Unleashing firms´ growth potential

For a long time, growth has been assumed to be the result of an optimal combination of the production factors of labour and capital. This article argues that growth of companies no longer depends on only those two factors, but also on a third one: i.e., intangibles, such as investment readiness, investors mindset and entrepreneurship. Tangibles are the necessary, but not sufficient condition. The current era of robotization, digitalization and disruptive innovation increases the importance of the intangibles. Therefore, regional policy should henceforth be reoriented towards those intangibles leaving behind the classical subsidy-oriented policy, focused on SMEs as such, without controlling for those intangibles. That is the only way to achieve that companies with a growth potential can succeed in becoming a scale-up company, and that lifestyle companies optimize their growth potential. Moreover, if support policies are designed on that basis, they might even bring former offshored companies back.

Durante mucho tiempo se ha asumido que el crecimiento era el resultado de una combinación óptima de los factores de producción de mano de obra y capital. Este artículo argumenta que el crecimiento de las empresas ya no depende solo de estos dos factores, sino también de un tercero: los intangibles, como son la disposición de inversión, la mentalidad de los inversores y el espíritu empresarial. Si bien los tangibles son necesarios, en la época actual de la robotización, la digitalización y la innovación disruptiva, la importancia de los intangibles es cada vez mayor. Por ello, a partir de ahora, la política regional debería reorientarse hacia los factores intangibles, abandonando las clásicas políticas orientadas a la subvención, enfocadas a las pymes, que obvian los intangibles. Es la única manera de que las empresas con potencial de crecimiento tengan éxito, al convertirse en empresas que crecen y se desarrollan, y que las 'empresas de estilo de vida' (*lifestyle companies*) optimicen su potencial de crecimiento. Además, si las políticas de apoyo se diseñan de esta forma, podrían incluso atraer a empresas que han emigrado.

Denbora luzez onartu da hazkundea eskulanaren produkzio-faktoreen eta kapitalaren konbinazio optimoaren emaitza zela. Artikulu honek argudiatzen du enpresen hazkundea ez dagoela soilik bi faktore horien mende, hirugarren baten mende ere badagoela dio: ukiezinak; hala nola, inbertitzeko erraztasuna, inbertsiogileen pentsamoldea eta enpresa-espiritua. Ukigarriak beharrezkoak dira, baina ez dira nahikoa. Egungo robotizazio aroan, digitalizazioak eta berrikuntza disruptiboak ukiezinen garrantzia handiagotzen dute. Beraz, oraindik aurrera, eskualdeko politika ukiezinetara berrorientatu beharko litzateke, diru-laguntzetara orientatutako politika klasikoak atzean utzita, ETE-etan fokua jarrita eta ukiezinak kontrolatu gabe utzita. Hazteko potentzialitatea duten enpresek arrakasta izateko dagoen era bakarra da. Zabaltzen eta garatzen diren enpresa bihurtzen dira. Era berean, bizimodu gisa ulertzen diren enpresek (lifestyle companies) beren hazkunde potentziala optimizatzeko dagoen era bakarra ere bada. Horrez gain, laguntzarako politikak era horretan diseinatuz gero, emigratu duten enpresak ere erakarri ditzakete.

Rudy Aernoudt
Senior economist DG GROW
European Commission

Table of contents

Keywords: investment-readiness, scale-up gap, offshoring, reshoring, lifestyle companies, high-growth focused policies, entrepreneurship.

Palabras clave: disposición a invertir, falta de recursos para escalar, deslocalización, relocalizar, empresas de estilo y de vida, políticas enfocadas hacia el alto crecimiento, emprendizaje.

JEL codes: L22, L26, D25

Entry Date: 2018/05/29 Acceptance Date: 2018/10/29

1. INDUSTRY IS NO LONGER TABOO

Industrial policy has for a long time been perceived as an old-fashioned post-war policy intervention technique, referring to the old steel- and textile plans. Consequently, industrial policy has been – in several governmental circles – a taboo word for the last thirty years. SMEs – small and medium enterprises – mainly active in the service sector, were assumed to form the backbone of the European economy. And services were considered more important for the economy than goods. Similarly, it was presupposed that the tertiary and quarterly sector would rule the economy. Big was no longer beautiful. A lot of industry went offshore, mainly to lower-wage countries. Europe was no longer supposed to be the place for mass production. Environmentalists considered that there was no more place in Europe for polluting heavy industry.

Over the past twenty years (from 1995 to 2015), the share of industry's contribution to GDP decreased in Europe from 23,3% to 19,3%; while the share of the public administration increased from 17,5 to 19,1%. Consequently, the GDP share of the public administration became as big as the share of the industry. And in some countries, like Spain, France or Belgium, industry came to represent far less than this European average of 19,3% of the GDP. Moreover, in those countries the share of the administration in the economy ended up being bigger than the share of the industry. Such a situation leads us to the question: «How can such a model be sustainable?»

Table 1. **SHARE OF INDUSTRY COMPARED TO SHARE OF ADMINISTRATION**

	Share of industry	Share of administration
EU	19,3	19,1
Belgium	16,7	22,5
France	14,1	23
Spain	18	18,8
Germany	25,5	18,2

Source: Eurostat.

Only recently, the European commission has tried to restore the importance of industry (European commission 2017). The commission stressed the need to bring industry's weight in the EU GDP back to 20% by 2020, both at the level of Member States and regions. In this context the Basque Country is an interesting example of a region that clearly maintained a firm confidence in its industry over time and has, consequently, preserved a strong industrial weight in its economy. Over the past decades, long term support policies in the Basque Country have favoured the evolution of traditional sectors, such as iron, steel, energy and of small and medium-sized companies at large. But also aeronautics became a pillar of the Basque economy, while the region even became one of the top producers in hyper competitive markets such as the one for wind energy, using the newest robot application in their production. As proven by all economic indicators, it was the right choice. Industry generates 23,9% of the Basque GDP; a ratio that is close to the one of the German economy. Amidst the industrial strength of the Basque economy, the agility of a range of firms to position themselves as first movers into specific market niches stands out, giving the Basque region a ratio of International Niche Markets Leaders of 14 per 1 million inhabitants, which is in line with countries such as Germany, Switzerland and Austria (Kamp 2017). Moreover, the

Basque industry is highly internationalized, through the production and export of components and input for overseas companies, and/or by setting up commercial and manufacturing activities abroad.

