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Small is beautiful (again)

Attracting SMEs to the stock market

Editorial

Launched two years ago, IntercontinentalExchange Inc.'s (ICE) takeover of NYSE Euronext is heading into the final stretch. In principle, the next step will be to spin off Euronext's continental European activities, since the merger – already approved by the regulators concerned – was recently greenlighted by the French finance ministry. This twin approval is predicated especially on the commitment by ICE to establish a group of core shareholders and keep 25 per cent of the capital for three years.

Creating this core shareholder group is meaningful only if it puts the new-look Euronext at the forefront of a market-wide industrial strategy to develop our collective interests over the long term. The key issue is not simply the symbol of a national stock exchange, even though that image is firmly imprinted on the public's imagination. What is truly at stake is the control of a central infrastructure. The various facets of this issue are underlined in the report by Thierry Francq on the future of trading and post-trade activities in Europe. They have also been taken up by Paris Europlace, speaking on behalf of users, be they issuers, investors or financial institutions.

Given the tenuous state and sharp contraction of the Paris market, the months ahead will be vital. The alternatives are straightforward. Either we stand by and watch as our financing model places increasing emphasis on the market rather than on lending. Or we forge together a credible industry-wide strategy, allowing France to hold onto a market ecosystem that provides affordable financing to its economy and businesses.

We have reached a crossroads. Our entire financial community – public authorities, regulators, companies, investors and market professionals – urgently needs to bring all its strengths to bear.

Philippe Tibi
Chairman, AMAFI

Feature

Small and midsized companies, or SMEs, have had a chequered history on stock markets. Investors have shunned them to concentrate on larger and more liquid firms, while banks have been lending less in these post-crisis times. Nevertheless fresh initiatives are afoot to encourage SMEs, including specially targeted markets and alternative capital raising opportunities. And exchanges are making a determined effort to woo these economic dynamos.

The importance of SMEs

Big businesses grab the headlines, but it is small and midsized firms that employ most of the labour force. Here in Europe, SMEs are the lifeblood of the economy, dragging it out of the worst crisis in half a decade, says European Commission Vice President Antonio Tajani. Yet these firms often struggle to raise funding in order to expand. Bank loans, the most common source of financing, have become harder to get as banks become increasingly wary of lending and are subject to tougher capital adequacy requirements. Besides, raising debt is more expensive for SMEs, and high interest expense on their P&Ls is often looked at askance.

Feature

The "2013 SMEs' Access to Finance" survey by the European Central Bank reported that these companies' needs for external finance had increased while the availability of bank loans had shrivelled.

In France, the non-profit organisation PME-Finance (motto "Because entrepreneur is a French word") reported in a recent survey that more than 90 per cent of funding available to French SMEs came from bank credit, which is stagnating. The situation is especially acute since France has one of the highest saving rates in the world, but only a tiny fraction of those readily available funds is ploughed into businesses.

Today, however, a number of factors are coming together that may change the situation going forward. Governments are anxious to nurture the SME ecosystem in order to boost economic activity and employment; yield-hungry investors are taking an increasing interest in smaller businesses; and alternative sources of financing such as crowdfunding are becoming available. Last but not least, with the dust from the crisis yet to settle, stock exchanges are trying to attract SMEs in order build up their lists. Could small be beautiful once again?

We AIM to please

In the UK, investing in SMEs has a longer history than in many other European countries. The UK has some 4.5 million small and midsized companies. But, like their counterparts elsewhere in Europe, a scant minority – some three per cent – rely on equity finance. In a recent article, the chief executive of the London Stock Exchange, Xavier Rolet, said the LSE was determined to play its part in nurturing SMEs and giving them access to the funding needed for growth.

London's Alternative Investment Market (AIM) was set up in 1995 and has since attracted more than 3,000 smaller and growing companies. It offers a one-stop support service through a network of advisors as well as an international investor base. Despite a lean patch since 2007, the exchange is beginning to attract new listings again. And in August, to kickstart personal investment in SMEs, the UK Treasury introduced new rules allowing individual investors to hold AIM-listed shares in tax-free Individual Savings Accounts.

