The e-Venture Capital Explosion, Sweden 2000

By Per Gustafsson

"An absolute explosion." That's how best to describe the market for venture capital in Internet business in Sweden today. BrainHeart has surveyed venture capital companies and found that half of them were founded in just the past two years. They have provided over 10 billion kronor – about 1.2 billion dollars – to some 500 Swedish IT projects. And more money is on the way, since tens of billions of kronor is being held in various funds, waiting to be invested.

Until recently, Swedish venture capital companies were very cautious. Companies were unwilling to take large risks. They preferred to invest in securities portfolios that contained a safe number of blue chip companies. A return of 15–25 percent over ten years was a good goal.

The new economy follows different business logic. There are no sure bets. And everything moves much faster. New actors among venture capital companies see opportunities. They act like Americans. They might lose everything, but they can also get a return of several hundred percent.

Many new actors have appeared on the scene:
Business angels (such as Kjell Spångberg in Emerging Technology) who often work behind the scenes.
Senior entrepreneurs who have left the board rooms of the old economy and entered into new partnerships with each other (for example, Jan Carlzon, formerly head of SAS, who teamed with Olof Stenhammar, founder of OM, to back Ledstiernan, or Sven-Christer Nilsson, former CEO of Ericsson, who joined with Rolf Skoglund, of Microsoft, to create StartUpFactory).
New venture capitalists who form venture capital companies on the classic model. They raise funds from institutions, wealthy individuals and families, and shareholders.
Foreign capital interests who invest in the Swedish market (such as Schroeders, which has entered SpeedVentures).

These new actors create a new type of financial sphere, in which well-known and less-known individuals and investors meet, forming a melting pot where new ideas are mixed and plans spread.

Sometimes they merge, as when *Ledstiernan* and *IT Provider* joined to reorganize computer retailer *Lap Power* by forming a new venture capital company, *E-Commerce Capital Group*. But most often, venture capital companies are relatively independent financial galaxies within the IT universe, attracting capital from various sources.

The increase in venture capital in Sweden is primarily the result of this nation's becoming a world leader in IT competence. Sweden is Europe's undisputed leader in the Internet and, with Finland, is the world leader in mobile telephony. It is estimated that 50 percent of all Swedes have a mobile phone and are connected to the Internet.

Although Swedish IT competence is recognized as world-class within companies and in the academic world, Swedes have not been especially good at transforming the new competence into new, profitable businesses. But a change is underway. The Internet boom (not the least on the Stockholm stock market) has caused many traditional investors to start looking closely into this new technology. New IT companies have seen the need for venture firms, and even created them, to help the growing number of IT entrepreneurs.

BrainHeart Magazine's study clearly shows that there are two types of venture capital companies. One consists of newly formed venture capital firms that have focused on IT and the Internet from the very start. The other is a group of somewhat older, established investment companies and venture capital companies that have recently become increasingly interested in IT.

The newly formed companies completely focus on IT, while the older venture capital firms (those formed before 1998) have mixed portfolios, heavily weighted in biotechnology.

Most venture firms in the study focus on companies based in Sweden, although a few work in an international perspective (for example, the old, well-established Investor, which has large investments outside Sweden).

The 43 firms studied have invested in 561 companies. The combined amount invested is at least 10 billion kronor. (The total of 9,896 million shown in the table is an underestimation, since a handful of companies declined to respond to this question in BrainHeart Magazine's survey.)

In addition, there are mutual funds and other funds with additional disposable capital, and these can be considered extremely large potential venture capital suppliers, having tens of billions of kronor available for IT investments.

