



European venture capital is better positioned than ever before to emerge from the shadow of its buyout cousin. A group of the asset class's biggest hitters discuss where they should be taking the industry next.

chaired by **PETER KNELLER** illustration **SARAH HANSON**

# VOICES OF VENTURE

## Where exactly do Europe's technological strengths lie?

**Cook:** Europe dominates the wireless industry. It dominates semiconductors. The iPhone is a European invention. In fact, it's harder to put your finger on what the US has produced in the past few years. Facebook isn't technology, it's a media. And even online advertising in the US, percentage-wise, is lower than in the UK. I don't think it's a question of what Europe's good at. Innovation in Europe is everywhere.

**Pollard:** In my field, cleantech, it's more a question of whether the US can compete with Europe, the Chinese and the Indians than whether we can compete with them.

**Deligny:** What Europe has been short of is not technology but an ecosystem which has the ability to produce consistently good returns.

**Cook:** What we've actually been short of is someone telling the story. Take Apax and QXL, Europe's biggest ever internet deal. Apax invested \$12m in February 1999 and the company was eventually sold for \$2bn last year. Or another former Apax investment, Autonomy: today it's a \$4.5bn global leader that's bought up everybody in the sector. By contrast, Yahoo! was a \$200m IPO. It wasn't the venture capital success story everyone thinks, it was a public markets success. There's this huge myth that European venture never makes any money, whereas in fact there have been many multi-billion-dollar exits.

## Other than poor PR, where has European venture gone wrong in the past?

**Deligny:** Firms like Permira, Apax and 3i were pretty good at early-stage investing, but they've been sucked into MBOs because there was more money to be made there.

**Elias:** By and large though you have to admit that European venture returns have been poor. We're in an environment where capital efficiency in terms of moving into productive investment areas is very high. Capital goes into cleantech because people think that's going to be hot, and it went into buyouts and hedge funds in the same way. The reason it hasn't gone into European venture is that in aggregate, the industry hasn't performed. The challenge is to identify those that can perform, and to see how we can improve returns.

**O'Keefe:** The opportunity should be there – the question is whether managers are able to identify those opportunities and make money out of them. I would argue that there have been too many small firms operating in pockets, and trying to develop local champions or global clusters, whereas the real opportunity is to pick assets on a pan-European basis and to be more American in the way you approach companies.

**Cook:** I would add that we could have taken better advantage of the credit markets over the past decade and leveraged up. There's a lot more we could have done to take our core returns of 20 per cent on growth and made them 40 or 50 per cent. The whole venture industry missed that cycle, and so we couldn't compete with leveraged returns. Also, venture capital is a long-term asset class. It takes seven years to build an overnight success. We're just coming through that now.

## Are there sufficient experienced fund managers with enough capital to create a thriving co-investment model in Europe?

**Chalfen:** I think it is a thin market, but it's definitely matured and professionalised – the thinning out has partly been Darwinian, which isn't the worst thing in the world. There is a

## Round the table



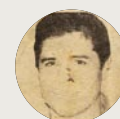
### Mike Chalfen

Chalfen is a general partner at Advent Venture Partners. He joined the company in July 2008



### Simon Cook

Cook is chief executive of DFJ Esprit and has been involved in UK venture capital since 1995



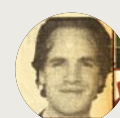
### Jean-Michel Deligny

Deligny is managing director of Go4Venture, with 20 years of experience in the hi-tech industry



### Michael Elias

Elias is managing director of Kennet and an expert in European technology investment



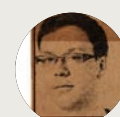
### Ben Holmes

Holmes joined Index Ventures in 2002 and specialises in the software and internet sectors



### Graham O'Keefe

O'Keefe is a senior partner in Atlas Venture's technology group. He joined in 1998



### Etienne Pollard

Pollard is an associate at Good Energies, working on downstream wind and solar transactions



critical mass, but only just. It's up to us collectively to build and succeed in the next couple of fund cycles. There probably need to be another two or three strong firms, and the firms that are here already need to be even stronger.

