In the meantime, catch up on past editions of Ask Venture Hacks<sup>30</sup>, where we tackled VCs vs. angels, build vs. sell, doom, the world's biggest fund-raising mistake, and the wonderful world of *supra pro rata* rights.

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<sup>29</sup> <mailto:ask@venturehacks.com>

<sup>30</sup> <http://www.venturehacks.com/topics/ask-vh>

## Ask VH: What's dumb money?

**Q: Everybody is telling us to raise smart money. What's the difference between smart money and dumb money?**

“The best assumption to make is that your VC’s primary value add is the cash they are investing. Then you’ll always be surprised on the upside.”

— Marc Andreessen<sup>31</sup>

Summary: *Smart money* is money plus the promise of help that's worth paying for, *dumb money* is money plus hidden harm, and *mostly money* is mostly money. Weed out the dumb money with diligence. Evaluate supposedly smart money with the smart money test. Finally, assume your investors are mostly money: unbundle money and value-add to get money on the best terms possible and value-add on the best terms possible.

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<sup>31</sup> [http://blog.pmarca.com/2007/06/the\\_truth\\_about\\_1.html](http://blog.pmarca.com/2007/06/the_truth_about_1.html)



If *smart money* is money plus the promise of help that's worth paying for, then *dumb money* is money plus hidden harm, and *mostly money* is mostly money. All three provide what entrepreneurs primarily want from investors: money.

1. Avoid *dumb money*: you don't hire harmful people—so don't marry them for the life of the company either.
2. *Mostly money* is great but there are very few investors who act like their primary contribution is capital.
3. *Smart money* is rare—after all, would you work with most investors if they didn't bring a piggy bank? Also, too many investors think the "smart" in smart money means "we know how to run your business better than you."

## Weed out the dumb money with diligence.

Don't assume any investor won't be harmful. Do the diligence to prove otherwise:

- Do you trust him?
- Will he provide his *pro rata* in the next round? (Not so important for seed funds and angels.)
- Will he support you if the company is going sideways?
- Does he have impeccable references?
- Does he want control?
- When it comes time to sell the company, will he let you?
- Will he let you expand the option pool to hire someone great?
- Does he want to replace you as CEO?
- Will he try to merge you with another dying company from his portfolio?
- Do you want to marry him for the life of the company?
- Is he committed to investing in startups and does he have a reputation to protect in the startup world?
- *et cetera...*

## Evaluate supposedly smart money with the smart money test.

After you've weeded out the dumb money, do the smart money test on everybody else:

Would you add the investor to your board of directors (or advisors) if he didn't come with money?

If the answer is no, he is mostly money (see below). If the answer is yes, subtract some dilution from his investment since he's eliminating the cost of a value-add director or advisor. You're paying for the smart money investor—with his own money!

A smart money investor can be very valuable because he is good enough to be an advisor or board member *and* he owns enough to really care about the company in good times and bad times. An advisor or independent director won't own enough of the company to really care if the company is in trouble—his career isn't on the line like an investor's.

But! If you're wrong and the investor you thought was smart doesn't add value, you can't fire him like an advisor or director and get your money back. You can only hope to ignore him. Which is why it is safer to...

### **Assume your investors are mostly money.**

Whether you raise smart money or mostly money, you should raise money *as if* your investors were mostly money. In other words, *unbundle money and value-add*<sup>32</sup>. Get money on the best terms possible and get value-add on the best terms possible.

You can buy advice and introductions for 1/10<sup>th</sup> of the price that most investors charge. An investor will buy 15-30% of your company. An advisor or independent director will require 0.25%-2.5% of your company with a vesting schedule of 2-4 years.

An advisor or independent director will be hand-picked from the population of planet Earth. He

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<sup>32</sup><http://www.startupboy.com/journal/2005/11/30/vc-bundling.html>

should be more effective than someone picked from the vast pool of investors who want to invest in your company.

He will own common stock, unlike an investor who owns preferred stock with additional rights.

And he won't have conflicting responsibilities to his venture firm, other venture firms, or limited partners.

### **Money-add first, value-add second.**

Value-add is great but it comes after money-add. First, find a money-add investor who will make an investment decision quickly, who is humble and trustworthy, who will treat you like a peer, who shares your vision<sup>33</sup>, and who is betting on you, not the market.

### **Got a question for us?**

Send your questions to [ask@venturehacks.com](mailto:ask@venturehacks.com)<sup>34</sup>. We read every question and answer the most interesting ones here!

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<sup>33</sup>[http://avc.blogs.com/a\\_vc/2007/10/why-do-you-want.html](http://avc.blogs.com/a_vc/2007/10/why-do-you-want.html)

<sup>34</sup><mailto:nandn@venturehacks.com>

# November 2007

## What should I send investors part 1: the elevator pitch

“Summarize the company’s business on the back of a business card.”

— Sequoia Capital<sup>1</sup>

Summary: An introduction captures an investor’s attention, but a great elevator pitch gets a meeting. The major components of the pitch are traction, product, and team.

If you’re building an interesting company, people will offer to introduce you to investors—it makes them look good. In Hollywood, content is king; in Silicon Valley, *dealflow is king*.

So, what should you send investors? Send an elevator pitch and a deck. We’ll cover the elevator pitch in this article.

### Get a first meeting with an elevator pitch.

A great elevator pitch is more important than your deck and less important than the “introducer”. If you don’t have an introduction, the elevator pitch is critical to a cold call.

An introduction sells the investor on reading the elevator pitch, which sells the investor on reading the deck, which sells the investor on taking a meeting. Many investors will just skim the deck and take a meeting if the introduction and elevator pitch are good.

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<sup>1</sup><http://www.sequoiacap.com/ideas/>

## An elevator pitch.

Send a brief email that the introducer can forward with a thumbs-up. I crafted this elevator pitch from Marc Andreessen's job listing for Ning<sup>2</sup>:

Subject: Introducing Ning to Blue Shirt Capital

Hi Nivi,

Thanks for offering to introduce us to Blue Shirt Capital. I've attached a short presentation about our company, Ning.

Briefly, Ning lets you create your own social network for anything. For free. In 2 minutes. It's as easy as starting a blog.

Ning unlocks the great ideas from people all over the world who want to use this amazing medium in their lives.

We have over 115,000 user-created networks and our page views are growing 10% per week. We previously raised \$44M from Legg Mason and others, including myself.

Before Ning, I started Netscape (acquired by AOL for \$4.2B) and Opsware (acquired by HP for \$1.6B).

I've admired Blue Shirt's investments from afar. We're starting meetings with investors next week and I would love to show Blue Shirt what we're building at Ning.

Best,

Marc Andreessen xyz@ning.com 415.555.1212

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<sup>2</sup><http://blog.pmarca.com/2007/11/join-the-ning-t.html>

## Dissecting the elevator pitch.

Let's dissect this pitch:

Subject: Introducing Ning to Blue Shirt Capital [**A useful subject line!**]

Hi Nivi,

Thanks for offering to introduce us to Blue Shirt Capital. I've attached a short presentation about our company, Ning.

Briefly, Ning lets you create your own social network for anything. For free. In 2 minutes. [**What is the product? What does it help the customer do? Who is the customer?**] It's as easy as starting a blog. [**What's the metaphor?**]

We built Ning to unlock the great ideas from people all over the world who want to use this amazing medium in their lives. [**What's the big problem or opportunity?**]

We have over 115,000 user-created networks and our page views are growing 10% per week. [**Traction.**] We previously raised \$44M from Legg Mason and others, including myself. [**Social proof and more traction.**]

Before Ning, I started Netscape (acquired by AOL for \$4.2B) and Opsware (acquired by HP for \$1.6B). [**Team.**]

I've admired Blue Shirt's investments from afar. We're starting meetings with investors next week and I would love to show Blue Shirt what we're building at Ning. [**Call to action and subtle scarcity.**]

Best,

Marc Andreessen marc@ning.com [**Contact information—how thoughtful.**] 415.555.1212

See David Cowan<sup>3</sup>'s excellent Practicing the Art of Pitchcraft<sup>4</sup> for more examples.

### **Pop quiz.**

How does Ali G apply these techniques (or not) as he pitches the Ice Cream Glove to Donald Trump? The best answer gets a wonderful Venture Hacks mug.

## **What should I send investors part 2, deck**

“PowerPoint plans greatly increase your chance of getting a term sheet, or at least the dignity of a quick no.”

— David Cowan<sup>5</sup>, Bessemer Venture Partners<sup>6</sup>

Summary: An introduction and elevator pitch are critical to getting a meeting. You should also provide a “ten-slide” deck that tells a compelling story about your team, product, traction, and plans.

A PowerPoint plan (“deck”) is less important than an elevator pitch, and an elevator pitch is less important than an introduction. Read What should I send investors? Part 1: Elevator

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<sup>3</sup><http://www.bvp.com/Team/Default.aspx?id=108>

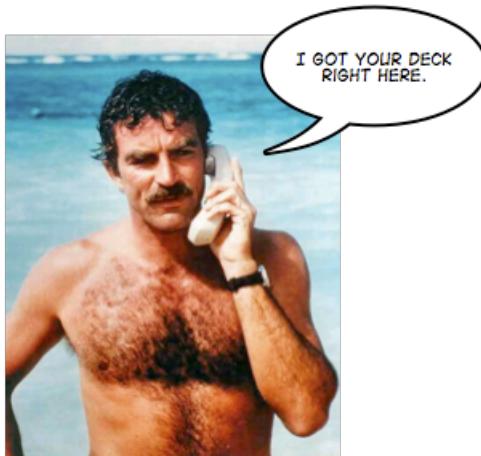
<sup>4</sup><http://whohastimeforthis.blogspot.com/2006/01/practicing-art-of-pitchcraft.html>

<sup>5</sup><http://www.bvp.com/Team/Default.aspx?id=108>

<sup>6</sup><http://www.bvp.com/>

Pitch<sup>7</sup> for tips on crafting an elevator pitch. Many investors will just skim a deck and take a meeting if the introduction and elevator pitch are good.

But you still need a deck. A deck lets investors learn more about your company. It demonstrates that you've thought about the company in detail. It's an industry norm. And you need one for presentations anyway.



### **Include a “ten-slide” deck with your elevator pitch.**

The best deck template in the universe is David Cowan<sup>8</sup>'s How To Not Write A Business Plan<sup>9</sup>—use it. There are other tem-

<sup>7</sup><http://www.venturehacks.com/articles/elevator-pitch>

<sup>8</sup><http://www.bvp.com/Team/Default.aspx?id=108>

<sup>9</sup><http://whohastimeforthis.blogspot.com/2005/11/how-to-not-write-business-plan.html>

plates from excellent sources on the Web, but this is the best. Apply these headings and minor changes to David Cowan's slides<sup>10</sup>:

1. **Cover.**
2. **Mission.**
3. **Summary.** Summarize the key, compelling facts of the company. You can steal the content from your elevator pitch<sup>11</sup>.
4. **Team.** Highlight the past accomplishments of the team; if your team has been successful before, investors may believe it will be successful again. Don't include positions you intend to fill—save that for the Milestones slide. Put yourself last: it seems humble and lets you tell a story about how your career has led to the discovery of the...
5. **Problem.**
6. **Solution.** Include a demo such as a screencast, a link to working software, or pictures. *God help you if you have nothing to show.*
7. **Technology.**
8. **Marketing.** Include market size estimates here or in the Problem. If you haven't launched, discuss your plan to acquire users or customers.
9. **Sales.** If you don't have sales, discuss your business model and prospective customers. Ignore the cost of customer acquisition unless you have some insight into the issue.

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<sup>10</sup>[http://whohastimeforthis.blogspot.com/2005/11/  
how-to-not-write-business-plan.html](http://whohastimeforthis.blogspot.com/2005/11/how-to-not-write-business-plan.html)

<sup>11</sup><http://venturehacks.com/articles/elevator-pitch>

10. **Competition.** Describe why users or customers use your product instead of the competition's product. Describe any competitive advantages that remain after the competition decides to copy you exactly.
11. **Milestones.** Don't build a detailed financial model if you don't have past earnings, a significant financial history, or insight into the issue. Instead, include your current status and milestones for the next 1-3 quarters for product, team, marketing, sales, and quarterly and cumulative burn.
12. **Conclusion.** This slide can be inspirational, a larger vision of what the company could do if these current plans are realized, or a rehash of the Summary slide.
13. **Financing.** Dates, amounts, and sources of money raised. How much money are you raising in this round?

## These slides tell a story.

This sequence of slides tells a story:

We have a *mission* and a *team* that is taking us there. Why? We discovered a large *problem* and *solved* it with a product that has this amazing *technology* inside. We're going to *market* and *sell* it to these customers, with these advantages over our *competitors*. In particular, we're working towards these *milestones* over the next few quarters. In *conclusion*, this *financing* is a great investment opportunity.

The product isn't revealed until the fifth slide of this methodical sequence—that's annoying. Fortunately, the elevator pitch and Summary slide kill the suspense by summarizing your company and product before an investor jumps into the deck.

## Put pictures in the slides and text in the notes.

Keep the slides simple, visual, and minimal, with 30 point or larger font<sup>12</sup>. The slides will look great when you present; see Gates, Jobs, & the Zen aesthetic<sup>13</sup>. (We'll cover presentations in a future article, this article is about the deck you send investors.)

Put talking points, reasoning, and prose in the notes that accompany each slide. Don't try to cram cogent arguments into bullet points on the slides; see The Cognitive Style of PowerPoint<sup>14</sup>.

Email a PDF that combines each slide and its notes on a single page. Please don't email a PowerPoint file unless your deck contains critical animations or movies.

You now have a single file for emails *and* live presentations. An investor can read the slides and notes together and imagine a presentation. And you can present the slides while you refer to the notes.

Finally, try Keynote<sup>15</sup> if you're on a Mac. It makes beautiful decks and it's fun to use.

## Got a question for us?

Send your questions to [ask@venturehacks.com](mailto:ask@venturehacks.com)<sup>16</sup>. We read every question and answer the most interesting ones here!

*Image Source: kimcm.dk*<sup>17</sup>.

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<sup>12</sup>[http://blog.guykawasaki.com/2005/12/the\\_102030\\_rule.html](http://blog.guykawasaki.com/2005/12/the_102030_rule.html)

<sup>13</sup>[http://presentationzen.blogs.com/presentationzen/2005/11/the\\_zen\\_esthetic.html](http://presentationzen.blogs.com/presentationzen/2005/11/the_zen_esthetic.html)

<sup>14</sup>[http://www.edwardtufte.com/tufte/books\\_pp](http://www.edwardtufte.com/tufte/books_pp)

<sup>15</sup><http://www.apple.com/iwork/keynote/>

<sup>16</sup><mailto:ask@venturehacks.com>

<sup>17</sup><http://www.kimcm.dk/4fun/hotornot/>

## What should I send investors part 3: business plans and traction

Summary: Don't send long business plans to investors. Don't ask for NDAs. Don't share information that must remain confidential. Understand that investors care about traction over everything else.

In Parts 1 and 2 of 'What should I send investors?', we covered the elevator pitch<sup>18</sup> and deck<sup>19</sup>. In this article, we present a few dos and don'ts of sending collateral to investors.

### Don't send a business plan.

"Nothing slows down a VC as much as a comprehensive business plan."

— David Cowan<sup>20</sup>, Bessemer Venture Partners<sup>21</sup>

Don't send a 50-page business plan to investors. Nobody reads them and nobody executes them. Investors who want a long plan look bad—so do companies that generate them.

Your deck<sup>22</sup> summarizes the company's plan for the next 1-3 quarters. Document your detailed plans on a napkin, wiki, spreadsheet, deck, to-do list, or whatever. Share it with investors sometime around your second meeting and make sure they generally agree with your plan.

But don't send investors a 50-page sales pitch that you call a business plan—an elevator pitch and deck are sufficient. You

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<sup>18</sup><http://venturehacks.com/articles/elevator-pitch>

<sup>19</sup><http://venturehacks.com/articles/deck>

<sup>20</sup><http://whohastimeforthis.blogspot.com/2005/11/how-to-not-write-business-plan.html>

<sup>21</sup><http://www.bvp.com/>

<sup>22</sup><http://venturehacks.com/articles/deck>

don't need an executive summary either—an elevator pitch and deck are sufficient.

## **Don't ask for an NDA.**

“Because of the large number of business plans... that we review, and the similarity of many such plans... we cannot accept responsibility for protecting against misuse or disclosure of any confidential or proprietary information...”

— Sequoia Capital<sup>23</sup>

Getting an NDA from professional investors is almost impossible. It can happen (like a rainbow!), but you shouldn't bother.

Investors don't sign NDAs because they don't want to get sued over them. Competing companies tend to get started at the same time because the market timing is right. Investors don't want you to sue them if they fund your competitor—so they don't sign NDAs. Read Why Most VC's Don't Sign NDAs<sup>24</sup> by Brad Feld to learn more.

Asking for an NDA creates a barrier to getting funded—aren't there enough barriers already? And this barrier is insurmountable: your request will be declined or, worse, ignored because you haven't done your homework.

Accept the fact that your elevator pitch and deck will contain information that you don't want printed on the front page of the Wall Street Journal. Fortunately, they won't get that far.

And if you must keep something confidential, don't email it to investors and don't mention it in person. Investors often look at several similar companies at once. Your plans probably won't get to your competitors, but you should assume they will.

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<sup>23</sup><http://www.sequoiacap.com/ideas/submitaplan.aspx>

<sup>24</sup>[http://www.feld.com/blog/archives/2006/02/why\\_most\\_vc\\_s\\_do.html](http://www.feld.com/blog/archives/2006/02/why_most_vc_s_do.html)

## Traction rules.

“Do whatever is required to get to product/market fit. Including changing out people, rewriting your product, moving into a different market, telling customers no when you don’t want to, telling customers yes when you don’t want to, raising that fourth round of highly dilutive venture capital—whatever is required.”

— Marc Andreessen<sup>25</sup>

Whether they’re reading an elevator pitch or listening to a presentation, investors care most about *actual* traction in a *seemingly* large market.

If you have *incredible* traction in what *seems* to be a large market, you can raise money no matter what the product and team look like—although a good product and team will improve your terms.

If you *don’t* have incredible traction but the market seems large, your product and team are both critical to raising money.

If the market *doesn’t seem* large, investors won’t care about your product or your team.

Traction is demonstrated profit, revenue, customers, pilot customers, or users (in order of importance), and their rates of change, and the rates of change of the rates of change, and the rates of change of...

Read The only thing that matters<sup>26</sup> by Marc Andreessen to learn more.

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<sup>25</sup><http://blog.pmarca.com/2007/06/the-pmarca-gu-2.html>

<sup>26</sup><http://blog.pmarca.com/2007/06/the-pmarca-gu-2.html>

## Grockit's founder on raising money



Brian Norgard<sup>28</sup> (Newroo<sup>29</sup> founder and Venture Hacks investor) recently interviewed<sup>30</sup> my brother, Farbood Nivi<sup>31</sup>, about his experience raising money for Grockit<sup>32</sup> from Benchmark *et al*:

Brian: Tell me about the funding process.

Farbood: I think raising money is great fun. The bottom line is that the money **has** to be spent. VCs are not in the business of holding their Limited Partner's investment in a 5% security. They **have** to spend the money on startups. So, either **your** startup gets the money or someone else's startup gets the money.

No VC has a perfect track record, nor do they pretend to. So, (1) either your idea or business sucks and the VCs know it (despite their imperfect record, they are not bad at telling) or (2) you suck at explaining it. There is literally more money to invest than the world's VCs know what to do with.

Getting a meeting is another issue.

What did you learn from raising your Series A?

I learned that a disproportionately large percentage of VCs, relative to most populations I've encountered, are extremely smart, gregarious, easy to get

<sup>27</sup><http://www.grockit.com/>

<sup>28</sup>[http://www.briannorgard.com/?page\\_id=2](http://www.briannorgard.com/?page_id=2)

<sup>29</sup><http://www.techcrunch.com/2006/03/14/fox-to-acquire-startup-newroo/>

<sup>30</sup><http://www.briannorgard.com/?p=69>

<sup>31</sup><http://www.linkedin.com/pub/0/85B/094>

<sup>32</sup><http://www.techcrunch.com/2007/07/24/grockit-raises-cash-prepares-massive-multiplayer-on>

along with, excited, positive and insightful. I'm usually surprised when I meet one that isn't.

This makes financings a far more positive experience than they would otherwise be and, just as importantly, makes the time and energy spent in meeting with them worthwhile in and of itself.

I also learned that, amazingly enough, of time, money and great people, time and great people are more scarce.

Any parting bits for entrepreneurs out there?

Make sure your deck is **great** not good.

Read the rest of the interview<sup>33</sup> where Brian and Farbood discuss Grockit and the massively under-served education market.

## Topix founder on Spice Girls Vs VC



Rich Skrenta<sup>34</sup>, a founder of Topix<sup>35</sup> and the Open Directory

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<sup>33</sup><http://www.briannorgard.com/?p=69>

<sup>34</sup><http://www.skrenta.com/about.html>

<sup>35</sup><http://www.topix.com/>

Project<sup>36</sup>, recently wrote about Spice Girls VC<sup>37</sup>:

“So one day a few years ago I’m sitting in a VC’s office having a chat. I had a few ideas rattling around in my head but the VC had his eyes on a then-current space which was hot. He tossed a business plan for one of the leading startups into my lap.

“Where’d you get this?” I asked.

“They gave it to me.” [A commenter suggests never sending decks to investors<sup>38</sup>. At least write “Proprietary and confidential. Do not distribute,” on any collateral you send investors. And ask any recipients, in writing, via email, to kindly not distribute the deck outside their firm.]

“He went on to talk about how he wanted to launch a company into the space as well, and I’d be a great VP Engineering. He said he knew a guy with some technology who could be CTO, had a VP Marketing in mind, and then we’d just need a *world class* CEO to round out the band.

“I formed a theory that the process of seeking VC ended up calling your own competitors into existence. You’ll meet with many more VCs than the 1-2 who end up funding you. But after seeing a company or two get funded in your space, the VCs who passed or weren’t able to get in decide they want to have a bet in the space too. Fortunately they have the benefit of having heard your pitch and the opportunity to personally grill you at length on your

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<sup>36</sup><http://www.dmoz.org/>

<sup>37</sup>[http://www.skrenta.com/2007/11/spice\\_girls\\_vc.html](http://www.skrenta.com/2007/11/spice_girls_vc.html)

<sup>38</sup><http://www.venturehacks.com/articles/deck#comment-1332>

approach. [Compare to Farbood's thoughts on the benefits of meeting VCs<sup>39</sup>.]

“But doing the Spice Girls or N’ Sync thing to put a startup together can be tricky. Startup founders can be so cranky/eccentric.”

Rich Skrenta’s blog<sup>40</sup> is great (a few classics: 1<sup>41</sup>, 2<sup>42</sup>, 3<sup>43</sup>). I would personally guess that the main source of startup competitors is market readiness, not Spice Girls startups.

## How much diligence should we do before signing a term sheet

“Once the term sheet is signed, the power shifts away from the startup to the purchaser. The typical term sheet will give the purchaser the discretion to step away from the deal if due diligence is unsatisfactory, or if the necessary internal approvals are not obtained.”

— Suzanne Dingwall Williams<sup>44</sup>, on M&A

“... there is a wide range of behavior among VCs—the group that doesn’t put a term sheet down until they are committed are at one end of the spectrum; the group that puts down a term sheet to try to lock up a deal while they think about whether or not they want to do it is at the other.”

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<sup>39</sup><http://venturehacks.com/articles/grockit>

<sup>40</sup><http://www.skrenta.com/>

<sup>41</sup><http://blog.topix.com/archives/000095.html>

<sup>42</sup><http://blog.topix.com/archives/000016.html>

<sup>43</sup><http://blog.topix.com/archives/000045.html>

<sup>44</sup><http://venturelaw.blogspot.com/2007/11/selling-startup-no-shop-clause.html>

— Brad Feld<sup>45</sup>

Summary: Complete business diligence and prepare for legal diligence before you sign a term sheet. Signing a term sheet early is a recipe for a hostage negotiation.

A reader asks:

“Our term sheet says ‘any obligation on the part of the investors is subject to satisfactory completion of due diligence by the prospective investors.’ How much diligence should we do before signing the term sheet?”

Whether or not your term sheet includes this term, complete business diligence and prepare for legal diligence *before* you sign a term sheet.

### **Signing a term sheet early is dangerous.**

Signing a term sheet, with or without a no-shop agreement<sup>46</sup>, while an investor is still conducting business diligence, is a recipe for a hostage negotiation:

You sign a term sheet, let other investors know, and go off the market while your prospective investors do diligence. After 2-4 weeks, your prospective investors say, “Uh, yeah, the results of diligence weren’t so good, we’ll still do the deal but with these (worse) terms instead.”

While you’ve been off the market, your prospective investors have been creating alternatives by looking at other companies.

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<sup>45</sup>[http://www.feld.com/blog/archives/2005/08/unilateral\\_or\\_s.html](http://www.feld.com/blog/archives/2005/08/unilateral_or_s.html)

<sup>46</sup>[http://www.feld.com/blog/archives/2005/08/unilateral\\_or\\_s.html](http://www.feld.com/blog/archives/2005/08/unilateral_or_s.html)

Every company that is raising money, not just your competitors in the marketplace, is competing for your prospective investor's time and money. Meanwhile, the market you created<sup>47</sup> before signing a term sheet has dissipated.

Even if you turn down these worse terms and approach new investors, you will have to explain why you walked away from a signed term sheet. So, before you sign a term sheet, complete business diligence and prepare for legal diligence.

## **Complete business diligence.**

Business diligence is whatever your investor needs to make his investment decision. Some firms complete business diligence before they offer a term sheet. Other firms offer term sheets before they complete business diligence because they want to lock out the competition while they evaluate the company.

Determine whether business diligence is complete by asking:

- Has this investment been approved by the entire partnership? Are any other approvals required?
- Why do you want to invest<sup>48</sup>?
- Have you done your references? (And have we done *our* references?)
- When was the last time you or your partnership signed a term sheet that didn't close? Why? How many times have you not closed a term sheet in the last five years? Why?

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<sup>47</sup><http://venturehacks.com/term-sheet-hacks#negotiation>

<sup>48</sup>[http://avc.blogs.com/a\\_vc/2007/10/why-do-you-want.html](http://avc.blogs.com/a_vc/2007/10/why-do-you-want.html)

## Prepare for legal diligence.

After you sign a term sheet, investors conduct legal diligence, looking for reasons to not invest or reasons to revise the terms.

Legal diligence,

1. Confirms whether your claims are actually true, *e.g.* your annual revenue actually is \$10M.
2. Uncovers important facts you didn't mention, *e.g.* you're being sued.
3. Completes tasks you should have done earlier, *e.g.* all employees sign NDAs.

Before you sign a term sheet, help your prospective investor eliminate most reasons to not invest by,

1. Telling the truth. (Duh.)
2. Disclosing everything.
3. Working with your lawyer to sign the agreements you need to sign. (If you can afford it.)
4. Asking your prospective investor, "What diligence remains once we sign the term sheet? Which items can we complete before we sign the term sheet?" Document these items in an email to your investor. This email is normative leverage<sup>49</sup> in case the list suddenly gets bigger during closing.

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<sup>49</sup>[http://en.wikipedia.org/wiki/Leverage\\_\(negotiation\)](http://en.wikipedia.org/wiki/Leverage_(negotiation))

**Desperation is no reason to rush into a term sheet.**

*You:* “It must be great to complete diligence before signing a term sheet—but we’re desperate for money *right now*.”

*Venture Hacks Shift Manager:* That’s the worst reason to rush into a term sheet. Signing a term sheet before completing business diligence makes you more desperate, not less. A term sheet with or without a no-shop takes you off the market, dissipates your market, and places you at the mercy of your prospective investor.



*Image Source: McDonald's.<sup>50</sup>*

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<sup>50</sup>[http://www.mcdonalds.ca/en/careers/restMgmt\\_benefits.aspx](http://www.mcdonalds.ca/en/careers/restMgmt_benefits.aspx)

# December 2007

## Should I shop around?

“We took the approach of wanting to get to know the different partners and the different possibilities and to see where there was the best fit. Partnerships take a lot of work—you want to go out on a few dates before you get married. Yes, we dated a few people but didn’t get married... and so there were a few unhappy girlfriends out there. The choice wasn’t an economic choice, it was a customer choice.”

— Steve Jobs<sup>1</sup>

Summary: A deal is only as good as its best alternative. Keep improving your alternatives until you have a signed term sheet. And keep developing your current offers or they will die. Finally, don’t say “shopping around”, it puts investors off their stroke.

A reader asks:

“I have spoken to only one person regarding an investment, and they immediately said they would back my company. Should I contact more than one potential investor, i.e. shop around for someone who has experience in this space, and might be capable of injecting more capital for bigger goals? The product looks good, so I’m confident I can successfully engage other potential investors.”

In your mother’s womb, you learned that a chain is as strong as its weakest link. Now, in the awesome womb of Venture Hacks, you learn that,

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<sup>1</sup>[http://blogs.guardian.co.uk/technology/2007/09/18/live\\_from\\_the\\_apple\\_announcement\\_london.html](http://blogs.guardian.co.uk/technology/2007/09/18/live_from_the_apple_announcement_london.html)

A deal is as good as its best alternative.

Receiving a term sheet is a significant milestone. Receiving a verbal offer or an indication of interest is also a significant milestone.

But you should keep engaging alternative investors until you sign a term sheet. Sometimes, you should keep engaging alternative investors until you close (assuming the term sheet you signed doesn't have a no-shop<sup>2</sup>).



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<sup>2</sup>[http://www.feld.com/blog/archives/2005/08/unilateral\\_or\\_s.html](http://www.feld.com/blog/archives/2005/08/unilateral_or_s.html)

## Improve your alternatives to get a better deal.

Create a market<sup>3</sup> that is filled with alternative buyers. Without alternatives, you will be stuck in a hostage negotiation with a single prospective investor. *With* alternatives, you will do well. In Bargaining for Advantage<sup>4</sup>, G. Richard Shell<sup>5</sup> writes,

“Research has shown that, with leverage, even an average negotiator will do pretty well while, without leverage, only highly skilled bargainers achieve their goals.”

*Spending time developing alternatives is as good as spending time developing your current offer.* It increases the chances of closing your current offer. It closes your current offer faster. And it improves the terms of your current offer. Keep this in mind if you “don’t have time” to develop alternatives.

## Develop your current offers or they will die.

Keep developing your current and pending term sheets while you engage alternative investors. If you sit on a term sheet for 2+ weeks, there’s a good chance, say 33%-50%, that the offer will disappear because the investor will move on to a shiny new company and his enthusiasm for your company will wane. Not to mention that most term sheets expire after a couple weeks.

Don’t let offers cool while you warm up alternatives. Shopping around for Gucci underwear is effective as long as stores

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<sup>3</sup><http://venturehacks.com/term-sheet-hacks#negotiation>

<sup>4</sup><http://books.google.com/books?id=WiSJAAQACAAJ&dq=G+Richard+Shell&prev=http://www.google.com/search%3Fhl%3Den%26lr%3D%26q%3DG.%2520Richard%2520Shell%2520&sa=X&oi=print&ct=result&cd=1&cad=author-navigational>

<sup>5</sup><http://www.google.com/search?num=20&hl=en&lr=&safe=off&q=%22g.+richard+shell%22&btnG=Search>

have it in stock. It's not effective if each store runs out of inventory while you're visiting its competitors.

The best way to keep investors warm is to focus on fund-raising<sup>6</sup> so you can (1) get all your offers at once and (2) pick the best one before any of them cool down.

### **Buy a little time after your first offer.**

When you receive your first offer, you can buy 1-2 weeks of time by saying,

“We’ve promised to close out conversations with a few investors and we need to honor our promise.”

“We’ve committed to a partner’s meeting next week and we need to honor our commitment.”

No investor is going to ask you to break your previous commitments. This little tactic buys you time and increases your social proof and scarcity.

### **You only need a few offers to clear the market.**

How do you know if you’ve cleared the market? You need two or three offers from investors who make it a habit to invest in startups at your stage. These investors should create enough demand, social proof, and scarcity among themselves to improve your terms and clear the market.

Finally, receiving more than two or three means you will have to disappoint more investors. Turning down investors is surprisingly hard.

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<sup>6</sup><http://venturehacks.com/articles/create-a-market>

## You're not “shopping around”.

Finally, don't use the words “shopping around” or “auction” with investors. Their reaction to these terms is,

“What am I, a bag of money? I can only get in this deal if I pay the most?”

You're not “shopping around”, you're “looking for the right partner”. While you're talking to investors, you can define the right partner in terms of domain experience, or someone who wants to invest more/less money, or someone who has a history of backing the founders, or anything but: *the guy who will pay the most.*

*Image Source: Visit Chandler<sup>7</sup>.*

## Should I pay my investor's legal fees?

“C'mon—you have \$500M and I am raising \$1.5M and you want me to take the first \$25K to pay your legal expenses for doing the deal? That's like your dad giving you your allowance and then asking you to buy him a hot dog. When we were raising money for Flixster I thought that must be a trick—like if I agreed to that term they would pull the term sheet at the last second and say I failed the secret fiscal responsibility test.”

— Joe Greenstein<sup>8</sup>, Founder of Flixster<sup>9</sup>

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<sup>7</sup><http://www.visitchandler.com>

<sup>8</sup><http://www.venturehacks.com/articles/reactions#comment-52>

<sup>9</sup><http://www.flixster.com/>

Summary: Venture capitalists don't want to pay their legal fees for financings. Don't fight this term—that's a "big move on a little issue." Instead, cap your contribution to the investor's legal bill. And watch the legal bills in small financings: don't spend a large portion of the investment on lawyers or give up a lot of equity for the privilege of paying your investor's legal bill.

Venture capitalists don't want to pay their legal fees for financings. We explain why in the appendix below.

So startups often pay their investor's legal fee. An investor gives you money, you use some of the money to pay his lawyer, and the investor buys a little bit of your company with his legal bill!



## **Pay your investor's legal bill.**

Although paying your investor's legal fee may fall outside the bounds of common sense, don't try to remove this term. It's an industry norm.

Norms are made to be broken, but this one isn't worth it. You will do a lot of work to win this argument and you will gain very little. "Make big moves on your little issues and little moves on your big issues," writes G. Richard Shell<sup>10</sup> in Bargaining for Advantage<sup>11</sup>. This is a little issue.

Also consider your investor's perspective. In every other financing, their investee paid the fund's legal fee. Are you really going to ask your investor to go to his partnership and say, "Hey, this deal is going to cost us \$50K in cash money."

### **Cap your contribution to the investor's legal bill.**

When you pay your investor's legal bill, you're paying their lawyers to negotiate against you. You're paying their lawyers to make your deal worse.

You may have to pay your investor's legal bill but you certainly don't need to keep paying their lawyers until they run out of things to say. Put a cap on your contribution.

Without a cap, their lawyers will just keep arguing and collecting fees. With a cap, they'll stop arguing once they hit the limit.

Propose a cap between \$10K-\$20K and let them make the case for a higher limit. Some investments require more legal work and *some require less*: in one rare case, we saw a top-tier investor do a large Series A financings (\$10M) with no external counsel at all.

Many caps include the fees for both sides, *i.e.* the company shall pay no more than \$X for the sum of the investor's and company's

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<sup>10</sup><http://www.google.com/search?num=20&hl=en&lr=&safe=off&q=%22g.+richard+shell%22&btnG=Search>

<sup>11</sup>[http://www.amazon.com/Bargaining-Advantage-Negotiation-Strategies-Reasonable/dp/0143036971/ref=pd\\_bbs\\_sr\\_1?ie=UTF8&s=books&qid=1197258930&sr=8-1](http://www.amazon.com/Bargaining-Advantage-Negotiation-Strategies-Reasonable/dp/0143036971/ref=pd_bbs_sr_1?ie=UTF8&s=books&qid=1197258930&sr=8-1)

legal fees. It makes more sense to cap only your investor's legal fee... but hey! this is venture capital, not math camp.

### **Watch the legal bills in small financings.**

Don't spend \$20K on lawyers if you're raising \$50K. Not only are you spending a lot of the investment on lawyers, but you're giving up a significant chunk of equity for the privilege of paying your investor's legal bill. Investors recognize this issue and usually pay their own legal bills in debt financings.

If the investor's expected legal bill is a large percentage of the investment, you could increase the investment to cover the bill and increase your pre-money to cancel out the dilution from the extra money. This makes sense but it's also a "big move on a little issue."

Instead, calculate your effective pre-money and do an apples-to-apples comparison to your alternatives. For example, if you raise \$50K on a \$50K pre-money and spend \$10K of the investment on your investor's legal fee, your effective pre-money is only \$40K since your investor bought half the company and you got \$40K. In general,

$$\text{effective pre-money} = \text{pre-money} \times (\text{investment} - \text{investor's legal}) \div \text{investment}$$

This is similar to calculating your effective pre-money in the option pool shuffle<sup>12</sup>.

### **Appendix: Why investors don't want to pay their legal bills.**

Many people think investors don't want to pay their legal bills because the money would come out of the investors' own pock-

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<sup>12</sup><http://venturehacks.com/articles/option-pool-shuffle>

ets. The argument goes like this: VCs pay their salaries from the fund's management fee<sup>13</sup> and if they had to spend the management fee on legal bills, they would have to reduce their salaries.

But investors already pay various expenses such as ongoing legal fees or accounting fees without touching their management fee.

And there are good reasons why investors and their limited partners may not want to pay legal fees out of the management fee: (1) legal fees are a variable expense so it's hard to include them in a budget that justifies the management fee to limited partners, and (2) limited partners don't want investors to feel like they're taking money out of their own pockets to do legal diligence.

(Of course, all these issues are irrelevant for investors who are investing their own money.)

We don't know how or why this became the norm, but there are several advantages and few disadvantages for the investor whose investee pays the legal bills. Paying the investor's legal bill:

- Insects you to not argue too much or quibble over basic things that investors will never remove.
- Lets the investor buy a little piece of the company with his legal bill.
- Avoids discussion about how to split the bill<sup>14</sup> among multiple investors.
- May slightly reduce the hurdle for the investor's carry<sup>15</sup>, depending on the investor's agreement with his limited partners.

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<sup>13</sup>[http://www.purevc.com/pure\\_vc/2006/03/vc\\_primer\\_manag.html](http://www.purevc.com/pure_vc/2006/03/vc_primer_manag.html)

<sup>14</sup><http://www.theonion.com/content/node/52324>

<sup>15</sup>[http://www.purevc.com/pure\\_vc/2006/02/the\\_carry.html](http://www.purevc.com/pure_vc/2006/02/the_carry.html)

*Image Source: University of Virginia<sup>16</sup>.*

## Is it safe to send my deck to investors?

“I know plenty of VCs that behave the way I do and plenty that don’t.”

— Brad Feld<sup>17</sup>, on keeping decks to himself

Summary: A deck can help you get a meeting but it can also get in the hands of the competition. Whether you send a deck depends on who wants the meeting most. If you want the meeting more than they do, provide what they want. If they want the meeting more than you do, provide what you want. Finally, keep your secrets secret.

In What should I send investors?<sup>18</sup>, we suggested sending investors a deck that describes your business plan. A reader subsequently emailed us and asked:

“Do I really want my business plan floating out there in venture land? What if it gets to my competitors? Is it safe to send my deck to investors?”

First, *focus on executing your idea so you can make it public instead of focusing on how to keep it private*. Second...

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<sup>16</sup><http://demolab.phys.virginia.edu/demos/demos.asp?Demos=F&Subject=1&Demo=1F20.22>

<sup>17</sup>[http://www.askthevc.com/2007/12/are\\_watermarks\\_on\\_presentation.php](http://www.askthevc.com/2007/12/are_watermarks_on_presentation.php)

<sup>18</sup><http://venturehacks.com/articles/deck>

## **There are pros and cons to sending a deck.**

We can't tell you whether you should send a deck. At times, we have sent decks and, at other times, we have avoided sending decks. There is no right answer but there are pros and cons that you can consider as you make your decision.

The pro is it might help you get a meeting.

The first con is it can lower the effectiveness of your electronic pitch. Sometimes less is more. If you've got a great elevator pitch<sup>19</sup> and introduction, do you need to send a relatively long document filled with arguments that are better delivered in person?

The second con is...

## **Your deck can get in the hands of the competition.**

In Spice Girls VC<sup>20</sup>, Rich Skrenta writes:

“So one day a few years ago I’m sitting in a VC’s office having a chat. I had a few ideas rattling around in my head but the VC had his eyes on a then-current space which was hot. He tossed a business plan for one of the leading startups into my lap.

“Where’d you get this?” I asked.

“They gave it to me.”

“He went on to talk about how he wanted to launch a company into the space as well...”

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<sup>19</sup><http://venturehacks.com/articles/elevator-pitch>

<sup>20</sup>[http://www.skrenta.com/2007/11/spice\\_girls\\_vc.html](http://www.skrenta.com/2007/11/spice_girls_vc.html)

Your deck probably won't get in the hands of the competition, but you should assume it will.

An investor's notes can also get in the hands of the competition. And if an "evil" investor cares enough about your company to email your deck to the competition, he cares enough about your company to schedule a meeting and take notes.

### **Send a deck if you want the meeting more than they do.**

Whether you send a deck depends on who wants the meeting most. Use this simple test:

If **you** want the meeting more than they do, provide what **they** want.

If **they** want the meeting more than you do, provide what **you** want.

It all comes down to who has the most leverage—that's it. And leverage comes from traction<sup>21</sup>. *Traction speaks louder than plans.*

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<sup>21</sup><http://venturehacks.com/articles/plans-ndas-traction#traction>



## Keep confidential things confidential.

If you do send a deck, keep confidential things to yourself. In What should I send investors?<sup>22</sup>, we wrote:

“Write “Proprietary and Confidential. Please do not distribute. Prepared for Blue Shirt Capital,” on the cover of your deck (some companies write it on every page). Investors are less likely to forward it if their name is on it. And ask any recipients, in writing, via email, to kindly not distribute the deck outside their firm.

“And if you must keep something absolutely confidential, don’t email it to investors and don’t mention

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<sup>22</sup><http://venturehacks.com/articles/plans-ndas-traction>

it in person. Investors often look at several similar companies at once. Your plans probably won't get to your competitors, but you should assume they will."

Finally, you might want to try the private sharing feature on SlideShare<sup>23</sup>. Please leave a comment if you do, we haven't tried it yet.

*Related: Are Watermarks on Presentations Useful?*<sup>24</sup>

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<sup>23</sup><http://www.slideshare.net/>

<sup>24</sup>[http://www.askthevc.com/2007/12/are\\_watermarks\\_on\\_presentation.php](http://www.askthevc.com/2007/12/are_watermarks_on_presentation.php)

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## Venture Hacks on Twitter



venturehacks

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**Steve Jobs does customer development, Part 2: Improving the business without improving the product; <http://bit.ly/rYO6J>.**

10:54 AM Sep 11th from bit.ly

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"Usually if [you] sell a lot of something, you want to tell everybody." - Steve Jobs, <http://bit.ly/P4t8G>

2:49 PM Sep 10th from Twaitter

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"There's not a drop of flash on this website [iTunes Store], from the rotating banners to the music preview player." - <http://bit.ly/Wjqmh>

12:47 PM Sep 10th from Twaitter

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**Steve Jobs does customer development: <http://bit.ly/2JXuv>**  
Yes, even Steve Jobs. The first new blog post on Venture Hacks in quite a while.

10:48 AM Sep 10th from web

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"How can you tell the difference between an Ice Cream Glov and a Snuggie? You can't. Only your customers can." - Ries <http://bit.ly/82tOo>

3:02 PM Sep 3rd from web

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**Hypothesis: Most consumer internet startups fail because they build products they want to use. And that's also how the huge ones succeed.**

1:26 PM Sep 1st from Twaitter

(RSS<sup>27</sup>).

We'll be posting interesting quotes, links, and other things we like. We've started with a few quotes:

“Common stock is decorative.” – Anonymous Investor

“Valuation is temporary, control is forever.” – Venture Hacks<sup>28</sup>

“You never ask board members what they think. You tell them what you're going to do.” – Bill Watkins<sup>29</sup>, CEO of Seagate

If you use Twitter, feel free to send us quotes, ideas, tips, suggestions @venturehacks<sup>30</sup>.

I also have a personal Twitter profile where I post aphorisms: twitter.com/nivi<sup>31</sup> (RSS<sup>32</sup>). Here's a few to get you started:

“Confidence in nonsense is required.” – Burt Rutan<sup>33</sup>, Aircraft Designer

“None of us have a real understanding of where we are heading. I don't. I have senses about it.” – Andy Grove<sup>34</sup>, CEO of Intel

“You can't be normal and expect abnormal returns.” – Jeffrey Pfeffer<sup>35</sup>, Stanford Business School

If you use Twitter, feel free to reach me @nivi<sup>36</sup>.

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<sup>26</sup><http://twitter.com/venturehacks>

<sup>27</sup>[http://twitter.com/statuses/user\\_timeline/11620792.rss](http://twitter.com/statuses/user_timeline/11620792.rss)

<sup>28</sup><http://tinyurl.com/25cdch>

<sup>29</sup><http://tinyurl.com/y9hu6p>

<sup>30</sup><http://twitter.com/venturehacks>

<sup>31</sup><http://twitter.com/nivi>

<sup>32</sup>[http://twitter.com/statuses/user\\_timeline/644863.rss](http://twitter.com/statuses/user_timeline/644863.rss)

<sup>33</sup><http://tinyurl.com/2x3drg>

<sup>34</sup><http://tinyurl.com/yo55py>

<sup>35</sup><http://tinyurl.com/ysuft6>

<sup>36</sup><http://twitter.com/nivi>

## Should I give my lawyers equity?

Summary: When lawyers defer their legal fees, they expect equity for the risk of not getting paid. If their risk is low or they're not deferring fees, you can say no. In any case, offer them the right to invest \$25K-\$50K in your financing instead of giving them free equity.

A reader asks:

"I wonder if I could pester you briefly for lawyer advice. We are talking to a law firm and I've got their standard letter of engagement which asks for *the right to purchase 1% of common stock at the same price as founders*. Their other terms seem reasonable but this term seems pretty tough. What do you think?"

This is a common 'ask' by lawyers.

It's also an example of a negotiation axiom: *you get what you ask for*. Particularly when one side is relatively clueless about industry norms, the other side's strategy is to ask and expect their clueless opponent to say yes.



## **Lawyers want equity for deferring their legal fees.**

If your lawyers are *not* deferring their legal fees, you should just say no. You're already paying them for their services, right?

If your lawyers *are* deferring their legal fees, they can ask for whatever they like: equity, backrubs, your car, whatever. They want compensation for the risk of never getting paid. That's fair.

But if your financing is imminent or nearly certain, the risk of not getting paid is low and you can still say no. Or give them the minimum equity you would give an advisor: roughly .1% vesting monthly over 1-2 years with no cliff.

## **Equity doesn't incent lawyers to work on your case.**

Most law firms spread the equity to (1) just the partners or (2) across the entire firm. In either case, the partner on your case

receives nearly zero equity and the associate who does all the work receives even less.

Unless you hire a one-man law firm, equity doesn't incent lawyers to work on your case.

### **Let your lawyers invest instead of giving them free equity.**

In any case, if your lawyers ask for a piece of the business, you can offer them the right to invest \$25K-\$50K in your financing instead—don't give them the equity for free. They get equity, you get money.

This unfortunately incents your lawyers to drive down the share price of your financing, but this conflict of interest is small relative to their existing conflicts of interest:

Most law firms do a lot more business with VCs than they're likely to do with you. VCs hire law firms. VCs refer new clients to law firms. Lawyers make money by executing transactions and your investors simply provide more transactions than you do.

So don't sweat this minor conflict of interest.

*Image Source: My Cousin Vinny*<sup>37</sup>

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<sup>37</sup><http://www.youtube.com/watch?v=1q7mjoxHzm4>

# January 2008

## The top 3 hacks of the year

Happy New Year and here's to an effective<sup>1</sup> 2008.



Here are the three most effective hacks of 2007. We maintain a Cheat Sheet<sup>2</sup> of all the hacks, but try to apply these three if you don't have time to apply them all.

Create a market for your shares<sup>3</sup>

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<sup>1</sup><http://www.design.caltech.edu/erik/Misc/Drucker.html>

<sup>2</sup><http://venturehacks.com/term-sheet-hacks>

<sup>3</sup><http://venturehacks.com/articles/create-a-market>

You need strong alternatives to hack a term sheet. Create alternatives with focus: pitch and negotiate with all your prospective investors at once. Focus compounds scarcity and social proof, which closes deals. Focus also yields a quick yes or no from investors—either way, you will soon get back to building your business.

*Related:* You can't clear the market in series<sup>4</sup>.

Create a board that reflects the ownership of the company<sup>5</sup>

Create a board of directors that reflects the ownership of the company and don't let your investors control the board through an independent board seat.

The composition of the board of directors<sup>6</sup> is the most important element of the Series A investment. It is more important than the valuation<sup>7</sup> of your company.

The valuation of your company won't matter to you if the board (1) terminates you and you lose your unvested<sup>8</sup> stock, (2) forces the company to raise a low-valuation Series B from existing investors by rejecting offers until the company is almost out of cash, (3) merges the company with another private company and wipes out your common stock<sup>9</sup> in the process.

*Related:* Make a new board seat for a new CEO<sup>10</sup>.

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<sup>4</sup><http://venturehacks.com/articles/adam-smith#series>

<sup>5</sup><http://venturehacks.com/articles/board-structure>

<sup>6</sup>[http://www.feld.com/blog/archives/2005/01/term\\_sheet\\_boar.html](http://www.feld.com/blog/archives/2005/01/term_sheet_boar.html)

<sup>7</sup>[http://www.feld.com/blog/archives/2005/01/term\\_sheet\\_pric.html](http://www.feld.com/blog/archives/2005/01/term_sheet_pric.html)

<sup>8</sup>[http://www.feld.com/blog/archives/2005/05/term\\_sheet\\_-ve.html](http://www.feld.com/blog/archives/2005/05/term_sheet_-ve.html)

<sup>9</sup>[http://www.feld.com/blog/archives/2004/07/liquidation\\_pre.html](http://www.feld.com/blog/archives/2004/07/liquidation_pre.html)

<sup>10</sup><http://www.venturehacks.com/articles/ceo-board-seat>

## The Option Pool Shuffle<sup>11</sup>

Don't let your investors determine the size of the option pool for you. Use a hiring plan to justify a small option pool, increase your share price, and increase your *effective* valuation.

Advanced students—here are the next three most effective hacks:

1. Focus on your share price, not your valuation<sup>12</sup>
2. Accelerate your vesting upon termination<sup>13</sup>
3. Unbundle money and value-add<sup>14</sup>

See the Cheat Sheet<sup>15</sup> for all the hacks.

## Terminating Cisco's founders

Don Valentine<sup>16</sup> from Sequoia Capital and Cisco's founders, Len Bosack<sup>17</sup> and Sandy Lerner<sup>18</sup>, discuss Len and Sandy's termination in this rare video:

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<sup>11</sup><http://venturehacks.com/articles/option-pool-shuffle>

<sup>12</sup><http://venturehacks.com/articles/share-price>

<sup>13</sup><http://venturehacks.com/articles/acceleration-termination>

<sup>14</sup><http://venturehacks.com/articles/dumb-money>

<sup>15</sup><http://venturehacks.com/term-sheet-hacks>

<sup>16</sup><http://www.sequoiacap.com/people/donald-valentine/>

<sup>17</sup>[http://en.wikipedia.org/wiki/Len\\_Bosack](http://en.wikipedia.org/wiki/Len_Bosack)

<sup>18</sup>[http://en.wikipedia.org/wiki/Sandy\\_Lerner](http://en.wikipedia.org/wiki/Sandy_Lerner)



We don't know the actual facts of the matter and we don't care who is "right". The lesson here is that, right or wrong, you don't want to look back and feel the way Len and Sandy do (except for the many millions they made).

There is no such thing as a "bad" deal as long as you understand the deal's pros, cons, and possible outcomes. But Len and Sandy, by their own admission, did not. We'll discuss how to avoid Len and Sandy's fate in an upcoming hack. Knowledge is power.

Some interesting quotes from the video:

"Len and I were not [savvy]."- Sandy Lerner video→<sup>20</sup>

"I would strongly advise anybody watching this pro-

<sup>19</sup><http://video.google.com/videoplay?docid=-2534997893350167670#51m59s>

<sup>20</sup><http://video.google.com/videoplay?docid=-2534997893350167670#52m38s>

gram not to do [what we did]... get your own [personal] lawyer.” – Sandy Lerner →<sup>21</sup>

“One day... seven vice-presidents of Cisco Systems showed up in my office... the outcome of which was a very simple alternative: either I relented and allowed the president to fire Sandy Lerner or they, all seven, would quit.” – Don Valentine →<sup>22</sup>

“[Sandy and Len] urgently sold their shares in Cisco at a time when the valuation of the company was a mere \$1B.” – Don Valentine →<sup>23</sup>

## How well do investors recruit?

“Nearly 100% of the investors interviewed believe that they add value to their portfolio companies. Unfortunately... only 45% of the entrepreneurs interviewed indicated that they believe that was the case.”

— Matthew Louie and Cali Tran<sup>24</sup>, Harvard M.B.A. Students  
Every investor claims to add value. But how much value do they really add? In particular, how well do they help with recruiting?

### 18% of executive hires come from investors.

Founder Frustrations<sup>25</sup> presents some interesting data in In-

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<sup>21</sup><http://video.google.com/videoplay?docid=-2534997893350167670#53m35s>

<sup>22</sup><http://video.google.com/videoplay?docid=-2534997893350167670#55m10s>

<sup>23</sup><http://video.google.com/videoplay?docid=-2534997893350167670#56m00s>

<sup>24</sup><http://founderresearch.blogspot.com/2006/10/investorenpreneur-value-expectation.html>

<sup>25</sup><http://founderresearch.blogspot.com/>

vestors (and Managers) as Headhunters<sup>26</sup>:

“Investors provide leads to a significant subset of hired executives (an average of 18% of executive hires). However, they trail both the non-CEO members of the management team (who referred, on average, 29% of executive hires) and CEOs (36%).

“The major exceptions were for the CEO and CFO positions, for which the percentages [for investor leads] jumped to 28% and 30%.”

Translation: investors refer 18% of hired executives, employees refers 65%, and “other sources” refer the remaining 17%.

### **Hire investors for money-add and employees for value-add.**

This data is consistent with our suggestion that you should hire investors for their money-add<sup>27</sup>. Investors *do* add value, but you should assume their primary contribution will be money. Most of your value-add comes from employees, not investors.

First, find an investor who will make an investment decision quickly, who is humble and trustworthy, who will treat you like a peer, who shares your vision<sup>28</sup>, and is betting on you, not the market. If you’re lucky enough to find more than one of these investors, you can start thinking about which one will add the most value.

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<sup>26</sup> <http://founderresearch.blogspot.com/2008/01/investors-and-managers-as-headhunters.html>

<sup>27</sup> <http://venturehacks.com/articles/dumb-money>

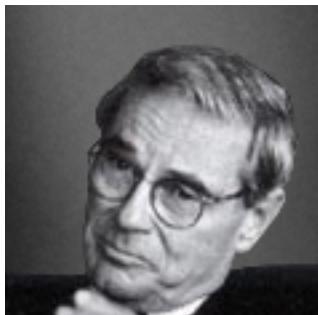
<sup>28</sup> [http://avc.blogs.com/a\\_vc/2007/10/why-do-you-want.html](http://avc.blogs.com/a_vc/2007/10/why-do-you-want.html)

## Ignore the averages: How will your investors help you?

Finally, this survey is really interesting, but it measures averages. You don't care how the *average* investor helps the *average* entrepreneur. You care about how *your* investor will help *you*. And the only way to figure that out is by referencing your investors<sup>29</sup>.

*Related:* Investor/Entrepreneur Value Expectation Gap<sup>30</sup>.

## Tom Perkins of KPCB interviewed



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Tom Perkins<sup>32</sup> from Kleiner Perkins<sup>33</sup> slaps us with knowledge in this interview with Creative Capital<sup>34</sup>. Here are some choice quotes from the beating:

<sup>29</sup><http://altgate.typepad.com/blog/2007/11/reverse-due-dil.html>

<sup>30</sup><http://founderresearch.blogspot.com/2006/10/investorenrepreneur-value-expectation.html>

<sup>31</sup><http://www.kpcb.com/team/index.php?Tom%20Perkins>

<sup>32</sup><http://www.kpcb.com/team/index.php?Tom%20Perkins>

<sup>33</sup><http://www.kpcb.com/>

<sup>34</sup><http://creativecapital.wordpress.com/2008/01/17/valley-boy-part-1-of-an-interview-with-vc-pioneer-thomas-j-perkins/>

## On Timing

“It’s always a good time to be in venture capital.”

“You can’t look at the stock market and decide whether or not to invest in a startup.”

“The growth of technology has been just about the only constant in our economy for a very long time.”

“[Is green technology trendy?] Sure, it’s trendy but you can’t ignore trends.”

“I love bubbles. We made a lot of money in bubbles.”

Tom speaks from the perspective of an investor but everything he says also applies to entrepreneurship.

## On Venture Capital

“I used to say venture capital was like a pilot light. But now it’s like a roaring glass furnace.”

“There’s always been too much money in venture capital. It doesn’t mean you can’t make... money in venture capital.”

“Money is the least differentiated of all commodities. And venture capitalists are in the business of selling money.”

“[Where would I be if I was just getting into the Valley today?] Always as an entrepreneur. Never as a venture capitalist.”

You can find these aphorisms and more in Venture Hacks’ Twitter updates<sup>35</sup>.

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<sup>35</sup><http://twitter.com/venturehacks>

## How do I find a lead investor, part 1

“Those kind of ‘sit on the sideline’ investors are worthless to you if you want to get a financing done... if you are raising a financing of any kind, spend all of your time looking for a lead investor.”

— Fred Wilson<sup>36</sup>, Union Square Ventures

Summary: Financings happen when you find a *lead investor*, negotiate a term sheet, and if there's room, politely tell followers that they can take it or leave it. Alternatively, if you have a group of seed investors who aren't asking you to find a lead, you can *mass syndicate* the round without a lead. Finally, ‘find a lead’ often means ‘no’.

So Bill the Cat writes in:

“We're out on the warpath, with the aim of raising a Series A round in the \$1M range. We've had a number of people say they are interested in participating, but nobody wants to lead because they know little/nothing about our market. Is there anything we can do about that, other than just keep searching for a lead? I'm pretty confident that at this point if we found one, we'd be set.”

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<sup>36</sup>[http://avc.blogs.com/a\\_vc/2007/10/the-lead-invest.html](http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html)

## What's a lead investor?



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From Fred Wilson<sup>38</sup>'s The "Lead Investor"<sup>39</sup>:

"I got an email from a friend yesterday who... said that he's got indications of interest from a number of investors but they are all waiting for a "lead investor".

"I told him that what he has is a bunch of followers who have no real conviction about his business because if they did, they'd step up, negotiate a deal, and get their money into his company. But instead they are going to sit on the sidelines, wait until someone with conviction shows up, and then try to get in alongside the investor with conviction.

"Those kind of "sit on the sideline" investors are worthless to you if you want to get a financing done. They don't impress the kind of investors who have conviction because investors with conviction are going to want all of the deal for themselves (or their friends they will bring in alongside of them).

"If you are raising a financing of any kind, spend all of your time looking for a lead investor."

*Lead investors* want at least half the round—and they often want the entire thing. If they don't want the entire round, they

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<sup>37</sup>[http://avc.blogs.com/a\\_vc/2007/10/the-lead-invest.html](http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html)

<sup>38</sup><http://www.unionsquareventures.com/team/>

<sup>39</sup>[http://avc.blogs.com/a\\_vc/2007/10/the-lead-invest.html](http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html)

will help you find followers (and some leads will even close before you find followers). They believe your stock is worth more than they're paying. They don't need social proof or scarcity to make an investment decision. Like great entrepreneurs, they are mavericks.

Financings happen when you find a lead, negotiate a term sheet, and if there's room, *politely* tell followers that they can take it or leave it.

Lead investors who bet on unproven markets, products, or teams (or all of the above) are rare. If you're unproven, don't be surprised if fund-raising takes time.

## **"Find a lead" might mean "no". #**



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"Investors saying that they are waiting for a lead are also saying 'no' without saying no... They don't want to miss out if this thing takes off (e.g., "Hey, we told you we were in, I hope you saved 10 percent for us!"), but they have no conviction and don't want to say no in case they're wrong."

— Dick Costolo<sup>41</sup>, Founder of FeedBurner

Instead of saying "no", an investor might ask you to "find a lead". Why? He wants to maintain an option to invest. If you

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<sup>40</sup> [http://avc.blogs.com/a\\_vc/2007/10/the-lead-invest.html#comment-6557](http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html#comment-6557)

<sup>41</sup> [http://avc.blogs.com/a\\_vc/2007/10/the-lead-invest.html#comment-6557](http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html#comment-6557)

find a great lead or the company starts kicking ass, the follower will say he intended to invest all along.

By telling you to find a lead, the follower is trying to extract a subtle commitment from you and manipulate your psychological desire to follow through on your commitments. Negotiators call this a *consistency trap*. We'll show you how to avoid this trap in Part 2.

Professional investors (VCs) have two legitimate reasons to not lead: #<sup>42</sup>

1. Your business is too far away and they want you to find a local lead<sup>43</sup>, e.g. you're in Shanghai and your investors are in Boston.
2. The investor's typical investment is less than half of your round.

In either case, the follower should *partner* with you to find a lead. His level of effort will tell you if he really wants to find a lead or he just doesn't want to say 'no'.

## You can mass syndicate seed rounds without a lead. #

Small seed funds that are investing their personal money and non-professional investors like angels may have other good reasons to not lead: they don't want to deal with negotiating terms and hiring a lawyer, their portion of the financing is too small to lead, they like you but they don't know the market, *et cetera*. #<sup>44</sup>

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<sup>42</sup><http://venturehacks.com/#vc-reasons>

<sup>43</sup>[http://avc.blogs.com/a\\_vc/2007/10/the-lead-invest.html#comment-6521](http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html#comment-6521)

<sup>44</sup><http://venturehacks.com/#angel-reasons>

If this is the case, you might not need a lead. If you have a group of seed investors who are not explicitly asking you to find a lead, you should:

1. Generate a term sheet. Your advisers and lawyers can help with the terms.
2. Get feedback on the terms from prospective investors at the end of the first meeting. They will ask about the terms if they're at all interested.
3. Incorporate the feedback into the term sheet.
4. Once enough prospective investors have said 'yes', circulate the term sheet with a list of investors who have committed to the financing.
5. Incorporate any additional feedback and send the closing documents to everyone. Set the closing date two weeks out.

## How do you find a lead?

In Part 2<sup>45</sup>, we'll suggest some ways to find a lead if you can't mass syndicate the round.

*Related:* VC Cliche of the Week: We are Passing<sup>46</sup>, The Art of Saying "No" Parts 1<sup>47</sup> 2<sup>48</sup> and 3<sup>49</sup>, and More favorite VC phrases<sup>50</sup>.

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<sup>45</sup><http://venturehacks.com/articles/lead-part-2>

<sup>46</sup>[http://avc.blogs.com/a\\_vc/2005/05/vc\\_cliche\\_of\\_th\\_3.html](http://avc.blogs.com/a_vc/2005/05/vc_cliche_of_th_3.html)

<sup>47</sup>[http://billburnham.blogs.com/burnhamsbeat/2005/03/the\\_art\\_of\\_sayi.html](http://billburnham.blogs.com/burnhamsbeat/2005/03/the_art_of_sayi.html)

<sup>48</sup>[http://billburnham.blogs.com/burnhamsbeat/2005/03/the\\_art\\_of\\_sayi\\_1.html](http://billburnham.blogs.com/burnhamsbeat/2005/03/the_art_of_sayi_1.html)

<sup>49</sup>[http://billburnham.blogs.com/burnhamsbeat/2005/03/the\\_art\\_of\\_sayi\\_2.html](http://billburnham.blogs.com/burnhamsbeat/2005/03/the_art_of_sayi_2.html)

<sup>50</sup><http://rickseagal.typepad.com/pmv/2007/11/more-favorite-v.html>

## How do I find a lead investor, part 2

Summary: Here are 3 microhacks for finding a lead investor: (1) If followers have good reasons to not lead, ask them for introductions to potential leads. (2) If you're early stage, find seed investors who invest in people and high risk startups. (3) If every prospective investor says "we don't know the market," find investors who have invested in your market or similar markets.

In Part 1<sup>51</sup>, we wrote,

*"Lead investors want at least half the round—and they often want the entire thing. If they don't want the entire round, they will help you find followers (and some leads will close immediately even if they're not taking the entire round). They believe your stock is worth more than they're paying. They don't need social proof or scarcity to make an investment decision. Like great entrepreneurs, they are mavericks."*

If you're doing a seed round, you may be able to mass syndicate<sup>52</sup> the financing without a lead. Otherwise, here are three microhacks for finding a lead, in rough order of importance—but you should probably try them all.

### 1. Ask the followers for introductions.

If the followers have good<sup>53</sup> reasons<sup>54</sup> to not lead, ask them for introductions to potential leads:

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<sup>51</sup><http://venturehacks.com/articles/lead>

<sup>52</sup><http://venturehacks.com/articles/lead#mass>

<sup>53</sup><http://venturehacks.com/articles/lead#vc-reasons>

<sup>54</sup><http://venturehacks.com/articles/lead#angel-reasons>

“Can you suggest any firms who would be interested in leading this investment? Why do you think they would be interested in leading? Would you make an introduction?”

This simple test will tell you whether the follower has good reasons to not lead. If a follower won’t make introductions, he doesn’t have a good reason to not lead. If the introduction doesn’t respond aggressively, the follower probably made a half-hearted introduction—he doesn’t have a good reason to not lead. The follower’s level of effort indicates if he really wants to find a lead or he just doesn’t want to say ‘no’<sup>55</sup>. (Caveat: This logic mostly applies to VCs, not angels.)

If a follower doesn’t have a good reason<sup>56</sup> *a priori*, don’t ask him for introductions at all. Skip this microhack altogether. An introduction by someone who *can* and *should* lead but would rather follow is a useless and harmful introduction. It’s a strong negative signal. Go get your own introductions.

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<sup>55</sup><http://venturehacks.com/articles/lead#no>

<sup>56</sup><http://venturehacks.com/articles/lead#vc-reasons>



Finally, if a follower introduces you to the eventual leader, the leader will rarely cut out the follower. (Investors who don't accommodate the middleman who gives them introductions stop getting introductions.) You'll end up with two investors and more dilution. But that's better than the alternative: zero investors and no dilution.

## 2. Find seed stage investors.

Every *professional* investor's fantasy investment is a sure thing: zero risk and infinite reward. If you're early stage, you can circumvent this fun fact by doing a seed round:

1. Focus on investors who go out of their way to invest in seed stage companies with lots of risk, not investors who *say* they invest in seed stage companies:

“What seed stage companies have you backed in the last 2 years? What exactly did the company (team, product, traction) look like when you invested?”

Does your company look similar?

2. Find *non-professional* angels whose primary motivation is working with great entrepreneurs, not profit. In particular, talk to folks who already know you well and are willing to bet on *you*.

Seed investors increase the probability of raising money from VCs. High-quality seed investors raise your valuation, provide social proof, and obviate the need for extensive due diligence in the VC round. Many companies close a small seed round and do a larger VC round in a few months.

If you want to skip the seed round, mere *commitments* from high-quality seed investors have a similar effect. And these commitments provide a strong alternative as you negotiate with VCs. Obviously, if you do the VC round, don’t cut out any seed investors you have committed to.

### **3. Find investors who know your market.**

If every prospective investor says “we don’t know your market,” find investors who have backed companies in your market or similar markets.

Educate investors about your market. It’s *your* job to convince them the market is great. Find successful companies in your market and figure out how they got there, how long it took them to get there, how much money they raised, how much money they’re making, how much money they would be making if they were as smart as you are, *et cetera*.

Talk to the management at these companies and see if they will personally invest in your business or advise you. Ask if their company wants to be a strategic investor.

### **Yet more ways to find a lead.**

In Part 3, we'll suggest two more ways to find a lead investor.

Image Source: Funny Treat<sup>57</sup>.

## **How do I find a lead investor, part 3**

Summary: Here are 2 more microhacks for finding a lead investor: (4) Incent followers to lead by telling them the truth: there probably won't be room in the round for followers. (5) The best way to find a lead is to build something that attracts a lead: keep building your company and reducing risk.

In parts 1<sup>58</sup> and 2<sup>59</sup>, we presented three microhacks for finding a lead investor. Here are two more microhacks, in continuing order of importance.

### **4. Incent a follower to lead.**

Whenever someone says "find a lead", you should say,

"We're happy you're interested. We're interested in working with you too.

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<sup>57</sup><http://funnytreat.com/>

<sup>58</sup><http://venturehacks.com/articles/lead>

<sup>59</sup><http://venturehacks.com/articles/lead-part-2>

“We’re looking for a lead and a lead is going to want the entire round. Or he will bring in his own co-investors. Or we’ll build a syndicate out of investors who want to lead. So we may be back but we probably won’t.

“Most likely, the investors who get to participate in this round are those who want to lead. If you’re interested, you can secure a spot in the round by leading and we’ll work with you to set the terms and decide who gets to invest.”

*Note:* Make an exception for (1) angels you are trying to mass syndicate<sup>60</sup> and (2) investors who have good<sup>61</sup> reasons<sup>62</sup> to follow and are partnering with you to find a lead<sup>63</sup>.

This polite diatribe combines positive leverage<sup>64</sup> (“you can secure a spot in the round by leading and we’ll work with you to set the terms and decide who gets to invest”) and negative leverage (“the only people who get to participate in this round are those who want to lead”, *i.e.* you may lose the option to invest if you don’t act now.) Their reaction to this message will tell you whether they have good reasons to follow or they just don’t want to say no<sup>65</sup>.

If you have existing seed investors, you can also use them as the bad cop:

“We really like you but my existing investors are pushing me to find a lead and not spend time building a syndicate. Are you willing to lead the round?”

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<sup>60</sup><http://venturehacks.com/articles/lead#mass>

<sup>61</sup><http://venturehacks.com/articles/lead#vc-reasons>

<sup>62</sup><http://venturehacks.com/articles/lead#angel-reasons>

<sup>63</sup><http://venturehacks.com/articles/lead-part-2#introductions>

<sup>64</sup>[http://en.wikipedia.org/wiki/Leverage\\_%28negotiation%29](http://en.wikipedia.org/wiki/Leverage_%28negotiation%29)

<sup>65</sup><http://venturehacks.com/articles/lead#no>

## 5. Get past no.

“If you’ve got a good idea, market, and team, raising money won’t be your problem.”

— Sam Altman<sup>66</sup>, Founder of Loopt<sup>67</sup>

“Nobody said this would be easy.”

— Marc Andreessen<sup>68</sup>

Your company may not be good enough to raise money. So how do you get good enough? Read Marc Andreessen’s When the VCs say “no”<sup>69</sup>:

“If you’re an investor, you look at the risk around an investment as if it’s an onion. Just like you peel an onion and remove each layer in turn, risk in a startup investment comes in layers that get peeled away—reduced—one by one.

Your challenge as an entrepreneur trying to raise venture capital is to keep peeling layers of risk off of your particular onion until the VCs say “yes”—until the risk in your startup is reduced to the point where investing in your startup doesn’t look terrifying and merely looks risky.”

Marc’s goes on to describe the various layers of risk and, even better, he tells you how to peel the layers away. This is the most useful article on improving the effectiveness of startups that we have ever seen—read it<sup>70</sup>.

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<sup>66</sup><http://news.ycombinator.com/item?id=84865>

<sup>67</sup><https://loopt.com/>

<sup>68</sup>[http://blog.pmarca.com/2007/06/the\\_pmarca\\_guid\\_2.html](http://blog.pmarca.com/2007/06/the_pmarca_guid_2.html)

<sup>69</sup>[http://blog.pmarca.com/2007/06/the\\_pmarca\\_guid\\_2.html](http://blog.pmarca.com/2007/06/the_pmarca_guid_2.html)

<sup>70</sup>[http://blog.pmarca.com/2007/06/the\\_pmarca\\_guid\\_2.html](http://blog.pmarca.com/2007/06/the_pmarca_guid_2.html)



Founder risk is the number one reason startups don't get funded: the team simply does not appear up to the task. If you have a good product in a good market and you can't figure out why you keep getting rejected, look in the mirror and remove/add people until the team inspires money to fly out of investor's pockets.

This is the fifth microhack but it should really be the first, second, third, fourth, and fifth. The best way to find a lead is to build something that attracts a lead.

"No one ever got anywhere by lavishing calls on Oprah. The only time I've succeeded in my career with Oprah was [when] Oprah called us."

— Barry Krause, in *Made to Stick*<sup>71</sup>

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<sup>71</sup><http://www.madetostick.com/>

## Why do investors want control?

“Trust, but verify.”

– Ronald Reagan<sup>72</sup>

**Summary:** Investors trust the entrepreneurs they back. But they verify their expectations with contracts and control. You should do the same—with the same tools investors use: contracts and control.

Why do investors want to control their investments through board seats<sup>73</sup> and protective provisions<sup>74</sup>? Shouldn’t they just give entrepreneurs bags of money and trust them to do the right thing?

David Hornik<sup>75</sup> has the answer in Venture Capital in China<sup>76</sup>:

“One investor with whom I met on my [China] trip described a recent situation in which he funded an entrepreneur, only to have that entrepreneur turn around and leave for business school months later. The entrepreneur assured the investor that he would be better situated to make the business a success after the two years of school. The investor had no recourse as his money left the country with the entrepreneur.

“In another instance, an investor backed an entrepreneur in a business that thereafter appeared to be failing. However, a couple years later when the same company started thriving, the entrepreneur informed the investor that it was not the company he had backed.

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<sup>72</sup>[http://en.wikipedia.org/wiki/Ronald\\_Reagan](http://en.wikipedia.org/wiki/Ronald_Reagan)

<sup>73</sup><http://venturehacks.com/term-sheet-hacks#bod>

<sup>74</sup><http://venturehacks.com/term-sheet-hacks#protective-provisions>

<sup>75</sup><http://www.augustcap.com/team/dh.shtml>

<sup>76</sup>[http://ventureblog.com/articles/2008/01/venture\\_capital\\_in\\_china.php](http://ventureblog.com/articles/2008/01/venture_capital_in_china.php)

The investor was incredulous. He told the entrepreneur that it was the very same company with the same team and even the same name. The entrepreneur assured the investor that it was, in fact, a different company and that he had not invested in this successful company, his investment was in the previous failed venture. Despite the obvious deception, the investor told me that he again had no legal recourse.

“...the legal structures needed to support a vibrant startup economy [in China] are, at best, embryonic. Neither entrepreneurs nor investors are particularly well protected by the Chinese legal system.”

### **Investors trust, but verify.**

Investors trust the entrepreneurs they back. They wouldn’t invest if they didn’t. Their trust is an expectation that entrepreneurs will:

1. Do what they say they’re going to do in *anticipated* situations.
2. Consider the investor’s interests in *unanticipated* situations.

Investors have been playing this game long enough to anticipate certain situations. So they use contracts and courts to enforce their expectations in those situations:

Investors trust entrepreneurs to stay at the company for 4 years, and they verify it with a vesting schedule<sup>77</sup>.

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<sup>77</sup><http://venturehacks.com/term-sheet-hacks#vesting>

Investors trust entrepreneurs to pay the investors first when the company exits, and they verify it with a liquidation preference<sup>78</sup>.

Investors trust entrepreneurs to consider their interests in an acquisition, and they verify it with protective provisions<sup>79</sup> and board seats<sup>80</sup>.

Investors have been playing this game long enough to also know that you can't anticipate every situation. So they use control to dispose the company towards the investor's interests in unanticipated situations.

## **Verify your expectations.**

China doesn't seem to have a legal system that lets investors and entrepreneurs verify their expectations. They have trust, but no verification.

But U.S. investors can trust and verify. And you should do the same—with the same tools investors use: contracts and control.

If you trust your investors to let you stick around long enough to vest all your shares, accelerate your vesting upon termination<sup>81</sup>.

If you trust your investors to let the board make the call on acquisition offers, automatically suspend protective provisions<sup>82</sup> when the offer is big enough (*e.g.* a 3x return).

If you trust your investors to let the founders run the company, control the board<sup>83</sup>.

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<sup>78</sup>[http://www.feld.com/blog/archives/2004/07/liquidation\\_pre.html](http://www.feld.com/blog/archives/2004/07/liquidation_pre.html)

<sup>79</sup><http://venturehacks.com/term-sheet-hacks#protective-provisions>

<sup>80</sup><http://venturehacks.com/term-sheet-hacks#bod>

<sup>81</sup><http://venturehacks.com/articles/acceleration-termination>

<sup>82</sup><http://venturehacks.com/term-sheet-hacks#protective-provisions>

<sup>83</sup><http://venturehacks.com/term-sheet-hacks#bod>

Writing a contract doesn't mean you don't trust the other guy.  
It just means you want to document and verify your trust.



# February 2008

## **Everything you ever wanted to know about advisors, part 1**

Here are answers to some frequently asked questions about advisors. If you have additional questions, email us at ask@venturehacks.com<sup>1</sup>.

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#### **General**

1. What do advisors do?<sup>2</sup>
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6. How can I tell if an advisor is any good?<sup>7</sup>

#### **Compensation** (coming in Part 2)

1. What should I pay advisors?

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<sup>1</sup>mailto:ask@venturehacks.com

<sup>2</sup><http://venturehacks.com/#do>

<sup>3</sup><http://venturehacks.com/#board>

<sup>4</sup><http://venturehacks.com/#good>

<sup>5</sup><http://venturehacks.com/#apply>

<sup>6</sup><http://venturehacks.com/#find>

<sup>7</sup><http://venturehacks.com/#test>

2. What are advisory shares?
3. Why should I pay advisors?
4. Should I give my investors equity for being advisors?

## General

### **1. What do advisors do?**

They provide advice, introductions, and social proof. Any combination of these three is useful, except for an advisor who just provides social proof—savvy folks don’t take those advisors seriously.

### **2. Should I put together a board of advisors?**

A “board” of advisors is not a formal legal entity like a board of directors, which is defined in the Constitution and shit. You don’t need a board to collect advisors.

Create a board if it makes you and your advisors happy. Perhaps some advisors feel fancy if they’re on a board. But it really doesn’t mean anything.

### **3. How do I get good advice?**

Ask questions. I usually ask questions about my immediate goals for the next day and week. This sounds obvious but most people simply don’t know how to get good advice and apply it.

Some entrepreneurs set up quarterly advisory board meetings and that probably works well for them. But we find savvy entrepreneurs tend to be transactional—they ping their advisors as needed and skip the advisory board meetings.

## 4. How do I apply advice?

Don't follow advice. Instead, learn<sup>8</sup> from your advisor and apply the lessons to your company.

Your advisor isn't you: he doesn't have your goals, history, or strengths and weaknesses. He doesn't know your company like you do. So take the advice and apply it to your specific situation. This is the *advisor paradox*: hire advisors for good advice but don't follow it (apply it).

Even good advisors may guide you with conventional wisdom. And startups are about applying unconventional wisdom. Your task is to hire the maverick advisors in the crowd.

"You can't be normal and expect abnormal returns."

– Jeffrey Pfeffer<sup>9</sup>, The Human Equation<sup>10</sup>

## 5. How do I find advisors?

From your network and cold calls. There is no magic solution. Hiring advisors is an ongoing effort. Start now and continue until you're dead.

If you're working on something interesting, smart people will offer to help you. The contrapositive is also true: if smart people don't offer to help you, you're probably not working on something interesting.

Personally, I'm always asking people for advice. I try to turn the folks that give great answers into advisors.

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<sup>8</sup><http://www.nivi.com/blog/article/what-is-learning-part-1>

<sup>9</sup>[http://www.amazon.com/Human-Equation-Building-Profits-Putting/dp/0875848419/ref=pd\\_bbs\\_sr\\_1?ie=UTF8&s=books&qid=1197949556&sr=8-1](http://www.amazon.com/Human-Equation-Building-Profits-Putting/dp/0875848419/ref=pd_bbs_sr_1?ie=UTF8&s=books&qid=1197949556&sr=8-1)

<sup>10</sup>[http://www.amazon.com/Human-Equation-Building-Profits-Putting/dp/0875848419/ref=pd\\_bbs\\_sr\\_1?ie=UTF8&s=books&qid=1197949556&sr=8-1](http://www.amazon.com/Human-Equation-Building-Profits-Putting/dp/0875848419/ref=pd_bbs_sr_1?ie=UTF8&s=books&qid=1197949556&sr=8-1)

## 6. How can I tell if an advisor is any good?

Try before you buy. Most advice is awful. Including advice from successful entrepreneurs. (Successful people probably have an intrinsic lead on making introductions though—they tend to have better networks.)

If you're considering a prospective advisor, (i) talk to his other advisees and find out exactly what he's done for them, and (ii) get some advice or introductions first. Then hire him if you like the results. No worthwhile advisor will resist this test.

You can gauge the quality of advice by asking questions (see above). Does the prospective advisor give you the best answers you have ever heard? Could he teach a course at Harvard on the topic? Would you invest in him? If no, move on. If yes, engage him and squeeze his brain dry.

*In Part 2, we'll cover advisor compensation.*

## T-shirts for VCs

Hilarious new t-shirts for the “top 2/20%” (get it?) of the population from VC Wear<sup>11</sup>:



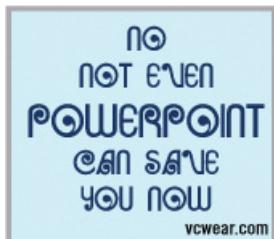
<sup>11</sup><http://www.vcwear.com/>

<sup>12</sup><http://www.vcwear.com/>

<sup>13</sup><http://www.vcwear.com/>



vcwear.com 14



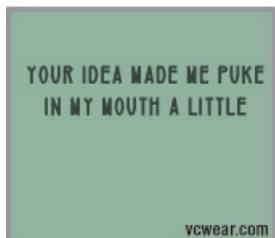
vcwear.com 15



vcwear.com 16



vcwear.com 17



vcwear.com 18



vcwear.com 19

There are more awesome t-shirts at VC Wear<sup>20</sup> as well as a Powerpoint Pitch<sup>21</sup> and a Buy it (the company) Now<sup>22</sup> button.

<sup>14</sup><http://www.vcwear.com/>

<sup>15</sup> <http://www.vcwear.com/>

<sup>16</sup><http://www.vcwear.com/>

<sup>17</sup> <http://www.yewear.com/>

<sup>18</sup><http://www.vcwear.com/>

<sup>19</sup><http://www.vcwear.com/>

<sup>20</sup> <http://www.ycwear.com/>

<sup>21</sup><http://www.ycwear.com/>

<sup>22</sup><http://www.ycwear.com/>

<http://www.vewear.com/>



There's truth in every t-shirt. I've heard that "every" VC in Silicon Valley passed on Google... sometimes more than once. David Cowan<sup>24</sup> of Bessemer Venture Partners<sup>25</sup> confesses to passing on Google in their Anti-Portfolio<sup>26</sup>:

"Cowan's college friend rented her garage to Sergey and Larry for their first year. In 1999 and 2000 she tried to introduce Cowan to "these two really smart Stanford students writing a search engine". Students? A new search engine? In the most important moment ever for Bessemer's anti-portfolio, Cowan asked her, "How can I get out of this house without going anywhere near your garage?"

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<sup>23</sup><http://www.vcwear.com/>

<sup>24</sup><http://www.bvp.com/Team/Default.aspx?id=108>

<sup>25</sup><http://www.bvp.com>

<sup>26</sup><http://www.bvp.com/Portfolio/AntiPortfolio.aspx>

## The latest quotes from our Twitter feed



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The latest great quotes from the Venture Hacks Twitter feed: [twitter.com/venturehacks<sup>28</sup>](http://twitter.com/venturehacks) (RSS<sup>29</sup>):

### Boards

“Don’t let conflicts get in the way of selecting the ideal board member.” – Fred Wilson<sup>30</sup>

“Avoid ‘big names.’ For the most part, they are useless.” – Fred Wilson<sup>31</sup>

“I was on the Spectra board and I think I nearly drove... the company CEO nuts with my ‘help’” – Tom Perkins<sup>32</sup>

### Venture Capital

“Money is the least differentiated of all commodities. And venture capitalists are in the business of selling money.” – Tom Perkins<sup>33</sup>

“Regular VCs don’t try to compete by developing innovative ways to invest; they compete for capital

<sup>27</sup><http://twitter.com/venturehacks>

<sup>28</sup><http://twitter.com/venturehacks>

<sup>29</sup>[http://twitter.com/statuses/user\\_timeline/11620792.rss](http://twitter.com/statuses/user_timeline/11620792.rss)

<sup>30</sup>[http://avc.blogs.com/a\\_vc/2008/02/thoughts-on-cho.html](http://avc.blogs.com/a_vc/2008/02/thoughts-on-cho.html)

<sup>31</sup>[http://avc.blogs.com/a\\_vc/2008/02/thoughts-on-cho.html](http://avc.blogs.com/a_vc/2008/02/thoughts-on-cho.html)

<sup>32</sup>[http://www.amazon.com/Valley-Boy-Education-Tom-Perkins/dp/1592403131/ref=pd\\_bbs\\_sr\\_1?ie=UTF8&s=books&qid=1202310633&sr=8-1](http://www.amazon.com/Valley-Boy-Education-Tom-Perkins/dp/1592403131/ref=pd_bbs_sr_1?ie=UTF8&s=books&qid=1202310633&sr=8-1)

<sup>33</sup><http://creativecapital.wordpress.com/2008/01/17/valley-boy-part-1-of-an-interview-with-vc-pioneer-thomas-j-perkins/>

and dealflow and try to pick winning investments.”  
 – Shimon Rura<sup>34</sup>

### **Money**

“All companies that go out of business do so for the same reason—they run out of money.” – Don Valentine<sup>35</sup>?

“Most businesses don’t need more cash, they need more brains.” – Mark Cuban<sup>36</sup>

“The term ‘investment banker’ is marvelously misleading... the term ‘fee-charging middlemen’ is... much closer to an accurate description of their function.”  
 – Tom Perkins<sup>37</sup>

### **Sundry**

“A private company’s valuation is solely determined by the CEO’s ability to create a one-time market for its shares.” – Venture Hacks

“The only way to find out is to find out.” – Frank Lucas, American Gangster<sup>38</sup>

If you use Twitter, feel free to send us quotes, ideas, tips, suggestions @venturehacks<sup>39</sup>.

*Image Source:* Jennifer Juniper<sup>40</sup> (*License*)<sup>41</sup>

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<sup>34</sup><http://geeksinboston.com/2008/01/29/more-combinators/>

<sup>35</sup><http://www.vccomfidential.com/2007/11/wisdoms-of-sequ.html>

<sup>36</sup><http://www.blogmaverick.com/2008/01/02/the-best-equity-is-sweat-equity/>

<sup>37</sup>[http://www.amazon.com/Valley-Boy-Education-Tom-Perkins/dp/1592403131/ref=pd\\_bbs\\_sr\\_1?ie=UTF8&s=books&qid=1202310633&sr=8-1](http://www.amazon.com/Valley-Boy-Education-Tom-Perkins/dp/1592403131/ref=pd_bbs_sr_1?ie=UTF8&s=books&qid=1202310633&sr=8-1)

<sup>38</sup>[http://en.wikipedia.org/wiki/American\\_Gangster\\_%28film%29](http://en.wikipedia.org/wiki/American_Gangster_%28film%29)

<sup>39</sup><http://twitter.com/venturehacks>

<sup>40</sup>[http://flickr.com/photos/sweet\\_child\\_of\\_mine/706541796/](http://flickr.com/photos/sweet_child_of_mine/706541796/)

<sup>41</sup><http://creativecommons.org/licenses/by-sa/2.0/deed.en-us>

## **Everything you ever wanted to know about advisors, part 2**

Here are more frequently asked questions about advisors. See Part 1<sup>42</sup> for the rest. If you have more questions, email us at ask@venturehacks.com<sup>43</sup>.

### **Frequently Asked Questions**

#### **General (from Part 1<sup>44</sup>)**

1. What do advisors do?<sup>45</sup>
2. Should I put together a board of advisors?<sup>46</sup>
3. How do I get good advice?<sup>47</sup>
4. How do I apply advice?<sup>48</sup>
5. How do I find advisors?<sup>49</sup>
6. How can I tell if an advisor is any good?<sup>50</sup>

#### **Compensation (answers follow)**

1. What should I pay advisors?<sup>51</sup>

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<sup>42</sup><http://venturehacks.com/articles/advisors>

<sup>43</sup><mailto:ask@venturehacks.com>

<sup>44</sup><http://venturehacks.com/articles/advisors>

<sup>45</sup><http://venturehacks.com/articles/advisors#do>

<sup>46</sup><http://venturehacks.com/articles/advisors#board>

<sup>47</sup><http://venturehacks.com/articles/advisors#good>

<sup>48</sup><http://venturehacks.com/articles/advisors#apply>

<sup>49</sup><http://venturehacks.com/articles/advisors#find>

<sup>50</sup><http://venturehacks.com/articles/advisors#test>

<sup>51</sup><http://venturehacks.com/#pay>

2. What are advisory shares?<sup>52</sup>
3. Why should I pay advisors?<sup>53</sup>
4. When do advisors get terminated?<sup>54</sup>
5. Should I give advisory shares to my investors?<sup>55</sup>

## Compensation

### 7. What should I pay advisors?

*Nothing—get them to pay you.* Ask advisors to invest. You get money, save stock, and amplify the advisor’s social proof in the process. But lots of good advisors can’t or won’t invest, so...

#### 7.5 What should I pay advisors if they won’t invest?

Advisors are not paid by the hour—they’re paid for results. They’re not paid for their inputs—they’re paid for their outputs. If an advisor can uncork a million dollars of your company’s latent value with 15 minutes of conversation or a single introduction, you should pay him appropriately.

There are roughly two types of advisors—we’ll call them the *normal* advisor and the *super* advisor.

#### Normal advisors

The normal advisor gets 0.1%-0.25% of a company’s post-Series A stock. Normal advisors do something important for the com-

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<sup>52</sup><http://venturehacks.com/#shares>

<sup>53</sup><http://venturehacks.com/#why>

<sup>54</sup><http://venturehacks.com/#terminate>

<sup>55</sup><http://venturehacks.com/#investors>

pany and aren't expected to do much beyond that. For example, they introduce the company to a key customer or investor.

Normal advisors are also assembled by naive entrepreneurs who think the mere presence of an advisory board will create social proof and help them raise money. But investors don't take these mock advisory boards seriously.

## **Super advisors**

The *super* advisor can get as much stock as a board member: 1%-2% of a company's post-Series A stock. Super advisors help make your company *happen*. They know all your prospective customers intimately. Or they raise your money for you. Or they bring you a handful of great employees. They can even add more value than an independent board member because they don't have to deal with corporate governance.

If you find a super advisor, you want to incent him as much as possible and push him to help make the company happen. They can be much more effective than 5 or 10 normal advisors.

Most super advisors are unique and Y Combinator<sup>56</sup> is a great example. YC takes about 6% of a company in return for \$15K-\$20K. Although most of their companies can survive with the small investment, the money is effectively meaningless—it's an artifice. Most of their companies would probably give 6% of their shares to YC for free, just to participate in the program.

YC acts like a super advisor, not an investor—and YC makes their companies *happen* by helping develop the company's product, introducing them to investors, and branding their companies.

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<sup>56</sup><http://ycombinator.com>

## Advisor compensation

Whether you're hiring a normal advisor or super advisor:

- Advisory shares are usually issued as common stock options.
- The options typically vest monthly over 1-2 years with 100% single-trigger acceleration<sup>57</sup> and no cliff<sup>58</sup>. Although the advisor is on a vesting schedule, you should expect them to add most of their value up-front—that's normal.
- Many advisors want options they can exercise immediately<sup>59</sup>—that's fine.
- If your company hasn't raised a Series A, increase the advisor's equity by roughly 30%-50% to account for dilution from seed investors, Series A investors, option pools, swimming pools, and the like.

Finally, there is a beauty to paying in equity rather than an equivalent amount of cash. If you pay for a service in cash and you want that service again, you have to pay again. If you pay in equity, you pay once and keep getting served *ad infinitum*. *Equity is the gift that keeps on giving. Your shareholders own you, but you also own them.*

## 8. What are advisory shares?

Advisory shares are normal common stock. There is no legal concept of ‘advisory shares’. The Supreme Court has never heard a case regarding advisory shares. Chief Justice Roberts doesn’t give a shit about advisory shares.

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<sup>57</sup><http://venturehacks.com/articles/acceleration-sale>

<sup>58</sup>[http://www.feld.com/blog/archives/2005/05/term\\_sheet\\_-\\_ve.html](http://www.feld.com/blog/archives/2005/05/term_sheet_-_ve.html)

<sup>59</sup><http://www.naffziger.net/blog/2007/11/12/startup-stock-options-should-you-exercise-your-options/>

## 9. Why should I pay advisors?

“Make sure that, for the people that count to you, you count to them.”

— Warren Buffett<sup>60</sup>

If someone helps your company succeed, it is only fair to share that success with them. If you want to do repeat business with people, you need to treat them right the first time around.

Equity also keeps advisors on the hook: you can go back to them again and again for help. If they were helpful once, they can probably be helpful again. And people with a financial interest in your future tend to return your calls.

Equity also incents advisors to keep working for you in the background whether or not you ask them to. They'll bring you leads for customers, employees, and investors.

## 10. When do advisors get terminated?

Advisors can get terminated when they don't add value at the level they originally agreed to. They can also get terminated if the company is “reset”, *e.g.*

- You hired a video game expert because you were building a video game but now you're building a photo sharing site. The company has left the line of business where the advisor added value.
- A naive entrepreneur hires the wrong business advisor and a major new investor asks the entrepreneur to clean up the dead wood.

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<sup>60</sup>[http://undergroundvalue.blogspot.com/2008/02/notes-from-buffett-meeting-2152008\\_23.html](http://undergroundvalue.blogspot.com/2008/02/notes-from-buffett-meeting-2152008_23.html)

- The company is acquired, recapitalized, or otherwise restructured and the advisors are no longer useful or desired.

## 11. Should I give advisory shares to my investors?

“Board members and (good) investors are always de facto advisors.”

— Paul Graham<sup>61</sup>

Angels or seed investors may ask for advisory shares. They might argue that they will be more helpful than the other investors, so they should get advisory shares.

But *every* investor thinks he will add more value than the other investors. We would like to propose a shareholder’s code of conduct: *if you think you’re doing too much, you’re probably just doing your share.*

So, how do you decide whether you should give advisory shares to an investor?

First, determine how many shares you would give him if he were just an advisor. Then subtract the number of shares he is buying with his investment. If the balance is significant, say, more than 50% of the shares he is buying, give him the balance in advisory shares. If the balance is under 25%, the additional shares won’t really matter to the investor and they aren’t worth the trouble of trying to justify the advisory shares to the other investors.

(This is why you never give advisory shares to venture capitalists nor do they ask for them: the balance for VCs is zero since they are buying so much of the company anyway.)

If the balance is *not* significant, you should just say no:

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<sup>61</sup><http://news.ycombinator.com/item?id=105194>

“All of our investors will be advising the company. That’s what good investors do. If I gave you advisory shares, I would have to give them to all the investors. And that wouldn’t make any sense—our valuation already takes the investor’s value-add into account.”

But if the balance *is* significant, you need an argument that makes sense to the other investors or they will also ask for advisory shares and lower your effective valuation:

“We want to hire him as an advisor. Fortunately, we don’t have to give him all the shares for free because he’s also going to invest as much as he can.”

You have to be able to convince the other investors—that’s the test. Or you can just “burn the boats at the shore” and give the advisory shares to the investor with the agreement that he will invest a minimum amount in the financing.

## The latest comments on Venture Hacks, founder edition

Here are the latest great comments from our readers—please keep ‘em coming!



62

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<sup>62</sup><http://www.roblord.org/>

Rob Lord<sup>63</sup>, founder of Songbird<sup>64</sup> (Sequoia Capital<sup>65</sup>), has some ideas for VC Wear t-shirts<sup>66</sup>:

“Mo’ money, mo’ board seats. “409a<sup>67</sup> a-okay! “Some of my best friends are EIRs. “Venture debt<sup>68</sup> is a non-starter.”



<sup>69</sup>

Jonathan Boutelle<sup>70</sup>, founder of SlideShare<sup>71</sup>, suggests using SlideShare to share decks privately<sup>72</sup>:

“One safe way to share a PowerPoint deck with potential investors: upload it to SlideShare as private. Share it only with the investor. After 48 hours (or whenever they’ve had time to check out the presentation) simply remove it from slideshare.

“You could also share via a “secret” URL: but that URL could potentially be forwarded to other parties so it’s not a good way to share files with people you don’t trust (which seems to be the challenge we’re speaking of here). Still, you could take the file down after 48 hours, and this approach wouldn’t require the other party to have a login on slideshare. So it might be the more practical option.”

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<sup>63</sup><http://www.roblord.org/>

<sup>64</sup><http://www.songbirdnest.com>

<sup>65</sup><http://www.sequoiacap.com>

<sup>66</sup><http://www.roblord.org/?p=16>

<sup>67</sup>[http://www.feld.com/blog/archives/2005/12/409a\\_government.html](http://www.feld.com/blog/archives/2005/12/409a_government.html)

<sup>68</sup><http://www.google.com/search?hl=en&lr=&q=venture%20debt>

<sup>69</sup><http://www.jonathanboutelle.com/>

<sup>70</sup><http://www.jonathanboutelle.com/>

<sup>71</sup><http://www.slideshare.net/>

<sup>72</sup><http://venturehacks.com/articles/sending-decks#comment-2246>



73

Nabeel Hyatt<sup>74</sup>, founder of Conduit Labs<sup>75</sup> (Charles River Ventures<sup>76</sup>), says you shouldn't send your deck to investors<sup>77</sup>:

"Not worth it. Not because your deck has some amazing information, it probably is pretty high level and isn't as unique as you wish it was, but because it kills the point of the presentation. What if Steve Jobs posted his Keynote presentation the day before Macworld and then gave his presentation the next day — how much harder would it be for him to get any sense of drama, intrigue, and frankly keep people awake?

"You should send them \*something\* to entice their interest, but whatever it is, expect it to be widely circulated, and think of it as just a teaser to get the meeting. You should be the main event, not your PDF."

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<sup>73</sup><http://nabeel.typepad.com/>

<sup>74</sup><http://nabeel.typepad.com/>

<sup>75</sup><http://www.conduitlabs.com/>

<sup>76</sup><http://www.crv.com/>

<sup>77</sup><http://venturehacks.com/articles/sending-decks#comment-1904>



78

Ted Rheingold<sup>79</sup>, founder of Dogster<sup>80</sup> (Michael Parekh<sup>81</sup>), has some ideas for protecting your deck<sup>82</sup>:

“Don’t forget to convert it to PDF or another read-only format to avoid any funny stuff once it has left your hands.

“And make sure the date is the day or month you sent it, as it then stands as a point-in-time snapshot which is likely out-of-date by the next quarter (in case the slides end up floating around inboxes month later)

“I like the idea of posting the recipients name on each page so it’s clear who leaked it if they do want to pass along.

“I also thinking striping out any slides you think reveal too much is a good compromise. (Ask a trusted person to be the judge of what is too revealing, company founders tend to over value their own IP)”

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<sup>78</sup><http://www.spideysenses.com/>

<sup>79</sup><http://www.spideysenses.com/>

<sup>80</sup><http://www.dogster.com/>

<sup>81</sup><http://mp.blogs.com/>

<sup>82</sup><http://venturehacks.com/articles/sending-decks#comment-1867>



Yokum Taku<sup>83</sup>, a partner at Wilson Sonsini<sup>84</sup>, disagrees with us on capping legal fees<sup>85</sup>:

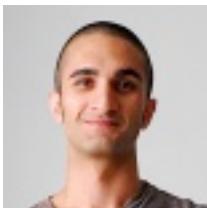
“The statement “Most caps include the fees for both sides” is not accurate. Term sheets typically only say that the company will pay reasonable legal fees of investors’ counsel, capped at \$X. (I also disagree with \$10K – \$20K as a reasonable cap to propose with straight face for investor counsel.) Of course, you can try to discuss a fee cap with company counsel, but almost all competent counsel will not agree to a cap. However, most experienced counsel can provide estimates based on actual data from previous similar transactions. Companies often have neglected corporate cleanup that needs to be fixed in connection with a financing (similar to not going to the dentist for years and paying the price later). In addition, there are always things that occur in financings that are difficult to predict (such as arguments among founders). Finally, capping company counsel fees is a disincentive to provide services after the cap is exceeded.”

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<sup>83</sup><http://www.startupcompanylawyer.com/>

<sup>84</sup><http://www.wsgr.com>

<sup>85</sup><http://venturehacks.com/articles/investors-legal-fee#comment-1790>



86

Farbood Nivi<sup>87</sup>, founder of Grockit<sup>88</sup> (Benchmark Capital<sup>89</sup>), thinks raising a good chunk of money is not a bad thing<sup>90</sup>:

“There is an argument that says too much money can cause one to take the foot off the gas.

“I can’t say it’s a false statement. I can say it doesn’t make sense to me or apply in Grockit’s situation. Raising the Series A we did, as opposed to a few hundred K seed round, has given us an engine with a lot more horsepower. That knowledge, if anything, should keep your foot feeling like lead. That said, keep in mind, a more powerful car requires more adept steering, braking and maintenance.

“Money well spent buys time (far more precious than money), quality (translate: scalability and user satisfaction), people (translate: your company), access, resources. Do you need any of these?

“Money is to a business what oxygen is to a human...

“All founders are desperate. The question is what for.

“I would rather be able to pursue my desperate need to create the ass-kickinest app I can over my desperate need to generate revenue for it.

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<sup>86</sup><http://www.linkedin.com/pub/0/85B/094>

<sup>87</sup><http://www.linkedin.com/pub/0/85B/094>

<sup>88</sup><http://www.grockit.com/>

<sup>89</sup><http://www.benchmark.com/>

<sup>90</sup><http://venturehacks.com/articles/grockit#comment-1500>

“Money allows you to reduce revenue based desperation and replace it with product building desperation.”

Like we says, keep the comments coming—we’ll highlight the best ones in the next ‘comment’ post.

# March 2008

## Half assed startup: how do I start my company and keep my day job?

*[Ed: I enjoyed Tony Wright<sup>1</sup>'s contrarian article, *Half-Assed Startup*<sup>2</sup>, when I first read it on his excellent blog<sup>3</sup>. Tony, a founder of RescueTime<sup>4</sup> (Y Combinator<sup>5</sup>), argues that you **can** start a company while you're otherwise employed. And he explains how to do it. Tony kindly agreed to re-publish his article on Venture Hacks. Take it away Tony.]*



<sup>6</sup>

I've done two part-time-to-full-time startups. One was acquired by Jobster<sup>7</sup>. The second startup is RescueTime<sup>8</sup>—currently a Y Combinator<sup>9</sup> funded company—cross your fingers.

At the end of the day, I think Paul Graham has it right in How

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<sup>1</sup><http://www.tonywright.com/about-tony/>

<sup>2</sup><http://www.tonywright.com/2008/half-assed-startup-how-to-start-your-company-and-keep-yo>

<sup>3</sup><http://www.tonywright.com>

<sup>4</sup><http://www.rescuetime.com/>

<sup>5</sup><http://ycombinator.com/>

<sup>6</sup><http://www.tonywright.com/>

<sup>7</sup><http://www.techcrunch.com/2006/05/23/jobster-to-acquire-two-month-old-jobby/>

<sup>8</sup><http://www.rescuetime.com>

<sup>9</sup><http://ycombinator.com>

## Not to Die<sup>10</sup>:

*“The number one thing not to do is other things. If you find yourself saying a sentence that ends with “but we’re going to keep working on the startup,” you are in big trouble. Bob’s going to grad school, but we’re going to keep working on the startup. We’re moving back to Minnesota, but we’re going to keep working on the startup. We’re taking on some consulting projects, but we’re going to keep working on the startup. You may as well just translate these to “we’re giving up on the startup, but we’re not willing to admit that to ourselves,” because that’s what it means most of the time. A startup is so hard that working on it can’t be preceded by “but.””*

In the beginning, however, it’s not always practical to dive in full-time. And when your idea is off-the-wall and easy to prototype, it’s smart to whip something out just to see if it’s as cool as you think it might be—before you take the full-time plunge.

So if you’re too poor or too unsure to do the right thing for your business and dive in full-time, here are a few things that seemed to work for us when we did it part-time:

1. **You need a co-founder and some cheerleaders.** If you can’t find two or three friends who are really excited to be beta testers for your product, ponder changing your direction. In a part-time effort, a co-founder is essential to keeping you on-track and working. At some point, you’ll hit a motivation wall... but if you have a partner who is depending on you, you will find a way past that. If you don’t have a partner, you’ll often lose interest and find something else to entertain you.

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<sup>10</sup><http://www.paulgraham.com/die.html>

2. **Pick a day or two per week where you always work, ideally in the same room as your co-founders.** Always, no exceptions. We worked one weekday evening and one weekend day. That doesn't mean we weren't working other days, but keeping a fixed schedule helps you through the phases of the project that might not be so fun.
3. **Have a boat-burning target.** What will it take for everyone to dive in full-time? 5,000 active users? 10,000 uniques a week? Funding? The target should be a shared understanding. You don't want one founder who is ready to go full-time while the other has reservations. This is easy to gloss over, but you should really nail it down. I've lost two co-founders who weren't ready to dive in full time when I was. It wasn't fair to them and it wasn't fair to me.
4. **Pick an idea that is tractable**<sup>11</sup>. Every startup is a hypothesis. If your hypothesis is, "we can build a better web-based chat client", that's something you could test quickly. If your hypothesis is "we can build a car that runs on lemonade", that's just not going to work as a part-time effort. The scarcity of available time should force you to distill the idea to the absolute minimum that is necessary to test the hypothesis. No extraneous features!
5. **Understand that your first version is probably going to suck.** Read David Rusenko's article, The importance of launching early and staying alive<sup>12</sup>. David is a founder of Weebly<sup>13</sup> (Y Combinator<sup>14</sup>). It's a long road. My second startup was a ridiculous fluke—it was acquired after 2 months. 99% of overnight successes were slogging in

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<sup>11</sup><http://www.tonywright.com/2007/evaluating-new-product-ideas-focus-on-tractability/>

<sup>12</sup><http://david.weebly.com/1/post/2008/02/the-importance-of-launching-early-and-staying-alive.html>

<sup>13</sup><http://www.weebly.com/>

<sup>14</sup><http://ycombinator.com/>

the muck for 5 years before the night in question. Be prepared for a long journey and be surprised if your startup is an immediate hit. So with your first version, look for the tiny little flicker than you might be onto something. And use it to motivate you to make it better. Every week, make it better than last week and see if that flicker of light can be fanned into a tiny flame.

6. **If you're going to screw off at work (everyone does), spend it getting smarter about the stuff you don't know.** If you're a coder, read a few design or usability blogs. Read up on what motivates angel investors. Research competitors and write down what they do well. Get brilliant at SEO (it's not hard). Write a *lot* more (blogging helps). Think about virality and research the heck out of it<sup>15</sup>. That said, be aware of the fuzzy line between using your cool-down time at work for your startup and stealing time or resources from your employer. If you're paid to do a job, you need to do it.
7. **Be sure you own your startup.** I've had the fortune of working in companies where there was very clear ownership of "after hours" work. If ownership of your personal intellectual property is not clear, do *not* rely on the good will of your employer. Greed can do funny things to people, even if they were initially big supporters of your startup. (Thanks to Ivan<sup>16</sup> from TipJoy<sup>17</sup> for this final suggestion.)

In short, you want to prove whatever you need to prove as quickly as possible, so you can dive in full-time. Near as I can tell, there are plenty of startups that have started as "hobbies",

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<sup>15</sup>[http://andrewchen.typepad.com/andrew\\_chens\\_blog/2007/09/fundamentally-v.html](http://andrewchen.typepad.com/andrew_chens_blog/2007/09/fundamentally-v.html)

<sup>16</sup><http://tipjoy.com/aboutus/>

<sup>17</sup><http://tipjoy.com>

but you need to take it out of that phase as soon as you can. There is nothing that drives a team forward like the fear of public failure, debt, and starvation. Leap off the cliff and start building the airplane on the way down—you might be surprised with what you can pull off.

## Getting recommended

**Summary:** The most common question we hear from entrepreneurs is, “Can you introduce me to investors?” Yes we can. We’re going to recommend startups on Venture Hacks. Investors are invited to subscribe to our recommendations. And everyone is welcome to recommend startups here. Request an invite<sup>18</sup> if you want to help test *Recommended* before we open it up—or just browse it<sup>19</sup> in the meantime.



20

On April 1st, we started publishing the best damn term sheet hacks<sup>21</sup> we could find. Why? Because a lot of entrepreneurs ask the same question:

“Can you help me understand term sheets?”

We’re trying to make everything we’ve learned—from other entrepreneurs, investors, and lawyers—readily available. We have

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<sup>18</sup><http://venturehacks.com/home>

<sup>19</sup><http://venturehacks.com/recommend>

<sup>20</sup><http://venturehacks.com/venturehacks>

<sup>21</sup><http://venturehacks.com/term-sheet-hacks>

a lot more work to do, but entrepreneurs seem to like the hacks<sup>22</sup> so far.

Now the most common question we hear from entrepreneurs is,

“Can you introduce me to investors?”

### **Yes we can.**

We like recommending startups to investors. And if you’re reading this, so might you. We want to help more entrepreneurs get introductions—so we’re going to recommend startups on Venture Hacks.

Here’s how *Recommended* looks for entrepreneurs, investors, and middlemen:

- If you’re an **entrepreneur**, we’ll recommend you to investors. The best way to convince us—or anyone—to make a recommendation is by presenting a good pitch and a good team. For example<sup>23</sup>:

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<sup>22</sup><http://venturehacks.com/about#reviews>

<sup>23</sup><http://venturehacks.com/edufire>



## Team



**Jon Bischke**  
Co-Founder



**Jared Haworth**  
Lead Developer



**Scott Johnson**  
VP of Engineering



**Kareem Mayan**  
Co-Founder

## About Us

*"Education is not the filling of a pail but the lighting of a fire."*

-William Butler Yeats

Within the next 5 years a service will emerge that will allow you to go online (through your PC, phone, whatever) and connect to  
teachsharefutureinvest in any subject imaginable ranging from

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- If you're an **investor**, you can subscribe to our recommendations:



## Babak Nivi

- [Subscribe to Babak](#)
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- [Forward Babak's profile](#)
- [Email Babak](#)

25

- Or subscribe to anyone's recommendations:

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<sup>24</sup><http://venturehacks.com/edufire>

<sup>25</sup><http://venturehacks.com/nivi>

## Public Feed

[Jon Bischke](#), [Ephraim Luft](#), [Adam Bain](#) and [Kareem Mayan](#) recommended [Mike Maples](#).



[Kareem Mayan](#) recommended [Tony Conrad](#), [Mike Jones](#), [Patrick Yee](#), [Adam Bain](#), [Dan Gould](#), [Brian Norgard](#) and [Mazen Araabi](#).



[Patrick Yee](#) recommended [Roger Ehrenberg](#), [Peter Pham](#), [sundeepahuja](#), [Josh Kopelman](#), [Dennis Fong](#), [Tony Conrad](#) and [Michael Cassidy](#).



[Carleen Hawn](#) joined [Giga Omni Media](#).



[Dan Gould](#) recommended [Jim Pitkow](#), [Allan M. Schiffman](#), [Peter Pham](#), [Kareem Mayan](#), [Mike Jones](#), [Rohit Khare](#), [Dave Peck](#) and [Adam Bain](#).



26

- And if you're a **middleman**—like us—who digs introducing entrepreneurs to investors, we can't wait to see what you recommend:

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<sup>26</sup><http://venturehacks.com/farbood>



## Shopflick

<http://www.shopflick.com>

- Track Shopflick (privately)
- Recommend Shopflick
- Forward Shopflick's profile



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## Microphone check.

We're building and testing Recommended now. Request an invite<sup>28</sup> if you want to help us test it before we open it up. Or just browse it in the meantime. Here are a few interesting places to get started:



<sup>29</sup>Fred Wilson<sup>30</sup> USV



<sup>31</sup>Mitch Lasky<sup>32</sup>Benchmark Capital

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<sup>27</sup><http://venturehacks.com/shopflick>

<sup>28</sup><http://venturehacks.com/home>

<sup>29</sup><http://venturehacks.com/fred>

<sup>30</sup><http://venturehacks.com/fred>

<sup>31</sup><http://venturehacks.com/mlasky>

<sup>32</sup><http://venturehacks.com/mlasky>



<sup>33</sup>Jeff Fagnan<sup>34</sup> Atlas Venture



<sup>35</sup>Grockit<sup>36</sup>



<sup>37</sup>Shopflick<sup>38</sup>



<sup>39</sup>eduFire<sup>40</sup>

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<sup>33</sup><http://venturehacks.com/jfagnan>

<sup>34</sup><http://venturehacks.com/jfagnan>

<sup>35</sup><http://venturehacks.com/grockit>

<sup>36</sup><http://venturehacks.com/grockit>

<sup>37</sup><http://venturehacks.com/shopflick>

<sup>38</sup><http://venturehacks.com/shopflick>

<sup>39</sup><http://venturehacks.com/edufire>

<sup>40</sup><http://venturehacks.com/edufire>



<sup>41</sup>Rob Lord<sup>42</sup>



<sup>43</sup>Sundeep Ahuja<sup>44</sup>



<sup>45</sup>Brian Norgard<sup>46</sup>

## Stay tuned.

There's more to come. Peace.



*Related:* TechCrunch explains it all better than we do<sup>47</sup>.

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<sup>41</sup><http://venturehacks.com/roblord>

<sup>42</sup><http://venturehacks.com/roblord>

<sup>43</sup><http://venturehacks.com/sundeep>

<sup>44</sup><http://venturehacks.com/sundeep>

<sup>45</sup><http://venturehacks.com/norgard>

<sup>46</sup><http://venturehacks.com/norgard>

<sup>47</sup><http://www.techcrunch.com/2008/03/20/venture-hacks-branches-out-from-blogging-launches>

## John Doerr of Kleiner Perkins on building business



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There is lots of wisdom in John Doerr<sup>49</sup>'s (Kleiner Perkins<sup>50</sup>) introduction to *Inside Intuit*<sup>51</sup> (emphasis added):

*"Inside Intuit* is a tale of missionaries, not mercenaries. It's about a founding team that prevails through tenacity, frugality, and an obsession with the customer experience...

"Kleiner Perkins first learned about Intuit in 1985... But when it came to large numbers of households using their home computers to manage their checkbooks, we just couldn't see it..."

*"Neither [of the founders] had created a new product nor started a company from scratch, let alone single-handedly faced nearly forty competitors.* So when Intuit's flagship product, Quicken, began to take off in the marketplace, my partners and I at Kleiner Perkins... took notice.

*"...the "bake-off" [that founder Scott Cook<sup>52</sup>] staged to help him choose from an array of eager potential*

<sup>48</sup><http://www.kpcb.com/team/index.php?John%20Doerr>

<sup>49</sup><http://www.kpcb.com/team/index.php?John%20Doerr>

<sup>50</sup><http://www.kpcb.com/>

<sup>51</sup>[http://books.google.com/books?id=lRs\\_4U43UcEC&printsec=frontcover&source=gbz\\_summary\\_r](http://books.google.com/books?id=lRs_4U43UcEC&printsec=frontcover&source=gbz_summary_r)

<sup>52</sup>[http://en.wikipedia.org/wiki/Scott\\_Cook](http://en.wikipedia.org/wiki/Scott_Cook)

*investors really distinguished him from the crowd.* More than a dozen venture capitalists vied to get a piece of Intuit. Cook and his team tested each finalist with a new, pressing, real problem: What should Intuit do if Microsoft entered the personal finance market to compete with Quicken?

“...we soon saw that Intuit differed in more ways than merely its approach to venture fund-raising. At the first Intuit board meeting I attended, I was surprised: more than half the meeting took place at Intuit’s tech support center, listening to tech reps answer customers’ product questions and fix their problems. Cook’s uniquely intense focus on happy customers and firsthand customer feedback impresses me to this day...

“Cook has an unusual ability to ask the right questions (which my partner Vinod Khosla<sup>53</sup> insists is more important than getting the right answers; in business, there are often several right answers).

“In 1993, Cook realized before any of the rest of us that Intuit needed a new CEO to help the company reach the next level. How unusual, I thought at the time, for a company founder to know and admit that he might be holding his company back...

“Great CEOs are great teachers... What is unusual about Intuit is that... three leaders are all still actively engaged in building the company. As CEO, [Steve] Bennett has “the last call,” setting the tempo, directing the team. As chairman of the board, [Bill] Campbell<sup>54</sup> [former CEO] holds sway from an off-campus office, advising the team, turning up on campus, and walking the halls. And Cook, as founder

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<sup>53</sup><http://www.khoslaventures.com/>

<sup>54</sup>[http://en.wikipedia.org/wiki/Bill\\_Campbell\\_\(CEO\)](http://en.wikipedia.org/wiki/Bill_Campbell_(CEO))

and chairman of the executive committee [and former CEO] provokes and celebrates strategy rethinking, inspires innovations, and continues, as ever, to obsess on the customers. As a leadership trio, they are unique in Silicon Valley.

“Not every businessperson aspires to be an institution-builder. Some simply want the freedom to be their own bosses, to achieve financial independence, to call the shots. Others want to solve problems and push the boundaries with their solutions; they work hard to “change the game” by innovating, rethinking, or breaking the rules. And yet, for all their efforts, business to them will always be just that—a game.

“For still others, however, and they’re a rare breed indeed, business is about striving for something more fundamental: to alter and improve their customers’ lives. These people aim to create companies that will transcend their creators, that will remain strong and productive from generation to generation. They aim to build lasting innovation...

*“I’ve always been awed by entrepreneurs, by how little they have to work with when they start and by how much they sometimes accomplish.“*

*Related:* Bill Cambell interviews Danny Shader of Good Technology<sup>55</sup>.

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<sup>55</sup><http://edcorner.stanford.edu/authorMaterialInfo.html?mid=1356&author=147>

## Marc Andreessen on Charlie Munger on cognitive bias



<sup>56</sup>

In *The Psychology of Entrepreneurial Misjudgment*, part 1: Biases 1-6<sup>57</sup>, Marc Andreessen<sup>58</sup> kindly interprets an essay from Charlie Munger<sup>59</sup>'s book, *Poor Charlie's Almanack*<sup>60</sup>:

“Mr. Munger’s magnum opus speech, included in the book, is *The Psychology of Human Misjudgment* — an exposition of 25 key forms of human behavior that lead to misjudgment and error, derived from Mr. Munger’s 60 years of business experience. Think of it as a practitioner’s summary of human psychology and behavioral economics as observed in the real world.

“In this series of blog posts, I will walk through all 25 of the biases Mr. Munger identifies, and then adapt them for the modern entrepreneur. In each case I will start with relevant excerpts of Mr. Munger’s speech, and then after that add my own thoughts.”

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<sup>56</sup><http://blog.pmarca.com/>

<sup>57</sup><http://blog.pmarca.com/2008/03/the-psychology.html>

<sup>58</sup><http://blog.pmarca.com>

<sup>59</sup>[http://en.wikipedia.org/wiki/Charlie\\_Munger](http://en.wikipedia.org/wiki/Charlie_Munger)

<sup>60</sup><http://www.poorcharliesalmanack.com/index.html>

<sup>61</sup>

I started summarizing Marc and Charlie's key points for my own use and I thought you might find the summary useful.

For another great article on cognitive bias, see Cognitive biases potentially affecting judgment of global risks<sup>62</sup>.

## 1. Reward and Punishment Super-Response

Once you realize how much incentives influence human behaviour, you need to assume their influence is even bigger than you think. Never think about something else when you should be thinking about incentives.

“If you would persuade, appeal to interest and not to reason.”

– Benjamin Franklin

Every incentive should have a counter-incentive to restrict gaming of the first incentive.

## 2. Liking and Loving

Liking and loving something conditions you to (1) ignore faults of and comply with wishes of the loved, (2) favor people, products, and actions associated with the loved, and (3) distort other facts to facilitate love.

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<sup>61</sup>[http://en.wikipedia.org/wiki/Charlie\\_Munger](http://en.wikipedia.org/wiki/Charlie_Munger)

<sup>62</sup>[http://64.233.167.104/search?q=cache:1\\_XrijI1xiAJ:www.singinst.org/upload/cognitive-biases.pdf+http://www.singinst.org/upload/cognitive-biases.pdf&hl=en&ct=clnk&cd=1&gl=us](http://64.233.167.104/search?q=cache:1_XrijI1xiAJ:www.singinst.org/upload/cognitive-biases.pdf+http://www.singinst.org/upload/cognitive-biases.pdf&hl=en&ct=clnk&cd=1&gl=us)

Wanting to be liked by your teammates impedes you from firing people and making unpopular but good decisions.

### 3. Disliking and Hating

Disliking or hating something conditions you to (1) ignore virtues in the disliked, (2) dislike people, products, and actions associated with the disliked, and (3) distort other facts to facilitate hatred.

Startups should focus on their customers, not their competition<sup>63</sup>—whom they may dislike.

### 4. Doubt Avoidance

Execution is often better than further contemplation:

“A good plan, violently executed now, is better than a perfect plan next week.”

— George Patton

Believing that something will happen, and convincing others that it will be so, makes it more likely to happen.

While a hypothesis is still doubted, wise<sup>64</sup> entrepreneurs know whether (1) persistence and iteration will prove the hypothesis, or (2) the hypothesis will not be proven and additional testing is a destructive waste of time—a new hypothesis is required.

*Related:* Realists vs. Idealists: Thoughts about Creativity and Innovation<sup>65</sup> and Decide To Do Something That Will Probably

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<sup>63</sup><http://www.nivi.com/blog/article/what-is-learning-part-1>

<sup>64</sup><http://www.nivi.com/blog/article/what-is-learning-part-1>

<sup>65</sup>[http://bobsutton.typepad.com/my\\_weblog/2007/11/realists-vs-ide.html](http://bobsutton.typepad.com/my_weblog/2007/11/realists-vs-ide.html)

Fail, Then Convince Yourself And Everyone Else That Success is Certain<sup>66</sup>.

## 5. Inconsistency Avoidance

Have strong opinions, weakly held<sup>67</sup>. New and correct ideas may not be accepted simply because they are inconsistent with existing ideas.

Your existing ideas may be unknown to you. They may be hidden assumptions. We often make hidden assumptions about unknown unknowns<sup>68</sup>.

If existing customers in the market aren't ready for a product that is inconsistent with their behaviour, go after customers who aren't in the market because they can't afford the existing product or don't have access to it. See The Innovator's Dilemma<sup>69</sup> and The Innovator's Solution<sup>70</sup>.

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<sup>66</sup> [http://bobsutton.typepad.com/my\\_weblog/2006/08/decide\\_to\\_do\\_so.html](http://bobsutton.typepad.com/my_weblog/2006/08/decide_to_do_so.html)

<sup>67</sup> [http://bobsutton.typepad.com/my\\_weblog/2006/07/strong\\_opinions.html](http://bobsutton.typepad.com/my_weblog/2006/07/strong_opinions.html)

<sup>68</sup> [http://en.wikipedia.org/wiki/Unknown\\_unknown](http://en.wikipedia.org/wiki/Unknown_unknown)

<sup>69</sup> [http://books.google.com/books?id=Slexi\\_qgq2gC&dq=the+innovator%27s+dilemma&pg=PP1&ots=AhrRfEB6Hk&sig=tza7KErSf48rjdKO3Y6AuWqwZ0E&hl=en&prev=http://www.google.com/search?hl=en&lr=&q=the+innovator%27s+dilemma&sa=X&oi=print&ct=title&cad=one-book-with-thumbnail](http://books.google.com/books?id=Slexi_qgq2gC&dq=the+innovator%27s+dilemma&pg=PP1&ots=AhrRfEB6Hk&sig=tza7KErSf48rjdKO3Y6AuWqwZ0E&hl=en&prev=http://www.google.com/search?hl=en&lr=&q=the+innovator%27s+dilemma&sa=X&oi=print&ct=title&cad=one-book-with-thumbnail)

<sup>70</sup> <http://books.google.com/books?id=ZUsn9uIgkAUC&dq=innovator%27s+solution&pg=PP1&ots=M4KWoxl4uO&sig=3sWT5I3N1jfT4JMSHydUr1Io1Yw&hl=en&prev=http://www.google.com/search?num=20&hl=en&lr=&safe=off&q=innovator%27s+solution&btnG=Search&sa=X&oi=print&ct=title&cad=one-book-with-thumbnail#PPP1,M1>

## 6. Curiosity

Insufficient curiosity prevents you from learning<sup>71</sup>. Hire curious people<sup>72</sup> and discover your customer's true needs—not what you think they need.

## Reactions to recommended

Every article about Recommended<sup>73</sup> described the feature better than our launch post<sup>74</sup>. Here's a few snippets we particularly liked.



75

From Mark Hendrickson's article in TechCrunch<sup>76</sup>:

“Entrepreneurs and venture capitalists can use the sub-site, simply called Recommended, to track who and what others think highly of, and to indicate their own affinities as well.

“It’s structured much like Twitter—users set up profiles and subscribe to each other, then review recommendations made by others and make recommendations of their own.

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<sup>71</sup><http://www.nivi.com/blog/article/what-is-learning-part-1>

<sup>72</sup>[http://blog.pmarca.com/2007/06/how\\_to\\_hire\\_the.html](http://blog.pmarca.com/2007/06/how_to_hire_the.html)

<sup>73</sup><http://venturehacks.com/recommended>

<sup>74</sup><http://venturehacks.com/articles/recommended>

<sup>75</sup><http://www.techcrunch.com/2008/03/20/venture-hacks-branches-out-from-blogging-launches>

<sup>76</sup><http://www.techcrunch.com/2008/03/20/venture-hacks-branches-out-from-blogging-launches>

“The overall idea behind Recommended is to lubricate the process by which members of the startup community network and determine who and what is popular.”



77

From Eric Eldon<sup>78</sup>'s article in Venture Beat<sup>79</sup>:

“While the service is very much a work in progress, the simplicity of the connections—and the fact that you’re connecting with influential people—makes this a promising service.”



80

From Carleen Hawn's article in FoundRead<sup>81</sup>:

“It is really straightforward, simple and stupid. It’s like RSS for deal flow,” Nivi told us this morning...  
“All startup deal flow is done by email and phone now—a push model. This is like a pull model,” Nivi explained.

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<sup>77</sup><http://venturehacks.com/eldon>

<sup>78</sup><http://venturehacks.com/eldon>

<sup>79</sup><http://venturebeat.com/2008/03/21/meeting-people-is-easy-in-business-venture-hacks-social->

<sup>80</sup><http://startitup.indieword.com/person/3291-carleen>

<sup>81</sup><http://foundread.com/2008/03/21/venturehacks-wants-to-help-you-get-venture-hitched/>

“Founders no longer need to spend weeks or days lining up reference calls for potential investors: just hand over the URL of your Venture Hacks profile...”



82

From Ashkan Karbasfrooshan<sup>83</sup>'s article in HipMojo<sup>84</sup>:

“I asked Nivi about the service and in typical elevator pitch fashion, he replied “it’s match.com for investors and entrepreneurs”.

“While I am not sure if we need one more social network to join or profile to create... the financing matchmaking process remains full of friction and inefficiency...”



85

Finally, from Bijan Sabet<sup>86</sup>'s (Spark Capital<sup>87</sup>) tumblelog<sup>88</sup>:

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<sup>82</sup><http://venturehacks.com/ash>

<sup>83</sup><http://venturehacks.com/ash>

<sup>84</sup><http://watchmojo.com/web/blog/index.php/2008/03/21/does-investing-need-a-matchcom/>

<sup>85</sup><http://venturehacks.com/bijan>

<sup>86</sup><http://venturehacks.com/bijan>

<sup>87</sup><http://venturehacks.com/spark-capital>

<sup>88</sup><http://bijansabet.com/post/29442069>

“I’m now alive in the world that [Venture Hacks] created. Very cool site.”

Browse Recommended or request an invite while we’re in private beta: Recommended<sup>89</sup>.

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<sup>89</sup><http://venturehacks.com/recommended>

# April 2008

## Missionaries, not mercenaries

This is a great slide from John Doerr's talk at Stanford<sup>1</sup>:

Mercenaries vs. Missionaries	
drive, paranoia	passion
opportunistic	strategic
"the pitch, the deal"	"the big idea, partnership"
sprint, short run	marathon, long run
obsess on competition	obsess on customers
aristocracy of founder(s)	meritocracy, best idea wins
financial statements	mission, values statement
bosses of wolf packs	mentors, coaches of teams
entitlement	contribution
the "deferred life" plan	a whole life (that works)
lust for making money	lust to make meaning <small>(A mission)</small>
success	significance

2

It's a little hard to read but it's worth a squint. Or just watch this 4 minute video where he lays it out:

*Link:* John Doerr on Mercenaries and Missionaries<sup>3</sup>.

## Venture Hacks tweets - Kleiner edition

The latest great quotes from the VH Twitter feed: [twitter.com/venturehacks](http://twitter.com/venturehacks)<sup>4</sup> (RSS<sup>5</sup>):

<sup>1</sup><http://edcorner.stanford.edu/authorMaterialInfo.html?mid=1274>

<sup>2</sup><http://edcorner.stanford.edu/authorMaterialInfo.html?mid=1274>

<sup>3</sup><http://edcorner.stanford.edu/authorMaterialInfo.html?mid=1274>

<sup>4</sup><http://twitter.com/venturehacks>

<sup>5</sup>[feed://twitter.com/statuses/user\\_timeline/11620792.atom](http://twitter.com/statuses/user_timeline/11620792.atom)

### Kleiner Perkins



“Entrepreneurs do more than anyone thinks possible, with less than anyone thinks possible.” – John Doerr<sup>7</sup>

“If the reason you’re taking on a mission is for the money you’ll make, I believe you’ll fail.” – John Doerr<sup>8</sup>

“Where most entrepreneurs fail is on the things they don’t know they don’t know.” – Vinod Khosla<sup>9</sup>

“How would you compete against yourself?” – Vinod Khosla<sup>10</sup> (ppt)

“We are in the company building business, not in the ‘deal’ or ‘capital’ business.” – Khosla Ventures<sup>11</sup>

“The great danger of dealing with venture capitalists is the ‘slow maybe’.” – John Doerr<sup>12</sup>

“We never ‘vote’ against management teams in our board role, except in making CEO decisions.” – Khosla Ventures<sup>13</sup>

<sup>6</sup><http://www.kpcb.com>

<sup>7</sup><http://www.apple.com/quicktime/qtv/iphoneroadmap/>

<sup>8</sup><http://edcorner.stanford.edu/authorMaterialInfo.html?mid=1274>

<sup>9</sup><http://edcorner.stanford.edu/authorMaterialInfo.html?mid=24&author=>

“All start up companies have one thing in common—they all get in trouble. It’s how they and you on the board handle their trouble that separates the winners from the losers.” – Tom Perkins<sup>14</sup>

### **Peter Drucker**



<sup>15</sup>“You cannot build performance on weaknesses. You can build only on strengths.” – Peter Drucker<sup>16</sup>

“One does not start with facts. One starts with opinions.” – Peter Drucker<sup>17</sup>

### **Warren Buffett**

“I’ve never gone to bed with an ugly woman, but I’ve sure woke up with a few.” – Warren Buffett<sup>18</sup>, explaining bad investments

“When the phone don’t ring, you’ll know it’s me.” – Warren Buffett<sup>19</sup>, explaining how he might say ‘no’

“If you are a professional and have confidence, then I would advocate lots of concentration.” – Warren

<sup>14</sup>[http://content.cdlib.org/dynaxml/servlet/dynaXML?docId=kt1p3010dc&dDoc.view=entire\\_text](http://content.cdlib.org/dynaxml/servlet/dynaXML?docId=kt1p3010dc&dDoc.view=entire_text)

<sup>15</sup>[http://books.google.com/books?id=pXbBSVsl3\\_IC&pg=PA252&lpg=PA252&dq=%22one+does+not+start+with+facts+one+starts+with+opinions%22&source=web&ots=H81Eg-l1Qa&sig=YvHYJzCEGiN071AMcBRC8HHlfg0&hl=en#PPP1,M1](http://books.google.com/books?id=pXbBSVsl3_IC&pg=PA252&lpg=PA252&dq=%22one+does+not+start+with+facts+one+starts+with+opinions%22&source=web&ots=H81Eg-l1Qa&sig=YvHYJzCEGiN071AMcBRC8HHlfg0&hl=en#PPP1,M1)

<sup>16</sup>[http://books.google.com/books?id=VYdkZ7LkMBoC&pg=PA57&lpg=PA57&dq=%22you+cannot+build+performance+on+weaknesses+you+can+build+only+on+strengths%22&source=web&ots=RWbCkLGNle&sig=A9eUtps6uH6ikJscqrwq7N1B\\_ho&hl=en](http://books.google.com/books?id=VYdkZ7LkMBoC&pg=PA57&lpg=PA57&dq=%22you+cannot+build+performance+on+weaknesses+you+can+build+only+on+strengths%22&source=web&ots=RWbCkLGNle&sig=A9eUtps6uH6ikJscqrwq7N1B_ho&hl=en)

<sup>17</sup>[http://books.google.com/books?id=pXbBSVsl3\\_IC&pg=PA252&lpg=PA252&dq=%22one+does+not+start+with+facts+one+starts+with+opinions%22&source=web&ots=H81Eg-l1Qa&sig=YvHYJzCEGiN071AMcBRC8HHlfg0&hl=en](http://books.google.com/books?id=pXbBSVsl3_IC&pg=PA252&lpg=PA252&dq=%22one+does+not+start+with+facts+one+starts+with+opinions%22&source=web&ots=H81Eg-l1Qa&sig=YvHYJzCEGiN071AMcBRC8HHlfg0&hl=en)

<sup>18</sup>[http://www.economist.com/daily/columns/businessview/displaystory.cfm?story\\_id=10794220](http://www.economist.com/daily/columns/businessview/displaystory.cfm?story_id=10794220)

<sup>19</sup>[http://www.economist.com/daily/columns/businessview/displaystory.cfm?story\\_id=10794220](http://www.economist.com/daily/columns/businessview/displaystory.cfm?story_id=10794220)

Buffett<sup>20</sup>

### Sundry

“Succeed and you are a brilliant visionary. Fail and you are a delusional loser.” – Don Dodge<sup>21</sup>

“You don’t need permission to start a company. From investors, co-founders, or anyone else.” – Venture Hacks

Read more quotes in the VH Twitter feed<sup>22</sup> and my personal Twitter feed: [twitter.com/nivi<sup>23</sup>](http://twitter.com/nivi) (RSS<sup>24</sup>).

*Thanks:* To James Cham<sup>25</sup> for the Tom Perkins interview.

## How much money should we raise?

**Summary:** Raise as much money as possible. With these caveats: (1) maintain control at any cost, (2) monitor your liquidation preference, and (3) act like you don’t have a lot of money. Also understand that if you do raise a lot of money, you will have to (1) “go big or go home” and (2) make a lot of progress if you ever want to raise money again. Alternatively, if you would rather maintain your exit options, at least raise enough money to run two experiments.

How much money should you raise? *As much as possible—with some caveats.* But hey! don’t take our word for it.

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<sup>20</sup> [http://undergroundvalue.blogspot.com/2008/02/notes-from-buffett-meeting-2152008\\_23.html](http://undergroundvalue.blogspot.com/2008/02/notes-from-buffett-meeting-2152008_23.html)

<sup>21</sup> [http://dondodge.typepad.com/the\\_next\\_big\\_thing/2008/03/how-to-make-you.html](http://dondodge.typepad.com/the_next_big_thing/2008/03/how-to-make-you.html)

<sup>22</sup> <http://twitter.com/venturehacks>

<sup>23</sup> <http://twitter.com/nivi>

<sup>24</sup> [feed://twitter.com/statuses/user\\_timeline/644863.atom](http://twitter.com/statuses/user_timeline/644863.atom)

<sup>25</sup> <http://venturehacks.com/james>

## Two investors' opinions.



26

Eugene Kleiner<sup>27</sup>, Founder of Kleiner Perkins:

“When the money is available, take it.”



28

William Janeway, Managing Director of Warburg Pincus:

“Failure to execute operationally is not the only source of risk; every venture is also subject to volatility in the price and availability of capital due to the volatility of the stock market. After the collapse of the Internet Bubble, many promising companies foundered because their funding dried up.

“By contrast, our biggest successes at Warburg Pincus (VERITAS, BEA) have come from inverting the normal venture funding model, with the visionary investor as company co-founder... And we have supported the multi-year process of building a sustainable business by underwriting all of the capital needed

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<sup>26</sup>[http://www.amazon.com/gp/reader/1592403131/ref=sib\\_dp\\_pt#](http://www.amazon.com/gp/reader/1592403131/ref=sib_dp_pt#)

<sup>27</sup>[http://www.amazon.com/gp/reader/1592403131/ref=sib\\_dp\\_pt#](http://www.amazon.com/gp/reader/1592403131/ref=sib_dp_pt#)

<sup>28</sup>[http://conferences.oreillynet.com/cs/et2004/view/e\\_sess/4903](http://conferences.oreillynet.com/cs/et2004/view/e_sess/4903)

to reach positive cash flow, thereby not only enabling management to focus full-time on the business but also insuring against the risks generated by a volatile stock market...

“In the post-Bubble world, long-term financial commitments are required to fund the ventures that will fulfill the long-term technological vision and implement the long-term commercial promise of the Internet Age.”

## Two founders’ opinions.



<sup>29</sup>

Mike Ramsay<sup>30</sup>, Founder and CEO of TiVo:

“One of the reasons that TiVO is thriving today is that we were well-capitalized. We were able to power our way through the downturn—that early 2000 period when [our competitor] Replay went away. We were capitalized enough that we knew we could ride through it. While we had to make a few adjustments at the company, there was never a question that we were going to survive. We knew we were going to survive.”

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<sup>29</sup><http://books.google.com/books?id=oFTYD9IHX5YC&pg=PT205&dq=%22We+were+able+to+power+our+way+through+the+downturn%22&ei=OJX-R9ujDIjosQOS6M0z&sig=gyzAaN1AUHSZ-03Qg9HukH83hAA>

<sup>30</sup><http://tinyurl.com/6rra8z>



<sup>31</sup>Marc Andreessen<sup>32</sup>, inventor of the bendy-straw:

**“So how much money should I raise?**

“In general, as much as you can.

“Without giving away control of your company, and without being insane.

“Entrepreneurs who try to play it too aggressive and hold back on raising money when they can because they think they can raise it later occasionally do very well, but are gambling their whole company on that strategy *in addition to all the normal startup risks*.

“Suppose you raise a lot of money and you do really well. You’ll be really happy and make a lot of money, even if you don’t make quite as much money as if you had rolled the dice and raised less money up front.

“Suppose you don’t raise a lot of money when you can and it backfires. You lose your company, and you’ll be really, really sad.

*“Is it really worth that risk?*

“...Taking these factors into account, though, **in a normal scenario, raising more money rather than less usually makes sense, since you are buying yourself insurance against both internal and external potential bad events** — and that is more important than worrying too much about dilution or liquidation preference.”

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<sup>31</sup><http://blog.pmarca.com/2007/07/the-pmarca-guid.html>

<sup>32</sup><http://blog.pmarca.com/2007/07/the-pmarca-guid.html>

Make sure you read Marc's full article for his caveats: How much funding is too little? Too much?<sup>33</sup>

### **Guidelines to consider no matter how much you raise.**

No matter how much money you raise,

1. Maintain control<sup>34</sup> at any cost.
2. Monitor your total liquidation preference<sup>35</sup> and avoid liquidation preferences above 1x non-participating. You will have to sell the company for at least the liquidation preference before the common stockholders see a penny.
3. Raise enough money to run more than one experiment. Some companies need 12 months of runway to do two or more experiments, others might need 24 months. Seed stage companies that can't raise enough money to run more than one experiment should keep their burn down to extend their runway.
4. Act like you don't have money.

### **Guidelines to consider if you do raise a lot of money.**

If you do raise a lot money,

1. Understand that your investors will have very high expectations. You have will have to "go big or go home".

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<sup>33</sup><http://blog.pmarca.com/2007/07/the-pmarca-guid.html>

<sup>34</sup><http://venturehacks.com/articles/understand-protective-provisions>

<sup>35</sup>[http://www.feld.com/blog/archives/2005/01/term\\_sheet\\_liqu.html](http://www.feld.com/blog/archives/2005/01/term_sheet_liqu.html)

2. You will have to make a lot of progress with this round if the company ever wants to raise money again.

Alternatively, if you would rather keep your liquidation preference low and maintain your exit options, at least raise enough money to run two experiments.

Raise too little money and you may go out of business when you run into trouble. Raise too much money and you may make less (or zero) dough when you exit. Take your pick: disaster vs. dilution.

*Image Sources:* Marty Katz for The New York Times<sup>36</sup>, SF-Gate<sup>37</sup>, Wired<sup>38</sup>.

## Former VC helps entrepreneurs raise money



39

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<sup>36</sup>[http://www.nytimes.com/2005/01/06/technology/06cablebox.html?\\_r=1&oref=slogin](http://www.nytimes.com/2005/01/06/technology/06cablebox.html?_r=1&oref=slogin)

<sup>37</sup>[http://www.sfgate.com/cgi-bin/blogs/sfgate/detail?blogid=19&entry\\_id=21916](http://www.sfgate.com/cgi-bin/blogs/sfgate/detail?blogid=19&entry_id=21916)

<sup>38</sup><http://blog.wired.com/business/2007/06/imagine-if-you-.html>

<sup>39</sup><http://billburnham.blogs.com/about.html>

In 4 Things to Do After You Get Your First Term Sheet<sup>40</sup>, Bill Burnham<sup>41</sup>, a former partner at Mobius<sup>42</sup> and Softbank Capital<sup>43</sup>, writes,

“I’ve recently been involved in helping a couple companies with their first major round of VC financing. It’s actually been pretty interesting for me because I have historically been on the other side of the table. In addition to generating several stories worthy of “The Funded” and getting a better appreciation of the trials and tribulations that entrepreneurs must go through when trying to raise money, I also gained a better appreciation for just how important it is to properly manage the “end game” of a VC financing.

“What is the “end game”? The End Game generally takes place after you have gotten a term sheet, but before you actually sign it. How well you manage this process can make a big difference in the actual terms and pricing you ultimately get, so it pays to approach this process as thoughtfully and diligently as you do any other part of fundraising.”

“With that in mind I present 4 things that you should definitely do after getting your 1<sup>st</sup> term sheet:

**“1. Get a second term sheet:** It may sound flip, but this is the single most important thing you should do upon getting your 1<sup>st</sup> term sheet. Nothing loosens up a VC’s purse strings or makes them more

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<sup>40</sup><http://billburnham.blogs.com/burnhamsbeat/2008/04/5-keys-to-maste.html>

<sup>41</sup><http://billburnham.blogs.com/about.html>

<sup>42</sup><http://www.mobiusvc.com>

<sup>43</sup><http://www.softbank.com>

flexible on a particular term than the threat of competition. Without competition (real or perceived) you have very little leverage against a VC. Now getting one term sheet, let alone two, is tough enough, but getting two must be your goal and you must not waiver in pursuit of that goal even you after you get the 1<sup>st</sup> one. The biggest problem most entrepreneurs have executing on this strategy is that they have mismanaged the sequencing of their fundraising. Many entrepreneurs make the mistake of pursuing an “in order” fundraising process whereby they take one meeting, run that process to its logical conclusion and if that doesn’t work out try to get a meeting with another VC. VC fundraising must be pursued concurrently! You must put as many irons in the fire in as short a time as possible so that all the firms start the process at roughly the same time. As firms progress through the process, you should do your best to try and “herd” them along by trying to slow down the ones pushing ahead and speed up the ones lagging behind. The ultimate goal is to ensure that when you receive your first term sheet you have several other firms that are very close (within a week or so) to potentially issuing their own term sheets. Proper sequencing ensures that you are not forced to take an inferior “bird in hand.”

Read Bill’s great post<sup>44</sup> for the rest of his suggestions. He agrees with everything we’ve been writing about, so he is obviously quite brilliant.

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<sup>44</sup><http://billburnham.blogs.com/burnhamsbeat/2008/04/5-keys-to-maste.html>

## New investors on Venture Hacks

Here are a few of the brave investors who have joined the Venture Hacks community<sup>45</sup>. I've also included descriptions of the types of companies they're looking for:



46

Josh Kopelman<sup>47</sup> from First Round Capital<sup>48</sup> is “looking for companies that find new uses for existing data sets.”



49

Mitch Lasky<sup>50</sup> from Benchmark Capital<sup>51</sup> says, “I still believe in mobile.”



52

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<sup>45</sup><http://venturehacks.com/recommended>

<sup>46</sup><http://venturehacks.com/josh>

<sup>47</sup><http://venturehacks.com/josh>

<sup>48</sup><http://venturehacks.com/first-round-capital>

<sup>49</sup><http://venturehacks.com/mlasky>

<sup>50</sup><http://venturehacks.com/mlasky>

<sup>51</sup><http://venturehacks.com/benchmark>

<sup>52</sup><http://venturehacks.com/marchustvedt>

Marc Hustvedt<sup>53</sup>, an angel investor, is “looking seriously at IPTV.”



<sup>54</sup>

Aydin Senkut<sup>55</sup>, an angel investor at Felicis Ventures<sup>56</sup>, has a “focus on early stage consumer internet companies.”



<sup>57</sup>

James Cham<sup>58</sup>, from Bessemer Venture Partners<sup>59</sup>, is “looking for companies that see the commercial opportunities in inference engines.”

We’ll highlight other investors (and startups) in an upcoming post. Browse the community<sup>60</sup> while we’re in private beta or request an invite<sup>61</sup> to help us test the site.

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<sup>53</sup><http://venturehacks.com/marchustvedt>

<sup>54</sup><http://venturehacks.com/asenkut>

<sup>55</sup><http://venturehacks.com/asenkut>

<sup>56</sup><http://venturehacks.com/felicisvc>

<sup>57</sup><http://venturehacks.com/james>

<sup>58</sup><http://venturehacks.com/james>

<sup>59</sup><http://venturehacks.com/bessemer>

<sup>60</sup><http://venturehacks.com/recommended>

<sup>61</sup><http://venturehacks.com/recommended>

## How do we set the valuation for a seed round?

A reader asks:

“My question is how do we value a company with no sales? I understand it’s an arbitrary valuation but is there anything we can possibly base it on? Is there a “default” valuation for companies in a seed round?”

We’ll answer this question with some questions (and answers) of our own:

1. How much money do we need?<sup>62</sup>
2. How do we set a valuation from this budget?<sup>63</sup>
3. How do we express our valuation to investors?<sup>64</sup>
4. What’s the range for seed round valuations?<sup>65</sup>
5. How low do seed round valuations go?<sup>66</sup>
6. How much money can we raise in a seed round?<sup>67</sup>
7. How much dilution should we expect in a seed round?<sup>68</sup>

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<sup>62</sup><http://venturehacks.com/#money>

<sup>63</sup><http://venturehacks.com/#valuation>

<sup>64</sup><http://venturehacks.com/#express>

<sup>65</sup><http://venturehacks.com/#range>

<sup>66</sup><http://venturehacks.com/#low>

<sup>67</sup><http://venturehacks.com/#max>

<sup>68</sup><http://venturehacks.com/#dilution>

## 1. How much money do we need?

First, figure out how much money you need to run at least two experiments\*. Then tack on 3 more months of runway so you can raise another round before you run out of money. This is the minimum amount of money you should raise. For example, let's say you need \$100K.

\* Your experiments should be constructed such that a positive result will let you raise more money at a higher valuation.

## 2. How do we set a valuation from this budget?

Now decide what percentage of the company you will sell for \$100K. Pick a number between 10% and 20% of the company's post-money. You *can* go below 10% but that probably means your valuation will be too high or you will raise too little money.

For example, let's say you're willing to sell up to 15% of the company—that's your *bottom line* dilution. This implies a bottom line post-money valuation of \$666K.

## 3. How do we express our valuation to investors?

Finally, tell investors that,

“We think we can make the company significantly more valuable if we raise \$100K—that’s our target. And we’re willing to sell up to 10% of the company to reach that target.”

10% is your *aspirational* dilution. It’s the lowest dilution you can justify. It’s the lowest dilution you can say with a straight face.

Notice that you didn't explicitly state your valuation. Combining the dilution (10%) with the amount you're raising (\$100K) implies a post-money valuation of \$1M. But the valuation is not explicit. This gives you room to raise your valuation if you raise more than \$100K (and we suggest you raise as much money as possible<sup>69</sup>).

#### **4. What's the range for seed round valuations?**

If \$25K buys 1% of company, your post-money is \$2.5M—that's on the high end.

If \$25K buys 5% of company, your post-money is \$0.5M—that's on the low end.

#### **5. How low do seed round valuations go?**

Y Combinator<sup>70</sup> has set new lows for seed round valuations. They get away with it because they also set new highs for helping seed stage companies.

According to the YC FAQ<sup>71</sup>, they buy about 6% of a company for \$15K-\$20K. So the post-money valuation of their investments is \$250K-\$333K.

But don't fixate on valuation. Low valuations aren't bad if you keep the dilution down too. 6% dilution is very low if the company makes a lot of progress with \$15K-\$20K.

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<sup>69</sup><http://venturehacks.com/articles/how-much-money>

<sup>70</sup><http://ycombinator.com/>

<sup>71</sup><http://ycombinator.com/faq.html>

## **6. How much money can we raise in a seed round?**

If you sell 20% of your company at a \$2.5M post-money, you raise \$500K. That's about the maximum for a seed round. Beyond that is Series A country.

## **7. How much dilution should we expect in a seed round?**

Take as much money as you can while keeping dilution between 15-30% (10%-20% of the dilution goes to investors and 5%-10% goes to the option pool<sup>72</sup>).

Compare this to a Series A which might have 30%-55% dilution. (20%-40% of the dilution goes to investors and 10%-15% goes to the option pool.)

A seed round can pay for itself if the quality of your investors and progress brings your eventual Series A dilution down from 55% to 30% (for the same amount of Series A cash).

Don't over-optimize your dilution. Raising money is often harder than you expect, especially for first-time entrepreneurs.

Smart investors don't over-optimize dilution either. They want to buy enough points to own a good chunk of the company. But they want to leave the founders with enough points to keep them highly motivated to build a lot of value for the founders and investors alike.

Finally, if you've made it this far, please enjoy the following presentation:

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<sup>72</sup><http://venturehacks.com/articles/option-pool-shuffle>

## VH Twitters: Ball punching edition

We usually quote other people's genius in our Twitter feed<sup>73</sup> but, once in a while, we throw in a microhack of our own. Here are a few of the popular microhacks:

You don't need permission to start a company. From investors, co-founders, or anyone else.

Trying to recruit while you're in "stealth mode" is like punching yourself in the balls (see picture).



Better to do the right thing wrong than the wrong thing right.

Sales: Always be closing. Product: Always be re-leasing. (Sam Purtill replies<sup>74</sup>, "Engineers: Always

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<sup>73</sup><http://twitter.com/venturehacks>

<sup>74</sup><http://friendfeed.com/e/f09c3a48-4de8-0a00-2a2c-f86b6f8660ed>

be coding.”)

Advice is for learning, not copying.

Don’t ask investors what they think. Ask your customers.

Competitors copy success, not ideas.

Traction speaks louder than words.

By the way, I figured out which twitters were popular by looking for entries that people “liked” in my FriendFeed<sup>75</sup>.

*Image Source:* RobbinsSports<sup>76</sup>.

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<sup>75</sup><http://friendfeed.com/nivi>

<sup>76</sup><http://www.robbinssports.com/sporting-goods-store/>

# May 2008

## Lijit's CEO on raising money from angels



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Todd Vernon<sup>2</sup>, the CEO of Lijit<sup>3</sup>, has written a great article<sup>4</sup> on raising money from angels. I especially like his taxonomy of angels:

**The Family Investor:** The Family Investor is likely not really a classic Angel Investor at all but rather a supportive family member that “knows you”. Their motivation is likely out of support (sometimes guilt), but their basic investment thesis is they trust **you**. For me these are the worst type of investor because you likely have intimate knowledge of their financial situation and whether or not they ‘should’ be investing. Likely, they have no inherent feel if your idea is good or not, but may have changed your diaper at one time or another and have overcome that experience to hand you a check for \$25K or \$50K. Personally, I like this category of investor the least

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<sup>1</sup><http://falseprecision.typepad.com/>

<sup>2</sup><http://falseprecision.typepad.com/>

<sup>3</sup><http://www.lijit.com/>

<sup>4</sup>[http://falseprecision.typepad.com/my\\_weblog/2008/05/angel-financing.html](http://falseprecision.typepad.com/my_weblog/2008/05/angel-financing.html)

because the investment is totally emotional and personal – and that sucks in business. But based on the financial situation of the individuals involved and the relationships this can work ok if everyone comes into the situation with their eyes open, but go out of your way to make sure.

**“The Relationship Investor:** The Relationship Investor is probably one or more co-workers from a previous gig or business friends you have known for a while. They may or may not understand what your new company is doing but they have had a track record working with **you**. They want to be supportive, but are looking for a return. You won’t lose them as friends if things go bad, but the investment for them is likely not ‘trivial’. In my experience these are good Angels to have, again as long as their eyes are open going in. These people can also be wildly supportive of you in terms of finding employees and other resources.

**“The Idea Investor:** The Idea Investor is probably very familiar with the space your company is targeting. These are in some ways the very best types of Angels because to some degree they validate your idea. Their investment is based on the **Idea** and there is little emotion around the table (always good). If you can get them onboard they can open doors into partner relationships and just generally good advice. You will spend most of your time convincing the Idea Investor that you and team are the right people to attack this problem (as they likely don’t have a strong relationship with you or the team). Often an influential Idea Investor makes a good early board member for the company.

**“The Once Removed Investor:** The Once Removed Investor is likely connected through a per-

sonal or professional relationship with either the Relationship Investor or the Idea Investor. They likely don't know you, and they likely don't have a clue if your idea is good or bad but they have translated the trust in the investment to the person they know. This is a great way to get additional Angel Investors onboard, but without a solid Relationship Investor or Idea Investor it just isn't going to happen."

Read the rest of Todd's article<sup>5</sup>.

(*Via: Ask the VC*<sup>6</sup>.)

## High concept pitches for startups

"For investors, the product is nothing."

– Marc Hedlund<sup>7</sup>

**Summary:** A high concept pitch distills a startup's vision into a single sentence. It's the perfect tool for fans who are spreading the word about your company.

Hollywood has perfected the art of the high concept pitch<sup>8</sup>:

"Its Jaws in space!" (*Alien*)

"A bus with a bomb!" (*Guess.*)

"Snakes on a plane!" (Do I really have to spell it out for you.)

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<sup>5</sup>[http://falseprecision.typepad.com/my\\_weblog/2008/05/angel-financing.html](http://falseprecision.typepad.com/my_weblog/2008/05/angel-financing.html)

<sup>6</sup><http://www.askthevc.com/blog/>

<sup>7</sup><http://radar.oreilly.com/archives/2006/03/entrepreneurial-proverbs.html>

<sup>8</sup><http://www.mtv.com/movies/news/articles/1535928/story.jhtml>

“A serial killer who bases murders on the seven deadly sins!” (*Se7en*)

“Bambi meets Terminator!” (Okay, I made this one up.)

## **High concept pitches for startups.**

“Summarize the company’s business on the back of a business card,” says Sequoia<sup>9</sup>. We agree—every startup should have a high concept pitch:

“Friendster for dogs.” (Dogster<sup>10</sup>)

“Flickr for video.” (YouTube)

“We network networks.” (Cisco)

“The Firefox of media players.” (Songbird<sup>11</sup>)

“Massively Multiplayer Online Learning.” (Grockit<sup>12</sup>)

“The entrepreneurs behind the entrepreneurs.” (Sequoia)

“Venture Hacks.” (Guess who.)

A high concept pitch distills a startup’s vision into a single sentence.

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<sup>9</sup><http://www.sequoiacap.com/ideas/>

<sup>10</sup><http://www.dogster.com/>

<sup>11</sup><http://songbirdnest.com/>

<sup>12</sup><http://www.techcrunch.com/2007/07/24/grockit-raises-cash-prepares-massive-multiplayer-on>



## What makes a good high concept pitch?

First, the pitch should be brief: one short sentence is perfect.

Second, people should already understand the building blocks of the pitch: buses, bombs, Jaws, space, the seven deadly sins, Flickr, Firefox, MMOGs, *et cetera*. The pitch combines the building blocks by using analogy, synthesis, juxtaposition, combination, whatever; *e.g.* “Jaws in space.”

Third, the pitch probably isn’t your company’s tagline. YouTube’s tagline is “Broadcast Yourself,” and their pitch is “Flickr for video”. If you’re lucky, you can find a pitch that’s also a tagline, *e.g.* Cisco’s “We network networks.” But don’t worry if your pitch isn’t a tagline.

## What's a high concept pitch good for?

First, the pitch is the perfect tool for fans who are spreading the word about your company. Investors use the pitch when they tell their partners about your startup. Customers use the pitch when they rave about your product. The press uses the pitch when they cover the company, *e.g.* see Mike Arrington's article, Comparing The Flickr's of Video<sup>13</sup>.



<sup>14</sup>

Second, the high concept pitch is a great way to describe your product and vision in an elevator pitch<sup>15</sup>. We started this article with a quote from Marc Hedlund<sup>16</sup>: "For investors, the product is nothing." Bad elevator pitches go on and on about the product. Good ones boil it down to a high concept pitch. The rest of the elevator pitch should be devoted to your traction, social proof, team, and market.

What are your favorite high concept pitches? Add them to the comments.

*Related:* "High Concept" startups<sup>17</sup>.

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<sup>13</sup><http://www.techcrunch.com/2005/11/06/the-flickr-s-of-video/>

<sup>14</sup><http://radar.oreilly.com/archives/2006/03/entrepreneurial-proverbs.html>

<sup>15</sup><http://venturehacks.com/articles/elevator-pitch>

<sup>16</sup><http://radar.oreilly.com/archives/2006/03/entrepreneurial-proverbs.html>

<sup>17</sup><http://lsvp.wordpress.com/2007/03/26/high-concept-startups/>

## From incoherent to high concept pitch

Anthony Stevens read our article on high concept pitches<sup>18</sup> and decided to write a high concept pitch for his startup<sup>19</sup>:

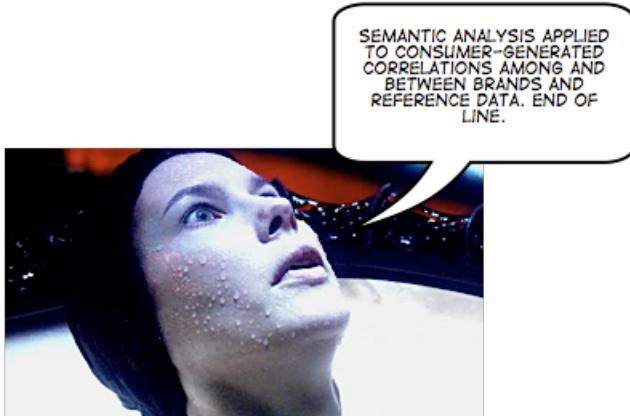
“So, let’s see: my startup is Crowdify, a tool for brand and reputation managers to discover new insights into consumers’ attitudes about their subjects and make better decisions about marketing and public relations strategy. We do this through semantic analysis applied to consumer-generated correlations among and between brands and reference data. Further, we utilize social-networking metaphors to keep interesting information flowing back and forth between branding people and the consuming public.”

Most elevator pitches look like this: long, boring, senseless, and ineffective. You probably stopped reading after the first sentence. Or the pitch looked so long you didn’t read it at all.

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<sup>18</sup><http://venturehacks.com/articles/high-concept-pitch>

<sup>19</sup><http://xidey.wordpress.com/2008/05/19/high-concept-pitches-for-startups/>



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Fortunately, Anthony came to same conclusion<sup>21</sup>:

"That's a little wordy, especially for a business card, so let's try a little high-concept pitch development. Hmm... relations that people will understand. "A for B", where A is a known brand in my space, and B is the target audience... how about:

### **Facebook for Brands**

"I think I like it! Not least of which is the rumor floating around today that Facebook is about to be acquired by Microsoft for something like 15 to 20 billion dollars."

I like it too. Anthony started with a long paragraph that actually hurt him more than it helped. Then he turned it into a high concept pitch that opens the door to a conversation about his company.

<sup>20</sup>[http://en.battlestarwiki.org/wiki/Hybrid\\_utterances](http://en.battlestarwiki.org/wiki/Hybrid_utterances)

<sup>21</sup><http://xidey.wordpress.com/2008/05/19/high-concept-pitches-for-startups/>

## O'Reilly Startup Camp



<sup>22</sup>

O'Reilly's venture capital fund, OATV<sup>23</sup>, is holding a Startup Camp<sup>24</sup> this summer. Bryce Roberts<sup>25</sup>, a partner at OATV, asked us to spread the word and we're happy to do it.

You need to apply<sup>26</sup> to get in and 6-8 startups will be selected. They're looking for companies that "have the potential to change the world for the better." (Their application asks for a deck<sup>27</sup> but we think they should ask for a high concept pitch<sup>28</sup> and elevator pitch<sup>29</sup> first.)

If I know O'Reilly, Startup Camp won't involve long, boring lectures. Instead, participants will teach each other in sessions led by startup veterans<sup>30</sup> like Evan Williams<sup>31</sup>.

The selected startups will also be invited to Foo Camp<sup>32</sup>, which is, in my opinion, one of the best technology conferences in the

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<sup>22</sup><http://venturehacks.com/bryce>

<sup>23</sup><http://oatventures.com>

<sup>24</sup><http://radar.oreilly.com/archives/2008/05/oreilly-alphatech-ventures-startup-camp.html>

<sup>25</sup><http://venturehacks.com/bryce>

<sup>26</sup><http://oatventures.com/foo/>

<sup>27</sup><http://venturehacks.com/articles/deck>

<sup>28</sup><http://venturehacks.com/articles/high-concept-pitch>

<sup>29</sup><http://venturehacks.com/articles/elevator-pitch>

<sup>30</sup><http://oatventures.com/foo/>

<sup>31</sup><http://evhead.com>

<sup>32</sup>[http://en.wikipedia.org/wiki/Foo\\_Camp](http://en.wikipedia.org/wiki/Foo_Camp)

world.

I think Startup Camp will also generate good dealflow for OATV—and there's nothing wrong with that. O'Reilly has been planting seeds in Silicon Valley with conferences like Foo Camp for years and years. They know that you have to give value before you get value.

## Free ideas. Just add execution.



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Go read Mike Speiser's new blog: Laserlike<sup>34</sup>. Its theme is, "Free ideas. Just add execution."

Mike recently joined Sutter Hill Ventures<sup>35</sup> as a Managing Director. Before that, he founded Epinions with fellow Venture Hacker Naval Ravikant<sup>36</sup> and founded Bix<sup>37</sup> (acquired by Yahoo).

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<sup>33</sup><http://laserlike.com/>

<sup>34</sup><http://laserlike.com/>

<sup>35</sup><http://www.shv.com>

<sup>36</sup><http://www.startupboy.com/>

<sup>37</sup><http://bix.yahoo.com/>

## Ideas

In his second post<sup>38</sup>, Mike writes,

“The theme of Laserlike is that ideas are overvalued. Entrepreneurs spend too much time worrying about protecting their ideas and not enough time launching them!

“I’m going to share my thoughts during my presentation at TiEcon this Friday at 11am, during which I am going to “give away” three of my favorite ideas. I will then blog about those ideas in more detail after the presentation and will continue sharing and discussing ideas openly on Laserlike in the future. Hope to see you there!”

My favorite idea on his blog is Shadow Market: Money management by the masses<sup>39</sup>.

## Execution

Make sure you read Mike’s TiEcon presentation<sup>40</sup> (pdf). The section on execution is invaluable. Here are some of my favorite snippets:

“The real cost of a startup is not career risk, but rather the amount of time and psychic energy they consume.”

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<sup>38</sup><http://laserlike.com/2008/05/13/speaking-at-tiecon-this-friday-at-11am/>

<sup>39</sup><http://laserlike.com/2008/05/27/shadow-market-money-management-by-the-masses/>

<sup>40</sup><http://mspeiser.files.wordpress.com/2008/05/mike-speiser-tiecon2008.pdf>

“Startups launch to the world too quickly and then lose some of their natural advantage of flexibility by inheriting backward compatibility.”

“Apply the same filter on your investors as you do on your founders.”

“If you have traction, you have a good deal of leverage. Even if you don’t have traction, you are better off boot strapping than going into a long-term business partnership with the wrong person or firm.”

“While it’s possible to invent a massive new market at the same time as building the market leader in that market, it’s a low probability bet.”

“The winner in your market will likely be the one with the best leader. A startup CEO needs to convince people to make “irrational” bets with their own lives. He needs to convince customers to be early adopters. He usually needs to raise capital and manage risk averse investors. A great group of people with a weak CEO will lose. A strong CEO has a strong grasp of strategy, can sell anything to anyone, and can inspire people to do what they never realized they could achieve.”

## Hollywood Pitch: Feedburner for iPhones

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<sup>41</sup> <http://yardley.ca/2008/05/29/pinch-media-is-now-live/>

I want to give Pinch Media a shout-out for mentioning our post on high concept pitches<sup>42</sup> in their funding announcement<sup>43</sup>. Their pitch is,

“FeedBurner for iPhone developers.”

Can they shorten it even further? “FeedBurner for iPhones”?

I wonder if they used our other hacks<sup>44</sup> too when they negotiated their deal with Union Square Ventures<sup>45</sup> and First Round Capital<sup>46</sup>. (Mobile analytics must be picking up steam; Motally<sup>47</sup> just joined Venture Hacks—they “track and report usage statistics across mobile websites.”)

Some people think high concept pitches are too simple. I agree, they are too simple—that’s the point. They’re the beginning of a conversation, not the end of one.

There are too many startups vying for too little attention. You simply won’t have the opportunity to tell your whole story at once. A high concept pitch is a meme that you use to capture some attention, so you have the chance to tell the rest of your story.

Marc Hustvedt<sup>48</sup>, an angel investor on Venture Hacks, calls the high concept pitch a “Hollywood pitch<sup>49</sup>”. I like it. “Hollywood pitch” is shorter and more concrete. Which one do you prefer?

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<sup>42</sup><http://venturehacks.com/articles/incoherent-to-high-concept>

<sup>43</sup><http://yardley.ca/2008/05/29/pinch-media-is-now-live/>

<sup>44</sup><http://venturehacks.com/term-sheet-hacks>

<sup>45</sup><http://venturehacks.com/unionsquareventures>

<sup>46</sup><http://venturehacks.com/first-round-capital>

<sup>47</sup><http://venturehacks.com/motally>

<sup>48</sup><http://venturehacks.com/marchustvedt>

<sup>49</sup><http://seedwatcher.typepad.com/seedwatcher/2008/05/the-hollywood-p.html>

# June 2008

## Control is a one way street

**Summary:** Control is a one way street that runs towards investors. Control doesn't run backwards towards founders or common stockholders. In each round of financing, the percentage of investor board seats goes up (or stays the same). Once the investors have more board seats than the common, you've lost control of the board and you're never getting it back. Your best bet is to be stingy with board seats and hope you never have to raise a round without good leverage.



<sup>1</sup>

An interesting idea came up in a meeting with Mike Speiser<sup>2</sup> last week:

Control is a one way street.

In startups, control is a one way street that runs towards investors. Control doesn't run backwards towards founders or common stockholders (unless you create dual-class stock<sup>3</sup> when you IPO).

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<sup>1</sup><http://venturehacks.com/mspeiser>

<sup>2</sup><http://venturehacks.com/mspeiser>

<sup>3</sup><http://blog.pmarca.com/2008/05/in-praise-of-du.html>

## Types of control.

Here's how control shifts to investors with each round of financing:

**The Board:** In each round of financing, the percentage of investor board seats goes up (or stays the same). And the percentage of common board seats goes down (or stays the same). In each round, the common can only hope to maintain their percentage of board seats.

