TEACHING GUIDE

Peter Thiel: Escape the Competition Podcases

Synopsis

The “Escape the Competition” podcases, which contain excerpts of Reid Hoffman’s interview with Peter Thiel from an episode of the Masters of Scale podcast ([www.mastersofscale.com](http://www.mastersofscale.com)), cover a rich array of topics that center on the entrepreneurial and strategic challenges that startups face. In the A and B podcases, Thiel and Hoffman first cover Thiel’s early years, prior to his cofounding of Confinity, one of the two companies (along with Elon Musk’s X.com) that merged to become PayPal. They then recount excerpts from Confinity/PayPal’s history, from its initial formation to its eventual acquisition by eBay. Thiel uses this account to explain why he believes firms must achieve “escape velocity” by scaling up rapidly to escape hypercompetition. His account also suggests why realizing this goal is difficult even in the somewhat favorable circumstances PayPal enjoyed. In the shorter C1 through C6 podcase supplements, Thiel and Hoffman focus more briefly on an array of topics, ranging from company culture to the role of co-founders.

Learning Objectives

1. Understand what Thiel means by “escape velocity” and the black hole of “hypercompetition,” and assess whether he is correct that a firm must achieve escape velocity to escape hypercompetition.

2. Evaluate whether “just about all successful businesses have some element where they are monopoly-like” and analyze whether there are boundary conditions to this hypothesis.

3. Analyze what elements of PayPal’s initial customer acquisition model made it more successful than more standard modes of customer acquisition typically are.

4. Understand the risks PayPal initially faced by being so closely affiliated with eBay.

5. Evaluate the conditions under which it might be more important to scale first, and when it is more important to have a business model first.
6. Use Peter Thiel’s comments from the A and B cases to consider the conditions that can make the long-term valuation of an enterprise difficult.

C1 (Building a high-tech culture): In a high-technology, high-growth context, understand why hiring friends can be an effective way to build a strong culture.

C2 (PayPal retrospective and exit): Use Peter Thiel’s theory of the need to escape from competition to assess whether PayPal was correct in selling itself to eBay.

C3 (The merit of co-founders — why are two heads better than one): Use Peter Thiel’s comments on the paradox of competing intensely in the A case to evaluate his belief that it’s better to have two (or more) co-founders than it is to have just one founder.

C4 (Professional education and the entrepreneurial mindset): Evaluate Reid Hoffman’s and Peter Thiel’s comments about the disconnect between the challenges of working in a startup and the professional educations many students choose and assess whether pursuing the latter makes it harder to pursue the former.

C5 (Contrasting theories of strategic opportunity): Analyze the conditions in which local search is more appropriate than positioning, and vice versa.

C6 (Setting managerial priorities): Use Reid Hoffman’s and Peter Thiel’s comments on triaging to the issues presented in the previous cases to consider whether any of the previous “fires” discussed were less important for them to “extinguish.”

**Suggested Readings**


**Assignment Questions**

1. What do the terms escape velocity and the black hole of hypercompetition mean?
2. Is Thiel correct in proposing that achieving escape velocity is necessary to escape hypercompetition?
3. Do “just about all successful businesses have some element where they are monopoly-like?”
4. Are there boundary conditions to this hypothesis?
5. What elements of PayPal’s initial customer acquisition model made it more successful than more standard modes of customer acquisition typically are?
6. What risks did PayPal initially face by being so closely affiliated with eBay?
7. When is it more important to scale first, and when is it more important to have a business model first?
8. What factors make the valuation of an enterprise more difficult?

**Teaching the Case**

Before class, have students listen to the A podcast. When the in-class discussion of the A podcast concludes (30-40 minutes), play the B podcast in class (eight to 10 minutes) and then discuss the material (15-20 minutes). Following this discussion, any of the C1 through C6 supplements can be used independently to focus on specific topics of interest (10-20 minutes).

