Bootstrap Your Startup

Backblaze's Rocky Road to Real Business Success with Zero Funding

Backblaze is a Silicon Valley startup that did a very non-Silicon Valley like thing: They started and built a successful cloud-based consumer data backup business for five years before seeking out any venture capital. How and why did they do it?

Backblaze "Office" August 2007.

From left to right: Billy Ng (Java Code Architect), Casey Jones (VP of Graphic Design), Gleb Budman (CEO and head of Marketing).

In today's high stakes, venture capital-funded culture, setting up a small business to make money right away almost seems like a quaint, last-century approach. However, in listening to Backblaze's story, it's clear that not all paths to startup success travel through Sandhill road and its profusion of venture funders. Backblaze took the road (or dirt path?) less traveled, and most surprisingly, are better for it.

Why Backblaze Didn't Even Want Venture Capital Funding at First

A cloud-based consumer data backup service would seem to automatically require VC funding. It's a low cost service that requires lots of upfront spending on infrastructure. This is not your usual business idea that can be bootstrapped.

Brian Wilson, one of the Backblaze founders, is a successful programmer and serial entrepreneur, but when it came to starting this company, he didn't seek VC money.
He didn't want it.

According to Brian, everything is a great party at VC-funded companies when growth is going fast, but it can quickly become a nightmare if growth slows, bringing into sharp contrast the different time horizons and outcomes VCs demand versus what founders want. Brian remembered one Thursday night board call at a previous venture that ended with the VCs saying, "That's it! We're out! We're pulling the plug and firing everyone (90 employees) and getting down to 4 employees on Monday," and hanging up.

> *"I like building products and working on them for a really long time. VCs aren't set up that way. They want to invest in you, scale, see staggering growth, then get their money out as quick as possible."*
>
> *Brian Wilson, Backblaze Founder*

So before you dream about how great getting millions from a VC would be, consider Brian's warning, "with great amounts of VC money comes great responsibility and expectation." His company luckily survived and exited well, but Brian remembered how close he was to ending up couch surfing—the panic, the stress, and lack of help and interest in saving the company from its funders that drove him to consider short term cash out options when what he really wanted to do was save the company.

Why Backblaze Changed Their Mind Later: The Difference Between Early and Late Investors

As Backblaze grew, it became clear that they had a viable business. In short, it made more money than it spent. That said, their cash flow, though positive, was constraining some optimal business decisions. For instance, they couldn't buy hardware in bulk, and they couldn't test additional marketing channels.

At this point, seeking VC money was no longer about getting an idea or product off the ground, but to allow them to drive some cost out of their business via bulk purchases, and to invest in marketing channels they could not test with their current cash flow. In one of Brian's earlier startup adventures, they had to give up over 50% of the company to have their idea funded. At Backblaze, with a viable product, profit, and clear business model, Brian and his cofounders go the same amount of money, but the ownership percentage was less that one-fifth than he had given up at his previous company.

Furthermore, not only did Brian and his co-founders retain control of Backblaze, they were in a position of strength to insist that any investing VC be a board observer, not a board member, leaving overriding control of the company to the Founders.

VC funding has many benefits, but it comes at great costs in ownership and control. It's important to ask yourself: Do you have to have it, and when do you have to have it?

Backblaze HQ, Feb 2008. Canine employees welcome.

Tim Nufire standing (VP of Engineering and head of Datacenter Operations), Casey Jones (VP of Graphic Design), Billy Ng (Java Code Architect). The dog is "Gromit" and comes to work with Tim.

Four Lessons Regarding Venture Capital Money

1 If at all possible, seek paying customers first, investors second. The difference in the cost of capital in terms of equity you must give up could be 10X. Furthermore, that equity is the difference between you controlling your company or the venture capitalists controlling your company.

2 Be sure your goals aligned to VCs goals in terms of time horizon and exit amount. Building a company worth $100 million is radically different than building one worth $1 billion. Is your business opportunity geared for long-term slow growth or short-term fast growth? Do you like working in big companies or would you prefer keeping your company small and nimble?