**Protective Provisions and Class votes:** In each round of financing, the number of investors who participate in protective provisions<sup>4</sup> and class votes<sup>5</sup> (also see here<sup>6</sup>) goes up (or stays the same). That means you'll have to ask more investors for their consent to do things like sell the company.

**Shareholders:** In each round of financing, the percentage of company shares held by investors goes up (obviously).

Class votes, shareholder votes, and the exercise of protective provisions are rare compared to board actions. The board meets about once a month to approve management decisions—so let's take a closer look at the board.

## An example.

Here's an example of how control of the board shifts to investors with each round:

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<sup>4</sup><http://venturehacks.com/term-sheet-hacks#protective-provisions>

<sup>5</sup><http://www.startupcompanylawyer.com/2007/08/07/what-stockholder-approval-is-necessary-to-complete-a-venture-financing/>

<sup>6</sup><http://www.startupcompanylawyer.com/2007/08/09/what-stockholder-approval-is-necessary-to-sell-a-company/>

**Founding:** The founders have all the board seats. Let's say the board consists of 2 founders.

**Seed:** The founders usually keep all the board seats.

**Series A:** The investors gain two board seats, an independent joins the board, and the founders don't gain any board seats. Let's say the board is now 2 investors, 2 founders, and 1 independent.

**Series B:** The company has a tough time raising money so the investors gain one more board seat but the founders don't. The board is now 3 investors, 1 independent, and 2 founders. The investors now control the board.

In each round of financing, the percentage of common board seats stayed the same or went down. Don't count independent directors when you're calculating the percentage of common board seats—you don't know how the independent director will vote<sup>7</sup>.

## Facts about investor board seats.

Here are some facts to consider when you're giving board seats to investors:

1. In every round of financing, you will have to give board seats to investors. (There are two exceptions: (1) many seed rounds don't give board seats to investors, and (2) some later-stage rounds don't give board seats to investors if the company has a lot of leverage or the new investor has a lot of experience following an existing investor.)

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<sup>7</sup><http://venturehacks.com/articles/board-structure#independent>

2. If you give a board seat to an investor, you're never getting that board seat back.
3. Every time the percentage of common board seats goes down, you're stepping towards losing control of the board. (Don't count independents when you're calculating the percentage of common board seats.)
4. If you ever raise a round with poor leverage, the investors will gain control of the board.
5. Once the investors have more board seats than the common, you've lost control of the board and you're never getting it back.

## **How to structure your board.**

Your best bet is to be stingy with board seats and hope you never have to raise a round without good leverage:

1. Build a great company with good traction<sup>8</sup> so you have a lot of leverage when you raise money.
2. Exploit your traction by creating a market for your shares<sup>9</sup> when you raise money. You need alternatives to get good terms.
3. Create a board that reflects the ownership of the company<sup>10</sup>. Some investors argue that a board that has an equal number of investor seats and common seats (not counting independents) is "balanced". But this board is actually "investor-leaning". In bad times, investors will take over this board. But, in good times, the common doesn't take over the board.

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<sup>8</sup><http://venturehacks.com/articles/plans-ndas-traction#traction>

<sup>9</sup><http://venturehacks.com/term-sheet-hacks#negotiation>

<sup>10</sup><http://venturehacks.com/articles/board-structure>

4. Don't let your investors control the board through an independent board seat<sup>11</sup>.
5. Create a new board seat for a new CEO<sup>12</sup>. Don't give him one of the common seats.

Control is a one way street. You have to go down the road to raise money—but be wise about how far you go.

## Mike Cassidy: Speed as THE primary business strategy

Mike Cassidy<sup>13</sup>'s talk on startup speed is a must-read for all entrepreneurs:

(The slides are here<sup>14</sup> if you don't see them embedded above.)

Mike founded Stylus Innovation (sold 2 years after launch for \$13M), Direct Hit (sold 500 days after launch for \$500M), and Xfire<sup>15</sup> (sold 2 years after launch for \$110M).



<sup>16</sup>

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<sup>11</sup><http://venturehacks.com/articles/board-structure#independent>

<sup>12</sup><http://venturehacks.com/articles/ceo-board-seat>

<sup>13</sup><http://venturehacks.com/mike2>

<sup>14</sup><http://www.slideshare.net/dmc500hats/best-strategy-is-speed-startup2startup-may-2008?src=embed>

<sup>15</sup><http://www.xfire.com/>

<sup>16</sup><http://venturehacks.com/mike2>

I originally saw Mike's talk at Dave McClure's Startup2Startup<sup>17</sup>. The audio from that presentation is not available, so I pieced together some clips of Mike on Tim Ferriss' Art of Speed<sup>18</sup> panel at SXSW: Mike on the Art of Speed<sup>19</sup> (mp3).

You'll learn a lot more from the slides if you listen to the audio too.

## VH Twitters: “It’s never been done before” Edition



<sup>20</sup>

Here are the latest great quotes from our twitter feed<sup>21</sup> (rss<sup>22</sup>):

“Just about everything has a strike against it. It’s either already been done or it’s never been done.” – Seth Godin<sup>23</sup>

“Silicon Valley is a place where ‘it’s never been done before’ is a compliment.” – Naval Ravikant<sup>24</sup>

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<sup>17</sup><http://startup2startup.com>

<sup>18</sup><http://www.fourhourworkweek.com/blog/2008/05/29/the-art-of-speed-conversations-with-monster-makers/>

<sup>19</sup><http://venturehacks.com/wp-content/uploads/2008/06/speed.mp3>

<sup>20</sup><http://twitter.com/venturehacks>

<sup>21</sup><http://twitter.com/venturehacks>

<sup>22</sup>[feed://twitter.com/statuses/user\\_timeline/11620792.atom](http://feed://twitter.com/statuses/user_timeline/11620792.atom)

<sup>23</sup>[http://sethgodin.typepad.com/seths\\_blog/2008/04/the-fibula-and.html](http://sethgodin.typepad.com/seths_blog/2008/04/the-fibula-and.html)

<sup>24</sup><http://venturehacks.com/naval>

“You can’t build to sell. If you build to sell, you’re not building anything of sustained value.” – Craig McCaw<sup>25</sup>

“Get good cofounders. You can’t change who you are, at least not in a short time.” – Paul Graham<sup>26</sup>

“The main thing is to keep the main thing the main thing.” – Jim Barksdale<sup>27</sup>

“They assured us that lots of things were standard, but, boy, were the standards awful.” – Jim Cramer<sup>28</sup>

And here are a few quotes from my personal twitter feed<sup>29</sup> (rss<sup>30</sup>)

“The uncreative mind can spot wrong answers, it takes a very creative mind to spot wrong questions.”  
– Antony Jay<sup>31</sup>

“If you’re having trouble succeeding, fail.” – Kent Beck<sup>32</sup>

Thanks kindly for reading our stuff.

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<sup>25</sup> [http://blog.seattletimes.nwsource.com/techtracks/archives/2007/11/mccaw\\_says\\_hes\\_not\\_ready\\_to\\_sell\\_clearwire\\_1.html](http://blog.seattletimes.nwsource.com/techtracks/archives/2007/11/mccaw_says_hes_not_ready_to_sell_clearwire_1.html)

<sup>26</sup> <http://www.paulgraham.com/frinterview.html>

<sup>27</sup> <http://blog.pmarca.com/2007/07/the-pmarca-guid.html>

<sup>28</sup> [http://books.google.com/books?id=uXVXu79IB8IC&pg=PA168&dq=%22They+assured+us+that+lots+of+things+were+standard+but+boy+were+the+standards+awful%22&lr=&num=20&ei=3sVESJ-zF4KijgHM0dC4Bg&sig=W1geQuptlMo\\_DW27\\_vNvKfNaV6A](http://books.google.com/books?id=uXVXu79IB8IC&pg=PA168&dq=%22They+assured+us+that+lots+of+things+were+standard+but+boy+were+the+standards+awful%22&lr=&num=20&ei=3sVESJ-zF4KijgHM0dC4Bg&sig=W1geQuptlMo_DW27_vNvKfNaV6A)

<sup>29</sup> <http://twitter.com/nivi>

<sup>30</sup> [http://twitter.com/statuses/user\\_timeline/644863.rss](http://twitter.com/statuses/user_timeline/644863.rss)

<sup>31</sup> <http://www.37signals.com/svn/posts/995-if-youre-working-in-a-big-group-youre-fighting-humanity>

<sup>32</sup> [http://www.amazon.com/Extreme-Programming-Explained-Embrace-Change/dp/0321278658/ref=ed\\_oe\\_p](http://www.amazon.com/Extreme-Programming-Explained-Embrace-Change/dp/0321278658/ref=ed_oe_p)

## Lawyers are referees, not coaches



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I learned a lot from a recent twitter by Andrew Chen<sup>34</sup>:

“Other people teach you the rules of the game. Venture Hacks teaches you how to play it.”

**First, I learned that lawyers are referees, not coaches.**

**Second, I learned that advisors<sup>35</sup> are the coaches of the startup game.**

Lawyers teach you the rules of the game. But they usually can't teach you how to play it.

Lawyers tell you whether you can do something, within the confines of the law and your existing contracts. Lawyers will also write the contracts and do the filings. But they usually can't tell you *what* to do—that's what coaches do.

Here's a classic startup mistake that illuminates the difference between a coach and a referee:

You're negotiating an investment and you've agreed to a board with 2 investors, 2 common, and 1 independent.

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<sup>33</sup><http://venturehacks.com/voodoo>

<sup>34</sup><http://venturehacks.com/voodoo>

<sup>35</sup><http://venturehacks.com/articles/advisors>

You're almost ready to sign the term sheet when your prospective investors say, "Sorry, we forgot, one of the common board seats needs to be the CEO."

You're thinking, "I'm the CEO and I was going to elect myself to the board anyway, so that's fine." Your lawyer agrees and says, "That's standard."

This is a mistake. If you hire a *new* CEO and he's aligned with the investors, the investors will gain control of the board. Instead, you should create a new board seat for a new CEO<sup>36</sup>.

A lawyer knows that you're not breaking any laws or contracts if you give a common board seat to a new CEO. He also knows how to write the contract. But an advisor knows the possible outcomes of that decision.

**Third, startups without advisors often assume their lawyers have good business advice.** That's a mistake. You need a coach, not a referee, to teach you how to play the game. And most referees aren't good coaches (but some are).

**Fourth, not every coach is a Phil Jackson**<sup>37</sup>. Not every coach has won 9 NBA titles *as a coach*. The effectiveness of coaches in the NBA varies widely. Why would the effectiveness of advisors be any different? Is your advisor a Phil Jackson?

**Fifth, there's more than one way to play the game.** Phil Jackson doesn't have a monopoly on coaching. And neither do we. Go find a coach who can teach you how to play the game. There's only one Phil Jackson in the NBA because basketball is a zero-sum game. Fortunately, there's more than one great startup advisor in the world—life is not a zero-sum game.

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<sup>36</sup><http://venturehacks.com/articles/ceo-board-seat>

<sup>37</sup>[http://en.wikipedia.org/wiki/Phil\\_Jackson](http://en.wikipedia.org/wiki/Phil_Jackson)

## A Hollywood for Startups

John Manoogian<sup>38</sup> sent me this great trailer for The Player<sup>39</sup>, a satire of the movie making system in Hollywood:

(Link: The Player<sup>40</sup>)

Silicon Valley is the Hollywood of startups.

Business plans are scripts, entrepreneurs are writers, engineers are talent, VCs are studios, angels are independent financiers, recruiters are casting agents, lawyers are lawyers, advisors are agents, points<sup>41</sup> are options, TechCrunch is Variety<sup>42</sup>, and so on.

What analogies am I missing?

## Don't follow our advice

“As for the advice? Lots to choose from. Think big, or maybe small.”

— John Abell<sup>43</sup>, on Startup School 08<sup>44</sup>

*Advice is for learning, not copying.* Don't follow our advice.

*Advice can be ignored.* One of my favorite advisors once told the founders of YouTube that, “People don't want to watch video on their computers.”

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<sup>38</sup><http://www.jm3.net/>

<sup>39</sup>[http://en.wikipedia.org/wiki/The\\_Player](http://en.wikipedia.org/wiki/The_Player)

<sup>40</sup><http://www.youtube.com/watch?v=dwnhRRRQtAI&eurl=http://venturehacks.com/>

<sup>41</sup><http://www.indietalk.com/showthread.php?t=10545>

<sup>42</sup><http://www.variety.com/>

<sup>43</sup><http://blog.wired.com/business/2008/04/world-dominatio.html>

<sup>44</sup><http://omnisio.com/startupschool08>

*Advice is useful if it helps you perceive and evaluate the outcomes of today's actions.* That's what it means to be wise<sup>45</sup>. But advisors can't be wise for you, especially since they don't know your values, goals, and environment.

*Understanding advice isn't as useful as understanding why you're supposed to be following it.*

*Advice tells you how to play the game*<sup>46</sup>. But there's more than one way to play the game in chess, football, business, and life.

*Advice distills the experiences of the past.* But what worked yesterday will not work tomorrow. Today is not for copying the past. Today is for testing hypotheses whose outcome is unknown.

*Advice asks for mimicry:* “*This works for me so you should do the same thing I do.*” But the essence of strategy<sup>47</sup> is to perform different activities than your rivals do. Strategy requires differentiation—not mimicry.

Once you've gathered advice, take the course that **you** think is best—you're the only one who will be faced with the consequences.

“You can't be normal and expect abnormal returns.”

– Jeffrey Pfeffer<sup>48</sup>, The Human Equation<sup>49</sup>

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<sup>45</sup> [http://books.google.com/books?id=xyIRdiAbpr8C&pg=PA162&dq=re-creating+the+corporation+%22wisdom+is+the+ability%22&lr=&ei=yOYOSoqSNouKtAOA27mMBg&sig=blKrNY2LATPyHRI\\_qvHYPV5ddH0](http://books.google.com/books?id=xyIRdiAbpr8C&pg=PA162&dq=re-creating+the+corporation+%22wisdom+is+the+ability%22&lr=&ei=yOYOSoqSNouKtAOA27mMBg&sig=blKrNY2LATPyHRI_qvHYPV5ddH0)

<sup>46</sup> <http://venturehacks.com/articles/referees>

<sup>47</sup> [http://www.google.com/url?sa=t&ct=res&cd=3&url=http%3A%2F%2Fwww.exchange.unisg.ch%2Forg%2Flehre%2Fexchange.nsf%2F1176ad62df2ddb13c12568f000482b94%2Fd58eda8f1f3dc90c1256fa3005ebc52%2F%24FILE%2FPorter%2520-%2520What%2520Is%2520Strategy.pdf&ei=F8gOSKuRF5OkpwTKiujaBw&usg=AFQjCNFjZpa\\_zOYjC1jUtsL9i1sGyeMPQ&sig2=Mx8uPs\\_ZRyfdFnznUTVK5w](http://www.google.com/url?sa=t&ct=res&cd=3&url=http%3A%2F%2Fwww.exchange.unisg.ch%2Forg%2Flehre%2Fexchange.nsf%2F1176ad62df2ddb13c12568f000482b94%2Fd58eda8f1f3dc90c1256fa3005ebc52%2F%24FILE%2FPorter%2520-%2520What%2520Is%2520Strategy.pdf&ei=F8gOSKuRF5OkpwTKiujaBw&usg=AFQjCNFjZpa_zOYjC1jUtsL9i1sGyeMPQ&sig2=Mx8uPs_ZRyfdFnznUTVK5w)

<sup>48</sup> <http://www.google.com/search?hl=en&lr=&q=Jeffrey%20Pfeffer>

<sup>49</sup> [http://books.google.com/books?id=vM4KVbYID-EC&pg=PR9&dq=%22You+can%27t+be+normal+and+expect+abnormal+returns.%22&lr=&ei=TiZISMjiK4ektAPu34WDBw&sig=S1F7ood8dUsv3kYqF\\_TfvdBdGD8](http://books.google.com/books?id=vM4KVbYID-EC&pg=PR9&dq=%22You+can%27t+be+normal+and+expect+abnormal+returns.%22&lr=&ei=TiZISMjiK4ektAPu34WDBw&sig=S1F7ood8dUsv3kYqF_TfvdBdGD8)

(Video: Write this... or that... or maybe<sup>50</sup>)

## Daddy, what's a soft circle?



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Brad Feld<sup>52</sup> recently proposed good criteria<sup>53</sup> to distinguish true followers from tire-kickers when you're raising money:

“While you can’t contractually commit the supporting investors [followers], you can usually separate the real ones from the tire-kickers (or—more generously—the call option people). Committed supporting investors are going to let you use their names with potential lead investors, will engage in active networking, and will name a specific amount they are willing to invest.

“These supporting investors are typically called “soft circles”—you’ve got a commitment from them, but it’s not a legally binding one. **A soft circle will always have a dollar amount attached to it** [emphasis added].”

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<sup>50</sup><http://www.youtube.com/watch?v=Zo1XFz0kac0&eurl=http://venturehacks.com/?p=332&preview=true>

<sup>51</sup><http://www.feld.com/blog/>

<sup>52</sup><http://www.feld.com/blog/>

<sup>53</sup><http://www.askthevc.com/blog/archives/2008/06/ive-got-angels.php>

True followers will also make strong introductions to potential leads.

Learn more about followers and leads in *How do I find a lead investor?*, Parts 1<sup>54</sup>, 2<sup>55</sup>, and 3<sup>56</sup>.

## Do you know any idea investors?

A reader asks:

“I’m an entrepreneur looking for seed investment. All I have right now is an idea and a pitch. I’m presently pitching friends and family and it has been very positive. Do you know any other idea investors I should approach?”

Investors want to see products and preferably traction unless you already have a significant track record. But,

### If you only have an idea.

If you have no traction, track record, or product—if you have nothing but an idea for a product in a large market, the only people who will meet you are:

1. **Family and Relationship Investors:** People who already know you and are willing to bet on **you**, based on your history together. They’re not betting on the company, they’re betting on you. They wouldn’t invest in

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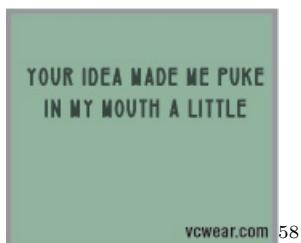
<sup>54</sup><http://venturehacks.com/articles/lead>

<sup>55</sup><http://venturehacks.com/articles/lead-part-2>

<sup>56</sup><http://venturehacks.com/articles/lead-part-3>

the company if you were replaced by someone who was equally effective. Todd Vernon calls these people family and relationship investors<sup>57</sup>.

2. **Idea Investors:** People who believe there's a big opportunity to serve the customer because they understand the customer as well as you do. Perhaps they've noticed the same opportunity as you but they haven't done anything about it.
3. **Once Removed Investors:** These investors trust or regularly co-invest with one of your family, relationship, or idea investors.



These investors sometimes have little to no experience investing in companies, but that is not an insurmountable hurdle. You will need traction, a track record, or a product to get meetings with other traditional seed stage investors.

*In general, the more you need money, the less likely you are to get it. But making something out of nothing is what entrepreneurs do.*

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<sup>57</sup> [http://falseprecision.typepad.com/my\\_weblog/2008/05/angel-financing.html](http://falseprecision.typepad.com/my_weblog/2008/05/angel-financing.html)

<sup>58</sup> <http://www.vcwear.com/>

### **Another option: Cold call funds.**

There are a few funds like Y Combinator<sup>59</sup>, Seedcamp<sup>60</sup>, and TechStars<sup>61</sup> who will look at applications from anybody doing anything. But you will probably need traction, a track record, or a compelling product to capture their interest—ideas need not apply.

### **Salesmen are an exception.**

Salesmen are good at getting people to comply with their wishes. That's what it means to be a salesman. Great salesmen can get meetings and raise money with just a large market and an idea (and maybe a sprinkling of track record).

## **Ideas need not apply**

There were a lot of good comments on yesterday's Do you know any idea investors?<sup>62</sup> post. Here's a few of them.

Michael Staton says:

“I'd say if you can't bother to build it yourself, get potential customers lined up, build revenue on an easier offshoot, or convince someone else to build it in their spare time, then you should reevaluate whether you are an entrepreneur.”

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<sup>59</sup><http://ycombinator.com/>

<sup>60</sup><http://www.seedcamp.com/>

<sup>61</sup><http://www.techstars.org/>

<sup>62</sup><http://venturehacks.com/articles/idea-investors>

Luca<sup>63</sup> says:

“The idea is the easy part. If you are a first-time entrepreneur, try scaling down your concept to something whose value you can prove with friends & family money, then go to professional investors. If your idea does not lend itself to such an approach, try your hand first with something you can bootstrap.”

Ben says:

“An idea has a dollar value of \$0. If you don’t believe in the idea enough to commit your cash/sweat equity to build it or a version of it to show it can work, why should friends, fools and family?”

## The Rocket Ship investment model



<sup>64</sup>

I’m reading Randy Komisar<sup>65</sup>’s book, The Monk and the Rid-

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<sup>63</sup><http://www.fairadvisors.com/blog/>

<sup>64</sup><http://www.kpcb.com/team/index.php?komisar>

<sup>65</sup><http://www.kpcb.com/team/index.php?komisar>

dle<sup>66</sup>. He wrote it before he became a partner at Kleiner Perkins<sup>67</sup> and I like his description of the Rocket Ship model of investing:

“Over the last several years... a new investment model has taken hold. Fill each startup with rocket fuel as fast as possible and blast it into space. The ones that fly, fly, and if the rest of them blow up, *c'est la vie*.

“In fact, the Rocket Ship Model of startup investment has recently produced many of the most prominent Valley successes. But for every one of them, there are many potentially viable companies that might have eventually prospered if they had been incubated longer.

“When too much money is pumped too fast into a startup, there's no room for mistakes. The initial product and the initial fix on the market have to be right. There's no way these companies can stop and reconsider what they're doing without a great deal of pain.

“You have to be able to survive mistakes in order to learn, and you have to learn in order to create sustainable success. Once the market is understood and the product is fully developed, then move fast and hard.”

Randy has a lot of other wisdom to share:

“[Angels] pay for the privilege of helping the company.”

“If I invest, I am prone to think like an investor, favoring my return over what's best for the team and often its long-term business.”

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<sup>66</sup><http://books.google.com/books?id=uYIGJWJGncYC&dq=monk+and+the+riddle&pg=PP1&ots=6o37yLsuia&sig=bFyAnzKMQFyUCtJGYzwmNVlpomY&hl=en&prev=http://www.google.com/search%3Fhl%3Den%26lr%3D%26q%3Dmonk%2Band%2Bthe%2Bridle&sa=X&oi=print&ct=title&cad=one-book-with-thumbnail>

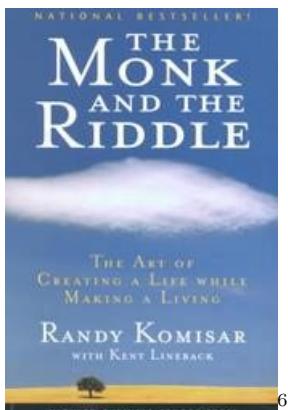
<sup>67</sup><http://www.kpcb.com/>

"In a privately held startup I don't favor the investors over the founders. This is probably the crucial way my thinking differs from a VC's."

"Business is one of the last remaining social institutions to help us manage and cope with change."

"The rules of business are like the laws of physics, neither inherently good nor evil, to be applied as you may. You decide whether your business is constructive or destructive."

## The Monk and the Riddle



68

More wisdom from Randy Komisar<sup>69</sup>'s *The Monk and the Rid-*

<sup>68</sup>[http://books.google.com/books?id=uYIGJWJGncYC&dq=the+monk+and+the+riddle&pg=PP1&ots=6o38tEqyna&sig=8E\\_YKP4BKT1tZP3KiyHGqCvBQFg&hl=en&prev=http://www.google.com/search%3Fq%3Dthe%2Bmonk%2Band%2Bthe%2Briddle%26um%3D1%26hl%3Den%26lr%3D%26safe%3Doff%26imgsz%3Dsmall%257Cmedium%257Clarge%257Cxlarge%26ie%3DUTF-8%26sa%3DN%26tab%3Diw&sa=X&oi=print&ct=title&cad=one-book-with-thumbnail](http://books.google.com/books?id=uYIGJWJGncYC&dq=the+monk+and+the+riddle&pg=PP1&ots=6o38tEqyna&sig=8E_YKP4BKT1tZP3KiyHGqCvBQFg&hl=en&prev=http://www.google.com/search%3Fq%3Dthe%2Bmonk%2Band%2Bthe%2Briddle%26um%3D1%26hl%3Den%26lr%3D%26safe%3Doff%26imgsz%3Dsmall%257Cmedium%257Clarge%257Cxlarge%26ie%3DUTF-8%26sa%3DN%26tab%3Diw&sa=X&oi=print&ct=title&cad=one-book-with-thumbnail)

<sup>69</sup><http://www.kpcb.com/team/index.php?komisar>

dle<sup>70</sup> (emphasis added):

### Passion

“So why were they doing this? Why was it worth their time? I am always amazed that venture capitalists don’t ask that question. Perhaps at this point everyone assumes it’s obvious: to get rich.

“Passion and drive are not the same at all. Passion pulls you toward something you cannot resist. Drive pushes you toward something you feel compelled or obligated to do. If you know nothing about yourself, you can’t tell the difference. Once you gain a modicum of self-knowledge, you can express your passion...

**“[Passion] is the sense of connection you feel when the work you do expresses who you are.**  
Only passion will get you through the tough times... It’s the romance, not the finance that makes business worth pursuing.

“I can’t get excited by a business whose biggest idea is making money.”

### Venture Capital

“Most VCs (even if they insist otherwise) simply don’t have the time to give close management attention to the companies they’ve funded. In addition, in contrast to the original VCs, who often gathered years of operating experience prior to becoming venture capitalists, many partners in today’s firms have

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<sup>70</sup>[http://books.google.com/books?id=uYIGJWJGncYC&dq=the+monk+and+the+riddle&pg=PP1&ots=6o38tEqyna&sig=8E\\_YKP4BKT1tZP3KiyHGqCvBQFg&hl=en&prev=http://www.google.com/search%3Fq%3Dthe%2Bmonk%2Band%2Bthe%2Bridle%26um%3D1%26hl%3Den%26lr%3D%26safe%3Doff%26imgsz%3Dsmall%257Cmedium%257Clarge%257Cxlarge%26ie%3DUTF-8%26sa%3DN%26tab%3Diw&sa=X&oi=print&ct=title&cad=one-book-with-thumbnail](http://books.google.com/books?id=uYIGJWJGncYC&dq=the+monk+and+the+riddle&pg=PP1&ots=6o38tEqyna&sig=8E_YKP4BKT1tZP3KiyHGqCvBQFg&hl=en&prev=http://www.google.com/search%3Fq%3Dthe%2Bmonk%2Band%2Bthe%2Bridle%26um%3D1%26hl%3Den%26lr%3D%26safe%3Doff%26imgsz%3Dsmall%257Cmedium%257Clarge%257Cxlarge%26ie%3DUTF-8%26sa%3DN%26tab%3Diw&sa=X&oi=print&ct=title&cad=one-book-with-thumbnail)

no executive management experience. They could be working on Wall Street as easily as on Sand Hill Road.”

“I have never seen a company fail for having too much money. Dilution is nominal, but running out of money is terminal.”

### **Excellence**

“[Mediocrity is] the biggest risk of all in Silicon Valley... Instead of managing business risk to minimize or avoid failure, the focus here is on maximizing success. The Valley recognizes that failure is an unavoidable part of the search for success.

“[Excellence] should be your primary measure of success... not simply the spoils that come with good fortune. You don’t want to entrust your satisfaction and sense of fulfillment to circumstances outside your control. Instead, base them on the quality of what you do and who you are, not the success of your business per se.”

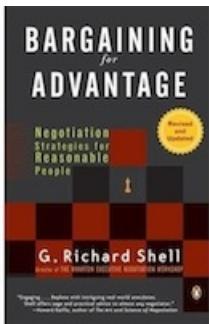
### **Leadership**

“Management is a methodical process; its purpose is to produce the desired results on time and on budget. It complements and supports but cannot do without leadership, in which character and vision combine to empower someone to venture into uncertainty. **Leaders must suspend the disbelief of the constituents and move ahead even with very incomplete information.**

“**Many ideas in this Valley happen against all common sense.** It’s good when entrepreneurs are a little bit deaf and blind, but if they’re completely deaf and complete blind—and many are—they’re unlikely to learn enough from the market and their advisors to make their vision a reality.”

# July 2008

## Books for Entrepreneurs: Bargaining for Advantage



This is the first in an ongoing series called *Books for Entrepreneurs*. We'll use these posts to recommend books that we've found useful as entrepreneurs (duh).

Our first book is *Bargaining for Advantage*<sup>2</sup> by G. Richard Shell<sup>3</sup>. Richard is a professor at Wharton<sup>4</sup> and this is my favorite negotiation book period. It synthesizes the principled negotiation of Getting to Yes<sup>5</sup> with the psychology of persuasion

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<sup>1</sup><http://www.amazon.com/gp/redirect.html?ie=UTF8&location=http%3A%2F%2Fwww.amazon.com%2FBargaining-Advantage-Negotiation-Strategies-Reasonable%2Fdpr%2F0143036971%3Fie%3DUTF8%26s%3Dbooks%26qid%3D1216083361%26sr%3D8-1&tag=httpventureco-20&linkCode=ur2&camp=1789&creative=9325>

<sup>2</sup><http://www.amazon.com/gp/redirect.html?ie=UTF8&location=http%3A%2F%2Fwww.amazon.com%2FBargaining-Advantage-Negotiation-Strategies-Reasonable%2Fdpr%2F0143036971%3Fie%3DUTF8%26s%3Dbooks%26qid%3D1216083361%26sr%3D8-1&tag=httpventureco-20&linkCode=ur2&camp=1789&creative=9325>

<sup>3</sup><http://www.wharton.upenn.edu/faculty/shellric.html>

<sup>4</sup><http://www.wharton.upenn.edu/>

<sup>5</sup><http://www.amazon.com/gp/redirect.html?ie=UTF8&location=http%3A%2F%2Fwww.amazon.com%2FBargaining-Advantage-Negotiation-Strategies-Reasonable%2Fdpr%2F0143036971%3Fie%3DUTF8%26s%3Dbooks%26qid%3D1216083361%26sr%3D8-1&tag=httpventureco-20&linkCode=ur2&camp=1789&creative=9325>

in Influence<sup>6</sup>.

Jim Pitkow<sup>7</sup> recommended this book while we were raising Songbird<sup>8</sup>'s Series A<sup>9</sup>. Since then, I have referred to it again and again while writing posts for Venture Hacks and answering questions from entrepreneurs.

Make sure you don't read this book if these questions are irrelevant to you: Should I be the first to open? Should I open optimistically or reasonably? What sort of concession strategy works best?

Here's a small sample of what you'll find in Bargaining for Advantage:

## What is leverage?

Everybody talks about leverage in negotiations but very few people know what it means. My favorite chapter, "Leverage" defines it (emphasis added):

**"A better way to understand leverage is to think about which side, at any given moment, has the most to lose from a failure to agree... the party with the most to lose has the least leverage; the party with the least to lose has the most leverage.**

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2FGetting-Yes-Negotiating-Agreement-Without%2Fd%2F0140157352%3Fie%3DUTF8%26s%3Dbooks%26qid%3D1216083467%26sr%3D8-2&tag=httpventureco-20&linkCode=ur2&camp=1789&creative=9325

<sup>6</sup><http://www.amazon.com/gp/redirect.html?ie=UTF8&location=http%3A%2F%2Fwww.amazon.com%2FInfluence-Psychology-Persuasion-Business-Essentials%2Fd%2F006124189X%3Fie%3DUTF8%26s%3Dbooks%26qid%3D1216083542%26sr%3D8-1&tag=httpventureco-20&linkCode=ur2&camp=1789&creative=9325>

<sup>7</sup>[http://www.pitkow.com/biography\\_precis.html](http://www.pitkow.com/biography_precis.html)

<sup>8</sup><http://getsongbird.com/>

<sup>9</sup><http://venturebeat.com/2007/10/31/songbird-a-browser-integrated-media-player-received-8m>

“Leverage often flows to the party that exerts the greatest control over and appears most comfortable with the present situation.

**“To gain real leverage, you must eventually persuade the other party that he or she has something concrete to lose in the transaction if the deal falls through.**

*“Positive leverage:* Every time the other party says “I want” in a negotiation, you should hear the pleasant sound of a weight dropping on your side of the leverages scales. [Positive leverage is the ability to provide things your opponent wants.]

*“Negative leverage:* Threat leverage [that] gets people’s attention because... potential losses loom larger in the human mind than do equivalent gains. But a word of warning is in order: Making even subtle threats is like dealing with explosives. [Negative leverage is the ability to hurt your opponent.]

*“Normative leverage:* [Normative leverage is the ability to apply general norms or your opponent’s standards and norms to advance your position.] You maximize your normative leverage when the standards, norms, and themes you assert are ones the other party views as legitimate and relevant to the resolution of your differences. Attack [your opponent’s] standard only as a last resort.

**“This way of thinking about leverage also points to more sophisticated ways of enhancing your leverage that go beyond just improving your BATNA<sup>10</sup>.** Your goal is to alter the situation (or at least the other party’s perception of the situation)

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<sup>10</sup>[http://en.wikipedia.org/wiki/Best\\_alternative\\_to\\_a\\_negotiated\\_agreement](http://en.wikipedia.org/wiki/Best_alternative_to_a_negotiated_agreement)

so you have less to lose, the other side has more to lose, or both.”

Bargaining for Advantage includes detailed examples that make the theory of leverage concrete. Read the book to learn about opening, making concessions, closing, the rogue’s gallery of tactics, ...

**Related:** The Monk and the Riddle<sup>11</sup>, Inside Intuit<sup>12</sup>.

## I have a job offer at a startup, am I getting a good deal? Part 1.

We've been answering this question a lot lately:

“I have a job offer at a startup, am I getting a good deal?”

This isn't a comprehensive answer—just some questions we would ask if we had an offer.

If you don't understand your offer, get a lawyer. But—right or wrong—most people don't hire lawyers to review their offer letter.

### Table of Contents

#### **The Offer** (answers follow)

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<sup>11</sup><http://venturehacks.com/articles/the-monk-and-the-riddle>

<sup>12</sup><http://venturehacks.com/articles/intuit>

1. Can you give me the offer in writing?<sup>13</sup>
2. How does my compensation compare to my peers in the company?<sup>14</sup>
3. What are my options worth?<sup>15</sup>
4. What percentage of the company do my options represent on a fully diluted basis?<sup>16</sup>
5. Can I exercise my unvested options early?<sup>17</sup>

### **The Company** (coming in Part 2)

1. How much money do you have in the bank right now? How long will the money last?
2. What was the company's post-money valuation in the last round?
3. What are the investor's preferences?
4. Who is on the board and whom do they represent?
5. Would I hire the CEO and board to increase the value of my options?

## **1. Can you give me the offer in writing?**

The only good answers to this question are,

“Yes, an offer is on the way.”

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<sup>13</sup><http://venturehacks.com/#writing>

<sup>14</sup><http://venturehacks.com/#peers>

<sup>15</sup><http://venturehacks.com/#options>

<sup>16</sup><http://venturehacks.com/#percent>

<sup>17</sup><http://venturehacks.com/#exercise>

and

“Let’s work out the major points and we’ll give you a written offer. We don’t want to start things off on the wrong foot with an offer that is way off the mark.”

## **2. How does my compensation compare to my peers in the company?**

Some companies pay more, some companies pay less, but an offer is fair if your compensation is in line with your peers’.

Your total *compensation* consists of salary, options, vesting<sup>18</sup>, cliff<sup>19</sup>, acceleration<sup>20</sup>, bonuses, and severance. And a *peer* is someone who (1) joined the company at roughly the same time as you did (e.g. halfway between the Series A and Series B) and (2) has roughly the same title you do.

Most employees have a 4-year vesting schedule with a 1-year cliff, no acceleration, no bonuses, and no severance. The exceptions are for Vice-Presidents and higher (and founders).

By the way, your cliff may be longer than the company’s runway, but *c'est la vie*.

## **3. What are my options worth?**

First you have to know how many options you have and how they vest<sup>21</sup>. Let’s say you have 1000 options and they vest over 4 years. So you get 250 options a year for 4 years.

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<sup>18</sup>[http://www.feld.com/blog/archives/2005/05/term\\_sheet\\_-\\_ve.html](http://www.feld.com/blog/archives/2005/05/term_sheet_-_ve.html)

<sup>19</sup>[http://www.feld.com/blog/archives/2005/05/term\\_sheet\\_-\\_ve.html](http://www.feld.com/blog/archives/2005/05/term_sheet_-_ve.html)

<sup>20</sup><http://venturehacks.com/articles/acceleration-sale>

<sup>21</sup>[http://www.feld.com/blog/archives/2005/05/term\\_sheet\\_-\\_ve.html](http://www.feld.com/blog/archives/2005/05/term_sheet_-_ve.html)

Now you have to guess what an acquirer would pay for your shares. Let's call this the *acquisition share price*. Setting the acquisition share price to the preferred share price of the last round is a good start—let's say it was \$1/share.

Now multiply your options (1000) by the acquisition share price (\$1) to calculate the *acquisition value* of your options: \$1000. Since the options vest over 4 years, the annualized acquisition value is \$250/year. And while the acquisition value of your options might be \$1000 today, you're naturally hoping that the company's acquisition share price increases over time.

If the company has gained a lot of value since the last round, you might set the acquisition share price higher than the preferred share price. If the company has not done well since the last round, you might set it lower. Either way, you will have to ask the company for the preferred share price in the last round. Or if someone has offered to buy the company for \$50M since the last round, I might use \$50M to calculate an acquisition share price.

Finally, you will have to pay for your options—they're not free. Options have an option strike price<sup>22</sup>, a.k.a the fair market value of the common stock. That's what you pay for your options. Sometimes it's much lower than the acquisition share price and can be ignored. Sometimes it's high and can't be ignored—high strike prices are becoming more common due to high-valuation rounds (Facebook), founder cash-outs, and high 409A<sup>23</sup> valuations.

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<sup>22</sup>[http://www.feld.com/blog/archives/2006/05/how\\_to\\_set\\_the.html](http://www.feld.com/blog/archives/2006/05/how_to_set_the.html)

<sup>23</sup><http://www.feld.com/blog/archives/409a/>

## 4. What percentage of the company do my options represent on a fully diluted basis?

Most people think this number is important—it's not. You care about the value of your options, not your percentage of the company. Your percentage will decline over time but the value of your options will hopefully increase.

Focus on the how many options you have and the acquisition share price (see question 3 above). Terms like percentage ownership and valuation can fool you<sup>24</sup>.

## 5. Can I exercise my unvested options early?

*This is for advanced Venture Hackers only. Don't do this without an accountant and/or lawyer.*

Exercise your options early if you want to start the clock on capital gains tax eligibility for your stock. Startup pros usually exercise their options early to lower the expected value<sup>25</sup> of the taxes on their stock. And they usually use an accountant and lawyer. Don't sue us if this blows up in your face.

**Related:** Other folks who have tackled the topic of “questions to ask before you join a startup”: David Beisel<sup>26</sup>, Dharmesh Shah<sup>27</sup>, and Guy Kawasaki<sup>28</sup>.

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<sup>24</sup><http://venturehacks.com/articles/share-price>

<sup>25</sup>[http://en.wikipedia.org/wiki/Expected\\_value](http://en.wikipedia.org/wiki/Expected_value)

<sup>26</sup>[http://www.genuinevc.com/archives/2005/10/seven\\_questions.htm](http://www.genuinevc.com/archives/2005/10/seven_questions.htm)

<sup>27</sup><http://onstartups.com/home/tabid/3339/bid/122/>

Joining-A-Startup-Top-6-Questions-You-Should-Ask.aspx

<sup>28</sup>[http://blog.guykawasaki.com/2006/03/nine\\_questions\\_.html](http://blog.guykawasaki.com/2006/03/nine_questions_.html)

## I have a job offer at a startup, am I getting a good deal? Part 2.

In part 1<sup>29</sup>, we covered some questions you should ask about your offer. In this second part, we'll cover some things you should ask about the company.

### Table of Contents

#### The Offer (see Part 1<sup>30</sup>)

1. Can you give me the offer in writing?<sup>31</sup>
2. How does my compensation compare to my peers in the company?<sup>32</sup>
3. What are my options worth?<sup>33</sup>
4. What percentage of the company do my options represent on a fully diluted basis?<sup>34</sup>
5. Can I exercise my unvested options early?<sup>35</sup>

#### The Company (answers below)

1. How much money do you have in the bank right now? How long will it last?<sup>36</sup>

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<sup>29</sup><http://venturehacks.com/articles/job-offer>

<sup>30</sup><http://venturehacks.com/articles/job-offer>

<sup>31</sup><http://venturehacks.com/articles/job-offer#writing>

<sup>32</sup><http://venturehacks.com/articles/job-offer#peers>

<sup>33</sup><http://venturehacks.com/articles/job-offer#options>

<sup>34</sup><http://venturehacks.com/articles/job-offer#percent>

<sup>35</sup><http://venturehacks.com/articles/job-offer#exercise>

<sup>36</sup><http://venturehacks.com/#runway>

2. What was the company's post-money valuation in the last round?<sup>37</sup>
3. What are the investor's preferences?<sup>38</sup>
4. Who is on the board and whom do they represent?<sup>39</sup>
5. Would I hire the CEO and board to increase the value of my options?<sup>40</sup>

## **6. How much money do you have in the bank right now? How long will it last?**

Investors call this *runway*.

If you're making an *essential* contribution to the business, you should have a job as long as the company has runway.

Whether you're essential depends on what the business needs today; *e.g.* assistants, recruiters, and salesman might not be essential if the company hasn't finished building a product yet.

## **7. What was the company's post-money valuation in the last round?**

Let's say the company's post-money valuation in the last round was \$10M. If the company is acquired for \$100M, the acquisition value<sup>41</sup> of your options should increase roughly 10x, assuming the company didn't incur any dilution after the last round.

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<sup>37</sup><http://venturehacks.com/#valuation>

<sup>38</sup><http://venturehacks.com/#preferences>

<sup>39</sup><http://venturehacks.com/#board>

<sup>40</sup><http://venturehacks.com/#trust>

<sup>41</sup><http://venturehacks.com/articles/job-offer#options>

## **8. What are the investor's preferences?**

If the acquisition price isn't greater than the investor's preferences, the common stockholders won't see a penny when the company is sold.

So don't join a company with \$100M in preferences unless you expect the business to sell for a lot more than \$100M.

## **9. Who is on the board and whom do they represent?**

Besides the CEO, the board has the greatest opportunity to increase or destroy the value of the company's shares.

The answer will also tell you whether the investors dominate the board<sup>42</sup>.

## **10. Would I hire the CEO and board to increase the value of my options?**

The CEO and the board can easily destroy the value of your options through incompetence and/or greed. You need to ask yourself:

1. *Would I hire the CEO and board to increase the value of my options?* Identifying great people is an aesthetic skill, like seeing the beauty in a painting. Most of us don't have this skill. And those of us who do still get it wrong a lot. Get help from someone who knows how to identify great people.

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<sup>42</sup><http://venturehacks.com/term-sheet-hacks#bod>

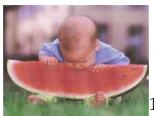
2. *Do I trust<sup>43</sup> the CEO and board to treat my options like their own?* Don't join the company if you don't trust the CEO and board to avoid opportunities to treat their stock better than yours.

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<sup>43</sup><http://venturehacks.com/articles/control>

# September 2008

## VH Twitters: Extreme Edition



Venture Hacks is back from a long and boring summer vacation. It's good to be back.

Let's get into the blogging groove with the latest quotes from our Twitter feed<sup>2</sup> (RSS<sup>3</sup>):

“I believe that the biggest advantage a startup has over a big competitor is intellectual honesty.” - Mike Speiser<sup>4</sup>

“How often do you hear business people poke holes in their own arguments the way engineers do?” - Mike Speiser<sup>5</sup>

“Startups are tools for investors and founders to get rich. Caveat employees.” - Me

“Entrepreneurs are vulnerable and easy to seduce. Caveat entrepreneur.” - Me

“The best test of a person’s character is how he or she treats those with less power.” - Bob Sutton<sup>6</sup>

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<sup>1</sup><http://twitter.com/venturehacks>

<sup>2</sup><http://twitter.com/venturehacks>

<sup>3</sup>[feed://twitter.com/statuses/user\\_timeline/11620792.atom](feed://twitter.com/statuses/user_timeline/11620792.atom)

<sup>4</sup><http://laserlike.com/2008/09/02/cargo-cult-management/>

<sup>5</sup><http://laserlike.com/2008/09/02/cargo-cult-management/>

<sup>6</sup><http://bobsutton.typepad.com>

“The amount of money you are raising is a good indicator of how much you think the company is worth.”  
 - David Hornik<sup>7</sup>

“Customer problems... are often painstaking, uncool and downright boring.” – charles in charge<sup>8</sup>

## Extreme Programming

Over the last few months, I’ve been reading a lot about extreme programming<sup>9</sup> and practicing it with Pivotal Labs<sup>10</sup>. Here are some great quotes on extreme programming from our Twitter feed:

“The less functional the initial delivery, the higher the quality in the final delivery.” - Bob Martin<sup>11</sup>

“A mile long To-Do list is proof of time wasted, not time saved.” - Ryan Singer<sup>12</sup>

“Delay [decisions] until the last responsible moment.”  
 - Mary and Tom Poppendieck<sup>13</sup>

“Abnormalities will never disappear if a worker always attends to a machine and stands in for it when

<sup>7</sup>[http://ventureblog.com/articles/2008/08/raising\\_venture\\_capital\\_how\\_much\\_money\\_matters.php](http://ventureblog.com/articles/2008/08/raising_venture_capital_how_much_money_matters.php)

<sup>8</sup><http://bits.blogs.nytimes.com/2008/08/25/sun-microsystems-has-a-fan-in-memphis/#comment-294429>

<sup>9</sup><http://www.extremeprogramming.org>

<sup>10</sup><http://www.pivotallabs.com/>

<sup>11</sup><http://www.amazon.com/gp/redirect.html?ie=UTF8&location=http%3A%2F%2Fwww.amazon.com%2FSoftware-Development-Principles-Patterns-Practices%2Fdpr%2FO135974445%3Fie%3DUTF8%26s%3Dbooks%26qid%3D1221454547%26sr%3D8-1&tag=httpventureco-20&linkCode=ur2&camp=1789&creative=9325>

<sup>12</sup><http://www.37signals.com/svn/posts/1226-how-to-manage-long-breaks-in-your-software-side>

<sup>13</sup>[http://books.google.com/books?id=8o1eom6ifIMC&pg=PA57&dq=%22last+responsible+moment%22+agile&lr=&ei=BGbTSLH2Bo6KswOspuTbAw&sig=ACfU3U3mymaXRoc\\_SX6jzKhlnsQiYXOSAQ#PPA57,M1](http://books.google.com/books?id=8o1eom6ifIMC&pg=PA57&dq=%22last+responsible+moment%22+agile&lr=&ei=BGbTSLH2Bo6KswOspuTbAw&sig=ACfU3U3mymaXRoc_SX6jzKhlnsQiYXOSAQ#PPA57,M1)

an abnormality does occur." - Taiichi Ohno<sup>14</sup>

"Writing code without a way to detect defects immediately is the fastest way to build up an inventory of partially done work." - Mary and Tom Poppendieck<sup>15</sup>

"A plan is an example of what could happen, not a prediction of what will happen." – Kent Beck<sup>16</sup>

Thanks kindly for reading our stuff.

## Our top 10 term sheet hacks

Venture Hacker Naval Ravikant<sup>17</sup> recently presented our top 10 term sheet hacks at Startup2Startup<sup>18</sup>:

(Here's a pdf of the presentation<sup>19</sup> if you don't see the slides embedded above. Or read it on Slideshare<sup>20</sup>).

Naval's slides are a must-read—and a great summary of our detailed hacks<sup>21</sup>.

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<sup>14</sup>[http://books.google.com/books?id=7\\_-67SshOy8C&pg=PA7&lpg=PA7&dq=Abnormalities+will+never+disappear+if+a+worker+always+attends+to+a+machine+and+stands+in+for+it+when+an+abnormality+does+occur.&source=web&ots=YlSsAeFkGY&sig=8BDiVrYMK38Z8SUqSr36122w\\_pU&hl=en&sa=X&oi=book\\_result&resnum=1&ct=result](http://books.google.com/books?id=7_-67SshOy8C&pg=PA7&lpg=PA7&dq=Abnormalities+will+never+disappear+if+a+worker+always+attends+to+a+machine+and+stands+in+for+it+when+an+abnormality+does+occur.&source=web&ots=YlSsAeFkGY&sig=8BDiVrYMK38Z8SUqSr36122w_pU&hl=en&sa=X&oi=book_result&resnum=1&ct=result)

<sup>15</sup>[http://books.google.com/books?id=8o1eom6iflMC&pg=PA57&dq=%22last+responsible+moment%22+agile&lr=&ei=BGbTSLH2Bo6KswOsptBbAw&sig=ACfU3U3mymaXR0c\\_SX6jzKhlnsQiYXOSAQ#PPA57,M1](http://books.google.com/books?id=8o1eom6iflMC&pg=PA57&dq=%22last+responsible+moment%22+agile&lr=&ei=BGbTSLH2Bo6KswOsptBbAw&sig=ACfU3U3mymaXR0c_SX6jzKhlnsQiYXOSAQ#PPA57,M1)

<sup>16</sup>[http://www.amazon.com/Extreme-Programming-Explained-Embrace-Change/dp/0321278658/ref=ed\\_oe\\_p](http://www.amazon.com/Extreme-Programming-Explained-Embrace-Change/dp/0321278658/ref=ed_oe_p)

<sup>17</sup><http://venturehacks.com/naval>

<sup>18</sup><http://startup2startup.com>

<sup>19</sup><http://www.nivi.com/junk/Top10TermSheetHacks.pdf>

<sup>20</sup><http://www.slideshare.net/dmc500hats/top-10-term-sheet-hacks-naval-ravikant-venturehacks>

<sup>21</sup><http://venturehacks.com/term-sheet-hacks>

Slideshare has a transcript of the slides<sup>22</sup> on a single page if you don't want to flip through the presentation (scroll to the bottom of the page). Mike Speiser<sup>23</sup> has put up his notes from the presentation<sup>24</sup>. And finally, here's a video of Naval describing his investment criteria:

(Video: Interview with Naval Ravikant<sup>25</sup>.)

## How common is accelerated vesting on change in control?

How common is accelerated vesting on change in control<sup>26</sup> (AV-CoC)? Noam Wasserman from HBS has the answer in *Unlocking Your Golden Handcuffs*<sup>27</sup>:

"I recently got an email from a serial entrepreneur who has been brought on as the head of finance and operations in a mobile-services start-up. One of his questions was: **How often do new-venture executives get AVCoC?** If it's not common for them to get it, he wouldn't push for it and would focus his negotiating leverage on another term, but if it's common, he wanted to push hard for it. (He felt that the start-up might be the subject of M&A activity in the future, and had already experienced working for a large company after a prior venture of his had been acquired.)...

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<sup>22</sup><http://www.slideshare.net/dmc500hats/top-10-term-sheet-hacks-naval-ravikant-venturehacks>

<sup>23</sup><http://laserlike.com/>

<sup>24</sup><http://startup2startup.com/2008/09/03/naval-ravikant-venture-hacks>

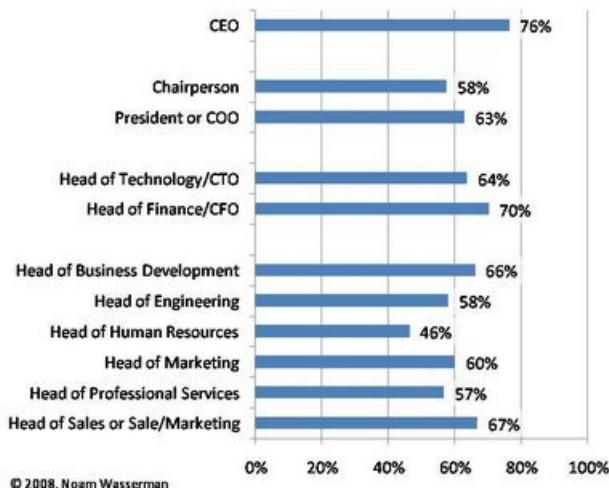
<sup>25</sup>[http://www.youtube.com/watch?v=\\_BwaxQwgNs](http://www.youtube.com/watch?v=_BwaxQwgNs)

<sup>26</sup><http://venturehacks.com/articles/acceleration-sale>

<sup>27</sup><http://founderresearch.blogspot.com/2008/08/unlocking-your-golden-handcuffs-how.html>

“Overall, the percentage of executives receiving AV-CoC was 65.5%. However, as shown in the chart below, the percentage varied from a high of 76.4% for CEOs down to 46.3% for the Head of Human Resources. (I only show the positions for which I had at least 100 data points.)...

### % of Executives with Accelerated Vesting on Change of Control (N=6,053)



© 2008, Noam Wasserman

“I also analyzed AVCoC at the *team* level, which is the focus of your first (“side note”) point. At the team level, **36% of the teams (429 ventures) had a “mixed” approach to AVCoC**, wherein some executives had AVCoC and some did not. In those ventures, executives would seem to have been negotiating AVCoC on a case-by-case basis, in the

absence of a consistent plan adopted across the team/venture. Of the other ventures, 47% (561 ventures) had AVCoC across all of the executives in the survey. Those **47% might include some ventures that adopted a consistent plan and others where the AVCoC's were put in place on a case-by-case basis.** Finally, 17% did not have a single executive with AVCoC (yet?).”

There is also a great discussion of AVCoC in the comments<sup>28</sup> to Noam’s post.

## (Not so) Scary terms in offer letters.

Offer letters are short and easy to read, as far as legal documents go. But they contain some seemingly scary terms that are (1) ubiquitous in Silicon Valley and (2) usually “no big deal”.

We’re not saying that no one has ever gotten into a conflict or lawsuit over these terms—just that it isn’t common. The offer letters from the major Silicon Valley law firms are very consistent.

Here are the seemingly scary terms from an offer letter I got from Yokum Taku<sup>29</sup> at Wilson Sonsini<sup>30</sup>. As always, this is not legal advice<sup>31</sup>.

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<sup>28</sup><http://founderresearch.blogspot.com/2008/08/unlocking-your-golden-handcuffs-how.html#comments>

<sup>29</sup><http://www.startupcompanylawyer.com/>

<sup>30</sup><http://www.wsgr.com>

<sup>31</sup><http://venturehacks.com/disclaimer>

## Options

“If you decide to join the Company, it will be recommended at the first meeting of the Company’s Board of Directors following your start date that the Company grant you an option to purchase X shares of the Company’s Common Stock at a price per share equal to the fair market value per share of the Common Stock on the date of grant, as determined by the Company’s Board of Directors.”

You don’t get your options until the board grants them at the next board meeting. But they should start vesting on your start date.

The strike price is equal to the fair market value as of the grant date (sometime after the next board meeting). But that probably won’t be higher than the FMV as of your first day of work.

“This option grant shall be subject to the terms and conditions of the Company’s Stock Option Plan and Stock Option Agreement.”

These are big documents that you’re agreeing to without seeing. If you’re concerned, request copies before you sign your employment offer.

We’ve never seen anyone negotiate exceptions to these documents. Just make sure the company doesn’t have a right to repurchase your vested stock<sup>32</sup>.

## Conflicts

“Moreover, you agree that, during the term of your employment with the Company, you will not engage

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<sup>32</sup><http://venturehacks.com/articles/vesting-microhacks#repurchase>

in any other employment, occupation, consulting or other business activity directly related to the business in which the Company is now involved or becomes involved during the term of your employment, nor will you engage in any other activities that conflict with your obligations to the Company.”

The company isn’t forbidding you to work on your own business on the side.

Get a lawyer to advise you on what you need to do to own your side business. At a minimum, work on the side business on your own time and don’t use anything owned by the company.

## **IP Assignment**

“As a condition of your employment, you are also required to sign and comply with an Invention Assignment Agreement (enclosed) which requires, among other provisions, the assignment of patent rights to any invention made during your employment at the Company.”

These Invention Assignment Agreements always seem too far-reaching but they’re rarely negotiated, especially if they’re coming from one of the major Silicon Valley law firms.

The Invention Assignment Agreement usually asks employees to carve out the IP they developed before joining the company by listing it in an exhibit. If you’ve developed a lot of IP that is relevant to the business, you might want to ask the company to list its IP instead of, or in addition to, yours.

## **At-Will Employment and Sundry Items**

“You should be aware that your employment with the Company is for no specified period and constitutes at-will employment. As a result, you are free to resign at any time, for any reason or for no reason. Similarly, the Company is free to conclude its employment relationship with you at any time, with or without cause, and with or without notice.”

This is an offer letter, not a 5-year contract with the Chicago Bulls.

“You should note that the Company may modify job titles, salaries and benefits from time to time as it deems necessary.”

You have no job security.

“This offer of employment will terminate if it is not accepted, signed and returned by such-and-such date.”

This offer expires soon.

“This letter, along with any agreements relating to proprietary rights between you and the Company, set forth the terms of your employment with the Company and supersede any prior representations or agreements including, but not limited to, any representations made during your recruitment, interviews or pre-employment negotiations, whether written or oral.”

If it isn't in this agreement, it isn't happening, even if we told you it was.

**Related:** I have a job offer at a startup, am I getting a good deal? Part 1<sup>33</sup> and Part 2<sup>34</sup>.

**Unrelated:** My new favorite show, Lil' Bush<sup>35</sup>:  
(Video: Lil' Bush White House Tour<sup>36</sup>)

## What do investors look for in a startup?

A few days ago, I posted a video where fellow Venture Hacker Naval Ravikant<sup>37</sup> answers the age-old question:

What do you look for in a startup?

I liked his answer and transcribed/paraphrased it below:

(Video: Interview with Naval Ravikant<sup>38</sup>.)

"There's no silver bullet or magic answer but I actually do have a set of criteria I've come up with based on my own startups, after looking back on what worked.

"I look for two things that are paramount above all:

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<sup>33</sup><http://venturehacks.com/articles/job-offer>

<sup>34</sup><http://venturehacks.com/articles/job-offer-2>

<sup>35</sup>[http://www.comedycentral.com/shows/lil\\_bush/index.jhtml](http://www.comedycentral.com/shows/lil_bush/index.jhtml)

<sup>36</sup><http://www.comedycentral.com/videos/index.jhtml?videoId=88286&title=exclusive-white-house-tour>

<sup>37</sup><http://venturehacks.com/naval>

<sup>38</sup>[http://www.youtube.com/watch?v=\\_BwatxQwgNs](http://www.youtube.com/watch?v=_BwatxQwgNs)

1. **Great team.** It's obvious. It's a tautology. Everybody says it. You have to be working with some of the best people in the industry you're in.
2. **Huge market.** Niche markets just don't work because the first idea never works. You always have to change the idea, so you need room to maneuver in a big market.

“There are three more factors that I look at. Not all three of them are required but I prefer a company to have at least two of them:

1. **Difficult technology** that is compounding over time.
2. **A proprietary distribution channel.** A clever viral marketing, or SEO, or partnership, or whatever strategy that gives them a leg up over competitors.
3. **A direct monetization model.** Something more than throwing up 10 cent banner ad CPMs.

“There’s a small number of companies that are very good and very qualified and they get an embarrassingly large number of offers. And there’s a large number of companies that miss on one or two of these dimensions and they pound the fund-raising pavement and don’t get anything.

“This makes sense when you think about it because this is a hit-driven business: a small number of companies account for all the returns. So when people recognize what they think is a winning company, they will pay almost anything and they will do almost anything to invest in that company. And when

they look at what they think is a non-winning company, they just say “bye”.

“It’s very similar to Hollywood where there are a few blockbusters and a lot of indie films made. Everyone’s got a camera but odds are you have an indie film. So go back to these five criteria and think about your blockbuster.”

My criteria are a little different. Yes, you need a great team in a big market (preferably, the team has years of experience with their customer).

The only other thing I look for is an amazing product. What makes a product amazing? You know it when you see it. The founders must be chasing a big vision with a beautiful product that is going to make a dent in the universe.

A great product automatically satisfies the technology, distribution, and monetization criteria. Great products are always hard to build. Grafting distribution onto something that isn’t great is a band-aid and a waste of time. It might work, but who wants to spend their lives doing it? Finally, a great product in a big market will either make a lot of money or shrink the market<sup>39</sup>.

Knowing these criteria is one thing. Applying them effectively is another; I hope to learn how someday. It takes practice, diversification, and an aesthetic sensibility.

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<sup>39</sup>[http://redeye.firstround.com/2006/04/shrink\\_a\\_market.html](http://redeye.firstround.com/2006/04/shrink_a_market.html)

## What does an employee offer letter look like?

Here is an employee letter from Yokum Taku<sup>40</sup> at Wilson Sonsini<sup>41</sup>, published in its entirety, in various formats:

Offer Letter: Microsoft Word<sup>42</sup> PDF<sup>43</sup> Google Docs<sup>44</sup>

The offer letter is also included at the bottom of this post.

If you're an employee, ask questions if your offer letter varies substantially from this one. Ask questions even if it doesn't.

If you're an employer, don't use this offer letter without legal advice. Don't use *any* legal documents without legal advice.

**Related:** (Not so) Scary terms in offer letters<sup>45</sup>. I have a job offer at a startup, am I getting a good deal: Part 1<sup>46</sup> and Part 2<sup>47</sup>.

### Offer Letter

*This document is for informational purposes only and does not constitute advertising, a solicitation, or legal advice. Transmission of such materials and information contained herein is not intended to create, and receipt thereof does not constitute formation of, an attorney-client relationship. Internet subscribers*

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<sup>40</sup><http://www.startupcompanylawyer.com/>

<sup>41</sup><http://www.wsgr.com>

<sup>42</sup><http://venturehacks.com/wordpress/wp-content/uploads/2008/09/offer-letter.doc>

<sup>43</sup><http://venturehacks.com/wordpress/wp-content/uploads/2008/09/offer-letter.pdf>

<sup>44</sup>[http://docs.google.com/Doc?id=dfgjqv57\\_114pnjfnpf](http://docs.google.com/Doc?id=dfgjqv57_114pnjfnpf)

<sup>45</sup><http://venturehacks.com/articles/not-so-scary-terms-in-offer-letters>

<sup>46</sup><http://venturehacks.com/articles/job-offer>

<sup>47</sup><http://venturehacks.com/articles/job-offer-2>

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Company

[Company Letterhead] [Click And Type Date]

[Click and Type Employee]

Dear [Click and Type Employee]: I am pleased to offer you a position with COMPANY NAME (the "Company"), as its [Click And Type Position]. If you decide to join us, you will receive a monthly salary of \$[Click And Type Amount], which will be paid semi monthly in accordance with the Company's normal payroll procedures. As an employee, you will also be eligible to receive certain employee benefits including [list employee benefits here or "The details of these employee benefits are explained in Exhibit A."]. You should note that the Company may modify job titles, salaries and benefits from time to time as it deems necessary.

\*\*\*Optional—Vesting Schedule May Differ Too\*\*\*In addition, if you decide to join the Company, it will be recommended at the first meeting of the Company's Board of Directors following your start date that the Company grant you an option to purchase

[Click And Type Amount] shares of the Company's Common Stock at a price per share equal to the fair market value per share of the Common Stock on the date of grant, as determined by the Company's Board of Directors. [Confirm Vesting Schedule] 25% of the shares subject to the option shall vest 12 months after the date your vesting begins subject to your continuing employment with the Company, and no shares shall vest before such date. The remaining shares shall vest monthly over the next 36 months in equal monthly amounts subject to your continuing employment with the Company. This option grant shall be subject to the terms and conditions of the Company's Stock Option Plan and Stock Option Agreement, including vesting requirements. No right to any stock is earned or accrued until such time that vesting occurs, nor does the grant confer any right to continue vesting or employment.

\*\*\*Optional\*\*\*Also, we are offering you reimbursement of relocation expenses for your move from \_\_\_\_\_ to \_\_\_\_\_, up to a maximum reimbursement of \$[amount]. The items for which we offer reimbursement are \_\_\_\_\_, \_\_\_\_\_, and \_\_\_\_\_. (Example: one trip for you and your spouse to do a home search, shipment of household goods, etc.) We will only reimburse for reasonable expenditures which are supported by valid receipts provided promptly to the Company.

The Company is excited about your joining and looks forward to a beneficial and productive relationship. Nevertheless, you should be aware that your employment with the Company is for no specified period and constitutes at-will employment. As a result, you are free to resign at any time, for any reason or for no reason. Similarly, the Company is free to conclude its employment relationship with you at any time, with or without cause, and with or without notice. We request that, in the event of resignation, you give the Company at least two weeks notice.

The Company reserves the right to conduct background investi-

gations and/or reference checks on all of its potential employees. Your job offer, therefore, is contingent upon a clearance of such a background investigation and/or reference check, if any.

For purposes of federal immigration law, you will be required to provide to the Company documentary evidence of your identity and eligibility for employment in the United States. Such documentation must be provided to us within three (3) business days of your date of hire, or our employment relationship with you may be terminated.

We also ask that, if you have not already done so, you disclose to the Company any and all agreements relating to your prior employment that may affect your eligibility to be employed by the Company or limit the manner in which you may be employed. It is the Company's understanding that any such agreements will not prevent you from performing the duties of your position and you represent that such is the case. Moreover, you agree that, during the term of your employment with the Company, you will not engage in any other employment, occupation, consulting or other business activity directly related to the business in which the Company is now involved or becomes involved during the term of your employment, nor will you engage in any other activities that conflict with your obligations to the Company. Similarly, you agree not to bring any third party confidential information to the Company, including that of your former employer, and that in performing your duties for the Company you will not in any way utilize any such information.

As a Company employee, you will be expected to abide by the Company's rules and standards. Specifically, you will be required to sign an acknowledgment that you have read and that you understand the Company's rules of conduct which are included in the Company Handbook. [If Handbook has not yet been adopted add "which the Company will soon complete and distribute."]

As a condition of your employment, you are also required to sign

and comply with an At-Will Employment, Confidential Information, Invention Assignment and Arbitration Agreement which requires, among other provisions, the assignment of patent rights to any invention made during your employment at the Company, and non disclosure of Company proprietary information. In the event of any dispute or claim relating to or arising out of our employment relationship, you and the Company agree that (i) any and all disputes between you and the Company shall be fully and finally resolved by binding arbitration, (ii) you are waiving any and all rights to a jury trial but all court remedies will be available in arbitration, (iii) all disputes shall be resolved by a neutral arbitrator who shall issue a written opinion, (iv) the arbitration shall provide for adequate discovery, and (v) the Company shall pay all but the first \$125 of the arbitration fees. Please note that we must receive your signed Agreement before your first day of employment.

To accept the Company's offer, please sign and date this letter in the space provided below. A duplicate original is enclosed for your records. If you accept our offer, your first day of employment will be [Click And Type Date]. This letter, along with any agreements relating to proprietary rights between you and the Company, set forth the terms of your employment with the Company and supersede any prior representations or agreements including, but not limited to, any representations made during your recruitment, interviews or pre employment negotiations, whether written or oral. This letter, including, but not limited to, its at-will employment provision, may not be modified or amended except by a written agreement signed by the President of the Company and you. This offer of employment will terminate if it is not accepted, signed and returned by [Click And Type Date].

We look forward to your favorable reply and to working with you at COMPANY.

Sincerely,

[Click And Type Name]

[Click And Type Title]

Agreed to and accepted:

Signature: \_\_\_\_\_ -

Printed Name: \_\_\_\_\_

Date: \_\_\_\_\_ -

—

Enclosures

Duplicate Original Letter

At-Will Employment, Confidential Information, Invention Assignment and Arbitration Agreement

## Who makes the best introductions to investors?

“VCs are generally bombarded by requests for meetings, so a warm introduction helps an entrepreneur’s request float to the top of the list.”

Chris Wand<sup>48</sup>, Managing Director, Foundry Group<sup>49</sup>

**Summary:** The best way to get a meeting with an investor is through an introduction from someone he listens to. The best

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<sup>48</sup><http://www.askthevc.com/blog/archives/2008/08/how-should-i-ap.php>

<sup>49</sup><http://foundrygroup.com>

intros probably come from entrepreneurs that the investor has worked with. But the specifics of the middleman's relationship with the investor are more important than the middleman's day job. Finally, skip intros from (1) investors who don't have a good reason why they're not investing and (2) middlemen who barely know the investor.

The best way to get a meeting with an investor is through an introduction from *someone he listens to*. (You could cold call him but you better have a great elevator pitch<sup>50</sup> and you should read How Should I Approach a VC I Don't Know?<sup>51</sup>.)

But not all introductions are created equal. Who makes the best introductions? Introducing the Hierarchy of Middlemen:

1. Entrepreneurs that the investor (a) has backed and made money with, (b) wants to back, or (c) is currently backing (in that order).
2. Investors he (a) has co-invested and made money with, (b) wants to co-invest with, or (c) is currently co-investing with (in that order).
3. Lawyers, accountants, and sundry industry people like us.
4. Communists.
5. Someone he met at a party once.

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<sup>50</sup><http://venturehacks.com/articles/elevator-pitch>

<sup>51</sup><http://www.askthevc.com/blog/archives/2008/08/how-should-i-ap.php>



### This list is really rough.

The specifics of your middleman's relationship with the investor are more important than this list. So figure out why the investor is going to pay attention to the introduction by asking questions like:

How do you know the investor? What did you work on together? What companies have you sent him that he has subsequently backed? What makes our company interesting enough for you to make an introduction?

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<sup>52</sup><http://splicd.com/zOydN3Z-PC4/218/233>

## Middlemen you should avoid.

You don't want introductions from investors who don't want to do the deal and don't have a good<sup>53</sup> reason<sup>54</sup> why. An introduction by a middleman who *can* and *should* invest but doesn't want to invest is a strong negative signal. Skip this introduction.

And you don't want intros from people the investor doesn't really know or doesn't listen to—that just makes you look bad. If the introduction starts with “I don't know if you remember me,” you're in trouble.

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<sup>53</sup><http://venturehacks.com/articles/lead#vc-reasons>

<sup>54</sup><http://venturehacks.com/articles/lead#angel-reasons>

# October 2008

## Elevator Pitches avec Bullets

**Summary:** If you’re having trouble writing an elevator pitch, try using bullets. And challenge yourself to keep the pitch under 100 words.

I received a cold call elevator pitch<sup>1</sup> yesterday that was very effective. It was short (88 words not including the signature), the company had good traction<sup>2</sup>, and the author used bullets to make his case (4 out of 5 bullets were about traction). Here it is (with the author’s permission):

Subject: Cold emai [sic]

Hi A quick “cold email” to see if you would be interested in helping X raise money.

Our Story

- We are the the X of Y
- Over X Million registered users
- Growing at X new users per day
- Projecting growth at X new users per day in next X days
- Zero cost per customer acquisition

If you are interested please contact me :)

Thanks

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<sup>1</sup><http://venturehacks.com/articles/elevator-pitch>

<sup>2</sup><http://venturehacks.com/articles/plans-ndas-traction#traction>

The prose, spelling, and formatting could use a little work, but the pitch was brief and effective. I'm going to follow up with him.



Later that day, I was helping a client refine his elevator pitch. We were stuck on the prose so we decided to try bullets and it worked well. Here's an example:

Subject: Introducing Ning to Blue Shirt Capital

Hi Nivi,

Thanks for offering to introduce us to Blue Shirt Capital. I've attached a short presentation about Ning. Here are some of the highlights:

- Ning lets you create your own social network for anything. For free. In 2 minutes. It's as easy as starting a blog. Try it at <http://ning.com>

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<sup>3</sup>[http://splicd.com/B\\_X4tdPa1iU/217/236](http://splicd.com/B_X4tdPa1iU/217/236)

- We have over 115,000 user-created networks and our page views are growing 10% per week.
- We previously raised \$44M from Legg Mason and others, including myself.
- Before Ning, I started Netscape (acquired by AOL for \$4.2B) and Opsware (acquired by HP for \$1.6B).

We're building Ning to unlock the great ideas from people all over the world who want to use this amazing medium in their lives.

I've admired Blue Shirt's investments from afar. We're starting meetings with investors next week and I would love to show Blue Shirt what we're building at Ning.

Best,

Marc Andreessen xyz@ning.com 415.555.1212

Not bad. But at 158 words (not including the signature) it's almost twice the size of the cold call I received today. Compare this Ning pitch to Ning's pitch without bullets<sup>4</sup>. Which one do you like better?

## The Laws of Productivity

The Laws of Productivity<sup>5</sup> is a must-read presentation for startups that want to be more productive. Here's a direct link<sup>6</sup> to the pdf. And here's my summary of the presentation:

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<sup>4</sup><http://venturehacks.com/articles/elevator-pitch>

<sup>5</sup><http://lostgarden.com/2008/09/rules-of-productivity-presentation.html>

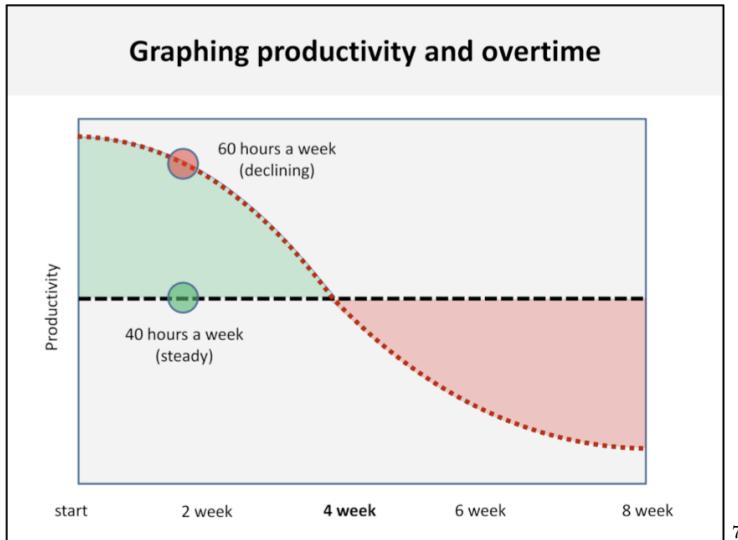
<sup>6</sup><http://lostgarden.com/Rules%20of%20Productivity.pdf>

## **Individuals**

1. Work 40 hours a week. (Working more feels like you're doing more, but you're actually doing less.)
2. Work below capacity (say 80%) during those 40 hours.
3. Consider spreading 40 hours across 4 days instead of 5.
4. Get the sleep you need; allocate 8 hours.
5. If you need a short productivity boost, work more for 3 weeks. But expect an equivalent reduction in productivity afterwards.

## **Teams**

1. Work in small cross-functional teams (< 10 people).
2. Put team members in a dedicated and closed room.
3. Try not to split people's time across multiple teams at once.



7

Thanks to Dan Cook<sup>8</sup> for creating the presentation and Andrew Chen<sup>9</sup> for bringing it to my attention.

<sup>7</sup><http://lostgarden.com/2008/09/rules-of-productivity-presentation.html>

<sup>8</sup><http://www.lostgarden.com>

<sup>9</sup><http://andrewchenblog.com/>

## Startup Lessons Learned



10

Go read Eric Ries' new blog: Startup Lessons Learned<sup>11</sup>. He's a Venture Advisor at KPCB<sup>12</sup> and a co-founder, CTO, and VPE of IMVU<sup>13</sup>.

Eric blogs about one of my favorite topics: applying lean<sup>14</sup>/agile to startups. *Lean thinking is the number one thing you can do to make your startup more effective.* His post on A new version of the Joel Test<sup>15</sup> is a great place to start...

On board meetings:

**“At IMVU, we opened up our board meetings to the whole company, and invited all of our advisers to boot. Sometimes it put some serious heat on the management team, but it was well worth it because everyone walked out of that room feeling at a visceral level the challenges the company faced.”**

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<sup>10</sup><http://startuplessonslearned.blogspot.com/>

<sup>11</sup><http://startuplessonslearned.blogspot.com/>

<sup>12</sup><http://www.kpcb.com/>

<sup>13</sup><http://www.imvu.com/>

<sup>14</sup>[http://en.wikipedia.org/wiki/Lean\\_software\\_development](http://en.wikipedia.org/wiki/Lean_software_development)

<sup>15</sup><http://startuplessonslearned.blogspot.com/2008/09/new-version-of-joel-test-draft.html>

On solitary programmers:

**“It’s not true that energized programmers primarily do solitary work;** certainly that’s not true of the great agile teams I’ve known. Instead, teams should have their own space, under their control, with the tools they need to do the job.”

On schedules:

**“Agile team-building practices make scheduling per se much less important.** In many startup situations, ask yourself “Do I really need to accurately know when this project will be done?” When the answer is no, we can cancel all the effort that goes into building schedules and focus on making progress evident. Everyone will be able to see how much of the product is done vs undone, and see the finish line either coming closer or receding into the distance. When it’s receding, we rescope.”

On QA:

“Imagine a world where your QA team never, ever worries about bug regressions. They just don’t happen. All of their time is dedicated to finding novel reproduction paths for tricky issues. That’s possible now, and it means that **the historical ratio of QA to engineering is going to have to change** (on the other hand, QA is now a lot more interesting of a job).”

SEM on five dollars a day<sup>16</sup> is another great post among many. Thanks to Andrew Chen<sup>17</sup> for bringing this blog to my attention.

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<sup>16</sup><http://startuplessonslearned.blogspot.com/2008/09/sem-on-five-dollars-day.html>

<sup>17</sup><http://andrewchenblog.com/>

tion.

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Email:

If you don’t see the form above, click here to subscribe<sup>19</sup>.

We promise to abuse your email address, sell it to the highest bidder, and send you viruses. Sign up now!

## What should I do before signing a term sheet?

Yesterday, I was brainstorming a list of things-to-do with an entrepreneur who is getting ready to sign a term sheet.

After searching through the Venture Hacks archives, I realized one of our posts already covers it: How much diligence should we do before signing a term sheet?<sup>20</sup> I think that post mostly stands the test of time—problem solved.

I revised the post to include this question for prospective investors:

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<sup>18</sup><http://www.feedburner.com>

<sup>19</sup>[http://www.feedburner.com/fb/a/emailverifySubmit?feedId=805452&loc=en\\_US](http://www.feedburner.com/fb/a/emailverifySubmit?feedId=805452&loc=en_US)

<sup>20</sup><http://venturehacks.com/articles/diligence>

“Do you agree with our plan for the next two/three-four quarters?”

Discussing this before you sign a term sheet has a few benefits:

1. **You learn what it's like to work with the investor**—before you marry him for the life of the company. If you don't like working with him, he may not be the right husband-for-life.
2. **You discover if your investor agrees with your plan.** If he doesn't agree with your plan or you don't agree with his revisions, why do you want him to join the company? Are you really going to put someone on the board who doesn't agree with what your plans?
3. **Getting agreement on the plan *before* the financing is normative leverage<sup>21</sup>.** If your investor wants to change the plan in the future, you can ask him to justify the change: “We agreed on a plan, how have the circumstances changed since we agreed on a plan, and why does that require us to change the plan?”

*Completely unrelated (or is it?):*

(Video: YOU ARE NOT THE FATHER!!!!<sup>22</sup>)

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<sup>21</sup><http://venturehacks.com/articles/bargaining-for-advantage>

<sup>22</sup><http://www.youtube.com/watch?v=vt2i0ts-uck>

## VH Twitters: Self Loving Edition



23

Here are the latest great quotes from our Twitter feed<sup>24</sup> (RSS<sup>25</sup>):

“It is an odd reflection on the priorities of our society that we value finance over technological innovation.”  
- Peter Thiel<sup>26</sup>

### **Eric Ries**

“At IMVU, we opened up our board meetings to the whole company.” - Eric Ries<sup>27</sup>

“Every startup has a chance to change the world, by bringing not just a new product, but an entirely new institution into existence.” - Ries<sup>28</sup>

“In a startup, both the problem and solution are unknown.” - Ries<sup>29</sup>

“Lean startups<sup>30</sup> can be the most capital efficient companies in the world, because they strive to prevent energy from being expended uselessly.” - Ries<sup>31</sup>

<sup>23</sup><http://twitter.com/venturehacks>

<sup>24</sup><http://twitter.com/venturehacks>

<sup>25</sup>[feed://twitter.com/statuses/user\\_timeline/11620792.atom](http://twitter.com/statuses/user_timeline/11620792.atom)

<sup>26</sup>[http://money.cnn.com/2008/09/29/technology/View\\_from\\_Valley\\_OBrien.fortune/](http://money.cnn.com/2008/09/29/technology/View_from_Valley_OBrien.fortune/)

<sup>27</sup><http://startuplessonslearned.blogspot.com/2008/09/new-version-of-joel-test-draft.html>

<sup>28</sup><http://startuplessonslearned.blogspot.com/2008/10/about-author.html>

<sup>29</sup><http://startuplessonslearned.blogspot.com/2008/09/customer-development-engineering.html>

<sup>30</sup><http://startuplessonslearned.blogspot.com/2008/09/lean-startup.html>

<sup>31</sup><http://startuplessonslearned.blogspot.com/2008/10/about-author.html>

“The hard part is to figure out the fewest possible features that could possibly accomplish your company’s goals.” - Ries<sup>32</sup>

### **Self-Loving**

“Are you so busy building barriers-to-entry that you’re not even in the market yourself?” - Us

“There’s only once company in the world with the ‘best’ developers. The rest of us have to make better products through better processes.” - Us

“Fund-raising is where you do or don’t capture the value of all the work you’ve done since you started the company. Treat it like an M&A.” - Us

“You’re not a team until the members take responsibility for combining their individual works into a collective work.” - Us

Thanks for reading our blog.

## **Sequoia’s advice is good advice anytime**

“Spend every dollar as if it were your last.”

- Sequoia Capital

**Summary:** In good times and bad, startups should be asking themselves the same questions: (1) What’s our runway? (2) What experiments are we running to extend our runway? (3) How long will we try the experiments before we switch to plan B? and (4) What’s plan B? Startups that survived the

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<sup>32</sup><http://startuplessonslearned.blogspot.com/2008/10/when-not-to-listen-to-your-users-when.html>

last downturn didn't take life-threatening risks with their runway—survival mattered more than market domination.

If you haven't seen Sequoia's presentation on the downturn, R.I.P. Good Times<sup>33</sup>, watch it now and read the meeting notes from GigaOM<sup>34</sup> and Silicon Alley Insider<sup>35</sup>.

(If you don't see the presentation embedded above, watch it on SlideShare: R.I.P. Good Times<sup>36</sup>)

Sequoia's presentation offers a lot of good advice with typical insight, simplicity, and clarity. Here are a couple thoughts on their presentation.

## 1. The future ain't what it used to be.

Don't take Sequoia's (or anyone's) predictions about the future too seriously. If they're smart enough to predict the future, they should have done it before the downturn.

## 2. Sequoia's advice is good advice anytime.

In good times and bad, startups should be asking themselves the same questions:

1. What's our **runway**?
2. What **experiments** are we running to extend our runway?  
*(e.g. chasing revenue, raising capital, taking debt, writing*

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<sup>33</sup><http://www.slideshare.net/eldon/sequoia-capital-on-startups-and-the-economic-downturn-pretype=powerpoint>

<sup>34</sup><http://gigaom.com/2008/10/09/what-startups-can-learn-from-sequoias-doomsday-warning/>

<sup>35</sup><http://www.alleyinsider.com/2008/10/sequoia-s-startup-advice-save-cash-slash-costs-stay-alivecomment-48ee83c614b9b92b0064eb60>

<sup>36</sup><http://www.slideshare.net/eldon/sequoia-capital-on-startups-and-the-economic-downturn-presrc=embed>

*grant proposals, cutting burn, grabbing market share in the hopes that it will help us raise capital later, et cetera)*

3. How **long** will we try the experiments before we switch to plan B?
4. What's **plan B**?

## Good times

When it seems easy to extend your runway (good times), companies operate with shorter runways, they run experiments that are less likely to work, that have higher value outcomes when they do work, and they run them longer:

Let's chase market share until we have 3 months of cash left so we can raise money at a high valuation and let's hope capital will be available then.

## Bad times

When it seems hard to extend your runway (bad times), companies operate with longer runways, they run experiments that are more likely to work, that have lower value outcomes when they do work, and they run them for shorter periods of time:

Let's raise money right now even though our valuation won't be optimal, and if that doesn't close in 2 months, let's cut our burn and chase customers.

## Good times, Bad times

Here's a table that summarizes the difference between good times and bad times:

**Good Times Bad Times** Seems easy to extend runway Seems hard to extend runway Short runways Long runways Long experiments Short experiments Low-probability experiments High-probability experiments High-value experiments Low-value experiments

## What's your runway plan?

For some, Sequoia's advice is good advice anytime. These people like to run their business as if it's always hard to extend their runway.

Others (contrarians) will ignore Sequoia's advice. They will take big risks and run their business as if it's easy to extend their runway.

There's nothing inherently right or wrong with either approach. Choosing a runway strategy is part of the CEO's job description.

But our observations match Sequoia's advice: startups that survived the last downturn ended up doing OK. They didn't take life-threatening risks with their runway—survival mattered more than market domination.

## Financings are blowing up



37

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<sup>37</sup>[http://www.avc.com/a\\_vc/2008/10/the-ying-and-ya.html](http://www.avc.com/a_vc/2008/10/the-ying-and-ya.html)

“Financings are blowing up, terms are being renegotiated, venture lenders are getting more conservative, and existing investors are stepping up to fill the gaps...

“I guarantee that there are some financings happening right now that are getting done at valuations which would have made sense nine months ago but don’t make sense right now... I also guarantee that there are some financings happening right now that are getting done at valuations at half or even less of what they would have commanded nine months ago, even though the public markets have only gone down about 33% year to date.

“You can look to the public markets for some clues, and everyone I know is doing that, but it will only help so much. We are going to have to make up a lot of this as we go along. But I know one thing for sure. Capital has gotten more expensive in the past month (actually it started getting more expensive late last year) and we all had better reflect that in our plans and strategies.”

– Fred Wilson<sup>38</sup>, Union Square Ventures

This is consistent with my observations and discussions with investors. Investors are looking at the public markets and renegotiating terms or pulling offers altogether. Their argument goes along the lines of “Google is worth less today and therefore so are you.” If you were a smart-ass, you would reply, “We didn’t come up with that valuation, you did.” But that won’t get you far if you don’t have leverage.

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<sup>38</sup>[http://www.avc.com/a\\_vc/2008/10/the-ying-and-ya.html](http://www.avc.com/a_vc/2008/10/the-ying-and-ya.html)

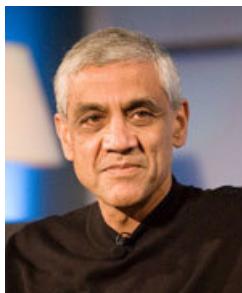
## **“They blew an opportunity to remain optimistic”**

“Over the past few months, I’ve witnessed the experts and the media bemoan and belabor the “tough economy.” *My attitude in times like these is to stay focused, stay optimistic, ignore the media and operate as normal.* We’ve done a great job of doing these at Infusionsoft and it’s paying off. We had our best quarter ever in Q3 and we’re on track to blow that away this quarter...

“Sequoia Capital is well respected. [But] they blew an opportunity to remain optimistic and they succumbed to the fear that’s swirling around. In the process, they spread their negativity to a bunch of smart people who really ought to know better.”

– Clate Mask<sup>39</sup>, Infusionsoft

## **Vinod Khosla: “Big opportunities are changing the structure of society.”**



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<sup>39</sup><http://www.infusionblog.com/company-info/checkin-in/>

<sup>40</sup>[http://www.pbs.org/newshour/bb/science/jan-june08/khosla\\_06-02.html](http://www.pbs.org/newshour/bb/science/jan-june08/khosla_06-02.html)

There's an outstanding interview with Vinod Khosla<sup>41</sup> on PBS's web site. Here are some of the highlights.

On the real big opportunities:

**“The real big opportunities are changing the infrastructure of society.** We are talking about things like the \$200 billion engines market for automobiles and trucks, things like lighting, billions of dollars spent on lighting. We can completely change that. Cement. Huge multi-hundred billion dollar market that needs to change. Glass. Then there's replacing all of the oil in the world. Hundreds of billions if not trillions of dollars worth of fuel that needs to be replaced. And there's gasoline, there's diesel, there's jet fuel.

“There's no doubt in my mind over the next 25 years how we drive, how we build our houses, how we fly, how we build our buildings, will all change. And that's essentially, like I said, the infrastructure of society...”

On stock prices:

“... we have too large a tendency to look at the symptom of stock prices which is almost irrelevant to the basic businesses we are trying to build.

On Khosla Ventures<sup>42</sup>:

“We want to invest in the technologies that are high risk, so it's okay to fail, but when we succeed it'd

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<sup>41</sup>[http://www.pbs.org/newshour/bb/science/jan-june08/khosla\\_06-02.html](http://www.pbs.org/newshour/bb/science/jan-june08/khosla_06-02.html)

<sup>42</sup><http://www.khoslaventures.com>

better be worth succeeding. We'd better have very large dislocations with these technologies.

“We like to say at Khosla Ventures, and this is one of the reasons to do what we do, **we'll take technical risks that nobody else will.**

“We take the larger risks, real science experiments, and that's been one of the founding pieces in our company.”

On venture capital:

**“95 percent of people in the venture business think it's a financial business, it's about investing. It's not.** It's about building companies, which is a different thing than investing. It's about taking large risks in science and technology. That's what we do.

“We are an investor that tries to build companies. We make money by building entities over the long term. We're not in the business of transacting or doing deals. We don't even allow that word here. It's not buying and selling, that's a transaction. You don't invest in something and say I can sell it tomorrow or next year. We take a five year, ten year view and say we can build a company that can significantly change the landscape. Now if you happen to do that, you build companies of lasting value, make a large impact and if you do, you're going to have a valuable company that you can make money on. So it's a long term versus short term perspective.”

**Thanks:** To sec314<sup>43</sup> for pointing me to this article.

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<sup>43</sup><http://news.ycombinator.com/user?id=sec314>

## “If you want to improve your chances”

“If you want to improve your chances, you should think far more about who you can recruit as a cofounder than the state of the economy. And if you’re worried about threats to the survival of your company, don’t look for them in the news. Look in the mirror.”

– Paul Graham<sup>44</sup>

## How do I lay people off?

“If you handle a restructuring well, the word gets out that you’re a good place to work.”

- Ron Thomas<sup>45</sup>, Martha Stewart Living Omnimedia

Bob Sutton<sup>46</sup> from Stanford has great advice on how to do a layoff with compassion in Layoffs: More Evidence on Costs and Implementation Practices<sup>47</sup>:

“John E. Pepper Jr., who was then P&C’s chairman, explained that they had learned plant closings do far less damage, in terms of lost productivity, retention of employees who are offered jobs elsewhere in the company, and lost sales in the city where the closing is done, when:

1. **Prediction:** They explain how the plant closing will unfold in detail to both employees and

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<sup>44</sup><http://www.paulgraham.com/badeconomy.html>

<sup>45</sup>[http://www.gazette.com/articles/layoffs\\_24336\\_article.html/managers\\_says.html](http://www.gazette.com/articles/layoffs_24336_article.html/managers_says.html)

<sup>46</sup><http://bobsutton.typepad.com/>

<sup>47</sup>[http://discussionleader.hbsp.com/sutton/2007/07/layoffs\\_more\\_evidence\\_on\\_costs\\_1.html?loomia\\_si=t0:a16:g2:r2:c0.216219](http://discussionleader.hbsp.com/sutton/2007/07/layoffs_more_evidence_on_costs_1.html?loomia_si=t0:a16:g2:r2:c0.216219)

members of the affected community. In particular, they announce the closing date and specific milestones well in advance.

2. **Understanding:** They explain the business case for closing the plant in detail to both employees and the community.
3. **Control:** They give affected employees choices over how they experience the closing, in particular giving them options about when and in what ways they find a job inside the company, along with other options such as help with finding a new job (or new career) outside the company.
4. **Compassion:** They express human concern—both in public and private—to affected employees and community officials.”



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<sup>48</sup>[http://discussionleader.hbsp.com/sutton/2007/07/layoffs\\_more\\_evidence\\_on\\_costs\\_1.html?loomia\\_si=t0:a16:g2:r2:c0.216219](http://discussionleader.hbsp.com/sutton/2007/07/layoffs_more_evidence_on_costs_1.html?loomia_si=t0:a16:g2:r2:c0.216219)

## Four Guidelines

Bob's article includes:

"Four guidelines to making [layoffs] in as humane a manner as possible:

1. **Prediction:** Give people as much information as you can about *what* will happen—to them as individuals, to their workgroups, and to the organization as a whole—and *when* it will happen. This makes the layoff real for people and helps them prepare for the future.
2. **Understanding:** Explain why you believe the change is necessary. Human beings have consistently negative reactions to unexplained events. This effect is so strong that it is better to give an explanation that people dislike than no explanation at all—so long as the explanation is credible.
3. **Control:** Giving people influence over what will happen is often impossible, but giving them influence over how it happens and when it happens is often possible.
4. **Compassion:** Senior executives should express human compassion, and when appropriate, sorrow, for the consequences of their business decisions."

## Layoffs at Martha Stewart

Here's another example of a layoff from Managing layoffs with tact, timing<sup>49</sup>:

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<sup>49</sup> [http://www.gazette.com/articles/layoffs\\_24336\\_article.html/managers\\_says.html](http://www.gazette.com/articles/layoffs_24336_article.html/managers_says.html)

“When Ron Thomas, vice president of organizational development at Martha Stewart Living Omnimedia, coached managers during two rounds of layoffs, he advised them on what to expect from themselves and from those getting the bad news. The company cut about 100 employees when it closed the catalog business in 2002 and then eliminated its television show in 2004. On both occasions, **“I told managers they weren’t going to sleep the night before” they had to announce layoffs**, he says.

“He urged them to “try to envision that one day you may be on the other side of the table — so you should treat people the way you’d like to be treated in this situation,” he adds.

“Thomas advised managers not to “sugarcoat” the news. He told them to say, “We’re closing something down and restructuring — and unfortunately your job is being eliminated.” They should then move quickly to discussing how the company plans to help with severance and other benefits, he says.

“He also has arranged help for the terminated employees. **“We make sure people who are losing a job know someone will call them to start helping them within a day,”** he says. He will often use his own network of contacts to help them land new jobs. When the catalog business was closed, he says he called every catalog company he could think of to inquire about job openings.

“These efforts fostered loyalty among current and former employees and helped the company recruit new talent. When Martha Stewart Living launched a new television show, it hired back some employees who had been laid off in 2004. **“If you handle a restructuring well, the word gets out that**

**you're a good place to work...** If we post a job opening today, we'll get 1,500 resumes tomorrow," Thomas says.

## Startups

In a startup, make sure you tell those who are staying and going that (1) there are no plans to do any more layoffs, (2) exactly how much runway the company has after the layoffs, and (3) the plans to extend the runway.

## More advice

There's more good advice in How to Manage a Layoff<sup>50</sup>, Layoffs and Creativity: Are You Expelling the Innovators?<sup>51</sup>, and The Art of the Layoff<sup>52</sup>.

## How Steve Jobs pitches a startup

Watch the master pitch man, Steve Jobs, analyze the market for NeXT<sup>53</sup> workstations in Part 1 of his Chalk Talk<sup>54</sup>. He explains:

"Who is our target customer? Why are they selecting our products over our competitor's? And what distribution channels are we going to use to reach these customers?"

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<sup>50</sup><http://www.2-speed.com/2007/07/how-to-manage-a-layoff/>

<sup>51</sup>[http://bobsutton.typepad.com/my\\_weblog/2008/10/layoffs-and-creativity.html](http://bobsutton.typepad.com/my_weblog/2008/10/layoffs-and-creativity.html)

<sup>52</sup>[http://blog.guykawasaki.com/2006/07/the\\_art\\_of\\_the\\_.html](http://blog.guykawasaki.com/2006/07/the_art_of_the_.html)

<sup>53</sup><http://en.wikipedia.org/wiki/NeXT>

<sup>54</sup><http://www.youtube.com/watch?v=p9dmcRbuTMY>

Steve covers a handful of the slides that you see in a typical startup deck<sup>55</sup>: Marketing, Sales, Competition, and a little bit of Problem and Solution. We should all try to present with Steve's clarity and simplicity.

Here's part two<sup>56</sup> of the video. Thanks to Daring Fireball<sup>57</sup> for pointing me to this video.

## Lean startups find their moment

“As an investor and board member, it’s comforting for me to see a team using lean development. It gives me transparency on product development and engineering. I even see it reflected in the way the company manages its business objectives and goals.”

– Scott Raney<sup>58</sup>, Redpoint Ventures

**Summary:** “Lean” is the most capital-efficient way to run a business. Lean is the never-ending process of eliminating waste: finding every activity that does not create value for the customer and eliminating it. The two greatest wastes are overproduction (making things the customer doesn’t want) and inventory (making things that aren’t used immediately).

Every entrepreneur must learn how to run a lean startup (some people say agile instead of lean — same thing). It’s the most capital-efficient way to run a business. It’s how you get to product/market fit<sup>59</sup>. It’s how you do more with less money.

If you’re not lean, getting lean is probably the most effective thing you can do for your business. Smart investors and boards

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<sup>55</sup><http://venturehacks.com/articles/deck>

<sup>56</sup><http://www.youtube.com/watch?v=vdn3Ex-5dPAo>

<sup>57</sup><http://daringfireball.net/linked/2008/10/19/jobs-next-video>

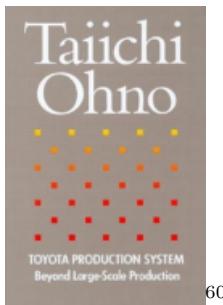
<sup>58</sup><http://www.redpoint.com/team/scott-raney/>

<sup>59</sup><http://venturehacks.com/articles/plans-ndas-traction#traction>

will soon be demanding lean. And smart startups will get lean while the other ones will get left behind.

## Q. What's a lean startup?

Lean startups eliminate waste: they eliminate every activity that does not create value for the customer. If you eliminate enough waste, you can be fast, cheap, high quality, and effective—because more and more of your activities will be creating value for the customer.

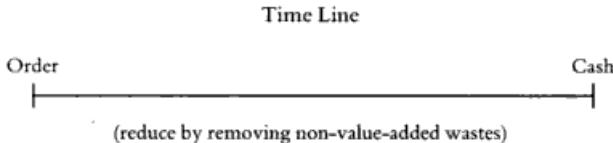


In Toyota Production System<sup>61</sup>, Taiichi Ohno (the father of lean) says,

“All we are doing is looking at the timeline... from the moment the customer gives us an order to the point that we collect the cash. And we are reducing that time line by removing the non-value-added wastes...

<sup>60</sup><http://www.amazon.com/gp/redirect.html?ie=UTF8&location=http%3A%2F%2Fwww.amazon.com%2FToyota-Production-System-Beyond-Large-Scale%2Fdpl%2F0915299143%3Fie%3DUTF8%26s%3Dbooks%26qid%3D1224043585%26sr%3D8-1&tag=httpventureco-20&linkCode=ur2&camp=1789&creative=9325>

<sup>61</sup><http://www.amazon.com/gp/redirect.html?ie=UTF8&location=http%3A%2F%2Fwww.amazon.com%2FToyota-Production-System-Beyond-Large-Scale%2Fdpl%2F0915299143%3Fie%3DUTF8%26s%3Dbooks%26qid%3D1224043585%26sr%3D8-1&tag=httpventureco-20&linkCode=ur2&camp=1789&creative=9325>



“True efficiency improvement comes when we produce zero waste and bring the percentage of work to 100 percent:

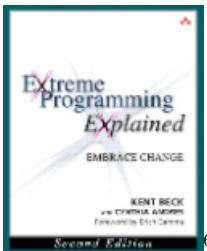
“Present capacity = work + waste.”

**Toyota created lean and used it to grow from a small company to the world’s largest automaker.** They simply find every activity that doesn’t create value for the customer and eliminate it.

## Q. What’s waste?

The two greatest wastes are:

1. **Overproduction:** *Things the customer doesn’t want.* Cars the customer won’t buy. Features the customer doesn’t want. Software the customer won’t purchase.
2. **Inventory:** *Parts that aren’t used immediately.* Mufflers that aren’t in cars. Features that can’t ship because they’re buggy. Code that isn’t in customer hands. Architectures that aren’t coded. Requirements that aren’t coded, shipped, and useful. Most to-do lists.



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In Extreme Programming Explained<sup>63</sup>, Kent Beck (the father of Extreme Programming) says:

“Taiichi Ohno, the spiritual leader of [Toyota Production System], says the greatest waste is the waste of overproduction. **If you make something and can't sell it, the effort that went into making it is lost. If you make something internally in the line and don't use it immediately, its information value evaporates.** There are also storage costs: you have to haul it to a warehouse; track it while it is there; polish the rust off it when you take it back out again; and risk that you'll never use it at all, in which case you have to pay to haul it away.

“Software development is full of the waste of overproduction: fat requirements documents that rapidly grow obsolete; elaborate architectures that are never used; code that goes months without being integrated, tested, and executed in a production environment; and documentation no one reads until it

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<sup>62</sup><http://www.amazon.com/gp/product/0321278658?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0321278658>

<sup>63</sup><http://www.amazon.com/gp/product/0321278658?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0321278658>

is irrelevant or misleading. While all of these activities are important to software development, we need to use their output immediately in order to get the feedback we need to eliminate waste.

“While individual machines may work more smoothly with lots of... inventory, the factory... as a whole doesn’t work as well. **If you use a part immediately you get the value of the part itself as well as information about whether the upstream machine is working correctly...** Parts aren’t just parts but also information...”

“Requirements gathering, for instance, will not improve by having ever more elaborate requirements-gathering processes but by shortening the path between the production of requirements... and the deployment of the software specified... Requirements gathering isn’t a phase that produces a static document; but an activity producing detail, just before it is needed, throughout development.”

## Q. How do you get lean?

Lean probably seems pretty abstract so far. Next up are a few posts describing specific ways to be lean and eliminate waste.

**Thanks:** To Fred Wilson for inspiring the title of this article with his post, Capital Efficiency Finds Its Moment<sup>64</sup>.

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<sup>64</sup>[http://www.avc.com/a\\_vc/2008/10/capital-efficie.html](http://www.avc.com/a_vc/2008/10/capital-efficie.html)

## How should I format my deck?

Don't try to cram cogent arguments into the slides of your deck<sup>65</sup>. Keep the slides simple, visual, and minimal. Put cogent arguments, talking points, and prose in the notes that accompany each slide.

How? Check out Dan Cook's Laws of Productivity<sup>66</sup> (pdf<sup>67</sup>) for a great example:

(If you don't see the embed above, see The Laws of Productivity on Scribd.<sup>68</sup>)

You now have a deck that you can send in emails or present in person. An investor can read the slides and notes and imagine a presentation. And you can present the slides while you refer to the notes. Bon Appetit.

## A quick and dirty guide to starting up

Naval recently presented our *Quick and Dirty Guide to Starting Up*<sup>69</sup> to Girls In Tech<sup>70</sup>:

**Slides:** A Quick and Dirty Guide to Starting Up<sup>71</sup> (pdf<sup>72</sup>)

Here are some of my favorite quotes from the presentation:

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<sup>65</sup><http://venturehacks.com/articles/deck>

<sup>66</sup><http://www.scribd.com/doc/6286696/Rules-of-Productivity>

<sup>67</sup><http://lostgarden.com/Rules%20of%20Productivity.pdf>

<sup>68</sup><http://www.scribd.com/doc/6286696/Rules-of-Productivity>

<sup>69</sup><http://www.slideshare.net/nivi/how-to-startup-presentation>

<sup>70</sup><http://girlsintech.net/>

<sup>71</sup><http://www.slideshare.net/nivi/how-to-startup-presentation>

<sup>72</sup><http://venturehacks.com/wordpress/wp-content/uploads/2008/10/how-to-startup.pdf>

“We are faced with insurmountable opportunities.”  
– Pogo

The most important thing: idea intelligence connections experience determination.

Ideas, and therefore NDAs, are worthless.

“... as in all matters of the heart, don’t settle.” – Steve Jobs, on picking co-founders

Co-founders are the biggest failure mode for startups.

“If you are facing in the right direction, keep walking.” – Buddha, on focusing your time in a startup

Markets are relatively efficient, so your first product is probably wrong.

If there’s demand, we’ll turn this into a slidecast.

## How to deal with Machiavellian investors



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<sup>73</sup> <http://www.vcconfidential.com/2008/10/be-careful-who-you-deal-with.html>

In Be Careful Who You Deal With<sup>74</sup>, Matt McCall, a Managing Director at DFJ Portage, has great advice for entrepreneurs who are dealing with “slimy bottom sucker” investors:

“As these markets continue their chaotic path downward, people’s true colors come out. Some people show increasing amounts of fairness and consideration. Others will self-optimize and use every bit of leverage that they can get their hands on.

“Two entrepreneur friends of mine recently had a very negative experience with an investor who has a reputation for being Machiavellian and it really, really has incensed me. These slimy bottom suckers use the changing market conditions to test how low they can retrade an existing deal. Here is the standard game plan for these kinds of assholes. When they sense a dramatic change in the market, they pull away their term sheet siting “policy” changes. However, instead of walking away from the deal, they mention in passing that they might reconsider under “different terms”. If the entrepreneur bites, they know that they have leverage and they proceed to throw down absolutely egregious terms (multiple liquidation preference, half the original price, etc). If the entrepreneur bites on this, they know they really have them and continue to ratchet down the terms until things break and they back off.”

Read the rest of Matt’s post<sup>75</sup> to learn how you can counter this investor’s game with your own game theory.

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<sup>74</sup><http://www.vcconfidential.com/2008/10/be-careful-who-you-deal-with.html>

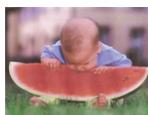
<sup>75</sup><http://www.vcconfidential.com/2008/10/be-careful-who-you-deal-with.html>

Machiavellian investors will try this trick in good markets too (I've seen it happen). Once you sign a term sheet, the investor will try to retrade terms. By then, you've told other prospective investors that you've signed a term sheet. It's hard to go back to them and explain what's happening. And if you walk away from the signed term sheet, it's hard to talk to new investors with a blown-up term sheet on your hands.

Of course, Machiavellian entrepreneurs exist too. And VCs have enough "institutional knowledge" to know that. Unfortunately, most entrepreneurs don't have commensurate knowledge about their counterparts.

(Via Ask the VC<sup>76</sup>.)

## VH Twitters: Persistence Edition



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We've been using our Twitter feed<sup>78</sup> (RSS<sup>79</sup>) more and more often to share great quotes, brief thoughts, and links. That's the place to go if you desperately need more Venture Hacks in your life. You can also subscribe via email<sup>80</sup> (no more than one email a day).

Here are some of our latest and greatest tweets:

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<sup>76</sup><http://www.askthevc.com/blog/index.php>

<sup>77</sup><http://twitter.com/venturehacks>

<sup>78</sup><http://twitter.com/venturehacks>

<sup>79</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>80</sup>[http://www.feedburner.com/fb/a/emailverifySubmit?feedId=2591565&loc=en\\_US](http://www.feedburner.com/fb/a/emailverifySubmit?feedId=2591565&loc=en_US)

“Persistence isn’t using the same tactics over and over. Persistence is having the same goal over and over.” – Seth Godin<sup>81</sup>

“The best business plan is to sell people the things they want.” – Stephan Schmidt<sup>82</sup>

“Startups need to develop an initial product with the least number of features that can sell to the most people.” – Brett Owens<sup>83</sup>

How to measure your lawyers: (1) How quickly do they turn things around? (2) How many mistakes are in the product? Forget other metrics.” – Venture Hacks [We later added ”(3) Cost” to the list.]

“For heavens sake, if you haven’t gotten comfy with Agile techniques and thinking, get on it right now.” – Tim Bray<sup>84</sup>

“Every fund has a silver bullet—someone who can kill any deal—and a lead bullet—someone who can’t get any deal done.” – Anonymous VC

“If an investor can’t give you a deadline for a yes/no, and you can’t force a deadline for a yes/no, you shouldn’t be talking to investors.” – Venture Hacks

“If they’re talking to you, you have leverage.” – Christopher Voss<sup>85</sup>

Thanks to everyone who has ever sent us a tweet @venture-hacks<sup>86</sup>. We can’t respond to every message, but we read and appreciate them all.

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<sup>81</sup> [http://sethgodin.typepad.com/seths\\_blog/2008/03/persistence.html](http://sethgodin.typepad.com/seths_blog/2008/03/persistence.html)

<sup>82</sup> <http://stephan.reposita.org/archives/2008/10/27/>

6-reasons-why-my-vc-funded-startup-did-fail/

<sup>83</sup> <http://venturehacks.com/articles/lean-startups#comment-5598>

<sup>84</sup> <http://www.tbray.org/ongoing/When/200x/2008/10/12/Tough-Times-Agility>

<sup>85</sup> [http://en.wikipedia.org/wiki/Christopher\\_Voss](http://en.wikipedia.org/wiki/Christopher_Voss)

<sup>86</sup> <http://twitter.com/venturehacks>

## Why startup pitches fail

**Summary:** Pitches usually fail because they answer the wrong questions. The right questions depend on the stage of your business—for example, some businesses are just getting started with an idea, while others are printing money. Focus your pitch on the key questions for your stage and if you keep getting non-key questions, *something is wrong with your pitch*. This post includes a hierarchy that you can use to classify your business and the key questions for each stage in the hierarchy.



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[Ed: This is a guest post by Eric Ries<sup>88</sup>, a founder of IMVU<sup>89</sup> and an advisor to Kleiner Perkins<sup>90</sup>. Eric also has a great blog called *Startup Lessons Learned*<sup>91</sup>.]

Every company will need to pitch itself from time to time. Usually we think of pitches in the context of raising money, but that is only one of many pitch situations. We pitch to potential partners, vendors, publishers, conferences, employees, and even lawyers.

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<sup>87</sup><http://startupplessonsslearned.blogspot.com/>

<sup>88</sup><http://startupplessonsslearned.blogspot.com/>

<sup>89</sup><http://www.imvu.com/>

<sup>90</sup><http://www.kpcb.com/index.html>

<sup>91</sup><http://startupplessonsslearned.blogspot.com/>

Pitching is different from selling a product, because it is not part of our regular business practice, it is not something that relates to our core competence, and it tends not to happen in a repeatable and scalable way. (I'll exclude those non-lean startups<sup>92</sup> who basically exist for the purpose of raising bigger and bigger sums of money. You're not one of *those* are you?)

### **Pitches usually fail because they answer the wrong questions.**

Most of the times I have seen pitches fail, it is not because they are poorly written, or that the entrepreneur lacks passion. It is because they don't answer the right question.

My favorite example of all time comes from students in an entrepreneurship class. Their idea was to build a next-generation autonomous robot, that could be used by defense and security agencies around the world. The whole pitch was about how valuable robots could be in the future. They even included a slide with The Transformers<sup>93</sup> on it.

Now there was nothing wrong with their analysis: anyone who invents a technology as sophisticated as The Transformers is definitely going to make a lot of money. But these students completely failed to address the one and only question on their audience's mind: can you three guys really build the robots of the future? (Turns out, they were incredibly well-credentialled graduate students who had, in fact, developed some interesting new robotics technology. But you wouldn't have known that from their pitch.)

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<sup>92</sup><http://startuplessonslearned.blogspot.com/search/label/lean%20startup>

<sup>93</sup>[http://en.wikipedia.org/wiki/The\\_Transformers\\_\(TV\\_series\)](http://en.wikipedia.org/wiki/The_Transformers_(TV_series))

## The right questions depend on your business' stage.

I have come to believe that there is a hierarchy of pitches, and that understanding where your pitch falls in this hierarchy can assist in making decisions about what information to highlight. Pitches that sit higher in the hierarchy tend to be more successful, and if you can fit your company into one of those categories, you can get better results or better terms.

Now, just because you *can* do a thing, doesn't mean you *should*—there are plenty of other great resources, like Paul Graham's essays<sup>94</sup>, that can help you think through whether and when to raise money (or do other kinds of deals).

With that disclaimer out of the way, here's the hierarchy of pitches:

1. **Printing money.** *Key questions:* Are those numbers real? How big is the market? Can your team execute the growth plan? *Most important slide:* Valuation.
2. **Promising results.** *Key questions:* Can you monetize that traffic (or drive traffic to that profitable destination?) Do you know why you've achieved those results? *Most important slide:* Hockey stick.
3. **Micro-scale results.** *Key questions:* Who is the customer, and how do you know? What is the potential market size? What are the business economics? *Most important slide:* Lessons learned.
4. **Working product.** *Key questions:* What does the product do? What's the launch plan? Who's on the marketing team? *Most important slide:* Live demo.

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<sup>94</sup><http://startuplessonslearned.blogspot.com/2008/09/paul-graham-on-fundraising.html>

5. **Prototype product.** *Key questions:* What will it take to ship a working product? How do you know anyone would want it? Who's on the engineering team? *Most important slide:* Demo (if the product solves an obvious problem), engineering resumes (if the product is nearly impossible to build), or "a day in the life of a customer"<sup>95</sup> (if neither of the above).
6. **Breakthrough technology.** *Key questions:* Who owns the patents? Can we make a product out of this technology? Are there any good substitutes? *Most important slide:* Barriers to entry.
7. **All-star team.** *Key questions:* Has the team made money for their investors in the past? Are they domain experts? Are they committed to an idea in their domain of expertise? *Most important slide:* Problem we are trying to solve.
8. **Good product idea.** *Key questions:* What kinds of risk does this company need to mitigate (technology risk, market risk, team risk, funding risk)? Is it a revolutionary and novel idea? Is this team the one to back? Can the team bring the product to market? Who is the customer? Who is the competition? Will they fail fast? *Most important slide:* About the founders.

*[Ed: Here's another way to think about the key questions and most important slide. The key questions should describe how you will get to the next stage of the hierarchy. And the most important slide should prove that you're at the stage you claim to be.]*

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<sup>95</sup>[http://books.google.com/books?id=oLL2pjn2RV0C&pg=PA40&lpg=PA40&dq=steve+blank+%22day+in+the+life+of+a+customer%22&source=web&ots=ucRoMIQ-Dz&sig=O\\_J5QJn5yf-\\_DcdkN154r6txPec&hl=en&sa=X&oi=book\\_result&resnum=2&ct=result](http://books.google.com/books?id=oLL2pjn2RV0C&pg=PA40&lpg=PA40&dq=steve+blank+%22day+in+the+life+of+a+customer%22&source=web&ots=ucRoMIQ-Dz&sig=O_J5QJn5yf-_DcdkN154r6txPec&hl=en&sa=X&oi=book_result&resnum=2&ct=result)

## **Focus your pitch on the key questions.**

In a pitch meeting, try to spend as much time as possible talking about the key questions for your pitch. If you find yourself getting asked non-key questions, try to use your answers to steer the conversation back to the key questions.

But here's the most important part: if you keep getting non-key questions over and over again, *something is wrong with your pitch*. Either you misunderstand where your pitch fits into the hierarchy, or you are not using the early part of your pitch to establish it.

Don't keep banging your head against the wall—if you can't convince your potential partners that your startup is printing money, try to figure out why. Experiment with different narratives. If you still can't do it, move one level down the hierarchy and see if you can make that story stick.

# November 2008

## Coming Soon: Pitching Hacks, The Book

We're busy working on our first book: Pitching Hacks. We're excited and—you guessed it—it's all about pitching to investors.

The book also includes passages from the writings of Marc Andreessen<sup>1</sup>, David Cowan<sup>2</sup>, Brad Feld<sup>3</sup>, and a mess of other folks.

Sign up<sup>4</sup> to get an email when we release Pitching Hacks. Here's a couple pictures of its gory insides from our first draft:

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<sup>1</sup><http://blog.pmarca.com/>

<sup>2</sup><http://whohastimeforthis.blogspot.com/>

<sup>3</sup><http://www.feld.com/blog/>

<sup>4</sup><http://venturehacks.wufoo.com/forms/pitching-hacks-the-book/>

NOVEMBER 2008

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Venture Hacks

# PITCHING HACKS

[venturehacks.com](http://venturehacks.com)

5

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<sup>5</sup><http://venturehacks.wufoo.com/forms/pitching-hacks-the-book/>

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<sup>6</sup><http://venturehacks.wufoo.com/forms/pitching-hacks-the-book/>

Stay tuned for updates on our progress and sign up<sup>7</sup> to get an email when we release Pitching Hacks.

## Books for Entrepreneurs: Agile Software Development

“For heavens sake, if you haven’t gotten comfy with Agile techniques and thinking, get on it right now.”

– Tim Bray<sup>8</sup>, Editor of XML 1.0

**Summary:** Start learning how to be lean by reading Agile Software Development<sup>9</sup>. It isn’t the cheapest book in the world but it’s one of the cheapest investments you will make in your startup. It includes 14 simple and counterintuitive practices that will help you *engineer* your engineering and product teams. This post includes several excerpts from the book.

In Lean startups find their moment<sup>10</sup>, we defined **lean** as the never-ending process of eliminating waste. We described its **benefits**: eliminating waste makes your business fast, cheap, high quality, and effective—yes, all the good stuff, all at once. We defined **waste** as anything that is not absolutely necessary for creating customer value. And we described the **two greatest wastes**: overproduction and inventory.

We also said that lean probably seems abstract so far. Time to make it more concrete.

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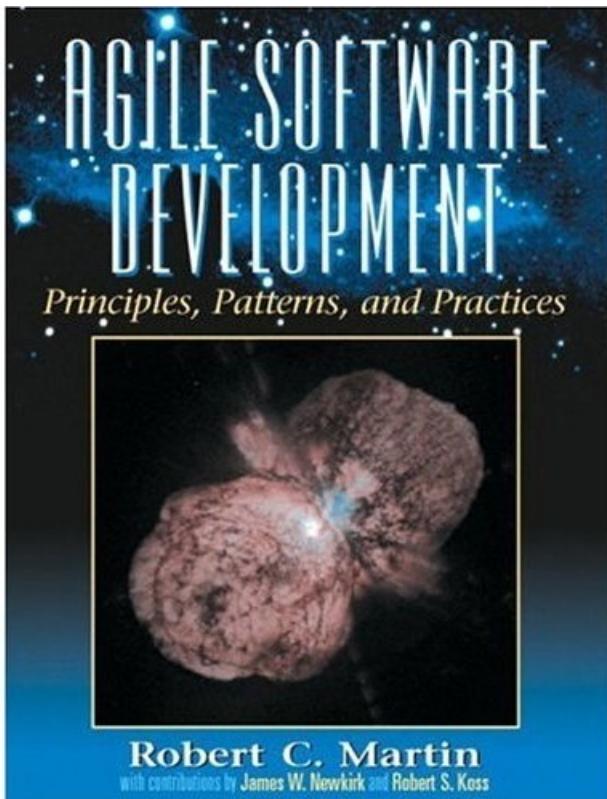
<sup>7</sup><http://venturehacks.wufoo.com/forms/pitching-hacks-the-book/>

<sup>8</sup><http://www.tbray.org/ongoing/When/200x/2008/10/12/Tough-Times-Agility>

<sup>9</sup><http://www.amazon.com/gp/product/0135974445?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0135974445>

<sup>10</sup><http://venturehacks.com/articles/lean-startups>

## Agile Software Development



<sup>11</sup> We first learned how to be lean from a book called Agile Software Development<sup>12</sup> by Robert “Uncle Bob” Martin. Uncle Bob is one of the creators of agile and agile is just another word that software

<sup>11</sup> <http://www.amazon.com/gp/product/0135974445?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0135974445>

<sup>12</sup> <http://www.amazon.com/gp/product/0135974445?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0135974445>

developers use instead of lean. This isn't the cheapest book in the world but it's one of the cheapest investments you will make in your startup.

Chris Sepulveda<sup>13</sup> recommended this book when we hired Pivotal Labs<sup>14</sup> to help us with software development. I remember having one of those aha! moments when I first read it, "Oh, so *this* is how you quickly translate a founder's vision into happy customers (hint: it isn't by specifying the requirements up front). *This* is how you deliver software on time (hint: it isn't by working overtime). *This* is how you eliminate bugs (hint: it isn't with QA). *This* is how you make developers effective (hint: it isn't by putting them in a quiet room by themselves). *This* is how you know when you'll be done (hint: it isn't with a Gantt chart). *This* is how you *engineer* an engineering and product team."

## Excerpt

Here's a excerpt of the simple, lightweight practices in *Agile Software Development*:

### “User Stories

“In order to plan a project, we must know something about the requirements but we don't need to know very much... we only need to know enough about a requirement to estimate it.

“The specifics of a requirement are likely to change with time, especially once the customer [the founder or product manager] begins to see the system come together. There is nothing that focuses requirements better than seeing the nascent system come to life.

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<sup>13</sup><http://www.pivotallabs.com/who#christian>

<sup>14</sup><http://www.pivotallabs.com>

Therefore, capturing the specific details about a requirement long before it is implemented is likely to result in wasted effort...

### **“The Planning Game**

“The essence of the planning game is the division of responsibility between business and development. The business people (a.k.a. the customers) decide how important a feature is, and the developers decide how much the feature will cost to implement.

“At the beginning of each iteration [an iteration is one week], the developers give the customers a budget, based on how much they were able to get done in the last iteration. The customers choose stories whose costs total up to, but do not exceed that budget.

“With these simple rules in place, and with short iterations and frequent releases... the customers will be able to determine how long their project will take and how much it will cost.

### **“Simple Design**

“An [agile] team will probably not start with infrastructure. They probably won’t select the database first. They probably won’t select the middleware first. The team’s first act will be to get the first batch of stories working in the *simplest way possible*. The team will only add the infrastructure when a story comes along that forces them to do so.

“You aren’t going to need it. An [agile] team seriously considers what will happen if they resist the temptation to add infrastructure before it is strictly needed. They start from the assumption that they aren’t going to need that infrastructure.

### **“Test-Driven Development**

“All production code is written in order to make failing tests pass. First we write a test that fails because the functionality for which it is testing doesn’t exist. Then we write the code that makes that test pass.

“Once a test passes, it is added to the body of passing tests and is never allowed to fail again. This growing body of tests is run several times per day, every time the system is built. If a test fails, the build is declared a failure. Thus, once a requirement is implemented, it is never broken. The system migrates from one working state to another and is never allowed to be inoperative for longer than a few hours.”

And here’s a pdf of Chapter 1<sup>15</sup> that I got from Uncle Bob’s website.

By themselves, these practices actually have too many flaws to be effective. *Agile Software Development* includes the nine remaining practices that you need to make an agile process work.

Parts of this book are for anyone, and parts are for developers. If you’re a founder or a product manager, read everything up to and including Chapter 3. If you’re a developer (I’m not), I’m guessing you should read everything up to and including Chapter 7—or read the whole book.

So what does any of this have to do with eliminating waste?  
*More on that later.*

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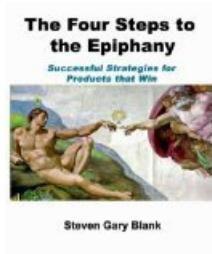
<sup>15</sup><http://venturehacks.com/wordpress/wp-content/uploads/2008/11/agile-software-developer-chapter-1.pdf>

## How to develop your customers like you develop your product

“In a startup no facts exist inside the building, only opinions.”

– Steve Blank<sup>16</sup>

**Summary:** In Four Steps to the Epiphany<sup>17</sup>, Steve Blank lays out a customer development process that complements a startup’s product development process. This post includes video and slides where Steve explains the ideas in this book.



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About a year and a half ago, Marc Andreessen described The Four Steps to the Epiphany<sup>19</sup> by Steve Blank as the “best book for tech entrepreneurs this year.” Marc wrote<sup>20</sup>:

“Steve Blank is a super-experienced Silicon Valley

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<sup>16</sup><http://books.google.com/books?id=oLL2pjn2RV0C&pg=PA8&dq=%22In+a+startup,+no+facts+exist+inside+the+building,+only+opinions.%E2%80%9D&lr=&ei=w3YSScqyKYLwsQP8umvBg>

<sup>17</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>18</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>19</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>20</sup><http://blog.pmarca.com/2007/07/book-of-the-w-1.html>

technology entrepreneur... a dude with serious street cred...

“In a nutshell, Steve proposes that companies need a Customer Development process that complements their Product Development Process. And he lays out exactly what he thinks that Customer Development process should be. This goes directly to the theory of Product/Market Fit<sup>21</sup> that I have discussed on this blog before—in this book, Steve provides a roadmap for how to get to Product/Market Fit.

“Buy it, read it, keep it under your pillow and absorb it via osmosis.”

I bought it, read it, couldn’t absorb it, put it on the shelf, and ignored it.

Fortunately, I’ve recently found a great talk and slides from Steve Blank that provide a more gentle introduction to customer development. *Be gentle Steve...*

## The talk

*How Alan Michaels took Convergent Technologies from zero sales to a \$400M exit in four years by discovering his customers:*

*Why most startups don’t need VPs:*

*Why most startups fail:*

(Videos: Acting on Customer Discovery<sup>22</sup>, No VP’s in a Startup<sup>23</sup>, Assessing Customer and Market Risks<sup>24</sup>)

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<sup>21</sup><http://blog.pmarca.com/2007/06/the-pmarca-gu-2.html>

<sup>22</sup><http://ecorner.stanford.edu/authorMaterialInfo.html?mid=2062>

<sup>23</sup><http://ecorner.stanford.edu/authorMaterialInfo.html?mid=2063>

<sup>24</sup><http://ecorner.stanford.edu/authorMaterialInfo.html?mid=2057>

Go to Stanford's Entrepreneurship Corner<sup>25</sup> to see the rest of the videos from Steve's talk. Or listen to audio of the talk<sup>26</sup>, which includes segments you won't see in the videos.

## The Slides

Here are the slides from another talk by Steve. They roughly complement the videos above.

(Slides: The Customer Development Methodology<sup>27</sup>)

## Back to the book

I'm going to take another stab at reading The Four Steps to the Epiphany<sup>28</sup> and I hope you join me. I'll let you know how it goes—please do likewise!

# “Agile methods and startup companies... go perfectly together.”

William Pietri<sup>29</sup> left a great comment on Books for Entrepreneurs: Agile Software Development<sup>30</sup> (emphasis added):

“Great to see these approaches getting more attention in the startup world. I've been soaking in both

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<sup>25</sup><http://ecorner.stanford.edu/authorMaterialInfo.html?mid=2056>

<sup>26</sup><http://ecorner.stanford.edu/authorMaterialInfo.html?mid=2048>

<sup>27</sup><http://www.slideshare.net/venturehacks/customer-development-methodology-presentation>

<sup>28</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>29</sup><http://www.scissor.com/>

<sup>30</sup><http://venturehacks.com/articles/agile-software-development>

agile methods and startup companies a long time, and I think they go perfectly together. They provide just enough structure to make everybody effective, without unnecessary constraints or process bloat.

**“One of my clients, sidereel.com<sup>31</sup> started with an XP-ish process from the first week. They had an alpha for investors in 2 months, a private beta in 3, and a public beta in 4 months. Now they’re happily funded, up to a dozen people, and just shy of Alexa 1000 site. Weekly iterations meant they always had new progress to show potential investors. And being able to change direction easily meant they could try a lot of things out and invest heavily in areas the users liked.”**

“Speaking of which, I and a colleague are interested in trying out some variations of the Planning Game with a couple of user-focused startups. If any VH readers want to be guinea pigs, we’re looking for Bay Area teams that are early in the process, actively struggling to put together a product plan, and have both business and technical people involved full time. If there’s anybody here that meets those criteria, just drop me a line. My email address is my first name at my domain name [scissor.com].”

Also check out An XP Team Room<sup>32</sup>, where William walks us through the offices of a lean startup in gory detail:

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<sup>31</sup><http://www.sidereel.com>

<sup>32</sup><http://www.scissor.com/resources/teamroom/>



## Our Sponsor: Charles River Ventures

We're going to try something new here: sponsorships. We hope this experiment will be effective for you and our sponsors. Send us your feedback.

We would like to welcome our first sponsor, Charles River Ventures<sup>34</sup>. And I would like to thank George Zachary<sup>35</sup> from CRV for working with me to get this done. You'll find the sponsorship near the top right of our website. It looks like this:



You'll also see occasional messages from our sponsors in our blog and Twitter feeds.

If sponsorships are useful to our readers, they'll be useful to our sponsors. And if they're not useful to you, they won't be useful

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<sup>33</sup><http://www.scissor.com/resources/teamroom/>

<sup>34</sup><http://crv.com/>

<sup>35</sup>[http://crv.com/team/george\\_zachary](http://crv.com/team/george_zachary)

<sup>36</sup><http://crv.com/>

to our sponsors. Let us know what you think as this experiment progresses.

Here's a message from CRV that describes what they do and how they do it:

"CRV's approach to investing is simple: we seek out visionary entrepreneurs, and give them the support they need to build great companies from the ground up. It's our job to enable startups. Not second-guess them.

"Our initial investment can be as small as \$100,000, or as large as \$5 million. The bulk of our investments have been to companies with fewer than 10 employees—many have as few as 2 or 3. We don't require a complete management team, since we can often help in bringing the right talent to the mix.

"Unlike many venture firms, we don't lurk on the sidelines waiting for a strong lead investor to step up. When we believe in a project, we want to be the lead investor.

"The best way to get our attention is not with a 100-page business plan. A concise executive summary, an expense budget for the first two years, the revenue model, and a PowerPoint presentation are the materials we're interested in seeing. It helps if one of our portfolio companies, or a member of our contact network recommends you.

"Since 1970, we have helped startups turn their ideas into real, viable businesses. Companies like Cascade, CIENA, ChipCom, NetGenesis, Parametric Technology, Sonus, Speechworks, Stratus Computer, Sybase, Vignette and dozens more have realized stunning success with our backing and support.

“But our greatest successes, we believe, are the ones that lie ahead.”

## VH Twitters: “Write a blog, not a business plan.”

We use Twitter<sup>37</sup> (RSS<sup>38</sup>) to share great quotes, brief thoughts, and links. If you like this blog, you’ll like our Twitter feed. Here are some of the latest and greatest tweets:

Epic post on how to demo from Wufoo: How We Prepare a Demo<sup>39</sup>.

Startup compensation studies from 2008 and 2007 for IT<sup>40</sup> and Life Sciences<sup>41</sup>.

What the office of a lean startup looks like: An XP Team Room<sup>42</sup>.

“Revenue... first... then... traction... is the safest way to grow a business but also the hardest move to make.” – Fred Wilson<sup>43</sup>

“Write a blog, not a business plan.” – Dharmesh Shah<sup>44</sup>

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<sup>37</sup><http://twitter.com/venturehacks>

<sup>38</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>39</sup><http://particletree.com/features/how-we-prepare-a-demo/>

<sup>40</sup>[https://www.compstudy.com/archive\\_IT.aspx](https://www.compstudy.com/archive_IT.aspx)

<sup>41</sup>[https://www.compstudy.com/archive\\_LS.aspx](https://www.compstudy.com/archive_LS.aspx)

<sup>42</sup><http://www.scissor.com/resources/teamroom/>

<sup>43</sup>[http://www.avc.com/a\\_vc/2008/11/portfolio-scree.html](http://www.avc.com/a_vc/2008/11/portfolio-scree.html)

<sup>44</sup><http://network.businessofsoftware.org/video/dharmesh-shah-on-insights-from>

Don't start a company if you're not willing to start another one if this one fails. You can't land on the moon with one shot.

In fund-raising, the exam comes before the lesson. Exam = Term sheet. Lesson = The multi-year consequences of the deal.

How to use an audience<sup>45</sup> to get your way when you're negotiating.

FriendFeed<sup>46</sup> (RSS<sup>47</sup>) is another good place to get more Venture Hacks in your life. Here are some of the latest and greatest from FriendFeed:

"IMVU... shipped in 6 months. Charged from day 1. No press releases. Shipped 20 times a day. 2007 revenues of \$10M." - Steve Blank and Eric Ries<sup>48</sup>

"You're going to have a hard enough time convincing your management team to work on the problem that you've decided to pursue, let alone having competitors go steal your idea and do the exact same thing." – Dharmesh Shah<sup>49</sup>

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<sup>45</sup> [http://fiveyearstoolate.wordpress.com/2008/11/06/  
self-sufficient-is-the-new-sexy/#comment-127](http://fiveyearstoolate.wordpress.com/2008/11/06/self-sufficient-is-the-new-sexy/#comment-127)

<sup>46</sup> <http://friendfeed.com/nivi>

<sup>47</sup> <http://friendfeed.com/nivi?format=atom>

<sup>48</sup> [http://www.slideshare.net/startuplessonslearned/  
lean-startup-presentation-to-maples-investments-by-steve-blank-and-eric-ries-presentation/  
v1?src=embed](http://www.slideshare.net/startuplessonslearned/lean-startup-presentation-to-maples-investments-by-steve-blank-and-eric-ries-presentation/v1?src=embed)

<sup>49</sup> [http://onstartups.com/home/tabid/3339/bid/7196/  
Video-from-Business-of-Software-Everything-I-Know-About-Startups.aspx](http://onstartups.com/home/tabid/3339/bid/7196/Video-from-Business-of-Software-Everything-I-Know-About-Startups.aspx)



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HTTP://WWW.USERFRIENDLY.ORG/ 50

## Updated: Our top 10 term sheet hacks

We've updated the presentation in Our top 10 term sheet hacks<sup>51</sup>. The new presentation includes the notes that accompany each slide.

I've also included the new presentation below. Watch it in full screen mode for maximum pleasure. The full screen button is at the bottom right of the embed and it looks like this: .

<sup>50</sup> <http://friendfeed.com/e/907d6743-aac2-4469-9b1c-d1bb79e1be7a/>  
Sophisticated-internet-investor-will-give-CASH/

<sup>51</sup> <http://venturehacks.com/articles/our-top-10-term-sheet-hacks>

(Slides: Top 10 Term Sheet Hacks<sup>52</sup> (pdf<sup>53</sup>))

## Updated: A quick and dirty guide to starting up

We've updated the presentation in A quick and dirty guide to starting up<sup>54</sup>. The new presentation includes the notes that accompany each slide.

I've also included the new presentation below. Watch it in full screen mode for maximum pleasure. The full screen button is at the bottom right of the embed and it looks like this: .

(Slides: A Quick And Dirty Guide To Starting Up<sup>55</sup> (pdf<sup>56</sup>))

Here are some of my favorite quotes from the presentation:

“We are faced with insurmountable opportunities.”  
– Pogo

The most important thing: idea intelligence connections experience determination.

Ideas, and therefore NDAs, are worthless.

“... as in all matters of the heart, don’t settle.” – Steve Jobs, on picking co-founders

Co-founders are the biggest failure mode for startups.

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<sup>52</sup><http://www.slideshare.net/venturehacks/top-10-term-sheet-hacks-presentation-725011>

<sup>53</sup><http://venturehacks.com/wordpress/wp-content/uploads/2008/11/top-10-term-sheet-hacks.pdf>

<sup>54</sup><http://venturehacks.com/articles/how-to-startup>

<sup>55</sup><http://www.slideshare.net/venturehacks/a-quick-and-dirty-guide-to-starting-up-presentation>

<sup>56</sup><http://venturehacks.com/wordpress/wp-content/uploads/2008/11/a-quick-and-dirty-guide-to-starting-up.pdf>

“If you are facing in the right direction, keep walking.” – Buddha, on focusing your time in a startup  
Markets are relatively efficient, so your first product is probably wrong.

## Pivotal Tracker: The iPod of project management software

“We are using Pivotal Tracker to manage all of our new web apps under development, this thing rocks.”

– Ezra Zygmuntowicz<sup>57</sup>, Founder, Engine Yard<sup>58</sup>

“It’s a relief to open Tracker at the start of the day and focus on the next most important task.”

– Aaron Peckham<sup>59</sup>, Founder, Urban Dictionary<sup>60</sup>

No matter what you’re using for project management, take a close look at Pivotal Tracker<sup>61</sup>. I’ve tried Bugzilla<sup>62</sup>, Trac<sup>63</sup>, Basecamp<sup>64</sup>, FogBugz<sup>65</sup>, Microsoft Project<sup>66</sup>, and Lighthouse<sup>67</sup>—and Tracker is the best for my needs. I’ve shown Tracker to many startups and many have made the switch.

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<sup>57</sup><http://brainspl.at/>

<sup>58</sup><http://engineyard.com/>

<sup>59</sup><http://www.google.com/search?num=30&hl=en&lr=&safe=off&q=%22aaron+peckham%22&btnG=Search>

<sup>60</sup><http://www.urbandictionary.com/>

<sup>61</sup><https://www.pivotaltracker.com/>

<sup>62</sup><http://www.bugzilla.org/>

<sup>63</sup><http://trac.edgewall.org/>

<sup>64</sup><http://www.basecamphq.com/>

<sup>65</sup><http://www.fogcreek.com/FogBUGZ/>

<sup>66</sup><http://office.microsoft.com/en-us/project/default.aspx>

<sup>67</sup><http://lighthouseapp.com/>



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## 10 reasons I like Tracker.

1. It's free.
2. It's hosted.
3. It's a joy to use. It's the iPod of project management software. It's all drag-and-drop and clickity-clack and it just works.
4. It's multi-user. Your co-founder in North Korea can make changes in Tracker and you will see them instantly. No page reloads.

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<sup>68</sup><https://www.pivotaltracker.com/>

5. It's for lean startups<sup>69</sup>. The building block in Tracker is a *story*: an increment of customer value that you deliver with minimal waste.
6. It's about completing your next most important task—not maintaining mile-long to-do lists, Gantt charts, and lists of bugs.
7. It's transparent. Everybody on the team knows what everybody else is working on, their priorities, and their accomplishments.
8. It's in sync with reality. It doesn't take time to keep your requirements and schedule in sync with reality, even if your business priorities change daily.
9. It doesn't do much. No, it doesn't do dependencies and critical paths. It just keeps you focused on delivering value to customers.
10. It's powerful as hell. Tracker hides a lot of technology under a simple interface. It's a serious Javascript-intensive web application that's in the same league as Gmail and Google Maps.
11. Bonus reason: Everything is on one page—there's no need to navigate around (unlike other project management tools). More Gmail, less Hotmail.

If it isn't clear by now, Tracker isn't a bug manager posing as project management software.

If you're already lean, Tracker is a no-brainer. If you're not lean, Tracker is a good way to start getting lean.

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<sup>69</sup> <http://venturehacks.com/articles/lean-startups>

## What do other folks say about Tracker?

Read the testimonials<sup>70</sup> from people who are using Tracker. I particularly like this one from Aaron Peckham<sup>71</sup>, the founder of Urban Dictionary<sup>72</sup>:

“I leave Tracker open all day. I use it for documenting, estimating and prioritizing things that need to be done. It’s a relief to open Tracker at the start of the day and focus on the next most important task. It keeps me from getting distracted and having too many things going at the same time. It also serves as documentation of what I’ve completed in the past—to show that I’m making good use of my time.”

Want more opinions? See what people are saying about Pivotal Tracker on Twitter<sup>73</sup>.

## What do you think about Tracker?

If you give Tracker a try, please let us know what you think!

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<sup>70</sup><http://www.pivotaltracker.com/teaser/testimonials>

<sup>71</sup><http://www.google.com/search?num=30&hl=en&lr=&safe=off&q=%22aaron+peckham%22&btnG=Search>

<sup>72</sup><http://www.urbandictionary.com/>

<sup>73</sup><http://search.twitter.com/search?q=%22pivotal+tracker%22>

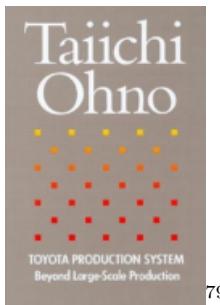
## Five whys, Part 1: The startup immune system

“When confronted with a problem, have you ever stopped and asked why five times?”

– Taiichi Ohno<sup>74</sup>

**Summary:** Whenever you find a defect, ask *why* five times to discover the root cause of the problem. Then make corrections at every level of the analysis. By applying five whys whenever you find a defect, you will (1) uncover the human problems beneath technical problems and (2) build an immune system for your startup.

*This is a guest post by Eric Ries<sup>75</sup>, a founder of IMVU<sup>76</sup> and an advisor to Kleiner Perkins<sup>77</sup>. Eric also has a great blog called Startup Lessons Learned<sup>78</sup>.*



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<sup>74</sup><http://www.amazon.com/gp/product/0915299143?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0915299143>

<sup>75</sup><http://startuplessonslearned.blogspot.com/>

<sup>76</sup><http://www.imvu.com/>

<sup>77</sup><http://www.kpcb.com/index.html>

<sup>78</sup><http://startuplessonslearned.blogspot.com/>

<sup>79</sup><http://www.amazon.com/gp/product/0915299143?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0915299143>

Taiichi Ohno was one of the inventors of the Toyota Production System. His book, Toyota Production System<sup>80</sup>, is a fascinating read, even though it's decidedly non-practical. After reading it, you might not even realize that there are cars involved in Toyota's business. Yet there is one specific technique that I learned most clearly from this book: asking why five times. I believe this is a critical lean startup<sup>81</sup> technique.

When something goes wrong, we tend to see it as a crisis and seek to blame. A better way is to see it as a learning opportunity. Not in the existential sense of general self-improvement. Instead, we can use the technique of asking why five times to get to the root cause of the problem and make corrections.

## **Ask why five times whenever you discover a defect.**

Here's how it works. Let's say you notice that your website is down. Obviously, your first priority is to get it back up. But as soon as the crisis is past, have the discipline to conduct a post-mortem in which you start asking *why*:

1. *Why was the website down?* The CPU utilization on all our front-end servers went to 100%.
2. *Why did the CPU usage spike?* A new bit of code contained an infinite loop!
3. *Why did that code get written?* So-and-so made a mistake.
4. *Why did his mistake get checked in?* He didn't write a unit test for the feature.

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<sup>80</sup><http://www.amazon.com/gp/product/0915299143?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0915299143>

<sup>81</sup><http://startupplessonsslearned.blogspot.com/search/label/lean%20startup>

5. *Why didn't he write a unit test?* He's a new employee, and he was not properly trained in Test Driven Development<sup>82</sup> (TDD).

## Make five corrections.

So far, this isn't very different from the kind of analysis any competent operations team would conduct for a site outage. The next step is this: you have to commit to making a *proportional investment in corrective action at every level of the analysis*. So, in the example above, we'd have to take five corrective actions:

1. Bring the site back up.
2. Remove the bad code.
3. Help so-and-so understand why his code doesn't work as written.
4. Train so-and-so in the principles of TDD.
5. Change the new engineer orientation to include TDD.

## Making corrections builds your startup immune system.

I have come to believe that this technique should be used for all kinds of defects, not just site outages. Each time, we use the defect as an opportunity to find out what's wrong with our process, and make a small adjustment.

By continuously adjusting, we eventually build up a robust series of defenses that prevent problems from happening. This approach is at the heart of breaking down the “time/quality/cost,

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<sup>82</sup>[http://en.wikipedia.org/wiki/Test-driven\\_development](http://en.wikipedia.org/wiki/Test-driven_development)

pick two<sup>83</sup>” paradox, because these small investments cause the team to go faster over time.

## **5 whys uncovers the human problems beneath technology problems.**

In the example above, what started as a technical problem actually turned out to be a human and process problem. This is completely typical. Our bias as technologists is to focus on the product part of the problem, and five whys tends to counteract that tendency.

It's why, at my previous job, we were able to get a new engineer completely productive on their first day. We had a great onboarding process, complete with a mentoring program and a syllabus of key ideas to be covered. Most engineers would ship code to production on their first day.

## **Make your corrections proportional to the cost of the defect.**

We didn't start with a great program like that, nor did we spend a lot of time all at once investing in it. Instead, five whys kept leading to problems caused by an improperly trained new employee, and we'd make a small adjustment. Before we knew it, we stopped having those kinds of problems altogether.

So it's important to remember the *proportional investment* part of the rule above. It's easy to decide that when something goes wrong, a complete ground-up rewrite is needed. It's part of our tendency to focus on the technical and to overreact to problems.

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<sup>83</sup><http://startuplessonslearned.blogspot.com/2008/10/engineering-managers-lament.html>

If you have a severe problem, like a site outage, that costs your company tons of money or causes lots of person-hours of debugging, go ahead and allocate about that same number of person-hours or dollars to the solution.

The budget for corrections should be, in total, proportional to the cost of the defect that triggered the five whys. So, if the site was down and five people burned a whole day on it, maybe five man-days of fixing is appropriate. But if the problem cost three customers 25 cents each, maybe only a few hours is appropriate.

But always have a maximum, and always have a minimum. For small problems, just move the ball forward a little bit. Don't over-invest. If the problem recurs, five whys will give you a little more budget to move the ball forward some more. You can keep your cool because five whys will be there if the problem recurs.

*In Part 2<sup>84</sup>, I'll describe how to get started with five whys.*

## **“It ain’t about right, it’s about money.”**

You'll probably learn more from this clip than two years at Harvard Business School. From HBO's The Wire<sup>85</sup>:

(Video: The Wire<sup>86</sup>)

I bet you didn't know this is Obama's favorite TV show<sup>87</sup>.

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<sup>84</sup><http://venturehacks.com/articles/five-whys-2>

<sup>85</sup>[http://en.wikipedia.org/wiki/The\\_wire](http://en.wikipedia.org/wiki/The_wire)

<sup>86</sup><http://www.youtube.com/watch?v=VAwDDAyLobY&fmt=18>

<sup>87</sup><http://www.tvguide.com/news/Im-Watching-Presidential-10827.aspx>

## Five whys, Part 2: How to get started

“For every dollar spent in failure, learn a dollar’s worth of lesson.”

– Jesse Robbins<sup>88</sup>, Amazon’s former Master of Disaster

**Summary:** Get started with five whys by applying it to a specific team with a specific problem. Select a five whys master to conduct a post mortem with everyone who was involved in the problem. Email the results of the analysis to the whole company. Repeatedly applying five whys at IMVU created a startup immune system that let our developers go faster by reducing mistakes.

*This is a guest post by Eric Ries<sup>89</sup>, a founder of IMVU<sup>90</sup> and an advisor to Kleiner Perkins<sup>91</sup>. Eric also has a great blog called *Startup Lessons Learned*<sup>92</sup>.*

In Part 1<sup>93</sup>, I described how to use five whys to discover the root cause of problems, make corrections, and build an immune system for your startup. So...

### How do you get started with five whys?

I recommend that you start with a specific team and a specific class of problems. For my first time, it was scalability problems and our operations team. But you can start almost anywhere—I’ve run this process for many different teams.

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<sup>88</sup><http://radar.oreilly.com/jesse/>

<sup>89</sup><http://startuplessonslearned.blogspot.com/>

<sup>90</sup><http://www.imvu.com/>

<sup>91</sup><http://www.kpcb.com/index.html>

<sup>92</sup><http://startuplessonslearned.blogspot.com/>

<sup>93</sup><http://venturehacks.com/articles/five-whys>

Start by having a single person be the five whys master. This person will run the post mortem whenever anyone on the team identifies a problem.

But don't let the five whys master do it by himself; it's important to get everyone who was involved with the problem (including those who diagnosed or debugged it) into a room together. Have the five whys master lead the discussion and give him or her the power to assign responsibility for the solution to anyone in the room.

### **Distribute the results of five whys to the whole company.**

Once that responsibility has been assigned, have that new person email the *whole company* with the results of the analysis. This last step is difficult, but I think it's very helpful. Five whys should read like plain English. If they don't, you're probably obfuscating the real problem.

The advantage of sharing this information widely is that it gives everyone insight into the kinds of problems the team is facing, but also insight into how those problems are being tackled. If the analysis is airtight, it makes it pretty easy for everyone to understand why the team is taking some time out to invest in problem prevention instead of new features.

If, on the other hand, it ignites a firestorm—that's good news too. Now you know you have a problem: either the analysis is not airtight, and you need to do it over again, or your company doesn't understand why what you're doing is important. Figure out which of these situations you're in, and fix it.

## **What happens when you apply five whys for months and years?**

Over time, here's my experience with what happens.

People get used to the rhythm of five whys, and it becomes completely normal to make incremental investments. Most of the time, you invest in things that otherwise would have taken tons of meetings to decide to do.

You'll start to see people from all over the company chime in with interesting suggestions for how you could make things better. Now, everyone is learning together—about your product, process, and team. Each five whys email is a teaching document.

## **IMVU's immune system after years of five whys.**

Let me show you what this looked like after a few years of practicing five whys in the operations and engineering teams at IMVU<sup>94</sup>. We had made so many improvements to our tools and processes for deployment, that it was pretty hard to take the site down. We had five strong levels of defense:

1. Each engineer had his/her own sandbox which mimicked production as close as possible (whenever it diverged, we'd inevitably find out in a five whys shortly thereafter).
2. We had a comprehensive set of unit, acceptance, functional, and performance tests, and practiced TDD across the whole team. Our engineers built a series of test tags, so you could quickly run a subset of tests in your sandbox that you thought were relevant to your current project or feature.

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<sup>94</sup><http://www.imvu.com/>

3. 100% of those tests ran, via a continuous integration cluster, after every checkin. When a test failed, it would prevent that revision from being deployed.
4. When someone wanted to do a deployment, we had a completely automated system that we called the cluster immune system. This would deploy the change incrementally, one machine at a time. That process would continually monitor the health of those machines, as well as the cluster as a whole, to see if the change was causing problems. If it didn't like what was going on, it would reject the change, do a fast revert, and lock deployments until someone investigated what went wrong.
5. We had a comprehensive set of nagios alerts, that would trigger a pager in operations if anything went wrong. Because five whys kept turning up a few key metrics that were hard to set static thresholds for, we even had a dynamic prediction algorithm that would make forecasts based on past data, and fire alerts if the metric ever went out of its normal bounds. (You can read a cool paper<sup>95</sup> one of our engineers wrote on this approach.)

### **A strong immune system lets you go faster by reducing mistakes.**

So if you had been able to sneak into the desk of any of our engineers, log into their machine, and secretly check in an infinite loop on some highly-trafficked page, somewhere between 10 and 20 minutes later, they would have received an email with a message more-or-less like this:

“Dear so-and-so, thank you so much for attempting to check in revision 1234. Unfortunately, that is

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<sup>95</sup><http://emiller.info/poisson.pdf>

a terrible idea, and your change has been reverted. We've also alerted the whole team to what's happened, and look forward to you figuring out what went wrong. Best of luck, Your Software."

OK, that's not *exactly* what it said. But you get the idea.

Having this series of defenses was helpful for doing five whys. If a bad change got to production, we'd have a built-in set of questions to ask: Why didn't the automated tests catch it? Why didn't the cluster immune system reject it? Why didn't operations get paged? And so forth.

And each and every time, we'd make a few more improvements to each layer of defense. Eventually, this let us do deployments to production dozens of times every day<sup>96</sup>, without significant downtime or bug regressions.

*In Part 3<sup>97</sup>, I'll show you how to apply five whys to "legacy" startups.*

## Five whys, Part 3: Legacy startups

"We can acquire knowledge from doing something incorrectly, but only if we can determine the cause of the error and correct it."

– Russell Ackoff<sup>98</sup>

**Summary:** It's never too late to start applying five whys, even if you're saddled with zillions of lines of legacy code. Just start

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<sup>96</sup><http://startuplessonslearned.blogspot.com/2008/09/just-in-time-scalability.html>

<sup>97</sup><http://venturehacks.com/articles/five-whys-3>

<sup>98</sup><http://www.amazon.com/gp/product/0195123875?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0195123875>

asking why whenever you find a problem—you’ll automatically start fixing the 20% of underlying issues that cause 80% of your problems. Five whys was first discovered by Toyota—if it can work for cars, it can work for you.

*This is a guest post by Eric Ries<sup>99</sup>, a founder of IMVU<sup>100</sup> and an advisor to Kleiner Perkins<sup>101</sup>. Eric also has a great blog called *Startup Lessons Learned*<sup>102</sup>.*

In Part 1<sup>103</sup>, I described how to use five whys to discover the root cause of problems, make corrections, and build an immune system for your startup. In Part 2<sup>104</sup>, I explained how to get started with five whys and how IMVU<sup>105</sup> built a startup immune system by applying five whys for months and years. In this final part, I’ll describe how to apply five whys to legacy startups.

## **It's never too late to start asking why.**

When I explain five whys to entrepreneurs and big-company types alike, I sometimes get this response: “Well, sure, if you start out with all those great tools, processes and TDD from the beginning, that’s easy! But my team is saddled with zillions of lines of legacy code and... and...”

So let me say for the record: we didn’t start with any of this at IMVU. We didn’t even practice TDD across our whole team. We’d never heard of five whys, and we had plenty of “agile skeptics” on the team. By the time we started doing continuous integration, we had tens of thousands of lines of code that wasn’t under test coverage.

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<sup>99</sup><http://startuplessonslearned.blogspot.com/>

<sup>100</sup><http://www.imvu.com/>

<sup>101</sup><http://www.kpcb.com/index.html>

<sup>102</sup><http://startuplessonslearned.blogspot.com/>

<sup>103</sup><http://venturehacks.com/articles/five-whys>

<sup>104</sup><http://venturehacks.com/articles/five-whys-2>

<sup>105</sup><http://www.imvu.com/>

But the great thing about five whys is that it has a Pareto principle<sup>106</sup> built right in. Because the most common problems keep recurring, your prevention efforts are automatically focused on the 20% of your product that needs the most help. That's also the same 20% that causes you to waste the most time. So five whys pays for itself awfully fast, and it makes life noticeably better almost right away. All you have to do is get started.

### **If it works for cars, it can work anywhere.**

So thank you, Taiichi Ohno<sup>107</sup>. I think you would have liked seeing all the waste we've been able to drive out of our systems and processes, all in an industry that didn't exist when you started your journey at Toyota.

And I especially thank you for proving that this technique can work in one of the most difficult and slow-moving industries on earth: automobiles. You've made it hard for any of us to use the most pathetic excuse of all: "Surely, that can't work in *my business*, right?" If it can work for cars, it can work for you.

What are you waiting for?

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<sup>106</sup>[http://en.wikipedia.org/wiki/Pareto\\_principle](http://en.wikipedia.org/wiki/Pareto_principle)

<sup>107</sup><http://www.amazon.com/gp/product/0915299143?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0915299143>

## The OODA Loop: Playing chess with half the pieces



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I just finished reading *Certain to Win*<sup>109</sup>. It's about the warfare strategy of John Boyd<sup>110</sup>, as applied to business. In war, you build your team and dismantle the enemy. In business, you build your team, delight the customer, and incidentally dismantle the enemy.

You might know John Boyd as the OODA Loop<sup>111</sup> guy. I never really "got" the OODA Loop so, based on Eric Ries<sup>112</sup>' recommendation, I read this book.

In a software startup, the OODA Loop looks like this: (1) Come up with an idea, (2) Code it, launch it, (3) Learn from usage

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<sup>108</sup><http://www.amazon.com/gp/product/1413453767?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=1413453767>

<sup>109</sup><http://www.amazon.com/gp/product/1413453767?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=1413453767>

<sup>110</sup>[http://en.wikipedia.org/wiki/John\\_Boyd\\_\(military\\_strategist\)](http://en.wikipedia.org/wiki/John_Boyd_(military_strategist))

<sup>111</sup>[http://en.wikipedia.org/wiki/ODDA\\_Loop](http://en.wikipedia.org/wiki/ODDA_Loop)

<sup>112</sup><http://startupplessonsslearned.blogspot.com/>

data. Keep repeating the loop, each time using the Learnings to influence your next idea. This is the Idea-Code-Data<sup>113</sup> loop.

As you eliminate waste in a lean startup<sup>114</sup>, you can repeat the loop at a higher tempo than the competition; serve customers more effectively; and incidentally sow panic, paralysis, and surrender in the competition. For example, the Obama campaign used high tempo OODA Loops<sup>115</sup> to win the most “market share” in the 2008 presidential election.

This might seem abstract or too obvious to be useful, so here are some of my favorite passages from the book—they should fill in some of the puzzle.

On agility and playing chess with half the pieces:

“Go find the best chess player you can and offer to play for \$1,000 under the following conditions:

- Your opponent moves first
- You move twice for every move of his or hers.

“In fact, you can even offer to give up some pieces, to make it more fair. You will find that, unless you are playing somebody at the grandmaster level, you can give up practically everything and still win. Keep the knights and maybe a rook.

**“This is a graphic illustration of how the smaller side, using agility, can overcome a large disadvantage in numbers.** Does it strike you as far-fetched and removed from what happens in the real world? Consider that Honda and Toyota can bring

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<sup>113</sup><http://startuplessonslearned.blogspot.com/2008/09/ideas-code-data-implement-measure-learn.html>

<sup>114</sup><http://venturehacks.com/articles/lean-startups>

<sup>115</sup><http://startuplessonslearned.blogspot.com/2008/11/learning-from-obama-maneuver-warfare-on.html>

out a new model in roughly 2 years, with superb quality, while it still takes Detroit at least a year longer...

“The idea that operating at a quicker time pace than one’s opponent can product psychological effects offers a way out of the “bigger (or more expensive) is better” syndrome. **An opponent who cannot make decisions to employ his forces effectively—his command and staff functions become paralyzed by bickering and bureaucracy, for example—is defeated before the engagement begins, no matter how many weapons sit in his inventory.** In this way, one could truly achieve Sun Tzu’s goal of winning without fighting. [Ed: If you move fast enough, every enemy is effectively incompetent.]“

On shaping the market through agility:

“With a strategy this powerful, your aim is not to respond to but to create the market conditions that you want...

“Customers often want things because competitors have dangled them in their faces... such “discovery of customer wants” does not provide the basis for strategy; it represents a failure of strategy...

“The essence of Boyd’s strategy in business competition is to shape ourselves and the marketplace to improve our capacity... to survive on our terms—generally at the expense of our competitors.”

On planning and strategy:

“Strategy is merely a scheme for creating and managing plans...

“There is nothing wrong with planning... generate and discard many of them as you cycle within your OODA loops.”

On not following the rules:

“The Americans would be less dangerous if they had a regular army.” – British General Frederick Haldimand, Boston, 1776

On culture as a long-term competitive advantage:

“Herb Kelleher, chairman and recently retired CEO of Southwest Airlines, brags that competitors could copy the details of his system—direct (as opposed to hub-and-spoke) routings, no reserved seats or meals, one type of aircraft, etc.—but they couldn’t copy the culture, the vibrant esprit de corps, because “they can’t buy that.” So far his words have been prophetic, at least as far as the other US major airlines are concerned.”

**Related:** Mike Cassidy: Speed as THE primary business strategy<sup>116</sup>

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<sup>116</sup><http://venturehacks.com/articles/speed>

## Robert Heinlein: “Specialization is for insects”

Here are the latest and greatest posts from Twitter<sup>117</sup> (RSS<sup>118</sup>) and FriendFeed<sup>119</sup> (RSS<sup>120</sup>). We use FriendFeed for the longer stuff and Twitter for the shorter stuff!

On specialization in lean startups:

“Specialization is for insects.” – Robert Heinlein<sup>121</sup>

“Break the ‘union mindset’ of specialization. Ask everyone to attack the bottleneck wherever it is.” – Bernie Thompson<sup>122</sup>



Kayak<sup>124</sup>'s CEO on stealing a page out of Google's playbook:

Steve Hafner: “[At Kayak], we are of the mentality that for every dollar which could be placed into marketing we would rather place it into engineering and make the product better...”

Sramana Mitra: “So you have built traction [for Kayak] with organic word of mouth?”

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<sup>117</sup><http://twitter.com/venturehacks>

<sup>118</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>119</sup><http://friendfeed.com/nivi>

<sup>120</sup><http://friendfeed.com/nivi?format=atom>

<sup>121</sup><http://www.amazon.com/gp/product/0441810764?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0441810764>

<sup>122</sup><http://leansoftwareengineering.com/2008/11/10/getting-lean-to-survive-the-downturn/>

<sup>123</sup><http://www.kayak.com/>

<sup>124</sup><http://www.kayak.com/>

Steve Hafner: “It is a page out of Google’s playbook. Build a great technology, syndicate that out to other affiliates like AOL who already have audience and then keep innovating on the product to make folks come back to you directly.”

(From Entrepreneur Journeys Volume 1<sup>125</sup>)



Zappos<sup>127</sup> CEO on culture over customer service:

“Your company culture and your company’s brand are really just two sides of the same coin... You may think that our number 1 priority [at Zappos] is customer service but it’s actually not. Our number 1 priority for the company is company culture... The reason why we ended up selling [LinkExchange]... it wasn’t a fun place to go to work for anymore... we didn’t know... to look for culture fit when we hired people.” – Tony Hsieh<sup>128</sup>

Random stuff:

“90% of the salespeople out there are below average because performance is a curve, not a line.” –

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<sup>125</sup><http://www.amazon.com/gp/product/1439206872?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=1439206872>

<sup>126</sup><http://www.zappos.com/>

<sup>127</sup><http://www.zappos.com/>

<sup>128</sup>[http://www.businessinnovationfactory.com/innovationstorystudio/bif4\\_thsieh.php](http://www.businessinnovationfactory.com/innovationstorystudio/bif4_thsieh.php)

Seth Godin<sup>129</sup> [Good advice for any group, not just salespeople!]

“A lot [of] what’s written about Silicon Valley... is actually part of a sales pitch... for the venture ecosystem.” – Sean Murphy<sup>130</sup>

“Spending our cash is the same as spending our equity.” – Jason Goldberg<sup>131</sup>

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<sup>129</sup>[http://sethgodin.typepad.com/seths\\_blog/2008/11/dont-sell-to-ba.html](http://sethgodin.typepad.com/seths_blog/2008/11/dont-sell-to-ba.html)

<sup>130</sup><http://www.skmurphy.com/blog/2008/11/09/overnight-success/>

<sup>131</sup>[http://blog.socialmedian.com/2008/08/7\\_months\\_into\\_my\\_2nd\\_stint\\_as.html](http://blog.socialmedian.com/2008/08/7_months_into_my_2nd_stint_as.html)

# December 2008

## Books for Entrepreneurs: Extreme Programming Explained

“We do use agile methodologies at Heroku—I developed my own (informal) style of agile at the last company I founded, and brought that forward to this venture.”

— Adam Wiggins<sup>1</sup>, Founder, Heroku<sup>2</sup>

I first learned about lean startups<sup>3</sup> in an excellent book called Agile Software Development<sup>4</sup>—learn more about it in our review<sup>5</sup>.



Kent Beck

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The second step in my lean journey was a book called Extreme Programming Explained<sup>7</sup>. It is dirt cheap (you can buy the first

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<sup>1</sup><http://adam.blog.heroku.com/>

<sup>2</sup><http://heroku.com/>

<sup>3</sup><http://venturehacks.com/articles/lean-startups>

<sup>4</sup><http://www.amazon.com/gp/product/0135974445?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0135974445>

<sup>5</sup><http://venturehacks.com/articles/agile-software-development>

<sup>6</sup><http://www.amazon.com/gp/product/0201616416?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0201616416>

<sup>7</sup><http://www.amazon.com/gp/product/0201616416?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0201616416>

edition for a penny) and the entire book is accessible to non-programmers. If you buy it, try to get the first edition<sup>8</sup>—the second edition<sup>9</sup> isn't as good as the first.

The subtitle of this book is “Embrace Change”—here are a few excerpts to whet your appetite...

## The Driving Metaphor

“Driving is not about getting the car going in the right direction. Driving is about constantly paying attention, making a little correction this way, a little correction that way.

“This is the paradigm for Extreme Programming (XP). Stay aware. Adapt. Change.

“Everything in software changes. The requirements change. The design changes. The business changes. The technology changes. The team changes. The team members change. **The problem isn't change, because change is going to happen; the problem, rather, is our inability to cope with change.**”

## What is XP?

“To some folks, XP seems like just good common sense. So why the “extreme” in the name? **XP takes commonsense principles and practices to extreme levels.**

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<sup>8</sup><http://www.amazon.com/gp/product/0201616416?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0201616416>

<sup>9</sup><http://www.amazon.com/gp/product/0321278658?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0321278658>

- If code reviews are good, we'll review code all the time (pair programming).
- If testing is good, everybody will test all the time (unit testing), even the customers (functional testing).
- If design is good, we'll make it part of everybody's daily business (refactoring)...
- If integration testing is important, then we'll integrate and test several times a day (continuous integration).
- If short iterations are good, we'll make the iterations really, really short—seconds and minutes and hours, not weeks and months and years (the Planning Game).

“When I first articulate XP, I had the mental image of knobs on a control board. Each knob was a practice that from experience I knew worked well. I would turn the knobs up to 10 and see what happened. I was a little surprised to find that the whole package of practices was stable, predictable, and flexible.”

## What XP promises

“**To programmers, XP promises that they will be able to work on things that really matter, every day.** They won't have to face scary situations alone. They will be able to do everything in their power to make their system successful. They will make decisions that they can make best, and they won't make decisions they aren't best qualified to make.

**“To customers and managers, XP promises that they will get the most possible value out of every programming week.** Every few weeks they will be able to see concrete progress on goals they care about. They will be able to change the direction of the project in the middle of development without incurring exorbitant costs.”

If you've already read this book, please let us know how you liked it. And if you haven't, what are you waiting for?

## Sponsor: Charles River Ventures

Thanks to Charles River Ventures<sup>10</sup> for sponsoring Venture Hacks.



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After our first post on CRV's sponsorship<sup>12</sup>, people suggested we make the sponsorship more “real”. We are down with that.

So here's an e-mail that George Zachary<sup>13</sup> from CRV sent me—I'm sharing it with his permission. It gives a good sense that CRV is “open for business”:

From: George Zachary To: Nivi Date: Thu, Nov 6, 2008

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<sup>10</sup><http://crv.com/>

<sup>11</sup><http://crv.com>

<sup>12</sup><http://venturehacks.com/articles/sponsor-crv>

<sup>13</sup>[http://www.crv.com/team/george\\_zachary](http://www.crv.com/team/george_zachary)

Nivi,

Sorry for the delay amigo. Just been s-w-a-m-p-e-d with 3 new investments for CRV in the last 2-3 weeks. We are closing docs on one of them today/-tomorrow. I issued a term sheet on another last Friday that's now signed and in major diligence/-docs mode. And just about to shake hands on a 3rd probably tomorrow. All are consumer internet.

**Probably the busiest 2-3 week period I have ever had since 1995 in venture.**

Also, prepping for my annual LP meeting in Boston which runs from this coming Monday through Wednesday. So, swamperoo'd.

Apologize on the delay.

The text<sup>14</sup> looks good with one exception. “Initial investment can be as small as \$100K...” instead of the \$25K.

Thank you for doing this!

What is new with you?

Thank you and sorry for my humongous delay, George

Yes, George actually sent me this email. I added the emphasis and hyperlink.

## Raising money is a black swan

Raising money is like finding a black swan<sup>15</sup>.

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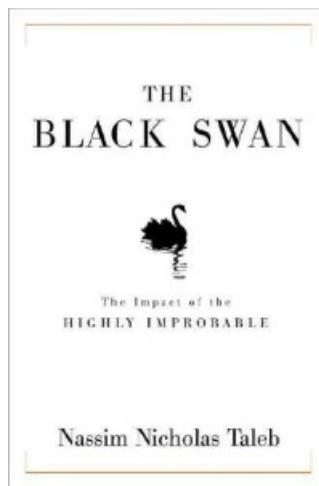
<sup>14</sup><http://venturehacks.com/articles/sponsor-crv>

<sup>15</sup>[http://en.wikipedia.org/wiki/Black\\_swan\\_theory](http://en.wikipedia.org/wiki/Black_swan_theory)

It seems like you will forever keep hearing “no”, “let’s keep talking”, or “find a lead.” Or worse, you sign a term sheet and it blows up before you can close it.

It seems like you’ll never raise money, until one day—boom—you meet the right investor, he says yes, you negotiate a deal, and suddenly there’s money in your bank account.

## What's a black swan?



A black swan is a highly improbable, high impact, and unpredictable event. Nassim Nicholas Taleb popularized the idea in his book, *The Black Swan: The Impact of the Highly Improbable*<sup>16</sup>.

