Blooming

Europe has become a more fertile place for technology companies. But its tech industries still have to show they can burst through old constraints.

MENTION the name of a big European technology firm in Silicon Valley and chances are the reaction will be a mixture of pity and disparagement. SAP, the German software heavyweight? Past its prime. Finland’s Nokia, the world’s biggest maker of handsets? Missed the boat on smart-phones. Ericsson, of Sweden, the leading vendor of gear for mobile networks? Clobbered by the Chinese.

Turn the conversation to start-ups, though, and ears prick up. When will Spotify, a popular London-based online music service, be available in America? Why did Playfish, whose online games attract tens of millions, sell out to Electronic Arts, an American giant? And what will happen to Skype, whose software handles nearly 10% of international telephone calls, after its divorce from eBay, an online auctioneer?

Californians’ interest is most piqued by a French company, vente-privee.com, the pioneer of “private flash sales”: members—and members only—can pounce when told they have a few days to buy this Prada bag or that Dior perfume at a discount of up to 70%. This year the firm’s revenues are expected to reach €850m ($1 billion), a quarter more than the previous year. It already has dozens of imitators. Even Silicon Valley entrepreneurs have been heard saying they would like to do something “like vente-privee”. In the tech heartland, this is the ultimate compliment.

You may joke that America is at last discovering Europe. But that reflects a change in European entrepreneurial potential more than in American attitudes. In recent years, a lively environment for young companies has emerged in Europe, complete with serial entrepreneurs, experienced venture capitalists and the necessary supporting infrastructure, such as law firms and PR agencies. And it is most visible where Europe has been considered weakest: the internet and other parts of the information-technology industry.

Granted, it is not yet clear whether Europe’s tech industries will become big enough to do the things that its entrepreneurs, venture capitalists and policymakers dream of: not just producing brilliant ideas, but turning them into lucrative commercial reality; creating a lot of jobs; and yielding the sorts of innovations that revolutionise old industries and spawn new ones. Nevertheless, the change is palpable.

Hermann Hauser, co-founder of Amadeus Capital Partners, a pioneer of Europe’s venture capital (VC) industry, says that a dozen years ago most of the start-ups his firm financed were led by first-time entrepreneurs. Amadeus, based in Cambridge, had a hard time finding like-minded venture capitalists. Today 70% of the chief executives are repeat entrepreneurs, and there are enough good venture capitalists around to team up on financing. “The progress has been spectacular,” he says, “particularly in Cambridge.”

Other places are blooming too. Europe has a collection of specialised clusters—a bit like Silicon Valley, but spread over a much bigger area. Cambridge resembles Santa Clara, where many big chipmakers are based. For London read Sand Hill Road, the place with the densest concentration of venture capitalists. Berlin is reminiscent of South of Market in San Francisco, the preferred habitat of more artsy start-ups.

Strength in diversity

Europe’s diversity may once have been a disadvantage, a clash of cultures and languages rather than a healthy mix of skills. Now firms have learned to exploit it and providers of capital see it as a strength too. “People from different countries are good in particular roles. Germans tend to excel at business development, Russians at developing software, the French at user interfaces,” says Danny Rimer, who established the London office of Index Ventures, a VC firm. As the internet becomes less dominated by American tastes, he adds, European skills, for instance in design and branding, are becoming more valuable.

Kristian Segerstrale, co-founder of Playfish, sees a further advantage in Europe’s diversity. “When you have to be international from day one, you build your business in a way that later allows you to exploit a truly global market such as the internet.” Mr Segerstrale is Finnish; the other founder, Sebastien de Halleux, is Belgian. Product development is spread evenly across studios in America, Britain, China and Norway. The games themselves are hosted on computers in America.

At Playfish, it may even seem that the idea of a “European” start-up has lost much of its meaning. The same goes for Plastic Logic, which has developed a high-end e-reader meant to replace paper. It is run from Cambridge, but marketing is based in Silicon Valley, much of the software is developed in India and manufacturing is done in Dresden as well as China. “Without videoconferencing and other online collaboration tools, such a structure wouldn’t work. Being attuned to cultural differences, Europeans are better at working in this environment,” says Richard Archuleta, the company’s (American) boss.

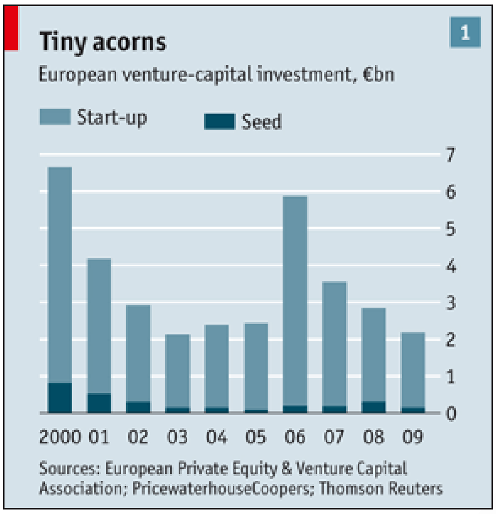
A further sign of Europe’s new liveliness is Seedcamp, a programme to train entrepreneurs set up by Saul Klein, a partner at Index Ventures. The list of its events this year reads like a modern Grand Tour: Barcelona, Berlin, Copenhagen, Prague, Zagreb. In recent years both the continent’s leading technology conferences, LeWeb in Paris and Digital, Life, Design in Munich, have become networking fests every bit as animated as their American equivalents. The halls are packed with venture capitalists looking for deals, entrepreneurs explaining their business plans and representatives from big companies trying to make sense of it all.

