During the late fifteenth century, Queen Isabella of Spain gave a businessman a capital for an extremely risky business venture. Some people might refer to Isabella as the world's first venture capitalist. The businessman Queen Isabella gave the capital too was named Christopher Columbus. The business venture was to find a shorter way to India so as to save money and time in trading goods. What is the risk of failure? Very high!

Let's move on to today's world of venture-capital-backed start-ups. Failure to this could result in death on the high seas, however, the risk is still extremely high. As a matter of fact, almost 90% of start-ups crumble.

This is where the role of good venture capitalists or VCs come into play. They give capital in the form of money in order for potential founders to bring their suggestions and concepts to life. Also, the VCs get an ownership stake of the company in return. Additionally, in order for the VCs to give funding; the VCS gives suggestions to the founders on long term decision making and the possible way of achieving strategic goals.

For a lot of people in the start-up world, the inner workings of the VCs still sound a little bit strange to them. Luckily, the author of this book Scott Kupor works in one of the biggest names in VC. In this short time, you will learn about a few of his perceptions of how the VC-backed companies operate.

The characteristics of venture capital have evolved during the last few decades.

In the early 1970s about half a century ago, Silicon Valley found itself host to a new number of businesses working in the venture capital. After thirty years, very few of these companies had the majority of venture capital in Silicon Valley. This shows that a few selected companies had a lot of influence over which entrepreneurs got their funding.

However, things started to change during the early 2000s. Two phenomena began to come together changing the relationship of the VC-entrepreneur.

Firstly, swift advancement in technology meant that the total capital expected to establish a start-up started to decrease. On another side, servers, networking, and data center got cheaper day by day. On another side, due to the introduction of cloud computing, start-ups didn't require office space to keep their data on-site, thereby saving on rent. Suddenly, establishing a start-up became less dependent on VC backing than it was in the past.

The second advancement that changed the VC-entrepreneur relationship was the establishment of the Y Combinator, or YC, in 2005. YC is a school where entrepreneurs learn how to establish companies and protect VC funding. Popular alumni of YC include the founders of Airbnb and Dropbox. The YC has also assisted former dispersed entrepreneurial communities to come together in order to exchange and share information; therefore by doing that, it also assisted in the balancing of power among VC firms and entrepreneurs.

This was the point where the VC firm of the author came into play. Investors Marc Andreessen and Ben Horowitz established Andreessen Horowitz in 2009. Noticing a change in the feature of Silicon Valley, they understood that VCs had to give more than capital to entrepreneurs. Therefore, having CEOs with vision and good products that are appropriate for the market was still as important as before. However, it might lack knowledge in some relevant aspects such as recruiting, marketing or sales.

This was the point where VCs like Kupor came into the equation. It is his duty to advice CEOs at Andreessen Horowitz, especially assisting them in building networks and relationships with people and institutions. By doing that, Andreessen Horowitz has created a winning way that has produced various huge companies like Pinterest, Slack and GitHub.

There are three essential things VC firms consider when determining which early-stage companies to fund.

Founders of early-stage companies do not usually have a product to show to their possible investors most times. Rather, the founder mostly comes to share an idea with the VC firms. This simply means the VC firms only have little information and data to examine when determining whether or not to invest in early-stage start-ups. Rather, they have to depend mostly on qualitative analyses.

The first feature of such analysis is basically about the people involved in the company. What are the histories of the founders? What proof does their idea give that they'll be able to initiate their idea to market effectively? Also, specifically, what makes their story top-notch out of other possible founders who have had exactly or similar ideas?

One of the approaches VC firms assess such questions is by considering a concrete founder-market fit. This simply means that the founder or founders have an exceptional experience that has given them a specific understanding of the possible product they are looking for backing.

For example, let us take a look at Airbnb. Its founders acquired exceptional insight from hotels that became fully booked when there was a big gathering in their town. Therefore, this made them come up with an idea: Why not rent out a cheap place in our apartment to conference attendees in order for them to sleep? By doing that, the attendees could save money, and the founders would find it more easy to pay for their rent. This story convinced Andreessen Horowitz, therefore, the firm decided to support Airbnb.

However, while people are the foundation of any successful venture, the products they propose have to be market fit in order for customers to buy them. This regularly depends on how revolutionary a product is. Small companies with new products won't achieve power if they are only a little bit better than the product that is out there already. The product must signify a revolutionary in the market.

