

# Venture Capital Ecosystem in the Czech Republic: The Importance of Local and Foreign VC Investors in the Startup Financing Process

## Summary of the Key Interview Findings

Eight respondents representing leading Czech VC funds with over €500 million in total assets under management.

## Czech startup ecosystem ranks among the top in the CEE region

All respondents agreed that the Czech Republic is one of the more developed regions within the CEE area. **Estonia and Poland** were two countries that were frequently **ranked higher** than the Czech Republic.

According to respondents, Czech ecosystem lags behind the top regions due to several reasons:

- The Czech ecosystem's **history of evolution**, the **shortage of global successes** that would drive the ecosystem's growth, and the consequent **lack of available capital**.
- According to the respondents, there are sufficient funds for VC investments in the Czech Republic but only for particular businesses, namely **B2B SaaS** (business to business software as a service). The Czech Republic has a favorable environment for traditional venture backable startups but not for non-traditional ones e.g., operating in healthtech, cleantech, or blockchain industries. However, the situation is swiftly improving.

## Czech founders lack global ambitions

Six out of eight respondents stated that one factor impeding the ecosystem's growth is the **Czech founders' local mindset**. Frequently, they lack global ambitions and think exclusively locally. They are hesitant to attempt setting up a business multiple times and are fearful of failing, which is often a natural part of the startup journey. Additionally, they often lack international experience and the ability to create strong networks early on. Furthermore, domestic founders frequently lack knowledge of the so-called venture capital game. Understand the difference between venture capital game and building a lifestyle business.

While there are many talented **programmers and IT developers** in the Czech Republic, Czech entrepreneurs frequently lack the capacity to **market their idea successfully**. Moreover, respondents mention the importance of connecting the Czech ecosystem to more developed regions in CEE and other western countries, as **internalization** of the Czech ecosystem can be extremely beneficial for future development.

## Lack of significant success stories that would stimulate growth

While **Rohlík and Productboard** are fantastic instances of recent successes, we are still seeking a business on a global scale comparable to Estonian Skype. As a result, the Czech Republic lacks what is known as **recycled money**, capital that would be reinvested in the ecosystem as a result of a domestic company's success. It is frequently a significant source of capital for the ecosystem as it carries the know-how and network of the investor.

Underdevelopment of the **Czech investment environment** as a whole might also be related to Czech investors' conservatism. LPs of Czech VC funds frequently invest only a small portion of their net worth into startups and the majority in less risky assets such as real estate. Additionally, there are many great innovative projects in the Czech Republic; however, they are frequently just not VC funded. Moreover, one respondent suggests that Czech founders should take inspiration from Estonian startups and focus on expanding to larger western markets already at the early stages.

## Limiting Czech legal environment

While some steps have been taken to improve the Czech legal environment, the current state still presents some constraints. Respondents argue that it is still **excessively restrictive for both businesses and venture capital funds**, for example in terms of transfer of shares between investment rounds, buyout processes, remote work regulations, or employee stock ownership plans. The majority of respondents think that it should be easier to establish and operate businesses in general and that **digitalization of administrative processes** would considerably assist in this endeavor.

In addition, an increase in support for Czech entrepreneurs, particularly in their **development and educational possibilities**, would contribute to the ecosystem's growth.

## Positive characteristics

The respondents also highlighted several positive characteristics of the Czech startup ecosystem. These include **high-quality technical universities, excellent software, an IT development environment**, and a stable economic environment. Additionally, there is a high level of willingness on the part of high-net-worth individuals to participate in innovative projects.

Furthermore, the Czech Republic is frequently a destination for skilled IT professionals migrating from the East. Simultaneously, highly skilled individuals frequently remain in the Czech Republic and do not migrate (brain drain process). Additionally, the Czech Republic is one of the few countries with a **positive net migration rate**, meaning immigration exceeds emigration.

## Government funding... double-edged sword

The majority of respondents agreed that government assistance has a slew of disadvantages. First, government money carries numerous **limitations** and can act as a **deterrent to other investors**. Furthermore, government money is frequently **just capital** that adds no other value (know-how, network, etc.). When a government official selects the wrong investment manager, money can end up in the **wrong projects**, yielding no return and not contributing to the development of quality projects, the ecosystem, or the economy as a whole. Additionally, government funding frequently comes with **additional limits**, such as location, fixed time frame, etc. Respondents use Poland as an example of how it might negatively impact the startup ecosystem.

On the other side, there are methods to utilize government funds effectively. **Proper use** of government funds should **prioritize educational initiatives** and **raise awareness** about the startup ecosystem. While government funding may be a feasible alternative when an ecosystem is entirely devoid of funds for development, respondents agree that this is not the case in the Czech Republic.

## Czech VCs and early-stage funding. Why?

According to the findings of the bachelor's thesis, local venture capitalists in the Czech Republic are **highly active** in the **Seed stage**, and their engagement begins to decline as the amount invested increases with each round. Between Series A and Series B, the largest decline in local VCF involvement occurs; beyond Series B, foreign capital often dominates. Three key hypotheses were brought up by respondents as possible explanations for the observed trend.

