FinTech funding in CEE

This report could not pretend to be a description of development opportunities and threats for FinTech start-ups in CEE without analysis of ways of financing that are accessible to those startups. By "financing" we understand external financing, so only such ways of financing as: cooperation with investment funds (especially with Venture Capital funds and Corporate Venture Capital), public donations, loans (from banks) and private investors (business angels) will be analyzed.

We will start from the general analysis of financing landscape in CEE and countries that are included – we will aggregate and describe main entities that are important for FinTech financing and are acting on these markets. To show the complete landscape of external financing opportunities and threats for Fin-Techs in Central-Eastern Europe we will also analyze an unusual form of financing, specific for this sector – IPCO, Initial Public Coin Offering.

Then, we will carry out an analysis **of the most important barriers for funds' financing, try to explain root causes of their existence and show what refrains investors from allocating their capital in specified companies**.

Many of barriers that arose between Fin-Tech startups and entities being a potential source of funds are caused by lack of understanding, lack of proper communication or regulatory uncertainty. Managing partners of investment vehicles are often afraid of investing money in something that exceeds their knowledge and CEOs of Fin Tech startups hardly ever can make it easier because of the level of complexity of their technology. The fact, that this is a completely new sector in the market does not help – there is a small group of people who successfully created and accelerated growth of their startups, so there is a small group which can advise others how to communicate with potential investors / donors and what to expect.

Unless both sides of the transaction understand each other, constructively talk about the opportunities to fasten the company's growth using its strengths and how to finance it, the market of financing for this kind of enterprises will remain ineffective.

We will especially try to analyze the impact of such barriers on problems in those companies' valuation. We will aim at proving that such an uncertainty is harmful for market's efficiency by detailed analysis of every step of valuation's process to show real weight of information in investment decision making process.

The goal of this section is to contribute to the change of status quo and provide representatives of all parts of the market with an useful analysis **not only showing how it is** (so, how many funds there are, how much can be expected to invested at once) **but also how it should be** (what do investors expect from their investment target).

General picture of new venture funding

Equity Investments:

Private Equity – total private equity investment in the CEE region reached €1.6 billion in 2016.This underlines the trend of increasing annual investment value in the region since the recent market bottom in 2013. CEE private equity investment activity is concentrated in a few countries: Poland (45% of total value of investments in 2016) Czech Republic, Lithuania, Romania and Hungary. These five countries aggregated 81% of total CEE investment value in 2016.

VC - in 2016, €100 million of venture capital (VC) funding was invested into the Central and Eastern Europe. The CEE share of total European venture capital investment value was 2.3% in 2016 while the region accounted for 7.5% of total European companies receiving venture funding. The average venture capital investment per company in CEE was €0.43 million, less than a third of the European average of €1.4 million. In case of Venture Capital funding, there is a strong potential among Corporate Venture Capitals too.

IPO – 2016 was a hard year for Initial Public Offerings in Europe, however the total value of IPOs during 2014-2016 in Europe exceeds EUR 134,8 bn. This is a form of financing dedicated mostly to much bigger companies than average FinTech startups, however is included as an option in many exit strategies of funds.

Problems of FinTech valuation

Here we will analyze opportunities for applying commonly known startup valuation methods to FinTech startups in CEE. We consider possible biases and methods of dealing with them and then move to recommendations how to decrease their negative influence on FinTech funding market in CEE.

Startup valuation methods

In our analysis we will focus on those nine method of new ventures' valuation:

METHOD	GENERAL DESCRIPTION
Berkus	It is a qualitative valuation's method that bases on assessment of five key success factors
Risk Factor Summation	This methods estimates base value of enterprise and adjusts it by 12 key risk factors
Scorecard	Weighted average value adjusted for similar companies
Comparable Transactions	Valuation based on a rule of three with KPIs from the other companies
Book Value	Tangible assets' value are the basis
Liquidation Value	Scrap value of tangible assets
Discounted Cash Flow	Valuation based on present value of all future cash flows of the company
First Chicago	Three scenarios of Discounted Cash Flow
Venture Capital	EV based on ROI expected by the investor

Examples of valuation biases described

1. It is hard to assess the Company's potential because of level of technological complexity and newness of technologies that are the base for the most of innovations (blockchain).
2. There are no "industry standards" in case of FinTech financing to search for comparable transactions.
3. There is no stable regulatory environment, it is almost impossible to assess if company's operations are legal or not.
4. There is no reasonable data to build in internal checks for reasonableness of valuations.
5. Taxation and cashflows classification biases – there is no strict rules how to identify costs, depreciation and many others. What's more, many FinTech companies tend to base in their operations on cryptocurrencies – it is hard to estimate a real value of those cash flows.

3 Main barriers identified:

1. Unstable regulatory environment
2. Lack of understanding of technological aspects
3. New ways of fund raising are substituting traditional loans or investments

Recommendation's highlights

1. Regulators should thrive to establish stable and flexible regulations that will allow to testify new solutions not only without risk of financial frauds but also with certainty of implementation.
2. Sharing knowledge internationally, transparent debate and public institutions engaging in the sector's development would help to confront uncertainty. Global potential of many FinTechs and banking industry's specific are making the role of hubs and clusters even more important than in case of the other industries. There is a strong need of technology and regulatory sandbox created in cooperation with incubating institutions helping to shape companies' communications in understandable way.
3. Especially new ways of fundraising (like ICO) should be regulated. Corporate Venture Capitals owned by banks should improve a usage of its technological knowledge and become a new way of increasing innovative environment. The financial institutions should be more proactive in searching for attractive targets.