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Playing It Small Doesn't Mean Not Making Money

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Skewed expectations present a major risk when accepting venture capital. Most venture capitalists expect to make a lot of money, and they expect the company they help to become billion-dollar ventures. David Heinemeier Hansson, partner at 37signals, compares this type of risk to putting all of your money on red five in a game of roulette. When you build a business that earns a million dollars per year, you're taking a more calculated risk, analogous to that of a skilled poker player who steadily builds up his winnings. "The fact of the matter is that a million dollars is a lot of money when it goes straight into your bank account," asserts Heinemeier Hansson, partner at 37signals.

Transcript

The VC route is that small is a beginning. Small is a stepping stone. Small is what you go through to get to the major leagues. Small is inconsequential. It's sort of a path to the billion dollar business. And everything is designed around that pipeline. Most VCs who invest are not going to be happy with the business that throws off a million dollars a year in cash flow, if that's sort of the scope of the business. That's not interesting. They need an exit that's 5, 10, 15 times, whatever it is, preferably a hundred million plus. "All right, we'll take 20 million, whatever." The fact of the matter is a million dollars is a lot of money when it goes straight into your bank account.

So, if you can build a small business that only makes you a few million dollars a year, you're doing pretty damn well. Now, what do you think your odds are of building a billion dollar business versus the odds of building a $3 million a year business? This one, the billion dollar business is about the same as going into a casino and putting it all on Red 5. "All right, roll it." Trying to get a $2 million a year business, a $1 million a year business, half a million dollar a year business, it's more akin to being a fairly skilled poker player and going to a table. You have a chance. It might still involve luck. It might still involve unknowns but at least you have a fighting chance. You're not just relying on the buy-out lottery. You're not just relying on the fact that the Google gods will favor you and buy you for X million dollars. You're actually playing for skill and not just random timing. So, I think you're much better off trying to build a small business.

And the fact is that most big businesses started as small businesses. There are a few business that go from nothing to everything in 18 months. But the problem is that there's just enough that we believe the story. There's just enough YouTubes and whatever else that gets that trajectory. Which is also just enough that all the VCs get all sharky and want get in on that action, like of course, who would want to invest $50,000 and get $200 million back? So, they try. And when they try, it sort of becomes that hit-driven business where, "All right, let's fund these 20 guys. If just one of them makes it, awesome. The other 19, collateral damage. That's fine. If it didn't work out or blow up their time bomb will reach its durational blow up.

No skin off our game." Skin off all those 19 guys game. Skin of all the game in time that they lost and they wasted and the missing dent that they didn't put into the universe.