Apart from the people and the product, market size is the final aspect VC firms look at before deciding on whether or not to back early-stage companies. This is significant due to the reason that almost 50% of the early-stage companies big VC firms invest in crumbles. To make up for these failures, successful start-ups require lots of market room in order to develop continuously.

Certainly, evaluating market size can be difficult when potential markets haven't been established yet. For example, Airbnb first saw itself assisting a small market like people that attend conference. However, Andreessen Horowitz saw much more than this for Airbnb and they saw a chance for Airbnb to develop into hotel markets and more which was what happened to Airbnb.

Mastering the art of the pitch includes an elegant balance of flexibility and determination.

If you have ever had an opportunity to pitch a business proposal to venture capitalists, then you are aware that it is a very anxious experience. Maybe you just quit a stable job in order to pursue your entrepreneurial dreams and your future survival might depend on whether or not the pitch goes well.

Fortunately, over the last ten years of the author working at Andreessen Horowitz, he has heard thousands of pitches and he is able to differentiate the good ones from the bad ones. From his experience, a good pitch is easily understood and a bad pitch is the opposite. Therefore, let’s start with the bad pitch.

Mostly, founders will pitch an idea, and afterward list various companies that might get them once their idea gets to market. However, some may think this is what the VCs want to hear, but it is not. The VCs want to hear about the founders’ approach to conquer-the-world even if the approach has a small chance of success. The question is not who might want to get the future company. The VCs want to know what the world will be like once the founders have dominated it with their idea.

Certainly, once founders present their conquer-the-world approach, they can presume VCs to put test their strategy. During a pitch, possible investors will certainly critique the founders’ strategies through a process the author calls the idea maze. This is the session where the entrepreneurs are being asked about the origins of their idea, why they consider their product a good product and what type of insights as well as market data they looked at during the ideation process.

At the end of the day, most founders will end up producing a product that is different from the one they initially pitched, known as a pivot in the VC industry. Therefore, when asking questions during the session of idea maze, the investors' aim isn't to discover if the founder's product will have a 100% chance of success but it is basically to put the founder's thought processes and deep knowledge of the product and marketplace to test.

Definitely, this sort of pivot shouldn't happen during the pitch. If the idea maze leads the founder to amend all their pitch during a one-hour meeting, then that is not a good sign. A sudden change of heart indicates a lack of commitment to the conquer-the-world approach that potential investors want to see showing from founders.

With this being said, it is essential that founders appear willing to listen to better advice and adapt their pitches accordingly.

Term sheets can be scheming to navigate, as they affect both the economic and governance parts of any venture.

If you as a founder have been fortunate enough to make a successful pitch to a VC firm, then you will start the regular hard process of negotiating a term sheet. Importantly, a term sheet shows all the essential rules, regulations and processes that the VC firm and the company have to obey if they want the deal to work out.

These requirements can be very complex and confusing particularly to the founders who seem to be less accustomed to the term sheets than the VC firm they are trying to partner with. However, the term sheets can be divided into two main parts which can make them more understandable and thereby balance the playing field of knowledge among VCs and founders.

The first part gets into the essential aspect of the economic side of the agreement. This can involve features like the size of the investment, liquidation preferences or who gets to control most shares in the company.

But the economic part of any term sheet negotiation is essential in both the short and medium-term. However, it is the other aspect, governance that has greater consequences in the long run. Governance is simply about how the company's board of directors operates its business and who becomes part of the board.

During term sheet negotiation, deciding who becomes part of the board is very essential because it is the duty of the board to say how the company functions, who runs it and whether or not its existence should cease or sold. And, maybe more essential, the board chooses who becomes the company's CEO.

For instance, the author's company mostly presents successful founders with a term sheet that shows a three-person board of directors. One of these positions is occupied by a representative of the VC firm and another is occupied by the company's CEO which is usually the founder. The third and last person on the board is an independent delegate, a neutral outsider who has no conflict of interest with any of the other two board members.

Certainly, as companies grow, it boards also grow as well. Therefore, it is essential in your initial term sheet to ensure that the board remains balanced. For instance, if your company goes through another finance round with another VC firm, they will likely also want to be part of the board. In that case if such happens, you will want to ensure you negotiate that for every additional VC on the board, there will also be an additional representative from the company itself.

Keeping a healthy CEO-board relationship is important to the success of any VC-backed company.

With an unbiased term sheet in hand, it is time for the CEO to make her priority on running her newly-funded company. Also, leading her team through the daily activities of the company. Additionally, it is the CEO's responsibility to keep her eye on the long-term vision of the company especially if she is also the founder. Nevertheless, a CEO's relationship with her board of directors can be a complicated thing and it is, therefore, necessary for both parties to keep a healthy relationship.