<sup>16</sup><http://www.amazon.com/gp/product/1400063515?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=1400063515>

9/11 was a black swan. It was hard to predict, it was highly improbable, and it changed the world—black swans define the future.

Once you see enough white swans, you start assuming all swans are white—until you see a black one. Once you get enough nos, you start assuming every investor will say no—until you get a yes.

### **The nos don't matter.**

The chances of raising money are low. You don't know when or if it will happen, who will invest, or how much you will raise.

(The exception to this rule are the *chosen ones*: “obviously” fundable companies that are founded by successful entrepreneurs, companies that are making money by the truck load, or have cured cancer, or whatever.)

There will be no precedent for a yes. If someone looks at your string of nos, they won't suggest that you'll get a yes tomorrow—they'll predict more nos. But just because you're getting a lot of nos today doesn't mean you will get a no tomorrow. The past is an indicator of the future—up until the moment you find a black swan.

If you're looking for a black swan, ignore the nos.

### **Searching for black swans can be a big waste of time.**

I've seen an entrepreneur sleep on my couch for months while he tried to raise money. It seemed like he had no hope—until he suddenly raised money from Big Firm X.

Many entrepreneurs implicitly understand this. They know that raising money is rare, unpredictable, and important to their

business. So they spend months and months searching for a black swan.

But perpetual fund-raising is a bad way to raise money. Investors like to invest in working businesses—which means you need to work on the business—not spend the next 6 months raising money.

The problem with black swan processes is that they don't always yield black swans. Sometimes they just give you white swans until you or your company dies. Black swans aren't guaranteed—they're the opposite of guaranteed: low probability and unpredictable.

## How to find black swans.

Here are a few ways to search for black swans:

1. **The Chosen One Strategy:** Wait until you're obviously fundable before you raise money. Keep building value until investors come to you.
2. **The Hobby Strategy:** Keep working on the business while you raise money as a hobby. Spend less than 25% of your time fund-raising so you can focus on activities that have a greater chance of creating value.
3. **The Efficient Strategy:** Raise money full-time and test the market very efficiently through focus, timeboxes<sup>17</sup>, and lessons learned.

The Chosen One strategy is the best if you don't need the money right now. Instead of trying to solve the black swan problem,

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<sup>17</sup><http://en.wikipedia.org/wiki/Timebox>

this strategy dissolves<sup>18</sup> it. If you *do* need the money right now, stop and seriously think about how to build the business without the money—remember, fund-raising is low probability and unpredictable if you’re not one of the chosen ones.

The Hobby strategy is awful. Don’t even bother—just work on the business instead. Raising money is a full-time job for at least one of the founders. If possible, also get your co-founder on the job part-time, so you can pair<sup>19</sup>, like detectives trying to solve a crime.

The Efficient strategy is the best way to find black swans if you can’t or won’t execute the Chosen One strategy. There are three pieces to this approach: focus, timeboxes, and lessons learned.

## 1. Focus

Raise money full-time.

Pick up the phone and get introductions to investors from middlemen. Call in every favor you have and explain why the middleman will look good by making an introduction. Get the middleman to focus on making a single great introduction. Three weak email introductions won’t do anything but one strong phone call might.

This is a lot of work just to get 10 or 15 introductions. And you haven’t even met any investors yet. That’s why we say fund-raising is a full-time job.

## 2. Timebox

Put time limits on each step of the fund-raising process.

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<sup>18</sup><http://books.google.com/books?id=2qu8EK7ickIC&pg=PA49&dq=dissolve+ackoff&ei=sMs9ScjXCJCQkQSXx4CNCw>

<sup>19</sup><http://www.extremeprogramming.org/rules/pair.html>

If you aren't getting good introductions in 1-2 weeks, quit fund-raising and start executing Plan B. If you aren't getting good meetings in 3-4 weeks, quit fund-raising and start executing Plan B. If you aren't doing partner's meetings in 5-6 weeks, quit fund-raising and start executing Plan B. If you aren't signing a term sheet in 7-8 weeks—you know what to do.

And don't start raising money until you have a Plan B—a Plan B is the simplest way to create a deadline and scarcity by fiat.

### **3. Lessons Learned**

As you raise money, get honest, high-quality feedback from investors, advisors, etc. Once you get enough feedback and nos, stop raising money, fix your team, product, market, and traction, and try again.

It's hard to get high-quality feedback from anyone period. Most people, even effective ones, don't give good advice. Honest feedback from investors is particularly hard because they don't like calling your baby ugly.

Try saying something like this when you get a no:

“Thanks. Yeah, I completely understand. We want to make this business work. What would we have to accomplish to make this business interesting to you?”

### **Optimism**

One more thing. Optimism: you can't raise money without it. The most effective way to stay optimistic is to find the right wife for your startup (also known as a co-founder).

Fund-raising isn't a part-time job. It's a black swan that you should avoid entirely or chase efficiently with focus, timeboxes, and lessons learned.

What do *you* think?

## How to moderate (and write) comments

The number and quality of comments on Venture Hacks is steadily increasing. This is most awesome; we really like comments. Thanks for commenting and please keep 'em coming. We read and moderate every one.



20

So prospective contributors don't have to comment into a black hole, we've adapted these moderation guidelines from Edward Tufte<sup>21</sup>'s epic thread on Moderating internet forums<sup>22</sup>:

1. Accept comments with good spelling, grammar, and formatting; that advance the quality of the discussion; and are civil. Focus on the quality of the discussion for the

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<sup>20</sup>[http://www.edwardtufte.com/bboard/q-and-a-fetch-msg?msg\\_id=0000fT](http://www.edwardtufte.com/bboard/q-and-a-fetch-msg?msg_id=0000fT)

<sup>21</sup><http://www.edwardtufte.com/>

<sup>22</sup>[http://www.edwardtufte.com/bboard/q-and-a-fetch-msg?msg\\_id=0000fT](http://www.edwardtufte.com/bboard/q-and-a-fetch-msg?msg_id=0000fT)

reader—whether a comment agrees or disagrees with us is irrelevant (of course).

2. Silently and lightly correct minor spelling errors, punctuation errors, or poor formatting in otherwise good comments.
3. Let the quality of the posts and existing comments serve as a standard for new comments.
4. Don't accept partially meritorious comments if the overall effect of the comment is to lower the quality of the discussion.
5. Quickly make final decisions about whether we're going to accept a comment.
6. Delete accepted comments if we later decide they don't advance the quality of the discussion.
7. Try to follow these guidelines when we write posts on Venture Hacks or comment on other sites.
8. Thank commenters and highlight good comments<sup>23</sup>.

What do you think? Are we missing anything?

**Related:** Edward Tufte's Moderating internet forums<sup>24</sup>.

## Our new archives

Check out our new archives<sup>25</sup>. They look like this:

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<sup>23</sup><http://venturehacks.com/topics/comments>

<sup>24</sup>[http://www.edwardtufte.com/bboard/q-and-a-fetch-msg?msg\\_id=0000FT](http://www.edwardtufte.com/bboard/q-and-a-fetch-msg?msg_id=0000FT)

<sup>25</sup><http://venturehacks.com/archives>

Archives – Venture Hacks  
http://venturehacks.com/archives

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**Advisors #**

[Everything you ever wanted to know about advisors, Part 1](#)  
[Everything you ever wanted to know about advisors, Part 2](#)  
[Lawyers are referees, not coaches](#)  
[Advice is for learning, not copying](#)

**Angels #**

[Office Hours: Technical Error Edition](#)  
[Potpourri: Introductions, Auctions, Tranches, and Co-Investors](#)  
[Raise money from VCs or angels?](#)  
[How do I find a lead investor? Part 1](#)  
[How do I find a lead investor? Part 2](#)  
[Lijit's CEO on raising money from angels](#)  
[Do you know any idea investors?](#)

**Auctions #**

[Office Hours: Technical Error Edition](#)  
[Potpourri: Introductions, Auctions, Tranches, and Co-Investors](#)  
[Create a market for your shares](#)  
[How is raising money like buying a car?](#)  
[What's the biggest mistake entrepreneurs make?](#)  
[Complete business diligence before you sign a term sheet](#)  
[Should I shop around?](#)  
[Tips from a ex-VC who helps entrepreneurs raise money](#)

**Board of Directors #**

[Create a board that reflects the ownership of the company](#)  
[Make a new board seat for a new CEO](#)

We've gone through every single one of our 142 posts and (1) renamed some, so they summarize their contents more effectively and (2) filed all of them in the appropriate categories. Most of the posts are filed in more than one category.

If you're just getting started, check out our posts on starting up<sup>27</sup>, lawyers<sup>28</sup>, and pitching<sup>29</sup>. If you're negotiating a term sheet, you might like our posts on auctions<sup>30</sup>, boards of directors<sup>31</sup>, and vesting<sup>32</sup>. If you're busy executing, check out our posts on lean<sup>33</sup> and advisors<sup>34</sup>.

The archives contain 75 categories in alphabetical order and, within each category, posts are in chronological order.

The old archives<sup>35</sup> will stay online, but they've been out-of-date for quite a while and are now deprecated.

So, how can we make our archives more useful to you?

## **Steve Jobs: “Apple is only its ideas”**

Some recent highlights from our profiles on Twitter<sup>36</sup> and FriendFeed<sup>37</sup>:

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<sup>27</sup><http://venturehacks.com/archives#starting-up>

<sup>28</sup><http://venturehacks.com/archives#lawyers>

<sup>29</sup><http://venturehacks.com/archives#pitching>

<sup>30</sup><http://venturehacks.com/archives#auctions>

<sup>31</sup><http://venturehacks.com/archives#board-of-directors>

<sup>32</sup><http://venturehacks.com/archives#vesting>

<sup>33</sup><http://venturehacks.com/archives#lean>

<sup>34</sup><http://venturehacks.com/archives#advisors>

<sup>35</sup><http://venturehacks.com/old-archives>

<sup>36</sup><http://twitter.com/venturehacks>

<sup>37</sup><http://friendfeed.com/nivi>

“Morons! I know there’s nothing out there. That’s why I want to build the railroad!” – Dean Kamen<sup>38</sup>, channeling J.P. Morgan

“Balance is a bad word. Work-life balance: what does that mean? Don’t balance work and life — integrate them.” – Me<sup>39</sup>

“The truth is that promoting science isn’t just about providing resources — it’s about protecting free and open inquiry. It’s about ensuring that facts and evidence are never twisted or obscured by politics or ideology. It’s about listening to what our scientists have to say, even when it’s inconvenient — especially when it’s inconvenient.” – Obama<sup>40</sup> [Also applies to intellectual honesty in startups.]

“Apple doesn’t make four billion semiconductors. Apple is only its ideas — which is only its people.” – Steve Jobs<sup>41</sup>

“I would like to make the case for the ‘magic’ of management theory. Imagine a world where some scientists know Maxwell’s equations<sup>42</sup> and others don’t. The scientists who know Maxwell’s equations can predict the future. Those who don’t are lost in the wilderness. That’s the world we live in today when it comes to the ‘equations’ of management and organizations. People who understand Peter Drucker<sup>43</sup>

<sup>38</sup> <http://books.google.com/books?id=wQZyasWDBbIC&pg=PA18&dq=%22Morons!+I+know+there%27s+nothing+out+there.+That%27s+why+I+want+to+build+the+railroad!%22&ei=ecRKSd3vA4nIMr7Ghf0C>

<sup>39</sup> <http://books.google.com/books?id=xyIRdiAbpr8C&pg=PA12&dq=%22work,%20play,%20learning,%20and%20inspiration.%22&num=30&ei=VyI2SYXvNKOskaSG-7wc#PPA12,M1>

<sup>40</sup> <http://www.youtube.com/watch?v=PMlXNrBxM0g#t=1m46s>

<sup>41</sup> [http://money.cnn.com/2008/07/21/technology/reingold\\_coach.fortune/index.htm](http://money.cnn.com/2008/07/21/technology/reingold_coach.fortune/index.htm)

<sup>42</sup> [http://en.wikipedia.org/wiki/Maxwell%27s\\_equations](http://en.wikipedia.org/wiki/Maxwell%27s_equations)

<sup>43</sup> <http://www.amazon.com/gp/product/0061345016?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=>

and lean manufacturing<sup>44</sup> are magicians compared to those who don't. Or, at least, they have the potential to be magicians — unfortunately, you still have to wake up in the morning and do the work.” – Me<sup>45</sup>

“The most prevalent loss to the economy doesn’t come from the planned crime, it comes from the little fudging that good people do just by a little bit.” – Dan Ariely<sup>46</sup>

“One should guard against preaching to young people success in the customary form as the main aim in life. The most important motive for work in school and in life is pleasure in work, pleasure in its result, and the knowledge of the value of the result to the community.” – Einstein<sup>47</sup>

“Valuations are down because investors want them to be down. Because, really, what else could it possibly be?” – Me<sup>48</sup>

You can find many more of these quotes on Twitter<sup>49</sup> and FriendFeed<sup>50</sup>.

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390957&creativeASIN=0061345016

<sup>44</sup><http://venturehacks.com/archives#lean>

<sup>45</sup>[http://bobsutton.typepad.com/my\\_weblog/2008/12/good-to-great-more-evidence-that-most-claims-of-magic-are-testimony-to-hubris.html#comment-143333906](http://bobsutton.typepad.com/my_weblog/2008/12/good-to-great-more-evidence-that-most-claims-of-magic-are-testimony-to-hubris.html#comment-143333906)

<sup>46</sup><http://www.youtube.com/watch?v=VZv--sm9XXU#t=44m45s>

<sup>47</sup><http://www.amazon.com/gp/product/0132346494?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0132346494>

<sup>48</sup><http://www.altgate.com/blog/2008/12/around-valuations-down-2550-while-b-and-crounds-nohtml#comment-4306043>

<sup>49</sup><http://twitter.com/venturehacks>

<sup>50</sup><http://friendfeed.com/nivi>

## **Extraordinary Organizations: \$170M company with no titles except “plant” manager**

We don't know a lot about organizing organizations.

We apply techniques like command and control<sup>51</sup>, specialization, batch processing, hierarchy, and other other lessons we've learned from TV, our parents, previous jobs, school, the military, wherever.

But there are other ways to organize organizations. And we're learning more about them every day.

Evolving Excellence<sup>52</sup> writes about Sun Hydraulics, a company that's organized in an extraordinary way:

“Their culture is really something to see. A \$170 million public company that manufactures high end hydraulic manifolds and valves, profitable since it was started in 1970, [with] six plants around the world employing roughly a thousand people.

“What's unusual about that? How about this:

- There is no organization chart
- There are no job titles or job descriptions
- No performance criteria
- No bonuses and no perks
- No regularly scheduled meetings
- No approval levels for capital or expense spending

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<sup>51</sup><http://www.joelonsoftware.com/items/2006/08/08.html>

<sup>52</sup><http://www.evolvingexcellence.com/blog/2008/01/no-titles-excep.html>

- No goals
- No offices or high-walled cubicles
- If the peers accept the idea, then “management” is presumed to accept it — hence the need for very little management
- Every employee is simply expected to figure out where they fit

“There is one honorary job title: Plant Manager. But it’s not what you think. This facility, what amounts to a very large machine shop filled with heavy 5-axis CNC’s, has hundreds of live plants hanging from the ceiling. The Plant Manager is the person in charge of maintaining the plants.”



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Read the rest of the post on Evolving Excellence<sup>54</sup> for some hints on how they organize under these conditions. More extraordinary organizations coming up.

<sup>53</sup><http://www.evolvingexcellence.com/blog/2008/01/no-titles-excep.html>

<sup>54</sup><http://www.evolvingexcellence.com/blog/2008/01/no-titles-excep.html>

# January 2009

## My visit to American Apparel

*Ed: This is a guest post by Kevin Meyer, the President of Factory Strategies Group<sup>1</sup>, which operates Superfactory<sup>2</sup>. He also writes an excellent blog called Evolving Excellence<sup>3</sup>. In this post, Kevin describes how American Apparel unwittingly applies lean<sup>4</sup> practices like short cycle times (concept-to-product in 8 days), integrated QA, cross-functional teams, and more.*



American Apparel<sup>6</sup> has long been one of my favorite companies. I love companies that think outside the box, ignore popular wisdom, and, in doing so, teach us some lessons.

Brief background on why I like them so much: this is a \$500 million manufacturer of t-shirts, underwear, and the like. Typically low margin products, the kind of thing that usually comes from Asian and Central American sweatshops.

But not at American Apparel. This company makes over 1 million articles of clothing per week, from their one factory in Los Angeles and they grew 40% this year. They pay their 5,000-person workforce significantly above minimum wage (average is \$12-\$15 per hour), give them full subsidized benefits (such as

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<sup>1</sup><http://www.factorystrategies.com>

<sup>2</sup><http://www.superfactory.com/>

<sup>3</sup><http://www.evolvingexcellence.com/>

<sup>4</sup><http://venturehacks.com/archives#lean>

<sup>5</sup><http://americanapparel.net/>

<sup>6</sup><http://americanapparel.net/>

high quality health care insurance for \$8 per week), and they turn a profit.

This should embarrass the heck out of any executive who thinks he has to outsource in order to find effective labor. Or at least call into question his fundamental competence as a leader. If American Apparel can manufacture low margin clothing efficiently enough to beat the sweatshops (in California no less), then anyone should be able to. If they try hard enough.

Apparently some of the brass at the company have kept tabs on my blog as, about a month ago, I got a phone call inviting me to come down for a visit. It was everything I expected, and more, and in many aspects it rivaled the various Japanese factories<sup>7</sup> I visited recently.

## First Impressions

One of those aspects was the first impression. When we arrived at Saishunkan<sup>8</sup> in Japan, we were greeted by a gardener who turned out to be the chairwoman of the \$270 million company. At another factory<sup>9</sup> we walked in to see the president of a \$100 million company on his knees scrubbing the floor.

When you arrive at American Apparel, you see several massive multi-story warehouse buildings. At the business address is an open entrance with an old table and a visitor sign-in sheet. That's it. It's on the lower left of building in the photo below. No, not the far left... that would be the company store. The open gap entrance just to the right of the store... which looks like any of the other roll-up dock doors.

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<sup>7</sup><http://www.evolvingexcellence.com/blog/2008/11/japan-kaikaku-experience---the-summary.html>

<sup>8</sup><http://www.evolvingexcellence.com/blog/2008/10/jke-day-2-saishunken-cosmetics---customer-care-trumps-a-factory.html>

<sup>9</sup><http://www.evolvingexcellence.com/blog/2008/10/jke-day-3-hoks---3s-gone-wild.html>



No fancy lobby with glitzy lighting and display cases, no plush waiting rooms. An open entrance with a guard and a sign-in sheet. For a \$500 million company with over 5,000 employees.

As you can tell from this photo and the others, the buildings aren't in particularly great shape either. But they serve their purpose, and do it well. They may need a coat of paint, but they're clean, neat, and filled with a lot of happy brains.

## The people

The value at American Apparel isn't created by the building, or the machines, but by the people<sup>10</sup>. So many companies—probably

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<sup>10</sup><http://americanapparel.net/contact/ourworkers.html>

the vast majority—think of their people as a cost. Very few companies recognize the value of the brain that sits slightly north of their people's hands. American Apparel realizes that the value of that brain more than offsets the traditional cost difference between their employee's hands and a pair of hands in a sweatshop.



What value has been added by the brains of their employees? How about this: their highest volume product, a “deep V” t-shirt, was the idea of one of their shop floor folks. Or this: American Apparel makes and sells a variety of unusual products, such as dog sweaters and baby bibs. Why? Because their employees figured out how to design those products with the little remaining scrap that exists after cutting out the patterns for the mainline products. There's still some scrap left, so they had another idea: create a machine that would combine and weave it into bikini straps and cords for hoodies... like in the photo on the right. There's still a tiny bit of scrap material left, so that is sent to a recycler, who turns it back into yarn and thread, which is then turned back into cloth for more products.

In fact, sustainability is a big deal to American Apparel. How many of you haven't embarked on sustainability programs because of their cost? Well, American Apparel recycles just about everything, obtains 30% of its power from solar cells on the roof (and they are looking into getting much more), and many of

their trucks run on biodiesel. They buy as much organic cotton as they can... *domestic* organic cotton—they believe that the carbon footprint created by sourcing organic cotton from overseas is too much of a negative offset. Anyone interested in growing more organic cotton in the U.S., here's your customer. So once again, if you think sustainability is too expensive, then you should be embarrassed.

## Workcenters

But let's get back to the people. Production takes place on each floor of all of these buildings by multitudes of 4 to 8 person cells (they call them "workcenters"). A kit of cut cloth is wheeled to each cell and they crank through it. A chart of metrics is maintained at each cell. See the column on the right, which I know you can't read? It's dollars... and reflects the dollar value of what the cell has created, and most importantly the actual dollar portion that they get to share. A form of piecework on top of a nice base hourly rate. Each cell has a quality control person, and other quality people roam between the cells.



Do you see that they're smiling? It's no wonder; they are valued and treated very well. Not only do they have a doctor on site, they have a full modern clinic. Back when there was a transit strike in LA, the company bought a couple thousand bicycles and created a bike loan program, with free maintenance, that still exists. How many companies have purposely eliminated phones on their manufacturing floor to cut costs? American Apparel has phones all over the place, and provides free calls—even long distance. That's a major benefit to their primarily immigrant workforce.

And perhaps most importantly, the company actively solicits their employee's ideas and recommendations, and they actively implement them. It's no wonder their retention rate is over 98%.

## Vertical integration

A few more concepts.

How about the importance of *gemba*<sup>11</sup>? Administration, marketing, design, and other offices are scattered throughout the buildings. They are not adjacent to each other. So everyone must walk through the factory floor multiple times a day. Everyone is continually aware that they are in a manufacturing facility.

Another concept: complete vertical integration. Everything is done at this cluster of buildings, with the exception of some dyeing that is done a few miles away. Design is done, often tested by Dov Charney himself, and sent to the factory floor. Time from raw concept to a finished product in over 200 stores worldwide? Eight days. Compare that to the weeks and months it can take to send a container across the ocean. Did the Olson Twins wear something unique yesterday? A new design can be created and placed into stores almost immediately to capitalize on the brief craze.

Complete advertising development, through photographing the models, to final printing, is also done at the factory. The props for all of the stores are created and sent from this factory. When a new store is opened, the fixtures and initial inventory are sent, often pre-hung on hangars so the new retail clerks can focus on selling.

Since everything is created in one factory, they can react fast, and therefore the stores don't have to maintain as much inventory. Shipments, globally, are smaller and more frequent. They have a unique way to balance raw material inventory: if raw inventory gets too large, they simply create a new design that will consume that inventory and sell it. A luxury many of us wish we had.

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<sup>11</sup><http://en.wikipedia.org/wiki/Gemba>

## Are you embarrassed yet?

I've previously written about Sun Hydraulics<sup>12</sup>, a 1,000 employee, \$170M company, with no job titles except "plant manager"... the guy in charge of watering the plants in the factory. American Apparel is very similar. Sure there is the CEO, there's a marketing department, and there are cell leaders. But not much more. I asked a couple of my hosts what they did and I got answers like "some strategy stuff, but then I also figure out how to hire people for the stores." Basically whatever needs to be done.

American Apparel may be very altruistic, but they still realize they're a business. A business that has to make money to continue to provide the stable solid jobs for their valued workforce. My hosts told me about some other companies with similar values, who focused too heavily on the "communal good" and soon went out of business.



And yes, I saw Dov. He's been in the news<sup>13</sup> quite a bit recently, thanks to a workplace atmosphere that would make some cringe. At the risk of offending the more sensitive among us, part of me applauds his guts to run the

<sup>12</sup><http://www.evolvingexcellence.com/blog/2008/01/no-titles-excep.html>

<sup>13</sup>[http://www.forbes.com/2008/11/13/american-apparel-retail-markets-face-cx\\_ra\\_1112marketsautofacescan02.html?partner=yahootix](http://www.forbes.com/2008/11/13/american-apparel-retail-markets-face-cx_ra_1112marketsautofacescan02.html?partner=yahootix)

company as he sees fit, traditional rules be damned. It even earned him a great spoof on Saturday Night Live<sup>14</sup>. By any measure, he is a retail genius and he has the smarts to see outside of the “must outsource to make clothes” traditional mindset.

But here’s my final and perhaps most important lesson: do what works. It’s that simple. Tools, even lean tools, are just tools. Leadership requires people. At American Apparel there are no cheesy signs with “Teamwork” and “Challenge” on them. There are no glitz glass lobbies. There is no sign of lean manufacturing in the traditional sense, and they don’t profess to be lean. No heavy lean training of employees, no overwhelming visual controls<sup>15</sup> besides the metrics charts at the cells, no Shingo Prizes or Baldrige Awards.

But there are bunch of people recognized and compensated for their knowledge, creativity, ideas, and experience. A group of people who realize that speed creates value, knowledge creates ideas, ideas create profit. They figure out what works, then they do it exceptionally well.

A 5,000 person, \$500 million low margin clothing company, operating from a single factory in the least business-friendly state of one of the highest “cost” manufacturing countries. Beating the overseas sweatshops and still growing rapidly.

Are you embarrassed yet?

## We don’t pay you to work here

“A raise is only a raise for thirty days; after that, it’s just your salary.”

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<sup>14</sup><http://www.gigglesugar.com/2062905>

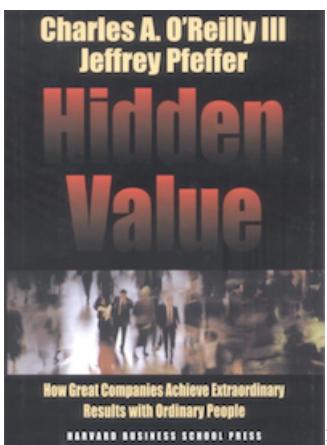
<sup>15</sup>[http://en.wikipedia.org/wiki/Visual\\_Control](http://en.wikipedia.org/wiki/Visual_Control)

– David Russo, VP of Human Resources at SAS Institute

This is one of my favorite quotes from the book *Hidden Value*<sup>16</sup>. It explains why money by itself doesn't motivate high performance. Money by itself can only motivate the quest for more money. A raise is only a raise for thirty days; after that, it's just your salary.

We are motivated to perform when our work expresses who we are<sup>17</sup>, when the business' goals are intrinsically meaningful to us, and we feel that we are valued as people, not simply as economic agents<sup>18</sup>.

But, even in startups, financial incentives and HR practices often treat us like economic agents:



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<sup>16</sup><http://www.amazon.com/gp/product/0875848982?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848982>

<sup>17</sup><http://venturehacks.com/articles/the-monk-and-the-riddle>

<sup>18</sup><http://books.google.com/books?id=FRUxoxThkow8C&pg=RA1-P A235&dq=%22feel+that+we+are+valued+as+people,+not+simply+as+economic+agents%22&ei=XVdnSZCIBIjClQSfgN0c#PRA1-PA236,M1>

<sup>19</sup><http://www.amazon.com/gp/product/0875848982?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848982>

“Consider the implicit values conveyed in the modern management practices adopted by many companies. Most firms today emphasize, among other things, the employee’s responsibility for being career resilient, employment at will and no-fault dismissal, pay for performance, downsizing to cut costs, and maximizing shareholder value above all else. What is the message any sentient employee takes from these practices? Pursue what is best for you, not the firm or the customer, adopt a free-agent mentality, and do not invest any more in the firm than it is willing to invest in you. The underlying values are crystal clear, even if they are never expressed in a formal way. In this sense, arguments by managers that value statements are irrelevant or inappropriate miss the point: All organizations have values; the only question is how explicit they are about them.

“And what happens when employees behave in accordance with these values? First, a rational employee is not likely to exert much effort in activities beyond what he or she is explicitly rewarded for. A ‘show me the money’ mood prevails. Second, a smart employee will be constantly alert for new and better job opportunities in other organizations—loyalty is for fools. Third, unless cooperation is explicitly monitored and rewarded, teamwork is viewed as optional... To resolve some of these problems, management’s job is to design ever more sophisticated control and incentive systems to ensure that the necessary teamwork occurs and that the loss of intellectual capital is minimized.”

The problem isn’t that money is a weak motivator. The problem is that money is a terribly strong motivator<sup>20</sup>. By itself, money

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<sup>20</sup>[http://bobsutton.typepad.com/my\\_weblog/2008/11/](http://bobsutton.typepad.com/my_weblog/2008/11/)

motivates the wrong people to do the wrong things in the quest for more money.

This is why Zappos pays employees to leave<sup>21</sup>. This is why Tandem Computers didn't tell employees their salaries until *after* they started working<sup>22</sup>. In other words: we don't pay you to work here—we pay you *so* you can work here.

## **Organizing around values, not value**

The authors, Charles A. O'Reilly III<sup>23</sup> and Jeffrey Pfeffer<sup>24</sup>, both from Stanford's Graduate School of Business, studied how eight companies, from Men's Wearhouse to Cisco, ignore the pernicious assumption that compensation should be the foundation for management systems:

"First, each of these companies has a clear, well-articulated set of values that are widely shared and act as the foundation for the management practices that... provide a basis for the company's competitive success. [e.g. Southwest's "Work should be fun... it can be play... enjoy it."]

"Second, each of these organizations has a remarkable degree of alignment and consistency in the people-centered practices that express its core values. [e.g. Southwest: "We hire happy people."]

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washington-mutual-and-perverse-incentives.html

<sup>21</sup> [http://discussionleader.hbsp.com/taylor/2008/05/wy\\_zappos\\_pays\\_new\\_employees\\_t.html](http://discussionleader.hbsp.com/taylor/2008/05/wy_zappos_pays_new_employees_t.html)

<sup>22</sup> <http://books.google.com/books?id=IIXIE9bYid8C&pg=PA122&dq=%22if+they+asked+about+their+salary%22&ei=Mm5mSbHbBILKIQSvzvDzDQ#PPA123,M1>

<sup>23</sup> <http://www.google.com/search?hl=en&q=Charles%20A.%20O%27Reilly%20III&aq=f&oq=>

<sup>24</sup> <http://www.google.com/search?hl=en&q=Jeffrey%20Pfeffer&aq=f&oq=>

“Finally, the senior managers in these firms, not just the founders or the CEO, are leaders whose primary role is to ensure that the values are maintained and constantly made real to all of the people who work in the organization... The senior managers in each of these companies see their roles not as managing the day-to-day business or even as making decisions about grand strategy but as setting and reinforcing the vision, values, and culture of the organization. Dennis Bakke at AES [a \$2B company] claims that he made only two decisions in 1998, one of which was not to write a book on the company.”

## **Extraordinary results with ordinary people**

The book’s subtitle is “How great companies achieve extraordinary results with ordinary people.”

Every rational company in the world is trying to hire the best people in the world. And all but one of them will fail at this task. There can only be one company with the *best* people. Hiring the best is a failing strategy.

Organizations must be designed to thrive with ordinary people. If businesses can thrive with the capabilities of ordinary people, they can also thrive with extraordinary people. Practices like Extreme Programming<sup>25</sup>, that were designed for programmers with ordinary skills<sup>26</sup>, work even better with extraordinary programmers.

Read Hidden Value<sup>27</sup> for specific recruiting, training, information-

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<sup>25</sup> <http://venturehacks.com/articles/extreme-programming-explained>

<sup>26</sup> <http://books.google.com/books?id=G8EL4H4vf7UC&pg=PR18&dq=%22on+the+close+collaboration+of+programmers+with+ordinary+skills%22&ei=SHRIScbnNYXSkwSU74yeBg>

<sup>27</sup> <http://www.amazon.com/gp/product/0875848982?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848982>

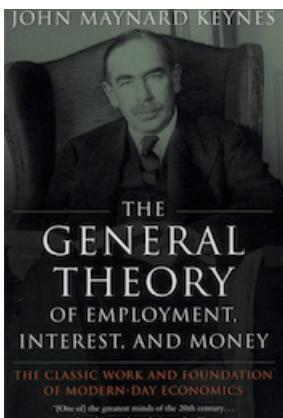
sharing, and rewards practices that aim to exploit the capabilities of ordinary and extraordinary people alike.

“If people come for money, they will leave for money.”

– James Treybig<sup>28</sup>, CEO of Tandem Computers

## The spontaneous optimism that drives startups

In 1936 (!), old-school economic giant John Maynard Keynes<sup>29</sup> described the spontaneous optimism that drives startups:



<sup>28</sup> <http://books.google.com/books?id=lxIE9bYid8C&pg=PA122&dq=%22to+paraphrase+treybig%22&ei=L29mSeqeNYKGkASLyr2VAQ#PPA123,M1>

<sup>29</sup> [http://en.wikipedia.org/wiki/John\\_Maynard\\_Keynes](http://en.wikipedia.org/wiki/John_Maynard_Keynes)

<sup>30</sup> <http://www.amazon.com/gp/product/0979905257?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0979905257>

“A large proportion of our positive activities depend on spontaneous optimism rather than mathematical expectations, whether moral or hedonistic or economic. Most, probably, of our decisions to do something positive, the full consequences of which will be drawn out over many days to come, can only be taken as the result of animal spirits—of a spontaneous urge to action rather than inaction, and not as the outcome of a weighted average of quantitative benefits multiplied by quantitative probabilities.

“Enterprise only pretends to itself to be mainly actuated by the statements in its own prospectus, however candid and sincere. Only a little more than an expedition to the South Pole, is it based on an exact calculation of benefits to come. Thus if the animal spirits are dimmed and the spontaneous optimism falters, leaving us to depend on nothing but a mathematical expectation, enterprise will fade and die—though fears of loss may have a basis no more reasonable than hopes of profit had before.

“It is safe to say that enterprise which depends on hopes stretching into the future benefits the community as a whole. But individual initiative will only be adequate when reasonable calculation is supplemented and supported by animal spirits, so that the thought of ultimate loss which often overtakes pioneers, as experience undoubtedly tells us and them, is put aside as a healthy man puts aside the expectation of death.”

— The General Theory of Employment, Interest, and Money<sup>31</sup>

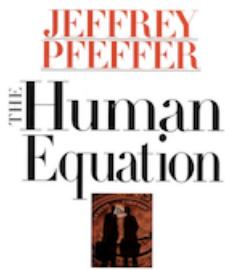
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<sup>31</sup><http://www.amazon.com/gp/product/0979905257?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0979905257>

(*Via: Mavericks at Work*<sup>32</sup>)

## The Human Equation: How to organize people for profit

From The Human Equation<sup>33</sup>:



HARVARD BUSINESS SCHOOL PRESS

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“Seven dimensions that seem to characterize most if not all of the systems that produce profits through people.

1. Employment security.
2. Selective hiring of new personnel [especially screening for attributes that cannot be taught such as attitude and cultural fit.]

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<sup>32</sup><http://www.mavericksatwork.com/?p=161>

<sup>33</sup><http://www.amazon.com/gp/product/0875848419?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848419>

<sup>34</sup><http://www.amazon.com/gp/product/0875848419?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848419>

3. Self-managed teams and decentralization of decision making as the basic principles of organizational design.
4. Comparatively high compensation contingent on organizational performance.
5. Extensive training.
6. Reduced status distinctions and barriers, including dress, language, office arrangements, and wage differences across levels.
7. Extensive sharing of financial and performance information throughout the organization.”

The author is Jeffrey Pfeffer<sup>35</sup>, a professor at Stanford. He also co-wrote *Hidden Value*, which we covered in We don't pay you to work here<sup>36</sup>.

## **Implementing the whole system**

Extreme Programming<sup>37</sup> works well when you implement all of its practices. Most of the practices by themselves have too many flaws to be very effective. Each practice by itself may even have more disadvantages than advantages.

But all of the practices *together* work well. Why? For each practice, there are other practices that obviate its flaws. Wheels by themselves just roll a bit and fall over. But when you connect them to a car, the entire system can get you from Boston to San Francisco.

The practices in The Human Equation also work well when you implement them all. You can't offer extensive training if you

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<sup>35</sup><http://www.google.com/search?hl=en&q=Jeffrey%20Pfeffer&aq=f&oq=>

<sup>36</sup><http://venturehacks.com/articles/ordinary-people>

<sup>37</sup><http://venturehacks.com/articles/extreme-programming-explained>

plan to lay people off when times are tough. That's just a good way to waste money on training. You can't offer employment security if you don't hire new employees very selectively and if you don't terminate the ones that aren't effective.

If you're searching for a magic incentive system to get high performance from your team, there isn't one. If you're willing to do the hard work of implementing a set of simple organizational practices, *The Human Equation*<sup>38</sup> and *Hidden Value*<sup>39</sup> have some suggestions.

## **Lowering the water level: Do bad economies spur innovation?**

“[Recessions] can cause people to think more about the effective use of their assets. In the good times, you can get a bit careless or not focused as much on efficiency. In bad times, you’re forced to see if there is a technology [that will help].”

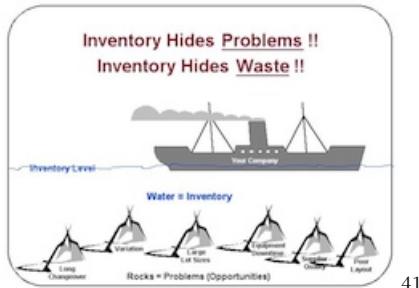
– Craig Barrett<sup>40</sup>, Chairman of Intel

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<sup>38</sup><http://www.amazon.com/gp/product/0875848419?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848419>

<sup>39</sup><http://venturehacks.com/articles/ordinary-people>

<sup>40</sup><http://www.nytimes.com/2009/01/26/technology/26spend.html>



Water hides the rocks at the bottom of the ocean. Lowering the water level exposes the rocks underneath.

In a great economy, money hides problems and opportunities. Companies will get orders whether or not they innovate. But in a bad economy, lowering the water level will expose new opportunities to our corporations.

Reduced spending will spur businesses to create products that even newly poor customers will buy. Products that customers truly need and value. Products with enduring value.

And businesses will create better ways of designing, manufacturing, marketing, and selling the products customers already buy.

At a minimum, they will learn existing practices they ignored while the water level was high.

Constraints spur creativity. Bad economies demand it. Innovation is easier when the alternative is death.

"The Toyota production system was conceived and its implementation begun soon after World War II. But it did not begin to attract the attention of Japanese industry until the first oil crisis in the fall of 1973. Japanese managers, accustomed to inflation and a high growth rate, were suddenly confronted

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<sup>41</sup> [http://elsmar.com/Identify\\_Waste/sld011.htm](http://elsmar.com/Identify_Waste/sld011.htm)

with zero growth and forced to handle production decreases. It was during this economic emergency that they first noticed the results Toyota was achieving with its relentless pursuit of the elimination of waste. They then began to tackle the problem of introducing the system into their own workplaces... Prior to the oil crisis, when I talked to people about Toyota's manufacturing technology and production system, I found little interest."

– Taiichi Ohno<sup>42</sup>

**Inspiration and Data:** Toyota Production System<sup>43</sup>, Depressed? Summon Your "Animal Spirits"<sup>44</sup>, Inventory Hides Problems!<sup>45</sup>, Implementing Lean Software Development<sup>46</sup>

## Pitching Hacks is almost here / Calling all testers

Pitching Hacks<sup>47</sup> is almost ready. It's all about pitching startups to investors. And we need your help testing it out.

We're looking for testers who want to buy the book for \$19 and give us feedback on the whole experience. Is the checkout process lame? Does the book suck? Did your computer explode? Did your head explode?

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<sup>42</sup><http://www.amazon.com/gp/product/0915299143?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0915299143>

<sup>43</sup>[http://books.google.com/books?id=7\\_-67SshOy8C&pg=PR13&dq=%22The+Toyota+production+system+was+conceived%22&ei=GPJnSYDuPljClQSfgN0c#PPR14,M1](http://books.google.com/books?id=7_-67SshOy8C&pg=PR13&dq=%22The+Toyota+production+system+was+conceived%22&ei=GPJnSYDuPljClQSfgN0c#PPR14,M1)

<sup>44</sup><http://www.mavericksatwork.com/?p=161>

<sup>45</sup>[http://elsmar.com/Identify\\_Waste/sld011.htm](http://elsmar.com/Identify_Waste/sld011.htm)

<sup>46</sup><http://www.amazon.com/gp/product/0321437381?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0321437381>

<sup>47</sup><http://venturehacks.com/articles/coming-soon-pitching-hacks>

Sign up<sup>48</sup> to be a tester. Of course, we'll send you a new copy when the final draft comes out.

## Free samples

Here's the Table of Contents<sup>49</sup> and an essay called Why do I need an introduction?<sup>50</sup> More samples to come.

Sign up<sup>51</sup> to be a tester or sign up<sup>52</sup> to be notified when the book comes out.

# (A bit of) Decision-making for startups



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“Decisions tend to be judged solely on the results they produce. But I believe the right test should focus heavily on the quality

<sup>48</sup><http://venturehacks.wufoo.com/forms/test-our-new-book-pitching-hacks/>

<sup>49</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/01/pitching-hacks-toc.pdf>

<sup>50</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/01/pitching-hacks-introduction.pdf>

<sup>51</sup><http://venturehacks.wufoo.com/forms/test-our-new-book-pitching-hacks/>

<sup>52</sup><http://venturehacks.wufoo.com/forms/pitching-hacks-the-book/>

<sup>53</sup>[http://en.wikipedia.org/wiki/Robert\\_Rubin](http://en.wikipedia.org/wiki/Robert_Rubin)

of the decision-making itself...

“Individual decisions can be badly thought through, and yet be successful, or exceedingly well thought through, but be unsuccessful, because the recognized possibility of failure in fact occurs. But over time, more thoughtful decision-making will lead to better overall results, and more thoughtful decision-making can be encouraged by evaluating decisions on how well they were made rather than on outcome...

“It’s not that results don’t matter. They do. But judging solely on results is a serious deterrent to taking the risks that may be necessary to making the right decision. Simply put, the way decisions are evaluated affects the way decisions are made.”

– Robert Rubin<sup>54</sup> From NYU<sup>55</sup> and Harvard<sup>56</sup> commencements

Rubin looks at the world through the lens of probabilities. A good decision might have bad results. But if you have the chance to do it all over again, under the same conditions, you should make the same decision.

## Evaluating advisors

“Any time you make a bet with the best of it, where the odds are in your favor, you have earned something on that bet, whether you actually win or lose the bet. By the same token, when you make a bet with the worst of it, where the odds are not in your favor, you have lost something, whether you actually win or lose the bet.”

– David Sklansky, The Theory of Poker<sup>57</sup>

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<sup>54</sup>[http://en.wikipedia.org/wiki/Robert\\_Rubin](http://en.wikipedia.org/wiki/Robert_Rubin)

<sup>55</sup><http://www.treas.gov/press/releases/rr3147.htm>

<sup>56</sup><http://www.commencement.harvard.edu/2001/rubin.html>

<sup>57</sup><http://www.amazon.com/gp/product/1880685000?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=1880685000>

Evaluate advisors on the quality of their decision-making, not on the quality of their past outcomes. The same goes for advice from investors, or anyone at all.

Entrepreneurs and investors can make poor decisions and still succeed. They can get lucky. But the odds that the same thinking will work at your company aren't favorable.

Other startups can make great decisions and still fail. They can get unlucky. But their thinking wasn't bad — they just need to roll the dice again.

## **Evaluating decision-making**

“Simply put, the way decisions are evaluated affects the way decisions are made.”

– Robert Rubin, *Ibid.*

This is the coolest part of Rubin's speech.

First, we evaluate decision-making processes and pick one. Second, we execute the process and get a decision. Third, the decision leads to action, which leads to an outcome. (All of these steps can be iterative.)

Does anyone actually evaluate decision-making? Yes. Often it's implicit. For example, a job interview is an evaluation. A candidate has a decision-making process whether he knows it or not. And an interview evaluates a candidate's decision-making process whether a startup knows it or not.

The decision-making process you pick is more important than the decisions it produces. And the way you evaluate processes is more important than the process you pick. Evaluation is king.

Evaluate decision-making processes based on their quality, not on a handful of their outcomes. For example, consider whether job interviews are an effective way to evaluate a candidate's

decision-making. In other words, (evaluate (processes for evaluating (processes for making decisions))). In other words, duh.

*Learn more:* Be the House<sup>58</sup>

## Pitching Hacks: Beta test update



Last week, we put out a call for beta testers<sup>59</sup> for our new book, Pitching Hacks (sign up<sup>60</sup> to be notified when it comes out). We want to share some interesting stats and feedback that we've received from our testers.

### Response rate

First, 120 people signed up to test Pitching Hacks, and 45 of them followed through and bought the book.

On the one hand, a 38% response rate is amazing, especially since we're asking beta testers to *pay* for the book (of course, we promised to send them the final draft when it's ready).

On the other hand, we're really wondering what happened to the other 75 people who signed up, but didn't buy the book. If

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<sup>58</sup> [http://www.michaelmauboussin.com/more\\_than\\_you\\_know\\_excerpt.htm](http://www.michaelmauboussin.com/more_than_you_know_excerpt.htm)

<sup>59</sup> <http://venturehacks.com/articles/pitching-hacks-testing>

<sup>60</sup> <http://venturehacks.wufoo.com/forms/z7x4m1>

you're one of these people, please get in touch and let us know why you didn't buy the book! E-mail us<sup>61</sup> or fill in this form<sup>62</sup>.

## Feedback

16 of our beta testers got in touch with us and sent great feedback, leading to many changes in the book and checkout process: adding a sentence here and there to clarify our meaning, improving the formatting so the book is easier to read, adding a notice to use the latest version of Adobe Reader if you're having problems viewing the book, etc.

Our beta testers rocked. Next time we start working on a new product, we're going to involve our community in product development much earlier. And we're going to think about how to start collecting money earlier.

We don't think there's anything wrong with charging your beta testers. If you're organizing your business around feedback, why distinguish between the feedback you get from beta testers and the feedback you get from regular customers? They're both paying to give you feedback. And the #1 piece of feedback they're giving you is that they're willing to pay for your product.

Of course, you should do something special for your beta testers, like giving them a discount. Or a hug.

## Testimonials

A nice side effect of the feedback from our beta testers is a collection of honest, unprompted testimonials that we can use to promote the book:

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<sup>61</sup><mailto:nivi@venturehacks.com>

<sup>62</sup><http://venturehacks.wufoo.com/forms/r7x4a3>

“The book was quite enjoyable (maybe because we are exactly starting to look for VC funding!)” – Emmanuel Marot<sup>63</sup>

“This was a great, extremely fast-paced read.” – Andre Gharakhanian<sup>64</sup>

“Thanks for the book. I just bought 5 licenses. I am very proud of you. This is fantastic. Mommy is also thrilled.” – Dad<sup>65</sup> (*Joke!*)

Sign up<sup>66</sup> to be notified when we release Pitching Hacks.

## **Paul Buchheit: “Consider spending less time talking, and more time prototyping”**

Some recent highlights from our Twitter<sup>67</sup> (RSS<sup>68</sup>) and FriendFeed<sup>69</sup> (RSS<sup>70</sup>):

“Some of the ways I’ve learned to estimate whether a team will be successful is how high-impact their project is, but also 1) how quickly they can iterate and 2) how they react to feedback.” – Matt Cutts<sup>71</sup>, Google

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<sup>63</sup><http://www.linkedin.com/pub/1/164/667>

<sup>64</sup><http://www.siliconlegal.com/>

<sup>65</sup><http://www.linkedin.com/pub/dir/hossein/nivi>

<sup>66</sup><http://venturehacks.wufoo.com/forms/z7x4m1>

<sup>67</sup><http://twitter.com/venturehacks>

<sup>68</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>69</sup><http://friendfeed.com/nivi>

<sup>70</sup><http://friendfeed.com/nivi?format=atom>

<sup>71</sup><http://www.mattcutts.com/blog/google-knol/>

“Firms should not pay high executive salaries merely to find leaders who can copy what others are doing.” – Jeffrey Pfeffer<sup>72</sup>, Stanford Graduate School of Business

“Lean startups are built from the ground up for learning about customers.” – Eric Ries<sup>73</sup>, Kleiner Perkins

“Consider spending less time talking, and more time prototyping, especially if you’re not very good at talking.” – Paul Buchheit<sup>74</sup>, FriendFeed

[Could you build a portfolio of consistently successful startups? Allen C. Ward could just as well be talking about startups and their investors in this quote.]

“Toyota and its suppliers have consistently successful projects. They analyze the few defective projects to improve the system. Morale is high and chaos low because projects consistently go right. In contrast, most conventional projects have serious problems and an occasional home run keeps the company afloat. Fire fighting is standard. It is hard to tell who is doing a good job and hard even to tell what the causes of the problems are. Waves of disruption run through the company, as projects are canceled, run over budget or schedule, or must be expedited to make up for failures elsewhere. Everyone is worried all the time.” – Allen C. Ward<sup>75</sup>

“Contentment is wanting what you have. Ambition

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<sup>72</sup><http://www.amazon.com/gp/product/0875848419?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848419>

<sup>73</sup><http://mashable.com/2009/01/02/how-to-raise-money/>

<sup>74</sup><http://paulbuchheit.blogspot.com/2009/01/communicating-with-code.html>

<sup>75</sup><http://www.amazon.com/gp/product/1934109134?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=1934109134>

is wanting what another has. Progress comes from wanting what nobody has.” – Bob Lewis<sup>76</sup>

“That’s another flaw with performance-based rewards: They are easy for one of your competitors to top.” – Joel Spolsky<sup>77</sup>

“The idea of a company that’s earning money, not losing money, that’s not, let’s say ‘industrially endangered,’ to have just cutbacks so they can earn another \$12 million or \$20 million or \$40 million in a year where no one’s counting is really a horrible act when you think about it on every level. First of all, it’s certainly not necessary. It’s doing it at the worst time. It’s throwing people out to a larger, what is inevitably a larger unemployment heap for frankly no good reason.” – Barry Diller<sup>78</sup>, IAC [See these creative ways to avoid layoffs<sup>79</sup>.]

“Forget about shortcuts. Run a business as if it’s forever.” – Norm Brodsky<sup>80</sup>

“A business plan that doesn’t require a wonderful economic environment in order to succeed... is a good idea all the time.” – Marc Andreessen<sup>81</sup>

“Entrepreneurs get blinded by firm reputations... they don’t do their due diligence on partners.” – via Jeff Bussgang<sup>82</sup>, Flybridge Capital Partners

<sup>76</sup><http://www.weblog.keepthejoinrunning.com/wordpress/?p=17>

<sup>77</sup>[http://www.inc.com/magazine/20090101/how-hard-could-it-be-thanks-or-no-thanks\\_Printer\\_Friendly.html?partner=fogcreek](http://www.inc.com/magazine/20090101/how-hard-could-it-be-thanks-or-no-thanks_Printer_Friendly.html?partner=fogcreek)

<sup>78</sup><http://blogs.reuters.com/summits/2008/12/04/diller-to-profitable-companies-lay-off-the-layoffs/>

<sup>79</sup><http://www.skmurphy.com/blog/2009/01/27/fewer-of-you-will-be-listening-to-someone-else/>

<sup>80</sup>[http://www.inc.com/magazine/20081001/street-smarts-secrets-of-a-110-million-man\\_Printer\\_Friendly.html](http://www.inc.com/magazine/20081001/street-smarts-secrets-of-a-110-million-man_Printer_Friendly.html)

<sup>81</sup><http://video.google.com/videoplay?docid=-672785046739379641&hl=en#5m13s>

<sup>82</sup><http://bostonvcblog.typepad.com/vc/2009/01/why-do-asshole-vcs-survive.html>

“Asking customers to adopt new priorities... is an uphill death march through knee-deep mud.” – Clayton Christensen<sup>83</sup>, Harvard Business School

“I’ve learned... that there is a lot more hidden talent and potential in your employees than you think.” – Tony Hsieh<sup>84</sup>, Zappos

“Most business practices repress our natural tendency to have fun and socialize.” – George Zimmer<sup>85</sup>, Men’s Wearhouse

If you like these quotes, you should subscribe to our Twitter<sup>86</sup> (RSS<sup>87</sup>) and FriendFeed<sup>88</sup> (RSS<sup>89</sup>) because you are missing out on many more quotes that will rock your bottom.

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<sup>83</sup> <http://hbswk.hbs.edu/item/3374.html>

<sup>84</sup> <http://www.evolvingexcellence.com/blog/2009/01/hsieh-on-people.html>

<sup>85</sup> <http://www.amazon.com/gp/product/0875848982?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848982>

<sup>86</sup> <http://twitter.com/venturehacks>

<sup>87</sup> <http://feeds.venturehacks.com/venturehacks-twitter>

<sup>88</sup> <http://friendfeed.com/nivi>

<sup>89</sup> <http://friendfeed.com/nivi?format=atom>

# February 2009

## How IMVU learned its way to \$10M a year

“Lean startups are built from the ground up for learning about customers.”

– Eric Ries<sup>1</sup>

I recently sat in on Eric Ries<sup>2</sup>, presentation on lean startups at Berkeley. The slides and audio are below. The presentation is about one hour long and it is gold.

Audio: The Lean Startup<sup>3</sup> (mp3<sup>4</sup>)

Slides: The Lean Startup<sup>5</sup> (pdf<sup>6</sup>)

The audience consisted of students from Steve Blank’s course on customer development<sup>7</sup>. So you will hear an occasional remark from Steve or his students. When Eric refers to a “case”, he is talking about this Stanford GSB case<sup>8</sup> about his company, IMVU<sup>9</sup>, and his previous company, there.com.

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<sup>1</sup><http://mashable.com/2009/01/02/how-to-raise-money/>

<sup>2</sup><http://startupplessonsslearned.blogspot.com/>

<sup>3</sup><http://odeo.com/episodes/24193242-The-Lean-Startup>

<sup>4</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/02/the-lean-startup.mp3>

<sup>5</sup><http://www.slideshare.net/venturehacks/the-lean-startup-2>

<sup>6</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/02/the-lean-startup.pdf>

<sup>7</sup><http://venturehacks.com/articles/customer-development>

<sup>8</sup>[http://harvardbusinessonline.hbsp.harvard.edu/b02/en/common/item\\_detail.jhtml;jsessionid=FJKYVZ532JCRIAKRGWCB5VQBKE0YOISW?id=E254&\\_requestid=14996](http://harvardbusinessonline.hbsp.harvard.edu/b02/en/common/item_detail.jhtml;jsessionid=FJKYVZ532JCRIAKRGWCB5VQBKE0YOISW?id=E254&_requestid=14996)

<sup>9</sup><http://www.imvu.com/>

## Built to learn

Many founders believe that early stage startups are endeavors of execution. The customer is known, the product is known, and all we have to do is act.

Eric takes a different approach. He believes that many early stage startups are labors of learning. The customer is unknown, the product is unknown, and **startups must be built to learn.**

IMVU learned its way to product/market fit<sup>10</sup>. They threw away their first product (40,000 lines of code that implemented an IM add-on) as they learned customers didn't want it. They used customer development<sup>11</sup> and agile software development<sup>12</sup> to eventually discover customers who would pay for 3D animated chat software (\$10M in revenue in 2007). IMVU learned to test their assumptions instead of executing them as if they were passed down from God.

## Learning to learn

This is the scientific way of building startups. It requires a commitment to learning and thoughtfulness. It is being documented in books like Steve Blank's Four Steps to the Epiphany<sup>13</sup> and blogs like Eric Ries' Startup Lessons Learned<sup>14</sup>. It represents the triumph of learning, over the naive startup creation myths we read about in the media.

**IMVU learned to learn.** This process can be replicated at your company. Please do try this at home.

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<sup>10</sup><http://blog.pmarca.com/2007/06/the-pmarca-gu-2.html>

<sup>11</sup><http://venturehacks.com/articles/customer-development>

<sup>12</sup><http://venturehacks.com/articles/agile-software-development>

<sup>13</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>14</sup><http://startuplessonslearned.blogspot.com/>

**Update:** Eric writes a follow-up to this post<sup>15</sup> on his blog.

## Launch: Pitching Hacks, The Book



<sup>16</sup>Pitching Hacks<sup>17</sup> is here. The PDF is \$19 and you can download it immediately. 83 pages. Buy it here<sup>18</sup>.

### Samples

We've raised \$100 million for startups like Epinions, invested another \$20 million in companies like Twitter, and advised many others. Pitching Hacks shows you how to apply the simple lessons we've learned along the way. Check out these samples:

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<sup>15</sup><http://startupplessonsslearned.blogspot.com/2009/02/lean-startup-at-uc-berkeley-haas-school.html>

<sup>16</sup><http://venturehacks.com/pitching>

<sup>17</sup><http://venturehacks.com/pitching>

<sup>18</sup><http://venturehacks.com/pitching>

## Table of Contents<sup>19</sup> Why do I need an introduction?<sup>20</sup> Can I get investors to sign an NDA?<sup>21</sup>

Many successful investors and entrepreneurs like Marc Andreessen<sup>22</sup>, David Cowan<sup>23</sup>, and Brad Feld<sup>24</sup> have generously contributed passages sprinkled throughout this weighty tome.

Many of the ideas in Pitching Hacks first appeared on this blog — that was our first draft. Thanks to your feedback, we've written this book — a second draft. Please send us more feedback — so the next revision is even better. You can always reach us at [team@venturehacks.com<sup>25</sup>](mailto:team@venturehacks.com).

## Testimonials

Thanks to the beta testers who paid<sup>26</sup> to give us amazing feedback (check your inbox for a revised copy!). They made the book much better. Here are some of their (unsolicited) testimonials:

“Your first stop if raising money!” – Adam Smith, Xobni<sup>27</sup>

“Almost every sentence in Pitching Hacks is a valuable nugget. I thought the book was \*awesome\*, and definitely up to the high standard of quality that

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<sup>19</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/02/pitching-hacks-toc.pdf>

<sup>20</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/02/pitching-hacks-introduction.pdf>

<sup>21</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/02/pitching-hacks-nda.pdf>

<sup>22</sup><http://blog.pmarca.com/>

<sup>23</sup><http://whohastimeforthis.blogspot.com/>

<sup>24</sup><http://www.feld.com/blog/>

<sup>25</sup><mailto:team@venturehacks.com>

<sup>26</sup><http://venturehacks.com/articles/testing-update>

<sup>27</sup><http://www.xobni.com/>

you've already established in your blog." – Travis Leleu, Industrial Interface<sup>28</sup>

"Pitching Hacks is amazing, just packed with great practical advice. A must-read if you're even thinking of raising money." – Luke Groesbeck, JobAlchemist<sup>29</sup>

"I loved the book! I suppose it should be no surprise that a book about articulating ideas clearly and concisely, has managed to clearly and concisely articulate its ideas." – Aaron Iba, EtherPad<sup>30</sup>

"I really truly liked the book. Entertaining and informative read. Can't say that about a lot of business-related books." – Yokum Taku, Wilson Sonsini<sup>31</sup>

See what people are saying on Twitter<sup>32</sup> and buy it here<sup>33</sup>.

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<sup>28</sup><http://www.industrialinterface.com/>

<sup>29</sup><http://jobalchemist.com/>

<sup>30</sup><http://etherpad.com/>

<sup>31</sup><http://www.startupcompanylawyer.com/>

<sup>32</sup><http://search.twitter.com/search?q=pitching+hacks>

<sup>33</sup><http://venturehacks.com/pitching>

# March 2009

## Take a course from the king of customer development

If you want to learn customer development<sup>1</sup>, you can take Steve Blank's course at Stanford, Berkeley, or Columbia. Or you can take his course *right here on Venture Hacks*. I'm taking the course right now and I've posted the audio and slides from the first lecture below.

### Steve Blank



<sup>2</sup>

According to his book, *Four Steps to the Epiphany*<sup>3</sup>, Steve is a “retired entrepreneur who... has been in 8 startups in operational roles from CEO to VP of Marketing... These startups resulted in five IPO’s, and three very deep craters.” Marc Andreessen calls Steve<sup>4</sup> “one of the most strategic thinkers you will find on the

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<sup>1</sup><http://venturehacks.com/articles/customer-development>

<sup>2</sup><http://venturehacks.com/articles/customer-development>

<sup>3</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>4</sup><http://blog.pmarca.com/2007/07/book-of-the-w-1.html>

topic of starting high-tech companies... buy [his book], read it, keep it under your pillow and absorb it via osmosis.”

## The course

In a nutshell, customer development teaches you how to **sell a product before you build it** (or while you build it). Unlike a lot of advice from entrepreneurs, customer development isn’t based on Steve’s experience in a single market — it’s based on his experience in a broad set of markets. His companies have made semiconductors, workstations, enterprise software, supercomputers, computer peripherals, military intelligence systems, and video games.

Customer development also works on the consumer Internet. In 2005, Steve funded IMVU<sup>5</sup> on the condition that its founders take his class. We recently wrote about the results of the founders’ experience in How IMVU learned its way to \$10M a year<sup>6</sup>.

Each lecture is two hours long. Steve’s war stories alone are worth the price of admission. Let me know if you like these lectures and I will post the rest.

## Class 1: Introduction

Audio: Class 1: Introduction<sup>7</sup> (mp3<sup>8</sup>) (Note: I only recorded the last 20 minutes of this class.)

Slides: Customer Development 1: Introduction<sup>9</sup> (pdf<sup>10</sup>)

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<sup>5</sup><http://www.imvu.com/>

<sup>6</sup><http://venturehacks.com/articles/lean-startup>

<sup>7</sup><http://odeo.com/episodes/24218857-Customer-Development-1-Introduction>

<sup>8</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/02/customer-development-1-introduction.mp3>

<sup>9</sup><http://www.slideshare.net/venturehacks/customer-development-1-introduction>

<sup>10</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/02/customer-development-1-introduction.pdf>

## Syllabus

The syllabus lists the readings for each class. The primary text is Four Steps to the Epiphany<sup>11</sup>. Buy it<sup>12</sup>.

Document: Customer Development Syllabus<sup>13</sup> (pdf<sup>14</sup>)

## Mike Maples: “My opinion is interesting, but irrelevant.”

Some recent highlights from our Twitter<sup>15</sup> (RSS<sup>16</sup>) and FriendFeed<sup>17</sup> (RSS<sup>18</sup>):

### Mike Maples

From Mike’s lecture to Steve Blank’s customer development<sup>19</sup> class at Berkeley:

“The first mistake that I see people make when they approach us is, they don’t really have that big of an

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<sup>11</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>12</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>13</sup><http://www.slideshare.net/venturehacks/customer-development-syllabus>

<sup>14</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/02/spring-2009-berkeley-haas-customer-development-syllabus.pdf>

<sup>15</sup><http://twitter.com/venturehacks>

<sup>16</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>17</sup><http://friendfeed.com/nivi>

<sup>18</sup><http://friendfeed.com/nivi?format=atom>

<sup>19</sup><http://venturehacks.com/articles/customer-development>

idea. The second mistake that I see them make is all they have is an idea... How the hell should I know if it's a good idea. I'm not a customer. My opinion is interesting, but irrelevant.”

Mike is the founder of Maples Investments<sup>20</sup>.

## Steve Blank

From another one of Steve's lectures:

“After you've raised money, shut up, put your slides away, stop selling, and start listening to your customers.”

From Four Steps to the Epiphany<sup>21</sup>:

“If you want to get my blood pressure up when you invite me in to see your newly formed startup introduce me to someone with a Business Development title. This is the most ill used and ill-abused title in a startup. By itself this function and title more than likely decreases the probability of success when used early in a startup more than any other single factor. When I hear it used in an early-stage company I question the competence of all involved.”

If we learn one thing from customer development, it is this: Sell it before you build it. Or while you build it.

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<sup>20</sup><http://www.maplesinvestments.com/>

<sup>21</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

## **Paul Graham**

From Startups in 13 Sentences<sup>22</sup>:

“Try making your customer service not merely good, but surprisingly good.”

“Deals fall through... We probably had 20 deals of various types fall through. After the first 10 or so we learned to treat deals as background processes that we should ignore till they terminated.”

From Ideas for Startups<sup>23</sup>:

“Startup ideas are not million dollar ideas, and here’s an experiment you can try to prove it: just try to sell one.”

## **Timothy Fitz**

From Emergent Properties of Continual Automation<sup>24</sup>:

“Every time you repeat a task, make progress on automating it. It doesn’t have to be big... It just has to be progress.”

From Continuous Deployment at IMVU<sup>25</sup>:

“On average we deploy new code fifty times a day.”

Tim is an engineer at IMVU<sup>26</sup>.

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<sup>22</sup><http://www.paulgraham.com/13sentences.html>

<sup>23</sup><http://www.paulgraham.com/ideas.html>

<sup>24</sup><http://timothyfitz.wordpress.com/2009/02/13/continual-automation/>

<sup>25</sup><http://timothyfitz.wordpress.com/2009/02/10/continuous-deployment-at-imvu-doing-the-impossible-fifty-times-a-day/>

<sup>26</sup><http://venturehacks.com/articles/lean-startup>

## Me

From A Note About Sabeer Bhatia's Interview<sup>27</sup>:

"Founders don't do the diligence they should on their investors.

Entrepreneurs should pick their investors like they pick their co-founders: very carefully. It is easier to divorce your wife, kids, and dog than it is to divorce your investors.

During their fund-raising, every entrepreneur meets an investor or two who is apparently God's gift to entrepreneurs: "Oh, you should meet these investors, they are a really great bunch of guys." Of course they're going to be friendly when you have something they want.

An experienced founder once called me to do a reference call on one of his investors. He had already signed a term sheet and was closing the financing. His attitude was "better late than never." He was absolutely right."

Investors who buy a lot of stock and control require the most diligence. Angels require less diligence, VCs require more.

Sundry tweets:

Is Wal-Mart more enlightened than your startup?  
See Life at Wal-Mart<sup>28</sup>.

Memo to entrepreneurs: VCs invest in the markets that entrepreneurs tell them to invest in. Not the other way around.

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<sup>27</sup><http://www.foundersatwork.com/1/post/2009/02/a-note-about-sabeer-bhatias-interview.html>

<sup>28</sup><http://www.boingboing.net/2009/02/01/life-at-walmart.html>

Most startups spend too much time acting and not enough time reflecting. Learning requires both activities.

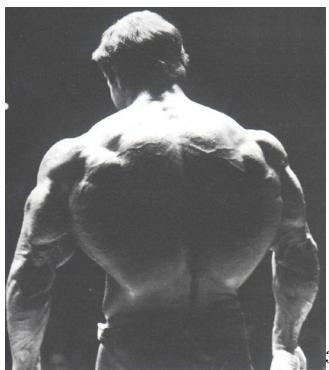
What happens if the CEO doesn't show up to work? Nothing. What happens if the team doesn't show up to work? Nothing.

## Humor

“Sony Releases New Stupid Piece Of Shit That Doesn’t Fucking Work” – The Onion<sup>29</sup> (video)

“We live in an amazing amazing world and it’s wasted on the crappiest generation.” – Louis C.K.<sup>30</sup> (video)

“My back is a weapon I use to destroy my opponents... only the very best of bodybuilders can stand beside me... without being blown offstage by the shock wave.” – Mr. Universe 1976<sup>31</sup>, on pitching



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<sup>29</sup>[http://www.theonion.com/content/video/sony\\_releases\\_new\\_stupid\\_piece\\_of\\_shit](http://www.theonion.com/content/video/sony_releases_new_stupid_piece_of_shit)

<sup>30</sup>[http://www.kk.org/thetechnium/archives/2009/02/so\\_amazing\\_but.php](http://www.kk.org/thetechnium/archives/2009/02/so_amazing_but.php)

<sup>31</sup><http://juniorplenty.com/>

<sup>32</sup><http://juniorplenty.com/>

Subscribe to our Twitter<sup>33</sup> (RSS<sup>34</sup>) and FriendFeed<sup>35</sup> (RSS<sup>36</sup>).

## The Venture Hacks Podcast

A lot of people have asked us to post the rest of Steve Blank's customer development classes<sup>37</sup>. Thanks for the feedback — we're glad you like the course and we'll post more classes over time.

Podcast-lovers can also receive Steve's course as a podcast. Just use your podcasting client to subscribe to our feed:

[feeds.venturehacks.com/venturehacks](http://feeds.venturehacks.com/venturehacks)

If you use iTunes, this link<sup>38</sup> should work automagically. If it doesn't, cut-and-paste the URL above into iTunes like this:

### Step 1

### Step 2

The podcast also includes any audio or video we post on Venture Hacks, such as Eric Ries' presentation on lean startups<sup>39</sup>.

## Class 2: Three types of markets

*Our first post<sup>40</sup> about Steve's course included two classes (and two MP3s). Some podcasting clients can't handle two MP3s in a*

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<sup>33</sup><http://twitter.com/venturehacks>

<sup>34</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>35</sup><http://friendfeed.com/nivi>

<sup>36</sup><http://friendfeed.com/nivi?format=atom>

<sup>37</sup><http://venturehacks.com/articles/customer-development-course>

<sup>38</sup>`javascript:void(0);`

<sup>39</sup><http://venturehacks.com/articles/lean-startup>

<sup>40</sup><http://venturehacks.com/articles/customer-development-course>

*single post. So we've moved the second class and its MP3 here.*

Audio: Customer Development 2: Three types of markets<sup>41</sup> (mp3<sup>42</sup>)

Slides: Customer Development 2: Three types of markets<sup>43</sup> (pdf<sup>44</sup>)

## How to be an angel investor, Part 2

Naval<sup>45</sup> and I recently put together a talk for AngelConf<sup>46</sup>, a conference for new angel investors. The conference was organized by Y Combinator<sup>47</sup> and included an great group of notable angels like Ron Conway. According to the AngelConf website,

“Investing in startups seems mysterious and difficult. How much are you supposed to invest? What legal agreements do you need? Where do you find startups to invest in? How do you pick winners?”

People liked Naval’s presentation — Dave McClure called it an “awesome fucking talk<sup>48</sup>,” and other tweets<sup>49</sup> seemed to agree.

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<sup>41</sup><http://odeo.com/episodes/24238119-Customer-Development-2-Three-types-of-markets>

<sup>42</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/02/customer-development-2-three-types-of-markets.mp3>

<sup>43</sup><http://www.slideshare.net/venturehacks/customer-development-three-types-of-markets-10451>

<sup>44</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/02/customer-development-2-three-types-of-markets.pdf>

<sup>45</sup><http://www.startupboy.com/>

<sup>46</sup><http://www.angelconf.com/>

<sup>47</sup><http://ycombinator.com/>

<sup>48</sup><http://twitter.com/davemclure/statuses/1285693786>

<sup>49</sup><http://search.twitter.com/search?q=%23angelconf+naval>

So we thought you might like it too — it's good advice for investors and entrepreneurs alike.

Paul Graham from Y Combinator wrote up his talk in a wonderful essay called How to Be an Angel Investor<sup>50</sup>. So we're calling our presentation "How to be an angel investor, Part 2".

Slides: How to be an angel investor<sup>51</sup> (pdf<sup>52</sup>)

Audio: How to be an angel investor<sup>53</sup> (mp3<sup>54</sup>)

## Transcript

*Here's a transcript of the conversation. I've highlighted some of my favorite bits.*

**Nivi:** Hi, this is Nivi from Venture Hacks.

**Naval:** And this is Naval from Venture Hacks.

**Nivi:** Naval recently gave a talk at Y Combinator's AngelConf on how to be an angel investor and we thought we would record it — people liked the talk — and we thought we would record a slightly longer version and put it online.

Naval's going to do most of the talking and I'm going to jump in with a question or a comment.

## Naval Ravikant

**Naval:** So, I've been in this business for a little while now, been involved with starting about seven companies, been an

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<sup>50</sup><http://www.paulgraham.com/angelinvesting.html>

<sup>51</sup><http://www.slideshare.net/venturehacks/how-to-be-an-angel>

<sup>52</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/03/how-to-be-an-angel.pdf>

<sup>53</sup><http://odeo.com/episodes/24338408-What-is-the-minimum-viable-product>

<sup>54</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/03/how-to-be-an-angel.mp3>

investor as an angel or a VC in well over 30 companies and been an advisor to over a dozen companies, and of course co-author Venture Hacks with Nivi.

After a while, you do enough of this and you start pattern matching — you notice a few things — and so I've put those together here and I'm using those to help out people who may want to get into the angel investment or even early stage venture business.

## **What do you need to be an Angel?**

**Naval:** Basically, to be in the angel business you absolutely have to have three things — to be in the business and to do well. First of course, is access to capital: either you own or you manage to raise the funds or somebody just gives you money.

You need good dealflow and by good dealflow, I mean, proprietary or a high-quality dealflow that not everybody has seen or you have some unique ability to get in to. There has to be some reason why people will take your money instead of somebody else's. Otherwise at the end of the day, you are commoditized and you get bid out of the game.

Finally, you need good judgment. Access to capital you either have or you don't. If you don't have it, then you probably shouldn't be in the angel business, you're just wasting people's time. If you have good judgment, everybody thinks they have, and it takes about 10 years to figure that out so I can't really help you there.

## **Dealflow**

**Naval:** So, what I'm mostly going to focus on is dealflow, which is how do you find good dealflow, how do you process it efficiently, how do you get into good deals, how do you evaluate

them? When it comes to dealflow, there are a lot of bad kinds of dealflow and there's some good dealflow. Early on, you will be seeing very few deals and you'll just be trying to get in the dealflow.

After you've made a few investments, you've got a few entrepreneurs who know what you're doing, you have built a bit of a brand, you've connected to the other angels you will have too much dealflow, and you will quickly have the opposite problem. If you raise your hand and you say to the world, "I can write a check", the world will beat a path to your door.

I'm going to help you with an odd problem, which is helping you filter the bad dealflow as well. So, you're going to get a lot from your social friends, these are the people whose kid goes to school with your kid or someone you just hang out with.

Most of this dealflow, although you should be polite and you should see it, you're going to have learn how to say no without taking a meeting, otherwise you're going to find your time chewed up very quickly because these people are not in the business, they don't have the same filters that you do, and they will pass along anything that looks like a company that's raising money.

**You, yourself, are going to be tempted to do the same thing and forward deals to other angels. Don't ever forward a deal you wouldn't do yourself.** Nivi: Or you're not seriously considering.

**Naval:** Yes. It's going to hurt your credibility, and it's also going to also waste the entrepreneur's time. The first thing any serious investor will ask you if you, yourself, are an investor and you forward a deal and say "Are you investing?" You don't want to hem and haw at that point.

You either want to say "Yes, I'm seriously considering it and I'm in the middle of my evaluation process" and you should mean it

or you should actually be doing it. Those are kind of the only two legitimate answers.

If an entrepreneur asks you to forward a deal that you have passed on, your best approach is to politely explain to them that, it does not make sense for you to do so as it would send a very negative signal.

**Nivi:** Yeah, and if you're an entrepreneur in that situation, I would actually ask for some names of potential investors and tell the angel that just turned you down that you're not going to use their name to reach out to these people, but you just want to get a list of names to find some other prospective angels to reach.

**Naval:** Yeah, that's a very good point. A lot of angels know a lot of other angels, you get a list of names then you have to sift through your own resources and frankly, you browse through your LinkedIn and your Facebook networks. If you've been around in Silicon Valley for a little while, you can usually find someone who knows someone.

Finally, one issue that crops up a lot when people first get into investing is, they think they're going to add their value in some unique process-oriented way, and so they come up with non-standard models. One could be incubation; another one could be acting CEO or so on.

They kind of say, "OK, I'll put in some money and then I'm going to be super-active, and I want this and that and I'm going to take more stock into that." I would suggest not doing that. Certainly you can offer it to people you know well, and certainly people can ask you for additional help or these kinds of non-standard deals, but they have two problems.

One is if you end up taking too much equity early on. It makes the company difficult to fund by VCs down the line. Secondly, it will lead to an adverse selection case, where if you're putting out

your services as a rent-a-chairman or a rent-a-CEO, you're going to see the companies that are so desperate raising financing where they won't entertain that notion.

Most really great entrepreneurs, yes they could use some advice and they'll listen to it, but they don't need you to run their company for them. So be careful about that adverse selection trap and be prepared that with some of the very, very best companies, your only value-add is essentially will be your money plus a few connections and a little bit of advice here and there.

**What's good? Deals that come from other angels who are doing them are usually very good. You build these up by quid pro quo. If they send you deals, you send them deals back and vice versa. Branding your advisory services is very good.** So if you have particular domain expertise, you are the founder of a company that was successful in a certain space, then you should be able to brand yourself in such a way that you will see the companies in your space.

Another way to brand yourself would be through some kind of a horizontal play. If you're a marketing genius for consumer web companies, then people may come to you for help on that.

**Nivi:** Yeah. So, here are a few examples of that. The way that Naval put it at AngelConf was Paul Buchheit is the Gmail guy; Naval, himself, is the Venture Hacks guy and he's also an expert on viral marketing and Facebook, and Paul Graham is Paul Graham. Those are the kind of examples you want to try to follow.

## Pitches

**Naval:** So, let's assume you've worked out this incredible dealflow pipeline and you're getting a lot of companies that are coming to you. You want to get through them relatively efficiently. What

you will find very quickly is that most business plans, executive summaries are a waste of time.

You can't sign NDA's, because doing so exposes you to far too much down the road. So what you really need is very high concept pitch where somebody explains to you, "we are this for that" like an analogy...

**Nivi:** Friendster for dogs.

**Naval:** Exactly. Dogster. Maybe a short 10 slide deck. If somebody comes to pitch you, don't schedule hour-long meetings, you don't need an hour to figure it out.

Usually within 20 minutes, is enough for the company to get their points across and you should not be pitching yourself at this point. First, you should just be listening; you can always pitch yourself a little bit later.

**Nivi:** I would say a high-concept pitch, like Friendster for dogs is great. One paragraph, or a couple paragraphs elevator pitch in email form is great, and if the company has it, a 10 slide deck. **Of course, more important than any of that is a working demo or screen cast or mock-ups or some realized version of the product.**

**Naval:** Generally, it's a poor sign if a start-up comes to you, especially if they're on the web, or consumer web, or iPhone, or one of these spaces where it's pretty easy to hack something out and they haven't put together a prototype or they haven't, as Nivi would point out, made early and meaningful contact with the customer.

**Nivi:** Which can be done through things like surveys, as well, right? If its offline and it involves hardware or whatever, they could have gone out and talked to the customer via surveys or interviews, or they could have spent the last 10 years of their life working with that exact customer and know them inside out.

## Evaluating Startups: Team

**Naval:** So, now when it comes to a valuable startup, you've got the short pitch, you've taken the half-hour meeting. There are times when you can eliminate the startup on the basis of team; this is not, obviously, fool-proof. Investing is not a science, it's an art.

But here are some general rules of thumb I've developed over the years, which helped me, filter dealflow. One of those is that usually the optimal configuration for a company, in terms of the founder basis, two to three founders and three is the max.

Five is a very unstable configuration, eventually it will fall apart. You cannot have five cooks in the kitchen.

**One is too difficult. The person gets too lonely and it gets too difficult to continue on, because they don't have a thought partner. So two to three turns out to be ideal.** If you look at the very, very successful companies in the Valley, Apple had Steve Jobs and Steve Wozniak; Microsoft up in Seattle had Bill Gates and Paul Allen and later on Paul Allen dropped out, they had Steve Ballmer and of course, Google had Larry Page and Sergey Brin; even Oracle had Larry Ellison and quickly thereafter had Ray Lane.

So generally, you need teams of two founders at least. **You want someone in the company who can build and someone who can sell and if there's going to be an imbalance; it should, probably, be in favor of the builder.**

Of course, it depends on the exact company, but you would rather be investing in a startup that has two builders and one salesperson, rather than have two sales people and one builder.

Generally, you want to say no to companies where the founders are all lawyers or all business guys and they don't have the product development expertise to back them up or where they are outsourcing the product development completely.

Companies that outsource product development completely, generally have a hard time iterating and keeping up with the changes in the market and the competitors.

One learning that I've found the hard way is that is that, especially in consumer web deals, traction matters more than anything. It's very hard to predict mass consumer behavior. It's a very efficient market out there.

So, it's good to find real customer adoption before you put too much money to work, whereas in enterprise deals, where you are selling to a small number of large customers, the team can make a meaningful difference.

**Nivi:** One thing on the topic of a guy that can sell; it doesn't have to be your conception of a prototypical salesman or a car salesman or whatever. If you are in a one-on-one meeting with Bill Gates, even though he is a complete nerd, you would be extremely compelled by whatever he has to say to you.

So in that sense he is a salesman, right? A lot of nerds in their nerdiness can actually be extremely compelling in the proposition that they are trying to put in front of you.

**Naval:** Yes, by salesman, I don't mean the bag-carrying enterprise sales quota matching guy. It's exactly as Nivi said, people who are compelling and who can convince early customers to sign up, through whatever means possible. They can convince early employees to sign up when the company has very little cash. They can convince early investors to sign up.

**In fact, usually if someone can sell you in an investment meeting really well, and you walk out dizzy, saying I don't really get the product or this space, but this guy almost sold me. That's a good sign.**

**Nivi:** Yes, that in and of itself is an asset in terms of being able to sign on customers, employees, other investors, and so on.

**Naval:** One other thing to think about is when you are evaluating companies at an early stage, the appropriate title for the people in the company is usually founder, or engineer, or things of those sort.

If you see a company that's very top-heavy, has its CEO, its CFO, VP of this, SVP of that, then it's usually a bad sign. It means that the people involved are more interested in building up impressive titles for themselves or building a large organization than they are in having a successful product and a good financial outcome.

**Nivi:** Yes, we want builders.

**Naval:** In evaluating entrepreneurs, Warren Buffett often says that when he looks at the company he buys, and very often these are multi-billion dollar companies, he's looking for intelligence, energy, and integrity. I find that the same criteria works extremely well in evaluating start-up founders also.

Intelligence for obvious reasons.

Energy because drive and passion are the number one predictor of an entrepreneur's success, and it's not actually intelligence in that case.

And integrity is paramount, because if you have someone with high intelligence and high energy, but they don't have high integrity, you've basically got a hard-working crook. You don't want to be associated with that. In fact, you prefer lazy, dumb crooks to hard-working smart crooks.

**Nivi:** Yes. They will have many opportunities to screw you, if they don't have any integrity.

## Evaluating Startups: Customers et al

**Naval:** So, intelligence and integrity I would not compromise on any of the three.

Similarly, we talked a little bit about teams. Let's talk about the customers. **As we talked about earlier, you don't want to invest in companies that have made no contact with the customer yet whatsoever.**

For an enterprise software company, it might be surveys; it might be a few big customers' meetings references. For a web company, it usually means the product has been released or some facsimile of it has been released and tried out.

You definitely want to look at a lot of companies, before you make early investments. The usual failure mode for individual angel investors is that they invest too early and too quickly. Part of this is you don't have a partner who can veto you.

Venture funds are deliberately organized, in such a way that there are a lot of experienced people saying no to the new guy's urge to go invest in the first hot thing he finds.

In angel fund, I would suggest that you be disciplined either by numbers, so say to yourself, I'm not going to make an investment until I see at least twenty companies. One hundred might not be a bad number. In a busy year, I'll easily see four, five, six hundred companies.

An even better approach might be to find some experienced angels that you team up with and give them an effective veto. No matter how much you like the deal, if you can't talk them into it, don't do it.

**Nivi:** Yes, and along those lines, you could just say, I'm not going to invest in any deals that these five notable angels are not also investing in for my first couple of companies.

## Saying No

**Naval:** So, saying no is something that you are going to be doing far more often than saying yes. So, let's get that out of the way. You have to learn how to say no, you have to learn how to turn down people.

It's uncomfortable, but usually people appreciate a quick and up-front and reasoned no, with some good advice and hopefully a little bit of help attached to it, than they do a dragged out long process where at the end then you hem and haw and have to say no.

**So, the best time to say no is before you take a meeting.** If some of these deals fail your filters, or if you just can't see yourself getting excited about the company or the business, say no over email before you meet.

If you hear the pitch, and it is not compelling, take five minutes out after the pitch, talk about it, think about it, and then say no to the entrepreneur before they even leave.

Since angel deals tend to be pretty small, you are investing tens or hundreds of thousands of dollars, you don't want to drag it out over months. You don't want to take weeks of the entrepreneur's time. You don't want to cause them to generate additional documents or write code just for you.

So try and be efficient about it. **Don't spend more than a couple of hours of their time, or if you had to noodle on it yourself for more than a few weeks, then it probably isn't right for you.**

Warren Buffett makes two really good points. Actually, Ron Conway lists one of them at the angel conference, which was don't invest in people that you really aren't excited about working with, because at the end of the day, the business model will change. The details will change. The company's progress will change.

**The only constant will be the person you invested in. If you don't like to take their phone calls, if you don't like to sit down there and talk to them all the time, then eventually you are going to see the deal as a burden.**

You will eventually run out of time. So, it's very important that you only pick the people that you want to work with. I just can't emphasize that enough. It sounds like an easy thing to say, and hard to follow, but in reality, you will find that it will make all the difference in the long term. **The other thing that Buffett points out is that this is a game where the swings that you don't make are not counted against you.** You just have to find a few hits, and if you let a lot of hits go by while you are waiting for the perfect pitch, that's absolutely fine. So, when in doubt, just say no.

Since the angel community is very small, the entrepreneur community is very small, your reputation is everything. So, it's very important that you try and add value to every company whether you invest in them or not.

If they took the time to present to you, and they paid you that honor, then you should take the time to maybe make an introduction or two for them, or give them some useful, honest advice. Generally, it's not a good idea to try and withhold your capability to help them too much, just because you did not make an investment.

Navi: Yes, and that is where your area of expertise, whether it is raising money or marketing or Facebook or whatever, can really shine right at the end of a meeting.

## Saying Yes: Terms

**Naval:** So, let's talk about the terms for a moment. So, let's say you've processed a huge amount of deals, you've found a company that you want. You've said no to the ones that you

don't want. You want to make an investment. **Some things to keep in mind is that one of the biggest risks of angel investing is the downstream financing risk.**

You may look at a company and say, I could see this being a small but highly likely exit. That's not initially a great company for you to invest in. The danger there is that a lot of companies use up cash very quickly, they run out of cash. You don't want to put money after your own investments, because you are obviously now a biased investor.

And VCs always evaluate things in terms of their huge market potential, as VCs have very large funds. It ends up being a little bit of what the economists call the Keynesian beauty contest, which is you pick a winner based on who you think the judges are going to pick to win in the next round.

So, you are not initially picking the most beautiful start-up, you are picking the start-up the judges are most likely to pick. So, it is a dead-end trap to finance too many companies that don't have the possibility of turning into something huge somewhere down the line.

One way to mitigate that is to co-invest with other venture capitalists. This is where you're an angel, you're putting a small amount of money and the VCs are putting in most of the money.

The issue there is that VCs are ownership sensitive. They want to own a lot of the company, but they tend not to be as price sensitive as angels because they have lot of money to throw around. So, one way to mitigate that is to give the VC some different rights that you don't care about, such as the ability to invest more money the next round, and in exchange keep the valuation lower for you as the angel of this round.

Another opportunity for some superstar angels, or if you are taking a very active role in the company, is you might be able to get a little additional advisory stock, relative to the amount you invested.

**Nivi:** Just to be clear on Naval's concern, his concern is that the seed round — that VCs get involved — ends up being for a lot of cash coming in at the high valuation. That makes it economically uninteresting for you as an angel investor, because you will end up owning a very small slice of the company because the valuation will be high.

So his suggestion, if I understand it right, is you basically give the investors — you do the round at a low valuation, you have a reasonable amount of cash coming in, the VCs co-invest, and what you give them is basically an option to invest in the next round. Is that right?

**Naval:** That's correct. And in fact, another point of the economics is a lot of first-time angels, especially when investing their own money, tend to invest in what are called "uncapped debt." So they're put in a convertible note at a 20% discount to whatever the next round is going to be.

That's an extremely uneconomic proposition. The odds of a startup going out of business are far greater than 20%, or the 16% that would be required to cover your investment. In fact, there are corporate bonds trading in the public markets today that are yielding 15-16%. So they are far more liquid with companies that are far better capitalized.

Generally, you're looking for a 3X, 4X, 5X increase in valuation between rounds, which means you are price sensitive. So it's OK to do a convertible note because that's often simpler for everybody involved, from a legal perspective. But you generally want to establish a conversion price cap, which pays you back for the risk that you're taking at this stage.

**Nivi:** One thing, just going back to the VC thing, from the perspective of an entrepreneur, if I have VCs investing in the seed round, the issue that it creates for me is that if those VCs don't want to invest in the series A, it makes it very difficult to do the series A, because the inside investors who know the

company best are basically saying the company is not a venture investment.

**Naval:** One other point about investing with groups. A good reason to invest with other angels, no matter how much you like the company, is that stuff always goes wrong with a startup. And when stuff goes wrong, very often the entrepreneur can make the choice to walk away, especially if the company has a very small amount of money invested.

Or the entrepreneur can choose to do something that would be adverse to you, because you're a minority shareholder without a lot of the protections that VCs often have. If you're in a group of angels, you are much more likely to have a good outcome in that situation.

An entrepreneur is much less likely to walk away, if there are five good angels as investors than if there's only one. An entrepreneur is less likely to change the terms that are adverse to you, if you're with four other angel investors rather than if you're alone.

One way in which, if you're an angel investor, you can squander a lot of time is if you're board seats. Essentially if you're taking board seats, you're going to be limiting yourself to only being able to handle five, six, seven investments, which may not be enough for you to achieve the portfolio affect that you need for the economics to work.

If 1-out-of-20 to 1-out-of-30 angel investments work, and you can only make five because you've taken board seats and your time is full, then your economic model is in trouble, and you would have to augment it by sprinkling around a lot of companies where you almost spend no time with them.

Board seats are really only worthwhile taking if you're getting paid for it, if you have some unique and proprietary insight to the company and its market — maybe you started a company in a similar space that did really well — or in that unique case

where the company is just someone who is very, very close to you.

Otherwise, realize that boards spend a lot of time on corporate governance issues, which often isn't the best use of your time.

**Nivi:** Yeah, I mean, you can simply advise the company. You don't have to be on the board to advise the company. The other downside is if you're not willing to leave the board whenever the company asks you to, you can screw up their series A investment, because VCs don't want to come into a company, which has a random guy who was one of the angels on the board of directors.

**Naval:** Yeah. It depends on who the angel is, of course.

**Nivi:** It depends, yeah.

In terms of how much of the company you want to buy, you're not going to end up with 40% or 50% of the company after an angel or seed round.

You should be thinking more in terms of 5%, 10%, 20%. Capital that is coming into the company is \$25K, \$50K, \$100K, up to \$250K, the valuations that you're looking at are going to be in the \$0.5 million to \$2 million dollar post-money valuations.

The way you justify the company's valuation isn't on the basis that the company is actually worth that much money, in the sense that somebody would buy the company for that price today. The way you justify it and the way entrepreneurs justify it, is through dilution.

You need to leave enough of the company in the hands of the entrepreneurs who are the guys who are creating value for you and for themselves alike, to be incented to create value for the two of you.

If after the first round they own less than half the company, and there are three more rounds of financing coming along over the

next five years, they're not incented to create value for you or for themselves.

So that's where you end up with the angels or the seed investors owning somewhere between 5% and up to 20% of the company after a seed round.

The other way entrepreneurs justify the valuation is just through a market clearing price. Things are worth what people pay for them, and as long as someone is willing to pay \$2 million post money for a company, you have to pay the same price, either if you want to invest alongside them or you want to outbid them.

## Economics

**Naval:** So let's talk about the economics a little bit. Think of yourself as a patron of the arts. If you were in 16th or 17th century Italy, you would be investing in paintings and sculptures. You're doing the same sort of thing now. You're not really in this so much to make money, as you are to help the next batch of entrepreneurs get to where you got to.

It's unlikely that most of us as entrepreneurs would have been successful and gone up in value, without angels as investors, and now you're giving that opportunity to the next young batch. And I say that because it's very difficult to make money in this business.

The hit rate is extremely low; the economics are tough because on the really interesting companies it gets bid up by the venture capitalists.

And very often even if you find a hit company and you manage to get a piece of it early on by making an investment, very often you can get wiped out if there's a bump in the road down the line and you don't have the capital to pony up.

So think of yourself as a patron of innovation. You'll sleep a lot better at night, if you assume your investments are lost on the day that you make them. And I'm not the only one to say that. At AngelConf, I think most of the professional angels, including the ones who had been in it for a long time like Ron Conway, made that point.

And your personal portfolio, outside of your angel investments, should be balanced with ultra-safe investments. Nassim Taleb, the author of "Fooled by Randomness" and "The Black Swan," advocates having a 10% ultra-risky portfolio, in other words, looking for a positive "black swan." And the other 90% being in T-bills and cash and equivalent safe investments.

But it's an extremely rewarding business in the sense that you get to work with very, very bright people who are young, full of energy and fire. They show up and they tell you everything they've learned about a topic, that they're deeply passionate about, in a short period of time. So the learning curve is high.

It's extremely fun, but if you're not careful you can lose a lot of money and annoy people.

**Nivi: I don't think that I've been involved in a company that somewhere along the way was not catalyzed by an angel investor or a seed stage investor.** I don't know if that's the case for Naval or not.

**Naval:** I have, but usually the ones that had good angel investors worked out much better. In the angel case, as an entrepreneur, you can get the advice and help and connections that you look for out of a VC but you can get it with much less dilution and much less capital and, most importantly, much less control over your company.

If you're really looking for good advisors, it's usually a much better idea to go and get a couple of angels than it is to raise a big VC round. If you need a lot of capital, because you have

something that you've figured out is working and you want to scale it, that's when venture investment makes sense.

**Nivi:** Yeah. One way to think of yourself as an angel is, as basically an advisor that pays for the privilege of advising a company, and in the process gets a little chip in the business, in the case that the company happens to be a Google or a sub-Google like exit, Skype, MySpace or whatever.

**Naval:** And to echo a point that Paul Graham made a long time ago, the best, highest quality people that you want involved in your startup are usually already pretty successful. You're not going to be able to recruit them as employees, you probably won't even be able to bring them on as advisors for small amounts of equity.

The only way that those people will participate in your businesses is, if they have a meaningful stake.

And you don't want to give huge stakes to a person just for a few words here or there where you don't know what the value will be down the line, no matter how famous or how successful they are. So the way the market clears is they get to invest in your company.

## Venture Hacks

**Naval:** If you have any questions about this or if you would like to talk more about it, feel free to contact us at [founders@venturehacks.com](mailto:founders@venturehacks.com). We'd also like to know if you're an angel investor who's available to invest capital and what your profile is.

So feel free to email us with that and we will try to show you interesting companies. What we would ask is that you tell us how much capital you have to invest, how much you're looking to put to work, and what your particular areas of expertise are.

## Don't launch? But the New York Times is on the phone!

Before you continue, read Eric Ries' excellent Don't launch<sup>55</sup>, where he questions the assumptions behind most marketing launches.

If you ask most entrepreneurs why they want to launch, you'll get an answer like, "So people find out about my product — are you stupid?" But a thoughtful founder who read Eric's article recently asked me,

*The New York Times wants to write about my company. It will take me no time or money to get this press. What should I do?*

You should still consider the downsides of launching:

1. Launching a product that doesn't solve a real customer problem establishes the wrong positioning<sup>56</sup> in the minds of customers.
2. You can only launch once. If you launch the wrong product or you have an un-optimized funnel<sup>57</sup> when you launch, you just wasted a one-time opportunity to harvest and generate demand<sup>58</sup>.

Launching isn't the only way to harvest demand. You can reach customers through customer development<sup>59</sup>: AdWords, search engine marketing, online ads, contacting prospective customers through LinkedIn, *et cetera* — get creative. Don't launch just because everybody else is doing it — be thoughtful.

Generally, you don't want to launch until,

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<sup>55</sup><http://startuplessonslearned.blogspot.com/2009/03/dont-launch.html>

<sup>56</sup><http://www.quickmba.com/marketing/ries-trout/positioning/>

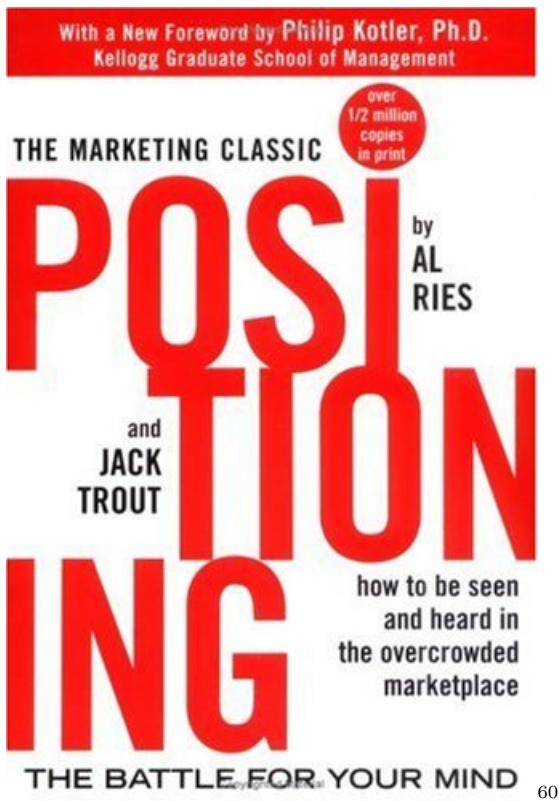
<sup>57</sup><http://startup-marketing.com/launch-your-startup-with-a-trickle/>

<sup>58</sup><http://startup-marketing.com/demand-harvesting-the-easiest-driver-for-startups/>

<sup>59</sup><http://venturehacks.com/topics/customer-development>

1. You've verified a customer's problem by taking money out of her pocket.
2. You've optimized your funnel so the money you spend on the launch yields the highest possible return on investment.

*But doesn't the traffic we get from customer development have the same problem as the traffic we get from a launch?*



Yes. In both cases, (1) you're going to mis-position our product, (2) you're going to sell a product that probably doesn't solve a problem, and (3) you're going to have a funnel that's sub-optimal.

The leads you get from customer development and the leads you get from a launch are going to have the same problem. But when you launch, there's a difference in what you do to the customers who *don't become leads*.

<sup>60</sup><http://www.quickmba.com/marketing/ries-trout/positioning/>

When you harvest demand through customer development, every consumer you contact is engaged with your product — for example, they visit your landing page. So you can learn from them. If you observe these customers and execute a feedback loop<sup>61</sup>, you can improve your product, positioning, and funnel. It's okay to expose these customers to the wrong product, positioning, and funnel as long as you learn from them. In fact, that's the only way to test your hypotheses.

But when you harvest demand through a launch, you position your product in the minds of many customers who *don't* engage in your product. They're not interested in your product yet; perhaps they're later adopters. But they still read your *New York Times* article and remember that "Technorati tracks blogs"<sup>62</sup>. They don't come to your website or call you, so you can't learn from these customers. You're imprinting the wrong positioning in the minds of these customers, but you're not learning anything from them.

*You can learn from the leads you get from the press and you can learn from the leads you get from customer development. But when you launch, there's a difference in what you do to the customers who don't become leads.*

And by the time you do want to launch, you may be the business that "collects, organizes, and distributes the global online conversation"<sup>63</sup>. But everyone who read your article in the *Times* still thinks you're in the blog tracking business. It's tough to change your positioning in their minds and the *Times* won't be interested in helping you fix your positioning because they already "launched" you. Do you have a clear idea what Technorati<sup>64</sup> does anymore?

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<sup>61</sup><http://venturehacks.com/articles/lean-startup>

<sup>62</sup><http://www.nytimes.com/2006/10/16/technology/16blog.html?scp=1&sq=technorati&st=cse>

<sup>63</sup><http://technoratimedia.com/>

<sup>64</sup><http://technorati.com/>

***How did people come up with the idea of a launch in the first place?***

Before the Web, it was a lot harder to harvest demand for products. Distribution channels like the shelves at K-Mart were locked up by big companies. Television commercials were expensive. Large newspaper ads were expensive. It was hard to set up and track small ads in newspapers and the Yellow Pages.

So I think young companies routed around these channels by going to the press, which consisted of a small number of influential newspapers. Startups harvested demand for their products by getting the press to write about them.

These days, we can harvest demand through customer development — we don't need to launch. So we usually reserve a launch for (1) generating demand from people who have a problem but don't know they have the problem and (2) harvesting demand from people who know they have a problem but aren't actively looking for a solution.

***How do I deal with a reporter who wants to write about our company?***

First, the press will often approach you for a comment. Second, we're no experts on working with the press, but here are some untested hypotheses.

Try saying, “We’re not ready for press yet. We would prefer if you didn’t write a story about our product right now. In exchange, let me tell you about what we’re ready to have you print right now. And we’ll put you on the very short list of people we contact when we launch.”

If that doesn’t work, try giving them a teaser, “In exchange, we’ll give you exclusive information about the company that you *can* write about...” The exclusive shouldn’t imprint your positioning in the minds of readers. Try something like, “we just hired Bill

Gates.” The exclusive might generate too much hype but, at this point, you’re controlling the situation as well as you can.

If that doesn’t work, try showing them something that no one outside the company has seen, “This is off-the-record, but I want to show you this cool demo, and we will give you an exclusive when we launch it.”

### ***Where can I learn more?***

Read Sean Ellis<sup>65</sup>, blog on Startup Marketing<sup>66</sup>. He has launched two companies that have filed for IPOs and he now works with Dropbox, Xobni, and other startups. Sean says, “I am insane enough to believe that I can change the way most VC backed startups are launched.”

Here’s a presentation from Sean to get you started:

Slides: Startup Marketing<sup>67</sup> (ppt<sup>68</sup>)

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<sup>65</sup><http://startup-marketing.com/about/>

<sup>66</sup><http://startup-marketing.com/>

<sup>67</sup>[http://www.slideshare.net/seanellis/marketing-plan-for-web-20-startups-presentation?  
src=embed](http://www.slideshare.net/seanellis/marketing-plan-for-web-20-startups-presentation?src=embed)

<sup>68</sup>[http://venturehacks.com/wordpress/wp-content/uploads/2009/03/  
gotomarketprocesspresentationforslideshare11208-122565320927-phpapp03.ppt](http://venturehacks.com/wordpress/wp-content/uploads/2009/03/gotomarketprocesspresentationforslideshare11208-122565320927-phpapp03.ppt)

## The king of customer development starts a blog (and tweets too)



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Steve Blank, the king of customer development<sup>70</sup>, has started a blog at [steveblank.com](http://steveblank.com)<sup>71</sup>. And he's on Twitter too: @sgblank<sup>72</sup>. Steve is one of the great startup mentors of all time and he is using his blog to share 30 years of Silicon Valley war stories. Start at the beginning, and read every word he writes.

According to his book, *Four Steps to the Epiphany*<sup>73</sup>, Steve is a “retired entrepreneur who... has been in 8 startups in operational roles from CEO to VP of Marketing... These startups resulted in five IPO’s, and three very deep craters.”

Marc Andreessen calls Steve<sup>74</sup> “one of the most strategic thinkers you will find on the topic of starting high-tech companies... buy [his book], read it, keep it under your pillow and absorb it via osmosis.”

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<sup>69</sup><http://steveblank.com/>

<sup>70</sup><http://venturehacks.com/articles/customer-development-course>

<sup>71</sup><http://steveblank.com>

<sup>72</sup><https://twitter.com/sgblank>

<sup>73</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>74</sup><http://blog.pmarca.com/2007/07/book-of-the-w-1.html>

Steve's theories are elaborate, thoughtful, and thorough. Most important of all, they're based on 30 years of success and failure — they're tested, not hypothetical.

A few people in the world have built big companies. Even fewer have done it many times. And even fewer can teach us how to do it. Now it's up to us to learn.

Here's a snippet from one of Steve's posts, There's a Pattern Here<sup>75</sup>, to get you started:

“So what is it that makes some startups successful and leaves others selling off their furniture? Simply this: startups are not small versions of large companies. Yet the processes that early-stage companies were using were identical to that of large corporations. In hindsight it appeared clear that startups that survive the first few tough years do not follow the traditional product-centric launch model espoused by product managers or the venture capital community. Through trial and error, hiring and firing, successful startups all invented a parallel process to product development. In particular, the winners invent and live by a process of customer learning and discovery. It's a process that doesn't exist in large companies with existing customers and markets. But it is life and death for a new venture.

“I call this process “Customer Development,” a sibling to “Product Development,” and each and every startup that succeeds recapitulates it, knowingly or not.

“The “Customer Development” model is a paradox because it is followed by successful startups, yet articulated by no one. Its basic propositions are the

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<sup>75</sup><http://steveblank.com/2009/02/23/theres-a-pattern-here/>

antithesis of common wisdom yet they are followed by those who succeed.”

## What is the minimum viable product?

Eric Ries<sup>76</sup> and I recently sat down to talk about minimum viable products: the product with just the necessary features to get money and feedback from early adopters.

The minimum viable product (MVP) is often an ad on Google. Or a PowerPoint slide. Or a dialog box. Or a landing page. You can often build it in a day or a week.

I recorded the interview and synchronized it with some simple slides below. That's my favorite way to consume the audio. You can also find a transcript and stand-alone audio below. Eric also highlighted some excerpts from the conversation on Lessons Learned<sup>77</sup>. Let me know what you think — I'm especially interested if you like the synchronized audio and slides.

In Part 2 of the interview, we discuss opening board meetings to the entire company<sup>78</sup>.

Slides: What is the minimum viable product?<sup>79</sup> (pdf<sup>80</sup>)

Audio: What is the minimum viable product?<sup>81</sup> (mp3<sup>82</sup>)

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<sup>76</sup><http://startupplessonsslearned.blogspot.com/>

<sup>77</sup><http://startupplessonsslearned.blogspot.com/2009/03/minimum-viable-product.html>

<sup>78</sup><http://venturehacks.com/articles/opening-board-meetings>

<sup>79</sup><http://www.slideshare.net/venturehacks/what-is-the-minimum-viable-product>

<sup>80</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/03/what-is-the-minimum-viable-product.pdf>

<sup>81</sup><http://odeo.com/episodes/24338408-What-is-the-minimum-viable-product>

<sup>82</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/03/what-is-the-minimum-viable-product.mp3>

## What is the minimum viable product?

**Nivi:** First of all, this is Nivi from Venture Hacks, and I'm talking to Eric Ries from... where are you from?

**Eric Ries:** From the Lessons Learned blog.

**Nivi:** From the Lessons Learned blog, formerly from IMVU, formerly an advisor to Kleiner Perkins. We're just going to have a discussion on a few topics of Eric's and my choosing.

**Nivi:** First topic: What is the minimum viable product? Talk to me about minimum viable products.

**Eric:** OK, well let's start with the question. Why do we build products in the first place?

In the end, we hope to be able to launch product to lots of customers and have them give us money so that we build a great business.

One approach to solving that problem would be, let's build a product with the maximum number of features that will maximize our chance of success in the end. But the problem with that is you won't get any feedback until you've already built all those different products.

All those different features, so you ship this product with a ton of features, and generally, by the time it's done, it's too late to make sure that you are on the right track.

The alternative would be, let's do the release early, release often thing, and let's get feedback as we go. The issue there is, if you just follow the release early, release often mantra, you find yourself running around in circles, because you ship code, you get some feedback from people, you do a focus group.

Some customers say, "Give me feature X," "Give me feature Y," now you're kind of like, maybe sometimes you do what they want, maybe sometimes you're going to do what you want, and

then they get mad at you, and you're chasing your own tail a little bit because you're not operating against a clear, long-term vision of what you're trying to accomplish.

The idea of minimum viable product is useful because you can basically say, look, our vision is to build a product that solves this core problem for customers, these kind of general feature areas, and we think that for the people who are early adopters for that kind of solution, they will be the most forgiving.

And they will fill in their minds the features that aren't quite there if we give them the core, tent-pole features that point the direction of where we're trying to go.

The minimum viable product is that product which has just those features and no more that allows you to ship a product that early adopters see and, at least some of whom resonate with, pay you money for, and start to give you feedback on.

**Nivi:** So there is some set of customers out there, we believe, that just with these features alone, this product is useful to them.

**Eric:** Exactly right. And sometimes it's useful to them because early adopters have the same kind of visioning power that entrepreneurs do, but because they can see what the end product is going to be.

## **Getting developers on the IMVU platform with a MVP**

**Eric:** There are cases where you ship them a product that actually doesn't work very well — at IMVU, the first version of our product worked pretty terribly, but, for example, it was all about user-generated content. We wanted to get developers on the platform.

The problem with developer platforms is this chicken and egg problem. Developers don't want to develop unless there are customers who are there to buy their products, and customers don't want to come on the platform unless developers are there selling them something useful.

What we did is we took early adopter developers and we told them a story about how IMVU was going to take over the world and be this really powerful product for mainstream customers and we made them believe it.

And we gave them an economic incentive that said, the earlier you get on board with the platform, the bigger your take is going to be for derivative products that get created down the road.

We shipped a product that basically had almost no customers — certainly no mainstream customers, and the developer tools weren't that great — but, because we had told that story effectively and we really understood those early adopter developers, we got a ton of them on the platform developing.

Because they felt like they were in the middle of a gold rush, despite the fact that there was really no evidence to support that belief other than their own power of imagining what this thing was going to be down the road.

Luckily, we delivered on that vision, and so they actually were — a lot of them — pretty happy.

## A non-MVP: The Kerry vs. Bush avatar

**Nivi:** I want some examples of these crazy minimum viable products. By which I mean, for example, and you can talk about any of these, the AdWords approach, the approach you talked about in terms of dialogue boxes and just popping those up, and just trying to sell a PowerPoint slide to an enterprise customer.

**Eric:** Let me start with an example of a time we didn't know the minimum viable product, to illustrate my point.

It was 2004 — you have to remember 2004, Bush versus Kerry election. At IMVU, we had this idea — it happens to entrepreneurs all the time, you wake up in the shower and you're like, "I've got an idea for a killer product."

The idea for us — this was probably September/October 2004, debates are happening, politics is in the air — our idea was, we're going to sell presidential debate avatar set that we would either dress up like Kerry or Bush, and you'll be able to debate with your friends in this 3-D presidential debate product.

Now, put aside for a second whether that actually seems like a good idea to anybody else. We convinced ourselves it was a great idea, and we spent two full weeks racing to get this thing built, because it was time sensitive, the election is coming, the debates are happening, every day counts.

We thought it was a great idea for that whole two weeks. We built it out and we shipped it and we spent countless hours debating exactly what features had to be in it or not in it, and we were going to sell it for \$1.99.

Our theory was, pricing won't get in the way of anybody buying this thing. We want to make it cheap and easy and it will make lots of buzz and Wall Street Journal and New York Times are going to cover this thing; it's going to be awesome.

I remember for us in those days, two weeks of development was a lot, because we were a pretty fast team. We did that, we shipped it — cut to the chase, nobody bought it. We sold exactly zero copies of the Kerry vs. Bush avatar.

We tried a bunch of different permutations and different variations of it and added features, and we changed the price, and eventually we gave it away for free, and even at free we couldn't sell any copies.

**Nivi:** Well how many bought it for free?

**Eric:** None.

We literally couldn't give this thing away. This thing was a dead weight money loser. There was actually nobody in AmERICA interested in having a presidential debate avatar.

## **How to turn the Kerry vs. Bush avatar into a MVP**

**Nivi:** How would you have approached this exact same product by taking the minimum viable product approach?

**Eric:** Well it's interesting. We thought we were taking the minimum viable product approach because we had only spent two weeks on it. Right? Where we had made a very early prototype and put it out there.

But, if you think about it, going back to the definition of the minimum viable product, which is the minimum features that are required to learn what customers want, we had spent way too much time on it.

What we should have done, and what we did for a lot of features thereafter, is started with a landing page that promised people that product. Then we should have taken out the AdWords we were planning to take out, drive traffic to that landing page, and offer people to buy the experience that we are talking about.

What we would have found out if we were doing that experiment is 0% of people would have clicked through, which means it doesn't matter what is on the second page.

The first page is so bad, not because it is badly designed, but because the features are wrong that you don't need to go through the effort of building out the product. So we wished we had done that, and we did make that mistake really.

**Nivi:** How would you have marketed that minimum viable product to your existing customers?

**Eric:** When you already have customers you need to have some way to experiment with making them an offer. In a lot of cases the minimum viable product really is just that offer.

You can crisply articulate to customers what they're going to get and how much they're going to pay for it. You can learn a lot by just popping up a dialogue box that says, "Hey, would you like this new feature?" or showing them a banner ad for that feature.

For example, on IMVU we would have a system setup so that we could arbitrarily from the server select a small percentage of customers and make them an offer by inserting a dialogue box into their conversation, and basically it's a simple "Yes" "No," would you like this thing, "Yes" or "No?"

When they say "Yes," we take them to a landing page where we try to sell it to them. Eventually if they really did want it, we would have to make up some excuse why we couldn't give it to them like, "We're experiencing technical difficulties right now." "We're not quite ready to give it to you. Give us your email address and we'll email you when it's ready."

Again, you've got to remember that 99% of the time nobody wants it. Most offers that appear to an entrepreneur as a good idea are actually horrible, horrible ideas. By making the offer and having it be rejected by customers, we learn not to waste time building stuff that nobody wants.

**Nivi:** Right. Maybe the right definition of a minimum viable product, like you were saying, is, essentially a test to see whether people will actually want the product that you're imagining in your head.

## **Rejecting false negatives: “But my customers don’t know what they want!”**

**Eric:** That’s right. The reason why this is an art and not a science is, I’ll have entrepreneurs come up to me and say, “But hold on, my customers don’t know what they want. If I ask them ‘Do you want this thing?’ They might say no when the answer is really ‘Yes.’”

Unfortunately, that’s an excuse that is used way too often, but there are situations where it’s true. The judgment call is; what really is the minimum set? In some cases like in entertainment products it might actually require you to build an early prototype, or a mockup, or even version one of the product with the minimum possible set of features that you think could go.

The nice thing about minimum feature set is you can always try intermediate points to ask yourself, “Am I at the minimum feature set yet? Am I at the minimum feature set yet?”

As long as you’re not afraid of the false negative, that is, if you don’t get discouraged because you’ve built your first paper prototype of it and shown it to people and nobody wanted it. That can’t mean that you give up because, “Oh, forget it, we’ll never make it.” You’ve got to say, “OK, well then let’s iterate some more.”

If you keep iterating at it, you keep making it a little bit more sophisticated, at a certain point after you’ve been through 10 iterations, that you still got no uptake whatsoever, and the feedback you’re getting from customers is still a yawn, you might say to yourself, “You know what? We’re not moving in the right direction. In fact, we’re past the point of minimum viable product. This just isn’t a viable product.”

**Nivi:** Right. Back to your point about entertainment, in Hollywood they start off in scripts. If the script looks good, then they will make a pilot. If the pilot looks good then they might

order a few episodes from the first season. After the first season, then they make from there. They don't build all three seasons, and then try to ship them.

**Eric:** Yeah, which means that some great shows never get made, because the early tests look negative and the people involved don't have the courage or stamina to see it all the way through.

On the other hand, sometimes people have the courage and stamina to see through a really bad idea. That's why the concept of learning is so important. This cannot be done on a spreadsheet. You have to keep training yourself on multiple iterations and multiple attempts to start to develop good instincts for it in your particular domain, your particular market space, what's likely to work and not work.

Then you can do that as an entrepreneur, but even more powerful is if you can get your whole organization, everybody, training themselves constantly to do that kind of learning, so that good ideas will be passed around the whole organization.

## **Building products like packets get routed on the Internet**

**Nivi:** Also minimum viable product ties into the concept of "build it before you sell it." Are there any other out of sequence things that you guys did at IMVU or elsewhere that you found helpful? For example; you guys probably wrote tests before you coded to some degree as well, didn't you?

**Eric:** Yeah, that's right. I mean test driven development is the same principle.

**Nivi:** I'm wondering if there are some other things that you guys have done.

**Eric:** If you think about the full range of the product development life cycle; from specification to design, to implementation

to testing, to maintenance to sales to deployment.

**Nivi:** Deployment and all that stuff.

**Eric:** I now think about that rather than as a linear sequence, I actually think about it as a big network. The question is; just for any given feature, in what path should you route it through that network? Different features should be routed differently, just like on the Internet we route packets differently as necessary.

**Nivi:** I'm wondering if you have some specific examples of paths you've taken.

**Eric:** Yeah, we just talked about writing tests first. We've talked about selling first. We've talked about deploying first.

## **Deploy first, code later**

**Nivi:** When do you deploy a product? When have you deployed something before you built it?

**Eric:** All of these forms have offers of products. For example in a lot of Internet products, how does the customer know that the feature exists? Yes, there might be 100 pages of fancy stuff, but how do they even know that stuff exists?

Generally, it's because there's a link in the header. There's one link on one key page that notifies them that they can go do this other thing or at a key moment they receive an email, even though the feature might be wide and complicated.

Generally, access to the feature is controlled through a simple choke point. We would often add those choke points in a split test just to see first of all, did anybody click on them? So we could look at the click-through rate of people that now believe there is this feature.

We would also see an interesting phenomenon, sometimes the presence of a feature, even if nobody clicks on it, still impacts

their behavior in other ways.

For example — I can't remember the data, we saw an experiment where, this isn't exactly right but something to this effect, we added a link to the header notifying people that there was a VIP Club for special people only to get access to on IMVU.

Now, it's not the same as what we have now. IMVU does have a VIP club today that is not anything related to this. But, in those days, the idea was, we were trying to test whether people wanted to have some kind of premium experience.

What happened was few people actually clicked on that link to go find out about the VIP club, but in the experimental cohort for people who were shown that header, their average spending was higher.

By constantly reminding them that there was such a think as a premium experience, we primed them to want to do more spending on IMVU. It was a very unexpected result.

And it's a good example of why you always do full cohort-based split tests. Always test for the macro effect, don't look at the micro effect. That's a case where deploying a feature before we've built it actually can give you an insight that maybe you don't need to build a feature after all.

**Nivi:** Interesting. Yeah. That reminds me of an example that one of our friends told us about where they couldn't get people to sign up for a free product, so they put a paid version of the product right beside it, and I don't think anybody signed up for the paid version...

**Eric:** It made the free version look a lot more...

**Nivi:** Yeah. It made the free product look legitimate. And they started to actually convert on that basis.

## Design first, code later

**Eric:** There are also cases where you want to design a product last, rather than design it first.

We would often ship things in a schematic form with horrible design to see if we'd gotten the information flow and information architecture right, and really good interaction designers, if they're being honest, will tell you that that's always the sequence.

You always re-factor your design out of specific use cases and out of specific uses, rather than starting with the broad vision of what it's like.

**Nivi:** Basically the trails where the people walk, you pave those?

**Eric:** Exactly right. And you could do that — I remember one time we used to use paper prototypes where you have designers sit down with a focus group of people and show them a fake screen shot that they came up with in Photoshop.

And then the customer says, “I want to click that button,” and you go grab the piece of paper that represents what happens when you click that button, you show them another prototype, and we used to do them that way.

We actually built a paper prototyping website into our website where, for certain customers, the designer could come in and actually replace sections of the website with full-on mockups from Photoshop that were sort of clickable and sort of functional.

Then we would bring a customer in and have them register an account; we would specify that that account should see the paper prototype, and then we would go through with them, do the focus group.

But the customer doesn't know they're seeing something that's a mockup. They think they're using the product.

And, yeah, the product is a little weird, because sometimes they click things and nothing happens, and sometimes things won't look a little right, but customers think that about your product anyways, so it's not particularly abnormal for them to see a product that looks completely incoherent to them. That's the state-of-the-art for most customers and those products.

That was another case where we would — and we would, occasionally, come up with some prototype that that functioned well enough that we would ship it to real customers while we're working on the full on, blown, beautiful version of it.

Sometimes customers would see a schematic version from which we would gather more information about whether we're on the right track, and put things in the right place.

## **Where did you get the money to experiment?**

**Nivi:** What allowed you guys to do all of this experimentation? Specifically from a financial point of view? Not about the mentality behind it and so on. Time is short and money is running out, or were you basically break-even this whole time, or how did you work that?

**Eric:** No, we believed in a concept we called "bridge to profitability," which is, whenever we raise money, we always raise money on the basis of a plan that we honestly believe, would get us to profitability on just that round.

If you notice, that doesn't mean that we actually got to profitability on that round. In fact, we kept raising more rounds because we kept believing that we had the opportunity to pursue a bigger opportunity by raising money, but we never had to raise money. We always felt like we could get there on our own.

But that meant that we were constantly a dollar short, because plans to get to profitability on a round generally involve you

going negative and then catching up before the money runs out, so we were not eager to learn, eager to experiment.

We did not love metrics. We were very scrappy and very afraid of running out of money, so we only ever adopted practices that we thought would have a high ROI.

The issue is that these practices do have a high ROI, and we got to them because we kept following the traditional model and failing and feeling like, God, we are burning money like there is no tomorrow. We keep building features that nobody wants. We literally don't have the time and we can't afford to keep doing the same old thing over and over again.

I don't know if we were just lucky that we had that mindset, but, for whatever reason, even though at some level we always believed the next feature we shipped was going to save the day and have a step change in our profitability and take us to the moon, because it's just the best feature since sliced bread.

Because we were so desperate to actually make money, we — I'm trying to think of how to put this — we became obsessively committed to actually being right rather than just believing in the next thing to save us.

If you look at the traditional hockey stick shaped curve, it's flat for an awful long time. We had been in a company previously where we were always promised, "Yeah, it's flat now, but we're on the verge of the hockey stick."

The problem with the hockey stick plan, when that's your plan, is you just work for a year and then the 13th month you're going to go to the moon. For the 12 months, you don't know if you're making progress or not, because you're following the plan.

Everything is flat like it's supposed to be, because when the final feature comes into place, you're going to go to the moon.

We just didn't believe that was going to happen. So we forced ourselves to actually test each feature to see if it was going to

be successful.

Then we just stopped being able to drink our own Kool-Aid, because we were just wrong so often, it became harder and harder and harder for us to convince ourselves that it was a good financial investment to just randomly try the next new thing versus actually trying to say, “Hey, is there a way that we can increase the probability of having a successful feature.”

**Nivi:** Yeah, and I think, there are probably two other things here, right? You charge from day one, so basically every experiment you ran was an experiment to make more money, right?

**Eric:** That's right.

## A preview of part two

**Nivi:** Why would you not run experiments if you're charging from day one. And then, the second thing is — this gets us to the second topic, which is: You guys weren't doing any of this really in public because you had not launched the product, right?

**Eric:** Amen.

**Nivi:** Nobody knew who you were. But people, at the same time were using the product, so how did you do that?

## Customer Development, Classes 3 and 4

We've gotten a lot of requests to keep posting Steve Blank<sup>83</sup>'s customer development course<sup>84</sup>. Thanks for the feedback, we're glad you like the course! Here's the audio and slides from classes three and four. And new students can catch up on Class 1<sup>85</sup> and Class 2<sup>86</sup>.

Steve's lectures usually have two parts: a group discussion of a case and a lecture. Steve sprinkles his war stories throughout both parts — those are my favorite parts of the class.

A case is a written history of a real business problem that the students try to "solve". For example, the E Ink case<sup>87</sup> addresses "How to retain E Ink's creativity, drive, and sense of fun while focusing the company on growth and the demands of a first-product introduction." Exciting! Steve wisely ignores the specific problem in each case and subverts the material to foment a discussion about customer development.

The readings for each class are listed in the syllabus<sup>88</sup>. And the main text for the class is Steve's must-read book, *Four Steps to the Epiphany*<sup>89</sup>.

This is wonderful material for entrepreneurs. I've already taken the class and I still subscribe to the Venture Hacks podcast<sup>90</sup> and listen to the classes on my iPhone.

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<sup>83</sup><http://steveblank.com/>

<sup>84</sup><http://venturehacks.com/articles/customer-development-course>

<sup>85</sup><http://venturehacks.com/articles/customer-development-course>

<sup>86</sup><http://venturehacks.com/articles/podcast>

<sup>87</sup>[http://harvardbusinessonline.hbsp.harvard.edu/b01/en/common/item\\_detail.jhtml?id=800143&referral=2340](http://harvardbusinessonline.hbsp.harvard.edu/b01/en/common/item_detail.jhtml?id=800143&referral=2340)

<sup>88</sup><http://www.slideshare.net/venturehacks/customer-development-syllabus>

<sup>89</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>90</sup><http://venturehacks.com/articles/podcast>

## **Class 3: Customer Development**

There is no audio for this class.

Slides: Customer Development 3: Introduction<sup>91</sup> (pdf<sup>92</sup>)

## **Class 4: Customer Discovery, Part 1**

The sound quality of the lecture improves dramatically after the first few minutes.

Audio: Customer Development 4: Customer Discovery Part 1<sup>93</sup> (mp3<sup>94</sup>)

Slides: Customer Development 4: Customer Discovery Part 1<sup>95</sup> (pdf<sup>96</sup>)

## **Opening board meetings to the entire company**

In the second part of my interview with Eric Ries<sup>97</sup>, we discuss (1) acquiring customers without launching and (2) opening up board meetings to the entire company.

At IMVU, Eric and the management opened up board meetings to the entire company. Why?

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<sup>91</sup><http://www.slideshare.net/venturehacks/customer-development-3-introduction-1190582>

<sup>92</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/03/customer-development-3-introduction.pdf>

<sup>93</sup><http://odeo.com/episodes/24346273-Customer-Development-4-Customer-Discovery-Part-1>

<sup>94</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/03/customer-development-4-customer-discovery-part-1.mp3>

<sup>95</sup><http://www.slideshare.net/venturehacks/customer-development-4-customer-discovery-part-1>

<sup>96</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/03/customer-development-4-customer-discovery-part-1.pdf>

<sup>97</sup><http://startupplessonsslearned.blogspot.com/>

1. To give people the information they need to do their jobs.
2. To teach everyone in the company to think like the CEO.
3. To prevent employees from gossiping about board meetings.

And more!

I've synchronized the audio with some simple slides below. That's my favorite way to consume the audio. You can also find a transcript and stand-alone audio below. Please let me know if you find the transcript useful.

Read on to learn what kind of employee Eric used to "show the door" at IMVU...

Slides: Opening up board meetings<sup>98</sup> (pdf<sup>99</sup>)

Audio: Opening up board meetings<sup>100</sup> (mp3<sup>101</sup>)

## **How do people find out about our product if we haven't launched?**

**Nivi:** And this gets to a second topic, which is you guys weren't doing any of this really in public, because you had not launched a product, right?

**Eric:** Amen.

**Nivi:** Nobody knew who you were, but people were, at the same time, were using the product, so how did you do that?

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<sup>98</sup> <http://www.slideshare.net/venturehacks/opening-board-meetings-to-the-entire-company>

<sup>99</sup> <http://venturehacks.com/wordpress/wp-content/uploads/2009/03/opening-up-board-meetings.pdf>

<sup>100</sup> <http://odeo.com/episodes/24340103-Opening-up-board-meetings>

<sup>101</sup> <http://venturehacks.com/wordpress/wp-content/uploads/2009/03/opening-up-board-meetings.mp3>

**Eric:** I got a question today which was something like, “I’d love to follow your advice about not having a public launch, but we need to get early beta users for our product launch. How can we do that if we are not willing to talk to bloggers? Nobody really knows who we are.”

I think a lot of people have that attitude, that without PR, you just can’t get any early customers. Again, we have got to start with, “What is the goal of early customers? Why do you want them?”

If you are charging from day one, one of the reasons you want them is you actually want to make money. You want to show that your business is viable. But even if you are not charging money, you have a need to find out whether your business is viable, whether you have that minimum viable product, whether the business model, at the end of the day, is going to work.

For that, you do need customers, and you do need to be putting customers through a product experience that will give you that information. But you don’t need a lot of customers. I think that is where people get confused.

For a big fancy launch you can get hundreds of thousands of customers to show up for one day. But for metrics analysis, generally a cohort of 100 people or 1,000 people are plenty to learn from.

If you change your goal from, “How do we get the maximum number of customers,” to, “How do we get the minimally sufficient number of customers to learn what we need to learn,” new possibilities get opened up to you.

## **Acquiring customers on \$5 a day**

**Eric:** For example, at IMVU, we practice the \$5 a day AdWords campaign. I was the VP of marketing in those days. If I actually

knew anything about marketing, I would have known not to try this. By traditional marketing standards it is considered crazy to spend only \$5 a day, but we had a pretty low budget and we really were pretty frugal.

I discovered that in those days you could buy clicks for five cents a click. But to me, \$5 a day meant every single day 100 human beings are coming to try my product.

If you think about that from a beta testing point of view, especially if you look back at the old days of software shipped by CD, getting 100 people to try your product is actually a lot and you can learn a lot from that. And at 100 people a day, you are in good shape, just at that tiny, tiny level.

The risks of doing that are really quite low. I think a lot of engineers have this idea that once you put your product out there in public, the investigative journalists are going to find out about it and write about it and we are going to lose control of the story. Let me tell you. You should be so lucky<sup>102</sup>.

IMVU was a top 1,000 website in the whole world before it got any press whatsoever. We were making millions of dollars a year. The press was writing about newly funded, venture backed competitors that had no traction whatsoever; because those were the guys sending them press releases.

It was frustrating, and psychologically you want to have that cover story on WIRED that you can send home to mom, but you know what? We did not start this company to have good vanity covers printed about you in the press. We were there to serve customers and serve them well.

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<sup>102</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

## **Running experiments under a different brand name**

**Nivi:** How do I run experiments, if I already accidentally got that TechCrunch article and I...?

**Eric:** Yeah, I am sorry. You are not doomed, but you are going to have to go waste energy later cleaning up the positioning that you put in that article, which is undoubtedly wrong.

**Nivi:** Right. There is that aspect of it, but do you think you should, just basically pretend that article never existed, or do you run tests under a different brand name?

**Eric:** That is not a bad idea. Especially on the iPhone, I see this because of Apple's stringent release process where there is this huge delay before you can actually bring things to market.

And also because people want to get into the top 25. That is where all the action is in the Apps store. There is a lot of competition to make sure that on the day you launch your app you get all the right coverage lined up and all the stuff happening.

People feel like they don't want to do a bad launch under their real brand name, because that will harm their ability to do the proper launch later and get to the top 25.

But there is no law that says you can only bring out products under one brand name. I strongly, recommend that to people if you are very concerned about your precious brand. I think most startups are way too concerned about the power of their brand. They should be so lucky to get some kind of brand going.

Even still, bring it out under a terrible name. I specifically recommend people bringing products out under brand names that they hate so that they won't ever be tempted to make that into their real official brand name and then become afraid to experiment with it.

You have got to be bringing products out under a brand that you feel comfortable experimenting in. Then once you find the right formula, there are two possibilities.

Either you will be able to port that product over to your new brand name and it will be great, or the product concept you brought up under that bad brand name will be so powerful, you just can't get people away from it.

It is too sticky and you are stuck with it. But congratulations! You are successful! Is it really so bad that you personally don't like the brand if customers do like it? I think it is not so bad.

## **Running pricing experiments in public**

**Nivi:** A friend of ours has a popular subscription based product that they don't charge for and now they want to start charging for parts of it for the premium model, and they want to find the optimal pricing strategy. How can they run those experiments in public and in secret? What would you suggest to them?

**Eric:** I would actually not be afraid to run them in public. It is hard for people who are afraid of what the worst possible thing that could happen is, to do this. But I think it is good to just try it and get over it.

What happens is, it is true that customers don't generally like the idea that one customer got charged one price for something that somebody else got charged a different price for the same item. So there is some risk when you do different pricing offers in a split test.

But in my experience, there are two mitigating factors that make it not so bad. The first is it is actually incredibly difficult for most customers to figure out that is happening, especially if you only do it in a limited time window.

For example, I am going to tell you a story that may not seem related, but bear with me. When we were at there.com, the virtual world company, we would do a lot of QA. That was a heavy QA company.

For hours every day we had QA testers sitting in a lab together running the virtual world software and testing to make sure that it worked. I remember one day getting called in to see about...

There was one tester. They were around a physical corner from each other. So you couldn't see each other, but they were not more than 20 feet away. They were both engaged in this activity.

The guy called me down and he said, "I am in this dune buggy riding around with somebody in the virtual world and we are seeing this glitch. We are not seeing the same thing. Something is not right." They were calling back and forth, trying to pin down what it was.

I remember sitting there really confused about what the problem was, because it looked like the two of them were sitting there in the dune buggy and everything was fine.

I walk around the corner to the other guy. I talk to him about what the problem is. I look at his screen. On his screen, he and the other guy are engaged in a paintball match. They are not in a dune buggy at all.

He was almost a mile physically distant in the virtual world from where the other guy was, yet their conversation was perfectly consistent to them and it never occurred to anybody to ask, "Wait. What planet are you on in this time that we are comparing notes?"

They had no clue that this was happening. I think, we totally tend to underestimate just how powerful the pull of what you see is to most people. They basically can't imagine the world, any other way than the way that it is.

Entrepreneurs don't have that problem, so a lot of times they don't grasp what is true for customers. It is actually very unusual for the customers to go onto a forum and post, "Here are all the offers that I am being offered and exactly what I see. Does anybody else see the same thing?" Our natural assumption is that everybody else sees the same thing.

So you are not totally likely to get caught. That is a mitigating factor. It is actually not as bad as you think when you do get caught, because don't forget; you have the power of the apology, especially as a startup.

If you screw up... You are going to screw up all the time. If you are a customer of a startup, your general experience is, "These guys are constantly screwing up." What customers care more about than whether you screw up or not, is how you treat them when you do screw up.

They care that you listen to them and take them seriously more than if you always get it right. If they want to work with a company that always gets it right, they will go work with some premium giant company that really has a very carefully constructed customer experience.

If you get caught doing this thing, you can always say, "We are so sorry. We were experimenting with this pricing. We didn't mean for this to treat anyone unfairly. And if anyone was treated unfairly, we have gone back in the records and we are going to give them all double the money back for the thing that happened," or whatever you have to do to make it right.

That is OK! It is really not that bad. What happens then is people say, "Wow. These guys are serious about making sure that we get treated fairly." Meanwhile, you get to keep experimenting.

## **Opening board meetings to the entire company**

**Nivi:** Yeah. You have talked a couple times on your blog about how you opened the board meetings up to the entire company and the positive benefits of that, and people's perceptions of negative benefits.

**Eric:** Yeah. Well this is not something that a lot of companies adopt. This is considered pretty crazy.

I don't know if it's that most people are actually afraid of giving the whole company information they need to do their job, because it might lead them to judge the top management harshly, but people judge you harshly whether you give them the information or not, from my point of view.

Just give them the information! Your pathetic attempts to hide what's happening don't fool anybody.

Having been on both sides of that divide, I can tell you I never felt like I was being successfully fooled. And if you do manage to fool me for a limited time, I'm awfully pissed. My point of view is: you want people to have the maximum information possible.

You need to do it in a trust-building way. You've got to make sure the people you're giving it to understand what they can and can't do with that information, and they understand that they need to keep company secrets confidential.

If you don't trust your employees to keep company secrets confidential, you've got bigger problems and you should go address those problems first.

There is some board business that has to be done in secret for legal reasons, so it's not true that absolutely every meeting that any time ever happened at the board level is open to the public.

## **Employees have critical things to say in board meetings**

**Eric:** But the interesting part about board meetings is the strategy conversation where you present progress, show data, and you make discussions about what should happen next. And that's the part of the meeting I strongly recommend people open up to their employees.

What we did is we actually had a board of advisors and then a board of directors that was a subset of those advisors. We would convene the full set, advisors and board, at nine o'clock in the morning and we would have a maybe two-hour strategy conversation followed by maybe a half-hour or one-hour private board meeting.

For the strategy conversation the rule was: every employee can attend. We did this up until we were a 50- or 60-person company. We actually, physically crammed everybody into one room, and we had the employees sit around in as much seating as we could fit and the board members would sit at the big table.

It wasn't a free-for-all, most of the employees were encouraged to listen, not to speak. But every once in a while the rule was that if someone had something they really needed to say, they could be recognized by the CEO and say their piece.

It was amazing. We would, occasionally have a board meeting where we would have a moment, where there would be data we were presenting to the board, and it would indicate that on a certain day, a certain metric went up and that was due to us launching that feature that day, or whatever our interpretation of what that data meant.

And not an insignificant number of times we would have an employee raise their hand and say, "Excuse me, but do you also realize that something else happened on that day?" Yada, yada, yada.

And occasionally, I'd be the one presenting! On the one hand, I'm really embarrassed. So I'm like, "No, I didn't realize that." This is a critical thing about running my own business I didn't know.

But once I got over my personal embarrassment, what you would find is the board loved it! They're like, "Thank God that guy was sitting in the room and could enlighten us about that. That changes our interpretation of what this means."

And quite a few times I think we saved ourselves months of work by coming to a realization of something way earlier than we would have, because the right guy happened to be sitting in the room.

And yeah, occasionally you had an employee who'd make an off-color comment or say something that really shouldn't have been said in front of the board, but people learn from those experiences. Most of the time most people had really substantive conversations.

**Nivi:** Did you ever get in a situation where some of the employees were like, "I don't even care about these board meetings. I don't even want to go?"

**Eric:** Yes, yes! We eventually had people who on occasion would beg me not to have to go to the meeting. And we eventually made them voluntary. For a while I was really rigorous, I said, "No, everyone has to be there. If I have to be at the meeting, you have to be at the meeting. Why do you think I'm any more privileged or unprivileged than you?"

Yeah, because board meetings are actually pretty boring. But when people are outside the room looking in — and you know most conference rooms have some form of glass — people can see what's going on. They'll come up with an excuse to walk by, kind of peek in. They will make up whatever crazy conspiracy theories are consistent with the data if they're not there.

An, in my point of view, that's such a source of waste: people gossip and there's rumors and people don't know. Let them be in the room, let them see how boring and mundane most board meetings are. So that for the occasional one where something actually interesting gets decided, let them be there to hear it themselves.

**Everybody in the company has the ability to understand what everybody else in the company has to understand**

**Eric:** There are some costs, definitely some down sides to doing it. One which took us by surprise was that, people can occasionally get confused about who's in charge, we did occasionally have people — some board member would say, "You guys should really build feature X."

Board members occasionally would just spout off about what's randomly on their mind, and occasionally you'd have an employee get confused that that means the company is now going to go do feature X because board member so-and-so said so.

And that was actually good practice for us, to be a constant reminder that no matter who you are, no matter what it says on your business card, nobody gets to decide randomly that the company's going to do feature X. Right? I don't care if you're the CEO or the lowliest person, we're going to have a reasoned and considered process for deciding what to do.

**Nivi:** And it's a learning opportunity.

**Eric:** It's always a learning opportunity. The other thing that was hard for me personally was it's hard to have your people who work for you see you be criticized in public. That was not fun.

**Nivi:** Hard for whom?

**Eric:** Well, it's hard for me. My emotional reaction was like, "Wait a minute! I'm doing the best I can and now you've got to watch me get smacked around because I screwed something up." But once I got over my personal emotional response to it, it was wonderful.

Because it humanized me to the people who worked for me — they got to see, "Oh, I see the pressure that he's under" — but more importantly, when I needed something from somebody for the purposes of presenting to the board I could go to them and say, "Do you remember what happened the last time I didn't have the right answers to these questions or I had shoddy this? You're really going to send me in there with this? Come on, you've got to help me out!"

So it made us collaborators in creating solutions for the board rather than I'm constantly asking them for stuff and they don't know why.

And I think, get over your own infallibility. We all make mistakes and it's better for people to see what the real stuff is.

**Nivi:** I think you wrote about this on your site, basically the assumption is that everybody in the company has the ability to understand what everybody else in the company has to understand.

**Eric:** That's right.

**Nivi:** The assumption is I have the ability to understand what the CEO has to understand.

**Eric:** That's right. And that makes people uncomfortable, because sometimes we would say, "You have the obligation to understand what the CEO's going through right now, because it's going to impact the way you do your job."

Some people would say, "I just want to sit in my narrow corner, do my little thing, and I don't want to worry about what the

company strategy is." And we would show those people the door. We were really serious about that.

You really needed to have people who were... they didn't have to be good at it! We weren't asking them to be good at the CEO's job, but we are asking them to understand why is the CEO making the decisions that he's making. Because they're going to have to make CEO-level decisions sometimes.

Sometimes the actions that have the biggest impact on the company's performance are taken by people at the line employee level. They may not realize it's going to have that big impact, but they are going to make those decisions. By the time the CEO finds out about it, sometimes it's way too late to do anything about it.

We sure hope that the guy at the line level understands what the company strategy is and how his decisions impact, at least the best that he can.

**Nivi:** Yeah, I think maybe their decisions impact the company more than the CEO in the sense that if the CEO doesn't come in to work, who cares? The company proceeds, but if the team doesn't come in to work nothing happens.

**Eric:** OK, let me tell you: when the community manager takes a day off, you can have serious, serious meltdowns in the community if it happens to be the wrong day. That can have major impacts on the company.

## **Should we share bad news with employees?**

**Eric:** I'll say one more thing because this is a real effect that people are afraid of, which is that if you give people information about how a company's doing, it can impact morale negatively. Sometime the company's not doing well.

It makes some people have this idea that part of your job as a manager is to shield people from bad news or shield them from chaos. Because it's not fair to them to have them have to do their job and also be confused about how the company's doing. I just think that's a really paternalistic attitude that we just need to let go as an industry.

If you want people to believe you when you tell them the good news, you have to sometimes tell them bad news. Otherwise, you have no credibility. And when there's bad news to be shared, yes, it negatively impacts morale. But for a good reason, because things aren't going well and we now need to rally the company around the fact that we need to change what we're doing.

And there's nothing like actually seeing the board say, "You guys have a major crisis on your hands that you have not yet understood," to get everyone in the company saying, "We're alarmed. We need to do something about it."

That can cause some chaos, and that can be disruptive, but if you build trust and rapport with your employees then what you could do is you can sit everybody down for an analysis meeting after the board, which we would always do, and say, "OK, let's talk about what we heard and what does it mean for the company," and let people share their perspectives.

Let people say stuff like, "This says to me we need to cancel all our projects and completely retool."

You need to get that idea out in the open because when somebody thinks that, you don't want them to just unilaterally go execute on that plan! You want the opportunity to tell them and everybody else who didn't have the courage to say the same thing: "No, we're not retooling, but we are going to make some adjustments and here's how we think about it, here's what we're going to do about it and here's what's going to happen." That was pretty powerful.

**Nivi:** Thank you!

**Eric:** You're welcome.

**Nivi:** I think that was great.

## Sell it before you build it

Fliggo<sup>103</sup> does it right:

The screenshot shows a user interface for selecting an account type. At the top, it says "Account Type". Below that, there are two options: "Fliggo Basic" (selected) and "Fliggo Pro coming soon". "Fliggo Basic" is labeled "FREE". "Fliggo Pro" is labeled "\$15/mo". Under "Fliggo Pro", there is a checkbox labeled "Notify me when this account becomes available" which is unchecked. To the right of this checkbox is a list of benefits: "Higher quality video", "Get a custom domain (e.g. www.yourvideosite.com)", "Remove Fliggo branding", and "Advanced customization options".

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Fliggo Pro is a minimum viable product<sup>105</sup> in action. MVPs reduce time to market. It's a good sign when people sign up to be notified. And if nobody signs up, you build the next iteration and see if *that's* the minimum viable product.

How would you modify this MVP to collect credit card numbers? Could you promise to not charge customers until Fliggo Pro is delivered? Could you give customers a discount for buying early? What do you think?

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<sup>103</sup><http://www.fliggo.com/>

<sup>104</sup><http://www.fliggo.com/>

<sup>105</sup><http://venturehacks.com/articles/minimum-viable-product>

Add links to your favorite minimum viable products in the comments.

# April 2009

## It's very easy to underprice your product

What's the right price for your product? According to Steve Blank<sup>1</sup>, it's apparently \$0. And it's also \$1 million. What?

Listen to this wonderful story to learn how Steve uses these two prices to create a bounding box around the highest price customers will pay for a product. And see why he thinks "It's very easy to underprice your product... particularly if you're an engineer."

Audio: It's very easy to underprice your product<sup>2</sup> (mp3<sup>3</sup>)

Steve's story is about enterprise software, but you can apply these same techniques and thoughtful approach to almost any market — including the consumer Internet.

This is an excerpt from the fourth class<sup>4</sup> of Steve's customer development course. I've already taken the class, but I still subscribe to the Venture Hacks podcast<sup>5</sup> and listen to it on my iPhone while I'm walking home from the gym.

*Here's a transcript of the story.*

### "And she realized... she left money on the table."

**Steve Blank:** Can I tell you a pricing story? When we starting Epiphany, I had no idea how to price enterprise software. There

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<sup>1</sup><http://steveblank.com/>

<sup>2</sup><http://odeo.com/episodes/24382581-It-s-very-easy-to-underprice-your-product>

<sup>3</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/03/its-very-easy-to-underprice-your-product.mp3>

<sup>4</sup><http://venturehacks.com/articles/customer-development-3-and-4>

<sup>5</sup><http://venturehacks.com/articles/podcast>

was one small problem, I had started an enterprise software company and never been in the business.

But, I had heard, and it actually was true, there was a woman named Sandy Kurtzig, who had started ASK Softwark. She was one of the first woman entrepreneurs, woman CEOs of a large corporation. And they were making software for IBM mainframes that was manufacturing software. Something called Manman, which I used in the late '70s, early '80s.

Since it was the first non-IBM enterprise software on IBM mainframes, [when] she got her first potential order, she didn't know how to price it. It must have been back in the mid-'70s. She's [with] this buyer, has a P.O. on his desk, negotiating pricing with Sandy.

The way she tells the story is, she didn't know what to ask for it. But, the head of manufacturing told the buyer to go buy this damn thing. [He] didn't care, [if] it was the world's best piece of software. So, Sandy said she goes into the buyer who says, "How much is it?"

And Sandy gulped and picked the biggest number she thought anybody would ever rationally pay. And said, "\$75,000 . And she said all the buyer did was write down \$75,000.

And she realized, shit, she left money on the table. Sandy Kurtzig was awesome. And she said, "Per year."

And the buyer wrote down, "Per year."

And she went, oh, crap what else? She said, "There's maintenance."

He said, "How much?"

"25 percent per year."

And he said, "That's too much."

She said, "15 percent."

And he said, "OK."

[Ed: This is called "flinch pricing."]

So, enterprise software got priced at \$75,000 per year, per module. Now, I have to tell you when I started at Epiphany I heard this story and someone said, "Steve, how much is your software?"

I said, "\$75,000 per year, per module."

Now, fast forward to about four years later. I'm leaving Epiphany, we're about to go public like the next week. I did not want to be a Section 16B officer. I happened to be walking by a conference room. It must have been conference room 702B then. I think we had 800 people.

I happened to be hearing a pricing discussion. So, I kind of stand outside. And they are arguing about the pricing I had just made up as an entrepreneur, because I heard this war story. And somebody was screaming, "You can't change the pricing. It was calculated by..."

**"I was about to let it go for \$75,000... By the time we walked out, we got an enterprise software order for about \$1.2 million."**

**Steve Blank:** But the best Epiphany story, which I actually learned from a world class saleswoman named Gina Rulon-Miller. Her brother Todd was the first sales person at Netscape.

We went into Triple A, CSAA in San Francisco. It was going to be our first multi-million dollar customer. I went in with Gina. They loved our stuff, it really was going to do them a world of good. They said, how much is it?

And I was about to go, "\$75,000..." And Gina goes, "Shut up I'm the salesperson." She said, "A million dollars."

And I went “...” Gina’s going, “Shut up. I’m the salesperson.”

And the guy looks at Gina and said, “Gina you’re out of your mind. We don’t pay more than \$675,000.”

And Gina said, “All right. We’ll let you have it for \$675,000.”

So, here was this software. I was about to let it go for \$75,000, my first professional software salesperson had just gotten \$675,000 and she did the same thing. And she said, instead of per year, she said, “But that’s for the base module. What other ones would you like?”

By the time we walked out, we got an enterprise software order for about \$1.2 million. The point about pricing is, particularly if you are an engineer, it’s very easy to under price your product. Because you tend to value it on cost or need or competitive or whatever.

## Bounding box pricing

**Steve Blank:** I, finally, in almost every business I now work up what I call “bounding box” estimate, which is:

“How much is your product?”

“It’s free.”

“Steve, you can’t mean it. This is our fourth meeting. You know I’m serious.”

“No, no, no. It’s free. Assume it was free, how many would you use?”

“No, Steve. How much?”

“No, assume it’s free. How many would you use?”

Now, for enterprise software does anybody know how you make money in enterprise software?

Yeah. Turns out for enterprise software it's the number of seats you actually got deployed on. Yeah, you made money on maintenance later, whatever. But, if you just got deployed on ten seats in one department, it's not really enterprise is it?

It's like closet software, which I used to get stuck into. You actually want to come out of the closet and be deployed broadly, as broadly as you can. And the test was if it didn't cost anything, what would it take to deploy it?

When I used to do that they said, "Well I didn't really tell you, but the IT guy really needs to approve this through the..."

"Well, why didn't you tell me that before?"

"Well, the product wasn't free before. I thought we were just going to put it on ten seats."

My point is going to zero flushes out a whole set of issues. Other times, I'll go say to that same question, "How much is the product?"

"It's a million dollars."

"Steve, we've been talking for three months now. You know I don't have a budget for a million bucks."

And you get an answer sometimes like Gina did. "The most we pay for this type of software is \$500,000." Seriously. In a startup, you will find out by asking these questions continually, what the bounding box of your potential revenue is.

Do not be bound by what other people are charging. Anybody know where that science experiment that is being run today on a much lower price? Anybody know?

Anybody have the device in their pocket? iPhone. What's the price of an iPhone app? Anybody know?

I don't know. There are a bunch of sites out there with some iPhone revenue charts. It's interesting. Go take a look at what

the right pricing for iPhone apps are. My observation is people are running bounding box experiments real time. Real time.

Are they free and they drive other upgrades later or they charge you \$9.99 and get real value now?

## How we encourage word of mouth for Pitching Hacks

We released Pitching Hacks<sup>6</sup> about 30 days ago. Since then, we've sold 280 copies, brought in \$4272 of revenue (including almost \$1000 from beta testers<sup>7</sup>), and received lots of positive reviews on Twitter<sup>8</sup>. Thanks to everyone who bought the book and spread the word!

### Encouraging word-of-mouth

We give everyone who buys the book a \$5 discount code to encourage them to tell their friends about Pitching Hacks. It works: you can see people sharing the discount code on Google<sup>9</sup> and Twitter<sup>10</sup>. We *were* trying to figure out how to make the book viral and, technically, this doesn't make the book viral — but it does encourage word of mouth.

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<sup>6</sup><http://venturehacks.com/pitching>

<sup>7</sup><http://venturehacks.com/articles/testing-update>

<sup>8</sup><http://search.twitter.com/search?q=pitching+hacks>

<sup>9</sup><http://www.google.com/search?hl=en&safe=off&num=20&q=%22PITCHINGROCKS%22&btnG=Search>

<sup>10</sup><http://search.twitter.com/search?q=pitchingrocks>

## More excerpts

Wilson Sonsini kindly published our chapter on Introductions in their Entrepreneur's Report for Winter 2008<sup>11</sup> (pdf).

And I put together this two-slide summary of the entire book for Steve Blank<sup>12</sup>'s customer development<sup>13</sup> class.

Slides: Pitching Hacks<sup>14</sup> (pdf<sup>15</sup>)

## Why aren't you buying site licenses?

A single copy of Pitching Hacks is \$19 and a five-copy site license is \$29. We have literally sold two site licenses — and one of them was to my dad!

When 37signals published Getting Real, 10% of their buyers bought site licenses<sup>16</sup>. Pitching Hacks is only clocking 1%. Please let us know why you aren't buying site licenses — I'm interested!

Read more free samples from Pitching Hacks and buy it here<sup>17</sup>.

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<sup>11</sup><http://www.wsgr.com/publications/PDFSearch/EntrepreneursReport-Winter-08.pdf>

<sup>12</sup><http://steveblank.com/>

<sup>13</sup><http://venturehacks.com/articles/customer-development-course>

<sup>14</sup><http://www.slideshare.net/venturehacks/pitching-hacks-1239714>

<sup>15</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/04/pitching-hacks.pdf>

<sup>16</sup>[http://www.37signals.com/svn/archives2/30day\\_update\\_getting\\_real\\_the\\_book.php](http://www.37signals.com/svn/archives2/30day_update_getting_real_the_book.php)

<sup>17</sup><http://venturehacks.com/pitching>

## We teach entrepreneurship like every vertical market has the same set of rules

Steve Blank<sup>18</sup>: “What I began to realize is that we teach entrepreneurship like every vertical market and industry has the same set of rules. So the first heuristic I want to offer is that — even in this class — there really is no common ‘these rules work’ for all vertical markets and industries.”

Listen to this excerpt from the second class<sup>19</sup> of Steve’s customer development course for the rest of this wonderful lesson.

Audio: Vertical markets<sup>20</sup> (mp3<sup>21</sup>)

Slides: Vertical markets<sup>22</sup> (pdf<sup>23</sup>)

*Here’s a transcript of the lesson.*

## We teach entrepreneurship like every vertical market has the same set of rules

**Steve Blank:** How many are in Web 2.0? Like the social something web. How many are in enterprise software? Anybody in semiconductors? EDA? OK. Is there a biotech guy still here? Oh!

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<sup>18</sup><http://steveblank.com/>

<sup>19</sup><http://venturehacks.com/articles/podcast>

<sup>20</sup><http://odeo.com/episodes/24425172-Vertical-Markets>

<sup>21</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/04/vertical-markets.mp3>

<sup>22</sup><http://www.slideshare.net/venturehacks/vertical-markets>

<sup>23</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/04/vertical-markets.pdf>

One of the interesting things about when I put up the fact that there are different industries or markets, everybody goes, "Well, yeah. Of course." I'm going to tell you a very funny story.

When I started teaching in the engineering school of the school not-to-be-named down south, but it starts with an "S," I formed teams just like you guys are going to do for projects. And I'd always say, "Listen, anybody can start a company. All you need is a half a million bucks." OK, yes, sir, a half a million bucks. Write that down.

Next week there's always a group that looks like these three people, that says, "Startup, half a million dollars." It's a divide by zero problems here, because in our business they'd come back and say, "Hey, Professor Blank, in our business the common wisdom is \$100 million."

And then I'd go, "Oh, well, yes of course, you're in the life sciences, that's completely different." The next week I'd say, "Except for these guys who need \$100 million, you ought to get out and start selling your product on day one, because you don't need to worry about any IP at all. Web 2.0. Just go out and get out there."

The next week someone raises their hand and says, "Professor Blank, in our industry there's a ton of patents and stuff and people tell us we shouldn't be out there unless we start patent protecting all our stuff."

And I went, "Oh, oh, oh, you're in a different vertical market. In that vertical market you're absolutely right. But OK, let's keep going on with the class. The rest of you guys can keep going out because you don't need to worry about anything, about government regulation or anything. It's a startup. Just go out there. There's no regulation to worry about."

The next week it's a group that comes up and says, "Professor Blank, we're doing a medical device and there's something called

the 510K, and that's a two-year process." And I go, "Oh, oh, for those of you in medical devices..."

And what I began to realize is that we teach entrepreneurship like every vertical market and industry has the same set of rules. So the first heuristic I want to offer is that even in this class, there really is no common "these rules work" for all vertical markets and industries.

And the first heuristic I want you to think about is, when you hear common advice from friends or other people who've done startups, always ask what industry were they in, and was that particular advice relevant for me or not.

So for example, here's a checklist of — I just randomly picked these. Web 2.0, enterprise software, enterprise software, communications software, communications software, consumer electronics, games software, semiconductors, EDA, clean tech, medical devices, life sciences, and personalized medicine.

I think, I've probably screwed up a startup in almost every one of these. That was a joke.

Did I miss anybody's vertical market? Anybody here who I didn't kind of get? All right. So this is not meant as a comprehensive list, but usually it takes about 95% of those students in the room.

## **Technical risk vs. market risk**

**Steve Blank:** Now what's interesting is if I ask you, Eric, in your biotech startup, what's your greatest risk? What is it?

**Eric:** Our team is working on an asthma inhaler.

**Steve:** Right. So what's the biggest risk?

**Eric:** The efficacy.

**Steve:** Right. The efficacy of what?

**Eric:** The efficacy of the drug and its impacts. That's a big risk.

**Steve:** So whether the product, as envisioned, works at all.

**Eric:** Right. And even if it works, are the adverse effects....

**Steve:** Does it kill you?

**Eric:** Yeah. Not to put too fine a point on it.

**Steve:** It's a very nice clinician's way of saying did it kill him or did he grow a third arm. How about you guys, do you have a particular drug or product in mind?

**Student:** The technology similar to some medical devices, the bio-monitoring... interactions.

**Steve:** So whether biomarkers are predicted, for a predictor from an assay you're thinking about making.

**Student:** Yes.

**Steve:** So it's a technical risk, right?

**Student:** Yes.

**Steve:** How many of you are thinking about a Web 2.0 startup? Great. What's the risk, Josh? What's the product?

**Josh:** It's a digital media company.

**Steve:** Perfect. What's the technical risk?

**Josh:** Finding the engineers.

**Steve:** Right. Is that a risk in Silicon Valley?

**Josh:** There's not a lot of risk.

**Steve:** What's the risk?

**Josh:** Getting people to use it.

**Steve:** Interesting. If our drug works for asthma, or your friends drug, does he have a customer problem?

**Josh:** No.

**Steve:** Why?

**Josh:** Because there are a lot of people that need....

**Steve:** If you're running out of air, you're going to probably want your drug, right? But you have a different problem. You could almost say, unless we really are stupid, we're not going to screw up the technology. Wouldn't you love it, if you were these guys, to be able to say that?

**Josh:** Yeah.

**Steve:** Big idea here. It's a big idea, one that I've never heard articulated before at all with startups, yet world-class VCs know this on day one. There are some industries where the risk is purely customer in market.

And by purely I just mean, in Silicon Valley we take for granted digital media and web, with all due respect, for the hard work your software engineers are going to do getting it up, it's not invention.

It's, gee, did, they do it efficiently or did the Oracle salesman convince them to buy half a million bucks of software they didn't need. But it's not invention.

There's a whole other set of industries where it truly is invention. Where it truly is, we should be so lucky to get this product working. Because if we get an asthma drug or an oncology for cancer curing drug, our only problem is how big is the licensing deal going to be? And not whether customers are going to want this.

Is this distinction clear? When you start a company, question one to self. Memo to self. Am I in a market risk company? Or am I in an invention risk company?

## Hybrid risks

**Steve Blank:** And by the way, I said this in the first class, I'll remind you again, though. I'm happy to have every one of you in the class, but if you are in an invention risk company, now I'll talk about hybrid companies in a second. Invention risk company, this class can offer you nothing.

To the extent that, what customer development is about, is how to dramatically reduce market risk. It is not how to reduce invention risk. So if I lose three of you next week. But you're more than welcome, I just want to understand...

**Student:** I'm a hybrid.

**Steve:** I'm sorry?

**Student:** I'm a hybrid.

**Steve:** You're a hybrid. And I'll talk about hybrids in a second. Is that clear so far? Memo to self, duh! Can we assume the technology works and our problem is whether the product and market fit is correct? Or is in fact, the product itself the risk factor. But I have something says both.

Give me an example of a vertical market or an industry that has both risks.

**Student:** Semiconductor?

**Steve:** Perfect. Why?

**Student:** Because the technology is fairly advanced. There's a lot of new insight there. But then the customers are very finicky, maybe, in the type of devices...

**Steve:** Let's get specific. What kind of semiconductors do you have in mind? That has technology risk.

**Student:** Say, consumer electronics or...

**Steve:** Give me more specific than that. Anyone else in the semiconductor business? You raised your hands in the beginning, now you're hiding. Yes?

**Student:** Yes, the industry I work in, we target what the customers want.

**Steve:** Right, so give me a specific case of technology risk in semiconductors.

**Student:** Like a high speed serial interface.

**Steve:** Perfect. OK. Or better, a new graphics architecture, or a new CPU architecture, or you're making a new IBM cell architecture. Yeah, that's on the bleeding edge. We don't even know if the architecture is going to work. Right? I just want to be clear.

Semiconductors, if you're just making a faster version of some one else's chip, you're not taking too much technical risk, are you? I mean, whether you can push it faster.

But typically in semiconductors, if you're taking architectural risk, if you really have some insight you believe, or communications hardware.

Pushing the envelope is usually about how deep you can go into packet inspection, to how fast and et cetera. Those are some pretty serious trade-offs. You don't know if this stuff works until you get first use out of the way. Is that fair?

**Student:** Yep.

**Steve:** That's the technical risk. What's the market risk in that kind of semiconductor business? What's the customer risk there? Anybody? You don't even have to be in the semiconductor business. Yes.

**Student:** For example, they could really mean technology. They could build a chip.

**Steve:** Yes.

**Student:** But for some reason, in benchmarking for the system provider assistance is another. Another vendor. Or even more, the old standard just doesn't pick up.

**Steve:** Right. So you could have a neat, new architecture, but your competitor could kick your butt. By convincing all the platform people who have to design your product in, "Oh, listen. That's so incompatible. It uses 62 Hz, rather than 60 Hz of electricity. You'll never be able to use it." By the way, I once convinced an entire industry of that, but that's another story.

So you could win on technical risk, and lose in market risk in hybrid technology. Give me another example. I picked Semiconductors. What's another one?

**Student:** I used to do R&D groups with Blu-ray.

**Steve:** Perfect, talk to me.

**Student:** I don't know much about it, but basically from a technical stand point, it seems like you're pretty similar technology. But it obviously, Sony and company convinced the company prior to movie studios that they're better off just shipping their content with Blu-ray rather than the DVD medium.

**Steve:** So this was the next standard for DVD's. Right? For the last three or four years. Huge battles over who would be the supplier. Lots of chess games, lots of technical risk.

Because even at the end, they were still playing games with the spec and adding more security layer and what ever. At the end of the day, Blu-ray won. Didn't win on technology, it won because they finally got a critical mass of people to design in the product.

Now the irony is, who do you think might actually, ultimately win? Who may undercut?

**Student:** Streaming Hi-Def?

**Steve:** Streaming Hi-Def. Right? It might be that the current DVD standard might have been the last one that sold upon these that it is. Most people, certainly my kids, don't go out and ever buy DVD's.

They download stuff to their iPods or Macs or some thing else, or to streaming video. Oops. They're all an investment. You might have just built the product that no one else wants.

So I just want to point out that when you look at a startup, ask those fundamental questions on day one. What problem do we think we have besides who are we, what business are we in, and what ever. It's like, are we going to be risking trying to understand our customers and we ought to try to focus on that.

Or is the focus truly inside the building. Because Steve, it doesn't matter what customers think unless we really nail this technology. None of this matters.

## The Startup MBA

“With knowledge being universally accessible, there will be no excuses for non-performance.”

– Peter Drucker<sup>24</sup>

Steve Blank<sup>25</sup> recently asked me to prepare a list of startup blogs for his customer development class<sup>26</sup>. Here you go Steve.

I read all of these blogs. They all have incredibly useful archives. And they're all written by people who teach *and* practice, so the advice is practical.

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<sup>24</sup><http://books.google.com/books?id=MGugUnmvhVQC&pg=PA545&dq=%22knowledge+being+universally+accessible%22&ei=wLfeSeO47QkwSPjNWNBA#PPA545,M1>

<sup>25</sup><http://steveblank.com/>

<sup>26</sup><http://venturehacks.com/articles/customer-development-course>

## Must read

Eric Ries<sup>27</sup> – Startup Lessons Learned Fred Wilson<sup>28</sup> – A VC  
Marc Andreessen<sup>29</sup> – pmarca Paul Graham<sup>30</sup> 37signals<sup>31</sup> – Signal vs. Noise

## More to read

Brad Feld and Jason Mendelson<sup>32</sup> – Ask the VC David Hornik<sup>33</sup> – VentureBlog Dharmesh Shah<sup>34</sup> – On startups Josh Kopelman<sup>35</sup> – Redeye VC

## Should be posting more often

Bill Burnham<sup>36</sup> – Burnham’s Beat David Cowan<sup>37</sup> – Who Has Time For This? Naval Ravikant<sup>38</sup> – StartupBoy Steve Barsh<sup>39</sup> – Barsh Bits

## Lawyers

Yoichiro “Yokum” Taku<sup>40</sup> – Startup Company Lawyer

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<sup>27</sup><http://startuplessonslearned.blogspot.com>

<sup>28</sup><http://avc.com>

<sup>29</sup><http://blog.pmarca.com>

<sup>30</sup><http://paulgraham.com/articles.html>

<sup>31</sup><http://37signals.com/svn>

<sup>32</sup><http://askthevc.com>

<sup>33</sup><http://ventureblog.com>

<sup>34</sup><http://onstartups.com>

<sup>35</sup><http://redeye.firstround.com>

<sup>36</sup>[http://billburnham.blogs.com/burnhamsbeat/venture\\_capital/index.html](http://billburnham.blogs.com/burnhamsbeat/venture_capital/index.html)

<sup>37</sup><http://whohastimeforthis.com>

<sup>38</sup><http://www.startupboy.com>

<sup>39</sup><http://blog.stevebarsh.com/>

<sup>40</sup><http://startupcompanylawyer.com>

## Up-and-comers

Mike Speiser<sup>41</sup> – Laserlike Steve Blank<sup>42</sup>

## On the town

Andrew Chen<sup>43</sup> – Futuristic Play Dave McClure<sup>44</sup> – Master of 500 Hats

## Comedy

Venture Capital Wear<sup>45</sup>

# Pitching Hacks at Stanford

I recently gave a talk on pitching startups to the students in Stanford's business plan competition<sup>46</sup>.

I recorded the talk with my iPhone and sync'd it with the slides below. I think the talk came out well — let me know what you think. I discuss a lot of the material from our book, Pitching Hacks<sup>47</sup>.

Thanks to Stanford's BASES<sup>48</sup> for putting on the event!

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<sup>41</sup><http://laserlike.com>

<sup>42</sup><http://steveblank.com>

<sup>43</sup><http://andrewchenblog.com>

<sup>44</sup><http://500hats.typepad.com>

<sup>45</sup><http://vcwear.com>

<sup>46</sup><http://bases.stanford.edu/e-challenge/>

<sup>47</sup><http://venturehacks.com/pitching>

<sup>48</sup><http://bases.stanford.edu/>

Slides: Pitching Hacks at Stanford<sup>49</sup> (pdf<sup>50</sup>)

Audio: Pitching Hacks at Stanford<sup>51</sup> (mp3<sup>52</sup>)

## Customer Development, Class 5: IMVU

Here's the fifth class of Steve Blank<sup>53</sup>'s customer development course<sup>54</sup>. Make sure you listen to Steve's story about how he funded IMVU at time 27:50. Steve is a master of using theatre to extract compliance from customers, investors, you-name-it.

This is wonderful material for entrepreneurs. I've already taken the class and I still subscribe to the Venture Hacks podcast<sup>55</sup> and listen to the classes on my iPhone.

**Administrivia:** The sound quality of the lecture improves dramatically after the first few minutes. New students can catch up on Class 1<sup>56</sup>, Class 2<sup>57</sup>, and Classes 3 and 4<sup>58</sup>. The readings for each class are listed in the syllabus<sup>59</sup>. The main text for the class is Steve's must-read book, Four Steps to the Epiphany<sup>60</sup>.

<sup>49</sup><http://www.slideshare.net/venturehacks/pitching-hacks-at-stanford>

<sup>50</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/04/stanford.pdf>

<sup>51</sup><http://odeo.com/episodes/24486132-Pitching-Hacks-at-Stanford>

<sup>52</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/04/pitching-hacks-at-stanford.mp3>

<sup>53</sup><http://steveblank.com/>

<sup>54</sup><http://venturehacks.com/articles/customer-development-course>

<sup>55</sup><http://venturehacks.com/articles/podcast>

<sup>56</sup><http://venturehacks.com/articles/customer-development-course>

<sup>57</sup><http://venturehacks.com/articles/podcast>

<sup>58</sup><http://venturehacks.com/articles/customer-development-3-and-4>

<sup>59</sup><http://www.slideshare.net/venturehacks/customer-development-syllabus>

<sup>60</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

Audio: Customer Development 5: IMVU<sup>61</sup> (mp3<sup>62</sup>)

You can find the second half of this class in How IMVU learned its way to \$10M a year<sup>63</sup>.

There are no slides for this class.

## How to close a term sheet quickly

How do you quickly turn a signed term sheet into cash in the bank? I've seen entrepreneurs do it in one week and I've seen them do it in four weeks.

How do you do it as quickly as possible?

1. Complete all business diligence before you sign a term sheet<sup>64</sup>.
2. Set a firm closing date for your lawyers and justify it with something like, "I'm leaving the country on that date."
3. Have a strong BATNA<sup>65</sup> that keeps the other side moving quickly.

