

THE FUTURE OF TECH STARTUPS IN CENTRAL & EASTERN EUROPE

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INTRODUCTION

The European tech ecosystem is finally coming of age. 2020 has been marked by [record amounts](#) of venture capital (VC) being poured into European companies during the first quarter. In February 2020, [OTB Ventures](#), a leading venture capital fund specialised in investments in technology companies in the CEE, announced the launch of its early growth technology fund, with €92.4 million in commitments. This fund is the largest VC fund in CEE and was backed by international institutional investors, including the European Investment Fund (EIF). In this context, the CEE startup ecosystem might be reaching its golden era, with its abundant engineering talent and lower labour costs and living expenses (when compared to Western Europe and the US) making the region attractive for founders and investors alike.

By 2019, 12 unicorns had sprung out of the CEE region, with a combined value of [€30 billion](#), and were mostly founded in Estonia, Poland and Romania. To name a few success stories from the region, the region's stars include Avast (Czechia), Prezi (Hungary), UiPath (Romania), Skype and TransferWise (founded by Estonians). These kinds of stories create a precedent for their countries of origin, reassure investors, pave a way for other projects and inspire other local founders. It is important to admit, however, that most of these companies have been acquired by larger players from the West, or have moved parts of their operations to the US or Western Europe, which shows that the CEE startup ecosystem still has a lot of work ahead to be able to provide conditions for the full life-cycle of startups.

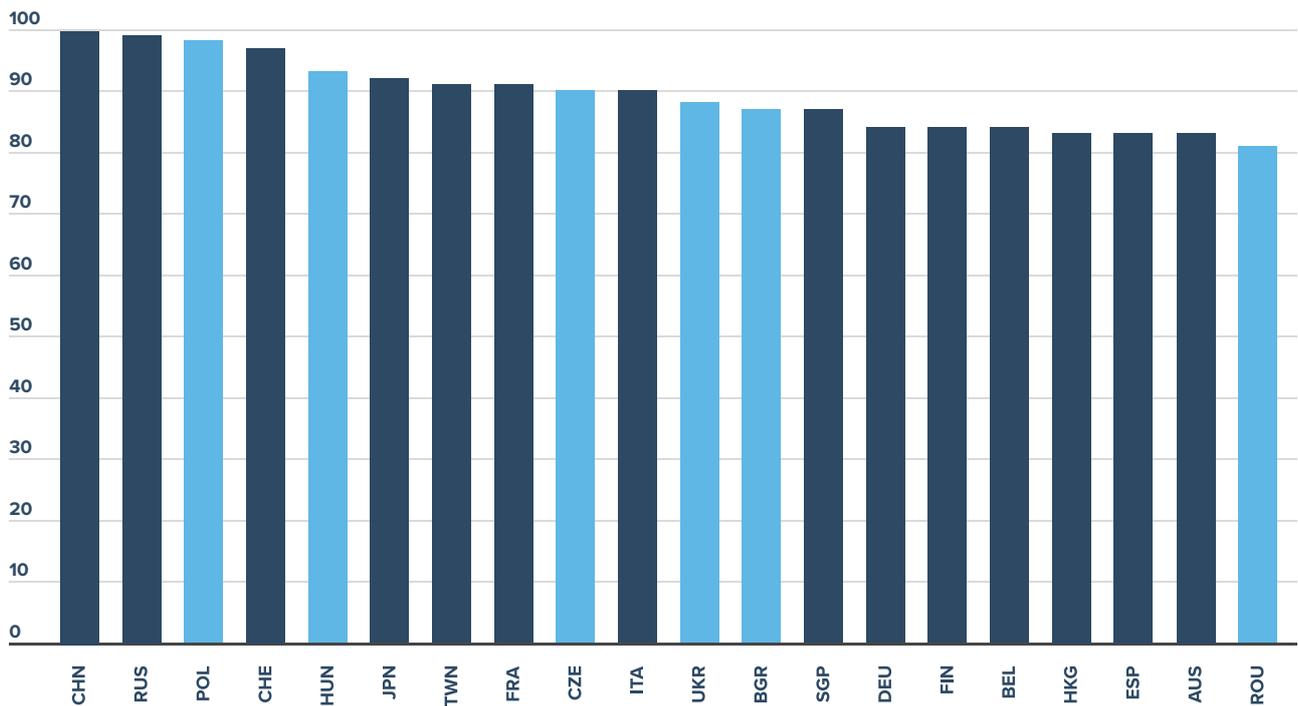
Due to the COVID-induced acceleration of digital transformation across businesses and governments, certain segments of the startup world could really be living their best years, especially the ones focused on process automation, remote collaboration, online security and e-health. On the other hand, the pandemic is expected to have a significant impact on deals in the ecosystem and flows of US capital into European tech companies. As we zoom into the CEE region, what are the most promising opportunities for tech entrepreneurs arising from the current market situation? Which roadblocks are yet to be addressed by entrepreneurs and policy makers alike? What should be the current priorities of the EU and national governments in supporting tech startups in the CEE to help them thrive?

