

European Commission

DIGITALISATION FOR DEVELOPMENT. A TOOLKIT FOR DEVELOPMENT COOPERATION PRACTITIONERS INTERNATIONAL PARTNERSHIPS (INTPA)

Digital Entrepreneurship and Startups

InfoSheet nº12

This InfoSheet is part of a series on digitalisation and relevance to EU International Partnerships and development cooperation programmes. The Toolkit is designed to provide key definitions, main opportunities and challenges for global development presented by digital transformation, case studies and suggested further reading. Learn more on <u>Cap4Dev</u>

What is Digital Entrepreneurship?

The European Commission broadly defines digital entrepreneurship as creating new ventures and transforming existing business by developing novel digital technologies and or novel usage of such technologies. The speed with which it is revolutionising business models and transforming labour markets makes it challenging for practitioners and academics to define, and for policymakers to keep up with its developments. On the other hand, it holds huge potential for growth and innovation in the economy.

Digital entrepreneurship includes everything that is **new** and **different** about the interaction between entrepreneurial drive and the digital world, from new ways of designing and offering products and services, to new avenues for collaboration. Whether novel technologies are used to create new information and communications technology ventures (ICT) or to transform existing businesses in other sectors, digital entrepreneurship generates opportunities and competitive advantages, while balancing risks.

The transformation brought about by the digital economy is driven by technologies including **artificial intelligence (AI)**, **big data**, **e-commerce, digital financial services (FinTech)**, and many more. **Social media, data analytics, mobile and cloud solutions** are among the tools leveraged to improve business operations, invent new business models, sharpen business intelligence, and engage with customers and stakeholders.¹

Big data and AI was the main topic of <u>Infosheet number 5</u> of this series.

Digital financial services will be the main topic of one of the subsequent infosheets of this series.

There are four entrepreneurial models:

Small business entrepreneurship

Officially, enterprises that employ fewer than 250 persons and have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.²

Large company entrepreneurship

Big companies with solid core products or services that may adapt to the innovative business environment by developing new products or investing in smaller business projects.

Scalable startup entrepreneurship

Ambitious enterprises with a high innovation component that often rely on venture investors to support their vision for growth from the outset and build a scalable business model.

Social entrepreneurship

Operators in the social economy whose main objective is to have a social impact rather than make a profit for their owners or shareholders.³ Social enterprises can operate as non- profit, profit, or hybrid companies.

¹ European Commission, Strategic Policy Forum on Digital Entrepreneurship, <u>Fuelling Digital Entrepreneurship in Europe</u>, background paper.

² Commission Recommendation, C(2003)1422, 6 May 2003, <u>Concerning the definition of micro, small and medium-sized enterprises</u>; see also European Commission, DG GROW, <u>User Guide to the SME Definition</u>, 2020.

³ European Commission, DG GROW, Social Enterprises webpage.

Small and medium enterprises (SMEs) account for the majority of businesses worldwide and are important contributors to job creation and global economic development. They represent about 90% of businesses and more than 50% of employment worldwide, playing a crucial role in emerging markets, where 7 out of 10 jobs are generated by SMEs.

In spite of their pivotal role in the economy of Europe and partner countries, SMEs often experience a digital gap. Especially in light of the changes that COVID-19 has brought about in the way businesses are managed, ensuring digital uptake in SME development has become crucial in ensuring their resilience to economic shocks and downturns.

Why digital entrepreneurship?

In 2019, the World Bank Group estimated that 28 million jobs will be needed each year in Sub-Saharan Africa and South Asia alone to employ the growing number of youths reaching working age. This requires a substantial increase in both wage employment and entrepreneurs. In turn, raising business productivity and growth is key for the creation of more and better jobs over the lona run.⁵

The need to focus on supporting digital entrepreneurship has become even clearer as countries face the socio-economic impacts of Covid-19, as it presents a number of advantages compared to traditional bricks-and-mortar business models: it can improve business intelligence and can facilitate communication with large numbers of customers in less time, thus making scaling businesses easier, it can increase productivity and efficiency and it offers more flexible working hours and arrangements. The growth of digital entrepreneurship can also lead to the invention of new methods and technologies, thus diversifying economies and making them more resilient to shocks, as well as offering great potential for job creation among youth and also women, who have access to digital technology and the required skills.

