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Venture spending soars, especially for Web video. Some say it's a lot of cash chasing too few ideas.

July 16, 2006 | Chris Gaither and Dawn C. Chmielewski | Times Staff Writers

Is the bubble about to burst -- again?

Investment in Internet companies has climbed so steeply since the dot-com crash of 2000 that some Silicon Valley veterans worry that too much money is again pouring into too many unproven, unprofitable ideas -- setting the stage for another high-tech shakeout.

Watching venture capital firms invest hundreds of millions of dollars in new Web companies last year, longtime Internet executive Richard Wolpert branded the upswing "a mini-bubble." But "about a month ago," he said, "I started dropping the word 'mini.' "

In the first three months of this year, venture investors funded 761 deals worth about $5.6 billion. That's up 12% from the same period last year and the highest first quarter since 2002. One sector in particular is heating up fast: online media and entertainment.

The $254.9 million invested in blogging and online social networks in the first half of the year already exceeds such spending for all of 2005, according to research firm Dow Jones VentureOne. The $156.3 million pumped into online video is on pace to surpass last year's investment.

The popular success of MySpace, a social networking site bought last year by Rupert Murdoch's News Corp. for $580 million, and YouTube, a video sharing site, has inspired scores of imitators. In online video alone, there are nearly 180 new companies -- not to mention big players such as Yahoo Inc., Google Inc. and CBS Corp. -- vying to be the next YouTube.

There's also VideoEgg and Video Bomb, Blinkx.TV and Blip.TV, Guba and Grouper.

But MySpace and YouTube, the industry leaders, have yet to make big bucks, and some skeptical investors wonder what hope there is for all of the copycats.

"YouTube has been a cultural phenom," said Mike Hirshland, a general partner with Polaris Venture Partners.

"But how many YouTube knockoffs have been funded in the last six to nine months? The market has capacity for a certain number of successful winners. Whether it's one, two or, if it's really exciting, three -- you can debate. But eight?"

Venture capitalists say they're being more responsible this time. Alan Patricof, who provided early funding for America Online, Office Depot Inc. and Apple Computer Inc., said the investment community probably wouldn't reach the late 1990s level of irrational exuberance.

But, he added, "it certainly is the beginning of a heightened frenzy developing."

The current run-up does differ from the late-1990s bubble that began to implode in 2000, wiping out within two years $5 trillion in paper wealth on Nasdaq, the stock market on which the shares of many tech companies are traded. The market value of Nasdaq companies peaked at $6.7 trillion in March 2000 and bottomed out at $1.6 trillion in October 2002. It has since rebounded to $3.6 trillion.

One key difference is that the volume of venture investment is much lower than it was during the first Internet boom's height. The amount invested in the first quarter of this year was just one-fifth the $28.1 billion spent in the first quarter of 2000, according to PricewaterhouseCoopers' MoneyTree report, which tracks venture investment.

Also significant is the lack of investor appetite for initial public offerings. Unlike the last round of online exuberance, small investors aren't likely to buy shares in an online pet store with a sock-puppet spokesman.

And the range of companies sprouting this time is narrower. In the 1990s, entrepreneurs tried adapting any number of business ideas to the Web. Now, the focus is more on free services supported by online advertising, which has been growing sharply.

Some investors argue that there won't be another dot-com implosion, that the investment boom in online media companies is part of the natural ebb and flow of venture capital: Money plows in to unproven start-ups, winners emerge and investors move on to the next popular collection of start-ups.

"There are going to be a lot of flameouts and some spectacular winners, because even in bubbles some enormous companies that have lasting value were created," said Gary Little, general partner in Morgenthaler Ventures.

Nevertheless, overinvestment carries potential consequences. If Silicon Valley again disappoints the pension funds and college endowments that bankroll venture capital, it could find itself spurned next time, stifling the next round of innovation.

"When there is a crash or implosion, it makes investors -- both private investors and public investors -- just reluctant to go into these categories, even if there are good investments there," said Josh Lerner, a Harvard Business School professor and co-author of "The Venture Capital Cycle."

Nasdaq's malaise is contributing to the interest in the start-up gold rush. Shares of Dell Inc., Intel Corp., Microsoft Corp., EBay Inc. and others are either stagnant or near multiyear lows. Fast-growing Google is a big exception, but when its profit growth slows -- as its chief executive has warned that it inevitably will -- investors could flee.

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