Les misérables

Europe not only has a euro crisis, it also has a growth crisis. That is because of its chronic failure to encourage ambitious entrepreneurs

THE St Oberholz café in eastern Berlin is as hip as any of the area's bars: graffiti-covered doors, in-your-face art, edgy fashion and the Beastie Boys in the background. It is not at first blush the sort of place to look for magnates in the making. But their presence makes a lot of sense. Europe's culture is deeply inhospitable to entrepreneurs; wanting to grow a start-up into a behemoth is quite as countercultural as piercings and performance art.

The Oberholz has become a centre for Berlin's young start-up scene, which has enterprising types flocking to the city from all over the world. The clientele starts out on the first floor, where computer programmers mingle with potential bosses over coffee in the "ko-work-ing" area. Once they attract capital, they move upstairs, where the café rents out office space cheaply. A business taking off may move into one of the café's apartments, often using the beds as desks. SoundCloud, a five-year-old audio-sharing website, spent its early days at the Oberholz, as did Brands4friends, an online private-shopping club. Txtr, a fast-expanding e-book platform, still has programmers in one of the apartments.

It is an enticing place to begin a business. Which is all to the good, because Berlin's fresh-faced hopefuls will get little enough enticement and encouragement elsewhere. They will struggle to hire professional managers to help their firms grow, because European executives are extremely risk-averse. Their young firms will quickly find that established European companies tend not to like dealing with tiny ones. Most sources of capital will shun them. Regulations will shackle them. And when they fail, as most are sure to do, they will not be allowed just to dust themselves off and start all over again. In Europe, a business blow-up leaves a lasting stain, akin to a moral failure.

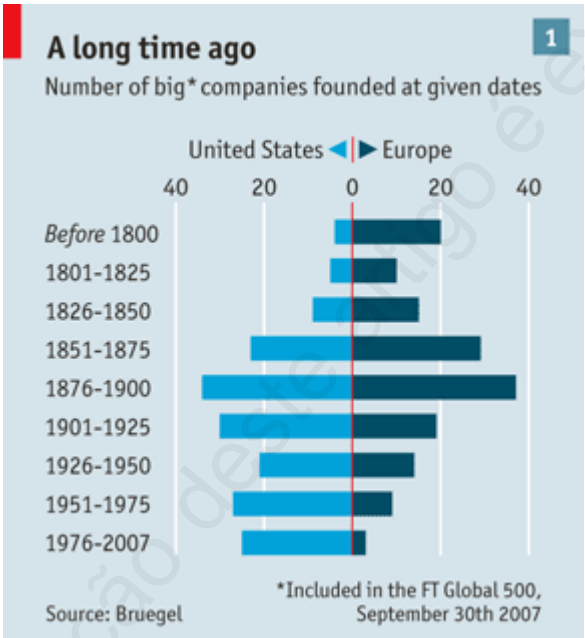
The giants are all ageing

Data show that continental Europe has a problem with creating new businesses destined for growth. According to the Global Entrepreneurship Monitor, which compiles comparable data across countries, in 2010 "early-stage" entrepreneurs made up just 2.3% of Italy's adult population, 4.2% of Germany's, and 5.8% of France's. European countries are below—in many cases well below—America's 7.6%, let alone China's 14% and Brazil's 17%.

Few in number, European entrepreneurs are also gloomy about their prospects. A study by Ernst & Young, an accounting firm, showed last year that German, Italian and French entrepreneurs were far less confident about their country as a place for start-ups than those in America, Canada or Brazil. Very few French entrepreneurs said their country provided the best environment; 60% of Brazilians, 42% of Japanese and 70% of Canadians thought there was no place as good as home. Asked which cities have the best chance of producing the next Microsoft or Google, Ernst & Young's businesspeople plumped for Shanghai, San Francisco and Mumbai (though, to be fair, London got a look in too).

For all this, Europe produces plenty of corner shops, hairdressers and so on. What it doesn't produce enough of is innovative companies that grow quickly and end up big. In 2003, analysing Europe's entrepreneurial gap, the European Commission cited a study which showed that during the 1990s, 19% of mid-sized firms in America were classified as fast-growers, compared with an average of just 4% in six European Union countries. The Kauffman Foundation, which promotes entrepreneurship around the world, argues convincingly that one reason America has outstripped Europe in providing new jobs is its ability to produce new, fast-growing companies such as Amazon, an online retailer, or eBay, an online auctioneer. And in terms of jobs, new small firms have an added advantage. They are less likely than existing giants to outsource a lot of their labour to cheap providers in Asia.

