Opinion **FTfm**

Unicorns rarely speak a European language

The view from Silicon Valley is that Europe remains a venture-capital sideshow, says Stephen Foley

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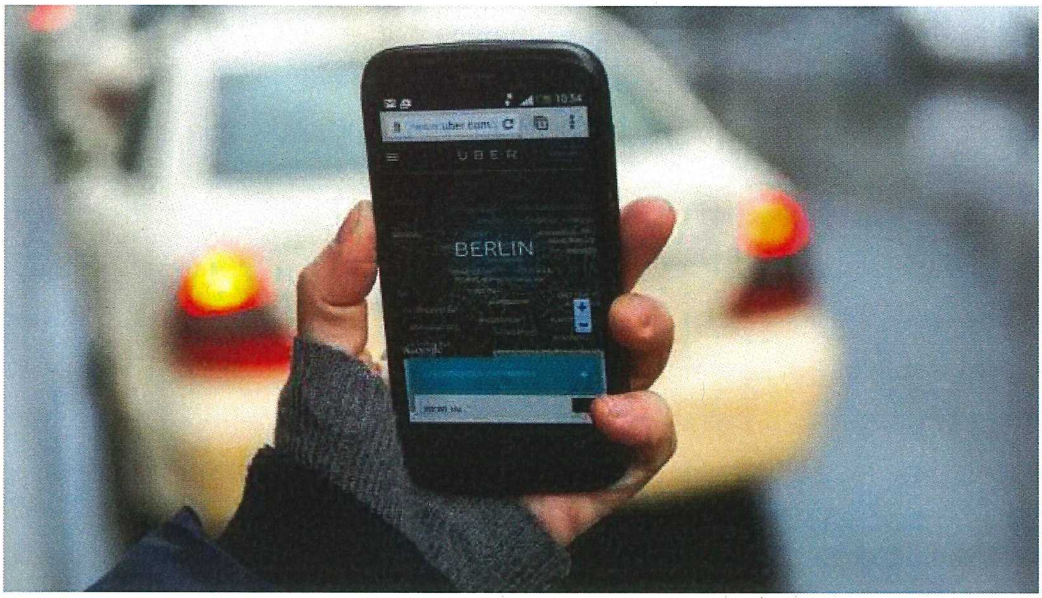

Uber, the taxi app, is an example of a unicorn, a private company valued at more than $1bn © Bloomberg

Stephen Foley AUGUST 2 2015

What is the language of unicorns? English, with a California twang, in the main. Often Mandarin, now, too. Rarely will you hear these beasts speaking a continental European tongue.

By unicorns, of course, I refer to private companies valued at more than $1bn, animals that are not only not mythical but an increasingly common site on the investment landscape. The clamour to get into the hottest growth companies means valuations have soared, and behind Xiaomi, the Chinese smartphone maker, Uber, the taxi app, and Airbnb, the accommodation website, are 120 other "unicorns". Only a dozen are European, though: five from the UK, two each from Sweden and Germany, and the others from Luxembourg, the Netherlands and the Czech Republic.

CB Insights, a venture capital database, and KPMG, the professional services group, have been tracking venture capital investments in private companies this year. Their scorecard prompted another round of angst about Europe's laggardness relative to the US when it comes to tech start-ups and venture capital, unease further stoked by signs that Asia is moving decisively ahead of Europe, too.

Investment into VC-backed companies in Europe was $6.6bn in the first half of the year, up from $4.4bn, a 50 per cent increase, but in Asia it was $15.1bn, up 122 per cent thanks to mega-fundraisings by Coupang, the South Korean ecommerce site, Dianping, the Chinese online review platform, and Flipkart, the Indian ecommerce site.

The US continues to dominate, with a fundraising total at midyear of $36.9bn.

The view from Silicon Valley, where I have spent the past couple of months, is that Europe remains a sideshow. Venture capitalists who do not openly deride Europe's perceived lack of entrepreneurial spirit are paying the continent little heed, fixated instead on opportunities in the giant markets of Asia, China in particular.

But I wonder if they may not change their tune, at least a little. Initiatives such as the European Commission's attempt to create a "digital single market" will not overcome the cultural barriers that fragment the market for start-ups, but they can clear away some of the legal ones, for example to licensing content. Beijing has frightened international investors with bizarre attempts to manipulate its stock market, adding to existing concerns about an economic slowdown in China.

Blow off the unicorn froth and take a deeper dive into that CB Insights-KPMG report and there are a couple more reasons for Europeans to feel cheerful.

The first is that government efforts to promote start-up communities can bear fruit, as they have done in Ireland. Here VCs deployed €120m just in the first three months of the year, a large sum in comparison with the scale of the Irish economy.

More significantly, at a time when US VCs are complaining about expensive valuations, European start-ups come cheap.

Forget the unicorns for a minute. One prominent micro-VC in Silicon Valley complained to me that early-stage valuations had gotten out of hand, too. The reason? Competition for engineering talent and office space.

This is the downside of a boom, of which there is evidence all around the San Francisco Bay area. Yelp, the reviews website, was a hot start-up once. Now a public company, it found it could not find enough sales staff here at any price, so last month it scaled back its expansion plans, stopped selling some kinds of advertising altogether and warned investors to expect sharply slower profit growth.

The cost of computing may get ever lower, but salaries and rents have made starting a new company more expensive, and the amount of money a company needs to get to scale is what dictates the size of funding rounds. The size of the round is a vital component in picking its early valuation. In Europe, the average size of seed and series A rounds in the first half of this year was $3.2m, compared with $5m or more in Asia and North America.

As CB Insights put it: "The lower [European] valuations have had a positive outcome. Companies are becoming increasingly attractive to foreign investors. US VC firms in particular are becoming more active players in the European VC market. The success of some of these US VC firms has created a ripple effect, encouraging other foreign VC firms to consider making their own investments."

No one is going to topple Silicon Valley. Unicorns will still speak mainly with a west-coast accent. Venture capital will flow more vigorously through here than any other location, Asia included. But there are reasons to suspect that Europe might attract a greater share of VC interest in the future.

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