

The Weekend Essay **Life & Arts**

Venture capital's new race for Europe

The continent has been slow to develop tech unicorns. Can Silicon Valley's creativity and cash spark a winning streak?

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In spring 2019, Matt Miller, a Silicon Valley venture capitalist, made an especially contrarian wager. He bet that Europe, the perpetual continent of yesterday, was on the verge of a technology take-off.

At the time he formed this conviction, it was a bold notion — in fact, his two senior European-born colleagues had resisted the idea of a Europe office. But Miller's intuition was an omen. Despite the continent's lacklustre business history, this could turn out to be a tipping point: the moment when Europe began to make the shift from tech bystander to tech contender.

Miller set out his provocative belief in two memos to his partners at [Sequoia Capital](#), the top venture shop in the Valley. The core of his argument was that tech ecosystems are like start-ups: winners advance exponentially. When a tech company is founded, there is generally no product, no established market, no staff — nothing. But each step forward makes the next steps easier. In 2019, Miller was saying, Europe was at the point where the curve of progress steepens. In a few more years it might go vertical.

Miller's theory of Europe's advance began with the number of unicorns — private tech companies worth at least \$1bn. Half a decade earlier, Miller reported, Europe had been home to fewer than 10 of these rare beasts. Now there were 49 — a fivefold increase in as many years — and that was without counting the most exciting successes, which had by now graduated from the list by being acquired or going public. A few of these winners were spectacular enough to induce a frisson of FOMO, even from the Valley's most august VC companies. Sweden's music-streaming giant [Spotify](#) had recently gone public and was at this point worth \$24.6bn.

As Miller and his colleagues understood, each European \$10bn-plus unicorn could be read as its own prophecy. It signalled that dozens of executives and engineers had experienced exponential growth from the inside. Having ridden a rocket one time, a fair number of these veterans would chase the thrill again — by founding new companies, joining or advising them, or backing them as venture capitalists. Following the Silicon Valley model, success would beget more success, as entrepreneurs left for new ventures and turned into coaches, mentors and angel investors.

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As Miller pointed out, Europe had the raw materials to feed this virtuous circle. The continent was home to three of the world's top five computer-science programmes — Oxford, Cambridge and ETH in Zurich — and 31 of the top 100. European governments invested heavily in coding literacy: the continent boasted 5.7mn software developers compared with 4.4mn in the US.

And Europe's technology firms could hire from across the continent because of the ubiquity of English. The fintech company Klarna had workers from 55 countries at its headquarters in Stockholm.

What's more, European coders were acquiring the ambition of their American equivalents. Inward investment had a lot to do with this: each of the Big Five US tech majors — Alphabet, Microsoft, Amazon, Apple and Facebook — had opened research and engineering offices in the region. On scouting trips to Europe, Miller kept running into start-up founders who had spent time at these outfits; on LinkedIn, he reported, fully 12,524 people described themselves as engineers at one of them. Exposure to entrepreneurial Americans could be highly contagious. No wonder Europe's start-up scene was starting to feel frisky.

Miller's memos to his partners concluded with a call to action. The US and China still had far more unicorns than Europe, he admitted. But Europe was catching up. In the previous five years, the number of early start-up investment rounds had doubled in the US. In Europe, by contrast, the number had leapt sevenfold. If there is one insight that venture capitalists share, it's that ignoring signs of exponential progress is worse than betting on them and being wrong. Risk \$100 and your maximum loss is \$100. Fail to risk \$100 and you could miss out on a gain of \$1,000 — or \$10,000.

“Long dead are the days when all the attractive start-ups were a bike ride away,” Miller admonished his California colleagues. “The geographic map of opportunity is only getting larger and more complex.”



Betting on Europe: from left, Sequoia's Matt Miller, Luciana Lixandru, Doug Leone and George Robson

Miller's colleagues listened — and acted. Miller moved to London and Sequoia poached a local star, a young Romanian named Luciana Lixandru, from the rival Silicon Valley company Accel. The courting of Lixandru involved secret meetings in out-of-the-way restaurants, the assigning of code names and a call-to-greatness email from Doug Leone, Sequoia's top partner. “What will you wish you had done 40 years from now?” he challenged her. Sequoia, Leone insisted, was offering Lixandru the opportunity to change her continent. Europe was ready to take off, and Sequoia would supply the rocket fuel it needed.