The **Background** material below offers a theoretical backdrop for the guide to the discussion questions that follow it. The theoretical frameworks discussed within this section informed the selection of material for the podcasts. Although the instructor should read the **Background** section while preparing for the class, in-class discussion of its material is optional.

**Background**

The “Escape the Competition” podcasts echo rich themes at the intersection of entrepreneurship and strategy. According to HBS Professor Howard Stevenson, entrepreneurship involves “the pursuit of opportunity beyond the level of resources controlled.” Entrepreneurs (and the firms they lead) then develop strategies to achieve superior competitive positions, and hence superior (i.e., economic) profits by maximizing the wedge between their own firms’ costs and customers’ willingness to pay as they pursue these opportunities. Of course, achieving these goals is easier said than done.

Scholars of strategic management have examined how firms achieve superior returns along several dimensions. One dimension has centered on strategic search. That is, how do firms search for strategic positions that enable superior returns? There have been two divergent perspectives on how such search
occurs and the mechanisms firms use to search.¹ The first, following the work of Michael Porter (1980, 1996), has assumed that managers are highly rational in searching for and finding superior positions within an industry structure a priori. It proposes that managers can typically access the information they need (albeit with some effort) and that they have straightforward analytical tools, such as ways to estimate market share, costs, and net present value, for evaluating what decisions to make, and assumes managers are not subject to behavioral biases such as social pressure or overconfidence. Based on this knowledge, firms then develop intricate activity systems to defend and deepen these positions. It also assumes that firms are plastic (i.e., their practices can be altered quickly and cheaply), and hence that managers can easily implement changes to a firm’s strategy.

The other perspective is guided by the principles of bounded rationality explicated in Simon (1947), March and Simon (1958), and Cyert and March (1963) and formally modeled within the paradigm of evolutionary economics (Nelson and Winter, 1982). It emphasizes the “localness” of search. It argues that because firms (and the decision makers within them) are boundedly rational, they are strikingly limited in their ability not only to search for superior positions but also to understand fully what makes them superior. It also emphasizes the continuity of organizational routines, which limit a firm’s plasticity. Hence, to the extent firms change strategies, they almost always select positions close to the ones they currently inhabit. Consequently, their success in finding superior positions is largely serendipitous (Denrell, Fang, and Winter, 2003).

Within this second perspective, the bounds on managers’ rationality are affected further by the interdependence among their policy choices (e.g., whom they hire, level of competitive differentiation, technology), which makes it difficult to ascertain how the payoffs from one choice (e.g., hiring more skilled workers) will be affected by other choices. In turn, this interdependence influences what returns their companies realize (Levinthal, 1997). In “competitive landscapes” where such decisions affect other little, the payoffs associated with each policy choice (e.g., lower-level employees’ autonomy) are largely independent. There are few superior “peaks” for firms to gravitate toward in such landscapes. A firm’s decisions about what policy choices to make are thus relatively straightforward because it is easier for managers to predict the payoffs of their decisions. Nonetheless, firms within such landscapes face a dilemma: many firms gravitate toward the few existing peaks, and (in theory) will compete away the returns such peaks provide.²

In contrast, when there is significant interdependence among policy choices, the landscape is “rugged.” Because boundedly rational managers cannot anticipate all the interactions—and consequences—that might occur among their choices, there are thus many local, non-optimal peaks (i.e., positions that yield inferior returns). Firms are more likely to get “stuck” on a “lower” peak because of the difficulty associated both with “seeing” a superior position and with knowing what to do to move to it.


