

The background features several large, curved, overlapping shapes in shades of light gray and white. A prominent red circle is located in the top right corner, containing the text 'Startup Hungary'.

Startup
Hungary

CEE

Startup Policy Report

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1

INTRODUCTION



Csongor Bias

Managing Director at Startup Hungary

“We would like to understand what governments should and should not do to help startups grow”

If we want startups to grow, there is no question that we must focus on supporting startups. But startups do not come out of nowhere.

This report looks at the Central European region, with a focus on Czechia, Hungary, Poland and Slovakia, and draws on insights from Baltic and other countries to find best practices in the state-startup relationship, as well as to identify which policy measures have negative consequences for entrepreneurship.

EU and national governments have the power to create a legal and business environment in which startups can thrive. This is a huge responsibility.

One of the main advantages of Central Europe is the very tight geographical proximity between innovation hubs. It only takes a couple of hours to get from Budapest to Bratislava, Warsaw or Prague. We should therefore not think in terms of a zero-sum game and compete for the title of the regional Silicon Valley, but should strive to create bridges between these hubs and to join forces to elevate the region together.

To do that, we need to gain a deeper understanding of the policy environment and harmonize policy efforts

both on regional and EU levels so that all startups have the same chance of success, regardless of their geographic origin.

This means removing barriers that stand in the way of growth and create an unnecessary bureaucratic overhead for startups. For example, by making it hard to distribute shares between founders, investors and employees through a lack of clear regulation on Employee Stock Ownership Plans (ESOPs), CEE businesses can struggle to retain talent.

The other thing governments must be mindful of is the fact that it is possible to provide too much help. Government funding is not, in itself, a negative – especially in this part of Europe, where pension funds, high net-worth individuals, investment banks and other financial institutions do not invest enough in VC and private equity.

But if governments are too active and do not have robust processes for selecting the projects which have the biggest market potential, state funding can sometimes be more of a hindrance than a help.

INTRODUCTION

Our report is aimed at two key groups. First, government officials and legislators. By sharing the best and worst practices we have found, we hope to raise the level of knowledge within government about what startups need.

Second, startups themselves. Regulation and policies at both EU and national level have real-world impacts for startups. We hope our report will show entrepreneurs just how important lobbying and advocacy is for them, and the benefits of advocating for a supportive policy environment.

There are a number of very complex regulations coming down the line at EU level, which will impact startups both directly and indirectly.

As we have found, awareness of these regulations is very low among founders. A clear understanding of what actionable steps these regulations require is often clearly missing. And there is also a tendency of not taking these regulations seriously due to patchy enforcement.

In the end, EU regulations aimed at reining in Big Tech can result in a higher administrative burden, and it is often startups that pay the price. Instead of creating barriers, EU decision-makers should practice a startups-first approach and create a regulatory environment that elevates the European digital and startup scene.

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EXECUTIVE SUMMARY

Central Europe is a fast-growing area of the continent, yet its regulatory environment has not always been well-calibrated to support entrepreneurship and startups.

With the CEE Startup Policy Report, Startup Hungary explores the relationship between the EU, national governments and startups in Central Europe (CE), focusing particularly on Czechia, Hungary, Poland and Slovakia.

This report's most important finding is that **it takes both a powerful top-down and a bottom-up effort to create a healthy startup ecosystem** that will help the smallest, newest businesses to grow.

For this reason, the report is intended for two distinct audiences:

1. Policymakers at both national and EU level, to drive top-down efforts
2. Startup founders and representatives of startup advocacy organizations, to drive activity from the bottom up

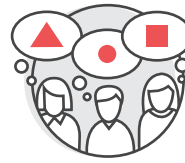
By getting to know both the best practices and bottlenecks in the policy and regulatory environments, we hope to give our audiences a deeper understanding of what regulation is needed, the role the government should play and the importance of being vocal at both a national and European level.

The report relies on 30 qualitative deep interviews with startup organizations, scale-up founders and operators, investors and domain experts as well as nearly a dozen of existing reports from partner organizations, such as the [Startups & State report](#) by Czech Founders, Startup Poland's [annual reports](#), [Hungarian Startup Reports](#), Google and Atomico's [CEE Startups 2022 Report](#), Civitta's 2022 [The Baltic Startup Scene Report](#) and reports of other contributing partners including [CzechInvest](#), [SAPIE](#), [Allied For Startups](#) and others.

Key takeaways of the report on EU level:



Startups exhibit low awareness of EU data regulations, and tend not to monitor legislative changes. GDPR provides an example of what happens when startups do not pay attention, while the EU regulates without startups in mind. The rush of last minute efforts by startups before it entered into force generated significant extra cost and bureaucracy, which disproportionately affected small companies compared to the burden on Google or Facebook. There is a fear new regulations – such as the Data Act, Digital Services Act, Digital Markets Act and AI Act – will be similarly burdensome. This is especially the case with the AI Act.



The upcoming Gigabit Infrastructure Act may incentivise telecommunications companies to invest in infrastructure that will help innovation, but the proposal also carries a risk for consumers and the principle of net neutrality. There is a risk that the proposal gets caught up in the resurrection of the decades-long debate around a potential network fee for delivering data users ask for, undermining net neutrality.



EU programs, initiatives and laws to create a common startup ecosystem are not always successful. Initiatives such as Startup Europe aim to facilitate networking in the European startup ecosystem, while Startup Nation Standards is intended to harmonize national legislative frameworks to build a common EU startup culture. Laws such as the GDPR or the recent Digital Services Act also seek to create a harmonized regulatory environment allowing startups to scale and thrive, but practical experience shows that the intent does not always align with the results. Rules can be complicated and costly to implement, and enforcement is often seen as patchy.



According to the [AI Act Impact Survey Report](#) published in December 2022, the majority of VCs expect that **the AI Act will reduce the competitiveness of European AI startups.** Half of AI startups also believe it will slow down innovation in Europe. A full 16% of AI startups are considering stopping AI development or relocating outside the EU.



The European Data Strategy will influence where startups choose to base themselves. This key harmonization effort – consisting of the Data Act and Data Governance Act – aims to create a European Single Market for data and prevent the emergence of a patchwork of regulations. But provisions in the Data Act to limit the transfer of non-personal data to third countries – as in the GDPR – might drive startups to move their businesses or research ventures outside the EU, scuppering European hopes of creating a thriving startup ecosystem.



Well-intended EU efforts aimed at startups can impede growth. For example, according to the AI Act Impact Survey Report, exceptions outlined in the AI Act for SMEs do not help as startups want to grow. Measures aimed solely at SMEs can create issues such as regulatory cliffhangers for startups as they scale and transition out of SME status.

Key takeaways of the report on national level:



It is essential that the highest levels of government are committed to creating a supportive policy environment for startups. When it comes to creating a policy environment that includes certain key regulatory measures for startups (such as Employee Stock Ownership Plans (ESOPs), SAFE, convertible note regulations, tax incentives for angels and investors, etc.), the level at which governments are engaged is crucial. The higher decision-making level of government involved, the greater the chance that necessary measures become law. In the Baltic countries, startups are on the prime ministers' agenda and it makes a clear difference compared to countries where the highest level of contact is limited to, for example, a state secretary.



Governments still have an important role to play in delivering entrepreneurship education in the CE region.

Entrepreneurship education must be acknowledged as an essential part of fostering a dynamic economy. In CE countries, entrepreneurship programs have been launched in several universities and secondary schools, often with government involvement. The entrepreneurial education programs that create the biggest impact share certain characteristics, such as access to high quality mentors, partnerships with international acceleration programs and efforts to identify and make up for missing talent in related fields (such as IT and marketing).



Attracting and retaining talent (and startups) is a big pain point in the CE region. A powerful brain drain towards Western Europe and the US persists, while “flipping” (moving the legal HQ outside of the country or the EU) is a general problem in all CE countries. Making the region attractive to foreign investors should be an important goal for all CE countries. Estonia's e-residency program is a great example in this respect: skilled talent is continuously attracted, and foreign investors are also assisted with identifying the necessary workforce. A combination of a stable and predictable economy, a balanced tax system, and a business-first approach make Estonia especially attractive for foreign investors.



Governments are investing large amounts of public money in startups in some Central European countries, but this can be a double-edged sword. Twenty-seven percent of CEE VC funding between 2016 and 2020 came from government sources, with two-thirds of this given to Polish and Hungarian VCs. This can have unintended consequences: the incentive for public investment managers to find return-generating, high-potential teams might be less than that of private investors, especially when there is a requirement to invest a set budget in a fixed timeframe. For startups, public funding also carries a significant administrative burden, which diverts attention from essential activities such as product development, validation and marketing. Finally, government money can also come with specific requirements that might ultimately make it harder to find international investors. State entities that invest public money must focus on impact and successful exits as their KPI and not the number of investments.



In contrast, a lack of available public money can sometimes be an advantage. This is the case in Czechia and Slovakia, where private investors have had to fundraise themselves. The early success of some of the first private VC funds has then encouraged other investors, creating a virtuous cycle.



Advocacy organizations need to show the economic proof points to get government buy-in, both in terms of job creation and tax revenues. In the most developed ecosystems of the region, such as Lithuania, startup advocacy groups do not ask for financial support from the government: they talk about what they bring to the table. This performance-based approach resonates with policymakers, who in turn are more likely to advocate for a supportive regulatory and policy environment.



ESOPs need a clear legal framework that is often missing. ESOPs are an important tool for startups to retain talent by allowing employees to become owners of company stock. When the state fails to create a clear legal framework, semi-legal solutions will prevail and startups will face difficulties in retaining skilled talent. Startup advocacy organizations need to educate both employees and policymakers about the importance of a clear ESOP framework.



All CE ecosystems struggle with a lack of pre-seed funding and business angels. The lack of a critical amount of business angels can however be linked to unfavorable legal conditions. In Hungary, for example, a serious problem for angel investors is that they cannot use investment vehicles like convertible notes or SAFEs. While standard in the U.S., in Hungary this qualifies as registered banking activity. In Estonia and Lithuania, a partnership of founders, investors, lawyers and government officials working closely together, however, successfully cleared the way towards thriving angel activity.



