What do you look for an investment? How long should a founder be without salary? And other Q&A

20-25 minutes

Dear readers,

I recently hosted an AMA on Quora where folks asked a bunch of really fantastic questions. Thanks to Adam D'Angelo and Alecia/Adrienne for getting this set up.

Wanted to share a couple of the most upvoted answers below:

- What do you look for in an investment?
- How long should a founder be without salary?
- What distribution channels should a new consumer internet startup consider in 2019?
- What investment have you made that is the most out there?
- Which commonly-discussed growth metrics in consumer tech businesses are the most meaningless and/or misleading?
- What is your advice for startup CEOs?

Enjoy!

Andrew

1. What do you look for in an investment?

This one is hard to answer generically — it's easy to say, great team! Or big market! Or technology differentiation! Or something generic like that. However, being in venture capital is about being in the "exceptions" business.

There were hundreds of mobile photo apps prior to Instagram and Snapchat, and they would have been money-losing investments. Same for social networks before Facebook, or there were more than a dozen investor-backed search engines before Google.

My job is to find the exception to the rule, and pick an individual company that will stand out, and I don't have to be bullish about an entire category of companies. In practice, this happens also because individually, I'm focused on doing 2–3 investments per year, and don't have the capacity to, say, invest in every single company working on XYZ.

All of that said, beyond the obvious things (team, market, product, etc.) there are a few things that make me lean into understanding a company, in particular.

First, it's interesting when a startup using a new platform or a new technology in a clever way. For example, Instagram Stories and Snap Stories are a huge new short-form video format, and an app that might interact with these stories in an interesting way might be compelling. Or because esports is so huge, if someone builds on the idea that perhaps games content could be streamable-first, then that's intriguing too. Taking advantage of a new technology helps answer the "Why now?" question and explains why it's a fresh opportunity that should be tried. If your new startup could have been built 15 years ago, perhaps the idea's already been tried and just isn't that good.

Second, technology changes constantly but people stay the same. And their motivations — in particular, to spend time with friends, to date, to be able to earn more, to find better work over their careers, to take care of their pets, etc., etc. — also stay constant over time. So when a new startup purports to create new consumer behavior, I'm sometimes skeptical. But if a product allows people to tap into a pre-existing motivation but in a new, fresh way, then I'm interested.

Third, I like to see a strong insight around how the product will grow. For example, it's important if a new video streaming startup, for instance, has deep relationships with the YouTube/Instagram influencer community to get it off the ground. Or if a new workplace collaboration tool is built to tap into calendars and be inherently viral through cal invites. The reason for this is that we are in an interesting era of new technology products where in general building the technology is not all that hard. Startups typically don't fail because of technology issues, given open source, AWS, lots of collaboration tools, a network of smart people, etc., etc. This used to be the case decades ago, but these days, startups fail because they don't get traction in the market. As a result, I like to see something clever and insightful in how the product will get off the ground — especially if it's driven by viral growth, or some form of organic, as opposed to paid marketing.

Usually at the stage where I am seeing companies, one of the big things I'm evaluating for is "it works!" I usually look at their growth metrics, cohort charts, acquisition mix, engagement data, etc., and try to make sure that it's sticky now and will remain so over time. Once I validate this, then I move onto some of the bigger qualitative questions like the ones above — what's the trick that makes it grow? Why now? What new technology does it exploit? What classic human motivation does it tap into?

And finally, I want to reiterate that it's all about finding the exceptions. You can spend as much time as you want analyzing a space, but it's just about picking the individual startup you like most.

[PS. Here's also a deck I published a few months back that is the more visual, longer-form answer to this question]

2. How long should a founder be without salary?

I'm a believer in free markets, and also in thinking long-term.

When founders first get their company off the ground, they often take risk and go without salary. However, as soon as they raise a real amount of money — either from institutional seed funds, a large group of friends/family, or with a VC — I think the founders should pay themselves basically market rate (within reason)

The reason for this, especially if there are cofounders, is that starting a company is already hard enough. Your customers are leaving you, recruiting is hard, employees will occasionally quit. It's hard to think long term, about all of this when you're worried about your paycheck.

If on top of all of this stress, the founders are paying themselves way below market, to the point where they are burning their savings, that's just not a good thing. It creates a lot of stress, and unwanted behavior from the perspective of an investor.

Obviously if there's a case where the founders were highly compensated before and it would impact the runway, OK, then great, there's an opportunity to trade off a longer runway by capping the cash compensation. If the team wants to do that, great.

But in general, I believe in market rates for everyone, including the founders and the employees, within reason.

