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Private Equity and Venture Capital in Germany: How Europe's Heartland is Poised to Become the Next Bay Area

Jake Besanceney*

Abstract

This note examines the current state of private equity and venture capital activity and investment in Germany, and specifically in Berlin, in relation to the state of such activity and investment that existed in the San Francisco Bay Area prior to and following its tech explosion in the late twentieth century. Numerous factors such as political and ethnic diversity, a comparatively lower cost of living, and proximity to higher education institutes are propelling Berlin's startup and tech scenes, and are eerily reminiscent of similar factors that fueled the Bay Area's growth and attracted private equity and venture capital activity to that region.

With a tumultuous history stretching back at least a century to the early 1900s involving numerous wars and political, physical, and national divisions, Berlin has lacked resources and lagged behind in terms of investment and activity compared to its European neighbors. However, almost thirty years after the fall of the Berlin Wall and the end of the Cold War, the startup and tech scenes in the Hauptstadt are finding their footing and thriving, and seed funding and other forms of investment are beginning to flow in as a result. Factors that significantly contributed to the Bay Area's tech blow-up and reputation as a tech Mecca, are now similarly positioning Berlin to become the next capital of venture capital and private equity in Europe.

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I. INTRODUCTION.

Superficially, one might not notice many similarities between San Francisco, California, and Berlin, Germany; between the hip and trendy Bay Area, and a city fraught with historical troubles in the European heartland. One is a seaside metropolis filled with high-tech corporations and investment firms, and the other is a city situated in a country and region that experienced a tumultuous twentieth century. However, when looking at venture capital and private equity investment in these two regions, certain similarities start to appear. The conditions that contributed to the late-twentieth century boom in venture capital and private equity in San Francisco and the Bay Area—primarily a strong startup scene, and access to willing funding sources—are increasingly prevalent in Germany through the beginning of the twenty-first century. These conditions have been particularly present in a handful of Germany's major cities, such as Munich, Frankfurt, and Hamburg.

However, a more recent player has entered the German scene as of late—the capital city, Berlin. While these other German metros have enjoyed the perks of stronger influences of capitalism and westernization as a result of the country's split following the Second World War, Berlin—30 years after Reunification—is finally catching up. As a result, this remarkably diverse and international German city is set to experience a boom in venture capital and private equity that might rival—if not even surpass—that of the Bay Area.

To better contextualize the amount of private equity and venture capital investment—collectively "Seed Funding"—it is important first to understand the levels and lenses surrounding Berlin through which such metrics are measured. Much of the investment activity, including venture capital and private equity investment in Germany and Europe, is considered through a slightly larger lens focusing on the German-speaking parts of central Europe known as the DACH region—including Germany ("D" for Deutschland), Austria (A), and Switzerland ("CH" for Confoederatio Helvetica).[1] Of these three sub-regions, Germany has been the consistently strongest driver supporting this trend since at least the early 2000s, and has experienced a consistent upward trend, unlike Austria and Switzerland, which have experienced a more static or erratic pattern.[2]

For the purposes of analyzing and comparing the blossoming situation in Berlin with the boom that occurred in the Bay Area, we will look primarily at venture capital and private equity investment. Both these are similar in some regards, namely that both involve a financial backer investing in a

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[1] Kinga Edwards, *The Complete Guide To Understanding the DACH Market*, ECOMMERCE GERMANY, https://ecommercegermany.com/blog/the-complete-guide-to-understanding-the-dach-market (last visited Dec. 23, 2021).

[2] Tobias Heinrich et al., *DACH Dealmaking Powers Ahead in 2021*, WHITE & CASE LLP (Dec. 7, 2021), https://mergers.whitecase.com/highlights/dach-dealmaking-powers-ahead-in-2021.

company.[3] Both institutions also invest in tech companies, including startups.[4] However, the purposes of these institutions often differ. Whereas both venture capital and private equity firms often seek an ownership stake in somewhat more mature and developed companies, venture capital firms tend to target younger budding companies, assisting them financially to grow their company, and often do not seek to obtain a controlling share of ownership.[5] Private equity firms, on the other hand, invest in a range of companies both new and old, often with the goal of taking a controlling share of ownership, improving the company, and selling it for a profit.[6]

Venture capital and private equity serve as useful indicators of a healthy start-up scene in that a large amount of venture capital funding flowing into a region is evidence that sophisticated, early-stage investors see promise in the area. Private equity activity, on the other hand, is evidence of a thriving market that is somewhat more mature; a successful startup,[7] particularly one in need of additional growth capital, will often attract a buyer[8] to purchase the company, generating activity beyond the metric of venture capital funding alone. While venture capital and private equity investments may be referred to severally, these statistics provide a measure of the success of start-up activity at various stages of its life—venture capital early on, and private equity later on as companies flourish. These metrics are symbiotic, and their combination creates a strong statistical indicator of a healthy tech-based start-up economy, and may be referred to jointly as "Seed Funding."

The DACH region—and specifically Germany—have seen remarkable growth in both the areas of venture capital and private equity in recent years. The area within DACH that has perhaps capitalized least on this growth to this point, however, has been the capital city Berlin. Despite lagging behind, Berlin has many factors and assets within its metro area that make it a powder keg, poised to explode in a venture capital and private equity boom not unlike that of the Bay Area in the late 1980s, 1990s, and early 2000s.

II. A LOOK BACK AT THE GOLDEN STATE AND THE GOLDEN GATE.

Perhaps the biggest—or at least the most famous—private equity and venture capital boom occurred in San Francisco and the greater Bay Area in the 1990s and 2000s. This boom catapulted the Bay Area into a place of prominence in not just the United States, but the world, with startups that had

3 *See Private Equity vs. Venture Capital: What's the Difference?*, PITCHBOOK (Dec. 7, 2021), https://pitchbook.com/blog/private-equity-vs-venture-capital-whats-the-difference.

4 *Id.*

5 *Id.*

6 *Id.*

7 Potentially as a result of venture capital funding.

8 Quite possibly a private equity firm.

their roots on Sand Hill Road[9] now having evolved into companies that touch the lives of people around the globe. This Bay Area venture capital and private equity explosion provides an ideal case study to examine the factors that significantly contributed to this advancement, as well as the various policies implemented by local governments that enabled and encouraged the growth of venture capital and private equity investment, and to measure these same or substantially similar factors that are currently present and growing in Germany and Berlin. While the Bay Area serves as a model example of how to take advantage of a tech boom, it also serves as a cautionary tale of how government policies can go wrong, and how an unwieldy tech scene can lead to unforeseen consequences.

