Entrepreneurs at the heart of economic recovery in Europe

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Abstract:
The traditional tools of economic policy will only become effective thanks to entrepreneurs. They have to form the core of the European Union’s and its Member States’ priorities. The role they play in economic dynamics and the creation of jobs is not acknowledged as it should be. Entrepreneurs need the support of all economic drivers if they are to succeed. Their main handicap is access to credit: Europe has never been skilled in helping start-ups and the banking crisis has not helped in this. The European universal banking model has to develop so that banks become real, long term partners. Europe lacks activity hubs, which certain, present clusters could become, where financing, competences and ideas are to be found, in the ilk of Silicon Valley. Helping young entrepreneurs and attracting “productive” foreign investments would bring the salutary wind of novelty to our economies. Some countries like Portugal and Spain are working on this and their export companies are innovating and developing. But this is not enough, the spirit of enterprise cannot be restricted to one industry alone, it has to feed all of the other sectors. Although entrepreneurship is still mainly national the European Union can act via the Single Market II and also prevent this movement from being a zero-sum-game in Europe, in which the most dynamic countries would grow to the detriment of the others. This supposes a minimum of coordination within a framework of revised and strengthened economic governance.

INTRODUCTION

As the economic and social situation declines daily in Europe, public authorities are increasingly powerless: the public finance situation no longer allows for large scale stimulus policies, whilst any additional action on the part of the European Central Bank alone (ECB) would not be enough to jump-start the economy. Internal devaluation enables the restoration of trade balances but it does not help the economy to recover. Public policies are in deadlock and the economy is stagnating and this is the cause of concern and discontent.

Too often we forget that economic impetus does not just depend on major economic policies but especially, and first and foremost, on the economic players themselves – on all of those who choose to launch a business and innovate as Joseph Schumpeter explained a century ago. Placing entrepreneurs at the core of economic policy – this is an acknowledgement of their fundamental role in reviving growth.

But how should this be done? The entrepreneur needs opportunities to develop his activity, society has to support him. He must have access to financing, technologies and competences. However none of this is guaranteed in Europe where the financial markets are fragmented and innovation is concentrated at the heart of the euro zone and also where migratory flows redefine demographic maps.

1. CHANGING THE ECONOMIC PARADIGM IN EUROPE

The exhaustion of the policy mix

The whole world is concerned about Europe’s economic slowing. Eurostat is forecasting an EU GDP contraction of 0.4% over 2012 and 2013: how can we recover our impetus?

The ECB’s monetary policy has undoubtedly reached its limits. Its leading rates are historically low, whilst the programme to purchase sovereign bonds is already a major derogation from its founding principles. The rates could become negative, the ECB could relax its lending terms even more but the transfer of the monetary policy to countries on the periphery of the euro zone is still a problem. Recovery via public spending, the second lever in the policy mix is up against the
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States’ poor financial situation. According to Eurostat at the beginning of 2013 the European Union’s public debt totalled 85.1% if the GDP which is high and deficits were badly supervised in countries where recovery will be all the more necessary. Except for the hope of European revival whose means and finances are not clear right now, it is vain to hope for recovery via spending. Any further significant downturn in public finances in Europe could endanger the fragile balance that we have achieved to date.

The inadequacy of internal and fiscal devaluation

Since traditional economic policy levers have reached their limits other solutions are now being developed. Based on the observation that the euro zone crisis originated in macro-economic imbalance between the Member States, the Commission, the ECB, and the IMF have worked towards the implementation of internal devaluation policies in the shape of price reductions. The reduction of labour costs enables businesses to reduce prices and to gain in terms of price/competitiveness: exports should increase because goods are sold for less. On the other hand the reduction in salaries reduces domestic demand and mechanically, imports. Reductions in prices then resemble monetary devaluation and help restore the trade balance.

