EPISODE 1110

[INTRODUCTION]

[00:00:00] JM: Acquisitions are part of the technology industry. A successful corporation will often have an exit, either going public or becoming acquired. And with each corporation, there is a set of stories that narrate the company from beginning to end. Acquired is a podcast that tells these stories of companies such as YouTube, Instagram and PayPal. During each episode, the life of a company is explored from its beginning until the end. Media companies, chip companies, and software companies all take the center stage on various episodes of Acquired.

David Rosenthal and Ben Gilbert are the hosts of Acquired and they join today’s show to talk about the podcast that they started, a few business stories and the podcast industry itself. It was a great episode and I enjoyed talking to the guys.

[SPONSOR MESSAGE]

[00:00:51] JM: When the New Yorker magazine asked Mark Zuckerberg how he gets his news. He said the one news source he definitively follows is Techmeme. For more than two years and nearly 700 episodes, the Techmeme Ride Home Podcast has been one of Silicon Valley's favorites. The Techmeme Ride Home Podcast is daily. It's only 15 to 20 minutes long and it's every day. By 5 PM Eastern, it has all the latest tech news, but it's more than just headlines. You could get a robot to read you the headlines.

The Techmeme Ride Home Podcast is all about the context around the latest news of the day. It's top stories, the top posts and tweets and conversations about those stories as well as behind-the-scenes analysis. Techmeme Ride Home is like TL DR as a service. The folks at Techmeme are online all day reading everything so they can catch you up. Search your podcast player today for Ride Home and subscribe to the Techmeme Ride Home Podcast.

[INTERVIEW]

[00:01:56] JM: David and Ben, welcome to the show.

[00:01:58] BG: Thanks for having us.

[00:01:59] BG: Thanks for having us.

[00:02:00] JM: We all know about how YouTube, and Instagram, and PayPal have been acquired by companies and become pivotal business lines in their acquirers. But there are also acquisitions that are more subtle, acquisitions that are more synergistic smaller acquisitions. If we're thinking about acquisitions, what role do these more subtle acquisitions play in developing a successful company?

[00:02:27] BG: Wow! Diving right in. I love it. Well, David, do you think talking about acquisition categories is probably the right way to –

[00:02:29] DR: Yeah. Well, the first disclaimer we should say is the show actually started focused solely on acquisitions. That was our original theme. We now do much more. We described Acquired as we tell the stories of great technology companies, and that can be acquisitions, that can be companies that have public. That can be – We've even done still private companies. So we're much more –

[00:02:55] BG: Partially because we've run out of really good acquisitions and didn't want to just browbeat the bad ones.

[00:02:59] DR: Exactly. We did AOL Time Warner and then we were like, "Hmm. We shouldn't broaden." But yeah. No. To answer your question, there are a bunch of great examples like this. Ben, I don't know if you're thinking about all the Apple acquisitions, but I'm thinking about Soundgem, which became iTunes. I'm thinking about P.A. Semi, which became Apple Silicon. I mean, that's huge. The impact of that – That was what? Like 200 some odd million dollar acquisition, I think? Right, Ben?

[00:03:27] BG: Yeah. It was either in the – The number 50 million stuck in my head, but may have been AuthenTec, which was basically the touch ID company. But yeah, there sort of like low 100 million or even just in the sort of dozens of millions of dollar acquisitions. And I think

Apple's line is that they buy small technology companies from time to time and don't comment on their plans for them.

They've been very successful at this type of acquisition that is buying a technology, integrating it and then creating defensibility around their overall business using that technology that they purchased. I think that's sort of the less splashy acquisitions. The ones you mentioned are obviously the ones that are sort of more in the news.

But if you think about how much of Apple enterprise value is attributable to what we now call Apple Silicon or the A-series chips that have been in all the iPhones and have enabled it to really do things that other phones haven't been able to keep pace with, that's like an incredibly high ROI use of a few $100 million a decade ago.

[00:04:35] JM: Most of your shows center around newer companies. Do you have any stories of old acquisitions? What about the Berkshire Hathaway textile mill that was acquired? Like old stories like that where it's became the name. It became part of the name of Berkshire Hathaway. But ironically was one of the money losing enterprises that –

[00:04:56] DR: Terrible acquisition. Yeah.

[00:04:58] BG: Yeah. It's funny. You're foreshadowing an episode that we really want to do this season, because we have not yet touched more internally the show, except in sort of tangential ones. I think they've funded capital cities before it became sort of Disney, ABC, all that. But one that comes to mind for me historically is we got to sit down Nolan Bushnell who is sort of the famous culture personality that founded Atari, and a lesser known, also founded Chuck E. Cheese, which was fun to get the story of how Chuck E. Cheese actually came out of Atari. And that was actually an acquisition that was for a small amount of money, they sold to – Was it Warner Media, David? Is that right?

[00:05:37] DR: Yeah. Exactly, before the merger with Time.

[00:05:39] BG: Right. And the interesting thing about that was they had sold before the home council market really blew up. And so the company that they built was largely coin-up arcade games. You have to remember, this is the 70s and the home council market largely created by sort of Atari and then really successfully sort of grown by Nintendo hadn't really come into being yet. Was it the 2600? That's the sort of famed Atari system. Actually came out after the acquisition. So all the value of that that sort of created in the world ended up accruing not to Atari, the independent company, to a very good acquisition by Warner that ultimately, as I mentioned, Nintendo, they sort of botched it over time and they could have become a multi-billion dollar player in the videogame industry had they continued to innovate. But they sort of just got the short-term benefit of acquiring Atari and getting all that initial value from the 2600. But that was an example of one where, frankly, it was a culture mismatch and they couldn't keep the party going and they couldn't keep all the innovators there long enough to keep inventing and staying on the cutting edge. At least that was my sort of takeaway. What did you think, David?

