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## Where The VCs Are Flocking Now

A few years ago, Central Europe and Russia were shunned by big investors. Not anymore

by [Gail Edmondson](#) and [Jennifer L. Schenker](#)

What's the hottest place to invest? That's always what any self-respecting venture capitalist wants to know. In 2004, Russian tech startups were clearly off the radar screen, as Sven Lingjaerde will tell you. Lingjaerde, a VC and founder of the European Tech Tour Assn., organized a visit to Moscow for 53 venture capitalists from the U.S. and Western Europe. At the time, none of the 25 outfits that pitched to the group got funding.

Fast-forward three years, and it's a different story. Today, eight of those companies have secured Western backing. And by some estimates, three could be valued north of \$1 billion.

Finally, investors are starting to look beyond China and India and are pouring more time, energy, and money into the fast-growing economies of Central and Eastern Europe. At least \$500 million is sitting in funds targeting the region, and far more is coming from global outfits that see potential in the former Soviet bloc. With a deep pool of creative technology talent and a gross domestic product expanding at a rate of 6% to 9% per year, Eastern Europe is piquing the interest of VCs large and small. Says Yoav Sarnet, who oversees business development in the region for Cisco System ([CSCO](#))s Inc.: "As we look globally to where the next venture asset class is going to emerge, it's definitely Russia and Central and Eastern Europe."

Some VCs even say the region could soon rival India and China when it comes to spawning tech startups with global potential. While India has built a global hub for information technology outsourcing, little of the business is core research and development for cutting-edge products. Russians, Poles, and Romanians, by contrast, excel at the kind of creative development work tech startups need for breakthrough innovations, many investors say. "Central and Eastern Europe are already a better play" than China and India, says Scott Maxwell, co-founder of OpenView, which has invested 30% of a \$100 million global technology fund in the region. "The technologies are more sophisticated."

Venture investors say the region is a bargain, with the potential for finding blockbuster hits by exporting these startups' wares and knowhow to customers worldwide. Some think valuations of tech companies are as little as 10% of comparable outfits in the U.S. "You can make very small investments with mega-returns if the technology works out," says Richard Stokvis, a partner at London investment bank Europa Partners and a medical technology expert who

advises venture backers in the region.

## PROS AND CONS

For the moment, Russia is getting lots of buzz, thanks in no small part to its huge and increasingly flush consumer class. Investors like the country's vibrant domestic market for Web and mobile phone services. And the potential profits in serving Russia's 150 million consumers is clear, thanks to successes such as Yandex and Ozon, Russia's answers to Google ([GOOG](#)) and Amazon.com ([AMZN](#)).

That has investors jumping in with both feet. Asset Management Co. in Palo Alto, Calif., run by legendary VC Franklin "Pitch" Johnson, has launched a \$104 million fund called Bioprocess Capital Partners. It will invest in Russian biotech and includes \$52 million from the Kremlin. Veteran tech executive Roel Pieper, based in the Netherlands, has set up a new fund primarily targeting Russian companies, including hydrogen technologies and light jets. And Alexander Galitsky, a Russian entrepreneur turned investor, is planning a fund later this year in partnership with unnamed Western VCs. "This is just the beginning," says Joe Bowman, an American working for Russian Technologies, a \$50 million early-stage fund based in Moscow. "We're entering a new era for Russian venture capital."

Diving into Russia, though, still carries plenty of risk, and for some the country remains strictly off-limits.

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