² Such returns may be more persistent for some firms than landscape theory suggests because of significant inter-firm differences in managerial competence. See Sadun, Bloom, and Van Reneen (2017) for a discussion of these differences.
To the extent managers in such landscapes possess superior cognition, they may have opportunities to realize superior returns. These returns can come either from the ability to see either somewhat higher local peaks or to see “cognitively distant” optimal peaks that will require the firm to pursue very different policy choices, and hence a very different strategy, to realize the returns from them. Nonetheless, other bounds may limit a firm’s ability to enact a cognitively distant strategy. What is strategically attractive is attractive precisely because it is difficult to achieve.” (Gavetti, 2012: 280)

In considering how firms achieve superior returns, a second dimension that strategy scholars have examined is whether competitive landscapes are exogenous or endogenous. The first approach assumes landscapes are “fixed,” where “winning” firms conform more closely than their competitors do to an industry’s underlying structural characteristics within a given technological or regulatory regime. This perspective suggests first-mover advantage can be important, insofar as being first might enable a firm to create substantial entry barriers through such means as exclusive access to necessary resources and economies of scale or scope before other firms have had time to act, but even first movers in this account are essentially passive observers that exert little influence over what the industry ultimately looks like or how it evolves. Some elements of PayPal’s story, especially Thiel’s emphasis on achieving escape velocity, assume the exogenous perspective: a market with returns to scale and network effects is one in which a first mover should scale aggressively because of the entry barrier doing so will create.

The endogenous approach, which is closer to the perspective advocated by many entrepreneurship scholars, proposes that the structural characteristics affecting an industry’s shape are complemented by firms’ efforts to shape the competitive landscape, and hence the payoff structure, for all the firms in an industry. Firms might, for instance, introduce new products or features, which then affect the opportunities perceived by other firms, or by “using marketing to reframe consumer perceptions of the value of an existing product, thereby altering consumer willingness-to-pay for all firms making the product” (Gavetti, Helfat, and Marengo, 2017: 198). Such shaping often entails extensive processes of social construction. In their discussion of successful entreprenuers, Applegate and Carlson (2014: 9) write that these individuals “recognized that having an idea was just the first step; they needed to shape it into a viable business opportunity by engaging with potential customers, advisers, and experts and by searching for information that could help them link their understanding of a compelling market need to a unique and compelling solution.” In some instances, entrepreneurs may even shape the landscape by working to legitimate and popularize a new type of offering (see Rao and Giorgi, 2006 cf. Gavetti et al, 2017). Thiel’s discussion of how PayPal worked to legitimate perceptions of its offering in his comments on helping businesses in Louisiana suggests one such mode of shaping.

Both the exogenous and endogenous approaches suggest the steep challenges that startups face. These firms usually have few resources beyond the energy, vision, and persuasive power of their founders. Even after they raise financial capital, recruit talent, and develop partnerships, they must develop

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4 Gavetti (2012) argues that associative processes facilitate managers’ ability to see such peaks, although the mechanisms underlying such processes remain underspecified.

5 A landscape’s endogeneity (i.e., the intrinsic “shape-ability” of a landscape) is discussed directly below. The question of plasticity is dealt with less directly in the discussion of boundary conditions. A fuller discussion of plasticity is outside the scope of this note, but the comments here draw largely from Gavetti (2012).
capabilities that will enable them to create compelling value added and willingness-to-pay before the money runs out. Even firms that first show promise often have difficulty sustaining this success. Not surprisingly, most new ventures fail.

Further, startups that are key players in developing new markets face constraints and opportunities not encountered by their counterparts in more established industries. The constraints include not only the resource limitations and legitimation challenges described above but also the frequent lack of existing templates for developing and scaling de novo products and services, as well as the capabilities to support them. Such templates are by definition more difficult to find and create for cognitively distant offerings than they are for more familiar ones. As Hoffman notes about how PayPal addressed its problems with customer service, “we had to figure out how to hack our customer service challenge at a very fact pace. There was no playbook to tell us what to do. There still isn’t.” (2016: 6)

Nonetheless, the opportunities available to such startups can also be significant. Most obviously, to the extent a new industry’s contours are endogenous, a startup can influence those contours both by creating a compelling offering that emphasizes the firm’s unique value added and by engaging with other constituencies in the ways that Applegate and Carlson (2014) describe above. Given the cost and time involved with transactions pre-PayPal, the company clearly offered value added, and it used feedback from the community that initially most valued it to shape its offering.

