

Y Combinator's Graham Says Startups Must Improve Lives

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Interviewer: Welcome back to Bloomberg West. I'm Emily Chang. With Groupon, LinkedIn, and Pandora all over the headlines, you might think moving a company from the idea phase to an IPO is a snap, but it's no easy task, and some in Silicon Valley take on that challenge every day. Joining us here in San Francisco is Paul Graham, founder of Y Combinator, a company that helps entrepreneurs take their ideas and make them the next big thing. Y Combinator has been dubbed the Harvard of Silicon Valley. And welcome back, Paul. Since the last time you were on, our fans have been clamoring for another Paul Graham appearance, so it's great to have you back.

Paul Graham: See what I can do.

Interviewer: So, given how fast innovation seems to be happening across the country, what do startups these days need to do to have a successful exit, whether it's an IPO or just building a great business?

Paul Graham: They have to make something that actually makes people's lives better. Like, it's funny how straightforward it is. People often think that business requires some sort of trickery. You have to, like, corner the market in something or something like that. But actually, what you have to do is you have to make people's lives better. And the amount of value that you create is the sort of rectangle where one side is the number of people and the other side is how many, you know, how much you make their life better. Big rectangle, big value. You're rich.

Interviewer: When you see companies like Pandora and Groupon, two very different companies but similar in the sense that they don't have profits, how does that strike you in this environment?

Paul Graham: Well, I don't know much about them specifically. I feel like some sort of securities analyst would actually understand better than I would. I haven't looked at their books. You know, I mean, I know Andrew Mason's a really smart guy, right? I know Andrew. He's a smart guy. So if I were betting on Groupon, I wouldn't be looking too closely at the numbers. I would just be, like, thinking, "I like Andrew. He seems like a good guy. It'll probably work."

Interviewer: Over the last few weeks, we've seen Twitter announce a photo service, which then invalidated a number of photo businesses that have built themselves on Twitter. Apple, at the developers conference, announced a whole slew of things that hit at a lot of different startups.

How do you advise your companies to work on things that Apple, Facebook, Twitter couldn't just come along and say, "We're going to do that now"?

Paul Graham: You know, actually, the right thing to do in a startup is not worry about it too much. The right thing to do in a startup is just, like, you're a mosquito, right? And like, maybe it'll work, maybe it won't, and you just, like, zoom along and don't spend your time looking over your shoulder. And like, if you get killed, okay, like, you do another startup.

Interviewer: For example, Dropbox, which is a very successful YC startup, but when Apple announced the iCloud, that kind of was a little punch to them, wasn't it?

Paul Graham: I don't get the—I don't get the impression they were worried about it. I didn't worry about it. Um, there's only ever been one out of 316 companies we funded, there's only ever been one that was actually killed by a competitor.

Interviewer: But do you think that companies shouldn't depend so much on one particular ecosystem, or is it all about, just as you said in the beginning, making people's lives better?

Paul Graham: Just, just work on making people's lives better. Don't spend your time worrying about, like, trying to make people's lives better, but also do it in a way that Apple won't do. Who knows what Apple's going to do? You just have to hope that they don't, right? And mostly they won't. Apple can't do 500 different things, so there's a small chance they'll kill you. Just take that risk.

Interviewer: Another one of your companies, Airbnb, is making a huge splash. It seems to be the breakout success of Y Combinator. Actually, Dropbox is bigger. Well, Airbnb raising money at a \$1 billion valuation, when you hear that kind of a number, is that fair?

Paul Graham: If you knew their numbers, it wouldn't seem so crazy. You know, uh, I don't know—I don't know if this is public knowledge or if we're still talking about rumors. Are you tricking me? But should there be a funding round, the participants are not exactly fools. They know what they're doing.

Interviewer: All right, I'm going to bring in Corey Johnson. Now I know he's got a lot of questions for you. Corey, go ahead.

Corey Johnson: Am I supposed to be the bad cop here? Paul, you said only one of your companies was killed by a competitor. Which one?

