

HOW TO SCALE-UP IN THE EU?

CREATING A BETTER INTEGRATED SINGLE MARKET FOR START-UPS

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SUMMARY

European start-ups intending to grow and internationalize within the European Single Market face tough challenges. While the scale-up problem is usually addressed in terms of funding sources, different business cultures or language barriers, this paper analyses scaling-up in Europe from a regulatory perspective. The reason for this is straightforward: The Single Market does not work properly for start-ups. Apart from difficulties with finding funding sources, the fragmented regulatory environment of the Single Market is regularly cited as one of the most important obstacles to growth by entrepreneurs and practitioners themselves. Against this backdrop, the paper essentially addresses three questions: How large are the growth differences between European and American start-ups? Why are European start-ups struggling to scale up? And what policies and regulations should be put in place to address existing barriers and create a more favourable regulatory environment for growth? Turning the tide towards a better regulatory growth environment will require policy action on a European and national level. While far from being exclusive, this paper recommends the following steps:

Taxation: Tax compliance in the Single Market has become a significant cost factor for European start-ups. Extending and simplifying this process by establishing an EU-wide VAT-clearing house would make it easier for start-ups to pay their taxes across the EU.

Labour laws & portability of social security benefits: Labour codes differ widely across the EU, making fast employment in new markets cumbersome due to adaptation costs. While employment legislation is an almost exclusively national domain, national employment agencies could do more to help start-ups from other EU-countries by providing special contact persons between agencies and start-ups.

Business Registration and other administrative procedures: Compliance with administrative procedures in other European markets is complicated as national administrations often do not offer online identification and trust systems for remote execution. Member States therefore have to speed up the creation of their own online administration systems.

Regulation of data flows and copyrights: National governments increasingly force companies to store data locally, rendering data storage more costly. EU-plans to extend copyright for unnecessarily prohibit data-driven innovation by start-ups. Fully implementing the “free flow of data” as complementary regulation to the GDPR and exempting text- and data-mining start-ups from copyright obligations would considerably improve their growth prospects.

National Best Practices: Member States should learn more from other national best practices, for example with regards to e-government and regulatory approaches to untested innovation.

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1. Taking Stock of the European Scale-Up Challenge

High-growth tech-start-ups and digital platforms have profoundly transformed the global economy over the last two decades. The five largest tech companies, Amazon, Apple, Facebook, Microsoft and Alphabet, three of them non-existent or still in their infancy only 20 years ago, now have a greater market capitalization than the annual GDP of France or the UK. Major traditional industries like publishing, retail or car manufacturing have been or are being disrupted by tech companies with an impressive speed of innovation. Digital companies are also rapidly becoming global innovation leaders: Amazon is now the world's largest corporate R&D-spender with \$ 16.09 billion in 2017, up from only \$1.73 billion in 2011.

While consumers around the world are benefiting from new and innovative digital services, the entrepreneurial distribution of this global shift has so far been rather lopsided, and to the detriment of Europe's digital economy. Seventeen years after the bursting of the dot-com-bubble and ten years into a now maturing app-economy, it appears that the EU has not been able to benefit as much as the US and parts of Asia from the last two waves of the digital transformation. There almost are no European tech giants of the likes of Amazon or Facebook, (SAP is the only European global software giant) and the European digital economy is comparatively fragmented along national borders. The core problem is that even though the EU offers the largest consumer market in the world its companies have difficulties engineering the same organic growth rates as American or Chinese digital start-ups.

This policy paper investigates the reasons for this growth gap. It essentially addresses three questions: How large are the growth differences between European and American start-ups? Why are European start-ups struggling to scale up? And what policies and regulations should be put in place to address existing barriers and create a more favourable regulatory environment for growth?

BOX 1 ► Start-ups and tech start-ups

What is a start-up? According to standard definitions (for example by the German Start-Up Association), start-ups are commonly defined as companies that are younger than ten years old and use (highly) innovative technologies / business models. They have significant employee and / or sales growth. High-growth start-ups account for about 70 % of employment growth in the EU.

What is a tech start-up? Tech start-ups are generally considered to be a sub-group of startups. They often have a platform business model marked by increasing returns to scale, engineered through built-in network effects.

1.1. The unfulfilled promise of the Single Market

Digital start-ups benefit from open, large and harmonized markets in their scaling-up process, and the European Single Market is (on paper) the largest integrated market in the world. The "four freedoms" enable companies to establish themselves or a subsidiary in every European country and to offer their services and goods in every Member State. In theory, a borderless and integrated market such as the European Single Market should allow innovative companies and start-ups to scale their services quickly, leveraging knowledge spill-overs and a skilled European workforce.¹ However, there has so far been no rapid growth of European tech start-ups, compared to the US. Instead, the continent is dominated by American online services and companies: in 2015, 54 % of all online services used in the EU were US-based. EU cross-border online services, on the other hand represented only 4% of all online services consumed in the union.²

1.2. Fewer unicorns, smaller unicorns

The largest growth gap can be observed with regard to so-called 'unicorns', tech start-ups with a market valuation of more than \$1 billion. Data for 2016 show that tech giants and very large platform companies are no longer an exclusively American phenomenon. China, in particular, is rapidly catching up: Alibaba, Tencent,

1. European Parliament, *A deeper and fairer Single Market New opportunities for business and people*, EU-Parliament Briefing December 2015.

