THE VENTURE HACKS BIBLE!

(Every post from Venture Hacks ever.)

The Venture Hacks Bible

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Contents

January 2008

The top 3 hacks of the year

Happy New Year and here's to an effective[1] 2008.

Here are the three most effective hacks of 2007. We maintain a Cheat Sheet[2] of all the hacks, but try to apply these three if you don't have time to apply them all.

[1]http://www.design.caltech.edu/erik/Misc/Drucker.html

[2]http://venturehacks.com/term-sheet-hacks

Create a market for your shares[3]

> 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[4].

Create a board that reflects the ownership of the company[5]

> 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[6] is the most important element of the Series A investment. It is more important than the valuation[7] of your company.
>
> The valuation of your company won't matter to you if the board (1) terminates you and you lose your unvested[8] stock, (2) forces the company to raise a

[3] http://venturehacks.com/articles/create-a-market
[4] http://venturehacks.com/articles/adam-smith#series
[5] http://venturehacks.com/articles/board-structure
[6] http://www.feld.com/blog/archives/2005/01/term_sheet_boar.html
[7] http://www.feld.com/blog/archives/2005/01/term_sheet_pric.html
[8] http://www.feld.com/blog/archives/2005/05/term_sheet_-_ve.html

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[9] in the process.

Related: Make a new board seat for a new CEO[10].

The Option Pool Shuffle[11]

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[12]
2. Accelerate your vesting upon termination[13]
3. Unbundle money and value-add[14]

See the Cheat Sheet[15] for all the hacks.

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[9] http://www.feld.com/blog/archives/2004/07/liquidation_pre.html
[10] http://www.venturehacks.com/articles/ceo-board-seat
[11] http://venturehacks.com/articles/option-pool-shuffle
[12] http://venturehacks.com/articles/share-price
[13] http://venturehacks.com/articles/acceleration-termination
[14] http://venturehacks.com/articles/dumb-money
[15] http://venturehacks.com/term-sheet-hacks

Terminating Cisco's founders

Don Valentine[16] from
Sequoia Capital and Cisco's founders, Len Bosack[17] and Sandy Lerner[18], discuss Len and Sandy's
termination in this rare video:

[19]

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).

[16] http://www.sequoiacap.com/people/donald-valentine/
[17] http://en.wikipedia.org/wiki/Len_Bosack
[18] http://en.wikipedia.org/wiki/Sandy_Lerner
[19] http://video.google.com/videoplay?docid=-2534997893350167670#51m59s

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⟶[20]
>
> “I would strongly advise anybody watching this program not to do [what we did]… get your own [personal] lawyer.” – Sandy Lerner ⟶[21]
>
> “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 ⟶[22]
>
> “[Sandy and Len] urgently sold their shares in Cisco at a time when the valuation of the company was a *mere* $1B.” – Don Valentine ⟶[23]

[20] http://video.google.com/videoplay?docid=-2534997893350167670#52m38s
[21] http://video.google.com/videoplay?docid=-2534997893350167670#53m35s
[22] http://video.google.com/videoplay?docid=-2534997893350167670#55m10s
[23] http://video.google.com/videoplay?docid=-2534997893350167670#56m00s

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[24],
Harvard M.B.A. Students
[25]

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[26] presents some
interesting data in Investors
(and Managers) as Headhunters[27]:

> "Investors provide leads to a significant subset of hired executives (an

[24]http://founderresearch.blogspot.com/2006/10/investorentrepreneur-value-expectation.html

[25]http://founderresearch.blogspot.com/2006/10/investorentrepreneur-value-expectation.html

[26]http://founderresearch.blogspot.com/

[27]http://founderresearch.blogspot.com/2008/01/investors-and-managers-as-headhunters.html

> 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[28]. 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[29], and is betting on you, not the market. If you're lucky enough to find more than one of these

[28] http://venturehacks.com/articles/dumb-money

[29] http://avc.blogs.com/a_vc/2007/10/why-do-you-want.html

investors, you can start thinking about which one will add the most value.

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[30].

Related:
Investor/Entrepreneur Value Expectation Gap[31].

[30]http://altgate.typepad.com/blog/2007/11/reverse-due-dil.html

[31]http://founderresearch.blogspot.com/2006/10/investorentrepreneur-value-expectation.html

Tom Perkins of KPCB interviewed


[32]

Tom Perkins[33] from Kleiner Perkins[34] slaps us with knowledge in this interview with Creative Capital[35]. Here are some choice quotes from the beating:

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."

[32] http://www.kpcb.com/team/index.php?Tom%20Perkins

[33] http://www.kpcb.com/team/index.php?Tom%20Perkins

[34] http://www.kpcb.com/

[35] http://creativecapital.wordpress.com/2008/01/17/valley-boy-part-1-of-an-interview-with-vc-pioneer-thomas-j-perkins/

> "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[36].

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

[36] http://twitter.com/venturehacks

financing of any kind, spend all of your time looking for a lead investor."

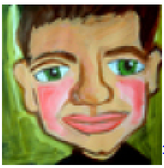
— Fred Wilson[37], Union Square Ventures

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."

What's a lead investor?

[38]

[37]http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html
[38]http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html

From Fred Wilson[39]'s The "Lead Investor"[40]:

> "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 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

[39]http://www.unionsquareventures.com/team/

[40]http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html

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".

[41]

"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[42], 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 find a great lead or the company starts kicking ass, the follower will say he intended to invest all along.

[41] http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html#comment-6557

[42] http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html#comment-6557

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: #[43]

1. Your business is too far away and they want you to find a local lead[44], *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.* #[45]

[43] http://venturehacks.com/#vc-reasons
[44] http://avc.blogs.com/a_vc/2007/10/the-lead-invest.html#comment-6521
[45] 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[46], 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[47], The Art of Saying "No" Parts 1[48] 2[49] and 3[50], and More favorite VC phrases[51].

[46] http://venturehacks.com/articles/lead-part-2
[47] http://avc.blogs.com/a_vc/2005/05/vc_cliche_of_th_3.html
[48] http://billburnham.blogs.com/burnhamsbeat/2005/03/the_art_of_sayi.html
[49] http://billburnham.blogs.com/burnhamsbeat/2005/03/the_art_of_sayi_1.html
[50] http://billburnham.blogs.com/burnhamsbeat/2005/03/the_art_of_sayi_2.html
[51] http://ricksegal.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[52], 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[53] 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.

---

[52] http://venturehacks.com/articles/lead
[53] http://venturehacks.com/articles/lead#mass

1. Ask the followers for introductions.

If the followers have good[54] reasons[55] to not lead, ask them for introductions to potential leads:

> "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'[56]. (Caveat: This logic mostly applies to VCs, not angels.)

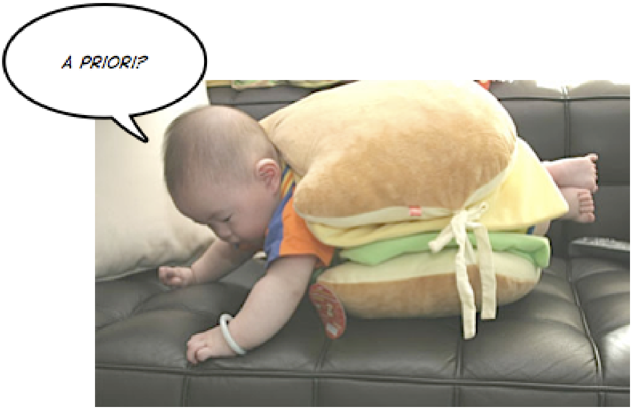
If a follower doesn't have a good reason[57] *a priori*, don't ask him for introductions at all. Skip this microhack altogether. An introduction by someone who *can* and *should* lead but would rather follow is a useless and harmful introduction. It's a strong negative signal. Go get your own introductions.

