Internet cluster regions across the world are providing fertile environments for Internet companies to grow and flourish. In addition to Silicon Valley and other U.S. domestic Internet “clusters” identified in last year’s report, major international “clusters” are growing in importance.
“While Silicon Valley enjoys a leadership position in the new economy, we face a number of challenges that require aggressive changes to public policies and regulations. The local governments in Silicon Valley hold important keys to the future of this unique region—they can either facilitate growth, or act as an impediment to it. Local government actions will largely determine whether the dream can continue to develop in Silicon Valley, or whether it will be forced to move elsewhere.”

—Daniel Eilers, General Partner, Vanguard Venture Partners, Silicon Valley

In 1999, Joint Venture: Silicon Valley Network engaged management consulting firm A.T. Kearney to conduct an analysis of Silicon Valley’s position in the Internet economy. Internet Cluster Analysis 1999, presented an economic and geographic overview of the key Internet cluster regions and outlined several internal challenges our region faces. The study received national media attention and stimulated local discussions on ways to address the growth challenges facing the Silicon Valley. Since then, a number of Silicon Valley cities have launched initiatives, including outreach efforts targeted at Internet companies, local workforce development initiatives, incentives to promote housing and job growth near mass transit corridors, and below market rate housing programs. Local pillar and start-up companies are also responding by setting up satellite offices to reduce commuting time, adopting telecommuting programs, and working with local governments on workforce development programs. While we still have a long way to go, we have clearly made a start in the right direction.

This year, we asked A.T. Kearney to conduct another study to help us keep a tab on the rapidly evolving Internet economy. A.T. Kearney surveyed and interviewed approximately 100 Internet executives and experts to understand recent trends in globalization and how they are impacting the location choices of Internet companies. The study presents a rich fact-base and poses some very relevant questions for Silicon Valley residents and leaders. This study is a part of Joint Venture: Silicon Valley Network’s long-term commitment to sustaining and improving the economic, social, and environmental conditions in the region. Our goal is to promote an economy that continues to astonish us all, while at the same time working with civic and community leaders to sustain a livable environment, create an inclusive society, and ensure the highest possible quality of life for all residents.

To this end, we continue to request the help of leaders throughout business, education, government, and the community to make sure that Silicon Valley continues to weld global influence in the new Internet economy without compromising the natural beauty and vibrant community that drew so many of us to this region even before the World Wide Web became a household phrase. We hope the information contained in this report will spur lively discussion as well as further actions towards this shared goal. Please join us in our efforts.

To learn more about Joint Venture, and access a full list of our activities and publications, please visit us on the Web at www.jointventure.org.

Ruben Barrales, President and CEO
Joint Venture: Silicon Valley Network
Today there is widespread consensus that the Internet is more than a new sales channel or communication medium. Rather, the Internet has created a new economy, and this emerging economy is having an enormous impact on global business. Specifically, the Internet economy is:

- Creating business opportunities that in turn lead to truly new categories of commercial enterprise.
- Spawning markets for new products and services.
- Requiring new legal and policy frameworks.
- Forcing economists to revisit traditional theories and metrics of economic health.
- Opening up global markets and making possible new international business relationships.

The Internet economy consists of a number of business segments that are based on the nature of products/services, business models, and target customers of the participating companies. (See glossary for further details.)

Sources: 1 Measuring the Internet Economy, Cisco Systems and the University of Texas, June 2000, 2 A.T. Kearney Analysis
Although the Internet revolution began in the United States, the truly global nature of the Internet is causing an inevitable shift away from a U.S.-centric economy to one that spans the world.

Already, we see multinational corporations using the Internet to connect with partners and customers worldwide. The Internet is also enabling smaller businesses to build successful international operations. International standard-setting bodies like the W3C Consortium are working to ensure that uniform development standards are used worldwide. And governments are beginning cooperative efforts to develop Internet policies that will be consistent across international borders.

Internet start-up activity has dramatically increased in Europe and Asia, creating a number of Internet cluster regions outside of the United States. For example, Scandinavia has become a global leader in the development of wireless technology; India continues to strengthen its position as one of the largest exporters of software in the world. Globally, over 120 million people have purchased goods and services on-line. And within the next three years, Europe is expected to overtake the United States in terms of sheer numbers of its population who are Internet users.
INTERNET ECOSYSTEMS
ARE BEING FORMED BY COMPANIES THAT ARE PARTNERING
TO CREATE NEW INTERNET-BASED BUSINESS SERVICES AND PRODUCTS.

Because the Internet economy is evolving so rapidly, the evolution paths of business opportunities are far less predictable than in the traditional economy. To compete in this environment, Internet companies must focus on “core competencies,” or what they do best, and partner with other companies that provide supporting or ancillary products and services. To do this, businesses are forging partnerships and alliances with other organizations, including former competitors. And these new relationships are not necessarily found just among economic equals: very large multinationals often find critical value in partnering with small specialized Internet firms. Size matters less than the true value offered by the core competency of the potential partner.