[00:06:53] DR: Yeah. I think that one of the sections we do on the show is what would have happened otherwise? Where we talk about this kind of stuff. But if Atari hadn't sold, if it had remained independent, would we be playing the Atari Switch today instead of the Nintendo Switch, or talking about Atari Xbox. Was it Series S that's coming out soon I think and the PS5?

[00:07:15] JM: Oh, yeah.

[00:07:16] DR: But yeah. Because Warner went through its own super complicated corporate drama around that. I mean, it just was impossible that I think Atari was going to flourish within it. On the other flipside of that, a historical small acquisition that most people don't know about at all that went incredibly well for the product and the company is – Ben, you're smiling. You're thinking about PowerPoint?

[00:07:39] BG: The funny thing is like what millennials we are to call PowerPoint in 1991, I think, or 1990, a historical acquisition. But –

[00:07:47] DR: I thought it was '87?

[00:07:49] BG: I could be wrong. Maybe the Office Suite came out in '91.

[00:07:50] DR: Maybe that's when it was founded. Yeah.

[00:07:53] BG: But yeah. It's certainly historical compared to all those companies that I listed off earlier, the Uber, SpaceX, Slack, those episodes we've done. Yeah, PowerPoint, I think the reason David and I are both smiling, it was Microsoft's first acquisition. Most people don't know it was an acquisition. You sort of assume much like Word and Excel that it was sort of grown internally at Microsoft. And the other crazy thing about it is people before PowerPoint, business presentations weren't done with like a slide deck. This was like kind of breakthrough – It's a breakthrough idea that you could have sort of a dynamic set of slides that you use to convey a message. And the best part about the whole thing was when Microsoft bought it, it was actually software that was used to print overhead projector transparencies. It was not the PowerPoint that we know today.

So you'd sort of finalize your deck. You'd send it off to the printer and then you use your transparencies. And I can't believe that Microsoft thought that that was valuable enough to purchase and later going to be a major leg of the stool of the Office Suite.

[00:08:58] DR: The other cool little trivia about that, you can tell, we're total history buffs about this. The other super cool bit of trivia about PowerPoint is when the company was called Forethought, I think, and the product was PowerPoint. It was based in Silicon Valley. It was not in Seattle. It was not in Redmond. And when Microsoft acquired it, the campus and the office space down in Menlo Park, where Forethought was, and that became Microsoft Silicon Valley campus. It was on Sand Hill Road in the Quadrus office complex on Sand Hill Road, which would go on to become like the epicenter of the venture capital industry. August Capital moved in there. August Capital had invested in Microsoft. Benchmark ended up moving in there. And it was all because it was the Microsoft south satellite, and that's why the VC industry grew up on Sand Hill Road.

[00:09:51] JM: Wow! Yeah, very fortuitous. And I think what's interesting about some of these acquisitions is how after the acquisition happens, the brand gets glossed over, like you mentioned, the Microsoft PowerPoint, and the same thing happened with the brand that became Google Docs. And then in other cases, you have the brand thriving as an entity under the acquirer, like Instagram acquisition. So it does seem like brand gets used differently depending on the acquisition.

So the M&A strategies that you see in acquirers, they sometimes center around different entities having synergies with each other and sharing the data or the business. Having this thing basically be ingested by the larger acquirer. Other times, the entities remain completely distinct. Like you could think of all the private equity companies that have acquired some of these newer SaaS companies and just kept them totally distinct. So there are two different strategies where you have strong overlap between the acquisition targets and then the other strategy where you have these highly distinct acquisition targets. Could you describe these two different strategies and what are situations where acquisitions become distinct versus merged?

[00:11:09] DR: Yeah, totally. It's funny, when you're talking about private equity [inaudible 00:11:13], it made me think of sort of a company that Ben and I both admire, is Constellation Software, which is a software holding company. You brought Berkshire earlier. People call them the Berkshire Hathaway of software. They're literally a company that all they do is acquire other software companies, They are a publicly traded company, not a fund. But they just leave the companies alone. They don't integrate them. There're no synergies. There's no – They keep operating, just like Berkshire.

I think for – As having done – Shoot over 100 episodes now, I think where each of these – Companies and acquirers do things based on often what the politics are within the company. And so they get this wrong a lot. So I don't think you can necessarily predict how to do this. But I think the right way to do this, that's going to be the biggest odds for success, is if the company that's being acquired is more of a technology platform like P.A. Semi. Obviously, Apple is not going to keep the P.A. Semi brand for Apple Silicon. Then that's obvious. Or even sometimes with products, like with PowerPoint, made more sense for that to become part of the Office Suite than to be fully standalone offering within Microsoft.

[00:12:29] BG: Or Siri. Siri was actually the name of the company that they acquired that did the voice tech. And then they were like, "You know what? We like this enough that the feature name is going to stay Siri when we launch it." I think that's a little bit of a rare case, but that was one where I would definitely not – There was no reason for them to keep the name Siri, but they decided to roll that anyway.

[00:12:47] DR: Yeah. One of the categories that we have on the show is called business line, and I think when there's an opportunity for an acquired company to become a true independent business line – And what we mean by that is like Instagram, is like YouTube, owned by Facebook, owned by Google. But those businesses have the potential to become of the same order of magnitude scale as the parent company. Or even, the best example of this ever is booking.com, was acquired by Priceline. Remember William Shatner, the Priceline negotiator? Ended up becoming much, much, much bigger than the parent company, than Priceline, in the fullness of time.

In those cases, the best thing to do – Facebook was really the first people to systematically figure this out, is just leave them alone. Let then sit there. Truly be an independent company. Oftentimes, not even on the campus, because anything you're going to do as a parent company is just going to mess with the magic.