[54] http://venturehacks.com/articles/lead#vc-reasons

[55] http://venturehacks.com/articles/lead#angel-reasons

[56] http://venturehacks.com/articles/lead#no

[57] 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?

1. 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 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[58].

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[59] and 2[60], we presented three microhacks for finding a lead investor. Here are two more microhacks, in continuing order of importance.

[58]http://funnytreat.com/
[59]http://venturehacks.com/articles/lead
[60]http://venturehacks.com/articles/lead-part-2

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.
>
> "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[61] and (2) investors who have good[62] reasons[63] to follow and are partnering with you to find a lead[64].

This polite diatribe combines positive leverage[65] ("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

[61] http://venturehacks.com/articles/lead#mass

[62] http://venturehacks.com/articles/lead#vc-reasons

[63] http://venturehacks.com/articles/lead#angel-reasons

[64] http://venturehacks.com/articles/lead-part-2#introductions

[65] http://en.wikipedia.org/wiki/Leverage_%28negotiation%29

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[66].

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?"

5. Get past no.

"If you've got a good idea, market, and team, raising money won't be your problem."

— Sam Altman[67], Founder of Loopt[68]

"Nobody said this would be easy."

— Marc Andreessen[69]

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"[70]:

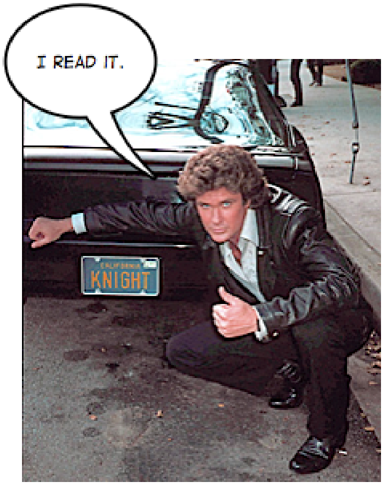
> "If you're an investor, you look at the risk around an investment as if it's an onion. Just like you peel

[66] http://venturehacks.com/articles/lead#no
[67] http://news.ycombinator.com/item?id=84865
[68] https://loopt.com/
[69] http://blog.pmarca.com/2007/06/the_pmarca_guid_2.html
[70] http://blog.pmarca.com/2007/06/the_pmarca_guid_2.html

> 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[71].

[71]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[72]

Why do investors want control?

“Trust, but verify.”

– Ronald Reagan[73]

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[74] and protective provisions[75]? Shouldn’t they just give entrepreneurs bags of money and trust them to do the right thing?

David Hornik[76] has the answer in Venture Capital in China[77]:

> “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

[72]http://www.madetostick.com/
[73]http://en.wikipedia.org/wiki/Ronald_Reagan
[74]http://venturehacks.com/term-sheet-hacks#bod
[75]http://venturehacks.com/term-sheet-hacks#protective-provisions
[76]http://www.augustcap.com/team/dh.shtml
[77]http://ventureblog.com/articles/2008/01/venture_capital_in_china.php

> 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. 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[78].
>
> Investors trust entrepreneurs to pay the investors first when the company exits, and they verify it with a liquidation preference[79].
>
> Investors trust entrepreneurs to consider their interests in an acquisition, and they verify it with protective provisions[80] and board seats[81].

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.

[78] http://venturehacks.com/term-sheet-hacks#vesting
[79] http://www.feld.com/blog/archives/2004/07/liquidation_pre.html
[80] http://venturehacks.com/term-sheet-hacks#protective-provisions
[81] http://venturehacks.com/term-sheet-hacks#bod

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[82].
>
> If you trust your investors to let the board make the call on acquisition offers, automatically suspend protective provisions[83] 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[84].

Writing a contract doesn't mean you don't trust the other guy. It just means you want to document and verify your trust.

[82] http://venturehacks.com/articles/acceleration-termination
[83] http://venturehacks.com/term-sheet-hacks#protective-provisions
[84] http://venturehacks.com/term-sheet-hacks#bod


YEP.

January 2009

My visit to American Apparel

Ed: This is a guest post by Kevin Meyer, the President of Factory Strategies Group[85], which operates Superfactory[86]. He also writes an excellent blog called Evolving Excellence[87]. In this post, Kevin describes how American Apparel unwittingly applies lean[88] practices like short cycle times (concept-to-product in 8 days), integrated QA, cross-functional teams, and more.

[89]

American Apparel[90] 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

[85]http://www.factorystrategies.com

[86]http://www.superfactory.com/

[87]http://www.evolvingexcellence.com/

[88]http://venturehacks.com/archives#lean

[89]http://americanapparel.net/

[90]http://americanapparel.net/

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 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[91] I visited recently.

First Impressions

One of those aspects was the first impression. When we arrived at Saishunkan[92] in Japan, we were greeted by a gardener who turned out to be the chairwoman of the $270 million company. At another factory[93] we walked in to see the president of a $100 million company on his knees scrubbing the floor.

[91] http://www.evolvingexcellence.com/blog/2008/11/japan-kaikaku-experience---the-summary.html

[92] http://www.evolvingexcellence.com/blog/2008/10/jke-day-2-saishunken-cosmetics---customer-care-trumps-a-factory.html

[93] http://www.evolvingexcellence.com/blog/2008/10/jke-day-3-hoks---3s-gone-wild.html

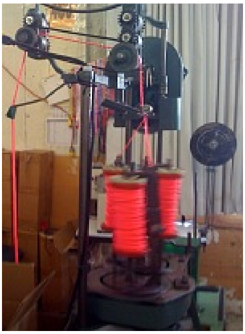
When you arrive at American Apparel, you see several massive multi-story warehouse buildings. At the business address is an open entrance with an old table and a visitor sign-in sheet. That's it. It's on the lower left of building in the photo below. No, not the far left... that would be the company store. The open gap entrance just to the right of the store... which looks like any of the other roll-up dock doors.

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[94]. So many companies—probably 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,

[94]http://americanapparel.net/contact/ourworkers.html

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[95]? 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,

[95] http://en.wikipedia.org/wiki/Gemba

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.

Are you embarrassed yet?

I've previously written about Sun Hydraulics[96], 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.

[96] http://www.evolvingexcellence.com/blog/2008/01/no-titles-excep.html

And yes, I saw Dov. He's been in the news[97] 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 company as he sees fit, traditional rules be damned. It even earned him a great spoof on Saturday Night Live[98]. 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 glitzy 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

[97]http://www.forbes.com/2008/11/13/american-apparel-retail-markets-face-cx_ra_1112marketsautofacescan02.html?partner=yahootix

[98]http://www.gigglesugar.com/2062905

visual controls[99] 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."

– David Russo, VP of Human Resources at SAS Institute

This is one of my favorite quotes from the book Hidden Value[100]. 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.

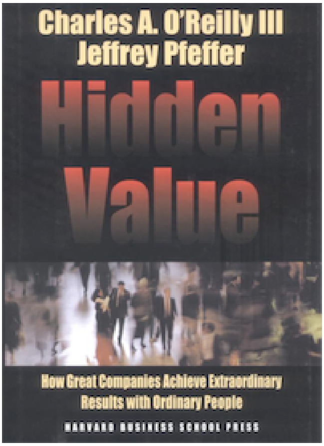
We are motivated to perform when our work expresses who

[99] http://en.wikipedia.org/wiki/Visual_Control

[100] http://www.amazon.com/gp/product/0875848982?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848982

we are[101], when the business' goals are intrinsically meaningful to us, and we feel that we are valued as people, not simply as economic agents[102].