Finally, from an industrial policy design and implementation perspective, the Basque region was at the forefront of the introduction of the use of the concept of clusters: already in the early nineties the first clusters were established by the regional government to boost cooperation for innovation and internationalization of the associated firms. At that moment, a lot of European regions weren't yet aware of the concept. Eventually, many regions, such as France, Italy and Belgium followed the Basque example.[1] Evidently, preserving a substantial share of industrial economy to underpin a territory's economy is one thing, but ensuring that industrial firms can grow and that the economy as a whole can expand is an entirely different issue. Particularly when the growth orientation of so many (small and medium-sized) firms that operate in manufacturing industries are, at best, led by cautiousness.

The remainder of the present text addresses both a series of characteristics of industrial firms and what policy makers (at different levels) can consider doing to unlock the growth potential of SMEs that are active in industry. To that end, the rest of the paper is structured as follows: after discussing the main challenges for high-growth firms, we'll focus on the main ingredients and obstacles for growth being growth capital, management mindset, skilled and affordable labour and an entrepreneurial context.

2. MAKING THE CASE FOR HIGH-GROWTH FIRMS

2.1. Importance of high-growth firms

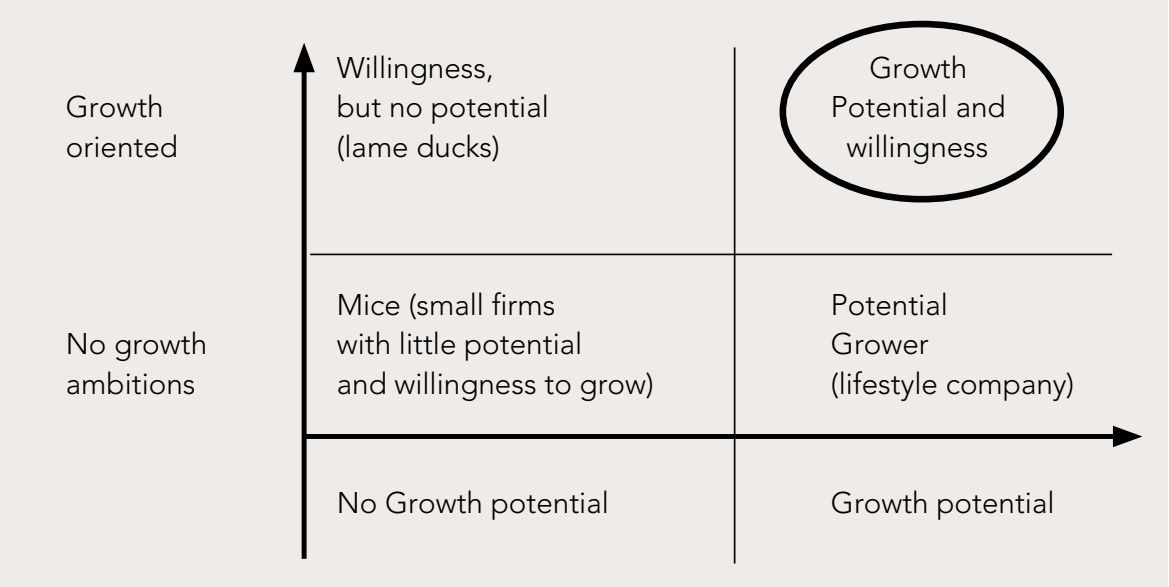
A lot has been done in Europe and its regions to promote start-ups. And figures show indeed that Europe is bridging the gap with the United States in this field (EPSC 2018). But this focus on start-ups often implied that the growth capacity of existing firms had somewhat been neglected. For example, family-owned businesses that don't always fully use their growth potential as family priorities block their ability to grow (Lorange 2005). Others, willing to grow are faced with obstacles impeding their growth. To illustrate the former, Europe is particularly underrepresented in the segment of fast-growing companies. Out of the 150 unicorns, i.e. companies having a value of one billion dollar after three years – for instance, only 9 are «living» in the European Union. However, this doesn't mean that only 9 started their business in the European Union.

[1] As head of cabinet to the minister of economy in Wallonia in the years 2002 - 2005, I came to the Basque region in order to convince my minister of the cluster approach. This approach is still nowadays considered as the best economic policy in the Walloon region with eight clusters: aeronautics, nanotechnology, biotechnology, new materials, logistics, health, agro-industry and mechanical engineering.

As a matter of logic, Growth policy should be focused on companies with Growth potential and Growth ambitions and enable those companies to surmount their obstacles for growth. Companies with growth potential, but without growth ambitions, should not be neglected either as a strategy change could allow them to exploit their untapped growth potential. From a policy point of view, focusing on these two company types could thus deliver good value for public money.

Schematically speaking, we can divide companies into the following categories according to their eligibility for policies for growth support:

Figure 1. **TARGET GROUPS FOR POLICY INTERVENTION IN SUPPORT OF COMPANY GROWTH**



Source: Own elaboration.

2.2. **Rationale for support to high-growth firms**

Industrial regions have often tried – when confronted with the closing of industrial plants, and subsequent job destruction – to compensate this loss by promoting support for fast growing economic activities. The former makes sense, as not all businesses have the same growth potential (Shane 2009) and a few rapidly growing firms often generate a disproportionately large share of all new net jobs compared to non high-growth firms (Henrekson & Johansson 2009). In the UK, for example, research has shown that a very small proportion of the UK businesses that count more than 10 employees (i.e., some 6 per cent of them) accounted for over half of all jobs created within the UK (Anyadike-Danes *et al.*, 2009, NESTA 2014).

The character of these firms' growth trajectories is very varied. Their growth can be based on disruptive technological innovation or on business model innovation.

The innovations in question can be both high tech and low tech, and the firms in question can be active in all types of sectors (including mature markets). Hence a sector-oriented policy is not a good instrument to promote high-growth firms and it is therefore better to tackle the barriers at a general level.

