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European Venture Capital Market: Scaling Beyond Current Boundaries

Gerard GEORGE
Singapore Management University, ggeorge@smu.edu.sg

Eva Nathusius
Technische Universität München

The European Venture Capital Market: Scaling Beyond Current Boundaries

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Conducted by
Professor Gerard George
Dr. Eva Nathusius

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About the paper

This project was carried out by the Private Equity Institute of London Business School and the Center for Entrepreneurial and Financial Studies (CEFS) of Technische Universität München. This report was prepared by Professor Gerard (Gerry) George (previously at London Business School, currently AIM Innovation Fellow at Tanaka Business School, Imperial College London) and Dr. Eva Nathusius (Technische Universität München) with the assistance of Dr. Sergio Tieri. The project was supported by Professor Eli Talmor (London Business School) and Professor Christoph Kaserer (Technische Universität München) and conducted on behalf of the European Private Equity and Venture Capital Association (EVCA).

About EVCA

The European Private Equity and Venture Capital Association (EVCA) was established in 1983 and is based in Brussels. EVCA represents the European private equity sector and promotes the asset class both within Europe and throughout the world.

With approximately 1,150 members in Europe, EVCA's role includes representing the interests of the industry to regulators and standard setters; developing professional standards; providing industry research; professional development and forums, facilitating interaction between its members and key industry participants including institutional investors, entrepreneurs, policymakers and academics.

EVCA's activities cover the whole range of private equity: venture capital (from seed and start-up to development capital), buyouts and buyins.

Disclaimer

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Foreword

After the burst of the technology bubble in 2001 and the following drought in the European venture capital market, a slow but steady comeback was noticed over the past four years. Not only have there been a number of prominent cases of successful venture capital backed companies and notable exits, but also limited partners (LPs) are increasingly looking at the European venture capital market.

The expected allocation of funds raised to venture capital more than tripled from €5.7bn in 2003 to €17.5bn in 2006 ([1]). Although the larger share is earmarked for the expansion stage (€11.5bn), an important €6bn is dedicated for early-stage projects. By the same token, investments in venture capital more than doubled from €8.4bn in 2003 to €17.3bn in 2006. Also the performance of European venture funds has shown signs of improvement with a 2006 one-year average net IRR of 17.2% ([2]).

Within the context of a growing venture capital market in Europe and the materialization of a rising number of success stories, in autumn 2006 EVCA commissioned the Private Equity Institute of London Business School (LBS) in collaboration with the Center for Entrepreneurial and Financial Studies (CEFS) of Technische Univerisität München, to undertake a study about the successes in the European venture capital market since 2001.

The purpose of the study is to:

- revive and stimulate the discussion about the European venture capital market and its successes;
- underline communalities or differences between venture capitalists and their approach when building up a successful company in Europe;
- showcase some of the many successful investments and learn from the experience of the business founders and their venture capitalists.

EVCA hopes that this study is a starting point for its members and the European venture community at large to become more vocal about their achievements. This should in turn encourage more LPs to take a closer look at the European venture capital market. Becoming more outspoken will also encourage new entrepreneurs to follow the example of very successful business founders. Entrepreneurs should be invited to use Europe as a platform to create and grow their business, encouraged by the support they will receive from a strong venture capital community.

I would like to take this opportunity to thank on behalf of EVCA, the Private Equity Institute of LBS and CEFS all the LPs, venture capitalists and portfolio companies that have participated in this study for their time and very valuable input. Without their contribution, this project would not have been possible.

This study "The European Venture Capital Market: Scaling Beyond Current Boundaries" is not only the outcome of a more than one-year-long research project, but also the start of a number of new activities that EVCA will launch for the venture community over the coming months. As the Director of the EVCA Venture Platform, I hope you enjoy reading this report and look forward to receiving any feedback you might have.

Georges Noël
EVCA Director - Venture Platform

([1]) EVCA Yearbook 2007: Annual Survey of Pan-European Private Equity and Venture Capital Activity.
([2]) Pan-European Survey of Performance 2007, Thomson Financial/EVCA.

Executive Summary

This study systematically documents the perceptions of LPs, venture capitalists and entrepreneurs and their views of the trends and challenges facing the European venture capital market. The interest from LPs in European venture capital funds was found to be neutral to marginally negative because of historical returns. However, buoyancy in the supply of high quality opportunities at reasonable valuations has the potential to improve this outlook. The findings suggest that European venture capitalists still face structural barriers in the form of heterogeneous consumer preferences, improving but weak exit and fundraising environments, and the scarcity of LPs of significant size. The study revealed that successful venture capitalists tended to build scaleable businesses, either global or European which improve the potential for returns. In addition to having an aspiration to build global companies, venture capitalists with entrepreneurial, industry and investment experience with access to a rich professional network were top performers.

1. Introduction

With European venture capital returns trailing their US counterparts, there have been discussions on the reasons for mediocre returns and attempts to find ways to bolster value creation in the sector. Within that broad remit, this study investigates drivers of success of European venture capitalists and some of the key challenges that they face. Though the study leverages the rigorous empirical data compiled by information service providers, the value-add of this study comes from a prospective look at the trends and perceptions of the key players in this sector.

To do so, this study systematically captures the perceptions of venture capitalists and their limited partners (LPs) on the entrepreneurial environment and the rationale behind LP investments in European venture capital. Similarly, interviews with venture capitalists and entrepreneurs focused on the underlying drivers of creating home run businesses that have returned high multiples of their investment were conducted. Understanding both the conditions facing the venture capital sector and the critical success factors underlying this business is a significant step forward in clarifying the potential for venture capital in Europe.

The study's findings are drawn from analyses of in-depth, semi-structured interviews with 20 venture capitalists (from 19 funds), 7 LPs, and 7 entrepreneurs with successful exits. The venture capitalist sample was selected as to induce differences in opinions by accounting for size of the fund, country location, geographic scope of investments (national, European, global), and stage of investments. The interviews were conducted mainly with institutional venture capitalists who have a committed portfolio of investments in the early-stage investment asset class. By soliciting views from the three key stakeholders, venture capitalists, LPs, and entrepreneurs, this study provides a holistic view of the factors influencing success in the European venture capital market.

The LPs interviewed currently hold a neutral to marginally negative view of the venture capital asset class because of poor historical returns. Nevertheless, these LPs suggest a glimmer of optimism that stems from an improving exit environment and a noteworthy increase in the supply of high quality opportunities at reasonable valuations; all suggesting the potential for an improved, positive outlook for the venture capital sector. The analysis of successful exits reveals that many of the investments made by venture capitalists with global aspirations and backed by an experienced team had an exceptionally high return potential. The report discusses these issues and further nuances of venture capital strategy and LP investment criteria in further detail.

2. Methodology and Sample Description

Qualitative interviews with three different target groups were conducted: European venture capitalists, their portfolio companies, and the LPs of European venture capital funds. The aim was to understand the perceptions of all three players on historical and future trends in the European venture capital market. In addition, successful investments of European venture capitalists post 2001 were analyzed.

The sample of interviewees was chosen based on theoretical considerations. There were three primary guiding principles behind this data collection effort. First, it was ensured that the data covered venture funds in all main European countries and with different geographic focus. Second, because performance and company business models vary by industry, it was ensured that a stratified sampling procedure was followed which captured the relative importance of different industries for venture investments. Finally, to avoid being biased towards successful companies, the sampling procedure included funds that were in the top, middle, and bottom quartiles of returns to their LPs. The aim was to ensure to cover various types of interviewees in order to be able to compare the findings across different categories of interviewees. As venture capitalists may differ based on their size, their investment stage focus, their industry sector focus and their country of origin, it was ensured to cover various categories within each criterion with the sampling.

In a first step, European venture capitalists were identified through the EVCA website, the website of national venture capital associations, internet search engines such as Google and company websites. State owned and corporate venture capitalists were excluded as their investment motivation differs from independent venture capitalists. By focusing on independent venture capitalists, a group of venture capitalists with a similar general investment motive solely based on financial returns was analyzed. Within the group of independent venture capitalists, a set of interviewees which covered the pre-defined categories was chosen. 30 venture capitalists were approached, of which 10 declined to participate in the study.

With these 20 venture capitalist interviews, it was possible to cover the different inclusion criteria of industry sectors, country of origin, investment stage focus and age of the fund. The sample represented global, pan-European and national venture capitalists. In addition, venture capitalists focused on early stage, expansion-development stage and on both stages were included. The sample represented various industry sectors and countries of origin. Table 1 provides a more detailed overview of the categories covered with the sample.

Table 1: Sampling criteria for venture capitalist (VC) interviews

Size		Investment stage		Industry sector		Country	
Category	Number of VCs	Category	Number of VCs	Category	Number of VCs	Category	Number of VCs
Global	2	Early	18	ICT/Media	14	Benelux	2
European	5	Expansion-Development	14	Life sciences	7	Eastern European	2
National	13			Sustainable	5	France	3
				Manufacturing	1	Germany	4
				Other	3	Italy	2
				All	3	Nordic	4
						Spain	4
						Switzerland	2
						UK	7

Source: EVCA website, company websites

Note: Venture capitalists meet more than one criterion in the investment stage category, industry sector and country.

The sampling of venture capital backed companies was driven by the aim to interview dyads of venture capitalists and their investment companies. The venture capitalists were asked to discuss investments where they have already had an exit. The companies selected had exits in the form of acquisitions and IPO listings. Companies which were chosen by the venture capitalists were interviewed in a second stage. These dyads enabled a triangulation of the findings from the venture capitalist interviews and to show contrasting perceptions. As the interviews with venture capitalists covered various industries, investment stages and countries, the portfolio companies were also dispersed across several of these criteria. A total number of seven venture capital backed companies were interviewed. An overview of their characteristics is given in Table 2.

Table 2: Sampling criteria for portfolio company (PC) interviews

Type of exit		Industry sector		Country	
Category	Number of PCs	Category	Number of PCs	Category	Number of PCs
IPO	3	ICT/Media	3	Germany	3
Trade sale	4	Life sciences	2	Italy	1
		Energy	1	Nordic	1
		Financial services	1	Switzerland	1
				UK	1

Source: Company websites, interviews

In addition, a total number of seven LPs who are investing in European venture capital funds were interviewed. Large, prominent LPs were included and complemented by interviews with additional smaller, specialized LPs. The intent was to understand their views on trends in the European venture capital market from a macro level because they tend to have a broader view across different venture capitalists and their performance metrics.

Table 3: Sampling criteria for limited partner (LP) interviews

Country	
Category	Number of LPs
Benelux	2
France	1
Germany	1
Switzerland	1
UK	2

Source: Company websites, interviews

Semi-structured interviews were conducted with all three target groups. The three interview guides consisted of open-ended questions to ensure a free expression of the interviewee's opinions and experiences. In addition, scaled questions with a rank-order scale were included. This allowed us to compare the perceptions across different interviews.

2. Methodology and Sample Description

Three different interview guides were used, each of which was specifically tailored for an interviewee group. They all entailed a section on the interviewee's perception on trends in the European venture capital market and on background information on the interviewee. In addition, the venture capitalist questionnaire also included questions on the success of one particular investment in their portfolio. The venture capitalists were asked to elaborate on their most successful exit since 2001. The interview guide included questions on the drivers of success of this portfolio company and the contribution of the venture capitalist to this success. The interview guide for the portfolio companies mirrored this theme. The management of the portfolio company was asked about their views on the key drivers of their success and on the role of the venture capitalist in that context.

The interviews were taped and transcribed. In three interviews, the interviewees declined the permission to tape the interview. The interviewers took detailed notes in all interviews and transcribed them after the interview. Interviews lasted between 50 to 90 minutes in duration. A total of over 35 hours of interview data was used across the different groups. The interview data was complemented with secondary data including databases such as Dow Jones *Venture One*, Thomson *Venture Xpert*, Venture Business Research, company websites and other publicly available sources such as press articles.

