

SME FINANCING THROUGH CAPITAL MARKETS

Final Report



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1. EXECUTIVE SUMMARY

Small and medium enterprises (SMEs) have a major role in contributing towards long-term economic growth and employment. However, SMEs often face limited access to financing due in part to the relatively higher risks associated with investing in them. The SME financing challenge has been exacerbated following the introduction of significant financial regulatory reforms in the aftermath of the global financial crisis, heightening banks' risk aversion when extending loans. Capital markets therefore have an imperative role in bridging this financing gap through the provision of alternative funding sources for SMEs, particularly as their needs evolve over the different phases of their life cycle.

Recognising the crucial role of capital markets in this regard, the then Emerging Markets Committee, (known as the Growth and Emerging Markets (GEM) Committee since 2013) of the International Organization of Securities Commissions (IOSCO) established a Task Force in 2013 to examine SMEs' access to capital markets, and explore possible measures to develop and enhance regulations to improve their access to capital market-based financing. In undertaking this work, a fact-finding survey was conducted among IOSCO members to gather insights and best practices within the various jurisdictions' SME markets. Forty-five jurisdictions responded to the survey, of which 31 respondents are GEM members.

The results of the survey indicated that bank loans typically constitute the primary source of financing for both publicly and privately held SMEs in the majority of jurisdictions, followed by equity finance, venture capital and other related governmental and international funds. In addition, capital markets in the jurisdictions surveyed have effectively catered to SMEs' financing requirements, albeit varying degrees, through the range of available funding avenues including equity financing via listing on alternative exchange boards, issuance of debt securities, crowdfunding, Sukuk funds, securitisation and government initiatives that encourage private investments.

Notwithstanding, SMEs continue to face impediments, which discourage them from accessing the capital market for financing. These include the fear of losing ownership, relatively high regulatory costs and inexperience with capital markets, amongst others. In this regard, most of the jurisdictions surveyed have been reviewing their respective regulatory frameworks with a view to facilitating access for SMEs. Other initiatives such as tax incentives and government guarantees have also been introduced to encourage access by SMEs to capital markets.

Our findings from the survey indicate that jurisdictions have had uneven success at helping SMEs to tap the capital markets. Successful measures that can be emulated include establishing separate equity and fixed income markets with regulatory requirements tailored to SMEs, establishing market advisor and market-making systems, as well as introducing alternative methods of financing such as private equity, venture capital and securitisation.

2. INTRODUCTION AND BACKGROUND

2.1. Why SMEs matter

SMEs are important actors in economic growth and transformation, creating positive value for the economy and contributing towards sustainable and balanced economic growth, employment and social stability.

Although SMEs play an important role in economies, their access to finance is limited and has been a challenge for policy makers globally. SMEs' access to finance varies depending on a number of factors, namely the level of development of SMEs in a particular jurisdiction, availability of finance channels, the nature of the business, management experience, marketing abilities and personal connections of the entrepreneur behind the business.

At the initial stages, promoters of SMEs often rely on their own resources, which can include savings, use of personal credit cards, loans or equity provided by friends and family and loans from banks and other financial institutions can be tapped into. Further, finance can also be made available by suppliers, angel and venture capital investors.

The challenging conditions SMEs face in accessing finance have been amplified as a consequence of the global financial crisis, which gave rise to current global financial reforms, including the introduction of stringent capital requirements for banks associated with Basel III.

The strengthening of prudential regulation in the banking sector has the effect of reducing intermediation capacity of the banking system as banks become more risk averse when extending loans, especially to the SME sector. Therefore, it has become crucial to examine possible alternative financing channels for SMEs. Raising funds by way of an organised, transparent, orderly functioning and reliable capital market could provide an important alternative source of finance for SMEs. In addition, the emergence of alternative markets where, on the one hand, SMEs can raise funds and, on the other, investors have access to a wider array of investment opportunities, are important to foster the development of capital markets.

Ensuring adequate investor protection, while at the same time establishing an effective regulatory framework that enables SMEs to access financing, is a major challenge. This is mainly due to the risky nature of investing in SMEs.

2.2. Objectives of the report

In order to highlight regulatory and other challenges facing SMEs in capital formation and explore ways in which securities regulators can help to overcome these challenges and develop recommendations, the then Emerging Markets Committee (known as the Growth and Emerging Markets Committee since 2013) of the International Organization of for Securities Commissions (IOSCO) set up a Task Force on "*Financing of SMEs through the Capital*

Markets". An important aspect of the mandate was to analyse the experience of various jurisdictions with SME financing and to use positive experiences as guidance.

Following revisions based on comments by Task Force members, an initial survey (Appendix 1) was circulated among ordinary members of IOSCO on 29 August 2012. Forty five jurisdictions¹ responded to this survey while nine jurisdictions² provided insights with respect to SME initiatives and best practices in their jurisdictions. These were examined and summarised in the Best Practices Section of this Report. Subsequent to this, a follow-up mini survey was sent to ordinary members on 20 November 2014 (Appendix 2) and 25 responses were received³ in this regard.

The purpose of this study is to examine SMEs' access to capital markets and to provide a regulatory overview of the range of possibilities that securities regulators may wish to explore in enhancing or developing regulations for SMEs, based on survey responses and best practices delivered by jurisdictions. In this context, this study first provides information on SME markets and different regulatory efforts of member jurisdictions and then describes their current initiatives, approaches and incentives to promote SMEs access to capital markets.

The Report is structured as follows:

- Introduction and Background
- Overview of the SME market
- Access to funding for SMEs
- Impediments/challenges
- Regulatory framework for SMEs
- Incentives / interventions for SME financing
- Conclusion
- Recommendations

¹ The respondent jurisdictions are namely; Alberta–Canada, Argentina, Australia, Brazil, Chinese Taipei, Colombia, Czech Republic, Denmark, Dubai, Ecuador, Egypt, Germany, Greece, Hong Kong, Hungary, Iceland, India, Israel, Italy, Kenya, Korea, Lithuania, Macedonia, Malaysia, Malawi, Maldives, Mauritius, Morocco, New Zealand, Oman, Ontario-Canada, Pakistan, Panama, Peru, Poland, Portugal, Romania, Singapore, Slovenia, South Africa, Spain, Thailand, Turkey, United Arab Emirates and United Kingdom.

² Australia, Canada, Hong Kong, India, Japan, Singapore, Chinese Taipei, UK, and USA

³ Argentina; Brazil; China; Chinese Taipei; Colombia; Dominican Republic; Finland; Hungary; India; Israel; Italy; Korea; Macedonia; Malaysia; Mauritius; Mexico; Morocco; Ontario-Canada; Palestine; Portugal; Slovenia; Sri Lanka; Thailand; Tunisia; Turkey

3. OVERVIEW OF THE SME MARKET

3.1. Definition of SME

SMEs vary widely from start-ups to medium sized companies. Several different terms and terminology are used to classify SMEs such as: SME issuer; small issuer; venture issuer; junior issuer; mid to small cap entity and medium sized company.

The abbreviation "SME" is commonly used in the European Union (EU) and in international organisations such as the World Bank (WB), the United Nations (UN) and the World Trade Organisation (WTO). The term "small and medium businesses" or "SMBs" is predominantly used in the USA. In South Africa the term is "SMME" for small, medium and micro-enterprises and elsewhere in Africa, MSME is used for micro, small and medium enterprises⁴.

SME definitions can be broadly categorised into two, i.e., "economic" and "statistical" definitions. Under the economic definition, a firm is regarded as small if it meets the following three criteria: (1) it has a relatively small share of its market place; (2) it is managed by owners or part owners in a personalised way and not through the medium of a formalised management structure; and (3) it is independent in that it is not part of a larger enterprise⁵.

The "statistical" definition, on the other hand, is used in three main areas: (1) quantifying the size of the small firm sector and its contribution to GDP, employment and exports; (2) comparing the extent to which the small firm sector's economic contribution has changed over time; and (3) in a cross country comparison of the small firms' economic contribution. These definitions, however, have a number of weaknesses. For example, the economic definition, which states that a small business is managed by its owners or part owners in a personalised way and not through the medium of a formal management structure, is incompatible with its statistical definition of a small manufacturing firm that might have up to 200 employees⁶.

According to the United Nation Industrial Development Organisation (UNIDO)⁷, the definition of SMEs is a significant issue for policy development and implementation and depends primarily on the purpose of the classification. For the purposes of policy development, UNIDO generally advises countries to take into account the quantitative and qualitative indicators for SME definition. Table 4 in Appendix 3 summarises the main qualitative indicators that may be used in order to differentiate between SMEs and large companies.

⁴ Literature Review on Small and Medium Enterprises' Access to Credit and Support in South Africa, prepared for National Credit Regulator (NCR), compiled by Underhill Corporate Solutions (UCS)

⁵ ibid

⁶ ibid

⁷ http://www.abj.org.jo/AOB_Images/633547381649218750.pdf

It should be noted that it is not the intention of IOSCO to be prescriptive and to provide a specific definition of SMEs.

3.2. SME Market Structure

The survey responses identify a range of factors used to describe or characterise SMEs in their jurisdictions. The most common thresholds used to differentiate or identify SMEs are number of employees, value of assets, annual sales turnover, market capitalisation, minimum free-float rate, paid up capital and minimum size of the offering. Some measures implemented by certain jurisdictions to identify or differentiate SME issuers from others in capital markets are summarised in Table 1 in Appendix 3.

SME markets aim to provide smaller companies with a platform to raise capital. A majority of the respondents highlighted the existence of a separate SME market in their jurisdiction which has less stringent requirements than the main market⁸.

Based on the 2012 mini survey, 19 jurisdictions⁹ stated that the separate market is organised under the main market as a junior market. Ten jurisdictions¹⁰ mentioned that the separate market operates as a separate exchange. In China for instance, in addition to its existing SME market that comprises two segments, namely the SME Board and the Growth Enterprise Board (GEB), it further developed a SME multi-tiered equity market in 2013 by launching a separate trading venue called the National Equities Exchange and Quotations (NEEQ), popularly known as the “New Third Board”¹¹.

On the other hand, some jurisdictions reported that there is no SME market separate from the main market in their jurisdictions¹².

Out of the new jurisdictions that responded to the 2014 mini survey, Dominican Republic, Mexico, Sri Lanka, Morocco and Slovenia also reported that there is no separate SME market in their capital markets. However, the laws governing stock exchanges and other laws in some

⁸ As reported by the survey respondents, 27 jurisdictions including, Argentina, Canada, Chinese Taipei, Denmark, Egypt, Germany, Hong Kong, Iceland, India, Italy, Kenya, Korea, Lithuania, Malaysia, Maldives, Mauritius, New Zealand, Pakistan, Peru, Poland, Portugal, Singapore, South Africa, Spain, Thailand, Turkey and United Kingdom have a separate SME market.

⁹ Argentina, Denmark, Egypt, Germany, Iceland, Kenya, Korea, Lithuania, Malaysia, Maldives, Mauritius, Pakistan, Peru, Poland, Portugal, Singapore, South Africa, Thailand and Turkey.

¹⁰ Canada (Ontario), China, Chinese Taipei, Hong Kong, India, Italy, New Zealand, Spain, Tunisia and United Kingdom

¹¹ For more details, refer to the IOSCO Research Note on *Market-Based Long-Term Financing Solutions for SMEs and Infrastructure* (September 2014) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD452.pdf>

¹² Australia, Brazil, Colombia, Denmark, Dubai, Ecuador, Greece, Hungary, Israel, Macedonia, Malawi, Morocco, Oman, Panama, Romania, Slovenia and United Arab Emirates.

jurisdictions¹³ are undergoing a major reform mainly to create SME markets. The Casablanca Stock Exchange plans to launch a SME market in 2015.

Table 3 in Appendix 3 shows the dates when various standalone SME markets were launched in different jurisdictions. The oldest SME market among survey respondents was established in 1987 in Singapore. The establishment of SME markets became a widespread practice after the year 2000. Since then 19 jurisdictions have established separate SME markets.

In this section of the Report, brief information regarding SME markets in various jurisdictions is provided, including Canada (Ontario), Greece, Brazil, New Zealand, Chinese Taipei and Israel.

In Canada (Ontario), the SME market is separate from the main market, the Toronto Stock Exchange (TSX). Briefly, it is comprised of the secondary market trading in Venture Issuers with securities listed on either the TSX Venture Exchange (TSXV)¹⁴ or the Canadian National Stock Exchange (CNSX), there is also the over-the-counter secondary market trading in securities of small public companies (reporting issuers) that have either never sought formal listing on a stock exchange in Ontario or that have been de-listed. SMEs that have been de-listed from TSXV may continue to trade for a prescribed time period on a separate board of TSXV. Companies that have low levels of business activity or have ceased to carry on active business are traded on this board. The TSXV is organised as a junior market under the main market and, along with CNSX, is subject to oversight by the securities regulator in Ontario.

The TSXV currently classifies Venture Issuers into different tiers based on prescribed criteria, including historical financial performance, stage of development and financial resources of the Issuer at the time of listing. Tier 1, being the premier tier, is reserved for its most advanced issuers with sizable financial resources. Tier 1 Venture Issuers include comparatively larger firms which benefit from less stringent filing requirements. Tier 2, on the other hand, is the tier where the majority of the TSXV's listed issues are traded.

In Greece the “Alternative Market” operates on the main market as a Multilateral Trading Facility¹⁵ as described in the Markets in Financial Instruments Directive (MiFID) of the EU.

While there is no separate SME market in Brazil, a listing segment on the main market is designed for SMEs.

¹³ Brazil, Morocco and Israel

¹⁴ For more details, refer to the IOSCO Research Note on *Market-Based Long-Term Financing Solutions for SMEs and Infrastructure* (September 2014)
<http://www.iosco.org/library/pubdocs/pdf/IOSCOPD452.pdf>

¹⁵ Article 4 (15) of MiFID describes MTF as multilateral system, operated by an investment firm or a market operator, which brings together multiple third-party buying and selling interests in financial instruments – in the system and in accordance with non-discretionary rules – in a way that results in a contract..

In the case of Mexico, the Securities Market Law (Ley del Mercado de Valores - LMV) published in 2005 and amended in 2014, provides the regulatory framework for two kinds of listed companies: i) public listed company (SAB, for its acronym in Spanish for Sociedad Anónima Bursátil) and Stock Market Investment Promotion Companies (SAPIB for its acronym in Spanish for Sociedad Anónima Promotora de Inversión Bursátil). SAPIB was created in 2005 to promote SME financing through the equity market. SAPIBs have up to ten years to convert into a SAB or when stockholders' equity reached USD 95.10 million (approximately), whichever occurred first. SAPIBs have more flexible listing and maintenance requirements than SABs. Nonetheless, SAPIBs are required to adopt progressively the regulatory regime that applies to SABs, including corporate governance requirements.

New Zealand has two markets for smaller companies. One is a registered securities market operated by the main exchange and is regulated under the Securities Markets Act. The only entry requirement to this market is a minimum number of shareholders (50). The second market is a trading facility called Unlisted¹⁶, which is a largely unregulated and unregistered to securities market or exchange and has no minimum/maximum entry requirements. Unlisted provides a facility for trading previously allotted securities. Trading in securities quoted on Unlisted can only be conducted via brokers. Investors trading in securities quoted on unlisted trade at their own risk. Unlisted is not accompanied by the investor protections which accompany a licensed financial product market. Issuers remain bound by the obligations contained in their constitutions and other legislation including the Companies Act and the Financial Reporting Act and by Common Law.

In Chinese Taipei, the SME market is organised under the main market but the trading system is different to the main market.

A proposed model in Israel is to consider the adoption of separate listings for smaller companies, a regular listing for corporations to which the regular disclosure requirements will apply and a separate list for smaller companies, which will be subject to less stringent disclosure requirement. SME issuers vary greatly in terms of their scale sometimes even within the same jurisdiction. It may be useful to have an idea of average market capitalisation of issuers in different SME markets.

Based on data provided by the jurisdictions that responded to the Survey, the average market capitalisation of a SME issuer in SME markets and its ratio to the average main market issuer capitalisation is provided in Appendix 3, Table 6.

As shown in Table 6, Appendix 3, the average market capitalisation of SMEs substantially differs among jurisdictions. For example, in the data provided in 2012, the average market capitalization of SMEs is only USD 2.7 million in South Africa, compared to USD 85.1 million in the UK. Even among EU countries, the range of market capitalisation of SMEs varies from USD 6.1 million to USD 85.1 million.

¹⁶ Unlisted provides a cost-efficient and simple share trading platform for small to medium sized companies (http://www.unlisted.co.nz/uPublic/unlisted_mt_public.html?p_id=2)

Table 7 in Appendix 3 provides details of the number of listed companies and market capitalisation of SME markets compared to the main market in the jurisdictions that provided data.

Generally, the number of listed companies in main markets exceeds the number of SME issuers in the capital markets. However, in Canada (Ontario), China and Korea the number of listed SME issuers exceeds the number of senior issuers. While the SME market capitalisation as a percentage of main market capitalisation is even below 1 percent in 12 jurisdictions, countries like Canada (Ontario), Chinese Taipei, Greece, Iceland, Korea, Mauritius, New Zealand and UK raise the average ratio to 1.48 percent.

In response to the 2014 survey, the number of companies in the SME market is still below that of the main market, though the SME market has expanded since the 2012 survey. The jurisdiction that has had significant changes is India, as the number of companies in the SME market jumped from eight in 2012 to 109 in 2014 and the market capitalisation in the same period, increased from USD 41 million to USD 2 078 million in 2014¹⁷. The SME market capitalisation as a percentage of the main market capitalisation, however, only rose by a small fragment, from 0 percent to 0.07 percent. China and Korea on the other hand have more of SME issuer companies than the main issuer companies. China has 1 014 more issuer companies than the main board as it has 2 480 SME listed companies relative to 1 466 of listed main companies. Korea has 1 061 SME companies compared with 772 companies in the main market, a difference of 290.

The data of the SME market capitalisation depicted in Table 6, Appendix 3, also shows that the main market's level of development may be one of the most significant impediments to SME access to finance in emerging markets. This observation could be explained by the direct relationship between the development level of the main market in terms of depth and liquidity and opportunities provided by that market. Consequently, it is obvious that a deeper and more liquid market could provide more opportunities for the growth of the SME market¹⁸.

Survey responses show that listed SMEs operate in a number of sectors. Technology,

¹⁷ The expansion of the SME market in India is due to the addition of two segments in their SME market in 2013 called the Bombay Stock Exchange SME Institutional Trading Platform and the National Stock Exchange SME Institutional Trading Platform.

¹⁸ In addition, 5 jurisdictions where there is no separate SME market also provided information about the funds that have been raised by SMEs from the main market by equity finance.

- Hungary stated that there are 33 listed issuers based on the SME definition. Their capitalization is Euro 555, 51 million based on the financial statements of 31.12.2011.
- Colombia mentioned that between 2007 and 2011 there was only one IPO by an SME where the issuer raised USD 102.943 (COP \$200.000.000) from the market. On the other hand, there are two SMEs with temporary listing on the exchange, but their shares have not yet been issued.
- In Australia, 108 mid to small caps raised (in total) \$3 billion by IPOs in 2011. In the same year, mid to small caps raised an additional \$4.1 billion through secondary capital raisings with private placements to selected investors. Such private placements are not conferred to all existing shareholders and are subject to a 15 per cent capital raising limit.
- Peru stated that one SME raised US \$ 42.7 million by an IPO in 2012.

financial services, real estate, construction, consumer goods and services and industrial products are the main sectors. Table 8 below shows the distribution and market capitalisation of these main sectors in which SMEs operate in 18 jurisdictions that submitted data.

Table 8 - Number of SMEs under Sectors (30 June 2012- Market Cap in USD million)

	Technology		Financial Services		Real Estate & Construction		Consumer Goods and Services		Industrial Products	
	Number	Market Cap	Number	Market Cap	Number	Market Cap	Number	Market Cap	Number	Market Cap
Argentina	2	5	2	1	4	10	11	16	3	6
Canada (Ontario)	111	1,284	47	1,999	30	1,010	169	70	163	1,895
Chinese Taipei	102	6,710	4	1,230	3	74	4	356	32	1,179
Denmark	-	-	65	8	-	-	-	-	26	3
Egypt	2	19,09			4	35	7	40	3	13
Hong Kong	56	3,099	14	857	2	158	71	2,919	14	1,052
Israel	-	-	69	715	78	1,224	64	1,121	121	1,499
Italy	4	87	2	84	-	-	-	-	15	199,95
Korea	29	3,211	15	1,073	28	1,819	667	56,887	62	180
Malaysia	72	1,444	1	29	-	-	25	626	17	283
Mauritius	-	-	14	628.03	-	-	5	31.93	13	96
New Zealand	-	-	11	280	-	-	13	249	-	-
Poland	30	248	31,241		17	183	61	324	-	-
Singapore	14	329.41	11	751.60	-	-	35	1,167.5	61	1117
South Africa	9	11.38	11	67.36	-	-	12	50.16	23	54
Spain	5	174.80	-	-	-	-	14	299,30	2	101
Turkey	-	-	1	8.9	-	-	1	10.1	4	130
UK	-	-	235	15,859	179	12,905			204	10,884

The respondents were asked how many SME issuers, if any, had since graduated from the SME market to the main board. Responses are depicted in Table 9 below:

Table 9 - Number of SMEs which have graduated to the Main Market

2007-2012			
0 SME	1-5 SMEs	6-10 SMEs	More Than 10 SMEs
Argentina, Brazil Colombia, Dubai, Egypt, Greece, Iceland, India, Italy, Lithuania, Malawi, Maldives Pakistan, Panama, Peru, Portugal, Spain,	Mauritius, Thailand, New Zealand,	Denmark	Canada (Ontario) (167), Chinese Taipei , Germany (13), Hong Kong (50), Korea (13), Malaysia (21), Poland (14) , South Africa, UK (40),
2012-2014 (year ending 30 June 2014)			
Republic of Macedonia, Palestine, India, Finland	Tunisia, Italy, Turkey	Republic of Mauritius, China, Korea	Chinese Taipei (279), Malaysia (14)

Seventeen jurisdictions have stated that no SMEs have moved up to the main market in the last five years running to June 2012. Three jurisdictions stated that between 1 to 5 SMEs have graduated to the main market and one jurisdiction stated that between 6 to 10 SMEs have graduated to the main market. Nine jurisdictions responded that more than 10 SMEs have moved up to the main market in the last five years.

The main reasons and motives for SMEs moving from the SME market to the main market are summarised as follows:

- When a SME company transfers to the main market, its shares become more liquid which gives shareholders the opportunity to sell their shares easily as an exit from the company
- The main market is a better benchmark for a company's valuation.
- Expectation of more investors seeking more liquidity and enhanced investment opportunities is another reason for being listed in the main market.
- Being listed on the main market ensures a stable investor base. For instance, it may attract more institutional investors and even foreign investors. Broadening the basis of shareholders attracts in-depth attention and recognition from key industry analysts and public investors (including institutional investors).
- Demand/request from shareholders and investors for the SME company to move to the main market.
- To enhance the reputation, profile and corporate image of the company.

It is important to note that, where an issuer no longer fits the definition of SME in a given jurisdiction, it is usually required to move from the SME market to the main market. As a consequence, the issuer may be subject to additional disclosure requirements, instead of the less stringent disclosure requirements applied in the SME market.

From the new response in the 2014 survey, five jurisdictions responded that no SMEs moved to the main market, two jurisdictions stated that between one to five SMEs moved to the main market and three jurisdictions reported that between six to ten SMEs upgraded to the main market. More than 10 SMEs moved to the main market in two jurisdictions.

4. ACCESS TO FUNDING FOR SMES

4.1. Principal sources of SME financing in relation to SME financing life cycle

The source and the availability of financing for an SME are seen as the major factors behind its development, growth and success¹⁹. The financial needs and the financing options open to SMEs vary depending on the stage in a firm's lifecycle. The access an SME has to capital depends on a number of factors, such as its level of development, the availability of finance in its jurisdiction, the nature of its business and its marketing capabilities, and the professional connections of the entrepreneur in charge.

The level and the type of demand for financing throughout an SME's life cycle depends on its stage of growth, as each stage requires a different financing strategy²⁰. This approach enables the business to grow and reach the capital markets, where it can raise long-term financing and sustain its growth.

The literature on the life cycle financing for SMEs indicated that SMEs should apply a holistic approach by using specific and different financing vehicles during their life cycle, as this leads to growth and survival. The life cycle financing approach cannot be applied to every small business; however, based on theory and empirical evidence, SMEs that adopt this approach reaped the benefits. The types of financing sources that are used on average by SMEs during their life cycle include:

- internal equity finance, represented by owner-manager personal savings, internally generated profits;
- venture capital;
- external equity, i.e. business angels;
- debt financing, e.g. mezzanine;
- trade credit;
- bank funding; and
- securities market.

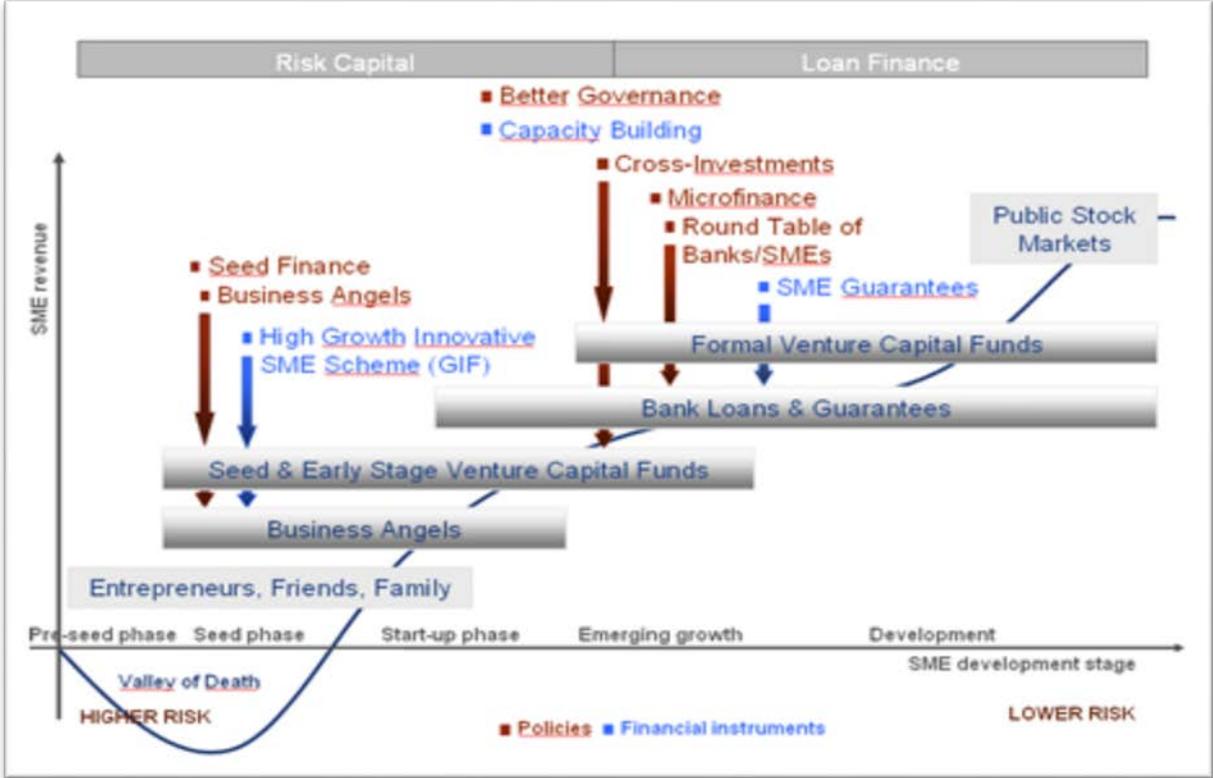
¹⁹ Cook, P. (2001). Finance and Small and Medium-Sized Enterprise in Developing Countries. *Journal of Development Entrepreneurship*, 6(1), 17.

Ou, C., & Haynes, G. W (2006). Acquisition of Additional Equity Capital by Small Firms- Findings from the National Survey of Small Business Finances. *Small Business Economics*, 27(2), 157-168. <http://dx.doi.org/10.1007/s11187-006-0009-8>.

²⁰ Abdulsaleh, A.M., & Worthington. A. C. (2013). Small and Medium Enterprises Financing: A Review of Literature, *International Journal of Business and Management*, Vol. 8, No. 14; 2013.

The above mentioned financing options produce benefits provided that they are used in the appropriate stages of the SME’s life cycle. The stages that exist within the life cycle of an SME, as depicted in the graph below (for example), include seed-stage, start-up stage, emerging stage and expansion / development stage.

Graph 1- The SME life cycle and financing needs.



Source: DG Enterprise, 2007

The graph demonstrates a funding escalator that depicts the type of financing required at each stage of an SME life cycle as it grows or transitions.

- At the start of a small business or during the seed stage, personal savings of entrepreneurs, family and friends, as well as second mortgages on property are often the most important sources of financing, as these firms tend to be highly risky with intangible assets, a lack of trading history and informational opacity. These features pose a difficulty for small businesses to secure loans from financial institutions, such as banks.
- At the second phase of survival during the start-up stage, personal funds become depleted and external sources of funding become necessary. At this stage, the investment in small businesses is still regarded as high risk and the business is not large enough to attract the attention of venture capitalists. Wealthy individuals like business angels can fill the gap between personal funds and institutional venture capital funds. The other appealing factor with regards to business angels is that they contribute their expertise, knowledge and contacts.

- After the small business has passed through the early stages, it requires a further injection of capital to fund growth. At this stage, the SME may still not qualify for debt financing due to its reliance on intangible assets, inability for investors to assess its future growth prospects, low profitability and short track record, thus making the SME unsuitable to raise equity through a public listing. Venture capitalists play a role in alleviating such financing obstacles faced by young firms at this stage. Venture capitalists scrutinize such firms intensively before providing capital and then monitor them closely afterwards.
- In the more advanced stages, such as the emerging and the development stages, the firm has established a track record, has the ability to provide collateral and information regarding its performance and has become more transparent, such that it may access securitised debt and publicly listed equity markets. The debt financing the firm can access includes bank loans, mezzanine funding, and debt securities.

Empirical studies on literature reviewed support the idea behind the life cycle financing approach. For example, Myers (1984) and Myers and Majluf (1984) proposed the Pecking Order Theory (POT), which states that firms will meet investment and financing requirements in a hierarchical fashion, with priority given to internal funds first, external debt and external equity as a last resort.

Chittenden et al. (1996) suggests that, consistent with the POT, there is a positive relationship between a firm's size and its source of financing, as smaller firms are more likely to rely on internal funds.