Listen to our podcast below for the details.

Audio: How to close a term sheet quickly<sup>66</sup> (mp3<sup>67</sup>)

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<sup>61</sup><http://odeo.com/episodes/24486131-Customer-Development-Class-5>

<sup>62</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/04/customer-development-class-5.mp3>

<sup>63</sup><http://venturehacks.com/articles/lean-startup>

<sup>64</sup><http://venturehacks.com/articles/diligence>

<sup>65</sup>[http://en.wikipedia.org/wiki/Best\\_alternative\\_to\\_a\\_negotiated\\_agreement](http://en.wikipedia.org/wiki/Best_alternative_to_a_negotiated_agreement)

<sup>66</sup><http://odeo.com/episodes/24510669-How-to-close-a-term-sheet-quickly>

<sup>67</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/04/how-to-close-a-term-sheet-quickly.mp3>

## Transcript

**Nivi:** I was talking to a couple of entrepreneurs today about how to expedite the closing process. Closing is when you go from a signed term sheet to money in the bank.

You are taking the signed term sheet, which is really just a letter of intent; it is for the most part non-binding, except for some confidentiality and no shop clauses, and turning it into a set of closing documents and money in the bank.

Closing can take anywhere from one week, to four weeks, to six weeks, depending on the complexity of the closing. There are some things that you just can't speed up. There may be legal diligence that needs to be done that just can't be expedited. It takes time to get it done.

Other than those issues that you can't really speed up any faster than they are going, it is really up to the entrepreneur to set the timetable for closing. You can set things up so it gets done in a week and you can set things so it gets done in four weeks.

My preference is to get it done quickly for a few reasons. One: It just reduces the risk of not closing. Two: The faster you get it done the quicker you can get back to building your business. Three: It is just good experience and practice to move things forward during negotiations with your lawyers, with the other side's lawyers, and with the other side.

There are three parts to closing quickly. One: What you do before you sign the term sheet. Two: After you sign a term sheet, what you do on your end to make sure things are moving quickly. Three: After you sign a term sheet what you do to make sure the other side is moving quickly. Lets cover each of those parts.

## Before you sign the term sheet

First lets talk about what you do before you sign a term sheet. Number one, most term sheets have a clause or term in there that indicates what the expected closing date is so your lawyers, the other side's lawyers, and the other side can all work together towards that date.

My next suggestion is to conduct all your business diligence before you sign the term sheet so there is no business diligence left to do once you have signed the term sheet, during the closing process.

A lot of startups, I think, make the mistake of signing a term sheet too quickly before the investors have made the decision to really invest in the company. And they are just locking the company up with the term sheet, taking the company off the market so they can do their real diligence.

I would prefer to get all the business diligence done before I sign the term sheet. And we have a blog post on this, look it up. It is called, Complete business diligence before you sign a term sheet<sup>68</sup>. We have also got another blog post called, Discuss your plans before signing a term sheet<sup>69</sup>.

You also want to complete as much legal diligence as makes sense and is possible before you sign a term sheet as well. Why leave some legal risks? Why take yourself off the market and expose yourself to the risks that there is some legal issue that is going to trip up the financing. You want to get as much of that done before you sign the term sheet as well. You can find more info on that in the blog post. For most seed stage investment there is not a lot of complexity in your legal documents, whether it is IP or existing contracts, or what have you.

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<sup>68</sup><http://venturehacks.com/articles/diligence>

<sup>69</sup><http://venturehacks.com/articles/signing-term-sheet>

And top tier investors aren't going to try to push business diligence to after a signed term sheet, in general. And if they do they are pretty up front about it and there is usually a good reason why. If you are working with a good firm you will get the business diligence done before you sign a term sheet anyway. And if you are a seed stage startup without a lot of complexity the legal work is pretty turnkey, which means that you can get it done quickly. And it is really up to you to determine how long it is going to take. These financing closings take as long as you let them take.

How do you expedite the closing process? There are two parts to this. The first part is making sure your lawyers move quickly. The second part is making sure the other side moves quickly. The other side consists of the fund and their lawyers.

### **Moving quickly on your end**

First lets talk about making sure your side moves quickly. You should understand that you are in a very high leverage position with respect to your lawyers. Your lawyers have taken the risk of working with you while you were an unfunded, seed state startup with a lot of risk that you would go out of business.

They perhaps deferred fees, or gave you reduced rates. And they took on the risks of working with you with the hopes that you would become a venture backed startup and grow on to great success and do a lot of business with them. Which is exactly what is starting to happen to you at this point in time, you are getting venture backed. You have a signed term sheet.

Your lawyers are in a pretty precarious position. They have taken a lot of risks and that risk is starting to bear fruit. But they are in a position where they are not locked-in in any way. You are not locked-in with them so you can terminate them at any point in time still. If you terminate them they have taken a

bunch of risks, worked for reduced rates, deferred fees, and they weren't interested in working with you while you were a seed stage company. They just did that to build the relationship so that you could work with them when you were a venture back startup spending lots of money on legal fees. If you terminate them, they won't be able to reap what they sowed. So they're in a precarious position. You have a lot of leverage over them.

The first thing to do to expedite the closing process is talk to my lawyers and tell them — if you haven't already, which hopefully you've done — is tell them you're going to measure them in four ways. High quality advice, one. Two, the speed at which they get things done for you. Three, the number of errors in the work product. Four, cost.

Next, you tell your lawyers that you want to have an extremely firm date for the closing process. You can take the Steve Blank approach<sup>70</sup> there, if you like, and tell them that prior to that date, if they need help you are available to help them out, but when that date comes you don't want any excuses. Right? If they come at you with excuses by that date, it's really a fireable offense.

The best way to justify an extremely firm date is with a justification. People like to have reasons for why you want them to do things. So come up with a reason why the closing needs to happen by such and such date. For example, "I'm going on vacation on that date, I'm having a baby, I'm leaving to go to a business meeting in a foreign country, we need the money to make a payment, we need the money to hire somebody." Just get with your team, brainstorm a solid reason why it absolutely has to be closed by that date.

That's the end of the story of making your side move quickly. Ultimately, it's really in the interests of your lawyers to actually get it done quickly. We've seen too many law firms get fired after

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<sup>70</sup><http://steveblank.com/2009/04/09/supermac-war-story-6-the-job-of-marketing-mission-stater>

a closing because the closing wasn't done quickly enough, there were too many errors and the entrepreneurs were not happy with it. I think it's important and good for the law firm for you to communicate what your metrics for success are. Finally, your lawyers are not computers, right? They're humans. So don't take the tone of the discussion here too literally. You want to treat them with grace and humility and make them excited to work with you.

### **Making the other side move quickly**

The other piece of the puzzle is getting the other side to move quickly on the closing and getting the other side's lawyers to move quickly on the closing. In general, if you're closing with a good firm, a good fund, they also want to close quickly. They don't have any interest in a slow closing process. It's just a question of getting their lawyer's bandwidth.

The best advice I have to get the venture fund, or investors and their lawyers to move quickly, is to have a great BATNA<sup>71</sup>. That's really the only advice I have for you there. Preferably you're in a situation where your BATNA has said something like, "If the other side blinks during the closing process, call me." You want to have a BATNA that's still chomping at the bit to invest in your company.

I'm not suggesting that you break any no shop clauses or anything like that, or confidentiality agreements that you have in your term sheet. What I am suggesting is prior to signing a term sheet, you want to have a BATNA that is chomping at the bit and will be interested in investing in your company even if the term sheet blows up after it's signed. They're chomping at the bit, like I said, they've said something like, "If the other side blinks during closing, call me."

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<sup>71</sup>[http://en.wikipedia.org/wiki/Best\\_alternative\\_to\\_a\\_negotiated\\_agreement](http://en.wikipedia.org/wiki/Best_alternative_to_a_negotiated_agreement)

If they haven't said something like that, you can say something like that. When you call the investors that you're not going to take money from and tell them that you're going to sign a term sheet with someone else, you can tell them, "If there's any problem during the closing process you are going to be my first call. I'm not expecting any problems during the closing process, but in the odd case that there is a problem during closing and we decide to pull the plug, you are going to be my first call."

So you're setting things up to have a great alternative if things blow up during closing, and you're providing yourself with an excuse. You're saying, if things do blow up it's not going to be them pulling the plug, it's going to be me pulling the plug.

Take it away Kazumi<sup>72</sup>.

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<sup>72</sup><http://www.youtube.com/watch?v=fucaV4SHSUs>

# May 2009

## Hey, have you heard of Twitter?

Listen man, subscribe to our Twitter<sup>1</sup> already. These brainiacs have:

RT @venturehacks: "Talking about 1 year venture returns is like talking about the score in 1 inning of a baseball game."  
<http://bit.ly/bwYF>

2:08 PM Apr 15th from twirlr

 timoreilly  
Tim O'Reilly

<sup>1</sup><http://twitter.com/venturehacks>

<sup>2</sup><http://twitter.com/timoreilly/statuses/1528376487>

"Most startups spend way too much time obsessing over their clueless competition." – Sean Ellis, <http://bit.ly/18xNxX> (via @venturehacks)

*12:28 PM Apr 22nd from Tweetie*



**ercries**

Eric Ries



3

RT @venturehacks: Ideas are worthless without execution. And execution is worthless without revision.



*7:23 PM Apr 16th from TweetDeck*



**ventilla**

4

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<sup>3</sup><http://twitter.com/ercries/statuses/1587403900>

<sup>4</sup><http://twitter.com/ventilla/statuses/1538825629>

RT @venturehacks: "I don't think I ever wrote a business plan... I got up to 12 PowerPoint slides and that was it."  
--@sgblank

*11:24 AM May 1st from TweetDeck*

 golda  
Christopher Golda

5

RT @venturehacks "Don't invent the problem, invent the solution." – Mike Speiser, <http://bit.ly/xhKOQ>

*3:05 PM Apr 23rd from web*

 chest  
Chester Ng

6

You've been served.

<sup>5</sup><http://twitter.com/golda/statuses/1671522009>

<sup>6</sup><http://twitter.com/chest/statUSES/1598171595>

# September 2009

## Steve Jobs does customer development



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Steve Jobs is the ultimate visionary. He has a vision, he implements it, and the world pays him tens of billions of dollars for it. He doesn't ask customers what they want because they would ask for a faster horse<sup>2</sup>, not a car. He knows what customers want before the customers do. He is the quintessential entrepreneur — the ideal that every founder strives to become.

Right? Wrong.

Even Steve Jobs does customer development<sup>3</sup>:

**David Pogue:** “You put a camcorder on the iPod Nano. Why not on the iPod Touch?

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<sup>1</sup><http://bits.blogs.nytimes.com/2009/09/09/inqa-steve-jobs-snipes-at-amazon-and-praises-ice-22+henry+ford&btnG=Search+Books>

<sup>2</sup><http://books.google.com/books?um=1&num=20&q=%22faster+horse%22+henry+ford&btnG=Search+Books>

<sup>3</sup><http://venturehacks.com/articles/customer-development>

**Steve Jobs:** “Originally, we weren’t exactly sure how to market the Touch. Was it an iPhone without the phone? Was it a pocket computer? What happened was, what customers told us was, they started to see it as a game machine. Because a lot of the games were free on the store. Customers started to tell us, “You don’t know what you’ve got here — it’s a great game machine, with the multitouch screen, the accelerometer, and so on.”

“We started to market it that way, and it just took off. And now what we really see is it’s the lowest-cost way to the App Store, and that’s the big draw. So what we were focused on is just reducing the price to \$199. We don’t need to add new stuff — we need to get the price down where everyone can afford it.”

(*From Q&A: Steve Jobs Snipes at Amazon, Praises Ice Cream*<sup>4</sup>)

Apple has changed the positioning<sup>5</sup> of the iPod Touch *twice*. First, it was a multitouch iPod. Then it was a “game machine”. Now it’s the “lowest-cost way to the App Store.”

## What does positioning have to do with customer development?

Refining the product’s positioning is the second step in Sean Ellis’ Startup Pyramid<sup>6</sup>:

“Once you have achieved product/market fit, it’s time to accelerate through the next steps of the pyramid and then begin scaling your business. Here’s a

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<sup>4</sup><http://bits.blogs.nytimes.com/2009/09/09/in-q-a-steve-jobs-snipes-at-amazon-and-praises-ice-cream/>

<sup>5</sup><http://steveblank.com/2009/03/26/supermac-war-story-4-repositioning-supermac-market-type/>

<sup>6</sup><http://startup-marketing.com/the-startup-pyramid/>

brief description of what to do at each of the steps before scaling:

**“Promise:** Highlight the benefits [positioning] described by your ‘must have’ users (those that say they would be very disappointed without your product).”

In this step, you use a combination of surveys and interviews to talk to your customers and ask questions like “In your opinion, what is the best reason for using our product?” If they say the best reason is playing games, start testing that positioning with new customers and see if it performs better than your current positioning.

## How do you position a product? #

In Four Steps to the Epiphany<sup>7</sup> (page 111), Steve Blank developed a model for positioning products based on market type<sup>8</sup>:

**“Existing Market:** Compare your product to your competitors. Describe how some feature or attribute of the product is better, faster — *an incremental improvement*.

**“New Market:** It’s too early for customers to understand what your product’s features will do for them. Instead, describe the problem your product will solve and the benefits that the customers will get from solving it — *a transformational improvement*.

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<sup>7</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>8</sup><http://venturehacks.com/articles/podcast>

**“Resegmented Market:** Compare your product to your competitors. If it’s low cost, describe price and feature set. If a niche, describe how some feature or attribute of the product solves the problem your customer has in a way comparable products do not. Describe the benefits that the customers will get from solving their problem this new way.”

The iPod was initially positioned in a resegmented market — it was a multitouch iPod. Then it was positioned in an existing market — portable game players. Now it’s positioned in a new market: a way to the App Store (although Steve Jobs probably should have said “pocket computer” instead of “way to the App Store” — pocket computer<sup>9</sup> is the new copy at apple.com).

If Apple wants to create a new market of devices that access the App Store, they’ll have to educate prospective customers who don’t know what the App Store is — or why they would want to access it. New markets always require customer education. Fortunately, Apple has been bombarding us with “there’s an app for that<sup>10</sup>” ads for some time now.

## Quiz

Jobs makes a second, subtler, point about customer development in the quote above. Can you find it? The best correct answer gets a shout-out in our next post.

Read part 2 of this series: No new features<sup>11</sup>.

*Photo: Jeff Chiu/Associated Press<sup>12</sup>*

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<sup>9</sup><http://www.apple.com/ipodtouch/what-is/ipod.html>

<sup>10</sup><http://www.youtube.com/watch?v=szrsfeyLzyg>

<sup>11</sup><http://venturehacks.com/articles/jobs-customer-development-2>

<sup>12</sup>[http://bits.blogs.nytimes.com/2009/09/09/in-qa-steve-jobs-snipes-at-amazon-and-praises-ice-](http://bits.blogs.nytimes.com/2009/09/09/in-qa-steve-jobs-snipes-at-amazon-and-praises-ice/)

## Steve Jobs does customer development: No new features



In Steve Jobs does customer development<sup>13</sup>, I asked readers to find a customer development lesson in Steve's interview. There were a lot of good responses<sup>14</sup> that I didn't anticipate. But Reece<sup>15</sup> came closest to the answer I was looking for:

"The subtler customer development point from Jobs is 'We don't need to add new stuff.' He realized the feature set is fine — instead of cramming in new features that most users won't touch, Apple can instead

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<sup>13</sup><http://venturehacks.com/articles/jobs-customer-development>

<sup>14</sup><http://venturehacks.com/articles/jobs-customer-development#comments>

<sup>15</sup><http://TeamHomeField.com>

focus on positioning the product via marketing and pricing.”

In other words, Apple didn’t add a camera so they could deliver on their positioning (“lowest-cost way to the App Store”), increase market share (“everyone can afford it”), and maybe even increase revenue.

I think Reece made one small, important error; so let’s pick on him for the sake of our education.

### **“But if we just add feature X”**

Reece implies that a camera is a feature “that most users won’t touch.” But adding a camera is probably a good idea. Maybe it’s the key to selling a billion more iPods. Who knows for sure?

Go to any group meeting at any startup and you’ll hear employees arguing for their own camera: “but if we just add *feature X* we’ll get more customers.” That’s a reasonable hypothesis. More people might buy the product with feature X. Should you build feature X?

Not necessarily. A startup’s cash-on-hand is shrinking every day. You want to add the features that will do the most to stop your losses. You don’t execute every random idea without prioritizing it.

The optimal plan may be to slow down product development, commit more resources to customer development, and find the right positioning for your product. The lesson here:

Once you reach a certain level of product/market fit<sup>16</sup>, the best plan may be to add *no new features*, focus on positioning, make more money, and move

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<sup>16</sup><http://startup-marketing.com/the-startup-pyramid/>

up the startup pyramid<sup>17</sup> — even though the team has a million obviously great ideas for new features that will make a buttload of money. You can improve the business without improving the product.

## Quiz

Can you find other examples where Apple and Pixar did customer development?

# How do I refine my product's positioning?

How do you pull a Steve Jobs<sup>18</sup> and refine your positioning based on customer feedback?

In Sean Ellis' model<sup>19</sup>, you need at least 40% product/market fit before the right positioning is going to improve your conversions dramatically. While you're iterating your product to get to 40%, use your own positioning hypotheses<sup>20</sup>.



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Once you get to 40%, email Matt Johnson<sup>22</sup> from Grockit<sup>23</sup> and get his expert opinion:

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<sup>17</sup><http://startup-marketing.com/the-startup-pyramid/>

<sup>18</sup><http://venturehacks.com/articles/jobs-customer-development>

<sup>19</sup><http://startup-marketing.com/the-startup-pyramid/>

<sup>20</sup><http://venturehacks.com/articles/jobs-customer-development#position>

<sup>21</sup><http://www.facebook.com/mathewgj>

<sup>22</sup><http://www.facebook.com/mathewgj>

<sup>23</sup><http://www.grockit.com/>

“First, we need to have attracted enough early users to be able to survey at all (of course).

“Second, we send an initial, kickoff survey that is very open-ended, the key positioning question is a simple free response: What most attracted you to want to try X? [Ed: A multiple choice question at this point would constrain user feedback.]

“Third, we collect these free responses, look for some signal/themes and boil them down into ~4 primary benefits that are resonating. In the iPod Touch case, those user-reported themes might be ‘more convenient than my laptop’, ‘awesome for games’, ‘cheapest way to get iPhone apps’, ‘best iPod for watching videos’.

“Fourth, we send a second survey out to a fresh group of users where the key positioning question is a multiple choice listing each of these benefits: In your opinion, what is the best reason for using X?

“After this we have a pretty good sense for the right positioning. In each survey we also ask the ‘Very Disappointed<sup>24</sup>’ question as a diagnostic to gauge the product/market fit.

“To actually write any ad/landing page copy we try to bubble up actual user responses that best fit our positioning and try to edit those words as little as possible. We’ll then always test a few of these copy variations in ads for a few days as well.”

## Bad features

Matt also sent me an email about our No new features<sup>25</sup> article:

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<sup>24</sup><http://startup-marketing.com/the-startup-pyramid/>

<sup>25</sup><http://venturehacks.com/articles/jobs-customer-development-2>

“One conversation that I have been having recently re: features is that most people discount the probability that an additional new feature will detract from the good thing you’ve got going (lucky you!). That is another realistic outcome to go along with the usual 1) the feature is a good idea, and everyone loves it or 2) the feature is a good idea , but not that many people use it.”

See Eric Ries’ article on The cardinal sin of community management<sup>26</sup> for a real-world example of a pernicious feature.

## Twitter updates

Here’s a snapshot of our latest updates from Twitter<sup>27</sup>. We use Twitter to post links to awesome resources for entrepreneurs. If you don’t use Twitter, subscribe via RSS<sup>28</sup>.

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<sup>26</sup>[http://www.startuplessonslearned.com/2009/09/  
cardinal-sin-of-community-management.html](http://www.startuplessonslearned.com/2009/09/cardinal-sin-of-community-management.html)

<sup>27</sup><http://twitter.com/venturehacks>

<sup>28</sup>[http://twitter.com/statuses/user\\_timeline/11620792.rss](http://twitter.com/statuses/user_timeline/11620792.rss)

**venturehacks**

Following Device updates OFF

**Steve Jobs does customer development, Part 2: Improving the business without improving the product; <http://bit.ly/rYO6J>.**

10:54 AM Sep 11th from bit.ly

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"Usually if [you] sell a lot of something, you want to tell everybody." - Steve Jobs, <http://bit.ly/P4t8G>

2:49 PM Sep 10th from Twwitter

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"There's not a drop of flash on this website [iTunes Store], from the rotating banners to the music preview player." - <http://bit.ly/Wjqmh>

12:47 PM Sep 10th from Twwitter

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**Steve Jobs does customer development: <http://bit.ly/2JXuvI>**  
Yes, even Steve Jobs. The first new blog post on Venture Hacks in quite a while.

10:48 AM Sep 10th from web

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"How can you tell the difference between an Ice Cream Glo and a Snuggie? You can't. Only your customers can." - Ries <http://bit.ly/82tOo>

3:02 PM Sep 3rd from web

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**Hypothesis: Most consumer internet startups fail because they build products they want to use. And that's also how the huge ones succeed.**

1:26 PM Sep 1st from Twwitter

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"The one number you should know about your equity grant by Chris Dixon, <http://bit.ly/v1KZO>. My comment:

## Term sheet tune-up

I recently received an email from an entrepreneur who had questions about a term sheet he received. Here are his questions and my answers.

### Bridge before Series A

The entrepreneur says,

“The investors are in the process of closing a fund so they want to give us a bridge loan now and do the Series A later in a few months after they’ve closed their fund.”

VC firms make seed investments all the time. If you have alternatives, take money from a firm that actually has the capital to invest in a Series A.

Even if the firm has capital, you won’t be able to raise a Series A from anyone if the bridge firm doesn’t like your progress after the bridge.

Read this article from our archives: Keep your Series A options open if you raise debt<sup>30</sup>.

### Board

“The board consists of 2 investors, 1 independent, 1 CEO, and 1 founder.”

This is too heavy for a bridge or a Series A. I recommend 1 investor, 2 founders for the bridge. Worst case: 1 investor, 1

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<sup>30</sup><http://venturehacks.com/articles/options-open>

founder, 1 independent. Best case: 0 investors, 2 founders. Use this quote from Marc Andreessen<sup>31</sup> as normative leverage<sup>32</sup>:

“In many cases, we don’t even think today’s raw startups should have boards.”

He’s talking about seed stage companies like you.

For the Series A, the worst case is 2 investors, 1 independent, 2 founders, 1 CEO (if and when we hire one). Read these articles: Create a board that reflects the ownership of the company<sup>33</sup>, Make a new board seat for a new CEO<sup>34</sup>, and Control is a one way street<sup>35</sup>.

## Valuation

“What are you seeing for valuations nowadays? Our prospective investor tells me ‘market’ is 40-40-20 (founders, investors, option pool) after the Series A.”

Market is whatever the market says, not what one investor says. You need at least two competing offers to create a market. If you have only have one offer, you’re going to have a tough time negotiating — although it can be done and companies do it all the time.

I would strive for 70 – 20 – 10 (founders, investors, option pool), depending on how much you’re raising. The more you raise, the greater your dilution. And I would settle for 60-25-15. These

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<sup>31</sup><http://blog.pmarca.com/2009/07/introducing-our-new-venture-capital-firm-andreessen-horowitz.html>

<sup>32</sup><http://venturehacks.com/articles/bargaining-for-advantage>

<sup>33</sup><http://venturehacks.com/articles/board-structure>

<sup>34</sup><http://venturehacks.com/articles/ceo-board-seat>

<sup>35</sup><http://venturehacks.com/articles/one-way-control>

goals will be dramatically easier if you only have one investor in your Series A syndicate.

Read these articles: Create a market for your shares<sup>36</sup>, Tips from a ex-VC who helps entrepreneurs raise money<sup>37</sup>, and Should I shop around?<sup>38</sup>.

## New CEO

“The investors want to replace the CEO during the Series A.”

This is a big red flag, especially if you aren’t interested in giving up the CEO spot right now. Fred Wilson says it well in The Human Piece Of The Venture Equation<sup>39</sup>:

“I’ve learned that nothing can replace the entrepreneur’s passion and vision for the product and the company. If you rip that out of the company too early, you’ll lose your investment. I think it’s best to wait until the initial product has succeeded in obtaining a critical mass of users and a business model has been developed that works and make sense for the business and is scaling. Then, if its warranted, you can sit down and have the conversation about bringing in experienced management.”

Use this quote as normative leverage.

This doesn’t mean you can’t collaborate with your investors to find a new CEO if you think the company needs one. Ask for

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<sup>36</sup><http://venturehacks.com/articles/create-a-market>

<sup>37</sup><http://venturehacks.com/articles/4-things>

<sup>38</sup><http://venturehacks.com/articles/shop-around>

<sup>39</sup>[http://www.avc.com/a\\_vc/2008/08/the-human-piece.html](http://www.avc.com/a_vc/2008/08/the-human-piece.html)

references from all of the founding CEOs they've replaced — including the bad references. Fred Wilson also has a great post on how to bring in a new CEO: I baked the cake, you can ice it, but don't screw it up<sup>40</sup>.

## **Startups are not assets under management**

Finally, who are the investors? If the investors are a well-known firm, they're probably trying to anchor<sup>41</sup> you and there's a lot of room to negotiate.

But if the investors are from an unknown firm, they might think this is a fair deal. They might have the mindset that they're investing in an asset that's going to be "managed" by the founders or new management. That's not the way startups work. If the founders give up too much of the company too early, they lose their drive to create value for the common and preferred shareholders alike.

## **New York Meetup**

We're excited to announce our very first meetup in the city of New York **THIS Wednesday Sep 30th 6-8pm at B Bar & Grill**<sup>42</sup>.

It will be an informal mixer for entrepreneurs, investors, and other startup folks to meet each other and talk about venture hacking. Naval<sup>43</sup> and I<sup>44</sup> (Nivi) will both be there. We look like this:

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<sup>40</sup>[http://www.avc.com/a\\_vc/2006/06/vc\\_clich\\_of\\_the\\_3.html](http://www.avc.com/a_vc/2006/06/vc_clich_of_the_3.html)

<sup>41</sup><http://hbswk.hbs.edu/archive/4302.html>

<sup>42</sup><http://www.yelp.com/biz/b-bar-and-grill-new-york>

<sup>43</sup><http://www.linkedin.com/in/navalr>

<sup>44</sup><http://www.linkedin.com/in/bnivi>



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This is our first offline meetup in any city ever — please help us make it a success. If you're in New York, come, we'd like to meet you. If you're not, please spread the word to your entrepreneur and investor friends there.

RSVPs aren't necessary but you can help us get a headcount by RSVP'ing on Facebook<sup>47</sup>.

We're looking forward to meeting the startup folks in New York. We understand these fellows are quite active in the community:



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<sup>45</sup><http://www.linkedin.com/in/navalr>

<sup>46</sup><http://www.linkedin.com/in/bnivi>

<sup>47</sup><http://www.facebook.com/editevent.php?picture&eid=169653771412#/event.php?eid=169653771412>

## Customer Development Patterns

Almost every startup with an unfinished application puts up a page like this:

### Get notified

Be one of the first to be updated when Spotify is available in your country, by entering your email address here:

  48

The customer development team at Grockit<sup>49</sup> (Sean Ellis<sup>50</sup> and Matt Johnson<sup>51</sup>) takes a more interesting approach:

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<sup>48</sup><http://www.spotify.com/en/why-not-available/>

<sup>49</sup><http://www.grockit.com/>

<sup>50</sup><http://startup-marketing.com/>

<sup>51</sup><http://www.facebook.com/mathewgj>

## Notify me when LSAT games become available.

Early sign up is now open and games are starting soon.

**Full Name**

**Email**

**Why are you interested in Grockit LSAT?**

- I'm studying for the LSAT
- Other

**Please take a moment to let us know why (optional)**

**Sign me up!**

52

Most startups just gather a list of email addresses. But Grockit measures the customer's intent: "Why do you want to use our product?"

Consider asking these additional questions, perhaps on a second page:

1. **"Can our CEO contact you to learn more about**

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<sup>52</sup>[http://grockit.com/preview\\_signups/new?group=lsat](http://grockit.com/preview_signups/new?group=lsat)

**your needs?"** Now you've got a list of earlyvangelists you can talk to — an awesome asset for startups that are iterating with their customers to reach product/market fit<sup>53</sup>.

2. **"How are you preparing for the LSAT today?"** Now you know if customers are putting together a solution out of other parts.
3. **"Would you pay for Grockit if it met your needs?"** Now you know if customers have a budget.

This is a customer development pattern that other startups should copy.

#<sup>54</sup> And here's Steve Blank<sup>55</sup>'s definition of an earlyvangelist — memorize it now.

## EarlyVangelist

Has / Or can Acquire  
a Budget

Has Put Together a Solution  
out of Piece Parts

Has Been Actively Looking For a Solution

Know They Have a Problem

Has A Problem

<sup>53</sup><http://venturehacks.com/articles/plans-ndas-traction#traction>

<sup>54</sup><http://venturehacks.com/#earlyvangelist>

<sup>55</sup><http://steveblank.com/>

# October 2009

## New York Meetup was awesome

We were amazed at the awesome turnout for the New York meetup on Wednesday. About 100 people joined us during the course of the evening. Thanks to everyone who came and everyone who spread the word.

It was a wonderful opportunity to meet old friends and make new ones. I saw lots of people exchanging cards and making new contacts. I only wish I had more time to talk to everyone.

### What I learned

First, a few folks said there aren't enough mixers for entrepreneurs and investors in New York. Can you recommend your favorite New York mixers in the comments?

#<sup>1</sup> Second, lots of people were wondering how to spread the word about their products. They're putting the cart before the horse. Instead of spreading the word, figure out how to make a handful of customers (say 100) happy. How?

1. **Build a minimum viable product**<sup>2</sup>. If your market is big enough, it doesn't matter if you piss off 10,000 customers along the way with a lame minimum viable product. If you're really worried about your brand, market your product under a different name.
2. **Get the MVP into the hands of few people.** Use Twitter updates, Facebook updates, Google Ads, Facebook Ads, LinkedIn Ads, standing on a corner, blogging,

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<sup>1</sup><http://venturehacks.com/#happy>

<sup>2</sup><http://venturehacks.com/articles/minimum-viable-product>

emailing<sup>3</sup> bloggers<sup>4</sup>, etc. to get your product in front of people and see if they make it to the finish line. If you can't find 100 customers this way, it won't do you any good to be on the front page of the New York Times.

3. **Iterate your product with these customers through surveys and interviews, until they think your product is a must-have<sup>5</sup>.** Yes, they might not embrace your product if you show them something too early — that's fine. Don't fear the false negative<sup>6</sup> — just build the next version and test it again.

Once you've reached product/market fit in a large market, *then* you can work on the economics of acquiring users profitably. Don't worry about acquiring customers until you solve a real problem in a big market. This is the theory described in Sean Ellis' startup pyramid<sup>7</sup> or Steve Blank<sup>8</sup>'s customer development model.

And if you don't have the resources to build a MVP, put up a survey on SurveyMonkey<sup>9</sup> or SurveyGizmo<sup>10</sup> and start finding your earlyvangelists<sup>11</sup>. You don't need a technical co-founder to do this.

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<sup>3</sup><http://runitback.tumblr.com/post/223371555/how-we-got-18-000-beta-users-in-4-weeks>

<sup>4</sup><http://news.ycombinator.com/item?id=903755>

<sup>5</sup><http://startup-marketing.com/the-startup-pyramid/>

<sup>6</sup><http://venturehacks.com/articles/minimum-viable-product#false-negative>

<sup>7</sup><http://startup-marketing.com/the-startup-pyramid/>

<sup>8</sup><http://steveblank.com/>

<sup>9</sup><http://www.surveymonkey.com/>

<sup>10</sup><http://www.surveygizmo.com/>

<sup>11</sup><http://venturehacks.com/articles/customer-development-patterns>

## People I met

Here's a brief description of some of the people I met. The list is missing many folks I met and others I didn't get to talk to — massive apologies. There's a lot of people working on cool things:

Josh Kaufman is writing a book version of the Personal MBA<sup>12</sup>.

John C. Akbari<sup>13</sup> is a sales agent for hire for early stage financial services software companies. No salary, higher commissions.

Anton Litvinenko is building Programeter<sup>14</sup> so managers can monitor software development.

Manish Vora just launched Arlo<sup>15</sup>, an easy way for artists to build portfolio sites.

Deepak Kapur<sup>16</sup> is building a product to help you get more Twitter followers.

Sarah Tavel<sup>17</sup> is off the rugby field and on her grind at Bessemer Venture Partners.

Lincoln Ritter from LearnVC<sup>18</sup> is building an online cap table for entrepreneurs and their employees.

Massimo LoBuglio<sup>19</sup> is working on the "(RED) of carbon emissions."

Trevor Owens<sup>20</sup> is a student at Stern and burgeoning entrepreneur.

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<sup>12</sup><http://personalmba.com/>

<sup>13</sup><http://www.linkedin.com/in/johnakbari>

<sup>14</sup><http://programeter.com/>

<sup>15</sup><http://arlosites.com/>

<sup>16</sup><http://kapurtech.com/>

<sup>17</sup><http://www.adventurista.com/>

<sup>18</sup><http://learnvc.com/>

<sup>19</sup><http://twitter.com/massimolobuglio>

<sup>20</sup><http://launchgrowipo.com/>

Eli Chapman's Mediatronica<sup>21</sup> is a software and entertainment consultancy in New York.

Kevin Murphy's is working on Beeing<sup>22</sup> to add a real-time social layer to the links you share.

Christine Lemke<sup>23</sup> is COO and co-founder at Sense Networks which analyzes large amounts of mobile location data in real-time to make recommendations.

Jason Yeh<sup>24</sup> recently joined Riot Games as Strategic Marketing Manager and also enjoys cardigans.

Bill Cromie is working on headliner.fm<sup>25</sup> which lets you virtually open for other bands.

Zach Harris is working on DiGiTS<sup>26</sup>, a show about a pickup artist gone wrong (think Ali G crossed with Derek Zoolander).

Zoran Knezevic is working on Fragrantica<sup>27</sup>, an online perfume community. He forgot to bring free samples.

What did you learn at the meetup?

## Get drunk with VCs and help charity

This post is for people who want to get drunk with Boston VCs and help charity at the same time. For free.

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<sup>21</sup><http://mediatronica.com/>

<sup>22</sup><http://www.beeing.com/>

<sup>23</sup><http://twitter.com/cklemke>

<sup>24</sup><http://simplyprepostero.us/>

<sup>25</sup><http://headliner.fm/>

<sup>26</sup><http://www.youtube.com/digitsshow>

<sup>27</sup><http://www.fragrantica.com/>



**GENERAL CATALYST  
PARTNERS**

<sup>29</sup> Atlas Venture<sup>30</sup> and General Catalyst<sup>31</sup> are throwing a charity wine party in Boston on Thursday, October 22, 2009 at 6pm. You can buy tickets at TUGG's site<sup>32</sup> and learn more in this Xconomy article<sup>33</sup>. VCs from about 10 Boston funds will be attending: Spark<sup>34</sup>, Battery<sup>35</sup>, CRV<sup>36</sup>, etc.

## Free tickets

They've given us 5 free tickets to give away (they're normally \$150) and we're running a contest to give them away: *Where do you think the money should go this year?* Last year, the party raised \$40K for Build<sup>37</sup>, a Silicon Valley non-profit that helps students start small businesses.

Send your idea to [dsamuels@tugg.org](mailto:dsamuels@tugg.org)<sup>38</sup> or tweet it with the #tugg<sup>39</sup> tag. We'll give free tickets to the 5 best ideas. Even if you don't know where the money should go, send a note to say hello and introduce yourself.

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<sup>28</sup><http://www.atlasventure.com/>

<sup>29</sup><http://www.generalcatalyst.com/>

<sup>30</sup><http://www.atlasventure.com/>

<sup>31</sup><http://www.generalcatalyst.com/>

<sup>32</sup><http://www.tugg.org/>

<sup>33</sup><http://www.xconomy.com/boston/2009/10/05/group-from-atlas-venture-general-catalyst-form-non-profit-to-promote-youth-entrepreneurship-and>

<sup>34</sup><http://www.sparkcapital.com/>

<sup>35</sup><http://www.battery.com/>

<sup>36</sup><http://crv.com/>

<sup>37</sup><http://www.build.org/>

<sup>38</sup><mailto:dsamuels@tugg.org>

<sup>39</sup><http://twitter.com/#search?q=%23tugg>

## **Atlas Venture: A new supporter**

Atlas Venture<sup>40</sup> is now supporting Venture Hacks. That's another way of saying they're sponsoring us. But I like the idea behind "support" better. It's more like the Hewlett Foundation sponsoring PBS, and less like P&G buying an ad on Days of our Lives.

Frankly, Atlas has supported us financially for quite a long time; I was an EIR at Atlas while I was getting Venture Hacks started<sup>41</sup>. Many other firms and people have also supported us financially and otherwise — we need to figure out a way to thank them soon.

## **Take our Twitter Survey**

We're spending more and more timing posting original content and links on Twitter at [twitter.com/venturehacks](http://twitter.com/venturehacks)<sup>42</sup>. For example:

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<sup>40</sup><http://www.atlasventure.com/>

<sup>41</sup><http://venturehacks.com/articles/term-sheet-hacks>

<sup>42</sup><http://twitter.com/venturehacks>

RT @venturehacks In business,  
personality matters. Unfortunately.  
Fortunately.

about 4 hours ago from TweetMiner

 **asmartbear**  
Jason Cohen

43

He was right, only, wrong too. RT  
 @venturehacks: "No-brainer pass." –  
 David Cowan on eBay, <http://j.mp/Ar4SS>

1:15 PM Oct 5th from TweetDeck

 **VCMike**  
Mike Hirshland

44

Once in a while, we post a summary of our tweets here on this blog — like this<sup>45</sup>.

Do you like our tweet summaries? Hate them? Want more? Want us to stop? We want your feedback.

Click here to take our Twitter survey<sup>46</sup>.

<sup>43</sup><http://twitter.com/asmartbear/statuses/4709288882>

<sup>44</sup><http://twitter.com/VCMike/statuses/4636527983>

<sup>45</sup><http://venturehacks.com/articles/heard-of-twitter>

<sup>46</sup>[http://www.surveymonkey.com/s.aspx?sm=5Ef51tDL5v\\_2fQU\\_2bkIIPLsZA\\_3d\\_3d](http://www.surveymonkey.com/s.aspx?sm=5Ef51tDL5v_2fQU_2bkIIPLsZA_3d_3d)

5 questions. 1 minute of your time. Your feedback: priceless. Thank you for sharing your thoughts and time.

There's also an opportunity to join our customer development team at the end of the survey. *Muchas gracias!*

## Put your tweets on your blog

We recently undertook a landmark survey<sup>47</sup> to determine whether our readers want to see our tweets<sup>48</sup> here on this blog. The short answer is: yes.

**First, 62% of respondents want to see tweets on the blog at least once a week.** And a whopping 75% want to see tweets at least once a month:

1. I want to see tweets on the blog.		<a href="#">Create Chart</a>	<a href="#">Download</a>
		Response Percent	Response Count
Once a day		23.4%	11
Once a week		38.3%	18
Once a month		12.8%	6
Never		25.5%	12
	<i>answered question</i>		47
	<i>skipped question</i>		6

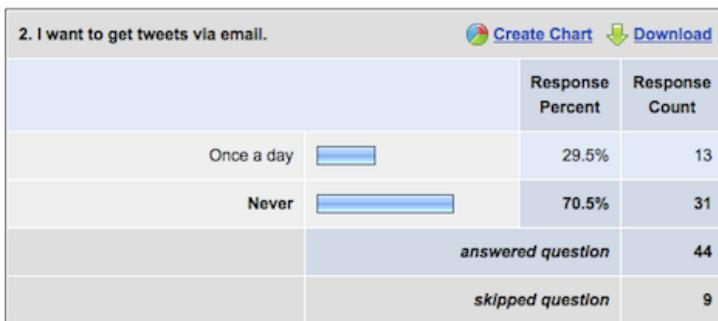
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<sup>47</sup><http://venturehacks.com/articles/twitter-survey>

<sup>48</sup><http://twitter.com/venturehacks>

Lesson: Consider putting your tweets on your blog. Surprisingly, and yet also, unsurprisingly, people who *already* follow us on Twitter are more interested in seeing tweets on the blog than people who *don't* follow us.

Second, a stunning 30% of respondents want to get our tweets over email:



Third, 65% of respondents already follow us on Twitter:



Fourth, 50% of respondents volunteered to be on our customer development team<sup>49</sup>. Lesson: Ask for help—you might be surprised by the response.

We also learned to pilot and test surveys on Twitter. Before distributing the survey broadly, we put up a tweet<sup>50</sup> asking people to check out the survey. Then we used their feedback to make the survey more clear.

Finally, here's my favorite comment from one of the respondents:

“[You] guys seem to exhibit a sense of humor. Absent that, all this stuff is unbearable.”

I need to remember that.

## “Your next feature won’t save you”

Here's our top 5 tweets from last week. You'll never miss another tweet if you subscribe via RSS<sup>51</sup> or email<sup>52</sup> (no more than one email a day; unsubscribe anytime). Of course, you can also follow us on Twitter<sup>53</sup>.

### Top 5 tweets of the week

We calculated the top 5 tweets of the week by looking at the click-throughs of our j.mp links (example<sup>54</sup>):

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<sup>49</sup><http://venturehacks.com/articles/customer-development-patterns>

<sup>50</sup><http://twitter.com/venturehacks/status/4691842970>

<sup>51</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>52</sup>[http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en_US)

<sup>53</sup><http://twitter.com/venturehacks>

<sup>54</sup><http://j.mp/info/3OEeKN>

438 clicks: Sell your product with fake screenshots. Read <http://j.mp/1vTIxI><sup>55</sup>. (*This tweet also made it to the top of Hacker News*<sup>56</sup>; *first tweet ever to make it to the top?*).

240 clicks: “The idea that anyone at all would build a business around funding startups is the remarkable thing.” – @pkedrosky<sup>57</sup>, <http://j.mp/10ICTQ><sup>58</sup>

217 clicks: VC-backed foursquare uses Google Docs to collect customer feedback: <http://j.mp/3Y9QLL><sup>59</sup>. No code, no maintenance. Keeping it minimal baby.

200 clicks: Chris Dixon (@cdixon<sup>60</sup>) on the problem with taking seed money from big VCs: <http://j.mp/2BHIPe><sup>61</sup>. Some solutions: <http://j.mp/4hFSsL><sup>62</sup>.

182 clicks: “We’re often told that there are no shortcuts to success... There are always shortcuts and loop-holes.” – Paul Buchheit (@paultoo<sup>63</sup>), <http://j.mp/2PLlcY><sup>64</sup>

## Editor’s choice

My favorite tweet of the week:

208 clicks: Your next feature won’t save you. But product/market fit, acquisition optimization, and creative distribution might. See: <http://j.mp/23hdE><sup>65</sup>.

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<sup>55</sup><http://j.mp/1vTIxI>

<sup>56</sup><http://news.ycombinator.com/item?id=877564>

<sup>57</sup><http://twitter.com/Pkedrosky>

<sup>58</sup><http://j.mp/10ICTQ>

<sup>59</sup><http://j.mp/3Y9QLL>

<sup>60</sup><http://twitter.com/CDixon>

<sup>61</sup><http://j.mp/2BHIPe>

<sup>62</sup><http://j.mp/4hFSsL>

<sup>63</sup><http://twitter.com/paultoo>

<sup>64</sup><http://j.mp/2PLlcY>

<sup>65</sup><http://j.mp/23hdE>

## “Real wealth creation will take founding, seniority, or staggeringly large exits.”

We wrote a lot of comments on other people's blogs this week. Then we shared them on Twitter. I think you'll like them. Here's the top 4:

How do you raise money if you're a very early stage companies with no product, traction, or track record? Some thoughts: <http://j.mp/Uy0iR><sup>66</sup>. (345 clicks — on the weekend!)

If you want to be a founder, but you're going to be an employee for now, should you join a startup or non-startup? See <http://j.mp/XTpYr><sup>67</sup>. (274 clicks)

Why create a new market if you can resegment an existing market? See <http://j.mp/e7wnN><sup>68</sup>. (255 clicks)

Does Sequoia's investment in Y Combinator hurt YC companies? My thoughts: <http://j.mp/1Iytwx><sup>69</sup>. (251 clicks)

## Links

And here's the top 5 links we shared on Twitter this week:

“Startups... punish effort that doesn't yield results.”  
– Eric Ries (@ericries<sup>70</sup>), <http://j.mp/qI5FE><sup>71</sup> (283 clicks)

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<sup>66</sup><http://j.mp/Uy0iR>

<sup>67</sup><http://j.mp/XTpYr>

<sup>68</sup><http://j.mp/e7wnN>

<sup>69</sup><http://j.mp/1Iytwx>

<sup>70</sup><http://twitter.com/ericries>

<sup>71</sup><http://j.mp/qI5FE>

“10 Disturbing Similarities Between Dating & Raising Capital” by SEOMoz founder, Rand Fishkin. Video: <http://j.mp/1WfnSv><sup>72</sup>. Thanks @zoransa<sup>73</sup>. (234 clicks)

“Real wealth creation will take founding, seniority, or staggeringly large exits.” – Aaron Cohen’s advice to employees, <http://j.mp/2CypaP><sup>74</sup> (198 clicks)

Meet a CO-FOUNDER at Founder Dating in the Bay Area: <http://j.mp/35teD7><sup>75</sup>. Great idea, great name. (195 clicks)

An oldy but goody from ex-VC Bill Burnham: “Understanding Why Your VC Is Acting Crazy”, <http://j.mp/1nswtZ><sup>76</sup>. (166 clicks)

## Tweet browser

Chris Turner<sup>77</sup> took our entire tweet archive<sup>78</sup> and categorized the tweets with his tweet browser<sup>79</sup>. I’ve been having fun reading our old tweets — I particularly like reading through the books we’ve tweeted about<sup>80</sup>.

*Never miss another tweet again if you subscribe via RSS<sup>81</sup> or email<sup>82</sup> (no more than one email a day; unsubscribe anytime). Of course, you can also follow us on Twitter<sup>83</sup>.*

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<sup>72</sup><http://j.mp/1WfnSv>

<sup>73</sup><http://twitter.com/ZORANSA>

<sup>74</sup><http://j.mp/2CypaP>

<sup>75</sup><http://j.mp/35teD7>

<sup>76</sup><http://j.mp/1nswtZ>

<sup>77</sup><http://www.linkedin.com/in/bigdataguy>

<sup>78</sup><http://twitter.com/venturehacks/status/5079312436>

<sup>79</sup><http://gentle-flower-43.herokuapp.com/venturehacks>

<sup>80</sup><http://gentle-flower-43.herokuapp.com/venturehacks/book>

<sup>81</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>82</sup>[http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en_US)

<sup>83</sup><http://twitter.com/venturehacks>

## 10 examples of minimum viable products

“Entrepreneurship in a lean startup is really a *series* of MVP’s”

– Eric Ries<sup>84</sup>

“We kept to minimum feature spec. I think that is always very important. It is hard to determine what to do until you launch.”

– Immad Akhund<sup>85</sup>

Do minimum viable<sup>86</sup> products<sup>87</sup> seem abstract? Here's 10 examples:

1. “If Apple can launch a smartphone without Find or Cut-and-Paste, what can you cut out of your product requirements?” – Sramana Mitra<sup>88</sup>
2. USV<sup>89</sup>-backed foursquare uses Google Docs to collect customer feedback<sup>90</sup>. No code, no maintenance.
3. Fliggo sells it before they build it<sup>91</sup>.
4. Grockit puts up a notify-me-when-you-release form<sup>92</sup> on steroids.

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<sup>84</sup>[http://www.startuplessonslearned.com/2009/10/  
inc-magazine-on-minimum-viable-product.html](http://www.startuplessonslearned.com/2009/10/inc-magazine-on-minimum-viable-product.html)

<sup>85</sup>[http://www.immadsnewworld.com/2009/02/  
heyzap-launches-forming-of-heyzap-and.html](http://www.immadsnewworld.com/2009/02/heyzap-launches-forming-of-heyzap-and.html)

<sup>86</sup><http://venturehacks.com/articles/minimum-viable-product>

<sup>87</sup>[http://www.startuplessonslearned.com/2009/08/  
minimum-viable-product-guide.html](http://www.startuplessonslearned.com/2009/08/minimum-viable-product-guide.html)

<sup>88</sup>[http://www.sramanamitra.com/2008/02/24/  
the-iphone-as-a-minimum-viable-product-archetype/](http://www.sramanamitra.com/2008/02/24/the-iphone-as-a-minimum-viable-product-archetype/)

<sup>89</sup><http://unionsquareventures.com/>

<sup>90</sup>[http://spreadsheets.google.com/viewform?hl=en&formkey=  
ck14Z3lTEJYRUNLNDlQ05wTkhhYWc6MA](http://spreadsheets.google.com/viewform?hl=en&formkey=ck14Z3lTEJYRUNLNDlQ05wTkhhYWc6MA)

<sup>91</sup><http://venturehacks.com/articles/sell-it-before-you-build-it>

<sup>92</sup><http://venturehacks.com/articles/customer-development-patterns>

5. Auto e-commerce site uses manualation<sup>93</sup> and flintstoning for their backend.
6. Semiconductor company uses 5 people and FPGAs<sup>94</sup> to build a \$100M semiconductor product line.
7. Consumer company uses fake screenshots<sup>95</sup> to sell their product.
8. Allicator uses Facebook ads<sup>96</sup>: “Ditch Digger? Feeling spread thin? Click here to complete a survey and tell us about it.”
9. ManyWheels uses Microsoft Visio to build clickable web demos<sup>97</sup> for prospective customers.
10. Cloudfire uses a classic customer development problem presentation<sup>98</sup>.

Work in small batches<sup>99</sup>. A minimum viable product is simply the smallest batch that will teach you something. What can you release in one day?

“The first version of Gmail was literally written in a day.”

– Paul Buchheit<sup>100</sup>

Please add your favorite MVPs in the comments. Don’t be lazy.

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<sup>93</sup><http://news.ycombinator.com/item?id=529420>

<sup>94</sup><http://venturehacks.com/articles/minimum-viable-product#comment-8057>

<sup>95</sup><http://leanstartup.pbworks.com/Case-Study-One>

<sup>96</sup>[http://groups.google.com/group/lean-startup-circle/browse\\_thread/thread/3ab7800f52d748da](http://groups.google.com/group/lean-startup-circle/browse_thread/thread/3ab7800f52d748da)

<sup>97</sup><http://kevindewalt.com/blog/2009/01/03/mitigating-market-risk-with-microsoft-visio/>

<sup>98</sup><http://www.ashmaurya.com/2009/10/how-i-built-my-minimum-viable-product/>

<sup>99</sup><http://www.startuplessonslearned.com/2009/02/work-in-small-batches.html>

<sup>100</sup><http://paulbuchheit.blogspot.com/2009/01/communicating-with-code.html>

## Even more MVPs

1. RightNow uses phone calls<sup>101</sup> to iterate on their MVP.

## The problem with VC motivation

*Thanks to Atlas Venture<sup>102</sup> for supporting Venture Hacks this month. This post is by Fred Destin<sup>103</sup>, one of Atlas' general partners. If you like it, check out Fred's blog<sup>104</sup> and tweets @fdestin<sup>105</sup>. And if you want an intro to Atlas, send me an email. I'll put you in touch if there's a fit. – Nivi*



<sup>106</sup>Many VC's, particularly in Europe, are disappointing in their (lack of) intensity. They are not 24/7, passionate advocates of the businesses they fund; neither do you meet them at random conferences scouting for new companies; nor do they necessarily come across as particularly engaged at board meetings. Why is that? Let's talk VC compensation and motivation for a second.

## My motivation as a VC

Introspection is as good a place as any to start. Here are my top motivations for being a VC (leaving out the personal stuff):

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<sup>101</sup><http://www.nikhileshrao.com/post/703/greg-gianforte-ceo-of-rightnow--building-minimum-via>

<sup>102</sup><http://www.atlasventure.com/>

<sup>103</sup><http://www.freddestin.com/blog/>

<sup>104</sup><http://www.freddestin.com/blog/>

<sup>105</sup><http://twitter.com/fdestin>

<sup>106</sup><http://www.freddestin.com/blog/>

1. **Company building:** Every VC is different, some like doing the deals but don't really care for the long-term relationship<sup>107</sup> that ensues. With me it's the "deal management" (as we call it) that provides me with the greatest satisfaction. An engaged relationship with the management team and co-directors towards building a great business. That's when I feel I am part of a greater whole, of creating jobs, of the whole great forward human movement of innovation and entrepreneurship.
2. **Intellectual stimulation:** I am a fairly consistent guy, but I do get bored. As a VC you get to see 100's of new projects every year and meet a ton of creative people, and understanding each one challenges your (dwindling number of) neurons in a different way. Every company you invest in is different, and requires fresh thinking. So being a VC keeps me entertained, frankly. This is the primary reason why I never started a company. The trade-off is that you work through others (the management teams you fund) and hence never quite get that satisfaction of achievement in the same way.
3. **Personal recognition:** Let's face it, I love being recognised for what I do. Thankfully my wife keeps that ever-burgeoning ego firmly in check.
4. **The Hunt and the Deal:** I don't think you can be an effective VC if you do not like to be a Hunter, to be always out on the move looking for the next big thing, to want to win the confidence and trust of entrepreneurs and co-investors to take your money and no-one else's. Inking that term-sheet and closing that deal gives me a great buzz every time. After all, I grew up on a trading floor !
5. **Money:** More on this below.

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<sup>107</sup> [http://en.wikipedia.org/wiki/Interpersonal\\_relationship](http://en.wikipedia.org/wiki/Interpersonal_relationship)

6. **Lifestyle:** I work hard, but on my own terms, when and where I choose. The less glamorous reality is that I spend 2/3 of my time on the road and that they greet me by name at hotels in at least 3 different cities, but I remain a master of my own destiny.

That's my list.

## **Let's zoom in on money**

Here is the issue with venture capital as a way of making money:

- It's easy to get a comfortable lifestyle (say \$300,000+ a year, often multiples thereof).
- It's (really) hard to make it really big (say \$20,000,000+).

The not-so-secret fact about venture capital is that it has not made serious money for 10 years now. That means many, if not most, venture capitalists have **not seen a large carry check in a decade**. For those who don't know venture economics, the partners in a fund contribute the first 1-3% of a fund with their own cash, which means most of us write checks worth > \$100,000 every year to our own funds, sometimes a lot more. So if you are a VC in a median return fund, you keep writing these checks vaguely hoping you will make your money back; some will tend to get more and more focused on the nice salary they can take out every year.

**To generate real carry, you need to work hard with *no obvious improvement in the probability* that your fund will be a wild success.** In other words, the marginal return on effort expanded is not obvious and may well be zero. You won't know until much later... And that, my friends, is the core **problem with VC motivation**.

Because it takes a very long time to know whether you are a good VC, partners can keep taking comfortable salaries for a decade or more before any form of verdict is placed on their money-making abilities. In the meantime, they manage their own calendar and work at their chosen intensity, with no immediately obvious return on effort expanded. Q.E.D.

## The Solution

The solution is not simple. As an LP you would only want to invest in partnerships that provide:

- Accountability
- Meritocracy
- Paranoia
- Professionalism
- Absolute hunger
- True Passion for the business

...and of course, deal picking skills, deal building skills, and returns!

Paul Kedrosky at Xconomy<sup>108</sup> has considered this problem from the LP angle with the following recommendation: pre-agree on budgets and/or find out what your chosen partnership uses its money on. Good advice, with plenty of practical problems, but clearly sound.

In a good partnership, **paranoia and professionalism mean that emulation keeps everyone on their toes**. And your

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<sup>108</sup> <http://www.xconomy.com/national/2009/10/08/venture-model-makeover-diet-plan-step-two/>

passion for the business keeps you working all the time. And you really want to make a ton of money. And you want to be remembered for all the great business you contributed to. All of the above!

Hence:

**VC is only a lifestyle business if you do not fundamentally care about being wildly successful.** Now how do you screen for that, when every manager that comes into your office sings the same song?

*Thanks for reading. If you like this post, check out Fred's blog<sup>109</sup> and his tweets @fdestin<sup>110</sup>.*

## Notes from Startup School 2009



<sup>111</sup>

Mark Bao has posted his notes<sup>112</sup> from this year's Startup School<sup>113</sup>. Here are my favorite parts (everything below is cut-and-pasted directly from his notes — read the full collection<sup>114</sup>):

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<sup>109</sup><http://www.freddestin.com/blog/>

<sup>110</sup><http://twitter.com/fdestin>

<sup>111</sup><http://journal.markbao.com/2009/10/startup-school-2009-summary/>

<sup>112</sup><http://journal.markbao.com/2009/10/startup-school-2009-summary/>

<sup>113</sup><http://startupschool.org/>

<sup>114</sup><http://journal.markbao.com/2009/10/startup-school-2009-summary/>

*Mark Pincus<sup>115</sup>, CEO, Zynga: My Startup Experience*

- what really matters is that YOU CONTROL YOUR BOARD.  
Mark Zuckerberg claps.

How? (1) Create a board that reflects the ownership of the company<sup>116</sup>. (2) Make a new board seat for a new CEO<sup>117</sup>, (3) Do a term sheet tune-up<sup>118</sup>.

*Mark Zuckerberg<sup>119</sup>, Founder and CEO, Facebook: Q&A with Jessica Livingston*

- he says he never pitched Facebook a lot. Just got introduced to people because already had x00,000 users

Traction solves every problem. Profit erases every sin.

- cognizant of the fact that engineers tend to move around companies. Facebook is a place to learn; he's cool with moves.

That's a neat solution: retention is a problem — so we "don't care" about retention. Jeffrey Pfeffer and Bob Sutton from Stanford offer other<sup>120</sup> solutions<sup>121</sup> for retaining employees.

*Twitter Founders Biz Stone<sup>122</sup> and Ev Williams<sup>123</sup>: Q&A with Jessica Livingston<sup>124</sup>*

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<sup>115</sup><http://markpincus.typepad.com/>

<sup>116</sup><http://venturehacks.com/articles/board-structure>

<sup>117</sup><http://venturehacks.com/articles/ceo-board-seat>

<sup>118</sup><http://venturehacks.com/articles/term-sheet-tune-up>

<sup>119</sup><http://www.facebook.com/markzuckerberg>

<sup>120</sup><http://venturehacks.com/articles/ordinary-people>

<sup>121</sup><http://venturehacks.com/articles/human-equation>

<sup>122</sup><http://twitter.com/biz>

<sup>123</sup><http://twitter.com/eV>

<sup>124</sup><http://www.foundersatwork.com/blog.html>

- motivation behind Twitter: two week hackweek at Obvious. they built, used it over the weekend, and they were passionately engaged

Hackdays are a great way to boost morale, clear out the ideas you can't stop thinking about, and build small, low-priority, high ROI features and products.

*Tony Hsieh<sup>125</sup>, CEO, Zappos: Delivering Happiness*

- Zappos' Committable Core Values are grounds for hiring and firing, very serious about it

*Greg McAdoo<sup>126</sup>, Sequoia Capital*

- good recession-era startups “buy the cash register early,” — they execute their pay business model earlier to generate revenues earlier and bank earlier
- enterprise sales tip: promote and talk about the HARD DOLLAR ROI. it’s the most important thing to talk about. make them scared to reject your product. make them think “if my boss ever found out we could have saved 50% on software X, he would be pissed.” make them fear that the competition get the product in their hands and beat you out.
- startups that gain revenue early are disciplined earlier, and get used to being an actual business earlier, and generally are better and more recession-proof

Also see Fred Wilson's post on Portfolio Screens<sup>127</sup>.

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<sup>125</sup><http://blogs.zappos.com/blogs/ceo-and-coo-blog>

<sup>126</sup><http://www.sequoiacap.com/us/greg-mcadoo>

<sup>127</sup>[http://www.avc.com/a\\_vc/2008/11/portfolio-scree.html](http://www.avc.com/a_vc/2008/11/portfolio-scree.html)

*Jason Fried<sup>128</sup>, CEO, 37signals: Funding and Charging for Your Product*

- the difference between a bootstrapped and funded company is easy to understand.
- the bootstrapped company starts off thinking: we need to make money.
- the funded company starts off thinking: we need to spend money. these investors have given us x million dollars—we should spend it!
- funding is like crack. it's an addiction with names like Series C. Don't keep going back for more and more funding; it'll make your addiction worse.
- sorry, failure is not a rite of passage. you don't have to fail. failing once doesn't prevent another. Fried thinks the idea of "you have to fail once" and having to "learn about failure" is ridiculous.
- learning a lesson from failure is learning what not to do. learning what to do is a lot better than learning what not to do.

Read all of Mark Bao's notes<sup>129</sup>.

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<sup>128</sup><http://twitter.com/JasonFried>

<sup>129</sup><http://journal.markbao.com/2009/10/startup-school-2009-summary/>

## Our first online workshop: How to pitch investors



We're teaching our first ever online workshop about "How to pitch investors" on eduFire — a platform for live video teaching online. Sign up here.<sup>131</sup> I've taken classes on eduFire and it works really well; here are some recordings of their classes<sup>132</sup>.

(**Update:** This class is full so I've opened up a second class. Sign up here<sup>133</sup>.)

(**Another update:** The second class is also full. E-mail me<sup>134</sup> to get on the waiting list for the next class. And if you want to buy a recording of the class, e-mail me<sup>135</sup> or contact me on eduFire. We obviously won't be able to work on your pitch with a recording, so it's half the price (\$49).)

### What you'll accomplish

You could be building the next Google — but investors won't know it if your pitch doesn't sing. You're going to "walk" out the workshop with:

- A great pitch for your startup.

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<sup>130</sup><http://edufire.com/classes/10506-pitching-hacks-how-to-pitch-investors>

<sup>131</sup><http://edufire.com/classes/10506-pitching-workshop-how-to-pitch-investors>

<sup>132</sup><http://videos.edufire.com/>

<sup>133</sup><http://edufire.com/classes/10588-pitching-workshop-how-to-pitch-investors>

<sup>134</sup><mailto:nivi@venturehacks.com>

<sup>135</sup><mailto:nivi@venturehacks.com>

- A list of things your startup will need to accomplish before you can raise money.
- An understanding of the fundamentals of pitching so you can revise your pitch anytime and teach your friends how to do it.
- A copy of our Pitching Hacks<sup>136</sup> e-book.

First we'll cover the fundamentals:

What investors want to see<sup>137</sup> How to get intros to investors<sup>138</sup> High-concept pitches<sup>139</sup> Elevator pitches<sup>140</sup> Decks and presentations<sup>141</sup> NDAs<sup>142</sup>

Then we'll work on your pitch as a group. You'll get lots of hands-on advice from me and other students. I'll also be sharing some of my latest pitching techniques which we haven't published anywhere.

This is the first time we've ever done anything like this and I'm psyched.

## Time and Cost

The workshop costs \$98 (just like Wal-Mart) and there are only 3 slots left (uh, somebody signed up while I was writing this). It consists of 2 sessions on Tuesday Nov 3rd 5-6pm Pacific and

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<sup>136</sup><http://venturehacks.com/pitching>

<sup>137</sup><http://venturehacks.com/articles/plans-ndas-traction#traction>

<sup>138</sup><http://blogs.harvardbusiness.org/nivi/2009/02/how-do-i-get-meetings-with-inv.html>

<sup>139</sup><http://venturehacks.com/articles/high-concept-pitch>

<sup>140</sup><http://venturehacks.com/articles/elevator-pitch>

<sup>141</sup><http://venturehacks.com/articles/deck>

<sup>142</sup><http://venturehacks.com/articles/plans-ndas-traction>

Thursday Nov 5th 5-6pm Pacific. *You go to both sessions.* Sign up here.<sup>143</sup>

(**Update:** This class is full so I've opened a second class on Wed Nov 4th 1-2pm Pacific and Friday Nov 6th 1-2pm Pacific. You go to both sessions. Sign up here<sup>144</sup>.)

(**Another update:** The second class is also full. If you want to buy a recording of the class, e-mail me<sup>145</sup> or contact me on eduFire. We obviously won't be able to work on your pitch with a recording, so it's half the price.)

## Reviews

We've helped startups raise tens of millions of dollars from investors like Sequoia, Benchmark, Bessemer, etc. See the reviews<sup>146</sup> of our pitching advice from entrepreneurs like Adam Smith at Xobni and Jonathan Grubb from Get Satisfaction.

## Prerequisites

The only prerequisite is determination. You'll be even better prepared if you read the fundamentals above.

Contact me on eduFire or email [nivi@venturehacks.com](mailto:nivi@venturehacks.com)<sup>147</sup> if you have any questions and sign up here<sup>148</sup>.

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<sup>143</sup><http://edufire.com/classes/10506-pitching-workshop-how-to-pitch-investors>

<sup>144</sup><http://edufire.com/classes/10588-pitching-workshop-how-to-pitch-investors>

<sup>145</sup><mailto:nivi@venturehacks.com>

<sup>146</sup><http://venturehacks.com/pitching#testimonials>

<sup>147</sup><mailto:nivi@venturehacks.com>

<sup>148</sup><http://edufire.com/classes/10506-pitching-hacks-how-to-pitch-investors>

# November 2009

## Customer development by the book



<sup>1</sup>Ash Maurya<sup>2</sup>'s new blog documents his journey through customer<sup>3</sup> development<sup>4</sup>. This is the most by-the-book<sup>5</sup> application of customer development that I have ever seen. I am following this blog very closely; it's thoughtful and well written. Some highlights:

Is AdWords the right MVP for your product?<sup>6</sup>

“For Timothy Ferris, his MVP for testing new products that don’t yet exist (micro-testing) comprises of a landing page, signup page, and Google Adwords to drive traffic. However, this approach presupposes that:

1. You can create a good landing page
2. You can write good adwords copy
3. Adwords is a viable distribution channel for your product

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<sup>1</sup><http://www.ashmaurya.com/>

<sup>2</sup><http://www.ashmaurya.com/>

<sup>3</sup><http://www.startuplessonslearned.com/2008/11/what-is-customer-development.html>

<sup>4</sup><http://steveblank.com/>

<sup>5</sup><http://www.amazon.com/gp/product/0976470705?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0976470705>

<sup>6</sup><http://www.ashmaurya.com/2009/10/how-i-built-my-minimum-viable-product/>

“Unlike a book title or some other other physical product, startups are usually characterized by products where the problem and solution are unknown and have not yet been validated which makes writing good landing page copy hard, and good Adwords copy even harder (you only get 25 characters for your headline!). At best, you can guess. But starting with that approach is a surefire way of dumping a lot of money on Google Ads fast. Plus the return on learning is low – When your click-through-rate is low, or the bounce rate high, you get zero visibility into why. Was it poor copy, poor product/market fit, or both? And don’t even get me started on how expensive CPCs have gotten in competitive markets.”

Have you ever stated or revised your problem hypotheses?<sup>7</sup>

“Our top 3 [problem hypotheses] were:

1. Sharing lots of photos and videos is a hassle
2. A lot of services downsize the images so the quality is poor
3. Notifying family and friends of updates was manual and a chore...

“During the interview, we were particularly interested in learning what their sharing workflow was like. We set up the stage and let them tell us everything they did with their photos/videos taking them from camera to shared, what they wished they could change, and the magical pricing questions: Would they use a solution like the one we were envisioning if it were free? Would they use it if it were \$X/yr?

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<sup>7</sup><http://www.ashmaurya.com/2009/10/how-i-built-my-minimum-viable-product/>

X changed from customer to customer but we kept it as real as we could.

“We talked to enough people until their answers started sounding the same. At that point we had a pretty good idea of what our product’s unique value proposition should be, a list of other benefits, and a price to put on our signup page.

“Our revised top 3 problems were:

1. Sharing lots of photos and videos is a hassle (**stayed the same**)
2. Requiring visitors to signup is annoying
3. Photo gallery design was too busy or complicated”

Have you ever collected feedback from your customers with, like, your ears?<sup>8</sup>

“By now we had also heard of the merits in listening to your users and decided to follow a release early/release often model. The only problem was we didn’t know how to listen. In the interest of efficiency and productivity, I generally avoided face to face meetings and phone calls and preferred email. Many people were struggling with the software (desktop apps are hard) but we didn’t know how to engage them. After they’d cancel their account, we would send them an email to learn why but many times it was too late.

“We were getting a lot of feedback over email but didn’t know the best way to qualify them. If more than one person asked for a feature and it sounded

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<sup>8</sup><http://www.ashmaurya.com/2009/10/how-i-learnt-to-grok-customer-development/>

like a good idea, we built it. The reverse was also true, if the feature didn't meet our model of "the vision", we ignored it no matter how many people asked for it. And that's how we kept busy for a while till I realized we still had a lot of leaky buckets despite all the listening we were doing.

"Determined to get to the bottom of this, I got an 800 number which I put on our website and also started calling on users directly. The findings were staggering. Most of our paying users were using a very small percentage of the application. We had built up a lot of bloated features or **waste** which had only taken time to build but also continued to create ongoing work with regression testing, feature dependencies, etc.

Thanks to Eric Ries<sup>9</sup> for the link.

## Lean startups aren't Cheap Startups



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*This post is by Steve Blank<sup>11</sup>, a serial entrepreneur with eight*

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<sup>9</sup><http://www.startuplessonslearned.com/>

<sup>10</sup><http://steveblank.com/>

<sup>11</sup><http://steveblank.com/>

*startups under his belt, including two large craters (Rocket Science and Ardent), one dot.com bubble home run (E.piphany), and several base hits. Steve is also the creator of customer development<sup>12</sup> and this is one of his best posts on the topic. If you like it, check out his blog<sup>13</sup> and tweets @sgblank<sup>14</sup>. – Nivi*

At an entrepreneur's panel last week, questions from the audience made me realize that the phrase "Lean Startup<sup>15</sup>" was being confused with "Cheap Startup."

For those of you who have been following the discussion, a Lean Startup<sup>16</sup> is Eric Ries<sup>17</sup>'s description of the intersection of Customer Development<sup>18</sup>, Agile Development<sup>19</sup> and if available, open platforms and open source.

## Lean Startups aren't Cheap Startups

A Lean Startup is not about the total amount of money you may spend over the life of your startup. It is about *when in the life of your company you do the spending*.

Over its lifetime, a Lean Startup may spend less money than a traditional startup. It may end up spending the same amount of money as a traditional startup. And I can even imagine cases where it might burn more cash than a traditional startup.

Lets see why.

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<sup>12</sup><http://steveblank.com/category/customer-development-manifesto/>

<sup>13</sup><http://steveblank.com/>

<sup>14</sup><http://twitter.com/sgblank>

<sup>15</sup><http://www.slideshare.net/sblank/lean-startups-steve-blank-eric-ries-presentation>

<sup>16</sup><http://www.startuplessonslearned.com/2008/09/lean-startup.html>

<sup>17</sup><http://www.startuplessonslearned.com/2008/10/about-author.html>

<sup>18</sup><http://steveblank.com/category/customer-development-manifesto/>

<sup>19</sup><http://www.startuplessonslearned.com/2008/09/customer-development-engineering.html>

## The Price of Mistakes are Inversely Proportional to Available Capital

In times of abundant venture capital if you miss your revenue plan, additional funding from your investors is usually available to cover your mistakes — i.e. you get “do-overs” or iterations without onerous penalties (assuming your investors still believe in the technology and vision.) In times when venture capital is hard to get, investors extract high costs for failure (down-rounds, cram downs<sup>20</sup>, new management teams, shut down the company).

The key contributors to an out-of-control burn rate are 1) hiring a sales force too early, 2) turning on the demand creation activities too early, 3) developing something other than the minimum feature set for first customer ship<sup>21</sup>. Sales people cost money, and when they’re not bringing in revenue, their wandering in the woods is time consuming, cash-draining and demoralizing. Marketing demand creation programs (Search Engine Marketing, Public Relations, Advertising, Lead Generation, Trade Shows, etc.) are all expensive and potentially fatal distractions if done *before you have found product/market fit<sup>22</sup> and a repeatable sales model*. And most startup code and features end up on the floor as customers never really wanted them.

Therefore, when money is hard to come by, entrepreneurs (and their investors) look for ways to reduce cash burn rate and increase the chance of finding product/market fit before they waste a bunch of money. The Customer Development process<sup>23</sup> (and the Lean Startup) is one way to do that.

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<sup>20</sup><http://growthstage.blogspot.com/2008/12/2009-year-of-cramdown.html>

<sup>21</sup><http://www.startuplessonslearned.com/2009/08/minimum-viable-product-guide.html>

<sup>22</sup><http://web.archive.org/web/20070701074943/http://blog.pmarca.com/2007/06/the-pmarca-gu-2.html>

<sup>23</sup><http://ecorner.stanford.edu/authorMaterialInfo.html?mid=2048>

## Repeatable and Scalable Sales Model

In Customer Development your goal is not to avoid spending money but to *preserve your cash as you search for a repeatable and scalable sales model and then spend like there is no tomorrow when you find one.*

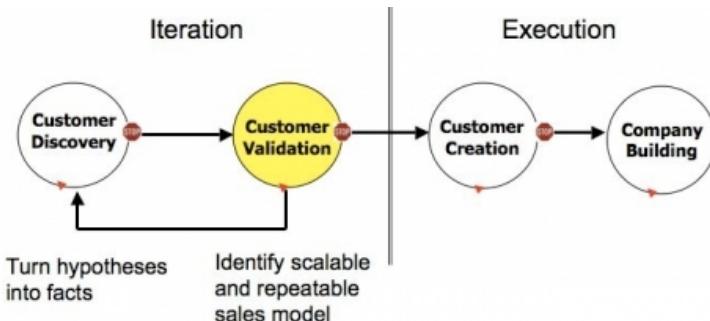
This is the most important sentence in this post and worth deconstructing.

- *Preserve your cash:* When you have unlimited cash (internet bubbles, frothy venture climate) you can iterate on your mistakes by burning more dollars. When money is tight, when there aren't dollars to redo mistakes, you look for processes that allow you to minimize waste. The Customer Development<sup>24</sup> process says preserve your cash by not hiring anyone in sales and marketing until *the founders* turn hypotheses into facts *and* you have found product/-market fit.
- *As you search:* Customer Development observes that when you start your company, all you and your business plan have are hypotheses, not facts — and that *the founders* are the ones who need to get out of the building to turn these hypotheses into customer data. This “get out of the building” activity is the Customer Discovery<sup>25</sup> step of the Customer Development Model:

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<sup>24</sup><http://www.amazon.com/Four-Steps-Epiphany-Steven-Blank/dp/0976470705>

<sup>25</sup><http://www.slideshare.net/sblank/customer-development-at-startup2startup>



- *Repeatable:* Startups may get orders that come from board members' customer relationships or heroic, single-shot efforts of the CEO. These are great, but they are not repeatable by a sales organization. What you are searching for is not the one-off revenue hits but rather a repeatable pattern that can be replicated by a sales organization selling off a pricelist or by customers coming to your web site.
- *Scalable:* The goal is not to get one customer but many – and to get those customers so each additional customer adds incremental revenue *and* profit. The test is: If you add one more sales person or spend more marketing dollars, does your sales revenue go up by more than your expenses?
- *Sales model:* A sales model answers the basic questions involved in selling your product: “Is this a revenue play or a freemium model<sup>26</sup> going for users? Something else? Who’s the customer? Who influences a sale? Who recommends a sale? Who is the decision maker? Who is the

<sup>26</sup><http://andrewchenblog.com/2009/01/19/how-to-create-a-profitable-freemium-startup-spreads/>

economic buyer? Where is the budget for purchasing the type of product you're selling? What's the customer acquisition cost? What's the lead and/or traffic generation strategy? How long does an average sale take from beginning to end? Etc.” Finding out whether you have a *repeatable, scalable sales model* is the Customer Validation<sup>27</sup> step of Customer Development. This is the most important phase in customer development. Have you learned how to sell your product to a target customer? Can you do this without running out of money?

- *Scale like there is no tomorrow:* The goal of an investor-backed startup is not to build a lifestyle business<sup>28</sup>. The goal is to reach venture-scale (~10x return on investment.) When you and your board agree you've found a repeatable and scalable sales model (i.e. have product/market fit) *then you invest the dollars to create end user demand and drive those customers into your sales channel.*

If you confuse Lean with Cheap when you do find a repeatable and scalable sales model, you will starve your company for resources needed to scale. Customer Development (and Lean) is about continuous customer contact/iteration *to find the right time for execution. (Ed: In other words, eliminate generic startup risks in the right order.)*

## The Customer Development Venture Pitch

**At this point I often hear entrepreneurs say, “We don’t have the money to scale. We’ve been running on small investments from friends and family or angels. How do we raise the big bucks?”**

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<sup>27</sup><http://www.slideshare.net/sblank/customer-development-at-startup2startup>

<sup>28</sup>[http://en.wikipedia.org/wiki/Lifestyle\\_business](http://en.wikipedia.org/wiki/Lifestyle_business)

How to raise real money with a Customer Development presentation in the next post on steveblank.com<sup>29</sup>.

## Best of the startup blogs

We read the startup blogs so you don't have to.



Jason Cohen explains how to hire employee #1<sup>36</sup> (practical, tested advice). Fred Wilson explains how to make an email intro<sup>37</sup> without making yourself look bad (this is how I do it). Bill Gurley explains why Google will pay mobile device companies to use their OS<sup>38</sup>. Fred Destin explains why, much of the time, he doesn't know why he passes on investments<sup>39</sup> (finally someone admits it — I look for reasons to say yes, not reasons to say no). Chris Dixon explains why he's reassured when Sequoia

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<sup>29</sup><http://steveblank.com>

<sup>30</sup><http://blog.asmartbear.com/startup-hiring-advice.html>

<sup>31</sup>[http://www.avc.com/a\\_vc/2009/11/the-double-optin-introduction.html](http://www.avc.com/a_vc/2009/11/the-double-optin-introduction.html)

<sup>32</sup><http://abovethecrowd.com/2009/10/29/google-redefines-disruption-the-%E2%80%9Cless-than-free%E2%80%9D-business-model>

<sup>33</sup><http://www.fredestin.com/blog/2009/10/the-one-sentence-e-mail-turndown.html>

<sup>34</sup><http://www.cdixon.org/?p=1746>

<sup>35</sup><http://www.fakesteve.net/2009/09/memo-from-putin.html>

<sup>36</sup><http://blog.asmartbear.com/startup-hiring-advice.html>

<sup>37</sup>[http://www.avc.com/a\\_vc/2009/11/the-double-optin-introduction.html](http://www.avc.com/a_vc/2009/11/the-double-optin-introduction.html)

<sup>38</sup><http://abovethecrowd.com/2009/10/29/google-redefines-disruption-the-%E2%80%9Cless-than-free%E2%80%9D-business-model/>

<sup>39</sup><http://www.fredestin.com/blog/2009/10/the-one-sentence-e-mail-turndown.html>

invests in a Y Combinator company<sup>40</sup>. Fake Steve Jobs is receiving critical advice from Vladimir Putin<sup>41</sup> (from the humor department).

Enjoy the knowledge, understanding, and wisdom.

## Startup Boy is back



<sup>42</sup>Naval's personal blog, Startup Boy<sup>43</sup>, is back. His posts, like The 80-hour Myth<sup>44</sup> and VC Bundling<sup>45</sup>, were an inspiration to me when I first moved to Silicon Valley. His latest post, The returns to entrepreneurship<sup>46</sup>, is a return to form:

“I was at dinner the other night with a group of entrepreneurs. One told the story of a 27-year-old whiz kid whose company will likely exit for \$500M – \$1B – the business now being less than two years old. You can imagine the effect that this had on the brilliant, hardworking 35+ entrepreneurs in the group, who have had their share of hits, but not at that magnitude and not that quickly.

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<sup>40</sup><http://www.cdxon.org/?p=1746>

<sup>41</sup><http://www.fakesteve.net/2009/09/memo-from-putin.html>

<sup>42</sup><http://startupboy.com/>

<sup>43</sup><http://startupboy.com/>

<sup>44</sup><http://startupboy.com/2005/11/29/the-80-hour-myth/>

<sup>45</sup><http://startupboy.com/2005/12/01/vc-bundling/>

<sup>46</sup><http://startupboy.com/2009/11/09/the-returns-to-entrepreneurship/>

“These stories are getting more commonplace. It seems that the entrepreneurs who “hit” these days are doing it more quickly, making more money, and doing it at a younger age. Back in the 70s, it took a decade plus to build a company and \$10M, even in today’s dollars, was a big victory for an individual. Up until the late 90s dot-com boom, even though these stories existed, they were less common and took longer.

“The storyteller explained that this 27-year-old is more brilliant and more hard-working than the previous entrepreneurs he’s seen.

“That can’t be it. There are only so many hours in the day, and the entrepreneurs of yesteryear worked just as hard as the entrepreneurs of today. And the ones who came before were just as brilliant. Human intelligence has not evolved that dramatically in 10-20 years.

“Rather, I posit that the amount of leverage available to a modern Internet entrepreneur is far, far greater than was available to entrepreneurs of previous generations. The number of entrants has dramatically increased as well. The overall hit rate might be lower, but the ones who win, win bigger and faster thanks to the leverage.”

Read the rest of The returns to entrepreneurship<sup>47</sup> for the exciting conclusion.

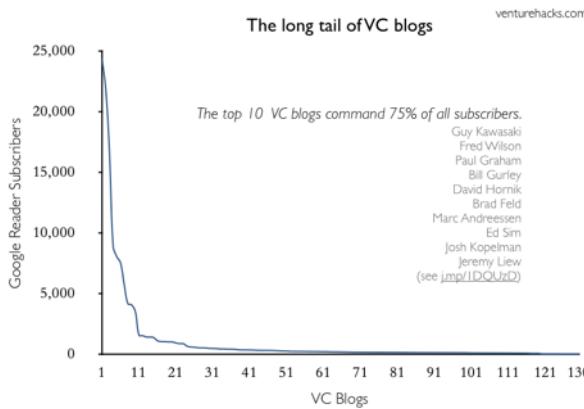
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<sup>47</sup><http://startupboy.com/2009/11/09/the-returns-to-entrepreneurship/>

## The long tail of VC blogs

Many VCs use blogs to share advice, wisdom, and other thoughts. A few of these blogs capture most of our attention. The rest slog it out in the long tail.

This chart shows the Google Reader subscribers of 131 VC blogs (click it to zoom in). The underlying data is from Larry Cheng's VC Blog Directory<sup>48</sup>.



49

I'm not sure Guy Kawasaki (the #1 blog) is still a VC but I left him on the list because he's a nice guy who answers my emails. Also, Venture Hacks would be #4 on the list, if we were on the list.

I'll make a similar chart for VCs on Twitter if someone can extract the follower numbers from this list of VCs on Twitter<sup>50</sup>. (**Update:** Thanks to Tony Stubblebine<sup>51</sup> and Waldron

<sup>48</sup><http://larrycheng.com/2009/09/08/global-vc-blog-directory-ranked-by-of-google-reader-subscribers.png>

<sup>49</sup><http://venturehacks.com/wp-content/uploads/2009/11/VC-blog-subscribers.png>

<sup>50</sup><http://listorious.com/venturemaven/venture-capitalists>

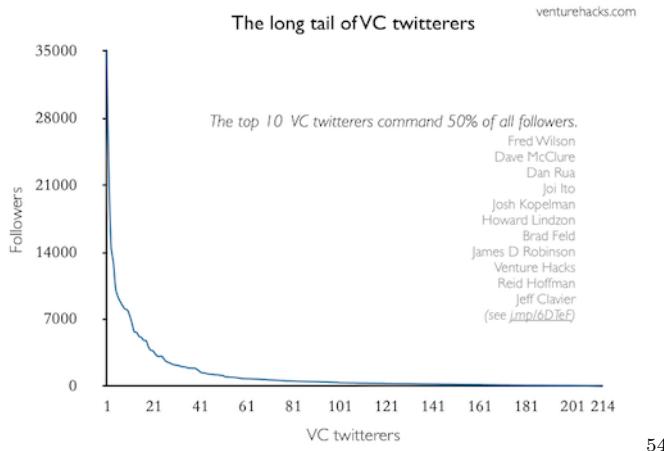
<sup>51</sup><http://www.stubbleblog.com/>

Faulkner<sup>52</sup> for sending me this data — post coming soon.)

## The long tail of VC twitterers

We previously posted about the long tail of VC blogs<sup>53</sup>. A few VC blogs capture most of our attention. The rest slog it out in the long tail.

And now, for the first time in the history of mankind, we present the long tail of VC twitterers (click to zoom in):



54

The underlying data is from Venture Maven's list of 217 VC twitterers<sup>55</sup>. I removed Chris Sacca<sup>56</sup>, Om Malik<sup>57</sup>, and David

<sup>52</sup><http://www.graphedge.com/>

<sup>53</sup><http://venturehacks.com/articles/long-tail-of-vc-blogs>

<sup>54</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/11/VC-twitterers.png>

<sup>55</sup><http://listorious.com/venturemaven/venture-capitalists>

<sup>56</sup><http://twitter.com/sacca>

<sup>57</sup><http://twitter.com/om>

Pakman<sup>58</sup> from the dataset because they have too many followers (they were on the Twitter suggested users<sup>59</sup> list).

This widget aggregates all 217 VC twitterers:

*(Widget: VC twitterers<sup>60</sup>)*

Thanks to Venture Maven<sup>61</sup> for aggregating the underlying data and to Tony Stubblebine<sup>62</sup> and Waldron Faulkner<sup>63</sup> for parsing it.

## How to pick a co-founder



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<sup>58</sup><http://twitter.com/pakman>

<sup>59</sup><http://blog.twitter.com/2009/03/suggested-users.html>

<sup>60</sup><http://listorious.com/venturemaven/venture-capitalists>

<sup>61</sup><http://venturemaven.com/>

<sup>62</sup><http://www.stubbleblog.com/>

<sup>63</sup><http://www.graphedge.com/>

Picking a co-founder is your most important decision. It's more important than your product, market, and investors.

The ideal founding team is two individuals, with a history of working together, of similar age and financial standing, with mutual respect. One is good at building products and the other is good at selling them.

## **The power of two**

Two is the right number — avoid the three-body problem<sup>64</sup>. Think Jobs and Wozniak, Allen and Gates, Ellison and Lane, Hewlett and Packard, Larry and Sergei, Yang and Filo, Omidyar and Skoll.

One founder companies *can* work, against the odds (hello, Mark Zuckerberg). So can three founder companies (hello, @biz, @ev, and @jack). In three founder companies, the politics can be tough — gang-up votes, jockeying for board seats, etc. — but it's manageable. Four is an extremely unstable configuration and five is right out<sup>65</sup>. When 4-5 founder companies work, it's because two founders dominate.

Two founders works because unanimity is possible, there are no founder politics, interests can easily align, and founder stakes are high post-financing.

## **Someone you have history with**

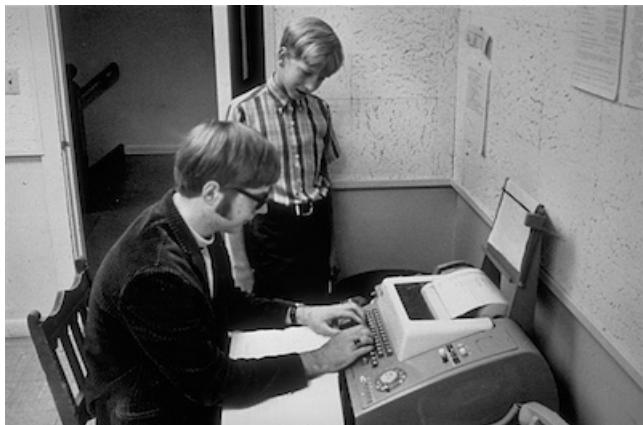
You wouldn't marry someone you'd just met. Date first<sup>66</sup>. Guess which pair of famous co-founders is in this photo:

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<sup>64</sup>[http://www.ids.ias.edu/\protect\\\$\\relax\sim\\\$piet/act/astro/three/index.html](http://www.ids.ias.edu/\protect\$\\relax\sim\$piet/act/astro/three/index.html)

<sup>65</sup>[http://en.wikipedia.org/wiki/Holy\\_Hand\\_Grenade\\_of\\_Antioch#Usage\\_instructions](http://en.wikipedia.org/wiki/Holy_Hand_Grenade_of_Antioch#Usage_instructions)

<sup>66</sup><http://founderdating.com/>



Go through something difficult, like a Prisoner's Dilemma<sup>67</sup> or a Zero-Sum Game<sup>68</sup>. If being ethical was lucrative, everyone would do it!

## One builds, one sells

The best builders can prototype and perhaps even build the entire product, end-to-end. The best sellers can sell to customers, partners, investors, and employees.

The seller doesn't have to be a "salesman" or "business guy". He can be technical, but he must be able to wield the tools of influence<sup>69</sup>. Bill Gates and Steve Jobs aren't salesmen, but they are sellers.

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<sup>67</sup>[http://en.wikipedia.org/wiki/Prisoner%27s\\_dilemma](http://en.wikipedia.org/wiki/Prisoner%27s_dilemma)

<sup>68</sup>[http://en.wikipedia.org/wiki/Zero-sum\\_\(game\\_theory\)](http://en.wikipedia.org/wiki/Zero-sum_(game_theory))

<sup>69</sup><http://www.amazon.com/gp/product/0688128165?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0688128165>

## Aligned motives required

If one founder wants to build a cool product, another one wants to make money, and yet another wants to be famous, it won't work.

Pay close attention — true motivations are revealed, not declared.

## Criteria: Intelligence, energy, and integrity

It's not the kid you grew up next to. It's not the person you like the most. It's not the hacker most willing to work for free.

It's someone of incredibly high intelligence, energy, and integrity<sup>70</sup>. You'll need all three yourself, and a shared history, to evaluate your co-founder.

## Don't settle

If it doesn't feel right, keep looking. If you're compromising, keep looking. A company's DNA is set by the founders, and its culture is an extension of the founders' personalities.

## Pick “nice” guys

Avoid overly rational short-term thinkers. There are bounds to rationality. Partner with someone who is irrationally ethical, or a rational believer that nice guys finish first<sup>71</sup>. Be especially careful with the “sales” guy here.

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<sup>70</sup><http://books.google.com/books?id=msOBPzhVqGgC&pg=PA58&dq=intelligence,+energy,+and+integrity+buffet+warren&num=20&ei=oKz7SqivKqa6lATO5c2BDw#v=onepage&q=&f=false>

<sup>71</sup><http://video.google.com/videoplay?docid=-3494530275568693212#>

## What you don't know

Business founders who don't code use bad proxies for picking technical co-founders ("10 years with Java!"). Technical founders who don't sell also use bad proxies ("Harvard MBA!"). Learn enough of the other side to have an informed opinion. If you're not seriously impressed, move on.

## FAQs

What if the right guy already has his own startup? Convince him to work on yours part-time — he'll drop his idea<sup>72</sup> once yours gets traction.

## Breakups are hard

If you're going to fall out with your co-founder, do it early, recover the equity into the option pool to keep the company going, and recruit someone else great to fill the missing slot. Build in founder<sup>73</sup> vesting<sup>74</sup> (a.k.a. the "Pre-Nup") to keep the breakup from getting messy. Building a great company without a partner is like raising kids without a...

Nearly everything I've written on this topic applies to dating and marriage. Coincidence?

Go forth and multiply.

*This post is by Naval Ravikant. If you like it, check out his blog<sup>75</sup> and Twitter<sup>76</sup>.*

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<sup>72</sup><http://twitter.com/ericnakagawa/status/4691780771>

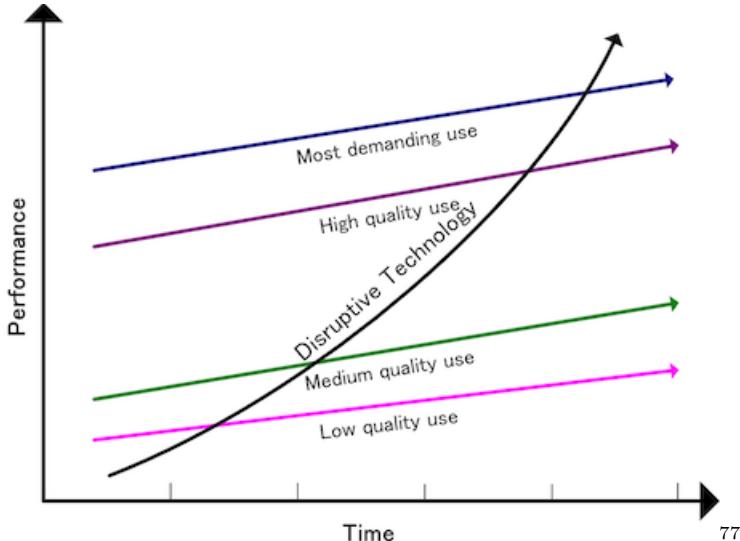
<sup>73</sup><http://cdixon.org/?p=164>

<sup>74</sup><http://walkercorporatelaw.com/2009/09/10/founder-vesting-five-tips-for-entrepreneurs/>

<sup>75</sup><http://startupboy.com/>

<sup>76</sup><http://twitter.com/naval>

## Extrapolating computing



77

Remember when mainframes did all of the computing? And workstations were dumb terminals docked to the mainframes? The terminals had less power, but were more “mobile”.

Then everyone got a desktop. And the desktop is where you did most of your computing. And you carried around your under-powered laptop, which had to be synced with your desktop, or docked to a big screen, keyboard and mouse to be usable. The laptop had less power, but it was more mobile than the desktop.

Now most early adopters have a laptop as their main computer. And they’re carrying around their underpowered smartphone, which has to be synced with their laptop on a regular basis. The smartphone has less power but, well, it’s more mobile.

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<sup>77</sup> [http://en.wikipedia.org/wiki/Disruptive\\_technology](http://en.wikipedia.org/wiki/Disruptive_technology)

We'll dock our smartphones to our laptops for a while. But, if we can extrapolate from the history of computing, the laptop is headed for the dustbin.

Which means that Apple will be OK. Google will be OK. But if Windows Mobile is any indicator, Microsoft is in deep, deep trouble.

*This post is by Naval Ravikant. If you like it, check out his blog<sup>78</sup> and Twitter<sup>79</sup>.*

*Image:* Wikipedia<sup>80</sup>

## The sultans of startup marketing

I recently re-connected with an up-and-coming venture capital Associate who thanked me for introducing her to the masterworks of Steve Blank<sup>81</sup> and Eric Ries<sup>82</sup>. I told her to check out Sean Ellis' blog<sup>83</sup>, and mentioned that I've learned just as much from Sean.

Later that night, she sent me a note: "Sean Ellis is awesome. Thanks so much." Let me tell you why Sean is awesome.



<sup>84</sup>First, Sean lead marketing from launch to IPO filing at LogMeIn and Uproar. He later worked with Xobni

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<sup>78</sup><http://startupboy.com/>

<sup>79</sup><http://twitter.com/naval>

<sup>80</sup>[http://en.wikipedia.org/wiki/Disruptive\\_technology](http://en.wikipedia.org/wiki/Disruptive_technology)

<sup>81</sup><http://steveblank.com/>

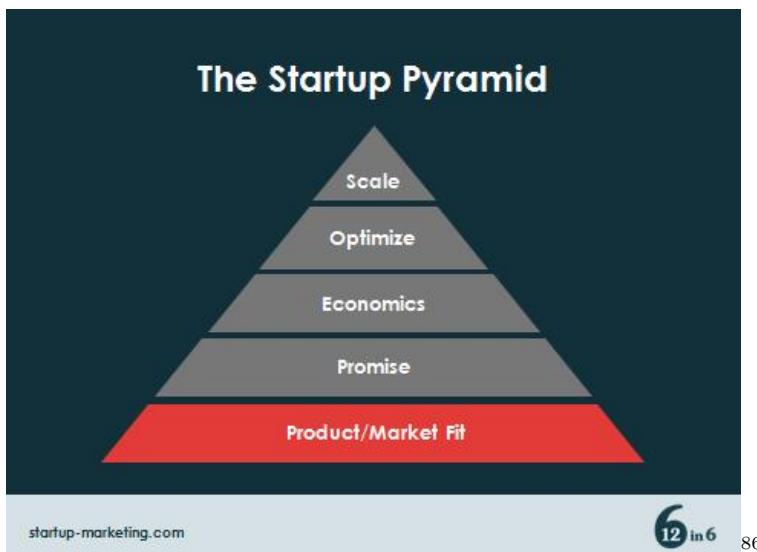
<sup>82</sup><http://www.startuplessonslearned.com/>

<sup>83</sup><http://startup-marketing.com/>

<sup>84</sup><http://startup-marketing.com/>

(Khosla Ventures, First Round Capital), Dropbox (Sequoia Capital), Eventbrite (Sequoia Capital), Grockit (Benchmark Capital), Flexilis (Khosla Ventures), eduFire (Battery Ventures)... the list goes on. So all of his theory is backed by a wealth of experience across a broad range of startups.

Second, his startup pyramid<sup>85</sup> changed my life and increased my bench press by 75 lbs. This is the best model I've seen on how to build a startup. Read it.



Finally, he shares a lot of his knowledge for free on his blog. Here are extracts from a few of his posts. Make sure you click through and read all of them in full. I read his blog from front-to-back when I first discovered it (start with the newer stuff).

### When Should a Startup Start Charging?<sup>87</sup>

<sup>85</sup> <http://startup-marketing.com/the-startup-pyramid/>

<sup>86</sup> <http://startup-marketing.com/the-startup-pyramid/>

<sup>87</sup> <http://startup-marketing.com/when-should-a-startup-start-charging/>

“I’ve recently changed my long held belief that all startups should charge immediately upon the release of a new product. I now believe that non-enterprise targeted startups should only charge once you have achieved product/market fit. As explained in this earlier post<sup>88</sup>, I define product/market fit as at least 40% of your active users saying they would be “very disappointed” if they could no longer use your product...

“For startups targeting enterprises, it actually does make sense to charge before reaching product/market fit. This is the best way to help the enterprise figure out how to get value from your product (somebody on the inside will be motivated to work with you to unlock value since they’ve already spent the budget). If you haven’t charged anything, your attempts to engage the customer and find value are likely to be perceived as an aggressive sales annoyance rather than genuinely helpful...

“Startups often delay implementing a business model claiming “we’re focused on growth right now.” But once you’ve achieved product/market fit, most startups will grow *faster* with a business model (I wrote a post on this earlier<sup>89</sup>). A business model gives you rational constraints within which you can execute very aggressively – otherwise you are held back by fear that you may be wasting money on paid marketing programs.”

### The Startup Pyramid<sup>90</sup>:

“Product/market fit has always been a fairly ab-

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<sup>88</sup><http://startup-marketing.com/the-startup-pyramid/>

<sup>89</sup><http://startup-marketing.com/growth-vs-revenue/>

<sup>90</sup><http://startup-marketing.com/the-startup-pyramid/>

stract concept making it difficult to know when you have actually achieved it...

“I’ve tried to make the concept less abstract by offering a specific metric for determining product/market fit. I ask existing users of a product how they would feel if they could no longer use the product. In my experience, achieving product/market fit requires at least 40% of users saying they would be “very disappointed” without your product. Admittedly this threshold is a bit arbitrary, but I defined it after comparing results across nearly 50 startups. Those that struggle for traction are always under 40%, while most that gain strong traction exceed 40%. Of course progressing beyond “early traction” requires that these users represent a large enough target market to build an interesting business...

“If you haven’t reached product/market fit yet it is critical to keep your burn low and focus all resources on improving the percentage of users that say they would be very disappointed without your product. Avoid bringing in VPs of Marketing and Sales to try to solve the problem. They will only add to your burn and likely won’t be any better than you at solving the problem. Instead, you (the founders) should engage existing and target users to learn how to make your product a “must have.” Sometimes it is as simple as highlighting a more compelling attribute of your product – but often it requires significant product revisions or possibly even hitting the restart button on your vision.”

## To Pay Or Not To Pay To Acquire Users?<sup>91</sup>

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<sup>91</sup><http://startup-marketing.com/to-pay-or-not-to-pay-to-acquire-users/>

“I recently heard a VC say that startups “should spend the least amount of money possible on marketing.” This is a healthier attitude than the opposite prescription of undisciplined land grab, but a better approach is pure ROI marketing. Marketing opportunities that offer a fast payback with additional profit margin are a key component for reaching your startup’s full market potential...

“If your growth is accelerating, you will attract competition. And this competition will likely be savvy enough to replicate the customer acquisition and monetization approaches that you worked hard to invent. So it is important to make it as difficult as possible for them to get traction. I know some of you are saying “but your recent post<sup>92</sup> told us to ignore the competition.” My point was not to ignore the competition forever, simply to ignore them while you are figuring out a repeatable, positive ROI way to acquire customers. Competition (especially those that are spending irrationally) will distract you from this critical task.

“But once you have optimized the first user experience and introduced a business model that generates sufficient revenue to fund user acquisition, it’s time to focus your marketing efforts to aggressively build new customer acquisition channels<sup>93</sup> and scaling existing channels – both free and paid.”

I am a fan. And so can you.

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<sup>92</sup><http://startup-marketing.com/indifference-is-your-real-competitor/>

<sup>93</sup><http://startup-marketing.com/category/acquiring-customers/>

## The ignorant VC

Sponsor Post Thanks to Atlas Venture<sup>94</sup> for supporting Venture Hacks this month. This post is an interview of Fred Destin<sup>95</sup> — one of Atlas' general partners — by David Woodward, a journalist<sup>96</sup> and blogger<sup>97</sup>. If you like it, check out Fred's blog<sup>98</sup> and tweets @fdestin<sup>99</sup>.



100

A few days ago, I had an interesting chat with Fred Destin<sup>101</sup>, Atlas Venture<sup>102</sup>'s ebullient technology partner. Atlas bought a stake in the property website Zoopla<sup>103</sup> at the beginning of 2008, which wasn't exactly a fun time to be involved in the property game. It was also a pretty difficult period to source capital in any sector — all in all an investment climate fit to make even the coolest of VCs twitch. Destin, who has a seat on Zoopla's board, adds that at that stage, his firm's investment was in "two people and some PowerPoint slides", hardly an invulnerable guarantee of success.

**It is often said of European VCs that they lack the gumption of the Sand Hill road<sup>104</sup> mob** — the kind of formalised chutzpah that turns garage upstarts into grade A

<sup>94</sup><http://www.atlasventure.com/>

<sup>95</sup><http://www.freddestin.com/blog/>

<sup>96</sup><http://www.director.co.uk/>

<sup>97</sup><http://awardforbestalien.blogspot.com/>

<sup>98</sup><http://www.freddestin.com/blog/>

<sup>99</sup><http://twitter.com/fdestin>

<sup>100</sup><http://www.freddestin.com/blog/>

<sup>101</sup><http://www.freddestin.com/>

<sup>102</sup><http://www.atlasventure.com/>

<sup>103</sup><http://www.zoopla.co.uk/>

<sup>104</sup>[http://en.wikipedia.org/wiki/Sand\\_Hill\\_Road](http://en.wikipedia.org/wiki/Sand_Hill_Road)

businesses. European investors, it is said, need data, data and more data, followed by proof of concept, before they are willing to stump up any capital. And to some extent that remains true. But Destin added an interesting spin.

The problem with European investors, he told me, was that even when faced with unmistakeable proof of concept, they tend to undercapitalise, thus hampering their investment's ability to scale to its full potential. Put it this way: **not many US VCs get accused of undercapitalising a potential winner.**

He also did a great job of making early-stage investments sound very much like sticking it all on red and preying to the gambling gods for clemency. Destin says he actually prefers working with unknowns. He says:

“Our job is to manage risk proactively. We don’t think about it as a casino at all. We scrutinise and think about it very hard. But it’s our job to take these shapeless risks. I am early-stage, my natural DNA is around early-stage. It’s tough to make investment decisions without much data, [but] that’s what makes it exciting. **Your average market practitioner does not how to deal with that level of risk. You take data away and they panic.**”

Conversely, Destin says he revels in a vacuum of information.

**I profess ignorance and I use that as a tool.** I can assess market attractiveness. I can assess the management team. We then make absolutely no assumption as to what’s going to work because if you do, you lock yourself into a strategy that you haven’t [yet] proven. You tend to be internally led rather than market led. This is where the risk may seem

inconsiderate because you're willfully declaring ignorance about the market you're addressing."

But ignorance allows you to

"...force yourself to be smart. You use what you know in terms of company building, supporting entrepreneurs, discovering the market. We will design the product around what the market needs with an intuition, but then we'll go and test it. **We don't want to be smarter than the market we are entering.**"

And here's Destin's view on Europe's investment weakness. There are, he says, three stages involved in readying a start-up for potential greatness:

"At Atlas we call it '**prove-build-scale**'. You spend very little at the prove stage. You have 6-15 people, spend as little as you can proving the hypothesis. The build stage is [about] scaling up the management team, adding talent, putting in place the technology you need to accelerate. Only when you're ready can you understand how to scale properly, go into a big investment round and hit the accelerator.

"I think that Europe usually fails on the third category: we tend to undercapitalise the businesses that are doing well. And this is where we get a competitive disadvantage to the US. They have a tendency to overcapitalise early, but when they scale they scale well because they are able to raise repeat large rounds of money to really capture an opportunity."

*If you like this post, check out Fred's blog<sup>105</sup> and his tweets*

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<sup>105</sup><http://www.fredestin.com/blog/>

*@fdestin<sup>106</sup>. If you want an intro to Atlas, send me an email. I'll put you in touch if there's a fit. Finally, contact me<sup>107</sup> if you're interested in supporting Venture Hacks. – Nivi*

## Weekend reading

Some weekend reading culled from our most popular tweets<sup>108</sup> this week.



109



110



111



112

Steve Blank<sup>113</sup> and I have a good discussion about his and Eric Ries' new customer development overlay. Regarding the Atlas Developer Beta, John Gruber<sup>114</sup> says that “Access to the beta program is \$20 — this is the new way and I like it. Fake Steve Jobs<sup>115</sup> always has better analysis than WSJ, NYT, TechCrunch, Economist, and your mom combined. I don't think you need operational experience to be a good VC but Mark

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<sup>106</sup><http://twitter.com/fdestin>

<sup>107</sup><mailto:nivi@alum.mit.edu>

<sup>108</sup><http://twitter.com/venturehacks>

<sup>109</sup><http://steveblank.com/2009/11/16/times-square-strategy-session-web-startups-and-customer/#comment-1899>

<sup>110</sup><http://daringfireball.net/linked/2009/11/17/atlas-beta>

<sup>111</sup><http://www.fakesteve.net/2009/11/developers-only-now-realizing-that-android-is-not-a-platform.html>

<sup>112</sup><http://www.bothsidesofthetable.com/2009/11/19/what-makes-an-entrepreneur-four-lettersjfdi/>

<sup>113</sup><http://steveblank.com/2009/11/16/times-square-strategy-session-web-startups-and-customer/#comment-1899>

<sup>114</sup><http://daringfireball.net/linked/2009/11/17/atlas-beta>

<sup>115</sup><http://www.fakesteve.net/2009/11/developers-only-now-realizing-that-android-is-not-a-platform.html>

Suster<sup>116</sup>'s great new post illustrates the difference.

I recommend you pair these posts with white tea<sup>117</sup>.

## 3 customer development case studies

If you're trying to implement customer development at your startup, you'll learn more from these 3 case studies than anything else I've seen. I consider each of these a "must-read". I've quoted some great bits from each case study, but make sure you click through and read each one in full.

1. Using an LOI to get customer feedback on a minimum viable product<sup>118</sup>:

"We decided from the get-go that, while we clearly saw the benefits and necessity of our concept, we would remain fiercely skeptical of our own ideas and implement the customer development process<sup>119</sup> to vet the idea, market, customers etc, before writing a single line of code.

"My partner was especially adamant about this as he had spent the last 6 months in a cave writing a monster, feature-rich web app for the financial sector that a potential client had promised to buy, but backed out at the last second. They then tried to

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<sup>116</sup><http://www.bothsidesofthetable.com/2009/11/19/what-makes-an-entrepreneur-four-lettersjfdi/>

<sup>117</sup><http://www.uptontea.com/shopcart/catalog.asp?begin=0&categoryID=59>

<sup>118</sup><http://www.startuplessonslearned.com/2009/10/case-study-using-loi-to-get-customer.html>

<sup>119</sup><http://www.startuplessonslearned.com/2008/11/what-is-customer-development.html>

shop the app around, and found no takers. Thousands of lines of code, all for naught — as is usually the case without a customer development process. (*See Throwing away working code<sup>120</sup> for more on this unfortunate phenomenon.* — Eric Ries)

“We made a few pencil drawings of what the app would look like which we then gave to a graphic designer. With that, the graphic designer created a Photoshop image. We had him create what we called our “screenshots” (which suggests that an app actually existed at the time) and had him wrap them in one of these freely available PS Browser Templates<sup>121</sup>. Now armed, with 4 “screenshots” and a story, we approached our target market, some of which was through warm introductions, and some, very literally, was through simple cold-calling.

“Once we secured a meeting, we told our potential customers that we were actively developing our web app (implying that code was being written) and wanted to get potential user input into the development process early on. Looking at paper print-outs of our “screenshots”, no one could tell that this was simply a printout of a PSD, and not a live app sitting on a server somewhere. We walked them through what we thought would be the major application of our product. Most people were quite receptive and encouraging...

“On the third visit, we pressed those who saw merit in the idea to sign a legally non-binding Letter of Intent. Namely, that they agree to use it free of charge if we deliver it to them and it is capable of X, Y and Z. And not only do they agree to use it,

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<sup>120</sup><http://www.startuplessonslearned.com/2009/02/throwing-away-working-code.html>

<sup>121</sup><http://piksels.com/photoshop-browser-templates/>

but that they intend to purchase if by Y date at X price if it meets their needs.”

The author of this case study is currently looking for a technical co-founder<sup>122</sup>.

## 2. proof that we’re not (completely) crazy:<sup>123</sup>

“The few customers we talked to had little in common except for the core problem we were solving. Two had very similar job titles, (let’s call them Ditch Diggers), so we ran a facebook ad with the job title at the top of the ad, which was roughly, “Ditch Digger? Feeling spread thin? Click here to complete a survey and tell us about it.” Facebook ads were the easiest because we could pick types of people — we have yet to create an effective adwords campaign. We offered \$10 Amazon gift cards to complete a 15 minutephone interview.

“What followed next was absolutely amazing. When we talk to a Ditch Digger it’s like every response has an exclamation point. “Yes, that’s me exactly!”, “I can’t believe you’re building a tool for this, thank you!”, “Here are 5 emails of other people that will want this!”, “It’s only (number that was so high we had to force each other to ask)/month? Great deal!”

## 3. How I built my Minimum Viable Product<sup>124</sup>:

“I filled out a set of hypothesis worksheets in Steve Blank’s book on product, customer, channel pricing,

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<sup>122</sup><http://eventsession.com/customer-development-oriented-lead-developer-for-start-up/>

<sup>123</sup>[http://groups.google.com/group/lean-startup-circle/browse\\_thread/thread/3ab7800f52d748da](http://groups.google.com/group/lean-startup-circle/browse_thread/thread/3ab7800f52d748da)

<sup>124</sup><http://www.ashmaurya.com/2009/10/how-i-built-my-minimum-viable-product/>

demand creation, market type, and competition. I would recommend everyone formalize this process. My initial scan of the worksheets made me believe I already knew all the answers. I involved Sasha in the process, and discussions that I thought would be 30 minute conversations turned into 2 hour discussions as she questioned almost all my assumptions... Yes, I still love her after that... **The biggest mind shift following a customer development process is from thinking you know something to testing everything you know.**

“We built out our initial customer problem presentation and decided to target people just like us – busy parents with young kids.

“Our top 3 problems were:

1. Sharing lots of photos and videos is a hassle
2. A lot of services downsize the images so the quality is poor
3. Notifying family and friends of updates was manual and a chore

“We were able to find the initial batch through friends and daycare, and subsequent batches through follow-on referrals. I’ll add that it is very important to talk to complete strangers to keep objectivity in check. Family and friends can be too kind sometimes and really lead you down the wrong path. We debated paying for their time with gift cards or doing a DSLR camera raffle and in the end decided to just lay out our objectives and ask for 30 mins of their time. That was enough....

“During the interview, we were particularly interested in learning what their sharing workflow was

like. We set up the stage and let them tell us everything they did with their photos/videos taking them from camera to shared, what they wished they could change, and the magical pricing questions: Would they use a solution like the one we were envisioning if it were free? Would they use it if it were \$X/yr? X changed from customer to customer but we kept it as real as we could.

“We talked to enough people until their answers started sounding the same...

“Our revised top 3 problems were:

1. Sharing lots of photos and videos is a hassle  
**(stayed the same)**
2. Requiring visitors to signup is annoying
3. Photo gallery design was too busy or complicated

If you’re crazy for case studies, I’ve found at least a billion at the Lean Startup Circle<sup>125</sup>. Let me know if you find any good ones there.

## Get the best of the startup blogs

“nicely done as always. i can count on one hand the number of daily emails worth signing up for.”

– Matt Oesterle<sup>126</sup>, Sweepery<sup>127</sup>

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<sup>125</sup> [http://groups.google.com/group/lean-startup-circle/search?group=lean-startup-circle&q=case+study&qt\\_g=Search+this+group](http://groups.google.com/group/lean-startup-circle/search?group=lean-startup-circle&q=case+study&qt_g=Search+this+group)

<sup>126</sup> <http://venturehacks.com/articles/best-blogs/comment-page-1#comment-9295>

<sup>127</sup> <http://sweepery.com/>

We read a lot of startup blogs and share our favorites on Twitter<sup>128</sup>. But not everybody uses Twitter. And the folks who use Twitter follow too many people to catch all our links.

So we've put together a daily digest that we're calling "Startup News". Once a day, you get links to our favorite posts via email<sup>129</sup> or RSS<sup>130</sup> (if you want to read it on the Web, go to our Twitter page<sup>131</sup>).

Here's what it looked like a couple days ago:

### A Look Back At Summize

**AVC**— In July 2008, Twitter acquired a company called Summize. The stated reason was to bring search into Twitter. And that was the main reason that Twitter did the deal. But Twitter also got a very strong engineering team in that acquisition. I remember asking Ev and Jack at the time "how are we going to integrate the engineering team?" and Jack replyin...

 *"They did not rebuild Twitter, they just replaced one thing at a time and evolved it." – @fredwilson, <http://j.mp/cXghWK>*

929 CLICKS 76 TWEETS

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### Aprizi's Customer Development Journey, part 3 – giffconstable.com

**GIFFCONSTABLE**— Aprizi is about to enter that crucial phase of open beta, so I wanted to pause and write down the latest installment in our customer development journey (part 1 and 2). For anyone new to the blog, Aprizi is building a personalization engine for online shopping — a Pandora for e-commerce, if you will. My thesis is that the intersection of tw...

 *"Build something for yourself is not the "best" way to come up with startup ideas. A different way: <http://j.mp/9IqPnW>."*

582 CLICKS 14 TWEETS

If you want us to consider including one of your posts, submit

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<sup>128</sup><http://twitter.com/venturehacks>

<sup>129</sup>[http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en_US)

<sup>130</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>131</sup><http://twitter.com/venturehacks>

it to Hacker News<sup>132</sup> — we read it every day. Or tweet it and include: “Tip @venturehacks”.

Try out Startup News for a few days via email<sup>133</sup> or RSS<sup>134</sup>. And please give us your feedback in the comments.

*Thanks to Mihai Parparita, whose wonderful Twitter Digest<sup>135</sup> makes this possible.*

## Venture Hacks Bookstore

“Buying every book recommended by Venture Hacks.”

– *Jonathan Grubb<sup>136</sup>, Founder of Get Satisfaction<sup>137</sup>*

The Venture Hacks Bookstore<sup>138</sup> is live and magnificent. Check it out.

It contains 8 of our favorite books for entrepreneurs and we’ll be expanding it over time. **We don’t recommend a book unless we refer to it regularly.**

We’ve sold \$13,385.74 of books since we first start tracking sales with Amazon Associates links. Here’s a little taste of the bookstore...

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<sup>132</sup><http://news.ycombinator.com/>

<sup>133</sup>[http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en_US)

<sup>134</sup><http://feeds.venturehacks.com/venturehacks-twitter>

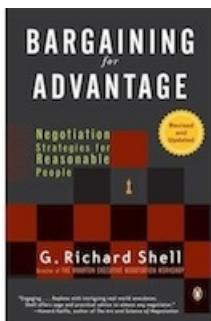
<sup>135</sup><http://twitter-digest.appspot.com/>

<sup>136</sup><http://twitter.com/jonathangrubb/status/1054884419/>

<sup>137</sup><http://getsatisfaction.com/>

<sup>138</sup><http://venturehacks.com/bookstore>

## Negotiation



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Bargaining for Advantage<sup>140</sup> *G. Richard Shell* My favorite negotiation book period. It synthesizes the principled negotiation of Getting to Yes<sup>141</sup> with the psychology of persuasion in Influence<sup>142</sup>. I refer to it often. Among other things, it helps you answer questions like “Should I be the first to open? Should I open optimistically or reasonably? What sort of concession strategy works best?” Our full post →<sup>143</sup>

<sup>139</sup> <http://www.amazon.com/gp/product/0143036971?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0143036971>

<sup>140</sup> <http://www.amazon.com/gp/product/0143036971?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0143036971>

<sup>141</sup> [http://www.amazon.com/Getting-Yes-Negotiating-Agreement-Without/dp/0395631246/ref=sr\\_1\\_1?ie=UTF8&s=books&qid=1258329446&sr=8-1](http://www.amazon.com/Getting-Yes-Negotiating-Agreement-Without/dp/0395631246/ref=sr_1_1?ie=UTF8&s=books&qid=1258329446&sr=8-1)

<sup>142</sup> <http://www.amazon.com/gp/product/006124189X?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=006124189X>

<sup>143</sup> <http://venturehacks.com/articles/bargaining-for-advantage>

## Product



Kent Beck

144

Extreme Programming Explained<sup>145</sup> Kent Beck Revelatory. Develop your product like this book tells you to, unless you know better (e.g. you have experience building operating systems, space shuttles, Googles.) Buy the first edition. Our full post →<sup>146</sup> This bookstore is the result of a multi-million dollar engagement with IBM Global Services that was three years late, even before it started. Please do visit<sup>147</sup> and up your entrepreneurial game.

## How to share secrets in a negotiation

Last week, I spoke to a startup that was in discussions to license one of their products to a competitor. The competitor asked for historical sales data about the product, and the startup was wondering whether they should share that information with a

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<sup>144</sup><http://www.amazon.com/gp/product/0201616416?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0201616416>

<sup>145</sup><http://www.amazon.com/gp/product/0201616416?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0201616416>

<sup>146</sup><http://venturehacks.com/articles/extreme-programming-explained>

<sup>147</sup><http://venturehacks.com/bookstore>

competitor. Our conversation went like this:

We feel uncomfortable giving them  
this information without any kind of  
protective provision (ie. NDA, MOU,  
etc.)

We are looking for advice on whether  
it is adviseable to disclose this  
information to them at this time

on the negotiation issue...



the right answer is in bargaining for advantage



the book



but basically, you show commitment to the negotiation as they show commitment to the negotiation



so if you consider this a state secret, you want them to show significant commitment to the negotiation



for example, an email MOU has been sent back and forth



or terms discussed



or the product has been slightly prototyped on their end, etc.



in addition the NDA is great idea



if you were in their shoes and acting in good faith, you would ask for this information right?



Without a doubt

I think the key, as you said is to show commitment as they show commitment

So, at the very least, we ask for an NDA

yes. so you guys just need to decide internally, what you need to see from them that would show enough commitment to trigger you to show them the data



i think the nda is a little orthogonal to that



get the nda anyway



but you're not likely to ever enforce it



or discover that they broke it

get the nda but assume it is worthless



Agreed. It's a sign of their commitment  
to the process

a little



But, we also need a more tangible  
sign from them

it doesn't take a lot for them to sign  
something



exactly, something more tangible



e.g. are you meeting with their CEO.



have you met their investors



brainstorming here...



totally, this is great

could they give us some information  
that we would want as a competitor

have they done a deep dive on the  
technology or the product or the  
people or the revenue model



you could also come at it from the top  
and bottom



e.g. we can start by telling you it is  
more than \$X



or less than \$Y



there's a whole chapter on  
exchanging information in  
[http://www.amazon.com/Bargaining-  
Advantage-Negotiation-Strategies-  
Reasonable/dp/0143036971/ref=sr\\_1\\_1?  
ie=UTF8&s=books&qid=1258764121  
&sr=8-1](http://www.amazon.com/Bargaining-Advantage-Negotiation-Strategies-Reasonable/dp/0143036971/ref=sr_1_1?ie=UTF8&s=books&qid=1258764121&sr=8-1)



I like that — give them a range

i'll try to take a look when i get home



I'm going to go to B&N and buy tonight

yes, that book has the answer to every  
negotiation question 😊



Awesome. That's my next stop

i guess the last piece



is diligence on other folks they've  
licensed from



e.g. give me a complete list of  
licensing successes and failures



i won't call them right now but i need  
to know you're open to that diligence



more interested in the failures of  
course although they may react poorly  
to that even if they have nothing to  
hide



you'll have to be smooth in how you  
ask for it



The book I mentioned  
in the conversation is Bargaining for Advantage<sup>148</sup>. It answers

<sup>148</sup><http://venturehacks.com/articles/bargaining-for-advantage>

almost every negotiation question. I read the book cover-to-cover — that's rare.

The answer to this particular problem starts on page 68 of Bargaining for Advantage and there's a good summary on page 72:

"The solution here is to take your time and build trust step by step. It helps if you can use your relationship network to check the other party out. If that is not possible, take a small risk before you take a big one. See if those on the other side reliably reciprocate in some little matter that requires *their* performance based on trust. If they pass the test, you have a track record on which to base your next move."

Almost every problem you run into in a startup is not unique. Someone else has had the same problem and knows how to solve it. With the right advisors (books, blogs, people), you can solve it the easy way, instead of the hard way (experience and failure). Save the risk and innovation for the important stuff.

P.S. If you're sharing secrets with VCs, read these posts: Three things you should never tell a VC when fundraising<sup>149</sup> and How to Deal with Skeletons in your Closet<sup>150</sup> (and my comment<sup>151</sup>).

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<sup>149</sup> <http://www.freddestin.com/blog/2009/11/three-things-you-should-never-tell-a-vc-when-fundraising.html>

<sup>150</sup> <http://www.bothsidesofthetable.com/2009/11/12/how-to-deal-with-skeletons-in-your-closet/>

<sup>151</sup> <http://www.bothsidesofthetable.com/2009/11/12/how-to-deal-with-skeletons-in-your-closet/#comment-22862990>

## Thanking our supporters

We've put together a page to thank our supporters<sup>152</sup>, whose financial contributions support Venture Hacks. They're also listed below. We also wish to thank them, and many others, for contributing their time and advice.

If you like Venture Hacks, take a moment to check them out. And please let them know you appreciate their support when you see them.

Finally, we want to thank **you**, our readers and customers, without whom Venture Hacks would be meaningless.

Our supporters

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<sup>152</sup><http://venturehacks.com/supporters>



**You:** Our readers and customers.

# atlas

<sup>153</sup>Atlas Venture<sup>154</sup>: Helping entrepreneurs build market-leading companies. On Twitter: @fdestin<sup>155</sup>, @maxniederhofer<sup>156</sup>.

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<sup>153</sup><http://atlasventure.com>

<sup>154</sup><http://atlasventure.com>

<sup>155</sup><http://twitter.com/fdestin>

<sup>156</sup><http://twitter.com/maxniederhofer>



<sup>157</sup> Charles River Ventures<sup>158</sup>: We back people who want to change the world.

<sup>159</sup> Pillsbury<sup>160</sup>: A full-service law firm with market-leading strengths in the energy, financial services, real estate and technology sectors.



<sup>161</sup> Pivotal Labs<sup>162</sup>: We create great software. We've done it for leading companies, and we can do it for you.



<sup>163</sup> Dharmesh Shah<sup>164</sup>: Founder of HubSpot and On-Startups.

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<sup>157</sup><http://crv.com>

<sup>158</sup><http://crv.com>

<sup>159</sup><http://www.pillsburylaw.com/>

<sup>160</sup><http://pillsburylaw.com>

<sup>161</sup><http://www.pivotallabs.com/>

<sup>162</sup><http://pivotallabs.com>

<sup>163</sup><http://onstartups.com/>

<sup>164</sup><http://onstartups.com/>



<sup>165</sup> Jonathan Abrams<sup>166</sup>: Founder of Friendster, Socializr, and Slide.

## Interview: How to pick a co-founder

We received a lot of good questions and feedback on How to pick a co-founder<sup>167</sup>:

*Is two co-founders the only way to go? How do we split up the company? Who's the boss? How do I know when to compromise on a co-founder?*

So Naval<sup>168</sup> and I<sup>169</sup> recorded a 40-minute interview to answer your questions, explain how to pick co-founders in detail, and describe not only *what* to do, but *how* and *why* to do it.

The interview comes in two versions: **Mini** and **Pro**.

### Mini

The **Mini** version of the interview is free. It includes the *first 5 questions* of the interview — audio and transcript. Voila:

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<sup>165</sup><http://www.jabrams.com/>

<sup>166</sup><http://www.jabrams.com>

<sup>167</sup><http://venturehacks.com/articles/pick-cofounder>

<sup>168</sup><http://startupboy.com/about/>

<sup>169</sup><http://www.linkedin.com/in/bnivi>

Audio: Mini interview with chapters<sup>170</sup> (for iPod, iPhone, iTunes) Audio: Mini interview without chapters<sup>171</sup> (MP3, works anywhere) Transcript: How to pick a co-founder (Mini)<sup>172</sup> (PDF)

## Pro

The **Pro** version is \$9. It includes the full interview, with *all 16 questions* plus:

- A nicely-formatted 48-page transcript. Here's a sample<sup>173</sup>.
- An MP3 you can download for your portable device or media player. Here's a sample<sup>174</sup>.
- Chapters, so you can jump to the part of the interview you want. This only works on iPods, iPhones, and iTunes. Here's a sample<sup>175</sup>.
- **Your money back if you don't like the interview.**
- **THAT AWESOME FEELING OF BEING A PRO.**

## Get the interview for \$9. One-click checkout & download. #

“Great interview. Well worth the \$9.”

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<sup>170</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/11/How-to-pick-a-co-founder-Mini.m4a>

<sup>171</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/11/How-to-pick-a-co-founder-Mini.mp3>

<sup>172</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/11/How-to-pick-a-co-founder-Mini.pdf>

<sup>173</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/11/How-to-pick-a-co-founder-Mini.pdf>

<sup>174</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/11/How-to-pick-a-co-founder-Mini.mp3>

<sup>175</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/11/How-to-pick-a-co-founder-Mini.m4a>

– Richard Burton, Hoodeeasy<sup>176</sup>

**Not interested?** That's cool. Tell us why<sup>177</sup> and we'll send you another one of our products for free.

## Questions

Here are the questions we cover in the interview:

1. How many co-founders?
2. How do you create a history together?
3. How should you divide up the company?
4. Who's the boss?
5. Do you even need a CEO?
6. What skills do you need on the founding team?
7. Why do you need aligned motivations?
8. Should I compromise on a co-founder?
9. Why should I partner with a nice guy?
10. How can I tell if the other guy is a good builder/seller?
11. How do I convince someone to partner with me?
12. What if my co-founder needs a salary?
13. Where do I find a co-founder?
14. How do I start a business with family?
15. How do I start a business with friends?

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<sup>176</sup><http://www.hoodeeasy.com/>

<sup>177</sup><mailto:nivi@venturehacks.com>

## 16. How many co-founders? (Redux)

*And here's a transcript of the first 5 questions (also available in PDF<sup>178</sup>).*

### 1. How many co-founders?

**Nivi:** This is Nivi from Venture Hacks.

**Naval Ravikant:** And Naval from Venture Hacks.

**Nivi:** We recently posted an article by Naval called "How to pick a co-founder." You probably checked it out. If you haven't, take a look.

We got a lot of questions based on the article, and I also have questions based on the article, so we're going to answer your questions. We're going to try to elaborate on what we wrote and try to give some more examples of some of the things we talked about.

So, the most common question we had was about two-founder companies. Is two founders really the only way to go? What are the pros and cons of two founders and other types of situations?

Here's some of the feedback we got:

Ram said, "As you point out, there are several advantages to having two co-founders, but I think your perception exaggerates the odds against single-founder companies. From this week's news, AdMobs is a great example of a successful single-founder company."

Gabor says, "Was Facebook really a one-founder company? Maybe I'm bad at my Facebook founding history, but it seems like there

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<sup>178</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/11/How-to-pick-a-co-founder-Mini.pdf>

were multiple. It was one-founder in the sense that Mark Zuckerberg is both a builder and a seller, but I feel like there have to be more good examples of successful one, three, and four-founder companies. It seems like you guys dismiss anything other than two, too quickly.”

And then finally, Mark Essel says, “I don’t see three to four being a problem with the right group. Certain projects lend themselves to two; others can really get powered up by three to four founders. Engineer-heavy startups are common now, so doubling or tripling your development team at the outset is incredible. It depends on what other responsibilities team members have as well. Many startups are grown while folks work their day jobs, or part time to survive.”

So, the first question is, are we dismissing anything but two-founder companies too quickly?

**Naval:** I would say that’s not the case. Of course three-founder and one-founder companies can be successful, it’s just that generally speaking, over mass statistics, if you look at many, many companies, especially the bigger ones, it’s usually two founders that really matter.

Now, you may start with three founders or four founders, but very often the company tends to coalesce around two founders.

Or, you may start with just one founder, but that founder may have a very early and senior confidant who then ends up almost playing a founder role even though they join the company later. For example, if you look at Microsoft, Paul Allen stepped aside after a certain point in time, and Steve Ballmer really became the guy who came in and was Bill Gates’ co-founder.

So, I guess the important things to point out are that it is very, very important to have a strong, day-to-day partnership element when you are going through something as difficult as doing a startup. And whether that’s with a co-founder or with a very

early person who joins the company and fulfills that role, the titles matter less.

The issue with three or four-founder companies is not to say they can't succeed, it's just that it is much, much harder to divide up the roles in such a way that there isn't stepping on people's feet. It's much harder to find people of roughly equal caliber.

And then as a company progresses, in the much later stage, especially for a venture-backed company, you just end up with a lot less equity to go around. And you don't want to be in a situation where 10 years down the road – and by the way, it takes 10 years to build a truly great, huge primary franchise – after your company's gone public, you've raised lots of venture capital, you may find that all of the founders, because you had so many of them, own one, two or three percent of the company, each, and there's nobody, really, who can take charge of the company and be the CEO and just drive it through thick and thin.

That persistence, that drive that's necessary in a founder, is important to the health and success of a company, not only early on, but also much later in the game. And as a company gets older and older, it becomes less likely that a four or five person company can sustain the equity stakes required.

Lastly, I would say that any time you have three people in a room together working on something, you get politics. Then it starts mattering who says it, how they position it and whether they can get two to gang up on the third.

One of the nice things about a two-founder company is both have to agree – at least in a well-structured two-founder company.

**Nivi:** OK. You went into a bit of the pros and cons, so why don't we talk a little bit more about the pros and cons. Three to four founders: what are the pros and cons? Let's catalogue them.

**Naval:** Well, the pros are, obviously, many hands make light work. So, if you have three or four highly incented founders, early on, and they're motivated like founders, they're just going to accomplish a whole lot. That's probably the single biggest pro.

You also have a diversity of voices and opinions, which can work both ways. It can be great when you're brainstorming and problem solving; it can be really bad when you're trying to make decisions.

One of the early problems a three or four-founder company struggles with is who's on the board. Because a lot of control and authority derives from the board, every founder wants to be on the board.

And VCs don't like that. They know it's dysfunctional when you have four founders on the board because then they can't really talk about each other or who's doing a good job and who's not.

The CEO also ends up having very diluted authority, because now he not only has to just command the respect of one person, he has to play a little bit of politics and keep everybody happy. So it ends up being a difficult management situation.

**Nivi:** How about pros and cons of two people?

**Naval:** The pros are, obviously, that you just have to establish one solid partner relationship, there's a clean division of roles and responsibilities, and there are minimal politics.

The cons are, if those two can't get along the company is effectively dead. You have no room for error or failure. If the people don't get along you're going to have massive clashing. You're going to have too much DNA and time burned up internally.

And you just don't have as many people to go around, so the two have to be extremely good at what they do, which is kind of why I made the "one builds and one sells" distinction, because although you can occasionally find the superstar who can build

and sell, selling is a full-time job, building is a full-time job, so you might as well just pick the best on the planet at each.

**Nivi:** Right. And how about the one-founder case pros and cons?

**Naval:** I think it's an extremely difficult case. I would recommend the three or four-founder case over the one-founder case.

**Nivi:** Right.

**Naval:** Well, let's start with the pros. The pro is that you get to keep a lot of equity. [laughs]

The con is that you have to do all the work.

Another pro is that it is completely your vision. It's one person's monomaniacal vision, which sometimes can be great. I don't know the histories of these companies, necessarily, but it sure feels like Salesforce.com is a one-founder company, with Marc Benioff having the bully pulpit.

So, it can definitely be one person's vision and one person's drive, and so forth, but that person had better be really, really driven and really confident, because every startup goes through tough times, and you won't have a shoulder to cry on, not really. You won't have someone to pull you up.

You also won't have a diversity of opinions so you'd better be right and just able to sustain it. But now you've basically got a company that is just an extension of one person's personality, with all the ups and downs of that. I think the proper analogy might be trying to raise kids by yourself; sure it's possible, but it's a lot easier with two.

**Nivi:** I would say, whether you have a two-person, three-person, or n-person team, where n is greater than one, if you have a functioning team, don't worry about everything that we've said too much because a functioning team – an effective, well-functioning

team – is basically the rarest thing in the world of startups. Markets can be put into place. Right? You can pick a product, you can pick a market, but it's hard to pick a team.

**Naval:** Absolutely. The first company I started had three founders. The second one had five. So, if it works, it works; if it doesn't, it doesn't. You should not go and remove founders just because you're over two.

But, I would say if you're a one-founder company and you're finding things to be just difficult and every day is a chore, you may want to consider bringing on, even at a later stage, an early employee or late founder – someone who can be your partner. It's that partnership element that's very important.

And keep in mind; human beings are pair-bonding creatures. We're evolved that way and so we're just designed to operate that way, and operating on your own for long periods of time in sustained difficult efforts is just highly unnatural.

## 2. How do you create a history together?

**Nivi:** You suggest people find someone that they have a history with – you wouldn't marry someone you just met – and that you should date first. And you suggest going through something difficult, like a prisoner's dilemma or a zero-sum game. How would you actually do that in real life?

**Naval:** Basically, what you want to look for are people who are cooperators who you can get along with. So, when I say prisoner's dilemma or zero-sum game, that just means go through a tough situation with them. A tough situation can be one in which they can gain at your expense, and that's really how you know someone. So, if you're dividing up some money or if you're trying to figure out who should do the dirty job or the hard work, you want to be with someone who's going to volunteer for that kind of stuff, who's going to volunteer to do a dirty job.

Steven Levitt and Stephen Dubner, who wrote Freakonomics, wrote a sequel to it called SuperFreakonomics that just came out, and in the prologue they have a very interesting and kind of funny little quip where they say: We were trying to figure out how to divide up this enterprise and we both wanted 60/40. At first it didn't feel right, and then when we realized that each of us was offering to give 60 to the other guy, and wanted 40 for himself, that's how we knew it was the right partnership.

So, I think you want to try and find that spirit of cooperation, because you will go through tough times, so you need to have some way to predict how the other person is going to behave in those tough times.

**Nivi:** So, one practical way to actually play this game would be to lowball what you think should be your equity percentage in the business and see how they react to that.

**Naval:** That's actually a really good test. Most people would fail that test, which is a good screen.

**Nivi:** Right.

**Naval:** But when your partner, in quotes, turns to you and says, yeah, that's great, I'll take 55, you take 45, or, I'll take 60, you take 40; now are you really going to get up and walk away?

Which is a natural segue into: how should you divide up a company amongst founders?

**Nivi:** Cool. Let's talk about that.

### **3. How should you divide up the company?**

**Naval:** I've seen lots and lots of different examples and cases, and at the end of the day what I found is that, again, there are multiple ways to do it, but far and away the most stable configuration is one in which it's a 50/50 split. It's an inherent fairness.

Yes, not everybody is created equal, but it's very hard to measure when people's contributions are important. Some people's contributions are very important early on. Some people's contributions are important later on. It's very hard to measure how much effort someone is putting in. It's very hard to measure which crucial deal made the difference. So, I think a good rule of thumb is, start working at the same time, both work at the same salary or neither salary, and just make it 50/50.

I've seen cases where it's 55/45 or 53/47 or some unnatural number made up, and the bad blood surfaces five years down the road when you least expect it.

**Nivi:** And what about the case where you're basically hiring the first employee, perhaps calling him a co-founder, and giving him a large equity chunk – say 10% – but it's not a 50/50 split. Is that common or is that rare? What do you think about that?

**Naval:** It's not common, but it's not uncommon either. I think it's a pretty good way to go if you don't have a co-founder, or even if you do have a co-founder but it's someone who joins you early on and they just do a stupendous job – they behave like a founder.

And by behaving like a founder I mean they take responsibility for the outcome of the company. They work above and beyond the call of duty repeatedly. They stick with you through thick and thin. They voluntarily sacrifice their salary or even things that might seem like it's good for them, for the betterment of the company. And if you see someone who's doing that and becomes indispensable to the company, I'm a big fan of giving them a lot of stock and treating them like a late co-founder.

Now, later in the game you can't go handing out huge chunks of the company without getting in trouble with employees and investors, but you should do the best that you can because companies take five or ten years to build. They're just the sum of the people who are involved, and if you have a superstar person

early on, you need to recognize that before you lose them.

#### **4. Who's the boss?**

**Nivi:** So, let's say I've got two co-founders with a 50/50 split. Who's the boss? How do I figure that out? Is there going to be a CEO? And say we have one board seat. So, we raise some cash from a small, early-stage VC fund. There's one investor on the board, one founder and one independent, or just one VC and one founder. Who's on the board? Who's the CEO? And who decides when a founder can be terminated?

**Naval:** Traditionally, this is a very difficult question. This is why it's very important to have a tremendous trust-based relationship with each other. You have to trust that even when you're not in the room, the other founder will take care of your interests as he or she would take care of their own.

If you don't have that level of trust with someone, then you cannot answer this question. Assuming you have it, it should almost be easy.

People should be saying: "No, no, you take it! No, no, you take it; I don't want to deal with it."

The truth is that CEO in a startup is a tough job. It's not a fun job. You deal with a lot of the crud. You have to clean up a lot of the employee issues, personality disputes, keep the investors up to date. It's actually among the less fun work. Anyone who thinks that CEO is a really fun and sexy job probably shouldn't have it. I would think that with two good founders who trust each other there should not be much of a dispute.

Ultimately the board is the arbiter of control in the company, and the board is elected by the shareholders. It's quite common for there to be a voting agreement that forces drag-along. I think it's pretty important that if you want to have a say in

your company and control in your company, then you reserve your right to vote as a board member.

So, in the two-founder case, you should not sign any voting agreement that allows just the other founder to select a board member or names and fixes a board member forever. It should be by mutual consent and you should be able to bring it up for re-election, and that will force there to be some level of good behavior and an alignment of interests.

In terms of who fires who or how does a founder get fired, you only want a founder to be able to get fired if – a) the other founders agree, and b) you also have some neutral, outside independent arbiter, which could be a VC or independent board member.

## 5. Do you even need a CEO?

**Nivi:** Here's a question. You've got a team of two guys who started a company, and maybe you've hired a few employees and you've got about five people. Do you even really need a CEO beyond the guy who is on the board who is somewhat on the hook to the investors, if there are investors on the board?

**Naval:** I think you need a CEO in the sense that, on a day-to-day tactical level there has to be someone who's just making decisions so that not every decision gets caught in a situation of he said, she said; or you don't have people going to one person, and if they don't like the decision they go to another person and lobby. That's a very inefficient process.

But at a strategic level, month-to-month you don't need a CEO in that nothing is going to happen that is huge and material for the business without both partners agreeing. So, in a five percent company, a CEO is not a guy who goes and cuts a deal or raises money without consulting his partner, but is a guy who decides on a day-to-day basis, yeah, we are going to go ahead

and make that slight tweak to the side, or, yeah, tell a lawyer that that interpretation of the options contract is OK, and so forth.

**Nivi:** And then, in terms of getting terminated, at the very early stages where it's me and another co-founder and maybe a few employees, I basically don't want to be able to be terminated without the consent of the board. This should be a board-style decision. Like, the CEO, whoever that is who has that title, can't get rid of me while we're in less than five employees or a few employees, right?

**Naval:** Yeah. Like I said, you want to have a process in place, and that process should require the consent of both the other founders and some independent arbiter. It's pretty hard to fire a founder, and it should be hard to fire a founder.

That being said, all founders should be vesting because the worst-case scenario is that if you have to let go of a founder and that person owns 30% or 40% of the company, there's no vesting so they walk off with all of it. Now you have very, very early-stage company with only 60% or 70% to go around and it's just not enough to build a company around.

*Intro/Outro Music: Entertainment Tonight<sup>179</sup>*

## Morale, distribution, profit, and games

*Startup thoughts:*

Every action in a startup increases or decreases money, time-to-live, and morale.

If you thought product development was hard, wait until you try to distribute it.

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<sup>179</sup><http://www.etonline.com/>

“To succeed in business, you have to have a genuine interest in profitability. And most people don’t.” – Derek Sivers<sup>180</sup>

“We didn’t get here by playing the rules of the game. We got here by setting the rules of the game.” – Chris Albrecht<sup>181</sup>, CEO HBO

*If you want more links and quotes, sign up for our daily digest of Startup News via email<sup>182</sup> or RSS<sup>183</sup>.*

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<sup>180</sup><http://sivers.org/book/ArtOfProfitability>

<sup>181</sup><http://www.nivi.com/blog/article/mavericks-at-work-part-1>

<sup>182</sup>[http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en_US)

<sup>183</sup><http://feeds.venturehacks.com/venturehacks-twitter>

# December 2009

## Just Say No: VC terms that can really hurt

Sponsor Post Thanks to Atlas Venture<sup>1</sup> for supporting Venture Hacks this month. This post is by Fred Destin<sup>2</sup>, one of Atlas' general partners. If you like it, check out Fred's blog<sup>3</sup> and tweets @fdestin<sup>4</sup>. And if you want an intro to Atlas, send me an email. I'll put you in touch if there's a fit. Thanks. – Nivi



If you believe the blogosphere chatter, the entrepreneur-VC relationship seems strained like at no time in the past. The discussion seems to veer towards the “good versus evil” myth of creepy financiers intent on screwing polymath entrepreneurs out of their hard-earned wealth. Good-versus-evil is not a very constructive way of framing complex debates (remember “the war on terror” and the “axis of evil”?). Most sour VC-entrepreneurs relationships are simply partnerships gone bad, and divorce is never a pretty experience.

I see a lot of misguided commentary out there focused on the wrong issues, such as “how can you ask for liquidation preferences and call yourself entrepreneur friendly?” I am happy to answer that one if you are interested.

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<sup>1</sup><http://www.atlasventure.com/>

<sup>2</sup><http://www.freddestin.com/blog/>

<sup>3</sup><http://www.freddestin.com/blog/>

<sup>4</sup><http://twitter.com/fdestin>

<sup>5</sup><http://www.freddestin.com/blog/>

What I wanted to do here instead is focus on a few of the **clauses that entrepreneurs should absolutely avoid**; the wrong tradeoffs which later expose them to really “losing” their company. There are rational explanations for all of these, but as we know hell is paved with good intentions. Here are some of the pathways to hell:

### **Now we own you: Full ratchet anti-dilution**

Anti-dilution says “your company has no tangible value and as result I accept 20% ownership today but if we don’t create value I want some protection on potential share price reduction”. This protection is embodied in a clause called anti-dilution protection which results in additional “bonus” shares being issued where there is a down-round, i.e. a subsequent financing at a lower price per share. You can attack this clause conceptually but if VCs did not have any form of anti-dilution they would set the initial price lower. In other words, you as entrepreneur are getting less diluted today but with some ownership risk if company value goes down (at least that’s the theory, would be interesting to see how prices adjust without anti-dilution).

Anti-dilution is usually mild. Broad-based weighted average anti-dilution says that a number of anti-dilution shares are issued (or the conversion price of the preference shares is adjusted) based on a formula nicely explained by Brad Feld back in 2005<sup>6</sup>.

Here is how you can get really screwed: there is one version of anti-dilution whereby the number of shares issued to the investor is FULLY readjusted if subsequent financings are downrounds. Say you raise \$1M at \$10 per share and hence issue 100,000 shares to your VC, in exchange for 10% of your company. The next round is at \$5 per share; the original VC now gets an additional 100,000 shares issued; in the original cap table, he

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<sup>6</sup><http://www.feld.com/wp/archives/2005/03/term-sheet-anti-dilution.html>

now owns 20% of your business, before the new money comes in.

This gets nasty when serious money has been raised. Imagine the following happens: the pre-money valuation on your next round is less than the cash you raised previously. Say your company is in difficulty and raises \$10M at \$10M pre-money, having raised \$10M previously. Because the anti-dilution calculation is iterative, guess what, the share price mathematically converges to... zero. Legally it will be set at the par value, say €0.0001.

Your ownership just evaporated.

If your VC understands how the world works, you will sit around the table and hammer out some deal. But your negotiating position is weak. If on top of that a new CEO has been hired, the rational optimisation is to keep as much equity free for the new sheriff in town and not for the original entrepreneur. You are now relying on people's ethics, sense of fairness, or belief that long-term you don't build venture firms by screwing entrepreneurs. In, say, 75% of cases, good luck — few people really believe in win-win in these situations.

Note that there is usually a shared responsibility in full-ratchet: the entrepreneur is obsessed with maximising the headline number and accepts anti-dilution as a tradeoff ("OK, I will agree to this silly price but you better not screw up"). Often a Pyrrhic victory.

### **"Thank You and Good Luck": Reverse vesting without good leaver clause**

First, let me state that reverse vesting matters to me. I would not do a deal without some form of reverse vesting. Here's why: I invest in three founders, two of which work hard and one of which decides to leave to open a restaurant. I (and his

co-founders) are screwed. The guy or girl who left gets a free ride on the back of everyone else. He needs to be replaced, for which additional stock options are required. This is why reverse vesting exists.

The usual reverse vesting that you will find in our term-sheet is: quarterly reverse vesting of founder stock over 4 years. This is watered down or adapted based on individual circumstances.

I have seen cases where reverse vesting is not qualified: you leave the company, you lose your stock. That is a very toxic clause, and you should never accept it. You are now fire-able at will and there is even an economic incentive to do so. Unfair and abusive.

So don't find reverse vesting *per se*, but fight on the details. Can a percentage of your stock be considered yours? Probably. Make sure there is a good leaver / bad leaver clause. You get fired for cause, you lose some. You decide to leave, you lose some. The company decides it does not want you around anymore, you keep it. The need to be watchful of the details; sometimes you will be asked to sell your stock at "fair market value" when you leave, or at last round price etc. Negotiate hard.

*Continued in Part 2<sup>7</sup> with limited exercise period options, multiple liquidation preferences, cumulative dividends, and the trap of complexity...*

*If you like this post, check out Fred's blog<sup>8</sup> and his tweets @fdestin<sup>9</sup>. If you want an intro to Atlas, send me an email. I'll put you in touch if there's a fit. Finally, contact me<sup>10</sup> if you're interested in supporting Venture Hacks. Thanks. – Nivi*

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<sup>7</sup><http://venturehacks.com/articles/terms-that-hurt-2>

<sup>8</sup><http://www.fredestin.com/blog/>

<sup>9</sup><http://twitter.com/fdestin>

<sup>10</sup><mailto:nivi@alum.mit.edu>

# Home improvement

Slowly, slowly, we've been making improvements to the Venture Hacks website:

## 1. Popular Posts

They said this widget would make us famous. They lied. And still, we've added our most popular posts<sup>11</sup> to the sidebar:

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### POPULAR POSTS

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- How to pick a co-founder
- Archives
- 10 examples of minimum viable products
- What is the minimum viable product?
- How to make a cap table

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This is a great place to start looking through our archives — especially if you're new to the site. It's like high school for blog posts.

## 2. About Us

We've added a whole damn page about us<sup>13</sup>:

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<sup>11</sup><http://venturehacks.com/#popular>

<sup>12</sup><http://venturehacks.com/#popular>

<sup>13</sup><http://venturehacks.com/about>

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## ABOUT US

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We're [Nivi \(bio\)](#) and [Naval \(bio\)](#). We're founders ([Epinions](#)), investors ([Twitter](#)), students ([life](#)), and advisors ([billions](#)).

Read some fun [reviews of this site](#).

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Finally, you can meet the guys who write this baloney.

### 3. Supporter Posts

This baby displays the latest post<sup>15</sup> from our current supporter:

SUPPORTER POSTS

*Fred Destin*

[Three things you should](#)

[never tell a VC when](#)

[fundraising](#) — Disclosure is a good thing.

Early disclosure of thorny issues is a very good thing (such as, "I am embroiled in a legal dispute with my co-founder over ownership of the company and here is why")... [read more→](#)

atlas

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Fred Destin<sup>17</sup>'s the name. VC's the game.

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<sup>14</sup><http://venturehacks.com/about>

<sup>15</sup><http://venturehacks.com/#supporter>

<sup>16</sup><http://venturehacks.com/#supporter>

<sup>17</sup><http://www.freddestin.com/>

## 4. Product Page

The coup de grâce: all of our products in one convenient product page<sup>18</sup>:



**Our book, \$9:** Check out the [free samples](#).



**Our cap table, \$9:** Check out the [video tour](#).



**Our interview, \$9:** Check out the [free version](#).



**SUPPORTER POST**

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[For example.](#)

**Our bookstore:** Read our [reviews](#).



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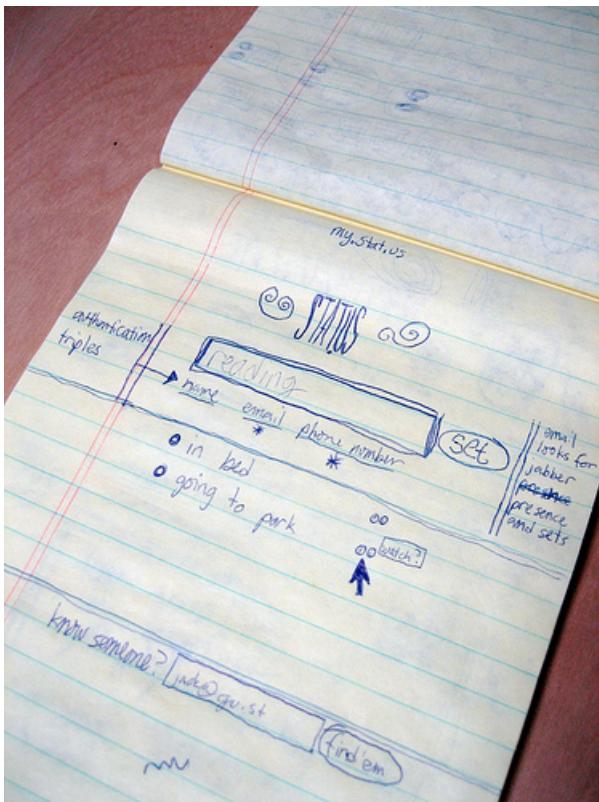
<sup>18</sup><http://venturehacks.com/products>

<sup>19</sup><http://venturehacks.com/products>

This is easily the most fabulous place to peruse our free and paid products.

*How can we make our site better for you?*

## Sometimes the feature is the product



Investors often dismiss startups with the refrain, “That’s a feature, not a product.” I do the same. They usually mean that the feature, by itself, will not be adopted by consumers — the value proposition is too simple or narrow.

But sometimes the feature is the product.

Was Twitter a feature or a product? Google? PayPal?

They're obviously products now. But before they were adopted by millions. Feature or product? Isn't Twitter "just" the status message feature from Facebook? Isn't Google "just" the search feature from Yahoo?

## Sometimes the feature is the product

This isn't surprising if you know a little bit about Eric Ries' pivots<sup>20</sup>:

"In a feature pivot, we select out a specific feature from our current product and reorient the whole company around that. A good example is Paypal realizing that their customers were gravitating to the email-payments part of their original solution, and ignoring the complex PDA-based cryptography solution. In order to do this kind of pivot, you need to pay close attention to what customers are really doing, not what you think they should do. **It also requires abandoning the extra features that make it hard for new customers to discover what's really valuable about the new, simplified solution** [emphasis added]."

Or if you know about Sean Ellis' gratifying experiences<sup>21</sup>:

"The majority of our project focus at 12in6 recently has been helping startups find their core user perceived value and exposing it in messaging optimized

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<sup>20</sup><http://www.startuplessonslearned.com/2009/06/pivot-dont-jump-to-new-vision.html>

<sup>21</sup><http://startup-marketing.com/milestones-to-startup-success/>

for response. Your objective should be to remove complexity from the initial user experience and messaging in order to highlight this core user perceived value. **Often this means burying or even completely eliminating features that don't relate to this gratifying experience** [emphasis added].”

## How can you tell if a feature is really a product?

You can wait for customers to start adopting it, see if they love it<sup>22</sup>, and then try to jump in as an investor or an employee.

What if you don't want to wait for customers to love it? Then you've got two options:

1. Invest in lots of startups like Y Combinator<sup>23</sup> or Ron Conway<sup>24</sup> — expect most of them to fail and a few to succeed wildly.
2. Work with a team that knows how to implement the theories of Eric Ries<sup>25</sup>, Sean Ellis<sup>26</sup>, and Steve Blank<sup>27</sup>. Bet on the team and plan to pivot your way to product/market fit. Needing to seem certain about the future, so you can recruit and raise money, works against this approach.

Those are the only ways I know how.

What other features were really products? Posterous<sup>28</sup> comes to mind.

*Image Credit: Jack Dorsey<sup>29</sup>*

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<sup>22</sup><http://startup-marketing.com/the-startup-pyramid/>

<sup>23</sup><http://ycombinator.com/>

<sup>24</sup><http://www.google.com/search?hl=en&q=ron%20conway&aq=f&oq=>

<sup>25</sup><http://www.startuplessonslearned.com/>

<sup>26</sup><http://startup-marketing.com/>

<sup>27</sup><http://steveblank.com/>

<sup>28</sup><http://posterous.com/>

<sup>29</sup><http://www.flickr.com/photos/jackdorsey/182613360/>

## Startup News, the first 2 weeks

“nicely done as always. i can count on one hand the number of daily emails worth signing up for.”

– Matt Oesterle<sup>30</sup>, Sweep ery<sup>31</sup>



Startup News is two weeks old today. I want to share some stats and thoughts about the product.

If you haven't seen it yet, Startup News is a daily digest of our tweets<sup>32</sup>, with links to the best startup advice on the Web. You can subscribe via email<sup>33</sup> or RSS<sup>34</sup>. It looks like this:

 venturehacks

Charging \$ for your product isn't a binary decision, it's a continuum: <http://i.mp/4KdcE0>,  
at 02:24 AM GMT from bit.ly

The #1 reason to charge for your product: It's fun. Learn more: <http://i.mp/59cXSc>,  
at 02:27 AM GMT from bit.ly

"Over a quarter of our active portfolio companies have done or are doing HR acquisitions." –  
@fredwilson, <http://i.mp/7gheX>  
at 06:06 PM GMT from bit.ly

Killer post by @msuster on raising money from strategic investors: <http://i.mp/7pp2B4>,  
at 06:12 PM GMT from bit.ly

Home improvements on Venture Hacks: Popular posts, about us, a supporter widget, and a  
consolidated products page: <http://i.mp/5f7ey5>.  
at 06:18 PM GMT from HootSuite

"There is plenty of capital to finance rapidly growing new technologies that are addressing  
large markets." – John Doerr, <http://i.mp/7TU1BN>  
at 06:55 PM GMT from HootSuite

Our first Follow Friday: @venturehacks/angelist. A Twitter list of investors on AngelList  
(<http://i.mp/6FBtA1>). I read it every day. #ff  
at 07:36 PM GMT from HootSuite

I'm pretty sure we have the only site in the world where the ads perform better than the  
content: <http://i.mp/6lZt6G>.  
at 08:10 PM GMT from HootSuite

<sup>30</sup> <http://venturehacks.com/articles/best-blogs/comment-page-1#comment-9295>

<sup>31</sup> <http://sweep ery.com/>

<sup>32</sup> <http://twitter.com/venturehacks>

<sup>33</sup> [http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en_US)

<sup>34</sup> <http://feeds.venturehacks.com/venturehacks-twitter>

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In the past, we could never get more than 50 people to subscribe to an RSS feed of our tweets (that's the flat part on the left side of the graph). **Re-positioning the same content as a daily digest made the difference.**

If you like the advice on this blog, you'll like the advice in our tweets. But lots of people don't use Twitter. And those who do don't catch all our links. I've been searching for a way to get our tweets into your hands and I think this daily digest is a great solution.

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<sup>35</sup><http://www.feedburner.com>

<sup>36</sup><http://twitter-digest.appspot.com/>

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## 10 skills I look for before writing a check

*This post is by Mark Suster<sup>40</sup>, a partner at GRP Partners. If you like it, check out Mark's blog with startup advice<sup>41</sup> and his tweets @msuster<sup>42</sup>. And if you want an intro to Mark, send me an email. I'll put you in touch if there's a fit. Thanks. – Nivi*



<sup>43</sup>One of the questions I'm most often asked as a VC is what I'm looking for in an investment. For me I've stated publicly that 70% of my investment decision is the team and most of this is skewed toward the founders. **I've watched**

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<sup>37</sup>[http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en_US)

<sup>38</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>39</sup><http://news.ycombinator.com/>

<sup>40</sup><http://www.bothsidesofthetable.com/>

<sup>41</sup><http://www.bothsidesofthetable.com/>

<sup>42</sup><http://twitter.com/Msuster>

<sup>43</sup><http://www.bothsidesofthetable.com/>

**people who went to the top schools, got the best grades and worked for all the right companies flame out.**

So what skills does it take to be a successful entrepreneur? What attributes am I looking for during the process? Having been through the experience as an entrepreneur twice myself, I have developed a list of what I think it takes.

## **1. Tenacity**

Tenacity is probably the most important attribute in an entrepreneur. It's the person who never gives up — who never accepts "no" for an answer. The world is filled with doubters who say that things can't be done and then pronounce after the fact that they "knew it all along." Look at Google. You think that anybody really believed 1999 that two young kids out of Stanford had a shot at unseating Yahoo!, Excite, Ask Jeeves and Lycos? Yeah, right. Trust me, whatever you want to build you'll be told by most VC's something like, "Social networking has already been done," "You'll never get a telecom carrier deal done," or "Google already has a product in this area." You'll be told by the people you want to recruit that they're not sure about joining, by a landlord that you'll need a year's deposit or by a potential business development partner that they're too busy to work with you, "come back in 6 months."

If you're already running a startup you know all this. But some founders have that extra quality that makes them never give up. At times it goes as far as being chutzpah. And I see this extra dose of tenacity in only about 1 of 10 entrepreneurs that I see. And if you're not naturally one of these people you probably know it, too. You see that peer who always pushes things further than you normally would. What are you going to get further out of your comfort zone and be more tenacious? It is really what separates the wheat from the chaff.

I once had a debate with a prominent VC on a panel. The moderator asked the question, “if an entrepreneur writes an email to a VC and doesn’t hear back what should they do?” This VC responded, “Move on. Next on the checklist. He’s not interested.” Without much thought I shot back, “That’s the worst advice I’ve ever heard someone give an entrepreneur.” Doh. I almost couldn’t believe I had blurted it out, but what came out of my mouth was so heartfelt that it just rolled out.

**If you fold at the first un-returned email what hope do you have as an entrepreneur?** As an entrepreneur, people aren’t going to respond to you and it’s your responsibility to politely and assertively stay on people’s radar screen. You no longer work for Google, Oracle, Salesforce.com or McKinsey where everybody calls you back. You had no idea how important that brand name was until you left it behind. Your customers don’t care that you went to Standford, Harvard or MIT. It’s just you now. And frankly if you went to a state college in Florida you’re at no disadvantage in the tenacity column. Persistence will pay off.

## 2. Street Smarts

OK, so you’re a tenacious person — you never give up. Well obviously that’s meaningless if your startup idea sucks. **I don’t think it takes book smart people to build great companies — sometimes it’s a hindrance.** But you do have to be a smart person and I personally prefer street smarts. I’m looking for the person that just “gets it.” They know instinctively how customers buy and how to excite them. They have a sixth sense for the competitors’ weaknesses. They spot opportunities that aren’t being met and the design products to meet these needs.

Because they’re street smart, most great entrepreneurs tend to prefer getting out and talking with real customers rather than sitting in a cubicle all day doing beautiful PowerPoint slides.

And when they walk in my office and present you can tell that they know what they're talking about. You can practically hear the "voice of the customer" when they're presenting their concept.

I often tell people that I'm looking for people who weren't born with a silver spoon in their mouths. **I like people who aren't worried about the social consequences of doing something they're not supposed to.** That's why I personally believe many immigrants or children of immigrants fare well in business. It never occurs to them to play by the same rules as everybody else; in fact, I'm not sure if they even know what the "rules" are. It leads many of these people to be more street smart than those defined by convention.

### 3. Ability to Pivot

**I don't like to invest in people that I've never met before who come through my office wanting to have a term sheet within 30 days.** I don't think most VC's do. Yes, there is the mythical company you all heard about that walked into Sequoia and had a term sheet 24 hours later. I'm sure that happens. But in most situations a VC will want to be able to judge how you perform over time. It's what prompted my post on how to build relationships with VCs<sup>44</sup>.

VCs often tell entrepreneurs that they want to see "traction" before they're ready to invest. What I believe they really want is longer to get to know you. And part of what they're looking for is how you adapt to the business you're building over time. Every entrepreneur starts with an idea that they believe makes sense. But then your customers start using your products, your competitors come out with new offerings and your business partners decide to launch a similar product rather than working with

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<sup>44</sup><http://www.bothsidesofthetable.com/2009/08/08/wtf-is-traction-a-6-step-relationship-guide-to-vc/>

you. You're forced to "pivot" on a regular basis. The best entrepreneurs get market feedback regularly and change their approach based on the latest information. The best entrepreneurs seek advice from everybody they need, learn lessons and make minor adjustments on a monthly basis.

This is the reason that I'm personally not that anal about your financial model. I've stated publicly that you MUST have a financial model because it serves as your ongoing compass and strategy but it will change on a regular basis during your first 2 years. So much so that your financial model 2 years out won't resemble your starting model at all!

So, for me, seeing how you respond to market challenges, what you learn and how you adapt is one of the most critical pieces of information I can collect about whether or not I want to invest in your company.

#### **4. Resiliency**

I like to say that "being an entrepreneur is really sexy... for those who have never done it." The reality is that it's lonely, hard work, high pressure and filled with mundane tasks. It's a gritty existence. In the grand scheme of things no matter how hard you work and despite your appearance on the TechCrunch50 stage, no one seems to really care. That next round of investment is proving difficult. Customers are harder to sign than you want. Journalists have just written an article that wasn't favorable. Your competitors just announced positive news. You've got 8 weeks of cash left and one of your employees just asked you to fill out a form so she can buy a house.

Every day you go home and face self-doubt but you've got to come back in the morning strong. Your employees are looking in your eyes for signs of weakness and self-doubt. They believe in you and they draw strength from you. You've got to be

able to come out of unsuccessful VC meetings, pull your socks up, and go into the next pitch. You've got to accept customer losses as learning experiences<sup>45</sup> and see how you can improve next time. You've got to see your product weaknesses and plug them. You've got to hear all of the doubters, and the world is FILLED with doubters, and still not give up. Resilience is one of the tell tale signs of an entrepreneur.

As a VC, if I can tell that you've survived tough times and you don't appear beaten down that's a huge plus. People always think that the big, successful brands they know were huge success stories from day one. **GRP Partners funded Starbucks and Costco. I can tell you both were less than 30 days from bankruptcy early in their lives.** They were survivors. One of the most famous case of resiliency in the US history is Abe Lincoln. If you haven't seen how many setbacks Abe had before becoming president<sup>46</sup> check out the link.

Or, more succinctly, from Sir Winston Churchill, "Success is the ability to go from one failure to another with no loss of enthusiasm." (quote via David Fishman<sup>47</sup>)

## 5. Inspiration

As an entrepreneur you're always under-resourced. You want to hire a crack team of developers but you haven't raised enough money yet. You want that key marketing resource from Google but he's on a fat salary that you can't match. You're trying to get your contacts to get you that introduction to Ron Conway to sprinkle his legitimacy on your company through an angel investment. All of these things are nearly impossible for most entrepreneurs. And tenacity alone won't yield positive results.

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<sup>45</sup> <http://www.bothsidesofthetable.com/2009/08/15/brace-losing/>

<sup>46</sup> [http://www.school-for-champions.com/history/lincoln\\_failures.htm](http://www.school-for-champions.com/history/lincoln_failures.htm)

<sup>47</sup> <http://twitter.com/PipitPurch>

Often entrepreneurs show me their management team slides with the names of the people who are going to join him once they're funded. I usually jokingly respond, "maybe you're not an entrepreneur?" This always gets people to sit up straight ;-) I say, "listen, nearly every successful entrepreneur I've ever met has a certain 'X-Factor' about them that makes people take notice. I know that these people who you want to join you are in comfortable positions at brand name companies and don't want to take the risk of joining you. But when the right entrepreneur comes along they think, 'I've got to join this person now. I think this is going to be hugely successful and I don't want to miss the opportunity.'"

The best entrepreneurs are like that. When you're around them it's almost contagious. They are passionate about what they're doing, they're confident about their success and they're driven to make it happen. Sure, they have self doubt when they're alone looking in the mirror, but you'd never know it from seeing them in the office. And what you need to know is that **for every chart you put up with the people who are going to join you when you're funded, I see companies that have actually gotten the team on board with no more cash in the bank than you have.**

Whenever I'm watching someone present to me I'm often thinking to myself, "Can this person inspire others?" And inspiration is so important because not only is it required to hire and lead your team, but it's required to get customers to work with you when, by all means, they should not. You've got less than 6 months cash in the bank and your product isn't really fully baked. But they have confidence that you'll get there even if they don't acknowledge this to themselves. TechCrunch is going to cover you. They probably shouldn't because you're a bit more hype than reality right now. But they sense your trajectory. They get a sixth sense that you're going to pull this thing off. Inspiration goes a long way in business.

*To be continued in Part 2 with perspiration, detail orientation, decisiveness, and more. If you like this post, check out Mark's blog<sup>48</sup> and his tweets @msuster<sup>49</sup>. If you want an intro to Mark, send me an email. I'll put you in touch if there's a fit. – Nivi*

## Just Say No: VC terms that can really hurt (Part 2)

Sponsor Post Thanks to Atlas Venture<sup>50</sup> for supporting Venture Hacks this month. This post is by Fred Destin<sup>51</sup>, one of Atlas' general partners. If you like it, check out Fred's blog<sup>52</sup> and tweets @fdestin<sup>53</sup>. And if you want an intro to Atlas, send me an email. I'll put you in touch if there's a fit. Thanks. – Nivi



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In Part 1<sup>55</sup>, I discussed a few of the term sheet clauses that entrepreneurs should absolutely avoid; the wrong tradeoffs which later expose them to really “losing” their company. There are rational explanations for all of these, but, as we know, hell is paved with good intentions. Here are some more pathways to hell...

<sup>48</sup><http://www.bothsidesofthetable.com/>

<sup>49</sup><http://twitter.com/Msuster>

<sup>50</sup><http://www.atlasventure.com/>

<sup>51</sup><http://www.freddestin.com/blog/>

<sup>52</sup><http://www.freddestin.com/blog/>

<sup>53</sup><http://twitter.com/fdestin>

<sup>54</sup><http://www.freddestin.com/blog/>

<sup>55</sup><http://venturehacks.com/articles/terms-that-hurt>

## **“Thank You and Good Luck” for options: Limited exercise period**

I am going to get some of my colleagues mad at me here. I see many stock options plans where, when employees leave the company, they have a short time window (usually 3 months) to exercise the options they have vested. This means they have to pay the strike price that the options were issued at and acquire the shares (strike price could be \$3 for shares valued at \$4 at the last round).

