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DIGITAL DOMAIN

It’s Not the People You Know. It’s Where You Are.

By RANDALL STROSS

FIBER networks cross the world. Data bits move at light speed. The globe has been flattened, and national boundaries obliterated. Yet in Silicon Valley, the one place that is responsible more than any other for creating the network technology that supposedly renders geography irrelevant, physical distance is very much on the minds of the investors who provide venture capital.

Meet the “20-minute rule” that guides fateful decisions in Silicon Valley. Craig Johnson, managing director of Concept2Company Ventures, a venture capital firm in Palo Alto, Calif., who has 30 years of experience in early-stage financings, said he knew many venture capitalists who adhered to this doctrine: if a start-up company seeking venture capital is not within a 20-minute drive of the venture firm’s offices, it will not be funded.

Mr. Johnson explained that close proximity permits the investor to provide in-person guidance; initially, that may entail many meetings each week before investor and entrepreneur come to know each other well enough to rely mostly on the phone for updates. Those initial interactions are fateful. “Starting a company is like launching a rocket,” Mr. Johnson said. “If you’re a tenth of a degree off at launch, you may be 1,000 miles off downrange.”

Capital and attention are lavished on entrepreneurs in the Valley as in no other place. Ten years ago, when Dow Jones VentureOne began a quarterly survey of where venture investments landed, one-third of all deals in the country went to the San Francisco Bay Area. Since then, the same share of deals has gone to the same place, almost without variation. Most recently, in the first six months of this year, Silicon Valley still pulled in 32 percent; the region with the second-largest total, New England, was far behind, at 10 percent.

The latest wave of innovation, embodied in Web 2.0 companies, is centered in Silicon Valley. Joshua Grove, a research analyst at VentureOne, said that 43 percent of Web 2.0 deals this year were in the Bay Area, the formal category for the Valley. These included three of the four largest financings: the $25 million that went to Facebook, $14.5 million to Zimbra and $12 million to Six Apart.

How well is the Valley doing in incubating this newest crop of start-ups? Ask the investors at YouTube, who are celebrating Google's $1.65 billion deal for a company that was all of 19 months old. Or look at Google's own record of growth: building a market capitalization of $141 billion in only eight years.

YouTube and Google share the same source of venture financing: Sequoia Capital, situated among the venture capital firms clustered in a handful of blocks in office parks along Sand Hill Road in Menlo Park, near the Stanford campus. Google's other source of venture capital, Kleiner Perkins Caufield & Byers, is nearby, too.

Why so many of these firms, which form the world's most concentrated source of capital for new ventures, originally collected in that particular spot, rather than, say, outside the Massachusetts Institute of Technology or the California Institute of Technology, is not important; what is important is that this is where they happen to be today.

Sequoia makes its preference for the 20-minute rule almost explicit, telling applicants whose companies are at the "seed stage" (receiving less than $1 million) or "early stage" ($1 million to $10 million) that "it is helpful if the company is close to our offices" because they "require very frequent contact."

Kleiner Perkins has only one office, the one in Menlo Park. Sequoia has reached out to entrepreneurs more considerately, providing five offices. But only one of the five, the one in Menlo Park, is in the United States. The others are in China (two), India and Israel.

If you have a brilliant idea for the New New Thing and want Sequoia to provide its funds and blessing — using the same golden touch provided not long ago to Google's founders — you would be much better off in Beijing, where Sequoia has an office, than in Boston, where it does not.

It's convenient for venture capitalists to have entrepreneurs close by, but the reverse is true, too, said Allen Morgan, a managing director of the Mayfield Fund, which manages $2.3 billion in venture capital and is also on Sand Hill Road. Mr. Morgan made the case by pointing out that a prospective entrepreneur would, on average, need to have three to eight meetings with a venture fund before he or she was successful, but would have to go through a similar process with 5 to 10 firms before finding the one that approved the funding request.