First, it might be due to the critical nature of a **VC investor's geographical location** in relation to the company's demands at various stages of development and the additional value the VC investor may bring. Respondents frequently claimed that having local investors during the early phases of growth benefits startups significantly since the investors can actively engage with them and introduce them to the investor's local network and potential first clients. Moreover, close geographic proximity at the early stages might also be a relevant explanation because local VC investors often source their deals via their networks, thus finding local startups at early stages as first investors before foreign investors even have a chance to notice them.

Second, respondents indicated that the likely explanation of the Czech VC **ecosystem's lack of development** has an effect on why Czech VC funds focus primarily on the early stages. The respondents confirm the author's assumption that the Czech VC ecosystem **lacks sufficient funds** to be heavily active in Series B and beyond. The respondents, however, go more in-depth, stating that it is not only due to the lack of Czech global successes that would significantly boost ecosystem growth and generate substantial additional capital but also due to the size of the Czech economy as a whole.

Third, respondents reveal that, as a result of the domestic VC **ecosystem's relatively short history of development**, the infrastructure of venture capital funds, accelerators, and other startup-related programs promoting the concept of venture capital and startups is not as developed as in the world's most vibrant VC ecosystems. Which ultimately results in a **shortage of projects** ready for funding at a later stage. Additionally, respondents state that a limiting factor is frequently the local mindset of domestic founders. Other possible explanations are further identified throughout the bachelor's thesis.

## Most significant recent changes

One of the most significant changes that the respondents highlighted was that the **public awareness of venture capital and startups** has increased significantly in recent years. Moreover, the entire Czech VC ecosystem has evolved tremendously during the past five years. Respondents cite the most significant improvements in **market standards, negotiations between funders and investors, the legal environment, the number of startup-related events and projects, media coverage, transaction volumes, and the number of existing Czech VC firms and startups** in general. Czech ecosystem is acquiring more expertise from the West, resulting in a quick maturation of the ecosystem. Furthermore, the entire **CEE region's credibility** has grown significantly in recent years. However, the region continues to suffer from a substantial lack of cooperation.

In addition, it was noted that in recent years there has been a phenomenon referred to as "too much available capital on the VC market" which has led to a situation in which not always the best startups receive VC funding and there is less pressure to create truly great innovative projects, which could be detrimental to the ecosystem. It is essential to highlight, however, that according to recent macroeconomic trends, this situation may alter considerably in the next months.

## Future development of the ecosystem

Last but not least, respondents provide their perspective on the future development of the Czech ecosystem. Generally speaking, it is anticipated that the **overall situation in Central and Eastern Europe will continue to improve**, but respondents agree that the Czech Republic will not dramatically excel in this respect. Likewise, the Czech Republic will not easily catch up to Germany or other Western countries. However, respondents anticipate that the relevance of smaller countries in the CEE region will continue to grow. There will be additional **one-time success stories** from smaller CEE countries. Moreover, the importance of startups and venture capital in the economy is expected to grow. In addition, one respondent anticipates that **unicorn status will no longer be as relevant** as in the past. It will become irrelevant metric for evaluating the ecosystem's performance over time. This is illustrated by the case of Avast, for which it was far more difficult to achieve a valuation of \$1 billion than it was for Productboard due to factors such as inflation and other factors.

Furthermore, it is expected that more Czech businesses will follow the path of **establishing a headquarters in the United States**, such as the company Shipmonk. According to the respondent, it will be necessary to establish a definition of a Czech startup before determining if its success is considered Czech or American. The respondent assumes that the straightforward answer to this question will be unclear. Moreover, another respondent optimistically adds that it is highly likely that the Czech Republic is currently in the pre-boom phase. According to the respondent, it is probable that Rohlík and Productboard's success is merely the beginning, and that the **ecosystem's greatest development is yet to come**.

On a related note, one respondent believes that the Czech Republic has the potential to develop into the **CEE region's startup powerhouse**. However, he adds that individual investors must embrace this common goal and that **collaboration** throughout the entire ecosystem is critical. Currently, there is a bit lack of cooperation between Czech VC funds and neighboring ecosystems. Moreover, other respondent notes that the Czech Republic has the potential to become a **startup hub for Web3.0** and blockchain sectors due to its excellent infrastructure of technological universities. The respondent continues by stating that geographic location will lose significance in the future. He believes that it will be irrelevant in twenty years whether the founder is from the Czech Republic or elsewhere in the world.

Furthermore, respondents agree that Czech ecosystem's **investment activity will increase**, and startups will become more competitive with the West. In case of Czech VC firms, the majority of respondents anticipate that Czech venture capitalists will continue prioritizing **early-stage** development and leveraging their know-how and collected experience rather than shifting their focus to later financing rounds such as Series B and beyond.

In addition, global investors will increasingly seek opportunities in **emerging markets** such as India and Asia. One respondent asserts that the market of venture capital funds will begin to **monopolize**. The respondent believes that VC investors will focus either on supporting startups at the very beginning (Pre-seed) or immediately supporting their global expansion (Series A, B, and beyond), while middle-class funds focusing on Seed or early-series A would gradually disappear. Finally, the **macroeconomic situation** is undoubtedly permeating the technological world of startups, but at a **slower pace** due to the inherent delay. Venture capital investors globally realize this risk, and some caution is already evident; nevertheless, only time will reveal the full effect on all global markets.

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For further information and more in-depth analysis, please refer to the entirety of the bachelor's thesis or do not hesitate to contact me directly.