THE WALL STREET JOURNAL.

Venture Capitalists Talk About the Investments That Got Away

How does it feel to pass up the next Facebook? Or Lyft? Investors share their stories.

Lyft began as a service that let college students share rides. PHOTO: ANDREW HARRER/BLOOMBERG NEWS

By Rob Curran
April 30, 2018 10:07 p.m. ET

We asked some seasoned investors to share their stories about the big chance that got away. Why did they pass on these startups? What didn't they see that somebody else did? And what lessons did they take away from the experience that helped them make better decisions down the line?

Here are their stories.

The one that got away: Lyft


Chris Farmer turned down an idea that would turn into the $11 billion ride-share giant Lyft. PHOTO: SIGNALFIRE

The lesson: Bet on people, not plans.

In 2011, Chris Farmer, founder and chief executive of venture-capital firm SignalFire, met with a pair of young entrepreneurs who pitched what seemed like a hopeless idea.

The partners, Logan Green and John Zimmer, were running a service called Zimride that allowed students to coordinate shared rides, often between campus and their hometowns. Now the duo wanted to raise money to expand their services to more college campuses.

Mr. Farmer says he "loved the founders," who he says were tech whizzes knowledgeable about transportation trends.

But their idea “was basically a long-haul bus service,” he says, adding, “you’re basically competing with Greyhound, and it’s just not that intriguing a business.”

What he didn’t realize was that the partners had an idea that would turn into the $11 billion ride-share giant Lyft. And he didn’t see it because he was focusing on their business plan, not personal potential.

The partners recognized the same problem with the idea that he had identified, and they figured out a way to correct it—by turning their dream company into an on-demand short-trip taxi service.

“What happened was, because they’re great founders…they pivoted into what became Lyft,” Mr. Farmer says. (Lyft confirms his account. Zimride, meanwhile, was purchased by Enterprise Holdings in 2013 and still provides the original service to students and employees of corporations.)

Mr. Farmer learned that founders’ abilities should carry more weight in the beginning than their business plan or profit-and-loss statements. “At the earliest stages, when things are just forming, you need to take substantial leaps of faith,” he says.

Mr. Farmer applied the Lyft lesson when his firm contributed the majority of a $2.5 million investment in Zume Pizza, of Mountain View, Calif., in 2015. On the face of it, the business plan sounded a bit pie in the sky: to revolutionize the industry by having robots make pizzas inside of delivery vans so the pies would arrive as fresh as possible.

But, as in the case of Lyft, the Zume founders brought both technological and industry expertise to the table, Mr. Farmer says. One had lived and worked at a cheese-producing buffalo farm in Italy, while the other was a former Microsoft executive and, Mr. Farmer says, a “lifelong inventor.”

Early-stage investments, he says, are “much more weighted to the human condition.” (Zume Pizza confirms Mr. Farmer’s account. Neither the company nor Mr. Farmer would comment on its current valuation.)

The one that got away: Square

The lesson: New isn’t everything.

Matt Harris passed on Square, which now has a market capitalization of roughly $20 billion.
PHOTO: BAIN CAPITAL VENTURES

Matt Harris of Bain Capital Ventures has backed successful startups including human-resources outsourcing company Justworks and cryptocurrency firm Digital Currency Group. But he passed on a company called Square when it was brand new—missing out on a multibillion-dollar behemoth.

Why? As someone who followed payment technology, Mr. Harris thought that the merchant-acquirer business—that is, handling the nuts and bolts of payments for other companies—was a very old idea. So he couldn’t understand the buzz around Square.

“People were paying really high prices, people seemed to be valuing it like it’s a new type of animal,” Mr. Harris says. “I told myself, ‘Everyone’s drinking the Kool-Aid and I’m a keen-eyed savvy investor, and I know categorically what this is.’ ”

Eric Wiesen didn't realize Twilio's technology would be a massive hit. **PHOTO:** BULLPEN CAPITAL

What he missed, he says, was that even a boring company can be a winner if it excels at its job. “If I'd been smart enough to ask [company co-founder] Jack Dorsey the right questions, he'd say, ‘Yep, you're exactly right, we're a merchant acquirer,” but we're going to beat the others, Mr. Harris says. (Square declined to comment.)

In the past five years, Square's credit-card processor has become ubiquitous in small stores, while its shares have become ubiquitous in the portfolios of technology investors. Square's market capitalization has risen to roughly $20 billion, rivaling that of Mr. Dorsey's other company, Twitter . Not long after passing on Square, Mr. Harris met with the leader of a company called Justworks. The company's pitch involved handling human resources for other companies. “It's a very old model,” says Mr. Harris. Once again, he wondered whether the company had anything new to offer.

Still, he was impressed with the chief executive. “He took the view that he could do it better,” Mr. Harris says, “similar to what Square did in merchant acquiring—getting customers more cheaply, getting higher margins, taking [market] share.”

Mindful of having missed that narrative in Square, he says, his firm was the lead investor in a $13 million funding round in 2015. The CEO of Justworks, Isaac Oates, says in an email that the company has raised $93 million in capital and has seen revenue double in the past 12 months.

“That is some slight evidence that I can learn,” Mr. Harris says.

The one that got away: Twilio

The lesson: Don't get fooled by market size.

Eric Wiesen, general partner at Bullpen Capital, says that he and many other venture capitalists can fall into “heuristics,” or ways of looking at the world, that damage their investment decisions. One example: a tendency to think too much about the “addressable market” for a new company.

