Masters of Scale Episode Transcript: Mariam Naficy

REID HOFFMAN: It's 1998, at the height of the first dot-com boom. Silicon Valley is on fire. Nothing bad can happen. My friend Mariam Naficy is CEO of a start-up called Eve and she *had* to have the domain name Eve.com. Only problem? She has to convince the owner to sell it to her. And she was facing a negotiation that I do not envy.

YOUNG GIRL: Hello? Who is this?

MARIAM NAFICY: It is a five-year-old girl, Eve Rogers.

YOUNG GIRL: This is Eve.

NAFICY: ...who gets on the phone. And so I think, "What on earth am I going to say to this 5-year-old?" So I said, "Hello."

YOUNG GIRL: Hi.

NAFICY: "Could I buy your domain name?" And she was just saying to me, "What? I don't really understand."

YOUNG GIRL: Um, what?

NAFICY: And I'm sure Eve's mom, on the other line, was laughing her head off. I mean, "This is a great joke to play on this silly entrepreneur from California who's calling. I'm just going to watch her be tortured by my five-year-old for a while."

HOFFMAN: Mariam then turns this risky negotiation over to her lead investor, the legendary start-up whisperer, Bill Gross.

NAFICY: So he gets on the phone with her mom, and he negotiated the purchase. And it was equity in the company, a board seat for her daughter—an observer board seat—trips to Idealab to see Bill several times a year.

HOFFMAN: You had a five year old observer on your board? [Laughing]

NAFICY: Yes. She didn't actually show up for the board meetings, but she did occasionally come by and visit. Disneyland, software, educational software—it was a very large package that was negotiated.

HOFFMAN: If you were going to call your younger self, how would you have handled this negotiation differently?

> **NAFICY**: I would probably throw in the Disneyland almost immediately, because now I know what a five-year-old girl wants. I have a daughter. And I would have said, "How many times a year do you want to go to Disneyland?"
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> **HOFFMAN**: Once a year? Twice a year?
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> **YOUNG GIRL**: Maybe about 100 times a year.
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> **NAFICY**: Exactly.

HOFFMAN: [Amused] $50,000 plus Disneyland trips may seem like *crazy* expenses. But in my experience? *Every* successful founder has a story like that.

[**THEME MUSIC]**

HOFFMAN: I'm Reid Hoffman, partner at Greylock, co-founder of LinkedIn and your host. On this episode, I'm going to make the case that, as an entrepreneur, you need to raise more money than you think you need—and potentially a *lot* more. I'm going to prove that theory through conversations with some of the smartest people I know.

So why should you raise more money than you think you need? One word: Disneyland. Mariam Naficy did not imagine that she'd spend over $50,000 buying a domain name from a 5-year-old. She certainly didn't imagine she'd have to sweeten the deal with tickets to Disneyland. But that's life as an entrepreneur.

If you look at a typical start-up's budget, and sort the line items by sheer strangeness, how many expenditures would fall outside the limits of your imagination? More than you'd think. So you have to plan, paradoxically, for the unknown. And that's the *first* reason you should raise more money than you think you need.

But there are more reasons. And you'll hear them in the story of my friend Mariam Naficy. Mariam has weathered booms and busts. She's one of those rare entrepreneurs who succeeded through the first dot-com boom *and* the second internet wave. Her story is a pretty convincing case for grabbing as much capital as you can, while you can.

We'll start with her first company, Eve.com, which back then sold cosmetics online. It was the height of the dotcom boom.

> **NAFICY**: I opened my doors at Eve.com, and we had literally orders coming in that very day. We're sitting there watching orders pile in for cosmetics—and all kinds of cosmetics that we didn't think we would sell online, like color cosmetics, things that you think you might have to try on. Success immediately. Immediate success at 28. We were able to

raise $26 million dollars in the first year. So we did a very fast scaling of the company—I think we went from zero to 120 people in six months. I think we'd hired the entire—what they call "C-suite" of executives—within six months. Can you believe it? It was like an entire executive team—poof, overnight in six months.

HOFFMAN: So when Miriam was describing her instant exec team I had three emotions all in one bundle: panic, calm and acceptance. Panic from the viewpoint of "Oh my gosh, that's going to be a train wreck." Calm because in the early days at LinkedIn, I did something similar. But of course I did that with all people I knew. And then acceptance because the classic part of the entrepreneurial journey here is being in permanent beta…You have to be always a work in progress and training.