Internal devaluation is underway in weakened peripheral countries like Greece and Spain, in the shape of labour market deregulation, the reduction of civil servants’ salaries, reductions in minimum wages and in budgetary cuts. Other countries like Finland, Denmark and to a lesser degree, France, have chosen “fiscal devaluation” comprising the transfer of fiscal pressure of production over to consumption [1]. This option “implies the increase of VAT and at the same time a reduction in social contributions” [2]. The effects are similar to those of internal devaluation but the process is not as painful, since no citizen witnesses a massive reduction in his available salary.

However the reduction of labour costs does not necessarily encourage businesses to reduce their prices. Whether in Spain or Greece export prices have not decreased at all, whilst inflation in Portugal and Italy are still at average levels [3]. The lack of competition between businesses does not encourage them to reduce their prices; the difficulty in accessing credit pushes them to retain high profit margins to hoard. Without price flexibility, domestic devaluation pushes wages down, reduces domestic demand and destroys jobs which are opposite to the desired effect. Moreover, devaluation does not affect non-price competitiveness, which however, is a vital factor of competitiveness. German products can be sold at high prices because they are of quality. Moving towards a low cost economy rules out the maintenance of the European social model.

Entrepreneurship, the core of economic recovery

Hence neither the policy mix nor devaluation is succeeding in reviving the economy. Without counting on macroeconomic policies alone, we now have to trust in the spirit of enterprise. Above all, crises are periods of transition during which society undergoes deep change. This “creative destruction” as described by Joseph Schumpeter [4] must form the core of European economic policy.

But Europe is no longer accustomed to counting on its entrepreneurs. Until 1925 European entrepreneurs created as many international groups, like Renault, L’Oréal and Citroën in France, as their American counterparts, with the peak of creation lying between 1876 and 1900, when around 30 companies were created on either side of the Atlantic. Since then impetus has waned and in 35 years nearly no international businesses have been developed in Europe[5]: less than five in Europe in comparison with more than 20 in the USA. Entrepreneurs are worried about the lack of prospects. No one dares take up the many opportunities offered by science or the emerging countries, with the IMF estimating, for example, that the growth of emerging countries in 2014 will achieve 5.7% and 3% in the USA [6].

The lack of investment weighs on growth

In the last quarter of 2013 the euro zone’s economy contracted by 0.9% in comparison with the previous year [7]. The effects of public finance consolidation policies and internal devaluation made themselves felt. Exports increased by 2.2% over the same period and imports decreased by 0.6%, thereby contributing to restoring trade balances. Government spending de-
creased slightly, and domestic demand contracted by 1.2%. But the main reason for this recession is the decline in gross fixed capital formation [8], down by 4.9%. The business investment rate in the euro zone totalled 19.7%, a historically low level which had only ever been reached at the end of 2009 in the midst of the economic crisis. Businesses barely have any trust in the future. Whatever the sector, industry heads are worried. Their order books are hardly full [9]. The situation is barely better in the construction business in which the production index has constantly declined since 2008, particularly in Denmark, Greece, Portugal and Lithuania. Without prospects company heads do not want to either invest or take people on. And even if they wanted to, would they be able to? The share of non-financial business profits has decreased constantly since 2010. Access to credit is increasingly difficult in certain peripheral countries like Spain due to the dangers that weigh over their banking system. Energy prices are constantly rising and in spite of efforts made the cost of labour is increasing [10]. Business financing is in a scissor grip. It is possible that European businesses will fall behind and not be able to catch up. How can we break from this negative spiral? In this regard a comparison between Europe and the USA provides an informative insight.

2. ENTREPRENEURSHIP IN EUROPE AND IN THE USA

Europe is as entrepreneurial as the USA

Contrary to common belief American citizens are not necessarily more entrepreneurial than their European counterparts. This was in fact true at the beginning of the 2000’s when 69% of Americans preferred to be their own boss, but today it is no longer the case since this share has fallen to 55% who dream of becoming their own boss [11]. The situation is extremely diverse from one Member State to another. Surprisingly the countries where the trend tends towards well paid, stable wage employment are in the north of Europe (Sweden, Denmark, the Netherlands). The crisis has affected countries differently. In Spain workers are now seeking stable jobs, whilst in Greece the desire to be self-employed has increased. This appetite for independent work undoubtedly comes in response to the importance of business hierarchies and a desire to be free by becoming ones ‘own boss’.