In March the LSE went a step further, launching the High Growth Segment (HGS) to offer medium and large growth companies an "additional route" to its main market. With EU Regulated Market status, the HGS is open to companies incorporated in the European Economic Area that can demonstrate at least 20 per cent revenue growth over the three years prior to admission and have no less than 10 per cent of their securities, worth at least £30 million, in public hands. HGS-listed companies will not be admitted the Official List and hence will not be subject to the LSE's Listing Rules.

The HGS has yet to make its first listing but the aim of the initiative is clear: to help both UK and European high growth companies expand.

Germany courts SMEs

The Mittelstand – a vast, overarching network of small and medium-sized companies – is a long-established feature of Germany's economic and business life. According to the Federal Ministry of Economics and Technology, it accounts for more than 99 per cent of all German firms. Hardly surprising, then, that the country has made an all-out effort to consolidate its SME base and attract new listings – particularly since these companies have started to use the capital markets in order to secure extra funding in addition to bank loans.

In early 2011 the Hamburg and Hanover exchanges launched a trading segment called Mittelstandsbörse Deutschland, which provides SMEs with access to both debt and equity funding. The segment is open to all companies, which can issue not only shares but also debt through an exchange-approved issuance programme. Smaller companies, including market newcomers, are attracted to the segment by the affordable cost of access. A similar initiative is the Freiverkehr, or Open Market (formerly the Regulated Unofficial Market), operated by the Frankfurt stock exchange. Governed by private law and exchange-regulated, the Freiverkehr is not an organised market within the meaning of German securities legislation. It trades both German and international shares – equities from more than 60 countries are listed there – as well as certificates, warrants, and bonds issued by German and international issuers. Among the Freiverkehr's attractions are the relative ease and low cost of listing. In addition, inclusion of securities in exchange trading on this segment is an easy fast-track to a main market listing.

Other exchanges, including Düsseldorf, Munich and Stuttgart, have made moves to attract SMEs looking for alternative sources of funding, often by tapping debt capital markets. All these initiatives underscore the vital importance of the Mittelstand to both Germany's and Europe's economies.

EnterNext steps up

France, too, has been responding for a decade to SMEs' needs for market funding as an alternative to bank debt. In May 2005 the then-Euronext opened Alternext, tailored specifically to the needs of eurozone SMEs seeking simplified access to the stock market. Organised not as an EU-defined regulated market but as a multilateral trading facility, the exchange offers three routes to listing and trading: public offering, private placement and direct listing. Like exchanges almost everywhere, Alternext suffered in the aftermath of the 2007 economic and financial meltdown, but listings and transfers subsequently picked up again.

Feature

In 2012 NYSE Euronext introduced its Initial Bond Offering programme to enable listed SMEs to arrange bond issues, approach private investors and raise their visibility. At the same time it homed in on the need for a marketplace catering specifically to smaller companies. It was keenly aware that many SMEs lacked the collateral needed to secure a bank loan and did not offer high enough returns to attract venture capitalists and other risk investors, a situation that created a so-called SME financing gap.

NYSE Euronext's response was to launch EnterNext, a market for SMEs capitalised at less than one billion euros. The new marketplace is designed to meet the financing requirements and aid the expansion of Europe's small and midsized firms. Key among EnterNext's aims is to position the stock exchange as a viable alternative to conventional collateral-based bank lending as a source of financing. Another goal is to promote SMEs as a compelling asset class for investors. EnterNext, which already covers over 750 SMEs listed on the regulated market of NYSE Euronext and on NYSE Alternext, has its own staff and financial resources but intends to build on its parent's market model. According to Eric Forest, EnterNext's Chairman and CEO, "Our mission is to promote financial markets and explain to business leaders the benefits of listing. In addition, we are fully supporting a new dynamic through creating and promoting new services and financing instruments, developing the investors' axis, bringing together the ecosystem and lobbying French and European public authorities". (*See Q&A*)