3 Consider how important it is to retain control of your company. How will you take it when someone tells you that you are wrong and need to do it a different way? After some bruising times at a couple of startups, Brian knew that he really didn't want to work at a big company (over 100 employees) or be told what to do by outsiders who knew less and were less connected intellectually and emotionally to his company. If you are VC funded early, when things go wrong, company ownership and voting rights come into play and Founder or not, you will do what you are told.

4 That said, VCs serve a vital role, allowing Founders to put their ideas and work out into the world while drawing a regular salary and leading a decent life. Not everyone can or should mortgage their homes, future, or give up income to fund a dream. The likelihood of failure is high, and the consequences too difficult to absorb in personal and professional life. Brian says, "I worry people will read about us, and think the best path to take is to mortgage their house instead of taking money from VCs."

Bootstrapping a Startup without Venture Capital: How Backblaze did it

Backblaze may not have wanted to take early funding, but how do you bootstrap a company that charges only $5 a month per customer and requires lots of expensive hardware that needs to be purchased up front? When you read about what it takes, you will be tempted to seek out your nearest VC for money. But look deeper. Backblaze's story is about as hard as it gets in terms of bootstrapping a company, and they did it, which suggests that other businesses with better financial models can do it too.

Working Capital

Backblaze Executive, Casey Jones (VP of Graphic Design) Strategizes on Building His Own Desk

First, Brian and team received about $400K from friends and family, critical money for buying storage space, bandwidth, lawyers, and other essentials, but how do you pay for the big expenses like employees and the office space?

Backblaze Answer: You don't.

Startups in the Bay Area seem to compete for the most awesome build out of some historical building, the number of massage chairs, and frequency of organically grown, freshly delivered gourmet meals delivered to the office every day. Those companies have VC money. Brian and team did not. To save on office expenses, Backblaze spent the first three years of its existence operating out of Brian's living room. For three years, Brian's personal home and belongings were restricted to his bedroom.

Employee Capital

The biggest expense to most startups is people. Originally, Brian approached some peers and colleagues that he'd known and worked with for ten years or so at other companies and asked if they would be willing to do a little consulting for some equity. They all said no. Instead, each of them asked if they could be partners in his company and provide full-time focus at no cost for an equal share in the company.

> **Insider Advice**
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> When looking at what a company needs to survive and thrive at the beginning, it comes down to three things: People, Capital and a Market. If you had to choose one, it's the people that make the difference, and the success of Backblaze clearly hinges on the capability of the founders on the team.

So instead of consultants, Brian ended up with four partners, all with equal shares in the company, and all of them willing to forego salary while they got the company off the ground. Brian said there is an unintended irony

Backblaze Team in worldwide headquarters, aka Brian Wilson's Living Room, October 2007

From left to right: Gleb Budman (CEO and head of Marketing), Chad West (Datacenter Architect who left Backblaze after a few months), Brian Wilson standing (CTO), Casey Jones (VP of Graphic Design) and Billy Ng (Java Code Architect).

in paying yourself $0 for a whole year. As he noted, "The law requires minimum wage, but we were both the employee (the victim) and the employer (the cruel boss), so does that mean we should go to jail? Or at least be fined? But in punishing the perpetrator, you also punish the victim. So, anyway, not sure how that works."

During this time, they each went through various personal challenges, including spouses who lost jobs, personal expenses that cut into the way of life they were used to, and so on. When in a real jam, there was an understanding among the team that everyone would chip in to help a team member until that person's situation stabilized.

The People Connection

The success of Backblaze is based on a foundation of collaboration and respect that was created at other companies, and would have endured even if Backblaze had failed. The group of people that Brian chose for his team were not people he met at a networking event or weekend hackathon. They were people he had worked with for years at different companies and knew intimately, how they worked through problems, how they communicated, and how they worked with others in tough situations, "It's really rare that anyone on our team yells. It almost never happens." The payoff was a group that supported each other and could speak openly about concerns to close up issues and gaps quickly without losing time, money or both on festering issues and disagreements.

Marketing on a Shoestring

How do you reach and acquire a consumer market for a $5 a month backup service without spending all of your margin?

