

Despite tech boom, venture activity in region is sluggish Rochester cited as upstate hot spot

June 27, 2008

by Neil Springer The Business Review

Although the Capital Region has done well in developing its entrepreneurial spirit, it lags behind other upstate regions right now in creating the kind of robust scene attractive to venture funds.

Of the seven venture capital deals totaling \$25 million done in upstate New York in the first quarter of 2008, only one involved a Capital Region company, according to the latest Pricewaterhouse-Coopers MoneyTree report on venture activity in the United States.

Clifton Park software developer **Apprenda Inc.** received \$500,000, but the rest of the deals were done with companies out of the region.

Three were done in Buffalo. SmartPill Corp., a Buffalo medical device maker, took in \$20 million. Still, the hottest place in the state, venture capitalists say, is Rochester, because of a confluence of factors revolving around the Lennox Tech Enterprise Center, an incubator affiliated with High Tech Rochester.

HTR is an economic development organization whose counterpart in the Capital Region is **the Center for Economic Growth**.

High Peaks Venture Partners, which was the sole investor in Apprenda and one of two in SmartPill, has other local companies in its portfolio: **Applied NanoWorks**, and advanced inorganic materials manufacturer in Rensselaer, **and ReQuest Inc.**, a developer of digital media storage and management systems in Ballston Spa.

FA Technology Ventures LLC also has investments in Applied NanoWorks, as well as in the East Greenbush software company **Autotask Inc.**; and **CoreSense**, a Saratoga Springs developer of Web-based retail management systems.

Both funds, and **Advantage Capital Partners**, which has one local investment in Washington County, look for early-stage companies. Investments generally range from around \$500,000 to \$3 million – and higher in some cases.

But right now, the focus is elsewhere.

“Of all the major upstate cities – Albany, Buffalo, Rochester and Syracuse – Rochester is the most dynamic at the moment,” said Scott Murphy, managing director of the Glens Falls office of Advantage Capital Partners.

“There is a lot of activity and good infrastructure. HTR [High Tech Rochester] is doing a very good job and there have been some quality deals,” Murphy said.

And the University of Rochester and the Rochester Institute of Technology are very active.

“The universities are pulling back alumni, leaning on the alumni community to get them involved as mentors and as business plan competition judges. That is really important,” Murphy said.

Bela Musits, managing director of High Peaks, said the entrepreneurial programs and schools of management at the University of Rochester and RIT are very strong, as are their engineering and science programs.

This is the native DNA for why people start companies,” Musits said.

Add on the Lenox Tech incubator at HTR, the strong incubators at the schools, and people searching for something to do after being shed by Kodak and other large employers, and the brew is very exciting.

“I’d like to steal whatever they are doing,” said John Cococcia, a partner in FA Technology Ventures.

“It’s a multiplicative effect, and all of them are necessary,” Musits said.

Several insiders in the Capital Region, however, point out that there are the right ingredients here for venture deals.

Peter Pritchard is program director for venture programs at the **Watervliet Innovation Center**, a business accelerator run by the CEG. He says the difference between the Capital Region and Rochester is one of scale – not

substance – across a number of parameters. A couple of “bumps up” in venture activity make a huge difference in perception about how vibrant an area is.

Right now, High Tech Rochester is doing a very good job with its entrepreneur-in-residence program, Pritchard said, which brings “high-value” individuals with commercial and industrial backgrounds into the mix.

It is a very important piece of the business ecosystem, he said, and although the Capital Region has some of those individuals, there are fewer here. The same goes in terms of angel investing.

“There is a robust investment community here, the same type of active investment groups, the same deal flows, just less in terms of the numbers of high net worth individuals,” Pritchard said.

Even so, the strong economy in the Capital Region, ironically, tends to dampen entrepreneurial activity somewhat, because laid off tech employees find there are other jobs to be had, said Musits of the High Peaks venture fund.

Rich Honen, a partner at **Phillips Lytle LLP** and head of the law firm’s Albany office, specializes in venture capital. He thinks there are companies in the region just not ready for infusions of \$500,000 and up.

Not long ago, Honen said, the early stage companies coming out of the incubators at **Rensselaer Polytechnic Institute** and the **University at Albany** were very robust, he said, citing ReQuest, among others.

Now, “there is a slowdown in the pipeline of early-stage companies coming out of the incubators,” he said, “and the very early-stage companies are turning to angel investors or government money.”

Murphy, the managing director at Advantage in Glens Falls, has been investing in upstate New York since 2001 and has been in Glens Falls since 2006. He would like to have more Capital Region companies in his portfolio, but it hasn’t clicked.

“We have looked at companies here, but perhaps it was not the right moment, or we were not comfortable with the business model or management team,” he said.

Or, in some cases, the management team found other sources of less expensive capital, like angel investors.

A company’s odds for landing venture funds are pretty thin. Musits said High Peaks receives about 200 business plans a year. Seventy-five get more than a cursory look.

Of those, 40 may be invited in for a deeper look, and about 10 of those will be offered terms stating how much High Peaks is willing to invest, and for what percent ownership. In the end, two to four deals are closed.

FA Technologies starts out with about 1,000 requests, Advantage with 400, but the whittling-down process is just as quick and decisive.

“This is a competitive business. It is frustrating. I would like to have something [invested in the Capital Region], but it hasn’t worked yet,” Murphy said.

“Yet” is the key word.

“The Capital Region, and all of upstate, has become better by an order of magnitude over the past 15 years in entrepreneurial startups and attracting VC funds,” said Musits.

The Capital Region now is on the radar screen of venture funds in Boston and New York City, he said, in part because of the billions that have been poured into the Albany NanoTech campus at the University of Albany, which has attracted other high-tech development.

“It’s a good start but it take time.” Musits said.

Murphy pointed out that the semiconductor-related work at Albany NanoTech has produced primary research and partnerships with large companies, but has not yet spun off the kinds of businesses VCs might want to invest in-yet.

He and others are confident that will happen, even if it’s not in terms of months.

“From research to products to companies will take a little longer-in years,” Murphy said. “This is a long-term project.”

Cococcia of FA Technology Ventures said expectations in some quarters about spinouts from the NanoTech campus may have been a little too high.

“The realty is very different. It takes a while for things to really ferment. There will be opportunities for spinouts, but it will take some patience,” Cococcia said.

He also thinks the pipelines out of the region’s incubators will pick up again.

We are doing a lot right. There is a very good infrastructure of tech support here, and a lot of resources,” he said.