BUSINESSEUROPE

POSITION

20 July 2016

BUSINESSEUROPE'S RESPONSE TO THE COMMISSION CONSULTATION UNDER THE START-UP INITIATIVE

I. INTRODUCTION

The Commission launched a consultation on 31 March 2016 as a follow-up of the "Start-Up Initiative" announced in its 2015 Communication on the Single Market Strategy.

The consultation questionnaire has a broad scope. It looks not only at the creation phase of a start-up, but also at the later expansion phase of start-ups, which can – in case of high success – result in companies with 50 or 500 more employees than at the start.

There is no neat and commonly accepted definition that captures the start-up phenomenon, but the following elements are generally recognised as typical features of a start-up:

- Focus on rapid growth in terms of turnover
- Focus on innovation (product, process, service or business model innovation)
- High dependence on non-banking finance.

One way to grasp the reality of start-ups in Europe and to compare the situation with the US is to look at the volume and structure of SME financing, with a particular attention being paid to business angel finance, "Family and friends" finance, venture capital and crowdfunding. The data on table I at annex show that a major deficit in capital between the US and the EU exists in business angel and venture capital funding, which are three and five times higher in the US respectively.

It should be noted that venture capital is not supplied to start-ups and innovative SMEs by financial operators only. Venture capital can also be provided by large groups, or by industrial companies of an intermediate size – this is the "corporate venture". This finance source can be a very useful tool for developing strategies of mutual interest in the area of innovation and growth[1].

[1] As an illustration, corporate venture has grown in France from 32 million euros in 2008 to 289 million euros in 2013, and represented 5% of investment in innovating start-ups and SMEs in 2013, against 16% in the US[1]. Since 2003 more than 10 000 innovating enterprises have been financed with corporate venture in the world, representing a total investment of € 51 bn through 900 funds. Source :'Association Française des Investisseurs pour la Croissance (AFIC)

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The core goal of any start-up is to reach the full scaling-up potential linked to its innovative ideas. A highly successful start-up is a start-up that scales-up to very high levels. From that point of view, Europe appears much less successful than the US:

- According to the Wall Street Journal, in April 2016 there were 16 European unicorns (venture-backed private companies valued at $1 billion), in comparison with the 88 US unicorns and the 40 Asian ones;
- Due inter alia to the lack of later-stage venture capital funding, European start-ups cannot keep the growing pace of their US counterparts. By 2009, only 5% of European companies created from scratch since 1980 were in the top 1000 in terms of market capitalisation.

II. IMPROVING THE FRAMEWORK CONDITIONS FOR GROWTH-ORIENTED SMEs IN GENERAL

According to the Commission Spring Economic Forecast, the economic recovery continues at a moderate pace, growth is still hampered by the legacies of the economic and financial crisis and investment remains weak on account of different bottlenecks, such as unfavourable business environments, public administration inefficiencies as well as obstacles to access to finance.

What is particularly missing is an integrated industrial policy framework, looking at the various EU policy initiatives and legislative proposals in a coherent and coordinated way, avoiding unintended negative impacts of EU legislation. It is therefore urgent to pursue a European agenda for competitiveness aiming at modernising the European industrial basis and promoting a favourable business environment. Action fields should include: reducing barriers to finance and private investments, unleashing the potential of the single market, increasing support for digitalisation, promoting worldwide markets access, establishing an innovation-friendly environment and reducing regulatory burdens on SMEs.

SMEs clearly represent a strategic asset for a return to growth. This is why, without questioning the important role played by start-ups, focussing only on start-ups should be avoided. Supporting the creation and scale up of start-ups should not be considered as an aim in itself. This support should be seen in a wider perspective, taking into account the substantial growth potential linked to dynamic interactions between start-ups and established companies, for example in the context of new value chains.

It is important to note that while start-ups may have specific needs, especially in the scaling up phase (for example, in terms of legal expertise), they have a lot of needs in common with the wider population of growth-oriented SMEs. For this reason, and given the broad economic challenges that Europe has to face, improving the framework conditions for SMEs in general, with a particular focus on growth-oriented SMEs, should be at the core of any future action at EU level. Such a policy agenda would deliver a substantial double dividend: positive effects both for start-ups and for growth-oriented SMEs.

