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Strangely, Ravikant argues that one key to making money is to be a lemming and to flock to the same startups where everyone else has clustered. The level of "social proof" that comes when sought-after angels like Ron Conway or Dave McClure join a deal helps create buzz and momentum, lifting the odds that a company will be able to raise more money later and take off. As in junior high, being part of the cool group becomes a self-fulfilling prophecy.

IN THE OLD DAYS, YOU COULDN'T GO ANYWHERE AS AN ENTREPRE-neur if you didn't have VC backing—companies were too expensive and needed a lead VC's mark of legitimacy. Today's most talked-about entrepreneurs can wait to take on VCs, and in the meantime, they can pick and choose the angels they want.

Take Rapportive, one of the hottest companies in Paul Graham's summer crop. The service mines a contact's tweets and online biographical information and photos and displays them for you in a Facebook-like format alongside any Gmail message you get from that person. (One blogger called it "big brother's little helper.") It was hacked together by 27-year-old Cambridge University computer-science dropout Rahul Vohra, who's been coding since the age of nine and built the product in six weeks at a friend's office in England. By Demo Day, Rapportive's customer base was growing 15 percent a week.

As Vohra and his two cofounders pitched to the crowd, however, they'd already quietly raised $1.2 million from the exact people they wanted, including more than 10 angels and three VC firms with young partners who do early-stage deals. "For each, there is a particular reason," says Vohra, during a call from London. (He'd wanted to Skype but demurred when I admitted I was a Skype virgin.) They'd sought Paul Buchheit, since he created Gmail. Luckily, Buchheit is a close friend of Graham's and a Y Combinator investor, so Graham made an easy introduction. McClure was chosen after he touted the company vigorously via tweets without having been solicited, then introduced the cofounders around. As for Ravikant, says Vohra, "basically, everyone we asked just said he's an awesome guy." Way back in February, Ravikant had already downloaded the product and had heard about the team from two investor friends. He met Vohra and one of the other cofounders for coffee at the Philz on Fourth and Berry Streets in San Francisco, Ravikant's morning hangout; this was followed by another meeting and more emailing about plans for the product and Rapportive's competitors. Ravikant wanted in.

Rapportive demonstrates why the traditional VC seed investment of many millions of dollars often doesn't work for the new brand of startup, which doesn't need a factory or an HR department or a SoMa warehouse with pool tables and bunkbeds. "The VC model took off in 1985 to fund semiconductor companies building huge wafer fabs," says Graham. But now it's so cheap to get a web business going that companies can show potential investors their products before they've raised a penny—and in some cases, they can even show real traffic data and paying customers. Rapportive spent less than $5,000 to launch.

Prototypes are so quick and cheap to build (and rebuild) that the companies can easily "pivot"—the term du jour. They iterate constantly, using feedback from real users. Nearly everything they need to launch can be outsourced, automated, or done in the cloud. In a blog he writes called Startup Boy, Ravikant describes the new ease of operations: "They coordinate with Skype and GTalk and wikis. The company itself is snapped together with outsourced HR, cookie-cutter incorporation, and outsourced finance/payroll. Marketing is done virally, or through SEO. PR is handled through tweets and blogging. Payments come via PayPal." Moreover, he continues, "what used to cost $1M–2M to set up now costs $10K. What used to cost $20M to go to market now costs $1M." By growing faster on less money, founders can give up a smaller percentage of their companies to get the necessary startup cash.

This new model has given traditional Valley VCs fits. To be fair, the primo firms are still managing to post profits, but those are slim by historical standards. Before the '90s dot-com bubble formed, VC firms were earning 30 to 50 percent profits; during the peak, they were doubling their money. Chasing the mega-returns of those years, big-eyed hedge funds began pouring vast amounts of capital into Sand Hill Road, ballooning the size of old-line firms. Then new shops created by B-school and finance types with no experience operating small companies came on like the 17-year locust. "It became suits taking money from suits and giving it to suits," says Graham. Now, says Len Baker, a partner at Sutter Hill Ventures, "I can't think of anyone in the top 10 firms who made more than 20 percent a year over the last 10 years—no, make that 15 percent." The years since 2000 have been termed "the lost decade" because investors in VC funds have taken—that's right—an overall loss.

The bigger the VC funds grew—$500 million is still common—the less practical or even possible early-stage bets became. The outcomes were too uncertain and the amounts too small to impact the bulging portfolios. So VCs started waiting for a tech company to succeed before committing, at which point it would be valued much higher—thereby upping the price of any stake. A recent example: Even when Benchmark Capital wisely invested in personal-finance software company Mint, it waited until the much safer later rounds. Eventually, Intuit paid $170 million for the company, and Benchmark quadrupled its money. But angels such as McClure, who took on the early risk, received returns of 10 to 17 times their original contribution.

