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Europe

By Gail Edmondson

Venture Capital Takes Off in Europe

For the first time since the bubble burst, venture capital is flowing freely. Good news for the economy -- and, perhaps, for investors

Marco Pescarmona had no trouble snapping up his first round of venture capital in 2000. He got $1 million to start an Italian online mortgage brokerage "in half an hour," he says. Europe's tech sector was soaring and investors were eager to fund startups. But by the time his company had spent the seed money and needed more cash a year later, the Internet bubble had burst and investors were running scared. Pescarmona's MutuiOnline faced financial crisis. "It was incredibly scary," recalls the CEO. "I thought we wouldn't survive."

Fast forward to the present. Pescamona and co-founder Alessandro Fracassi -- both business school graduates from MIT -- eventually scored another $5.2 million in venture capital. MutuiOnline turned profitable in 2003 and hit $19 million in revenues last year, up 76% over 2004. With an estimated valuation in excess of $128 million, the company will likely pay investors handsomely for their steely nerves.

The co-founders -- now a post-bubble success story -- field calls from investment bankers eager to take them public. "Their execution was excellent," says Michele Appendino, founder of Net Partners Ventures in Milan, which provided seed money to MutuiOnline. "There is still a lot of room for growth."

NEW PHASE. Europe's so-called "New Economy" may have vanished with the Net bubble, but the core of venture capitalists and entrepreneurs who survived the five-

year investment blight that followed are savvier and more determined than ever to create new companies and stoke Europe's startup culture.

"We learned a lot (through these hard times) about how to build businesses and what is sustainable," says Helmut Schüssler, president of the European Venture Capital Association and a partner at Munich-based TVM Capital. "The industry is entering a new phase now."

Just look at the dizzying success enjoyed by Luxembourg-based Mangrove Capital. Co-founder Mark Tluszcz made a bet two years ago on an obscure voice-over-Internet phone company called Skype. He hit the jackpot last fall when eBay (EBAY) bought the startup for an eye-popping $2.6 billion. The Skype deal refocused the world's attention on European technology -- and on the Continent's seemingly out-of-vogue venture investing scene.

SCHOOL SPIRIT. Now, what outsiders are seeing is a European venture capital business that is finally coming of age, after long lagging behind the U.S. The greatest vote of confidence: Investors who shunned European venture capital funds during the past four years in favor of private equity and buyout funds are piling cash back on the table.

In 2005, European venture capital funds raised $16.1 billion, up 44% over 2004, according to preliminary data compiled for the EVCA by Thomson Financial and PricewaterhouseCoopers. That nearly matches the level of 2001.

Startup funding has soared, too. Venture firms laid out $4.2 billion in early-stage capital last year, triple the amount in 2004. At the same time, there's a renaissance under way in entrepreneurial spirit, especially among recent MBA graduates. Business schools are even getting into the act with programs that pair students with real world startup managers (see BW Online, 5/26/06, "The New Entrepreneurial Class").

EMPLOYMENT GROWTH. Capping it off, venture capitalists are finally getting the welcome mat from European stock markets, which are inviting them to step up and cash out of their investments. The market for initial public offerings, which went cold for three years after the crash, topped $67 billion last year on European bourses, up nearly 65% from 2004, according to Dealogic. Among those IPOs were 99 venture-backed companies -- twice the number there were two years earlier -- that together raised $1.1 billion.

And trade sales, or acquisition of startups by other companies, climbed 27% in 2005, to $7.5 billion, thanks to an overall surge in European M&A. "It looks like a much more sober but receptive market for high-growth technology companies," says Christian Claussen, a partner at TVM.

All of this is good news for the European economy. Venture-backed companies now

employ one million people in the region, according to a research report by the EVCA. Even during the investment drought from 2000 to 2004, such startups created only 630,000 jobs. Overall, employment in venture-backed companies grew by an average rate of 30.5% per annum from 1997 to 2004 -- 40 times the employment growth rate for the EU as a whole.

ESSENTIAL BOOST. Companies with venture funding also invested, on average, $64,900 per employee per year on research and development -- five times the average $10,700 spent per employee by the 500 companies with the largest R&D spending in the European Union.

Such outsize economic contributions highlight why venture-backed startups are so essential to Europe's future. If investment levels continue to rise, the Old World could boost its pool of high-skill jobs -- helping offset outsourcing to Eastern Europe, India, and China.

"This industry will help reshape society and work, creating skilled jobs in an increasingly global economy," says TVM's Schüssler. Even politicians are starting to recognize that. European venture capital has come a long way in the last decade.

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The New Entrepreneurial Class

With the help of universities, newly minted MBAs and others are rejecting tradition and moving from startup to startup

Time was, being an entrepreneur in Europe carried a lot more than just economic risk. In countries where social conformity prevailed and many workers sought comfortable lifetime employment, business failure often meant a permanent stigma. Even in the go-go 1990s, venture capitalists had to scour university labs and huge companies for hot technologies to spin off, and coax academics or managers to start their own companies.

Now, a new breed of entrepreneur is starting to multiply, from MBA graduates determined to strike out on their own to seasoned executives eager to run their own show. In part, they're inspired by so-called "serial entrepreneurs" -- Dennis Payre, for example, the co-founder of France's Business Objects (BOBJ) -- who are grabbing headlines as they launch second or third companies. That hardly ever used to happen in Europe (see BW Online, 5/26/06, "Venture Capital Takes Off in Europe").

"MAD, PASSIONATE ACT." Business schools, too, are getting in the act of boosting Europe's entrepreneurial base. In January, Fontainebleau-based management school INSEAD teamed up with Barcelona's IESE to create what has been dubbed European Entrepreneurship Accelerator, a 10-week elective course

that allows students to work side by side with serial entrepreneurs. "More and more students are joining business schools with the intention of becoming entrepreneurs," says Julia Prats, professor of entrepreneurship at IESE. "In the past, we had to convert them."

In the pilot course that took place between January and March, 20 students from the two schools joined six companies, where they worked closely with the CEO-founder on projects such as designing a business plan for a second round of venture financing.

"The impact is that in a very limited period of time, students get a fairly honest picture of what starting a company is all about -- matching the business school theory with the mad, passionate act of creating and running a company," says Peter Zabouji, INSEAD entrepreneur-in-residence, who got the idea for the Accelerator while teaching a course on writing business plans. Forty students will participate in September.

RICH IN RESOURCES. Mathieu Carenzo, an IESE graduate who took the accelerator course in January, certainly experienced the harsh reality of managing a fast-growth company. He and three fellow students landed at an Internet-related company that failed three weeks later when a fresh round of financing collapsed. Carenzo and his teammates then joined an information technology company specializing in data storage and helped the CEO write the business plan to help secure a loan from a U.S. bank.

"One thing you learn is that you can't do everything yourself," says the 30-year-old Frenchman, who aims to start his own company some day. "You need contacts, and you need a team."

He should have plenty of people to pick from. At IESE, some 30% to 35% of graduates now begin their own company within five years. Creating European startups may remain tough, but today there's more capital and talent available than ever before. The years of laying the foundation for a new industry are starting to pay off.

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