



## **WFE Report on SME Exchanges**

**(with input from the the World Bank Group's Finance and Markets Global Practice)**

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## **Executive Summary**

World Federation of Exchange's (WFE) members, across emerging and developed markets, continue to seek ways to enhance small and medium enterprise's (SME) access to finance. Set against a backdrop of growing global concerns about the impact of the financing constraint on SMEs' ability to contribute to economic growth and development, this report showcases four case studies of WFE member exchanges with dedicated SME offerings. While it is not possible to identify a single 'one-size-fits-all' model of SME market the report highlights relevant factors such as tailored listing and disclosure requirements and methods for enhancing secondary market liquidity. The paper also suggests that issues beyond market design (such as ongoing outreach and education of SMEs) are critical success factors. Finally, the report concludes that exchange offerings – while important – are only part of the overall ecosystem that must be in place to support SME development.

## **Overview/Introduction**

Small and medium sized enterprises (SMEs) are recognized as being important contributors to economic growth and development. The focus on SMEs has intensified post the 2008 global financial crisis, not only in emerging markets economies, but equally in the developed markets of Europe and the United States (U.S.). Given slow growth and recovery in the aftermath of the crisis, policy makers and politicians increasingly emphasise the role of SMEs as engines of growth and employment. At the launch of the World SME Forum in Istanbul in May 2015 (under the auspices of the current Turkish presidency of the G20), Turkey's Deputy Prime Minister Ali Babacan declared: "The SME sector is vital to the world economy, and small business is the powerhouse of employment, innovation and entrepreneurial spirit."

Thus, the development of a vibrant SME sector is considered necessary to restore global growth. It is generally accepted however that a lack of access to finance is a central impediment to the growth of SMEs and that one of the consequences of the global financial crisis (both direct and indirect) is a curtailment of bank financing – still the primary source of funding for SMEs around the world. Much of the recent research and policy attention has therefore focused on finding ways to both improve access to bank financing and on enhancing access to alternative sources of financing such as capital market financing.

Stock exchanges play an important role in the financing ecosystem though markets in different jurisdictions have had variable levels of success in developing a viable market for SME funding. The World Bank Group (WBG) Policy Research Working Paper 7160 "SME Exchanges in Emerging Market Economies: a Stocktaking of Development Practices" focused on the development of SME markets in emerging economies specifically. The paper noted that while SME exchanges may be valuable to have and many countries (both emerging market economies – EMEs - and developed countries) have attempted to develop them, few have succeeded. That paper therefore sought to assist stock exchanges and policy makers think through some of the key questions to be addressed to determine if, when, how and for whom to develop an SME Exchange in emerging market countries.

This paper seeks to build upon the work of that report by:

- Reviewing some of the more recent findings and recommendations specifically as they relate SME access to equity capital;
- Presenting World Federation of Exchanges data relating to SME Exchanges beyond just emerging markets, and providing a snapshot of the state of SME markets as at end 2014;
- Drawing on the experience of an additional 4 exchanges/market offerings: the Shenzhen Stock Exchange ChiNext market (ChiNext); the Bombay Stock Exchange SME market (BSE SME); the Korea Exchange (KOSDAQ); and the EnterNext offering of Euronext; and
- Identifying recommendations/focus areas for jurisdictions looking to introduce SME exchanges and possible additional areas of research.

## Literature review:

### The United States: US IPO Task Force:

In October 2011 the IPO Task Force in the United States presented its final report to the US Department of Treasury<sup>1</sup>. The Task Force was established in March of that year after a Treasury conference looking at how to address issues of access to capital, including through public markets. The members of the Task Force included representatives from the venture capital community, academics, institutional investors, CEOs, investment bankers and security lawyers. The focus of the taskforce was twofold:

- to identify why so-called emerging growth companies were not accessing public markets; and
- to develop recommendations to address this.

The stated purpose of the recommendations was to (re-)enable SME access to capital markets, thereby generating jobs and growth. Or, to use the language of the authors, to address: “(the) precipitous decline of the US IPO market – driven by a paucity of emerging growth companies going public – (*which*) has stifled job creation, undermined US economic strength and imperilled America’s global technology leadership.”

The authors note the overall decline in the US IPO market over the last decade with a specific decline in smaller IPOs. They point out that companies are also waiting longer before going public. One of the underpinning “real economy” concerns of this development that they highlight is the historical link in the US between IPOs and job creation, with (according to their analysis) 92% of job creation happening post-IPO.

Based on their analysis of the sources of the problem in the US, the Task Force proposed four high-level recommendations, namely:

- Providing an “on-ramp” for emerging growth companies whereby qualified companies would be given up to five years from the date of their IPOs to scale up to full regulatory compliance.
- Improving the availability and flow of information about smaller cap companies by increasing the availability of company information and research.
- Lowering the capital gains tax rate for investors who purchase shares in an IPO and hold these shares for a minimum of two years.
- Educating issuers to enable them to maximize the benefits of the capital markets.

The proposals regarding an IPO on-ramp were encapsulated in the Jumpstart Our Business Startups (JOBS) Act of 2012. The Act defines an emerging growth company as an issuer with total annual gross revenues of less than US\$1 billion in their last fiscal year before IPO and

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<sup>1</sup> ‘Rebuilding the IPO On-Ramp’ (20 Oct 2011). Issued by the IPO Task Force. Available at: [https://www.sec.gov/info/smallbus/acsec/rebuilding\\_the\\_ipo\\_on-ramp.pdf](https://www.sec.gov/info/smallbus/acsec/rebuilding_the_ipo_on-ramp.pdf)

companies that met the definition would be exempted from certain disclosure, auditing, accounting and other requirements that would otherwise apply.

### The European Union: EU IPO Task Force and Capital Markets Union

While the EU, similar to the US, has also seen a decline in IPO activity over the past decade, businesses in the EU have historically been more reliant on bank financing (as opposed to market financing), than their counterparts in the US.<sup>2</sup> The EU's Capital Markets Union (CMU) initiative, with its explicit focus "jobs and growth" identifies the need to bolster capital markets in the EU to provide alternative sources of financing for (amongst others) SMEs. This focus on enhancing the availability of financing for SMEs demonstrates that policy-makers in the EU, similar to policy-makers elsewhere, regard SMEs as important sources of economic growth and job creation.

The final report of the European IPO Task Force<sup>3</sup>, prepared as an input to the CMU process, stressed the importance of well-functioning IPO markets for economic growth and development. In their assessment of the operating environment and the challenges facing particularly smaller companies looking to access capital markets, the Task Force noted similar concerns to their US counterparts. They categorized these as supply side, demand-side and ecosystem challenges.

- Supply side challenges: The authors argue that a range of regulatory initiatives in the EU and the recent financial crisis have combined to make it more challenging and costly for companies (particularly smaller companies) to come to market. They reference the recent Kay Review on Equity Markets<sup>4</sup> (which focused specifically on UK equity markets) citing with approval the conclusion that "the cost of equity capital to companies was today high by historical standards and in absolute terms". They also mention the distrust that some companies seem to have in regard to public markets more generally as well as the ongoing direct and indirect costs associated with being public.
- Demand side challenges: As regards investors, the Task Force borrow from largely US-focused research to suggest that the recent financial crisis has likely had a negative impact on investors' perceptions of markets and specifically their trust in markets. They also point out that regulatory provisions aimed at institutional investors have the effect of increasing the cost of holding equity relative to debt and certain types of equity relative to others. This would have the effect of dampening investor interest in particularly SME investments.
- Ecosystem challenges: Again, similarly to the US, the authors note that markets have increasingly skewed towards the larger, more liquid counters with a concomitant impact

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<sup>2</sup> European IPO Task Force, (March, 2015). "Rebuilding IPOs in Europe - Creating jobs and growth in European capital markets"

<sup>3</sup> Comprised of representatives from EuropeanIssuers, the European Private Equity & Venture Capital Association and the Federation of European Securities Exchanges

<sup>4</sup> J. Kay (2012). The Kay Review of UK Equity Markets and Long-Term Decision Making. Final Report. Available at:

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf)

on the broader ecosystem of banks, brokers and auditors – all of whom are necessary to support an IPO and ongoing listing, regardless of company size. One of the consequences (amongst many) is a decline in available research about smaller cap companies on listed markets.

