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Venture Capital Forced to Perform Triage

By [PUI-WING TAM](#)

OAKLAND, Calif. -- Claremont Creek Ventures recently had to decide which of its young to forsake.

The venture-capital firm had invested in such companies as online travel site cFares Inc. and genetic-technology start-up Gene Security Network Inc., with cash from a \$130 million venture fund it launched in 2005.

Amid the financial crisis and the plunging stock market, Claremont Creek decided to focus on the fund's best investments and stop backing the less-promising start-ups. It wanted to be sure it had enough cash for the next few years for the winners. The venture firm ranked the start-ups in the fund's 16-company portfolio with an A, B or C grade.

"We're doubling down on the As and likely won't invest any more capital in the C companies," says John Steuart, a Claremont Creek managing director. "The portfolio is competing against itself and it's survival of the fittest. It's brutal."

Gene Security, a fast-growing maker of genetic tests to identify potential abnormalities in embryos, got an A. Last month, Claremont Creek poured \$3 million into the company on top of \$2.7 million it has already invested.

CFares, which Claremont Creek says hasn't performed as strongly, got a C. The venture firm says it will give the Web site the \$3.2 million it has already committed, but won't fund the start-up further unless it hits aggressive milestones.

CFares Chief Executive Tom Kalinske says his company likely will be profitable by year end, based on the funding that already has been committed. Gene Security CEO Matthew Rabinowitz says his venture capitalists "are bringing out the best in us."

Many venture-capital firms, which put money into start-ups with the aim of profiting when those firms go public or are sold, are going through a similar Darwinian exercise of sorting through their potential winners and losers. While the venture business enjoyed something of a revival in the past few years, the financial crisis has slowed the spigots of cash going into the sector. It also has

crimped returns by damping the market for initial public offerings of stock and for mergers. Meanwhile, many venture-backed start-ups are getting hurt as demand for their products shrinks.

As venture firms save their cash for their most promising start-ups, it often means pulling the plug on weaker companies. "Ultimately, there's some fallout," says Theresia Gouw Ranzetta, a venture capitalist at Accel Partners. "For companies that can't weather this storm, [there] may be a smaller asset combination to achieve scale and last longer."

Claremont Creek passed on putting more money into two start-ups in addition to cFares. Meanwhile, it lined up bridge financings for three others to get them through most of 2009. Since October, the firm raised new money for two of its start-ups at a higher valuation than in the past, though it accepted a lower valuation for a financing round for a third start-up.

Pressure is on young venture-capital firms like Claremont Creek, which have a shorter track record than older, better-known firms such as Sequoia Capital and Kleiner Perkins Caufield & Byers. There were 741 venture-capital firms in the U.S. as of 2007, the most recent data available, according to the National Venture Capital Association. Many expect that number to drop as the financial crisis plays out.

Claremont Creek finished raising a new \$175 million fund in September and then laid off two members of its 10-person team in December. The stress sometimes led to arguments between Mr. Steuart and his two main partners, Randy Hawks and Nat Goldhaber. Last month, they brought in someone Mr. Steuart calls "a corporate shrink" to facilitate internal communication.

"We're burning the candle on both ends," says Mr. Hawks, who co-founded Claremont Creek in 2005. "Partnerships have to work hard to keep it on a calm and smooth trajectory."

As of last October, Claremont Creek had deployed \$44.3 million of the \$130 million fund it launched in 2005. After an analysis showed its 16 portfolio companies were burning through more than \$30 million a year, it quickly pushed some start-ups to cut costs.

cFares laid off four employees, reducing its work force to 18 people. Mr. Kalinske, the CEO, says he wasn't surprised when Claremont Creek said it didn't plan to give cFares more new money. Given the tough economy and the relatively small size of Claremont Creek's fund, "that's business."

At the same time, Claremont Creek persuaded some of its A-graded companies to raise more funds to survive the downturn. Gene Security CEO Mr. Rabinowitz wasn't planning to look for new money last year. In October, Mr. Steuart, who is on the start-up's board, helped convince him to

speed up fund raising and raise more than enough cash for the company to beef up product development and weather the recession.

Mr. Rabinowitz worked with Mr. Steuart to find new investors. Venture-capital firm Alafi Capital last month participated in a new \$6 million funding round for Gene Security at more than twice the valuation of the startup's previous financing.

Overall, Claremont Creek has trimmed \$10 million a year in expenses from its start-ups since October. While the firm once planned to invest in 20 companies with its 2005 fund, it now plans no new investments so it has more cash for existing start-ups. It has set aside \$40 million for companies it will keep funding, up from less than \$30 million previously. Mr. Steuart says Claremont Creek has now made enough changes for many of its start-ups to live to see 2011.

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