The typical venture capital company is managed by a small team of people, who often have entrepreneurial back-

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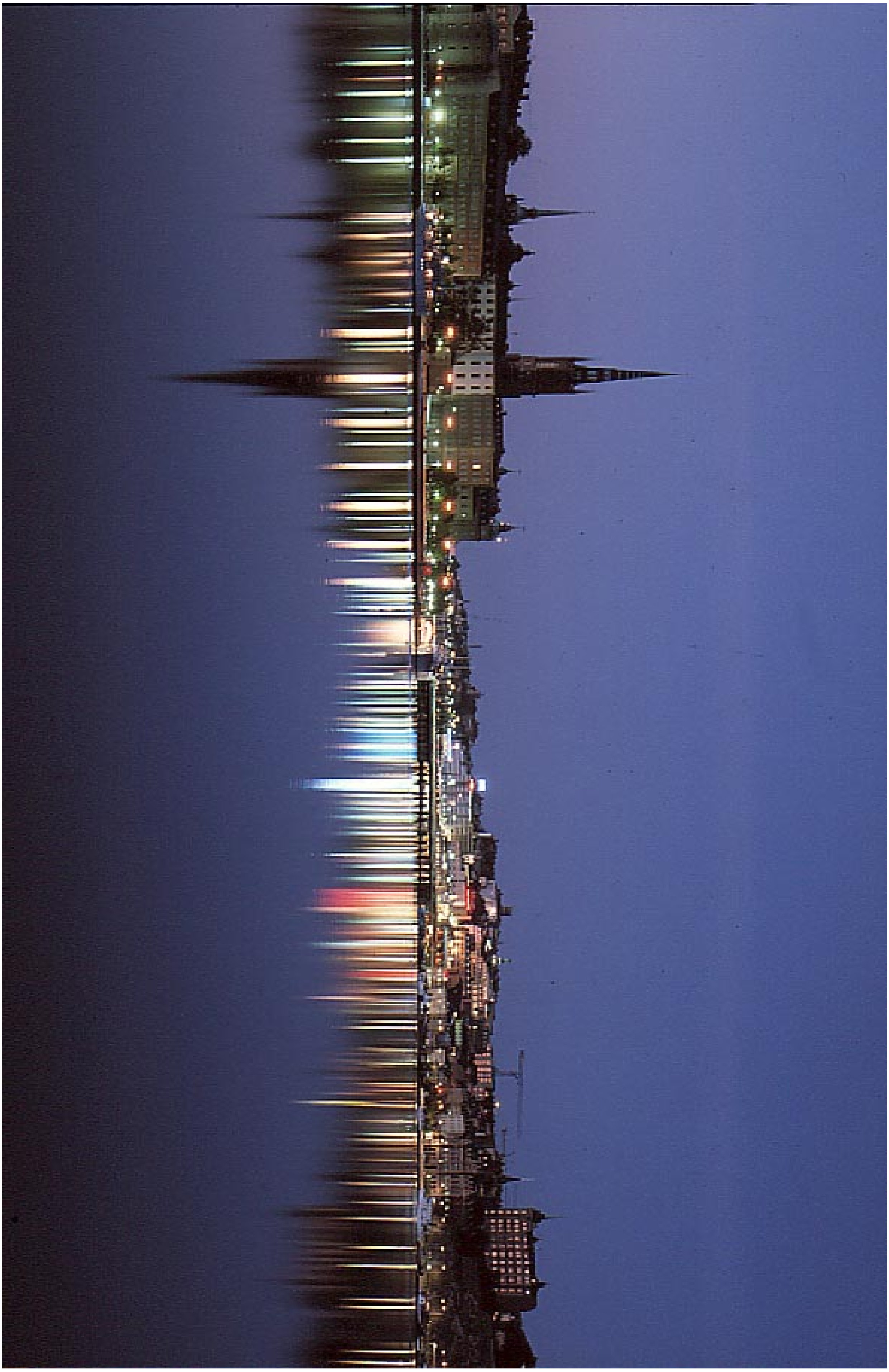

Stockholm, Capital of the Wireless Continent grounds. There are also several companies with funds in the billions of kronor that operate inter-nationally. The average venture capital company is capitalized by owners' own money or by that of private individuals or institutional investors. Companies invest in one to 20 projects. Investments in each project are modest, varying between 2 and 70 million kronor (235,000–8.5 million dollars). Companies' total investments vary between 20–150 million kronor (2.3–17.5 million dollars).