And in 1998, everyone was a work in progress. Most Silicon Valley start-ups were spending and hiring at a blistering pace. Mariam did exactly what any sensible entrepreneur would have done: She raised as much money as she could, and she moved fast. She went all in.

NAFICY: I think the thing was that the market was so heated, and so many VCs were backing competitors in this space, that I had to raise. It was good that we raised that much, and got out ahead of everyone, because we ended up in the number-one spot. And five venture-backed beauty companies launched in after us. We were running TV ads. It was a complete land grab.

HOFFMAN: Mariam called it a land grab, and she was right. Everyone used that language—land grab and even gold rush. And in that kind of heated market, you *have* to raise a lot of money. Because your competitors are raising a lot of money. After all, you're trying to win.

It's easy to err on the side of caution—to raise less and to spend less. But there's a potential mortal risk in being conservative. You might think you're best serving your investors by being as efficient with capital as possible, but that's actually not true. You reward your investors by creating a successful company. And raising *only* $20M might mean *losing* the $20M if your competitors out-spend you.

Now Mariam raised $26 million, and it kept her one step ahead of her competitors. If she could have raised even more, she would have.

But is there such a thing as raising *too much money*? Personally, I don't think so. But let's hear from someone who does. My friend Selina Tobaccowala co-founded Evite—an online invitations service—around the same time that Mariam founded Eve.com. Selina went on to serve as president of SurveyMonkey and is now co-founder of a new start-up, Gixo. I asked her to reflect on the money she raised for Evite.

SELINA TOBACCOWALA: We took *way* too much capital. We took 37 million dollars in the end for online invitations. It sounds crazy, it *was* crazy. At the time, it was all about:

Get the eyeballs. Put a billboard on [Highway] 101. Spend the capital. Hire, hire. The thing I've learned was: Make sure you have a strong business, and then scale it out. Make sure you have the right unit economics, make sure you have the right fundamentals. And there was no reason we should have taken so much capital.

HOFFMAN: Selina looks back on the 37 million and says "Wow, that was kind of crazy." And it *does* seem crazy. But that's the market you're in. You have to play to win. Just as your competitors are playing to beat you, *you* have to be the last person standing. The truth is, $37 million in Silicon Valley seems kind of average—or even on the low side—today. The amount of capital going in to these companies has been growing. It's worth the risk, because if you succeed, you create something spectacular.

And Mariam is in full pursuit of the spectacular at Eve.com in 1999.

NAFICY: Working until ten o'clock every night, seven days a week.

HOFFMAN: She's flush with capital—having raised more than she thought she needed at the time. And then… the bubble burst. And this was a very dramatic moment for those of us who lived through it in Silicon Valley. Companies were going under every day.

NAFICY: There was this website devoted to covering businesses that are failing. I won't say the name of it.

HOFFMAN: I think we can—although maybe they'll edit it out—which is obviously Fucked Company.

NAFICY: So everybody is looking at it every day, and the Wall Street Journal's reporting, and The New York Times. So it looks like the world—from a young 29-year-old's perspective—your whole world is basically imploding, and the internet is over, basically.

HOFFMAN: "The internet is over." It may sound like a punchline. But, back then, people really believed it. And the right response was actually, "No no, the internet is huge. It's still coming. This is actually precisely the time to bet on a dotcom company."

I was personally lucky, because I was an executive at PayPal, and we survived—and in fact thrived—through the dot-com crash. But I also read Fucked Company. I knew the entrepreneurs splayed across its pages. And those stories have a funny way of sticking with you. As for Mariam, she sold her company just in the nick of time.

NAFICY: I get my investors whole—they've all made money, basically. I've made money. I, at this point, am feeling a sense of relief-slash-exhaustion at the the whole roller coaster I've been on. So I think at this point, I really wanted to get away and exit, and just leave San Francisco for a little bit.

HOFFMAN: And on top of the exhaustion, there were unexpected consequences.