However, the pandemic also revealed that countries struggling to adapt to the need for non-traditional solutions and business models are bound to lag behind. Against the backdrop of fragmented digital infrastructure and markets, as well as the lack of specific digital entrepreneurial skills, weak digital innovation eco-systems and lagging adoption of digital technology for businesses in many countries, digital entrepreneurship is far from reaching its true potential.

An enhanced understanding of how and why new technologies have been transforming the entrepreneurial sector, together with the various forms this process takes in different places, can fuel inclusive economic development across the globe.

Digital economies that achieve tangible and consistent results address all different dimensions of digital transformation. In this sense, it is fundamental to adopt an ecosystem approach when developing support strategies and programmes. Such an approach includes areas like legislation, public administration, infrastructure, financial inclusion and education, with a special focus on gender and youth.

Similarly, as the pace of job creation remains far below the needs, it is equally crucial to support the governments in developing strategy plans that foster the education system and align it with the demands of the new labour market.

Skills and VET for professionals were the main topics of Infosheet number 9 of this series.

Considering the **big added value of the startup business** concept in development cooperation and the emerging role of startups in economic prosperity and dynamism, this Infosheet offers a focus on startups: their life-cycle, the funding needs at each stage of their development, and the challenges that they face.

Startups

Startups often begin on a very small scale based on innovative and disruptive business ideas. While the original startup setup may look like a traditional small business, it differs in its vision of fast-growing evolution with a long-term perspective of scalability. Startups run on a trial-and-error basis and typically evolve through the close involvement of external investors, until they reach their business outcomes.

Although SMEs and startups and may be visualised as similar, they have strong differences, including in their business models, revenue objectives, functions, funding and other arrangements.

SME VS. STARTUP	
SME	STARTUP
Business model:	Business model:
Traditional	Scalable and disruptive
Revenue objectives:	Revenue objectives:
Moderate	Ambitious
Functions:	Functions:
Structured	Trial-and-error
Funding:	Funding:
Traditional	Non-traditional sources

Startups are changing the world by creating **innovative solutions** to challenging problems and are taking on critical issues such as climate change, social inequality and access to education. Startups develop across all sectors of the economy, but a great number of them are built on technology-based business ideas. Business ideas based on innovation and disruption often focus on **developing new** markets that diversify the economy, bringing in new products or services or existing ones that were previously not accessible locally. An added value of supporting startup development and innovation in partner countries lies in their **non-traditional goals**. However, these solutions can also **trigger a number of risks** related to consumer safety and privacy, the use and traceability of data and a high probability of technology bias, due to lax regulation or lack of regulation at national level in many countries, but also at multilateral level, given the transboundary nature of digitalisation.

⁴ "Small and Medium Enterprises (SMEs) Finance, Improving SMEs' access to finance and financing prinova ⁵ "Jobs and Economic Transformation", 2019, International Development Association - World Bank Group. apital" webpage, World Bank

Regulating digital innovation

Since 2014, the EU has been striving to regulate the digital economy and innovation and to facilitate the development of a data-agile economy. In 2020, the <u>European Industrial Strategy</u> set the threefold objective of a globally competitive, green and digital Europe. The main steps of the European digital strategy include regulation of the free flow of non-personal data, <u>the</u> <u>Cybersecurity Act</u>, <u>the Open Data Directive</u> and the <u>General</u> <u>Data Protection Regulation</u>, as well as a <u>European approach to artificial intelligence</u>. Alongside these, the <u>Digital Services Act</u> and the <u>Digital Markets Act</u> respectively ensure that the online environment is safe and accountable and that digital markets are fair and open.

When it comes to sharing its experience in setting **global standards for innovation policies and regulations** in partner countries and regions, the EU certainly has a competitive edge. A similar approach is crucial to prevent new technologies like big data and AI from having **negative social impacts** in partner countries that have weak relevant institutions.

Digital reforms need to be adequately supported by investments and to foster innovation. The lack of factors such as digital education, cross-border arrangements and access to finance – venture capital funding or private equity –may compromise the successful uptake of innovative businesses.

According to the <u>2020 Global Innovation Index (GII) Report</u>, beyond GII top-level rankings, some top spots on selected innovation indicators are held by middle- or low-income economies. In South-East Asia, for example, Thailand is 1st in business R&D, and Malaysia is top in high-tech net exports. In Sub-Saharan Africa, Botswana ranks 1st in education spending. In Latin America, Mexico is the largest creative goods exporter worldwide.