2. EU-Commission, *Why we need a Digital Single Market*, 2015 Fact-Sheet.

Huawei and JD.com are becoming contenders to the global dominance of Alphabet, Facebook, Amazon or Apple.³ The EU is watching this coming battle unfold mainly from the side-lines, as the three graphs below demonstrate: both in the absolute number of platforms and, especially, as regards market capitalization and employment, European platforms are much less successful than American or Asian ones.

FIGURE 1 - Total number of 1-\$ billion platforms, 2015

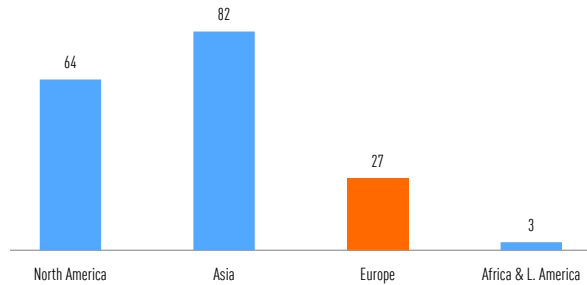


FIGURE 2 - Market capitalization of 1-\$ billion platforms, in \$ billion, 2015

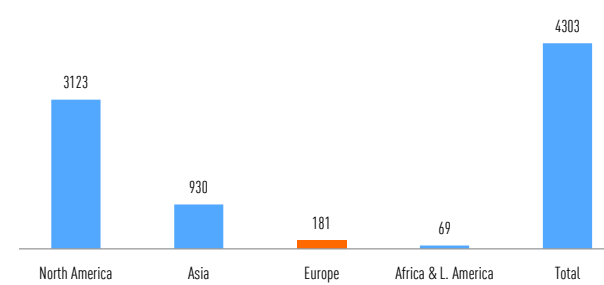
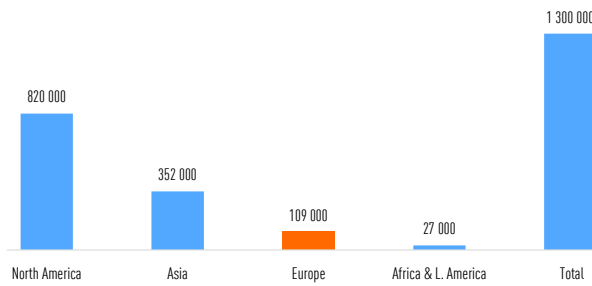


FIGURE 3 - Total number of employees of 1-\$ billion-platforms, 2015



Source: C. Evans, Annabelle Gawer, 2016⁴

” MODERN TECH PLATFORMS ENTER NUMEROUS MARKETS IN A VERY SHORT SPACE OF TIME AND DISRUPT ENTIRE ESTABLISHED INDUSTRIES.”

without such tech-giants is at risk of being undermined from various sides:

To pin down the economic and (geo-) political significance of this development it is important to grasp the dynamics of the platform economy. By leveraging the power of the decentralized network structure of the internet and smartphones, digital platforms have been able to grow with unprecedented speed and are having a disruptive impact on established industries. The famous examples of Facebook, Uber or Spotify show how modern tech platforms can attract millions of new customers/users per month, enter numerous markets in a very short space of time and disrupt entire established industries (taxi, publishing, recorded music etc.) within a few years. A European economy

1. The new digital growth paradigm and the dominance of tech companies often lead to a delicate market structure: because of the nature of platform markets and their inbuilt networks effects, their inherent structure tends towards monopolies and winner-takes-all markets. Google dominates the online-search business, Amazon the online retail market. Smaller European companies have no choice but to play along with the rules set up by these platforms if they do not want to lose market access in a steadily growing area of industries, even though platforms are increasingly scrutinized by European competition authorities. Winner-takes-all markets and monopolies can also lead to a strong concentration of value creation, patents or employment.

2. The digital transformation risks undermining Europe’s traditional industrial strength. As ‘software is eating the world’ more and more traditional industries become the target of tech giants and profits shift from traditional manufacturing and services companies to those companies that command and commercialize data flows. Old and established companies often have more difficulties adapting to this new paradigm of value creation. A European Union without a high number of fast-growing tech companies able to play along in this disruptive and rapidly evolving market place is likely to lose substantial influence in the shaping of the global digital economy of the 21st century.

