Saturday, 27 June 2020

The Moonshot Game

Chapter 2

- Like us, many other VC firms in India were founded in 2006. Somehow, the size of the first fund for most firms was around $140 million. Investors in overseas countries who backed these funds found this to be a comfortable size for firms that had a team of two or three investment partners. Like us, most of these firms came back for their second fundraise in 2008. This meant that 2007 and 2008 were two of the most action-packed years for VC investing in India. After a long, dry spell, Indian VC firms were making a new investment once in two months on average
- 'Referencing the founders'. The founders would provide a list of people that could offer their views on their personality and capability. VCs would then call the people on that list but would also find some people who were not on the list. Speaking to ten to fifteen people to understand the past is not uncommon
- Lengthy negotiations are not only unproductive in the venture business but also risky because either side can find options or go through a rethink
- The constant analysis of what makes some start-ups successful while some equally smart founders fail shows that timing has a massive role. This one factor is a huge determinant of success and is hardest to determine

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Chapter 4

- Every VC fund has three years to deploy its capital. The investments that the fund makes and its overlap with the big companies that are born in that three-year window will determine the success of that fund
- Funds invest in three phases - the first part of this three-year period is when the team has fresh capital: newly raised, ready to deploy. This phase is the 'clueless' phase where the investment team is making random calls. The second phase is the 'sane' phase where some semblence of structure is brought back and bets are usually more sensible. The last phase is the 'lazy' phase where the fund is about to run out and a new fund is being raised. The team is busy working on raising the new fund and some half-baked decisions are made without the usual zeal and diligence. There could be surprises, but the most likely winners, predictably come from the 'sane' phase
- We decided to invest in this company and called a few VCs to co-invest with us. One of them liked the company so much that they decided to keep us out and funded the company entirely on their own. It was a strange experience, but we admired the VC firm for their single-mindedness

- Culture and DNA are the hardest to change. Expecting a twenty-year-old organization like Getit to start galloping was a mistake. I overestimated the power of venture investment. The older an organization gets, the more set it becomes in its ways. Just like humans. A tech company's DNA is the most valuable piece of a start-up. This DNA allows a puny start-up to take on the might of gigantic competitors. This DNA needs a crack team driven towards a common goal with urgency. It produces exceptional products that deliver value to its users and immense growth, milestone after milestone. This DNA is the prerequisite to success in the VC business

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Chapter 6

- The obvious idea of replacing the founder would be brought up. In most cases, it would be a difficult conversation. Founders would begin politely, putting it off to 'when the time is right.' Most would say, putting it off to 'when the time is right'. Most would way, 'We ourselves would like someone who is better suited to run the organization', but when the time came, they resisted fiercely. And even when a replacement was made, it rarely succeeded. Despite the competency and the compensation, the replacement of a founder by a professional could not be accomplished by the life energy that only a founder can provide to a start-up. So a founder's ability was also measured by the life force they could provide to grow an organization

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Chapter 7

- Exitability was now an internal measure of how we saw the chances of an investment going public or being purchased by another investor. Wider demand to buy out so we can return capital to our investors. We needed this score because we realized that factoring this in at the time of investment helped us see the journey ahead better
- Sometimes, every investor has the ability to throw a spanner into a highly contentious investment - a founder is caught between a new investor and the existing investor, who has the right to say, 'No, I will not approve this new round.' These rights are called affirmative rights and can make a founder's life very hard
- Founder salaries are Gandhian tools to keep the balance between founders and investors. They are Gandhian because it's a moral position achieved through a personal sacrifice. How much is a founder's salary worth? When everyone around the table knows the salary-earning potential of a founder who has chosen to take an income only for sustenance, the power of that moral stand helps maintain the balance in the board
- As an investor, I have tremendous respect for founders who forego high salaries to put the company's interests first. The cash is limited; it can be dissipated in high salaries or be used to build more equity value for everyone
- Between Equitas, Spandhana and Shubham, I discovered an India that had been alien to me. It was all around me but I had never paid attention. I only saw what was familiar. I noticed problems that affected people like myself. But here was the

largest mass of India - desirous of asset ownership, toiling for upward mobility and a better life, and yet unserved. This quiet but large opportunity was hidden from many investors