Based on the afore-going diagnosis, the authors recommend the following:

- Creation of a more flexible regulatory environment for SMEs including lower barriers to entry (similar to the on-ramping proposal in the US).
- Relaxation of constraints on investors' ability to access IPO markets and smaller cap companies.
- Improving the ecosystem to better serve companies at different stages of growth and different types of investors.
- Creation of an equity culture through education of investors and companies and ensuring greater availability of capital markets data and research.
- Refocus of tax incentives to remove preference for equity over debt and encourage long-term investment particularly in growth companies.

The CMU Action Plan (released end September 2015) incorporates elements of the Task Force proposal with a commitment to the “modernization of the Prospectus Directive” (which should serve to reduce the cost of capital raising) while the SME Growth Markets concept encapsulated in MIFID II makes provision for multilateral trading facility (MTF) tailored for SME markets.

### **SME Growth Markets in the EU**

The concept of multilateral trade facility as distinct from a regulated market was first introduced under MIFID in 2007. (Please note that the previous World Bank paper referred to Alternative Trading Platforms (ATPs), which are the same as MTFs). London's AIM market – regarded by many as the gold standard of SME markets – is structured as an MTF, rather than a regulated market, as is Euronext's Alternext market. The MTF structure allows the market operator (within certain parameters) to set the listings requirements and monitor compliance.

The proposed SME Growth Market would be a subset of the MTF category. In order to qualify as an SME Growth Market, at least 50% of the issuers whose financial instruments are traded on an SME growth market should be SMEs. For purposes of the regulation, SMEs are defined as companies that had an average market capitalisation of less than €200m as determined. European regulators will specify certain criteria with which the SME Growth Market must comply but otherwise it is for the market operator to determine the detail. For example, the market operator must specify minimum free float and / or minimum value of capital raised so as to ensure sufficiently liquidity. Similarly, where the Prospectus Directive does not apply, the market operator must ensure that the issuer provides an admission document containing sufficient information to enable investors to make an informed assessment of the financial position and prospects of the issuer, and the rights attaching to its securities.

In addition, some EU countries, such as the UK, have already introduced some form of tax exemption for listed SMEs.<sup>5</sup>

### Other research and jurisdictions

The US and Europe are not alone in their focus on equity markets as a potential source of funding for SMEs. A January 2014 Asian Development Bank paper concluded: “SME development is ... critical for promoting inclusive economic growth in Asia”.<sup>6</sup> The author notes that SMEs in Asia have historically relied on bank financing and that with the exception of venues in Korea and China, stock exchanges have not been a viable source of financing for SMEs. Some of the conclusions of the report are that financial (market) literacy/education are critical for SMEs generally, and that simplicity and cost are key considerations. The report also suggests that it is worth exploring the desirability of tax breaks for investors and issuers and that creating investor demand is a critical part of any solution.

Finally, a recent OECD report on SME financing<sup>7</sup>, highlights similar concerns and recommendations to those brought out in the US and EU studies. The authors stress the importance of finding the right balance between reduced regulatory requirements and investor protection but note that in addition to cost issues, there may also be cultural impediments to seeking financing via public markets. These include an unwillingness to give up ownership in the business or to subject oneself to the vagaries of market valuations. On the investor side they acknowledge concerns re secondary market liquidity in SME markets and stress that liquidity, sales and research support may be required. Finally, the report stresses the importance of broader ecosystem-focused initiatives (whether government or market-driven) that promote the listed markets and prepare companies for listing.

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<sup>5</sup> From April 2014, Stamp Duty and the Stamp Duty Reserve Tax (SDRT) are no longer chargeable on transactions in eligible securities on London Stock Exchange’s AIM and High Growth Segment.

<sup>6</sup> Shinozaki, S. - ‘Capital Market Financing for SMEs: A Growing Need in Emerging Asia’. ADB Working Paper Series on Regional Economic Integration. Available at:

<http://www.adb.org/sites/default/files/publication/31179/reiwp-121.pdf>

<sup>7</sup> OECD, (2015). “New approaches to SME and entrepreneurship financing: broadening the range of instruments” Available at: <http://www.oecd.org/cfe/smes/New-Approaches-SME-full-report.pdf>



### **The Current State of SME Exchanges: WFE Member Exchanges - An Overview**

As noted previously, building an SME exchange is difficult to do successfully, even in advanced economies and particularly in EMEs where companies overall – let alone the SMEs - are significantly smaller in size. Nonetheless, as can be seen from the table below, a number of exchanges, in both emerging and developed markets, currently have dedicated SME markets within the exchange group. The table below shows predominantly World Federation of Exchanges (WFE)<sup>8</sup> member exchanges, but also includes the LSE Group's AIM market and the Warsaw Stock Exchange, as these markets are often held up as benchmark SME markets.<sup>9</sup>

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<sup>8</sup> The World Federation of Exchanges is an industry body representing 64 regulated exchanges across the world with a further 35 affiliate exchange members and clearinghouses.

<sup>9</sup> Other exchanges that have SME markets (but that are not shown in the table below as they are not WFE members and their data is thus not as readily accessible) include the Nairobi Securities Exchange (with its GEMS market), and the Jamaica Stock Exchange (the Junior Market).

**Table 1: Overview of SME markets<sup>10</sup>**

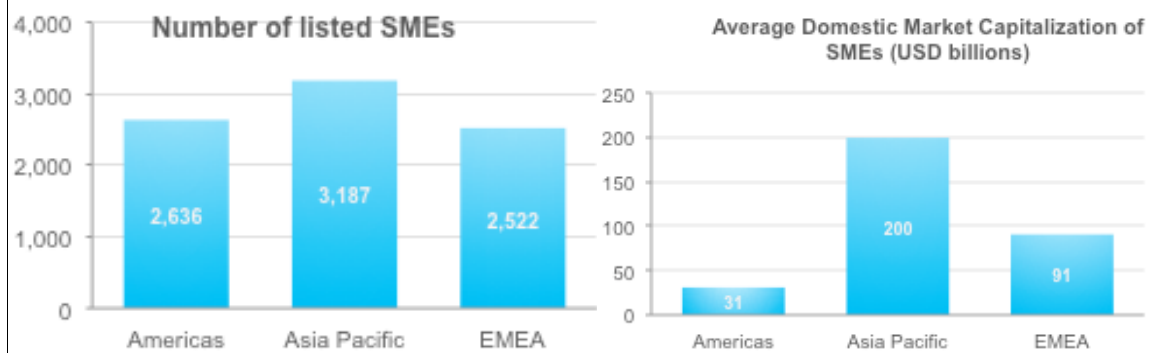
<i>Exchange Name</i>	<i>Name of SME Market</i>	<i>Listed cos</i>	<i>Market cap (USD millions)</i>	<i>Avg market cap (USD millions)</i>	<i>Market cap as % of total</i>
BM&FBOVESPA	<i>Bovespa Mais</i>	8	532	66.52	0.06%
Bolsa de Comercio de Buenos Aires	<i>Pyme Board</i>	3	43	14.21	0.07%
Intercontinental Exchange Group (NYSE)	<i>Intercontinental Exchange, Inc. / NYSE MKT</i>	278	57,923	208.35	0.30%
TMX Group	<i>TSX Venture</i>	2,347	23,251	9.91	1.12%
BSE India Limited	<i>Small &amp; Medium Enterprises</i>	82	1,437	17.52	0.09%
Bursa Malaysia	<i>ACE Market</i>	107	2,764	25.83	0.61%
Hong Kong Exchanges and Clearing	<i>Growth Enterprise Market</i>	179	23,135	129.25	0.72%
Japan Exchange Group	<i>JASDAQ</i>	844	78,742	93.30	0.63%
Japan Exchange Group - Osaka	<i>Mothers</i>	208	27,396	131.71	-
Korea Exchange	<i>Kosdaq</i>	1,061	130,180	122.70	12.03%
National Stock Exchange India	<i>Emerge</i>	6	68	11.33	0.00%
NZX Limited	<i>NZAX</i>	24	659	27.46	0.89%
Philippine Stock Exchange	<i>SME Board</i>	4	771	192.65	0.30%
Shenzhen Stock Exchange	<i>ChiNext</i>	406	352,055	867.13	20.46%
Singapore Exchange	<i>SGX Catalist</i>	155	8,143	52.54	1.09%
Stock Exchange of Thailand	<i>Market for Alternative Investment (mai)</i>	111	10,972	98.85	2.62%
Taipei Exchange	<i>Taipei Exchange</i>	685	84,822	123.83	-
Athens Stock Exchange	<i>Alternative Market (EN.A)</i>	14	172	12.28	0.31%
BME Spanish Exchanges	<i>MAB Expansion</i>	26	2,178	83.77	0.22%
Borsa Istanbul	<i>Second National Market</i>	94	10,253	109.07	4.89%
Cyprus Stock Exchange	<i>Emerging Companies Market</i>	20	807	40.33	25.01%
Deutsche Boerse	<i>Entry Standard</i>	168	18,752	111.62	1.09%
Egyptian Exchange	<i>NILEX</i>	33	152	4.60	0.22%
Euronext	<i>Alternext</i>	191	10,293	53.89	0.31%
Irish Stock Exchange	<i>Enterprise Securities Market</i>	26	56,732	2,181.99	65.41%
Johannesburg Stock Exchange	<i>Alternative Exchange</i>	58	1,780	30.69	0.19%
London SE Group	<i>AIM</i>	1,104	111,406	100.91	2.86%
Luxembourg Stock Exchange	<i>Euro MTF</i>	50	803	16.07	1.29%
Moscow Exchange	<i>Innovations and Investments Market</i>	21	1,395	66.43	0.36%
NASDAQ OMX Nordic Exchange	<i>First North</i>	174	6,078	34.93	0.51%
Nigerian Stock Exchange	<i>Nigerian Stock Exchange</i>	11	47	4.26	8.98%
Oslo Bors	<i>Oslo Axess</i>	35	1,646	47.04	0.76%
Stock Exchange of Mauritius	<i>Development &amp; Enterprise Market</i>	36	1,510	41.95	20.86%
Warsaw Stock Exchange	<i>New Connect</i>	431	2,572	5.97	1.55%
Wiener Borse	<i>Second Regulated Market and Third Market (MTF)</i>	30	2,512	83.75	2.66%

