

Despite perceptions and some predictions to the contrary, the prospects for growth in Silicon Valley are as strong as they ever were. While the boom/bust cycle of the last decade may be seen as the downside of a turbo-charged industry, it is also a requirement of dynamic markets characterized by constant innovation and unexpected upheaval.

In 2003, the mood and business appetite in the valley between San Jose and San Francisco, California are reminiscent of the same region in the late 1960s and 1980s. During those bust periods, Silicon Valley was flat on its back. Prospects then, as now, appeared dim. Technology spending was down, U-Haul rentals heading out of town were up. Companies were suffering, thousands of technology workers were laid off and, as the job and tech markets languished, people began questioning the long-term viability of the area as the world's most prominent technology center.

What happened then? In the 1960s, there was the integrated circuits boom. In the 1970s and 1980s, PCs and workstations drove the upswing. In both cases, one of the most remarkable things was that no one – not the most informed insider or the most innovative technologist – predicted or even anticipated the technologies that would spur them.

Silicon Valley has hit bottom. That's the bad news. It's also the good news, because we've returned to a healthy environment for venture investing while potential opportunities continue to percolate all around us.

Innovative environment

The conditions in Silicon Valley that fueled previous growth cycles have expanded and strengthened. The infrastructure of investors, capital, engineers, developers and service providers, including professional service firms and lenders supporting entrepreneurs, is stronger in Silicon Valley than in any other place in the world. Beyond that, the need for technology of all sorts continues to grow. The continued push for business productivity and the need for a clearer perspective on world events, the ageing population and environmental responsibilities are examples of the factors driving demand for innovations and technologies in such areas as security, privacy, defense and healthcare.

In addition, venture capitalists, who invest more than one-third of their dollars in Valley-based companies, collectively have more than \$53 billion available to deploy. To be sure, VC investment has fallen dramatically in the past three



Silicon Valley returns to the fundamentals

Innovative boom technologies may be difficult to predict or even anticipate before they arrive, but conditions are right for recovery in the Valley, argues **Marc Verissimo**, chief strategy and risk officer of Silicon Valley Bank.

years, but it shows signs of stabilizing.

For those looking for predictions about the next big thing and when it will arrive, we must say, don't waste your time. Silicon Valley is not about specific technologies or even business sectors. It is about innovation as a whole – innovation that will drive new markets, new opportunities and, eventually, financial growth. Despite the ability of opportunists to make a killing during boom times, the innovations responsible for generating long-lasting value and far-reaching ecosystems in and beyond Silicon Valley come from long-standing contributors at unlikely times. While Pets.com made an impression on the advertising industry, its impact on the remaining Internet-enabled business sector is questionable. The same is true

with venture capital returns. Venture funds created in the years leading up to the booms tended to have better overall returns than those created in the recognized 'bubble' years.

Innovation, the soul of the technology industry, is alive and well here. Silicon Valley's unparalleled infrastructure still makes it the best place in the world to start a technology company. There is easy access to highly qualified, experienced engineers and technology workers. There is a robust ecosystem of legal, financial, consulting and marketing firms that specialize in supporting technology companies. Despite the upheaval of the last four years, the Silicon Valley culture continues to encourage risk and be respectful of failure. As in much of the rest of the country, the cost of starting a



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Illustration: Paul Wearing/Heart Agency

generate an idea in January, go public in June and cash out in December.

The net result of this refocusing on fundamentals is that Silicon Valley companies today have wrung out the excesses, are running leaner, and are better positioned to increase net income and profits when technology spending picks up again. Cheaper, better, faster technology has, in and of itself, contributed to the future growth of Silicon Valley. Technology has been able to cut significantly the cost of innovation, and sharing and developing new ideas. Regardless of the next innovation to capture investors' imaginations and dollars, technology's role is not likely to change in that respect.

Overcoming challenges

While prospects are strong, challenges do exist. Commonly cited hurdles to Silicon Valley's reinvigoration include an ailing world economy further hampered by war and terrorist events; potential challenges from emerging world tech centers such as Bangalore or Munich; and the declining fortunes of nearly every company in the U.S.