Startup advocacy groups play a critical role in persuading governments. Founders of the most successful companies, including unicorns, play a significant role in local ecosystems with their knowledge and network, even if they have already flipped to Western Europe or the US. The best advocacy groups make contacts across government, not just in 'digital' departments. A startup-friendly regulatory environment takes a coordinated effort from several policy portfolios, including justice, finance, education and internal affairs. If advocacy groups have good working relations with all of these departments, it makes the task of the lead government ministry or agency significantly easier.

2.1. The geographical focus: CEE

The rationale for concentrating this report's focus on Central and Eastern Europe is simple: these countries share many similarities. The narrower geographic focus of the report is Central Europe, but to get the big picture and to see what solutions and best practices have been developed in neighboring countries with similar conditions, the scope is extended to the wider CEE region (e.g. including the Baltic countries or Bulgaria).

Czechia, Hungary, Poland and Slovakia make up the [fifth largest economy](#) in Europe in terms of growth and consistently perform above the EU average. Due to their geographical proximity, these countries are each other's top trading partners.

All governments in the region have committed to implementing measures that serve the growth potential of startups, with varying levels of success, and there is a growing realization that startups are vital for economic success.

Regional cooperation on best practices and policies has the potential to elevate the entire regional ecosystem, which can be much more powerful and visible than respective countries acting exclusively on their own.

2.2. Data and methodology

The report is based on approximately 30 interviews with important ecosystem players, such as VC, startup founders, government representatives, representatives of startup advocacy organisations. The report also borrows insights from contributing partner's reports, such as [Startup Poland's Polish Startups report](#), and the [VC Golden Book 2021](#), Czech Founders's [State & Startup Report](#), Civitta's [The Baltic Startup Scene report](#), [Atomico - Google - Dealroom - Credo's CEE Startups 2022 Report](#), HVCA's [Jubilee 30 Years Yearbook 2021](#), and additional sources from SAPIE, CzechInvest and more.



2.3. EXPERT GALLERY



Maria Avramidou
Data Policy Expert,
Allied for Startups



Michal Bas
Investment Principal,
VentureFriends



Laszlo Bodis
Deputy State Secretary for Innovation,
Ministry of Culture and Innovation, Hungary



Eline Chivot
Senior adviser on digital policy
at the European People's Party



Jirina Dunkova
Operations Manager,
Czech Founders



Meeri Haataja
AI Analyst,
CEO & Co-Founder, Saidot



Michal Kardos
Executive Director,
Slovak Alliance for Innovation Economy



Petr Kopecek
Senior Startup Specialist
Czech Invest



Laszlo Koranyi
Senior Advisor,
Ministry of Culture and Innovation, Hungary



Petra Kovacsics
Data & Technology Lawyer



Krisztián Kölkedi
Deputy Chief Strategy Officer of Express
Innovation Agency, HSUP founder



Inga Langaite
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Eve Peeterson
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Jared Schrieber
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Tomasz Szarzyk
CEO,
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Dária Szabó
Senior Associate,
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Ivan Vasilev
Policy and Strategy Director,
Besoo



Zsolt Weiszbart
Partner,
Day One Capital



3

INTRODUCTION

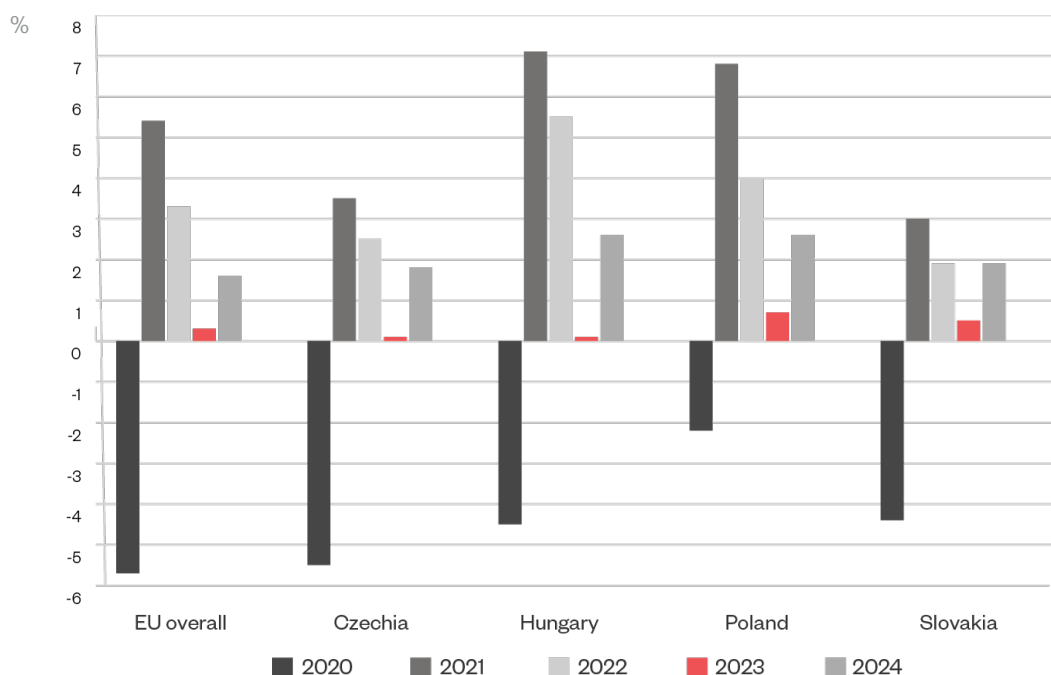
3.1. Overview of the recent growth in CEE

3.1.1. The macroeconomic environment

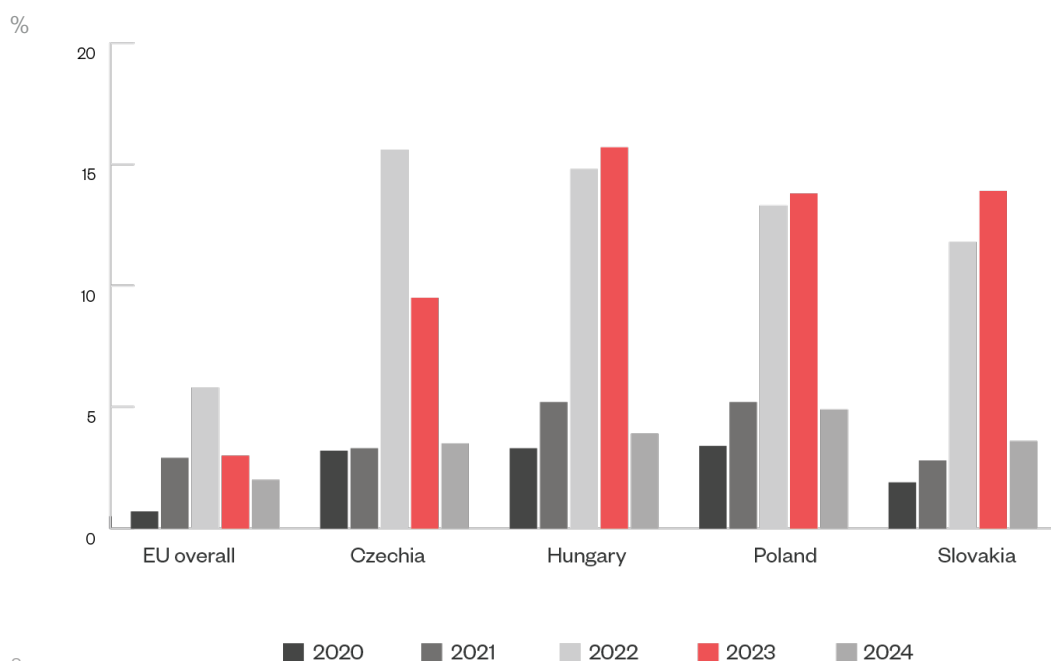
As a consequence of the Russian invasion of Ukraine, the entire global economy and the EU is witnessing higher inflation and lower growth. Trade disruptions, decreasing consumer confidence, rising commodity prices, and tightening monetary policy all play a role in this trend.

The EU economies, especially Central European ones, are vulnerable to soaring energy prices due to their strong reliance on Russian gas. Therefore, growth is markedly slowing down in the region. **Tighter financing conditions, the inflation profile, and elevated costs have a negative impact on investment decisions.** GDP growth is also slowing down significantly.

Expected GDP growth in CE



Expected inflation growth in CE



Source:
European Commission, Economic Forecasts, 2022.
[Accessible here](#)

3.1.2. Growth in the startup ecosystem

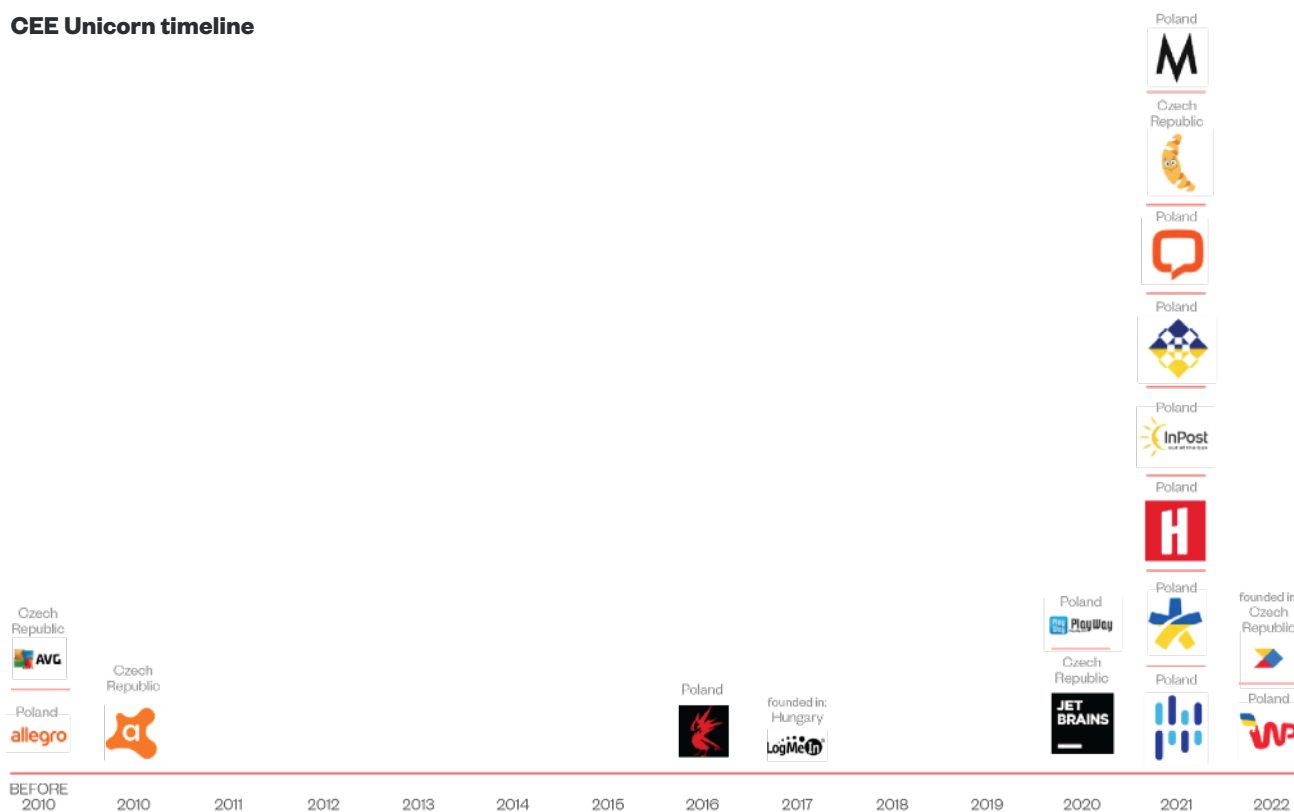
In spite of the dire economic outlooks, the regional startup ecosystem is still experiencing growth. Even during these uncertain times, the **CEE startup scene is showing resilience**.

