Venture capital with a European twist

Cultural factors suggest that European venture capitalists will follow a different model than their US counterparts in selecting companies to fund.

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Fifteen years ago, during the halcyon days of the American biotech industry, one of the major differences between Europe and the United States was the availability of venture capital for biotech startups. While it seemed at the time that US startups were awash in money, European companies were finding it difficult to scrape together even the smallest amounts of venture capital funding.

Today, the situation is far different, perhaps even reversed. European investors have discovered biotechnology, and in the wake of several successful initial public offerings, venture capital has greatly expanded. There are, however, some significant differences between the two sides of the Atlantic when it comes to the criteria for successful venture capital behavior. These differences are rooted in both material and cultural differences, and possibly in the kind of companies that will receive funding in the future.

Fast return on investments

Looking back over the years, it seems that US venture capitalists have shown a general tendency to follow fads and trends in the biomedical sciences. At any given time, the crop of new companies has typically been dominated by a certain new technology—the flavor of the day, so to speak. This was evident at the industry's birth, when recombinant proteins were all the rage and companies such as Genzyme (Cambridge, MA), Genentech (S. San Francisco, CA), Amgen (Thousand Oaks, CA) and the now-defunct Synergen (Boulder, CO) sprang up and acquired substantial early funding.

Later, combinatorial chemistry became hot, giving rise to NeXagen (Boulder, CO), Pharmacopeia (Princeton, NJ) and ArQule (Medford, MA), for example. Today, we have the genomics push, and companies such as

Tularik (S. San Francisco, CA) are receiving venture capital on the basis of their particular genomics approach to drug discovery.

Thus, venture capitalists in North America have been inclined to take chances on new technologies and themes, and the background for this investment strategy rests in the way that US venture capitalists measure success—ensuring a relatively fast return on any individual investment. In other words, the successful venture capitalist is the one who makes money for the investors in the venture fund. As a consequence, the focus in biotech funding has been on making it to the IPO. One might say that the question posed by the venture capitalist when

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faced with an investment opportunity is more likely to be “What can I sell on the stock market in two years?,” rather than “How is this company going to make money in the long run?” Indeed, for US venture capitalists, the long-term fate of the funded companies clearly takes second place to the welfare of the investors.

The behavior of any venture capitalist is, of course, partly determined by the demands of the institutional investors who are fueling the funds. Thus, part of the reason that US venture capitalists must operate with such a tight focus on short-term return probably resides with the corporate culture of institutional investors. Viewed from the outside, such institutions are characterized by a high degree of mobility within these organizations, producing a situation in which portfolio managers rarely stay in a position for very long. Such an ever-changing management environment will naturally favor a short-term over a long-term focus.

Mobility also comes into play with regard to those who manage US biotech companies. In the US, heading one or even several failed companies does not, in the eyes of venture capitalists, make a manager unfit for the position of chief executive officer. In fact, quite the opposite is true: a failed CEO is likely to be regarded as a person with valuable experience. At the root of these characteristics lies a strong tradition for entrepreneurship that pervades the personal as well as the corporate spheres. In this cultural tradition, trying is viewed as a positive in and of itself, regardless of the actual results.

When it comes to biotech funding, there are both pros and cons to this approach. On the plus side, many new companies are formed and many possible routes to discovery are tried. On the negative side, the focus of venture capitalists—fast investment return—produces a relatively high failure rate among funded companies. This became painfully evident in the US in the early 1990s, when a host of biotech companies failed. Typically, the companies that succumbed in this period had concentrated their efforts on developing one compound or one technology, pushed to that approach by the short-term focus of their venture backers.

Less room for failure

In Europe, the successful venture capitalist is not so much characterized by his or her ability to secure investment return, but by whether he or she is able to show a record of funded companies that survive and thrive. At the heart of this lies the fact that there is much less room for failure in the European biotech industry, partly because the local venture capitalist communities are much smaller than the compounded American market. Today, these communities are mainly situated in Germany, the UK, and Scandinavia, and they each depend heavily on their reputation among local institutional investors.

