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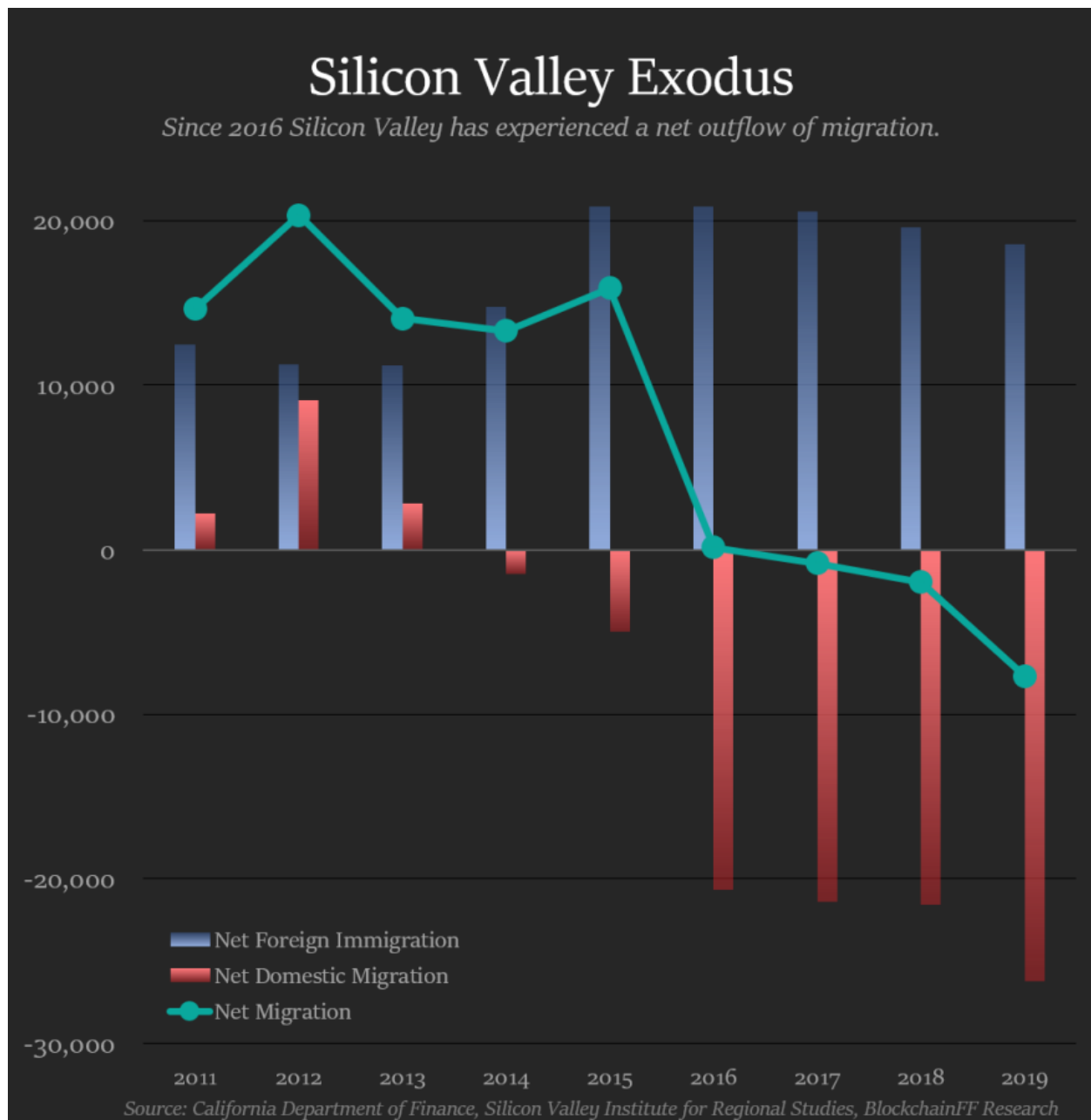
# How Silicon Valley Ate Itself – and What Comes Next



