The geeks shall inherit the earth

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Australian entrepreneurs are being forced to leave home in search of the funding they need to become the next YouTube in the Web 2.0 dotcom boom.

Joshua Gliddon reports

Cameron Reilly has $5000 in the bank and a plane ticket. Eighteen months after starting internet company ThePodCastNetwork, Reilly, 36, is leaving his family in Melbourne and going to seek his fortune in San Francisco. The ace in his hole is the quarter of a million listeners that his podcasts gather every month – and an investment market that's looking for the next Google and YouTube. "I'm already running a virtual global company," says Reilly, a former technology executive with Microsoft. "It makes sense to go to the US. That's where 65% of our audience is, and that's where the action is."

Reilly is not alone. A new generation of Australian internet entrepreneurs is skipping the chore of finding money in Australia and going straight to the source in America – and they're on track to become instant millionaires.

Take Martin Wells, the 36-year-old CEO of Tangler, a company that's building a next-generation internet messaging system. Tangler is his second internet business. The first, Dot Communications, has 35 employees and is focused on building the specialised software used by telecommunications companies. With Tangler, he's raised in excess of $1m in start-up funding from the United States and Asia, and will launch his software in the next few months.

Also in the gang is David Bolliger, 40, CEO of Tilefile. He has 25 employees, an office in Japan and another at Bondi Junction in Sydney, and interest from two major American media companies for his social networking software. Bolliger is a former film-maker who started out making software for online learning. The idea for Tilefile was originally as learning software, until he realised that it made much more sense to take on MySpace and YouTube. "What Tilefile is," he says, "is a new knowledge atom." By that he means that the software is a building block that can contain video, audio, text – and even work as a transaction link.

Customers will be able to link together the bricks and create their own rich media spaces.

There's also Wollongong's Nik Cubrilovic, 26, whose California-based company Omni-Drive has raised $5m in venture funding and is looking at taking on competitors in the online storage market. Cubrilovic started OmniDrive as a research project more than three years ago. The concept is what he calls "storage as a service", and although he won't be drawn too much on how his company differs, says there's a lack of innovation and new research in internet storage.

The idea of internet storage is that instead of keeping things on your desktop or laptop hard drive (or inside your mobile phone, music player or palmtop computer), you keep things somewhere out on the internet so that whenever you're connected, you've got access to your stuff.

This new wave of IT entrepreneurs are part of a movement dubbed Web 2.0. Think of Web 2.0 as the next generation of internet services. Web 1.0 was all about home pages and corporate spaces. Web 2.0 is all about letting users create their own content and spaces. It's also about using the internet as an extension of the desktop, laptop or palm computer. And unlike the dotcom boom, which began in 1995 with the launch of Netscape and petered out in 2001 after hundreds of billions had been burned on ventures that people simply didn't understand, all these companies are building markets by buzz and word of mouth. "The truism is that if you have to spend lots of money on marketing, you're doing something wrong," says Bolliger.

But what's true of Web 1.0 is also true of Web 2.0 – all the action is overseas. That's where the money is; where the markets are. And that's why the vanguard of Australia's next generation of internet entrepreneurs is looking to the US – and to Asia. "I speak to lots of Australian internet entrepreneurs," says Wells.

"And my advice to them is to get up, get on a plane, and head to the US." They're looking to replicate the success of Mitchell Davis, an expat Australian who sold his company, Massive Incorporated, to Microsoft earlier this year for an estimated $US300m ($400m). Massive places advertisements in video games. A gamer might walk past a car dealer in Grand Theft Auto, for example, and see the latest Holden sitting in the showroom. Or it could be the latest Coke campaign jingle playing in the background when the gamer walks past a convenience store in the massively popular online game Second Life. The business is estimated to be worth $750m this year.

But Davis didn't start his company here. He left Encyclopedia Britannia, where he headed the company's online efforts, to found a software company called Parcelhouse, then left to start Massive in the US in 2004.

Australian entrepreneurs are also seeking to replicate the success of YouTube, which was sold to Google last week for $US1.65bn. On the surface, YouTube is merely a place to post videos so that anyone else can watch them. Could an Australian have come up with the idea? Sure. And if they had, could they get it off the ground?

Reilly doesn't think so. "Australian investors don't really get it. We have the money in Australia, but the VCs [venture capitalists] are too conservative to invest in the next Google, YouTube or Netscape." Reilly is a former Microsoft executive. He spent six years at the company, eventually winding up as the software giant's "e-business evangelist". He started blogging very early on, but left Microsoft in 2004, after management took exception to some of his blog posts. "When I left Microsoft, I was keen to form a start-up. I'd been hearing about podcasts, but couldn't find any Australian ones, so I put the word out and started one with [former business partner] Mick Stanic." They formed ThePodCastNetwork in February 2004, and The Bulletin wrote about them not long afterwards.