When it comes to raising money in Europe, it is important to have a good track record with these investors, and that means a history of funding companies that have been successful long past the IPO. Because the market is more driven by local reputation,

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there is much less tolerance for disaster in Europe than in the US, and the background for this makes sense when you consider the sheer difference in the number of public companies. In the US today, there are over 300 public biotech companies, compared with just two in Denmark and one in Germany.

The aversion to failure is also found in a more personal incarnation at the level of management. The European, and particularly the Scandinavian, chief executive officer whose company ultimately fails does not easily get a second chance. Figuratively speaking, no points are given just for trying. The personal risk involved in leaving the relative security of the pharmaceutical industry for life in the more volatile biotech is perceived as larger in Europe than in the US.

As a consequence, both management and researchers are more reluctant to join biotech startups. This has a clear impact on financing: when forming a new biotech company, Europeans ask for more capital upfront than their US colleagues. Typically, a company's projections include having 30–50 employees within 12–18 months, and a European venture capitalist will have to come up with enough funding to last at least two years at a substantial burn rate that reflects the higher short-term inducements needed to attract high-caliber talent to a startup in Europe.

Given all these circumstances, a European venture fund evaluating potential biotech investments is inclined to look for projects that will be sustainable and can make money after going public. Such an emphasis on sustainability would be reflected in the configuration of new European biotech companies as well as in their business strategies. In contrast to many American companies—particularly those of the 1980s biotech boom—European counterparts should be integrated drug discovery companies with several products in development.

A tale of two companies

One way to compare the European and US business models is to look at the central characteristics of an example of each system. Amgen is the paragon of a successful US biotech endeavor, while NeuroSearch (Glostrup, Denmark) is a young company whose overall success to date, despite recent setbacks, has inspired the current optimism in Danish biotechnology. The differences between these two companies are pronounced, from business strategy to financing to management.

Amgen was founded in 1980. Even though George Rathmann, Amgen's first chairman and CEO, came from Abbott Laboratories, a large part of the early team came directly from academia without any kind of track record in management or the

pharmaceutical industry. What the fledgling company did have were several hot targets. From the beginning, Amgen was a product company focused on developing the two proteins: EPO and G-CSF. As it turned out, both proteins became major products—Epogen and Neupogen, respectively—forming a firm foundation for further development and healthy growth. If those two projects had failed, Amgen would not have survived.

In contrast, NeuroSearch, founded in 1989 and listed on the Copenhagen Stock Exchange in 1996 as the first biotech-like company in Denmark, never relied on one or a few products to succeed. The company, which targets the large and diverse central nervous system market, has always been relatively technology-independent, as it is based on an integrated approach to drug discovery. Even if its most advanced and much awaited compound Brasofensin, for the treatment of Parkinson's disease, fails, NeuroSearch will still possess a considerable and promising pipeline and valuable technological expertise. The company's survival will not be threatened.

NeuroSearch originally grew out of the Danish pharmaceutical industry, and its management team, as well as many of its early key employees, is characterized by considerable experience in drug development. Notably, when chief executive officer Jürgen Buus Lassen was at Ferrosan (Soeborg, Denmark), he was in charge of developing Paxil—marketed by SmithKline Beecham (London) as one of the best-selling drugs in the world.

The future of venture capital

When it comes to funding biotech startups in the future, the key to success for European venture capitalists is not to adopt the fast investment return strategy—there are too many factors endemic to the European market that will not go well with such an approach. Rather, they should think along the lines of long-term profitability and seek out companies with key parameters comparable to those of NeuroSearch. This also means that the key to securing venture funding as a European biotech entrepreneur will be to focus on platform technologies and integrated discovery approaches rather than on one target or one product.

Whether the hard times experienced in the US biotech industry recently will lead to a rethinking of the local investment strategies is not clear. There is some evidence that US venture capital is beginning to lean toward the European model, as platform product companies are now performing better. However, the willingness to take significant risks at the chance of large profits is deeply ingrained in the American business ethos. One would not expect the US venture capital industry to abandon its ways quickly. ///