“A lot of VCs are doing a paint-by-numbers analysis,” says Mr. Wiesen, whose past investments include Venmo, the payment-technology company that was eventually acquired by PayPal . “Looking at a company, they want to create a market model…. If it can't get to a market of multiple billions of dollars, they just don't make the investment.” That is a mistake, he says. “The way you make money is betting on a market segment that starts out pretty small when the company gets going and ends up being big.”

Mr. Wiesen fell into this trap with a company called Twilio . TWLO +3.15% At the time, the central part of Twilio's pitch was that it would allow app users to make and receive phone calls and texts inside the apps.

He couldn't see what use there was for the technology. But he didn't realize a huge change was on the way: Sending and receiving messages would be critical to services like Uber, which rely on contacting people and giving updates. Twilio is now publicly traded and worth more than $3.5 billion. (The company declined to comment.)

After the Twilio experience, in 2011, RRE Ventures, the firm Mr. Wiesen was with at the time, was one of several venture-capital investors to participate in a $10 million funding round for 3-D printing company MakerBot.

At the time, the market for 3-D printing was only about $50 million, which was dramatically undersized "on the paint-by-numbers analysis," he says. "The market grew triple digits from that point until now."

The estimated size for MakerBot's kind of 3-D printers was $417 million in 2017, according to market-research firm Context. Even after a pullback, the market "continues to grow very very quickly," Mr. Wiesen says.

MakerBot, which was purchased by 3-D printing concern Stratasys for about $604 million in 2013, declined to comment on Mr. Wiesen's investment. Much as Mr. Wiesen has learned from his mistakes, he still expects to make more.
"Sometimes you're just wrong…. You have the right framework, you have all the data available to you to make a decision about a particular market and you just get it wrong," he says, adding, "Those are just part and parcel of being a risky-asset investor."

The one that shouldn't have gotten away: Facebook

The lesson: Stick to your guns.

There might just be one thing worse than missing out on a bonanza by making the wrong call on an investment: missing out after making the *right* call.
In 2004, Larry Cheng was an associate at venture-capital firm Battery Ventures in the suburbs of Boston. He pitched investments to a committee of superiors but never had the final say.

In March of that year, he attended a Harvard University alumni event. During his visit, he asked some students what was new on campus.

"Everybody was saying, check out 'The facebook,' it's blowing up on campus," says Mr. Cheng, who estimated what was then an online Harvard student directory was about four weeks old.

Years later, in a blog post, Mr. Cheng described his "aha moment."

"They had uploaded the Harvard course catalog into the network so that with a single drop-down menu, you could sort the entire network by those taking the same class as you," Mr. Cheng, now a managing partner at Volition Capital , wrote on his blog.


Larry Cheng was a junior associate at venture-capital firm Battery Ventures when he heard about "The Face Book." PHOTO: VOLITION CAPITAL

That feature allowed students to find out more about classmates, a utility whose appeal would be clear to anyone who has ever had a classroom crush.

According to Mr. Cheng's account and his records, he contacted Mark Zuckerberg electronically and arranged to meet him at the Charles Hotel in Cambridge. Mr. Zuckerberg brought a friend, Facebook co-founder Eduardo Saverin.

The duo's ambition was clear, according to Mr. Cheng, but what really impressed him was their focus.

"They were focused on solving a problem for one college campus, and they did it in a very good way," Mr. Cheng says. "They limited their focus and scope, then rolled out to a few more college campuses and solved the same problem.…That would not have existed if they had just opened to the masses.”

The next meeting was over breakfast back at the Charles Hotel. Mr. Cheng could tell the two students were “unaccustomed” to the morning schedule. “They came in looking a little bleary-eyed,” he says. The students’ apparent aversion to the early hour didn’t color Mr. Cheng’s impression of them, however, as he remembered being the same way himself.

The final meeting was in Battery Ventures’ former Wellesley offices in May 2004, Mr. Cheng says. In the intervening weeks, according to Mr. Cheng, Facebook had launched at about 20 other top-tier schools.

Mr. Cheng realized Messrs. Zuckerberg and Saverin probably couldn’t afford a taxi back to campus. So he gave the pair—who now have a combined net worth of about $80 billion—a lift back to Cambridge and $40 for the ride to Wellesley. It was, unfortunately for Mr. Cheng, the only stake that changed hands.

Mr. Cheng says he sent a memo to his superiors in Battery Ventures, extolling the potential of an investment in what became Facebook. He says he heard many objections to the idea. The principal impediment was an existing bet that Battery Ventures had made on Friendster—venture-capital firms seldom back two direct competitors. Other objections included the “limited scope” of the network at that stage and the employment status of the company founders.

Ultimately, Mr. Cheng says, he failed to persuade his superiors.

“Hindsight is 20/20,” says Battery Ventures General Partner Scott Tobin, in an email. At the time, he says, Friendster was popular in the Philippines, a huge market of social-media users. “Unfortunately, that didn’t make up for air-balling one of the most successful venture investments of all time.”

Facebook didn’t respond to requests for comment on the contact between the two firms.

One of the lessons Mr. Cheng learned from his brush with Facebook was the importance of persevering with strong hunches.

“In retrospect, I should have pushed the opportunity more aggressively, even though consensus was hard to come by—not just because Facebook was a historic success but because I’ve since learned that the best investments are never obvious at the time and it is so important to follow your convictions,” he says.