

Start-ups still don't know the way to San Jose

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San Jose may call itself the Capital of Silicon Valley, but that's not the case when it comes to attracting startups.

Among the region's municipalities, San Jose ranked 11th in venture capital invested in startups in 2009, behind not just Palo Alto but also San Carlos.

Is this a big deal? I think so. Mayor Chuck Reed isn't as worried, saying the city should play to its traditional strength: Being the place that startups go when they grow up.

"As soon as they move past that first stage of growth, I want them looking at San Jose," Reed said.

Why do I disagree? This is not just about civic pride. Attracting more early-stage startups is critical for the city's economy.

San Jose's startup deficiency is one of those obvious yet unspoken truths that has existed for decades. While the rest of the world sees Silicon Valley as one homogeneous region that's a hotbed of startups, on the ground here it's clear that some spots are hotter than others.

First, let's look at the numbers. According to PricewaterhouseCoopers, 43 companies in San Jose received \$262.5 million in venture funding last year. Compare that to San Francisco, which sits at the top of the list with \$1.01 billion invested in 173 companies in 2009, and Sunnyvale, which was No. 2 with \$662.9 million. It's even less than the \$290.8 million for San Carlos and the \$266.5 million raised in Menlo Park.

"Startups are not setting up shop in San Jose," said Vish Mishra, president of TiE. "What's wrong with this picture?"

San Jose struggles to attract the earliest stage startups for several reasons. Entrepreneurs want to be close to venture firms in Palo Alto. The bike and pedestrian friendly nature of smaller towns like Palo Alto and Mountain View and San Francisco is attractive to many startup workers. Many younger workers, especially those coming out of Stanford, rarely visit San Jose because of its reputation for a less than sizzling nightlife.

San Jose's strategy is to capture these companies as they grow and need more room. This

plays to its strengths. The city has more space that's less expensive. And it has payroll tax advantages thanks to its enterprise zones and other breaks.

"San Francisco has a lot of startups," Reed said. "But when those companies start adding more payroll, it starts to get more expensive for them and they look to leave."

Here's where Reed and I disagree: I don't think that strategy will still work.

That's because the valley's entrepreneurial economy is undergoing significant changes. While many startups are still launched in Silicon Valley, their next stage of growth increasingly happens overseas, meaning that San Jose can't bank on growing companies heading here. At the same time, the drought of initial public offerings means these companies have less money for expansion.

This means fewer companies migrating south over time. San Jose needs to capture more of those companies from inception, or risk missing out altogether. Reed said his focus is on companies as they grow from one to 100 employees.

But even in this niche, San Jose has to work extra hard. Reed estimates he's spoken to more than 200 CEOs and venture capitalists to get them thinking about San Jose.

"Some of them haven't been to San Jose in 20 years, so they have no idea what we're doing here," he said.

The city has taken steps to address some of my concerns. Its updated economic strategy plan, for instance, says:

"While several significant high-tech companies were born in San Jose (such as eBay), the city traditionally has been a place for expansion of companies started further north on the Peninsula. Sustaining a robust pipeline of new, growth-oriented start-ups is critical to the future of San Jose/Silicon Valley."

Kim Welsh, the chief strategist of the city's economic development office, pointed out that San Jose has one of the largest city-backed incubator programs in the country, which is good.

Some other things the city must address include issues like subsidized parking for startups to compete with free or cheap parking in towns like Palo Alto. And there other cultural quirks. Welsh told me about one entrepreneur who ran into problems negotiating a lease in downtown San Jose because he wanted to bring his dog to work in a building where dogs were banned. Despite the hurdles, it's worth noting that San Jose does attract solid entrepreneurs.

Pinger.com , which makes some of the most popular iPhone apps, has about 20 employees in a downtown space. Co-founder Greg Wook talks up San Jose to other entrepreneurs all the time.

"I'm a big booster for San Jose," Wook said. "Although there are still challenges, it's clearly gotten a lot better."

Better is a good start. But the city will need a lot more ambassadors like Wook to convince those Stanford graduates to leave the cozy confines of Palo Alto to explore the start-up frontier of San Jose.

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