On Risk and Imagining the Future — Neal Khosla

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10-13 minutes

One of the most important aspects of the Silicon Valley ethos is the emphasis on learning in a startup. In particular, we often see the promotion of learning in the name of risk reduction — you try things, learn, and iterate so you can solve your core risks. I love the notion, introduced by Phin Barnes of First Round, of learning per dollar spent that suggests the most important metric as you scale is your capital efficiency in learning and derisking a business. However, I've been thinking more about the notion of risk in venture-backed startups (aside: this post addresses only venture-backed startups) and I've come to worry that the startup ecosystem doesn't have a healthy relationship with risk. The ecosystem has seemingly forgotten that taking on large risks is actually a core competitive advantage startups have. While incumbents can take on greater financial risk, they tend to shy away from other kinds of risk such as market risk, scalability risk, business model risk, etc. Many well-known pieces of startup advice like starting in a small niche (market risk), "do things that don't scale," (scalability risk) or "look for products that seem like toys," (monetization risk) are just specific incidences of advising a startup that it's OK to take on risk. While derisking per dollar is certainly a metric to shoot for, sometimes it's not possible and we need to be ok with ambitious shots that have sustained risk over long periods of time.

How do you win as a startup?

Startups have a couple of core advantages: constraints, velocity, and agility among them. Constraints on your strategy end up helping you build a differentiated company, product, or solution. For example, not having a network of stores forced Netflix to bet on the alternative content delivery models that beat Blockbuster. Facebook initially targeted college students, which was a user segmentation constraint that helped them cold start (and grow) their network. Velocity has helped many small companies win (e.g., Uber, Amazon, etc.). Velocity, which I consider to mean the speed at which a startup can move in a given direction, is different than agility, which I consider to be how quickly a startup can change directions. Being agile doesn't necessarily mean pivoting, just reacting to new information in some capacity. Agility is a huge advantage startups have over big companies which typically require buy-in from multiple people to act on new information. While constraints, velocity, and agility are frequently discussed, they aren't the only advantages a startup has.

On top of these, I would argue that calculated risk appetite needs to be your biggest advantage. From a strategic perspective, unless you have defensibility that accrues rapidly, moving fast as your only advantage is a recipe for serious competitive pressures. **This is something that both investors and startup founders need to remember and keep in mind.**

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So what does this mean practically? As a startup, you should have *explicitly stated* and *carefully selected* risks. Startups are risky business by nature and your strategy should embrace that. Risk allows you to do things that are objectively foolish and thus nonsensical for other players. That is exactly where you can win. Note that in some cases, such as with Netflix, risks can come from your constraints, but that's not always true. Airbnb was built on the hypothesis that people would rent out their bedrooms. SpaceX decided to build a rocket from scratch. Snapchat built a company around college students sexting. By any measure, these are objectively crazy decisions that worked. Risks can be in your product, market, business model, or technology approach but they can also be baked far deeper into the organization (who you hire, how you hire, your culture, etc.). As a great example, GitLab built a completely remote business from the start and it's a big reason they've been so capital efficient. In the startup world, all our pattern matching efforts are biases. Exceptions are the rule. Never forget this.

I want to add that taking risks means we're going to have overhyped companies that end up being wrong. Failures like Airware, KiOR, and Rethink Robotics are the necessary price of making risky bets on ambitious futures. The nature of challenging the status quo is falling flat on your face sometimes. I don't believe that most of Silicon Valley is okay with this. Currently, Sam Altman and Elon Musk are two of the folks who have put stakes in the ground on exciting visions of the future — Sam on AGI and Elon on space and renewables — but everyone is bothered by this. Instead of saying, "I disagree with you, let's see who's right," we've seen a ton of vitriol and hatred towards them. It's one thing when this comes from the external world, but another when it comes from inside the community. Startups should be a calculated bet on a fundamental hypothesis, not a linear business plan that is highly predictable. These types of bets were what made Steve Jobs **so incredible**. Go dig around his interviews online. His foresight and vision were repeatedly on point and he went and made that future happen. Apple is notorious for taking a far less "lean startup" approach and I believe it was because of Jobs' vision and ability to go build the future they wanted. As Steve said, "I would rather gamble on vision than make a 'me too' product."