[00:13:47] BG: Yeah. I would say that the way I sort of look at this is like it depends whether you are basically making an investment, which a private equity firm would do or a Constellation Software would do, or a Berkshire would do and say, "It's a good idea for us to own this and let it run, and hopefully it grows dramatically in value while we own it."

The most successful ones that we've covered on Acquired, and we did this top 10 episode to try and pick apart and do some analytical slicing on one of the top 10 best acquisitions of all time. The ones that we sort of came away with are the ones where there are synergies and the synergies are on the revenue producing side of the house rather than the cost-cutting side of the house. So it's one thing for Zillow and Trulia to merge and say, "Great. Now we can have less finance and operations people. So we get to slash that. And also, we get to cut our marketing spend in half, because now we don't have to bid on the same keywords." Lots a cost savings there, but doesn't make the top 10 ever.

It's a logical acquisition to do, but it doesn't create tons of value. The ones that create tons of value are where you look at something like Instagram where they have unbelievable path to audience, but they themselves have no infrastructure to reach advertisers or have an advertising platform. Meanwhile, Facebook has the best one in the world. And so by combining Instagram's reach, and frankly, the trajectory they were on, because they just didn't have that many users when they got bought. But everyone could sort of see where it was going. And couple that with Facebook's ability to plug it into all the existing assets of the business. That makes for a just tremendously valuable acquisition.

It's kind of the classic Microsoft playbook, where they have one of the best sales channels in the world with their massive sales force and by buying a great technology that they can then push out through their existing sales distribution, customer acquisition, that whole machine, the go-to-market machine. Those are pretty valuable as well.

[00:15:43] DR: Yeah. For Cisco and Oracle, same story.

[00:15:46] BG: Yeah. That's sort of my framework of thinking about it is, "Okay. Is it a Berkshire type buy and leave it alone thing? No. Okay. Well, are they buying it for cost-cutting or are they buying it for potential new revenue creation." And that potential new revenue creation is where all the best ones live.

[SPONSOR MESSAGE]

[00:16:12] JM: This episode of Software Engineering Daily is sponsored by Datadog. Datadog is a cloud monitoring platform built by engineers for engineers enabling full stack observability for modern applications. Datadog integrates seamlessly to gather metrics and events from more than 400 technologies including cloud providers, databases and webservers. Easily identify slow running queries, error rates, bottlenecks and more fast with built-in dashboards, algorithmic alerts and end-to-end request tracing and log management from Datadog.

Datadog helps engineering teams troubleshoot and collaborate together in one place to enhance performance and prevent downtime. You can start a free trial of Datadog today and Datadog will send you a free t-shirt. Visit softwareengineeringdaily.com/datadog to get started. That's softwareengineeringdaily.com/datadog.

[INTERVIEW CONTINUED]

[00:17:16] JM: Moving on from the topic of just acquisitions. As you said, your show has gone on to become something more like a variety of company stories as well as things that are more timely. And that's your series on adaptations. These are adaptations that companies are making to this unprecedented, weird, social distancing, COVID-19 world we're living in. Give an overview of what you're trying to tell with these adaptations.

[00:17:48] BG: The notion behind adapting, and we did three episodes before we realized, "We're going to be in this COVID thing for a while, and we don't just want to tell adapting stories." So we're sort of back to our normal telling –

[00:18:02] DR: We adapted back.

[00:18:03] BG: Yeah, telling stories of epic companies, whether they're adapting or not.

[00:18:08] JM: By the way, the whole thing where we were all like, "Okay. We're just going to be in this quarantine for a while." And then it's like everybody sort of simultaneously has realized, "Uh-oh! This is never-ending."

[00:18:19] DR: Right.

[00:18:19] BG: Yeah, no kidding. And I also felt like –

[00:18:23] JM: How is it that nobody recognized that early on, that this was just going to become the new norm?

[00:18:28] BG: Well. I mean, not to get political. But I think we observed what some of the countries who handled this, and I'm speaking as a US citizen here. Countries who handled this the best did. And if you truly isolated everyone before it got to spread around, then you could actually run a test, trace, isolate strategy and get down to a manageable number. We just didn't do that. And so now it's just spread around everywhere and we got to, I guess, wait for a vaccine.

[00:18:56] DR: I think there's also definitely a human nature element to this too of like is just – I at least, so didn't want to believe that this was going to be the next like year, to 2 years of my life. But yeah, it’s crazy.

[00:19:13] BG: Yeah. Maybe it's more of that. I don't need to make this. It’s also unlike anything else we've ever experienced before. So like the natural human thing is to pattern match off of what has ever happened to you so far, and bad things don't last that long. Bad things happen and then you recover from them and then you move on. And this is like no matter how much we want to be like, “Okay. That wave is over.” It's still out there.

But yeah, what we're trying to do with adapting. And I guess we did with adapting was it felt so wrong to release anything in like mid-March through the end of April. David and I, we we're talking about like should we just stop doing Acquired? Does the world really need glory stories of what brilliant business strategists pulled off the best, most value-capturing acquisitions of all time? And like it just felt like so off the mark, and local businesses were shutting down, tech startups were laying off half the company. Lots of our employees were – Or lots of our listeners were getting laid off. We are like, “There's got to be a way that we can use sort of our platform and our understanding of how to analyze these companies to tell stories right now that are like useful or more interesting to listen to,” especially if you're one of those people that were affected.