Paul Graham: It was called Kiko, and the founders later went on to do Justin.tv. It was an online

calendar, and then Google introduced Google Calendar, and they lost half their users in one month.

Corey Johnson: Wow. Well, so I assume we've had some other companies die. If they weren't killed by competitors, what kills young companies?

Paul Graham: They make something that users don't like. They make dog food that dogs do not like to eat. That is the killer of all startups. They build something that users look at and they say, "That's what you [unclear] the back button."

Corey Johnson: I'll talk more about that, because I want to know as an investor, what do you do? Obviously, every company's first iteration is not its best. What do you do to try to—when do you know to fish or cut bait?

Paul Graham: Well, the first iteration may not be very good, but as long as you get it out here very quickly, it doesn't matter if it's not great, because you start the conversation with users, and users will say, "Oh, well, I sort of like this, but I wish you would do such and such." And then you do such and such, and you repeat that process 200 times or so, and then you have something really good.

Corey Johnson: So, back to your thing about backing a smart guy, backing an Andrew Mason. What if the business model just doesn't make sense? What if it's, as Paul Kedrosky said about Groupon on our air, you know, selling a dollar for 50 cents, that's not a great business model. Are we talking about Groupon specifically? I mean, I think the general—you tell me, any company, backing a smart guy with a bad idea doesn't make it a good investment.

Paul Graham: A smart guy by definition will eventually realize that a bad idea is a bad idea and will tweak it until it becomes good. I mean, however whatever you think of Groupon's current idea, it's a lot better than the idea they started with back when they were The Point. The Point lost less money.

Corey Johnson: Yeah, lost perhaps less on lower revenues.

Paul Graham: Right. It just didn't matter. At least Groupon matters.

Corey Johnson: The point is, there are a lot of—I—go ahead, Corey. No, sorry. I'm curious about the idea of competition. You know, you have so many people that you've invested in, some of whom compete with each other directly, some of whom compete with each other accidentally. But how do you think the competition can be used as a tool to motivate entrepreneurs?

Paul Graham: You know, honestly, I spend a lot more time telling people to stop thinking about their competitors than I do telling them to, like, you know, use their competitors to make themselves work harder. People who are good have this inner drive that makes them work hard anyway. I've found the really successful companies, they don't spend a lot of time obsessing about their competitors. It's companies that get old and are starting to suck that are looking over their shoulders, worrying, and trying to imitate their competitors. All right, really good companies don't.

Interviewer: Paul, stick around. We're going to talk to you more about this after the break. I know you got more applications than ever for your latest boot camp. I want to hear all about that and the highlights, coming up next on Bloomberg West.

This is Bloomberg West. I'm Emily Chang. We are speaking with Paul Graham, founder of Y Combinator, a company that helps entrepreneurs turn ideas into marketable concepts. Before the break, we were discussing tech companies like LinkedIn, Groupon, and the process they went through to get from idea to IPO. And I want to talk to you about your program. In the break, you were talking about how the startup world is an optimistic place where the glass is half full rather than half empty. You got more than 2,000 applications for your latest class. You pick 64 startups. Yeah. When it gets to be that big, how do you find the gems?

Paul Graham: You know, we have a lot of practice. We've been doing this for six years now. And when we first started, if somebody had dropped 2,000 applications in our lap and said to sift through them, we would have—we wouldn't have been able to do it. But we have so much practice now trying to pick winners. We've been through 13 batches where we've picked people and seen what happened, and now we know what works and what doesn't, sort of. Practice.

Interviewer: And you said some of the craziest ideas become the biggest successes, right?

Paul Graham: Right. That is why—that's why we look for people. We don't care that much about ideas, right? If the people seem really good, then either the idea is better than it seems if the people are really good, or maybe the idea is bad, but they'll come up with something else, right?

Interviewer: And you yourself as an entrepreneur and the founder of Y Combinator had a great idea that has become a huge success. There are now many other incubators. Even when we started, we didn't think we were on to anything. We were just doing it as, like, this little throwaway summer. And look at all the incubators now that are across the country. One in particular, TechStars, has been getting a lot of attention. What do you think about them?

