



Introduction

YAHOO! WE'RE RICH!





Some say it was success by accident. Others see it as the classic story of a Silicon Valley startup. And there are those who even tout it as the digital Horatio Alger tale of our time.

The story of Yahoo! is one that must be told because it combines an interesting array of elements and people coming together to make it happen. What started as a hobby between two graduate engineering students at Stanford University today ranks as one of the world's leading Internet media companies that offers a branded network of media, commerce and communication services to more than 155 million users worldwide (Yahoo! FQ2 2000 report) via a growing global network that includes 23 world properties.

Yahoo! continues to wow investors with strong growth, both in terms of revenue and traffic. Revenue jumped a whopping 120 percent between 1999 and 2000, from \$103 million to \$228 million. At the same time, the number of page views spiraled at a rate of 40 percent, from 465 million per day in December 1999 to 625 million in March 2000.

Even more appealing for analysts is Yahoo!'s gross margins of 86 percent. With \$1.2 billion in cash, the company owns a mere \$64 million in property, plant and equipment. (*Motley Fool*, April 6, 2000)

These are pretty impressive statistics for a company that, according to its founders, was born solely as a fun way to avoid doing their doctoral dissertations. And it certainly has made



them extremely wealthy in the process. According to *Fortune* magazine's inaugural list of *America's 40 Richest Under Forty*, 33-year-old David Filo holds the number 5 spot, having amassed some \$3.12 billion in wealth. His partner, 30-year-old Jerry Yang, follows closely behind in the number 6 position with \$3.05 billion.

Could such tremendous wealth and success actually happen by accident? Is this the classic American rags-to-riches story? Does Yahoo! represent a prime example of the Silicon Valley basement-to-big business model?

We believe Yahoo! incorporates aspects from all three scenarios. True, the company can trace its roots to "basement" beginnings, although in this case it's actually a trailer. The individuals involved did not come from wealthy backgrounds. And, yes, you could say there was a little luck thrown in.

But more important, the guiding principles that continue to drive Yahoo! – established by its founders and supported by other key players within the company – make this a valuable study in business management for the Internet economy. If it weren't for the vision, expertise and strategic style of the people behind Yahoo! – particularly its two chief Yahoos! – this certainly would have been a very different story.

HUMBLE BEGINNINGS

Jerry Yang was ten years old when he emigrated from Taiwan to the US, with his mother Lily, and younger brother Ken (his father had died eight years earlier). The family arrived in San Jose, California. While his mom worked as a maid to support



the family, Yang easily settled into the local school system as a straight-A student.

Meanwhile, David Filo was growing up with his architect father, Jerry, and his accountant mother, Carol, in Moss Bluff, Louisiana. During his childhood years, the Filo family lived in an alternative community, sharing a garden and a kitchen with six other families.

Their two paths did not cross until many years later at Stanford University. Filo, who had completed undergraduate studies in computer engineering at Tulane University in New Orleans, arrived on campus following his decision to earn a masters degree in electrical engineering. Yang, who had completed his undergraduate studies at Stanford in electrical engineering, stayed on for his masters degree. Both received their MS degrees in 1990, and soon started sharing an office in a campus trailer as electrical engineering PhD candidates working in the same electronic computer-aided design research group and supporting themselves as Stanford resident assistants.

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A labor of love

As students, the Internet became a daily part of their lives, starting with email and newsgroup postings, followed by Gopher – a pre-Web system developed at the University of Minnesota that organized and displayed content available on Internet



servers as a hierarchically structured list of files. But it wasn't until 1993 when the two got their hands on the earliest version of Mosaic – the first Web browser application developed by the National Center for Supercomputing Applications – that the future of Yahoo! appeared on the horizon.

By the end of the year, Filo's personal list of "bookmarked" Web sites had outnumbered 200. And Mosaic's "hot list" feature could not organize all these Web-site links into convenient on-screen folders. So Yang and Filo decided to write some software

that would help them locate, identify and edit Web-based content so their growing list could be organized into subject areas.

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– David Filo

Yahoo!'s founders are the first to admit that creating a business was the furthest thing from their minds when they started to compile the list.