These new relationships look less like traditional linear value chains and more like ecosystems similar to those found in nature, in which a web of carefully balanced relationships allow diverse species to co-exist in ways that are mutually beneficial. An Internet ecosystem is comprised of focused and nimble businesses who bridge the boundaries formerly erected between industries and geographies in order to complement each others’ ability to serve customers.

The Mobile e-Services Ecosystem provides an example of how multiple companies located in different cluster regions around the world are working together to provide new Internet-based services to customers.

INTERNET ENABLED MOBILE E-SERVICES ECOSYSTEM*

*Only representative list of companies included
Internet companies within these ecosystems are often located in regions boasting a critical mass of the five key “cluster characteristics” as identified in last year’s report. According to Internet executives, these characteristics provide the necessary environment to support companies charting new territories in the high-growth Internet world. This year’s research established an important sixth cluster characteristic: a supportive government. The cluster characteristics are:

- A large pool of skilled, experienced, and technically-savvy talent.
- “Pillar” companies that anchor, support, and evangelize Internet and entrepreneurial activities.
- A critical mass of available venture funds or other sources of capital.
- Universities which supply talent as well as research results that can be transferred to commercial ventures.
- Specialized support services such as tech-savvy attorneys, accountants, and headhunters.
- Strong government programs that foster economic growth, develop the local workforce, and address critical quality of life and economic issues.

**Characteristics of Internet Cluster Regions**

1 Source: Internet Cluster Analysis, 1999; A.T. Kearney analysis
2 Pillar companies, as defined in the Internet Cluster Analysis-1999, are leading high-tech, media and entertainment companies which provide talent, capital and other resources critical to Internet start-ups.
The key resources that characterize Silicon Valley and other U.S. Internet clusters are increasingly available in other locations around the world.

One of the most interesting results of this year’s study was that the key characteristics that encourage Internet business activity are becoming more readily available in more places.

**Talent**

Finding and retaining talent clearly continues to be the No. 1 challenge facing Internet companies. Executives cited this factor more than twice as often as any other when explaining how they made a location decision. Interestingly, however, it appears that some companies may be finding new ways to address the well-publicized scarcity of Internet talent other than relocating. Although 86% of executives surveyed in 1999 said talent was key when choosing a new location, that number dropped dramatically—down to 58%—in this year’s survey.

**Pillar Companies**

The definition of pillar companies has evolved. As firms outside the traditional Internet industry continue to amass considerable Internet sophistication, more companies become pillars, and in turn help drive Internet business activity in their geographic region. For example, in Japan, 75% of the top 25 Web sites are operated by large established brick-and-mortar companies—not new startups. Indeed, this new category of pillar companies—including UPS in Atlanta, and Boeing in Seattle, have become important sources of Internet talent to start-ups in their geographic regions. In addition, leading technology companies are continuing to expand globally. As companies like Compaq, HP, Cisco, Microsoft, and IBM establish local offices in India, China, and elsewhere, these regions begin to see a greater availability of talent, capital, management expertise, and technology know-how.

**Universities**

Even as U.S. universities race to announce new Internet research and degree programs, universities around the world have established innovative academic and research initiatives. Among others, Helsinki University of Technology launched Global Entrepreneurship Monitor, an international consortium focused on fostering entrepreneurial activities throughout Europe; Tsing Hua University is establishing technology development centers throughout China.

“VCs are increasingly finding that they need to have a global presence and global capabilities—not just to benefit from international investment opportunities, but also to help their existing portfolio companies become global.”

—Maximilian Schroek, Vice President, A.T. Kearney Ventures, Silicon Valley
INTERNET COMPANIES ARE FINDING THAT **CAPITAL** AND SOPHISTICATED **SUPPORT SERVICES** ARE MORE AVAILABLE AROUND THE WORLD.

**CAPITAL**

The increased availability of venture capital in the United States is highly publicized—so much so that the formerly specialized terms “getting funded” and “IPO” have become part of everyday conversation. And although the United States still gets the bulk of the private venture capital dollars, other countries, particularly in Europe and Asia, are beginning to benefit from the vastly increased cash flow.

Venture capital firms also have begun earmarking funds toward international markets, and even for specific countries, industries, and initiatives. Among others, Benchmark Capital established a $500M fund in Western Europe; Kleiner Perkins Caufield & Byers formed eVolution Global Partners with two other partners to target global e-commerce opportunities for established companies; GE Capital created a $180 million fund in Japan; and CMGI started a $1.5 billion partnership to develop Internet companies in Asia, Europe and the Americas.

Financial markets similar to the NASDAQ—are also becoming a major source of capital for international Internet companies. Germany’s Neuer Markt, United Kingdom’s TechMARK, among others, are an important liquidity tool for Internet startups overseas.

