East-West Digital News

STARTUP INVESTMENT & INNOVATION IN EMERGING EUROPE

2018 EDITION, VERSION 1 – FEBRUARY 2018

The first-ever comprehensive startup research on 24 countries of Central and Eastern Europe

Includes a special Russia section with participation from

RVC

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ABOUT THIS REPORT

Published by the regional news and research agency East-West Digital News, this report highlights the main facts, numbers and trends of startup ecosystems and VC activity in Central and Eastern Europe. **The full version of the report can be downloaded at no charge from http://cee.ewdn.com .** It includes the following parts:

PART 1: Regional Trends

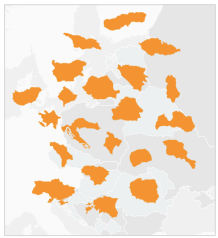
- Trend analysis & executive interviews
- Venture deals & VC market data
- How EIF supports venture activity in CEE
- How corporations are getting involved
- Key regional events and industry resources

PART 2: The Token Spring of Central & Eastern Europe

- ICO market data
- Trend analysis & expert opinion
- Case studies & select articles

PART 3: Artificial intelligence: The New Powerhouse of Europe?

- Trend analysis & expert opinion
- Case studies & entrepreneur interviews
- Select articles



PART 4: Local landscapes

Discover the startup and venture ecosystems in Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Czechia, Estonia, Georgia, Hungary, Kosovo, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Serbia, Slovakia, Slovenia and Ukraine

PART 5: Special Russia section

- Country data & trend analysis
- Executive interviews & expert opinion
- Select articles

PART 6: Featured startups & entrepreneurs

Case studies and interviews to discover some of the region's most remarkable entrepreneurs and technologies!

REGIONAL TRENDS

DOWNLOAD THE FULL VERSION OF THIS RESEARCH: HTTP://CEE.EWDN.COM

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KEY FINDINGS: CEE STARTUP ECOSYSTEMS

1. The region is very diverse: it comprises some of Europe's most advanced innovation ecosystems (Estonia, Slovenia) and some of the least developed (certain republics of the former Soviet Union and Yugoslavia)

2. In absolute terms, Russia is by far the regional leader in technological assets, number of startups and volume of investment Estonia and Slovenia are ahead in relative terms (per capita).

3. Many countries of the region display strong technological and engineering assets along with a high educational level. This is partly a legacy of their communist past. In a range of countries, these assets laid the foundations of internationally-integrated software development capacities; these countries are now switching to a more product- and innovation-oriented model

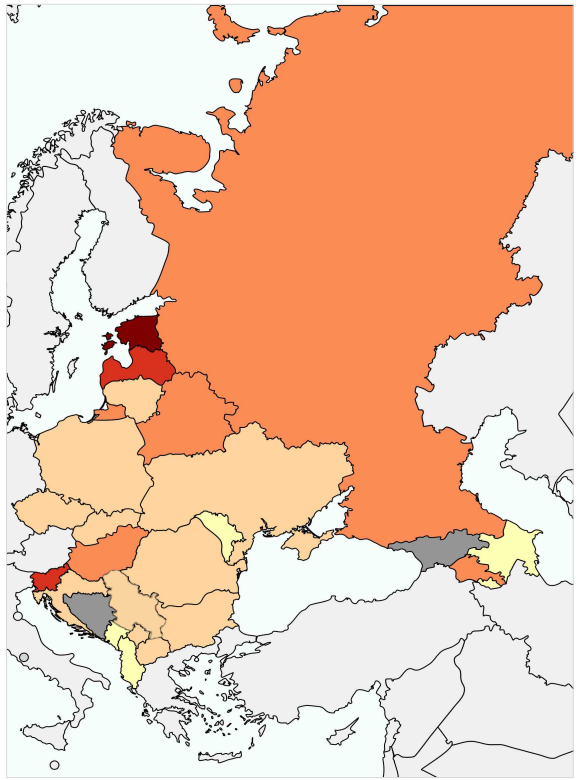
4. In most countries, the local innovation ecosystem has progressed in spectacular fashion over the past few years. A few countries, however, still lag behind – this is the case, in particular, with Albania, Azerbaijan, Bosnia and Herzegovina, Moldova, Montenegro and some others.

5. In most countries, governments and public institutions have played an active role in supporting the emergence of local startup and venture activities. In some cases, for example Russia, the local landscape has been structured to a large extent by state-backed organizations and programs. In member states of the European Union, European funds have brought considerable support to the emerging venture activity.

6. Brain drain and startup emigration affect many countries of the region, due to the appeal of the US market and, to a lesser extent, Western Europe. Other issues for startups emerging in the region include the limited size of the local market, limited access to capital, and in certain cases a negative political or social context. However, the impact of emigration is not completely negative: many startups do keep a foot in their country of origin, and successful entrepreneurs do invest back in their homeland.

KEY FINDINGS: CEE STARTUP ECOSYSTEMS

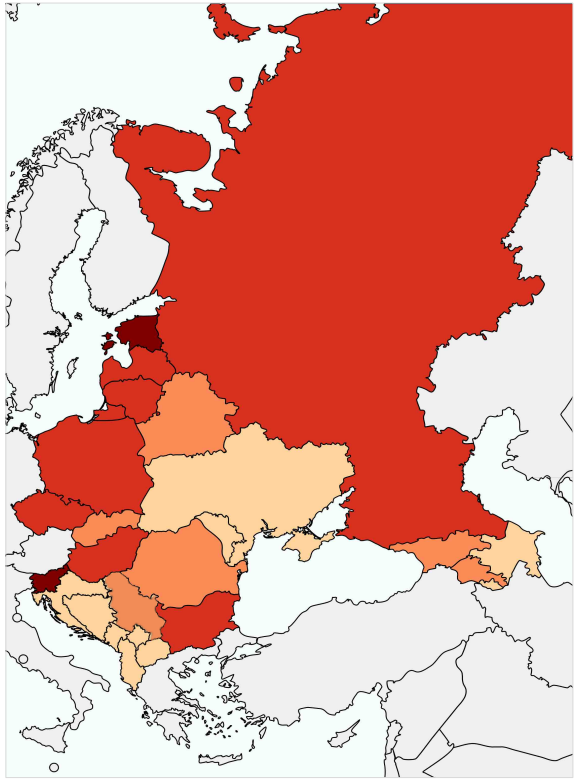
STARTUP INVESTMENT PER CAPITA



- Less than €1
- From €1 to €5
- From €5 to €10
- From €10 to €30
- Around €50
- No data

BASED ON ESTIMATES RELATED TO 2016, INCLUDING INVESTMENT IN STARTUPS WITH CEE ORIGINS BUT ESTABLISHED IN OTHER COUNTRIES

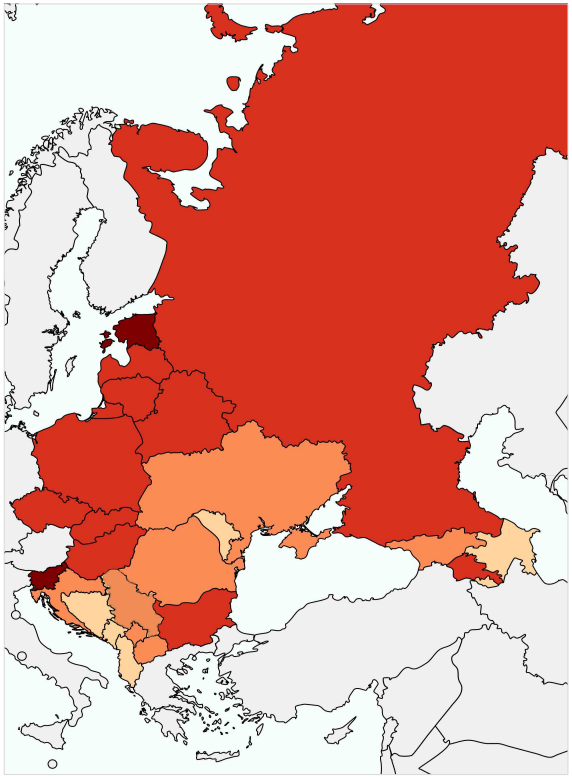
STARTUP ECOSYSTEM MATURITY



- Nascent startup ecosystems
- In development
- Nearing maturation
- Highly-developed ecosystems

BASED ON EWDN KNOWLEDGE AND EXPERT ASSESSMENTS IN EACH COUNTRY (SEE COUNTRY SECTIONS IN PARTS 4 AND 5 OF THIS REPORT)

OVERALL MARKET MATURITY



- Group 1: Underdeveloped startup markets
- Group 2: Early-stage startup markets
- Group 3: Maturing startup markets
- Group 4: Highly-developed startup markets

THIS RANKING COMBINES STARTUP INVESTMENT PER CAPITA (CHART 1) AND EXPERT ASSESSMENTS OF ECOSYSTEM MATURITY (CHART 2)

KEY FINDINGS: CEE STARTUP INVESTMENT TRENDS

1. With less than 1% of the global investment volume, venture activity in the region remains very weak. Russia boasts significant numbers in absolute terms (nearly $900m in 2016), but its venture activity looks extremely modest when compared with the world's leading markets ($70 billion in the USA, $30 billion in China). The Russian numbers are low, too, if calculated per capita: just $7 in 2016.

2. The only country in the region with high venture activity in relative terms is Estonia, with around $60 of venture investment per capita (compared with $185 in the USA and $33 in France). Investment per capita is significant in Slovenia and Latvia as well. But in certain countries, such as Albania, Azerbaijan, Moldova and Montenegro, local venture activity is almost unnoticeable.

3. Only a few international VCs come to Central or Eastern Europe. This is due to the relatively small size of the local markets and, even more often, to a lack of information about these markets and their opportunities. In some cases, moreover, the local political or legal context is not favorable, tending to discourage international investors. However, some foreign investors have enjoyed huge returns on investment after investing in startups from the region.

