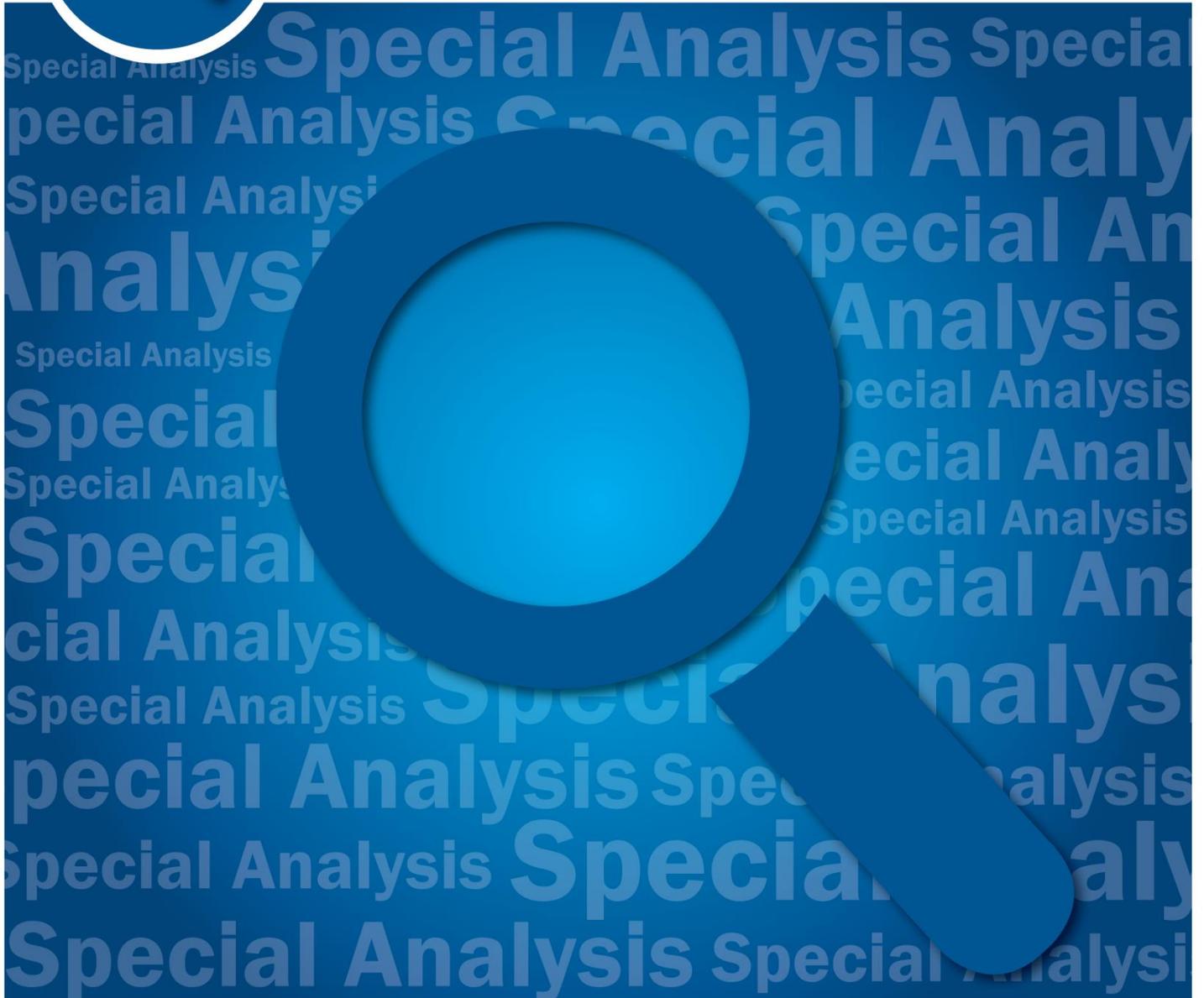




SPECIAL ANALYSIS

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Start-Up: the current trend

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Introduction

The term start-up is nothing new, but in the Czech Republic it's becoming more and more popular and the number of start-ups is growing - presently in the Czech Republic we can talk about approximately two thousand start-up companies. The most numerous work in the technology field, but gastronomic start-ups, for example, are also gaining in popularity. In the field of financing start-ups in the Czech Republic significant changes have occurred in recent years - on the one hand, there has been an increase in the volume of venture capital, and on the other hand new tools for financing start-up projects have been established.

