

Georgia's Business # 429

Guest: Chris Klaus CEO/Founder, Kaneva

Richard Warner: Welcome, I'm Richard Warner and on Georgia's Business this week, he founded a technology company in his Georgia Tech dorm room that IBM later bought for over a billion dollars. For his next act he's created a company called Kaneva that allows computer game enthusiasts to compete with each other and to hang out on line. For free. His name is Chris Klaus, and he's recognized as one of the countries leading expert in online gaming. Actually, I asked you, "What did you want to talk about?" And you said, "Virtual worlds," sometimes we feel like we live in a virtual - what is that in your orbit?

Chris Klaus: Sure, what we're building, or what is a virtual world is really an online community where people come meet. And ultimately it's taking gaming technology, the 3-D aspect of running around, if you've seen any of the video games now days they're pretty life-like. And where they're going, though, is with the capability of the internet, you can bring all these people together and start interacting, going to dance clubs and concerts and...

Richard Warner: So you have, and they're called Avatars, right?

Chris Klaus: Yeah

Richard Warner: You have some likeness of yourself whether it's real or not

Chris Klaus: You usually design yourself, yeah that's right. And you build out your character and you run around on the computer or on the TV set and meet other people though this

Richard Warner: They're Avatars

Chris Klaus: Your Avatar meets other Avatars. And behind each Avatar is a real person so we see a lot of relationships, a lot of friendships growing.

Richard Warner: Between Avatars. Do you know that this is really who the person is?

Chris Klaus: I think most people end up playing them self in our world, it really comes down to what kind of virtual world are you trying to build. In our case, we're asking you to be yourself. So most our users end up being them self, and dress up however they dress, and they'll upload photos and kind of verify here's who you're talking to. But it's been exciting because there's been a lot of, I call it "emergent" behavior, behavior that we did not expect.

Richard Warner: Would that mean behavior that you exhibit because they're really aren't any controls that you and I would have sitting here in person?

Chris Klaus: That's right. I mean ultimately we're providing the world as a sandbox. People come in, build their Avatar's, but then they're free to do all kinds of activities. And as they're meeting each other, one of the things that really stood out was a lot of people not only meet, but then they start dating, and next thing you know I'm getting requested to join part in the celebration of marriages and weddings.

Richard Warner: Is this real marriages or is this Avatar marriages?

Chris Klaus: Some of them are make-believe in the world, but there's quite a few, actually, that are real. And they bring in the real priest and they actually are getting married, online, because

Richard Warner: This is the behavior you didn't expect.

Chris Klaus: I did not expect that. The thought never crossed my mind that people would be planning to get married.

Richard Warner: Chris give me an example of one.

Chris Klaus: Well we just had one of our engineers, who joined Kaneva, I was talking with him and he goes, "Oh well I invited one of my best friends, he joined the world, and then over the weekend I had to go to his online wedding." And it turned out he was really serious and they had a priest and everybody was there and it was pretty interesting. So it's a way to bring people together from all over the country, or all over the world. And you can connect with people you wouldn't otherwise have met.

Richard Warner: Who share similar interests?

Chris Klaus: I think ultimately it's sharing interest, it's finding activities together, we have a lot of people creating dance clubs, we get a lot of DJ's.

Richard Warner: I'm seeing the demographic here. So we're talking 18-24?

Chris Klaus: It's actually - it's interesting. We skew younger like 18-34, but then I'd say we're predominantly more and more female.

Richard Warner: Really? I would have assumed male.

Chris Klaus: Yeah, you would think with video games, maybe more male but actually in our world, I think it's because of the activities. We have a lot of socializing, a lot of decorating; you decorate your home. You decorate these clubs. Within that you end up

with - we put a dance game in so people come in, start dancing, and getting points and as you get more points -

Richard Warner: Is my Avatar a better dancing than I am?

Chris Klaus: Yes. That's the feedback everybody goes, is they go in and they're like, "Finally I can do the lawnmower," or whatever, and next thing you know you're on the dance floor with everybody else. I still make mistakes, so I fall over, you know everybody's pretty friendly though.