2.3. **Barriers to unlock the potential of high-growth firms**

In view of their relevance, it is required to look into the main obstacles that prevent companies with strong growth potential from actually growing. Aernoudt and Van Rompaey (2016) identified eight barriers to growth, four with an internal firm character and four with an external character. The following table presents the respective barriers:

Table 2. **BARRIERS TO GROWTH**

Internal barriers	External barriers
Qualified labour force	Hugely competitive & fragmented market
Management skills	Government restrictions (e.g. in the field of competition or labour)
Capital	Red tape & corruption
Governance structure	Limited external partners

Source: Own elaboration.

The internal barriers are of a rather universal nature, as they also apply to low growth companies, and they suffer a lot from these barriers. Employing a qualified labour force is hampered by high labour costs and the rigidity of labour markets. To illustrate, the excessive labour cost is one of the main reasons why following surveys 46% of the start-ups want to leave Silicon Valley in the next few years (The economist, 2018). In relation to the lack of management skills, this often comes down to the lack of a versatile team that includes technical, commercial and financial capacities. Access to finance is a further obstacle to growth, and it is not untypical that companies that don't manage to find funds in Europe, and do find transatlantic donors end up going where the money comes from (De Prycker, 2017). As regards governance structure, particularly family enterprises often chose to keep total control over their venture, disallowing outsiders to play a role in the eventual growth of the firm.

External barriers are evidently not so mouldable by the entrepreneurs concerned, whereas some of them are neither a «captive» issue for policy makers. The external barrier on which policy makers can have a huge impact is the issue of red tape. Companies that are confronted with too much red tape, a corrupt government, too strict labour laws or highly regulated markets are more likely to suffer

from growth constraints. Network failures in the form of limited access to external partners is another barrier, just like lack of consensus on standards across borders leading to fragmented markets.

When summarizing the four most obvious challenges and their respective policy antidotes to allow firms to seize their growth potential, we obtain the following overview:

Table 3. **POLICY RESPONSES TO PERTINENT GROWTH CHALLENGES**

Challenges to growth	Policy actions
Capital	Hybrid offer of financing instruments
Management openness	Investment-readiness actions
Skilled and affordable labour	Avoid offshoring & promote reshoring (tailor-made)
Enterprise and entrepreneurship-friendly policy (limited red tape, no corruption, fast decision-making)	From SME to high-growth focused entrepreneurship policy

Source: Own elaboration.

In what follows, we will address each of grounds for policy action.

3. FINANCING INSTRUMENTS

3.1. Europe's loan culture

Europe has above all a loan culture. This «dumb money» preference – bankers hardly get involved in the management – hinders growth, implies systemic undercapitalization and generates a competitive disadvantage in comparison to e.g. American companies that depend less on debts.[2] Lack of finance and undercapitalization are major reasons why companies do not fully exploit their development potential. One of the major issues is here that European 'risk-capitalists', despite their epithet, avoid risks. They prefer either to invest small amounts in the start-up phase of a firm, or –at the other side of the lifecycle of businesses– finance a MBO (management buy-out) or if possible a LBO (leveraged by-out) operation where return is higher and risk is lower. Therefore, the money readily available in Europe doesn't go to companies looking to finance their expansion.

The European market is characterised by fragmentation and a systemic lack of cross-border investments. Firms with a scope to scale up and to internationalise their

[2] For a comparative analysis between US and EU balance sheets we refer to R. Aernoudt (2017a). For an analysis focused of the indebtness of Spanish and Basque enterprises, see Gonzalez-Pernia *et al.,* (2016).

activities have severe difficulties in finding funding. This either leads to start-ups not being financed anymore and therefore suspending operations (e.g. «Take eat easy») or to European scale-ups leaving Europe and going mostly transatlantic or to China where money is abundant. To illustrate: 44% of European-born companies that got EU-support (through R&D or EIF) in their start-up phase and that successfully scaled up left the EU. As examples are more convincing than statistics: the Danish customer software service Zendesk, the German robot manufacturer Kuka, the Finnish gaming developer Supercell, the French digital performance display advertiser Criteo, and the Estonian global internet giant Skype; they all left Europe.

3.2. **The scale-up gap**

There is no longer a major difference between the EU and the US as regards new firm creation, but Europe is lagging behind in relation to scale-ups (Scale-Up Manifesto, 2016). Out of one hundred start-ups in the US, 22 succeed in becoming scale-ups[3] compared to only 12 in the EU (Streeter, 2012). Various causes explain this difference, such as a lack of skills, including management skills, lack of innovation and the non-completion of the internal market (Scale-up manifesto, 2016). But above all, it seems more and more difficult to obtain equity financing in the later stages. As such, the barriers that potential scale-ups face coincide a lot with the barriers presented in Table 2 and 3.

Venture capitalists, when interviewed, stated that scale-ups in the US seeking capital to get them through an expansion phase, raise between two and three times the level of capital than their peers in Europe (Thomson, 2015). Available equity capital in the US is 21 times than in the EU (against 'only' eight times for start-up and seed money). This later stage equity gap is the biggest financial obstacle for start-ups to scale up in Europe (European Commission survey 2016a). Consequently, 90% of the fast-growing companies have problems to finance their growth in Europe (Innovfin study 2016). Following estimations, closing this scale-up gap – the gap between supply and demand for venture capital for big amounts in a later stage – between the EU and the US could create up to one million new jobs in the EU over the next 20 years (Scale-up manifesto, 2016).

Indeed, venture capital investing is about trying to support different companies in developing scale hoping that some of them will become gazelles. It is high risk. Most investee companies do not achieve high growth and many fail. The success of an investment portfolio therefore depends on achieving a couple of 'winners', the returns from which will more than compensate the investments that turn out to go nowhere. But in order to have a couple of winners you need to make at least 10 to 15 invest-

[3] Scale-ups are defined as high-growth firms with a growth rate, in either employment or turnover, higher that 60% over a three-year period and with a growth rate of at least 20% each year. The requirement of a positive growth rate of 20% is based on Birch's work on gazelles (Birch, 1995).

ments (Mason 2016). European companies active in advanced technologies struggle to raise the huge amounts of finance they need for further growth and development (InnovFin, 2015). European scale-ups have to finance their investments with internal funds and their growth is therefore threatened by financial constraints. There is widespread evidence that the current size of the venture capital funds is not great enough to adequately meet the current and forecasted strong demand (Baldock, 2016). For fast growers access to growth finance, which in practice for those companies means access to equity and quasi-equity, remains hence problematic, especially when looking for bigger amounts (OECD, 2016). Apparently, demand and supply do not meet at the higher end. We can thus conclude that previously the small equity early stage gap was the biggest obstacle for starters, but at present the big equity later stage gap seems to be an even bigger financial obstacle for scale-ups (Aernoudt 2017a).

