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Finance

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Venture capitalist still hungry for tech firms

Substantial void in traditional businesses as entrepreneurs pour money into dot.coms and online enterprises to detriment of offline companies

By NIALL MCKAY

Four years ago Mr Eric Lawrence, a partner in Retail and Restaurant Growth Capital, invested $2 million (€2.1 million) in the US sandwich franchise Quizno's. Then it was a privately held company with just 200 outlets, now it's trading on the Nasdaq and has more than 800 franchises in four continents.

"We're pretty much e-tail (Internet) protected until they figure out a way to get a sandwich down a modem line," said Mr Lawrence apologetically. "But if you get a home run then it doesn't matter whether it's a dot.com or more traditional company."

Retail and Restaurant Growth Capital is one of the decreasing number of venture capital firms investing outside the technology and biotechnology industries. Indeed, PricewaterhouseCoopers reported that of the $36.5 billion in venture capital invested last year, only $3.2 billion went to non-tech companies. The reason, it seems, is that both the money and the entrepreneurial talent is going to the high-tech industry leaving a substantial void in traditional so called "bricks and mortar" business.

For the past two years, nontech investing has been holding it own at $3.4 billion but last year it dropped for the first time, said Mr Kirk Walden, national director of the PricewaterhouseCoopers's Money Tree Survey.

Not surprisingly, most of the money is following the opportunity into the high-tech sector. And why not? Venture capitalists are inclined to poo-poo traditional returns of between 25 and 50 per cent because a successful dot.com can yield as much as 500 per cent.

Those that invest outside hightech are a little defensive about their decisions. "Just because there has been a five-year history of strong growth in high tech does not mean that it's the only way to make money," said Mr Lawrence. "We're looking for companies that have value today. Do they have strong revenues? Are those revenues growing? Is it a good IPO candidate?

Besides, argues Mr Lawrence, sooner rather than later the pendulum is going to swing back and high tech will take a dive. Mr Lawrence is right. Even now, dozens of dot.com companies are closing doors and laying off staff and recently CDNow one of the largest music retailers on the Internet got snapped up by the German media giant Bertelsmann for a paltry $117 million - to put things in perspective that would not buy a single state's worth, such as California, of Quizno's.

Although chasing the high-tech pot of gold is not the only reason why funding outside of the technology industry is on the decrease. Historically, there were four non-tech sectors that received venture capital; restaurants, retail outlets, healthcare and new distribution channels. Barring restaurants, much of the venture capital for the other sectors is moving into high-tech flavours of these businesses.

Healthcare can be further segregated into, managed care, healthcare services, and medical devices. "Managed care is not funded right now because there are too many players and a shake out is taking place," said Mr Marty Sutter, managing director of Essex Woodlands Health Ventures.

Much of the remainder of the money earmarked for healthcare services is going into those that are using technology to create a competitive advantage. For example, last year, InterWest invested in physician practice management firm, Kelson Physician Partners.

It manages the practice so that paediatricians can get on with being doctors, says Mr Steven Holmes, InterWest general partner. "But it will become a dot.com by the end of the year."

Likewise, new retail distribution channel funding is being eaten by the dot.coms. Several years ago InterWest invested in OfficeClub (later acquired by Office Depot). "It

was the perfect example of disintermediation," said Mr Homes. "Today we are investing in that same theme but in Internet companies."

Retail outlet finance has taken the same route with business such as Amazon.com, Drugstore.com and Pets.com getting the lion's share of the money.

But the current high returns have blinkered entrepreneurs to the opportunities offline. According to the National Restaurant Association, in the 1950s eateries accounted for 25 per cent of all food dollars, now it accounts for 40 per cent and in the next 10 years it will jump to 50 per cent.

Furthermore, successful investing is about identifying interesting new trends either offline or online, according to Mr Art Berliner, founder and partner of the Walden Group.

On a recent holiday in London, Mr Berliner discovered Wagamama's, an ultramodern Japanese noodle bar tailored for the western palate. "It was an idea that couldn't fail in the US," he said.

However, when he approached the management they said that they had other fish to fry. So Mr Berliner found a US entrepreneur and funded a restaurant chain called Zao.

So is the situation hopeless? Far from it, according to Mr Ralph Sabin, managing director of Pacific Venture Group.

"It's just a question of investment cycles," he said. "Healthcare is a trillion dollar industry and will experience strong growth in the next three decades owing to the US's ageing population."

Furthermore, Retail and Restaurant Growth Capital's Mr Lawrence expects Internet companies to drive an offline retail renaissance in the next two years as online companies begin to establish an offline presence.

In the meantime, most venture capitalists are concentrating on the high-tech and biotech sectors. "Technology is the land of opportunity and that's were we like to be, that's where we're paid to be and that's where our investors demand us to be," said Mr Holmes of InterWest.

Perhaps its time for a change.

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