By Aly Madhavji (INSEAD MBA '16D), Partner at Blockchain Founders Fund, Sameer Hasija , INSEAD Dean of Executive Education, and Mike Grandinetti , Co-Founder & CEO of Global Venture Catalyst

**The Valley's pre-eminence isn't going anywhere, but its special gloss has faded. And that's a good thing, for both society and the future of innovation.**

Silicon Valley has been a global hub of innovation for several decades. The Santa Clara Valley is home to many of the world's largest tech giants, a sprawling ecosystem of start-ups, entrepreneurial talent and, most critically, risk capital. However, anyone looking at the exodus of businesses and talent from the region might argue that it has already peaked, and it's all downhill from here.

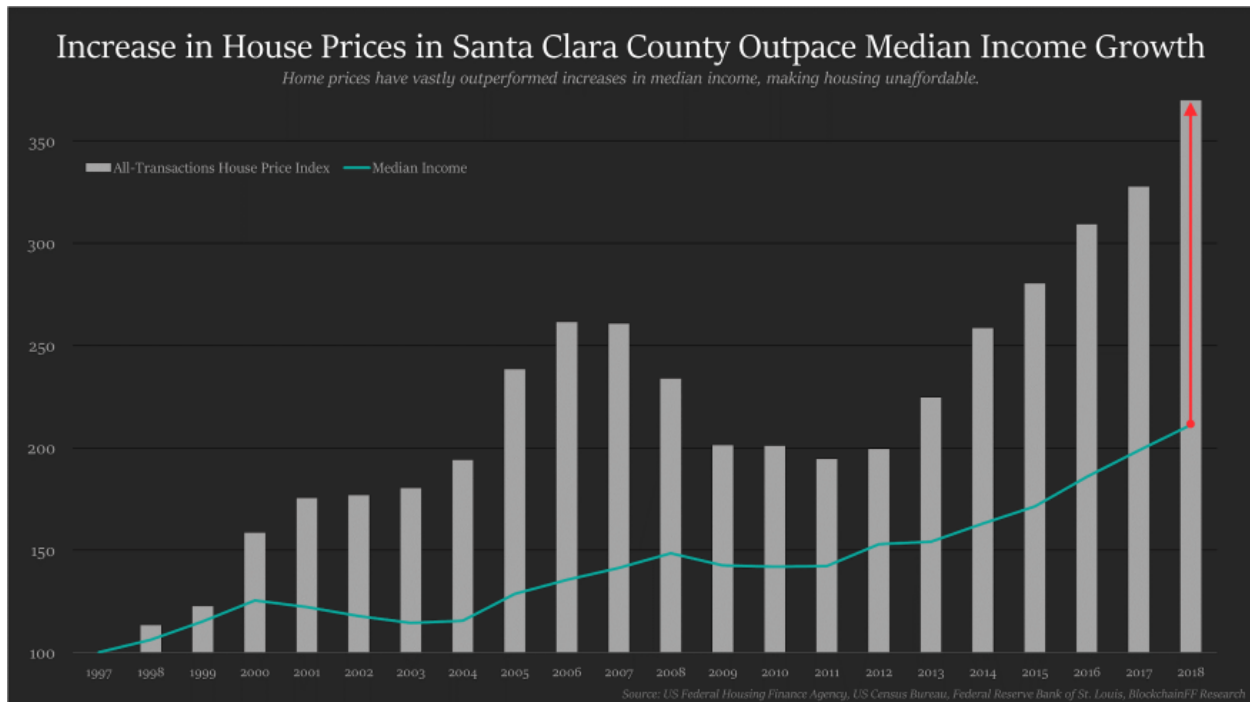


In fact, *The Economist* first reported on this theme in September 2018 with its provocative cover story, “**Peak Valley**”. While moderating panels at MIT and in San Francisco, one of the co-authors of the article you’re reading had a chance to ask several Silicon Valley luminaries what they thought of *The Economist* story. He was met with deep denial each time. Yet, two years later, there is no denying that this trend is real.

