

SURVIVAL MODE

Web startups fighting hard to be recession-resistant

By **Jonathan Sidener**
STAFF WRITER

Adam Jacobs picked an interesting time to become an entrepreneur. After stints with San Diego Web startups CollegeClub.com, Akonix and Kidzui, Jacobs decided last year to launch his own net venture, Freakatars.com.

Designed for children ages 3 and older, the Freakatars concept was to let visitors cobble together custom creatures from libraries of fanciful limbs, torsos and other features. The business plan was to generate revenue through the sale of collectable trading cards featuring the creatures and to market a Freakatars line of toys.

Jacobs stepped down as director of business development for kid-safe browser company Kidzui in July 2008 and launched his Web startup in August, a month before Lehman Brothers filed for bankruptcy protection and Wall Street went into free fall.

Surprisingly, at least to people outside the world of Web startups, Freakatars is up and running despite the economy. A beta, or draft, version of the site has 3,000 registered users, and the company is about to launch the first piece of its e-commerce plan: the ability to generate professionally printed trading cards — for a fee — based on the custom creations.

"In the past, you could get funded on an idea," Jacobs said. "I knew in September that we would have to show that we can build something. I knew that there would be no venture capital money out there (for an idea)."

Freakatars is not the only local Web business surviving when funding for new companies is nearly nonexistent. San Diego is home to a number of recession-resistant startups, including:

ArtisticHub.com, an online T-shirt- and tchotchke-design software business;

TakeLessons.com, a Web site coordinating a national staff of music teachers and students;

FoodieView.com, a food and recipe site;

FiveSprockets.com, an online screenwriting and media production software suite;

JustMyTicket.com, a last-minute discount ticket broker.

All these companies report some silver lining on the recession gloom.

Changes in technology are one factor in today's Web startups getting out of the gate. A decade ago, in the original dot-com frenzy, creating a sophisticated Web site meant hiring a lot of developers and raising the funds to pay them.

"The cost of starting a Web-based business has fallen through the floor," said Bryce Roberts, who is managing director of the San Francisco Bay Area venture capital firm O'Reilly Alpha Tech Ventures. "Advances in software lets companies get to a point where in the past, people would have had to raise a million dollars or more."

Recession startups are generally expected to get up and running and prove that they are breakout ideas, not just "nice side businesses generating \$10,000 a month," Roberts said.

Experts debate whether the recession is slowing the number of Web startups. Roberts said he doesn't see a decrease, though there is clearly a decline in the number of startups getting significant funding.

But San Diego serial tech entrepreneur Dmitry Shapiro said local Web startups are noticeably down from two years ago. Shapiro launched online video site Veoh Networks in 2004 and before that,

peer-to-peer and instant-messaging security company Akonix Systems. His latest venture is WeekendU.com, which offers classes on topics such as the production of Internet video.

Shapiro said most entrepreneurs

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bucking the recession know what they're getting into.

"They're working for sweat equity because they believe in their ideas," he said. "They're going to be eating a lot of Top Ramen noodles."

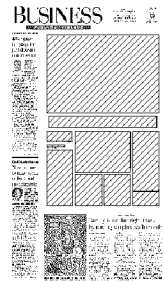
Red Herring publisher Alex Vieux, who conducts a series of conferences for tech startups and venture capitalists, said the recession will continue to be hard on young tech companies. Of the estimated 8,000 tech companies that have launched in the past three years, about 30 percent are expected to fail.

"Web companies will do better than others," Vieux said. "You can still start a Web business with a credit card and build it in your dorm room or your kitchen."

The recession-driven shift away from funding unproven businesses nearly did in ArtisticHub.com, which launched about a year ago as CollarFree.com. The plan was to compete with Threadless.com, a successful site that holds design contests for T-shirts. Anyone can offer a design, and site visitors vote. The winning T-shirts are printed and sold, and the designers get a cash prize.

By the time CollarFree was up and running, funding had dried up.

