Money for a fledgling boosts self-esteem For start-ups, support may be in bigger supply

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Dale Pfost is grateful for the $500,000 his fledgling company just got from Ben Franklin Technology Partners of Southeastern Pennsylvania.

The money will pay the bills, but the confidence boost it gave is priceless, said Pfost, chief executive officer of Acuity Pharmaceuticals Inc. of Philadelphia.

The Ben Franklin investment late last year, and a like amount from BioAdvance, are the first dollars it has gotten from outside institutions. Coming after months of scrutiny of its research, business plan and leadership by experts working for the two state-backed agencies, the money seems to validate Acuity's work.

The company says it believes it has a potentially effective and profitable treatment for diabetic retinopathy and macular degeneration, conditions that can lead to blindness. But it will not know for sure until clinical studies are completed years from now.

For about a year, using science licensed from the University of Pennsylvania, Acuity and its seven employees have functioned mainly on friends-and-family money.

"There are many steps as companies grow," Pfost said. "The step represented by the Ben Franklin and BioAdvance investments is important beyond the money invested."

Neither the money nor the boost to self-esteem has been easy to come by recently for technology companies such as Acuity that are just starting up.

Take away Ben Franklin and a handful of other sources, and there would be almost no start-up investing worth noting in the Philadelphia region.

According to the MoneyTree Survey by PricewaterhouseCoopers, Thomson Venture Economics and the National Venture Capital Association, eight of the 18 deals in the region in the last quarter of 2003 were early investments in young companies. All were attributed to Ben Franklin or BioAdvance.

At least two more, not reported to the survey, were by Murex Investments of Philadelphia, which also made two later-stage investments during the quarter.

There are subtle signs of change that might loosen the purse strings for companies such as Acuity.

After two years of being dormant, some private-equity funds are raising new money again. That has encouraged some industry experts to think investors will not shy away from these typically speculative early investments for much longer.

But for now, private investors, mindful of their losses in the Internet fiasco, remain nervous about jumping into the fray too early.

They also have not had much need to because demand for start-up investments fell off following the Internet collapse, said Bill Molloie, who heads the venture practice at PricewaterhouseCoopers in Philadelphia.

Finally, many private-equity funds have put investments in new companies on hold as they continue to tend to companies already in their portfolios.

Including $1 million in the fourth quarter, a total of $3.5 million was reported in "seed" investments locally last year.

That was down from $5 million in 2002, although the eight such deals last year were an improvement over the two in 2002.

During the year, 17 investments totaling $114 million were deemed to be "early stage." The amount invested was nearly double that in 2002, but short of previous years' amounts.

Nationally, the $354 million in seed investments last year was barely higher than the $352 million recorded in 2002. Total private-equity investment declined to about $18 billion in 2003 from $21 billion in 2002.

But there are new developments.

A year after a single Philadelphia-area fund reported raising $22 million, five funds reported raising nearly $418 million last year. Nationally, nearly $11 billion was raised last year, up from $9 billon the previous year - though both totals were far short of the $37 billion raised in 2001.

At the same time, the funds are working through an estimated $55 billion still uninvested - down from about $75 billion a year ago.

Most of the new money is destined not for seed investments but for follow-on rounds. There has been an upsurge, too, in money raised by mezzanine funds, which back mature companies preparing for mergers or initial public offerings of stock.

Last year marked a small national comeback of IPOs among venture capital-backed companies, with 29 of them going public, vs. 24 in 2002.

As private-equity funds crowd the field for later-stage investments, however, they will push up valuations for those companies and make them less lucrative for investors, Molloie said.

Some funds then will look to invest in companies that offer investment opportunities at earlier stages, Molloie said.

"I'm optimistic this year the faucet will open up more to early-stage companies," said Jesse Reyes, vice president at Venture Economics.

At Ben Franklin, it is taking some ingenuity to raise new money. The agency gets about $7 million a year from the state.

But it has launched new programs to leverage other money, by partnering with wealthy individual investors called angels and with other publicly funded agencies, such as BioAdvance and Innovation Philadelphia, said Terrence H. Hicks, vice president of investments and entrepreneurial services.

BioAdvance, funded from Pennsylvania's share of the national tobacco accord, has given $6 million to biotechnology ventures so far, including $500,000 to Acuity, said Barbara S. Schilberg, a managing director.

It, too, is raising new money, not for more early-stage investments but to make larger follow-up investments as companies it has seeded grow bigger. It hopes to raise between $20 million and $40 million, at least doubling its present size.

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