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Interview with Timothy C. Draper
Draper Fisher Jurvetson

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Baker Library | Bloomberg Center
Harvard Business School
Boston, MA 02163
617.495.6411
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TIMOTHY C. DRAPER

The Early Years

I grew up in Atherton, California. Atherton was a very different place than it is now, fairly near Stanford University. I went away to prep school to Andover because I was really good in math, and really difficult for my parents to deal with. And then I came back to Stanford, [where I] studied electrical engineering, was on the football team, and I had a wonderful time. And then I worked at Hewlett Packard for a couple of years. While I worked there I also created something called "Stanford, The Game," which was a board game. And that was great fun. That was enough for my application to Harvard Business School. I applied to Stanford as well, and got into both.

I decided to go to Harvard, because it was a bigger change for me. Also a bigger challenge, because I understood Stanford was more math-oriented, and Harvard was more case-oriented. I realized that that was the part I was missing. And it was great. I learned a lot about many, many different types of business, and really truly enjoyed the experience at Harvard Business School.

The summer between business school, Dad helped me get a job as the assistant to the president of Apollo Computer, and I worked there for a summer, and then a little bit during the year. And then, when I got out of business school, I wanted to be an entrepreneur, but realized that it was more fun to be a venture capitalist for me. Not for everyone, but for me, because I had a new idea for a business every couple of weeks. And if I had been an entrepreneur I would have only been able to pick one of them, and go with it. And maybe that would have worked out well. I don't know.

Then I got going in the venture capital business because, for one thing, my grandfather was a venture capitalist, and my father was a venture capitalist. And so, it was a natural progression. I guess I had it in my blood. I got a job with Alex Brown and Sons, and that was part venture capital and part investment banking. I realized that I was not cut out for investment banking, because I always said the wrong thing, and did the wrong thing. I always liked to be on one side or the other, I didn't like trying to play both sides. Venture capital is much more of a natural for me.

When I said I really wanted to break away, Dad said, "Well, we do have this small SBIC [Small Business Investment Company] and we can put up a little bit of money and borrow three times that amount from the SBA [Small Business Administration]. That's what I did. I was very aggressive. I went in and I convinced the SBA to allow this young whippersnapper to go manage a fund, where we borrowed six million dollars against two, but the two million was already invested in private companies. I don't know what it was worth, but roughly two. That six million was what allowed me to build my track record. Along the way, after three or four years, I had pretty much run out of money. I had a lot of interesting investments, but I was out of cash. I was maybe six months away from the end, and I got this letter that said, "Come up to Alaska and tell us about venture capital, because oil prices have dropped down to six dollars a barrel, and we're looking for new industries to get into up here in Alaska." I thought, "Well, okay, I'll try it."

I went up to Alaska, and about two years later we were able to set up a fund that was half Alaska and half Silicon Valley. I worked with a local partner there, so I got a little bit of a flavor for what it was like in another region. And then 1991 hit, and Parametric went public, and Banyan, and, we got about five or six public offerings after a really long period of time, maybe five or six years, where nothing had happened. Suddenly, we went from being on the SBA's dirt list -- not just their watch list, but their dirt list, to having my picture on the door in the SBA, because I was the SBIC of the year, or something. So, the fortunes really did change.

The Alaskan fund worked out pretty well, and so I brought in a few other partners. We set up our first fund, and we went out and raised money. The way I was able to raise money was all the way along, while I was building my track record, I just kept touching base with all of the wealthy people I knew, all the venture capitalists I knew, and building those relationships, so that by the time the fund was announced, it was already starting to happen.

We did have one thing happen, and this will be great for Harvard to have. Stanford had committed -- this was a 20 million dollar fund, and Stanford had committed 5 million to me. And just before they signed the papers, they pulled the plug, and that was a quarter of the fund. I had to go scramble and somehow we were able to find another investor, who was willing to come in with 5 million dollars. We were off to the races. John Fisher and I built our next fund. Then the record just kept improving. As the record improved, there would be more and more investors and our investors went from individuals who thought we might have some potential, to institutions who were seeing how well we had done in the past. That made a big difference.

We did recognize that there were other regions that were going to be very important, and so we set up offices in lots of other places around the US, and then, ultimately, around the globe.

Finding the Opportunity: International Venture Capital

If we had not gone to China, we would not have found the best investment we have ever made, and that was Baidu, which is the search engine for China. They have a 70 or 80 percent market share there, it just keeps growing, and growing, and growing, and it is worth many tens of billions of dollars today. That investment we never would have made if we had not pushed out beyond the Silicon Valley, and found different places to invest. Even Parametric was not in the Silicon Valley at the time, but it was in Boston, and that was a great investment for us.

I would say our plan to grow outside the Silicon Valley, and into other regions has really panned out well for us. Skype was also in Eastern Europe and it took a real adventurer to identify that there were interesting opportunities outside the US.