But, even in startups, financial incentives and HR practices often treat us like economic agents:



[103]

> "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

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[101] http://venturehacks.com/articles/the-monk-and-the-riddle

[102] http://books.google.com/books?id=FRUxoxTkow8C&pg=RA1-PA235&dq=%22feel+that+we+are+valued+as+people,+not+simply+as+economic+agents%22&ei=XVdnSZCIBIjClQSfgN0c#PRA1-PA236,M1

[103] http://www.amazon.com/gp/product/0875848982?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848982

> 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[104]. By itself, money

[104]http://bobsutton.typepad.com/my_weblog/2008/11/washington-mutual-and-perverse-incentives.html

motivates the wrong people to do the wrong things in the quest for more money.

This is why Zappos pays employees to leave[105]. This is why Tandem Computers didn't tell employees their salaries until *after* they started working[106]. 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[107] and Jeffrey Pfeffer[108], 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

[105] http://discussionleader.hbsp.com/taylor/2008/05/wy_zappos_pays_new_employees_t.html

[106] http://books.google.com/books?id=lIXIE9bYid8C&pg=PA122&dq=%22if+they+asked+about+their+salary%22&ei=Mm5mSbHbBILKlQSvzvDzDQ#PPA123,M1

[107] http://www.google.com/search?hl=en&q=Charles%20A.%20O%27Reilly%20III&aq=f&oq=

[108] http://www.google.com/search?hl=en&q=Jeffrey%20Pfeffer&aq=f&oq=

> people-centered practices that express its core values. [e.g. Southwest: "We hire happy people."]
>
> "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[109], that were designed for programmers

[109]http://venturehacks.com/articles/extreme-programming-explained

with ordinary skills[110], work even better with extraordinary programmers.

Read Hidden Value[111] for specific recruiting, training, information-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[112], CEO of Tandem Computers

The spontaneous optimism that drives startups

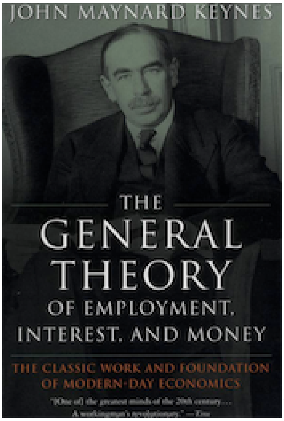
In 1936 (!), old-school economic giant John Maynard Keynes[113] described the spontaneous optimism that drives startups:

[110] http://books.google.com/books?id=G8EL4H4vf7UC&pg=PR18&dq=%22on+the+close+collaboration+of+programmers+with+ordinary+skills%22&ei=SHRlScbnNYXSkwSU74yeBg

[111] http://www.amazon.com/gp/product/0875848982?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848982

[112] http://books.google.com/books?id=lIXIE9bYid8C&pg=PA122&dq=%22to+paraphrase+treybig%22&ei=L29mSeqeNYKGkASLyr2VAQ#PPA123,M1

[113] http://en.wikipedia.org/wiki/John_Maynard_Keynes



[114]

"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

[114] http://www.amazon.com/gp/product/0979905257?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0979905257

> 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[115]

(*Via:* Mavericks at Work[116])

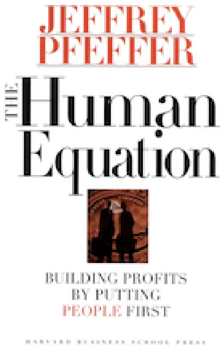
The Human Equation: How to organize people for profit

From The Human Equation[117]:

[115] http://www.amazon.com/gp/product/0979905257?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0979905257

[116] http://www.mavericksatwork.com/?p=161

[117] http://www.amazon.com/gp/product/0875848419?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848419



[118]

"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.]
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.

[118]http://www.amazon.com/gp/product/0875848419?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848419

7. Extensive sharing of financial and performance information throughout the organization."

The author is Jeffrey Pfeffer[119], a professor at Stanford. He also co-wrote *Hidden Value*, which we covered in We don't pay you to work here[120].

Implementing the whole system

Extreme Programming[121] 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 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

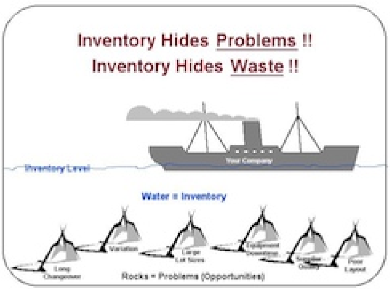
[119] http://www.google.com/search?hl=en&q=Jeffrey%20Pfeffer&aq=f&oq=
[120] http://venturehacks.com/articles/ordinary-people
[121] http://venturehacks.com/articles/extreme-programming-explained

do the hard work of implementing a set of simple organizational practices, The Human Equation[122] and Hidden Value[123] 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[124], Chairman of Intel



[125]

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.

[122]http://www.amazon.com/gp/product/0875848419?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848419

[123]http://venturehacks.com/articles/ordinary-people

[124]http://www.nytimes.com/2009/01/26/technology/26spend.html

[125]http://elsmar.com/Identify_Waste/sld011.htm

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 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[126]

[126] http://www.amazon.com/gp/product/0915299143?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0915299143

Inspiration and Data: Toyota Production System[127], Depressed? Summon Your “Animal Spirits”[128], Inventory Hides Problems![129], Implementing Lean Software Development
[130]

Pitching Hacks is almost here / Calling all testers

Pitching Hacks[131] 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?

Sign up[132] to be a tester. Of course, we’ll send you a new copy when the final draft comes out.

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[127]http://books.google.com/books?id=7_-67SshOy8C&pg=PR13&dq=%22The+Toyota+production+system+was+conceived%22&ei=GPJnSYDuPIjClQSfgN0c#PPR14,M1

[128]http://www.mavericksatwork.com/?p=161

[129]http://elsmar.com/Identify_Waste/sld011.htm

[130]http://www.amazon.com/gp/product/0321437381?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0321437381

[131]http://venturehacks.com/articles/coming-soon-pitching-hacks

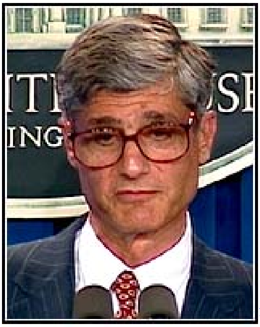
[132]http://venturehacks.wufoo.com/forms/test-our-new-book-pitching-hacks/

Free samples

Here's the Table of Contents[133] and an essay called Why do I need an introduction?[134] More samples to come.

Sign up[135] to be a tester or sign up[136] to be notified when the book comes out.

(A bit of) Decision-making for startups

[137]

"Decisions tend to be judged solely on the results they produce. But I believe the right test should focus heavily on the quality of the decision-making itself...

"Individual decisions can be badly thought through, and yet be successful, or exceedingly well thought through, but be

[133]http://venturehacks.com/wordpress/wp-content/uploads/2009/01/pitching-hacks-toc.pdf
[134]http://venturehacks.com/wordpress/wp-content/uploads/2009/01/pitching-hacks-introduction.pdf
[135]http://venturehacks.wufoo.com/forms/test-our-new-book-pitching-hacks/
[136]http://venturehacks.wufoo.com/forms/pitching-hacks-the-book/
[137]http://en.wikipedia.org/wiki/Robert_Rubin

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[138]
From NYU[139] and Harvard [140] 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[141]

[138] http://en.wikipedia.org/wiki/Robert_Rubin
[139] http://www.treas.gov/press/releases/rr3147.htm
[140] http://www.commencement.harvard.edu/2001/rubin.html
[141] 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[142]

Pitching Hacks: Beta test update

Last week, we put out a call for beta testers[143] for our new book, Pitching Hacks (sign up[144] 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).