As the Google Atomico [CEE Startups Report 2022](#) shows, the past two years have witnessed **the biggest growth so far in terms of the number of unicorns**, their number more than doubling **from 21 to 44** between late December 2020 and the end of 2022. Out of the 23 new unicorns, 11 were created in Central Europe. Since in previous years the CE region had only been able to produce 5 unicorns, this not only means that these countries more than doubled the number of unicorns but that the last two years have shown extraordinary growth in companies with a net worth of over 1 billion USD. When looking at specific countries, the skyrocketing unicorn numbers can be attributed to Poland, more specifically, its thriving gaming industry (3 out of 9 new unicorns in the last two years).

Similarly, **the enterprise value of CEE startup companies grew significantly** in the past few years, from 140 billion EUR in 2020 to 190 billion EUR in 2022. Within this growth, the CE region accounts for 82.4 billion EUR.

The biggest growth in combined enterprise value in the period between 2017 and 2022 happened in Hungary, where this value more than quadrupled from 1.4 billion EUR to 7.6 billion EUR¹. During the same period, Czechia produced a growth of 4.4 times, Poland of 3.2 times. We do not have data on Slovakia, although, according to Dealroom, “the rest of CEE”, which includes Slovakia as well, tripled its growth in the given period.

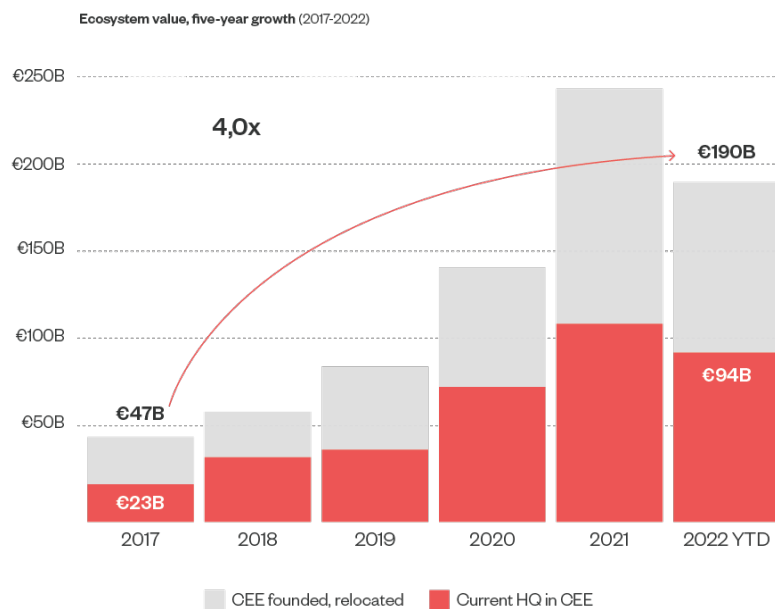
CEE Unicorn timeline



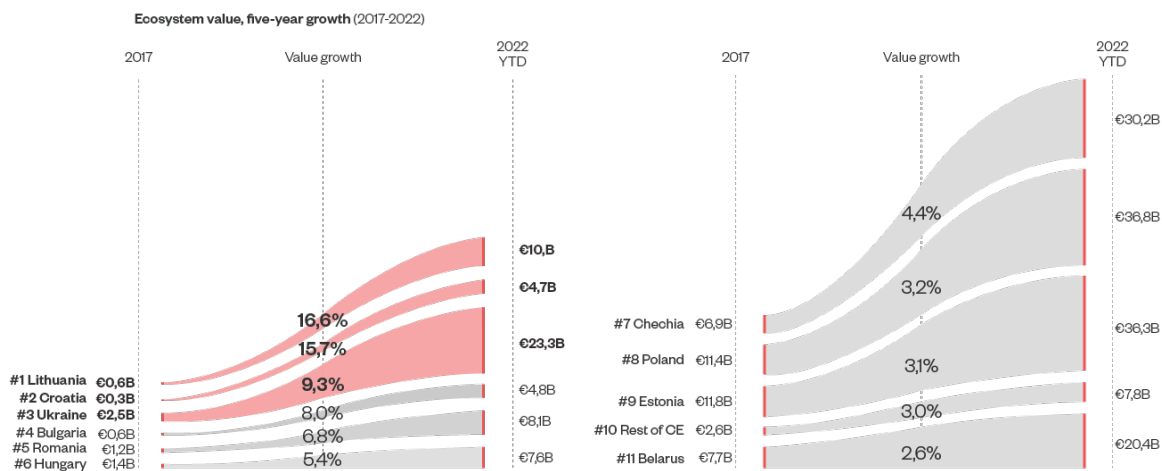
Source:
Dealroom, own data collection

¹This figure should be looked at with a critical eye, as Dealroom defines startups as a broad form of entrepreneurship. The data may include the number of startups that have substantial capital from the outset, including entities supported by the government, compared to 'classic' startups. For instance in Hungary, according to Startup Hungary's calculations, the growth was more moderate, with an approx. multiplier of 2.5.

Combined enterprise value of CEE startups has quadrupled in the last five years, now totalling €190B.



Among CEE countries, Croatia, Lithuania & Ukraine have grown fastest since 2017 in combined enterprise value.

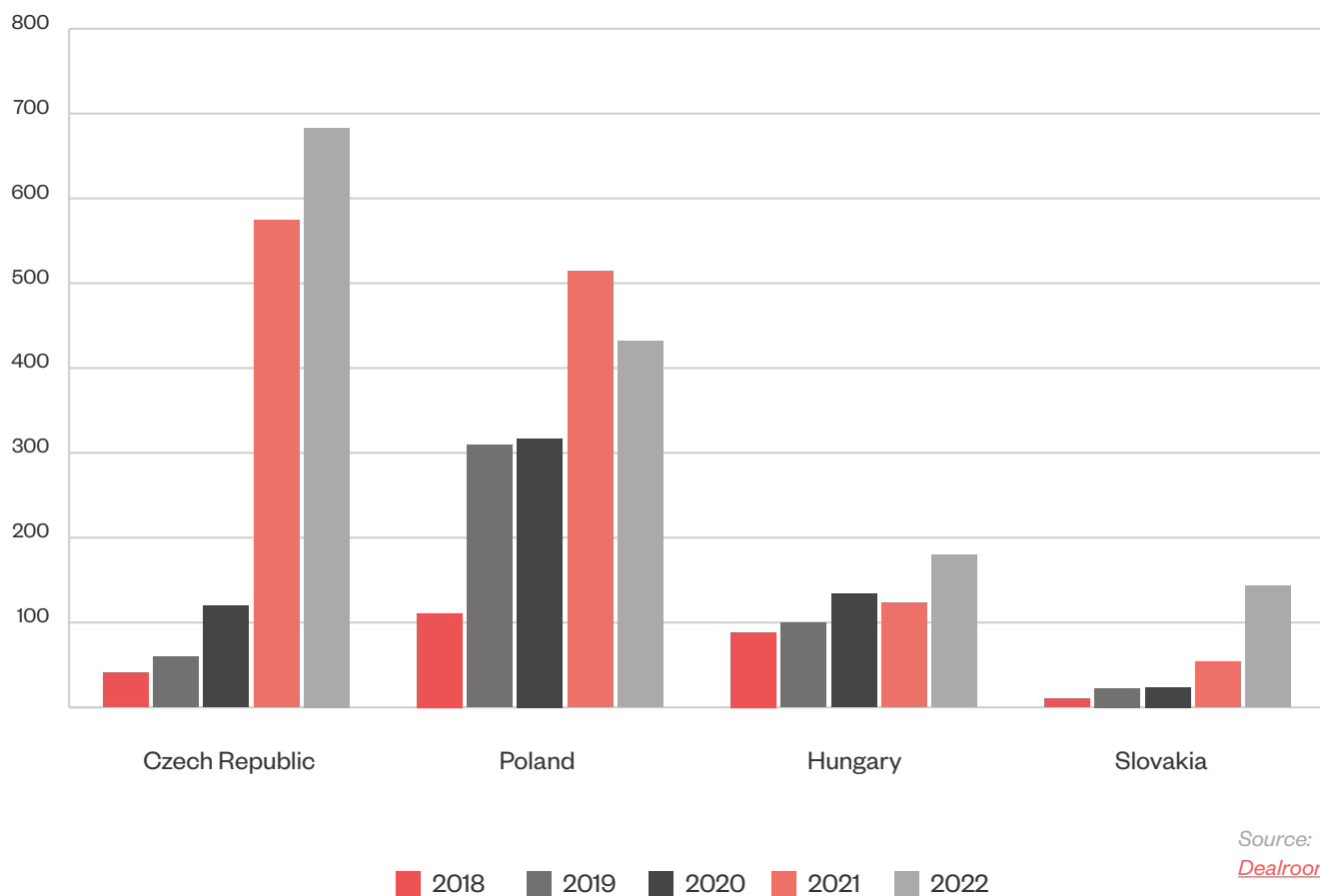


Source:
Dealroom

VC investment experienced significant growth during the last five years, especially in 2021. In the post-pandemic year of 2021, total VC funding doubled both in Europe and in the CEE and OE countries. The most significant increase happened in the Czech Republic, where VC funding jumped from 120 million to 574 million USD.