4. Meanwhile, a number of venture funds and wealthy individuals from the region are asserting themselves on the global venture scene. This is typically the case of investors with Russian, Polish and Ukrainian roots. Some of these globalized investors invest even more abroad than in their country of origin.

5. In contrast with its modest VC activity, the region boasts an impressive record on the global ICO scene. Companies with roots in the region account for around 17% of the ICOs and pre-ICOs conducted globally in 2017, and 22% of the funds raised. Fully 130 ICOs or pre-ICOs came from Russia (out of 237 from the region as a whole) – making this country by far the regional leader. Next comes Estonia (22 identified operations), then Slovenia and Ukraine (22 and 13, respectively).

THE CEE & RUSSIAN VENTURE MARKETS: INTERNATIONAL COMPARISONS
(ORDERS OF MAGNITUDE IN 2016)

USA: Around
$70bn

China:
Around
$30bn

Russia:
Around **$0.9bn**

CEE (excl. Russia):
around **$0.6bn**

EU: Around **$15bn**

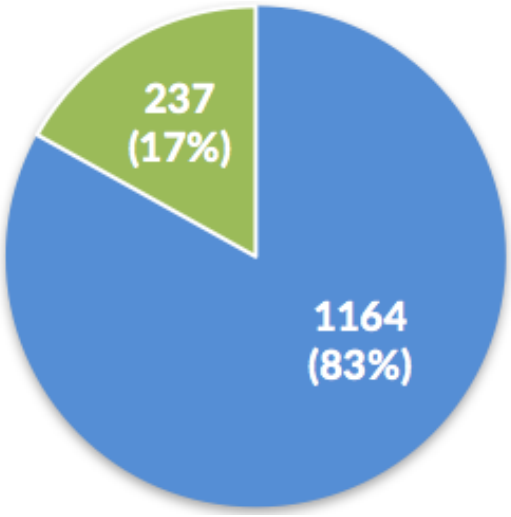
These orders of magnitude are based on the compilation and comparison of various sources. For CEE, we have aggregated the country estimates provided by local experts and communities – which usually take into account deals with an international dimension and, in certain cases, undisclosed deals. The Russia figure is taken from the RG Partners-EY research, the most reliable of available ones.

SOURCE: EWDN CEE VC & STARTUP REPORT HTTP://CEE.EWDN.COM

CEE IN THE GLOBAL ICO MARKET IN 2017

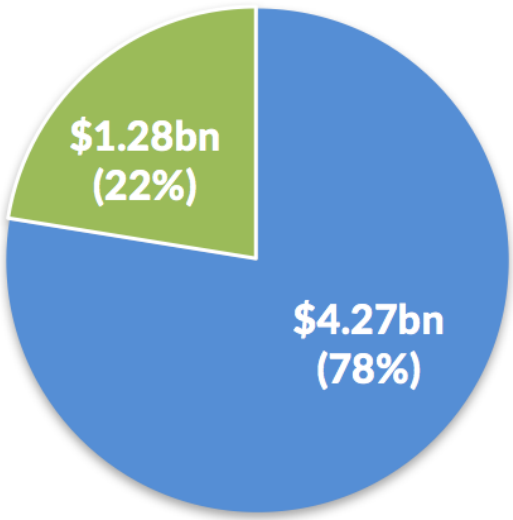
WITH SUPPORT FROM ICO bench

NUMBER OF IDENTIFIED ICOs AND PRE-ICOs



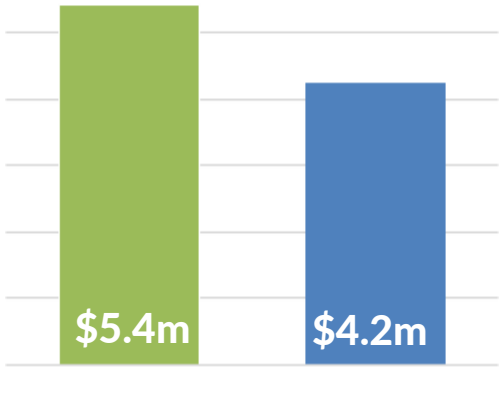
NUMBER OF IDENTIFIED ICOS AND PRE-ICOS CONDUCTED BY COMPANIES FROM CEE, OR WITH CEE ROOTS, BASED ON COMPANY REGISTRATION OR FACTUAL ORIGIN.

RAISED AMOUNTS IN IDENTIFIED ICOs AND PRE-ICOs



AMOUNTS RAISED THOUGH IDENTIFIED ICOS AND PRE-ICOS BY COMPANIES FROM CEE, OR WITH CEE ROOTS, BASED ON COMPANY REGISTRATION OR FACTUAL ORIGIN. DOES NOT INCLUDE UNIDENTIFIED OPERATIONS AND UNDISCLOSED AMOUNTS.

AVERAGE AMOUNTS RAISED IN IDENTIFIED ICOs AND PRE-ICOs



SOURCE: EWDN CEE VC & STARTUP REPORT HTTP://CEE.EWDN.COM

FROM RECENT EUPHORIA TO BRAIN DRAIN CHALLENGES: THE TECH FUTURE OF CENTRAL AND EASTERN EUROPE

BY ADRIEN HENNI, CHIEF EDITOR AT EAST-WEST DIGITAL NEWS

In most CEE countries, startup innovation is a very recent phenomenon. Some of these countries traditionally did have strong scientific, technological and industrial assets, but usually innovation did not translate into Silicon Valley-style startups and VCs.

Illustrating this difference, when in 2009 then-Russian president Medvedev decided to build a state-of-the-art innovation center, he decided to launch the Skolkovo project from scratch instead of building on the numerous existing Russian scientific centers.

True, a first generation of Internet companies had emerged in the country the late 1990s and early 2000s (Yandex, Mail.ru, Ozon, Parallels…) – but this had not led to the emergence of any startup or VC industry. In 2008, there was just one startup incubator and a handful of venture funds in the Russian capital *(see the interview of Pavel Terentiev of AddVenture in Part 5 of this report via http://cee.ewdn.com)* .

Thus, a massive startup wave hit the region around 2010 (some ten years after Western Europe). Countries like Czechia, Hungary, Poland or Russia saw the emergence of local startup and venture ecosystems, which are currently in the process of maturation.

In the past couple years, another series countries were hit by a second wave. Thus Armenia, Bulgaria, Georgia, Latvia, Lithuania and a few others saw their local startup ecosystem emerge and mature in a spectacular way.

For example, sizable infrastructure projects were implemented in Lithuania's capital Vilnius in 2015 and 2016. Linkmenu Factory, a 1,100 sq. m. creativity and innovation area, was launched by a local university, quickly followed by Vilnius Tech Park, which claims to be the largest ICT hub in the region with more than 9,000 square meters and 750 working places. It has become a new home for Startup Lithuania, VC funds, Startup Highway and a variety of startups.

Even some little-developed areas of the former Soviet Union or Yugoslavia have not stayed completely aside. From Baku, to Chisinau, to Sarajevo, to Tirana, the startup scene is far from being empty, even though startup infrastructure and VC investment are still weak or inexistent in these cities.

Will the euphoria continue?

Such expansion cannot continue endlessly in its current forms. There is an effect of maturation or even saturation in the most developed areas – as well as natural selection: obviously, not all the new funds and accelerators which have been springing up over the past years will survive.

Strong government support is not granted forever either. For example, after having invested massively in infrastructure (the cost of the Skolkovo project has reached several billions of US dollars) the Russian authorities are now more inclined to check the efficiency and optimize existing programs than to launch new ones.

However, there are reasons to believe that we have seen only the beginning of the emergence of startup ecosystems in the region.

First, because the infrastructure is far from being built everywhere and the ecosystems are still at the intermediate stage of development. There is still a lot to do in most countries; in some of them, (typically Montenegro, Serbia, Slovakia and Ukraine), the burgeoning startup activity might benefit from increased support from governments which so far had not realized the importance of developing startup innovations – or not been able to support it effectively.

FROM RECENT EUPHORIA TO BRAIN DRAIN CHALLENGES: THE TECH FUTURE OF CENTRAL AND EASTERN EUROPE

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Corporate support could play an important role in the next stage of development of startup ecosystems, believes Janet Todorova of Founder Institute *(see interview in the Bulgaria section in Part 4 of this report via http://cee.ewdn.com)*. According to her, a city like Sofia, for example, is on the verge of switching to the next stage, with corporates joining little by little to support the ecosystem – following a pattern Todorova already saw in in Berlin years before.

Todorova's assertions are supported by the growing number of corporate initiatives on the startup scenes across the region. In certain countries, this corporate involvement seems to have been even more impactful than that of venture investors or local government programs.

As a consequence of such factors, Todorova expects that, in the next five years, "every large city (not only the capital) in virtually all countries of the region will have established such an infrastructure. This means co-working spaces, mentor networks, regular startup events."

"Then, some cities will become larger hubs with an industry focus, where startups will be able to grow to the next level – by entering a startup accelerator program, opening an office to access a larger market, receiving wider access to talent and capital, etc."

Human capital, the key asset

To support further progress, many CEE countries have a key asset: a highly qualified and relatively abundant IT workforce.

This is the case not only in Belarus, Bulgaria, Poland, Romania, Russia and Ukraine, which are well-known powerhouses in the global IT outsourcing and software development market. (With more than 70,000 IT specialists, Bulgaria has been ranked third in the world for the number of IT professionals per capita.)

Even smaller countries like Armenia, Lithuania, Macedonia and Moldova have armies of talented programmers. In Macedonia, the IT sector is growing with over 5,000 new IT graduates each year and foreign companies opening software development and outsourcing centers.

