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Planting the seeds of innovation, everywhere!

by: Sean Foote, Labrador Ventures – August, 2006

Re-creating a culture of innovation across the U.S. and around the globe is not as easy as it looks, and it's certainly not just about replicating Silicon Valley elsewhere.

Sean Foote

As seen in the...

Venture Capital Journal

It happened again. I was again approached by government officials, business leaders and economic development experts seeking feedback on plans to create local communities of innovation and entrepreneurship around the world. Yet, invariably, the plans are often the same – 'We'll build Silicon Valley right here!' they'll say.

Philadelphia, Albuequerque, Scotland, New Zealand, Italy – the location doesn't matter. If they can just replicate Silicon Valley itself, they can somehow replicate the growth, innovation and employment opportunities that have come to represent this country's high-tech mecca. The problem is, it just doesn't work like that. You can't simply take Silicon Valley, tie it up in a bow, and replant its seed corn somewhere else. There's more to it than that. So much more, in fact, that some of the smartest people determined to help young companies grow and prosper are searching for the true magic behind Silicon Valley itself; interested less in capturing the Valley's mirror image and more in figuring out the basic building blocks of its underlying ecosystem.

As Margaret O'Meara, Professor of History at Stanford University and author of *"Cities of Knowledge"* states, "Replicating the entrepreneurial culture of Silicon Valley is hard but not impossible; replicating Silicon Valley is impossible."

Step 1: The Ingredients

John Kapral, CEO of *High Desert Venture Management,* a startup and emerging business consulting firm based in Albequerque, New Mexico, figures he's identified at least several elements that must exist in any 'petri dish' of entrepreneurship for it to thrive outside Silicon Valley.

"First, there must be a solid base of higher education to consistently generate the knowledge workers," says Kapral. "Second, there must be a culture of innovation that pushes people and their companies to explore and think in big ways. Third, there must be identifiable 'rock stars' to serve as role models for the future (think Hewlett and Packard, Ken Olsen from DEC, Guy Kawasaki of Apple, etc.). Fourth, geographic locale does mean something. An example is the growth of the fiber optic industry in south central Massachusetts; early companies in this industry like *Galileo* and *SpecTran* were actually incubated by employees from stodgy, two century-old *American Optical* which was located in the vicinity and first created to manufacture simple glasses."

Yet, I believe five other rules also apply. First, bigger is not always better. Sometimes a decent sized industry can take root in a small geographic area and make it a signature of that locale; think biotech in San Diego. Second, don't underestimate a deliberate plan promoting communication and fluid movement between large industry, the entrepreneurial world, government, and education. All parties need to talk to each other, share ideas, leverage resources. Third, you need entrepreneurs themselves to build and locate startups within these communities following in the footsteps of at least a few other entrepreneurs before them. Moreover, it helps greatly if these entrepreneurs might have learned their craft from the master craftsmen of their field; the offspring of the Microsofts, Ciscos, and even *Baidu.coms* of the world.

Fourth, there needs to be a vision towards entrepreneurship that comes from the local community itself. O'Meara, who recently spoke at our Labrador LP conference, argues in her book that Silicon Valley was not only built on Cold War research dollars going to Stanford, but that the Valley itself was built, just as importantly, on Stanford's prescience in turning its endowment of land into a research park for innovation. "In the 1950's that decision was a very forward-looking way of thinking, and Stanford could do that because it received a lot of money from the government to do R&D," says O'Meara. That decision not only reflected the Valley's early commitment to innovation and ideas, but represents the underlying culture of willingness to take risks – to think outside the box – even in the face of potential failure.

Last, there must be seed capital. Though all other elements of creating the 'ecosystem' of entrepre-

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neurship must equally be in place, there should exist a source – if not multiple sources – of seed capital and angel money to help bring ideas to market. Though everyone talks about the glut of money overhanging the venture capital industry – $20 billion raised last year, and climbing – the reality is that this venture money is tagged for mid to late stage deals. Of the deals done in 2005, only 63 were 'seed' round deals, defined as rounds of $1.5M or less. By comparison, The Angel Capital Association (ACA) estimates that angels invested an equivalent amount, a staggering $20 billion dollars, in mainly seed stage investments. Without this angel money available at the seed stage, there simply will not be enough qualified deal flow for later stage rounds.