And so adapting, we covered three companies that went through that adapted to the change, that basically saw the writing on the wall, acted with leadership, acted decisively and changed their strategy. And we covered Canlis, which was one of the first restaurants. It’s a fine-dining restaurant here in Seattle. Probably the nicest restaurant in the city and internationally renowned for just the unbelievable experience in food that they provide. And we covered them deciding to do what seemed like a crazy thing, is shut down the dining room and switch to a delivery business, a morning drive through bagel shop and a CSA, which is like they leveraged all their relationships with their suppliers to just sell their –

[00:19:13] JM: And this was crazy when they did this. I mean, every other restaurant in the city was opened. There were no mandates about this.

[00:21:18] BG: I think this was like March 15th or so they did this. Now it seems like, "Duh?" But I think they were really a leader in sort of pioneering, "Okay. What does a restaurant even wanted this tier do amidst all this?" And so we also covered – We had Roelof Botha on from Sequoia who talked about their black swan memo, which again was early. I mean the memo heard round the world. This was something where they were writing about – And they sent to their portfolio CEOs, frankly, two weeks before everyone else had sort of said, "Uh-oh! Every business needs to change dramatically now. Throw out your plans. Write new plans." They changed the strategy a little bit at Sequoia, not to spoil the episode too much. So we thought it was very interesting to have him on.

And then we told a historical story from a different crisis where, little-known fact, Intel, for its first 15, 20 years as a business didn't make CPUs. They made memory chips. And overnight – Well, overnight. Over a five-year period, that basically became a pure commodity, and there were these Japanese companies that were far superior in quality and far cheaper on price, and they were coming into the market. They had tons of volume. And Intel had this moment of crisis where they bet big on what was to become a 25-year differentiated path of being. The best CPU company. And that was very – It's a huge bet for them as a company, and kind of an amazing story of leadership to adapt to the times.

And once we got through telling those three, we basically had settled in to this new normal, and we were looking to other like, "God! I miss doing the regular show." I don't want just keep saying [inaudible 00:23:00] me and what lessons can we learn." I think people are looking for little bit more escapism.

[00:23:06] JM: Indeed. I want to escape to the past or escape to the future somehow. I would love to do that. Coming back to your segmentation of different types of acquisitions, there are different types of companies, and is revisiting the acquisition story. How do the mechanics of acquisition change depending on what kind of company we're talking about? So let's say media companies, versus chip companies, versus software companies. How does the different categories of an acquisition affect how the mechanics of that acquisition take place?

[00:23:41] BG: Yeah. Well, the first thing I'll say, and I'll give David some time to think on how that category actually affects mechanics. The number one thing that affects mechanics is deal heat. And I always wanted to be the type of acquisition, because then we could do a more academic look at exactly the question you're asking. But the Instagram deal got done over the weekend without the M&A team involved and they were notified on Sunday night that they were going to be announcing the deal on Monday morning. And it was just done by Mark Zuckerberg and Kevin Systrom and Mike. And that was crazy. It was just something that the founders wanted to do. Mark knew that now was the time. There was sort of a competitive pressure to do it.

[00:24:22] DR: And Twitter [inaudible 00:24:23].

[00:24:24] BG: Yeah. WhatsApp, pretty similar situation. Deal heat sort of forced to commitment. You look at another. I'm thinking of Disney and Pixar. Bob Iger came in to become CEO of Disney and wanted to pull off this crazy thing of buying Pixar. And he thought this is going to be the first thing I want to do at the helm of this company, is go and mend the relationship that we've broken with Pixar and with Steve Jobs and I'm going to extend the olive branch.

Steve Jobs basically said, "Look. Disney sucks it doing deals. You guys take forever. You bring in all the lawyers. I don't trust you. I didn't trust your predecessor. We're out." And Bob, to prove a point and say, "we're different", got a deal done in 10 days." And so, interestingly enough, I think it's other motivating factors around how motivated someone is to get a deal done and how senior of a sponsor is on the deal if it's the CEO or not that really affects how much red tape and process there is around pulling the acquisition off.

[00:25:26] JM: Go ahead, David.

[00:25:28] DR: Oh yeah! I was just going to say on – To question, what type of acquisition and how that impacts the process. I don't know that the type of acquisition impacts the process is directly kind of – What Ben said, deal heat is the most important. But one thing we started doing recently, we had on our second show on Acquired, on our LP show, we had the author Hamilton Helmer on. When was that? Was that in February, I think? Ben? Yeah, February. It was right before COVID hit. That's right. And we've gotten to know him a little bit, where he actually re-launched a book club on as part of the LP program. And *7 Powers*, his book, is the first book in the book club. But his book, *7 Powers*, he talks about there are seven – He's identified seven “powers” in business, and these powers are what makes a business defensible. You could think of it in the Berkshire Hathaway parlances, what is the nature of the moat around the business?

And I think one thing we’ve seen – So we started sometimes categorizing companies and acquisitions according to which power they have. And so I think what's super important in the process of an acquisition is like making sure you don't mess with the power. And the powers range from – Network effects is an obvious one. Most people know switching cost is a different one. That a lot of SaaS companies are built around these days, could be a very powerful brand like Tiffany's.

But a really interesting one in terms of acquisitions is a cornered resource. A cornered resource could be a patent. Like this happens in biotech and pharma a lot. But the Pixar deal is really interesting. The cornered resource, Hamilton kind of defines it as like what is something – It's not just one person, but what is some resource that this corporation has access to uniquely that nobody else could competitively come arbitrage and hire away in the case of a person? And for Pixar, it was the brain trust, right? It wasn't just Ed and John. It was the two of them and the collective culture around all the directors of Pixar and what they were able to accomplish in the creative process.

And so I think Disney masterfully handled this where they, in terms of Bob Iger getting the acquisition done, a big reason that happened was he said to Ed and John, and Steve Jobs too, “We want you to come take over Disney Animation in addition to Pixar.” We realized the brain trust is what is magical. What is the power here? And so not only are you going to keep it. We’re going to expand – Bob used the analogy of the canvas that you get to pain on, which is perfect for that deal.

