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Opportunities and limitations of public equity markets for SMEs

by
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This article on public equity financing for small and medium-sized enterprises (SMEs) complements earlier OECD work on market-based finance for SMEs. The development of this market segment could promote investment in SMEs and, together with securitisation and other non-bank debt financing instruments, encourage an enhanced allocation of risk and risk taking, and thus support growth. Despite the benefits of public SME equity, its share is small and an equity gap exists for risk financing more generally. A number of important impediments to the wider use of public equities for SMEs are identified, such as admission cost and listing requirements, lack of liquidity, educational gaps, limited ecosystems, and tax treatment, all of which require attention by regulators and policy makers alike.

JEL classification: G1, G2, G23, G28.

Keywords: SME finance, market-based finance, SME public equity markets, growth markets, small caps, initial public offering (IPO), exchanges, risk capital, small equity offering

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Executive summary

This article complements earlier OECD work on market-based small and medium-sized enterprise (SME) finance. It draws on discussions with market participants and other research, and provides analysis of IPOs and related data. It does so with a view to provide **background and input to further work** on the opportunities and constraints of market-based financing for SMEs. A number of policy actions that may mitigate constraints facing equity capital market financing for SMEs and enhance its potential are also discussed in this paper. These proposed policy actions are intended to provide some guidance for policy makers when designing actual measures to support public equity financing for SMEs. Governments should have discretion as to the adoption of any these policy actions, taking into account their domestic circumstances and other policy approaches.

The share of small and medium-sized enterprise (SME) financing provided through equity markets is currently very small. Equity capital is critical to growth and the development of small IPO markets could incentivise investment in SMEs and, together with securitisation and other non-bank debt financing instruments, encourage an enhanced allocation of risk and risk taking, and thus support growth.

A more nuanced view of the SME financing gap is necessary. An **equity gap seems to exist for risk financing, in particular for fast-growing companies rather than for SMEs in general** or for mature but non fast-growing firms. SME funding is considered to be a difficult business mainly because the segment as a whole is characterised by low survival rates and a large diversity of entities, which makes it extremely difficult to assess risks. Moreover, some SMEs are not appropriate candidates for debt financing, owing also to their lack of collateral or positive cash flows, their need for longer maturities to finance capital expenditure and investment, or other impediments to servicing debt, such as irregular cash flow generation. In Europe in particular the main issue appears to be on the equity side, both public and private, rather than a generalised lack of debt financing. This situation might reflect to some extent deeper "cultural" factors.

There are benefits of public equity offerings for SMEs that extend beyond initial access to capital (IPO), to longer-term repeat access to financing (secondary/follow-on raisings), as well as to benefits related to increased creditworthiness, transparency and visibility through association with a dedicated ecosystem. Despite those benefits, the share of SME financing provided through capital markets is as mentioned currently very small, particularly in Europe, despite the fact that equity markets could serve as an alternative financing source. A number of important **impediments to the wider use of public equities for SMEs** (for both issuers and investors) are identified that require attention by regulators and policy makers alike.

Admission cost and listing requirements in the main markets are often very high for SMEs. However, a number of equity markets targeting smaller listings have been established in different jurisdictions. With momentum building behind alternative non-bank sources of financing for SMEs, there may be an opportunity for SME equity capital markets and other equity financing stakeholders to work with the official sector to assess how public SME equity financing might best be supported.

The educational gap of SMEs with regard to equity financing, and the limited awareness of SMEs when it comes to equity instruments, limit their access to such instruments. There is a role for policy makers to bridge this gap by promoting financial education for SMEs and support the development of the skills necessary to tap the public markets. **The limited ecosystems (exchanges, platforms, brokers, market-makers, advisors, equity research)** necessary both for the development of SME equity finance and the limited liquidity in such markets may also be inhibiting. The recent decline in equity research, coupled with inactive secondary markets for small cap offerings, mean that only those institutional investors that command a special expertise in the relevant industry or sector are likely to participate. **Improving economic incentives for participants in SME equity markets** can in turn incentivise the development of healthy and vibrant ecosystems dedicated to small firms. Higher tick sizes, for instance, could provide economic incentives to intermediaries such as market-makers, when it comes to smaller shares, which in turn could improve liquidity (Weild et al., 2013).

Liquidity is most likely the key challenge in publicly traded SME equity, with SME shares tending to be very illiquid, hampering the ability of early-stage investors to realise their investment through normal exit. A number of options to enhance liquidity are available and should be considered. Increased standardisation and homogeneity could potentially enhance speed and reduce disparities that create arbitrage opportunities (e.g. differential tax treatment). **Government policy could be particularly useful** in addressing some of the illiquidity in growth markets (abolition of stamp duty taxes in AIM, the US Jobs Act creating more room in the retail investor space, etc.).

A perceived reluctance of institutional investors to invest and the asymmetric treatment of equity and debt financing in some cases (e.g. tax treatment) have impeded the fostering of SME public equity financing from the supply-side. The lack of a risk equity culture across Europe is an important obstacle to the fostering of SME equities, with striking comparisons between the United States (50% of the population invested in equities) and parts of continental Europe (e.g., only 5% of the population with direct equity investments). This calls for increased education regarding equity investments for all market constituencies (SMEs, individual investors and advisors alike) and the need to induce participation by both institutional and possibly also retail investors (e.g. private pension schemes) in order to foster the development of vivid and liquid growth markets.

Against this backdrop, policy makers should be mindful of the role of financial regulation in affecting SME public equity financing. For example, the diversity of SMEs creates the potential for substantial diversification benefits, but market players argue that such **diversification advantages are insufficiently recognised** in new regulations, affecting the capacity of institutional investors such as insurance companies and pension funds to invest in that sector. More generally, **unintended consequences of regulatory reform** perceived by the market highlight the need for a balanced and coordinated approach to regulation that will encourage the deployment of such patient capital in SME equities.

Nonetheless, specific rule-making covering equity markets should be designed with caution. **A one-size-fits-all approach to rule-making could be inefficient**, if not detrimental to the fostering of SME growth markets. **Proportionate, adapted legislation**

designed for small (and mid) caps rather than simple relaxation of certain listing and reporting requirements for SMEs could alleviate cost and other impediments for small issuers, while preserving investor protection and confidence in such instruments. Changing prospectus requirements is of particular importance so as to allow for more streamlined, proportionate requirements for SMEs, without demoting/ degrading the level and quality of information provided or risking investor protection.

While it is generally agreed that a bias exists in the **tax treatment of debt against equity** (tax deductibility of interest across the board), **views differ over the effectiveness of tax breaks** (and, for that matter, **regulatory support**) as a means to resolve the issue of suboptimal investment in SME equities in the long run, **as they do not address the structural cost disadvantages of small-sized deals, and might create vested interests, by providing benefits that go directly to the beneficiaries' profits**. On the other hand, tax relief is a simple and straightforward way to incentivise investment in SME equities at the current juncture and has proven a quick and efficient way to induce participation in small equity markets. Such interventions require backing by studies investigating whether and to what extent tax breaks are effective and what is the additionality effect of such policies when it comes to SME investment.

Private equity and venture capitalists are well established as providers of value added to SME businesses they invest in, as evidenced by a lower failure rate during the crisis. Venture capital stays involved in a business even after the initial investment period has ended, acting as **anchor investors** in any public offering. Peer-to-peer, crowdfunding and other similar financing platforms could help fill part of the finance gap created by banks. However, such new sources of finance, in their current form and magnitude, cannot yet play the role of more established sources of risk capital.

The **interconnectedness of the entire funding landscape** means that the various forms of SME financing are not necessarily exclusive. In that context, the benefits of venture capitalists remaining anchor investors after IPOing, and debt investment as basis for (entry or follow-up) equity investment by private investors are two illustrative examples of this interconnectedness. New approaches of peer-to-peer SME financing coming from high-net-worth individuals (HNWIs) with SME expertise could be another way forward, as with the existing public-private co-investment schemes in Europe (European Angels Fund, under the auspices of the EIF).

SME equity financing in public opinion remains a challenge given experiences with small cap equity markets and the tarnished reputation of the financial sector after the crisis. It may be assisted by the provision of **incentives to retail investors** participating in SME public equities (e.g. UK ISA inclusion of certain small caps or the French PME-PEA).

Promotion of equity finance for SMEs should not be seen as a way to disengage banks from SME financing, but rather as **a way to complement bank lending** and other financing alternatives. Indeed, bank lending is expected to continue to represent the primary source of financing for SMEs, not least because of its very size and informational advantages. In the context of a closely interconnected SME financing environment, a holistic and **coordinated effort by all market constituencies involved (investors, intermediaries, advisors, policy makers and SMEs)** is required to support investment in the SME asset class and allow SMEs to fully benefit from capital market financing when and as appropriate, without posing a risk to financial stability.

I. Introduction and overview

This article complements earlier OECD work on non-bank debt financing for SMEs[1] that was also part of a project on broadening the range of financing instruments for SMEs.[2] It also draws on discussions with private financial sector representatives at an OECD Financial Roundtable held in October 2014. That Roundtable focused on the identification of drivers and impediments for SME equity financing on a standalone and comparative basis (*vis-à-vis* Venture Capital and Private Equity financing) and the role of public policy in fostering publicly traded SME equities. Discussions concluded that SME funding continues to be a difficult business mainly because the segment as a whole is characterised by low survival rates and a large diversity of entities, which makes it extremely difficult to assess risks. In light of the risks, there does not seem to exist a generalised lack of debt financing for SMEs, although a shortfall of SME debt funding may arise in countries with a weak real economic growth outlook. Otherwise, the main issue, in Europe at least, appears to be on the equity side, both public and private, and this situation might reflect to some extent deeper "cultural" factors. Against this backdrop, participants recommended that policymakers be mindful not to introduce additional obstacles. This article enhances the results of these discussions and the analysis in earlier work on SME finance in several ways, including by dissecting and discussing IPO data.

To motivate the discussion and analysis, the next section briefly reviews the limitations of bank financing and looks at the "conundrum" of an SME financing gap. The following, main section on primary equity markets for SMEsanalyses, in the first two subsections, the benefits and constraints of such markets. The next subsections discuss appropriate SME definitions from a financing perspective, analyse small company IPOs and discuss proportionality as a means to spur public equity funding. The problem of liquidity, the need for a dedicated ecosystem and the fiscal bias against equity are examined in the following subsections, with the last subsection discussing the lack of equity culture and educational gaps. Concluding remarks and policy implications are presented in the final section.

II. Limitations of bank financing and the financing gap conundrum

Financing conditions for small-and medium-sized enterprises (SMEs) have remained tight in the years following the Great Recession in several OECD countries, despite an environment of monetary easing and a number of measures adopted by policy makers to enhance access to finance and credit conditions for SMEs (OECD, 2014). Opaque, cumbersome and expensive bank lending processes with strict collateral and other criteria could discourage SMEs from seeking bank credit. Despite an expansionary environment of abundant liquidity, many SMEs which need bank credit find it particularly difficult to obtain in a number of economies, especially in the euro area. A negative bias in banks' perceptions about SMEs riskiness and profitability tends to result in suboptimal lending – a financing gap –that in the current environment adds to the sluggishness in the pick-up of economic growth, particularly in Europe.

Policies addressing a financing gap for SMEs need to differentiate between *small* companies and *fast-growing* ones. Indeed, studies indicate that the size (or the age) of a company and its probability of growth are uncorrelated. The analysis of a retail bank's books has shown that SMEs do not grow any faster than any other segment and that there is no correlation between growth and age, once the data is appropriately weighted.[3]

Therefore, an attempt of policy makers to achieve growth by focusing on SMEs as a broad class could be unsuccessful because SMEs as a broad, all-embracing category do not appear to grow any faster or slower than any other companies in the real economy. Instead, policies should focus on young, high growth firms. As demonstrated by an analysis of firm-level data across 17 OECD countries and Brazil such firms are responsible for a disproportionately large share of the net job creation in an economy (Criscuolo et al., 2014).

Naturally, most SMEs enter into saturated markets, with the exception of highly innovative SMEs that reach new niches of the markets in their home jurisdiction or are able to expand internationally and sell overseas. Young, high-growth firms or "gazelles" are found predominately in knowledge-intensive and high-tech sectors (Machado and Wilson, 2014). While such fast-growing businesses are often short of funding, banks are not best placed to provide it due to structural, rather than capital, reasons. Indeed, banks in most instances are not capital constrained: despite the application of stricter capital requirements (Basel III) (ADB and OECD, 2014), in the current environment of monetary expansion and historic low cost of borrowing, many banks seem to have sufficient capital to absorb the uptake in demand one would expect as the cycle continues to improve. **While not constrained in the quantum of their lending, banks are nevertheless constrained by risk considerations**: the risk of IT development and expansion of innovative, creative start-ups is normally beyond the range of risks banks are able or willing to take.