You don't, not in the traditional sense.

This year's 30-second Super Bowl ad will cost $4.5 million. How many $5 a month customers do you need to recoup that expense?

Answer: A lot. Bootstrappers will have to forgo the flashiest marketing and seek out free and low cost promotion.

Insider Advice

Cost of acquisition is the critical element that must be managed when bootstrapping an early stage startup.

When you look at the list of early marketing programs that worked, it's marketing without a budget. In Brian's words, "Early sales are incredibly hard." So how did they acquire customers cost efficiently? Their evolution provides insight into the changing nature of marketing in general, and in particular for startups with little money to spare.

Great product plus great reviews equals low acquisition cost: A good portion of early sales came from glowing reviews about Backblaze in terms of the product and low cost. Investing in great product development and execution became a primary early sales winner as positive reviews provided a zero cost acquisition channel that delivered both increased awareness and credibility to Backblaze. Technically oriented people were the primary consumers of the reviews. A downside was that they were also the most likely to use massive amounts of storage space (cutting into margins), but they were also the most likely to provide informal word of mouth sales. In addition, they allowed for a more formal channel to emerge. Fans of Backblaze could sign up as affiliates of Backblaze and receive a small finders fee for new customers signed up from their recommendation.

Fast Fact

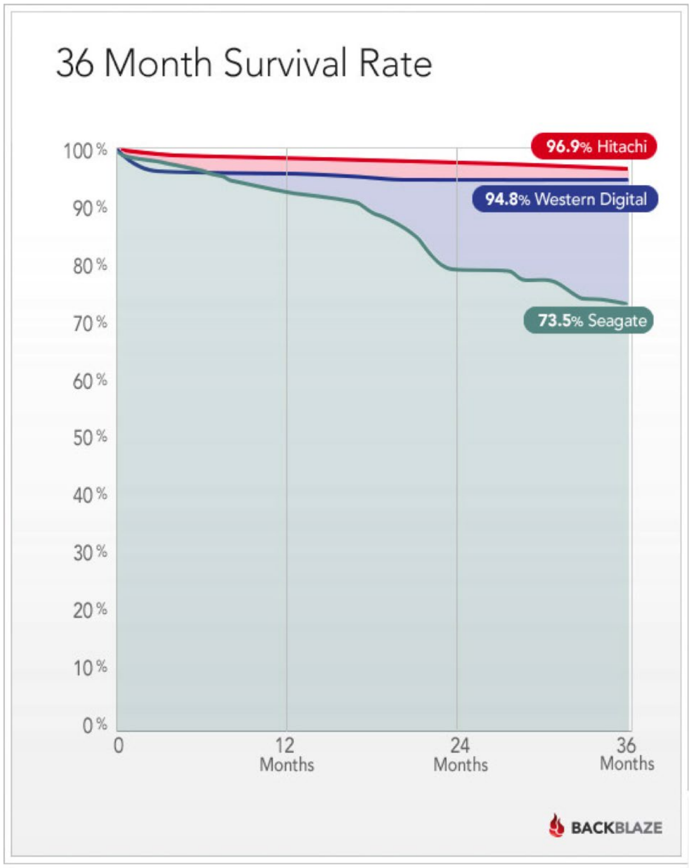
Expected lifetime value of a customer must be greater than the marketing and operational expense associated with that client.

Content marketing was a big win: As the customer base slowly grew, Backblaze needed to find additional channels for creating awareness. Their biggest success in marketing has come from content they created and distributed for free. The key to developing a content marketing approach that worked? Providing valuable information. With a growing number of customers, Backblaze's unique system for storage required using thousands upon thousands of hard disk drives from lots of different manufacturers. What they discovered was that not all disk drives are created equal. Some are better than others with different failure rates. Backblaze thought that this information would be useful to their audience: tech-savvy professionals, who might be the type to leverage different technologies to enhance their professional lives.

In 2009, and in subsequent years after, Backblaze has provided explicit data on failure rates of different hard disk providers like Western Digital, Hitachi, Seagate, etc. The result was a huge increase in website traffic, SEO benefits and ultimately Backblaze trials.