To date, the traditional approach to SME financing through application of proportionate regulation with less burdensome disclosure and listing requirements - initial and ongoing – has not always proved to be sufficient. Similarly, although multi-tier exchange structures can have an important role to play, they cannot be the only solution to the SME financing gap. New ways and alternative methods of financing should be considered through the involvement of more innovation and use of technology. IOSCO recently published its research note on *Market Based Long Term Financing Solutions for SMEs and Infrastructure*²¹, which was sent to the G20 Finance Ministers. The note illustrates some novel techniques for SME financing. One such example is AliBaba using its online trading and payment platforms to collect and analyze SME data. This technique solves one of the biggest impediments to SME financing; namely providing “data” regarding the creditworthiness of SMEs. AliBaba analyses and uses the transaction data it collects for loan distribution and collection. Integrated platforms like Alibaba combine transaction rated electronic commerce, an e-payments system and financial market services such as banking services and money market funds. The growth of this business model is particularly rapid and seems to be an effective method in supporting the financing of the SME industry.

²¹ <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD452.pdf>

Other types of SME financing are dependent not just on the availability of the financing instruments but also on the financial knowledge of the SMEs. Asset backed financing and securitisation could be used by SMEs. However, the amount of investment in these structured finance instruments depends on the maturity of local financial markets, the value of the backed assets, the credit rating of the SME, and whether the instrument is standardized and its potential liquidity. In addition, there are different types of “hybrid instruments” that SMEs could use which are basically a combination of debt and equity features that culminates into a single financing vehicle. Crowd funding through an online platform is another innovative financing method for SMEs, as long as regulators are well aware of and prepared for the investor protection and market abuse concerns it can raise. IOSCO believes that these new ways and alternative methods of funding that are cost efficient could be encouraged by SMEs in different jurisdictions.

4.2. Types of financing used by the surveyed jurisdictions

The jurisdictions that responded to the 2012 questionnaire were asked to rank the principal sources of financing of both publicly held and private SMEs in the survey. The responses are provided in Table 10 below.

Table - 10 Sources of SME Finance

	1	2	3	4	5
Argentina	Bank Loans	Deferred Payment Checks	-	-	-
Australia	Bank Loans	Owner’s Equity	Venture Capital	Equity Markets	Corporate Bonds
Brazil	Bank Loans	Equity Finance	Government Funds	Venture Capital	
C. Taipei	Bank Loans	Equity Finance	Corporate Bonds	-	-
Canada	Savings	Family finance-Love Money	Bank Loans	Supplier Credits	Lease Financing
Denmark	Bank Loans	Equity Capital	Venture Capital	International Funds	Corporate Bonds
Ecuador	Bank Loans				
Egypt	Bank Loans	International Funds	Equity Finance	-	-
Germany	Own Funds	Bank Loans	Subsidies	Equity Capital	
Greece	Bank Loans	Corporate	Venture	Equity	-

	1	2	3	4	5
		Bonds	Capital	Finance	
Hungary	Bank Loans	EU funds	Factoring Leasing	Venture Capital	State subsidy
Israel	Corporate Bonds	Bank Loans	Non-Bank Loans	Foreign Bank Loans	-
Italy	Bank Loans	Venture Capital	International Funds	Equity Finance	Corporate Bonds
Kenya	International Funds	Bank Loans	Family Financing	Supplier credit Finance	Development Funds
Korea	Bank Loans	Policy Funds	Corporate Funds	Equity Finance	Non-Bank Loans
Lithuania	Bank Loans	Venture Capital	-	-	-
Malawi	Bank Loans	Venture Capital	-	-	-
Malaysia	Bank Loans	Development Funds	Government Funds	Venture Capital	Factoring Leasing
Maldives	Bank Loans	-	-	-	-
Mauritius	Owner's Equity	Bank Loans	-	-	-
New Zealand	Related Parties Loans	Bank Loans	Sale of Personal Assets	Private Equity	IPOs
Oman	Bank Loans	Venture Capital	Leasing	- Government Funds	-
Pakistan	Retained Earnings	Bank Loans	-	-	-
Panama	Bank Loans	-	-	-	-
Peru	Bank Loans	Venture Capital	Short Term Debt	Corporate Bonds	Equity Capital
Portugal	Self- Investment	Bank Loans	Equity Finance	Corporate Bonds	International Funds
S. Africa	Bank Loans	Equity Finance	Angel Investors	Venture Capital	
Singapore	Shareholder's Equity	Bank Loans	Equity Capital	Venture Capital	Angel Capital
Slovenia	Bank Loans	Corporate Bonds	Equity Finance	-	-
Spain	Capital Investments	Bank Loans	Commercial Credit	Venture Capital	Corporate Bonds

	1	2	3	4	5
Thailand	Family Financing	Accumulated Profit	Bank Loans	-	-
Turkey	Bank Loans	Equity Capital	Supplier Credits	Other Financial Institutions	Government Subsidies
UK	Credit Cards	Overdrafts	Trade Credit	Leasing	Term Loans

The survey responses show that bank loans are the primary source of financing for SMEs in the majority of the jurisdictions. After bank loans, equity finance, venture capital, governmental and international funds²² are the other most common sources of SME financing.

The remaining jurisdictions stated they do not have available statistics on the relative size of funds raised by SMEs from the various sources ranked in Table 10 above. Table 11 below shows the average share of each source of SME financing, based on the information provided by the 11 respondents. Accordingly bank loans appear to be the dominate source of financing, followed by equity finance and venture capital.

Table 11 – The Breakdown of SMEs Finance Sources

	Sources	percent
1	Bank Loans	60
2	Equity Finance	25
3	Venture Capital	10
4	Other-Governmental and International Funds, Corporate Bonds, Factoring and Leasing	5

4.3. Cost of capital – Traditional and non-traditional sources

The cost of capital varies from company to company, and depends, amongst other considerations, on factors such as operating history, profitability and credit worthiness. In general, newer enterprises with limited operating histories will have higher costs of capital than established companies with a solid track record, since lenders and investors will demand a higher risk premium for the newcomers.

Every company has to chart out its game plan for financing its business at an early stage. The cost of capital thus becomes a critical factor in deciding which financing track to follow – debt, equity or a combination of the two.

In addition, entrepreneurs are often required to provide personal guarantees in order to access bank finance. Thus, the amount of personal wealth invested in the venture, is not only the

²² Typically, these international funds are SME funds established by International Finance Institutions, e.g. the International Finance Corporation, European Investment Bank, East African Development Bank

equity. In fact, in case of liquidation, entrepreneurs can incur additional losses linked to the guarantees provided.

A bank may charge prime plus a number of basis points, with the likelihood of also asking for a personal guarantee. There are also hybrid instruments, which combine characteristics of debt and equity.

For investors, especially those considering investing globally, estimating the cost of capital in less-developed (i.e. “emerging”) countries can present an even greater challenge, primarily due to lack of data (or poor data quality) and the potential for magnified financial, economic, and political risks²³. The risks associated with investing internationally can largely be characterised as *financial, economic, or political*. Many are risks associated with investing in general – a possible loan default, a possible delay in payment of supplier credits, possible inefficiencies arising from efforts to comply with unfamiliar (or burdensome) regulation, and asymmetric information and liquidity issues, to name just a few. Some risks, however, are typically associated more with global investing: currency risk, lack of good accounting information, poorly developed legal systems and even expropriation, government instability, or war.

4.4. IPO Cost

Going public requires the involvement of several service providers (intermediaries, auditors, legal advisors, communication specialists, etc.). Some of the fees related to these services are fixed and others are determined according to the amount of capital raised. The principal expenses for an SME’s IPO include audit and accounting fees, legal fees, underwriters’ fees, associated regulatory fees, exchange listing fees, communication, marketing and investor relations fees, printing, public relation service fees, transfer agency fees, NOMAD²⁴ and market maker fees.

None of the jurisdictions conducted a comprehensive study to identify the cost structure of SME IPOs. Some jurisdictions submitted the overall cost while others provided a breakdown of the costs derived from recent public offers, which may not reflect the exact IPO cost structure of their markets. The results are summarised below.

²³

http://www.duffandphelps.com/sitecollectiondocuments/articles/DUF_COC_Emerging_Markets_Sept_2010.pdf

²⁴

A NOMAD is a company that has been approved as a nominated advisor for the Alternative Investment Market (AIM), by the London Stock Exchange. The primary responsibility of a NOMAD is to help a new company in its admission to the AIM, and to provide advice and to avoid the delisting of the new company. The London Stock Exchange sets strict criteria for becoming an AIM Nomad, in order to safeguard the integrity of the market, and to ensure that existing and prospective AIM companies have access to the high-quality advice they deserve. A similar system is found in a number of jurisdiction, albeit called different names.

The overall cost as a percentage of the offered amount differs widely. It is up to 20 - 30 percent in Singapore and as low as 0.49 percent in India. Some other examples are 12 - 15 percent in Canada (Ontario), 5 - 10 percent in Dubai, 10 percent in Greece, 4.2 percent in Korea, 1.8 percent in Macedonia, 8 - 20 percent in Malaysia, 10 percent in Morocco, 6 - 7 percent in New Zealand, 16.6 percent, in Spain, and 11 percent in UK.

Within total IPO costs, underwriting cost is the most important item. As a ratio to offered amount, it is 10 – 12 percent in Canada (Ontario), 2.45 percent in Iceland, 3 – 7 percent in Italy , 5 – 8 percent in Lithuania, 3 percent in Korea, 1 – 2 percent in Malaysia, 5.2 percent in Spain, and 3 percent in Thailand.

Peru states that the IPO cost is between USD 100,000 and USD 140,000 and the underwriting cost ranges from USD 50,000 to USD 70,000 depending on the offer. In Chinese Taipei, the underwriting cost is 66 percent of the total IPO cost.

A common practice with initial issuances in the equity capital markets entails a lock-up period. A lock-up provision is a contractual arrangement between insiders of a firm undergoing an IPO and the underwriter who agrees not to sell shares for a specified period, usually 180 days after the IPO offer. Lock-ups are not required by law, but essentially all IPOs feature them. Insiders often own a large portion of the shares of a newly public firm. By restricting sales, the lock-up agreement insures that insiders will maintain a significant economic interest in the firm following the IPO, thereby aligning the interests of old and new shareholders. Lock-up agreements also limit the supply of shares available for trading, which may help support the issue price in the post-IPO period. Either way, the lock-up agreement should increase the marketability of the IPO, thereby increasing its likelihood of success²⁵.

Lock-ups are generally not binding in that shares may be sold before expiration if consent is given by the underwriter. In addition, lock-up expiration does not necessarily eliminate restrictions on insider sales. Furthermore, newly public companies, particularly in recent years, are often engaged in merger and acquisitions and/or other material non-public activity, thereby further limiting insider selling possibilities. Thus, even though a lock-up expires, it may be several years before an insider is legally allowed to sell²⁶.

Traditionally, going public via an IPO has been the predominant path for a private firm to obtain a listing status on a stock exchange. However, alternative routes for going public are also available and one of these routes include reverse takeover (RTO). Because of the unique

²⁵ Bradford D. Jordan, Daniel J. Bradley, Ivan C. Roten, and Ha-Chin Yi*. *Venture Capital and IPO Lockup Expiration: An Empirical Analysis*. University of Kentucky

²⁶ *ibid*

features of the RTO transactions, going public through this path is commonly known as backdoor listing (hereafter BDL)²⁷.

BDL deals are complex inter-corporate transactions by which unlisted private-held firms achieve a listing status through the corporate shell of publicly-listed companies. A BDL transaction is normally structured as a takeover of the private firm by the public company but in essence, the vendors of the private firm obtain control of the enlarged public shell (a reverse takeover) at the conclusion of the event. From the public firms' point of view, BDLs represent major corporate restructurings which typically involve a change of name, business activities, board of directors and management. From the private firms' perspective, BDLs can be seen as an alternative route for going public and has often been touted as a cheaper, easier and faster way to go public. Backdoor listing is, in particular, popular in Australia as there has been no shortage in the supply of listed shell companies on the Australian Stock Exchange (ASX).

In Australia, reverse takeover transactions are normally structured as an acquisition by the public firm of all the shares in the private firm, so that the latter becomes a wholly-owned subsidiary of the former. However, the deal can also be structured as an acquisition of assets and business operations from the private firm vendors. The public firm pays for the acquisition by issuing a large quantity of new shares with voting rights in the company to the private firm vendors. The consideration shares may be supplemented by other forms of consideration, which may include cash, stock options, convertible notes and earn-outs (e.g., performance shares). At the conclusion of the reverse takeover transaction, the private firm vendors obtain effective control of the combined public private entity. The private firm becomes part of an enlarged group, which is publicly-listed. In fact, the private firm business and assets will become the dominant focus of the merged entity since the public firm is essentially a corporate shell with no or minimal operations.

4.5. Participation of institutional investors in SME financing

The investment strategies of institutional investors differ significantly across countries. Asset allocation is influenced by a variety of factors such as market trends, investment beliefs, regulation, risk appetite, liability considerations, cultural factors, governance structures, tax issues and ultimately domestically available assets.²⁸ With over USD 70 trillion in assets, institutional investors may provide an alternative source of financing.

The interest in alternative assets reflects the growing appetite among pension funds for diversification, their search for yield and the attraction of valuation methods for unlisted

²⁷ Brown, Philip R, Ferguson, Andrew and Lam, Peter. *Choice between Alternative Routes to Go Public: Backdoor Listing versus IPO*. July 30, 2010. Available at SSRN: <http://ssrn.com/abstract=1897816> or <http://dx.doi.org/10.2139/ssrn.1897816>

²⁸ <http://www.oecd.org/finance/private-pensions/G20reportLTFinancingForGrowthRussianPresidency2013.pdf>

assets. Institutional investors have been increasing allocation to alternative assets such as hedge funds, real estate, private equity and, most recently, infrastructure.

The implementation of Basel III requirements is expected to have a significant impact on

SMEs. Financing to SMEs could come under pressure, according to some industry observers and analysts, who are of the view that the global banking regulatory standard will pose a challenge to banks as it could make SME financing more costly.

Many stakeholders, including regulators, the banking industry, as well as small businesses and their advisors, have warned that Basel III and its European version, the Capital Requirements Directive (CRDIV), which require banks, amongst other requirements, to hold more capital, are likely to have a disproportionately negative impact on SMEs' access to finance, even though this sector had little to do with the causes of the financial crisis. In Europe, given the greater dependence of SMEs on debt financing, the impact is likely to be even more adverse. It is therefore critical to develop alternative sources of funding, such as venture capital, micro credit or leasing, including through vehicles such as the new European Programme for the Competitiveness of Enterprises and SMEs (COSME)²⁹.

Policy makers are increasingly aware of the important role insurers can play in aiding economic recovery by providing long-term funding to businesses and households. Because most insurance policies create predictable and long-term liabilities for insurers, they can invest in long-term and illiquid assets³⁰. Insurers are ideal sources of the long-term funding for businesses that policy makers hope will stimulate renewed economic growth. However, certain policy developments could inadvertently threaten insurers' ability to continue providing this long-term funding. Due to the recent financial crisis, regulators are introducing new rules aimed at making financial institutions safer, but that may unavoidably increase the cost of lending. So financial firms must either charge borrowers more, dampening demand, or restrict their supply of funds.

A range of regulatory developments have the potential to create framework conditions that affect insurers' ability to continue providing long-term funding to the economy. Regulation is important for a healthy industry and the move to modern, risk-based regulation should be supported. The prudential regulation of insurers aims to ensure that they hold enough capital to cover the risks they face and that they act in the interests of their policy holders. Such regulations can affect insurers' investment behaviour, making some assets less attractive than others in cases where, for example, capital rules might apply a high capital charge to certain assets, creating a disincentive to invest in them³¹.

²⁹ From Basel III to alternative sources of funding: Assessing the impact of financial regulation on access to finance for SMEs and the real economy

³⁰ <http://www.insuranceeurope.eu/uploads/Modules/Publications/funding-the-future.pdf>

³¹ *ibid*

Private equity is an asset class consisting of equity in operating companies that are not publicly traded on a stock exchange. Private equity capital has a continuing claim on corporate earnings; therefore it can be used to finance projects with uncertain and long-term returns such as research and product development. Consequently, private equity plays a special role in funding new and innovative business ventures that have an uncertain outcome and form the very basis for economic growth³². Development Finance Institutions (DFIs) often have a long term perspective and see themselves as long term investors. DFIs are typically comfortable locking in their capital for 8-10 years and rely on fund managers to decide exits. As such, there is merit to examine the role that DFIs can play in supporting SME financing including playing a stronger role as catalyst investors to go beyond the provision of financing. Further, there is a potential for DFIs to reach more frontier markets and aid in the development of the venture capital or private equity sector in these jurisdictions.

There is much that can be done to advance an understanding of the results of the investments already made by DFIs. The IFC is leading efforts to harmonise SME finance indicators and the system of data collection. The objective is to establish a consistent framework to measure the development impact of investments in SMEs and help bridge the SME funding gaps in the best way possible. These efforts will certainly assist in understanding how DFIs can effectively support SME financing gaps³³.

4.6. SME Financing through capital markets

SMEs have largely relied on bank loans for financing rather than capital markets. However, since the financial crisis, access to bank lending has become more challenging following a period of bank deleveraging, reduced lending and tighter lending criteria by banks as well as the introduction of more stringent capital requirements associated with Basel III. In this regard, and against the backdrop of a shift towards market-based financing, there is therefore a greater need for capital markets to play a stronger role as a source of financing for SMEs.

The survey responses clarify the following crucial points on the respondents' views about the efficiency of raising equity capital in comparison to other financing options.

- Raising equity capital by means of capital markets primarily offers access to capital via an organized, transparent, orderly functioning and reliable market.
- Unlike borrowing, equity finance does not require principal and interest payment obligations that may put pressure on the cash flows of a company.
- Also, with regard to equity financing and listing on a stock exchange, firms can benefit from the positive effects of market discipline on the quality of management and from greater visibility for potential investors, suppliers and clients.

³² *ibid*, p. 24

³³ <http://www.cgap.org/blog/how-are-public-investors-and-donors-fillingthe-sme-financing-gap>

- SMEs generally have limited access to venture capital and debt funding, particularly at the early stages in their life cycle. In order to promote new areas of growth and move towards an innovation-led economy, there is a need to strengthen new avenues of financing to support start-ups and innovative firms. Banks are typically not structured to take on these types of financing, and because of this, access to equity capital is key to financing the growth of these firms.
- Financing options appropriate for an SME issuer will depend on many factors, including its stage of development, business plan, industry segment, management experience and marketing experience. The majority of SMEs are not publicly traded so it would appear capital market financing is either not an attractive and/or viable option for most of them.
- In terms of efficiency, raising equity capital may involve a longer process when compared to other financing options. It may also require a greater initial outlay of costs and involve ongoing regulatory and administrative compliance requirements.
- SMEs choose to raise funds by way of equity financing for reasons that are unique to their particular circumstances, owners and management. Whilst borrowing rates may be higher than the cost of equity capital, the overall cost of listing and ongoing compliance may outweigh the benefit of that lower cost.

Therefore the following issues would have to be considered in conjunction with the other benefits of being a publicly traded company:

- Better access to capital for growth with opportunities to raise funds both at the time of listing and at later stages.
- Higher profile and visibility in the market resulting in increased business, greater assurance among the company's customers and suppliers and an improved corporate image.
- Increased corporate transparency to gain recognition from institutional funds and the investing public.
- Improved corporate governance as a result of listing requirements to help improve management efficiency and information flow.
- Fostering employee motivation and loyalty through stock option programs.
- Raising funds from capital markets after listing by issuing new securities, since investors are often prepared to provide follow-up funding as the business grows.
- Present incentive for greater venture capital participation by providing them an exit route.

4.7. Equity Capital Markets

Multi-tiered markets have been increasingly important in providing a viable option for SMEs to access market-based financing while addressing the demands of various parties. For example, by providing SMEs with specific entry and regulatory requirements tailored to their characteristics at lower listing cost compared to the main market as well as acting as a

liquidity provider with a wider investor base on a transparent and compliant platform³⁴. Notwithstanding, there are still certain challenges to the widespread use of multi-tiered markets for SMEs. For example, although the listing cost is lower compared to the main market, the average cost for companies to list (USD 80- USD 100 000) and remain listed (USD 100- USD 120 000 per annum) can be high for some SMEs which suggests that SME listing platforms are more suited to larger SMEs.³⁵

In Korea and Turkey, there are specific market segments for SMEs within the main exchange. The listing and disclosure requirements are relaxed in both countries compared with the main markets. There are also government, exchange or regulator incentives to improve SME listings. Over-the-counter (OTC) markets for unlisted companies, which are mostly SMEs, are also established in both countries. Generally, market advisors assist the companies to list on the exchanges. In Turkey, SME equities are traded with a market making system, whereas in Korea, continuous trading takes place.³⁶

According to the ADB Working Paper Series on Regional Economic Integration (2014), in emerging Asia, equity financing venues for SMEs have been mostly created under stock exchange operations³⁷. India has recently developed dedicated stock exchanges for SMEs, following the recommendation of the Prime Minister's Task Force in June 2010. The Bombay Stock Exchange (BSE) launched the SME Exchange in March 2012 and it had 41 listed SMEs as of 19 November 2013. The National Stock Exchange (NSE) has also launched the SME platform named Emerge, with three listed SMEs.³⁸

KOSDAQ is the largest organised market for SMEs and venture businesses in the Republic of Korea and is operated by the Korea Exchange (KRX). As KOSDAQ is becoming a funding venue for high-end larger enterprises, a new market designed for SMEs named KONEX was launched under KRX in July 2013. MESDAQ under Bursa Malaysia was re-launched as the ACE (Access, Certainty, Efficiency) market in August 2009, a sponsor-driven alternative market. Catalyst in Singapore is a Singapore Exchange (SGX)-regulated but sponsor-supervised market for rapidly growing enterprises, modelled on the UK-AIM (December 2007). The Securities Exchange of Thailand (SET) has operated the market for alternative investment (mai) since June 1999, targeting SMEs as potential issuers³⁹.

Equity markets for SMEs in emerging Asia are typically small in scale, with market capitalisation equal to less than 10 percent of GDP and market performances that significantly

³⁴ IOSCO Research Note on *Market-Based Long-Term Financing Solutions for SMEs and Infrastructure* (September 2014) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD452.pdf>

³⁵ Oliver Wyman report on *Towards Better Capital Markets Solutions for SME Financing*, 2014

³⁶ *Financing of SMEs through Capital Markets in Emerging Market Countries*

³⁷ *Capital Market Financing for SMEs: A Growing Need in Emerging Asia*, ADB Working Paper Series on Regional Economic Integration

³⁸ *ibid*

³⁹ *ibid*

vary by country. In China, both the SME Board and GEB have been sharply expanding in terms of size and the number of listed companies, with more than 1,000 listed companies in both markets combined, although their growth rates have slowed recently. Similarly with China’s National Equities Exchange and Quotations (NEEQ), there are 881 companies listed as of June 2014⁴⁰.

KOSDAQ and Hong Kong, China’s GEM enjoyed V-shape recoveries from the global financial crisis, but the growth of these markets tends to be slowing with few new listings. The market size of Catalist Singapore, ACE Malaysia, and mai Thailand has not expanded well like similar markets in the China and the Republic of Korea, and their listed companies are not increasing at a sufficient pace. This suggests that equity markets in Asia, except for those in China and the Republic of Korea, have not yet become a financing venue for SMEs. Extensive national policies and strategies for improved SME access to capital markets are needed⁴¹.

In China, the Shenzhen Stock Exchange (SZSE) has developed a three-tier market venue comprising the Main Board, SME Board (May 2004), and the GEB (October 2009; high-tech venture board), in line with national economic development strategies. Hong Kong, China’s Growth Enterprise Market (GEM), is an alternative stock market for high-growth enterprises operated by the Stock Exchange of Hong Kong Ltd⁴².

Another successful equity market in China that was established in 2013 is NEEQ, which was designed to address the different needs of SMEs of varying size and stages of development⁴³. Market making services were launched on the NEEQ in August 2014.

4.8. Debt Capital Markets

The Oliver Wyman report titled “*Towards Better Capital Markets Solutions for SME Financing*” postulated that given the low interest rates seen in most developed markets, issuing debt securities has become a better option than equity IPOs. In Europe there has been an increase in small bond issuances of less than USD 15.6 million. With equity platforms, issuing debt securities is better suited to the more mature and larger SMEs⁴⁴.

According to the report, Spain recently set up MARF, an alternate fixed income platform designed to ease access to the market for both issuers and investors, and that NYSE Euronext recently announced plans to promote the issuance of corporate bonds by SMEs via its

⁴⁰ ibid
⁴¹ ibid, p.27
⁴² ibid, p.27
⁴³ Refer to the IOSCO Research Note on *Market-Based Long-Term Financing Solutions for SMEs and Infrastructure* (September 2014) <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD452.pdf>
⁴⁴ *Towards better capital markets solutions for SME financing*, 2014 Oliver Wyman, fn 35

Alternext Capital Markets Platform. The report also mentions that several regional stock exchanges in Germany have successfully launched SME debt platforms in recent years. As a result, close to USD 4.2 billion have been raised via the SME bond market platforms established individually by the Düsseldorf, Frankfurt, Hamburg-Hannover, Munich and Stuttgart exchanges.

These initiatives are encouraging and are worth exploring further. Issuing equity and debt securities can provide SMEs with a stable, long-term financing that bank lending typically does not. Because these securities are tradable, their prices provide information about the performance and value of the SMEs concerned. This transparency, combined with the ease of exit created by tradable equity and debt, makes SMEs more attractive investments for venture capitalists (VCs), thus creating discipline on SMEs' management, improving their internal governance and external communications⁴⁵. It should however, be cautioned that corporate bond markets are generally not as liquid as government bonds, and therefore SME corporate bond issuances would be no exception.

There is a new movement for creating an SME bond market in countries such as China and Korea. In the latter, a qualified institutional buyer (QIB) system was established for SME bond trading in May 2012. However, SME bond transactions under the QIB system are quite limited and not attractive to individual and institutional investors due to the existence of low investment grade bonds (BB or below). China has developed three types of SME bond instruments: (i) SME Collective Note; (ii) SME Joint Bond; and (iii) SME Private Placement Bond. The SME Collective Note market is an inter-bank market regulated by the People's Bank of China (PBOC) and the National Association of Financial Market Institutional Investors (NAFMII). It is growing rapidly, with annual issuance of USD 1.1 billion in 2012. An SME Collective Note is issued on behalf of between two and 10 SMEs and generally guaranteed by a guarantee institution. SME Joint Bonds are traded in the inter-bank and exchange markets, which are regulated by the National Development and Reform Commission (NDRC), but the issuance volume is quite limited at USD 0.24 billion in 2012. SME Private Placement Bonds are regulated by the China Securities Regulatory Commission (CSRC)⁴⁶.

Based on survey responses, the majority of the jurisdictions including Argentina, Australia, Brazil, Colombia, Chinese Taipei, Denmark, Egypt, Greece, Hong Kong, Hungary, India, Italy, Kenya, Lithuania, Maldives, Malawi, Oman, Pakistan, Peru, Poland, Portugal, Slovenia, Spain, and Thailand indicated that their non-equity securities markets have not been sufficiently developed in terms of depth and liquidity. By contrast, Korea, Malaysia, New Zealand, Germany, Canada, Iceland, Dubai, South Africa, Panama and Singapore believe that non-equity markets are adequately developed for securities issues by SMEs.

⁴⁵ Ibid, p. 28

⁴⁶ ADB Working Paper Series on Regional Economic Integration - Capital market financing for SMEs: A growing need in emerging Asia, January 2014, authored by Shigehiro Shinozaki

Jurisdictions were asked to provide information on the outstanding amount and default rates of SME issuers in corporate bond markets. Additionally, they were surveyed on whether there are any measures and/or criteria to differentiate SME issuers from other senior issuers. Almost all jurisdictions have indicated that they do not have any measures or criteria to differentiate SME issuers from large issuers in the corporate bond markets.

A legal framework for the issuance of bonds for the corporate sector exists in all jurisdictions and SMEs are not precluded from raising funds in these markets. Nevertheless, due to market structure, SMEs rarely participate in corporate bond markets. The issuers of corporate bonds are mostly senior issuers, especially financial institutions.

As of 30 June 2012, the breakdown of outstanding⁴⁷ domestic bonds and notes for 17 jurisdictions⁴⁸ in terms of issuers is presented in Table 12 below⁴⁹.

Table 12 - Breakdown of Issuers in the Bond Markets as of 30 June 2012

Issuer	Outstanding Amount (USD Billion)	Share in the Bond Market (percent)
Government	3,742.7	62.36
Financial Institutions	1,344.7	22.40
Non-Financial Institutions	914.6	15.24

The total share of government and financial institutions in the bond markets for the aforementioned 17 jurisdictions is 84.76 percent. These figures indicate that government and financial institutions are the main issuers. Although figures are not available on the distribution of large and small issuers, other evidence suggests the SME share would be rather small. As a consequence, there is not much room for SME issuers in corporate bond markets as even the larger corporations’ access to this market is limited when compared to government and financial institutions.

Some practical information provided in the 2012 survey by the jurisdictions is as follows:

- Germany reported that they have measures and criteria to differentiate SME issuers in corporate bond markets. Germany’s latest outstanding amount for SME corporate bonds is USD 543.78 million in total. They also stated that there were no defaults in corporate bonds of SMEs in the last five years.

⁴⁷ <http://www.bis.org/statistics/secstats.htm>, Money market instruments are not included.

⁴⁸ Australia, Canada, Chinese Taipei, Chile, Colombia, Hungary, Israel, Malaysia, Mexico, Peru, Philippines, South Africa, South Korea, Singapore, Switzerland, Thailand and Turkey. Japan is excluded due to the size of its debt market and data is not available for some jurisdictions including Argentina, Brazil, China, France, Germany, Italy, Spain, UK and USA.

⁴⁹ According to the Bank of International Settlements latest Quarterly Review published in December 2012.

- Iceland stated that widespread defaults occurred in corporate bond markets following the collapse of Icelandic banks in 2008.
- Israel defines "small company" either: (a) as a publicly traded company: (i) whose market capitalisation is lower than USD 76 million; and (ii) is not included in the TA 100 index⁵⁰ or the Tel-Aviv Yeter 50 index⁵¹ ; or (b) as a publicly traded company whose bonds nominal value is lower than USD 50 million and that is not included in the TA 100 index. The total amount of funds raised by SMEs through corporate tradable bonds - including on capital markets in Israel, was USD 778 million in 2009, USD 1 billion in 2010, USD 804 million in 2011 and USD 209 million to July 2012 (approximately).

New Zealand responded that their securities markets, apart from equity have developed sufficiently in terms of depth and liquidity for corporate bonds and other securities issues of SMEs. Nevertheless, while the corporate bond market is available to SMEs, listing and compliance costs are likely to be the main deterrent for SMEs since, from the perspective of potential issuers, they are similar to the main equity market.

