

Committed to Europe



Helping digital entrepreneurship breed future European “tech champions”

In a nutshell:

The EU and its Member States hope that innovation - hi-tech especially – will prove a potent way to lift Europe out of recession and help regain its former industrial lead. However, in the digital economy, the uncomfortable fact remains that overseas players were the ones to revolutionise social networks and entertainment and that they now dominate global markets. There is little sign at present of European companies being in a position to challenge them.

At the same time, in many business areas that Europe once pioneered, mobile communications for example, both platforms and operating systems are now led by other regions. Increasingly this means that products used or even developed in Europe must be interoperable with - and dependent on - technology from outside the EU.

Nevertheless, Europe has not turned its back on innovation and has produced some large, successful ICT companies and app producers - alongside myriad start-ups. For every four US tech ‘unicorns’ - a company worth more than US\$ 1bn - Europe produces three, albeit with twice the population to draw on. Meanwhile, there has never been more support for start-ups, now found in many Member States, and ranging from financial aid to networking and skills mentoring.

Thus the question vexing policy makers is what more can be done to increase the rate the EU produces ‘tech champions’? Then follows a question about how European start-ups can grow and flourish without necessarily having to find a future in the embrace of large overseas companies.

At the root of entrepreneurship: a good product and... an attractive exit?

For many entrepreneurs, the appeal of entrepreneurship lies both in creating a new business and being able to leave the company when it’s firmly on the road to growth and the time has come for others to turn the project into something larger and more sustainable.

This phase, from inception to the next stage, is referred to by analysts as ‘the time to reach a liquidity event’. A liquidity event can be a ‘trade sale’ - purchase by a bigger company that will absorb its products and people - or an IPO (Initial Public Offer) on the stock markets. The aim of the IPO is to raise cash for further development and expansion.

In practice, the time to reach a public offer often determines which development path to choose. Founding investors have to wait on average seven years for a start-up to reach a successful IPO and small companies that take the risk can face disappointing share price performance for some while after launch.

So, while IPO remains the preferred mechanism in the US, there seems to be a trend among European tech entrepreneurs to favour an earlier exit from their start-up, through trade sale to larger, often overseas-based, companies. As an illustration, among recent European ‘exits’ were sales of Skype to Microsoft and Supercell to Softbank.

This trade sale strategy does have some advantages: for example, the funding needed is significantly less than that required to take a company all the way to IPO. Tech start-ups can now be relatively cheap and take advantage of new shared platforms in the cloud for modelling and development.

Yet, this preference in Europe for an early exit does have an impact on innovation and investment. Since venture capital companies typically make their profit from an IPO, the financing of start-ups with no plan for an IPO will often have to depend on other investment sources. This is why European investors now show a growing preference for alternatives such as 'business angels' or larger companies.

Shaping start-ups for trade sale instead of IPO has an impact on their capacity to innovate for various reasons. First, companies exiting by trade sale generally do not possess the working capital to aim for new or significantly 'disruptive' technology models. Moreover, start-ups aiming at a trade exit do not grow into the kinds of successful consumer 'unicorns' seen in the US: they do not last long enough and founders lack the energy and commitment 'to the long haul' of their IPO-bound counterparts. As a matter of fact, trade sales can even end up killing an original business idea as the acquiring companies are tempted to use the talent of the founders for other projects – so-called 'acqui-hiring'.

At a larger scale, there are wider impacts:

- Since companies with enough cash to acquire technology ventures are not so numerous, especially in Europe, trade sales are often to non-EU companies: as a result, the venture's technology or platform heads overseas.
- While trade sales produce earlier returns on an investment, sales will happen at a smaller scale and generate less return. Less reward for investors also means less money to invest in future projects, hence a shrinking of the "virtuous circle" of innovation.

Easing the route to IPO – with capital and policy

By contrast, an injection of capital from an IPO is a trigger for investment and expansion that few alternative mechanisms can provide. However, while finding the financing to reach this stage is clearly desirable, it often remains difficult for small, apparently risky, tech start-ups. Financial institutions in particular have had a poor track record of support in this respect.

However, there are new financial players in the market, ranging from peer-to-peer lenders to 'crowd-funding' and private capital. Policy makers can also help: some specific measures might have a positive impact on IPO activity. In particular, tax breaks for investment in small or tech companies could help make them more attractive and reengage venture capital.

In addition to these measures, there is also a strong complementary case for positive treatment of private equity, including the taking of minority shares by bigger players committed to the development of a European digital ecosystem.

- This commitment can consist in helping start-ups grow with 'acceleration programmes', giving a valuable boost toward the scale needed for sustainable activity. These can involve networking assistance and the sharing of effective business practices: something larger companies in the field, like Orange, are often well-placed to offer.
- In other cases, support can involve the bigger company taking a minority stake. It is thus important that the equity market remains as fluid as possible: competitive regulation in an immature market may be tempting but will be counter-productive for innovation.

Private investment of this kind between bigger players and young seeds is a vital component of innovation and technological leadership as financing resources are scarce in Europe. In this context, it will be important not to discourage – but rather protect – the variety of financing resources, in particular from corporate players, by acknowledging that the proper incentive for private investment lies in future profits.