[00:28:08] BG: Yeah. Last. This is so funny. The other big thing that dictates this is leverage. I think most of the folks listening to your show, Jeff, is like many of them are entrepreneurial software engineers. They may have sold a company at some point. And us saying things like it took 10 days for Disney to get a deal done with Pixar or it took the weekend to buy Instagram. If they've ever sold their company, they're , "That was a six-month awful, awful process." And like that is largely the case when the big companies got nothing but time on their side. The start-up usually is either running out of money or has to make a call at some point soon. Do we need to fund raise, versus sell? It's hard to get multiple bidders looking at you.

And so it's this really rare scenario where a company actually has enough that the acquiree actually has enough leverage to force a deal to get done and to force a bidding war. And I think most of the time, what it looks like is your sponsor needs to – The deal sponsor on the acquiring side needs to carefully use their political capital and build decks, and build models, and make pitches internally and stake their career on getting it done. And that is just a many month process. It gets expensive. It has lawyers. And so that to me is also a big factor in sort of mechanically how the acquisition happens.

[00:29:32] JM: Have you guys seen any impact of COVID on acquisitions? Whether it changes acquisition prices, or it changes acquisition mechanics?

[00:29:44] BG: Interesting question. In some ways, it's too soon to tell. I know of a mid-stage startup that just bought not a tech-base competitor, but a sort of older world competitor for much cheaper than they otherwise would've, because that company basically looked around at their options right now. Revenue is down. They had to do some layoffs. Their opportunity for future capital is much more diminished than it otherwise would be. And so they sold to this mid-stage startup that I know of for a very attractive price to the buyer. And so I just have that without one example that's top of mind that I know of from this week. But I have to assume, that sort of consolidation is going on in a lot of places. And I guess the way to create that bucket is there's a lot of companies that are on sale right now that otherwise would be more expensive.

[00:30:37] DR: Although some companies, they're higher priced than they were before. I think that I agree. I don't know if they were close enough to current processes to say. But one area we are both close to is the venture financing landscape as investors ourselves. And that's interesting. A lot of investment rounds are still getting done. Capital is still being deployed just as strongly and just as rapidly. But it seems – I don't know about you, Ben. But every VC I talk to every conversation, people say, "New stuff – What's getting done is stuff that I already had a relationship. It was moving along. I was tracking this company ever since their last round." But new companies, people say like, “I don't know. I think it’d be really hard to build a relationship with a founder just over Zoom.” So I do wonder if it's hitting the early stage and making that harder for companies to fundraise disproportionally.

[00:31:34] BG: Yeah. I do think that that is true, and that translates to the M&A market is well, where unless the startup has been building a relationship with the potential acquirer through potentially being a partner or a distribution deal or something through previous years. Forming relationships right now is just hard. And so it's like in any deal, be it a funding or an acquisition, there is a – Let’s see. What’s the right physics analogy here? The coefficient for static friction is higher than the coefficient for kinetic friction. And so it's much higher to like generate the activation energy to start that relationship on a good enough foot where you’re going to have enough momentum to carry you through to actually getting the deal done.

And that's definitely happening. I saw some great data published this week from Redpoint, which basically said, at least in the funding markets, lots of capital is still being deployed. But it's happening into fewer companies at higher valuations. And the way to translate that, if you're thinking about, “Well, why is that happening?” The investors are basically willing to pay up more expensive prices for more safe bets. “Hey, already know this companies doing well.” So, everybody's chasing those few companies that are doing well, and all the companies that are like not doing well or doing fine are getting ignored, and people are willing to just deploy more capital at higher prices into those sort of few proven companies. I think the exact same thing is going to play out in M&A. But those things sort of take a while to surface.

[00:33:03] JM: My favorite episode that you guys have done is not about Acquired, or it’s not about an acquisition. It's not really about company. It's about Sequoia Capital. Sequoia is a company, but it's an investment firm. You did this epic two-part story of Sequoia. What did you learn from studying Sequoia?

[00:33:24] DR: Oh my gosh! So much. I mean, they are the OGs. Don Valentine, the founder of Sequoia, he almost single-handedly invented modern venture capital. There were others. Kleiner Perkins was started right around the same time. Draper and all of his crew were operating too. So it wasn't completely – But just so much, the way he and Sequoia operated from the beginning, he was the only person that was from the technology industry. He was the head of sales at Fairchild, and head of sales and marketing, which marketing meant something very different back in those days.

[00:34:07] BG: It certainly didn't mean growth hacking.

[00:34:09] DR: No. Something much more akin to strategy. And the way that he – And I think you can –Everything Sequoia has done over the past 40 years since came out of this, and so much of the rest of the venture industry evolved from just a financial way of thinking about things. I mean, like shoot! Fairchild was financed as not as an independent company, but as the division of a camera company based in Long Island New York. Everybody else who is coming at this new industry from a finance perspective wouldn't have seen that what mattered was the market potential for products and technologies. And so that was everything that Don – Because, first, it was just Don in the beginning, focused on. And then Sequoia ever since, Don says famously – There's a quote. It gets something we – He's giving a talk at Stanford and he saiys, "If you were interviewing venture capital firms and they ask you – We asked the candidates at Sequoia. Why do you think we're successful, if we're successful?" And most people say, "Oh! You finance the best and brightest, and you have people from Stanford and blah-blah-blah." And Don says, "That's not it at all. We focus on the market. We only care about the market potential, the future market potential of this technology or product. And who the people are who are building it, is of course important, but in many ways it's secondary. The financials of the deal at the time. Who the people are? Their histories, their background is secondary to is there going to be a market for this thing?"