In 2017, the Valley witnessed negative net migration for the first time in decades, a trend that continued through to last year. Recently, many icons such as HPE, Oracle, JUUL, **Tesla**, Dropbox, Tanium and Palantir have

announced that they're re-establishing their HQ in other parts of the United States or have already moved. Another example is the Founders Fund, a renowned VC fund currently looking at various cities across the US for its new major office location.

## The Valley eats itself



To an extent, the Valley may have been the victim of its own success. As the region became one of the wealthiest in the world, with a median income well over US\$100,000 per year, a steep rise in home prices and rents pushed housing costs beyond the reach of even those making in excess of US\$10,000 per month. And the fact that California's income tax rates are the highest in the US almost certainly helps explain why swaths of new start-ups are relocating to cities like Austin and Miami.

In addition, the culture of the Valley has evolved from creating multi-billion dollar companies to working for them. It's impossible to attract good talent when the largest tech corporations are offering their employees stability and high incomes that start-ups can't match. Increasingly, the combined market power of Apple, Facebook, Google and Twitter (Amazon Lab126 has an outsized presence in the Valley as well) has had a chilling effect on start-up formation and success.

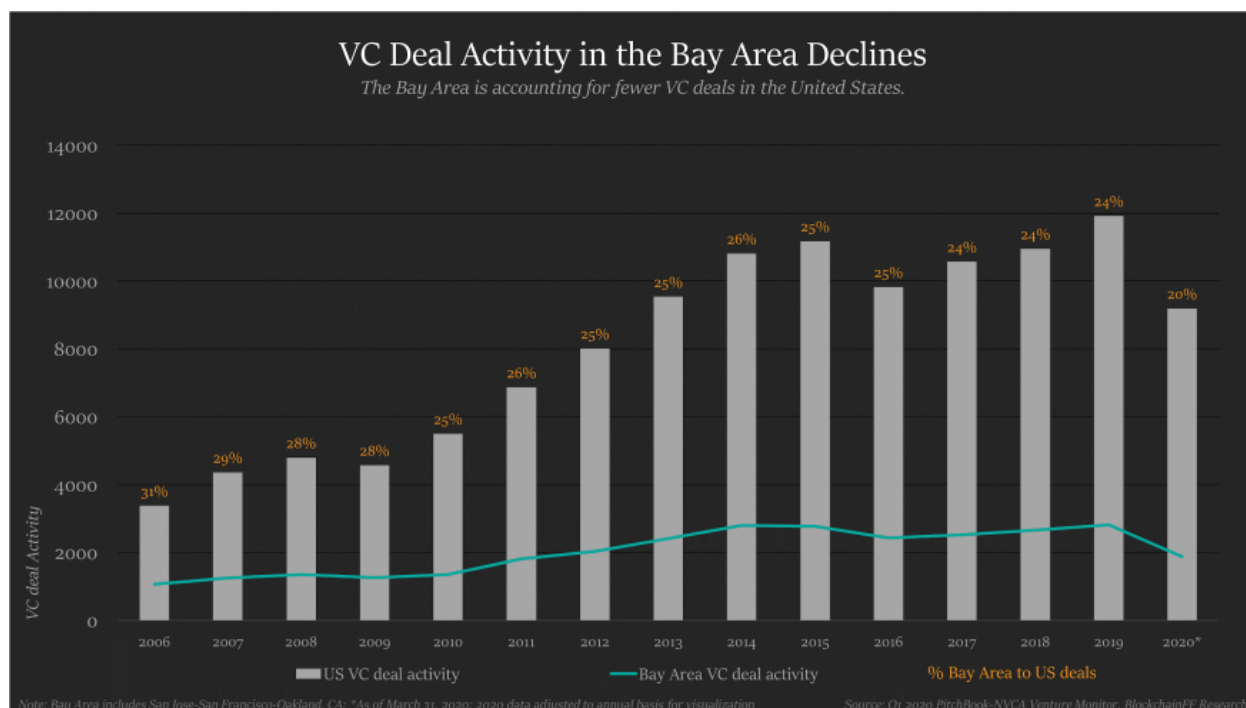
Covid-19 is accelerating what looks to be the demise of Silicon Valley as an incomparable super-hub. Tech firms have moved to work-from-home (WFH) policies giving employees options to reside in more affordable regions. For example, Salesforce, having only recently built its massive office tower that redefined the San Francisco skyline, issued a new, permanent WFH policy.