3.3. **Need for bigger funds**

Bigger funds tend to perform better, which results in a healthier, more sustainable VC market. Therefore, studies recommend having funds that are large enough to invest in start-ups at all stages of development, especially the late and growth stages (Brigl, 2015). The structural weakness of the European venture capital market relates indeed mainly to the small average fund size. Funds in the US have an average size of USD 135m, being more than twice as much as the average size of their peers in Europe. Companies trying to raise EUR 15-25m in third round financing are often unable to find this in the EU and are forced to move somewhere else. Concretely, the average «ticket» that a scale-up is looking for is 22 million euro. Be careful, this is an average. Skype for instance was looking for 122 million euro. Now given the diversification and sound management principle that a fund should not put more than 10% of its assets in one company -and given the average size of a European fund at 65 million euro- it is almost impossible to land this type of ticket in Europe.

So the only solution is to make funds bigger. However, this does not imply that we consider these supply measures more important than regulatory or fiscal measures. As we know, the road to a mature equity market is paved with favourable tax laws, legal structures that accommodate the establishment of private equity funds and liberal bankruptcy laws that provide little or no time of discharge for entrepreneurs (Aernoudt 2017a). Focusing on the money-supply side gap, we can distinguish between three main types of interventions: direct involvement into investees, co-investment at investor's' level and government-backed lending mechanisms.

Government policy in the eighties and nineties often meant setting up public funds. This was based on the philosophy that if the market doesn't work, the public sector should take over. Therefore, governments have tried to fill the investment gap left by private venture capital investors, by launching public venture capital funds, such as university seed and regional government-controlled funds.

These funds are mainly investing in small, young, seed-stage companies; and not in scale-ups. These public funds are however not the best policy option as public investors rarely have the competence to pick winners, either because they lack the skills to perform successful selections or because of possible distortions of the investment strategies due to political interests (Brander *et al.*, 2008). Moreover, those funds are rarely effective in monitoring, nurturing, and mentoring investee companies (Cumming *et al.*, 2013) and they fail to attract private VCs to the public venture capital backed companies. Finally, public investment may displace private investment, leading to crowding-out effects (Cumming and MacIntosh 2006). Eventually, the performance of their portfolio companies is limited (Grilli and Murtinu 2014). An alternative for direct investments is to use public guarantees in order to protect against losses via downside guarantees, but this is even worse in terms of value for public money.

Lessons learned, government policy dealing with the supply side of venture capital, typically takes nowadays the form of participation in the capital of selected commercial funds. Public selection criteria might include regional preferences, or focus on innovation, on selected sectors and/or on small amounts. The public co-investor can operate on a European (through the European Investment Fund), national or regional level. Examples are the BPIFrance, the KfW in Germany, SITRA in Finland, Axis Participaciones in Spain, Easo Venture in the Basque country, the UK Innovation Investment Fund in UK and so on. More than one third of all funds in Europe are publicly co-financed (Scale up manifesto, 2016). Public venture capital increased its share from 9.9% to 39.1% of the VC market (EVCA, 2013). The importance of government agencies became unsatisfyingly high for the long term (EIF 2015). Therefore, co-investment schemes can partially narrow the equity gap by injecting more money into the venture capital markets, but do not really close the scale-up gap. The over-reliance on the public sector goes along with a lack of private sector interest (Oxford Research, 2015). The involvement of pension funds as investor is the most important element behind the underdeveloped state of the European VC ecosystem (EIF 2018).

A third way to increase the supply of venture capital is a Government-backed lending approach. This means that the public involvement enables additional and cheaper funds to be raised, creating a leverage advantage to private investors. Structuring the government participation as a loan (or technically as B – shares) creates a leverage effect that increases the private profit when the IRR of the fund exceeds the interest rate on the debt. Moreover, profit entitlement of the public investor or the publicly backed lender-investor is capped. Both factors increase the relative share of any surplus that the private investors receive. This lower public return often goes along with a less risky position for the public or publicly backed investor. De facto, the investors are composed of risk-taking and risk-averting investors. One of the most known examples of this approach is the US SBIC program, which stands for

Small Business Investment Company. The basic characteristic of the SBIC programme is «leverage». In SBIC jargon this means that SBICs can raise funding on public capital markets by using an SBA (Small Business Administration) guarantee. To obtain leverage and in order to attract other type of investors to the venture capital world – the risk-averters – the SBA issues bonds, guaranteed by them, on the financial markets and uses that money to lend to regular SBICs. The effect of the leverage is to reduce the average cost of capital for the SBICs, in the sense that the equity returns are geared upwards, if the company's investment portfolio as a whole makes a return above the interest cost (Aernoudt, 2017b). Tesla, Apple, Fedex are some examples of the around 175.000 companies financed through the SBIC-system. The European commission explores the idea of implementing an SBIC-inspired approach for Europe, under the name of «ESCALAR»: European scale-up action for risk capital (European commission, 2016b).

4. **INVESTMENT-READINESS**

Besides this supply issue, there is a demand-side issue. Too often businesses, in particular second and third generation family-owned enterprises do not use their growth potential as they are not willing to open their capital and ownership structure to outsiders. In corporate finance jargon they are considered as «not investment-ready». They prefer 100% ownership instead of the expansion of their company by all means. Eventually, though, if they end up taking on increased debt financing it can happen that they are sold to international groups or in the worst-case scenario, they become zombies or eventually go out of business.

4.1. **Lifestyle companies**

Organizational choice towards be(com)ing a «lifestyle company»[4] is another form by which the scale-up potential of firms, and hence the growth potential of territories can be limited. Particularly in regions whose economies used to depend on industrial and family-run businesses, the existence of «lifestyle» companies can be abundant and this may hinder regional growth potential. Those companies are reluctant to open their capital structure and therefore they put a financial constraint to their growth possibilities. A study by Bains (2002) showed that indeed more than half of the growth potential among this type of firm was untapped. According to Aernoudt (2011), this is a luxury one cannot afford, especially in times of crises and when being confronted with a massive closing down of industrial plants. The fact that enterprises at a certain stage have difficulties in financing further growth based on internal funds, also forms an indication that (family) firms should consider ex-

[4] A lifestyle company is a company set up and run by its founders primarily with the aim of sustaining a particular level of income and no more.

ternal participation as an element of a growth strategy as it gives them the oxygen of capital and management support.

