



TRANSCRIPT, PODCASE A

Escape the Competition, a Podcase with Peter Thiel

Peter Thiel:

“The greatest adventure is what lies ahead. Today and tomorrow are yet to be said.

The chances the changes are all yours to make. The mold of your life is in your hands to break.”

Reid Hoffman:

That was Peter Thiel, reciting “The Greatest Adventure” by J.R.R. Tolkien. Peter’s career definitely breaks the mold, so it’s no surprise he’s memorized that poem. I’m Reid Hoffman, founder of LinkedIn, investor at Greylock, and host of the Masters of Scale podcast. What you’re about to hear is the podcase we created from my conversation with Peter Thiel, the co-founder and CEO of PayPal. Peter is also an old friend of mine and I worked alongside him at PayPal, initially as his chief operating officer. Peter was featured in the Masters of Scale episode called “Escape the Competition,” but this podcase includes extensive material from our original conversation, much of which didn’t appear in the episode.

In this podcase, we’ll explore the organizational challenges of rapid growth and extreme competition. I think you’ll get a lot out of it. Enjoy.

Hoffman:

I’m here with my good friend, frequent collaborator, and always intellectual provocateur, Peter Thiel. And we’re here at Greylock on some Thursday afternoon.

Thiel:

Excited to be here, Reid.

Hoffman:

So let’s start with a little bit of your history, kind of going back to both school days and then before we get to the main subject to PayPal. One of the things that I learned only recently was that you actually went to boarding school in what was then I think called South West Africa, now is called Namibia.

Thiel:

It was actually a public school there.

Hoffman:

And was it a boarding school or was it a...?

Thiel:

I went to a private school in Johannesburg one year and then a public elementary school in Swakopmund, Namibia.

Hoffman:

And you gave an interview once that suggested that this experience of rigid conformity kind of set you on your path. Can you say a little bit more about that?

Thiel:

Well, you were required to wear school uniforms every day. In Johannesburg, it was this British-style prep school where you had to wear a blazer, a cap, a tie. And I remember my first day of second grade, and I had gone to Montessori school before that in the US, so it was this extreme culture shift from a Montessori school to a British-style prep school from the 19th century. And the first day of school the teacher was appalled that I did not know how to tie a tie, and she did not mean a shoelace, she meant a tie as in a suit tie. And it resulted in this dynamic where after school I always raced to go home and take off the uniform as quickly as possible.

Hoffman:

And do you think that this, when you look back on the whole arc of your life, do you think that this rigidity was part of what planted the seeds of why being contrarian is important?

Thiel:

I was always incredibly competitive. One of my friends wrote in my eighth-grade yearbook, "I know you're going to get into Stanford four years from now." Four years later, I went to Stanford and then I got into Stanford Law School. And I ended up at a top law firm in Manhattan, and it was sort of winning one competition after another. And it was this very strange place, the law firms. From the outside it was a place where everybody wanted to get in. On the inside, it was a place where everybody wanted to get out. When I left after seven months and three days, one of the people down the hall from me said he had no idea anyone could leave this quickly and that it was possible to escape from Alcatraz. And of course all he had to do was go out the front door and not come back. And so there was something about this intense competition and desire to win that I came to question as I had sort of this rolling quarter life crisis in my 20s.

Hoffman:

So we met each other at Stanford, and we actually combined our student Senate campaigns because it was a fun way to spend time together. As an undergraduate you were very focused at competing intensely and playing to win. What did competition mean to you then? And did your understanding of competition change as you got older?

Thiel:

Still very much, yes. When you compete very intensely, you do get to be very good at the thing you're competing on. And so you get, in fact you have to be better at the thing you're competing on than you otherwise would be. But then you often don't ask enough critical questions about whether the thing you are competing on is really worth doing.

Hoffman:

In this next segment, Peter Thiel and I discuss Thiel's learning from his time at Sullivan and Cromwell, a prestigious Top 5 law firm based in New York City.

Hoffman:

Was it your time at Sullivan and Cromwell that changed your definition of competition? Because when we got to PayPal, you were still very focused on being competitively strong.