Startup life cycle⁶

Given the ever-growing number of digital businesses and startups that are being created and their potential low survival rates, it is essential to consider business sustainability when funding and implementing development cooperation actions targeting innovative business models. While the projects pursued by startups are often very risky, those that survive and succeed may have large economic impacts.⁷

The idea ●	A problem is identified, and a solution developed. Once the business idea has been established, target users are identified, and feedback is gained.
Minimum Viable Product (MVP)	The product hypothesis is tested with the minimum possible investment of time and capital (MVP). Customer demand is established, while minimising risks.
Product- Market Fit	Once the MVP has gained traction and paying customers are there, retention rates are recorded, and product refinement is initiated.
Scale •	Startups focus on channels and processes that drive growth, expanding their team with technical and specialised staff.
Maturity •	The growth rate may slow down but should never stop. Companies should continue investing in their growth teams and work towards internationalisation, with an eye to the regional dimension.

With 9 out of 10 startups failing in the first year, potential entrepreneurs can often be discouraged from embarking on this journey. To provide a solution to this problem, the European Commission offers support to startups through programmes within Europe and through international partnerships, with the objective of lessening the impact of the administrative procedures and motivating more people to become entrepreneurs, therefore creating new jobs and improving Europe's economic performance (example below).

Hackathons

Hackathons are sprint-like events that take place over a night, day or weekend aimed at creating technology-driven solutions. Initially aimed at programmers, they are now being used as catalysts for change in development cooperation.

As part of the efforts to address the impact of Covid-19, the European Commission and the German Ministry for Economic Cooperation and Development (BMZ) launched the **#SmartDevelopmentHack** in the framework of "Team Europe" in spring 2020. The hackathon called for **innovative digital solutions to tackle the challenges caused by the coronavirus outbreak in low- and middleincome countries.** Nine winning projects were selected and are currently scaling their innovations around the world through the #Smart Development Fund. Among them is **CoAmana**, a **tech startup from Nigeria**, which aims to improve the livelihoods of Nigerians by addressing market inconsistencies which cause poor performance of businesses and farmers. Its **digital marketplace**, **Amana Market**, enables buyers to source produce directly from farmers, cutting out the middleman. Learn more about the #Smart Development Fund and its support to startups <u>here</u>.



⁶ E. T. Adhanan, <u>"What are the three stages of a startup?"</u>, SVB.

⁷ F. Rossetti, D. Nepelski, M. Cardona, "The Startup Europe Ecosystem", Technical Report, 2018, JRC, European Commission.

Startups in developing countries: challenges and opportunities

New businesses and startups are being recognised as key drivers of economic advancement in developing countries. However, even when a startup has defined a valid business idea to start off with, the chances are that it will not survive the structural constraints of the local market if these are adverse. An **ecosystem approach** needs to be taken into account while supporting private sector development (PSD) and digital transformation through external action. For the digital business ecosystem to thrive in developing countries, essential components need to be in place.



Startup boosters

- Incubators: institutions that support entrepreneurs in the initial stage of their development. Examples include academic institutions, venture capital firms, government organisations, and profit/non-profit development corporations and ventures.
- Accelerators: rapid business programmes that support startups in their early stages, providing services including education, mentoring, and financing services. Admission is highly competitive, and the aim is to condense years' worth of learning into a few months.
- Venture builders: organisations that accompany startups throughout their pathway to independence, leveraging their internal team of business developers, designers, and marketers. Support is focused on identifying problems and creating solutions internally, building the startup team accordingly.

Challenges

Digital startups face a wide array of challenges which depend on the structure and capacities of their ecosystems, and their needs can vary from country to country and region to region. For example, **startups in Sub-Saharan Africa** experience rather slow and linear growth, which is highly unevenly distributed across the continent. Their digital products mainly target customers in urban markets at local and only in few cases at regional scales, due to lagging infrastructure, while strategy innovations like the last-mile platform are often employed, due to their blend of digital technologies with analogue outreach structures. In Latin America and the Caribbean, a region where low productivity due to the slow adoption of technology is pervasive, venture capital and business accelerators can become key players in the innovation ecosystem by promoting startup creation and increasing its supply of startups with high potential. In October 2020, the **Donor Committee for Enterprise Development** (DCED) published a <u>synthesis note</u> that highlights the main risks and opportunities at the intersection between PSD and digitalisation, including practical programming options for PSD donors and practitioners in partner countries.