Limited demand for finance by SMEs in weak and uncertain business environments can also be considered as a key obstacle to growth, as companies are reluctant to undertake any investment projects. Even in the case of larger companies, capex in real investment projects has nowadays been replaced by massive share buy-backs. According to observers, regulatory changes have rendered the loan process more challenging for small bank finance seekers, discouraging them further and adding to the weak demand for financing coming from weaker macroeconomic environments. Fully untangling the supply from the demand side of the SME financing question is a challenging exercise. Nevertheless, policies to assist SMEs in public listing and to stimulate demand for quoted SME equity may be warranted.

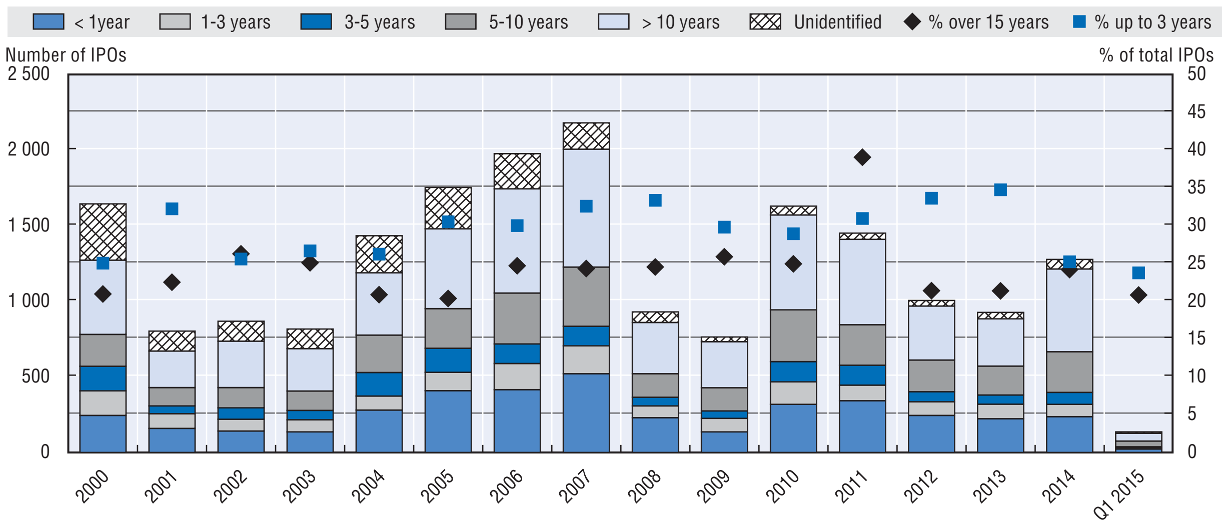
Many observers perceive a financing gap for risk finance delivered in a form that is suitable for SMEs, rather than a general SME financing gap applying to all SMEs. This view clearly differentiates between SMEs in general and fast-growing companies of smaller size. A mixture of mezzanine structures as, for example, available in the European corporate lending market, carrying higher interest rates in special structures, could be seen as a means to close such a financing gap by providing *de facto* equity in *de jure* loan structures. In this way the risk capital gap could be closed through the use of bank lending – the latter still being the preferred and best understood instrument, especially on the European continent. The bundling of standardised mezzanine for very small deals in an appropriately transparent, financial technology-supported fashion could probably be one of the few viable options available for these small, highly risky deals (Altenburg, 2015).

Equity markets are to a large extent tapped by fast-growing, young companies. Indeed, in the period 2000-15, the percentage of companies choosing an IPO path less than 3 years since foundation of the firm has been consistently higher than the percentage of older companies of 15 years or more of existence (Figure 1[4]).

SMEs are expected to continue to obtain most of their funding through bank lending despite lower lending growth, particularly in Europe. This is mainly attributed to SMEs'

Figure 1. **Breakdown of global IPOs by age of company at the time of listing, 2000 – Q1 2015**

In number of IPOs (l.h.s.) and in % of total IPOs (r.h.s.)



Notes: Global IPOs as defined in Footnote 4. Excluding real estate investment trusts (REITs) and blank check companies or special purpose acquisition vehicles (SPACs). Age from year of founding to year of listing, rounded to full years for calculation purposes.
Source: Factset, OECD calculations.

fundamentals and inherent characteristics such as diversity, scarcity of credit information as well as to the fixed costs associated with sourcing and monitoring small local firms (Wehinger, 2012). All the same, bank lending is neither the most appropriate nor the most feasible way to fill the identified risk finance gap for small, fast-growing companies.

The rapidly growing shadow banking segment, coupled with traditional venture capital, business angels and other early stage capital providers is expected to increasingly fill the gap that banks are unable or unwilling to cover when it comes to private equity financing.[5] Such private capital pools are beneficial in terms of cost rationalisation; however, alternative risk-based structures are perhaps needed in order to replace debt-driven risk finance – i.e. debt instruments used to finance equity risk – and offer a better solution in terms of quantum achieved.

Public markets are perceived as natural platforms for equity financing of small companies with important growth prospects, with a specific focus on the firms' risk and performance characteristics rather than on their size. The pool of fast-growing small businesses and their respective needs are different from those of the broad SME category. If a financing gap for the segment of fast-growing SMEs can be filled by markets for risk financing, this will have a direct impact on the ability of the real economy to grow. All the same, **public equity markets have to be regarded as complementary, rather than competitive, to bank financing.** To that end, a more coordinated effort among capital markets and the banking industry is required in order to fill this funding gap for "growthness".

III. Primary equity markets for SMEs

A. Developments of small IPOs and characteristics of SME public equity markets

As banks are reducing their lending in a post-crisis financial landscape, capital markets have to play a bigger role especially in financing long-term investment, including in infrastructure, SMEs and knowledge-based capital, which are key contributors to economic growth and job creation.[6] The role of capital markets is even more pertinent for the financing of SMEs, as these are heavily reliant on traditional bank lending and currently face important financing constraints in a deleveraging environment where restricted bank credit availability prevails.

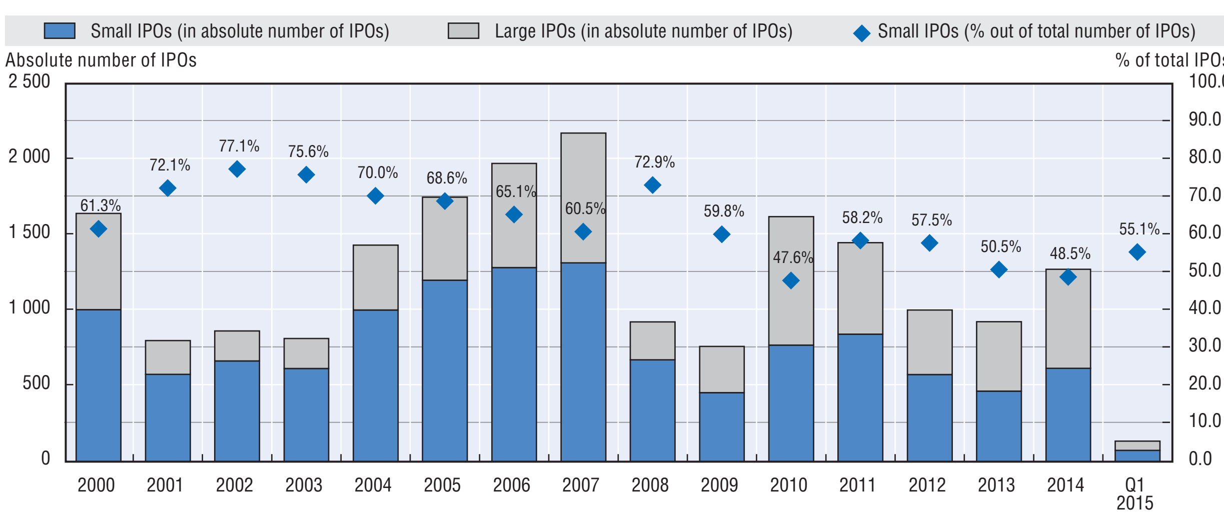
Besides the US, where equity markets are more liquid and mature, most developed and developing countries have still a large scope to increase the size, depth and relevance of their equity markets – particularly for smaller issuer firms. In many of today's economies outside the US, banks have remained the dominant source of external financing. This is the case particularly in Europe, despite the fact that organised exchanges offer an attractive and abundant alternative long-term financing source. Further development of equity markets in emerging economies is critical, as corporates rely heavily on external financing for their growth and expansion.

The number of listings and amount of equity raised in OECD countries has followed a downward trend that began in the early 2000 and was aggravated following the 2008 crisis (Isaksson and Çelik, 2013). This was true even in the US, traditionally regarded as the leading IPO market. There is also evidence (provided in the same study) for a global shift in public equity issuance from OECD to non-OECD markets, with almost 55% of all capital being raised in non-OECD markets in the period 2008-12 (compared to 20% levels before that) and 60% of all proceeds coming from non-OECD country companies.

Despite its relevance and appropriateness, capital market financing for SMEs remains underdeveloped, both for debt (securitisation, bond issuance, debt private placements[7]) as well as for equity (public listings, equity private placements). The proportion of small IPOs out of the total number of listings has dropped from mid-70% levels prior to the financial crisis to mid-50% levels thereafter (Figure 2). **The median size of IPO offerings has increased in the aftermath of the crisis**, peaking in 2012 (Figure 3).

Figure 2. **Global small IPO issuance, 2000 – Q1 2015**

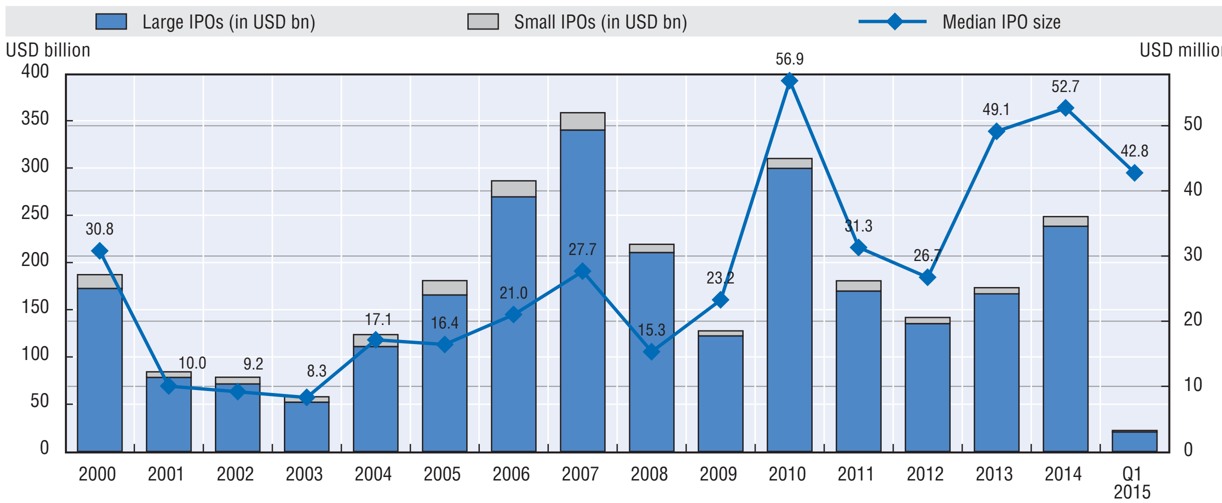
In absolute number of IPOs (l.h.s.) and % of total number (r.h.s.)



Notes: Global IPOs as defined in Footnote 4. Assuming a USD50m threshold as the cut-off for small IPOs. Excluding real estate investment trusts (REITs) and blank check companies or special purpose acquisition vehicles (SPACs).
Source: Factset, OECD calculations.

Figure 3. **Global small IPO issuance proceeds, 2000 – Q1 2015**

In USD billion (l.h.s.) and median IPO size in USD million (r.h.s.)



Notes: Global IPOs as defined in Footnote 4. Assuming a USD 50 m threshold as the cut-off for small IPOs. Excluding real estate investment trusts (REITs) and blank check companies or special purpose acquisition vehicles (SPACs).
Source: Factset, OECD calculations.

While it has dropped since, the post-crisis median size has broadly stayed above pre-crisis values, suggesting a lower use of public equity markets by smaller issuers, which in most cases represent smaller-size companies.