3. European Investment Environment for Venture Capital

The European investment environment for venture capital continues to evolve and is showing signs of improvement in recent years from the post 2001 lull. Perceptions of both venture capitalists and LPs have shifted from a markedly negative tone to expressing varying degrees of optimism in the market. Despite some guarded optimism in venture capital circles, the interviewed LPs and venture capitalists acknowledge that the European venture capital market continues to suffer from structural as well as capability issues and relatively low returns. Overall, three main structural challenges in the European venture capital market were found across the interviews, (1) the heterogeneity in language, cultural, and consumer preferences across European markets restricts the prevalence of scaleable business opportunities across these markets, (2) the improving, but relatively weak exit environment in both IPOs and trade sales, and (3) the scarcity of European LPs of significant size who invest into venture capital funds and a relatively weak fundraising environment for venture capital in general. In addition, capability issues of venture capitalists and entrepreneurial teams were revealed in the interviews.

3.1. Structural issues

The heterogeneity in language, cultural, and consumer preferences in the European markets presents an intriguing challenge for venture capital models. This heterogeneity makes it difficult to enter and operate in multiple European markets as customer preferences in each country may require a tailored marketing strategy; thereby placing significant demands on the management team. Consequently, European venture capitalists often find it more difficult to build a high-growth company serving pan-European customer segments compared to building high-growth companies in homogeneous markets such as the US.

For the venture capital market, this has two main consequences. First, it is difficult for start-up companies to expand to other European countries, which can limit the growth potential of venture capital backed companies. Therefore, it can be difficult for venture capitalists to find target companies with a scalable business model that is likely to achieve high growth rates needed for an appropriate exit valuation. Second, the support provided by venture capitalists for their portfolio companies may also not be scalable across different European countries. Knowledge of markets other than the home country is required to help a portfolio company on its path to internationalization. In a few home runs analyzed in this study, some European countries offered strong domestic markets that provided the potential for growth. Depending on the industry sector, internationalization may not be necessary to achieve the required growth as the domestic market already provides a reasonably large potential revenue base. Nevertheless, the constraints placed by geographic and customer differences make it difficult to find scalable business models with growth potential in Europe.

The weak exit environment through secondary capital markets has improved post 2001 but still remains rather lackluster. Post 2001, the interest of investors in technology companies listed on public capital markets was dismal and, as a consequence, the valuations of these companies bottomed in 2003. Due to the lack of interest and the low valuations, an IPO was not an exit option for most venture capital backed companies. In recent years, however, the IPO environment in Europe has significantly improved with a nice positive bounce for European companies in Q2, 2007. In Table 4, evidence of a reasonably buoyant exit environment through IPOs of European and US companies is shown.

3. European Investment Environment for Venture Capital

Table 4: IPO proceeds of European and US companies

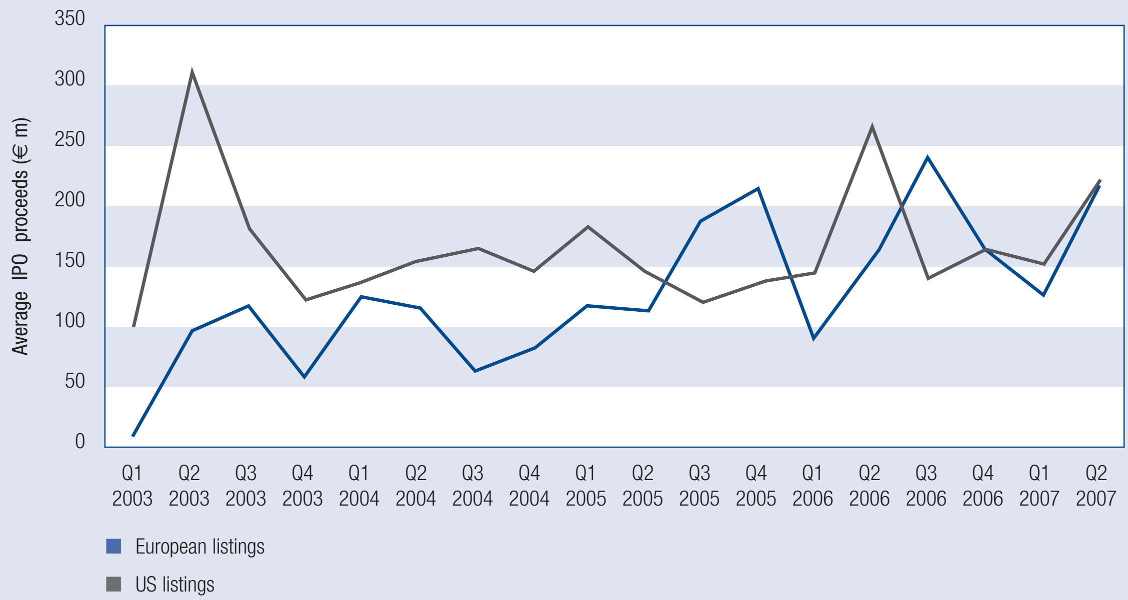
IPO issue date	European proceeds (€ m)	Number of European issues	Average European proceeds (€ m)	US proceeds (€ m)	Number of US issues	Average US proceeds (€ m)
Q1 2005	6,633	57	116	7,998	44	182
Q2 2005	12,425	109	114	6,427	45	143
Q3 2005	9,794	52	188	7,983	67	119
Q4 2005	21,982	102	216	6,868	51	135
Q1 2006	8,011	91	88	5,988	42	143
Q2 2006	21,787	138	159	13,659	51	268
Q3 2006	19,114	79	245	4,365	32	136
Q4 2006	27,634	171	166	11,724	71	165
Q1 2007	10,671	85	126	6,331	42	151
Q2 2007	31,862	144	221	12,617	57	221

Source: Thomson Financial

Note: The data are attributed geographically by the domicile nation of the issuer's headquarters, regardless of the target market. European data comprises IPOs of companies domiciled in Europe, including Central and Eastern Europe.

Figure 1 shows changes in the average proceeds raised by European and US companies in IPO events over the past five years. The average proceeds raised by IPOs in Europe have increased from €6 million in Q1 2003 to €221 million in Q2 2007.

Figure 1: Average IPO proceeds per listing in Europe and US



Source: Thomson Financial

Though several successful IPOs of venture capital backed companies have taken place in the past two years, there is still a widely shared perception as being possible only selectively with a highly convincing equity story. Some venture capitalists see the necessity to list companies on their domestic market in order to achieve enough liquidity. In Table 5, the number of IPO issues by European companies on European exchanges and their proceeds for the first half year 2007 is documented. However, other venture capitalists and their LPs believe that NASDAQ remains the market that provides sufficient liquidity for young technology companies.

Table 5: Patterns of IPO by European companies

European company IPO stock exchange totals Jan-June 2007		
Stock exchange	Proceeds (€ m)	Number of issues
London	19,488.3	28
Russian Trading System	8,074.1	8
Frankfurt	5,055.4	25
London AIM	4,082.6	61
Istanbul	2,087.0	6
Barcelona	1,844.2	4
Bilbao	1,844.2	4
Madrid	1,844.2	4
Valencia	1,844.2	4
Irish Stock Exchange	1,594.9	2
Mercado Cn	1,588.7	3
Milan	1,505.8	3
Euronext Paris Premier Marche	1,414.6	10
Vienna	921.4	4
Oslo	795.9	13
Milan Star	723.8	6
Warsaw	570.6	11
Nasdaq	473.1	3
Swiss Stock Exchange	444.0	5
Milan Expandi	436.8	6
Other	1,731.2	34

Source: Thomson Financial

Note: Due to dual listings, the stock exchange totals do not match the quarterly IPO activity levels.

3. European Investment Environment for Venture Capital

Based on governance and related IPO listing costs, there is a shared perception that European public capital markets have become more attractive for small technology companies in comparison to the US market. In the US, costs of complying with Sarbanes-Oxley governance regulations have put pressure on small public companies. The interviews indicate that such compliance costs are disproportionately high for small companies; thereby increasing the likelihood for small venture capital backed companies to seek capital from outside the US. This could potentially have a positive impact on the exit environment in Europe. Nevertheless, existing data do not show that there are significant numbers of US firms that list on European exchanges nor do they show that European listings, on average, raise more IPO proceeds than US listings.

The trade sale market in Europe is also perceived as being relatively weak in comparison to the US. The interviews reveal that large European corporations are less willing to pay strategic prices for technology companies in comparison to their US counterparts. However, in the past two years, successful trade sales were realized across industry sectors in Europe. In general, the M&A market is seen to have improved in recent years with increasing interest from large corporations.

The fundraising environment in Europe for venture capital was perceived to be relatively weak compared to the US but is showing signs of improvement. The interviews with venture capitalists reveal that it has been difficult for many European venture capitalists to raise new funds. LPs shied away from high-risk investments in Europe. The results do not show marked improvements from the EVCA 2006 survey([3]) where 81% and 36% of LPs interviewed respectively suggested that weak performance and bad experience in the bubble were primary reasons for their hesitance to invest in this sector. LPs noted that the returns have trailed other asset classes and their investment outlook is either neutral or, in some cases, underweighted. Investments in later-stage buyouts have, thus far, been able to achieve significantly higher returns than venture capital investments. Even here, LPs voiced concerns about the late-stage buyout market and the risks associated with high interest rate environments and the difficulties in sourcing appropriate value-adding opportunities.

Table 6: Net return to LPs of European private equity funds (2006)

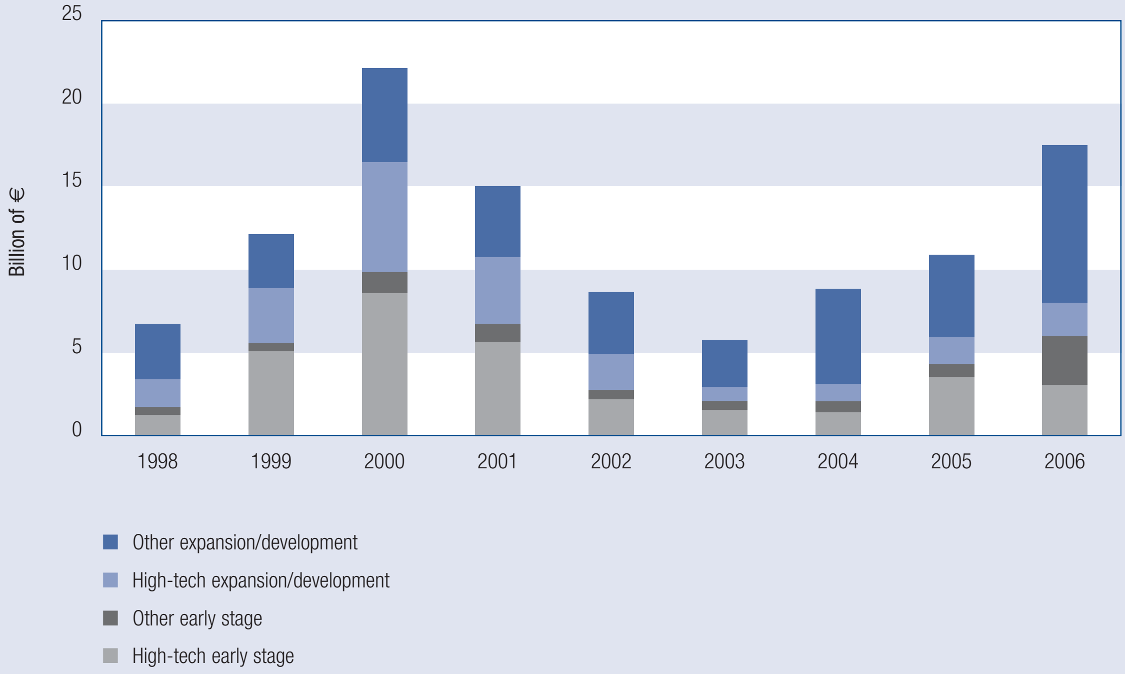
Stage	1 YR	3 YR	5 YR	10 YR	20 YR
Early stage	5.7	2.3	-4.7	-1.1	0.0
Development	2.4	6.9	1.2	7.1	8.5
Balanced	35.3	6.6	-1.8	7.9	8.1
All venture capital	**17.2**	**5.0**	**-2.0**	**4.1**	**5.6**
Buyouts	29.6	15.3	8.3	14.3	14.4
Generalist	98.6	15.8	5.9	10.0	9.8
All private equity	**36.1**	**13.0**	**5.4**	**11.0**	**11.0**

Source: Thomson Financial/EVCA, updated Benchmarks 31 December 2006

([3]) EVCA (2006): EVCA Barometer May 2006.