Various factors in the region combined to contribute substantially to the Bay Area economic tech boom. Some of the most critical factors to the Bay Area's success have been the availability of funding for projects, the ability to obtain such funding, and a strong willingness early on in the Bay Area's history to give out such capital resources liberally.[10] While much of the infrastructure for the budding tech industry was located in Silicon Valley, the funding infrastructure needed to support it was initially elsewhere. Modern venture capital firms originated in the Northeast, primarily in New York City and Boston, and it was not until after the tech scene in Silicon Valley had begun that venture capital firms began migrating westward to be closer to the tech industry and West Coast-based firms themselves began cropping up in the Bay Area—and not in earnest until the capital and dot-com booms.[11] While Silicon Valley has developed some of its own venture capital firms based in the immediate vicinity, such as Sequoia Capital and Menlo Ventures, New York and Northeast-based venture capital firms continue to play a role in financing startups from across the country.[12]

III. THE HISTORY OF PRIVATE EQUITY AND VENTURE CAPITAL IN GERMANY.

Private equity currently plays a substantial role both in Germany and in the DACH region, and in their respective economies. In Germany alone,

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9 *See* Keith Reid-Cleveland, *A Guide to Sand Hill Road: The Epicenter of Venture Capital*, BUILT IN SAN FRANCISCO (Apr. 1, 2020), https://www.builtinsf.com/2020/04/01/sand-hill-road. Sand Hill Road is a 5.6 mile stretch of road that connects various areas of Silicon Valley in which some of the largest tech companies today were founded. Due to this proximity, Sand Hill Road was a favorite location for budding venture capital firms.

10 *The Evolution of the Bay Area Tech Scene*, ONEPIECE WORK (Mar. 11, 2020), https://www.onepiecework.com/blog/the-evolution-of-the-bay-area-tech-scene. Liberal investment in the Bay Area primarily began in the 1970s.

11 *See Venture History 101*, VENTURE FORWARD, https://ventureforward.org/education/history-101/#riseinvc (last visited Apr. 2, 2022); *see also* ARUN RAO, A HISTORY OF SILICON VALLEY, Chapter 3 (Omniware Group 2011) (available electronically at https://www.scaruffi.com/svhistory/arun3.html).

12 *See* RAO, *supra* note 11.

more than 400 private equity firms currently operate within the country.[13] These 400 firms finance approximately 1000 companies.[14] The country hosts more than 5,500 investment portfolio management companies and involve more than 1.1 million employees.[15] In 2020, even despite the declaration of a global pandemic, €14.8 billion was invested, and between 2016 and 2020, €61.4 billion was invested.[16] Among these portfolio management companies, revenues of €207 billion in sales were reported.[17] While the declaration of the COVID-19 pandemic in early 2020 served as a slight stumbling block in the progression of venture capital and private equity in Germany, the country has regardless seen a strong and steady increase in investments in venture capital and private equity investments.[18] Private equity in Germany is undoubtedly in a healthy place—but how did it get here?

Historically, Germany has been relatively skittish when it comes to private equity and private equity firms. In 2005, Franz Müntefering, the former Vice Chancellor and chair of Germany's Social Democratic Party,[19] described private equity firms as "swarms of locusts that fall on companies, stripping them bare before moving on."[20] This attitude has slowly begun to

[13] *Der deutsche Beteiligungkapitalmarkt im ersten Halbjahr 2021*, BUNDESVERBAND DEUTSCHER KAPITALBETEILIGUNGSGESELLSCHAFTEN E.V. at 3 (Oct. 2021), https://www.bvkap.de/sites/default/files/page/2021_bvk-statistik_h1_2021_vorlaeufig_in_charts_final_0.pdf. "Bundesverband Deutscher Beteiligungsgesellschaften" translates approximately to "Federal Association of German Investment Firms."

[14] *Id.*; *see also M&A Activity: Top Sectors by Value 2006–2021 [YTD]*, WHITE & CASE (last visited Dec. 27, 2021), https://mergers.whitecase.com. Regarding M&A activity in the DACH region generally in recent years, three sectors in particular have generated both the most deal value and deal volume—industrials and chemicals; pharma, medical, and biotech; and telecommunications, media, and technology.

[15] BVK, *supra* note 13.

[16] *Id.*

[17] *Id.*

[18] *Id*. at 8. Investments in Germany saw at least a slight reduction across the board in terms of venture capital, growth, and buyout investments following the investment phase in the first half of 2020, in part due to the announcement of and global panic due to the SARS-CoV-2 pandemic. However, these figures enjoyed a relatively quick turnaround and recovery. For the second half of 2020, while venture capital and growth investment numbers remained slightly low compared to previous numbers, buyout numbers soared back to above pre-pandemic levels, rising €1.343 (million/billion) compared to the same time period the previous year (the second half of 2019 saw buyouts after the investment phase at €5.211 (million/billion), compared to €6.554 (million/billion) in the second half of 2020).

[19] *See, e.g.,* Rina Goldenberg, *Germany's Political Parties—What You Need to Know*, DEUTSCHE WELLE (Oct. 10, 2021), https://www.dw.com/en/spd-green-party-fdp-cdu-left-party-afd/a-38085900. The Social Democratic Party, or SDP, is historically the ruling party in modern German politics, and has had significant sway in the country.

