

Venture Capital's Favorite Startups

Investment capital flows to lean-and-mean startups with the best track records and favors growth industries like clean tech and biotech

By John Tozzi

Over the past four quarters—even as the depths of the nation's [economic problems](#) became evident—venture capitalists invested more than \$7 billion in seed and early-stage companies in more than 1,400 deals, according to the [MoneyTree Report](#) from the [National Venture Capital Assn.](#) and . That's more money raised by young companies than in any calendar year since the dot-com bubble burst in 2001.

In the largest deals of the past year, venture capital firms poured money into companies tackling the global problems of climate change and disease. The challenges are great—and investors bet that the payoffs will be, too—for the startups that successfully commercialize ideas like solar power, low-emission cars, and new medications.

Who are these hot startups? To find out, we followed the money, looking at deals that took place in the four most recent quarters available, from October 2007 to September 2008, based on the MoneyTree report, which uses data from [Thomson Reuters](#). We then reached out to a selection of the seed and early-stage companies that raised the most money and profiled them in a [slide show](#).

Who Tops the List?

At the top of the list are some veteran [entrepreneurs](#) who have already proven themselves to investors by founding companies that led to acquisitions. The team behind [Relypsa](#), a Santa Clara (Calif.) drug development company working on a treatment for life-threatening hyperkalemia in heart and kidney patients, sold their last company to Amgen ([AMGN](#)) for \$420 million in 2007. Relypsa, founded months after the acquisition, raised \$33 million in late 2007.

But even for well-capitalized startups with proven track records, the [uncertain funding outlook](#) means they have to make every dollar count. Gerrit Klaerner, Relypsa's chief operating officer, says startups that are only now thinking of [ways to trim](#) may be in trouble. "Operating a small company, I think you have to be lean and mean. If you start thinking about capital efficiency today, it's too late," he says.

Recession-Proof Bets

For other businesses, the downturn carries the scent of opportunity. Ron Gonen, co-founder and chief executive officer of [RecycleBank](#), says the sudden need for cities and households to conserve cash puts his company in a position to grow. The 85-employee New York firm runs recycling systems for cities that let residents earn points, based on the amount they recycle, that they can redeem at retailers. "Now that cities really need to save money and people are really looking for a way to get disposable income, we're at a unique time in our growth curve," Gonen says. He says families can earn up to \$400 a year in RecycleBank points. RecycleBank, which raised \$30 million last year on top of \$15 million in an earlier round, takes a cut of the savings that the cities get from reducing how much trash they send to landfills.

Venture capitalists see other companies that focus on conservation, renewable power, and reducing the emissions that cause global warming as strong bets even in bad times.

"No matter how much worse the economy could get over the next six to 12 months, there are many who believe that [clean tech](#) kind of rides above the economic uncertainty," says Mark Heesen, president of the National Venture Capital Assn. Demand for clean power from governments around the globe, along with renewed attention to cutting emissions from the incoming Obama Administration, has convinced investors to bet on solar and wind power, as well as hybrid cars.

Biotech's Promise

Likewise, Heesen says, biotechnology and medical device companies will continue to draw investors because the promise of their products to extend lives is so important. "We all are living longer, and we want to live longer, more productive lives, and biotech is at the cusp of that," he says. The startups Heesen predicts will suffer most from the downturn are IT firms that ultimately sell their products to consumers or businesses, because both are cutting spending.

Still, developing drugs or clean technology takes a lot of money, with long time frames for exits potentially made longer by an [IPO drought](#) and a tough market for acquisitions. One drug development company, [IRX Therapeutics](#) in New York, has raised more than \$60 million since its founding more than a decade ago, mostly from high-net-worth individuals and some VCs, to develop treatments to restore immune function in head and neck cancer patients. "We're obviously a company without revenue in a business that eats capital," says Chief Financial Officer Jeffrey Hwang. He says the firm has had to cut staff by a third and delay clinical trials it planned for 2009, because he's not sure whether the funding will be there to complete them. "We're not going to start anything we can't finish," he says.

Heesen says many startups may face the same problem next year. He expects fewer companies to get funded. Those entrepreneurs that do will have to prove the value of their ideas and their ability to execute them even in a downturn.

For a look at 25 promising startups, flip through this [slide show](#).



RecycleBank

New York

Founders: Ron Gonen and Patrick Fitzgerald

VC Investment over the last four quarters: \$30 million

Founded in 2004 by Columbia Business School grad Ron Gonen, [RecycleBank](#) is a recycling system designed for municipalities that rewards people for recycling with points that can be redeemed at retailers. The company, which has raised a total of \$45 million, contracts with cities and towns to set up systems to collect and track recycling. Currently running in 15 cities from Alexandria, Va., to Albuquerque, N.M., RecycleBank makes money by taking a cut of the savings municipalities realize by reducing the amount of waste they send to landfills. With local government looking to save during the downturn, Gonen calls it a "unique time in our growth curve."

Key to startup success: "The most important thing, more important than price, valuation, or EBITDA, is the quality and character of the person with whom you are doing business."