VC investment in CE countries

million USD



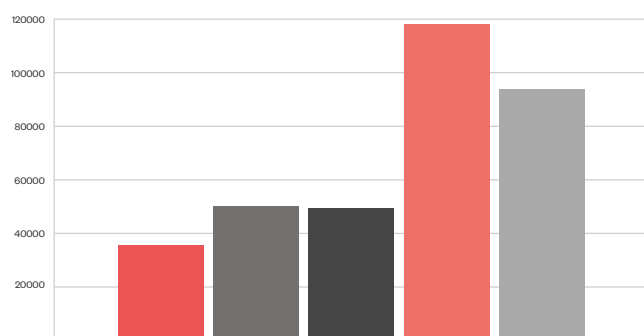
INTRODUCTION

International investors have increased their activity in CE startup funding especially from the US and Europe. This high increase in total VC investment since 2020 is largely due to the activity of top tier international investors, e.g. Index Ventures, Accel, 500 Global, Techstars, Y Combinator, Creandum, or Institutional Venture Partners, as well as megarounds. In Hungary, for example, the series B round of SEON led by IVP (94 million USD) accounted for more than 50% of total VC investments in 2022.

All in all, startups in Central Europe are navigating these challenging times well, which is a clear sign that startups are able to keep up with changing customer behavior. Since the pandemic, the digital and tailor-made experience is becoming all the more important, and tech startups by definition are positioned very well to reap the benefits of this trend.

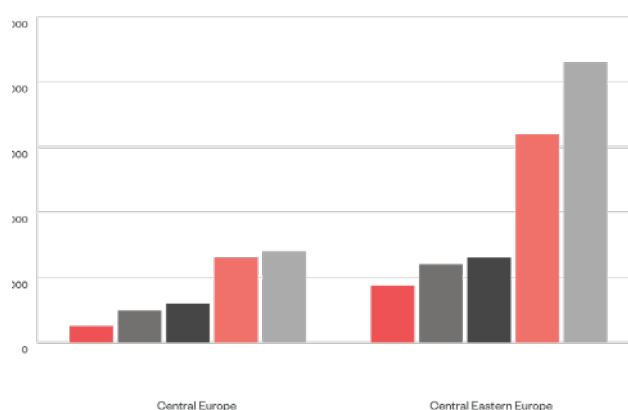
VC investment in Europe

thousand USD



VC investment in CE and CEE

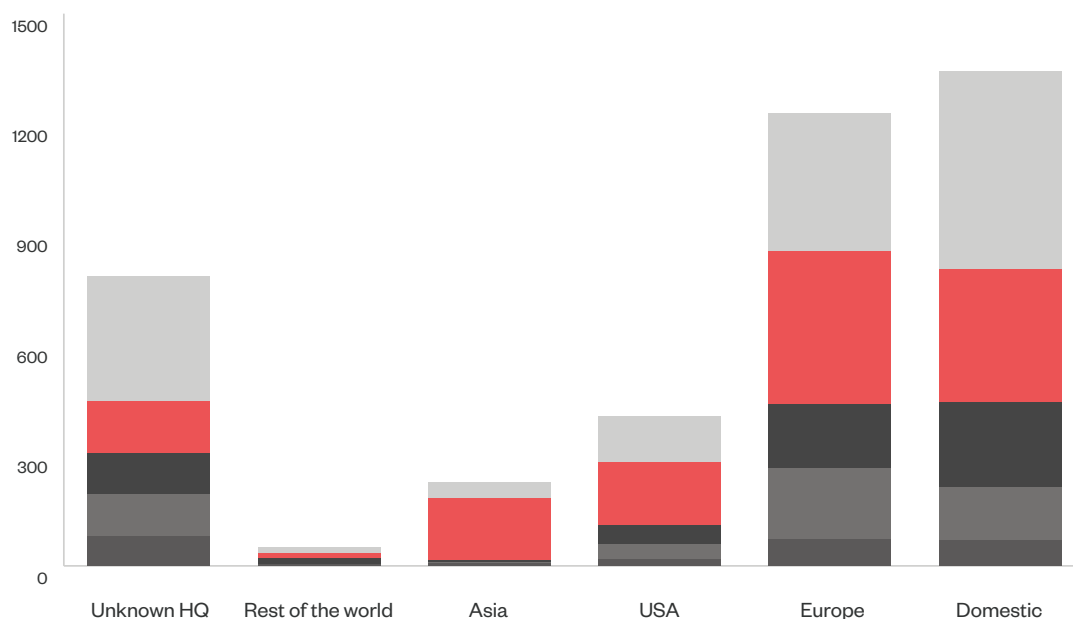
million USD



2018 2019 2020 2021 2022

Investment into companies with HQ in CE by investor origin

million USD



2018 2019 2020 2021 2022

Source:
[Dealroom](#)

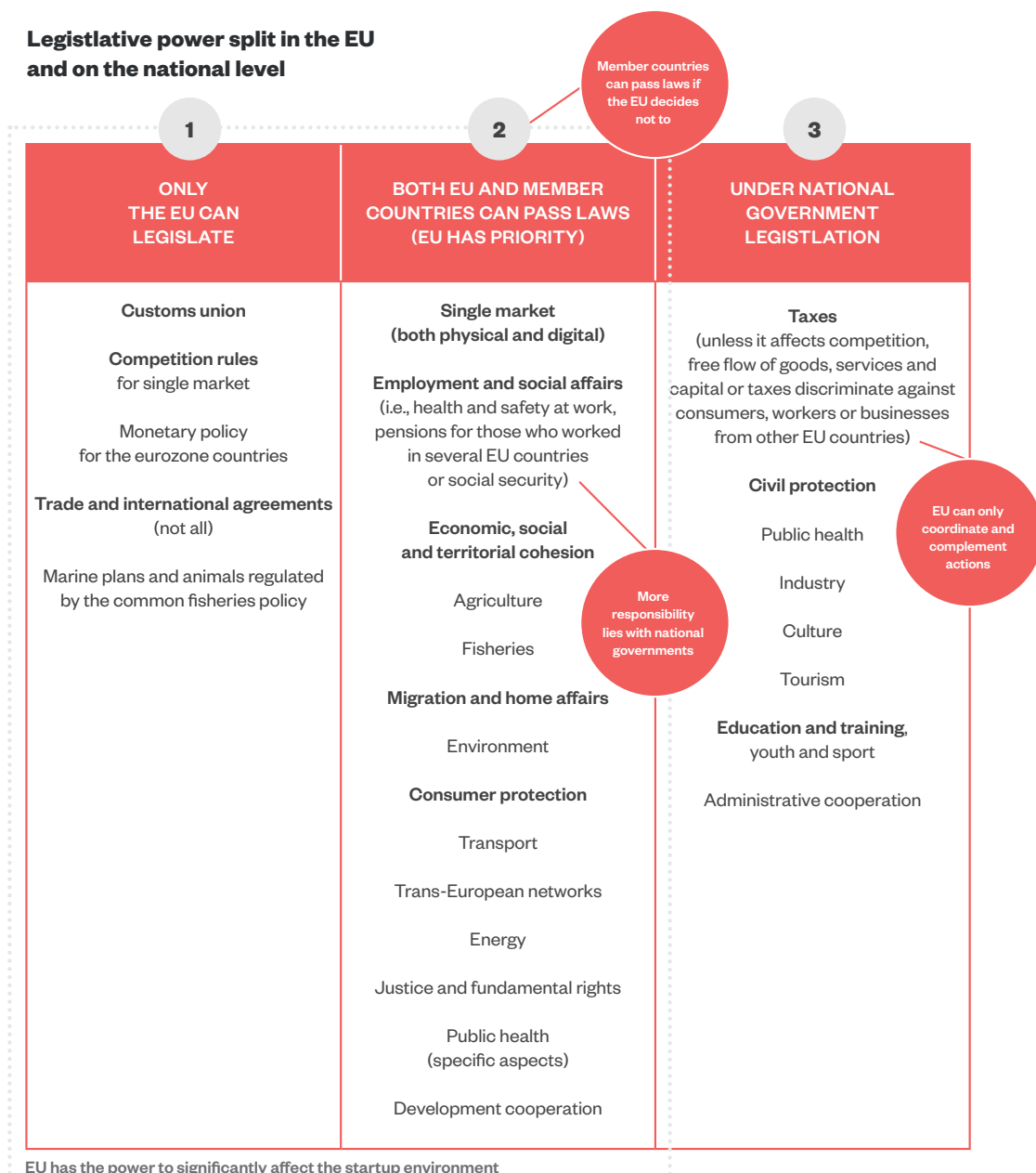
3.2. Policy in startup ecosystems

3.2.1. The role of the EU

Laws and regulations can make or break ecosystems. Although the European Union has less influence over startup landscapes than national governments that regulate their own ecosystems, the EU's various support programs and soft and hard law instruments nonetheless have a determining effect on the overall success of startups. The CE region is no exception to this.

While company laws, tax laws, procurement procedures, intellectual property rights, or startup funding policies mostly belong to the jurisdiction of the state, **the EU has significant power to influence the startup environment** through its legislation on the EU Single Market (both physical and digital), as well as its competition laws and sectoral regulations.

The EU has three types of direct instruments for startups: **non-regulatory initiatives, soft regulations, and hard regulations**. Non-regulatory initiatives aim directly at startups, fostering their funding, networks, and operations in general, soft regulations refer to non-binding instruments to create a single European startup ecosystem through recommendations and standards, while hard law means mandatory requirements with potential sanctions for non-performing companies. Binding regulations also have at least two types: regulations, which are directly valid in member states, and directives, which leave some room for nation states to legislate along defined lines. Most hard law instruments that affect startups aiming for high growth touch upon data and data management, and they are mostly governed by regulations.