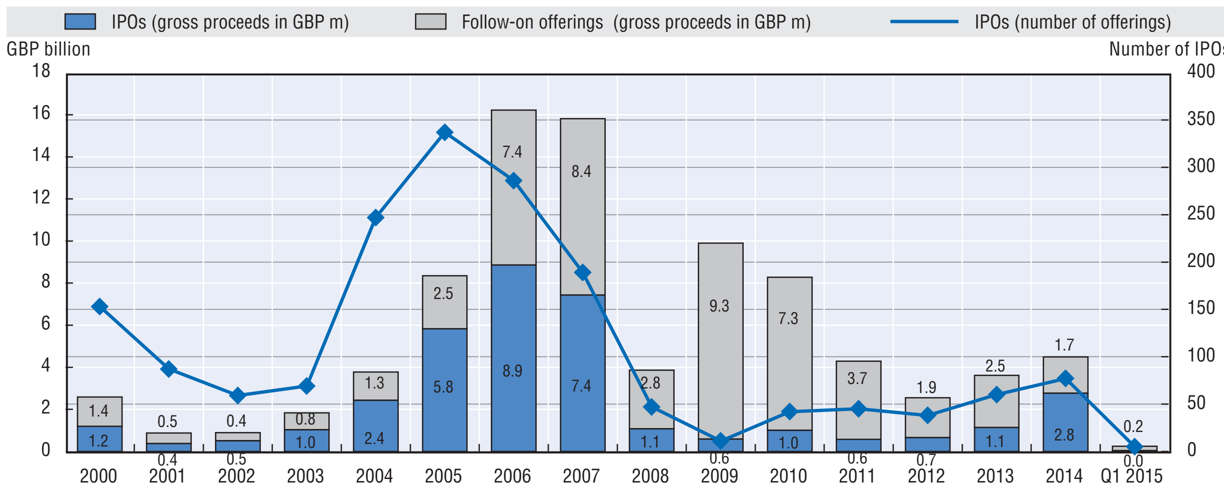
The level of follow-on offerings in secondary markets is another barometer of the health of the equity market, providing quoted companies with long term repeat access to finance. As those small companies grow, investment begins to pick up and the financing needs shift from funding working capital to funding fixed assets and other investment. The financing instruments that address those needs are also shifted from core bank lending and revolving facilities to cover day-to-day needs to equity finance to further invest and grow their business. In the UK for example, out of 4.5 bn GBP being raised on the Alternative Investment Market (AIM) in 2014, 62% was raised through IPOs and the remaining 38% through follow-on offerings (Figure 4). Activity was still reported to be much lower than prior to the financial crisis, with 77 IPOs coming to the AIM market during this period compared to on average 180-200 companies in a comparable period pre-crisis.

Public offerings in main markets entail admission costs and listing requirements that are, reportedly, "discouragingly high" for SMEs and disproportionately high relative to the size of offerings coming from smaller issuing companies. As an alternative, these companies could use trading venues beyond regulated exchanges, including multilateral trading facilities (MTF) and over-the-counter trading (OTC) of ad-hoc and irregular transactions, as well as systematic internalisers (market makers), investment firms dealing on their own account outside a regulated exchange or MTF.

A number of growth segments in regulated markets, multilateral trading facilities and other specialised SME equity platforms targeting smaller issuers have been established in different parts of the world as an alternative, and precursor, to main exchange listings. Examples of such listing platforms include the Alternate Investment Market in London UK, Deutsche Börse's Entry Market, Spain's Mercado Alternativo Bursatil, TSX Venture in Canada, NewConnect (Warsaw stock exchange) in Poland, Alternext/

Figure 4. **AIM IPOs and secondary offerings, 2000-Q1 2015**

In GBP billion (l.h.s.) and in number of IPOs (r.h.s.)



Notes: Excluding real estate investment trusts (REITs) and blank check companies or special purpose acquisition vehicles (SPACs).
Source: Factset, OECD.

Euronext and Alternativa in Europe, AltX in South Africa. The Enternext pan-European initiative (Euronext Group) promotes equity markets to SMEs and facilitates their access to financial markets. A number of growth platforms have been developed in Asia with Mothers and JASDAQ in Japan, ChiNext and the SME Board by the Shenzhen Stock Market in China, KOSDAQ and KONEX in Korea, China's Growth Entreprise Market in Hong Kong (HK GEM), the Market for Alternative Investment in Thailand, the SME Exchange and NSE India Emerge (Bombay Stock Exchange) in India.

SME growth markets offer more flexible listing criteria (see for example in Japan, Table 1), **eased disclosure requirements and comparatively low admission costs** (see Table 2 as an example) **so as to cater to SMEs' inherent characteristics.**[8] However, post-crisis activity in terms of IPOs on these specialised exchanges has slowed, in some cases more than on main exchanges (Figure 5). This may reflect the fact that advantages of listing on a main market (higher liquidity, larger range of investors) may outweigh the benefits of small growth exchanges (lower fees and more lenient listing requirements). It may be inferred that investor confidence in growth markets is also lower and therefore investor participation remains restrained particularly as compared to participation and confidence levels for the main exchanges.

At the same time, potential risks of exponential growth in the value of small platforms which may not be safeguarded by "circuit breaker" mechanisms need to be monitored. Rapidly rising valuation levels especially in emerging market growth platforms, not accompanied by a growth of the platform itself (i.e. number of listings) but instead driven by changes in the market structure, need to be carefully monitored. Recent changes in the number of securities trading accounts retail investors can hold in China aiming to spur competition between brokerage firms has, for example, contributed to a large extent to the ChiNext's valuation growth in the past year or so.

Table 1. **Listing requirements in main and growth markets, Japan**

	Main market		Mothers	JASDAQ		TOKYO PRO market
	1st section	2nd section		Standard	Growth	
Number of shareholders	2 200 or more	800 or more	200 or more	200 or more		-
Tradable shares (number of tradable shares)	20 000 units of more	4 000 units or more	2 000 units of more	-		-
Market capitalisation of tradable shares	JPY 1 billion (USD 10 million) or more	JPY 1 billion (USD 10 million) or more	JPY 500 million (USD 5 million) or more	JPY 500 million (USD 5 million) or more		-
Ratio of tradable shares to listed shares	35% or more	30% or more	25% or more	-		-
Public offering	-	-	500 trading units or more	10% or more or 1 000 trading units		-
Market capitalisation of listed shares	JPY 25 billion (USD 250 million) or more		JPY 1 billion (USD 10 million) or more	-		-
Number of years of business operation	3 years or more		1 year or more	-		-
Shareholders' equity	JPY 1 billion (USD 10 million) or more		-	JPY 200 million (USD 2 million) or more	Not negative	-
Amount of profits or market capitalisation	Ordinary profit: Total amount of JPY 500 m (USD 5 m) or more in the last 2 fiscal years Market cap: JPY 50 bn (USD 500m) or more Sales: JPY 10 bn (USD 100 m) or more		-	Ordinary profit: JPY 100 m (USD 1 m) or more Market cap: JPY 5 bn (USD 50m) or more	-	-

Source: Tokyo Stock Exchange, Osaka Exchange, Japan Exchange Regulation.

Table 2. **Fee comparison of Deutsche Börse's main market vs. Entry Standard market**
As of August 2014

	Regulated market		Open market (regulated unofficial market)
	General standard	Prime standard	Entry standard
Admission fee/inclusion fee	€ 3 000 admission & € 2 500 introduction fee	€ 3 000 admission & € 2 500 introduction fee	€ 1 500 inclusion fee
Annual fee/quotation fee	€ 7 500 p.a.	€ 10 000 p.a.	€ 5 000 p.a.

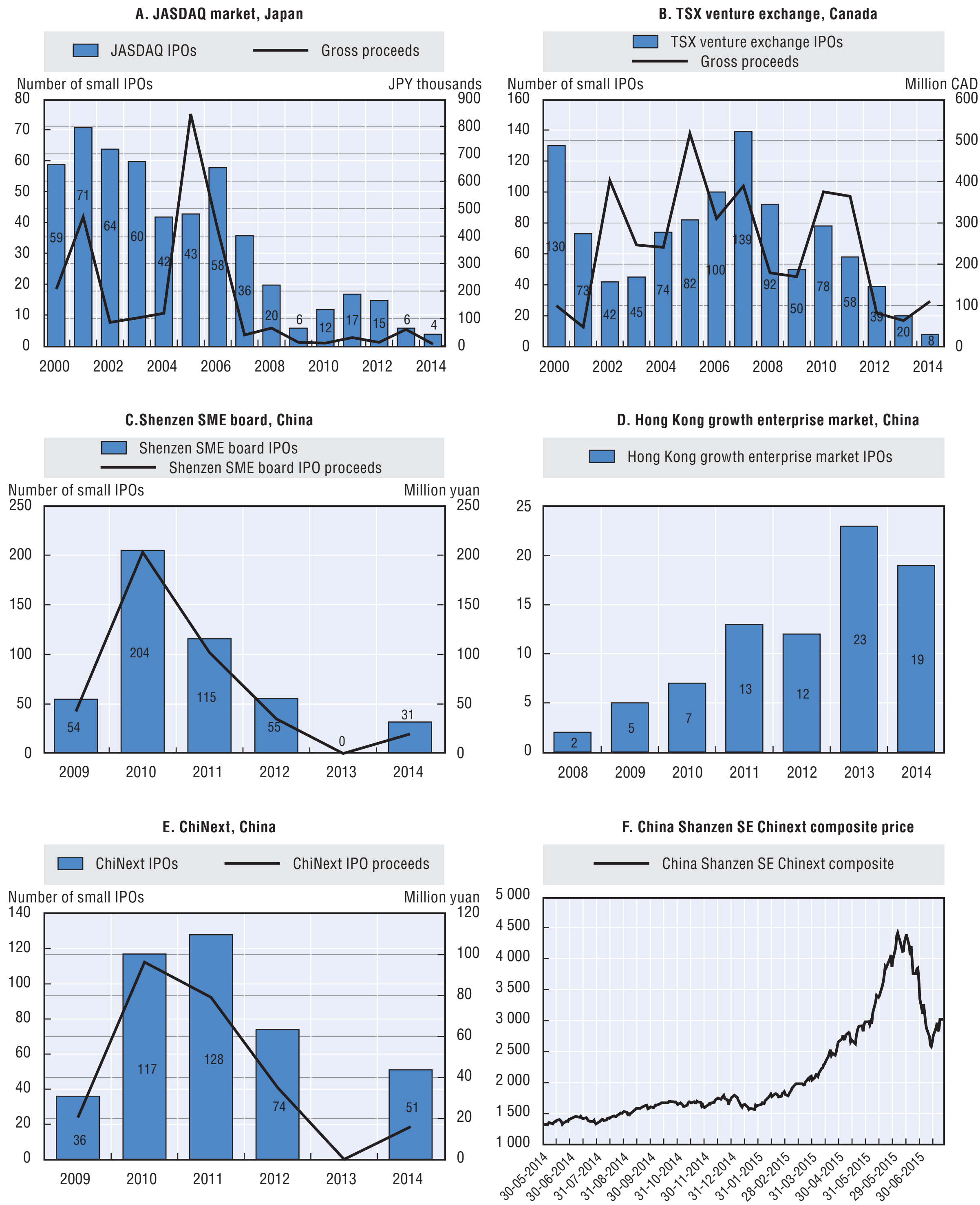
Notes: The Entry Standard for shares is a market segment regulated by the stock exchange with lighter prerequisites for inclusion and follow-up obligations that make it more suitable as an entry-level segment especially for young and medium-sized growth companies.
Source: Deutsche Börse (2015).

B. Benefits of SME public equity markets in an interconnected funding landscape

Market participants see the benefits of public equity offerings for SMEs, and these are thought to extend beyond initial access to capital (IPO) to longer-term repeat access to financing (secondary/follow-on raisings). Besides access to capital, SMEs publicly issuing equity enjoy a number of other benefits related to increased creditworthiness, transparency, visibility and credibility by association with a dedicated ecosystem and an advisor community. Public accountability, increased transparency and reporting implicitly or explicitly required by the markets encourage better management practices, governance and performance monitoring. The investor base of a company is extended (retail investors, sophisticated long-term institutionals) and at the same time risk tends to be distributed more efficiently. SME owners can realise their capital gains while enhancing the capital structure of their company and manage their cost of capital.

Figure 5. **Small IPOs in selected growth platforms**

In number of small IPOs (l.h.s.) and gross proceeds in domestic currency (r.h.s.)



Source: Factset, OECD calculations.

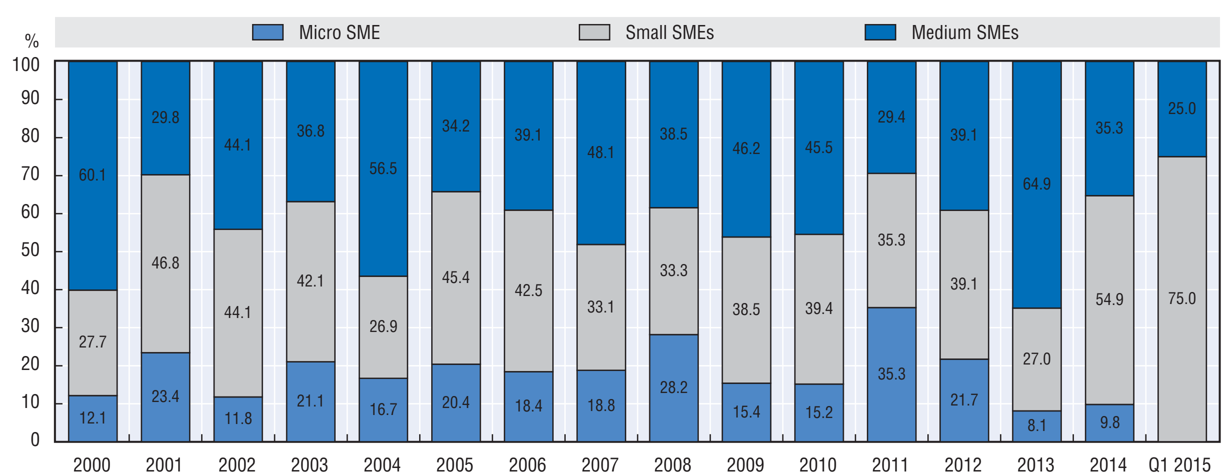
Nonetheless, SME equity markets could be considered to be most beneficial to the upper end of the SME size spectrum, at least at present time (for Europe see Figure 6). The SME universe is a fragmented territory covering a very wide range of business realities, not all of which can benefit from capital market financing. Companies of a sufficient size and adequate level of development find it easier to access the capital markets, with bank intermediation still recognised as essential for coping with information asymmetries inherent in smaller seekers of finance. Heavy reliance on pure financial market financing may prove problematic for SMEs given the size and characteristics of their individual needs at each stage of their development.