Europe was not always so laggardly. When Britain's industrial revolution spread to the continent after 1848, ambition and access to capital could take a young man far. August Thyssen founded ThyssenKrupp, a German steel group, Eugène Schueller founded L'Oréal, a French beauty empire, and A.P. Møller set the course for A.P. Møller-Maersk Group, a Danish shipping giant. The vast majority of Europe's big companies were born around the turn of the last century. So was much of the German Mittelstand, and clusters of manufacturers from Lombardy to the Scottish lowlands.



After the world wars, Europe never regained this fecundity. The devastation made Europeans more risk-averse than they had previously been. Markets that had been closely linked before 1914 fell back into fragments, says Leslie Hannah, a business historian at the London School of Economics. That limited the ability of new firms to build scale and grow into giants, especially in the decades before the European Union's single market. According to an analysis of the world's 500 biggest publicly listed firms by Nicolas Véron and Thomas Philippon of Bruegel, a think-tank, Europe gave birth to just 12 new big companies between

1950 and 2007. America produced 52 in the same period (see chart 1). Europe has only three big new listed firms founded between 1975 and 2007. Of those, two were started in Britain or Ireland, which are closer to America in their attitude to enterprise than continental Europe. Europe's big privately held firms, too, mostly date from before 1950, often a very long time before.

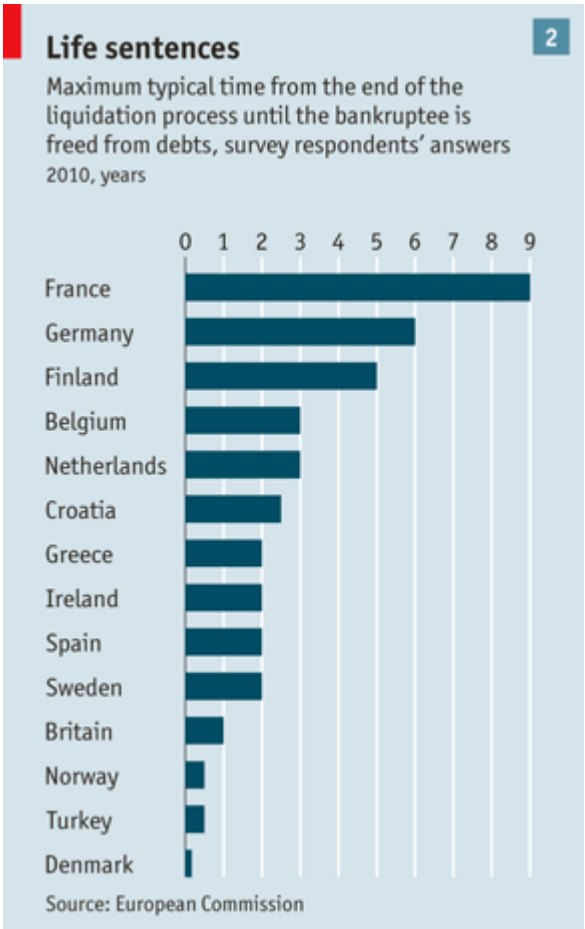
If Europe were more entrepreneurial, says everyone from the commission down, it would not have been such a poor producer of big businesses. And it would have produced more successful new technology firms. Entrepreneurship doesn't have to be channelled through the tubes of the internet, but over the past few decades a great deal of it has been. That an economy so copiously provided with the technically educated as Germany's has not produced a single globally important business-to-consumer internet company suggests a big problem with entrepreneurship.

"Why was Google not made in Germany?" asked Konrad Hilbers, the former chief executive of Napster, an online-music service, in a talk last year. The lack of a risk-taking entrepreneurial culture was part of his answer. Firms such as Skype, an internet voice- and video-calling firm founded by a Dane and a Swede, Spotify, a Swedish online-music service, and Wonga, a British online lender, suggest that the picture is not as bad as it could be. But Europe's entrepreneurs are still underrepresented on the internet. "Though there are some signs of life," says Yossi Vardi, a veteran Israeli high-tech entrepreneur and "angel" investor, the region is "semi-dormant".

