ECONOMICS & SOCIETY

What's Next for Silicon Valley?

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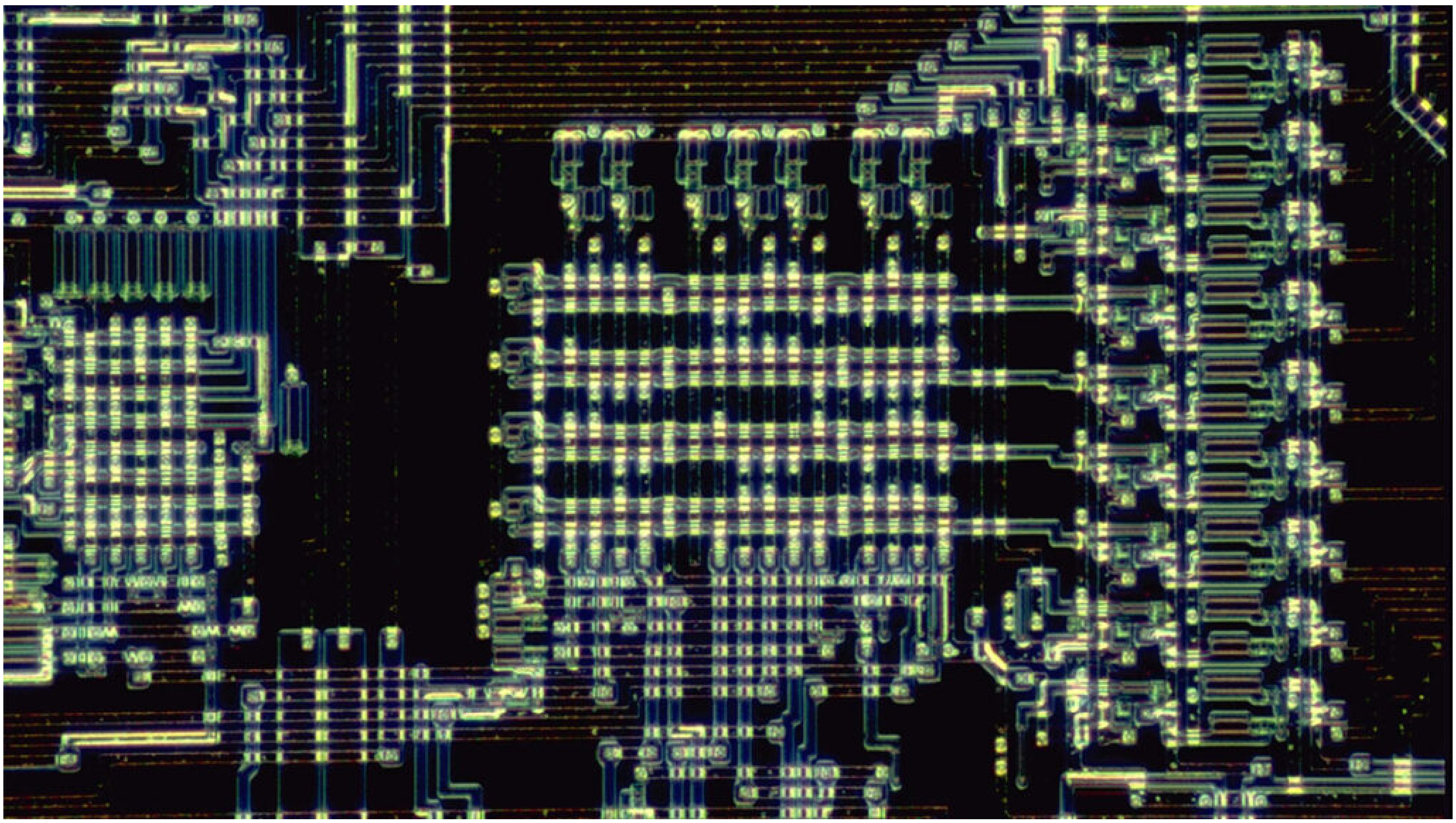

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Over the last 20 years, Silicon Valley has benefited from a once-in-a-lifetime alignment of advantages. American primacy, the ubiquity of cheap capital, the arrival of the smartphone (among other widely adopted tech innovations), and, perhaps most significantly, a benign regulatory environment have all conspired to create a historic concentration of wealth and power. The titans of the Valley and their heirs have been free to roam far ahead of lawmakers, watchdogs, and tax codes.

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That might not be true for much longer, however. Despite the fact that many public tech companies saw their valuations skyrocket during the lockdown and that the Covid-19 pandemic has accelerated mass adoption in e-commerce, online payments, telemedicine, and video conferencing, there are signs that the gilded age for consumer internet businesses may be drawing to a close.

There are four main driving forces behind this.