[PS. I tweeted this out and my friend Suhail Doshi responded with a pretty cool rule of thumb:

> My rule of thumb is…
> – seed funding: what you'd pay your lowest paid employee
> – when you're growing a bit: your lowest paid engineer
> – scaling: mid level engineer

– successful: market for ceo pay
– not growing: cut back to your previous comp until you are / helps survive

This is pretty great. Thanks Suhail!]

3. What distribution channels should a new consumer internet startup consider in 2019?

First, let me start with the negative. It's been said (and written) that we are kind of in a funky consumer internet winter, compared to 2007 when we had the Facebook platform and the iOS/Android platforms and so on. As a result, the conclusion is that there's a general industry malaise and everything sucks and we should all go home, etc., etc.

It's my conclusion that this is a vastly overhyped POV about consumer.

Last year, when Fortnite went from zero to 200M+ users, how could you not be excited about consumer tech? Or where we see Kylie Jenner built a multi-hundred million dollar revenue stream selling stuff on Instagram? Or you have a content creator like Ryan, the kid that makes unboxing videos, generating $20M+ per year?

There's a lot of exciting opportunities out there. In my first few months at a16z, I met hundreds of companies in my first 3 months. Hundreds! There's a lot of innovation and entrepreneurs out there trying to do great things.

Yes, it's true that you can't just build well-designed social photo apps and still expect to succeed. You have to do something different, and evolve with the time. But IMHO there are still fantastic opportunities.

OK, now going past the preamble and answering the question directly:

The best distribution channels for your startup are the ones that only make sense for your product to use — meaning it's proprietary, and people can't just tap into the same channel right away. The problem with Facebook ads as a channel, for instance, is that if you're a mattress startup buying ads, you're not just competing against all the other mattress companies but you're also competing with the cool new protein shake company. Contrast that to Dropbox, which has primarily grown using shared folders inside the workplace — they own that channel, and the only others who could compete on that are folks who have some kind of shared folder functionality. The performance of the channel is unlikely to degrade over time via competition because it's proprietary.

If you agree, then the obvious question is, if I'm a startup looking for a proprietary channel, which one do I use? That's hard to answer generically, so I won't attempt to do so. However, the better observation is that if you are starting a brand new company, then you have the opportunity to both pick the idea — and have a hypothesis about product/market fit — as well as to pick its growth strategy at the same time. If you can think about both at its inception, then you can start thinking about a proprietary channel from day 1.

I think this is not the answer the person who wrote the question wanted to hear, so let me also try to give some more trend-driven ideas too.

I like video. There's a lot of video being created and consumed, and I like the idea of a "video-native" product that is designed to create a lot of video as part of user engagement. Or create a lot of opportunities for streaming.

I like social data in the workplace. If you are building a workplace collaboration tool, whether it's horizontal like Slack or more vertical like Figma, most of the files and systems you touch understand who all the users are inside the company. In particular, the calendar is a very rich data asset full of people and their relationships, and I feel that's underleveraged by startups seeking to grow. I love the pattern of putting, say, ZOOM links, inside of calendar requests, and think more startups might end up finding opportunities to do the same.

I also like "in-real-life virality." If you walk around and see a bunch of lime green scooters, and people are using them, then you will want to try it too. Magically, no customer acquisition cost! Or if you see people walking around playing Pokemon Go, then you might want to try it also, since they are out and about, and enjoying it so much. I think this is an underrated channel.

4. What investment have you made that is the most out there?

One day I was in the Mission district of San Francisco, and saw a huge line of people. I wondered what they were waiting for, and naturally, the curiosity got the best of me and I got in line too. As I looked around in line, I read the sign for the place. There was a huge aardvark icon, and lettering that said BOBA GUYS.

I had heard of Boba Guys before, and remember that every time I saw one of their stores, I would skip it because the line was too long. Business was that good.

While waiting, I tried to google to figure out who their founders were. No luck. Eventually I found a Kickstarter page with some info, for a store they had opened near Union Square, and found their names. Just my luck, they were already following me on Twitter. I DM'd them, ordered my boba — hong kong style with pearls — and waited.

A week later, they replied. We met for lunch near Hayes Valley, and I didn't know what to expect. Maybe I could invest money into this thing? Did I even want to? It's just milk and tea, right? But so was Coca Cola, or Starbucks, or Blue Bottle.

To my surprise, both Andrew and Bin were fantastic. They had great consumer packaged goods experience, had worked at Timbuk2, and came with a 20-slide deck prepared. The deck had retail comps versus other high-end stores, financial projections, and more. It blew my mind. These were very obviously the most talented bubble tea store operators on the planet.

