What Europe needs to create more Spotifys
William Echikson

Europe is home to many potential Larry Pages and Mark Zuckerbergs. It just needs to stop holding them back in a web of national regulations and let them fly.

Early last month, Sweden’s music-streaming star Spotify listed its shares on the New York Stock Exchange, closing up 13% after the first day of trading. This put its market capitalisation at around $27 billion – making it the eighth largest tech IPO in history, just behind Google, but well above Twitter and Groupon.

A few days later, the European Commission announced a 64% increase in funds allocated for research, innovation and digital in the upcoming budget. This comes on top of €410 million in EU funds to develop investment in Europe’s venture capital industry, which according to the Commission’s statement, remains “underdeveloped in Europe”.

Unfortunately, the chances are slim that this new funding will give birth to the next Spotify. Contrary to popular perception, Europe’s venture capital (VC) market is booming. Atomico, the 11-year-old European venture firm, announced in its 2017 report on “The State of European Tech” that investors poured more than $19 billion into start-ups, a huge jump from 2016 when $14.5 billion was invested. Europe is minting many Spotifys. Seven European tech start-ups joined the billion dollar club this year, bringing the continent’s total to 41.

Gone are the days when Europe’s tech sector largely comprised consumer-oriented e-commerce businesses – often blatant knock-offs of successful US companies. Today, Europe is the home of real pioneering innovation, led by what Atomico calls “deep tech” – the kind of artificial intelligence developed by Google’s DeepMind. Deep tech accounted for $1.3 billion of European venture investments in 2015, delivered in 82 rounds, up from $289 million, delivered in 55 rounds, in 2011.

New European tech hubs are emerging in unexpected places, far beyond the early hotspots of London, Berlin and Stockholm. Atomico pinpoints Paris, Munich, Zurich and Copenhagen as the cities to watch in the coming years. The French capital, Atomico points out, is already starting to challenge London and Berlin in terms of the number and volume of venture capital-financed deals.

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Instead of pouring public money into start-ups, what Europe could and should be doing is to strengthen its weak capital markets. Spotify listed its shares in New York, not London or Stockholm. Why? According to CEPS CEO Karel Lannoo, the continent’s stock markets are too fragmented to support such a large IPO: “Attempts to harmonise the rules for listings and allow for mutual recognition of these offerings among EU member states are as old as the single market, but they are still incomplete. ... Successive updates of the original 1989 text in 2003, 2010 and 2017 still do not allow for a single pan-European offering.”

If Spotify wanted to list in Europe, its home country Sweden would need to authorise the sale. The company then would need to notify 27 or more different authorities just to obtain permission to call upon local investors. Its prospectus would have to be translated into all the local languages and comply with local investor protection rules. Lannoo concludes that “Europe has the capacity to grow innovative high-tech companies, but once these firms need capital, Europe disappears from the map”.

Another big European handicap is its treatment of employee compensation, and in particular, stock options. According to Index Ventures’ "Rewarding Talent" study, employees own 20% of late-stage start-ups in the US, compared to just 10% in Europe. Index Ventures, which backed Deliveroo, Funding Circle and Skype in their early days, warned that the best talent will leave Europe if start-ups don’t become more generous with their stock option schemes.

The VC firm found that tax policies vary in countries across Europe. The UK has the most favourable conditions for start-ups in Europe, while Germany and Spain are most in need of change. Speaking at a CEPS event last December on Estonia’s programme for a digital Europe, Index Ventures founding partner Neil Rimer warned that "Europe is on the cusp of greatness, but risks coming short of building companies the size of Amazon, Facebook and Google if it cannot compete for the talent it needs".

For too long, Europeans have moaned about the continent’s failure to produce the next Google or Facebook. The solutions are political, not technical: stop wasting public money on start-ups, create a strong continental capital market and lower taxes on options and other compensation. Europe possesses great technical talent. It is home to many potential Larry Pages and Mark Zuckerbergs. It just needs to stop holding them back in a web of national regulations and let them fly.