However, in family companies, there is not always full separation between family and business, implying that the two interest spheres typically need to be reconciled. Often, this hinders the opening up of the firm to external capital or attracting external management. Instead, owners-entrepreneurs prefer being their own boss.

Managerial competence is however not by definition present within the family, and as shown before, can form a major internal barrier to growth. Therefore, often it is suggested that the best way to maintain a sustainable development is by assuring that an external manager succeeds the initial pioneer-entrepreneur. Of course, the same applies to the company's board where external independent board members can also form a welcome asset in view of the company's development. In particular if family interests overshadow company interests.

The family origin character of a region's businesses is not only observable when looking at the management structures of firms, but also -perhaps even more clearly- when looking at their financing modes. The traditional pecking order theory (Myers and Majluf 1984) suggests that the financing source of choice is earnings retention, followed by external debt. External equity is the last resort. The pecking order theory is often referred to as the big boss syndrome. From this point of view, owners/those-in-charge prefer to finance their investments with earning retention from cashflow. And only afterwards they consider bank financing, whereas venture capital is still considered as a worst-case option. This systematic appeal to bank financing to fund investments, both in the long and short run, leads to a systemic undercapitalization of the company and can provoke liquidity problems. In the European Union 75% of the enterprises get bank financing, whereas in Spain, for example, 35% of the companies are considered as financially vulnerable with the respective figures for Navarra and Euskadi being 28% and 30%, respectively (Gil de Vicente, *et. al*. 2017).

4.2. **Looking for real entrepreneurs**

Real entrepreneurs such as the 1st generation entrepreneurs are oriented towards the future and have growth ambitions. Therefore, they are keen to convince venture capitalists to invest in their project. Most literature agrees that venture capital backing leads to growth, while refusing such backing may impede growth. There is indeed robust empirical evidence that VC financing is associated with faster firm growth and an acceleration of the innovation and commercialization process (Kelly and Hankook, 2013).

Nevertheless, most European enterprises do prefer short-term considerations and the entrepreneur hence often prefers to remain 'the boss of a small company'

rather than the 'manager/shareholder of a big company'. Consequently, entrepreneurs that display satisfactory behavior are essentially concerned with creating an income for themselves and a lifestyle for their families. One of the ways to accelerate the growth of these companies is to identify and convince the family members that opening their capital might lead to better performance. The Investment Readiness Program of the British Department of Trade and Industry forms an interesting initiative in this regard is. It is designed to groom entrepreneurial businesses to the point where they are an attractive proposition to outside investment capital (DTI report, 2008). A subtle formula for that might be the promotion of mezzanine financing. Although considered by the banks as own capital – quasi-equity in the corporate finance jargon – facilitating hence further access to finance, the owner remains 100% shareholder of his or her company. This enables companies to find the necessary financing for their development, without diluting ownership; in other words, without opening their capital. Mezzanine financing is still underdeveloped in Europe and should be further promoted. Leading regions betting on industry and new technology could play a vanguard role in this.

Besides the unwillingness to lose total control, another reason why companies try to avoid venture capital is the fiscal discrimination whereby interests on credits are deductible while return on venture capital isn't. The fiscal discrimination stimulates entrepreneurs to favor debt financing over own funds financing or venture capital funds. In order to neutralize this discrimination, one could consider that financing with equity should lead to fiscal advantages similar to debt financing. This would give an incentive to entrepreneurs putting their own savings or opening their capital and would hence lead to a better solvency and enhance the competitiveness of the enterprises.

Finally, preparing the transmission in due time by promoting interim management and setting up fiscal incentives both for the investor and for the investee combining taxation with transmission and coaching and by developing specific financial & legal construction for transmission such as LBO and holding companies that are separating ownership and control could anchor family businesses in their home regions and avoid them offshoring or ceasing activity once the family is no longer interested in the daily management.

5. **OFFSHORING AND RESHORING**

The two aspects linked to the mindsets of investors (scale-up gap) and entrepreneurs (investment readiness), do not imply that tangibles are not important. The cost of labour, the cost of energy and the high taxes – just to enumerate some of the tangibles that make it hard to set up and expand business in Europe – were at the basis of the off-shoring dynamics that the European economy has known.

5.1. **Offshoring**

European regions are confronted with a huge industrial challenge. The manufacturing industry is still an important industry. External investors, in combination with pioneers-entrepreneurs, laid the basis for the prosperity of the European regions and its inhabitants for several decades. The comparative advantages that allowed the European industry to prosper eroded, and the attractiveness of Europe and its regions as locations for new plants weakened, consequently. At present, subsidies are hardly allowed to support large scale business or sectoral activities by the EU-competition law, at least in non-crisis circumstances. Similarly, available space for large scale industrial real estate became rare and quite expensive. In addition, labour cost is high mainly due to taxation policy, provoking a high salary gap (difference between gross and net salary). Consequently, a lot of companies decided to move, at least partly, to low-cost areas in particularly Asian countries. Big enterprises moved their production plants to Asia but still focused on the European market to sell their products. One could say that the wage difference should be compensated for by productivity surpluses. But productivity growth has attained its limits in neutralising the competitive disadvantage provoked by the salary differential. Following estimations, during the period 2007-2009, around 40% of companies employing more than 50 persons moved their production to some extent. This had not only a negative impact on growth and employment in Europe, but also increased the mobility challenge and our ecologic footprint. It does not make sense to produce for instance sport shoes in China and then transport them back to Europe where the main costumers are. A study realised by the IESE business school and the Duke University, calculated that half of the large Spanish companies have relocated services and 23% intended do so in the future.[5]