Innovative companies have found that they can function remotely just as well as if employees were in the same physical space. This would be unthinkable without the tools created by Silicon Valley-based companies such as Zoom and Slack. Over the past decade or more, then, the Valley has been chipping away at its own reason for being.

### **Dispersed deal-making**

That's not to say the Valley doesn't have significant clout. It still hosts the largest number of unicorns in the world and attracts thousands of highly skilled tech workers, more than half of whom come from outside the US. Its "brand" as the world's premier capital of tech innovation remains very much intact, exerting on fresh talent a powerful magnetic pull that is unlikely to ebb quickly.

According to Pitchbook/NVCA data, in 2019, more than half of VC deals in the US were closed in the state of California, more than 2.5 times the next big state, New York. In sheer value terms, California takes an even greater lead with more than US\$65 billion in VC transactions, most of which is centred around Silicon Valley. San Francisco and San Jose alone account for 45 percent of all VC investment in the US and outpace their peers several times over in terms of capital per capita. It shouldn't be a massive surprise, therefore, that most of America's unicorns are situated in California and centred around Silicon Valley.

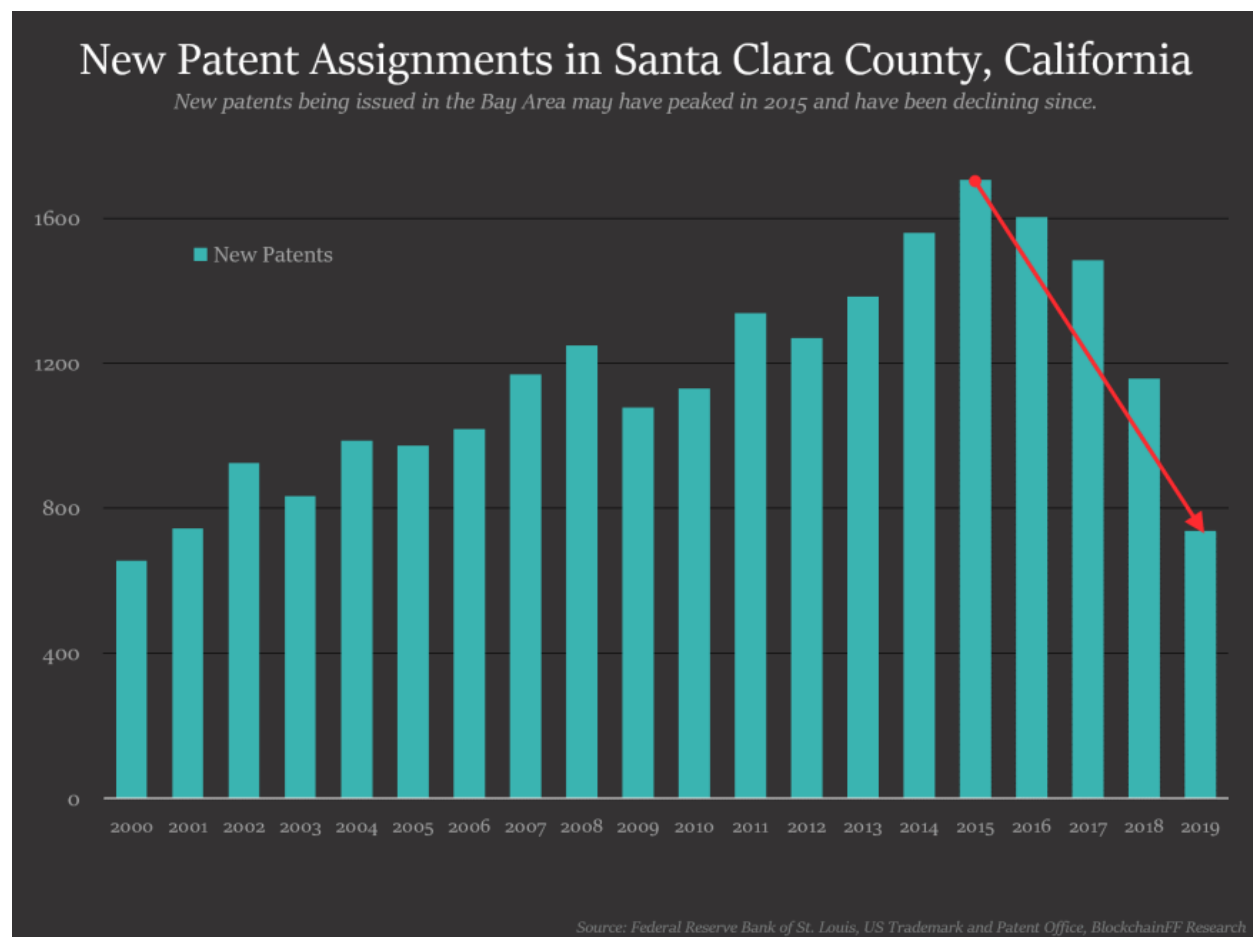


A deeper dive into the figures, however, reveals something out of the ordinary. Even as 45 percent of VC investments went into Silicon Valley, only 30 percent of all deals in the US could be located in the region. This implies that a much larger chunk of deal-making is now being focused outside of the narrow mindset of the ‘Silicon Valley Start-ups’. While these start-ups benefitted from their locations and were able to raise more money in fewer transactions (as VCs kept outbidding each other to add new portfolio companies), start-ups across the country could raise less per transaction (as VCs faced much less competition when vying for investments outside hubs like California, Boston and New York).