IT'S ALL ABOUT TALENT

One of the reasons why the tech boom in the CEE came about lies in its cost-effective, highly skilled tech talent. The labour costs of workers who excel at in-demand software development and IT skills are much lower in CEE countries than in Western Europe, turning the region into an attractive investment destination. With regards to the [quality of CEE developers](#), 6 CEE countries ranked among the top 20 out of 50 countries across the globe. The best developers from the region come from Poland, Hungary, Czechia, Ukraine, Bulgaria, Romania.

WHICH COUNTRY HAS THE BEST DEVELOPERS?

Ranked by average score across all HackerRank challenges



Source: <https://blog.hackerrank.com/which-country-would-win-in-the-programming-olympics/>

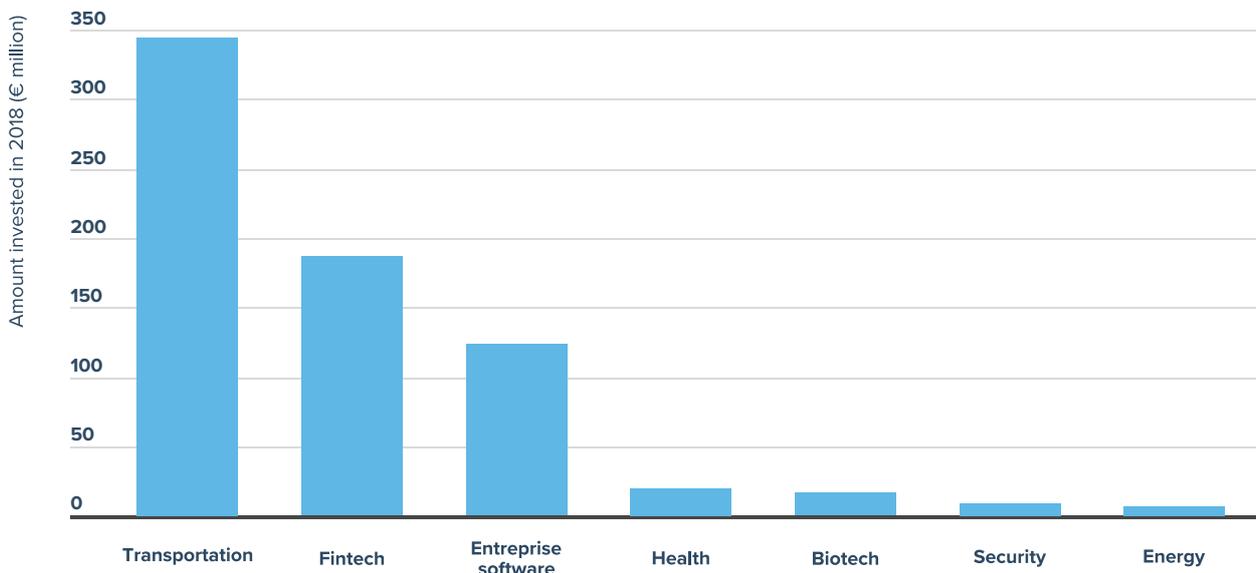
Based on [data from 2019](#), there are about one million developers based in the CEE, with half of them concentrated in Poland, Romania and Czech Republic.

Despite positive outlooks for the CEE with regards to its talent, it is important to take into account the wider context of the widening skills gap in Europe's ICT industry. While we have witnessed a [rising number of ICT jobs](#) in Europe during the past years, companies report [difficulties](#) in filling such vacancies. The EU Commission [predicts](#) that the gap will further grow from 373,000 in 2005 to about 500,000 by 2020. The widening gap between the supply and demand side of ICT professionals will therefore need to be addressed by a set of policy measures, such as programmes aimed at reskilling and upskilling workers as well as major updates of curricula in public education.

In addition, the region's countries share a major challenge of "[brain drain](#)", or the emigration of skilled individuals to Western Europe. If left unaddressed, this could form a major impediment to the development of the digital economy.

INDUSTRIES ON THE RISE

Although most industries in the CEE lag behind their respective counterparts in more advanced Western economies, some of the sectors are almost on par - namely [financial services and information and communication technology](#) (ICT). More specifically, the [leading industry verticals](#) on the CEE tech scene are transportation, fintech and enterprise software. In 2018, invested amounts reached €345 million for transportation, €187 million in Fintech and €123 million in enterprise software. In comparison, investments in biotech (€17 million), security (€9 million) and energy (€7 million) were much lower.



Source: <https://blog.dealroom.co/wp-content/uploads/2019/03/Google-CEE-v25.pdf>

Due to the widespread digital acceleration triggered by COVID-19, we can expect [more opportunities](#) for startups that can facilitate remote collaboration, process automation and centralisation of essential business functions online. The pandemic has pushed some of the new technologies such as robotic process automation (RPA) to the forefront, as companies look for ways to automate more quickly. As a result, companies such as UiPath, whose software is based on RPA, are growing at steady pace, having [recently announced](#) a \$225 million Series E funding and openly spoken about IPO.