Points III to VII below highlight improvements needed in various policy areas that strongly influence the general framework conditions in which SME operate. BusinessEurope insists on policy measures that are in line with market mechanisms or get them working better, and that foster the exploitation of the full potential of new and existing markets.

In an additional document complementing this position (19 July 2016), examples are provided of:

- problems/ challenges encountered by SMEs, which should be addressed through EU specific initiatives
- problems encountered by SMEs, which call for more efficient policy measures at national level. Improvement of the national policy frameworks should be stimulated through the European Semester process and through a stronger implementation of the Small Business Act at national level.

Point VIII comments on a number of specific measures geared to start-ups and scale-ups, mentioned in the Commission questionnaire under the Start-up Initiative.

Point IX touches upon issues of definitions.

III. REDUCING BARRIERS TO FINANCE AND PRIVATE INVESTMENTS

The role of non-bank debt finance[2] and equity finance[3] is key for start-ups and growth oriented SMEs, but in many European countries, access to that type of finance is restricted. There are missing steps in the “funding ladder”. These missing steps depend partly on national circumstances, reflecting for example the risk level that national private and public investors are willing to manage in their asset portfolios. Gaps can be seen for example for risk finance in the 500,000 to 1,000,000 Euros segment[4] or in the 5 to 15 million Euros segment[5].

While some national measures are necessary to fix these gaps, additional initiatives are needed at EU level.

Against that background, it is to be noted that US private providers of equity have shown a capacity to react quickly to European innovation investment proposals in the segment ranging from 0,5 to 15 million Euros mentioned above. This explains that a significant number of European start-ups have ultimately looked to the US for financing their growth.

Initiatives at EU level should be aimed at:

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[2] Venture debt financing, mezzanine finance, crowdfunding…

[3] Business angel finance, venture capital, corporate venture capital, crowdfunding,…

[4] FEBELFIN Workshop on Risk Capital, 20 June 2016

[5] “Supporting investors and growth firms – a bottom-up approach to a Capital Markets Union” – T.Aubrey, R.Thillaye and A.Reed, Policy Network, 2015

1. Assist the market-based development of alternatives to lending

BusinessEurope supports the action lines of the Capital Markets Union initiative that reflect a market-based approach for assisting the development of alternatives to lending, such as:

- Mobilising long-term investors such as insurance companies and pension funds

  EU capital requirements rules for insurance companies and pension funds should be defined in a way that does not unduly discourage investment in assets that are essential for the growth of start-ups and growth-oriented SMEs.

- Achieving an integrated EU venture capital market.

2. SME-geared EU financial instruments

BusinessEurope has consistently advocated for deploying SME-geared EU financial instruments on a wider scale. In the context of the current discussion regarding the renewal of EFSI, the role and volume of the other EU instruments should not be forgotten. Establishment of a holistic view of all available instruments should be considered, to see if the overall spectrum of EU financial instruments (including Horizon 2020, InnovFin, EIF´s and EIB´s ordinary instruments) develops smoothly according to the needs of companies, without overlapping actions. The objectives and focus of the full spectrum of EU financial instruments should be reviewed in the context of the discussion on the renewal of EFSI.

3. Facilitating the introduction of tax incentives encouraging cross-border investment in start-ups and innovative SMEs

There is a need to facilitate the introduction of such incentives. It is positive that DG Competition of the Commission is willing to clarify how these incentives should be designed to fit with the 2014 Community guidelines for state aid in the area of RD and innovation*.* It is essential that tax structures should be transparent.

4. Facilitate identification of cooperation and financing opportunities involving SMEs, larger companies and investors.

Improving the supply of equity finance to SMEs depends partly on enhancing their visibility and their exposure to potential partnership opportunities. Initiatives like the Startup Europe Partnership (which is very much focused on collaboration between start-ups and very large companies in the digital area) have made some contribution in that direction.