Corporate bonds that are outstanding, as provided in the 2014 survey, are issued by SMEs in some jurisdictions such as:

- Chinese Taipei: reported that the outstanding amount of corporate bonds issued by emerging companies as of 30 November 2014 was USD 1.5 million.
- Republic of Mauritius: as of 30 June 2014, it had USD 12.5 million in outstanding SME Corporate Bonds issuance.
- Mexico: corporate debt issued by Stock Market Investment Promotion Companies (SAPIB)⁵² accounted for USD 262.56 million.
- Hungary: approximately USD 18.6 – 37.3 million is outstanding in corporate bonds issuance.
- China: by 30 November 2014, outstanding corporate bond issuance on the SME Board, GEB, and NEEQ totalled USD 12 685 million.
- Turkey does not have criteria or a definition of an SME that enables it to differentiate SME issuers in corporate bond markets from others. However, an idea of the number of SME issuers in the market can be inferred. Based on the assumption that SMEs are more likely to make relatively smaller bond issues, and using USD 4.3 million as a threshold, only two outstanding SME corporate bond issues are in the market, with a total amount of USD 3.6 million. Both issuances were not publicly offered. One was offered to qualified

⁵⁰ stock market index of the 100 most highly capitalised companies listed on the Tel Aviv Stock Exchange

⁵¹ stock market index of the largest 50 shares which are not included in TA-100 Index

⁵² In Mexico, Stock Market Investment Promotion Companies (SAPIB) are companies with a market capitalization lower than USD 72.63 million.

investors and is traded on Borsa Istanbul⁵³, and the other was a private placement transaction.

Many jurisdictions stated that corporate bonds are not attractive in terms of liquidity and market awareness, as well as being at the early stages of development. None of the 178 SME market issuers in Hong Kong currently listed have issued debt securities for listing on the exchange. Also, as an example, Turkish corporate bond markets started to develop in 2010. Previously, there were almost no corporate bond issues due to high public borrowing requirements and the crowding-out effect. As of August 2012, 88 percent of the issuers were banks, 9 percent were non-bank financial institutions and the remaining 3 percent were corporate issuers.

Pakistan highlighted that their corporate bond market started in 1995 but is still at a nascent stage due to structural issues. Various measures including a simplified listing process, the introduction of a specialised trading/reporting system at the exchange and the categorisation of mutual funds have been completed. However, further steps are necessary to address impediments for a sound corporate debt market. An OTC platform also provides a listing of debt market securities but so far only two bond issues have been made through this platform to qualified investors by senior issuers.

The main reason for Brazil's underdeveloped corporate bonds markets was competition from government bonds, which in the past paid high interest rates and offered low risk. The government has sharply reduced the basic interest rate over the past year, removing this hurdle. In addition, last year, several measures were taken by the public and private sectors to stimulate the corporate bond market, including measures aiming at facilitating the issues of debentures, increasing their dispersion and fostering their liquidity on the secondary market.

However, in the absence of bank loans or credit lines, the corporate bond market remains a viable alternative for SME financing and the development of deeper and more liquid corporate bond markets continue to be a priority for policy makers in emerging markets.

4.9. Pooling investments

According to survey responses, the ratio of market capitalisation of the SME markets to the main market is only 1.48 percent and according to recent observations on these markets, SMEs' access to the corporate bond market and other debt securities market is almost non-existent.

Apart from the factors above explaining why SMEs are reluctant to tap the capital markets, another key reason for for this situation is inadequate institutional investor demand for SME

⁵³ The Borsa Istanbul (abbreviated as BIST) is the sole exchange entity of Turkey combining the former Istanbul Stock Exchange (ISE) (Turkish: İstanbul Menkul Kıymetler Borsası, IMKB), the Istanbul Gold Exchange (Turkish: İstanbul Altın Borsası, İAB) and the Derivatives Exchange of Turkey (Turkish: Vadeli İşlem Opsiyon Borsası, VOB) under one umbrella.

securities primarily due to the lack of liquidity. The data submitted by eight jurisdictions about the share of retail investors in the equity markets is shown below⁵⁴.

Table 13 - Retail Investors Share (as of 30 June 2012)

	SME Market (percent)	Main market (percent)
Egypt	88.0	47.0
Greece	77.8	35.8
Iceland	8.7	7.5
Italy	-	25.0
Korea	92.4	52.3
Portugal	-	22.5
Thailand	97.0	53.0
Turkey	93.0	19.2

Individual investors have a weighted average share of 91.8 percent of the SME market capitalisation and of 40.1 percent of the main market capitalisation. Turkey and Thailand also provided unsolicited data about foreign shareholdings in their SME markets, which stand at 0.3 percent and 1.7 percent, respectively. This could indicate that almost no foreign investor demand exists for SMEs. It is generally accepted that institutional investors avoid investments in SMEs due to insufficient size and liquidity.

In this regard, jurisdictions were also asked if there is any specific program or practice to pool or bundle SME securities into a package that would attract institutional investor demand. The answers submitted by four jurisdictions are provided below.

In Brazil, there is a special class of investment funds named FIEE⁵⁵, which invests in emerging enterprises. These funds are targeted at enterprises that are not large companies and whose gross revenues are below USD 311.46 million.

In Colombia, SMEs can join other issuers and raise funds through a syndicated issue of corporate bonds by a number of entities, provided that:

1. They constitute a warranty of the outstanding amount and interest to be paid to cover the issue syndicated or, alternatively, all issuers syndicated constitute debtors;
2. They establish an agreement amongst the issuers about the details of the transaction, which includes conditions such as rules for syndication and its characteristics, fulfilment of the obligations to the investors, total amount of the issue and its distribution among participants in the syndication.

⁵⁴ There is no available data on retail investor share of other securities.

⁵⁵ FIEE stands for Fundo de Investimento em Empresas Emergentes, i.e. Investment Fund in Emerging Companies

Some provincial governments in Canada (e.g. Ontario) previously encouraged the creation of labour-sponsored funds (collective investment schemes) in which investors would invest and the money within the fund would be used to invest in a number of SMEs though it has not been used extensively. Still, investment in these funds seemed to be targeted primarily at retail investors rather than institutional investors. Investors received a tax incentive when they invested.

In Canada some venture capital funds and private equity funds purport to specialise in investing in SMEs. There is also one exchange traded fund that focuses on investment in SMEs. From an investment perspective, investors can generally gauge the performance of various venture issuers securities through various market indices that are narrowed down to an investable set of stocks where index constituents must meet minimum size and liquidity requirements.

4.10. Crowd funding

Crowd funding is more popular or rather successful in advanced economies, as it is quite dependent on mature internet markets and access to money (disposable income or GDP per capita). Every country has its own regulations and culture with regards to online sales and donations, making it difficult to make blanket predictions on potential international outcomes. In South Africa, for instance, payments need to be for goods or services rendered. If you want to send money to someone, it is considered a remittance and remittances have to go through an entity with a banking licence⁵⁶.

Crowd fund investing is a valuable tool for individual and institutional investors, as well as for policy makers and for public sector SME funds because of its efficiency, transparency, and market validation⁵⁷.

- **Efficiency:** By consolidating a standard set of applicant data on one platform, crowd fund investing sites speed up the process of investigating and comparing different project ideas, companies, and management teams. Democratic access to this data speeds up and simplifies decision making.
- **Transparency:** With open data and social decision making also comes greater transparency. Users of crowd funding websites quickly expose fraudulent campaigns and vigorously hold fundraisers to account for their promises. According to Wharton Professor Ethan Mollick, less than 0.1 percent of the funds raised on crowd funding websites are raised by people with no intention of delivering on the promises they make.
- **Market validation:** When a particular idea proves a hit with individual investors, it can also enhance its attractiveness for institutional investors to act as lead investors or

⁵⁶ <http://www.wernervanrooyen.com/crowdfunding-in-south-africa-rewards-based-charitable-and-equity/>

⁵⁷ <http://www.cipe.org/blog/2013/11/20/crowdfundings-potential-for-entrepreneurs-in-emerging-markets/#.VV1KIPmqkko>

co-investors. In similar fashion, crowd funding can be a neat selection mechanism for public sector SME funds — some of which have more funds for entrepreneurship than they do the ability to disburse them⁵⁸.

Crowd funding still has plenty of obstacles to overcome in emerging markets. One major challenge is trust. In a recent TechCrunch article, SeedAsia co-founder Tom Russell noted that transparency which has become the hallmark of successful Western crowd funding projects often presents challenges for many Chinese entrepreneurs, primarily due to the fear that their work or ideas may be infringed upon by competitors.⁵⁹ However, although such concerns may exist, crowd funding has experienced rapid development in China. About 30 equity crowd funding platforms had been set up, with over RMB 1 billion raised for more than 30,000 projects by the end of 2014.

Brazil's crowd funding ecosystem is also facing some tough hurdles. There is what is known as the "custo Brasil" or the Brazil Cost, an umbrella term for the legal and bureaucratic frustrations international businesses often face when doing business in Brazil. Inexperienced entrepreneurs who use crowd funding may not be able to follow through with their projects if the custo Brasil is too high. Brazil also lacks a firm legal framework for crowd funding, and currently operates under e-commerce laws⁶⁰. In view of this scenario, the Brazilian regulator, based on a study of the international experience, is working on the guidelines of a regulatory framework addressing the matter.

Chinese Taipei has completed issuance of related regulations on crowd funding at the end of April, 2015. The Financial Supervisory Commission (FSC) will allow securities brokers meeting specific criteria to operate equity crowdfunding. As for rules regarding fund raising companies and investors, the company can only raise up to USD 486,493 annually, and the investors can only invest USD 1,622 at most in one fund-raising project and total annual investment via one platform shall not exceed USD 3,243⁶¹. Chinese Taipei has also introduced a Go Incubation Board for Startup and Acceleration Firms (GISA). GISA is designed as the platform for small-sized non-public innovative companies with creative ideas, and to offer entrepreneurship counseling and capital raising functions, but not trading functions to help innovative companies to acquire needed capital. There is a limitation on the amount of capital raising through GIS, whereby the company (including a GISA registered company) or a preparatory office can only raise up to USD 486,493 to add to its capital annually through GISA (not including employees' and original shareholders' purchasing prior to GISA registering).

⁵⁸ *ibid*

⁵⁹ <http://www.forbes.com/sites/hsbc/2014/08/05/crowdfundings-untapped-potential-in-emerging-markets/>

⁶⁰ <http://www.forbes.com/sites/hsbc/2014/08/05/crowdfundings-untapped-potential-in-emerging-markets/>

⁶¹ <http://www.fsc.gov.tw/en/home.jsp?id=55&parentpath=0,4>

There are potential benefits for new businesses. However, governments and the private sector are required to make a concerted effort to ensure that crowd funding is successful.

- First, they should define clear regulatory frameworks and robust market regulations to yield investor confidence in local financial markets.
- Second, direct foreign investments, supported by the right policy framework, can support technology and infrastructure environments, i.e. the crowd funding platforms.
- Third, they should support entrepreneurship stakeholders at the grassroots level by offering, for example, training for entrepreneurs, business accelerators, incubators, mentor networks and other service providers.

In the US they have established the following protocols for crowd funding under the JOBS Act⁶².

- **Offering threshold:** An issuer (i.e. a company) may sell up to USD 1,000,000 of securities, taking advantage of the crowd funding exemption, during any 12-month period.
- **Investment threshold:** For an investor with annual income or net worth below USD 100,000, the investor's annual investment in crowd funded securities is capped at greater of USD 2,000 or 5 percent of the investor's annual income or net worth. For an investor with annual income or net worth above USD 100,000, the aggregate annual investment in crowd funded securities is capped at 10 percent of the investor's annual income or net worth.
- **Crowd funding intermediaries:** Crowd funding intermediaries may be either brokers or funding portals registered with the SEC and the SRO. Brokers are subject to existing restrictions and regulations. Intermediaries may not compensate promoters or finders and may not allow their officers or directors to take a financial interest in any issuer using their services.

Funding portals are prohibited from: (i) offering investment advice; (ii) soliciting transactions for securities offered on the portal or compensating employees or agents for doing so; and (iii) holding investor funds or securities.

4.11. Sukuk funds

The global Sukuk industry is the fastest growing segment in the Islamic finance industry, and its geographical reach has extended globally with a growing investor base. In 2014, a total of USD 118.8 billion worth of Sukuk were issued, slightly below the USD 119.7 billion in 2013.

⁶² JOBS ACT, Crowd Funding Basics

The global Sukuk outstanding volume surpassed USD 300.9 billion at the end of 2014, a 12.0 percent increase from USD 269.4 billion outstanding at the end of 2013⁶³.

Innovative developments in the corporate Sukuk markets can complement the corporate debt SME market. It is timely for SMEs to leverage on Sukuk considering that Sukuk have a larger investor base. A new market such as France has demonstrated that it could come up with a pint-sized Sukuk through an asset-backed hybrid Sukuk using a *mudaraba* contract worth USD 700,000 in 2012⁶⁴. Sukuk have predominantly been issued by governments and corporates, as well as financial institutions. Sukuk for SMEs to date remains significantly under-developed, although the legal and regulatory frameworks in some jurisdictions support their Shariah compliant financing, including for SMEs. As in the corporate debt market, the Sukuk market faces the challenge of a non-supportive market structure that does little to help SME sukuk to thrive. Sukuk for SMEs are likely to be more successful when a country does not have a strong banking base nor a dominant corporate market for Sukuk. In this case, SME Sukuk could be the starting point for capital-raising. In other more-developed jurisdictions, changes to the current market structure could pave the way for SME participation in the Sukuk market.

Sukuk may be structured either as a risk-sharing instrument or as a debt. Many of the Sukuk in the global market are debt-based. The issues and challenges facing Sukuk (which are debt-based) are similar to those of corporate debt. Initiatives to develop the Sukuk market for SME can draw on the experiences of similar initiatives in the corporate debt markets of some countries. (Refer to Part 4.8).

Learning from the experiences of major corporate debt markets, and creating an exchange to cater specifically to SME Sukuk could be one way to move forward. Established exchanges have done this in the case of corporate debt, and the result is suited for larger SMEs. Exchanges will nevertheless have to look into the issues surrounding lack of secondary trading; as SMEs are smaller and riskier, they tend to be illiquid.

The introduction of guarantee mechanisms by governments will also induce more investors to participate. Guarantees have been demonstrated to increase the growth of this segment.

The use of credit enhancements such as credit guarantee schemes or insurance schemes to provide the credit cover would also help make SME Sukuk more attractive to investors. The insurance policy can help issuers tap into strong investor demand for investment-grade Sukuk. Countries may consider creating an agency to play a role in this sector. Multi-lateral agencies such as the Islamic Corporation for the Insurance of Investment & Export Credit (ICIEC) has launched an insurance product designed to boost the credit ratings of Sukuk but restricts the current coverage only to sovereign issuers. This is an innovative financing model that could be researched further with the aim of extending the application to SME financing.

⁶³ KFH Research

⁶⁴ http://www.gifr.net/gifr2013/ch_05.pdf

Many SMEs would fall under non-investment-grade if they were to have a corporate debt rating. Doing away with corporate debt rating would open up opportunities for SMEs by inviting investors who are willing to undertake their own credit assessment and assume higher risks. This would be more successful and sustainable for markets which are more risk-assuming.

Nevertheless the above are not one-size-fits-all ideas as it is important to assess or review (in the case of established markets) the market structure of SME Sukuk and to develop the right ecosystem so as to effectively support the financing of SMEs. In this regard, different jurisdictions would have to tailor-make their respective market structures to meet their SME's financing needs.

Sukuk in its ideal form promotes risk-sharing. However since debt is cheap and prevalent, there have not been many true risk-sharing Sukuk structures. The application of risk-sharing Sukuk structures can be explored in the area of SME considering that this is a higher risk class and attracts different investors such as those from the private equity side. Risk-sharing structures have been successful in the past as demonstrated by Mit Ghamr Savings Bank, Egypt and especially where banking is less developed. Greater liquidity coming from a wider investor base enhances the chances of attracting investors with a higher risk appetite and a preference for exposure to SME financing.

In some countries, governments have established dedicated SME banks to enable SMEs better access to capital. One SME bank has issued a Sukuk to fund SMEs - SME Development Bank Malaysia in 2012 issued a 20-years RM3 billion (USD 1 billion) guaranteed Sukuk⁶⁵. There are also commercial banks that focus on SME financing. Turkey recently witnessed the issuance of 5 year Sukuk amounting to USD 250 million by its domestic bank which is mainly targeted to finance clients that are primarily SMEs and corporates. Thus Sukuk benefits SMEs indirectly as the financial provider taps into the Sukuk market.

Sukuk as an alternative to corporate debt or loans can certainly be looked into as an option for SMEs where banking or the absence of banking inhibits the growth of the industry. Despite the potential the sukuk market continues to face challenges, including:

- The lack of Shari'ah compliant assets.
- The US Federal Reserve is expected to increase its benchmark interest rate in the second quarter of 2015, which could lead to a reduction in liquidity on global markets, including in emerging markets⁶⁶.

⁶⁵ Part of the Islamic Medium Term Notes Programme sukuk under the programme was the Bank's working capital requirements. The Sukuk programme supports the development of SME in Malaysia by providing additional funds to assist more SMEs in Malaysia.

⁶⁶ Sukuk Market: Emerging Headwinds May Cause Turbulence in 2015, 19 Jan 2015

- A continued drop in the oil price could slow economic growth and eventually infrastructure-related borrowing in core Sukuk markets³⁶.

It should be noted that the questionnaires did not seek to determine the size of this market, or the nature of the activities financed by Sukuk funds.

4.12. Securitisation

SME securitisation is another avenue that can help bridge the SME financing gap. It also facilitates the transfer of some risks to non-bank financial institutions. Following the global financial crisis, there has been some stigma attached to securitisation and reluctance on the part of investors to participate in this segment of the market. In general, securitisation markets in emerging markets tend to be relatively underdeveloped compared to developed markets. However, it is worth considering the potential benefits that securitisation offers as well as the need for well-developed, simple and transparent structures to facilitate the use of securitisation for SME financing.

Among the members surveyed, all except Spain, Italy, Thailand, Portugal, South Africa, Ecuador and Canada, responded that there are no other types of securities issued by SMEs other than equity and corporate bonds such as securitized instruments, pooled bonds or other securities, hybrid instruments, mezzanine finance and covered bonds.

Ontario-Canada responded that generally a majority of securities issuances are equity securities but venture issuers for example have the flexibility to choose to raise capital through issuing other types of securities, either through formal public offering or private placement. Information relating to the outstanding amount and breakdown of securities other than equity and corporate bonds is not readily available at this time.

Italy mentioned that warrants have been issued by SMEs. Thailand and South Africa stated that the outstanding amount of warrants is USD 150 921.58 million and USD 2.4 million, respectively. Ecuador indicated that the total outstanding amount of debentures and commercial papers is USD 6.8 million. Singapore mentioned that USD 93 million of convertible preference shares has been issued in the last five years.

Alberta-Canada responded that Canada venture issuers traded on the venture markets tend to predominantly issue equity securities but they may occasionally issue warrants or debentures that typically are convertible to equity.

Spain has USD 13 531.70 million in outstanding amounts of securitisation transactions with underlying assets that are bank loans backed by its government under the condition that financial entities assigning their assets re-invest at least 80 percent of the proceeds received in new credits for SMEs. They also have USD 2 253.83 million of securitised bank loans to SMEs but the bulk of these funds are backed by private financial institutions, mainly banks and the residual part of these funds are backed by some autonomous regions.

Structured products backed by SME loans or assets are not common in Bulgaria, Mexico and Turkey. On the other hand, securitisation of SME loans has grown rapidly after the year 2000 in Korea, supported by the credit guarantees of government⁶⁷.

4.13. Other Supporting Measures

Generally, in the aftermath of the crisis, government initiatives have often been aimed at encouraging private investments through capital markets. Particularly in Mexico, different types of vehicles for private equities have been introduced. In Korea, new types of investment funds (some of which are backed by the government) have been designed to invest in sustainable SMEs and venture capital companies⁶⁸. For instance, the South Korean Government has established a venture capital Fund of Funds to invest in SMEs with the exit mechanism being the South Korean stock exchange. The central and local governments in South Korea are the largest investors in venture capital companies' fundraising, comprising 24.4 percent of the total fundraising, while other business entities come in second, with 20 percent of the total fundraising. Moreover, the tax rate for capital gains on SME equities in Korea is lower than that for larger corporate shares, an incentive that is uncommon in other jurisdictions.

⁶⁷ Financing of SMEs through Capital Markets in Emerging Market Countries
⁶⁸ *ibid*

5. Impediments / Challenges

The survey responses identify the most common impediments that discourage SMEs from accessing finance through capital markets as shown in Table 14.

Table 14 - Hurdles for SMEs in Accessing Capital Markets

	Impediments	Percent
1	Family owned structures and fear of losing control of the company	20
2	The costs and fulfilment of regulatory requirements during and after an IPO	20
3	Lack of familiarity with capital markets	15
4	Shortage of skilled personnel	10
5	Issuance price, that is, the discount applied by the market over the stock's price would be not fair	10
6	Misconception that the company is too small and stock markets are for big issuers	10
7	Lack of liquidity in the secondary market	10
8	Lack of investors and the existing uncertainties surrounding the success of the offering after paying the initial costs of the IPO	5

Loss of management control is one of the main factors that discourages SMEs from accessing capital markets given that post-listing, issuers may have to alter their business approach as a public company. For example, a privately held company may maximise company expenses to minimise profitability and resulting taxes while a publicly-held company will be under pressure to show increasing profitability. Also the majority of the SMEs are family-owned businesses and are reluctant to share their business information with competitors.

Another issue is the initial and on-going costs of an IPO and listing. SMEs also hold the view that fund raising through capital markets is costly and the listing procedure will impose a large bureaucratic burden on their shoulders. There are key conditions including the need to have a convincing investment story, a business model, a solid financial track record, an appropriate board and management team, good financial prospects and sound systems and controls in order to access the equity markets successfully. Significant time and resources are required to fulfil these conditions, which may not be reflected in the IPO cost. Post-listing conduct is also an important factor. An SME will be under scrutiny and must disclose detailed information on a regular basis thereby straining its systems and controls. In this context it may also be more difficult for SMEs to attract and compensate experienced and independent directors and managers due to factors such as limited financial resources and greater risk of business failure.

Other impediments to financing through the capital markets are related to the IPO process i.e. the higher discounts to the SMEs in pricing of IPOs due to the greater perceived risk associated with them, less liquidity, and lack of investor demand and awareness about the SME markets.

Limited interest in and research on SMEs diminishes the attraction of SME shares for investment. Although smaller companies listed on the main board do not attract much interest from analysts, the research activities and listing services provided by market intermediaries can play a key role with respect to SME access to capital markets.

The survey responses identify factors that most discourage to brokers from working with SMEs, as presented in Table 15 below:

Table 15 - Factors Discouraging Brokers

	Impediments	Percent
1	There are no SMEs interested in raising capital through equity	30
2	There are no investors interested in small and medium offerings (due to, for instance, issues related to liquidity, portfolio composition, etc.)	25
3	Their distribution channels are not suitable for investors interested in investing in SMEs.	15
4	Liability risks	15
5	Reputational risks	10
6	The remuneration on small and medium offerings does not pay off	5

The most important factor in Table 15 is the lack of interest on the part of SMEs in raising capital through capital markets. Companies will bear the costs of accessing capital markets as long as the benefits are higher than the cost and there are enough investors interested in SME equities. As indicated in the survey results convincing potential investors to contribute additional capital is another challenge, since the client base of brokers tends not to be interested in investing in SMEs. As a result, brokers may not consider financing a small issuer worth the effort or the limited compensation, taking into account the associated liability and reputational risk.

5.1. Delisting of SME securities

There can be a variety of external and internal factors that result in the delisting of an issuer. The exchange can cancel the listing of these companies because they may fail to maintain their operations or assets to warrant continued listing on the exchange. Likewise, a listed company can become a private company after a merger or takeover. Table 9 below shows the number of delistings grouped by relevant reasons that occurred during the period from 2002 to 2012, both in the SME and main markets of the respondent jurisdictions.

Table 16 - Number of Delisted SMEs 2002-2012

	Bankruptcies in SME Market	Voluntary Delisting in SME Market	Other in SME Market	Bankruptcies in Main Market	Voluntary Delisting in Main Market	Other in Main Market
Chinese Taipei	-	-	236	-	29	379
Colombia	-	-	-	-	389	-
Denmark	4	2	7	18	4	77
Dubai	-	-	-	2	55	1
Egypt	-	3	-	-	413	699
Greece	-	-	-	48	24	51
Hong Kong	16	11	-	24	65	-
Hungary	-	-	-	2	35	-
Iceland	-	-	-	7	71	-
India	-	-	-	-	160	1355
Israel	-	-	53	-	-	98
Kenya	-	-	-	-	1	-
Korea	36	14	362	12	25	144
Lithuania	-	-	-	4	19	7
Malawi	-	-	-	-	1	-
Malaysia	13	9	-	-	238	121
Mauritius	-	4	2	-	7	4
New Zealand	-	-	8	-	-	134
Pakistan	-	-	-	-	4	133
Portugal	-	-	-	-	32	3
South Africa	-	16	-	-	283	-
Spain	-	-	-	-	32	33
Thailand	-	2	1	-	49	9
Turkey	-	-	-	7	-	-

Although Colombia, Egypt, India, Malaysia and South Africa have experienced a large number of voluntary delistings in the main market, this trend has not been observed in the SME markets of these countries. In Chinese Taipei and Korea, delisting is a result of factors other than bankruptcies and voluntary delisting. Moreover, with the exception of Korea and Malaysia, the number of delistings resulting from bankruptcies is lower in SME markets than in the main markets.

5.2. Financial reporting

Financial information for most SMEs tends to be prepared by owners, bookkeepers (relying on computerised systems in developed economies) or externally by a hired accountant. Evidence shows that while most SMEs maintain accounting records of some sort, SME owners tend to have limited financial expertise, especially in developing economies, due to low levels of literacy, limited access to accounting education and computerised accounting systems, thus affecting their ability to produce quality financial information⁶⁹. The report further points to concerns raised by owners of SMEs, which include the cost of producing financial statements, ability to understand them and concern about confidentiality. The issue of producing financial information is further complicated by determining the main users of these financial statements. The report suggested that by and large, the users are banks and other finance providers (to determine capacity to repay, assess profitability, security and liquidity), owners and tax authorities.

Some of the reasons mentioned for SMEs failing are⁷⁰:

- Lack of forward planning - *often strategies aim to be all things to all people*
- Poor leadership - *leaders should have followers, but they often lack the people skills for successful leadership*
- Lack of investment - *at the right time*
- Cash flow problems
- Innovation - *inability to capture and manage innovation*
- Inertia - *reactive as opposed to pro-active / inability to change - culture too deep-rooted*
- Lack of business experience
- Inadequate market research - *i.e., if it feels good, let's do it!*
- Little or no external help
- Not customer focused - *this is what we want to deliver*
- Wrong product (or service), *wrong price, wrong time*
- Little encouragement for people to work together as a team

⁶⁹ IFAC – Micro entity financial reporting <http://www2.ifac.org/publications-resources/micro-entity-financial-reporting-perspectives-preparers-and-users>

⁷⁰ <http://www.brad.ac.uk/smenetwork/print.php?page=facts1>

6. Regulatory framework for SMEs

The primary objective of SME markets is to facilitate access of SMEs to capital markets by creating an enabling environment and accommodative regulatory framework for them. In this respect, many jurisdictions have eased their listing requirements to make their markets more accessible for SMEs.

Effective communication and co-ordination among different governmental agencies and market stakeholders also help increase SME access to the markets. Co-operation among the entities responsible in each jurisdiction for the supervision of SMEs at the different stages of their life cycle is also important.

In Mauritius, the Development Enterprise Market (DEM) that is designed for small and medium sized companies has amended its rules to cater for the 'Requirements for the listing of Mineral Companies and Exploration Companies' in order to facilitate publication of SME Quarterly Reports.

In October 2013, the Securities and Exchange Board of India introduced a framework for Institutional Trading Platform (ITP) that envisages eligible SMEs and start-ups listing on stock exchanges without launching an IPO.

Jurisdictions seeking to lighten regulation on listing rules have primarily done so by easing the requirements on minimum paid up capital, minimum free float, revenue, market capitalisation, number of years in operation, number of public shareholders, number of minimum shareholders, equity, paid up capital and profitability.

Almost all jurisdictions have introduced proportionate regulation aimed at alleviating the burden of selective regulatory compliance that may affect SMEs. This calls for eliminating certain disclosure obligations of less significance to investors, and replacing them with supplemental disclosure that regulators consider more relevant to investors. Relaxing disclosure obligations will further assist SMEs, many of which lack sufficient financial resources and expertise to fully comply with the details of underlying securities law requirements. This regulation will also make available key information, helping facilitate informed decision making by investors. Importantly, disclosure requirements will be tailored to SME issuers, without compromising the public interest and investor protection objectives. The regulations also are designed to give SME management more time to focus on the growth of their business by reducing the time it spends on complying with disclosure requirements.

In a number of jurisdictions, the regulatory regime concentrates primarily on the differentiated prospectus and listing requirements for SMEs and on the IPO processes for large scale issuers. Generally, SMEs are entitled to publish a shorter and simplified prospectus or informative document, subject to less onerous information requirements than those for larger issuers in public offerings. In certain instances, SME issuers are exempted from prospectus requirements when the amount issued within a given period is below a

certain threshold. In some jurisdictions these documents are approved by the exchange where the securities are traded and not by the competent authority.

For example, in Canada, the Ontario Securities Commission (OSC) published for public comment on 20 March 2014 proposed rules for four new capital raising prospectus exemptions⁷¹. The four capital raising exemptions include:

- Offering memorandum (OM) prospectus exemption that would allow businesses to raise capital based on an offering memorandum being made available to investors. The exemption would be available for a wide range of businesses at different stages of development.
- Family, friends and business associates prospectus exemption that would allow businesses to raise capital from investors within the personal networks of the principals of the business. It is intended to enable start-ups and early stage businesses to access capital.
- Existing security holder prospectus exemption that incorporates important investor protection measures; and
- Crowd funding prospectus exemption along with regulatory requirements applicable to an online crowd funding portal that allow businesses to raise capital from a potentially large number of investors through an online portal registered with securities regulatory authorities. Businesses could raise up to USD 1.5 million during a 12 month period.

In addition, the OSC announced that, in conjunction with the other Canadian Securities Administrators (CSA) jurisdictions, the OSC was consulting on several amendments to certain existing prospectus exemptions.

A company joining the SME market in Italy is not required to publish a listing prospectus compliant with EU legislation and has to prepare only an admission document that provides investors with information on the activities, management, shareholders, and financial data of the issuer.

In Brazil, the regulator has introduced automatic exemptions for registration (both issuer and offer) for securities offerings belonging to the same issuer and limited to USD 1.15 million for each period of 12 months.