>> Policy first

Addressing constraints deriving from **non-existent or uncoordinated policies and regulations** allows businesses to thrive. This requires policymakers to address **digital-specific constraints** in parallel to **traditional challenges faced by business creators,** with specific focuses on youth and women's entrepreneurship.

Such an approach ranges from addressing barriers to **cross-border trade** to developing institutional enablers for **locally relevant digital content**, and from ensuring **fair taxation and lower transaction costs** to developing **national plans to train and support young entrepreneurs.** The intangible assets that startups rely on especially need to be protected through public support for patenting and **intellectual property rights (IPRs)**. The lack of a consistent approach to IPRs in some countries means that small businesses and startups cannot easily access public tenders and achieve scalability. Regulating funding tools and actors is also essential to maximise credibility and trust. These factors need to be considered by policymakers in order to attract, develop and retain high-end digital skills and talent.

Europe's Digital Decade and its external dimension

On 9 March 2021, the Commission presented a vision and avenues for Europe's digital transformation by 2030. This Digital Compass for the EU's Digital Decade revolves around four cardinal points- secure and sustainable infrastructures, digital transformation of businesses, digital skills and the digitalisation of public services – and has a strong external dimension. For example, the EU aims to promote its human-centred digital agenda on the global stage, as well as alignment or convergence with EU norms and standards. It will also seek to ensure the security and resilience of its digital supply chains and deliver global solutions. These will be achieved by:

- providing a toolbox combining regulatory cooperation, addressing capacity building and skills, investment in international cooperation and research partnerships
- designing digital economy packages financed through initiatives that bring together the EU, Member States, private companies, like-minded partners and international financial institutions.
- combining EU internal investments and external cooperation instruments, investing in improved connectivity with the EU's partners, for example through a possible Digital Connectivity Fund.

Policy and regulation was the main topic of <u>Infosheet</u> <u>number 2</u> of this series.



>> Digital infrastructure

In order for a business to thrive, basic services such as infrastructure services play a fundamental role. Good roads, transportation systems, affordable broadband and reliable power are all essential to deliver quality goods and services in a timely manner yet remain limited in many developing countries.



Digital infrastructure and connectivity was the main topic of <u>Infosheet number 11</u> of this series.

>> Access to funding

Startup capital is consistently identified as perhaps the most pressing challenge for startups and SMEs alike in developing contexts. Here, they are often faced with high interest rates, extra bank charges and limited financial knowledge, making it difficult to make the initial concept into a viable business plan. From an investor perspective, many local financial institutions are biased or lack awareness of the digital market's potential. Funding gaps can be identified across all stages of the life cycle, especially for small-sized businesses which do not benefit from small investment tickets, often leading startup projects to fail before they reach profitability.

Startup funders

>> Friends, family, and fools

The most basic form of crowdsourcing: friends and family may lend or gift funds to first-time entrepreneurs who struggle to access institutional funding.

The relationship is informal, but friends and family members may invest by taking a stake in the business venture. The term fools is added due to the risk associated with investing in a seed venture with little product or business experience.

>> Angel investors

Individuals or small teams with high net worth that invest their own money in a business idea, usually at early stages of startup development.

They tend to operate with poorly structured investment proposals and often develop a close relationship that includes hands-on mentoring and guidance. However, they often ask for a large equity stake and sometimes acquire a controlling interest, which can generate conflicts.

>> Venture capitalists

Professional investors who invest large amounts of money, usually at later stages of startup development.

Typical venture capitalists can offer anything from strategic assistance to networking with potential customers, partners, and employees, as well as capital investment.

>> Family office

An organisation that manages the wealth of affluent families or individuals looking to invest in rapidly growing startups with a high associated risk.

Advantages include a direct knowledge of business management on the investor's side, limited fund constraints, flexibility and strategic networking opportunities with clients and other potential investors.

>> Foundational and interoperable digital systems

Services that are relevant to business development and management are often offline and thus need to be digitalised. These include those strictly related to **administration**, **taxes**, **permits and licences**, but also **eID**, **e-government and mobile money**. These services and systems need to be interoperable, that is, able to communicate and exchange data within and across boundaries.

eGovernance was the main topic of <u>Infosheet number 4</u> of this series.

