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The Rules of Venture Capital - Brad Feld on The Funding Frequency Podcast - Podcast Notes

About The Author MMiller

10-13 minutes

HomeFunding FrequencyThe Rules of Venture Capital – Brad Feld on The Funding Frequency Podcast

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Key Takeaways

- **As a company, focus on what you can be the best in the world at** (as opposed to trying to do lots of different things you're mediocre or good at)
- As a VC firm, have a deliberate strategy that covers:
  - **What you're investing**
  - **How you're investing**
  - **What kind of companies you're helping build and develop**
  - **How you plan to get returns back to your limited partners (LPs)**
- Advice for VCs:
  - **"Understand what your strategy is and define it clearly. Then execute it over a long period of time and over multiple funds. It doesn't mean it's static or can't evolve. It doesn't mean that your mistakes, as well as your successes, shouldn't inform the strategy."** – *Brad Feld*
    - Avoid doing things "just because" – **THINK through your reasoning**
- If you're an early-stage startup, to help prepare for a potential economic downturn:
  - **Ask yourself: "If capital suddenly became unavailable, what would we do so our business could continue running?"**
    - (Most of the time, this relates to what spending you'd cut which might then enable you to become cash flow positive in a short time window)
  - **Then, think about all the second-order effects of other people/companies within your industry reacting to the market downturn**

Books Mentioned

- Brad's book – *Venture Deals*

Intro

- Host – Andrew Waine (@AndrewWaineVC)
- Brad Feld (@bfeld) is a venture capitalist at Foundry Group
  - Check out his blog – Feld Thoughts
  - Check out the full list of his investments here
  - Fun fact: Brad has completed 25 marathons as part of his mission to finish a marathon in each of the 50 states

Venture Deals

- The 4th edition just dropped
  - Check out the book's website
- This edition includes added chapters on:
  - Venture debt (how to raise venture debt, how it works, what lenders are focusing on, how the process impacts your business from an equity perspective, etc.)

    - Hiring an investment banker to help you sell your company
- Brad also added several sections to various chapters on legal-related issues for startups
- Andrew adds – "The 3rd edition was such a helpful resource to me. I recommend everybody listening to check out the 4th edition."

How Brad Got Into Venture Capital

- In 1987, while still a student at MIT, Brad co-founded his first company – Field Technologies, a custom software development startup (it was self-funded)
    - In 1993, they were acquired by a public company (AmeriData) for around $2 million – Brad took the role of CTO
- Over the next few years, between 1994 and 1996, Brad took his earnings and made a series of angel investments in ~40 companies
- In 1997, Brad co-founded Mobius Venture Capital
- In 2007, Brad co-founded Foundry Group

What Brad Learned From Jack Tankersley

- Jack was one of Brad's early mentors in the field of venture capital
- What's the best piece of advice Brad took from Jack?
    - There's quite a bit Brad learned from Jack about investing, but one quip he remembers: "Even pigs can fly in a hurricane"
    - **"What I take away from Jack that sticks with me the most is this intense desire and intense focus on being the best in the world at a 'thing,' rather than trying to do lots of different things that you're mediocre or good at."** *– Brad Feld*
        - **"From a company creation perspective, focusing on what you can be the best in the world at is a very powerful construct. The thing that a lot of companies do, especially early in their life, is they try to do too many different things, and as a result, they never really end up mastering anything."**

Can a VC firm raise "too capital-rich of a fund"?

- "What's more important than limiting demand or capital amounts is to **have a very deliberate strategy around what you're investing, how you're investing, and more importantly what kind of companies you're helping build and develop, and ultimately how you get liquidity, or get exit, and returns back to your investors"** *– Brad Feld*
    - "I think the thing VCs, at all stages of the development of the firm, don't think hard about is how to use the capital they raise as part of a durable, long-term strategy"
- Many VCs, after raising a fund valued at $X, have a natural tendency to then go out and raise a fund valued at $2X, without any logical reason for doing so
    - If asked why: "The answer of, 'Well we had some extra demand, so we took some extra money,' is not a great reason" *– Brad Feld*
    - In short: **"Understanding what you're doing and why you're doing it is fundamental"** *– Brad Feld*

For a VC firm that's just invested all of fund #1, what do LPs want to see before they begin to raise fund #2?