**SUPPORT SERVICES**

Executives, particularly in emerging regions such as Atlanta and Chicago, referred to the increasing availability of support services such as technology-savvy accountants, financial service professionals, and others as critical to their success.

An equally important trend has been in the number of “incubators,” beginning to emerge, both in domestic locales, and around the globe. Such organizations are specifically designed to take promising concepts and grow them into viable Internet businesses much more quickly and cost-effectively by providing ready-to-go back-office infrastructure (office space, web hosting, network administration) and other essential services like financial, legal and administrative functions.
A STRONG AND SUPPORTIVE GOVERNMENT HAS EMERGED AS A SIGNIFICANT NEW CLUSTER CHARACTERISTIC.

In addition to the five original cluster characteristics, governments have become very active in attracting and nurturing local Internet business activity. Internationally, some of these initiatives include:

**Changing or simplifying financial regulations, especially those that previously discouraged foreign venture capital investments.**
- India’s parliament formed the Securities Exchange Board of India (SEBI) to create new rules for venture capital investments in India.
- China is changing its policies to allow foreign venture capital investments in local firms.
- Singapore is reforming bankruptcy laws to encourage tolerance of failure.
- The United Kingdom changed its taxation laws and now treats stock options as capital gains, not personal income.
- Germany is in the process of eliminating taxes on capital gains.
- The Israeli government offers companies tax exemption for up to ten years.

**Enacting tax laws more favorable to businesses and individuals participating in the Internet economy.**
- The United Kingdom changed its taxation laws and now treats stock options as capital gains, not personal income.
- Germany is in the process of eliminating taxes on capital gains.
- The Israeli government offers companies tax exemption for up to ten years.

**Building incubators and technology parks.**
- China has established the Zhong Guan Cun Tech Park in Beijing’s High Tech Valley and the Caohejing High Tech Park in Shanghai.
- Singapore’s Science Technology Park already hosts more than 200 high-tech companies and provides on-site VCs, management consultants, and accounting and legal services.

**Providing start-up capital, loans, and other kinds of financial support.**
- Germany’s government matches or tops venture capital investment in startups.
- England’s government approved a £50M fund for investment in incubators.
- The Israeli government has offered guaranteed loans at fixed rates and R&D grants (ranging from 20% to 66% of R&D costs) with accelerated amortization rates.

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THE HONG KONG CYBER-PORT

The Hong Kong Cyber-Port is a comprehensive facility designed to foster the development of Hong Kong’s Information Services sector and to enhance Hong Kong’s position as the premier information technology and telecommunications hub in Asia. Developed by the Pacific Century Group, a private company, the Cyber-Port will be government-owned upon completion. The project is estimated to cost HK$13 billion, or $1.7 billion in U.S. dollars, and is expected to generate more than 12,000 IT-related positions.

The Cyber-Port will accommodate 30 medium to large companies and 50 small companies. A steadily increasing number of leading global technology companies have signed letters of intent to become anchor tenants, including: Cisco Systems, Hewlett-Packard, IBM, Oracle, Softbank, Sybase and Yahoo. Microsoft has announced its intention to participate in the initiative with Microsoft founder Bill Gates saying last spring that the firm will invest “considerable resources” in the project.

Pacific Century Group also recently formed a joint venture with Intel Corp., which is investing $50 million in the relationship. Called Pacific CyberWorks, the joint venture’s mission is to accelerate broadband Internet initiatives in Asia—a move seen by analysts as providing a significant boost to the Cyber-Port initiative.
U.S. GOVERNMENTS HAVE ALSO INCREASED THEIR EFFORTS TO ATTRACT INTERNET BUSINESSES AT BOTH STATE AND LOCAL LEVELS.

Witnessing the impact the Internet boom has had on other local economies, many city, county, and state agencies in the United States are being extremely proactive with Internet development efforts in the hope that their regions might also grow into clusters.

ATLANTA
Technology Association of Georgia is a new organization formed to collectivize resources among multiple technology organizations in the region.
Georgia Center for Advanced Telecom Technology is an academic, business, and government partnership to make Georgia a premier center for advanced telecom.
Industries of the Mind 2000 is an initiative aimed at attracting and retaining employees to support tech growth.

MIAMI
Internet Coast recently formed to unite the communities in Southeast Florida and establish the region as a hub for Internet activity.
Beacon Council was established to market Miami-Dade county to potential businesses and employees.
Recruiting Consortium being developed to reach out to sources of talent in other regions, such as Massachusetts and California, as well as to nurture relationships with local students.

“Our government has done all the right things. One of them has been to focus on attracting and retaining larger companies. This is extremely important because these larger companies train the workers who subsequently spin off and start small companies.”
— David Hose, Founder and CEO, SignalSoft, Boulder, CO

“We have had strong support from the government, as well as from the businesses, incubators, and research communities in Atlanta. We can’t be all things to all people. But we are building a critical mass of domain expertise that is aggressively supported by the governor of Georgia.”
— Stephen Fleming, General Partner, Alliance Technology Partners, Atlanta, GA

CEOS OF INTERNET COMPANIES CITE KEY AREAS FOR GOVERNMENT SUPPORT AND INVOLVEMENT:
• Minimize tax burden for start-ups.
• Improve commute, mass transit and parking conditions.
• Provide support for start-ups (e.g., access to early stage funding, government loans, and special exemptions).
• Improve education and develop the local workforce.
• Improve housing resources/address cost of living issues.