So far in 2013 17 companies have listed on EnterNext, raising a total of 246 million euros and taking their combined market capitalisation to 1.4 billion euros. The same buoyant trend can be seen in the secondary markets: listed issuers on all the markets covered by EnterNext had raised 4.4 billion euros at end October. This goes to show that financial markets have a major role to play in financing SMEs and mid-tier firms

Critics of small and midcap market segments such as EnterNext have argued that the ongoing credit crunch affecting SMEs might prompt firms to seek a listing simply in order to raise money and fund their working capital requirement. But these arguments miss the point. With other channels of financing such as crowdfunding coming on stream and banks being encouraged to step up lending, exchanges have a vital role to play in providing funding for SMEs. And, in doing so, financing nations' economic activity.

Anthony Bulger

Q&A with...

Eric Forest, Chairman and CEO, EnterNext (Euronext Group)

HGS, Mittelstandsbörse, ISDX: why are exchanges trying to attract SMEs?

The financial crisis and subsequent solutions have placed European SMEs' financing model under pressure. Traditionally in Europe, the SME external financing structure is largely dominated by bank credit. In France for instance, banks cover approximately 92 per cent of SME's external financing needs compared with 7 per cent for private equity and 1 per cent for financial markets. But banks are now required to be highly selective in lending, so will no longer be able to support SME growth to the same extent. There is an equally significant knock-on effect for the private equity industry. Stock exchanges thus have a unique window of opportunity to position financial markets as an efficient channel for SME financing and development. On this basis, it comes as no surprise that European market operators are renewing and reinforcing their efforts to support SMEs. We are facing a paradigm shift, and we must rise to the challenge. The launch of EnterNext, Euronext's new marketplace for SMEs, demonstrates our commitment.

Are alternatives such as crowdfunding a game-changer for SMEs?

Crowdfunding leverages the power of the internet to help people with ideas get up and running. The emergence of this new financing tool is a positive move and meets needs otherwise unmet. When an entrepreneur requires funding for business development - for example €200k to acquire a machine-tool- and sees their credit request turned down, crowdfunding may constitute an alternative and a step towards future use of financial markets. Financial markets will be a key element of the new financing model but they cannot be the sole response to the growing needs for diversified financing sources. Markets constitute one of the many links of the financing chain and we welcome any initiative which may consolidate it.

What advantages does EnterNext offer?

The market experience of listed SMEs is different to that of large caps. The creation of EnterNext provides us with the means to define and set up a strategy to address the particular needs of small and mid-caps. All SMEs' resources (human, technical and financial) are gathered within a dedicated subsidiary to develop value-adding services for all stakeholders. The synergies achieved will ensure a personalised and close follow-up of the companies. Proximity to entrepreneurs and members of the ecosystem is essential for our success. In addition to a strong presence of EnterNext team in Paris, local representations have been set up in major French cities as well as in Lisbon, Brussels and Amsterdam.

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Europe

Benchmarks

The proposal for a European regulation on benchmarks, designed to make the determination and use of these indices more secure, was made public on 18 September 2013. The measure is a political response to the LIBOR-rigging scandal. It sits alongside the draft Market Abuse Regulation, now being finalised, which specifically punishes benchmark manipulation. The EU benchmark proposal – a priority for the outgoing European Parliament – will be examined at a plenary session on 30 January 2014.

Multiple and detailed requirements will apply to administrators of benchmarks, in terms of governance (particularly conflict of interest avoidance), oversight and input data as well as relations with contributors and transparency vis-à-vis users. Administrators of benchmarks will have to be authorised, and the use of third country benchmarks will be subject to equivalence requirements, an aspect bound to raise serious practical problems.

While it certainly is necessary to regulate key indices, AMAFI is concerned about the problems that would arise if proprietary indices tailored to specific needs and used solely by their administrators were included in the same category as benchmarks. In such a case, the economic viability of some proprietary indices could be undermined by an unwieldy administrative burden and the fact that some of the upcoming rules are not fit for purpose.