Some of these hurdles are beyond our control. As long as world events continue to impact consumer confidence, growth will remain stunted. Until corporate IT spending picks up, prospects may continue to appear dim. Nevertheless, these challenges will be offset in the long term by the need for new technologies and new ways of doing business, and the indomitable entrepreneurial spirit that has given the Valley its unique character.

Other barriers are imaginary. Burgeoning tech hubs worldwide are additive to Silicon Valley's progress and potential. Far from diminishing opportunity in the U.S., new markets worldwide will create more opportunities for growth in both the technology and life sciences industries. For example, the ability to outsource essential-yet-commoditized programming functions to India frees U.S. companies to focus their intellectual resources on new innovations. The emergence of software and device companies elsewhere in the world creates new customers for hardware and chipmakers here in the U.S.

Time to invest

Beyond these considerations, there is a tendency among many people to think of the boom years of the late 1990s as a phenomenon that will never occur again. To a certain extent, this is true, as the heavy investment and idea harvesting of that period were driven in part by a sense of invulnerability that

business is substantially lower today than three or four years ago, when rents for precious commercial space skyrocketed, and compensation for any living, breathing person to do the work followed suit. Since then, a roughly 30 percent office vacancy rate has resulted in significant drops in commercial rental rates. Silicon Valley salaries, bonuses and incentives have come back down to earth, and so have workers, most of whom are grateful to have employment.

Back to basics

Today, venture dollars are being distributed in more reasonable and sustainable amounts by chastened investors. The heightened scrutiny of a smaller number of companies receiving funding is leading to the old-fashioned kind of decision-making – based on business fundamentals – and, ideally, to better returns in the long run. While not every deal that sees the light of day today will succeed, the bar for viable business plans and revenue generation has been raised significantly.

Entrepreneurs and investors alike are aiming to build companies over five to seven years, rather than taking a company public in six months. This is in stark contrast to the late 1990s, during which Internet entrepreneurs pitched ideas to potential investors on a napkin over breakfast and were funded before dinner. Investors' due diligence periods were dramatically reduced and it was not uncommon for an entrepreneur to

Eight reasons to be optimistic about Silicon Valley growth:

- \$53 billion in available venture capital.
- Human nature breeds innovation; entrepreneurial spirit remains.
- Easy access to the greatest concentration of raw material that fosters innovation.
- Contracted economy results in better companies, ideas, business plans and potential managers being available.
- Strongest infrastructure to support new and established technology companies.
- Cost of doing business has declined.
- Venture investments are now being distributed with more careful analysis of the business prospect.
- Silicon Valley companies are running leaner while maintaining or increasing productivity.

led many investors and business leaders to make decisions that would not have held up in less abundant markets, let alone pass muster in today's recessionary climate. The fact remains, however, that the Internet boom, like the PC and semiconductor booms before it, was not predicted by anyone and, in fact, crept up on an entire industry that originally thought Marc Andreessen's browser software might be nice for viewing online animation.

The last few years have made it clear there are no sure things, but when it comes to searching out areas for future growth, no one will go wrong betting on Silicon Valley. The most fundamental rule in investing is 'buy low'. If we are, as many investors and business people believe, at the bottom of this cycle, now is the time to invest. The markets are over-corrected to the low end of the spectrum. When we see small-cap, public companies trading at or below their cash balances, we know something is wrong and is ripe for correction.

History offers another reason for investors to move now. The biggest winners of 1999 invested in technology in 1994. Regardless of what comes next, surely Silicon Valley will have everything to do with it and those investing in technology and this region will be the biggest winners. ■

Marc Verissimo is chief strategy and risk officer at Silicon Valley Bank (NASDAQ: SIVB).

Silicon Valley Bank serves emerging growth and middle market companies in targeted niches and has grown to become the U.S.'s largest independent bank with \$5.6 billion in assets. After 20 years in business, it currently serves more than 9,000 clients.