Opportunities

Despite these challenges, many startups have succeeded, partly thanks to increasing **urbanisation** and population sizes, and a **rise in income** across Africa and Latin America and the Caribbean. New business opportunities are often identified in hospitality, finance, healthcare and education.

Many startups, such as Rappi (a Colombian marketplace delivery service), Myra (an Indian online pharmacy), and Kobo360 (an African global logistics operating system), have begun optimising the logistics and online payments infrastructure by developing urban logistics networks and user-to-user transfer payment systems, ultimately supporting economic growth and creating an environment for entrepreneurial ecosystems to thrive. Furthermore, the entrepreneurial movement in developing countries is triggering regulatory change by creating profitable markets that need regulation. In Latin America, governments have started supporting market-creating innovations, such as digital ride-share apps in Mexico, developing new regulations and policies which improve transparency and access to new sources of income.

BRIDGING DIGITAL INNOVATI ECOSYSTEMS ACROSS AFRI AND EUROPE

as the objective to strengthen a common A al innovation ecosystem by supporting loca start-up ecosystems in Africa and facilita ition between European and African DIHs

European Fund for Sustainable Development Plus (EFSD+)

The ESFD+ is a financial instrument which allows the **EU to lower investment risk in several thematic priority areas**. Working alongside the European Investment Bank (EIB) for sovereign and sub-sovereign lending, and alongside European and international financial institutions for private lending, the EFSD+ will allow the EU to create an enabling environment and access less developed and risky markets, as found in least developed countries.

For Digital for Development (D4D), three priority areas have been identified under the Open Architecture Connectivity Window of the ESFD+: **digital connectivity, digital entrepreneurship/***innovation/startups and digital services*. Concretely, this means designing opportunities for the deployment of digital infrastructures, digital transformation of businesses, promoting the uptake of innovations by the market and scaling up the digital services supporting digital transformation of societies and economies in partner countries.



One of the flagship initiatives of the <u>Digital4Development (D4D) Hub</u> is the <u>African European Digital Innovation Bridge</u> <u>NET (AEDIB NET)</u>. AEDIB NET aims to connect and develop digital innovation ecosystems in Africa and Europe – thereby creating highquality solutions for SDG challenges and boosting a resilient digital economy.

Initiated by three EU Member States (Germany, France and Belgium) and the European Commission with funding from Horizon2020, AEDIB NET aims to consolidate a pan-African network of <u>digital</u> <u>innovation hubs</u> (DIHs). DIHs are one-stop shops or clusters bringing together people from across the knowledge triangle (education, research and business) for digital innovation-related initiatives, helping companies become more competitive with regard to their business/production processes, products or services using digital technologies. DIHs provide access to technical expertise and experimentation, so that companies can "test before they invest". They also provide innovation services, such as financing advice, training and skills development, that are needed for a successful digital transformation.

As AEDIB NET is being phased out at the beginning of 2024, the EU and some EU Member States have joined forces again to follow up on this pilot project with a new action, **AEDIB 2.0**. The overall objective of **AEDIB 2.0** is to enhance digital cooperation between Africa and Europe through the operationalisation of a 'digital innovation bridge' with a strong focus on the twin transition. This 'bridge' will support the development of **African digital** entrepreneurship and innovation through the promotion of ecosystem cooperation within Africa and with Europe, with the long-term goal of contributing to a single market for digital innovation between the two continents and of positioning the EU as a reference partner for Africa.

More concretely, AEDIB 2.0 will harness best practices from EU Member States and the African continent to set up a framework for strengthening digital innovation ecosystems, providing a specific support model to digital innovation hubs, designed by Team Europe in co-creation with African stakeholders. The project will start in 2024 and will be built around three pillars:

- Enhancing science, technology and innovation policy and regulatory environment conducive to the twin digital and green transition
- 2. Building, strengthening, and connecting digital innovation ecosystems for the twin digital and green transition
- 3. Promoting innovative financing for the twin digital and green transition

Further Reading

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Digital Decade: <u>https://commission.europa.eu/strategy-and-</u>policy/priorities-2019-2024/europe-fit-digital-age/europesdigital-decade-digital-targets-2030 en

#Smart development Fund: https://sdf.d4dhub.eu/

AEDIB NET: https://d4dhub.eu/projects

Guarantees brochure under the EFSD: <u>https://ec.europa.eu/</u> eu-external-investment-plan/sites/default/files/documents/ efsd_guarantees-feb_2021-en.pdf

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