[20] Charlotte Gifford, *Germany is Changing Its Tune on Private Equity Investment*, EUROPEANCEO (Apr. 27, 2020), https://www.europeanceo.com/finance/germany-is-changing-its-tune-on-private-equity-investment/; *see also* Eric Burg, *Private Equity is Honing in on the German Mittelstand*, PITCHBOOK (Mar. 26, 2019), https://pitchbook.com/news/articles/private-equity-is-honing-in-on-the-german-mittelstand. Then-Vice Chancellor Müntefering also described private equity firms as only being interested in short-term gains, and that they

change over the past decade and, as the perception of private equity sponsors in Germany improves, so too does the number of and access to deal openings in the region.[21]

One of the strengths of the German market and the DACH region, particularly over other jurisdictions in Europe and the world, is the strength of its Mittelstand[22]—small and mid-sized companies that create between one-third and one-half of the country's GDP and employ between 60% and 70% of its workforce.[23] Mittelstand companies generate revenues across a broad range, from as little as €5 million to hundreds of millions of Euros.[24] Mittelstand companies are often family-owned and tend to be attractive to private equity investors in that their revenues are steady and predictable, and they tend to contain sufficient resources that can be leveraged in a buyout.[25] The Mittelstand serves as the critical foundation of Europe's largest economy and has played a key role in the past decade in private equity making inroads despite Germany's once hard anti-private equity mentality.[26]

Often considered to be the traditional heart of the German economy, the Mittelstand model has been considered by some to be an antithesis to Silicon Valley-style entrepreneurship—that is, focusing on small and middle-sized family firms as opposed to a focus on finding "gazelles and unicorns with impressive growth rates."[27] German Mittelstand companies, often being wholly owned by individuals or families, historically have strong ties to the communities in which they were founded, with a keen eye on improving their services and products to meet the needs of consumers in these communities, as well as more broadly.[28] Mittelstand firms "value their economic and personal independence," and along those lines, have a preference for self-financing.[29] Despite being viewed by some as small family-owned businesses, Mittelstands are ultimately more than that—they value their

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effectively robbed the companies they purchase of their substance.

[21] *DACH Fundraising Report, 2020 edition*, AZTEC GROUP (February 2020), https://www.aztecgroup.co.uk/wp-content/uploads/2020/02/DACH-Fundraising-Report-2020.pdf.

[22] "Mittelstand" translated literally from German to English means something close to "middle level" or "middle class."

[23] Burg, *supra* note 21; *see also* Hanz Schulz, *Three Lessons from the German "Mittelstand,"* INTER-AMERICAN DEVELOPMENT BANK GROUP (Mar. 3, 2014), https://idbinvest.org/en/blog/three-lessons-german-mittelstand; Ulrike Hinrichs, *The German Private Equity Universe: A Comprehensive Guide for Institutional Investors 2015*, BUNDESVERBAND DEUTSCHER KAPITALBETEILIGUNGSGESELLSCHAFTEN (BVK) (Jan. 2015), at 7, https://www.bvkap.de/sites/default/files/bvk_guide_for_lps_2015_web_1.pdf.

[24] *See* Burg, *supra* note 21.

[25] *Id.*

[26] *Id.*

[27] André Pahnke & Friederike Welter, *The German Mittelstand: Antithesis to Silicon Valley Entrepreneurship?*, 52 SMALL BUS. ECON. 345, 346 (2019).

[28] *Id.* at 347, 349.

[29] *Id.* at 348.

longevity and independence, but nevertheless continue to seek to innovate and improve, perceiving themselves as belonging to the forefront of any given industry.[30] While different from the focus of Silicon Valley entrepreneurism on the possibility of finding a diamond in the rough, the Mittelstand model is similarly viable in that innovation by smaller actors remains the focus.

Germany is certainly a rising star in European private equity, although in part as a result of its historically negative perception of private equity investment, it has not yet reached the top. In measuring the success of a region with regard to private equity, there are two important measures: first, the number of private equity firms and, second, the level of private equity investment. While these two metrics can and often do correlate, they remain distinct, and the presence of the first is not strictly necessary for the second. Over the past several decades, some German cities have enjoyed more success than others in attracting venture capital and private equity firms. Cities like Munich, Frankfurt, and Hamburg of the former West have traditionally enjoyed the most success.[31] While Berlin has ranked highly in recent surveys of European venture capital and private equity activity, it continues to lag behind other European capitals—such as Paris and London—by a sizable margin.[32] However, due to recent trends, Berlin—and Germany as a whole—are poised to make significant bounds that might land them in the driver's seat of European venture capital and private equity.

Prior to the COVID-19 pandemic and its economic impacts, German venture capital experienced varying degrees of vacillation through 2019, in part due to drops in the venture capital fundraising climate and lackluster IPOs; however, despite this drop, confidence by private equity firms, investment managers, and others in the industry in German venture capital remained positive and "in the green."[33]

Seed Funding in Germany and the DACH region responded in resilient

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30 *Id.* at 349, 355.

31 *See generally Top Private Equity Firms in Germany by HQ City*, PITCHBOOK (Oct. 22, 2021), https://pitchbook.com/blog/top-private-equity-firms-in-germany-by-hq-city.

32 *See* Elisângela Mendonça, *Paris Emerges as Europe's Venture Capital Hub*, PRIVATE EQUITY NEWS (Dec. 5, 2019, 2:33 PM), https://www.penews.com/articles/paris-emerges-as-europes-venture-capital-hub-20191205. In a survey of investment activity between 2007 and 2015, the Île-de-France region (the region surrounding the French capital, Paris) received €3.1 billion in investments, the most of any other region within Europe during that timeframe. London received the second highest level of investments at €2.8 billion, while Berlin placed as a distant third, attracting €1.7 billion in investments.

33 *See* Dr. Georg Metzger, *Private Equity Market Sentiment Continues to Fall: German Venture Capital Barometer: 4th Quarter 2019*, KREDITANSTALT FÜR WIEDERAUFBAU (Mar. 18, 2020), https://www.kfw.de; *see also* Metzger, *Private equity market sentiment continues to fall: German Private Equity Barometer: 3rd Quarter 2019*, KREDITANSTALT FÜR WIEDERAUFBAU (Nov. 28, 2019), https://www.kfw.de. The German Venture Capital Barometer measures the confidence in and around Germany in the prospects of venture capital investment in the region and is reported on a quarterly basis.

fashion to the brief downturn caused by COVID-19 due to a number of reasons, including a swift, strong, and thorough response to the crisis by governments, a wave of pre-pandemic activity that was not entirely lost due to the virus, and the strength of mid-cap market—the Mittelstand—activity.[34] From Q1 to Q3 in 2020, venture capital investments in startups in the DACH region nearly doubled, reaching €2.4 billion in Q3.[35] By Q4 2020, private equity investment in the region had already recovered to pre-pandemic levels, and was continuing on an upward trend.[36]