3. Bloomberg, *U.S. Tech Superpowers Are Getting Some Overseas Competition*, Fortune Magazine, 31.08.2017.

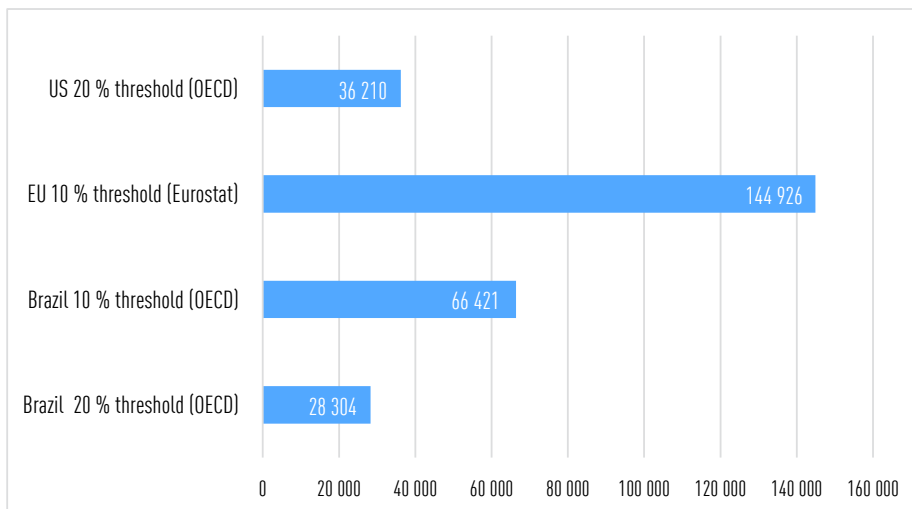
4. Peter C. Evans, Annabelle Gawer, *The Rise of the Platform Enterprise*, The Center for Global Enterprise, 2016. Note that “Europe” includes Russia.

1.3. The potential of closing the US-EU gap is huge

The fact that the EU is currently lacking behind in the number of “unicorns” however doesn’t mean that this has to be the case in the future. There are already signs that European digital start-ups are becoming more successful in finding funding and expanding. In 2015 and 2016 European start-ups got record levels of founding and the number of IPOs is increasing as well. However, the EU is still far away from unlocking its full potential. A comparative look at data on high-growth enterprises in the US and the EU gives a better idea of this potential. High-growth enterprises, many of them tech start-ups or companies with a digital business model are nowadays generally being acknowledged as being among the main drivers of innovation and, crucially, employment growth in modern economies.⁵ How do the EU (i.e. the Single Market) and the US compare as regards the absolute number, size and employment of high-growth companies? The answer is complicated, not least because of differing ways of defining and measuring high-growth enterprises.

According to the OECD definition, high-growth enterprises, as measured by employment figures (or turnover), are enterprises with average annualized growth in employee numbers (or turnover) greater than 20% per year, over a three-year period, with ten or more employees at the beginning of the observation period.⁶ Eurostat, on the other hand, has since 2014 defined enterprises as high-growth enterprises as enterprises with 10% annualized employment-growth over three years, following the implementation of Regulation (EU) No 439/2014. Eurostat unfortunately gives no figures relating to a 20% threshold, rendering a direct comparison of this crucial indicator somewhat difficult. This caveat must be considered when interpreting the following numbers. The two graphs below compare the absolute number of high-growth enterprises in the US and the EU and the average number of employees in each enterprise. By adding Brazil for which the OECD gives both a 10% and 20% threshold figure, the overall relative difference between the two threshold-indicators can at least be estimated. At first sight, the data are surprising: there are considerably more high-growth enterprises in the EU than in the US. According to Eurostat data, more than 140 000 enterprises in the EU were considered to be high-growth in 2014,⁷ compared to less than 40 000 in the US.⁸ If the OECD threshold of 20% employment growth over three years were used this difference would most likely shrink. As the comparison with Brazil shows, increasing the threshold from 10% to 20% more than halves the number of high-growth enterprises. However, since the EU features more than four times as many high-growth enterprises at to the 10% threshold, it can be speculated that the overall number of high-growth enterprises in the EU is considerably higher than in the US.

FIGURE 4 ► Number of high-growth enterprises in the US, EU and Brazil in 2014.



Source: Eurostat, OECD.

5. See Henrekson, Magnus and Dan Johansson, *Gazelles as job creators: a survey and interpretation of the evidence*, Small Business Economics, Volume 35, Issue 2, pp 227–244, September 2010 for an overview on the firm growth literature.

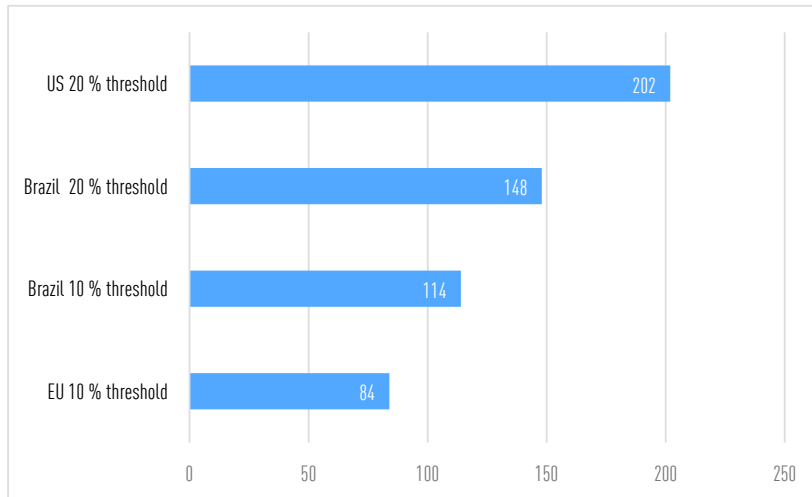
6. OECD, *Entrepreneurship at a Glance 2017*, OECD-Report.

