Christian Czernich of Round2 Capital

Speaker1: [00:00:04.77] This is the Investor Connect podcast program. I'm Hall Martin and the host of the show in which we interview Angel Investors, venture capital, family offices, private equity, many other investors for early stage and growth companies. I hope you enjoy this episode. Well, hello, this is Hall Martin Investor Connect we're here with Christian Czernich , CEO, founder and managing partner at Round2 Capital. Round two is a financing partner for European scale ups with digital and sustainable business models. And the scale of Fais outstanding entrepreneurs means to transform their business from a successful venture into a real company. Round two offers innovative funding, instruments and insights. Each master this transformation process that in twenty seventeen round two has pioneered revenue based finance in Europe. Flexible, non dilutive funding instrument. Christian, thank you for joining us.

Speaker2: [00:00:53.98] It's a pleasure to be here.

Speaker1: [00:00:55.69] So what was your background before investing in early stage companies? What did you do before this?

Speaker2: [00:00:59.83] Well, I spent the last 16 years doing deals first as an investment banking and then in private equity. And then eventually I started my own business. That was right after the financial crisis. And we did a lot of mid-market transactions, M&A, and then I started to direct investments. And that eventually then evolved into round two capital where we do revenue based funding predominantly of B2B SaaS firms in Europe. Before before my career in investment banking, I had an academic career. So I did my PhD at the Stockholm School of Economics where where I did in-depth research on technology spinoffs and also in venture capital. I also spent that part of my studies at at the at Stanford University in the program, which was a great time back then, right after the first Internet crash. That was 2001. And I had the pleasure to talk to a number of very well-known because at that time and I got really inspired after the industry.

Speaker1: [00:02:17.32] Great. So what excites you right now?

Speaker2: [00:02:19.18] Well, I mean, of course. So we are investing predominantly in SaaS. So obviously, I mean, I am very I'm very excited about digitization and and what various SaaS companies can do for supporting the digitization of society in Europe. In Europe, we still like a little behind other other countries are especially the US when it comes to the degree of digitization. I really I really like the SaaS business model for a number of reasons. Of course, one of the major reasons are the recurring revenue. So if a US model is wrong in a good way to the development of the companies is quite stable and predictable and the companies don't need any working capital and that the capital intensity to set up such a business is not so high. And so if you have a if a if you have a good concept and you know how to program well, you can get started with the business quite easily. So I like that because that opens the market and it's it's easy for for good entrepreneurs to to start a business.

Speaker1: [00:03:39.40] Right. And so you see a lot of startups and a lot of investors. What's your advice for people investing in startups? What do you tell them to do before they write that check?

Speaker2: [00:03:47.26] Well, I think what what what's still a lot of people underestimate is the huge difference between B2B and B2C business models. If you if it's a totally different world where you invest in a B2B model or in a B2C model, my advice is for investors to really think that through until the end what it means to to scale up B2C business as compared to B2B model. I often see entrepreneurs, but also investors who totally underestimate the time it takes to scale a business and also big capital it takes to to scale a business. And both of these dimensions are totally different for B2B and B2C. So for me, I would say that B2C can be scaled much quicker, but with much larger capital needs and the B2B model is much slower to scale. But you can also do it with lower capital needs because you don't have to have this huge marketing budget.

Speaker1: [00:04:49.09] Right. And so what's your advice for people running startups? What do you tell them to do before they go out to raise funding?

Speaker2: [00:04:54.70] Yeah, so. Well, I would say, you know, the most important thing is, you know, test before you scale. So I really have that. I mean, so many entrepreneurs now every week and it's so many, so many people out there who are just, you know, start raising capital because they they think it's cool to raise three million dollars, five million dollars, a million dollars, whatever. But they don't really understand their own economics and their own business model. So I think it's extremely important that that you first know your economics and you test your model and then you go out and raise the capital. I understand that that's that's tough. You know, it's I experienced that, you know, entrepreneurs focus more of the time in raising capital than investing and acquiring customers. But, you know, at the end of the day, if you want to build a great business, there is no other way you need to perform. And then you will get the capital and it's not the other way around. So and I think that's really my major advice. Then take it step by step. That's also, of course, we all see these huge successes out there of now reasonably soon or, you know, all these examples and everybody thinks, OK, I'm going to do that again and I'm going to do that as well.

Speaker2: [00:06:27.41] And that's simply not possible because, you know, that's just very rare and exceptional cases. So. I advise entrepreneurs to take it step by step and see a little bit patient and then they will succeed. I think also that advice, which I also see very frequently, is get a CFO. So that's really at least in the communist light. I see. And if they don't have a CEO, the businesses, it's just impossible to see that at the beginning that the founders do. The finance is just a little bit on the on the side. And I think that's just how it's going to work also when they start growing and really scaling up. But that's, of course, not the case. So the reading that need to get to see CFO and finally, at least what I've seen is, you know, you need to run your business on your own as a founder. So I've seen a couple of firms that try to hire an external CEO pretty early on in the process. And that just doesn't work. If you as a founder cannot run your own business and cannot scale it on your own, you shouldn't you shouldn't do it.