To a substantial extent, this strength is a legacy of the past. As noted by Sasha Galitsky of Almaz Capital: "Under communism, these countries were busy developing copies of IBM computers. This activity involved Bulgaria and Hungary (computer disks, disk drives, printers and etc.), East Germany (memory chips, processors), and Czechoslovakia as well as the Soviet republics of Estonia (cybernetics in Tartu), Latvia (microelectronics), and Lithuania (monitors manufactured in Kaunas). Based on these specializations, engineering schools, R&D and production capacities emerged — and they have continued to develop until now." *(see interview)*

Most of these countries have started the process of switching from essentially outsourcing activities to more product-oriented, value-added models of development, thus generating even more startup activity.

But, simultaneously, the human factor comes as one of the region's biggest challenges.

Over the last decade, many countries in Eastern Europe have been facing substantial brain drain. Some countries have even seen their population decline (– 8% in Latvia between 2010 and 2017; – 13% between 2004 and 2014 in Moldova), which is sometimes perceived as an existential threat.

FROM RECENT EUPHORIA TO BRAIN DRAIN CHALLENGES: THE TECH FUTURE OF CENTRAL AND EASTERN EUROPE

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Tech professionals are among those who can easily find better-paying jobs in the West, and their proportion among those leaving their home countries is high. As for startup entrepreneurs, they tend massively to establish their company abroad as soon as they reach a certain level of development.

Thus, according to unverified but unsurprising estimates, more than 1,000 Russian startup entrepreneurs left their country in 2015.

Brain drain is also reflected by what may be mildly called the internationalization of venture deals.

The largest part – by far – of post-seed funding raised by Armenian, Estonian, Slovenian or Ukrainian startup entrepreneurs, to take just the most notable examples, has been secured from international funds injecting money in companies registered outside the region.

Such evolutions are probably inevitable due to the appeal Silicon Valley, Berlin, London, Singapore or even Chile *(see the case of PromoRepublic, one of the most globalized Eastern European startup, in Part 6 of this report via http://cee.ewdn.com).*

Most CEE countries are not helped by their size: their domestic markets are generally too small to support the development of startups after a certain stage (the only exceptions here being Russia and perhaps Poland).

What's more, in many CEE countries, the scarcity of locally available capital leaves entrepreneurs no choice but seeking agreements with foreign funds.

As their startup grows, successful CEE startup entrepreneurs also tend to build their sales and marketing skills in the USA or Western Europe, where these skills are more available than in their native region.

This being said, the internationalization of the CEE startup activity does not only have negative consequences. Even when establishing themselves in another country, raising money from international funds and developing on the global markets, the startups founded by Eastern-European entrepreneurs tend to keep ties with their countries of origin.

Most Armenian, Romanian, Russian or Ukrainian-founded startups incorporated abroad have kept R&D teams in their countries of origin, taking advantage of valuable human assets and contributing to raise and retain them locally.

This makes financial sense since salaries of developers and engineers are much lower in CEE than in Western Europe or US.

What's more, many tech entrepreneurs invest back in their country or origin after reaching success abroad. Among the most spectacular examples are those of Estonian Skype founders and Hungarian Prezi founders, who not only funded a range of local startups, but contributed in various other ways to develop their country's startup ecosystems *(http://cee.ewdn.com, Part 6).*

The very existence of such success stories has also played an invaluable social role, attracting the attention of the young generation to startup opportunities, setting a positive example to entrepreneurs and, in certain cases, pushing the authorities to take the startup industry more seriously.

Thus, in spite of brain drain challenges, CEE countries seem to have no other choice than continuing to develop highly qualified IT professional communities. But the region's tech future lies in highly-developed startup ecosystems and their smart integration into the global markets, which appear as the only way for these countries to become more than a modest HR appendix of large global tech hubs and corporations.

THE EASTERN EUROPEAN INNOVATION SCENE AND THE POTENTIAL IT HOLDS

A RESEARCH BY ALMAZ CAPITAL

This analysis is based on a research by Almaz Capital, an international venture fund with Eastern European roots. It is published here with the fund's permission.

To a large extent, the Eastern European startup scene is a legacy of the past. For starters, let's take the former Soviet Union (FSU) as an example. As much as 22% of its GDP was dedicated to defense and about 5% went to education. Of a total of 139 million employed, 2 million worked in IT. About 23% of the population had a university degree, and there were more than five million students enrolled in college.

Surely, the region was no stranger to innovation. There were more than 350 research institutes in the FSU, over a million scientific researchers, and 10 million people employed in research and development (R&D). The region was also marked by a number of scientific developments over the decades, including the creation of the world's first nuclear power station in the 1950s and the launch of the first Space Station in the early 1970s, among others.

Migration contributed to spreading the knowledge of FSU scientists and engineers across the world, most notably to Israel, Germany and the USA. As a result, it has helped shape a lot of the world's IT industry. More than 1 million immigrants from the FSU live in Israel, of which over 85,000 are trained engineers and technologists. In Silicon Valley alone, the number of Russian-speaking engineers is above 45,000.

Talent is key

Today, Eastern Europe continues to hold great potential for the global IT industry, as the engineering talent in the region is nothing short of top-notch. Russia, Poland and Hungary, in fact, are in the top-five of countries with the best engineering talent, spanning domains like algorithm, Java, C++ and artificial intelligence (AI) development.

With regard to data engineering, Russia and its neighbors take the fourth place on Kaggle, the world's largest data scientists community. The Yandex Data School is the largest non-university-based school of data analysis with about 500 graduates since 2007.

When it comes to blockchain, Russia and Eastern Europe are the second largest community (after the US) contributing to the technology, with multiple companies pioneering it globally. Those include BitFury (which has roots in Latvia and Ukraine), Ethereum (Russia), Iconomi (Slovenia), and Golem (Poland).

The development of machine learning, too, is closely tied to the region. Markov chains and models – used to model randomly changing systems – are the very basis of deep learning. The hidden Markov model developed by Russian-born Ruslan Stratonovich is the main model for speech recognition. Alexey Ivakhnenko, sometimes referred to as the "father of Deep Learning", in turn, developed the Group Method of Data Handling (GMDH) and published the first functional Deep Learning networks.

High quality, low cost

The region is also attractive because of the lower cost of labor. Companies with access to the regional talent pool get high-end software development at a fraction of the US cost, thus, driving capital efficiency for their investors. The median annual salary in IT in the US stands at $110,000, while that in Russia is 5 times lower, at $22,000.

With its cost efficiency and high-quality engineering talent, Eastern Europe has raised many IT startups. Its most famous international success stories are Skype, Viber, Evernote and Avast, as well as Internet company Mail.ru, software company GoodData, and instant messaging service Telegram.

THE EASTERN EUROPEAN INNOVATION SCENE AND THE POTENTIAL IT HOLDS

A RESEARCH BY ALMAZ CAPITAL

The key to the success of many of those IT businesses has been the ecosystem's ability to forge lasting relationships between its various stakeholders – from accelerators, incubators and investors, to other startup support organizations, and universities. A strong connection to Silicon Valley and other entrepreneurial hubs has also played an important role in bridging the gap between Eastern Europe and the rest of the world.

That being said, Eastern European companies have best chances to build world champions when they target clients in the US, the most vibrant and receptive IT market in the world. Take the sharing economy as an example: for global ride- and apartment-sharing services like Uber and Airbnb, the US market is still the leading source of revenue (around 70% in 2015).

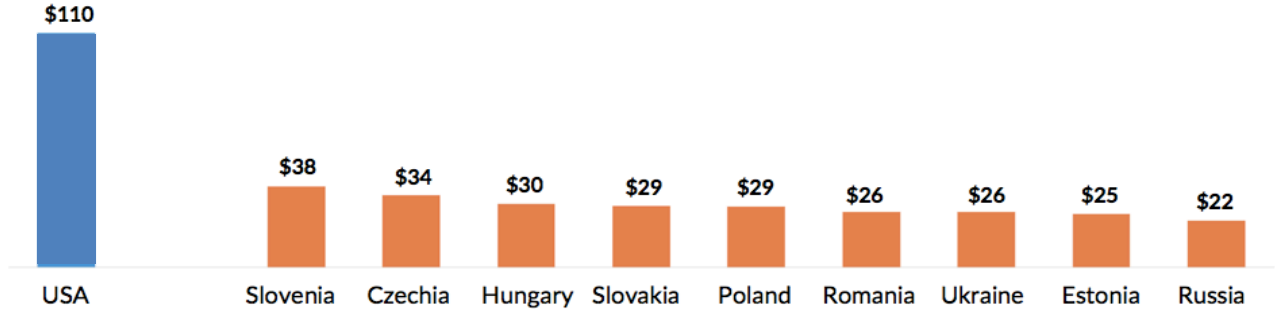
Yet, while Russia and Eastern Europe still have a way to go to catch up with many of the entrepreneurial ecosystems of the West, there is no doubt that the region holds great potential. With multiple success stories coming from the region over the past decade, it has certainly positioned itself as a strong contender in the global innovation scene.

