

STARTUPS IN THE CONTEXT OF THE DIGITAL SINGLE MARKET: COMPARATIVE ANALYSIS OF EU AND RUSSIAN LEGISLATION FRAMEWORKS*

Dinara Garaeva**

ABSTRACT

In recent years, due to the widespread access to the Internet, the speed of appearance of innovations is progressively increasing and these innovations play the role of the driving force in economy at all levels and in all types of organizations. Due to high risks present when introducing new products and services, innovations are usually commercialized via isolated formal organization types or structures such as startup companies. Today start-up is well-known phenomenon, the establishment of which every third teenager dash further. But do we really know how does it work and do we have all opportunities provided by European Union legislation in the context of Digital Single Market Strategy to start it and then make it profitable business without unjustified risks? This article explores legal frameworks of start-ups in the EU and Russian Federation. By comparing them, the article seeks to create the vision of start-ups regulation problems nowadays and ways to improve current problems concerning this topic.

Key words: start-ups, investments, Digital Single Market Strategy, entrepreneurships

1. INTRODUCTION

“Starting your own business is like riding a roller coaster. There are highs and lows and every turn you take is another twist. The lows are really low, but the highs can be really high. You have to be strong, keep your stomach tight, and ride along with the roller coaster that you started”.

Lindsay Manseau, photographer and entrepreneur

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** Student at Faculty of Law, Kazan Federal University; gymun2011@gmail.com.

Nowadays the word “start-up” becomes as common as TV or Internet in their era. Everyone at least once has heard about it, half of them exactly know the meaning of this word, and other half have a direct connection to this movement. It is not such a new term, first it was mentioned in 1939 by two Californian students who invented their own project and called it “start-up” and later it became transnational corporation called “Hewlett Packard”. Commonly it has logged in using when the process of the development of new software, hardware and network solutions, called startups, was conducted during the transition period, the period of mass computerization and was commonly recognized as innovative projects established via the Internet and high tech technologies.¹ Startup entrepreneurship is extremely crucial because of high speed of development, innovations, new jobs and bringing competitive dynamics into the business environment. No one can't deny the importance of this movement today to the global economic growth and each country accordingly.² The private sector economy is dynamic, and these are start-ups.³ Nowadays start-up is a perfect form of organization in order to gather talent people in one group and unlock human potential in a way which was not possible before. It allows people to be creative, to use their knowledge and skills, to use them in a right way and to invent new types of technologies which solve our daily problems and make our life better. And of course, for being successful and competitive on the market, there is necessity in a suitable support and developed infrastructure organized by government via legal framework.

In recent years the importance of creating appropriate infrastructure for start-ups, in particular from the legal point of view, has been noticed. Things have started to move in the right direction. Nevertheless, it is still not at optimal

¹ “Start-up” Natalya Safronova/February, 13, 2015 http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2564525

² The Global Entrepreneurship Monitor (GEM) research data show that worldwide, an entrepreneurship with high potential creates on average as much as 3 times more jobs than entrepreneurship with average potential and as much as 15 times more jobs than an entrepreneur with low potential. Thus there is only 4% of entrepreneurs who can be placed in the group of dynamic companies that have the potential to grow on global markets (on average they reach at least 20 % annual income growth) and they truly contribute to the economic development of the society, as they create as much as 38 % of all jobs... A research by the Global Entrepreneurship Monitor South Africa (2012) states, that one third of dynamics of countries' economic growth can be attributed to the dynamics of start-up entrepreneurship. The activity of The Start-up Foundation. More information is available: www.startupmzansi.org

³ These words correctly encompass the private sector's growing need for new and flourishing companies. Rosebush express the private sector's deep need for innovation and ideas, but more importantly, the conversion of these ideas into productive companies. These companies will not only provide jobs to sustain the private sector, but to expand it as well. James Rosebush, Business Insider.

levels, facing structural obstacles and impediments to financing. How will it overcome fragmentation, market localization and scaling challenges? Positive changes implemented by the European Union must be complemented by the ingenuity of startups themselves, among which Start-ups offers its own solutions.⁴ Whereas, this article deals with position of start-ups in the global market, definition of its notion, comparison of EU and Russian Federation legislation. In this article author has analysed current situation in the field of legislation regulating activity of start-ups in EU and Russian Federation. The article is divided into 4 parts including conclusion. First part deals with the definition of the start-up as it is a basic thing which needs to define before making a comparative analysis and others. Second part deals with the analysis of the European legislation framework of the start-ups. The third one is about the comparative analysis of European and Russian legislation of start-ups. The article ends with conclusion.