This is specifically true of the relationship among the CEO and the VC representatives that are part of the company's board. While most good board directors allow the CEOs to run their companies, this isn't usually the case. In so many cases, VCs themselves were the CEOs in the past and they can constantly face the temptation to get involved in the daily activities of the companies they have funded.

However, at the end of the day, VCs are not supposed to know all the main daily activities of a company because it is the duty of the CEO. Therefore, it is highly essential that VCs keep a safe distance and allow the CEOs to perform their duty.

Having said this, it is essential that the CEO maintains a stable medium of feedback with VCs and the other members of the board. After all, VCs have been part of the boards of other companies severally and so they may have various important ideas to share with a CEO based on mistakes that other CEOs they've advised have made.

This is essentially true if you are a CEO for the first time, even though you might have a great vision and team; it might be that you a making rookie mistakes in aspects like hiring or planning long-term growth. VCs can offer their help in such cases; however, it is essential that you ensure they do not overstep.

In the long run, even though VC firms are the ones giving the capital, it is the CEO's duty to run the whole company which also consists of the board member. From the get-go, the CEO should inform the board the type of feedback mediums she wants to establish like weekly meetings at which advice is required and company news conveyed.

In a situation where the company has more than one VCs, the CEO may not have time to meet with all of them one on one, if that is the case, it's is more useful for VCs to come together and gather feedback that can be presented to the CEO in a more compact way.

At the end of a successful VC life cycle, boards are confronted with two choices for how companies may carry on in the future.

Let us imagine for a minute that your company isn't bankrupt and doesn't close down after a few rounds of VC funding that ultimately led nowhere. If that is the case, then congratulations because your company is part of the 10% start-ups that do not crumble.

If you are now a CEO of a profitable business that can endure on its own without venture capital, it is possible you are being granted possible acquisition deals. As a matter of fact, 80% of successful VC-backed start-ups end up to be acquired by bigger companies.

However, there are various problems CEOs and boards need to think through during any potential acquisition deals. Maybe the biggest of these is the question of which employees will be left with the company post-acquisition. It could be that a lot of employees have stayed with you while you were a CEO for years and now it is time for them to be compensated for their good work. Also, this means negotiating favorable equity treaties for your team members that you bring in with you into your company’s post-acquisition existence.

Apart from acquisition, another choice for the boards is to make an initial public offering or IPO. This involves making the company public and selling its shares on the stock exchange. One of the main problems here is the pricing of shares. For instance, in 2012 when facebook made its IPO, the initial share price was set at $38. During the first day, it reduced to $14. Fortunately, in mid-2019, the shares had more than quadrupled.

However, such overpriced initial pricing can lead to negative associations affecting your public company in the nearest future. Therefore, ensure that you have good investment bankers so they can advise you on the price you should set your initial shares.

It is certain that whether or not a company is acquired or it falls into the public, the question of the compensation for VC firms is supreme as far as they are concerned. At this stage in the company’s history, the life cycle of venture capture is almost complete. The initial funding of the company is about to pay off now and the VCs are preparing themselves to get the fund of the initial risk they took all these years.

But, if VCs sell their shares immediately, the value of the company may fall as a result of the enormous sell-off. Therefore, it is mostly a good option for VCs to pull out their stock in a company over a period of time instead of all at once.

Lastly, as a CEO, your next stage of the journey is about to start. Either you have just gone through an IPO or acquisition, the original idea you pitched to VCs has just started a new phase. You are now required to either accept a bigger company's CEO or to public shareholders. However, irrespective of whatever happens, you should be proud of yourself due to the fact that you have become part of the small start-ups that pass the VC stage.

Secrets of Sand Hill Road: Venture Capital and How to Get It by Scott Kupor Book Review

During the early 2000s, with the advertisement of various new tech start-ups, the relationship between venture capitalists (VCs) and entrepreneurs transformed tremendously. Nowadays, one of the key features VCs consider in companies is a founder who has an exceptional insight into the issue his product is trying to address. The main strategy to make the VCs accept your product is mastering the art of the pitch, which includes showing a willingness to adapt while still being fully committed to the validity of your idea.

Once you acquire funding from VCs, the challenge them becomes sustaining positive relationships with them: a good term sheet can assist with this. Also, if you get through to an IPO or acquisition, then you will have become the small club of founders who are successful.

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