A number of inherent characteristics of SMEs may put a ceiling on their ability to draw bank financing from their "house banks". Examples of such characteristics are irregular or limited revenue streams (to respond to debt servicing requirements), limited bankable assets or the intangible nature of available collateral or unwillingness to secure debt with their own wealth. Highly levered capital structures might on the other hand make additional debt finance for expansion unsuitable for small, high-risk high-growth firms. Peer-to-peer lending and similar alternative loan providers can largely help fill the gap to bank debt finance, but cannot be considered as the most appropriate sources of risk capital for SMEs.

While public equity issuance can address the inability of some SMEs to access bank financing, equity financing should be seen as complementary to, rather than a substitute for, banking lending. Equity financing should go "hand in hand" with debt financing and the existence of both well-functioning equity and debt markets are required for efficient and effective SME financing. Various restrictions imposed on non-bank lenders in the SMEs (and broader) lending space[9] might drive investors such as hedge funds to equity investing. At the same time, a large number of hedge funds investing in SME equities have already been active in the wider SME debt space as their point of entry, gaining traction and experience with the asset class. Inversely, public listing of SME equity

Figure 6. **Split of European SME IPO sample by number of employees**

In percentage of total SME IPO sample



Notes: Based on the analysis of a sample of 1 102 IPOs identified to have been performed by European SMEs, as defined by their number of employees according to the EU definition.[1]

1. Employee criterion defined as follows: < 10 employees corresponding to a Micro SME, < 50 to a Small and < 250 to a Medium-sized SME.

Source: Factset, OECD calculations.

through primary and secondary offerings can increase the availability of, and improve conditions for, subsequent debt financing as a result of the equity on their balance sheet.

Strong links and interconnections exist between public equity markets for SMEs and the Private Equity (PE)/Venture Capital (VC) financing and the different forms of SME financing are not necessarily exclusive. Public equity offerings by small growth companies have traditionally been one of the most important exit avenues for PE and VC. But with the evolution of the risk capital model away from a leverage-based financial engineering one, observers see most of the value creation (around 80%) coming from heavier involvement in project realisation, active ownership, transformation of governance structure, expertise in the management of the business and people involved.[10] This can be reportedly evidenced by the lower insolvency rate of smaller growth companies backed by VC during the crisis. The strategic support and ongoing interaction of small companies with their VC-backers improves at the same time their suitability for a public equity offering (transparency, governance, reporting). At present, venture capitalists tend to remain involved in backed companies as anchor investors even after a company's IPO, using the public equity markets for further rounds of capital raising rather than a complete exit.

On the supply side, institutional investors like pension funds and insurance companies could constitute a great potential source of risk capital that may, however, need more regulatory support for its full deployment. Financial market regulation imposed in the wake of the recent financial crisis is thought by market participants to have unintended consequences on the flow of capital from large pools of patient capital to small units in the real economy via intermediate agents (fund and asset managers). A well-balanced regulatory and institutional framework could provide incentives for institutional investors to make their capital pools available for fast-growing SMEs and mature innovative SMEs that need capital to grow and explore new markets, while maintaining financial stability.

Some of the largest global asset management firms are providers of equity capital to VC-backed growth companies on their way to going public and upon their listing (when a listing is envisaged in a medium-term horizon, e.g. within 3 years). Such funding opportunities are sourced and brought to global asset managers by VCs that have gone through one or two rounds of seed capital investment in these companies. VCs can therefore further link fast-growing companies with other private sector actors, such as asset management companies, before their listing on a public exchange. While direct lending to SMEs may not be a profitable economic proposition for large private fund managers given the relatively high costs involved in getting a small deal done, profitable opportunities do exist in SME equity financing. Opportunities for a shift up in value that can be multiples of the investment are typically found in fast-growing but cash-burning SMEs in heavily innovative-intensive sectors such as pharmaceuticals and the broader technology sector.

Although there is space for aggregation funds and other listed investment vehicles to invest in SME equities, their viability is questionable on grounds of insufficient liquidity. Such vehicles have in the past traded at a significant discount to their net asset value, according to observers. For such structures to be fairly valued, investors require a method allowing them to realise their investment. With no cash coming out of the structure in the form of dividends and with dried up liquidity there is no way for holders to realise their investment but to sell. As a result, the bid/ask spread of the listed vehicle can rise significantly and is subsequently treated as a permanent capital vehicle rather than a listed instrument which can be traded and monetised on demand, limiting the willingness of investors to buy in.

The emergence of crowdfunding is the most recent link in this interconnected funding landscape for SME equities. Views differ over the position of debt crowdfunding and other peer-to-peer (P2P) lending, as such platforms could potentially indirectly compete with traditional banks (particularly in the US) providing financing for innovative projects and nimble players in a quick and efficient way, in projects where speed is of the essence. On the other hand, projects funded by P2P platforms and crowdfunding have been – in most instances – turned down by professional credit assessors as not debt suitable and are being passed on by the banks to retail investors with more appetite for high-risk high-return propositions. Regarding equity crowdfunding[11] in particular, risks seem to be underpriced and leave especially retail investors unprotected against, or uncompensated for, high default rates (of around 18% on some accounts). It should be noted, however, that it is still early days for both P2P lending and crowdfunding to assess their full potential, and their evolution should continue to be monitored. Be that as it may, like venture capitalists, equity crowdfunding investors will also seek an exit for their investment and therefore require well-functioning and liquid equity markets to be used as exit routes for the growth companies they back.

C. What hinders the development of SME public equity markets

The share of SME financing provided through capital markets is currently very small, despite the fact that a number of organised exchanges and platforms could present an attractive and abundant long-term alternative financing source offering numerous benefits to all participants involved. **A number of important impediments to the wider use of public equities for SMEs,** for issuers and investors alike, hamper the promotion of equity markets for small issuers. Overcoming such impediments may be a more important effort in Japan and Europe where equity issuance overall is smaller in terms of GDP than in the United States where equity markets play are more prominent role (Figure 7[12]).

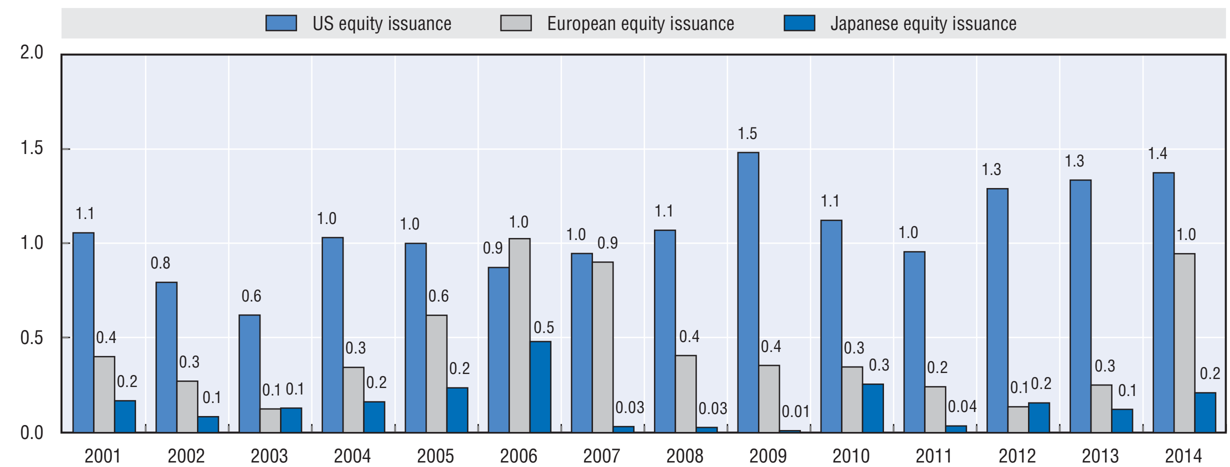
Difficulties facing SMEs seeking public equity financing are not limited to the respective cost burden (admission fees, advisors and broker commissions), although this is arguably the largest impediment SMEs face on their way to a public offering. Red tape and heavy reporting requirements are considered as an indirect form of cost related to going public. Fear of being exposed to share price volatility but also aversion to sharing sensitive information is particularly important to innovative business models (for the United Kingdom, see Figure 8). Lack of education around the process of listing and life after an IPO leads to loss of confidence to go through the offering process and partially explains the reluctance of SMEs to join equity capital markets.

Besides being reluctant to tap the capital markets, SMEs have substantial structural disadvantages that arise from limitations inherent to their nature. Such limitations are found in terms of intrinsic risk assessment due to the lack of transparent and standardised information,[13] financial sophistication and reporting capabilities, communication and visibility.

Such inherent characteristics of SMEs explain the relatively small absolute number of companies that are suitable for accessing capital markets. This might explain the focus

Figure 7. **Equity issuance in Europe, Japan and US, 2000-14**

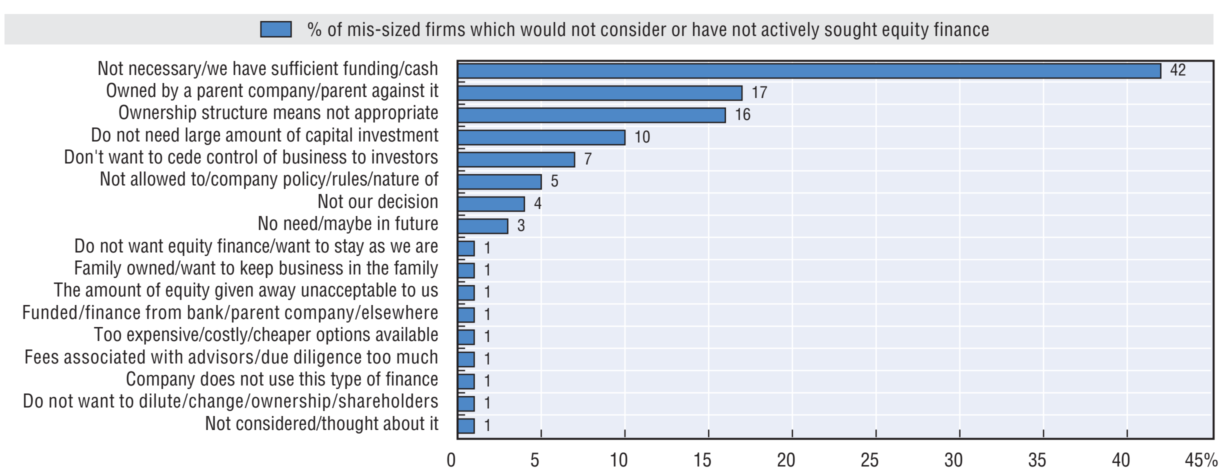
In per cent of nominal GDP



Notes: Based on annual exchange rates and on GDP in current prices. Excluding REITs and SPACs. For Japan, primary issuance only.
Source: Factset, Thomson Reuters Datastream, OECD.

Figure 8. **Reasons not seeking equity finance in the United Kingdom**

% of respondents



Source: British Business Bank (2014).

on bank lending and other forms of debt financing in the policy discussions around access to finance for SMEs.

Fast growth seems to be the common characteristic of those SMEs that are deemed suitable for tapping the equity capital markets: The majority of the 1 700 companies admitted to growth markets across Europe are noted to be the highest growth businesses in the area. For example, 1 100 small companies are quoted on (AIM) market, with the median market capitalisation value being GBP 25 million and the average close to GBP 17 million. All of these companies tend to be at the higher risk end of the spectrum, thus equity finance is often the right form of finance for them.

An alternative firm "labelling" according to the cash flow generation of a firm instead of its riskiness has been proposed by some market participants,: *cash-flow-positive* vs. *cash-flow-negative* companies, instead of low-risk or high-risk ones. Such cash-flow-positive companies are most likely to prefer the terms of debt financing, finding equity financing at times too expensive, while on the contrary, equity financing is typically the right type of financing for cash-flow-negative ones. Despite their global nature, the primary amount of SME equity investing has been in the US, assisted by the better organised ecosystem existing in the Silicon Valley.

The limited development of successful growth company exchanges and platforms is also explained by the unwillingness of entrepreneurs to relinquish any share of ownership or control of their business (as is the case with VC investments) or accept potential lock-in periods upon listing. The ownership structure of many family-owned and -run SMEs or ownership by a parent-company render equity a less sought for financing form.