Another approach refers to a market advisory system of Nominated Advisors known as NOMAD. NOMADs are companies authorised or registered by exchanges to act as corporate financial advisors for SMEs. The NOMAD reviews issuers' compliance with listing requirements and confirms their suitability to list on the SME market. NOMADs are held responsible for breaches of issuers' obligations under the listing requirements and the exchange retains the right to suspend or revoke the admission or impose fines for breaches of

⁷¹ http://www.osc.gov.on.ca/documents/en/News/nr_20140320_osc-proposes-four-capital-raising-background.pdf

advisors' obligations and duties in this process. This type of system was utilised in Warsaw, Poland by NewConnect, an alternative exchange operated by the Warsaw Stock Exchange (WSE). An Authorised Advisor is an investment firm or other entity providing business related services that is on the WSE's list of NewConnect Authorized Advisers and whose duties are the following:

- choosing a company of suitable quality (company verification);
- helping draw up an information document;
- monitoring the progress of work on the information document and approving it for at least three years after the debut;
- working with the issuer to meet its disclosure requirements on the NewConnect market; and
- advising the issuer on its obligations on the NewConnect market. The costs of the Adviser are paid by the company.

In several jurisdictions, SME issuers are subject to certain additional disclosure requirements compared to senior issuers. The rationale for this approach is that at that stage of development these companies are new to investors and information asymmetries are larger. For example, in Hong Kong, SME market applicants must state business objectives and how they will be achieved after listing, whereas senior issuers are required to include a statement concerning the issuer's prospects for the current year only.

In Alberta, Canada, junior issuers are required to disclose not just the use of proceeds, but the use of all "funds available", including for example, from working capital. The junior issuer must then provide disclosure of how the "funds available" will be spent. If a junior issuer had negative operating cash flow in its most recently completed financial year, disclosure must also be provided regarding the estimated total operating costs to achieve stated business objectives, the time that the offering proceeds are expected to fund operations, and the estimated amount of other material capital expenditures during this time. Junior issuers must also disclose their business objectives and milestones that are to be achieved with the funds available. For this requirement senior issuers' disclosure obligation is limited to their intended use of proceeds from the offering. Junior issuers are required to provide additional disclosure about their management compared to senior issuers.

Two other examples of practices particular to SME IPOs are; limiting the offer to qualified investors only and requiring full underwriting of the issue.

In some jurisdictions, sectoral differentiations are made irrespective of company size for specific types of issuers. For instance, mineral companies, investment companies and infrastructure project companies are subject to listing requirements with modifications and exceptions. For instance in Ontario, Exploration and Mining companies on the Toronto Stock Exchange and TSX Venture Exchange have certain listing requirements that differ with respect to property, recommended work program, working capital and financial resources, net tangible assets, earnings or revenue.

In Lithuania and the Maldives, there are no listing requirements for SMEs, whereas in Colombia, Denmark, Dubai, Hungary, Israel, and Romania, there are no different listing requirements for SMEs. A summary of the listing requirements for SMEs in different jurisdictions is given in Appendix 4.

In Hong Kong, in order to be listed on the SME Board, a minimum positive cash flow generated from operating activities in the ordinary and usual course of business of USD 2.6 million is required in aggregate for the two financial years immediately before the issue of the listing documents. Furthermore, SME issuers must have substantially the same management throughout two full financial years and a continuity of ownership and control throughout the full financial year immediately preceding the issue of the listing document.

In Korea, capital should not have been reduced at the end of the most recent fiscal year and similar to the main market, the audit prior to IPO should be conducted by one of the big Four Accounting Firms.

In Mauritius, SME issuers may be granted admission with less than 10 percent of shareholding in public hands or with less than 100 shareholders, provided that the company undertakes to increase its shareholding in public hands to 10 percent and its number of shareholders to 100 no later than the end of the first year of admission.

6.1. Role of legislation

The survey findings revealed that only four jurisdictions answered “no” to all the questions when asked if there have been any significant regulatory changes or developments in their jurisdictions with regard to SMEs since the initial survey of 29 August 2012. Jurisdictions that gave an affirmative response all referred to the development/promotion of crowd funding in their jurisdictions. A number of respondent jurisdictions such as Korea, Finland, China and Israel pointed to proposals for revised legislation. The proposals include draft rules for regulation of equity crowd funding, and platforms for SME securities, including, *inter alia*, peer-to-peer lending and integrative entrepreneurship counselling.

6.2. Proportional regulation

Most SMEs are growth companies without a proven profit track record. Given the inherently high risk and limited experience of SMEs, introducing lighter securities regulation for them may pose risks to investor protection. Compliance with regulatory requirements may be weaker at the lower end of the market due to resource constraints or entrepreneurs may not fully appreciate securities regulation requirements.

The initial survey results indicate that 18 percent of respondent jurisdictions are of the opinion that lighter regulation envisaged for SME gives rise to investor protection problems. With any securities regulatory initiative, a balance must occur between the goals of investor protection and fostering the capital market. The goal of proportionate regulation is not intended to result in lighter regulation but rather better tailored regulation. Therefore, it is important to note that

less disclosure by an issuer does not necessarily mean less investor protection. A closer supervision and monitoring of SMEs' compliance should be provided, particularly considering investors in SME securities are mainly retail investors with less resources and sophistication.

Regulation should address information asymmetries that may exist between issuers and their principals, existing investors, and future investors. Requirements for timely and continuous disclosure by issuers, in addition to restrictions on the latitude for insiders to trade their securities on the basis of non-public material information, are examples of regulatory approaches for addressing information asymmetries.

Some of the respondents mentioned the following initiatives in their jurisdictions:

- China has amended rules on its Growth Enterprise Board, as well as relaxed financial threshold by eliminating the requirement for continuous earnings growth.
- In Finland, bonds can be admitted to trade without the FSA (Financial Supervision Authority) approved prospectus. There is also a relaxation of the requirement to comply with IFRS accounting standards.
- Macedonia has decreased the costs for issuance of bonds and decreased the cost of IPOs.
- In Turkey, there are less listing requirements than the main market.

In March 2006, the European Council explicitly recognised the crucial role of SMEs in creating growth and better jobs in Europe and underlined the need for a regulatory environment that was simple and transparent and conformed to the principle "think small first". According to the report issued⁷² by the Expert Group on Models to Reduce the Disproportionate Regulatory Burden on SMEs, usually three explanations are offered for the disproportionate regulatory burden on smaller businesses:

- The fixed-cost nature of regulation.
- The lower efficiency of smaller businesses in dealing with regulation.
- The fact that in small businesses the most important resource, the entrepreneur himself, has to deal with regulation.

A large part of regulation results in costs that are more or less fixed, i.e. do not change much with the size of a business. This is true for most information duties. Filling in a questionnaire takes a certain amount of time, and it makes no difference that a larger business might have to fill in bigger figures than a small enterprise⁷³.

⁷² http://europa.eu.int/comm/enterprise/entrepreneurship/support_measures/index.htm

⁷³ http://ec.europa.eu/enterprise/policies/sme/files/support_measures/regmod/regmod_en.pdf

The models presented to reduce the regulatory burden for small enterprises can be grouped into the following ten categories⁷⁴.

1. Size related exemptions.
2. Reduced obligations (i.e. partial exemptions).
3. Simplified obligations.
4. Temporal exemptions.
5. Administrative coordination, especially one-stop shops.
6. Common commencement dates.
7. Tailor-made information, coaching, training.
8. Electronic services.
9. Privileged treatment of small businesses.
10. Early evaluation of regulatory impact on small businesses.
 - Exemptions are the most widely used method to reduce the regulatory burden for small enterprises and can be found in almost all areas of regulation. Exemptions are either applied directly (i.e., businesses below certain thresholds do not have to comply with certain rules) or indirectly (i.e., the exemption depends on a criterion strongly correlated with size such as economic sector or legal form).
 - Applying a reduced set of regulatory obligations for smaller businesses is often used as an alternative when a complete exemption is not possible without jeopardising the original purpose of the regulation (e.g., reduced obligations for taxation and record keeping).
 - Simplified obligations for small businesses may be achieved by introducing simpler formal requirements or “standard treatments” (e.g., a forfeiture tax).
 - Temporary reductions or exemptions do not appear to be used very often. Possibilities include longer intervals for certain obligations (e.g., annual instead of quarterly tax payments), a lower frequency/probability (e.g., for audits) or longer transitional periods (e.g., for new regulation).
 - Typical forms of improved administrative coordination benefiting small businesses are one-stop shops where businesses can take care of different obligations with different authorities at one local point. The majority of one-stop shops currently address start-up businesses.
 - One or two annual common commencement dates for all new rules and regulation (including changes to existing rules) can greatly facilitate life for small businesses,

⁷⁴ Ibid, p.49

since businesses can concentrate search, information and learning activities at certain times of the year.

- Small businesses need to be informed about the regulations that apply to them in a way that is understandable and straightforward. Typical information activities include websites, helpdesks, handbooks and brochures, but can involve coaching and training activities as well.
- Adapting information to the needs of small businesses requires some omissions and simplifications. Electronic services with databases that provide specific information on the basis of a relatively detailed profile of the individual business provide a solution to this problem.
- Privileged treatment of small businesses by the public authorities (e.g. lower fees, shorter periods for processing applications) appears to be only rarely used.
- General impact assessments are used by an increasing number of governments to estimate the likely effect of new regulation. Given the disproportionate burden on small businesses, it is important to ensure early evaluation of the specific regulatory effects on small businesses. In some countries, the general impact assessments already take into account the special situation of small businesses.

Moreover, impact assessments can be used to judge the possibility of introducing special measures for small enterprises into the new rules.

6.3. Disclosure after Listing

SME issuers may be subject to lighter ongoing disclosure requirements after listing. Based on the survey results, 60 percent of the jurisdictions reported that SME issuers and larger issuers are subject to different regulatory requirements after becoming a public company whereas 40 percent noted that applicable on-going disclosure obligations are the same for both kinds of issuers. Differences stated by the jurisdictions are summarized below under the following four topics; (a) Prospectus Standards; (b) On-going Public Disclosure, including accounting standards; (c) Corporate Governance Principles; and (d) Other Requirements.

a) Prospectus Standards

The shorter and simplified prospectus standards have been discussed in Section 4 on the IPO Process and Cost. A few respondents commented on the prospectus standards of publicly held SMEs that became listed companies.

In Canada (Ontario) most venture issuers conducting non-IPO prospectus offerings are not expected to use a “long form prospectus”. Provided that the venture issuer is listed on an exchange and has voluntarily filed an annual information form (AIF), the venture issuer is generally permitted to use the short form prospectus system which allows for an abbreviated prospectus that incorporates most of the disclosure from the issuer’s continuous disclosure base. Venture issuers, unlike other issuers, are not required to file an AIF as part of their continuous disclosure obligations; but they must file one if they wish to use the short form

prospectus system. There are other advantages to the short form prospectus system, notably a three day instead of 10 day securities regulator review time that makes the short form prospectus system attractive. A simplified version of the prospectus is acceptable in Chinese Taipei for exercising pre-emption rights by existing shareholders in seasoned rights offers.

In Argentina information requirements in the prospectus are less than those for large issuers and prospectus approval corresponds to the regulator.

b) Ongoing Public Disclosure

Material events which are likely to affect the value of securities or investment decisions or the exercise of rights by investors must be disclosed by the issuer in a timely manner. None of the jurisdictions have reported any regulatory differences for SMEs and senior issuers with regard to this obligation.

In the context of periodic disclosures, companies must have their annual financial statements audited independently and must also disclose such statements. In some jurisdictions this burden is lighter for SMEs, such as disclosing financial results on a semi-annual rather than quarterly basis. For example, in Turkey companies traded on the main market must disclose their audited semi-annual and annual financial statements as well as non-audited first and third quarter results. For this obligation SMEs must have only their annual financial statements audited and disclose non-audited semiannual financial statements.

Portugal has a different approach; SMEs are obliged to disclose quarterly information on shares admitted to trading on a regulated market in cases where two of the following thresholds are exceeded in two consecutive years:

- a) Total balance sheet – USD 126 million;
- b) Total net sales and other proceeds – USD 189 million;
- c) Average number of employees during the financial year - 150.

The issuers under this threshold must disclose a statement twice a year. The statement must also contain an explanatory description of relevant events and transactions carried out during the related period and their impact on the financial position of the issuer and companies controlled by the issuer during the related period. In addition, these issuers must provide an overall description of their financial position and performance during the related period.

In contrast, Hong Kong SME issuers are subject to quarterly reporting in addition to semi-annual and annual reporting, whereas the Main Board issuers are required to publish semi-annual and annual reporting (quarterly reporting for main Board issuers is only a recommended best practice).

The time period on submitting financial reports, interim management statements etc. is extended in some jurisdictions for SMEs to give them more time to prepare reports. Being

aware that the international accounting standards could be a burden for SME issuers, several jurisdictions allow the application of national accounting standards for their financial tables.

In Alberta, Canada senior issuers are required to file an annual information form (AIF), (a comprehensive disclosure document describing various matters) simultaneously with annual financial statements, whereas venture issuers are not required to file AIFs⁷⁵. A venture issuer that has not received significant revenue from operations in the prior two years must also include a supplementary disclosure in its *Management Discussion & Analysis* (MD&A), i.e., a breakdown of the material components of various expenses including exploration expenditures, research and development costs and general and administrative expenses. This supplementary disclosure is not required in the MD&A of non-venture issuers. All reporting issuers must file a business acquisition report upon completion of a significant acquisition and again Venture Issuers are subject to less stringent rules with reference to this report.

c) Corporate Governance

Preparing a report in compliance with Corporate Governance principles is mandatory for the majority of survey respondents. Depending on the jurisdiction, this is either not applicable to SMEs or less stringent governance requirements are applicable to them. The relaxation on this obligation is provided by shorter, simplified corporate governance reports and exemptions on the composition of audit committees, fulfilling the independent director requirement, separation of the function of Chairman and CEO, etc.

It can be argued that corporate governance is more significant for large listed entities with a wide shareholder base. However, this is not to say it is not relevant for SMEs, as aspects such as transparency; openness and corporate social responsibility are desired in order to attract financing. Apart from the normal requirements of company law, banks and other financiers may require SMEs to have boards of directors and professional management. Clearly these arrangements give comfort to financiers, as well as to current and potential investors.

d) Other Requirements

Some practices for on-going disclosure other than the abovementioned requirements are summarised below.

In Spain the selling option for minority shareholders is regulated when a majority shareholding is reached in takeover bids for SMEs. Senior issuers are required to have a mandatory bid for all the shares of the company in the same situation.

In Hong Kong, SMEs must comply with an additional requirement to appoint an executive director as compliance officer and must retain a compliance adviser to assist its compliance with Listing Rules until publication of the annual report for the second full financial year after

⁷⁵ However, if a Venture Issuer intends to distribute securities using a short-form prospectus, or pursuant to a prospectus exemption using a short form offering document or qualifying issuer offering memorandum, then it must file an AIF to be qualified to do so.

listing. A senior issuer must retain a compliance adviser only until after publication of the annual report for the first full financial year.

In New Zealand, companies with less than 25 shareholders are not required to comply with statutory financial reporting obligations. In Iceland, SMEs are not subject to takeover provisions and not required to disclose executive compensation.

In South Africa, SMEs listed on the SME board (Alt X) do not have to publish financial reports in newspapers.

There are a few additional requirements applicable to SMEs that are not applied to senior issuers. In this respect, some examples are provided below.

In Canada (Ontario) venture issuers without significant revenue from operations in either of their last two financial years must disclose in their *Management Discussion & Analysis* (MD&A), a breakdown of material components of certain costs and expenses. The same information must be presented in the case of a long form prospectus. When filing a long form prospectus, junior issuers are required to comply with additional requirements, including the use of proceeds, additional disclosure in the MD&A and they must provide certain information for each member of management.

The response from Canada (Ontario) also states that exchange requirements for venture issuers are generally more “hands-on” than those applicable to senior issuers. Venture issuers are more likely to require prior review and approval of proposed transactions than the larger issuers.

6.4. Difficulties in Implementation of Proportional Regulation

The emergence of a diversified capital market, where SMEs can raise funds by issuing securities and which gives investors access to a wider array of investment opportunities, is important for fostering economic development.

Also important is to strike a balance between compliance requirements and investor protection, as securities regulators might find it difficult to implement proportional regulation for SMEs. SMEs may not have the professionalism or the experience needed to understand and meet their obligations, giving rise to compliance issues regarding investor protection. However, the majority of jurisdictions reported that no significant difficulties were identified regarding SMEs and the implementation and monitoring of compliance with securities regulation in comparison to senior issuers.

Common challenges faced by SME issuers in complying with regulatory requirements could be; meeting the reporting timeline, submission of periodic reports, completion of audited financial reports and notification on material changes.

Some examples are given below.

- The compilation of information required for SMEs could be difficult because of their limited employee size and lack of professional staff. As a consequence, SMEs could lack transparency and publicly available information. One other effect of non-compliance could result in agency information and records not being complete or up-to-date.
- SMEs do not have good and developed corporate governance systems, which makes it harder to supervise them.
- If a company is relying on exemptions (i.e., exemption from the requirement to prepare a prospectus), it is difficult to monitor compliance under the conditions of that relief.
- SMEs may not be prepared to obtain external legal advice due to associated costs. This could be a challenge for a jurisdiction that does not have a NOMAD system.
- The introduction of a new class of issuers would increase the level of complexity of the legal environment and require greater resources for supervisors.

Regarding the monitoring of SME issuer compliance with securities regulation, securities regulators in each jurisdiction should conduct their own risk assessment and prioritise their own resources. Some jurisdictions may determine that they will prioritise their resources to focus first on issuers with the largest market capitalisations because of the larger systemic implications if an abuse were to occur. Other jurisdictions may have concerns that market abuse or failures in the junior market will affect investor confidence in both markets and place a greater emphasis on the review of junior issuers.

6.5. Supervision and Monitoring

The compliance of any issuer with securities regulation is, at first instance, the responsibility of the issuer itself, regardless of whether or not the issuer is an SME. This will generally be addressed by the issuer's senior management and can include their legal counsel. Among their many responsibilities should be the development and implementation of suitable internal controls and processes to best support the issuer's compliance with applicable legal requirements.

The survey results indicated that SMEs are generally supervised and monitored in the same way as any other company. These measures taken by both capital market authorities and exchanges usually include monitoring trading, examining regulatory filings, and handling complaints against listed issuers and their directors. Disciplinary actions are considered against issuers or their directors when regulations are violated and if the conduct of the issuers or their directors constitutes a criminal or civil offence, the case is referred to appropriate law enforcement agencies.

In Australia, ASIC has a Small Business Compliance & Deterrence team which specifically monitors compliance with regulatory requirements by SMEs, including breaches of director duties, preparing false documents and failing to deliver financial reports.

In Argentina, the regulator registers SMEs for statistical purposes. Self-regulated entities on which securities are traded issue the necessary regulations for a proper legality review of the primary and secondary public offering. All the regulation must be approved by the regulator. The regulations mentioned above contemplate the procedure and time limits by which they should inform the regulator about the results of their supervision.

Where applicable, it is crucial for NOMADs to maintain regular contact with their respective SME issuer clients to confirm that they are providing timely and complete information and that they understand their on-going disclosure obligations. These advisors should also conduct regular reviews of the actual trading as well as the financial and operational performance of the company to ensure appropriate disclosure of information to investors and in order to assist the authorities when requested to do so.

6.6. Market Abuse

Survey responses show there is no available data on the difference between market abuse cases for SMEs and larger companies. In some developed markets where information is available, the incidences or reports of market manipulation appear to be higher in the SME market than in the senior market. This appears to be related to a number of circumstances including greater likelihood that the float is controlled by insiders, illiquidity of the market, and promotional activities.

All of the respondents noted that there are no differences between the supervision of market abuse in the SME market and the main market. Therefore, as long as there is a suspected market abuse case, the processes in which an investigation of the case is carried out for such activities will be the same in all types of markets.

In smaller enterprises, it could be easier to arrange some types of market manipulation like scalping⁷⁶, cold calling, closing price manipulation. In the case of shares of bigger enterprises, it is much more difficult to arrange this kind of market manipulation successfully because of the higher liquidity and analyst coverage in these shares.

In jurisdictions where market abuse cases frequently occur, SME shares may be more vulnerable to market manipulation compared to senior issuers, therefore these shares should be closely monitored and investigated by the authorities to maintain investor confidence.

In 2011, the European Commission adopted a proposal on market abuse which aimed to reduce administrative burdens on issuers whose financial instruments are admitted to trading on SME growth markets. In particular, according to the proposal, inside information relating to issuers whose financial instruments are admitted to trading on an SME growth market may be posted by the trading venue on its website, instead of the website of the issuer, where the

⁷⁶ Scalping is a trading style specialising in taking profits on small price changes, generally soon after a trade has been entered and has become profitable. It requires a trader to have a strict exit strategy because one large loss could eliminate the many small gains that the trader has worked to obtain.

trading venue chooses to provide this facility for issuers on that market. Moreover, issuers whose financial instruments are admitted to trading on an SME growth market would be exempt from drawing up the insider list if certain conditions are met, specifically if:

- (a) they take all reasonable steps to ensure that any person with access to inside information acknowledges the legal and regulatory duties entailed and is aware of the sanctions attached to the misuse or improper circulation of such information, and
- (b) the issuer is able to provide the requesting competent authority with information identifying those persons working for the issuer or on the issuer's account with access to inside information before it had been disclosed, as well as the date when the persons obtained access to inside information.

6.7. Accounting standards

In its Information Paper on Micro-Entity Financial Reporting: Perspectives of Preparers and Users⁷⁷, the International Federation of Accountants⁷⁸ (IFAC) suggested that the increasing significance of SMEs in the global economy has given rise to new regulatory regimes for SMEs, e.g., International Financial Reporting Standards (IFRS) for SMEs. The IFRS for SMEs is a self-contained Standard of 230 pages, designed to meet the needs and capabilities of SMEs. Compared with full IFRSs (and many national GAAPs), the IFRS for SMEs is less complex in a number of ways:

- Topics not relevant for SMEs are omitted. Examples: earnings per share, interim financial reporting and segment reporting.
- Where full IFRSs allow accounting policy choices, the IFRS for SMEs allows only the easier option. Examples: no option to revalue property, equipment, or intangibles; and requiring a cost model for investment property unless fair value is readily available without undue cost or effort.
- Many principles for recognising and measuring assets, liabilities, income and expenses in full IFRSs are simplified. For example, amortise goodwill; expense all borrowing and R&D costs; cost model for associates and jointly-controlled entities; and no available-for-sale or held-to-maturity classes of financial assets.
- Significantly fewer disclosures are required (roughly a 90 percent reduction).
- The Standard has been written in clear, easily translatable language.

⁷⁷ <http://www.ifac.org/sites/default/files/publications/files/micro-entity-financial-repo-1.pdf>

⁷⁸ IFAC's mission is, inter alia, to strengthen the accountancy profession worldwide and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards and furthering the international convergence of such standards. One of its committees, Small and Medium Practices (SMP) works to raise the profile and build the capacity of SMEs globally, representing their interests to standard setters and regulators and developing tools and resources to promote their continued success.

- To further reduce the burden for SMEs, revisions to the IFRS are expected to be limited to once every three years⁷⁹.

The need for differential reporting

Most accounting regulatory regimes recognise differences between larger and smaller enterprises and between those that are listed and unlisted and/or non-publicly accountable (Devi, 2003). Recognising the burdens placed upon smaller enterprises by financial reporting, many countries exempt smaller enterprises from statutory audit and subject them to differential reporting requirements. For instance, as a result of EU accounting directives, SME companies throughout Europe have the option of filing abbreviated reports with reduced levels of disclosure and all private companies in the US are exempted from the need for GAAP financial statements and audit⁸⁰.

⁷⁹ <http://www.ifrs.org/ifrs-for-smes/Pages/IFRS-for-SMEs.aspx#>

⁸⁰ Micro-Entity Financial Reporting: Perspectives of Preparers and Users” .
<http://www.iasplus.com/en/binary/ifac/0612smemicro.pdf>

7. Incentives / interventions for SME financing

7.1. Tax incentives

Jurisdictions were asked if they have any tax or other incentives for SME issuers and investors. The majority of respondents stated that there are no tax incentives targeting SMEs using capital markets. Some of the respondents were unable to provide much information as implementing or monitoring tax incentives is not part of the securities regulators' mandate. The practices set out below are examples of tax incentives in place in some of the responding jurisdictions.

In Spain for instance, there has been a fiscal tax credit on the regional tranche of personal income tax amounting to 20 percent of the investment in shares of local enterprises listed on the SME market since 2010. This is applicable, provided that the investor:

- acquired shares issued in capital increases (i.e. the incentive is for financing the company, not for buying on the secondary market),
- does not hold more than 10 percent of the company's share capital, and
- holds the shares for a minimum of two years.

The maximum tax credit is USD 12 658, which would imply a maximum investment relief of USD 63,291 per personal income taxpayer. This type of incentive is only available for some autonomous regions where the company is located. In July 2011, a tax incentive scheme of national scope was introduced for the first time in Spain to encourage direct investment by third parties in the early stages of small companies. The scheme was framed within a package of measures aimed at promoting business activity. The tax incentive consists of the exemption of capital gains from personal income tax for third parties investing in shares or participations issued by companies not listed on a regulated market. At the time of the investment, the companies must be no more than three years old, with equity of no more than USD 253 165. Investments eligible for relief may not exceed USD 31 646 a year or USD 94 937 in three consecutive years. Furthermore, investors may not hold over 40 percent of the company's share capital and must hold the shares for a period of between three and seven years. The regulation does not exclude companies listed on the SME market, but it is unlikely to affect such companies to any significant extent, given the limited size of the companies at which it is aimed and that the minimum capital required for companies going public on the SME market is USD 2.53 million.

In some jurisdictions, there are also some tax incentives designed for both large and small issuers and not in particular for SMEs. In Kenya, preferential tax treatment is available for all kinds of newly listed companies depending on the amount of issued shares for certain periods. For instance, the tax rate is 20 percent for five years if the percentage of issued shares to paid-up capital is at least 40 percent and 27 percent for three years if the percentage of issued shares to paid-up capital is at least 20 percent.

In Pakistan, no particular benefits are provided specifically to SMEs. Any issuer listed on the exchange gets a 15 percent tax credit for the first year of admission and investors in any IPOs get a tax credit on the amount invested. In Morocco, there are fiscal incentives for all companies that decide to carry out an IPO; they benefit from reduced earnings tax of up to 50 percent for the first three years following the IPO.

In Argentina, SMEs have the same tax benefits as the large issuers provided that the funds of the issue are intended for the purposes specified in regulations referring to bonds.

In Thailand, the securities exchange, in cooperation with the Board of Investment⁸¹ (BOI), has obtained a major tax concession for listed companies. Such firms are exempted from corporate income tax, with no ceiling, as long as their BOI tax holiday is in effect. The terms and conditions include: (1) application to all BOI-promoted industries; (2) exclusion of companies listed on the market before seeking BOI promotion from the application of the tax holiday; (3) eligibility for projects that have been granted BOI promotion and have started to generate income to apply for additional promotion under this scheme provided that their tax exemption period is still in effect; and (4) all applications must be delivered to BOI by 31 December 2012, with no limitation on the number of projects.

In Canada, where a resource company has more expenses than it can deduct for tax purposes, it can issue flow-shares to investors whereby a portion of the expense cost can be attributed to investors, allowing them to reduce their taxes. Because investors receive a reduction in taxes, they may be willing to invest or invest more than they would otherwise. Tax credits are also provided to investors in labour-sponsored funds.

According to survey results, tax incentives for venture capitals, private equity and business angels are available in 45 percent of the respondent jurisdictions.

In Greece, VCs are not subject to any tax and only unit holders of the fund are liable to pay tax as co-owners of assets belonging to the fund. The transfer or any transaction on the units of the fund is taxed in the same way as the corresponding transaction on the related unit in connection with the assets contained in the fund. In addition, for the establishment and management of a VC, as well as the payment of the participation of the unit holders, no tax, duties, stamp duties, contributions and rights in favour of third parties can be imposed.

In Singapore, there is a tax incentive which aims to stimulate business angel investments into Singapore-based start-ups and to encourage more angel investors to add value to these start-ups. An individual must apply for the scheme before committing a minimum of USD 79 000 investment in a qualifying start-up. An approved angel investor can enjoy a tax deduction equal to 50 percent of his investment amount at the end of a two-year investment holding

⁸¹ The Office of the Board of Investment (BOI), which operates under the Prime Minister's Office, is the principal government agency for encouraging investment. In addition to guarantees, permissions and fiscal and non-tax incentives the BOI offers as part of its investment promotion package, there are two units under the BOI that facilitate investment by speeding up the paperwork associated with government regulations.

period. The tax deduction will be subjected to a cap of USD 197 500 for each year and will be offset against the total taxable income. Also, to encourage the inflow of local and foreign VC funds into Singapore, there is a tax relief period of a maximum of 10 years for approved funds in respect of gains arising from the investment of approved portfolio holdings and dividends income from approved foreign portfolio companies.

In Spain, VCs registered with the securities regulator only have to pay a 1 percent corporate income tax rate (against the general rate of 30 percent for large firms and 25 percent for SMEs). In Malaysia, upon fulfilling certain criteria, VCs are exempted from payment of income tax for statutory income on all sources of income, other than interest income arising from savings or fixed deposits and profits from Sharia-based deposits. The exemption period is granted for ten or five years of assessment or equivalent to the life of the fund established for the purposes of investing in an SME, whichever is shorter.

There is a ten year tax holiday for registered VCs in respect of income from their investments in eligible venture entities and dividends in Kenya. In Pakistan, profits and gains of VCs and private equities are exempted from income tax until July 2024.

In Portugal, any income held by VCs constituted and operating under the national law, is exempted from tax on corporate income. In addition, capital gains and losses realised by VCs from shares held by them for more than a year, as well as financial costs incurred with the acquisition of shares, are not taken into account in the assessment of taxable income. Turkey exempted VCs from corporation tax and business angels are granted relief from the 75 percent income tax.

In addition to the tax incentives stated by the respondents, below is a discussion, based on literature reviewed, of other small businesses' tax incentives used in other countries.

- **Simpler depreciation rules:** In South Africa, the Income Tax Act provides for a tax reduction on the wear and tear of machinery, plant, implements, utensils and articles. Wear and tear on the assets of small business corporations can be claimed as a tax deduction and the tax relief measures are mainly aimed at the manufacturing industry⁸². The deduction may be claimed as follows:
 - 50 percent of the cost in the year in which the asset is brought into use, 30 percent in the second year and 20 percent in the third year. This deduction is not allowed for assets that were acquired for no consideration.

⁸²

Smulders, 2007:36

For an SMME (Small Medium Micro Enterprise) that is in a non-manufacturing industry, it can claim the deduction as follows:

- 50 percent in the first year, 30 percent in the second year and 20 percent in the third year. It can elect to claim the asset over the write-off periods as provided for in the Practice Note 47 of the Act, which range between one and twenty-five years.

An SMME that qualifies as a small business corporation can therefore claim the cost of an asset over a much shorter period compared with an entity that does not qualify as small business corporation.

In Australia, a small business entity can claim an immediate deduction on assets with a cost price less than USD 1 020. Most of the entity's remaining assets can be grouped together and one depreciation calculation may be performed for all the assets in one group using the diminishing value method. Assets with a useful life shorter than 25 years are grouped together and depreciation is calculated using a rate of 30 percent. Assets with a minimum useful life 25 years are grouped together and depreciation is calculated using a rate of 5 percent⁸³.