And this applies specifically to emerging markets for innovation. "When you're trying to develop a region, you need angel investors to recognize the entrepreneurs and get them going, that's an essential part of the ecosystem before you even get to the next step of venture capital," says Patrick Von Garben, head of the Kauffman Fellows Program in Menlo Park, California. "Northern Virginia, San Diego, Austin, Texas, none of these areas started with lots of venture capital, though venture capital came in over time. Rather, it was the successful entrepreneurs who became angels who helped create the ecosystem of innovation and entrepreneurship."

Step 2: A Different Mindset

The irony of all this is that once an 'ecosystem of innovation' gets off the ground – once entrepreneurship can find its legs, once technologies have been created and the seed money has done its job effectively – the traditional model of venture capital not only should come in, it must come in and take hold in order for these newly formed communities of entrepreneurship to grow in their own right.

"While the early stage and seed capital is the more important ingredient, later rounds of capital are important as well, at the right time! And interventions are needed to develop a later stage venture capital industry especially in a globalized economy, where companies have to compete against Silicon Valley firms no matter where they are located," says Michael Clouser, Associate Professor with the Edinburgh-Stanford Link at the School of Informatics, University of Edinburgh. Otherwise, the effects of an innovative culture, a good university, and of marketable innovations are minimal."

O'Meara cites Philadelphia as an example of where entrepreneurship should have thrived – but didn't. The reason? "You need that loosey-goosey tradition of entrepreneurial spirit," she says. Philadelphia has a strong educational institution in the University of Pennsylvania, a large electronics and pharmaceuticals industry, a bunch of smart academics and access to capital; yet, it just couldn't create the same ecosystem of innovation. It just didn't work. Philadelphia didn't have the necessary culture sufficient enough to form a baseline foundation of entrepreneurship and risk-taking.

Clouser described to me the same dynamic abroad – that regardless of country of origin, a localized culture of risk-taking must be present and embraced. "In fact, it is accepted that one of the big impediments to changing the culture is just this – changing the mentality of would-be entrepreneurs. And people do admit that the Scots, and the Brits for that matter, have a low tolerance for risk-taking, and an even lower one for failure. Culturally, the Scots have lost in some pretty big deals; and the Brits continue to see the empire erode. Structurally, the bankruptcy laws disfavor the individual. There is a time lag when you can't go into business again if you've failed in a company and gone bankrupt – basically you are out of the game for one to three years, depending."

Step 3: Add More Capital, and Stir

Which brings the argument back to one of money. Does availability of startup capital play the most important role in creating a culture of innovation, or is it from the just one essential part, but not the dominant part, of an ecosystem?

Clouser and O'Meara both argue that, in many ways, to create Silicon Valley's look and feel and substance, governments and universities must become the first true angel investors within any community. "I think governments should first seek to seed universities with monies for science and research to form a competitive advantage for that community, and even then, universities have to build more entrepreneurial cultures themselves," says Clouser. "There is a market research function that has to interact with the applied research such that ideas can be developed into marketable products and intellectual properties."

And it's here, from the seeds of innovation, from the research done in the labs and universities and think tanks and large corporate R&D divisions, where ideas can truly emerge and entrepreneurs can grab hold and bring them to market. If the policymakers, economic development experts and local government officials can seed these ideas and innovations and either embrace or foster a culture of risk taking – where failure is a completely acceptable outcome – then seed capital should indeed come to their doorsteps. From there, larger pools of capital will emerge as success, even at its earliest stages, will yield even more success and innovation down the road.

This is one in a series of monthly columns on seed and early stage investing that Labrador Ventures was selected to contribute to the *Venture Capital Journal.*

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