D. Re-defining SMEs: The financial perspective

There is no single definition of an SME. SMEs are generally considered to be non-subsidiary firms which employ less than a given number of employees (500 in the US, 250 in the EU, etc.; OECD, 2006). The number of employees is not necessarily the sole defining criterion in the various jurisdictions: for example, financial assets are used to define SMEs in the EU together with the number of employees, with the turnover limit for SME firms set at EUR 50 million and/or total assets at EUR 43 million maximum.[14] **Such SME definitions are designed to orient policy makers** in the design and implementation of targeted SME policies.

In practice, financial institutions do not in general follow the preferred definition of national authorities when categorising their SME lending. Each bank sets a ceiling (EUR 1 million or EUR 25 million for instance) as the cut-off point for their SME business, making it extremely challenging to identify SME financing gaps. A gap in the credit process is reported by market participants to exist in the range of EUR 2-10 million required financing, amounts too small for public offering or PE funding but too large to fall into that small category for which the bank is willing to take the risk of small loan amounts. The origination of small SME loans is extremely demanding in terms of infrastructure, fixed-cost nature of sourcing, local presence and relationship building while the risk is high, with default rates in some cases reaching 40-60% of the portfolio for start-ups, according to observers' estimates. As discussed elsewhere (Nassr and Wehinger, 2015), especially for such small loans, securitisation may offer a viable solution to the SME financing problems, by creating headroom in banks' balance sheets and allowing them to originate and monitor more small heterogeneous and mostly local credit..

The high-growth, innovation-based characteristics of small companies most suited for equity market financing are not covered by the standard SME definitions. Instead, a plethora of definitions of companies eligible for admission in growth markets exists. In Europe, an average market capitalisation of less than EUR 200 million on the basis of end-year quotes for the previous three calendar years is used as the basis of the Market in Financial Instruments Amended Directive (known as MiFID II; EC, 2014a). Wider use of such a definition would present the downside of excluding young firms with a lifespan of less than 3 years, as the definition reflects a specific purpose which is to ensure market access for more seasoned SMEs. At the same time, young SMEs would not be accounted for in the calculation of the 50% SME issuers threshold for the characterisation of the platform as an SME Growth Market (see Box 1). The European Securities and Markets Authority (ESMA) has proposed a more flexible definition to the Commission, allowing young firms with market

Box 1. Defining SME growth markets under MiFID II

The ongoing process of MiFID II, expected to come into force on January 2017, provides for a new category of specialist markets catering specifically for the needs of SME issuers. It envisages the establishment of a regime for the registration of multilateral trading facilities (MTFs) offering facilities to SMEs as "SME growth markets" (SME-GMs), should they meet certain criteria specified by MiFID. The establishment of this new category of market aims to raise their visibility and profile while developing common regulatory standards for such markets across the EU.

In order for a MTF to be registered as a SME-GM, at least 50% of the issuers whose financial instruments are admitted to trading on the MTF have to be SMEs at the time of registration of the MTF as an SME growth market and in any calendar year thereafter. For the purposes of MiFID Directive, SMEs are companies that had an average **market capitalisation of less than EUR 200 million** on the basis of end-year quotes for the previous 3 calendar years.

The European Securities and Markets Authority (ESMA) proposes a more flexible way for assessing the 50% threshold while allowing and promoting access of *young* issuers to SME-GM. In its technical advice on MiFID around the eligibility criteria of SME-GM, ESMA considers that as an expression of the flexible way of implementing the 50% criterion, SMEs with a history of less than 3 years should also be counted as SMEs if their market capitalisation upon commencement of trading or based on the end-year quote after the first year of trading or the average of the end-year quotes after the first two years of trading is below EUR 200 million. In addition, the 50% threshold of issuers whose financial instruments are admitted to trading and which can be classified as SMEs should be assessed on the basis of the number of issuers only, disregarding other factors such as firm size, turnover etc. Safeguards against deregistration of SME-GMs are introduced, and an SME-GM shall only be deregistered as such if it falls below the qualifying 50% threshold for a number of 3 consecutive years. Entirely new markets applying to become an SME-GM can qualify if there is an expectation that at least 50% of the prospective issuers will be SMEs.

Source: EC (2014a), ESMA (2014).

capitalisation of less than EUR 200 m even upon commencement of trading to be counted as SMEs (ESMA, 2014). The Prospectus directive, in its 2010 amendment, uses the standard EU definition for SMEs and proposes a new category of companies with "reduced market capitalisation" for listed companies on regulated markets that have an average market capitalisation of less than EUR 100 million on the basis of end-year quotes for the previous three calendar years (EC, 2010).

In the **United States**, the Securities and Exchange Commission (SEC) proposed a different approach by defining companies under USD 75 million of public equity float as ***Smaller Reporting Companies***, allowing for scaled and streamlined disclosure (SEC, 1998).[15] The Jumpstart Our Business Startups Act (JOBS Act) which became effective in 2012 introduced a new category of issuer under the Securities Act and the Exchange Act defined as an ***emerging growth company (EGC)*** (see Box 2). For a company to be qualified as emerging growth, its total annual gross revenue should not exceed the cap of USD 1 billion in the last fiscal year, allowing a significant part of new companies willing to go public to take advantage of such status.

Box 2. **Emerging growth companies under the Jumpstart Our Business Startups Act**

The Jumpstart Our Business Startups Act (JOBS Act) aimed to ease access to the public capital markets for *Emerging Growth Companies* (EGCs) in order to stimulate entrepreneurship and job creation and addresses, *inter alia,* the crisis of the US IPO market (Figures 9 and 10).

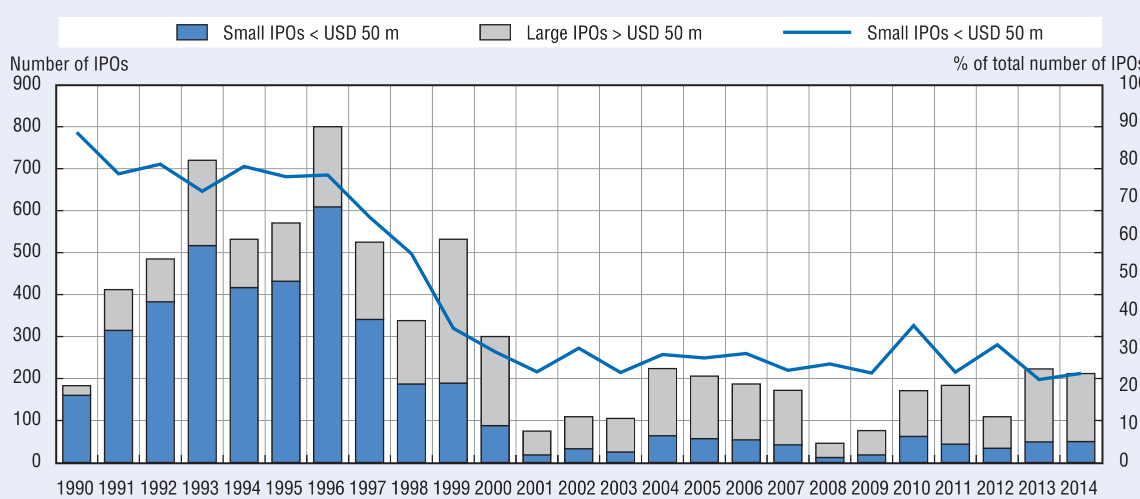
For an issuing company to be defined as an EGC, its total annual gross revenues should not exceed USD 1 billion for its previous fiscal year. An EGC remains qualified for 5 years following its first sale of common equity securities, until its revenues surpass USD 1 billion, it issues USD 1 billion of non-convertible debt securities over a rolling 36 month period, or it becomes a large accelerated filer (seasoned issuer with public float of USD 700 million or more). Issuers that had their first common equity securities offering under an effective registration statement on or prior to 8 December 2011 cannot qualify as EGCs. Foreign private issuers are eligible, representing 10% and 15% of total issuers in the first and second year, respectively, after the Act's enactment.

EGCs are provided with regulatory relief during the IPO "on-ramp" period (up to 5 years), facilitating their transition from a private to a public company:

- **Testing the waters** with qualified institutional buyers (QIBs) before or after filling a registration, EGCs benefit from prospective investors' feedback while maintaining confidentiality and flexibility around the timing of the IPO.
- **Confidential SEC registration review** allowing the company not to publicly disclose sensitive information prior to publicly filing.* Combined with the investor market sounding exercise, ECGs benefit from invaluable insights from the market and flexibility around the timing and market conditions, allowing them to decide whether and when an offering is realistic and/or optimal. Almost 90% of ECGs submitted confidentially on the second year of the JOBS Act.
- **Scaled financial disclosure** with two (instead of three) years of audited financial statements required, together with two (instead of five) years of selected financial data.
- **Internal controls audit exemption** reducing the costs and distractions of the management team from the IPO process, **streamlined disclosure of executive compensation, extended phase-in for new accounting standards** and **lifted restrictions on general solicitation (purchasers must be accredited investors) and post-IPO research**.

Figure 9. **Small IPOs by US companies, 1990-2014**

In number of IPOs (l.h.s.) and % of small IPOs in total (r.h.s.)



Notes: Excluding offerings by investment trusts.
Source: Thomson Reuters, OECD.

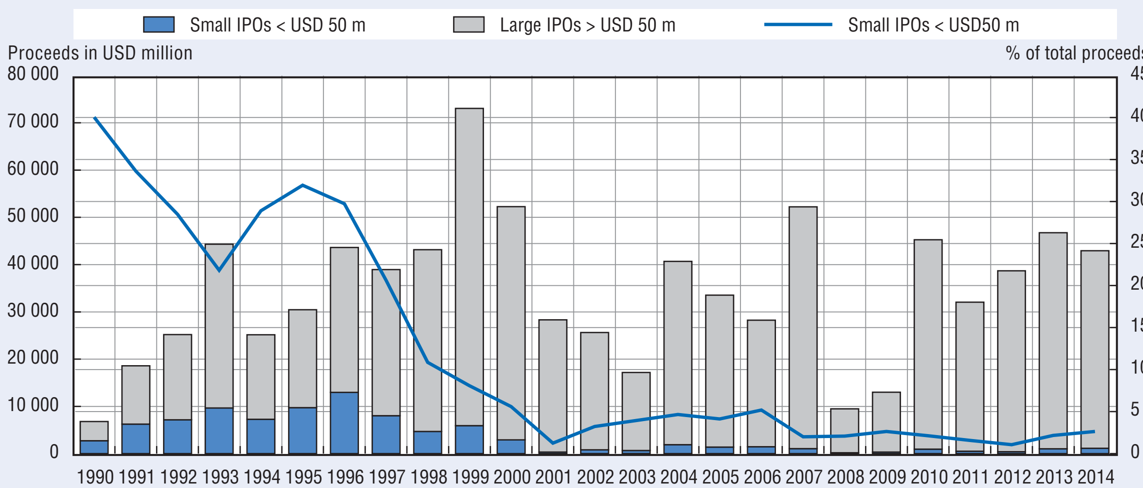
Box 2. **Emerging growth companies under the Jumpstart Our Business Startups Act** *(cont.)*

Most EGCs made use of the SEC confidential review process (almost 90% in the second year after implementation of the Act) and the scaled financial disclosure (65% of EGCs for the same period). On the other hand, companies seem to opt out of the extended phasing-in for the new accounting standards, or solicitation-related or research possibilities available to them.

All in all, the JOBS Act has helped to spur the IPO market, with more than 75% and 85% of total IPOs in US markets performed by EGCs benefiting from the relief of the Act in the first and second year of implementation of the Act, respectively (Latham and Watkins, 2014).

Figure 10. **Small IPOs by US companies by proceeds, 1990-2014**

In USD million (l.h.s.) and in % of total proceeds (r.h.s.)



Notes: Excluding offerings by investment trusts.
Source: Thomson Reuters, OECD.

* Initial confidential submission and all following amendments must be filed publicly at least 21 days before the roadshow.
Source: US Congress (2012).

Under Regulation A, non-publicly traded small companies were granted an exemption to SEC's registration rules for offerings of maximum USD 5 million [Section 3(b) of the Securities Act), allowing them to raise public equity through an abbreviated, "mini-registration" process (reduced disclosure, "test the waters" ability, etc.). Public solicitation of both accredited and non-accredited investors was also allowed. Despite its various benefits, Regulation A has not been widely used, due to requirement by the issuers to comply with state "blue sky" laws (regulating the purchase and selling of securities) in each of the states where the offering was to be conducted, but also due to the relative offering costs compared to the absolute amount being raised.

Title IV of the JOBS Act expanded the exemption from SEC registration rules for "mini public offerings", raising the threshold to offerings of securities over USD 5 million and up to USD 50 million within a 12 month period (known as **Regulation A+**).[16] Regulation A+ provides for two Tiers of offerings, Tier 1 for up to USD 20 million and Tier 2 of up to USD 50 million in a 12-month period. In order to protect investors, investor protection provisions were also expanded: issuers are subject to initial and ongoing disclosure obligations, although these are less onerous than those required of most publicly listed companies. The purpose of Regulation A+ was to align in some ways Regulation A+ offering statement disclosures with smaller reporting companies conducting registered offerings, with a view to reduce regulatory compliance requirements and subsequent costs (SEC, 2013). Indeed, Tier 2 offerings (up to USD 50 million) are exempt from state securities law regulation, known as "state blue sky security laws", although such offerings are required to provide audited financial statements. Similar to EGCs, issuers under Regulation A+ can "test the waters" with investors, soliciting interest in from the general public to participate in their capital raising, both before and after the filing of the respective offering statement.