"David and I were just fooling around on the Internet, making our own database of Web sites and clicking them onto our page," Yang recalled during a 1997 interview with *Money* magazine. "We didn't know what our list was worth. We just liked doing it." (*Money*, October 1, 1997)

Filo agrees, noting that Yahoo!'s beginning was solely a means for the two of them to keep track of Web sites that they found interesting. And at the start, it wasn't something they were willing to share. "It was just between us at first," Filo said during a May 1995 interview with Sun Microsystems' *What's Happening* newsletter (*What's Happening*, June 1995). But the duo did eventually float their directory on the Internet, using their two student workstations, which they named after two





famous Hawaiian sumo wrestlers. Yang's computer, named *akebono*, ran the original directory, while Filo's computer, named *konishiki*, ran the search engine. Even then, they never bothered to list their directory on any other Web sites or newsgroups. "A couple of friends started to use it," Filo added. "It just grew by word of mouth and by people linking to it from their home pages."

Although their directory (originally titled *Jerry and David's Guide to the World Wide Web* before they renamed it *Yahoo!*) was born as a hobby, not as a business, its potential did not escape the two graduate students. "I think from Day One, we believed the potential of what we created [was] huge," Yang told CNNfn correspondent Valerie Moss in 1997 (CNNfn, September 24, 1997). "So David and I really took this as a hobby, a labor of love if you will, for about a year and a half before we decided that we should take some venture capital and try to do this as a business ourselves."



Getting into shape

Early 1995 proved a pivotal time for Yahoo! For starters, Marc Andreessen, co-founder of Netscape Communications, offered Yang and Filo the opportunity to move their files over to larger computers housed at the company's Mountain View, California-based offices. This move, according to the company's history, proved beneficial to both Yahoo!'s founders and the university from which they took a leave of absence (neither Yang nor Filo received their doctorates). Stanford's computer network, which was suffering under the weight of increasing traffic to the directory, returned to normal. Even better, Andreessen was so impressed by Yahoo! that he made it the default directory



for Netscape's Navigator Web browser. Net-heads came to the site in droves, and Yahoo!'s legendary status began to take shape. But others in the business world were eyeing the site as well.

Offers abounded. Both Netscape and America Online reportedly offered to absorb Yahoo!, but Yang and Filo turned them down. "We didn't want to work for a big company," the pair said during their Sun interview in 1995. "We also thought our services would be better if Yahoo! remained an independent entity." So, the pair opted to set their sites on attracting venture capital. Not a bad move, considering that early 1995 proved to be a very productive time for young entrepreneurs with an Internet idea. They had no trouble attracting callers.

Kleiner Perkins, the largest Silicon Valley venture firm, approached the duo but reportedly wanted them to merge with Architext (now known as Excite), which was another search engine created by Stanford graduates. Yang and Filo declined. But when Menlo Park, California-based Sequoia Capital – which had helped fund Apple Computer and Cisco Systems – offered to put up \$1 million for a stake in the company, the business of Yahoo! Inc. was put into gear.

Yang and Filo have said that their decision to go with Sequoia Capital was two-fold: one certainly was the venture firm's reputation and track record, but the other factor was its support of the pair's vision to keep Yahoo! as a free service, not turn it into a subscription service. "Mike supports our vision, which is to make Yahoo! commercially viable without diminishing the spirit that makes it so popular," Yang told Newsbytes News Network in April 1995 (Newsbytes News Network, April 20, 1995).



In the same article, Moritz (who still serves on the company's board of directors) applauded the spirit and vision of Yahoo!'s founders which, he noted, was based on respect for the Internet community and its diverse needs. But the venture capitalist knew there was more to this arrangement. "Our attraction to Yahoo! was not only the vision of the founders, but its impressive success which happened seemingly overnight. We support David and Jerry's commitment to keep Yahoo! free for users," Moritz said, adding his belief that gradual integration of advertising and sponsorships needed to make the venture profitable would not jeopardize that promise.

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Filling the talent pool



With funding secured, Yang and Filo knew the next step was to bring onboard the talent they needed to make Yahoo! successful. Although they knew that people were needed on the business management side – although both had anointed themselves as chief Yahoo! – the pair focused first on maintaining the science that drove their directory. One of their first additions was Srinija Srinivasan, a Stanford alumna with expertise in artificial intelligence, who – with the title Ontological Yahoo! – was put in charge of organizing the branching hierarchies that steer people to content. Today she serves as vice president, editor-in-chief.