Founder Jimmy Hendricks



changed the business plan and began marketing the custom design software to other Web sites, allowing them to run contests to create T-shirts, coffee mugs and other brand-promoting items.

The startup money was just about gone when ArtisticHub signed its first customer. Fortunately for Hendricks, it was a sizable site, Sports Illustrated's SIKids.com.

"Another month and we would have been dead," Hendricks said. "Literally two days before payroll, we got a \$50,000 check."

In the no-frills spirit of Web startup survival, Hendricks and five other entrepreneurs meet monthly for lunch. The owner, who picks up the tab, presents a business issue and the group brainstorms solutions.

For TakeLessons.com, the recession seems to be leading people to take up music lessons.

In 2006, founder Steven Cox and three employees began work on the software to coordinate a nationwide network of students and music teachers. In addition to scheduling and billing, it lets teachers send students audio files and motivational messages.

Last year, Cox formally launched the site, which has grown to include teachers in 2,800 U.S. locations.

The company started working out of Cox's house. It now has offices, but not the \$700 Aeron chairs that typified the excesses of the first dot-com wave.

"Our plan is to preserve cash," Cox said. "We work at tables that cost \$20 at Staples."

Cox said his business is growing, but he suspects growth would be faster in a better economy.

"Anyone who says they're not affected by the recession has their head in the sand," Cox said. "But if you're agile, quick and can preserve your

cash, there can be advantages."

One of those advantages is that competitors may hesitate to jump in, allowing companies to build or extend a head start, Cox said.

Another company finding business in cost-conscious times is FoodieView.com, a Web site featuring a search engine for recipes.

"In the recession, people are tending to stay home and cook more," founder and CEO Howie Wang said.

Advertising rates are down, Wang said, but traffic is up enough to keep revenue growing.

Consumer belt-tightening is also an advantage for JustMyTicket. The Web site works with restaurants and entertainment venues to promote last-minute special offers to fill empty seats.

President Steve Persitza said the site has more than 7,000 subscribers. He and a partner have not quit their day jobs yet, Persitza said.

"From the first month, we've been in the black," he said.

For San Diego media production site FiveSprockets, a company with Hollywood roots and an early round of financing, launching in the recession is like walking into the wind. It's not stopping the business from going forward, but it's moving more slowly.

Founder Randy Ullrich grew up in Los Angeles. Now a Solana Beach resident with a family, Ullrich launched the company here.

"It's a Web business, so we could have started anywhere," Ullrich said.

FiveSprockets landed an angel round of funding last year. With that funding, "three employees and a lot of consultants" have developed online tools to help writers put stories into proper formats for film, TV, stage, novels or comic books.

By guarding money in a "really lean and mean" mode, the company can sustain growth,

he said.

"I continue to talk to investors," Ullrich said. "If we could get more funding, we could roll out the site faster. I'd like to move faster."

Ullrich and others say that there are advantages for startups with revenue or enough cash to move forward, particularly in recruiting talented people.

At Freakatars, Jacobs said there are more people in the market than jobs now. For his business, that meant he could recruit skilled people willing to work for a stake in the company, not a paycheck.

The team has created software that allows children to play with and create low-resolution, Web-quality images. But when site visitors purchase a printed trading-card version of their creations, the software generates a high-resolution, print-quality image.

"I'm really proud of that technical accomplishment," Jacobs said. "I don't know of any other environment where I could have found this level of quality talent, and they're all working on equity alone."



TakeLessons.com founder Steven Cox with his dog, Nutty, and the site's director of marketing, Jill Strasser. *Eduardo Contreras / Union-Tribune photos*



Web entrepreneur Adam Jacobs created Freakatars.com. The site lets users create a creature and order merchandise with that character.



Adam Jacobs (from left), Matt Spangler and Kyle Tyacke met at Cream in University Heights to work on their Web site, Freakatars.com, over coffee. Eduardo Contreras / Union-Tribune