

# Y Combinator's Graham Doesn't See `Bubble' in Technology: Video

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Interviewer: Well, think of it as real world for geeks. Y Combinator is an early stage investment firm and boot camp for entrepreneurs. Y Combinator was founded, co-founded by Paul Graham in 2005 to find the nation's most promising startups. But it's no longer the only game in town. Copycat incubators are springing up everywhere, but YC is considered the Harvard of the group. It's attracted high-profile endorsements from two prominent internet investors, including Digital Sky Technologies' Yuri Milner and SV Angel's Ron Conway, who together pledged 150 thousand dollar convertible loan to every YC startup. Co-founder Paul Graham joins me now. Paul, welcome to Bloomberg West.

Paul Graham: Thank you.

Interviewer: So if this is the Harvard for entrepreneurs, how do you decide who gets in?

Paul Graham: The main thing we care about is the founders. A lot of people think the most important thing about a startup is the idea. We don't care that much about the idea because historically, you know, successful startups, the idea has changed a lot. What you can't change is the founders, so that's what we care about.

Interviewer: So this endorsement right from DST and SV Angel's raise the bar, you raise the level of expectations. So maybe, um, although you know historically 90% of each batch were able to raise at least that kind of money in the past. So now 90% has become 100%. It's not that much different. But that kind of money cannot change the game for some of these companies. 150,000 dollars sounds like a lot on the scale of household expenses, but on the scale of startup investments, it's not a lot. Like most of these, like the average startup after YC would raise maybe 800,000, so it doesn't change everything.

Interviewer: Well, let me ask you about that. The cost of the startups have fallen for a lot of reasons, but what do you think the driving reason is for that change in the cost of a startup?

Paul Graham: Technology. Technology, like startups use technology to make technology, and the start of the technology that they use has become so cheap, it's almost free.

Interviewer: From the way the instructions, uh, the structure of the investment, particularly when

it comes to DST and Ron Conway's SV Angel's, a convertible loan is different than buying the equity in an early startup. Uh, does that equity convert right away or does that signal maybe less of an investment commitment on their part?

Paul Graham: No, no, it doesn't signal less of a commitment. It just makes the paperwork easier. What you're doing with a convertible note is you're saying you're going to punt on what the terms are going to be. They'll be whatever the terms are for the next round. Who cares? It's just 150k at whatever the terms are in the future.

Interviewer: At this point, what do you consider your biggest successes?

Paul Graham: Probably Airbnb and Dropbox. Those are the ones you hear about from, you know, people's brother-in-law, right?

Interviewer: I thought you might mention Heroku, which sold to Salesforce for more than 200 million dollars.

Paul Graham: Heroku is definitely a big success, but you couldn't buy Airbnb or Dropbox for 200 million dollars right now.

Interviewer: As an advisor to these entrepreneurs, how do you advise them whether to sell or to hold out for something better?

Paul Graham: Usually we tell them to do whatever they want, right? If someone wants to get bought for 200 million dollars or 20 million dollars, frankly, or go public and try and be worth 20 billion dollars, it's up to them. Our attitude is for us it'll all average out. We don't try and push people to hold out for bigger deals.

Interviewer: How many companies are you in right now and how do you monitor what they're doing and try to help them along the way?

Paul Graham: Three. What? Yeah.

Interviewer: How can you easily manage 253 investments?

Paul Graham: Software. I'm a programmer and we have written a lot of software and we have basically written a CRM system for keeping track of startups, so everything's software.

Interviewer: How do you make sure that you give every company the time they deserve because that's the point, right?

Paul Graham: Yeah, we let them book time with us online using software and we can tell if there are office hour slots that are untaken, then that means demand must be satisfied.

Interviewer: So some of the Y Combinator companies have been criticized for being more like features or mini products, not real companies. What's your response to that?

Paul Graham: Well, let's think about how Microsoft started. They started writing a BASIC interpreter for some crappy little machine that probably had a couple thousand users, right? Like features are just what startups look like when they first start. If you have some big visionary plan, you're probably Webvan.

Interviewer: Evaluations for the hottest social networking companies like Twitter and Facebook have been soaring, with Facebook valued as high as 65 billion dollars. How do these valuations impact funding at early stage companies? We've been speaking with Paul Graham, co-founder of Y Combinator. So Paul, when you see these valuations for Facebook and Twitter, do you think they're justified?

Paul Graham: Well, would you bet money that Mark Zuckerberg is going to lose? Like really? No, I mean on the one hand it's a very high valuation, but on the other hand, would you bet that it's wrong? I wouldn't. You know, who knows what's going to happen.