[142]http://www.michaelmauboussin.com/more_than_you_know_excerpt.htm
[143]http://venturehacks.com/articles/pitching-hacks-testing
[144]http://venturehacks.wufoo.com/forms/z7x4m1

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 you're one of these people, please get in touch and let us know why you didn't buy the book! E-mail us[145] or fill in this form[146].

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.

[145] mailto:nivi@venturehacks.com

[146] http://venturehacks.wufoo.com/forms/r7x4a3

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:

> "The book was quite enjoyable (maybe because we are exactly starting to look for VC funding!)" – Emmanuel Marot[147]

> "This was a great, extremely fast-paced read." – Andre Gharakhanian[148]

> "Thanks for the book. I just bought 5 licenses. I am very proud of you. This is fantastic. Mommy is also thrilled." – Dad[149] *(Joke!)*

Sign up[150] 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[151] (RSS[152]) and FriendFeed[153] (RSS[154]):

[147] http://www.linkedin.com/pub/1/164/667
[148] http://www.siliconlegal.com/
[149] http://www.linkedin.com/pub/dir/hossein/nivi
[150] http://venturehacks.wufoo.com/forms/z7x4m1
[151] http://twitter.com/venturehacks
[152] http://feeds.venturehacks.com/venturehacks-twitter
[153] http://friendfeed.com/nivi
[154] http://friendfeed.com/nivi?format=atom

"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[155], Google

[156]

"Firms should not pay high executive salaries merely to find leaders who can copy what others are doing." – Jeffrey Pfeffer[157], Stanford Graduate School of Business

[158]

"Lean startups are built from the ground up for learning about customers." – Eric Ries[159], Kleiner Perkins

[160]

"Consider spending less time talking, and more time prototyping, especially if you're not very good at talking." – Paul Buchheit[161], FriendFeed

[162]

[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

[155] http://www.mattcutts.com/blog/google-knol/

[156] http://www.mattcutts.com/blog/google-knol/

[157] http://www.amazon.com/gp/product/0875848419?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848419

[158] http://www.amazon.com/gp/product/0875848419?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848419

[159] http://mashable.com/2009/01/02/how-to-raise-money/

[160] http://mashable.com/2009/01/02/how-to-raise-money/

[161] http://paulbuchheit.blogspot.com/2009/01/communicating-with-code.html

[162] http://paulbuchheit.blogspot.com/2009/01/communicating-with-code.html

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[163]

“Contentment is wanting what you have. Ambition is wanting what another has. Progress comes from wanting what nobody has.” – Bob Lewis[164]

“That’s another flaw with performance-based rewards: They are easy for one of your competitors to top.” – Joel Spolsky[165]

“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

[163] http://www.amazon.com/gp/product/1934109134?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=1934109134

[164] http://www.weblog.keepthejointrunning.com/wordpress/?p=17

[165] http://www.inc.com/magazine/20090101/how-hard-could-it-be-thanks-or-no-thanks_Printer_Friendly.html?partner=fogcreek

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[166], IAC [See these creative ways to avoid layoffs[167].]

"Forget about shortcuts. Run a business as if it's forever." – Norm Brodsky[168]

"A business plan that doesn't require a wonderful economic environment in order to succeed... is a good idea all the time." – Marc Andreessen[169]

"Entrepreneurs get blinded by firm reputations... they don't do their due diligence on partners." – via Jeff Bussgang[170], Flybridge Capital Partners [171]

"Asking customers to adopt new priorities... is an uphill death march through knee-deep mud." – Clayton Christensen[172], Harvard Business School [173]

"I've learned... that there is a lot more hidden talent and potential in your employees than you think." – Tony Hsieh[174], Zappos

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[166] http://blogs.reuters.com/summits/2008/12/04/diller-to-profitable-companies-lay-off-the-layoffs/

[167] http://www.skmurphy.com/blog/2009/01/27/fewer-of-you-will-be-listening-to-someone-else/

[168] http://www.inc.com/magazine/20081001/street-smarts-secrets-of-a-110-million-man_Printer_Friendly.html

[169] http://video.google.com/videoplay?docid=-672785046739379641&hl=en#5m13s

[170] http://bostonvcblog.typepad.com/vc/2009/01/why-do-asshole-vcs-survive.html

[171] http://bostonvcblog.typepad.com/vc/2009/01/why-do-asshole-vcs-survive.html

[172] http://hbswk.hbs.edu/item/3374.html

[173] http://hbswk.hbs.edu/item/3374.html

[174] http://www.evolvingexcellence.com/blog/2009/01/hsieh-on-people.html

[175]

> "Most business practices repress our natural tendency to have fun and socialize." – George Zimmer[176], Men's Wearhouse

If you like these quotes, you should subscribe to our Twitter[177] (RSS[178]) and FriendFeed[179] (RSS[180]) because you are missing out on many more quotes that will rock your bottom.

175 http://www.evolvingexcellence.com/blog/2009/01/hsieh-on-people.html

176 http://www.amazon.com/gp/product/0875848982?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0875848982

177 http://twitter.com/venturehacks

178 http://feeds.venturehacks.com/venturehacks-twitter

179 http://friendfeed.com/nivi

180 http://friendfeed.com/nivi?format=atom

January 2010

The Arrogant VC: Why VCs are disliked by entrepreneurs, Part 2

SPONSOR POST *Thanks to Atlas Venture*[181] *for supporting Venture Hacks this month. This post is by Fred Destin*[182]*, one of Atlas' general partners. If you like it, check out Fred's blog*[183] *and tweets @fdestin*[184]*. – Nivi*

[185]

In Part 1 of The Arrogant VC[186], 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

[181] http://www.atlasventure.com/
[182] http://www.freddestin.com/blog/
[183] http://www.freddestin.com/blog/
[184] http://twitter.com/fdestin
[185] http://www.freddestin.com/blog/
[186] http://venturehacks.com/articles/arrogant-vc

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.

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.”**

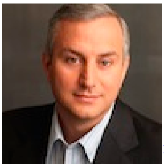
And to VC’s: “tread softly, remember that in a position of power, you can do many sensible things but a few stupid ones and end up with a ‘George Bush’ problem, and as a result the approval rating of Dubya.”

If you like this post, check out Fred’s blog[187] *and his tweets*

[187] http://www.freddestin.com/blog/

@fdestin[188]*. 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*[189] *if you're interested in supporting Venture Hacks. Thanks. – Nivi*

How to re-negotiate with your customers — and not lose a single one

[190]

Mark Suster[191], entrepreneur turned VC at GRP Partners:

> "When I was at BuildOnline (my first company) and things went 'pear shaped[192]' 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

[188] http://twitter.com/fdestin
[189] mailto:nivi@alum.mit.edu
[190] http://www.bothsidesofthetable.com/2009/12/16/what-makes-an-entrepreneur-210-street-smarts/
[191] http://www.bothsidesofthetable.com/2009/12/16/what-makes-an-entrepreneur-210-street-smarts/
[192] http://www.urbandictionary.com/define.php?term=pear+shaped

> 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[193]. You can also find my favorite negotiation book, Bargaining for Advantage[194], in our bookstore[195].