The flexibility provided by Registration A+ can be especially appealing to institutional investors. Securities issued under such ruling are not restricted and shall be publicly offered and freely tradable in the secondary market.

Small equity offerings enabled by such regulation can act as a precursor to an IPO. Such mini public offerings clearly respond to the need of mature private companies of small size, willing to raise capital through equity offering but unable to take on the cost of a full listing. The experience of preparing for such an issuance and complying with the (even lighter) requirements can educate the managers and smooth the path to a potential full equity listing at a later stage.

E. Small company IPOs and proportionality as a means to spur public equity funding

Rather than trying to harmonise the SME definition across the range of financing instruments, the replacement of the "SME" by a "small IPO" or "small cap" designation for the purposes of public equity markets appears to be the most appropriate way forward. Such a definition would embrace small and medium-size firms of different age and size.

To that end, the qualification of a small company IPO could be based on the size of the offering and potentially the relative weighting of the company's market capitalisation instead of absolute company size criteria, similar to the spirit of the US regulations. Previous proposals for a Small Business Act for European SME issuers, for instance, suggested an offering size criterion of EUR 75 million coupled with a market capitalisation ceiling of 35% of the average market capitalisation on the specific listing venue (Demarigny, 2010).

A proportionate approach with regard to listing rules, regulation and supervision could encourage public equity issuance for small companies. Any attempt to lower the requirements for small company equity issuances in terms of transparency, corporate governance or disclosure could diminish investor protection and by consequence market appetite for such instruments. The application of proportionate requirements for smaller issuers would translate into different, not necessarily lower, requirements, and in some cases these would even have to be higher for small caps as compared to large caps.

The listing prospectus is a good example showcasing the merits of proportionality. Corporate governance requirements concerning audit and remuneration committees are tailored for blue chip companies with dispersed shareholding and are not relevant for most small issuers where the owner can be the inventor of the product, the manager and a major shareholder. Given the riskiness of such small innovative companies, information disclosure about the specific risks of the company (dependence on a client, a product, innovative product related information, market integrity areas etc.) should be further enhanced as compared to blue chip companies. But alleviating requirements may be an obvious solution in some cases. For example, disclosure of historical information cannot be equally feasible for long-established companies as for the youngest, fastest growing SMEs that wish to list. Rethinking the requirements according to the age of the company and the size of the offering can result in information that is not only more proportionate but also more informative to the investor, strengthening the level of protection granted to prospective investors. **High standards of information disclosure throughout the life of an equity offering/listing should be preserved for all issuers in order to attract and retain investors.**

Proportionality in listing rules and requirements allows for more affordable transaction and regulatory costs for small equity issuers. The costs associated with the listing process and with the ongoing requirements once public are mentioned as one of the main reasons for the inability of small issuers to tap those markets. The prospectus requirements at the Alternative Investment Market (AIM) of the London Stock Exchange (LSE) is a good example of such practices: although AIM admission documents are modelled on the prospectus directive – thus the disclosure requirements are broadly similar for large and small issuers – vetting by an external regulator is not required. Such vetting involves an additional cost for the issuer that is not necessarily meaningful for a small company that is better understood by its advisors more than by any other external party. Besides cost saving, such a vetting waiver expedites the process by six to eight weeks and gives an important flexibility to the issuer with regard to market timing. This is particularly important in volatile markets when having an admission document that is tied up with the regulator can often deprive the issuer of the advantage of choosing the perfect market timing, entailing further costs.

The JOBS Act increased the threshold for registration of a class of securities with the SEC if the securities are held of record by 2 000 people or more, from 500 people previously, provided that no more than 499 of those 2 000 holders of record do qualify as "accredited investors" under SEC rules. This provision effectively allows small issuers **a wider retail participation in their shareholding,** dissociating a wider shareholder base from the perhaps costly reporting obligations applicable to larger public companies and promoting retail investment in small equity offerings. Given that this new ruling excludes from these calculations holders having obtained equity under the issuer's equity compensation plans, high-growth companies can **maintain effective equity compensation strategies for hiring** and expansion without worrying that such schemes might trigger registration requirements.

The corresponding thresholds in Europe for exemption from Prospectus requirements (the parallel to SEC registration) are as low as 150 natural or legal persons participating in an offer of securities, other than qualified investors.[17] Offerings of securities with a total consideration of less than EUR 5 million are also exempt from Prospectus requirements, as well as offerings solely addressed to qualified investors. Such disproportionately lower thresholds compared to the US are considered by market participants as an impediment to the wider use of equity markets by SMEs in Europe, forcing small issuers to perform tightly controlled institutional offerings and ending up with very tight shareholder registries. Companies that have already publicly traded equity are offered a prospectus exemption for secondary issuances of a class of securities that is already admitted to trading on a regulated market up to a limit of 10% p.a. Information on companies that are already publicly traded is available in the public domain and the production of a prospectus for a follow-on/secondary offering is therefore viewed by market participants as an unnecessary cost that neither investors nor issuers benefit from.

In such cases prospectuses tend to be "boilerplated" including a lot of information that is regarded as unnecessary or useless in the interest of time and cost, resulting in hundreds of pages of detailed information that is deemed complex to wade through by investors and heavily costly by issuers.

The European Commission has recently launched a consultation process on the Prospectus Directive with a view to making it easier for SMEs to raise capital throughout the EU while ensuring effective investor protection (EC, 2015a). The consultation considers, *inter alia*, the recalibration of all the abovementioned thresholds for exemption from the prospectus requirement, while also simplifying the information included in prospectuses, and streamlining the approval process. This is intended to facilitate the widest possible access to the capital markets by companies across the EU, with a particular focus on small companies. The consultation was launched together with the Capital Markets Union project,[18] and the final rulings are expected to reflect market developments around SME growth markets pursued in the context of the CMU.

The right balance between administrative cost or regulatory burden and transparency of information needs to be struck such that any proportionality or flexibility provided to SMEs does not result in weak investor protection or compromised integrity of market participants, weak corporate governance or insufficient transparency while the administrative burden is somehow alleviated on small issuers and small offers.

F. Liquidity and lack thereof

Low levels of liquidity, somehow inherent in the SME asset class, act as one of the most important deterrents to investment in public SME equities. Liquidity risk is reported by investors as one of the biggest challenges when it comes to small public equities. SME equity markets are reported to typically have about 30% of the liquidity of main markets (Oliver Wyman, 2014). According to market participants' illustration of the situation, 95% of the liquidity of a small equity market is concentrated in 5% of the companies, which are the equivalent of the main market's blue chips.

The relative low volume of shares traded on growth markets compared to main markets is often attributed to the small sizes and limited free float that small caps regularly offer. Entrepreneurs and owners tend to retain important stakes in the company while management compensation schemes in innovative high-growth companies often involve distribution of shares. Buy-and-hold strategies of institutional investors can also limit day-to-day trading. Minority shareholder rights and investor protection mechanisms seem to also drive depth of equity markets overall, irrespective of size of the offering.

Liquidity remains the precondition for an exit from an investment and exchanges can facilitate such exits, assisted by the broader ecosystem existing around the exchange. Listing in itself does not provide a true exit strategy for investors who want to disinvest. With insufficient market liquidity it might take years for an investor to completed sell off their holdings in a company (unless it is under conditions of a fire sale). When liquidity is constrained, investors cannot get the stocks required to fulfil their portfolio requirements in a timely fashion, deterring their participation in such markets. The small size of issue offerings are, by definition, not supporting deeper markets and present another obstacle to larger institutional investors who look for larger trades. In the absence of liquidity, price discovery is distorted altogether and investors are diverted to more accessible alternatives such as investing in blue chip shares instead.

While promotion of SME listed shares to retail investors might be a way to enhance market liquidity, appropriate safeguards would need to be put in place for their protection. Although active retail investor participation could provide much sought-for liquidity for small listed shares, risks of inappropriate sales practice and abuses may occur, highlighting the need for safeguards particularly given potential damage to confidence in markets. The right balance needs to be achieved between maintaining retail participation alongside wholesale and institutional investors in the SME equity space and appropriate investor protection mechanisms for retail investors.

In Europe, tight thresholds for prospectus requirements exemption might be damaging already constrained liquidity in the small public equity markets. As previously mentioned, issuing a prospectus can be a costly and administratively burdensome process for small companies. Smaller issuing companies are therefore indirectly incentivised to restrict their offering to a very limited number of non-qualified investors in order to be exempt from the requirement of a prospectus (current threshold set at 150 natural or legal non-professional investors). With such limited offerings, most small companies start out their life as public companies with very tight shareholder registries, which has a damaging effect on liquidity.

Similarly, denominations for transactions tend to be too large for retail investors in Europe. The minimum entry ticket for offers to be eligible for exemption from the European prospectus directive (currently set at EUR 100 000) does not render the offering easily accessible to retail investors. This effectively raises the cost and requirements of a transaction targeting retail investors and limits the spectrum of investors for small issuers that try to avoid such costs. This has a dampening effect on liquidity for small equities.

Retail participation in SME equities through collective investment vehicles of small investors might be a safer and more appropriate way for retail investors to access the SME market space. A companion product to European *Undertakings for Collective Investment in Transferable Securities (UCITs)*, allowing for illiquid instruments (whether fixed income or equities) would be an example of such investment fund. Indeed, the European *Long-Term Investment Fund (ELTIF)*, a new type of collective investment framework introduced in early 2015, allows investors to invest into companies and projects that need long-term capital. Besides infrastructure, ELTIFs can also invest in certain listed SMEs, real assets that need long-term capital to develop them, intellectual property and other intangible assets, as well as European Venture Capital Funds (EuVECA), and European Social Entrepreneurship Funds (EuSEF) (EC, 2015c).

Wealth management/private banking could be considered as an additional source of liquidity, adding to the breadth and variety of the investor base for small equity markets. Wealth management investor pools consist of several investors that tend to be well-positioned to pick winners and identify genuine growth potential and attractive investment opportunities in equities, especially in the sectors where they might have earned part of their wealth. Bridging the SME book and the wealth management book of a bank could facilitate transformative investments for growth. Unintended consequences of regulation (e.g. ring-fencing in the UK) in place raise barriers to the connection of the two books of such platforms.

Furthermore, **passive investment strategies**, such as indexing, could be examined as a new way to attract long-term institutional investors to SME listed equities, particularly given information asymmetries and high transaction costs relative to the size of the investment.

Public policy, including tax measures, can be effective in stimulating liquidity in small equities, not only by inducing participation of institutional investors, but also retail investors specifically, in growth markets. In the UK, the abolition of the stamp duty on trades of AIM shares resulted in a 40% increase in average daily value of trading in the three months following the implementation of the policy. Furthermore, eligibility of AIM shares for ISA inclusion in August 2013 had a direct result of over GBP 4.5 bn directed into those products. Similarly, in France, the creation of a PEA-PME savings account[19] incentivises and promotes active participation of the retail base in SME quoted shares. Such promotion of investor participation in growth markets also demonstrates that the liquidity of public growth equity markets can be enhanced through public intervention, despite SME equities being relatively less liquid almost by nature. But while the inclusion of small equities in tax-efficient individual savings accounts can stimulate retail participation and deepen markets for such shares. The benefits of such widening of participation must be balanced against the high level of riskiness of investment in SME public equity. Such concerns may raise financial consumer protection issues and call for enhancing financial education especially for small investors.

