Stanford eCorner

A Common Mistake: Treating VC money as Your Own

16-01-2002

URL: https://stvp.stanford.edu/blog/videos/a-common-mistake-treating-vc-money-as-your-own

Roizen thinks that one of the biggest mistakes companies made in their hayday was considering VC money as their own. Entrepreneurs forgot they had to pay back their investments. If there is any value that gets created as a result of the entrepreneurs sweat and VC money, she says, then the VC's get the money back first.

Transcript

One of the errors I think that people made in this heyday was that they started to believe that somehow as soon as you got the money in the bank it was yours.. I remember when I raised venture capital and my first round was in '89 and I raised money from Ann Wynblad and Tim Draper.. I was hammered by the very first invest and it was a little over a million bucks.. I remember putting it in the bank and thinking I've got to get that money back before I ever get to see a dime.. All that money and all the appreciation that comes with the terms had to be paid back before I ever get to have any money.. So I had a number I used to keep on my wall, and the number was the amount of money the company had to be worth in order to clear all the hurdles and get the comma to equal the preferred.. That was my number.. I knew that if I didn't get the company to be worth that number and couldn't get a liquidity event to happen above that number, the venture capitalists were going to get a disproportionate share because they had put dollars in and that's the way it works.. I think one of the biggest mistakes entrepreneurs made in the last couple of years is hey, I own a company and I sold 50% of it for $5 million and the day that $5 million gets in my bank, I've got $2.5 million.. No, you don't..

You have $5 million of debt and usually at three or four liquidity preferences and participation that you got to pay back before you ever see a dime.. That money is very dear and very precious and that's why I would caution everyone that terms are more important than valuation and recognizing that that money is yes, it's risk capital and yes, it's okay.. We're in the business that we intend that many of our investments will be lost and we won't ever see that money again.. But if there's any value in the company that gets created as a result of your sweat and our money, our money that's first, right? Whatever the expression is, I'm not a baseball fan so I never know.. Is it bats last or bats first? Well, whatever it is, we get our money back first.. That's the point.. So just pay attention to that when you go into these things...