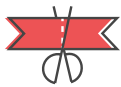
Source: CIVITTA & Google: *The Baltic Startup Scene Up-Close: Today's Realities, Tomorrow's Possibilities*, 2022

3.2.2. The role of national governments

Governments have a unique responsibility to create an enabling environment, where businesses can thrive, and where startups can easily incorporate, operate, and attract capital.

The scope of state support primarily spans **venture-friendly legislation and regulation**, although it can also have far-reaching effects in other domains of the entrepreneurship ecosystem, such as financial and human capital, education and incubation, entrepreneurship culture, entrepreneurship networks, and general infrastructure. The policy environment also plays an indirect role in the general business environment through investment decisions and spending power.

Entrepreneurship-friendly regulation and legislation has **five dimensions**:



Opening a business (e.g. time and cost of incorporation, minimum capital)



Obtaining a location for the company (e.g. time and cost of property registration)



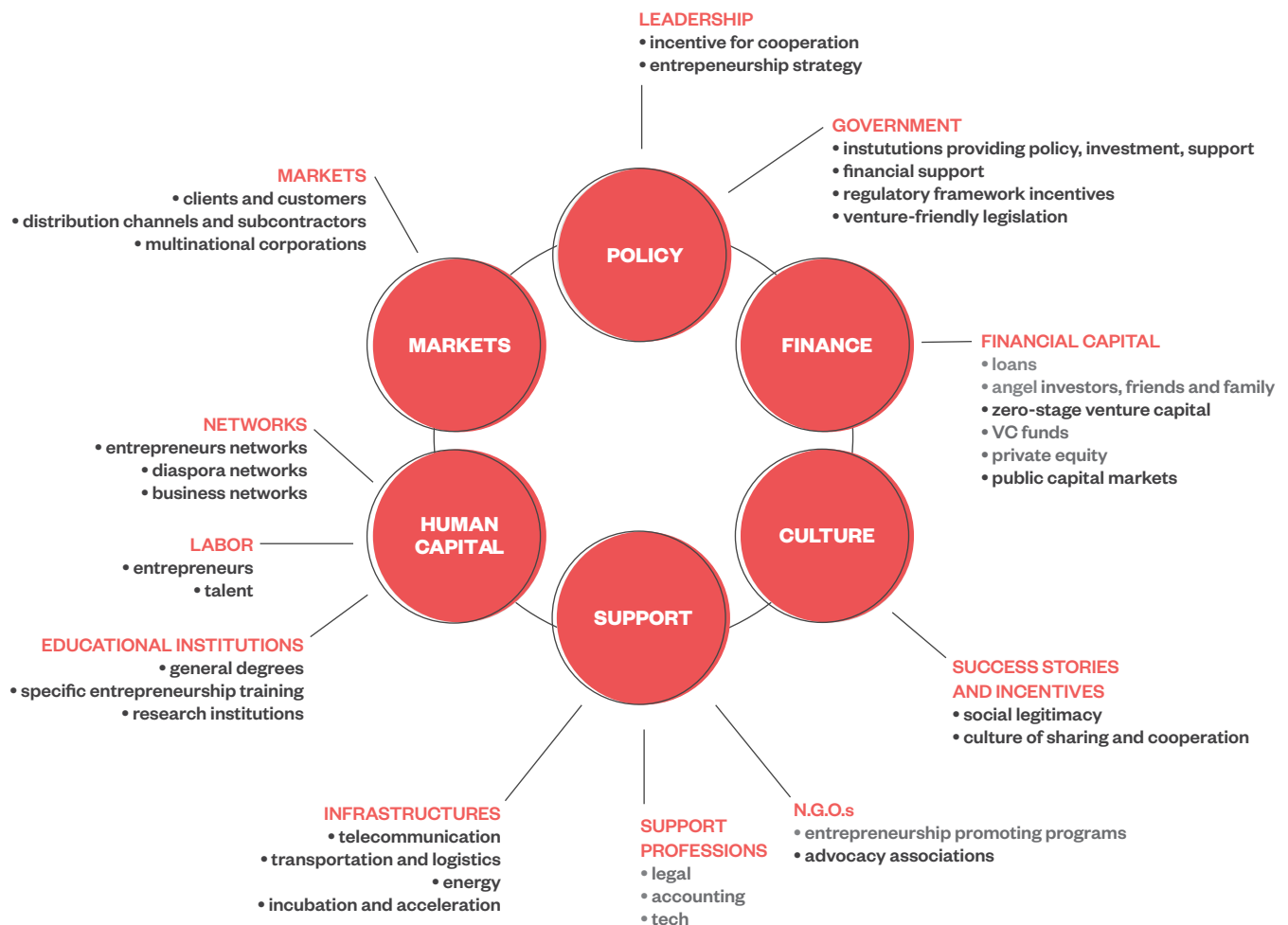
Accessing finance (e.g. access to credit, protection of minority investors)



Operating the company on a day-to-day basis (e.g. taxation: number of tax payments per year, total tax and contribution rate, time to comply with and obtain VAT refund, time to complete a corporate income tax correction and trade across borders, as well as time and cost to import and export)



Operating in a secure business environment (e.g. contract enforcement, resolving insolvency)

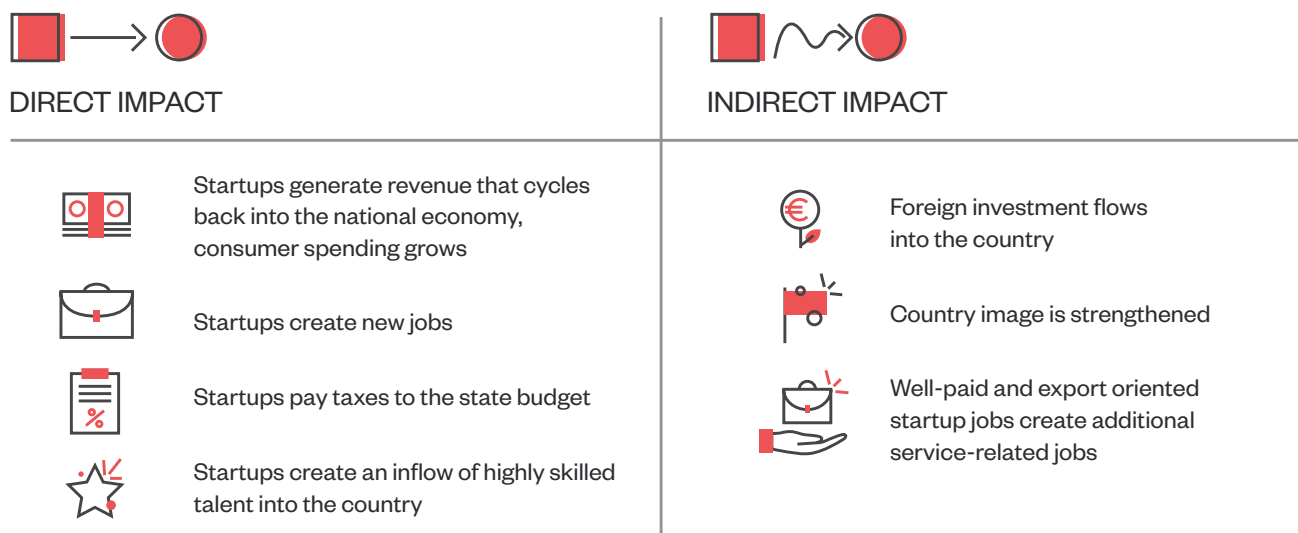


Source:

Isenberg, D. (2011). *The Entrepreneurship Ecosystem Strategy as a New Paradigm for Economic Policy: Principles for Cultivating Entrepreneurship*. Institute of International and European Affairs, Dublin, Ireland, 12 May 2011, 1-13.

All efforts national governments make to advance startups have tangible effects on the national economy:

Economic impact of startups



Investing time and money in the startup ecosystem by the national governments brings multiple returns, but only if it is done well. These returns should be the primary incentive of any government to put time, effort, and money in startups. Startups serve national economies, national governments serve startups: this is the circular economy of the startup ecosystem.

3.2.3. The role of startup advocacy

The EU and national environments allow lobbying in their regulatory processes, which means that **startups can and should have a voice in how regulations are shaped**.

While startups appreciate the EU's effort in facilitating networking and widening funding opportunities, they are less content with the existing and emerging regulatory environment at both the EU and the state level. Although advocacy at the national level is mostly taken up by dedicated national organizations, such as Startup Estonia, Deutsche Startups, Startup Hungary, Startup Poland, Czech Founders, or SAPIE, at the EU-level, **actors on the startup scene are joining forces on single issues, or they are creating dedicated organizations to represent their case in the EU institutions**, where single startups or other ecosystem players would be too small to effectively advocate their individual case.

An example for single-issue advocacy is the [Not Optional campaign](#), where more than 500 leading European entrepreneurs joined forces to advocate for a legal reform of stock options, also highlighting that limited availability of talent is a serious bottleneck to growth.

An example for a dedicated European level startup organization is [Allied for Startups](#). It was founded in 2014 and has evolved into a high-performing, cross-border, and multi-issue organization that represents a network of over 45 national organizations. The mission of Allied for Startups is to ensure that the voices of startups are heard at the EU and the state level on issues such as data privacy, data flow, net neutrality, copyright, AI, platform liability rules, or startups visas. They are actively promoting the [adoption of the Startup Nations Standards](#) at the state level, and they are advocating for more startup-friendly policy proposals at the EU level. Their latest advocacy campaign will be launched in defense of the [net neutrality principle](#).



4

STARTUPS AND THE EU

4.1. European startup programs and initiatives

EU non-regulatory initiatives are aimed at creating a single European startup ecosystem by **connecting the actors of the various country-level ecosystems in meaningful ways**, by providing information for cross-border ventures, and by making it easier to launch and do business in any EU member states by offering funds or funding opportunities, standardizing practices, and fostering cultural change.