In general terms, private equity buyers are expressing increasing interest in Germany and the DACH region as a whole. Looking strictly at private equity activity and buyouts, while the region faced a noticeable decline leading up to and during the 2008 financial crisis in terms of both deal value and volume, in the past decade it—and in particular Germany—has experienced a steady and marked increase. After deal volume bottomed out in 2009 at only 72 deals in Germany and 110 in the entire DACH region, and after deal value bottomed out in 2010 with deal value only reaching US$4.92 billion in Germany and DACH only reaching US$9.97 billion, the region has shown a strong recovery and showing an upward trend that does not appear to be slowing anytime soon.[37]

Historically having always been approximately level with or below France and the United Kingdom in terms of private equity investment, in the past year private equity investment in Germany has taken the launch it needs—perhaps propelled in part by results of and responses to the COVID-19 pandemic—to become the top player in Europe.[38] While the United Kingdom and France saw strong rebounds in private equity activity following the initial pandemic slump, they have since faltered, and activity has begun

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[34] *See* Emma-Victoria Farr, *How Did DACH Dealmakers Weather the Coronavirus Pandemic Better than Their European Neighbours*?, MERGERMARKET (Jul. 14, 2021), https://events.mergermarket.com/insights/how-did-dach-dealmakers-weather-the-coronavirus-pandemic-better-than-their-european-neighbours.

[35] Felix Faltin, *The DACH Report: An Analysis of Tech and Venture Capital in the German-Speaking World*, MEDIUM (Dec. 8, 2020), https://medium.com/speedinvest/the-dach-report-an-analysis-of-tech-and-venture-capital-in-the-german-speaking-world-2019-2020-980969177dbd. Middle-market companies, or "Mittelstand," contribute significantly to the strength of the German financial system and activity.

[36] *Id.*

[37] *Private Equity Activity by Value 2006–2021 [YTD]*, WHITE & CASE (last visited Dec. 27, 2021), https://mergers.whitecase.com; *Private Equity Activity by Volume 2006–2021 [YTD]*, WHITE & CASE (last visited Dec. 27, 2021), https://mergers.whitecase.com. Using data available from Mergermarket (available severally at https://members.mergermarket.com/mergermarket-dach-ma-and-private-equity-data-trends), New York-based law firm White & Case has compiled data on merger activity in the DACH region by country. This data is then further separated into overall M&A activity, private equity activity, and what sectors have seen the most M&A activity, during the time period from 2006–2021.

[38] *See M&A Explorer*, WHITE & CASE (last visited Dec. 28, 2021), https://whcs.law/3s5PhaC.

to decline.[39] Private equity investment in the United Kingdom and France, while both experiencing sudden and steep drops in both deal value and volume due to the outbreak of the COVID-19 pandemic in early 2020 much like Germany, both also experienced a strong rebound in the latter half of the year and into 2021.[40] However, after an initial rebound, private equity activity in the United Kingdom and France has begun to falter and decline after hitting, in some instances, record or near-record numbers; while Germany's private equity activity has only continued to rise following its initial pandemic dip.[41]

IV. A "POOR, BUT SEXY" PAST LAYING THE GROUNDWORK FOR A RICH AND REWARDING FUTURE.

For years, Berlin has been considered by many to be "arm, aber sexy"—meaning "poor, but sexy"—a phrase that caught on after being spoken during a TV interview in the early 2000s by then-Mayor Klaus Wowereit referring to the spirit of the city.[42] In looking exclusively at the venture capital investment in German city-states—that is, not simply cities, but cities that are also German states in their own right[43]—Berlin has often taken second place, behind the likes of Hamburg and Bremen, both cities that were in the former West Germany.[44] However, in the third quarter of 2013, for the first time, Berlin finally reached the top spot in terms of city-state venture capital investment. Despite becoming the premier venture capital city-state in

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[39] *See id.*

[40] *See id.* From Q1 2020 to Q2 2020, the United Kingdom experienced a drop from US$18.62 billion to US$7.7 billion in deal value, a 58.6% reduction; and in terms of deal volume, the United Kingdom experienced a drop in that time frame from 117 deals to only 56 deals. Similarly from Q1 2020 to Q2 2020, France experienced a drop from US$15.67 billion to US$4.21 billion, a 73.1% reduction; in terms of deal volume, France experiences a less drastic decline—down from 87 deals to only 53 deals.

[41] *See id.* In rebounding from its initial pandemic decline, the United Kingdom returned resurgently, hitting a high of US$46.26 billion in deal value in Q3 2020, and in Q1 2021 hitting a deal volume high of 223 deals. France experienced a similar—albeit somewhat smaller—resurgence, hitting a high of US$38.49 billion in deal value in Q2 2021, and hitting a deal volume high in both Q1 and Q2 2021 of 111 deals. However, both deal value and volume have begun to decline from the United Kingdom and France in the latter half of 2021. German deal value and volume, however, continues to climb. Beginning at a pandemic low in Q2 2020 of US$1.73 billion and 48 deals, Germany has since climbed to US$28.46 billion and 115 deals in Q3 2021, and has experienced no such levelling-off or drop-off as its European neighbors have.

[42] *See* Bert Schulz, *15 Jahre "Arm, aber sexy"-Spruch, Und heute? Reich, aber öde!*, TAZ (Nov. 10, 2018), https://taz.de/15-Jahre-Arm-aber-sexy-Spruch/!5546816/.

[43] German city-states, for the purposes used here, does not refer to city-states such as Monoco, Vatican City, or Singapore. The closest comparison that might be drawn is Washington D.C.—while D.C. is both a city and state/territory, it still maintains rank beneath that of the greater United States of America.

[44] *See* Scheuplein et al., *Berlins Aufstieg als Finanzzentrum für Venture Capital*, WESTFÄLISCHE WILHELMS—UNIVERSITÄT MÜNSTER, https://edoc.ku.de/id/eprint/17613/.

Germany, however, in that same year, Berlin still lagged behind non-city-state Munich.[45]

The leaders of entrepreneurship, venture capital, and private equity in Germany have perennially been Munich and Frankfurt, although this is quickly changing. Berlin, the capital of the communist former East, is quickly catching up to its previously Western siblings. With a new startup being founded on average every twenty minutes, Berlin is shaping up to make a name for itself on the international stage, and is quickly becoming a leader in the DACH region.[46]

While cities in the former West have been particularly impacted in regard to economic development and opportunities by the influences of Western nations such as the United States, England, and France, Berlin is in a unique situation given the geographic and political landscape of post-War Germany. Germany, and in particular the German capital city, have experienced a tumultuous twentieth century, and the effects of this history continue to reach into the modern day. In 1945, following Germany's defeat in World War II, the county and the capital were divided into four distinct sectors—one each for the United States, France, Great Britain, and the USSR. While technically and on paper split into four, this division had the greater effect of effectively being split into two—the capitalist Bundesrepublik Deutschland, commonly referred to as West Germany; and the communist Deutsche Demokratische Republik, commonly known as East Germany.