**Holmes:** I agree that we probably need one more cycle of births and deaths in the VC fund industry. I would also add that the aggregate statistics hide the fact that Europe is a fundamentally different place for investing than the US. One of the joys and frustrations about doing deals in Europe is that you can come across a company one day, which is pitching a particular plan, and it will be completely unaware that the same plan is being pitched by other companies in the same space.

**So that means less competition for European VC-backed businesses?**

**O'Keefe:** The advantage that America has is its size. But the flip side of that critical mass is that there will always be nine or ten copycats with 20 or 30 VCs each waiting to latch on to one of them. In Europe, although the markets are smaller, in any one segment that emerges you typically only find one or two competitors. Ticketing is an interesting example. Viagogo is backed by Index, and Seatwave is backed by us and Mangrove, so there are only two companies, both with a slightly different twist.

**Elias:** We've always found that the herd mentality among US investors is much stronger than it is in Europe, and that in Europe being something of a maverick is actually more respected than it is in the Valley. On the other hand, market adoption is also a herd instinct in the US, and there's an incredibly rapid adoption of technologies.

**There have been a few high-profile examples of US VCs coming to Europe. Does the herd mentality mean more are on their way?**

**Cook:** There has been a huge increase in interest among American VCs for investing outside the US. I have been to two venture capital conferences in San Francisco this year, and one in every two sessions was about investing internationally. But most of the interest has been directed at India and China. A wave of US firms targeting Europe may be coming, but it hasn't happened yet.

**Elias:** I'd actually say US activity in Europe is decreasing. The sense we have is that most American firms are thinking that they should

focus their energies at home right now. They accept the conventional wisdom, right or wrong, that Europe is a tough place to do venture.

**Holmes:** I think there are firms like Sequoia that have clearly done very well over the past few years. But some firms, like Benchmark, haven't had fantastic performances and I'm sure their LPs are telling them to get back to what they were doing in 1999: focusing their attentions at home.

I also think a lot of the US firms are coming up to generational changes in their partnerships, and that it's harder for younger partners taking over to be as global in their views. They have to focus on maintaining share and continuing to build their reputation in their core market.

**Chalfen:** I think there's a management problem as well, because as an industry we have not managed to figure out how to build institutions that can endure generational changes, let alone scale across geographies. Sequoia's China and India funds do not rely on the US - they're stand-alone funds that are managed completely separately. The culture in the two funds is different. I think until that management challenge has been resolved, US funds may pick off European deals opportunistically, but no more.

**Deligny:** You can't deny that some of these US firms have come over with fairly substantial funds, operated on a pan-European basis and made some ballsy investments, some of which are paying off. This has been an adjustment for some of the local players, sharpening up their game.

**Cook:** If there were US firms making money in Europe there would be a lot more of them here. That's why they're in China, because some people made a killing and they all piled in. Money goes to where the returns are.

Benchmark did more but became Balderton. Accel is starting to do well but still has more to do. The issue is bandwidth. There's so much they have to deal with in the US, China and India now that further expansion isn't likely over the next 12 months. But in the long term I do think you'll see the emergence of some global brands.

**What about more involvement - be it competitive or collaborative - from other non-traditional investors such as pension funds and hedge funds?**

**Chalfen:** Pension funds, no. Family offices, yes. Although not many and not on a sustained basis. Hedge funds have been more active, but apart

from Tudor, I can't think of any that consistently apply capital to our asset class, and the reason is scale. This is a very specialised asset class.

It's great when people who are passionate get involved as co-investors, but I'm not worried that there'll be sustained competition from those sorts of institutions.

**Holmes:** I think these guys have a fundamentally different mindset from VCs. If you're a fund manager, the key to success is making the right asset allocation. The key to success in our industry is getting into the deal, because we're only buying 20 or 30 per cent of a company's equity. With us it's all about relationships. How can we convince the entrepreneur that we're not going to irritate him for the next seven years?