For example, [Startup Europe](#) is an initiative that connects high-tech startups, scaleups, investors, accelerators, corporate networks, universities, and the media to accelerate the growth of the European startup scene. It is supported by a budget of 95.5 billion EUR between 2021-2027. The EU also supports innovation through a dedicated EU body, the [European Institute of Innovation and Technology](#), which has become Europe's largest innovation network with more than 2,000 business, research, and education organizational partners, and it has powered more than 3,100 startups and scale-ups, raising more than 3.3 billion EUR in external capital.

Indicating that the EU acknowledges the gap in competitiveness between the Western and Eastern regions, it launched the [Digital Innovation and Scale-up Initiative \(DISC\)](#) in 2019 to specifically address the investment gap in Central, Eastern, and South Eastern Europe in the digital economy. The EU wants to set up a regional investment facility to change the fact that 46% of startups incubated in this region raise financing mainly from US and Chinese investors.

Finally, the EU published its first ever policy roadmap for startups in 2022, the [New European Innovation Agenda](#). Over the course of the [upcoming 12 months](#), the EU is planning to issue a guidance document on regulatory sandboxes, as well as establish and connect its “deeptech innovation valleys”, i.e. local innovation ecosystems that will provide financial and business support to founders.

4.2. EU recommendations: Startup Nation Standards

The EU also aims to standardize and harmonize the ecosystems of its individual member states in order to create a single, competitive European startup ecosystem. One of its most recent tools is the European Startup Nation Standards, adopted in 2021, which startup founders and VCs believe to be one of its most important tools.

As a response to the Covid-19 pandemic, as well as the difficult situation of the European startup ecosystems, the European Commission (EC), together with member states and stakeholders in an open and inclusive process, has identified a **number of best practices that are hallmarks of a growth-friendly environment**. These are outlined in the [European Startup Nation Standards](#) (SNS) as standard-setting recommendations for states on how to foster a startup-friendly environment. 25 European countries have signed up to it, although Hungary, Bulgaria, and Croatia unfortunately decided to hold out initially. Later on, Bulgaria and Croatia decided to join SNS after all. The best practices are not mandatory, but the countries are [expected](#) to change the rules over time so that they approximate the EU-wide standards. The most important changes touch upon the following issues:

- **ESOP:** states should ensure that employee share options are not subjected to capital gains tax until they are actually cashed in, and that stock options can also be issued to employees with non-voting rights.
- **Establishing a new company:** as mentioned before, states should ensure a fast-track process: creating a new venture should not take up more time than a day either offline or online, nor should it cost more than 100 EUR.
- **Startup Visa:** states should accelerate visa processing for tech talent from outside the EU, and incentivize the return of European talent.
- **Overall:** states should reduce regulatory red tape, for example, allow startups to handle all their business affairs digitally, and create regulatory sandboxes.

When the SNS was signed, hundreds of CEOs and dozens of startup organizations [started to urge governments](#) to adopt the recommendations, and **become ‘Startup Nations’**. As a response, the Portuguese government [launched](#) the European Startup Nations Alliance to facilitate regulatory change, and as the first tangible result, Spain [adopted](#) its Startup Law in November 2022, taking into account SNS best practices and thus becoming the first Startup Nation.

4.3. European data, digital infrastructure and platform regulations

4.3.1. The characteristics of the European data market

The third type of regulations include hard law instruments, i.e. regulatory frameworks that introduce binding measures for states, which have a direct or indirect impact on startups. The European regulations on data, e.g. the GDPR, the Data Act, or the future AI Act, constitute such measures. Generally, the EU has recently focused on regulating the digital environment in as much detail as possible, with a single objective outlined by Ursula von der Leyen, President of the EC, in her State of the Union address on 16 September, 2020: “We must make this Europe’s Digital Decade”.

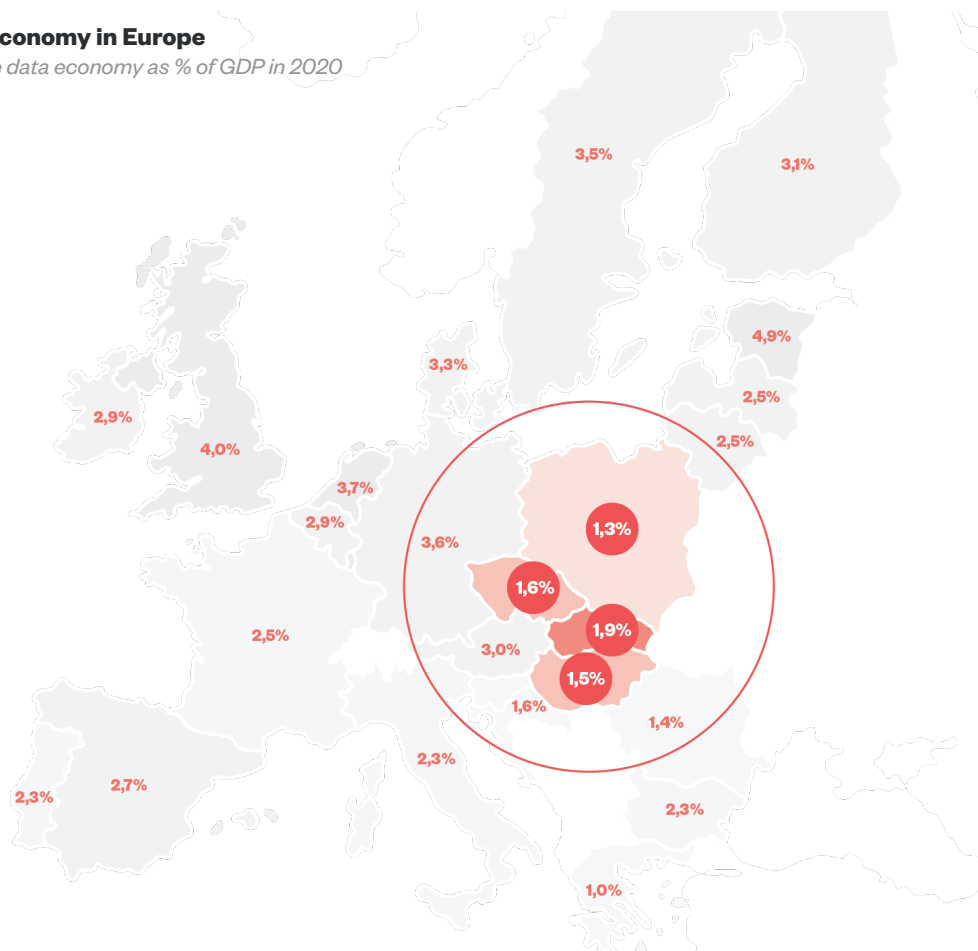
The reason for this ambitious goal is that the **EU continues to lag behind the US in terms of both the size and the growth of the data market, not to mention digitization**

in the business sector. According to [Eurostat](#), European companies have a decent digital intensity, and only 31.5 percent of the companies in the EU27 score very poorly on the digital intensity index on average. However, there is an enormous difference between CE or Scandinavian and other Western European countries: whereas only 8.8 percent of enterprises have a very low digital intensity in Finland, this number is 29 percent in Czechia, 41.6 percent in Poland, 42.9 percent in Slovakia, and 48.4 percent in Hungary.

In addition, in 2019, the EU27 plus the UK [generated](#) a data market value that was approximately 2.5 times smaller than the value produced in the US in the same year (72.3 billion EUR in the EU vs. almost 185 billion EUR in the US). In the CE region, the share of the data economy is even smaller: while in 2020, it represented 4.9 per cent of Estonia’s GDP, in Poland it was only 1.3 per cent, in Hungary 1.5 per cent, in the Czech Republic 1.6 per cent, and in Slovakia 1.9 per cent, as indicated below. However, as Ray Pinto, Digital Transformation Policy Director for DIGITALEUROPE shared at [CEE Digital Summit 2022 in Warsaw](#), the fastest-growing software developer communities in Europe are located in Poland and Ukraine at the moment.

The data economy in Europe

Impact of the data economy as % of GDP in 2020

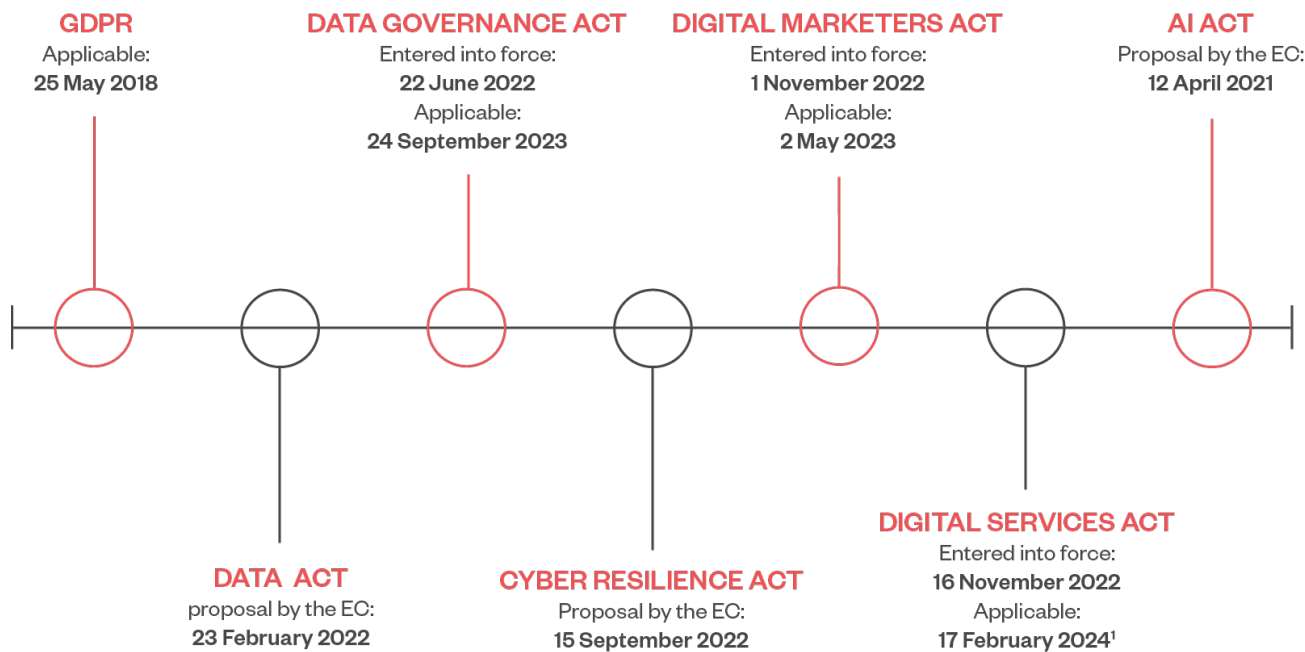


Source:
DIGITALEUROPE/ DATA LANDSCAPE/
Ray Pinto, Digital Transformation Policy Director for DIGITALEUROPE at CEE Digital Summit 2022, Warsaw

The EU also recognizes that the data economy drives innovation and growth: the **largest share** of the fastest-growing companies operate in the technology industry both in the US and in EU member states. However, of the 100 largest global tech firms by market capitalization, **the share of European tech companies** only amounts to 6%, while the share of the US alone represents 75%, and the combined share of the US and Asia is 93%. This would make it possible for the digital life of Europe and Europeans to be controlled by third countries without appropriate legislation. This is why the EU strives to create a regulatory environment that makes Europe more competitive, as well as allowing safer, more trusted, and more adaptable technologies on its market.