CASE STUDY: PITTSBURGH
Pittsburgh, Pennsylvania is far from what most would consider a technology center. Or is it? The state and local governments have aggressively worked on attracting Internet and technology-related companies to the area. According to Mike Nelson, Managing Director of Red Leaf, “Governor Tom Ridge’s administration has aggressively targeted technology-focused companies, and facilitated the move of Red Leaf to Pittsburgh.” In addition to state-sponsored initiatives such as grants and tax incentives, local public/private collaboratives such as The Pittsburgh Technology Council focus on developing the local workforce and facilitating networking within the community. Through @phg.café and the University Summer Jobs Program, PTC’s objective is to drive growth, development and retention of technology-focused talent. “The activity we’ve seen here in the last year is incredible, and the companies and business propositions are really high quality and exciting,” says Nelson.
SEATTLE — “SILICON FOREST”

VENTURE CAPITAL INVESTMENT ( $ in millions)

- Hotbed for software and e-tailing companies.
- Number of IPOs in 2000: 11

SAN FRANCISCO — “MULTIMEDIA GULCH”

VENTURE CAPITAL INVESTMENT ( $ in millions)

- Internet activity is concentrated on digital media and B2C.
- Number of IPOs in 2000: 19

SILICON VALLEY

VENTURE CAPITAL INVESTMENT ( $ in millions)

- Leader in the industry, with Internet companies spanning across all segments.
- Number of IPOs in 2000: 62

LOS ANGELES — “DIGITAL COAST”

VENTURE CAPITAL INVESTMENT ( $ in millions)

- Content services and alternative media are the strongest Internet segments.
- Number of IPOs in 2000: 13

AUSTIN/DALLAS — “SILICON HILLS”

VENTURE CAPITAL INVESTMENT ( $ in millions)

- B2B exchanges and enabling technologies are the most important segments.
- Number of IPOs in 2000: 13

Sources: 1PWC Money Tree Report, 2IPO Monitor
NEW YORK — "SILICON ALLEY"

VENTURE CAPITAL INVESTMENT (in millions)

- Financial services and new media companies leverage New York's traditional industries.
- Number of IPOs in 2000: 18

WASHINGTON, D.C. — "SILICON DOMINION"

VENTURE CAPITAL INVESTMENT (in millions)

- The highest growth high tech segments are telecom and wireless.
- Number of IPOs in 2000: 7

ATLANTA — "CAPITAL OF THE NEW SOUTH"

VENTURE CAPITAL INVESTMENT (in millions)

- Wireless and Telecom companies dominate Atlanta’s high tech landscape.
- Number of IPOs in 2000: 9

MIAMI — "SILICON BEACH"

VENTURE CAPITAL INVESTMENT (in millions)

- Neutral hub for Internet companies targeting Latin American countries.
- Number of IPOs in 2000: 12

RESEARCH TRIANGLE — "SILICON TRIANGLE"

VENTURE CAPITAL INVESTMENT (in millions)

- Research Triangle Park specializes in broadband infrastructure and applications.
- Number of IPOs in 2000: 4

BOSTON — "ROUTE 128"

VENTURE CAPITAL INVESTMENT (in millions)

- Often referred to as the Silicon Valley of the East, Boston’s high tech industry spans across all segments.
- Number of IPOs in 2000: 31
Canada — "Silicon Valley North"

- Proximity to U.S. and open trade agreements have fueled the e-commerce industry in Canada.
- The non-U.S. country with the most companies listed on the NASDAQ, with 147 companies currently trading on NASDAQ.
- 1998-2000 start-up growth: 387%

E-Commerce Revenue ($ in billions)

United States

- Origin of and leader in Internet start-up activity in all Internet sectors.
- 1998-2000 start-up growth: 594%

E-Commerce Revenue ($ in billions)

Japan — "Bit Valley"

- Destination for U.S. companies expanding to Asia due to large Internet-savvy market.
- 1998-2000 start-up growth: 1300%

E-Commerce Revenue ($ in billions)

India

- e-Commerce revenue: N/A
- Bangalore and Hyderabad are becoming local clusters focused on software and enabling technologies.
- Becoming major source of talent for other international clusters.
- 1998-2000 start-up growth: N/A

E-Commerce Revenue ($ in billions)

China/Hong Kong — "Cyber Port"

- e-Commerce revenue: N/A
- Large population creating excitement for market potential.
- 1998-2000 start-up growth: 1600%

E-Commerce Revenue ($ in billions)

Sing...
SINGAPORE — “INTELLIGENT ISLAND”

Start-up revenue: N/A

Singapore is leveraging policies in hopes of creating Silicon Valley-like innovation and becoming VC capital of Asia.