Hence it is not as much the entrepreneurial spirit that is lacking in Europe but the possibility of applying it adequately.

European entrepreneurs prefer protected sectors

Business creation is not as dynamic in Europe. In the States the rate of creation and also that of failure is greater. This high turnover finds explanation in the fact that there is greater competition on the markets and also in the choices made by the entrepreneurs [12]. European entrepreneurs prefer to enter the most protected sectors, like services and trade, whilst Americans prefer technological sectors where the risks are greater and the profit to be made all the more so. In spite of a scientific environment of equal quality, Europeans do not cross the boundary between technology and business. This aversion to risk, cultural reasons aside, can be explained by several economic factors.

The economic role of entrepreneurship is not acknowledged in Europe.

Firstly it is much easier to take risks in the USA than in Europe. Here failure is deemed to be a lesson that provides experience and a sign of an inability to manage a business. In real terms European entrepreneurs are liable with their own assets for the losses made by their business. In France it takes nine years to cover a debt after bankruptcy, whilst in the USA it takes just a few months [13]. An American entrepreneur established in Spain recalls that if a start-up cannot pay an employee’s social charges, the administrator is held personally responsible. [14] This situation can be worse in countries where legislation governing the labour market protects workers to the detriment of the employers. The reforms now on-going in many countries should ease this constraint. The distinction between personal assets and those engaged in the company is never clearly established. The economic role of the entrepreneur is therefore not acknowledged. Only the bravest or the richest have

8. Gross fixed capital formation La formation brute de capital fixe (GFCF) in national accounts measures all of the acquisitions made by companies, households, and administrations of durable goods like housing or capital goods which will be used to improve and increase future production.
10. The remuneration of wages and taxes from which subsidies are deducted, increased by +0.4% in 2012. In other words the tax and labour burdens have increased for businesses. Source : Eurostat.
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the means to launch into an entrepreneurial adventure, which *de facto* excludes all of those for whom the creation of a start-up would be a solution to improving their financial and social situation. The harmonization and modernization of the status of entrepreneurs in Europe should be made a priority focus of the community policies.

*Access to credit is at present the main impediment to entrepreneurship*

Access to financing comprises a major difference between the two continents. Young businesses need patient capital that is prepared to wait for several years before the first profits are produced. It has to be prepared to take risks and be able to understand the specific nature of innovation. Notably thanks to the pension funds, the USA has a capital risk market that is extensive and liquid. In addition to capital, many specialised funds and business angels provide their experience and network to entrepreneurs, thereby taking full part in the success of a project.

The situation is totally different in Europe where the capital-risk market is often more restricted. Finance is dominated by banking intermediaries who are neither patient investors nor business angels. The creation of public investment banks like the Banque Publique d’Investissement (BPI) in France is one, yet modest, answer.

The prevalence of financial institutions and banks explains why the European banking crisis has had such effect on the economy. The lack of own funds, mistrust between institutions, the link between banking and sovereign risk and the new Basel III rules explain the banks’ extremely prudent behaviour [15]. The European financial markets are fragmenting, banks are calling in their capital and the ECB’s policy is not being implemented in the peripheral countries.

This situation first affects the small businesses in countries that are struggling, those who are the very key to economic recovery [16]. They have not been able to turn to other financial actors as was the case in the US during the crisis, especially in the countries in the south of Europe where the banking model predominates. [17] The chronic difficulty experienced by the European financial system in supporting start-ups has been worsened by the economic downturn.

Although it is important to restore a climate of confidence on the financial markets, notably via banking union or the direct recapitalisation of the banks by the European Stability Mechanism (ESM), an in-depth reform of the banking system is all the more necessary. Undoubtedly it is not about copying the American model but rather improving the European banking system.