Emotions at work

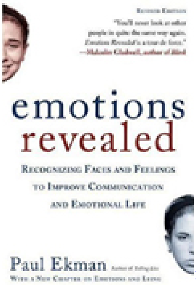
> "Some managers are uncomfortable with expressing emotion about their dreams, but it's the passion and emotion that will attract and motivate others."
>
> – Jim Collins
>
> "People will forget what you said, people will forget what you did, but people will never forget how you made them feel."
>
> – Maya Angelou

[193] http://www.bothsidesofthetable.com/2009/12/16/what-makes-an-entrepreneur-210-street-smarts/

[194] http://www.amazon.com/gp/product/0143036971?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0143036971

[195] http://venturehacks.com/bookstore

(Both quotes are from The Presentation Secrets of Steve Jobs[196] by Carmine Gallo.)



[197]

I've started reading Emotions Revealed[198] by Paul Ekman, a consultant to the television series Lie to Me[199]. It's an excellent and accessible catalog of emotions. For example, Ekman 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[200] (a fun and easy read), which you can find in our bookstore[201].

[196]http://www.slideshare.net/cvgallo/the-presentation-secrets-of-steve-jobs-2609477

[197]http://www.amazon.com/gp/product/0805083391?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0805083391

[198]http://www.amazon.com/gp/product/0805083391?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0805083391

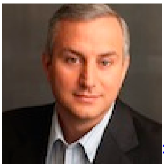
[199]http://www.hulu.com/lie-to-me

[200]http://www.amazon.com/gp/product/0553804723?ie=UTF8&tag=httpventureco-20&linkCode=as2&camp=1789&creative=390957&creativeASIN=0553804723

[201]http://venturehacks.com/bookstore

10 skills I look for before writing a check, Part 2: Perspiration and Appetite for Risk

This post is by Mark Suster[202], a serial entrepreneur turned VC at GRP Partners. If you like it, check out Mark's startup advice blog[203] and his tweets @msuster[204]. 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

[205]

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 meetings spread out over 6 weeks, which is why I believe that raising VC[206] 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[207], 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

[202] http://www.bothsidesofthetable.com/

[203] http://www.bothsidesofthetable.com/

[204] http://twitter.com/Msuster

[205] http://www.bothsidesofthetable.com/

[206] http://www.bothsidesofthetable.com/2009/08/08/wtf-is-traction-a-6-step-relationship-guide-to-vc/

[207] http://venturehacks.com/articles/10-skills

blog series on VC startup advice[208].

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[209]. And this is where the last post left off — inspiration.

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

[208]http://www.bothsidesofthetable.com/entrepreneur-dna/

[209]http://www.bothsidesofthetable.com/2009/12/19/what-makes-an-entrepreneur-511-inspiration/

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[210], 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[211]. 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.

[210]http://www.jasonnazar.com/

[211]http://eu.techcrunch.com/2009/11/20/european-startups-need-to-work-as-hard-as-valley-ones-or-forget-it/

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 recently posted some VC startup advice[212] 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[213]? 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

[212]http://www.bothsidesofthetable.com/2009/11/19/what-makes-an-entrepreneur-four-lettersjfdi/

[213]http://en.wikipedia.org/wiki/Tencent_QQ

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?

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[214]. 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

[214] http://thisweekinstartups.com/2009/11/twist-25-with-mark-suster/

you're 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 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[215]? 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[216] and his tweets @msuster[217]. If you want an intro to Mark, send me an email. I'll put you in touch if there's a fit. – Nivi

5 New Year's resolutions for closing deals in 2010

SPONSOR POST[218] *Thanks to Walker Corporate Law Group[219], a boutique law firm specializing in the representation of entrepreneurs, for supporting Venture Hacks this month. This post is by Scott Edward Walker[220], the firm's founder and CEO. If you like it, check out Scott's blog[221] and tweets @ScottEdWalker[222]. – Nivi*

[215] http://en.wikipedia.org/wiki/Cojones
[216] http://www.bothsidesofthetable.com/
[217] http://twitter.com/Msuster
[218] http://venturehacks.com/support
[219] http://walkercorporatelaw.com/
[220] http://walkercorporatelaw.com/about-the-founder/
[221] http://walkercorporatelaw.com/blog/
[222] http://twitter.com/ScottEdWalker

[223]

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…

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.

[223] http://walkercorporatelaw.com/blog/

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[224], 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 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**

[224] http://walkercorporatelaw.com/lessons-learned/lessons-learned-in-the-trenches-of-two-big-nyc-law-firms/

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 venture 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[225] 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[226] 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 LegalZoom, (2) pulling forms off the web and trying to play

[225] http://mixergy.com/bullied-board-lessons-funded-startup-brandon-watson-imsafer/

[226] http://mixergy.com/bullied-board-lessons-funded-startup-brandon-watson-imsafer/#comment-12491974

lawyer, or (3) retaining the cheapest lawyer to save money. And as the Madoff affair[227] 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 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

[227] http://www.pbs.org/wgbh/pages/frontline/madoff/

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[228] *and tweets @ScottEdWalker*[229]. *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*[230] *if you're interested in supporting Venture Hacks. Thanks. – Nivi*

No ocean boiling please

[231]

Tim Bray[232], 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.

[228] http://walkercorporatelaw.com/blog/
[229] http://twitter.com/ScottEdWalker
[230] mailto:nivi@alum.mit.edu
[231] http://www.tbray.org/ongoing/When/201x/2010/01/02/Doing-It-Wrong
[232] http://www.tbray.org/ongoing/When/201x/2010/01/02/Doing-It-Wrong

> "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[233]. And my favorite book on iterative software development is Extreme Programming Explained[234], which you can find in our bookstore[235].

How to bring a product to market, Part 2 — after product/market fit

[236]

"Where the #@!% is Part 2?"*

That's what I've been hearing since we published Part 1[237] of our rare interview with Sean Ellis[238].

Here's part 2.

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[233]http://www.tbray.org/ongoing/When/201x/2010/01/02/Doing-It-Wrong
[234]http://venturehacks.com/articles/extreme-programming-explained
[235]http://venturehacks.com/bookstore
[236]http://startup-marketing.com/
[237]http://venturehacks.com/articles/sean-ellis-interview
[238]http://startup-marketing.com/

In Part 1[239], 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[240] or tweets[241], he lead marketing from launch to IPO filing at LogMeIn and Uproar. His firm, 12in6[242], 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."

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[243]
> Audio: Interview with chapters[244] (for iPod, iPhone, iTunes)

[239] http://venturehacks.com/articles/sean-ellis-interview

[240] http://startup-marketing.com/

[241] http://twitter.com/seanEllis

[242] http://startup-marketing.com/12in6-projects/

[243] http://www.slideshare.net/venturehacks/how-to-bring-a-product-to-market-part-2

[244] http://venturehacks.com/wordpress/wp-content/uploads/2010/01/How-to-bring-a-product-to-market-Part-2-Sean-Ellis-Interview.m4a

Audio: Interview without chapters[245] (MP3, works anywhere)
Transcript with highlights: Below

This inteview is free — thanks to KISSmetrics

[246]

We're bringing this interview to you free, thanks to our sponsor KISSmetrics[247].

