

European VC investors: Time to think big

As U.S. investors pour into Europe, European VC investors should also think big, according to a report by The Boston Consulting Group and IESE

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First, some good news for Europe: Venture capital (VC) investments now stand at their highest levels since the bursting of the dot-com bubble. At the same time, European VC returns and money multiples are growing, innovation hubs are emerging and serial entrepreneurs are doing well. In sum, the VC market appears to be thriving.

Now the not-so-good news: European fund-raising has steadily slowed. Drilling down, it is evident that Europe's private investors — particularly institutional investors — are behind the slowdown, with their fund-raising plunging by 33 percent since 2012. Meanwhile, institutional investors from the United States, where the VC market is more competitive, are spilling over to European territory, pushing investment totals up. They are joined by Europe's government investors, who tend to invest in smaller, one-country funds to support more local concerns.

So, what can be done to liven up Europe's homegrown VC fund-raising? According to a [report](#) by Michael Brigl, partner at The Boston Consulting Group (BCG), and [Heinrich Liechtenstein](#), professor of financial management at IESE, European investors need to think big, with bigger funds that cross borders and tap into multiple funding sources. Bigger funds tend to perform better, which results in a healthier, more sustainable VC market. This could help Europe better support its entrepreneurs, especially in startups' later stages.

The story in numbers

Brigl and Liechtenstein come to these conclusions after analyzing the state of European VC based on data and interviews. Specifically, the co-authors crunch the available data and find:

- VC investments in Europe surged strongly from 2012 through 2014, growing by 73 percent.
- Returns on VC investments grew at a 7 percent compound annual rate from 2011 through 2014.
- Since 2012, European fund-raising has plunged by 33 percent, while U.S. investment has increased by 45 percent to approach a 10-year high.

The chief cause of the slide in European fund-raising is the dearth of private money, the co-authors note. In Europe, institutional investors — e.g., pension funds, academic endowments and family offices — account for relatively little of the money in the VC market when compared to the United States. For example, European pension funds make up 14 percent of all private VC limited partners in Europe, compared with 29 percent in the U.S.

European venture capital

Meanwhile, European governments' share of investment in the VC market more than doubled from 2008 through 2014, picking up some of the slack as private investors backed off. The problem here for the broader VC market is that government funding tends to prioritize building up regional or national champions over their financial returns. When government funds are leading equity investments, private investors seeking the best returns may stay away.

What else is scaring off private European investors? The report names a few key factors. First, the current European financial-regulatory regime discourages equity investing. In addition, the European VC market lacks transparency and unity. Instead of large funds, it has many small ones which tend to be nationally focused and make it more difficult for institutional investors to take big bets in promising startups.

Recommendations to attract private investors

To attract private investors, the report makes several recommendations:

- Offer investment opportunities with a pan-European focus to bring in bigger ticket investors (e.g., over 50 million euros).
- Have funds that are large enough — potentially with capitalizations of 350 million euros or more — to invest in startups at all stages of development, especially the late and growth stages.
- Bolster the transatlantic expertise and networking among VC fund managers to

support the growth of ventures in the U.S.

- Continue to use government funds as catalysts, but do not let them lead private investors in new fund vehicles.
- Increase transparency to facilitate investment decisions.

The report also recommends that Europe ease regulatory restrictions currently in place for pension funds, insurers and other private equity investors. Tax incentives could also boost funding supplies. As another option, the report suggests that VC market players could consider setting up a "fund-of-funds" to attract both private and public money in one pool — as an interim step or medium-term solution. Canada has implemented a successful version of this approach, the co-authors note. "Such a structure could deepen the European VC pool and finance several hundred companies that would create jobs and drive incremental growth," they write.

The co-authors write that a fund-of-funds should only remain as a means to scale up private investment sufficiently enough to allow the VC market to then be supported mainly by private capital. In their view, Europe's VC market should be "largely a private affair" to help assure that Europe is "a healthy, well-funded hub of innovation."

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