In the meantime, the situation changed drastically. Labour cost in Asian countries increased rapidly. Logistics have become costly. The environmental awareness and sustainability issue becomes more and more critical for companies producing in low-cost countries; countries that don't have the same environmental and social conditions as the countries where the products are consumed. As the consumer becomes a major stakeholder the attractiveness of producing under such conditions loses appeal. But above all, digitalisation and robotisation lead to a significant productivity increase (up to 60%) hence reducing the relative share and the cost of labour in the total cost and giving a relatively higher weight to the costs of logistics. The single market strategy, the digital agenda, the capital market union and the energy union will further work on the conditions enabling and facilitating economic growth and job creation and

[5] http://www.europapress.es/economia/noticia-economia-empresas-mitad-grandes-empresas-espanolas-deslocalizado-servicios-23-hara-futuro-20061213134124.html

create conditions for the development and the reshoring of the industry. And indeed, the tendency of off-shoring seems to be on its way back, literally. In several cases, the rise in the cost of labour along with the hidden costs of off-shoring starts to outweigh the competitive advantages that delocalization used to yield. Moreover, further productivity growth implies that the labour factor becomes less important in the total cost. All these factors mean that the total cost of operation (TCO) of delocalisations increases and that off-shoring is not the best choice (any more). Therefore, we can imagine that for a lot of delocalised companies reshoring could become a real option.

5.2. **Reshoring**

Re-shoring or back-shoring is a voluntary corporate strategy regarding the partial or total relocation of previously off-shored production to the original home country. Re-shoring, or potential reshoring, has become an option in many company decisions regarding the allocation of manufacturing activities. From a policy point of view, we could therefore wonder if one should not pro-actively approach those industries that have left Europe to produce abroad and analyse how they can be brought back.

The US has set up a reshoring agency that pro-actively screens companies that left the US and tries to bring them back. The agency estimates the reshoring potential somewhere between 3 and 4 million jobs. Of course, the US suffered more from off-shoring than the EU, so there is a larger reshoring potential for the USA to be tapped into. Whirlpool, for instance, is an example of a successful reshoring. In Europe, some countries took similar initiatives. Also in the UK the government has set up an agency called «Reshore UK», aiming to assist firms to come back. On request of the European Commission, Eurofound started a European Reshoring Monitor. This is a statistical tool that monitors the extent with which manufacturing activities are returning to Europe. The European Reshoring Monitor identifies cases of reshoring. In this context, we should raise the question if reshoring is a policy issue or if we should limit ourselves to observing and monitoring the reshoring phenomenon. Together we could, case by case, determine which area in Europe is best positioned for reshoring. Companies that are labour-intensive might find European countries with relative low wages to be the most attractive. Companies looking to be at the crossroad of the consumer market, may prefer to reshore within a triangle like Paris – Brussels – Berlin, which includes a large and diversified consumer base. And companies that would obtain an advantage from embedding themselves in a sector-specific cluster environment, might benefit from moving to regions with strongly developed cluster structures in particular industries, as in the Basque Country. So we need a tailor-made solution. An «enterprise 5.0» approach. Such a reshoring policy could of course be integral part of an industrial policy.

6. **ENTREPRENEURSHIP-FRIENDLY POLICY**

The recent crisis has shown that globalisation processes (can) lead to a competitive disadvantage of European SMEs that are faced with high labour costs and a shrinking market. At the same time, however, and due to the delocalisation of bigger firms, SMEs were considered as the *deus ex machina* for regional development. While some big enterprises decided to leave their region and delocalise their production units, subcontractors, mostly SMEs, had to make a choice: or to follow their contractors or to realise a turnaround of their activities as they were faced with underutilised production capacity. The public authorities –in an attempt to retain as many industries and SMEs as possible -–as well as pushed by the SME lobby organisations– invented different incentives in order to stimulate SMEs to grow and to invest in their regions. The starting point of such an SME-policy was the neo-classical approach, i.e. that one should reduce imperfections or negative external effects in the market place. The goal of such an SME policy is hence to strengthen the existing base of enterprises by ensuring they can compete in the global marketplace and that they are not put at a disadvantage because of their small size relative to large firms.

6.1. **A patchwork of measures**

Different measures at local, regional, national and European level have been set up in order to assist SMEs. Most of these measures were an answer to sectoral lobbying and were therefore heavily sectoral oriented. The whole SME policy became a patchwork quilt of complexity and idiosyncrasy and the outcome of most evaluations regarding their effectiveness was rather negative. It was made clear that only few small businesses appear willing to accept support. Different reasons were identified for the low take-up of support measures: the support provider does not understand the owner's business, accepting external support is often perceived as threatening personal autonomy, measures ignore the heterogeneity of small firms or the specific character of the localities they are located in, and the application procedure is considered heavy involving a lot of red tape.

An analysis of the SME policy in the United Kingdom concluded that the alleged benefits of small business support may have to be called into question. Indeed, the policies and the infrastructure to deliver support to SMEs are expensive while small business owners themselves appear resolutely unwilling to accept their alleged benefits. An analysis of the Belgian SME policy comes to similar conclusions. An in-depth historical study shows that more than 70 years of Belgian SME policy did not serve the SMEs. The biggest shortcoming is that one of the aims of SME policy –positive discrimination of SMEs in order to create equal opportunities for all enterprises – has especially led to discrimination among the SMEs themselves within a

given sector. There is absolutely no need of a specific SME policy, concluded Lambrechts (1998) at the end of his research.

Recent analysis showed that efficient SME policy should not be sectoral focused, as innovation (as the main determinant for growth) is open and interdisciplinary. Moreover, sectoral focus leads to fragmentation of the SME policy and hence creates inefficiency. Therefore, SME policy should be redesigned in order not to hinder intersectoral collaboration and intrasectoral discrimination in order to result in good value for public money.

The different types of incentives in the SME policy support area can be summarized as follows:

Table 4. **DIFFERENT TYPES OF INCENTIVES IN THE SME AREA**

Type of incentive	Type of problem	Size of resources	Example of Objectives
Administrative burden	Too much High compliance costs	Relatively small	Reduce burden by x %
Financial efforts	Lack of capital at reasonable terms and conditions	Significant resources Few grants	Set up guarantee schemes
Counselling and information	Lack of competence high cost	Many providers	Create transparency
R & D	Little technology transfer	Significant resources	Facilitate research and innovation
Export	Low degree of internationalisation	Relatively small resources	Better use of export potential
Special programs	Too few	Relatively small	More women entrepreneurs

Source: Own elaboration.