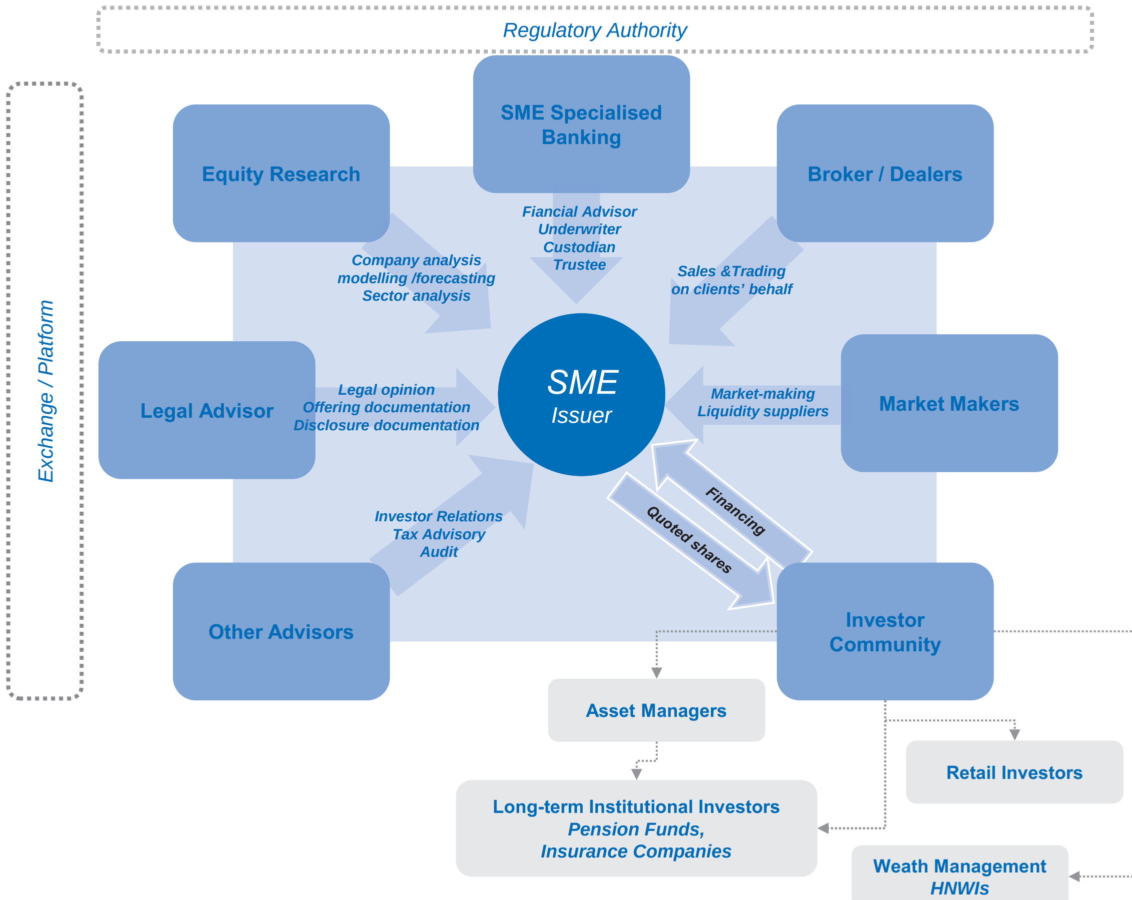
The promotion of long-term investment schemes in SME equities could be facilitated by adjustments in regulation which is deemed by the market to have unintended negative consequences on the availability of equity for SMEs, particularly in Europe (Basel III, Solvency II). Supply side institutional investors willing to invest in small equities are faced with capital requirements deemed restrictive, if not prohibitive. Risk weightings under Solvency II are often being mentioned as an example of such regulation, with insurance companies investing in government bonds with 0% risk weighting vs. 39% risk weighting for an equity investment. This is a reason why such investors may not invest, or invest very little, in equities as they would have to set aside 40% of the capital to make such equity investment. Nevertheless, financial stability concerns are relevant especially for this asset class, and any deliberate promotion of SME equities or other non-bank lending instruments for SMEs should not come at the expense of reduced overall financial stability.

G. The need for a dedicated ecosystem

Public equity markets for small companies need to be supported by a healthy ecosystem dedicated to sustain capacity to take SMEs public and support them in secondary markets. Such ecosystems consist of investment banks, SME-specialised banks, research analysts, sales, brokers, market makers, and other third party advisors focused on SMEs (Figure 11). Legal and financial advisors, accountants and other professionals providing ancillary services specifically targeted to SMEs can benefit issuing companies, investors and the overall market by enhancing transparency and confidence. Such ecosystems could be developed at the local level, in case the small local growth market model is chosen, or at a more centralised level, in case the model of proportionate participation of SMEs in some main exchanges is favoured.

The absence of an ecosystem that can cater to SMEs' specific needs can be an impediment to the functioning and deepening of equity markets and reduce these companies' willingness to list altogether. Currently the ecosystem for SMEs is not wide-ranging enough, to a large extent due to the lack of profitability, i.e. an economic rationale

Figure 11. **A valuable ecosystem for SME equity offerings**



Source: OECD Secretariat.

of SME-related services by brokers and advisors in general. A larger number of participants in such an ecosystem would create a greater capacity to take SMEs public and support them in the aftermarket.[20] Consequently, more IPOs could get executed when the "IPO window" is open, which in turn would create a willingness on the part of investors to invest in small quoted companies and lead other private companies or VC/PE investors to consider the IPO as a viable exit strategy.

Market-makers in particular act as catalysts to the provision of liquidity in secondary equity markets, but are potentially challenged by regulatory reforms. The existence of committed market-makers providing buy and sell quotes at any given time is critical to professional investors' participation in small equity markets. Without liquidity, professional investors tend to shift their assets away from SMEs into larger capitalisation stocks.

Lower trading spreads and tick sizes (minimum price variation) intended to bring down transaction costs may, according to one study, be partly responsible for the decline in US equity offerings (Weild et al., 2013).[21] In particular, tick sizes as a percent of share prices for companies with a market value of below USD 500 million probably need to exceed 1% of share price to fuel investment. A one-cent tick size for all shares reduce the economic incentives of intermediaries who facilitate small company IPOs and new capital formation, while also supporting their aftermarket activity. Higher tick sizes could incentivise market-making especially for smaller shares, which in turn would improve liquidity. According to the study, the possibility of allowing small companies to choose their tick size could potentially boost investment in SME equities by driving liquidity, while higher commissions to market stocks to retail investors could incentivise broker/dealers. Interestingly, the study also suggests that GDP growth only predicts 10% of small IPO activity while economic incentives explain 70%. The impact of tick sizes on the supply of IPOs illustrates the pitfalls of one-size-fits-all regulation for every stock irrespective of size, liquidity and other characteristics.

The declining provision of equity research on small and mid-sized companies (but also across the board) reduces their visibility and attractiveness among professional investors. Equity research plays a key role in equity markets, assisting investors in making informed investment choices, providing absolute and relevant evaluation of the attractiveness of an individual stock or a whole industry or market, and of the expected operating performance of the underlying company. Equity research is of particular importance in the case of small high-growth companies where information is scarce and harder to assess. It is argued by market participants that equity research assists capital formation by potentially lowering the cost of capital for growth companies, as they balance short-term losses and risks with long-term company valuation estimates in their evaluation exercises. Good equity research coverage improves public awareness of listed companies and of the capital markets overall and promotes them to institutional and other investors.

Equity research coverage of small and mid-sized equities is constrained because of cost considerations, inherent characteristics of small companies and regulatory changes in some markets. The relative size of small company IPOs and secondary trades renders equity research provision for small companies economically challenging, if not unviable. The "transparency barrier" resulting from the reluctance to share sensitive information by even the most successful and best managed SMEs in order to protect their strategic position is another impediment to their research coverage (Altenburg, 2013). Limited coverage of small floated companies by equity research analysts inhibits the wider participation of institutional investors, restraining liquidity. A large part of professional investors would reportedly not engage in a trade on either primary or secondary markets without relevant research being available. Lack of equity research for small quoted companies **adds to the information deficit around SMEs, a prominent structural impediment to their access to finance across financial instruments and markets.**

Recent regulation in Europe (MIFID II), proposing the restructuring of the compensation model for research, is seen by the industry as a potential risk for the provision of equity research on SMEs. Under the proposals, dealing commission will no longer be able to pay for sell-side investment research with a view to completely unbundling the way dealing commission may be used to pay for the provision of research. In practical terms, dealing commissions that are attributed to equity research will need to be identified separately and no portion of the dealing commission will be allocated to research provision. The buy-side would have to determine which research they wish to purchase and for how much. While this is intended to avoid conflicts of interest, investors have expressed concerns about the impact this fundamental change will have on the availability of equity research in Europe, in particular for the smaller end of the floated company spectrum.

Pure for-profit stock exchange models could sometimes cause perverse incentives to the detriment of the respective ecosystem. For example, the replacement of quote-driven markets, supported by market-makers, by electronic order books could be more profitable for the exchange itself but could at the same time deprive the marketplace of some of the most liquid stocks that feed the ecosystem. At the same time, profits are potentially siphoned off the ecosystem and market-makers would then be left with only the most thinly traded stocks of the market.

The proliferation of electronic markets and recently expanding market practices, such as high-frequency trading (HFT), have a profound negative effect on small equities. The shift from quote-based markets to electronic order book markets has had a major impact on US IPO activity, since they resulted in a collapse of dealer incentives by as much as 87.5% (Weild et al., 2013). Despite the potential of HFT and other low-cost trading techniques to add value to the efficiency of price discovery in larger and more liquid markets, in SME markets they may curb the economic incentives necessary for the ecosystem of the market to create value and sustain market activity. Given the idiosyncrasies and usually short trading history of SME equities, there may also be a threshold below which HFT techniques cannot be meaningfully applied and where liquidity has to be generated by traditional trading.

Policy makers have a role in facilitating the infrastructure element of the ecosystem around SME public equity markets and support its network of participants. Appropriate economic and other incentives could be allowed to enable a fully functional ecosystem that can support SME listings. Stock exchanges can also provide such incentives, as with the example of the mandatory requirement for an assigned market maker and lower trading fees for market makers in return for minimum requirements in order to build deeper markets (e.g. the NewConnect market at the Warsaw Stock Exchange[22]).

The existence of healthy and active ecosystems can also be useful as a springboard for the development of other, non-traditional SME equity instruments that could rely on that same ecosystem. Such instruments could include equity private placements, equity crowdfunding, listed funds (with potential co-funding and risk sharing between the private and public sector), and corporate venturing. A lack of vibrant SME IPO markets and aftermarkets could ultimately create negative feedback loops that risk stunting the development and growth of such instruments and other innovations.

H. Addressing issues of possible fiscal bias against equity

Some asymmetries in the tax treatment of equity and debt can, in some tax systems, **create biases against equity,** favouring debt**.** Both debt and equity finance have an important role to play in the sustainable financing of the real economy. The fact that there is no equivalent of the tax deductibility of interest payments for equity investments across jurisdictions is thought by market participants to be a clear disadvantage for equity investment.

A potential reduction of some asymmetric treatment of tax for debt and equity, for the demand as well as the supply side, could potentially support the development of equity markets. On the demand side, entrepreneurs are likely to include tax considerations in their choice of financing instruments. Different instruments are needed depending on the different stages of the life and characteristics of an SME. If the tax system somehow distorts the choice in favour of debt this may potentially lead to suboptimal outcomes. Such potential distortions are typically introduced through tax deductibility of interest payments, but also through double taxation of equity in some jurisdictions.

On the supply side, **tax considerations play an important role in institutional and retail investors' portfolio allocation** (provided that they choose among investments of equal risk-return characteristics). Investment-driven tax reliefs, perhaps by providing tax incentives, could induce long-term investment into SMEs. Tax relief is indeed the most commonly cited incentive by market participants, and examples of such practices have proven to accelerate the development of respective equity markets for SMEs. In the United Kingdom, a number of tax-advantaged venture capital schemes and tax reliefs incentivise individual investors in the UK to invest in small growing businesses which would otherwise struggle to access finance (British Business Bank, 2015). These are the Enterprise Investment Scheme, Seed Enterprise Investment Scheme, Venture Capital Trusts, relief for losses on investment, but also the abolition of stamp duty on purchases of shares made on equity growth markets and eligibility of SME equity shares in ISA accounts, as mentioned above. The abovementioned French PEA-PME savings accounts also provide tax incentives for retail investors.

Nevertheless, tax incentives cannot overcome the structural cost disadvantage of small-sized deals (whether they are debt or equity), might introduce distortions with unintended consequences (e.g. underpricing of risk) and create vested interests by providing benefits that go directly to the beneficiaries' profits. It is doubtful whether tax reliefs and other across the board regulatory reliefs are sustainable and efficient to resolve structural SME problems. "Smarter" deal-oriented solutions could more effectively address the structural cost disadvantage of small-sized deals, as with the example of the EIF's European Angels Fund co-investment scheme.[23] Wealth investors and investors with SME expertise and successful SME entrepreneurs can apply for core EIF funding. Their qualification in terms of expertise is examined based on prior equity investments and the resulting group of investors has the ability to judge their peers and undertake successful equity investments. More than a public equity co-investment vehicle, the scheme could be described as a form of peer-to-peer investing and could be an effective way to overcome the structural cost disadvantage of smaller companies.

I. A lack of equity culture and the SME educational gap

The lack of equity culture and awareness has a significant negative impact on both the demand and the supply side of SME equity markets, limits their depth and breadth and restricts participation by SMEs and investors alike.

On the demand side, SMEs are often restricted by an educational gap; unawareness of public equity financing or the lack of appropriate financial education and skills does not allow them to access equity financing. Financial education and skills are necessary for SMEs to be aware of their financing options through capital market instruments, be able to assess the appropriateness of risk finance for their business model, access their options and respond to listing and market requirements. Such a skillset consists of financial reporting, business planning, forecasting and budgeting, investor relations capabilities, tax planning and other. Educational and awareness limitations reinforce the reluctance of some SMEs to raise public equity financing for fear of losing control of the business or discouraged by previous rejections on other financing instruments.