Reilly's going to the US because he believes Australian investors undervalued his company. "They were talking five times earnings, or about $2m or $3m. Yet in the US, PodShow [another podcasting company] attracted $US24m. Based on that, and compared to their traffic, we're worth at least $US15m." On November 1, he'll present to 100 American venture capitalists as part of ANZA Technology Network's annual roadshow. ANZA Technology Network is a US-based non-profit organisation that specialises in putting Australian entrepreneurs in contact with US investors.

All of which begs the question of why Australia can't incubate its own companies. Wells reiterates Reilly's point that money isn't the problem. It's the venture capital experience that's lacking. "The effect is magnified in the internet sector, because internet companies have weird business models," he says.

And nowhere is that better illustrated than with YouTube. Despite its 100 million streams per day, it didn't appear to have any business model at all. It's the same dilemma that News Corp must have faced when it purchased the social networking site MySpace for what now looks like a bargain price of $US580m just over a year ago.

Although MySpace, which allows people to set up personal home pages complete with music and video, is widely popular, it's still not clear how you go about generating money from the hundreds of millions of eyeballs that visit it every day. Worse, not all the content is tasteful (or legal, as with YouTube). MySpace has since signed a preferential advertising deal with Google, which will see the search giant place its wildly profitable contextual ads on the site. Advertisers pay Google a certain amount, depending on the popularity of the words, to appear when someone performs a search. They pay again if someone clicks on the ad and visits the advertiser's site.

"How would you go about explaining the business model of a MySpace or a YouTube to a VC that didn't understand the internet space?" asks Wells. "You couldn't do it."

Brett Morris, CEO of Neo Technology Ventures, a Sydney-based VC firm with five start-up companies in its portfolio, says there's a lack of depth to the Australian venture capital community. "And more generally, there's a lack of early-stage investment capital for risky consumer internet businesses."

About 50 proposals come across Morris' desk every month, but the quality of the management pool is also quite low, he says. Venture capitalists don't only supply money; they supply knowledge, expertise and the contacts needed to get top-flight management. And in Australia, the problem is that there simply aren't that many managers out there with extensive IT experience. Especially not in the fast moving web-world.

The VC pool is also shallow. "The local market has continued to mature, but there is no way that it has the depth and sophistication of the North American markets," says Tony Stephen, a partner at PriceWaterhouseCoopers, specialising in IT and biotechnology companies. He says that it's not as if there's no money in Australia. It's more that the venture capitalists who are around are very selective about what they invest in.

Peter Costello's last budget included some tax concessions for venture capital but it has not impressed the dotcom community.

After three months of searching for local funding, Nik Cubrilovic decided to try the US. Within a week, he had an offer document from a venture capital firm for OmniDrive. "The first-term sheet was for a $5m round." The terms the VCs were offering were also much better than in Australia.

Cubrilovic says first-round funding in Australia usually means handing over the keys to the company. In the US, the firms that offer initial funding get only 30%.

The scale of the Google buy, along with News Corp's purchase of MySpace and Yahoo! picking up the Flickr photo-sharing site for a mere $US30m in March 2005 have all the makings of the next internet boom.

"Web 2.0 is a bottom-up rather than top-down model," says Ben Barren, CEO of Gnoos, an Australian blog search engine and software developer. "The key to Web 2.0 is the social elements. It's when a community of members has got together and created and uploaded content. The ultimate example is Wikipedia. The more that people upload, the more valuable it becomes."

Web 2.0 businesses have benefited from the dotcom bust. Since then, a lot of money has gone into core internet infrastructure. And lots more people have the high-speed broadband internet. Almost 15 million Australians have internet access, although only 1.4 million have high-speed access.

This places Australia around 15th among 22 OECD countries. Australia is considered as lagging behind the pack in broadband, but it's still much easier to get online, and once you're there, to grab rich content, than it was during the first boom.

But is this boom any different from the last one? Mike Zimmerman, a VC with Technology Venture Partners, an Australian-based firm with 15 companies and $150m in its portfolio, thinks it is. "You remember Pets.com and those companies? They advertised in the Superbowl. These new companies aren't spending anything on marketing, or if they are, it's very little. People are looking for viral growth. They're looking for companies that take off through word of mouth."

But the word of mouth generally won't bring overseas investors to Australia. Zimmerman says it's hard for Australian companies to get traction if they're based in Australia, particularly if they're going for a global market. VCs want to see a tenfold return on their investment, he says, which means that if you're putting $5m into a company, you want to get $50m out. That would put a value on the company – given that VCs take a stake around 30% – in the $150m range. "You're not going to get a valuation for a company like that here in Australia."

So where does that leave Australia's bright young things? The fact is that the majority of them are going to spend their time on aircraft, high over the Pacific. "I'm going to come home once a month or so," says Reilly. "I've got to see my wife and boys. But we've also put a lot of money into this company. We've got to see what it can do."

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