In Table 6, the performance (net IRR to LPs) of European buyout and venture funds formed after 1980 is shown. Venture capital returns, on average, have improved this past year and are showing signs of strength. For example, the one-year returns of all venture capital funds have improved to 17.2%, up from 5% when considering a three-year average. The increase in returns and the improvements in cash flow supply and general positive economic outlook in Europe may explain why venture capitalists have fared significantly better in raising new funds for investments (see Figure 2). In 2006, LP investments in European venture capital funds have improved from €10.9 billion in 2005 to €17.5 billion. In some interviews, LPs were considering to improve their outlook on venture capital funds.

Figure 2: Expected allocation of European funds raised to venture capital



Source: EVCA/Thomson Financial/PricewaterhouseCoopers

The dearth of LPs of significant size is another problem that negatively impacts European venture capitalists. In the US, a large proportion of the funds invested in venture capital are sourced from pension funds or endowment funds; this class of LPs does not exist in many European countries. There are legal requirements in some countries that severely restrict certain types of LPs to invest in venture capital. For instance in Germany, insurance companies are allowed to invest a limited amount of their assets in high-risk equity investments. LPs in Europe tend to be smaller and have a shorter tradition of investing in venture capital compared to their US counterparts. The relatively low interest of national LPs in venture capital in Europe tends to be construed as a negative signal for foreign LPs to invest in this asset class. All these structural factors have added to the difficult fundraising environment in Europe. Such restrictions and limitations of LPs decrease the supply of funds for venture capital investments, possibly disproportionately affecting national venture capitalists more so than global or pan-European venture capitalists.

3.2. Capability issues

In addition to structural issues that influence the venture capital market environment, there is considerable variability in the capabilities and the quality of venture capitalists and entrepreneurs. In the interviews, LPs noted that, in comparison to more mature markets such as the US, Europe has a larger share of novice venture capitalists and entrepreneurial teams. At the same time, the supply of investment opportunities with a reasonable pre-money valuation is generally perceived to be more positive in Europe than in the US. With an increasing number of serial entrepreneurs and a strong supply of investing opportunities, there is an emerging positive outlook on the viability of venture capital investing models in Europe.

The European venture capital market is still relatively young. The UK has to be considered an exception as there is a longer history of venture capital investments. Therefore, the UK has at present a more mature venture capital market compared to continental Europe. In continental Europe, many professionals turned towards a career in venture capital during the boom cycle in the late 1990s. LPs noted that the surfeit of funds availability and the interest of governments to actively engage in venture funding allowed inexperienced individuals to become venture capitalists. As many of them had a background in banking, accounting or consulting, they also often lacked a technology background and had no entrepreneurial experience. The value adding capabilities of these venture capitalists were limited. As one prominent LP noted, *"… In Europe the wrong people entered the venture capital business, a lot of them are ex-accountants, as opposed to what you see in the US where a partner typically has a technology background or a sales and marketing background. That is changing here, so that's why we have invested, because we're hopeful that going forward it will be better because the model is changing …".* With the completion of one full fund cycle for most venture capitalists, there have been plenty of opportunities to improve their investment strategy, gain a deeper understanding of viable opportunities, and evaluate mechanisms to add value to their portfolio companies.

There is a trend towards reduction in the surplus of venture capital firms. After the bust in late 2001, a consolidation in the venture capital market saw a significant number of individuals leave the venture capital industry. Unsuccessful venture capitalists found it more difficult to raise further funds in recent years. Although there are a number of very successful venture capitalists in Europe who have built up experience and are able to generate exceptionally high returns, LPs and venture capitalists both expect the venture capital industry consolidation to continue in the near future. In the interviews, some venture capitalists expect a significant contraction from about 300+ venture capitalists to less than 200 venture capitalists in Europe to be active in early stage venture investments over the next five to ten years. Though the numbers vary widely, most LPs agree that there are fewer than 100 venture capitalists which meet their criteria to invest. Some LPs suggest that the smaller number of venture capitalists in each industry sector is likely to build up additional experience and value adding capabilities, all of which will improve subsequent returns and create a vibrant and thriving venture capital industry in Europe.

The increasing number of serial entrepreneurs in Europe in recent years suggests that the raising number of entrepreneurs with experience in creating start-ups will concomitantly improve the supply of opportunities. In the interviews, participants noted that though there may be exceptions ("pockets of tolerance"), in general, Europe does not have an entrepreneurial culture that embraces failure of start-ups. An unsuccessful start-up company is still widely perceived as a failure and not as a learning opportunity. Historically, few people preferred being an entrepreneur over employment as a manager in a large corporation; a mentality that has begun to change. Many venture capitalists emphasize the quality of management teams as a critical piece of their investment decision. There are many successful venture capital backed companies in Europe which show improving entrepreneurial capabilities of management teams.

One LP echoed this enthusiasm, *"… History changes … The market is becoming more experienced, we have more experience-settled venture capitalists, with more skills, but what's important, what we are seeing in our portfolio which is tangible to us, is the increasing number of repeat entrepreneurs …".*

A significant improvement in the supply of investment opportunities in Europe was a common theme across interviews. One London-based venture capitalist noted that *"… We are coming across more good opportunities than we can invest. We have an excellent pipeline of companies …".*

Still lagging the US, however, are university-based technology spin-outs. With some exceptions such as Imperial College London, Cambridge, and Leuven, most European universities generate surprisingly few successful spin-outs. The technology transfer entities in these universities are often weak and support for faculty to spin-out innovative companies is limited ([4]). In addition, there is often a lack of an entrepreneurial culture among faculty and scientific staff that hinders the start of innovative companies out of universities. More recent focus on technology transfer by several countries is likely to gradually improve the spin-outs of technology-based companies over the next five to ten years, which will likely bolster the technology-based opportunities in the life and physical (engineering) sciences.

3.3. Return potential and self-reinforcing spiral

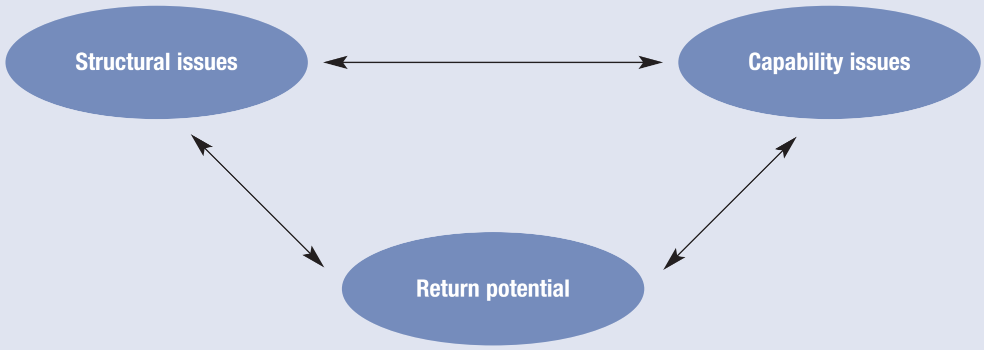
There are more deals chasing capital in Europe. With a general reduction in the number of European venture capitalists with fewer funds available compared to the US funds, there is a viable mix of capital availability and good investment opportunities. Venture capitalists and LPs concurred that although there are fewer opportunities (in absolute terms) compared to the US, there is also a relatively low density of venture capitalists in Europe, which leads to fewer venture capitalists chasing good deals. Also, many LPs pointed out that valuations in US investments have become too rich so that subsequent returns are more likely to be erratic. Therefore, many LPs and venture capitalists noted that there is less pressure on pre-money valuations in Europe compared to the US. This can possibly give European venture capitalists a competitive edge over US-based venture capitalists in fundraising when their performance also increases. In Europe, the increased supply of opportunities and the improvement in fundraising (Figure 2) augur well for subsequent returns to LPs in more recent fund vintages.

Due to the fact that there are fewer players in the European venture capital market compared to the US, the increase in supply of opportunities bolsters the likelihood that venture capitalists find investment opportunities at the right entry valuation, which will likely yield higher exit multiples. The European market can therefore be considered to be as economists would term it, imperfect markets, where venture capitalists can pick appropriate investments in innovative companies. Imperfect markets offer the opportunity to achieve excess returns, which the top European venture capitalists have shown can be achieved. However, as LPs noted, there are many mediocre and underperforming venture capitalists that lower the overall return generated in European venture capital to levels significantly below US returns. In Figure 3, the three main issues which according to the interviewees define the venture capital investment environment in Europe are shown: structural issues, capability issues, and returns to LPs.

([4]) Wright, M., Clarysse, B., Mustar, P., Lockett, A. 2007. Academic entrepreneurship in Europe. Cheltenham, UK: Edward Elgar.

3. European Investment Environment for Venture Capital

Figure 3: Issues of the European investment environment for venture capital



Source: LBS/CEFS/EVCA

A self-reinforcing spiral between structural as well as capability issues and the generated returns with European venture capital can be identified. It can be expected that as the consolidation in the venture capital market continues the returns will increase. With improving capabilities of venture capitalists and more serial entrepreneurs in Europe, the spiral to higher returns will be positively enhanced. In addition, improvements of structural barriers such as the exit or the fundraising environment can have a similar positive impact. This leads potentially to a positive reinforcement of the spiral to higher venture capital returns.

However, there is also the potential to derail the self-reinforcing spiral and create a downturn. A weak exit environment can depress returns in venture capital which would hamper dissolving the structural and capability barriers, which could further exacerbate the returns achieved with European venture capital. One LP noted, *"… (The environment) has already turned, but very little. I think we have reached the bottom last year, say end of 2005/ beginning of 2006, but we're only very slowly climbing out of the bottom. Probably, we will need another two years to really get people excited, I'm afraid. I hope there will be enough LPs believing in the market. There's a shakeout going on and fewer good venture capital firms remain, but I think in the end we will be allright …".*

Table 7: Responses regarding European venture capital environment

	Number of responses from venture capitalists					
	Average	Very positive	Positive	Neutral	Negative	Very negative
Q1: Supply of investment opportunities	2.1	4	11	2	-	1
Q2: Exit environment	2.2	3	9	5	-	-
Q3: Interest from LPs	3.2	3	2	2	6	3
	Number of responses from limited partners					
	Average	Very positive	Positive	Neutral	Negative	Very negative
Q1: European venture capital environment	3.2	-	1	2	2	-
Q2: Exit environment	3.0	-	1	3	1	-
Q3: Attractiveness of European VCs vs. US VCs	4.0	-	-	-	5	-

Source: LBS/CEFS/EVCA

Note: Not all interviewees provided a scoring on the above questions.

Table 7 provides a summary of responses of venture capitalists, LPs, and entrepreneurs to questions on the European venture capital environment. 83% of the 18 venture capitalists that provided these scores were positive or very positive on the supply of investment opportunities. 71% of the venture capitalists perceived the exit environment to be positive. For the question on interest of LPs, there was considerable variance with a few venture capitalists citing a very positive environment but a significant proportion (56%) indicating a negative or very negative environment. This result matches with the interviews on the shifting underlying dynamics where LPs are making a concerted choice of reducing the number of venture capitalists in which they invest and restricting their exposure to those venture capitalists that they believe were more experienced and specialized in a particular space.