Table 1: WFE member and other exchanges and SME markets – data as at end 2014

These markets vary greatly in terms of number of listed companies and market capitalization as well as the rules and regulations governing the market and the nature of the support that the exchange provides to the market. Worth noting is the large range in size of these markets – including variation in number of listed companies and average market capitalization. The latter particularly ranges from a few million dollars to over a billion. To some extent this is attributable to differences in how an SME is defined in various jurisdictions, particularly with regard to size. SMEs in EMEs are generally smaller than those in advanced countries and not all alternative markets necessarily have the same objectives. It also highlights the fact that most exchanges do not prevent a company from listing on a dedicated SME market even if they meet the main board listings requirements, nor in most instances do they compel or (or even allow) ‘graduation’ to the main board. Thus, in some jurisdictions, companies of significant size are listed on the SME Exchange.

<sup>10</sup> Note: the Taipei Exchange was part of the initial World Bank report under its previous name of GreTai Securities Market.

**Box 1: Companies listed on dedicated SME/Alternative markets**



Source: WFE data, end 2014

SMEs are also not necessarily found only on dedicated SME boards. Using the WFE’s market segmentation data<sup>11</sup>, it seems that the number of listed SMEs is potentially higher than the SME market data would suggest. While there were approximately 7,000 SMEs listed on dedicated WFE-member SME exchanges as at end 2014, there are an additional roughly 6,000 companies with a market capitalization of less than US\$65m listed on the main boards of these same exchanges. Obviously US\$65m is a fairly high threshold, particularly in emerging economies, and further analysis of the data is required before meaningful conclusions can be drawn, but this does raise the question as to whether or not a separate market with distinct rules is a necessary consideration in enabling SME market access.

**Box 2: Listed companies according to market segmentation**

The graph below shows the breakdown by market capitalization of all companies listed on WFE member (and other) exchanges profiled above (i.e. for their SME markets). Classifying companies



according to the WFE’s market segmentation methodology reveals that nearly half of all listed companies fall into the micro-cap category i.e. having a market capitalization of less than US\$65m.

Additional research and analysis (including introducing greater granularity in the micro-cap category) is required to draw meaningful conclusions. However, it is interesting to note that in some emerging market jurisdictions, where one would expect the bulk of listed companies to fall into the micro-cap category, they either have no listed micro-cap companies or the spread is more concentrated in the other categories.

<sup>11</sup> The WFE market segmentation classification is as follows: large market cap segment comprises companies with a market cap > USD 1.3bn; mid-market cap segment comprises companies between USD 1.3bn > market cap > USD 200m; the small market cap segment comprises companies of between USD 200m > market cap > USD 65m; the micro market cap segment consists of companies with a market cap < USD 65m

## Building an SME Exchange

When exchanges think about creating an offering for SME issuers, there are a range of factors that they consider, from the structuring of the market, to the ecosystem of products and services that are provided, to the role of the intermediaries relative to the exchange. This section builds on the roundtable discussion that informed the World Bank paper referred to earlier in this document. That paper did not prescribe particular approaches but rather highlighted commonalities in approach by the surveyed exchanges. The conclusions of that paper (restated below for ease of reference) were that SME markets:

- Focus on SMEs that have a fairly sizable growth rate, as they will have capital demands and be most willing to use an exchange to obtain it.
- Are legally related to a main board, often to receive some form of subsidy; few are stand-alone entities.
- Do not reduce disclosure *content* to reduce costs. Content is considered too important. They reduce other requirements, such as the *frequency* of submitting disclosure documents and allowing online dissemination rather than requiring printed materials.
- Allow issues to be done as private placements, to further reduce entry requirements and costs, at least as a first-stage step to being listed.
- Have advisors that vet issuers and provide comfort to investors about the quality of the issue. To be most effective, these advisors should be licensed, regulated, and sanctioned if they support too many ultimately poorly performing issuers.
- Have outreach, public awareness campaigns, and training for SMEs to build understanding, interest, and capacity among market participants.
- Benefit from tax incentives for investors, typically as part of a broader SME finance program.<sup>12</sup>

This paper brings in some additional SME markets and highlights some potentially new approaches that exchanges are adopting in relation to SMEs. The markets that were interviewed for this paper are: the Bombay Stock Exchange SME market (BSE SME); the Korea Exchange KOSDAQ market (KOSDAQ); the Shenzhen Stock Exchange ChiNext market (ChiNext), and the Euronext EnterNext offering. Given the slightly different approach of the last, it will be dealt with in detail in a separate section.

This section largely follows the format of the World Bank paper to allow the reader to compare the experiences of these new exchanges with the roundtable group. The information in this section is therefore presented in the following categories:

- The Structure of the Market
- Market Participants
- Regulations, Fees and Other Requirements

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<sup>12</sup> World Bank Policy Research working paper, page 40

- Bridging the Information Gap Between Issuers and Investors
- Improving Trading and Liquidity
- Providing Other Incentives

Table 2. SME Exchange Structures									
Exchange	Launch Date	Target Companies and Start-ups	Number of Companies Listed Since Launch	Number of Companies Listed as at August 2015	Current Sector Breakdown	Total Capital Raised Since Launch	Average Issue Size of an IPO	Total Market Cap as of August 2015	Average Market Cap of Issuers
BSE SME	2012	No specific sector or type of company targeted. Since April 2015 focus on manufacturing and growth companies. Separate platform for start-ups (Institutional Investor Platform).	110	106	17 sectors: 15% Construction and Engineering, 15% Distribution and trading, 11% Financial services, 10% Advisory services	US\$126.51m	US\$1.2m	US\$1.18bn	US\$11.14m
KOSDAQ	1996	No specific sector or type of company are targeted, however, it is a high-tech oriented market where more than 60% of companies are engaged in IT, BT (Bio Technology), CT(Cultural Technology).	1,941	1,103	Range of sectors though dominated by IT companies: 39.4% IT, Other manufacturing 21.4%, Bio-tech 17.3%, Culture-tech 3.5%, Distribution 7.1%, Finance 1.3%, Other - 1.9%	US\$14.8bln	US\$ 16.15m	US\$160bn	US\$145m
ChiNext	2009	Caters for emerging companies particularly in high growth sectors (IT and services)	484	484	Range of sectors: 62% Manufacturing <sup>13</sup> , 18% IT, 4.5% Media, 5% Agriculture	US\$59bln	US\$87.1m	US\$564bn	US\$1.2bn

<sup>13</sup> Note: in the case of ChiNext, manufacturing is a broad category that includes for example, biotechnology manufacturing.

