How are Europe's capital markets hurting startup growth?

Savings and Investment Union Consultation

March 7, 2025

Europe's innovation future hinges on the Savings and Investment Union. With the U.S. and China leading global innovation, Europe's fragmented and overregulated capital markets weaken the economy and stifle innovation. If left unaddressed, this gap could soon cost Europe €1 trillion annually in lost market value.[1] One structural issue is the lack of capital, with 69% of European startups and 61% of scale-ups reporting access to finance as the key obstacle to growth.[2] To build a strong capital market and a robust VC sector, Europe will need to reform its exit markets, especially as research has shown that IPOs and exits are the strongest driver of VC investment.[3] Sadly, EU markets are currently in a spiral where weak venture capital is a major factor in encouraging European start-ups to relocate outside Europe. As an example, globally, the EU only accounts for 5% of global VC funds raised, compared to 52% in the US, 40% in China, and 3% in the UK.[4] This in turn is causing less IPOs in Europe, further weakening the exit markets. In 2021 alone, the U.S. witnessed more tech IPOs than the EU managed to generate between 2015 and 2023, resulting in an economic loss in the EU of $439 billion.[5] This is capital that could have gone into strengthening the European VCs and innovation. Today, 30% of European unicorns (scale-ups valued over €1 billion), and 15% of scale-ups have relocated abroad. This is compared to 9% of US scale-ups relocating and 12% in London.[6] Adding to this, Europe only holds a small fraction of the world's scale-ups, 8% compared to North America 60%, meaning each relocation is extra harmful to the ecosystem.

But who can blame a founder, who has invested all of their capital, time and energy in their business, for relocating to the market where they are more likely to get the returns they seek? Because, according to the European Investment Bank, while EU scale-ups that list abroad tend to raise less capital initially, they often achieve higher valuations, ultimately leading to higher returns for investors.[7] Additionally, relocated EU scale-ups are also more likely to undergo an IPO or M&A, and over 30% of the relocated EU-founded companies are acquired, compared to just 15% of those that stay, making relocation to the U.S. a more attractive path for investors seeking returns. As founders

---

[1] McKinskey, 2024, Accelerating Europe: Competitiveness for a new era.

[2] European Commission, 2021, European scale-up gap, page 4 & European Investment Bank, 2024, The scale-up gap: Financial market constraints holding back innovative firms in the European Union, page 2.

[3] Hellmann and Thiele, 2023, Scaling versus Selling Startups: The Role of Foreign Acquirers in Entrepreneurial Ecosystems. & Jeng and Wells, 2000, The determinants of venture capital funding: evidence across countries.

[4] European Commission, 2024, The Future of European Competitiveness - Part B, page 242.

[5] Mckinsey, 2024, Overcoming the European Tech IPO Challenge.

[6] European Investment Bank, 2024, The scale-up gap: Financial market constraints holding back innovative firms in the European Union, page 19.

[7] European Investment Bank, 2024, The scale-up gap: Financial market constraints holding back innovative firms in the European Union, page 15-21

want a return on their investment, the U.S. is clearly a more attractive choice. The figures also suggest that European companies are less willing to engage in M&A activity, and that the European regulatory environment is characterised by high uncertainty, cost and administrative burden, contributing to the exodus of EU startups. M&A activity also benefits scale-ups looking to accelerate their growth. Scale-ups that acquire more than five companies per year grow at twice as fast as those that complete fewer deals.[8] This has become a common practice to scale in Europe.

As IPOs and M&A are key pillars in building strong and resilient capital markets, and serve as key pillars of a successful VC climate, Europe's weak exit markets are also actively contributing to innovation brain drain and loss of resources.[9] This outflow disrupts the flow of capital into the European innovation ecosystem, creating a negative cycle that risks driving even more businesses to relocate.

1. **Address fragmentation**

Fragmentation is expensive. These barriers cost Europe 5-10% in GDP and equal trade tariffs worth 44% in the manufacturing industry, and up to 110% in the services sector. Compare this to 15% between U.S. states. Europe's financial markets also suffer from this fragmentation. Today, Europe has 35 exchanges vs 3 in the US and over 200 trading venues vs 50 in the US. This creates inefficient market conditions, and leads to dispersed liquidity and higher transaction costs. As both innovation and capital thrives on scale, this fragmentation hampers growth and hinders innovation. As a result, the Savings and Investment Union must reduce fragmentation and enhance liquidity, while facilitating cross-border venture capital participation in startup funding.

- **Simplifying IPOs**: By imposing further harmonisation and simplification of listing requirements and reporting standards across EU markets will create a more seamless and efficient investment environment. Additionally, establishing an EU-wide trading platform for the smallest 20% of Europe's public companies across various EU exchanges would streamline trading, enhance liquidity, and improve startup access to funding, all while reducing costs.
- **Harmonise M&A:** Today, multiple overlapping regulatory reviews for M&A across jurisdictions increases transaction costs and uncertainty. Considering M&A is a common strategy for scaling in Europe, the overlapping reviews hinder startup success and discourages scale-ups from growing in Europe.
- **Common insolvency framework**: With 90% of startups failing, Europe's fragmented insolvency framework only adds to the challenges facing the startup ecosystem.[10] When investors invest, they don't only think about how much they could win, but also how much they might lose. Today, founders and investors, wary of navigating inconsistent insolvency laws, face restricted capital flows, tend to only invest in their home market. Additionally, complex insolvency procedures prevent the liquidation of failed ventures, draining resources that could be reinvested in new ideas, stifling creativity and growth across the Union.
- **Simplify tax compliance**: By expanding the One-Stop-Shop (OSS) system beyond B2C e-commerce to cover all startups, VAT compliance for cross-border sales can be further simplified. Additionally, we recommend fully harmonising digital tax rules for e-commerce and online services across the EU. In addition, the