- **Turnover/ gross income-based presumptive systems:** The small business community is divided into several business segments with different tax rates for each segment and this is designed to take into account the different profit margins of SMEs. Examples of this system are the Armenian small business tax, which distinguishes three categories of business:
 - a) Traders, who pay 4 percent of gross turnover
 - b) Caterers with a 7 percent rate on gross turnover, and
 - c) Other businesses, for which the rate is 7 percent for turnover up to USD 12 538.80 million and 12 percent for the portion of turnover exceeding USD 12 538.80 million.

The Kyrgyz simplified system establishes different turnover tax rates depending on the type of business, whereby rates vary between 5 percent and 10 percent of turnover. Another system introduces a progressive tax on gross income. In Kazakhstan the system taxes gross income at rates between 3 percent and 9 percent⁸⁴.

- **Micro-business patents:** Some countries use general patent schemes for the taxation of micro-businesses. The micro-business patent is not based on any indicator of the profit potential of the business. The amount of the patent only depends on the kind of business, so taxation is irrespective of the size, the location and turnover of the business. Kosovo, for example, introduced such a system in 2000 for moving traders, artisans and other low-

⁸³ Australian Taxation Office, 2010b

⁸⁴ Engelschalk, M. *Small Business Taxation in Transition Countries*. The World Bank, Washington, D.C

income generating activities. These businesses are subject to the payment of a quarterly patent of USD 47.25.

- Another form of tax relief is by Belgium with an allowance that amounts to €1 840 (US\$6 292) per taxable period and per additional staff member employed in Belgium. If, however, in the course of the year following the exemption, the work force diminishes in comparison with the year of allowance, the total amount of formerly granted allowance shall be included in taxable profits by €1 840 (US\$6 292) (tax year 2008) per release member of the personnel.

7.2. Government guarantees

According to the OECD Scoreboard⁸⁵, governments responded to the global financial crisis and its impact on SME financing with a variety of instruments. The most popular measure remains loans guarantee programmes, which expanded substantially over 2007-11. As the table below shows, extensive government policy responses remained in place in 2012. The use of government guarantees to secure bank lending to SMEs continued to be the most widespread measure among countries participating in the OECD Scoreboard. Furthermore, new elements were added to some of these programmes, such as “express guarantees” that could be granted in five days in Belgium, or the creation of new instruments outside the traditional guarantee programmes. Other public instruments to enhance SME finance included direct loans, micro loans, export guarantees, and support for risk capital (equity), either in the form of co-financing, tax credits for investors or the promotion of crowd funding.

Table 17: Government policy responses to improve access to finance, 2007-12

Policy response	Countries
Government loan guarantees	Austria, Belgium, Canada, Chile, Colombia, Czech Republic, Denmark, Finland, France, Greece, Hungary, Ireland, Israel, Italy, Korea, Mexico, the Netherlands, Norway, Portugal, Russian Federation, Serbia, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Thailand, Turkey, United Kingdom, United States
Special guarantees and loans for start-ups	Austria, Canada, Denmark, Mexico, the Netherlands, Serbia, United Kingdom
Government export guarantees, trade credit	Austria, Belgium, Canada, Colombia, Czech Republic, Denmark, Finland, Hungary, Korea, the Netherlands, New

⁸⁵ OECD (2014), *Financing SMEs and Entrepreneurs 2014: An OECD Scoreboard* OECD Publishing, Paris.

Policy response	Countries
	Zealand, Spain, Sweden
Direct lending to SMEs	Austria, Belgium, Canada, Chile, Colombia, Czech Republic, Finland, France, Greece, Hungary, Ireland, Israel, Korea, Norway, Portugal, Serbia, Slovak Republic, Slovenia, Spain, Sweden, Turkey, United Kingdom
Subsidised interest rates	Austria, Greece, Hungary, Portugal, Russian Federation, Spain, Turkey, United Kingdom
Venture capital, equity funding, business angel support	Austria, Belgium, Canada, Chile, Denmark, Finland, France, Greece, Hungary, Ireland, Israel, Mexico, the Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Turkey, United Kingdom
SME banks	Czech Republic, France, Portugal, Russian Federation, United Kingdom
Business advice, consultancy	Austria, Colombia, Denmark, Finland, the Netherlands, New Zealand, Sweden
Tax exemptions, deferments	Belgium, Finland, Italy, New Zealand, Norway, Spain, Sweden, Turkey
Credit mediation/review/code of conduct	Belgium, France, Ireland, New Zealand, Spain
Bank targets for SME lending, negative interest rates for deposits at central bank	Ireland, Denmark
Central Bank funding to banks dependent on net lending rate	United Kingdom

Source: Data compiled from the country profiles of Financing SMEs and Entrepreneurs 2014: An OECD Scoreboard

7.3. Other support initiatives

In developing new rules, securities regulators could operate on a cooperative basis so that new securities rules are adopted on a harmonised basis. Protocols and policies could be developed to assist the national policy-making process; consultations could be conducted in various ways, including requests for comment, external conferences and meetings related to policy development and setting up formal and informal committees.

Some of the initiatives from different jurisdictions are summarised below:

In Spain, the Ministry of Economy and Competitiveness has launched an initiative to promote SME access to bond markets. The exchange reached agreement with a professional research association to promote coverage through independent analysis of issuers listed on both the main and SME markets. Also, noteworthy is a private sector initiative that aims to establish a new credit rating agency focusing on SMEs and non-financial firms.

In Brazil, several initiatives have been carried out by the public and the private sectors to develop SME access to capital markets. In 2011, the exchange created a Listing Consultant Committee to discuss measures relating to the list of new companies on the SME segment, including potential regulatory measures that would facilitate capital raising. Additionally, the regulator has acted to identify barriers (regulatory, market structure, operational, costs etc.) to SME access to capital markets. In cooperation with the exchange, the regulator, the Brazilian Development Bank and other market entities prepared a diagnosis of the experiences of other countries where small and medium sized companies have accessed capital markets, and reached some conclusions and proposals. Based on this assessment, new rules regarding IPOs and listings of SMEs were recently issued in order to promote attractive conditions for investors and viable alternatives for SMEs to raise funds in the capital markets. In this sense, among other measures, the regulator simplified public offering proceedings, reducing costs and the timeframe of such offers, and developed the investment fund “Ações – Mercado de Acesso”, a new vehicle with tax incentives (subject to a minimum redemption period) provided by federal law to foster investments in SMEs.

In Ontario, Canada, the provincial regulator OSC has several consultative committees, including (1) Continuous Disclosure Advisory Committee, (2) Exempt Market Advisory Committee, (3) Investment Funds Product Advisory Committee, (4) Market Structure Advisory Committee, (5) Mining Technical Advisory and Monitoring Committee, (6) Registration Advisory Committee, (7) Securities Advisory Committee, and (8) Small and Medium Enterprises Committee. The Small and Medium Enterprises Committee (SMEC) advises OSC (regulator) staff on a range of projects, including the planning, implementation and communication of the OSC’s review program, as well as policy and rule-making initiatives relevant to small issuers. The SMEC also serves as a forum to advise OSC staff on emerging issues and unique challenges faced by small issuers. The SMEC is comprised of individuals with small issuer experience (for instance entrepreneurs, advisors and venture capital providers).

The OSC also hosts an annual public conference called “OSC Dialogue”, during which OSC staff and capital market panellists engage in interactive discussions on various topics, including regulatory outlook, capital market trends, and recent global market infrastructure developments. The Investor Education Fund (IEF) was established in 2001 by the OSC, to develop and promote independent financial information, programs and tools to help consumers make better financial and investing decisions.

In Thailand, there are several initiatives for SMEs that the Securities and Exchange Commission has introduced in cooperation with other organisations. The Pride of Province Project, launched by the Commission in cooperation with the Ministry of Interior Affairs, the Stock Exchange of Thailand, the Federation of Thai Industries, Thai Chamber of Commerce, National Science and Technology Development Agency, Investment Banking Club and auditors, is an initiative to promote high potential businesses nationwide and help them raise funds through a listing on the main market or the SME market or through the issuance of bonds and bills of exchange. Businesses participating in the project are invited to join training courses on capital markets and other related matters in preparation for becoming publicly traded companies. Participating businesses with potential to be qualified to go public will be advised by a financial advisor and auditor to help them restructure their organisational management to be on par with listed companies. In case of obstacles, the Commission and the exchange are available for consultation.

In Portugal, the regulator, jointly with market partners, created an SME Committee to discuss SME related issues and to identify the main constraints and policy measures aimed at easing access to SME financing.

In Israel, the regulator has established an intergovernmental Committee to examine measures to improve the access of R&D companies to the market.

In all jurisdictions, all issuers are subject to securities regulatory requirements and are expected to comply with applicable obligations for becoming public companies. Senior issuers can receive assistance and advice on how to comply with their regulatory requirements by consulting with their advisers. They should also develop appropriate internal controls and policies and procedures to ensure compliance with securities law requirements.

The need to retain professional staff for publicly held companies for operational needs, as well as to ensure compliance with regulations, is mentioned as a significant impediment that discourages SMEs from using capital markets.

One solution to this problem is to introduce the NOMAD system.

The NOMAD system, which assists SMEs with their compliance with securities regulatory requirements, is available in 56 percent of respondent jurisdictions. These advisors are obliged to assist the company to complete preparations necessary for the application for listing on a stock exchange. NOMADs can be held responsible jointly with the issuer, for the accuracy of all or part of information and documents publicly disclosed during an IPO or

other capital raising activities. In the majority of the jurisdictions that have this system in place, market advisors provide guidance and advisory services to the company and directors to comply with on-going regulatory requirements from a certain time, for example three years after listing, as long as their shares traded on the market. In cases where NOMAD support is provided for a limited time, SMEs are responsible for the fulfilment of regulatory requirements after the termination of support.

Moreover, with experience and expert knowledge of IPOs, these advisors may evaluate the capital market situation, analyse the SME's prospects, establish contacts and develop an issuing strategy tailored to the SME's individual needs. They can also publish research coverage for companies they sponsor and inform the regulatory authority in case the issuer fails to comply with rules and regulations.

NOMADs are usually investment banks but they could also be an advisory firm, audit company or corporate finance entity that works together with an investment bank for the purpose of raising capital.

In Italy, the Ministry of Economic Development promotes the development of new innovative SMEs based in disadvantaged areas, facilitating their access to risk capital through the provision of financial advance payments to banks and financial intermediaries aimed at the acquisition of temporary and minority participations.

In Portugal, "PME Investimento" is a limited company with the mission to promote the development and increase of the financing offer to SMEs. To pursue its goals, "PME Investimento" dedicates itself to the administration of closed investment funds and giving advice in capital structure, corporate strategy, business and technology, as well as consultancy and services relating to mergers or acquisitions of companies.

This institution receives money from the Portuguese Government and the European Community to support economic development, mainly using the following instruments:

- **Guarantee Fund for Securitisation:** this works as a tool to provide guarantees under securitisation of loans to SMEs, bonds issued by SMEs and bonds issued by groups of SMEs.
- **Syndication Fund Venture Capital SME:** it has the main purpose of stimulating VC activity in Portugal, through risk sharing with the VC specialised entities.
- **FINOVA - Financing Innovation Support Fund:** this was created under the National Strategic Reference Framework to boost the spread of funding instruments that provide better financing conditions for Portuguese SMEs.
- **PME Consolida,** this is one of the main programs of the Ministry of Economy and Innovation directed at supporting economic activity and employment and aiming to improve access to financing instruments for strengthening the capital structure of companies, especially SMEs. The "PME Consolida" program has an estimated budget of

EUR 400 million, consolidated into three different instruments to support domestic companies.

In Turkey, the government SME agency supports firms through subsidy packages for the costs they encounter in the process of going public at the SME market. The subsidy of up to USD 37 000, aims to partially reduce fund raising costs. Some of the securities regulators and exchanges have also lowered or granted exemption to SME issuers from registration and listing fees.

One of the hurdles discouraging SMEs from tapping capital markets is the lack of sufficient staff for complying with the regulatory burden. This is further exacerbated by inadequate financial resources for engaging the services of professional advisors. Apart from the NOMAD system, these issues are being addressed through education and information initiatives aimed at assisting SMEs to comply with regulation, such as seminars, brochures, meetings and websites.

These initiatives are mainly run by exchanges with some examples provided below:

- Organising seminars and other training programs on issues concerning the operation of the stock markets and the general institutional framework for capital markets and providing technical assistance to SMEs on going public.
- Publishing general guidance materials, on regulatory matters and frequently asked questions.
- Publishing reports summarising the observations and findings on the review of issuers' financial reports and their compliance with the Corporate Governance Code.
- Providing guidance to individual issuers on compliance matters upon consultation.
- Launching training programs to help companies with compliance requirements.
- In order to deliver responsive regulation, undertaking research on capital raising regimes, consultation with issuers, investors, dealers, academics and other market stakeholders.

In Singapore, the exchange, jointly with the Singapore Institute of Directors, organises the Listed Company Director Program to provide comprehensive training to company directors (particularly independent directors), on compliance with regulatory and corporate governance matters.

In Ontario, Canada, in order to foster a culture of compliance to improve market confidence and safeguard investors, the provincial regulator Ontario Securities Commission (OSC) established the OSC SME Institute in July 2012 and is launching a series of educational seminars specifically tailored towards SMEs to help them understand their regulatory obligations. The OSC SME Institute offers a series of seminars on a variety of topics including securities regulatory requirements, capital raising in Ontario's capital market, as well as tips on working with the regulator. Participants of the OSC SME Institute benefit from training and workshops offered, and from hearing first-hand from OSC Staff and industry representatives on the latest regulatory issues affecting the SME market. This is also an opportunity for SMEs to share their concerns with the OSC.

The TSXV Exchange also offers various workshops and seminars for Venture Issuers, including Internal Control, Investor Relations Fundamentals, Managing Public Companies, Mining Company Disclosure Fundamentals, Rules and Tools, Venture Filing Fundamentals, Timely Disclosure Fundamentals. These workshops and seminars provide an interactive discussion and learning opportunity for Venture Issuers and legal counsel to enhance their knowledge specifically in TSXV Exchange policies and transaction filings.

The efforts could be focused in specific sectors depending on the characteristics of the industry. For instance in Canada, the mining industry represents over 55 percent of Venture Issuers (by number of firms) and seminars were held exclusively for executive officers of smaller mining issuers and their advisors. The objective of these seminars was to help these venture issuers attain a better understanding of their continuous disclosure obligations in connection with a range of matters, including MD&A, executive compensation and mining technical disclosure. In addition, securities commission staff regularly present information concerning regulatory requirements at conferences where representatives of smaller issuers are in attendance.

Furthermore, training of NOMADs is also important especially for emerging markets. In Egypt, the regulator and exchange have provided several training programs to NOMADs to better help SMEs in fulfilling and complying with the regulations.

7.4. Market Making

As mentioned in several sections of the report, the outstanding amount of SME securities, the investor base and the market structure, especially in emerging markets, may not be sufficiently well-developed to promote liquidity for SMEs. Providing liquidity to SME securities ensures a reliable price formation process and an increase in the volume of shares in public hands.

Survey results show that promoting liquidity in SME securities by market makers is mandatory in 60 percent of the respondent jurisdictions. The market should be allowed to rise and fall naturally, while market makers operate to smooth out imbalances and to enhance liquidity by increasing the demand or supply where needed.

This action is performed in accordance with restrictions and conditions set forth in the rules of the trading system such as providing simultaneous bid and ask prices at a minimum quantity and maximum price spread. In Argentina, the market maker simultaneously maintains offers to sell and bids to buy, in line with the maximum percentage difference of prices approved. The minimum amount that is required to be offered by the SME market maker is set at USD 1 100. The requirement of an offer to sell is subject to the availability of securities that SME market makers have in their own portfolio account opened for this purpose.

In Ontario, a market-making system is not expressly referenced in the securities law; or addressed in detail by any exchange by-laws, rules or policies or in general guidelines set out to help distinguish between proper market-making activity and market manipulation or

market control in the TSX Venture Market (TSXV). Subject to the requirements and normal procedures of trading on the TSXV, a person engaged in market-making normally would not buy all securities offered at the posted price; but would rather buy a portion of the securities at the posted price and allow the price to drop before making further purchases. This allows the market to find its own level at a stable rate. Persons involved in market-making activities should either trade through one account only for a particular security, or if more than one account is used, ensure that trading does not create misleading appearances of investor participation in the market-place. Using one account for market-making purposes allows regulators to ensure that the activity is being conducted fairly and in accordance with applicable securities laws.

With respect to trading systems on the market, almost all jurisdictions apart from three, which only have quote driven systems for their SME markets (Maldives, Chinese Taipei, and Pakistan), stated that their trading system on the SME market is only order driven or both order and quote driven trading systems parallel to the main market depending on liquidity. Colombia and Australia have hybrid trading systems.

7.5. Risk Disclaimer for Investors

In the survey, jurisdictions were asked if there is any risk disclaimer for investors to read and sign before making transactions on the SME market and 35 percent of them responded that investors must sign a risk disclaimer prior to investing in SME shares.

Generally an investor proposing to open an investment account with a brokerage firm must sign a client agreement which contains a risk disclaimer statement for trading of securities on the market. In addition, in cases of reduced disclosure, the prospectus for SME offers has to include a warning statement that it may not contain as much information as would be required for senior issuances. SME issuers seeking to raise funds from capital markets are required to provide risk disclosure to investors that SMEs may carry higher investment risk when compared with larger or more established companies listed on the main market. The same kind of disclosure can also be made in other offering documents in private placements sales. Documentation associated with a private placement may also include written acknowledgment by investors that they understand the risks that may be associated with the offering and issuer.

In India, the client is required to read and sign a Risk Disclosure Document before opening the trading account with a stock broker for both SME and other segments of the market.

In Ontario, there is no specific disclaimer required from investors before trading in publicly listed venture securities in TSXV. However, registered dealers soliciting or accepting orders for trades in these securities are obliged to take reasonable steps to know their client and assess the suitability of the investment for the client taking into consideration, among other things, the client's financial position and investment objectives. An exemption from the dealer registration requirement is available for sales of securities that are issued pursuant to an

exemption from the prospectus requirement on certain conditions, including that the investor completes a risk acknowledgement form. In addition, an investor investing under the offering memorandum with the prospectus exemption must complete a similar but separate risk acknowledgement form. Furthermore in stock quotes and other publications, issuers that trade on the TSXV are identified as trading on exchange “V”. This is distinguished from issuers that trade on the TSX which are identified as trading on exchange “T”.

7.6. Outreach initiatives for SMEs

There are various practices including events, programs, publications, research, web pages, and advice lines to inform SMEs about the processes and advantages of raising funds from capital markets. Some of the more common initiatives in promoting SME access to capital markets submitted by different jurisdictions in response to the survey are summarised below:

- Carrying out surveys and market research to find out reasons for the reluctance of SMEs to secure financing from the capital markets and to identify suitable investors.
- Communication with SMEs by way of promotional campaigns, public seminars, conferences, IPO summits, trade fairs, road shows and workshops to share knowledge on the benefits of capital markets and to raise awareness.
- The training of SMEs and the development of a service to assist them during the listing process.
- Establishing a working group or development team to promote SMEs’ access to capital markets.
- Coordinating actions between related SME agencies, government bodies, the exchange and the securities regulator.
- Setting up a website for publishing periodic information and securities analysts’ research reports on SME stocks to enhance investor interest.
- Making presentations at seminars, conferences, meetings with business clubs and business associations.
- Approaching local companies by sending letters to companies and main shareholders.
- Reducing the fees of securities regulators and exchanges.
- Educational efforts for investors to widen the investor base.

Some other experiences of jurisdictions are given below.

In the USA, the SEC has resources directed at supporting SMEs in meeting their regulatory requirements and other financing options. Under the SEC’s Division of Corporation Finance,

the “Office of Small Business Policy” (OSBP), specialises in matters related to SMEs. The staff in the OSBP answer questions on disclosure and other issues relating to small public companies including those classified as smaller reporting companies and on private and intrastate offerings of securities. Questions are answered by phone, online forms, and e-mails. The OSBP also considers letters requesting a no-action position or interpretive advice. The OSBP acts as the Division of Corporation Finance’s liaison to the state securities regulators on corporate finance issues and Small Business Administration. The SEC’s website also includes links under the Division of Corporation Finance to assist small businesses with information on US securities laws.

In Spain, the manager of the Spanish SME market launched an initiative aimed at increasing market visibility and investor demand for SMEs in September 2011. The availability of an independent analysis service with a sufficiently broad and diverse scope is essential to attract and hold the interest of investors. With this purpose in mind, an agreement with the Spanish Institute of Financial Analysts was reached to manage an analysis service called *In Research*, which could be contracted to companies on both SME and main market. The agreement established a protocol regarding conditions the analysts have to meet and the procedure employed to select them.

The Spanish state agency for SMEs (ENISA), helps viable and high growth potential SMEs to search for and access funds for their growth and consolidation projects. In particular, ENISA provides technical and financial assistance to SMEs going public, but also collaborates with venture capital firms and business angels networks co-investing in start-up business and seeks to direct the interest of investors who are more specialised and more active in other countries towards Spain’s high-potential entrepreneurs. In this respect, ENISA has developed an active policy of attracting projects with major networks of business angels, incubators and accelerator projects. To illustrate this involvement with some data, ENISA participated in 14 venture capital firms, with a contribution of USD 33.16 million, thus generating available funds of about USD 375.94 million. To promote a public debate about the convenience of developing SME access to capital markets, the regulator has organised working seminars with the wide participation of issuers, financial industry members, public sector institutions, private consultants and academics. The regulator has also contributed to initiatives with a similar goal promoted by the exchange and other private institutions. Finally, the regulator has published a working paper on the issues regarding the access of SMEs to capital markets.

Moreover, in Spain, a proposal from the Spanish Ministry of Economy and Competitiveness is currently under consideration. The proposal focuses on the creation of an alternative secondary market dedicated to corporate bonds issued by medium size, non-financial companies; the promotion of commercial paper issued by non-financial companies; and the promotion of equity financing for SMEs. The proposal requires a discussion on a wide range of issues of a different nature, such as possible regulatory measures (including the regulatory trade-offs), issues regarding microstructure and market design, the role of tax and other incentives.

Portugal recommends the creation of special funds; for instance, a closed real estate investment fund, which could acquire SME premises during a specific period of time, giving the company an option to buy back its premises, after having fulfilled certain conditions.

In Mauritius, as part of efforts to raise awareness of capital markets, the exchange organises the Young Investor Award Competition at the high school level. The aim of the competition is to develop an investment culture by providing students with the experience of investing in a real-life environment.

In Morocco, the Casablanca Stock Exchange proposed creating a dedicated SME market through the restructuring of the main market's present architecture. It proposed setting up a main market and an alternative market. The main market will trade all large companies based on capitalisation. It will have two lists: one of companies with a capitalisation of USD 0.11 billion to USD 1.1 billion, and another for companies with a capitalisation exceeding USD 1.1 billion. The alternative market will have two submarkets: the first will list all SMEs and will be tailored to their needs, The other, called the free market, will have all types of companies wishing to familiarise themselves with listing procedures and requirements before making a choice to either access one of the two markets or to exit.

In Canada, the proportionate regulation committee has conducted a comprehensive review of all current securities regulatory requirements applicable to venture issuers. The proposals and related amendments to other instruments, if adopted, will consolidate and further tailor the securities regulatory requirements applicable to venture issuers. In addition, Canadian securities regulators are currently reviewing existing exemptions from the prospectus requirement to assess whether any new exemptions or variations on existing exemptions are necessary or appropriate, for example with respect to crowd funding. The provincial regulator in Alberta Canada revised policy development guidelines to require that with each new policy project or rule-making initiative specific consideration is given to the impact on venture issuers and that an assessment is made as to whether the proposed new rules are appropriate to venture issuers.

There are also investor education or financial literacy efforts that provide information to investors on the basics of investment, risks associated with investing, identifying potential scams and other related matters. This information is provided in a variety of formats including web, phone, formal presentations (e.g., at retirement centres, schools, clubs, and fairs), contests, and radio and television advertising.

8. Conclusion/Recommendations

8.1. Key Takeaways

Key takeaways from the survey responses and best practices are set out below.

1. Proportional regulation:

Proportional regulation would lessen the regulatory burden on SME issuers, Particularly important would be to increase the availability of relevant information on SMEs in order to help investors make informed decisions. Regulators should engage with stakeholders and review all current securities regulatory requirements applicable to SME issuers. They should also conduct cost–benefit and regulatory impact analyses.

- **Exemption from certain disclosure requirements:** Certain disclosure obligations that may be of less value to SMEs should be eliminated. This in return will enable SME management to focus more on the growth of the company business, while saving it time and resources.
- **Create different levels of listing requirements:** It could be useful to lighten listing requirements for SMEs and to lower the thresholds on minimum paid up capital, the number of years of operation and minimum free float, revenue, market capitalisation, the number of public shareholders, the number of minimum shareholders, equity, paid up capital and profitability requirements.
- **Reducing the cost of capital:** It is important to lower the registration and listing fees, both for admission to trading and for maintenance of the listing. When companies seek access to capital markets, they expect to raise capital at a reasonable cost. In this context, SMEs would benefit from the implementation of differentiated financial reporting standards. The responsibility for the review of prospectuses of companies seeking admission to SME markets could also be delegated to the Market Operator and/or NOMADs. Alternatively, IPO costs for SMEs could be covered to some extent by a governmental body, for example, the SME agency.

2. Access routes:

- **Private placements:** Private placements (without a prospectus or modified prospectus or offering document) could be used for prescribed categories of private investors as an alternative way for SMEs to access financing from capital markets. SMEs that prefer to stay private with no intention or desire to ever become public entities, given the costs, time, and disclosure requirements associated with a public offering, should be able to benefit from obtaining funds through the capital markets. This can be achieved by increasing available issuance options such as private placements and hybrid offer regimes. These options are crucial in terms of increasing the flexibility of the primary market’s regulatory framework and can also

play a role in attracting and facilitating SME financing.

- **Backdoor Listing:** In some jurisdictions, backdoor listings are considered an attempt to circumvent or avoid listing and disclosure requirements. In the case of these listings, a prospectus, filing statement or information document should be prepared for approval by shareholders of the public company being acquired. This document should contain disclosures that enable investors to make informed decisions.

3. Investor protection - The need for balanced regulation: It is crucial to ensure investor confidence as a way to increase investment flows into the SME markets. Retail investor protection is particularly important given that they are the main investors in SME securities. Less disclosure does not necessarily mean less investor protection. Therefore, the challenge for regulators is to strike the right balance between an adequate level of investor protection and the optimum level of requirements for issuers. If it is relevant, SME issuers could be subject to additional disclosure requirements compared to senior issuers to highlight any big investment risks unique to SMEs.

4. Supporting SME Market:

- **Market Making:** Introducing a market making system for liquidity of SME shares would benefit the market. Inadequate liquidity is one of the reasons for the limited demand for SME securities. Providing liquidity to SME securities ensures a reliable price formation process and increases the number of shares held by the public. To this end, introducing a market making system may help, since the outstanding amount of SME securities, the narrow investor base and the market structure, especially in emerging markets, may not be sufficiently well-developed to promote liquidity.
- **Ensure good availability of investment research information:** It is important to provide incentives to foster independent research on and ratings of SMEs. Conducting research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for this service. On the other hand, research and rating information should be made available to a wide array of potential investors in order to reduce the information asymmetries associated with smaller companies. For this purpose, publishing periodic analysis and rating reports by relevant institutions on SME securities could enhance investor interest.
- **Lock up:** Policymakers could consider introducing lock up provisions in order to protect the integrity of the SME market. Lock up provisions could have the important effect of ensuring that management remains committed and that securities issued are appropriately valued.

5. Financial Literacy:

- **Increasing public awareness:** Regulators and policymakers should organise promotional campaigns, public seminars and conferences to explain the benefits of

capital markets and to increase public awareness of the need for SME financing. They should also conduct surveys to understand why SMEs fail to take full advantage of capital markets. Furthermore, regulators could consider establishing an internal working group or development team to promote SME access to capital market financing.

- **Training and education to assist SMEs for compliance:** Regulators could consider setting up teams to respond to SME questions relating to regulatory requirements. SMEs may be reluctant to explore the benefits of capital markets owing to a lack of professional staff who are able to comply with technical regulatory requirements. Thus, it is important to assist SMEs in complying with securities regulatory requirements through education and training initiatives. In this context, it may be particularly important for emerging markets to have well-trained NOMADs.
- **Website:** Policymakers could consider setting up a website (or use an existing website) for the purpose of informing, educating and assisting SMEs and investors, and to publish periodic analyst reports for SME securities.

6. Monitoring and supervision of SMEs and coordination with relevant governmental bodies:

- **Monitoring compliance:** Policymakers should strive for a close and direct monitoring of SME compliance with regulatory requirements. For this, they may consider establishing a team that specifically monitors SME compliance with regulatory requirements. It is important to note that proportional and lighter regulation for SMEs does not mean that supervision should also be lighter for SMEs.
- **NOMAD System:** It is useful to introduce the NOMAD system to help ensure SME compliance with security regulatory requirements. These nominated advisors are authorised by or registered with exchanges and are obligated to assist the company during the application procedure for listing on the stock exchange. The advisors could be held responsible - jointly with the issuer - for the accuracy of all or part of the information and documents disclosed to the public when establishing contacts and developing an issuing strategy tailored to the issuer's individual needs.
- **Market Abuse:** Since SME shares may be more vulnerable to market manipulation than those of senior issuers, trades in SME shares should be closely and specifically monitored and investigated when necessary by the authorities to maintain investor confidence and market discipline.
- **Coordination among regulators and stakeholders:** Coordination among SME agencies, governmental bodies, stock exchanges and public authorities is crucial in harmonising efforts for promoting SME financing, setting up consultative committees and exploring alternative incentives.

7. Fostering the demand side

- **Institutional investor demand:** On the demand side, it is important to explore methods of engaging long term institutional investor demand for SME securities for both developed and emerging markets. The survey findings indicate that retail individuals are the predominant investors in SME markets. However retail investments are likely to remain an inadequate source of financing, both in terms of the amount invested and in the consistency and duration of the investments.
- **Products pooling SME securities:** Pooling SME securities into one package via an SPV may attract institutional investors and SMEs to capital markets thanks to the lower transaction costs. Such initiatives are likely to have a positive impact given that lack of liquidity is the leading factor behind the limited institutional investor demand for SME securities. When bundling SME securities the role of risky assets in the global financial crisis should be kept in mind. Therefore only the highest rated SMEs should be considered for participating in such pooled securities structures.

8.2 Recommendations

Long-term financing for SMEs is key for promoting sustainable economic growth and job creation, as stated during the G20 Finance Ministers and Central Bank Governors Meeting in Moscow in July 2013 and at the Saint Petersburg Summit in September 2013. The following measures are recommended for the development of SMEs in emerging markets.