In addition, because of its age, a startup may have a level of plasticity (i.e., an ability to change) that more mature firms do not. That plasticity is usually more pronounced in young industries because of the uncertainty these settings entail. PayPal’s early history suggests several pivots (e.g., its quick embrace of a community that it was initially reluctant to serve) in its search for a strategy and the best way to implement it. Such flexibility would have been difficult for a more mature firm with established routines and relationships.

For businesses that aspire to grow, the challenge of scaling operations is especially pertinent to such constraints and opportunities. Applegate (2014: 3) notes:

Scaling requires leveraging the capabilities that were built to enter the market while building new operating capabilities as the organization shifts from a multifunctional team to an interconnected set of work units. Scaling may also require new leaders who understand how to manage the increased organizational and business complexity.

For startups that wish to compete in new industries in which there are scale, scope, and/or network effects, where the average cost per unit of offerings in existing and/or new markets decrease and returns typically increase, the need to address these challenges becomes especially urgent. Such industries often exhibit “winner take all” or “winner take most” effects, where one or a small handful of firms are highly profitable and other firms either fail or compete for niche segments of the total market. Eisenmann (2003: 1) notes, “In a new market with increasing returns, a first mover [i.e., the first company to enter a new market] with a long head start may achieve an unassailable lead before rivals enter.” Stated alternatively with the landscape imagery developed above, it may be especially

6 Gavetti and Rivkin (2007) develop a series of propositions for the interactions among firm age, industry age, types of search mechanisms, and degrees of plasticity.
necessary for a firm to scale aggressively (consistent with the policy choices that enable this scaling) because superior points in these landscapes will quickly become clear to other potential entrants.

Another factor that can be especially relevant to scaling—and is useful for understanding PayPal’s success—is network effects (a network denotes the base of customers that uses a product or service), where “a network’s value to any given user—that is, the user’s willingness to pay (WTP) to affiliate with the network depends on the number of other users with whom they can interact” (Eisenmann, 2003: 7). Although other factors such as switching costs can affect the size of networks and users’ propensity to stay within a given network, other things equal, networks with larger customer bases enjoy a virtuous circle whereby a larger base of users continually makes it attractive for more users to join.

Not surprisingly, networks with a large user base can enjoy the best of both worlds. First, absent a shift in technological regimes, their average cost per user typically continues to decrease. This decline is especially true for products such as software, where the marginal cost of serving an additional customer is essentially zero. Second, as Eisenman suggests, because the customer base is so large, a firm that owns such a product or service can charge more—and hence enjoy superior returns—for customers to use it. Once PayPal achieved such scale, it became very difficult to dislodge.

Questions

1. **What do the terms escape velocity and the black hole of hypercompetition mean?**

   Escape velocity denotes the ability to scale a business up so quickly that it effectively becomes a quasi-monopolist (or at least an oligopolist) whose scale effectively becomes an entry barrier against competitors. Here, escape velocity is (by definition) so rapid that most or all other firms cannot simultaneously scale up as quickly given the total market size and/or the investment and capabilities required to scale up.

   Using the landscape imagery developed above, the black hole of hypercompetition refers to situations where the payoffs associated with a given position are evident (i.e., where there is limited interdependence among policy choices) and it is relatively easy for firms to copy each other, particularly when no firm enjoys a scale advantage. The entry of many such firms means that total capacity can be far greater than the corresponding market size is. When that happens, all competitors have a strong incentive to cut price, especially when variable costs are negligible and fixed costs are high. Profits quickly get competed away, and many firms do not survive.

   This situation is even more problematic when entry barriers are low. The airline industry in the 1990s is an exemplar of how hypercompetition can eat away profits because competing firms have no “lift” (i.e., extra money or resources) to “escape the black hole.” Instead, they are using all their resources just to survive and keep getting “sucked back in” by the need to respond to competitors.

