Lost in the Valley

The heart of America's high-technology economy has only itself to blame for the downturn, argues **Bijan Khezri**

PERSONAL VIEW

Silicon Valley is depressed. But its problems are not simply the result of excessive risk-taking, or the slump in the Nasdaq, or the dramatic decrease in US corporate spending on information technology. These explanations are too money-centric. The Valley itself is to a large degree the cause of the US technology sector's recession.

The pace of knowledge creation in Silicon Valley remains unparalleled worldwide. But in the past five years, money rather than entrepreneurs assumed an excessive and distorting importance.

How did we get here? Nasdaq's appetite for technology stocks dramatically accelerated the way business got done in the region. Venture capitalists, seduced by the prospect of quick exits via highly valued initial public offerings, could not evaluate and execute investment opportunities fast enough. Silicon Valley law firms increasingly became gatekeepers: well established venture capitalists would not waste time looking at a business plan unless it was sponsored by a recognised Silicon Valley lawyer. Entrepreneurs spent more time on lobbying the network than on building companies.

The Valley's historically highly competitive ecosystem, consisting of entrepreneurs, academics, lawyers, venture capitalists and investment bankers, has mutated into an introverted and excessively self-confident club. The system has become obsessed with "Who do you know?" and "What big have you done lately?"

The Valley's labour mobility, once a crucial competitive advantage, has become a hindrance to building and managing a business. To avoid excessive staff turnover, highly leveraged share option packages have had to be provided and systematically upgraded. The region has created an unsustainable level of leverage that can probably best be measured against the speed and vehemence with which falling equity prices have had an impact on real estate. Property prices have fallen by at least 30 to 40 per cent in six months.

Of course, Silicon Valley has a remarkable history of ups and downs. In 1957, Hewlett-Packard went public on the New York Stock Exchange and, consequently, provided a showcase for how a high-technology start-up can provide an exit route for its investors. Since then, Silicon Valley has attracted ever-increasing numbers of entrepreneurial and financial risk-takers and ever more greed. Risk-taking has not only facilitated efficient resource allocation but has also given the area its outstanding regenerative power.

The problem today is that Silicon Valley did not stick to its core activities of nurturing entrepreneurs, focusing on usable innovation and creating and building strong and independent companies. In the 1990s, the Valley switched its resources to building and maintaining a machine dedicated to selling companies – in many cases, companies that were just being formed.

Company formation and venture capital support have become distorted by an obsession with identifying technologies that could potentially be acquired by the big information technology and networking players. Strong equity capital markets – driven largely by the vision of a new high-growth and low-inflation internet-based economy – provided in most cases a credible initial public offering strategy and allowed venture capitalists to bargain from strength with potential buyers. As a result, many companies went public far too early. Disillusionment was bound to follow. This money machine encouraged innovation for the sake of innovation. Instead of its usefulness to the end-user, technology's saleability to a corporate acquirer or to Wall Street, has become the primary concern. The consequences largely explain today's demise of the technology sector. People around the world are questioning the value proposition.

Intel's Andy Grove summarised the dangers of excessive innovation as follows: "We make a cult of how wonderful it is that the rate of change is so fast. But what happens when the rate of change is so fast that before a technological innovation gets deployed, an innovation sweeps in and creates a destructive interference with the first one? . . . These things are just tumbling on each other and the result could be a traffic jam in which users and suppliers and investors are all choking." This is where we are today.

Silicon Valley should go back to its roots: nurturing entrepreneurs and building sustainable businesses for profitable innovation. Unless the Valley revitalises its core, it will neither have a credible value proposition nor be able to drive the engine of US productivity growth. As the US historian Stuart Leslie said of the manufacturing process of microwaves in the 1950s, the foundation for the subsequent success of Silicon Valley's microelectronics industry: "To get one right you pray over it, you nurse it, you make love to it."

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