The New Boom

Silicon Valley is roaring back to life, as startups mint millionaires and Web dreams take flight. But, no, this is not another bubble. Here's why.
By Chris Anderson

Be careful what you wish for, all of you with the "Please, God, just one more bubble!" bumper stickers. It's getting wild again in Silicon Valley. In recent months, the breathtaking ascent of Google has lit a fire under its competitors, which include practically everyone in the online world. The result is all too familiar: seven-figure recruiting packages, snarled traffic on Highway 101, and a general sense that the boom is back.

A boom perhaps, but not (phew!) a bubble. There's a difference. Bubbles are inflated with hot air and speculation. They end with a wet pop, leaving behind messy splatters. Booms, on the other hand, tend to have strong foundations and gentle conclusions. Bubbles can be good: They spark a huge amount of investment that can make things easier for the next generation, even as they bankrupt the current one. But booms - with their more rational allocation of capital - are better. The problem is that exuberance can make it hard to tell one from the other.

Six years ago, people were likewise making the case that the dotcom frenzy was more boom than bubble, built as it was on the legitimate ground of the Internet revolution. And until late 1999 or so, maybe that was true. Then the Wall Street speculators gained the upper hand, and growth became malignant.

It's hard to know what "normal" prosperity looks like in Silicon Valley. This is, after all, the land of boom and bust - it's been alternating between greed and grief ever since the gold rush. But if there is such a thing as a healthy boom, we're living it now. Google may be trading above $400, but the Nasdaq as a whole has hardly budged in five years. Companies are once again minting millionaires, but venture capitalists are investing less than a fifth of what they were at the 2000 peak. About 50 technology companies went public last year, but more than 300 went public in 1999.

Of course, abundant venture capital and plentiful IPOs were once seen as evidence of vitality. Now, however, we know their true cost: The promise of heady valuations encourages venture capitalists to shower startups with money. And having placed such large bets, the VCs naturally want to fatten those startups for market. Fast cash and accelerated growth make a company lose touch with reality, the simplest explanation for the bubble's most notorious flameouts.

So why is the froth missing from the wave this time? Because the underlying economics are so much healthier, in three main ways.

First, technology adoption has continued at a torrid pace (and even accelerated at times) despite the bust. The dotcom business models of the 1990s may have been based on wild projections of broadband, advertising, and ecommerce trends. But the funny thing is, even after the bubble burst, those trends continued. These days, it's hard to find a technology-adoption projection from 1999 that hasn't come true. Meanwhile, the digital-media boom sparked by the iPod and iTunes has blown through even the most aggressive forecasts.

Today, broadband is mainstream, online shopping is commonplace, everyone has a wireless device or two, and Apple's latest music player was - for the fifth season in a row - the must-have holiday gift. The Internet and digital media are clearly not fads. Over the past decade, we've started to live a life only imagined in mid-'90s business plans. As a result, some silly bubble-era ideas are starting to actually make sense - perhaps a lot of sense.

Free phone calls over the Internet? That's Skype, which eBay just bought for nearly $4 billion. Online virtual communities? Now a global phenomenon in the form of massively multiplayer online games. Free music sites? MySpace, which rivals Google in traffic. (The boom's ultimate echo: The owner of Dog.com just paid $1 million for Fish.com, in hopes of starting what amounts to a new Pets.com. Just so long as it doesn't ship 50-pound bags of chow.)

The second reason that this boom is so different from the last is that the sunk costs of the dotcom era make the economics of entrepreneurship more favorable. In the bad old days, companies bankrupted themselves building out their fiber-optic networks. Bad for investors, good for everyone else: We're now enjoying supercheap bandwidth. So, too, for storage, screens, and a host of other technologies that are benefiting from profligate '90s-era investment and research.

Meanwhile, open source software has come of age, and computer hardware will soon cost less than the electricity it takes to run it. The result: industrial-strength servers that are cheaper than desktop PCs (sorry, Sun). Or, if you prefer, you can buy hardware and software even more cheaply as a hosted service (there's that inexpensive bandwidth again).

The result is that you can start a company today for a tiny fraction of what people spent five years ago. Joe Kraus, cofounder of the bubble-era search engine Excite, estimates that his new company, JotSpot, will make it to first revenues with a total investment of about $100,000 - less than 5 percent of what Excite burned through a decade earlier. Today companies are starting small and lean and staying that way - no more blowing all the first-round funding on PR stunts and rooftop parties. As a result, they're hitting break-even sooner.

In this new environment, startups can grow organically. That means less venture capital is needed - and that's the third reason this boom is different. Less venture capital leads to fewer venture capitalists hustling for early exits at high valuations. That, in turn, reduces the pressure to go public and translates to fewer undercooked companies launching IPOs on hype alone.

So there you have the recipe for a healthy boom, not a fragile bubble: a more receptive marketplace, lower costs, and lighter pressure from investors. Today, the typical exit strategy is to sell your startup to Yahoo! for a few million, not to maneuver for a rowdy IPO and an appearance on CNBC. Highway 101 is jammed with Prius-driving engineers, not biz-dev guys in Beemers. And most New York cab drivers are happily ignorant of what's hot in the Valley, just as they should be.

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