[00:35:43] BG: Which is very contrarian to what you hear from most early-stage investors today who say it's all about the people. Sequoia, at least, in that era was like, "Look. If we need to change the people, change the people. But we need to like what they're going after."

I think Sequoia is a great picture of clear thinking. And I just pulled up my notes from the episode when you asked the question to reflect back on what did we learn. And one of my favorite things were Don Valentine's ground rules, where he basically said, "There're these six things. One, must be a very big market. Two, must be in Northern California. Must be an advanced technology. Must have high gross marginability. Must have the potential for Sequoia to make $100 million, and must be positively responsive to our active participation.

And by laying out those like very – That was sort of the earliest investment criteria in the venture industry, whereby having that clarity of thought and saying, “Look. We’re only going to do deals that look like this.” It really not only saves you a lot of time, but it clarifies what your job is and what Sequoia's job was in the ecosystem. And that dovetails well with my other big take away, which was Sequoia was started at this moment in time, whereas one of the very first technology waves with semiconductors. And we talk a lot about waves on Acquired. I'm sure everybody has sort of talked about the Zeitgeist stuff. You had the wave of PCs, and then had the wave of the Internet, and you have the wave of mobile, and that enables a 5 to 10-year span of new innovation that's available on top of that brand-new platform before it sort of reaches the top of the S-curve and you have sort of decelerating innovation in that area.

Well, Don had come out of being as head of sales for Fairchild. And so he knew what all the customers were looking for out of Fairchild to do with the semiconductors and they just couldn't fulfill demand. So when he started Sequoia, he knew like, “Okay. Semi-conductors are going to be used in everything. There's going to be this explosive growth, and it's up to me to basically just finance the best sort of uses of semiconductors that I think are the most interesting businesses.” And he executed what they called the aircraft carrier strategy of just funding the companies around a wave. He later did this with Apple Computer, because Sequoia was one of the earliest investors there and funded a lot of companies that sort of sat around the original Apple machine.

[00:38:13] DR: Disk drives, printers, etc.

[00:38:14] BG: Yup. But I just thought it was so – Not everyone can pull that off, or I should say it takes – There're a very few set of people who could pull that off and there's a very specific set of times ever that that can be pulled off and it has to be right in that first year or so of a wave and from a person who has the experience to basically see the future of that wave and be able to bet with the clarity of thought that Don was betting to create so many of those successful early companies.

[00:38:44] DR: It’s funny. Ben mentions Apple and Sequoia’s history there. That's the other big lesson that I think I've really taken from studying Sequoia that's changed my thinking and behavior hugely, is the lesson they learn from what happened with Apple. They sold their stake in Apple. They were one of the main first financers of the company. They sold their stake I think it was right before the IPO and they "return to the fund" that Apple was in. But the net made – What was it? $6 million on Apple? Something like that, Ben?

[00:39:16] BG: Yeah.

[00:39:18] JM: Yeah. If they'd held on to that, it would be worth like $200, $300 billion today, and that was such an important lesson for them as a firm, which was that when things are going well, when there's a bright future ahead, whatever – There're always all sorts of noise and external circumstances, and it'd be nice to get liquidity and blah-blah-blah. But if you think there's a real big chance ahead for a company, that's just noise. You need to hold as long as possible.

And so you see, a perfect example, this is Square, right? Square went public in – What was that? 2016, I think? Right, Ben? And Sequoia was the first – I believe, first investor. The IPO went terribly, but Sequoia held on to their shares. They still hold on to the shares. They're still on the board. It's been public for 4+ years. And the company has 12-exed I think in the public markets. And I don't think they have any intention of selling their shares.

[00:40:16] BG: Yeah. I have been shook. One lesson from Acquired is for the best companies, it is staggering how much of their growth happens after the IPO. Because the canonical wisdom in our industry, especially in startups, is about getting in on the ground floor. Because, gosh! If you can be a part of a company when it's worth $10 million by the time it IPOs, you never need to work again. Of course, that's not true for lots of reasons, including getting in at series B or C valuations, or stock-option tax crap. But the sort of best companies are able to see those 10, 50, 100X increases in valuation after they go public.

And so the – I think, David, it's exactly what you're alluding to with square. Obviously, we've seen it with zoom recently. We saw tons and tons and tons of times with all those companies in the 80s, I think Microsoft, Apple. A lot of the highest market cap tech companies in the world were started before 2005. So in the last 15 years, we haven't really had anybody come in to replace the thing fang, or however you want to describe the sort of tech stocks right now. But it definitely is counter to the trend that we sort of all buy into of get in early, because that's when the multiples happen.

[00:41:32] DR: Well, it’s get in early. But if the future is bright, don't exit.

[00:41:36] BG: Yup.

[SPONSOR MESSAGE]

[00:41:45] JM: Your code is going to have errors, even code written by an amazing developer. And when bad things happen, it’s nice to know that Honeybadger has your back. Honeybadger combines error monitoring, uptime monitoring and cron monitoring into a single easy to use monitoring platform for less cost than you’re probably paying right now. Honeybadger monitors and sends error alerts in real-time with all the context needed to see what’s causing the error and where it’s hiding in your code so that you can quickly fix it and get on with your day.

The included uptime monitoring and cron monitoring also lets you know when your external services are having issues or your background jobs are going AWOL or silently failing. Honeybadger.io is 100% bootstrapped. It’s a monitoring solution that’s bootstrapped, and this is important, because a self-funded business means that they’re priced simply. They operate the business simply and they answer to you, not investors.

Software Engineering Daily listeners can get 30% off for 6 months of Honeybadger, and you can simply mention Software Engineering Daily when signing up. They’ll apply the discount to your account and you don’t need a credit card. Thanks for listening, and thanks to Honeybadger for being a sponsor.