Thiel:

By the time I was at Sullivan and Cromwell, about five years before we started PayPal, that I came to question conventional competition. I thought that a lot of the conventional ways people competed resulted in too many people do conventional things, and then you end up in very competitive dynamics and then even when you win it's not quite worth it. You might get a slightly better paying job than you otherwise would, but you sort of have to sell your soul. That doesn't seem like a very good economic or moral tradeoff.

By the time we started PayPal when I was 30, 31 in 1998, I was focused on doing something entrepreneurial, doing something that, strictly speaking, other people were not doing. There was obviously some vague generalized startup competition. But then A lot of it was how do we compete very intensely maybe to avoid competition altogether. We needed to achieve escape velocity, we needed to grow so quickly that it would discourage anybody from even trying to compete with us. On one hand, you have to race really hard to scale fast, but the benefit if you do it is that you're sort of achieving escape velocity from the black hole that is hyper-competition.

There are two types of businesses. There are companies that are purely competitive; they do not make any money, think a restaurant. And then there are businesses that do not compete. They are monopolies, and they do very well. And even though this is not the way people want to talk about it on the inside, you always want to have a monopoly on the inside. You never want to be in the restaurant business.

Hoffman:

Restaurants, airlines are frequently your examples of the non-monopoly businesses, but isn't non-monopoly businesses actually in fact the vast majority of businesses?

Thiel:

Just about all successful businesses have some element where they are monopoly-like. So you at least have a brand. Maybe if you're a consumer-facing product, there are businesses that have maybe some sort of oligopolistic structure. You could say that Coke and Pepsi compete very intensely. On the other hand, you could say that they are somehow quite differentiated from a brand so that in practice different people prefer Coke or prefer Pepsi and there is a much smaller set of people who view them as interchangeable products. So I think measuring how much actual competition is happening is not always a straightforward thing to do. Because just as people want to have monopolies, they want to also downplay them, and so they will suggest that they're facing enormous amounts of competition everywhere whether or not that happens to be true.

Hoffman:

Let's talk about your time at PayPal. How did it start? What was the thing that led you to investing and then stepping in as co-founder and CEO?

Thiel:

I'd become interested in the internet boom in Silicon Valley. A number of my friends were involved in it. You had just started a company yourself called social net. And then I connected with Max Levchin with some mutual friends, Luke Nosek, and he was looking at starting a new business.

Hoffman:

Max Levchin was a co-founder at Confinity, the company that became PayPal. Luke Nosek and Ken Howery were part of the founding team of PayPal, along with me on the board of directors. Confinity was an early entrant into the payments market; it's PayPal service enabled users to transfer money from their credit card or bank account quickly and securely to any email user in the world. Initially, paypal offered this service for free; it planned to derive its revenue from the float, or interest, that it would earn from the money customers left in their accounts, and also from advertising.

Thiel:

There's this question about financial cryptography, could you start a new currency, could you start some new secure financial product. We started with secure financial products on Palm Pilots and then maybe cell phones were better. After Nokia invested in our firm a month later at our first board meeting, we concluded that the smartphone was still ways off. And maybe we should just do an Internet product. We gradually shifted to building the PayPal product on the internet. There was a tremendous amount of iteration around this idea of doing something with payments, with moving money.

Then we were also very focused on getting to scale as quickly as possible. How do you scale it very quickly, how do you get it to grow by word of mouth? Reid, you and I had many sort of late-night

conversations about virality and exponential marketing. The X factor in the exponent was growing at about seven percent a day. Even when you start with only 24 people, the compounding dominates. You go from 24 to 1,000 by mid-November. We were up to 13,000 by end of December '99. By early February of 2000, we were up to 100,000. By mid-April of 2000, we were up to a million. That's the kind of thing that you want to do. There was this question how do we get some compounding to work. And we concluded that you know linking money with email and maybe giving people some money to sort of accelerate the process would really get it started. It made for a very crazy ride.

Hoffman:

What were you learning during this period, especially about working with eBay and establishing the company within an ecosystem of much bigger players?

Thiel:

Yeah, it's always hard to know what lessons one can draw from PayPal. In 1999/2000, a lot of it was trying to come up what's the best way to do this. We were looking at business development versus direct to customer. There was one day where Luke Nosek and myself and Jack Selby, the three of us went to London...