As new Facebooks or Twitters have loomed, a few nimble firms, especially Sequoia Capital, have become regular seed funders. Last year, Greylock Partners hired angel Reid Hoffman and provided him with a $20 million sandbox in which to do the early deals he does best. But other firms have taken angel-like steps that look suspicious to angels. Kleiner Perkins' John Doerr, who recently raised $250 million to fund social-media startups, announced his plans in October with three billionaires by his side: Facebook's Mark Zuckerberg, Amazon's Jeff Bezos, and Zynga's Mark Pincus. The first investment made by the fund (in a startup called CafeBots, cofounded by a 54-year-old Stanford professor) was a whopping $5 million—not exactly ramen money. Ravikant believes that such efforts may be doomed, because Foursquare-monitoring, FarmVille-playing technophiles dislike the relatively analytical, cloistered, expensive ways in which VCs tend to operate. "Today's entrepreneurs don't want to show up in [their investors'] gilded and mahogany offices on Sand Hill Road," he says.

To wit, entrepreneurs used to brag about the size of their funding round; now they boast about how little money they need. Rapportive could have raised far more than $1.2 million. But the founders didn't want to give away any more of the company so cheaply and, like the heads of many new startups, they believe they can shoestring and microfund themselves until the money runs out in a year or two. Only at that point, when the company's valuation is much higher, will they take on large VC investments if they need them. Ravikant believes that some of these startups will be so successful and inexpensive to operate that they'll never have to go back to the financing well—meaning they'll never have VC hooks in them. That would be a very good thing, says Graham: "The reason things are moving this way is because the old way sucked for the founders."

GRAHAM WOULD KNOW: LIKE MOST ANGELS, he is a bona fide geek and a former web genius with a profoundly entrepreneur-centric view of the universe. In 1995, he founded Viaweb, an online-store-building app that he sold to Yahoo! in 1998, pocketing $50 million. But he's not a typical quant jock, having always gravitated toward creative enterprises while operating with a philosophical mindset. After getting a PhD in computer science at Harvard, Graham went to art school. He believes that software coders and painters have the most in common out of all people, and his website includes dozens of essays he's written on hacker culture, entrepreneurs, and life. As the angel economy has gone from Facebook fast to 1,000-launches-a-month insane, Graham almost gloats about how well it's going for the top young entrepreneurs.

Graham's vibe may be mellow and his hair unkempt, but he's like a moth to the limelight, and his incubator has become a cult of personality. His chosen entrepreneurs all call him PG and drop everything when he calls. He has an idea every second and an analogy for every situation (on the negative effect of angel investments on VCs: "It's like eating snacks spoils your dinner"). Sometimes he is impressed with a team of founders but not with their idea, at which point he will spew forth a litany of intriguing business suggestions. Andrew Sugaya's iPhone remote was thrown together at first to ease navigation on his now half-forgotten initial concept, but Graham encouraged Sugaya's team to seize on it as the capital idea. The original concept matters "almost not at all," Graham insists. He uses it mostly to understand how an entrepreneur thinks.

Over time, Graham has developed a set of indicators to help him pick his entrepreneurs—qualities that he believes correlate to a high likelihood of success. He has found that determination trumps all other qualities, but frustratingly, it's the most difficult to discern. "No one, including the people themselves, know how much of that they have," he says. Graham also looks for the "relentlessly resourceful." For example, while he was considering whether he should invite AirBnB, the eBay for private travel accommodations, to become a Y Combinator company, the founders told him that they'd designed and sold $36,000 worth of kitschy Obama O's and Cap'n McCain's cereal to take advantage of the 2008 election mania. Graham didn't need to hear another word; he signed them on. Now the company has listings in 8,000 cities in 167 countries.

Every two weeks, Graham and his partners, one of whom is his wife, Jessica, rate their current batch of startups, and they check back regularly as each venture's story unfolds to assess how good their instincts were. Y Combinator has been criticized for funding small niche concepts with dreams no bigger than becoming a quick acquisition target. TechCrunch editor Michael Arrington riled up the crowd at one Y Combinator event by repeating an inflammatory comment he'd heard from a top VC: "There's an entire generation of entrepreneurs building dipshit companies to sell to Google for $25 million." Graham's response: "Big ideas are not necessarily better than small ones." He tells his entrepreneurs to think of their starting concept only as a beachhead. "Think of what Microsoft would have been pitching on Demo Day—basic interpreter for a machine when only a couple of thousand [of them] existed."