When the two reunified in 1990, compatibility issues, created by the almost 50-year schism, caused difficulties that persist to varying degrees through today.[47] Given the city's relative insulation from Western influence, despite the West's best efforts to keep the Western sectors of Berlin "up-to-date" and under capitalist influence, being located behind the Iron Curtain nevertheless made a clear impact.[48] In addition to the problems related to economic development faced by Berlin during the Cold War, Reunification has posed its own unique and continuing challenges in the city, as well as in the nation at large. In a recent polling of public opinion of those located in the East, only 38% considered Reunification to have been a success, and many considered themselves to be second-class citizens compared to their Western counterparts.[49] However, as the effects of Reunification and the challenges of integrating the former East into the West begin to fade into the

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45 *See id.*

46 Alex Riabtsev, *The Startup Ecosystem of Berlin*, STARTUP JEDI (Oct. 29, 2020), https://startupjedi.vc/content/startup-ecosystem-berlin.

47 *See e.g.*, Marcel Fürstenau, *United Germany? The East Lags Behind*, DEUTSCHE WELLE (Oct. 3, 2020), https://www.dw.com/en/germany-reunification-2020/a-55131890; Stephen Beard, *East Germany Still Reeling from the Economic Aftermath of the Berlin Wall*, MARKETPLACE (Nov. 8, 2019), https://www.marketplace.org/2019/11/08/berlin-wall-economic-aftermath-affects-east-germany/.

48 *See, e.g.,* Fürstenau, Beard, *supra* note 47.

49 Beard, *supra* note 47.

rearview mirror, Berlin—an already vibrant, diverse, and thriving metropolis—is now poised to become a financial center for venture capital investment, as well as perhaps a premier destination for venture capital firms.[50]

Despite struggling both economically and otherwise at various points over the past century, due to such factors as ethnic and political diversity, proximity to leading education institutes, and affordable housing, Berlin is particularly well-positioned to reap the benefits of an explosion in business and commerce—including an explosion in Seed Funding. While its history throughout the twentieth century is undoubtedly grim, the city's past turmoil and troubles serve to create an electric undercurrent that fuels some of its greatest strengths.

One of Berlin's key strengths that contributes to its potential to experience an explosion in venture capital and private equity growth is its unique status as a remarkably diverse metropolis that exists as a bridge between the West and the East. Berlin is diverse in both ethnic and political terms,[51] and while this diversity might at times serve as somewhat of a stumbling block here and there in various regards simply due to the potential for conflicts that inherently lie between individuals of differing backgrounds—given Berlin's past, this has historically been particularly relevant for the divisions between capitalist- and communist-leaning individuals, groups, and ideologies.

However, despite any potential difficulties, Berlin's diversity ultimately serves much more as a tremendous strength in that it makes the city a center point where the capitalist West and the formerly communist-East converge. Thinking back to the context of the post-war period and the Cold War, Berlin remains at the epicenter of where two expansive and powerful empires once clashed—the United States and the greater West on one side, and the Union of Soviet Socialist Republics (U.S.S.R.) on the other. Despite the collapse of the U.S.S.R. in the early 1990s, thirty years has proven to be short in the expanse of history and in relation to the reach and might of the Soviet Union, and cultural and political differences still run deep and often impact the daily lives of those living in Germany's capital city.[52]

Another strength of Berlin as a hub for venture capital and private equity

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50 *See* Scheuplein et al., *supra* note 44.

51 *See* Kirsten Grieshaber, *Germany's Diversity Shows as Immigrants Run for Parliament*, ASSOCIATED PRESS (Sep. 22, 2021), https://apnews.com/article/immigration-middle-east-elections-germany-migration-5bcf3a55e7ba0f55edde2effadc0c190; *see also Zensus 2011*, Statistik Berlin Brandenburg (accessed Oct. 15, 2022), https://www.statistik-berlin-brandenburg.de/bevoelkerung/zensus/zensus_2011. Berlin's population has approximately 35% of residents with foreign roots.

52 *See, e.g.*, *Annual Report of the Federal Government on the Status of German Unity 2020*, FEDERAL GOVERNMENT COMMISSIONER FOR THE NEW FEDERAL STATES (Apr. 7, 2021) (detailing the ongoing status of German Reunification and current divides that still exist as a result of the splintering of the country during the Cold War).

is the accessibility it offers to higher education.[53] A strong foundation and the ability to grow talent is critical to attracting venture capital and private equity.[54] Similar to Silicon Valley and the presence of Stanford University and the University of California—Berkeley in its vicinity, Berlin succeeds in this regard by having universities within the metro area that are ranked and considered highly both in Germany and around the world, such as Humboldt Universität zu Berlin in Mitte,[55] and Freie Universität in Dahlem.[56] Germany itself offers a host of world-renowned universities, such as Ludwig-Maximilians-Universität and Technische Universität in Munich,[57] and Heidelberg Universität in Heidelberg.[58] Higher education in Germany is also offered at low- or no-cost in many instances, enabling a larger portion of the population to access education, and for a greater portion of the population to become talented.[59] In addition to being able to cultivate talent and provide higher education within Berlin and Germany itself, in part due to its reputation as a diverse and truly international city, Berlin has enjoyed success in attracting talent from abroad.[60]

Despite an ongoing rise in housing costs and an increasingly short housing supply in Berlin,[61] another advantage of Berlin over other European metro areas is a comparatively cheaper cost of living—similar to the comparatively affordable housing market present in Silicon Valley and the Bay Area prior to its tech boom.[62] In recent years, the average monthly rental cost of an apartment has remained well below that of other European metro areas, including other major venture capital investment and aspiring technology hubs, such as Paris and London.[63] Despite being the most

53 *See* Florida & Mellander, *infra* note 81.

54 *Id.*

55 "Mitte" translated from German to English means literally "middle"—in reference to the city center.

56 *See* FREIE UNIVERSITÄT BERLIN, https://www.fu-berlin.de (last visited Feb. 17, 2022).