Hoffman:

Jack Selby headed up international development for PayPal.

Thiel:

We spent a day meeting with people at HSBC. It was endlessly disappointing. It was like you'd thrown a giant rock into a big pond and there was a splash and the waves were going to die down and nothing was going to happen. We could not get distribution by working with big banks. We worked with AmEx. They had a team show up at our office. We had two large boxes full of due diligence materials were sent back to AmEx headquarters. A month later, they were sent back to us unopened. They couldn't even figure out who should open the boxes. And so there may be a way for people to do business development, but we were not that good at it.

Hoffman:

One of the specific inventions that the PayPal team on the scaling was to say look, all these other Internet services are paying for advertising. What we're going to do is much, much better, just give the money directly to our customers, we have a money transmission business anyway. So giving essentially money for them to transmit. like bring in a new person, they get 10 bucks, you get ten bucks, this way of doing it was actually one of the innovations that was a cheaper form of customer acquisition than the current highly competed form of advertising.

Thiel:

Then if you went direct to the consumer, you know one way to do it would be with marketing or advertising, and the advertising cost may be \$80 to \$100 to acquire a customer, if they would click through and sign up, and then it was not clear that the customer would even be connected in any organic way to anybody else. Whereas if you paid customers who got a payment from somebody, that would be sort of a \$20 customer acquisition cost, \$10 for the referrer, \$10 for the new customer, at least they'd be organically connected to the person referred them. In this case, it turned out to be good because on eBay, there were all these people moving money between one another and you could easily turn the \$10 bonus into a \$10 discount. If you used PayPal, you got \$10 off or \$5 off. It could be used by sellers to accelerate sales. the bonus got shifted into something, it became a much more organic way to use the PayPal product, and then we got to sort of very fast lock-in. But we were focused on the scale, getting to a network, the payment system would be a network, there'd be economies of scale, network effects, and the combination of that was absolutely paramount.

Hoffman:

In this next segment, Peter Thiel and I dive into the relationship between PayPal and eBay. Over time, PayPal became the payment platform of choice for sellers on eBay, and that caused an evolution in the relationship between the two companies.

Hoffman:

And do you remember the first week or two of, "Well, these eBay people they're are using it." What the dialogue was internal to PayPal?

Thiel:

The way I remember it was the initial reaction was quite negative. It's like wow this is like the junkiest stuff being sold on the Internet and it's so bad for our brand to be affiliated with all of this. And then in retrospect it turned out to be this incredibly tight community, a new use case where the alternatives were much worse, the alternatives were typically using a check, which would take seven days to clear. And because people were both buyers and sellers on eBay it had a natural fluidity to the whole thing where the money went from one PayPal user to another and stayed inside the system. It turned out to be quite powerful. We got to sort of a decent size share of the eBay market very quickly, I'd say within three to four months of it being used on eBay, we were probably at something like 30% of the eBay power sellers were using PayPal.

Hoffman:

When I tell the PayPal story, PayPal has the most near-death experiences, like kind of running through the minefield and just getting around various minefields.

Thiel:

There was crazy competition with eBay owning the platform, with Visa and MasterCard owning the credit card platform, where you did a tremendous job as our Firefighter in Chief and stopping all the

various pyromaniacs who were trying to burn the company to the ground. And then there was definitely the regulatory piece and the fraud piece.

Hoffman:

You were actually at that time fairly concerned about people think we have this really valuable thing, but we haven't established it yet. It's a house of cards right now. This whole thing could blow over. There was a six- to 12-month period where you had me essentially seeing if anyone would buy the company.

There's a funny untold story around you know if Verisign had upped their bid by \$50 million, they may have actually owned PayPal, right?

Thiel:

If we didn't get to scale, maybe somebody else would beat us and we wouldn't achieve escape velocity and we didn't know that there would still be a rapid organic growth even when we stopped giving customers the referral bonuses, for example. I also thought that we either could get to scale or figure out our business model. So we should we should get to scale and then see if the business model worked, rather than see the business model worked and then scale it. In practice, we had a burn rate north of 10 million a month from March to September of 2000. That was pretty uncomfortable.

It was exponentiating, and there were no revenues yet.