2. DEFINITION OF THE TERM “STARTUP”

The definition a start-up is crucial for understanding its legal nature and position in the global market since different states take legislative approaches”. The exact legal definition of the word “start-up” is still debated world-wide. Most countries, as Russia, Asian countries and EU, would define it by using several criteria such as age, growth, revenue, profitability or even stability (in detail we will look further). However, many of the world’s largest technology companies, including Google and Facebook, still consider themselves to be start-ups in one sense or another. If you are looking for unwritten definitions of the term, most of all are similar. For instance, Eric Ries, the creator of the Lean Startup movement, defines a startup as “company is a newly formed company, the purpose of which is to develop new, usually innovative products or services in uncertain circumstances”. Steve Blank and Bob Dorf, who are considered to be role model start-uppers for others, define a startup as an “organization formed to search for a repeatable and scalable business model”.⁵

⁴ “The Startup Tortoise & The Economic Hare: Challenges Of The European Ecosystem” <http://magazine.startus.cc/the-startup-tortoise-the-economic-hare-challenges-of-the-european-ecosystem/>

⁵ Here the word “search” should be explained as an exploration of unknown or innovative business model in already well-known field of business, as, for example an operating of café or hostels, in order to disrupt existing markets, as in the case of Amazon, Uber or Google. Blank and Dorf’s definition shows us the difference between start-up and large companies in a contrast,. A start-up is a temporary organization designed to search the market field and, using all results, even if it is a failure to establish new business model and continue to grow as a large business. See more in ...

If try to turn to legislation of the EU or the Russian Federation or to legislation of other countries, one can find references about start-up in different sources through which one could conclude how do national legislators define start-ups.

The most recent mention of the necessity to define a start-up has been the result of the initiative launched by the by Honorable Prime Minister of India. He supported idea of establishing a plan to support early stages of creation of start-ups.⁶ The flip side of the coin was the fact that there has been no legal definition of start-ups. Therefore, the decision to make a draft legal definition was made: a Startup is an incorporated legal entity of not more than 7-years, which uniquely uses technology to deliver products, services or solutions across India.⁷

In Russian Federation there is no legal definition of a “start-up”, because it doesn’t differentiate from others legal entities. Therefore all legislation which regulate questions about legal entities automatically relate to the startups, as Civil Code of Russian Federation (art.48)⁸, Law “ On foreign investment in Russian Federation”⁹, Law “On state registration of legal entities and individual entrepreneurs in Russian Federation”¹⁰ and etc.

There are some documents in the European Union legislation which mention the word “start-up”. For instance, “Entrepreneurship 2020 Action Plan”. In proposals for the Member States start-ups are mentioned in the same line with small and medium sized enterprises (SMEs) the regulation of which needs to be simplified.¹¹ It is also necessary to mention the European Start-up Monitor 2015 (ESM), which published its own report which includes basic statements

⁶ <http://yourstory.com/2016/02/government-definition-startup/>

⁷ And in any Financial-Year it has

1. annual profits of less than Rs. 5 crores;
2. and annual revenues of less than Rs. 100/- crores;
3. and less than 100 direct-employees on its rolls;
4. and also market capitalization of less than Rs. 100 crores.

⁸ http://www.consultant.ru/document/cons_doc_LAW_5142/

⁹ http://www.consultant.ru/document/cons_doc_LAW_16283/

¹⁰ http://www.consultant.ru/document/cons_doc_LAW_32881/

¹¹ The Member States are invited to: “Assess the need of amending current national financial legislation with the aim of facilitating new, alternative forms of financing for start-ups and SMEs in general, in particular as regards platforms for crowd funding, as well as consider the need for simplification of tax legislation to stimulate further development of alternative financial markets like for example business angel investments.” Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions: Entrepreneurship 2020 action plan. See more: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012DC0795> date of approach.