Sean is an advisor at KISSmetrics and we interviewed their CEO, Hiten Shah[248], in How to measure product/market fit with survey.io[249]. KISSmetrics built survey.io[250] 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

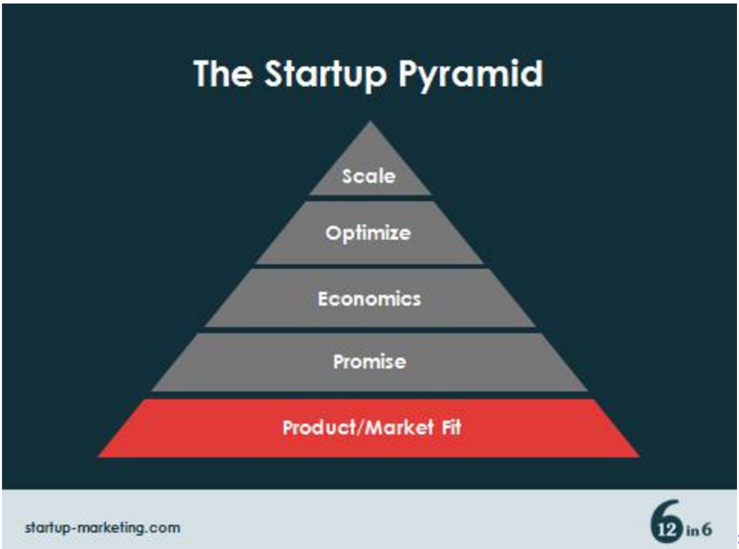
You'll get more out of this interview if you also read:

1. Part 1[251] of our interview with Sean.

[245]http://venturehacks.com/wordpress/wp-content/uploads/2010/01/How-to-bring-a-product-to-market-Part-2-Sean-Ellis-Interview.mp3
[246]http://kissmetrics.com/
[247]http://kissmetrics.com/
[248]http://hitenshah.name/
[249]http://venturehacks.com/articles/measure-fit
[250]http://survey.io/
[251]http://venturehacks.com/articles/sean-ellis-interview

2. The startup pyramid[252].

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 + optimizing the funnel.



[253]

Outline

Here's an outline and transcript of Part 2.

1. What comes after fit?

[252] http://startup-marketing.com/the-startup-pyramid/
[253] http://startup-marketing.com/the-startup-pyramid/

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[254] *by Tortoise*[255]

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[254]http://www.google.com/search?hl=en&q=the%20equator%20by%20tortoise&aq=f&oq=

[255]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[256] *Thanks to Walker Corporate Law Group*[257]*, a boutique law firm specializing in the representation of entrepreneurs, for supporting Venture Hacks this month. This post is by Scott Edward Walker*[258]*, the firm's founder and CEO. If you like it, check out Scott's blog*[259] *and tweets @ScottEdWalker*[260]*. He's also*

[256]http://venturehacks.com/support
[257]http://walkercorporatelaw.com/
[258]http://walkercorporatelaw.com/about-the-founder/
[259]http://walkercorporatelaw.com/blog/
[260]http://twitter.com/ScottEdWalker

writing a new series on VentureBeat: Ask the attorney[261]*. – Nivi*

[262]

Last week I offered 5 New Year's resolutions for closing deals in 2010[263]. This week, I thought I'd have a little fun and address the issue of entrepreneurs' frustration with lawyers. A recent tweet[264] 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[265], 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[266] for a brief video version of this post.

[261] http://venturebeat.com/tag/ask-the-attorney/
[262] http://walkercorporatelaw.com/blog/
[263] http://venturehacks.com/articles/closing-deals
[264] http://twitter.com/bramcohen/status/7336163022
[265] http://www.enotes.com/shakespeare-quotes/lets-kill-all-lawyers
[266] http://www.blip.tv/file/3039552

#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*[267], Former U.S. Solicitor General Theodore Olsen[268] 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 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.

[267] http://federalappeals.net/why-all-the-legalese/

[268] http://en.wikipedia.org/wiki/Theodore_Olson

Tom Kane, a legal consultant, notes[269]: "[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.

As John Derrick, a California appeals specialist, points out in his book Boo to Billable Hours[270], "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

[269] http://www.legalmarketingblog.com/marketing-tips-how-do-you-keep-clients-informed.html

[270] http://www.californiaappeals.com/lawyer/Boo_to_Billable_Hours_Chapter_8_overlawyering.html

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[271]: "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."

[271] 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[272]". 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[273], "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

[272] http://www.marginalrevolution.com/marginalrevolution/2009/03/are-big-law-firms-built-on-implicit-leverage.html

[273] http://walkercorporatelaw.com/videos/behind-the-big-law-firm-curtain-the-good-the-bad-the-ugly/

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 Capital Association[274]. 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[275], "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[276] struck a chord with me: "I just didn't look

[274] http://www.nvca.org/index.php?option=com_content&view=article&id=108&Itemid=136

[275] http://www.jasonmendelson.com/wp/archives/2008/06/why-start-up-lawyers-frustrate-me.php

[276] http://www.nytimes.com/2010/01/10/business/10corner.html

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 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[277] 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[278]"). 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.

[277]http://walkercorporatelaw.com/

[278]http://www.law.com/jsp/article.jsp?id=1202426547201

LawShucks[279] 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[280], "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 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

[279] http://lawshucks.com/2010/01/the-year-in-law-firm-layoffs-2009/

[280] http://dealbook.blogs.nytimes.com/2009/07/01/another-view-in-praise-of-law-firm-layoffs/

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[281], a professor and retired partner at Skadden Arps in New York, points out[282], "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."

[281] http://www.skadden.com/index.cfm?contentID=45&bioID=35

[282] http://www.abanet.org/buslaw/blt/8-6problem.html

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[283] *and tweets @ScottEdWalker*[284]*. He's also writing a new series on VentureBeat: Ask the attorney*[285]*. 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*[286] *if you're interested in supporting Venture Hacks. Thanks. – Nivi*

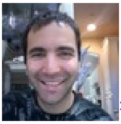
Bram Cohen: "Lawyers can't tell you you can't do something"

Yesterday, we published Top 10 reasons why entrepreneurs hate lawyers[287], 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 [288]from lawyers like well-

[283] http://walkercorporatelaw.com/blog/
[284] http://twitter.com/ScottEdWalker
[285] http://venturebeat.com/tag/ask-the-attorney/
[286] mailto:nivi@alum.mit.edu
[287] http://venturehacks.com/articles/hate-lawyers
[288] http://venturehacks.com/articles/hate-lawyers#comments

known Silicon Valley folks Yokum Taku[289], Josh King[290], and Matt Bartus[291].

[292]

Second, Bram Cohen[293], the inventor of BitTorrent, left an awesome comment[294] 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 are given.
>
> "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.

[289] http://www.startupcompanylawyer.com/
[290] http://corporatetool.blogspot.com/
[291] http://twitter.com/mbartus
[292] http://twitter.com/bramcohen
[293] http://twitter.com/bramcohen
[294] http://venturehacks.com/articles/hate-lawyers#comment-10362

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 entrepeneurs 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[295] 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

[295] 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[296] 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[297], created a lot of awesome discussion about startup lawyers. See the comments[298] to that post and the comments to Bram Cohen's follow-up, "Lawyers can't tell you you can't do something"[299].

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[300] (comment[301]). Matt Mullenweg[302] (Automattic's founder) works with him and intro-

[296] http://futureoffunding.eventbrite.com/?discount=venture_hacks
[297] http://venturehacks.com/articles/hate-lawyers
[298] http://venturehacks.com/articles/hate-lawyers#comments
[299] http://venturehacks.com/articles/bram-cohen-lawyers
[300] http://twitter.com/mbartus
[301] http://venturehacks.com/articles/hate-lawyers#comment-10360
[302] http://ma.tt/

duced us. Matt Bartus is sponsoring Venture Hacks in a few weeks.

George Grellas[303] (comment[304]). George has lots of good advice on his website[305] and he's active on Hacker News[306].

Rob Hyndman[307] (Toronto) (comment[308]). Rob has left a lot of comments on Venture Hacks if I remember correctly.

Antone Johnson[309] (comment[310]). I really liked his comment[311] and Twitter bio[312].

Nathan Roach[313] (IP focus) (comment[314]). Former programmer — always a bonus.