[INTERVIEW CONTINUED]

[00:43:06] JM: As people can tell, you guys have a great rapport, and I love your podcast. So it would be remiss not to talk about podcasting a little bit. Podcasting in 2020, strange times. How have things changed since the earliest days when you started podcasting? It feels so long ago.

[00:43:24] BG: Yeah. And I thought we were getting into podcasting late. I remember, I think, David, we originally started talking about doing a show in February 2015, and finally actually released our first episode in October 2015. I remember thinking podcasting is a decade old. Like I wish I had done this so much earlier.

[00:43:43] DR: It's like the quote about Marc Andreessen and showed up in Silicon Valley in – What was it? '95 or something, and felt like he'd missed it.

[00:43:49] BG: Yeah. Yeah. It's definitely shown that he hasn't. But yeah, I want to say there was something like I would guess on the order of 50,000 to 100,000 podcasts in 2015. And we just pass – I think we're plateauing, but we just pass 1.3 million in the iTunes directory. And I think the question is who in the millennial generation doesn't have a podcast is probably the most interesting question to ask at any given party.

For us, I think there's a certain element of luck of feeling like we got to ride a bit of a wave here. But as you said, that market dynamics are changing dramatically. The biggest driver of which is Spotify. They've basically decided, "Hey, Apple screwed up by not capitalizing on the market position that they had with a player that had 75+ percent of the share of year of people who listen to podcasts." And various people had made a run at sort of turning, aggregating all those listeners and creating private content over the years.

But the first real competitor now is Spotify leveraging the fact that – What is it? 80 some million people. Is it 80 million paid? I can't remember exactly. My numbers – Lots of people use Spotify.

[00:45:01] DR: I think, yeah. I think it's 200 million+ total.

[00:45:05] BG: Yeah, to listen to music. And so the other job to be done by your ears is listening to spoken audio. And so they thought we can serve that need too. And by initially running the playbook that everyone else ran of, "Hey, we're just going to put all to shows in here. Just like Overcase does. Just like Apple Podcast does." But then slowly figuring out not all at once, one way to create private content, but by slowly introducing, "Hey, this is windowed content." Or, "Hey this show is going to be better on Spotify, but available everywhere." And now they're having – They're really doing more exclusive content. They are both capturing share of ear, because they were right, that they could effectively turn their music listeners into podcast listeners. But they're also doing a good job doing value capture there. Because to the extent where they can use private podcasts to bring new people into being paid Spotify members. And you look at things like the new shows that Gimlet is producing, or what will happen with Joe Rogan later this fall or winter. Their cost structure for podcasting is so much better than their cost structure for music. Because with music, they have no upside of scale. For every stream, they got to pay it out to a record label no matter how streams happen.

But with podcasting, they can pay upfront, and then all the upside gravy is theirs. And so they've just been – I mean, it is one – There is going to be amazing business strategy case studies on this of masterfully being both right and then able to capture value from it. And I think that is the main driver of what you're seeing in all these other changes by all these other companies who are trying to fortify their defenses against Spotify becoming the dominant way to listen to podcasts.

[00:46:50] DR: Yeah. How are you finding things?

[00:46:52] JM: The thing I'm actually struggling with the most existentially right now is like do we actually learn from podcasts? Is podcast like – Are these actually useful? What are we actually doing in this stuff? I listen to it, I'm like, "Am I retaining this?" Is this like sort of massaging my ears and just – You know what? It kind of reminds me of – This is a really self-deprecating way of putting it. But you know those infomercials with the electrodes that you put across your stomach and like the electrode is just kind of like, "Jit-jit-jit."

[00:47:22] BG: Yeah. It's how I stay in shape.

[00:47:24] JM: Right. Exactly. It's how you get a six pack.

[00:47:27] DR: Somebody should start marketing that in time of coronavirus.

[00:47:31] BG: [inaudible 00:47:31] as like a beautifully branded, like pink and green site.

[00:47:35] JM: Well, exactly. But here's the thing, is like are we just sitting here with the electrodes attached to our abs and like trying to get a six pack by listening to software engineering content or business content? That's what concerns me the most. I mean, people are still listening. I'm still enjoying it. I enjoy the interviews. But it is kind of an existential question for me. How educational is this stuff?

[00:47:58] BG: Yeah. I mean, for me there're two jobs to be done by spoken audio. One is entertainment and one is education. And if it's entertainment, great. There are I of – Entertainment is a very valid way to spend your time. It's probably too hedonic to spend all your time doing that. But we pay to go to the movies. We play Fortnite. If podcasts are entertaining, then awesome. If it's education, then the question is like do we make use of that education? And is it really education if you're not making use of it? Otherwise, is it just sort of indulgent entertainment and a curiosity where you're never going to apply that knowledge in any way, shape or form?

And I'll say like, as a business tech podcaster, who didn't go to business school and do not have a formal business education. I did computer science undergrad and was sort of an indie iOS developer for a long time. And now more of what I do is on the business side of things, both starting and investing in companies. I think podcasts were transformative to in my sort of understanding of key business concepts. And I often find them to be like a top of funnel into something deeper. So I'll here Bill Gurley talk in a podcast and bring up some concepts that are alluding to the Michael Porter HBS article on competitive strategy. And then I go read that and I'm like, "Whoa! I so fundamentally understand business strategy more now because the podcasts taught it to me in a high level in an approachable way. And then I went and ate my vegetables, and now I really understand that thing." I think, to me, that's been the most useful use of podcasts in my life.

[00:49:39] JM: Indeed.

[00:49:40] DR: How did you feel about it with engineering topics? Is it – How is communicating?