On the business side, Yang and Filo knew they had to gain management expertise and, along with Moritz, interviewed





numerous professional managers for the job of CEO. The search was extensive and, at times, interesting since some candidates were eager to talk about how they would shake things up if given the opportunity. One reportedly told the trio that his first action would be to change the name. Naturally, they immediately scratched him from the list.

The CEO search spotlight finally focused on Tim “T.K.” Koogle, a Stanford-bred engineer who at the time was president of Intermec Corporation, a Seattle-based manufacturer of data collection and data communications products. Prior to that, Koogle had spent nine years at Motorola where he held numerous executive management positions in operations and corporate venture capital. In 1999, Koogle was named chairman and continues to hold both titles.



The final addition to the initial management team in mid-1995 was chief operating officer Jeffrey “Sparky” Mallet, at the time vice president and general manager of Novell’s worldwide consumer division. Previous roles included being vice president and founding executive team member of Reference, acquired by Word Perfect Corp. in 1992. In 1999, Mallet was named president of the company.



In the public domain

With the management team firmly in place, an employee base exceeding 100, and no profit yet to be reported, 1996 seemed like the perfect time to go public. And Yahoo! did just that on April 11, when it offered 2.6 million shares of common stock at \$13 per share. That first day of trading proved historic as the stock rose 154 percent, beating the





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previous first-day record of 105 percent set by Netscape. The company's market capitalization stood at \$848 million. Yahoo! employees were ecstatic; management was a bit anxious over the \$35 million in capital that had suddenly flowed into the company. As Yang told *Fortune*, he felt "panic – no, not panic, but anxiety" at the realization that Yahoo! now had shareholders.

The following day, however, many shareholders turned skeptical and began to bail out. The stock fell to less than half of the previous day's close, prompting Manish Shah, publisher of *IPO Maven*, to sarcastically proclaim Yahoo! as Yet Another Highly Overhyped Offering – a reference to Yahoo!'s legendary acronym, Yet Another Hierarchical Official Oracle.

The stock price remained flat through the rest of 1996, but with the dawn of 1997 came several developments that started to propel the company toward its current leading position. For starters, Yahoo! began to see the results of its "guerilla marketing" campaign. In January of that year, Yahoo! reported that it had signed on 550 advertisers. Better yet, the company posted its first quarterly profit of \$92,000. And a mere three months later, Yahoo! proudly announced that Internet surfers were using the site to view 1 billion Web pages per month.

The rest of the story

Much has happened at Yahoo! in the ensuing three years. We'll take a look at those events in the upcoming chapters since they serve as prime examples of the following principles that have guided – and continue to guide – Yahoo!





- ◆ *Understand the medium and its message.* As pioneers of the first Internet search engine, Yang and Filo never lost touch with their audience or the medium they used to build their company. They remain steadfast in their vision to keep Yahoo! free for users, and to support the independent nature that online services can provide to them.
- ◆ *Put people first, technology second.* Yahoo! had the best name and the worst technology when it came to search engines. But Yang and Filo never wavered from their belief that the “human touch” incorporated in the Yahoo! categorization process would prove victorious. And it did.
- ◆ *Build local communities in the global village.* The Internet is indeed a global platform, but Yahoo! gained considerable strength through creation of local US sites that were later expanded throughout the world. The founders believed this was critical in making their service not just an online resource, but a “destination.”
- ◆ *Give users plenty of reasons for repeat visits.* Customization has been essential in Yahoo!’s success, starting with its My Yahoo! service. Add to that a growing array of services for younger generations of Internet surfers, as well as for business and commerce. It’s a big reason why traffic growth outstrips the competitors, and also a key to the fact that Yahoo! continues to record the longest average user time among all of the top-traffic Web sites.
- ◆ *Partner with the best.* Yahoo! takes its vision of remaining independent to heart. That’s why it has amassed an extensive and constantly growing list of companies it partners with to provide services and content that users want, all designed to





support its ongoing mission to provide users with the “best Web experience possible.”