**Deligny:** Last year we advised on eight transactions, and four of them involved non-traditional VCs. This is a trend. On a monthly basis we are seeing new names. I agree that they're not consistent players. They are investing opportunistically because they have some connection to a deal.

**Cook:** But two or three years ago AIM was overpaying for companies. There's always somebody in the market that will overpay. The job of an adviser is to get too much money from people who are willing to pay. If you're an entrepreneur there are thousands of places to get money, but you have to get it at the best price you can. As venture capitalists, our money and our skills are right for certain types of business. And in those businesses, together with the entrepreneur, we can create a lot of success.

**Deligny:** I don't think you should be so dismissive about these forms of competition. It says something about the way entrepreneurs feel about VC investors. There are a lot out there who feel hard done by and poorly treated. There is incredible scepticism about this wonderful value-add that venture is supposed to bring. We have most of the better ones in this room, but at the same time this is a real issue, otherwise people wouldn't bother going to Dubai for money.

**O'Keefe:** The other investor that has come back in a big way is the corporate. We've invested in the femtocell market through Ubiquisys and Picochip, but if you add IP access to that group you've got Cisco, AT&T, Intel, Qualcomm, Samsung, Google. There are eight corporates involved.

**Elias:** Do they lead big rounds or mostly follow?

**O'Keefe:** They tend to follow. But Google

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obviously led the Ubiquisys round and I think Intel Capital still has some influence on terms.

**Cook:** A part from Intel, a lot of this investment is done for strategic reasons though, not for a financial return.

**O’Keefe:** Unilever Ventures has a very interesting model though. There are new groups emerging with a very clear mandate to make money.

#### **If we could turn briefly to cleantech. What are Europe’s particularly strengths in this area?**

**Pollard:** The US is lauded in social policy terms, because they have 50 states, and can experiment in one area before rolling out. But the EU actually has a similar model. For instance, the feed-in tariffs in Germany, which are now ten years old, were initially an experiment in lower Saxony that then spread to the rest of Germany, creating this world beating mini-economy around solar PV. Other initiatives driving innovation in Europe include the emissions trading scheme and some of the small-scale regulation in the UK. There’s an emissions trading scheme for buildings that’s resulting in all manner of interesting refrigeration technologies and air conditioning, for example.

So at the moment, Europe is more than competing with the US. The US will get there, but they have a lot more trucks than we do so I think you’ll probably see more innovation in fuel emission before you see innovation in areas that Europe is focusing on.

#### **Does Europe now have sufficient depth of that most sought-after commodity, the repeat entrepreneur?**

**Cook:** All companies are inter-networked with previous successes because everybody has worked somewhere before. So it depends what you mean by serial entrepreneur. Do we have chief executives that have made a gazillion for us and gone back in? There’s a number of them. There are also a number of chief executives that move between VCs. We sold Buy.at earlier this year and Kevin Cornils, who we brought in as chief executive there, has now gone over to join an Index company, Glasses Direct. There’s a core group of professional chief executives emerging in Europe that are jumping from start-up to start-up.

**Holmes:** It is worth saying that if you look at the statistics most of the great, billion-dollar businesses have been built, particularly in the internet sector, by people who are under 20,

or thereabouts. I think the value of a repeat entrepreneur is mostly to do with the seed financing they can bring to the industry.

**Cook:** The angel community is thriving. Even many of the LPs in VC funds are people who made money through entrepreneurship in the past. It’s a sea change. Entrepreneurship as a culture is emerging everywhere. Look at the popularity of *Dragons’ Den*. The idea of risk equity investing as a TV programme? It’s just crazy. But that mentality does drive deal flow.

**O’Keefe:** I would identify three different types of entrepreneur. There is the one that Ben described, that irritant who starts the whole process going. It’s often the anarchist 22-year-old with his internet company. And then there’s the seed investors, angels and advisers, people who just help along the way. The third type is the executive who really knows what they’re doing.

Historically, getting hold of this third type has been about trying to find CEOs based in the States who are prepared to come to Europe. The good thing about this cycle of internet investment is that there are native Europeans who have cut their teeth and made some money, and who are now prepared to go for the big time.