7. Eurostat, *Almost 1 in 10 enterprises in the EU recognised as high-growth companies*, press release 209/2016

8. OECD, *Entrepreneurship at a Glance 2017*, OECD-Report.

When comparing the actual size and concentration of high-growth enterprises, their average number of employees provides a useful measurement tool as a proxy for their total size. The graph below shows that on this measure the difference between European and American high-growth enterprises is particularly marked. American high-growth companies have, on average, many more employees than their European counterparts (202 as against 84).

FIGURE 5 ▶ Average number of employees per high-growth enterprise in the US, EU and Brazil in 2014.



Source: Eurostat, OECD, author's calculations; numbers are rounded.

Again, this difference must be interpreted through the lens of the different thresholds applied. However, the fact that Brazil, too, has a higher average number of employees (at the 10% threshold) than the EU points to higher fragmentation in the Single Market. The EU has a larger number of enterprises with high growth but their absolute size is smaller on average. The example of Brazil also shows that the overall differences in average employment between the 10% and the 20% thresholds might not be that high after all. Even though these numbers must be taken with a pinch of salt, part of the difference in average employment is probably explained by the larger total size of American high-growth enterprises, which in turn results from access to the large and more harmonized American market. European high-growth enterprises, among them many digital start-ups, expand less often in the Single Market.

” GERMAN START-UPS GENERATED ONLY 11% OF THEIR REVENUE IN 2016 IN OTHER EU-COUNTRIES.”

A recent report from Germany confirms this: according to the German Start-Up Monitor, German start-ups generated only 11% of their revenue in 2016 in other EU-countries (compared to 78.7% in Germany and 4.4% in North America) and only 34.4% of them were even considering internationalizing in another European market, even though 82.7% of them planned a (further) internationalization in general.⁹ Not being able to make use of the growth opportunities of the Single Market, they grow more slowly than potential American rivals and risk being swallowed at an early stage.¹⁰ Research by Start-up

Europe Partnership showed that 94% of large start-up acquisitions were completed by non-European companies in recent years, and 70% of those start-ups were less than 5 years old.¹¹ A vivid example of this dynamic, especially in the era of the platform economy, is the many European social networks that existed prior to the rise of Facebook. Failing to scale beyond their countries of origin, they were all eventually pushed out of the market by the social network giant from the US. In other words, the EU does currently not have a problem with founding innovative start-ups or high-growth enterprises in general, but it does have a problem with scaling a considerable number of them up into large entities operating across the entire Single Market. Closing this growth gap offers considerable economic advantages. It is estimated that up to 1 million jobs and up to € 2

9. Prof. Dr. Tobias Kollmann et al., *Deutscher Startup Monitor 2017. Mut und Macher*, KPMG October 2017.

10. Glenn W. Leaper, *The Start-up Tortoise & The Economic Hare: Challenges Of The European Ecosystem*, startusmagazine, 07.04.2016.

11. Leonard Koschwitz, *The European Parliament is discussing an expiry date for start-ups*, 11.07.2017

trillion in GDP could be added to the European economy if the EU had the same share and rate of growth of scale-ups as the US.¹²

1.4. Why is Europe struggling to scale up?

The ‘scaling-up’-problem has many complex and interlinked underlying structural causes, but they all boil down to one result: the great majority of European entrepreneurs, whether digital or non-digital do not perceive the Single Market as a fully integrated Single Market (and they are right).¹³ Instead, they view the European market as splintered into 28 very different national markets, with distinctive national approaches to regulation, financing or business culture. What are the structural roots of this perception of fragmentation? There are three distinctively European structural disturbances which act as obstacles to faster start-up growth, all of them connected to the very nature of the European integration project and the diversity of the continent itself:

1. An inherently more complicated process of talent acquisition and service roll-out, due to language barriers resulting in lower labour mobility and different business cultures, less competitive salaries and a more restrictive visa policy for non-EU foreigners. These are hard factors where the US has an advantage over the “old continent” (the policies and actions of the current US-administration notwithstanding). Structural disturbances of this kind compose long-term policy challenges (e.g. labour mobility) and most of them cannot (and should not) be addressed at an EU-level (language barriers, culture affiliations).

2. In comparison with the US, European start-ups lack financing options. EU financial markets (largely based on debt-financing and itself still fragmented) offer fewer equity-based capital and high-risk funding options for start-ups than venture capital funds or pension funds in the US provide to their American peers.¹⁴ The financing problem is now widely acknowledged by national and European policy-makers as a central problem and therefore high on the policy agenda in most Member States. Many national administrations have set up national growth funds¹⁵ and European solutions are in the making as well. Financing instruments such as EFSI are increasingly devoting financial resources to European start-ups.¹⁶ Last but not least, the Capital Markets-union, once implemented, could make cross-border financing of start-ups and innovative companies easier and more efficient.¹⁷

3. This leaves one of the largest structural disturbances, regulatory fragmentation, for closer examination. Complex regulatory requirements in terms of labour law, taxation and administrative procedures were listed in a 2016 EU-public consultation on the matter as main obstacles to expanding a digital company, after access to finance for expansion.¹⁸ Start-ups which intend to grow and internationalize across the European Union face high burdens in complying with specific national requirements upon market entry in each Member State. They range from compliance with national taxation regimes to different labour laws to non-digital administrative procedures for setting up shop, to restrictions on data storage in individual Member States.