Similarly, opportunities will also emerge for software startups focusing on personal security online, as scams and phishing attempts have reportedly increased and as companies look to improve their resilience against malicious actors. This is also a good time for startups which are able to assist with the research phase of the COVID-19 response. For example, Germany-based biopharma startup [CureVac](#) received a €82.4 million grant from the EC to support the development of a vaccine for COVID-19.

INVESTMENT LANDSCAPE

In 2018, a record €0.7 billion was invested in CEE startups, partly driven by two mega-rounds of more than €100 million ([Taxify/Bolt](#) and [Citybee](#)). This is [more than double](#) the amount of five years earlier. In the wider context, though, it remains tiny. [Startups in London](#) raised more than €2 billion last year – almost triple that of the CEE region.

Venture Capital has been historically slow in expanding into the region. Some of the [key reasons](#) include the smaller amount of quality deals when compared with Western Europe and the US, the lack of a network and knowledge of the local ecosystem to access deals, and the difficulty of achieving successful exits. Early-stage CEE startups therefore rarely appear in the portfolios of the top western VCs. Some funds insist that startups move to the West or they will not invest, which in turn hits the investment image of the region and prevents the local startup ecosystem from maturing.

Although 2020 got off to a [good start](#), the coronavirus pandemic could have a significant impact on deals in the European tech ecosystem, [threatening the flow of US capital](#) into European companies. This is due to fact that the rate of [US private equity](#) dealmaking in 2020 continues to lag well behind past years as a result of the coronavirus crisis. [To combat](#) the effects of the coronavirus crisis, startups all across Europe have turned to government-backed loans and frozen hiring to combat the effects of COVID-19.

With [public funding](#) being the largest source of capital in the region, accounting for 42% of the capital raised in 2018, we can expect that the region will further benefit from the EU funds that aim to boost innovation. The most promising financial instruments include [Horizon 2020](#), EU's largest research and innovation programme ever, with nearly €80 billion of funding available over 7 years (2014 to 2020). Similarly, [European Green Deal](#)'s Investment Plan will mobilise public investment and help unlock private funds through EU financial instruments, notably InvestEU, which could lead to at least €1 trillion of investments.

SUPPORT INFRASTRUCTURE

Creating a vibrant startup ecosystem requires a solid enabling infrastructure that consists of access to funding and talent, a supportive regulatory environment (especially with regards to IP, taxes and data protection), and high-speed broadband connectivity, as well as opportunities to network, learn and collaborate. [Estonia](#), one of the startup leaders in the CEE region, prides itself on the world's best free Wi-Fi network, coding being part of school curricula, and an e-residency program. In other sites throughout the CEE, we can see startup support through accelerator and incubator programmes, such as the Baltic [Startup Wise Guys](#) taking place in Riga, Vilnius and Tallinn, or [Seedcamp](#), known for its continued investments in CEE startups. Co-working spaces with a focus on community-building and collaboration are also key to startup success, for example [HubHub](#) (with branches in Prague, Budapest, Warsaw, Bratislava and London), and [Cambridge Innovation Centre](#) (Warsaw).

CONCLUSIONS & POLICY RECOMMENDATIONS

While it is difficult to predict how the CEE startup ecosystem will look like in years to come, the future appears bright. Global investors and big firms are actively seeking out investment with lower expenses and high quality talent, both of which are the region's fortés. Building a truly flourishing startup ecosystem, though, will not be possible without systematic support for entrepreneurship and innovation on the EU and national level. Below, we outline key areas that could be instrumental in maximising the potential of tech startups to drive CEE's future growth:

TALENT

- ▶ Development of entrepreneurial and digital skills in formal education through cooperation with the private sector, and via life-long learning, re-skilling and upskilling opportunities.
- ▶ CEE countries should join forces to tackle potential talent pool issues such as brain drain and the increased need for more ICT skills, for example by initiating a joint promotional effort of the region as a digital hub to attract talent and investments.

PUBLIC POLICY

- ▶ Support for research, development and deployment of new technologies should be a key part of governmental strategies to maximise opportunities for the development of local tech entrepreneurship.
- ▶ Governments should work with local stakeholders to ensure that the regulatory framework enables and incentivises investments into the startup system by business angels, venture capital funds and larger corporations.
- ▶ Creating regulatory "sandboxes," or testing environments, where startups can conduct live experiments in a controlled environment under a regulator's supervision.
- ▶ With enough funding for early stage startups in the region, the priority should be increase funding opportunities for scale-ups (more mature tech startups).

REGIONAL & INTER-INSTITUTIONAL COLLABORATION

- ▶ The countries of the CEE could form a coalition at a European level to ensure that their digital interests are heard.
- ▶ Synergising collaboration on the EU level, especially between the European Institute of Innovation and Technology and European Innovation Council, can identify promising companies in the CEE and allow them quick access to funding.

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