These are the main objectives, as specified in the **EU's Digital Agenda**, for creating the Single Market for Data, a regulatory patchwork of more than 130 regulations, which include legislative efforts for data protection (GDPR, a proposal for a **Cyber Resilience Act**), an appropriate **European Strategy for Data** (Data Act, Data Governance Act, AI Act), dealing with cross-border data transfers and open data, as well as creating European data spaces.

EU Data & Platform Regulations timeline



¹Some provisions already applicable

European data legislation landscape

DATA PROTECTION	EU DATA STRATEGY ON DATA	EU STRATEGY ON AI	EU CYBER STRATEGY
GDPR	OPEN DATA DIRECTIVE	AI ACT	CYBER RESILIENCE ACT
ePRIVACY DIRECTIVE	DATA GOVERNANCE ACT	AI LIABILITY DIRECTIVE	NIS 2 DIRECTIVE
	EUROPEAN HEALTH DATA SPACE		
	DATA SPACES		

■ PURPOSE OF LEGISLATION ■ Applicable ■ Entered into force ■ To be adopted ■ To be implemented by member states

Source:
Ray Pinto, Digital Transformation Policy Director for DIGITALEUROPE at CEE Digital Summit 2022, Warsaw; own data collection

4.3.2. The characteristics of the European data market

The reasons behind the low take-up of the digital economy at the EU level are multifaceted, and it all started when Europe [did not keep pace](#) with the US in the first wave of technology development centered on software and the internet. Today, a lack of appropriate human capital (lower digital skills, low proficiency in problem-solving in technology-rich environments, a net outflow of highly valuable workforce), insufficient digital investment and research and development are all widening the gap. Moreover, according to [McKinsey analysts](#), fragmentation and lack of scale, a lack of established technology ecosystems, a less developed risk-capital funding, and a regulatory environment that could be more supportive of disruption and innovation are the challenges that face the EU when it comes to levelling up in competitiveness.

When it comes to the regulatory environment, especially around digital, the biggest question always centers on the issue whether the intent to defend European values, European companies, and European people in the virtual space can go hand in hand with making the EU competitive. **Do data and platform regulations enable or stifle innovation? Do data regulations target the actors they are supposed to, or do they also drag down the up-and-coming tech scene with them?** These are the questions that we raised with our experts, as regulations around all kinds of data (raw, personal, non-personal, cross-border, data handled by business actors, governments, or other stakeholders) boil down to these central issues.

Data Protection via GDPR

The [general data protection regulation](#), a central piece in the data regulation universe of the EU, became applicable on 25 May 2018, after a two-year transition period. There are some who [celebrate](#) the GDPR as a milestone and a global role model for user rights. Fostering individual rights to access, rectify, transfer, and request the deletion of personal data, the regulation essentially gives data ownership back to more than 500 million “data subjects” within the EU rather than leave it in the hand of the “data controllers”, i.e. the companies that store and process user data. The influence of the GDPR has even led [third countries](#) to take it as a reference model for enacting similar legislation.

Although the intent to protect EU citizens’ data has been clear from the beginning, the implementation process has proved to be difficult. **Companies were lagging behind in compliance:** only **28%** were compliant by the time it became

applicable. Overall, the [implementation cost](#) around 24 million EUR for the technology and telecoms sector, while the banking sector had to pay 79 million EUR for compliance in 2018 alone. Startups have been **disproportionately burdened by the GDPR**, which has [proven to be](#) difficult to understand, complex, and expensive.

Largely as a consequence of the GDPR, the EU started negotiations with the US about the legal basis of **transatlantic data flows**, as the data transferred between the two continents represents significant economic value: [7.1 trillion USD](#) in trade and investment in 2019. The result has been the [Safe Harbor](#) and [Privacy Shield](#) agreements, but transatlantic data transfers have been in disarray since July 2020, when the European Court of Justice (CJEU) invalidated the Privacy Shield amid questions over the surveillance practices of the US government. At the moment, the situation is uncertain: in [December 2022](#), the EC developed a third transatlantic data flow agreement, the **EU-US Data Privacy Framework**, which the CJEU may or may not approve. As [5,300](#) companies relied on the EU-US Privacy Shield to transfer data across borders in order to conduct their business activities, and over [70%](#) of the companies registered under the EU-US Privacy Shield were small and medium-sized businesses, a negative decision would greatly impact startup ecosystems too.

Data Act

The GDPR opened up many avenues for further regulation: as it only handles personal data, a regulatory need has presented itself for non-personal data, raw data, data transfers, as well as business-to-business (B2B), business-to-government (B2G), and business-to-consumer (B2C) data. As part of its European Strategy on Data, in February 2022, the EC put forward a regulation proposal on harmonized rules on fair access to and use of data, i.e. the [Data Act](#).

This new piece of legislation consists of three main strands: **data relations between industrial actors, cloud data infrastructure, and international data transfers**. It creates new rights for the users of products or related services of products (be they private individuals or companies) to access, use, and share with third parties the data generated by their use. In practice, the legislation creates mandatory obligations to share data for B2B, B2G, and B2C. The Data Act will also create an obligation for all data processing services to allow their customers to switch services within 30 days. Finally, it will also set up new restrictions on international non-personal data flows whenever the transfers are in conflict with EU laws.

Data Governance Act (DGA)

Published by the EC in December 2020 and part of the European Strategy for Data, the DGA complements the Data Act and wants to foster the availability of data by increasing trust in data intermediaries and strengthening data sharing across the EU and between sectors.

The **DGA aims to facilitate the sharing of data held in public sector bodies**, which is subject to the rights of others, including businesses, against remuneration. It allows personal data to be used with the help of a data-sharing intermediary, which is designed to help individuals exercise their right under the GDPR. In addition, it introduces the concept of allowing **data use and donation on altruistic grounds**, which means that organizations are able to donate data. Moreover, it introduces a new EU body, the [European Data Innovation Board](#), to bring together member states on issues around data and data policies.

Connected to the DGA, the EU has also introduced the [Open Data Directive](#), encouraging countries to make the re-use of information possible. The directive introduces the concept of [high-value datasets](#), such as geospatial, meteorological, mobility, and company ownership data, as well as earth observation and environmental data and statistics. Furthermore, the DGA also aims to create sector-specific data spaces to enable the sharing of data within the given sector. For example, it plans to create data spaces for transport, [health](#), energy, or agriculture.

4.3.3. Expert's view

**Maria Avramidou**

Data Policy Expert at Allied for Startups

Regulating data: The bread and butter of startups

Maria Avramidou,
Data Policy Expert at Allied for Startups

An entrepreneur is often just an idea and the right data set away from a startup. Access to data, hence, is the bread and butter of the startup ecosystem, and ensuring that the process to carry them out is straightforward and clear will allow startups to be competitive, create jobs and continue answering consumers' demands. In the last years, the EU has started to regulate such access of data through the Data Governance Act and the Data Act, here's what it means for startups:

The **Data Governance Act (DGA)** and the **Data Act** are part of the European Commission's European strategy for data aimed at creating a single market for data that ensures Europe's global competitiveness and data sovereignty. The Data Act complements the measures of the DGA. While the DGA creates the processes and structures to facilitate data, the Data Act clarifies who can create value from data and under which conditions.

The **DGA** seeks to increase trust in data sharing, strengthen mechanisms to increase data availability and overcome technical obstacles related to the reuse of data. It will also support the set-up and development of common European data spaces in strategic domains, in sectors such as health, environment and energy. To this aim, it establishes rules in relation to the reuse of public sector data that is subject to certain protections and rules for data intermediaries. Moreover, the DGA introduces the concept of data altruism, i.e. people voluntarily donating their data for the public good, and it creates the European Data Innovation Board, which will advise and assist the European Commission in enhancing the interoperability of data intermediation services.

Undoubtedly, more data flows within the EU create opportunities for startups. However, the DGA creates a new system of intermediaries. This means startups will need to invest significant time and resources in order to take advantage of the opportunities of public data sharing. The DGA also restricts the possibility for public sensitive data to be transferred outside of the EU, which might be challenging for startups given that they operate globally from day one.

Data Act: aims to maximise the value of data in the economy by ensuring that a wider range of stakeholders gain control over their data and that more data is available for innovative use, while preserving incentives to invest in data generation. It has the potential to bring a key resource, data, to more startups. It is built on the idea that the more misallocated or underutilised non-personal data is being shared, the more virtuous cycles in the data economy can be triggered.

Data is a vital asset, especially in startup ecosystems. Startups can make the most out of simplified data accesses and seamless data flows. But policymakers should ask themselves if the Data Act is on track to delivering this. Data sharing obligations should be in line with the technical and financial realities of startups. Moreover, attempts to curb international non-personal data transfers could be very detrimental to startup ecosystems. Lastly, horizontal data portability & interoperability provisions should be designed to bolster startups' innovation potential.

Startups share the intention of EU policy makers: making data legislation fit to the digital economy. However, these rules should take into account the vision, financial and technical realities of startups.