Firm Culture

Culture has evolved over time. I think we were more swashbuckling risk-takers way back when, and today we're a little bit more of an institution. As an institution, we keep trying to break it, and change it, and fix it so that we become more risk seeking. Our investors are more and more cautious, and so we have become more and more cautious. And I hope what that does is keep us from the bad investments, but doesn't keep us from doing the ones that end up doing very well. I'm hoping that that's the way it all pans out.

The culture is good. For the office, for the rank and file we work very hard to make it a very comfortable place to work. A place where your lunch is here, your breakfast is here, your dinner is here, you can come, and it can be, in effect, your work home. It is home, for a lot of people. And I think that's a really important feature, because we don't try to keep the pace up all the time; we know that the pace comes in fits and starts and we allow people to cool it once in a while so that when the heat is on, they really come through. That turns out to be really a good idea.

The other thing is that we make sure that everyone, in one way or another is an owner. That means they take a piece of the carry, or they get a bonus based on our performance, and that kind of thing. I think that can make a big difference for people. We want them to feel like owners, and they do. They live and breathe it. They will come in and tell me when something is really wrong, and we should be doing it in another way. We'll take that feedback to heart.

Biggest Challenges in Venture Capital

The biggest challenges that venture capitalists face, other than any internal political machinations, are when you have to fire a CEO, or you have to make a decision to stop investing in a company that looks like it still could have some promise. We almost get jaded, hardened to that over the years, but it is never very easy to cut off a company, or to let a CEO go, or to change things around, or down round financing. There are so many of those issues that come up that are difficult to deal with. What I try to do is I try not to let the failures overwhelm me, and try to move in, make the decisions, and then move out of the way as quickly as possible when things are not working. The biggest mistakes I make are usually leaving the status quo when I know there is a problem.

Hotmail

The most exciting deals that I have been involved in have been the ones that exploded virally. The first one was, of course, Hotmail, where I came up with a way to create a viral marketing program. Because that exploded in such a way, that no one had ever seen that kind of consumer growth for a company in the history of the world. It was the fastest growing company that had ever happened in the world. It went from zero to eleven million users in eighteen months.

Now that does not sound that extraordinary now, because it's happening a lot, because viral marketing is now proliferated throughout the business world, but at that time, that was phenomenal growth. That was growth unprecedented in any way, shape, or form. Nobody had ever seen anything like it. We were right in the thick of it, and we knew we were on to something, but we were losing money. We were just giving away email. We did not know how we were going to make money, we just had lots of customers. I had been involved in *Upside* magazine and it took us ten years to get to a hundred thousand *Upside* subscribers. In eighteen months, get eleven million users, I knew there was something here.

We started to build our business plan for how we were going to make money. Then some of the big companies came, and they started to bid for Hotmail, and at some point we finally said, "Oh, this is such a big offer," we sold it to Microsoft. So that was a very exciting, that whole experience was very exciting.

We had a similar thing happen with Skype, where it grew at a phenomenal rate; much faster, even, than Hotmail had. They got to a point where they were profitable, and the world was recognizing it. Then there was another bidding war, in effect, and we sold it. I think I upset the founders by voting against it, because I thought Skype had much more legs in it than to sell out to eBay, but that stuff happens.

Summary Reflections

[Venture Capital] is a wonderful career. It is getting to be more institutionalized, a little less freewheeling than it once was; although some of the angels still look at it as the freewheeling business that it used to be. It is very much global, so if you want to get into venture capital, I would be very anxious to make sure you get on a lot of airplanes, so that you understand what each of these markets is bringing, in terms of entrepreneurs, and marketplace. I would say, "Are you sure you don't want to be an entrepreneur?" "Are you sure you don't want to be a CEO of a larger company?" There are a lot of questions I'd ask myself before jumping in.

Venture capital is still a growth industry, although we have had a flat ten years. I think the cycle will be coming back. There are a lot of people in it already. Unless you have sort of a new approach, a new way of going about it, I'm not sure I'd fight my way into the business, but if you have a new approach, come see me.

The Evolution of Venture Capital

I think venture capital will be much more automatic. It will feel a little bit more like banking. That would be my guess, on the getting in. On the getting out, I think it will be more mechanized. I think the returns will actually start going back up. I think there will be more and smaller investments. I think then certain of those smaller investments will grow to the point where they will get more, and then more later on. A lot of them will fall by the wayside, or get merged. Merging companies will be much more efficient, and I think taking companies public, or public will be easier to do.

The company, Xpert that my son works for is going to allow a company to go public.

They will stay private, but they will be able to be traded. I think that will make a big difference. That liquidity will come back into the business. I think we are going to see a renewed industry, but it is going to be a lot different.