**Chalfen:** There is a risk in assuming that someone who has done it before can do it again. Not everyone has the passion and hunger second time around. Equally, I’d argue very few people can emerge from the corporate world and become an entrepreneur overnight. The pace of execution is really what you’re looking for, and it’s either in someone’s DNA or its not.

**Elias:** We are not so much looking for serial entrepreneurs as hired gun senior executives that have been through a couple of growth companies – not start-ups and not working for corporate America, but actually running businesses from \$10m to \$100m of revenues. Those are still hard to find in Europe.

#### **Kennet’s investment focus has clearly shifted towards that “growth” type of company. Do you expect others to follow, Michael?**

**Elias:** I hope not. Our view was that, post-bubble, it was, and still is, particularly difficult to make money from traditional early-stage venture. At the same time we felt that there was an opportunity in later-stage investing.

We’re much more interested in backing founders that have already built businesses and

are interested in taking on capital for the first time. But you can’t build an entire ecosystem with boot-strapped technology businesses, so someone has to continue to target early-stage.

**Cook:** When you’re doing venture, you’re looking to make all sorts of exponential changes to fundamentally alter a business’s value – be it early- or late-stage. It doesn’t matter how many employees a company’s got, we’re all trying to get to that next level to make the company twice as valuable. That’s a completely different mindset to buyouts. I don’t think anyone in venture is looking to shave bits here or there to create value. The big difference exists between buyout and venture, not between early- and late-stage.

**Elias:** I don’t think there’s that divide between venture and private equity any more though. It has become more of a continuum and there are people placing themselves halfway across that line. I think that there are a lot of us round this table that are doing transactions that fit into the middle road where the expectation isn’t a 15 or 30-times win, but more like three to five.

**Cook:** Maybe. But I think private equity wants two-times within two years and none of us are looking for that. Three to five is still a venture return.

**Chalfen:** Having said all that, if everyone in the room including Michael was only doing series A start-ups, then I think we’d be pretty useless to those companies. It’s all very well dealing with businesses for the first couple of years, but if you can’t back them all the time then I’m not sure whether we’re doing our jobs.

I think it’s a slightly artificial distinction and there’s a certain pride in being venture capitalists. But if you can’t then add value to a growth-stage company, I’m not sure what use we are.

#### **Should VCs allocate a liquid amount to early- and late-stage investing?**

**O’Keefe:** No, you’ve got to follow your money.

**Cook:** You have to have a visible fund strategy, so that means a few of us get together in a series A round and we know that we’re going to put in a lot more money if it succeeds, and that if it doesn’t we will kill it early on.

**Elias:** The interesting thing is that in our experience we make the most money from situations where we only did one round.

**Cook:** The highest multiples or the most money?

**Elias:** I think both.

**Cook:** It’s very hard to build a big business

without a lot of money, unless you have some viral or something magic happens. You still have to hire and pay several hundred people if you're going to build a \$50m business.

**Deligny:** As an observer from slightly outside the industry, there seems to be an obsession among the smaller VCs in Europe with this idea that you can build a successful company with an elastic band. What we see repeatedly is a company being starved of capital and not being able to execute. We're losing lots of companies in Europe simply because the funds behind them don't have the money, the confidence or the resources to take care of them when difficulties arise.

**Chalfen:** That's a really big call to say that we're all wrong not to put good money after bad. We've all said yes, the industry's got more mature and that the firms left are the better ones who know what they're doing. To then say that those firms are wrong not to support companies that they've decided to kill early is a bit odd.

**Deligny:** No, what I'm saying is that if you have a majority of fairly young players who have smaller funds and who don't really know what they're doing, then these guys are not particularly great sources of capital and support for companies.

**Elias:** I would argue that European investors do, in fact, have a history of putting good money after bad. My guess is that most of the companies in Europe that have got ~75m or so of venture capital have got it because they've failed somewhere along the way.

There are exceptions, sure. But certainly in our portfolio the businesses where we've deployed the most capital have been the worst performers.

