Stanford eCorner

Unique Approaches to Compensation and Valuation

Warren Packard, *Thuuz*

February 09, 2012

Video URL: http://ecorner.stanford.edu/videos/2894/Unique-Approaches-to-Compensation-and-Valuation

When starting Thuuz, co-founder and CEO Warren Packard decided upon an internal economy for compensation where cash and equity were fungible. Packard also explains the logic behind raising early money at a lower valuation, in an effort to help investors make greater returns in the long run.

Transcript

One of the first things we've to do is compensate people for the work even when we're working part-time. And that brought up cash versus equity. And all of us at first were on equity, but what we did was something that I throw out you as a proposal because I'm not sure how often this has been done, but we created an economy in our company where cash and equity were fungible. And basically when we raised seed money for our company, we priced the round and we basically said, it's - whatever, $0.10 per share for this. And when individuals invested in our company, they invested at $0.10 per share. And when somebody did work for us, we simply could convert that either a dollar amount or a share amount and it just didn't matter to us, because some of the folks that were working part-time for our company needed cash and some of the folks that were working for our company wanted equity. And we wanted to accommodate both without creating attention. So, we created this economy within the company, it forced us to price our seed round and it's very popular these days to do a convertible and I won't get into all the details, but to basically bring money in that would convert into around that would be priced later. We decided not to do that, so we could create this economy and I'll just throw out that. This experiment I believe worked very well because those of us who wanted equity, we're all in for equity and those who want cash, no problem, and you could take out cash and get equity, you could put in cash, right, take out, okay, well, anyway, you could go back and forth.

But this was a very interesting decision that we made for fund raising. Number two, from Thuuz, valuation, how do you set a valuation for your company when there is not much there? And of course that's an art rather than a science, but the point that I'm going to just push out here in the next minute is it's very attractive to have a high valuation, and value your company at something that you can go on boast about or at least internally feel like, hey, we got this high valuation. We actually set out to get the lowest valuation we could. That's not exactly correct because we didn't want to just give away the company. But we - and this is going to really sound weird perhaps, we really want to make our investors money. And as a consequence, we don't want to raise money at a super high valuation. We want to make sure that the valuation that we set on our company is low enough so that we give our investors the maximum chance of making money in the venture, which of course we want to give ourselves the maximum chance of making money in the venture and if you want to raise a subsequent round of financing, in your prior round just priced too high, it becomes more difficult. So we strove to raise as little money as we could at as low a valuation as we could. And we're now just - just now going out for our first institution round of financing and it seems to be playing out well, because we're not getting pushed back in terms of where our prior round valuation was. So something to think about.

You can brag a lot about high valuations, but they - you want the right valuation. You got to balance dilution; you got to balance getting your next round. And finally, well I guess the final point I've already brought up is do you care or not care about your investors? Do you care or not care about your venture capitalist? And this is, I guess, it's an obvious one coming from somebody who was formally a venture capitalist. But I have seen on many occasions an entrepreneur very, very thankful for the money that comes in from the venture capital backers, but then forgetting the fact that the venture capitalist has their own goals and desires in terms of making money and making money fast. And it's something to think about; they're a stakeholder, your employees are stakeholders, your customers, your partners, they're all stakeholders, you got to balance all these things in incredible uncertainty and it's very difficult to do. But it's - I guess, I'll implore you that as you build your business forward, don't lose sight of any of these stakeholders and take on the challenge of balancing all these different uncertainties. There are no answers, but ultimately you make really good decisions because you will be able to justify and based on how your decisions impact all the different stakeholders. Not easy, but I think a lot of you're going into entrepreneurship and you realize that in the final analysis, you are living in uncertainty and you're just going to have to deal with it.