The low interest rate environment and the lack of sufficiently profitable projects has thus attracted many private investors, funds and investment groups to this area.

The characteristics and financing of start-ups

The start-up concept

The term start-up began to be widely used during the "internet fever" in the second half of the 1990s when many companies were established in the United States as part of the internet boom. Despite this, there is still no uniform definition in the world today of what a start-up is considered to be.

In its simplest version, the term start-up means an emerging business idea, project or newly founded company with a business plan that has the potential to be monetized. A detailed definition adds a condition of innovativeness, i.e. a start-up tries to resolve a situation on the market in an innovative way in terms of place and time. Last but not least, what is also important is the potential for rapid growth (in terms of sales and customers), the role of the founders (initial investment, idea), and mostly the future need for external investments for further growth and introduction of a product on to the market.

The aim of start-ups is to grow as quickly as possible into a profitable, viable and stable company that is no longer a start-up.

The lifecycle of start-ups can be divided into four phases:

- 1) Pre-seed, Early Stage:** The initial phase of an idea when the organizational structure of the company does not yet exist. The founders of an early stage start-up believe they have found an innovative solution to a problem or a niche market that could be monetized.
- 2) Seed:** The idea has been brought to life and there is already a legally constituted company. The company endeavours to introduce the first prototypes of their products or services to the market.
- 3) Growth:** The company has a ready end product and tries to grow and expand quickly.
- 4) Start-up:** A fully developed business idea. The company already has a clear structure, is stable and can work on further growth, which if it continues further should result in the establishment of a classic business.

The most successful start-ups are called „unicorns“. This is the name for start-up companies that have a minimum valuation of US\$1 billion (e.g. Uber or Airbnb).

“Venture capital” is also a term widely used in connection with start-ups. Within the Czech environment this is understood as medium to long term capital invested in the form of capital entry into a company. An investment fund acquires a share of the founding capital in the company and together with its funds transfers expert assistance to the company (the principle of “smart money”).

This is mostly financial and strategic assistance in developing the company. The form of support will vary for individual investments, and may relate to the active strengthening of the team in top management positions or a passive role as an advisor in the financial field.

An investor will mostly enrich a company with the contacts that may be useful in various fields of business and in attracting new customers.

Financing of start-ups

Significant changes have occurred in the field of the financing of start-up projects in recent years. On the one hand, the volume of venture capital earmarked for investment in start-up projects has significantly increased, and on the other hand new financial instruments to fund start-ups are being created. Basic options for start-ups raising capital in various stages of development are:

Initial phase: This is the first phase of financing a start-up when the founder has an idea or a working prototype, and is looking for resources that will help him or her devote him or herself fully to their project. The principal sources of funding are:

- **Own sources, family, friends;**
- **Business angels** – individuals providing capital to start-ups during the riskiest phase of the project life, usually in exchange for shares in the company or participation in profits. It often concerns investors who have already completed an exit from their own projects and will invest their money back into the start-up environment;
- **Incubators / Accelerators** – organizations that provide counselling (mentoring) and facilities in exchange for shares; in the company (e.g. 5-10%).

Seed capital: These are the funds needed to start a company to market the product. The main providers of capital at this level are angel investors, “super angels” (a group of investors) or venture capital companies. In Europe it usually concerns an investment of EUR 250,000 to 750,000 (max. to EUR 1 mil.).