The LPs who were interviewed reflected slightly different opinions. The variance across these interviews was significantly lower than in the interviews with venture capitalists. When asked about the European venture capital environment in general and the exit environment, their perception was, on average, neutral. On the attractiveness of European versus US venture capital for their investments, they tended to hold a more negative opinion. One London-based LP commented, *"… I think that Europeans tend to have rosy views of the US markets, that they are making fantastic returns. When you talk to US institutions, you actually realize that they are not doing that well and unless you are in the top five names or the top ten names, which you actually can never get into, the rest of the market is not doing particularly well. So in terms of the environment, the infrastructure, the knowledge, the US market is a lot more mature and the exit market is a lot more fluid than over here. Is it a better venture capital market? The answer is yes. It is mature and a fluid exit market …".*

Other interviews provide additional insights: one LP noted, *"… On average, venture capital is 13% and buyout is around 9% in the US. In Europe, it's been the other way around for us, 12% for buyouts and 8% for venture capital, which really is the wrong way around when you consider the risk-return profile …".* Another LP summarized the mood, *"… European venture capitalists still have to deliver. I'm not saying that they can't deliver, because we have some reason to be a bit more optimistic, but I think as an industry it still has its challenges …".*

4. Cases of Successful European Venture Capital Investing

Previously, structural and capability issues which according to the interviewees affect the performance of European venture capitalists were described. These factors help explain the relatively lower returns achieved in Europe vis-à-vis the US. Despite the lower average industry returns, top players in the European venture capital market were indeed able to generate exceptionally high returns for their LPs. Highly successful venture capitalists were interviewed along with those that yielded mediocre and underperforming returns to LPs. A sizeable part of the interviews delved into the contribution of venture capitalists to their portfolio companies. In this context, the venture capitalists explained key features of their own funding cycles and business model and its implications for performance. Based on these interviews, a pattern analysis of common features among venture capitalists with top, mediocre and bottom performance was conducted. From this analysis, three causal drivers that predominantly governed success of a venture capitalist, namely, experience, aspiration, and external resources were identified. These conversations are parsed out into thematic findings and sample descriptions that cover each theme are provided.

4.1. Characteristics of successful venture capitalists

Entrepreneurial, industry and investment experience does matter significantly in the venture capital industry. The notion of 'smart money' depends on the value that these venture capitalists add to their portfolio companies. One such important value-adding activity is in defining the firm's business strategy and its goals by serving as a sounding board for the management team. Key strategic decisions such as entering new markets or hiring new management staff are discussed thoroughly with the venture capitalist. In many cases, venture capitalists are deeply involved in sourcing and helping recruit top managers, especially CEOs and senior sales and finance managers. In addition, the support in negotiating future financing rounds with additional outside venture capitalists is regarded as critical support for the portfolio company. Taken together, these skills help enhance the success of a venture and, therefore, can improve the overall returns of venture capital funds. Nuances in the different types of experience required by the venture capitalist to fulfill this task were found in the interviews. These are:

- Entrepreneurial experience
- Industry experience
- Investment experience

Emergent Pattern # 1:
Entrepreneurial, industrial and investment experience of a venture capitalist positively influences his value-adding capability and, consequently, the success of his portfolio companies.

"… Just having a sense of what works and what doesn't work, and trying to share that same experience with the entrepreneurs to make sure that they don't make the same mistakes that we have made in the past […]. Success in a company is not an epiphany you wake up with in the morning, but doing lots, and lots of little things you do right. […] We can help facilitate, we try to give our entrepreneurs a competitive advantage and shortcuts …"
Partner, venture capitalist C

"… It's an entrepreneurial dream to do everything yourself, but it's not possible anymore, because you need specialized players and you need people with real experience in the industry …"
Partner, venture capitalist D

Emergent Pattern # 1:

"… Genuinely speaking, unless you've been through a couple of cycles and you've seen successes and failures, you can't be a fully-rounded investor. The failures are more important in terms of learning than the success stories …"
Partner, venture capitalist K

"… I think we differentiate ourselves from other European venture capitalists by coming from the industry. We are all engineers; we were involved either in start-up or technology companies before we started investing. I think that was fairly unique and a differentiator when we raised the fund …"
Partner, venture capitalist C

While it is simple to say that experience matters, it was found that a larger proportion of underperforming venture capitalists had less experience in both the functional and the softer aspects of portfolio company development. The start-up and industry experience revealed itself as useful in developing and bringing a product or service to the market and, in many cases, in positioning a product for the right customer segment. The softer experience came in valuable to 'connect' with the entrepreneur and empathize on the difficult decisions that needed to be made in managing teams, and in supporting and coaching roles to tide companies through difficult transition phases in management or in difficult industry cycles.

In raising funds, LPs consider the experience of a venture capitalist to invest to be one of the key decision parameters. One prominent LP noted, *"… We look at domain knowledge, as we call it. You should know your industry and what needs to be done, this is the operational experience. The third one is investment experience. Those are three important aspects to be successful ... three types of experience that we look for, which we highly value …".* Another LP emphasized the investment and portfolio experience, *"… You need to be careful with investment rounds and how you manage cash flows. This business is based on capital efficiency, get in at a lower valuation, exit at a higher valuation, and manage cash flows to get the best value. It is how best you can put money to work quickly to improve returns …".*

Aspirations of the venture capitalists have strong implications for their portfolio companies. An entrepreneur in casual conversation observed, *"… We never think of interviewing venture capitalists, we tend to think of it the other way around. But you have to [interview them] … to find out what they really want to be. Not just that they want to see 10x returns … every one likes to have 10x returns … but at a more basic level, they have to have the hunger to grow your business and they aspire to be the leading venture capitalists in this space …".* Many portfolio companies which were interviewed echoed the sentiment that it was one of the primary contributions of a venture capitalist to be keen on an ambitious growth plan.

Aspiration, in turn, gets into practice as a systematic effort across portfolio companies to build scalable businesses rather than a strategy focused on minimizing risk. Venture capital firms that followed a home run strategy were more likely to push their companies to grow globally. However, this largely depends on the growth potential the national market can offer. In many cases though, it can be necessary to grow beyond national boundaries in order to achieve an exceptional growth story that can be realized through an eventual IPO. Portfolio company inertia, inhibitions or operational roadblocks to take steps towards internationalization can be strong and the aspiration and encouragement by the venture capitalist often helps to overcome them.

Emergent Pattern # 2:
The venture capitalist's aspiration to build a scalable business and to grow globally is positively linked to the likelihood of success in their portfolio companies.

"… The most successful part of our investment was our support in the internationalization process. We helped them to get into other countries and to be the global leader in their specific niche …"
Partner, venture capitalist E

"… It's one of our core roles to both assist and push the company to go international. We actively encourage it and set it as a prerequisite when we invest …"
Partner, venture capitalist G

"… We needed to grow this business and growing it globally was all part of the strategy. Ultimately, going back to the basics, what we were trying to do is to make it attractive for a US software company …"
Partner, venture capitalist K

The capacity to marshal external resources is a significant value-add activity provided by the venture capitalists. These external resources include networks to other venture capitalists which can be essential in securing later financing rounds. In addition to the extra funding, the co-investors can provide additional contacts from their network. The network of the venture capitalist to industry players can also be highly valuable as the portfolio company might be able to get customers through these contacts. In addition to industry contacts or contacts in the finance community, networks to head hunters can be helpful as well. In the process of building an international team, head hunters can be particularly helpful for start-up companies as it is usually difficult to find capable candidates.

From the LP's perspective, their funding decisions are significantly influenced by the venture capitalist's external resources. LPs believe that one important outcome of wider, deeper networks is the sourcing of new opportunities. One LP noted, *"… Networks, that is the key, you have to be able to convince us why you will find the diamonds in the rough …"*. Another LP found networks to be critical for exits, *"… More than 90% of the positive exits for venture capital backed companies in Europe are through acquisitions. If you are well networked into an industry, then you can take your companies to the right people for these exits. You have to know who will be interested and why and who the right person is … that's why the venture capitalists' networks are a critical piece of the performance puzzle …"*.

An analysis of the venture capitalist interviews showed that top performing venture capitalists are well positioned in all three areas: experience, aspiration and external resources. To empirically capture how venture capitalists and their portfolio companies discussed the importance of various parameters for success, each interview was coded for content by checking if the interviewee mentioned a particular issue as important. From the emergent patterns described above, subcategories for their responses were constructed on their contribution to the success of a portfolio company.

Emergent Pattern # 3:
Venture capitalists' access to external resources positively influences the success of their portfolio companies.

"... If the start-up needs to speak to IBM, rather than going through thousands of circles, we will introduce them to the key contact. We give them access to people that an early stage company ordinarily wouldn't get ..."
Partner, venture capitalist C

"... We helped the company in the process of getting additional financing. When they needed to raise a substantial amount of money, we brought in some major players in the venture capital industry ..."
Partner, venture capitalist D

For example, within the 'experience' category, it was counted how often the interviewee mentioned their (1) entrepreneurial, (2) industry, and (3) investment experience as a contributor to a successful exit. If an interviewee mentioned all three forms of experience, then they received a score of three. Similarly, the subcategories for aspiration included: (1) building a scalable businesses and (2) going global. For external resources, the subcategories that emerged were: (1) network to other venture capitalists, (2) connections to industry players, and (3) other contacts, e.g. head hunters. In cases when factors were not mentioned as being important or not fulfilled, they were marked as negative (they are noted in parentheses in the table). In Table 8, the results of this analysis are reported.

As seen in Table 8, the top performers were stronger across the board on the issues that they mentioned were important in creating successful exits. It was found that the top quartile venture capitalists were particularly strong in their experience and their external resources compared to other venture capitalists. Both experience and external resources accumulate over time, which mirrors the fact that the top performing venture capitalists are all in an older age group above 15 years compared to the other venture capitalists. Negative numbers for bottom quartile venture capitalists indicate that they mentioned negative attributes, e.g. a lack of industry-specific experience.

In addition to the above discussed factors, other common features of the business model of top performing venture capitalists were found. These features include: a well-devised funding strategy, a thorough investment preparation, a 100-day strategy, and an efficient time allocation to their portfolio companies.

Funding strategy. The drip feed funding approach which is related to the strategy of minimizing risk is still common in Europe. Some European venture capitalists state that a drip feed funding approach is required to ensure that the portfolio companies are spending the capital efficiently and to mitigate risk. However, top performing venture capitalists state that the drip feed funding approach is only sensible for portfolio companies in which they have already lost confidence. For potential home runs, they have a different strategy in providing them with enough capital to comfortably reach the next stage of their development.

Table 8: Characteristics of venture capitalists in different performance classes

	Performance	Age	Number of exits post 2001	Number of active investments	Number of investment professionals	Subcategories covered in each area		
						Experience	Aspiration	External resources
Venture capitalist A	Top quartile	> 30 years	160*	200	50	3	1	3
Venture capitalist B	Top quartile	> 30 years	?	65	10	2	1	2
Venture capitalist C	Top quartile	20-25 years	6	?	9	3	1	3
Venture capitalist D	Top quartile	20-25 years	8	65	23	3	2	2
Venture capitalist E	Top quartile	15-20 years	7	35	15	2	1	1
Venture capitalist F	Middle 50	11-15 years	5	8	6	-	1	1
Venture capitalist G	Middle 50	11-15 years	?	21	8	1	1	1
Venture capitalist H	Middle 50	6-10 years	2	5	4	-	1	1
Venture capitalist I	Middle 50	6-10 years	8	18	9	-	1	2
Venture capitalist J	Middle 50	6-10 years	4	26	15	1	1	1
Venture capitalist K	Middle 50	6-10 years	11	38	10	1	2	2
Venture capitalist L	Middle 50	6-10 years	7	14	3	1	-	2
Venture capitalist M	Middle 50	6-10 years	4	16	8	2	1	2
Venture capitalist N	Middle 50	6-10 years	4	15	4	1	2	1
Venture capitalist O	Middle 50	6-10 years	7	11	5	-	-	2
Venture capitalist P	Bottom quartile	11-15 years	1	10	10	1	(1)	-
Venture capitalist Q	Bottom quartile	6-10 years	-	10	2	(1)	-	1
Venture capitalist R	Bottom quartile	6-10 years	2	12	4	-	-	-
Venture capitalist S	Bottom quartile	< 5 years	-	12	8	2	-	1

Source: LBS/CEFS/EVCA

* Includes buyouts

Investment preparation is regarded as highly important for successful venture capitalists. The analyses showed that it is particularly important to invest a significant amount of resources in a detailed due diligence of the business plan and an intensive scrutiny of the management team. An important asset of a venture capitalist is their ability to judge the quality of a management team and its business model. Spending more resources in this area helps reduce subsequent surprises. One LP commented, *"… There are some benefits to size … a more established due diligence process where the fund managers can spend resources to make sure that everything falls in place before the investment …".*

Working out a 100 day strategy. Within the first one hundred days of their investment, venture capitalists usually try to agree with the management team on the company strategy going forward. One main interest of venture capitalists at this stage of their investment is to uncover negative information about the portfolio company that was not disclosed in the due diligence process. One venture capitalist commented, *"... You really cannot uncover everything with due diligence, you find out some things after you invest. The trick is to make sure that you can work with the founders to set out a clear vision and strategy within the first couple of months. If you lose that starting momentum, it is difficult to recover later …".*

Time allocation varies widely by stage of investment, growth phase, financing or exit event, and the relative success of the company's strategy. Usually, more time is spent at the early stage of development of the portfolio company and during a crisis. On the one hand, venture capitalists state that they have to fight through difficult times of company development in order to create successful portfolio companies. Home runs have often lived through very difficult stages of their development. Venture capitalists would not have been able to gain from the success if they had not supported the company intensively during the crisis. On the other hand, most venture capitalists admit that too much of their resources are invested in companies who will never be home runs. Unfortunately, in this study, a way to track the time spent by venture capitalists to provide more detailed insight into their time management was not found. Top performing venture capitalists realized that they have to write off the 'living dead', rather than spending too much time on trying to save them. However, they did verbalize that it is always difficult to make that decision as they have once trusted the management team and the business model. Consequently, they often struggle to withdraw support even though they realize that it is an important step for their own success.