about start-up ecosystem in Europe. The question about defining the term “start-up” was raised. Start-ups are defined by 3 characteristics: start-ups are younger than 10 years, start-ups feature (highly) innovative technologies and/or business models, and start-ups have or strive for a significant employee and/or sales growth.¹²

Consequently, we can see, talking about the legal definition of start-up, that there are still not so many examples of legal frameworks, where we can find exact definition which will satisfy all countries. Mostly start-ups don't differentiate from legal entities of the small and medium-sized business that is why the concrete separate legislation regulating start-up as a new movement is not still common. Questions about tax rates, entrepreneurs' and investors' risks and etc., there are concluded in different laws which regulate other legal entities. However there are various definitions including basic statements which define the “essence of a start-up”.

3. EUROPEAN UNION LEGAL FRAMEWORKS OF STARTUPS

Regulatory regime for start-ups in the EU is defined by variety of documents. Recently the EU issued documents as a consequence the Digital Single Market Strategy, at the first place, start-ups are regulated by national legislation of countries as part of investment laws, tax laws, intellectual property laws and etc., as for instance the way of defining by what law will be regulated the treaty of investment of start-ups if the investor is a foreign person should be decided under the international private law which is in Russian Federation legislation, for example, concluded in Civil Code of Russian Federation. However, according to the survey of European Start-up Monitor, 50 % of the European startups pursue their business activity at international level and 8 out of 10 have planned to internationalize their activity further within next 12 months. That proves that European startups and the environment in which they do business are not national but European as well. There are few acts, as “*The Small Business Act*”¹³, “*European Patent Convention*”¹⁴, “*Digital Single Market Strategy for Europe*”, “*European Private Company Statute*”¹⁵,

¹² European Startup Monitor/ 2015/ p.15 http://europeanstartupmonitor.com/fileadmin/presse/download/esm_2015.pdf

¹³ <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52008DC0394>

¹⁴ [http://documents.epo.org/projects/babylon/eponet.nsf/0/00E0CD7FD461C0D5C-1257C060050C376/\\$File/EPC_15th_edition_2013.pdf](http://documents.epo.org/projects/babylon/eponet.nsf/0/00E0CD7FD461C0D5C-1257C060050C376/$File/EPC_15th_edition_2013.pdf)

¹⁵ http://ec.europa.eu/internal_market/company/docs/epc/proposal_en.pdf

“European Startup Act 2020” and etc.,¹⁶ which aim to prepare and propose policies in order to help the European startups to grow through the harmonization of the European markets.

We can look on the context of these acts and see how it works, for instance: “Statute for a European private company” in its explanatory memorandum includes statements like *“The proposal for a Statute for an SPE is adapted to the specific needs of SMEs. It allows entrepreneurs to set up an SPE following the same, simple, flexible company law provisions across the Member States. The proposal also aims to reduce compliance costs on the creation and operation of businesses arising from the disparities between national rules both on the formation and on the operation of companies.”*

A huge supporting role play unique platforms and organizations, such as “Startup Europe Club One Stop Shop”¹⁷, “Startup Europe Advisory Board”¹⁸, “Startup Europe Hub”(Startup Europe aims to strengthen the business environment for web and ICT entrepreneurs so that their ideas and business can start and grow in the EU.)¹⁹ “SOLVIT initiative”²⁰, which help to start and organize the startups in other countries by using information available on this platform about other countries` rules and a lot of other programs, funds and initiatives which help entrepreneurs to start realizing their ideas into business.

Concerning investments, the “World Economic Forum 2014”²¹ report showed us not such a favorable picture. “Startup” phase of the entrepreneurship life cycle ecosystem factors plays a crucial role. This section focuses on access to capital as a key bottleneck in starting a company: 79% of Europeans specify access to finance as an issue preventing them from starting or expanding a business. While regulatory frameworks are often also cited as a barrier to business set-up and operation in Europe, these are very heterogeneous across European countries – for example: in some countries, all the necessary licenses required to start a business to manufacture small IT devices can be obtained

¹⁶ REGULATION (EU) 2015/1017 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 25 June 2015 on the European Fund for Strategic Investments, the European Investment Advisory Hub and the European Investment Project Portal and amending Regulations/..... OJ L ..., date, pages...