100 start-up growth: 700%
SCANDINAVIA — “WIRELESS VALLEY”

- Leader in development of wireless; significant broadband activity.
- Wireless penetration more than 60% in Scandinavian nations.
- 1998-2000 start-up growth: 240%

UNITED KINGDOM — “SILICON KINGDOM”

- Became the first destination for U.S. Internet companies expanding into Europe because of the common language.
- Over 30,000 start-ups in 1998, and more than 100 new incubators in 1999.
- 1998-2000 start-up growth: 666%

GERMANY — “SILICON SAXONY”

- Strong economic growth in recent years combined with risk seeking culture have lured the high tech industry.
- Largest European Internet market.
- Predicted to be largest European e-commerce market.
- 1998-2000 start-up growth: 375%

FRANCE — “TELECOM VALLEY”

- One of the first countries that replicated U.S. Internet business models, taking advantage of language barrier.
- 1998-2000 start-up growth: 312%

ISRAEL — “SILICON WADI”

- e-Commerce revenue: N/A
- Availability of tech professionals from the military and immigration from the former Soviet Union has catalyzed the development of the industry.
- 200 start-ups in 1999, with 300 more estimated for 2000.
- 1998-2000 start-up growth: N/A
As the core characteristics become more widely available, location choices are increasingly influenced by more traditional factors.

“We were running into some stumbling blocks with one of our business partners. But because they were close by, we were able to get a mass of engineers and business people from both companies in the same room until we solved the problem. We never could have done that if we weren’t close by.”
— Deva Hazarika, Founder and Chief Strategy Officer, Moai Technologies, San Francisco, CA

“Different countries have different operating models, different laws. This makes local expertise and a country CEO extremely important. The solution must be tailored to the country’s needs.”
— Peter Falvey, Director, Finance and Business Development, Band-X, New York, NY

As key resources become more generally available, and as Internet companies continue to expand and mature, location decisions are being increasingly affected by other market forces—some of which are very similar to issues faced by traditional companies. Chief among them:

• Wanting to be located in close proximity to key partners.
• Requiring a local presence in foreign markets.
• Needing to minimize the on-going costs of doing business.
• Having to relocate and/or reorganize as the result of a merger or acquisition.
• Being sensitive to their employees’ quality of life.

PROXIMITY TO PARTNERS

Like the paperless office, the truly virtual company may be a long time coming. Yes, exciting new collaborative technologies such as desktop videoconferencing and ever-more sophisticated ways of sharing documents and data make long-distance business relationships much easier to manage. But Internet executives agree: when it comes to key partner relationships, nothing beats being there.

Which is why so many executives said they were increasingly influenced by where their key technology vendors, suppliers, distributors, and other partners were headquartered when making location decisions.

Indeed, “proximity to partners” was the No.1 reason executives said they would consider relocation from their current location.

LOCAL PRESENCE

As they continue to grow and expand into new markets, Internet companies are also finding it important to have a strong local presence. The primary reason executives gave for this was that they need to be as close to customers as possible.

After all, success in the Internet economy depends just as much on meeting customer needs as in any traditional brick-and-mortar endeavor, and ideas for new products and services as well as opportunities to develop sources of talent often come from interactions with customers.

And in international markets, there are additional cultural and language challenges, as well as unique competitive scenarios, that require a closer relationship with local customers than simply running a website from halfway across the world would allow.
EVEN AS THE RECENT MARKET ADJUSTMENT HAS FORCED COMPANIES TO PAY MORE ATTENTION TO OPERATING COSTS, INTERNET PROFESSIONALS ARE PLACING INCREASING IMPORTANCE ON QUALITY OF LIFE.

MERGERS AND ACQUISITIONS
Merger and acquisition activity has increased dramatically over the past few years. More deals were done in the first quarter of 2000 than in the full year of 1999. This level of activity not only leads to consolidation, it creates further geographic reach for affected companies, providing access to more talent pools as well as the opportunity for increased growth in potentially lower-cost regions.

COST OF DOING BUSINESS
As the heady early days of dot-com enthusiasm subsides into more reasonable assessments of the potential opportunities represented by various Internet start-ups, venture capitalists and Internet executives alike are looking more closely at the long-term operational costs of businesses. With increasing emphasis on eventual profitability, executives are carefully considering whether they need to be located in a high cost cluster such as Silicon Valley.

QUALITY OF LIFE
And many Internet executives say that quality of life has become an important issue both for themselves and for their employees. Given the high demand for Internet talent still evident across all industries and geographic regions, workers with Internet experience and skills can pick and choose where they want to work. More of these highly sought-after individuals are making quality of life a key issue when choosing an employer. Consequently, many Internet executives are promoting the quality-of-life benefits of joining their companies—benefits that can include company policies on daycare and flextime as well as the innate attractions of the geographic region, such as affordable housing or moderate weather.