4. Cases of Successful European Venture Capital Investing

Other Common Patterns:
A successful business model of venture capitalists usually includes an upfront approach to funding, a 100 day strategy and an efficient time allocation.

"… Our view in drip-feeding companies is that it is fundamentally limiting the growth potential. You're holding the company back, you're holding on to the reins too tightly, you're not giving the company a head to go and expand, do deals and actually spend time on the business and the market and the proposition, rather than coming back to you every three months for the next tranche …"
Partner, venture capitalist K

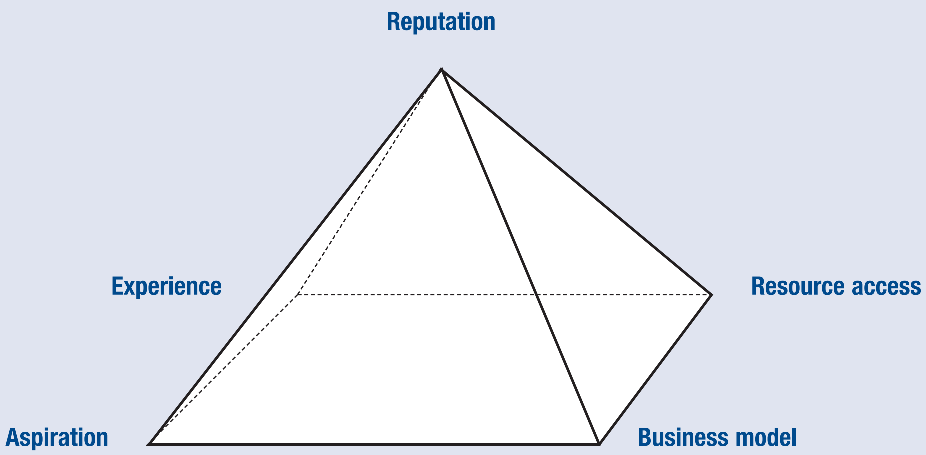
"… The other strategy is to stay very close to them in the first couple of months, in the first 100 days, three-four months, so that you're there for them, but you also always see what's going on. Establishing this personal relationship with them and the interaction pattern will decide very much how over the years the personal relationship and the information flow goes …"
Partner, venture capitalist D

"… I would say that companies at any point in their evolution when they're challenged take the most time. In hindsight it's very easy to say, "The company was a dog". When you're living it, it's really difficult. Some of our best had so many near-death experiences in the first year. […] Start-ups are very fragile organisms, they all have challenges and at those challenging times, they take a lot of time from us. It's not to say they're dogs - they're going to hit bumps in the roads, it's not 'if' it's 'when'. At those times, yes, they're very time-consuming …"
Partner, venture capitalist C

The experience, aspiration, access to external resources, and the venture capitalist's business model form a self-reinforcing pyramid to success. The top tier venture capitalists show strength in all these factors and believe that they form the basis of their success. High performance then leads to a strong, positive reputation that, in turn, further enhances opportunities to raise funds and create new home run investments. This self-reinforcing model forms the pyramid of success of a venture capitalist illustrated in Figure 4.

As one LP summarized, *"… For every fund we invest in, we focus on the team and the organization, because in our business we'll pretty much write a blank cheque, so it's not that we're buying a particular portfolio, we're buying people. The organizational stability, the aspiration and the way they operate is obviously one important aspect, but at the end of the day for every fund we invest in, they should be leading in their particular space, whether it's in a geographical sense, whether it's a sector or a stage of investing. They should be known in a particular market as the leading group that people would go to with their opportunities …".*

Figure 4: Pyramid of success of venture capitalists



"… Our last fundraising went well because we had good returns, we have a very stable team, we have been around for many years so we had a consistent investment policy for a long time - doing always the same things. Investing in start-up situations - we've kept doing so whatever the cycles …"
Partner, venture capitalist B

"… If you have the best reputation, with that comes the best access to follow-on rounds, more companies, the best access to investment banks, management, HR, a long list of advantages …"
Partner, venture capitalist I

Source: LBS/CEFS/EVCA

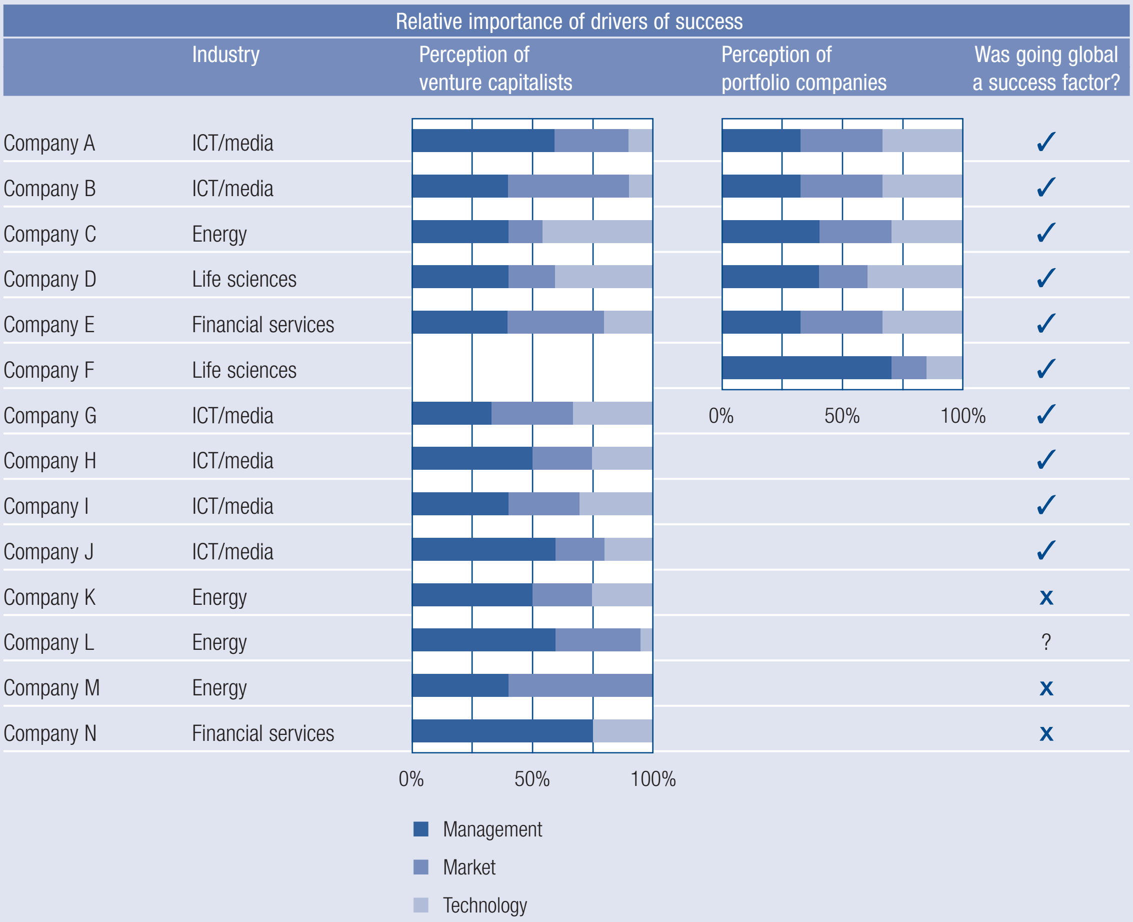
4.2. Key drivers of successful investments

Some of the recent successful investments of European venture capitalists were examined. The analysis was focused on investments in which the venture capitalist was able to realize an exit post 2001. Thereby, successes which were due to the bubble of the high-tech markets were excluded. In the following, the general findings are displayed.

Empirical studies suggest quite broadly that the management team, the technology and the market are important factors for the success of an innovative start-up. These factors were investigated further. The perception of the venture capitalists and, when available, the perception of the portfolio companies on the relative importance of these drivers of success were compared.

The following figure illustrates the findings.

Figure 5: Importance of drivers of success of portfolio companies



Source: LBS/CEFS/EVCA

Figure 5 shows that the quality of the management team is seen as the main driver of success in most of the companies. In cases where both perspectives were available, the perception of venture capitalists differed from the perception of portfolio companies. Venture capitalists emphasize the importance of the management team more so than their portfolio companies because of the information asymmetry between the entrepreneurs' knowledge of the business and the venture capitalist's knowledge of the operations. Portfolio companies gave their technology a higher importance because they know the business and rely on their innovation in product or service to get to the customer. One managing partner commented, *"… The three main drivers of success are entrepreneurial skill, entrepreneurial skill and entrepreneurial skill. So it's team, team, team. It is really about finding the right people and investing in the right team …"*.

Major differences between the perception of the relative importance of management, market and technology can be identified across the different cases of successful companies. Common features in terms of the relative importance of the market and the technology across the perception of venture capitalists can not be seen. It is likely that the relative importance of the market and the technology depends too much on the individual set-up of a company in its particular market and the degree of innovation of its technology. A venture capitalist emphasized the value of the technology for the exit scenario, *"… They had an innovative technology. Actually, one of the issues for them was that a lot of times companies want to have two or three suppliers and a problem would be if the technology was too unique, that there was no second supplier; but the technology was their strength and the reason for our successful exit …".* Another venture capitalist underscored the importance of satisfying a customer need through technology, *"… Their technical base and the quality of their service were absolutely first-rate and that was the key to their success. In that way, they kept their customer base happy and they kept sending the cheques …".* However, technology alone is not important. Another venture capitalist explained, *"… We do see good teams in which we refuse to invest because we think that they are sitting on a business concept which is probably not large enough with regard to the market potential …"*. The common theme was to emphasize market conditions to position the company as a niche player with a very good proposition.

An important reoccurring theme for success was globalization. It was often mentioned as key for the rapid growth of the business and creating an attractive business for potential buyers or an IPO. However, it was also noted that in some cases the domestic markets offered a growth potential high enough to create a scalable business. In such cases, going global was not seen as a required step in the development of a successful company.