RANKING OF THE WORLD'S TOP ENGINEERING TALENT

RANK	COUNTRY	SCORE INDEX	RANK	COUNTRY	SCORE INDEX
1	China	100.0	13	Singapore	87.1
2	Russia	99.9	14	Germany	84.3
3	Poland	98.9	15	Finland	84.3
4	Switzerland	97.9	16	Belgium	84.1
5	Hungary	93.9	17	Hong Kong	83.6
6	Japan	92.1	18	Spain	84.4
7	Taiwan	91.2	19	Australia	83.2
8	France	91.2	20	Romania	81.9
9	Czechia	90.7	21	Canada	81.7
10	Italy	90.2	22	South Korea	81.7
11	Ukraine	88.7	23	Vietnam	81.1
12	Bulgaria	87.2	24	Greece	80.8

SOURCE: HACKERRANK

MEDIAN ANNUAL SALARIES IN IT (IN THOUSAND USD)



SOURCES: O'REILLY MEDIA, PAYSCALE.COM

THE RUSSIAN STARTUP & VENTURE SCENE

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COUNTRY BACKGROUND

POPULATION: 143.4 million (2017)

- 74.1% of urban population (2016)
- 5.5% unemployment rate (2015)
- 78.7% with tertiary education (2017)

SOURCE: GLOBAL INNOVATION INDEX 2017

GDP: $1.267 billion (2017)

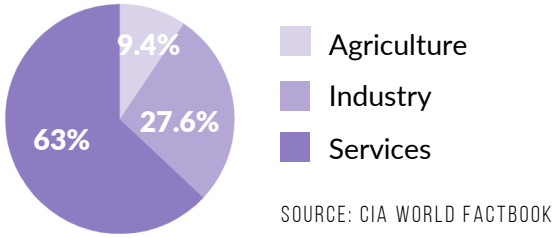
- Average growth rate 2014-16: +3.3%

SOURCE: WORLD BANK

- Per capita: $25.410 (2017)

SOURCE: GLOBAL INNOVATION INDEX 2017

LABOR FORCE BY OCCUPATION (2016)



SOURCE: CIA WORLD FACTBOOK

RUSSIAN HAPPINESS

The country ranks 49th in the UN's World Happiness report (2014-2016)

Old and new Moscow: The Digital October innovation center, established in a former candy factory (red buildings in the center of the picture) and the cathedral of Christ the Savior, built in the 19th century and rebuilt in the 1990s after having been destroyed under Soviet rule. (Photo credit: Depositphotos)

KEY VENTURE FACTS & TRENDS

1. With deeply rooted traditions of technological excellence and more than 90 million Internet users, Russia is, by far, the region's largest market in terms of innovation.

2. The local startup and VC ecosystem has reached a high level of development, partly due to massive state interventions.

3. With less than $1 billion per year, however, the venture market remains tiny in comparison with other major global tech powers. A substantial part of Russian capital goes to foreign startups, or Russian founders established abroad, making access to funding more difficult to domestic entrepreneurs.

4. In spite of numerous opportunities, many Western tech investors have turned away from Russia over the past few years as international tensions were growing. Giant investment agreements have been signed with China, but with little noticeable effect on the Russian startup ecosystem so far.

5. Russian entrepreneurs have strongly asserted themselves on the global ICO scene, placing their country second after the USA in number of ICOs and pre-ICOs in 2017

ESTIMATED NUMBER OF INVESTORS (2017)

- The Firrma-RBC-EY research identified 47 funds based in Russia or with Russian roots having made at least one startup investment between December 2016 and December 2017.

SEE THE RANKING (IN RUSSIAN): HTTP://GOO.GL/ZDMZEP

VC MARKET DATA

- **Total startup investment activity (funds + business angels)** according to the RB Partners-EY-Firrma research

Period	Amount	Nb of deals
2015	$383m	297
2016	$894m	302
H1 2017	$321m	149

SEE THE 2016 REPORT: HTTP://GOO.GL/MCS4JP
LIST OF DEALS: HTTP://GOO.GL/KTHK7K

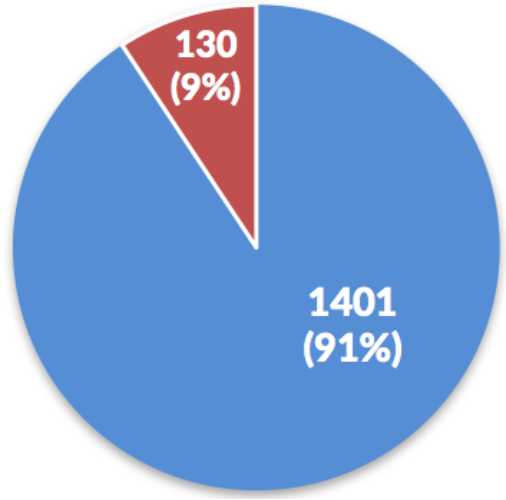
- **Investment from BAs only:** The National Association of Business Angels (www.rusangels.ru) identified 92 startup investment deals involving individual investors in 2016. A considerable additional number of deals has remained undisclosed.

SEE THE REPORT (IN RUSSIAN): HTTP://GOO.GL/4JFVWI

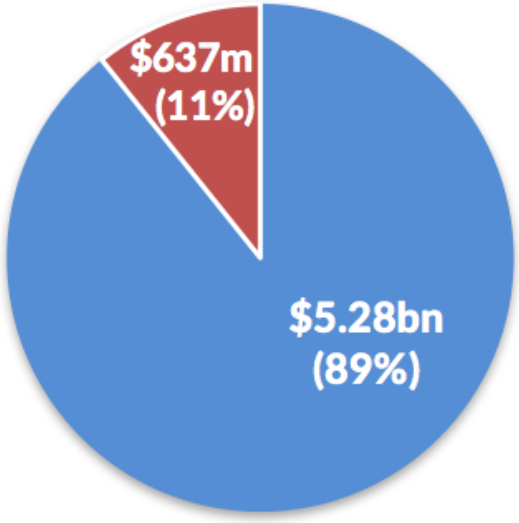
RUSSIA IN THE GLOBAL ICO MARKET IN 2017

WITH SUPPORT FROM ICO bench

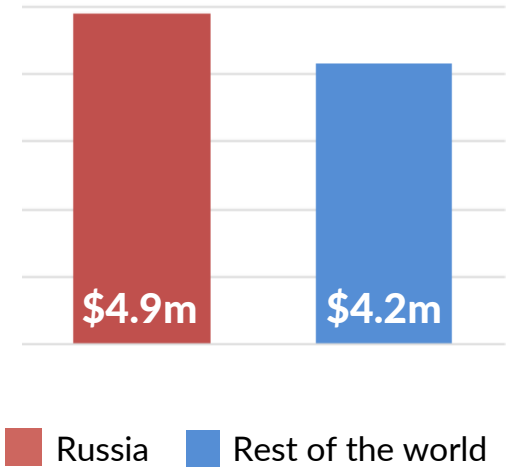
NUMBER OF IDENTIFIED ICOs AND PRE-ICOs



RAISED AMOUNTS IN IDENTIFIED ICOs AND PRE-ICOs



AVERAGE AMOUNTS RAISED IN IDENTIFIED ICOs AND PRE-ICOs



NUMBER OF IDENTIFIED ICOS AND PRE-ICOS CONDUCTED BY COMPANIES FROM RUSSIA, OR WITH RUSSIAN ROOTS, BASED ON COMPANY REGISTRATION OR FACTUAL ORIGIN.

AMOUNTS RAISED THOUGH IDENTIFIED ICOS AND PRE-ICOS BY COMPANIES FROM RUSSIA, OR WITH RUSSIAN ROOTS, BASED ON COMPANY REGISTRATION OR FACTUAL ORIGIN. DOES NOT INCLUDE UNIDENTIFIED OPERATIONS AND UNDISCLOSED AMOUNTS.

SOURCES: ICOBENCH (GLOBAL), ICOBENCH+EWDN (CEE), COMPANY INFORMATION

HOW RUSSIA ATTRACTED 11,000 STARTUP PROJECTS TO A CORPORATE-ORIENTED ACCELERATOR

AN INTERVIEW WITH RVC DEPUTY CEO MIKHAIL ANTONOV

RVC, Russia's state-owned fund of funds for innovation, supports a variety of initiatives and programs aimed at developing the country's innovation ecosystem. Among its major initiatives over the past few years has been GenerationS, a giant acceleration program aimed at matching innovation ideas and startups with corporate needs. In this interview Mikhail Antonov, RVC's Deputy CEO and Innovation Infrastructure Development Director, provides details about this program and its achievements to date.

How does the Russian market look in terms of open innovation?

In spite of some notable moves over the past couple of years, major Russian companies, unfortunately, do not yet work with tech entrepreneurs and startups as actively as foreign corporations. International giants – General Electric, Google, Procter & Gamble and others – are constantly searching and introducing breakthrough technologies as a part of their open innovation strategies. Russian big business is lagging behind for a number of reasons.

These reasons include a lack of understanding of how to start such collaborations, how to develop entrepreneurship culture within the corporation, and how to build connections with the innovation ecosystem. What's more, Russian corporations, generally speaking, are conservative and reluctant to any changes.

At RVC, we launched GenerationS (http://en.generation-startup.ru) as a platform to involve Russian corporations in startup innovation through customized acceleration programs. Year after year, we see the number of corporate partners increase, along with their interest in startups.[1]

Besides RVC, the organizer of GenerationS, other government-backed organizations support the initiative. These include Skolkovo Foundation, the Foundation for Assistance to Small Innovative Enterprises (FASIE, also known as Bortnik Fund), which provide grants and other non-monetary support to our finalists.

Is GenerationS equally open to Russian and foreign companies?

GenerationS is equally open to Russian and foreign companies. Over 150 government organizations and private companies have been involved in the accelerator's operations since 2013. Many major international corporations – SAP, Visa, Microsoft, Raiffeisenbank and others – have been partners of GenerationS.

We expect these numbers to grow with even more foreign startups applying and more international corporations searching for strong Russian technology teams.

Can you provide examples of particularly fruitful cooperation with foreign corps?

We strive to develop cooperation with all partners, be they Russian or foreign. For us, the ideal partners are those which are committed to working with startups as part of their business strategy, not as a one-time exercise.

1. GenerationS was launched in 2013. In 2016, the initiative attracted as many as 4,237 teams (up 65% from 2015) from 30 countries, with up to 15 million rubles (around $266,000) in prizes. Another 100 million rubles (almost $1.8 million) was offered by both Russian and international corporate partners.

HOW RUSSIA ATTRACTED 11,000 STARTUP PROJECTS TO A CORPORATE-ORIENTED ACCELERATOR

AN INTERVIEW WITH RVC DEPUTY CEO MIKHAIL ANTONOV

This is the case SAP, for example, which has been a partner of GenerationS since the very start, and continues to select projects each year to introduce them into their corporate ecosystem. By the way, beyond GenerationS, we do many joint events with SAP, where they share their best corporate venturing and open innovation practices.

Another example – among many! – is Microsoft, which has been a partner for several years, providing expertise and infrastructure to the most promising startup teams.