” THE REGULATORY DISRUPTION TO FASTER GROWTH HAS RECEIVED FAR LESS ATTENTION FROM NATIONAL POLICY-MAKERS IN RECENT YEARS THAN THE ISSUE OF START-UP FINANCING.”

This regulatory disruption to faster growth and especially its European dimension has received far less attention from national policy-makers in recent years than, for example, the issue of start-up financing. A first step should be for policy-makers to fully acknowledge the European dimension of the scale-up challenge and shift their policy narrative from founding to scaling up.

12. European Commission, *Europe's next leaders: the Start-up and Scale-up Initiative*, 22.11.2016.

13. Fredrik Erixon and Rositsa Georgieva, *What is wrong with the Single Market?*, ECIPE Five Freedoms Project, Working Paper No. 1 /2016.

14. Cornelius McGrath, *European tech companies need money to scale up, not just start up*, *Financial Times*, 03.05.2017. See also Philipp Ständer, *Public Policies to Promote Venture Capital: How to get National and EU-Measures in sync*, Jacques Delors Institut – Berlin, Policy Paper No. 203, 31.08.2017.

15. German Federal Ministry of Economic Affairs and Energy, *Financing start-ups and growth: Overview of existing instruments*

16. European Commission, *EFSI in the digital sector* Homepage of the EU-Commission.

17. Deutsche Bank Research, *EU Monitor: Start-ups and their financing in Europe*, 30.09.2016. For more information on how to harmonize European VC-markets see Philipp Ständer, *Public Policies to Promote Venture Capital: How to get National and EU-Measures in sync*, Jacques Delors Institut – Berlin, Policy Paper No. 203, 31.08.2017.

18. European Commission, *The Start-Up and Scale-Up Initiative*, Presentation, 22.02.2017.

2. Shifting the policy narrative to scale-up in the Single Market

The good news is that the topic is gathering steam on a European level. The European Commission has not been idle in the last few years when it comes to addressing the actual needs of start-ups in the Single Market. Grass roots movements, start-up associations and entrepreneurs are stepping up their lobbying efforts in Brussels as well.¹⁹ The Digital Single Market-Strategy (DSM), while far from being perfect, includes a number of important measures designed to make life easier for digital companies in Europe. As part of the DSM-Strategy, the EU-Commission published the Start-Up and Scale-Up-Initiative in 2016, after an extensive period of public consultation.²⁰

Substantial hands-on policy proposals are offered by the 2016 Scale-Up Manifesto, a crowd-funded document of start-up practitioners and start-up associations intended to convince policymakers to improve the regulatory environment for start-ups in the Single Market.²¹ In national capitals, on the other hand, the policy debate around start-ups in Europe is more often than not still skewed towards the ‘founder-narrative’ and the EU-dimension remains largely excluded. Numerous events are held every week at the EU or Member-State level to encourage young people to found start-ups and tech companies, while only a very few occupy themselves with the more technical, but possibly far more relevant question of facilitating EU-wide start-up growth. A strong policy focus on founding culture and entrepreneurial spirit is by no means wrong. Yet, to propel the European digital economy forward and bring out its full potential, national policy-makers should devote at least as much attention of to the scale-up challenge. Entrepreneurs should also be encouraged see the Single Market as their natural territory for internationalization. Currently, efforts in this direction are mainly being undertaken in the form of private initiatives, for example by the The Family, a support, networking and financing platform for start-ups.²²

” SHIFTING THE NARRATIVE TO A MORE EUROPEAN PERSPECTIVE WILL ALSO REQUIRE MORE CONCENTRATED EFFORTS BY START-UPS AND START-UP ASSOCIATIONS.”

Shifting the narrative to a more European perspective will also require more concentrated efforts by start-ups themselves and start-up associations on the European as well as the national level. In particular they should:

- 1) promote the ways in which the Single Market can help entrepreneurs;
- 2) help start-ups to navigate the complicated European regulatory environment with cross-country advice; and
- 3) create stakeholder councils of entrepreneurs and European and national public officials so as to facilitate ongoing dialogue between start-ups and various levels of the administration, in order to develop concrete policy proposals for reducing barriers; and
- 4) support national governments directly with policy advice on how to eliminate regulatory barriers to start-ups.

3. Addressing the main regulatory impediments

Which specific policies and national regulatory requirements are holding European starts-up back? Most barriers are to be found in policy areas such as taxation, labour laws, portability of social security benefits, administrative procedures like registration or policies on the store and use of data. Current proposals within the framework of the Digital Single Market-Strategy (for example for copyrights) risk raising further barriers to start-ups instead of alleviating them. For larger corporations these stumbling blocks are just a nuisance. For Start-up-entrepreneurs with meagre resources on the other hand they present substantial hurdles. Each individual hurdle might be small, but taken together they can scare many aspiring start-ups off expanding in other European markets. The following section analyses the most-important regulatory barriers and discusses possible policy solutions in order to reduce them.