It is however desirable to explore if the EU could pave the way for more initiatives in this area. A possible approach would be to create a platform of entrepreneurial ideas where start-ups could provide detailed information about themselves. Such a platform would promote their visibility and provide investors (public or private funds, business angels, incubators) with the information they need. This database, which could be based on the model of the existing Startup Europe Partnership, could be used by start-ups to make visible, beside standard information, also indications regarding their business: personal description of the start-upper and of the foreseen goods and services, indications about the level of development, the needs, etc. In this way, all private and public interested actors (public funds, business angel, private equity funds, incubators etc.) would have access to detailed information about the start-ups.

5. Enhance the availability of bank financing in countries where other financing options are completely marginal

In certain countries that have been particularly strongly hit by the financial crisis, the sources of risk capital have dried up. In addition, SMEs experience serious difficulties for getting traditional finance like bank loans or credit, or they do get it under significantly tighter conditions. The fact that lending costs for small businesses vary substantially across Europe leads to some fragmentation of the Single Market. It is therefore vital to act on both the systemic and non-systemic issues that can improve the lending capacity of banks.

IV. UNLEASHING THE FULL POTENTIAL OF THE SINGLE MARKET

1. Improve the implementation of the mutual recognition principle in the area of goods and services

The principle of mutual recognition should be better defined and consolidated through a revision of EU-regulation 764/2008 laying down procedures relating to the application of certain national technical rules to products lawfully marketed in another Member State.

The introduction and establishment of a ”Quick Assessment Procedure” could promote better application of mutual recognition in goods and services and would improve the transparency of national decisions.

New national technical regulations should be subject to an impact assessment with respect to the principle of free movement, and their justification and proportionality should be documented and based on special conditions of the Member State in question.

2. The need for enhanced business portals on the Single Market

BusinessEurope stresses that the Single Digital Gateway Initiative should result in transforming the Points of Single Contact (PSCs) and Product Contact Points (PCPs) into true business portals for services/goods.

3. Facilitate cross-border trade by simplifying VAT-related administrative tasks

a) Reduce the burden of proof in VAT-related procedures connected to intra-community trade

The application of the EU VAT Directive in the case of goods sold and transported cross-border gives rise to unreasonable administrative requirements (burden of proof) by some Member States, which generates serious obstacles to intra-Community trade.

The Commission should take an initiative to reduce to burden of proof regarding intra-Community trade, through a Regulation, as this would ensure consistency across Member States.

b) Combating VAT fraud without applying reverse liability or imposing administrative burdens

Today Member States apply reverse liability as a means to combat VAT fraud. However, the use of reverse liability implies that businesses must operate different sales and accounting systems for different business transactions, as well as inform their customers accordingly, which constitutes a significant administrative burden.

The application of reverse liability on purchasing as a means of combating fraud should be replaced by a simpler basic VAT regime in the EU. The EU should work toward a long-term and sustainable solution: a simpler, more efficient, neutral, and robust VAT system that is secured against fraud (cfr Council conclusions of May 15, 2012).

c) Establish an EU VAT Information Portal

VAT rules are not harmonised in the Single Market. Not only are there major differences between the documentation requirements, requirements of signatures, invoice requirements and texts on the invoices, but the challenges are growing with the introduction of rules on reverse liability, various distinctions and definitions of delivery point and different rates of VAT. As a consequence, SMEs that begin to trade within the single market often encounter difficulties.

To tackle this issue, an EU VAT information portal should be established, giving to any SME information on VAT regulation in foreign EU countries.

d) Introduction of a wide One-Stop-Shop for EU VAT declarations

The SME-geared Mini One-Stop-Shop (MOSS) aimed at easing compliance with VAT formalities for cross-border supplies of selected electronic services should serve as a basis for introducing a simplified system for declaring and transferring VAT collected from foreign private consumers (VAT on goods and services). BusinessEurope will examine carefully the upcoming Commission proposals in this respect.