Richard Warner: Do you earn online currency as you're doing things? Is that how you earn the right to put up drapes in your club?

Chris Klaus: That's right, that's right. And one of the things we're doing with Keneva is creating kind of a fame and fortune system where people can earn money, they can earn fame, they get experience points. They're actually getting status, so you can become the world's greatest dancer. And as you earn money, you're actually taking this-and it's really Monopoly money-you're off buying stuff for your house, you can upgrade your outfit for your Avatar, and what our users end up doing is a lot of them become builders. They're building out these huge city blocks and doing all kinds of neat real estate things.

Richard Warner: And I heard there are cases where people actually sell, for cash, they go on E-Bay or whatever and they sell their Avatar.

Chris Klaus: There's people who will sell their Avatar for sure. In our case, it's probably less so just because it's you.

Richard Warner: And who wants to buy me?

Chris Klaus: Yeah who wants to buy me, so within that, you know, a lot of games they end up doing that. In our case, they do end up selling-what we've done is we've encouraged fashion designers, where they're building out outfits and t-shirt designs and they're then in the world creating stores and selling it to other players. Because there's a whole online virtual economy that starts to manifest. It's kind of like a Monopoly game, but an infinite number of activities.

Richard Warner: You used the term Monopoly money, and I'm sure Chris would love to be paid in something other than Monopoly money. Where's the financial model for it?

Chris Klaus: Sure. I think one of the things that we've been practicing is a new model that I think more and more online businesses are looking at. And that's called a Freemium Model. So it's free to come in, and then what we do is we layer in premium services. So we upgrade people, so ultimately, kind of like Dave and Buster's: you can go in there and then if you want to start playing some of the better games you have to buy the bucket of chips. And in our case we sell a bucket of credits. And what we try to do is have a

balance. You know, you come in, you can play a lot of our games for free, but if you want to buy the big mansion, you can pull out your credit card and buy it that way.

Richard Warner: Or you can earn it?

Chris Klaus: You can earn it.

Richard Warner: You can earn it by doing things that earn micro points.

Chris Klaus: Yep, it's all about the micro-transactions. And what's interesting about it is the players love it. Because it's all make believe but they're having fun and they're enjoying the world.

Richard Warner: Well micro-transactions, I would imagine that younger people adapt to this faster than older people, but like with my iPhone - I can buy an application, make my iPhone do something brand new for 99 Cents. There are some people who won't spend a dollar under any circumstance for their iPhone, but then once you start doing it and you're paying a buck and its like, "Wow I'll just spend another buck, see what that one does." Do you find that there's that adoption model?

Chris Klaus: Yeah, very much so. You know, ultimately, they can earn it, or in a lot of cases, our users end up you know what, I'd rather just put it on my credit card and buy the virtual money and that way they can build faster, get to the levels that they want to at a much faster pace.

Richard Warner: So I would imagine that on the back of an envelope when you created Kaneva, Latin for Canvas,

Chris Klaus: Canvas, that's right

Richard Warner: You envisioned a worldwide audience of potential customers doing micro-transactions, that's fine, did it pan out the way you thought it would?

Chris Klaus: You know it's interesting. It's a blend of this 3-D world technology. Underneath it we've been really focused on two core pillars: one is the media. We're really focused on entertainment. So we've got a lot of our players going after, creating music in our world - we get a lot of DJs, real DJs that are testing out their tunes, and you go into these virtual clubs and you end up, there's a party all night and they'll see if their newest mix tape works.

Richard Warner: Can you buy that mix tape? Do they own that music?

Chris Klaus: You would have to buy it from them; we're not selling the music.

Richard Warner: Alright, so that's part of the model. You as a participant can raise money yourself.

Chris Klaus: Raise awareness. A lot of musicians just want to get their name out there, build awareness. The other thing is we partner with Turner, with TBS, TNT, we're able to bring in shows like Family Guy and a lot of their TNT shows -

Richard Warner: To do what?