- Is a return on investment from fund #1 required before a firm goes out to raise more capital?
    - "For the most part, especially if you're an early-stage investor, there's no possible way you're going to have meaningful returns when you go out to raise fund #2… Unless you had some really extraordinary thing happen, the chance of you having meaningful returns at that stage are close to nil." *– Brad Feld*
- "It's not that LPs are looking for something if they've invested in fund #1 to decide whether or not to invest in fund #2. **They're observing whether or not you executed the strategy you said you were going to invest on when they decided to invest in fund #1."** *– Brad Feld*
- When it relates to institutional investors (LPs that are institutions as opposed to high-net-worth individuals) specifically, they're not really looking at the returns you've gotten, but more so at:
    - **The networks you've developed**
    - **What you've done in the companies you've invested in and whether that lines up with your strategy going forward**
    - **Whether or not they think you & your partners have any unique advantages from a sourcing perspective, network perspective, company-building perspective, or even just a thesis that has unique characteristics**

What if your strategy changes?

- For example, say you start off as a seed investor in fund #1 but end up developing more of a series A/B network, and then decide to change your strategy going into fund #2… how would LPs react?
    - "It depends on the type of strategy shift you have, the amount of dimensions the strategy changes on, and whether or not that strategy shift is rational against the backdrop of your skillset and your experience" – *Brad Feld*
    - An example of an irrational strategy shift:
        - Say you have a successful entrepreneur who's started 1-2 tech/software companies and has made quite a few angel investments within their network in the past
        - They then go raise fund #1 based on that story (doing the same but with more capital per deal)
        - But… for fund #2, that entrepreneur has the strategy of only investing in biotech companies in Europe – it just doesn't make sense

How can an early-stage startup prepare for a potential economic downturn?

- **Understand where your capital will come from when you need your next chunk**
    - Ideally, you'd have existing investors who would support you or you're in an industry that's financeable
- **Ask yourself: "If capital suddenly became unavailable, what would we do so our business could continue running?"**
    - (Most of the time, this relates to what spending you'd cut which might then enable you to become cash flow positive in short time window)
- **"One of the things I don't think companies do a very good job of when thinking about this is they don't incorporate in all the second-order effects that are going to play out"** – *Brad Feld*
    - For example, say you're a fast-growing software company with a bunch of customers who are small tech startups – what happens when all those companies cut back their spending?
- "There are a lot of things that, as a startup, are outside of your control when things reverse. Think things through. Know where your line of supply comes from. Know where additional capital comes from. Know what you can change within your business so you don't need additional capital." – *Brad Feld*

Follow-on Capital | Does Brad typically make follow-on investments?

- Andrew is a huge fan of Fred Wilson's blog
    - Fred has written extensively on the importance of follow-on capital
- Brad's strategy at Foundry:
    - In addition to participating in future rounds & protecting ownership position, they try to increase their ownership position in the first couple of rounds by buying up more of the company than just their pro rata
        - But: "Once we hit a valuation point of $300-400 MM, that's kind of the top point for us in terms of us allocating capital to a company" – *Brad Feld*

Brad's Investment Advice

- **"Understand what your strategy is. Define it clearly. Then execute it over a long period of time and over multiple funds. It doesn't mean it's static or can't evolve. It doesn't mean that your mistakes, as well as your successes, shouldn't inform the strategy."**
    - Avoid doing things "just because" – **THINK through your reasoning**

Why Brad Invests in Other VC Funds

- Brad and his partners at Foundry have been doing so (with both their own money and through an entity they funded) for quite some time
    - Brad has invested in most of the VC funds in Colorado
    - Other examples: Union Square Ventures, K9 Ventures, First Round Capital, LOWERCASE Capital
- Why?

- “We started to realize that we could be impactful as an LP in different ways than we were impactful as GPs (General Partners). Incorporating that into our strategy, in a formalized way, and being deliberate about it, was a lot better than the mode of being personally reactive to all the impound coming at us.” – *Brad Feld*

Techstars

- Brad is one of the co-founders
- Techstars now has 50 accelerators/year they run around the world in ~15 countries
- Who participates?
  - Quite a range of people:
    - First-time entrepreneurs with just an idea
    - Companies doing $1MM/year in revenue trying to figure out how to get to the next level
- One of the most significant benefits is the network entrepreneurs get access to while participating: mentors, corporate partners, investors, and peer entrepreneurs

Closing Advice for Learning About the Venture Capital Industry

- Know that it’s WAY easier to do so in 2019 compared to 1999
- Check out the blogs of Fred Wilson and Mark Suster
- Give Venture Deals a read
- Check out the Kauffman Foundation’s resources

Additional Notes

- Brad is married to Amy Batchelor
- Brad lives in Boulder, Colorado