V. HELP SMEs SEIZING GROWTH OPPORTUNITIES IN THE DIGITAL SINGLE MARKET

1. Reduce the costs faced by SMEs in their relationship with customers due to divergent national consumer protection legislation

2. Improve the framework conditions for e-commerce

The recent publication of the Commission e-Commerce and Content Package is timely, because while e-commerce is continuously increasing at national level, cross-border online sales are still underdeveloped, also as a result of remaining fragmentation in the single market.

With regard to geo-blocking, BusinessEurope agrees that unjustified different treatment in terms of price or conditions purely based on nationality or residence of recipients should be addressed.

However, there are objective and justified reasons for different treatment and these must be assessed on a case-by-case basis. Examples of justified reasons for different treatment from Member State to Member State are diverse or additional national regulation, extra costs due to distance or different market conditions. These are often the direct result of remaining fragmentation in the single market. The Commission should focus first on tackling the reasons for different treatment which are often due to existing fragmentation and barriers in the single market.

3. Apply the new EU data protection rules in a forward-looking way

The new EU data protection rules should be applied consistently across the single market and in a way that facilitates e-commerce and solutions based on big data, the internet of things and cloud computing.

4. Eliminate the VAT-related obstacles to cross-border trade in electronic services

There is a need to improve the scope and the design of the SME-geared MOSS system (Mini One-Stop-Shop) aimed at easing compliance with VAT formalities for cross-border supplies of selected electronic services.

The current EU VAT regulation applicable to electronic services acts as a deterrent for SMEs to sell to private customers, because credit card or Paypal payments give no indication about where the customer lives, which makes it difficult to define the applicable VAT rate.

VI. PROMOTING ACCESS TO WORLDWIDE MARKETS

The expansion of many growth-oriented SMEs depends on pursuing an ambitious EU trade agenda. The inclusion of an SME dedicated chapter in all EU free trade agreements, containing specific provisions that will ensure companies' access to information on the benefits of the preferential agreement and the new business opportunities, is a good step in the right direction. The provision of targeted services that can help companies on the ground should also be envisaged.

Furthermore, one needs to realize that the huge global markets linked to life sciences, transport infrastructure and environmental technologies will increasingly be served by strong global value chains. These value chains are lead by large global "frontrunners", which have an important carrier function because they offer platforms for other firms to integrate in the chain. As a result, domestically oriented SMEs and service providers also have the chance to taylor their products to suit world demand and benefit from global growth. SMEs can also significantly enhance their innovation capacity by cooperating along the value chain.

Looking at the EU as one economy, only 30% of its exports are part of global value chains. This shows that Europe does not make optimal use of the value chain instrument for penetrating foreign markets.

This context shows the importance of designing a modern EU industrial policy delivering a much more business- and innovation-friendly framework, enabling more large Europe-based companies to act as frontrunners. This economic framework should also enable ever more SMEs to reach a sufficient level of efficiency and of "technological readiness" to be attractive to join forces with the frontrunners.

VII. FOCUSING ON AN INNOVATION-FRIENDLY ENVIRONMENT

1. Continuous efforts are needed to improve the framework for innovation promotion at EU level

The fact that Horizon 2020 has introduced a stronger emphasis on the innovation dimension and on the importance of bringing research results close to the market is a positive move, and one needs to build on it.

The mid-term review of Horizon 2020 which will start after the summer should be an opportunity to assess the spectrum of EU instruments geared to innovation promotion, both individually and from a more integrated point of view, to see how the EU framework for innovation can be further improved.

Commission reflections on possible models for new instruments (such as the EIC – the European Innovation Council) will only be meaningful if they are based on a careful evaluation of the existing EU instruments, and of the possibilities to optimise their functioning.

2. Assessing the impact of new regulation on innovation

Well-drafted legislation can stimulate innovation but poor legislation can stifle it. This can happen when attention concentrates excessively on risk avoidance and fails to consider both risks and benefits of technological innovation.

Therefore BusinessEurope supports the introduction of an Innovation Principle, under which one should assess and address the impact on innovation of any EU regulation that is under consideration. Such an approach would help making the regulatory environment more predictable for SMEs wanting to define long term investment strategies.