¹⁷ <http://startupeuropeclub.eu/>

¹⁸ <https://ec.europa.eu/digital-single-market/en/startup-europe-advisory-board>

¹⁹ <http://www.startuphubs.eu/>

²⁰ http://ec.europa.eu/solvit/_docs/2002/conclusions_en.pdf

²¹ http://www3.weforum.org/docs/WEF_GlobalCompetitivenessReport_2014-15.pdf

in less than 10 days, while in others it can take more than 80 days.²² The sources of financing for European venture funds differ strongly between European regions. While in Germany, Austria and Switzerland (hereinafter as: DACH), as in the United Kingdom and Ireland, less than 20% of venture funds have come from government agencies, such agencies have accounted for over 40% of venture funding in Central and Eastern Europe. Banks are particularly important for venture funds in Southern Europe (22% of financing) and Central and Eastern Europe (CEE) (26%), giving an indication as to why financing in these regions has become more challenging in the aftermath of the financial crisis, and may remain tight as regulation and capital requirements restrict the ability of banks to invest²³.

Current situation with the European Union legislation framework is only in the first stage of developing the process of creating active Internal Single Market which will also provide enough elaborated environment for start-ups to make business not only via national market but also spread their products or services consumers in all Member States without any burdens.

4. COMPARISON OF EUROPEAN UNION AND RUSSIAN FEDERATION LEGISLATION

Primarily, there is no exact law which regulates start-ups, as I proved it in the first part, gives its legal definition. It is considered to be as one of legal entities forms which exist in Russian law. In the first place, when establishing a start-up, entrepreneurs, should think about legal entities forms in which they would like to continue to exist. They should also consider a form of protection of their idea, or better to say, make an idea come true and protect the object by intellectual property law rules as soon as possible. Whereas, the question about start-ups' regulation in Russian Federation, firstly, is provided by Civil Code, where one can find basic statements about regulation of legal entities and articles about intellectual property law. Last summer, on the 1st of June, 2015, there were significant amendments offered by "The Internet Initiatives Development Fund" (IIDF) to simplify the activities of investors in Russia, and introducing in the legal field, some tools to work with entrepreneurs, which can directly be used for the regulation of startups, as new articles about "option agreement",

²² Start up: Supporting the Establishment and Initial expansion of Innovation-driven Ventures/ p.19/

More information in the "World Economic Forum" report "Enhancing Europe's Competitiveness. Fostering Innovation-driven Entrepreneurship in Europe"/ June 2014/

²³ The Global Competitiveness Report 2014–2015 http://www3.weforum.org/docs/WEF_EuropeCompetitiveness_FosteringInnovationDrivenEntrepreneurship_Report_2014.pdf

“indemnity”, assurances about the circumstances”. Thus, the Russian investors and entrepreneurs have existing tools to help facilitate the work and mutual relationships between companies and investors.²⁴

Detailed regulation can be found in several federal laws such as Federal law “*About investment activity in the Russian Federation, implemented in the form of capital investments*”²⁵; Federal law “*About foreign investments in Russian Federation*”²⁶; Federal law “*About advertisement*”²⁷; Federal law “*About state registration of legal entities and individual entrepreneurs*”²⁸; Federal law “*About information, information technologies and protection of information*”²⁹

According to the “Compass” company’s second survey called “The Global Startup Ecosystem Ranking 2015”³⁰ on the development of start-ups ecosystems of different cities, in the list of top-20 of big cities with developed ecosystems, Moscow took the 13th place.³¹ Comparing with European countries, Russian start-ups’ ecosystem is the youngest in Europe. Developing rapidly, it still needs to overcome some imbalance. Most venture capital funds are managed by professionals, who prefer to invest at later stages. Sowing and pre-sowing investment remain largely the prerogative of state funds in Russia. There is a lack of “smart money”³² in the market needs to venture investors

²⁴ See more about activity of “The Internet Initiatives Development Fund” on the <http://www.iidf.ru/> date of approach.