57 *See* LUDWIG-MAXIMILIANS-UNIVERSITÄT MÜNCHEN, https://www.lmu.de/de (last visited Feb. 17, 2022); TECHNISCHE UNIVERSITÄT MÜNCHEN, https://www.tum.de (last visited Feb. 17, 2022).

58 *See* UNIVERSITÄT HEIDELBERG, https://uni-heidelberg.de/de (last visited Feb. 17, 2022).

59 *See generally Is College Free in Germany? Here's the Truth!*, STUDYING IN GERMANY (last visited Apr. 2, 2020), https://www.studying-in-germany.org/is-college-free-in-germany/.

60 *See, e.g., International Students Love Berlin! Here's Why:*, STUDY.EU (last updated Jan. 24, 2022), https://www.study.eu/article/international-students-love-berlin-heres-why.

61 *See, e.g.*, Norbert Koch-Klaucke and Katrin Bischoff, *Mietendeckel gekippt: Jetzt haben viele Berliner Angst, auf der Straße zu landen*, BERLINER ZEITUNG (Apr. 16, 2021, 6:40 PM), https://www.berliner-zeitung.de/mensch-metropole/mietendeckel-gekippt-jetzt-haben-viele-berliner-angst-auf-der-strasse-zu-landen-li.153213?pid=true.

62 *See* Patrick Carlisle, *30+ Years of Bay Area Real Estate Cycles - Compass*, BAY AREA MARKET REPORTS (last updated Nov. 2021), https://www.bayareamarketreports.com/trend/3-recessions-2-bubbles-and-a-baby. Toward the beginning of the Bay Area's tech boom, the cost of housing in the Bay Area was comparatively cheaper than the rest of the United States.

63 *European Cities Report 2018*, KNIGHT FRANK (2018), at 4, https://content.knightfrank.com/research/635/documents/en/european-cities-review-2018-5810.pdf. In 2018, the average

populous city in Germany, having almost twice the population of the second biggest city,[64] Berlin similarly had a lower average monthly rental apartment cost than other venture capital hot spots in Germany, such as Munich and Frankfurt.[65] Despite being the largest population center and metro area in the entire DACH region, Berlin can claim a competitive if not lower average monthly apartment rental cost than metro areas in its neighboring German-speaking countries, such as Zürich and Geneva in Switzerland and Vienna in Austria.[66]

V. BERLIN AND GERMAN REGULATORS MUST STRIKE WHILE THE IRON IS HOT AND TAKE NEXT STEPS TO FULLY CAPITALIZE ON THE OPPORTUNITY AT HAND.

Given the rising competition among major European cities attempting to court venture capital activity and private equity interests, there are several things that both the German federal government and Berlin can do to position themselves to fully capitalize on their growing venture capital and private equity environments.

There are a handful of theories as to what specific set of factors allow for venture capital—and thereby private equity—to be successful in Berlin. One such theory is the "centralization" theory, which hones in on the location and availability of resources that contribute to a successful and healthy venture capital and private equity environment, and that accounts for the relative success of Frankfurt am Main as a hub for venture capital.[67] The centralization theory focuses on whether a given location has or can offer various highly specialized service providers that are able to contribute to venture capital success.[68] In Frankfurt, it is theorized that the movement of the Federal Bank of Germany to the metro area created a domino-like effect

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monthly rental cost of an apartment in Paris was €18.00 per square meter; and in London, €28.20 per square meter. In Berlin, the average monthly rental cost of an apartment was far below that of these other major European metro areas—comparatively, a mere €9.80 per square meter.

64 *See Population of Cities in Germany (2022)*, WORLD POPULATION REVIEW, https://worldpopulationreview.com/countries/cities/germany (last visited Apr. 2, 2022).

65 *See European Cities Report 2018*, *supra* note 63. In 2018, the average monthly rental cost for an apartment in Frankfurt was EUR 13.30 per square meter.

66 *See Bau- und Wohnungswesen 2016*, SCHWEIZERISCHE EIDGENOSSENSCHAFT (Apr. 9, 2018), at 18, https://www.bfs.admin.ch/bfs/en/home/statistics/catalogues-databases/graphs.assetdetail.4966444.html. In 2016, the average monthly rental cost for an apartment in Geneva, Switzerland was approximately CHF 1,390. In Zürich, Switzerland, the average monthly rental cost was approximately CHF 1,550; *see also European Cities Report 2018*, *supra* note 63. Even looking to Austria, Berlin's average rental cost was competitive—for 2018, the average monthly rental cost for an apartment in Vienna was €9.40 per square meter. Even Vienna, the closest metro area to Berlin in terms of average monthly rental cost, and also a capital city, was only €0.40 per square meter per month difference for housing.

67 Scheuplein et al., *supra* note 44, at 3.

68 *Id.*

that eventually resulted in the relocation of—or at least tended to result in the relocation of—all other important parts of the German financial sector to the city.[69]

While the centralization theory holds some truth, the Bay Area proves that the centralization of financial resources and a thriving tech scene are not strictly necessary. Whereas New York City served as a venture capital funding center for Silicon Valley when it lacked local funding infrastructure,[70] an area of Germany with an already-established financial scene—such as Frankfurt—could compliment the upstart tech scene in Berlin. The presence of the current venture capital and financial institutions primarily outside of Berlin need not necessarily hinder or otherwise work against the capital city's ascendency; it simply means connections must be built, if and until such institutions become more well-established within Berlin's own borders. As Silicon Valley illustrates, where tech and early venture capital investments from afar are successful, firms will be drawn to the area to operate closer to the heart of the action.

Another theory is the "co-evolution" theory.[71] Instead of focusing strictly on the location of any given institution or set of institutions, the co-evolution theory instead focuses on the relationship between high-tech corporations, startups, and developments, and venture capital investors and firms.[72] Generally developed in the 1980s and 1990s,[73] this theory postulates that high-tech companies and venture capital firms grew up, advanced, and thrived off of each other, together[74]—a symbiotic relationship of sorts. According to the co-evolution theory, where high-tech industry and startups, budding or established venture capital firms and investors, and research facilities and capabilities all co-existed, the three would feed into and fuel each other, generating talent from within while simultaneously attracting it from afar.[75] A snowball effect would thereby be created—potentially only a handful of high-tech, venture capital firms, and research institutions in one single location or area can work together to create new and successful technologies and products that invite further high-tech companies, venture capital firms, and research facilities to relocate to the area.[76]

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69 *Id.*

70 At least initially.

71 Scheuplein et al., *supra n*ote 44, at 3.

72 *Id.*

73 This theory was articulated and circulated around the time Silicon Valley was beginning to enjoy great success and enter the venture capital and private equity spotlight.