6.2. **From SME policy to entrepreneurial policy**

Entrepreneurship policy is more ambitious and focuses rather on the creation of a mindset where the target group should be the entire population and the ultimate goal is to create an entrepreneurial society. Fostering entrepreneurship is nowadays recognized as one of the best ways to boost economic growth (González-Pernía *et al.*, 2015, Aernoudt *et al.*, 2015).

We can schematically try to compare both approaches:

Table 5. **COMPARISON BETWEEN SME POLICY AND ENTREPRENEURSHIP POLICY**

	SME policy	Entrepreneurship Policy
Basic assumption	Market imperfection	Entrepreneurial gap
Objective	Help SMEs to overcome inconvenients towards big enterprises	Encourage people to set up a business or to think entrepreneurial
target Group	Enterprises, mainly existing firms	Individuals, entrepreneurs
specific criteria	Picking winners: high growth sectors	Particular segments possible: women, ethnic groups, youth, ...
Levers	Financial (investment subsidies, financing, R&D, export, ...)	Mainly non-financial support (venture capital, business angels, crowdfinancing)
Focus on	Business environment	Entrepreneurial culture

Source: Own elaboration.

The emerging interest for entrepreneurship policy often leads to the false conclusion that the end of the SME policy is in sight. The focus on and the shift towards entrepreneurship policy does not however imply the end of an SME policy but a shift of focus towards environment and financing issues rather than direct support and subsidy measures. A close look at the table indeed shows that the choice is not one between SME policy and entrepreneurship policy, but that they can be complementary as neither the focus nor the target group are the same. As already mentioned, growth is only possible in an environment where the efforts of the entrepreneur are supported and sustain the growth of his/her venture. Only where all the concerned actors (universities, government, trade union, etc.) work together, can a growth ecosystem lead to sustainable job and wealth creation. Sustained growth supposes, as mentioned earlier, real entrepreneurs. People willing to take initiative and risk, building trust among their fellows, taking responsibility and inspiring the people they lead. Such people should be fostered. Building an ecosystem for fast growers and high growth companies is worth a collective effort (i.e., deserving public support), where each group and function has its specific responsibilities. Rather than concluding the absolute inefficiency of SME policy, we claim that an SME policy cannot be efficient in the absence of an entrepreneurial society. The SME policy is hence complementary to the entrepreneurial approach.

Finally, such an entrepreneurial approach should not be focused on «picking winners» as neither governments, nor venture capitalist, are able to pick winners. At

the same time, entrepreneurship policy should not be generic, but focused on high-growth entrepreneurship initiatives. Such a policy can deliver a non-trivial, value-adding impact on the high-growth entrepreneurial activity (Autio, et. al, 2016).

7. **BY WAY OF CONCLUSION**

In creating a prosperous context for growing enterprises, the government has a major role to play. Indeed, creating jobs is not an obligation but a consequence of a motivational and stimulating environment. *As fast-growing young firms account for a disproportionate share of net job creation,* it is not surprising that *policy makers seek to foster the creation of more high-growth firms.* A non-growth oriented environment however doesn't attract growth-oriented entrepreneurs.
Machiavelli states that Entrepreneurs are simply those who understand that there is little difference between obstacle and opportunity and are able to turn both to their advantage. Therefore, regions that do not want to rely only on services and tourism, should convert these obstacles in opportunities allowing companies to unleash their growth potential. Consequently, regional policy should be focused on four axes: coping with the scale-up gap, making entrepreneurs investment-ready, creating an industry-friendly environment and bringing industry back and finally assuring an entrepreneurship-friendly climate

Networking, mezzanine financing, private investors and open innovation are crucial in order to untap the growth potential of a region. Indeed, one of the main characteristics of an entrepreneurial area is to offer a hybrid variety of financial instruments. Besides the classical bank financing and the correlated guarantee policy, other forms of financing should be developed. This includes larger funds able to finance the huge financial needs for scale-ups. Besides, special attention should be given to alternative financial instruments. In particular, financial instruments such as the mezzanine financing might be of particular interest in regions dominated by family-owned business reluctant to open their capital. Mezzanine is quasi-equity, facilitates access to bank financing in a next round but allows the family to remain in full control of the business.

Moreover, one should not neglect the big enterprises, too often considered as a threat for the SMEs instead of a trigger for regional growth. The digitalisation reduces the comparative disadvantage towards lower costs regions. Salaries and wages in «low-cost» regions have increased over the last ten years. An active, tailor-made, reshoring policy and the setting-up of reshoring agencies could be considered as a very interesting «good value for public money» option. And finally, given that entrepreneurship is positively correlated to growth, SME policy should be converted into pure entrepreneurship policy whereby subsidies are transformed into financial instruments.

Let us recap with ten concrete growth recommendations for the regional level:

1. *Make venture capital funds bigger*: Public money should trigger – and not make reluctant – private international venture capital companies focused on high growth businesses. Therefore, public funds should have a hands-off approach and focus on private leverage.
2. *Develop Mezzanine:* Promote supply of financing by focusing on subordinated capital and other mezzanine instruments. These instruments allow external non-banking finance without losing ownership of the company.
3. *Investment readiness:* Focus on financing demand side by working on Investor readiness action.
4. *Launch a high-growth academy*: entrepreneurs willing and capable to grow and learn from one another on concrete topics such as stock management, strategic mergers, financing, HRM, etc.
5. *Networking and community:* Facilitate growth by facilitating networking amongst entrepreneur and potential investors. Informal contacts may be the best way to bridge the gap between risk-averting investors and not investment-ready investees.
6. *Clouds:* Develop clouds (on top of clusters): this interdisciplinary approach will be positive for the collaboration amongst sectors needed for future innovation. Open innovation and open clusters are the only way to develop new niches.
7. *Transmission:* Preparing the transmission in due time by promoting interim management and setting up fiscal incentives both for the investor and for the investee.
8. *Reshore:* Detect and approach companies that have offshored, partly or completely, and analyze under what conditions reshoring could be possible.
9. *Ecosystem for growers:* all actors (universities, government, trade unions, incubators, financiers) should be involved enabling an eco-community for growers.
10. *Focused entrepreneurship policy:* SME policy should be replaced by a high-growth entrepreneurship policy, without falling in the pitfall of 'picking the winners'.

