

A dozen things I've learned from Bill Gurley about investing and business

By Tren Griffin
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Bill Gurley. Photo via Wikipedia

Editor's note: Tren Griffin has created a list of a dozen things he's learned from Silicon Valley venture capitalist Bill Gurley, one of the keynote speakers at the GeekWire Summit on September 12. This is part of his "Dozen Things" series. Griffin is a senior director at Microsoft who previously worked at Craig McCaw's Eagle River. You can follow him on Twitter at @TrenGriffin.

1. "All the great investors I've ever studied have felt macroeconomics is one of the silliest wastes of time possible." There is a nonlinear relationship between the simplicity of the system you are trying to understand and your ability to make bets which can generate alpha. The simplest system that one can work at understanding is an individual company. Every great investor in this series of blog posts thinks like Gurley does about the futility of making bets based on macroeconomic forecasts.

2. "Venture Capital has long been a trailing indicator to the NASDAQ. Venture capital is a cyclical business." The Howard Marks maxim "most things are cyclical" definitely includes venture capital. Mr. Market's bipolar nature

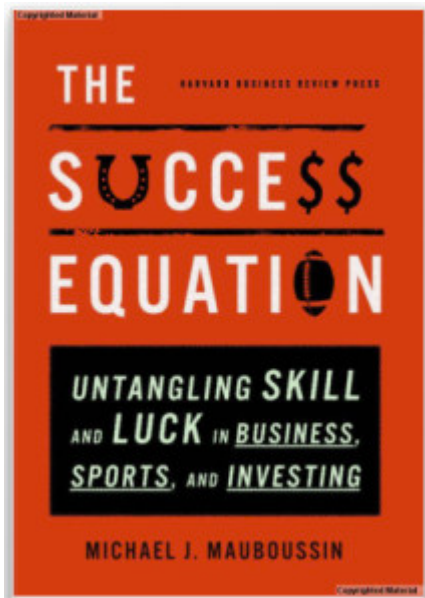
impacts the venture capital business like anything else. When Mr. Market is depressed and pessimistic a hard working venture capitalist with dry powder can find opportunities which don't exist when Mr. Market is euphoric. Being "long term greedy" often means investing despite the pessimism of others

3. "There's a lot of luck involved [in venture capital]." Bill Gurley is a longtime friend and former colleague of Michael Mauboussin who literally wrote the book on "skills versus luck." Everyone should read Mauboussin's work. No exceptions. People who acknowledge the role of luck in life are as a rule far more humble and less susceptible to mistakes caused by hubris.

4. "If you can't sell, venture capital is not a good industry to be in." The idea that the venture capital business is about sitting around in boardrooms thinking about strategy is false and maybe 5 percent at most of what a venture capitalist does. If you are not selling a product or service, you are selling a potential hire or another investor or board member or something.

5. "[Venture capital is] not even a home run business. It's a grand slam business.... If your idea is not something that can generate \$100 million in revenue, you may not want to take venture capital." The distribution of returns in venture capital is a power law. When investing it is magnitude of

correctness and not frequency that matters (the Babe Ruth Effect). The failure rate is high enough in the venture business that the math dictates that a very small number of winners will determine whether a particular fund will be financially successful. Venture capitalists are looking for significant optionality (an asymmetric



upside) with a downside limited to what they invest (i.e., you can only lose 1X what you invest, but the potential upside is many multiples of what you invest).

6. “Good judgment comes from experience, which comes from bad judgment.” Warren Buffett says that there is nothing like walking on land for a day if you are a fish. Actually doing something and failing is a great teacher. Reading about people who actually do things and fail or succeed can definitely be better than “peeing on the electric fence” yourself. But all of us make mistakes and personal mistakes are a fantastic teacher.

7. “We like to say that ‘more startups die of indigestion than starvation.’ We are all fascinated by the stories of Steve Jobs and Jack Dorsey, who work on two companies at once, but this is not the norm.” The root cause of “running out” of cash is often that the business lost focus and diverted resources to things not on the critical path toward success. Starvation is often a symptom of things like premature scaling and wild goose chases. Sometimes when a company tries to do everything, it ends up doing nothing.

8. “With great companies the consumers buy because the product is so good. They aren’t spending [tens of millions] on marketing.” These words could just as easily have been spoken by Jeff Bezos who thinks just the same way (which is not surprising since Amazon was one of the companies that Bill Gurley covered as a young Wall Street analyst). Too often a lifetime value (LTV) analysis ends up being a justification for too much spending on non-organic marketing. The essence of business is arguably acquiring customers in a cost effective way.

9. “High price/revenue multiple companies have wide moats or strong barriers to entry.” This is straight up Warren Buffet/Michael Porter. If the supply of what your competitors offer is not limited in some way, the price of that offering will drop to your cost of capital. Yes, sometimes you figure out your business model after you have wide adoption, but thinking about generating networks effects in some way is wise before your business model is fully formed. Bill Gurley has also said “Strong form network effect companies are far and few between. Fortunately, when they do exist, they are typically leading candidates for the 10X+ price/revenue multiple club.”

10. “(Discounted cash flow) is an unruly valuation tool for young companies. This is not because it is a bad theoretical framework; it is because we don’t have accurate inputs. Garbage in, garbage out.” Spreadsheet disease is a byproduct of people not thinking hard about the assumptions that go into a model. Valuing the optionality of a business is not simple.

11. “If a disruptive competitor can offer a product or service similar to yours for “free,” and if they can make enough money to keep the lights on, then you likely have a problem.” Digital offerings have very strange economics in that multi-sided markets are often involved and offerings in such a market can have close to zero marginal cost once it has been created. Solving the “chicken and egg” problem inherent in any platform business usually involves either a free egg or free chicken on one “side” of the market. It’s easy to wake up in a digital world and have whatever you were selling now being offered “for free.”

12. “Being ‘right’ doesn’t lead to superior performance if the consensus forecast is also right.” Gurley is quoting Howard Marks on this point and my thoughts on that are here.