Interviewer: Well, I would probably, I probably would short Facebook, but I've shorted stupider things than that before. But when you look at your companies, it seems like what you're trying to do is not pick the right valuation. Just imagine that here's a better valuation, but how do you assess the valuation of these tiny little companies that are just starting out, maybe one or two-man shops?

Paul Graham: Well, what you're doing with the valuation of an early stage startup is you're guessing the percentage chance that they'll be big. So if you invest in a startup at a valuation of 10 million, say, you're not really saying that the company is worth 10 million because it's just a couple guys with the, you know, a few thousand lines of code. What you're saying is that it has a 1% chance of eventually being worth a billion dollars, right? So you're just guessing the chance they'll hit it big.

Interviewer: Street like Goldman Sachs getting in these hot internet companies, how is that enthusiasm trickling down to the seed stage? Is it getting more and more competitive to invest?

Paul Graham: Yeah, valuations are definitely higher. I would say valuations are maybe two and a half to three times higher than what they were in the trough of the recession.

Interviewer: So would you say investors need to be more careful about what they back?

Paul Graham: Well, no, because the way you win in startup investing is not by getting low valuations, right? It's by getting the winning startups. And if you get the winning startups, it almost doesn't matter what valuation you get. If you invest in Google, you're going to make tons of money, and you invest in lame startups, you're doomed. Whether the lame startups are cheap or Google is expensive, it's still all about picking the right startups.

Interviewer: So when you look at these companies, they're such an earlier stage, they must invite many other companies to pitch to you. What's the best advice you give to those entrepreneurs who pitch you wanting your money to start their company?

Paul Graham: The most important thing is your co-founders. People come to me and they say, "I have this great idea," and I say, "Don't tell me about your idea, tell me about your co-founder. How long have you guys known each other? How good are they? What have you worked on together? What have you done in the past?" It's all about the people.

Interviewer: So if you had to answer the question, bubble or no bubble, is there a bubble now?

Paul Graham: I wouldn't say a bubble. I mean in every market prices sort of rise and fall like a sine wave. Prices are kind of high now, they'll probably go down in the future, right? Um, but high prices is not a bubble. A bubble is like a mania, right? I mean people are thinking, "I gotta get in or I'll be left behind," right? And I don't feel like people are thinking that now. I don't think that's what's going on with these secondary markets. No, no, I don't. It doesn't, I mean I was there for the first bubble and that was a mania. I remember thinking, "Boy, anybody who has their money sitting in bonds is kind of a fool because they're like going to be stuck with 1998 money," right? I don't feel like I'm a fool for having a lot of money in bonds now. I don't think anybody feels that.

Interviewer: Well, I was there when they were selling tulip bulbs in Holland in the 1600s. That was a bubble. You should have seen that.

Paul Graham: Yeah.

Interviewer: But it seems to me the bubble's about public markets getting into these companies, sort of taking out some stakes from early investors, taking out stakes from venture capitalists, taking out stakes of founders before the companies do IPOs. Does this create, do you imagine a possibility of getting out of some of your deals that may be headed towards an IPO long before they do that?

Paul Graham: We don't think about it. You know, honestly, I have never tried to calculate the paper value of our investments. I've never done it.

Interviewer: I like this suspicious dislike for it.

Paul Graham: It wouldn't change anything anyway. I don't want to think about it. So we're like in for the long term just by default.

Interviewer: I want to talk to you a little bit about Apple. A lot of your entrepreneurs are building things for the iPhone and the iPad. You recently blogged, "I worry about the power Apple could have with this force behind them. I don't want to see another era of client monoculture like the Microsoft one in the 80s and 90s." What do you mean by that?

Paul Graham: Well, back in the 80s and 90s, the late 80s and the early 90s, writing software meant writing software for Windows and it sucked. I mean, as a software developer, I just didn't want to do it. I like went to grad school, you know? So if you have a monopoly, monopolies always tend to suck, you know? Um, so far Android and iPhone are neck and neck and so it's not a monopoly yet.

Interviewer: Here's some irony that Apple's success mirrors that of Microsoft, its hated enemy for so many years, because they've gone with this monoculture. It is a richly ironic situation. I mean, I wonder what Steve Jobs is thinking. Doesn't he see like he's the guy in that old Apple commercial who's the mean dictator saying, "We're going to lock everything down now, things will be orderly," you know? I mean, it's like a description of the App Store. What should Jobs do differently?

Paul Graham: Quickly, he should like think about developers and make things, he should make the Apple platform something fun to build software for, you know? Don't treat them like slaves.

Interviewer: All right, thank you so much, Paul Graham of Y Combinator. Great to have you here and hear your views on [unclear].