That forces startup employees to fork out cash and often crystallizes tax liabilities. It feels harsh to me. I think options should be exercisable over long periods of time, so people who have contributed to the wealth creation process can exercise when the value is realized (i.e. the company is sold) and it becomes a cash-less exercise for them.

## **Things I cannot get too excited about**

*Multiple liquidation preferences:* This means investors get a multiple of their money back before you see anything. I don't like these conceptually, they feel very un-venture to me, but they are only part of the deal. If you push super hard for a \$100M valuation but have to accept multiple liquidation preferences as a trade-off, it's your call. If the company goes public (at which point preferred shares convert into ordinary shares and the liquidation preferences disappear), you win. If the liquidation preferences are negotiated away in a subsequent round of financing, you win. **Personally, I have a strong preference for simple terms at the right price from the outset.**

*Cumulative dividends:* Sometimes an 8% dividend is slapped on, and it accrues over time when it isn't paid. Again, this is not appropriate for most venture deals, but it may be part of an acceptable trade-off.

## The trap of complexity

**More than anything else, I find the real danger is complexity.** When you need 3 full days of modeling to come to grips with a cap table, or when no-one can agree anymore on how clauses should be applied, you are in trouble. You will spend more time discussing internally how clauses should be applied than focusing on that critical acquisition you should be closing. I have seen cases where you needed robust macros to model outcomes. How about adding an exit-value-dependent management carve-out to a participating liquidation preference reverting linearly above 3X return on top of a French legal requirement that the first 10% gets distributed to all shareholders equally ? I have modeled this and it's simply not worth it.

**Value is not created by arcane legal language but by nailing business execution and growth.** Keep it simple and keep yourself focused on the right elements.

## Get good advice (duh!)

I was at Seedcamp<sup>56</sup> on the VC panel with Fred Wilson<sup>57</sup> and a few others recently and there was a lot of talk about terms and how not to get screwed (evil evil VCs...). I will repeat the advice I gave then: you want to protect yourself adequately, get a good lawyer. **You will not out-compete us on terms negotiation.** I use Tina Baker at Brown Rudnick in the UK and Karen Noel / Olivier Edwards at Morgan Lewis in Paris; they are great, go talk to them.

Having said that, **it is completely your responsibility to understand what you are signing**, and it is up to you to push back. Read the documents, ask questions about everything you

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<sup>56</sup><http://www.seedcamp.com/>

<sup>57</sup><http://www.avc.com/>

do not understand. Ask your lawyer: where does this document create risk for me, both on my income stream and my ownership. How does this go wrong and how do I protect against it? This is advice you are seeking, not an outsourcing service.

And remember, **there is no such thing as standard terms**. May the force be with you.

*If you like this post, check out Fred's blog<sup>58</sup> and his tweets @fdestin<sup>59</sup>. If you want an intro to Atlas, send me an email. I'll put you in touch if there's a fit. Finally, contact me<sup>60</sup> if you're interested in supporting Venture Hacks. Thanks. – Nivi*

## Pitching Hacks, in paperback

“Your first stop if raising money!”

– Adam Smith, Founder of Xobni<sup>61</sup>

The rumors are true. You can buy Pitching Hacks<sup>62</sup> in paperback, for \$19. And you can still buy the good old-fashioned PDF for \$9. Get them here<sup>63</sup>.

So far, we've sold about 700 copies of Pitching Hacks and gotten great reviews<sup>64</sup>. But we want to sell even more.

So we're selling it in paperback. And we've added a short new section on *Pitching Resources*, with links to great blog posts we wish we had written. *And* we're giving away the first two

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<sup>58</sup><http://www.freddestin.com/blog/>

<sup>59</sup><http://twitter.com/fdestin>

<sup>60</sup><mailto:nivi@alum.mit.edu>

<sup>61</sup><http://www.xobni.com/>

<sup>62</sup><http://venturehacks.com/pitching>

<sup>63</sup><http://venturehacks.com/pitching>

<sup>64</sup><http://venturehacks.com/pitching#testimonials>

chapters of the book for free. You can find the new *Pitching Resources* section and free chapters here:

Link: Pitching Hacks Preview<sup>65</sup> (pdf)

Buy Pitching Hacks here<sup>66</sup>.

## How to bring a product to market / A very rare interview with Sean Ellis



<sup>67</sup>Sean Ellis<sup>68</sup> recently sat down with us and explained how to bring products to market. *You should listen to this interview for ideas on how to get to product/market fit, how to measure fit, and how to survey your users so you can improve fit.*

If you don't know Sean from his blog<sup>69</sup> or tweets<sup>70</sup>, he lead marketing from launch to IPO filing at LogMeIn and Uproar. His firm, 12in6<sup>71</sup>, then worked with Xobni (Khosla), Dropbox (Sequoia), Eventbrite (Sequoia), Grockit (Benchmark)... the list goes on. 12in6 "helps startups unlock their full growth potential

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<sup>65</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/12/Pitching-Hacks-Preview.pdf>

<sup>66</sup><http://venturehacks.com/pitching>

<sup>67</sup><http://startup-marketing.com/>

<sup>68</sup><http://startup-marketing.com/>

<sup>69</sup><http://startup-marketing.com/>

<sup>70</sup><http://twitter.com/seanEllis>

<sup>71</sup><http://startup-marketing.com/12in6-projects/>

by focusing on the core value perceived by their most passionate users.”

This is the first time Sean has done an interview on the record. I’m really psyched he’s making his insights public — this interview is a must-listen. We’ve broken the interview into two parts: 1) before fit and 2) after fit. This post contains Part 1.

SlideShare: How to bring a product to market<sup>72</sup> Audio: Interview with chapters<sup>73</sup> (for iPod, iPhone, iTunes) Audio: Interview without chapters<sup>74</sup> (MP3, works anywhere) Transcript with highlights: Below

## This interview is free — thanks to KISSmetrics



<sup>75</sup>We’re bringing this interview to you free, thanks to the kind support of KISSmetrics<sup>76</sup>. Sean is an advisor at KISSmetrics and we interview their CEO, Hiten Shah<sup>77</sup>, in How to measure product/market fit<sup>78</sup>.

KISSmetrics built survey.io<sup>79</sup> with Sean — now they’re collaborating on KISSMetrics, a new tool for funnel optimization.

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<sup>72</sup><http://www.slideshare.net/venturehacks/how-to-bring-a-product-to-market>

<sup>73</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/12/How-to-bring-a-product-to-market-Sean-Ellis-interview.m4a>

<sup>74</sup><http://venturehacks.com/wordpress/wp-content/uploads/2009/12/How-to-bring-a-product-to-market-Sean-Ellis-interview.mp3>

<sup>75</sup><http://kissmetrics.com/>

<sup>76</sup><http://kissmetrics.com/>

<sup>77</sup><http://hitenshah.name/>

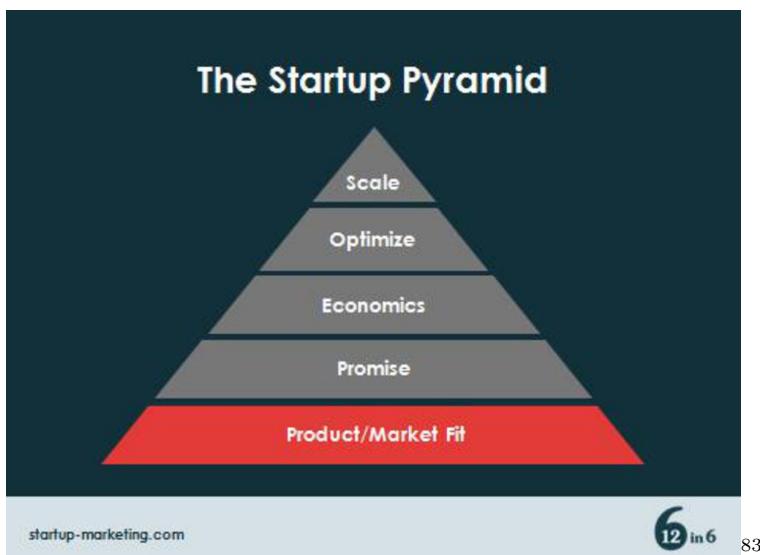
<sup>78</sup><http://venturehacks.com/articles/measure-fit>

<sup>79</sup><http://survey.io/>

## Prerequisites

You'll get more out of this interview if you also read:

1. An example of the survey.io survey<sup>80</sup> Sean uses before fit. (Several phrases we use in the interview mean the same thing: Product/market fit = Fit = 40% of surveyed users consider the product a “must-have” = 40% of surveyed users would be “very disappointed” if they could no longer use the product.)
2. The startup pyramid<sup>81</sup>.
3. Some of our favorite posts by Sean<sup>82</sup>.



<sup>80</sup><http://survey.io/survey/demo>

<sup>81</sup><http://startup-marketing.com/the-startup-pyramid/>

<sup>82</sup><http://venturehacks.com/articles/sean-ellis>

<sup>83</sup><http://startup-marketing.com/the-startup-pyramid/>

## Outline

Here's an outline and transcript of Part 1.

1. Half the marketing battle is the product
2. Must-have products make marketing much easier
3. How PayPal built a must-have product
4. Understand the must-have users
5. How to get to product/market fit
6. How not to get to fit
7. Should I launch?
8. You can't set a deadline on fit
9. How to communicate with the board during fit
10. How to use positioning to improve fit
11. It's frustrating to try to grow without fit
12. How many users do you need to determine fit?
13. Who do you survey?
14. What is promise?
15. Don't over-position your product during fit
16. Pivot the business around the love
17. Focus the product on the love
18. Create a great experience around the love
19. Create a business model around the love

20. First find the love
21. Are recommendations a good indicator of fit?
22. The must-have metric is a good indicator of fit
23. Preview of Part 2: What comes after fit?

## Transcript

**Nivi:** Hi, this is Nivi from Venture Hacks, and I'm here with Sean Ellis. We're going to talk about how to bring a startup's product to market.

This interview is broken up into two parts: before product-/market fit and after product/market fit. **Or to put it another way, what are the set of activities you have to do to get the product/market fit, and then once you're there, what are the set of activities you have to do to prepare for sustainable growth.**

I'm super psyched about this interview. This is Sean's first-ever interview on the record. We're going to jump right into it.

### Half the marketing battle is the product

Sean Ellis: The whole idea that's gotten me to where I am right now, where I'm doing multiple companies, is basically that I'm just trying to get lots of cycles, up front, in that really critical zone — I call it the fail zone — that if you don't get that done right, the company will fail. And if you figure that part out, then it's really a question of how much success is the business going to have?

Particularly, one of the things that I've learned that's been a little humbling through the experience is that if nobody wants

the product, it doesn't matter how effective the marketer is, you're going to have a really hard time being successful. And if people want the product, you don't have to be that great a marketer — the product is just so much easier to market. **So half the battle, I've realized over time, is just finding the right company with a product that people actually need, and that there's a big enough market that can support growth for that business.**

## **Must-have products make marketing much easier**

**Nivi:** Yeah, and what might be interesting for some people to hear is what's in that grey zone between nobody wants the product, to a lot of people consider the product to be a must-have. For example, sites that have great marketing and distribution through viral marketing, but they don't necessarily have any real must-have-it-ness with their customers or with their users.

**Sean:** All right, so the question really being: the grey-zone products that fall between those must-have products, and products that maybe aren't as strong of a must-have, but can you be successful with those?

I am just figuring this out as I go along. I know that there is no right answer on any of these things. What I do know is that if you have a must-have product, your chances of success are very high.

**And the way that I figure out if a product is a must-have or not is: what percentage of people are telling me that they'd be very disappointed if they could no longer use it?** But it seems like you find a lot of categories where you might say that it's a nice-to-have, rather than a must-have.

And I think that the difference is that for a nice-to-have product — so, something where not a lot of people say they'd be very disappointed without it — that you probably can be successful,

but it's going to take a lot of effort on the marketing side to make up for those product deficiencies.

I think if you really step back and say, as a business, that ultimately our goal is to create a successful, fast growing business, that people really need our product, and that over time we have a defensible business where it's really hard for somebody to come in and provide an alternative product where we start losing customers, that in an early stage startup you have an opportunity to put a product out there, get that initial user feedback, and then you have two choices.

If that feedback is really strong and the users say that they'd be very disappointed without it, in a large percentage, then you can try to grow the business.

Alternatively, if they come back and say that they wouldn't be that disappointed without the product, then you have the choices where you can either try to grow it or you can decide that you're not going to try and grow the business. **And to me, my recommendation has always been to decide not to grow the business if it doesn't have a lot of people that are real passionate about the solutions.**

Actually, you can operate a startup at a pretty low cost if you basically have a small engineering team and you're putting product out there and you're not spending a lot to get people on there, but you're really engaging the people that do come in. You can engage them much better if there aren't that many people, so you're in a position where it may take you a year or two years, but you can really, over time, start to evolve a product into being something that someone wants.

Maybe you find early on that absolutely nobody wants the product, and in that case you might want to do a complete restart on the business.

And when I'm presenting to groups, the example that I always point to, mostly so that people know that there's hope if they

don't have great product/market fit initially....

## **How PayPal built a must-have product**

**Sean:** That product/market fit is how I describe having a large percentage of people that would be very disappointed without the product. If you're above 40% of the people saying they'd be very disappointed, I tend to say you've found product/market fit, and if you're less than that, you haven't.

So a lot of times I meet with companies that are maybe in the 15% to 20% range on that, and it's very discouraging. You've worked very hard to put out a product, so the example that I give them is PayPal, where the initial product that they came out with was a cryptography product where you would use a PDA to store access codes for servers, and it was better than carrying a bunch of individual devices to access those servers. And the problem they were solving was that there was a lot of clutter in carrying those devices, and they were going to consolidate them all onto a single hand-held.

In "Founders at Work" there is a great case study on this. What Max Levchin says in "Founders at Work" is that they put the product out there and "nobody really needed it." That was a direct quote — "nobody really needed it." So what they decided.... Most companies would try to interpret the data and keep blasting away and say that somebody needs it. They just don't get it yet.

**Nivi:** We need more distribution....

**Sean:** Yeah, they blame marketing, they blame sales, but ultimately, it took a lot of guts, and just honesty, to say: You know what? We created something that nobody really needs.

So what they did at that point was they stepped back. They asked what are we good at? We're good at developing for a

handheld PDA. We're good at security. What else can we do with these skill assets that we have? And they decided that they were going to get into the mobile PDA payment space, where basically, people could beam payments back and forth.

And on the initial vision they were able to raise a couple hundred thousand dollars. On this new vision, they were able to get a prototype out on that initial money that they had raised, and they were able to raise... I think it was four million dollars. I don't remember the exact number on it. And they actually beamed the VC money over so they had a good enough prototype to be able to accept the payment via this PDA payment. And then they were off to the races, and they started executing the business.

I think, in that case, my guess is that if they had surveyed those users who were using PDAs to make payments; it was more of a party trick. It was something that there wasn't a real big need for, but they got users on there. They got lots of users on there, and they were able to get those users coming back. But, I'd put it in that probably-nice-to-have category.

Nice-to-have is kind of a scary thing, because you get enough success that you want to keep at it. But they were very fortunate in that they sort of stumbled into what ultimately became their market, which was, of course, the web-payment platform that PayPal is today. And that was really a function of people just starting to use it that way. And so, that's why I focus a lot with companies on helping them figure out the use cases behind their product. **If the people who have one use case consider it much more of a must-have than people who have a different use case, then that's probably the business you're going to be able to build a successful business on.**

## **Understand the must-have users**

**Nivi:** So, do you ask the must-have users what they use the product for?

**Sean:** I ask everybody what they use the product for, and I'm trying to see, really, who has the most passion around the product. And usually it breaks down by use cases, sometimes by user types. It's really just looking through the initial data to really understand who really needs this product, and it can be on demographics, it can be on use cases, it can be on a lot of different things. But once you really understand a group that really needs the product, then you start to have that true North for the business — the part that you can actually start to build a business that will grow and thrive around if they represent a big enough market.

**Nivi:** Right. In that product/market fit stage that you're talking about, which is basically the bottom layer of your pyramid, what don't you do? For example: PR, trying to get a lot of distribution, increasing your burn.

**Sean:** Well, it depends a little bit on the type of business that you have.

So just one quick thing on wrapping up the PayPal example was, by the time they pulled the plug on their mobile-payment business they actually had, I think it was 1,000 times more people using the web payments. They had obvious traction, so they didn't need to necessarily get that from a survey. They could just see that they had the traction there at that point. They could say: You know what? That's where our real business is. Even though they fought it, initially, because they had different preconceptions about where their business would be.

## How to get to product/market fit

**Sean:** I purposely try to avoid working with companies that are pre-product/market fit, because they're in such a risk zone that, one, it's going to hurt my reputation if I string too many of those together, and two, to ask people, who have a product that people don't need, to pay me to help them with marketing would just not be the right thing to do. It would be a mistake for them to pay me, and it's just not smart, from my perspective, to stake my reputation on their success.

But I found myself working with one fairly recently, on a very short, almost advisory project, of just helping them out. And my advice to them was to really be laser focused on that number and to really monitor that very-disappointed number.

So, one of the things that I've seen work well for companies that are in the 20% range, or even lower, of the user saying they'd be very disappointed without it, is to focus on, one, why those people would be very disappointed without it, and to really start to say, OK, this is our best signal of value that we're creating.

And then, to look at the feedback from the people who would only be somewhat disappointed without it. Ignore the people who say they would not be disappointed without it, because they're so far from being satisfied.

**But then look at those somewhat disappointed people, and look at feedback from those people — particularly on what changes they'd like to see in the product. And look for things that relate to the very-disappointed feedback.** If you take all feedback equally, you're going to have a very broad product experience that is very disjointed.

And I think one of the mistakes when people are too responsive to user feedback is that it's a product that does everything, because if you try to please everybody, you're essentially going to have a very unfocused product. But if you use the feedback

from your very-disappointed people to give you that focus, and now you're looking for feedback from everyone else that relates to what the very-disappointed people have told you...

**Nivi:** Like with PayPal, for example.

**Sean:** I think, using PayPal as an example, if they had surveyed all of their users, I'm assuming that a lot of the people who were doing the hand-held payments would basically have been saying that they're only somewhat disappointed without it. And then the people who were doing the web payments would be saying that they'd be very disappointed without it. But some of the people on the web payments would be saying somewhat-disappointed, and they would say: if only I felt more comfortable about security; or, if only I could do it faster; or, if only you could give me better records of payments that have been made.

**So you could take the feedback from the somewhat-disappointed who were using hand-held payments, and act on that to try to get there, but then you're not really honing in on where the passion is.**

Or, you could take it from the other side, saying, OK, these people may be a little pickier about what defines something that's a must-have, but the feedback that they're giving would improve the experience for the people who already say it's a must-have. So, it's really trying to just hone a consistent, core-product vision that is already starting to crystallize based on the feedback from the really passionate users.

**Nivi:** Yeah, that's great. So in this case, it's related in the sense that somewhat-disappointed people are using the same segment of features in PayPal.

**Sean:** Yeah. It's that use case.

**Nivi:** Use case.

**Sean:** Yeah. They're suggesting improvements to the use case that's consistent with the most gratified users there are.

## How not to get to fit

**Nivi:** Great! Yeah. So that's a great idea in terms of getting what you need to do to get product/market fit, and I'd like to talk more about that, but it would also be great to hear what you don't do.

**Sean:** I think the thing that you don't do — and I'll make one caveat in a second, on this — is that you don't aggressively try to grow the business. Particularly, you're not trying to do business development relationships. **Maybe you can spend enough to create some flow so you actually get people giving you the feedback on the product, but one thing I wouldn't do is obsess over ROI on that flow.**

**Your goal is not to figure out that repeatable, scalable customer acquisition engine at that point.** Your goal is to get enough people in there to where you can react to their feedback and hone the product experience on their feedback.

## Should I launch?

**Nivi:** How about a launch?

**Sean:** This is very debatable. A lot of people would say that a launch is a really important event. For me, I've never been big into launches. **Launch is a one-off.** With launch, you're going to get a group of people in one time, and you're going to get some feedback on them. And yes, they may be cheaper because you got some good press around it, but you haven't learned anything about how to grow the business with a launch. So for me, I'm much more....

I wrote a blog post way back when. I think it was called "**Launch with a Trickle,**" and that's much more of my focus on things. Just get enough people on there as early as you can, so that you can react to their feedback. And you may find

that they absolutely love the product. Then hone in on why they love the product. And then get the messaging right and the experience right, so that you're delivering that better. Once you've kind of tightened up and you've got that validation that a lot of people love your product — hopefully more than 40% say they'd be very disappointed without it — then you can step on the accelerator and a big launch might make sense at that point.

### **You can't set a deadline on fit**

**Sean:** But what I see too many companies do is set a date. They say, we're going to have our launch on January 14th, and they're two months away from that and they're working towards... I mean, it's either time or it's not time.

**Nivi:** Yeah, and you can't set a deadline on product-/market fit. Right? That is the point in time, in the growth of a company, where you basically are unable to predict anything.

**Sean:** Right. And all you're going to do then is make the mistake of being too aggressive too early, or piss off your investors by missing that date for the launch.

So it's much better to say, our clear objective — the next milestone that we need to get to before we do all of these things — is to actually make sure that enough people love this product. As soon as we get there, then we have to figure out why, and make sure that we're really honing every piece of the business to reflect why people love the product.

### **How to communicate with the board during fit**

**Nivi:** Right. So, on that topic, how do you communicate with the board and set expectations when you're trying to get to the

product/market fit stage?

**Sean:** What I've found is that people either get it or they don't.

**Nivi:** What are the responses of the people that don't get it, like from a board perspective? What have you heard board members say directly, or secondhand?

**Sean:** They're just: You've got to go for it! You've got to go for it! It's good enough. It's good enough. And they just want to accelerate the business.

I have a great example of a company that was about 15% or 20% on product/market fit and I loosely advised them at no cost, because I was going to spend some time in Scotland and they're based in Scotland. And I wanted to get to know these guys better because I was going to be spending a week over there. So we just worked together over a period of time.

And when we first started working together they were at the 15% or 20% very-disappointed number, and they explained to me that their board of directors was just pushing them on: We've got to get to this growth number! We've got to get to this growth number!

And they took the time to really explain: This is our goal right now. We don't think our product is good enough to accelerate this business. Our goal is to take the feedback from the users that we have and keep getting our product better.

In the process of doing that, they had the very painful process of actually having to lower projections on growth, and doing it week after week, and frustrating their board of directors through that process. But they did exactly the right thing, because today their very-disappointed number is over 50%.

And when I met with them when I was in Scotland about a month-and-a-half ago, they were at a really exciting point where they said they keep going back to their board of directors and saying: Hey! We're going to revise those numbers up. They

kept going and saying the numbers are too low. It's going to be better than that, because now that they have the product right they could really focus on that, and they weren't going to have the....

You can grow when your product/market fit is lower than that, but you're going to grow a lot slower than you otherwise would, and you're not going to address the real problem. And you're going to have a very frustrating experience trying to grow that business over the next several years, versus saying: Let's keep our costs really low, let's get the product right, and when we're focused on growth, no excuses. Now we're absolutely accelerating that business and it's going to be much easier to grow the business at that point.

And ultimately, you take it a year out or two years out, you're going to have a much bigger userbase doing it that way than if you're trying to grow through the whole period of time.

## **How to use positioning to improve fit**

**Nivi:** Now, what changes should they make to get to that number, without getting into the specifics of the business?

**Sean:** I don't know. I didn't work with them, so all I know is that they did the things that I've mentioned, where they really took the feedback of the very-disappointed people, really tried to look for the signal of who loves this product. Somebody loves it. Who loves it? Why do they love it? How can we really put a stake in the ground around that and try to make that piece better, and try to play down the other pieces?

**Nivi:** Then maybe reposition?

**Sean:** Yes. Some of it's definitely through repositioning.

I have another company that I worked with that was before I had [done] that. This was really the company that helped me

come up with the idea that I was going to survey people ahead of time, because I got into two companies at the exact same time who were both at about [where] 7% of their users said they'd be very disappointed, and found myself in the "oh, crap!" moment of figuring out that now I'm going to have to help these guys transition to growth and grow, but they're not ready for it yet. And why did I wait until I had a six-month contract with them to run the survey? From now on I'm going to survey it ahead of time.

But at one of those two companies, we were able to see a really strong signal in the 7% that said they'd be very disappointed without it, reposition on that signal... [interrupted]

**Nivi:** So how do you reposition on the signal. In this case, did you get a little bit more data...?

**Sean:** We just found out — I mean, I can't give any specifics on it — **they had a product that had lots of different features, and each one of those products could be a product in itself.** They built a really big suite of tools, within a product, and everyone who said they'd be very disappointed was focused on just one of those. So we basically only talked about the one they were focused on, and we didn't talk about any of the other things.

**Nivi:** To the user, say, on a landing page or on the home page.

**Sean:** Exactly — on the home page we only highlighted that and said we'll introduce the other stuff after we get them in. One of the benefits with that was that we were really able to simplify messaging. Having a really complex product set that you have to present people is way harder than simplifying that and only highlighting one. **So, we basically highlighted the most important must-have product from the group, and hid some of the other products, and as a result we could be much clearer in what the benefit was for the people coming through and what we were actually offering.**

So, one week later, on the next cohort of people coming through, we were over 40% because they had a very different expectation of what this product was, just by changing the messaging and focusing their first user experience on just this one piece of the business.

**Nivi:** Right. **So, with no real change in the product, but a change in the messaging and a little bit of first-user experience change, you got a huge uptick in the must-haves.**

**Sean:** Yup, exactly. And the interesting thing is that business, probably out of every business that I've worked with, is the one that I think has the opportunity to be a multi-billion dollar business, and one that I'm most excited about. And when I first saw that 7% number, it was the one that I thought: how do I get out of this? So now I'm really happy that I stuck with it, and I'm happy that we were able to figure those things out. And I'm really good friends with the founders.

### **It's frustrating to try to grow without fit**

**Sean:** When everything's going well, the chemistry gets much stronger and it's just a much more enjoyable place to be. That's just one of the things that I've learned, is that in a company with a low product/market fit, it's not a fun place to be. It's frustrating trying to grow that business.

And for a company that can really embrace the fact that: You know what? We missed. The product that we created just isn't something that people really seem to want or need.

**Nivi:** And we don't really measure ourselves through growth right now, either.

**Sean:** Yeah. So for us, we've got a lot of money in the bank. Somehow we got lucky enough to raise the venture capital. If

we try to grow we're going to waste a lot of that money trying to grow. Let's just keep our costs way down, get just enough users in there and either do a complete reset on the business — like PayPal did, which I think most companies don't need to do — or just find the love.

In my last blog post I talk about "just find the love." Somebody loves it. Somebody really needs that, and once you find that, that's the stake in the ground that you can figure out how to create a successful business.

## **How many users do you need to determine fit?**

**Nivi:** And what is just enough users?

**Sean:** That's a good question. I think it kind of depends on the business, but ideally, if you have a product that ultimately is going to cost thousands of dollars, then it's just not going to be realistic that you can bring in a hundred every day on that product. But if you have a product that's going to have a 10% upgrade rate or a 10% purchase rate, and it's going to be \$100, then that's a product that you probably want to try to have a pretty constant flow of around 100 new people a day.

And whatever it costs to get to that 100 new people a day is a really good flow to iterate on. If you can only be at 30 or 40, that's probably OK.

**Nivi:** And how about on the output side of that — the people that you're going to survey, the people that have gotten to the finish line? How many people do you need to be talking to, to get a good signal there?

**Sean:** I look for around 30 responses as a minimum. It really depends. If you have a very low percentage of users that say they'd be very disappointed... Say you've got 30 responses and you've only got 5% that say they'd be very disappointed without it, that's not a whole lot to work with on finding a signal.

But I ran a survey this morning with a business that has 70% of their users that say they'd be very disappointed. We got a very strong signal on 42 responses.

**Nivi:** OK. Right.

**Sean:** Really, it kind of depends, first, on how strong that number is. And then what you're trying to do is get enough responses in there to find some sort of signal that either says: We completely missed, or that [there are] very few people we've hit with, so we want to make sure that we survey enough people that we've got maybe 10 or 20 people who say they'd be very disappointed, that we can start to hone in on the feedback that they're giving.

## **Who do you survey?**

**Nivi:** And do you ever have trouble defining what that finish line should be? For example: active monthly users, people who just signed up for the product, or is it... [interrupted]

**Sean:** Do you mean on who to survey?

**Nivi:** Yeah.

**Sean:** What I tend to do is say, people who have been back at least once.

And I think for a consumer product you shouldn't be charging at this point; it should be free at this point, because the money side already starts to put a big filter out there. Even if you had a trial, people would make up their mind pretty quickly. If they decide they're not going to buy it, then they're not going to say they'd be very disappointed without it, and not buy it. So, just pulling money off until you can get that signal is pretty important.

**For me, I define what is actually the experience that we think is the experience that gives them a full taste for**

**the product, then I want to make sure that people have at least done that when they come back to us.**

**Nivi:** So in the case of PayPal what would that be?

**Sean:** That they've at least made a payment with PayPal or accepted a payment.

**Nivi:** One payment?

**Sean:** Yeah. And then, that they've been on the site within the last two weeks.

**Nivi:** OK.

## **What is promise?**

**Sean:** So those would be kind of the two pieces. You just asked about intent and the value proposition in some of those things, so I think the important starting point is that the promise or the differentiated value proposition is really based on whatever signal that you find. Where you find the love on the product, that's what you're trying to do there.

**Nivi:** And you call that promise.

**Sean:** Promise is one of the names I use for it, but it's all synonymous with just the value proposition, the differentiated value proposition of just what is this product going to do for you. What is the unique piece about it?

**Nivi:** Right. So in the PayPal case: send money to friends online.

**Sean:** Yeah.

**Nivi:** OK.

**Sean:** Yeah. I think that would be... And at the time, that was fairly differentiated. Now you can use credit cards and other

things, so something that remembers your log-in information might be trying to differentiate from just Visa or Master Card or American Express.

### **Don't over-position your product during fit**

**Sean:** But what I was going to say with that is that there are two periods where that becomes important. One, before you have product/market fit you're trying to find that signal, so you can do some sort of early positioning to try to highlight that. **But the problem is, too much positioning is going to steer your users in a certain direction. So, early on, a lot of times it's good to actually be very feature-function oriented.**

**Nivi:** OK.

**Sean:** Because unless you have a real strong signal.... You can experiment with it, like, OK, let's bring people in and we'll give them this message and we'll see what their very-disappointed number does, just on this group of people. We'll survey them separately.

But in general, if you don't have a real strong signal, then **it can be kind of dangerous to shape their experience by highlighting some unique attributes that turn out not to be the important unique attributes.**

**Nivi:** Because it might be inconsistent with...?

**Sean:** Because you're going to shape their experience so much that they may miss the other thing that would have been the thing that would really thrill them.

**Nivi:** Right. So give me an example of how I would do that.

**Sean:** X Corp. is a prime example on that. In the early days at X Corp., it was just one of those things that I realized that

if I really focused on homepage messaging it was going to take me a really long time to get some level of consensus, and that's just the way that the business....

**The way most startups operate, early on, is that everyone has opinion around what the homepage looks like and what it says. And so, what I realized is that getting a lot of those early users, we were going to be getting them through search anyway, so I basically said I'd let everyone else figure out what's going to be on the homepage, I'm just going to take people in through landing pages.**

With landing pages you know what the person's intent is when they're coming in through a specific search word, so you can really hone things in a more segmented way.

But our homepage ended up being very feature-function oriented, and the group we initially built the product for ended up being a relatively small percentage — especially on a revenue side — of where the business ultimately ended up generating a lot of revenue. **So I think if I had taken a traditional marketing approach to that I would have been very benefit-oriented right from the beginning.** And I probably would have positioned it away from what ended up being the really interesting market for us, because I would have given so many details about how they should use the product that this other group may not even have considered using the product.

And so, as a result of having, essentially a group of engineers be able to initially determine the wording for the homepage, they just focused on the features that they created, with not a lot of why someone would need it. And that turned out to be the best thing that could happen because, ultimately for us, by the time I really started looking for that signal, the signal was very different than what we would have initially had if I had positioned out of the gate for that.

## Pivot the business around the love

**Sean:** A big theme that I keep coming back to is, where is the love? It's basically just finding out which users are passionate about the product. What is the use case on the product that those people have? Why do they actually love the product? And that gives you a good core of information to guide every part of your business. So messaging, you want to reflect that, but also, now that you know that, you want to make sure that you can really get a lot more people to that particular type of use case and that particular type of gratifying experience. So understanding user gratification is really critical in all of it.

First of all, you want to know that you have enough that you can try to grow the business — that you actually have something that will be growable. And then in growing the business, having that gratification should give you guidance on everything. **So product roadmap should be a function of how people are gratified with the product and who's gratified, so it should give you a lot more focus on that product roadmap as opposed to a lot of feature feedback and ideas and different things that, over time...**

You know, initially you have to kind of scatter-shoot it. You have to cast a fairly wide net of things that might please people, but once you really know where that gratification is, that's where you really want to double down, and that's your business. Before, everything's an experiment. But your business is really on where that gratification or where that love is.

**Nivi:** Does that go to what is the primary benefit of the product in your Survey.io?

**Sean:** Yes. That's where I start to see it. I start to see it in each of those questions. I can start to see, in the very-disappointed question there's a: why did they pick that? You can start to see it in there, as well.

*Ultimately, that's the first thing that I'm trying to look at. One, do enough people love this product? And two, why do they love this product? And then everything that I'm doing is basically helping the business to — I wouldn't say reposition, because reposition is associated with messaging — realign itself around that really strong user gratification. And once you have that alignment around that, it gives you a lot more direction.*

Early on, everything is an assumption, everything is vision, but once you have users on there you can finally start to find that nugget of value.

## **Focus the product on the love**

**Sean:** And one of the things, *if you really step back and ask a lot of entrepreneurs why startups fail, a lot of people rightly focus on lack of focus as being what causes a lot of startups to fail. But then the question is, OK, if it's lack of focus, what should you be focused on? Obviously, lots of focus on the wrong thing is still going to cause you to fail, so then it's a big question of what you should be focused on.* And for me, ultimately it's that strong signal that this is something that users really love about the product. So understanding who loves that product — who really has that need — that starts to give you guidance on who you're going to target going forward.

What other things can we do that can enhance that use case — that can make that particular use case? How can we prioritize those feature enhancements, the parts of the product roadmap that relate to that, and maybe drop some of the things that are the wild cards that we've had in there for a while?

**The thing that amazes me is a lot of startups have got a little side-product project of a completely unrelated product or something else, which I think, early on when you don't have product/market fit, is probably not a**

**bad idea.** You're throwing a lot of stuff out there to start to see what sticks.

But once you've found that signal, you're ahead of 90% of the startups out there. So once you find that strong signal, your ability to be really successful is focusing on that strong user gratification and passion and figuring out how to get more users to it, more of the right types of users to it. How can we make it even better — but, that part better, not all parts better, that part better?

### **Create a great experience around the love**

**Sean:** How can we completely refine that brand experience?

Now is the time to go and get a better designer to come in and really get the graphics perfect on that part. Now is the time to bring in someone who is the absolute wordsmith to get the descriptions perfect on the website, but making sure that they're being very responsive to that user feedback and they're not just being a wordsmith by what they think is what's important to people.

### **Create a business model around the love**

**Nivi:** Business model?

**Sean:** Business model is absolutely a function of that. You want to make sure that you are not trying to monetize something that's not important to users. If users tell you they'd be very disappointed without it, the other thing that they're telling you is that you could keep cranking that price up for a long time before they change to being somewhat disappointed without it.

And if you're really focusing on that to determine your price and how you charge for the product, you're going to have a lot

more signals.

## First find the love

**Sean:** So I think that's a big theme that startups should look at, is focus, and focus on what and when.

The "when" — early on your focus is on just trying to find some love within your product. Find somebody who loves something about your product. And you can get that day one, before your product is even developed, just by talking to people and saying: Hey, this is the problem that we think people have out there and this is how we're going to try and solve that. Does that seem like something that would be useful for you?

**Nivi:** The customer development approach.

**Sean:** Yeah, the customer development approach. Steve Blank has a really good book that's documenting everything on that and has written a lot more about that.

I purposely, again, have stayed out of that area because it's so high risk, and you can't be good at everything so that's the part that I've said I'm not going to try to be good at.

But essentially from day one, it's all about that search for something that somebody really needs.

## Are recommendations a good indicator of fit?

**Nivi:** Going back to the must-have — that metric — you don't see user recommendation in that metric there, as well?

**Sean:** It's interesting; I see a lot of correlation on success in businesses with the must-have.

I had somebody contact me recently who had a 70% must-have number and they are adding 20,000 new users a day with great

monetization, and they just started recently. It was just one of those things that wasn't surprising to me to see all that success because they have that strong must-have number without really even having a marketer in the company.

So the must-have, I think, is really big, but there are a lot of people that have good recommendation numbers that struggle, and part of that is that... **I think YouTube videos is a prime example that sometimes you just see some really funny things that you want to share with other people, but ultimately would you be very disappointed if you couldn't? Probably not.**

**Nivi:** Right. So it could be a false-positive. But let's say for the folks that do have the 40% must-have, do you see a correlation of recommendations then?

**Sean:** Not necessarily. Sometimes I see it really high. A company that I surveyed today, with surveys rolling in right now, was 90% recommend rate, but sometimes I see it being pretty low on a company that's doing really well. Sometimes I see, as I said before, companies that are pretty low on the must-have, but high on the recommendation rate. So I actually don't think that's a good proxy for success, but I haven't studied it enough to know for sure.

### **The must-have metric is a good indicator of fit**

The only thing that I do know is, on the must-have number, I've probably looked at 150 companies now on that number and I could maybe point to one or two that were less than 40% that had any kind of traction and success. And over 40%, everybody had some success. And maybe it's 35%, maybe it's 45%, but somewhere around there you get enough people.

The only thing I tend to find a challenge with is that some companies have a must-have number that's around 40%, but

then the feedback is all over the board on why they consider it a must-have and that becomes really hard for being able to find any kind of signal to base the business on. So that's a different problem, and I haven't figured out how to deal with that.

**Nivi:** There are too many segments in the customer base.

**Sean:** Yeah. Everybody loves it, but for different reasons. Then maybe you have to figure out which one of those reasons represents the biggest target user group and hone in on that.

## What comes after fit?

**Nivi:** Right. One thing you talk about is, once you have the product/market fit, trying to get through the next few steps as quickly as possible. So it would be great if you could talk about that, and also, for people that don't know what the pyramid looks like, what are the next few steps?

**Sean:** Sure. As I said, if you don't have product/market fit, you want to be obsessively focused on getting there, however you're defining product/market fit. I think the easiest kind of definition to work toward is trying to get 40% of your users to say they'd be very disappointed without it.

And during that period you're trying to stay very low burn and very conservative on all of your expenses within the business. And once you find 40% of your users that say they'd be very disappointed without the product, then you're in a position that you have a business that can grow now. *So then the question is: do you try to grow the business right then or are there some things that you can still do that are going to make it even easier to grow when you're focused on that? And what I've found in working with so many companies at this stage is that you're definitely better off waiting a little time until you try to grow the business.*

**Nivi:** And what does it mean to grow the business? You're talking about spending money to acquire users, essentially.

**Sean:** Acquiring users, for a lot of businesses, means starting to spend money, but it might also mean really trying to crank up the virality of the business, or it might be SEO that doesn't require a lot of spending.

**Nivi:** But it's time and money that you require for people... [interrupted]

**Sean:** Yeah, and focus. The time piece, you could say, has time or focus. But it's essentially saying...

*To be continued in Part 2 where we discuss how to prepare for growth once you've achieved fit.*

*Music: Tortoise*<sup>84</sup>

## How to measure product/market fit with survey.io

Sponsor Post

*Thanks to KISSmetrics<sup>85</sup> for supporting our interview with Sean Ellis<sup>86</sup>. If you want an intro to KISSmetrics, send me an email. I'll put you in touch if there's a fit. Thanks. – Nivi*

<sup>84</sup><http://www.google.com/search?hl=en&q=tortoise%20music&aq=f&oq=>

<sup>85</sup><http://kissmetrics.com/>

<sup>86</sup><http://venturehacks.com/articles/sean-ellis-interview>



<sup>87</sup>Hiten Shah<sup>88</sup> from KISSmetrics<sup>89</sup> recently sat down with me to explain how to use their product, survey.io<sup>90</sup>, to measure product/market fit and find the “best grass” in your product. You may know Hiten from his Crazy Egg<sup>91</sup> days.

survey.io<sup>92</sup> is a free survey tool that helps you implement some of Sean Ellis’ techniques to get to fit. KISSmetrics actually built survey.io with Sean. Unfortunately, there hasn’t been great documentation for survey.io besides Sean’s launch post<sup>93</sup>. Until now.

SlideShare: How to measure product/market fit<sup>94</sup>  
Audio: Interview with chapters<sup>95</sup> (for iPod, iPhone, iTunes)  
Audio: Interview without chapters<sup>96</sup> (MP3, works anywhere)  
Transcript with highlights: Below

## Prerequisites

You’ll get more out of this interview if you also read:

1. An example survey<sup>97</sup> from survey.io.

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<sup>87</sup><http://kissmetrics.com/>

<sup>88</sup><http://hitenshah.name/>

<sup>89</sup><http://kissmetrics.com>

<sup>90</sup><http://survey.io/>

<sup>91</sup><http://crazyegg.com/>

<sup>92</sup><http://survey.io/>

<sup>93</sup><http://startup-marketing.com/free-customer-development-help-surveyio/>

<sup>94</sup><http://www.slideshare.net/venturehacks/how-to-measure-product-market-fit>

<sup>95</sup>[http://venturehacks.com/wordpress/wp-content/uploads/2009/12/How-to-measure-product\\_market-fit-Hiten-Shah-interview-2.m4a](http://venturehacks.com/wordpress/wp-content/uploads/2009/12/How-to-measure-product_market-fit-Hiten-Shah-interview-2.m4a)

<sup>96</sup>[http://venturehacks.com/wordpress/wp-content/uploads/2009/12/How-to-measure-product\\_market-fit-Hiten-Shah-interview.mp3](http://venturehacks.com/wordpress/wp-content/uploads/2009/12/How-to-measure-product_market-fit-Hiten-Shah-interview.mp3)

<sup>97</sup><http://survey.io/survey/demo>

2. Our interview with Sean Ellis<sup>98</sup>.

## Outline

Here's an outline and transcript of the interview. The interview and transcript are about 19 minutes long so we've highlighted some of the juicy bits to get you started.

1. survey.io: Before product/market fit
2. survey.io measures fit
3. How did you discover the product?
4. How would you feel if you could no longer use the product?
5. What would you likely use as an alternative if product were no longer available?
6. What is the primary benefit that you have received from the product?
7. survey.io is open-ended
8. The flock will always find the best grass
9. You don't need survey.io to find the best grass
10. Have you recommended the product to anyone?
11. What type of person do you think would benefit most from the product?
12. How can we improve the product to better meet your needs?
13. survey.io is more powerful with filtering

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<sup>98</sup><http://venturehacks.com/articles/sean-ellis-interview>

14. Would it be okay if we followed up by email to request a clarification to one or more of your responses?
15. Upcoming survey.io features
16. Get qualitative feedback before fit
17. Must-have % by industry
18. Ask the must-have question

## **Transcript**

**Nivi:** Hi there! This is Nivi from Venture Hacks, and I'm here with Hiten Shah from KISSmetrics.

First of all, I want to thank them for sponsoring our interview with Sean Ellis and making it available, free, to you guys.

We're going to talk a little bit about what KISSmetrics does and how it ties into the things that we discussed in the interview with Sean. And Sean is actually an advisor to KISSmetrics. Is that right?

**Hiten Shah:** Yes, that's right.

### **survey.io: Before product/market fit**

**Nivi:** Cool. The interview with Sean was broken into two parts — before product/market fit, and then after product/market fit, where you do the things to prepare for growth.

Why don't we talk a little bit, first of all, about what you guys have and do for the before product/market fit stage?

**Hiten:** Sure.

**Nivi:** Take it away!

**Hiten:** Yeah, I will! First of all, I want to thank Venture Hacks. We're happy to support it and thank you guys for bringing interviews like Sean and Eric and all those guys to a bigger audience. I think you guys are doing a great job of that, and that's why we're pretty happy to sponsor the podcasts.

In terms of pre-product/market fit we're following a lot of these practices in our own business, so we're eating our own dog food, so to speak — everyone says that we're actually really doing it.

## **survey.io measures fit**

**Hiten:** So that's why we built survey.io with Sean Ellis, and the idea of it was, Sean's got a bunch of questions he asks. **The key question is: how disappointed would you be if a product name, say, Google didn't exist?** There are a bunch of key questions there. I'm sure it's gone over in the interview, previously, in the first part.

But basically, there wasn't a template that had that question on it. So we worked with Sean Ellis to come up with a simple product, a simple tool that was free that people can use to assess whether they have hit product/market fit, and that's what we did with survey.io.

So anyone can go into survey.io and basically send off the survey to their users and get an idea of whether they have a product/-market fit.

### **1. How did you discover the product?**

**Nivi:** So the main questions are: How did you discover the app?

## **2. How would you feel if you could no longer use the product?**

**Nivi:** How would you feel if you could no longer use the app — which is the key product/market fit question — very disappointed, somewhat disappointed, or not disappointed at all?

## **3. What would you likely use as an alternative if the product were no longer available?**

**Nivi:** What would you use as an alternative?

What's the thinking behind that? Do you have any thoughts on that?

**Hiten:** Yeah. It helps you understand how you fit against competitors, or what space you fit into. **You might think that you're a customer feedback tool, while customers might weigh you as a customer support tool.** So that question is actually pretty telling in helping you understand, from your customer's perspective, what other products they would compare your product with. So I think actually that's a pretty important question.

**Nivi:** Have you ever seen any surprises on that, just to flesh it out, either with you guys or other guys?

**Hiten:** Yes, actually I have. In a few early questionnaires about the KISSmetrics product, an older version of it, people actually put us up against optimization tools like A/B testing tools and things like that, and we didn't have any functionality around that. So I think that was an interesting insight. Maybe it was just the fact that the analytics space is pretty crowded and there are a lot of tools in it and it's kind of a nebulous definition, like what is analytics?

#### **4. What is the primary benefit that you have received from the product?**

**Nivi:** The next question in survey.io is: what is the primary benefit that you've received from the product?

What's the thinking behind that?

**Hiten:** The thinking around that is, basically, **if you understand what benefits people see your product for and you filter it by people that would be very disappointed if your product didn't exist, you can get a really good idea of what passionate customers consider the benefit of your product — and in their own words.** So you can use that to change your messaging, and kind of A/B test a bunch of things around landing pages and things like that and see if you can have a higher conversion rate based on the messaging you have there.

#### **survey.io is open-ended**

**Hiten:** I'm thinking that this interview with Sean has probably had a strong impact on getting people to understand what these questions are all about, much more. And that's what I'm hoping happens because I get a lot of questions about all of these things, as well: What does each question mean? What do I do with these answers?

And that's actually a typical problem with most survey tools, as well. If you notice, in this survey there aren't any questions that are very least, most, least, and have radio buttons when you go there, because you're basically making your customer think a lot with those types of questions. With these open-ended questions people are just typing in whatever they want to say, and then it's up to you as the person giving the survey out, to analyze

the results. So, that's a big difference with this survey and the questions that are asked.

### **The flock will always find the best grass**

**Nivi:** Right. Going back to the question: what is the primary benefit you've received from the product? Sean quotes Vinod Khosla a lot that, "the flock always finds the best grass." I didn't actually understand what he ever meant by that until the interview where he... What he really means is, **look at the must-have users and see where in the product they consider the grass to be — they've found the grass.** Before that, I didn't even really understand what Vinod meant by it. I guess that's what he means by it. Right?

### **You don't need survey.io to find the best grass**

**Hiten:** Yeah. Let me give a different perspective. I think that's absolutely correct, but let's say you don't know about product/market fit, and you don't know about giving out this survey or asking that question because you've never seen Sean's stuff. Someone who has a lot of customers, and only some of them are addicted to the product, what they typically do is go look in their logs or look in their user database and see who's logging in the most or see who sends support requests or is contacting the company the most, and they would consider those people the flock that's going towards being very passionate about the product.

So I think there are number of ways you can determine this type of stuff. So to me, what Vinod Khosla said feels like there are multiple ways you can determine this. This seems to be a very strong and efficient way compared to how people used to do it.

In some of our own products, in the past, we would just do it based on: Oh! This guy logs in every day. Or, this guy keeps bugging us and wants features, and at the end of every email says, "Oh, I love your product!" We're actually getting that with our latest product that we have, and those are the people who typically you try to cater to and things like that. This puts a little more science behind it.

**Nivi:** Right. And this tells you why they love the product.

**Hiten:** Absolutely.

## 5. Have you recommended the product to anyone?

**Nivi:** The next question is: Have you recommended the product to anyone? And if so, please explain how you described it.

What's the thinking behind that?

**Hiten:** This goes back to something called Net Promoter Score.

These questions are all developed by Sean, but this question is interesting because when I first saw it, it reminded me of Net Promoter Score. Net Promoter Score is a methodology that a lot of Fortune 500 companies have implemented, where they ask people: how likely are you to recommend this product? And they have a scoring system based on the responses.

**Nivi:** And it's a scale of 1 to 10.

**Hiten:** Yeah, it's a scale. Exactly. It's not a simple question. It makes people think. But they have scoring around it, so I don't know exactly how the scoring is. But if the average people say 3 to 4, and then you make some changes, you want to see those people start saying 5 to 6, or whatever it may be. And then you group... It's not a gauge....

**Nivi:** Do you take cohorts of those?

**Hiten:** Yeah, you take cohorts of those people and try to improve them over time. And there's a whole methodology around it. It's pretty complex. Another part of it is....

The key thing about this question that people don't get at first glance is that they think it's really asking them if they'd recommend, and trying to make them recommend to people, or trying to suggest they should recommend it, and it's actually not about that, and neither is Net Promoter Score. All it is, is that there is some psychology around if you're willing to say you'd recommend it. You would be bucketed into more of a passionate customer. It doesn't mean necessarily that you've ever recommended it, or that you would, but it's more just to solicit how satisfied customers are with your product.

So this question doesn't come out of NPS, because Sean didn't even know about Net Promoter Score, I believe, when he created it, but it's got the same kind of feeling towards it. So it's just basically another identifier of people who are passionate.

But the real thing about asking them the yes or no question is when you ask them to describe how they would describe it to a friend, because in this case it's an open-ended field and they're typing in the way that they would describe it, which is basically another gauge, a different sort of angle on: what benefit have you received from the product? You're having them actually help you figure out what your messaging should be, quite frankly.

**Nivi:** Yeah, and that is, literally the positioning of the product, the position it holds in the user's mind, and that's how he would describe the product to someone else.

**Hiten:** Absolutely. Yep, it's really powerful.

## 6. What type of person do you think would benefit most from the product?

**Nivi:** Just this next quick question: what type of person do you think would benefit most from the product? Question 6.

**Hiten:** Yeah, I actually have a term that relates to this question a little bit, but my term is data porn. Some things are just data porn. This doesn't fall into this category, but it just reminds me of that because I get a lot of enjoyment out of this question when I look at results, because people will describe it in all sorts of ways. You'll hear people say: my best friend would best use it.

You know, depending on what type of product, obviously. I think this question is important because it helps you understand what your target market should be, potentially. Right?

**Nivi:** Right.

**Hiten:** And a lot of times people won't even say it's someone like them. They might say that it's someone different than them, and that could give you some insight into, based on your current messaging, what people really think the type of person who would be attracted to your product would be.

So, I haven't learned as much from this question, but it's always fun to look at, because it's another one of customers saying something.

**Nivi:** Just thinking about the interview with Sean, which you haven't heard yet, **I think this could be helpful, in particular, when the product is very horizontal and you're trying to figure out which vertical in that group is really the one that you're going to go after, potentially.** For example, Sean talked a little bit about how they initially positioned the product in a feature-based way so as not to narrow down the use case.

**Hiten:** Yup.

**Nivi:** So here you're basically asking them the title of the person who's going to use the product, or what the use case is.

**Hiten:** Yeah. Yeah.

**Nivi:** So I think it can help you narrow down the positioning and the market that you're going to go after.

**Hiten:** That's a great point.

## **7. How can we improve the product to better meet your needs?**

**Nivi:** How can we improve the application or product to better meet your needs? Question 7.

**Hiten:** That's always a great question. People tell you...

This one's interesting. I think this one gets the most quantity, especially with passionate people. They want to tell you exactly how you can improve their product.

If you haven't asked this question to your customers, I don't understand why not, because they're going to give you all kinds of insights into little tidbits they don't like. I've seen people answer this question and go into: oh, the button should be moved; or the UI is like this; or even try to get into really descriptive stuff.

### **survey.io is more powerful with filtering**

So it's just a cool question, and again, all these questions are really powerful when you start filtering. That's why actually we don't have an export feature that's public on this thing, but a

tidbit is that if you just add a /export to your results, you'll get an export of the data.

**Nivi:** OK, nice. Yeah, and the filtering would actually be super interesting. The first segment filter is by must-have, nice-to-have, and I-don't-care users.

Going back to Question 7: how can we improve the product? Again, you haven't heard the interview yet, but **what Sean talks about is going to the nice-to-have users and figuring out how you can improve the product for them and turn them into must-haves.**

**Hiten:** Yup.

**Nivi:** So he gave the PayPal example, where some of the nice-to-have users may have still been using the mobile to mobile payment. You don't care about those guys because you've seen like 1,000x increase on desktop to desktop payment. But of those nice-to-have users who are using the desktop to desktop payments, you might want to know how they want to see the product improve; for example, better security or if it had my address book in there already or something like that.

**Hiten:** Yup.

## **8. Would it be okay if we followed up by email to request a clarification to one or more of your responses?**

And then: would it be OK if we followed up by email to request a clarification? Question 8. What's the thinking behind that?

**Hiten:** These are people that you have... you know what they answered, and you can segment into different groups and you can follow up with them with follow-up surveys and things like that. It's always good to get email addresses.

What we've noticed, on the weakest products, the ones that aren't as sticky, maybe are more consumer oriented, we'll still see 50% of the people giving an email address. And you might not even have the email address of these people because one of the things we let you do with the survey is embed it on the page, and it might not be a logged-in user so you might not even know what their email address is.

So now all of a sudden you've got these people, you've got their email address, and you've got all these answers associated with that email address. So that just becomes really powerful to follow up with them or, back to the previous question, **if you add a feature that they want, you can go notify them and let them know you added it because they wanted it. Customers get delighted by that.** I don't see why every company isn't trying to delight their customers — it's one of those things.

**Nivi:** Right. And when you're in the trying to get to product-/market fit stage, getting a list of potential, early evangelists is probably at the top of your to-do list. Right?

**Hiten:** Absolutely. Yeah, we don't even let you edit the questions yet. That's a feature coming out. We're building a much deeper product out of this. We have some ideas around it. We're still working with Sean on it.

## Upcoming survey.io features

**Nivi:** What's coming in this? The segmentation would be cool.

**Hiten:** Yeah. It's been a very interesting conversation at our own company about what we should do about this. One thing is we want to, obviously, have this same thing for free, but **we've also got some ideas on how to get qualitative feedback from customers in a much leaner way where you almost ask them one question at a time. You might build up**

**some of these answers over time.** So we're working on embeddable surveys and things like that, to do that, and this is stuff we really haven't seen anywhere else.

Also there are things like, **if you know someone's username or email address, you could already pass in to the survey so that you don't have to ask for it.** And then you can associate a specific customer with the response, and stuff like that, which SurveyMonkey and other tools currently make a little bit tedious to do, or basically impossible in some cases.

We don't want to compete with SurveyMonkey or the survey tools, so we've really thought long and hard about what we want to do about this. We will be launching something, probably by mid-to-end-of January that's a whole revamp on this tool. It makes it so, hopefully, you don't have to copy and paste the questions into other tools. So editing, filtering — we're really focused on embeddable surveys. These are just some of the pains that we've noticed about getting feedback from our own users.

**If you ask them one question within the interface, it's really powerful because you can get a lot more context.** So in our system, if they're looking at an analytics report, we might want to ask them: is this report useful to you? And if they say yes, say great, thanks! We love you. If they say no, we can pop-up a form field and ask how we can improve it for them. Those are the kinds of more mini-surveys and mini-questions that we don't really see a product online that does that, so we're going to move the product in that direction.

We'll always have this specific survey for free though, and add some of that stuff. And this is all about....

## **Get qualitative feedback before fit**

We feel that before product/market fit, what's really important is those early customers and getting as much feedback as you can

that's qualitative from them, and quantitative metrics aren't as important as the qualitative metrics at that time.

## Must-have % by industry

I'm amazed by some of the percentages I see on the disappointed score that's segmented by industry. In general, trends-wise, **if it's a SaaS sort of product, like a web app, I tend to see a higher score on the percentage of people that would be very disappointed.**

**Nivi:** So that would actually be a great little study for you guys to publish. Right?

**Hiten:** Yeah. And another thing, **on the opposite end, is that we notice score in the 20% to 30% for consumer applications.** Typically they're very low. People wouldn't say that about Facebook, necessarily, but a lot of people would say that about more trivial consumer sites. I would say that you would probably see a lower score on something like YouTube, where it's very passive and people aren't necessarily very passionate about it and there are a lot of alternatives and there isn't really some sticky glue that makes people really want to come back. So those scores are usually under 40%, while SaaS apps I've seen as high as 80%

**Nivi:** Well that makes sense, especially if you're going to filter by... SaaS guys are already paying for the product; they're probably going to consider it to be a must-have.

**Hiten:** Yeah, and even some of those freemium businesses though. Think about the emotional attachment to a free product you have if you're constantly using it. You're going to be disappointed if it doesn't exist. Right? So I think those are the trends that we see, overall.

## Ask the must-have question

**Nivi:** The key question here, if you're going to walk away with one thing from survey.io, is that you should probably survey the people who actually use the product and ask them how disappointed would they be if they could not use the product anymore.

**Hiten:** Yup! Absolutely.

*To be continued in part two of our interview with Hiten Shah, where we'll talk about their product called KISSmetrics, a new tool for optimizing funnels.*

*Music: Squarepusher<sup>99</sup>*

## Take guidance from VCs, not orders

Sponsor Post Thanks to Atlas Venture<sup>100</sup> for supporting Venture Hacks this month. This post is by Fred Destin<sup>101</sup>, one of Atlas' general partners. If you like it, check out Fred's blog<sup>102</sup> and tweets @fdestin<sup>103</sup>. And if you want an intro to Atlas, send me an email. I'll put you in touch if there's a fit. Thanks. – Nivi



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<sup>99</sup> <http://www.google.com/search?hl=en&q=squarepusher&aq=f&oq=>

<sup>100</sup> <http://www.atlasventure.com/>

<sup>101</sup> <http://www.freddestin.com/blog/>

<sup>102</sup> <http://www.freddestin.com/blog/>

<sup>103</sup> <http://twitter.com/fdestin>

<sup>104</sup> <http://www.freddestin.com/blog/>

There is a behavior I witness in some first-time CEOs that I meet, not necessarily the younger and more mavericky generation, that I do not think is necessary, nor helpful. *It's an insidious but frequent tendency to let the board decide, rather than advise or approve.* It goes like this...

Because VCs have blocking rights on some important decisions (approving the budget, your compensation, raising money), they are often able to wield way more power than their 20% ownership would suggest they should have. As a result, entrepreneurs often talk of coming to the board with their slides in hand, asking "what does the board want me to do?", which is code-speak for, "I am here to ask for permission from my investors to do what I need to do."

Entrepreneurs will present the strategy they believe in, but essentially allow the board (read: the investors) to walk straight through the carefully thought-out action plan and redesign the entire strategy in one swell meeting. The investor probably walks away feeling like he provided value and the entrepreneur now goes back to his team to explain that his investors puked over the team's strategy and that the priorities have changed.

## **It's the CEO's fault**

That may be the product of investor behavior, but I would argue this is the CEO's fault. *Nature abhors a leadership vacuum, and VCs will fill that gap if you don't.*

If you really believe in what you are doing, you come to the board telling board members what you are planning to do, taking considered advice on whether this is the right strategy, considering that advice and executing on what is, in your best judgment, the right path for the business. That's what you are there to do. Make decisions fast, don't fall for analysis-paralysis, trust

your gut, execute and iterate. As Tim Ferriss would say, ask for forgiveness, not permission.

## Why VCs shouldn't drive strategy

Guy Kawasaki<sup>105</sup> does lists all the time and it seems to work for him so I thought I would try one too: Here are the top five lighthearted reasons why VCs should not drive your strategy:

1. *We forget 50% of what we said at the last board meeting.*
2. We don't know the people inside the company and hence have no clue what the team can really execute.
3. We meet many smart people and hence we have way too many ideas than you can possibly implement.
4. We are focused on the 5 year vision, yet we are focused on the quarter too — we're confused.
5. We don't need to deliver on it, you do. We come and collect when the job is done.

You want to leverage your board and you don't want to get fired for being a solo player either. Personally I really like what my partner Jeff refers to as a culture of "champion and challenge". I guess you have to be born in the USA to say phrases like that, but it's spot on. If I really disagree with a strategy decision, trust me, we will have a serious discussion about it. But come and champion what you believe in, take ownership, step into the role. Ultimately, I backed you because I believe in you, and you know better.

*If you like this post, check out Fred's blog<sup>106</sup> and his tweets @fdestin<sup>107</sup>. If you want an intro to Atlas, send me an email.*

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<sup>105</sup>[http://blog.guykawasaki.com/2006/01/the\\_top\\_ten\\_lie.html](http://blog.guykawasaki.com/2006/01/the_top_ten_lie.html)

<sup>106</sup><http://www.freddieestin.com/blog/>

<sup>107</sup><http://twitter.com/fdestin>

*I'll put you in touch if there's a fit. Finally, contact me<sup>108</sup> if you're interested in supporting Venture Hacks. Thanks. – Nivi*

## **“Angel investors are becoming the dominant force in consumer internet venture capital”**



<sup>109</sup> Bill Burnham<sup>110</sup>, hedge fund manager and former VC:

**“Angel investors are becoming the dominant force in Consumer Internet Venture capital.** The vacuum created by the withdrawal of VCs from traditional Seed and Series A opportunities in the Consumer Internet space has been filled by a motley collection of angel investors. It is angel investors, not VCs, that are writing checks based on good ideas,

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<sup>108</sup> mailto:nivi@alum.mit.edu

<sup>109</sup> <http://billburnham.blogs.com/burnhamsbeat/2009/12/the-great-abdication-consumer-internet-venture-capital-and-angels.html>

<sup>110</sup> <http://billburnham.blogs.com/burnhamsbeat/2009/12/the-great-abdication-consumer-internet-venture-capital-and-angels.html>

business plans, and “alpha sites”; not VCs. The importance of angel investors is such that it is not unusual these days to see an internet startup publicly announce its round of angel funding, when in the past such events did merit a public mention. Yes, angel investors have always provided seed money, but today they typically provide 100% of what was once considered Series A money as well.”

(If only there was a list of angel investors<sup>111</sup>...)

There's also a good discussion in the comments. Bill says<sup>112</sup>:

“My take on most seed/ super-angel funds is surprise, a fairly cynical one. I think if you offered \$1BN to the managers at these seed stage funds they would go from Seed focused to multi-stage in a remorseless heartbeat.”

Dave McClure replies<sup>113</sup>:

“no, i wouldn't trade my model for that bowl of bullshit, even for the bigger paycheck in the short-term. it's just not sustainable.”

Read Bill's full post<sup>114</sup>.

I would like to hear from VCs who are co-investing and competing with these angels. What seed stage companies are you

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<sup>111</sup><http://venturehacks.com/angellist>

<sup>112</sup><http://billburnham.blogs.com/burnhamsbeat/2009/12/the-great-abdication-consumer-internet-venture-capital-and-angels.html#IDComment47727149>

<sup>113</sup><http://billburnham.blogs.com/burnhamsbeat/2009/12/the-great-abdication-consumer-internet-venture-capital-and-angels.html#IDComment47736538>

<sup>114</sup><http://billburnham.blogs.com/burnhamsbeat/2009/12/the-great-abdication-consumer-internet-venture-capital-and-angels.html>

investing in? What were the company's metrics like when you invested? Are you seed stage (plus follow-on investments) or truly multi-stage?

## Marketing science Q&A with Sean Ellis

The product is half the marketing battle

The comments<sup>115</sup> to our interview with Sean Ellis<sup>116</sup> turned into an awesome Q&A — this post is a roundup.

(Feel free to keep asking questions here or there and I'll try to get answers from Sean.)

### Is my product a nice-to-have or a must-have?

Jae Chung<sup>117</sup> wonders whether his product is a nice-to-have despite the positive press:

"I spent the past 24 hours poring over each of the points [in the interview]. We also formed about 8 months ago and the site is currently undergoing beta

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<sup>115</sup><http://venturehacks.com/articles/sean-ellis-interview#comments>

<sup>116</sup><http://venturehacks.com/articles/sean-ellis-interview>

<sup>117</sup><http://venturehacks.com/articles/sean-ellis-interview/comment-page-1#comment-9731>

testing and has received positive feedback from many of our users and the press. However, my gut tells me we are in the “nice to have” category, and could never quite put our finger on what it was that users found appealing. We’ll definitely be implementing your survey to find out where the “love” is!”

The survey he’s talking about is [survey.io](http://survey.io)<sup>118</sup>.

## Should I charge users before fit?

Sean Ellis<sup>119</sup>:

“I think that it is easier to evolve toward product/-market fit without a business model in place (users are free to try everything without worrying about price). As soon as you have enough users saying they would be very disappointed without your product, then it is critical to quickly implement a business model. And it will be much easier to map the business model to user perceived value.”

Michael Harry Scepaniak<sup>120</sup>:

“...freeing yourself (pun intended) of paying customers early on would seem to allow you to make more radical moves (pivots), since you don’t have to worry about angering anyone that has given you money and expects you to deliver on their expectations in return.”

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<sup>118</sup><http://survey.io/>

<sup>119</sup><http://venturehacks.com/articles/sean-ellis-interview/comment-page-1#comment-9622>

<sup>120</sup><http://venturehacks.com/articles/sean-ellis-interview/comment-page-1#comment-9623>

Instead of charging users for a part of the product they don't even want, first find the part they love, and then figure out how to get users to pay for it. Entrepreneurs who advise you to charge from day one probably had fit early on in their startups.

## **How do I tell users that I'm going to charge someday?**

Eric Santos<sup>121</sup>:

“Do you communicate to the users that the product will have a price someday?”

Sean Ellis<sup>122</sup>:

“I would communicate that “it is free during Beta” or if “beta” is too techie, then free during the introductory period. If you plan to have a free version, you can also let people know that.”

## **Should I pay users to send feedback?**

Gregory<sup>123</sup>:

“What about offering a gift or paying users to send feedback? Is this a useful technique, why or why not?”

Sean Ellis<sup>124</sup>:

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<sup>121</sup><http://venturehacks.com/articles/sean-ellis-interview#comment-9610>

<sup>122</sup><http://venturehacks.com/articles/sean-ellis-interview#comment-9619>

<sup>123</sup><http://venturehacks.com/articles/sean-ellis-interview#comment-9597>

<sup>124</sup><http://venturehacks.com/articles/sean-ellis-interview#comment-9599>

“I haven’t needed to offer a gift for feedback yet. However, on SMB targeted products I tend to create a formal beta program that includes feedback requirements. Those people that participate in the beta program lock in a discount on the product (generally I don’t announce price at this point, just that they will receive a 50% discount). In addition to providing great feedback, these people tend to convert at a very high rate (since they worked for a discount).”

## **What if my customers aren’t filling in surveys?**

Vincent Chan<sup>125</sup>:

“From my experience, many SMB users don’t like to fill in a survey for an unknown startup. Should I take that as a bad sign? In other words, is the survey response rate an equally important metric as the “must-have metric”?”

Sean Ellis<sup>126</sup>:

“Yes, I’ve found survey response rate directly correlated to the percentage of users that consider the product a “must have.” For “must have” SMB products I often see the response rate over 10%.”

## **How do I find the love in a hardware company?**

Samuel Bouchard<sup>127</sup>:

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<sup>125</sup><http://venturehacks.com/articles/sean-ellis-interview#comment-9612>

<sup>126</sup><http://venturehacks.com/articles/sean-ellis-interview#comment-9620>

<sup>127</sup><http://venturehacks.com/articles/sean-ellis-interview/comment-page-1#comment-9615>

“Sean, how can this “find the love approach” apply to hardware companies? What needs to be adapted to the method when you sell a product that is worth several \$k’s?”

Sean<sup>128</sup>:

“Samuel, I haven’t worked on a hardware product, so I’d just be guessing... Given the cost of getting a hardware product to market, I’d spend a lot more time up front on “where’s the need?” Steve Blank’s book Four Steps to the Epiphany<sup>129</sup> gives great guidance on this.”

If you can build a product in a day, show customers the product. If the product is going to take weeks, show customers a PowerPoint instead.

## Play us out

Ryan Nile<sup>130</sup> knows what it means:

“This basically describes what we need to do after the MVP is up.”

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<sup>128</sup><http://venturehacks.com/articles/sean-ellis-interview/comment-page-1#comment-9599>

<sup>129</sup><http://venturehacks.com/articles/customer-development>

<sup>130</sup><http://venturehacks.com/articles/sean-ellis-interview#comment-9626>

## “NDAs up the wazoo”



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Matt Mireles<sup>132</sup>, Founder of SpeakerText<sup>133</sup>:

“More than anything, being secretive, being stealth and making people sign NDAs up the wazoo sends a message that you don’t trust them, that you think they might fuck you. And when people get that vibe, they assume (consciously or not) that you yourself are not trustworthy, that you might fuck them. This is not the message you want to send to people you’re gonna ask to commit to a journey filled with hardship and that will probably fail.

“As they say, you want missionaries, not mercenaries.”

Read the rest of Hiring & The Benefits of Radical Transparency<sup>134</sup> to learn how Matt inspires people to join SpeakerText.

*Related: Our posts on NDAs<sup>135</sup>.*

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<sup>131</sup><http://www.metamorphblog.com/>

<sup>132</sup><http://www.metamorphblog.com/>

<sup>133</sup><http://www.speakertext.com/>

<sup>134</sup><http://www.metamorphblog.com/2009/12/hiring-the-benefits-of-radical-transparency.html>

<sup>135</sup><http://venturehacks.com/topics/nda>

## Get our interviews on the Venture Hacks Podcast



<sup>136</sup>You can always get our interviews — with Eric Ries<sup>137</sup>, Sean Ellis<sup>138</sup>, Naval Ravikant<sup>139</sup>, Hiten Shah<sup>140</sup>, and others — on the Venture Hacks Podcast.

iTunes users: Click here to subscribe to the podcast<sup>141</sup> Everyone else: *feeds.venturehacks.com/venturehacks*

Put the podcast on your iPod and listen at the gym, in the car, on the train. If you've been skipping class, catch up on all the interviews in our Podcast category<sup>142</sup>.

We're going to try to do more interviews in 2k10. Hopefully with guys like Don Reinertsen<sup>143</sup>, Al Ries and Jack Trout<sup>144</sup>, and Steve Blank<sup>145</sup>.

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<sup>136</sup>javascript:void(0);

<sup>137</sup><http://venturehacks.com/articles/minimum-viable-product>

<sup>138</sup><http://venturehacks.com/articles/sean-ellis-interview>

<sup>139</sup><http://venturehacks.com/articles/co-founder-interview>

<sup>140</sup><http://venturehacks.com/articles/measure-fit>

<sup>141</sup>javascript:void(0);

<sup>142</sup><http://venturehacks.com/topics/podcast>

<sup>143</sup><http://www.amazon.com/gp/product/1935401009?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=1935401009>

<sup>144</sup><http://www.amazon.com/gp/product/0071359168?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0071359168>

<sup>145</sup><http://steveblank.com/>

## When the cost of customer acquisition exceeds your ability to monetize them



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David Skok<sup>147</sup>, serial entrepreneur turned VC at Matrix Partners:

“In the many thousands of articles advising entrepreneurs on what they have to focus on to build successful startups, much has been written about three key factors: team, product and market, with particular focus on the importance of product/market fit. Failure to get product/market fit right is very likely the number 1 cause of startup failure. However in all these articles, *I have not seen any discussion about what I believe is the second biggest cause of startup failure: the cost of acquiring customers turns out to be higher than expected, and exceeds the ability to monetize those customers... [emphasis added]*

“A quick look around all the B2C startups shows that, although viral growth is often hoped for, in reality it is extremely rare. When it does happen, the associated businesses are usually extremely attractive, provided they have a way to monetize their

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<sup>146</sup><http://www.entrepreneurs.com/startup-killer>

<sup>147</sup><http://www.entrepreneurs.com/startup-killer/>

customers. (For more on the topic of Viral Growth, refer to my blog post on that topic here<sup>148</sup>.)

“Far more common is a need to acquire customers through a series of steps like SEO, SEM, PR, Social Marketing, direct sales, channel sales, etc. that will cost the company significant amounts of money. What shocks and surprises many first time entrepreneurs is just how high the numbers are for CAC [Cost to Acquire Customers] using these kinds of techniques.”

Read the rest of David’s excellent post: Startup Killer: the Cost of Customer Acquisition<sup>149</sup>. But don’t worry about it too much until you’ve built a product people want<sup>150</sup>. It’s hard to know what the CAC is before you know what the product is. And check out the rest of David’s new blog — his post on Viral Cycle Time<sup>151</sup> is great.

## The Arrogant VC: Why VCs are disliked by entrepreneurs

Sponsor Post Thanks to Atlas Venture<sup>152</sup> for supporting Venture Hacks this month. This post is by Fred Destin<sup>153</sup>, one of Atlas’ general partners. If you like it, check out Fred’s blog<sup>154</sup> and tweets @fdestin<sup>155</sup>. I’ve also generated an MP3 version<sup>156</sup> of this post.

<sup>148</sup><http://www.forentrepreneurs.com/lessons-learnt-viral-marketing/>

<sup>149</sup><http://www.forentrepreneurs.com/startup-killer/>

<sup>150</sup><http://venturehacks.com/articles/sean-ellis-interview>

<sup>151</sup><http://www.forentrepreneurs.com/lessons-learnt-viral-marketing/>

<sup>152</sup><http://www.atlasventure.com/>

<sup>153</sup><http://www.freddestin.com/blog/>

<sup>154</sup><http://www.freddestin.com/blog/>

<sup>155</sup><http://twitter.com/fdestin>

<sup>156</sup>[http://venturehacks.com/wordpress/wp-content/uploads/2009/12/The-Arrogant-VC\\_-Why-VCs-are-disliked-by-entrepreneurs.mp3](http://venturehacks.com/wordpress/wp-content/uploads/2009/12/The-Arrogant-VC_-Why-VCs-are-disliked-by-entrepreneurs.mp3)

*Let me know if it's useful. – Nivi*



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Below is the summary of all the answers I received to my recent post, “Tell me why VCs are disliked by entrepreneurs<sup>158</sup>”. There is a shorter and easier to stomach version on Xconomy if you prefer, here<sup>159</sup>. I have tried to keep my role as editor limited to re-organising, so this remains true to the commentary. I would add that **most or all of these entrepreneurs had real, hands-on experience with (often prominent) VC’s**, sometimes through multiple companies and fundraising. And yes, I also plan on writing a feature about the “good side” soon...

The VC-Entrepeneur relationship seems damaged. Whilst business partnerships gone bad and company failure can lead to fallout, this is different. I wanted to find out why and used my blog to ping the entrepreneur community to try and understand this better, listen to my audience as it were, and share the feedback.

As with all articles of this kind, it is plagued by generalizations and simplifications. In trying to do justice to the sixty detailed and mostly confidential responses that I got, I probably lost some of the color and detail. But for anyone interested in rebuilding the social contract with entrepreneurs and getting our VC mojo back, the scale of the problem should be apparent.

*Clearly as VC’s our job is not be loved but to contribute in building great business and return money to our shareholders.*

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<sup>157</sup> <http://www.fredestin.com/blog/>

<sup>158</sup> <http://www.fredestin.com/blog/2009/11/tell-me-why-vcs-are-so-disliked-by-entrepreneurs.html>

<sup>159</sup> <http://www.xconomy.com/boston/2009/12/08/the-arrogant-venture-capitalist-a-view-from-the-trenches/comment-page-1/#comment-96814>

*Read on regardless; as you will see, the status quo is not an option.*

A common answer I got was “sour grapes”. As Richard Jordan put it, “failures breeds frustration” and there is a natural tendency to spray the blame around. Externalize guilt as resentment, combine it with some old fashioned finger pointing, and there you go.” Many VC’s excel at that too. Sometimes anger stems from the “sheer exhaustion from being told ‘no’ too many times”. Now let’s dig deeper.

## Poor first impressions

Richard Jordan (read him<sup>160</sup>) says: “probably more than half of the VC pitches I have done have involved participants on the VC side who have **behaved in a rude and disrespectful manner**“. Arriving late, cutting out early, reading their blackberry, constantly interrupting pitches, taking calls, you name it. Some of the pitching experiences border on the ridiculous, as evidenced by a young founder who got invited to pitch for fifteen (yes, fifteen) minutes with five minutes Q&A, only to find the meeting started ten minutes late and was not to be extended...

The **absence of feedback loop** is a common theme with entrepreneurs griping about “dozens of unanswered calls and mails, from people they met. If nothing else works, what are your PA’s for?” Another common gripe is the need to be dealing with an Associate who needs to sell his deal internally and is often insecure and not clear himself on his chances of getting the deal done.

Even in early meetings, the **lack of “empathy** with and experience of the startup and the sacrifices involved” can leave entrepreneurs fuming. Finally, many entrepreneurs complain

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<sup>160</sup><http://richardjordan.tumblr.com/post/254781145/why-do-so-many-entrepreneurs-have-vc-issues>

about a lack of confidentiality with their pitches sometimes “landing on competitors’ desks days after the meeting”. In a recent example, a well known General Partner interrupts 50 minutes of cross questioning with this casual statement, “By the way, I am personally invested in a new startup that is targeting this segment”.

## **Getting strung along or left at the altar**

“Raising capital depletes far more energy than investors realize”, says one entrepreneur. “Getting a ‘no’ is actually fine from an entrepreneur point of view (one has to be rejection-proof anyway), but to preserve their opportunities many **VC’s tend to string along entrepreneurs forever**, blatantly lying about deal status only to let it fall apart at the last minute, wasting an entrepreneur’s time and energy.”

Many investors appear to be “**vague on their decision and engagement process**”, which tends to be liquid.” Some VC’s promise term-sheets that never come, others withdraw at closing (the worst I personally heard was an SMS turndown by a “tier one” VC followed by a competitive investment), others still don’t bother checking conflicts of interest. “VCs are too opportunistic in their behaviour,” says one experienced entrepreneur.

A common gripe concerns the lack of clarity (or absence) in the **rules of the game**. Some companies are forced to jump through endless hoops to get a tiny round done whilst others raise a ton of money at seed with no substance. VC’s pretend to do seed but then say no to everything that is early and want revenues, customers, a business model, and a team. Entrepreneurs are confused and sometimes angry about this, as they feel fundraising is like a marathon with no end, when the hills keep getting steeper along the course. “The whole process leaves me with this feeling that landing funding is nothing more than getting lucky with the right pitch on the right day with the

right person in the room,” says D. It makes you feel like “a sort of magic and certain incantations and artistry is required,” yet despite that, “investors often still fail to ask the right questions, the hard questions”.

## Getting a raw deal

“Taking capital does feel a bit like making a deal with the devil after all.” Entrepreneurs fundamentally want to change the world and dealing with the Money Men is often a compromise they would rather do without.

“The entrepreneur is a bit like a child who’s just learned the rules of chess — he’s studying the current move intently, but he’s rarely thinking far ahead. The VC is an old hand at this game — he knows its patterns intimately and can see how it’ll develop far into the future. The entrepreneur tries to play well, but the terms he fights for often turn out not to be important, while the terms he thinks are innocuous can surprise him in unexpected ways. Unless things at the company go astoundingly well, **the entrepreneur comes away feeling like he was played** — taken advantage of by someone far, far more experienced at this particular game.” Clauses like participative liquidation preferences, anti-dilution, aggressive reverse vesting, board control or simply shareholders’ rights come up frequently, with good reason.

“My own VC’s have been great. That said — like many entrepreneurs, I’ve only realized **some of the longer-term implications** of the documents I’ve signed well after the fact. This was enough to make me wary.”

## Great (but misguided) Expectations

“Many entrepreneurs want an investor to fund the idea (equivalent to a TV production house looking for funds from a commissioning editor to make a show, and generate a profit from it). It often takes them a long time to realize that such VCs don’t exist. By which time they are bitter and tired and blame the VCs, rather than their own **lack of understanding** of what it takes to get VC funding.

David Smuts<sup>161</sup> believes there are two kinds of VC’s: “Careerists VC’s” and “**Entrepreneur VC’s**” and two kinds of Entrepreneurs: “Real Entrepreneurs” and “Wannabe Entrepreneurs”. “Entrepreneur VC’s behave in the best interests of the business they are investing in,” whereas “Careerist VC’s put their own career prospects first.” “Wannabe Entrepreneurs either hate all VC’s because they reject their business idea,” or “suck up to all VCs because they want their money.” Long story short: The goal is to match Real Entrepreneurs with Entrepreneur VC’s.

*Continued in Part 2<sup>162</sup> with unwanted advice, arrogance, and the dark side of the force... (I’ve also generated an MP3 version<sup>163</sup> of this post. Is it useful?)*

*If you like this post, check out Fred’s blog<sup>164</sup> and his tweets @fdestin<sup>165</sup>. If you want an intro to Atlas, send me an email. I’ll put you in touch if there’s a fit. Finally, contact me<sup>166</sup> if you’re interested in supporting Venture Hacks. Thanks. – Nivi*

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<sup>161</sup><http://twitter.com/DavidSmuts>

<sup>162</sup><http://venturehacks.com/articles/arrogant-vc-2>

<sup>163</sup>[http://venturehacks.com/wp-content/uploads/2009/12/The-Arrogant-VC\\_-Why-VCs-are-disliked-by-entrepreneurs.mp3](http://venturehacks.com/wp-content/uploads/2009/12/The-Arrogant-VC_-Why-VCs-are-disliked-by-entrepreneurs.mp3)

<sup>164</sup><http://www.freddestin.com/blog/>

<sup>165</sup><http://twitter.com/fdestin>

<sup>166</sup><mailto:nivi@alum.mit.edu>

## Our top 10 posts of 2009 — dominated by customer development

I really wanted to be a cool cat and make a list of the most popular *outgoing links* for 2009 — a top 10 list of *other people's posts*. But it wasn't meant to be — we don't have the Javascript installed to track those clicks.

And so, we present *our* 10 most popular posts of 2009:

1. How IMVU learned its way to \$10M a year<sup>167</sup>. *A talk by Eric Ries*<sup>168</sup>.
2. What is the minimum viable product?<sup>169</sup> *An interview with Eric Ries*.
3. The Startup MBA<sup>170</sup>. *Links to the best startup blogs*.
4. My visit to American Apparel<sup>171</sup>. *How American Apparel gets lean*.
5. How to pick a co-founder<sup>172</sup>. *Also see the accompanying interview*<sup>173</sup>.
6. Sell it before you build it<sup>174</sup>. *Fliggo's minimum viable product in action*.
7. We don't pay you to work here<sup>175</sup>. *A review of the book Hidden Value — you can find it in our bookstore*<sup>176</sup>.

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<sup>167</sup><http://venturehacks.com/articles/lean-startup>

<sup>168</sup><http://www.startuplessonslearned.com/>

<sup>169</sup><http://venturehacks.com/articles/minimum-viable-product>

<sup>170</sup><http://venturehacks.com/articles/startup-blogs>

<sup>171</sup><http://venturehacks.com/articles/american-apparel>

<sup>172</sup><http://venturehacks.com/articles/pick-cofounder>

<sup>173</sup><http://venturehacks.com/articles/co-founder-interview>

<sup>174</sup><http://venturehacks.com/articles/sell-it-before-you-build-it>

<sup>175</sup><http://venturehacks.com/articles/ordinary-people>

<sup>176</sup><http://venturehacks.com/bookstore>

8. Customer Development: How to develop your customers like you develop your product<sup>177</sup>. *Videos and slides from Steve Blank*<sup>178</sup>, king of customer development.
9. It's very easy to underprice your product<sup>179</sup>. *A short talk by Steve Blank*.
10. How to bring a product to market<sup>180</sup>. *A very rare interview with Sean Ellis*<sup>181</sup>.

Use this list to catch up on great posts you missed.

When we started Venture Hacks in 2007, we were all about hacking term sheets<sup>182</sup>. In 2008, we continued to write about raising money and expanded to general startup advice — for example, see our posts on job offers<sup>183</sup>. Looking at the top 10 list above, 2009 was clearly the year of customer development. It was also the year of monetization, as we created more free and paid products — here's a list of them<sup>184</sup>.

What's coming in 2010? Wait and see...

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<sup>177</sup><http://venturehacks.com/articles/customer-development>

<sup>178</sup><http://steveblank.com/>

<sup>179</sup><http://venturehacks.com/articles/pricing>

<sup>180</sup><http://venturehacks.com/articles/sean-ellis-interview>

<sup>181</sup><http://startup-marketing.com/>

<sup>182</sup><http://venturehacks.com/articles/term-sheet-hacks>

<sup>183</sup><http://venturehacks.com/archives#employees>

<sup>184</sup><http://venturehacks.com/products>

## Chris Dixon: How much seed money should I raise?



<sup>185</sup>Chris Dixon<sup>186</sup>, serial entrepreneur and seed-stage investor:

“... You should try to answer the question: what is the biggest risk your startup is facing in the upcoming year and how can you eliminate that risk? You should come up with your own answer but you should also talk to lots of smart people to get their take (yet another reason not to keep your idea secret<sup>187</sup>).”

“For consumer internet companies, eliminating the biggest risk almost always means getting ‘traction’ — user growth, engagement, etc. Traction is also what you want if you are targeting SMBs (small-/medium businesses). For online advertising companies you probably want revenues. If you are selling to enterprises you probably want to have a handful of credible beta customers.”

*“The biggest mistake founders make is thinking that building a product by itself will be perceived as an accretive milestone [emphasis added].* Building a product is only accretive in cases where there is significant technical risk — e.g. you are building a new search engine or semiconductor.”

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<sup>185</sup><http://cdixon.org/2009/12/28/whats-the-right-amount-of-seed-money-to-raise/>

<sup>186</sup><http://cdixon.org/2009/12/28/whats-the-right-amount-of-seed-money-to-raise/>

<sup>187</sup><http://cdixon.org/2009/08/22/why-you-shouldnt-keep-your-startup-idea-secret/>

Read the rest of Chris' What's the right amount of seed money to raise?<sup>188</sup> Also see our post, How do we set the valuation for a seed round?<sup>189</sup>

If I had to stuff my answer to this question into one sentence, I would say: "As much as possible<sup>190</sup> while keeping your dilution under 20%, preferably under 15%, and, even better, under 10%." Raising as much as possible is especially wise for founders who aren't experienced at developing and executing operating plans.

## The Billy Mays method of picking startups



<sup>191</sup>David Anderson<sup>192</sup>, VC and supply chain master:

"Billy is perhaps best known for his Oxi Clean<sup>193</sup> commercials, where one softball size ball of detergent, chucked into your washing machine and forgotten, will do 25 loads of laundry. *Simple messages, great customer testimonials and products that really worked were Billy's forte.* He rejected perhaps 99% of the hundreds of inventors/companies

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<sup>188</sup><http://cdixon.org/2009/12/28/whats-the-right-amount-of-seed-money-to-raise/>

<sup>189</sup><http://venturehacks.com/articles/seed-valuation>

<sup>190</sup><http://venturehacks.com/articles/how-much-money>

<sup>191</sup>[http://supplychainventures.typepad.com/my\\_weblog/2009/12/billy-mays-crucial-lessons-for-entrepreneurs.html](http://supplychainventures.typepad.com/my_weblog/2009/12/billy-mays-crucial-lessons-for-entrepreneurs.html)

<sup>192</sup>[http://supplychainventures.typepad.com/my\\_weblog/2009/12/billy-mays-crucial-lessons-for-entrepreneurs.html](http://supplychainventures.typepad.com/my_weblog/2009/12/billy-mays-crucial-lessons-for-entrepreneurs.html)

<sup>193</sup><http://www.youtube.com/watch?v=s3KEkBqDahg>

that approached him, choosing only those products that met his three key metrics. And he and his inventors made millions in the process...

“Address clear customer needs: Billy wanted products that anyone could use, not just a select market segment—who does not have dirty clothes (Oxi Clean)? Needs a knife to cook (Samurai Shark)? Want shiny clean floors (Orange Glo)? or, my favorite, who has ever wished they could permanently cement their mother (or father)-in-law to a chair (mighty putty)?

“Have believable customer testimonials: Billy did not use actors, but recruited users who were true believers. *Who could not like the housewives who had orgasms over their newly waxed floors?*”

*(Italics mark my emphasis.)*

That’s a great set of requirements for picking startups: simple messages, great customer testimonials, and products that really work — that anyone can use. (You can also take the opposite approach<sup>194</sup> on the “products that anyone can use” requirement.)

Bonus: Also see David’s post on Hiring the Right Sales Guy<sup>195</sup>:

“So what’s the best type of sales guy for a start up? To be honest, none of the above. The founders are the best sales guys, supported by the correct marketing and sales support technology, processes and people. They know their solutions and vision best and should be the one who lead the charge in the marketplace.

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<sup>194</sup><http://steveblank.com/2009/03/26/supermac-war-story-4-repositioning-supermac-market-type>

<sup>195</sup>[http://supplychainventures.typepad.com/my\\_weblog/2009/12/hiring-the-right-sales-guy.html](http://supplychainventures.typepad.com/my_weblog/2009/12/hiring-the-right-sales-guy.html)

*“Instead of hiring a very expensive super sales guy, for example, use your board members to get introductions at target customers.* That’s a prime role for board members and should be a key criteria in choosing them. Want C-Level introductions? Try cold calling at 8am in the morning when the C-levels get in early to check their emails. Need a group of specialists to sell the solution? Assemble the team from current employees to make the pitch. Everyone should be a sales person in a start up.”

This is consistent with Steve Blank’s advice<sup>196</sup> that founders should be on the customer development team and, if necessary, complemented by a ‘sales closer’.

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<sup>196</sup><http://venturehacks.com/articles/customer-development>

# January 2010

## The Arrogant VC: Why VCs are disliked by entrepreneurs, Part 2

Sponsor Post Thanks to Atlas Venture<sup>1</sup> for supporting Venture Hacks this month. This post is by Fred Destin<sup>2</sup>, one of Atlas' general partners. If you like it, check out Fred's blog<sup>3</sup> and tweets @fdestin<sup>4</sup>. – Nivi



<sup>5</sup>

In Part 1 of The Arrogant VC<sup>6</sup>, I discussed 4 reasons why VCs are disliked by entrepreneurs:

1. Poor first impressions
2. Getting strung along or left at the altar
3. Getting a raw deal
4. Great (but misguided) Expectations

This post contains 4 more reasons why VCs are disliked by entrepreneurs. Both of these posts contain direct quotes from entrepreneurs with real, hands-on experience with (often prominent) VC's, sometimes through multiple companies and fundraising.

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<sup>1</sup><http://www.atlasventure.com/>

<sup>2</sup><http://www.freddestin.com/blog/>

<sup>3</sup><http://www.freddestin.com/blog/>

<sup>4</sup><http://twitter.com/fdestin>

<sup>5</sup><http://www.freddestin.com/blog/>

<sup>6</sup><http://venturehacks.com/articles/arrogant-vc>

## 5. Unwanted advice, poor communication, and lack of operational sense

“While VCs are always happy to dish out advice, this feels disingenuous from people who have never actually built a company or had a knockout success as an investor. Learning from mistakes is far less useful than emulating success.” One entrepreneur goes further in accusing VC’s of **seeing everything through the lens of money**: “Often times they have zero operational experience (how to launch a company/product or manage customers), don’t understand marketing beyond just building their own brand, and see money as their ticket for everything.”

VC’s are often ex-lawyers or bankers and some have a tendency to feel safe with “experienced suits” that sometimes do nothing but drive the burn rate up and compound cash-flows problems. Entrepreneurs are often “driven, creative types who want out of larger organizations,” whose traits map poorly to those of many VC’s. Ultimately, since many of them don’t understand the businesses deeply, they “try to make up [for] this particular information asymmetry with legal enforcement.”

Some VC’s are not that shy about it. One partner in a tier I fund described his role in this way: “Industry experience is not that important. **I see my role on a board as to challenge every decision the management makes.**” Here’s a variant on the same theme: “I don’t give a s\*\*t about the company’s strategy, my job is to come here once a month and check what you are doing with my money.” QED.

## 6. Different objectives and time frames

“It takes patience and time to build a great business, and target returns and time frames (e.g. five times in five years) can get in the way. On the other side, entrepreneurs burn out and blow

up all the time, so it's **tough to keep both sides aligned** and together for a long time."

Sigurd says "short investor time frames to meaningful exits means forcing businesses to scale too much and too fast (and offsetting this risk through a portfolio approach), whereas the entrepreneur must offset the market and product risk by slower movement and something akin to agile development." David agrees on this natural misalignment of interests: "VCs need home runs, and entrepreneurs need singles at least on their first couple of companies."

The going really gets tough when entrepreneurs **lose their original sponsor**. "The new guy is either too junior, does not know the business, or feels he has the right to wash his hands of the mess left by his departing partner."

## **7. Arrogance and lack of empathy**

At the end of the day, most entrepreneurs completely understand that objectives are not always aligned and that VC's work for funds that need to return capital. What they have trouble with regardless, are "**double standards**". One entrepreneur who has raised money multiple times says, "A lot of VCs do things no regular employee would dare to do but are largely unaccountable for those behaviors: forgetting about board meetings, showing up 20 minutes late, bullying the team or CEO, being generally unavailable, paying no attention in meetings because they are arranging a golf game on their BlackBerry, failing to read the board pack before the meeting, so the actual meeting is remedial in nature." the message seems to be, "**Don't treat me the way I see fit to treat you.**"

Net-net, VC's are too often "**out of touch with the reality of entrepreneurs**." "They are often times elitist, clashing with the very scrapiness of their entrepreneurs." Arrogance is

the word. “I was told forcefully ‘you will fail’ and that I should join another startup... funded by the very same VC.” “I spent 4 years in poverty ignoring my family and my friends to get the company to this point, and now they want me to vest my shares.” Yet another: “I have mortgaged my house, I have spent all my money, my family lives on pizza coupons and now you are telling me you want customers and a live product to boot? Why don’t I call you back when I have gone public, bozo. You call yourself a risk taker? You want 30% of my company when all the risk has been taken out?” (I added the pizza coupon piece for effect, but you get the idea).

Finally, entrepreneurs feel VC’s are “**crap at sharing the wealth**,” recognizing “how tough it is to create value” or “properly re-incentivising managers who gave up many years of their lives, effectively abusing a position of power and often manipulating entrepreneurs by threatening their reputation.”

Bottom line: “**VC’s really don’t take any personal risk but expect everyone else to...**”

Add to this some “dumb practices” such as demanding board remuneration and monitoring fees or “submitting ridiculous expenses” to complete a picture that betrays a complete lack of empathy.

## 8. Dark Side of the Force

Finally, some ugly business behaviour. A fairly common practice seems to be what you might call “slow strangulation”, whether by design or not. “An equity investor will knowingly under-capitalize your startup only to gain control of it once the opportunity manifests itself by use of a wash-out round; milestone financing and abusive board control are used for similar tactics. As a consequence, myself and others now prefer to bootstrap/self-fund rather than taking any amount of early-

stage capital that will not *\*clearly\** take the company to the next level.”

This is a common gripe with smaller funds, who have badly under-performing portfolios and little follow-on reserves, and who fall back on such slow strangulation of businesses they fund by trickling money, gradually washing every one else out, and hoping that 50% ownership for little money invested will somehow pay back for the rest of their portfolio. Smaller regional, government-backed funds get a particularly bad rep in this area. Lacking experience and confidence, they rely on punishing paperwork and self-anointed gurus to help them through the hard process of building successful companies.

Entrepreneurs have come forth with **other dubious practices**, including outright lying about the state of the business when refinancing, disclosing confidential information or personal confidences, negotiating on behalf of management and forcing deals through, making a mockery of governance rules. One systemic problem appears to be a failure to represent the interests of the company in board meetings, but rather short-term investor interests. “This is a plague on the industry and makes the board worse than useless to the company.”

Another entrepreneur identifies what he calls “classic VC tricks” such as “firing the team just before an acquisition, term sheet bombs, hiding or obscuring key information, manipulating the team to try to change ownership or board composition, changing deal terms just before closing.” He adds: “These destroy alignment and trust, and without some alignment and trust the necessary working relationship and motivation is destroyed.”

The worst I got related to VC’s pushing to recover shares from the heirs of a deceased co-founder under a reverse vesting provision. As the contributor put it, “**it will take a lot of good karma from a lot of VC’s to make up for this one.**” I was stunned.

## Conclusion

Last words to entrepreneurs from Rory Bernard: “**Choose your VC’s with care. Good ones transform your business, bad ones wreck it.**”

And to VC’s: “tread softly, remember that in a position of power, you can do many sensible things but a few stupid ones and end up with a ‘George Bush’ problem, and as a result the approval rating of Dubya.”

*If you like this post, check out Fred’s blog<sup>7</sup> and his tweets @fdestin<sup>8</sup>. If you want an intro to Atlas, send me an email. I’ll put you in touch if there’s a fit. Finally, contact me<sup>9</sup> if you’re interested in supporting Venture Hacks. Thanks. – Nivi*

## How to re-negotiate with your customers — and not lose a single one



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Mark Suster<sup>11</sup>, entrepreneur turned VC at GRP Partners:

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<sup>7</sup><http://www.freddestin.com/blog/>

<sup>8</sup><http://twitter.com/fdestin>

<sup>9</sup><mailto:nivi@alum.mit.edu>

<sup>10</sup><http://www.bothsidesofthetable.com/2009/12/16/what-makes-an-entrepreneur-210-street-smarts/>

<sup>11</sup><http://www.bothsidesofthetable.com/2009/12/16/what-makes-an-entrepreneur-210-street-smarts/>

“When I was at BuildOnline (my first company) and things went ‘pear shaped<sup>12</sup>’ we called all of our customers and said, ‘I know that we signed contracts with you. The reality is that the market has changed and I need to change to the new realities. We committed to product features. I can’t ship those as promised. I’m sorry. Do you like our product & service? Yes? Ok, thank you. Listen, I know that if you like what we do then you’ll want a healthy supplier/partner. I need to be able to earn a profit and with the contracts we’ve signed I cannot. I either need to cut product development staff (and therefore can’t ship products as promised) or I need to be able to charge you slightly more for our service or for features you want to see so that I can make ends meet. Help me understand which you prefer.’ I lost zero customers. In fact, we built tighter relationships. I had no choice and as they say, ‘necessity is the mother of all invention.’”

From What Makes an Entrepreneur (2/11) – Street Smarts<sup>13</sup>. You can also find my favorite negotiation book, Bargaining for Advantage<sup>14</sup>, in our bookstore<sup>15</sup>.

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<sup>12</sup><http://www.urbandictionary.com/define.php?term=pear+shaped>

<sup>13</sup><http://www.bothsidesofthetable.com/2009/12/16/what-makes-an-entrepreneur-210-street-smarts/>

<sup>14</sup><http://www.amazon.com/gp/product/0143036971?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0143036971>

<sup>15</sup><http://venturehacks.com/bookstore>

## Emotions at work

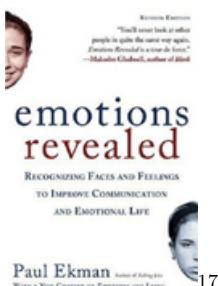
“Some managers are uncomfortable with expressing emotion about their dreams, but it’s the passion and emotion that will attract and motivate others.”

– Jim Collins

“People will forget what you said, people will forget what you did, but people will never forget how you made them feel.”

– Maya Angelou

*(Both quotes are from The Presentation Secrets of Steve Jobs<sup>16</sup> by Carmine Gallo.)*



I've started reading Emotions Revealed<sup>18</sup> by Paul Ekman, a consultant to the television series Lie to Me<sup>19</sup>. It's an excellent and accessible catalog of emotions. For example, Ekman

<sup>16</sup><http://www.slideshare.net/cvgallo/the-presentation-secrets-of-steve-jobs-2609477>

<sup>17</sup><http://www.amazon.com/gp/product/0805083391?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0805083391>

<sup>18</sup><http://www.amazon.com/gp/product/0805083391?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0805083391>

<sup>19</sup><http://www.hulu.com/lie-to-me>

describes the differences between 10 or so different kinds of enjoyable emotions: sensory pleasures, contentment, excitement, relief, wonder...

It's a good complement to The Definitive Book of Body Language<sup>20</sup> (a fun and easy read), which you can find in our bookstore<sup>21</sup>.

## 10 skills I look for before writing a check, Part 2: Perspiration and Appetite for Risk

*This post is by Mark Suster<sup>22</sup>, a serial entrepreneur turned VC at GRP Partners. If you like it, check out Mark's startup advice blog<sup>23</sup> and his tweets @msuster<sup>24</sup>. And if you want an intro to Mark, send me an email. I'll put you in touch if there's a fit. Thanks. – Nivi*



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There are 10 skills I look for in an entrepreneur before writing a check. They are not things that a VC can pick up on in 3

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<sup>20</sup> <http://www.amazon.com/gp/product/0553804723?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0553804723>

<sup>21</sup> <http://venturehacks.com/bookstore>

<sup>22</sup> <http://www.bothsidesofthetable.com/>

<sup>23</sup> <http://www.bothsidesofthetable.com/>

<sup>24</sup> <http://twitter.com/Msuster>

<sup>25</sup> <http://www.bothsidesofthetable.com/>

meetings spread out over 6 weeks, which is why I believe that raising VC<sup>26</sup> is something you do over a long period of time, rather than just 2 months of the year. It's best to meet VCs when you don't need their money, so they can really get to know you.

In Part 1<sup>27</sup>, I published the first five skills I look for in an entrepreneurs: tenacity, street smarts, resiliency, ability to pivot, and inspiration. I then elaborated on each of the topics in my blog series on VC startup advice<sup>28</sup>.

## You need the whole package

Through comment conversations with many of you I tried to emphasize that it isn't enough to just have one attribute. **Being tenacious without the mental flexibility to pivot based on market feedback is a disaster.** Having street smarts with no inspirational ability to build teams can yield a great small business but will be difficult to scale into a large VC-backed business.

So we as VCs search for entrepreneurs/founders who have the whole package or as much of it as possible. Few people have it.

These are often amazingly talented people who are really strong in some of the skill areas and there is no shame in this. They often make great team members such as head of products, CTO, head of sales, CFO, etc. Great companies are comprised of great individual point people or functional leaders.

But when I'm looking to write my check I need to look in the eyes of the captain — the maestro who brings the whole orchestra together<sup>29</sup>. And this is where the last post left off — inspiration.

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<sup>26</sup><http://www.bothsidesofthetable.com/2009/08/08/wtf-is-traction-a-6-step-relationship-guide-to-vc/>

<sup>27</sup><http://venturehacks.com/articles/10-skills>

<sup>28</sup><http://www.bothsidesofthetable.com/entrepreneur-dna/>

<sup>29</sup><http://www.bothsidesofthetable.com/2009/12/19/>

## 6. Perspiration

Inspiration alone is not enough. We've all met inspirational leaders who talk the great talk. They get you all jazzed up after a company meeting but fail to get people to take action or to get things done themselves. Inspiration without perspiration is the equivalent of being a coach — not a CEO. Inspiration is part of what a VC provides, including goal setting, cheerleading, and challenging you. But the CEO needs to move the ball forward a few inches every day. Your VC can't do that for you.

### *Celebrity CEOs*

As a VC, I also see the apparently great leader who is a great public speaker and networker. He does the conference circuit but is somehow missing from running his company. Someone else is left back at the ranch minding the shop. Worse yet, internal company decisions often aren't made without the CEO around and in-fighting amongst the direct reports is not uncommon. Talk to any management team with a "celebrity seeking" CEO and you'll see what I mean.

If you're the guy at every conference don't think that people don't notice. I notice. I love hanging out with you. I'll gladly drink a few beers with you. **But when it comes time to cut checks I'm backing the guy who's back at the office getting stuff done.** I believe great leaders eschew the limelight in favor of building their companies. (before I get attacked in the comments section I'm not saying ZERO conferences — but you need to be selective.)

I would also say that I found some VCs can't tell the difference because they haven't been inside an early-stage company so these CEO's are usually able to raise money. VC money does not equal success.

### *99% perspiration*

The most poignant quote about perspiration comes from Thomas Edison, “Genius is one percent inspiration and ninety-nine percent perspiration.” For entrepreneurs it’s probably a healthy dose of both. I know you think a VC would take for granted that all entrepreneurs work hard but you can tell the difference between those that see their startup as merely a slightly longer version of their last big job and those that are maniacal and focused about what they’re doing.

My favorite example is Jason Nazar<sup>30</sup>, the CEO of DocStoc. There’s no ‘off button’ on this guy. He’s always open for business. If I’m up super late trying to crank out work, I often get IM messages from Jason at 1am. He attends many social events in the LA scene but he seems to always go back to the office afterward. He’s at TechCrunch50 but he knows why he’s there, who he wants to meet, and what he wants out of those meetings. It’s not a boondoggle. It’s all part of his DocStoc obsession.

#### *Starting a company isn’t a job*

There was a recent TechCrunch UK article by an anonymous VC (yes, I think posting anonymously is chicken shit) that talked about the work ethic of European tech companies versus those Silicon Valley<sup>31</sup>. I retweeted this article and got some people in Europe telling me it was unfair to stereotype this way. It’s not. The reality is that many Silicon Valley entrepreneurs/companies are more obsessive and maniacal about their businesses in a way that many others around the world are not. The local culture breeds it. I’m not saying it’s good or bad — it just IS. Europe isn’t the only place to garner criticism for not being driven enough. We get the same criticism in Los Angeles.

But that doesn’t have to be you. **If you want a “job”, don’t be an entrepreneur. It’s not a job — it’s your life.** I

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<sup>30</sup><http://www.jasonnazar.com/>

<sup>31</sup><http://eu.techcrunch.com/2009/11/20/european-startups-need-to-work-as-hard-as-valley-ones>

recently posted some VC startup advice<sup>32</sup> about the need for entrepreneurs to have a bias toward action or JFDI (a play on the Nike slogan). Well the second sign I had on the wall of my first startup was SITE. Ask anybody who worked with me how seriously I took it. Sleep is the Enemy.

*Success breeds competition — from around the world*

For every person who comes into my office with a good idea I respond, “Don’t worry about your failure, worry about your success. If you fail, you move on. But if your good idea pops big time then, trust me, there will be three Ph.D.’s from Stanford sharing a cheap apartment in San Jose working around the clock to beat you. They’ll be eating Ramen or Taco Bell every night and saving their pennies to pour into the company.”

It may be unfair, but it’s the reality of capitalism. It’s the dynamic that drives innovation. In the future, the competition won’t only be in San Jose, but also in Shanghai, Seoul, and Bangalore. I only wish more people in the US Congress understood this as well as Brad Feld does. **The Startup Visa is one of our most important innovation movements.** You think China can’t build great Internet companies? Have you heard of TenCent<sup>33</sup>? It’s more valuable than Facebook.

In conclusion, if you’re not prepared to be “all in”, then you’re not prepared to build a huge company. **You think Marc Benioff built Salesforce.com into a multi-billion company by having a good idea?** I can tell you from having been on the inside that even now this guy never shuts off. He’s driven. He creates the success at Salesforce.com. **He’s a billionaire and he still works harder than many startups.** Are you willing to go that hard for that long?

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<sup>32</sup><http://www.bothsidesofthetable.com/2009/11/19/what-makes-an-entrepreneur-four-letter-jfdi/>

<sup>33</sup>[http://en.wikipedia.org/wiki/Tencent\\_QQ](http://en.wikipedia.org/wiki/Tencent_QQ)

## 7. Appetite for risk

Entrepreneurs are risk takers. Not wild speculators, but pragmatic risk takers who have a blind belief that they will find a way to make things work. **If you put on paper what it would take to be successful in your company, you'd never take the first step, which is why most people don't.** It is often called a “leap of faith” because you jump from safety into the abyss with only the blind faith that you'll find a way.

*If you won't take the risk, why should I?*

I know it sounds trite to say that entrepreneurs are risk takers so let me describe the normal, rational person who I meet on a regular basis. I was recently on TWiST with Jason Calacanis<sup>34</sup>. A caller dialed in to ask us questions about his startup. He was from South America but living in Switzerland and had launched a startup while holding down a day job at a consulting firm (McKinsey if memory serves). He wanted to raise angel money. I told him to quit his job first. If he wasn't prepared to do that he wasn't a real entrepreneur.

I know that 80+% of the people listening to me must have thought that was the wrong advice. **But to me if you're not willing to quit and take a risk on yourself, then you're not confident enough in your own idea and skills. Why should I be?** If your idea is so amazing that it warrants my hard-earned angel money then why should I take a risk on you if you won't take a risk on yourself?

*The locked-up entrepreneur who wouldn't jump*

About a year ago I had lunch with a guy who I believe is an amazing entrepreneur. He had built and sold his first company and had good ideas for his second company. He gave me the 50,000 foot idea and he was convinced that this idea would be

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<sup>34</sup><http://thisweekinstartups.com/2009/11/twist-25-with-mark-suster/>

a monster. The problem was that he was still working out the lock-up period in his big company.

He and his partner told me about this new idea over the course of nearly a year. I finally called bullshit. **If this idea was so big then why would they risk not being first to market, not building defensible IP for the sake of a few hundred thousand dollars extra in lock-up money at a big company?** I think the mind of an entrepreneur would be far more paranoid about yielding his great next idea than protecting his last 20% payout on the last one. They finally quit. I'm enjoying watching their progress.

#### *The MBA who wouldn't jump*

I run recruiting for my VC firm, GRP Partners. About 18 months ago in early 2008 we hired an analyst (pre-MBA), but wanted to wait until after Summer to hire a post-MBA associate. It was May. I received an unsolicited resume from a second-year MBA student at Stanford. He had exactly the skills I was looking for in an associate. I interviewed him on the phone and in person. I introduced him to my partners who liked him. But we weren't ready to hire an associate yet so I offered him a summer internship. He told me that, as a second-year student, he could only accept a summer internship if I would guarantee him the job in the fall if he performed well. He wanted an assurance that if he performed well, we wouldn't go through a recruiting process.

I told him I couldn't guarantee that. If he was confident in his skills he should take the internship. I told him I couldn't imagine that a guy performing really well on the inside had anything to worry about from a great resume and interview from somebody we didn't really know. I told him to join and "become part of the furniture." Without the guarantee, he turned me down. A few months later he called me back and said he would take the internship. I told him, "Sorry mate, it was a one-time offer. You had the door cracked open and should have taken it."

Was I too harsh? I don't think so. I want our associate to have empathy for the customers we serve — our portfolio companies. If the person I hired wasn't cut from the same cloth as an entrepreneur, then how could I expect him to be able to see inside the mind of entrepreneurs?

*My leap into venture capital*

I joined GRP Partners in 2007 before they raised their current fund (we closed a \$200 million fund in March 2009). They told me not to join until after the fund-raising was done. I told them it was now or never. **“Once you’re done raising a fund you’ll hire anybody you want! I want to join now while there’s risk.** I’ll help you raise the fund. And I’ll take the risk. Pay me half salary until the fund is closed. I’ll pay my own moving costs and if we don’t raise the fund you owe me nothing.”

I figured that the alternative was that I start my third company with no salary and all risk. I had nothing to lose! And so it was. If I was willing to take risks to get into VC then how could I accept an associate who had no *cojones*<sup>35</sup>? And how can I fund you if you don’t?

*To be continued in Part 3 with competitiveness, decisiveness, and more. If you like this post, check out Mark’s blog<sup>36</sup> and his tweets @msuster<sup>37</sup>. If you want an intro to Mark, send me an email. I’ll put you in touch if there’s a fit. – Nivi*

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<sup>35</sup><http://en.wikipedia.org/wiki/Cojones>

<sup>36</sup><http://www.bothsidesofthetable.com/>

<sup>37</sup><http://twitter.com/Msuster>

## 5 New Year's resolutions for closing deals in 2010

Sponsor Post<sup>38</sup> Thanks to Walker Corporate Law Group<sup>39</sup>, a boutique law firm specializing in the representation of entrepreneurs, for supporting Venture Hacks this month. This post is by Scott Edward Walker<sup>40</sup>, the firm's founder and CEO. If you like it, check out Scott's blog<sup>41</sup> and tweets @ScottEdWalker<sup>42</sup>. – Nivi



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It's a new year — which means it's time to make resolutions. Rather than write about my resolutions, I decided to put on my lawyer hat and advise entrepreneurs on what I think their New Year's resolutions should be. During my 15-year career as a corporate lawyer (including nearly eight years at two major law firms in New York City), I have seen entrepreneurs make certain fundamental mistakes over and over again. So what better way to welcome in the new decade than to recommend the following resolutions to entrepreneurs...

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<sup>38</sup> <http://venturehacks.com/support>

<sup>39</sup> <http://walkercorporatelaw.com/>

<sup>40</sup> <http://walkercorporatelaw.com/about-the-founder/>

<sup>41</sup> <http://walkercorporatelaw.com/blog/>

<sup>42</sup> <http://twitter.com/ScottEdWalker>

<sup>43</sup> <http://walkercorporatelaw.com/blog/>

## **Resolution 1: “I will create a competitive environment when I’m doing deals”**

There is nothing that will give an entrepreneur more leverage in a negotiation than a competitive environment (or the perception of one). Every investment banker worth his salt understands this simple proposition. Not only does competition validate a firm’s interest, but also it appeals to the human nature of the individuals involved. Competitors can be played off each other and, as a result, the entrepreneur will be able to strike the best possible deal.

I learned this important lesson as a young corporate associate in New York City. As I discuss in my video post, *Lessons Learned in the Trenches of Two Big NYC Law Firms*<sup>44</sup>, I recall having two M&A transactions on my plate: one was a divestiture — i.e., the sale of a division of a multinational corporation being auctioned by an investment bank; and the other was the sale of a private company to a competitor (with no i-bankers involved). In both deals, my firm was representing the sellers but, as we worked our way through the negotiation process of each deal, we ended-up with two completely different acquisition agreements with respect to the material terms.

**In the auctioned deal, because the i-banker was able to play the prospective buyers off each other and create a competitive environment, the final agreement was extremely seller friendly and included broad materiality qualifications, a huge basket/deductible and a cap on seller’s liability of 10% of the purchase price.** In the private-company transaction, however, there was only one prospective buyer — and the buyer’s principals knew that the seller was anxious to sell and thus were playing hardball. The deal terms ended-up being extremely buyer-friendly and included

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<sup>44</sup> <http://walkercorporatelaw.com/lessons-learned/lessons-learned-in-the-trenches-of-two-big-nyc-law-firms/>

a large portion of the purchase price being escrowed and a cap on the seller's liability equal to 100% of the purchase price.

The lesson learned is that you must create a competitive environment (or the perception of one) in order to have strong negotiating leverage. There is, however, one important caveat that entrepreneurs should keep in mind: **this game must be played carefully and is better handled by someone with experience**. The last thing an entrepreneur wants is to end up with is no deal at all.

## **Resolution 2: “I will leave my heart at home”**

You have to think with your head, not with your heart — particularly when you're doing deals. The best deal guys are masters at taking their emotions out of transactions and being extremely disciplined. They will just walk from a deal if they get out of their comfort zone (e.g., with respect to the price, risk profile, etc.), regardless of how much time and money they have spent.

On the other hand, most entrepreneurs become emotionally wedded to a particular transaction and are unable to maintain their objectivity as they move further along the deal process. They get all excited as soon as someone waves some money at them and allow themselves to get drawn into the money guy's web. It is critical that entrepreneurs understand this dynamic. **Entrepreneurs will generally be negotiating with guys on the other side of the table who are far more deal savvy than they are – venture capitalists, private equity guys, etc. – guys who are masters at playing on their emotions.**

This is why it is so important for entrepreneurs to establish a game plan (i.e., dealbreakers) before the negotiating process begins and to have the discipline to stick to the plan and be willing to walk, if necessary. If an entrepreneur is seeking ven-

ture capital financing, he should sit down with his transaction team before reaching out to the VC's to establish his dealbreakers with respect to key terms, such as valuation, the liquidation preference, board composition, etc. The same approach should be followed if he's interested in selling his company: What's the lowest purchase price you'll accept? What's the highest cap on liability you'll agree to? Will you agree to escrow part of the purchase price? If so, how much and for how long? Once you establish the dealbreakers early on, you can take your heart out of the equation and think with your head.

### **Resolution 3: “I will work my balls off”**

This is the advice a senior partner gave me when I was a young corporate associate at a major New York City law firm: “If you want to be a great lawyer, you have to work your balls off and make practicing the law the number one priority in your life.” He explained that this means everything else in your life has to be pushed aside, and you need to “work, work, work.” And when you’re not working, he added, you need to be reading treatises and articles discussing the deals you’re working on to get a deeper understanding of the significant issues. **When I explained to him that, after three months, I had been working nearly every weekend and that my girlfriend was ready to leave me, he told me that I need to get a new girlfriend.**

I received similar advice from Harry Hopman, my old tennis coach (and the winningest coach in Davis Cup history), when I was playing tennis in the minor leagues after college. He preached to me that: “It all comes down to one word — desire. How badly do you want it? How much are you willing to sacrifice?” And he was right. When I was traveling and playing tournaments in Europe and South America, I noticed that the best tennis players were generally the hardest working; the

qualifiers were the ones going out drinking every night, not the top seeds. Sure there were exceptions — like John McEnroe — but the exceptions were rare.

I have seen this same pattern during my legal career: the most successful clients tend to be the hardest working. The private equity guys and hedge fund guys I represented in New York City were animals; working around the clock and cranking out deal after deal. I attribute a lot of their success to just plain hard work. In 2005, I moved out here to California to help entrepreneurs, and it's been a mixed bag in terms of the work habits that I've seen. **Some of my clients are intense and put in the long hours; others, however, are just dreamers — and they are the ones who struggle.** In short, there are no shortcuts to success.

#### **Resolution 4: “I will not let my investors screw me”**

Here's the advice I give all my clients to avoid getting screwed by their investors: do your due diligence prior to accepting any money. The number one mistake I have seen entrepreneurs make in any deal is the failure to investigate the guys on the other side of the table. Remember, you will, in effect, be married to your investors for a number of years. Accordingly, entrepreneurs must do what any bride or groom does prior to tying the knot — date for a while and, of course, meet the family.

What does this mean in practical terms? It means surfing the web and learning everything you can about the particular firm making the investment and, more importantly, the particular individuals with whom you are dealing (and who, presumably, will be sitting on your board for a number of years); it means breaking bread and having a couple of beers with the potential investors; and it means getting references and talking to other entrepreneurs and founders who have done deals with them. Issues to address include: How have they treated their other

portfolio companies? Are they good guys or jerks? Can they be counted-on and trusted? **Do they share your vision for the venture?** Will they add significant value (e.g., through contacts, domain expertise, etc.)?

There is an outstanding video discussion<sup>45</sup> on Mixergy.com between Brandon Watson, a smart entrepreneur (currently at Microsoft), and Andrew Warner, the founder of Mixergy, as to what could happen if you don't adequately diligence your investors. Brandon is extremely candid and discusses how he got "bullied" by his board. Moreover, he expressly notes in the comments<sup>46</sup> to that post that, "**the diligence factor was that I knew them, but had never taken money from them.** It's hard to know how people are going to react when they are at risk of losing money because of something you are directly responsible for until you are actually at that point."

### **Resolution 5: "I will retain a strong, experienced lawyer to watch my back"**

This is obviously a bit self-serving, but every entrepreneur needs a strong, experienced lawyer to watch his back. There is just too much at stake for entrepreneurs to be (1) using sites like Legal-Zoom, (2) pulling forms off the web and trying to play lawyer, or (3) retaining the cheapest lawyer to save money. And as the Madoff affair<sup>47</sup> and other recent high-profile cases demonstrate, there are a lot of unscrupulous characters out there trying to take advantage of unsophisticated entrepreneurs.

There are also more subtle potential problems entrepreneurs need to be protected from, including the inherent conflict of

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<sup>45</sup><http://mixergy.com/bullied-board-lessions-funded-startup-brandon-watson-imsafer/>

<sup>46</sup><http://mixergy.com/bullied-board-lessions-funded-startup-brandon-watson-imsafer/#comment-12491974>

<sup>47</sup><http://www.pbs.org/wgbh/pages/frontline/madoff/>

interest that certain service providers have. For example, entrepreneurs need to be careful with investment bankers, who generally only get paid if a particular deal closes. Indeed, a middle-market i-banker's entire year can be made or broken based on whether or not he can close one or two deals.

Unfortunately, I experienced this issue first-hand shortly after moving to California when I got pulled onto an M&A deal in which an i-banker stuck his finger in my chest and warned, "We're going to get this deal done despite you fucking lawyers." He then later complained to the managing partner (who had the client relationship) that I was blowing up the deal because I had retained special environmental counsel from my old NYC law firm and we were pushing too hard on the environmental indemnity. Good work by the i-banker (and cheers to my former managing partner) for getting the deal closed by watering down the environmental indemnity: less than six months later our client's company was indicted for environmental problems that it inherited as part of the acquisition.

**The bottom line is that a strong, experienced corporate lawyer will sober the entrepreneur and lay out all of the significant legal risks in a particular transaction; he will then push hard to negotiate reasonable protections.** If the deal sours and lawsuits are filed, well-drafted documents with appropriate protections become a kind of insurance policy to the entrepreneur.

*If you like this post, check out Scott's blog<sup>48</sup> and tweets @ScottEdWalker<sup>49</sup>. If you want an intro to Scott, send me an email. I'll put you in touch if there's a fit. Finally, contact me<sup>50</sup> if you're interested in supporting Venture Hacks. Thanks. – Nivi*

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<sup>48</sup> <http://walkercorporatelaw.com/blog/>

<sup>49</sup> <http://twitter.com/ScottEdWalker>

<sup>50</sup> mailto:nivi@alum.mit.edu

## No ocean boiling please



<sup>51</sup>Tim Bray<sup>52</sup>, co-editor of the XML specification:

“The Web These Days · It’s like this: The time between having an idea and its public launch is measured in days not months, weeks not years. Same for each subsequent release cycle. Teams are small. Progress is iterative. *No oceans are boiled, no monster requirements documents written.*

“And what do you get? Facebook. Google. Twitter. Ravelry. Basecamp. TripIt. GitHub. And on and on and on.

“Obviously, the technology matters... More important is the culture: iterative development, continuous refactoring, ubiquitous unit testing, *starting small, gathering user experience before it seems reasonable.*”

*Italics mark my emphasis.* Read the rest of Tim Bray’s Doing It Wrong<sup>53</sup>. And my favorite book on iterative software development is Extreme Programming Explained<sup>54</sup>, which you can find in our bookstore<sup>55</sup>.

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<sup>51</sup><http://www.tbray.org/ongoing/When/201x/2010/01/02/Doing-It-Wrong>

<sup>52</sup><http://www.tbray.org/ongoing/When/201x/2010/01/02/Doing-It-Wrong>

<sup>53</sup><http://www.tbray.org/ongoing/When/201x/2010/01/02/Doing-It-Wrong>

<sup>54</sup><http://venturehacks.com/articles/extreme-programming-explained>

<sup>55</sup><http://venturehacks.com/bookstore>

## How to bring a product to market, Part 2 — after product/market fit



<sup>56</sup> “Where the #@!% is Part 2?”

That’s what I’ve been hearing since we published Part 1<sup>57</sup> of our rare interview with Sean Ellis<sup>58</sup>.

*Here’s part 2.*

In Part 1<sup>59</sup>, Sean discussed what you do *before* product/market fit: how to get there, how to measure it, and how to survey your users so you can improve fit.

In Part 2, he explains what you do *after* fit: optimizing your positioning, implementing a business model, and optimizing your funnel — all so you’re prepared to acquire users quickly and profitably.

If you don’t know Sean from his blog<sup>60</sup> or tweets<sup>61</sup>, he lead marketing from launch to IPO filing at LogMeIn and Uproar. His firm, 12in6<sup>62</sup>, then worked with Xobni (Khosla), Dropbox (Sequoia), Eventbrite (Sequoia), Grockit (Benchmark)... the list goes on. 12in6 “helps startups unlock their full growth potential by focusing on the core value perceived by their most passionate users.”

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<sup>56</sup><http://startup-marketing.com/>

<sup>57</sup><http://venturehacks.com/articles/sean-ellis-interview>

<sup>58</sup><http://startup-marketing.com/>

<sup>59</sup><http://venturehacks.com/articles/sean-ellis-interview>

<sup>60</sup><http://startup-marketing.com/>

<sup>61</sup><http://twitter.com/seanEllis>

<sup>62</sup><http://startup-marketing.com/12in6-projects/>

This is the first time Sean has done an interview on the record. I'm really psyched he's making his insights public — this interview is a must-listen.

SlideShare: How to bring a product to market, Part 2<sup>63</sup> Audio: Interview with chapters<sup>64</sup> (for iPod, iPhone, iTunes) Audio: Interview without chapters<sup>65</sup> (MP3, works anywhere) Transcript with highlights: Below

## This interview is free — thanks to KISSmetrics



<sup>66</sup>We're bringing this interview to you free, thanks to our sponsor KISSmetrics<sup>67</sup>.

Sean is an advisor at KISSmetrics and we interviewed their CEO, Hiten Shah<sup>68</sup>, in How to measure product/market fit with survey.io<sup>69</sup>. KISSmetrics built survey.io<sup>70</sup> with Sean — now they're collaborating on KISSMetrics, a new tool for funnel optimization that we'll discuss in an upcoming interview with Hiten Shah.

## Prerequisites

You'll get more out of this interview if you also read:

<sup>63</sup><http://www.slideshare.net/venturehacks/how-to-bring-a-product-to-market-part-2>

<sup>64</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/01/>

How-to-bring-a-product-to-market-Part-2-Sean-Ellis-Interview.m4a

<sup>65</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/01/>

How-to-bring-a-product-to-market-Part-2-Sean-Ellis-Interview.mp3

<sup>66</sup><http://kissmetrics.com/>

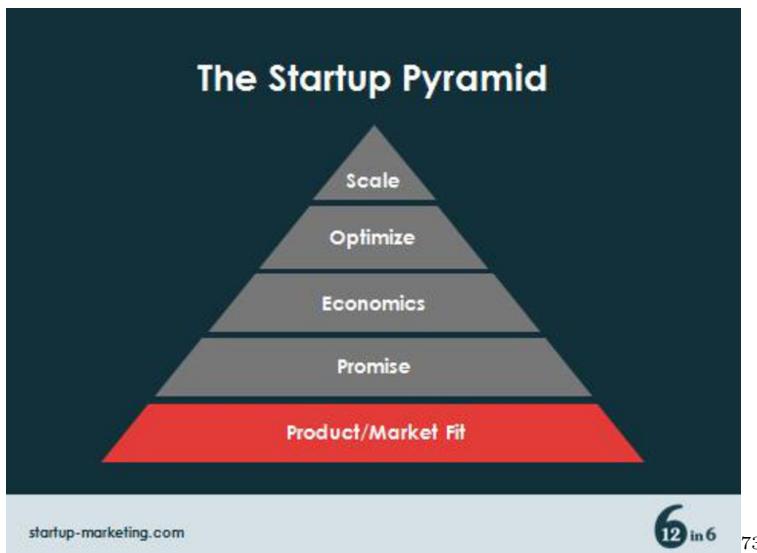
<sup>67</sup><http://kissmetrics.com/>

<sup>68</sup><http://hitenshah.name/>

<sup>69</sup><http://venturehacks.com/articles/measure-fit>

<sup>70</sup><http://survey.io/>

1. Part 1<sup>71</sup> of our interview with Sean.
2. The startup pyramid<sup>72</sup>.
3. We use several phrases interchangeably in the interview:  
Growth = scaling = acquiring customers with a known  
ROI. Preparing for growth = after product/market fit =  
optimizing promise + implementing economics + optimiz-  
ing the funnel.



## Outline

Here's an outline and transcript of Part 2.

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<sup>71</sup><http://venturehacks.com/articles/sean-ellis-interview>

<sup>72</sup><http://startup-marketing.com/the-startup-pyramid/>

<sup>73</sup><http://startup-marketing.com/the-startup-pyramid/>

1. What comes after fit?
2. Prepare for growth
3. a) Put the metrics in place
4. b) Optimize the funnel
5. c) Optimize the messaging
6. Prepare for growth as quickly as possible
7. Remove bottlenecks to preparing for growth
8. Preparing for growth is not a low-burn period
9. Preparing for growth doesn't require growth
10. Use a business model to grow quickly
11. Grow and create new channels
12. Nail the first user experience while preparing for growth
13. Leave no room for the competition
14. Marketplaces are an exception to this model
15. Why Sean decided to focus on startup marketing
16. Just scratching the surface

## Transcript

*Music: The Equator<sup>74</sup> by Tortoise<sup>75</sup>*

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<sup>74</sup><http://www.google.com/search?hl=en&q=the%20equator%20by%20tortoise&aq=f&oq=>

<sup>75</sup><http://www.google.com/search?hl=en&q=tortoise%20music&aq=f&oq=>

## What comes after fit?

**Nivi:** Right. One thing you talk about is, once you have the product/market fit, trying to get through the next few steps as quickly as possible. So it would be great if you could talk about that, and also, for people that don't know what the pyramid looks like, what are the next few steps?

**Sean:** Sure. As I said, if you don't have product/market fit, you want to be obsessively focused on getting there, however you're defining product/market fit. I think the easiest kind of definition to work toward is trying to get 40% of your users to say they'd be very disappointed without it.

And during that period you're trying to stay very low burn and very conservative on all of your expenses within the business. And once you find 40% of your users that say they'd be very disappointed without the product, then you're in a position that you have a business that can grow now. So then the question is: do you try to grow the business right then or are there some things that you can still do that are going to make it even easier to grow when you're focused on that? **And what I've found in working with so many companies at this [post-fit] stage is that you're definitely better off waiting a little time until you try to grow the business.**

**Nivi:** And what does it mean to grow the business? You're talking about spending money to acquire users, essentially.

**Sean:** Acquiring users, for a lot of businesses, means starting to spend money, but it might also mean really trying to crank up the virality of the business, or it might be SEO that doesn't require a lot of spending.

**Nivi:** But it's time and money that you require for people... [interrupted]

**Sean:** Yeah, and focus. The time piece, you could say, has time or focus. But it's essentially saying...

## Prepare for growth

**Sean:** Is now the time to orient — especially the CEO and the marketing group and maybe a sales group — is now the time to build up that group and just say, let's step on the accelerator and do everything that we can to get very aggressive about growing this business? And I would say, not quite.

The reason being, one, up until this point you shouldn't have really focused on really trying to get the metrics into your business, so one of the ways that you can effectively grow a business today is, you can experiment in lots of different areas and figure out, in which areas do I invest a dollar and get that dollar paid back the most quickly or make a really strong return on the investment? But you can't do that if you don't have the measurement systems in place. **So one of the first steps that you want to do is specify what metrics you really need to be tracking in order to be able to grow this business. And you want to then work to implement those.**

So, to some degree, Google Analytics can help you, but the problem with Google Analytics is that you don't really have tracking on a very user-specific level. So maybe you can track with Google Analytics or with Website Optimizer, even with Google AdWords with action tags, you can track a first transaction through dollars spent, but what you can't track is lifetime value. **And ultimately, expected lifetime value is what you should be basing your customer acquisition investments on.**

**Nivi:** With the per-user tracking, is that what KISSmetrics is for?

**Sean:** That's what KISSmetrics is working on. For other companies that I've worked with, it's basically been database driven reports where we're cookie-ing users when they're coming in to track them back to the source, and we're recording that information in the user's permanent record in the database, and that

way any revenue that's generated from that user, we're able to tie back to the money that was spent on that referring origin, coming in.

The reason why I started working closely with KISSmetrics is that all of my projects were six months, and that type of a system that I just described tends to be fairly complicated, especially as you start to track where you're losing users along the way, and some of the other pieces. It was taking a big chunk of the time that we had together to implement that, and there were a lot of bottlenecks around it, so I was trying to find someone who could build that type of a solution as an off-the-shelf type solution and KISSmetrics was on their way to doing something like that. So I've been advising them for a couple of years to try to get the full vision out there of something that can really give the metrics that any business needs to be able to drive and manage growth.

## Optimize the funnel

**Sean:** So metrics is just one part of it. Obviously, as I started to touch on right there a second ago, most companies initially have a very inefficient customer-acquisition process. So it's not just how effectively can you spend money externally, but how can you convert people once they get to your website to having a gratifying first experience, and then ultimately buying your product? And metrics are a good way of determining experiments that you run along the way — how can I get more and more people to actually convert?

That can be through landing-page testing. You can be really effective on that front, or all the way down to just testing purchase prompts. There are all different areas, so you want to have a pretty sophisticated measurement system in place to do that.

I've worked with businesses where, at the start of that process to the end of that process, in a matter of just a couple of months, we've seen five times as many people purchasing just by more efficiently on-ramping them into the product and converting them into being paying customers, which means that when we then focused on trying to grow the business and buy growth, we could spend five times as much money to get someone to the website at the same return on investment, after that process.

And when you can spend five times as much money to get someone to the website, there are a lot more viable marketing channels that are open to you — a lot of times channels that would not have been effective at all before. If you're putting a dollar in and you're only getting 50 cents back, after you've gone through this process and you try that channel again and now you're putting a dollar in and you're getting \$2.50 back, you're going to put as many dollars as possible into that channel, and you would have cut it previously.

**Nivi:** And the expected LTV of the user is equal to your allowable acquisition cost per user. Is that right?

**Sean:** That would be your allowable acquisition cost for a break even. It kind of depends on what your objectives are. If you're trying to do market share you might even be buying users at a loss initially. If you're trying to generate a profit, you probably want to build in some profit on that.

## **Optimize the messaging**

**Nivi:** Right. So, we put the testing in place. What other steps are we going to do before we grow?

**Sean:** So messaging. You want to make sure that you've got good messaging. So part of that was to get the product/market

fit. You might be doing some positioning and messaging. But this is where you want to do a lot of landing page optimization and fine tuning just to see, what's the best way to convert users coming in?

**Nivi:** In terms of positioning.

**Sean:** Ultimately in terms of converting them, positioning is part of that. To me, positioning is sort of the qualitative side and then testing and optimization is the quantitative way of getting to the best result. Hopefully, where you end up is somewhat consistent with what your positioning usage led you.

## **Prepare for growth as quickly as possible**

**Nivi:** And what are your thoughts on just going through this whole process as quickly as possible?

**Sean:** That's a good question. The mistake that I've seen a lot of companies make, particularly those that struggled to get to product/market fit, is that the whole mentality while you're trying to get to product/market fit is to be super conservative and not spend very much money, so a lot of companies kind of [say]: OK, we got there. Now let's prepare to grow.

And they, again, are really conservative and they're taking six months to.... A prime example would be: I need to spend \$100 a day or \$200 a day to know that this is the best-performing landing page, or home page even, or I need to send 1,000 people or 10,000 people through there, and most people will space it out over two weeks. They'll say they don't want to spend more than \$100 a day while we figure that out, so we'll space it out over two weeks.

In reality, if you have some place where you can spend the money — let's say you're doing that through a Google campaign and you're not getting the cap on that, but you're saying, I just don't

want to spend more than \$100 a day, you're essentially going to spend exactly the same amount of money to get to the answer if that's a good page or not. One way it's going to take you two weeks; one way is going to take you one day. If you consider that time is money as well, then you're closer to being able to accelerate the business after one day than you would have been otherwise and it costs you the same. But it's just really hard I think, a lot of times, for people to go through that mentality.

## **Remove bottlenecks to preparing for growth**

**Sean:** Another example would be if you are tight on graphic design resources internally, if you test 50 landing pages or 100 landing pages or 1,000 landing pages, you're going to be so much more efficient at being able to drive growth in your business that it just doesn't make sense, if your big bottleneck is on graphic design, then you want to bring in two or three people. Pay them a little bit more. It's a temporary spike in costs to get much faster to the point where you've got a lot more landing pages in there.

So you combine those two things. We're going to spend more to get people through, and we're going to be able to test five landing pages at a time rather than just two. So being able to do all of those things... The goal should really be....

## **Preparing for growth is not a low-burn period**

**Sean:** You have two low-burn periods in the business. The first is pre-product/market fit. You're trying to spend the least amount possible.

And then the second low-burn period is once you accelerate the business you're working within the parameters of your allowable acquisition costs, so you can actually

go to being cash-flow positive pretty quickly at that point.

One of the companies that I worked with, once we got through this period of — it took us about four months to transition to being able to really accelerate the business and we got it to the point where we could scale marketing to close to a million dollars a month with a fast payback on those marketing dollars.

And at that point we had to raise some more money to be able to fund those campaigns. We raised the money on some very proven metrics and went cash-flow positive the month after we raised the money. So it shows that if we had taken 16 months to go through and really optimize that experience, it probably would have taken a lot longer to get the cash flow positive, but we were very focused and aggressive on it through that period of time and could really accelerate that business in a very cash-efficient way once we got through that period.

### **Preparing for growth doesn't require growth**

Sean: The mistake that most people make is they're trying to manage growth and optimization at the same time. For this period of time, growth isn't important. That's the other thing that's really hard for people to consider. That is not the objective — efficiency is the objective.

So for the first part of the pyramid, the base of the pyramid, you're just trying to create a product that's good enough, that people want, so growth is definitely not important.

A lot of companies still pat themselves on the back if they grow faster than expected through that period. You shouldn't, because what happens, especially if you go to your VCs and you

pat yourself on the back publicly to them, then you're essentially saying growth is important to us, and you're setting expectations that they should want more of it. So basically, say: Hey, we grew. That's not what we were trying to do yet, but it's positive on the hope for the business, but before we really focus on growth we want to get our product/market fit number to this.

Now, in this case, basically we want to be able to grow as efficiently as possible when we're focused on it. And so what we want to do is build in efficiency in the business and the customer acquisition monetization.

## **Use a business model to grow quickly**

**Sean:** So this is the time when you put in the business model as well, because you can't spend real aggressively if you aren't confident that you're going to get that return on the investment.

A lot of companies make the mistake of... at least I believe it's a mistake. **This is probably one of the most debatable things that I say; a lot of companies believe they can grow faster without a business model.** To me, having seen companies that can arbitrage dollars to grow and do it really effectively, you can just accelerate the business so much with that, why would you not spend money to grow? But you can't do that if you don't have a business model in place. So that's why I tend to want to put a business model in place at that point.

The mistake of trying to put a business model in earlier, before you have product/market fit, is that you don't know if you're charging for the right things in the right way. You may be charging for things that are totally irrelevant for people and giving away stuff that is really important to people. So that's one of the big reasons I like to delay the business model until,

one, I have product/market fit, and two, I know why I have product/market fit — I know why people love the product.

## **Grow and create new channels**

**Sean:** Now I'm in a position to put the business model in place, work on all the efficiency on the customer acquisition side, and do everything so that when it comes time to focus on growth, the marketing group or the CEO or whoever is going to be managing that process can be completely focused on driving growth — they're experimenting with lots of channels and finding those that work and killing those that don't, and basically just as quickly as they can, adding as many new customer acquisition sources to the mix.

And you shouldn't focus on that until you know how to efficiently convert people and until you have a product that people really need. So that's why this pyramid just gives you the idea that until you have really achieved that level, and if you're trying to do multiple things at the same time, you're not going to give things the necessary focus to actually accomplish them.

And your goal is ultimately to be growing a product that has very efficient conversion, that you've got all of the metrics in place to really manage that growth, you've got a product that people love, and at that point you're starting to become a regular company. You're organized into product teams and marketing and sales and finance and all of those things that are needed to create an efficient, high-growth company that can manage that growth and not implode under that growth.

That's really why in that center period of time, it's exciting. What should be driving you, day in and day out, is that we're close. We're right to the point where we're almost going to accelerate the business.

## **Nail the first user experience while preparing for growth**

**Sean:** So, one other piece that I think fits into this is that a lot of times it requires a lot of experimenting with how you introduce people to your product. What do you show them first? What is that whole first user experience?

**The mistake a lot of companies make is that they try to get that first user experience right before they have product/market fit, so those companies are essentially pulling limited resources off of their core product and saying: we're going to focus those resources on getting that first user experience right. Then that means that they're not really dealing with the problem. They can maybe get twice as many people in to experience the product, but it still sucks. So they're not really dealing with the issue.**

But now everybody who comes in, or a big chunk of people who come in, are saying that they'd be very disappointed without this product — there's a lot of love for that product. At that point, basically hitting the pause button on core-product development for two months isn't even going to hurt the business because people already love it, and taking all of those resources that would have been focused on honing that core-product development, and refocusing those on: How do you introduce people to that? What does that first user experience look like?

The mistake that a lot of companies make is that they'll take one person off to do that, and it's going to take them a lot longer to do the development to get that right. But now you've got that core-product experience right, taking the majority of your development resources to get through it in a few weeks is going to get you there faster and that is going to put huge dividends on your business.

**Nivi:** You'll become master of your own destiny much more quickly. Right?

**Sean:** Yeah. The way that I've been able to get development teams excited about that is, one, I give them the context of the whole big picture, and then I essentially say this is not something that we're going to ask you to keep coming back and refining the first user experience. Once we've really got it right, backed up by numbers, backed up by saying twice as many or three times as many or ten times as many people are getting in and experiencing that core-product experience, then you can go back into just working on that awesome core-product experience that you've created, and evolving that and just continuing to create a great product experience.

But otherwise, we're going to have to keep asking you for help for the next six months, until we get that first user experience right. It's just much better for everybody, for you guys, to put the pause button on that, help us get this right, and then we're going to be able to grow the business and it's going to be a lot more exciting.

### **Leave no room for the competition**

**Nivi:** And once you're growing the business, what do you think about growing quickly to eliminate slack in the marketplace and basically leave no room for the competition?

**Sean:** Once you have product/market fit, and once others see you having traction, you're going to attract a lot of copycats into the business. And they should be trying to come in because, like I said, the product/market fit is kind of the hardest thing to get to, so once somebody sees that you have a lot of passionate users who really love it, it's the easiest way to create a moderately successful business — to knock that off.

So you have a short-term advantage, which is you're able to respond to all the real product feedback that you're getting from users who are coming in and experiencing that, so you can start to evolve your product better.

So partly what you want to do is just buy every related keyword, maxed out, and be very efficient on those keywords so that you can spend a lot more money on them acquiring users. So, the next guy can't even consider spending keywords, so you've killed that channel for them. You just want to basically make it so that by the time someone can respond, it's going to take them several months to be able to come out with something that's close to your product. By the time they come in there, there's just no market left for them to play in — you're really redlining that market.

It's interesting. In companies that I've been with through the growth period, the products that come easiest are the ones that often get the least focus because, oh, we're hitting the targets on those numbers. We have to work harder on these other numbers. **But it's always the products where the growth comes easiest where the competition comes in because we didn't take the slack out of the market in those products, and then suddenly competition that we didn't expect, and then it's not so easy to grow any more.**

### **Marketplaces are an exception to this model**

**Sean:** I think all of the things that I've talked through are a snapshot of what I think is best right now. There are so many exceptions in the different types of businesses that are out there. For example, **marketplaces do need to focus on growth a lot earlier. Their business is a function of the people that are on there and how they're using the product, and the experience changes for everybody else**

**with more people on the product. eBay would be a good example of that.**

I think each of these things are some of the guidance that I wish I had in the startups that I was in, but don't just take it exactly as-is and think you can just plug it right on your business and that it will work. You need to sort of interpret what this means for your business.

**Nivi:** Do you have any experience applying any of this theory to marketplaces at all?

**Sean:** Yeah, Y Corp. is a company that I've worked with that is a marketplace that I've definitely learned a lot and learned that it's different than a lot of the companies, like Dropbox or Xobni, where it's a more specific product that, with a million users or fifty users, there would be experience where the product doesn't change that much, where for Y Corp. the experience changed a lot.

**Nivi:** So how do you still take a thoughtful approach when you're building a marketplace?

**Sean:** It's just a lot more complicated. I think, for me, one of the things that's kind of come out, in my head, on marketplaces is that you probably need deeper pockets for it. You don't have the luxury of focusing quite as laser focused on each of the steps in the pyramid that I talked about — that you actually do need to think about growth earlier on, and that even when you're then focused on growth you need to make sure that you're constantly finding out if the love is moving, if it's on something else. It's just a lot more dynamic to try. It's fun. It's interesting, but it's definitely harder.

And I've had enough conversations with other people from dating sites to anything that's got the experience based on the mix of people that are there, that it's really something that affects any businesses like those. So that's one piece that, don't just feel

like you can plug this in directly. There are probably exceptions for a lot of these things.

## **Why Sean decided to focus on startup marketing**

**Nivi:** Why did you decide to focus on startup marketing, and why is it important to you and how did you come to that conclusion?

**Sean:** It actually happened when I was coming off of LogMeIn and figuring out what I was going to do after LogMeIn. I knew that the company had gotten big enough that it was not really the size that I wanted to be working in anymore, and that I wanted to go back to early stage.

So it was more just thinking, OK, I can jump into another startup and hopefully I can be fortunate enough to get into a startup where it has the success. But just looking at realistic startup success rates, LogMeIn was the second in a row of two startups that I had run marketing from launch through a NASDAQ IPO filing, and I just knew, realistically, that there was not a good chance that I was going to be able to do that with a third one.

And so partly what I was looking at was just in general.... I kind of went through the thought process of: did I just get completely lucky, which certainly had something to do with it, or were there some things that we did that actually led to that success? And when I really started thinking through both of the companies, I came to the conclusion that the hardest part and the part that really mattered in building a successful company, was what we did in the first year, and really just figuring out everything about the business: Who really needs this product? Why do they need it? How are we going to charge for it? How are we going to acquire new users?

All of these things that needed to be figured out, once we had them figured out then it was much more about, OK, now how do we get more users? But a lot of the moving parts had stabilized at that point and we could really focus on just getting more new users. And so I thought, if that's really the most important part, I thought that it was also the most challenging part, and so future success that I have is really going to be based on how well I can do that first part.

**And then I realized that in 10 years, across these two startups, I'd only spent one or two years in that really challenging stage, so if I really wanted to get good at that I was going to need to figure out how to work in that stage a lot.**

And the problem with startups is that every person working in a startup full-time, basically has an option vesting period that's usually about four years on those initial options. So you work really hard in the beginning and you get some level of success and then it takes another four years to be compensated for that success, so there's no way you're going to create all this success and then leave the company right away.

So for me it was more about: how can I work really hard in that stage and actually be compensated for it? The only thing that I really figured would be the best way to structure it would be as an interim VP marketing role, and I was introduced, from one of the investors in LogMeIn, to a company that was in his portfolio called Xobni. They were still in private beta, and he said just talk to the guys. So we had a conversation that ended up extending for a couple of hours and we really bonded over some things.

And I got excited about the product and they got excited about potentially working with me and tried to bring me in long-term, full-time, and that was not something I wanted to jump right into. I was really passionate about figuring out this early stage and doing cycles there. So we decided that it made sense to

pursue an interim VP marketing role. So I basically went there and thought, I'll do interim VP marketing role after interim VP marketing role, for the next several years — essentially negotiate my exit before I came in so that I'd be able to keep a reasonable amount of options. That was the initial plan, and the whole idea was just to get the experience, up front, and practice, up front, to get good at that and to really document what's important and what's not important.

I think the challenge that I figured out was that, really, on the marketing side, there's a lot of bottlenecks to get a lot of the things done, like optimization and trying to get resources to do a lot of those things. Everybody's scrambling to get the overall product out.

So I knew a lot of what needed to be done, but there's just a lot of waiting around until you have the tools that you need to do that. So where I'm looking at everyone around me working 14 hours a day, and wanting to put that time in myself, there just wasn't that much to do. So I almost felt guilty that I wasn't putting in the same amount of effort that everybody else was, so I still spent the time in the office, but I just found myself doing a lot of things that maybe weren't that important.

**That was why, after Xobni, I decided that I was going to do a more leveraged model where I could work with a couple of companies where they actually had somebody inside to manage the execution of things, but that I would actually be more on the outside, being able to not spend more time in the company than I needed to spend. So that's why I did Dropbox and Eventbrite in that sort of way, where I was balancing two companies at once, and that worked pretty well.**

## **Just scratching the surface**

**Sean:** I feel like I'm still just scratching the surface on what can be learned in early-stage startups. There are not a lot of people that have deep enough experience and frequent enough experience in that really critical up-front stage to get good at it. It's been fun to try and figure it out, but there's a big variety of companies. There are certain things that I think are applicable to all businesses.

One of the most important discoveries in the last couple of years, since I've been focused on this stage, is figuring out this very-disappointed number and just understanding that trying to grow a business that doesn't have users that would be disappointed without it, or don't consider the product a must-have, is going to be a difficult and frustrating experience for anybody, including me. It's humbling. I can't do it.

**I can't do it very well, and when I see companies doing it I have a lot of admiration for them to be able to grow a business that is weak on that [fit] number. Those are the hard-core marketers that are kind of too good for their own good, because they've basically allowed the business not to focus on what the core issue is that's holding them back. But those people would really benefit from taking a step back and tightening up some of these things.**

I'm doing an experiment with Webs.com, for example, that is a later-stage company. They've been around for a long time. They're a top-100 website and have a ton of user passion and a lot of the things that I've done to help prepare companies to grow are things that Webs hadn't done, so we're working together to see if we can retroactively put some of these things in place to accelerate their business.

And for me it's all about learning and just experimenting in companies to find out what's unique to startups and what's

unique to later-stage companies and what applies to everything.

**Nivi:** Great! That's great. I just want to say thanks very much, Sean, for talking to us.

## Top 10 reasons why entrepreneurs hate lawyers

Sponsor Post <sup>76</sup> Thanks to Walker Corporate Law Group<sup>77</sup>, a boutique law firm specializing in the representation of entrepreneurs, for supporting Venture Hacks this month. This post is by Scott Edward Walker<sup>78</sup>, the firm's founder and CEO. If you like it, check out Scott's blog<sup>79</sup> and tweets @ScottEdWalker<sup>80</sup>. He's also writing a new series on VentureBeat: Ask the attorney<sup>81</sup>. – Nivi



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Last week I offered 5 New Year's resolutions for closing deals in 2010<sup>83</sup>. This week, I thought I'd have a little fun and address the issue of entrepreneurs' frustration with lawyers. A recent

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<sup>76</sup> <http://venturehacks.com/support>

<sup>77</sup> <http://walkercorporatelaw.com/>

<sup>78</sup> <http://walkercorporatelaw.com/about-the-founder/>

<sup>79</sup> <http://walkercorporatelaw.com/blog/>

<sup>80</sup> <http://twitter.com/ScottEdWalker>

<sup>81</sup> <http://venturebeat.com/tag/ask-the-attorney/>

<sup>82</sup> <http://walkercorporatelaw.com/blog/>

<sup>83</sup> <http://venturehacks.com/articles/closing-deals>

tweet<sup>84</sup> from Bram Cohen, the inventor of BitTorrent, captures this frustration well: “Lawyers are like phone companies. Their bread and butter is in tricking you into racking up minutes.”

There’s a time in just about every entrepreneur’s career when he or she has wanted, in the words of Shakespeare<sup>85</sup>, to “kill all the lawyers”. In the spirit of David Letterman, here are my Top 10 reasons entrepreneurs hate lawyers (I should point out that “hate” is too strong a word to describe the feelings of most entrepreneurs, but it makes for a catchier title than “dislike” or “complain about”). Click here<sup>86</sup> for a brief video version of this post.

## #10 – “Because they don’t communicate clearly or concisely”

Lawyers love speaking legalese and hearing themselves talk. I learned this first-hand as a corporate associate for nearly eight years at two large New York City firms. The tax lawyers, the employee benefits lawyers, the antitrust lawyers and the rest all spoke their own language. As a corporate associate in charge of quarterbacking transactions, I dealt with the various legal specialists and had to learn their mumbo jumbo. At times, I was as frustrated as the clients.

In the book *Garner on Language and Writing*<sup>87</sup>, Former U.S. Solicitor General Theodore Olsen<sup>88</sup> wrote, “Legalese is jargon. All professions have it. All professions use it as a substitute for thinking, and they all use it in a way that makes them appear to be superior. Actually, they appear to be buffoons for using it. The legal profession may be the worst of all professions in using

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<sup>84</sup><http://twitter.com/bramcohen/status/7336163022>

<sup>85</sup><http://www.enotes.com/shakespeare-quotes/lets-kill-all-lawyers>

<sup>86</sup><http://www.blip.tv/file/3039552>

<sup>87</sup><http://federalappeals.net/why-all-the-legalese/>

<sup>88</sup>[http://en.wikipedia.org/wiki/Theodore\\_Olson](http://en.wikipedia.org/wiki/Theodore_Olson)

jargon. It's not necessary to communicate that way. You're really not communicating, and you're not really thinking."

## #9 – “Because they don’t keep me informed”

Lawyers often keep their clients in the dark. The real estate lawyer I hired to handle the sale of a property came highly recommended and seemed like a good guy. But I never knew what was happening throughout the process. I showed up to the scheduled closing only to learn it was postponed because of some wrinkles, including the buyer’s financing.

Tom Kane, a legal consultant, notes<sup>89</sup>: “[A] failure to communicate often (as in constantly, frequently, persistently, regularly...) is not only foolish from a professional standpoint (as in discipline by the bar, keeping professional insurance premiums reasonable, and so forth), BUT it is just dumb marketing. One could even say it is marketing malpractice.”

## #8 – “Because they are constantly over-lawyering”

Corporate lawyers often have a one-size-fits-all approach to deals. I recently represented a software company in a relatively small business sale (about \$10 million). The buyer was represented by a large law firm that sent an acquisition agreement with three pages of environmental representations. When I explained that none of the environmental reps (or indemnities) was applicable to the target because it was a software company with one office lease, the corporate counsel got on a soapbox about his client “not assuming any environmental risks.” He even patched in the firm’s environmental lawyer to support his argument.

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<sup>89</sup> <http://www.legalmarketingblog.com/marketing-tips-how-do-you-keep-clients-informed.html>

As John Derrick, a California appeals specialist, points out in his book Boo to Billable Hours<sup>90</sup>, “Just as the cost-plus contractor has no financial incentive to keep the price down once hired for the job, so the lawyer who charges by the hour has little incentive — at least in the short term — to keep down the hours billed. To the contrary, the lawyer’s incentive is to bill as much as possible. The result can be unnecessary lawyering.”

## #7 – “Because they have poor listening skills”

While lawyers love hearing themselves talk, they are often not very good at listening. Entrepreneurs want their lawyers to listen carefully to their concerns and address them appropriately; and they don’t want to be interrupted. I feel the same way, particularly when I am negotiating a transaction and trying to close a deal. I have sat in too many conference rooms negotiating with other lawyers as they played with their Blackberries and answered calls on their cell phones. This is not only rude, but it’s also bad lawyering.

From the Wabet Blog<sup>91</sup>: “While great corporate lawyers have several different attributes, one stands apart from the rest: being an exceptional listener. First of all, it’s essential that the corporate lawyer is always ready and able to listen to the client’s description of [his or her] goals and needs. This sounds trite, but involves a set of skills that is more than simply hearing the words spoken or reading the words on the written page. The exceptional corporate lawyer looks beyond the words to delve into the facts, circumstances and other aspects that define the situation... Some of the skill is derived from training, but to a large extent the exceptional corporate lawyer applies his or her experience and the wisdom derived from that experience.”

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<sup>90</sup>[http://www.californiaappeals.com/lawyer/Boo\\_to\\_Billable\\_Hours\\_Chapter\\_8\\_overlawyering.html](http://www.californiaappeals.com/lawyer/Boo_to_Billable_Hours_Chapter_8_overlawyering.html)

<sup>91</sup><http://www.wabet.com/2009/07/successful-practice-unwavering-commitment/>

## #6 – “Because inexperienced lawyers are doing most of the work”

This is the dirty little secret at most law firms, particularly large ones. It even has a name: “leverage<sup>92</sup>”. Law firms try to create the highest possible ratio of associates to partners. The higher the ratio, the more money the partners make. For most entrepreneurs, this generally means paying for the training of young associates.

I discuss this issue in my blog post Behind the Big Law-Firm Curtain: The Good, The Bad, The Ugly<sup>93</sup>, “The reality is that the smaller the client — the smaller the transaction — the further down the ladder the work gets pushed at the big law firms. That’s the way these firms work. The entrepreneur may meet the senior partner at the first meeting for his \$15 million acquisition or \$3 million financing, but that partner then goes back to his office, calls the assigning partner and gets some young associate to start cranking out the work.”

## #5 – “Because they spend too much time on insignificant issues”

**Lawyers are notorious for failing to prioritize issues.** This is especially true in small transactions. Since I moved to Los Angeles from New York City in 2005, I have handled predominately middle-market M&A transactions, financings and restructurings, a departure from the billion-dollar deals I handled in New York. I expected lawyers on these transactions to produce documents relatively quickly and focus on the key issues of a deal, particularly in venture capital transactions that benefit from standardized documents from the National Venture

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<sup>92</sup><http://www.marginalrevolution.com/marginalrevolution/2009/03/are-big-law-firms-built-on-implicit-leverage.html>

<sup>93</sup><http://walkercorporatelaw.com/videos/behind-the-big-law-firm-curtain-the-good-the-bad-the-ugly/>

Capital Association<sup>94</sup>. Instead, I found much of what I found in New York: lawyers spending needless time fighting over insignificant issues.

Foundry Group co-founder and managing director Jason Mendelson recently asked<sup>95</sup>, “Why can’t lawyers know when to leave well enough alone and not feel like every piece of paper needs a mark up? Especially given how expensive lawyers are these days, why on earth would the culture of ‘must mark up documents to show value’ persist? (Answer: lawyers make more money). Especially in the world of venture financing, this is very frustrating.”

#### **#4 – “Because they don’t genuinely care about me or my matter”**

Too few lawyers are passionate about the practice of law. Before launching my own firm, I worked alongside many big-firm lawyers who didn’t seem to enjoy what they were doing. This translates to indifference toward clients.

This quote from Zappos CEO Tony Hsieh in a recent New York Times interview<sup>96</sup> struck a chord with me: “I just didn’t look forward to going to the office. The passion and excitement were no longer there. That’s kind of a weird feeling for me because this was a company I co-founded, and if I was feeling that way, how must the other employees feel? That’s actually why we ended up selling the company.”

That’s how I felt at the law firms where I worked. There were a number of passionate superstars at each of my previous firms. But many others were burned out and just going through the

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<sup>94</sup>[http://www.nvca.org/index.php?option=com\\_content&view=article&id=108&Itemid=136](http://www.nvca.org/index.php?option=com_content&view=article&id=108&Itemid=136)

<sup>95</sup><http://www.jasonmendelson.com/wp/archives/2008/06/why-start-up-lawyers-frustrate-me.php>

<sup>96</sup><http://www.nytimes.com/2010/01/10/business/10corner.html>

motions. “Just another fuck’n deal,” one of my former colleagues once complained to me. That’s why I launched my own firm: to create a team of passionate, hard-working corporate lawyers who love what they do and love helping entrepreneurs.

### #3 – “Because their fees are through the roof”

As I discuss in the introductory video<sup>97</sup> on the home page of our website, the traditional law firm business model is broken. Legal fees have sky-rocketed over the past decade, with lawyers at some national firms billing more than \$1,000 per hour and lawyers at smaller, so-called “regional” firms, billing more than \$600 per hour (see “Law Firm Fees Defy Gravity, Annual Survey Shows<sup>98</sup>”). The number one thing driving these outrageous rates: overhead. Traditional law firms simply pass huge overhead costs onto their clients — expensive office space with lavish artwork and dramatic views; large support staffs complete with librarians, and receptionists; and, of course, high-paid associates.

As a result of the recession and this broken business model, large law firms have recently shed associates in large numbers. LawShucks<sup>99</sup> reports, “2009 will go down as the worst year ever for law-firm layoffs. More people were laid off by more firms than had been reported for all previous years combined.” But as Dan Slater argues in his recent *New York Times DealBook* post, Another View: In Praise of Law Firm Layoffs<sup>100</sup>, “These layoffs — which in many cases have been paired with salary freezes or cuts and significant reductions in law school recruiting — are the best thing to happen to the legal industry in years. Call it a blessing amid recession. Start with the benefit to cost-conscious

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<sup>97</sup> <http://walkercorporatelaw.com/>

<sup>98</sup> <http://www.law.com/jsp/article.jsp?id=1202426547201>

<sup>99</sup> <http://lawshucks.com/2010/01/the-year-in-law-firm-layoffs-2009/>

<sup>100</sup> <http://dealbook.blogs.nytimes.com/2009/07/01/another-view-in-praise-of-law-firm-layoffs/>

corporate counsel, who for too long have been bilked by a law firm compensation model that leads lawyers to prioritize their ‘hourly quotas,’ which determine year-end bonuses, over quality service.”

## #2 – “Because they are unresponsive”

We’re all busy, but that’s not a viable excuse for failing to promptly return a client’s phone call or email. Clients may have differing definitions of “promptly,” but one business day is a good starting point. I experienced unresponsive lawyers as a client in personal matters, and I experience it as a corporate lawyer trying to close deals on behalf of my clients. Entrepreneurs crave immediacy (and so do I).

A recent deal I was on ran days late, requiring an all-hands conference call to finalize a few key issues in the acquisition agreement. I distributed an updated version the same day with instructions to the lawyer on the other side to call me for an update before he left for the weekend. The weekend passed. I heard back from the lawyer on Monday afternoon, over email — and he had sent a new blacklined version with all new issues raised.

## #1 – “Because they are deal-killers”

Lawyers are often viewed as deal-killers because of their failure to set a positive tone and their annoying habit of raising all sorts of reasons why a particular deal won’t close or why a particular idea won’t work. One of the better lawyers I worked with at a firm often said: “**Good lawyers are able to identify significant potential legal problems; great lawyers provide solutions to those problems.**”

As James Freund<sup>101</sup>, a professor and retired partner at Skadden Arps in New York, points out<sup>102</sup>, “In a transactional practice, nothing comes easy. There are invariably two opposing points of view on significant issues, and the parties will even clash... over a circumstance that may never come to pass. Every disputed issue has to be resolved in order for the deal to take place. And the business lawyers bear the primary responsibility for getting it done. Viewed in its broader context, this activity falls under the rubric of problem solving. Unless you’re a problem solver, you’re unlikely to be an effective business lawyer. And the problems that stand in your way aren’t limited to transactional matters... they can involve dealings with regulatory agencies, tax planning, strategizing about how to protect intellectual property, and on and on.”

## Conclusion

While much of this list includes criticisms of my industry, I hope it helps initiate dialogue among entrepreneurs and the lawyers who represent them, to improve the value of the services we offer. And, please remember, I put this list together in the spirit of having a little fun. What experiences have you had with lawyers? Feel free to share in the comments section.

*If you like this post, check out Scott’s blog<sup>103</sup> and tweets @ScottEdWalker<sup>104</sup>. He’s also writing a new series on VentureBeat: Ask the attorney<sup>105</sup>. If you want an intro to Scott, send me an email. I’ll put you in touch if there’s a fit. Finally, contact me<sup>106</sup> if you’re interested in supporting Venture Hacks. Thanks.*

*– Nivi*

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<sup>101</sup><http://www.skadden.com/index.cfm?contentID=45&bioID=35>

<sup>102</sup><http://www.abanet.org/buslaw/blt/8-6problem.html>

<sup>103</sup><http://walkercorporatelaw.com/blog/>

<sup>104</sup><http://twitter.com/ScottEdWalker>

<sup>105</sup><http://venturebeat.com/tag/ask-the-attorney/>

<sup>106</sup><mailto:nivi@alum.mit.edu>

## Bram Cohen: “Lawyers can’t tell you you can’t do something”

Yesterday, we published Top 10 reasons why entrepreneurs hate lawyers<sup>107</sup>, a sponsor post by Scott Edward Walker. Scott’s a lawyer.

First, I thought other lawyers would hate it. I was totally wrong — we got a bunch of nice comments<sup>108</sup> from lawyers like well-known Silicon Valley folks Yokum Taku<sup>109</sup>, Josh King<sup>110</sup>, and Matt Bartus<sup>111</sup>.



<sup>112</sup>Second, Bram Cohen<sup>113</sup>, the inventor of BitTorrent, left an awesome comment<sup>114</sup> that I’m reproducing here with *added emphasis*:

“Thanks for the link to my tweet, Scott.

“You cover the problems very well. My particular gripe in that tweet had to do with the practice of billing up several hours to answer a question asked in email, when all that was really wanted was the answer \*if\* the lawyer knew it off the top of their head. Next time I start a small company I’m going to have a policy that any hours billed need to be approved in advance, after estimates of how many they will be given.

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<sup>107</sup><http://venturehacks.com/articles/hate-lawyers>

<sup>108</sup><http://venturehacks.com/articles/hate-lawyers#comments>

<sup>109</sup><http://www.startupcompanylawyer.com/>

<sup>110</sup><http://corporatetool.blogspot.com/>

<sup>111</sup><http://twitter.com/mbartus>

<sup>112</sup><http://twitter.com/bramcohen>

<sup>113</sup><http://twitter.com/bramcohen>

<sup>114</sup><http://venturehacks.com/articles/hate-lawyers#comment-10362>

“You’re very right about the over-lawyering, and the NVCA docs in particular. There’s no reason in principle why one couldn’t take an NVCA document verbatim and simply fill in the blanks and do a round of funding without needing a lawyer at all. The contracts which people go into when they buy a candy bar are equivalently complex, but they’re implicit and contained in the uniform commercial code, and always going with the boilerplate works for everybody.

“Associates doing work is a real problem. *I’ve found that insisting that all work be done by partners results in better work for less money in the end*, even though the nominal hourly rate is much higher, because an associate will bill for several hours researching a subject which the partner already knows off the top of their head.

“Not only is the biggest problem with lawyers them being deal-killers, but being general activity killers. Too many inexperienced entrepreneurs get into ‘The lawyers say we can’t do X’ disease. *Lawyers can’t tell you you can’t do something*. They can warn you about risks, and in extreme cases tell you that something is such a bad idea you’ll need to get someone other than them to do it (although I’ve never personally been told that) but the judgment call of whether the risk is worth it is the entrepreneur’s. Since lawyers are trained in risks and don’t generally even think about the business, they always advocate being overly conservative, sometimes to ridiculous excess.

*“All this sounds much more negative on lawyers than I generally feel.* I view lawyers as performing a necessary function, but their costs can easily skyrocket and need to be contained, and their advice needs

to be taken with a very large grain of salt. I don't have the deep distrust for them that I have of, say, sysadmins and HR directors, who who are entrusted with running the core systems for a company and can easily get away with all kinds of stuff if they're of dubious ethics."

Bram, if you're reading this, can you share more lawyer hacks and maybe tell us about your experiences with sysadmins and HR directors?

## I'm speaking at The Future of Funding



Naval here. I'll be on a panel about "The Growth of Small Firms" at The Future of Funding<sup>115</sup> on Feb 17. Matt Marshall, Mike Maples, Rob Hayes, Reid Hoffman are all on the panel with me.

The conference is full of accessible early-stage investors like Chris Dixon, Mike Maples, George Zachary, Jeff Clavier, Tim

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<sup>115</sup>[http://futureoffunding.eventbrite.com/?discount=venture\\_hacks](http://futureoffunding.eventbrite.com/?discount=venture_hacks)

Draper, Dave McClure... I'm leaving out a ton of great names — it'll be a who's who of early stage investors.

