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State should continue to see venture capital flowing

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by John M. McDonald

In spite of all the negative press that private equity investing got during the past two years, we continue to see strong activity in this sector of investing.

Most of the negative news relates to the large reduction of capital raised and invested in venture-stage private companies relative to the past three "bubble" years.

It also hinges on many venture funds that were active investors during the past several years that reported losses for the first time in many years.

What is completely overlooked by many is that with more than $16 billion in venture capital invested during the first nine months of 2002, if you exclude the bubble period, it is on track to report a record year. More astonishing is that there is an estimated amount of more than $100 billion raised or committed to venture capital investments that currently remains uninvested and seeking new opportunities.

Where is all of this capital flowing, and what is the current criteria for new investments?

If you break down the investments made by stage of investment so far this year, approximately 80 percent of the capital flows into "expansion" or "later" stage companies, compared with "startup" or "early-stage" companies. This is a huge shift from just two years ago when investment skewed toward earlier-stage companies with much less developed businesses.

Today's venture investors seek proven technology and real customers to minimize the risk of product commercialization and market acceptance.

Today's investors also gravitate toward traditional financial metrics such as, if you can believe it, revenues and profits.

"Eyeballs," "click-throughs" and "lines of code" are all out.

Proven management, revenue momentum, sales pipelines, and diverse product offerings are in. Mantras such as "build it and they will come" and "spend as fast as you can to capture market share" have long disappeared.

In general, today's venture investors seek lower risk and gladly accept lower returns and longer holding periods as a result.

What about a sector? What's hot and what's not?

Judging by year-to-date results, venture investors continue to overwhelmingly seek software and information technology opportunities. These two sectors captured close to 60 percent of the investment pie so far this year.

Biotech is capturing more of the investment pie — with 14 percent, compared with 8 percent in 2001. To no surprise, telecommunications dropped to 7 percent from 16 percent in 2001.

We expect software and IT to remain strong, and telecom reversing the downward trend beginning early next year as investors realize that this sector has been overly beaten down. Biotech should remain flat to slightly down as a percent of total investing.

Geographically, private companies in California continue to receive the largest amount of venture capital, with 45 percent of the total dollars so far this year. This trend will not change since venture capital does not travel well, and California has the lion's share of venture dollars.

The Southeast, Florida in particular, has always been grossly under-served by the venture community.

But with hope for new funding from the state of Florida's CapCo program, along with new and emerging investment banking firms that focus on bringing venture capital dollars into the state, Florida should expect to see more venture capital investing going forward.

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