EnterNext	June 2013	No specific sectoral focus – very diversified across the listed companies.	81	730	Range of sectors though dominated by 24% Industrials, 20% Financials/real estate, 16% Consumer Goods, 14% Health Care, 9% Consumer Services , 9% Technology	US\$22bln <sup>14</sup>	US\$46.7m	US\$144.3bn	US\$197m
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**Source:** Exchange interviews and Marketgrader.com<sup>15</sup>

<sup>14</sup> On both primary and secondary markets

<sup>15</sup> [http://www.marketgrader.com/mg\\_blog/2015/06/24/investigating-chinas-stock-market/](http://www.marketgrader.com/mg_blog/2015/06/24/investigating-chinas-stock-market/)

## Structure of the exchange

### Legal structure

As noted in the previous study, while SME markets typically fall somewhere along a continuum (part of the main board; separate board or market under the main exchange; stand-alone exchange) the majority tend to be structured as a separate board or market under the main exchange. The reasons cited for this are usually cost<sup>16</sup> (including economies of scale) and the desire to create a pipeline for the main board. The regulatory environment will also play a role to the extent that it determines how much latitude exchanges have to tailor listings requirements within a single market structure.

All of the exchanges interviewed for this report provide a separate board or market for SMEs, housed within the broader exchange group. All of these markets use the same trading and settlement infrastructure across the main and the SME boards, both in order to achieve economies of scale in the provision of the market and to minimize costs for trading intermediaries.

- The Korea Exchange (KRX) has a very successful, dedicated SME market (KOSDAQ) which forms part of the exchange group. KOSDAQ began life in 1996 as an independent market and was only absorbed into KRX in 2005. It remains an independent market within the group.
- The Bombay Stock Exchange (BSE) established its SME Platform in 2012 after the Securities and Exchange Board of India (SEBI) – the market regulator - introduced regulatory changes providing for differentiated listings requirements for SMEs. In regulatory terms, the SME platform is distinct from the main board though it is not licensed as a separate exchange. SEBI remains the primary regulator of the market and determines many of the requirements for the market.
- In China, the Shenzhen exchange has three markets. The Main Board is comprised largely of former state-owned enterprises while the SME Board (established in 2004) is targeted predominantly at private enterprises with more traditional core businesses and stable profitability.<sup>17</sup> The listings requirements for the SME Board and the Main Board are the same. ChiNext (established in 2009) like the SME Board, is also focused on private companies but with a greater emphasis on innovative, growth companies. The listings requirements for ChiNext are different to (in some instances, less demanding than) the Main and SME Boards.
- Euronext also has a dedicated SME market, Alternext, established in 2005. It is structured as a multilateral trading facility (MTF)<sup>18</sup> under EU legislation and is wholly owned by the exchange group. As an MTF, rather than a regulated market, the exchange acts as the primary regulator of the market and has some flexibility in setting listings

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<sup>16</sup> SME acquisition costs tend to be high relative to the listing and trading fees that they earn for the exchange.

<sup>17</sup> The concept of ChiNext dates back to 2000 when the exchange identified the potential for a market dedicated to high-tech, SME companies. However, the work on ChiNext coincided with the bursting of the internet bubble and the project was therefore suspended. The exchange therefore started the SME Board to restart the IPO market, focusing specifically on stable, steady-growth companies.

<sup>18</sup> Referred to as an Alternative Trading Platform (ATP) in the World Bank report.



requirements. In 2013 Euronext reconceived its SME offering with the introduction of a service offering called EnterNext. While the exchange group retains the Alternext market, it has expanded the range of companies that it covers under its SME heading to include Euronext main board listed companies that fall into the B and C compartments<sup>19</sup> of Euronext. When launching EnterNext, the exchange noted that while one option was to create a new SME market, it had determined that what was required was not further refinement of listings requirements but enhanced services to SMEs, regardless of the market that they chose to list on.

Table 3. SME Exchange Structures			
Exchange	SME Exchange Structure	Regulator	Subsidised by the Main Board?
BSE SME	Separate board	SEBI	Yes, uses main board's trading, clearing and settlement infrastructure and personnel.
KOSDAQ	Separate market	Financial Supervisory Commission and Financial Supervisory Service (Statutory Regulators) and KRX (SRO)	
ChiNext	Separate market	China Securities Regulatory Commission (CSRC)	
EnterNext incl. Alternext	Alternext – separate market	Relevant listings authority and exchange as SRO	In addition to the above, there is a dedicated EnterNext team focused on SMEs.

### Branding the Exchange

While some exchanges have positioned their SME market to target specific types of SMEs, the ability of the exchange to do this is necessarily constrained by their operating environment, the underlying economy and broader policy considerations. In addition, as highlighted in the previous paper, having a narrow sectoral focus may limit the market's ability to withstand economic downturns that impact particular sectors. Nonetheless, given the nature of these types of markets and the stated intent behind their creation, the emphasis should be on attracting growth companies in need of capital, though this is not always the case.

- BSE SME positions itself as a growth market with the tag-line 'Small is the next big thing. Grow big on the BSE SME Platform'. BSE SME does not limit the sectors of companies that it targets, focusing on SMEs generally.
- ChiNext and KOSDAQ both have very strong brand identities. ChiNext, with its focus on private sector, growth companies is seen as representing China's new economy while KOSDAQ is strongly associated with technology companies.

<sup>19</sup> Companies with a market capitalization of between Euro 150m and 1bn (B category) and companies with a market capitalization of less than Euro 150m (C category). Note: the definition of an SME under MIFID and MIFID II is a company with a market capitalization of less than Euro 200m thus some of the companies that fall into Compartment B would not be regarded as SMEs under EU regulation.

- Alternext and EnterNext more broadly have no specific sectoral focus, however, over the last two years specific attention has been paid to high-growth innovative companies.

None of these exchanges prevent companies from listing on the SME Board if they meet the requirements of the Main Board, leaving it to the issuer to determine which market best meets their requirements.

### Graduating to the Main Board

As noted in the previous report, many exchanges encourage “graduation” from the SME market to the main board of the exchange, particularly where the SME market offers lower admission and different ongoing disclosure requirements. That said, very few exchanges require a move to the main market (the new SME markets in India are a notable exception). In Europe, the EnterNext team meets with SME companies to discuss which market will best meet their particular requirements (which may change over time) but graduation from Alternext is not required.

In Korea and China, the approach is different in that there is no concept of graduation. Companies may elect which market they wish to list on (assuming they meet the listings requirements) but once they have listed on that market, they do not have the option to migrate (from KOSDAQ to KOSPI in the case of Korea<sup>20</sup> or from ChiNext to the SME Board or Main Board in China). Recently however, the Chinese securities regulator announced that it was planning to introduce rules that would allow graduation from the Beijing OTC market (Chinese National Equities Exchange and Quotations – NEEQ<sup>21</sup>) to ChiNext. Similarly in Korea, the sub-KOSDAQ board, KONEX<sup>22</sup>, allows fast-track graduation of qualifying companies to KOSDAQ.