74 Scheuplein et al., *supra* note 44.

75 *Id.*

76 *Id.*; *see also* John Hennessy, Stanford University, *Silicon Valley: History and Secret*, STANFORD UNIVERSITY (Apr. 21, 2004), https://ecorner.stanford.edu/videos/silicon-valley-history-and-secret/ (detailing how the presence of Stanford University—a top research institution in the world—and its location in the Bay Area played a large role in the early and continuing development of Silicon Valley).

However, while theories may provide a roadmap on which Berlin might find Seed Funding success, several issues remain that serve as roadblocks to fully realizing such potential. First, the growth of capital available in Berlin remains behind that of the Bay Area and London, and is not keeping pace with the growth of entrepreneurship present within the metro area.[77] The availability of capital is of great importance, and a vital part of what enabled the Bay Area's boom was remarkably liberal investments of capital being thrown at almost any potentially reasonable idea.[78] While Berlin currently has a number of seed funds that provide billions of Euros to support the city's venture capital scene,[79] it nevertheless continues to lag behind.[80]

Several factors contribute to the willingness of investors to provide venture capital funding in a given metro area.[81] Numerous indicators tend to correlate with strong venture capital investment in a metro area, namely the presence of high-tech industry, the presence of talent and a more highly educated population, and diversity.[82] While still behind some of its European peers, such as London, the high-tech industry in Berlin is quickly rising to prominence. In recent years, Berlin has been called home by a myriad of tech businesses, such as challenger bank N26 and online car marketplace AUTO1.[83] While the comparative lack of capital availability is no doubt a concern, it is not entirely unlike the Bay Area—a remarkably strong and vibrant entrepreneurship presence, albeit without capital in close proximity. As Silicon Valley shows, where a well of untapped entrepreneurial potential is discovered, the resulting economic tech boom will undoubtedly draw the necessary resources to continue to fuel that boom.

In addition to being a diverse city generally, Berlin's diversity is further amplified through the city's active integration of diversity at the university level.[84] However, while talent is certainly present and on the rise in Berlin,

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77 Riabtsev, *supra* note 46; *see also* Alejandro Cremades, *Top 10 Cities Around the World to Seek Investors*, FORBES (Feb. 7, 2019, 7:59 AM EST), https://www.forbes.com/sites/alejandrocremades/2019/02/07/top-10-cities-around-the-world-to-seek-investors.

78 ONEPIECE WORK, *supra* note 10.

79 Riabtsev, *supra* note 46.

80 *See also* Scheuplein et al., *supra* note 44. Berlin has been criticized by many in regard to its rising star-status in the venture capital world. Several analysts have postulated that the city cannot and will not be successful due to a lack of investment funding, when compared to other areas that are or have been successful in cultivating a thriving venture capital scene.

81 *See* Richard Florida & Charlotta Mellander, Rise of the Startup City: The Changing Geography of the Venture Capital Financed Innovation, Centre of Excellence for Science and Innovation Studies, at 12-13 (Sep. 2014) (available digitally at https://static.sys.kth.se/itm/wp/cesis/cesiswp377.pdf). A study was conducted of 130 metro areas that received venture capital investment, and correlations were drawn relating to various economic, demographic, and social factors that might contribute to—or detract from—venture capital investment in a given metro area.

82 *Id.*

83 *See* Leah Hodgson, *Is Berlin Europe's Next Big Tech Hub?*, PITCHBOOK (Mar. 11, 2019), https://pitchbook.com/news/articles/is-berlin-europes-next-big-tech-hub.

84 *See* Integration of refugees, STATE OF BERLIN (last visited Dec. 28, 2021),

the effects of the Cold War still noticeably persist. Prior to and throughout the split between East and West, the East experienced "brain drain," and many of those most motivated and talented individuals who were able to flee to the West did so.[85] The disparity and talent gap between the former halves continues to have lasting impacts on the country and region, and it is uncertain when equality of talent will be realized.[86]

Second, despite being a remarkably multicultural and diverse city, and despite English being the preferred language of entrepreneurs, German bureaucracy continues to operate exclusively in the German language, complicating and adding unnecessary steps to processes that ultimately hinder entrepreneurs in Germany—if not perhaps even potentially dissuade them from coming to the country in the first place.[87]

Third, the current state of employee stock option plans in Germany make it difficult for startup employees to easily benefit from their corporate startup success, and reforms to such systems could make the prospect of creating a startup in Germany more appetizing.[88] At the 2019 World Economic Forum, stock option policies were determined to be one of the foremost hindrances to tech growth in Europe.[89] Depending on the mechanics of how they are taxed, employee stock option plans can be attractive options for budding startups, or startups that might otherwise not be in ideal financial condition, as they allow employees to take equity in the company as compensation.[90] Assuming a company does well, employees who received these options might draw on them to receive financial compensation at a later date.[91] However, there is also the possibility that should a company trend in a negative direction, such options might decrease in value to the point of potentially being worthless.[92] As a result, some startup employees, including those of tech startups in Europe, might be reluctant to accept employee stock options as compensation.[93]

France, seeking—like Germany—to be a city on a hill in the technology industry, has implemented various reforms to its employee stock options schemes to reduce taxation for foreign companies, as part of the "BSPCE."[94] This reduction in tax burden has helped French startups enjoy more success

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https://www.berlin.de/sen/wissenschaft/en/policy/artikel.711405.en.php.

85 *See* Beard, *supra* note 47.

86 *Id.*

87 Riabtsev, *supra* note 46.

88 Horstmann, *infra* note 104.

89 *See* Maija Palmer, Marie Mawad, & Catherine Treyz, *Europe Loosens Rules on Stock Options, But Employees are Still Skeptical*, SIFTED (Jan. 20, 2020), https://sifted.eu/articles/stock-option-changes-europe/.

