

Why There Aren't More Googles

paulgraham.com · Paul Graham · 2008-04 · [source](#)

|

April 2008

Umair Haque

wrote recently that the reason there aren't more Googles is that most startups get bought before they can change the world.

Google, despite serious interest from Microsoft and Yahoo—what must have seemed like lucrative interest at the time—didn't sell out. Google might simply have been nothing but Yahoo's or MSN's search box. This has a nice sound to it, but it isn't true. Google's founders were willing to sell early on. They just wanted more than acquirers were willing to pay. Why isn't it? Because Google had a deeply felt sense of purpose: a conviction to change the world for the better.

It was the same with Facebook. They would have sold, but Yahoo blew it by offering too little.

Tip for acquirers: when a startup turns you down, consider raising your offer, because there's a good chance the outrageous price they want will later seem a bargain.

[1]

From the evidence I've seen so far, startups that turn down acquisition offers usually end up doing better. Not always, but usually there's a bigger offer coming, or perhaps even an IPO.

Of course, the reason startups do better when they turn down acquisition offers is not necessarily that all such offers undervalue startups. More likely the reason is that the kind of founders who have the balls to turn down a big offer also tend to be very

successful. That spirit is exactly what you want in a startup.

While I'm sure Larry and Sergey do want to change the world, at least now, the reason Google survived to become a big, independent company is the same reason Facebook has so far remained independent: acquirers underestimated them.

Corporate M&A is a strange business in that respect. They consistently lose the best deals, because turning down reasonable offers is the most reliable test you could invent for whether a startup will make it big.

VCs

So what's the real reason there aren't more Googles? Curiously enough, it's the same reason Google and Facebook have remained independent: money guys undervalue the most innovative startups.

The reason there aren't more Googles is not that investors encourage innovative startups to sell out, but that they won't even fund them. I've learned a lot about VCs during the 3 years we've been doing Y Combinator, because we often have to work quite closely with them. The most surprising thing I've learned is how conservative they are. VC firms present an image of boldly encouraging innovation. Only a handful actually do, and even they are more conservative in reality than you'd guess from reading their sites.

I used to think of VCs as piratical: bold but unscrupulous. On closer acquaintance they turn out to be more like bureaucrats. They're more upstanding than I used to think (the good ones, at least), but less bold. Maybe the VC industry has changed. Maybe they used to be bolder.

But I suspect it's the startup world that has changed, not them. The low cost of starting a startup means the average good bet is a riskier one, but most existing VC firms still operate as if they were investing in hardware startups in 1985.

Howard Aiken said "Don't worry about people stealing your ideas. If your ideas are any good, you'll have to ram them down people's throats." I have a similar feeling when I'm trying to convince VCs

to invest in startups Y Combinator has funded. They're terrified of really novel ideas, unless the founders are good enough salesmen to compensate.

But it's the bold ideas that generate the biggest returns. Any really good new idea will seem bad to most people; otherwise someone would already be doing it. And yet most VCs are driven by consensus, not just within their firms, but within the VC community. The biggest factor determining how a VC will feel about your startup is how other VCs feel about it. I doubt they realize it, but this algorithm guarantees they'll miss all the very best ideas. The more people who have to like a new idea, the more outliers you lose.

Whoever the next Google is, they're probably being told right now by VCs to come back when they have more "traction."

Why are VCs so conservative? It's probably a combination of factors. The large size of their investments makes them conservative. Plus they're investing other people's money, which makes them worry they'll get in trouble if they do something risky and it fails. Plus most of them are money guys rather than technical guys, so they don't understand what the startups they're investing in do.

What's Next

The exciting thing about market economies is that stupidity equals opportunity. And so it is in this case. There is a huge, unexploited opportunity in startup investing. Y Combinator funds startups at the very beginning. VCs will fund them once they're already starting to succeed. But between the two there is a substantial gap.

There are companies that will give \$20k to a startup that has nothing more than the founders, and there are companies that will give \$2 million to a startup that's already taking off, but there aren't enough investors who will give \$200k to a startup that seems very promising but still has some things to figure out. This territory is occupied mostly by individual angel investors—people like Andy Bechtolsheim, who

gave Google \$100k when they seemed promising but still had some things to figure out. I like angels, but there just aren't enough of them, and investing is for most of them a part time job.

And yet as it gets cheaper to start startups, this sparsely occupied territory is becoming more and more valuable. Nowadays a lot of startups don't want to raise multi-million dollar series A rounds. They don't need that much money, and they don't want the hassles that come with it. The median startup coming out of Y Combinator wants to raise \$250-500k. When they go to VC firms they have to ask for more because they know VCs aren't interested in such small deals.

Vcs are money managers. They're looking for ways to put large sums to work. But the startup world is evolving away from their current model.

Startups have gotten cheaper. That means they want less money, but also that there are more of them. So you can still get large returns on large amounts of money; you just have to spread it more broadly.

I've tried to explain this to VC firms. Instead of making one \$2 million investment, make five \$400k investments. Would that mean sitting on too many boards? Don't sit on their boards. Would that mean too much due diligence? Do less. If you're investing at a tenth the valuation, you only have to be a tenth as sure.

It seems obvious. But I've proposed to several VC firms that they set aside some money and designate one partner to make more, smaller bets, and they react as if I'd proposed the partners all get nose rings. It's remarkable how wedded they are to their standard m.o.

But there is a big opportunity here, and one way or the other it's going to get filled. Either VCs will evolve down into this gap or, more likely, new investors will appear to fill it. That will be a good thing when it happens, because these new investors will be compelled by the structure of the investments they make to be ten times bolder than present day VCs. And that will get us a lot more Googles. At least, as long as acquirers remain stupid.

Notes

[1]

Another tip: If you want to get all that value, don't destroy the startup after you buy it. Give the founders enough autonomy that they can grow the acquisition into what it would have become.

Thanks to Sam Altman, Paul Buchheit, David Hornik, Jessica Livingston, Robert Morris, and Fred Wilson for reading drafts of this.

|