Where did the ambition go?

Why don't ambitious visions exist as much as they should? On the part of the founder, it's easier to derisk anywhere you can with strategic choices because **uncertainty is so fucking uncomfortable**. As humans, we do everything we can to dispel with uncertainty, not to sit with it for years at a time. Sitting with uncertainty is part of what makes starting a company so difficult. Dispelling uncertainty, however, is what leads to "let's just build a rocket engine instead of the whole rocket," or, "how about we pivot to a customer with more money?" even if that moves you away from your vision. It's even harder to sit with uncertainty when your board members and investors are insisting you move away from it (ironically, it is **their** business model that warrants this approach). Founders should instead be cognizant and purposeful about what their main risks are and how they are solving them. Lean into those risks and have conviction. In fact, I would argue that you should enumerate them and discuss them with your entire team. Employees should also be familiar with the venture model and how you're approaching it since that is what warrants taking those risks.

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On the part of the investor, prior experiences can lead them away from ambitious visions. I can't tell you how many times I've heard an investor say, "I like what you're doing, but I invested in this space and it didn't work out, so I'm no longer investing here." This is insanely flawed logic. If you believe in something that has very low probability and it doesn't succeed, your probabilistic prior shouldn't be updated significantly. Imagine this: you're a professional sports bettor and you've decided to bet on a horse to win a race because of its great pedigree and early results as a 2 year-old (for horses, big races happen at age 3). The catch is that there are 1000 other horses in the field so even if your horse is better by a standard deviation there's a very low chance it wins. The horse ends up running well but loses the race. Unless you learned something foundational, why would your response be to say "I'm done betting on horse races and instead am going to bet on greyhounds and other equally improbable sporting events?"

Learning from these "mistakes" blinds the startup community from truly exceptional opportunities. I want to be clear and add that this isn't to say that we shouldn't be socially conscious, but that we need to maintain our belief in those better futures we envisioned. For example, the learning from Theranos shouldn't be that we can't build a portable blood test for the whole range of labs with a prick of blood. It should be that fraud is horrible. But does anyone think this is a good time to be starting a new blood diagnostics company in the valley? What lesson did we actually learn as a community? There are a number of historical examples where not having conviction in the vision could've been damaging: there were a plethora of companies touting video streaming on the internet before a small one with a goofy logo called YouTube came around. Google was the 20-something-th search engine. Mark Pincus believed in the social web so much so that after his own social networking startup failed he invested early in Friendster (which publicly flopped), then again in Facebook, and then extended it to the gaming space with Zynga. That's the kind of vision people need to be successful in startups and it starts with a willingness to be wrong.

What does this all mean?

How do you build that conviction? You imagine the future and think backwards. Every startup in Silicon Valley should represent a coherent bet on a hypothesis that could create fundamental prosperity and economic value for humanity. Your beliefs should be strong enough that they go beyond the success or failure of your own company. For example, if you ask me if there will be a world in which every human being can get access to primary health care on their phones at ultra-low cost, the answer is yes. Regardless of what happens to Curai, I believe this is a world that will exist in 10–15 years. Our approach is a bet on how that future comes into fruition. That doesn't mean that I don't question our strategy/methodology, but ultimately I always come back to the same point: this is the way the world will look in the future and we have a plausible shot of building it. In startups, the success or failure of a given initiative probably shouldn't affect your prior beliefs that strongly. We've seen that through YouTube, Webvan, General Magic, or any of the countless rehashed ideas that eventually became successful. Silicon Valley has long been the place where entrepreneurs take longshots at building a better future. Let's keep believing in those futures.

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