As a quick segue, I had been going to pitches for high-end restaurants with a few friends prior to that, but had never invested. Going to a restaurant pitch was extremely fun, as you went with a group of friends, met the chef, and they made the entire food menu and all the drinks too. You hung out and could invest after. But I never liked the model because it felt like it could never scale. It'd be a fun hobby, but it'd be hard to make money. But it helped prepare my mind for investing in retail, and a beverage play like Boba Guys.

Back to bubble tea, I realized after the pitch that although it wasn't a tech company, I should figure out a way to invest. Andrew, Bin, and I had a great conversation — the first of many, and then I rallied some of my friends to put a syndicate together to invest.

The bonus to all of this is that I now have a Boba Guys Black Card. This is a special investor card that lets me get my daily bubble tea fix for free. It's amazing, and the investment was worth it just for the bragging rights with that.

5. Which commonly-discussed growth metrics in consumer tech businesses are the most meaningless and/or misleading?

These are the obvious offenders:

- Cumulative charts for anything. These can only go up and to the right
- Registered users. Totally useless, although sometimes I like to ask about this as a ratio to active users to get a sense for how efficiently the user acquisition is happening
- Any retention metrics that aren't standardized into cohort curves. Sometimes people will give a single snapshot number, like a "3 months later, X% still use the app!" and that's not that helpful
- Install numbers, without signups or activated signups or something more meaningful
- For marketplace companies, "revenue" that's actually "gross bookings" or GMV. Or GMV that counts in weird things, like security deposits or one-time setup charges
- ARR meaning, "annual revenue run rate" as opposed to "annual recurring revenue." Please, let's just stick to ARR for recurring, not run rate. Thanks.
- Taking the peak revenue of any single day and annualizing it as the headline number
- Unlabeled X and Y axes in charts
- Cohort curves that are some complex subset of users that make the retention look better
- Showing "CAC" that's actually blended CAC, and when you just look at the Paid CAC, it's way above LTV
- Actually LTV. Because who really cares about the lifetime of a user — startups should just manage to margin earned by a customer you acquire over the first 6–12 months, not the lifetime. That's how you will make your ad spend decisions
- Any misleading ratios where the denominator and numerator are totally non-obvious. Stick to actives, please.
- Active user definitions that are complicated (must have visited 3 sessions in the last week, and done one action out of a list of 5). It makes all the downstream calculations on retention, engagement, etc., misleading since you're throwing away all the data for the less active users
- If you have a desktop app, and web, and mobile, break down the metrics for all three. Don't combine, please

There are many, many more… but that’s a quick start.

6. What is your advice for startup CEOs?

I have a lot of advice, but maybe I will share the top 10 that come into my head:

1. You’re not doing this alone. You have friends, family, your investors, and employees rooting you on. Talk to them
2. Everything seems like it sucks — metrics go up and down. Customers leave. An employee quits. Product/market fit could be a lot better. But this is how it feels even if it’s a rocket ship. Important to put into perspective
3. Your job changes dramatically over time. Your first job is to build the machine — the product that attracts the customers, and generates the revenue. But eventually it turns into a job where you’re building the machine that builds the machine. It’s all about hiring, leading, managing, etc., etc. Prepare for this to feel weird when it transitions — especially spending 25%+ of your time hiring
4. Everyone’s gotten very data-driven these days, which is great, but you should set your strategy, and then your metrics should follow. It’s to verify that your strategy is working — having a lot of dashboards is no substitute for strong product insight and strategy.
5. Some people say to stay off Twitter and forget the distraction. I say the opposite – find interesting, knowledgeable people from social media, and DM them to meet in person. Stay outbound. Use it for recruiting, networking, fundraising and more.
6. Raising money is a really, really important thing. It can feel like a great milestone, but it’s just the beginning.
7. Ben Horowitz’s book The Hard Things About Hard Things is the best book about being a CEO and managing your own psychology as you set out to do this crazy hard thing. It’s fantastic. Read and re-read it.
8. Also read and re-read High Output Management by Andy Grove.
9. Build long-term relationships with your employees, investors, and people in the ecosystem. Hopefully your startup thrives, but maybe it won’t — and you’ll still want to build a long-term network because there will be more to do in the future
10. Don’t worry about generic startup advice — including lists like this one :) Make sure you find advice that’s tailored to your startup’s stage, industry, and specific situation. Talk to experts who are willing to dig in. Lists like this are fun to read but there’s a big gap in applying them
11. …

OK that’s my first 10 :)

PS. Get new updates/analysis on tech and startups

I write a high-quality, weekly newsletter covering what's happening in Silicon Valley, focused on startups, marketing, and mobile.