Exchange	Allow/Encourage Graduation?	Requirement	No of Companies Graduated
BSE SME	Yes - required to graduate if SMEs post-issue paid up capital exceeds \$ 4.5mil	<ul style="list-style-type: none"> <li>• Minimum of two years on BSE SME Platform.</li> <li>• Post issue paid up capital of at least \$1.53 mil.</li> <li>• Special resolution passed in AGM.</li> </ul>	4
KOSDAQ	No	N/A	N/A
ChiNext	No	N/A	N/A
EnterNext	Yes, if the company is listed on Alternext but not required.	Meet the main board requirements	Since the launch of EnterNext, 3 companies have transferred from Alternext to Euronext.

<sup>20</sup> Companies can opt to delist from KOSDAQ and apply for a listing on KOSPI if they meet the requirements of KOSPI.

<sup>21</sup> The New Third Board or NEEQ was established in 2012 and is an OTC market similar to the OTC Bulletin Board in the US. Share sales in this market are predominantly through private placement.

<sup>22</sup> KRX launched KONEX in 2013 targeting companies that were too small to list on KOSDAQ or KOSPI. The market has lower barriers to entry than the other markets.

While policy makers – at least in the US and EU – seem to favour more of an on-ramp rather than voluntary graduation approach (i.e. the company is given a few years to ‘adjust’ to being listed, after which it is expected that it will comply with the full set of listings requirements) it is not clear that one approach is necessarily better than the other. What it does suggest however is that even within the same country, there may be value (at least for issuers) in providing differentiated market offerings.

## Market Participants

### Issuers and issuance

Just as definitions of SMEs vary widely, the size of companies listed on SME markets also vary dramatically from one jurisdiction to another. As seen in Tables 1 and 2, in some markets the average market capitalization of a company on the SME market is larger than the average market capitalization of a company on the Main market in another jurisdiction. The exchanges shown below cover the full spectrum, with the bulk of companies on the BSE SME platform having a market capitalization of under US\$5m to ChiNext where (due in large part to the run-up in Chinese market valuations over the last year) the average market capitalization is now over US\$1bn and no companies of less than US\$100m are listed on the market.

- BSE SME targets companies from all sectors that meet the listing requirements, and that have less than \$3.81 million post issue paid up capital. An average IPO on the BSE SME platform is US\$1.2 million.
- As mentioned, KOSDAQ does not target a particular type of company but the brand association means that it tends to attract high-tech growth companies. The average size of a KOSDAQ IPO is US\$16.15m.

Exchange	% <\$5m	% >\$5m and < \$20m	% >\$20m and <\$50m	% >\$50m and <\$100m	%>R100m
BSE SME	70%	20%	3%	5%	3%
KOSDAQ	0.1%	9.7%	31.7%	24.8%	33.7%
ChiNext	N/A	N/A	N/A	N/A	100%
EnterNext	8.5%	18.6%	18.6%	14.1%	40.2%

The question for exchanges and policy markets alike is at level to pitch the market offering i.e. at what point in the companies life-cycle? Realistically, smaller companies with a shorter track record carry a higher risk of failure than larger, more well-established companies. Additionally, companies in the early stages of their development may be less well-suited to meeting the requirements associated with being publicly listed.

- KOSDAQ allows start-ups that meet the statutory definition of Venture Companies or Growth Technical Companies to list on the market (with slightly moderated listings requirements) and more recently (2013), the Korea Exchange launched the KONEX market for SMEs that meet the legislative definition of SMEs (as opposed to the

slightly higher standard set by the exchange). This market has lower listings and disclosure requirements than KOSDAQ and makes provision for fast-track admission to listing on the KOSDAQ market.

- The BSE in contrast has recently tightened its SME Board listings requirements, thereby increasing the entry-threshold. The stated rationale was to enhance the quality of company listed on the market and to ensure that the companies that list are able to comply with the listings requirements on an ongoing basis.

### Investors

Investors in SME markets tend to be overwhelmingly retail though some markets (such as ChiNext) show a higher level of institutional participation. The investor composition is undoubtedly a consequence of a variety of factors such as the national policy environment (what are permissible investments for institutional investors?); the extent of development of the institutional investor base; and the domestic propensity to save and invest. The exchange's traditional investor base and the focus of its intermediaries will also play a role.

- Retail investors dominate the BSE SME market though these are typically High Net Worth individuals as a consequence of the minimum lot size of \$1,526 (a regulatory requirement introduced by SEBI). The initial investors in public offers tend to be individuals who know the companies because they are from the same region or are involved in the companies in some way (vendors or customers of the company). Over time, as the company becomes more established, the mix changes to include institutional investors.
- Retail investors equally account for the bulk of the activity on KOSDAQ and there are no minimum investment requirements in these markets.
- Although Chinese markets tend to be dominated by retail investors (accounting for up to 80% of the value traded) ChiNext tends to have a higher institutional (including Qualified Foreign Institutional Investors) participation than the other markets. This is driven by investor interest in the market that represents the 'new' Chinese economy.
- Institutional investors dominate the EnterNext markets though the exchange is focused on increasing the extent of retail participation in the market. Since the launch of EnterNext, retail investors have represented 27% of total capital raised at IPO.

Exchange	Domestic Investors		Foreign Investors
	Retail	Institutional	
BSE SME			
KOSDAQ	87.7%	5.4%	5.9%
ChiNext	70%	30% <sup>23</sup>	
EnterNext	70%		30%

<sup>23</sup> As all foreign investors in China invest through the RQFII scheme, foreign investment is captured as part of the institutional investment.

### Regulations, fees and other requirements

One of the core propositions behind the establishment of a dedicated SME market with differentiated requirements in jurisdictions where there is an existing exchange is that the cost of accessing the main market is too onerous for SMEs. Costs consist of both direct costs (such as initial and ongoing listings fees and advisers) and indirect costs (such as time spent by management ensuring compliance with the relevant listings requirements). SME market models tend therefore to have a strong focus on cost containment for SMEs, whether in the form of reduced listings fees and/or reduced compliance requirements.

### Workable cost structures

As many exchanges adopt a tiered listing fee structure (both initial and ongoing) based on the market capitalization of the firm, there is in some regards always an built-in “discount” for smaller-sized firms (the smaller the company, the less they pay). Nonetheless, many exchanges go further and offer additional discounts for listings on the SME market.

In many jurisdictions, however, exchange fees are a small proportion of the total cost to list. Other direct costs include costs of advisers (lawyers and sponsors) and intermediaries required for ongoing compliance. In jurisdictions where there are large numbers of intermediaries and potential listed companies, providing services to the issuers in the market on a cost-effective basis is more viable for intermediaries. However, where the market is underdeveloped, advisers may not be interested in servicing small-cap companies or may simply introduce additional costs without providing the desired benefits. This may reduce the attractiveness of the market overall.

Exchange	Cost Structure
BSE SME	One tenth of the cost of the Main Board, an all-in cost of listing for SME Board of roughly US\$80k. Reduced time to list (3 months for BSE SME, as compared to 9-12 months for Main Board). BSE engages with market intermediaries to encourage them to lower costs.
KOSDAQ	Depending on the size of the company, the initial and ongoing listings fees are significantly lower than the Main Board fees (e.g. the initial listing fee for a US\$17m market cap company is US\$1100 for a KOSPI listing vs US\$520 of KOSDAQ while the ongoing listing fee is US\$1100 for a KOSPI listing and US\$173 for a KOSDAQ listing).
ChiNext	ChiNext listings fees (initial and ongoing) are 50% of the Main Board listings fees. In China, the total IPO fees are an estimated 5%-8% of the IPO proceeds.
EnterNext	At launch, the exchange offered a 10% discount on the initial listing fee (admission fee) for equity listings. There is now a 50% discount for upstream and downstream Euronext/Alternext transfers and a 25% discount for debt listings. This is not restricted to Alternext listings but covers all companies that meet the Euronext definition of an SME.

- In India, the BSE engages with intermediaries to encourage them to keep costs low. The market model (described in more detail later) whereby the merchant bank maintains an ongoing relationship with the company means that there are ongoing fee opportunities for the banks. India also has a large number of mid to small

merchant bankers who are focused on the SME market and according to the exchange, because of the large potential size of this market (relative to the Main Board) there are an increasing number of bankers focusing on this market.

