Empire of the geeks

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Silicon Valley should be celebrated. But its insularity risks a backlash

Leader

THE English have Silicon Fen and Silicon Roundabout, the Scots have Silicon Glen. Berlin boasts Silicon Allee, New York Silicon Alley. But the brain of the tech world is the ecosystem in and around San Francisco. Silicon Valley's entrepreneurs and innovators, technologists and moneymen are busy revolutionising nearly every aspect of the global economy.

A place named for its skill in making silicon-packed semiconductors is transforming how firms make decisions, people make friends and protesters make a fuss. Startups touch more people, more quickly than ever before. Airbnb, a seven-year-old firm that helps people turn their homes into hotels, operates in 34,000 towns and cities around the world. "On-demand" firms like Uber are changing what it means to be an employee. Just as the big platforms like Google, Facebook and Apple benefit from "network effects", because each new user makes the service more valuable for all the others, so the Valley's success as a venue to launch, fund, staff and sell a technology firm is feeding on itself.

As a result, American capitalism has a new hub in the west. Wall Street used to be the place to seek fortunes and make deals; now it is increasingly the Valley. The area's tech companies are worth over $3 trillion. Last year one in five American business-school graduates piled into tech. Jamie Dimon, the boss of JPMorgan Chase, has warned of mounting competition for Wall Street. Goldman Sachs recently held its annual shareholder meeting in San Francisco.

The enormous, disruptive creativity of Silicon Valley is unlike anything since the genius of the great 19th-century inventors. Its triumph is to be celebrated. But the accumulation of so much wealth so fast comes with risks. The 1990s saw a financial bubble that ended in a spectacular bust. This time the danger is insularity. The geeks live in a bubble that seals off their empire from the world they are doing so much to change.

Silicon lining

The American economy would be hit hard by a repeat of the financial shock that followed the dotcom crash in 2000. With the NASDAQ index near its record high, this is a common fear. Fortunately, although money and talent are pouring into the Valley, there is not yet much danger of a disastrous bust. That is because tech companies today not only have more robust business models than their dotcom predecessors did (ie, many actually make money), but they also rely on a smaller group of financial backers.

Today's firms are staying private for longer. Tech firms that went public in 2014 were on average 11 years old; back in 1999 they waited only four years before listing their shares. Tapping wealthy investors means risk is borne by people who can afford to take losses. It is easy to lament the decline of the publicly listed company (though even when founders do list they keep a tight rein), but if tech firms fall short of their promises, ordinary investors are less likely to see their wealth destroyed.

Staying private allows entrepreneurs to avoid the headaches that come from being quoted: the nuisance of activist investors, the drudgery of compliance, the vision-crushing ritual of quarterly reporting. In theory, a coterie of investors is better than an anonymous multitude of shareholders at making sure managers act in the interests of all a firm's owners.

But staying private has risks, too. One is that firms under no obligation to make public a full set of audited accounts will remain veiled from the scrutiny of analysts and short-sellers and so act irresponsibly. America's tech "unicorns"—firms that have reached a valuation of more than $1 billion—are worth around $300 billion between them. The danger that some of this capital is being misallocated is high.

The other risk is that a charmed circle with great wealth becomes cut off from everyone else. For a group rewriting the rules for industry after industry, that is a special danger.

The empire of the geeks draws its strength from a culture of techno-evangelism that enables entrepreneurs to rethink old systems and embrace new ones. Many denizens of the Valley believe that tech is the solution to all ills and that government is just an annoyance that still lacks an algorithm. So far the public's relationship with the tech titans has been mostly harmonious. Consumers enjoy their taxi-hailing apps, music streaming and voice-recognition software.

Yet cracking open established industries inevitably results in conflict. Uber is the firm most embroiled in controversy, whether facing licensed taxi-drivers on the streets or demands from its own drivers in the courts. European regulators are also scrutinising firms like Facebook and Google for everything from antitrust concerns to data protection. And American regulators are reportedly looking at whether Apple has abused its clout in the music business.

Critics are often from industries wanting to protect their privileges; the geeks' aggressive behaviour is sometimes part of the creative destruction that leads to progress. But that is not the only source of anger. Silicon Valley also dominates markets, sucks out the value contained in personal data, and erects business models that make money partly by avoiding taxes. There is a risk that global consumers will feel exploited and that the effects of a shrinking tax base will infuriate voters. If the perception takes root that enormous profits from exploiting data and avoiding taxes are crystallised in the fortunes of a few people living on a patch of ground near San Francisco, then there will be a backlash.

Mind the techlash

The Valley's firms are hardly the only ones to push against taxes and regulation. They are free to operate as they like within the law. But they risk becoming targets because they are so global. They should remember that the law can change. If they want a seat at the table when it does, they need to be part of the markets they sell into, not isolated from them. Even private firms run by geniuses need a licence from society to operate.

At its best Silicon Valley is an expression of iconoclastic freedom and creativity. It would be a terrible shame if it became an unpopular and remote manifestation of elitism.