Growing globally implies many things for the company and across venture capitalists. Some consider global strategy to imply outsourcing, while others have an integrated view of logistics, markets and management as having global footprints and origins. One venture capitalist provided an example, *"… We had to open an office in Boston and shifted some of our core management there…there were really only two big reasons, our major customer was on the east coast and we needed to prepare the company for an IPO …".* Underneath the different global growth strategies was a simple realization, growing globally creates scale. This scale was operationalized often as size of customer base but also in terms of access to capital, sourcing of inputs, and importantly, access to potential partners and exit events. One venture capitalist expressed his views, *"… In my perspective, it's not about the globalization of the business per se, it's about having a global access to international capital markets as a key factor of success. It can be absolutely sufficient to be a domestic player, as long as the domestic market is large enough …".*

In sum, while there were many factors that venture capitalists and their portfolio companies attributed to their success, one underlying theme remained the size of the potential market. Often, venture capitalists emphasized management as key for precisely the same causal reason, i.e. the entrepreneurs had to change their original strategy in order to reach a larger, more lucrative market. In some cases, the technology had to be adapted in order to make it attractive for a potential buyer or because the market needed to be larger. As a venture capitalist noted, *"… It is all about scale …"*.

4.3. Cases of successful venture capital investments

The following cases illustrate in more detail key drivers of success of venture capital backed companies. In addition, the contribution of the venture capitalist or the venture capitalists to this success is laid out.

Case 1: Alantos Pharmaceuticals

Industry:	Biotechnology	
Financing rounds:	2000:	$3 million from Heidelberg Innovation, Audax Private Equity Fund and two additional investors
	2003:	$24 million from Oxford Biosciences, SV Life Sciences, Earlybird, ABN AMRO Capital Life Sciences, Ventech, Auriga Ventures, Heidelberg Innovation and two additional investors
	2005:	$20 million from Oxford Biosciences, SV Life Sciences, Earlybird, Ventech, Heidelberg Innovation, ABN AMRO Capital Life Sciences
Exit:	2007:	Acquisition by Amgen for $300 million
Investment period:	7 years	
Exit multiple/IRR:	Not disclosed	

Company profile

Alantos Pharmaceuticals is a chemistry-driven biopharmaceutical company with a broad proprietary pipeline of small molecule drugs focused on proteases that impact type II diabetes and Osteoarthritis/inflammation. Their lead drug candidate is in clinical development (Phase 2a) for the treatment of type II diabetes.

Alantos was founded in 1999. The headquarters was located in Heidelberg, Germany, and was later moved to Cambridge, US. Alantos Pharmaceuticals was acquired by Amgen in June 2007 for $300 million. Prior to the acquisition, Alantos employed 45 people and maintained research laboratories in Heidelberg and Cambridge.

Key drivers of success

- Change in business model
  In the early years of company development, Alantos Pharmaceuticals was a technology boutique. As the company grew, the management decided to expand the business model and move from a technology company to a classical pharmaceutical company focused on identifying compounds. This was key for their future success as it offered higher growth potential than the original business model.

  In 2006, a collaboration with Servier was started about the diabetes drug candidate shortly after the start of its clinical development in the US. This step secured financing of Alantos' running activities.

- Management team

  In the process of changing their business model, the management team was expanded. Additional people who brought in further complementary expertise were hired. In 2003, Alantos Pharmaceuticals hired a new CFO, Matthias Jaffé. A year later, Keith Dionne, who had many years of experience in biotech in the US, joined Alantos Pharmaceuticals as new CEO. Their experienced and highly qualified workforce was key for their success. The management team included specialists who understood the technical background as well as the needs of the pharmaceutical industry.

  "… We hired a lot of key people. This was one of our success factors: we had a wonderful consortium of very talented and experienced people …"
  Fritz Frickel, former CSO and acting CEO, Alantos Pharmaceuticals

- Interaction management team and board

  Most of the board members were representatives of venture capitalists. The very experienced management team and the board worked seamingless together and built an almost classical, very well functioning pharmaceutical company which brought in record time a compound to the clinic (diabetes) and a second one from an own product platform (MMP inhibitors) to formal preclinical development.

- Switch to a US-based company

  In 2004, Alantos Pharmaceuticals was changed from a German-based company to a US-based company. This move was very important for the future success of the company mainly due to two reasons. First, it was less difficult for them to run clinical trials in the US with a development group that was based in the US rather than in Germany. Second, it gave them the ability to raise additional funding more easily.

Contribution of venture capitalists to the success

- Support in strategic decisions

  Alantos Pharmaceuticals was financed by a large syndicate of different venture capitalists. SV Life Sciences and Oxford Biosciences stood out as the leading venture capitalists. These venture capitalists took the most active role in supporting the company in strategic decisions. Heidelberg Innovations and Earlybird were also important as they were located close to Alantos Pharmaceuticals' initial headquarters. This allowed them to meet in person with the management team of Alantos Pharmaceuticals more easily than the other venture capitalists. The lead investors supported Alantos through their technical as well as their managerial expertise and the company profited from having the opportunity to have discussions with the venture capitalists whenever needed.

  "… Oxford Biosciences and SV Life Sciences were the lead investors. They actively brought in their technical expertise and helped to build the company's management. They were extremely helpful for individual conversations – whenever I needed help, they were always available …"
  Fritz Frickel, former CSO and acting CEO, Alantos Pharmaceuticals

- Access to networks
  Alantos Pharmaceuticals very much profited from the network of its venture capitalists. For instance, the new CEO, Keith Dionne, was found through a personal contact of one of their venture capitalists. Alantos Pharmaceuticals also profited from the network of its venture capitalists. When Alantos Pharmaceuticals considered expanding their activities in a new field, another venture capitalist brought them together with experts in that field from the US. This was useful to decide whether or not to go through with the expansion.

  "… The two lead investors have a very good network. An investor like SV Life Sciences is capable of connecting you to almost anybody who plays a role in a certain technical field …"
  Fritz Frickel, former CSO and acting CEO, Alantos Pharmaceuticals

- Push to internationalize
  The venture capitalists very much pushed Alantos Pharmaceuticals to further internationalize their business and actively recommended to move their headquarters to the US. The venture capitalists even formulated it as a prerequisite in order for them to provide additional funding in the financing round of 2005. It was proven in the long run, that the venture capitalists thereby helped Alantos Pharmaceuticals to successfully grow their business internationally.

Case 2: BlackSpider Technologies

Industry:	Software
Financing round:	2004: £4.6 million from DJF Esprit
Exit:	2006: Acquisition by SurfControl for £20 million
Investment period:	2 1/2 years
IRR:	40-50%

Company profile

BlackSpider Technologies provides managed service e-mail and web security solutions. The company provides an outsourced service to customers to offer protection from e-mail and web borne threats such as viruses, spam and malware. The flagship product MailControl, which can be managed via a secure portal, provides customers with the confidence that the latest up to date anti-virus and spam control software was being applied to protect the orgainsation against threats, without requiring to install any onsite hardware or software.

BlackSpider Technologies was founded in 2002 with headquarters in Reading, UK. The business was expanded in Europe and presences in Germany and France were built up. In the year ending June 2006, BlackSpider Technologies generated £4 million of revenues and had 102 employees. The company was acquired in 2006 by the US-based company SurfControl for over £20 million.

Key drivers of success

- Management team
  BlackSpider Technologies was founded by a proven and experienced management team. It was the second start-up for the CEO, John Cheney. The company very much profited from the learning experience he had had with his first start-up. He already had a valuable network to European contacts in their market. This helped substantially when BlackSpider Technologies expanded their business to Germany and France. Both market entries were done on the basis of contacts from John Cheney.

  "… The people were very, very good. We knew them through various connections and we took many references on them through people they had worked with. We got terrific feedback on the team. Further, the team was operationally first rate – having proven much of the Blackspider model and technology with previous companies they knew exactly what they were doing …"
  Paul Murray, Partner, DFJ Esprit

- Expansion to Germany and France
  The expansion to Germany and France was key for the company's strategy. The management made a conscious decision not to go to the US and stay in Europe. There was relatively less competition and BlackSpider was able to quickly establish itself as one of the major players in the European market. This was an important aspect for the US based acquirer, SurfControl, as they wanted to further build up operations in Europe.

- Business model and corporate culture
  When the founders set up the business they realized the trend in the software market from license sales to managed services. They built up a high quality service with an excellent technical architecture. Very early on the team focused on quality of service, deliberately applying a hands on approach to early customers to build up valuable reference accounts. With this track record, they demonstrated their customer credibility early on. The strategy was to maintain that focus on customer satisfaction and care – crucial in building up a Managed Services company.

  "… I would not underestimate the team spirit we created inside the company and I do not just mean the management. I mean nearly all of our 102 employees thought towards the success of the business …"
  John Cheney, former CEO, BlackSpider Technologies

Contribution of venture capitalists to the success

- Push to grow aggressively
  A significant part of the venture capital funding was specifically intended to support the push into continental Europe from the UK, a strategy strongly advocated by the venture capitalist. The progress of this strategy was a core element of the value achieved in the sale process.

  "… Esprit gave us the confidence to think a little more aggressively about our expansion plans than perhaps we would have done on our own. I think this is probably the biggest value-add they delivered to us in the initial part of the investment period …"
  John Cheney, former CEO, BlackSpider Technologies

- Access to networks
  BlackSpider Technologies profited from the network of its venture capitalist who brought them in contact with Phil Lawler. Lawler has over 22 years of experience in IT, including being CEO of HP UK. He became Non-Executive Chairman of BlackSpider and played an important mentoring role for the management team.

  "… Another thing they did for us was helping us to recruit our Non-Executive Chairman who was very helpful for us in different stages of our company development …"
  John Cheney, former CEO, BlackSpider Technologies

Case 3: Intercell

Industry:	Biotechnology
Financing rounds:	1999: €5 million from TVM Capital and regional investors (Kapital&Wert, Wiener Städtische)
	2001: €27 million from Apax Partners, Nomura and TVM Capital
	2003: €46 million from Global Life Science, MPM Capital, Star Ventures and TVM Capital
Exit:	2005: IPO on the Vienna stock exchange
Investment period:	6 years
Exit multiple:	Exit is not yet completed by all venture capitalists

Company profile

Intercell focuses on the design and development of vaccines for prevention and treatment of infectious diseases. The company develops vaccines based on antigens and immunizers which are derived from their platform technologies. With two late-stage clinical products and five follow-up candidates, Intercell has a promising product pipeline. The company has its own in-house manufacturing capability and has built strategic partnerships with several global pharmaceutical companies.

Intercell was founded in 1998 in Vienna. In addition to the headquarters in Vienna, the company has a vaccine manufacturing plant in Livingston, Scotland, and a business development entity in Mooresville, US. Intercell today has over 200 employees. In 2006, Intercell generated annual revenues of €23.5 million and spent €31 million on R&D. It is currently valued at over €1.0 billion on the Vienna stock exchange.

Key drivers of success

- Management team
  The most important driver of Intercell's success was its founder and management team. The company was founded by an international team of highly qualified and reputable scientists in molecular biology. With their combined efforts and knowledge, they were able to create their innovative technologies. A key characteristic that differentiated them from other teams was their profound research capabilities acquired through many years of academic research.

Alexander von Gabain, the CEO of Intercell up to November 2005, played an important role in extending the management team at the right time and well synchronized with the growing company's needs. He understood that in order to build a successful company, he had to bring in competent and experienced management with complementary capabilities. So Intercell hired Gerd Zettlmeissl who had a scientific background and experience in the pharmaceutical industry as COO in 2001. In addition, Werner Lanthaler joined as new CFO. As Intercell developed, finance and marketing were increasingly important and Werner Lanthaler had the required background in these areas.

After the succesful IPO in 2005, Alexander von Gabain decided to hand over the position as CEO to Gerd Zettlmeissl and to become the CSO instead. At the time the company was approaching approval of their lead product JEV. Therefore, issues of manufacturing, sales and distribution became as important as scientific advancements. Alexander von Gabain realized that Gerd Zettlmeissl was better positioned to run the company as CEO from then on. And a senior scientist like Alexander von Gabain was needed to run the R&D processes.

"… It was quite exceptional that Alexander von Gabain decided to step aside as the CEO and continue to focus on new science and strategic issues as the company's Chief Scientific Officer. It was the right decision at the right time and I can not say enough how much I think this has helped the company to become as succesful as it is. I think this smart move makes him one of the best founding CEOs I have ever put money in …"
Helmut Schühsler, Managing Partner, TVM Capital

- International workforce
  From day one, Intercell had an international workforce. Almost all employees had an international background and were very much used to thinking on a global scale. This helped substantially in the internationalization process. They had no problems in negotiating financing rounds with international venture capitalists or later in setting up a global presence.