19. Raf Weverbergh and Kristien Vermoesen, *Research: lobbying is becoming a core competency for start-ups and VCs – so what about Europe?*, FINN 2016,

20. EU-Commission, *Europe's next leaders. The Start-up and Scale-Up Initiative*, 22.11.2016.

21. *Scaleup Manifesto. A Manifesto for Change and Empowerment in the Digital Age.*

22. The Family, *Homepage (About)*.

3.1. Taxation: Reducing the complexity of compliance with 81 VAT regimes

Compliance with different tax regimes in 28 Member States weighs particularly heavily on fledgling start-ups seeking to expand to other European markets.²³ According to the Commission's 2016-consultation, around 30% of tax-related expenditure by start-ups is spent on compliance costs in the home market and these expenses become even higher in a cross-border context.²⁴ The compliance process has been further complicated by the 2015 VAT-Regulation, especially for companies selling online across the EU. The new regulation forces start-ups offering online services to pay VAT at the rate of the buyer's country instead of the seller's. The problem is that with 81 different VAT rates in total, paying taxes can become a painful bureaucratic exercise for start-ups, which also have to prove the location of their customers. Simplifying compliance procedures and digitizing parts of the tax-compliance process could considerably reduce these unnecessary costs and encourage start-ups to offer their (digital) services across European borders.

One possible solution in this direction is the concept of the one-stop-shop for VAT, which was also introduced in 2015 for a limited array of online services (the Mini-One-Stop-Shop, MOSS).²⁵ However, even the MOSS system has drawn criticism for being complicated to implement. Yet the underlying idea of the One-Stop-Shop would offer a real improvement: with its help, start-ups which generate revenue online in different European countries would only have to pay their taxes once to their national taxation authority, which would then distribute the tax revenue to all the countries where the company has accrued revenue under the differing VAT regimes across the EU. Expanding the system to a real European-wide VAT clearing house should thus become a priority for European policymakers. However, such a proposal would require Member States to agree upon a centralized institution and their national tax authorities to trust each other with the correct and efficient national implementation and execution of such a system.

3.2. Labour Law and the portability of social security benefits: How much can the EU do?

Start-ups often voice their frustration with complicated hiring processes under 28 different European labour laws and social security systems. The costs of adaptation to new labour markets often entail expenses for lawyers, consultants and accountants. This process of adaptation can considerably slow down the expansion of a hopeful start-up, if not completely discourage it. An additional burden is the still unresolved question of portability of social benefits. This is even more relevant for digital start-ups since they statistically employ a very large number of specialists from other countries.²⁶ Employees moving for a new job to another European country often have to find out that the recognition of their pension rights can be very complicated, that they are only entitled to a very limited period of unemployment or that vacation entitlements accrued in one country are not transferrable. The maze of 28 different national security and employment systems can render moving for a new job less attractive.

”IT SHOULD GET EASIER FOR START-UPS TO HIRE WORKERS IN OTHER EUROPEAN MARKETS.”

It should get easier for start-ups to hire workers in other European markets. The question is whether the EU can do much to relieve the situation. Legislation related to employment and social security is an almost exclusively national domain. Proposals to exempt from start-ups from certain country-specific labour-related legislation (for example by setting up a “Young Innovative Company Status”) would probably run into considerable resistance by Member States. Companies could even go “regime-shopping” and set themselves up where labour and social security legislation is weakest and expand from there. It is therefore in the responsibility of each national administration to make hiring for start-ups more attractive. As a first step national governments could help them with their EU-workers-related paperwork by establishing designated contact persons for entrepreneurs in employment agencies. National employment

23. Edithe Cruz, *How the Start-up VAT Nightmare could have been avoided*, Re:Think 27.09.2016.

24. EU-Commission, *Europe's next leaders. The Start-up and Scale-Up Initiative*, 22.11.2016.

25. The Mini-One-Stop-Shop (MOSS) was introduced in conjunction with the 2015-VAT regulation. It has the potential to simplify compliance with VAT-payment for business-to-consumer (B2C) sales of telecommunications, broadcasting, and electronically supplied services (TBE services), which are now taxable where the consumer is located, regardless of the vendor's place of establishment. For more information: *The European mini one-stop shop: A model for future indirect tax compliance?*

26. In Berlin for example, 42 % of all start-up employees have a foreign passport. See for more information: Prof. Dr. Tobias Kollmann et al. *European Startup Monitor 2016 – Country Report Germany*.

agencies should also step up their European coordination efforts to match start-ups employment needs with suiting candidates.

3.3. Registration and administrative barriers: national administrations must be digital

Registering a business in another European market and the general contact to national administrations often causes headaches for start-ups. Requesting documents remote from other countries is still not possible in many Member States as well as ID-verification. Relevant documents (from notaries, for example) are rarely available in translated form and have to be translated individually. Opening a bank account or requesting a permit from authorities or signing a rental agreement often still requires the physical presence of the applicant.²⁷ Many of these problems are related to the lack of an EU-wide eID and trust infrastructure that would allow companies and entrepreneurs to securely verify their identity from abroad and help them handling administrative chores online and from abroad.