   Further, it is much harder for older firms that compete in multiple business lines in established industries where there are dominant logics, identities, and relative market stability (see Gavetti
and Rivkin, 2007) to achieve escape velocity. As Hoffman (2016: 5) notes, such firms are “not as fast or as focused.”

As a startup in a new industry that sold a single service, PayPal faced none of these constraints. Despite its lack of established routines, it had the advantages of “newness” and could focus and move quickly. Having raised substantial capital, it also had the means and the incentive to scale; being a low-margin business meant that it could become profitable in the long run only if it handled many transactions.

Nonetheless, scaling to achieve escape velocity was inherently risky. At the end of the A podcase, Thiel notes the cash-flow issues that PayPal faced as it scaled. This concern began to abate only after it developed a sustainable business model.7

Elsewhere, Hoffman refers to this extremely rapid scaling up as “blitzscaling.” He notes, “Blitzscaling is always managerially inefficient—and it burns through a lot of capital quickly … In hiring, for instance, you may need to get as many warm bodies through the door as possible, as quickly as you can—while hiring quality employees and maintaining the company culture” (2016: 5).

2. Is Thiel correct that achieving escape velocity is necessary to escape hypercompetition?

Thiel is correct insofar as:
   a) scale and/or scope effects are strong. Otherwise, the risks and fixed costs of achieving escape velocity can outweigh many potential benefits associated with this effort;
   b) there is relatively little differentiation among customers. Hypercompetition is less likely to occur when there is such differentiation because firms are more likely to focus on different clusters of customers with distinct needs and willingness to pay, and there is somewhat less need to scale quickly;
   c) figuring out which strategic position(s) have the best payoffs is not too difficult. When this effort is more complex, new entrants are more likely to get stuck on local peaks because of bounded rationality, and hence may be unable to change course toward peaks with superior returns.

PayPal met at least conditions a) and c), which made it more valuable to scale up quickly given the likelihood of new entrants. Although Thiel notes that PayPal had breathing room because no one else had entered the market, it is unclear whether it lacked competition because others did not perceive the opportunity or because PayPal had pre-emptively arrived at the superior peak.

PayPal might not have fully satisfied condition b). Nonetheless, there was very likely a large critical mass of customers whose needs were sufficiently homogenous that PayPal could capitalize on them.

7 For details about PayPal’s history, this guide draws from Thomas R. Eisenmann and Lauren Barley’s PayPal Merchant Services, HBS Case 806-188.
The other reason PayPal needed to scale massively centered on the demand side. First, its user base was growing exponentially. Thiel suggests a growth rate of 7% daily during late 1999 and early 2000, which translates into an eightfold increase in customers each month. To handle that growth, it had to scale its physical and human capital. Second, even to the extent PayPal had preempted this space, it would lose customers and other firms would enter if PayPal could not scale up quickly enough. Hoffman’s discussion of the customer-service challenge that PayPal faced as it scales and its intense focus on resolving this issue suggests just how important it was for the company’s long-term viability.

3. Do “just about all successful businesses have some element where they are monopoly-like?”

By definition, a business must possess a monopoly-like element because if all the factors it uses to produce its good/service are freely available and implementable, other firms would quickly compete away its economic profit. PayPal had an obvious monopoly-like advantage after it scaled up quickly, but it also had another monopoly-like attribute: managerial acumen first to pivot away from its initial business plans (work with Palm Pilots and then phones in 1999) and second to embrace the customers who were initially using it by recognizing the value of this community for enabling critical mass. (See Thiel’s comment about PayPal’s initial reluctance to be associated with users who were selling junky items.) PayPal also developed a more robust, and less expensive, customer acquisition model that was critical to the network effects it enjoyed. Regardless of whether this model resulted from luck or foresight, it catalyzed PayPal’s early growth.

4. Are there are boundary conditions to this hypothesis?

There are important qualifications to the above assertion. First, it is easier for other firms to compete away monopoly-like elements that are tangible and/or visible through imitation or substitution. Even if, for instance, a firm comes up with a great user interface that it patents, other firms may be able to “invent around it.”