Businesses in peripheral nations are suffering because the latter lack access to credit whilst in countries like Germany they require available capital at a moderate cost. If we are to boost the European economy it is vital to link financing from the centre to the periphery. There also has to be greater solidarity. Moreover, if financing took the shape of investments rather than loans this would enhance European territorial solidarity. The heart of the euro zone would not play the central lending role but it would become an actor in the economy of its periphery.

Universal European banks would be able to do this. They would need to draw closer to the “originator – distributor” model that links depositors to business thereby creating a long term relationship of confidence. Regulation has to place risk taking and aid to company heads at the heart of the banking business.

*Is European business governance over careful?*

Further to this, the spirit of enterprise depends on the freedom given to the entrepreneur. The desire to create does not just involve “lone entrepreneurs”. Some, like Jean Thermé, an employee of STMicroelectronics and then of the CEA, who was behind the development of Digiteo, Nanobio, Clinatec and INES, have had a career any entrepreneur might dream of without having been their own boss.

Likewise, *intrapreneurship* understood as being the chance given to employees to launch their own activity within their company, is a vital factor in innovation within large companies. Hence it is possible to reconcile enterprising spirit and professional stability as many European aspire to do.

The composition of the board and of capital is obviously a vital factor. Overly cautious shareholders or board members will naturally mitigate the entrepreneurial
will of the director or his teams. Unlike in the USA [18], in Europe, capital is focused amongst a small number of hands, notably those of the State - the company head is therefore not as free. He has to account for his actions to the main shareholders and convince them to accept his strategy. The participation of employees on the board as in Germany accentuates this phenomenon. The European entrepreneur has greater ties with public power, the unions and the major financial institutions than his American counterpart. Cooperation like this, as in the German Mittelstand, is a marvellous asset to federate a territory or a country to a project. But it supposes a common will for enterprise otherwise prudence can turn into conservatism. In Europe, much more than in the USA, entrepreneurship relies on a collective dynamic which has often been lost from sight. Freeing the entrepreneur of his constraints is not enough, all social forces have to be involved. In Europe the spirit of enterprise is born of a system that bears, encourages and helps it. Risk taking has to be considered as a duty on the part of the productive forces and not just the sole preserve of a few audacious and even “brave” entrepreneurs.

The importance of foreign investment

Europe has a labour force of quality but which is not always possessed of the entrepreneurial spirit. The USA is happy to recruit the scientists and engineers that they manage to train: why shouldn’t Europe do the same with entrepreneurs? The quality of the labour force is one of the leading factors in Europe’s attractiveness. Training is excellent here and foreign businesses know this when they decide to set up in Europe. According to the PISA programme the level of education in the USA is almost the same as that in Europe, but it is lower than in the Netherlands and Finland [19].

Europe is still the world’s top destination for foreign direct investment (FDI’s). Nearly 80,000 jobs were created in the first half of 2012 thanks to FDIs. These were mainly oriented towards the centre of the euro zone, software and services sectors[20] : the attractiveness of the peripheral countries as well as industrial and export sectors are a vital factor to emerge from stagnation and restore balance to trade in Europe. The countries on the periphery have workers of high quality but they will not leave their country without prospects or the promise of a job. Migratory flows are already high - the first estimates show high rates of migration by the Greeks, Spanish and the Portuguese towards Germany. [21] It is important to reverse the trend by fostering productive FDIs in these countries.

At present the centre of the euro zone is repatriating its investments from the periphery whilst e new capital export countries like Qatar and China are investing in Greece and Portugal [22]. The problem is that these investments are not productive: Qatar is buying many villas in Portugal, anticipating a recovery in the tourist sector, whilst China is investing in the port of Piraeus so that it has access to the Balkans and Turkey where it will be able to sell its goods. Neither of these types of investment helps to create productive or export activities; on the contrary they will strengthen the position of exteriority of both countries since they will be considered as simple leisure resorts or logistic crossroads.