Some of these barriers will soon be partly reduced. The introduction of a truly harmonized European system of e-identification is not possible due to the large grown differences for standards and protocols of the national e-administration systems. However, the new eIDAS regulation, which will come into force by September 2018, will require national administrations to make their national eID systems *inter-operable* with those of all other Member States by establishing secure inter-faces between them. From September 2018 national administrations will have to process any request for e-identification from every European citizen and businesses.²⁸ The eIDAS-regulation will be a large step forward, especially since it is a binding regulation, not a directive. However, while the regulation has its merits by forcing Member States to make their systems inter-operable many still do not have the underlying e-infrastructure in place, which would allow start-ups to faster and remotely access relevant government documents.²⁹

Complementing the European policies for inter-operability, establishing easier access to documents and enabling online-processes for administrative requests is a duty for Member States. In the 2017 “Tallinn-declaration on eGovernment” Member States have committed themselves to implementing the comprehensive EU eGovernment Action Plan until 2022. Start-ups and start-up associations will have to put constant pressure on national governments and monitor its comprehensive implementation. Even more effective for start-ups would be to licence out of eIDAS standards and protocols out to the private sector. While the system will become mandatory for government services, opening it up for use not only vis-à-vis administrations but also between private businesses could substantially boost trust in cross-European business relations.

3.4. Data Economy: How to foster data-driven growth and innovation?

Completing the Single Market for digital goods and services is a flagship-initiative of the Juncker-Commission. Its Digital Single Market-Strategy (DSM) is an ambitious set of regulations and directives aimed at improving and updating current EU-legislation to the requirements of a modern internet and data economy. Cross-border parcel delivery, changed regulation for telecommunication-providers or new rules to prevent geo-blocking in e-commerce are examples for the different regulatory proposals, which are currently being negotiated between the EP and the Council. With the General Data Protection Regulation (GDPR) entering into force in May 2018 the EU also gets a (almost fully) harmonized data protection regime. The Commission specifically intends to strengthen the European data economy, which it expects to grow from € 285 billion in 2015 to € 739 billion by 2020.³⁰

Despite these successes and the general ambition of the DSM-Strategy some of the current proposals under the framework have been drawing criticism for erecting up new barriers for start-up growth instead of eliminating them. This criticism is most relevant with regards to the proposed new rules for copyrights in relation to text- and data-mining. The “mining” of texts and data-sets i.e. the structured search for patterns in large

27. Jeroen de Wit, *Scaling Up in Europe: hacking the digital single market for start-ups*, Guest Blog EurActiv, November 25 2016.

28. Regulation (EU) No 910/2014 of the European Parliament and of the Council of 23 July 2014 on electronic identification and trust services for electronic transactions in the internal market.

29. See this [chart](#) for an overview of national implementation progress of the eIDAS-regulation in April 2017.

30. EU-Commission, *Buidling a European Data Economy*, Homepage EU-Commission (last retrieved 08.11.2017).

bodies of text and data with the help of algorithms is a fast growing field of data analytics and A.I.-applications. Yet, text- and data-mining is currently often conducted in a regulatory grey-area and under legal uncertainty with regards to copyright. Under the current legislative proposals in the framework of the DSM-strategy, start-ups offering text- and data-mining services would have to pay copyright fees for this specific use of a document (even if they own the rights to physically “read” the text).

” COMPANIES THAT SPECIALIZE IN TEXT AND DATA-MINING SHOULD BE EXEMPTED FROM HAVING TO PAY COPYRIGHT-FEES.”

From the perspective of start-ups with scarce resources this is problematic: While it is important to protect the proprietary rights of artists, journalists and film-makers in the digital age, companies that specialize in text and data-mining should get a chance to develop innovative big data-services using text- and data-mining and therefore be exempted from having to pay copyright-fees for the underlying texts. Otherwise start-ups offering these kinds of services will never get the chance to scale in the Single Market and the EU would unnecessarily diminish a possible source of future innovation whose economic and social potential is not yet fully conceivable. Adding an exception to copyright for text- and data-mining-purposes is becoming more popular worldwide: Countries like Japan, Israel or South Korea have already introduced such national exceptions.

In recent years, Member States have enacted an increasing number of restrictions on the portability of data across borders. In many countries, tax, health and other data about citizens and designated as sensitive are not allowed to be stored outside their country of origin.³¹ Forcing start-ups to store data in every individual country can considerably increase operational costs for start-ups as they are forced to buy additional server capacity or cloud space in every country instead of pooling customer data where it is most economically viable. It also increases legal uncertainty about the use and storage of data in general. The Commission has recently adopted its “Free Flow of Data”-initiative with proposals to counter this trend.³² The ‘Free Flow of Data’-initiative will prohibit the arbitrary storage of *non-personal*, e.g. machine-generated data in one country. This initiative is complementary to the GDPR, which will prohibit the storage of *personal* data in one European country. However, there will be exceptions that the Member States can use to justify data localisation, for example exceptions on the ground of national security concerns. As the “Free-Flow-of-Data” is negotiated between Parliament and Council in the coming months, start-ups should make their voices heard on this particular act of legislation.

3.5. Leveraging national best practices for start-up growth

There are many examples from individual Member States where governments have enacted measures to create a more seamless and less bureaucratic environment for start-ups. In the spirit of voluntary cooperation and sharing of best practices among Member States, they should be promoted by start-ups and start-up associations in their dialogue with national governments. This section presents two such national best practices, in the area of e-government and the regulatory framework for untested innovation.