### **Box 3: The case of the Bombay Stock Exchange SME Exchange**

The Bombay Stock Exchange was the first exchange in India to launch an SME platform as a separate market segment. This was in response to regulatory changes introduced by the Securities Exchange Board of India (the market regulator) after extensive market consultation.

BSE SME has attracted 110 listed companies with a combined market capitalization of US\$126.5 million since the launch of the board March 2012. BSE believes there is a strong pipeline of future SMEs coming to market. BSE SME attributes its success in attracting companies to its extensive outreach campaign, conducting over 450 seminars across the country to create awareness of the benefits of listing among a large group of SMEs. BSE has 10 Regional Centres across the country where there are people involved in business development – responsible for promoting both Main Board and SME Board listing. The exchange collaborates with various industry bodies at state and central level, and continues to leverage its network of intermediaries to enhance awareness and explain the value proposition of listing on BSE SME.

In April 2015, the BSE tightened its eligibility criteria for companies listing on BSE SME increasing the minimum net worth, and increasing the post issue paid up capital and the net tangible assets of the company from \$0.15 mil to \$0.45 mil. In addition, stock/commodity broking companies are no longer eligible for listing on the BSE SME platform; and finance companies other than systemically important non-deposit taking non-banking financial companies are not be eligible for listing. This was in response to concerns about the quality of listed companies and to encourage listings from stronger growth oriented companies such as manufacturing companies that are employment generators.

The BSE is optimistic about prospects of the SME Platform – having averaged 40 companies listed per year since launch, they expect this trend to continue.

### **Reducing Regulations and Protecting Investors**

As mentioned, the costs for SMEs are not just the direct costs (the actual fees that must be paid either to the exchange or to the intermediaries) but also the indirect costs associated with compliance. Consequently, many exchanges and regulators seek to reduce listings and ongoing compliance requirements. The challenge however, is how to do this in a way that does not unduly diminish investor protection.

### *Easing Entry Requirements*

Most SME markets offer some “reduction” in entry requirements. Given that the starting premise is that these are “younger” companies that need to access capital in order to grow, the requirements that are reduced typically relate to size of company, number of shareholders and profitability/earnings history. Another reason for limiting

requirements relating to the number of shareholders is to address founder concerns regarding loss of control of the company.

Table 8. Entry and Prospectus Requirements		
Exchange	Minimum Entry Requirements versus Main Board	Prospectus Requirement
BSE SME	<ul style="list-style-type: none"> <li>• Minimum post-issue paid up capital of US\$0.45m vs US\$1.52m</li> <li>• No profit history requirement vs pre-tax operating profit of at least US\$2.29m for 3 out of preceding 5 years</li> <li>• Issue must be 100% underwritten</li> <li>• Minimum 50 shareholders vs 1,000 for Main Board</li> <li>• There should not be any change in the promoters (founders) of the company in preceding one year from date of filing the application to BSE for listing under SME segment.</li> </ul>	Same as the Main Board
KOSDAQ	<ul style="list-style-type: none"> <li>• Lower equity capital required (US\$2.6m for general cos and US\$1.3m for venture and growth technical cos vs US\$26m)</li> <li>• Smaller number of public shareholders (500 vs 700)</li> <li>• Lower revenue requirement (positive income vs min US\$100bn for recent year and US\$70bn for 3 years on average). No financial requirements for growth technical companies.</li> <li>• Largest shareholder is locked in for a year on KOSDAQ vs 6 months on KOSPI</li> </ul>	Same as Main Board
ChiNext	<ul style="list-style-type: none"> <li>• ChiNext has shorter and lower profitability requirement (profitable for 2 years vs 3 year and US\$1.6m vs US\$4.7m) than Main Board</li> </ul>	Same as Main Board
EnterNext (Alternext)	<ul style="list-style-type: none"> <li>• Companies can elect to provide financials in local GAAP instead of IFRS (IFRS mandatory for main board)</li> <li>• There is a US\$2.7m minimum free float requirement (vs 25% for the main market)</li> <li>• Only two years financial history required (3 years for main market)</li> </ul>	If public offer, prospectus required. If private placement, admission document to be submitted and approved by the Exchange.

- ChiNext arguably does not have lower listings requirements so much as different requirements that recognise the nature of the companies that the exchange seeks to attract to the market. Thus, for example, while Main Board companies may not have more than 20% of their net asset value attributable to intangible assets, while ChiNext companies simply have a specified net asset value requirement. Both Main Board and ChiNext listed companies have a “sustainable profitability” requirement.



### *Private Placement*

While some markets allow companies to list using the concept of a private placement as a way to reduce the costs of listing, other than EnterNext, none of the markets reviewed for this paper permit the concept of a private placement.

Table 9. Do SME Exchanges Allow Private Placements?	
Exchange	Private Placement
BSE SME	No
KOSDAQ	No
ChiNext	No – private placement permitted in the NEEQ OTC market in Beijing.
EnterNext	Yes – on Alternext only

### *Reducing Disclosure Requirements*

The previous paper pointed out that most jurisdictions do not reduce disclosure content requirements, but do allow less frequent reporting (typically jurisdictions that require quarterly reporting for the main board) or different reporting formats to reduce costs for SME issuers.

Table 10. Reduced Disclosure Requirements			
Exchange	Content Requirements	Frequency of Reporting	Form of Publication
BSE SME	Abridged version of results required to be sent to investors.	Half yearly vs. quarterly	Exemption from publishing in printed newspaper, only required on website.
KOSDAQ	Same as KOSPI	Same as KOSPI	Same as KOSPI
ChiNext	Same as Main Board	Same as Main Board	Same as Main Board
EnterNext (Alternext)	Slightly less constraining than on main market	Half-yearly with lighter requirements for Alternext.	Same as Main Board

### *Governance Requirements*

Compliance with corporate governance requirements is another cost for issuers. While some exchanges have sought to reduce costs through reduced governance requirements, the exchanges reviewed for this paper impose the same governance standards on companies listed on their SME boards as for their main board listed companies. In the case of ChiNext, given the very high and active retail participation in the market, the stated preference is to tend more heavily towards investor protection. The exchange also points out that there is no shortage of companies wishing to list and the intention is therefore (for the time being) not to look to reduce listings, disclosure and governance requirements but rather to focus on improving transparency of listed companies and the overall regulatory regime.



Table 11. Governance Requirements	
Exchange	Governance
BSE SME	Corporate governance requirements apply to both the SME Platform and Main Board. SME is required to appoint a compliance officer and merchant banker assists in meeting of compliance requirements.
KOSDAQ	Same as Main Board
ChiNext	Same as Main Board
EnterNext (Alternext)	Report on internal control and corporate governance is not mandatory on Alternext (vs main market). Adherence to a Governance Code is recommended.

## Bridging the Information Gap between Issuers and Investors: The Use of Advisors

### Advisor Requirements

Given the success of the AIM Nominated Advisors (NOMADS), some exchanges have sought to replicate the NOMAD model where authorised intermediaries assume a higher degree of responsibility for the quality of the listed company and its ongoing compliance. The idea is that advisor takes on some of the risk of the company stemming either from the lower disclosure requirements imposed on the company and/or the generally riskier nature of SME companies. All exchange models (SME or otherwise) rely on intermediaries to bring the company to market including performing some level of initial evaluation – the question is the extent of the involvement in the company pre and post-listing and whether this changes from the main board to the SME board. As noted in the previous paper, the efficacy of an intermediary dependent model relies on the existence of sufficient, high-quality intermediaries that are able to perform this function and who are subject to appropriate oversight and sanction if they consistently bring problematic companies to market.