First, the near total dominance of the top tech giants — Facebook, Amazon, Alphabet (Google), Apple, and Microsoft — has become stifling. These companies not only hoover up top talent, but have grown to such a size and expanded into adjacent markets to such an extent that they are starving all but the best new tech businesses of oxygen. Smaller companies who compete in one of the markets that Big Tech considers as strategic — an ever-expanding list — risk becoming a target of full financial power of one of the giants, who aim to crush or buy possible contenders before they grows beyond a certain size. This hegemony impacts innovation and centralizes capital allocation.

Second, triggered in part by the poor post-IPO performances of Uber and Lyft — as well as smaller companies like Casper, SmileDirectClub, Super League Gaming, YayYo, and the WeWork/SoftBank debacle — investors, both private and institutional, are calibrating their approach. They are tightening requirements for additional financing to reflect the fact that a clear path to profitability, and not just exponential growth or "blitzscaling," is now considered key. This, combined with the pandemic hitting certain sectors especially hard, has exposed some startups as having suspect business models. In the absence of easy access to funding, whether because of the pandemic or because of pre-crisis problems, a number of them have seen their investors withdraw and were forced to close.

Third, regulators, the media, and the public at large are now far more familiar with the downside of tech and the multiple ways the promises made to consumers have been broken. Mass privacy breaches, voter manipulation, disinformation, more precarious working arrangements, life-threatening products, or the outlandish behavior of certain founders were largely tolerated five years ago, mainly because of public ignorance and faith in tech bro mantras such as “Move fast and break things” and “We’re making the world a better place.” Today, the tech industry receives much more critical scrutiny, as the cost of the industry’s unfettered reach and toxic side-effects — such as how social media and personalized search results make us more skeptical about science and more hardened in our opinions, or how short-term rentals drive rent increases — becomes increasingly clear.

Fourth, similarly, the public mood has decidedly shifted and expectations for tech to be accountable for their impact on society have grown. As the tech giants have reached market caps equivalent to midsize national economies, expectations and moral obligations have grown, too. Facebook has a market cap of more than $700 billion, up from $240 billion just five years ago, while Apple, Amazon, Microsoft, and Alphabet are now trillion dollar-plus companies. Even the Business Roundtable, America’s most influential group of corporate bosses, has taken to cheerleading “capitalism with a conscience” with their 2019 statement on the purpose of a corporation asserting a “modern standard for corporate responsibility.”

All of these trends point to a reckoning on the horizon. In September, according to Pew Research, 73% of Americans said they were not very confident or not at all confident in the ability of tech giants like Facebook, Twitter, and Google to prevent the misuse of their platforms to influence the 2020 presidential election. Separate research found that 85% of respondents felt Big Tech has too much power. Meanwhile, there’s a growing expectation on both sides of the Atlantic for tech companies to pay their taxes fairly and in full, rather than play the tax minimization game they’ve been able to get away with for so long; researchers at Fair Tax Mark, a U.K. nonprofit that campaigns for tax transparency and justice, identified a gap of $155.3 billion between the expected rate of tax and the cash taxes actually paid by Facebook, Amazon, Netflix, Google, Apple, and Microsoft between 2010 and 2019.

Against this backdrop, it's clear the typical tech business templates of the past couple of decades are no longer going to cut it — from either a business or societal perspective — for companies who plan to be around, let alone thrive, 20 years from now. The ready availability of investor cash coupled with sky-high revenue growth expectations that incentivized the use of predatory pricing (where VC billions are used to keep prices of, say, an Uber ride or a DoorDash delivery artificially low to undercut competitors), the exploitation of independent contractors in the on-demand economy, the algorithms that fuel outrage to increase time spent on social media platforms, and the advertising optimization encouraging privacy shredding micro-targeting are under threat and unsustainable.

What then will the tech business models of the future look like? Given the changing conditions outlined above, thriving in the next era of tech will likely involve meeting a different set of goals. While it is something of a taboo in the Valley (and on Sand Hill road in particular) to say so, tech's new era will very likely see slower, yet more sustainable growth and reduced profitability.

All these changes in funding, regulation, and public sentiment will likely alter key aspects of the scale-first current business models I've described — and disrupt existing sources of revenue. Based on my 15 years working in tech as an executive for large tech companies and a consultant for the Boston Consulting Group and now 18 months writing a book about how to make Big Tech more empathetic and human-centric, I believe we're about to see some major shifts in this rapidly evolving environment — and that there may be new opportunities for a different kind of tech company:

- **The micro-targeted advertising model will increasingly be under attack and will weaken:** Due to growing concerns around privacy invasion the dissemination of conspiracy theories and voter manipulation, look for companies to move away from the micro-targeting approach used by Twitter, Facebook, and Google/YouTube. The value of this model has been contested, and scandals related to hate speech, privacy violations, data breaches and more, have flourished. Web-based advertising platforms will likely limit micro-targeting to a very narrow subset of categories and advertisers, while moving towards some kind of "freemium" model, more acceptable to regulators and users.