90 *Id.*

91 *See id.*

92 *Id.*

93 *Id.*

94 *Id.*

in both attracting and retaining talent, and for foreign tech companies that operate and have offices in France, this reform was "nothing short of essential."[95] Other countries in Europe, such as Ireland, have attempted to implement new tax reforms on employee stock options to a considerably lesser degree of success; Ireland attempted to implement a scheme that would tax employee stock options as capital gains, but due to a wealth of restrictions imposed by this scheme, employee stock options under it have seen remarkably little adoption.[96]

By contrast, in Germany, employee stock options are practically nonexistent, in large part resulting from the immediate timing and steepness at which such options are taxed.[97] As it currently stands, employee stock options granted in Germany are taxed the instant they are granted, much in the same way as an ordinary salary would be.[98] This hurts startups and their employees, as these individuals must pay a tax on money which they do not actually have in their pockets, and as a result, the government is also at a greater risk of such individuals being unable to pay it the tax it is owed.[99]

Instead of using such ordinary employee stock options, German startups have used a workaround of sorts in the form of virtual, or "phantom," stock options.[100] These virtual stock options seek to emulate a more American-like stock option plan in which taxation occurs at the time an employee receives money from the equity; however, despite triggering taxation at a more opportune time, virtual stock options are still taxed at a comparatively high rate, and such programs are difficult to implement.[101] Startups and groups representing them have increasingly lobbied for change in German stock option plan regulations, stating that if a proper stock option regime remains unimplemented, Germany will be at a "major disadvantage in the global war for top talent."[102] While many in the entrepreneurship and tech scene in Germany believe the Bundesregierung has a desire to support startup activity within the country and is generally in favor of innovation, those familiar with the current scheme believe the government is not listening to experts, does not fully grasp what is necessary for startups to enjoy greater success, and is resistant to any plan that grants tax breaks.[103]

In considering how Berlin can improve to capitalize on its entrepreneurship, tech, and Seed Funding potential, it is equally important to remember nothing lasts forever. While San Francisco and the Bay Area

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[95] *Id.*

[96] *Id.*

[97] *Id.*

[98] *Id.*

[99] *Id.*

[100] *Id.*

[101] *Id.*

[102] *Id.* These comments were made by Christian Vollman, the founder of Nebenan, a social media platform headquartered in Berlin, and an advocate for startups in Germany.

[103] *Id. See generally* GRÜNDERSZENE, https://www.businessinsider.de/gruenderszene/.

certainly enjoyed a boom that lifted it to global prominence the past several decades, the future of Silicon Valley is somewhat uncertain. During the COVID-19 pandemic, the venture capital and tech scenes in many locations, including Germany and the DACH region, held relatively stable, with their growth and growth potential not having been damaged.[104]

The same cannot necessarily be said for the Bay Area. Silicon Valley is to some degree suffering from its own success—after becoming a tech Mecca, the massive influx of individuals, corporations, and capital subsequently led to shortages in housing and a skyrocketing cost of living.[105] This has resulted in a subsequent exodus in recent years, with tech companies and startups fleeing to escape the rising costs of the Bay Area. Once COVID-19 caused a shift to remote work, this exodus was only accelerated.[106] Tech and venture capital are not only migrating from San Francisco to other parts of the United States, however; rather, the decentralization of venture capital is promoting growth abroad as well.[107] Over the course of the pandemic, Germany's venture capital and private equity have continued to thrive, with venture capital activity in the country higher than that of its neighbor France—€6.7 billion in Germany compared to €5.7 billion in France.[108] While Berlin is enjoying the fruits of these occurrences so far and is not experiencing the negative post-boom side effects as the Bay Area is, it must be aware of and ready to address such effects should they arise. In part due to the potential for these negative impacts to hamper Seed Funding potential and realization, regulators in the European Union are analyzing how a more controlled and healthier tech environment can emerge on the continent, including in Berlin.[109]

VI. CONCLUSION.

Germany, and specifically Berlin, is poised to experience just as big a boom as the San Francisco Bay Area of the 1990s and 2000s, if not possibly even bigger. However, while current conditions certainly make such growth possible, there are at least a handful of ways regulators can make changes to fully capitalize on this opportunity. The Bundesregierung has the opportunity

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[104] Uwe Horstmann, *Germany's VC Industry is Ready to Take Off, But Bureaucrats Need to Release the Handbrake*, TECHCRUNCH (July 9, 2021, 1:30 AM CDT), https://techcrunch.com/2021/07/08/germanys-vc-industry-is-ready-to-take-off-but-bureaucrats-need-to-release-the-handbrake.

[105] *See* Levi Sumagaysay, *Why a Majority of Silicon Valley Residents Want to Move*, MARKETWATCH (Oct. 13, 2021, 8:26 AM ET), https://www.marketwatch.com/story/why-a-majority-of-silicon-valley-residents-want-to-move-11634067042.

[106] *See* Ryan Heath, *Why Silicon Valley Could Become Tomorrow's Detroit*, POLITICO (Dec. 18, 2020, 9:00 AM EST), https://www.politico.com/news/2020/12/18/silicon-valley-bay-area-business-model-448065.

[107] *Id.*

[108] Horstmann, *supra* note 104.

[109] Horstmann, *supra* note 104.

to take various steps and adopt various policies that can further encourage and allow for the full realization of venture capital and private equity potential, both in the country generally, and in its capital Berlin. Policy decisions—such as reducing bureaucratical hurdles like opening important governmental documents and functions by offering language options beyond strictly German—that is, namely English; being more forgiving on taxing employee stock options to allow budding and/or struggling startups to more easily compensate and retain talent; as well as reducing and being more flexible with licensing costs to encourage spinoff companies and allowing talent to be more fully realized and capitalized upon therein—can ignite an already-primed and ready to explode entrepreneurship scene in Germany, with the potential to catapult the country, and specifically its capital, to venture capital and private equity prominence in not only Europe, but the world.

Cities like Frankfurt and Munich have long held the crown as the capitals of private equity in Germany, although the venture capital scene thriving in Berlin is driving a shift towards the capital city. Although Frankfurt is currently regarded as the financial focal point of Germany, Berlin has its strength in its flourishing entrepreneurship, much like New York was to Silicon Valley. Despite Munich also having a healthy amount of entrepreneurship, Berlin is unrivaled in its position as a diverse and truly global city, enabling it to challenge and even overtake its more established Bavarian counterpart in terms of Seed Funding. Always a bridesmaid throughout history in more ways than one, the city on the Spree is finally shaping up to be a proper bride in the private equity world.