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Chapter 8

- In offline businesses like restaurants and clinics, the hardest part is figuring out scale because their growth is linear. Variability never goes away and there are always plenty of variables that can stall growth. Would a new location work out? Would customers eat more at the store or would only new stores cause growth? Of course, there have been brands like Dominos, Starbucks and McDonald's that have defied these notions. They had access to food tech, which made their supply chain more predictable and customer experience more repeatable.
- Linearly growing businesses that are not VC-funded have to fund their growth from their own profits. The founders are forced to figure out profitability early. Being VC-funded removes this very important constraint of being economically viable at every step. So VC-funded linearly growing businesses have to overcome two challenges. First, they have to figure out the economics after they have established unprofitable practices. Second, they have to raise rounds of capital from investors who would always be wary of growth slowing down
- Technology-led businesses tend to scale better because they grow non-linearly and they are rewarded early when they prove this. Their growth is called the 'J-curve': there is a point in the journey where the original thesis is proven, the unit metric works out and then pumping in growth capital causes a nearly 90-degree curve upwards, taking the business to the stratosphere. At least that's the principle investors have in mind. The business starts getting rewarded with a premium valuation because there is a clear expectation for growth

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Chapter 9

- A business that loses cash to growth needs to have a lead investor who can afford to carry the company on their shoulders for a few years. There was a paucity of capital that could be deployed unless there was a visible light at the end of the tunnel
- I would often tell founders. 'The market will happen, we have to stay ready for the big wave, and until then, let's build a great product.' The team would plan for longer terms and remain in preparation mode. Many founders would go to the other extreme and hesitate to spend capital, choosing to keep the company in the lower gears. Other than in microfinance, I had so far not heard that 'market demand is infinite so let's grow as much as we can'
- Indian VCs learning the formula for funding high-growth companies was a turning point in the history of venture capital in India

Chapter 10

- So we conducted an exercise to study the strongest CEOs in our network. What made them tick. Why one CEO was more successful than the other over the long run. We arrived at a set of common attributes that these CEOs displayed. These attributes covered resilience, lack of greed, humility, action orientation, vision and strategic thinking
- Our goal was that at least 80 per cent of all startups operating in our sectors of interest should be talking to us about their next round of investment. This was an indicator that we were a preferred partner. If entrepreneurs did not want to talk to us, something was wrong. Our spectrum of investments had been broad, so we were seeing all kind of deals
- The culture of a VC firm was on external display when its team interacted with its startup. This interaction was tricky. In most cases, we knew that we would not end up investing. The founders would pitch to us in earnest expectation. We felt that the least we could do in turn was to keep the session meaningful and engaging. The team had to do this without appearing dismissive or smug. We definitely didn’t know the business better than the founder
- We preferred candidates who reflected humility because we wanted our employees to treat start-ups with respect. At the same time, they had to be sharp enough to understand the complexities of a new business every week. If finding smarts and humility in the same person was not hard enough, we also had to look for another complex trait: long-term orientation
- Most founders would expend their energy in hiring the next-level team and assume that once you throw professionals into the pit, an organic structure would evolve effortlessly. This was where most scale-ups fail. The effort to integrate this team of hires was where the real effort was needed

Chapter 11

- Just ask five sought-after founders whom they would like to take capital from, and if four out of five put you in their top three options, then the firm is doing its job well. We were on the top-three lists of many founders in 2012. The top investors in the world had placed their trust in us. We stood for something. The market saw us as a trendsetter
- The IP around repeatability is the value that limited partners look for in VC firms. Helion had at least five successful startups by 2012, demonstrating repeatability in backing winners

Chapter 13

- The most important element of the shareholding structure of a start-up is the ownership held by the founders. In companies that give away too much too early, investors who come in later often worry that founders with low ownership may not remain motivated in the long run. This worry is often suspended by the

enthusiasm of investing in a new company, but it usually comes back to haunt investors

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Chapter 14

- My view is that once a founder gets going, the life energy that is infused into getting a business off the ground, combined with the ability to envision the future, is independent of age. Most founders are not weighing options and in reality they know that the life they lived before becoming a founder has been left behind