Chris Klaus: Well everybody has a home in our world where-

Richard Warner: So Stewie's got a home?

Chris Klaus: Well he's got a home in there, so you can actually visit Family Guy's home. And within that, you can actually watch different TV shows with other fans. And you can be chatting with others as you're watching these shows together. So it's kind of like that Mystery Theater.

Richard Warner: Science Theater.

Chris Klaus: Science Theater, yeah that's right.

Richard Warner: I forgot about that. The game tap Turner Property, which was an online, I don't know how that's different then yours. Subscription, I think, was their business model, did not do what Turner anticipated that it would do. Now I believe Game Tap is still alive, but if I'm correct - it's not a Turner Property? Are they selling it?

Chris Klaus: I think they sold it, that's right.

Richard Warner: Well, so clearly, while there is potential at least in some cases, big companies with smart people weren't able to crack it. Are you going to crack it?

Chris Klaus: Um I think we're cracking it right now. Initially, you know, it wasn't sure whether these micro-transactions would work. Meaning, "Hey I'm going to play the game for free, why would I ever actually spend money?" But our users really are enjoying it and it's for them, for a lot of those players that are in there, for them it's actually a pretty low cost entertainment solution. Compared with going to the movies or going out to dinner. And as people are looking to save money, they're actually in our world probably having just a much fun, if not more because they're meeting people from all over the country. We've actually added a lot of social networking features. And so part of social networking, if you're familiar with Facebook or MySpace, allows you, really tries to bring your friends in with you. And what's been exciting is when you enable those kinds of features, it takes like one guy from one part of the world - and two weeks ago we had somebody from Romania come into our world, and wasn't really on our radar of concerning Romania but we have like 200,000 Romanian's show up in our world-

Richard Warner: As a result of?

Chris Klaus: Well of one guy telling

Richard Warner: It just grows?

Chris Klaus: Yeah, tells one friend

Richard Warner: Tells another, tells another

Chris Klaus: that then tells 20

Richard Warner: There's a commercial like that

Chris Klaus: Yeah so it's been fascinating. For awhile there, you go to a party and everybody's speaking Romanian, you know, I didn't know what they were saying but it was fun. So we're helping create a Romanian center, and a US center, and now a lot of International places to go.

Richard Warner: Kind of a personal question here: You can afford to do, and we'll get into that in a minute, anything you want. Based on ISS - you're previous company that you created. You could make this into anything you want - you could fund it, you can grow it. The bottom line is not an issue, or is it? Are you running it like a real business?

Chris Klaus: Yeah I think we are running it like a real business. I mean ultimately for us to really grow it, it's got to be a successful business and that's why we're making sure that we're putting in the right monetization strategies. I do believe, long term, the online worlds - these are the next generation of video games - will be the next way to provide entertainment. And what I mean by that is even video games today you have to pay \$50 at the store. What's exciting about this is by making it free, the video games, we actually get a much bigger audience than if you were trying to charge up front. But then through all these little micro-transactions, we're actually making more money than through the traditional video game, which is pretty fascinating to me.

Richard Warner: Walter Isakson is a former president of CNN and used that exact analogy as how America's newspapers need to save themselves. Give it away - because you know print editions are collapsing under their own weight, so give it away online but charge micro-transaction for certain articles, or back issues, whatever.

Chris Klaus: I could see that happening because our user, you know, you pay \$10, \$20, hundred dollars for these buckets of credits - and once it's in a virtual, Monopoly money, users just, "Hey, I'm interested in this, I'm interested in that, I'll spend ten cents on this, twenty cents on that," Because you know it, you've used up your bucket and you're back to the well again so buy more virtual content.

Richard Warner: This is Chris Klaus 2.0. Chris Klaus 1.0 was in a Georgia Tech dorm room. What happened?