- **Venture Capital firms / funds** - capital used to finance innovation projects and the incipient development of companies (venture capital), in the form of capital investment in a company. A venture capital fund thus acquires a share of a company's founding equity. The concept of venture capital is often confused with ‘private equity’, which, however, is a broader concept that includes not only venture capital, but also investments in existing companies (buyouts through internal management, through external management), and angel investors, etc.
- **Crowdfunding** – a financing method in which a larger number of individuals contribute a small sum to a target amount. It happens on crowdfunding servers (aggregators) that allow one to locate and invest in supported projects. There are two types of crowdfunding: Reward funding when people choose a project, financially support it, and in return receive the product or service that the project provides; Share funding where investors acquire a stake in the funded company and the right to share in future profits. There are large crowdfunding platforms in the world like Kickstarter or Indiegogo, and several platforms have been created in the Czech Republic in the last few years (Fundlift, Peněždroj, Startovač, HitHit, Nakopni.me).
- **Syndicated investment** - the purpose is to bring investors together. A leading investor (an angel) chooses a start-up project in the pre-seed phase and other investors add with their co-investments at different stages of development of the start-up.

Growth phase: Companies at this stage need to finance increasing production and expansion of the provision of services, improve distribution systems or set up a business model. When an original start-up company is successful venture capital funds will want to withdraw from it, sell their stake and thus realise a profit. The options (especially abroad) are the issue of an IPO or acquisition by a much larger company.

The start-up scene in the Czech Republic

Official statistics mapping the number of start-ups in the Czech Republic have not yet been created because the definition of what is and what is not a start-up is not clear. Furthermore, successful start-ups grow over time and become stable and viable companies, and are therefore no longer identified as start-ups.

Nevertheless, it's possible to estimate the number of start-ups operating in the Czech Republic by using the database portal StartupJobs.cz, which helps Czech start-ups in finding personnel.

Roughly 70% of start-up companies in the Czech Republic (1,250 – 1,450 companies that meet the definition of start-up) use the portal StartupJobs.cz when searching for employees. We can estimate from this the actual number of start-ups in the Czech Republic at around 1,800 to 2,060 (but bio/nanotechnology start-ups, for example, are not counted). Nearly half of the companies that advertise jobs through StartupJobs.cz operate in the technology field. Others operate in e-commerce and services.

State support

The Ministry of Industry and Trade

The idea of financing a seed fund by the state in the Czech Republic appeared in 2011, but due to delays in the preparation of the fund it ultimately failed to be put into practice. The Ministry of Industry and Trade (MIT), however, didn't conclude the preparations and in October 2015 the Government approved the National Innovation Fund (NIF). About 75 million euros, i.e. over CZK 2 billion from European and Czech public sources will be put into it. More money will come within the scope of co-financing from private investors. The actual investments in venture capital funds will be managed by the European Investment Fund (EIF), with whom the MIT should conclude an agreement on financing this autumn. The start of operations is expected in the second half of 2017. At the very start of business in the "seed" phase the state may finance up to 90% of the capital entry of investors into a company; the percentage of the state's equity participation should then decrease depending on the degree of the development of the applicant's business. At a later phase of the start-up, the fund will get involved with a project to a maximum amount of 60% of the investment value.

If the investments serve to expand an already relatively well-established business from among many smaller companies, the fund will finance a maximum of 40% of investment with a majority share by private qualified co-investors. The investment strategy of the National Innovation Fund will generally be directed toward the seed phase of a business, specifically in high-tech fields, especially with a longer expected payback period. The aim of the programme is to increase the innovation potential of the business sector, as well as more efficient use of alternative forms of financing the development of SMEs and the development of new repayable forms of supporting business with the participation of the private sector.

The first step within the framework of the National Innovation Fund was the approval of a MIT programme called Venture Capital by the Government on 12 September 2016, and whose aim is to promote the access of SMEs to venture capital financing in the early stages of their development (seed and start-up capital). The programme has been allocated EUR 53 mil. (CZK 1.4 bn.) from European structural and investment funds, although private capital should always be involved in the investments. The total amount of investments will not exceed CZK 370 mil. per recipient. The first start-up projects will be able to apply for support during the course of 2017. The market potential of the business projects is what will primarily be evaluated. According to the MIT, it is not a new initiative, but rather the next step in the operations of the NIF.