“One of the exciting things about emerging clusters outside Silicon Valley is that there is less friction when starting up or operating a young company. This is due in part to the availability of service providers and physical infrastructure that a company needs, because whether it’s access to a knowledgeable attorney, a high-tech PR firm, or the easy availability of affordable office space, it’s often easier and less expensive to establish yourself in an emerging cluster.”
— Erik Straser, General Partner, Mohr, Davidow Ventures, Silicon Valley

“The first few years of a startup require a lot of up-front investments, such as infrastructure, salaries, hosting, rent, etc. The companies that settle in Silicon Valley are losing vast amounts of money because things are so expensive. They are short-term thinkers, though, because if you can reduce these costs by 50%, the path to profitability is much shorter.”
— Ajay Murthy, Vice President, Business Development, Bidpath, Bellevue, WA
When established companies join the Internet economy, they face unique location issues.

Although most established brick-and-mortar companies choose to base their Internet businesses near existing corporate headquarters, others have set up offices in Silicon Valley or other cluster regions in order to take advantage of the core cluster characteristics. For example, although General Motors, Dell Computer, and Disney have all chosen to keep their online subsidiaries in the hometowns of their original businesses, other business leaders, such as K-Mart and Wal-Mart, have chosen Silicon Valley as the location of their all-important Internet initiatives.

Executives said that this decision typically depends on how closely the parent company wishes to align its Internet initiatives with the brick-and-mortar business. According to Fortune 500 CEOs surveyed, most Internet initiatives are primarily related to the core business, and therefore the majority of brick-and-mortar companies’ on-line operations are located near corporate headquarters. When Internet initiatives are located elsewhere, what often emerges is a separate organization that may bear the same name as the parent for branding purposes, but which in all other ways is a completely new business.

“For brick-and-mortar companies, it can be important to be located away from corporate headquarters to get away from a restrictive culture, as Walmart.com and Kmart have done. However, if companies move too far away, they can potentially move too far away from the core business, and often develop ideas that are wholly non-implementable.”

— Mike Jacob, Ignite Sports Media, Vice President Strategy and Operations, Chicago, IL (formerly with Sears.com)
SILICON VALLEY’S INTERNAL CHALLENGES ARE REACHING A CRITICAL POINT.

This report presents Silicon Valley with two distinct sets of implications and challenges.

First, many of the issues raised last year continue to be relevant. Although a number of innovative initiatives have been put into place, Silicon Valley still faces challenges directly related to economic success. Housing prices continue to rise; traffic congestion worsens; and the region is subsequently becoming unaffordable to everyone but the most highly compensated. Teachers, clerical workers, food-service personnel, even medical doctors are leaving the area because the cost of living is so high, and the quality of life compromised.

Some recent local initiatives that are addressing these issues:

• Community initiatives that help local residents work with Internet companies to voice and resolve their concerns.
• Training and education programs that prepare local workers to participate in the new economy.
• Programs to make below-market housing available to qualified individuals and families.
• Mass-transit plans to reduce traffic and congestion.

These and other efforts are encouraging. Yet this year’s survey also uncovered a curious fact: although executives from all over agreed that talent remained their top reason for choosing a location, Silicon Valley executives differed significantly from their colleagues on several key location issues. Specifically, quality of life was seen by Silicon Valley executives as dramatically less important than it was by non-Silicon Valley executives (18% vs. 47%).

And a number of cases of Silicon Valley firms relocating to less expensive parts of the country have been widely publicized. Insweb announced in August 2000 that it will move from Silicon Valley to Sacramento by the end of the year because of its desire to be profitable by 2002—something that simply would not be possible in Silicon Valley. The firm estimates it will save more than $10 million in the next two years due to lower real-estate prices—and even more than this if it includes the decreased payroll costs it anticipates. Another Silicon Valley firm, PlanetRx, announced plans to move to Memphis, where it hopes to reduce costs of rent, communications, travel, and labor by a full 50%.

“The cost of doing business in Silicon Valley and San Francisco is insane. For one thing, real estate is outrageous. But what I found most unbelievable was the cost of recruiting and retaining employees. You have to recruit the recruiters, and convince them to recruit on your behalf. It’s exactly the opposite in Atlanta.”
— Jay Hall, Founder of ChemConnect, which moved from Atlanta to San Francisco
In addition, Silicon Valley faces emerging issues such as the widening digital divide.

“Most kids in Silicon Valley are already Internet savvy. We, as a community, must focus on providing the education and training to prepare them to succeed in the new economy.”
— Elaine Curran, President, Junior Achievement of Santa Clara County, CA

“Inventiveness and creativity are prime virtues of this new economy. These virtues spring from diverse groups of people talking about the possibilities. And although the Internet has made it simpler for diverse communities to connect, to share, and to unite in ways unlike any other time in history, we’re in danger of widening the gap between the haves and have-nots as technology continues to drive change at an accelerating pace.