4.3.4. Digital Services

In 2020, as part of its strategy [“Shaping Europe’s digital future”](#), the EC stated that competition rules alone cannot address all the systemic problems arising in the platform economy. While looking at updating the [E-Commerce Directive](#) that was adopted in 1995, the EC decided to explore ex ante rules to ensure that markets remain fair and contestable for innovators, businesses and new markets entrants.

Digital Services Act (DSA)

According to research conducted by [various startup organizations](#), there are over 12,000 platform startups in Europe, and the app developer workforce grew from 1.8 million in 2013 to 4.8 million in 2018. Therefore, designing the DSA in a way that works for startups is in the EU’s current economic interest. The [proposal](#) was published in December 2020, and it lays down [the rules and obligations for online platforms while providing an updated framework for the removal of illegal content online](#). The legislative proposal establishes a

clarified framework for the intermediary liability exemption, which means that a platform is not liable if it does remove or disable access to illegal content as soon as it is aware of it. In addition, the DSA contains proactive measures to remove illegal content without losing the liability exemption.

For startups, the most important parts are [thresholds and exemptions](#). The companies that qualify as online platforms (hosting services) above 50 employees and an annual turnover of 10 million EUR will face new requirements, such as having an internal complaint mechanism or following the [Know Your Business Customer \(YBC\) principle](#). The latter would oblige online intermediaries to collect identification information from their commercial business users to verify their identity. The goal is to stop bad actors from using legitimate services to engage in illegal activity, such as selling unlawful or unsafe goods and services. Moreover, **Very Large Online Platforms** (above 45 million users) will have additional measures and requirements, such as annual risk assessments on how they are stopping illegal activity from spreading on their networks. If they do not comply, they can be fined up to 6% of their global annual revenues.

Obligations of companies according to the DSA

SYSTEMIC RISK OF VERY LARGE SERVICES						CONSUMER PROTECTION VIA REQUIREMENTS ON THE DESIGN OF SERVICES						HANDLING OF ILLEGAL CONTENT						TRANSPARENCY		POINT OF CONTACT						
SUPERVISORY FEE	COMPLIANCE FUNCTION	DATA ACCESS FOR AUTHORITIES AND RESEARCHERS	INDEPENDENT AUDIT	CRISIS RESPONSE MECHANISM	RISK ASSESSMENT AND MITIGATION	INFORMATION OBLIGATION REGARDING ILLEGAL	MOTITORING OBLIGATION FOR ILLEGAL PRODUCTS AND SERVICES	COMPLIANCE BY DESIGN	TRACEABILITY OF TRADERS	PROTECTION OF MINORS	TRANSPARENCY OF RECOMMENDER SYSTEMS	TRANSPARENCY OF ONLINE ADVERTISING	PROHIBITION OF DARK PATTERNS	MEASURES AGAINST MISUSE OF THE SERVICE AND COMPLAINT MECHANISM	COOPERATION WITH TRUSTED FLAGGERS	OUT-OF-COURT DISPUTE RESOLUTION	INTERNAL COMPLAINT-HANDLING SYSTEM	REPORTING OF CRIMES	MODERATION DECISIONS WITH STATEMENT OF REASON IN DATABASE	NOTICE AND ACTION PROCEDURE	TRANSPARENCY REPORTING	FAIR TERMS AND CONDITIONS	LEGAL REPRESENTATIVE (FOR SERVICES WITHOUT EU ESTABLISHMENT)	POINT OF CONTACT USERS	POINT OF CONTACT FOR AUTHORITIES	
																					✓	✓	✓	✓	✓	ALL INTERMEDIARY SERVICES
																		✓	✓	✓	✓	✓	✓	✓	✓	HOSTING SERVICES
										✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	ONLINE PLATFORMS
✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	ONLINE MARKETPLACES
✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	VERY LARGE SERVICES (>45 MILLION USERS)

Source:

[Noerr Consulting AG](#)

Digital Services Act (DSA)

In December 2020, the EC released its [proposal](#) to **regulate the digital market, which is characterized by large platforms with significant networks** acting as “gatekeepers”, in order to restore and enhance fair and contestable competition. These gatekeepers are defined as core platform service providers with a significant and durable impact on the market. Search engines, operating systems or services related to social networking, video-sharing, messaging, cloud computing, online intermediation, and advertising are listed as such. There are three threshold criteria to be designated as a gatekeeper:

- **Size:** a market value of over 65 billion EUR or a turnover in the European Economic Area of at least 6.5 billion EUR in at least three EU Member States;
- **Control gateway:** more than 45 million monthly active end users or more than 10,000 yearly active business users in the EU;
- **Durable position:** presumed to be the case if a platform meets the two requirements above in the last three financial years.

Once designated a gatekeeper, a platform has to comply with a series of prohibitions and obligations, such as self-preferencing, data access, portability, or interoperability. In case of non-compliance, the EC can impose fines of up to 10% of the company's global annual turnover and periodic payments of up to 5% of total global annual turnover.

According to Eline Chivot, Senior Adviser on Digital Policy at the European People's Party, the idea behind regulating core platform service providers is to lower barriers to entering these digital markets. Oft-cited barriers include the lack of access to data, a lack of data sharing from larger firms to smaller ones, expensive requirements for business users, e.g. commission fees, unfair contracts enacted by dominant firms over less strong companies (unfair conditions for businesses using these platforms), and killer acquisitions.

However, she added that prohibiting practices such as self-preferencing (ranking their own services higher) could drive platforms to charge business users more for advertising their products or services online and increase the cost of market entry to millions of small businesses. Instead of opportunities for innovative entrepreneurs, we will see small companies that have been relying on platform ecosystems and consumers paying the price for a regulation that has overlooked such unintended consequence.

4.3.5. Expert's view



Maria Avramidou

Data Policy Expert at Allied for Startups

EU platform & data regulation: how does it impact the startup ecosystem? Rules for 10,000 startups

Maria Avramidou,
Data Policy Expert at Allied for Startup

The European Parliament has recently adopted the **Digital Services Act (DSA)** and the **Digital Markets Act (DMA)**, which set rules for internet platforms. While different in scope and effect, both the DSA and the DMA will play an important role in building a harmonized EU framework for the digital economy, where startups can thrive.

The DSA aims to harmonize the conditions for the provision of intermediary services across the European Union. It creates new procedures for faster removal of illegal content, transparency measures (including on online advertising and algorithms used to recommend content to users), and comprehensive protection for users' fundamental rights. The DSA maintains the three principles that are key for startups: **1) intermediary liability exemption, 2) the Country of Origin principle, 3) the no-monitoring obligation and a broad level of proportionality.** For example, by maintaining the Country of Origin principle, the DSA strengthens the Digital Single Market. It allows startups to operate as global businesses, trade across borders, and test their innovations from a single location - so they only have to scale up once, not 27 times!

The DMA creates new obligations for big technology platforms acting as "gatekeepers providing core platform services", with the aim to **create a fairer environment for business users that rely on gatekeepers**, and to ensure consumers have access to better services and can easily

switch providers. Startup communities across the EU have expressed their support for the objectives and aims of the DMA. Nevertheless, it will be important to take into account the direct and indirect impact that the DMA could have on startup ecosystems. The DMA introduces obligations for the biggest online platforms and could potentially improve the landscape for startups in the EU. However, it is crucial that startups retain the ability to be acquired by the platforms impacted by the DMA, given that exits are one of the most important growth and revenue tools for startups.

Both the DSA and the DMA create significant opportunities for startups by harmonizing rules across the EU bloc. Startup communities are following the implementation process to understand their practical impact on startup ecosystems.

4.3.6. Artificial Intelligence Act (AI Act)

In 2021, the EC introduced its [proposal](#) on AI, the world's first cross-sectoral, horizontal regulation targeting to safeguard people residing in Europe against the potentially harmful impacts of artificial intelligence. While the AI Act is still in preparation, the expectation for final adoption is a question of months rather than years. The regulation will apply to providers and users of AI systems irrespective of whether they are established within the EU, as long as the output produced by the AI in question is used there.

The rationale behind the AI Act is at least twofold. On the one hand, artificial intelligence is regarded as having the same powerful effect on societies as the invention of electricity, permeating every single area of society, thus it will have an enormous impact on Europeans and their way of living. On the other hand, AI-based algorithms have huge potential in every economic area from healthcare to mining. AI may contribute 1.8 trillion USD or 9.9 percent to the GDP of Northern Europe and 15.7 trillion USD to the global economy by 2030, [according to PwC](#).

However, these powerful tools are mainly shaped by US and Chinese companies, where annual investment is around 5.1 billion EUR and 6.8 billion EUR, respectively, while the [EU is only estimated to be investing](#) around 1 billion EUR into AI development. Thus, the EU wants to regulate AI so that it does not have to let control of algorithms out of the hands of European citizens, or let the US or China shape the future of the life of Europeans.

The objectives of the regulation are the following:

to ensure that the AI systems placed on the EU market are safe and respect the existing law on fundamental rights and EU values;

- to ensure legal certainty to facilitate investment and innovation in AI;
- to enhance governance and the effective enforcement of the existing law on fundamental rights and the safety requirements applicable to AI systems; and
- to facilitate the development of a single market for lawful, safe, and trustworthy AI applications and prevent market fragmentation.

The AI Act proposes various layers to regulate AI systems of different risk levels differently. It creates four categories according to risk level, with social scoring and mass surveillance systems being categorized as AI systems with unacceptable risk and becoming effectively banned in the EU. AI tools for recruitment, diagnostics and medical decision-making, educational or credit-scoring, or legal decision-making are categorized in the high-risk area, and these algorithms must comply with strict requirements.

The **high-risk AI system** category is of the most interest for European startups and scaleups, as according to the [AI Act Impact Survey Report](#) published in December 2022 by [appliedAI](#), 33-50 per cent of all European AI systems would classify as high-risk. This actually goes way beyond the assumption of the [EC Policy Impact Assessment](#), which estimated the number of high-risk European AI businesses to be between 5-15 percent. High-risk systems will fall under two categories:

- Stand-alone AI systems will be subject to a new compliance and enforcement system including internal checks, enforcement, proof of compliance, and the registration of their products in an EU database
- The safety component of products, which will be subject to the same compliance and enforcement mechanisms that the original products are subject to.