Does GenerationS cooperate with foreign organizations, putting aside corporations?

Among the recent examples is our partnership with the Lithuanian tech park Sapiegos (Vilnius Tech Park), with support from city authorities and the venture fund IMI.VC. A special nomination, the 'Vilnus Tech Park Award,' has been established, providing winners with grant certificates and a residence permit in Lithuania, as well workspace in the tech park, legal, mentoring, and marketing support. These mechanisms aim to support the expansion of these startups to the EU and US markets (http://goo.gl/zaUWsB).

After more than four years of operations, what have been the main achievements of GenerationS, and its main issues?

In 2013, GenerationS was the first accelerator introduced in Russia in such a format. In early 2017, we achieved a total of 20 acceleration programs. Each one gathered a unique pool of partners, investors, experts and, most importantly, startups. The total volume of investments in startups which went through GenerationS has exceeded 1.1 billion rubles [some $16.5 million at the 2016 exchange rate], and their valuation reached some 2.2 billion rubles [$33 million].

Since 2013, a few dozens of accelerators have appeared in Russia. As a market leader, we play an important role in establishing a startup acceleration culture in Russia with the proper performance standards. Over these years, we have built a community of nearly 11,000 Russian startups or startup projects, getting access to a variety opportunities for growth and sustainability.

We help universities, corporations, regional business incubators to build their own acceleration programs, providing them with project expertise, mentors network, IT infrastructure across the country. At the regional level, GenerationS provides methodological and financial support for people and organizations dealing with startup generation and incubation. In turn, this generates new pipelines to fuel our own accelerators.

GenerationS is now active beyond Russian borders, with a total of 240 cities and 30 countries, including Belarus, Armenia, Kazakhstan, Ukraine, France and the United States. Every year we observe increasing number of applications for participation in GenerationS.

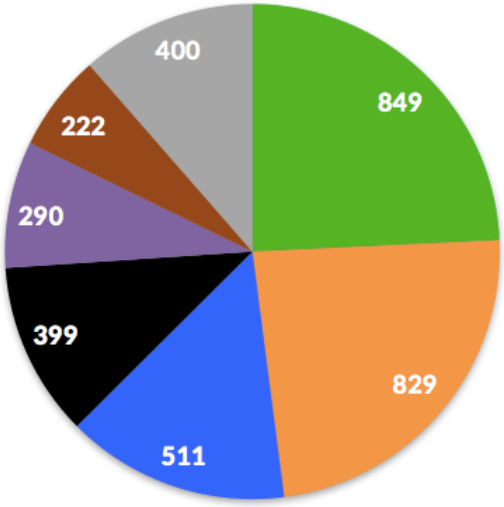
Though we have grown older and more experienced, we are still startup-minded. We are open, agile and totally cooperative. We believe that, together with our partners, we can change our world and make our lives more comfortable and more efficient.

(July 2017)

HOW RUSSIA ATTRACTED 11,000 STARTUP PROJECTS TO A CORPORATE-ORIENTED ACCELERATOR

GENERATION S PROJECT ANALYSIS IN 2017:

BY INDUSTRY:



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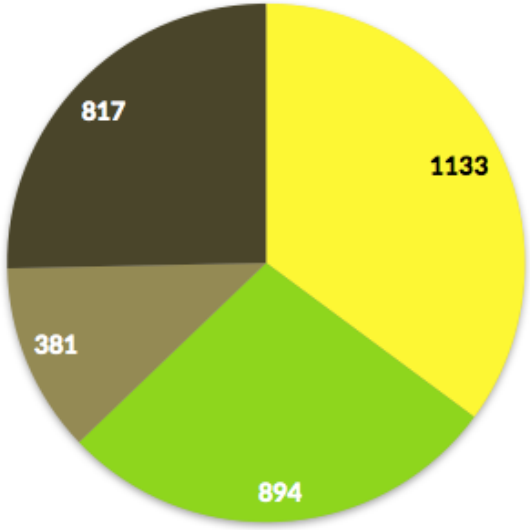

*Approximation

SOURCES: GENERATION S, EWDN

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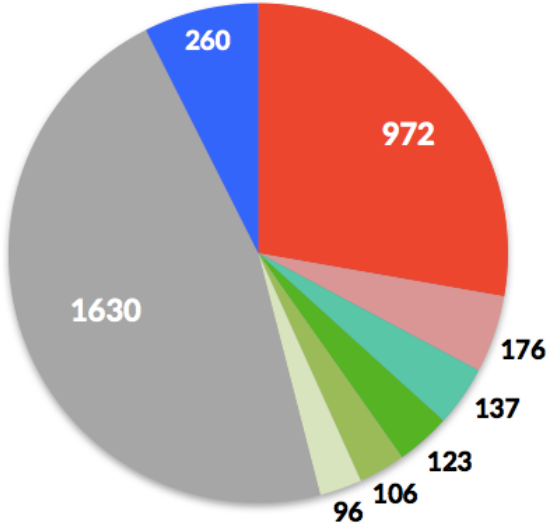


ARÈCHE ALAMIR OF AUCHAN RETAIL: "RUSSIA, ALONG WITH FRANCE AND CHINA, IS A KEY COUNTRY IN OUR OPEN INNOVATION STRATEGY"

Arèche Alamir is Chief Customers and Innovations Officer at Auchan Retail Russia. In this interview, he outlines the key points of his group's open innovation strategy and how it applies to Russia and Eastern Europe.

Tell us a bit about Auchan's open innovation strategy

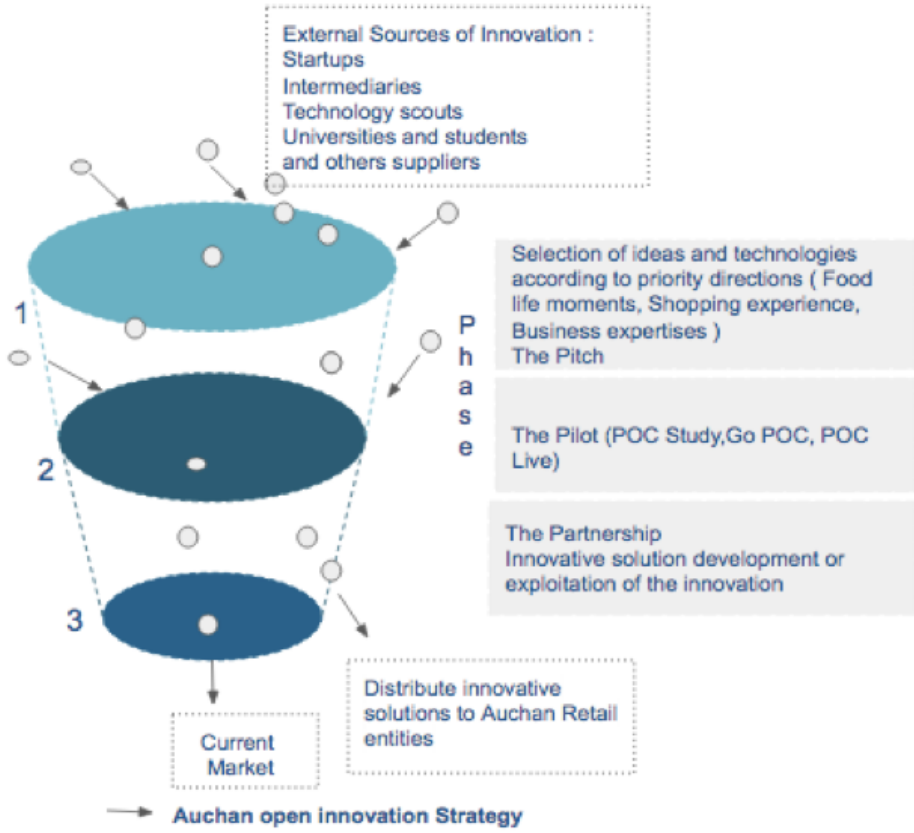
Auchan Retail's open innovation strategy aims to address the internal needs, and corresponds to our Global Strategic Vision. Two core processes are being used. The "outside-in" process allows the company to leverage external sources of innovation through collaboration with startups and other innovation actors. Through the "inside-in" process, the company's own innovative solutions are spread across Auchan Retail entities. There is no aim to build an "inside-out" process and sell license knowledge and technology.

The strategy focuses on three main strategic fields: what we call "food life moments" (before and after purchases); the shopping experience (in-store and on-line); and business expertise (innovations aiming at improving our processes).

Currently, the company collaborates with startups through two key open innovation mechanisms: Open Call Startup Program and Open Startup Platform. Five key tech areas are being scouted outside the company: recognition tools, indoor geolocation, bots and artificial intelligence, augmented and virtual reality, APIs. We are starting to look at Blockchain, too.

Are things organized locally or centrally?

A global platform in France, currently under a pilot study, will provide a single entry-point for innovative start-ups seeking to partner with Auchan Retail. The platform will also enable the company's units to experiment with new technologies more efficiently and rapidly, and facilitate communication and coordination between different Auchan entities.



ARÈCHE ALAMIR OF AUCHAN RETAIL: "RUSSIA, ALONG WITH FRANCE AND CHINA, IS A KEY COUNTRY IN OUR OPEN INNOVATION STRATEGY"

We have set up an open innovation team with representatives from the global office as well as France, Russia and China — reflecting the importance of Auchan Retail's activity in these countries. This team must screen, identify, work with, and monitor large numbers of startups. They are also responsible for experimentation and effectuation processes, as well as the development of innovation capabilities.

Thus, Russia is among the key countries of our open innovation strategy. Auchan Retail Russia launched an outside-in startup program in December 2016, in partnership with French Tech Moscow, Skolkovo and the IIDF [FRII in Russian, the country's largest startup investment fund]. Potentially interesting startups were identified through private meetings; then they got the chance for conducting a pilot study. Out of 43 applicants, 21 startups had individual meetings with us, 15 seemed interesting to us and we're now conducting pilots with a couple of them.