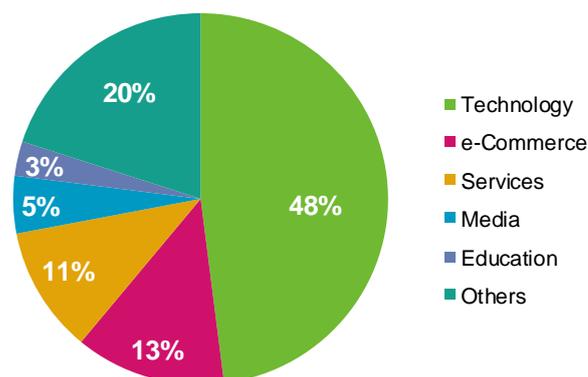
CzechInvest

The state agency CzechInvest also promotes its own Czech start-up programmes. One of the projects has been and in the future will be the CzechAccelerator project that provides office space and mentoring to selected companies, e.g. in Silicon Valley, New York, London or Singapore. Selected start-ups will spend 3-6 months in local incubators or accelerators, gain access to the networking activities of technology companies, professional conferences, training, mentoring, legal assistance and protection of intellectual property rights and attempts to break through into a market. CzechInvest will also assist companies with translations and marketing.

The CzechStarter consultancy programme for aspiring entrepreneurs should then be released in autumn 2016. CzechInvest will provide entrepreneurs with services that will support them in various stages of their company development as part of this framework. CzechInvest will also provide start-ups with participation in international conferences through the CzechDemo programme and it wants to organise them itself as part of the CzechMatch project.

The projects are financed from EU funds. The Association of Small and Medium Enterprises also wants to identify ten Czech technology companies and send them to accelerator centres in New York for at least half a year. The aim is to prepare companies for further work in the US.

Field of activity of start-ups on StartupJobs.cz



Source: StartupJobs.cz

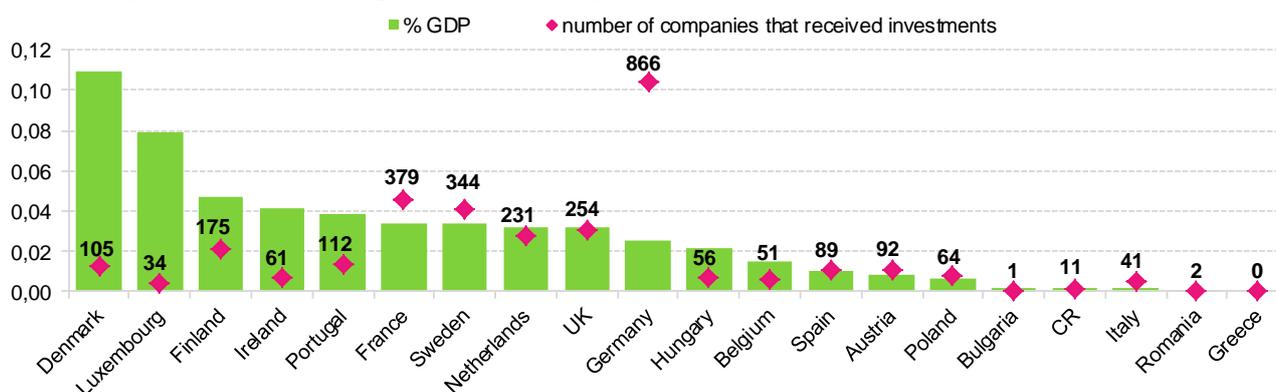
Investors in the Czech start-up market

Venture capital in the Czech Republic

The CVCA association, which is a member of the European private equity and venture capital (EVCA), represents the interests of companies involved in private equity and venture capital in the Czech Republic.

According to statistics from EVCA, whose data is published by Eurostat, the Czech Republic tends to be at the other end of the ladder in terms of volume of investments in venture capital (0.002% of GDP in 2015 invested by Czech private entities). In terms of the sectors toward which venture capital investments are directed (venture capital investments in the Czech Republic), the most represented are areas such as communication, computers and consumer electronics or consumer goods. Overall, about 30% of venture capital investments are directed toward high-tech areas.