The tickets aren't cheap but the organizers have kindly given us a 25% discount<sup>116</sup> to share with you. If you're a Venture Hacks reader, please come introduce yourself to me at the conference.

## A list of social startup lawyers

Scott Edward Walker's sponsor post, Top 10 reasons why entrepreneurs hate lawyers<sup>117</sup>, created a lot of awesome discussion about startup lawyers. See the comments<sup>118</sup> to that post and the comments to Bram Cohen's follow-up, "Lawyers can't tell you you can't do something"<sup>119</sup>.

Scott's post also generated a lot of positive comments from lawyers who blog, tweet, and comment. So let's start a list of "social" startup lawyers: lawyers who blog, tweet, Facebook, etc.

Here's a first draft, in alphabetical order, including a link to the comments they left on Bram and Scott's posts. I've included info on how I know each one.

Matt Bartus<sup>120</sup> (comment<sup>121</sup>). Matt Mullenweg<sup>122</sup> (Automattic's founder) works with him and introduced us. Matt Bartus is sponsoring Venture Hacks in a few weeks.

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<sup>116</sup>[http://futureoffunding.eventbrite.com/?discount=venture\\_hacks](http://futureoffunding.eventbrite.com/?discount=venture_hacks)

<sup>117</sup><http://venturehacks.com/articles/hate-lawyers>

<sup>118</sup><http://venturehacks.com/articles/hate-lawyers#comments>

<sup>119</sup><http://venturehacks.com/articles/bram-cohen-lawyers>

<sup>120</sup><http://twitter.com/mbartus>

<sup>121</sup><http://venturehacks.com/articles/hate-lawyers#comment-10360>

<sup>122</sup><http://ma.tt/>

George Grellas<sup>123</sup> (comment<sup>124</sup>). George has lots of good advice on his website<sup>125</sup> and he's active on Hacker News<sup>126</sup>.

Rob Hyndman<sup>127</sup> (Toronto) (comment<sup>128</sup>). Rob has left a lot of comments on Venture Hacks if I remember correctly.

Antone Johnson<sup>129</sup> (comment<sup>130</sup>). I really liked his comment<sup>131</sup> and Twitter bio<sup>132</sup>.

Nathan Roach<sup>133</sup> (IP focus) (comment<sup>134</sup>). Former programmer — always a bonus.

Yokum Taku<sup>135</sup> (comment<sup>136</sup>). Yokum's blog<sup>137</sup> is one of the best startup law resources on the web.

Scott Edward Walker<sup>138</sup>. The sponsor who started this all.

(Apologies if you left a comment and you're not on this list — please add yourself in the comments here.)

**Update:** Giff Constable has his own list of Great startup lawyers<sup>139</sup>.

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<sup>123</sup><http://twitter.com/grellas>

<sup>124</sup><http://news.ycombinator.com/item?id=1056170>

<sup>125</sup><http://www.grellas.com/resources.html>

<sup>126</sup><http://news.ycombinator.com/user?id=grellas>

<sup>127</sup><http://www.robhyndman.com/>

<sup>128</sup><http://venturehacks.com/articles/hate-lawyers#comment-10385>

<sup>129</sup><http://twitter.com/antonejohnson>

<sup>130</sup><http://venturehacks.com/articles/bram-cohen-lawyers#comment-10394>

<sup>131</sup><http://venturehacks.com/articles/bram-cohen-lawyers#comment-10394>

<sup>132</sup><http://twitter.com/antonejohnson>

<sup>133</sup><http://nathanroach.com/>

<sup>134</sup><http://venturehacks.com/articles/bram-cohen-lawyers#comment-10377>

<sup>135</sup><http://www.startupcompanylawyer.com/>

<sup>136</sup><http://venturehacks.com/articles/hate-lawyers#comment-10349>

<sup>137</sup><http://www.startupcompanylawyer.com/>

<sup>138</sup><http://walkercorporatelaw.com/blog/>

<sup>139</sup><http://giffconstable.com/2010/01/great-startup-lawyers/>

**Update 2:** See the comments<sup>140</sup> for more recommendations, including my legal friend Andre Gharakhanian<sup>141</sup>.

**Update 3:** Mark Suster<sup>142</sup> and True Ventures<sup>143</sup> also have their own lists.

I've never met any of the lawyers on this list in person — except Yokum, who I've met once. That's the way it usually goes with startup lawyers. You meet them once and then phone/email them for the next few years.

Obviously, a startup lawyer doesn't need to be social to be good. Venture Hacks works with Jorge del Calvo<sup>144</sup> and Tom Thomas<sup>145</sup>. Neither one is social and they both rock.

Please add your favorite *startup-focused* lawyers in the comments. They can be social or not — but tell us *why* you like them, e.g. have you worked with them? And if you're a startup lawyer, feel free to add yourself — especially if you're social.

## Get Venture Hacks on Facebook

We now have a Facebook fan page for Venture Hacks<sup>146</sup>. It's a feed of our blog posts and tweets<sup>147</sup>.

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<sup>140</sup> <http://venturehacks.com/articles/social-lawyers#comments>

<sup>141</sup> <http://venturehacks.com/articles/social-lawyers#comment-10477>

<sup>142</sup> <http://www.bothsidesofthetable.com/2010/01/21/how-to-work-with-lawyers-at-a-startup/>

<sup>143</sup> <http://www.trueventures.com/recommendations/>

<sup>144</sup> <http://www.pillsburylaw.com/index.cfm?pageid=15&itemid=20502>

<sup>145</sup> <http://www.pillsburylaw.com/index.cfm?pageid=15&itemid=20949>

<sup>146</sup> <http://www.facebook.com/pages/Venture-Hacks/70612138702>

<sup>147</sup> <http://twitter.com/venturehacks>

I was surprised to see how many people get their news on Facebook. The fan page already has 677 fans. Check it out<sup>148</sup>.

Here's how we put it together.

## How to get fans

I mentioned the page on Twitter a few times — that's the first few bumps of fans on the left and middle of this graph.



Then I added a fan page widget to the sidebar on venture-hacks.com<sup>149</sup>. That's the steady slope on the right side of the graph — about 12 new fans a day. Otherwise, I haven't sent any messages to my Facebook friends asking them to "fan" the page — I think that's spam.

<sup>148</sup><http://www.facebook.com/pages/Venture-Hacks/70612138702>

<sup>149</sup><http://venturehacks.com>

## How to set up your fan page

I looked at a lot of solutions for powering the fan page and this is what I came up with for my needs:

- HootSuite<sup>150</sup> to publish tweets to Twitter and our fan page at the same time. It also lets me schedule tweets.
- NetworkedBlogs<sup>151</sup> to publish our blog posts to the fan page.
- Involver<sup>152</sup> to power the Twitter tab at the top of the fan page.

I also use tweetpo.st<sup>153</sup> to publish our tweets to my personal Facebook profile. I wish tweetpo.st worked on fan pages because it adds pictures to the tweets and changes @names into real names.

(If you're a complete psychopath, you might like the specs for My Ultimate Twitter Client<sup>154</sup>, which also includes the instructions for my Twitter/Facebook workflow.)

## Should I get a fan page?

I recommend a fan page if you're serious about blogging and tweeting. Facebook already accounts for 5% of the clicks on my bit.ly links:

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<sup>150</sup><http://hootsuite.com>

<sup>151</sup><http://www.facebook.com/apps/application.php?id=9953271133&ref=mf>

<sup>152</sup><http://www.involver.com>

<sup>153</sup><http://www.facebook.com/apps/application.php?id=68044745059>

<sup>154</sup><http://docs.google.com/Doc?docid=0AYVOOOq2NeN3ZGZnanF2NTdfMTUwZ3p2NWtoMzQen>

Referring Site	Click(s)
Email Clients, IM, AIR Apps, and Direct +	19,619
twitter.com +	6,764
www.facebook.com +	1,540 155

The top two sources are Twitter of course.

## Twitter is my continuous deployment tool

Finally, I like to say that Twitter is my continuous deployment<sup>156</sup> tool. If I build something, I release it *that day* on Twitter. That's what I did with our fan page. Even though it took me a few more months to improve it and get around to blogging about it.

## How to raise money without lying to investors

[SPONSOR POST]<sup>157</sup> Thanks to FastIgnite<sup>158</sup>, a startup advisory firm, for sponsoring Venture Hacks this month. This post is by Simeon Simeonov<sup>159</sup>, the firm's founder and CEO (and formerly a partner at Polaris Ventures<sup>160</sup>). If you like it, check out Sim's blog<sup>161</sup> and tweets @simeons<sup>162</sup>. – Nivi

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<sup>155</sup> images/facebook-traffic.png

<sup>156</sup> <http://www.google.com/search?hl=en&q=continuous%20deployment&aq=f&oq=>

<sup>157</sup> <http://venturehacks.com/support>

<sup>158</sup> <http://fastignite.com/>

<sup>159</sup> <http://fastignite.com/about>

<sup>160</sup> <http://www.polarisventures.com/>

<sup>161</sup> <http://blog.simeonov.com/>

<sup>162</sup> <http://twitter.com/simeons>

“Prediction is very difficult, especially if it’s about the future.”

Niels Bohr<sup>163</sup>, Nobel Prize winner



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**By penalizing entrepreneurs who are humble and honest about how their companies will grow, many investors cause entrepreneurs to over-promise (and later under-deliver) when they’re raising money.**

The histories of some of the best-known technology companies demonstrate the power of luck, timing, the mistakes of incumbents<sup>165</sup>, and solid execution.

Execution is the main tool under a startup’s control but it’s often under-valued by investors.

So it’s not surprising that most entrepreneurs come to pitch meetings armed with very precise statements about a very uncertain future and a list of proven strategies<sup>166</sup> guaranteed to make their company successful. While sitting through these pitches, I sometimes wonder which is worse: the entrepreneurs who know they’re spinning tall tales or the ones who “got high on their own supply<sup>167</sup>. ”

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<sup>163</sup>[http://en.wikipedia.org/wiki/Niels\\_Bohr](http://en.wikipedia.org/wiki/Niels_Bohr)

<sup>164</sup><http://blog.simeonov.com/>

<sup>165</sup><http://blog.simeonov.com/2009/07/30/how-ibm-and-yahoo-made-microsoft-and-google/>

<sup>166</sup><http://blog.simeonov.com/2007/02/21/guy-kawasaki-why-good-strategies-fail/>

<sup>167</sup><http://blog.aweissman.com/2009/10/dont-get-high-on-your-own-supply.html>

## **VCs and entrepreneurs collaborate to lie about the future**

Instead of bringing entrepreneurs back down to earth, some investors push them further into orbit. Some VCs ask a seed-stage, pre-product startup for a detailed five-year financial plan. When I was a partner at Polaris Ventures<sup>168</sup>, I saw many of these spreadsheets built “for fundraising purposes.” We didn’t ask for these spreadsheets — entrepreneurs had usually built them after meeting other, less early-stage, investors.

I find the process of planning — and understanding how a founder thinks about a business — educational and valuable. But pushing the exercise to the point of assumptions layered upon assumptions is not just wasteful, but dangerous, because it sets the wrong expectations.

**After a few pitches, entrepreneurs realize that the distant future is safer territory than the immediate.** It’s easier to boast about 30 must-have features your product will have in three years, than to show the three must-have features in the current prototype. It’s easier to talk about how you’ll recruit world-class CXOs when you’re big and successful, than to show a detailed plan for bringing in an amazing inbound marketing specialist, when everyone on the team is getting paid below-market rates to conserve cash. The examples go on and on.

I’ve co-founded four companies. The two that most quickly and easily raised money did it with nothing but slide decks. Both were funded by Polaris, which has a lot of experience with very early stage investing. We didn’t waste time over-planning the future in those two companies.

And for good reason. Both startups ended up quite different than the fundraising presentations promised — for solid,

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<sup>168</sup><http://www.polarisventures.com/>

market-based reasons that were invisible during diligence. Plinky<sup>169</sup> acquired a new product line and became Thing Labs<sup>170</sup>. 8th Ring failed quickly and cheaply, only seven months after funding. The CEO and I decided the execution risk was too high. And, in retrospect, we were right: our only competitor had an unexciting exit a few years later.

## **Over-promising causes startups to throw away money**

Over-promising is not a problem when it comes with over-delivery. But the overwhelming majority of startups fail to meet the promises they've made during fundraising. After years of observing this pattern, I've come to believe that over-promising can actually cause under-delivery. Entrepreneurs over-promise to raise money easily and set themselves up for pain down the road.

How? The reasons have to do with information signals, expectation setting, and the psychological contracts between entrepreneurs and investors. It's very hard to pitch one story today and then change it the day the money hits the bank, especially if you've drunk the Kool-Aid.

**An overly rosy pitch leads to expectations and fateful commitments that downplay the variability of the future.** Decisions are made based on assumptions rather than tested hypotheses. The burn goes up earlier. The sales team is hired much too soon. In venture funds, over-promising also spreads from the investing partner to the rest of the partnership. It can also spread from the company to its customers and partners, further extending the reality distortion field<sup>171</sup>.

If you're Apple and you've got Steve, that's awesome. For everyone else, it can get rough. I saw this play out with one of my

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<sup>169</sup><http://www.plinky.com/>

<sup>170</sup><http://www.thinglabs.com/>

<sup>171</sup>[http://en.wikipedia.org/wiki/Reality\\_distortion\\_field](http://en.wikipedia.org/wiki/Reality_distortion_field)

companies that was expanding internationally (the reason why the company had raised money). The world was going to be our oyster and, before the reality that our go-to-market strategy wasn't as effective as everyone had hoped set in, we had burned through a good chunk of capital.

## **Find investors you don't have to lie to**

How should you choose between being honest (and hearing “no” a lot) vs. amping up the pitch and risking the anti-patterns<sup>172</sup> above? I give two answers to the CEOs I work with at my startup advisory firm FastIgnite<sup>173</sup>.

First, I strongly advise startups to go to venture firms where the decision process is more collaborative and less “salesy.” One of the main reasons a VC will push an entrepreneur to over-promise is his need to sell a deal internally.

Second, **pitch investors with a track record of valuing a team's ability to execute, over any specific strategy or execution plan.** While most firms pay lip service to this cliché, few do many investments this way. Here are some examples from my experience in the past few months:

- On the smaller side, Betaworks<sup>174</sup> and First Round Capital<sup>175</sup> get this. Their portfolios and their philosophy<sup>176</sup> show it. I look forward to working with them some day.
- Among VCs, General Catalyst<sup>177</sup> has repeatedly backed companies like Brightcove<sup>178</sup>, m-Qube, and Visible Mea-

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<sup>172</sup><http://en.wikipedia.org/wiki/Anti-pattern>

<sup>173</sup><http://fastignite.com/>

<sup>174</sup><http://betaworks.com/>

<sup>175</sup><http://firstround.com/>

<sup>176</sup><http://blog.aweissman.com/2009/10/i-want-to-be-platform.html>

<sup>177</sup><http://gcvp.com/>

<sup>178</sup><http://www.brightcove.com/en/>

sures<sup>179</sup> very early — with the understanding that many important questions will have answers only after months of execution. I'm actively partnering with them at FastIgnite.

- Surprisingly, at the very high end, a private equity firm like Warburg Pincus<sup>180</sup> can be a great place for the right early-stage entrepreneur. Last year, a Warburg entrepreneur-in-residence incubated Better Advertising<sup>181</sup>, a company where I'm a co-founder and acting CTO. Better Advertising's market and business model required a backer with staying power that exceeds most other investors'.

The firms above practice a form of agile investing by (1) not forcing entrepreneurs to over-plan for an uncertain future and (2) following the principle of minimizing wasted effort. Ultimately, it's the investors' responsibility to reward honesty with trust and cash. And I think that's a win-win. I'm looking forward to discussing this with you in the comments<sup>182</sup>.

*If you like this post, check out Sim's blog<sup>183</sup> and his tweets @simeons<sup>184</sup>. And contact me<sup>185</sup> if you're interested in supporting Venture Hacks. Thanks. – Nivi*

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<sup>179</sup><http://www.visiblemeasures.com/>

<sup>180</sup><http://www.warburgpincus.com/Default.aspx>

<sup>181</sup><http://betteradvertising.com/>

<sup>182</sup><http://venturehacks.com/articles/lying-to-investors#comments>

<sup>183</sup><http://blog.simeonov.com/>

<sup>184</sup><http://twitter.com/simeons>

<sup>185</sup><mailto:nivi@alum.mit.edu>

## Launch: Sponsor Posts — ads that rule

Over the last few months, we've built and tested a new "ad" format on Venture Hacks that I really like. I'm writing this post to launch it (voila<sup>186</sup>), describe the ads, and pitch new sponsors.

### The ads

You've already seen the ads. They're 'sponsor posts' like How to raise money without lying to investors<sup>187</sup> by Simeon Simeonov. They're labeled with an image like this,

A small rectangular button with the words "SPONSOR POST" in white capital letters.

and an introductory message from us: "*Thanks to FastIgnite<sup>188</sup>, a startup advisory firm, for sponsoring Venture Hacks this month... "*

### Why they rule

We expect sponsor posts to meet the same standards as our own posts: startup advice that tries not to suck. I think we're succeeding. Sponsor posts get 50-150 retweets<sup>189</sup> by cool people<sup>190</sup> and 10-30 substantial comments<sup>191</sup>. They get on the front page of Hacker News<sup>192</sup> and Techmeme:

<sup>186</sup><http://venturehacks.com/sponsor>

<sup>187</sup><http://venturehacks.com/articles/lying-to-investors>

<sup>188</sup><http://fastignite.com/>

<sup>189</sup><http://www.backtype.com/connect/venturehacks.com%252farticles%252fhate-lawyers/tweets>

<sup>190</sup><http://twitter.com/aweissman/status/6528587774>

<sup>191</sup><http://venturehacks.com/articles/lying-to-investors#comments>

<sup>192</sup><http://news.ycombinator.com/item?id=1068029>

**Venture Hacks:****Just Say No: VC terms that can really hurt**

— Thanks to Atlas Venture for supporting Venture Hacks this month. This post is by Fred Destin, one of Atlas' general partners. If you like it, check out Fred's blog and tweets @fdestin. And if you want an intro to Atlas, send me an email.



**The sponsor posts often perform better than our own posts.** They do well because you read them and spread the word. Thank you. And the sponsors are already great bloggers, so all we have to do is give them a little distribution bump.

Our challenge now is to maintain and increase the quality of our sponsor posts. Upcoming sponsors include George Zachary<sup>193</sup> from Charles River Ventures<sup>194</sup> and Wordpress' lawyer, Matt Bartus<sup>195</sup> from Dorsey & Whitney<sup>196</sup>.

**For prospective sponsors**

Sponsor posts are a great way to start a conversation with the Venture Hacks community — one of the best startup communities on the Web. They're a chance for our readers to get inside the minds of their potential business partners — whether you're a VC, lawyer, startup, or service provider. Past sponsors call it a "no-brainer."

Sponsor posts get 5000+ views, 50-150 retweets, 10-30 substantial comments, and 50-100 new Twitter followers. *We're the only*

<sup>193</sup><http://twitter.com/georgezachary>

<sup>194</sup><http://www.crv.com/>

<sup>195</sup><http://twitter.com/mbartus>

<sup>196</sup><http://www.dorsey.com/>

*site in the world where the ads perform as well as the content.* Learn more about sponsoring Venture Hacks<sup>197</sup>.

## Asking for your help

We want to ask for your help. Who should be sponsoring Venture Hacks? Who do you want to hear from? Who has a great blog that needs more distribution? Please send them a link to this page describing our sponsor posts<sup>198</sup> and ask them to consider sponsoring Venture Hacks. And please send me your suggestions in the comments<sup>199</sup>.

I recently described our sponsor posts to Eric Ries<sup>200</sup> and he called them “ads that are really content you can share.” I like that a lot.

## Comments of the week: Legal fees, financial projections, and fit

We’re determined to have the best comment section of any blog in the universe. Comments that are really worth reading.

One of the tactics we use to improve comments is tweeting<sup>201</sup> about the good ones. Another tactic is highlighting good comments on this blog. Here are three comments from last week that really rocked (among many other excellent ones).

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<sup>197</sup><http://venturehacks.com/sponsor>

<sup>198</sup><http://venturehacks.com/sponsor>

<sup>199</sup><http://venturehacks.com/articles/sponsor-posts#comments>

<sup>200</sup><http://www.startuplessonslearned.com/>

<sup>201</sup><http://twitter.com/venturehacks>



<sup>202</sup>Mark Suster<sup>203</sup> from GRP Partners writes<sup>204</sup>:

My biggest recommendation for startups: Make sure you negotiate a fixed-fee arrangement with your lawyers on fund-raising events.

- Most people will tell you this can't be done. We've done it every time.
- Simply tell your lawyer that this is a "vanilla" standard funding with no big, non-standard items.
- Make sure to also talk with 2-3 lawyers and let them know politely that it's competitive.
- Also make it clear that whomever you choose for the funding will likely get your work in the future as your company progresses.
- Finally, tell your lawyer that if any "non standard" items pop up in the fund raising then you'll accept these are change items that they can carve out of the standard arrangement.
- This way you get a mostly "fixed fee" agreement. Most importantly it sets everybody's expectations up front how much the transaction will cost. By doing this lawyers will be less tempted to allow "billing creep" in your arrangement.

This works like a charm.



<sup>205</sup>George Kassabgi<sup>206</sup> from Keas says<sup>207</sup>:

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<sup>202</sup><http://www.bothsidesofthetable.com/>

<sup>203</sup><http://www.bothsidesofthetable.com/>

<sup>204</sup><http://venturehacks.com/articles/bram-cohen-lawyers/comment-page-1#comment-10408>

<sup>205</sup><http://www.linkedin.com/in/georgek>

<sup>206</sup><http://www.linkedin.com/in/georgek>

<sup>207</sup><http://venturehacks.com/articles/lying-to-investors/comment-page-1#comment-10548>

“The pertinence of forward looking sales projections depends on the stage of the business. If you raise capital from investors who pretend not to understand this, you will be setup for financial incongruity.

“Consider 5 distinct business stages:

1. Incubation
2. Build Product
3. Early-Adopter Success
4. Repeatable Sales
5. Scale the business

“In (1,2) sales projections are useless, the time to prepare them is wasted effort. In (3) sales projections are presumptuous; you have yet to comprehend WHY and HOW the buyer will commit. In (4) sales projections become essential to internal planning.

“Raising capital between stages 3,4, a 1-year plan is valuable, surfacing the right questions/equations within the business, and with potential investors. A 3-5 year plan is chimerical until stage 5 and the shift preceding it.”

Jae Chung<sup>208</sup> from goBalto comments<sup>209</sup>:

“It’s been exactly one month since I implemented Sean’s suggestions<sup>210</sup> regarding assessing our before ‘product market fit’ strategy using survey.io<sup>211</sup>. I can say that we’ve now clearly identified what the core value of our site is and have done a complete redesign focusing on what people love and ended up discarding all of the distractions. Our traffic has actually been growing (presumably due to word of

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<sup>208</sup><http://www.gobalto.com/>

<sup>209</sup><http://venturehacks.com/articles/sean-ellis-interview/comment-page-1#comment-10546>

<sup>210</sup><http://venturehacks.com/articles/sean-ellis-interview>

<sup>211</sup><http://survey.io/>

mouth) and we are now on a clear path to monetization. We are hovering at the 30-40% “very disappointed” and continue to refine the functionality addressing our core mission.

“In summary, I am a believer in Sean’s suggestions and even reread Steven Blank’s “4 steps to epiphany” to focus all of our company’s efforts on customer development and minimize mission drift.

“Thanks again guys!”

Please keep the awesome comments coming. We read every single one.

## 10 skills I look for before writing a check, Part 3: Detail Orientation, Competitiveness, Decisiveness

*This post is by Mark Suster<sup>212</sup>, a serial entrepreneur turned VC at GRP Partners. If you like it, check out Mark’s startup advice blog<sup>213</sup> and his tweets @msuster<sup>214</sup>. And if you want an intro to Mark, send me an email. I’ll put you in touch if there’s a fit. Thanks. – Nivi*



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<sup>212</sup><http://www.bothsidesofthetable.com/>

<sup>213</sup><http://www.bothsidesofthetable.com/>

<sup>214</sup><http://twitter.com/Msuster>

<sup>215</sup><http://www.bothsidesofthetable.com/>

This is the last in a three-part series about the 10 things I look for in an entrepreneur. In Part 1<sup>216</sup>, I addressed tenacity, street smarts, resiliency, ability to pivot, and inspiration. In Part 2<sup>217</sup>, I discussed perspiration and appetite for risk. I elaborated on each of the topics in my blog series on VC startup advice<sup>218</sup>.

Most successful entrepreneurs have an attractive mix of skills, know-how and personal qualities that separate them from the herd. Today I cover three more of these critical elements and throw in a couple of bonus entries that didn't make my top 10 list but are important nonetheless.

## 8. Detail Orientation

One of the easiest ways to rule out an entrepreneur is when he doesn't know the details of his business. There are tell-tale signs, and discussions about competitors often expose them. You can tell whether an entrepreneur has logged into his competitors' products, talked to their customers, read news coverage of them and gotten the back-channel info.

You can tell if the entrepreneur has a deep-seated competitive spirit. Can't go a mile deep on competition? Buh-bye.

Let's talk about your product, and let's look at your financial projections. Can't walk me through them on a granular basis? **Did someone else pull your financial model together while you did "your job"? Not good enough.** The best entrepreneurs focus on details. They can tell you the square-foot costs of their property, how much they spend monthly on Amazon Web Services, and the 12 features being developed for the next release. Another big tell is a CEO's grasp of the sales pipeline. I can't tell you how many CEOs I've met who can't

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<sup>216</sup><http://venturehacks.com/articles/10-skills>

<sup>217</sup><http://venturehacks.com/articles/10-skills-2>

<sup>218</sup><http://www.bothsidesofthetable.com/entrepreneur-dna/>

walk me through the details of their sales pipeline. I want the names of key buyers, when you met them last, who the competition is, and what the criteria is for making a decision. You think we're just going to talk about your largest lead? Sorry. Let's go through the whole pipeline, please. I care about the details, but I'm more interested in finding out whether you do.

Along with detail orientation, I have a strong bias for "doers". **When I ask for a quick demo and the CEO suggests a follow-up meeting with a sales rep because he's not "a demo guy," I usually think to myself, "A follow-up meeting probably isn't necessary."** Similarly, if you need your CFO to walk me through your financial model, you're probably not the right investment for me.

Ask any CFO I worked with as a CEO: They did the hard work, but I edited the spreadsheets cell by cell. In fact, I usually built the first three versions of the financial model (but then my ADD took over, and I needed a great closer to make the model complete). Founders need to be hands-on. As I wrote in an earlier blog post<sup>219</sup>: "You can't run a burger chain if you've never flipped burgers."

A startup seeking investment from me once put their "president" on a call with me. When I told him that "president" was a strange title for a startup, he announced they also a CEO. When asked about their different roles, the president told me the CEO set the strategy while he traveled to conferences evangelizing on behalf of the company. "So who runs the company on a daily basis?" I asked. "Oh," he responded, "we have a COO." The company had under \$1 million in revenue and was burning \$850k a month. It had a strategy-setting CEO, a limelight-seeking President and a COO who ran the company. I gave that company one of the cheekiest responses I have given in my two and a half years as a VC: **"You don't want to raise money**

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<sup>219</sup>[http://www.bothsidesofthetable.com/2009/10/15/  
startup-founders-should-flip-burgers/](http://www.bothsidesofthetable.com/2009/10/15/startup-founders-should-flip-burgers/)

from me,” I said. “The first thing I would do is fire you. Then I’d fire the CEO. Then I’d cut the burn to a realistic level and build a company.” They got their round done anyway from a big late-stage VC. One of the large parts of the burn was PR, marketing, and conference attendance. There are VCs who are fooled by all of this, but it doesn’t equal success. A year later the president and the CEO had moved on.

Bad VCs funded this madness in the first place and weren’t close enough to the company to see what was happening. When the CEO of an early-stage startup tells me he plans to hire a COO, I’m usually not interested in another meeting. (Funny side-note: The company was recently nominated for a Crunchie Award. Unfortunately, money *can* buy you awards.)

## 9. Competitiveness

As I wrote in my previous post on perspiration<sup>220</sup>, good ideas attract competition.

Everybody these days is fascinated by the “private sale” concept offered by companies like Gilt, Ruelala and HauteLook. There are some great companies in this category, but the initial category killer was a French company called Vente Privee<sup>221</sup> (which translates to “private sale”). From what I’m told, the founders were in the Schmatta (Jobber<sup>222</sup>) business selling other people’s excess, end-of-line inventory at a bargain. There wasn’t the same end-of life infrastructure that we have in the U.S. (think T.J. Maxx), so they had an early lead. When the internet part of their business took off, a number of competitors surfaced.

By then, Vente Privee was a powerhouse and they used that market power. They made it clear to suppliers that Vente

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<sup>220</sup><http://www.bothsidesofthetable.com/2009/12/21/what-makes-an-entrepreneur-perspiration-611/>

<sup>221</sup><http://en.wikipedia.org/wiki/Vente-privee.com>

<sup>222</sup><http://www.merriam-webster.com/dictionary/jobber>

Privee would stop carrying their products if they supplied the newly formed competitors. This was a bare-knuckle industry, and money was at stake. Good competitors fight.

**Just ask Overture about Google (“Don’t be evil”) and how they competed in international markets. It wasn’t all smiles, hugs and “let the best man win.”** A lot was at stake, and Google competed fiercely.

Have a nice little idea and think you can carve out a large market niche? Not if you’re a nice guy. I’m not saying you need to be an arsehole, but entrepreneurs hate to lose. They’re hyper-competitive in everything they do. I look for that fighting spirit in the individuals at my table. It doesn’t matter if they’re playing golf, poker, Ping-Pong, Scrabble, or Guitar Hero. Entrepreneurs play to win, and they take losing seriously.

Think Mark Zuckerberg doesn’t have some sleepless nights about Twitter despite having more than 300 million users himself? **Steve Jobs isn’t a “nice guy.” Nor are Bill Gates, Steve Ballmer, Marc Benioff, Larry Ellison, Tom Siebel, Rupert Murdoch, or any number of people you’ll find who built empires.**

## 10. Decisiveness

Being an entrepreneur is about moving the ball forward a few inches every day. What astounded me when I switched from being a big-company executive to an entrepreneur was the sheer number of decisions I had to make on a daily basis.

They sound so basic when you’re not the one having to make them. Should you go with Amazon Web Services (AWS) or have your own servers hosted at RackSpace? Should you build in Ruby, Java, or .NET? Should you sign a two-year lease or rent month-to-month? Should you hire an extra developer now or a business development resource? Should you take angel money

or just go for a seed round from a VC? Is venture debt a good idea? Should we launch at TechCrunch50? Should we charge for a product or offer freemium<sup>223</sup>? Should we ask for a credit card up front, even if we don't charge for 30 days?

It never ends. **There is no such thing as a startup decision with complete information. The best entrepreneurs have a bias for making quick decisions and accept that, at best, 70 percent of them will be right.** They acknowledge some decisions will be bad and they'll have to recover from them. Building a startup might be a game of inches, but you don't get timeouts to pause and analyze all of your decisions.

I recently have been considering investing in an entrepreneur in Silicon Valley. He was deciding between taking another senior role at a prominent Silicon Valley tech company and starting his own business. I told him I didn't think he needed any more resume-stuffers and now was the time to go do something big on his own. Within a week he delivered a deck outlining his strategy for a new company. A day after we discussed the possibility of him flying down to meet with my partners, he was on a plane.

He then booked tickets to China to talk with suppliers and promised to revise his strategy by the time he returned to the U.S. He is getting stuff done in entrepreneur years, which is a step change faster than dog years. By the time we speak again, I'll be able to judge results by the quality of his thinking about the opportunity. But by that time, I imagine, he will have made so much progress that he'll question whether he should take my money. I'm certain he will have talked with other funding sources. This is how it should be.

**If you've been “thinking about doing something” and batting the idea around with your favorite VC more than six months, don't be surprised if they're not prepared to back you in the end.** Entrepreneurs don't “noodle”.

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<sup>223</sup><http://en.wikipedia.org/wiki/Freemium>

They “do”.

Now that I’ve addressed the top 10 skills I look for in an entrepreneur before investing in them, I’d like to offer two additional qualities that can be critically important but won’t necessarily hold someone back from seeing success.

## **11. Domain Experience**

This isn’t a “must” for me, but it’s certainly a huge plus when entrepreneurs have it. You can spend a year putting your hypotheses on paper while researching a market. But you never really have a handle in the minute details of the industry until you’ve lived in it. If you are launching mobile application and have sector experience working for Apple, Blackberry, Ad-Mob, or JAMDDAT, then I know your product will have your experiences baked into it.

I learned this lesson when I launched my first company in 1999. We offered a SaaS document management in the cloud (we were called ASPs back then). I had no experience in document management systems beyond being a user, and nobody had SaaS experience because the market was too new. We were forced to make assertions about features we thought people would want, how to price them, and how to overcome objections to managing data in the cloud.

When I began hiring product managers, sales reps, and implementation staff, I benefited from what employees learned working at places like Documentum and OpenText. They brought the lessons they had learned in their companies over the previous decade. I know this stuff cold now. So when I launched my second company – which was also a SaaS Document Management company – we already had a vision for what would do well in the marketplace.

Domain experience also brings relationships. **If you spent three years building relationships with senior executives at media companies, a starting point for your next business ought to be, “How can I exploit these relationships in the next venture I launch?”**

One successful entrepreneur I know wanted to launch his next venture in financial services because it was a bigger industry. Fine. But I pointed out that he would be up against competitors who had spent years building relationships with the big financial services companies (as well as channel partners), and he would be starting from scratch. I’m not sure why you’d do that unless you had to.

## 12. Integrity

The most obvious attribute that didn’t make my top 10 list is integrity. It is very important to me. **If I thought I could make a lot of money backing a dishonest person, I personally would pass. I know many private equity firms that would not.** I’m proud that most early-stage VCs I know care about making money ethically. So you should include integrity on my personal list of attributes required to raise money from a reputable, early-stage VC.

Unfortunately, people with low integrity can be successful and can raise money from investors. So I left it off the master list. I personally know a billionaire CEO who I wouldn’t put high on the list of people with high integrity. But he built his company from scratch to become a very large enterprise. He is well respected (but not liked) in his industry and in his company. He spends a lot of money on personal marketing so the story is written the way he wants it.

But I’ve seen his actions up-close and wouldn’t claim that they are high on the integrity scale. I’ve heard this about similar

technology executives of some of the biggest names in history.

I also know him to not be a very happy man. Money can buy a lot of things but, as the saying goes, it can't, in and of itself, buy you happiness. I believe that true happiness comes from a sense of fulfillment, giving, and doing what your moral compass knows is right. Better that you be this person, whatever level of business success you achieve in life.

*If you like this post, check out Mark's blog<sup>224</sup> and his tweets @msuster<sup>225</sup>. If you want an intro to Mark, send me an email. I'll put you in touch if there's a fit. – Nivi*

## When to fire your co-founders

Sponsor Post <sup>226</sup> Thanks to FastIgnite<sup>227</sup>, a startup advisory firm, for sponsoring Venture Hacks this week. This post is by Simeon Simeonov<sup>228</sup>, the firm's founder and CEO (and formerly a partner at Polaris Ventures<sup>229</sup>). If you like it, check out Sim's blog<sup>230</sup> and tweets @simeons<sup>231</sup>. – Nivi

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<sup>224</sup> <http://www.bothsidesofthetable.com/>

<sup>225</sup> <http://twitter.com/Msuster>

<sup>226</sup> <http://venturehacks.com/support>

<sup>227</sup> <http://fastignite.com/>

<sup>228</sup> <http://fastignite.com/about>

<sup>229</sup> <http://www.polarisventures.com/>

<sup>230</sup> <http://blog.simeonov.com/>

<sup>231</sup> <http://twitter.com/simeons>



<sup>232</sup>The best strategy for not having to fire your co-founders is to not bring them on board in the first place.

One of the most common early-stage startup mistakes<sup>233</sup> is building a weak founding teams. **Since a good team is often the closest you can get to a good business plan, this one anti-pattern is the cause of many company failures.** Before we dig into why this happens so frequently and what entrepreneurs can do about it, I want to share one of the formative stories from my early days as a VC.

## **An entrepreneur who should have fired his co-founders**

Many years ago, I met a 20-something technical founder who had recently left graduate school with interesting technology in the enterprise search and knowledge management market. Beyond his compelling personality and the technology, he had an impressive approach that allowed him to deliver benefits to users without prior user setup or explicit user actions, using desktop and email client integration. To use a current analogy, it was like Xobni<sup>234</sup> but better.

A week later, he came to Polaris with his founding team. He had three co-founders. They all had grey hair and so-so backgrounds.

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<sup>232</sup><http://blog.simeonov.com/>

<sup>233</sup><http://blog.simeonov.com/2010/01/05/startup-mistakes/>

<sup>234</sup><http://xobni.com/>

Over the course of an hour, I learned one of the three was a relative who, after hearing about the idea, pushed himself onto the team as “the business guy” and then promptly brought in a couple of former co-workers as co-founders. The net effect was that a backable founder had become essentially unfundable. I passed on the deal. As expected, the company went nowhere. I am friends with the founder and would like to back him some day.

This is an extreme example, but it underscores the randomness by which founding teams are created. Three disclaimers before we dive into the issues:

- I’m not advocating that an entrepreneur goes it alone. Much has been written about the costs and benefits of partners when starting a company. I’m advocating for more thoughtfulness about the building of a founding team and more creativity around how to make progress with limited resources. See Venture Hacks’ post on How to pick a co-founder<sup>235</sup>.
- I’m not advocating that what’s best for the company in an abstract sense should trump personal relationships or commitments that have been made. I am advocating for greater care in making commitments and more openness around the balance between business and personal spheres.
- I’m focusing specifically on founding teams here, but many of the lessons apply equally well to hiring in very early stage companies (before product/market fit has been proven).

## How weak teams get built

**Arrogance and ignorance, in small doses, are powerful tools that help entrepreneurs focus and execute against**

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<sup>235</sup><http://venturehacks.com/articles/pick-cofounder>

**overwhelming odds.** In larger doses they make a dangerous poison that kills startups. In most cases, they are the root cause behind weak founding teams.

It's no secret that startup business plans tend to evolve over time, sometimes substantially. Yet, at any given point along that evolutionary path, many entrepreneurs are over-confident that, this time, the plan will succeed. Then they look at the founding team and, if they think they are missing a key role, they may bring a co-founder on board. This process repeats itself up to the point where either the company converges to what it will likely end up doing in the next few months or the founding team gets to a size that makes additions practically impossible.

I recently met an entrepreneur who started working on a consumer social media idea about a year ago. Thinking he was building a small dot-com, he brought on a college buddy who had done Amazon Web Services work as a chief technical officer (CTO). In a few months, the idea shifted toward working with agencies. He brought in a VP of marketing from the agency space, because he was confident that was where the opportunity was. After a few more months, the team realized there was only a services business in the agency space. **Now they are pivoting towards expert identification/collaboration in enterprises, and neither his CTO nor his VPM is right for the team.**

The entrepreneur in this example is a smart guy. But he didn't have enough experience to understand what would be required for a co-founder role over the early evolutionary path of the company. He didn't fully appreciate the opportunity cost of making these early hires given his limited recruiting network and the pre-product, pre-funding stage of the company. Further, he did not know how to evaluate a VP of marketing. He ended up with a communications-oriented exec who — beyond lacking understanding of the enterprise domain — is not very helpful in

general with product marketing issues. This is how ignorance hurts.

## What VCs think about bad co-founders

Keep in mind that when you recruit or you pitch investors, they don't get the benefit of the history that might explain your decisions. Let's imagine what goes on in a VC's head:

"Shoot, this is a backable entrepreneur and the idea may have legs but the two other founders are B players and a poor fit for the company at this point. I could talk to the lead founder, but I don't know about the personal relationships on the team and this can backfire. Also, I don't want word getting out that I break founding teams. This can hurt my dealflow. Anyway, the CEO showed poor judgment in bringing these people on board. Also, there is still a lot of recruiting work to do whether the team changes happen before or after an investment. Frustrating... this could have been a good seed deal. Now it's too complicated. I'll pass using some polite non-reason."

## Agile founding teams

There is a principle in agile development that centers on minimizing wasted effort. One of the cornerstone strategies — supposedly one of Toyota's rules<sup>236</sup>, too — is to delay decisions until the last *responsible* moment<sup>237</sup>. Because the future is uncertain, the idea is to make decisions with the most information. The

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<sup>236</sup><http://discuss.joelonsoftware.com/default.asp?design.4.484158.14>

<sup>237</sup><http://venturehacks.com/articles/extreme-twitters>

emphasis is on “responsible,” because a lot of procrastination is bad too.

Last week, I wrote about how to raise money without lying to investors<sup>238</sup> with this same principle. The logic also applies to building strong founding teams. Because you don’t know what your startup will end up doing, it can be a big mistake to hire the best people for *this point* in the company’s life.

The obvious solution is to build an amazing team of well-rounded, experienced athletes who can do anything that comes their way. The Good-to-Great companies put the right people on the bus and the wrong people off the bus<sup>239</sup>. If you can do it, more power to you. However, you may have a few problems...

## **Entrepreneurs Anonymous**

I am an entrepreneur, and I have team-building problems:

- I am not exactly sure what my company will do.
- I have limited resources and can’t have many people on my team.
- My recruiting network is limited.
- My company, especially pre-product and pre-funding, may not be very attractive.
- I may not be the best person to evaluate people in \_\_\_\_\_ - \_\_\_\_\_ and \_\_\_\_\_.

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<sup>238</sup> <http://venturehacks.com/articles/lying-to-investors>

<sup>239</sup> [http://www.jimcollins.com/article\\_topics/articles/good-to-great.html](http://www.jimcollins.com/article_topics/articles/good-to-great.html)

## Ten rules for building agile founding teams

Here are some specific strategies for building founding teams. There are no silver bullets. Some of the advice is contradictory and situation-specific. Caveat entrepreneur.

1. **Network, network, network.** Learn how to learn through people. It's the fastest way to understand a new domain. Value negative feedback. It often carries more information than a pat on the back. Expand your recruiting network, so you get access to better talent.
2. **Set clear expectations.** When getting involved with someone, establish the right psychological contract from the beginning. Talk about what might happen if there is a pivot in an unexpected direction.
3. **Go easy on titles.** Don't give out big titles unless you have to and, even then, question why you have to. You can always "upgrade" someone's title later if they perform well. They'll appreciate it. On the flip side, big titles can cause many problems when you recruit or raise money.
4. **Structure agreements well.** Founders should have vesting schedules with some up-front acceleration. In some cases, you can bestow founding status without giving founding equity with accelerated vesting.
5. **Be honest with and about your team.** Get in the habit of discussing team fit with the business plan in an open, non-threatening manner. When you talk to experienced investors or advisors, be honest about the limitations of your team. Most likely they see any warts just as well or better than you, and you can only win by showing you have a firm grip on reality.
6. **Hire generalists early.** Hire specialists later.

7. **Hire full-timers reluctantly.** You can only have a few of them in the early days, whether they are co-founders or not. Be picky. Don't fall for the chimera of "If only I hire a \_\_\_\_\_, then I can \_\_\_\_\_. This may be true, but only if the person you hire is perceived to be good and does a good job. The perception of the quality of your team is as important as reality for recruiting and fundraising.
8. **Find experienced part-timers.** Sometimes you can get a lot of value out of very experienced people even if they only spend a few hours, or a day, each week with you. The key is to do this over a period of time and build context. Over time, experienced part-time employees can help in the process of building the company. They can help make many decisions — for example, around team-building, financing and the business plan — as opposed to any one decision. This is how I work with startups through FastIgnite<sup>240</sup>. Depending on the situation, I'm an active advisor or co-founder and/or acting CTO. Other people, like Andy Palmer<sup>241</sup>, take on a board or acting CEO role.
9. **Find the right investors.** Seek investors who pride themselves on their recruiting abilities and have a track record of helping startups build teams. These investors may see the holes in your team as an opportunity instead of a problem, as long as they feel confident the company is a good recruiting target. Some firms have internal recruiting teams led by experienced former executive recruiters. Examples include Benchmark<sup>242</sup> (David Birne<sup>243</sup>) and Polaris<sup>244</sup> (Peter Flint<sup>245</sup>). Others, such as General Cata-

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<sup>240</sup><http://fastignite.com/about>

<sup>241</sup><http://www.linkedin.com/in/andypalmer>

<sup>242</sup><http://benchmark.com/>

<sup>243</sup><http://benchmark.com/sv/partners/beirne.shtml>

<sup>244</sup><http://www.polarisventures.com/>

<sup>245</sup><http://polarisventures.com/WhoWeAre/TeamDetail.asp?ContactID=>

lyst<sup>246</sup> and Founders Fund<sup>247</sup>, favor partners who are former entrepreneurs with deep networks and team-building experience.

10. **Fire your co-founders.** If you are behind the 8-ball and see your team as a key constraint, you should do something about it. Don't wait for an investor or someone else to do it for you. The non-CEO co-founders can fire their CEO co-founder, too (or change their role and level of responsibility). This happened at a social commerce startup in the Bay Area I liked. The CEO came up with the idea (kudos to him) but he had enterprise background and provided little value-add. His two co-founders were responsible for most of the progress. It took them too long to reshuffle things. By that point, they'd made a bad impression in front of too many investors. The team fell apart eventually.

If you successfully apply these strategies, you stand a better chance of going after the right people at the right time and bringing top talent on board.

You may not even have to fire your co-founders.

## Most inspiring speech ever

Actually two dueling inspirational speeches. Very NSFW — contains, as they say, “strong” language.

Video: The Thick of It, Season 3 Episode 8, Ending speeches<sup>248</sup>

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<sup>246</sup>7b336198AC-DE78-45EC-A26C-163C958D1F08%7d

<sup>246</sup><http://www.generalcatalyst.com/>

<sup>247</sup><http://foundersfund.com/>

<sup>248</sup><http://www.youtube.com/watch?v=ElNlIfwlF-w>

Thanks to Fred Destin<sup>249</sup> for suggesting we post some lighter fare once-in-a-while. And see why Mark Suster thinks inspiration is a critical piece of what makes an entrepreneur<sup>250</sup>.

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<sup>249</sup><http://www.freddestin.com/>

<sup>250</sup><http://www.bothsidesofthetable.com/2009/12/19/what-makes-an-entrepreneur-511-inspiration/>

# February 2010

## **When you're raising money, the competition isn't the competition**

Simeon Simeonov<sup>1</sup>:

“You have to understand that you are not competing with an abstract notion of what a good investment is. You are competing with the other teams that saw the investor that week.”

This is why investors often don’t have good reasons why they’re passing. Maybe your company is good, but the competition is simply better. It’s really hard to understand this until 20 companies pitch you in one week. Simeon continues,

“To an investor, it costs about the same in terms of time to make a big or a small investment. Given the same risk/return expectations, they’d prefer the large investment most of the time.”

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<sup>1</sup><http://venturehacks.com/articles/lying-to-investors/comment-page-1#comment-10778>

## Launch: AngelList, a curated list of angel investors



I'm psyched to announce  
a curated list of super high-quality angel investors. And how to  
reach them.

<sup>2</sup>Angel

Investors like Jeff Clavier<sup>4</sup>, Dave McClure<sup>5</sup>, Rob Hayes<sup>6</sup>, Aaron Patzer<sup>7</sup>, Brad Feld<sup>8</sup>, and 50 other investors have already joined. I want to thank all of the angels for taking the time to fill out these extensive profiles.

And it's not fair for me to list just a few of the investors here

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<sup>2</sup><http://venturehacks.com/angellist>

<sup>3</sup><http://venturehacks.com/angellist>

<sup>4</sup><http://venturehacks.com/angellist#jeff-clavier>

<sup>5</sup><http://venturehacks.com/angellist#dave-mcclure>

<sup>6</sup><http://venturehacks.com/angellist#rob-hayes>

<sup>7</sup><http://venturehacks.com/angellist#aaron-patzer>

<sup>8</sup><http://venturehacks.com/angellist#brad-feld>

— they're all awesome. You should click and browse the entire AngelList<sup>9</sup>. Together, they represent \$80M that will be invested in early-stage startups *this year*.

## Angels: How to join AngelList

If you're an angel investor, apply to join AngelList here<sup>10</sup>. At a minimum, you should have made two \$25K angel investments in 2009 and plan to make two more \$25K investments in 2010.

## Startups: How to contact the angels

Read an angel's profile before you try to get in touch with him. All the angels have listed how many investments they expect to make this year, their typical investment amount, the markets they invest in, **how to get intros**<sup>11</sup>, and lots more information you can't find anywhere else.

Some of the investors let you contact them directly. But, before you do, build a minimum viable product<sup>12</sup> and learn something about your customers<sup>13</sup> by putting it in front of them. If you can't get that far on your own, go find some idea investors<sup>14</sup> instead. Then send the angels an amazing 150-word elevator pitch<sup>15</sup>.

**Don't send them nonsense.** Angels talk to each other and they talk to me. Your reputation is all you've got — so please follow our suggestions in the previous paragraph.

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<sup>9</sup><http://venturehacks.com/angellist>

<sup>10</sup><http://venturehacks.com/angellist#angels>

<sup>11</sup><http://venturehacks.com/angellist#contact>

<sup>12</sup><http://venturehacks.com/articles/minimum-viable-product-examples>

<sup>13</sup><http://www.google.com/search?hl=en&q=customer%20development&aq=f&oq=>

<sup>14</sup><http://venturehacks.com/articles/idea-investors>

<sup>15</sup><http://venturehacks.com/articles/elevator-pitch>

And — stay tuned — we're announcing a sweet new way to reach AngelList soon.

## Get AngelList updates

Get notified about new angels on AngelList via RSS<sup>16</sup> or Twitter<sup>17</sup>. And here's a Twitter list<sup>18</sup> of the angels on AngelList:

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<sup>16</sup><http://feeds.venturehacks.com/angellist>

<sup>17</sup><http://twitter.com/angellist>

<sup>18</sup><http://twitter.com/venturehacks/angellist>

## Launch: StartupList — a new way to reach angels



Yesterday, we launched AngelList<sup>19</sup>, a curated list of angel investors, representing \$80M going into early-stage startups *this year*.

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<sup>19</sup><http://venturehacks.com/angellist>

Today, we're launching a cool new way to get intros to these angels: **StartupList**<sup>20</sup>. It's a weekly email we send to AngelList, with 3 high-quality startups who want intros. Here's how it works: you send us your pitch<sup>21</sup>, we review it and, every Monday, we email the best 3 startups of the week to AngelList.

## **StartupList is already getting meetings for startups**

I'm psyched because StartupList is already working. We released it on Twitter a few weeks ago and 9 investors like Mike Hirshland<sup>22</sup> (Polaris), Matt Mullenweg<sup>23</sup> (Founder of WordPress), and David Cohen<sup>24</sup> (Techstars) have already asked for intros to 7 early-stage startups and counting. See the full list of investors who have gotten intros here<sup>25</sup>. (We're publishing these names with the permission of the investors.)

## **Startups: How to get on StartupList #**

If you're a startup, apply for StartupList here<sup>26</sup>. We welcome startups from all over the world. We look for the same things that early-stage investors look for: traction<sup>27</sup>, social proof<sup>28</sup>, and team<sup>29</sup>. You don't need all 3, but you need to kick ass in at least one of them.

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<sup>20</sup><http://venturehacks.com/startuplist>

<sup>21</sup><http://venturehacks.com/startuplist>

<sup>22</sup><http://venturehacks.com/angellist#mike-hirshland>

<sup>23</sup><http://venturehacks.com/angellist#matt-mullenweg>

<sup>24</sup><http://venturehacks.com/angellist#david-cohen>

<sup>25</sup><http://venturehacks.com/startuplist>

<sup>26</sup><http://venturehacks.com/startuplist>

<sup>27</sup><http://venturehacks.com/articles/plans-ndas-traction#traction>

<sup>28</sup>[http://en.wikipedia.org/wiki/Social\\_proof](http://en.wikipedia.org/wiki/Social_proof)

<sup>29</sup><http://andrewchenblog.com/2009/09/14/building-the-initial-team-for-seed-stage-startups/>

Before you apply to StartupList, build a minimum viable product<sup>30</sup>, put it in front of customers<sup>31</sup>, and learn something about product/market fit<sup>32</sup>. If you can't get this far on your own, find some idea investors<sup>33</sup> instead.

Then write a 150-word elevator pitch and apply to StartupList. Our elevator pitch template<sup>34</sup> is a good place to start. Spend time writing and re-writing the pitch until it's awesome. Get feedback from good writers and entrepreneurs who have raised money. *You have 100% control over the quality of your pitch and there's no reason not to kick its ass.*

## Runners-Up

If you're not one of the 3 startups we highlight on StartupList each week, we may include you in the runners-up of the week. Investors have asked for intros to the runners-up, so it's also a good place to be. One of the runners-up writes, "Where can we send you a small token of thanks? This added some social proof in itself with a couple of the folks we're chatting with. I greatly appreciate it."

## Privacy

No one will review your pitch except the Venture Hacks team: Nivi<sup>35</sup> and Naval<sup>36</sup>. If we send your pitch to AngelList, it's obviously out of our hands, but that's no different than sending

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<sup>30</sup><http://venturehacks.com/articles/minimum-viable-product-examples>

<sup>31</sup><http://www.google.com/search?hl=en&q=customer%20development&aq=f&oq=>

<sup>32</sup><http://www.google.com/search?hl=en&q=product/market%20fit&aq=f&oq=>

<sup>33</sup><http://venturehacks.com/articles/idea-investors>

<sup>34</sup><http://venturehacks.com/articles/elevator-pitch>

<sup>35</sup><http://www.linkedin.com/in/bnivi>

<sup>36</sup><http://startupboy.com/about/>

the pitch yourself. At your request, we can also send your pitch to specific angels instead of the whole list.

## **Angels: How to get StartupList**

While AngelList<sup>37</sup> is public, StartupList is only emailed to the investors on AngelList. If you're an angel, apply to AngelList here<sup>38</sup>. At a minimum, you should have made two \$25K angel investments in 2009 and plan to make two more \$25K investments in 2010.

## **Why we're building StartupList and AngelList**

Entrepreneurs are always asking us if we can introduce them to angel investors. It's one of the most common questions in the startup world. And startups spend a lot of time trying to get these intros. Even the startups who end up raising money from Ron Conway<sup>39</sup>, Fred Wilson<sup>40</sup>, or Sequoia<sup>41</sup>.

We think this is an unnecessary friction and we want to make it easy for qualified entrepreneurs to get intros to qualified investors.

Apply for StartupList<sup>42</sup> and please help us spread the word! I'm looking forward to discussing your feedback in the comments<sup>43</sup>.

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<sup>37</sup><http://venturehacks.com/angellist>

<sup>38</sup><http://venturehacks.com/angellist#angels>

<sup>39</sup><http://www.google.com/search?hl=en&q=ron%20conway&aq=f&oq=>

<sup>40</sup><http://www.avc.com/>

<sup>41</sup><http://www.sequoiacap.com/>

<sup>42</sup><http://venturehacks.com/startuplist>

<sup>43</sup><http://venturehacks.com/articles/startuplist#comments>

## StartupList: Day 1 — Thank You

We're blown away by the support for StartupList<sup>44</sup> and AngelList<sup>45</sup>.

Thank you to TechCrunch<sup>46</sup>, Business Insider<sup>47</sup>, and ReadWriteWeb<sup>48</sup> for describing these lists better than we could.

Thank you to the well-known investors, successful entrepreneurs, and up-and-coming entrepreneurs discussing these lists on Twitter<sup>49</sup>.

Widget: Twitter discussion about AngelList and StartupList<sup>50</sup>

### New angels on AngelList

75 new angels have applied to AngelList<sup>51</sup>. We're going through the applications one-by-one. I added some great investors today:

Chris DeVore<sup>52</sup> from Founders Co-opRobin Klein<sup>53</sup> in London Thomas Korte<sup>54</sup>, an investor in Heroku David Shen<sup>55</sup>, an investor in bit.ly David Rose<sup>56</sup>, a

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<sup>44</sup><http://venturehacks.com/startuplist>

<sup>45</sup><http://venturehacks.com/angellist>

<sup>46</sup><http://www.techcrunch.com/2010/02/03/startuplist-angel-investors/>

<sup>47</sup><http://www.businessinsider.com/a-new-way-to-meet-angel-investors-2010-2>

<sup>48</sup><http://www.readwriteweb.com/start/2010/02/angellist-venture-hacks.php>

<sup>49</sup><http://twitter.com/#search?q=startuplist%20OR%20angellist>

<sup>50</sup><http://twitter.com/#search?q=startuplist%20OR%20angellist>

<sup>51</sup><http://venturehacks.com/angellist>

<sup>52</sup><http://venturehacks.com/angellist#chris-devore>

<sup>53</sup><http://venturehacks.com/angellist#robin-klein>

<sup>54</sup><http://venturehacks.com/angellist#thomas-korte>

<sup>55</sup><http://venturehacks.com/angellist#david-shen>

<sup>56</sup><http://venturehacks.com/angellist#david-rose>

New Yorker with 75 angel investments Shervin Pishevar<sup>57</sup>, founder of SGN Pejman Nozad<sup>58</sup>, an investor in Dropbox

And I didn't even know these three entrepreneurs were angels until they applied to AngelList:

Jeremy Stoppelman<sup>59</sup>, founder of Yelp Joe Greenstein<sup>60</sup>, founder of Flixster Aaron Patzer<sup>61</sup>, founder of Mint

*Silicon Valley has a tradition where entrepreneurs start investing as soon as they can — and that tradition is spreading to the rest of the world.*

## Startups are getting intros

Since we released StartupList<sup>62</sup> on Twitter a few weeks ago, we've introduced 7 startups to 11 investors. With their permission, here's a list of investors who've gotten intros:

Jeff Clavier<sup>63</sup> (Angel in Mint) Bill Lee<sup>64</sup> (Angel in Posterous) Mike Hirshland<sup>65</sup> (Polaris) Chris Yeh<sup>66</sup> (Angel in AppJet) Naval Ravikant<sup>67</sup> (Angel in Twitter)  
Jeff Fagnan<sup>68</sup> (Atlas) Brian Norgard<sup>69</sup> (Angel in ad.ly)

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<sup>57</sup><http://venturehacks.com/angellist#shervin-pishevar>

<sup>58</sup><http://venturehacks.com/angellist#pejman-nozad>

<sup>59</sup><http://venturehacks.com/angellist#jeremy-stoppelman>

<sup>60</sup><http://venturehacks.com/angellist#joe-greenstein>

<sup>61</sup><http://venturehacks.com/angellist#aaron-patzer>

<sup>62</sup><http://venturehacks.com/startuplist>

<sup>63</sup><http://venturehacks.com/angellist#jeff-clavier>

<sup>64</sup><http://venturehacks.com/angellist#bill-lee>

<sup>65</sup><http://venturehacks.com/angellist#mike-hirshland>

<sup>66</sup><http://www.crunchbase.com/person/chris-yeh>

<sup>67</sup><http://venturehacks.com/angellist#naval-ravikant>

<sup>68</sup><http://venturehacks.com/angellist#jeff-fagnan>

<sup>69</sup><http://venturehacks.com/angellist#brian-norgard>

George Zachary<sup>70</sup> (Charles River) Alex Finkelstein<sup>71</sup> (Spark Capital) David Cohen<sup>72</sup> (Techstars) Matt Mullenweg<sup>73</sup> (Angel in DailyBurn)

## How to get on StartupList

We've received 50 new pitches from startups. If you've got a good pitch, don't worry about getting lost in the noise. *A good pitch will stand out* — and we will find a way to help that startup through StartupList or something else. If you've got a great startup on your hands, people will *insist* on helping you out.

Yesterday, we published guidelines for applying to StartupList<sup>74</sup>. We said we look for the same things that early stage investors look for: traction<sup>75</sup>, social proof<sup>76</sup>, and team<sup>77</sup>. But we didn't mention another critical piece of the puzzle: the quality of the pitch itself.

Spend time writing and re-writing an awesome elevator pitch. Our elevator pitch template<sup>78</sup> is a good place to start. Then get feedback from good writers — writers who have fans. *You have 100% control over the quality of your pitch and there's no reason not to kick its ass.*

Apply to StartupList<sup>79</sup>. Browse AngelList<sup>80</sup>. And enjoy the weekend.

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<sup>70</sup>[http://www.crv.com/team/george\\_zachary](http://www.crv.com/team/george_zachary)

<sup>71</sup>[http://www.sparkcapital.com/team/bio/alex\\_finkelstein/](http://www.sparkcapital.com/team/bio/alex_finkelstein/)

<sup>72</sup><http://venturehacks.com/angellist#david-cohen>

<sup>73</sup><http://venturehacks.com/angellist#matt-mullenweg>

<sup>74</sup><http://venturehacks.com/articles/startuplist#get-on-startuplist>

<sup>75</sup>[http://venturehacks.com/articles/plans\\_ndas-traction#traction](http://venturehacks.com/articles/plans_ndas-traction#traction)

<sup>76</sup>[http://en.wikipedia.org/wiki/Social\\_proof](http://en.wikipedia.org/wiki/Social_proof)

<sup>77</sup><http://andrewchenblog.com/2009/09/14/building-the-initial-team-for-seed-stage-startups/>

<sup>78</sup><http://venturehacks.com/articles/elevator-pitch>

<sup>79</sup><http://venturehacks.com/startuplist>

<sup>80</sup><http://venturehacks.com/angellist>

## In a board room, somewhere in Silicon Valley...

... a founder, a VC, and his Associate negotiate a down round.  
Very NSFW.

Video: Old Face Andre talks economics with Omar<sup>81</sup>

Another business lesson from The Wire — about intellectual property: “It ain’t about right, it’s about money.”<sup>82</sup>

## A brief history of your investors (and their investors)

Sponsor Post<sup>83</sup> Thanks to George Zachary<sup>84</sup>, a partner at Charles River Ventures<sup>85</sup>, for sponsoring Venture Hacks this week. If you like this post, check out George’s blog<sup>86</sup> and tweets @georgezachary<sup>87</sup>.  
– Nivi

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<sup>81</sup> <http://www.youtube.com/watch?v=dTIlZUOu0Rc>

<sup>82</sup> <http://venturehacks.com/articles/the-wire>

<sup>83</sup> <http://venturehacks.com/support>

<sup>84</sup> [http://www.crv.com/team/george\\_zachary/](http://www.crv.com/team/george_zachary/)

<sup>85</sup> <http://www.crv.com/>

<sup>86</sup> <http://senseandcents.blogspot.com/>

<sup>87</sup> <http://twitter.com/georgezachary>



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Why should you read this post? So you know what questions to ask your potential investors about *their* investors (their limited partners<sup>89</sup>). You need to understand how your investors are compensated, how they're motivated, and how they'll act in critical situations — so you know if you and your investor's commitments are well aligned.

By the end of this two-part post I'll provide a list of questions to ask investors to help determine if they're the right investors for you. This post focuses on the history of venture capital. The second post will focus on the present and future of venture capital and how it will affect startups.

**Some say that startups should raise smart money but not dumb money. Others say all the money is green, so there's no difference. The issue is more complex than that. And this complexity involves the capital sources that your investors use as well as the terms of their agreements with limited partners (LPs).**

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<sup>88</sup>[http://www.crv.com/team/george\\_zachary/](http://www.crv.com/team/george_zachary/)

<sup>89</sup>[http://en.wikipedia.org/wiki/Venture\\_capital#Structure\\_of\\_Venture\\_Capital\\_Firms](http://en.wikipedia.org/wiki/Venture_capital#Structure_of_Venture_Capital_Firms)

## **Angels invest their own money, VCs invest their LP's**

Venture capital firms have limited partners. These limited partners come in all shapes and sizes from all over the world. And in turn these limited partners are frequently entities that are funnels for other sources of money.

Traditionally, angel investors were individuals that would use their own personal capital to make an investment. Recently, “seed stage” venture firms have emerged that have between one to three partners. These seed stage firms are usually backed by institutional limited partners or even by venture firms. They are really small venture firms that present more like angels because there are usually one or two partners running the seed stage firm.

To understand how these angel and VCs roles came to be, we need to look back in history.

## **1960's and 1970's: LPs realize they can seek alpha in VC**

Let's go all the way back to the 1960's and 1970's — early days in technology angel and venture investing. There were very few venture firms at the time. Most of them were formed by former technology executives who had had enough of operating but wanted to stay involved in startups. So they took some of the cash they made during their operating careers and started investing in companies that were in their work or social domain. **And soon, corporate financial services and university endowments realized that these former execs-turned-angel investors had good instincts about which companies to invest in.**

Meanwhile, these corporate financial services and university endowments started to apply financial asset allocation theories to their portfolio. It's well known in financial theory that the allocation of capital in a fund across asset classes is the single most important decision that affects the fund's return and volatility. In addition to having investments in liquid public equities, they also had investments in oil & gas funds, real estate, commodities, and other asset classes. These endowments (the early limited partners) started looking for "alpha<sup>90</sup>" so they could outperform other limited-partner managers. So they created a new asset class with the highly descriptive name of "Alternative Assets."

The LPs saw that angel investors and early venture firms made some spectacular returns. For example, MCI and Amgen came out of early small funds like Charles River Ventures and Genentech came out of Kleiner Perkins. **So the LPs got smart and said, "Aha, let's allocate some of our alternative investments to venture capital."** In a way, it became the asset they could invest in to differentiate their performance from their competition. And to also earn a healthy bonus for themselves for "winning."

These financial services companies and endowments would back these angel investors in a firm structure that usually took the form of a limited partnership — which, not incidentally, is totally different than an operating company. A limited partnership has limited partners and general partners; the limited partners are the major sources of capital. Historically, the limited partners would get 80% of the fund's returns and the general partners would get 20%. The funds were small — for example, Charles River Ventures was \$5M in 1970 and Kleiner Perkins was \$7M. Most of the capital came from the limited partners.

General partners would typically get a 2% annual management fee. At that time, venture firms had small headcounts and the

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<sup>90</sup>[http://en.wikipedia.org/wiki/Alpha\\_investment](http://en.wikipedia.org/wiki/Alpha_investment)

2% fee on the small fund was used to cover business expenses like rent, travel, administrative staff, and meals. The fees were not a way to earn a living. And through the 1970's, venture capital marginally outperformed the horrific public market.

## **Early 1980's: Weak public markets tighten VC money**

In the early 1980s, the 15-year public equity disaster came to an end. The public market literally went sideways from 1966 to 1981. If you invested \$1 in the public stock market in 1966, you would have \$1 in 1981. Worse, if you accounted for inflation, you only had 70 cents!

**Because of the weak public market, startup valuations were low and investment syndicates were a must. Founders looked for deep pockets, not just easy pockets. In short, money was tight, not a commodity.**

Investors were concerned that there would be few exits and worried that, even if companies became cash flow-generating businesses, they wouldn't necessarily become high margin, high value companies. A whole host of terms became important in the term sheet like redemption rights, dividends, and participating preferred.

## **1982: Low interest rates and successful technology companies lead LPs to invest even more in VC**

Starting in 1982, interest rates fell from 15%+ to 5%, paving the way for a lot of available capital as well as a lot of profit generation. These profits fed back to limited partners, who, in turn, pumped the profits back into venture capital through their "alternative assets" allocation, which was now 5% of their manageable funds. So the terms of limited partner's investments

in venture firms loosened up a bit, which also permitted venture firms to loosen up the terms of their investments into startups.

At the same time, technology companies like Apple and Microsoft were printing money. It was in the air that technology companies would disrupt and create new industries. And our government was printing actual paper money and creating a lot of debt to fund the deficits spurred by high defense spending and other spending. So there was a lot of new liquid capital.

All this extra capital boosted the size of venture funds. There were serious and large limited partners that wanted to place a lot of capital into these well-performing venture funds. These limited partners were university endowments, insurance companies, charitable foundations, as well as “fund-of-funds,” which were channels that would pool the capital of small limited partners that didn’t have the capital base or reach to invest in these venture firms.

## **1982–2000: \$120B goes into venture firms in 2000 alone**

Meanwhile, the 1980s and 1990s marched on, with the public market taking off and seeing an annualized 18% return into 2000. Limited partners were also happy because they were getting good returns, and venture firms were growing and specializing by domain. By 1996, venture firms had total capital of \$12B+ and the average venture fund was about \$120M.

In the next four years, the public market went ballistic and became a huge bubble. This was partly a social phenomenon, but it was also because of the Fed, which provided easy money at low interest rates. Also, the Fed, fearing a market collapse caused by Y2K problems, was pumping the market with liquidity in 1999.

**Valuations on the private market skyrocketed across all stages and private companies were raising capital at billion dollar valuations fairly early in their development. The time frame also accelerated: investments were made within days to weeks and diligence was measured in days.**

By 2000, limited partner's returns were turbocharged and top venture firms saw annualized returns of more than 200% — far in excess of the public market. In fact, from 1995 to 2000, a total of \$180B was invested into venture capital and approximately \$325B was returned to limited partners. And what did the limited partners do? They put in more money. In fact, they invested \$120B into venture capital firms in 2000, a tenfold increase in five years.

Limited partners were very happy with their returns from venture firms and did whatever it took to place their capital into these firms. It was like a feeding frenzy to raise a fund. **My partners and I raised a \$300M fund in three weeks during that period.** It was just really easy. Limited partner allowed select venture firms like CRV to have better carry (25%-30%) and terms between entrepreneurs and VCs loosened up again.

## **2002-2009: \$205B goes into VC but only returns \$220B to LPs**

So far so good — until we hit the year 2000, when the public market cratered and limited partners and the broad populace scrambled to defend their portfolios. Cash liquidity decreased and limited partners got very concerned about how some venture firms were being run. They also began to worry about the ballooned size of most venture funds.

But that worry didn't last long enough, as the Fed began pump-

ing more money into the system to “save” the United States from a recession. The great housing bubble started to grow and the public market began a strong rise in 2003, a rise that buoyed the public market portion of the limiter partners’ funds. LPs began to feel and think more positively, resulting in more capital flowing back to venture capital with good terms intact. Limited partners also began to characterize the bubble as the result of macro forces that were then tamed by Alan Greenspan. As a result, the limited partners rationalized away their worry about venture firms and we soon found ourselves returning to \$30B/year going into venture capital each year. This was more sane, but not totally sane.

As the public markets improved, limited partners (who are now both domestic and international capital sources) worried that too much of their portfolio was in the public market and started pumping more money into venture capital firms. From 2002 to 2009, a total of \$205B was invested into venture capital, and approximately \$220B was returned. You can do the math. That is not a good return for the whole asset class.

What happened? **A big part of the problem was that the public market never really responded like it did in the 1990s.** The stock market blowout left collective scars across retail and institutional public market investors. **There was no crazy bubble period, which was a problem because the amount of venture capital in total was still way too high given the total return.** And while venture capital returns did slightly outperform that public market over the decade ending in 2009, the public market returns and private venture capital returns diverged in terms of the median return per company.

## **LPs: “The fund I invest in better be investing in the next Google.”**

Along the way, something interesting happened to the shape of the return curve. In the 1980s and 1990s, venture capital returns were usually Gaussian with respect to their portfolios. Yes, there was Benchmark’s investment in eBay and a couple of others that created 1000x returns. But most of the exits were shaped around \$300M exits. A big exit was a 10x return.

In the 2000s, the middle of that curve got blown out, making a lot of portfolios look bipolar. Most portfolio companies returned less than the capital that was put in. And a few companies generated astronomical results: Google measured in the 1,000X to 10,000X multiple. Limited partner data showed that eight venture funded companies a year were generating the vast majority of venture firm profits, and that’s out of a universe of three to four *thousand* companies funded every year.

Pretty soon this was common knowledge across the limited partner community, and the top limited partners — in terms of size and longevity — were looking for these “return the fund” opportunities when venture firms talked about their investments with them. If you couldn’t speak about a potential “billion dollar opportunity,” limited partners thought you really weren’t in the game. **This data started a conversation across the limited partner community, which usually included the words “the fund I invest in better be investing in the next Google.”** And limited partners liked to bring that up in their conversation with venture firm’s partners, “Which one of these companies can return the whole fund?”

Additionally, a decade had passed since the 2000 blowout. The decade returns for venture capital in aggregate were weak and limited partners started to reassess how, who, and what venture firms to invest in. And then the savage bear market that started in late 2007 started to ravage the limited partners’ port-

folios again. This was the start of limited partners asking tough questions and looking for proof of how returns would get generated over the next decade.

## **2010: The balance of power shifts to limited partners?**

Limited partners face the issue of diminishing returns because they also have shareholders. Likewise, the venture firms and seed stage firms that are down the pipeline from these limited partners are also subject to these hard questions.

Today, we're beginning to see a shift of money turning back into a commodity. But without the massive government bailouts, it turns out that money supplies like M2<sup>91</sup> are declining, indicating that the core economic environment is one of deflation. This means that cash is gathering more value than any asset, and this macro shift will shift the balance of valuation and terms in favor of the root sources of capital.

In the next post, I will review what this means for direct investors and what it means for portfolio companies. I'll also include a list of questions to ask your potential investors to ensure that they're the right investors for your company.

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<sup>91</sup>[http://en.wikipedia.org/wiki/Money\\_supply](http://en.wikipedia.org/wiki/Money_supply)

**“He has no clue whether it will be another Google, yet he has to make promises that only hucksters can make.”**



<sup>92</sup>Ho Nam<sup>93</sup> (@honam<sup>94</sup>):

“The blockbusters are oftentimes the ‘ugly ducklings.’ Cisco is probably the best example in the VC world. Everyone passed except for Sequoia. In the book world, almost everyone passed on JK Rowling.

“It’s just hard to predict the future looking into the rear-view mirror, yet everyone wants to pile onto the brand names [VCs] and they in turn pile into the hot deals in droves pushing up valuations to unsustainable levels.

“It doesn’t help the poor entrepreneur who just wants a little capital to back his dream. *He has no clue*

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<sup>92</sup><http://blog.altosventures.com/>

<sup>93</sup><http://blog.altosventures.com/>

<sup>94</sup><http://twitter.com/HoNam>

*whether or not it will be another Google, yet in order to raise VC funding he has to make promises that only hucksters can make. The VCs in turn make those same promises to LPs and some LPs actually believe the nonsense. What a shame.”*

*Emphasis added.* Read Ho’s full comment<sup>95</sup>. Also see Simeon Simeonov’s How to raise money without lying to investors<sup>96</sup>.

## My experiments in lean pricing

*This guest post is by Ash Maurya<sup>97</sup>, a lean entrepreneur who runs a bootstrapped startup called CloudFire<sup>98</sup>. If you like it, check out Ash’s blog<sup>99</sup> and his tweets @ashmaurya<sup>100</sup>. – Nivi*



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What you charge for your product is simultaneously one of the most complicated and most important things to get right. Not only does your pricing model keep you in business, it also signals your branding and positioning. And it’s harder to iterate on pricing than other elements of your business. Once you set a price, coming down is usually easier than going up.

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<sup>95</sup> <http://venturehacks.com/articles/history-of-investors#comment-11032>

<sup>96</sup> <http://venturehacks.com/articles/lying-to-investors>

<sup>97</sup> <http://www.ashmaurya.com/>

<sup>98</sup> <http://www.getcloudfire.com/>

<sup>99</sup> <http://www.ashmaurya.com>

<sup>100</sup> <http://twitter.com/ashmaurya>

<sup>101</sup> <http://www.ashmaurya.com/>

## Should I charge for my MVP?

Most people choose to defer the “pricing question” because they don’t think they (or the product) are ready. Something I hear a lot is that a minimum viable product is by definition (embarrassingly) minimal. How can you possibly charge for it?

A minimal product is not synonymous with a half-baked or buggy product. If you’ve followed a customer development process, your MVP should address the top 3 problems customers have identified as important *and it should do it well*. You can ensure that by dedicating 80% of your efforts to improving existing features versus cranking out new ones.

Steve Blank<sup>102</sup> bakes price exploration right into the initial customer interviews. Price, like everything else, is built on a set of hypotheses that needs to be tested early. Steve suggests you ask potential customers if they’d use the service for free. This is to gauge if the product’s value proposition is compelling at all. You then ask if they’d use the service for \$X/yr. How do you come up X? You can simply roll the dice and adjust along the way, or use Neil Davidson’s excellent guide to software pricing<sup>103</sup> to start with a more educated guess. Once your MVP is built, Steve asks you to sell it to your early customers. There is no clearer customer validation than a sale.

Sean Ellis<sup>104</sup>, on the other hand, argues that achieving initial user gratification (product/market fit) is the first thing that matters and suggests<sup>105</sup> keeping price out of the equation so as not to create unnecessary friction:

“I think that it is easier to evolve toward product-/market fit without a business model in place (users

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<sup>102</sup><http://www.steveblank.com>

<sup>103</sup><http://www.neildavidson.com/dontjustrollthedice.html>

<sup>104</sup><http://startup-marketing.com/>

<sup>105</sup><http://venturehacks.com/articles/qa-sean-ellis>

are free to try everything without worrying about price). As soon as you have enough users saying they would be very disappointed without your product, then it is critical to quickly implement a business model. And it will be much easier to map the business model to user perceived value.”

**Both Steve and Sean advocate removing price from the equation — but at different points.** Steve removes price during the customer discovery process but suggests you charge for your MVP. Sean removes price from the MVP and suggests you charge after product/market fit. I can see the merits of both approaches and wondered which was right for my product: CloudFire<sup>106</sup>: Photo and Video Sharing for Busy Parents.

## Why not use freemium?

On the surface, freemium seems like the best of both worlds: Get users to try your service without worrying about price, then up-sell them into the right premium plan later. However, many people make the mistake of giving away too much under the free plan, which leads to low or no conversions. It’s human nature — we all want to be liked.

More important, we don’t yet have enough information to know how to price or segment the feature set. I made this mistake with my first product, BoxCloud: an early visionary customer called me up and said, “I really like your product and want to pay for it but your pricing doesn’t require it.” After a few more iterations of segmenting the feature set, I decided to forgo the free plan and simply offered premium plans with a trial period. Sales went up and so did the quality of feedback, which I attribute to the difference between feedback from customers versus users.

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<sup>106</sup><http://www.getcloudfire.com>

(Hiten Shah<sup>107</sup> shared a similar story with me around his experience with Crazy Egg<sup>108</sup>. Even 37signals has greatly deemphasized their free plans<sup>109</sup> to almost being fine print on their pricing pages.)

Lincoln Murphy just published a timely white paper on “The Reality of Freemium in SaaS<sup>110</sup>” which covers many important aspects to weigh when considering Freemium, such as the concept of *quid pro quo* where even free users have to give something back. In services with high network effects, participation is enough. But most businesses don’t have high enough network effects and wrongly chase users versus customers. What I particularly liked in this paper is Lincoln’s recognition that *“Freemium is a marketing tactic, not a business model.”*

I strongly feel that, especially for SaaS products, starting with free and figuring out premium later (all too common) is backwards. If you know you are going to be charging for your product, start by validating if anyone will pay first. There is no better success metric and it leads to less waste in the long run. **Focusing on the premium part of freemium first lets you really learn about your unique value proposition — the stuff that will get you paid. You can then come back and intelligently offer a free plan (if you still want to) with more intelligence and the right success metrics clearly defined.** Even if you think you have a one-dimensional pricing plan like I did (e.g. number of projects), you’d be better served testing it with paying users because pricing experiments take a much bigger toll than other types of experiments.

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<sup>107</sup><http://twitter.com/hnshah>

<sup>108</sup><http://www.crazyegg.com>

<sup>109</sup><http://basecamphq.com/signup>

<sup>110</sup><http://sixteenventures.com/blog/the-reality-of-freemium-in-saas.html>

## Testing price in interviews

How did I put all this to test? The biggest mind shift in following a lean startup process is going from thinking you know something to testing everything you think you know.

So I followed Steve Blank's advice and built some pricing questions into my initial face-to-face customer interviews. Because CloudFire is a re-segmented product in an existing market, potential customers referred to competitor pricing. This had to be balanced against the perceived value of our unique value proposition – *saving time with faster and easier sharing of lots of photos and videos*. Through these interviews I determined that, like their sharing needs, my potential customers valued simple hassle-free pricing and \$49/year for unlimited photo and video sharing was a fair price they were willing to pay. That is what I charged them once my MVP was ready.

## Testing price on the web

I wanted to run the same set of pricing tests with web visitors that I did during my interviews. Short of split testing a free and paid version of the MVP, which is technically illegal (update<sup>111</sup>) and unfair to paying customers, I decided to split-test 3 different products with 3 different prices:

1. \$49/yr for unlimited photo and video sharing
2. \$24/yr for unlimited photo sharing
3. FREE for 500 photos

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<sup>111</sup><http://venturehacks.com/articles/pricing-experiments/comment-page-1#comment-11204>

All plans have a 14-day free trial with the exception of the free plan which is free forever. Here are the variations I tested:

### **Original: Single unlimited plan**

This is the simple option I discovered during customer discovery interviews. It served as the control.

The screenshot shows a dark-themed sign-up page for a service. At the top, it says "Try us Free for 14 days." Below that, it states "Then pay just \$49/year for unlimited photos and videos." A note follows: "No credit card required. No strings attached. If you don't fall in love with CloudFire, your account will automatically cancel after 14 days." A large button below reads "Start sharing your special moments in under 60 seconds." Underneath the button, there's a section for connecting via Facebook, with the text "Use your Facebook account:" and a "Connect with Facebook" button. An alternative section for non-Facebook users follows, with the text "Or, if you don't have a Facebook account:" and a "Create a new CloudFire account" button.

### **Variation 2: Multiple plans**

I segmented the product into 2 offerings: unlimited photos+video and unlimited photos only. I wanted to test price sensitivity and gauge interest in video sharing. Not many people I interviewed were currently taking lots of videos but they all wanted to be taking more.

**Try us Free for 14 days.  
Then pick a plan that's right for you.**

No credit card required. No strings attached.

If you don't fall in love with CloudFire, your account will automatically cancel after 14 days.

Plus	Basic
\$49/year <a href="#">Unlimited Photos and Videos</a>	\$24/year <a href="#">Unlimited Photos</a>
<a href="#">Unlimited photos</a> <a href="#">Unlimited videos</a> <a href="#">Unlimited galleries</a>	<a href="#">Unlimited photos</a> <a href="#">No video</a> <a href="#">Unlimited galleries</a>

### Variation 3: Freemium

This has the 2 plans from above along with a limited free plan. Yes, this is a freemium plan. I wanted to measure if a limited free plan would disproportionately drive the right type of traffic (busy parents in my case).

**Try us Free for 14 days.  
Then pick a plan that's right for you.**

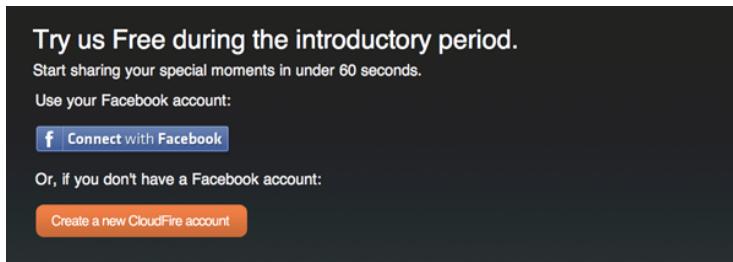
No credit card required. No strings attached.

If you don't fall in love with CloudFire, your account will automatically cancel after 14 days.

Plus	Basic	Free
\$49/year <a href="#">Unlimited Photos and Videos</a>	\$24/year <a href="#">Unlimited Photos</a>	<a href="#">Free forever</a> <a href="#">2GB storage</a>
<a href="#">Unlimited photos</a> <a href="#">Unlimited videos</a> <a href="#">Unlimited galleries</a>	<a href="#">Unlimited photos</a> <a href="#">No video</a> <a href="#">Unlimited galleries</a>	<a href="#">500 photos</a> <a href="#">No video</a> <a href="#">1 gallery</a>

### Variation 4: No Price During Introductory Period

I added a fourth variation to test Sean Ellis' advice on removing price till product/market fit, but I tested this differently. I was not comfortable offering the full product for a price and for free at the same time. So rather than including this page with my A/B tests, I instead tested it with new parents I interviewed.



## The Results

**First Place:** The original single plan — second place in conversions and best overall performer. Surprisingly, the original page was the best overall performer.

**Second Place: Variation 3: Freemium – most conversions but second place overall.** Not surprisingly, the freemium variation drove the most conversions but only outperformed the original by 12% and had the lowest retention. Referral stats combined with random polling/emailing revealed a majority of the users that signed up were just curious (and not parents).

**Third Place: Variation 2: Multiple plans – least conversions and worst overall performer.** People reacted least favorably to the two paid plans.

**Non-starter: Variation 4: No price during introductory period.** Parents I interviewed did not understand the intro-

ductory period without explanation and were reluctant to try the service without knowing how much the service was going to cost. Probing further, they weren't willing to invest the time building up web galleries and inviting others only to find that the service might be priced out of their expectation.

## What I learned

It does pay to align pricing with your overall positioning. Our unique value proposition is built around being “hassle-free and simple” and people seemed to expect that in the pricing model as well. A lot of our existing customers were already paying for their existing sharing service so the leap from free to paid was not a big one. While Sean suggests removing price before fit for consumer facing products, he suggests always charging for enterprise customers to gain their commitment. This is another case where pricing needs to be explicit. Using Cindy Alvarez's model<sup>112</sup>, our customers appear to be Time-Poor, Cash-Rich. Offering no-hassle free trials was sufficient to remove the commitment risk. Money back guarantees might be another way to further lower this risk.

The biggest lesson learned, though, is how accurate my initial customer interview findings were, compared to all the hypotheses that followed. Pricing is more art than science and your mileage will vary, but whenever possible get out of the building, talk to a customer, and consider testing price sooner rather than later.

What do you think? Why do you think these variations finished the way they did? What other variations would you like to see us try? How else do you think we could increase conversions? I'm looking forward to discussing your responses in the

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<sup>112</sup>[http://www.cindyalvarez.com/profitability/  
is-your-pricing-a-dot-or-a-triangle](http://www.cindyalvarez.com/profitability/is-your-pricing-a-dot-or-a-triangle)

comments<sup>113</sup>.

## How to optimize web apps with KISSmetrics

SPONSOR POST

*Thanks to KISSmetrics<sup>114</sup> for supporting our interview with Sean Ellis<sup>115</sup>. If you want an intro to KISSmetrics, send me an email. I'll put you in touch if there's a fit. Thanks. – Nivi*



<sup>116</sup>Hiten Shah<sup>117</sup> from KISSmetrics<sup>118</sup> recently sat down with me to discuss how to optimize funnels with their upcoming analytics tool, KISSmetrics<sup>119</sup>.

You may know Hiten from his Crazy Egg<sup>120</sup> days and survey.io<sup>121</sup>, which Hiten and I discussed in How to measure product/market fit with survey.io<sup>122</sup>.

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<sup>113</sup><http://venturehacks.com/articles/pricing-experiments#comments>

<sup>114</sup><http://kissmetrics.com/>

<sup>115</sup><http://venturehacks.com/articles/sean-ellis-interview>

<sup>116</sup><http://kissmetrics.com/>

<sup>117</sup><http://hitenshah.name/>

<sup>118</sup><http://kissmetrics.com>

<sup>119</sup><http://kissmetrics.com>

<sup>120</sup><http://crazyegg.com/>

<sup>121</sup><http://survey.io/>

<sup>122</sup><http://venturehacks.com/articles/measure-fit>

SlideShare: How to optimize your web apps with KISSmetrics<sup>123</sup> Audio: Interview with chapters<sup>124</sup> (for iPod, iPhone, iTunes) Audio: Interview without chapters<sup>125</sup> (MP3, play anywhere) Transcript: See below

## Prerequisites

You'll get more out of this interview if you also read:

1. Our interview with Sean Ellis parts 1<sup>126</sup> and 2<sup>127</sup>.
2. Our previous interview with Hiten: How to measure product/market fit with survey.io<sup>128</sup>.

## Outline

Here's an outline and transcript of the interview. The interview and transcript are about 23 minutes long and we've highlighted some of the juicier bits for you.

1. After fit, prepare for growth
2. KISSmetrics helps you optimize your funnel
3. KISSmetrics helps with all optimization steps
4. First user experience isn't necessarily the paid user experience

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<sup>123</sup><http://www.slideshare.net/venturehacks/how-to-optimize-web-apps-with-kissmetrics-3042804>

<sup>124</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/01/How-to-optimize-web-apps-with-KISSmetrics-Hiten-Shah-Interview.m4a>

<sup>125</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/01/How-to-optimize-web-apps-with-KISSmetrics-Hiten-Shah-Interview.mp3>

<sup>126</sup><http://venturehacks.com/articles/sean-ellis-interview>

<sup>127</sup><http://venturehacks.com/articles/sean-ellis-interview-2>

<sup>128</sup><http://venturehacks.com/articles/measure-fit>

5. KISSmetrics is most valuable after fit
6. How Cloudfire uses KISSmetrics during fit
7. Startups aren't a science — but we're getting closer
8. How other people use KISSmetrics
9. KISSmetrics is on it's third iteration
10. Why KISSmetrics' hasn't launched
11. KISSmetrics tracks actions on a per-user basis
12. KISSmetrics lets you calculate customer LTV
13. Get more startup advice

## Transcript

*Music: Squarepusher*<sup>129</sup>

**Trent Wolodko:** Hey there everybody, my name's Trent and I'm new to Venture Hacks. I'm going to be helping with producing content for the site so that the guys can concentrate on bringing you good advice faster and more furiously than ever. Today Nivi speaks once again with Hiten Shah from KISSmetrics.com. He spoke with Hiten recently about survey.io and today he'll be talking to him about optimizing your web apps using the tools over at KISSmetrics. Right off the bat, these guys make a lot of references to Nivi's interview recently with Sean Ellis about bringing your product to market as well as his former interview with Hiten regarding survey.io. So, you may want to check out those interviews as well on the site. The guys have a lot of ground to cover as you can see, so without further adieu, I'll throw it over to them...

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<sup>129</sup><http://www.google.com/search?hl=en&q=squarepusher&aq=f&oq=>

**Babak Nivi:** So the second part of the interview with Sean is what activities you do to prepare for growth. Right?

**Hiten Shah:** Yeah.

### **After fit, prepare for growth**

**Nivi:** One of the insights that I got from the interview was that you do a whole bunch of stuff to get to fit. That's step one. Then step two is that you do a whole bunch of stuff to get ready to prepare for growth.

**Hiten:** Yeah.

**Nivi:** And Survey.io is great for the product/market fit stage, where you're trying to get the fit. And you guys also have a product called KISSmetrics, which helps you prepare for growth, or to put it another way, to optimize.

**Hiten:** Yup, and that's our main product.

**Nivi:** So, what does it do?

### **KISSmetrics helps you optimize your funnel**

**Hiten:** First, it's an analytics product, pure and simple, but the difference is that it's meant to do one thing really well, and the thing it does really well is help you optimize a funnel – help you understand what your funnel looks like for whatever type of product you have.

**Nivi:** So, Sean has a few steps in the optimization stage, right?

**Hiten:** Absolutely.

### **KISSmetrics helps with all optimization steps**

**Nivi:** Economics: put into place a business model and optimize it. For example, change your price or change the way that you charge, completely, whether it's by the year or by the pound or

however. So that's the economic step. That requires optimization.

There is the positioning step – how you describe the product – which also requires optimization.

And then there is the step of essentially moving people through the funnel and getting them to the finish line. That requires optimization.

**Hiten:** Yup!

**Nivi:** How do I use KISSmetrics in any of those?

**Hiten:** You can use them in all of them, because when you have economics in place it means that you're charging customers and that you need to understand things like how different price points affect your revenue. In essence, it's a funnel. You're still funneling people through a sign-up process, and you might be A/B testing two different things.

So we facilitate some level of A/B testing today, because you can pass in the data and visualize it, but in the future we're going to start adding more components around A/B testing and optimization. Right now it's a hard focus on helping people understand their funnel, but then that goes into both of those areas we were talking about.

So, in the economic stage it's just about when you're testing different pricing plans and things like that, and understanding if there are any differences, also, in different channels of customers depending on where they came from, and if your revenue is different for those based on the price points.

Then on the promise side you're probably doing a lot of things around testing landing pages and things like that, so you'd build different funnels for different landing pages and different cohorts of users, and we completely facilitate that, as well.

**Nivi:** So you let me – and maybe you can just send me a couple screen shots that I can put in – compare two

cohorts, how many people get to the finish line based on their channel, based on the positioning that they saw on the landing page, based on the final price or business model that they saw that we offered them, and also based on what Sean calls that “first experience.”

**Hiten:** Yeah, first user experience.

**First user experience isn't necessarily the paid user experience**

**Nivi:** The first user experience, which is just kind of the funneling. I mean, it's everything.

**Hiten:** Yeah, but it's primarily how to optimize your on-boarding process of first-time customers so you can make that more efficient – efficient meaning highest conversion rates – and so that you can spend on marketing and you understand what the value is of each user.

**Nivi:** What does that mean to you, other than a conglomeration of the landing page and all the steps between that and putting the credit card in or signing up?

**Hiten:** In every product there are a number of steps people take to get gratified with the product. Gratification, usually in freemium products, happens during the free period, most likely, that instant gratification, and then they have another reason to go pay. So it's all about understanding how people are moving through those stages of their usage of your product. So the idea is to track all the different events of gratification and optimize against that. And there are always steps in between before they're gratified.

For the first gratification, they have to sign up. They probably have to fill out a form. They probably have to install something, or depending on what type of product it is there are a number of things they need to do before they feel satisfied that this is a must-have product. And once they hit that point, then you're

going to have an ask of asking them to upgrade, and making sure they hit a point where.... It's really about you trying to understand what point they hit before they're willing to give you money, and understanding the different things you can do around that to encourage them to give you money.

This all has to do with, if you have free plans, you've optimized your first user experience. Now you really need to understand what the prompts are and where you put them to get them to pay you money. So it's all about prompt optimization.

An example is if you have an analytics product and you have a free plan, but you want to charge users, you probably need to put prompts in different places, as customers do different things with the product, to get them to pay, basically.

**Nivi:** In order for KISSmetrics to be useful to me, should I be done with the product/market fit stage. In other words, should I have 40% must-have users, or can I use KISSmetrics earlier, effectively?

### **KISSmetrics is most valuable after fit**

**Hiten:** The short answer is that I think KISSmetrics is most valuable after product/market fit. But, this is one of those things where creating a startup and the steps to creating a startup aren't defined yet. People look at them in all different ways.

I think both Sean Ellis and Eric Ries are making a lot of noise and movement, and there are a few other people like Dave McClure that are doing all of this, to get people to think of it more as a methodology, and there are different stages to a company and different things you should do at each stage. So if you follow one of those methodologies or one of those mindsets or theories, what you really want to do is wait until you have product/market fit before you optimize first user experience.

My own example is that we're not optimizing our first user ex-

perience for KISSmetrics right now. We're getting users in, but we're not optimizing it because, really, that's not the important part right now. The important part for us is getting enough users and building and iterating on the product to make it so that it's something they can't live without. And that's not a quantitative thing; that's not something where if I can measure how they go through a funnel, it's going to necessarily help them. It's more about things I need to add in the product, and it's a little more of a fuzzy goal. Honestly, hitting product/market fit, in my opinion, is a pretty fuzzy goal.

**Nivi:** Tell me how Ash, who has written about this...What's the name of his company? CloudFire? Is that right?

**Hiten:** Yeah.

**Nivi:** How is he using KISSmetrics actually in the product/-market fit stage? Is that right?

### How Cloudfire uses KISSmetrics during fit

**Hiten:** Yeah. What he's actually doing is combining a few ideas. Dave McClure has something called AARRR!! that's a framework that he came up with years ago. He's also one of our advisors, for a good reason. And he spread a lot of the religion of metrics, so a lot of people say he's the church of metrics.

But basically, what it does is break down your business metrics for a startup into 5 different things. Acquisition, which is metrics around how you acquire customers, what channels are profitable or what channels are bringing in customers and how you're bringing them in. So it's more like market.

**Nivi:** So you define acquisition.

**Hiten:** Yeah.

**Nivi:** One definition might be: they signed up.

**Hiten:** Yes, exactly. They signed up, and where they signed up from.

What Ash has done is taken acquisition and made a funnel for it, and he calls it the acquisition funnel in KISSmetrics.

Then the next one is Activation, which is how to get them to have their first gratifying experience. They've activated with the product. They've used it. They've experienced it.

**Nivi:** And in his case it's something like, they downloaded my software and uploaded some photos with it. Something like that.

**Hiten:** Exactly! Exactly. It's like they activate it, which means they downloaded it and uploaded a photo. They had the first experience of using it.

And then the next one is Retention, which is that they came back or they used it multiple times or some factor of that. It depends on what your startup is. So for him it may be that they used it once, but then they used it a second time and that would be retention.

**Nivi:** In thirty days, say, they use it again.

**Hiten:** Yeah. So he's got another funnel around that.

And then the next one is Referral. That one is more like, are they referring other users? And that's a whole thing in itself; it's 'forward to a friend' and 'contact importer' kind of stuff. There are all kinds of things around referral.

**Nivi:** Tweet about it.

**Hiten:** Yeah. That also gets into virality and all of that kind of stuff.

And then the last one is Revenue. So he's got some revenue funnels around all of the prompts. I don't know if this is exactly what he's doing, but this is what I would imagine he would be doing. I don't look into his account; I just talk to him and read his blog posts.

**Nivi:** That's good.

**Hiten:** He's probably got a funnel that's focused around the prompts that he's using to get people to pay. So he's actually using it [as an] analytics tool, in general. People end up using it whatever way they want, and that's one of our challenges, which is that we really need to figure out what type of use-cases we want to support.

**Nivi:** Question number 6 or 7.

[laughter]

**Hiten:** Yeah. You got it. So we're not even there yet of giving out that survey, but we will be soon enough, hopefully.

**Nivi:** I think it will be interesting to see how his activation and retention numbers tie into the must-have segment.

**Hiten:** Agreed. Yeah.

**Nivi:** Probably mostly on the retention, if I'm thinking about it right now correctly, because for the person to even be a user that you would survey with Survey.io, you'd probably want them to already be activated.

**Hiten:** You might even want them to be a retained user, and hit the retention step.

**Nivi:** Yeah, you'd want them to be retained. Right.

### **Startups aren't a science — but we're getting closer**

**Hiten:** So I think he's actually using it in a very interesting way that we're probably going to study a little bit deeper, because Dave's an advisor and we buy into his theories. Actually, our first iterations of this product, which not many people saw, each of those was a view in our system, so we're actually very intrigued by what he's doing with our product. But again, I don't think startups are a science yet, and I think we're getting closer and closer to it, so it just really depends on what people subscribe to. All we can provide is a tool at the moment, and then hone in on these different use cases of it.

**Nivi:** Right. One thing that Sean actually mentioned in the interview is that he doesn't see a lot of correlation between the recommendation figure and "success of the startup."

**Hiten:** Right.

**Nivi:** Whereas he sees a fair amount of correlation between the success and the must-have figure. So that's one thing to keep in mind for Ash, perhaps.

**Hiten:** Sure.

**Nivi:** And then, too, just in your case, like you were saying, with KISSmetrics, the way you're bringing it to market is very feature oriented right now, and then you'll figure out the positioning based on qualitative conversations with customers.

**Hiten:** You've got it. Right now it's more about product and how to tweak the product. I hate to call it features because for us, actually in the market we're in, every analytics product has hundreds of features. We actually want to provide the features that matter, so that's kind of the difference.

It's basically iterating on the product and making it so people like Ash love it. There are probably a number of things... He might already love it. He might be a very unique case where he's been looking for something like this. But a lot of other people, I get on calls with these people or talk to them, and....

**Nivi:** So how do other people use it?

### **How other people use KISSmetrics**

**Hiten:** How they're using it is that there are several Facebook applications that are using it. They're using it to optimize their own funnels and just optimize the conversion rates between each step, and things like that – normally what you would do with funnel optimization.

And then other folks, like SaaS businesses that are using it, are buying traffic from AdWords and they're passing in the dollar

value for their customers at one of the steps, and they're just basically optimizing the funnel, but based on revenue because that's what their main goal is and they've already got their revenue set up.

**Nivi:** So, visualize the funnel and visualize cohorts, and compare them.

**Hiten:** Yeah. And some of this stuff is still things we need to do better in our own product. We're very early. We released this version on November 1st, so we're not even a month-and-a-half into it.

**Nivi:** You guys have basically realigned the company around this product, is that right?

**Hiten:** We've realigned the company around this product through doing our own customer development this whole time – “this whole time” meaning this is our third iteration of the product and this is the one that we're being a lot more public about.

**Nivi:** What were the first two?

**Hiten:** With our first one we had assumptions around doing metrics for Facebook applications and social network applications. And what we realized there was that we had a very constrained view, and it was based on Dave McClure's AARRR!! stuff that we just talked about. What we realized about that was that people started asking all kinds of questions that our interface could not answer for them.

So we took what we learned there and we built a second product, which was very super-flexible event tracking, and we had no funnel analytics or anything like that, so this kind of stuff would help you with tracking engagement of users. If you were a game it would help you track game plays by gender and all of those kinds of things. And if you were a SaaS app, it was more about if Ash needed to measure what types of photos people

were uploading or what kinds of things they were storing on his system, we would provide metrics around that kind of stuff.

**Nivi:** And what was that called?

**Hiten:** It was KISSmetrics. All of these are KISSmetrics, we just didn't publicly release them.

**Nivi:** OK, got it!

**Hiten:** And so we used these other two products to kind of learn about the market and figure out what our target should be. And it was super-generic products, especially the second one. The first one was very targeted towards a market, then we kind of ran away from that and said, let's get Facebook apps, but let's also get SaaS applications; let's get blogs using our product. And that was a very highly flexible product.

In some ways it would have been really fun to market that product and deal with it, but we were just heading down a path, in terms of sales and marketing and things like that, that we didn't want to. As a business our DNA was more around building a really simple solution.

We have a previous analytics tool that the people in our company built called Crazy Egg, and it's a simple tool, and we wanted to go back to that thinking and say, analytics is something where people log into analytics systems, and a lot of the time if they're not expert users they're very confused about what they're looking at, and then they end up just using it as a trending tool just to see general trends.

And the kinds of features that we felt were most important were conversion goals, conversion rates and funnels. So with all this learning from our previous products we basically decided that we should hone in on that proposition, and instead of tacking funnels onto an analytics product, like the other one, we would just make that the product. And it was a big bet. I'm actually super excited about it and very happy that we went in this

direction because I think we can really make an impact on the market and produce something really useful for customers.

**Nivi:** The feature is the product, here.

**Hiten:** The feature is the product, and that's a trend. I mean, Twitter is just a feature, right?

**Nivi:** Right.

### **Why KISSmetrics' hasn't launched**

**Hiten:** A lot of people have said, "Oh, you guys are creating a lot of buzz. We know your brand, but what the hell is your product, and when are you going to launch?" And for us it's not about that. It's not about launch; it's not about things like that. It's about building a product that people love and iterating until you get that.

**Nivi:** Yeah, and this is a good example of why you probably don't want to launch until the business is working.

**Hiten:** Yeah, exactly. We don't even have our economics down, so we're not charging anyone right now, and everyone can come in and use the product. At some point we want them to help us figure out what the value is and what we can charge for it.

The way most analytics packages charge, people are penalized for being successful, and we want to see if we can change that a little bit. I don't know what it means yet. I don't know what it means for our pricing model, but I'd love to make it so that if you get more traffic we don't necessarily charge you more. It sounds really fucked up and weird, but yeah. Excuse my language, but we want a better pricing model if we can find it, that's more aligned with our customers. So there might be more features that they pay for, and it might be access to data or something that's not exactly like: you get more paid views or you get more growth and we charge you more money, and it scales up like that. Even for us, that's not necessarily the most scalable business model.

**Nivi:** Sean talked about using action tags with AdWords, in the interview, to track users on a per-user basis. We talked about Google Analytics, which doesn't really track users on a per-user basis. What does KISSmetrics do differently here?

### **KISSmetrics tracks actions on a per-user basis**

**Hiten:** The things we're trying to solve are if someone comes to the site multiple times and then they sign up, let's say on the third or fourth time, we're allowing you to identify that user and we're trying to attach all of those times that they came, previously, to that customer. What that means is that we'll understand the first touch point they had with you and where it came from, and we'll be able to attach that for the history of that user using your product. And that's a much different view than most analytics have, which is either page-view tracking or event tracking. This is actually, honestly, people tracking, which means that we're trying to actually track people.

Eric Ries has a great quote on this which is, "Metrics are people, too," and we firmly believe that. If we can track things on an individual-user basis without getting into a lot of privacy concerns, because you're already doing this in your data base, so you just have to have the proper terms-of-use for it, we can provide a much more valuable analysis on your user base. And as long as we're not doing anything in aggregate there's not any real privacy implication, while with Google Analytics I feel like it's very hard for them to do that because they have a huge business that has nothing to do with analytics, in a lot of ways.

**Nivi:** Right. Does tracking people on a per-user basis let you calculate LTV, and to put it another way, cost of customer acquisition, and does Google Analytics not let you do that?

### **KISSmetrics lets you calculate customer LTV**

**Hiten:** I'm not going to say that Google Analytics does not let you do that. We definitely think there's a lot of value in the product, and we actually use Google Analytics in a lot of our

products, and they do different things than we do. But legally, you cannot pass personally identifiable information into Google Analytics. So, if you've got 100 conversions in Google Analytics, you might have 110 in your data base simply because you're not able to identify each individual user and they might lose some of the data.

And they've got, my guess is, 100 million sites using the product. That's a high load. We're probably never going to have 100 million sites using our product. There are a lot of issues that come around dealing with that many customers with a free product.

**Nivi:** Yeah. What I'm just trying to understand is what the requirements are to calculate cost of customer acquisition. Have you guys thought about that at all?

Hiten: Yeah, absolutely. We want to make it as simple as you passing a dollar value every time an event occurs where someone's paying. And then in our interface, it's not like magic, but it's magic. We can show you revenue by referrer, revenue by channel, revenue by plan type, and all of those kinds of things that typically you would have to do a lot of data base queries in your own data base, your user data base, to get all this data out.

And honestly, this is some of the pains we had with our previous products. So, for the first 6 months, we never tagged referrer for each customer that came in, so we couldn't boil it down to what referrers were creating the most revenue for us. Once we started doing that it was enlightening. So KISSmetrics is actually based on a lot of the pains that we had with our previous SaaS product.

**Nivi:** So the dollar value that you pass to KISSmetrics will let you calculate the LTV, to some degree, of the customer, right?

**Hiten:** Yeah, that's the goal.

**Nivi:** But not on the cost side. It doesn't tell you how much it

cost you to get the guy.

**Hiten:** Not today.

**Nivi:** Right.

**Hiten:** That's a really good question, and that's something that we do want to answer in the future. Obviously it depends on what type of customers we get and how they want to pass in the data. Is it automatic? Is it manual? Things like that. But it's a problem that we're thinking about a lot because then you can have a full picture in one dashboard. It's all about that one report to rule them all, which doesn't exist in analytics today. And if it does exist, it's an internal report that's built by your development team, and that's kind of the problem we're trying to solve.

**Nivi:** Cool! Thanks again for spending the time talking and also sponsoring the interview with Sean and making it free for everyone.

**Hiten:** Absolutely! Our pleasure.

### Get more startup advice

**Trent:** You've been listening to Hiten Shah, from KISSmetrics.com on how to optimize your web apps. And if you want to find out more, you can check out the KISSmetrics.com website. You can also follow Hiten on Twitter @hnshah, or check out his personal site at hitenshah.name.

Be sure to also have a listen to Nivi's interview with Hiten regarding Survey.io, and the two-part interview with Sean Ellis on bringing your product to market, on the VentureHacks.com website.

Of course, if you're into all other sorts of good advice for startups, head on over to Venture Hacks and just soak it all in.

Thanks again for stopping by. See you next time!

## How to not over-optimize your Series A term sheet

Sponsor Post<sup>130</sup> Thanks to Matt Bartus, a partner in the venture capital and emerging companies practice at the law firm Dorsey & Whitney<sup>131</sup>, for sponsoring Venture Hacks this week. If you like this post, check out Matt's blog<sup>132</sup> and tweets @mbartus<sup>133</sup>. — Nivi



<sup>134</sup>

Negotiating term sheets isn't straightforward and when you combine first-time entrepreneurs with inexperienced counsel, the results can be toxic.

Entrepreneurs have access to a wealth of online information about starting companies and getting funded. This is good, but it sometimes causes a condition like Medical Students' Disease<sup>135</sup> where many first-time founders get overwhelmed by the various lengthy and "legalese heavy" provisions in a term sheet and don't know what to negotiate because they don't have the appropriate context.

**Without this context and the experience that goes with it, founders sometimes feel the need to optimize every term in a term sheet according to guidelines they've**

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<sup>130</sup><http://venturehacks.com/support>

<sup>131</sup><http://www.dorsey.com/>

<sup>132</sup><http://www.mattbartus.com/>

<sup>133</sup><http://www.twitter.com/mbartus>

<sup>134</sup><http://www.mattbartus.com>

<sup>135</sup>[http://en.wikipedia.org/wiki/Medical\\_students%27\\_disease](http://en.wikipedia.org/wiki/Medical_students%27_disease)

**found online.** This slows deals down, raises (and wastes) legal fees, and negatively affects the founder's and investor's ability to work together after the deal.

## Two examples

A founder recently expressed his outrage to me that a VC wanted an 8% non-cumulative dividend preference<sup>136</sup> on the preferred stock, given the historical lows of current interest rates. He didn't realize that dividends in fast growing companies *are almost never paid*, thus making this provision essentially irrelevant and a relic of past practice. Even if the dividend preference was "out of market" at 10%, it probably wouldn't have mattered.

Another example: one of my partners enjoys telling the story of representing a VC that was investing in a company started by a first-time founder using his father — who was not a startup lawyer — as legal counsel. **My partner wasted a week convincing the father that liquidation preferences in preferred stock were not only legal but also customary. This should have been at most a five-second conversation.** The founder was not well-served in this situation, and he paid the price dearly since the VC's legal fees are paid by the company.

## The “Rule of 3

I recommend you hire counsel that does these types of deals day-in and day-out. That shouldn't be a surprise.

Next, follow the “Rule of 3.” Focus your energies on three initial issues to negotiate. Sure, there might be more (or fewer) issues worthy of discussion, but, in my experience, there are usually

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<sup>136</sup><http://www.feld.com/wp/archives/2005/03/term-sheet-dividends.html>

about three issues in any given term sheet that are worth arguing about at the start.

## **Pushing back on vesting acceleration for termination without cause**

**Of course, if you accept the term sheet “as is” and don’t negotiate the important issues, you will lose credibility with the investor.** How a founder acts during this phase can have a significant impact on the relationship going forward. You want to show investors that you’re not a pushover and that you’ll argue important issues.

One of the founders I’m advising recently received a term sheet that was pretty reasonable, except that the terms of his vesting contained no acceleration for termination without cause<sup>137</sup>. In other words, he could be fired at any time and lose his unvested stock. When we pushed back on the VC, the response from the VC was:

*“We’re all in this together, and we really need you to help build this company. We would never terminate you without cause, that would destroy our investment thesis.”*

This founder thought that was a reasonable response and wasn’t inclined to push back because he needed the money. However, I told him what everyone reading this already knows: Even though what the VC said is probably true, things often change, founders are terminated all the time, and he could end up with nothing.

He won that particular battle because the VC knew it was a reasonable request, and the VC learned that this founder was

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<sup>137</sup><http://venturehacks.com/articles/acceleration-termination>

willing to stand up for himself when it was the right thing to do.

## **Focus on the issues that really matter**

On the flip side, if you argue endlessly about 10 points, seven of which are largely immaterial, all parties will cease to focus on what really matters. **You need to show investors that not only will you stand up for the important issues, but that you also know what the important issues are.**

This strategy doesn't apply in all transaction types. In a complicated M&A negotiation, the parties engage in tactics that might include throwing up red herring issues to detract from more important ones. **However, an investment transaction is fundamentally different from an M&A deal because the parties must work together — usually intensely — after closing, and aligned interests are critical.**

## **Six terms to scrutinize closely**

Work with a trusted advisor or an experienced lawyer to help weed out the most important issues. Resources like Brad Feld's term sheet series<sup>138</sup> detail the various term sheet provisions. And here I've identified below some of the most common terms that are worth fighting over.

- 1. Valuation/Dilution.** This is obviously one of the most important issues, although not a legal one. Make sure you understand the effect of including the option pool in

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<sup>138</sup> <http://www.feld.com/wp/archives/2005/08/term-sheet-series-wrap-up.html>

the pre-money valuation<sup>139</sup>. Think about alternatives to simply changing the valuation, such as using warrants<sup>140</sup>.

2. **Liquidation Preference.** This is usually the next most important business issue, although it is often mistaken for a legal issue and sometimes glossed over — at your peril. The liquidation preference defines the return that an investor receives in a sale of the company, and it can have a very significant impact on the founder's return. Be sure to model out expected exit values so you understand the actual dollar differences between the liquidation preference formulas. Also keep in mind that terms put in place in the Series A often carry over to the Series B and beyond, so be careful what you agree to here — even if it seems relatively harmless at this stage. The fact that Series A terms carry over into later rounds (and sometimes negatively affect the Series A investors in those later rounds) can often be used as leverage to resist their inclusion. For example, a “participating preferred” for a small seed round might not result in a meaningful extra return for the investor at exit (at least in absolute dollar numbers), but it will be very painful to the founders if all future rounds include participating preferred stock. MATT WE NEED TO INCLUDE COMMON APPROACHES... ISN'T IT OBVIOUS BY NOW THAT WE SHOULD BE DOING 1X NON-PARTICIPATING.
3. **Board of Directors/Voting Provisions.** The makeup of the board of directors and governance of the company is critical to the success of the company. One common arrangement is one director appointed by common stock, one director appointed by the Series A stock, and one independent director. But there are many variations on this theme and Venture Hacks has argued for more ag-

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<sup>139</sup><http://venturehacks.com/articles/option-pool-shuffle>

<sup>140</sup><http://www.mattbartus.com/2010/02/how-to-pump-up-your-vc-valuation/>

gressive<sup>141</sup> terms<sup>142</sup>. Have a constructive discussion with your investors about board makeup and ensure that everyone is aligned on the governance of the company.

**4. Founder Vesting** This is a critical area to review and understand.

- On what date does vesting commence<sup>143</sup>?
- Does vesting accelerate upon termination without cause<sup>144</sup>?
- Does vesting accelerate upon a change of control<sup>145</sup>?

**5. Anti-dilution Protection.** Nearly all VC deals in the United States have some form of anti-dilution protection to protect the investors from the future sale of preferred stock at a lower valuation. The variations in the types of antidilution protection define the extent to which the VC is protected. If it is broad-based antidilution protection<sup>146</sup>, move on. If you see the phrase full ratchet<sup>147</sup>, talk to your lawyer.

**6. No-shop**<sup>148</sup>. It's common for the only binding part of a term sheet to be a restriction that you don't engage with other VCs for some period of time after you sign the term sheet. This is a reasonable request, as the VC is going to be paying lawyers to draft documents and perform due diligence on your company. But be sure the time period is not too long — 30 days is plenty of time to finalize a VC investment in almost all cases.

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<sup>141</sup><http://venturehacks.com/articles/board-structure>

<sup>142</sup><http://venturehacks.com/articles/ceo-board-seat>

<sup>143</sup><http://venturehacks.com/articles/get-vested-for-time-served>

<sup>144</sup><http://venturehacks.com/articles/acceleration-termination>

<sup>145</sup><http://venturehacks.com/articles/acceleration-sale>

<sup>146</sup><http://www.feld.com/wp/archives/2005/03/term-sheet-anti-dilution.html>

<sup>147</sup><http://www.startupcompanylawyer.com/2007/08/04/what-is-full-ratchet-anti-dilution-protection/>

<sup>148</sup><http://www.feld.com/wp/archives/2005/08/unilateral-or-serial-monogamy.html>

Most of the other provisions in the term sheet are either harmless or have become so customary that it's not worth spending any time negotiating them. There are always exceptions and special situations, so talk to your own counsel, but here are some of the things that you can mostly ignore in most cases:

- dividends (except for accruing dividends)
- information rights
- conversion rights
- customary protective provisions (i.e., special voting rights)
- registration rights
- standard conditions to the investment
- rights of first refusal

Certainly these and other boilerplate provisions are relevant, but I would not advise any of my clients to spend any time negotiating them unless they are so "out of market" that it might harm the client to accept them or your company represents a special situation.

But does your typical entrepreneur care how many S-3 registration rights the investor has? He doesn't — and he shouldn't. He owes it to himself and his investors to negotiate and resolve important points early, get the deal closed quickly, and get back to the business of growing the company.

## StartupList: The first startup gets funded

We launched StartupList<sup>149</sup> 3 weeks ago and immediately updated you on the day after results<sup>150</sup> (75 new angel applications, 7 startups getting intros to 11 investors). Now we're 3 weeks in and we've got great news.



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**The first startup has been funded through StartupList.** The investor is Matt Mullenweg<sup>152</sup> and it's a Y Combinator<sup>153</sup> company. We're not releasing the name of the startup right now but let's call it Startup #0<sup>154</sup>. This is a big milestone and we want to thank Matt, the AngelList investors, and the startups who've applied to StartupList for making it happen.

## Power Brokers: Our new referral program



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<sup>149</sup><http://venturehacks.com/articles/startuplist>

<sup>150</sup><http://venturehacks.com/articles/startuplist-day-1>

<sup>151</sup><http://venturehacks.com/angelist#matt-mullenweg>

<sup>152</sup><http://venturehacks.com/angelist#matt-mullenweg>

<sup>153</sup><http://ycombinator.com/>

<sup>154</sup>[http://en.wikipedia.org/wiki/0\\_%28number%29#Numbering\\_from\\_1\\_or\\_0](http://en.wikipedia.org/wiki/0_%28number%29#Numbering_from_1_or_0)

<sup>155</sup><http://coconutheadsets.com/>

We also want to thank *you* for referring startups to StartupList<sup>156</sup> and AngelList<sup>157</sup>. And we want to single out Rob May<sup>158</sup> (@robmay<sup>159</sup>), founder of Backupify<sup>160</sup>, for referring Startup #0. So we've created a referral program to thank you for your referrals. It starts with a list Power Brokers<sup>161</sup>: people who've referred high-quality startups to StartupList — check it out<sup>162</sup>.

**Here's what we do for the power brokers.** If we select a startup you've referred for StartupList, we highlight your name to all the investors on the list (for example<sup>163</sup>). This is an awesome way to build a relationship with the investors on AngelList (and us). Second, we'll highlight your name in announcements about the startup (see the fine photo of Rob above). Third, we're brainstorming other 'thank-you's' for the power brokers. An invite-only conference with the angels on AngelList? A demotivational poster<sup>164</sup>? Please share your ideas in the comments<sup>165</sup> or email me<sup>166</sup>.

If you refer a startup to StartupList, please tell them to fill in your name in the field for referrers in the application<sup>167</sup>.

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<sup>156</sup><http://venturehacks.com/startuplist>

<sup>157</sup><http://venturehacks.com/angellist>

<sup>158</sup><http://coconutheadsets.com/>

<sup>159</sup><http://twitter.com/Robmay>

<sup>160</sup><http://www.backupify.com/>

<sup>161</sup><http://venturehacks.com/power-brokers>

<sup>162</sup><http://venturehacks.com/power-brokers>

<sup>163</sup><http://gist.github.com/312636>

<sup>164</sup><http://despair.com/viewall.html>

<sup>165</sup><http://venturehacks.com/articles/startuplist-first-funding#comments>

<sup>166</sup><mailto:nivi@alum.mit.edu>

<sup>167</sup><http://venturehacks.com/startuplist>

## New investors on AngelList

We're working through the investors who've applied to AngelList<sup>168</sup>. There's 54 investors on the list so far and about 25 of them have asked for intros to StartupList startups — here's a few examples:



Ann Miura-Ko<sup>169</sup> from Maples Investments<sup>170</sup>



Jon Callaghan<sup>171</sup> (Investor in Meebo)



Michael Dearing<sup>172</sup> (Angel in Aarvark)

These are just a few of the new angels who've asked for intros... go browse all the investors<sup>173</sup> and tweet them a hello.

And you don't need StartupList to get in touch with the angels — you can contact many of them directly or, better, through the referrals they list. But you should still apply to StartupList because it often takes three tries to get a meeting<sup>174</sup>.

<sup>168</sup><http://venturehacks.com/angellist>

<sup>169</sup><http://venturehacks.com/angellist#ann-miura-ko>

<sup>170</sup><http://www.maples.net>

<sup>171</sup><http://venturehacks.com/angellist#jon-callaghan>

<sup>172</sup><http://venturehacks.com/angellist#michael-dearing>

<sup>173</sup><http://venturehacks.com/angellist>

<sup>174</sup>[http://www.avc.com/a\\_vc/2008/06/trying-zemanta.html](http://www.avc.com/a_vc/2008/06/trying-zemanta.html)

## Twitter Widgets

I've collected Twitter testimonials from AngelList members in our Twitter favorites<sup>175</sup>:

Widget: Venture Hacks Twitter favorites<sup>176</sup>

And this Twitter list of AngelList members<sup>177</sup> is always fun:

Widget: AngelList Twitter list<sup>178</sup>

Startups: apply to StartupList here<sup>179</sup>. Angels: join AngelList here<sup>180</sup>. Everyone: thank you for being part of this.

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<sup>175</sup><http://twitter.com/venturehacks/favorites>

<sup>176</sup><http://twitter.com/venturehacks/favorites>

<sup>177</sup><http://twitter.com/venturehacks/angellist>

<sup>178</sup><http://twitter.com/venturehacks/angellist>

<sup>179</sup><http://venturehacks.com/startuplist>

<sup>180</sup><http://venturehacks.wufoo.com/forms/p7x3x5/>

# March 2010

## [Startup Digest]: “The best startup events in 27 cities”

### [StartupDigest]

<sup>1</sup>Every day (literally), I get an email from someone asking me to introduce them to investors, advisors, and co-founders. We’re building StartupList<sup>2</sup> and AngelList<sup>3</sup> to handle the intros to investors.

For intros to advisors and co-founders, I always tell people to sign up for [Startup Digest]<sup>4</sup> — a weekly curated list of the best events in 27 cities — and start going to lots of events.

### Good things happen to you at events

I don’t go to a lot of events anymore because I “wouldn’t be here working<sup>5</sup>. ” But I went to a lot of events when I moved to Silicon Valley 5 years ago. And great things happened to me at these events. I met Mike Arrington<sup>6</sup> and ended up crashing at his place for a few months when I had no place to stay and very little money. I was re-introduced to David Cowan<sup>7</sup> and ended up working with him as an EIR at Bessemer<sup>8</sup>.

Going to an event can create its own luck. From the archive<sup>9</sup>

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<sup>1</sup><http://thestartupdigest.com/>

<sup>2</sup><http://venturehacks.com/startuplist>

<sup>3</sup><http://venturehacks.com/angelist>

<sup>4</sup><http://thestartupdigest.com/>

<sup>5</sup><http://twitter.com/venturehacks/status/9842323218>

<sup>6</sup><http://twitter.com/ARRINGTON>

<sup>7</sup><http://twitter.com/davidcowan>

<sup>8</sup><http://bvp.com/>

<sup>9</sup><http://pmarca-archive.posterous.com/luck-and-the-entrepreneur-part-1-the-four-kin>

of the blogger formerly known as pmarca (a.k.a. Marc Andreessen):

“In Chance II, something else has been added — motion.

“Years ago, when I was rushing around in the laboratory [conducting medical research], someone admonished me by asking, “Why all the busyness? One must distinguish between motion and progress”.

“Yes, at some point this distinction must be made. But it cannot always be made first. And it is not always made consciously. True, waste motion should be avoided. But, if the researcher did not move until he was certain of progress he would accomplish very little...

“A certain [basic] level of action “stirs up the pot”, brings in random ideas that will collide and stick together in fresh combinations, lets chance operate.

### **Events are the place to meet people who won't meet with you**

People who aren't available over email or one-on-one go to events to make themselves available. Mark Suster writes<sup>10</sup>,

“One area where I have made in-roads is in the “I'd like to buy you a coffee for 15 minutes and get some career advice” emails from people I don't know. I really do like to help people so in the early days I took some of these. I simply can't fit in the time any more. So I often advise these people to find me at

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<sup>10</sup><http://www.bothsidesofthetable.com/2010/03/02/im-moving-you-to-bcc/>

a conference and I promise to spend time with them there. I've already allocated that time as "general networking time." I've developed a system for the polite "no" in this context."

Sure, we would all like to get a 30-minute phone call with Mark, but I think you form a deeper psychological bond if you can talk to him for 10 minutes *in person*.

So if you're looking for intros to advisors and co-founders, sign up for [Startup Digest]<sup>11</sup>, start going to events, and create some luck.

## More diligence and less capital coming for startups (and their investors)

*SPONSOR POST* <sup>12</sup> Thanks to George Zachary<sup>13</sup>, a partner at Charles River Ventures<sup>14</sup>, for sponsoring Venture Hacks this week. If you like this post, check out George's blog<sup>15</sup> and tweets @georgezachary<sup>16</sup>.  
– Nivi

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<sup>11</sup> <http://thestartupdigest.com/>

<sup>12</sup> <http://venturehacks.com/support>

<sup>13</sup> [http://www.crv.com/team/george\\_zachary/](http://www.crv.com/team/george_zachary/)

<sup>14</sup> <http://www.crv.com/>

<sup>15</sup> <http://senseandcents.blogspot.com/>

<sup>16</sup> <http://twitter.com/georgezachary>

<sup>17</sup>

In my first post, A brief history of your investors (and their investors)<sup>18</sup>, I wrote about the history of venture capital. I described how the economy and stock market drives investments into venture capital and startups. I also covered how the basic incentive structures are affected by these drivers.

I ended with a suggestion that cash is gaining power relative to other assets and a suggestion that this will shift the balance of valuation and terms in favor of the root sources of capital (limited partners and above). In this second part, I'll discuss why I think this is happening and what it means for venture investors and entrepreneurs.

## **Speculative returns are a major component of total returns**

The coming decade is not going to be a bull like the 1980's or 1990's. Why is this important? Because it's going to turn money into a "scarce" commodity and therefore drive down valuations, erode returns, remove under-performing venture funds, and reduce company exit valuations.

The 1980's and 90's were incredibly bullish. The annualized return from the public stock market was 16.8% from 1982-2000.

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<sup>17</sup>[http://www.crv.com/team/george\\_zachary/](http://www.crv.com/team/george_zachary/)

<sup>18</sup><http://venturehacks.com/articles/history-of-investors>

That is huge. If you dive into the 16.8%, the fundamental return<sup>19</sup> was 9.9% annualized.

What's the remainder? I'll call it speculative return. The speculative return was 6.9% between 1982-2000. And what is speculative return? It's the expansion of the starting and ending P/E from 1982 to 2000. **We started 1982 with a P/E of 8.0 and finished 2000 at 26.4!**

As I wrote in part one, the increased supply of money drove these large returns. M3 money supply<sup>20</sup> started its ballistic rise in the early 1980s. The total debt market went from \$4T in 1980 to about \$52T at the end of 2009. So the credit boom and decreasing interest rates fire-hosed cash into all markets. And that's how a speculative return of 6.9% a year was driven. Other drivers included the baby boomer demographic, the technology boom, geopolitical stability, and the boom in international trade from globalization.

If we look back in time, the preceding time period of 1966 to 1981 had a total return of 5.9% (including dividends of course). However, the fundamental return was 11.1% and the speculative return was -5.2%! We started 1966 with a P/E of 17.8 and finished 1981 with a P/E of 8.0. And to add a little more color, the 1950-1965 post-WWII time period had a total return of 16.1%. That was comprised of a 10.0% fundamental return and a 6.1% speculative return. And, looking forward a bit, we can see the 2001-2005 time period had a total return of -1.3% with a -6.9% speculative return.

**This data suggests that the speculative return component is a huge driver on total returns.** And that it has a fairly long half-cycle time. It's in the vicinity of 16-18 years if we do the analysis since the early 1900s. In a short 5 year period,

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<sup>19</sup><http://www.google.com/search?hl=en&q=fundamental%20return&aq=f&oq=>

<sup>20</sup>[http://en.wikipedia.org/wiki/Money\\_supply](http://en.wikipedia.org/wiki/Money_supply)

speculative return can comprise 55% of the total return. And, over a 40 year period, speculative return drops to near 0%.

Benjamin Graham said it best when he said that the stock market worked like a voting machine, but in the long term like a weighing machine. If you are building a long term company, that is the good news. The not-so-good news is that the short term pain of being part of the voting machine could be very significant.

## **2001-2020 will have negative speculative returns**

Okay, its 2010. Could the speculative return dynamics since 2001 have ended? Umm — probably not. Take a look at this table of important drivers that compare 1981 (the start of the mega 20 year bull period) to now.

**1981 Today** CPI 8.9% -1.3% 30-year bond 13.65% 4.24% Fed Funds rate 12.00% 0.25% Highest marginal tax rate 69% 35% Highest LT capital gains tax rate 28% 15% Home ownership rate 65.2% 67.4% Household debt as % of income 56.1% 114.4% % of families with retirement accts 20.4% 52.6% Personal savings rate 11.4% 3.0% Mortgage debt as % of disposable inc 43.1% 95% Baby Boomer age range 17-35 45-63 Federal Deficit as % of Nominal GFP 2.5% 11.2% est PCE (consumer spend) as % of GDP 61.9% 70.7% US debt as % of GDP 32.2% 85.8% Household debt as % of GDP 47.2% 96.8% To me, these are very sobering statistics. They paint a completely different picture than at the start of the last bull cycle of 1982-2000. My judgment is that these statistics are going to seriously suppress speculative return. The -6.9% of 2001-2005 will get worse and total returns will suffer. In 2021, statistics will show that the 2001-2020 time period had good fundamental returns. But horrific speculative returns.

## **Valuations go down and diligence goes up for startups and VCs**

What will this mean for the U.S. entrepreneurs and investors? In short, we are not going to be “partying like its 1999” for quite awhile. (Who knew that the artist formerly known as Prince could forecast market peaks?)

The implications of negative speculative returns will be huge. The number of venture firms and their personnel will shrink. And probably hit bottom sometime this decade. Venture firms will be under significant pressure to outperform their peers and outperform their limited partners’ common benchmark indices like NASDAQ. Limited partners will feel the same type of pressure as they too source their capital from sources that will be under tremendous economic pressures. Angel firms (translation: angels who are institutionally backed) will feel the same pressure. Angel investors (individuals investing their own capital) will become more risk averse.

How will these pressures affect entrepreneurs? As a whole, valuations will stay suppressed and will probably come down further over the future years. Revenue multiples and “discount to public market multiples” will re-enter and dominate the late stage financing lexicon. Early stage companies will also feel this suppression with smaller venture rounds. Capital-intense startups that need to raise large initial Series A financing rounds will be particularly affected.

The amount of time spent in due diligence will go up and get more rigorous and detailed. Of course, there will always be companies that are exceptions. But as a rule, the suppressed return environment will force all parts of the money chain to spend way more time in diligence. Way more time and energy for limited partners to raise capital. And the same for venture investors. And the same for angel firms.

Startups will feel this diligence pressure next as they are the

next stop on the money supply chain. **My guess is that new service providers will emerge to help both investors and entrepreneurs with these diligence processes.** How they will be paid is an open question.

Since individual angels use their own cash, they won't be directly affected. But they will probably diversify their portfolio by making smaller investments on average. And put less of their total portfolio in startups so that they can have greater portfolio liquidity. In aggregate, they will put less money into startups.

## **Some startups and VCs are going to disappear**

Okay, so valuations down and diligence up for every part of the money supply chain. We can all work through that.

Where matters are going to get tricky is that parts of the money supply chain will disappear. A venture investor or angel firm may run out of cash in a fund and need to raise a new fund. A startup company has a similar problem.

If you are a startup company, a pure non-dilutable asset is your time. Raising a new financing round requires time. Since we've already established that investor due diligence time will increase, the last thing an entrepreneur will want to do is spend that time talking with investors who don't have cash to invest. Or who can only invest with particularly harsh terms because of their own liquidity needs.

In the next and final part of this series, I will detail the questions you should ask your potential investors. These questions will assist you in ensuring you are talking to the right investors for your company.

In closing, here's the "New York Daily Investment News" front page from the early part of the Great Depression to remind us that history may not repeat exactly. But it does rhyme.



## It takes more than one intro to get a meeting



Don't be afraid to get multiple intros to a single investor. Fred Wilson<sup>21</sup>:

“One of my favorite VC quotes comes from Bill Kaiser of Greylock. He once said, “when I hear about a company once, I often ignore it, when I hear about it twice, I pay attention, when I hear about it for the third time, I take a meeting”.

“It happened to me this week. I met with Reshma who runs seedcamp<sup>22</sup>, the european version of Y Combinator, on Monday and she told me about Zemanta<sup>23</sup> which came out of last year’s seedcamp. Then I saw this blog post about Zemanta<sup>24</sup> on Techmeme the next day. And then on Thursday, Alex Iskold, founder of our portfolio company<sup>25</sup> Adaptive Blue<sup>26</sup>, introduced us to Andraz, one of the founders of Zemanta<sup>27</sup>.

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<sup>21</sup>[http://www.avc.com/a\\_vc/2008/0a6/trying-zemanta.html](http://www.avc.com/a_vc/2008/0a6/trying-zemanta.html)

<sup>22</sup><http://www.seedcamp.com/>

<sup>23</sup><http://www.zemanta.com/>

<sup>24</sup>[http://www.webware.com/8301-1\\_109-9957395-2.html](http://www.webware.com/8301-1_109-9957395-2.html)

<sup>25</sup>[http://en.wikipedia.org/wiki/Portfolio\\_company](http://en.wikipedia.org/wiki/Portfolio_company)

<sup>26</sup><http://www.adaptiveblue.com/>

<sup>27</sup><http://www.zemanta.com/>

“Three hits in one week is absolutely a “pay attention” notice. So this morning I am trying Zemanta out. The image and most of the links in this post were automatically provided by Zemanta.”

Put yourself in Fred’s shoes. His inbox is overflowing with intros to companies that are *as good as yours*. He has to ignore most of the intros and focus on a few of them. One of Fred’s best filters is the quality and quantity of the people referring your company. And, by the way, Fred went on to invest in Zemanta<sup>28</sup>.

## How to get multiple intros

This is what we tell entrepreneurs who use AngelList<sup>29</sup> and StartupList<sup>30</sup>: we recommend doing all of these at the same time,

1. Email investors directly if they allow it. But first read their profile to see if you’re a good fit. **Don’t contact them if you don’t fit their interests — you’re not the exception that proves the rule.**
2. Use one of the referrers they suggest. But don’t spam referrers — you should either know the referrer or the referrer should be open to cold calls.
3. Use Facebook/LinkedIn and ask mutual friends for an intro. You should either know the mutual friend well or the mutual friend should be open to cold calls.
4. Send your elevator pitch to StartupList<sup>31</sup> and, if you’ve got a good pitch, we’ll send it to the investors on AngelList

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<sup>28</sup>[http://www.avc.com/a\\_vc/2008/09/zemanta.html](http://www.avc.com/a_vc/2008/09/zemanta.html)

<sup>29</sup><http://venturehacks.com/angellist>

<sup>30</sup><http://venturehacks.com/startuplist>

<sup>31</sup><http://venturehacks.wufoo.com/forms/x7x3p9/>

— or, if you prefer, specific investors you suggest. 4 weeks in, we've already done intros between 15 startups and 25 investors — and gotten 1 startup funded<sup>32</sup>. Even better, with StartupList, *the investors come to you.*

The idea here isn't that you should keep bugging investors — the idea is that it often takes three tries to get a meeting<sup>33</sup>.

## Give tweet a chance

According to Google Reader, we write 2 blog posts a week. And according to TweetStats<sup>34</sup> we write **73 tweets** a week.

If you only read our blog, you're missing the great links we post on Twitter. We take the same care with our tweets that we do with our blog posts and we try to keep the quality stratospheric.

You can follow us on Twitter<sup>35</sup> but maybe you're already following too many people. So we've created a daily digest of our tweets that you can get via email<sup>36</sup> or RSS<sup>37</sup>. 600 people have already subscribed to the digest and it looks like this:

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<sup>32</sup><http://venturehacks.com/articles/startuplist-first-funding>

<sup>33</sup>[http://www.avc.com/a\\_vc/2008/06/trying-zemanta.html](http://www.avc.com/a_vc/2008/06/trying-zemanta.html)

<sup>34</sup><http://www.tweetstats.com/>

<sup>35</sup><http://twitter.com/venturehacks>

<sup>36</sup>[http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en_US)

<sup>37</sup><http://feeds.venturehacks.com/venturehacks-twitter>

### A Look Back At Summize

**AVC**— In July 2008, Twitter acquired a company called Summize. The stated reason was to bring search into Twitter. And that was the main reason that Twitter did the deal. But Twitter also got a very strong engineering team in that acquisition. I remember asking Ev and Jack at the time “how are we going to integrate the engineering team?” and Jack replyin...

 *“They did not rebuild Twitter, they just replaced one thing at a time and evolved it.” – @fredwilson, <http://j.mp/cXghWK>*

929 CLICKS 76 TWEETS

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### Aprizi's Customer Development Journey, part 3 – giffconstable.com

**GIFFCONSTABLE**— Aprizi is about to enter that crucial phase of open beta, so I wanted to pause and write down the latest installment in our customer development journey (part 1 and 2). For anyone new to the blog, Aprizi is building a personalization engine for online shopping — a Pandora for e-commerce, if you will. My thesis is that the intersection of tw...

 *“Build something for yourself is not the “best” way to come up with startup ideas. A different way: <http://j.mp/9IqPnW>.”*

582 CLICKS 14 TWEETS

**But wait there's more!** First, we're working on a redesign of the digest with a designer who can only be described as a badass — subscribe and you'll see it first. Second, we usually preview new projects like StartupList<sup>38</sup> and AngelList<sup>39</sup> on Twitter for many weeks before we publish them here — again, subscribe and you'll see them first. Third, we're working on a sweet new project that we'll preview on Twitter soon — its code name is “Talk”.

So give tweet a chance: Twitter<sup>40</sup>, Email Digest<sup>41</sup>, RSS Digest<sup>42</sup>.

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<sup>38</sup><http://venturehacks.com/startuplist>

<sup>39</sup><http://venturehacks.com/angellist>

<sup>40</sup><http://twitter.com/venturehacks>

<sup>41</sup>[http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=venturehacks-twitter&loc=en_US)

<sup>42</sup><http://feeds.venturehacks.com/venturehacks-twitter>

# I'm speaking at SXSW + Holding a SXSW MEETUP



Naval Ravikant  
Vast.com Inc



Marc Nathan  
ChaiONE



David Cohen  
TechStars



Paul Graham  
YCombinator



Joshua Baer  
OtherInbox

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Naval<sup>44</sup> here.

For those of you going to SXSW, I'll be on the Seed Combinators Panel<sup>45</sup> on Monday March 15 3:30pm. I'm joining Paul Graham<sup>46</sup>, David Cohen<sup>47</sup>, Marc Nathan<sup>48</sup>, and Joshua Baer<sup>49</sup> to talk about YStars, TechCombinators, SeedBoxes, and the like. Here's the Plancast<sup>50</sup> if you want me to "count you in."

I'm also throwing a **SXSW Venture Hacks Meetup** on Sunday March 14 5-7pm in the Four Seasons Lobby Lounge at 98

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<sup>43</sup><http://my.sxsw.com/e/387>

<sup>44</sup><http://startupboy.com>

<sup>45</sup><http://my.sxsw.com/e/387>

<sup>46</sup><http://www.paulgraham.com/>

<sup>47</sup><http://www.techstars.org/mentors/dcohen/>

<sup>48</sup><http://twitter.com/marc1919>

<sup>49</sup><http://austinprenuer.com/>

<sup>50</sup><http://plancast.com/a/14ba>

San Jacinto Blvd<sup>51</sup>. If you're coming to the meetup, please RSVP on Facebook<sup>52</sup> xor Plancast<sup>53</sup> so we can get a headcount.

If you're a Venture Hacker, please come talk to me about your startup and venture hacking at these two events. I'm looking forward to pressing the flesh and kissing some babies.

## The only reason investors say ‘no’

The only reason investors say ‘no’ is because you haven't figured out how to get far enough on your own.

2:35 PM Mar 13th via HootSuite

Retweeted by 15+ people



**venturehacks**  
Venture Hacks

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This is one of our most popular tweets<sup>55</sup> ever. You never know which tweet will be popular<sup>56</sup>.

The tweet isn't exactly true but it's close enough for 140 characters. Exceptions and corrections welcome in the comments<sup>57</sup>.

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<sup>51</sup> <http://maps.google.com/maps/place?cid=1610221185715858428&q=Four+Seasons+Hotel+Austin,+98+San+Jacinto+Boulevard,+Austin,+TX+78701&hl=en&cd=1&ei=ubyaS9OYIJH4iAPg69zDAw&sig2=qRkm7TKDu1v3Q8RwJSH20g&sll=30.262087,-97.741713&sspn=0.02313,0.038418&ie=UTF8&ll=30.292127,-97.769308&spn=0,0&z=14&iwloc=A>

<sup>52</sup> <http://www.facebook.com/event.php?eid=357556860903>

<sup>53</sup> <http://plancast.com/a/1vm5>

<sup>54</sup> <http://twitter.com/venturehacks/status/10441386686>

<sup>55</sup> <http://twitter.com/venturehacks/status/10441386686>

<sup>56</sup> <http://laserlike.com/2008/10/25/forget-the-tipping-point-focus-on-joe-the-plumber/>

<sup>57</sup> <http://venturehacks.com/articles/say-no#comments>

## Solvate is simple outsourcing for startups

We like to write about tools that make life better for startups. We've written about Pivotal Tracker<sup>58</sup>, the iPod of project management software. And we recently covered [Startup Digest]<sup>59</sup>, which curates the best startup events in 27 cities.



<sup>60</sup>Today I want to talk about Solvate<sup>61</sup>. Solvate says they "recruit and contract talent to work on demand." But I like to say they're "simple outsourcing for startups." I've been using Solvate to produce interviews like How to optimize web apps with KISSmetrics<sup>62</sup>.

SlideShare: How to optimize your web apps with KISSmetrics<sup>63</sup>

### My Solvate experience

I told Solvate what I needed: "Turn my MP3 interviews into blog posts that look like this<sup>64</sup>." It took them about a day to find someone: "Trent<sup>65</sup>'s going to get in touch with you." I talked to Trent on the phone and described how I've produced our interviews in the past. He took a lot of notes and sent me a spot-on email that described what he was going to do.

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<sup>58</sup><http://venturehacks.com/articles/pivotal-tracker>

<sup>59</sup><http://venturehacks.com/articles/startup-digest>

<sup>60</sup><http://solvate.com/e/vh>

<sup>61</sup><http://solvate.com/e/vh>

<sup>62</sup><http://venturehacks.com/articles/optimize-kissmetrics>

<sup>63</sup><http://www.slideshare.net/venturehacks/how-to-optimize-web-apps-with-kissmetrics-3042804>

<sup>64</sup><http://venturehacks.com/articles/measure-fit>

<sup>65</sup><http://www.solvate.com/talent/profile/38/547/>

Then I sent Trent a raw MP3 interview and he produced everything you see in the full blog post<sup>66</sup>: a Slideshare with Slidecast, a podcast with chapters that look great in iTunes, an outline, a transcript, and a polished draft of the blog post. Along the way, he sent me 2 or 3 emails asking for feedback: “What do you think of this outline? Can you take a look at this podcast before I make a Slidecast?”

Trent probably saves me 5-10 hours per interview. I think my favorite part is that I rarely have to repeat instructions twice — with Trent or Paul<sup>67</sup>. They both really want to do a good job. And Solvate takes care of the hassle of negotiating contracts with the talent — all I did was sign a click-through contract with Solvate.

## **Free hour of Solvate!**

I’ve arranged for Solvate to foot the bill for the first hour of any project you start with them in March. Try it out<sup>68</sup> and let me know what you think.

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<sup>66</sup><http://venturehacks.com/articles/optimize-kissmetrics>

<sup>67</sup><http://www.solvate.com/talent/profile/36/537/>

<sup>68</sup><http://solvate.com/e/vh>

## How to schedule meetings with investors



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*Image: Pink Floyd<sup>70</sup>*

Scheduling meetings with investors — this topic is so banal you may wonder why someone needs to write about it all. But since we started AngelList<sup>71</sup>, we've been making daily introductions between investment-grade<sup>72</sup> startups and top-tier investors like Satish Dharmaraj<sup>73</sup> (Posterous), Jeff Clavier<sup>74</sup> (Mint), and Aaron Patzer<sup>75</sup> (Milo). We see a lot of first time entrepreneurs trying to schedule meetings with investors.

This is **not** how you do it (based on a true story):

Shervin,

<sup>69</sup><http://www.youtube.com/watch?v=IXdNnw99-Ic>

<sup>70</sup><http://www.youtube.com/watch?v=IXdNnw99-Ic>

<sup>71</sup><http://venturehacks.com/angellist>

<sup>72</sup><http://venturehacks.com/articles/startuplist#get-on-startuplist>

<sup>73</sup><http://venturehacks.com/angellist#satish-dharmaraj>

<sup>74</sup><http://venturehacks.com/angellist#jeff-clavier>

<sup>75</sup><http://venturehacks.com/angellist#aaron-patzer>

It is a pleasure to meet you. I would love to tell you more about YomommaCo. Next week we are at DEMO but the following week is wide open. Please let me know if there is a date/time that works for a meeting.

BTW, I am big admirer of some of your investments... KISSmetrics looks very interesting. Gowalla too.

Looking forward to speaking with you,

Yngwie Malmsteen CEO, YomommaCo 777.212.2323

What's wrong with this email? First, Yngwie proposes meeting in over a week — what's wrong with *right now*? Second, he doesn't propose any times to meet. Third, he doesn't talk about the fact that he lives on the other side of the country. Fourth, he CC'ed me instead of moving me to BCC<sup>76</sup>. Fifth, he makes an attempt to add a personal touch about KISSmetrics and Gowalla but he's too colloquial (BTW?) and the touch isn't personal at all — it's just a list of company names.

## How to do it right

This is how you do it (based on a true story):

Thanks Nivi (bcc'ed).

Shervin,

I'm back in SF on Wed 3/31. I could meet anytime the following day Thurs 4/1 after 3pm or Fri 4/2 before noon.

Since I won't be in SF for 10 days and we've already secured some commitments for the financing,

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<sup>76</sup><http://www.bothsidesofthetable.com/2010/03/02/im-moving-you-to-bcc/>

why don't we get the conversation started with a 30 minute phone call anytime tomorrow Mon 3/22 after 2pm or Tue 3/23 after noon? My cell is 213.333.8923.

If you happen to be in Cambridge, MA anytime between now and 3/31, I could meet you there. Similarly, if you're in NYC in the next week, I could hop on a bus and make that work too.

I'm looking forward to talking.

Yngwie Malmsteen 213.333.8923 <http://yomommacorp.com>

## The principles of scheduling meetings with investors.

Respond immediately and be available to meet immediately. BCC the introducer. If you don't live nearby, find out where the investor is (Plancast<sup>77</sup> anyone?) and let them know if you're going to be there soon. If you're not going to be near them soon, propose a phone call. Propose specific times to talk. If there's a deadline on the financing or you're going to be oversubscribed, politely let them know. Write less — you have no idea how busy a typical investor's inbox is. Don't be colloquial. Attach a copy of your deck. Use an email program like Gmail that generates narrow fucking columns<sup>78</sup>. Don't write HTML emails. Include a cell # and URL in the signature and not much more. Bonus: include one line of good news — or start the email with a substantive sentence about a mutual acquaintance or something about the investor's portfolio or blog or whatever.

P.S. Good news: we just hired Steve Wozniak. /  
Barney Rubble just committed to the financing. /  
We just had our first \$1000 revenue day. / I got hair  
plugs and they look great.

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<sup>77</sup><http://plancast.com>

<sup>78</sup>[http://www.google.com/search?hl=en&safe=off&q=narrow+columns+are+easier+to+scan&aq=f&aqi=&aql=&oq=&gs\\_rfai=](http://www.google.com/search?hl=en&safe=off&q=narrow+columns+are+easier+to+scan&aq=f&aqi=&aql=&oq=&gs_rfai=)

Seed financings get done through a positive feedback loop of social proof, scarcity and momentum<sup>79</sup>. Focus on the financing, get it done, and get back to work.

## Our most popular links

Favstar<sup>80</sup> automagically collects your most popular tweets. This is a great way to catch up on the great links we've been sharing, that you missed while you were on the beach eating lasagna. Check out our most popular links<sup>81</sup>.

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<sup>79</sup><http://venturehacks.com/articles/create-a-market>

<sup>80</sup><http://favstar.fm/users/venturehacks>

<sup>81</sup><http://favstar.fm/users/venturehacks>

 Very rare interview with [@seanellis](#) on Venture Hacks: <http://j.mp/8BV3IM>. We discuss "How to bring a product to market". It's a must-listen.

 @venturehacks 3 months ago

28		13
FAVS		OTHERS

 You need to understand Clay Christensen's theory of APIs (interfaces). [@cdixon](#) has a good intro with an iPad example: <http://j.mp/a2GRg7>.

 @venturehacks about 1 month ago

23		8
FAVS		OTHERS

 3 must-read customer development case studies, on Venture Hacks: <http://j.mp/6lxJY>. These 3 really helped me "get" customer development.

 @venturehacks 3 months ago

22		7
FAVS	nomad	OTHERS

 How to fake confident body language: <http://j.mp/4RbCzS>.

 @venturehacks 4 months ago

22		7
FAVS	Jordan	OTHERS

 Free Terms of Service Generator (<http://j.mp/8LtEOU>) and Privacy Policy Generator (<http://j.mp/8ijwdn>) for startups. From Legal River.

 @venturehacks about 1 month ago

21		6
FAVS	swarni	OTHERS

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<sup>82</sup><http://favstar.fm/users/venturehacks>

## What happens at SXSW gets published right here

Last week, Naval<sup>83</sup> threw a Venture Hacks meetup at SXSW and sat on the Seed Combinators Panel<sup>84</sup> with Paul Graham<sup>85</sup>, David Cohen<sup>86</sup>, Marc Nathan<sup>87</sup>, and Joshua Baer<sup>88</sup>. Much thanks to everyone who joined us. Here are some pics and highlights.

### Panel



*Photo by Joshua Baer<sup>89</sup>*

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<sup>83</sup><http://startupboy.com/>

<sup>84</sup><http://my.sxsw.com/e/387>

<sup>85</sup><http://www.paulgraham.com/>

<sup>86</sup><http://www.techstars.org/mentors/dcohen/>

<sup>87</sup><http://twitter.com/marc1919>

<sup>88</sup><http://austinpreneur.com/>

<sup>89</sup><http://austinpreneur.com/>



*Photo by Elegant Machines<sup>90</sup>*

My favorite paraphrased quotes from the panel — I grabbed them from Dave McClure's tweets<sup>91</sup>:

“Can you start a startup alone? Yes, of course. it’s entirely possible to raise kids alone, but it’s easier to do it in a marriage.” – Naval

“The Y-Combinator application form is like an intellectual CAPTCHA.” – Paul Graham

“Incubators are graduate school for entrepreneurs... instead of getting a job, create jobs.” – Naval

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<sup>90</sup><http://twitpic.com/photos/elegantmachines>

<sup>91</sup><http://twitter.com/davemcclure>

“We often fund companies on 2nd/3rd try... Drew Houston at DropBox was an initial reject.” – Paul Graham

“Press is negative ROI in most startups.” – Naval

ReadWriteWeb<sup>92</sup> also has a good round-up of the panel.

## Meetup

The last minute meetup was a monster, check out the pics and video. Thanks to everyone who came. You can find each other on Plancast<sup>93</sup> and Facebook<sup>94</sup>.



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<sup>92</sup><http://www.readwriteweb.com/start/2010/03/seed-incubator-panel.php>

<sup>93</sup><http://plancast.com/a/1vm5>

<sup>94</sup><http://www.facebook.com/event.php?eid=357556860903>

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*Photos and video by John Price<sup>95</sup>*

## **Which angels have taken meetings from AngelList?**

You already know about AngelList<sup>96</sup>, our curated list of top tier angel investors.

You also know that you can get in touch with these angels by

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<sup>95</sup><http://www.linkedin.com/in/jdprice>

<sup>96</sup><http://venturehacks.com/angellist>

sending us your pitch<sup>97</sup> and, if it's investment grade<sup>98</sup>, we'll pass it on to the angels. We've already announced<sup>99</sup> the first startup that was funded this way and more announcements are on the way.

In the meantime, I thought you might like to know which angels have taken meetings (or are setting up meetings) with the startups we've sent to AngelList. It's a pretty awesome list of angels. All of these angels have given us permission to use their name. In no particular order, here we go...



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102 Dharmesh Shah<sup>103</sup>

(Investor in Backupify) Thomas McInerney<sup>104</sup> (Investor in Mochi Media) Aaron Patzer<sup>105</sup> (Investor in Milo)



106



107 108 Shervin

<sup>97</sup> <http://venturehacks.com/startuplist>

<sup>98</sup> <http://venturehacks.com/articles/startuplist#get-on-startuplist>

<sup>99</sup> <http://venturehacks.com/articles/startuplist-first-funding>

<sup>100</sup> <http://venturehacks.com/angellist#dharmesh-shah>

<sup>101</sup> <http://venturehacks.com/angellist#thomas-mcinerney>

<sup>102</sup> <http://venturehacks.com/angellist#aaron-patzer>

<sup>103</sup> <http://venturehacks.com/angellist#dharmesh-shah>

<sup>104</sup> <http://venturehacks.com/angellist#thomas-mcinerney>

<sup>105</sup> <http://venturehacks.com/angellist#aaron-patzer>

<sup>106</sup> <http://venturehacks.com/angellist#shervin-pishevar>

<sup>107</sup> <http://venturehacks.com/angellist#jeff-clavier>

<sup>108</sup> <http://venturehacks.com/angellist#matt-mullenweg>

Pishevar<sup>109</sup> (Investor in Gowalla) Jeff Clavier<sup>110</sup> (Investor in Mint) Matt Mullenweg<sup>111</sup> (Angel in Daily-Burn)



<sup>112</sup> <sup>113</sup> <sup>114</sup> George Zachary<sup>115</sup> (Charles River) Chris Yeh<sup>116</sup> (Angel in EtherPad) Jeff Fagnan<sup>117</sup> (Atlas)



<sup>118</sup> <sup>119</sup> <sup>120</sup> Brian Norgard<sup>121</sup> (Angel in ad.ly) Mike Hirshland<sup>122</sup> (Polaris) Alex Finkelstein<sup>123</sup> (Spark Capital)

<sup>109</sup><http://venturehacks.com/angellist#shervin-pishevar>

<sup>110</sup><http://venturehacks.com/angellist#jeff-clavier>

<sup>111</sup><http://venturehacks.com/angellist#matt-mullenweg>

<sup>112</sup>[http://www.crv.com/team/george\\_zachary](http://www.crv.com/team/george_zachary)

<sup>113</sup><http://www.crunchbase.com/person/chris-yeh>

<sup>114</sup><http://venturehacks.com/angellist#jeff-fagnan>

<sup>115</sup>[http://www.crv.com/team/george\\_zachary](http://www.crv.com/team/george_zachary)

<sup>116</sup><http://www.crunchbase.com/person/chris-yeh>

<sup>117</sup><http://venturehacks.com/angellist#jeff-fagnan>

<sup>118</sup><http://venturehacks.com/angellist#brian-norgard>

<sup>119</sup><http://venturehacks.com/angellist#mike-hirshland>

<sup>120</sup><http://www.sparkcapital.com/team/bio/alexfinkelstein/>

<sup>121</sup><http://venturehacks.com/angellist#brian-norgard>

<sup>122</sup><http://venturehacks.com/angellist#mike-hirshland>

<sup>123</sup><http://www.sparkcapital.com/team/bio/alexfinkelstein/>

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David Cohen<sup>127</sup> (Techstars) Bill Lee<sup>128</sup> (Angel in Posterous) Michael Dearing<sup>129</sup> (Angel in Aardvark)



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Rob Go<sup>133</sup> (Spark Capital) Richard Chen<sup>134</sup> (Angel in Aardvark) Joe Greenstein<sup>135</sup> (Angel in Eventbrite)

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<sup>124</sup><http://venturehacks.com/angellist#david-cohen>

<sup>125</sup><http://venturehacks.com/angellist#bill-lee>

<sup>126</sup><http://venturehacks.com/angellist#michael-dearing>

<sup>127</sup><http://venturehacks.com/angellist#david-cohen>

<sup>128</sup><http://venturehacks.com/angellist#bill-lee>

<sup>129</sup><http://venturehacks.com/angellist#michael-dearing>

<sup>130</sup><http://venturehacks.com/angellist#rob-go>

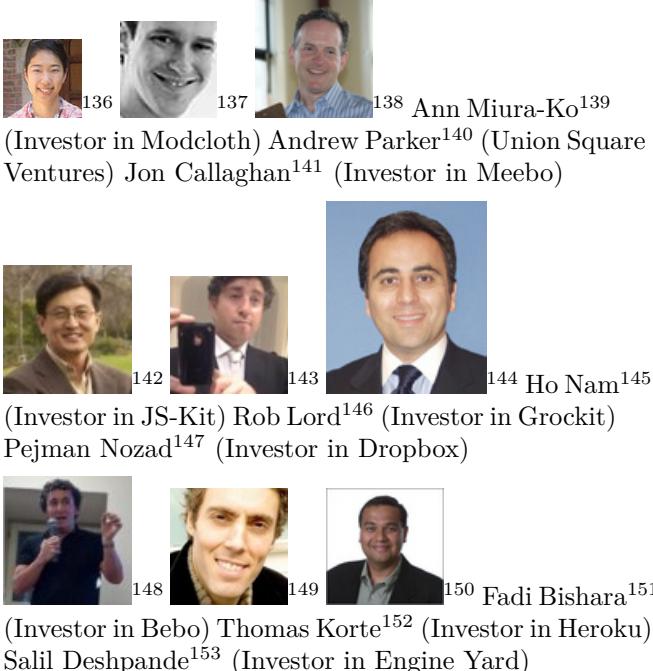
<sup>131</sup><http://twitter.com/rchen>

<sup>132</sup><http://venturehacks.com/angellist#joe-greenstein>

<sup>133</sup><http://venturehacks.com/angellist#rob-go>

<sup>134</sup><http://twitter.com/rchen>

<sup>135</sup><http://venturehacks.com/angellist#joe-greenstein>



<sup>136</sup><http://venturehacks.com/angellist#ann-miura-ko>

<sup>137</sup><http://content.usv.com/pages/andrew-parker>

<sup>138</sup><http://venturehacks.com/angellist#jon-callaghan>

<sup>139</sup><http://venturehacks.com/angellist#ann-miura-ko>

<sup>140</sup><http://content.usv.com/pages/andrew-parker>

<sup>141</sup><http://venturehacks.com/angellist#jon-callaghan>

<sup>142</sup><http://venturehacks.com/angellist#ho-nam>

<sup>143</sup><http://venturehacks.com/angellist#rob-lord>

<sup>144</sup><http://venturehacks.com/angellist#pejman-nozad>

<sup>145</sup><http://venturehacks.com/angellist#ho-nam>

<sup>146</sup><http://venturehacks.com/angellist#rob-lord>

<sup>147</sup><http://venturehacks.com/angellist#pejman-nozad>

<sup>148</sup><http://venturehacks.com/angellist#fadi-bishara>

<sup>149</sup><http://venturehacks.com/angellist#thomas-korte>

<sup>150</sup><http://venturehacks.com/angellist#salil-deshpande>

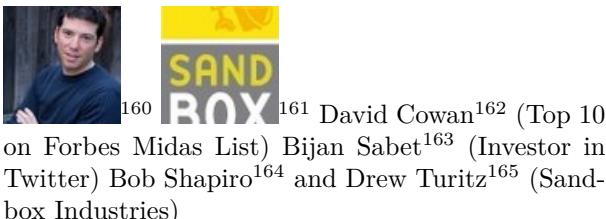
<sup>151</sup><http://venturehacks.com/angellist#fadi-bishara>

<sup>152</sup><http://venturehacks.com/angellist#thomas-korte>

<sup>153</sup><http://venturehacks.com/angellist#salil-deshpande>



(Investor in awe.sm) Peter Chane<sup>158</sup> (Investor in Aardvark) Gabriel Weinberg<sup>159</sup> (Investor in Wakemate)



David Cowan<sup>162</sup> (Top 10 on Forbes Midas List) Bijan Sabet<sup>163</sup> (Investor in Twitter) Bob Shapiro<sup>164</sup> and Drew Turitz<sup>165</sup> (Sand-box Industries)



Chris Sheehan<sup>168</sup> (Investor in Carbonite) Sim Simeonov<sup>169</sup> (Investor

<sup>154</sup><http://venturehacks.com/angellist#mark-suster>

<sup>155</sup><http://venturehacks.com/angellist#peter-chane>

<sup>156</sup><http://venturehacks.com/angellist#gabriel-weinberg>

<sup>157</sup><http://venturehacks.com/angellist#mark-suster>

<sup>158</sup><http://venturehacks.com/angellist#peter-chane>

<sup>159</sup><http://venturehacks.com/angellist#gabriel-weinberg>

<sup>160</sup><http://www.bvp.com/Team/David-Cowan.aspx>

<sup>161</sup><http://www.sandboxindustries.com/Team/RobertShapiro>

<sup>162</sup><http://www.bvp.com/Team/David-Cowan.aspx>

<sup>163</sup><http://www.sparkcapital.com/team/bio/bijansabet/>

<sup>164</sup><http://www.sandboxindustries.com/Team/RobertShapiro>

<sup>165</sup><http://www.sandboxindustries.com/Team/DrewTuritz>

<sup>166</sup><http://venturehacks.com/angellist#simeon-simeonov>

<sup>167</sup><http://venturehacks.com/angellist#satish-dharmaraj>

<sup>168</sup><http://venturehacks.com/angellist#chris-sheehan>

<sup>169</sup><http://venturehacks.com/angellist#simeon-simeonov>

in Veracode) Satish Dharmaraj<sup>170</sup> (Investor in Posteroos)



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Keith Rabois<sup>174</sup> (Investor in YouTube) Manu Kumar<sup>175</sup> (Investor in CrowdFlower) Bipul Sinha<sup>176</sup> (Investor in Sweepery)



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Phineas Barnes<sup>179</sup> (First Round Capital) Saar Gur<sup>180</sup> (Investor in Admob) Ariel Poler<sup>181</sup> (Investor in StumbleUpon)



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184 Andrea Zurek<sup>185</sup>

(Investor in Tapulous) You (Join AngelList →)<sup>186</sup> And You (Join AngelList →<sup>187</sup>)

<sup>170</sup><http://venturehacks.com/angellist#satish-dharmaraj>

<sup>171</sup><http://venturehacks.com/angellist#keith-rabois>

<sup>172</sup><http://venturehacks.com/angellist#manu-kumar>

<sup>173</sup><http://venturehacks.com/angellist#bipul-sinha>

<sup>174</sup><http://venturehacks.com/angellist#keith-rabois>

<sup>175</sup><http://venturehacks.com/angellist#manu-kumar>

<sup>176</sup><http://venturehacks.com/angellist#bipul-sinha>

<sup>177</sup><http://venturehacks.com/angellist#saar-gur>

<sup>178</sup><http://venturehacks.com/angellist#ariel-poler>

<sup>179</sup>[http://www.firstround.com/team/profile/phin\\_barnes/](http://www.firstround.com/team/profile/phin_barnes/)

<sup>180</sup><http://venturehacks.com/angellist#saar-gur>

<sup>181</sup><http://venturehacks.com/angellist#ariel-poler>

<sup>182</sup><http://venturehacks.com/angellist#andrea-zurek>

<sup>183</sup><http://venturehacks.wufoo.com/forms/p7x3x5/>

<sup>184</sup><http://venturehacks.wufoo.com/forms/p7x3x5/>

<sup>185</sup><http://venturehacks.com/angellist#andrea-zurek>

<sup>186</sup><http://venturehacks.wufoo.com/forms/p7x3x5/>

<sup>187</sup><http://venturehacks.wufoo.com/forms/p7x3x5/>

That's 40+ angels and counting who have taken meetings from AngelList (ping me if I missed you or I shouldn't have included you).

I want to thank all the angels who are making AngelList happen and the startups who are applying for intros. Startups, apply for an introduction to AngelList here<sup>188</sup>. Angels, join AngelList here<sup>189</sup>.

## What's the vision?

High concept pitches<sup>190</sup> are great for getting your foot in the door ("It's Friendster... for dogs!").

But once you're in the building, pitch a bigger vision. I've been talking to a lot of startups that apply to AngelList<sup>191</sup> and most of them don't have a vision that would separate investors from their money. Here are some great visions:

*Facebook isn't a social network.* Facebook "gives people the power to share, making the world more open and connected."

*Plancast*<sup>192</sup> *isn't a place to share plans.* It's a "platform for all intent data"<sup>193</sup>."

*Sequoia isn't a VC firm.* They're "the investor and business partner in companies that make up over 10% of NASDAQ's value."

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<sup>188</sup><http://venturehacks.com/startuplist>

<sup>189</sup><http://venturehacks.wufoo.com/forms/p7x3x5/>

<sup>190</sup><http://venturehacks.com/articles/high-concept-pitch>

<sup>191</sup><http://venturehacks.com/angellist>

<sup>192</sup><http://plancast.com/>

<sup>193</sup>[http://www.readwriteweb.com/archives/plancast\\_future\\_as\\_platform.php](http://www.readwriteweb.com/archives/plancast_future_as_platform.php)

*Twitter isn't [insert whatever Twitter is here].* They're "the best way to share and discover what is happening right now."

*Google isn't a search engine.* They "organize the world's information and make it universally accessible and useful."

## Vision principles

Vision isn't a replacement for traction and milestones. But a compelling vision helps differentiate you from the competition<sup>194</sup> (i.e. every other startup pitching that investor). And vision is especially helpful for a startup like DailyBooth<sup>195</sup> where the value proposition isn't immediately clear (*It's not an online photo booth. It's your life in pictures.*)

Don't make your vision too abstract. Be concrete<sup>196</sup> like Plan-cast and Sequoia. Facebook and Twitter can get away with abstraction because everybody already knows what they do.

Vision is aspirational. Google couldn't claim to organize the world's information when they wrote their first line of code. But they could aspire to it.

Make sure your vision is crisp, short, and articulate. No *ums*, *ahs*, *justs*, *you-knows*, or *likes*. This is hard for everyone, but there's a solution: talk slower. You say *um* when your brain needs time to think. So give your brain time to think by slowing down and replacing the *ums* with silence.

Don't belabor the vision. Keep it brief — extremely brief. Consider mentioning it once at the beginning of the pitch and once again at the end.

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<sup>194</sup><http://venturehacks.com/articles/competition-raising-money>

<sup>195</sup><http://dailybooth.com/>

<sup>196</sup>[http://www.google.com/search?hl=en&safe=off&q=concrete+%22made+to+stick%22&aq=f&aqi=&aql=&oq=&gs\\_rfai=](http://www.google.com/search?hl=en&safe=off&q=concrete+%22made+to+stick%22&aq=f&aqi=&aql=&oq=&gs_rfai=)

**Vision is free. Unlike your product, team, and traction, you can literally make it up.**

## Where's the demo?

I just replied to a startup that applied to AngelList<sup>197</sup> with a website behind a closed beta<sup>198</sup> wall:

"Thanks Jeff. Where's the demo? If your team isn't pedigreed (founded a company and made money for its investors) and you don't have outstanding traction<sup>199</sup>, the #1 thing you have going for you is a demo. I also think closed betas are generally a bad idea. Who cares if someone sees the site? Hope you don't mind the direct feedback. Send us a demo and we can take it from there."

Unless you're famous or a big company, why do a closed beta?