The largest investors, those that have invested over 150 million kronor (17.5 million dollars) each, are, in declining order: Emerging Technology, Investor, Cognition, Novestra, Centrecourt, Atle, EQT, CoreVentures and Ledstiernan. However, this list is not complete, since several important companies declined to provide information on invested capital. These include IT Provider, CellVentures and Speed Ventures.

The number of completed projects in which companies have exited completely or sold their interest is rather small: only 74 projects according to the companies. This is explained by the fact that most of the venture capital companies are newly formed.

» A combination of technical and marketing know-how by venture capital companies is absolutely necessary – having a superb perception of this hyper-active market leads to success. «

The responses to the study's question about the goals of the venture capital companies show that competition between the firms has greatly increased. The newly-started companies like to describe their aim to be "best in the world" or "best in Europe". Or, as a more modest company with more realistic expectations, expressed it: "At least to be largest in Scandinavia".

The willingness to take risks varies greatly. Almost half said that they enter projects very early, providing seed money, and that they consider this their mission. An equally large group responded that they invest in companies that are already in a stage of being built up and that have a business concept demonstrating it can succeed.

But this does not quite agree with the earlier description of the Swedish venture capital market, where 65 percent of risk capital is invested in the expansion phase of companies, where the business concept and company team already function and at a time when the company needs capital to expand. Early entrepreneurs had to battle for capital, while investors were in a position where they could pick and choose.

The situation in the IT field is quite different. IT capital is needed very early, at the idea stage. That 35 percent of the capital has been directed to the most risk-filled projects – in seed companies and start-ups – can be explained by the fact that such projects seldom receive more than several million kronor (two hundred thousand dollars or so) in a starting phase. Now, the IT tempo and new business logic demand more capital in an early stage.

In the old industrial society, venture capital could be allowed to work in companies for five or 10 years. But in the information society, venture capital must move in and out faster: exiting within 3–5 years through sale or public listing on the stock market. One can describe it this way: a queue of investments is forming at the exit door.

This is connected with the fact that the foundation of the new economy – information technology – is undergoing tremendous changes.

The "old Internet" – the Age of Home Pages – is being transformed more to e-commerce and e-learning. Interactivity is increasing, the Net is continuously available, and one need no longer boot up and get connected: you are always on the Net. You can get information and act on it anytime.

In the product side, we see how mobile phones and handheld computers merge to become mobile Internet terminals. In the near future more hand-held devices will be sold than PCs, according to Internet forecasters. The Internet revolution has just begun.

Specialization to specific fields is unavoidable. But few venture capital companies appear to be moving in that direction. New VC companies, to spread their risks among several fields.

However, several companies do concentrate in wireless and mobile communication. They include Y3K, Swedestart Management, StartUpFactory, Aspiro Ventures, Starthouse, Affärsstrategerna, Zodiak, Ledstiernan and BrainHeart Capital. Some other venture capital companies focus on e-commerce and e-learning.

The tempo of the new economy is extremely high. Some say it's hysteric. Venture capital companies must walk a tightrope, balancing between focussing their portfolios on one field or spreading risks. One can make a comparison with the biotechnology field, which requires long development and patient research and testing of unique products. This demands perseverance by venture capitalists. But in IT/Internet, the situation is entirely different. Companies work with similar products and services, but with tremendous pressure to turn out special versions, and where updating and improvements are forced almost overnight.

The trick is to invest early in those solutions that will stand out from the competitors, to invest in the so-called disruptive ideas that successfully break out from older technology. Then, a company will have a couple of years at the most to be a leader on the global market. □

Per Gustafsson
pergus@bahnhof.se