Venture capital express rarely stops in urban America

By Sidney Morse
Special to Sentinel-Voice

Despite a technology recession, amidst an overall slowing down of the national economy, the venture capital community, while certainly undergoing a period of restructuring and repositioning, continues to accumulate capital and make investments in an attempt to create high returns.

Often thought to have helped cause the "tech bubble" to burst late last year by the intense level of speculative investment in which it engaged, "The Venture Capital Express" is alive and well, still succeeding in finding those deals that promise to turn ordinary into extraordinary on the trail to wealth creation.

The Price Waterhouse Coopers/MoneyTree survey of venture capital activity for the first quarter of 2001 stated that while it was down 40 percent from the same period a year earlier, a hefty $10.1 billion managed to still pour into robust investment activity.

The regions that attracted the most were, of course, Silicon Valley, with slightly more than $3 billion, followed by New England at better than $1.1 billion, Texas at just ahead of $1 billion, New York Metro at $875 million, San Diego at almost $600 million and the Washington D.C./Metroplex area rounding out the top spots at about the same level. Los Angeles/Orange County also registered a fairly strong performance at nearly $330 million as well.

To the surprise of some, the top five industries most successful in attracting venture capital were Communications and Networking, followed by Software Development, Consumer and Business Services, Information Services and Biopharmaceuticals. Electronics and Computer Hardware, previously the banner child for venture investment, dropped to eighth in a precipitous decline over the previous two years. Venture investment also appears to shadow research and development capability, the engine of innovation and creativity and a magnet for "New Economy" formation.

But curiously, a closer look reveals that particularly investment connected to technology is occurring near major metropolitan areas but generally outside of the urban centers they contain.

Perhaps part of the reason for this lack of private capital formation is the fact that a disproportionate amount of urban businesses are steeped in "old economy" retail and other consumer driven, service sector activity, offering limited visibility for the kind of returns the venture community has come to expect.

It is clear that the mood, coming from a growing spirit of self-empowerment in urban communities and resulting from a failure of product and service purveyors to have a presence in those markets, that the primary motivation has been to fill the void left vacant in these underserved communities.

However, venture capital and other private investment institutions are increasingly looking for the kind of scale that can leverage the potential of huge returns, difficult to achieve by the simple servicing of local markets.

Further, with technology today, it is too easy for local firms to penetrate global markets using the power of the Internet and other similar tools. So now, urban businesses will be faced with a decision challenge: exist to service your community or think about global markets that will attract a different type of investment partner. The Business Services sector offers excellent growth opportunity where urban businesses can play, using technology as a lever of participation and at "costs of entry" often lower than at any time in previous decades.

It will take a fundamental shift in thinking and strategic positioning amongst urban entrepreneurs in order to attract private equity capital to the degree it has arrived in suburban locations.

An exit strategy, just as one example, will be a relatively new decision challenge that urban businesses will have to face. In the past, strong cultural sentiment has condemned the transfer of business ownership controlled by ethnic minorities for fear of a change in practice harmful to the community it serves.

Attracting venture capital will require a re-thinking of that cultural anchor in the context of the strategic benefit the community might derive from the infusion of stronger and more intense capital investment. A decision not easily changed.

"Business is one of the few environments the word 'Black' is not used in a negative connotation, it represents profitability." according to Lem Daniels, first vice president of investments for Smith Barney.

Daniels has more than a little experience in understanding urban investment markets. In 1991, he was the broker of record coordinating taking the famed Black Entertainment Television (BET) public on the New York Stock Exchange, attracting such investment stars as Michael Jordan and Ervin "Magic" Johnson, and then most recently, helping to engineer the participation of Citigroup in Faithful Central Church's acquisition of the Great Western Forum, former home to the Los Angeles Lakers.

"African-Americans should become more aware of what the word represents in business circles and leverage that psychology for productive purposes," said Daniels. "It's a positive, not a negative."

He indicates that venture capital players up to now have largely not understood urban markets nationwide, most commonly viewing them as "poor markets."

"However, the misperception resulting from the lumping of what are now, diverse socio-economic classes, into one basket is to miss huge opportunity connected to the wealth potential that lies in those communities," he says.

Said Daniels: "Changing demographics, such as the rapid rise of the Latino population, and shifting and use motivations are causing a rethinking of urban opportunities. Regentrification and a return of White residents to urban neighborhoods, driven by their fatigue of long suburban commutes, will help lift the profile of these often forgotten communities and is already beginning to attract "smart" money on an increasing level."

It is clear that there are challenges ahead in changing the image of urban markets in order to make them (See Technology, Page 17)