Sequoia's decision to plunge into Europe could turn out to mark a tipping point because of the partnership's stature. Sequoia owns stakes in a fifth of the world's unicorns, more than any of its rivals. But the larger point relates to venture capital itself. Despite claims that they are free-riders, extracting unearned riches from the sweat of company founders, sophisticated venture investors are the main catalyst behind productive tech clusters.

The triumph of Silicon Valley illustrates this truth neatly. Believers in industrial policy sometimes attribute the Valley's rise to government-backed science or lucrative federal defence contracts. For their part, pro-business chroniclers celebrate the Valley's entrepreneurs and inventors.

Yet neither perspective is satisfying. After all, the US has never pursued an industrial policy that favoured Silicon Valley over rival technology clusters such as Boston. During the cold war, when defence dollars mattered most, more flowed to MIT and Harvard than to Stanford and Berkeley. As to the Valley's entrepreneurs and inventors, many of them hatched their ideas elsewhere. They moved to the region because something attracted them.

AnnaLee Saxenian, a distinguished Berkeley sociologist, has come closest to [explaining](#) the Valley's key advantage. In Boston, the electronics business was dominated by large, secretive, vertically integrated corporations. Engineers might come up with brilliant inventions, but if these didn't fit with corporate strategy, they would fall by the wayside — and technicians at other companies would never hear of them. Silicon Valley, by contrast, was a bubbling cauldron of small businesses, each one hungry for a new idea, none of them held back by hierarchy. Corporate secrecy was not a thing. Ideas spread like wildfire around the Valley because of places like Walker's Wagon Wheel, a packed watering hole where techies from competing firms traded gossip freely.

Why did it take a sociologist to spot this advantage? Economists have always acknowledged the vitality of industrial clusters — finance in New York, movies in Hollywood. They are less good at explaining why one cluster might pull ahead of others.

But in a celebrated [article](#) published in 1973, Saxenian's fellow sociologist Mark Granovetter demonstrated that a network with a plethora of weak ties generates a greater circulation of information than a network with a handful of strong ones. It followed that Boston was hobbled: its large, self-contained companies featured tight relationships among colleagues but few links between professionals at one firm and similar professionals at another. Silicon Valley's myriad loose ties promoted richer idea-sharing and creativity.

For most venture capitalists, relentless networking was not just one thing they did. Rather, it was the thing — the key to succeeding in the business

Of course, the sociologists' insight raises a question. What generated the abundance of weak ties in the Valley? The answer is that one tribe of professionals is relentlessly focused on cultivating such ties. This tribe is the venture capitalists.

