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An inside look from VentureWire at high-tech startups and their investors.

December 13, 2013, 10:30 AM

Where Angel Investors, VCs Let Their 'Dogs' Out

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By LORA KOLODNY [CONNECT](#)

In angel and venture capital, a startup becomes a winner if it generates meaningful returns for investors within about seven years. That happens with a liquidity event such as an initial public offering or acquisition. But funded startups become “dogs” if they chug along, failing to generate meaningful returns or slumping towards bankruptcy.

So how do investors let their “dogs” out?

A new company called [CapGain Solutions](#) (Zombie Apocalypse Holdings LLC) buys startup shares from investors, helping them realize a tax break for their losses, and helping struggling entrepreneurs wind down responsibly, or revitalize what’s left of their viable business.

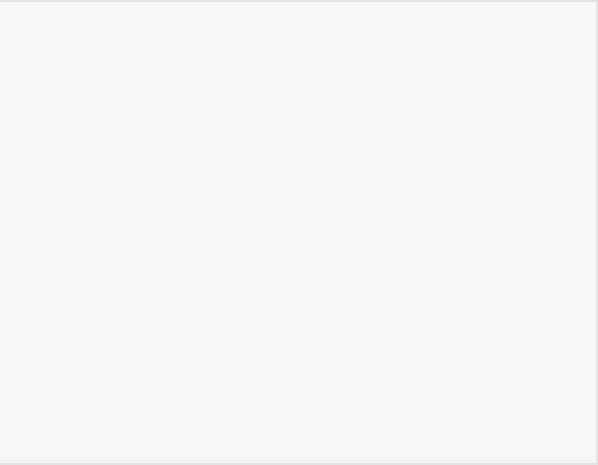


Eliza Wiley/Associated Press

CapGain founder and Chief Executive [Gary Kremen](#), a prolific angel investor and serial entrepreneur best known as the founder of Match.com, says he was inspired to start this service by his own portfolio’s stragglers, which he declined to name.

Mr. Kremen has funded more than 100 companies as an angel investor, including rapidly growing ventures like [Crowdfunder Inc.](#) and [Clean Power Finance Inc.](#), he says. He admits, like all early-stage investors, he wants all of his deals to become winners [like Instagram Inc., Splunk Inc. or Zulily Inc.] but the reality is that most angel deals become dogs.

At least 30% of his own angel investments over the past decade have failed to hit a “hypergrowth phase,” and instead became more of “time-consuming burden at tax season,” than anything else, Mr. Kremen said. Others have yet to mature



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Produced by the editors of [Dow Jones VentureWire](#), Venture Capital Dispatch tracks the fast-moving developments at the intersection of high-tech innovation and venture capital finance. Featuring the VentureWire reporting team in the Silicon Valley, New York, Boston and Shanghai tech centers, Venture Capital Dispatch provides insight into the newest start-ups and latest trends in venture capital investing. Write us at VCdispatch@dowjones.com. For more information on Dow Jones products covering venture capital and other financial markets, go to www.fis.dowjones.com.

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enough to assess.

CapGain will generate revenue from what its executives call “modest service fees” to cover legal documentation of each transaction, and from returns when the rare startup that it invests in provides an upside.

What did investors do before CapGain offered to take suffering startups off their books?

According to [Ben Black](#), an angel investor and co-founder of [Akkadian Ventures](#) in San Francisco, they would try to sell their restricted shares in startups back to founders; wait for a portfolio company to go bankrupt; compel an acquisition or other deal; or leave their money in, and allow a startup to “pivot” into a born-again success in a totally different market.

So-called “[zombie startups](#)”—which are neither closed, nor profitable enough to deliver returns—can sometimes restructure their businesses, or pivot into new markets successfully. Although, the recently shuttered [Turntable.fm](#) Inc. proves, the pivot is not always a sure path to profitability, or a good thing for investors.

Mr. Black became a CapGain customer as soon as he learned of the service. “The idea of harvesting my losses in private companies never occurred to me,” he said, but doing so freed enough of his personal capital to do more angel deals next year, though he previously planned to do fewer.

Other providers of investor relief—alongside CapGain—include the recently launched [ExitRound Inc.](#), a matchmaker and marketplace for large corporations seeking innovation and talent, and startups ready to sell out; and [Et Brutus LLC](#), founded in 2000, which buys startups for a dollar apiece, with a \$25 transaction fee.

[Et Brutus](#) allows investors the same kind of tax breaks on their losses that CapGain Solutions would, but doesn’t negotiate when it comes to pricing. Its focus is on being fast and convenient for institutional investors, says a co-founder of Et Brutus, [Carol Sands](#) (also the founder of The Halo Funds).

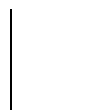
Et Brutus does hundreds of deals each year, across a broad spectrum of sellers and different industries, about 70% from institutional venture and seed funds, she reports.

CapGain hopes to serve individual angel investors and angel groups as much as VCs says CapGain co-founder and principal Michael McTeigue. He believes his service will be popular among Silicon Valley investors, especially.

“Let’s say you have a \$5 million position in a company—and in five years it may be worth five cents on the dollar,” he explained. “But if you unload it now and take the writeoff, it could shield \$5 million worth of gains in some other deal, like if you were in Facebook or Twitter. That can be as high as 33% in California.”

Write to Lora Kolodny at lora.kolodny@wsj.com. Follow her on Twitter at [@lorakolodny](#)

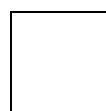
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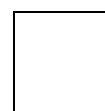
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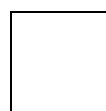
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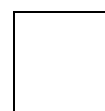
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