GreenHills Ventures, LLC.

GreenHills Ventures – How Not To Strangle Your Unicorn

Lessons to be Learned- “If Fab had been more conservative in its numbers, more careful about its rate of spending, and had not such aggressive growth goals, it might still be around today”.

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In June 2013, Fab.com’s chief executive officer, Jason Goldberg, dressed in all black with a red belt, arrived at the Bloomberg Television studios in New York, ready to spread the gospel of quirky home decor. Fab sold Texas-shaped coffee tables, necklaces with expletive pendants, cardboard lion heads, and other unique items, and investors loved it. Goldberg had raised hundreds of millions of dollars, and the latest round of venture capital valued Fab at $1 billion. Back then, a 10-figure valuation placed you in rare air, but Goldberg wasn’t satisfied: He wanted to be bigger.

“There are currently four e-commerce companies that are worth more than $10 billion dollars— Amazon, Rakuten in Japan, Alibaba in China, and eBay. And we think Fab has a good chance of being the fifth one,” he told Bloomberg’s anchors. “We have more money than we need right now to run Fab well into the future.”

But Fab did not have enough money. Goldberg had raised only about half of what he needed. Soon after his televised brag, Bloomberg published my story about troubling cracks in the business—revenue shortfalls, a revolving door of executives, low morale—and it was even harder for Goldberg to get cash from investors.

The turmoil that followed was well chronicled: round after round of job cuts, departures of executives, including Goldberg’s co-founder, and, in 2015, the sale of what was left of the brand to an Irish manufacturer. The price was $15 million.

Now Goldberg is back, with something new to sell. Later this month he’ll launch Pepo, a consumer messaging company. It’s based in Berlin, where Goldberg now lives, and there’s an engineering team in Pune, India. This time, he says on the first episode of the Decrypted podcast (subscribe on iTunes here), things won't get as crazy.

Fab’s crash is a cautionary tale for any startup that relies on selling things directly to consumers. Flush with venture capital, startups use it to afford marketing or steep discounts for their customers, which help them grow—but it can’t last forever. The current startup landscape—with more than 150 companies valued at more than $1 billion—is peppered with e-commerce companies yet to prove their business models. There are the subscription box companies such as Birchbox, food delivery startups such as Instacart and Doordash, and online stores trying to have a breakout success like Fab: Wish, Poshmark, and OfferUp.

In the larger startup landscape, enthusiasm for some of the unicorns has started to fade. Some of them are taking on debt, some of them are laying off employees. Goldberg is well-equipped to tell those CEOs what may come next: rounds of layoffs that aren’t enough, rifts between co-founders, and a selloff of assets.

“Don’t ever allow yourself to slip into thinking, ‘We figured it out,’ or you risk losing it all,” Goldberg said. “If you are ambitious and if you grow your company fast, this will be your own personal epic battle. It is very hard to remain humble when you are piloting a rocket ship. It is very hard to remain humble when the world is telling you: You are winning.”

If Fab had been more conservative in its numbers, more careful about its rate of spending, and had not such aggressive growth goals, it might still be around today, said Sucharita Mulpuru, chief retail strategist at Shoptalk.

“They might be smaller than they were, but they would be around,” Mulpuru said. “That’s the question that every entrepreneur has to face—how do you grow quickly and still stay alive?”

Silicon Valley is a place where people like to talk about failure. Posters at Facebook’s headquarters urge employees to “fail fast, fail often,” and books, such as one from Fab investor Ben Horowitz, “The Hard Thing About Hard Things,” canonize the subject. The countless entrepreneurs on Medium droning on about their shortcomings also preach that ultimately, to win big, you have to take risks. But failure isn’t always a quick stop on the way to success. Sometimes it’s final.

"A lot of people say they're humbled by success," Goldberg said. "I've experienced a real sort of humility from the colossal failure that was Fab. I'm still working my way, personally, through it." He said he thinks often of his investors, who lost their money, and his employees, who dedicated themselves to the vision. "I let them down as a leader, and that's not fun. I feel awful for it."