Back in 2005, when Y Combinator incubated its first eight startups, Graham couldn't have imagined handling 15 companies in a year, he says—yet in 2010, Y Combinator has taken on 63. So far, 10 or so of its ventures have produced multimillion-dollar exits, but none have blasted into the stratosphere. As respected super angel Mike Maples says, "the real question is, 'Can YC become a place that produces the best 10 companies of the year?' That remains an open question." Graham isn't slowing down to wait for an answer. "We're approaching YC like software," he says. "You crank up the volume and see where the system breaks."

Some angels seem to be peeved at Graham's dominance. They say he's not as angelic as entrepreneurs believe. To be accepted into Y Combinator, companies—many of whose founders are too green to know better—give up a 2 to 10 percent stake to Graham and his partners. Y Combinator, itself basically the earliest-stage investor of all, with 208 companies in its fold, wouldn't mind being the next Zynga-size success story, and Graham took on Conway's SV Angel and ex-Googler Aydin Senkut's firm as investors. Sequoia Capital also has a stake in the incubator and so presumably gets a first look at companies like Rapportive.

At a secret dinner party in September at Bin 38, in the Marina, virtually all the big-name super angels met to discuss how to keep Y Combinator in check, as well as how to keep deals away from VCs and work collectively (i.e., "collude") to drive down valuations so

Change angels

THE DOING-WELL-BY-DOING-GOOD SEGMENT OF THE INVESTOR WORLD INCLUDES PLENTY OF PEOPLE AND ORGANIZATIONS NOT NAMED SKOLL.

Ron Cordes

How big: 12 investments, ranging from $25,000 to $500,000.
Cred: Cofounded Asset-Mark, sold it for nearly $230 million; co-chair of Genworth Financial, an $18 billion investment-management platform.
Seeds: Lots and lots, if you consider that he invests in microfinance.
Focus: Microcredit lending in the U.S. and abroad; sustainable schools in Kenya and Guatemala; home ownership for local low-income families.
On the side: Helped found University of the Pacific's social-entrepreneur program and, with the school, paid for needy entrepreneurs from around the world to attend a conference; worked with the Rockefeller Foundation to create the Global Impact 50 Index, a NASDAQ for social-impact companies.
How he thinks: Believes in "hand-ups" rather than "hand-outs."
Best bets: Bridge International Academies (ultra-low-cost private schools in Nairobi); buying bank-owned homes in the East Bay to resell to low- and moderate-income families.
Classic tweet: Not on Twitter, though his comments have been tweeted.

Stuart Davidson

How big: About 60 investments of up to $1 million each.
Cred: Managing partner at Labrador Ventures, an early-stage, tech-focused VC fund.
Seeds: 10 to 20, including the Acumen Fund, a leading impact-investment group.
Focus: Poverty alleviation and access to employment in the U.S. and abroad.
On the side: Founded what became REDF, a job-creation and job-placement program for low-income and homeless people and ex-convicts; funds internships for MBA students at nonprofits; on the boards of Acumen and Rockefeller Philanthropy Advisors.
How he thinks: "Seek out uncommonly gifted social entrepreneurs and get them the means to make things happen."
Best bets: Root Capital (helps Latin American and African businesses too big for microlenders, too small for banks); Pogo Park, in Richmond; Core Innovation Capital (loans for entrepreneurs).
Classic tweet: He doesn't use Twitter, but others do who repeat his words: "portfolio investing good, systems investing up/down value chain is better."

Stephen DeBerry

How big: In addition to his own investments, his firm oversees more than $100 million in social-impact money for Kapor Enterprises and other institutions.
Cred: Founder of Bronze Investments, an asset-management firm for endowments and high–net worth individuals; former investment director at Omidyar Network.
Seeds: 35.
Focus: Energy, food, and property—mostly in the U.S., but also in disaster-stricken places such as Haiti.
On the side: On the board of the Dalai Lama Foundation; chairman of Friends of New Orleans.
How he thinks: Passion matters. When an entrepreneur has it, "the universe conspires to help them, and so do I."
Best bets: UniversityNow (open-platform, adaptive, and affordable online college courses); Emerald Cities Collaborative (job creation through clean-energy retrofitting); Prosper (formalized peer-to-peer lending).
Classic tweet: "Who gets VC money? Mostly white folks in their late 30s. Black folks get 1%. Here's the data."

