Follow the Web 2.0 money

Too much money chasing too few deals? Who cares? VCs still upbeat about the next wave of Web services.

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NEW YORK (CNNMoney.com) -- Web 2.0 may be a buzz word, but it's still attracting big bucks.

Some of the novelty surrounding Web 2.0 has worn away since the term first gained traction in 2004, but venture capitalists in search of the next big thing are still pouring money into the industry.

Venture capitalists invested $3 billion in Web 2.0 firms last year, up nearly 9 percent from 2004, according to the MoneyTree report by PricewaterhouseCoopers and the National Venture Capital Association.

As the growing penetration of broadband makes the Internet a routine part of life, these so-called Web 2.0 sites - which revolve around user-oriented and user-driven content - are revolutionizing the way people interact with the Web.

Ajit Jaokar, a Web 2.0 evangelist who also chairs Oxford University's next generation mobile applications forum, refers to Web 2.0 as the "intelligent Web."

"It's about harnessing the collective intelligence. The users are the ones who add value to these sites," he said.

With online advertising booming, some of these start-ups can become viable businesses, venture capitalists said.

"These firms represent the new wave of consumer online services. They're able to leverage lower infrastructure costs to generate real businesses," said Neil Sequeira, a principal with Cambridge, Mass.-based VC firm General Catalyst Partners.

There's some concern that venture capitalists are creating a Web 2.0 investment bubble, and while industry insiders say there's more capital flowing than there are opportunities, it's not all hype.

"There's a lot of enthusiasm about all that is afoot. With the growth in broadband and wireless connectivity, there's a fundamental shift in how people experience the Internet," said Gary Morgenthaler, general partner at Morgenthaler Ventures.

Web users can be fickle though, and rival sites can spring up virtually overnight and overtake established market leaders.

The canonical example: Kleiner Perkins-backed Friendster, one of the first sites to connect friends on the Web, doesn't even rank among the top 10 social networking sites today.

According to Web traffic tracker Nielsen//NetRatings, Friendster now attracts only a fraction of the audience of MySpace - the site Rupert Murdoch bought for $580 million last year.

Winners circle widens

There's a lot of money chasing the same opportunities, and competition can be stiff, VCs said. But the consumer market is also large enough for there to be more than one winner in any given sector, they said.

The market can be segmented - for instance online communities can be formed around age, according to David Shapiro, a director at 3i, one of the largest private equity and venture capital firms in the world.

"You can make multiple winners that way. There is the ability to leverage online communities in a more specialized way," Shapiro said.

The smart money flows to innovative firms with solid business plans, VCs said.

David Sze of Greylock Partners says he's wary of copycats that don't offer anything new to the user experience. "The biggest thing that scares me is the me-too companies. I look for those that are leaders, first-movers or innovators."

Not every start-up is going to make it, but those that do - through a public listing or corporate acquisition - generate plenty of interest in the market.

"It's a tough stock environment and it's hard to find growth," Rob Lutts, president and CIO with Cabot Money Management said.

"The common theme of these Web 2.0 firms is that they're using the Internet to improve productivity in older industries, which can have a startling effect on the economy," he said.

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