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Opinion: VCs find many attractions in the region

By Zygmunt Grajkowski

In contrast to more developed markets such as the US, Israel or the UK, venture capital in the countries of central Europe is still in its infancy. One has only to contrast the value of VC investments in Israel – $1.9bn in 2012 – with the combined value of those in Poland, the Czech Republic, Slovakia, Romania and Bulgaria – which were €102m.

Barbara Nowakowska, director of the Polish Private Equity and Venture Capital Association, says some international venture capital funds have noticed the region is a growing market with strong potential, a culture of entrepreneurship and little in the way of competition – and see this as an opportunity.

As a result, development centres now employ thousands of programmers for companies such as Motorola (in Krakow), Intel (in Gdansk) and Samsung (in Warsaw). Their decision to locate to central and eastern Europe was not based solely on the relationship of price to quality – prices are similar to those in India – or because of the access to well-qualified people trained at European universities, but mainly because of their work ethic and creativity.

For other companies, the most important factor is the safety of being in the European Union rather than in a region of the world threatened by an explosion of political or religious conflicts.

John Biggs, East Coast editor at Techcrunch, the US tech news blog, regularly visits CEE, and points out it is a region where one can still find interesting technology companies priced several times lower than in more developed markets. Because of their lower operating costs, such companies can accomplish a great deal more development than similar companies in the US. And the quality and pace of work done by local programmers in areas such as mobile applications or game graphics is outstanding.

VC investors also find that CEE has a large enough internal market for a technology company to be able to try out its concept and technology on the local market before expanding elsewhere, thanks to the EU's open borders. That was the path taken by Asseco Poland, which started as a small software company before growing into the country's market leader and becoming one of Europe's top 10 IT integrators.

That sort of growth potential also attracted Dariusz Pronczuk, a partner with Enterprise Investors, a leading CEE private equity fund who, together with Intel Capital, invested in the Czech Republic's AVG Technologies. That grew from a local start-up into one of the world's largest antivirus providers, now listed on Nasdaq with a market capitalisation of more than $1bn.

Venture capital investors also keep a close eye on the flow of EU funds into the region. Over the past five years, the Innovative Economy programme has spent more than €10bn in Poland alone, which has gone on improving qualifications, creating a network of incubators and financing new companies' business plans.

While there is no denying these programmes have strengthened emerging businesses, some critics are worried about ineffective allocation. It would be wise to look at the experience of a number of countries that have shown that replacing venture capital investors with government financing of risky innovations has produced lacklustre results. Every government institution is risk averse by nature, and tends to be more enthusiastic about financing an entrepreneur who can fill out a form correctly than qualify a talented inventor who is no good with paperwork.

The right path seems to be to use public funds to lower risk at the early stages of technology development, and leave investment decisions to private-sector professionals.

The challenge for entrepreneurs is to change from the current model of selling knowledge as a service and begin creating start-ups on the basis of their intellectual capital. But before the owners of these can turn their initial development costs into share sales, they need financing in the form of venture capital.

It is also crucial for start-ups to grow and stay in the region, as that expansion will be of value to stock buyers.

Although such a company may change owners in the form of foreign capital investors, it is hugely important that it stay in CEE together with its founders, and not emigrate when it is still at the ideas stage to look for better financing conditions in other countries.

Zygmunt Grajkowski is the managing partner of Giza Polish Ventures, a Polish-Israeli investment fund