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Chapter 15

- The last quarter had been slow for the company, and despite how long-term an investor has to be on a start-up's future, new investors always use the last quarter performance as an excuse to negotiate price
- When VCs invest, they care a lot about the multiple on their capital - they budget for five-six years before they get returns - but the objective is to make at least five-ten times return in five years. So as a start-up raises capital over the years, the motivation to exit varies across the early entrants and the late entrants
- Depending on whether you favour a sale or not, you choose between 'the competition could kills us' and 'we could kill the competition'
- Every transaction starts as a complex one. Then everyone jumps up and says, 'Oh, it's too complex. Let's keep it simple'
- This is the second law of thermodynamics, which states that 'the total entropy of an isolated system can never decrease over time.' Why does entropy feature in a book about founders and VCs? It's found a mention here because this brilliant law offers great insight when it comes to explaining the ups and downs of human life. The amplitude of swings from 'It's all good' to 'Oh my God, I don't know what the heck just happened' hits founders frequently. It is more frequent than for any other average person. They just learn to take it in their stride and force their broken spirits to recover much faster than the rest of us
- Good entrepreneurs bounce back like good sportspersons. That is because their daily highs and lows make them better at dealing with this chaos that start-ups keep going through. At Helion, we firmly believed that all start-ups would go through at least one near-death experience. Especially those destined for greatness
- We had also never seen a merger of start-ups that had worked. The odds were stacked high against a successful outcome. The partnership had discussed the issues threadbare
- In VC discussions where there is a lot of future-gazing and people extrapolating based on past experiences, fear belongs to the people who are not close to the company and optimism belongs to the ones who are. Conviction alone can put an end to the debate

Chapter 16

- The year 2014 was what they call a bubble year. A spike in capital availability had caused over-allocation to venture capital. VCs had bigger funds and were also investing faster. Companies were raising fresh rounds of capital faster than before. When a VC deploys capital, price discovery is driven by a shallow buyer market of other VCs. Public markets are sophisticated in pricing efficiency because of a much higher number of buyers; VCs are far fewer in number and information is grossly asymmetric. When market sentiments are frothy, prices tend to drift away from value more acutely than in public markets
- The stage of entry for an investment firm had been easy to determine, but starting 2014, there was no telling which firm would come in at what stage. Tiger could come in at a Series A and an early-stage firm could do a Series C. Mostly it was backwards, with typical late-stage capital investors entering start-ups early in their journey. Tiger had already started entering in Series A with co-investors in 2012 in companies like LetsBuy and BabyOye, but in 2014 it started going solo in Series A investments. Tiger made a total of seventeen investments in India in 2012 and 2013
- Many new startups in India were being formed by replicating the business models of successful startups from the US and China. Sometimes Indian consumers were ready and sometimes the business turned out to be too early for a diverse country like India. Food tech was a category that took a bite of this apple in several different ways. Many of these companies assumed that Indian consumers had sophisticated palates and needed to be delivered fancy food at their doorstep. The foodtech space saw more than 400 startups in 2015. Foodtech was a hot sector in the US and China, where the per capita GDP exceeded India's $1,600 by at least five times. Per capita GDP in the US $56,000 and in China, $8,000 in 2015. Yet, founders and investors backed the sector as if India were a wealthy country
- No other sector ignored the spending power of an average Indian as much as foodtech. With only 7 million households in India earning more than $30,000 in 2017, we were woefully short of the hundreds of millions of customers needed to make the high-burn businesses viable
- It was after the lessons from the US market were learnt that India would start to replicate. Foodtech was the first sector that was replicated, even before it was clear whether it made sense in the US
- In 2014, to have Tiger's fund back you was a prayer on every competitive founder's lips. If you had Tiger on your side, the odds of another investor getting into the ring to compete with your startup were minimized. You could raise a lot of capital, but you wouldn't need to burn cash excessively unless you were forced to do so by another startup that was fighting for the top spot. And if you can pull the biggest investors to your side, you create a deterrent for others based on your power to outspend the competition. Unless a large global competitor with more capital on its balance sheet appears as competition, under ideal conditions, capital can be a deterrent

- For every ‘smart’ investor, there is a trail of club investors who add to the pool of capital available to the companies that this investor chooses to back. These investors who follow the smart investor are maximizing their chances of winning by joining the right club. If you belong to the wrong club, you could find yourself struggling to convince late-stage investors to back your company

