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Silicon Valley grows up: Tech industry matures, stabilizes

By Michelle Kessler, USA TODAY

SAN FRANCISCO — Silicon Valley has long been the kind of place where offices have slides, khakis are formalwear and the hottest companies in town spell their names in big, multicolored letters.

It's the kind of place where two billionaire software tycoons, Oracle CEO Larry Ellison and Siebel Systems Chairman Tom Siebel, can engage in a 15-year playground-like fight — and few find it weird.

It's the kind of place where a young industry — one constantly flinging itself into boom-and-bust cycles while chasing the next big thing — thrives.

Except now, there are signs that tech is maturing — possibly even approaching middle age.

Gulp.

Don't expect to hear about it from tech entrepreneurs, who would rather talk about "changing paradigms." Instead, look at the surprising signs of stability in the notoriously go-go industry.

Corporate spending on tech is growing, but at a slower pace than before. Tech employment and venture-capital investment have settled in at levels last seen in the late 1990s, before the dot-com boom. Traffic has even settled down in tech's epicenter, the San Francisco Bay Area.

As if that wasn't unusual enough, Oracle recently acquired Siebel Systems with nary a negative word from either side.

It's not a sign of the apocalypse. It just means that steady growth is beginning to supplant the spikes and drops of an adolescent market, says longtime Valley entrepreneur Bill Krause.

Tech companies are already being forced to adapt. As their markets age, they're consolidating, reorganizing and pursuing almost any opportunity for growth — even if it isn't as lucrative as their traditional businesses.

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These kinds of changes are the only way tech firms will thrive in an older industry, says Stanford University professor emeritus Bill Miller. But Miller argues that maturity isn't necessarily a bad thing. Older industries can be more predictable than those in flux.

And tech companies have had plenty of time to prepare for the shift. "After all, the industry is more than 50 years old," Miller says with a laugh.

Not all parts of tech are aging equally. Areas such as nanotechnology and biotechnology are still quite young. Search-engine firm Google sports boom-era growth rates. "I don't think the iPod is a mature market," says Jonathan Schwartz, president of computer-maker Sun Microsystems.

It's areas such as PCs and corporate software that are growing up, experts say. Business tech spending is growing at about 6% a year, down from an average of 11% over the past several decades, says Stanford's Miller. After all, once businesses have a full range of tech tools, they don't need to keep boosting budgets to buy tons of new stuff.

Take PCs. They used to change so fast that they lasted only about three years before needing an upgrade. Now, PCs are so speedy that even older models work fine. Thus, many are being kept in service for four years or more, tech analysts say.

As a result, PC sales are expected to grow just 8% in the USA this year, says researcher IDC. That's down from 15% in 1996.

"The old markets — places where venture capital had made its greatest returns — have matured," says prominent venture-capitalist Gary Morgenthaler.

Making changes

That doesn't mean sales are stalling — just that they're not growing as fast as they used to. And that's enough to force companies to make changes. What they're doing:

- Consolidating.** Tech companies spent \$207 billion on tech mergers and acquisitions last year, up from just \$65 billion in 2002, says researcher The 451 Group.

When a market is young, there are enough new customers for everybody. Once growth slows, "Companies acquire other companies to get their customer base," Krause says.

PC makers are a good example. Since 2002, Hewlett-Packard has acquired Compaq, Gateway has acquired eMachines, and IBM has sold its PC division to a Chinese rival, Lenovo.

In business software, Oracle has led the acquisition charge. In the last year, it has announced plans to acquire or take majority ownership in 10 companies. It spent \$16 billion just on Siebel and PeopleSoft.

- Quietly reorganizing.** Tech companies must make bold moves to stay afloat in boom-and-bust markets but can make more moderate reforms in quieter times.

Flashy Hewlett-Packard CEO Carly Fiorina was known for dramatic gestures, such as a massive attempt to reshape HP's corporate culture. She was ousted by HP's board in February and replaced by little-known NCR chief Mark Hurd.

Some Wall Street analysts called for big changes, such as a spinoff of HP's printer division. But Hurd has stuck to internal reforms and layoffs. HP shares have risen 38% in the six months he's been in the job.