> **NAFICY**: We worked really hard on Eve.com, and we made the right ultimate decision at the exact right time, so that's good. But we were often called fortunate and lucky, which we were. And then when the whole thing came crashing down, there was so much resentment that had been—understandably—built up around these young entrepreneurs who had so much money to spend, that there was a huge backlash from everyone. They were like, "Thank goodness these people have been shown a lesson." And so you basically went from being someone to being absolutely no one—and shunned—and it was really humbling.
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> **HOFFMAN**: Was there a particular experience which suddenly represented that shift from being in this kind of golden spotlight to being completely shunned?
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> **NAFICY**: Like a pariah?
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> **HOFFMAN**: Yeah.
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> **NAFICY**: Yes. All the agencies that would call on us at Eve, that always wanted to get to know you as a CEO, or make your friend or your acquaintance, and help you—they all just basically overnight turned off, the relationship just turned off. And there was absolutely no receptivity to anybody among the headhunting firms, for example. It was very much the opposite of welcoming. And so that was really humbling.

HOFFMAN: When Mariam was reflecting on her transition from being a Grand Poo-Bah—somebody important—to being a deliberately ignored nobody, it made sense to me. It's a very human reaction to worry about how people look at you. But you can't let this paralyze you. When I consider investing in someone, I look for founders who will risk almost *everything*—including notably their reputations—in order to succeed. Mariam now runs the risk of not risking enough.

> **NAFICY**: I saw a banker after this, who was much older than I was, and he was like, "Your biggest problem in life from now on is that you are going to be too conservative. I anoint you, therefore, your curse is that you will be forever too conservative."

HOFFMAN: This idea of the conservatism really stuck with me. A week later, I was thinking about it in the car…

> **HOFFMAN:** When Mariam was commenting on her own curse of conservatism—the incentive being not to risk that and make it look like it was just a fluke or a mistake—it made me kind of think about: Who are the people that I see who also end up playing that way. Why do people risk it? Why do I risk it? A lot of people risk it because they're still

hungry, they have something to prove. A lot of people risk it because they're just kind of risk blind, they just don't see risk. I can think of people in each of these categories.

HOFFMAN: When it came time for Mariam to launch her second company, she didn't want a lot of risk. She wanted what's known as a lifestyle business. The kind of business that's predictable and fairly safe, with a steady stream of revenue that supports a comfortable lifestyle for its owners. No big risks. No crazy drama. At least that's what she thought.

NAFICY: This time I said to myself, "Let's not bring in all the VCs at the beginning—I know what I'm doing this time." So I chose no co-founder this time, no VC this time. Let's figure out how to build perhaps a sustainable lifestyle business, a cash flow business—this is what I was thinking at the beginning.

HOFFMAN: If Mariam and I had known each other when she started Minted I would have actually told her: "Abandon that theory from the very beginning, because it's really not going to work." So-called lifestyle businesses are very stable and reliable. Technology companies just don't behave that way. They need to move super-fast. And they need to be able to constantly correct and pivot. They need to be able to perform the twists and turns of fighter-plane combat.

Tech businesses absolutely need to raise more money than they think they'll need. They'll need that capital for all of the unknown pivots, whether it's new customer needs or competitive attacks.

To show you this difference between lifestyle businesses and scale businesses, like tech, I wanted to talk to the classic kind of entrepreneur—the kind I usually don't get to work with. Like Amos Kedmey. He's the proud owner of the Wine and Cheese Place in St. Louis. And he *knows* his business model. He also happens to be our producer's Dad.

AMOS KEDMEY: Wine and Cheese Place.

DAN KEDMEY: Hi Dad.

AMOS KEDMEY: Hi Dan.

DAN KEDMEY: Are you ready for your big interview?

AMOS KEDMEY: Sure.

DAN KEDMEY: [Laughter] Are you nervous?

AMOS KEDMEY: Are you kidding me?

DAN KEDMEY: So it's just a simple math question. If you were to open another Wine and Cheese Place, how much would it cost?

AMOS KEDMEY: Roughly $400,000.

DAN KEDMEY: You don’t have to pull up a spreadsheet or anything?

AMOS KEDMEY: No, I’ve been in that game for so long I know pretty closely what it takes. You have to understand that our type of business is pretty stable. It’s almost as stable as supermarkets. The parameters are known. The risk is low. And that’s why when you observe, you see that not too many supermarkets go under. They may be more profitable or less profitable but they are not going under at the rate that someone like say in the fashion business or in the software business.