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Chapter 17

- Angels also found a formula to start clubbing their small cheques to form ‘angel syndicates’. Usually, an angel would be part of a bunch of investors ‘hunting in packs’. An individual would write a single cheque of Rs 10-15 lakhs and then club it with five more similar-sized syndicate members’ cheques
- These angels were mostly founders of other successful startups. Their risk appetite was high and they also had a good eye for the most business-minded founders. VCs can be too intellectual in identifying businesses - these angels were more practical and liked to back founders who understood ‘dhanda’
- Unicorn founders had sold a part of their own holdings to their investors and were using that money to write their angel cheques. By the time the company would raise their second or third VC round, these angel cheques would have grown handsomely in value. New investors would then offer to buy out the angels. The profits would flow to newer start-ups. This quick turnaround motivated even more angels to join in
- By 2015, VC firms had handed the chequebooks to their staff and made the seed-investing programme simple and fast. One founder was made to sign a term sheet at her apartment when junior team members from an aggressive VC firm cornered her one early morning at her doorstep to beat the rush of VCs who wanted to fund her
- At some VC firm, senior partners would sponsor a $10-20 million seed cheque. This was extremely lethal combination of stage and capital exposure. The discipline and respect for capital was an unknown trait in the founders, so trusting these early-stage startups with so much capital turned into a wild circus. Steve Jobs was a God to many of these founders and they made it a point to first lose their ability to listen to their investors. Then they went about town making incredible offers to employees who didn’t think it necessary to make sacrifices on their pay-cheques before moving to a start-up
- In slow markets, investors like to wait for more traction. Once start-ups achieve that, the investors ask for some more. Then some more and more. There is no incentive to risk capital unless there is the fear of losing the investment to some other investor
- In early stage companies, a large strategic investor was a hindrance - it would prevent financial investors from funding the business because they would doubt that the start-up would ever be able to discover its market price and hence provide the right exit to financial investors. The presence of a strategic investor who is also a potential buyer as a shareholder scares everyone off

- We had learnt painful lessons from the past when we were ejected out of an investment by the same VC whom we had invited in to partner with us

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Chapter 18

- It was a serious exercise, bringing back the culture of productive action. It would seem routine from the outside, but a company that had so many unproductive parts needed a lot of axle grease to move it forward with the new discipline of cash conservation. The housing.com saga would always be remembered as one that set a new benchmark for pissing off the greatest number of people in the least possible time
- By the summer of 2015, I was already telling the founders of companies whose boards I was on to start planning for a slowdown in funding. I had seen enough quick failures and expensive flameouts to know that this was coming
- In the ninety-day plan, we determined the open positions, gave out the job search mandates, identified the relevant metrics and also determined the 'guard rails' within which we had to remain and not drift too far from when pushing the pedal, like customer stickiness. If they started losing it at the cost of growth, then we had to pull back and fix the drift before pushing forward again. The ninety-day plan helped us tremendously in setting the company off on a good trajectory
- The TinyOwl layoff was the low point of this frothy period - young founders making wrong choices, young employees having their start-up dreams cut short by layoffs, and anger all around. After TinyOwl, I didn't have to waste my breath prophesizing the cash crunch period

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Chapter 19

- Success had been equated with growth. Growth meant that you had to ignore some basic questions about sustainability. When I sat in the board meeting of a start-up I had no clue about my own position on this sensitive topic - the peer pressure was so great that it sounded insincere to talk about conserving cash. I would feel two-faced asking about the growth rate and then ending the meeting with concerns about the insufficient amount of capital left
- By 2016, VCs hit the pause button on investments. The small cheques that helped new companies get off the ground had all but disappeared. A few mega rounds had kept the clock turning on total capital invested, but that impacted just a handful of companies. The majority were starving or quietly shutting down
- In a tightening funding environment, the portfolio adds from 2014 and 2015 were the first priority for each VC. Almost all of them were candidates for an internal bridge round. Every VC made sure that their own companies had cash and stopped investing in new companies
- More late-stage capital helped keep venture-funded companies stay private for longer periods of time. Pressure to list had been replaced by the notion that 'We can remain private and keep growing because there is more private capital

available.' No one was getting an exit. One of the well-regarded institution investors we met in New York told us wryly that 'in a way, the return in the Dotcom crash was better than now, because at least companies were going public in 2000.' Perception of venture had become more illiquid than before

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Chapter 21

- The start-up culture was now well-established. For the VCs, the founders who had survived 2015 were those who had taken the hard knocks and gone through a period of heavy learning. They looked even more credible to back. These founders were demanding of their VCs. They wanted to partner with VCs who could provide depth in thinking and strategy inputs specific to the industry vertical that the start-ups belonged to
- Like a very experienced PE investor once told me, returns on private investments mean nothing until you heard the money in your pocket
- Investing and harvesting are the two sides of the VC business and need to be achieved in conjunction. One cannot be successful without the other. We did not plan it that way, but of our investments, those that were focused on the greater mass of consumers who were not in the top income bracket were the ones that scaled best