REFERENCES

Aernoudt R. (2011): Leven zonder Job, Roularta, 212 p.

— (2017a): The scale-up gap: and how to address it. *Venture Capital*, An International Journal of Entrepreneurial Finance19 (4), 361-372 (2017)

— (2017b): *Financial Management in Practice*, Intersentia, 467 p.

Aernoudt, R.; Van Rompaey, M. (2016): *Entrepreneurship, A way of life*, Intersentia, 189 p.

Anyadike-Danes, M.; Bonner, K.; Hart, M.; Mason, C. (2009): *Measuring Business Growth: High Growth Firms and their Contribution to Employment in the UK, Research Report MBG/35,* London: National Endowment for Science Technology and Arts (NESTA).

Autio, E.; Rannikko, H. (2016): Retaining winners: Can policy boost high-growth entrepreneurship? Research Policy, 45(1), 42-55.

Bains & Cie (2002): Using Belgian's growth Potential.

Baldock, R.; Mason, C.M. (2016): «Establishing a New UK Finance Escalator for Innovative SMEs: The Roles of the Enterprise Capital Funds and Angel Co-investment Fund». *Venture Capital: An International Journal of Entrepreneurial Finance* 17: 59–86.

Birch, D. (1987): *Job creation in America*: How our smallest companies Put the most people to work, New York.

— (1995): Hot industries, Cognetics Inc., Cambridge.

Brander, J.A.; Egan, E.J.; Hellmann, T.F. (2008): *Government sponsored versus private venture capital:* Canadian evidence, University of Chicago Press, Cambridge.

Brigl, M.; Liechtenstein, H. (2015): The State of European Venture Capital, A Rise in good deals but an Investor Drought, bcg Perspectives.

Cumming, D.J.; Macintosh, J.G. (2006): Crowding out private equity: Canadian evidence. *Journal of Business Venturing,* 21:569–609.

Cumming, D.J. (2013): Public economics gone wild: Lessons from venture capital, I*nternational Review Financial Analyst*, 10.1016.

Curran, J. (1999): What is Small Business Policy in the UK?, *International Small business Journal*; volume 18, issue , 36–50.

De Prijcker, S.; Manigart, S.; Collewaert, V.; Vanacker, T. ugent (2017): Relocation and venture capital Business Relocation to get venture capital : a resource dependence perspective.

European Commission (2016a): Report on the public consultation under the Start-Up Initiative.

— (2016b): Europe's next leaders: the Start-up and Scale-Up initiative, Communication, 733.

— (2016c): Proposal on a common corporate consolidated tax base.

European Investment Fund (2015): European Small Business Finance Outlook.

— (2017): Communication from the commission, investing in a smart, innovative and sustainable industry a renewed EU industrial policy strategy, com/2017/0479 final.

— (2018): VC Survey, Fund managers' market sentiment and views on public intervention.

European Political Strategy Centre, Epsc (2018): *10 trends shaping innovation in the digital age*.

Evca (2013): Year report.

Innovfin Advisory (2015): *Study on access-to-finance conditions for KETs companies*, carried out with the support of Roland Berger Strategy Consultants, 2015.

González Pernía, J.L.; Sisti, E.; Díaz Mendoza, A.C. (2016): Tamaño, crecimiento y competitividad de las empresas vascas desde un punto de vista económico-financiero. Ekonomiaz, (90), 76-129.

González-Pernía, J.L.; Peña-Legazkue, I. (2015): Export-oriented entrepreneurship and regional economic growth. Small Business Economics, 45(3), 505-522.

Gil de San Vicente, I.; Murciego, A.; Sisti, E. (2017): *Orkestra-Basque Institute of Competitiveness,* Vulnerabilidad financiera de las empresas de Euskadi y Navarra.

Grilli, L.; Murtinu, S. (2014): Government, venture capital and the growth of European high-tech entrepreneurial firms. Res Policy 43:1523–1543.

Henrekson, M.; Johansson, D. (2009): Gazelles as Job Creators – A Survey and Interpretation of the Evidence, IFN Working Paper No. 733.

Kamp, B. (2017): *Competitive strategies on behalf of international niche market leaders*: evidence from the Basque Country, Orkestra-Basque Institute of Competitiveness, Bulletin de Estudios Económicos, Agosto.

Kelly R.; Hankook, K. (2013): Venture Capital as a Catalyst for High Growth, Economic Research and Policy Analysis Branch Industry Canada.

Lambrecht, J. (1998): 70 years SME policy in Belgium, EHSAL.

Lorange, P. (2005): The Growth Dilemma in Family-Owned Firms, Finance & Bien Commun, No 23.

Mason, C. (2016): Promoting High-Growth Entrepreneurship in Peripheral Regions: a Critique of Government Sponsored Venture Capital Funds, Welsh economic review.

Myers, S.C.; Majluf, N.S. (1984): Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have. Journal of Financial Economics, 13, 187-221.

Nesta (2009): The vital 6 per cent: How high-growth innovative businesses generate prosperity and jobs. London: Nesta.

— (2014): Increasing 'The Vital 6 Percent': Designing effective public policy to support high growth firms, Nesta Working Paper 14/01, Issued: January 2014.

Oecd (2016): Cross-country evidence on Start-ups.

— (2017a): The Walking Dead?, Zombie Firms and Productivity Performance in OECD Countries, Economics department, working papers No. 1372.

— (2017b): Breaking the shackles: zombie firms, weak banks and depressed restructuring in Europe, Economics department, working papers n° 1433.

Oxford Research (2015): Assessing the Potential for EU Investment in Venture capital and other Risk Capital Fund of Funds, Centre for Strategy & Evaluation Services.

Scale-up Manifesto (2016): A report of the Lisbon Council Think-Tank.

Shane, S. (2009): Why encouraging more people to become entrepreneurs is bad public policy, *Small Business Economics*, 33(2), 141-149.

Streeter R. (2012): What do High-Growth Firms in the United States and Europe teach Policymakers?

The Economist (2018): Why startups are leaving Silicon Valley, Augustus 30th 2018.

Thomson one in bsg perspectives (2015): The State of European Venture Capital. Entrepreneurship Theoray and practice.