DAN KEDMEY: So Silicon Valley is not the place for you.

AMOS KEDMEY: Silicon Valley is a wonderful place to live in. But I won’t put a nickel there, because I don’t have the guts.

HOFFMAN: Perhaps Silicon Valley has made me an adrenaline junkie but I actually kind of look at certainty as somewhat boring. And that’s the sort of certainty Mariam is craving as she launches what she thinks will be a lifestyle business. We’ll head down that winding path with her in a moment. But first, note that Mariam’s life had changed between her first and second company.

NAFICY: I had become a mom in between. I'd had my son, and I was having my daughter, when this lightning bolt struck. Being a mom and an entrepreneur the second time was really difficult and challenging but I also felt like others people probably anticipated it being too challenging. They do write you down a little bit, if you're a mom, and you're pregnant, and you’re starting a company, versus if you're a young 28-year-old entrepreneur starting a company. There's significantly different ways in which you're treated as an entrepreneur raising capital.

HOFFMAN: Which is terrible. And you are the perfect example of why that's actually even a dumb idea, let alone an immoral idea.

NAFICY: I think I got seriously discounted, despite the experience of having a successful exit for people.

HOFFMAN: I said this in the room, but I have to say it again: The idea of discounting entrepreneurs who have families is ridiculous. Investors need to let go of it. Back to Mariam.

NAFICY: My close friends and acquaintances knew that I was good. Now my angel friends said, "We believe in you—screw it. We're giving you two-and-a-half million dollars to start Minted." So there was a significant upside from having delivered a successful exit.

HOFFMAN: And so, Mariam launched her new business, Minted, an online stationery store—not so different from an upscale neighborhood card shop. She stocked up on cards from brand-name companies. But Minted also included a daring little side experiment. Mariam invited unknown artists to submit designs to an online competition. Anyone could participate. Anyone could vote. The winners would then compete head-to-head with the heavyweight champs of the card industry. And so, in 2008, Mariam was ready to release her slightly offbeat selection of stationery to the world. Here's what happened:

NAFICY: I open the doors. There's not a sale for an entire month. Nobody wants the branded stationery products that we'd spent most of our two-and-a-half million launching—because again, being conservative, I'd said, "I know, I'll do an Eve.com, I'll put all these brands online, sign them up exclusively." We had exclusive distribution rights. Nobody wanted to buy them at all.

Instead, the teeny-weeny assortment that I had sourced through this one competition I had run, one transaction a week. Then the next week, there were two. We had sourced 60 designs through our competition, and I'd saved a tiny bit of money to build what I *really* wanted to build.

Out of the two-and-a-half million, I probably spent like $100,000 on what really became Minted. It was like this little side thing, and there was a programmer up in Oregon, and he and I were working at night on building the first competition. And that is the only place where we saw any sales movement.

HOFFMAN: Mariam stumbled onto the power of crowdsourcing—the idea that ordinary people, when they come together in large numbers, can do work once reserved only for experts. Etsy is an example of this. Kickstarter as well. But at this point, in 2008, it wasn't understood very well. It was something Silicon Valley was just getting its head around.

NAFICY: I realized that this crowdsourcing thing was way different, and I'd uncovered something that was more of a massive social, cultural change going on in the US—and maybe in the world—versus some small-business idea. Because what was happening, that I didn't realize, was that who's considered a creative out there is actually changing a lot right now, due to technology and exposure. And so people are emerging as creatives who haven't gone to school. They haven't gone to design school, they haven't gone to art school, and they're massively disrupting art and design right now. And there is a true meritocracy that you can actually build and unleash.

HOFFMAN: So her sensible, lifestyle business has nearly collapsed. There's only a teeny sign of life in a funky, little crowdsourced marketplace—a place where amateur designers sell cards to adventurous shoppers. It’s new. It’s different. And aside from a trickle of sales, there’s almost *no evidence* that it will work. There’s only one certainty at this point. Mariam needs money. A lot more money.

> **NAFICY**: And we were about to shut the company down. I thought, "You know, I could take whatever’s left of the capital, and just give it back to my friends." I cannot lose the money of my friends—I was maniacal about that. “These are my friends, it's terrible—100,000, 200,000 each—this is going to be really bad. I've got to give the money back.” But then when I started seeing these little bits of sales, and my true lead angel, he said, "I think that you need to save the company potentially by considering venture capital." He's like, "I think you should potentially consider a raise." And I started seeing signs of life too. So I said, "I can save this company, and I can get the money back to my investors. I should do that—reputation is everything. I want to do this."