Targeting young entrepreneurs

If a person is to launch into entrepreneurial adventure it is better to enjoy some financial, social and professional capital to optimise one’s chances and to be able to take any potential failure. In Greece and Italy entrepreneurs are most afraid of failure. However, except in some countries like the Netherlands, young people (25-35) make up the greatest majority of entrepreneurs [23], followed by the 35-45 year olds. They have the necessary energy and audacity to imagine and build the future. But the path is not always easy for them. The youngest entrepreneurs have the lowest initial capital - they have less to lose and can take greater risks. But they also need more help from their elders. Networks of sponsorship help from the public authorities or entrepreneurial communities are all important means of support. In Spain many young people left school during the real-estate boom and now have no work or qualifications: how can they be trained to become entrepreneurs? There is no improvisation in entrepreneurship, it has to be learned but theoretical lessons cannot cover everything. Practice is required and as a result failure is necessary. Investing in young entrepreneurs is a long term undertaking. The second age segment has different requirements -

18. Frydman Roman, Omar Khan and Andrzej Rapaczynski, ibid
19. OECD, What students know and can do: student performance in reading, mathematics and science, PISA programme, 2009
22. OECD and the author’s calculations.
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A wide range of reform

Placing the entrepreneur at the heart of economic dynamics is a challenge for every European country. Aware of this issue, many of them have launched major reforms to make their economies more business-friendly, often on advice offered by the troika, comprising the ECB, the European Commission and the IMF. Mario Monti’s government in Italy initiated a great number of reforms to modernise the Italian economy, to make it more competitive and to orient it towards exports - cutting red tape in favour of businesses, strengthening competition notably in protected sectors like energy, transport and professional services including pharmacies, notaries’ offices, support to innovation and start-ups [26], making the labour market more flexible, transformation of the State as well as reforms to the legal and medical systems. The list is long but in reality very few of these measures are really being implemented: Mario Monti’s programme set a reforming framework which is now waiting to be implemented.

Mariano Rajoy’s government in Spain circumvented the problem by using the exception procedure enabling him to override parliament. However this haste is not always the sign of quality reform. This wide range of reforms has to be adapted to the specific features of each country. Cultural weight is also required to perpetuate confidence in society. It is not a good idea for European countries to converge towards one model only, because it is impossible for all countries to be focused on exports and for them to have a trade surplus. A certain amount of heterogeneity, both in terms of supply and demand, is necessary to ensure the balance between the countries and to best exploit their complementary qualities.

Creating places devoted to entrepreneurship

All of these constraints encourage European entrepreneurs to opt for the most protected and safest sectors like personal services or trade. But new technologies improve productivity and create new products and customs. Companies like Google, Facebook, Amazon are not just simple Internet businesses – they structure the trade of data the world over. The mastery of new technologies enables us to retain control of our own destiny.

There are few places in Europe which offer budding entrepreneurs everything they might ever dream of in the ilk of Silicon Valley or New York City – i.e. a specialized labour force, land and financing [24]. Some competitiveness hubs in France or specialized clusters in Austria and Sweden offer services to entrepreneurs but their influence is national at best. The creation of European centres of innovation and industry would help them to change scale and gain profile [25]. They would also attract FDIs to foreign activity.

3. EUROPEAN COUNTRIES AND THE CHALLENGE OF ENTREPRENEURSHIP

The creation of businesses means taking a risk for his/her family, for example. Returning to work in a company after a failure is extremely difficult in Germany. However these entrepreneurs succeed better on average than their younger counterparts. Defining extremely different needs of both types of entrepreneur is vital for public policy.

In spite of this, the rate of entrepreneurial activity is lower in Europe than in the US. Entrepreneurship is a way for the younger generations to make a place for themselves in society by introducing new lifestyles. A low entrepreneurial rate means that the renewal of the generations, the “creative destruction” of society is more difficult to bring about in Europe than in the US.

In the countries that are in the process of reform, awareness of this issue, many of them have launched major reforms to modernise the Italian economy, to make it more competitive and to orient it towards exports - cutting red tape in favour of businesses, strengthening competition notably in protected sectors like energy, transport and professional services including pharmacies, notaries’ offices, support to innovation and start-ups [26], making the labour market more flexible, transformation of the State as well as reforms to the legal and medical systems. The list is long but in reality very few of these measures are really being implemented: Mario Monti’s programme set a reforming framework which is now waiting to be implemented.