- BSE does not have an identical NOMAD model to that of AIM and BSE is ultimately responsible for admitting companies to listing on the SME Board (unlike the Main Board where SEBI is the listings authority). This includes conducting a site visit to the company to understand the prospects of the company and the quality of the disclosure. However, SMEs wanting to list are required to engage a Merchant Bank (MB) that is involved in the process of listing and post-listing. The MB also appoints other intermediaries such as market makers, lawyers, syndicate bankers, and auditors. The responsibilities of the MB include: conducting due diligence before bringing the company to the exchange; ensuring compliance with the listings requirements; underwriting the public offering, with 15% of the issue size required to be on the books of the MB. The MB is required to be associated with the company for a minimum of three years, which allows them to benefit from secondary offerings.
- Companies listing on ChiNext are required to retain their sponsor for the remainder of the year of listing and three years thereafter (as compared to two years for the Main Board). Given the early stage of development of Chinese financial markets,

Chinext considers that it is not yet able to outsource the oversight and assessment of companies in the same way that is possible in a jurisdiction such as the UK. The exchange therefore takes on responsibility for ensuring adequate disclosure of information to investors through (for example) initiatives such as the Easy Investor Relations Platform (see below for more detail).

- Companies listing on Alternext are required to appoint a listing sponsor that prepares the company for listing and continues to support the company in meeting its post-listings requirements. These listings sponsors are approved by the exchange.

### Improving Trading and Liquidity

It is generally accepted that SME markets and small cap companies tend to suffer from lower levels of liquidity than large cap companies, though this is not the case for two of the markets covered in this report, namely ChiNext and KOSDAQ. For markets where this is a reality, exchanges and investors are more often concerned with the lack of liquidity than the issuers themselves. This may demonstrate a lack of appreciation by issuers of the importance of liquidity for follow-on capital raising initiatives or indicate that a listing decision has less to do with capital raising than profile-raising. Nonetheless, regardless of issuer perspectives on the matter, some level of secondary market liquidity is required in order to make the market viable and exchanges therefore seek to promote liquidity either by promoting secondary market trading activity directly and/or by improving the availability of research information on small cap companies (indirect promotion of liquidity).

### Improving Secondary Market Liquidity

Some exchanges/jurisdictions utilize market-making (or analogous) models to ensure some level of secondary market liquidity.

- Volumes on the BSE SME exchange are lower than those of the Main Board. This is at least partly explained by the minimum lot size requirement for the companies listed on the SME market (which does not apply to main board companies). The lot size is reviewed on a half yearly basis and reduced if necessary to encourage more investors to participate. To address liquidity concerns, SEBI has introduced a market-making requirement whereby the relevant MB has a responsibility for market making (through a broking member) for a minimum of three years post IPO.
- Market liquidity is not a problem in Chinese markets generally nor does the exchange seek to promote more liquidity in ChiNext at this point in time.
- In Europe, EnterNext encourages companies to put a liquidity contract in place to ensure some level of secondary market liquidity, though this is not restricted to SME companies. This is an agreement between the company and an authorized liquidity provider broker. In addition to authorizing liquidity providers, the exchange also determines minimum liquidity provision requirements with which the broker must comply. There is also a market practice which allows issuers to participate to share buyback programme.

Table 12. Market Maker Models and Other Incentives of SME Exchanges	
Exchange	Market Maker Requirement
BSE SME	Yes, for 3 years after listing. Responsibility of the MB (through a BSE broker)
KOSDAQ	No but will introduce in 2016. Companies can currently participate in Liquidity Provider Program.
ChiNext	No, market liquidity not a problem in China
EnterNext	No specified market-making requirement though has the concept of a "liquidity contract".

### Encouraging Research

Exchanges increasingly recognize the importance of ensuring at least some research coverage of listed SMEs. SMEs tend to be underserved even as regards research coverage and this problem has worsened over time as regulatory changes have impacted on the ability of firms to finance this activity. Exchanges have responded with a variety of models.

- Once a company has listed on the BSE SME Platform, an independent research house covers the company, producing one or two reports per year. The cost of research is covered by the BSE out of its Investor Protection Fund. Research reports are concise and focus on fundamentals of the company, the sector and the economy.
- EnterNext takes a two-pronged approach to enhancing research coverage of SMEs. On the one hand they commission an independent equity research provider to produce basic research information on listed SMEs. This programme currently covers over 330 companies and will be extended to cover all EnterNext stocks in the near future. The output (single-page, quantitative analysis) is available for free on the EnterNext website. In addition, EnterNext has a broker incentive program where the exchange offers brokers trading fee discounts on the SMEs for which they are providing coverage. The size of the discount is anywhere between 30-50% dependent on the number of companies they are covering. About 10 brokers have signed on to the program. These broker reports are much more extensive than those provided by the equity research provider. All companies in EnterNext scope are eligible for broker incentive programme. There is some degree of overlap in the companies covered but the nature and extent of coverage is different.

Table 13. Paying for Research	
Exchange	Subsidize Research?
BSE SME	Yes, exchange pays a third party provider to produce research on listed SME companies.
KOSDAQ	Yes, support analyst research on selected companies (e.g. KOSDAQ Rising Star companies, companies with leading technologies in their sectors – companies selected by a panel of experts).
ChiNext	No.

EnterNext	Yes, exchange pays third party provider to produce research on a proportion of listed SME companies and encourages brokers to produce a detailed research through a broker incentive programme.
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## Providing Other Incentives to List and Invest

### Government Support and Incentives

None of the markets surveyed offered incentives for issuers though some provided tax incentives for investors. Typically though these extended to investment in listed companies more broadly rather than SMEs specifically.

### Exchange Incentives and Support—Outreach and Training

All the exchanges surveyed highlighted the work involved not just in educating companies about the financing opportunities provided by equity markets but also in ensuring readiness and suitability for listing. Once listed, exchanges have varying degrees of ongoing engagement with the companies.

- BSE SME engages extensively with prospective listed companies. The exchange has held 450 seminars with companies across the country to create awareness of the benefits of listing and has met with roughly 150,000 companies. The exchange also collaborates with various industry bodies at state and central level. The focus of this company engagement has been predominantly on addressing SME concerns about listing, namely that being listed means too much focus on compliance, with a loss of focus on the business; loss of control of the business; and excessive responsiveness to shareholders some of whom have vested interests that are not aligned with those of the founders.
- EnterNext similarly engages with listed companies in order to “educate” them about financial markets generally and the potential benefits of listing. They encounter similar concerns to those raised by issuers in India. The EnterNext team also focuses on building relationships with other actors in the financing ecosystem with whom they co-host events targeting SMEs. In the past year, EnterNext has hosted individually or in partnership, a large number of conferences and workshops aimed at both issuers and investors. Once a company is listed, EnterNext continues to interact with it, encouraging companies to engage with investors and exploring opportunities to use of markets for additional financing requirements.
- At KOSDAQ, the exchange also targets companies for listing and on an ongoing basis provides marketing, PR, and IR support to companies. The exchange also conducts educational programmes for employees and management of listed companies.
- ChiNext focuses its efforts both on enhancing the quality of investor and issuer dialogue and building out the capital markets infrastructure more broadly. Additional measures targeting companies include setting up major enterprise service teams, which are aimed at linking investment banks, VC/PEs etc., therefore enhancing support for innovative businesses including IT, Biomedicine and cultural and entertaining services.

#### **Box 4: The ChiNext market – tailored to local circumstance**

The ChiNext market, founded 2009, is an independent market with own rules and different listing standards to the other two markets in the Shenzhen Stock Exchange group. It is targeted at emerging companies particularly in the high growth sectors of IT and services. The exchange believes that its primary value proposition is the difference of its offering to the manufacturing businesses that historically formed the basis of Chinese markets.

ChiNext emphasizes the origins of the market and the socio-economic context within which it originated. As China has historically had a collective economy, ownership of assets – including land and rights of use – was not very clear. In order for companies to list, they needed clarity around these and other issues. Before the market was launched, the exchange spent considerable time working with the local governments to define ownership issues and to fill regulatory gaps (2003/4).

Another challenge was the SMEs who were initially very reluctant to issue shares, as the founders did not want to relinquish control of the company. The exchange therefore focused on “selling” the listing proposition - not just to the companies but to the local government as well. The exchange held training seminars with companies and government officials to explain how each of these would benefit from listing. As regards local government, they argued that by attracting international capital (termed “sunshine capital”) the local government would be able to earn more tax revenue, enhance human capital, and have more suppliers setting up in the region. All of this created a virtuous cycle that would enable the local authorities to enhance their provision of public services. Capital markets were therefore positioned as being advantageous for local economies. The exchange then engaged with companies to understand what they needed in order to access the markets. Ultimately, government would then work with the exchange and the companies to address any impediments to enabling the companies to issuing shares on the markets. Eventually the exchange moved from a position of having to “sell” the listings proposition to having a range of companies wishing to access the market.