What about other countries Central and Eastern Europe?

Several pilot projects are currently being conducted at the experimental stage in such countries as Romania, Hungary, Poland and Ukraine. I would cite, in particular, Brandquad (content management platform), Chargecart (shopping trolley with charger for consumer), Chatbots in Recruitment, "A2IA" (Scan Shopping List mob app), Tellspec (food scanner), PassDrive and others. Some of these experiments have revealed a latent cooperation potential, created new data, and led to consider new approaches.

(November 2017)

Arèche Alamir speaks to Russia startups at international tech hub Skolkovo (December 2016)

ARSENIY DABBAKH: "VENTURE INVESTMENT VOLUMES ARE STILL VERY LIMITED, BUT THE ECOSYSTEM IS DEVELOPED AND RUSSIA IS PROBABLY READY FOR A HUGE LEAP AHEAD"

RB Partners partner Arseniy Dabbakh is an attentive observer of the Russian venture scene, as witnessed by the authoritative industry reports he publishes twice a year. In this interview, he reviews the key evolutions of the sector and their implications for international investors.

The Russian venture market doesn't even reach $1 billion per year. Why such a small size in a country which is known for offering top technologies in a variety of fields?

Before 2014, Russia was – and I believe will be again – among the top ten VC markets in the world. Such poor results are due in part to the political tensions and sanctions imposed on Russia by Western countries, with a range of large Western VCs reducing their presence or turning away from Russia, even though the sanctions didn't formally concern VC activity.

Another reason has been the economic downturn, and the ruble's depreciation in 2014-2015 – by nearly 50% – which led to smaller market numbers in US dollars.

Can the Russian venture industry be described as mature?

If judging by the volume of transaction, the market looks at a very early stage; however, the venture ecosystem is quite developed. Russia has an important number of players, incubators, accelerators, state support programs, and a huge number of private and government-backed players involved in this business. This market is probably ready for a huge leap ahead.

To which extent and how does the industry enjoy government support?

The government has been very active in supporting the Russian VC industry. This is reflected in a variety of grant mechanisms for early-stage startups, tax breaks and subsidies for startups, a large number of tech parks – including Skolkovo, the international tech hub under completion bear Moscow, which has cost several billion dollars, – and many other initiatives. RVC, the state-owned fund of funds, provide hundreds of million USD to VC firms investing in Russia.

Support from the local or regional authorities may be substantial, too, as exemplified by Tatarstan with its venture fund, tech parks and other initiatives supported by the local government.

Does state intervention have more of a positive or negative effect?

This is positive taking into account the lack of long term capital and the need to develop the startup and VC infrastructure. State institutions are filling the gap which has been created by the economic and political situations as well as historic factors. This being said, the government is less efficient when investing directly, and more activity from private Russian and foreign VC firms would be welcome.

Do you expect the government to increase or decrease its involvement in the future?

The government will be more selective in their support. In certain fields, they will intervene even more while in others, they will take a less active stance. For example, I expect the Russian government to push the launch of CVCs from both state-controlled and private corporations. On the other hand, the state is likely to be less active than in the past in forming new institutions and launching dedicated support programs.

ARSENIY DABBAKH: "VENTURE INVESTMENT VOLUMES ARE STILL VERY LIMITED, BUT THE ECOSYSTEM IS DEVELOPED AND RUSSIA IS PROBABLY READY FOR A HUGE LEAP AHEAD"

Do Russian corporations — putting aside pure players — invest significantly in tech companies?

Not yet, and this is an important issue for Russia. The country lacks corporate or strategic investors, which results in a low number of exits. But the diversification of the Russian economy, which has been traditionally focused on oil and gas, has begun, and some large corporations now show more interest in corporate venturing and open innovation.

This evolution started a couple of years ago, when we saw a growing number of large corporations participate in tech conferences and discuss corporate investment. I know for sure that more than 10 new corporate funds will be launched soon. This is coming in addition to the development of tech scouting, corporate acceleration and other related activities.

Are foreign investors active on the Russian venture scene?

Big foreign VCs haven't not been active for the last couple of years, in part due to the degradation of the political climate. However, in 2017 I saw strong interest from Asian VCs – especially from Japan, China and Korea, – while some Western firms were coming back or at least considering doing so.

These investors are encouraged by the macroeconomic stabilization (since 2015 already) and the increasing number of strong startups in Russia. On their side, Russian investors are very interested in co-investing abroad with established western VCs.

Do you believe that foreign tech investment can gain significant traction while Russia is still experiencing problematic relations with the Western world?

Russia has an obvious interest in developing relations with Western and US players. Cooperation with Asian or even Latin American firms is fine, but it cannot fill the gap left by Western players, should these leave the country. Russian innovation suffers from the lack of capital, which is abundant in the US market, while a variety of Russian technologies and development capacities can be useful to the West.

On the Chinese side, several joint funds or programs, including tech-oriented ones and involving considerable amounts, have been announced over the past two years. Did you record real deals from this side, or these have been mainly announcements?

These were mega-deals, some of them with a political component. So far they didn't translate massively into real business deals, projects or noticeable influence on the Russian market.

(December 2017)

- *Arseniy Dabbakh is Partner at RB Partners (www.rbpartners.ru), a Moscow-based VC, PE and growth advisory firm. He is also an executive member of the National Alternative Investment Management Association (NAIMA) a major Russian investor association (www.naima-russia.org). You may reach him by email at dabbakhad@rbpartners.ru.*

IIDF HEAD KIRILL VARLAMOV: "WE PROVIDE OUR STARTUPS WITH ENOUGH MONEY TO GROW PERHAPS MORE SLOWLY, BUT STEADIER THAN THEIR WESTERN COUNTERPARTS"

The Internet Initiatives Development Fund (IIDF, or FRII in Russian) is the most active seed and early-stage startup investment fund not only in Russia but in Europe at large. Its director Kirill Varlamov shares comments on the peculiarities, track record and strategy of this fund, and how it contributes to the maturation of the Russian VC and startup ecosystem.

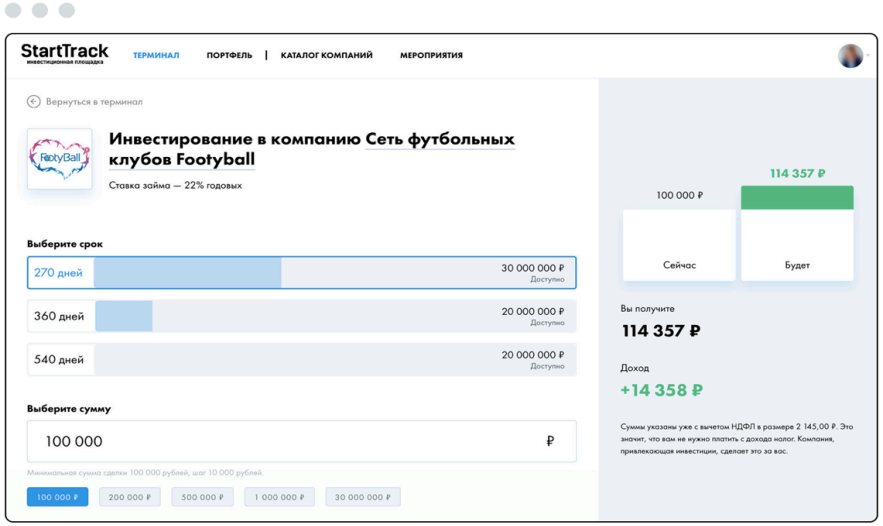
With more than 300 investments in less than four years, the IIDF has been the most prolific startup investor in Russia. Why and how did you build such a big VC business?

The IDFF emerged on the venture market five years ago. Since its inception, we have asserted ourselves as the most active fund in Europe, according to Dow Jones. The IDFF is among top five accelerators in the world, according to Pitch Book.

Our mission is to make the Russian market transparent and accessible to all entrepreneurs willing to launch or expand their business in the field of technology. We have 6 billion rubles [a bit more than $100 million at the current exchange rate] under management. We annually select the best projects out of 10,000 Russian companies, help them develop and invest in them.

Thus, some 85% of the Russian venture pipeline goes through the IDFF, while the fund accounts for over the half of total number of venture deals in Russia annually.

Over the past several years, we have built a full-fledged ecosystem. We hold a range of educational events across Russia – thus last year 28,000 people took part in 265 IDFF events. We develop the angel investment market through special training programs as well as through the crowdfunding platform StartTrack (https://starttrack.ru), which the market leader with more than 2,000 participating investors to date.



Through the IIDF-backed StartTrack crowdfunding platform, anyone can provide Russian startups with a loan or a capital injection in just a few clicks.

We launched our acceleration program after studying the operations of major and the most successful funds and accelerators in the world. This program helps young projects to grow productively, quickly test business ideas, and increase sales and revenue. Thousands of teams have participated in the program. We have gathered a community of experts in the fields of IT, sales, marketing and technology. These experts help our companies achieve maximum results in minimum time.

A variety of players and groups are involved in our activities, from local or international corporations, to industry associations, to students or even children in entire regions. Besides, the IDFF's experts has been used by lawmakers when drafting regulating IT market regulations and legal frameworks for entrepreneurs and investors.

IIDF HEAD KIRILL VARLAMOV: "WE PROVIDE OUR STARTUPS WITH ENOUGH MONEY TO GROW PERHAPS MORE SLOWLY, BUT STEADIER THAN THEIR WESTERN COUNTERPARTS"

What are the average tickets in your investments?

We invest up to 2.5 million rubles [nearly $44,000] at the earliest stage, from 15 to 50 million rubles [$260,000 to $870,000] at the seed stage, and up to 324 million rubles [roughly $5.7 million] at the Series A stage and further. Since 2014, we have injected over 500 million rubles [roughly $8.7 million] in 326 pre-seed stage companies, while 53 more mature startups have received 2.4 billion rubles [$42 million] from us.