Speaker1: [00:07:45.72] Great. Well, let's talk about the state of startup investing. How do you see the industry evolving going forward?

Speaker2: [00:07:51.71] I think in my view, at least when it comes to to SaaS and to digital companies, to the market is getting a little bit more mature. I think there's a much better understanding out there know both on the investor side, but also on the founder side, know how the business model is really working and what it takes. And that's that's, of course, good, because there's more knowledge out there that everybody's getting more professional and dealing with with with SaaS business models. But then, on the other hand, also, if the market is getting more mature, the dreams are getting more realistic, I would say so. Now, it's I think that

that the outlook for for for building a I'm always talking about SaaS here, but for building a sales business has become a little bit more realistic, I would say. So it's the better people understand the model and better understand they understand what it takes to scale it that the more realistic expectations. That doesn't mean that you can not be hugely successful. Of course, there's there's huge opportunities out there, but it's just that people understand better what it takes and how long it takes to to to to scale such a business up.

Speaker1: [00:09:19.56] Graeme, what do you think is the biggest change you'll see in, say, the next five years in this market?

Speaker2: [00:09:23.74] Yeah. So for the next five years, I think that SaaS will continue to grow. So I don't think that we are at the end of the cycle. We had just you know, we we are away from the end of the birth phase of this industry, but it's going to grow for many years to come. What I don't believe in is the winner takes it all markets in B2B. So, you know, I don't see that the network externalities are strong enough in the in B2B so that there will be only the winner takes it all market. So I don't believe that there will be, I don't know, five or 10 or 20 dominant SaaS companies out there or one dominant SaaS company for Vertica. I really believe that there is that the market will continue to be divided into several niches and there is space for mid-sized companies now, companies with, I don't know, 20 million recurring revenue, up to 200 million recurring revenues. And that's really, I think, a very interesting space that we will see now to develop. And I think that the digitization will, of course, continue. We are not at the end of digitization, so digitization will continue and it will permeate all aspects of our of our life. So this old saying software eats the world. I really believe into that. And it has not by far not eaten, not even half of our world. So there's a lot of work to be done.

Speaker2: [00:11:04.37] And I actually think that's very positive because software makes our life much more convenient. Good software is just great and it makes life better and it will continue. So what we see done is, is that some consolidation is starting in the in the sauce business in Europe, at least probably in the US. That has started already a couple of years ago. But in in Europe, we really see now buy and build strategy. Used to emerging in the south space, so there is a number of investors out there who do platform investments and then, you know, step by step acquire smaller players to to build larger platforms. But again, this consolidation does not mean that this is a winner takes all market. So I believe an unknown number of players in each vertical. So I think in the future, and that's also our investment thesis, is that there will be many niche players out there there where there will be a number of mid-sized players where you can make great returns, especially of, of course, those with revenue based finance, because we don't need to invest into the next Google. We we we are fine with companies that that are growing, I don't know, with Cagle's like 15 to 70 percent or 50 percent or so. And there's there's a lot of opportunity out there for for for for building these kind of companies.

Speaker1: [00:12:39.49] Well, let's talk about your investment thesis for making investments. What is the criteria you have for it and what do you look for in startups to invest in?

Speaker2: [00:12:47.80] Yeah, so we we are a little bit different from VCs. So we do. We do. We do revenue based finance. So that means we don't take a stake in the equity, but we just take a stake in the in the in the revenue of the of the business, which has a number of advantages for the entrepreneur. Most obvious is, of course, that there is no dilution, so. We when we when we look for companies, we we are different from VCs in the sense that, as I said, we don't need as aggressive hockey stick plans as the BCS would like to see. I mean, of course, we want growth. We want aggressive growth, but we don't need this, you know, doubling your revenue every six months or whatever out there. I think we have more realistic expectations on on on on the firms. And we we really like what we are called a sustainable business building. So we like to see entrepreneurs who are able to build their companies in a more sustainable way, which means that now with. Low burn rates, I mean, I'm not I'm not against burn rates, and there's a number of instances where it makes sense to to to burn capital, of course. But but I I see, unfortunately, so many companies, as I said before, and they just think it's cool to burn money because then you need to raise more and you don't understand your own economics and you just continue raising capital. And there is no business model at all there. So that's what we like. We want to see, you know, sustainable development in the sense that know that the companies have been showing if you give them a million bucks, they know what to do with this cap and then that actually transfers into value. And so that means they need to understand their their KPIs and their economics very well.

Speaker1: [00:14:46.96] Can you mention one or two startups that fit that thesis?

Speaker2: [00:14:50.60] Sure. I mean, we have invested in a number of these companies. They are on our website. So we we like we like businesses that are bootstrapped also. So there are entrepreneurs out there who can grow their business to, I don't know, three, five, seven, 10 million dollars yearly turnover and didn't bring in any external capital. So they just, you know, funded that growth by internally generated cash flow, by by funding for their customers. And so that's that's the companies that we like. We have we have a number of those in our portfolio. So we see them in different in different areas.