Monopolies on internal capabilities, as well as configurations of said capabilities, are much harder to copy and are hence longer lived because they are opaque to outsiders. Sadun, Bloom, and Van Reneen (2017), for instance, have found that superior management carries large, persistent differentials on a variety of measures, including profitability, because it is difficult for other firms to glean the inner workings of this capability, much less replicate them. Similarly, webs of activities that are moderately complex but that are mutually reinforcing are hard to copy (Porter, 1996; Rivkin, 2000).

Second, a firm might enjoy a monopoly-like element for a certain product or geography, but not be able to capitalize on that element beyond a limited scope. Many large cities, for instance, have indigenous restaurant chains that are popular (and the franchisors likely enjoy substantial

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8 Hoffman (2016: 6) suggests a lower growth rate, between 2% and 5% daily, but even this figure suggests PayPal needed to engage in a massive scaling effort to handle all these customers.

9 As noted in the comments for this question, “factors” as used here denotes a broad array of inputs that include not only external factors like tangible resources, location, and patents but also less tangible internal resources like superior managerial ability.
rents) within a geographic region, but that cannot extend their advantage beyond their home region. PayPal’s advantage was geographically far broader (despite the occasional regulatory hurdles that it encountered).

Third, advantages that are not embedded in platforms/ecosystems are easier to compete away. Platforms/ecosystem advantages, such as what PayPal enjoyed, are typically much harder to replicate or compete away because of the virtuous circles these ecosystems create. In the smartphone market, for example, Apple’s iPhone initially succeeded because of superior functionality, but it became far more successful after Apple opened its app store, which quickly drew interest from software developers and customers. As is common in two-sided markets, the simultaneously growing bases of users and apps fed on each other.

5. What elements of PayPal’s initial customer acquisition model made it more successful than more standard modes of customer acquisition typically are?

a) First, as noted above, the model was relatively cheaper. During the dotcom boom, many internet startups burned through a lot of cash while trying to acquire customers, at a much higher acquisition cost per customer. Thiel suggests the average cost of customer acquisition was $80 to $100 per customer; elsewhere, Hoffman (2016: 6) suggests they were $40 per customer. “So when we gave customers who recommended a friend 10 bucks and gave the friend 10 bucks, we were cutting our acquisition costs in half.” Nonetheless, PayPal’s model still cost the company a lot of money, as suggested by Thiel’s comment about all the cash the company was burning through during this period. Eisenmann and Barley indicate that PayPal was spending $100,000 daily on customer bonuses.

b) Second, the strong element of community of eBay users and the fact that customer acquisitions were structured to encourage users to continue transacting within this community (e.g., by crediting them with a $10 discount that they could use on a subsequent transaction) initially made PayPal stickier for users as the company scaled up.

c) Finally, the network effects described above took hold and then strengthened as PayPal’s user base continued to grow.

6. What risks did PayPal initially face by being so closely affiliated with eBay?

a) The most obvious risk involves how closely PayPal’s fortunes were tied to that of eBay. If the latter failed, the former likely also would.

b) The second centers on the fact that PayPal was eBay’s “cash register,” and hence took a cut of each transaction. As Thiel and Hoffman’s reference to BillPoint suggests, eBay clearly had a strong incentive to build its own payment system and cut out the middleman.
c) The podcasts hint at, but do not fully capture the steps eBay took to weaken PayPal’s power when it introduced Billpoint. The relationship between the two entities was more contentious until eBay acquired PayPal. Eisenmann and Barley note (2):

eBay gave Billpoint prominent placement on its auction pages; waived sellers’ auction fees for accepting Billpoint during promotional periods; imposed restrictions on the size of PayPal logos displayed on auction pages; and, for fixed-price transactions, mandated the use of either Billpoint or an expensive credit card merchant account. Some of eBay’s tactics were reversed through quiet threats of legal action; others were rebuffed by eBay’s vocal online community [alluded to by Thiel and Hoffman] which sided with PayPal in many scuffles.

eBay’s own stumbles, such as the 4.75% transaction fee it imposed, as well as the fact that eBay was working with a financial institution (Wells Fargo) that had to be concerned with regulatory issues, also gave PayPal an inherent advantage over eBay.