**Holmes:** I think the equity gap is there for a reason. I actually think that it's not wide enough. Too many firms get over that initial jump from being test stage with a very limited amount of money, into series A of a proper VC cycle.

Governments are always striving to close this equity gap and create incentives for people to fund these businesses. I think that's misguided.

**Cook:** The problem is you've got lots of small funds in Europe. If you've got ten assets you can't afford to take a hit. Those of us with larger funds should be able to do early-stage deals, but then only put money behind the real winners. If you look at the big European exits, MySQL had around \$50m in total, I think. Bebo was unusual with only \$15m, but many of the billion-dollar companies have at least \$50m.

**Is it a VC's job to create a billion-dollar company, or simply to maximise returns for investors?**

**Elias:** There is an argument, which I subscribe to, that the way to make money in Europe is not to focus on building giants - that it is in fact better suited to

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building very good \$200m or \$300m companies.

**Cook:** I agree with you. But there are a lot of people in the US who will just say this is a billion-dollar game.

**What is the perfect size for a venture fund?**

**Cook:** Traditionally, the model has been \$50m per partner, but the whole industry is changing. We used to be able to IPO companies. Yahoo! went out and raised a couple of hundred million dollars between 1997 and 1998, but Nasdaq is no longer providing those growth spurts and that's where some of the bigger funds are coming in. That said, the old-fashioned venture capital model of a partner being hands on and having four or five companies hasn't seemed to change. So up to around \$700m is probably the most that you can deploy effectively as a team.

**O'Keefe:** Only ten per cent of capital that gets deployed goes into companies where you get a ten-times return. Statistically, if you don't have one of those, you will not be a top quartile performer, and then you will cease to exist as a manager. If you want to be 90 per cent confident that you'll have at least one out-performing company you need to have around 20 in your portfolio. If you have 16 it's 80 per cent. It just comes down to the maths.

**There's a lot of scepticism among LPs regarding European venture, but would you say fundraising has become easier in recent years?**

**Holmes:** I guess if you'd ranked the asset classes over the past four or five years you'd have European private equity right at the top, then US venture, followed by US buyout, with European venture bringing up the rear. And in the minds of those that control LPs' allocations, that's probably still the pecking order.

In Europe, there are very few firms with the length of track record that the US firms have. LPs' attention is therefore always more focused on what you have done in your last fund than it would be if you were Benchmark or Sequoia on your tenth or eleventh vintage. That's been the challenge. Because of the long-term nature of

venture, European VCs have not been able to realise exits before the end of the three- or four-year cycle. They may have some great companies, but they haven't realised any return. So they end up going into a sort of hibernation period where they haven't got much capital to deploy.

**Cook:** One of the best signs that things are changing that I've seen was a very large pension fund that has recently restructured its private equity exposure and no longer has a "US venture" allocation. I think that's a huge step forward. It used to be: yes we do venture - US venture, and then maybe we'll think about a little something else on the side. To be able to get capital redeployed from US venture to global venture is a great development.

**Finally, if you had to put all your funds into one emerging technology, which would it be?**

**Holmes:** Cloud computing is a buzzy word. There is certainly a substantial amount of flux in the software industry. We're seeing a generation of companies that are coming to us in the internet space, which are fundamentally building their businesses on top of Amazon and Google web services, for example. These are companies that have kicked Microsoft out of their entire corporate structure, from the technology they use to run the service to the technology they use as an executive group. There are lots of smart VCs who have similar visions of what's going to happen. The challenge is getting into those deals and how well you can execute.

**Cook:** Our job, as venture capitalists, is to try and find out what is going to be really big in three to five years' time. Not ten years' time - that's what futurologists do - and not 12 months, because that's what public markets try to do. What will be different in the world in three to five years' time, if I had to make one bet? I think we will see a drastic change in the cross-over between the internet and television.

**Holmes:** I completely agree. There are lots of different angles but if you look at the success of the BBC iPlayer, I think this is a transition that is going to happen in two to three years' time. ●