In order for this economy to truly flourish, we must make technology available and accessible to everyone so that they will have the tools to explore, to communicate, to collaborate, and to invent.”
— Debra Dunn, Vice President, Strategy and Corporate Operations, Hewlett-Packard Co., Palo Alto, CA

And just as companies are facing more complex location decisions, the cluster regions acting as hosts to Internet companies see new challenges arise. Although many regions—particularly the core cluster regions such as Silicon Valley, Seattle, and Boston—have benefited greatly from the booming Internet economy, they have also begun to experience related liabilities. Most visibly, traffic increases, long-standing mom-and-pop businesses are crowded out by escalating costs, and housing prices skyrocket.

Not quite as visible as the daily traffic snarls—yet potentially more destructive—is the increasing gap between those individuals who have benefited from the economic growth and those who have not.

The regions that aggressively address these issues will benefit from more than simply the short-term economic boom. They will also help solve the No. 1 issue facing companies today—the workforce gap—which is costing regions such as Silicon Valley $3 billion to $4 billion annually, according to the Joint Venture Workforce Study.
Nearly every executive interviewed acknowledged the importance of maintaining—or establishing—some sort of presence in Silicon Valley. And every one stressed that Silicon Valley continues to play a critical role in leading the Internet economy. Interestingly, many maintained that as more Internet cluster regions emerge around the globe, Silicon Valley is likely to solidify, not lose, its position as the hub of technical innovation.

Still, Silicon Valley’s civic and business leaders need to address a number of key questions:

**Do we want Silicon Valley to continue in its leadership role in a truly global Internet economy?** The answer is a resounding “yes,” according to Joint Venture Silicon Valley’s 2010 Community Report. Most Silicon Valley executives want Silicon Valley to remain the primary hub of both technology innovation and entrepreneurial business initiatives.

**How can Silicon Valley maintain leadership without further straining its quality of life?** Growth needs to be managed so problems aren’t made worse. Perhaps one way is to position Silicon Valley as a giant incubator where new companies are established and nurtured. Rather than staying, they will be encouraged to expand to or relocate in other regions once they are stable. An alternate plan would be to focus on retaining existing companies and putting less effort into attracting new startups. Public discussion of this is clearly needed.

**And, of course, there are other related questions.** If Silicon Valley plays the role of a giant entrepreneurial incubator—where companies based elsewhere come to establish “outposts of innovation”—how will that affect the long-term economic health of Silicon Valley? The social fabric and culture? How can Silicon Valley take a leadership role in resolving social issues such as the Digital Divide? What initiatives can the local governments in Silicon Valley undertake? Will the expansion of regional transportation infrastructure, such as the Bay Area Rapid Transit District (BART), provide needed transit relief? Is more affordable housing possible?

These are important questions. The responses to them will have a fundamental impact on the future of the Silicon Valley. What is needed: an on-going, open, and constructive public discussion—one in which the entire community participates.

“A year ago, I thought Silicon Valley was at risk of losing its leadership position to competing clusters like Austin and Boston. But now there are so many other clusters that the risk has been diffused. The playing field is less likely to ever become level. Today there are probably twelve to fifteen major high-tech centers, each with its own strengths, but there is nothing that comes close to Silicon Valley. As Internet development continues to spread out across the globe, it is increasingly less likely that any other single region could ever take over Silicon Valley’s central leadership role.”

—Deva Hazarika, Founder and Chief Strategy Officer, Moai Technologies, San Francisco, CA

“It makes sense for us to have an office here (in Silicon Valley) even though our headquarters are in Austin, simply because so many of our partners are here.”

—Anthony Hall, Vice President, Business Development, Vignette, Silicon Valley

“We needed a Silicon Valley address without the high cost of having all of our technology staff located there. So we moved our headquarters from Tulsa to Silicon Valley. The majority of our operations remained in Tulsa, and in Houston. In fact, the only people in Silicon Valley are four members of the senior management team, and some support staff.”

—Paul Westervelt, Vice President, Business Development, PennNet, Houston, TX
BUSINESS TO BUSINESS (B2B)
Companies that connect business buyers and suppliers to facilitate exchange of products and services. Examples include firms like ChemConnect, eSteel, and Farmbid.com.

BUSINESS TO CONSUMER (B2C)
Companies that offer consumers new convenient ways to shop and find information. Examples of this type of firm include Amazon.com, ToysRUs.com, and WebVan.

BUSINESS TO EMPLOYEE (B2E)
An emerging e-services segment describing companies that offer information and work related services to employees.

BUSINESS TO GOVERNMENT (B2G)
Organizations specializing in facilitating transactions between businesses and governments.

CONSUMER TO CONSUMER (C2C)
Organizations that specialize in connecting consumers to other consumers.