7. Under what conditions is it more important to scale first, and when it is more important to have a business model first?

The above is something of a trick question: First, Thiel and Hoffman do not suggest a startup can have no idea about what its business model might be and still succeed. Rather, they propose that a startup does not need to know everything about this model—that it can resolve some things as it scales. Often, scaling up either makes certain problems go away—because few if any competitors remain—or because there are relatively less important elements to the business model that a firm can figure out later.

Beyond the economies of scale and network benefits discussed above, scaling up rapidly before a business model is decided also makes more sense when there are learning effects and switching costs. Companies’ use of the learning curve to decrease costs and prices has long been a common tactic. When switching costs are high, it’s helpful to gain first-mover advantage because the firm that does so will acquire some lock-in of customers that will be harder for later movers to reach.

That said, scaling up before the business model is solidified would appear more viable in markets where the fixed costs of scale that is large relative to the market are smaller and firms can hence adapt quickly if their assumptions are incorrect. In contrast, firms in industries for which fixed costs are high and irreversible, and where there is a long lag between initial investment and revenue realization, such as semiconductor fabrication, need to ensure their business models are viable before scaling because they will quickly go bankrupt if their models do not work.

Other situations when it’s helpful to have the business model figured out first may occur when the last-mover advantage can be greater. Thiel and Hoffman discuss the virtues of first-mover advantage, but Eisenmann notes (2003: 23) that factors like the ability of late movers to free ride off others’ early marketing investments, learn from early movers’ positioning errors,
revers engineer others’ innovations, and leapfrog with superior technology facilitate last-
mover advantage. In those situations, the basic parameters of how an industry makes money
have already been worked out.

8. **What factors make the valuation of an enterprise more difficult?**

The key difficulty of valuation is estimating both the market size and key value drivers for a
market in 10 years, especially when that market is growing and evolving quickly. As Thiel
notes, with PayPal, 80% of the company’s projected terminal value resided in cash flows that
began a decade out. For a long period, even modest mistakes in growth projections can lead to
significant over/underestimates of the total market. It is difficult to project what competitors
will do over that time, such as whether a rival firm will introduce an offering that hives away
much of the market. Further, changes in a technological or regulatory regime can significantly
affect the behavior of buyers, suppliers, complementors, and potential entrants, and hence the
value added (and the free cash flow emanating from that value) any one company provides.

**COMMENTS FOR OPTIONAL PODCASE SUPPLEMENTS C1-C6**

**C1 (Building a high-tech culture): In a high-technology, high-growth context, why might hiring
friends be an effective way to build a strong culture?**

In his 2016 interview, Hoffman repeatedly emphasizes the importance of maintaining a strong
culture. He mentions Uber as an example of a firm that, to scale quickly, would ask incoming
engineers who were the three best engineers they worked with in their previous job and then
sent job offers to these individuals without even interviewing them (5-6). In this instance, the
prior relationship among individuals helps foster accountability that might not otherwise be
present and, on average, creates a stronger culture. That also holds true for current employees’
friends from other contexts, who because of homophily (like affiliating with like) on average
share enough similarities in perspectives and preferences that there will be more coherence
among them—and hence a stronger culture—than there would be on average from randomly
matched individuals.

The downside to this heuristic should not, however, be overlooked. Strong cultures can also
lead to lower performance because they can foster insularity, superiority, and an “us versus
them” mentality than can hinder organizations from responding effectively to ongoing
problems. Some of the recent stories about Uber, for instance, suggest its culture has
contributed to its problems.

