

## **A RETROSPECTIVE ANALYSIS OF RAISING START-UP CAPITAL IN ROMANIA**

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### **Abstract**

*Entrepreneurship refers to an individual's ability to turn ideas into action and it includes creativity, innovation and risk taking, as well as the ability to plan and manage projects. As cities look to entrepreneurship as an economic development strategy, it is important to consider the capital markets in place to finance companies within the start-up ecosystem. Put simply, growth must be funded.*

*This article presents the main sources of start-up funding and evaluates the extent to which Romanian companies make use of those opportunities relative to other European countries.*

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**JEL classification:** *O16, O52*

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### **1. Introduction**

As defined by Aulet (2013), entrepreneurship is about creating a new business where one did not exist before. While this remains entrepreneurship's core concept, there are broader definitions also accepted by scholars.

The elements presented in this article begin by distinguishing two types of entrepreneurship (Aulet, 2013): 1) Small and Medium Enterprise (SME) Entrepreneurship and, 2) Innovation-Driven Enterprise (IDE) Entrepreneurship.

SMEs are most likely a family-style business that is meant to serve the local market. The general business lifecycle involves self-funding the venture followed by slow and steady growth.

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IDEs are most likely built on a new technology or invention and aims to grow beyond the local market. We conclude that IDEs are in fact what we call start-ups focused on addressing global markets based on technological, processes, or business model innovation (Kauffman Foundation, 2013).

Considering the purpose of the article, the key distinguishing factor between SMEs and IDEs is the latter's need of greater capital. Since the IDE entrepreneurs are more interested in creating wealth, they are also more willing to sell equity in their company in order to support its exponential growth.

## **2. Funding Opportunities**

IDEs generally need to raise multiple rounds of funding throughout their business lifecycle. While IDEs hope of becoming profitable later in their lifecycle, they often begin by losing money trying to achieve product-market fit (Kauffman Foundation, 2013). The number of funding rounds, where start-ups go to the market to raise more capital, has been growing (Cremade, 2019). In the last decade, more capital has become available for entrepreneurs, but there are many stages of attracting venture capital that they need to understand in order to build a successful company.

Venture Capital is a generic term that refers to equity and equity-based financing for all stages of a company's lifecycle (Bygrave, 2004). The process of raising funding has many stages (rounds) and the typical characteristics of each round are presented in Table 1.

Every round is specific to a certain moment in the growth lifecycle of a start-up, as shown in the characteristic's column. Also, the typical type of investor changes as the amount of capital needed changes. Not all the companies get to go through all the investment funding rounds as shown in Table 2.

**Table 1: Investment funding rounds**

<b>Round</b>	<b>Characteristics</b>	<b>Potential investors</b>	<b>Approximate fundraising range (USD)</b>
Pre-Seed Round:	Formulating initial idea and developing a team	Start-up owners Family & friends	10K-150K
Seed Round:	Testing initial idea and demonstrating product-market fit	Angel investors Micro VCs Crowdfunding	10K-2M

Series A Round:	Going-to-market and stabilizing the company structure	Accelerators Super Angel Investors Venture Capitalists	1M-15M
Series B Round:	Scaling products and delivery channels	Venture Capitalists	10M-35M
Series C Round:	Scaling reach and operations	Large VCs Private equity firms Hedge funds	20M-55M
Series D Round:	Gathering large market share and preparing for exit	Large VCs Private equity firms Hedge funds	\$30M-80M
Series E Round:		Large VCs Private equity firms Hedge funds	55M-150M
IPO: Stock market launch	Going public	General public	+150M

The different start-up funding stages enable entrepreneurs to scale their business at the highest levels, but the main aspect is that the companies need to be mature enough and prepare for the specific requirements of each stage.

### **3. Romanian vs. European Start-up Investment Statistics**

The road to attracting funding as a start-up can be very different depending on the company's market, the information available to the entrepreneur, and the country's broader entrepreneurial ecosystem. Table 2 presents a summary of all the deals made by European start-ups in the year 2019, based on the data gathered by CB Insights<sup>3</sup>.

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<sup>3</sup> CB Insights is a tech market intelligence platform streamlined to process millions of data to assist to provide high-quality data analytics to companies in the business of venture capital, private equity, corporate development, investment banking, and other similar enterprises.

**Table 2: European Investment Deals 2019**

<b>Europe 2019</b>	<b>Seed/Angel</b>	<b>Series A</b>	<b>Series B</b>	<b>Series C</b>	<b>Series D</b>	<b>Series E+</b>
% of deals	66,08%	21,07%	7,96%	2,85%	1,17%	0,84%
Average deal size	\$1,56M	\$8,19M	\$20.7M	\$48,6M	\$76M	\$125,7M
Median deal size	\$750K	\$5,05M	\$12,4M	\$27,8M	\$32,6M	\$62,4M

Source: CB Insights data, 2019

As shown by the data in the table, most of the deals at European level are at the seed round (66,08%) and only 4,86% of them get to series C.

The situation in Romania is different than that of the European continent – in 2019, no company has managed to get to series B, as presented in Table 3\*.

**Table 3: Romanian Investment Deals 2019**

<b>Romania 2019</b>	<b>Seed/Angel</b>	<b>Series A</b>	<b>Series B</b>	<b>Series C</b>	<b>Series D</b>	<b>Series E+</b>
% of deals	93,44%	6,55%	0,00%	0,00%	0,00%	0,00%
Average deal size	\$500K	\$4,88M	\$0M	\$0M	\$0M	\$0M
Median deal size	\$160K	\$1,56M	\$0M	\$0M	\$0M	\$0M

Source: CB Insights data, 2019

*\*The Romanian-founded company UIPath raised Series D investment round of \$568M at more than \$7B valuation in April 2019, but it is not included in the presented data due to the fact that it has officially changed its headquarters from Bucharest, Romania to New York, USA in 2017.*

**Table 4: Number of European and Romanian Start-up Deals in 2019**

	<b>Europe (USD)</b>	<b>Romania (USD)</b>
No. of deals	6,683	66
Total funding	\$66,6B	\$62,4M
Average deal size	\$13,9M	\$1,22M
Median deal size	\$1,68M	\$200K

Source: CB Insights data, 2019

Table 4 compares the volume of deals between Europe and Romania. While there were 6,683 investment deals across Europe in 2019, only 66 of those were made into Romanian companies.