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Businesses in Europe

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Diverging paths
The countries on the periphery are now following different paths. In Spain for example, businesses that have been disappointed by a depressed domestic market have turned to foreign markets as they have each time there has been a situation like this. Without foreign demand the Spanish GDP would have contracted by 4% in 2012, whilst it decreased by 1.4%. But these export businesses, apart from the fact they alone cannot pull along the entire Spanish economy, have extremely weak bases. Their life expectancy is low and they are too small.

Portugal has a strong industrial base around Porto and Lisbon in various sectors (metals, textiles, cork, shoes, refinery etc) but this is quite traditional and in direct competition with Asian economies like China. The aim is to modernize and boost these sectors. The city of Lisbon has created Startup Lisboa which is a centre devoted to the creation of start-ups, in association with the textile, digital and tourist sectors. Some businesses like Renova, a household and sanitary paper manufacturer, is counting on technology and marketing in order to position itself successfully in the international market. Privileged relations with Portuguese speaking countries (Brazil and Angola) have enabled the luxury sector to discover new outlets. The economic situation and reforms attract FDIs notably foreign investments (UK, USA, Qatar) which are seeking cheap positions in the tourist sector. Will these FDIs be really productive?

A zero-sum game?
These strategies are taking their time to produce results. An economy is not just based on exports or the trade balance, even though these export industries help towards spending in R&D, it needs dynamic domestic consumption, public and private investments to modernise the country and businesses. Although there is limited room to manœuvre, the European macro-economic environment is a major factor for the overall dynamic of the economies - entrepreneurship can only lead the economy forward if there is a relatively favourable environment.

Will these diverging paths re-balance the European economy? The decline in wages agreed by the employees of Renault decided the company to set up a new factory in Spain rather than in France creating 1,300 jobs. Is this a zero-sum game? Does the recovery of one economy occur at the expense of another?

The question of entrepreneurship, although it is still a national issue in terms of its operational implementation, is basically European in terms of its consequences. We have to ensure that all countries make an effort but that they do not cancel out each other’s work.

CONCLUSION
Given the paralysis of traditional macro-economic policies and the difficulties encountered by devaluation in
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Europe, entrepreneurship has to be placed at the heart of economic policy. The mobilization of reforming, entrepreneurial forces is vital if we are to emerge from the present state of stagnation and revive the economy. Europe is not the calcified continent that some “declinists” would have it – it is full of men and women who would like to become entrepreneurs, but who find themselves impeded by economic and social conditions. Hence the creators of businesses prefer protected, defined sectors in which the risks are minimal and the gains modest. “High risk, high gain,” say the financiers. Fostering the spirit of enterprise for those who set up companies and for innovative employees within their workplace the “intrapreneurs” is fundamental to revive growth.

Access to credit and to financing is the present problem. The European financial markets have never been very open to innovation but the banking crisis has worsened the situation. Banking union is a first step that should lead to the reform of the European banking model so that banks recover their primary role i.e trusting the entrepreneur and helping him. In Europe entrepreneurship relies on a collective impetus involving bankers, public authorities, unions and professional networks to a greater extent than in the USA. It cannot just be based on personal ambition - all economic forces must be aware of what is at stake. Creating places for entrepreneurship, “European centres of innovation and industry” would give form to a “culture of risk” and a “taste for novelty.”

Entrepreneurship is not just an individual adventure, even if the entrepreneur often feels alone. He has a social role to play that must be recognized in practice as well as in law. He notably takes part in the renewal of society and in the transfer of power between generations. This is why he is also the strongest embodiment of youth policy. Even if entrepreneurship policies remain national because they rely on the strengths and weaknesses of each economy, their consequences are European. One country’s dynamism must not result in the apathy of another. Community level coordination of entrepreneurial policies is just as important as their implementation nationally.

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