> **HOFFMAN**: So the venture raise was primarily triggered by “I have to make sure I deliver to the angels.”

HOFFMAN: So basically, the *only* reason Mariam did a round of financing was to pay her friends back.

> **NAFICY**: Yes. I was very much driven by a feeling of obligation and loyalty to my friends. And so I raised the venture [capital], thinking that I would then save the company and then somehow deliver the money back—not because I really wanted to raise venture.

HOFFMAN:-Here, Mariam runs into another reason you need to raise more money than you think you need: unexpected opportunities. Mariam’s plan to start a lifestyle business just didn’t pan out. She didn’t have enough funding to cover her Plan B—or her “Plans B” as I like to say. Opportunities may arise later than you hoped, and you want the capital to carry you in new directions. So she reluctantly pitched her idea and secured another round of funding. And if that weren’t risky enough, she’s about to encounter one more familiar source of uncertainty…a stock market crash.

> **NAFICY**: And we raised our venture around two weeks before Lehman failed, because this investor of mine had said to me, "I feel something really bad is going to happen, you should go raise." So we just went out in August—"Who's in town? Anybody? Is anyone in town in August?" So we went and raised money, and closed it literally right before Lehman [Brothers] failed.

> [Sounds of various news reports, chronicling the stock market crash]

HOFFMAN: Believe it or not, Mariam launched her wildly risky, experimental business idea into the heart of the worst economic crisis since the Great Depression: the collapse of the U.S. housing market in 2008. Suppose she had waited until, say, September to raise that money.

Lehman collapses, panic grips investors and no one in their right mind gives cash to a bold little experiment in crowdsourcing. Like that, Minted closes for business. Which is another reason you should always take money whenever and wherever you can get it. You know never know when it will dry up. As it is, Mariam did raise the money. And she still has to create a thriving company. So first, she has to figure out what her customers really want.

I want to take you into the heart of Mariam's grand experiment. When you're launching a truly disruptive business, questions don't lead to answers. They lead to still more questions. Questions you hadn't even thought to ask. You put a product in front of a customer. Their reaction surprises you. You go back to the drawing board and return with an improved product. Your customers surprise you again. It's a bit like a mad scientist desperately trying to prove a hypothesis, and running up the budget in the lab.

> **NAFICY**: So I do a lot of my own focus groups myself with customers—I moderate them, I write the scripts still. I love to talk to consumers. And I do that many, many times a year. People are really shocked when they come in for a focus group, and the CEO is moderating. But I love it, because I'm listening very carefully to find little, tiny nuggets of insight that I love collecting.
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> **HOFFMAN**: Is there one particular nugget from one of those focus groups that comes to mind?
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> **NAFICY**: Oh god, there are so many. Making prices all equal for different kinds of paper, and realizing the analysis/paralysis people went through. You almost had to give them a reason to make a decision, just by changing the price. That was just fascinating. I realized, for example, talking to people who buy art, that it really depends, their art decisions depend a lot on whether they buy a home, or which home they're on, frankly—are they on the first home, second home?
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> You know, the gen-Xers were telling us, when we started the company, they didn't care who made the design. Flash-forward five years later, the people are like, "Why aren't you telling the story more? I need to hear about these artists." What's going on here? We're in the middle of a cultural shift.
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> Millennial men like to be involved in the wedding decision with the millennial woman. There are more involved dads, and they're more involved husbands, actually, it turns out. We learned that our designs were too feminine in wedding and you wouldn't necessarily even know to *ask* that question.

HOFFMAN: And that's the problem with building a business that has no blueprint for success. You have to anticipate false starts. You design cards for brides, and then realize grooms are the ones buying. You give short shrift to the artist's profiles, and then realize millennials want their whole life story. Here's the lesson: Your customers are always a bottomless well of surprises.

How do you budget for an experiment on this scale? Mariam has a simple rule of thumb.