AMAFI has set up a working group to address these issues and draft alternative proposals that it will put to the European and French authorities. The group is also reviewing the draft report produced by Sharon Bowles, the ECON Committee's rapporteur. Based on a proportionality principle for enforcing the regulation, this report is likely to solve some of the difficulties.

Stéphanie Hubert

EFSA meeting, London, 7- 8 November 2013

The European Forum of Securities Associations (EFSA) is an informal group of industry associations representing Denmark (DSDA), France (AMAFI), Germany (BWF), Italy (ASSOSIM), Spain (AMF), Sweden (SSDA) and the UK (AFME). It generally meets twice yearly to address issues of common interest.

The latest meeting was organised in London by AFME on 7 and 8 November 2013. AMAFI was represented by its Chief Executive, Pierre de Lauzun, together with European and International Affairs Director Véronique Donnadieu and Market Activities Director Emmanuel de Fournoux. Among the items on the agenda was EFSA members' work in areas such as market making, benchmark index management and the MiFID review.

Véronique Donnadieu

News

Europe

MiFID 2

Talks on the review of the Markets in Financial Instruments Directive (MiFID) continue as part of the trialogue initiated in July 2013 under the Lithuanian Presidency. Officially, the aim is still to reach a final compromise between the Parliament and the Council by late December. But the chances of success now seem slim in view of the persistent deadlock on several key issues. As various proposals are brought to the table, AMAFI continues to emphasise the points it believes should be addressed at this stage of the discussions. These mainly concern commodity derivatives markets, client protection and market structure.

Discussions on **commodities** are focusing on how MiFID will apply to the scope of exemptions and to the definition of what constitutes a financial instrument. The crucial issue for AMAFI is the consistency of the overall framework, based on the principle that the same rule should apply to the same business. AMAFI is also paying close attention to the procedures involving position limits and reporting, which will be key to the overall effectiveness of the new measures. In particular we believe the European authorities should carefully consider recent developments in the United States.

In the area of **client protection**, AMAFI is anxious to ensure that the planned measures, intended chiefly to protect retail clients, do not apply equally to wholesale business. It is vital that the regulatory framework should also be tailored to relations between professionals, since they cannot be protected in the same way as individual investors.

Last, AMAFI's **Market Structure** Committee met with the French securities regulator, AMF, to review ESMA's forthcoming task of drafting MiFID implementing measures. Although major decisions on issues such as the rules for Organised Trading Facilities or possible exemptions from pre-trade transparency requirements have yet to be taken as part of the trialogue, a number of areas can already be broached. Chief among these are the most innovative aspects of MiFID 2, such as the structure of bond and derivatives markets. The rules applicable here, designed on the basis of those applicable to equity markets, now need to be transposed and calibrated. On this point, it is necessary to define what is meant by the terms "liquid market" and "standard market size" for different categories of instruments. The Market Structure Committee will provide practical input for these discussions.

Véronique Donnadieu, Stéphanie Hubert, Emmanuel de Fournoux

Revised Transparency Directive published

The revised version of the Transparency Directive was published in the Official Journal of the European Union on 22 October 2013. Member states have until 26 November 2015 to transpose the long-awaited measures.

With ESMA working on regulatory technical standards, AMAFI is paying close attention to two issues it has been closely involved in from the outset, firstly the method used to calculate delta adjustment for cash settled derivatives and secondly the calculation of the 5 per cent exemption disclosure threshold for instruments in firms' trading portfolios.

A consultation is due to be held once the draft technical standards are complete, and AMAFI will of course submit its response.

Sylvie Dariosecq, Julien Perrier

News

France

Cross-market work on the Euro PP market

AMAFI was the first to set up a dedicated working group to investigate ways of encouraging private debt placements, particularly by mid-tier firms, directly with institutional investors. It remains closely involved in this issue, playing an active part in the work being done by a market advisory group (MAG) set up by the Banque de France and composed of stakeholder representatives. The aim is to make the private placement market for euro-denominated bonds (Euro PP) a benchmark, both in France and internationally.