United Kingdom - Framework for a regulatory sandbox in fin-tech: Many start-ups, especially in the digital economy, operate in novel and innovative areas of business not as yet covered by sector-specific regulation. More often than not they are unable to roll-out a new and innovative service owing to regulatory uncertainty. This hampers faster growth and the diffusion of innovative solutions and services. Allowing start-ups to experiment more (under the supervision of the government) could help them to test and realize the market potential of their services faster. Such a step could also foster regional competition and the development of tech-clusters: If European regions and cities competed more by allowing designated innovative technologies to be tested in their municipalities, more powerful regional technology clusters could eventually be created across the EU. In the US, for example, there has been fierce competition between American cities to get Uber, Google and established car companies to test their autonomous vehicles in their municipalities first.³³ A good example for such a national best practice is the UK’s approach to innovation in the fin-tech sector. The UK ‘regulatory sandbox’ provides a framework for fin-tech start-ups with innovative business models operating in an as yet

31. Matthias Bauer, Martina F. Ferracane, Hosuk Lee-Makiyama, Erik van der Marel, *Unleashing Internal Data Flows in the EU: An Economic Assessment of Data Localisation Measures in the EU Member States*, ECIPE Policy Brief No. 03/2016.

32. European Commission, *DSM Strategy – The Free Flow of Data-Initiative*, Presentation.

33. USA Today, *Cities vie to become hubs for self-driving technology*, 25.06.2017.

unclear regulatory environment.³⁴ It ‘creates a “safe space” in which businesses can test innovative products, services or business models together with regulators. The sandbox framework enables firms to manage regulatory risks during the testing stage.’³⁵

Estonia - E-Residency: The Estonian e-government services have become a benchmark for other European countries. Their most innovative feature is the E-Residency-scheme. Every citizen of the world can register as an E-citizen of Estonia and open location-independent businesses online under Estonian company law in order to get access to the European market. At no point during the process of setting up a business or opening a bank account does the e-resident have to be physically present in Estonia. Additional services offer remote accounting, compliance and legal services. The scheme might even become a legal loophole for some British entrepreneurs after Brexit by providing them with direct access to the Single Market while physically operating from the UK.³⁶ If more European countries adopted such residency-schemes, the EU and the Single Market would become a much more attractive place to start a business.

TABLE 1 ► Summary of the main regulatory impediments and policy recommendations

POLICY AREA	CONTEXT	POLICY RECOMMENDATIONS
Taxation	Start-ups, especially in e-commerce need to comply with 81 different VAT-regimes in each EU-market. Tax compliance in the Single Market has become a significant cost factor.	-Extend and simplify the one-stop shop mechanisms for VAT into an EU-wide VAT-clearing house to make it easier for start-ups to pay their taxes across the EU.
Labour law & portability of social security benefits	-Labour codes differ widely across the EU, making fast employment in new markets cumbersome for foreign companies due to adaptation costs. -The portability of social security benefits is still complicated which makes moving to another European country less attractive.	-Employment legislation is an almost exclusively national domain. However, national employment agencies could do more to help start-ups from other EU-countries to get accustomed by providing special contact persons between agencies and start-ups.
Business Registration and other administrative procedures	Compliance with administrative procedures in other European markets is complicated as national administrations often do not offer online identification and trust systems for remote execution.	-In light of the coming eIDAS-regulation Member States have to speed up the creation of their own online administrations. -Expand eIDAS – standards and protocols to the private sector by licencing them out to increase trust between businesses across borders.
Regulation of data flows and copyrights	-National governments increasingly force companies to store data locally, rendering data storage more costly. -Extending copyright for text- and data-mining unnecessarily prohibits data-driven innovation by start-ups.	-Fully implement the “free flow of data” as complementary regulation to the GDPR. -Improve the current proposals for copyrights legislation to help start-ups specializing in text and data mining by exempting them from copyright.
National Best Practices	-Member States should learn more from national best practices, for example with regards to e-government or regulatory approaches for new, untested innovation.	-Take up best-practice examples, like the UK-regulatory sandbox where innovation and new services can be tested together with regulators during the growth phase. -Further develop national e-government systems modelled for example on Estonian e-Residency.

34. Financial Conduct Authority, *Regulatory Sandbox*, Homepage, 08.08.2017.

35. Pēteris Zilgalvis, *Regulatory Sandboxes: An Innovation in Policymaking*, Blogpost for the Startup Nation Summit Tallinn 2017.

36. EurActiv, *Estonia e-residency offers Brexit Brits EU loophole*, 14.08.2017.

4. Conclusion: A better integrated Single Market for start-ups

The still untapped potential of a more harmonized Single Market for scaling up is huge. Start-ups should be able to make use of it without restraint. European start-ups intending to grow and internationalize within the European Single Market currently face too many unnecessary regulatory and administrative barriers. Apart from difficulties finding the best funding sources, language barriers and different business cultures, they are often held back by the fragmented regulatory environment of the Single Market. Taxation, hiring process, registration or the question of data storage are only few of many policy areas where start-ups face not one harmonized European, but 28 different national markets. The chart below illustrates these barriers and shows policy options from which start-ups in the EU could specifically benefit in the Single Market upon market entry in another member state.

TABLE 2 ► Touchpoints between start-ups and administrations in other Member States and policy recommendations.



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