Does your investment practice differ from that of other funds?

Technically, we work under the same standards than any other VC fund. However, the IIDF has some peculiarities. It is an evergreen fund, which is a specific type of fund with an indefinite life period.

Besides, our approach differs from that of many Western VCs, which consists in pushing companies to super-fast growth and quickly selling them. In this model, investors are not discouraged by the absence of revenue, they rather look at growth indicators. By contrast, we support our future unicorns with enough money to stay afloat and grow perhaps more slowly, but steadier than their Western counterparts.

How successful are your startups?

One in three teams successfully graduating from our acceleration program attracted further funding rounds from the IDFF within the next six to nine months.

Today, a substantial part of our portfolio companies – in which we invested at the early stages – show impressive growth and are getting close to business maturity. This is why I am confident that we'll see more and larger exits in the middle term, confirming the success of our evergreen fund model.

Are these startups rather Russia-centered or internationally-oriented?

The majority of our portfolio companies are internationally-oriented. It is logical to consider domestic market as a testing ground for an idea or a business – after which the business can expand internationally, learn from work with clients from different countries, test ideas on other markets.

Is it easy for Russian startups to go global?

The success of a startup lies in the transformation of an idea into a real and globally-oriented business. It is essential for us that the teams create services that are competitive on the global market. We help them to stick to this strategy, which includes providing financing. Some of our portfolio companies target exclusively Western markets, for example Semantic Hub and Data Matrix, which serve major players of the European pharmaceutical industry. There should be no borders for cutting-edge technologies; we encourage our startups to envision a global strategy from the very start than limit themselves to one country.

Does your fund work with international players?

We do collaborate closely with international venture and tech businesses. These include such Y Combinator, 500 Startups, HAX, SOSV, TechStars, Seedstars as well as such major corporations as Auchan, Leroy Merlin, MediaMarkt, Raiffeisen, Visa, Stada, Michelin, BMW, Schneider Electric, Microsoft, Inditex, Quelle, Otto, LG, SAP, Samsung and BCG, etc. Last year, our portfolio companies launched more than 50 pilot projects in cooperation with corporations with our help. For instance, Bayer, Teva and Fasten tested AI-powered HR Robot Vera, while Auchan and Enel tried HoloGroup, an AR solution to build shopping malls. Over 150 other pilot projects are being discussed or pending approval.

IIDF HEAD KIRILL VARLAMOV: "WE PROVIDE OUR STARTUPS WITH ENOUGH MONEY TO GROW PERHAPS MORE SLOWLY, BUT STEADIER THAN THEIR WESTERN COUNTERPARTS"

Does your fund or its portfolio companies have any particular geographic or industry priority?

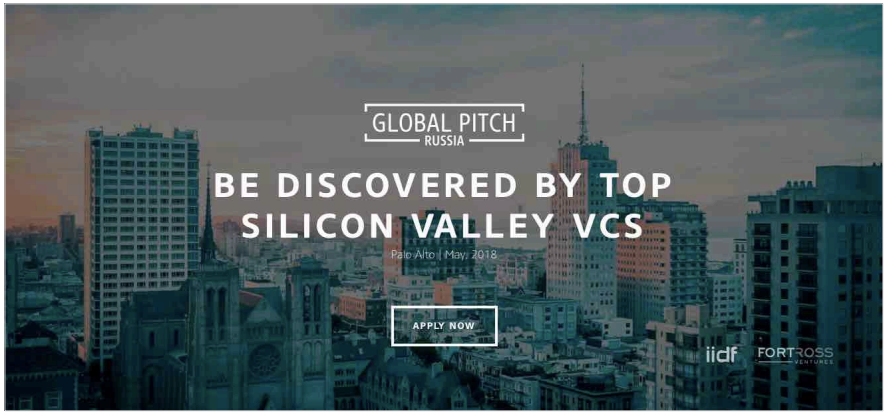
Our portfolio companies are actively considering all the major markets. For instance, last year we launched two US-oriented formats. In spring, we held the first on-site acceleration program Techmafia with advice from our American partners, for example 500 Startups. This is an intensive three-month soft landing program for IT startups to test the US market, check the demand for their products, get insights while communicating with their target audience, and launch their first pilot projects. The second round of Techmafia (http://tm.iidf.vc) started on January 22, 2018. This time we are giving the teams more time to be in San Francisco and interact more deeply with the local community.

In December 2017, in partnership with Sberbank and Fortross, we launched Global Pitch (www.globalpitch.vc) . As part of the project, we will select 20 startups which will go to the Silicon Valley next spring to interact with top international funds and venture experts, and receive expertise and investment. Within the next several years, in cooperation with our partners, we are planning to provide 60 Russian startups with world-class expertise and access to US investors through the Global Pitch project.

Industry-wise, the IDFF invests in IT solutions in the fields of telecommunication, telemedicine, corporate and platform software, education technologies, Big Data and AI, IoT, VR/AR/MR, cyber security, marketing solutions, media and cybersport. We constantly monitor emerging industries — we are curious and flexible in this area.

Did the sanctions affect your international strategy, or could they affect it in the future?

Not so far. I can't tell about the future, though.



Launched in 2017, TechMafia and Global Pitch are two instruments to help Russian startups grow in the USA and enter the global market.

IIDF HEAD KIRILL VARLAMOV: "WE PROVIDE OUR STARTUPS WITH ENOUGH MONEY TO GROW PERHAPS MORE SLOWLY, BUT STEADIER THAN THEIR WESTERN COUNTERPARTS"

What have been, in your perception, the main evolutions of the Russian startup ecosystem over the past few years?

When the IDFF just started operating, the market didn't have any rules or a common language — it might sound funny, but when referring to the term "market size," investors and entrepreneurs had absolutely different things and figures in mind.

Many things have improved for the past several years. Today it is much easier to launch an IT business than it was ten years ago: technology is more accessible, qualified human resources are more available, and grants will allow you to create the first version of a product within one or a few months. As a result, we see hundreds of startups emerge monthly.

However, difficulties remain. The number of companies meeting VCs' requirements hasn't changed – while the requirements themselves have become more strict. Few projects can avoid the "death valley;" and we are trying to fix this.

Besides, when comparing the Russian market with others, exit prospects are still virtually inexistent. Strategic investors do not show a big motivation to buy startups: in spite of recent progress, corporations in their majority have not realized yet that acquiring a startup may increase capitalization, improve financial performance, conquer new markets, etc.

What can a fund like the IIDF do to stimulate corporate interest?

It's important to create the right ecosystem to stimulate venture investment and open innovation, not just work with players individually. We've created a variety of cooperation formats to bring together companies, corporations, government bodies and startups.

We pay particular attention to raising corporates' interest in startups, teaching them to work with innovations and explaining that startups are not to be afraid of.

Besides, we regularly show technologies from our portfolio companies to potential corporate customers, and contribute to create corporate accelerators. Our latest partnerships in this field involve Rostelecom, Russia's biggest telecommunication company Rostelecom, and X5, the largest retail group.

(January 2018)

- *Born in 1974 in Sverdlovsk (now Yekaterinburg), Mr. Varlamov graduated Ural State Technical University, attended classes at Bradley University, Peoria, IL, and graduated Moscow management school Skolkovo as Executive MBA. In 2012, he won the Entrepreneur of the Year competition (IT section) organized by Ernst & Young. Before heading the IIDF, Mr. Varlamov was CEO at Naumen, a major software development company he co-founded in 2001.*

DAVID WAROQUIER OF MANGROVE CAPITAL PARTNERS: "THE TIME HAS COME TO RE-ACTIVATE OUR INVESTMENTS IN STARTUPS FROM EASTERN EUROPE"

An international early-stage investment fund based in Luxembourg, Mangrove Capital Partners has been an active investor in Russia and several other CEE countries, including Estonia (where the fund backed Skype at the early stage) and Czechia. Fund partner David Waroquier explains the ups and downs of venture activity in Russia and how he works with Russian entrepreneurs and institutions.

Why is your fund interested in Russia and other CEE countries?

Our focus geography is Europe and Israel, but we are very active observing how emerging markets are developing, in particular as we see that innovation tends to emerge from any corner of the world. In general, CEE has a long history of breeding quality technology education and expertise, and Russia is one of the best examples.

More broadly speaking, emerging markets are particularly interesting as they provide large domestic markets which are ripe for innovation and technology jumps, and usually count large communities of entrepreneurs who are eager to succeed.

You were among the first Western VCs investing in Russia, and probably among the rare ones who deeply explored this huge country's potential. Do you still invest in this country "with love," as you said a few years ago? (http://goo.gl/txKAKe)

It is true that we have been particularly active in Russia and made a total of seven investments, our most famous one being KupiVIP (http://goo.gl/st9apH). We have been focusing mostly on Moscow, St Petersburg and Kazan, even though we also met a number of highly promising teams coming from such different other cities and regions as Rostov, Perm, Nizhniy Novgorod, Novosibirsk…

Russia is particularly appealing considering its size and large consumer population, the dynamism of its market expansion and consumerism, the quality of its scientists and technologists. Over the past few years we have also seen an increasing number of teams focusing on deploying their products and solutions on a global scale. These teams draw most of our attention.

Did the sanctions have an impact on your strategy or activities in the country?

They have put our investment strategy in the country on hold for the last years, not because of a lack of interest in Russia, but mainly due to the general freeze by international investors in Russia, combined with well-established Russian VCs shifting their investment strategy outside of Russia. The M&A dynamic has been weak compared to Western standards.

On a more positive note, this trend has begun to change over the past one or two years with a few but significant transactions, such as the acquisition of Delivery Club (http://goo.gl/Bc5AZV) and Pixonic by Mail.Ru Group, HeadHunter by Elbrus Capital as well as Masquerade by Facebook in Belarus.