Yokum Taku[315] (comment[316]). Yokum's blog[317] is one of the best startup law resources on the web.

Scott Edward Walker[318]. The sponsor who started this all.

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[303] http://twitter.com/grellas
[304] http://news.ycombinator.com/item?id=1056170
[305] http://www.grellas.com/resources.html
[306] http://news.ycombinator.com/user?id=grellas
[307] http://www.robhyndman.com/
[308] http://venturehacks.com/articles/hate-lawyers#comment-10385
[309] http://twitter.com/antonejohnson
[310] http://venturehacks.com/articles/bram-cohen-lawyers#comment-10394
[311] http://venturehacks.com/articles/bram-cohen-lawyers#comment-10394
[312] http://twitter.com/antonejohnson
[313] http://nathanroach.com/
[314] http://venturehacks.com/articles/bram-cohen-lawyers#comment-10377
[315] http://www.startupcompanylawyer.com/
[316] http://venturehacks.com/articles/hate-lawyers#comment-10349
[317] http://www.startupcompanylawyer.com/
[318] http://walkercorporatelaw.com/blog/

> (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[319].
>
> **Update 2**: See the comments[320] for more recommendations, including my legal friend Andre Gharakhanian[321].
>
> **Update 3**: Mark Suster[322] and True Ventures[323] 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 withJorge del Calvo[324] and Tom Thomas[325]. 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.

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[319] http://giffconstable.com/2010/01/great-startup-lawyers/

[320] http://venturehacks.com/articles/social-lawyers#comments

[321] http://venturehacks.com/articles/social-lawyers#comment-10477

[322] http://www.bothsidesofthetable.com/2010/01/21/how-to-work-with-lawyers-at-a-startup/

[323] http://www.trueventures.com/recommendations/

[324] http://www.pillsburylaw.com/index.cfm?pageid=15&itemid=20502

[325] http://www.pillsburylaw.com/index.cfm?pageid=15&itemid=20949

Get Venture Hacks on Facebook

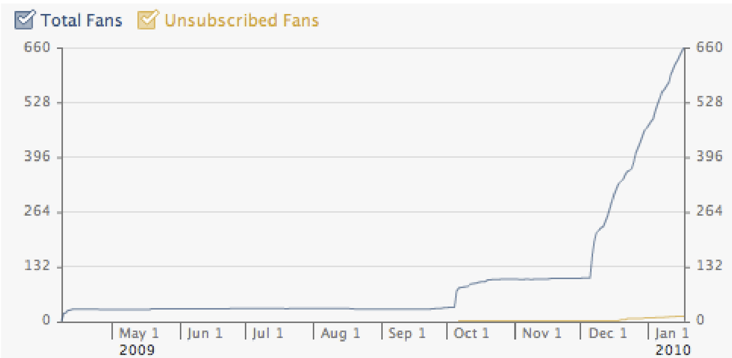
We now have a Facebook fan page for Venture Hacks[326]. It's a feed of our blog posts and tweets[327].

I was surprised to see how many people get their news on Facebook. The fan page already has 677 fans. Check it out[328].

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-

[326] http://www.facebook.com/pages/Venture-Hacks/70612138702
[327] http://twitter.com/venturehacks
[328] http://www.facebook.com/pages/Venture-Hacks/70612138702

hacks.com[329]. 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.

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[330] to publish tweets to Twitter and our fan page at the same time. It also lets me schedule tweets.
- NetworkedBlogs[331] to publish our blog posts to the fan page.
- Involver[332] to power the Twitter tab at the top of the fan page.

I also use tweetpo.st[333] 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[334], which also includes the instructions for my Twitter/Facebook workflow.)

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[329] http://venturehacks.com
[330] http://hootsuite.com
[331] http://www.facebook.com/apps/application.php?id=9953271133&ref=mf
[332] http://www.involver.com
[333] http://www.facebook.com/apps/application.php?id=68044745059
[334] http://docs.google.com/Doc?docid=0AYVOOOq2NeN3ZGZnanF2NTdfMTUwZ3p2NWtoMzQ&hl=en

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:

Referring Site	Click(s)
Email Clients, IM, AIR Apps, and Direct +	19,619
twitter.com +	6,764
www.facebook.com +	1,540

[335]

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[336] 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[337] *Thanks to FastIgnite[338], a startup advisory firm, for sponsoring Venture Hacks this month.* ***This post is by Simeon***

335 images/facebook-traffic.png
336 http://www.google.com/search?hl=en&q=continuous%20deployment&aq=f&oq=
337 http://venturehacks.com/support
338 http://fastignite.com/

***Simeonov**[339], the firm's founder and CEO (and formerly a partner at Polaris Ventures[340]). If you like it, check out Sim's blog[341] and tweets @simeons[342]__. – Nivi*

"Prediction is very difficult, especially if it's about the future."

Niels Bohr[343], Nobel Prize winner

[344]

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[345], and solid execution.

Execution is the main tool under a startup's control but it's often under-valued by investors.

[339]http://fastignite.com/about
[340]http://www.polarisventures.com/
[341]http://blog.simeonov.com/
[342]http://twitter.com/simeons
[343]http://en.wikipedia.org/wiki/Niels_Bohr
[344]http://blog.simeonov.com/
[345]http://blog.simeonov.com/2009/07/30/how-ibm-and-yahoo-made-microsoft-and-google/

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[346] 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[347]."

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[348], 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

[346] http://blog.simeonov.com/2007/02/21/guy-kawasaki-why-good-strategies-fail/
[347] http://blog.aweissman.com/2009/10/dont-get-high-on-your-own-supply.html
[348] http://www.polarisventures.com/

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, market-based reasons that were invisible during diligence. Plinky[349] acquired a new product line and became Thing Labs[350]. 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

[349]http://www.plinky.com/
[350]http://www.thinglabs.com/

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[351].

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 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[352]

[351]http://en.wikipedia.org/wiki/Reality_distortion_field
[352]http://en.wikipedia.org/wiki/Anti-pattern

above? I give two answers to the CEOs I work with at my startup advisory firm FastIgnite[353].

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 clichÃ©, few do many investments this way. Here are some examples from my experience in the past few months:

- On the smaller side, Betaworks[354] and First Round Capital[355] get this. Their portfolios and their philosophy[356] show it. I look forward to working with them some day.
- Among VCs, General Catalyst[357] has repeatedly backed companies like Brightcove[358], m-Qube, and Visible Measures[359] 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[360] can be a great place for the right

[353]http://fastignite.com/

[354]http://betaworks.com/

[355]http://firstround.com/

[356]http://blog.aweissman.com/2009/10/i-want-to-be-platform.html

[357]http://gcvp.com/

[358]http://www.brightcove.com/en/

[359]http://www.visiblemeasures.com/

[360]http://www.warburgpincus.com/Default.aspx

> early-stage entrepreneur. Last year, a Warburg entrepreneur-in-residence incubated Better Advertising[361], 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[362].

If you like this post, __check out Sim's blog[363] and his tweets @simeons[364]. And contact me[365] if you're interested in supporting Venture Hacks. Thanks. – Nivi

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[366]), describe the ads, and pitch new sponsors.