- **More rights for gig workers and the end of "zero hours" contracts:** Because of changing attitudes and user and customer pressure, "disruptors" of physical consumer businesses such as Uber, Lyft, Airbnb, and DoorDash will likely be forced to offer protections to full-time equivalent workers. Ultimately this will result in these companies being somewhat smaller and less profitable than the FANGAM-style tech giants their investors envisioned, which may well make this model less attractive to VCs seeking outsized returns. But new companies in this space, freed from the bottomless brunch of venture cash, have an opportunity to become genuinely profitable and sustainable from the get-go.
- **There will be big winners and many failures in the direct to consumer (D2C) and online product subscription model:** Over the past decade there has been much buzz around D2C businesses for physical goods online, such as Dollar Shave Club, Harry's, The Honest Company, and Casper. In theory by cutting out the middleman (i.e. the retailer), D2C companies can sell their products at lower price points than legacy brands, and double-down on product. But it turns out that D2C isn't all it was cracked up to be. It's not that the model is unviable per se, just that most D2C businesses haven't really built any domain expertise: Their products aren't necessarily better, they haven't mastered digital marketing, and their unit economics are less attractive than at first glance because of acquisition costs and lack of scale. There are also too many of them, which is why only the biggest and best run D2C companies will win, and many will fail. Yet out of these ashes, new business opportunities will emerge. As consumer demand continues to shift online, I believe we are going to see a new generation of platform infrastructure businesses that will help any consumer brand become a D2C player. These platform infrastructure businesses (e.g., Stripe and Shopify) will benefit from the aggregation they create — you can't be a master of digital marketing with one small D2C brand, but you can if you have 100. This trend will also power legacy brands to transition faster to D2C.
- **Companies that focus on "conscious capitalism" and empathetic tech will have an advantage:** In an era where consumers demand higher ethical standards from all brands, all of the leading tech companies will increasingly be expected to exercise their

power with far greater responsibility and will be held accountable by regulators, users, boards/investors, and even their own staffs (something we're seeing more and more of) to make the right trade-offs. These decisions include: 1) Whether to benefit from high user engagement from outrage and right-wing populism on platforms or provide a universal communication platform free from disinformation, bullying, and hate through stricter standards (Twitter, Facebook, and YouTube). 2) Whether to offer consumers lower prices with less vetting or limit inventory by cracking down on bogus or potentially dangerous products or situations (Amazon, Airbnb). 3) How to support legitimate security efforts of democratic governments without enabling surveillance, profiling and government overreach (Google, Microsoft, Apple). The list goes on. While the last thing I'm suggesting is that all startup founders/legacy CEOs should turn to social entrepreneurship and build B Corps, value-based and empathy-driven companies make business sense: A study of exceptionally conscious firms demonstrated that they outperformed the S&P 500 index by a factor of 10.5 between 1996 and 2011.

While the convergence of these trends means some businesses will disappear altogether or be significantly downsized, others will thrive, albeit with different business models and economics, alongside reduced expectations and growth trajectories. Still, there is a wild card in all this: the regulators. As businesses are pushed towards monopoly and aggregation to achieve the profitability and competitive advantage required by the markets, increasingly hawkish regulators will likely turn towards antitrust and hands-on oversight and interventions — and the big question is how far they might go. The uncertainty around future regulators' actions on both sides of the Atlantic is particularly high given how the looming economic crisis renders protectionism and the defense of national champions increasingly tempting. My hope would be that the combination of industry-led initiatives, increased consumer scrutiny, and balanced regulation will help tech goes back to its original aspirations of being a force for good and of progress for humanity.

Interestingly this shifting landscape creates in my view a unique opportunity for legacy businesses — not just for them to pivot digitally, but to become the Platforms 3.0. Legacy businesses have a huge advantage in that they know how to operate in the physical world, they have marketing teams, who know how to build and sustain brands, and crucially they know how to operate profitably in multiple territories within the law. It won't be easy — most of them will fail — but the ones that succeed will be richly rewarded.

Maëlle Gavet has worked in technology for 15 years. She served as COO of Compass, EVP of Operations at Priceline Group, and CEO of Ozon. She has been named a "Young Global Leader" by the World Economic Forum, one of Fortune's "40 Under 40," one of the "Most Creative People in Business" by Fast Company and was fifth among Time magazine's List of the Top 25 "Female Techpreneurs." Her book *Trampled by Unicorns: Big Tech's Empathy Problem, and How to Fix it* will be published by Wiley in September, 2020.