Since the establishment of the SME Board in 2004 every region with a population of at least 1m people has a regional Company Listing Promotion Office. This office is responsible for data gathering about local companies, and provision of information about the process for listing. The exchange works with the regional finance office and through them, reaches out to companies, and is able to design local policies that facilitate listing of companies.

#### ***Investors:***

The exchange is very focused on retail investor education and ensuring investor engagement with the fundamentals of the company. Among the exchange’s initiatives are an online information portal where the exchange provides information about all the companies on the website. The exchange encourages retail investors to visit companies and understand what the companies are doing and what they are investing in. The exchange also enables mock-trading via the website where investors can “invest” without putting up any capital.

A particular initiative worth highlighting is the Easy Investor Relations platform, established in 2012. This is an online platform (similar to a micro-blog) managed by the exchange. All ChiNext listed companies are on the platform and anyone can post a question to a listed company. The company has to respond within two working days and the response has to meet a certain standard. The exchange evaluates both the relevance of the questions and the timeliness and quality of response. If not satisfactory, the exchange may censure the company. The quality of responses also

forms part of annual disclosure review – if they perform poorly, the company will publicly lose face. Consequently the exchange believes they have very high quality response to questions raised. The platform is well used with approximately 100 questions posted per day - up from 3 or 4 initially.

### ***Building the ecosystem***

The exchange notes that they are not able to rely on intermediaries to do the initial issuance and ongoing maintenance of corporate governance oversight as the ecosystem is not yet sufficiently developed to enable this. The exchange therefore assumes much of this responsibility but at the same time attempts to build the capacity of securities firms that would potentially play the Nomad type role. The exchange therefore holds yearly meetings to discuss listings standards and practice and offers training to employees of these firms to improve the quality of practice overall.

### **Beyond an SME market – the EnterNext approach**

This section highlights the comprehensive approach adopted by Euronext in relation to SMEs and the ecosystem more broadly.

As noted earlier in this paper, while Euronext established an SME market, Alternext, in 2005, Euronext reconceived its SME offering in 2013 with the introduction of EnterNext. Under this structure, the group retains the Alternext market, but has expanded the range of companies that it covers under its SME heading. The exchange's emphasis has therefore moved away from the SME market as a product to be sold to companies, to focusing on SMEs more holistically. This new approach seems to acknowledge the fact that while a market with differentiated requirements may be helpful for SMEs, what is at least as important is servicing of SMEs according to their specific requirements and providing ongoing support. Additionally, it recognizes (as the WFE market segmentation data shows) that many smaller-cap companies may elect to list on the exchange's main board.

The EnterNext team adopts a three-pronged approach to SMEs focusing on the core constituents (issuers and investors) and the broader ecosystem:

- **Companies:** EnterNext focuses both on targeting potential new listings and continuing engagement with currently listed companies. As regards unlisted companies the team focuses on educating companies about financial markets and promoting the benefits of listing. Once listed, the team will meet with companies to discuss follow-on financing requirements and how to use markets to meet these requirements. They also remind companies to remain engaged with the markets and investors (through roadshows etc.) to encourage liquidity in their stocks and ensure they attract the right types of investors for their stock. Finally, they provide CEOs with market information, market trends etc. and news about financial markets. This approach not only brings companies to market but ensures companies are able to derive maximum benefit from being listed. In 2015 EnterNext launched an enhanced offering whereby the team offers companies dedicated pre-listing and post-listing services.
  - **Pre-listing services:** similar to the services provided by advisory boutiques. The team will be charge of monitoring and explaining the IPO process to the company. They will also support the management in their discussions with the Board, their

choice of intermediaries and the deal structuring. Services also include conception of equity story and road-shows materials as well as Prospectus coordination (i.e supervision of due diligence process, first Prospectus draft and management of the Master document).

- **Post-listing services:** this offering is analogous to the work performed by financial communication agencies. The team will help the company management with their investor relations (roadshows, retail strategies etc.) as well as and key financial communication mechanisms. To do so, they monitor investors' activity, and conduct investor surveys and perception studies.
- **Investors:** EnterNext also focuses on better understanding investor needs and expectations in relation to SMEs by (amongst other things) co-organizing roadshows between investors and listed companies. Unlike many other SME markets, EnterNext is dominated by institutional investors (over 70%). The intention is to focus on both institutional and retail investors and expand retail investor participation in the market.
- **Ecosystem:** Finally, EnterNext works on creating an ecosystem of entities that support SMEs such as banks, lawyers, auditors, and professional associations. The emphasis is on developing SME-focused events, predominantly focused on business development. As just one example, EnterNext hosts the EnterNext Tech Conference which gathers tech company executives (listed & un-listed) and organisations, VCs, Business Angels, institutional investors, analysts, incubators, banks, advisors, specialised technology media, and government representatives and public bodies. The event covers a range of topics including “key features of a successful IPO”.
- **Creating the Pipeline:** More recently EnterNext launched the TechShare Programme – a targeted programme aimed at creating a pipeline of companies for listing. TechShare is an annual program for 30 unlisted technology companies that is focused on preparing them for the listed environment. Activities for the year include individual sessions with auditors, lawyers and communication advisors as well as a combination of academic and technical sessions with relevant experts. Companies apply for the programme and are selected for participation based on a range of criteria including commitment to participating in the program and likely eligibility for listing within two years.



## Conclusion

As stated at the outset, this report does not attempt to draw any particular conclusions about what constitutes a successful SME market. Instead it seeks to add more information to the foundational work of the World Bank paper referred to elsewhere in this document. What this paper and the previous one, together with recent thinking on SME access to equity markets, demonstrate is that while there is a degree of consensus on structural issues, there is also a broad range of offerings and structures that fall under the heading of an SME market. This in itself produces certain insights that will hopefully prompt further research.

These initial insights (early hypotheses) are summarized below:

- While there seems to be certain consensus that considerations such as tailored listings requirements and manageable costs are a given, what is appropriate and strikes the right balance between issuer access and investor protection is less clear and will likely vary from one market to another.
- Following from this, just as the definition of an SME tends to be jurisdictionally specific, so its market of operation and the broader policy environment and objectives will determine what the SME exchange looks like and what it attempts to do. For example, ChiNext and KOSDAQ are very different in structure, focus and listed issuers than EnterNext and BSE. Arguably however, all of them are successful markets.
- The structure of the market/platform will depend on the ecosystem in which the exchange operates. Thus, in jurisdictions where capital markets are under-developed, the exchange may have to play a much larger role in vetting companies and monitoring their ongoing compliance than in markets where there are a broad swathe of high-quality intermediaries.
- While the initial report identified the need for an enabling ecosystem it perhaps did not stress sufficiently the extent to which this is required, particularly in markets where there isn't natural, pre-existing demand for equity market capital or where the traditional ecosystem has been eroded. EnterNext and BSE provide examples of some of the things that exchanges have done in order to address ecosystem challenges but exchanges will obviously not be able to provide an enabling environment for SMEs on their own.

What this suggests therefore is that there is unfortunately no cookie-cutter model for building a successful SME market but rather a toolbox of options that markets seeking to develop or refine their SME markets can choose to deploy, depending on their particular circumstances. Exchanges, policy makers and market intermediaries will have to work together to determine what is most appropriate for the market and the defined objectives. Finally, it is important to note that even within the narrow realm of SME financing, while exchanges have a role to play and certainly seem to recognize this (at least based on the number of WFE member exchanges that operate SME markets) they are not the sole solution to SME funding challenges – other actors and associated types of financing such as banks, private equity and venture capital firms amongst others, all have an important role to play.



**Next steps**

The WFE and its members (through the WFE's SME Working Group) will continue to focus on improving the understanding of the critical success factors for SME markets and building a comprehensive database of SME market information. This will be done in partnership with relevant partners where appropriate.