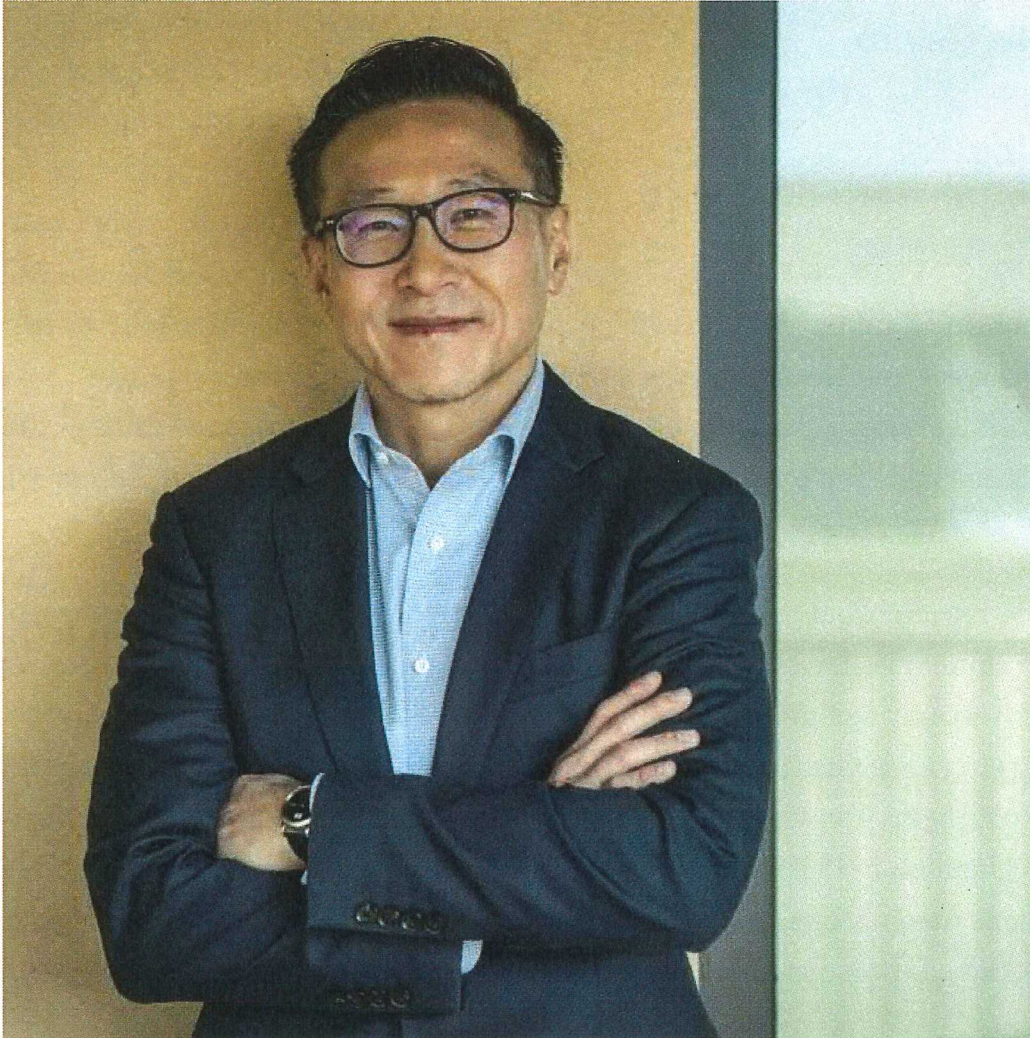
It was not a coincidence that Silicon Valley outran Boston following a surge of fundraising by West Coast venture shops in the late 1970s and early 1980s. Copious venture dollars meant that more eager dealmakers plied their trade in the Valley,

schmoozing founders, interviewing prospective hires for their portfolio firms, linking ideas, people and money. For most venture capitalists, relentless networking was not just one thing that they did. Rather, it was *the* thing — the key to succeeding in the business. The loose ties that Saxenian stressed did not arise by accident.

In fact, most of what makes the Valley distinctive can be traced to venture capital. Small companies have multiplied in the region because plentiful venture dollars make it so easy to start them. Engineers share confidences with rivals because VC hiring circulates talent continuously: today's competitor may well be yesterday's close colleague. The Valley's celebrated tolerance of failure, often ascribed to some magical potion in the water, comes from venture capital as well. People quit secure positions to join start-ups because they trust VCs to slot them into a new job if their start-up becomes a shutdown.

Venture capital has been equally central to China's tech ecosystem. Again, the government's role is frequently exaggerated: in the early internet era, Chinese industrial policy aimed to promote strategic technologies such as semiconductors, and the result was mostly failure. Instead, China's digital economy got started in sectors that the government ignored, because the vacuum created space for venture capitalists to pick out rising firms and shape them. Alibaba, Baidu, Tencent and a host of other consumer-internet triumphs raised money from American VCs who brought the Valley's tools to China.