Too few Virgins; not enough Red Bulls

Europe does have entrepreneurial success stories. The richest is Spain's Amancio Ortega, who started work for a clothes store at the age of 13 before going on to found Inditex, a fast-fashion empire. Austria has Dietrich Mateschitz, who started Red Bull, an energy-drink maker. France has Xavier Niel, who this year started a mobile-phone revolution by offering consumers extremely low prices; Britain has Sir Richard Branson. But the list is short. And many European entrepreneurs—Sir Richard not included—hide their success. Mr Ortega has never given a media interview; there appear to be just two published photographs of him. Ingvar Kamprad, the billionaire founder of IKEA, a Swedish furniture retailer, assiduously avoids any hint of plutocratic airs.

Many aspiring entrepreneurs simply leave. There are about 50,000 Germans in Silicon Valley, and an estimated 500 start-ups in the San Francisco Bay area with French founders. One of the things they find there is a freedom to fail. If your firm goes under in France, says Dan Serfaty, the French founder of Viadeo, a fast-growing business-networking website, you don't get a second chance.



Trying to discover what holds back entrepreneurs, the commission last year examined insolvency regimes and found that many countries treat honest insolvent entrepreneurs more or less like fraudsters, though only a tiny fraction of bankruptcies involve any fraud at all. Some countries keep failed entrepreneurs in limbo for years. Britain will discharge a bankrupt from his debts after 12 months; in America it is usually quicker. In Germany people expect it to take six years to get a fresh start, according to the commission; in France they expect it to take nine (see chart 2). In Germany bankrupts can face a lifetime ban on senior executive positions at big companies.

A second important hurdle is finance. Getting seed capital up to €1m ($1.2m) from "friends, fools and family" is pretty easy. Technology entrepreneurs such as Germany's Samwer brothers, Oliver, Marc and Alexander, made fortunes in the first dotcom boom and then became angel investors in such very young start-ups. In Germany seed money has roughly quintupled in the past five years, says Hendrik Brandis of Earlybird Venture Capital, a venture-capital firm in Munich.

For the €1.5m-4m that firms need to work an idea up into a real business model, though, money is in desperately short supply. Institutional investors such as pension funds regard European venture capital as a bad asset class. European venture-capital firms lost money during 2000-10 after the bursting of the dotcom bubble. The total money invested in European venture capital halved from €8.2 billion in 2007 to €4.1 billion last year. Much of it now comes from governments rather than from private investors.

Some people argue that if there were enough ambitious entrepreneurs with brilliant ideas in Europe, the money would come from America and elsewhere. There is some truth in this. But investors who put money into very young firms tend to prefer operating in their own language and culture, so start-ups depend mostly on backers from their own country.

For the third stage of funding, when firms are looking to raise up to €20m or so to build on what looks like success, American money is increasingly available—though since they depend on big hits to offset dozens of failures, American funds are still more likely to back entrepreneurs at home, where such things are known to happen, or in high-growth emerging economies. And anyway, most European entrepreneurs have hit the buffers long before they get to the €20m stage.

The third big obstacle is labour law. If young firms are to survive near-terminal mistakes, or fluctuating demand, they need to be able to reduce staff costs quickly and cheaply when necessary. That is far harder in many European countries than elsewhere. The complexity and cost of firing people in Europe is a big concern for American venture capital, says Georges Karam, the chief executive of Sequans Communications, a French chipmaker for smartphones which went public on the New York Stock Exchange last year. A fund in Boston recently pulled its investment in a start-up which its French founder had intended to begin in America but then had to bring back to France for family reasons.

The cost of paying out large severance packages (six months of severance pay is typical even for very recent hires) can be a huge drain for a small company. "In San Francisco and in China, a communist country, I pay one to two months," says a beleaguered French chief executive who does not want his name attached to such a sensitive subject. Big severance packages also make it much harder for start-ups to recruit the professional managers that can take them into the big league. Experienced executives are loth to forgo such reassuring goodies by resigning.

Anil de Mello, who started Mobuzz, a Spanish online-video firm, in 2005, watched his fledgling company implode with the onset of the financial crisis. He thought bankruptcy would give him a new start. But after business creditors were dealt with, Spanish social security pursued him for five more years to extract repayment of severance money it had paid to the firm's employees on his behalf. Mr de Mello nearly gave up being an entrepreneur entirely. Instead he started his next company—devoted to bringing down roaming tariffs for mobile-phone users—in Switzerland, where the labour laws are less of a deterrent.