The sanctions have also had some unexpected and indirect effects. They have dramatically impacted the capacity of Russian startups to raise funds in Russia both at the early and expansion stages; as a result, many entrepreneurs have left the country and/or have learned to develop a business in a more capital-efficient way. Thus, we are now witnessing the emergence of a new generation of hungry entrepreneurs, coming up with well thought-through products targeting the international markets with a particular focus on B2B and SaaS offerings.

DAVID WAROQUIER OF MANGROVE CAPITAL PARTNERS: "THE TIME HAS COME TO RE-ACTIVATE OUR INVESTMENTS IN STARTUPS FROM EASTERN EUROPE"

To stay ahead of the curve, we believe the time has come to re-activate our investment strategy in Russian startups and in the region in general.

What do you intend to do exactly?

Over the past few years we have been nurturing the idea of creating a (regional) seed fund, and we feel that the conditions for such an initiative are improving. When we decide to go ahead with this strategy, such a seed fund would focus on Russia and entrepreneurs from the former Soviet Union (FSU) with a global ambition from the get-go.

Mangrove's fund performance is best in class, with a number of huge successes, and we intend to continue finding and helping build more worldwide successes. We believe that founders and teams from Eastern Europe can be important contributors to achieving this goal.

How do your Russian portfolio companies feel today?

In Russia, we did our first investment in 2005, and since then have funded seven startups. We are still involved in two companies: KupiVIP, the leading off-price fashion retailer in Russia, also operating offices in Berlin, Belorussia and Kazakhstan, and Paymo, an online payment service provider active in Russia, Kazakhstan and Uzbekistan.

KupiVIP, by far our flagship investment in Russia, is profitable, employs 1,000 people, counts 18 million members, and operates six department stores in Moscow in addition to its mobile and online platforms. It is worth noting that one in five women in Russia made at least one purchase on KupiVIP.

In 2016, in the midst of the crisis, Oktogo.ru, our second largest investment in Russia (http://goo.gl/fAsF7a) was running out of breath. Over the last four years, the travel industry in Russia has been severely impacted by a series of economic and geopolitical issues. After a failed merger as a last resort and due to persistent difficulties to finance working capital, Oktogo had finally been brought to an end in its previous form.

Russian state institutions and state-backed funds play an important role in the Russian startup scene. What is your experience in working with them?

We do not have extensive experience in co-investing with state-backed funds or regional government funds. We have had advanced partnership discussions with a number of them but for multiple reasons none ever materialized into real transactions. Various bodies have attempted to build venture activities through public money, but few have had any success so far. This is not just limited to Russia.

We believe the market is best suited for professional venture firms with years of experience, and with a consistent strategy such as ourselves. In order to help the venture capital industry develop, there is a unique opportunity to build a limited partnership market in Russia that could be led by state-owned corporates and government funds. These would contribute into managed portfolios under regulated entity protections.

This being said, we have already collaborated with institutions like RVC, Skolkovo and Innopolis [a tech hub under completion in Tatarstan, 800km east from Moscow] at different stages.

We all aim to contributing to the development and promotion of the Russian tech ecosystem both in Russia and abroad. As a leading venture capital firm, we believe it is also our responsibility to share experience and contribute locally to the ecosystem; our role does not stop with investing and growing our own successful startups.

(December 2017)

OSKAR HARTMANN: "I HAVE BEEN ABLE TO BUILD MANY BUSINESSES HERE ASSUMING THAT EVERYTHING WOULD BE THE SAME IN RUSSIA, JUST A LITTLE BIT LATER"

Born in Soviet Kazakhstan, Oskar Hartmann emigrated to Germany as he was still a child. In 2008, at the age of 27, he moved to Russia with the aim to launch his first business. He founded KupiVIP, Russia's first flash-sales fashion site. Supported by international investors, and taking advantage of the opportunities of the Russian consumer Internet at its early days, the site became one of Russia's most notable online success stories. Hartmann subsequently involved himself in a variety of new projects, asserting himself as a top figure of the Russian tech entrepreneurship scene.

Back in 2008, why did you decide to launch a startup in Russia — rather than Germany where you came from, for instance?

The main reason for moving to Russia was that I was so happy in Russia, I love Russia so much, so I wanted to live in Russia. The question of what I should do in Russia came second. I wanted to build a business where I live, as I became a father, so I decided to build a business in Russia.

How did the Russian and the German ecosystems compare when you arrived in Russia — and now?

When I came to Russia, my first big kind of insight was that Russia was about let's say 7-8 years behind Germany in the development in almost all the things related to the Internet. It was very easy to predict the future because my basic assumption was that Russia would do the next 5-10 years exactly the development stages which Germany had gone through from 2000 to 2007.

So, basically, for example, if you take the online fashion market in 2007, the entire German e-commerce market amounted to €16 billion euros with fashion accounting for 25% of it — €4billion!

At that time, the entire Russian e-commerce market didn't even reach €4billion, and fashion was zero — just like in Germany ten years before. Then my assumption was: in the next five years, maximum ten, the Russian e-commerce will reach the same size as the German, and fashion will be also 25% of the e-commerce market. Everybody was saying: maybe Russia is special, people won't buy fashion online. But for me the picture was clear — in China, the fashion was already growing; so why not in Russia?

Now, if you look at the 2016 numbers, the Russian e-commerce market reached around €16 billion, of which fashion accounted for €4 billion (in spite of the ruble's huge depreciation in 2014). So, basically, Russia is now at the same point as Germany was in 2008. Further, if we consider that the German e-commerce market is now around €50 billion euros, we can predict what will happen in Russia in the next five years.

We may say the same about other segments: other e-commerce segments, dating, services... By number of users, Russia became the biggest Internet market in Europe in the early 2010s; and since the average age of Internet usage is growing, Russian e-commerce can expect a bright future.

Aren't there any differences between Russia and other markets?

I didn't focus on what is different in Russia, I focused on what is the same. Because focusing on what is different gives you no opportunities. But if you think Russia will be the same as Europe, you have a lot of opportunities.

Take another example, Blablacar. While it was already very successful in France, everybody believed this business model would never work in Russia, because Russia is this or that, but now Russia is becoming the biggest market for Blablacar.

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And if you look at the top 100 business models in Russia — you have classifieds, mobile classifieds, car classifieds, real estate — these are basically the same as in Germany, France, the UK and Spain. Conversely, you can see that there is no really unique business in Russia that is successful there but would not exist anywhere else.

I was able to build many businesses because of the assumption that everything would be the same in Russia, just a little bit later. This assumption made investment decisions relatively easy.

Has the new international context since 2014 with the sanctions and counter-sanctions affected the Russian startup industry?

In the Internet sector, which has not been targeted by the sanctions, business operations haven't been affected. Nothing has changed in building a business, attracting customers, solving problems, etc.

The only difference is access to capital. Basically, people are afraid to invest in Russia. Since there is no capital coming to Russia due to the sanctions, capital has become scarce and very expensive. What investors can get in terms of shares and rights is much-much higher than in Western Europe. And the return on capital is much-much higher in Russia. So, capital is very valuable.

Meanwhile, the quality of the businesses which are being created now is superior than in the past – and not only because entrepreneurs need to be cautious about capital. People used to believe that they could build a business and then sell it to Western European and US companies. So a lot of companies were built to be sold.

But this is no longer a good strategy, as acquisitions to enter the Russian market have become rare. So now companies are created to be developed independently, to become real businesses.

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Overall, I think Russia has been very resilient to the sanctions. An amazing number of new companies have been created to produce locally, be it in food production or other segments.

How do you envision the future of the Russian startup industry?

I believe that Russia is perfectly positioned for the future. Historically, Russia was not strong in mass production. So, in the last industrial revolution Russia wasn't among the biggest winners. But in the current industrial revolution, what was historically the weak sides of Russia is now being replaced by robots and computers.

Meanwhile, Russia has plenty of strong sides to leverage in this new revolution – from IT, to mathematics, to data science and creative problem solving. The Russians are absolutely amazing in these fields. There's here an absolutely crazy number of teams and startups. The ecosystem is very healthy, not only in Moscow but in virtually all regions and all cities – even small ones. In such important fields as AI, you have absolutely the best infrastructure in the world to find talent.

How many digital projects did you launch in total in Russia?

I have been involved in more than twenty startups. I built or invested in companies essentially at the very early stage because I was a young entrepreneur, I didn't have any capital.

What have been your best successes and worst failures?

Of course, we had big successes and failures as well. There are all kinds of reasons for failures. In one or two cases, customers didn't really need what we offered. In other instances, we underestimated the resources required to build a business. We were trying to do more with less – which sometimes turned out to be impossible. So, basically, either the customer or the investors didn't want to support the business. This was never due to regulation or government intervention. These were market forces — like everywhere else.

Do you have projects outside Russia?

In 2017 Igor Rybakov – one of the richest men in Russia (Forbes 117) – and I joined forces to launch a fund, Larix VC. It aims to align itself with the most active founders who believe in digital transformation. We are entrepreneurs ourselves, so we like to support people who are building similar things in other countries.

Thus, Larix VC invests in IT platforms globally, from Australia to the USA, closes deals quickly, and supports projects through its expert community. We invest at the early stage and up to Series B. The amount of the fund is $100 million of which no less than 20% is provided by the General Partners.

Tell us a bit about your non-profit activities.

I spend a lot of time on nonprofit work. I really love entrepreneurship, so I initiated or took part in various projects to support entrepreneurship. One of them is a foundation which provides scholarships to the most talented students who want to build their own business. Another one, Preactum, is a contest for student projects from all universities across Russia. It is open to both profit and non-profit projects. We also have leadership programs for people to increase their self-confidence, lower their fears of failure and find their team mates. Another organization, called R2, provides entrepreneurs with an independent board of advisers. It is for people who are already successful but want to grow their businesses ten times more. We also created entrepreneur networks and cooperate a lot with universities and schools.

One of our latest initiatives is the World Entrepreneurship Foundation, which was launched this year. This endowment fund gives funding to leadership programs around the world in order to develop entrepreneurial tracks inside leadership programs.

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