Going back to the statistics forces one to think about the need for more localised penetration of VC funds and more equitable distribution across the US. A lot of the fundraising process has already gone virtual, as have exit opportunities like IPO roadshows. Smaller hubs such as Austin and Denver may never have the Valley’s cachet, but they seem poised to grow in prominence. VCs that align their positions to the new normal have a lot to gain in terms of competitive advantage, grassroots relationships and access to deal flow.

By being in closer proximity to the start-ups, VCs are able to build better relationships with teams and communities and thus get better access to deals and stay ahead of industry trends. One possibility for VCs is to focus more on remote relationship building over Zoom with founders outside the

Valley. However, VCs may find it valuable to look at extending their physical presence, either through more frequent trips or establishing satellite offices, or via strategic deal-flow partnerships with VCs in other regions.



#### A more equitable future for innovation

The decline of the Valley will also impact start-up development. For all the fanfare around entrepreneurs who dropped out of university to chase their dreams, most successful ventures come from people who have worked in the industry for several years and bring broad experience to the role. As many of them leave, new start-ups will be minted in a more fragmented manner, across the country, and indeed, the world, as most techies come from abroad.

Does this mean the time of Silicon Valley is over? The answer is likely no. The Valley will always be an important place for tech innovation given its history and proximity to top talent from schools like Stanford and UC Berkeley. However, as more companies begin to accept remote work and

more capital is invested outside this hub, the Valley won't be able to hold the monopoly on tech success it once had.

While San Francisco enthusiasts may be dismayed by this future, it may actually be positive for both workers and individuals around the world. With increased capital diffusion into less represented areas of the country and globe, founders with different backgrounds who were not forced into Silicon Valley will be able to develop new ideas and solutions to problems that stem from their diverse experiences. The Valley has often been accused (arguably rightly so) of becoming a place that innovates only for the 1%. The trends discussed in this article could help change that, and perhaps, lead to a more equitable future for all.

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