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LinkedIn and Reid Hoffman: Recession Ready

The business networking site's creator will play a big role in shepherding startups through the downturn

By Stephen Baker

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"Pull up a chair." Reid Hoffman waves a big arm toward his computer. It's not easy to maneuver in this office strewn with books, wires, and empty Amazon.com (AMZN) boxes. The 41-year-old Hoffman, wearing sneakers and black shorts from a morning workout, opens up his page on Linked¬In, the social network for professionals that he founded six years ago. His inbox is jammed with solicitations for meetings and funding. "Here's a guy from Minneapolis who wants me to help on a social-good project he's doing." He reads for a moment and then shakes his head. "Looks like it's based on bad math."

Hoffman, whose headquarters is a mile up the road from Google (GOOG), cuts an unusual figure in Silicon Valley. He's a Californian with a philosophy degree from the University of Oxford, and his expansive body looks more heartland than coastal. But his brain is in sync with the Valley. In addition to founding LinkedIn, he has become in the past six years the leading angel investor in the so-called Web 2.0, the wave of Internet companies spawned this decade. The list on his LinkedIn profile reads like an industry almanac. He has pieces of social network companies Facebook and Ning, news aggregator Digg, and blog companies Six Apart and Technorati. He was an early backer of the photo site Flickr, which was later sold to Yahoo! (YHOO) During the boom, Hoffman's portfolio was the object of the most intense envy in Silicon Valley.

Survival Strategies

Now, though, he must navigate the downturn. As the economy dives and the market for public offerings dries up, venture firms are cutting off funding for startups and forcing their portfolio companies to slash costs and race for revenue. This punishes much of his portfolio, including LinkedIn. On Nov. 5, the company announced lay-offs of 36 employees, 10% of its staff, in a restructuring move to focus on revenue growth and maintain positive cash flow.

Hoffman is going through the same process with his collection of start-ups, hammering out survival strategies and scrounging for savings and revenue. "Without Reid, [many] entrepreneurs are left with limited options," says Peter Fenton, a partner at Benchmark Capital. Mary Hodder, an entrepreneur in the Valley (whose geolocating startup, Apisphere, is not backed by Hoffman) predicts that, like other investors, he'll subject his portfolio to triage (BusinessWeek.com, 10/23/08). "He'll pick a few likely to win and keep them funded," she says.

Hoffman won't discuss specific plans for companies he has stakes in, but he's free with his views on the industry overall. Internet companies with a service up and running and millions of users should fare O.K., though the likely ad recession may force them to make painful adjustments. This could apply to Facebook and, to a lesser degree LinkedIn (which relies less on advertising). Early-stage startups face ruder choices. Those lucky enough to attract investors, he says, should be ready to part with lots of equity—or sell out altogether. These days, survival trumps the prospect of a jumbo payday. "You want to stay in the game," says Hoffman.

Networking in Hard Times

Many Net startups won't make it (BusinessWeek.com, 10/24/08). In recent weeks music site Social.FM, travel site TripHub, and news site Thoof have closed their doors. Hoffman's startups, he knows, are hardly immune. Seesmic, a Web video company, laid off 7 of its 21 employees in October. Hoffman sees more pain ahead. "You have to remember that in startups, most end up as corpses," he says.

But LinkedIn, he argues, may be a recession play. As industries struggle, he says more workers shed the illusion that they're safe and protected inside companies. They face what Hoffman calls the reality of the modern career: "Essentially," he says, "every individual is a small business." He predicts that workers increasingly will be networking outside their companies, looking for the right leads or morsels of knowledge—and for this, millions of them will turn to LinkedIn.

Hoffman sees his own network as the key to his influence. It extends from his associates at Oxford, where he visits yearly to teach, to partners at venture firms Sequoia and, entrepreneurs like Netscape Communications co-founder Marc Andreessen, academics, members of the Barack Obama campaign, and finally on to leaders of charities and the open source movement. All of these connections amount to what Hoffman calls his business and investing ecosystem. And he manages it on the same LinkedIn page he is furiously navigating. In essence, he built a tool to manage his life.

The question is whether the fast-growing LinkedIn can become as valuable for businesspeople worldwide as it is for Hoffman. With 30 million members, LinkedIn is no match in scale for giants Facebook and MySpace.com, each with more than 120 million members. But LinkedIn execs argue the company should suffer less than the bigger social networks in any advertising downturn. Ads account for only 30% of its revenues, which are expected to hit $75 million to $100 million this year. Another 30% of revenue comes from corporate recruiting services, while the rest comes from sales of premium subscriptions, which help users establish contacts and be located.

Hoffman trusts that survival instincts will lead professionals to nurture their networks—and pay for subscriptions. A typical 30-year-old, he says, should have 50 to 100 contacts. And the middle-aged journalist who's peering over his shoulder? "I'd bet you'd have 1,000 to 1,500," he guesses. By extending the reach to friends of friends, so-called second- and third-degree connections, an active user like Hoffman can buttonhole contacts in companies throughout much of the economy. Hoffman and his team have convinced investors that LinkedIn will be the base for such networking, and the information pouring through the system will amount to a new "social" form of media.

On Oct. 22, Goldman Sachs (GS), German software giant SAP (SAP), and The McGraw-Hill Companies (MHP), the parent of *BusinessWeek*, invested $22.7 million in LinkedIn. (LinkedIn is also a technology partner in *BusinessWeek*'s topic network, Business Exchange.) The new money, along with a $53 million venture round last summer, gives LinkedIn a sizable stash as it heads into the downturn. (The company is also profitable, according to chief executive officer Dan Nye.) These investments value the company at a bit more than $1 billion. Hoffman's goal is for LinkedIn to be "a major Web company" with a market value above $4 billion.

To guide LinkedIn, Hoffman and the board hired the veteran software executive Nye last year. Hoffman, who admits to a chaotic management style, stayed on as board chairman and director of product development. Part of his CEO job, Nye says, is "wrestling to get the thinking out of Reid's head, package it, and get it to the other people."

It was at the bleakest stage of the dot-com bust, in 2002, that Hoffman began to build his empire. He had been a key partner at PayPal, the online payment company) bought that June for $1.5 billion. Flush with his share, he looked for next-generation investments—and found himself nearly alone. "The common wisdom was that the consumer Net was dead," he recalls, and "that it was controlled by Yahoo, eBay, and Google. I thought it was just beginning."

So he devised a strategy. He would start a company to run the business side of the social Net—LinkedIn—and he would participate in the consumer side as an investor. "The huge majority of things I have invested in are massively successful," he says. Many of the investments, of course, are still locked up in companies, including Facebook and LinkedIn, which haven't yet gone public. The return on Hoffman's holdings hinges largely on how they navigate the coming downturn. Still, he continues trumpet the economics of Internet businesses. "This is the only time in human history when, for somewhere between $5 million and $30 million of capital investment, you can create a sustainable ecosystem for 10 million-plus people," he says.

When discussing his career, Hoffman can sound positively utopian. He says, for example, that he left academia for business because he wanted more "scaled impact" in his quest to make the world "a much nobler place." He regards LinkedIn as a system where the good are rewarded by the community for their deeds, while liars and cheaters are exposed.

Despite lofty visions, his advice to entrepreneurs is hard-boiled pragmatism. Hoffman urges them to focus first on financing—and only later to hone a product or service. He describes the launch of a company as a sea crossing. The financing rounds are islands, where each venture can replenish its provisions. The goal of the product strategy is to carry them to the islands. In short, it's the financing, not the products, that keeps them alive. And in a Silicon Valley now chronicled by the DeadPool, survival is the game's new name.