Sun Microsystems — the company that famously declared itself "dot" in "dot-com" — is also quietly changing. Instead of trash-talking rivals, it's patching up rifts. Sun signed a partnership with enemy Microsoft. It agreed to sell computers built on the same processor as HP and almost every other computer maker, instead of only ones with its own chip.

Sun has also revamped 100% of its product line and signed a partnership with Google. It's regularly pushing laidback president Schwartz as the face of the company, instead of sometimes-caustic CEO Scott McNealy. "It's a different world," Schwartz says, adding that Sun is now "on offense."

Former Sun executive Ed Zander is making similar changes at Motorola. He took the top job there in early 2004, when the cellphone maker was losing share to rivals.

Zander did spin off Motorola's semiconductor division, a move planned before he joined the company. But he's otherwise stuck to small changes, such as a layoff of 1,900 workers this month. Motorola's stock is up 61% since he took charge, and the company is again the world's No. 2 cellphone maker, says researcher Gartner.

•**Chasing new markets.** Tech companies are pursuing growth anywhere they can find it.

Cisco Systems gets most of its revenue from pricey networking gear used by telephone companies and big businesses. But it's also investing big in new markets, such as wireless networking for homes and small offices.

Cisco is chasing those markets even though they're less lucrative because consumers and small businesses are generally more price-sensitive than giant corporations. Cisco's profit margins before taxes, depreciation and other charges fell to 68% in its 2004 fiscal year from 70% in 2003.

Oracle and rival IBM are both expanding beyond their core database markets, since most big companies already have them. Oracle's acquisitions are pushing it into programs that run along with a database, such as human resources software. IBM has extensively revamped its Lotus line of desktop tools for workers.

And nearly every tech firm is running to India, China, Brazil and other emerging markets. Those are countries that, for political or economic reasons, weren't very open to Western tech companies until recently. Now that's changed, and U.S. tech companies are chasing the opportunity.

As these changes take place, a kind of eerie calm has descended on tech. "This is pretty much like the mid-'90s, right before things started ramping," says Patti Wilson, a Silicon Valley job counselor.

Heidi Roizen, managing director at Mobius Venture Capital, likens it to a stock portfolio. "There are times when everything goes up. There are times everything goes down. Right now ... the net is 'even' " she says.

Calm before next boom?

Can it last? Or is this just the calm before the next boom?

No one knows for sure. But many experts argue that it's unlikely that a dot-com-size bubble will occur anytime soon.

One reason is that public companies now must comply with Sarbanes-Oxley and other rules implemented after accounting scandals at Enron and other companies, says venture-capitalist Morgenthaler.

The rules can keep companies honest but also require them to spend millions on accountants and paperwork, Morgenthaler says. It's so expensive that many firms are staying small instead of going public, he says. That could keep the next Google or eBay from breaking out, he says.

There are also concerns over technology barriers. Since the 1960s, the industry has been governed by Moore's Law, an engineering tenet that basically means tech products get faster and cheaper at an astounding rate.

Some have begun wondering how long Moore's Law can last as engineers hit the physical limits of computer-chip materials.

"We're clearly in the later stages," Krause says. If Moore's Law no longer holds, hardware won't improve as fast, dragging down the software that runs on it.

Others aren't worried. "We've still got a long way to go," says Gartner PC analyst Martin Reynolds. Still, chipmakers are already adjusting. Both Intel and rival Advanced Micro Devices have recently shifted focus away from pure chip speed. Instead, they're working on other ways to make electronics faster, such as using two processors instead of one.

Finally, there's concern that the emerging markets that hold such promise for the U.S. tech industry will also steal its business. The Information Technology Association of America, a trade group, estimates that one out of every two tech jobs created by the U.S. economy from 2003 to 2008 will be located offshore.

But not everyone is worried. Wilf Corrigan, chairman of chipmaker LSI Logic, recently took on pessimists in an editorial for a trade journal.

Corrigan acknowledged the lack of a "killer app," a stunning product or technology to spur the industry into another growth spurt. It will take lots of money and hard work to keep growing under these conditions, Corrigan wrote.

But he was confident that it could be done: "Once again, we will use innovation and creativity to overcome these challenges and prosper."

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