**C2 (PayPal retrospective and exit): Use Peter Thiel’s theory of the need to escape from
competition to assess whether PayPal was correct in selling itself to eBay.**

As Thiel suggests, the close relationship between the two companies posed challenges for both.
PayPal’s business and fortunes were so tied to those of eBay that so long as eBay was growing
rapidly, PayPal would have difficulty investing too many resources—when its long-term
future was still not assured—into other growth opportunities. In short, eBay was giving PayPal
the biggest bang for its buck, so its value at that point was greatest if it committed wholly to
eBay. Conversely, it had an incentive to deter potential rivals on eBay’s platform. Another
entrant that was willing to work with eBay could reduce the switching costs for consumers who used PayPal on eBay and begin to erode the business and scale that PayPal enjoyed—even if there was no guarantee this entrant would ultimately supplant PayPal.

C3 (The merit of co-founders—why are two heads better than one): Use Peter Thiel’s comments on the paradox of competing intensely in the A case to evaluate his belief that it’s better to have two (or more) co-founders than it is to have just one founder.

Early in the podcast, Thiel notes that although individuals get good at what they’re doing when they compete very intensely, they often “don’t ask enough critical questions about whether the thing they are competing on is really worth doing.” Having a second co-founder, especially when it’s someone with whom there is a long-term relationship and some history of productive disagreement (see the comment about how starting a company with someone you met a week ago is a bad idea), can help offer a needed reality check by providing a different perspective. That is, it is important to work with someone who offers divergent thinking, rather than someone who is just like you. Despite, or perhaps because of, their political differences, Thiel and Hoffman show the potential fruits of such a relationship.

C4 (Professional education and the entrepreneurial mindset): Evaluate Reid Hoffman’s and Peter Thiel’s comments about the disconnect between the challenges of working in a startup and the professional educations many students choose and assess whether pursuing the latter makes it harder to pursue the former.

The socialization provided by professional programs, especially regarding the emphasis on formal analytical tools in business schools and all the possible things that can go wrong in law schools, may intensify a desire for certainty that does not exist in the world of startups. In many respects, and consistent with Stevenson’s observation about what entrepreneurship entails, professional programs may inculcate the bias toward assuming the landscape is external—the exogenous approach—when startups involve attempting to reshape the world endogenously. Stated alternatively, an entrepreneur has to be willing to assume that she can overcome the odds of failure by being proactive even when the exogenous landscape would suggest otherwise.

C5 (Contrasting theories of strategic opportunity): Analyze the conditions when local search is more appropriate than positioning, and vice versa.

One of the interesting tensions within the Thiel podcasts is the extent to which Hoffman and he discuss PayPal’s journey as one that involves positioning. Yet, apart from the deliberate desire to scale, PayPal’s strategy and trajectory seem more about local search and serendipity. Gavetti and Rivkin (2007: 433) suggest this pattern is common, however, arguing that local search may be necessary early in an industry’s history (such as what PayPal experienced) because the environment is highly ambiguous at that stage. As industries mature, the ability to use more rational search mechanisms then increases. Nonetheless, the parameters discussed here (e.g., economies of scale and scope, network effects, learning, and switching costs) can guide a firm at least partially toward a choice of strategy. Such firms must still assess what good use cases are, such as those provided by the eBay community for PayPal, and work over time to figure out what a viable revenue-generating model will be, and those efforts will likely
involve more local search unless there are suitable analogies that can be ported from other industries (Gavetti, 2012).

**C6 (Setting managerial priorities): Use Reid Hoffman’s and Peter Thiel’s comments on triaging to the issues presented in the previous cases to consider whether any of the previous “fires” discussed were less important for them to “extinguish.”**

The podiums allude to the challenge of PayPal facilitating financial exchange even though it was not a financial institution. Although that issue clearly needed to be resolved in the long run, PayPal’s small size may have shielded it from too much scrutiny early on and given the company some freedom to experiment. This issue did prove problematic, however, when credit card fraud began to cost it significantly (see Eisenmann and Barley); one challenge companies face is figuring out when the fire is getting too big to be ignored.