



Stanford eCorner

Entrepreneurship: A High-risk Investment

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Hoffman believes that out of three kinds of investment strategies, sure bets, low-risk management and high risk investments, entrepreneurship is the third kind. This style of investment is called accurate contrarian theories where raising sufficient money might help in mitigating risks, but does not ensure success.



Transcript

One of the focuses to think about entrepreneurship is thinking of it as investing. And there are basically, I think, really three types of investment strategies. There are sure bets. Frequently you think of a sure bet than you don't. But sure bets are, you have some kind of edge. You have resources that are unique and under your control. You have inside information. You have a privilege skill point. You're the only one who's allowed to invest. That's not really applicable to entrepreneurship--I'm recognizing more people in the audience--because usually entrepreneurship is in the high risk.

So the second type is kind of low-risk management. It's portfolio. It's diversification. Many of these people go by looking for a career, so I go to law school, I go to business school. A lot of people join McKenzie Management Consulting. And by the way, one little side tip. I have found that consulting backgrounds and MBAs are negative predictors for successful entrepreneurship. So it's not 100% negative. There are successful entrepreneurs with both of those elements in the background, but usually the things that attract people to that are the low risk category. It's like, "Oh, I get into Stanford.

And I've got Stanford GSB on my background. I've met all these people. It's a way for preparing for the future." Well, it's not taking a risk. It's not going, "I see something that other people don't see and I'm going to"- -one of the metaphors that I frequently use in entrepreneurship--"I'm going to jump off the cliff and assemble the plane on the way down." And frequently you find that you've left key elements out, like the propeller or the engine. And the end result is you hit the ground. Now, a path that's like, "Oh, I'm going to go to McKenzie," which are really smart people, it's an interesting job, and everything else. Well, it's safe. It's a salary. It's a proven path. You compete with a lot of people.

You get there. So one of the things that I think what entrepreneurship is is actually the third style of investing, which is accurate contrarian theories. So you want to pick something that is not what everyone else thinks. If everyone else thinks it, it's almost actually in fact impossible to do it in any interesting way. So for example, if you're starting a generic photo-sharing site right now on the web, you are out of your mind. Now, maybe there's some kind of unique edge, something, but it can't be, "Oh, mine has music." It's got to be something that's actually, in fact, pretty unique. And if you really want to get it to discontinue its value, it's got to be something contrarian. It's got to be something which is not packed with lots of other people. You have to have a chance to get off the ground, to assemble the plane first, if you want to use the metaphor. Another metaphor I use is scuba-diving, because one of the things that's really important to understand about entrepreneurial ventures is you're basically walking dead.

So you think about it: when you're underwater with an air tank, the air will run out; if you do not get back to the surface, you're dead. So in entrepreneurship, you're trying to figure out which way is the surface and how much oxygen do I have before I get there. Financing? It's additional oxygen. It's not success to raise money. Money, it only gives you a longer runway. As a matter of fact--and it makes the hurdle at the end higher. You raise \$50 million? You now have to make a really good exit. It's not really a success metric. And it's really funny because sometimes I listen to some entrepreneurs talk about, "Well, you want to hear about how successful I've been? I've raised \$100 million." OK. Raising money is only a step that enables you to try to be successful.

It gives you enough runway. And if you raise a lot of money, then the bar at the end is much higher.