On the supply side, the lack of equity culture in parts of the world is an important obstacle to the provision of a sustainable flow of investment into equities (Schuller, 2014). Indicatively, the percentage of German-speaking investors directly or indirectly exposed to the public equity markets stands at 13.8% and 6.7% respectively, while almost 50% of their US counterparts are invested in public equities. Besides the stigmatisation of the equity markets following the bursts of the dot-com and subprime crisis bubbles, educational attainment of individual investors is also responsible for such startling differences.

Financial education of both SMEs and (mostly retail) investors is clearly the best, but not the only way, to induce participation in quoted SMEs. The affinity to an equity home bias could also be used to intrinsically motivate investors to participate in public equities (Schuller, 2013). An investor is more likely to identify with a local business and such home bias could act as an entry point for changing the equity culture in parts of the world lagging behind. The ability and willingness of retail investors to place savings or allocate part of their pension funds in capital markets can be promoted through the use of mutual funds, exchange-traded funds, and retail brokerages specialised in small public equities. Robust consumer financial education would need to accompany the sale of such products, explaining the risks of such instruments and the benefits of diversified savings portfolios.

There is a role for governments and regulators to promote awareness around public SME equities and make equity a prominent part of the SME finance discussion. The debate on access to finance tends to concentrate on the importance of loans and guarantees, with the equity markets being often an afterthought. Even if public equity markets are perhaps not suitable for all types of SMEs or for all types of investors, as was argued above, the promotion of public SME equity markets in public opinion can help foster innovation and job creation. Companies need to be educated so as to construct demand by SMEs for risk finance,[24] particularly in an environment of below-trend bank lending. Investors need to be motivated and incentivised to seek exposure in SME equity instruments. For pension fund investments, for example, default pension plan solutions could include appropriate shares of SME equity in the equity portfolio part as long as the risk-return profile is beneficial for pension plan members.[25] Governments can induce further participation of SMEs in public equity markets by bridging the educational gap of small companies when it comes to capital market financing, raising their awareness of public financing options available and appropriate to them and equipping them with the skills necessary to tap the capital markets.

IV. Concluding remarks and policy implications

The contribution of SMEs to economic growth and job creation depends to a large extent on their ability to grow. Equity markets provide appropriate financing for high-growth, innovative SMEs, where unpredictable cash flows and lack of track record renders bank lending unsuitable, if at all possible. A number of **policy actions that may mitigate constraints facing equity capital market financing for SMEs and enhance its potential** can be distilled from the analysis in this paper. The policy implications raised and actions proposed here are intended to provide some guidance for policy makers when designing actual measures to support public equity financing for SMEs. Governments should have discretion as to the adoption of any these policy actions, taking into account their domestic circumstances and other policy approaches.

Equity markets are better suited for young, fast-growing SMEs, with the proportion of younger companies (under 2 years of age) tapping the equity capital markets being consistently higher than that of older companies (15 years or more). **However, current standard SME definitions are perhaps less appropriate to describe the relevant target group when it comes to public equity markets,** potentially rendering policy making around SME equities less effective.

A **risk finance gap is often and erroneously being attributed to the banking sector** but loan finance is normally not suitable to provide risk capital. However, mezzanine finance could be a way to close the risk capital gap through the use of bank lending, attempting to provide *de facto* equity in *de jure* loan structures.

Trends on the deal flow for small IPOs indicate a drop in small IPO issuance and an upward shift of offering size. A number of specialised growth markets are being developed across the globe, although listing activity has yet to pick up. Given the strong interdependence between the various types of SME financing, **healthy and vibrant IPO markets are important for the functioning of the entire funding spectrum of SMEs.** For example, healthy public equity markets stimulate PE/VC activity by providing fast and profitable exit opportunities or venues for further rounds of capital raising.

Accessibility of public equity markets by SMEs is mainly impeded **by listing and compliance costs** which are disproportionately high for small issuers. **One-size-fits-all regulation and stock market structures** on main markets cannot equally serve large and small stocks. A dearth of investors is partially due to the **lack of equity culture** in certain parts of the world, particularly when it comes to retail investors. SMEs themselves are faced with an **educational gap** that is prominent when it comes to tapping the equity markets. **Institutional and retail investors may be dissuaded by inadequate liquidity**, particularly in specialised growth markets. **The lack of SME-specialised ecosystems** that can support small offerings on their listing and in the aftermarket impede the fostering of SME equities. For example, the existence of well-functioning market-making systems is critical for the participation of professional and institutional investors in these markets, and without liquidity, institutional investors shift assets away from SMEs into larger capitalisation stocks.

Recognising the need for better access of SMEs to equity capital markets, there is **a role for policy makers to catalyse institutional long-term investor participation** in SME quoted markets. A more **supportive tax framework,** which reduces asymmetric treatment of debt and equity, could perhaps be a quick and effective fix for inducing private participation, **although it would not address the fundamental structural disadvantages** of SME deals. High monitoring costs, absence of track record and other information asymmetries which are prominent across the board of SME financing can be addressed though measures and tools that improve transparency that may also involve the public sector.[26] Governments can **bridge the educational gap of SMEs when it comes to financial markets**, raising their awareness of capital market financing options for SMEs and equipping them with the skills required for them to tap the public markets. A co-ordinated approach on regulation can help avoiding distortions in risk pricing and stimulate investor appetite. Besides patient capital, **retail participation can be further encouraged** provided that financial consumers are well informed on the respective risks.

Improved economic incentives for participants in SME equity markets might help to foster healthy ecosystems dedicated to small firms. The cost of going public needs to be reasonable and tailored to the size of the SME. **Proportionate regulatory and listing requirements** are a way to ensure that the cost of public listing is reasonable and appropriate for SMEs. The entire **market infrastructure for growth equity markets needs to be adapted** to the inherent characteristics of SMEs (which is the case with growth markets in Europe under MIFID II). The promotion of equity markets for SMEs should not be done at the expense of financial market stability, which is why regulatory requirements for this segment need to be proportionate and not necessarily lower.

Promotion of equity finance for SMEs does not disengage banks from SME financing, but rather complement bank lending and other financing alternatives. But equity finance should be available as a possibility to be drawn upon in cases where this is more suitable and appropriate from a risk perspective. The role of SME specialised banks or house banks could be broadened so as to facilitate public equity issuance for SMEs by acting as advisors and as educators raising their SME clients' awareness of such tools. It is difficult to build a functioning equity market for SMEs without a functioning debt market, hence the importance of a healthy and vibrant ecosystem overall. In the context of a closely interconnected SME financing environment, **a holistic and coordinated effort by all market constituencies involved (investors, intermediaries, advisors, policy makers and SMEs) is required to support investment in the SME asset class** and allow SMEs to fully benefit from capital market financing when and as appropriate, without posing a risk to financial stability.

Policy makers also need to acknowledge that **SME finance is, like SMEs themselves are, exceptionally diverse and complex, and faces unique challenges.** As such, there is no "magic bullet" for SME finance and it is only by pushing different ideas, avenues and instruments that the different constraints and predicaments can be tackled in developing a healthy non-bank debt market for SMEs. To achieve this, a joint effort may be needed, involving all constituents concerned: investors, issuers, intermediaries, regulators and public policymakers. Governments and regulators can provide valuable support for developing the necessary infrastructure for new financing instruments for SME financing and incentivise investment in securitisation and other non-bank debt instruments suitable for SMEs. Such financing, when used properly, can play a significant role in the recovery of the real economy by unlocking resources and capacity for further lending, broadening the SME investor base and diversifying their portfolios, as well as assisting in the creation of a sounder financial system through better risk sharing within the economy.

Notes

1. Nassr and Wehinger (2014, 2015).
2. OECD (2015b).
3. According to a study by Barclay's (unpublished) and Freeman (2013).
4. The set of global IPOs in this and the following figures comprises of listings on: Abu Dhabi Securities Exchange, Aktie Torget, Alberta Stock Exchange, Alternext Paris, Athens, Australian Securities Exchange, Bahrain (Manama), Bangkok, Barcelona Stock Exchange, BATS Exchange, Belgrade Stock Exchange, Berlin, Berne Stock Ex-change, BM&F Bovespa SA, Bogota, Bolsa Mexicana de Valores, Bombay, Borsa Istanbul, Borsa Ital-iana S.P.A., Budapest, Buenos Aires, Cairo, Canadian Securities Exchange, Casablanca, Colombo, Copenhagen, Cyprus Stock Exchange, Dhaka Stock Exchange Ltd, Dubai Financial Market, Dublin, Euronext Amsterdam, Euronext Brussels/ Lisbon/Paris, Frankfurt, Gretai Securities Market, Hanoi Stock Exchange, Helsinki, Hong Kong (China), Indonesian Stock Exchange, JASDAQ, Johannesburg, Jordan (Amman), Korea Stock Exchange, Kuala Lumpur, London Alternative Market, London Stock Exchange, Malta, Moscow,

NASDAQ, NSE, NYSE, Oslo Bors, Plus Markets (London), Prague, Qatar Exchange, Reykjavik, Riga, Romania (Bucharest), Santiago, Sapporo (JP), Saudi Stock Exchange, Shanghai, Shenzhen, Singapore, SIX Swiss Exchange, Sofia, Taiwan (Chinese Taipei) Stock Exchange, Tel Aviv, Tokyo, Toronto, TSX Venture Exchange, Vietnam Stock Market, Warsaw Stock Exchange, Wellington, Zagreb.

Footnote by Turkey: The information in this document with reference to "Cyprus" relates to the southern part of the Island. There is no single authority representing both Turkish and Greek Cypriot people on the Island. Turkey recognises the Turkish Republic of Northern Cyprus (TRNC). Until a lasting and equitable solution is found within the context of the United Nations, Turkey shall preserve its position concerning the "Cyprus issue".

Footnote by all the European Union Member States of the OECD and the European Union: The Republic of Cyprus is recognised by all members of the United Nations with the exception of Turkey. The information in this document relates to the area under the effective control of the Government of the Republic of Cyprus.

5. For an extensive analysis of seed and early-stage finance see Wilson and Silva (2013), on business angel financing see OECD (2011).
6. This is also being recognised in OECD's work on institutional investors and long-term investment (*www.oecd.org/finance/lti*), a project that also feeds into efforts at G20 level in this area. Besides infrastructure, SME financing is an important component of this work.
7. See Nassr and Wehinger (2014, 2015).
8. These include relatively small size of deals no matter what kind of financing is involved, limited resources, unsophisticated structures and management, absence of financial and other reporting, etc.
9. The US and the UK markets have been noted as exceptions to this phenomenon with active support to non-bank lending to all types of enterprises.
10. High-leverage models for PE/VC investment may anyway be inappropriate for small growth companies due to their lack of predictable high cash flow generation required to support such leverage streams.
11. For more on equity crowdfunding, see OECD (2015c).
12. Note, however, that the numbers shown in the chart are not fully comparable for Japan where they include primary issuance only.
13. Similar to credit assessment limitations found in SME market-based debt and SME securitisation in particular, for more see Nassr and Wehinger (2015).
14. SMEs are defined as companies fulfilling at least 2 out of the 3 abovementioned criteria. Extract of Article 2 of the Annex of Recommendation 2003/361/EC.
15. Companies without calculable public equity float qualify when their revenues are below USD 50 million in the last fiscal year. Foreign companies are also eligible under certain requirements.
16. Adopted by the SEC on 25 March 2015 and become effective on 19 June 2015 (SEC, 2015).
17. Article 4 of Directive 2010/73/EU (EC, 2010). Admission of securities to trading in multilateral trading facilities (MTFs) is not currently subject to a prospectus requirement.
18. See *http://ec.europa.eu/finance/capital-markets-union/index_en.htm* and the consultation document EC (2015b).
19. PEA-PME: *Plan d'Épargne en Actions destiné au financement des PME et ETI*.
20. Conglomerates (such as Berkshire Hathaway) or large multinationals may provide a natural ecosystem for SMEs in the broader context of equity (including private equity) although this is not applicable to all SMEs.
21. This study led by David Weild, former vice chairman of the Nasdaq Stock Market, reviewed Weild and co-author Edward Kim's involvement in events leading up to the JOBS Act in the United States, providing their views on IPO markets throughout the world, and was sponsored by Grant Thornton LLP.
22. See *www.newconnect.pl/index.php?page=1125*.
23. *www.eif.org/what_we_do/equity/eaf/index.htm*.

24. The ELITE platform by the London Stock Exchange Group (e.g. at Borsa Italiana) is an interesting example of an educational programme that can both enhance financial capabilities and also induce cultural change for participating SMEs, by building relationships with the wider ecosystem and fostering organisational changes that allow the company to benefit from a potential equity listing further down the line. The Deutsche Börse Venture Network launched on 11 June 2015 is another interesting example of a programme designed to connect growth companies with professional investors.
25. This could, for example, be further developed on the basis of the OECD roadmap for the good design of defined contribution pension plans; see *www.oecd.org/daf/fin/private-pensions/designingfundedpensionplans.htm*.
26. Similar conclusions as the ones in this paragraph apply with regard to market-based debt finance and were put forward in Nassr and Wehinger (2015).

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