1. The study finds that separate equity markets for SMEs have been established successfully in several jurisdictions. However, we note that policy makers have yet to achieve similar success at improving SME access to the fixed income markets. As such, we recommend that policymakers facilitate SMEs' access to both equity and fixed income markets through the establishment of separate markets specifically created for them in these segments.
2. One notable feature of the dedicated SME equity markets is that listing requirements have been tailored to SMEs, which have reduced their issuance costs. We recommend that such tailored listing requirements be introduced for dedicated equity and fixed income markets for SMEs.
3. On the other hand, in order to encourage investor interest in these markets, we also recommend that the procedures for custody, clearing and settlement be the same in the dedicated SME markets as in the main markets.
4. The report indicates that SMEs' access to the corporate bond market and other debt securities markets is almost non-existent. The main reason for this situation is the inadequate institutional investor demand for SME securities, caused primarily by the lack of liquidity. One way to overcome this hurdle is to pool SME securities, either equity or

debt, into one product. These products should offer enough equity and other securities to attract institutional investor demand.

To increase institutional investor demand, securities regulators, exchanges, brokerage houses, institutional investors and related government parties could collaborate to develop practices or models that offer higher liquidity for equity and other SME securities. This work could be conducted through joint committees or task forces and would take into account the local legal framework, government support, contractual issues between the parties, fulfilment of on-going disclosure obligations, etc.

5. In addition, the study finds that the dedicated equity markets for SMEs develop at a faster pace following the introduction of the market advisor system that assists firms in preparing for listings. We therefore recommend that policymakers introduce a similar market advisor system to facilitate the issuance of securities by SMEs.
6. In the secondary market, the study observes that a market making system is instrumental in improving market liquidity for SME securities. We recommend that, wherever possible, policymakers should introduce a market making system for securities issued by SMEs.
7. The study also finds that policies which encourage the issuance of securities through private placements help improve SME's access to capital markets and such measures should be introduced by policymakers to facilitate SME's ability to obtain funding from the capital markets.
8. Finally, the study finds that alternative methods of financing, such as private equity, venture capital and securitisation, can be effective tools for financing SMEs. We therefore recommend that policymakers explore the suitability of these alternative sources of financing for SMEs in their respective jurisdictions.

APPENDIX 1

IOSCO INITIAL SURVEY

FINANCING of SMEs THROUGH THE CAPITAL MARKETS

I. Profile of the SME Market

1. Is there any definition of SME in your jurisdiction based on criteria/thresholds in relation to sales, assets, employees, gross income/revenue, no of shareholders, public float, net capital, company’s market capitalization, etc.? (Only if the definition is related to capital markets)

Yes No

If the answer is yes, please specify.

2. Is there a separate SME market from the main market in your jurisdiction?

Yes No

If so, how is it organized? Please tick the box below.

It is organized under the main market as a junior market

It operates as a separate exchange

3. When did the separate SME market start?

Year:

4. If your response to question 2 is yes, please give information in the table below about the SME market compared to main market at 30.06.2012 or latest available data (by mentioning date).

	SME Market	Main Market
Number of Listed Companies		
Market Capitalization (million USD)		
Average Market Capitalization (million USD)		
Daily Average Turnover for 2012		
Share of Individual		

Investors (%)		
Average free float rate (%)		

5. Is there a subdivision of the listed SME's in the SME market? (more than one layer of SMEs)

Yes No

If the answer is yes, please specify.

6. If there is no separate SME market can you provide data for the funds raised by SMEs from the main market by equity finance (based on the SME definition in Question 1)?

7. What are the main sectors in which the listed SMEs operate? Please identify the number of issuers by market capitalization for each sector.

Sectors	Number of issuers	Market capitalization

8. How do the listing requirements for SMEs differ for the SME market in comparison with large issuers? (e.g. minimum paid up capital, minimum allocation to retail investors, minimum free float in percentage or in actual terms, minimum number of subscribers / shareholders required, amount of investment required by each investor, number of years of profitable operation, etc.)

Please specify briefly.

9. How many SMEs have moved to the main market in the last five years?

0

6-10

1-5

More than 10 (please specify the number)

- 10.** What are the conditions/reasons causing SMEs to move from SME market to the main market? Is it a voluntary or mandatory action?
Please specify briefly.

--

- 11.** How many delistings have happened during the last 10 years? Please fill in the below table

	SME Market	Main Market
Bankruptcies		
Voluntary delistings		
Other		

- 12.** Do you think your jurisdiction's securities markets other than equity market have not been developed enough yet, in terms of depth and liquidity, for corporate bonds and other securities issuance of SMEs?

Yes No

Please explain briefly.

--

- 13.** Do you have measures and/or criteria to differentiate SME issuers/issues in Corporate Bond Market?

Yes No

If your answer is yes, by using the measures and/or criteria to differentiate SME's from the large scale issuers in your regulation; If not, by using the SME definition given at question 1;

- a) What is the latest outstanding amount in USD for SME Corporate Bonds issuance?

- b) Has there been any default in Corporate Bonds of SMEs in the last 5 years?

Yes No

14. What is the outstanding amount and breakdown of securities, other than equity and corporate bonds, issued by SMEs? (e.g. all kind of securitization, pooling of bonds or other securities, hybrid instruments, mezzanine finance, covered bonds, etc)

Types of securities	Outstanding Amount

II. Access to capital markets for SMEs

15. What are the principal sources of financing of SMEs (both publicly held and private SMEs) in your jurisdiction? Please rank them in the following table. (Bank loans, equity finance, international funds, venture capital, corporate bonds, etc)

1.
2.
3.
4.
5.
Other (Please specify out of the ranking)

16. Is there any available data related to the sources of finance mentioned in Question 15?
Yes No

If yes, please specify in the below table the percentage of each type/source of financing.

Sources/Type of financing	(%)

17. Please rank the impediments below that you think discourage SME owners⁸⁶ from access to capital markets financing on a scale from (1) to (8). (1) indicates less discouraging, and (8) most discouraging.

() Lack of familiarity with capital markets

⁸⁶

For questions 17,18 and 19 we refer to SMEs that have not accessed to capital markets yet.

- () Misconception that company is too small and stock markets are for big issuers
- () Shortage of skilled personnel
- () The costs and fulfillment of regulatory requirements during and after an IPO
- () Family owned structures and fear to lose the control of the company
- () Issuance price, that is, the discount applied by the market over the stock's price would be not fair
- () Lack of investors and the existing uncertainties surrounding the success of the offering after paying the initial costs of the IPO
- () Lack of liquidity in the secondary market

- **OTHER** (Please specify below out of the ranking).

18. Please rank the impediments below that you think discourage brokers from working with SMEs (6) indicates less discouraging and (1) most discouraging

- () There are no SMEs interested in raising capital through equity
- () There are no investors interested in small and medium offerings (due to, for instance, issues related to liquidity, portfolio composition, etc)
- () Their distribution channels are not suitable for investor interested in investing in SMEs.
- () The remuneration with small and medium offerings does not pay-off
- () Reputational risks
- () Liability risks

- **OTHER** (Please specify below out of the ranking).

19. How beneficial/efficient do you feel/think is raising of equity capital or other securities for SMEs in your jurisdiction, considering other financing options (such as bank financing or financing from other financial institutions, etc)?

Please explain briefly.

III. IPOs, Registration Process and Related Costs

- 20.** What are the differences between the SME issuers and large scale issuers in respect of registration and IPO process? Please specify briefly.

SME issuers	Large scale issuers

- 21.** What are the costs for an SME's IPO? If possible, indicate the breakdown of the costs as a percentage of IPO proceeds (e.g. accounting, audit, brokers, underwriting, listing, registration fees, etc).

Costs	(%)

- 22.** What is the regulatory framework on private placement regimes, small offering exemptions, sales to qualified or accredited investors and other related reliefs/exemptions from registration for SMEs in your jurisdiction?

Please specify briefly.

--

- 23.** What are the alternatives in your jurisdiction for SMEs going public apart from IPOs? (e.g. mergers & acquisitions)

Please specify briefly.

--

- 24.** Are shareholders of an SME allowed to sell their shares within the IPO? Are there any practices or regulation for locking up the shares of SME owners for a certain period of time after the IPO?

Yes No

Please specify briefly.

--

25. Is there any regulation in your jurisdiction that enables owners to keep control of the company with minority shares? (such as preferred stocks)

Yes No

If the answer is yes, please specify briefly and comment whether it has been usual for companies that went public (IPO) recently not to follow one share one vote practice.

IV. Regulatory framework for SMEs

26. How do the requirements for SME issuers and large issuers differ in reference to the requirements below?

<i>Requirements</i>	SME issuers	Large issuers
Prospectus Standards		
Ongoing Public Disclosure and filing requirements after IPO (e.g. financial statements, audit reports, disclosure of material events, etc)		
Compliance to Corporate Governance Principles		
Accounting Standards		
Other		

27. Are there any other specific requirements (not covered in Question 26) imposed on SMEs that are not applied to other issuers?

Yes No

If the answer is yes please specify briefly.

28. Is there any risk disclaimer for investors to read and sign before doing transactions on the SME market?

Yes No

29. Does lighter and proportional securities regulation envisaged for SMEs create investor protection problems in your jurisdiction?

Yes No

If the answer is yes, what are the main problems? Please specify briefly.

1.
2.
3.

30. Please list difficulties regarding the implementation of proportionate securities regulation and monitoring SMEs' compliance to securities regulations in your jurisdiction.

1.
2.
3.

31. How are SMEs supervised and monitored according to the securities regulation in your jurisdiction? Please specify briefly.

--

V. Incentives on SME financing through capital markets

32. Does your jurisdiction have tax incentives or any other incentives for SMEs using capital markets? Are there any incentives for SME investors?

Yes No

If the answer is yes, please list the incentives both for the SMEs and the investors.

1.
2.
3.

33. Does your jurisdiction have tax incentives for venture capitals, private equity and business angels?

Yes No

If the answer is yes, please specify the incentives.

1.
2.
3.

34. Do any agencies, institutions or public funds in your jurisdiction support SMEs using the capital markets? (e.g. covering or subsidizing a portion of IPO costs).

Yes No

If the answer is yes, please specify the name and the task of the agency in your jurisdiction.

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VI. Other Issues

35. Have you experienced any market abuse cases (insider trading, market manipulation) in the SME market/on SME shares?

Yes No

If the answer is yes, are there any regulatory/supervisory differences on the market abuse cases between the SME market and the main market? Please specify briefly.

--

36. Is there a market advisory system that assists SMEs' compliance with securities regulatory requirements?

Yes No

If the answer is yes, please give brief information about this system.

--

37. Are there any practices where intermediaries promote liquidity to SME shares? (e.g. as a market maker)

Yes No

If the answer is yes, please specify briefly.

--

38. What is the trading system in your jurisdiction for main market and for SME market, if any: (e.g. quote driven, order driven, hybrid, etc)?

39. Are there any recent/ongoing initiatives, for example coordination of different parties (public, private etc.) or any other efforts to increase the SMEs' access to capital markets in your jurisdiction?

Yes No

If the answer is yes, please specify briefly.

40. Are there any efforts (events, programs, publications, research, web pages, advice lines, etc) to increase the investor demand to SME market and inform the SMEs about the process and benefits of providing funds from capital markets?

Yes No

If the answer is yes, please specify the efforts briefly.

41. Are there any training or other initiatives to assist SMEs to comply with securities regulation requirements?

Yes No

If the answer is yes, please specify briefly.

42. Is there any program or practice to pool or bundle SMEs' securities into a package that would attract institutional investors' demand?

Yes No

If the answer is yes, please specify briefly.

43. Do you have any proposals about promoting SMEs' access to capital markets? (New financial products or services, or any other ideas)

Thank you for contributing to this survey. Your opinion is very important to us.

If you have any inquiry on this survey or need further assistance, please contact: at the Capital Markets Board of Turkey, Mr. Yildirim Akar by email yildirim.akar@spk.gov.tr or by phone on +90 312 292 85 44 or Ms. Tuba Altun by email taltun@spk.gov.tr or by phone on +90 312 292 88 81; OR at the IOSCO General Secretariat, the EMC Team by e-mail emcteam@iosco.org or by phone on +34 91 787 04 07; +34 91 787 04 13; or +34 91 787 04 16.

***Important:** Please indicate the name, e-mail and phone number of a contact person in your agency in case we need clarification on any aspect of your responses to this survey or need further feedback from you.*

Jurisdiction:

Agency:

Name:

E-mail:

Phone:

APPENDIX 2

IOSCO FOLLOW-UP MINI SURVEY

SME FINANCING THROUGH THE CAPITAL MARKETS

Objective

The mandate on the “Financing of SMEs through the Capital Markets” was approved during the EMC meeting of 15 May 2012. A Questionnaire was circulated among ordinary members of IOSCO on 29 August 2012. [46 responses were received on the basis of which a draft report was produced.]

This mini-Survey seeks to update information provided in response to the initial Survey questionnaire, as well as to incorporate any developments/changes since then.

I. Profile of the SME Market

1. If there is a separate SME market in your jurisdiction, please give information in the table below about the SME market compared to main market as at 30.06.2014 or latest available data (by mentioning date).

	SME Market	Main Market
Number of Listed Companies		
Market Capitalization (million USD)		
Average Market Capitalization (million USD)		
Daily Average Turnover for 2014		
Share of Individual Investors (%)		
Average free float rate (%)		

2. How many SMEs have moved to the main market in the last five years ending 30.06.2014 or later (by mentioning date)?

0 6-10

1-5 More than 10 (please specify the number)

3. What is the outstanding amount in USD for SME Corporate Bonds issuance as at **30.06.2014** or latest available data (by mentioning date)?
4. What is the outstanding amount and breakdown of securities, other than equity and corporate bonds, issued by SMEs as at **30.06.2014** or latest available data (by mentioning date)? (e.g. all kind of securitization, pooling of bonds or other securities, hybrid instruments, mezzanine finance, covered bonds, etc.)

Types of securities	Outstanding Amount

5. Have there been any significant changes / developments in your jurisdiction in relation to SMEs since the initial Survey of 29 August 2012 with regard to the following?
- a. Profile of SMEs
 Yes No

 - b. Financing options, e.g. crowd funding
 Yes No

 - c. Access to capital markets and cost of capital
 Yes No

 - d. Regulatory framework
 Yes No

 - e. Regulation of non-traditional sources of funding, e.g. crowd funding
 Yes No

 - f. Incentives and other support
 Yes No

 - g. Other
 Yes No

If YES to any of the above, please explain.

--

6. What are the relative costs for SMEs for raising capital through various methods (e.g. banks, IPOs, corporate bonds, pooling arrangements)?

Source of funding	Cost of capital

7. In your view, how can technology help bring the suppliers of capital closer to those SMEs who demand it?

Thank you for contributing to this survey. Your opinion is very important to us.

If you have any inquiry on this survey or need further assistance, please contact the IOSCO General Secretariat, the GEM Team by e-mail gemteam@iosco.org or by phone on +34 91 417 5549.

Important: *Please indicate the name, e-mail and phone number of a contact person in your agency in case we need clarification on any aspect of your responses to this survey or need further feedback from you.*

Jurisdiction:

Agency: Name:

E-mail:

Phone:

APPENDIX 3

Table 1- Definition of SMEs in Various Jurisdictions

Jurisdiction	SME definition
Australia	No standard definition of an SME but multiple definitions of small and medium enterprises are used across the finance sector. Australia's main equity market, the ASX, has defined a “mid to small cap entity” as a listed entity that has a market capitalization of \$300 million or less and is outside the S&P/ASX 300 index.
Canada	The “venture issuer” concept is used to demarcate smaller issuers from larger ones in the IPO context. The term “junior issuer” is also used to identify certain smaller issuers.. The term “junior issuer” refers to an issuer that is not a reporting issuer, which files a preliminary prospectus, and whose consolidated assets, total consolidated revenue and shareholders’ equity are all less than USD 9 800 000. Recent significant acquisitions and proposed acquisitions (which have a high possibility of being completed) are included in the calculation.
Dubai	The aggregate market value of the securities of an issuer who intends to seek listing on NASDAQ Dubai is currently set at USD 10 million.
Egypt	Listing rules of the Egypt Stock Exchange defines SMEs as the joint stock companies whose issued capital is not more than USD 8 million or its equivalent in foreign currencies when applying for listing for the first time. Issued capital cannot exceed USD 16 million or its equivalent in foreign currencies thereafter.
EU	The Prospectus Directive defines SMEs as companies which, according to their last annual or consolidated accounts, meet at least two of the following three criteria: an average number of employees during the financial year of less than 250, a total balance sheet not exceeding USD 53.75 million and an annual net turnover not exceeding USD 62.5 million. The same Directive contains another definition for “companies with reduced market capitalization” (Small Caps) as companies listed on a regulated market that had an average market capitalization of less than USD 125 million on the basis of year-end quotes for the previous three calendar years. This definition is used as the basis for allowing a proportionate disclosure regime for such companies.
India	An issuer whose post-issue face value capital does not exceed INR 100 million (USD 1.82 million) can issue its securities only in accordance with the regulation governing SMEs.
Israel	The securities regulator is considering the adoption of a model that combines the use of market value and of the value of public holdings. A small company would be defined as one with a market value of less than

	USD 75 million and whose value of public holdings is less than USD 12.5 million.
Maldives	SMEs are defined by their paid-up capital, which must be between MVR 0.06million to0.3 million.
New Zealand	Although there is no specific rule, the Exchange recommends that the main market is best suited to companies with revenue in excess of USD 41.2 million.
Peru	The Exchange differentiates SMEs with regard to average annual revenue from the sale of goods or services in the last 3 years, which do not exceed Sol 200 million (USD 77 million) according to available financial information or annual income tax filing.
Thailand	An issuer should have a paid-up capital between USD 0.62-9.3 million and the total value of ordinary shares based on market capitalization must be over USD 31 million, in order to be listed on the SME market. Furthermore, shareholders' equity must exceed USD 0.62 million.
Turkey	Registered securities which cannot meet the main market listing requirements are traded on the SME market. The criterion to qualify for either the main market or the SME markets is quantitative. If the market value of free floating shares ratio to the paid up capital of the issuer is less than 15 percent and the market value of the floating shares is less than USD 3.36 million or 5per cent and USD 6.71 million, then the application to be listed should be made to the SME market.
Jurisdiction	SME Differentiation Based on Other Criteria
Argentina	Sectoral differentiation is conducted by the annual sale of companies.
Chinese Taipei	In line with the “Act For Development of Small and Medium Enterprises”, enterprises in mining, sand and gravel gathering, manufacturing, and construction industries with paid-in capital less than NT\$80,000,000 (about USD 2.6 million) fall into the category of SME. Enterprises in other industries with paid-in capital less than NT\$100,000,000 (about USD 3.3 million) also fall into this category.
Colombia	Entities are defined as SMEs if the amount of assets and the number of employees are less than about 8.4 million USD and 200 respectively.
Hong Kong	Enterprises with fewer than 100 employees and non-manufacturing enterprises with fewer than 50 employees are regarded as SMEs.
Korea	SMEs are defined in 19 different sectors with reference to standards regarding the number of full-time workers employed by the business entity and the scale of its capital or sales.
Malaysia	SMEs are those enterprises with a sales turnover of less than RM25 million or with less than 150 workers employed full-time. For services and other sectors, SMEs refer to enterprises with a sales turnover of less

	than RM5 million or less than 50 workers.
Mauritius	SMEs are enterprises which have an annual turnover of less than 1.55 million USD.
Singapore	SMEs are defined as enterprises with annual sales turnover of not more than S\$100 million, or with an employment size of not more than 200 workers.

Table 3 - Synopsis of SME Definitions by Region

	EU	USA	ASIA(Mlysia)	EGYPT	GHANA	BRAZIL		RUSSIA	INDIA	RSA
						Industrial	Commercial			
WORDS	Small and Medium Enterprise	Small and Medium Businesses	Small and Medium Enterprise	Micro,Small and Medium Enterprises	Micro,Small and Medium Enterprises	Small and Medium Enterprise	Small and Medium Enterprise	Small and Medium Enterprise	Micro,Small and Medium Enterprise	Small and Medium and Micro Enterprise
# of EMPLOYEES										
Micro	< 10	0	< 5	1 to 4	up to 5	Up to 19	Up to 09	0	0	< 20
Small	< 50	<100	5 to 50	5 to 14	6 to 29	20 to 99	10 to 49	15 to 100	0	50-99
Medium	< 250	<500	51 to 150	15 to 49	30 to 99	100 to 499	50 to 99	101 to 250	0	100-200
TURNOVER										
Micro	\$3m	0	USD 78.000	0	\$10 k	0	0	0	<USD 0.9m	<USD 18K
Small	\$13m	0	USD 78.000	0	\$100k	0	0	12m USD	USD 0.9-	USD

	EU	USA	ASIA(Mlysia)	EGYPT	GHANA	BRAZIL		RUSSIA	INDIA	RSA
			to< USD 3.12m					max	1.08m	0.24m to USD 0.54m
Medium	\$67m	0	USD 3.12m to USD 7.8	0	\$1million	0	0	0.030 B USD max	USD 1.08-991.78m	USD 0.54 to USD 6m

Source: Literature Review on Small and Medium Enterprises ⁸⁷

⁸⁷

Literature Review on Small and Medium Enterprises: Access to Credit and Support in South Africa Prepared for the National Credit Regulator (NCR) Compiled by Underhill Corporate Solutions (UCS)
Project Manager and Lead Researcher: Edmore Mahembe

Table 4: The main qualitative indicators that may be used in order to differentiate between SMEs and large companies

Category	SME's	Large Companies
Management	<ul style="list-style-type: none"> • Proprietor entrepreneurship • Functions-linked personality 	<ul style="list-style-type: none"> • Manager-entrepreneurship • Division of labour by subject matters
Personnel	<ul style="list-style-type: none"> • Lack of university graduates • All- round knowledge 	<ul style="list-style-type: none"> • Dominance of university graduates • Specialisation
Organisation Sales Buyer's relationships Production Research development	<ul style="list-style-type: none"> • Highly personalized contacts • Competitive position not defined and uncertain • Unstable • Labour intensive • Following the market, intuitive approach 	<ul style="list-style-type: none"> • Highly formalised communication • Strong competitive position • Based on long- -term contracts • Capital intensive, economies of scale • Institutionalised • Finance
Finance	<ul style="list-style-type: none"> • Role of family funds, self-financing 	<ul style="list-style-type: none"> • Diversified ownership structure, • access to anonymous capital market

Table-5 Launch of SME Market

Jurisdiction	Year	Jurisdiction	Year
Argentina	2002	Morocco	1997
Canada (Ontario)	1999	New Zealand	2003
Denmark	2005	Pakistan	2003
Egypt	2007	Peru	2012
Germany	2005	Poland	2007
Greece	2008	Portugal	2007
Hong Kong	1999	Singapore	1987
Iceland	2007	South Africa	2003
India	2012	Spain	2008
Italy	2012	Taipei	2002
Korea	1996	Thailand	1999

Jurisdiction	Year	Jurisdiction	Year
Lithuania	2007	Turkey	2009
Malaysia	1998	United Kingdom	1995
Mauritius	2006		

Table - 6 Average Market Capitalization of SMEs

Jurisdiction	As of 30 June 2012		As of 30 June 2014	
	Av. Cap. of SME Issuer (USD Million)	Av. SME Issuer Cap. /Av. Senior Issuer Cap. (per cent)	Av. Cap. of SME Issuer (USD Million)	Av. SME Issuer Cap. /Av. Senior Issuer Cap. (per cent)
Argentina	-	-	N/A	N/A
Canada (Ontario) (07/12)	17.5	1.4	12.89	0.88
China	-	-	530	19
Chinese Taipei	68.1	13.4	103.92	9.26
Denmark	28.9	2.5		
Egypt	9.1	3.2		
Finland	-	-	313	0.15
Germany	14.9	0.8		
Greece (09/11)	22.6	20.3		
Hong Kong	52.9	2.8		
Iceland	59.8	22.4		
India	5.1	1.4	81.12	6.85
Italy	20.2	1.8	1,900	0.31
Korea	83.9	7.1	149	9.72
Malaysia	20.7	3.7	36.7	5.50
Mauritius	29.2	21.2	N/A	N/A
New Zealand	30.5	8.7		
Poland	6.1	1.2		
Portugal	9.4	0.2	37.4	
South Africa	2.7	1.1		
Spain	27.4	0.7		
Thailand	46.8	7.1		
Tunisia	-	-	513.41	6.03

	As of 30 June 2012		As of 30 June 2014	
Jurisdiction	Av. Cap. of SME Issuer (USD Million)	Av. SME Issuer Cap. /Av. Senior Issuer Cap. (per cent)	Av. Cap. of SME Issuer (USD Million)	Av. SME Issuer Cap. /Av. Senior Issuer Cap. (per cent)
Turkey	24.0	3.3	18.08	2.82
UK	85.1	1.9		

Table - 7 SME Markets and Main Markets

		Number of Companies		Market Cap. (million USD)		
Jurisdiction	Date	SME Market (s)	Main Market(s)	SME Market (s)	Main Market(s)	SME Market Cap/Main Market Cap (per cent)
Argentina	30June 2012	49	171	N/A		
	30June 2014	52	196	N/A	471.387	
Canada (Ontario) (07/12)		2,264	1,577	39,642	1,953,751	2.03
China	30June 2012	-	-	-	-	-
	30June 2014	2 480	1 466	1 313 651	4 085 695	32.2
Chinese Taipei	30June 2012	274	1,419	18,665	721,886	2.59
	30June 2014	275	1,530	28,578	932,627.98	
Denmark		16	175	462	199,528	0.23
Egypt		22	212	201	60,545	0.33
Finland	30June 2014	10	126	556	214,319	
Germany		177	601	2,640	1,180,323	0.22
Greece ⁸⁸		149	278	3,362	30,829	10.91

⁸⁸

SME Market data is as of 30.09.2011

		Number of Companies		Market Cap. (million USD)		
Jurisdiction	Date	SME Market (s)	Main Market(s)	SME Market (s)	Main Market(s)	SME Market Cap/Main Market Cap (per cent)
Hong Kong		179	1,355	9,475	2,525,826	0.38
Iceland		4	8	239	2,134	11.20
India	30June 2012	8	6,634	41	2,424,489	0.00
	30June 2014	109	7 225	2,078	3,106,277	0.07
Italy	30June 2012	23	394	465	438,099	0.11
	30June 2014	57 (as of December 18, 2014)	287	2,159	621,138	0.34
Korea	30June 2012	1,102	785	92,484	931,535	9.93
	30June 2014	1 061	772	129 654	1 183 254	10.96
Malaysia	30June 2012	115	815	2,382	452,250	0.53
	30June 2014	108	797	3,964	531,812	0.75
Mauritius	30June 2012	48	40	1,400	5,500	25.45
	30June 2014	46	45	7 471	1 506	496
Mexico	30June 2012	-	-	-	-	-
	30June 2014	N/A	137	N/A	548,266	N/A
New Zealand		42	142	1,282	49,630	2.58
Palestine	30June 2012	-	-	-	-	-
	30June 2014	N/A	49	N/A	3 120	N/A
Poland		397	398	2,430	201,140	1.21

		Number of Companies		Market Cap. (million USD)		
Jurisdiction	Date	SME Market (s)	Main Market(s)	SME Market (s)	Main Market(s)	SME Market Cap/Main Market Cap (per cent)
Portugal	30June 2012	1	56	9	235,562	0.00
	30June 2014	2	50	102	216 136	0.05
Republic of Mecedonia	30June 2012	-	N/A	-	-	-
	30June 2014	N/A	116	N/A	206,000	N/A
South Africa	30June 2012	63	338	171	80,206	0.21
Spain	30June 2012	21	148	576	557,360	0.10
Thailand	30June 2012	75	545	3,510	359,420	0.98
	30June 2014	109	501	384,700	139,785,00	
Tunisia	30June 2012	-	-	-	-	-
	30June 2014	11 (Nov 2014)	65 (Nov 2014)	447.25	8 927.74	5.01
Turkey	30June 2012	9	354	216	257,000	0.08
	30June 2014	23	408	415.85	261,472.62	0.16
UK	30June 2012	1,105	1,338	94,080	5,864,320	1.60
Total	30June 2012			273,733	18,531,333	1.48
	30June 2014					

APPENDIX 4

LISTING REQUIREMENTS FOR SMEs IN DIFFERENT JURISDICTIONS

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
Argentina							The maximum amount of issuance of bonds for SMEs is up to AR\$ 15M. They must be purchased by qualified investors.
Brazil				The CVM has included in its rules automatic exemptions for registration with the CVM for these enterprises (micro and small enterprises).	Securities offers belonging to the same issuer is limited to R\$ 2,400,000.00 for each period of twelve (12) months.		

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
				<p>A micro enterprise is the one whose gross revenue is equal to or less than R\$ 360,000.00 in each fiscal year;</p> <p>A small enterprise is the one whose gross income is over R\$ 360,000.00 and equal to or less than R\$ 3,600,000.00 in each fiscal year.</p>			
Canada (TSXV Tier 1)	Material interest in a tier 1 property which		Adequate working capital and financial	\$2 million net tangible assets, earnings or	20 percent of issued and outstanding	1.000.000 free trading shares 250 public	Sponsor Report may be required

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
	has substantial geological merit		resources to carry out stated work program or to execute business plan for 18 months following listing. \$ 200.000 in unallocated funds.	revenue	shares publicly held	holders with board lots and no resale restrictions	Geological Report recommending completion of work program. \$ 200.000 on the qualifying property as recommended by geological report.
Canada (TSXV Tier 2)	Significant interest in a qualifying property with evidence of \$ 100.000 expenditures in the past 3 years or sufficient expenditures		Adequate working capital and financial resources to carry out stated work program or to execute business plan for 12 months following	No requirement for net tangible assets, earnings or revenue	20 percent of issued and outstanding shares publicly held	500.000 public free trading shares 200 public holders with board lots and no resale restrictions	Sponsor Report may be required Geological Report recommending completion of work program. \$ 200.000 on the qualifying

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
	incurred.		listing. \$ 100.000 in unallocated funds.				property as recommended by geological report.
Chinese Taipei	At least 2 years		Its paid in capital shall not be less than NT\$ 50 million	The pretax earnings for the most recent shall reach NT\$ 4 million		Minimum of 50 shareholders is required	
Czech Republic	No requirement	No requirement		National accounting standards or IFRS	No requirement	No requirement	Information document or prospectus is needed
Dubai		USD 10 million market value for Shares and USD 2 million market value for Debentures		Publication of audited accounts for the most recent 3 years or shorter period if acceptable to the DFSA	25 percent shares to be held by public		Appointment of a compliance adviser to assist with the compliance of the continuing listing obligations

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
							Comply and explain model applied for corporate governance best practices compliance that gives flexibility to design a governance structure depending on nature, scale and complexity of business
Egypt			Less than L.E. 50 million	The company should submit audited financial statements for at least one fiscal	Min of 10 percent of the total issued shares.	25 shareholders	Nominated Advisors are mandatory.