ENABLING TECHNOLOGIES
Companies that provide hardware and software products for digital delivery and networking. They develop and sell products and solutions to a wide range of clients, and their revenue is generated from product sales and related support. Enabling technologies companies require an environment that enables innovative research and development and quick time-to-market.

INFRASTRUCTURE COMPANIES
Companies that fall into traditional hardware, software, and technology services categories, and which provide the basic products and services with which a company can build an Internet business. On the hardware side, this includes everything from basic desktop PCs, to notebook computers, to network servers; on the software side, this includes operating systems and basic software applications, including office automation products. This also includes all “supporting” hardware and software used to build and operate basic networking services for all sorts of businesses.

ACCESS PROVIDERS
Companies that enable Internet access to businesses and consumers through private networks or partnerships with other bandwidth providers. Their revenues are primarily derived from service fees. National/regional access providers are consolidating to achieve broad, cost-effective presence, while local access providers are focusing on high-service niches.

APPLIANCES
Companies that are developing new hardware devices and supporting software that can be used to access the Internet and other networking-enabled services and applications. Firms such as Palm, Handspring, Nokia, Netpliance, and WebTV fall into this category.
Co-Chairs:
Hon. Ron Gonzales, Mayor, City of San Jose
Mark Hyde, President and CEO, Lifeguard, Inc.

Ruben Barrales, President and CEO, Joint Venture Silicon Valley
Bill Agnello, Senior Vice President, Workplace Resources, Sun Microsystems
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J. Michael Patterson, Tax Partner, PriceWaterhouseCoopers
Hon. Joe Simirian, Supervisor, Santa Clara County Board of Supervisors
Steve J. Tedesco, President and CEO, San Jose Metropolitan Chamber of Commerce
Hon. John Vasconcellos, Jr., State Senator, 13th District, CA State Senate
Chester Wang, Chairman, Pacific Rim Financial Corporation
Colleen Wilcox, Superintendent, Santa Clara County Office of Education
David Wright, President and CEO, Amdahl

ECONOMIC DEVELOPMENT ROUNDTABLE MEMBERS
Composed of Economic Development professionals from Silicon Valley cities, counties and other public and private sector organizations.

Susan Arpan, City of Palo Alto
Carol Atwood, City of Cupertino
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Geoff Bradley, City of Campbell
Ceil Cirillo, City of Santa Cruz
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Diana Whitecar, City of San Mateo
A.T. KEARNEY (www.atkearney.com) is one of the world’s largest and fastest growing management consulting and executive search firms. With a global presence spanning every major and emerging market, A.T. Kearney provides strategic, operational and information technology consulting and executive search services to the world’s leading companies. A.T. Kearney works with companies in the Internet economy through several of its practices. Notable among them are:

A.T. Kearney’s Global High Technology Practice, based in the heart of Silicon Valley, specializes in serving companies that are creating technologies that enable the Internet Age. The Practice addresses a variety of management issues ranging from business strategy development to acquisition analysis and assists high-tech companies ranging from Fortune 100 to venture capital-based startups build their businesses and management teams. The Practice’s consultants provide expertise that is backed by years of industry and professional services experience in software, computer equipment, networking, consumer electronics, and semiconductor industry.

Formed in December 1999, EDS/A.T. Kearney Ventures deploys financial, intellectual and human capital to build or transform portfolio companies quickly. When fully funded at $1.5 billion over five years, the EDS/A.T. Kearney Ventures will be one of the largest corporate venture funds of its kind. Investments are global and heavily focused on Business-to-Business commerce, e-business enabling technologies and infrastructure companies.

A.T. Kearney’s e-business initiative is focused on enabling clients to flourish in the digital marketplace. The e-business team serves as a catalyst bringing together A.T. Kearney’s state-of-the-art capabilities, deep industry expertise and superior account management to assist clients in establishing themselves successfully in this new economy.

A.T. Kearney has also developed strong links to Silicon Valley’s high-technology business and civic communities by sponsoring pro bono engagements and partnerships with a select set of organizations, focusing on key client issues. Through its sponsorship of pro bono projects for organizations such as Joint Venture: Silicon Valley Network, the San Francisco Partnership and the Bay Area Council, A.T. Kearney applies its consulting skills to address economic growth and quality of life concerns that all Silicon Valley companies share. A.T. Kearney also partners with and supports many Silicon Valley organizations such as Junior Achievement of Santa Clara County, United Way and local chapters of The Boys & Girls Clubs through board positions and donations.

A.T. Kearney is the high-value management consulting subsidiary of global information technology services leader EDS.

**JOINT VENTURE: SILICON VALLEY NETWORK** (www.jointventure.org) is a civic incubator working to ensure that all people in our region have opportunity to succeed in the new economy. Joint Venture introduced to Silicon Valley a model of regional collaboration that is now being replicated across the United States and around the globe. A non-profit organization, Joint Venture is supported by investors representing government, community organizations and industry.