Kevin Jones

How big: 10 investments, ranging from $15,000 to $700,000.
Cred: Former CEO of Net Market Makers, a B2B commerce site with $18 million in revenue.
Seeds: 3.
Focus: Alleviating poverty caused by climate change, the loss of biodiversity, and forced migration.
On the side: Founder of SoCap, *the* social-capital convention; led a program with Columbia economist Jeffrey Sachs to distribute insecticide-treated bed nets in Swaziland and Mozambique.
How he thinks: It's all about "scalable social impact: something that can expand or be replicated, rather than be a one-off project or company."
Best bets: Hub (a work-space and incubator downstairs from the *Chronicle*); Better World Books (an Amazon that gives back, and it's carbon neutral); the Hoop Fund (a microloan and shopping site).
Classic tweet: "@tbeckett well giving is also a bet on a future you want to be part of, so in some ways it acts like an investment. it has long term value."

Pierre Omidyar

How big: His Omidyar Network has made $371 million in for-profit and nonprofit investments since 2004, plus a $55 million pledge announced at a recent Clinton Global Initiative event.
Cred: eBay's founder and chairman.
Seeds: You name it, he's funded it.
Focus: Access to capital and transparency in government to foster political change; operates worldwide, but mainly in India and subSaharan Africa.
On the side: When you're this big, there is no "on the side."
How he thinks: With the right information, capital, and ways to connect, individuals can make true change.
Best bets: LeapFrog (the first microinsurance fund); Digg; Kiva; Meet-up; Ashoka (funding and networking for 2,000 social entrepreneurs).
Classic tweet: "The more citizens understand what govts are doing, the more power they have to have impact on those policies."

–JUSTINE SHARROCK

each of their funds could own more of a company for less. On hand for Conway's firm was young partner David Lee, but when this fact ended up in the press and threatened to tar Conway's reputation, he sent a scathing email to the other participants: "In my opinion, your motives are driven by self-serving factors around ego satisfaction and 'making a buck.'" McClure responded by parading around in a T-shirt emblazoned with the words "I was at Bin 38 and all I got was a lousy valuation." What became known as Angelgate showed that the potential for spoils had put an end to the kumbayas, if not to the humor.

Graham thinks that the meeting amounted to little more than a group grumble about the tripling in value assigned to tech startups in the past two years, "the way a bunch of old people get together to talk about their infirmities." He laughs at the idea that colluding would even work; with all the other potential funding sources out there, the super angels don't have a monopoly on early-stage investing. "They'd need to be idiots to think that they could actually achieve this, and they're not idiots," he says.

It's unclear where all this energy is taking the Bay Area and the nation. "We are in the fog of battle," says Stanford's Blank. Yet it's hard to imagine that we aren't riding a bubble of some size when Andreessen's new firm raised $650 million in three weeks for its second fund devoted to consumer-tech startups, and when John Doerr touts his social-media fund as "a quarter-million-dollar party." Free-floating money is landing in scarily reminiscent places: an online vintage-clothing boutique and a web company where users post celebrities' favorite novels and getaway locales.

Graham doesn't seem to be worried. "After this last YC batch," he says, "I did think to myself, 'Could this be a bubble forming?' because the valuations were so high." Now he's convinced that the inflation stems not from anything that angels are doing but from the VCs' war to get in at the earliest stages. "An investment bubble, in the strict sense, is when people overpay—knowingly—because they think that someone else will overpay later. That's not what's going on. This isn't fools eating up companies that have one quarter of earnings and a vague business model." Anyway, the overall amount being invested is tiny compared to past booms. When these companies fail, exponentially fewer employees, leases, and livelihoods are at stake.

And that's the point, Graham says. Small—and relentlessly experimental, quick-footed, and determined—truly is beautiful now. "In the '20s and '30s, there was a turn toward big national companies—U.S. Steel and others," he says. "'Small' meant Uncle Joe's shoe store. Small meant lame." But it's clear to Graham that brilliant technologists who work small are anything but lame. Instead, they are the rocket ships everyone is clamoring to board.

Whether the angel-touched companies of the Twitter age will endure, produce something of true value, and propel us all forward remains to be seen. That was the gold standard that the former Silicon Valley—including its VCs—judged itself by. Though Graham won't say that his entrepreneurs and the angels who watch over them will go down in the history books alongside the giants who created the Valley's iconic companies, he does speak of working at the center of a shift on the scale of the industrial revolution. Then he checks himself: "Not even the participants know how this is going to end up." ■

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