And European business founders find it difficult to wield the entrepreneur's main weapons: the stock options and free shares that make start-ups attractive to employees. The legal complexity of giving new hires free shares is prohibitive, says one entrepreneur who is currently trying to poach someone away from Google, which routinely hands out Google stock units. Everyone advises not doing it, he says. That further limits entrepreneurs' ability to tempt people into a risky career move.

All these limits have left the continent with a dearth of the sort of entrepreneurial successes which would serve to inspire others; very few people think that going to work for a loony in a garage offers a long-shot at millionairedom. Parisian opinion is convinced that if Sergey Brin's father had picked France instead of America after leaving Russia, the son would have become an ivory-tower computer scientist instead of co-founding Google.

With the odds so stacked against them, the flickers of enterprise seen in Berlin, London, Helsinki and a few other places offer cause for seemingly disproportionate hope. If the requisite wild spirits can survive in these conditions, how might they flourish if not held back?

Yearning to be free

Though they have suppressed demand and made financing ever harder, the great recession and the euro crisis may also mark a long-term change in Europeans' perception of risk. For executives, joining a start-up is less of a gamble when big companies are shedding staff. Since the crisis began in 2007, says Martin Varsavsky, an Argentinian serial entrepreneur who has founded a number of telecom companies in Spain, it has been noticeably easier for

his current venture, Fon, a global Wi-Fi community, to recruit. The engineers he wanted to hire used to spurn him for Telefónica, a telephone giant, or Prisa, a media company; now those firms are firing people, well-qualified people are more willing to join a new company.

In a presentation to Spanish entrepreneurs last year called "Why you should not move your company to Silicon Valley", Mr Varsavsky pointed out that salaries for software engineers are currently 70% lower in Europe than in California. There are millions of young people looking for work. And Europe has far fewer lawyers waiting to make life difficult for young firms and lots of protected, uncompetitive sectors ripe for disruption.

Governments are paying attention. A few years ago entrepreneurs were not a priority for politicians, says Mathieu Carenzo, head of the centre for entrepreneurship at IESE Business School in Barcelona. Now, he says, government heads and royalty turn up to promotional events. States are trying all manner of tricks to boost business creation, for better or worse, and there is a whole industry of consultants devoted to the task. There are schemes to create clusters of start-ups, to get academics to hate business less, to expose schoolchildren to entrepreneurial notions. Germany and other countries have recently set up state-backed agencies to send enterprising Europeans straight to Silicon Valley, knowing that successful founders often recycle their money, contacts and experience into start-ups back at home.

The French government has done some useful things for business founders; Mr Karam cites a measure that offers tax relief on research. But France's real problem, he goes on to say, is its rigid labour law. Nothing governments offer by way of assistance, say entrepreneurs, is as helpful as simply removing the hindrances they currently impose. Germany's government has made four big attempts in the past 13 years to help entrepreneurs, says Dietmar Harhoff, the director of the Institute for Innovation Research, Technology Management and Entrepreneurship at Ludwig-Maximilians University in Munich, but they have mostly failed.

The branches of government that try to boost entrepreneurship are not powerful enough to do anything about the real problems for entrepreneurs, such as labour rules. Again, the depths of the euro crisis may allow change that was previously stymied. Mario Monti, Italy's prime minister, says he will lower the administrative cost of starting a company from €10,000 to €1. Italy and Spain are both taking steps to make it somewhat easier to fire workers.

Berlin's rapid rise and international appeal—about half of the business founders in the city are not German—make it an object lesson in what really matters in an environment appealing to entrepreneurs. There has been zero help from the state; the city is simply too poor to lavish money on the usual schemes. But it is a cheap place to live and work, and it is relatively easy for foreigners, who are especially likely to start companies, to set up shop. This is in contrast to Britain, where targets for net immigration have been slashed after rates rose to record levels.

In the St Oberholz café, among the bars and shared offices and kaffeeklatsches, there is also a soundproofed cupboard. It offers a place to make private calls—and to cry when you miss a deal, jokes Philipp von Sahr, the founder of an online store for organic food. Europe's entrepreneurs, like all entrepreneurs, will do their fair share of crying in the years to come. But their governments could do a great deal to help them get out of the cupboard and back into the game.

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