Goldberg and his best friend, Bradford Shellhammer, launched Fab in 2011 and sold $20 million worth of merchandise in their first six months. The early problems were good ones to have. Sometimes, demand outstripped supply, and a lot of manufacturers were small and inexperienced. A baker offering rainbow "unicorn poop cookies" assumed nobody would buy them but ended up selling out. Fab scrambled to rent her an industrial kitchen, and employees in aprons arrived to help her bake. Some presents people ordered didn't arrive in time for Christmas 2011, so Fab paid for similar things on Amazon.com, just so there would be something under the tree (with the original gift still en route).

Fab sped up shipping, but it wasn't cheap. The company bought warehouses to prepurchase and store inventory. Meanwhile, Goldberg and his investors were encouraged by how enthusiastic people seemed to be about the products, so they started spending on marketing to expand more. They had a $30 million marketing budget in 2013, complete with a TV commercial over the holidays. The customers flooded in, but not in the way Goldberg expected. They would see an ad and make a purchase, and then never come back.

"We kept getting new customers, but we started to see that the profit margins were zero to negative," said Howard Morgan, an investor at First Round Capital who was on Fab's board. "The only way the model made money was if people bought multiple items. If you could lose money on each customer, you're not going to get money out of the whole, and it took us too long to understand that's what was happening."

It's a common story among startups, especially in e-commerce, said Jeremy Levine, a partner at Bessemer Venture Partners. When capital is easy for a hot startup to obtain, investors are so desperate to get in on the deal that they don't take the time to understand how much the business is spending to acquire each new customer. Meanwhile, entrepreneurs often assume that as long as they can keep raising money, they can fix their business models down the line.

"If the math doesn't work, eventually the capital dries up," Levine said. "And sometimes it dries up very quickly."

Since Fab, there's been a deeper focus among investors on understanding the unit economics of startup businesses—how much the company makes from every item sold, according to Kirthy Kalyanam, who teaches marketing at Santa Clara University. Fab was badly positioned because it was selling a product people don't need regularly, so it costs a lot to acquire and retain customers through marketing. Couple that with how much it costs to store and ship products, as well as the capital needed to support small-scale designers, and Fab's model was bad even when the business looked successful.

"Some of these people invest thinking that the founder has some magic, that he can think about it in a way that nobody understands," Kalayanam said, noting that Fab had some high-profile investors—Andreessen Horowitz, Menlo Ventures. "Why did it take so long for investors to figure it out? That's the effect of a charismatic founder."

In 2012, Goldberg was convinced that it was time to expand into Europe. Copycat sites had cropped up there, and he was eager to beat them while they were still small, instead of having to acquire them expensively later. He acquired one in Germany and another in London. He had the London employees move to Germany and visited them frequently. The chaos was mounting.

"We had no business doing that. In hindsight it was not just the money spent, it was the time sunk and the attention sunk," Goldberg said. "We should have been spending all of our time on how to get the business to a really repeatable standard process in the U.S. And instead we were fighting on two fronts with half a leg and half an arm."

That year, Fab was trying to turn an expected $80 million in domestic sales into $100 million; in Europe, it hoped to get $40 million. It expanded into food, pet goods, and sex toys. "It resulted in a deterioration of the merchandise—the brand value, the assortment," Goldberg said. "And frankly, at the end of 2012, that got kind of kitschy."

Anyone who would challenge Goldberg's numbers would get scolded for not believing in the vision. "You can get somewhat delusional in thinking that you can just figure it out," Goldberg said. "You see that you're growing, and if you can figure out a way to keep growing, you can grow your way through it."

Three years after Fab started to unravel, Goldberg has different priorities he said. He isn't focused on being as big as Amazon and Alibaba. He started Pepo with $1 million of his own money, and he's going to be careful not to take anything for granted, he said.

"I've had people ask me: How do I know Pepo is going to be successful?" Goldberg said. "I don't know if Pepo is going to be successful. Now I just think: We're going to build a good product."

About GreenHills Ventures

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