Funding boom shows power of tech startups, raises concerns

January 16 2015, byBrandon Bailey

In this Tuesday, Dec. 16, 2014 photo, a woman leaves the headquarters of Uber in San Francisco. Venture capitalists poured a whopping $48.3 billion into U.S. startup companies last year, investing at levels that haven't been seen since before the dot-com bubble burst in 2001, according to a new report issued Friday, Jan. 16, 2015. The two biggest deals in 2014 were separate rounds of investment in Uber Technologies, the high-flying and controversial ride-hailing service, now valued at $41 billion. (AP Photo/Eric Risberg)

Venture capitalists poured a whopping $48.3 billion into U.S. startup companies last year, investing at levels that haven't been seen since the heady days before the dot-com bubble burst in 2001.

Software and biotechnology companies were the leading recipients of venture funding in 2014, which rose more than 60 percent from the previous year, according to a new report issued Friday.

Experts say the surge comes as tech startups are performing well in public stock offerings, and shows that investors recognize the power of new technology to disrupt and replace old industries. But it also underscores a nagging concern that investors may be sinking money into some companies at inflated values.

"There really is an unprecedented level of innovation that is taking place," said Robert Ackerman, managing director and founder of Allegis Capital, a Silicon Valley venture firm. "What I worry about is how the excess of capital is affecting valuations and expectations."

The new figures come from the quarterly "MoneyTree Report" issued by PricewaterhouseCoopers and the National Venture Capital Association, based on data from Thomson Reuters. The report counted 4,356 venture deals last year, only 4 percent more than the 4,193 deals reported in 2013. But the value of those deals has surged.

Last year saw a record 47 "mega-deals," defined as investments of more than $100 million, nearly twice as many as reported in 2013, said Mark McCaffrey of PricewaterhouseCoopers.

"We've never talked about this level of fundraising before," said McCaffrey, who leads the accounting and consulting firm's global software practice. "This points to a dynamic change in the market."

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Uber Technologies, the high-flying and controversial ride-hailing service, now valued at $41 billion. Each round was pegged at $1.2 billion. Other major deals included $542 million invested in Magic Leap Inc., a secretive startup working on virtual reality technology; $500 million in Vice Media, which operates online news and video channels; and $485 million in SnapChat, the popular messaging service.

Software companies got the biggest chunk of funding, as they have for the last five years. Venture investors put $19.8 billion into software deals last year, or 77 percent more than in 2013. The second leading sector, biotech startups, raised $6 billion or 29 percent more than a year earlier.

Venture funding has never matched the peak of $105 billion that was reported in the go-go year of 2000, right before a host of untested new Internet companies collapsed after failing to produce revenue. The total fell to just under $41 billion in 2001 and hasn't regained that level until now. It had climbed to just under $30 billion in 2013.

McCaffrey said last year's surge shows investors increasingly believe U.S. tech companies are capable of succeeding quickly on a global scale, which means they are poised to reach vast markets and reap sizable revenue. He also noted that new kinds of investors, including private equity or hedge funds, and the corporate investment arms of major companies, are now vying with traditional venture capital firms to back promising startups.

"What we're seeing is healthy competition for these deals, which can drive them up to be frothy," McCaffrey said.

But some prominent figures in Silicon Valley have voiced alarm at the valuations of some companies, suggesting that investors are taking on excessive risk.

"There has been increasing concern about valuations," said Mark Cannice, professor of entrepreneurship at the University of San Francisco, who conducts his own quarterly survey of investor confidence. "It's not that many businesses aren't viable, but the question is what are you paying for them."

Still, many venture investors shy away from characterizing the current trend as a "bubble." Ackerman, whose firm focuses on commercial software and networking technology, said he's convinced that new software and communications advances are revolutionizing vast sectors of the world's economy.

But he said hedge funds and other new investors are investing at higher levels because they expect significant returns after seeing a series of successful initial public stock offerings over the last year. "They are basically chasing returns," he said.

That has led to "excess capital and excess valuations," Ackerman added. "Are there companies out there that are overvalued today by traditional metrics? Yes."

The market will eventually re-calibrate, he said, and when it does, some investors may lose money. Meanwhile, he warned, some companies that are receiving massive infusions of cash are not spending it wisely, which can lead to unsustainable operations.

McCaffrey and other experts said they expect venture funding will continue without any sharp drop in 2015, however.

Commercial software companies, especially those that offer cyber-security services and tools for analyzing large amounts of data, are expected to be big draws in the coming year, along with biotech and health technology.

But one veteran investor predicted fewer new companies may be funded in the future. Bigger venture capital firms are investing in older, more developed startups because they are viewed as proven businesses that offer less risk, said Brian Cohen, chairman of the New York Angels, a consortium that invests in very early-stage companies.