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[361]http://betteradvertising.com/

[362]http://venturehacks.com/articles/lying-to-investors#comments

[363]http://blog.simeonov.com/

[364]http://twitter.com/simeons

[365]mailto:nivi@alum.mit.edu

[366]http://venturehacks.com/sponsor

The ads

You've already seen the ads. They're 'sponsor posts' like How to raise money without lying to investors[367] by Simeon Simeonov. They're labeled with an image like this,

and an introductory message from us: "Thanks to FastIgnite[368], 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[369] by cool people[370] and 10-30 substantial comments[371]. They get on the front page of Hacker News[372] and Techmeme:

[367] http://venturehacks.com/articles/lying-to-investors

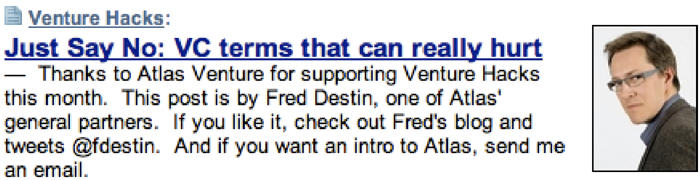
[368] http://fastignite.com/

[369] http://www.backtype.com/connect/venturehacks.com%252farticles%252fhate-lawyers/tweets

[370] http://twitter.com/aweissman/status/6528587774

[371] http://venturehacks.com/articles/lying-to-investors#comments

[372] http://news.ycombinator.com/item?id=1068029



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[373] from Charles River Ventures[374] and Wordpress' lawyer, Matt Bartus[375] from Dorsey & Whitney[376].

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."

[373] http://twitter.com/georgezachary
[374] http://www.crv.com/
[375] http://twitter.com/mbartus
[376] http://www.dorsey.com/

Sponsor posts get 5000+ views, 50-150 retweets, 10-30 substantial comments, and 50-100 new Twitter followers. *We're the only site in the world where the ads perform as well as the content.* Learn more about sponsoring Venture Hacks[377].

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[378] and ask them to consider sponsoring Venture Hacks. And please send me your suggestions in the comments[379].

I recently described our sponsor posts to Eric Ries[380] and he called them "ads that are really content you can share." I like that a lot.

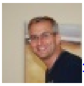
Comments of the week: Legal fees, financial projections, and fit

We're determined to have the best comment section of any blog the universe. Comments that are really worth reading.

One of the tactics we use to improve comments is tweeting[381] about the good ones. Another tactic is highlighting good com-

[377] http://venturehacks.com/sponsor
[378] http://venturehacks.com/sponsor
[379] http://venturehacks.com/articles/sponsor-posts#comments
[380] http://www.startuplessonslearned.com/
[381] http://twitter.com/venturehacks

ments on this blog. Here are three comments from last week that really rocked (among many other excellent ones).

[382]

Mark Suster[383] from GRP Partners writes[384]:

> 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.

[382]http://www.bothsidesofthetable.com/

[383]http://www.bothsidesofthetable.com/

[384]http://venturehacks.com/articles/bram-cohen-lawyers/comment-page-1#comment-10408

- 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.

[385]

George Kassabgi[386] from Keas says[387]:

> "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

[385] http://www.linkedin.com/in/georgek
[386] http://www.linkedin.com/in/georgek
[387] http://venturehacks.com/articles/lying-to-investors/comment-page-1#comment-10548

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[388] from goBalto comments[389]:

> "It's been exactly one month since I implemented Sean's suggestions[390] regarding assessing our before 'product market fit' strategy using survey.io[391]. 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 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.

[388] http://www.gobalto.com/

[389] http://venturehacks.com/articles/sean-ellis-interview/comment-page-1#comment-10546

[390] http://venturehacks.com/articles/sean-ellis-interview

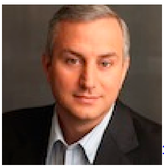
[391] http://survey.io/

> "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[392], a serial entrepreneur turned VC at GRP Partners. If you like it, check out Mark's startup advice blog[393] and his tweets @msuster[394]. 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

[395]

This is the last in a three-part series about the 10 things I look for in an entrepreneur. In Part 1[396], I addressed tenacity, street

[392]http://www.bothsidesofthetable.com/
[393]http://www.bothsidesofthetable.com/
[394]http://twitter.com/Msuster
[395]http://www.bothsidesofthetable.com/
[396]http://venturehacks.com/articles/10-skills

smarts, resiliency, ability to pivot, and inspiration. In Part 2[397], I discussed perspiration and appetite for risk. I elaborated on each of the topics in my blog series on VC startup advice[398].

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.

[397] http://venturehacks.com/articles/10-skills-2
[398] http://www.bothsidesofthetable.com/entrepreneur-dna/

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 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[399]: "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 evangalizing on behalf of the company. "So who runs the company on a daily basis?" I

[399]http://www.bothsidesofthetable.com/2009/10/15/startup-founders-should-flip-burgers/

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 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[400], 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 cate-

[400] http://www.bothsidesofthetable.com/2009/12/21/what-makes-an-entrepreneur-perspiration-611/

gory killer was a French company called Vente Privee[401] (which translates to "private sale"). From what I'm told, the founders were in the Schmatta (Jobber[402]) 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 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**

[401]http://en.wikipedia.org/wiki/Vente-privee.com

[402]http://www.merriam-webster.com/dictionary/jobber

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[403]? 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

[403] http://en.wikipedia.org/wiki/Freemium

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". 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, AdMob, 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[404] *and his tweets @msuster*[405]. *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[406]

Thanks to FastIgnite[407]*, a startup advisory firm, for sponsoring Venture Hacks this week. This post is by Simeon Simeonov*[408]*, the firm's founder and CEO (and formerly a partner at Polaris Ventures*[409]*). If you like it, check out Sim's blog*[410] *and tweets @simeons*[411]. *– Nivi*

[412]

The best strategy for not having to fire your co-founders is to not bring them on board in the first place.

[404]http://www.bothsidesofthetable.com/
[405]http://twitter.com/Msuster
[406]http://venturehacks.com/support
[407]http://fastignite.com/
[408]http://fastignite.com/about
[409]http://www.polarisventures.com/
[410]http://blog.simeonov.com/
[411]http://twitter.com/simeons
[412]http://blog.simeonov.com/

One of the most common early-stage startup mistakes[413] 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[414] 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. 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

[413] http://blog.simeonov.com/2010/01/05/startup-mistakes/

[414] http://xobni.com/

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[415].
- 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 overwhelming odds. In larger doses they make a dangerous poison

[415] http://venturehacks.com/articles/pick-cofounder

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[416], too — is to delay decisions until the last *responsible* moment[417]. Because the future is uncertain, the idea is to make decisions with the most information. The 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[418] 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[419]. 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.

[416]http://discuss.joelonsoftware.com/default.asp?design.4.484158.14
[417]http://venturehacks.com/articles/extreme-twitters
[418]http://venturehacks.com/articles/lying-to-investors
[419]http://www.jimcollins.com/article_topics/articles/good-to-great.html

- 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 ___.

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[420]. Depending on the situation, I'm an active advisor or co-founder and/or acting CTO. Other people, like Andy Palmer[421], take on a board or acting CEO role.

[420]http://fastignite.com/about

[421]http://www.linkedin.com/in/andypalmer

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[422] (David Beirne[423]) and Polaris[424] (Peter Flint[425]). Others, such as General Catalyst[426] and Founders Fund[427], 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.

[422] http://benchmark.com/

[423] http://benchmark.com/sv/partners/beirne.shtml

[424] http://www.polarisventures.com/

[425] http://polarisventures.com/WhoWeAre/TeamDetail.asp?ContactID=%7b336198AC-DE78-45EC-A26C-163C958D1F08%7d

[426] http://www.generalcatalyst.com/

[427] http://foundersfund.com/

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[428]

Thanks to Fred Destin[429] 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[430].

[428] http://www.youtube.com/watch?v=ElNlIfwlF-w

[429] http://www.freddestin.com/

[430] http://www.bothsidesofthetable.com/2009/12/19/what-makes-an-entrepreneur-511-inspiration/