The explanation for the less great performance of the country is complex and reflects on the Romanian entrepreneurship ecosystem. One of the most important factors is that Romanian IDEs lag behind the European Union average in terms of innovation, as reported by the European Innovation Scoreboard 2019 where the country is ranked as a Modest Innovator. According to the same report, key indicators such as venture capital investment, sales share of new product innovations, and IDEs innovating inhouse are significantly behind the European average.

Another report regarding entrepreneurship in Romania points out that “an entrepreneurial ecosystem can develop and grow in a sustainable way over time in countries with a lower level of innovation capacity, only if it can continuously interact with other innovation hubs and attract international talent and investors (European Commission, 2017).” Unfortunately, the European Commission states also that the Romanian start-up ecosystem suffers from fragmentation and proposes a series of solutions for improving the situation which involve a central role for higher education institutions (HEIs) along with incubators and accelerators as key actors.

HEIs provide the knowledge and the latter actors can serve as touch points for various stakeholders from the public and private sector such as angel investors, venture capital firms, representatives of government agencies and communities.

**Table 5: Romanian Start-up Investments by Industry in 2019**

	<b>Industry</b>	<b>No. of deals</b>	<b>%</b>
1	Internet software & services	30	45
2	Mobile software & services	8	12
3	eCommerce	6	9
4	Healthcare software	3	5
5	Conferencing & communication	2	3
6	Application & data integration	2	3
7	Mobile commerce	2	3
8	Crop production	1	2
9	Biotechnology	1	2
10	Accounting & finance	1	2
11	Electrical product distribution	1	2
12	Automotive manufacturing	1	2
13	Gaming	1	2
14	Supply chain & logistics software	1	2
15	Advertising, sales & marketing	1	2
16	Education & training software	1	2
17	Natural gas utilities	1	2
18	Foodservice	1	2
19	Retail banking	1	2
20	Security software	1	2
		<b>66</b>	<b>100</b>

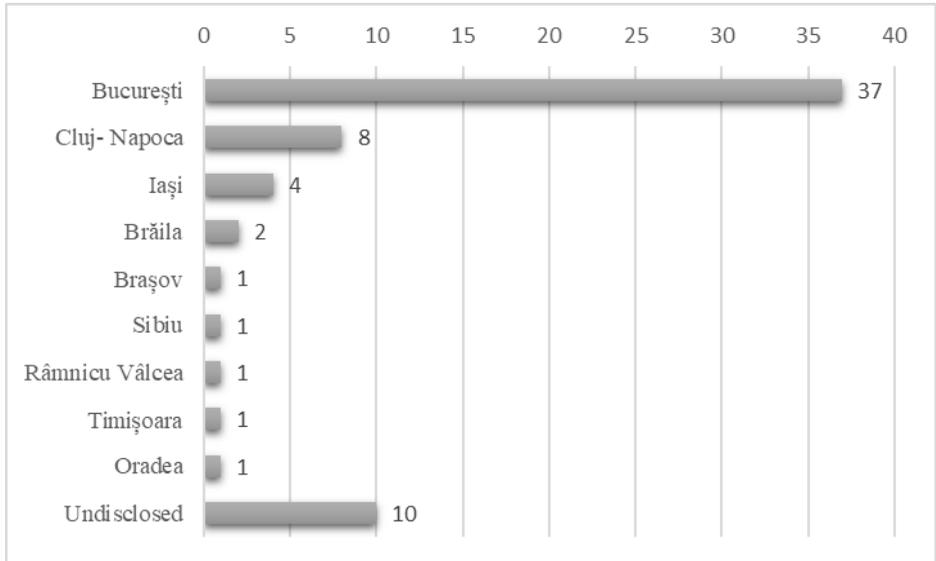
Source: CB Insights data, 2019

Table 5 presents an overview of the Romanian investments landscape in 2019 across industries.

There is a large gap between the first industry (internet software and services) and the other industries in the ranking. This is consistent with the distribution of the cities in which the deals were made (Figure 1), with Bucharest and Cluj-Napoca being well known as IT hubs.

Figure 1 shows the distribution of start-up deals in 2019 across Romanian cities. Most of the deals involve companies from Bucharest (37) with a large gap between Cluj-Napoca (8).

**Figure 1: Number of Romanian Deals Per County in 2019**



Source: CB Insights data, 2019

Although 66 investments were made in 2019, only 56 deals were fully released to the public. Therefore, only 56 deals are included in Figure 1.

#### **4. Conclusions**

The Romanian entrepreneurial ecosystem is still developing. While there are more funding opportunities in Romania today relative to the previous decade, many young entrepreneurs still do not know how to successfully receive funding. While the country has a lot of potential, the path towards a more innovative economy and digital society is a work in progress. As pointed out by the European Commission, the biggest barriers hindering Romania's development include: 1) lack of trust, predictability and transparency, 2) access to capital, and 3) the limited capacity of higher education institutions to play an active role as a stakeholder in the entrepreneurial ecosystem.

While there are islands of entrepreneurial excellence in Romania, policy makers should leverage access to our well-educated talent pool and develop city-specific entrepreneurial zones to aid start-up investment.

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