Another factor weighting against the IPO option is that the depth of expertise in tech investment found in the US does not really exist in the EU. This lack of 'investment culture' also explains why many young companies are tempted to seek success in the US. The EU thus needs to build up a supportive framework of private-sector tech investment expertise.

Entrepreneurship needs more tech skills, more ICT specialists

A growing challenge faced by digital entrepreneurs is the shortage of relevant skills in the European Union. While many companies struggle to find skilled staff, smaller companies find it hardest of all. Evidence shows that almost all other world regions produce more ICT specialists than the EU. As the track records of most successful ICT companies show the value of founders with technical degrees, it is highly likely that a skills shortage will have an impact on Europe's capability to innovate. This is why skills availability was a core issue in the start-up manifesto¹ from the Leaders' Club – a group of decision makers from leading European start-ups such as Rovio, Spotify and others.

In response, there is, in Europe, a growing range of programmes to expand the research base and encourage more ICT training. But since education remains a Member State competence, they need to find ways to encourage school science which, because of its rigour, is losing appeal for children in parts of the EU. However, one thing is certain; the science underpinning cutting-edge businesses will not get easier. Teachers must be at the forefront of any plan to meet this challenge and, where necessary, be better prepared, digitally confident and ready to rise to the challenge.

Comparable challenges can be found at higher education levels, with some advocating that entrepreneurship be taught as early as possible, opening students to the principles, processes and passion needed for entrepreneurship. Another helpful initiative - the EU's Code week - raised awareness of coding among young Europeans and involved industry players like Orange, which contributed the 'Super Coders' programme and gathered more than 200 young people from France, Spain, Poland and Romania. Events of this kind are a first step in helping society address the digital challenges ahead.

The development of digital skills and promotion of digital entrepreneurship is also about preparing graduates for a radically different marketplace, in which career development will have to reflect the changes in industry and the employment market. The 'Grand Coalition for Digital Jobs and Skills' initiated by the European Commission clearly illustrates how the industry can help aligning curricula throughout Europe with the current needs of the job market.

Overall, Europe has understood the importance of digital skills not only for the development of its digital industry, but also for the health of the economy as a whole. As the Union faces high unemployment rates, especially among the young, there is need to rethink the training offered to students, young professionals, or experienced workers. An all-encompassing strategy is needed, with active contributions from Member States, industrial players and academia.

Start-ups need the space for bigger dreams: the case for a digital single market

For digital entrepreneurs, coming up with a good idea is clearly only the beginning of the journey. Expanding business operations is a complex challenge, particularly in Europe with its long-held national, legal and linguistic barriers. So, while international payment systems are gradually reducing consumer risk and increasing confidence in transactions, the costs of trans-European activity for a start-up can prove a real obstacle compared to achieving the same customer base in the US, India or China.

The patchwork of national regulations in the EU and their effect on competition needs to be considered afresh. This is especially the case with data and consumer protection. In an increasingly data-driven digital economy, the fragmented national regulations for privacy and personal data are a block to the development of European scale business proposals. As EU institutions are well aware, there needs to be consistency and clarity about rules across the Union.

Data and data handling are currently both a huge opportunity and a source of concern. On one side, government data sources - so called 'open data' - could be the foundation for many new businesses when they become more widely available. At the same time, preventing personal data and corporate records from being misused remains a top priority. For better efficiency, data security rules need to be the same in all Member States if the huge market is to be properly exploited. Some 28 separate regimes are too costly to manage, particularly for a small or medium sized company.

¹ <http://startupmanifesto.eu/>

The fragmentation of consumer protection law that exists between Member States and within the internet value chain can also be confusing and difficult for small companies. A move toward a more harmonized framework – applicable to all digital players, domestic and overseas – would greatly clarify the compliance context. Consumers across the EU should benefit from similar protection and means of redress when ICT services work in unexpected or unwanted ways.

Innovation is a global race, so it is important that domestic companies, especially start-ups, do not start with an unfair disadvantage when competing with global players for customers and funding.

Summary

While there is no single action that can rapidly increase the level of European ICT start-ups, there are a range of possible measures, divided between the EU and its Member States. Beyond the vital ‘environmental’ issues of regulation and tax, a renewed focus on technical education and incentives for start-up investment will likely help in the medium and longer term.

Similarly, help for small businesses to widen their potential market beyond their country of origin by further harmonisation of EU law and regulation could also be worthwhile, only so long as the net effect is more proportionate legislation – rather than its increase.

Orange and digital entrepreneurship

Considering the current trends among European start-ups, there are also opportunities for cooperation between digital start-ups and bigger players within the digital economy. It is not always understood that larger companies depend on a thriving ‘ecosystem’ of small, innovative start-ups and SMEs to supply popular content and apps, for example, or new technological breakthroughs.

From the point of view of companies such as Orange, it is clearly very much in our interest to see such companies prosper and that is why Orange has developed a range of Open innovation programmes, from investments (Orange Digital Ventures) to talent grooming (Orange Fab) and community building (Orange Partners).

For more detail on Orange Innovation : <http://www.orange.com/en/innovation>

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