²⁵ About investment activity in the Russian Federation, implemented in the form of capital investments, (N^o 39/02/25/1999)

²⁶ Federal Law About foreign investments in Russian Federation (N^o 160 /09/07/1999)

²⁷ Federal Law About advertisement (N^o 38/13/03/2006)

²⁸ Federal Law About state registration of legal entities and individual entrepreneurs (N^o129 /08/08/2001)

²⁹ Federal Law About information, information technologies and protection of information (N^o149 /27/07/2006)

³⁰ http://www.businesslocationcenter.de/imperia/md/blc/service/download/content/the_global_startup_ecosystem_report_2015.pdf

³¹ The authors of the report noted a well-developed start-up infrastructure in Russia, – commented Gulnara Bikulova, Director of Innovation markets Department, member of the Board of RVC. Russian venture capital market is not just developing - the players start to join efforts, in fact it becomes a large cooperative. So, within the Generation S there was created the largest regional network of educational partners, bringing together 41cities and 83 platforms: there are a startup school, business incubators, universities and other participants in the innovation ecosystem, working with startups”.

³² Smart money is cash invested or wagered by those considered to be experienced, well-informed, “in-the-know” or all three. Although there is little empirical evidence to support the notion that smart-money investments perform any better than non-smart-money investments

who were helped their portfolio companies to successfully grow a business. This problem will be overcome when there is a change of generations and today's entrepreneurs will act as business angels³³.

Currently in Russia carry out their activity more than 30 innovation platforms, association of innovation regions, techno-parks, it-parks and other platforms, which provide necessary facilities for entrepreneurs in various areas as legal consulting, investment and IT consulting etc.. It helps them to start business with minimum losses. As a very productive example, it is necessary to notice the Innovation center "Skolkovo", 2 It-parks and innovative "Innopolis city" in the Republic of Tatarstan, Russian special economic zones and others as there are special zones and spaces which provide start-uppers legal, economic, territorial, tools means for realizing their ideas.

On the one part, the start-up ecosystem has been developing rapidly nowadays, establishing centers supported by main state universities as Moscow State University or High School of Economy which also offer legal help to the entrepreneurs with their first steps concerning choice of legal entity or the protection of intellectual property, a lot of other platforms, economic zones, which provides not only with consulting but with employment and investments, necessary facilities and etc.

Comparing with Europe, in some areas there are much more opportunities to grow for startups than in Russia. For instance, "Startup Sauna" in Finland, as a country with a rich start up ecosystem, providing state aid by grants, special financial features, loans, allow Russian entrepreneurs to also receive a financial support from this accelerator by winning a competition. The same situation is with Switzerland – country specialized on medical, biotechnological and travel industry start-ups, known by its low level of liquidation the business, international experts and investors.

do, many speculation methods take such influxes of cash very seriously. Read more: Smart Money Definition | Investopedia <http://www.investopedia.com/terms/s/smart-money.asp#ixzz49PpnvOhi>

³³ Usually, a former entrepreneur or professional who provides starting or growth capital in promising ventures, and helps also with advice and contacts. Unlike venture capitalists, angel investors usually operate alone (or in very small groups) and play only an indirect role as advisors in the operations of the investee firm. They are deemed to be 'angels' in comparison with grasping investors who are termed 'vulture capitalists.' Read more: <http://www.business-dictionary.com/definition/angel-investor.html#ixzz49PqiwC4K>

5. CONCLUSION

Summing up, it can be said that the legislation of start-ups is of course very important thing nowadays as this entity develop very quickly and needs special legal regulation in order that people can realize their ideas which will be protected by law as others legal entities which have longer history. Today we already have a lot in this sphere despite the fact that it is comparatively new field, especially in EU. The comparison showed that Europe is on the right way, especially concerning the question with investments, when it is necessary to support start-ups from the beginning and that there is enough practice with good results supporting start-ups believing only to their ideas and powers of abilities and youth. Start-ups need freedom, human resources, educational experts, as well as investors and entrepreneurs.

The European Commission's **Startup Europe** "aims to strengthen the business environment for web and ICT entrepreneurs so that their ideas and business can start and grow in the EU", with better access to capital and a lowered barrier for success.

In my opinion, in Russia we should use the example of European countries and make more on the question of reforming the investment law as it still has shortcomings about providing protection from economic risks of investors, and also should work on the education of people in the way how work with their start-ups in a legal form and etc. We are still on the way of growing but we have good potential, so just need to continue to cooperate and move forward.

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