When Loïc Le Meur, a French entrepreneur, started LeWeb in 2005, it attracted only 250 participants and most speakers were American. Last December ten times as many came and on the stage were plenty of Europeans, including Marten Mickos of MySQL, a maker of databases now owned by Oracle, a software giant, Marc Simoncini, founder of meetic.com, Europe’s largest dating site, and Niklas Zennstrom, who started Skype. “There are now enough success stories. You no longer have to defend yourself for being an entrepreneur,” says Mr Le Meur.

Some successful entrepreneurs have become “angel investors”: rich individuals who put money into start-ups in their early stages. Mr Simoncini has earmarked €100m of his fortune for this. Others include Lukasz Gadowski, founder of Spreadshirt, a shopping site, and Brent Hoberman, co-founder of lastminute.com, a travel site, who is a partner in PROfounders, an early-stage investment firm. In March Mr Zennstrom said he had raised $165m for his new VC firm, Atomico Ventures. All of them explain their enthusiasm by remarking that established VC outfits have virtually abandoned early-stage firms. “When it took us more than a year to get financing for Skype, we knew what line of business we eventually had to get into,” says Mr Zennstrom.

Yet those older VC firms, most of them based in London, have not stood still. Some of the funds set up by big American firms in the early 2000s have stayed and thrived, notably the subsidiary of Accel Partners, which has invested in 42 European start-ups. “Silicon Valley no longer has the monopoly in innovation,” says Kevin Comolli, the managing partner.

There is even a handful of European VC firms of a similar scale to American ones, with both the capital and the expertise to take start-ups global. These include Mr Hauser’s Amadeus, Northzone Ventures, Wellington Partners and Index Ventures, perhaps the leading European fund in internet investments. It has funded several of the continent's most successful start-ups, notably Skype, MySQL and Last.fm, an online music service.



Despite all this excitement, Europe's tech breeding ground is still much smaller than Silicon Valley's: in 2009 young European companies received €2.2 billion in seed and start-up capital (see chart 1), less than their American peers were given in the first quarter of this year alone. Europe lags behind Silicon Valley largely because it started much later and from a much lower base. For entrepreneurship to thrive, several specific conditions must be in place. "It's like a biological cell where everything depends on everything else," says Jeff Skinner, executive director of the Institute of Innovation and Entrepreneurship at London Business School.

A tortoise stirs

There are at least half a dozen reasons for Europe's slow and halting start, and they all still ring true to varying degrees. Top of the list are entrepreneurs themselves. Europe has never been short of talented people with good ideas, yet its entrepreneurs seem more interested in making products than making money; they take fewer risks and appear to be less driven—and maybe less greedy. American VCs in Europe chuckle when they tell of employees of start-ups who had to be talked into taking equity stakes or stock options.

Doubtless this has much to do with Europeans' preferences, but it surely reflects incentives too. In Europe starting your own company has long carried higher risks and lower rewards than across the Atlantic. In America, a failed start-up tends to be a badge of honour; in Europe, it often spells professional death. In some countries, the law prevents anyone who has gone bankrupt from running a company again. At the same time, taxes make shares and options much less attractive than a good salary. In Germany, for instance, any equity stake is taxed immediately.

Second, Europe is more fragmented. In Silicon Valley meetings may be a car ride away; Europe's tech entrepreneurs are likelier to board an aeroplane. More important, unlike American start-ups, European ones do not have the benefit of a huge homogeneous market that allows them to grow quickly. This is in spite of the European Union's efforts to establish a single market among its members.

Third, European entrepreneurs must still contend with thick red tape. In Spain, for instance, labour law makes it "difficult to experiment", in the words of Martin Varsavsky, founder of FON, based in Madrid, which has knitted a global network of Wi-Fi base stations. Firing is expensive, because of compulsory severance payments. Younger employees with fresher skills are the first to go because of seniority rules. Equally inhibiting, says Mr Varsavsky, is the difficulty of getting work permits for employees from non-EU countries. In contrast, most start-ups in Silicon Valley are run by immigrants, mainly from China and India, but also Europe.

Fourth, the paucity of successful start-ups left Europe short not only of VC but also, more important, of the expertise that ideally comes with the money. In America, university endowments and other institutions with an interest in technology provide the VC industry with its financial foundation. Europe’s pool of capital available from such investors is about 8% of America’s, estimates Thomas Meyer of the European Private Equity and Venture Capital Association (EVCA).

