SpotLight

Texas Venture Capital

Revived Spending Ends Prolonged Lull

In 2000, Texas venture capital spending was booming at almost $6 billion a year—up more than five times from 1998. The high-tech bust led to a precipitous decline in 2001 and 2002, and venture capital showed little or no growth for the next several years.

Venture capital investment began to rebound in late 2005, and it grew 28 percent in 2006, outstripping the nation's 12 percent growth (*Chart 1*). Even so, last year's $1.4 billion represented slightly less than 6 percent of the U.S. total.

According to PricewaterhouseCoopers' MoneyTree Survey, telecommunications, software, semiconductors and other high-tech sectors still receive the largest share of funds, accounting for half of the Texas venture capital investment (*Chart 2*).

As venture capital growth has revived in the past two years, however, the state has seen more funding for energy and nontraditional sectors, including media and entertainment and electronics. The biotechnology, medical devices and equipment industries are also making strides, with this life sciences sector identified as one of the drivers for innovation and economic growth.

Although high tech remains dominant in Texas venture capital, its composition has changed. Networking, equipment and telecommunications investments grew steadily in the late 1990s but collapsed with the dot-com bust in 2000. More than five years later, these sectors still haven't recovered. Overinvestment created a glut of telecom and Internet infrastructure, such as wireless equipment, routers and fiber-optic lines. Today, software and semiconductors, which together account for about half of high-tech venture capital dollars, have filled the void left by the telecommunications and networking industries.

Another notable change is in the administration of venture funds. Financiers are now more conservative and have shown increasing preference toward mature companies over neophytes. This affinity stems from a lower likelihood of companies going public, which venture capitalists trace to the burdensome costs of Sarbanes–Oxley compliance, particularly for small-cap companies, and to the residual effects of the high-tech bust.

More than two-thirds of Texas venture capital investment takes place in the five largest metropolitan areas. Austin leads the pack by a large margin, increasing its share of Texas venture capital from 33 percent to over 43 percent since 2000. All told, the capital city commands more venture capital than Dallas–Fort Worth, Houston and San Antonio combined.

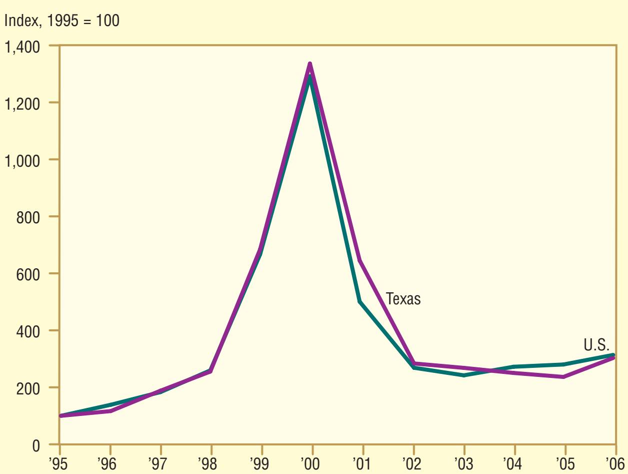
Despite Austin's dominance, San Antonio is the only major metro posting gains in venture funding in this decade. The city's share of the Texas market increased fivefold—from 0.9 percent in 2000 to an average of 4.7 percent from 2003 to 2006. Fueling San Antonio's upsurge are investments in the life sciences and high-tech sectors.

Venture capital investment fosters job creation, both nationwide and in the state. In 2003, for example, venture-backed companies accounted for nearly 12 percent of Texas private employment and generated about $188 billion in annual sales, according to a 2004 study by the National Venture Capital Association and Global Insight.

Although venture capital spending isn't likely to regain the lofty heights of 2000, the most recent data suggest that Texas investment may have broken out of its slump. This bodes well for the confidence and optimism of Texas firms—and it should help boost job creation and output.

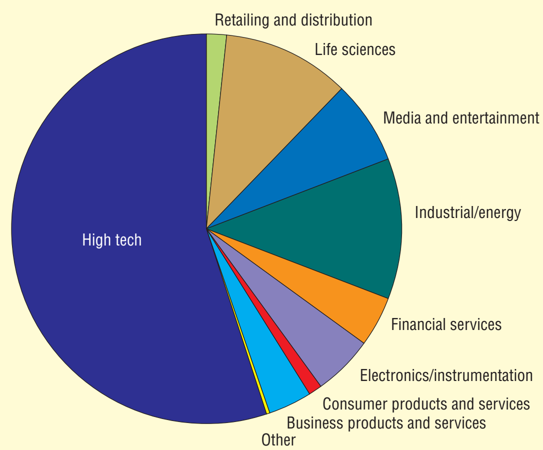
—Laila Assanie and Raghav Virmani

Chart 1
Venture Capital Investment in Texas Picks Up in 2006



SOURCE, Chart 1 and 2: National Venture Capital Association, Thomson Venture Economics, PricewaterhouseCoopers MoneyTree Survey.

Chart 2
High Tech Still Dominates Texas Venture Capital



NOTES: Data are for 2006. High-tech sector: IT services, networking and equipment, semiconductors, software and telecommunications firms. Life sciences sector: biotechnology, medical devices and equipment, and health care services industries.