Their content was not only widely viewed, but hotly debated, creating even more traffic and engagement with people weighing in on the side of one manufacturer or another, not unlike what you'd find on some NFL game blogs, where fans trash the other team, players, and each other.

Example of Backblaze content marketing showing failure rates of hard drives:



Before it was obvious, Backblaze was creating content that was of high value to their current and prospective users, but wasn't necessarily about them. In providing valuable content, they created low cost awareness of Backblaze, increased their trust and credibility among potential buyers, and got the best marketing/sales returns on their efforts. Today, content marketing is one of the key sales/marketing acquisition tools Backblaze invests in, employing several full-time content marketing employees.

Success: How Patient Are You?

At the end of year one, the company gained enough customers that each of the Founders was earning Costco Greeter wages. By year two, they were making Trader Joe's cashier money, and by year three, they were making what a top computer science student out of college makes.

With the inflow of some VC funding, Backblaze now has the flexibility to drive down infrastructure costs and test different marketing channels without starving the current cash flow. Founders make a great living, and none of them have expressed any short-term desire to move on.

The company has a solid base of customers that continues to grow, supporting new employee hires. Brian and team are working on different products that could serve new markets, and continue to improve the Backblaze product and service experience for their users. Word of mouth is hard to build on when you start (you have no customers) but as time goes on, word of mouth becomes increasingly valuable for low cost acquisition.

Backblaze's story suggests succeeding without early-stage VC capital is more possible than people think, especially for those with business ideas that can be marketed.

It's been a seven-year journey, but as Brian noted, the company is in a position to grow and develop into something really significant. He's engaged and motivated to see what comes next. He loves the company, his co-founders, and is proud of what they've accomplished. That said, bootstrapping a company is not for everyone, "The last thing I want people to take from this article is that they should not take VC funding," explains Brian. "If you want a life and financial stability while building your dream, VCs are a really great way to go. They have their purpose and benefits."

Many new entrepreneurs believe that building a business starts with an idea and then spending lots of time trying to get VC funding. Backblaze is an extreme case where the Founders undertook a quixotic goal of selling an online consumer backup service for $5 a month without any VC capital. Backblaze's story suggests succeeding without early-stage VC capital is more possible than people think, especially for those with business ideas that can be marketed for very little money.

Although you may not be able to do everything Backblaze did, it's clear that starting with an idea, followed by acquiring customers first provided Backblaze two huge benefits:

1. Successfully acquiring paying customers before seeking funding radically eliminates risk for venture capitalists and allows the entrepreneur to get more money and keep more ownership of their company. You don't have to choose hardship for five years like Backblaze did -- even one to two years can significantly change the investment dynamic.

2. The benefit of maintaining ownership is that the entrepreneur has more leverage in determining the way forward for the company. Getting VCs in your company is like a marriage—everything is great during the honeymoon, but the diverging interests of the entrepreneur and the VC when things get hard can leave the Founder on the outside looking in to the company he or she created.

That said, if you don't have the people or capital to get off the ground, and you need a way to eat and live, VCs are a great way to go. Just remember that with lots of investment capital comes great expectation and responsibility.

Bootstrapping vs. Capital Investment: Key Considerations

Here are some key aspects of Backblaze's success along with a couple of other suggestions for startups considering bootstrapping:

- Can you get enough startup capital to start your business and survive one year?
- How long have you known your co-founders and in what capacity?
  - Brian had an average of 8 years working with each of them.
  - He knew what they were like when things were good and bad.
  - They all knew that their success would be collective and were willing to step in and support anyone in dire straits early on.
  - Can founders live off of no income or severely restricted income?
- Are you willing to eliminate all costs that can be eliminated?
  - Office space in someone's house?
  - No admin support or IT staff
  - No frills
- Do you have a market where:
  - Cost of acquisition is lower than lifetime value?
  - There is an unmet need? (Steven Blank's 4 Steps to the Epiphany is a great textbook guide.)
  - Test marketing suggests low cost acquisition that fits within financial model.