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<sup>197</sup><http://venturehacks.com/angellist>

<sup>198</sup>[http://en.wikipedia.org/wiki/Software\\_release\\_life\\_cycle#Open\\_and\\_closed\\_beta](http://en.wikipedia.org/wiki/Software_release_life_cycle#Open_and_closed_beta)

<sup>199</sup><http://venturehacks.com/articles/plans-ndas-traction#traction>

# April 2010

## Postling gets funded with AngelList

We recently wrote<sup>1</sup> about the first startup that got funded through AngelList<sup>2</sup>: Matt Mullenweg<sup>3</sup> invested in a Y Combinator<sup>4</sup> startup we called Startup #0<sup>5</sup>.



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Today, we're announcing that Postling<sup>7</sup> is the second startup to raise money from AngelList. The AngelList investors are:



<sup>8</sup>Dave McClure<sup>9</sup> (Investor in Mint)

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<sup>1</sup><http://venturehacks.com/articles/startuplist-first-funding>

<sup>2</sup><http://venturehacks.com/angellist>

<sup>3</sup><http://venturehacks.com/angellist#matt-mullenweg>

<sup>4</sup><http://ycombinator.com/>

<sup>5</sup>[http://en.wikipedia.org/wiki/0\\_%28number%29#Numbering\\_from\\_1\\_or\\_0](http://en.wikipedia.org/wiki/0_%28number%29#Numbering_from_1_or_0)

<sup>6</sup><http://www.postling.com/>

<sup>7</sup><http://www.postling.com/>

<sup>8</sup><http://venturehacks.com/angellist#dave-mcclure>

<sup>9</sup><http://venturehacks.com/angellist#dave-mcclure>



<sup>10</sup>David Cohen<sup>11</sup> (Investor in Twilio)



<sup>12</sup>Thomas Korte<sup>13</sup> (Investor in Heroku)



<sup>14</sup>Chris Yeh<sup>15</sup> (Investor in PBworks)



<sup>16</sup>Paige Craig<sup>17</sup> (Investor in Plancast)



<sup>18</sup>David S. Rose<sup>19</sup> (Investor in Ambient Devices)

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<sup>10</sup><http://venturehacks.com/angellist#david-cohen>

<sup>11</sup><http://venturehacks.com/angellist#david-cohen>

<sup>12</sup><http://venturehacks.com/angellist#thomas-korte>

<sup>13</sup><http://venturehacks.com/angellist#thomas-korte>

<sup>14</sup><http://venturehacks.com/angellist#chris-yeh>

<sup>15</sup><http://venturehacks.com/angellist#chris-yeh>

<sup>16</sup><http://venturehacks.com/angellist#paige-craig>

<sup>17</sup><http://venturehacks.com/angellist#paige-craig>

<sup>18</sup><http://venturehacks.com/angellist#david-rose>

<sup>19</sup><http://venturehacks.com/angellist#david-rose>



<sup>20</sup>Thomas McInerney<sup>21</sup> (Investor in Mochi Media)

Gary Vaynerchuk<sup>22</sup> and Kal Vepuri<sup>23</sup>, who aren't on AngelList yet, also invested. That's an awesome list of angels.

## How did Postling do it?

First, Postling had traction — in fact, they were already charging for their product.

Second, they listened to customer and investor feedback and pivoted<sup>24</sup> into a larger market during their fund raising process. More details about the pivot in this post<sup>25</sup> on GigaOM — Postling's website<sup>26</sup> doesn't reflect the pivot yet.

Third, the company was started by two of the founders of Etsy<sup>27</sup>. But they didn't need that pedigree to raise the round — they could have done it with just their traction and pivot.

**Update:** Read Postling's story, in their own words: The inside story on how I raised \$200k in 6 days<sup>28</sup>.

<sup>20</sup><http://venturehacks.com/angellist#thomas-mcinerney>

<sup>21</sup><http://venturehacks.com/angellist#thomas-mcinerney>

<sup>22</sup><http://garyvaynerchuk.com/>

<sup>23</sup><http://www.linkedin.com/pub/kal-vepuri/0/205/aa8>

<sup>24</sup><http://www.startuplessonslearned.com/2009/06/pivot-dont-jump-to-new-vision.html>

<sup>25</sup><http://gigaom.com/2010/04/01/for-postling-angel-investors-mail-in-their-checks/>

<sup>26</sup><http://postling.com>

<sup>27</sup><http://www.etsy.com/>

<sup>28</sup><http://caterpillarcowboy.com/post/489762022/the-inside-story-on-how-i-raised-200k-in-6-days>

## AngelList is growing quickly

There are now 75 angels on AngelList and we're adding 1-2 new angels a day like Mike Maples<sup>29</sup>, Ram Shriram<sup>30</sup>, and Aydin Senkut<sup>31</sup>. You can track the day-to-day minutiae of these angel's lives with the AngelList Twitter list<sup>32</sup>:

*Startups:* Get intros to AngelList here<sup>33</sup>. *Angels:* Join AngelList here<sup>34</sup>. *Everyone:* Get AngelList updates with Twitter<sup>35</sup> or RSS<sup>36</sup>. *Thank you all for being part of this.*

## “Being open early worked well for us”

In Where's the demo?<sup>37</sup>, I asked, “Unless you're famous or a big company, why do a closed beta?” There are lots of good reasons why in the comments<sup>38</sup>.



<sup>39</sup>But my favorite comment is from Rob May<sup>40</sup>, founder of Backupify and AngelList power broker<sup>41</sup>:

<sup>29</sup><http://venturehacks.com/angelist#mike-maples>

<sup>30</sup><http://venturehacks.com/angelist#ram-shriram>

<sup>31</sup><http://venturehacks.com/angelist#aydin-senkut>

<sup>32</sup><http://twitter.com/venturehacks/angelist>

<sup>33</sup><http://venturehacks.com/startuplist>

<sup>34</sup><http://venturehacks.wufoo.com/forms/p7x3x5/>

<sup>35</sup><http://twitter.com/angellist>

<sup>36</sup><http://feeds.venturehacks.com/angellist>

<sup>37</sup><http://venturehacks.com/articles/demo>

<sup>38</sup><http://venturehacks.com/articles/demo#comments>

<sup>39</sup><http://www.backupify.com/>

<sup>40</sup><http://twitter.com/Robmay>

<sup>41</sup><http://venturehacks.com/power-brokers>

“In the early days of Backupify (when it was still called Lifestreambackup), not only was I worried that someone would steal the idea and execute it better, but I was also embarrassed by the quality of the product when I demo’ed it. But ultimately, some early users loved it and that kept us going. By releasing an early buggy minimum viable product, we got a pretty big lead on everyone else. Now we have a bunch of competitors, but with more than 60K users and 30 terabytes of data backed up, we are pretty far ahead in terms of traction. Being open early worked well for us.”

By the way, Backupify recently raised money from General Catalyst<sup>42</sup> and First Round Capital<sup>43</sup>.

## Top heavy startups

Seed-stage investors don’t like top-heavy companies: CEO, COO, CXO, CYO, VP of X, Y, and Z. It’s almost an immediate pass. No sophisticated investor is impressed by titles in an early stage startup.

If you’re an early-stage consumer internet company, you don’t need fancy titles, you need founders<sup>44</sup> and employees<sup>45</sup> who get can either build the product or sell it. (One of the founders should be the CEO<sup>46</sup> so you can make decisions quickly.)

There are many exceptions to this bit of advice but, unless you really know what you’re doing (you’ve been starting companies

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<sup>42</sup><http://www.generalcatalyst.com/>

<sup>43</sup><http://www.firstround.com/>

<sup>44</sup><http://venturehacks.com/articles/pick-cofounder>

<sup>45</sup><http://venturehacks.com/topics/employees>

<sup>46</sup><http://venturehacks.com/articles/co-founder-interview>

and investing in them for the last 10 years), keep it simple. CEO, founders, engineers, salesmen, marketers. If one of the founders wants to be the President, give him an internal title, but keep it simple for investors.

## Can I send my pitch to just some of the angels on AngelList?

Some AngelList<sup>47</sup> applicants don't want to send their pitch to everyone on the list. Maybe they don't want to send their pitch to angels who have competitive investments. Or they simply don't want to distribute their pitch widely.

*No problem.* Use the 'Custom Intros' feature when you apply<sup>48</sup> to AngelList:

- Intro me to **all** the angels on AngelList.
- Intro me to **some** of the angels on AngelList  
(we'll get the names from you later)

We can give you custom intros, a mass intro, or both. Most startups ask for both. Even when we've already done a mass intro for a startup, custom intros get high response rates — about 50%.

And how do you research the angels you want intros to? Guess<sup>49</sup>.

I hope you've enjoyed the introduction to this new introduction.

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<sup>47</sup><http://venturehacks.com/angellist>

<sup>48</sup><http://venturehacks.com/intro>

<sup>49</sup><http://venturehacks.com/angellist>

## Interview: How to close an angel round

Just got a sneak peek at a @venturehacks interview. It's like drinking valuable info from a fire hose.

7:36 PM Mar 18th via web  
Retweeted by 1 person

Reply Retweet

 **RafaelCorrales**  
Rafael Corrales

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Sean Ellis<sup>51</sup> taught me that startups need to be as creative and thoughtful about their marketing as they are about their products. But we've never applied that thinking to Venture Hacks. We focused on writing stuff that doesn't suck, didn't engage in marketing histrionics, and figured the customers would come. More important, we simply weren't excited about marketing.

But! Since we started AngelList<sup>52</sup>, we've suddenly gotten excited about marketing — who knows why. And so, on to the histrionics...

## Interview: How to close an angel round

Naval and I have recorded one of our best interviews yet: how to close an angel round. But there's only one way to get it: apply

<sup>50</sup><https://twitter.com/RafaelCorrales/status/10702624719>

<sup>51</sup><http://startup-marketing.com/>

<sup>52</sup><http://venturehacks.com/angellist>

to AngelList<sup>53</sup>. And if you *don't* want to apply AngelList, apply anyway, tell us *why* you don't want any intros, and we'll still send you the interview.

*Here's a 10-minute teaser of the full 40-minute interview:*

SlideShare: How to close an angel round – Teaser<sup>54</sup>  
Video: Interview with chapters<sup>55</sup> (for iPod, iPhone, iTunes)  
Audio: Interview without chapters<sup>56</sup> (MP3, works anywhere)  
Transcript: Below

**¡Get the full interview by applying<sup>57</sup> to AngelList!**

A keeper: synced it to iPhone & love it:RT @venturehacks: How to close an angel round: <http://j.mp/d48sHM>. A new interview on Venture Hacks.

4 minutes ago via TweetDeck

Reply Retweet

 **jkaljundi**  
Jüri Kaljundi

58

<sup>53</sup><http://venturehacks.com/intro>

<sup>54</sup><http://www.slideshare.net/venturehacks/how-to-close-an-angel-round-teaser>

<sup>55</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/03/How-to-close-an-angel-round-teaser.m4a>

<sup>56</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/03/How-to-close-an-angel-round-teaser.mp3>

<sup>57</sup><http://venturehacks.com/intro>

<sup>58</sup><https://twitter.com/jkaljundi/status/11715432114>

## Outline

Here's the outline of the full 40-minute interview (not just the teaser).

1. You can close an angel round with ‘mass syndication’
2. Start with terms and valuation below market
3. What you want in your term sheet
4. What you don’t want in your term sheet
5. Should you have a board seat for seed investors?
6. This isn’t comprehensive term sheet advice
7. Memorize the term sheet before your first meeting
8. How do you set your valuation? Price it to move
9. How do you bring up the terms in a meeting?
10. Describe how the terms are investor-friendly
11. A preferred round is a good way to set up good initial terms
12. Does a small seed round need protective provisions? Pros and cons.
13. Get feedback on the terms in the first meeting
14. Drop names to build social proof
15. Social proof works differently in a Series A round with VCs
16. See if the “interest” includes a dollar amount, intros, and name-dropping (a.k.a. soft circled)
17. When do you need a lead?

18. Approach the financing as if you won't find a lead
19. What's a lead investor?
20. If they say "find a lead," ask why
21. How to create a deadline
22. Raise the money when you don't need it
23. Send two emails to the angels
24. Do a rolling close: the cash comes in just-in-time
25. Mass syndication can fail if a very high social proof investor drops out
26. Use AngelList and StartupList to get intros to angels
27. What do angels look for?
28. Advisors are good for getting your foot in the door, not in a pitch
29. Get advisors by going to events or talking to entrepreneurs
30. Before you raise a seed round, you need a product in the marketplace
31. Use customer development and lean startup techniques to get to market with less
32. Pitching hacks free chapter: Advice on getting investor intros
33. If you need money to get something in the marketplace, pitch idea investors
34. Pitch incubators or do your startup on the side
35. What are the different types of seed stage investors?

36. If you're talking to a VC, make sure they really do seed stage rounds
37. Potential concerns with pitching multi-stage and seed-stage firms
38. Get intros to seed investors with AngelList/StartupList

## Transcript

*Here's a transcript of the first 10 minutes of the 40 minute interview.*

(Music: Squarepusher)<sup>59</sup>

**Nivi:** Hi there, this is Nivi from Venture Hacks.

**Naval:** And Naval from Venture Hacks.

**Nivi:** And we're going to talk about how to close an angel round, how to put together an angel round, or in other words, how to herd a motley crew of angel investors and turn those meetings that you're getting into money in the bank.

I think we're going to start off by talking about mass syndication, which is an approach that I think more entrepreneurs should be taking to close their angel rounds.

### You can close an angel round with ‘mass syndication’

**Nivi:** I think entrepreneurs make two typical mistakes when they're doing an angel round, and they come from what they've read online about how to close a VC round. So, there are two things.

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<sup>59</sup><http://www.google.com/search?hl=en&q=squarepusher&aq=f&oq=>

One: they don't name drop enough. They don't mention who else is interested.

Two: and I guess more importantly, they're looking for a lead, which you don't necessarily need in an angel round.

When you put those two together and combine them with a term sheet that you essentially write yourself, you've got a new way to close an angel round which we call mass syndication, which I've done personally. And Naval, maybe you can talk about how often you see that happening, or if you don't see that happening, or whatever.

**Naval:** It happens fairly often these days. Especially the Y Combinator companies, which are well trained by Paul Graham and crew, will exercise mass syndication a lot. So, they take the standard term sheet that they've been given and they go out and do a rolling close of various convertible notes. And it generally works pretty well.

The keys are that you have to set the terms and the valuation very, very reasonably. In fact, you have to probably price slightly below market, because otherwise the angels don't trust you, then they want a lead who's done the due diligence. You have to work with people that you have warm intros with, you have to name drop like crazy, and you have to create forcing functions to get the round to close. You can't give people all the time in the world.

## **Start with terms and valuation below market**

**Nivi:** Right. So let's dig into all that stuff. First off, I think you want to start with a term sheet that you've generated yourself.

**Naval:** I think it's even better to have a term sheet that comes with someone else's authority attached. So, it could be one that Wilson Sonsini has put up. It could be one that Y Combinators

put up or Founder Institute has put up or Founders Fund has put up, but it's just better to start with a widely accepted circulated term sheet where you can point to it and say dozens of other startups have used this term sheet, it's not new.

**Nivi:** Yeah. And then there are the new Series C documents from Andreessen Horowitz and Ted Wang and other investors, which we haven't reviewed, by the way. At least, I haven't.

**Naval:** Yeah, we're not endorsing any particular set.

**Nivi:** Yeah, so I would look at the term sheet first, and I find that a lot of entrepreneurs that I talk to have not really studied the terms that they're signing onto enough, and they end up using the authority of: it's a Y Combinator series AA doc, so we're going to use it because everybody else has used it.

## **What you want in your term sheet**

**Nivi:** I think there's some wisdom in that, but at the same time I really want to understand what I'm signing. The things that I look for, personally, in a seed-stage term sheet are: If you're going to do convertible debt there's going to be a cap on the conversion price. In the event of an early acquisition you're probably going to use that same cap to give the investors a non-participating liquidation preference.

**Naval:** Yep.

**Nivi:** If the debt matures before the company is acquired or does another round, you want the debt to convert into common or preferred stock, and that's at the company's behest.

And I like to have a majority or supermajority of the investors able to amend the documents.

**Naval:** They have to approve any amendment of the documents.

**Nivi:** Yeah, they can approve an amendment of the document, so you don't need everybody's approval to make some change – to extend the maturity date, or whatever, or to increase the amount of debt you can raise. Off the top of my head, that's kind of....

### **What you don't want in your term sheet**

**Naval:** Yeah, what's equally interesting and what's usually not in a seed or angels syndication round is that you don't have a minimum raise requirement. You don't have, usually, a board seat or board structure. You often have vesting, but because the company is still controlled by the founders, the vesting is more of a pre-nup agreement between the founders than it is anything to do with the investors. But generally you want to keep it very simple.

**Nivi:** No option pool, really.

**Naval:** There can be. Actually, I would say that there usually should be, because you don't want the situation where an investor starts reading the documents, finds out there's no option pool, and therefore doesn't feel like your valuation is properly represented, because these days in the market, people are used to seeing an option pool.

### **Should you have a board seat for seed investors?**

**Nivi:** OK. And yeah, with the board seat thing, I think too many seed stage companies probably have board seats, especially if there is a VC involved in the round. If you want some normative leverage on that you can go to Marc Andreessen's blog where they write, essentially, that they don't think most seed-stage companies should have investors on their board of directors. Right?

**Naval:** Yeah, and it absolutely depends on the stage the company's at and how much money you're raising. If you're raising a million bucks from institutional investors, you're actually really doing more of a mini-VC round than a seed round, so you are going to have a board seat at least, although you probably won't give it board control.

On the other hand, if you're raising \$250,000 spread across 10 investors, then you don't need to have a board seat, although you may want to have an external board member just to help resolve any founder issues that come up, and to get some good advice.

### **This isn't comprehensive term sheet advice**

**Nivi:** This isn't intended to be a comprehensive discussion of term sheets for seed-stage companies, but it's a good start.

### **Memorize the term sheet before your first meeting**

**Nivi:** So I think that's our best advice on the first step, which is generating a term sheet. And you should be able, when you go into a meeting with any of the prospective seed investors you have, to essentially rattle off the major terms in that term sheet.

### **How do you set your valuation? Price it to move**

**Nivi:** I guess the only thing I would add to what Naval said earlier when he described it as maybe the price is "below market," I sometimes describe it as "priced to move." So you want a price where there should be no discussion around the price that you're putting forward.

We've got an article, actually, that you should look up. It's called How do we set the valuation for a seed round?<sup>60</sup> Let me look it up right now.

**Naval:** The valuation is a very difficult topic, especially when the entrepreneur is trying to do it themselves. They invariably get it wrong, and usually it's too high. You just want to talk to somebody who has a lot of data points in the market and can give you those data points.

**Nivi:** Right. So you need the market data, and then check out this article we have. It's called How do we set the valuation for a seed round?<sup>61</sup>

## **How do you bring up the terms in a meeting?**

**Nivi:** OK, so at this point you've generated the term sheet, we're going to assume that you've got some meetings lined up, and we'll get back to this topic of how to get some meetings, but let's assume that you've got some meetings lined up. You do the meeting. How do I bring up a discussion of the terms?

**Naval:** I think if the investor's interested, as a final step they're going to ask you. They're going to ask what the terms are or who's in the round, or they'll ask you to give them some details about the financing. And that's when you basically say: So-and-so is committed to invest. We have a couple of people looking at it. We're hoping to close by such-and-such a date, or we are going to close by such-and-such a date. There are x dollars available, and it's a convertible note and it's capped at a valuation of x and a discount of y. So, you can just throw the terms out. You can be pretty straightforward with most angels.

If you want to be a little more subtle you can say we're raising x, and we're selling no more than y% of the company; but I feel

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<sup>60</sup><http://venturehacks.com/articles/seed-valuation>

<sup>61</sup><http://venturehacks.com/articles/seed-valuation>

that with most angels you can just be direct and say the cap is whatever it is, and just give the number.

**Nivi:** Yeah, if they don't bring it up you should just have a slide that says "Financing" at the end of the presentation, [laughing] and you tell them exactly what Naval said. You drop the names, and we'll get back into the specifics of exactly how you drop the names.

### **Describe how the terms are investor-friendly**

**Nivi:** And you discuss the terms, and you discuss them in a way that shows how investor friendly they are and how sane they are, and frankly, there really should be no room for discussion on them. Not that there's no room, just that there's no need because the valuation is priced to move and there are a lot of good investor protections – which the only ones they really care about are ...

**Trent:** Oh the suspense! Please don't shoot the messenger, but that is the end of 10-slide preview of Nivi and Naval's conversation on how to close an angel round. Of course, there's all sorts of invaluable advice packed into the remaining 30 minutes or so that you haven't heard yet. Nivi and Naval are going to touch on a wide range of angel related topics, about 30 more topics I believe. Everything from using advisors to getting your foot in the door, how to find advisors, what angels look for in an investment, what they don't want to see, what they do want to see, getting introductions to angel investors, finding angels for idea investments, pitching incubators and a whole lot more to help you seal the deal on your angel funding round.

So, if you're eager to get that started and listen to the entire interview, all you have to do is head on over to [venturehacks.com/startuplist](http://venturehacks.com/startuplist)<sup>62</sup>, get yourself registered there.

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<sup>62</sup><http://venturehacks.com/startuplist>

And dont forget... Over on venturehacks, there's all kinds of interesting articles and great advice for your startup.... So, browse around!

For venturehacks.com, I'm Trent... Thanks for listening.

## “AngelList is the real deal”

AngelList<sup>63</sup> reviews from entrepreneurs in the trenches:



<sup>64</sup>Tony Wright<sup>65</sup>, Founder of RescueTime<sup>66</sup> (and AngelList power broker<sup>67</sup>) says<sup>68</sup>:

“AngelList is the real deal. I've heard quite a few people having some success there. Even as a YC company, there is a startling hole after Demo Day... It can take months to close a round (it took us 5ish), even loaded down with Demo Day biz cards and meeting invites. If I were doing YC again today, I'd try to get on AngelList right after Demo Day...”

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<sup>63</sup><http://venturehacks.com/angellist>

<sup>64</sup><http://www.tonywright.com/>

<sup>65</sup><http://www.tonywright.com/>

<sup>66</sup><http://www.rescuetime.com/>

<sup>67</sup><http://venturehacks.com/power-brokers>

<sup>68</sup><http://news.ycombinator.com/item?id=1235590>



<sup>69</sup>Paul Stamatiou<sup>70</sup>, Founder of Skribit<sup>71</sup> says<sup>72</sup>:

“Nothing but great things to say about AngelList. I applied with my startup and while we weren’t selected for that week, Nivi sent me a nice personalized email and has been super friendly and always open to chat about startups.”



<sup>73</sup>Dave Lifson<sup>74</sup>, Founder of Postling<sup>75</sup> says<sup>76</sup>:

“So we pivoted (explained in the GigaOm<sup>77</sup> post, but I’ll say more soon), and sent the new direction to AngelList. And this is where the craziness started.

“My first phone call was with Tom McInerney<sup>78</sup>, 3 hours before I was flying out to SXSW. After about a 30 minute phone call, Tom was in. He then introduced me to his friend Paige Craig<sup>79</sup>, who would also be at SXSW. I met Paige in Austin, and after meeting, he told me he was in. The next day, at

<sup>69</sup><http://paulstamatiou.com/>

<sup>70</sup><http://paulstamatiou.com/>

<sup>71</sup><http://skribit.com/>

<sup>72</sup><http://news.ycombinator.com/item?id=1235590>

<sup>73</sup><http://twitter.com/DLifson>

<sup>74</sup><http://twitter.com/DLifson>

<sup>75</sup><http://www.postling.com/>

<sup>76</sup><http://caterpillarcowboy.com/post/489762022/the-inside-story-on-how-i-raised-200k-in-6-days>

<sup>77</sup><http://gigaom.com/2010/04/01/for-postling-angel-investors-mail-in-their-checks/>

<sup>78</sup><http://venturehacks.com/angellist#thomas-mcinerney>

<sup>79</sup><http://venturehacks.com/angellist#paige-craig>

a Venturehacks meetup at the Four Seasons hotel, he pulled over Dave McClure<sup>80</sup>. We went out to the balcony<sup>81</sup> (he wanted a cigarette) and I pitched him. He was in. The following day, I spoke with Thomas Korte<sup>82</sup>, who moved up our scheduled phone call a couple days once he heard Dave was investing, and he was in. I also got an email introduction via my friend Russ (founder of SeatGeek<sup>83</sup>) about his investor Kal Vepuri<sup>84</sup>, who was also at SXSW. Kal and I spoke on the balcony of the Austin Convention Center, and I was blown away by his intelligence and humility. So Kal was in. Finally, my friend Michael Galpert<sup>85</sup> of Aviary<sup>86</sup> connected me with Gary Vaynerchuk<sup>87</sup>, who is a perfect investor for us given what he is passionate about (social media for businesses). David Cohen<sup>88</sup> finished off our round not too long after that.

“So that’s it. Through a combination of a great team (Chris & Haim founded Etsy), customer development, responding to feedback, AngelList, networking, and being able to articulate a compelling vision backed by domain expertise, I was able to raise \$200k in the 6 days of SXSW!”

*Startups: Apply to AngelList<sup>89</sup>. Angels: Join AngelList<sup>90</sup>. Ev-*

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<sup>80</sup><http://venturehacks.com/angellist#dave-mcclure>

<sup>81</sup><http://caterpillarcowboy.com/post/470928054/me-and-dave-mcclure-more-information-to-come>

<sup>82</sup><http://venturehacks.com/angellist#thomas-korte>

<sup>83</sup><http://seatgeek.com/>

<sup>84</sup><http://www.linkedin.com/pub/kal-vepuri/0/205/aa8>

<sup>85</sup><http://msg.tumblr.com/>

<sup>86</sup><http://aviary.com/>

<sup>87</sup><http://garyvaynerchuk.com/>

<sup>88</sup><http://venturehacks.com/angellist#david-cohen>

<sup>89</sup><http://venturehacks.com/startuplist>

<sup>90</sup><http://venturehacks.wufoo.com/forms/p7x3x5/>

eryone: Get AngelList updates with Twitter<sup>91</sup> or RSS<sup>92</sup>.

## Facebook acquires AngelList startup



<sup>93</sup>

Today, we're announcing that Divvyshot<sup>94</sup> is the third company to raise money with AngelList<sup>95</sup>. **And the first AngelList-funded startup to be acquired<sup>96</sup>** — by Facebook no less. The AngelList investor is:



<sup>97</sup>Richard Chen<sup>98</sup> (Investor in Aardvark)

And Divvyshot was referred to us by an AngelList power bro-

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<sup>91</sup><http://twitter.com/angellist>

<sup>92</sup><http://feeds.venturehacks.com/angellist>

<sup>93</sup><http://www.divvyshot.com/>

<sup>94</sup><http://divvyshot.com/>

<sup>95</sup><http://venturehacks.com/angellist>

<sup>96</sup><http://techcrunch.com/2010/04/02/facebook-buys-up-divvyshot-to-make-facebook-photos-eve>

<sup>97</sup><http://venturehacks.com/angellist#richard-chen>

<sup>98</sup><http://venturehacks.com/angellist#richard-chen>

ker<sup>99</sup>:



<sup>100</sup>Jamie Quint<sup>101</sup> (Founder of Simple Condo<sup>102</sup>)

Divvyshot also raised money from Y Combinator<sup>103</sup> (in a previous round), Jim Young<sup>104</sup> and Gabor Cselle<sup>105</sup>. That's a great list of investors. Soon after raising this round, Divvyshot was acquired<sup>106</sup> by Facebook.

**Update:** Jolie O'Dell picks up this story for Mashable<sup>107</sup>.

## New angels on AngelList

Some of the awesome new angels on AngelList:



<sup>108</sup>Mitch Kapor<sup>109</sup> (Investor in Pos-  
terous)

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<sup>99</sup><http://venturehacks.com/power-brokers>

<sup>100</sup><http://jamiequint.com>

<sup>101</sup><http://jamiequint.com/>

<sup>102</sup><http://simplecondo.com/>

<sup>103</sup><http://ycombinator.com/>

<sup>104</sup><http://venturehacks.com/angellist#jim-young>

<sup>105</sup><http://www.gaborcselle.com/>

<sup>106</sup><http://techcrunch.com/2010/04/02/facebook-buys-up-divvyshot-to-make-facebook-photos-eve>

<sup>107</sup><http://mashable.com/2010/04/08/facebook-divvyshot/>

<sup>108</sup><http://venturehacks.com/angellist#mitch-kapor>

<sup>109</sup><http://venturehacks.com/angellist#mitch-kapor>



<sup>110</sup>Ram Shriram<sup>111</sup> (Investor in Google)



<sup>112</sup>Mike Maples<sup>113</sup> (Investor in Twitter)

You can track the day-to-day minutiae of these angel's lives with the AngelList Twitter list<sup>114</sup>. 2 years ago, you would have had a tough time convincing me that the best angel investors in the world would be publishing hourly updates about their lives via txt message. But here you go:

*Startups:* Get intros to AngelList here<sup>115</sup>. *Angels:* Join AngelList here<sup>116</sup>. *Everyone:* Get AngelList updates with Twitter<sup>117</sup> or RSS<sup>118</sup>.

## Who has time for meetings?

Venture Hack'er Naval Ravikant has a personal blog that I consider a must-read. It's called Startup Boy<sup>119</sup> and his latest post

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<sup>110</sup><http://venturehacks.com/angellist#ram-shriram>

<sup>111</sup><http://venturehacks.com/angellist#ram-shriram>

<sup>112</sup><http://venturehacks.com/angellist#mike-maples>

<sup>113</sup><http://venturehacks.com/angellist#mike-maples>

<sup>114</sup><http://twitter.com/venturehacks/angellist>

<sup>115</sup><http://venturehacks.com/startuplist>

<sup>116</sup><http://venturehacks.wufoo.com/forms/p7x3x5/>

<sup>117</sup><http://twitter.com/angellist>

<sup>118</sup><http://feeds.venturehacks.com/angellist>

<sup>119</sup><http://startupboy.com/>

is Who has time for meetings?<sup>120</sup>

“A lot of entrepreneurs assume that the initial way to engage with an investor is to \*insist\* on a meeting. It’s a relatively safe assumption that anyone on the buy side (an investor, an advertiser, an executive at a large company) receives far more requests for meetings than they can follow up on, and are constantly looking for excuses to say “no.”

“Synchronous activities, such as phone calls, screen-casts, videos, and webex conferences are almost as bad. If you’re trying to get the attention of an investor or exec at a major company, and don’t want to waste either your time or their time, pay very, very close attention to the cost of their time and you’ll fare better. In order of escalation, one should proceed as follows...”

Read the full post<sup>121</sup>. More of my favorite posts from Naval’s personal blog here<sup>122</sup>.

## Presentation Hacks

Naval<sup>123</sup> here. Adeo Ressi recently invited me to speak at the Silicon Valley Founder Institute<sup>124</sup>. The topic was how to present to investors.

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<sup>120</sup><http://startupboy.com/2010/04/10/who-has-time-for-meetings/>

<sup>121</sup><http://startupboy.com/2010/04/10/who-has-time-for-meetings/>

<sup>122</sup><http://venturehacks.com/articles/startup-boy>

<sup>123</sup><http://www.startupboy.com/>

<sup>124</sup><http://www.founderinstitute.com/>

[Nivi: There's a lot of new stuff in this presentation — I learned a lot that goes far beyond the topic of pitching VCs. I **bolded** my favorite parts in the transcript below.]

SlideShare: Presentation hacks<sup>125</sup> Audio: Interview with chapters<sup>126</sup> (for iPod, iPhone, iTunes) Audio: Interview without chapters<sup>127</sup> (MP3, play anywhere)  
Transcript: See below

## Outline

Here's an outline and transcript of the presentation.

1. Does the presentation matter?
2. The presentation doesn't matter
3. What really matters
4. Preparing for your presentation
5. What's in the pitch?
6. Seducing investors
7. The high concept pitch
8. The elevator pitch
9. Elevator pitch example
10. The 10/20/30 rule of PowerPoint

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<sup>125</sup><http://www.slideshare.net/venturehacks/presentation-hacks>

<sup>126</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/03/Presentation-Hacks.m4a>

<sup>127</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/03/Presentation-Hacks.mp3>

11. The 12 pieces of the presentation
12. Learn from the masters
13. AngelList

## Transcript

**Naval:** So, Rashmi mentioned the information asymmetry that exists between investors and entrepreneurs, and at this point I've been lucky enough to have been involved with a large number of startups as a founder, advisor, and investor. And along the way, what my partner Nivi and I are doing is trying to break open that information asymmetry. So everything we know about venture capital, from term sheets, financings, cap tables, equities, negotiations, goes up on Venture Hacks, and we're always trying to update it.

Recently we even launched a list, an open directory of angels, and we connect the startups with the angels directly so they don't have to pound the pavement all the time.

So, what is Venture Hacks? Basically, game theory applied to venture capital is the shortest summary I can give you, and I'll get into it.

I've focused this time on presentation. There's a lot we could talk about: How do you raise money? How do you pitch investors? How do you convince people? And [we could talk about] the process itself. But right now I'm just going to talk purely about presentation, because I think that was the topic at hand. So, let me see if this works. Forward! No.

**Man in audience:** We'll go manually.

There we go. OK.

## The presentation doesn't matter

So here is my first piece of advice – the presentation doesn't matter. I really don't think it's that relevant, not to a high-quality, experienced investor. They're not really there for the presentation, and your presentation skills are kind of secondary.

What matters much more is the substance of what you're talking about, and you should take heart in that because even though it seems like an arcane process, funding is still largely a meritocracy. It is your job to articulate what you have, but if you don't have that much you're not going to get funded. And if you have something great you will eventually get funded.

## What really matters

Here are the things that matter in rough order of importance.

I think traction is the most important thing. So, congratulations to SlideShare<sup>128</sup>; you guys did it the right way. You built a product that had traction, and then you went to raise money.

Secondly, you – you, the team – are the second most important thing. And if you're not getting funded when you have traction, or you're not getting funded when you think you have a really good team, maybe you don't have that great a team. Maybe you need to take a cold, hard look in the mirror, go back to the drawing board, recruit another cofounder, or go get some more experience or build up your own credibility.

Social proof. As Rashmi said, investors are sheep; they stampede in herds. But you know what? Everyone

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<sup>128</sup><http://www.slideshare.net/>

**does.** We're all the same. It's the theory of cumulative advantage. We listen to a band because our friends listen to a band. We go and watch Avatar, not because it's a great movie, it's because everybody else went to see Avatar. Investors are no different.

The product is number four. Especially if you're a consumer web facing company or a largely web facing company, you should have built a product before you go to raise money. Certainly if you're spinning silicon or you're building a giant routing device, you need to raise money before you can go and build a product, but if you're on the web you should have a product or at least a strong prototype of a product.

The market size is important. **Even angel investors look for fairly large markets, and it's not because they necessarily need the huge exits, it's because a lot of times they face a downstream funding scenario, which is the they might give you money, you run out of money, then you need VC money and VCs only fund very, very large ideas – things that are going after big markets.**

In fact, if I had to point out one overarching failing of incubators and combinatorics and those kinds of institutions, it's that too often their entrepreneurs are going after very niche ideas, and that means that when they go out for funding they hit a wall. So go for the biggest idea possible. You can always narrow it down.

So after all that stuff, now comes what I consider the three important components of presenting your company.

The most important is the high-concept pitch. So for example, Venture Hacks, you could say in my words, is game theories applied to venture capital. That small, pithy pitch is very important. I'll get more into that.

Then comes the elevator pitch – the old line, something you could pitch in an elevator or in a TV commercial.

And finally, the least important is the presentation itself. I spent maybe 30 minutes on this presentation, just as long as it took me to write the stuff down. So I'm reading it for the first time also, or second.

## **Preparing for your presentation**

More important than your presentation is being prepared for your presentation. You have to know your subject cold, inside out. You have to know your company inside out, and the test that I use for that is the whiteboard test, which is: **could you get up and pitch your company on a whiteboard without a single slide? If you cannot do that you are not ready to present. You don't know your own material well enough.**

In fact, the first company for which I raised a substantial amount of money, and I confess it was during the bubble, but I raised an \$8 million Series A, with not a line of code written.

[audience laughter]

Those were the days. It was all done on a whiteboard. I just got up on a whiteboard with my cofounders and we just drew it out, and we walked out with a commitment for \$8 million.

I think the whiteboard pitch is also very impressive because it stands out. Everybody fires up the slides – everybody. If you can just sit down in front of your investor and pull out a sheet of paper and sketch your business out, or if you can do it in front of a whiteboard, I guarantee you're going to make an impression. Now, of course, if all of you do it then maybe it won't make as much of an impression, but whichever ones of you can do it, I guarantee it will make an impression.

Public speaking. There's a lot that's been said on this topic. It's actually quite simple. Public speaking is purely about confidence. Confidence comes from knowing your topic.

There is a famous school of public speaking called the Dale Carnegie School. Scott Adams, Warren Buffett – they have a lot of famous graduates. It's the oldest school of public speaking in the country. You can go to that school; they do a great job, but I'll tell you everything you need to know about that school. It's just about confidence building. What they do is get you up there, you pitch, and then everybody in the audience, afterwards, is allowed to give you feedback on your pitch. But they're only allowed to say positive things. They're not allowed to criticize you in any way, shape or form. And after 10 sessions of this you think you are so great at public speaking that you are very confident, and you are a good public speaker. **So public speaking is purely about confidence.** A lot of this stuff applies to relationships, too.

[audience laughter]

**Man in audience:** So if we have Adeo Ressi, he's building us up.

Yeah. OK, good. Yeah, Adeo.... that's not building confidence.

[audience laughter]

**Man in audience:** We don't say anything nice about anyone who gets up.

In the spirit of being positive, I'd say Adeo was trying a different strategy.

[audience laughter]

One big mistake I see in a lot of presentations is that the entrepreneur will go on and on about the macro economics of the market that they are operating in. They will spend a lot of time trying to convince you that it's a \$34 billion market instead of a \$32 billion market. It doesn't matter as long as it's a big market. Forget macro economics. Anybody who reads the news knows that with macro economics you can find anybody who will say anything on the topic.

**What matters are the micro economics of your business.** You better know what a customer costs to acquire. You better know what they're worth. You better know how long they'll last. You better know their churn rate. You better know what their alternatives are. If you understand your customer, your individual customer at a micro economics level, then you will do a very good job of convincing the investor that you know your stuff around the business.

So whenever you're dealing with stats, numbers or marketing, focus on the micro, not the macro.

## **What's in the pitch?**

This is an interesting thing that I learned a long time back, and I still can't do it because I just used the word "uh" a moment ago. Get rid of the words "you know," "like," "uh," and "so" from your vocabulary. They just make you sound less confident. They make you sound like you're less of a good public speaker. **The reason you do these things, the reason you go "uh" and "ah" is because your brain is buying time for you to figure out what to say next. It's a very common thing.** So, just learn to pause. It's OK to pause. You don't sound dumb because you pause; it adds more gravitas to the situation. But learn to eliminate these words from your vocabulary. This is probably the single best thing you can do to sound more intelligent and persuasive in your life, so this is beyond just presentation.

And finally, when you're in doubt about your fundraising and your pitch, when you think your presentation is not up to snuff, don't work on your presentation. Go and code. Build your product. That's far more important than actually tweaking your presentation. Anyone who tweaks their presentation repeatedly is wasting their time.

Now, the pitch itself — we will get to the pitch. Uh....

I just used “uh.” See? Even after 10 years of knowing that rule, it’s very hard to get it out of your vocabulary.

Start off by introducing yourself. People should know who they’re speaking to. **Tell them a story – this is very important. Don’t just give them a random series of facts; stitch together a narrative.** Very often it is a true historical narrative of how you started the company, how you met your cofounder, why you got excited about what you’re doing. Tell a story.

Keep a quick pace. You have about 10 minutes before you lose everybody. Human beings do not have a long attention span. This is true in almost anything. **Very often in good pitches I find that you get stuck on the summary slide that’s at the beginning and you never get past that because right there in the summary you’ve pointed out all of the important things for the investor, and then they just go straight into Q&A.**

**Confess ignorance if you don’t know the answer to something. It’s always OK to say: Well, you know, that’s interesting. I didn’t know that. I’m going to go figure that out.**

Now, that shouldn’t be about core and basic things. That should only be about curve balls that they throw at you.

**And finally, it’s OK to think out loud and to muse about things.** It’s completely OK to say on the one hand this, on the other hand that. You don’t want to project false confidence when you don’t have any.

One of the things you’ll find in this process from a lot of the mentors is that very often we’re going to contradict each other. We’re going to contradict each other because **there are no absolute rights and wrongs in this game.** If there were

**it would have been automated a long time ago, and there would be no value to being an entrepreneur.** Every situation is unique, has to be figured out on its own merits, so it's OK to think out loud and to express uncertainty.

## Seducing investors

Now we get into the fine art of actually seducing the venture capitalist. A very good friend of mine put this well, He said, "The process of raising venture capital is a process of younger men and women seducing older men and women."

[audience laughter]

**Basically what you're doing is going to somebody who still fancies themselves an entrepreneur, but no longer has the energy or the time to be an entrepreneur, but they don't know this. So what they're doing is projecting into your shoes and saying: Oh yeah, this is great! I can see the younger me. If I wasn't already above this or beyond this, I would go ahead and do this and I would be so good at it.**

So you're going through that process. The best study on seduction is a book by Robert Cialdini called *Influence*<sup>129</sup>. If you haven't read it, I highly recommend it. Cialdini is a psychologist who basically breaks down what he believes are the six ways in which people influence other people, and he goes into it in excruciating detail, but here they are. I'm just going to give you examples as they apply towards fundraising.

Reciprocity might be [where] you do the investor a favor; they want to do you a favor. A classic example is when there are entrepreneurs who, before they even come to me to raise money they send me high-quality deals. And then after I've looked at

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<sup>129</sup> <http://www.amazon.com/Influence-Practice-Robert-B-Cialdini/dp/0321011473>

a couple of high-quality deals they've sent me I have no choice but to look favorably upon them.

**The classic example of reciprocity is the Hari Krishnas. You're walking around the airport and they hand you a flower. You just got a 10 cent flower and then they try to sell you a \$20 copy of the *Bhagavad Gita*. At this point, reciprocity kicks in, and the next thing you know you're forking over \$20 for a \$2 book.**

Commitment and consistency bias. People are highly consistent with their past statements, so if your investor has written a blog, and in a blog post they've made a certain point, you can always say, well, we agree with your point on so-and-so. It's sort of locking them into their earlier decision.

Social proof I've talked about. It's very, very, very important. It's a herd mentality. You build up your advisors and you build up your angels and you build up your VCs.

Authority. If you have people who come from a high stature or a high background, as Rashmi mentioned, some very high name and value advisors like Mark Cuban for example, those people can lend you a lot of proof.

Liking just means that they like you. Do you smile? You don't have to dress well, but you have to be a likeable person. I think that's actually pretty important. This one is underplayed. **Most investors have more money than time, and so they're always having to choose; is this someone I'm going to spend time with?** And every great investor that I know eventually comes to the same set of conclusions, and those conclusions are: this business is completely random, I don't know if I'm going to succeed, and so I might as well only spend time with people that I really like because that way, even if it doesn't work out, I had a good time.

[audience laughter]

And finally, scarcity. You do have to create a sense of scarcity around your business. You have to create a time limit on your fund-raising process. You have to make it clear, especially to lead investors, that there's not room for two or three, so that they will collude. And, **it is only when they feel that the deal is disappearing that people will be incented to move.**

### **The high concept pitch**

So let's get into high-concept pitch. This is the most important piece of your presentation. Hollywood has perfected the art of the high-concept pitch.

So, Sequoia Capital has their version of it that they put on the back of a business card.

And here are the Hollywood examples: jaws in space is Alien, bus with a bomb is Speed, snakes on plane – self explanatory. They're very, very, very, good at summarizing a very quick pitch.

Here are examples from the entrepreneurial world, from the world we know. I especially like the Sequoia Capital one. I think that one's pretty clever. It would have taken me a while to come up with that one.

Venture Hacks is a little self explanatory.

YouTube did start off pitching as Flickr for video, which actually did them a bit of a disservice because the Flickr exit was pretty small by comparison.

You basically want to draw quick, short analogies.

### **The elevator pitch**

Elevator pitch is a little longer. Here you just go through some of the other factors that I've talked about. It shouldn't be very

long. It should be something that could run in a 60 second TV ad. You could write it down in two paragraphs, or you could explain it in a long elevator ride.

The pieces of it are kind of obvious, and I'll hand this presentation out later so you don't have to write all this down. **The one piece that I think is pretty important is to be very, very, very concrete.** I see a lot of elevator pitches where people say: we are creating an exciting and large new business! Well, that was a worthless sentence. They coded absolutely no information. Be very concrete. Do not use adjectives. Do not use adverbs, they have no value. You should actually talk about things that are specific and unique to you. If you see a single word in there that could apply to any startup in your graduating class other than "the" or "a" or prepositions, remove it.

## Elevator pitch example

Here's an example of an elevator pitch. It's a little hard to read. It violates all the rules of presentation, but you can go over it later. This is one Nivi and I wrote up of what Marc Andreessen<sup>130</sup> would be like if he were pitching Ning. We have all the components tagged out such as the links to the product, the social proof, talking about the team, et cetera, et cetera. Your experience might vary.

## The 10/20/30 rule of PowerPoint

I like Guy Kawasaki<sup>131</sup>'s rule on the presentation itself, the 10, 20, 30 rule of PowerPoint: no more than 10 slides, no more than

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<sup>130</sup><http://blog.pmarca.com/>

<sup>131</sup><http://twitter.com/guykawasaki>

20 minutes, no font smaller than 30 points.

There are exceptions to that when you're presenting data, when you're presenting charts and graphs and information, of course you can go a little more data-heavy. In fact, in those cases you probably want to go very dense rather than less dense, but in general you should be talking to your audience, not reading off the slides. You should know a lot more about the business than is prevalent on the slides. And you also have to be watching your audience, and obviously adapting what you're saying to them. It helps to be a little empathic.

## **The 12 pieces of the presentation**

These are the 12 pieces of what could go in a pitch. I'm just going to talk about what I think are the non-intuitive pieces.

On the team, I think it's pretty important to brag. I think it's pretty important to brag about your accomplishments, but you can't do it for yourself. So, normally you go into a pitch with a cofounder; your cofounder should be talking about how amazing you are; you should be talking about how amazing your cofounder is. That's great.

**When you talk about the problem, people can belabor this one. Just be quick. You should be able to summarize it, again, a high concept pitch.**

**When you talk about your solution, especially if you're a web company, you should be able to show it, you shouldn't be talking about it.**

When you're talking about your technology piece, you should be pointing out that you're doing something hard. Fundamentally we're all in tech business. If it's something that you're doing that can be very, very easily replicated, or if you need an NDA to protect it, then it's probably not really hard technology.

When you talk about marketing this is a tough one. **A lot of people, when they're talking about marketing are being very qualitative. I think it's important to be quantitative. Your marketing slides should be among the heaviest in numbers.** All the modern marketing on the web is done through numbers, either SEM where you're buying traffic, or SEO where you're doing link building, or even in APIs and cost of customer acquisitions or Facebook virality coefficients and so on, you should be very quantitative in your marketing slide. And I think this is where engineers can excel in marketing. It's a real opportunity for an engineering-trained marketer that did not exist 5 or 10 years ago.

I'll talk on sales on business development. **Business development is just sales without a quota. It's a bunch of people sitting around having coffee.**

[audience laughter]

**You should not have BD people in your company at the start. It's a huge negative indicator. You should have a sales person, you should have a quota driven, pipeline driven, card carrying, bag carrying sales person who's willing to fly to the ends of the Earth and get you your 10 customers every quarter.**

**BD as a role did not used to exist in Silicon Valley until around 1990 when we had to figure out what to do with the problem of that business founder who was now useless in the company because the company had outgrown them, and what do you with them? So you stuck them in BD.**

[audience laughter]

It's not a real role, people.

About the competition, be honest.

**Man in audience:** That's like 2/3 of the room.

[audience laughter]

Yeah. Well, sorry. It's not too late to go to Stanford for that CS class. Don't mind that. I did BD for a while.

So, on the competition be honest. Those two-by-two matrices are kind of neat, and yes, you're supposed to be up and to the right, but I don't take any competition slide seriously unless someone tells me the tradeoffs the competition made. **So, it's not that the competition is worse than you at everything; it's that they made a different set of trade-offs.** They made a different set of decisions. Be articulate about what those decisions are, especially when you're competing with big companies. Don't say the big company can't do this; it's better to say the big company won't do this. They will make a different decision because of their incentives, their motivations, or their legacy structure. I think that's a much more intellectually honest way of talking about the competition.

**Milestones are good; projections are bad.** By that I mean that projections are prognosticating about how you're going to perform in the market. Nobody really knows. Milestones are good because they're talking about what you're going to build and who you're going to hire and what you're going to do. **Milestones are talking about things under your own control. Projections are often talking about things outside of your control, so projections are often not taken seriously.** Milestones are taken seriously.

That's kind of it.

On the financing side, as Rashmi said, you can answer that question wrong by throwing out a valuation when you shouldn't be. On the other hand, if you have talked to someone who is knowledgeable in the space and you have a good sense of what a valuation is, there are ways to signal it without being too Machiavellian about it. For example, you don't want to say you

have \$5 million pre-money because that's putting a number out there and you're kind of throwing it in their face, but you can say something like: **we're raising a million bucks and we don't want to give up more than 20% of the company.** So there are subtle ways to signal it. All of this is on Venture Hacks.

## Learn from the masters

Finally, if you actually want to do a good presentation or a good pitch or a good explanation, [here are] the two most influential things I've seen or read on the topic. First is this guy, Charlie Munger. He's Warren Buffett's right-hand-man. He has a little speech<sup>132</sup> that he gave where he dissected Coca-Cola as a business, and he did it in what I would call whiteboard fashion. It's really worth reading that speech. I have the link to it up there. But it's fascinating how he digs underneath and shows that he clearly understands the important pieces of the business. After you've read that you would write that man a check for any amount that he wanted.

And finally, Lawrence Lessig, who is a professor at Stanford, did a presentation called Free Culture<sup>133</sup>. The whole flash of it is online, and he does kind of this fun stream of consciousness rolling presentation. You can learn almost every trick about presenting by watching that presentation.

## AngelList

And next steps: *Pitching Hacks*<sup>134</sup> is our book on Venture Hacks that is kind of the collated, best-of hits about how to go out

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<sup>132</sup><http://stableboyselections.com/2008/03/25/charlie-munger-turning-2-million-into-2-trillion/>

<sup>133</sup><http://randomfoo.net/oscon/2002/lessig/>

<sup>134</sup><http://venturehacks.com/pitching>

and pitch your startup. Just as a freebie, afterwards, Adeo, I can give you a link. You can pass it around and give it to everyone in the company as well as everyone here. It's a paid product normally, but we're not really making money off of it. It's just there because if something doesn't have value people aren't going to pay for it.

And then we have Startup List<sup>135</sup> and Angel List<sup>136</sup> in Venture Hacks. When you're ready to raise money, please feel free to send us your companies. We're happy to introduce you to any number of angels, assuming you pass muster. Right now we have about 75 angels on the Angel List, including people like Ram Shriram<sup>137</sup> and Ron Conway<sup>138</sup>'s group and Founder Collective<sup>139</sup>. And what we do is every week select one or two great startups and we send them out to the whole list.

That's it.

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<sup>135</sup><http://venturehacks.com/startuplist>

<sup>136</sup><http://venturehacks.com/angellist>

<sup>137</sup>[http://www.sherpalo.com/about/meet\\_ram.php](http://www.sherpalo.com/about/meet_ram.php)

<sup>138</sup>[http://en.wikipedia.org/wiki/Ron\\_Conway](http://en.wikipedia.org/wiki/Ron_Conway)

<sup>139</sup><http://foundercollective.com/>

# May 2010

## How much traction do I need?



The top 3 things we look for in the startups that apply to AngelList<sup>2</sup> are initial traction, social proof, and product. The team is also obviously important, but good teams tend to have good traction, social proof, and products.

Since I was a child, people have asked me, “How much traction do investors want to see?” My answer is “you tell me.” *Find the competitors that investors wish they had invested in, and compare yourself to them.* And skip the #’s—show graphs. The Google Analytics screenshot above compares the traffic bump that [Startup Digest]<sup>3</sup> got from TechCrunch vs. Venture Hacks.

Even better, show cumulative graphs that imply your second derivative<sup>4</sup> is positive:

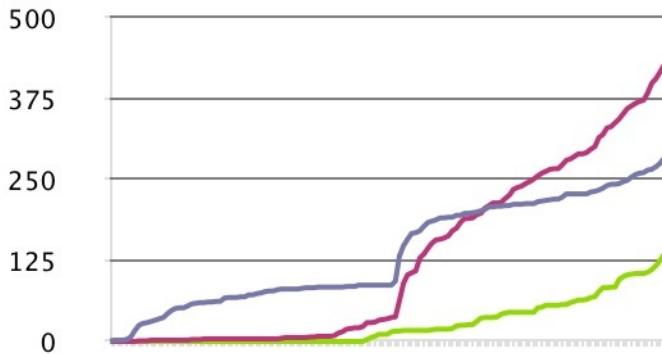
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<sup>1</sup><http://tweetphoto.com/18120033>

<sup>2</sup><http://venturehacks.com/angelist>

<sup>3</sup><http://thestartupdigest.com/>

<sup>4</sup>[http://en.wikipedia.org/wiki/Second\\_derivative](http://en.wikipedia.org/wiki/Second_derivative)



(Unlike these graphs, make sure you include axis labels, a legend, and a title.)

I've heard that Google's entire presentation when they were raising money was a metrics graph. You should put together a more complete presentation<sup>5</sup> than that — but, if you only have time to pull together one slide, make it traction.

## **Startup Lessons Learned: I wish this conference was around five years ago**

"Startup Lessons Learned Conference #sllconf<sup>6</sup> is going to be the Woodstock for entrepreneurs. If you weren't there you will say you were."

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<sup>5</sup><http://venturehacks.com/articles/presentation-hacks>

<sup>6</sup><http://twitter.com/#search?q=%23sllconf>

– Steve Blank<sup>7</sup>

Startup Lessons Learned<sup>8</sup>, the best startup conference of the year, is **this Friday**:



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I think this is going to be the most actionable startup conference ever and the lead organizer, Eric Ries<sup>10</sup>, has given us a whopping 25% discount for Venture Hacks readers who use the discount code VENTUREHACKS<sup>11</sup>. (If you're not in the Bay Area, check out the simulcasts<sup>12</sup>.)

The list of speakers and mentors<sup>13</sup> at the conference is off the hook. And we've interviewed Eric Ries many many times:

What is the minimum viable product?<sup>14</sup> How IMVU learned its way to \$10M a year<sup>15</sup> Opening board meetings to the entire company<sup>16</sup>

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<sup>7</sup><http://twitter.com/sgblank/status/12538509679>

<sup>8</sup><http://www.sllconf.com/>

<sup>9</sup><http://www.sllconf.com/>

<sup>10</sup><http://www.startuplessonslearned.com/>

<sup>11</sup><http://startuplessonslearnedsf-c1.eventbrite.com/>

<sup>12</sup><http://startuplessonslearnedsf-c1.eventbrite.com/>

<sup>13</sup><http://www.sllconf.com/>

<sup>14</sup><http://venturehacks.com/articles/minimum-viable-product>

<sup>15</sup><http://venturehacks.com/articles/lean-startup>

<sup>16</sup><http://venturehacks.com/articles/opening-board-meetings>

## My lean journey

I first learned about lean software development when my brother Farb<sup>17</sup> closed a Series A for Grockit<sup>18</sup> with Benchmark. He was looking for developers and I told him to check out my del.icio.us bookmarks for developers<sup>19</sup> and designers<sup>20</sup>. He went through my bookmarks and hired Pivotal Labs<sup>21</sup>, a team of contract developers that follows a rigorous Extreme Programming<sup>22</sup> process (Farb has hired his own team since then.)

Fast forward a couple years and Farb turned *me* on to Pivotal for a project I was working on. I hired them and got hooked on Extreme Programming. I started learning more about lean and eventually wrote a half-wrong post called Lean startups find their moment<sup>23</sup>. Fortunately, Eric Ries was already blogging about lean startups, saw my post, and corrected my errors in Lean startups vs. lean companies<sup>24</sup>.

Now, Eric has roped Farb in to speak at the conference:

(The video also seems to imply that Farb is auditioning for the cast of CSI.)

Learn more about the Startup Lessons Learned Conference<sup>25</sup> and don't forget to use discount code VENTUREHACKS<sup>26</sup>.

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<sup>17</sup><http://twitter.com/farbood>

<sup>18</sup><http://grockit.com/>

<sup>19</sup><http://delicious.com/nivi/developers>

<sup>20</sup><http://delicious.com/nivi/designer>

<sup>21</sup><http://pivotallabs.com/>

<sup>22</sup><http://venturehacks.com/articles/extreme-programming-explained>

<sup>23</sup><http://venturehacks.com/articles/lean-startups>

<sup>24</sup><http://www.startuplessonslearned.com/2008/10/lean-startups-vs-lean-companies.html>

<sup>25</sup><http://www.sllconf.com/>

<sup>26</sup><http://startuplessonslearnedsf-c1.eventbrite.com/>

## Our Inc. interview about angels



Howard Greenstein from Inc. recently interviewed Naval and me for a post called 5 Questions for an Angel Investor<sup>28</sup>:

**Howard Greenstein:** How does a start-up know when it is ready for Angel funding?

**Venture Hacks:** If you've just got an idea, check out incubators like Y Combinator and TechStars. Or you might be able to convince someone who knows you well (a former boss or family member) to invest. Or you might be able to convince someone who knows the market really well (they've had the same idea as you) to invest if they believe in the team.

If you've got amazing pedigree and connections (your last company was acquired and the investors made money) you might be able to raise money on just that alone. If investors are clamoring to invest before you start raising money, you can take this route, otherwise, you can't.

Otherwise, build something (anything), put it in the hands of customers and get some traction before raising money. Any hardware/software/whatever startup can do this thanks to lean startup and customer development techniques and the decreasing costs of doing \*everything\* — the exception is startups with

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<sup>27</sup> <http://www.inc.com/howard-greenstein/5-questions-for-an-angel-investor.html#>

<sup>28</sup> <http://www.inc.com/howard-greenstein/5-questions-for-an-angel-investor.html#>

predominantly technical risk. Also get some social proof (brand name advisors) before contacting angels. Social proof lubricates getting in the door.

Read the rest of the interview<sup>29</sup> for our answers to 4 more questions, including our thoughts on what to look for in an angel and trade-offs between raising money vs. boot-strapping. I think the interview turned out well. Thanks for pulling it together Howard.

## One way to start a startup

I recently answered this question on a Q&A site: “*What generic first order principles should a new technology project or startup follow?*” But I used the politician’s prerogative to give an answer to the question I wish he had asked:

1. Move<sup>30</sup> to Silicon Valley.
2. Pick a great co-founder<sup>31</sup> with complementary skills.
3. Select people with intelligence, energy and integrity<sup>32</sup>.
4. Pick a big market<sup>33</sup>.
5. Develop the minimum viable product<sup>34</sup> to test your hypothesis about what the market needs. Preferably it’s a product that you’re passionate about since you’ll need to

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<sup>29</sup><http://www.inc.com/howard-greenstein/5-questions-for-an-angel-investor.html#>

<sup>30</sup><http://startupboy.com/2010/01/17/why-you-need-to-be-in-silicon-valley/>

<sup>31</sup><http://venturehacks.com/articles/pick-cofounder>

<sup>32</sup><http://twitter.com/thomask/statuses/10655284958>

<sup>33</sup><http://startupboy.com/2009/11/09/the-returns-to-entrepreneurship/>

<sup>34</sup><http://www.quotationspage.com/quote/26979.html>

stick with it to an irrational point (the Internet especially is efficiently arbitraged<sup>35</sup>).

6. Iterate like crazy<sup>36</sup> until you find product/market fit<sup>37</sup>. If you don't find it, do not raise money, do not pass go. Start over.
7. If you have found product/market fit, raise money from high-quality people that you trust<sup>38</sup>. Keep control<sup>39</sup>.
8. Scale<sup>40</sup>. Hang on.

## Two great talks from SLLConf

I watched most of the Startup Lessons Learned Conference<sup>41</sup> from home. Thanks to the magic of justin.tv<sup>42</sup>, I also brushed my teeth, had breakfast, cleaned the bathrooms, and did a couple phone calls at the same time. Here are my two favorite talks from the conference.

### Steve Blank: Customer Development 2.0 “Why Accountants Don’t Run Startups”

Steve<sup>43</sup>'s talk is a must-watch. I've watched it twice now.

Video: Customer Development 2.0<sup>44</sup>

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<sup>35</sup><http://news.ycombinator.com/item?id=930612>

<sup>36</sup><http://venturehacks.com/archives#customer-development>

<sup>37</sup><http://pmarca-archive.posterous.com/the-pmarca-guide-to-startups-part-4-the-only>

<sup>38</sup><http://venturehacks.com/angellist>

<sup>39</sup><http://venturehacks.com/articles/one-way-control>

<sup>40</sup><http://voices.allthingsd.com/20100317/the-case-for-the-fat-startup/>

<sup>41</sup><http://www.sllconf.com/>

<sup>42</sup><http://www.justin.tv/startuplessonslearned/all#r=BSjgo5A%7E>

<sup>43</sup><http://www.steveblank.com>

<sup>44</sup><http://www.justin.tv/startuplessonslearned/b/262670582>

## Kent Beck: Beyond agile programming

Kent Beck<sup>45</sup> is a natural speaker, brilliant, and humble to boot. Fans of agile software development<sup>46</sup> and extreme programming<sup>47</sup> will especially enjoy this talk. At least watch until he talks about scratching goats — that's my favorite part.

Video: Beyond agile programming<sup>48</sup>

There were many other excellent talks at the conference — see them all here<sup>49</sup>. Now I'm looking forward to the Startup School<sup>50</sup> conference, coming later this year.

## Where to find the best startup advice

“This is probably the first methodology that’s been crowdsourced. Big idea. Unlike previous methodologies where there was an author, textbook and take-it-or-leave-it, this is an iterative process and I think we’re all collectively getting smarter at a very scary rate.”

– Steve Blank<sup>51</sup> (at 6:53)

**Where can you find the best startup advice?** Short an-

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<sup>45</sup><http://twitter.com/kentbeck>

<sup>46</sup><http://venturehacks.com/articles/agile-software-development>

<sup>47</sup><http://venturehacks.com/articles/extreme-programming-explained>

<sup>48</sup><http://www.justin.tv/startuplessonslearned/b/262656520>

<sup>49</sup><http://www.justin.tv/startuplessonslearned/all>

<sup>50</sup><http://startupschool.org/>

<sup>51</sup><http://www.justin.tv/startuplessonslearned/b/262670582>

swer: We collect it in this daily email<sup>52</sup>, daily RSS<sup>53</sup>, or real-time Twitter<sup>54</sup>. Here's a pic of the email version:

### A Look Back At Summize

**AVC**— In July 2008, Twitter acquired a company called Summize. The stated reason was to bring search into Twitter. And that was the main reason that Twitter did the deal. But Twitter also got a very strong engineering team in that acquisition. I remember asking Ev and Jack at the time "how are we going to integrate the engineering team?" and Jack replyin...

 *"They did not rebuild Twitter, they just replaced one thing at a time and evolved it." – @fredwilson, <http://j.mp/cXghWK>"*

929 CLICKS 76 TWEETS

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### Aprizi's Customer Development Journey, part 3 – giffconstable.com

**GIFFCONSTABLE**— Aprizi is about to enter that crucial phase of open beta, so I wanted to pause and write down the latest installment in our customer development journey (part 1 and 2). For anyone new to the blog, Aprizi is building a personalization engine for online shopping — a Pandora for e-commerce, if you will. My thesis is that the intersection of tw...

 *"Build something for yourself is not the "best" way to come up with startup ideas. A different way: <http://j.mp/9IqPnW>."*

582 CLICKS 14 TWEETS

## Long answer

When we started Venture Hacks in 2007 (April 1st to be exact), there wasn't a lot of great startup advice on the Web. Of course, we weren't the only game in town and guys like Paul Graham<sup>55</sup> and Fred Wilson<sup>56</sup> were rocking well before us (I'm sure I'm ignoring many other examples).

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<sup>52</sup><http://capitolcircle.us1.list-manage.com/subscribe?u=bd9e9122beecd7af58b9ac335b&id=b2bda72936>

<sup>53</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>54</sup><http://twitter.com/venturehacks>

<sup>55</sup><http://www.paulgraham.com/>

<sup>56</sup><http://www.avc.com/>

Since then, the quantity of good and bad startup advice on the Web has exploded. I listed 20 startup blogs I read religiously in The Startup MBA<sup>57</sup>. Many good startup blogs have popped up since — Chris Dixon<sup>58</sup>'s and Mark Suster<sup>59</sup>'s blogs come to mind (I'm sure I'm ignoring many other examples again).

## **Who has time for this?**

We do. We read every post on dozens of startup blogs and Hacker News<sup>60</sup>. Then we link to the good stuff with Twitter<sup>61</sup>. And if you don't want to miss a link in your Twitter stream, sign up for the daily email<sup>62</sup> or daily RSS<sup>63</sup> too.

## **Help us find the best advice**

Please tweet good startup advice to @venturehacks<sup>64</sup> — that's much better than email. We'll try to credit you if we link to your suggestion.

Steve Blank is right — we're all collectively getting smarter at a very scary rate.

## **The Wilson bump**

"Hacking the VC business one web service at a time."

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<sup>57</sup><http://venturehacks.com/articles/startup-blogs>

<sup>58</sup><http://cdixon.org/>

<sup>59</sup><http://www.bothsidesofthetable.com/>

<sup>60</sup><http://news.ycombinator.com/>

<sup>61</sup><http://twitter.com/venturehacks>

<sup>62</sup><http://capitolcircle.us1.list-manage.com/subscribe?u=bd9e9122beed7af58b9ac335b&id=b2bda72936>

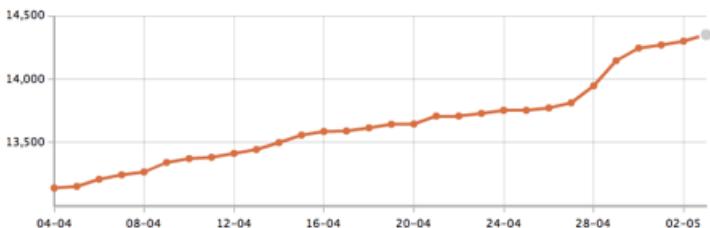
<sup>63</sup><http://feeds.venturehacks.com/venturehacks-twitter>

<sup>64</sup><http://twitter.com/venturehacks>

– Fred Wilson<sup>65</sup>

It's interesting how investors are turning into media properties and using those properties to promote startups.

1000+ people subscribed to our daily email newsletter<sup>66</sup> when Fred Wilson<sup>67</sup> wrote about it recently. That's not 1000 *visitors* — that's 1000 new people who have given us permission to invade their inbox every day. Fred also sent us a stack of new Twitter followers:



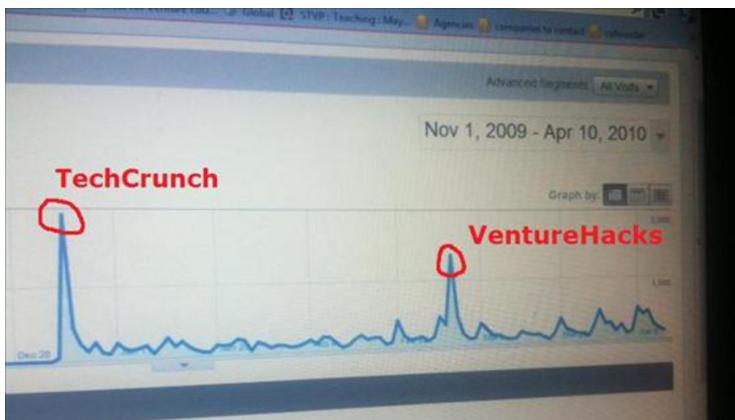
Venture Hacks also sends a good amount of traffic (and signups) when we write about a startup. Here's a screenshot of [Startup Digest]<sup>68</sup>'s traffic from a post on TechCrunch vs. a post on Venture Hacks:

<sup>65</sup>[http://www.avc.com/a\\_vc/2010/04/venture-hacks-daily-newsletter.html#comment-47851831](http://www.avc.com/a_vc/2010/04/venture-hacks-daily-newsletter.html#comment-47851831)

<sup>66</sup><http://venturehacks.com/articles/best-advice>

<sup>67</sup>[http://www.avc.com/a\\_vc/2010/04/venture-hacks-daily-newsletter.html](http://www.avc.com/a_vc/2010/04/venture-hacks-daily-newsletter.html)

<sup>68</sup><http://thestartupdigest.com/>



## How not to promote your investments

If you're a VC, I don't think you get much out of writing a single blog post announcing your investment. "Why I invested" posts won't cut the mustard if they simply amount to "good team, good market, good traction."

You might have to write about the company before<sup>69</sup> you make an investment. You might have to piss some people off<sup>70</sup>. And you will have to take risks with what you disclose. If you feel a little uncomfortable about the post, that's probably a good sign. Look at Fred's posts on Twitter<sup>71</sup>, Disqus<sup>72</sup>, and Foursquare<sup>73</sup> for a model.

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<sup>69</sup>[http://www.avc.com/a\\_vc/2009/09/the-foursquare-crush.html](http://www.avc.com/a_vc/2009/09/the-foursquare-crush.html)

<sup>70</sup>[http://www.avc.com/a\\_vc/2010/04/the-twitter-platform.html](http://www.avc.com/a_vc/2010/04/the-twitter-platform.html)

<sup>71</sup>[http://www.google.com/search?num=20&hl=en&safe=strict&q=site%3Ahttp%3A%2F%2Fwww.avc.com+twitter&aq=f&aqi=&aql=&oq=&gs\\_rfai=](http://www.google.com/search?num=20&hl=en&safe=strict&q=site%3Ahttp%3A%2F%2Fwww.avc.com+twitter&aq=f&aqi=&aql=&oq=&gs_rfai=)

<sup>72</sup>[http://www.google.com/search?num=20&hl=en&safe=strict&q=site%3Ahttp%3A%2F%2Fwww.avc.com+disqus&aq=f&aqi=&aql=&oq=&gs\\_rfai=](http://www.google.com/search?num=20&hl=en&safe=strict&q=site%3Ahttp%3A%2F%2Fwww.avc.com+disqus&aq=f&aqi=&aql=&oq=&gs_rfai=)

<sup>73</sup><http://www.google.com/search?hl=en&q=site%3Ahttp%3A//www.avc.com%20foursquare&aq=f&oq=>

“There was certainly a few times during this transaction when I regretted how public we were with our interest in Foursquare.”

– Fred Wilson<sup>74</sup>

## **Every blog should have an aggregator**

I think Y Combinator<sup>75</sup> has the smartest approach to the “investor = media property” problem. I read YC’s Hacker News<sup>76</sup> every day because it serves up one or two gems every day.

What’s in it for YC? Among other things, every YC startup with a significant post will be sure to get on the front page of Hacker News. And every single one of Paul Graham<sup>77</sup>’s posts will rise to the top.

*If you’re a media property and you don’t run an aggregator, you’re simply ceding your audience’s attention to someone else’s aggregator.*

## **Hello vh.co**



Say hello to vh.co, our new short URL<sup>79</sup>, powered by bit.ly Pro<sup>80</sup>.

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<sup>74</sup>[http://www.avc.com/a\\_vc/2009/09/the-foursquare-crush.html](http://www.avc.com/a_vc/2009/09/the-foursquare-crush.html)

<sup>75</sup><http://ycombinator.com/>

<sup>76</sup><http://news.ycombinator.com/>

<sup>77</sup><http://www.paulgraham.com/>

<sup>78</sup><http://www.cointernet.co/domain/become-co-founder>

<sup>79</sup>[http://en.wikipedia.org/wiki/URL\\_shortening](http://en.wikipedia.org/wiki/URL_shortening)

<sup>80</sup><http://bitly.pro>

.co domains will be available to the general public in June. But! the registrar has created a program called .CO Founder<sup>81</sup> to give legit startups early access to .co domains. That's how we got vh.co.

I'm pretty psyched about .co. Other domains like .us, .es, and .ly are cool but I don't know if they make sense to normal people. I think .co has a good chance of going mainstream and we're putting our money where our mouth is.

venturehacks.com is staying right where it is — we're just using vh.co for short URLs on Twitter. You can also enter vh.co in your mobile Web browser and we'll take you to the mobile version of venturehacks.com.

Startups who want to put .co domains to good use should apply to the .CO Founder program<sup>82</sup>. Tell 'em we sent you. Everyone else can pre-register for general availability at their favorite registrar.

## VCs in seed clothing: Chris Dixon, Mark Suster, and Naval Ravikant interviewed

I recently got on the phone for a cross-continent conference call with Chris Dixon<sup>83</sup> from Founder Collective<sup>84</sup>, Mark Suster<sup>85</sup> from GRP Partners<sup>86</sup>, and our own Naval Ravikant<sup>87</sup>. The topic

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<sup>81</sup><http://www.co인터넷.co/domain/become-co-founder>

<sup>82</sup><http://www.co인터넷.co/domain/become-co-founder>

<sup>83</sup><http://cdixon.org/>

<sup>84</sup><http://foundercollective.com/>

<sup>85</sup><http://www.bothsidesofthetable.com/>

<sup>86</sup><http://www.grpvc.com/team/mark-suster/>

<sup>87</sup><http://startupboy.com/>

was VC signaling in seed rounds — and how these signals help or hurt your ability to raise money in the next round.

The interview was inspired by Mark Suster's (VC) and Chris Dixon's (super-angel) discussion<sup>88</sup> on whether entrepreneurs should take seed money from VCs — and Mark's claim that “if we discussed the issue live we'd probably end up agreeing more than disagreeing.”

This is the first time we've interviewed so many people. The resulting interview is fun, with lots of actionable info for entrepreneurs — at one point, Naval asks if we're getting too deep and my response was roughly *hell no*.

SlideShare: VC signaling in seed rounds<sup>89</sup> Audio:  
Interview with chapters<sup>90</sup> (for iPod, iPhone, iTunes)  
Audio: Interview without chapters<sup>91</sup> (MP3, works anywhere)  
Outline and transcript: Below

*Thanks to the SlideShare<sup>92</sup> team for helping us resolve a technical issue very quickly.*

## Prerequisites

The interview was inspired by these posts (in chronological order):

1. Venture Hacks: Keep your Series A options open if you raise debt<sup>93</sup>

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<sup>88</sup><http://www.bothsidesofthetable.com/2010/04/03/understanding-vc-signaling/>

<sup>89</sup><http://www.slideshare.net/venturehacks/vc-signaling-in-seed-rounds-3880218>

<sup>90</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/04/VC-signaling-in-seed-rounds.m4a>

<sup>91</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/04/VC-signaling-in-seed-rounds.mp3>

<sup>92</sup><http://www.slideshare.net/>

<sup>93</sup><http://venturehacks.com/articles/options-open>

2. Chris Dixon: The problem with taking seed money from big VCs<sup>94</sup>
3. Mark Suster: Understanding the Risks of VC Signaling<sup>95</sup>

## Outline

1. VC signaling in seed rounds
2. Chris Dixon bio
3. Mark Suster bio
4. Naval Ravikant bio
5. 3 guests, 3 different types of funds
6. What stages of investment does a startup go through?
7. The \$ amount in a round changes based on the public markets
8. Seed investors make decisions quicker and ask for less control with simpler documents
9. The cast of characters you run into when you're raising money
10. What is VC signaling?
11. VC signaling is when insiders convey information through their actions
12. Investors aren't the only insiders who can signal
13. VC signaling is the action or lack of action of people who have information you don't have

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<sup>94</sup><http://cdixon.org/2009/08/14/the-problem-with-taking-seed-money-from-big-vcs/>

<sup>95</sup><http://www.bothsidesofthetable.com/2010/04/03/understanding-vc-signaling/>

14. Investment decisions are often influenced by social proof and momentum
15. Social proof short-circuits investment decisions
16. Social proof is rational
17. How do investors transmit signals?
18. Typical investor signals
19. When signaling matters
20. All VCs talk to each other — you can't keep them apart
21. If you hear 5-6 people passed, you're predisposed not to like it
22. 4 types of investor signals
23. In the good old days, supportive investors would always do their pro rata
24. Supportive investors still tend to do their pro rata in the Series B
25. Funds can establish norms and stick to them
26. Does GRP have a follow-on policy?
27. Do early stage funds do selective follow-on rounds?
28. There's a difference between focused seed stage investing by VCs and shotgun seed investing by VCs
29. Don't give VCs contractual options on your next round
30. Taking office space can also be a signal
31. If my existing investors don't want to invest, how do I talk my way out of it?

32. Does a VC work against you in the Series A if they don't buy enough of the company in the seed round?
33. What are the pros of taking seed money from a VC?
34. Anything I missed that I should have brought up?
35. How to take an option-style investment from a VC
36. What's your favorite blog these days?
37. What's your favorite life hack these days?
38. Get intros to seed investors with AngelList

## Transcript

*Music: The Moog Cookbook<sup>96</sup>*

**Nivi:** Hi, this is Nivi from Venture Hacks. I'm here with Chris Dixon, who I think is in New York; Mark Suster, who I think is in L.A.; and Naval Ravikant, who is in San Francisco with me. The subject today is VC signaling in seed rounds, and we're going to use that as a jumping off point to branch into other aspects of VC involvement in seed rounds.

Before we get into it, why don't we just go around and you guys can each give us your 140-character bio. Well start with off with Chris then Mark then Naval.

**Chris Dixon:** OK, sure. Way back I was a computer programmer and then I started a couple of companies. The last company was called SiteAdvisor, which was acquired by McAfee. My current company is called Hunch<sup>97</sup>, which I co-founded with my SiteAdvisor co-founder Caterina Fake, from Flickr.

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<sup>96</sup><http://www.google.com/search?hl=en&q=the+moog+cookbook>

<sup>97</sup><http://hunch.com/>

And then on the side, I am an angel investor. I was a personal angel investor, now I do it through a fund that I co-founded called Founder Collective<sup>98</sup>.

**Mark Suster:** That sounded like the Facebook edition rather than the Twitter edition.

**Chris:** Yeah, sorry, I exceeded it.

[laughter]

**Mark:** Just teasing. This is Mark Suster. And I'll give the Facebook edition as well. I also started as a developer, for what it's worth. I built, founded, and was CEO of two companies, both in document management space. The first I built in Europe, and ended up selling to a French publicly-traded company called the Sword Group.

The second I built in Silicon Valley, also a document management company, called Koral. I sold that to Salesforce.com, where I became VP of product management. And for my sins, I have joined the dark side as a fulltime gig, working for GRP Partners<sup>99</sup>, who funded both my companies. Based in sunny Los Angeles, we are the largest venture capital firm in Southern California.

**Naval:** Great. This is Naval, and I'll give the LinkedIn edition, which will run full-on for about 10 minutes.

[laughter]

**Naval:** I'm a startup guy as well. I started out as a developer; Co-founded Epinions<sup>100</sup>, where I was the founding CEO. The company went public as Shopping.com<sup>101</sup>, and it was eventually acquired by eBay. I started Vast.com<sup>102</sup>, which is a large

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<sup>98</sup><http://foundercollective.com/>

<sup>99</sup><http://www.grpvc.com/team/mark-suster/>

<sup>100</sup><http://www.epinions.com/>

<sup>101</sup><http://www4.shopping.com/>

<sup>102</sup><http://www.vast.com/>

classified ad network that powers Kelly Bluebook, AOL USA, and some other very large sites.

I have also started Venture Hacks with Nivi, where I'm a co-author and help create Venture Hacks and Angel List. These days I'm angel investing as well, so I was an early investor in Twitter, Social Gold, Plancast most recently, and a bunch of others.

**Nivi:** If I've got this right, we've got Chris Dixon, who is at what I would call a seed stage fund, or what some people would call a super angel fund, is that right, Chris?

**Chris:** Yeah. Just to clarify, that's really a side thing for me. I'm full-time at Hunch.

**Nivi:** Right. And also a practicing entrepreneur at Hunch.

And then we've got Mark Suster, who is a full-time VC at GRP, which is a multi-stage fund. And he's a former serial entrepreneur. So you guys do seed rounds, A rounds, all the way through up to what?

**Mark:** We do B and C rounds as well.

**Nivi:** OK. And then Naval, who represents himself mostly as an angel investor. People know him as Naval, but he's investing other people's money, he has a fund, is that right, Naval?

**Naval:** Yeah, I'm investing my money and other people's money out of a fund.

## **What stages of investment does a startup go through?**

**Nivi:** Right. OK, great. Why don't we start off with some definitions, if that's cool? One thing I'd like to hear, and I'm sure our audience would like to hear, is what are the different types of funds that are doing seed investing right now? What

sizes are they? What are the relevant attributes that distinguish these funds?

Maybe I'll throw it out to Mark to start the conversation.

**Mark:** Sure, I'll be happy to. Listen, the definition of what a seed investment is has really blurred. Historically money was raised by what they call the "Three F's": friends, family, and fools. And that typically was your immediate group of people that you knew.

And then people graduated into an angel round, which might have been prominent people from the community who had built tech firms in the past. Those rounds historically were, call it 150K to 250K. A lot of professional angel groups or super angel groups have been founded, and there's also just a lot more wealth these days from people who created and sold tech business and want to do angel investing, so they're moving up the stack and doing 750K investments.

A traditional seed round, I would call somewhere between \$500,000 to \$1 million, and there are seed-stage funds that do that. And then the next thing you graduate into would be a venture capital round. Venture capital rounds tend to be – I don't know why – but they tend to go in letters.

An A round tends to be your first round of investment. That usually is somewhere in the neighborhood – and I'm going to leave out outliers, outliers being people who are superstars and have created companies and can raise a 90-pre on their first deal – but a traditional first investment will be \$2 million to \$3 million from a venture capitalist, and that might creep up to \$5 million if it's a big team and a big idea, and if a lot of progress had been made previously.

A B round will typically be in the \$5 million to \$7 million range, but can be \$8 million to \$10 million. And I'll stop talking there.

**Nivi:** Naval, you want to add anything to that?

## **The \$ amount in a round changes based on the public markets**

**Naval:** Yeah. My definition is not so much around the cash, because the amount of cash that these different funds put in is squishy, it depends on the supply of cash flowing through the system. So right now with the NASDAQ being up again, after there recently being some exits, there's a lot more angels out there investing.

And so even the definition of a seed round, as Mark put it, has gone to 500K to a million, but even a year-and-a-half ago, seed rounds were smaller than that. They might be 250K to 750K, or even under 500K. So the cash definition moves around based on the environment.

## **Seed investors make decisions quicker and ask for less control with simpler documents**

What doesn't change is kind of the attitude, philosophy, and investment style. Generally out of a seed round investor, or a seed fund, you can get a decision out of one or two meetings, without extensive due diligence and that multi-months of "get to know you" process.

You also don't get onerous control terms. Most seed investors these days don't take a board seat. And if they do, it'll expire at the A round. And the term sheets and the documents are usually on one of the standardized forms or are a one or two page term sheet kind of thing.

**Nivi:** Great. Chris?

**Chris:** Yeah, I'll agree with that. What else can I say? Often the angel rounds will be...

I do a lot of convertible notes with caps on them. Should I define that, or is that something your listeners would know? The type of security will vary, often seed rounds versus proper venture rounds.

**Naval:** Yeah, that's a good point, Chris. That goes hand-in-hand with the lower control issue.

**Chris:** Yeah, and it's also like legal fees. A convert with a cap kind of gives the seed investors the economics of setting a valuation without the control rights, which they tend not to care as much about, but doing it in a less expensive way. So you could do that with \$5,000 or something, as opposed to \$20,000 for an equity financing. When you're doing a \$500,000 round, that's meaningful.

**Naval:** The convertible notes type structure has an effect where it actually gives the seed entrepreneur a lot more flexibility. They can run the business however they want, they don't have to have board meetings, they don't have to check in. They can even add a co-founder and dilute another 20-30%. The investor's less likely to care because they're protected against that by the conversion cap.

**Chris:** Yeah, I think it's a decent structure. Obviously as an investor I want it to have a cap that allows for some reasonable upside if things are going well, and allows you as an investor to feel an incentive to go help the entrepreneur raise the higher priced A round.

But it also, as you said, gives you flexibility, because it's sort of baked in there. So the way it works is either investor gets the better of a 20% discount, or let's say a \$4 million valuation. So it's like if you do the next round at \$3 million, you still get a discount and it's not sort of seen as "down round." It's the greatest thing optically but it's not... So yeah, you're right, it gives more flexibility. It defers a lot of these sorts of voting rights, and also they're kind of stuck, which just seems excessive

at this early stage, to the equity round.

## **The cast of characters you run into when you're raising money**

**Nivi:** Cool. Thanks, Chris. Let's go on to the next question. And let me throw in what I see before we go on to the next question.

The cast of characters I see entrepreneurs running into – and tell me if I'm right or wrong – is basically they run into an angel investing his own money, or it's an angel investing other people's money – like Naval, who markets himself as an angel, or say Jeff Clavier. They run into seed stage fund like First Round Capital or Founder Collective. And they run into multi-stage funds like GRP. Am I missing anything in that list of folks that you'll run into when you raise the seed round?

**Chris:** There are certain outliers like Beta Works, who I'm buddies with in New York. They are actually like a seed corp and they're really funky in terms of structure. But I think that what you've just described is generally the case, I'd say.

## **What is VC signaling?**

**Nivi:** OK, great. Next question is, what exactly is VC signaling? And I'm going to throw it out to Naval, but before I do I'm going to propose a definition. I'm going to throw this out: VC signaling is when a firm that is known to a prospective investor to invest in subsequent financing and has knowledge of the company, says that they're not going to reinvest in the next round, or says they are going to reinvest in the round, or says they're going to do their pro rata.

But it's basically what they say they're going to do in the round. What do you think about that, Naval?

## **VC signaling is when insiders convey information through their actions**

**Naval:** I would use actually a slightly broader definition. I would say that VC signaling is when insiders, through their actions, convey information that is more powerful than what is being conveyed through words.

**Nivi:** OK, so what's in insider?

**Naval:** Insider is any investor who's an insider. It's more of an issue with VCs, because VCs have more capital, and they tend to have put in more diligence, and they tend to participate in future rounds. So their signaling effect is more powerful than angel signaling.

## **Investors aren't the only insiders who can signal**

**Mark:** I'm sorry, can I broaden the definition further?

**Nivi:** Yes, go ahead.

**Mark:** I don't think it's prohibited to just people who made the investment.

**Naval:** That's true. It's the actions of insiders who may have more knowledge than you.

**Chris:** It also can be the fact that... I think what Mark is saying, I agree with him. It can be the fact that some entrepreneur was an EIR at Sequoia and now they're going out and raising money, everyone's like, "Why the hell didn't Sequoia invest?" And Sequoia might not be an investor.

**Mark:** Exactly.

**Chris:** The basic idea is that, especially in a seed stage round, you have so little other information to go on – you don't have revenues, you don't have a product in the market, you don't

have all these other things. Signaling happens in every market, including the public market. The fact that some smart hedge fund took a position can have an effect on other investors.

**Mark:** I think signaling can be as much about what insiders do in your fund as what people did not invest in your company. The classic case that I like to give of signaling is you worked for somebody, you were VP of whatever. There was a CEO, they got a huge exit, they sold of \$400 million, they put \$70 million in their pocket. You have a list of angels, let's say five prominent people from your community, and that CEO who you reported to did not invest.

And if they're known to do angel investments, like it or not it's a signal.

### **VC signaling is the action or lack of action of people who have information you don't have**

**Naval:** Maybe the broadest definition would just be that it is the public actions of people who have information that you do not have.

**Mark:** Yes. **Chris:** And not actually – sorry to be nit-picky.

**Nivi:** No, keep going.

**Chris:** Often it's not even public, it's sort of back-channel, or the lack of action, for example, as Mark just pointed out.

**Naval:** Yeah, the action or lack of action of people who have other information.

## **Investment decisions are often influenced by social proof and momentum**

**Chris:** The reason it's so important in seed rounds... One of the reasons I like to blog about this topic is I think it's not at all obvious to entrepreneurs who haven't done investing. I think when you're an entrepreneur, you kind of think like, oh, these investors, you go in, they analyze your business, they're really super-smart and rational. You kind of maybe give them more credit than they deserve, and I'm including myself in that, of course. [laughs]

When in fact, a lot of how you actually make decisions is: things are moving very quickly, it's referred by a really trusted source, their boss who is great guy is investing, a bunch of other interesting people are investing, and you don't have that much more information in a lot of these seed investments.

**Mark:** Nivi, I've read on Venture Hacks the other day, you talked about this. You called it "social proof." And I even tried that on This Week in Venture Capital with Jason Calcanis, and he didn't like the term. I kind of like it, social proof.

## **Social proof short-circuits investment decisions**

If I'm looking at doing an angel deal and four people I know have already done it, there's a certain short circuiting that happens, almost like – rightly or wrongly, by the way – but almost like if you're hiring somebody and you know they were at Google or McKinsey or went to Harvard Business School or whatever. There's a certain signal implied in that.

## Social proof is rational

**Naval:** Social proof is completely rational, and it's employed more in markets where each entity has a little piece of the information. So if you look in the public markets, there's a form of social proof going on with the pricing. Many different people are making a decision, and all their collective information is determining the price of the security.

The difference is, in the public market is those decisions are made and everyone kind of moves at the same time. The difference in private investing is that people move in series. So I commit to the round before Chris commits and he commits before Mark commits and so on.

So, that signal propagates in a way that we can cumulatively add the information value and get the deal done. So the herd mentality is not irrational, it just emerges from the fact that private rounds close in series, whereas public rounds close in parallel.

## How do investors transmit signals?

**Nivi:** Great. So that's a segue into the next question, which I'll throw out to Chris. We talked about insiders taking action, so we're talking about a signal. How exactly is that signal transmitted? Does it go from VC to VC? VC to entrepreneur to VC? Is it over email? Do VCs call each other on the phone as soon as they see a company? Do they call the last round investors or anyone else who might have information? Should I assume every prospective investor I talk to automatically emails my existing investors?

I'll throw it out to Chris.

**Chris:** The first thing is that this business of seed investing, and frankly, early-stage entrepreneurship, is so much about getting

good information. And almost all that information, unfortunately, is not published.

Hence, any entrepreneur or early stage or mid-stage investor — any investor, for that matter — you're constantly talking to people. It's just part of your job. I'm sure Mark will say that as well. And so it happens through all different forms.

But in particular, I'll just give you a simple example. This is what prompted me to write a post last year, I think it was titled "Don't Take Seed Money From Big Investors," or something.

A kid came into my office and he said, "I want to raise a follow-on round, I raised a round earlier." And the prior round was, let's say, \$100,000 done by a big VC and \$300,000 done by a bunch of angels. So it was a \$400,000 round, right?

## **Typical investor signals**

And I had seen him six months before. I knew that this big VC had invested, and he was raising more money. He's like, "I want to raise more money." So the first question I asked, and the first question every investor is going to ask is, "What is the big VC doing?"

So at that point the big VC has roughly three things they'll typically do. They'll be leading the round, meaning they're doing \$500,000 or \$1 million or \$2 million or \$3 million. They're doing pro rata, which says they kind of like you but they're continuing it. Or they're doing nothing, which says basically they hate it.

And he's like, "Oh, they're doing nothing. They don't want to participate in the round." So what do I think? I think, OK, these are smart money, professional investors, who've been tracking this guy very closely for the last nine months. I was very blunt with the guy. I said, "Look, it's going to be hard for me to

invest, and quite frankly I don't think anyone's going to invest in you now, because you're damaged goods in the eyes of the investment community. That's totally unfair, you may have a great company, but that's just the way it is."

Six months later he shut down the company and sent me an email saying, "Unfortunately you were right. No one would touch me because of the action of that big VC." After I got that email, I wrote that blog post.

## **When signaling matters**

The sad thing is that there's these... let's say that 5% or 10% of the time the company's hitting out of the park and it doesn't matter what the signaling is. Another 10% of the time, the company's a disaster and should just shut down anyway. But I would say 80% of the time things are kind of going mediocre and they're going OK, and the signaling can actually get in and kill a reasonably good company.

The big VC did it so they would get an option in a later round, so it was completely sort of self-interest on their side, and they killed a company and they didn't think twice about it. I think it's really, really sketchy, and that's why wrote about it and use it consistently as one of the themes on my blog.

## **All VCs talk to each other — you can't keep them apart**

**Nivi:** Mark, do you want to follow up, but not necessarily getting into the whole "take seed cash from VCs or not" because we'll get to that. I'd like to get into a little bit more into different types of signaling that occur in addition to the ones Chris described.

**Mark:** Sure, sure. Just talking more broadly about signaling and picking up on some of the things that were said, all VCs talk to each other. And seed investors too. You can try to keep them apart, but they're all really poorly behaved, and you just have to realize that.

I'll give you an example. When I was fundraising for my second company, Salesforce was already a major client of mine. And I said to people during the process, "If you become interested and we're interested in you at the right time, I'll set you up to call whoever you want. You can validate at any level in Salesforce, please just don't call without my consent."

Three VCs in Silicon Valley called Mark Benioff, the CEO, and asked about us. And one called the other co-founder who was the CTO.

**Nivi:** Did they just call them right after the meeting, essentially?

**Mark:** I don't know, within a week. And the other called Parker Harris, the CTO. I had expressly asked them not to. And each time, Mark Benioff would send it down to the head of corporate development, who was managing the relationship with me, and not in a flattering way. Like, "Why are these guys bugging me and who the hell are these Koral guys?"

## **If you hear 5-6 people passed, you're predisposed not to like it**

And every time, just shit rolls downhill and it would roll down to me. I found it really irritating. I wrote blog posts about this stuff publicly, why I tell people it's not a smart idea to go out and cast a really wide net. Everybody talks to everybody. Everybody makes calls they say they're not going to. And because it's such an insular community, if five or six people passed, everyone will hear and venture capitalists and seed stage investors

and everybody, it's an industry filled with lemmings. So if you hear five or six people passed, you're predisposed not to like it. It's unfortunate, but it's reality. So you have to be careful.

But to answer your question, Nivi, about other types of signaling...

**Nivi:** I actually think that was a great example. Do you mind if we pass it on to Naval?

**Mark:** Oh, yeah, go on.

**Naval:** Sorry, there's a plane flying over, so I'm waiting for that to pass before I talk.

## 4 types of investor signals

I've got a lot of thoughts, not in any discrete order. But going back to what Chris Dixon was talking about, making some very good points. I would say that there's basically five levels of signals that can get sent, all the way from an insider trying to do the whole round, which is something that Sequoia does very often, which sends a hugely positive signal.

Somewhere in the middle there's doing a little bit more than the pro rata. Pro rata is a point of indifference, where the entrepreneur is indifferent to the VC, the VC is indifferent to future VCs coming in.

If you do than your pro rata, you're signaling that the valuation is low. You want to own more, and so other investors want to come in. But now you're at odds with the entrepreneur.

If you do less than your pro rata, you're signaling you don't really believe in this valuation, so new investors are less likely to come in. And of course if you pass altogether, as the example that Chris gave, you're sending a very bad signal, saying that you don't believe in the company at all.

**In the good old days, supportive investors would always do their pro rata**

Obviously this is a very old problem. The old VC community had established a method of working through this, which was that they only worked with other investors they liked, and it was considered that a supportive investor would do their pro rata, no more, no less, so that they were not at odds with the entrepreneur or with a subsequent investor.

It was expected that if a deal came to you, it would come to you through another VC, and of course that VC was doing their pro rata. And if that VC wasn't doing their pro rata, they shouldn't even be sending you the deal. And of course they shouldn't be doing more than their pro rata, because they were at odds with the entrepreneur.

This was considered the definition of a supportive investor. And I think that it has broken down, and it has broken down for two reasons. One is you have a lot of players who are now getting in at the seed stage or the A stage who have no intention of following on later, or are inconsistent in their actions.

It's also breaking down because you have VCs who are reaching down to the seed level, and they have no intention of following back up onto the A level.

So the pro rata supportive investor definition was a stable configuration that kept the VC industry past the signaling problem, or kept the signaling problem out for decades, I think it's just broken down now because so many of the deals now are seed deals. Everybody wants a seed deal.

## **Supportive investors still tend to do their pro rata in the Series B**

**Chris:** I would argue, Naval, that it still works that way series A and later on the marketing side.

**Naval:** You're right, it's a seed issue.

**Chris:** Right. The fundamental problem here, going backwards, is that I think that the VC... Basically you have to trace it back to the LP community. But basically the VC world got way too big. The good funds – Benchmark was \$85 million in '96, now it's \$400 million – got really big, and then a whole bunch of bad funds were created because there was excess appetite for LPs. You just had this huge...

**Naval:** Right. And on top of it, it became so cheap to start a company.

**Chris:** Exactly. Exactly. You had this divergence of trends. The thing still functions normally at the later stages when you're still putting in \$10 million, and there is this sort of collegiality or something.

But there is this sort of confusion in big VCs in how to play in the seed rounds. You're right, that's in total turmoil right now. There's new people like us entering, etcetera, and I think there are good firms like Mark's and Fred Wilson and other people who are kind of determining new norms for how VCs go into this earlier stage. I think there's sort of emerging to be a right and wrong way.

## **Funds can establish norms and stick to them**

**Naval:** OK, so the clean way out of this is if people establish a norm and stick to it. For example, a seed fund that says, "We

never do any investment after the seed stage. We don't do pro rata. We don't follow on."

Or it could even be a VC fund that's investing in seed and they say, "If we invest seed, we've bought our fill, and we always do pro rata." Or, "We never do pro rata." Or, "We always do super pro rata."

You have to establish a rule and stick to it, otherwise you're signaling. And even the people establish... [interrupted]

**Chris:** The only people who really establish that rule though are smaller funds. Because bigger funds, the business isn't to be in... [interrupted]

**Naval:** OK, but temptation is very strong when you see a hot company growing up, that even for a seed fund you want to put more in.

## **Does GRP have a follow-on policy?**

**Nivi:** OK. That was great. And on that point, I'm going to throw the next one out to Mark. Do you guys have a policy at GRP, or do you want to talk about other folks that may or may not have a policy? And to set the stage, you guys don't really do a lot of willy-nilly seed stage investing as options. You don't invest 100K in 15 different companies. You guys do focused seed investing, is that right?

**Mark:** Yes. I think the velocity of how many deals you do matters. If you do 30 investments as an individual partner, and let's just be honest, if you do 15 investments in a two-year period of time in seed-stage type deals at the same time while you're doing later stage investments, it's an option value to you. You just can't track that many companies, and you can't substantively help them.

There are people who do high volume and have set up different kinds of VC models to handle that kind of volume, but the traditional VC cannot. And so we do a low volume of seed stage. For me, it's often because the entrepreneur doesn't want to raise as much capital, and it's an earlier stage business that hasn't yet determined product market fit. We're willing to take that risk for the right investor.

I think the world breaks down into three buckets, and I've talked to Fred and Brad and everybody about this. I think everyone – the good guys, as I call them – sort of all agree. And Chris already went through these.

But A is the company that just isn't performing. It's not doing well and no investor, whether it's an angel, a seed, an A round, anyone, if you're not doing well, no one's going to guarantee your next round. So there are some that, if you end up doing 10 seed-stage deals, there could be two of those that you just shut down and that don't even get another penny.

The opposite case is the ones that are doing tremendously well. I tell these seed companies the same thing. Number one, if you want GRP to price the round and lead the round, I am as Brad Feld calls it, "syndicate agnostic." I am willing to write the next check and I'm willing to set price and I'm willing to take the whole thing if you want. I'm willing to take half of it if you want.

If you prefer to shop the deal and you're doing well and you want to go to Silicon Valley and see the highest price you can get, you can tell them I'll take half the round. And if they won't let me take half the round, I guess I'll be forced to take pro rata.

But it's my job to convince the entrepreneur that A) I add enough value to want me to either lead the round or do half; and B) that I've offered a fair price, that it's not worth both the time investment and all the information leak and signaling that happens with the fundraising. And I have actually done that

before.

But the more troubling scenario is scenario B. Unfortunately that happened, and my percentage was 70% at the time – Chris said 80%. But let's call it between 65% and 80% of the time where you're doing OK, it's not clear that you're going to be amazing, but you're not underperforming. It's just OK.

And that's the overwhelming majority of companies. And what we said at GRP when we set up this fund, we set up \$7.5 million, \$5 million is for primary investment, and that's just our seed program, \$2.5 million is for follow-ons for these B scenarios.

Because if it's a good scenario and it's doing well, that comes from the bigger fund where we're leading the round. And what's important is there are times where you just have to do an extra \$500,000 that'll buy them an extra 9-12 months to get more proof points.

But when we write that check we will say – and we haven't had to write one yet – but when we write that check we will say, "Listen, this may be the last you check you get from us unless we see positive performance. And we're hoping we will."

So you either are going to want to perform better, or you might start trying to think over the next 18 months about parking this asset somewhere. Or about getting the ramen profitability to you preserve your options.

But as a VC fund, you can't guarantee that you're going to follow every single investment.

**Naval:** Right. But the problem emerges, Mark, because you are funding the winners with insider rounds, you're making them those big offers. So all the guys who are doing OK that you're not making those offers to, they suddenly have this little bit of a stench of failure about them.

**Mark:** I accept your argument in theory, but then there's life. And the reality is that these are real markets. Just because

they're private doesn't mean they're not real markets. These are real markets. And I can't imagine any fund is going to set up and say, "We're going to have a 100% rule; no way, no how, are we ever going to lead and pick winners." It just isn't going to happen.

### **Do early stage funds do selective follow-on rounds?**

So let's take some of the early stage funds that usually didn't do follow-on rounds. Well, you know, I heard through the grapevine that out of their 40 investments, they did do two or three follow-on rounds. So either you're absolutely, 100% religiously, in your conviction never going to do it, or even if you do one or two it's a signal.

We tell people up front, before we do the investment, our kind of A-B-C mentality. And by the way, just because you're a B does not mean that you're not going to succeed. What it means is you might need an extra year to be able to get to that point. And because we write the check internally and we give you that extra year, it just may there is no signal in the market.

Nobody every knows that, because a year from now, either you sold the company, you got the ramen profitability, or now you're ready to do a proper round and now we're really excited and ready to invest. Or you shut down.

### **There's a difference between focused seed stage investing by VCs and shotgun seed investing by VCs**

**Nivi:** OK. Thanks, Mark; that was great. I'll go to Naval and Chris to get a quick reply to anything Mark said and then we'll go on to the next question. Naval?

**Naval:** I think there is a signal buried in that whole transaction, and Mark argues it very eloquently. But if he's funding two out

of ten companies in an insider round and then he's bridging a bunch and he's passing a bunch, he's sending signals.

And I don't disagree that other people don't send signals either. It's at varying degrees. If Ron Conway doesn't invest in your follow-on round, it doesn't mean anything, right? Whereas if Sequoia did your seed deal and then they have an option on your follow-on round and they decline that option, that signals something.

**Mark:** But hold on, Naval. Everyone knows that Ron has an A list and a B list, right? Everybody knows that.

**Chris:** If I could just defend Mark here for a minute. Every action has signaling, there's no question, but there's a massive, massive difference between a big fund like Mark's doing real diligence, putting in meaningful money like \$500,000 or \$2 million or something, and having a true intention to create a great company and follow on and help them and work with them, versus people, who we all know of, going around and literally after a 20-minute conversation at a conference who will write a \$50,000 check, never speak to the entrepreneur again until they are raising more money, and then try to exercise an option.

There's just a massive, massive difference between the two. And we have acknowledge that. And it's important, because I think what Mark's fund is doing is a very sort of ethical and proper response. There's always some signaling and etcetera, but it's an attempt for a big firm to move down market.

And I always judge these things, and at then end of the day I'm saying, is this person at the end of day creating more great companies or are they just sort of trying to steal great pieces of existing companies? And I think that practice is the former and the better practice, and actually programs like Y Combinator sort of increase net innovation in the world, and that's a good thing, versus these kind of bad guys who are just trying to go around a steal a piece of another person's innovation.

So I think that is a big difference, and maybe when I blog about this sometimes, sometimes the message is taken to be all big firms shouldn't do seed investment...

**Naval:** I think we could divide the world into good and evil, and coincidentally the evil guys always happen to be the ones who aren't on the line, right? [laughs]

**Chris:** Like how much time they spend is a critical thing. Did they do due diligence? Are they continuing to follow up? If a guy meets you at a conference – this literally happened last week. I met these guys and they met somebody at a conference from a big VC, and in 20 minutes he said, “I'll write a \$50,000 check.”

That is clearly an option, right? And that's just ridiculous, because it's just going to screw up the company. And Mark knows what I'm talking about. We all know what I'm talking about.

**Mark:** I'm with you 100%.

**Nivi:** Hey, next question, next question.

## **Don't give VCs contractual options on your next round**

**Naval:** I was going to say one last thing, and that leads to at least one distinction, which is: don't give somebody a contractual option to... [interrupted]

**Chris:** That's the thing I'm saying, though. Of course you don't give them contractual options, but I'm saying that some of these firms, just even writing a \$50,000 check sort of gives them an effective option. Not completely effective, but it's somewhat of an effective option just through signaling value.

**Nivi:** OK. Thank you Chris and Naval and Mark. Next question. Let's say I have actually taken VC cash in my seed round and.... [interrupted]

### **Taking office space can also be a signal**

**Chris:** Can I say one other thing? It's not just cash. I think if you take office space, I think if you take anything that sort of sticks yourself with a VC – and even if it's called something like "Candylandville" or something and it's not called "Big VC" or whatever, it still has that effect.

Because what happens with the VCs, every time people like us call them out, they come up with another new, more obfuscated way to do the same thing. And we're seeing another round of that right now, I think. And it's just the same thing.

**Mark:** And it is the same....

**Nivi:** Hey, OK, come on. I'm going to cut all you guys off. No more. We'll get back to that point, Chris, obfuscation.

### **If my existing investors don't want to invest, how do I talk my way out of it?**

Let's talk about the case where I've taken cash from a VC. We don't have to talk about whether I was an EIR there or took office space there. But let's talk about the case where I took cash from a VC and I'm the middling case where maybe they're not being too helpful with the financing. Or I'm in the bad case where they're not interesting in investing at all.

What do I do other than shut down the company? What's my way out of it? How do I talk my way out of it, for example, when I'm talking to new prospective investors? And I think it's Naval's turn to start.

**Naval:** Sure. That's a really tough situation, where your VC is not willing to do their pro rata. And it's a fund that has a habit and a history and a size commensurate with their normally doing pro ratas.

In that case, if it truly is an exceptional case, for example they've decided to exit this section of the market or they're shutting down the fund or the partner who sponsored the deal is gone, then you want to be very up front about that with prospective investors. And you want to have that checked out in the reference if they call your original investor.

The second case is you could have such a hot deal that it doesn't matter. You could just have so much traction that people will overlook that. But if you don't have the incredible traction, or if you don't have a really good and exceptional reason that can be checked out with your investor, then I think you have the stench of death about you and you're going to have a very hard time raising money.

It is the exact situation that Chris described at the opening of this conversation.

**Nivi:** But still, how can I talk my way out of it?

**Naval:** An example would be the partner's gone, they're no longer in the space, their fund is shutting down, they're low on cash, we didn't get along. You could even try and say stuff like, "We pissed them off. We got into a fight. They just didn't like us. But here, look at our great product and look at our great traction."

But these are difficult situations. There's no magic bullet answer. They're highly contextual, difficult situations.

**Nivi:** Got it. Chris?

**Chris:** Yeah. It's really, really tough. But I think you try to do things that send opposite signals. Obviously making progress in the core business is the number one thing. But aside from that,

let's say you're a security company, like a technology information security company, you go and find five luminaries in the business who say you've done the most amazing thing in the world, and maybe that'll counteract the VC's negativity.

There's other things you can do to kind of build up the story so that it outweighs this sort of strong negative thing. Obviously the best thing of all is revenues and profits and things, but I'm assuming you're at too early a stage.

I've seen it be only fatal so far in my experience pretty much.  
[laughs]

**Nivi:** OK. Mark?

**Mark:** I want to disagree with your definition, because you said the middling case or the case that they're not going to support you at all. In the middling case, I'll make the very clear argument that I think better VCs will bridge you.

So if I've written a \$500,000 check and I think you're doing OK tracking, but not killing it, I might do another \$500,000 investment in your company to give you equally as long as the first time to prove yourself. And nobody knows about that. I just want to make that clear.

What I think I'm talking about is a case where the VC doesn't support you at all. And my view – and I always tell this to people – deal with the elephant in the room. Don't try to pretend like it isn't there.

There's L.A.-based company that raised money from very prominent VC, and those guys got into a drag-out fight. I talked to the VC, and the VC doesn't say good things about the entrepreneurs. But the entrepreneurs got to me first and they said, "We took money from this VC, here's the partner we dealt with, he's a complete dick. Here's what he did, here's why we were unhappy, here's why they don't like us."

And they were also very honest. "Here are the mistakes we made in the last year and why we haven't performed. Here's what our new strategy is," etcetera. And I just think you've got to deal with the elephant in the room. It's better than hiding it, because I think the information will come out anyway.

### **Does a VC work against you in the Series A if they don't buy enough of the company in the seed round?**

**Nivi:** OK, great. The next question is going to be what if a VC invests in your seed round? Let's say they don't do it as an option but like it's a focused investment in your seed round, but they don't own much of your company. Let's call it under 15% and maybe closer to 10%.

Does that matter, and do they end up fighting against your valuation in the next round? Or as some people argue, can they actually afford to pay more in the next round because they can dollar-cost average their purchase in the new round? I think we're up for Chris to start, is that right?

**Chris:** Yeah. I'm sorry, you're saying if they have under their target percentage?

**Nivi:** Yeah. The question wasn't very clear. Let's say a VC does a focused investment in your seed round, they own 10% to 15% of the company, but not 20% to 30%. Do they end up fighting against your valuation in the next round because they're trying to increase their percentage ownership? Or as like some folks argue, can they actually afford to pay more than outside investors in the next round because they can dollar-cost average their investment?

**Chris:** I think these decisions vary so much. I'm watching a case right now where the VC put in less than his target amount.

Every VC seems to have these different magic amounts they want to own, 15%, 20%. But in reality if it's a hot company they'll own far less.

I don't believe in the ladder thing. The insider is probably not going to, if it's a good company, have the highest willingness to pay in terms of valuation. I don't know. This is really hard one; it just varies so much.

If they love the company, they'll probably want to pay up and do a preemptive round. And then the company has to decide do they want to go out and spend the time and spread all this information about the company around, and try to get a market price.

I often counsel that they should talk to one or two people, not 20, and get some sense of the market. And then give their favorite one a 25% discount or something.

**Nivi:** Great. Mark?

**Mark:** I don't think that investment is that rational. I don't think people sit around and say: What price will we pay? Will we cost average up? Will we do this, or will we do that? It's very emotional. It shouldn't be, maybe.

It has some amount of rationality in terms of what we think the exit price is, our investment price, whether think we're going to get a good multiple on our investment. But the reality is that an investor, whether they own 8% of your company now and they're trying to decide if they want to re-up in the next round and what price they'll pay, they'll pay what the market will bear if they feel you're a hot company.

**Chris:** Yeah, but will they signal against you if they're trying to own more than they own right now?

**Naval:** That's a signal in your favor.

**Mark:** I don't believe so. I don't believe...

**Naval:** Oh, you're saying... yeah. OK.

**Mark:** I don't believe an inside investor will work hard to stop you from raising at a higher price if you can.

**Chris:** It's hard to get. I've had the situation many times as an entrepreneur where you go out and everyone's like, "Am I a stalking horse? Why are you talking to me when you have Bessemer, this billion dollar fund, as a seed investor? Am I just being used as a stalking horse to set the price?" And then you get in this really weird situation, right?

**Mark:** I completely agree with you. And I tell it to people all the time. I even say the same about strategic investors because if they're used and you try to sell to one of their competitors, it's the same signal, right?

That why for me, when I make the investment, I've said to my companies, "If you want to go shop at a higher price, when you're shopping tell them I'll take half the round."

**Chris:** What I do is I actually force my investors to kind of give me a decision ahead of time and then like a no-action letter so I can – not literally – but so I can know if I'm going out and telling someone they're not a stalking horse, that they're really not a stalking horse. Otherwise I'll look like a total jerk.

**Nivi:** OK. Naval?

**Naval:** By the way, this is a thought, we might want to go back up to a level of greater simplicity, because we are talking about things that are very sophisticated and very advanced, and we understand them because we're all entrepreneurs and we're investors.

But I would guess that to the average Venture Hacks reader, this is going straight over their heads.

**Nivi:** Maybe. Maybe not. I'm glad to talk about some simple issues if there are some that you think that we're missing?

**Naval:** I don't have any offhand.

**Nivi:** OK, that's fine.

**Naval:** But we're getting very detailed.

**Nivi:** Very detailed is the name of the game at Venture Hacks, so I don't care. [laughs] All right. Naval, did you have anything to say about VCs not owning enough in the seed round?

**Naval:** Yeah. I think if you have a very large fund and they bought a very small percentage of the seed round, then you can expect that they are going to try and up their ownership next round. They're not going to do it by sending negative signals out into the marketplace to try to keep your valuation down or anything.

Usually the tactic is that they'll propose an insider round. They'll say, "Hey, this is preemptive. Before you go talking to everybody else why don't you take this?" And these days the savvy entrepreneur will figure out what the right answer for preemptive is.

They'll talk to a few friends, they'll read up on TechCrunch and they'll make their decision about what's truly preemptive or not. I've seen some preemptive financing done recently by VCs who put up a little bit in the seed round and then they want to do the whole series A. And generally I'd say they're at about market, or maybe even higher.

## **What are the pros of taking seed money from a VC?**

**Nivi:** Got it. OK, good. I think we have time for two more questions.

The first one is going to be what are the benefits of taking VC cash in the seed round? And at the same time, let's talk about

why maybe this is more about the integrity and the policies of the firm than taking seed cash from a VC firm, yes or no. Did that make sense?

**Naval:** No, it didn't make sense.

**Nivi:** Mark understands it and I'm going to throw it out to him anyway.

**Mark:** OK. Listen, I think, and I've tried to argue, that the most important decision when you're raising money is the people you're raising money from, knowing their background, doing your due diligence, talking to everybody who's ever taken money from them – not everybody, but enough from the sample pool of people who've taken money from them. Find out about their reputation.

And whether you're raising money from angel seed, VCs, that matters to me more than signaling. I think the world is a signal. Everything that happens is a signal. You're an EIR, it's a signal. Your boss, who you reported to at Yahoo is now a VC and isn't investing, that's a signal. It shouldn't be, but it is.

The world is a signal. So knowing from whom you take money is really important. And by the way, I think very few venture capitalist make good seed investors, very, very few. I would include True Ventures, First Round Capital, Founder Group, Union Square. I think I do a reasonable job of it at GRP. But very few actually do.

But the benefit if you do, is if you raise \$750,000 and you end up in the 70% case, which is you're doing OK but not amazing, it is far easier to get a \$500,000 extension or a \$750,000 extension with relatively painless work, to get a bridge note from that VC investor, than it is to go out to eight different angels and try to get checks for \$70,000 each.

The reason is, a lot of the signal for angel investors on whether or not they should continue funding you, I think, is if you've

gone out and done all the VC rounds and no one was interested, then that's a signal to them that it's going to be hard to get financed through to the next round.

So I think there are some positives, there are some negatives. It all comes down to the individual.

**Nivi:** Thanks. Naval?

**Naval:** Yeah, I think Mark made a really good point at the beginning of that, that I would accentuate, which is: You can always break up with your co-founder if they're not working out. You can fire your customer if they're a pain. You can break off a deal with a partner. You can get rid of an employee. But you can't divorce your investor. You're stuck.

And I've seen companies show up that hate their investor and say, "Can you buy my investor out?" And it's such a huge disaster that those companies never make it. So that is paramount. It's job one.

And in terms of what Mark was saying with a bridge. I had a real-life experience with that recently, where a company that was going OK ran out of cash, and there were two of us who had seed funds, so we had quite a bit of money relative to the other 10 investors who were all individuals.

The company needed a bridge, and the other seed fund guy and I had to step up and do it. Luckily the company is doing well now, but none of the individuals could or wanted to or felt the need to step up. They're good guys, but it's just not their model.

So if you feel like your company may need a bridge in order to continue onward, that's a good reason to get a larger fund involved. Even in my case, a small seed fund. It was a tough decision for me, whereas I think a fund like Mark's, if they like the company they might just write a 200K extension check without thinking twice.

**Nivi:** Thanks. And, Chris, can you do me a favor and just move a little closer to the polycom or whatever you're using?

**Chris:** Sure. Can you hear me now?

**Nivi:** And it's your turn.

**Chris:** I completely agree with Mark. It's all about people. I guess just what concerns me right now is I see a lot of these Internet 24-year-old types and I don't know if they have the network yet to truly assess who they're dealing with. That, I guess.

I completely agree with Mark. It's a different world when you have sort of third-time entrepreneurs in the ecosystem and everyone knows. What you're seeing more and more is kind of these people with really good product skills, etcetera, who don't really understand the funding landscape.

I think there's going to be, in five years, a lot of bodies on the field and people are going to realize this stuff the hard way.

## **Anything I missed that I should have brought up?**

**Nivi:** OK, so the last few things – anything that I missed that you wanted to talk about? And I'll start with Naval.

**Naval:** Anything you missed? Come back to me. I've got to parse that. I've got to think about it.

**Nivi:** OK. We'll move on to Chris and then come back to you.

**Chris:** No, I don't think so. [laughs] I think I'm OK.

**Nivi:** Mark?

**Mark:** I'll do a good summary, which is just what Chris said. It is hard for 24-year-olds with no network to know, so we've talked about some of the funds: True, First Round, Union Square, Foundry, GRP. There probably are others, but those are the

ones that come to mind. Everyone who's worked with Founder Collective that I know has said great things about them.

So you can get a lot of signals from a lot of people out there in the market. And what you should really be careful of is a wolf in sheep's clothing. Look out for people who do a high volume of deals. And look out for people who look at this as purely an option. That's probably a pretty good signal that it's purely an option.

**Nivi:** Got it. Naval?

**Naval:** Yeah. I think one thing that we didn't talk about that's screwy and out there and I'm seeing quite a bit is when the VC fund doesn't invest in a company but an individual partner from the fund invests in a company. I never quite know what to make of that when one of those companies show up.

They'll say, "Oh, the senior partner invested in the company, but his fund wouldn't let him invest it in." And I'm never quite sure how to parse that one.

## **How to take an option-style investment from a VC**

**Nivi:** Got it. And I'll throw one thing in here, and maybe you guys'll shit on my head. But as long as the entrepreneur knows what he's getting into – and maybe that's next to impossible, especially for first-timers – I don't think it's that big a deal to take an option-style investment from a VC.

And what I would suggest that they do – and I see this happening more and more – is take that option-style investment from two, three, four, even five VCs, so the signaling value goes down tremendously.

**Naval:** Well, the signaling value gets diversified, if all five of them pass in your next round, you're screwed.

**Nivi:** True. And like I said, as long as you know what you're getting into. Anyone want to take a shit on my head?

**Chris:** A lot of times I get responses to my blog posts like, "Well, that was my only choice." And if it's your only choice, it's your only choice. What can I say? But I see a lot of cases where people actually do have choices and they make this choice, and I think it's a mistake.

## **What's your favorite blog these days?**

**Nivi:** Great. OK. Fun question to wrap things up. What's your favorite blog these days on any topic? We'll start with Mark.

**Mark:** Crap, you're going to start with me? Listen, the truth is I don't read 50 blogs. I don't have time. When you're a person who contributes a lot of content, it's harder to...

**Nivi:** What do you read? What's the one you like?

**Mark:** I read Chris Dixon's blog. I read Venture Hacks. I read Brad Feld<sup>103</sup>. I read Fred Wilson<sup>104</sup>. And I read every post of every one of those people. I'm a parallel consumer so I tend to, on the weekend, read four posts rather than necessarily read them as they come out.

I sometimes like the snarky reporting at Silicon Alley Insider<sup>105</sup>. Nick Carlson makes me laugh. I regret that Valley Wag went away, not matter how many people hated it. I kind of like a little bit of snarky reporting about what's going on in the industry. It's a bit of fun.

**Nivi:** Yeah, me too. Naval?

**Naval:** A little not related to the industry, but right now I like reading Paleo New, which is about the biochemistry behind

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<sup>103</sup><http://www.feld.com/wp/>

<sup>104</sup><http://www.avc.com/>

<sup>105</sup><http://www.businessinsider.com/sai>

evolutionary fitness. I like reading the Rawness, which is about sexual and social psychology. And I like reading the Angry Economist, it's Austrian economics in short little sentences.

**Nivi:** Got it. Chris Dixon?

**Chris:** It's funny, my behavior has totally shifted now where I get everything from Twitter. So I just constantly prune my Twitter list. But I do read Mark. I think Mark's blog is phenomenal. I read Fred's of course. TechCrunch, Business Insider. But I'm getting so much more from Twitter and people re-Tweeting stuff.

**Naval:** I agree with that, Chris. I've noticed the same behavior pattern in myself.

**Chris:** I spend most of my time, frankly, pruning the people I follow or whatever.

**Mark:** That's exactly it. So the behavior that's different is RSS. I don't subscribe to as many things on RSS because I figure I'll see it on Twitter.

**Chris:** Exactly.

## **What's your favorite life hack these days?**

**Nivi:** Honest to goodness last question. We'll start with Naval. What's your favorite life hack these days?

**Naval:** Low carb. [laughs] Changed my life.

**Nivi:** Chris?

**Chris:** God, I don't know, life hack? I'm trying to not have meetings, the maker's schedule, or whatever.

**Nivi:** Ah, that's a good one. Mark?

**Mark:** For me it was getting rid of voicemail. I went over to PhoneTag<sup>106</sup> where everything gets transcribed and I read all my voicemails. It's saved me an immeasurable amount of time.

**Nivi:** Great. OK, I think we're good. I think that was a lot of fun.

**Mark:** Good.

**Naval:** Thanks.

**Chris:** Good. I enjoyed it. Thanks for setting that up, Nivi, it was fun.

**Trent:** If you've got a startup company hungry for seed money and you're looking for intros, or if you're an angel investor and you're looking for an easier way to have hot prospects dropped into your lap, then you'll want to subscribe to AngelList. It's Venture Hack's curated list of angel investors, and you can check it out at [venturehacks.com/angellist](http://venturehacks.com/angellist)<sup>107</sup>.

Plenty of other valuable news, interviews, and general advice to help your startup succeed at Venture Hacks, so be sure to poke around. Check us out on Twitter as well. Until next time, from everyone at Venture Hacks, thanks for listening.

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<sup>106</sup><http://www.phonetag.com/>

<sup>107</sup><http://venturehacks.com/angellist/>

## NYC startup raises money with AngelList



Today we're announcing that MightyMeeting<sup>109</sup> is the **fourth** startup to raise money with AngelList<sup>110</sup>. MightyMeeting is "WebEx for iPad" and it also works on iPhone and the Web. They also happen to be based in New York.

George Zachary<sup>111</sup> from Charles River Ventures introduced us to MightyMeeting's founder, Dmitri Tcherevik<sup>112</sup>. I think George met Dmitri at Founder Showcase<sup>113</sup>. George was already committed to the financing and wanted to use AngelList to help raise the rest of the round. We sent MightyMeeting to AngelList, and Dmitri got **10 intros in 4 days**. The AngelList investors, including George, are:



<sup>114</sup>George Zachary<sup>115</sup> (Investor in Twitter)

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<sup>108</sup><http://www.mightymeeting.com/>

<sup>109</sup><http://www.mightymeeting.com/>

<sup>110</sup><http://venturehacks.com/angellist>

<sup>111</sup><http://venturehacks.com/angellist#george-zachary>

<sup>112</sup><http://twitter.com/cherevik>

<sup>113</sup><http://foundershowcase.com/>

<sup>114</sup><http://venturehacks.com/angellist#george-zachary>

<sup>115</sup><http://venturehacks.com/angellist#george-zachary>



<sup>116</sup>Bill Lee<sup>117</sup> (Investor in Tesla Motors)



<sup>118</sup>Andrea Zurek<sup>119</sup> (Investor in Tapulous)



<sup>120</sup>Shervin Pishevar<sup>121</sup> (Investor in Gowalla)

**Great startups can raise money wherever they are.** In this case, a bunch of Silicon Valley investors invested in a New York startup. But AngelList has investors from all over the world (New York, London, Boston, LA, Europe...). And startups apply for intros from all over the world (Israel, Sweden, Italy, Argentina....).

**Update:** Read MightyMeeting's story in their own words: Raising a Seed Round in 21 Days<sup>122</sup>. And here's a video<sup>123</sup> of MightyMeeting on the iPad:

## New angels on AngelList

Meet a few of the new angels on AngelList:

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<sup>116</sup><http://venturehacks.com/angellist#bill-lee>

<sup>117</sup><http://venturehacks.com/angellist#bill-lee>

<sup>118</sup><http://venturehacks.com/angellist#andrea-zurek>

<sup>119</sup><http://venturehacks.com/angellist#andrea-zurek>

<sup>120</sup><http://venturehacks.com/angellist#shervin-pishevar>

<sup>121</sup><http://venturehacks.com/angellist#shervin-pishevar>

<sup>122</sup><http://www.mightymeeting.com/blog/2010/05/06/127314750000.html>

<sup>123</sup><http://www.youtube.com/watch?v=0x1eOXptmEI>



<sup>124</sup>Geoff Ralston<sup>125</sup> Investor in Powerset ex-Chief Product Officer at Yahoo



<sup>126</sup>Sam Pullara<sup>127</sup> Several stealth investments EIR at Benchmark



<sup>128</sup>Josh Stein<sup>129</sup> Investor in SugarCRM, Managing Director at DFJ

You can track the day-to-day minutiae of these investor's lives with the AngelList Twitter list<sup>130</sup>:

**Startups:** Get intros to AngelList here<sup>131</sup>. **Angels:** Join AngelList here<sup>132</sup>. **Everyone:** Get AngelList updates with Twitter<sup>133</sup> or RSS<sup>134</sup>.

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<sup>124</sup><http://venturehacks.com/angellist#geoff-ralston>

<sup>125</sup><http://venturehacks.com/angellist#geoff-ralston>

<sup>126</sup><http://venturehacks.com/angellist#sam-pullara>

<sup>127</sup><http://venturehacks.com/angellist#sam-pullara>

<sup>128</sup><http://venturehacks.com/angellist#josh-stein>

<sup>129</sup><http://venturehacks.com/angellist#thomas-korte>

<sup>130</sup><http://twitter.com/venturehacks/angellist>

<sup>131</sup><http://venturehacks.com/startuplist>

<sup>132</sup><http://venturehacks.wufoo.com/forms/p7x3x5/>

<sup>133</sup><http://twitter.com/angellist>

<sup>134</sup><http://feeds.venturehacks.com/angellist>

## If this is your first time raising money...

Last week, I tweeted some thoughts<sup>135</sup> for first-time entrepreneurs raising money and asked Naval, Chris Dixon, and Mark Suster to chime in. Here are the results.

### Me

If this is your 1st time raising money...

1. It takes way longer than you think.
2. You'll assume you're much further along than you really are.
3. It's not about optimizing the round, it's about whether you can raise the round at all.

### Naval (@naval)



<sup>136</sup>If this is your 1st time raising money...

1. If you've launched and have traction but you're not getting funded, your team is likely the problem. Look in the mirror.

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<sup>135</sup><http://twitter.com/venturehacks/status/13567202226>

<sup>136</sup><http://startupboy.com/>

2. Your financing usually goes nowhere until you're suddenly oversubscribed.
3. Launch first, raise later.

## **Chris Dixon (@cdixon)**



<sup>137</sup>If this is your 1st time raising money...

1. Make sure the valuation is one that you can get a 2-3x step up on if you hit your milestones.
2. The earlier the investment stage the more you should think of them as partner versus buyers of stock.
3. After 3 months of pitching, you risk being perceived as damaged goods.

## **Mark Suster (@msuster)**



<sup>138</sup>If this is your 1st time raising money...

1. The biggest problem is “anchor tenants.” Once you get them, the lemmings will follow.

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<sup>137</sup><http://cdixon.org/>

<sup>138</sup><http://www.bothsidesofthetable.com/>

2. Everyone wants a “deal.” Even rich people. Get the highest profile anchor tenants and give them a deal. My commentary is specifically related angel investing.
3. Everyone obsesses with dilution from investors. The biggest dilution comes from co-founders. If you have 2 co-founders, you’ve diluted 66% before doing any of the hard work. Start by yourself and bring in co-founders for smaller stakes once you’ve got initial momentum. Unconventional wisdom, but the most economically practical advice you’ll ever get.

## Naval on GigaOm TV

GigaOm TV released an interview<sup>139</sup> with our Naval today. It’s pretty damn good:

Video: Naval on GigaOm TV<sup>140</sup>

The topics aren’t new but I always learn something when I listen to Naval. He discusses the three traits you need to look for in a partner, how important it is to be in Silicon Valley, and lots more.

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<sup>139</sup><http://gigaom.com/2010/05/13/video-want-to-be-an-entrepreneur-listen-to-naval-ravikant/>

<sup>140</sup><http://gigaom.com/2010/05/13/video-want-to-be-an-entrepreneur-listen-to-naval-ravikant/>

## Steve Ballmer from the Microsoft Corporation with an iPad review

Fred Destin<sup>141</sup> tells me that Venture Hacks is too serious. He tells me that even The New Yorker publishes cartoons beside their articles about mass starvation in North Korea<sup>142</sup>. And so, courtesy 1938 Media<sup>143</sup>, we present:

Video: Ballmer reviews iPad<sup>144</sup>

## This week in Twitter

37signals' This week in Twitter<sup>145</sup> has inspired me to round up this week's most popular @venturehacks<sup>146</sup> tweets:



Entrepreneurship is not an end in and of itself. Serial entrepreneur is an oxymoron.



"I start companies because it gives me an opportunity to create teams." – @englishpaulm<sup>147</sup>, <http://vh.co/b0tGgY><sup>148</sup>

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<sup>141</sup><http://www.freddestin.com/>

<sup>142</sup>[http://www.newyorker.com/archive/2003/09/08/030908fa\\_fact4?currentPage=all](http://www.newyorker.com/archive/2003/09/08/030908fa_fact4?currentPage=all)

<sup>143</sup><http://www.1938media.com>

<sup>144</sup>[http://www.youtube.com/watch?v=cRcTYgEx3mI&feature=player\\_embedded](http://www.youtube.com/watch?v=cRcTYgEx3mI&feature=player_embedded)

<sup>145</sup><http://37signals.com/svn/posts/2328-this-week-in-twitter>

<sup>146</sup><http://twitter.com/venturehacks>

<sup>147</sup><http://twitter.com/englishpaulm>

<sup>148</sup><http://vh.co/b0tGgY>



“Integrity is the safest way to make money... Situational ethics problem is huge ('everyone else is doing it')” – Buffett,  
<http://vh.co/9VLhSh><sup>149</sup>



What Business is Wall Street In? <http://vh.co/b61I7s><sup>150</sup>.  
Too many aphorisms in this thoughtful post by @mcuban<sup>151</sup>.  
Just read it.



From Zero to a Million Users <http://vh.co/aEHIzO><sup>152</sup>.  
Tons of marketing tactics in this talk by @drewouston<sup>153</sup> at  
@dropbox<sup>154</sup> & @asmith<sup>155</sup> at @xobni<sup>156</sup>.

Instead of showing our avatar next to each tweet, I've picked images that are related to the tweet. And it's easy to find your most popular tweets on the Your Tweets, Retweeted<sup>157</sup> page on Twitter. For this post, I picked tweets that had 8+ retweets.

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<sup>149</sup><http://vh.co/9VLhSh>

<sup>150</sup><http://vh.co/b61I7s>

<sup>151</sup><http://twitter.com/mcuban>

<sup>152</sup><http://vh.co/aEHIzO>

<sup>153</sup><http://twitter.com/drewouston>

<sup>154</sup><http://twitter.com/dropbox>

<sup>155</sup><http://twitter.com/asmith>

<sup>156</sup><http://twitter.com/xobni>

<sup>157</sup>[http://twitter.com/#retweeted\\_of\\_mine](http://twitter.com/#retweeted_of_mine)

## Venture Hacks TV



<sup>158</sup>[venturehacks.tv](http://venturehacks.tv)<sup>159</sup> is our new blog where we collect the best startup advice on video. We're starting it off strong with an hour of Q&A with Marc Andreessen<sup>160</sup> from Stanford's ECorner.

You can subscribe to VHTV via RSS<sup>161</sup>, Email<sup>162</sup>, or Twitter<sup>163</sup>.

### Why VHTV?

In the last week or so, we've noticed an increase in good startup advice on video. There's TWiVC<sup>164</sup>, GigaOM TV<sup>165</sup>, SLL-Conf<sup>166</sup>, TechCrunch TV<sup>167</sup>, Stanford's ECorner<sup>168</sup>, and lots more.

Who has time to watch all this? You don't. Neither do I. But I do have time to watch *some* of it while I'm brushing my teeth, folding laundry, and cleaning the toilet. If I watch it and like it, we'll link to it on venturehacks.tv<sup>169</sup>.

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<sup>158</sup><http://venturehacks.tv>

<sup>159</sup><http://venturehacks.tv>

<sup>160</sup><http://venturehacks.tv/post/605467958/pmarca-qa>

<sup>161</sup><http://feeds.venturehacks.com/vhtv>

<sup>162</sup>[http://feedburner.google.com/fb/a/mailverify?uri=vhtv&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=vhtv&loc=en_US)

<sup>163</sup><https://twitter.com/venturehacks>

<sup>164</sup><http://thisweekin.com>thisweekin-venture-capital/>

<sup>165</sup><http://gigaom.com/2010/05/13/video-want-to-be-an-entrepreneur-listen-to-naval-ravikant/>

<sup>166</sup><http://www.justin.tv/startuplessonslearned/videos>

<sup>167</sup><http://techcrunch.com/2010/04/04/top-vcs-debate-rising-startup-valuations-video/>

<sup>168</sup><http://ecorner.stanford.edu/index.html>

<sup>169</sup><http://venturehacks.tv>

## Why Tumblr?

We've been using WordPress<sup>170</sup> since the dawn of time but we're trying Tumblr<sup>171</sup> for VHTV. First, I just wanted to try Tumblr and see what it's like. Second, Tumblr themes<sup>172</sup> are badass. Third, topherchris's blog<sup>173</sup> sucked me into Tumblr. He's Tumblr's Editorial Director and general internet jackass. Everyone running a community should watch and learn from topherchris.

**Update:** A nice side effect to publishing on Tumblr is that people are now following us on Tumblr. That's a new distribution channel for us.

Now, please head over to venturehacks.tv<sup>174</sup> and watch pmarca in formal VC Wear:



<sup>170</sup><http://wordpress.org/>

<sup>171</sup><http://tumblr.com>

<sup>172</sup><http://www.tumblr.com/themes/>

<sup>173</sup><http://topherchris.com/>

<sup>174</sup><http://venturehacks.tv>

<sup>175</sup><http://venturehacks.tv/post/605467958/pmarca-qa>

## Why startups should train their people



<sup>176</sup>Ben Horowitz<sup>177</sup>:

“Training is, quite simply, one of the highest-leverage activities a manager can perform. Consider for a moment the possibility of your putting on a series of four lectures for members of your department. Let’s count on three hours preparation for each hour of course time—twelve hours of work in total. Say that you have ten students in your class. Next year they will work a total of about twenty thousand hours for your organization. If your training efforts result in a 1 percent improvement in your subordinates’ performance, your company will gain the equivalent of two hundred hours of work as the result of the expenditure of your twelve hours...

“When people interview managers, they often like to ask: have you fired anyone? Or how many people have you fired? Or how would you go about firing someone? These are all fine questions, but often the right question is the one that isn’t asked: When you fired the person, how did you know with certainty that the employee both understood the expectations of the job and were missing them? The best answer is that the manager clearly set expectations when she trained the employee for the job. If you don’t train your people, you establish no basis for performance management. As a result, performance management in your company will be sloppy and inconsistent...

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<sup>176</sup><http://bhorowitz.com/2010/05/14/why-startups-should-train-their-people>

<sup>177</sup><http://bhorowitz.com/2010/05/14/why-startups-should-train-their-people/>

“Andy Grove writes, there are only two ways for a manager to improve the output of an employee: motivation and training.”

Read the full post<sup>178</sup>.

Ben’s post reminds me of classic Peter Drucker. For examples, see Drucker’s Management by Objectives<sup>179</sup> and other<sup>180</sup> writings<sup>181</sup> by Drucker.

## Angel Boot Camp coming to Cambridge

My friends in Boston are running Angel Boot Camp<sup>182</sup> (@angelbootcamp<sup>183</sup>) in Cambridge, MA on June 1:

“Have you thought about angel investing but weren’t sure whether it was right for you or how to get started? Are you an entrepreneur who wants to learn more about working with angels and how angel investment differs from venture capital? Here’s a chance to learn from the experts.

“Why do angel investing? How do you find and evaluate potential investments? What’s the right amount of money to invest? How do you set terms? How do you work with other angels, entrepreneurs and VCs? What are the legal issues?”

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<sup>178</sup><http://bhorowitz.com/2010/05/14/why-startups-should-train-their-people/>

<sup>179</sup><http://www.nivi.com/blog/article/mbo>

<sup>180</sup><http://www.nivi.com/blog/article/the-essential-peter-drucker-part-1>

<sup>181</sup><http://www.nivi.com/blog/article/the-essential-peter-drucker-part-2>

<sup>182</sup><http://seedboston.com/angelbootcamp/>

<sup>183</sup><http://twitter.com/angelbootcamp>

The speakers, presented in a 4×4 array, look great:



Alexis Ohanian  
Founder  
Reddit



Andy Payne  
Angel Investor  
Open Market



Angus Davis  
Founder  
Swipely



Bill Warner  
President  
Warner Research



David Cawel  
Founder  
Performable



David Cohen  
Founder  
TechStars



Dharmesh Shah  
Founder  
HubSpot



Don Dodge  
Developer Advocate  
Google



Eric Paley  
Managing Partner  
Founder Collective



John Landry  
Angel Investor  
Lead Dog Ventures



Lee Hower  
Angel Investor  
PayPal, LinkedIn



Mike Hirshland  
General Partner  
Polaris Ventures



Phil Barnes  
Principal  
First Round Capital



Rich Miner  
Partner  
Google Ventures

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If you're a Boston angel, check out the Boot Camp<sup>185</sup>. Startups are invited too. And when you're done, join AngelList<sup>186</sup>.

## Boot Camp: Stay-at-Home Edition

Angel Boot Camp is modeled after Y Combinator's AngelConf<sup>187</sup>. Angels who want to learn more about angel investing should

<sup>184</sup><http://seedboston.com/angelbootcamp/>

<sup>185</sup><http://seedboston.com/angelbootcamp/>

<sup>186</sup><http://venturehacks.com/angellist>

<sup>187</sup><http://angelconf.org/>

read this excellent essay by Y Combinator's Paul Graham: How to Be an Angel Investor<sup>188</sup>. And this semi-excellent interview with me and Naval: How to be an angel investor, Part 2<sup>189</sup>.

Without angel investing, there would be no VC investing. Fred Wilson writes<sup>190</sup>, "The angel funding mechanism is potentially the single most important funding mechanism in startup land." I couldn't agree more.

## John Doerr: The salesman for nerds

Here are the latest videos from Venture Hacks TV<sup>191</sup> (the best startup advice you can get while you're folding the laundry). You can subscribe to VHTV via RSS<sup>192</sup>, email<sup>193</sup>, or Twitter<sup>194</sup>.

### 1. John Doerr: The salesman for nerds

*Video: Charlie Rose interviews John Doerr*<sup>195</sup> I'm going to keep my eyes on the videos coming out of TechCrunch Disrupt<sup>196</sup> this week. The best talk on Monday was Charlie Rose's interview of John Doerr<sup>197</sup>.

I've always thought of John Doerr as a *salesmen for nerds*. And Doerr always looks at the big picture — I remember him talking

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<sup>188</sup><http://www.paulgraham.com/angelinvesting.html>

<sup>189</sup><http://venturehacks.com/articles/angel>

<sup>190</sup>[http://www.avc.com/a\\_vc/2009/12/public-policy-and-venture-capital.html](http://www.avc.com/a_vc/2009/12/public-policy-and-venture-capital.html)

<sup>191</sup><http://venturehacks.tv/>

<sup>192</sup><http://feeds.venturehacks.com/vhtv>

<sup>193</sup>[http://feedburner.google.com/fb/a/mailverify?uri=vhtv&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=vhtv&loc=en_US)

<sup>194</sup><https://twitter.com/venturehackstv>

<sup>195</sup>[http://www.livestream.com/disrupt/video?clipId=pla\\_400810ff-aa43-4b53-9839-67b6bae4bfef](http://www.livestream.com/disrupt/video?clipId=pla_400810ff-aa43-4b53-9839-67b6bae4bfef)

<sup>196</sup><http://disrupt.techcrunch.com/>

<sup>197</sup><http://www.kpcb.com/team/doerr>

about how the browser was going to be important again, well before Firefox emerged.

## 2. Gates convinces Jobs to give him 3 pre-release Macs

*Video: Pirates of Silicon Valley<sup>198</sup> Watch how Gates manipulates Jobs hatred of IBM to get his way at 6:45.*

Every entrepreneur should see *Pirates of Silicon Valley*<sup>199</sup>. This made-for-TV movie from 1999 is amazingly well-done. It's a dramatization of Steve Jobs and Steve Wozniak starting Apple; Bill Gates and Paul Allen starting Microsoft; and how Jobs and Gates collided.

The script and acting ring true. Wozniak writes<sup>200</sup> that “the personalities were very accurately portrayed.” Steve Jobs actually invited Noah Wyle, the actor who portrays Jobs, to impersonate him at Macworld<sup>201</sup>. And the negotiations are pretty realistic.

Watch the clip above and rent the movie if you like it — it's cheesy but good.

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<sup>198</sup> [http://www.youtube.com/watch?v=fJl0jCknB6c&feature=player\\_embedded#t=2m52s](http://www.youtube.com/watch?v=fJl0jCknB6c&feature=player_embedded#t=2m52s)

<sup>199</sup> <http://www.google.com/search?sourceid=chrome&ie=UTF-8&q=pirates+of+silicon+valley>

<sup>200</sup> <http://www.woz.org/letters/pirates/01.html>

<sup>201</sup> <http://www.youtube.com/watch?v=TIClAanU7Os>

### 3. This Week in Venture Capital with Jason Calacanis

*Video: This Week in Venture Capital Episode 6<sup>202</sup> (Download<sup>203</sup>)* This Week in Venture Capital<sup>204</sup> is a combination of startup analysis and startup advice from Jason Calacanis<sup>205</sup>, burgeoning ThisWeekIn<sup>206</sup> empire. Mark Suster<sup>207</sup> is the host. Jump to 33:05 for a solid block of startup advice on:

1. Your deck getting in the wrong hands @ 33:05.
2. If this is your first time raising angel money...<sup>208</sup> @ 38:13.
3. “VCs—when we fund raise—never ever are raising money. We’re pre-marketing until the round’s closed.” – Mark Suster @ 44:34

If you’re into startup analysis, check out the deal of the week, Stack Overflow<sup>209</sup>, @ 1:00. Jason’s Q&A expertise shines through here. And here’s Mark’s recap of the episode<sup>210</sup>.

**Subscribe to VHTV via RSS<sup>211</sup>, email<sup>212</sup>, or Twitter<sup>213</sup>. Do so immediately and without hesitation. How else are you going to get startup advice while you do the dishes.**

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<sup>202</sup><http://thisweekin.com/thisweekin-venture-capital/twvc-06-with-jason-calacanis/>

<sup>203</sup><http://itunes.apple.com/us/podcast/this-week-in-venture-capital/id364736777>

<sup>204</sup><http://thisweekin.com/thisweekin-venture-capital/>

<sup>205</sup><http://twitter.com/jason>

<sup>206</sup><http://thisweekin.com>

<sup>207</sup><http://www.bothsidesofthetable.com/>

<sup>208</sup><http://venturehacks.com/articles/first-time>

<sup>209</sup><http://stackoverflow.com/>

<sup>210</sup><http://www.bothsidesofthetable.com/2010/05/15/this-week-in-vc-episode-6-with-jason-calacanis-best-one-yet/>

<sup>211</sup><http://feeds.venturehacks.com/vhtv>

<sup>212</sup>[http://feedburner.google.com/fb/a/mailverify?uri=vhtv&loc=en\\_US](http://feedburner.google.com/fb/a/mailverify?uri=vhtv&loc=en_US)

<sup>213</sup><https://twitter.com/venturehackstv>

## Resiliency

Michael Wolff<sup>214</sup> on Guess Who:

“Windows knocked him off the main stage for 10 years; then the Internet seemed to sideline him; not to mention that serious business people (along with many others) thought he was nutty; then he had problems with the SEC (and not insignificant ones); then he nearly died.”

They call this resiliency<sup>215</sup>.

## This Week in Venture Capital

This Week in Venture Capital<sup>216</sup> is awesome. I've watched every episode. The show is a mix of startup advice and startup analysis:

“Entrepreneur [now VC] Mark Suster<sup>217</sup> and a rotating group of guest experts bring you weekly news and commentary on the top 10 recent venture deals and exits.”

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<sup>214</sup><http://www.newser.com/off-the-grid/post/480/the-last-mogul-has-steve-jobs-won.html>

<sup>215</sup><http://www.bothsidesofthetable.com/2009/12/18/what-makes-an-entrepreneur-410-resiliency/>

<sup>216</sup><http://thisweekin.com/thisweekin-venture-capital/>

<sup>217</sup><http://www.bothsidesofthetable.com/>

## Episodes

This Week in Venture Capital (TWiVC) is a great way to get to know Mark and his guests without ever meeting them. And if you're not in the Valley, TWiVC is a wonderful way to get a feel for Valley culture, even though the show is filmed in LA — Silicon Valley is a mindset, not a location.

Here's a recent episode:

*Video: TWiVC #6 with Jason Calacanis*<sup>218</sup>

Jump to 33:05 for a solid block of startup advice on:

1. Your deck getting in the wrong hands. @ 33:05
2. If this is your first time raising angel money...<sup>219</sup> @ 38:13
3. “VCs—when we fund raise—never ever are raising money. We’re pre-marketing until the round’s closed.” – Mark Suster @ 44:34

And if you see a guy named Farb Nivi<sup>220</sup> on the site, that's my brother (yes, I go by my last name):

*Video: TWiVC #8 with Farb Nivi*<sup>221</sup>

## One more thing...

Also check out TWiVC's sister show, This Week in Startups<sup>222</sup> with Jason Calacanis<sup>223</sup>. The episode with Joel Spolsky<sup>224</sup> is

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<sup>218</sup><http://thisweekin.com/thisweekin-venture-capital/twivc-06-with-jason-calacanis/>

<sup>219</sup><http://venturehacks.com/articles/first-time>

<sup>220</sup><http://twitter.com/farbood>

<sup>221</sup><http://thisweekin.com/thisweekin-venture-capital/this-week-in-venture-capital-8-with-farb-nivi/>

<sup>222</sup><http://thisweekin.com/thisweekin-startups/>

<sup>223</sup><http://twitter.com/jason>

<sup>224</sup><http://thisweekin.com/thisweekin-startups/twist-51-with-joel-spolsky-2/>

the best one I've seen so far.

## This fortnight in Twitter

*Highlights from the @venturehacks<sup>225</sup> Twitter feed from this fortnight. The most retweeted tweets.*

“The toughest and most important decisions in technology companies are always about product strategy.” – @bhorowitz<sup>226</sup>, <http://vh.co/a3DO7h><sup>227</sup>

“With our stock buyback... we were signaling that we didn’t see much of a future in our business.” – @fredwilson<sup>228</sup>, <http://vh.co/9udDmm><sup>229</sup>

You have acquisition interest—now what? <http://vh.co/98Yy4n><sup>230</sup> by @davidcohen<sup>231</sup>. The negotiation principle is “reciprocal displays of commitment”.

“You can explain your business in mind numbing detail or you can inspire an investor and let them imagine.” – @fredwilson<sup>232</sup>, <http://vh.co/bLdDQm><sup>233</sup>

“Whenever you see a company being built for an exit, you will see short term decision making.” – @BostonVC<sup>234</sup>, <http://vh.co/btEkaA><sup>235</sup>

*P.S. Instead of showing our avatar next to each tweet, I’ve picked images that are related to the tweet.*

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<sup>225</sup><http://twitter.com/venturehacks>

<sup>226</sup><http://twitter.com/bhorowitz>

<sup>227</sup><http://vh.co/a3DO7h>

<sup>228</sup><http://twitter.com/fredwilson>

<sup>229</sup><http://vh.co/9udDmm>

<sup>230</sup><http://vh.co/98Yy4n>

<sup>231</sup><http://twitter.com/davidcohen>

<sup>232</sup><http://twitter.com/fredwilson>

<sup>233</sup><http://vh.co/bLdDQm>

<sup>234</sup><http://twitter.com/BostonVC>

<sup>235</sup><http://vh.co/btEkaA>

*P.P.S. It's easy to find your most popular tweets on the Your Tweets, Retweeted<sup>236</sup> page.*

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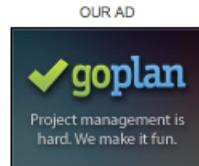
<sup>236</sup>[http://twitter.com/#retweeted\\_of\\_mine](http://twitter.com/#retweeted_of_mine)

# June 2010

## Ads for startups

For the last few months, we've been using InfluAds<sup>1</sup> to power an ad widget near the top right of Venture Hacks<sup>2</sup>. I think of InfluAds as "ads for startups".

This is what it looks like:



Goplan makes online project management easy and fun

Powered by influAds

3

Advertising with InfluAds gets you on Venture Hacks and about 20 other startup blogs<sup>4</sup> like A Smart Bear<sup>5</sup>, Tony Wright<sup>6</sup>, and Hiten Shah<sup>7</sup>. InfluAds calls that group of blogs the "startup community". You can also advertise on other groups of blogs<sup>8</sup> for Design & UX, Work & Productivity, and Web Development.

Personally, I like the ads — they're relevant and tasteful. They're modeled after ads from The Deck<sup>9</sup>. Whenever a new ad shows

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<sup>1</sup><http://influads.com?f=venturehacks>

<sup>2</sup><http://venturehacks.com/>

<sup>3</sup><http://venturehacks.com>

<sup>4</sup><http://influads.com/communities/startups-and-entrepreneurs?f=venturehacks>

<sup>5</sup><http://blog.asmartbear.com/>

<sup>6</sup><http://www.tonywright.com/>

<sup>7</sup><http://hitenshah.name/>

<sup>8</sup><http://influads.com/communities?f=venturehacks>

<sup>9</sup><http://decknetwork.net/>

up, I click on it to learn more about the product. I've corresponded with their CEO, Anibal Damião, over email and he seems genuinely interested in helping startups reach new customers with classy ads.

So check out InfluAds<sup>10</sup>, tell them we sent you so we get rich off the referral fees, and use the VENTUREHACKS<sup>11</sup> promo code to get a whopping 20% discount.

## The Startup Game

Why Games Are Fun: The Psychology Explanation<sup>12</sup>:

“Fun games operate on the principle that our actions will definitely bring us closer to the goal. If you go and slash rabbits (action), you will definitely gain experience points (relation), and you will eventually level up (goal).

**“This is the reason so many people, including myself, have failed at difficult, uncharted things like entrepreneurship. There’s no guarantee that our next step will bring us closer to the goal.** For example, we could easily invest 6 months into building a product that nobody wants to buy. Now, that specific problem can be ameliorated through processes of customer development<sup>13</sup>, but the general problem still exists.

“If we get a job, we’re probably going to get paid for our labors.

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<sup>10</sup><http://influids.com?f=venturehacks>

<sup>11</sup><http://influids.com/pricing-and-signup?f=venturehacks>

<sup>12</sup><http://www.zacharyburt.com/2010/06/why-games-are-fun-the-psychology-explanation/>

<sup>13</sup><http://www.amazon.com/dp/0976470705/?tag=httpwwwwhiph02-20>

“If we build a product and take it to market, we’re probably not going to get paid for our efforts. So where’s the motivation? It requires a lot of risk, and the human brain is not wired to consider long-term rewards! The nucleus accumbens, which may play a large role in the distribution of the phenomenon of pleasure and reward seeking, is part of the ancient limbic system, which motivates lots of behavior. Long-term goals require premeditated planning by the prefrontal cortex.”

[Emphasis added.]

I think there’s an opportunity to apply game mechanics to:

1. Starting a startup.
2. Managing employees in a startup.
3. Managing teams in general.

Please steal this idea and let me know what you come up with. This would be a great project for a business school Ph.D.

## Local startup BlockChalk raises national money with AngelList



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<sup>14</sup><http://www.blockchalk.com/>

Today we're announcing that BlockChalk<sup>15</sup> has raised money with AngelList<sup>16</sup>. BlockChalk is a "GPS-enabled communication system for your neighborhood."

**Update:** Read BlockChalk's story in their own words: Lessons from raising a seed round<sup>17</sup>.

**Update 2:** Scott Austin at The Wall Street Journal reports on AngelList: Start-Ups Get Free Chance to Pitch to Angel Investors<sup>18</sup>.

Joshua Schachter<sup>19</sup> introduced us to BlockChalk. He was already committed to the financing and suggested they use AngelList to fill out the round. We sent BlockChalk to AngelList and the following investors asked for intros and invested:



<sup>20</sup>Joshua Schachter<sup>21</sup> (Our source)



<sup>22</sup>Mitch Kapor<sup>23</sup> (Investor in Twilio)

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<sup>15</sup><http://blockchalk.com/>

<sup>16</sup><http://angel.co>

<sup>17</sup><http://blog.blockchalk.com/post/708678386/lessons-from-raising-a-seed-round>

<sup>18</sup><http://online.wsj.com/article/SB10001424052748704198004575310561617944540.html>

<sup>19</sup><http://angel.co/joshu>

<sup>20</sup><http://angel.co/joshu>

<sup>21</sup><http://angel.co/joshu>

<sup>22</sup><http://angel.co/mkapor>

<sup>23</sup><http://angel.co/mkapor>



<sup>24</sup>Thomas McInerney<sup>25</sup> (Investor in Klout)



<sup>26</sup>Josh Stylman<sup>27</sup> (Investor in betaworks)

Josh Stylman (one of the AngelList investors above) then introduced BlockChalk to Chris Dixon<sup>28</sup> and Eric Paley<sup>29</sup> who also invested:



<sup>30</sup>Chris Dixon<sup>31</sup>



<sup>32</sup>Eric Paley<sup>33</sup>

**So an AngelList intro to Josh Stylman turned into friend-of-a-friend intros to Chris Dixon and Eric Paley.** It's obvious in retrospect, but we didn't anticipate these second-order intros when we started AngelList. It's very cool to see this emergent behavior.

Satya Patel, Michael Dearing, and David Liu also invested in BlockChalk (though they didn't source it with AngelList):

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<sup>24</sup><http://angel.co/tgmtgm>

<sup>25</sup><http://angel.co/tgmtgm>

<sup>26</sup><http://angel.co/jstylman>

<sup>27</sup><http://angel.co/jstylman>

<sup>28</sup><http://foundercollective.com/people/Chris-Dixon>

<sup>29</sup><http://foundercollective.com/people/Eric-Paley>

<sup>30</sup><http://cdixon.org/>

<sup>31</sup><http://cdixon.org/>

<sup>32</sup><http://angel.co/epaley>

<sup>33</sup><http://angel.co/epaley>



<sup>34</sup>Satya Patel<sup>35</sup> (Battery Ventures)

<sup>36</sup>Michael Dearing<sup>37</sup> (Investor in AdMob)

<sup>38</sup>David Liu<sup>39</sup> (Investor in SimpleGeo)

## About BlockChalk

In their own words,

“BlockChalk<sup>40</sup> is an early stage location-based service that helps people connect with their neighbors

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<sup>34</sup><http://angel.co/satyap>

<sup>35</sup><http://angel.co/satyap>

<sup>36</sup><http://angel.co/mcgd>

<sup>37</sup><http://angel.co/mcgd>

<sup>38</sup><http://www.crunchbase.com/person/david-liu-2>

<sup>39</sup><http://www.crunchbase.com/person/david-liu-2>

<sup>40</sup><http://blockchalk.com/>

and mobilize their local communities. Using GPS-enabled smartphones, BlockChalk users can interact with people in their neighborhood to ask, answer, praise, gripe, report, prevent, borrow, trade, and much more. It's easy and free; you don't even have to sign up. BlockChalk is currently on iPhone and Palm, as well as on Android via HTML5."

I think the foundation of BlockChalk's fund-raising story is the pedigree of their team: Stephen Hood is the former head of product at del.icio.us, Dave Baggeroer is part of Stanford's d.school faculty, and Josh Whiting is a former senior engineer at craigslist and former head of engineering for del.icio.us.

Mark Suster says<sup>41</sup> that "Everything that happens is a signal." And it's a great signal when Joshua Schachter, who worked with two of the co-founders at del.icio.us, is investing.

*Startups:* Get intros to AngelList here<sup>42</sup>. *Angels:* Join AngelList here<sup>43</sup>. *Everyone:* Get AngelList updates via Twitter<sup>44</sup> and RSS<sup>45</sup>.

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<sup>41</sup><http://venturehacks.com/articles/vc-seed>

<sup>42</sup><http://venturehacks.com/startuplist>

<sup>43</sup><http://angel.co/apply>

<sup>44</sup><http://twitter.com/angellist>

<sup>45</sup><http://feeds.venturehacks.com/angellist>

JUNE 2010

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## The WSJ reports on AngelList

**ALL BUSINESS**

**ng: Green**

*ance in Catastrophes*

**Start-Ups Get Free Chance To Pitch to Angel Investors**

By SCOTT AUSTIN

Start-ups hungry for cash are often expected to pay a fee to pitch to angel investors. But some free services are cropping up to counter the so-called pay-to-pitch model.

Earlier this year, Internet entrepreneur and blogger Jason Calacanis started Open Angel Forum, which holds free pitch events in various cities where entrepreneurs can select from a pool of applicants to pitch to about 20 to 30 angel investors. At Open Angel's first event in February, three of six companies found new investors.

Another free service, AngelList, started in February by angels Naval Ravikant and Babak Nivi, vets dozens of deals before highlighting the best ones in emails each week sent free to a group of 200 investors.

Messrs. Ravikant and Nivi—who also run Venture Hacks, a for-profit site that provides advice to start-ups—say they have received pitches from more than 1,000 start-ups. Of the 48 companies featured so far on AngelList, about half have received funding, they say.

Marcos Zapacosta, founder of Thumbtack Inc., a site that lets people book services like tutors and dog walkers, won three commitments from angels after pitching his company in March at an Open Angel Forum event in San Francisco. He then turned to AngelList and received three more commitments to close a funding round at \$1.2 million in June. The service, he says, "is good at getting worthy start-ups into the inbox of investors."

The free services come in the wake of recent criticism of the pay-to-pitch model, which some angel investors have argued is justified because they offer advice and should be paid for their time. Mr. Calacanis, an outspoken figure in the tech industry, last fall publicly admonished angel investment groups for charging bootstrapped entrepreneurs hundreds, if not thousands, of dollars to pitch to them.

Last month, Chris Hurley shut down his Revolutionary Angels service that proposed to charge entrepreneurs \$4,995 for advisory services and entry into a business competition that would award \$250,000 to the winner. Revolutionary Angels received only 20 entries, far short of its goal of 60 participants.

In retrospect, "\$5,000 is a lot of money for early-stage entrepreneurs," said Mr. Hurley.

But the new free services aren't entirely altruistic. They give their founders inside access to companies in which they might be interested in investing and Messrs. Ravikant and Nivi can use AngelList to indirectly market Venture Hacks' start-up guides.

Not all entrepreneurs have won investments. Jen Lilenstein, one of six entrepreneurs selected to pitch last month at an Open Angel Forum in Los Angeles, hasn't raised any cash for her start-up, Kidmet.com, which helps parents enroll their kids in extracurricular activities.

But Ms. Lilenstein says the event was helpful because angel investors stuck around for hours to offer advice. Ms. Lilenstein says she is

**Angel investors argue that fees are justified because they should be paid for their time.**

now in "a dating phase" with investors and continuing conversations.

Some pay-to-pitch services have changed their business models amid the criticism. In September, **FundingUniverse** LLC stopped charging a \$125 fee for entrepreneurs to pitch at its events, attended by angels and loan providers like banks. The winners of its events receive a few thousand dollars in in-kind services, and sometimes, investments.

**FundingUniverse** does, however, sell products through its website, such as a \$99 online "diagnostic tool" that analyzes a business's funding prospects. "We think the services we do charge for are perfectly acceptable," says Alexander Lawrence, a partner at the company.

**WATCH**

**AccuWeather.com**

It's a pain in the ass for interesting startups to get meetings with good angels. You have to bug your friends, one-by-one, to introduce you to the angels they know.

The global community of angels on AngelList<sup>47</sup> offer an alternative.

Startups apply to AngelList, we pick the ones that we think the angels will like, and we send them to the angels. The angels read these pitches, meet the startups they like, and, perhaps, invest.

We've announced 5 startups that have been funded through AngelList but, as Scott Austin<sup>48</sup> reports in The Wall Street Journal<sup>49</sup>,

"Of the 48 companies featured so far on AngelList, about half have received funding.... Marco Zappacosta, founder of Thumbtack Inc., a site that lets people book services like tutors and dog walkers, won three commitments from angels after pitching his company in March at an Open Angel Forum event in San Francisco. He then turned to AngelList and received three more commitments to close a funding round at \$1.2 million in June. The service, he says, "is good at getting worthy start-ups into the inbox of investors."

Read the full article here<sup>50</sup> before it goes behind the WSJ's pay wall.

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<sup>47</sup> <http://angel.co/>

<sup>48</sup> <http://twitter.com/scottmaustin>

<sup>49</sup> [http://online.wsj.com/article/SB10001424052748704198004575310561617944540.html?mod=wsj\\_share\\_twitter](http://online.wsj.com/article/SB10001424052748704198004575310561617944540.html?mod=wsj_share_twitter)

<sup>50</sup> [http://online.wsj.com/article/SB10001424052748704198004575310561617944540.html?mod=wsj\\_share\\_twitter](http://online.wsj.com/article/SB10001424052748704198004575310561617944540.html?mod=wsj_share_twitter)

By the way, the 5 startups that we've announced are Startup 0<sup>51</sup>, Postling<sup>52</sup>, Divvyshot<sup>53</sup>, MightyMeeting<sup>54</sup>, and BlockChalk<sup>55</sup>. Scott "outed" Thumbtack<sup>56</sup> in the WSJ — so that makes it six.

*Startups:* Get intros to AngelList here<sup>57</sup>. *Angels:* Join AngelList here<sup>58</sup>. *Everyone:* Get AngelList updates via Twitter<sup>59</sup> and RSS<sup>60</sup>.

## A tale of 3 financings

When startups raise money with AngelList, we encourage them to share their fundraising story. Here are 3 stories from BlockChalk<sup>61</sup>, MightyMeeting<sup>62</sup>, and Postling<sup>63</sup>. I've excerpted the nice things they wrote about AngelList, but you should click through and read their whole posts — each startup tells their unique funding story from start to finish.



<sup>64</sup>BlockChalk<sup>65</sup>:

<sup>51</sup><http://venturehacks.com/articles/startuplist-first-funding>

<sup>52</sup><http://venturehacks.com/articles/postling-funded>

<sup>53</sup><http://venturehacks.com/articles/divvyshot-angellist>

<sup>54</sup><http://venturehacks.com/articles/mightymeeting>

<sup>55</sup><http://venturehacks.com/articles/blockchalk>

<sup>56</sup><http://www.thumbtack.com/>

<sup>57</sup><http://venturehacks.com/startuplist>

<sup>58</sup><http://angel.co/apply>

<sup>59</sup><http://twitter.com/angellist>

<sup>60</sup><http://feeds.venturehacks.com/angellist>

<sup>61</sup><http://blockchalk.com/>

<sup>62</sup><http://www.mightymeeting.com/>

<sup>63</sup><http://www.postling.com/>

<sup>64</sup><http://blockchalk.com/>

<sup>65</sup><http://blog.blockchalk.com/post/708678386/lessons-from-raising-a-seed-round>

“AngelList<sup>66</sup> [is] a service that sends pre-screened startup pitches to angel investors who sign up to receive them. We wrote up a version of our pitch that matched AngelList’s requested format (an exercise that in itself was very useful) and submitted it. They sent it out to the list and within a day we had received ten quality angel inquiries. In just a few days, we had our first new commitment — Tom McInerney<sup>67</sup>.

“After Battery Ventures signed on to lead our round, Nivi and Naval sent BlockChalk out to AngelList once again. With this new added social proof, the response was even stronger than the first time around. We literally received dozens of new angel inquiries and things began to rapidly come together. In the span of a few days we had a commitment from the legendarily awesome Mitch Kapor<sup>68</sup>. We also met Josh Stylman<sup>69</sup> who signed on and also introduced us to Chris Dixon<sup>70</sup> and Eric Paley<sup>71</sup> of Founder Collective<sup>72</sup> (who themselves signed on).

“AngelList is a remarkable experiment that is re-defining the way entrepreneurs connect with angels. It’s something you want to be a part of.”

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<sup>66</sup><http://venturehacks.com/angellist>

<sup>67</sup><http://tgm.com/>

<sup>68</sup><http://www.kaporcapital.com/>

<sup>69</sup><http://www.crunchbase.com/person/joshua-stylman>

<sup>70</sup><http://cdixon.org/>

<sup>71</sup><http://angel.co/epaley>

<sup>72</sup><http://foundercollective.com>



<sup>73</sup>MightyMeeting<sup>74</sup>:

“We’ve been fortunate to get great advice from a few good people. Let me mention some of them here.

“First, there is Adeo Ressi’s Founder Institute<sup>75</sup>. I did not get a chance to attend the training program, but I did have the pleasure of pitching at the Founder Showcase.

“The outcome of the event has been tremendous, and Adeo’s advice has been invaluable, always blunt and to the point. One of his emails started with: “You are making rookie mistakes and your round will fail”. Got my attention.

“True to the style, Adeo’s thefunded.com<sup>76</sup> offers an honest review of the investment community. Definitely worth a look.

“Second, there is Venture Hacks<sup>77</sup>. The blog is run by Nivi and Naval. I actually discovered their book<sup>78</sup> before I discovered the blog. Both are highly recommended. Good stuff that will educate you and save you tons of time.

“Venture Hacks also runs AngelList<sup>79</sup>. You can apply online. If you got the goods, you will get intros

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<sup>73</sup><http://www.mightymeeting.com/>

<sup>74</sup><http://www.mightymeeting.com/blog/2010/05/06/1273147500000.html>

<sup>75</sup><http://www.founderinstitute.com/>

<sup>76</sup><http://thefunded.com/>

<sup>77</sup><http://venturehacks.com/>

<sup>78</sup><http://venturehacks.com/pitching>

<sup>79</sup><http://venturehacks.com/angellist>

to angels in the list. The intros carry Venture Hacks credibility, which is significant.

“In our case, the intros we got through the Founder Showcase and through Venture Hacks lead to great connections and, ultimately, money in the bank.

“I also had good experience with the Open Angel Forum<sup>80</sup> and the DEMO<sup>81</sup> conference. Both are very selective. Both are also very high quality in terms of the advice and the connections that they offer.

“The exposure and intros we got helped us build the funnel.”



<sup>82</sup>Postling<sup>83</sup>:

“AngelList is a collection of amazing angel investors, all waiting for your brilliant idea. You fill out an application<sup>84</sup> and, if you’re awesome enough, your application will be sent out to everyone on the list. You’ll then be introduced personally over email to anyone who is interested.

