

Star Gazer Vinod Khosla – Kleiner Perkins

Vinod Khosla was a co-founder of Daisy Systems and founding Chief Executive Officer of Sun Microsystems, where he pioneered open systems and commercial RISC processors. Vinod serves on the boards of Agami, eASIC, Indian School of Business, Infinera, Kovio, Metricstream, Spatial Photonics, Xsigo and Zettacore. Vinod holds a Bachelor of Technology in Electrical Engineering from the Indian Institute of Technology in New Delhi, a Master's in Biomedical Engineering from Carnegie Mellon University, and an MBA from the Stanford Graduate School of Business.

[start box] “I sort of think of myself as a private market investor and even then, somebody who focuses on technology, not private equity. I know nothing about public markets. I almost never trade in public markets just because I feel pretty incompetent when it comes to public markets.

From my point of view, focus is very important. As you might guess, from an investing point of view, you want to be in areas where you know more than the others do, which means you pick areas and then you focus in on those. I'm not a portfolio investor, unfortunately. I'm a focused investor.

Having said that, I also find that early stage growth markets, the kind that venture capital addresses, I like to say I fail often enough that it's worth picking markets, worth succeeding when you do succeed. So, if you invest like traditional business schools teach, you diversify your investments, preserve your capital and then focus on growth. My world is more about you can only lose one times your money, but you can make 50 or 100 times. That says two things. One, you do work in areas where you know you have some sort of a comparative advantage in picking growth segments. You pick areas where you have an advantage.

Large markets forgive a lot of mistakes. In the high growth segment, they tend to be newer markets. When markets are new, there's a lot about the market that's uncharacterized. To me, that is absolutely key to realizing that you won't understand all of it. You'll just be ahead on the learning curve compared to people coming behind you. I think the investing process is one of making the mistakes before others do and getting smarter about a market, but the market wave is large enough that it's quite forgiving while you're learning.

The other thing I like to see in these markets is short-term advantages and long-term advantages. In the end, the short-term advantages end up being generally technology.

You get some patents. There are technical advantages. Then the business strategy over time becomes how do you take a technical advantage and parlay it into a permanent long-term advantage.

If you look at what Apple has done, they took an iPod and basically their advantage was a better design and some neat technology, but nothing earth shattering. In the end they will have 50 million or 100 million people with their music library locked into their service. That's a permanent advantage; not a technology advantage. You start with your foot in the door, generally with a technology advantage, and parlay it into something more permanent. It could be brand; it could be locking into consumers; it could be distribution; it could be any of the traditional things that businesses talk about.

The other component of this is people. I find most people say they want great people, but they don't pay enough attention to them. When they do, they don't realize what having good people means, especially in growth markets.

Let me illustrate what I mean. It's okay to say you're looking for great people. It's much harder to say you'll take ten percent of the company's equity and give it to a great CEO. It's just not a decision too many people in the investment business will make, especially in the later stage of private equity. I'm always arguing about it.

If I find a great person who might be willing to join a company, I'm always looking to find an excuse, create a position within the organization so you can fit the person in as opposed to saying, oh, we don't need another head of marketing, we already have one. Every time I find somebody good, I will twist around the whole structure to try and fit them in as opposed to focusing on just what we need because the people add value independent of title.

To understand growth markets, there's a lot of stuff that's undefined, which means, as I said earlier, you're really going through learning about the market, you're just figuring it out ahead of everybody else by hard work and being smart. You need different points of view on a company.

Process matters in mature industry and process matters in growth markets too. But in growth markets what's different is instinct and sort of what I call an on organized chaos style of management. You need a team not only as a great process oriented manager who has all the right metrics, weekly staff meetings and corporate goals and evaluation against goals and bonuses, all the usual stuff of managing a company. You also need entrepreneurial instincts. That's much harder for a process-oriented person. That's where I think growth equity becomes a little bit different because entrepreneurial instincts become very, very critical unlike in your traditional industries where you pretty much know what works and what doesn't because people have already tried it. In new markets and growth markets we talk about that, that's not the case.

You need a different style of person who's willing to take more risks. For example, in a management style geared towards growth, you want to reward failure if it's an intelligent risk. You want to reward good judgment even if it doesn't always succeed.

Not only are people important and paying attention to people important, the mix of people is very important. I call that engineering the gene pool of a company that you have the wild guys and the process guys and the experienced operating guys and the guys who think what is impossible is doable. That's sort of that mix, the creative engine between the group. The constructive tension is really important.

It's not a sergeant style of management where you have a whole army marching in step. It's more like where you'll see a shepherd herding sheep in a general direction, but the sheep within are probably going left ward, right ward, and backward discovering new pastures of green grass. That's really sort of how you manage growth equity, you keep changing the trajectory and start dealing and experimenting at the edges of a herd, while the herd generally is following the direction. It's not the rigid management style where you lock in four or five year plans.

I find it's much easier to build entrepreneurial companies in markets that don't exist, but have the potential to be large than existing markets that analysts have covered in sort of defined metrics because the guys with the much higher resources generally ruin it. Let me give you a classic example on both sides. Nobody thought the market for Google was big enough when Google started, right? They took a different task to it. In fact the first market they were in was the online advertising market. Their business model centered around advertising was as important as their search technology. People thought it was a geeky start-up, but in fact, it was about adding advertising value proposition to small companies. Suddenly you could see a five or ten thousand dollar ad campaign. The guy I buy my sheepskin rugs from could have a thousand dollar advertising campaign. And if it paid off, he could invest another thousand.

So it was a change in business models and it was new. Contrast that to another high growth market like say Mobile. If everybody knows the market, then the guys with the biggest resources, the Verizons and Cingulars, are the ones who are going to win. So, this issue is picking markets that haven't yet been figured out. You have to pick your markets a little bit carefully to be much more focused on large markets that are what I call zero billion dollar markets. Picking markets makes a difference between the zero million dollar markets and the zero billion dollar markets. That takes vision and passion to differentiate. I always sort of look for zero billion dollar companies and I know when I see a zero million dollar company.

I'm spending a lot of time on energy because my other rule is every missed problem is a major opportunity. It's just a fact of life. Then there's – off the fringes – technical capability.

I like operating on the fringes. When I first mentioned synthetic biology a year and a half ago to people, they looked at me weird. In fact, 90 percent of biologists won't have heard of it.

But the problem with operating on the fringes is you never know what technology will have a huge economic impact. Much of nanotechnology has been sort of on and off. Basically, you can't have just an idea for a company that has technology without a market and a path to that market. There's some very promising markets impacted by nano-technology and I love looking at those.

Energy is an important area. Synthetic biology is on the fringes where technological change can cause a huge economic impact in major areas. Now, that's not to say there aren't opportunities where there's no technological change. I'm just saying that's not for me. I just focus on what I do well. So when people start doing growth retail investing, I stayed out of it. I didn't want to touch it because other people knew a lot more about retail than I did, but in an area like synthetic biology or alternative energy, where nobody knows anything, I can have an advantage." [end box]