  "… Already from day one, the company was very international. We had many different nationalities under our roof and also on the scientific board there were top scientists from all over the world. The language in the company was English, like in an internationally renowned research institute …"
  Alexander von Gabain, CSO, Intercell

- Technology
  In addition to the management team, Intercell's innovative technologies were the second key driver of success. Already in the start-up phase, Intercell's business model was based on platform technologies applicable in the vaccine field rather than on a single target or on a single product. With these platform technologies, they had the opportunity to build a scalable business in the growing market of vaccines. They decided to also in-license a late-stage product in 2004 to complement their early-stage pipeline and move closer to the market. This product (Japanese Encephalis Vaccine) came to Intercell through the TVM Capital network. The acquisition of JEV made it much easier to take the company public and raise substantial money in the public markets.

Contribution of venture capitalists to the success

- Support in strategic decisions

  The venture capitalists played a particularly important role in the success of Intercell. The lead investor in the first financing round developed a close relationship to Intercell up to the IPO and was in regular contact with Intercell management to discuss company issues.

  "… The relationship I had with Intercell was very important at times. They usually came to me and told me about their concerns, the good and the bad. I knew everything that was going on between the people and could always contribute by giving them my view as a venture capitalist, in this case representing the 'capital market' …"
  Helmut Schühsler, Managing Partner, TVM Capital

- Support in raising additional capital

  The first round lead investor also gave valuable support to Intercell in negotiating future financing rounds with other venture capitalists. Even in tough market conditions between 2001 and 2005 they were able to finalize successful B and C rounds of financing.

  "… 2003 was a tough year. The investments in venture capital rounds in biotechnology in Europe were about €250 million and we managed to get €46 million to Intercell. We only managed this because Helmut Schühsler was like a knight on our side and supported us …"
  Alexander von Gabain, CSO, Intercell

- Access to networks

  The lead investor in the first round had a large network which helped Intercell particularly in their early stages of development. When Intercell aimed to in-license a product in 2004, the advisory relationship of one of the venture capitalists to a specialist in anti-infective therapies from the US was crucial. The advisor brought this opportunity to Intercell and the company was able to acquire it at a very crucial point in its development. Venture capitalists from later rounds of financing had valuable additional international contacts. They were thereby very supportive in the internationalization process of Intercell which was crucial in the later stages of their success prior to the IPO.

  "… MPM and particularly Apax were fantastic from an international point of view. When they came in, they had important ties to the Anglo-Saxon world …"
  Alexander von Gabain, CSO, Intercell

Case 4: MutuiOnline

Industry:	Financial services
Financing rounds:	2000: €1 million from Net Partners-360° Capital Partners
	2002: €5 million from Net Partners-360° Capital Partners and Jupiter Ventures
Exit:	2007: IPO on the Milan stock exchange
Investment period:	7 years
Exit multiple/IRR:	Above 20x and IRR > 70%

Company profile

MutuiOnline is an Italy-based company engaged in credit brokerage. The company provides intermediary services between customers and banks. Its intermediation includes personal loans, debt consolidation loans and loans refinance. MutuiOnline is the largest mortgage broker in Italy, with more than 400 closed mortgages per month. In addition to financial brokering for the end user, MutuiOnline is also active in business process outsourcing to Italian banks. The company provides its services mainly through the internet and telephone.

MutuiOnline was founded in 2000. In 2006, the company had 202 employees and generated annual revenues of c. €22 million. The headquarters is located in Milan, Italy.

Key drivers of success

- Fast implementation of the business model
  One of the key drivers of success was the fast implementation of the business model. MutuiOnline was based on an idea of selling loans through the internet which was already adopted in other European countries like the UK. MutuiOnline introduced this idea in Italy. The company was able to gain competitive advantage as the first mover. Today, MutuiOnline is the leading player for major Italian banks for the sale of loans through the internet channel. The company was able to create a widely known brand in Italy.

  "... We strongly focused on being the first in Italy to be launching the innovative trend of the European market – selling loans over the internet. The fast implementation of this business idea in Italy was very important for our success … "
  Stefano Rossini, MD, MutuiOnline

- Management team
  The management team was critical in order to achieve the fast implementation of the business model in Italy. The management team was very good at realizing the trend in the European market and adapting it to Italy. As the timing was so essential, the management team had to be able to move quickly and to build up a business fast. The current MD joined MutuiOnline in 2002. He worked for MutuiOnline's venture capitalist prior to joining the company full-time and added important investment experience to the management team. This proved to be highly valuable in realizing the envisioned company growth through extending the business to their second business area, business process outsourcing to Italian banks.

  "... Management is fundamental, because even with the same market not all the companies are successful. The second element is the speed of execution, and the continuous improvement of operations … "
  Stefano Rossini, MD, MutuiOnline

Contribution of venture capitalists to the success

- Direct involvement in management
  The main contribution of the venture capitalist was the direct involvement of one its investment managers in the development of the company. One of the Managing Directors of MutuiOnline had originally worked for Net Partners-360° Capital Partners, the venture capitalist of MutuiOnline. In 2002, he became directly involved in the company's operation. This helped substantially in moving the company forward and extending their business activities to other areas.

  "... Our key support for MutuiOnline was in helping them selectively in key areas such as management structure and exit timing/strategy … "
  Fausto Boni, Partner, 360° Capital Partners

- Support in realizing value and finding an exit strategy
  A key strength of the venture capitalists was their ability to recognize the full value potential of MutuiOnline. Even in difficult business circumstances in 2002, the venture capitalists were willing to invest additional capital and to help the company to sustain. As the performance improved, it helped MutuiOnline to have a partner at its side who consulted them whether or not to take different exit opportunities. Instead of taking the first exit opportunity that came up, the venture capitalist had enough patience to wait for an exit with which they would be able to realize MutuiOnline's full value potential.

  "... When the first exit options appeared through other private equity firms or investment banks, the venture capitalist was able to reject the opportunities which were not in line with the expected value of the company and was willing to wait for a better opportunity … "
  Stefano Rossini, MD, MutuiOnline

Case 5: NextGenTel

Industry:	Telecommunications	
Financing rounds:	2000:	c. $15 million from Geocapital, Northzone and Skandia
	2001:	c. $2 million from Geocapital
	2002:	total of c. $10 million from Geocapital, Northzone, Skandia and five other investors
	2003:	c. $1 million from Northzone
Exit:	2004:	IPO on the Oslo stock exchange
	2006:	Acquisition by TeliaSonera
Investment period:	6 years	
Exit multiple:	5x	

Company profile

NextGenTel is a telecom provider of broadband ADSL services to the Norway market using local loop unbundling (LLU) [5] based broadband access. The company has established itself as the number two broadband and ADSL player in Norway and one of the fastest growing private ADSL operators in Europe.

NextGenTel was founded in March 2000. The company has more than 200 employees in 5 locations: Bergen (HQ), Oslo, Trondheim, Stavanger and Kristiansand in Norway. NextGenTel is today a fully owned subsidiary of TeliaSonera, which is a leading telecommunications company within the Nordic and Baltic countries.

Key drivers of success

- Early opportunity recognition and timing
  One of the main drivers of NextGenTel's success was the fact that the founders recognized their opportunity very early compared to the market. Olav Stokke, the founder/co-founder and CEO of NextGenTel, realized "copper could become gold" as the opening of an LLU-opportunity would create an intriguing possibility to offer broadband through ADSL to consumers and SMEs. In 2000, he believed it would be the right timing to enter the market. Through its early market entrance the company was able to secure a leading market position in Norway.

  "… NextGenTel realized a unique opportunity in 2000. As such it was a company which even in a downturn was building real value and growing fast. Even in weak market conditions in 2000 and 2001, the venture capitalists were willing to put a value on NextGenTel and to fund its expansion …"
  Bjørn Stray, General Partner, Northzone

- Management team
  The complementary capabilities of the management team were another reason for NextGenTel's success. The management team was based on previous work experience of Olav Stokke. He ensured that within the management team all required know how to build the business was covered.

[5] Local loop unbundling (LLU) is the process of allowing a telecommunications operator access to a customer's premises via the use of connections from the telephone exchange's central office.

Therefore, he brought in managers with financial, technical, sales and marketing experience, all of whom he had worked with beforehand or knew about in detail via the other members of the management team (his co-founders).

"... In the case of NextGenTel we had a very strong management team. They combined all the specific competencies required to build a successful company. Therefore, our role was not to secure the overall quality of the management team as it was already high when we entered …"
Bjørn Stray, General Partner, Northzone

- Focus on the national market
  NextGenTel decided to focus their operation on their national market in Norway. The management realized that it was more important to become a leading player in their home country before considering going international. This is perceived to have been the correct strategic decision, and one of the major reasons for the success as everything was focussing on the local market.

"… Early on, the owners and the management undertook an analysis of the European ADSL opportunities, and concluded that a Norwegian scope only was the right choice for NextGenTel in building shareholder value. I think that if we had spread all over Europe, as it was a definitive trend in 2001, we would have run out of money …"
Olav Stokke, CEO, NextGenTel

Contribution of venture capitalists to the success

- Monitoring business performance
  The venture capitalists had an important role in monitoring NextGenTel's performance. Through regular reporting, board meetings and individual meetings, the venture capitalists followed the development of NextGenTel very closely. This helped NextGenTel to be more aware of whether or not they met their growth targets and what business area they had to focus on. Extensive use of measurements and process focus and automation allowed the board and the management to constantly focus the most critical parameters of the business.

"... The venture capitalists were very helpful in that they were impatient and eager to following up on our performance very closely. This made us more aware of the quick progress we had to make in order to achieve our growth. To that extent, they contributed to the overall development of the company as the company pushed forward towards success …"
Olav Stokke, CEO, NextGenTel

- Access to an international venture capitalist
  Another key contribution of the initial venture capitalist was their ability to bring in a US-based international venture capitalist. It helped in the process of realizing the IPO to be backed by an additional prominent venture capitalist from another country. The international venture capitalist supported them in creating a convincing profile that helped to realize a good performance on the public market which later on led to the sale of NextGenTel to TeliaSonera.

  "... When you try to find a local venture capitalist, you have to find one with a strong relationship to larger, international venture capitalists. The Norwegian-US relationship between Northzone and Geocapital was key to actually make our concept fly. The international venture capitalist also brought valuable insight from early phases of ADSL broadband initiative in the US … "
  Olav Stokke, CEO, NextGenTel

Case 6: PEMEAS

Industry:	Chemical
Financing rounds:	2004: c. $20 million
	2004: c. $8 million
	2006: c. $4 million
	Venture capitalists: Conduit Ventures, BankInvest, CDP Technology Ventures, Emerald Technologies (formerly SAM Private Equity)
Exit:	2006: Acquisition by BASF
Investment period:	3 years
Exit multiple/IRR:	Not disclosed

Company profile

PEMEAS is a leading supplier of key components and subsystems to the emerging fuel cell industry. For serving its global customer base, the company is operating in two business areas. First, PEMEAS is focusing on the development and commercialization of high temperature membranes and MEAs (Membrane Electrode Assemblies) enabling fuel cells to be operated at an elevated temperature. Second, PEMEAS is providing a range of precious metal based products to its customers to improve the performance of fuel cell systems.

PEMEAS was a venture capital backed spin-out from Celanese Chemical Group in April 2004. The Celanese fuel cell business which was initiated in 1994 as part of Hoechst Research & Technology and later transferred to Celanese AG after the restructuring of the Hoechst AG Group was continued under PEMEAS. With currently approximately 50 employees, PEMEAS operates manufacturing and R&D facilities in Germany and in the US. Through a network of agents, PEMEAS is present in various Asian markets like Japan or Taiwan. In December 2006, PEMEAS was acquired by BASF.

Key drivers of success

- Technology

  The innovative technology is pointed out both by venture capitalists and PEMEAS itself as the key driver of their success. They developed a technology which helped their customers to lower their production costs and to produce more reliable fuel cells. Thereby, PEMEAS offered two benefits to its customers and was able to achieve high growth rates on the global market. Their unique technology made PEMEAS an attractive target for BASF.