- ◆ *Buy what you need.* Sometimes it’s better to acquire the technology or services you need. The key is to avoid having such acquisitions become a drain on the company’s bottom line. Within the past three years, Yahoo! has acquired some 14 companies, and each purchase has given rise to positive results for the company and its shareholders.
- ◆ *Brand it.* According to Filo, the most important factor in Yahoo!’s success has been its name. People would remember the name, even if they had no idea what the company did. These days, Yahoo! has been able to carve out a strong brand identity worldwide as a media channel.
- ◆ *Promote the hell out of it.* From their catchy slogan – Do You Yahoo? – to more eclectic stunts, such as a parachutist making an online purchase or employees tattooing the company logo on various body parts, the company has never veered from its marketing strategy of “Yahoo! Everywhere.” And it has successfully towed the line whilst avoiding the pitfall of overcommercialization.
- ◆ *Create a dynamic corporate culture.* Although every company needs some sort of structure to succeed, Yahoo! has built a fairly flat organization without much hierarchy. The work is dynamic; everybody’s plates are constantly full. And decisions are made on a distributed basis.
- ◆ *Stay paranoid.* Yang has said that Yahoo! is in the business of tracking changes. But the company also knows that the Internet will continue to change as it evolves into a true



mass-market medium. Competitors lurk everywhere, which requires flexibility and the ability to rethink services and new outlets to meet the changing needs and demands of customers.

YAHOO! TIMELINE OF KEY EVENTS

- ◆ 1990: Jerry Yang and David Filo receive their MS degrees in electrical engineering from Stanford University and later become part of the same research group as PhD candidates.
- ◆ 1993: Yang and Filo begin compiling a directory of favorite Web sites, write software to help them search and categorize their “guide,” and post it on their own Web page.
- ◆ April 1994: Yahoo! is officially born as Yang and Filo rename their directory.
- ◆ January 1995: Marc Andreessen, co-founder of Netscape, offers to host Yahoo! and make it the default directory for the company’s Navigator Web browser.
- ◆ April 1995: Yahoo! receives \$1 million investment from venture capital firm Sequoia Capital
- ◆ August 1995: After hiring Tim Koogle as CEO and Jeff Mallet as COO, the management team writes its first business plan.
- ◆ April 11, 1996: Yahoo! issues IPO of 2.6 million shares at \$13 per share. By close of trading, the stock has jumped 154 percent.
- ◆ April 12, 1996: Investors start to bail out, and Yahoo! stock drops to half of the previous trading day’s price.
- ◆ January 14, 1997: Yahoo! posts its first quarterly profit of \$92,000.
- ◆ April 1997: PC Meter survey cites Yahoo! as the number 1 search and directory guide for the Internet.
- ◆ May 7, 1997: Yahoo! announces that traffic across all Yahoo! properties reached 1 billion page views during the preceding month.
- ◆ July 29, 1997: Yahoo! announces 3-for-2 stock split.

- ◆ November 10, 1997: Mediamark Research Inc. cites Yahoo! as the online service with the largest US audience: 25.4 million unique visitors representing 63 percent of all adults using the Web.
- ◆ January 14, 1998: Yahoo! announces fourth quarter pro forma net income of \$.05 per share.
- ◆ April 8, 1998: Yahoo! traffic reaches new record of 95 million page views per day during the month of March, a 46 percent increase.
- ◆ July 8, 1998: Yahoo! announces 2-for-1 stock split.
- ◆ December 17, 1998: More than 3000 merchants participate in Yahoo! Shopping one month after its launch.
- ◆ January 12, 1999: Yahoo! announces 2-for-1 stock split; Tim Koogle is named chairman and Jeff Mallet is named president.
- ◆ May 25, 1999: More than 5000 merchants have taken advantage of Yahoo! Store commerce solution.
- ◆ December 27, 1999: Orders to Yahoo! Shopping increase more than 385 percent on the previous year.
- ◆ January 11, 2000: Yahoo! reports audience doubled in 1999 and now exceeds 120 million unique users.
- ◆ January 11, 2000: Yahoo! announces 2-for-1 stock split.
- ◆ April 5, 2000: Yahoo! posts \$228 million in revenues, \$63 million in pro forma net income.
- ◆ June 26, 2000: Yahoo! enters the highly competitive business-to-business marketplace with the announcement of Corporate Yahoo!
- ◆ June 28, 2000: Yahoo! signs agreement to acquire the email group communication service company eGroups.
- ◆ August 1, 2000: Nielsen//NetRatings' first-ever global Internet index crowns Yahoo! as the top Web property in the world with a unique audience totaling more than 62 million users, representing a stunning reach of 54 percent.

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