VC firms rain down cash on tech startups, is bubble brewing?

January 17 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)

Cash rained down on startups in 2014, as venture capitalists poured a whopping $48.3 billion into new U.S. companies—levels not seen since before the dot-com bubble burst in 2001. Strong technology IPOs are luring investors chasing the next big return, but with valuations this high, critics suggest some investors may be setting themselves up for a major fall.

"It's not that many businesses aren't viable, but the question is, what are you paying for them?" said Mark Cannice, a professor of entrepreneurship at the University of San Francisco.

Venture funding surged more than 60 percent in 2014 from the prior year, most often fueling software and biotechnology companies, according to a new "MoneyTree Report" issued by PricewaterhouseCoopers and the National Venture Capital Association, based on data from Thomson Reuters. But the money wasn't spread around to buoy many more companies. A few just got huge piles of cash.

Last year saw a record 47 "mega-deals," defined as investments of more than $100 million. That's nearly twice as many as reported in 2013, said Mark McCaffrey of PricewaterhouseCoopers, who leads the accounting and consulting firm's global software practice.

Uber Technologies, the ride-hailing service disrupting the transportation industry and generating plenty of press, received the top two biggest rounds of investment last year. Each raised $1.2 billion for Uber, and the company's value is now pegged at $41 billion. Other major deals included $542 million (mostly from Google Inc.) 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.

What's driving those deals?

U.S. tech startups are proving they can reach vast global markets and reap sizable revenue, said McCaffrey. And there are more investors eager to get a piece of that return—private equity and hedge funds and corporate investment divisions are vying with traditional venture capitalists to back promising startups. But critics say some companies may never make enough money to justify the sky-high valuations.

The worries harken back to the go-go year of 2000, when the dot-com boom drove venture funding to a peak of $105 billion. But then a wave of new Internet companies crested and collapsed, many of them failing to ever make money. Venture funding bottomed at $19.7 billion by 2003 and spent the last decade bobbing in a $20 billion to $30 billion range before making the big leap last year.

Several experts expect funding this year to continue at a similar rate. Commercial software companies, especially those that offer cybersecurity services and tools for analyzing large amounts of data, are expected to be big draws in 2015, along with biotech and health technology.

So are we approaching another bubble?

Most experts won't go that far, but are raising concerns about so-called "froth" in the market. Robert Ackerman, managing director and founder of Silicon Valley venture firm Allegis Capital, is convinced new software and communications startups are revolutionizing the world's economy. However, beyond the risk of investors losing money, Ackerman said some companies may see these cash windfalls as permission to burn through money at an excessive rate, rather than spending at a level justified by their own realistic earnings potential.

"There really is an unprecedented level of innovation that is taking place," he said. "What I worry about is how the excess of capital is affecting valuations and expectations."