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
				year preceding the listing application-exceptions are made in the case of a viable business plan for the coming 5 years endorsed by a Qualified Sponsor.			
Egypt			Less than L. E. 50 million	The company should submit audited financial statements for at least one fiscal year preceding the listing application	Minimum 10 percent of the total shares issued	Minimum 25 shareholders	Nominated Advisor is obligatory
Germany	Corporate history of the		Nominal capital of the Issuer	Accounting Standards:	At least 10 percent of the	The shares or certificates	Number of employees of

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
	Issuer for more than 2 years		more than EUR 750,000	national GAAP or IAS / IFRS Turnover of the Issuer more than EUR 1 million Net win/loss of the Issuer, loss less than 20 percent of the equity capital	issuer's shares or certificates representing shares to be included are traded publicly.	representing shares which are traded publicly must be held by at least 30 shareholders or bearers.	the Issuer more than 10 people.
Hong Kong	At least 2 years	USD 12 million		A positive cash flow generated from operating activities in the ordinary and usual course of business of at least HK\$20 million in aggregate for the	USD 3.6 million	100 holders	Substantially the same management throughout the 2 full financial years and a continuity of ownership and control throughout the

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
				two financial years immediately before the issue of the listing documents			full financial year immediately preceding the issue of the listing document. A new applicant is free to decide on its offering mechanism and may list by way of placing only.
Iceland	2 years history for MTF (SME)		No capital minimums for MTF (SME)		10 percent ownership by retail investors for MTF (SME)		Modified prospectus document for MTF (SME)
India	NSE - Track record of at least three years, positive cash		Paid up capital less than \$ 4.72 million approx.		\$ 1887 approx.	Minimum of 50 shareholders is required.	Draft offer document is not required to be filed with SEBI

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
	<p>accruals (EBDT) from operations for at least 2 financial years and positive net worth.</p> <p>BSE - Track record of distributable profits for at least two of the immediately preceding three financial years along with minimum net worth and net tangible assets. Otherwise, the net worth shall</p>						and also SEBI observations not required to be obtained prior to opening of the issue.

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
	be at least \$ 0.57 million.						
Italy	No minimum number of years of existence for the company required	No minimum capitalisation		<p>One fiscal year audited IFRS financial statements or according to Italian accounting standards</p> <p>No due diligence of Consob (yes if in the presence of public offer)</p> <p>No due diligence by Borsa Italiana</p>	A free float of at least 10 percent		A company joining AIM Italia is not required to publish a listing prospectus complying with the EU legislation and has to prepare only an admission document which provides investors with information on the company's activities, its management, its

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
							shareholders, and its financial data.
Kenya			Minimum authorised and fully paid up ordinary share capital of 10 million shillings	No requirement for audited financial statements or profit history prior to listing	15 percent of the issued shares (except those held by a controlling shareholder or people associated with the Company's Senior Managers) should be available for trade to the public	The issuer must have not less than one hundred thousand shares in issue.	Not required to have a clear future dividend policy
Korea	At least 3 years	At least 9 billion won	Shareholders' Equity: At least 3 billion won	Unqualified (recent year) Audited by Big 4 Accounting	Proportion of minority shareholders: At least 25 percent	At least 1 million shares	Capital not impaired at the end of recent fiscal year

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
				<p>Firms (PWC, KPMG, Ernst & Young, Deloitte)</p> <p>Exempted in case of secondary listing</p> <p>IFRS or U.S. GAAP for Consolidated financial statements</p> <p>Either of the following:</p> <ul style="list-style-type: none"> Income: (2 billion won) or (ROE: 10 			<p>No change of the largest shareholder in 1 year before application</p> <p>No restriction on transfer of shares</p>

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
				percent) <ul style="list-style-type: none"> Market Cap 30 billion won & Revenue 10 billion won 			
Malawi				There is no need to submit the profit history for SMEs while large issuers require 3 year profit history.		Companies differ in terms of size (less than USD 1.84 million issue capital for SMEs while large issuers need to have more than USD 1.84 million)	
Malaysia	No minimum profit and					Number of public	Sponsors must be appointed by

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
	number of years in operation for SMEs					shareholders for SMEs lower than the Main Market	SMEs Longer moratorium period for shares held by promoters of SMEs
Mauritius		A minimum market capitalisation of Rs 20 million		Published financial statements for at least 1 year, prepared in accordance with IFRS and audited in accordance with ISA without qualification.	A minimum of 10 percent of its shareholding in public hands	At least 100 shareholders. SME may grant admission to a company having less than 10 percent of shareholding in public hands or having less than 100 shareholders	Admission may also be granted to a company if it has no proven track record provided that the company submits to the SME a sound business plan covering at least 3 years and certified by an

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
						<p>provided that the company undertakes to increase its shareholding in public hands to 10 percent and its number of shareholders to 100 not later than the end of the first year of admission, failing which the company may be struck off from the DEM.</p>	<p>independent financial adviser, demonstrating sustained viability of the company and disclosing risk factors.</p> <p>The SME may accept a minimum percentage in public hands of 5 percent in the case of a new applicant with an expected market capitalisation at the time of</p>

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
							listing of over MRU 500 million, subject to the approval of the FSC.
Morocco (2nd compartment)			No minimum equity but minimum revenues of 50 million dirhams	Choice between National Accounting Standards and IFRS Consolidated accounts optional	Amount of minimum issue: 25 million dirham	Minimum number of shares to be issued: 100.000 shares	2 years certified financial statements
New Zealand			Companies with turnover of more than NZ\$5m (USD \$4.1m) per annum			Minimum of 50 shareholders is required.	
Pakistan			Rs. 10 million		Free Float of USD 0.05	The public issue should be fully	

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
					million or 25 percent whichever is higher	subscribed or have been fully underwritten thus there is no requirement for minimum number of subscribers to the public offering	
Peru	The issuer must submit the Annual Report for the last financial year. Instead of submitting the Annual Report for the last two financial years.			The latest individually audited financial information should be made available, and the last individually unaudited half-yearly information.			The issuer should contract the services of at least one (1) risk rating firm to issue the permanent classification of securities. Instead of having two risk

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
				Instead of audited financial information for the last 2 years, the last quarterly unaudited financial information and the last consolidated financial information will be sufficient.			rating firms. The issuer must not present the Degree of Compliance with the Principles of Good Governance as a part of the Prospectus. This information must be presented mandatorily since the third year of the registry.
Portugal	At least 2 financial years.				USD 3.13 m distributed to the public.		

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
Singapore					Minimum public float: percent 15	Minimum number of public shareholders: 200	<p>Issuers need to retain a Sponsor⁸⁹ to remain listed on Catalyst.</p> <p>Limits of:</p> <p>(i) 100 percent of the issued share capital for shares issued on a pro rata basis; and</p> <p>(ii) 50 percent of the issued share capital for shares issued on a non pro rata</p>

⁸⁹ Sponsors are qualified professional companies experienced in corporate finance and compliance advisory work. They are authorized and regulated by SGX through strict admission criteria and continuing obligation under the Catalyst Rules.

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
							basis.
South Africa			Share capital: AltX R2 million	Profit History: AltX None	AltX 10 percent	Number of shareholders: AltX 100	AltX Designated Advisor
Thailand	At least 2 years	Market capitalisation must be over USD 31 million	Paid up capital no less than USD 0.62 million	Record net profits in the most recent year prior to application and net profit for all combined results in the year of filing the application	Shares offered to the public must be no less than 15 percent of paid up capital The Proportion of minority shareholders must be no less than 20 percent paid up capital	No less than 300 persons	
Turkey				The shares eligible for			Neither qualitative nor

	Minimum Operating Period	Minimum Market Capitalisation	Paid up Capital	Financial Information	Minimum Public Float at the Time of Listing	Number of Public Shareholders at the Time of Listing	Other
				trading on the ECM should be issued by joint stock companies in capital increases partially or fully restricting the preemptive rights of the existing shareholders, and in the case of secondary offerings, the shares acquired by using the rights attached to such shares.			quantitative admission criteria are sought for trading on the ECM Regulation.

APPENDIX 5

BEST PRACTICES

The Task Force has studied SME initiatives and best practices provided by IOSCO members as agreed in the mandate. Nine jurisdictions (Australia, Chinese Taipei, India, Japan, Hong Kong, Ontario Securities Commission-Canada, Singapore, UK and US) agreed to contribute to the Best Practices Section of the Report. The jurisdictions were asked to submit their experiences within the framework given below.

- Evolution and Current SME landscape
- Analysis and Development of SMEs to access the Capital Markets
 - What has worked and why?
 - What has not worked and why?
- Conclusions
- Recommended Practices for other markets.

The responses of the jurisdictions that prepared best practices are placed in the related sections and recommendations of the report. This section contains the best practices of 9 jurisdictions that submitted best practices in the following order;

- 1) Australia
- 2) Chinese Taipei
- 3) India
- 4) Japan
- 5) Hong Kong
- 6) Canada (Ontario Securities Commission)
- 7) Singapore
- 8) United Kingdom

9) United States of America

1) AUSTRALIA

There is no standard definition of small and medium enterprises (SMEs) in Australia. This question was recently considered in an inquiry undertaken by the Parliamentary Joint Committee on Corporations and Financial Services in April 2011⁹⁰, which found that multiple definitions of small and medium enterprises are used across the finance sector in Australia. (see Q1, IOSCO survey attached.)

In June 2011, the Australian Bureau of Statistics found that Australia had more than 2.1 million businesses, with the vast majority (96 percent) of Australian businesses being 'small businesses', defined as businesses employing less than 20 staff and with an annual turnover of less than \$2 million⁹¹.

Australia's main equity market, the Australian Securities Exchange (ASX), has defined a "mid to small cap entity" as a listed entity that has a market capitalisation of \$300 million or less and is outside the S&P/ASX 300 index. According to ASX, there are currently more than 1,600 mid to small cap companies listed on ASX⁹². As at the end of 2011, mid to small cap entities accounted for 76 percent of the total number of listed companies, 6 percent of the total market capitalisation and 52 percent of mid to small cap entities are resource companies.

In the 2011 inquiry, the Parliamentary Joint Committee on Corporations and Financial Services concluded that there is no evidence to suggest that the absence of a uniform definition of SMEs directly restricts SME access to finance⁹³.

SME ACCESS TO CAPITAL MARKETS

Debt Funding

In the inquiry undertaken by the Parliamentary Joint Committee on Corporations and Financial Services in April 2011, the Committee was informed⁹⁴ that SMEs have limited funding options and place considerable reliance on debt funding. (see attached report *Access*

⁹⁰ Parliamentary Joint Committee on Corporations and Financial Services, *Access for Small and Medium Business to Finance*, 28 April 2011.

⁹¹ Australian Bureau of Statistics, *Counts of Australian Businesses, including Entries and Exits (cat. no. 8165.0)*, 31 January 2012, available at: www.abs.gov.au

⁹² Australian Securities Exchange, *Strengthening Australia's equity capital markets*, April 2012

⁹³ Ibid.

⁹⁴ See submissions made to the Committee by Reserve Bank of Australia and The Commonwealth Treasury. See also the CPA Australia Asia Pacific Small Business Survey 2011.

for Small and Medium Business to Finance 28 April 2011.)

The Committee found that smaller businesses, when compared with large companies, tend to make greater use of debt funding and less use of equity funding. SMEs appear to fund their activities from a variety of sources, including internal funding, owner equity, venture capital, secured and unsecured intermediated credit, and bank bills, while larger businesses can issue corporate bonds and equity as alternative sources of finance⁹⁵.

Equity Markets

The main equity market in Australia is the ASX. There are currently four other licensed market operators which list equities. These exchange markets cater specifically for small or micro capitalisation companies⁹⁶.

ASX currently operates a “one-size-fits-all” market. There is one set of listing rules and one set of trading rules which apply universally across all listed securities. Based on consultation with the market in 2011⁹⁷, ASX is of the view that the current single board market structure is successful in catering to the needs of SME, mid-cap and micro-cap companies, which represent the majority of ASX listings by number. Furthermore, ASX has found that the concept of a second board for mid to small caps is not supported by the market and accordingly, it will continue to operate a single board and listing rule framework⁹⁸.

Capital Raising Initiatives

ASX analysis of capital raisings conducted in 2011 showed that placements provided close to 70 percent of the secondary capital needs for mid to small caps⁹⁹. In August 2012, ASX introduced changes to the ASX Listing Rules to address the needs of these companies to raise capital via placements and to reduce the compliance costs associated with conducting placements.

Prior to the changes, all entities, including SMEs, were restricted to raising 15 percent of their issued capital over a 12 month period. Certain issues of securities, such as pro rata rights issues, employee incentive schemes, share purchase plans and issues approved by

⁹⁵ Senate Committee, Parliamentary Joint Committee on Corporations and Financial Services, *Access for Small and Medium Business to Finance*, 28 April 2011

⁹⁶ The other market operators are the National Stock Exchange, SIM Venture Security Exchange (formerly Bendigo Stock Exchange), Asia Pacific Exchange and IMB Ltd. As at October 2011, National Stock Exchange had 16 participants, and SIM VSE three. See also ASIC Report 215 Australian equity market structure November 2010.

⁹⁷ Australian Securities Exchange, ASX SME, Mid-Cap and Micro-Cap Equity Market Review, March 2011, page 1

⁹⁸ Ibid

⁹⁹ Ibid

shareholders are exempt from the 15 percent limit.

The changes allow small to mid-cap listed entities to issue an additional 10 percent of their issued capital at a maximum discount of 25 percent to market price¹⁰⁰. This 10 percent capacity can be used in addition to the 15 percent already available to all listed companies under existing Listing Rules. The additional 10 percent capacity is only available to entities that meet the definition of a small to mid-cap entity. ASX has defined a “mid to small cap entity” as a listed entity with a market capitalization of \$300 million or less and is outside the S&P/ASX 300 Index. Small to mid-cap entities seeking to use the additional placement capacity will need to get shareholder approval by way of special resolution (75 percent vote) at the Annual General Meeting. Once shareholder approval is obtained, it is valid for 12 months and a company can use the additional capacity to conduct a placement at any stage during the following 12 months¹⁰¹.

Admission Requirements

The ASX has one set of admission criteria that apply to all Australian registered companies seeking admission to the official list. Other licensed equity markets in Australia, such as National Stock Exchange (NSXA) and SIM Venture Security Exchange (SIM VSE), have tailored their admission criteria to suit the limited capital resources of small or micro capitalisation companies to promote the listing of these entities (however, as a result, these markets have some liquidity issues¹⁰²).

For an Australian registered company to be eligible to list on ASX, it must meet a specific set of minimum admission criteria, including structure, size and number of shareholders. Firstly, an entity must meet either the profit test (\$1 million net profit over past 3 years and \$400,000 net profit over last 12 months) or the asset test (\$3 million in net tangible assets or \$10 million market capitalisation)¹⁰³.

In contrast, SIM VSE has a listing admission requirement that entities have minimum net tangible assets (NTA) of \$500,000. NSXA does not have a minimum NTA requirement and, instead, applies both ‘suitability’ and an ‘adequate track record’ test, the latter based on two years of trading under the same management, who must be of known character and integrity.

¹⁰⁰ Note placements conducted by listed entities under the existing rules can only be issued at a maximum discount of 20 percent of market price.

¹⁰¹ Note additional disclosure requirements will apply at the time the placement is conducted.

¹⁰² For the FY 2010–11, declines in trading volumes have persisted, with average executed trades now reduced to about two per day. NSXA monthly average trading volume/value for FY 2010–11 was 18,767,307 shares/units/\$10,990,779. SIM VSE monthly average trading volume/value for FY 2010–11 was 77,908/\$58,056: ASIC Report 260 Market assessment report: NSX Ltd group, October 2011.

¹⁰³ Note the Net Tangible Asset test was amended on 1 November 2012 to increase the NTA test from \$2 million to \$3 million for applicant entities seeking admission under the assets test.

In addition, NSXA requires a market capitalisation of at least \$500,000.

In addition, to list on ASX a company must also meet a minimum shareholder spread requirement. The shareholder spread thresholds were recently decreased in November 2012 to enable companies to list with a lower number of security holders holding a minimum of \$2,000 worth of that company's securities. Previously, companies needed either a minimum 500 security holders, or 450 security holders (with 25 percent held by unrelated parties) or 400 security holders (with 25 percent held by unrelated parties). As a result of the changes, companies will now need either a minimum of 400 security holders, or 350 with 25 percent unrelated or 300 with 25 percent unrelated.

In contrast, both NSXA and SIM VSE require a minimum of 50 security holders each holding a minimum of \$2,000 worth of the company's securities, with 25 percent held by unrelated parties.

ASX's rationale for the relaxation of the shareholder spread requirements is that spread is not necessarily a good indication of liquidity, particularly in smaller floats at the low end of the market¹⁰⁴. Furthermore, the results of the consultation undertaken by ASX in 2011¹⁰⁵ indicated that the spread requirements can sometimes act as a barrier to capital market activity for smaller companies due to practical difficulties involved in obtaining sufficient shareholder spread¹⁰⁶.

THE REGULATORY FRAMEWORK

Fundraising Disclosure

SMEs seeking to raise corporate funds through the issue of securities are subject to the fundraising provisions of the Corporations Act¹⁰⁷, which seek to enable companies to raise money efficiently while protecting different categories of prospective investors. Under these provisions, SMEs are required to provide a disclosure document (usually a prospectus) for every offer to issue or sell securities to prospective investors, except in specified cases.

The Corporations Act provides a number of specific exemptions from the requirement to use a disclosure document when issuing securities. In general, the exemptions are intended to ensure that the efficient operation of the securities markets is not unreasonably impeded by the onerous requirement to prepare a disclosure document, where there are no investor

¹⁰⁴ Australian Securities Exchange, Strengthening Australia's equity capital markets, April 2012, page 37

¹⁰⁵ Australian Securities Exchange, ASX SME, Mid-Cap and Micro-Cap Equity Market Review, March 2011,

¹⁰⁶ Australian Securities Exchange, Strengthening Australia's equity capital markets, April 2012, page 37

¹⁰⁷ See Chapter 6D of the *Corporations Act 2001* (Cth)

protection concerns. Exemptions available to SMEs include:

- small scale issues of securities, where no issue or transfer of securities exceeds the 20 investor ceiling¹⁰⁸ or \$2 million ceiling¹⁰⁹ in any 12 month period¹¹⁰;
- private placements made to sophisticated investors¹¹¹, professional investors¹¹² and investors associated with the company¹¹³;
- offers to existing shareholders under a pro-rata rights issue¹¹⁴, dividend re-investment plan or bonus share plan¹¹⁵; and
- offers of quoted securities for sale in the ordinary course of trading on a market¹¹⁶.

Where a disclosure document is required, the type of document (prospectus, short form prospectus or offer information statement) required will depend upon the size of the fundraising and the type of securities being offered. Usually, a prospectus must be prepared and must contain all the information that investors and their professional advisers would reasonably require to make an informed assessment of the rights and liabilities attaching to the securities and the financial position, performance and future prospects of the company.

Where a company's securities have been continuously quoted on an exchange, a short form prospectus may be used, which has reduced disclosure requirements. A company may use an offer information statement with a reduced disclosure standard, rather than a full length prospectus, in circumstances where the amount to be raised under the offer (when added to all previous amounts raised by the company or a related company) is \$10 million or less.

ASIC has issued Regulatory Guide 228 *Prospectuses: Effective disclosure for retail investors* to assist issuers and advisers on how to word and present prospectuses in a 'clear, concise and

¹⁰⁸ An offer to issue securities breaches the 20 investors ceiling if it results in the number of people to whom securities have been issued exceeding 20 in any 12 month period.

¹⁰⁹ An offer to issue securities breaches the \$2 million ceiling if it results in the amount raised by issuing securities exceeding \$2 million in any 12 month period.

¹¹⁰ See section 708(1) of the Corporations Act 2001.

¹¹¹ For a definition of 'sophisticated investor' see section 708(8) of the Corporations Act 2001. Generally, a person is a 'sophisticated investor' if, based on a certificate provided by a qualified accountant issued no more than 6 months prior to the offer being made, they have net assets of at least \$2.5 million, or whose gross income for each of the last 2 financial years of at least \$250,000 per year.

¹¹² For a definition of 'professional investor' see section 708(11) and section 9 of the Corporations Act 2001.

¹¹³ See subsection 708(12) of the Corporations Act 2001.

¹¹⁴ See section 708AA of the Corporations Act 2001.

¹¹⁵ See subsection 708(13) of the Corporations Act 2001.

¹¹⁶ See subsection 708A(5) of the Corporations Act 2001.

effective' manner. The guide also sets out our guidance about how to prepare prospectuses that satisfy the content requirements in the Corporations Act 2001.

Related Party Placements

In the Australian experience, it is relatively common for SMEs to seek raising funds through private placements to related parties (i.e. directors and their families, parent companies or entities controlled by a related party). In such circumstances, the Corporations Act¹¹⁷ requires SMEs that are also public companies (companies with greater than 50 non-employee shareholders) to obtain shareholder approval of the placement¹¹⁸ to ensure shareholders are fully informed and are given an appropriate opportunity to vote on the proposed placement. ASIC has issued guidance in relation to related party procedures and disclosure. (see ASIC Regulatory Guide 76 *Related Party Transactions*.)

Takeovers and Acquisitions

Apart from an Initial Public Offering (IPO), merging or acquiring a listed entity or getting acquired by a listed shell entity (i.e. through a backdoor listing) are alternative options for SMEs going public. Transactions involving acquisitions of shares in listed companies or large unlisted companies with over 50 shareholders are regulated by the takeovers rules in Chapter 6 of the Corporations Act. The overriding purpose of these rules is to ensure that any acquisition of control takes place in “an efficient, competitive and informed market”¹¹⁹.

Specifically, acquisitions of shares that may result in a person increasing their voting power in the company beyond 20 percent are prohibited under the Act¹²⁰. The most significant gateways to legitimately exceed the legislative threshold of 20 percent are by an off-market bid (quoted or unquoted securities), a market bid (only quoted securities), by acquisitions of maximum 3 percent tranches every 6 months (known as the ‘3 percent creep’ rule), acquisitions approved by shareholders, acquisitions under a pro-rata rights issue, acquisitions pursuant to an IPO and acquisitions under a court approved compromise or arrangement.

The Act also regulates the procedure that must be followed by a bidder, in making an effective takeover bid, and by a target, once a formal bid is made. ASIC plays an active role in monitoring both on-market and off-market takeover bids and other transactions affecting the control of a company including rights issues, reconstructions and schemes of arrangement.

¹¹⁷ See Part 2E of the *Corporations Act 2001* (Cth)

¹¹⁸ Unless the one of the exceptions apply: that is, the financial benefit to be given to the related party is on arm's length terms or is reasonable remuneration: see sections 210 and 211 of the Corporations Act 2001.

¹¹⁹ See section 602 of the Corporations Act 2001.

¹²⁰ See section 606 of the Corporations Act 2001 (Cth)

Financial reporting requirements and accounting standards

Chapter 2M of the Corporations Act contains the financial reporting and audit requirements for companies including requirements about keeping financial records, annual financial reporting, half-yearly reporting and disclosure obligations.

The nature and extent of these reporting obligations depends on the size of the SME. Small proprietary companies¹²¹ are exempt from the requirement to prepare accounts, and lodge financial information with ASIC. Small proprietary companies that are controlled by a foreign company which does not itself lodge a profit and loss account which includes the activities of the small proprietary company, are required to prepare and lodge accounts for purposes of the Corporations Act.

All large proprietary companies, public companies, disclosing entities¹²² and registered schemes are required to prepare a financial report and a directors' report on an annual basis, have them audited, and lodge them with ASIC. Disclosing entities must also prepare and lodge an audited financial report and directors report on a half-yearly basis.

ASIC has granted class order relief to large proprietary companies and small proprietary companies that are controlled by a foreign entity from the requirement to appoint an auditor and have the financial reports audited¹²³.

Financial reports prepared in accordance with the Corporations Act generally must comply with accounting standards¹²⁴. Australian Accounting Standards meet the requirements of International Financial Reporting Standards (IFRS) as Australia adopted IFRS in 2005. The directors of a Company are required to certify that the financial statements give a true and fair view of the Company's financial position and performance and that the company's financial statements comply with the accounting standards¹²⁵. The Reduced Disclosure Regime accounting standard adopts the IFRS for SMEs accounting standards as it relates to reduced disclosures.

¹²¹ Small proprietary companies are defined as being proprietary companies which satisfy two of the three tests being consolidated revenue of less than \$25 million, consolidated gross assets of less than \$12.5 million, and fewer than 50 employees: see section 45A of the Corporations Act 2001.

¹²² "Disclosing entities" includes a company whose securities are listed on a prescribed financial market and unlisted companies whose securities are held by 100 or more persons as a result of issues under a disclosure document, or as consideration for an acquisition under an off-market takeover bid or Pt 5.1 compromise or arrangement: see section 111AD of the Corporations Act 2001.

¹²³ See ASIC Class Order [CO 98/1417]

¹²⁴ See section 296 of the Corporations Act 2001.

¹²⁵ Australian Accounting Standards do not necessarily apply to all companies. AASB 101, 107, 108, 1031 and 1048 apply to all companies that are required to prepare financial statements, whereas the rest of the standards generally only apply to reporting entities. AASB 133 only applies to listed entities and those that disclose earnings per share.

Continuous disclosure requirements

The Corporations Act contains continuous disclosure provisions that apply to both listed companies and unlisted disclosing entities¹²⁶. Specifically, a listed company must immediately notify the market operator of information that is not generally available and is information that a reasonable person would expect to have a material effect on the price or value of the securities¹²⁷.

ASIC's key role in administering these requirements is to ensure that listed and unlisted disclosing entities disclose material information on a timely basis and comply with any relevant listing rules of the markets on which they are listed. Our approach is based on the principle that the continuous disclosure obligations are fundamental to maintaining the integrity of the market by ensuring transparency and equal access to information. ASIC may impose civil penalties or take action for criminal liability against a listed entity and its officers if they fail to comply with their continuous disclosure requirements.

2) CHINESE TAIPEI

In Chinese Taipei, regarding the structure of capital markets, there are two main securities markets for companies to list for fundraising: the Taiwan Stock Exchange and Gre-Tai Securities Market (hereinafter respectively referred to as the "TWSE" and "GTSM"). In order to foster SMEs and help them to raise funds from capital markets, the Competent Authority, the FSC set up the "Emerging Stock Board" (hereinafter referred to as the "ESB"), which is organised under the GTSM to be a separate trading platform for the registration and trade of SMEs' stocks.

SMEs' Development and Current Situation

SMEs play a vital role in the process of economic development in Chinese Taipei. They are not only the backbone of Chinese Taipei's economy, but also the key players to ease unemployment and improve income distribution. Once in recession, SMEs can bring their flexibility characteristics into full play, helping to stabilise economic fluctuations and prevent unemployment deterioration.

There is no explicit definition of SME in our capital markets. Nevertheless, according to the "Act For Development of Small and Medium Enterprises", enterprises in mining, sand and gravel gathering, manufacturing, and construction industries with paid-in capital less than NT\$80,000,000 (about US\$2,666,667) fall into the category of SME, and enterprises in other

¹²⁶ See section 11AC and 111AD of the Corporations Act for a definition of 'disclosing entity'.

¹²⁷ See section 674 and 675 of the Corporations Act 2001 (Cth) and ASX Listing Rule 3.1.

industries with paid-in capital less than NT\$100,000,000 (about US\$3,333,333) also fall into this category. Moreover, according to the “2012 White Paper on Small and Medium Enterprises” of the Ministry of Economic Affairs (MOEA), the number of SMEs reached a record high of 1,279,784 in 2011, accounting for 97.63 percent of the total enterprises in Chinese Taipei. This figure represented an increase of 31,786 enterprises (2.55 percent). Among them, 80.09 percent were in the service sector, 50.94 percent in the wholesale and retail business, about 57 percent were sole proprietorship, and 47.01 percent have operated for more than 10 years.

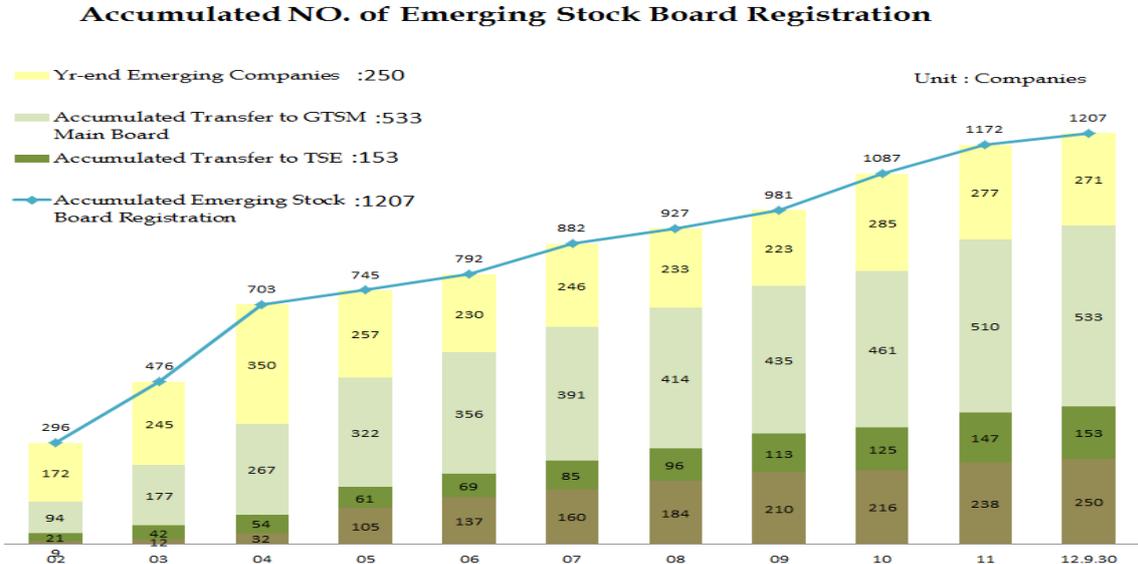
Principal Sources of Financing of SMEs

The fund-raising of SMEs from direct financing, i.e. raising fund from capital markets, has increased year by year since 1994, reaching 26.18 percent at the end of 2003. While the ratio is roughly between 22 percent to 26 percent, which showed a downward trend from 2004 to 2008, there was a slight increase to 23.11 percent in 2009. The ratio was slightly downward after 2010, and was 21.64 percent in 2011. Indirect financing remained the main source of fund-raising for SMEs. In 2011, the ratio of indirect financing was 78.36 percent.

Fund-raising is often the most common challenge for SMEs when they start to becoming more developed and internationalised. As a result, stepping into the capital markets seems to be the only way. In order to promote SMEs’ access to capital markets, the FSC has set up the ESB, which has served as a fund-raising platform for SMEs since 2002.