Chris Klaus: With the dorm room - fortunately I've been very blessed in that my passion around computers really stemmed in two areas when I was a kid. One was video games, which now I'm going back to pursue

Richard Warner: Atari or whatever

Chris Klaus: Atari and PacMan, and all that. And you know saying hey thing things I liked about video games I'm really going to explore - which was all about multi-player and connecting with people. The other passion I had was computer security. Which was-

Richard Warner: You had a passion for computer security?

Chris Klaus: Mostly because of the video game aspect, in that it was good guys versus bad guys. Meaning if you look at internet security system - it was really founded on trying to understand how hackers hack, how do they break in? And then more importantly, how does the company I started develop technologies to stop those bad guys. So a lot of the security companies prior to internet security systems had been focused on encryption, and they kind of just focused on trying to make good stuff more secure. I focused on, or ISS really focuses on what do bad guys do? And really get into understanding that mind set, and how do you keep bad guys out? As opposed to allow good guys in, and so the entire infrastructure that ISS' mission was to protect the internet from bad things on the internet.

Richard Warner: So was it Chris and - I mean did you call people into your dorm room or did you get a room down the hall or something and gather a core group of people who were skilled at the same thing you were?

Chris Klaus: You know what, fortunately with the internet - this was in late '80/early '90's this is before the internet even had a browser, it was going on there I was fortunate in that one of the things I was able to was find a summer job through the internet, which is probably common now, but back then it was all government and military sites and I found a summer internship with the Department of Energy. And while I was out there, their networks were being hacked by a lot of hackers, especially from Germany and the KGB, and there was a lot of

Richard Warner: Really?

Chris Klaus: ..attacks back in the late '80's.

Richard Warner: And not much sophistication in stopping it.

Chris Klaus: And there was no sophistication. In fact, I looked for security books and there was like two of them, and they said, "Change your password."

Richard Warner: Change it to "Password"

Chris Klaus: Yeah, change it to "Password," and so I knew there was more to it. I just went on to the internet and anybody who could spell computer security I started emailing and saying, "Hey I'm working on this project, I'm at Georgia Tech, was going to that school," and had people from around the world saying, "Oh hey here's way that you should be stopping hackers." And so I took all that information and automated basically the first, what they called, "Vulnerability Scanner." And it's like checking the building to see what doors and windows are open, and telling you, "Oh this door is unlocked." And then I'd generate this report that would say, "You need to lock the door and close these windows." And from that, that was what I really sat for free -

Richard Warner: Called what?

Chris Klaus: Internet Security Scanner and it was called ISS. And hence, later on, I was like, "What do I call this company?" So, Internet Security Scanner was the product, and then I said, "Well what about internet security systems," which was the company name.

Richard Warner: And it was, product number one, was free.

Chris Klaus: It was free.

Richard Warner: Well received?

Chris Klaus: Very well received. In fact, the-they're called the computer emergency response team that's sponsored by the federal government. They had called me up and said, "Hey we saw that you released a software for free on the internet and it's helping a lot of people find issues with their network and they're able to fix it," and the guy I was talking with said, "Have you ever thought about commercializing it?" And I sat there and, sitting in Math class I started calculating if I could charge a dollar for every vulnerability I found

Richard Warner: Micro-payments

Chris Klaus: With this product, basically micro-payments, and within 6 months of releasing it for free, I announced a commercial version.

Richard Warner: "I announced." It's Chris' product?

Chris Klaus: Yeah

Richard Warner: This is Chris.

Chris Klaus: Just I was kind of programming it completely at that point, and I got a check for \$5,000

Richard Warner: Yeah baby.

Chris Klaus: Yeah, yeah I was like, "Woo Hoo!" And it came from an Italian research center. So it was out of-not even from the U.S.

Richard Warner: Out of left field.

Chris Klaus: Yeah. In fact, the ironic thing is all my customers for Internet Security Systems for the first, probably year to two years, were all outside of Georgia. Which was the power of the internet, you know, I was looking for business people in the Atlanta area are fortunately found Tom Newnan who became my partner, and later became CEO of Internet Security Systems.