Success breeds success: many American venture capitalists have run start-ups themselves. European ones tend to be bankers and lawyers with little operational experience and less appetite for risk. That is why they have focused on more mature companies rather than on young start-ups. Even there, they have done less well than their American colleagues. And it is why Europe’s new angels are determined to focus on infant firms.

Fifth, European consumers are little help. They are much less “venturesome” than Americans, to borrow a term from Amar Bhidé, a visiting scholar at Harvard University. Big American cities in particular contain a critical mass of early adopters eager to try new online services such as Twitter or Foursquare. Many Europeans still shy away from online shopping because they are afraid that their payment information could be intercepted.

Finally, timing has been unkind. The European tech business started growing decades later than America’s, and first really got going only in the late 1990s—just in time for the bursting of the internet bubble. Entrepreneurial networks disintegrated, venture capitalists stopped funding infant companies, and the media ridiculed anything to do with the internet.

Weeding and fertiliser still required

Europe has gone some way to overcoming these difficulties. According to an index compiled by the OECD, establishing a company has become easier (see chart 2). Perhaps surprisingly, some European countries score better than America. But America’s mark is dented by the lack of competition in its network industries, such as telecommunications and utilities. Regulation in Europe remains more onerous than in the United States.

Bureaucracy is not European entrepreneurs' only grumble. These days their biggest gripe is about finding the right employees. "It sometimes is a challenge to get people to move from Cambridge to Bristol [150 miles, or 240km]," jokes Stan Boland, boss of Icera, a maker of radio chips for mobile devices. "Europe lacks this mixture of technology and business acumen. People mostly stay in their silos," says Stephan Uhrenbacher, founder of Qype, a website for user reviews of local services.

Despite the strides Europe has made, it has produced few world leaders—and certainly no equivalent of Google or Facebook. European start-ups tend to sell themselves early and mostly to American firms. Last.fm was bought for $280m by CBS; Electronic Arts paid $400m for Playfish. Amazon is said to be willing to fork out $3 billion for vente-privee.

For this there are several possible explanations. Many venture capitalists cite a lack of "exit options". Only a few European start-ups can hope for a big flotation at home. No stockmarket in Europe is a match for the NASDAQ, where most American technology companies are listed. In addition, Europe's big IT firms still mostly prefer to develop new technology themselves rather than buy it. Europe also lacks executives with the experience to turn a start-up into a big company, says Hussein Kanji, formerly of Accel's European branch, who is now raising capital for a new early-stage venture fund.

It is tempting to wonder what governments might do to help. The answer may be: not all that much. "You cannot build an ecosystem, you have to grow it," says Mr Skinner of the London Business School. Simon Levene, formerly of Accel Partners Europe, adds: "These things take time. Europe is now where Silicon Valley was in the early 1990s."

Still, government intervention has helped IT industries in the past. Without it, Silicon Valley might not be what it is today, argues Josh Lerner, a professor at Harvard Business School. Particularly in its early days, he says, public funding played a key role. In Israel, which has several thriving high-tech firms, the state also helped, mainly by jump-starting a VC industry.

Europe has all kinds of programmes to inject public money into VC. The European Investment Bank and the EU jointly own the European Investment Fund, a "fund of funds" placing money with other funds rather than directly in start-ups, which by the end of 2009 had invested €4.1 billion. Some national governments have been even more generous. In France, citizens get all kinds of tax breaks for investing in VC funds or directly in start-ups. Among other things, they can cut their wealth tax by up to 75% if they invest an equivalent amount. Not surprisingly, France has plenty of VC: nearly €2 billion was thus raised last year.

State programmes do leave a mark. Bristol, in the west of England, would not be home to so many semiconductor companies had the government not poured tens of millions of pounds into a chipmaker a few years ago. The firm was a financial disaster, but spawned several start-ups. Yet this shows that a lot of money is wasted along the way. In France a good slice goes to big banks and insurers, which operate most funds and charge hefty fees: on average, 38% of the initial investment over eight years, according to a report by the French finance ministry.

Public funding tends also to distort the market, being loaded with political objectives and preferences for certain technologies, as the EVCA noted recently. Worse, despite high hopes, private money did not follow the public lead and, in the wake of the credit crunch, is even leaving the market. The EVCA said that Europe's VC industry was "in deep crisis" and that a new regulation debated in Brussels would make life even harder by burdening funds with "punitive disclosure requirements".

Still, the high-tech industry has moved up the political agenda, notably in Brussels. The EU now has an innovation commissioner, Maire Geoghegan-Quinn. She heads a group of commissioners which, this autumn, is to produce a “research and innovation plan” to make life easier for European technology start-ups.

If history is any guide, the commission will mainly suggest throwing more public money at innovation, fears Ann Mettler, executive director of the Lisbon Council, a Brussels think-tank. To keep up with America and Asia, she says, Europe instead has to become more adventurous: entrepreneurs and venture capitalists must take more risks, politicians stop protecting vested interests, incumbent companies be open to experiment and consumers try more new things. The much-needed cultural revolution in Europe’s tech industries is not yet complete.

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