> **NAFICY**: In those early years, when there was little access to capital, we had to be really cash-conscious. Things are always more expensive than you think they are, and they're always going take more time to prove out, and you're gonna need more optimizations, and more loops to correct things than you think you will. That's why we just say roughly speaking at Minted, "Act like you've got half, because you've got to factor in all the failures and all the optimizations that really kill great entrepreneurs and businesses all the time." We know so many people—both of us, probably—people who had good ideas, were on the right track. They just ran out of runway.

HOFFMAN: I want to point something out here. Mariam was an investment banker. She can crunch numbers and budget with the best of them. But her rule of thumb, spend half, is not quite an exact science. Will twice as much money keep the experiment going? Why not three times as much? Why is it so hard to accurately predict costs? In fact, there's an academic term for this.

> **DANIEL KAHNEMAN**: It's called a planning fallacy.

HOFFMAN: That's Daniel Kahneman, genius Nobel Prize winner and one of the leading experts in our budgetary blind spots. We asked him why this so-called "planning fallacy" exists, and what it means for different kinds of entrepreneurs.

> **KAHNEMAN**: The planning fallacy is that you have a plan and then you get the resources that are needed for the plan with a little bit of margin of safety. But most plans *fail*. They fail dramatically. The way to overcome it, in part, is that, and it's implemented by the way, there is something that, actually I invented it, and I call it the "outside view." When you have a problem you look at the range of similar problems and you look at the statistics of what happens. In particular you can look at the statistics of overruns and they're different for different types of projects. So familiar projects like building another house or things like that, the overruns are small, by and large. But the more unfamiliar the project is, the bigger the overruns on average.

HOFFMAN: The kind of entrepreneurship that I pursue and, frankly is the kind of entrepreneurship that Silicon Valley pursues almost always, is something new. Right. It's almost always a new game. It may be a new game because the tech platforms are different. It may be a new game because the competitive landscape has changed. It may be a new game because there's an anticipation or fact of an opening up of a certain form of market demand or consumer demand. So almost always you really have no clue. You're throwing darts at a dart board about how it plays out. The jump into the unknown where you're like, "Who knows," is at least a certain adrenaline rush that perhaps I'm over addicted to.

My own worry is that certain areas that I get too expert in I then become a bad investor because

I'm too aware of all of the landmines. For example, at Greylock, because of PayPal, I'm the payments guy. I haven't really done a payment investment yet at Greylock because every time I look at them I think back in terms of the literal huge landmine field that PayPal ran through and go, "Oh my gosh. I'm aware that there's explosives all over the place," and it makes me too conservative for making bets that I otherwise should make because there are some great payments companies out there—Stripe, Square, et cetera—that I talked to very early and couldn't bring myself to lean in to do despite world class great entrepreneurs. Note to self, mistake. I was going, "Oh my gosh. I know how bad this payments area is." So that's my curse is kind of a curse of knowledge versus a curse of conservatism which may lead to making bad risk bets in some selected circumstances.

> **NAFICY:** So I feel that I fail, and I still fail, every day, several times a day. It's just that you hope that you have enough successes that outweigh the failure. It's completely normal, and it's something that I think hopefully everybody could talk about.

HOFFMAN: There's an important postscript to Mariam's story. She raised $89 million in venture capital for Minted, which is now a 9-figure revenue company with 350 employees. They've shipped products to 70 million households around the world since she founded the company.

By now you have the sense for my theory: Entrepreneurs need to raise A LOT more money than they think they need. But every good theory has a *counterpoint*. For this, we'll turn to my friend Brian Chesky, the CEO and co-founder of Airbnb.

> **BRIAN CHESKY**: I think startups raise way too much money. The less money you raise, the more control of the company you keep. But more importantly the more constraints you create. They develop a scrappy culture. The scrappy culture requires you to build more novel solutions, use fewer out-of-the-box software things and you end up just building a scrappy, more frugal, more startup like environment. I would make sure that you give away control grudgingly.

HOFFMAN: So Brian would take my advice cautiously. But cautiously or not, there are a lot of important reasons to raise *more* money than you think you need: to respond to unexpected expenses, to outmaneuver the competition, to guard against economic downturns, and to take advantage of opportunities that may unfold late in the game.

The only thing you can do is set aside the uncertainties and just know the failures will come. Budget like you don't know when they'll stop. And each time you're walloped by some unexpected expenses, remind yourself: It's normal.

I'm Reid Hoffman. Thank you for listening.