Even if the process goes smoothly and requires only 15 meetings — the fewest possible, given the lowest range of possibilities — and even if most of those meetings are set up in advance, the time consumed in getting to Sand Hill Road, even using local highways, can be significant. The problem is that much worse when, as often happens, a meeting is called with just an hour or two of notice. “If you live in Santa Clara, it’s doable,” Mr. Morgan said. “If you live in Dubuque, it’s not.”

Entrepreneurs who live in Silicon Valley also find the technical talent they need faster than they can in any other place; they pay more for that talent, but speed is the sine qua non for success. Seth J. Sternberg, the chief executive of Meebo, an instant-messaging company in Palo Alto that is backed by Sequoia, described Silicon Valley with the fervent appreciation of a recent transplant from New York, where he had suffered three separate bad experiences with start-ups, none of which had attracted venture funding.

The ecosystem in Silicon Valley, Mr. Sternberg said, includes “incredible techies, who live here because this is the epicenter, where they can find the most interesting projects to work on.” The ecosystem also includes real estate agents, accountants, head hunters and lawyers who understand an entrepreneur’s situation — that is, emptied bank accounts and maxed-out credit cards.

“In New York, it would be extremely difficult to find a law firm willing to defer the first $20,000 of your legal fees,” Mr. Sternberg said. “Here, we got that. It’s a pretty standard thing in Silicon Valley.”

On the East Coast, a business plan contest at the Harvard Business School in 2004 prompted one M.B.A. graduate, Arijit Sengupta, to found BeyondCore, a software company, in his apartment in Boston. Mr. Sengupta, who earlier had earned a bachelor’s degree in computer science and economics at Stanford, was determined to develop a finished product and to acquire customers by the oldest method of all: bootstrapping, or starting a business without outside capital.

He did end up needing Silicon Valley for something else: technical talent that would be willing to accept equity in place of any salary. Six weeks ago, he moved to Silicon Valley to recruit more people like his chief technical officer, who has been working full time since Jan. 1 for equity only.

“Elsewhere, if people in a large organization think you have potential, they offer you a job, trying to save you from the uncertainties of a start-up,” said Mr. Sengupta, who himself has worked at Oracle, Microsoft and General Motors. “In Silicon Valley, they say, ‘Can I join you?’ ”

Mr. Sengupta now has six “employees” working for BeyondCore without salaries. Only in Silicon Valley, he said, do “people have confidence that if you act on great ideas, the money will come.”

Predictions of the Valley’s demise have become a perennial, said Mr. Morgan, the Mayfield venture capitalist. “Every five years, Time or Newsweek runs a story: ‘Silicon Valley is Dead,’ ” he said. “But Silicon Valley is bigger and more vibrant and better at creating companies than it has ever been.”

Silicon Valley is not “bigger” in a literal sense. In fact, it remains geographically contained by the Santa Cruz Mountains on one side and San Francisco Bay on the other. The physical features of the place help explain the Valley’s vitality.

MR. JOHNSON, the venture capitalist in Palo Alto, noted that the greater Los Angeles area also has a pool of talented engineers (working at aerospace companies like Lockheed, Northrop and Hughes) and great universities (notably Caltech and U.C.L.A.) and plenty of money to invest. “But in Los Angeles,” he said, “people are scattered across a wide area; everything is more spread out.”

It’s harder for entrepreneurs to meet with one another and with investors, he added. And that means connections take longer, deals move slowly, fewer companies are formed. “Like a gas, entrepreneurship is hotter when compressed.” he said.

Why, one might ask, must relationships be built only by physical presence? Why, if the phone does not serve well, cannot the newest generation of videoconferencing gear — which provides stunning video to accompany sound — save the various participants from the vexations of getting together in person?

Mr. Morgan of Mayfield scoffed at the suggestion of virtual meetings as a feasible medium of establishing trust in business. He said that if the matter were important — and human beings were involved — he believed that there would never, ever be a replacement for face-to-face meetings.

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