[00:49:44] JM: Same thing. I think it's the top of funnel is the way to think about it. You hear a little bit about some technology thing and then you go try it out and see if it solves your problem.

[00:49:56] DR: Yeah. I guess it'd be like taking a CS course in college, like you go to the lectures and like get exposed. But like then you do the programming exercises and you build things. And then that's how you internalize it.

[00:50:13] JM: Indeed.

[00:50:14] BG: Yeah. Jeff, I'm actually curious. Dave and I have learned the hard way over the years that even though in our notes, we have lots and lots of tabular information. It doesn't translate well at all in audio. Like we have to cut off all decimal places. We try not to use too many numbers, because it just gets confusing. And I find that like the more obviously a show about engineering is not just reading numbers. But like the more technical a topic, the more it drifts toward being tabular in nature. And do you ever struggle with I'm trying to explain something technical here, but it doesn't translate as well the audio as it would in written content?

[00:50:53] JM: Well, I think every piece of technology has a set of organizational or human level problems that come with it. And so you can often touch a little bit on the technical side of things and then you can touch on the human level or the organizational side of things, which is easier to digest. You know what I mean?

[00:51:11] DR: Yeah. That makes sense.

[00:51:12] JM: You don't have to get into like, "All right. Tel me the method name for this piece of functionality.

[00:51:20] BG: Right. Yeah. You have the philosophical conversation on the podcast, and then people can go read the documentation on their own time.

[00:51:27] JM: Yeah, exactly. Well, final question. What's the differentiator? For people who are still listening and they haven't checked out Acquired. There are many, many business podcasts these days. How do you differentiate?

[00:51:40] DR: Ooh! We talk about this all the time.

[00:51:42] BG: Yeah. It's like you're in our I message here. I will be the first to say and, and this has always been my approach sort of in life. David, you can give your more well-thought through answer in a second. But like – So I went to Ohio State.

[00:51:56] DR: My approach is let Ben answer first.

[00:51:59] BG: And studied computer science there. I was by no means the smartest person in my computer science class. And so like I just figured if I wanted to get good grades, then I just had to work harder than anybody else. And that hard work could sort of like overcome – I'd say I'm like smart, but not genius. And so I think the way that I've approached the show is kind of the same way, which is like just go deeper. Do more work. If you're going to have a guest on, know everything that they've ever put on the Internet. And if you're going like do a deep dive on a company, do a really effing deep dive on that company. And like we have David to thank for this mostly, because he's so good at the history and facts and does – He leads the kind of historical research part of the show.

But like our SpaceX episode neared three hours. And for me, like that's sort of like depth and our willingness to be just like diving head first into an Internet rabbit hole of like what is everything I can possibly learn about the subject is part one of sort of what defines the show. But then it's our ability to do – What's the phrase? There the first 90% of the work, and then the last 10% is the other 90% or something. But to do the second 90%, which is like actually assembling it in a way that is digestible. Once you become expert on a topic, to actually then figure out what's the pony in here. What's the story? What should people care about? How do we anchor on it? To me, it's the marriage of the willingness to go deep and then the willingness to do the work to really synthesize it that I think is differentiating.

[00:53:38] DR: Yeah, which is totally, Ben, superpower. Ben writes all of our – We structure our episodes with – We do like a fun, like kind of joke quote, as like a cold open air. And then Ben does a little hook. We started this a year or two years ago maybe of like, "Okay. What's the 60 to 90 seconds that's going to be like why should you listen to this?" And Ben just does a masterful job with it.

All this reminds me, Ben, what you're saying, I totally agree, of the Warren Buffett quote since we've just been all about Warren entirely on this episode of what's going to get you farthest in life is not the horse powering your engine, but the quality of your drivetrain. And I think that, yeah, totally – That defines Acquired, I think.

[00:54:23] BG: Yeah. The other thing I think that since many listeners of this show may have never listened Acquired, it's probably David and my background, the fact that we're not journalists. So there's a whole set of shows, including things like how I built this that like we're going to have a different approach because we're industry practitioners, myself being a dev, gone PM, gone startup studio, gone VC. And David coming from the much more financial side, but both of us being nerds at heart where we're there's a practitioners approach to it that I think is different than the journalist's approach. But there's a willingness to try and do the work to build the story that makes it not just a pile of facts.

[00:55:03] JM: Cool, guys. Well, I really appreciate you coming on the show, and thanks for creating a podcast that I've gotten a lot of value from.

[00:55:08] BG: Hey!

[00:55:09] DR: Likewise.

[00:55:11] BG: Thanks for listening to what started as David and I trying to find a reason for us to hang out more. And thanks for having us on the show. I think this has been fun.

[END OF INTERVIEW]

[00:55:28] JM: If you listen to this show, you are probably a software engineer or a data scientist. If you want to develop skills to build machine learning models, check out Springboard. Springboard is an online education program that gives you hands-on experience with creating and deploying machine learning models into production, and every student who goes through Springboard is paired with a mentor, a machine learning expert who gives that student one-on-one mentorship support over video.

The Springboard program offers a job guarantee in its career tracks, meaning that you do not have to pay until you secure a job in machine learning. If you're curious about transitioning into machine learning, go to softwareengineeringdaily.com/springboard. Listeners can get $500 in scholarship if they use the code AI Springboard. This scholarship is for 20 students who enroll by going to softwareengineeringdaily.com/springboard and enter the code AI springboard. It takes about 10 minutes to apply. It's free and it's awarded on a first-come first-served basis. If you're interested in transitioning into machine learning, go to softwareengineeringdaily.com/springboard.

Anyone who is interested and likes the idea of building and deploying machine learning models, deep learning models, you might like Springboard. Go to softwareengineeringdaily.com/springboard, and thank you to Springboard for being a sponsor.

[END]