3. Promoting partnerships at the European level between start-ups and consolidated SMEs

Creative approaches should be defined for promoting partnerships at the European level between start-ups and consolidated SMEs. This would help to accelerate the dissemination of innovation, particularly in more mature and traditional sectors. Such partnerships would allow start-ups to benefit from existing services and to take advantage of commercial cooperation established at national or international level. They would provide start-ups with management experience and financial support, foster the exchange of innovative ideas. As regard existing SMEs, these partnerships would represent an important opportunity to accelerate innovation, invest in R&D, improve products and processes, diversify the activities, contaminate each other in order to discover new business models.

VIII. COMMENTS ON SPECIFIC MEASURES GEARED TO START-UPS AND SCALE-UPS, MENTIONED IN THE COMMISSION QUESTIONNAIRE

In its questionnaire, the Commission asks to assess a number of practical measures that can be used at various policy levels to support start-ups. According to BusinessEurope, the following measures, if well designed, can play an important role for supporting start-ups:

1. Company / start-up creation phase

- Enabling links between source of knowledge (tech/engineering centres) and source of finance to facilitate access to finance for viable start-up

- Establishing matchmaking platforms for exchange of ideas and information on cooperation possibilities between start-ups, medium sized and large companies

- Promoting the 'outsourcing' of R&D, e.g. through tax incentives related to outsourced R&D expenses

- Promoting partnerships between start-ups and medium sized companies to facilitate access to innovation

- Establishing and supporting long term partnerships of business, research and higher education institutions to strengthen EU innovation capacity

- Supporting access to innovation and value chains, e.g. through clusters

- Connecting European research and innovation centres with similar ones outside the EU to support European researchers and entrepreneurs globally

2. Expansion of a company/scale-up phase

- Developing tailor-made support measures for rapidly growing scale-ups, e.g. mentoring on how to manage change

- Supporting the uptake of resource efficient solutions to reduce production costs

- Facilitating links between large corporations and start-ups to unleash the scale-up potential through collaboration.

3. Protection of intellectual property rights

- Helping to secure intellectual property (IP) in the early stages of a company and after

- Developing intellectual property (IP) valuation models to better assess the value of intangible assets.

As a general remark, BusinessEurope stresses that in the past, a lot of attention has been focused on encouraging the creation of start-ups. Much greater emphasis should be put on optimizing the conditions that influence the successive scaling-up phases of start-ups.

In many cases, the national or even the regional/local level is the most appropriate to implement measures to support start-ups or scale-ups. BusinessEurope is however open to discuss specific initiatives at EU level that would provide a special value-added.

IX. FINAL REMARK ON DEFINITIONS

Sections III to VII above show that there is a lot of work to be done in terms of improving the framework conditions for growth-oriented SMEs. Looking at issues of definitions (for start-ups, scale-ups,…) should not attract a disproportionate investment in time and energy compared with taking action to progress concrete initiatives.

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Annex

Table I: Source of Financing for SMEs in the US and EU, 2013 (€bn)					
Source		*Stock (of Oustanding Financing)*		*Flow (of New Financing in 2013)*	
		US	*EU*	*US*	*EU*
Banks	Loans	464	1,425	281	712
	Securitised loans	30	118	5	36
	Bonds/Equity	(a)	(a)	(a)	(a)
	Subtotal	**494**	**1,543**	**286**	**748**
Non-banks	Mutual Funds	107	88	10	7
	Segregated Mandates	5	10	1	0
	Pension Funds	(a)	(a)	(a)	(a)
	Insurance				
	Sovereign Wealth Funds				
	Private Equity Funds	59	32	14	9
	Venture Capital Funds	104	22	26	5
	Family and Friends	371	168	186	84
	Crowdfunding	3	1	20	6
	Angel Investing	39	11	20	6
	Subtotal	**688**	**332**	**258**	**112**
Government	Government guarantees and sponsored loans	54	132	27	66
	Subtotal	54	132	27	66
Total		**1,236**	**2,007**	**571**	**926**

(a) AFME/Boston Consulting Group desk research and investor interviews indicated only marginal investments

Source: AFME (2015), Bridging the Growth Gap, p. 9, available at: http://www.afme.eu/funding-economy/