Richard Warner: So I got to ask: Now Tom was already your guy, your business partner who was the true business side. I mean you're the entrepreneur, you're the Tech student. He's the suit.

Chris Klaus: Yes.

Richard Warner: How big was the company when Tom joined you?

Chris Klaus: So I started out in my dorm, getting that \$5,000 check helped and convinced me to call up my dad and my grandmother - my grandmother lived here, she was one of the reasons I came to Atlanta. And I asked her if I could use her spare guest room as ISSs' first headquarters, and was very fortunate she said yes. And so I moved in with her and it was like a one little bedroom office and bed.

Richard Warner: That's not when Tom joined you.

Chris Klaus: No, no. I did that for about a year, and the ironic thing is I had the Department of Energy - the one I interned with - I went back and sold the software, like five different copies, at least five or six copies, you know, to Sandia National Labs, Oakridge National Labs, Lawrence Livermore, etc, etc. and at that point - and the funny thing with those labs were when I first tried to sell it to them, you know, I had worked out pricing based on how big is the network that they're trying to protect, and I was trying to charge like \$50,000 and the gentleman was like well for \$30,000 we don't have to go through all this approval

Richard Warner: Fine!

Chris Klaus: And I was like Fine let's - and that way I don't have to fly out there

Richard Warner: I want it by legal.

Chris Klaus: Yeah, yeah, and so sold quite a few of those 30K deals, set up ISSs' official headquarters off of Miller Court in Norcross and that's when I was like, "Well now I got three offices and I'm ready to-"

Richard Warner: I got the dorm room, I got grandma's house, and I got

Chris Klaus: Now I can double the size of the company, and that's when I went out and found Tom Newnan.

Richard Warner: So the other thing I wanted to know, you know, is that this is all, looking at it from standing outside looking in and wondering - you stepped back and one of the hardest things for an entrepreneur to do with the baby that he creates is step back. Any emotional ping pong as a result of doing that?

Chris Klaus: You know, fortunately, I think, you know, I was- a couple of things - I was very fortunate to find people early on with internet security systems, Tom obviously was a massive part of the success, but I think the team we put together early on, people you could trust, hard working, and really worked together, I think I was very fortunate that I could trust the people that we brought together. It definitely, you know, when you are giving up part of your baby that you've been working on for a couple of years now -

Richard Warner: And this is your brass ring - you've got to be careful with these decisions.

Chris Klaus: Yeah so I definitely took the time to make sure I was connecting with the right people and checking references and everything, but ultimately, you know, I think part of the decision process was, you know, do you want to own a small piece, or the whole piece of a pea, or do you want to own a slice of the watermelon. And you know looking at the bigger picture, I knew that I wanted to grow the business and knew I was going to have to bring in the right people and the right team, and it is challenging though I think for any entrepreneur-anybody to give up control. But fortunately, you know, I think looking at the people we did bring in, it was definitely the right choice.

Richard Warner: No regrets.

Chris Klaus: No regrets. I think, you know, couldn't ask for a better team, you know, both from very fortunate to have not only Tom, but when we went out to the venture capitalists, I know there was a million horror stories, but our VC's actually stayed with us even after we went public and up until we sold it just a couple of years ago. And that's very rare to have that kind of a board supporting the company from start up to acquisition.

Richard Warner: The Company is called Kaneva, K-A-N-E-V-A.com, Chris Klaus, it was a pleasure.

Chris Klaus: Thank you. Good to be here.

Richard Warner: Thanks for being with us. And thank you for watching. You can catch a replay of this broadcast on the radio in Atlanta on WCFO, that's 1160 AM. You can also listen on iTunes, just do a search on Georgia's Business, you can get the audio track

from the show. And you can sound of to me directly at RichardWarner.com. And now for all of us here at Georgia Public Broadcasting, thanks for watching, I'm Richard Warner. And until next week, don't sell yourself short.