  "… In our case, the key driver for the success has been first of all the outstanding technology position we had. Our technology gave us enormous attraction in the market place …"
  Horst Tore Land, CEO, PEMEAS

  "… PEMEAS' technology was quite truly unique. That was basically the strength of the company and that is probably a key reason BASF was so interested in it …"
  Daniel Carter, Principal, Conduit Ventures

- Management team

  The management team was crucial in making the company successful. They brought in substantial industry and research experience from their time working with Celanese. Therefore, they were capable of understanding their technology and explaining the unique value of it to potential customers. As the technology was so innovative, this was crucial for its acceptance by customers.

  "… A thorough understanding by the management of the technology and the value that it provides to the customers was critical for PEMEAS. The management was able to demonstrate that their technology offered better value than the available technology. That was the main strength of the company …"
  Even Bakke, Partner, BankInvest

  In addition, the management was used to working on a global scale as the working environment at Celanese was characterised by international business. Moreover, the CEO of PEMEAS had worked in the US for some time and had an international mind-set. This helped in the process of going global.

- Early internationalization

  Continuing their internationalization process was another important driver of PEMEAS' success. Even before the venture capitalists entered the company, they had already built up an international presence. However, they grew their Asian activities significantly following the investment. It was critical for their business growth that they were able to market their products on a global scale.

  "… PEMEAS already had international presence, but during the time we invested in them they really grew their Asian costumer base. Getting those extra costumers internationally was really important …"
  Daniel Carter, Principal, Conduit Ventures

Contribution of venture capitalists to the success

- Review of business strategy

  The venture capitalists were supportive to PEMEAS in reviewing and discussing the business strategy. They challenged the strategic decisions of the management at various occasions such as board meetings or individual meetings. From PEMEAS' perspective, all of the four venture capitalists involved contributed equally in this role as a sounding board.

  "… An accomplishment by the venture capitalists was their continuous challenge of the business strategy to assure that the management team is taking the company in the right direction. There were no differences in the contribution of the different venture capitalists. They have all been supportive as for the business strategy and the day-to-day operations were left to the management …"
  Horst Tore Land, CEO, PEMEAS

- Access to networks

  In addition, the venture capitalists also helped PEMEAS through access to their networks. Hereby, they were able to help PEMEAS in building up additional relationships to customers, hiring new international employees and identifying potential acquirers.

  "… We helped the company to find candidates from different countries and new customers. We also supported them to find organizations that were interested in buying them through our network …"
  Even Bakke, Partner, BankInvest

- Support in finding an exit strategy

  The venture capitalists also supported PEMEAS in finding agreement on the exit strategy. In addition to the venture capitalists, PEMEAS also had a number of shareholders who had differing views on the optimal exit strategy. Venture capitalists were helpful in facilitating a constructive discussion on this issue between all shareholders. Through this discussion, it was possible to come to a joint decision to sell the company to BASF.

  "… The venture capitalists have created a constructive dialogue about the possible exit options. It was important for all of our shareholders – including the venture capitalist and the corporate shareholders – to create a consensus on the exit strategy. Naturally, corporate shareholders have a different focus than venture capitalists. But the venture capitalists were very helpful in aligning the interest of the corporates with their own …"
  Horst Tore Land, CEO, PEMEAS

Case 7: Xing AG

Industry:	Online services/network management
Financing round:	2004: Angel financing round
	2005: €5.7 million from Wellington
Exit:	2006: IPO on Frankfurt stock exchange
Investment period:	3 years
Exit multiple:	6x

Company profile

Xing AG provides an online network platform for contact management and networking. Their target group is business people worldwide. Their platform Xing AG offers tailored features for their target group making networking, contact management and online business easier.

Xing AG was founded in 2003. The company's headquarters is located in Hamburg, Germany. In addition, the company has offices in Spain (Barcelona), China (Beijing) and Switzerland (Zurich). 87 full-time equivalents are employed by Xing AG. Over 3.5 million users are registered on their platform and, in calendar year 2006 (pro forma), Xing AG generated annual revenues of €10.1 million. In December 2006, the company went public on the Frankfurt stock exchange.

Key drivers of success

- Management team
  Xing AG was founded by a management team with broad entrepreneurial experience. One of their key success factors was their drive to build a successful business model.

  "… The management had the typical strength of an entrepreneur who does not give up. They had a very good understanding of the industry and the drive to make it work …"
  Rolf Dienst, Partner, Wellington

  The CEO Lars Hinrichs is a serial entrepreneur with over ten years of entrepreneurial experience. As a result he already had a large corporate network prior to founding the company. This helped substantially in getting a first critical mass of users. This customer base initiated a viral effect in Germany and abroad. New users wanted their friends to be on the network and invited them. It was a key strength of the management team to always focus very much on the customer's needs and to adjust the platform accordingly. Thereby, they were able to create a tailored service for their target group. Up to today, this has allowed Xing AG to achieve high growth rates in the new users listed on their platform.

- Business model of a virtual company
  From the first day on, Xing AG had a clear business model that enabled them to reach a positive cash flow already after 90 days of operations. In early stages of their development Xing AG was a true virtual company. Lars Hinrichs did the financial planning and auditing but programming and even his secretary was outsourced. This helped to keep the cost base down.

- Early globalization
  Xing AG started to lay the ground for globalization in early stages of their company development. Their platform was created in two languages, German and English. Through a joint venture in China and an acquisition in Spain, they were able to extend their global presence and build up a larger global customer base. Currently, their platform is available in sixteen languages and over 60% of Xing's customers are located outside of Germany.

Contribution of venture capitalists to the success

- Support in strategic decisions and access to networks
  Xing AG had offers from various reputable international venture capitalists. They decided to go with Wellington mainly because of Wellington's prior experience in the market. One of their partners had done a similar investment in the US in eGroups which was later sold to Yahoo!. Therefore, he was able to give valuable support to Xing AG in their strategic decisions. For instance, he advised them to exchange part of their management team which later on proved to be the right move. In addition, he was able to help them in finding additional managers from the US through his contacts.

  "… It is difficult to get top-level Americans to work for a German company and to relocate for a certain period of time to Hamburg. We were able to find the right people through the personal relationships Eric Archambeau had abroad … "
  Lars Hinrichs, CEO, Xing AG

- Support in the IPO process
  The venture capitalist played a crucial role in the IPO process of Xing AG. Xing AG very much profited from the venture capitalist's experience in exiting an investment via an IPO. The venture capitalist supported them in putting together a convincing equity story. In addition, the venture capitalist also provided valuable contacts to investment banks which helped in realizing the IPO.

  "… Without Wellington's full support we would not be public today …"
  Lars Hinrichs, CEO, Xing AG

4. Cases of Successful European Venture Capital Investing

Findings on key drivers of success across the case studies

The key drivers of successful venture capital investments in Europe are described in detail within the case studies. First, the overall quality of the management team is perceived to be a success driver in all analyzed companies. In many cases, it was also noted from the interviewees responses regarding the relative importance of different success factors (see Figure 5), that technology has played an important role. However, these estimates are a result of prompted questions. In unprompted, open-ended questions on the key drivers of company's success as done in the case studies, only two out of seven companies mentioned technology as the key factor. Second, growing internationally is highlighted as an important success factor in four out of seven cases. However, in one case, focusing on the national market early on before going international was key for the success. Finally, in three out of the seven cases, the founder of the company was a serial entrepreneur.

As only seven companies were interviewed, it is not possible to generalize conclusions from these case studies regarding differences across industries or development stages. Nevertheless, the detailed case studies help illustrate that there are some common patterns underlying success across ventures.

Findings on the contribution of venture capitalists across the case studies

The case studies highlight the four factors that differentiate between successful venture capitalists described earlier in this study. The four factors (experience, aspiration, external resources and business model) identified as forming the base for the venture capitalist's pyramid of success find further evidence in these case studies. First, the support of the venture capitalist in strategic decisions was mentioned as a key contribution in five of the seven cases. The multi-faceted experience of top performing venture capitalists is mirrored in this contribution as different types of experience are required to support companies on various strategic levels. Second, access to external resources such as networks is also believed to be a key contribution of the venture capitalist in five of the seven cases. Finally, aspiration to grow a scalable business was identified as another key characteristic for top performing venture capitalists. Most of the portfolio companies emphasized that an important role that venture capitalists played was in acting as a coach to lift and continuously coax the team to have higher and global ambitions for growth.

5. Conclusion and Outlook

The study brings to the fore some key issues for the venture capital sector in Europe. It was found that structural barriers of heterogeneity in consumer preferences and a weak exit environment have hobbled venture capital returns in recent years. To overcome these structural issues, venture capitalists who have invested in opportunities that are scalable business models, either across geographic boundaries or across consumer verticals, have managed to generate substantial returns. The study showcases a few of these successful exits and identifies some of the key underlying lessons in successful exits: management, technology and markets.

However, before an exit can be realized, the venture capitalist has to identify the opportunity, invest appropriately, and cultivate the opportunity to a high-growth phase. This arduous and often challenging endeavor does have its payoff but requires venture capitalists to have a certain repertoire of skills and capabilities. From the LP perspective, the early 1990s saw several new entrants into the venture capital market with capital but without adequate experience or networks to manage and add value to early-stage companies. LPs attribute the lower returns in Europe primarily to a large number of venture capitalists in the market with mismatched capabilities. The post-bubble years have reduced the number of venture capitalists and a further attrition of venture capitalists can be expected.

In the interviews with LPs and entrepreneurs, both emphasize the importance of the venture capitalist's external resources and industry experience to source the deals. Entrepreneurial experience helps venture capitalists understand and aid portfolio companies to embark on high-growth trajectories. Perhaps key from an LP perspective is the venture capitalist's grasp of fund management, it is a fine balance between providing adequate investment for a company to grow and a drip feed approach that may starve the company of resources or alter its aspirations to become a global player. A venture capitalist which has a well-rounded team with industry expertise, entrepreneurial and investment experience tended to command the attention of the interviewed LPs. In the analyses, four key factors were found that were the foundation for a positive reputation of a venture capitalist and also synonymous with a successful investment strategy: Experience, Aspiration, External Resources and Business Model.

In gauging the environment, venture capitalists tend to be more optimistic of future potential than LPs because they are closer to the deal flow. Nevertheless, both venture capitalists and LPs agree that European venture capitalists have a challenge ahead of them to prove that the risk that LPs take to invest in a fund will need to provide commensurate returns. In this regard, there are several positive indications. First, there is an improving trend in the supply of high-quality opportunities from serial entrepreneurs and new technologies across sectors. Second, the consolidation among venture capitalists is providing a better playing field with reasonable valuations for investments in early-stage opportunities to justify risk-commensurate returns. Finally, though fickle, the exit environment is showing signs of improvement in Europe. Though there is a need to be cautious, these factors justify a reason to be optimistic.

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7. List of Abbreviations

ADSL	Asymmetric Digital Subscriber Line
CEO	Chief executive officer
CFO	Chief financial officer
CSO	Chief scientific officer
EVCA	European Private Equity and Venture Capital Association
HQ	Headquarters
GP	General partner
IPO	Initial public offering
JEV	Japanese Encephalis Vaccine
LP	Limited partner
LLU	Local loop unbundling
MD	Managing director
MEA	Membrane electrode assemblies
MMP	Matrix metalloproteinases
PC	Portfolio company
UK	United Kingdom
US	United States
VC	Venture capitalist

For definitions of terms used by private equity and venture capital practitioners, please consult the EVCA glossary available at www.evca.eu.

For further information, please contact:

Sabine Rummel
Economic & Industry Analyst, EVCA
Tel: + 32 2 715 00 20 or e-mail: sabine.rummel@evca.eu

European Private Equity &
Venture Capital
Association

Bastion Tower, Place du Champ de Mars 5, B-1050 Brussels, Belgium
Tel: + 32 2 715 00 20 Fax: + 32 2 725 07 04
e-mail: info@evca.eu web: www.evca.eu