Speaker1: [00:15:38.29] And so let's talk about challenges in the market today. What are the challenges you see your startups facing when they run their business?

Speaker2: [00:15:45.10] Yeah, of course. I mean, the key challenge in Insight's is always sales. So we hardly see the challenge now in the in the programming percent, of course. I mean, if there are sometimes they the the entrepreneurs make mistakes at the beginning and they don't set up a scalable software platform. But if if they if they have made these mistakes at the beginning and all the scaling up to software policy is not not the key challenge, at least not what we experience in the companies that we look into. The key challenge is really how to organize sales and and to to to set up efficiencies process and to to understand what's working, what's not working. Is it better to use a direct channel or an indirect channel? Are you working with partners or do you do that directly to the customers? I think that's that's really, really difficult to figure out for for for the firms, because there's no one recipe that always works. You just need to find it out for your industry, for your product. And that takes time and trial and error. And that's I think that's the key challenge. Once, once, once a business has found the model that works in sales, then, you know, they have really, really good chances of scaling up then it related to that.

Speaker2: [00:17:19.21] Also, what I said before is really that the. The startups need to understand their own KPIs and that not just take something as simple as customer acquisition costs. Now there's, of course, many that firms will always report to you some customer acquisition costs. But if you don't look into detail how they calculate it now, it's not always that they are honest to themselves. And so they sometimes they don't include major, major part of their costs. Well, they don't really understand the customer lifetime. No, they are not honest when it comes to churn and all of these things. So I think understanding the KPIs in detail and showing that also to the investors is this very is is is a key challenge for for the for the firms. And only once you understand your business model and your key KPIs in depth, then it's a good time to scale. So I think that sometimes entrepreneurs want to scale too early and then they end up in a situation where they burn a lot of capital because they haven't understood, know how the growth engine is working.

Speaker1: [00:18:39.86] I think we see a lot of different sectors and applications out there today. If he had to pick one or two that you put at the top of the list as being the best ones to pursue, what would you call out for the top applications today for investors to look for?

Speaker2: [00:18:52.60] So, I mean, that's also I mean, we are investing in that in that area is, of course, data security. We see that as a key, key challenge, obviously, in the US, but also in Europe. I mean, it's it's a war out there. So Europe, European companies and I think U.S. companies as well are under constant attack from hackers, from from, you know, from all kinds of areas, but all kinds of agendas behind it. So I would say that protecting the data that that we have and making sure that it's not hacked but secure is for me one of the key challenges of all in in in Europe. I'm talking about Europe, obviously, and I see that all member of both in the public. So politicians, but also in the corporate area players are not fully aware of of that challenge and they don't know how to how to handle it. So so I really see that there is a there's a key area that that we are interested in very

Speaker1: [00:20:06.79] Well in the last year that we have here. What else should we cover that we haven't?

Speaker2: [00:20:10.18] No, I think it's. I said we the revenue based finance and I come out of the equity world, so I was doing only equity deals actually in my career, but no, I thought that we need to find alternative ways for entrepreneurs to to get funding. Venture capital and equity funding is, of course, extremely important. And it's crucial for for many companies, but it doesn't fit to all situations. So I see that, you know, it has been overused because entrepreneurs, they don't know they know that they cannot get any funding from the banks so that they just think, OK, now I need to raise equity. And then they start selling substantial parts of their business very early on. And then they they cannot scale it up because they get in the way that their key capital, which which are the equity in their business to early on. So so I think it's it's really important that there is a market for alternative funding for scalable developing. And I see again, in Europe, the market is very, very early. I mean, we are we are really the pioneers in Europe. We started this and we have an enormous inflows of companies from all over Europe coming to us. So last year we have seen around a thousand companies coming to round to to to ask for funding. And that just shows that there is an enormous market need, which is good for us. But I think it's from a societal perspective, it's important that this alternative funding market is developing so that that we make sure that the young companies that are scaling get the funding they need and they get in the right way.

Speaker1: [00:22:01.86] That's great. Well, how best for listeners to get back in touch with you.

Speaker2: [00:22:05.40] So, yeah, you can you can reach me via our website or via email or we are linked in. So I'm always very curious and happy to to get new contacts and I'm always open for further discussions and conversations.

Speaker1: [00:22:26.94] Great. We'll put those in the show notes. I want to thank you for joining us today and hope to have you back for a follow up soon. Thank you, Martin. Investor Connect helps investors interested in startup funding. In this podcast series Experience, investors share their experience and advice. You can learn more at Investor Connect, Doug. Paul Martin is the director of investor Canek, which is a 523 non-profit dedicated to the education of investors for early stage funding. All opinions expressed by Hall and podcast guests are solely their own opinions and do not reflect the opinion of Investor Connect. This podcast is for informational purposes only and should not be relied upon as a basis for investment decisions.