Venture capital investments during seed and start-up phase (2015)



Source: Eurostat, EVCA

*data may not include all venture capital investments made in the country.

Private start-up investors in the Czech Republic

A number of funds and investment groups that focus on investing in small companies that come up with technological innovations usually associated with the internet have appeared in the Czech Republic in recent years. In sum, the investment represents at least several billion crowns. This relates to, for example, groups like J&T or KKCG and former leading figures in the energy section like Martin Roman and Vladimir Johanes. Start-up investments, however, are also begun by people who themselves started out with small internet and technology companies. An example is Jakub Havrlant's Rockaway or Vaclav Muchna's Y Soft. Classic examples of investors are business owners who are looking to invest part of the profits from their existing company. Similarly, these investments are also participated in by people who received more money from the sale of their company than they can spend and are looking for investment opportunities which, although requiring their involvement, do not require them to be full time.

It's therefore not difficult at all for the founders of start-ups to get into contact with the largest Czech investors.

The entry of Czech investors into start-ups

Investor	Start-up	Investment (mIn CZK)
J&T Bank (J&T Ventures)	FetView, Ice Gateway, Dateio, Pygmalios, 720°	108
KKCG (Springtide Ventures)	Cleerio, Nejřemeslníci, Geewa, Cloude4com	hundreds
Metatron (Vladimír, Petr and Marek Johanes)	Savvy, Yonderbound, Audacy, Palladium, Ageo, Edueto, Eco Leather, Deep Space Industries	-
Rockaway (Rockaway Ventures)	Bileto, Brand Embassy, SQLdep, Socifi, Silicon Jelly, Dreadlocks	dozens
RSJ (Credo Ventures)	18 projects	486
Y Soft (Y Soft Ventures)	Lumitrix, GreyCortex, Sewio, Compratio, Videoflot, OrganizeTube	dozens
Miton	dozens of internet start-ups	hundreds

Source: E15 (15/7/2016), Miton

The Israeli Yozma programme or a shining example for all

The basis for the Israeli expansion of venture capital funds was the Yozma state programme (Hebrew for "Initiative") launched in 1993. The programme included an attractive tax on capital venture investment from abroad and a state fund, which offered a 50% entry into Israeli technology companies. The result was a massive development of start-ups and other private venture capital funds, while between 1991 and 2000 the amount of money in Israel invested by venture capital grew 60x (from USD 58 mil. to USD 3.3 bn.) and the number of companies financed from 100 to 800. The Yozma state fund was privatized in 1997.

Another group focusing on supporting and investing in start-up projects are large (multinational, technology) companies.

These use start-ups as a means of obtaining ideas or partial solutions which wouldn't be established within their corporate structure or would be difficult to implement. In the Czech Republic those supporting start-ups are for example:

- IBM, through its IBM Global Entrepreneur Program from which start-ups receive support with the development of solutions and mentoring penetration into foreign markets, and IBM cloud services are available to them. The program involves 23 Czech start-up projects.
- In SAP's Startup Focus programme successful applicants may obtain a development license or consultations with SAP specialists for the duration of the development of their project. HANA technology is also available, which speeds up working with big data. In addition to technological support, start-up projects can also obtain funding from SAP from the SAP HANA venture fund.
- Czech Seznam has invested in the accelerator StartupYard, O2 is developing its own accelerator BOLT, and Vodafone has the Idea of the Year contest for business plans.

The start-up scene in the CR also includes many websites summarising the latest news from the field, mapping the actors in the market (start-ups, incubators, investors) or providing some advice and recommendations to emerging start-ups.

Česká spořitelna's Start Up company credit

We are looking for anybody who has the courage to do things differently, but still carries his ideas in his head. It's time to inject new blood into the veins of Czech business!

In cooperation with the European Investment Fund (EIF), we're providing finance of up to CZK 550 mil. to start-up entrepreneurs to start a business.

For more information see: www.nova-krev.cz

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