[8] McKinsey, 2022, Buy and scale: How incumbents can use M&A to grow new businesses.
[9] Hellmann and Thiele, 2023, Scaling versus Selling Startups: The Role of Foreign Acquirers in Entrepreneurial Ecosystems & Jeng and Wells, 2000, The determinants of venture capital funding: evidence across countries.
[10] European Commission, 2024, The Future of European Competitiveness - Part B, page 283-284 & 293.

implementation of the BEFIT framework would allow start-ups with cross-border activities in the EU to report to a single tax authority instead of several.
- **Address withholding tax regimes**: Today, for some European investors, it is more expensive to invest in Europe than the US. This is due to the complexity of withholding tax systems. This raises costs and is a major barrier to cross-border investment, further fragmenting European capital markets.
- **Bank sector support for startups**: While banks are by no means perfect in funding startups and scale-ups, numbers from the US indicate that almost 40% of all initial funding comes from debt. Given their size, by steering banks to provide a small increase in bank investments in EU risk capital, could therefore significantly impact startups and scale-ups.

2. Unleash European Savings

One such way is to use pension funds set up to accumulate future wealth, investing in startups makes sense. However, many EU Member States don't use pension funds.[11] For example, in 2022, pension assets in the EU were only 32% of its GDP, compared to 142% in the US and 100% in the UK. Interestingly, pension assets in the EU are also concentrated in the Member States that represent the more advanced EU startup ecosystems. Furthermore, EU households hold €500 billion more in savings than their U.S. counterparts.[12] However, much of this capital remains in savings accounts. While this contributes to a more stable banking sector, providing liquidity for loans and investments, it also highlights a major drawback, banks are not best equipped to drive innovation. Additionally, the tendency of Europeans to keep their money in savings indicates a lack of financial literacy. Compounding this issue, Europe's underperforming markets, partly due to low investment, further dampen demand, creating a vicious cycle where even less capital flows into European businesses. Instead, up to €300 billion from European investors is channeled into U.S. stock markets rather than supporting domestic growth. By harmonising regulatory frameworks, Europe can encourage more people to invest their savings locally, triggering a flywheel effect that fuels innovation, benefits startups and scale-ups, and strengthens European markets.

- **Financial literacy**: Today, 72% of Europeans don't invest in financial products. This needs to change. Policymakers should learn from successful models, like Sweden, who in 1984 launched a financial product enabling ordinary Swedes to invest in stock markets. This has fostered a strong investment culture and in 2012, Sweden launched a new product, the ISK, simplifying the process further. This helped its stock market grow 85% in the last decade, outperforming the Euro Stoxx 600 (49%) and London's FTSE 100 (17%). Additionally, despite a population of only 10 million, Sweden has seen more IPOs in the past decade than France, Germany, the Netherlands, and Spain combined.[13]
- **Pension funds**: While the main barrier to fully using pension fund investments lies with Member States, which impose rules that restrict pension funds from investing in venture and growth capital, the EU should, minimum, launch general guidelines to promote pension fund rules that address EU innovation growth needs. The U.K. also has self invested personal pensions, SIPPs, where an individual is free to invest their pension into any financial asset. All U.K. pensions are also invested in the stock market, unlike most of those in Europe.

---

[11] European Commission, 2024, The Future of European Competitiveness - Part B, page 242.
[12] European Commission, 2024, The Future of European Competitiveness - Part A, page 63
[13] Financial Times, How Sweden's stock market became the envy of Europe, April 18 2024

- **Retail investment**: The EU should promote tax relief policies like the UK's EIS and SEIS schemes to boost early-stage startup investment. In the UK, investors get 30% income tax relief on investments up to £1 million per year, with tax-free gains after three years and loss offsets. This attracts angel investors, strengthening startup networks. Currently, in Europe private investment is 40% costlier than business investment, which retail investment schemes could help balance. Notably, 68% of UK angel investors cite tax relief as their key motivation.

3. **Encourage Foreign Direct Investment (FDI)**

European businesses receive more funding from abroad than they invest abroad. It is crucial for the EU to continue capturing this capital, while ensuring that startups stay in Europe. As a lack of capital is driving innovation away from Europe, attracting capital is key, and by fostering the right conditions, Europe can strengthen its VC landscape, drive sustained growth, and unlock greater opportunities for job creation and innovation. A recent example of how FDI can fund innovation is the French €109 billion AI investment plan. With most of the funding coming from abroad, the rest of Europe can use this case to take inspiration on how to fund strategic assets[14].

- **FDI investment in critical assets**: Recent changes to the EU's FDI regimes might drive away this critical investment. While the goal is to prevent foreign capital from gaining ownership of critical assets, the result is even less capital for critical assets. Arguably, we want critical assets to access more capital. Instead, as InvestEurope suggests, the goal should be holding fund managers accountable for preventing any investor from influencing portfolio companies within the fund.[15]
- **Harmonise FDI frameworks:** The 27 different national FDI regimes are also no picnic to navigate. To attract investment, harmonised, clear and consistent terminology and criteria is needed. Additionally, there is a need for streamlined procedures coupled with stronger coordination between Member States. This will boost investor confidence and make the EU a more attractive destination for FDI.

This consultation is based on the AFS publication, the Startup Journey. In this report, Allied for Startups outlines the five key stages of a startup's journey: ideation, startup, acceleration, global expansion, and exit, highlighting the unique challenges at each stage and how EU policymaking can help address them.

Contact: vasco@alliedforstartups.org & hello@alliedforstartups.org

[14] Euroactive, France unveils €109 billion AI investment plan, Feb, 10, 2025
[15] Invest Europe, Invest Europe Position: Savings and Investment Union