Paul Graham: I don't know. What's that face? I think they're fine people. Fine people.

Interviewer: You know, YC has been criticized for having now so much control over the startup ecosystem because you guys have been so successful. How do you address those concerns?

Paul Graham: Well, you know, even though we fund a lot of startups, it's still only a small percentage of the total number of startups. I mean, if we got to the point where we were funding 50 or 60% of the startups in the valley, then, you know, maybe we would be this malign influence having too much control. But, you know, it's probably like 5% or even less than that.

Interviewer: All right, Corey wants to jump in here.

Corey Johnson: Yeah, Paul, let me ask you about one of your investments. I want to ask you about a bunch of investments, but let's start with Hipmunk. Hipmunk is thought to be so ridiculous by our managing editor, he's banned the saying of it on the air. Convince us that Hipmunk is something to pay attention to.

Paul Graham: All you have to do is look at the alternatives. Think about what it's like to do a flight search. You search for a flight, you get page after page of search results, and it includes flights that, like, take 14 hours and have a layover overnight, right? Why do they show you all that crap? It's possible to do better, and Hipmunk does better. It just shows you everything on one page, and it just jumps out at you.

Interviewer: You what's the right flight? So when you looked at a company like Hipmunk, did are you trying to imagine, well, the reason that you know Orbitz shows you a bunch of ads and a bunch of crummy flights is because the more pages you click through, the more ad revenue they generate from clicks?

Paul Graham: Exactly.

Interviewer: And that's what they're trying to do. So so you're trying to think of a of of something that's really useful, maybe less profitable. Like where's the business part of this?

Paul Graham: Well, actually, nobody makes that much money out of flight search. The big money is in hotel search. Um, and so for Hipmunk, I mean, this is not flight search is not the last thing they're doing. It's just it's just it's just sort of a way to get a way to make people happy, a way to make people's lives better and get people's attention. And then once they got their attention, they can sell them other things.

Interviewer: So it is getting their attention and selling something there. You're sort of imagining a business that comes after getting the attention.

Paul Graham: Yeah, you make money from hotels. The margins on hotels are immensely higher than flights.

Interviewer: So when you're looking at a business like, tell me about the research you do when someone walks into your office and says, "I'm going to make the flight search results a lot better and we're going to get to hotels and those are going to be really loved by consumers." What kind of homework do you do as an investor to understand that market, the potential market better?

Paul Graham: You know, it's a lot lower tech than you would think. The answer is I had known both of the founders of Hipmunk for five years. I knew Adam since he was in high school. Um, I just knew these guys were good. And I think Adam too had like gone through college thinking when he graduated from MIT he was going to apply to Y Combinator. So, um, there was we never had any thought that we would reject them. They could have applied with the stupidest idea in the world and we still would have funded them.

Interviewer: We have had Adam on this show and he did a good job and we will be watching only 22 or something. Well, we'll be watching to see how Hipmunk uh performs in the world of travel websites. But I want to ask you of the startups that you're investing in now, what areas or trends are you most excited about?

Paul Graham: One big thing that's happening now is uh startups competing in industries that people didn't really think were susceptible to competition by startups before.

Interviewer: What do you mean by that?

Paul Graham: Um, well, Airbnb is an example, right? Like online rentals and stuff, like the space rental. Like it's they're kind of competing with the hotel business, and I don't think the hotel business realized that like they were that they were in a world that was even susceptible by invasion by startups. But what's happening is that more and more of the world is becoming susceptible to startups, disruptive startups at that.

Interviewer: Yeah, yeah. Like the just things written to run on tablets, like the iPhone, right? They're replacing everything. iPhones, they're replacing everything. iPhones replaced your GPS and your camera and now your keys. Just about everything can be replaced by software running on an iPhone. But it's not Apple per se that's replacing those things, it's some startup writing an app that's running on that tablet and that's where innovation comes from.

Paul Graham: Paul Graham, we could we could talk about this for hours. Um, amazing to watch what you've done with Y Combinator, and again, always great to have you here. I'm Bloomberg West.

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