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It's tech's turn to feel others' folly

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SOMEWHERE IN the tech industry – be it on the Eastside or in Silicon Valley, at a giant like Microsoft or a tiny startup – someone is watching the housing finance debacle eat Wall Street, the banking industry and perhaps the American economy as a whole, and saying, "Well, at least they can't blame this one on us."

The one they could blame on tech – and did, and with considerable justification – was the dot-com bust of 2001-02, in which companies closed, people lost their jobs and billions of dollars in market value evaporated.

That downturn was felt beyond the realm of technology, but the ripple effects were nothing compared with the tsunami the housing-finance earthquake has apparently unleashed. The tech bust's effects also were eclipsed by other hits to the economy, including the post-9/11 contraction of the aerospace industry that translated into thousands of layoffs at Boeing.

Now it's tech's turn to be on the receiving end of someone else's folly.

Just how much it receives is critical to the regional economy, since technology has been one of the sectors propping it up. The Washington Employment Security Department recently reported that the software-publishers category, for example, had 53,000 jobs in August, up 4,300 jobs from the same month a year ago.

For a perspective on this, we turn to Jay Bhatti, who has been in big and small tech. For three years he worked at Microsoft, as product manager in the Windows server marketing group and later in consumer services. More recently, Bhatti was co-founder of Spock.com, which developed a search engine designed specifically for finding people.

Thus Bhatti also has spent time in both the Puget Sound region and the Valley, and before that he worked as a tech consultant for major banks, which is where we begin our journey through the impacts of the financial sector's swoon on technology.

"In big tech it's going to have a huge impact," Bhatti says. At many companies, "What you're going to see is a lot of (chief information officers) being given memos by their CEOs saying, 'cut down costs, get rid of some projects that aren't mission-critical.' You're going to see a lot of CIOs cutting out budgets, and going to Microsoft and going to Oracle and going to SAP and telling them, 'Look, we're not going to do the upgrade as fast as we planned.' "

The hit will be felt both by hardware manufacturers, as customers defer spending or look for less expensive alternatives, and software providers who license their products for use on employees' desktop and laptop computers, he adds.

Even though startups don't depend on Wall Street or traditional banking channels for their lifeblood, they'll feel the effects as well, Bhatti says.

Venture capital, private equity and hedge funds draw their money from the same sources – pension funds, endowments, trusts and other pools of investment capital, who are "going to be a lot more prudent and cautious about where they put their investments."

That will mean a contraction in both the amount and sources of funding. "Over the past two or three years, what's happened in tech is a lot of the hedge fund guys and private equity guys have gotten in in the later stages," Bhatti says. "That became a very lucrative option for a lot of entrepreneurs because (they) found a lot of these guys were not price sensitive. Valuation was not a big sticking point for them. ... You're probably going to see that market close up a lot quicker."

Those still willing to fund startups may not be offering as much money or as attractive terms, and they're likely to be pickier about the companies they'll support. "One of biggest things the Valley is learning is because of MySpace and Facebook and all the social networks, that having an advertising-only supported business model is pretty tough." Start-up funders are "not as excited about companies saying 'We're the next social networking site, we're going to be an advertising business model with a huge user base.' "

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What VCs want to know, Bhatti says, is: Are companies building a compelling, sustainable business model with proprietary technology behind it "that other companies would be willing to pay for to get?"

The result, in Bhatti's estimation: Fewer startups being formed or getting funded, "but the ones that do get funded, I think you'll see them having a lot higher potential for success. The VCs will have vetted them out." Those that have been funded will have to resist the natural urge to grow as fast as possible in order to conserve cash. The "dead pool" of companies that don't make it will also grow, but the pileup of wrecked companies won't be as large as last time.

While the excesses of the 2005-06 funding boom were minuscule compared with the late '90s dot-com boom, the industry did see money thrown at fads and entrepreneurs seeking to build companies on them in the more recent boomlet. As Bhatti puts it, the startup segment of the tech industry "created a mini-bubble, and now it's time to deflate the bubble."

In other words, having learned some painful lessons in the past, the tech industry will contract, retrench, focus on fundamentals, examine risk more closely, re-examine goals and strategies and operate with caution and prudence – an operating philosophy that, had Wall Street and the mortgage and banking industries followed it, might have spared the country considerable economic trouble now.

Who would have predicted eight years ago that it would be the tech sector that would one day provide the model for financial rationality?

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