A best practice charter will be drawn up to encourage Euro PP deals. In addition to governing relations between issuers, investors and intermediaries, it will include a number of standard legal documents. Accordingly, the ongoing discussions will be pursued on the basis of an AMAFI working group memo (*AMAFI / 13-44*). The charter is due to be published during first quarter 2014 under the auspices of the industry groups involved.

Sylvie Dariosecq, Julien Perrier

Crowdfunding

This new form of capital raising was discussed at market-wide meetings organised in first half 2013 by the Treasury, the prudential oversight and resolution authority ACPR and the AMF. As a result, draft legislation and regulations – including amendments to the AMF General Regulation – and a draft ACPR/AMF policy statement were put out for consultation this autumn. The aim is to establish a new legal framework that will foster crowdfunding in France.

As stated on an earlier occasion, AMAFI is giving due attention to this initiative, which will likely satisfy companies' special needs at a time when France's economic financing method, traditionally based on bank lending, is undergoing fast-paced change (*see Feature*). With this in mind, AMAFI has carefully examined the proposals resulting from the consultation, focusing on those within its sphere of expertise, specifically financial securities offered over a Web-based platform managed by intermediaries holding the new status of crowdfunding investment advisor, or CIP (*AMAFI / 13-55*).

In AMAFI's opinion, the main problem stems from the fact that the offering of securities through CIPs does not validly fit in with the current European legal framework. Their business is equated with an investment service, which can be supplied only by investment services providers. With the European Commission and the UK Financial Conduct Authority also consulting on this issue, AMAFI believes initiatives ought to be undertaken at European level to design an apposite operating framework. Whatever the outcome, any proposed solutions must strike a sensible balance between, on the one hand, the proper financing of economic activity and, on the other hand, orderly markets and client protection, specifically where clients are not pursuing charitable or philanthropic aims and do not have close family links and geographical ties with the person or persons seeking funding.

AMAFI intends to respond to a European Commission consultation underway until the end of the year. It will fill in a questionnaire that seeks to review existing models and to poll interested parties within the EU on the advantages and risks involved in different forms of crowdfunding.

Bertrand de Saint Mars, Sylvie Dariosecq

News

Taxation

Financial transaction tax

Scant progress has been made recently at European level on the financial transaction tax (FTT), pending news on the policy stance to be adopted by Germany's new coalition government. Nevertheless, the FTT will be discussed at the mid-December ECOFIN meeting, when both the timetable and the guidelines for the tax will be examined. A new proposal for a directive, possibly incorporating all or part of the Council's legal opinion published in September, is unlikely to be released before the end of January 2014.

Uncertainty about the directive's timing prompted AMAFI to postpone the conference it had organised on the FTT in association with PWC-Landwell. The event was due to be attended not only by professionals but also by representatives of the European Commission, France's Treasury and Tax Legislation directorates, and the Italian finance minister. A new date will be set shortly.

Regarding the measures that France will adopt, AMAFI alerted the authorities to the problems that would arise if the parliamentary finance commission went ahead with a plan, slated for inclusion in the 2014 finance bill, to levy the TTF not only on trades involving transfer of ownership but also on intra-day trades. Fortunately the proposed amendment was dropped at the request of the government before the bill went to parliament for discussion.

Eric Vacher

Tax on operating profit

AMAFI, along with the French employers' federation MEDEF, took steps to oppose the government's plan to tax operating profits. In addition to the harmful impact on many companies, the measure was at odds with proposals to overhaul corporation tax, to be put forward at the behest of President François Hollande at the high-conference on taxation planned for 2014. To fight the proposals effectively and highlight specifically its effects on the financial intermediation industry, AMAFI conducted a poll showing that the measure would have a serious impact on half of its members *(AMAFI / 12-48)*. In the end, the government withdrew the measure and replaced it with an increase in the rate of additional corporate income tax.

Eric Vacher

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www.amafi.fr
Most of them, notably AMAFI's responses to public consultations, are freely available, but some are restricted to members only.

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