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New firms find plenty of venture cash

By George Avalos
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The innovative spirit is alive and well in the Bay Area and the East Bay, as venture capitalists pour more money into privately held companies in the region.

The venture financing activity in the Bay Area during the third quarter reached its highest level in more than a year, according to the latest data compiled for the quarterly MoneyTree survey.

"Money is flowing into the venture capital funds that invest in new companies," said Pete Solvik, managing director with the San Ramon office of Sigma Partners, a venture firm. "You have a lot of venture capital firms out there, they have money to deploy, and they are looking to invest money."

Fledgling companies in the Bay Area attracted $2.07 billion in venture capital funding in the third quarter, up 25 percent from the same quarter the year before, the study by PricewaterhouseCoopers, Venture Economics and the National Venture Capital Association found.

East Bay startups captured about $286.5 million in financing through venture financing in the July-September period, according to the survey. That was a gain of 66 percent from the previous year.

The rebound in financing for the Bay Area suggests the venture capital market has begun to revive after some sluggish quarters recently.

"It is significantly easier to fund companies in the current environment than it was in 2001, 2002, 2003 and 2004," said Gary Morgenthaler, a general partner with Menlo Park-based venture firm Morgenthaler Ventures. "That period was very challenging for young companies."

The latest totals mark the first time in more than a year that venture financing in the Bay Area topped the $2 billion mark. The previous high was $2.42 billion, a figure reached in the second quarter of 2004.

"In prior years, investors were shell-shocked by the technology downturn, there was an oversupply of companies, and the market went through a Darwinian process to weed out the weak companies," Morgenthaler said. "Now we see a return to normal rates of activity and normal rates of investment and new company formation."

What's more, infant companies that are solid stand a very good chance to be nurtured by venture funds.

"There is plenty of money out there to finance good deals that come up," said Steve Bengston, a managing director with PricewaterhouseCoopers. "People may disagree as to which deals are good and which are bad, but the markets will ultimately make the decision."

And what might make a good deal? Bengston sees three key factors.

"You need money to fund these companies, you need management people who are willing to work to make these companies successful, and you need technologies that are going to disrupt things and change the way things work," Bengston said.

Bengston believes that venture financing will likely bounce up and down in a narrow range and will not skyrocket to the bubble levels or nose-dive to the depths reached after the dot-com meltdown.

"We are down 70 to 80 percent from the peak levels of 1999 and 2000," Bengston said. "But people would probably agree that at the peak, there was way too much money going into companies that were no good."

Telecommunications companies and business software firms still have a tough time getting venture funding.

But industry officials believe that companies developing and selling wireless technologies, life science products and medicines, and computer and network security products are landing robust levels of financing.

Even Internet-related companies are enjoying a comeback, primarily firms that supply services and products for what's known as "the digital home," adding Internet and wireless technologies to peoples' houses.

"People feel better about this new Internet era," Morgenthaler said. "The new Internet companies are required to have revenue already or revenue is imminent. Venture capitalists are not funding companies that are science experiments or have business plans that were developed by 20-something entrepreneurs."

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QUARTERLY FUNDING

Area 3rd quarter of 2004 3rd quarter of 2005 % change

Bay Area $1,650 $2,068 25%

East Bay $173 $286 66%

Sources: PricewaterhouseCoopers, Venture Economics, National Venture Capital Association