“... we sent out our application once, touting our idea of “social media management for businesses”, got 8 fantastic introductions, and were ultimately funded by David Rose<sup>85</sup> and Chris Yeh<sup>86</sup>. The Venture Hacks guys came back to us and said, ‘We want

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<sup>80</sup><http://openangelforum.com/>

<sup>81</sup><http://demo.com/>

<sup>82</sup><http://www.postling.com/>

<sup>83</sup><http://caterpillarcowboy.com/post/489762022/the-inside-story-on-how-i-raised-200k-in-6-days>

<sup>84</sup><http://venturehacks.wufoo.com/forms/x7x3p9/>

<sup>85</sup><http://venturehacks.com/angellist#david-rose>

<sup>86</sup><http://venturehacks.com/angellist#chris-yeh>

to send your application back out onto AngelList with the added social proof<sup>87</sup> of being invested.'

"To give you some context, over the last 3 months, we followed the Customer Development methodology and went outside of the building<sup>88</sup>. And we found that the social media management tools space was commoditizing quickly, with everyone concentrating on selling to a small sliver at the top (media companies, PR, agency, etc). We also met with VCs, who gave us the same feedback. So it was time to pivot.

"So we pivoted (explained in the GigaOm post, but I'll say more soon), and sent the new direction to AngelList. And this is where the craziness started.

"My first phone call was with Tom McInerney<sup>89</sup>, 3 hours before I was flying out to SXSW. After about a 30 minute phone call, Tom was in. He then introduced me to his friend Paige Craig<sup>90</sup>, who would also be at SXSW. I met Paige in Austin, and after meeting, he told me he was in. The next day, at a Venture Hacks meetup at the Four Seasons hotel, he pulled over Dave McClure<sup>91</sup>. We went out to the balcony<sup>92</sup> (he wanted a cigarette) and I pitched him. He was in. The following day, I spoke with Thomas Korte<sup>93</sup>, who moved up our scheduled phone call a couple days once he heard Dave was investing, and he was in. I also got an email introduction via my

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<sup>87</sup>[http://en.wikipedia.org/wiki/Social\\_Proof](http://en.wikipedia.org/wiki/Social_Proof)

<sup>88</sup><http://steveblank.com/2009/03/20/supermac-war-story-2-facts-exist-outside-the-building-opi>  
E2%80%93-so-get-the-hell-outside-the-building/

<sup>89</sup><http://venturehacks.com/angellist#thomas-mcinerney>

<sup>90</sup><http://venturehacks.com/angellist#paige-craig>

<sup>91</sup><http://venturehacks.com/angellist#dave-mcclure>

<sup>92</sup><http://caterpillarcowboy.com/post/470928054/me-and-dave-mcclure-more-information-to-come>

<sup>93</sup><http://venturehacks.com/angellist#thomas-korte>

friend Russ (founder of SeatGeek<sup>94</sup>) about his investor Kal Vepuri<sup>95</sup>, who was also at SXSW. Kal and I spoke on the balcony of the Austin Convention Center, and I was blown away by his intelligence and humility. So Kal was in. Finally, my friend Michael Galpert<sup>96</sup> of Aviary<sup>97</sup> connected me with Gary Vaynerchuk<sup>98</sup>, who is a perfect investor for us given what he is passionate about (social media for businesses). David Cohen<sup>99</sup> finished off our round not too long after that.”

Big thanks to the guys from BlockChalk, MightyMeeting, and Postling for sharing their fundraising stories for the benefit of other entrepreneurs.

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<sup>94</sup><http://seatgeek.com/>

<sup>95</sup><http://www.linkedin.com/pub/kal-vepuri/0/205/aa8>

<sup>96</sup><http://msg.tumblr.com/>

<sup>97</sup><http://aviary.com/>

<sup>98</sup><http://garyvaynerchuk.com/>

<sup>99</sup><http://venturehacks.com/angellist#david-cohen>

# July 2010

## Where we office

We're spending the next few months officing at Kicklabs<sup>1</sup> at 250 Brannan<sup>2</sup> (info@kicklabs.com) and the new SOMAcentral building at 153 Townsend<sup>3</sup> (ken@somacentral.com).

These spaces are good for startups, service providers, lawyers, VCs, and folks in the south bay who want an auxiliary office space in the city. Leases are short, rent is affordable, and they're perfect for small teams under 5 people.

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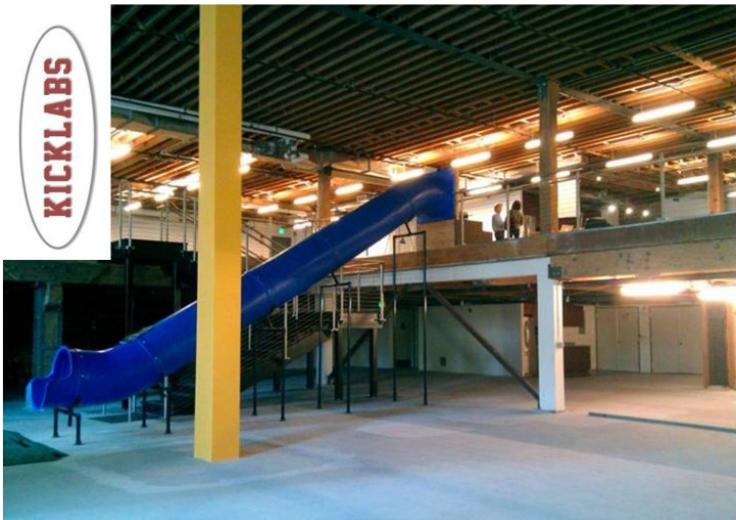
<sup>1</sup><http://www.facebook.com/pages/San-Francisco-CA/KickLabs/118284881519112>

<sup>2</sup>[http://maps.google.com/maps?f=q&source=s\\_q&hl=en&geocode=&q=250+brannan,+sf+ca&sll=37.779882,-122.391407&sspn=0.00837,0.006899&ie=UTF8&hq=&hnear=250+Brannan+St,+San+Francisco,+California+94107&ll=37.782858,-122.390978&spn=0.008369,0.006899&z=17](http://maps.google.com/maps?f=q&source=s_q&hl=en&geocode=&q=250+brannan,+sf+ca&sll=37.779882,-122.391407&sspn=0.00837,0.006899&ie=UTF8&hq=&hnear=250+Brannan+St,+San+Francisco,+California+94107&ll=37.782858,-122.390978&spn=0.008369,0.006899&z=17)

<sup>3</sup>[http://maps.google.com/maps?f=q&source=s\\_q&hl=en&geocode=&q=153+townsend,+sf+ca&sll=37.779882,-122.391407&sspn=0.016739,0.013797&ie=UTF8&hq=&hnear=153+Townsend+St,+San+Francisco,+California+94107&z=17&iwloc=A](http://maps.google.com/maps?f=q&source=s_q&hl=en&geocode=&q=153+townsend,+sf+ca&sll=37.779882,-122.391407&sspn=0.016739,0.013797&ie=UTF8&hq=&hnear=153+Townsend+St,+San+Francisco,+California+94107&z=17&iwloc=A)

JULY 2010

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Kicklabs (top) is a big fun open space. SOMAcentral (bottom) is the opposite: private offices with doors that close and great views. We're using both. If you're looking for office space in San Francisco with Zipcar-like simplicity, check them out and tell them we sent you.

Please add your office space suggestions in the comments — keep them restricted to places with leases under 6 months that are good for small teams (~ 5 people).

At the end of the day, the reason to get an office is simple. It is so you can bring people into your office and say, this is where I office<sup>4</sup>.

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<sup>4</sup>[http://elections.donyell.net/president\\_george\\_w.htm](http://elections.donyell.net/president_george_w.htm)

## This fortnight in Twitter

*Highlights from the @venturehacks<sup>5</sup> Twitter feed from this fortnight. The most retweeted tweets.*

“The toughest and most important decisions in technology companies are always about product strategy.” – @bhorowitz<sup>6</sup>, <http://vh.co/a3DO7h><sup>7</sup>

“With our stock buyback... we were signaling that we didn’t see much of a future in our business.” – @fredwilson<sup>8</sup>, <http://vh.co/9udDmm><sup>9</sup>

You have acquisition interest—now what? <http://vh.co/98Yy4n><sup>10</sup> by @davidcohen<sup>11</sup>. The negotiation principle is “reciprocal displays of commitment”.

“You can explain your business in mind numbing detail or you can inspire an investor and let them imagine.” – @fredwilson<sup>12</sup>, <http://vh.co/bLdDQm><sup>13</sup>

“Whenever you see a company being built for an exit, you will see short term decision making.” – @BostonVC<sup>14</sup>, <http://vh.co/btEkaA><sup>15</sup>

*P.S. Instead of showing our avatar next to each tweet, I’ve picked images that are related to the tweet.*

*P.P.S. It’s easy to find your most popular tweets on the Your Tweets, Retweeted<sup>16</sup> page.*

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<sup>5</sup><http://twitter.com/venturehacks>

<sup>6</sup><http://twitter.com/bhorowitz>

<sup>7</sup><http://vh.co/a3DO7h>

<sup>8</sup><http://twitter.com/fredwilson>

<sup>9</sup><http://vh.co/9udDmm>

<sup>10</sup><http://vh.co/98Yy4n>

<sup>11</sup><http://twitter.com/davidcohen>

<sup>12</sup><http://twitter.com/fredwilson>

<sup>13</sup><http://vh.co/bLdDQm>

<sup>14</sup><http://twitter.com/BostonVC>

<sup>15</sup><http://vh.co/btEkaA>

<sup>16</sup>[http://twitter.com/#retweeted\\_of\\_mine](http://twitter.com/#retweeted_of_mine)

## A conflict of interests

*If you're a passionate entrepreneur*, you can often see the vast potential for your product. In your head, the possibilities of the future branch out, with infinite forks and potential. When pitching to investors, you've learned to define your market as broadly as possible while remaining credible. So, it's not surprising that you're disappointed when investors don't disclose a conflict, and you steer clear of investors who might already have an investment in the same space — dating, social gaming, compliance, security, etc.

*If you're an experienced investor*, you've seen it all. How every startup thinks they can take over the world, but usually has to struggle to accomplish even its one core product or task. How three copycat business plans will arrive in the same week, and how each one thinks they're unique and protectable. How domain knowledge and therefore your ability to help a startup accrue by having multiple investments in the same space.

Both points of view are pretty extreme, and the truths about conflicts of interest are highly contextual. Here's how to think about it.

### 1. The idea

Firstly, the idea — it's no big deal. If it's any good, someone has had it before and someone will have it again. If you're still convinced it's that good, go file a patent first, and then go talk about it. Keep in mind that investors outside of big tech (cleantech, biotech...) automatically have a bias against "patented" ideas, and most brilliance seems obvious in hindsight. Ask an investor to sign an NDA, and you've just filtered out all but the most desperate investors.

## **2. The space**

Secondly, the space — it's tricky, but you have to define it as realistically narrow. There was a time when having an investment in "web" might have been considered a conflict for another "web" company. There was a time when the term "portal" was a competitive category. Unless it's head-on competition, Foursquare v. Gowalla, Disqus v. IntenseDebate, Google v. Bing, it's really, honestly, not competitive. If there's room for multiple equal-sized players in the space, it's not as competitive as you might think. Also, theories about where you might zig or zag don't count — just compare on what you're doing at this moment.

## **3. Angels vs. VCs**

Thirdly, the type of investor matters — active angels have a lot more deals than active VCs and are more likely to have an investment in an adjacent space. This is not a big problem — angels invest in syndicates and usually only provide help in a contextual, on-demand way. Because VCs are likely to be on your board, have more money into the company, and have more control and information rights, it makes more sense to pay attention to conflicts VCs might have (Disclosure: I consider myself to be an angel investor).

## **4. Conflict checks**

Fourthly, just ask the VC to disclose potential conflicts up front, but don't be too broad-minded about what constitutes a conflict.

Lastly, beware the "entrepreneur check." This is where the VC tells you that they like your company, want to do due-diligence, and then just have to check with the entrepreneur in one of their investments about whether this investment would be competitive or not. Since entrepreneurs tend to have an overly-broad

view of what's competitive, this check usually fails. Even in the rare case that it doesn't, it's used as an excuse by the investor to pass. Therefore, always insist that they run the "entrepreneur check" early in the process, before you've invested too much into this investor.

## **Your own biggest competition**

Our flawed patent system aside, ideas do not have the merit that we were all raised believing. You do have to pick the right space, but after that, execution is everything. Here's a quick confirmation test — go back to your classmates and pick out the smartest ones, and then the hardest working ones. Now look at who is successful. A certain base level of intellect and idea-formation capability is required, but beyond that are strongly diminishing or even negative returns.

Consequently, the best entrepreneurs display a lot of chutzpah. They aren't fazed by the competition, nor do they see shadows in every corner. They are their own biggest competition.

## **If you've run out of ideas, buy gold**



Angel investor Thomas McInerney<sup>17</sup>:

"Take a look at all the innovation happening today  
— Tesla has produced a beautiful 100% electric car.

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<sup>17</sup><http://tgm.com/2010/07/07/why-gold-may-be-a-bad-investment-aka-case-for-being-optimistic>

The cost of mapping the human genome has gone from \$3 billion ten years ago to thousands today. Moore's Law continues unabated and the rate of innovation in smart phones is staggering. The computer has moved from the desktop to the pocket, this trend alone reminds me of the World Wide Web in 1994. Social networking is in its infancy, and Twitter and Facebook are growing explosively. IP traffic is growing so fast that it has stunned the pioneering people who helped create it.

"Ray Kurzweil<sup>18</sup> maps out an optimistic view of the future with a tremendous amount of data supporting his main thesis — that the rate of innovation is increasing on a geometric scale. This means that innovation is happening faster every day. So yes, there are macro-level concerns about the economy, but there is also a staggering amount of data that supports the case for being an optimist. The data supports the fact that **we'll see more innovation in the next ten years than we've seen in the last one hundred years.**

"If you are an investor or entrepreneur, this is the best time in history to make a fortune and create a better world... **So if you've run out of ideas, buy gold. But I argue this is the best time to find innovators and invest in the future.** Fortune favors the bold."

[Emphasis added.]

Read the full post<sup>19</sup>. You can reach Thomas via AngelList<sup>20</sup>.

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<sup>18</sup>[http://en.wikipedia.org/wiki/Ray\\_Kurzweil](http://en.wikipedia.org/wiki/Ray_Kurzweil)

<sup>19</sup><http://tgm.com/2010/07/07/why-gold-may-be-a-bad-investment-aka-case-for-being-optimistic>

<sup>20</sup><http://angel.co/tgmtgm>

## Fred Wilson: “Angels love to share deals with each other”



<sup>21</sup>Fred Wilson reviews AngelList<sup>22</sup>:

“...The old model of angel deals is alive and well. Angels love to share deals with each other. It is how angel rounds come together. But AngelList adds at least two things to the mix. First, it adds a place where the deals can come together online. **And second it adds people to the mix that would not be part of the offline deal sharing networks that already exist.**

“I am on AngelList. I see all the deals come together. I don’t personally invest in angel deals in the web/tech space because of potential conflict with USV down the road. But even so, I find it immensely useful to see what companies are getting traction in the angel market. It’s part of my radar/early warning system. And it is entirely possible that we will decide that USV needs to participate in an angel round that is coming together on AngelList, although that has not yet happened.

**“So if you are putting together an angel round, particularly if you already have it partially raised but need to finish it off, I strongly suggest looking into AngelList. It’s a great service.”**

[Emphasis added.]

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<sup>21</sup>[http://www.avc.com/a\\_vc/2010/07/the-angellist.html](http://www.avc.com/a_vc/2010/07/the-angellist.html)

<sup>22</sup>[http://www.avc.com/a\\_vc/2010/07/the-angellist.html](http://www.avc.com/a_vc/2010/07/the-angellist.html)

Fred describes our value proposition better than we do. It's not just great PR when your users blog and tweet about you — it's also a form of customer development.

## Thumbtack raises money with AngelList



<sup>23</sup>Today we're announcing that Thumbtack<sup>24</sup> has raised money with AngelList<sup>25</sup>. Thumbtack is "your marketplace for local services."

Thumbtack got their first commitments at Open Angel Forum<sup>26</sup>, from Joshua Schachter<sup>27</sup>, Cyan & Scott Banister<sup>28</sup>, and Jason Calacanis<sup>29</sup>. Then they used AngelList to contact Ariel Poler<sup>30</sup> and Auren Hoffman<sup>31</sup> who invested:



<sup>32</sup>Ariel Poler<sup>33</sup> (Investor in AdMob)

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<sup>23</sup><http://www.thumbtack.com/>

<sup>24</sup><http://www.thumbtack.com/>

<sup>25</sup><http://angel.co>

<sup>26</sup><http://openangelforum.com/>

<sup>27</sup><http://angel.co/joshu>

<sup>28</sup><http://angel.co/cyantist>

<sup>29</sup><http://angel.co/jason>

<sup>30</sup><http://angel.co/ariel>

<sup>31</sup><http://angel.co/auren>

<sup>32</sup><http://angel.co/ariel>

<sup>33</sup><http://angel.co/ariel>



<sup>34</sup>Auren Hoffman<sup>35</sup> (Investor in Aardvark)

Thumbtack's CEO, Marco Zappacosta<sup>36</sup>, sent me this very nice email about his AngelList experience:

"Both Ariel Poler and Auren Hoffman came from AngelList. And Auren introduced me to Scott Fabor and Mark Britto who are also now investing. Joshua Schachter<sup>37</sup> & Jason Calacanis<sup>38</sup> are also on the list but I was first introduced to them through Jason's Open Angel Forum.

"The value of AngelList goes beyond the money, though — the introductions have been killer, even when they didn't net a check. I got to meet with Keith Rabois<sup>39</sup>, Bryan Schreier<sup>40</sup>, Floodgate<sup>41</sup>, First Round<sup>42</sup>, Jeremy Levine<sup>43</sup>, and others: relationships that I would not have been able to initiate without you guys."

Read more about Marco's fundraising experience on the Thumbtack blog<sup>44</sup>.

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<sup>34</sup><http://angel.co/auren>

<sup>35</sup><http://angel.co/auren>

<sup>36</sup><http://twitter.com/MLZ>

<sup>37</sup><http://angel.co/joshu>

<sup>38</sup><http://angel.co/jason>

<sup>39</sup><http://angel.co/rabois>

<sup>40</sup><http://www.sequoiacap.com/us/bryan-schreier>

<sup>41</sup><http://angel.co/m2jr>

<sup>42</sup><http://angel.co/joshk>

<sup>43</sup><http://angel.co/jeremyl>

<sup>44</sup><http://www.thumbtack.com/blog/?p=120>

## About Thumbtack

What is Thumbtack<sup>45</sup>? In their own words,

“Why can you go online right now and buy any product you want but you can’t do the same for tutors, handymen, dog walkers, or other local services? Thumbtack is changing that.

“Thumbtack isn’t like typical local search directories that simply return business listings with ratings and reviews, leaving you no better off than the paper Yellow Pages.

“Instead, Thumbtack gives you the ability to vet, contact and book service professionals the moment you find them.”

Sounds like a service I need to try.

*Startups:* Get intros to AngelList here<sup>46</sup>. *Angels:* Join AngelList here<sup>47</sup>. *Everyone:* Get AngelList updates via Twitter<sup>48</sup> and RSS<sup>49</sup>.

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<sup>45</sup><http://www.thumbtack.com/>

<sup>46</sup><http://venturehacks.com/startuplist>

<sup>47</sup><http://angel.co/apply>

<sup>48</sup><http://twitter.com/angellist>

<sup>49</sup><http://feeds.venturehacks.com/angellist>

## LearnBoost raises money with AngelList



LEARNBOOST

50

Today we're announcing that LearnBoost<sup>51</sup> has raised money with AngelList<sup>52</sup>. LearnBoost makes an "easy-to-use online gradebook<sup>53</sup> for teachers."

LearnBoost was referred to us by two-time Power Broker<sup>54</sup> Harper Reed<sup>55</sup>. They used AngelList to contact George Zachary<sup>56</sup> and Jeff Fagnan<sup>57</sup> who invested:



<sup>58</sup>George Zachary<sup>59</sup> (Investor in Twitter)

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<sup>50</sup><http://www.learnboost.com/>

<sup>51</sup><http://www.learnboost.com/>

<sup>52</sup><http://angel.co>

<sup>53</sup><http://www.learnboost.com/>

<sup>54</sup><http://venturehacks.com/power-brokers>

<sup>55</sup><http://twitter.com/harper>

<sup>56</sup><http://angel.co/georgezachary>

<sup>57</sup><http://angel.co/jfagnan>

<sup>58</sup><http://angel.co/georgezachary>

<sup>59</sup><http://angel.co/georgezachary>



<sup>60</sup>Jeff Fagnan<sup>61</sup> (Investor in Songbird)

George then introduced LearnBoost to AngelList members Bill Lee<sup>62</sup>, James Hong<sup>63</sup>, and Othman Laraki<sup>64</sup> who also invested:



<sup>65</sup>Bill Lee<sup>66</sup> (Investor in Tesla Motors)



<sup>67</sup>James Hong<sup>68</sup> (Investor in Slide)

Othman Laraki<sup>69</sup> (Founder of Mixer Labs)

Finally, here's a few of the investors who sourced LearnBoost without AngelList and invested:

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<sup>60</sup><http://angel.co/jfagnan>

<sup>61</sup><http://angel.co/jfagnan>

<sup>62</sup><http://angel.co/westcoastbill>

<sup>63</sup><http://angel.co/jhong>

<sup>64</sup><http://angel.co/othman>

<sup>65</sup><http://angel.co/westcoastbill>

<sup>66</sup><http://angel.co/westcoastbill>

<sup>67</sup><http://angel.co/jhong>

<sup>68</sup><http://angel.co/jhong>

<sup>69</sup><http://angel.co/othman>



<sup>70</sup>RRE<sup>71</sup> (Investor in Venmo)



<sup>72</sup>Bessemer<sup>73</sup> (Investor in Postini)

**Update:** Read more about LearnBoost's fundraising experience on the LearnBoost blog<sup>74</sup>.

## About LearnBoost

What is LearnBoost<sup>75</sup>? In their own words,

“Our Teacher Gradebook is the best gradebook software on the web.

“Beautiful design and wonderful user experience makes you wonder why you’ve been using other gradebooks. Plus we’re free. Your new found productivity means you can spend more time doing what you do best: teach.”

**Update 2:** Learn more about LearnBoost in this detailed Xconomy profile: LearnBoost Bets on Better Tools for Teachers<sup>76</sup>.

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<sup>70</sup><http://www.rre.com/>

<sup>71</sup><http://www.rre.com/>

<sup>72</sup><http://www.bvp.com/>

<sup>73</sup><http://www.bvp.com/>

<sup>74</sup><http://www.learnboost.com/learnboost-experience-raising-a-seed-round/>

<sup>75</sup><http://learnboost.com>

<sup>76</sup><http://www.xconomy.com/san-francisco/2010/07/28/learnboost-bets-on-better-tools-for-teachers/>

*Startups:* Get intros to AngelList here<sup>77</sup>. *Angels:* Join AngelList here<sup>78</sup>. *Everyone:* Get AngelList updates via Twitter<sup>79</sup> and RSS<sup>80</sup>.

## How to raise money with no lead

Paul Graham says<sup>81</sup> “The future [of funding] is no fixed amount, no fixed closing date, and no lead.” In other words, the future of financing is *continuous*, not *discrete*.

This post explains how to raise a seed round with no lead, no fixed amount, and a fluid closing date. The process is called mass syndication, or a party round<sup>82</sup>.

Paul proposes eliminating rounds altogether, but we’re not there yet. Mass syndication is a single continuous seed round and I think it’s the state of the art in continuous fundraising.

We originally offered this interview exclusively to AngelList<sup>83</sup> applicants — now it’s available to everyone.

## Another future

The future of funding is also finding the *right* investors for your startup, *quickly*. Not just picking from the investors you can get introductions to.

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<sup>77</sup><http://venturehacks.com/startuplist>

<sup>78</sup><http://angel.co/apply>

<sup>79</sup><http://twitter.com/angellist>

<sup>80</sup><http://feeds.venturehacks.com/angellist>

<sup>81</sup><http://gigaom.com/2010/07/29/how-y-combinator-is-remaking-silicon-valley-in-its-image/>

<sup>82</sup><http://blog.rafaelcorrales.com/2010/05/mass-syndication-is-party-round.html>

html

<sup>83</sup><http://angel.co>

How? You want to get instant meetings with any investor you want. And you only want to meet investors who are *genuinely* interested in your startup. That's what AngelList<sup>84</sup> is for. One danger of this approach is that your round is *oversubscribed*.

Despite the name, you can use AngelList to request intros to any subset of investors on the list — you don't need to send it to the whole list.

## Leads aren't going away

Fred Wilson writes<sup>85</sup> “If you don’t want a lead investor, then don’t knock on my door because I don’t know any other way to be.”

This interview explains how to raise a seed round with the conservative assumption that a lead won’t step forward — but it doesn’t preclude you from changing course if a lead appears.

### 1. Interview

Video: Interview with chapters<sup>86</sup> (for iPod, iPhone, iTunes)

Audio: Interview without chapters<sup>87</sup> (MP3, works anywhere)

Transcript: Below

### 2. Outline

Here's an outline and transcript:

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<sup>84</sup><http://angel.co>

<sup>85</sup>[http://www.avc.com/a\\_vc/2010/07/lead-investors-dipshit-companies-and-funding-every-entrepreneur.html](http://www.avc.com/a_vc/2010/07/lead-investors-dipshit-companies-and-funding-every-entrepreneur.html)

<sup>86</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/03/>

How-to-close-an-angel-round.m4a

<sup>87</sup><http://venturehacks.com/wordpress/wp-content/uploads/2010/03/>

How-to-close-an-angel-round.mp3

1. You can close an angel round with ‘mass syndication’
2. Start with terms and valuation below market
3. What you want in your term sheet
4. What you don’t want in your term sheet
5. Should you have a board seat for seed investors?
6. This isn’t comprehensive term sheet advice
7. Memorize the term sheet before your first meeting
8. How do you set your valuation? Price it to move
9. How do you bring up the terms in a meeting?
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11. A preferred round is a good way to set up good initial terms
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27. What do angels look for?
28. Advisors are good for getting your foot in the door, not in a pitch
29. Get advisors by going to events or talking to entrepreneurs
30. Before you raise a seed round, you need a product in the marketplace
31. Use customer development and lean startup techniques to get to market with less
32. Pitching hacks free chapter: Advice on getting investor intros
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35. What are the different types of seed stage investors?
36. If you're talking to a VC, make sure they really do seed stage rounds
37. Potential concerns with pitching multi-stage and seed-stage firms
38. Get intros to seed investors with AngelList/StartupList

### 3. Transcript

*Music: Squarepusher*<sup>88</sup>

**Nivi:** Hi there, this is Nivi from Venture Hacks.

**Naval:** And Naval from Venture Hacks.

**Nivi:** And we're going to talk about how to close an angel round, how to put together an angel round, or in other words, how to herd a motley crew of angel investors and turn those meetings that you're getting into money in the bank.

I think we're going to start off by talking about mass syndication, which is an approach that I think more entrepreneurs should be taking to close their angel rounds.

#### **You can close an angel round with ‘mass syndication’**

**Nivi:** I think entrepreneurs make two typical mistakes when they're doing an angel round, and they come from what they've read online about how to close a VC round. So, there are two things.

One: they don't name drop enough. They don't mention who else is interested.

Two: and I guess more importantly, they're looking for a lead, which you don't necessarily need in an angel round.

When you put those two together and combine them with a term sheet that you essentially write yourself, you've got a new way to close an angel round which we call mass syndication, which I've done personally. And Naval, maybe you can talk about how often you see that happening, or if you don't see that happening, or whatever.

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<sup>88</sup><http://www.google.com/search?hl=en&q=squarepusher&aq=f&oq=>

**Naval:** It happens fairly often these days. Especially the Y Combinator companies, which are well trained by Paul Graham and crew, will exercise mass syndication a lot. So, they take the standard term sheet that they've been given and they go out and do a rolling close of various convertible notes. And it generally works pretty well.

The keys are that you have to set the terms and the valuation very, very reasonably. In fact, you have to probably price slightly below market, because otherwise the angels don't trust you, then they want a lead who's done the due diligence. You have to work with people that you have warm intros with, you have to name drop like crazy, and you have to create forcing functions to get the round to close. You can't give people all the time in the world.

## **Start with terms and valuation below market**

**Nivi:** Right. So let's dig into all that stuff. First off, I think you want to start with a term sheet that you've generated yourself.

**Naval:** I think it's even better to have a term sheet that comes with someone else's authority attached. So, it could be one that Wilson Sonsini has put up. It could be one that Y Combinators put up or Founder Institute has put up or Founders Fund has put up, but it's just better to start with a widely accepted circulated term sheet where you can point to it and say dozens of other startups have used this term sheet, it's not new.

**Nivi:** Yeah. And then there are the new Series C documents from Andreessen Horowitz and Ted Wang and other investors, which we haven't reviewed, by the way. At least, I haven't.

**Naval:** Yeah, we're not endorsing any particular set.

**Nivi:** Yeah, so I would look at the term sheet first, and I find that a lot of entrepreneurs that I talk to have not really studied

the terms that they're signing onto enough, and they end up using the authority of: it's a Y Combinator series AA doc, so we're going to use it because everybody else has used it.

## **What you want in your term sheet**

**Nivi:** I think there's some wisdom in that, but at the same time I really want to understand what I'm signing. The things that I look for, personally, in a seed-stage term sheet are: If you're going to do convertible debt there's going to be a cap on the conversion price. In the event of an early acquisition you're probably going to use that same cap to give the investors a non-participating liquidation preference.

**Naval:** Yep.

**Nivi:** If the debt matures before the company is acquired or does another round, you want the debt to convert into common or preferred stock, and that's at the company's behest.

And I like to have a majority or supermajority of the investors able to amend the documents.

**Naval:** They have to approve any amendment of the documents.

**Nivi:** Yeah, they can approve an amendment of the document, so you don't need everybody's approval to make some change – to extend the maturity date, or whatever, or to increase the amount of debt you can raise. Off the top of my head, that's kind of....

## **What you don't want in your term sheet**

**Naval:** Yeah, what's equally interesting and what's usually not in a seed or angels syndication round is that you don't have a minimum raise requirement. You don't have, usually, a board

seat or board structure. You often have vesting, but because the company is still controlled by the founders, the vesting is more of a pre-nup agreement between the founders than it is anything to do with the investors. But generally you want to keep it very simple.

**Nivi:** No option pool, really.

**Naval:** There can be. Actually, I would say that there usually should be, because you don't want the situation where an investor starts reading the documents, finds out there's no option pool, and therefore doesn't feel like your valuation is properly represented, because these days in the market, people are used to seeing an option pool.

## **Should you have a board seat for seed investors?**

**Nivi:** OK. And yeah, with the board seat thing, I think too many seed stage companies probably have board seats, especially if there is a VC involved in the round. If you want some normative leverage on that you can go to Marc Andreessen's blog where they write, essentially, that they don't think most seed-stage companies should have investors on their board of directors. Right?

**Naval:** Yeah, and it absolutely depends on the stage the company's at and how much money you're raising. If you're raising a million bucks from institutional investors, you're actually really doing more of a mini-VC round than a seed round, so you are going to have a board seat at least, although you probably won't give it board control.

On the other hand, if you're raising \$250,000 spread across 10 investors, then you don't need to have a board seat, although you may want to have an external board member just to help resolve any founder issues that come up, and to get some good advice.

## This isn't comprehensive term sheet advice

**Nivi:** This isn't intended to be a comprehensive discussion of term sheets for seed-stage companies, but it's a good start.

## Memorize the term sheet before your first meeting

**Nivi:** So I think that's our best advice on the first step, which is generating a term sheet. And you should be able, when you go into a meeting with any of the prospective seed investors you have, to essentially rattle off the major terms in that term sheet.

## How do you set your valuation? Price it to move

**Nivi:** I guess the only thing I would add to what Naval said earlier when he described it as maybe the price is "below market," I sometimes describe it as "priced to move." So you want a price where there should be no discussion around the price that you're putting forward.

We've got an article, actually, that you should look up. It's called How do we set the valuation for a seed round?<sup>89</sup> Let me look it up right now.

**Naval:** The valuation is a very difficult topic, especially when the entrepreneur is trying to do it themselves. They invariably get it wrong, and usually it's too high. You just want to talk to somebody who has a lot of data points in the market and can give you those data points.

**Nivi:** Right. So you need the market data, and then check out this article we have. It's called How do we set the valuation for a seed round?<sup>90</sup>

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<sup>89</sup><http://venturehacks.com/articles/seed-valuation>

<sup>90</sup><http://venturehacks.com/articles/seed-valuation>

## **How do you bring up the terms in a meeting?**

**Nivi:** OK, so at this point you've generated the term sheet, we're going to assume that you've got some meetings lined up, and we'll get back to this topic of how to get some meetings, but let's assume that you've got some meetings lined up. You do the meeting. How do I bring up a discussion of the terms?

**Naval:** I think if the investor's interested, as a final step they're going to ask you. They're going to ask what the terms are or who's in the round, or they'll ask you to give them some details about the financing. And that's when you basically say: So-and-so is committed to invest. We have a couple of people looking at it. We're hoping to close by such-and-such a date, or we are going to close by such-and-such a date. There are x dollars available, and it's a convertible note and it's capped at a valuation of x and a discount of y. So, you can just throw the terms out. You can be pretty straightforward with most angels.

If you want to be a little more subtle you can say we're raising x, and we're selling no more than y% of the company; but I feel that with most angels you can just be direct and say the cap is whatever it is, and just give the number.

**Nivi:** Yeah, if they don't bring it up you should just have a slide that says "Financing" at the end of the presentation, [laughing] and you tell them exactly what Naval said. You drop the names, and we'll get back into the specifics of exactly how you drop the names.

## **Describe how the terms are investor-friendly**

And you discuss the terms, and you discuss them in a way that shows how investor friendly they are and how sane they are, and frankly, there really should be no room for discussion on them. Not that there's no room, just that there's no need because

the valuation is priced to move and there are a lot of good investor protections – which the only ones they really care about are some kind of liquidation preference in the event of an early sale. They care about getting the same terms as the Series A investors, whenever that happens, which they'll get through convertible debt or through one of the other types of mechanisms in a preferred financing. What kinds of mechanisms?

**Naval:** Essentially, if it's convertible debt, it'll just convert into the same security as is being sold in the next round. If, on the other hand, the convertible debt has a term sheet attached to it and has specific rights, then those rights will be negotiated, but that's pretty unusual. With convertible debt usually you usually just get whatever security is in the next round.

**Nivi:** No, I meant if there's a preferred financing in the.... I mean, here's the question: what percentage of deals do you see being done convertible in the seed round versus preferred in the seed round these days, you personally?

**Naval:** It's about half-and-half. The larger the round the closer it gets to just being a preferred round. The smaller the round the more likely it will just be debt.

### **A preferred round is a good way to set up good initial terms**

**Naval:** Generally, even in the startup side, it's probably better to do a preferred round because these are the times to set your terms very favorably for yourself, and they form a precedent for what happens when you do later rounds, whereas if you're negotiating, if your first negotiation is with a VC you're not going to set yourself the friendliest terms. So there's nothing wrong with doing a preferred round, it's just that the expense is slightly higher, but it's not tremendously higher.

**Nivi:** Yeah, I guess I'm wondering if there is usually some kind of most-favored nation clause in those preferred term sheets that gets those investors the same terms that happen in the next round.

**Naval:** No, there almost never are except that there is one game-theory element that comes into play, which is, any subsequent round has to be approved by the current round investors. So if there is some term that the subsequent investor is getting that the current investor is not, very often they will not approve the transaction unless they get that.

### **Does a small seed round need protective provisions? Pros and cons.**

**Nivi:** Yeah. Actually I haven't looked at the Series C docs. I think they might not have that in there. My preference is that if you're doing a small seed round, under \$500K, there should really be no protective provisions like in terms of vetoing the next round, vetoing a sale of...

**Naval:** Well, you kind of have to have some of those because unfortunately these are minority shareholders, so you do have cases where an entrepreneur, for example, will raise money from their cousin at a low valuation, or they will sell a company to an affiliated entity. These things actually happen.

**Nivi:** Yeah.

**Naval:** And so that's why the investors often need to assure that there aren't linked transactions or need approval. And that's why you've got to know your investors; you've got to trust your investors to also do the right thing. People who have a history of investing in good companies and having good exits likely aren't the types who will block financings or block sales.

## Get feedback on the terms in the first meeting

**Nivi:** You can ask them right at the end of the meeting, after you've presented the terms, what feedback they have on the terms, if any. So you could solicit some immediate feedback. My guess is if your terms are structured right you probably won't get much, if any, but make note of any feedback they give you on the terms.

## Drop names to build social proof

**Nivi:** Let's talk about what kind of names you can drop at the end of the meeting.

**Naval:** Yeah, you definitely want to use social proof to build up momentum in closing a mass syndication round. So, every angel who signs up, you should make clear to the other angels that this angel has signed up. Now, you have to be careful about what the definition of "signed up" is. If someone says they're interested, don't go around representing them as committed, because angels will talk and if they find out that you've been exaggerating or lying it will cost you trust in the whole financing. Basically, the clear indicator is if somebody says they're in, they negotiate an amount with you, they say they're happy with the terms, and they shake hands on it. If you want to play it extra safe, if you don't have a long-standing relationship with this person, then I would also suggest getting an email confirmation.

**Nivi:** Right. So, just going from the top of the list, if they've wired the money, signed the term sheet, and the money's in your bank account, you should almost certainly use their name, unless for some reason they've specified that you can't. Ok; so that's an easy one.

Next, if you're in the process of closing with them and you're negotiating a term sheet, I think, again, unless they've said you

can't use their name, it's extremely safe to say that you are in the process of closing with such-and-such, assuming they're negotiating the deal with you in good faith.

Next on the list, I don't think there's anything wrong if the angel, at the end of the meeting after you've discussed the terms, has said they're interested, for you to ask: are you interested enough for me to tell the other guys I'm talking to that you're interested?

**Naval:** Yeah, that's perfectly reasonable.

**Nivi:** That's what I would do with the guys who you're not actively negotiating the deal with. Just ask them, hey, is it OK if I use your name?

## **Social proof works differently in a Series A round with VCs**

**Naval:** Social proof in a venture round works differently because in a venture round you want independent bids because you're actively negotiating a valuation. Here, because you are setting the valuation and there's room for multiple players, social proof is much more important than getting independent bids.

## **See if the “interest” includes a dollar amount, intros, and name-dropping (a.k.a. soft circled)**

**Nivi:** Yeah, the advice for an angel round and a VC round are exactly the opposite of each other. Another way to test people's interest or to just see how interested they are is to talk to them at the end of the meeting about a dollar amount that they would be interested in investing, and then whether they would be willing to make introductions to other angel investors.

A guy who has given you a dollar amount and is willing to make intro's – I think that's basically what I would call the formal definition of a soft circle in an angel round. I guess the third part of a soft circle is they're willing to let you use their name.

So, the definition of a soft circle is:

- 1) There's a dollar amount attached to it.
- 2) They're willing to let you use their name with other investors.
- 3) They're willing to make introductions.

If you've got all three, I would call that guy essentially soft circle.

## **When do you need a lead?**

**Nivi:** So, we talked about mass syndicating the round, and we're not done with that, but what are some cases where you would actually want, or let me put it another way, where the angels would actually want a lead in the round?

**Naval:** Angels will want a lead if they don't know you and they don't trust you, or if they don't agree with the terms and they want the terms renegotiated, but their amount is too low to do it themselves; or if you have a very complex business that requires a lot of due diligence, or a very mature business that requires a lot of due diligence, so someone is going to have to go in there and investigate it; or if the price is just high enough. If you just need to raise a certain amount of money, usually beyond around \$500K I would say is the upper limit, then you need an institutional investor and that person is going to be a lead.

**Nivi:** Do you think the majority of financings of \$500K or lower are done without a lead?

**Naval:** They certainly can be; I wouldn't say they are. I would say about half and half. It's always harder to do without a lead

because you're looking for smaller angels. If you find a lead it shortcuts the whole process. You'll close much, much more quickly, but one may not always want to find a lead, either because one doesn't want the oversight and that institutional investor mentality that a lead generates, or one doesn't want to negotiate the terms.

## **Approach the financing as if you won't find a lead**

**Nivi:** Yeah, and just to be clear, we're not saying that you shouldn't find the lead, but I think you want to approach the financing as if you're not going to get one.

**Naval:** Yeah. If a lead steps forward and is willing to negotiate a term sheet and do the bulk of the round, or half the round, then yes, you should definitely entertain it. If they're someone you like and trust they can short-circuit the whole process for you.

## **What's a lead investor?**

**Nivi:** And we've got a few articles, actually, on Venture Hacks you can look up, How do I find a lead investor?<sup>91</sup>

What's the definition of a lead investor? Let me throw one out: They want at least half the round, and often they want the entire thing. If they don't want the entire round they'll help you find the other investors. They're essentially willing to make the decision for themselves, and in the best case they're willing to put their money in your bank account and close the deal even if all of the money is not signed up yet.

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<sup>91</sup><http://venturehacks.com/articles/lead>

## If they say “find a lead,” ask why

**Nivi:** So, I would say if a sophisticated angel investor, or even an unsophisticated one, at the end of the meeting or in an email says yeah, I’m interested but I need you to find a lead, I would ask why, and why they’re not interested in participating in the mass syndications. And they may end up telling you one of the things that Naval said, for example, they like you, they like the product, it looks interesting, but they don’t know the market well enough to make the decision on their own, they don’t know enough about the terms or they don’t know enough about you to negotiate the deal with you, or they don’t care enough to negotiate the deal with you, they just want to put the money in and not worry about the deal. So just ask why. Don’t take hey, I want you to find a lead, as a great answer. It’s often a way for people to preserve the option to invest in the round, just in case Sequoia decides they want to invest in the round.

## How to create a deadline

**Nivi:** OK, after the first meeting how do we turn all these angels interest into money in the bank?

**Naval:** This is a very difficult problem because you have to create a forcing function, and really there are two forcing functions that work well. There are some artificial, external ones. It could be the case that your company has some kind of a partnership coming up where you have to make a payment by a certain date or you’re going to go under, so that can create a forcing function, but that’s not necessarily the good kind because it gives people leverage over you.

There are two of the better forcing functions. One is time based where you very clearly say: We’re closing a round at such-and-such a date, the notes are all authorized to close at that date. After that date we will not be able to accept more money, we

will be back to focus on our business, and if we raise less than the maximum amount that we'd authorized, that's fine, we'll just make do on that amount, and when we go to raise money next time it will be on different terms.

That is the lesser of the two good forcing functions, and that allows you to at least put a time limit on it. Now the problem here is you have to be credible and you have to stick to it and you have to pick good time, because if you arrive at that date with no money, or too little money, you will lose all credibility when you go back and ask for more money.

**Nivi:** Holidays can be good forcing functions.

**Naval:** That's true. Holidays are very good that way. You can say you're trying to get it done by Christmas or before the New Year, and so on.

**Nivi:** By Thanksgiving.

**Naval:** By Thanksgiving. You probably don't want to use ones like: we're trying to get it done by Boxing Day, or something like that, or more obscure. [laughs] But certainly if there are trips coming up, or if the founders have to go back to the UK for visa purposes for a month, that would be another way to do it. But the time-forcing function is the lesser of the two.

The better one is over-subscription, where you basically say: We have more people who are interested than we have room for. We like you very much, but we can't guarantee a spot until you're committed. Allocations will be on a first-past-the-post basis. And you basically line up more angels than you have room for.

## Raise the money when you don't need it

**Nivi:** And the third thing I'd add is raise the money when you don't need it. That can be super tricky, or perhaps impossible on a seed round where you're trying to build the product, a

team, and get a little bit of traction so you can go to the angels with something other than just a product or an idea, with some traction. It's hard to raise the cash when you don't need it, but if it's possible I would do it.

**Naval:** Absolutely.

## **Send two emails to the angels**

**Nivi:** So, just very tactically, how do I get the money into my bank account? What I would do, or what I've done in the past is collect the names of all the people who are interested, have said yes, they'd like to participate in this round. Send an email to each one with the term sheet, with the same exact terms that you discussed previously. Tell them who else is going to be participating in this round, just as long as the guy has said that they're interested and they're willing to let you use their name. I would list all those people in the email. Tell them here's the day we want to sign this term sheet by – at least put it two weeks out. Ask if they have any feedback on the terms; if not, you're going to send them the closing documents.

Basically, do they want to invest? What's their final decision? Do they have any feedback on the terms? If not, we'll send you the closing docs.

**Naval:** It can often be a good tactic to send the closing docs through the lawyers, because the lawyers will make it very formal, and they'll put things like: the closing date is such-and-such date, here are the wire instructions. That creates an air of authority and formality around it, which helps the closing.

**Nivi:** Yeah. I don't think I would send the closing docs until they've agreed to the term sheet, though. Right?

**Naval:** Absolutely. Absolutely.

**Nivi:** OK. So don't force the closing docs down their throat. See if they have any feedback on the term sheet. If not, I would just send them the final rev of the term sheet that incorporates feedback from all of the investors, as well as the closing docs and the wire instructions all in one email – so this is the second email we're describing now – again, listing the names of all the angels who have committed to sign the term sheet now, or have seen the term sheet and have approved it.

So this is actually two emails. The first one is term sheet, and please give me feedback on it, with a list of angels who are interested in signing it. The second email is: here's the final term sheet, the closing and wire instructions, and the final list of angels.

Again, for the first email I would set at least two weeks out for them to get back to you. Do you think two weeks is too long?

**Naval:** Probably. I would just give a week.

**Nivi:** OK. I guess I would do a week. I would expect to blow that deadline in my limited experience, though. [laughs] And you'll have to send a few emails to these guys, just bugging them a couple of times with: hey, do you want to invest or not? kind of emails. Put it nicer than that, and also always include one sentence on something great that has happened in the meantime to the company, just so you can show momentum.

### **Do a rolling close: the cash comes in just-in-time**

**Naval:** This is where the concept of a roll-in close comes in, which means that investors don't have to put their cash in all on the same day. All of the investors don't have to commit all at the exact same time. As they get to your email, sign the docs, get their account into the lawyer to set up the wire, the money comes in. And that money can come in over the course of, say, a week or two in practice.

And you can also set up the documents so that even when all the money's come in, there is still room in the documents to raise another 50 or 100 or another \$200K using the same, exact documents.

So you can do this first roll-in close, and then you can do a subsequent roll-in close if you find some new investors you want to bring in on these same terms.

### **Mass syndication can fail if a very high social proof investor drops out**

**Nivi:** Have you ever seen this mass syndication approach blow up at the end?

**Naval:** Mass syndication could fail at the end. It would fail, most likely, if some very high social proof investor drops out. That's probably the single biggest reason it could fail, but it's pretty unlikely because here you have sort of a diffuse group, so it's unlikely that any one person would blow up the deal.

**Nivi:** It's really a question of how effectively you've read their interest in your round when they say they're interested. Again, I would use those signals that we put forth before, in terms of are they a soft circle or not? Did they say you can use their name? Did they talk about a dollar amount? Did you discuss the terms with them? Are they introducing you to other investors?

### **Use AngelList and StartupList to get intros to angels**

**Nivi:** OK. Let's talk about how to get intros to angels. I'll start off.

**Naval:** Angel List.

**Nivi:** Angel List is one thing. We've got a list of angel investors. It's called Angel List. You can contact a lot of the angels directly or through referrals.

Read the free chapter from Pitching Hacks<sup>92</sup> for tactical advice on getting intros

And then we've got something called Startup List, where you send us your pitch, and if it's a good pitch we pass it on to the angel on Angel List.

## What do angels look for?

**Nivi:** When we look at the applications for Startup List we look for a few things: Social proof – essentially who have you convinced to let you use their name as an advisor or investor or team member. We look for your traction.

**Naval:** We look at your bio – who you are, what you've accomplished. Plus we look at your product if it's a web-based product. We like to see the demo or the alpha or the prototype. It's very hard to actually send something out to Angel List without having seen some evidence of the product.

**Nivi:** Right. If I had to boil it down to two things, I'd say social proof and traction. And if I had to boil it down to one thing, I'd just say traction.

**Naval:** Yeah. I'd say in order of importance, it's probably traction then team then social proof then product.

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<sup>92</sup><http://venturehacks.com/pitching>

**Advisors are good for getting your foot in the door, not in a pitch**

**Nivi:** Right. And VCs and other folks like to make fun of people's advisor slides that they tend to put too much emphasis on when they pitch, which I think is right, but I think advisors and social proof are a great way to get into the door. When you're in the door I don't think it's important anymore, but it's a good way to get in the door.

**Get advisors by going to events or talking to entrepreneurs**

**Nivi:** And by the way, how do you get advisors? Go to events. We recently talked about this thing called Startup Digest, which is the best events in 27 cities or so. It's a curated email list. You can subscribe to that. It's called Startup Digest.

**Naval:** You can ask other entrepreneurs.

**Before you raise a seed round, you need a product in the marketplace**

**Nivi:** And I think we already answered this question a little bit, but what do I need before I raise a seed round? I would say you need your product to have been prototyped in some way or another, and it needs to have been put into the marketplace in one way or another and have some traction.

**Naval:** Yeah, and obviously that differs on the product type. For a consumer web product you should probably have launched it or soft launched it. For an enterprise product or something that requires a lot of money and a big team to build, you may at least want to test the market demand.

I would define traction as quantitative evidence of market demand.

### **Use customer development and lean startup techniques to get to market with less**

**Nivi:** Yeah, that's good. And look up SteveBlank.com for customer development techniques. Also look up Eric Ries' blog, StartupLessonsLearned.com for lean startup techniques. It's basically how to get more traction with less work.

### **Pitching Hacks free chapter: Advice on getting investor intros**

**Nivi:** For some really tactical advice on how to get meetings with angel investors, we've got a whole book on that topic called Pitching Hacks<sup>93</sup>. Look it up. You can buy it for \$9.00. I think it's worth it. You can check out the testimonials from smart guys like Adam Smith, the founder of Xobni, or Aaron Iba, the founder of EtherPad. And the chapter on how to get introductions to investors is actually free online, so you can get the PDF of that chapter for free.

### **If you need money to get something in the marketplace, pitch idea investors**

**Nivi:** If you need money just to get to the point where you can apply to Startup List or talk to angels, essentially to get to the point where you have some product, some team and some traction, my recommendations are friends and family investors. So those are your actual family or people who know you and

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<sup>93</sup><http://venturehacks.com/pitching>

are willing to essentially back you. So it might be a boss that you worked for for 10 years who has enough disposable income to write you a check for \$5K or \$10K or \$25K. And finally I would say people who just see the same problem that you see, and they believe in the product and the market. Like, they've had that same idea themselves and they don't have the time to pursue it themselves, but they're willing to put a little bit of money behind the guy who does have the time to do it. I call those three groups of people idea investors.

## Pitch incubators or do your startup on the side

**Nivi:** An alternative to raising that idea money is to apply to one of the Y Combinator style incubators, like Y Combinator, TechStars, DreamIt, there are a bunch of them now. Just do some web searches. They will back you on the basis of essentially an idea alone, but in general you need to have a team of people who can get things done. It can't be all just business guys.

Another option is to keep your day job and do your startup on the side, which you can find lots of great posts on, online, if you just do some searches. We've got a post on it on Venture Hacks called Half-Assed Startup<sup>94</sup>, written by Tony Wright from RescueTime.

## What are the different types of seed stage investors?

**Nivi:** I guess the last topic is what are the different types of people who invest in seed rounds? You've got your independent angel investor who's investing his own cash. You have angel investors, or let's call it a seed-stage fund, which is investing an LP's cash. They have other investor's cash that they're investing. And that seed-stage fund may be represented as a fund,

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<sup>94</sup><http://venturehacks.com/articles/half-assed>

like first round capital, or it may be represented as more of a person, like Naval, say.

**Naval:** Yeah, generally the way a seed-stage fund will differ from a pure venture fund is they'll be investing smaller amounts, they will be willing to do convertible debt with a cap, and they also will not require board seats or require heavy oversight. They can also probably decide a lot more quickly. Most seed-stage funds, although not all, don't have the concept of a partner's meeting. Usually when you're talking to one or two people, you're talking to everyone.

**Nivi:** Right. So I guess another example of a seed-stage fund that presents as an individual is like Jeff Clavier. Is that right?

**Naval:** Yes.

**Nivi:** Seed-stage funds that present as firms are First Round Capital. Who else?

**Naval:** Founders Fund.

**Nivi:** Founders Fund are more multi-stage aren't they?

**Naval:** Ah, fair enough. True Ventures.

**Nivi:** True, right. And now we're getting into the topic of multi-stage funds, so now you have classic VC funds, or new ones like Founders Fund, that invest across a broad range from incubation all the way to Series E.

**Naval:** Right. Charles River Ventures has a very active seed program, all the way from 25,000 to a quick start of 250,000 to Series A and Series B.

**Nivi:** Yeah, and other firms that don't have specific programs like Sequoia Capital, for example, do seed-stage investments all the time, although they don't have a specific program for it.

**Naval:** Correct.

## If you're talking to a VC, make sure they really do seed stage rounds

**Nivi:** I think if you're talking to any VC that does multi-stage investing, you really want to ask them: When was the last time you made a seed-stage investment? How many have you made in the last year, essentially, and more importantly, what did the company look like when you made that seed stage investment? Their definition of what the company looked like may be 5 million uniques a month coming to the website and they still call it a seed-stage investment, while you're struggling to release your product. So you want to ask them what their definition is of a seed-stage investment.

## Potential concerns with pitching multi-stage and seed-stage firms

**Nivi:** I want to talk about two things. One: what are the things to be concerned about when you start to bring seed-stage firms into your angel round, and multi-stage firms into your angel round? And two: a lot of these firms are acting more like angels these days, and let's talk a little about that. But let's talk about the concerns first.

**Naval:** The concerns are that you don't want to have a process that's a VC process, so you don't want to go through too many rounds of meetings and due diligence and so forth. You don't want to have governance that's VC governance, so you don't want to give up board control; you don't want to have regular board meetings; you don't want to have to concentrate too much on financials at this stage. And finally, you want to be careful about firms that may have negative signaling value – so, people who often do invest in subsequent rounds and sometimes don't – because if one of those people invest in your financing and then

does not follow on in the next round, it can be a signal of death, a death knell to the other prospective investors.

**Nivi:** Right, so the ones to worry about most on the signaling value are the multi-stage firms who are investing in seed rounds mostly to have the option to invest in the next round, and maybe a little bit about the seed-stage firms that present as firms.

**Naval:** Seed-stage firms generally don't lead or invest in following rounds, so it's less of an issue.

**Nivi:** Not even for pro rata? I'm talking about a First Round.

**Naval:** Yeah, it depends on the firm, but yes, for example First Round probably normally does pro rata so that signal is important. But someone who is investing and doesn't seem to care about the valuation at this time, but wants a contractual option to invest in the next round, there you'd really have to worry.

**Nivi:** And they don't even need a contractual option. It doesn't matter.

**Naval:** Yeah, it's just an even stronger signal with the contractual option if they don't exercise it.

**Nivi:** Yeah. I guess the other thing to worry about if it's a multi-stage firm, is if they don't own enough in the seed-stage round.

**Naval:** Yes, because then they're going to want to invest maybe more than their pro rata in the next round, and that can create strange dynamics where they're trying to bid your valuation down.

**Nivi:** Yeah, and the bottom line is if they're trying to increase their percentage ownership in a subsequent round of financing, they have an incentive to drive down your valuation in the next round. You might ask if they don't always have that incentive. No. If you want to do your pro rata or decrease your percentage ownership in the next round, you'd no longer have that incentive.

If you want to just do your pro rata, you're indifferent on the valuation of the next round, and if you want to decrease your ownership you actually want to increase the valuation in the next round as much as possible.

What do you see when these seed-stage and multi-stage firms participate in terms of leaving room for angels, taking half the round, just participating as like 25% of the round like another angel?

**Naval:** The good ones will leave room, and it's up to the entrepreneur to dictate. Probably one of the biggest mistakes you can make in doing a syndicate is where you don't leave enough room for individual investors, and you give everything up to one or two lead investors. The amount of help you get out of a person is relatively fixed. There might be slight variations around the edges, but you're passing up most of the advisory benefit of having angels if you don't do a mass syndication to a large group.

**Nivi:** Another bit of advice I would give is if you're going to raise money from a fund in a seed round that has signaling power in the next round, don't raise money from just one, get a couple in there.

**Naval:** Yeah, it helps to diffuse that signal.

## **Get intros to seed investors with AngelList/StartupList**

**Nivi:** OK, thanks for listening. Nivi and Naval are signing off.

A last plug for our products is Angel List, which is our curated list of angel investors and what they're looking for and how to get in touch with them, and Startup List, which is where you apply to us, we look at your pitch, if we like it we pass it on to

whatever angels you want us to pass it on to, or we'll pass it on to all the angels on Angel List if you like.

The metrics on that, to date, are pretty good. The whole idea is about five weeks old. We've had about 25 investors ask for intros. The other cool thing about it that I like is the investors come to you and ask for an intro, but great investors like Jeff Clavier, and Ann from Mike Maples' fund, and guys like Matt Mullenweg, and Jon Callahan from True – just a great bunch of guys – are asking for intros. About 15 startups have gotten intros and we've even gotten one startup funded so far, and probably more coming online pretty soon.

**Naval:** One that we can talk about right now.

**Nivi:** One that we can talk about, yeah, where Matt Mullenweg, the founder of WordPress, invested, and we hope to announce some more success stories about Startup List soon.

Thanks for listening! Bye, bye.

# August 2010

## Tracking testimonials — the lazy way

I use Twitter favorites to keep track of AngelList testimonials. I just favorite the testimonials I like. It's super easy:



And it's trivial to embed them anywhere:

Widget: *AngelList Favorites*<sup>2</sup>

### Not every testimonial is a tweet

You can track a non-tweet testimonial by linking to it on Twitter and then favoriting it. Or by bookmarking it on del.icio.us — I use the testimonial tag<sup>3</sup>.

If you go to my testimonial tag<sup>4</sup> on del.icio.us, you'll see I've also

<sup>1</sup><http://twitter.com/rabois/status/20036470692>

<sup>2</sup><http://twitter.com/angelist/favorites>

<sup>3</sup><http://delicious.com/nivi/testimonial>

<sup>4</sup><http://delicious.com/nivi/testimonial>

bookmarked private Gmail conversations. Gmail lets you link to threads — although you have to be logged in to see them.

I pull up these testimonials when I'm telling people about AngelList. There's a story behind each tweet and it's a fun way to start the conversation.

## 7 angel investing tips in 7 minutes

Last week, Naval and a slew of angels shared their investing advice with an audience of angels-in-training at AngelConf 2010<sup>5</sup>. Here's the video (each talk is 7 minutes long):

*Video: AngelConf 2010*<sup>6</sup> Wade Roush at Xconomy took detailed notes on all the talks and published them here<sup>7</sup> and here<sup>8</sup>.

### 7 angel investing tips

Naval's 7-minute talk starts at 26:00. Here are Wade's detailed notes<sup>9</sup>:

“1. Don't move in a herd, but do be a pack animal. Not everybody has all the information. One angle might know the market, one might know the founder, one might know the customer base. Every time an angel comes into a round, they bring a piece of information. Ride on their coattails.

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<sup>5</sup><http://angelconf.org/>

<sup>6</sup><http://www.justin.tv/b/ycombinator/b/267536844>

<sup>7</sup><http://www.xconomy.com/san-francisco/2010/08/02/lessons-for-budding-angel-investors-from-y-combinators-angelconf-part-1/>

<sup>8</sup><http://www.xconomy.com/san-francisco/2010/08/03/lessons-for-budding-angel-investors-from-y-combinators-angelconf-part-2/>

<sup>9</sup><http://www.xconomy.com/san-francisco/2010/08/03/lessons-for-budding-angel-investors-from-y-combinators-angelconf-part-2/>

2. Say no early and often. You should be doing one deal for every 20 to 30 that you see. If you do more than that, you're overinvesting.
3. You need to have a brand. The really great deals are obvious, and everybody wants in, and if you want to get in you need a brand. That could be that you have been successful with great companies in the past. **And building a brand does not mean taking coffee meetings. Shallow connections do not mean much. If you have a fancy office on Sand Hill Road or Market Street, the best deals are not going to come to you. If you're not out there running around getting to know people, then you are really just practicing the VC model.**
4. Humility. When you're sitting there all day and people are asking for money and more often than not you are saying no, it eventually goes to your head. The problem is that when a Mark Zuckerberg walks in, those guys have more offers than they have room for. If you come across as arrogant, they will drop you.
5. Your job is to be a little dispassionate. Don't try to run the company. Don't even take the power—if you don't have it, you won't be tempted to use it.
6. Filters. Every winner is unique by definition, because what they're doing is new. But the losers tend to cluster around common mistakes, such as investing in a company with one founder. You will find you can establish filters, even one as simple as "Do what you love."
7. There are many paths to success. You have to be very careful about taking your limited experience and trying to shoehorn your companies into it."

I haven't watched all the angels yet but I'm making a mental note to watch it while I brush my teeth tomorrow morning.

## 7-minute abs

If you're not an angel investor, watch this instead:

*Video: 7-Minute Abs*<sup>10</sup>

## Quora Marketing



<sup>11</sup>

Quora<sup>12</sup> is a Q&A site. We were planning on posting a question asking startups and angels to share their AngelList<sup>13</sup> experience. But someone beat us to it:

What do people think of AngelList?<sup>14</sup>

I can't think of a better piece of marketing than this thread. There's nothing we could say better. I want to replace the AngelList homepage with this thread.

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<sup>10</sup><http://www.youtube.com/watch?v=h9mioHO4hoM>

<sup>11</sup><http://quora.com>

<sup>12</sup><http://www.quora.com/>

<sup>13</sup><http://angel.co>

<sup>14</sup><http://www.quora.com/What-do-people-think-of-AngelList?>

## Quora spam

Quora's goal<sup>15</sup> is "to have each question page become the best possible resource for someone who wants to know about the question."

The Quora community will kill you if you fill it with rubbish. You have to have a lot of very happy users to try Quora marketing. And you have to expect negative reviews too. Quora's looking for the best answer — not your answer.

## Hating Quora

I've resisted Quora since they were in closed beta. Partly because everyone was raving about it. Partly because I thought the user experience was insane.

Now I'm hooked. And I think they've created a new class of user experience. It's a "go with the flow" experience. Don't try to load a model of the site in your head — it's too complicated and they're constantly redesigning<sup>16</sup> it. Just expect things to be there when you need them. And expect that you can do a lot with each piece of data on the site (suggest revisions, revise it, revert it, vote on it, eat it, thank the author...).

Quora's a lot like The Wire<sup>17</sup>, you'll hate the first 5 episodes — then something will happen in your head and you won't be able to shut up about it. Follow me<sup>18</sup> and Naval<sup>19</sup> on Quora and check out the AngelList thread<sup>20</sup> already.

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<sup>15</sup> <http://www.quora.com/about>

<sup>16</sup> <http://www.quora.com/Is-Quora-going-to-do-significant-redesigns-like-Facebook-has-done-wire>

<sup>18</sup> <http://www.quora.com/babak-nivi>

<sup>19</sup> <http://www.quora.com/Naval-Ravikant>

<sup>20</sup> <http://www.quora.com/What-do-people-think-of-AngelList?>

## Xconomy covers AngelList



This Xconomy article by Wade Roush<sup>21</sup> does a great job of telling the AngelList and Venture Hacks story:

In Seed Funding Race, AngelList Sorts the “Junk” from the “Maybes”<sup>22</sup>

I hesitated to link to it because these articles always make you look more handsome than you really are. But Wade does a great job of rounding up the state of the art of angel investing and placing AngelList in that context. Here's a choice quote:

“I think the way to get into angel investing is, first, you obviously have to have money; you have to have a brand, otherwise you are not going to be differentiated and you are not going to see good deals; and you have to have a network of angels to work with, so you can move in packs and find other people to help you with due diligence,” Ravikant says.

It's only then that AngelList can help. “The final thing is that you need to have good deal flow, so that you can see when the good things come along,” Ravikant says. “We will bring you deal flow, make it

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<sup>21</sup><http://twitter.com/wroush>

<sup>22</sup>[http://www.xconomy.com/san-francisco/2010/08/20/in-seed-funding-race-angelist-sorts-the-junk-from-the-maybes/?single\\_page=true](http://www.xconomy.com/san-francisco/2010/08/20/in-seed-funding-race-angelist-sorts-the-junk-from-the-maybes/?single_page=true)

easy to syndicate deals, and we'll show you deals that hopefully over time matches up to your interests."

Check out the rest of the thoughtful article<sup>23</sup>.

## How we're recruiting a product designer for AngelList

We're recruiting a product designer for AngelList<sup>24</sup>. Here's how we're doing it and what we're learning. (If you're interested in working with us, details are at the bottom of this post.)

I didn't start by putting up a job post. I figured if everybody else is doing it, I need to take a different approach. So I called the smartest designers and entrepreneurs I knew and asked them for advice. Here's what I've learned:

- We want a **product designer**. This job post<sup>25</sup> from Quora defines a product designer as "Extraordinary product, interaction, and visual design talent [with] a curiosity and passion for crafting amazing experiences." Product design encompasses visual design, interaction design, branding... it's the whole user experience.
- A small team like ours should hire designers who can **build what they design**. At a minimum, that means building HTML, CSS, perhaps JS, perhaps beyond. See these posts

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<sup>23</sup>[http://www.xconomy.com/san-francisco/2010/08/20/in-seed-funding-race-angellist-sorts-the-junk-from-the-maybes/?single\\_page=true](http://www.xconomy.com/san-francisco/2010/08/20/in-seed-funding-race-angellist-sorts-the-junk-from-the-maybes/?single_page=true)

<sup>24</sup><http://angel.co/>

<sup>25</sup><http://www.quora.com/jobs#design>

by Jason Putorti<sup>26</sup> and Rebekah Cox<sup>27</sup> for more info. Also read Rebekah's Early Quora Design Notes<sup>28</sup>.

- Quora has the best job postings<sup>29</sup> I've seen in a long time — they're muscular and much better than all the quirky job postings in the world.
- Consultants are good if you want to build the product. Full-time people are good if you want to build the team. *We want to build the team.*

## The opportunity for product designers

AngelList<sup>30</sup> is a *community of angel investors* who make it fast and easy for worthy startups to raise money. These links tell the story better than we ever could:

What do people think of AngelList?<sup>31</sup> AngelList Twitter Favorites<sup>32</sup> Fred Wilson covers AngelList<sup>33</sup>

In short, the 250+ angels on AngelList are bringing startup funding online — in fact, they've already funded about 40 startups (here's a few of them<sup>34</sup>). This is a very high-impact and difficult problem... and a giant opportunity to *help the industry that funds the startups we know and love*: Facebook, Google, Twitter, Apple, you name it.

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<sup>26</sup><http://www.quora.com/Should-user-interface-designers-be-able-to-build-what-they-design/answer/Jason-Putorti>

<sup>27</sup><http://www.quora.com/Should-user-interface-designers-be-able-to-build-what-they-design/answer/rcox>

<sup>28</sup><http://www.artypapers.com/ap.log/thread.php?346>

<sup>29</sup><http://www.quora.com/jobs>

<sup>30</sup><http://angel.co>

<sup>31</sup><http://www.quora.com/What-do-people-think-of-AngelList>

<sup>32</sup><http://twitter.com/angellist/favorites>

<sup>33</sup>[http://www.avc.com/a\\_vc/2010/07/the-angellist.html](http://www.avc.com/a_vc/2010/07/the-angellist.html)

<sup>34</sup><http://www.quora.com/What-startups-have-been-funded-via-AngelList>

**What's in it for you?** Investors throughout Silicon Valley and the world will use your product daily. You get to lead the product and company by turning vision into product, with no managers in your way. Your title will be the same as everyone else on the team: Venture Hacker. You'll work with a founding team<sup>35</sup> of investors (Twitter), founders (Epinions), students (life), and advisors (billions served). And you get to push the envelope of what is possible with product design on the Web.

We're committed to building a high-impact and long-lasting team. If you're a product designer who's **irrationally interested** in this problem and wants to work with us full-time in San Francisco, send us a few links<sup>36</sup> (we don't need/want anything else), and please let us know if you have any questions.

## AngelList Scouts

AngelList Scouts find high-quality startups for the angels on AngelList<sup>37</sup>. When a Scout tells us to look at a startup, we pay attention.

**Update:** Liz Gannes covers this story for GigaOM<sup>38</sup>.

We look at every startup that applies to AngelList — whether or not they have social proof — but a little social proof makes it easier for us to say yes. And the social proof of a Scout is especially interesting to us.

Why? Because the average Joe usually doesn't get anything when he makes intros for a startup. He might get some advisory shares but that's rarer than you think.

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<sup>35</sup> <http://venturehacks.com/about>

<sup>36</sup> <mailto:nivi@venturehacks.com>

<sup>37</sup> <http://angel.co>

<sup>38</sup> <http://gigaom.com/2010/08/31/angellist-designates-scouts-to-refer-new-startup-deals/>

**The Scouts program is different.** First, the Scouts are getting AngelList profiles with badges that display how many high-quality startups they've referred to the community. With the startups' permission, we'll list the names of the startups too. And most important: *the Scouts will be able to send startups directly to AngelList, under their own names, without us in the middle.*

**Who are the Scouts?** Each of these Scouts has sent us one high-quality startup that was good enough for AngelList. And most have sent more.

*Los Angeles:*



<sup>39</sup> J. Grubb<sup>40</sup> (@jonathangrubb<sup>41</sup>), Founder of Get Satisfaction<sup>42</sup>

*Seattle:*



Tony Wright<sup>43</sup> (@webwright<sup>44</sup>), Founder of RescueTime<sup>45</sup>

*Chicago:*

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<sup>39</sup><http://jonathangrubb.com/>

<sup>40</sup><http://jonathangrubb.com/>

<sup>41</sup><http://twitter.com/jonathangrubb>

<sup>42</sup><http://getsatisfaction.com/>

<sup>43</sup><http://www.tonywright.com/>

<sup>44</sup><http://twitter.com/webwright>

<sup>45</sup><http://www.rescuetime.com/>



Harper Reed<sup>46</sup> (@harper<sup>47</sup>), Former CTO of Threadless<sup>48</sup>

*New York:*



David Lifson<sup>49</sup> (@dlifson<sup>50</sup>), CEO of Postling<sup>51</sup>

*Silicon Valley:*



Jamie Quint<sup>52</sup> (@jamiequint<sup>53</sup>), Founder of Snaptalent



Gagan Biyani<sup>54</sup> (@gaganbiyani<sup>55</sup>), Founder of Udemy



Sam Odio<sup>56</sup> (@sodio<sup>57</sup>), CEO of Divvyshot<sup>58</sup>

<sup>46</sup><http://www.nata2.org/>

<sup>47</sup><http://twitter.com/harper>

<sup>48</sup><http://www.threadless.com/>

<sup>49</sup><http://caterpillarcowboy.com/>

<sup>50</sup><http://twitter.com/dlifson>

<sup>51</sup><http://www.postling.com>

<sup>52</sup><http://jamiequint.com>

<sup>53</sup><http://twitter.com/jamiequint>

<sup>54</sup><http://www.udemy.com/u/gaganbiyani>

<sup>55</sup><http://twitter.com/gaganbiyani>

<sup>56</sup><http://sam.bluwiki.com/blog/>

<sup>57</sup><http://twitter.com/sodio>

<sup>58</sup><http://www.divvyshot.com>



Jason Putorti<sup>59</sup> (@putorti<sup>60</sup>), Mint<sup>61</sup> designer, Founder of Votizen<sup>62</sup>

*Boston:*



David Hauser<sup>63</sup> (@dh<sup>64</sup>), Founder of Grasshopper<sup>65</sup>, Chargify<sup>66</sup>

*London:*



Brendan Baker<sup>67</sup> (@brendanbaker<sup>68</sup>), Oxford MBA

And here's a Twitter list of the Scouts: @angellist/scouts<sup>69</sup>.

**How do you get to be a Scout?** Refer one high-quality startup that's good enough to share with AngelList (tell startups to list you in the referrer field). Then get in touch with us, tell us you want to be a Scout, and we'll start a conversation. I'm sure we'll modify these guidelines over time, but it's a good start.

**Questions?** Contact our Scout @brendanbaker<sup>70</sup> and cc me @nivi<sup>71</sup>.

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<sup>59</sup><http://jasonputorti.com/>

<sup>60</sup><http://twitter.com/putorti>

<sup>61</sup><http://mint.com>

<sup>62</sup><http://votizen.com>

<sup>63</sup><http://davidhauser.com/MINDdrift/>

<sup>64</sup><http://twitter.com/dh>

<sup>65</sup><http://www.grasshopper.com/>

<sup>66</sup><http://chargify.com>

<sup>67</sup><http://www.cashewman.com/>

<sup>68</sup><http://twitter.com/brendanbaker>

<sup>69</sup><http://twitter.com/angellist/scouts>

<sup>70</sup><http://twitter.com/brendanbaker>

<sup>71</sup><http://twitter.com/nivi>

If you're a startup that's trying to contact the angels on Angel-List, consider getting in touch with one of our Scouts. They can help.

# September 2010

## How Udemy got oversubscribed



Gagan Biyani, founder of Udemy, tells the story<sup>2</sup> of how he got 2x oversubscribed with a little help from Keith Rabois, Adeo Ressi, AngelList, and many others:

Udemy went out to raise money in February-March 2010. We received more than 30 no's largely because investors weren't confident enough in the business to pull the trigger.

Udemy focused hard on traction and launched the product in May 2010. By July, we had some promising numbers and decided to pitch again. We leveraged Adeo Ressi<sup>3</sup> of the Founder Institute<sup>4</sup> heavily before and during the fundraising.

I connected with a lot of friends and great CEO's before fundraising to get intros. One of the most helpful was Darian Shirazi<sup>5</sup> (CEO of Fwix<sup>6</sup>), who intro'd us to 3 of our investors. Afterwards, we made him advisor to thank him and because we wanted to keep an ongoing relationship with him.

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<sup>1</sup><http://udemy.com>

<sup>2</sup><http://www.udemy.com/blog/udemy-fundraising/>

<sup>3</sup><http://www.adeoressi.com/>

<sup>4</sup><http://founderinstitute.com/>

<sup>5</sup><http://twitter.com/darian314>

<sup>6</sup><http://fwix.com/>

Keith Rabois<sup>7</sup>, one of the first people we re-met with, agreed to lead the round. In this meeting, we told Keith we wanted to raise \$300K-\$500K.

We leveraged AngelList<sup>8</sup> to get additional momentum and investors for the round. It was critical to our success.

Within 2 weeks, we had more than \$500K committed.

One more week later, we had more than \$1M committed. We closed the round at \$1M...

We can't speak higher of AngelList and the value it provided to Udemy's fundraising process. We received over 25 intro's to top-tier investors. What other way can you get 25 investors to ask for intros to YOU! AngelList led to investments from Jeremy Stoppelman<sup>9</sup> (CEO of Yelp), Dave McClure<sup>10</sup> (500 Startups), Josh Stylman<sup>11</sup> (Angel Investor, co-founder at Rotomedia and Reprise Media), and Ben Ling<sup>12</sup> (executive roles at Google, Facebook, YouTube). But what was even more important was that AngelList got our round over-subscribed, so we had momentum which helped convince our other investors to make their decisions faster and in our favor.

This is what I like about great startup cities like Silicon Valley: a loosely organized team of investors and entrepreneurs giving their time and money to help get a company off the ground. Read the full post<sup>13</sup>.

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<sup>7</sup><http://krabois.com/>

<sup>8</sup><http://angel.co/>

<sup>9</sup><http://angel.co/jeremys>

<sup>10</sup><http://500hats.typepad.com/>

<sup>11</sup><http://angel.co/jstylman>

<sup>12</sup><http://angel.co/bling0>

<sup>13</sup><http://www.udemy.com/blog/udemy-fundraising/>

## Blogging on Quora

I've been doing a bit of blogging on a Q&A site called Quora<sup>14</sup>.

Quora makes it fun and easy to write. Sometimes I ask and answer my own questions. Sometimes I answer other people's questions. Here's a few of my answers.

How strong does your traction, social proof, product, and team have to be to be accepted to AngelList?<sup>15</sup>

It's always a good time to apply. You can now continuously update your application and we'll review it every time.

Here's how I personally filter the startups:

1. If you've got good **social proof**, I'm done — I'll make intros.
2. If not, then if you've got great **traction**, I'm done — I'll make intros.
3. If not, then if you've got an awesome **demo**, I'm done — I'll make intros.
4. If not, then if you've got a killer **team**, I'm done — I'll make intros.
5. If not, no intros. Go back to work on your startup, improve one of these metrics, and apply again.

But those are just my personal filters. And my filters don't matter much anymore. Any of the angels on AngelList can now share deals with their followers.

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<sup>14</sup><http://www.quora.com/Babak-Nivi>

<sup>15</sup><http://www.quora.com/How-strong-does-your-traction-social-proof-product-and-team-have-to>

What is good social proof?<sup>16</sup>

Social proof is when you do something because other people are doing it. If you're walking down the street and everyone is looking up at the sky, you look up at the sky.

In this context, social proof is looking at what other investors, entrepreneurs, and advisors are doing. Customers don't count.

I'll disagree with Naval Ravikant<sup>17</sup> on "An investor is choosing not to invest in your company and is making the introduction for you". I don't think this is as bad as he makes it out to be.

The primitive part of your brain will probably recoil when a peer sends you their rejects. But the logical part of your brain will ask why the investor is passing. And there's often a good reason: wrong market, wrong stage, wrong geography, bad chemistry with entrepreneur, some known risks that the investor doesn't want to take, etc.

Rejecting a deal just because a peer rejected it is mathematically unsound. Here's the proof. Every deal you ever invested in was probably rejected by a peer at around the same time you made the investment. So, if your criterion is that you will reject deals that peers reject, you will never make any investments

How do I get started in angel investing?<sup>18</sup>

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<sup>16</sup><http://www.quora.com/What-is-good-social-proof/answer/Babak-Nivi>

<sup>17</sup><http://www.quora.com/What-is-good-social-proof/answer/Naval-Ravikant>

<sup>18</sup><http://www.quora.com/How-do-I-get-started-in-angel-investing/answer/Babak-Nivi>

For dealflow, check out Y Combinator and the other incubators that are popping up all over the world. Also check out AngelList.

For how-to, see Paul Graham's How to be an angel investor<sup>19</sup>, our follow-up How to be an angel investor, Part 2<sup>20</sup>, and the AngelConf videos<sup>21</sup>.

To meet other angels, check out AngelConf<sup>22</sup> (roughly once a year), and introduce yourself to the angels on the AngelList Twitter List<sup>23</sup>.

Who were the first 25 angels on AngelList?<sup>24</sup>

We started with Naval and emailed the angels we knew. It spread and there are about 400 angels on the site now.

1. Naval Ravikant<sup>25</sup> 2. Manu Kumar<sup>26</sup> 3. Dharmesh Shah<sup>27</sup>

See the rest of the list<sup>28</sup>

Go to Quora for more of my questions<sup>29</sup> and answers<sup>30</sup>.

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<sup>19</sup><http://www.paulgraham.com/angelinvesting.html>

<sup>20</sup><http://venturehacks.com/articles/angel>

<sup>21</sup><http://www.justin.tv/c/angelconf>

<sup>22</sup><http://angelconf.org/>

<sup>23</sup><http://twitter.com/angellist/angels>

<sup>24</sup><http://www.quora.com/AngelList/Who-were-the-first-25-angels-on-AngelList/answer/Babak-Nivi>

<sup>25</sup><http://angel.co/naval>

<sup>26</sup><http://angel.co/manukumar>

<sup>27</sup><http://angel.co/dharmesh>

<sup>28</sup><http://www.quora.com/AngelList/Who-were-the-first-25-angels-on-AngelList/answer/Babak-Nivi>

<sup>29</sup><http://www.quora.com/Babak-Nivi/questions>

<sup>30</sup><http://www.quora.com/Babak-Nivi/answers>

# October 2010

## If only we could raise money

Stop saying:

“If only we could raise money, we could do X.”

Start saying:

“If we do X and we’re lucky, we might be able to raise money.”

*(This was quite popular on Twitter — 91 retweets — so I’m reproducing it here. You should follow us on Twitter<sup>1</sup>. There’s a lot of good and bad startup advice coming out these days and we tweet about the best.)*

## Welcoming the Kauffman Foundation

KAUFFMAN  
The Foundation of Entrepreneurship

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<sup>1</sup><http://twitter.com/venturehacks>

<sup>2</sup><http://www.kauffman.org/>

We're very happy to announce that the Kauffman Foundation<sup>3</sup> has made a significant contribution to support Venture Hacks. If you don't know them, Kauffman is a \$2B non-profit foundation devoted to entrepreneurship.

## How it happened

**Update:** See Bo's comment<sup>4</sup> about why they decided to support Venture Hacks.

Earlier this year I got an cold email from Bo Fishback<sup>5</sup> at the Kauffman Foundation:

Hey Nivi –

I've been following Venture Hacks for a while and have sent many many people there.

I'm interested in talking to you about sponsorship or support. Can we get on the phone for a super short call sometime in the next couple of weeks? Not this week.

Thanks,

Bo Fishback

After a phone call, I flew to Kansas city to meet Bo and the Kauffman team. I pitched them without a deck<sup>6</sup>. Instead, I built a 1-page outline, Wufoo-style<sup>7</sup>, and "did it live". If I wanted

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<sup>3</sup><http://www.kauffman.org/>

<sup>4</sup><http://venturehacks.com/articles/kauffman#comment-12665>

<sup>5</sup><http://www.google.com/search?sourceid=chrome&ie=UTF-8&q=bo+fishback>

<sup>6</sup><http://venturehacks.com/articles/deck>

<sup>7</sup><http://particletree.com/features/how-we-prepare-a-demo/>

to show them our analytics, I pulled up Google Analytics. If I wanted to show them our products, I went to our products page<sup>8</sup>. If I wanted to show them testimonials, I went to our Twitter favorites<sup>9</sup>.

When I got home, I got some advice from Steve Blank<sup>10</sup>: when you're making an enterprise sale, do your sponsor's work for him. If your sponsor needs a pitch for other people in the organization, build it for him. So I called Solvate<sup>11</sup> and they helped me build a deck which Bo used to make the sale to their grant committee. Here are a few random slides from the deck:

## About Kauffman

Kauffman is a \$2B non-profit foundation devoted to entrepreneurship — they fund Nobel prize winners. And now they want to reach you — the future founders of high-growth companies.

*We're very happy to bring them on board as a supporter and to welcome them to Silicon Valley.*

## Vinod Khosla: “I was much more of a glorified recruiter.”

Vinod Khosla at TechCrunch Disrupt<sup>12</sup>:

“I think the single, most important fact about doing a startup is being clear about your vision and not

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<sup>8</sup><http://venturehacks.com/products>

<sup>9</sup><http://twitter.com/angellist/favorites>

<sup>10</sup><http://steveblank.com/>

<sup>11</sup><http://solvate.com>

<sup>12</sup><http://www.ustream.tv/recording/9895601>

letting it get distorted by what pundits and experts tell you.

“But the second most important thing is finding the right team. And that’s really, really hard, because people tend to look for people around them and so it’s the person who they happen to know as opposed to the best possible person to find.

“You know, I was relentless. It took a lot of time. I used to say when I was starting my first company, I was much more of a glorified recruiter than a CEO, or a founder. I really spent probably well over 50% of my time recruiting, and I encourage all entrepreneurs to try and do that.

“It’s also hard because you’ve never hired a marketing person. You don’t what a good marketing person is. You don’t even know what a good developer is. So whose judgment to trust, whose advice to take, is really really hard.”

Corollary: If you can’t recruit a good team, your vision probably needs distortion. Vinod’s quote starts at 19:20 in the video but I encourage you to watch the whole interview.

## The rise of the angels

This is Naval’s keynote from Capital Factory<sup>13</sup>’s demo day. It’s called *The Rise of the Angels*, but it should be called *The Rise of the Entrepreneur*. It’s excellent.

Video: The rise of the angels<sup>14</sup> Here are the slides. Make sure you check out Slide 8 for a draft Entrepreneur’s Bill of Rights.

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<sup>13</sup><http://www.capitalfactory.com/>

<sup>14</sup><http://www.youtube.com/watch?v=tjzDY9Z3HF0>

And Slide 20 for Naval's prediction that spectacular fraud will occur in angel investing.

Slides: The rise of the angels<sup>15</sup> Some of my favorite quotes from the presentation:

The venture industry has already changed.

Venture capital is a business and is open to attack by startups with disruptive new business models and technologies.

Less meeting; more tweeting.

Thanks to Joshua Baer<sup>16</sup> for inviting us to give the keynote.

## What you can learn from The Social Network

I've been blogging a bit on Quora — here are a couple recent posts.

What you can learn from The Social Network<sup>17</sup>:

The Social Network is an incredibly well made and motivating film.

I don't care about the facts of the matter — they're irrelevant. The movie tells a better story about startup life than anything you've ever read in the press.

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<sup>15</sup><http://www.slideshare.net/venturehacks/the-rise-of-the-angels-5244611>

<sup>16</sup><http://www.google.com/search?sourceid=chrome&ie=UTF-8&q=joshua+baer>

<sup>17</sup><http://www.quora.com/Babak-Nivi/What-you-can-learn-from-The-Social-Network>

Pretend this is a film about fictional people and a fictional product. Here are a few things you can learn:

*Facebook was built on strengths, not weaknesses.* Mark, Sean, and Eduardo each have their strengths. If you focus on their weaknesses, they seem like bad apples. It is their strengths that make them effective. You can only build performance on strength — you cannot build it on weakness.

*If you're not in the room while the deal is going down, prepare to get screwed.* My favorite line in the movie is when Sean and Mark meet Peter Thiel for a few minutes and Peter concludes the negotiation with, “So, who is this Eduardo Saverin?”

Read the rest<sup>18</sup> ...

Why Cleantech is Boring<sup>19</sup>:

Cleantech is boring because it doesn't attract product designers.

Cleantech problems are engineering problems, not product problems.

Here's the product design of the best cleantech product ever: lots of clean energy in a very small space, at low cost — the end.

So cleantech attracts engineers who like to solve puzzles instead of product designers who like to build things like iPads and Quoras.

Right or wrong?

See my Quora posts<sup>20</sup> for more masterpieces.

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<sup>18</sup><http://www.quora.com/Babak-Nivi/What-you-can-learn-from-The-Social-Network>

<sup>19</sup><http://www.quora.com/Babak-Nivi/Why-Cleantech-is-Boring>

<sup>20</sup><http://www.quora.com/Babak-Nivi/posts>

## The Venture Hacks Newsletter is back

The Venture Hacks Newsletter<sup>21</sup> is back baby. It's a daily digest of our tweets<sup>22</sup> — subscribe via email<sup>23</sup> or RSS<sup>24</sup>. The email version looks pretty sweet:

### A Look Back At Summize

**AVC**— In July 2008, Twitter acquired a company called Summize. The stated reason was to bring search into Twitter. And that was the main reason that Twitter did the deal. But Twitter also got a very strong engineering team in that acquisition. I remember asking Ev and Jack at the time "how are we going to integrate the engineering team?" and Jack replying...

 *"They did not rebuild Twitter, they just replaced one thing at a time and evolved it." – @fredwilson, <http://j.mp/cX9hWK>"*

929 CLICKS 76 TWEETS

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### Aprizi's Customer Development Journey, part 3 – giffconstable.com

**GIFFCONSTABLE**— Aprizi is about to enter that crucial phase of open beta, so I wanted to pause and write down the latest installment in our customer development journey (part 1 and 2). For anyone new to the blog, Aprizi is building a personalization engine for online shopping — a Pandora for e-commerce, if you will. My thesis is that the intersection of tw...

 *"Build something for yourself is not the "best" way to come up with startup ideas. A different way: <http://j.mp/gIgPnW>."*

582 CLICKS 14 TWEETS

(The newsletter was broken for a few months and we've finally gotten around to fixing it.)

We read all the startup advice on the Web and link to the best

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<sup>21</sup><http://venturehacks.com/articles/best-advice>

<sup>22</sup><http://twitter.com/venturehacks>

<sup>23</sup><http://venturehacks.us1.list-manage.com/subscribe?u=36878c2ab9e43b6c36eeaf230&id=4d6a109373>

<sup>24</sup><http://feeds.venturehacks.com/venturehacks-twitter>

stuff on Twitter. If you don't want to miss a tweet, sign up for the daily digest. Fred Wilson<sup>25</sup> and 2000 other folks have given us permission to invade their inboxes, so it can't be too bad.

Subscribe via email<sup>26</sup> or RSS<sup>27</sup> — if you hate it, you can unsubscribe with a single click.

## Which startups have been funded via AngelList?

I'm working on a Quora thread called:

Which startups have been funded via AngelList?<sup>28</sup>

So far, the thread lists 27 startups that have raised money with AngelList. I think the real number is closer to 40 and I'm still prodding AngelList startups to write responses. Check it out<sup>29</sup>.

Quora makes it fun and easy to create quality content. But that's not the only reason I used it. Quora lets people answer in their own words, without going through my filter. So readers get to see the raw data. And it opens us up to revision and criticism. We don't control the environment so the data seems more authentic.

I'm guessing the Quora team shudders at the thought of Quora marketing<sup>30</sup> (I would too) but good marketing is just good communication and education. Everyone who works on a Quora

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<sup>25</sup> [http://www.avc.com/a\\_vc/2010/04/venture-hacks-daily-newsletter.html](http://www.avc.com/a_vc/2010/04/venture-hacks-daily-newsletter.html)

<sup>26</sup> <http://venturehacks.us1.list-manage.com/subscribe?u=36878c2ab9e43b6c36eeaf230&id=4d6a109373>

<sup>27</sup> <http://feeds.venturehacks.com/venturehacks-twitter>

<sup>28</sup> <http://www.quora.com/Which-startups-have-been-funded-via-AngelList>

<sup>29</sup> <http://www.quora.com/Which-startups-have-been-funded-via-AngelList>

<sup>30</sup> <http://venturehacks.com/articles/quora-marketing>

thread is driven by an incentive and talking about your product isn't a bad one.

## Free the Firehose



@albertwenger

Albert Wenger

Wow -- the @angellist firehose is amazing!

8 Oct via web ⭐ Favorite ↗ Retweet ↙ Reply

31

That's a tweet from Albert Wenger<sup>32</sup> at Union Square Ventures. Thanks kindly Albert.

The **Firehose** is a new feature on AngelList<sup>33</sup> that gives investors unfiltered access to *all* the startups that want to meet them. Startups tell us who they want meet — if they say they want to meet Albert, they show up in Albert's Firehose. If not, they don't.

We still go through the Firehose every day and email the best startups to the investors they want to meet. But every investor has different filters. And they want to find startups before anyone else gets their hands on them. That's what the Firehose is for. **Investors login every morning to see what's new on AngelList** (we get 10-20 new startup applications a day).

We released the Firehose last week and 37 startups have already gotten intros to 12 investors like Thomas Korte<sup>34</sup> (Heroku), Bob

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<sup>31</sup><http://twitter.com/#!/albertwenger/status/26752591083>

<sup>32</sup><http://www.google.com/search?sourceid=chrome&ie=UTF-8&q=albert+wenger>

<sup>33</sup><http://angel.co>

<sup>34</sup><http://angel.co/thomask>

Pasker<sup>35</sup> (Mint), Ori Sasson<sup>36</sup> (VMWare), Beau Lasky<sup>37</sup> (Playdom), Auren Hoffman<sup>38</sup> (Meebo), and Peter Chaney<sup>39</sup> (iLike).

That's 37 startups that probably wouldn't have gotten meetings with investors if they had to rely solely on the Nivi and Naval filter. There's no reason we should be the only filters on AngelList and we're working on ways to get the right startups into the hands of the right investors on AngelList.

We're really excited about this feature — big ups to the law offices of Leonardo<sup>40</sup>, Slayton<sup>41</sup>, and Capone<sup>42</sup> who built this bad boy.

## Primo essay on team building



Go read Steve Newcomb's essay on building teams:

<sup>35</sup><http://angel.co/rbpasker>

<sup>36</sup><http://angel.co/ori-sasson>

<sup>37</sup><http://angel.co/blackfish>

<sup>38</sup><http://angel.co/auren>

<sup>39</sup><http://angel.co/peterchane>

<sup>40</sup><http://twitter.com/#!/shiftb>

<sup>41</sup>[http://www.google.com/search?sourceid=chrome&ie=UTF-8&q=josh+slayton#sc1ent=psy&hl=en&source=hp&q=joshua+slayton&aq=f&aq=i=g-sx1g1&aql=&oq=&gs\\_rfai=&pbx=1&fp=2a733231160964be](http://www.google.com/search?sourceid=chrome&ie=UTF-8&q=josh+slayton#sc1ent=psy&hl=en&source=hp&q=joshua+slayton&aq=f&aq=i=g-sx1g1&aql=&oq=&gs_rfai=&pbx=1&fp=2a733231160964be)

<sup>42</sup><http://twitter.com/#!/michecapone>

### Cult Creation<sup>43</sup>

Steve's the founder of Powerset. This essay is very long and very good. It's the best article I've read on building teams. And team building is 10x more difficult, tedious, and important than raising money.

I love/hate this essay.

I love the fact that Steve is open sourcing his secrets. I hate the fact that high-quality startup advice is the exception and not the norm.

I love that this essay was written in Silicon Valley. I hate that Silicon Valley dominates the world in quality startup advice.

Here's a sample from Steve's essay:

#### **Engineers Suck at Negotiating, so Don't Negotiate, Be Fair** –from me, after being pissed off about hiring practices I experienced from bad founders.

Over the years, I have noticed some sort of weird inverse correlation between the talent an engineer has for coding and their ability to negotiate. I've seen people that could have hacked into NSA suddenly shit twinkies the second I bring up the topic of their salary. I don't exactly get it, but it's there.

Founders, on the other hand, are almost by nature programmed to negotiate everything. In some cases, I have seen founders take advantage of engineers who don't negotiate well, or who simply hate to negotiate so much that it's a near-phobic experience.

DO NOT DO THIS! If you do, you're an ass-hat.

Besides being unfair and a dick move, it is also stupid and even worse yet in my book – it's illogical.

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<sup>43</sup><http://www.blognewcomb.com/cult.html>

What inevitably happens is that the engineers, who all have different deals, get drunk one night. Then the shit hits the fan when they tell each other what they all make and what equity they got. Come Monday morning, every engineer's password is "my\_founder\_is\_a\_dick," several viruses and backdoors are suddenly installed into the code base, and the founder gets the silent treatment – none the wiser of his impending doom. Way to go ass-hat!

If you can't tell, this one pushes my buttons. I don't give a frog's fat ass how good a negotiator an engineer is when I'm interviewing them. I want them to have such pristine code that it makes my other engineers cry. I want them to have a beautiful mind that can use logic and reason to solve the engineering challenges that I hand them. It is completely irrelevant how good they are at negotiating.

Go read the rest<sup>44</sup>.

## The Venture Hacks Bible



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The Venture Hacks Bible is out. Every single post in one PDF. 1400 pages. \$19. Check out the free sample<sup>46</sup> and buy it here:

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<sup>44</sup><http://www.blognewcomb.com/cult.html>

<sup>45</sup><http://leanpub.com/venturehacks/>

<sup>46</sup><http://s3.amazonaws.com/samples.leanpub.com/venturehacks-sample.pdf>

### Purchase The Venture Hacks Bible<sup>47</sup>

The Bible is updated once a month and you get the updates for free. We've already sold about a 100 copies during the soft launch.

I wondered why people would buy the Bible when you can get the same posts for free on our blog. So we surveyed our customers and here's what they said:

“It’s easier to search.”

“I can read it on the plane.”

“If my computer is online, I don’t sleep. So for me, turning that wifi switch is a big deal. Now I can peruse/study/reference VH stuff without being online.”

“Easier navigation, plus I can read it full screen like an ebook.”

File under: *You are not your customer*. Thanks to Peter Armstrong and Scott Patten at Leanpub<sup>48</sup> for making this book happen. If you want to turn your blog into a book, get in touch with them.

Check out the free sample<sup>49</sup> below and buy the The Venture Hacks Bible<sup>50</sup>.

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<sup>47</sup> <http://leanpub.com/venturehacks/>

<sup>48</sup> <http://leanpub.com/>

<sup>49</sup> <http://s3.amazonaws.com/samples.leanpub.com/venturehacks-sample.pdf>

<sup>50</sup> <http://leanpub.com/venturehacks/>

## “Intros from AngelList were responsible for 54.5% of the \$1M we raised”

Daniel Odio from AppMakr<sup>51</sup> is chronicling their fundraising in a series of blog posts starting here<sup>52</sup>.

AppMakr used AngelList<sup>53</sup> to close Mitch Kapor<sup>54</sup>, a VPE at Google, Jeremie Berrebi<sup>55</sup>, Pietro Dova<sup>56</sup>, and other folks in the paperwork stage.

And Daniel's first post includes a long interview with Naval:

Video: Daniel Odio interviews Naval<sup>57</sup> See Daniel's post<sup>58</sup> for more details and an invite to the AppMakr party on October 28th. Thanks for putting this together Daniel.

## AngelList in real time

There isn't much to do on AngelList<sup>59</sup> if you're not an approved angel. Startups can apply<sup>60</sup>, track some basic stats about their application and that's about it. The angels get all the cool features for now — for example, they get a pretty nice interface for reviewing pitches that I'll show you sometime.

But until then, check out this real time feed of investor activity

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<sup>51</sup><http://www.appmakr.com/iPhone-App-Maker/>

<sup>52</sup><http://www.danielodio.com/2010/10/21/fundraising-hacks-interview-with-naval-ravikant-of-a>

<sup>53</sup><http://angel.co>

<sup>54</sup><http://angel.co/mkapor>

<sup>55</sup><http://angel.co/jberrebi>

<sup>56</sup><http://angel.co/pdova>

<sup>57</sup><http://vimeo.com/16034713>

<sup>58</sup><http://www.danielodio.com/2010/10/21/fundraising-hacks-interview-with-naval-ravikant-of-a>

<sup>59</sup><http://angel.co/>

<sup>60</sup><http://angel.co/intro>

on the AngelList home page<sup>61</sup>:

## Recent Activity

-  **Mike Jung** took an [intro](#) to a startup raising \$1.2m (\$800k is committed)  
23 minutes ago
-  **Jason Calacanis** took an [intro](#) to a startup raising \$1.2m (\$800k is committed)  
33 minutes ago
-  **Ben Narasin** took an [intro](#) to a startup raising \$1.2m (\$800k is committed)  
1 hour ago
-  **Rich Miner** took an [intro](#) to a startup raising \$1.2m (\$800k is committed)  
1 hour ago
-  **Hadley Harris** took an [intro](#) to a startup raising \$1.2m (\$800k is committed)  
1 hour ago
-  **Randy Haykin** took an [intro](#) to a startup raising \$1.2m (\$800k is committed)  
1 hour ago
-  **George Zachary** [shared](#) a startup raising \$1.2m (\$800k is committed)  
1 hour ago
-  **Cyril Ebersweiler** took an [intro](#) to a startup in New York  
5 hours ago
-  **Eileen Burbidge** took an [intro](#) to a startup raising \$1m  
8 hours ago
-  **Naval Ravikant** [shared](#) a startup raising \$250,000  
10 hours ago

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When an investor takes an *intro* to a startup, *invests* in a startup, *shares* a startup, or *likes* a startup, you'll see it on the home page. We obviously don't display the startup's name. And, of course, angels can go anonymous.

This is the real time pulse of AngelList. We stare at it all day. It's also a pretty nifty way for angels to get on the home page (we get requests for this all the time). So please let us know how you like it.

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<sup>61</sup><http://angel.co>

<sup>62</sup><http://angel.co>

## How much money should I raise?

We get this question all the time and there's no right answer. So I started a discussion on Quora to learn more. Here's my answer<sup>63</sup>:

Raise **less** if you want to keep your valuation down and keep the option open for an early exit where everyone (investors, employees and founders) makes money.

Raise **more** if you're here for the long term and you want to protect your company from poor funding environments or hiccups in your growth. Just try to maintain control, monitor your liquidation preference, and monitor your dilution. Also understand that, if your valuation is high in this round, you will have to make a lot of progress for the next round to be an up round.

In summary, raise too little money and you may go out of business when you run into trouble. Raise too much money and you may make less dough when you exit. Take your pick: disaster vs. dilution.

In either case, try to act like you don't have a lot of money. The conventional wisdom is that when you have a lot of money, it's hard not to slow down because you start spending it (which takes time in and of itself) and you start thinking that you have a lot of time left before you die, so what's the hurry?

Read the rest of my answer on Quora<sup>64</sup>. Also see this old post<sup>65</sup> on Venture Hacks for related quotes from Eugene Kleiner, Bill Janeway, and Marc Andreessen.

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<sup>63</sup><http://www.quora.com/How-much-money-should-I-raise>

<sup>64</sup><http://www.quora.com/How-much-money-should-I-raise>

<sup>65</sup><http://venturehacks.com/articles/how-much-money>

# November 2010

## Always assume competition

Earlier this month, I got this email from a friend:

“Why didn’t you ever tell me about this site? This is exactly what I was trying to create and just spent the last few weeks pulling people together to build me a site. Do you know how they are doing? They never once came up through my competitive intelligence and I just learned about them. Would like to know before I dump anymore money in my venture.”

This was my response:

“I can’t give you any insider information on any of these companies. I know the founders of all of them. It doesn’t matter. It has nothing to do with you. It’s good to know the market but the competition is irrelevant. The market is big. Winning comes by knowing the customer better, executing better, and continuing to work on the problem after sane people have cashed out. **If a competitor is going to scare you, you shouldn’t have started a business in the first place.** Every big market or successful business will attract competitors anyway. Always assume competition.”

This was originally published on Quora. See my original post and the comments here<sup>1</sup>.

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<sup>1</sup><http://www.quora.com/Babak-Nivi/Always-assume-competition>

## Before you raise money

This is an awesome talk by Naval on what to do *before* you raise money. I know I say this all the time, but this may be his best talk yet.

Video: Before You Raise Money<sup>2</sup> This talk is part of a course on Udemy<sup>3</sup>, which lets people “take and build online courses on any subject.” They asked Naval to teach part of a paid course called *Raising Capital for Startups*. We agreed, as long as they let us give away the part we taught for free.

You can buy the full course from Udemy for \$29 here<sup>4</sup>. Use promo code VentureHacks to get \$10 off.

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<sup>2</sup>[http://www.udemy.com/raising-capital-for-startups/  
before-you-raise-money-36063.html](http://www.udemy.com/raising-capital-for-startups/before-you-raise-money-36063.html)

<sup>3</sup><http://udemy.com>

<sup>4</sup>[http://www.udemy.com/raising-capital-for-startups/  
before-you-raise-money-36063.html](http://www.udemy.com/raising-capital-for-startups/before-you-raise-money-36063.html)

# December 2010

## Control which investors see your startup

They said it couldn't be done, but we've released a feature that lets you control which angels see your startup on AngelList<sup>1</sup>. When you add your startup<sup>2</sup> to AngelList, you'll see a button to pick your angels:

All Angels Selected

Click it, and this beast will pop up:

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<sup>1</sup><http://angel.co>

<sup>2</sup><http://angel.co/intro>

**Select Angels**

Search

Select All Select None View: All Selected (790)

 500 Startups Incubator, Silicon Valley	 Aaron Iba Angel, Silicon Valley	 Aaron Patzer Angel, Silicon Valley
 Abrar Ahmad Seed Fund, Los Angeles	 Adam Beguelin Angel, Reno	 Adam D'Augelli VC, Silicon Valley
 Adam Jackson Angel, Silicon Valley	 Adam Katz Seed Fund, Los Angeles	 Adam Ludwin VC, New York
 Adam Smith Angel, Silicon Valley	 Adeo Ressi Incubator, Silicon Valley	 Adrian Vanzyl Angel, Australia, Silicon Valley
 Aileen Lee VC, Silicon Valley	 Ajit Varma Angel, Silicon Valley	 Akash Agarwal Angel, Silicon Valley

Then pick the angels who should see your startup. **The angels you don't pick won't get access to your startup at all.**

**Select Angels**

Search

Select All Select None View: All Selected (5)

 500 Startups Incubator, Silicon Valley	 Aaron Iba Angel, Silicon Valley	 Aaron Patzer Angel, Silicon Valley
 Abrar Ahmad Seed Fund, Los Angeles	 Adam Beguelin Angel, Reno	 Adam D'Augelli VC, Silicon Valley
 Adam Jackson Angel, Silicon Valley	 Adam Katz Seed Fund, Los Angeles	 Adam Ludwin VC, New York
 Adam Smith Angel, Silicon Valley	 Adeo Ressi Incubator, Silicon Valley	 Adrian Vanzyl Angel, Australia, Silicon Valley
 Aileen Lee VC, Silicon Valley	 Ajit Varma Angel, Silicon Valley	 Akash Agarwal Angel, Silicon Valley

You can search for angels by name:

DECEMBER 2010

1172

Select Angels

aaron | Filter Investors

Select All Select None View: All Selected (790)

 Aaron Iba Angel, Silicon Valley	 Aaron Patzer Angel, Silicon Valley
--	---

Save and Close

And you can filter the list by fund type (angel, VC, seed fund...), activity (is the angel actually taking meetings and doing investments on AngelList), and location.

**Select Angels**

Search

Select All Select None

 500 Startups Incubator, Silicon Valley	 Aaron Iba Angel, Silicon Valley
 Abrar Ahmad Seed Fund, Los Angeles	 Adam Beguelin Angel, Reno
 Adam Jackson Angel, Silicon Valley	 Adam Katz Seed Fund, Los Angeles
 Adam Smith Angel, Silicon Valley	 Adeo Ressi Incubator, Silicon Valley
 Aileen Lee VC, Silicon Valley	 Ajit Varma Angel, Silicon Valley

✓ Filter Investors

Fund Type

- Angel
- VC
- Seed Fund
- Incubator
- Advisor
- Scout
- M&A

Activity

- Taken Intros
- Made Investments

Location

- Atlanta
- Austin
- Australia
- Baltimore
- Boston
- Boulder
- Brazil
- Burlington
- Canada
- Chicago
- Chile
- China
- Cleveland
- Columbus
- Dallas
- Denver
- Detroit
- Dubai
- Durham
- Europe
- Houston
- India
- Indianapolis
- Israel
- Japan
- Los Angeles
- Louisville
- Miami
- New York
- North Carolina
- Ohio

er our butts, but it's also good advice. Read it,

the investors you meet through AngelList. You're edited. The AngelList community spends time vetting accreditation. They're getting better at it every day. Find a good startup lawyer. You have to agree to indemnify us for your profile on AngelList, your communication with investors, and your use of the platform. If you can't agree to this, don't use AngelList! Please. And thank you kindly for using AngelList. — Niv

vitter Quora VH · Privacy Terms

## So what the hell is this good for?

Avoid angels who've invested in competitors, keep your pitch hidden while you're still editing it, avoid VCs, embrace VCs<sup>3</sup>, pitch VCs on your Series A, test out your pitch on half the list first, pitch local investors, *et cetera, et cetera.*

In general, unless you really know what you're doing, you should select everyone on AngelList. If the AngelList admins decide to mail your startup to the investors you've selected, you'll get more intros if you pick all the angels. And if the admins don't think your startup is ready for an email, the angels who review all the startups that join AngelList might decide to take an intro on their own. Again, you're more likely to get "crowd sourced" by the angels if you select more angels.

Please let us know how you use this new tool. We've tested it on Chrome, Safari and Firefox too. IE is another story. Anyway, if you haven't tried Chrome, you should give it a go — my mom likes it.

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<sup>3</sup><http://venturehacks.com/articles/vc-seed>

# January 2011

## The Secret History of Venture Hacks

Andrew Warner recently did us the honor of interviewing Naval for Mixergy<sup>1</sup>:

Video: Naval on Mixergy<sup>2</sup> Watch the video to learn about the secret history of Venture Hacks and see why Naval calls this the most thoroughly researched interview he's ever done. I also sneak on the set for 5 seconds before they throw me off.

## Why would a seasoned entrepreneur use AngelList?

*A Quora user asks: why would a seasoned entrepreneur, who can get his or her own intros, use AngelList? This is the answer I posted on Quora<sup>3</sup>.*

We started AngelList to help startups get intros to investors, but we've learned that intros are just a *feature* of AngelList, not the *benefit*. We consistently hear the same set of benefits from the startups that use AngelList—even the ones that can get intros on their own:

**The AngelList community helps you raise money on market terms, from the most value-add investors, fast. In short, AngelList is efficient.**

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<sup>1</sup><http://mixergy.com/naval-ravikant-venture-hacks-interview/>

<sup>2</sup><http://mixergy.com/naval-ravikant-venture-hacks-interview>

<sup>3</sup><http://www.quora.com/Why-would-a-seasoned-entrepreneur-use-AngelList>

Or, in other words, AngelList gets you answers to three questions:

1. How do I know what my shares are worth?
2. How do I know the girl/guy I'm marrying is the best one?
3. When is the deal closing?

Before I get into how the community answers these questions, let me say that, one, AngelList is free and, two, you can control<sup>4</sup> exactly which investors in the community see your startup.

## 1. Market terms

*How do I know what my shares are worth?*

When you sell your car, do you go to Craigslist, or do you go knocking on doors? When you sell your action figures, do you use eBay, or do you throw a garage sale and offer your toys to one person at a time, over a timespan of ‘whenever’?

You can’t clear the market in series, you can only clear it in parallel. And the only way to clear the market is to *go to the market*. The best companies on AngelList end up raising money on better terms than they expected. It’s impossible to get that outcome if you’re meeting investors one-at-a-time.

“More than doubled the round size and significantly increased the pre-money.” – Bertram Meyer, Taulia

“[AngelList helped] us close the existing deal more quickly and on better terms than we would have without the considerable additional investor interest generated by AngelList.” – Sean Harper, FeeFighters

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<sup>4</sup><http://venturehacks.com/articles/angel-picker>

“We were over-subscribed not once but twice.” – Gagan Biyani, Udemy

*All quotes are from <http://angel.co/reviews><sup>5</sup>*

## 2. Most value-add investors

*How do I know the girl/guy I’m marrying is the best one?*

Terms aren’t everything. You also want investors who can add the most value. All the investors you know are probably on AngelList—but there’s also a thousand other investors on AngelList that you don’t know. It’s highly likely that some of them have massive domain expertise in your market and you will want them involved in your company.

“[AngelList] adds people to the mix that would not be part of the offline deal sharing networks that already exist.” – Fred Wilson, Union Square Ventures

“Not only did we receive high quality responses, they were from investors that had significant experience and insight into our specific vertical. These were angels that understood the market and quickly dove into the core strengths and weaknesses of the business and understood what needed to happen to get to the next level. Nowhere else will you be able to get a collective response from industry experts willing to help not only in terms of capital but from an operational and hands-on perspective as well.” – Nikhil Sethi, Adaptly

“Your network only goes so far. As a NYC-based company, our “reach” into SF / SV investors was fairly limited. AngelList changed that. We have had dozens of investors contact us via AngelList.” – Dave Lifson, Postling

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<sup>5</sup><http://angel.co/reviews>

“Most startups know about the “famous” investors — those who have great public reputations or are name brands. But there are an amazing number of high quality angels, who fly below the radar, that AngelList gives you exposure to.” – Anonymous

### 3. Fast

*When is the deal closing?*

On AngelList, you show your startup to all the investors that you want to meet *at the same time*. The investors know that, so they move fast. Even the investors you’re already talking to know that, so *they* move fast. People sitting on the fence know the time for sitting on the fence is over. The best startups on AngelList start closing in days, not weeks.

“Within hours of posting, we had dozens of qualified, top-shelf investors and by the end of the day we were 100% oversubscribed.” – Mark Risher, Imperium

“Investors I’ve been chasing around for months finally emailed me back. We got \$50K committed in the first 10 minutes.” – Anonymous

“By the weekend I had multiple term sheets and by Monday we had closed our round with exceptional investors that I could only dream about. There is simply no other way to raise a round so quickly.” – Shafqat Islam, NewsCred

### Bonus: Advice

Fundraising advice from the dudes who do Venture Hacks. We didn’t think this was a big deal and we definitely don’t want to

toot our own horn too much but this consistently comes up in customer development with gratified users (see <http://angel.co/reviews><sup>6</sup>).

“Nivi and Naval were both available to give me advice as we went around raising our “party round”. For example, I remember having an idiosyncratic issue that I couldn’t figure out, and Naval took a 20 minute call with me where he basically solved what two professors couldn’t quite help me with (background: I was finishing up school while raising my round). The non-obvious value that AngelList has is that Nivi and Naval are like sherpas helping you scale the Mt. Everest that is fundraising.” – Rafael Corrales, Learnboost

## Summary

It’s the difference between going door-to-door to sell vacuum cleaners and placing an ad on Google. One approach is a pain in the ass. The other is fast, easy, efficient.

Or think of it like this: you do everything else online, why wouldn’t you raise your money online? You put your code on GitHub. You put your servers on Amazon. You buy customers on Google. You market on Twitter. And you can raise your money on AngelList.

If you have any questions about AngelList, send us an email at [team@angel.co](mailto:team@angel.co)<sup>7</sup>.

Frankly, the less you need AngelList, the more the community can do for you. That sounds surprising but it’s not. The stronger you are, the better your terms will be, the better your investors will be, and the faster you’ll close.

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<sup>6</sup><http://angel.co/reviews>

<sup>7</sup><mailto:team@angel.co>

“My only regret is that I delayed posting for so long.”  
– Mark Risher, Imperium

Join AngelList<sup>8</sup>.

## Benefits, not features

When you build a new feature, you try to think about its benefits. But you never know what the real benefits are, until you talk to gratified users.

But getting out of the building and talking to users is hard. Naval and Brendan<sup>9</sup> talk to a lot of AngelList users but I've gotten lazy.

So I use Quora to do customer development. I read this Quora thread<sup>10</sup> in agonizing detail to extract the AngelList benefits<sup>11</sup> I posted a couple days ago.

This<sup>12</sup> anonymous answer motivated the exercise because it completely ignores the features of AngelList and focuses exclusively on some surprising benefits (emphasis added):

- 1) The Application Process AngelList has a very simple and straightforward application process. But they force you to focus on the key metrics, social proof and other factors that lead to successful fundraising. **Just the process of applying, helps you clarify what is necessary to put your company**

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<sup>8</sup><http://angel.co/intro>

<sup>9</sup><http://twitter.com/#!/brendanbaker>

<sup>10</sup><http://www.quora.com/What-do-people-think-of-AngelList>

<sup>11</sup><http://venturehacks.com/articles/why-angellist>

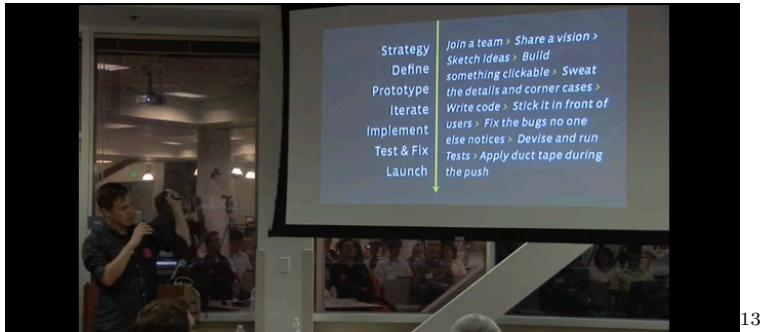
<sup>12</sup><http://www.quora.com/AngelList/What-do-people-think-of-AngelList/answers/165220>

**in the best position to fundraise, whether it is through AngelList or through other methods.** (It is kinda like a test prep course; all standardized test can be hacked with some preparation and knowledge about how it works. The AngelList process + venture hacks is your Kaplan prep course for raising a round.)

- 2) The Depth of the Roster Most startups know about the “famous” investors – those who have great public reputations or are name brands. But **there are an amazing number of high quality angels, who fly below the radar, that AngelList gives you exposure to.** Oftentimes, it can be these angels who help close out your round.
- 3) The Time Factor **AngelList creates a sense of urgency around the investment process.** Nearly every investor that reached out to us, resulted in a call or meeting within 10 days. When compared to non-AngelList intros we received, this is a huge difference in time. Also, decision (both yes and no's) were given fairly quickly.
- 4) The Validation Compared to other conversation, the investors we met through AngelList seemed to be leaning towards investing from the initial conversation. A large part of this is the validation a startup gets by being on AngelList. **What I mean is that investors were looking for reasons to say yes, as opposed to reasons to say no.** The answer still might be no in the end, but it was always a more productive and engaged conversation.

Thank you, Anonymous.

## Sweat the details and corner cases



13

“Sweat the details and corner cases... Fix the bugs no one else notices.”

– Facebook’s Aaron Sittig<sup>14</sup> at a Design Tech Talk<sup>15</sup> (video)

## Raise a Series A on AngelList

There are almost 300 VCs<sup>16</sup> on AngelList now. Investors from Sequoia, Kleiner, Accel, Greylock, CRV, A16Z, and on and on. They all take intros via AngelList and you can see which ones are the most active here<sup>17</sup>.

Four startups have already used AngelList to raise their Series A. So if you’re raising a Series A and you want to raise money on

<sup>13</sup><http://www.facebook.com/video/video.php?v=151887435468>

<sup>14</sup><http://www.google.com/search?sourceid=chrome&ie=UTF-8&q=aaron+sittig>

<sup>15</sup><http://www.facebook.com/video/video.php?v=151887435468>

<sup>16</sup><http://angel.co/vc>

<sup>17</sup>[http://angel.co/vc?order\\_by=meetings](http://angel.co/vc?order_by=meetings)

*market terms*<sup>18</sup>, from the *most value-add* investors, *fast*, reach out to the AngelList community here<sup>19</sup>.

If you just want intros to VCs, we can do that. If you want intros to angels too, we can do that. The angel picker<sup>20</sup> gives you complete control over which investors see your startup.

And if you have any questions about your Series A, feel free to email me at nivi@venturehacks.com<sup>21</sup>.

## Appendix: What's a Series A these days?

I think of a Series A as a round that's big enough to require at least one (multi-stage) VC. Today, you can raise a seed round of \$25K – \$1.5M from incubators<sup>22</sup>, angels<sup>23</sup>, seed funds<sup>24</sup>, VCs<sup>25</sup>, or any combination of these four. But once you get above \$2M, you usually need a VC in the deal. That's my definition of Series A.

## How does AngelList work?

AngelList has changed a lot since we launched it, so I want to describe how the site works today.

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<sup>18</sup><http://venturehacks.com/articles/why-angellist>

<sup>19</sup><http://angel.co/intro>

<sup>20</sup><http://venturehacks.com/articles/angel-picker>

<sup>21</sup><mailto:nivi@venturehacks.com>

<sup>22</sup><http://angel.co/incubator>

<sup>23</sup><http://angel.co/angel>

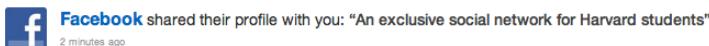
<sup>24</sup><http://angel.co/seed-fund>

<sup>25</sup><http://angel.co/vc>

## 1. Share your startup with investors

First, you create a startup profile<sup>26</sup> and pick<sup>27</sup> which investors can see your startup. If your profile isn't ready to share with investors, just pick zero investors. You can update your profile and investors anytime.

As soon as you share your startup with an investor, they will see it in their feed:



## 2. The admins email the best startups to investors

Every investor on AngelList sees 10-20 new startups in their feed *every day*. Plus they have their own non-AngelList dealflow. So you may get a few intros this way (and we're working on some things to increase the rate of these spontaneous intros).

[Get an intro](#)

Since the investors can't review every startup profile, the AngelList admins (Nivi, Naval<sup>28</sup>, Brendan<sup>29</sup>), with help from a few crazy investors and scouts<sup>30</sup>, review *every single startup* that

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<sup>26</sup><http://angel.co/intro>

<sup>27</sup><http://venturehacks.com/articles/angel-picker>

<sup>28</sup><http://angel.co/naval>

<sup>29</sup><http://angel.co/brendan>

<sup>30</sup><http://venturehacks.com/articles/scouts>

that pops up in their feed. If any of them like a startup, they can e-mail it to their followers<sup>31</sup>.

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<sup>31</sup>[http://angel.co/angels?order\\_by=followers](http://angel.co/angels?order_by=followers)

To (leave blank to send to all of your followers)

Subject

Note (optional)

Send me a Test Email      Cancel      Share

And that's where the magic<sup>32</sup> happens—investors pay attention to the startups that land in their inboxes and take intros.

### 3. How long does it take to get feedback?

Before an admin emails your startup to investors, they'll get in touch and suggest some improvements to your startup profile. This usually happens a few days after you create your profile.

If you don't hear from an admin by then, keep updating your profile as you make progress. We're working on tools that let you notify investors when you've made significant progress. And we're working on tools to give you specific feedback on what you need to improve before you can get intros on AngelList.

### 4. Start early, update often

It's never too early to start your profile. Pick zero investors and leave a note for the admins that says you're still working on your profile.

If you have any questions, please email us at team@angel.co<sup>33</sup>.

*AngelList is changing every day, so don't expect this post to be accurate 3 months from now. That's just the nature of building software on the Internet today—perpetual design and redesign.*

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<sup>32</sup><http://venturehacks.com/articles/why-angellist>

<sup>33</sup>mailto:team@angel.co

## Tour: Markets on AngelList

AngelList now has markets at <http://angel.co/markets><sup>34</sup> and we're using them to match startups and investors. The markets look like this:

**Markets**  
[Name](#) · [Recently Added](#) · [Followers](#) · [Blockers](#)

### Information Technology

418 followers · 1 blocker

- » Internet
- » Mobile
- » Software
- » Games
- » Big Data
- » Analytics
- » Marketplaces
- » Telecommunications
- » Hardware
- » Retail Technology
- » Real Time
- (more)

35

Startups add markets to their profile, investors follow markets, and we match them. Magic!

### 1. Adding markets to startup profiles

Startups can add 4 markets to their profile:



And here's what a startup sees while they're editing their markets:

<sup>34</sup><http://angel.co/markets>

<sup>35</sup><http://angel.co/markets>



## 2. Adding markets to investor profiles

Investors can add markets to their profile with a similar interface:

**Markets I'm Interested In** [Edit](#)  
[Information Technology](#), [World Domination](#)

**Markets I'm Not Interested In** [Edit](#)  
[Baby Accessories](#)

(For example, check out the markets Mitch Kapor<sup>36</sup> is following and blocking.)

You won't see this part unless you're an approved investor, but investors can also **follow** and **block** markets from various places on the site like <http://angel.co/markets><sup>37</sup>:

[Cloud Computing](#) [Follow Market](#) [Block Market](#) • 70 Followers • 2 Blockers • 14 Startups

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<sup>36</sup><http://angel.co/mkapor>

<sup>37</sup><http://angel.co/markets>

...or any market page like the cloud computing<sup>38</sup> page:



### 3. Matching startups and investors

If an investor **blocks** a market, the admins won't email them startups in that market at all (but investors can still find these startups on the website).

If an investor **follows** a market, the admins will email them startups in that market before everybody else. If the startup performs well among those investors, the admins will email it to everybody else (who isn't blocking the startup's markets).

### Organizing the markets with a tree

Investors don't need to worry about following and blocking every single market on AngelList. The markets are set up as a tree—like your desktop file system—with markets inside other markets. So when investors follow a market, they also follow its submarkets. Likewise with blocking.

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<sup>38</sup><http://angel.co/cloud-computing>

If you prefer to view the markets as a flat list, go to <http://angel.co/markets/list><sup>39</sup>

[View List](#) · [View Tree](#)

## Sorting

Whether you're viewing the markets as a tree or list, you can sort them by *name*, *recently added*, *# of followers*, and *# of blockers*. Approved investors can also sort the markets by *# of startups*. Here's a picture of the the flat list<sup>40</sup>, sorted by followers:

<b>Markets</b>	
	<a href="#">Name</a> · <a href="#">Recently Added</a> · <a href="#">Followers</a> · <a href="#">Blockers</a>
<b>Information Technology</b>	419 followers · 1 blocker
<b>Internet</b>	269 followers · 7 blockers
All Parents: Information Technology	
<b>Mobile</b>	259 followers · 2 blockers
All Parents: Information Technology	
<b>Consumer Internet</b>	245 followers · 3 blockers
All Parents: Internet, Consumers and Information Technology	

41

## Searching for markets

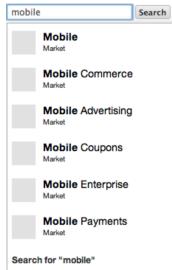
The search box at the top left of the site lets you search for investors and markets (and startups too, if you're an approved investor):

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<sup>39</sup> <http://angel.co/markets/list>

<sup>40</sup> <http://angel.co/markets/list>

<sup>41</sup> <http://angel.co/markets/list>



Again, investors who follow mobile<sup>42</sup> will also follow all of its submarkets like mobile commerce<sup>43</sup>, mobile advertising<sup>44</sup>, etc. Or if they're only interested in mobile coupons<sup>45</sup>, they can just follow that instead.

## Stealing from Quora

We stole a lot of the design for markets from Quora's topics<sup>46</sup>. There are some differences and technical details that we'll write about soon. But we refer to Quora and Facebook a lot while we're designing. The rest of the web is going to look like Quora in a few years anyway, so you may as well **steal from the best**.

## Serving new markets

We're very excited about this feature. It's going to increase the relevancy of the startups that we send investors. And it will let

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<sup>42</sup><http://angel.co/mobile>

<sup>43</sup><http://angel.co/mobile-commerce>

<sup>44</sup><http://angel.co/mobile-advertising>

<sup>45</sup><http://angel.co/mobile-coupons>

<sup>46</sup><http://www.quora.com/Topics-on-Quora>

us serve startups and investors in markets that we haven't been able to serve before (biotechnology<sup>47</sup>, clean technology<sup>48</sup>, life sciences<sup>49</sup>, you name it).

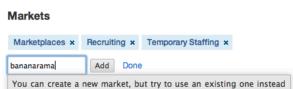
The markets tour continues in Part 2<sup>50</sup>.

## AngelList Markets Tour, Part 2: The Details

See Part 1<sup>51</sup> for an introduction to the new markets feature on AngelList. This part is all about the details.

### Creating new markets

We encourage people to use the existing markets<sup>52</sup>, but anyone can create a new market:



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<sup>47</sup><http://angel.co/biotechnology>

<sup>48</sup><http://angel.co/clean-technology>

<sup>49</sup><http://angel.co/life-sciences>

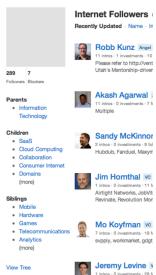
<sup>50</sup><http://venturehacks.com/articles/markets-details>

<sup>51</sup><http://venturehacks.com/articles/angellist-markets>

<sup>52</sup><http://angel.co/markets>

## Admins organize the new markets

The admins regularly review new markets and delete, rename, alias<sup>53</sup>, or merge<sup>54</sup> them (we stole this straight from Quora<sup>55</sup>). Only the admins have these powers and only the admins can set the parents and children of a market. For example, see Internet's parents and children in the sidebar at <http://angel.co/internet><sup>56</sup>:



...and you can see the full Internet tree at <http://angel.co/internet/tree><sup>57</sup>.

## Trying to make it “just work”

I don't think we could have made a list of 20 canonical markets and called it a day. Believe me, we tried—and it would have been a lot easier. Just check out the rich set of markets here<sup>58</sup>—20 hand-picked markets wouldn't do justice to the diverse interests of investors and startups.

<sup>53</sup> <http://www.quora.com/How-do-topic-aliases-work-on-Quora-and-what-are-some-good-examples>

<sup>54</sup> <http://www.quora.com/Why-bother-having-Merge-Topics-as-an-option-isn't-using-Topic-Alias>

<sup>55</sup> <http://www.quora.com/Topics-on-Quora>

<sup>56</sup> <http://angel.co/internet>

<sup>57</sup> <http://angel.co/internet/tree>

<sup>58</sup> <http://angel.co/markets>

It's also the nature of venture capital to chase new markets, whether it's a broad new market like Mobile<sup>59</sup> or a specific one like Location Based Services<sup>60</sup>. A static set of markets defeats the purpose.

So we let anyone create a new market and we use tricks to keep things from spinning out of control. I've already written about how admins organize the markets. Next, we hide markets with fewer than 10 followers:

**Business Intelligence**  
11 followers · 1 blocker

**Design**  
11 followers · 1 blocker  
Product Design  
Web Design

(more) Show markets with fewer than 10 followers

Third, we use color to indicate that following a market also implicitly follows its children. For example, I just followed Mobile<sup>61</sup> and all of its children turned green:

**Information Technology**  
426 followers · 1 blocker · 511 startups

- Internet
- ▼ Mobile [Unfollow Market] Block Market • 265 Followers • 2 Blockers • 123 Startups
  - Location Based Services
  - Mobile Commerce
  - Mobile Advertising
  - iOS
  - Tablets
  - Mobile Coupons
  - Mobile Enterprise
  - Mobile Payments
  - Android
- (more)

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<sup>59</sup><http://angel.co/mobile>

<sup>60</sup><http://angel.co/location-based-services>

<sup>61</sup><http://angel.co/mobile>

If I hover over one of Mobile's children, I see a message like this:



So if you're already following Mobile<sup>62</sup>, you don't need to follow Mobile Commerce<sup>63</sup>. But the "Follow Anyway" link lets investors add Mobile Commerce to their profile, if they want to show startups that they're specifically interested in Mobile Commerce.

## The markets are technically not a tree

Even though I say that the markets are organized in a tree—like your desktop file system—that's not technically true. They're actually a directed acyclic graph<sup>64</sup> (DAG). The main difference between a DAG and a tree is that a market can have multiple parents. It's as if a file on your desktop could be in two folders at once.

For example, Games<sup>65</sup> has two parents: Information Technology<sup>66</sup> and Consumers<sup>67</sup>. You can see the Games tree at <http://angel.co/games/tree>

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<sup>62</sup><http://angel.co/mobile>

<sup>63</sup><http://angel.co/mobile-commerce>

<sup>64</sup><http://www.quora.com/Are-Quora-topic-hierarchies-a-directed-acyclic-graph>

<sup>65</sup><http://angel.co/games>

<sup>66</sup><http://angel.co/information-technology>

<sup>67</sup><http://angel.co/consumers>

<sup>68</sup><http://angel.co/games/tree>



Structuring the markets as a DAG is *Yet Another Idea I Stole from Quora™*. It would have been impossibly difficult to implement markets with an actual tree—we would have had to put each market inside *exactly one* parent. Where would you put Games<sup>69</sup> or Mobile Enterprise<sup>70</sup> or Digital Media<sup>71</sup>? Multiple parents ease the burden of organizing markets.

(Crazy people can learn more about different classification systems like DAGs, tags, and trees here<sup>72</sup>).

## The most accurate set of market names in the world?

Back in the day, when investors applied to AngelList, we had a text box that asked investors to list the markets they’re interested in, and the markets they’re *not* interested in. We extracted the initial set of market names from this text. Then we automatically made those investors follow and block those markets. Finally, we replaced the text-box with a nice autocomplete form:

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<sup>69</sup><http://angel.co/games>

<sup>70</sup><http://angel.co/mobile-enterprise>

<sup>71</sup><http://angel.co/digital-media>

<sup>72</sup><http://www.quora.com/What-are-the-different-types-of-classification-structures/answer/Robin-Green>



I think we now have the most accurate set of venture capital market names in the world. First, the initial markets were self-reported by investors, so they came up with their own names for markets. Second, there was no autocomplete until very recently, so each investor named their markets independently, without looking at what other investors were doing.

In other words, investors voted for market names independently, without being influenced by how other investors were naming markets—and that's a critical component of a wise crowd<sup>73</sup>.

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<sup>73</sup>[http://en.wikipedia.org/wiki/The\\_Wisdom\\_of\\_Crowds](http://en.wikipedia.org/wiki/The_Wisdom_of_Crowds)

# February 2011

## VCs are generalists, and other lies

The venture industry works on the premise that investors are generalists and entrepreneurs are specialists. VCs are good at being, well, VCs, and the entrepreneurs have to be really good at whatever specific task they set out to do.

This isn't by choice—ask an entrepreneur what they're looking for in an investor and they won't say things like "advice, corporate governance, recruiting." Entrepreneurs would prefer someone who has specific connections, interest, and knowledge about the market they're attacking and the technology they're building.

The problem is that it's very, very difficult to find VCs by sector and expertise. The new markets<sup>1</sup> feature on AngelList solves that problem. For example, a smartphone baby monitoring company joined AngelList. They wanted to meet investors with who had expertise in Analytics<sup>2</sup>, Babies<sup>3</sup>, Consumer Electronics<sup>4</sup>, Parenting<sup>5</sup>, and Mobile<sup>6</sup>. A music startup joined AngelList and wanted to know which investors still love the music<sup>7</sup> market (and which hate it<sup>8</sup>).

Now you can go find your specialist investor. The one who can *really* add value. Try the search box or browse<sup>9</sup>.

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<sup>1</sup><http://angel.co/markets>

<sup>2</sup><http://angel.co/analytics>

<sup>3</sup><http://angel.co/babies>

<sup>4</sup><http://angel.co/consumer-electronics>

<sup>5</sup><http://angel.co/parenting>

<sup>6</sup><http://angel.co/mobile>

<sup>7</sup><http://angel.co/music>

<sup>8</sup><http://angel.co/music/blockers>

<sup>9</sup><http://angel.co/markets>

## VCs (slightly) more active than angels on AngelList



Liz Gannes from AllThingsD has a great article<sup>10</sup> on AngelList today:

“AngelList ran the numbers this week and found that venture capitalists are actually more active than angels on its year-old service...

“Currently, 725 angels and 557 venture capitalists subscribe to their matchmaking service. (Nivi counts 378 of the VCs as multi-stage investors, and 179 as seed-fund investors.)...

“AngelList doesn’t formally track the investments that occur due to those intros, but Nivi estimated that the service has helped orchestrate funding for 219 start-ups from 384 investors.

“AngelList counts about half of the investors in each category as active participants. Active seed fund investors have taken 5.6 AngelList intros on average, active multi-stage VCs have taken 5.4, and angels have taken 5.

Read the article<sup>11</sup> to find out who are the 5 most active VCs on

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<sup>10</sup><http://networkeffect.allthingsd.com/20110215/venture-capitalists-actually-slightly-more-active-than-angels-on-angellist/>

<sup>11</sup><http://networkeffect.allthingsd.com/20110215/venture-capitalists-actually-slightly-more-active-than-angels-on-angellist/>

AngelList and which VCs have recently invested in startups via AngelList.

We generated most of the data in Liz's article at her request. It's always fun answering questions from reporters like Liz because they force you to think.

## **Venture Hacks sucks now, all you talk about is AngelList**

Some people<sup>12</sup> don't like our posts about AngelList. I've heard this enough times now that I want to address it. But first, thanks for the feedback and for reading our stuff. Here we go...

AngelList is product-izing everything we've written on Venture Hacks. Would you rather do a search on Google or would you rather have Larry and Sergey tell you how to use the Dewey Decimal system?

Nothing would make me happier than making everything we've written on Venture Hacks irrelevant. Our motto at the office is "productize yourself." And I think you can learn as much from our posts about AngelList as any of our posts on how to structure your board of directors<sup>13</sup>.

That said, we'll try to write more about non-AngelList topics. As always, thanks for the feedback and for reading our stuff.

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<sup>12</sup><http://venturehacks.com/articles/active-angellist/comment-page-1#comment-13566>

<sup>13</sup><http://venturehacks.com/topics/board-of-directors>

## 4 types of scale

You can't do all the work in a startup yourself. So you have to scale. Here are four ways to scale:

1. People
2. Product
3. Capital
4. Community

In detail:

1. *People.* Hire people to help you. This will be your first instinct but it should really be your last resort.
2. *Product.* Build product to do the work for you. Every single product in the world is a type of scale. Facebook has taken this to the extreme through automation<sup>14</sup>.
3. *Capital.* This is what VCs do. They raise billions of dollars, invest it, let their CEOs manage it, and hopefully profit.
4. *Community.* This isn't a recent innovation but it might seem that way. Communities have been banding together for a long time to form countries, topple dictators, knit, save the environment and so on. But now they're forming quicker than ever and building products like Wikipedia.

Which kinds of scale are you using and why?

*Note: I prefer the word leverage to scale because it implies that there is a goal and that one should not scale for its own sake.*

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<sup>14</sup><http://algeri-wong.com/yishan/engineering-management-tools-are-top-priority.html>

## Are founders really 1000x more valuable than employees?

Is it fair for founders to own about 100% of a startup while employee #1 only owns a few percent? Are founders 10-1000x more valuable than employees?

The answers are

1. Yes, it is fair.
2. Value doesn't matter, timing does.

In fact, **many employees get better equity deals than the founders**. There are two cases.

### **1. The founders are not intrinsically fundable**

When the founders start the company, it is worth approximately \$0. So their equity is worth \$0.

Let's say the founders work for 6 months, make progress, and then raise money at a \$10M post. Then employee #1 joins and gets 1% of the company. So his shares are worth \$100,000.

So each founder got \$0 of stock when he joined the business. The employee got \$100,000 of stock when he joined the business.

**Every employee that joins the business gets more stock than the founders did.** Not in shares, or as a percentage of the company. But in the only metric that really matters, the dollar value of stock *at the time the employee joins*.

That's why some people say that anyone who joins a company before they raise money is a founder. In other words, anyone who joins the company before the stock has value to a third party, is considered to be a founder.

## 2. The founders are intrinsically fundable

Some founders can raise money with nothing to show other than their smiling faces.

Let's say the founders raise money at a \$10M post-money, simultaneous with founding the company. In this case, *the market is valuing the founders' contribution at \$10M.*

Then the company identifies employee #1 and tries to hire her. The company will have to compete with every company in the world for that employee, and therefore *the market, not the company, is setting the employee's compensation.*

### Addendum

Measuring your stock in dollars<sup>15</sup> is not at odds with measuring your stock in percentages<sup>16</sup>. They're just different views on the same data. If you're an employee at Facebook and the stock price is monotonically increasing, look at the dollar value of your stock. If you're joining a company today and you're trying to figure out what you get if the company sells for \$100M, use percentages.

*(Note: This is the first time I'm testing this argument. Be gentle.)*

## Fred Wilson's 5 rules for market fit

If you're looking for more non-AngelList content go subscribe to my posts on Quora<sup>17</sup>.

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<sup>15</sup><http://venturehacks.com/articles/share-price>

<sup>16</sup><http://cdixon.org/2009/08/27/the-one-number-you-should-know-about-your-equity-grant/>

<sup>17</sup><http://www.quora.com/Babak-Nivi/posts>

The latest post, Fred Wilson's 5 rules for finding product/market fit and turning it into dollar bills y'all<sup>18</sup>, is a winner.

Here's an RSS<sup>19</sup> feed of my Quora activity, but it's not just posts, it includes activity like votes too.

Finally, I'm always posting the best startup content on the Web to the @venturehacks<sup>20</sup> Twitter feed. I read all the startup blogs, Hacker News, Quora, etc. and tweet about the best of the best.

## Taulia raises Series A from top performing VC fund of all time — via AngelList

Startups are starting to raise Series A's and B's from big VCs<sup>21</sup> on AngelList (*Ed: We should have spent more than 30 seconds thinking of a name for the site*).

Taulia<sup>22</sup> recently raised a \$3M Series A from Matrix Partners<sup>23</sup> via AngelList. Josh Hannah<sup>24</sup> from Matrix has joined Taulia's board of directors. Trinity Ventures and The Angels' Forum also participated in the round.

Matrix doesn't have the biggest brand in the VC world but they do have the **top performing VC fund ever**<sup>25</sup>. Which is insane. We're very happy to have them in the community.

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<sup>18</sup><http://www.quora.com/Babak-Nivi/Fred-Wilsons-5-rules-for-finding-product-market-fit-and>

<sup>19</sup><http://www.quora.com/Babak-Nivi/rss>

<sup>20</sup><http://twitter.com/venturehacks>

<sup>21</sup><http://angel.co/vc>

<sup>22</sup><http://taulia.com>

<sup>23</sup><http://www.matrixpartners.com/>

<sup>24</sup>[http://www.matrixpartners.com/site/team\\_detail/josh\\_hannah/](http://www.matrixpartners.com/site/team_detail/josh_hannah/)

<sup>25</sup>[http://paul.kedrosky.com/archives/2010/10/all-time\\_best-p.html](http://paul.kedrosky.com/archives/2010/10/all-time_best-p.html)



Here's what Bertram Meyer<sup>26</sup>, Taulia's CEO told me about the experience:

"We were distributed on AngelList one Friday evening based on a signed term sheet from The Angel's Forum and some initial traction. Requests for introductions started to come in immediately and by the end of the weekend we had received close to 40 requests; the majority from senior partners at top VCs. We felt a great fit with Josh Hannah and David Skok from Matrix, who also were the fastest to commit, such that we were oversubscribed by next Wednesday. 4 weeks later we closed our round with Matrix, Trinity Ventures and TAF, but **compared to the initial term sheet we had more than doubled the round size and significantly increased the pre-money**. Hindsight my only mistake was to contact Naval a bit too late in the process—had I known how powerful AngelList is (and how willing Naval is to give advice), I would have done so much earlier."



I also reached Josh Hannah<sup>27</sup> from Matrix for a quote and he said:

"AngelList is a powerful service for connecting entrepreneurs with the investors who can be the most

<sup>26</sup>[http://www.taulia.com/page/taulia\\_management](http://www.taulia.com/page/taulia_management)

<sup>27</sup>[http://www.matrixpartners.com/site/team\\_detail/josh\\_hannah/](http://www.matrixpartners.com/site/team_detail/josh_hannah/)

helpful to their business. For Matrix, the Taulia investment was as close to a no-brainer as you'll see: a full battle-tested team, on their second venture together, in a market they know intimately. Put that together with the deep expertise in scaling a SaaS business that Matrix can bring, and I think together we have a shot to build a really big company."

## What does a typical AngelList email look like?

Here's the email that Naval sent to the investors that Taulia wanted to meet (I've updated it a bit to meet Naval's current email style):

Subject: Taulia - Enterprise discount network, serial entrepreneur  
Taulia "helps Global 2000 corporations save tens of millions of dollars.  
Thanos Triant (investor in Postini) and The Angels' Forum are coming.  
[1-2 sentences about traction normally go here. Redacted for obvious reasons.]  
The founders previously founded and sold Ebydos, a provider of APAs.  
Taulia is based in San Francisco and is raising a \$xM Series A and B.

Every elevator pitch should be this short: product, social proof, traction, team, location, deal. The end.

The other thing you should know about AngelList is that Naval and I are not the only people who can share startups via email. **Anyone can share a startup with their followers**<sup>28</sup>. And we're building tools to make that easier and move obvious. Naval and I want to get out of the dealflow curation business and let the community curate dealflow. And it's already starting to happen.

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<sup>28</sup>[http://angel.co/investors/all?order\\_by=followers](http://angel.co/investors/all?order_by=followers)

If you're an investor, there are more Series A's and B's happening on AngelList right now. And if you're a startup raising a venture round, please get in touch via AngelList<sup>29</sup>.

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<sup>29</sup><http://angel.co>

# March 2011

## AngelList Goes Global

We can now match investors and startups based on location at <http://angel.co/locations><sup>1</sup>.

It's simple. Investors follow locations and startups add location(s) to their profile. Then they get matched.

### Browse

Browse by continent<sup>2</sup>, country<sup>3</sup>, region<sup>4</sup>, or city<sup>5</sup>. Here's a screenshot of Silicon Valley<sup>6</sup>:

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<sup>1</sup><http://angel.co/locations>

<sup>2</sup><http://angel.co/continents>

<sup>3</sup><http://angel.co/countries>

<sup>4</sup><http://angel.co/regions>

<sup>5</sup><http://angel.co/cities>

<sup>6</sup><http://angel.co/silicon-valley>



**610**  
Followers      **602**  
Startups

#### Parents

- California
- United States

## Silicon Valley

Sort by popularity: [Today](#) · [Week](#)

Startup in [Communities, €](#)  
19 intros to [Dan Rosen, George Z...](#)

Startup in [Telephony, Sal...](#)  
12 intros to [Ryan Spoon, Christoph...](#)

Startup in [Personal Health](#)  
83 intros to [Dan Rosen, Kal Vepuri,](#)

Startup in [Mobile, Clean T...](#)  
45 intros to [Christoph Janz, Jason ...](#)

## I want to see everything

If you're an investor and you want to see everything, follow Earth<sup>7</sup>. But you should still follow other locations if you're particularly interested in them. It will help our code and community match you to interesting startups.

## Where are the startups?

San Francisco and New York are essentially tied for the top spot<sup>8</sup>:

<sup>7</sup><http://angel.co/earth>

<sup>8</sup><http://angel.co/cities>

## San Francisco

618 followers · 303 startups

## New York City

273 followers · 301 startups

## Los Angeles

151 followers · 158 startups

## London

108 followers · 85 startups

## Chicago

92 followers · 81 startups

## Austin

80 followers · 67 startups

## Boston

172 followers · 62 startups

## Flattening and Fattening

The Internet is obviously flattening investing. So investors in India can find good startups in New York. And startups in Austin can find good investors in Europe.

**But I think it will also *fatten* cities all over the world.** So startups in Paris can find investors in Paris. And investors in Moscow can find startups in Moscow. We just need to fatten up those cities. There's no reason we can't have Silicon Valleys all over the world<sup>9</sup>.

## **Mark Suster interviews AngelList survivor TODAY (Wednesday 5pm Pacific)**



@msuster

Mark Suster

My guest on [#TWiVC](#) on Wed 5pm raised \$2m on [@angellist](#) including from [@davemcclure](#) - tune in to find out who he is & what he's learned

28 Feb via web [Favorite](#) [Undo Retweet](#) [Reply](#)

Mark Suster<sup>10</sup> is interviewing a founder who used AngelList on This Week in Venture Capital<sup>11</sup>. Today. This Wednesday 5pm Pacific. The show is live and you can send in questions. Watch

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<sup>9</sup><http://www.paulgraham.com/siliconvalley.html>

<sup>10</sup><http://www.bothsidesofthetable.com/>

<sup>11</sup><http://thisweekin.com/thisweekin-venture-capital/>

it here<sup>12</sup>.

If you've been reading this blog for the last few months, you know we're big fans of Mark<sup>13</sup>. You may also know Mark as the guy who wrote this<sup>14</sup>.

I never miss an episode of Mark's show—it helps me get into the work groove while I'm brushing my teeth in the morning.

Mark is being very stealthy about who he's interviewing and your guess<sup>15</sup> is as good as mine. The AngelList team<sup>16</sup> is going to be watching it live. See you there.

## Thoughts on Investing

“The easiest way to become a millionaire is to start off a billionaire and go into the airline business.”

— Richard Branson

**Summary:** Every investor uses social proof to filter dealflow; Ron Conway has a fund that uses social proof as the sole investment criterion. Angels should almost do more homework than a professional VC would—VCs invest other people's money while angels invest their own. We should all be thankful that we live in a world in which VCs exist. Finally, the accelerating returns on innovation means that all of the value in the public markets will be shrunk and put in the hands of startups.

I'm not an investor. And maybe that's a good thing. Because it means I don't have an investment philosophy.

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<sup>12</sup><http://thisweekin.com/thisweekin-venture-capital/>

<sup>13</sup>[http://www.google.com/search?sourceid=chrome&ie=UTF-8&q=site:  
http://venturehacks.com+%22mark+suster%22](http://www.google.com/search?sourceid=chrome&ie=UTF-8&q=site:http://venturehacks.com+%22mark+suster%22)

<sup>14</sup><http://techcrunch.com/2011/02/26/angelist/>

<sup>15</sup><http://www.quora.com/What-do-people-think-of-AngelList>

<sup>16</sup><http://twitter.com/angellist/team/members>

Naval has a personal investment philosophy<sup>17</sup> that he uses for his own investments—it's focused and it has nothing to do with social proof. But there is no AngelList investment philosophy. The site helps startups and investors connect and the rest is up to them.

## On Social Proof

Almost every investor uses social proof to filter dealflow. They just call it a “personal intro” or a “referral”. In fact, it’s usually the first filter they apply.

*If social proof is a good filter, is it also a good investment strategy?* Can I make my entire investment decision based solely on social proof? Will I make money if I invest in a company just because Warren Buffet invested in it, as long as I get the same price<sup>18</sup> as him?

As in all investment matters, the answer is “who knows”. When I share a startup on AngelList, I consider the company’s traction, product, team, and social proof—in that order. If you do a great job with an early item on that list, it doesn’t really matter how bad the later items look.

But some interesting people are pursuing the social proof strategy. Yuri Milner, Ron Conway, and David Lee created Start Fund to “blindly” invest in every Y Combinator startup. And several VC funds are set up to provide follow-on capital to startups backed by Sequoia, Benchmark, Khosla, and other tippy-top-tier venture funds.

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<sup>17</sup><http://venturehacks.com/articles/investment-criteria>

<sup>18</sup><http://www.quora.com/Is-social-proof-a-rational-approach-to-investment-selection/answer/Naval-Ravikant>

## On Angels

If you're going to invest your own money in private companies, as an angel or otherwise, get educated. Read Mark Suster<sup>19</sup>'s series on angel investing. Listen to our (old and somewhat out of date) podcast<sup>20</sup> on the topic.

*Angels should almost do more homework than a professional VC would—VCs invest other people's money but angels invest their own!*

And don't invest in a startup if you can't lose all that money *tomorrow*, with a smile on your face. Frankly, I wouldn't invest in *anything* if it didn't meet that criterion (except money markets and very broad, low-fee index funds).

## On VCs

We've gotten about half a dozen Series A's and B's funded on AngelList, and we have 400 happy VCs<sup>21</sup> on the site. I think Marc Andreessen put it<sup>22</sup> best, well before he became a VC:

“Why we should be thankful that we live in a world in which VCs exist, even if they yell at us during board meetings, assuming they'll fund our companies at all:

“Imagine living in a world in which professional venture capital didn't exist.

“There's no question that fewer new high-potential companies would be funded, fewer new technologies

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<sup>19</sup><http://www.bothsidesofthetable.com/2010/09/14/angel-investing-1-dealflo...>

<sup>20</sup><http://www.slideshare.net/venturehacks/how-to-be-an-angel>

<sup>21</sup><http://angel.co/vc>

<sup>22</sup><http://pmarca-archive.posterous.com/the-truth-about-venture-capitalists-part-2>

would be brought to market, and fewer medical cures would be invented.”

## On Startups

Startup valuations are up. That’s because capital is flowing into the system and, therefore, there is more demand. That’s a cyclical trend: the amount of available capital will go up and down and so will valuations.

But there are some secular trends that are driving up valuations.

First, many investors believe that the vast majority of returns come from a few new companies every year and, therefore, those companies attract a disproportionate amount of investor interest.

Second, startups are getting better at creating a market for their shares<sup>23</sup> and unbundling capital, control, and advice<sup>24</sup>. This is where AngelList can help.

Third, startups have become a (bit of a) science. Entrepreneurs are much smarter about the art of building companies than they were even five years ago.

Fourth, the accelerating returns on innovation<sup>25</sup> means that all of the value in the public markets will be shrunk<sup>26</sup> and put in the hands of startups. The NYSE alone has \$14 trillion of value. NASDAQ has almost a trillion dollars of volume *every day*. Today’s startups are the heirs to that value.

Of course, today’s startups will be disrupted by more startups. And on and on, with shorter and shorter time cycles. But I don’t

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<sup>23</sup><http://venturehacks.com/articles/create-a-market>

<sup>24</sup><http://startupboy.com/2010/12/01/the-unbundling-of-the-venture-capital-industry>

<sup>25</sup><http://www.kurzweilai.net/the-law-of-accelerating-returns>

<sup>26</sup>[http://redeye.firstround.com/2006/04/shrink\\_a\\_market.html](http://redeye.firstround.com/2006/04/shrink_a_market.html)

think big companies will hold onto this value. The principal-agent<sup>27</sup> problem is too pervasive, among many other reasons that big companies are considered “dumb”.

[Click the links in this post, they’re all good.]

## The first 1000x in valuation is the easiest

I recently wrote<sup>28</sup> that it’s “fair for founders to own about 100% of a startup while employee #1 only owns a few percent.”

My argument was that the dollar value of stock that founders get when they start the company is actually *less* than the dollar value of stock that employees get when they join the company. The disparity between founders and employees is therefore just a matter of timing.

There’s a corollary to this theorem:

*The first 1000x in valuation is the easiest.*

The first 1000x in stock appreciation is easier than the next 1000x. Here’s why:

Let’s say the company is worth \$1 when you start. To get a 1000x increase in valuation, you only need to grow the company to \$1000 in value. So if you join a company when it’s worth \$1, you only have to create \$999 of value for your stock to appreciate 1000x!

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<sup>27</sup>[http://en.wikipedia.org/wiki/Principal-agent\\_problem](http://en.wikipedia.org/wiki/Principal-agent_problem)

<sup>28</sup><http://venturehacks.com/articles/employees-founders>

If someone else joins the company after it's already worth \$1000, he has to create \$999,000 of value for his stock to appreciate 1000x!

To get a 1000x return on your stock, you either have to create \$999 or \$999,000 of value. One of these is easier. By 1000x.

The first 1000x is the easiest, because it is easier in an absolute sense.

## Launch: The AngelList Blog

AngelList now has a sweet new blog<sup>29</sup>. Therein, the AngelList team<sup>30</sup> expounds upon the latest features, including screenshots that are sure to bring you great joy.

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<sup>29</sup> <http://blog.angel.co>

<sup>30</sup> <http://twitter.com/#!/angellist/team/members>

## Sample Startups

Investor



**Tinychat**

Group Video Chat Community

Advisor



**Gambit**

Branded social video distribution

Team Member



**AngelList**

Badass community of startups and investors

Investor

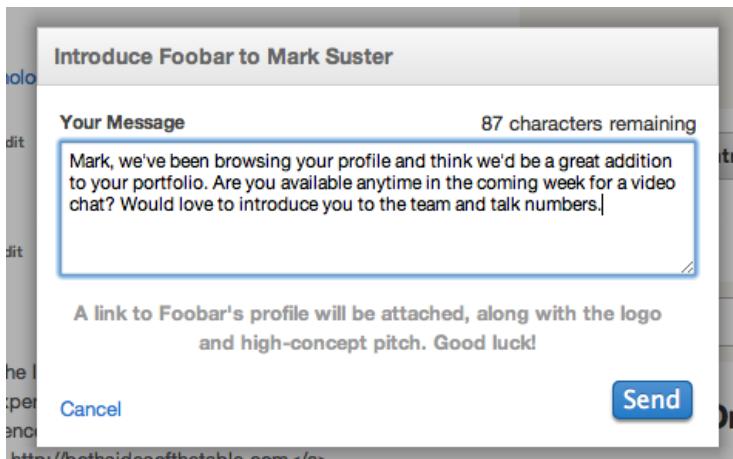


**Zaarly**

Hyper-local, real-time, Craigslist For Buyers

MARCH 2011

1220



AngelList — Boom goes the dynamite Search

Mark Suster · Inbox · Help · Logout

Mark Suster Edit Your Profile

Startups Investors Activity Markets Locations

Also have a startup? Create a Startup Profile

Introducing...

Foobar  
"GitHub meets OpenTable meets Groupon!"

Mark, we've been browsing your profile and think we'd be a great addition to your portfolio. Are you available anytime in the coming week for a video chat? Would love to introduce you to the team and talk numbers.

Mark Suster

Reply...

Reply

Our team is using the AngelList blog to post our weekly progress.

We used to put it on Yammer, but now we're posting it publicly on the blog. So don't expect polished posts with the "final" version of each feature. We'll be sharing works in progress (that we've shipped).

So check out the AngelList blog<sup>31</sup> and stay up to date on our endless product developments. We promise a steady stream of pretty pictures.

## **So who is actually investing on AngelList?**

Mike at TechCrunch published a nice post<sup>32</sup> today about VCs who use AngelList. I especially like the quote<sup>33</sup> he pulled from DFJ's Josh Stein.

The only part I disagree with is the "VCs hate AngelList" idea. I think it's the opposite—they're all over it like white on rice. What's not to like about high-quality dealflow in your inbox?

Personally, I'm juiced to see firms like Kleiner, Sequoia, Khosla, A16Z, and other "Gods of VC" use the site.

### **Okay, enough preamble, who is actually investing?**

Mike broke the news about which investors are taking intros. Now I want to break some news about which VCs have actually invested via AngelList.

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<sup>31</sup><http://blog.angel.co>

<sup>32</sup><http://techcrunch.com/2011/03/23/venture-capitalists-may-hate-angelist-but-theyre-still-usi>

<sup>33</sup><http://www.quora.com/AngelList/What-do-people-think-of-AngelList/answer/Josh-Stein-1>

We don't have a good way to track who is investing in what. AngelList makes the connection and gets out of the way. But here are a few of the VCs that we know sourced (or reconnected with) a startup via AngelList and then made an investment:

Kleiner Matrix CRV Google Atlas Greylock Softbank Floodgate General Catalyst...

...and angels and seed funds like Matt Mullenweg, Mitch Kapor, Dave Morin, Jim Young, Jeff Clavier, and tons more listed here<sup>34</sup> and here<sup>35</sup>.

I'm psyched these investors are using AngelList and I'm even more psyched to see startups like Uber, Yipit, Wanderfly, Branchout and a billion more use AngelList to raise money. That's why we're really here—AngelList is a platform for startups.

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<sup>34</sup> [http://angel.co/investors/all?order\\_by=investments](http://angel.co/investors/all?order_by=investments)

<sup>35</sup> <http://www.quora.com/Which-startups-have-been-funded-via-AngelList>

# May 2011

## Are you selling your startup's shares door-to-door?

We've covered this before<sup>1</sup>, but it's worth repeating: don't raise money in series, raise it in parallel.

Don't talk to one investor at a time, talk to all of them at once. It's the only way to get market-clearing terms.

Meeting every investor over a short period of time creates a positive feedback loop of social proof and scarcity that closes deals.

Recently, we've noticed a new way of making this mistake. The entrepreneur says, "I'll use AngelList if my other intros don't work out."

If you can get intros on your own (and all the good startups can), you should use AngelList at the same time, not afterwards. Why?

First, no matter how good your offline network is, it's unlikely to introduce you to the optimal investors<sup>2</sup>, or help you close the deal as quickly as AngelList can.

Second, if your other intros don't work out, AngelList probably won't work out either — the startups that do well on AngelList are the ones that use it to complement their offline intros.

*Related:* Why would a seasoned entrepreneur use AngelList?<sup>3</sup>

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<sup>1</sup><http://venturehacks.com/articles/adam-smith#series>

<sup>2</sup><http://venturehacks.com/articles/why-angellist>

<sup>3</sup><http://venturehacks.com/articles/why-angellist>

## AngelList startup wins TechCrunch Disrupt

Congrats to TechCrunch Disrupt winner GetAround<sup>4</sup>. Guess what<sup>5</sup> they used to raise part of their first round?



6

<sup>4</sup><http://techcrunch.com/2011/05/25/and-the-winner-of-techcrunch-disrupt-nyc-is-getaround/>

<sup>5</sup><http://angel.co/>

<sup>6</sup><http://techcrunch.com/2011/05/25/and-the-winner-of-techcrunch-disrupt-nyc-is-getaround/>

# June 2011

## “A” players write the playbook

Eric Paley’s Curve of Talent<sup>1</sup> is a brutal must-read. I’ve remixed it a bit to come up with the following definitions; the word’s are Eric’s, I’ve just re-ordered them:

**F performers** are not at all productive.

**C performers** struggle to competently fill their role, but are somewhat productive with sufficient coaching. Hard to admit, but most people in the business world don’t have a particularly clear idea on how to do their job well. Startups need to help C players transition out of the organization.

**B players** understand their objectives well and deliver them competently with minimum coaching. Coach B players on the need to not just competently deliver their function, but drive toward innovation within that function.

**A players** write the book and not just read it. They not only have a clear idea how to competently accomplish their functional objectives, but actually lead the organization to innovate and be world class within their functional area. They raise the bar on the entire organization. One way these candidates can be identified during an interview is when they actually teach the interviewer something about how the company can win.

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<sup>1</sup><http://epaley.posterous.com/the-curve-of-talent>

## Reading your legal docs

Go read Elad Gil's You Should Read Every Word of Every Legal Doc<sup>2</sup>.

Some docs are too long and boilerplate to read, so this is how I read financing docs:

- 1. Read and understand everything in the term sheet.**  
But when it comes to the *closing docs*, ask your lawyer to explain all the terms that he has seen written, or could have been written, more favorably to the startup. The closing docs are too long and boilerplate to read.
- 2. Get a good lawyer because you probably don't have one.** You really won't know what a good lawyer is until you've fired a few. I regularly run into lawyers at big firms who give bad advice alongside good advice. Don't assume your lawyer is good just because he works at a big Silicon Valley law firm.
- 3. You probably can't tell the difference between good legal advice and bad legal advice.** So you will need a great advisor like Elad.

You should subscribe to Elad's blog<sup>3</sup>. It is consistently great.

## Getting Leverage in Hostage Negotiations

"Every time the other party says 'I want' in a negotiation, you should hear the pleasant sound of a weight dropping on your side of the leverage scales."

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<sup>2</sup><http://blog.eladgil.com/2011/06/you-should-read-every-word-of-every.html>

<sup>3</sup><http://blog.eladgil.com/>

– G. Richard Shell, Bargaining for Advantage<sup>4</sup>

Most entrepreneurs don't understand the power of positive leverage. Here's a typical situation:

After weeks of fund-raising, you find a brave investor who says "Yes, I want to invest." He says he will give you an offer soon. You're excited. A few days later he delivers a term sheet that you don't like. The valuation is really low. Or the non-economic terms aren't favorable. Your excitement turns to disappointment and frustration. This is the only offer you have so far. What do you do?

First, we hope you've been talking to several investors at the same time and creating a market for your shares<sup>5</sup>. With an adroit touch, you can use this first offer to create the scarcity and social proof that drives other investors to say "yes". At a minimum, you can use this offer to drive investors to make any decision at all — up or down. And keep improving your alternatives<sup>6</sup> until you've a signed term sheet.

But let's assume you don't have any other offers and you have to negotiate with this investor. Or that this investor is your first choice — whether or not you have alternatives.

## Positive leverage

This type of negotiation is similar to a hostage negotiation because you can't walk away from your opponent. You can't say,

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<sup>4</sup><http://www.amazon.com/gp/product/0143036971?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0143036971>

<sup>5</sup><http://venturehacks.com/articles/create-a-market>

<sup>6</sup><http://venturehacks.com/articles/shop-around>

“Yeah, it’s okay, go ahead and kill the hostages, we’re not interested in your demands.”

When you have to negotiate without good alternatives, the tools of positive, negative, and normative leverage<sup>7</sup> are essential. Positive leverage is your ability to provide things that your opponent wants. You have positive leverage when your opponent says, “I want to buy your car”, “I want you to release my friends from jail” or “I want to buy your shares”.

As soon as your opponent says he wants something from you, you have some positive leverage. You control what they want. You can grant them access or deny it. That’s why experienced opponents delay making offers — they don’t want to give you leverage.

## In practice

How does positive leverage work in practice?

First, positive leverage should improve your psychology during the negotiation. You’ve gone from a situation where you want something from the investor to a situation where you both want something from each other. Your psychology is critical in a negotiation because<sup>8</sup> “leverage often flows to the party that exerts the greatest control over and appears most comfortable with the present situation.”

Second, you can now identify other things that your opponent wants and deliver them. Maybe you’re working with a partner who is trying to get his first deal done at the firm. Help him succeed and help yourself in the process. Maybe you’re working with a firm who is excited about stealing a deal from a top-tier firm. Help them succeed. Maybe you’re working with a firm

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<sup>7</sup><http://venturehacks.com/articles/bargaining-for-advantage>

<sup>8</sup><http://venturehacks.com/articles/bargaining-for-advantage>

who wants to co-invest with a top-tier firm so they can show off to their LPs. Help them succeed.

Third, even before investors makes an offer, you gain a little bit of leverage every time they ask for something. Don't try to use it after the first meeting. But if you've been talking to them for three weeks and they're getting deeper and deeper into diligence, you should recognize and use your leverage. At a minimum, you should ask for information about their process and thinking at every step of the way.

The prime time to negotiate is when your opponent says, "I want."

"If they're talking to you, you have leverage."

– Christopher Voss, FBI Negotiator

## Anatomy of an (un)fundable startup

Naval and Mark Suster<sup>9</sup> recently gave the keynotes at the 7th Founder Showcase<sup>10</sup>. Andrew Chen<sup>11</sup> did a better job of describing Naval's keynote than I ever will:

"People spend a surprising amount of time on things that will contribute little or no value to getting them to a seed round, and this talk is the best I've seen in terms of presenting the issues in its entirety.

"Naval broke down the 5 main qualities of an 'exceptional startup,' in the following order:

1. Traction
2. Team
3. Product
4. Social Proof
5. Pitch/Presentation

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<sup>9</sup><http://techcrunch.com/2011/06/18/mark-suster-raise-money-now-so-when-the-partys-over-yo>

<sup>10</sup><http://foundershowcase.com>

<sup>11</sup><http://andrewchenblog.com/2011/06/21/video-the-anatomy-of-a-fundable-startup-by-naval-r>

“And while all these qualities are important, Naval explained, the most important thing is to understand that: ‘Investors are trying to find the exceptional outcomes, so they are looking for something exceptional about the company. Instead of trying to do everything well (traction, team, product, social proof, pitch, etc.), do one thing exceptionally. As a startup you have to be exceptional in at least one regard.’”

Here are the video and slides:

Some of my favorite quotes from the presentation:

“If you can’t generate traction, do you really want to raise money?”

“If you need money to recruit the best, you’re not ready.”

“It’s easier to pitch a new investor than to convert one.”

“Capital is mobile, but capitalists are lazy.”

# **July 2011**

## **But I don't want to follow you on Twitter**

We post links to the very best startup advice on Twitter at @venturehacks<sup>1</sup>. We read Hacker News, the best blogs, Quora, and everything else startup-related. Then we tweet about the best content we find.

But maybe you don't use Twitter. Or you don't want to follow us there. Or you hate us.

Well then, you can subscribe to a daily digest of the links we post on Twitter via email<sup>2</sup> or RSS<sup>3</sup>. Here's a pic of the email version:

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<sup>1</sup><http://twitter.com/venturehacks>

<sup>2</sup><http://eepurl.com/bf28D>

<sup>3</sup><http://feeds.venturehacks.com/venturehacks-twitter>

## A Look Back At Summize

**AVC**— In July 2008, Twitter acquired a company called Summize. The stated reason was to bring search into Twitter. And that was the main reason that Twitter did the deal. But Twitter also got a very strong engineering team in that acquisition. I remember asking Ev and Jack at the time “how are we going to integrate the engineering team?” and Jack replyin...

 *“They did not rebuild Twitter, they just replaced one thing at a time and evolved it.” – @fredwilson, <http://j.mp/cXghWK>*

929 CLICKS 76 TWEETS

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## Aprizi's Customer Development Journey, part 3 – giffconstable.com

**GIFFCONSTABLE**— Aprizi is about to enter that crucial phase of open beta, so I wanted to pause and write down the latest installment in our customer development journey (part 1 and 2). For anyone new to the blog, Aprizi is building a personalization engine for online shopping — a Pandora for e-commerce, if you will. My thesis is that the intersection of tw...

 *“Build something for yourself is not the “best” way to come up with startup ideas. A different way: <http://j.mp/9IqPnW>.”*

582 CLICKS 14 TWEETS

Subscribe via email<sup>4</sup> or RSS<sup>5</sup>.

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# Before product-market fit, find passion-market fit

Before product-market fit, find passion-market fit.

Building a product is a process, not a discrete action. And the Internet is efficiently arbitraged. Every single simple thing that can be done is being done, or has been done. The lesson of

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<sup>4</sup><http://eepurl.com/bf28D>

<sup>5</sup><http://feeds.venturehacks.com/venturehacks-twitter>

history is that product-market fit is very precise—one wrong tweak or slightly bad timing and you can miss the whole thing.

So the only way you're likely to find product-market fit is if you're almost irrationally obsessed with the market and if you've been working on it for a long time. Where the journey is the reward. Then, you're likely to have unique insights (in the details) and consistent execution, through thick and thin, to find fit.

Often, the best companies are ones where the product is an extension of the founder's personality, which shouldn't be a big surprise, since everyone is passionate about themselves.