The case of [Alibaba](#) is instructive. Its first outside investors were two Taiwanese-born products of the Ivy League: Joe Tsai, a Wall Street lawyer turned investor, and Syaru Shirley Lin, a Goldman Sachs banker. Along with US capital, the two brought US lawyers, who created an ingenious corporate structure featuring a Cayman Islands parent company. This proved to be a game-changer, because it endowed Alibaba with the power to issue employee stock options.



Joe Tsai, an early outside investor in Alibaba who became its first Silicon Valley-style hire © David Paul Morris/Bloomberg

When Alibaba obtained this tool, the whole idea of equity was novel in China. The mainland's two clunky stock exchanges, in Shanghai and Shenzhen, had opened as recently as 1990. Employee stock options were not recognised in Chinese law, and Chinese-American entrepreneurs struggled to find Chinese words for them. But once it got its hands on these exotic instruments, Alibaba moved aggressively.

The company's first Silicon Valley-style hire was none other than Tsai, who waved goodbye to a plush salary and accepted minimal wages, figuring that Alibaba options would more than compensate. Alibaba now had a star chief operating officer. Next, the company courted John Wu, the Silicon Valley-based lead engineer at Yahoo. Unsurprisingly, Wu balked — why would he leave one of the Valley's hottest companies? But Alibaba countered with a generous package of options, plus a twist: Wu could remain in California and build his own team, using more Alibaba options to attract great people.

Like Silicon Valley, China's digital economy owes much to venture capital

Thanks to world-class recruits like Tsai and Wu, Alibaba became a world-class company. More than just a formidable enterprise in its own right, it became a training ground for go-getters who in turn created other start-ups. And Alibaba's story was just one among several. Tencent raised early capital from a US venture shop called

IDG, and later used options to hire a top executive, Martin Lau, from Goldman's Hong Kong office. Baidu received capital from a fund led by the Silicon Valley investor Tim Draper, and the three early Chinese internet portals — Sina, Sohu and NetEase — all took foreign venture money. Without VC backing, any of these companies might easily have stalled. Like Silicon Valley, China's digital economy owes much to venture capital.

Which brings us back to Europe's prospects. The continent has long had many of the ingredients that tech clusters need: strong universities, lots of engineers, access to a rich consumer market. But Europe has been held back, supposedly, by cultural factors: a lack of appetite for risk, an alleged commercial timidity. The history of innovation offers an encouraging lesson. People will take a risk if venture capitalists underwrite it.

The progress that Sequoia spotted in 2019 underscores this verdict. Just as in China, US-linked venture capitalists were heavily involved in Europe's awakening. European VC firms may have been the first investors, but the music-streaming giant Spotify was backed by US venture-capital firms such as Accel and Founders Fund. The Dutch fintech juggernaut Adyen received capital from the American firms General Atlantic and Iconiq Capital. The payments company Wise raised money from the Valley's Andreessen Horowitz. On a narrow definition, more than a fifth of European venture capital deals involve an American participant. But that doesn't count European participants with Valley DNA. A prominent example is Index Ventures: two of the firm's leaders, Neil and Danny Rimer, worked at Valley investment banks before building their bicontinental venture partnership.

To make the most of this incipient venture boom, Europe's political leaders must embrace it. There are signs that they will. Some taxes penalising employee stock options have been reformed: as of last year, workers at mid-sized European start-ups owned around 16 per cent of their firms, up from 10 per cent five years earlier, according to Index Ventures. Britain is planning to relax visa rules for tech companies seeking foreign talent. But despite these hopeful marks of progress, there are risks of a backlash. The unpopularity of US tech behemoths may perversely tarnish the reputation of US VC firms — even though the best antidote to the monopolistic tendencies of Big Tech is venture-backed small tech.

Rather than resenting the influx of Valley-style venture capital, Europe should welcome the help in fertilising the ground for its own tech champions. Already, Spotify is the global leader in music streaming. Klarna is the global leader in buy-now-pay-later finance. UiPath is the global leader in robotic process-automation software. There is no reason why this roster cannot grow. The continent of yesterday can do better tomorrow.

Sebastian Mallaby's 'The Power Law: Venture Capital and the Art of Disruption' is published by Allen Lane

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