The only requirement for companies applying for their stocks to be traded on the ESB is to have written recommendations by two or more advising/recommending securities firms. The ESB makes it easier for SMEs to finance from capital markets. Up to September 30th, 2012, 271 SMEs were registered on the ESB.

The accumulated number of ESB registration is as follows:



Regarding the best practice exercise case of Chinese Taipei, the case of “MICROBIO CO.LTD.” could be taken as an example. This company was established on May 3, 2000, and primarily engaged in new drug research and dietary supplements. Due to the fact that new drug research doesn't generate sales revenue at its development stage, the company faced uncertainty and needed huge cash flow to support its research. Thus, it was necessary for the company to create fundraising channels, and it initiated public issuances and commenced trading on the ESB on February 10, 2003, with paid-in capital of USD 16.5 million. The company then had a cash capital increase of NT\$180 million in 2003, and its paid-in capital reached USD 21.45 million. The company then applied for IPO as “Technology Enterprise”, and was listed on the GTSM, one of the two main boards in Chinese Taipei, on June 9, 2006. Before the IPO the company had another cash capital increase of USD 3.76 million and its paid-in capital reached USD 24.72 million. Furthermore, the company issued convertible bonds of USD 6.6 million in 2007 and initiated a cash capital increase of USD 24.75 million and USD 92.4 million in 2007 and 2009 respectively. The company's paid-in capital increased to USD 90.39 million at the end of 2011. Compared to the year 2003 before its stocks were traded on the ESB, the company has raised USD 129.69 million at the growth rate of 686 percent.

As for the company's operation, due to its new drug research company identity, its sale revenue is volatile and less predictable, but the company utilised the capital market to strengthen its capital structure and development foundation. Its product “Chemotherapy Waterfront” went through a research period of ten years, and obtained the first oral cancer treatment NDA (New Drug Application) in Chinese Taipei. In addition to “Chemotherapy Waterfront”, there are several other new drug researches going on. The company's sales revenue and consolidated revenue has reached USD 17.06 million and USD 39.30 million respectively in 2011, and its EPS has increased from 1.79 in 2002 to 1.02 in 2011. What's more, the company utilised investment and spin-off strategies and evolved from an ESB company into a conglomerate. By the end of 2011, there were 10 subsidiaries and various affiliates under its flag. One of them is already listed on the main board of the GTSM, and several others are planning to follow suit.

In terms of financing sources, companies engaged in new drug development do not have tangible assets such as property, plants and equipment; therefore it is hard for them to borrow from banks. A year before MICROBIO listed on the Emerging Stock Board, its bank loans were merely USD 1.02 million. After the company increased its public awareness by listing on the Emerging Stock Board, it was able to negotiate with banks for loans for up to NT\$369 million. In addition, the company also utilises an employee stock ownership plan to attract

more talent to strengthen its research ability.

In conclusion, through entering the capital markets (phases of public issuances, listing on the Emerging Stock Board, and IPO applications), enterprises can obtain funds from investors through direct financing and obtain loans from banks to maintain the operation. Therefore, entering the capital market has become the best way for most growing companies to obtain long-term funding in Chinese Taipei.

Factors for SMEs Successfully Entering Capital Markets

According to the aforementioned case of SIMPLO TECHNOLOGY CO. LTD. and other success cases, we can generalise several factors for SMEs entering capital markets, successfully or not successfully, as follows:

What has worked and why?

- (1) External environment (e.g. macro economy and stock markets) is stable or upward.
- (2) Revenue and profits are stable without abnormal related party transactions in recent years.
- (3) Management must actively cooperate with CPAs and underwriters to establish and improve the management system, including operating system, internal control, and corporate governance, etc.
- (4) Set complete plans, including organisational structure adjustment, group structure adjustment, tax planning, and carry out these plans.
- (5) Management must be determined to promote all kinds of reforms.
- (6) SMEs can build their image and name brands. Through incentives such as Employee Stock Bonus and Option Plans, they can also obtain and keep good talent.
- (7) SMEs can raise capital directly from the capital market, and it encourages development of self-owned technology, channels, and patents.
- (8) SMEs can strengthen their financial structure and make capital-raising more convenient to help them to expand and obtain better financing criteria.
- (9) SMEs being listed on the GTSM or whose stocks are traded on the ESB have better chance of recognition by customers and so a better chance to obtain orders especially from global leading companies.
- (10) SMEs' financial and business information are kept open and subject to the supervision from securities and exchange authorities. As a result, the general public's investments are better safeguarded. In addition, there are open trading markets for companies listed on the GTSM and for their stocks to be traded on the ESB, which provide liquidity for general public investors.
- (11) Through internal control and corporate governance system compliances, SMEs are encouraged to grow in a sustainable way.

What has not worked and why?

- (1) External economic environment is not good. The stock market has declined significantly, or the state of the industry is not good.
- (2) The company's revenues and profits are declining and the financial structure of the company is inefficient.
- (3) The company does not cooperate well with the CPA and underwriter, and many of the reforms cannot be implemented successfully.
- (4) The financial or business affairs of the company are not independent from related-parties. Any material non-arms-length transaction of the company has been discovered.
- (5) The financial report of the company is not in accordance with the generally accepted accounting principles.
- (6) SMEs' internal control and corporate governance systems may not be appropriately built and effectively executed.
- (7) SME had significant labor disputes or environmental pollution conditions that haven't been improved.
- (8) SMEs' major production plants and facilities may not be in compliance with current regulations.

Conclusion

Management must have a firm determination and commitment to improve its internal control system and strengthen corporate governance in order to handle the macro economy risk and the industry risk and to reduce the possibility of fraud events. The management should also improve the transparency of financial reports and information disclosure to enhance investors' confidence and successfully raise funds through capital markets.

For SMEs entering the capital market means encouragement for sustainable development. For the government, having more SMEs enter the capital market means more sources for tax revenue due to better understanding of SMEs' financial and business information. Facilitating SMEs to enter the capital market creates a win-win situation for the SMEs and the government.

Based on our successful experiences of SMEs entering the capital market, we would like to contribute several recommended practices for other jurisdictions' reference as follows:

- 8.** Improving corporate governance and ensuring the board of directors and audit committee function well.
- 9.** Enhancing the transparency of information and requiring fair presentation of the financial reports and full disclosure of significant information.
- 10.** Establishing and implementing internal control and internal audit systems.

3) INDIA

Evolution and Current SME Landscape

Regulations

The regulations on issue of specified securities by Small and Medium Enterprises (SMEs) were introduced on April 13, 2010 as Chapter XB of SEBI (Issue of Capital and Disclosure requirements) Regulations 2009 (SEBI (ICDR) Regulations). These regulations sought to differentiate public issue of securities by SMEs from similar issuance by larger companies and laid down particulars regarding eligibility to qualify as an SME, waivers from filing offer document with the regulator, and other conditions such as minimum application lot, market making etc.

Trading platform

The SME trading platform is separate from the Main Boards of the stock exchange. Currently there are two SME exchanges/ platform in India run by The Bombay Stock Exchange Ltd (BSE) & National Stock Exchange of India Limited (NSE) respectively.

Following notification of the regulations, a circular was issued by SEBI on May 18, 2010 which provided a framework for 'Setting up of a Stock Exchange/ a trading platform by a recognized stock exchange having nationwide trading terminals for SME' so that SMEs so listed could be traded on a separate platform. In 2011, BSE and NSE were accorded approval to commence trading platform for SME and they launched their trading platform on March 13, 2012.

Listed Companies

Presently 11 companies are listed and traded on the BSE's SME platform, and one company is listed on NSE's SME platform. The details of these 12 companies are given below:

Name of the Issuer	Date of Opening	No. of securities issued	Issue Price	Size of Issue
BCB Finance Ltd.	23-Feb-12	3540000	INR 25 (USD 0.45)	INR 8.85 crores (USD 1.61 millions)
Monarch Health Services Ltd.	12-May-12	3000000	INR40 (USD 0.73)	INR 12.00crores (USD 2.18

				millions)
Max Alert Systems Ltd.	28-Jun-12	4000000	INR 20 (USD 0.36)	INR 8.00crores (USD 1.45 millions)
Sangam Advisors Ltd.	24-Jul-12	2304000	INR 22 (USD 0.40)	INR 5.07crores (USD 0.92 millions)
Jupiter Infomedia Ltd.	30-Jul-12	2040000	INR 20 (USD 0.36)	INR 4.08crores (USD 0.74 millions)
Jointeca Education Solutions Ltd.	16-Aug-12	3568700	INR 15 (USD 0.27)	INR 5.35crores (USD 0.97 millions)
SRG Housing Finance Ltd.	22-Aug-12	3504000	INR 20 (USD 0.36)	INR 7.01crores (USD 1.27 millions)
Thejo Engineering Ltd.	4-Sep-12	472800	INR 402 (USD 7.31)	INR 19.01crores (USD 3.46 millions)
Comfort Commotrade Ltd.	5-Sep-12	6000000	INR 10 (USD 0.18)	INR 6.00crores (USD 1.09 millions)
Anshu's Clothing Ltd.	26-Sep-12	1872000	INR 27 (USD 0.49)	INR 5.05crores (USD 0.92 millions)
RCL Retail Ltd.	27-Sep-12	5795000	INR 10 (USD 0.18)	INR 5.79crores (USD 1.05 millions)
Bronze InfraTech Ltd.	19-Oct-12	5704000	INR 15 (USD 0.27)	INR 8.56crores (USD 1.56 millions)

Salient Features

Eligibility

An issuer whose post-issue face value capital does not exceed 100 million INR (approx. 1.82 million USD) may issue its specified securities only in accordance with the regulations on SMEs. An issuer whose post issue face value capital is more than 100 million INR (approx. 1.82 million USD) and up to 250 million INR (4.55 million USD) may also issue its specified securities in accordance with the regulations on SMEs. However, such an issuer has the option not to use the SME route and instead make an IPO as per regulations which apply to companies other than SMEs. SME issuers are waived from meeting the eligibility criteria specified under Regulation 26 of SEBI (ICDR) regulations, which include minimum tangible assets, minimum net worth, distributable profit being available in the previous 3 out of 5 years, etc.

Scrutiny of Offer Document by SEBI

The Regulation clarifies that while the offer document shall be filed with SEBI along with the merchant banker's certificate of having undertaken due diligence, the regulator shall not be issuing any observations on the same. The offer document will be displayed on the websites of SEBI, the issuer, the merchant banker and the SME exchange/platform where it is to be listed.

Underwriting

It is required that the issue is 100 percent underwritten and the merchant banker is required to underwrite at least 15 percent of the issue size on his/their account. Such details of underwriting is also required to be disclosed in the offer document and further the underwriters are forbidden to participate in the issue in any manner except for fulfilling their underwriting obligations as per agreement with the merchant banker.

Minimum Application Value

The minimum application size in terms of number of specified securities shall not be less than one hundred thousand INR (approx. 1818 USD) per application and this has to be disclosed in the offer document.

Minimum Number of Allottees

There should be at least 50 prospective allottees in the initial public offer failing which allotment shall not be made.

Migration to SME exchange

A listed issuer whose post-issue face value capital is less than 250 million INR (4.55 million USD) may migrate its specified securities to the SME exchange if its shareholders approve such migration by passing a special resolution through postal ballot to this effect and if such issuer fulfils the eligibility criteria for listing laid down by the SME exchange.

Migration to Main Board

An issuer, whose specified securities are listed on a SME Exchange and whose post issue face value capital is more than 100 million INR (1.82 million USD) and up to 250 million INR (4.55 million USD), may migrate its specified securities to the Main Board if its shareholders approve such migration by passing a special resolution through postal ballot to this effect and if such issuer fulfills the eligibility criteria for listing laid down by the Main Board.

Proviso

In both cases above, of migration to SME exchange from the main board or to the main board from the SME exchange, the special resolution shall be acted upon if and only if the votes cast by shareholders other than promoters in favor of the proposal amount to at least two times the number of votes cast by shareholders other than promoter shareholders against the proposal.

Market Making

The merchant banker is required to ensure compulsory market making through the stock brokers of the SME exchange in the manner specified by SEBI for a minimum period of three years from the date of listing of specified securities on the SME exchange or from the date of migration from the Main Board.

The Market maker shall not buy the shares from the promoters or persons belonging to promoter group of the issuer or any person who has acquired shares from such promoter or person belonging to promoter group, during the compulsory market making period. Subject to the agreement between the issuer and the merchant banker/s, the merchant banker/s that has the responsibility of market making may be represented on the board of the issuer.

Analysis and Development of SMEs to access the Capital Markets

Often it takes a few years before nascent markets stabilise and start attracting substantial investments and issuers. A few examples are supplied below:

- Novo Mercado of Brazil was established in December 2000 and the 100th company was listed on Novo Mercado by the year 2007.
- Growth Enterprise Market (GEM) of Hong Kong was established in 1999 and presently it has 178 listed companies
- AIM market of the UK, which can be considered as one of the most successful SME markets, was launched in 1995.

In this context, it has been barely 8 months since the first SME was listed in India's BSE's SME platform in March 2012. Since then 11 companies have listed on BSE's SME platform and one on NSE's SME platform. The Indian primary market during the period has seen relatively little activity compared to the previous 5 years. At this juncture it would be too early to arrive at conclusions as to whether the present policies have worked or not.

Conclusions

The Indian SME Framework has been broadly structured based on the AIM market of the London Stock Exchange. Some of the distinguishing features of the Indian SME regulations which were put in place mostly to accommodate domestic legal requirements and concerns are given below:

- Minimum required dilution of 25 percent
- At least 50 investors required at the time of IPO but no minimum requirement of shareholders post listing.
- Minimum application and trading lot of INR 1,000,000 (approx. 1818 USD).
- All continuous listing requirements which apply to main board companies are also applicable to listed SMEs except for certain relaxations regarding:
 - Being allowed to send an abridged annual report;
 - Financial reports to be submitted to stock exchanges on bi-annual basis instead of quarterly; and
 - Financial statements not required to be published in print media, and only to be uploaded on the stock exchange and own website.

Recommended Practices for other markets

We recommend the following practices for the other emerging markets:

- The SMEs should be provided a framework that would enable them to raise capital quickly and at a low cost.
- Differentiation of public issue of securities by SMEs from similar issuance by larger

companies with regard to waivers in the filing of offer documents.

- Relaxations in the continuous disclosure requirements so as to decrease the compliance cost for the listed SMEs.
- Creating awareness amongst the SME and facilitating fund raising through the capital market.

4) JAPAN

Evolution and Current SME Landscape

Small and medium entities (SMEs) play significantly important roles for the Japanese economy and society. According to statistics by the Japanese government in 2009, the number of SMEs reached USD 0.05 million, which accounted for 99.7 percent of the total number of companies in Japan. Over 28 million people worked for SMEs, remarkably more than the 14 million people working for large companies. In addition, SMEs generated 48.4 trillion yen of the added value in the manufacturing industry in 2008, which accounted for around 50 percent of the USD 1.21 in total added value by the industry, according to calculations by the Japanese government. While Japan has many well-known manufacturing companies, it can be said that the Japanese economy is built on SMEs' business.

In respect of financial arrangements, SMEs reportedly receive funding through financial intermediaries, such as banks, which is called "indirect financing," rather than through capital markets, which is called "direct financing." There are a range of reasons why SMEs rely on indirect financing; however, this note focuses on SMEs fundraising through capital markets.

There are currently five main stock exchanges in Japan: Tokyo, Osaka, Nagoya, Fukuoka, and Sapporo, while the Tokyo Stock Exchange (TSE) and Osaka Securities Exchange (OSE) will be under a single holding company from January 2013 and will be merged into a single stock exchange accordingly. Japan also has five emerging stock markets mainly for SMEs, managed by each of the five main stock exchanges. Mothers (market of the high-growth and emerging stocks), JASDAQ, Centrex, Q-Board, and Ambitious are governed by Tokyo, Osaka, Nagoya, Fukuoka, and Sapporo stock exchanges, respectively. They compete with each other, and a company can list its shares on more than one of the markets at the same time. The listing requirements vary among the markets, while they take into account the needs of both companies and investors in order to achieve fairness and effectiveness and ensure investor protection. The number of companies currently listed on each market is shown in the table below.

Number of Listed Companies

Stock Exchange	Market Section	Listed Companies
Tokyo Stock Exchange	1 st and 2 nd Section	2,108
	Mothers	178
Osaka Securities Exchange	1 st and 2 nd Section	700
	JASDAQ	926
Nagoya Stock Exchange	1 st and 2 nd Section	297
	Centrex	20
Fukuoka Stock Exchange	Main Section	117

	Q-Board	9
Sapporo Stock Exchange	Main Section	70
	Ambitious	8

In addition to the markets introduced above, there is another market regime on which SMEs in Japan, particularly venture businesses, can issue and trade unlisted shares. Unlisted companies are not required by law to disclose their corporate information in Japan, and, in principle, Japan Securities Dealers Association (JSDA), a self-regulatory organisation in Japan, prohibits securities companies from soliciting investment in such issues. However, JSDA allows its member brokers to solicit customers for investment in securities regularly disclosing specified corporate information, provided that the brokers continuously publish quotes and other relevant market information for the securities. This trading framework is called the Green Sheet System. Issues under the system are divided into three categories: emerging issues (securities issued by emerging venture companies that have growth potential and aspire to go public); investment trust and SPC issues (certificates of investment trusts, including real estate investment trusts, or REITs) and ordinary issues (other securities). The emerging issues category can be used for SMEs to raise capital, to which 14 companies are designated, while 25 companies are traded as the ordinary issues category and no issues are designated as the investment trust and SPC issues as of end of October 2012.

Analysis and Development of SMEs to access the Capital Markets

What has worked and why?

As seen from the numbers of listed or designated companies on each trading venue, Mothers and JASDAQ are apparently major market venues for SMEs. Comparing the fundraising through IPO, these two markets gain an advantage over the others as capital markets for SMEs.

Market	2007	2008	2009	2010	2011
Mothers	31.8 (23)	8.9 (12)	9.0 (4)	8.0 (6)	9.0 (11)
JASDAQ	68.1 (74)	11.5 (28)	11.4 (9)	5.4 (10)	17.2 (16)
Centrex	0.39 (2)	0.20 (1)	0 (0)	0 (0)	0 (0)
Q-Board	0.82 (2)	0 (0)	0 (0)	0 (0)	0 (0)
Ambitious	1.00 (5)	0.10 (1)	0 (0)	0 (0)	0 (0)
Green Sheet	0.22 (3)	0.25 (9)	0.23 (10)	0.03 (2)	0.02 (2)

* The amount of fundraising through IPOs in billion yen (the number of IPOs)

* Data for JASDAQ is the aggregated data of JASDAQ Standard and Growth in 2011 and the aggregated data with the start-up markets of OSE (Hercules and NEO) before then.

Mothers (market of the high-growth and emerging stocks) was established as a new market place in November 1999 by TSE in order to provide venture companies access to funds at an early stage of their development and to provide investors with more diversified investment products. This concept is clearly different from the TSE First Section and Second Section, and Mothers is recognised as a market for emerging companies aiming to step up to the TSE First Section in the future. From its establishment, Mothers played a pivotal role for emerging companies in Japan, with listing requirements that differ from the ones for the TSE First Section and Second Section. As stated earlier, Mothers is a market for companies with high potential for growth, so it evaluates how likely a company will grow in the future in order to examine its application for listing. In this context, Mothers does not require any criteria regarding financial information, including profits, which could provide more opportunities for emerging companies to access capital sources.

Similarly, JASDAQ also plays an important role as a securities market for growth and start-up companies. However, its origin is in contrast to Mothers. While Mothers was established as a stock exchange from the beginning, JASDAQ traces its origins back to the over-the-counter market. After World War II, all stock exchanges were closed, and any stock trading had to be done on the OTC market. When the country's stock exchanges were reopened in May 1949, stocks were still actively traded over the counter, so JSDA introduced rules for authorising issues eligible for OTC trading. Although the authorisation rule was abolished due to inadequate investor protection, the JSDA introduced the OTC registration system in 1963 to address the needs of unlisted companies desperately looking for access to capital funding along with the high growth in the Japanese economy at the time. The OTC registration system led to the JASDAQ market in 1983 through the expansion of functions and systems.

Following that development, the increase in start-up companies registering on the market called for a revision of the OTC registration system. At that point, the JSDA decided to convert the JASDAQ market into an exchange and obtained an exchange license to launch the JASDAQ Securities Exchange, Inc. in December 2004. With debate about the state of the overall start-up market emerging in 2007, the JSDA sold its shares in the JASDAQ Securities Exchange to the OSE in a step-by-step manner, and finally the OSE consolidated the JASDAQ and the other emerging markets owned by the OSE, resulting in the formation of a new JASDAQ market as the largest start-up market in Japan in April 2010.

The concept of JASDAQ is to support the growth of new industries and small to medium sized start-up companies by providing them with access to equity capital and to offer attractive investment opportunities for investors. Based on this policy, JASDAQ has been divided into the two sections of JASDAQ Standard and JASDAQ Growth to enable the supply of equity capital to a broad range of companies. The JASDAQ Growth section is for companies that have outstanding technology or business models and ample growth potential, while the JASDAQ Standard section is for companies that have a certain level of business size and results, and are expected to expand. Following the above concept, the different

criteria are adopted for listing requirements regarding net assets and profits. Like Mothers, JASDAQ Growth does not have any criteria regarding profits, but growth potential is required as one of the qualitative listing criteria. Such criteria could allow some flexibility for the market and could extend fundraising opportunities to more emerging companies, as stated in the JASDAQ's concept.

What has not worked and why?

In contrast to Mothers and JASDAQ, the other start-up markets governed by stock exchanges, namely Centrex, Q-Board, and Ambitious, are relatively small. This may be caused by a variety of reasons, including the development of information technology, and historical reasons. Those emerging markets were established generally for providing funding opportunities for companies in each region. At the time when information and transportation costs were relatively high, regional stock exchanges could have enjoyed some relative advantages against TSE or OSE for regional companies and investors. However, the development of information technology eliminated such advantages. Moreover, JASDAQ has a long history as described already so that it could enjoy some first runner advantages, and Mothers may be more attractive as a preliminary market to list on the TSE First section, which is the largest stock market in Japan.

The Green Sheet System also struggles against some issues. The system was introduced to stimulate the market for issuing and trading unlisted shares in order to improve the financing environment for venture businesses in 1997. Although 90 companies' shares were traded under the system and around 1 billion Yen was solicited as fundraising in 2006, the market gradually shrank to 52 shares traded and to around 100 million Yen solicited in 2011. There are various likely factors, but it is probably because there are many other markets for emerging companies in Japan that, like the Green Sheet System, do not have financial requirements for listing. Also, the Green Sheet System requires companies to establish an internal system for appropriate timely/periodic disclosure, which could cost a lot in comparison with the expected amount of funding. In response to those challenges, the JSDA is considering improving the system, bearing in mind the trading and issuing situation for unlisted companies as well as investor protection.

Conclusions with recommended practices for other markets

The stock exchanges in Japan have been addressing the various funding needs of SMEs to provide a range of markets taking into account the needs of both companies and investors. While SMEs are different from large or developed companies, they also vary among each other in terms of size, funding needs, potential for growth, etc. In order to sufficiently respond to such varying SMEs, some diversity would be needed as stock markets, for example, through different levels of listing requirements. On the other hand, widely diversified markets

may not work properly, as the Japanese examples indicate, so it would be impossible to draw a conclusion on the optimal diversification at this stage. The lessons learned from the Japanese examples will prove useful in monitoring the market and economic situations, and in reviewing the rules on markets, including listing requirements, in order to achieve a fair and effective market for SMEs, and ensure investor protection.

5) HONG KONG

Current SME landscape in Hong Kong

According to the website of the Hong Kong SAR Government¹²⁸ manufacturing enterprises with fewer than 100 employees and non-manufacturing enterprises with fewer than 50 employees are regarded as small and medium enterprises (SMEs) in Hong Kong. As at June 2012, there were about 300,000 SMEs in Hong Kong. They accounted for over 98 percent of the total business, provided job opportunities to over 1.2 million persons, and about 48 percent of total employment (excluding Civil Service). Our research finding also indicates that most of the SMEs were in the import/export trade and wholesale industries, followed by the retail industry. They accounted for over 50 percent of the SMEs in Hong Kong and represented about half of SME employment

Analysis and Development of SMEs to access the Capital Markets

As set out in the response of the Stock Exchange of Hong Kong Limited (HKEx) to the IOSCO EMC's survey "Financing of SMEs through the Capital Markets" (IOSCO survey), HKEx does not classify listed companies based on their size, and the term "SME" is neither defined nor used for classifying companies listed on the Stock Exchange of Hong Kong Limited.

It is however noted that the Growth Enterprise Market (GEM) has been established to provide capital formation opportunities for growth companies of all industries that cannot or do not yet fulfill the Main Board profit requirements. In 2008, GEM was repositioned as a second board and a stepping stone to Main Board. Set out below are the key development milestones of GEM with reference to a discussion paper issued by HKEx in 2006:

- GEM was launched in November 1999 following the HKSAR Chief Executive's 1998 Policy Address which committed to "study proposals for a Venture Board for smaller and emerging technology companies' stocks".
- The launch of GEM coincided with the global high-tech boom of 1999/2000 and there was great enthusiasm for companies that held out the promise of growth. Not only SMEs but also the technology offshoots of Main Board companies applied to list on GEM.
- Subsequently, the global high-tech boom ended, and in common with stock markets worldwide, share prices on GEM fell. The price declines on GEM were generally

¹²⁸ http://www.success.tid.gov.hk/english/lin_sup_org/gov_dep/service_detail_6863.html

more prolonged than on the Main Board.

- GEM's regulatory approach also underwent major changes. Before its launch, GEM was intended to be a professionals-only market, in view of the high risk of growth company shares. However, by the time the market opened, retail investors were allowed to participate as it was envisaged that there would be retail interest in growth companies.
- Although GEM was originally intended to be lightly regulated, operating on a disclosure basis. However, as some companies failed and a few more implicated in scandals, HKEx decided to scrutinise listing applications and subsequent transactions more closely.
- GEM was repositioned in 2008 as a second board and a stepping stone to the Main Board.

What has worked and why?

According to HKEx's response to the IOSCO survey, companies (including SMEs) choose to raise funds by means of equity financing for different reasons such as better access to capital at the time of listing and at later stages, higher profile and visibility in the market and increased corporate transparency to gain recognition from institutional funds and the investing public.

What has not worked and why?

As mentioned above, GEM was originally intended to be an alternative market and was supposed to operate under a modified disclosure-based, light-touch, buyers beware regulatory regime. However, as set out in the HKEx's response to the IOSCO survey, they found it difficult to sustain a distinct regulatory approach on GEM as compared to the Main Board, particularly in face of potentially problematic companies, declining share prices and public concern.

In response to these factors, HKEx decided to unify the regulatory approaches on GEM and the Main Board as much as possible. However, the quantitative admission requirements for GEM such as profit requirement remain less stringent than the Main Board.

Conclusions

HKEx has published a number of discussion papers, consultations and conclusions on the initial establishment and subsequent repositioning of the GEM market. They can be found at http://www.hkgem.com/research/e_default.htm.

6) CANADA (Ontario Securities Commission)

Evolution and Current SME Landscape

Securities regulation in Canada is a matter of provincial regulation. Each of the 10 Canadian provinces and three Canadian territories has adopted securities legislation under which local securities commissions or regulators have been established.

Canada's provincial and territorial securities regulators work together through a forum called the Canadian Securities Administrators (or CSA). The CSA's key objective is to co-ordinate and harmonize regulation of the Canadian capital markets. As a result of co-operative efforts among CSA members, many areas of Canadian securities regulation are set out in instruments (i.e. rules) and policies that are adopted by all commissions with substantially harmonized wording in all jurisdictions. References to Canadian securities law in this note generally apply across all Canadian jurisdictions.

A. Prospectus vs. Prospectus-Exempt Distributions

Under Canadian securities law, the regulation of SME public market financing falls within two broad categories.

Public prospectus offerings: A "distribution" of securities requires a prospectus to be filed with securities regulators and delivered to investors. The prospectus is subject to regulatory review and must contain certain prescribed disclosure. An issuer that obtains a receipt for a prospectus from a securities regulator becomes, if it is not already one, a "reporting issuer" (i.e. a public company). Reporting issuers are subject to continuous and timely disclosure requirements.

Private prospectus-exempt offerings: Canadian securities law also provides a number of exemptions from the prospectus requirement. Prospectus-exempt offerings are not subject to review by a securities regulator but must comply with certain conditions. For example, the conditions of one exemption include restrictions based on the sophistication and financial resources of the investor. Both reporting and non-reporting issuers may access capital markets through prospectus-exempt offerings. A non-reporting issuer does not become a reporting issuer by completing a prospectus-exempt offering.

B. Venture Issuers – Securities Law Requirements

The term SME is not used in Canadian securities law. However, the term "venture issuer" is used as a proxy for smaller or junior reporting issuers. The consolidation of stock exchanges in Canada affected the decision to use the term venture issuer as a proxy for smaller or junior

reporting issuers. In 1999, the Vancouver Stock Exchange and the Alberta Stock Exchange merged and formed the Canadian Venture Exchange. In 2000, the Winnipeg Stock Exchange merged with the Canadian Venture Exchange. The Canadian Venture Exchange also acquired the Canadian Dealing Network (formerly COATS), a junior quotation and trade reporting system in Ontario. In 2001, the Toronto Stock Exchange (TSX) acquired the Canadian Venture Exchange, which was then renamed as the TSX Venture Exchange (TSX-V). The TSX-V is the principal junior exchange in Canada.

The venture issuer term was first introduced into Canadian securities law in 2004. A “venture issuer” is defined in general terms as a reporting issuer that is not listed on the TSX, the principal senior equity market in Canada, a “national securities exchange” under U.S. securities law or the Nasdaq Stock Market, or a market place outside of Canada or the United States, other than certain specified international junior markets, including for example, the Alternative Investment Market of the London Stock Exchange. Generally, certain aspects of the Canadian securities law and other regulatory requirements applicable to venture issuers are less onerous than those applicable to non-venture issuers.

Canadian securities law: Canadian securities law contains various carve-outs, exemptions and other special provisions for venture issuers. For example, under Canadian prospectus requirements, venture issuers only have to include annual financial statements for periods ended more than 120 days before the date of the prospectus. In contrast, the comparable time period for non-venture issuers is 90 days.

Similarly, under Canadian periodic and timely disclosure requirements, annual financial statements of venture issuers must be filed within 120 days of fiscal year end. In contrast, the comparable time period for non-venture issuers is 90 days. Other special provisions for venture issuers under Canadian periodic and timely disclosure requirements include those related to the certification of financial statements, business acquisition reporting, and executive compensation reporting.

While some of the exemptions from the prospectus requirement are intended to help SMEs access capital without incurring the costs associated with a prospectus offering, none of these exemptions are subject to a condition that the issuer be a venture issuer (or a SME).

Exchange listing requirements: In addition to the differences between the regulation of venture issuers and non-venture issuers under Canadian securities law, venture and non-venture issuers are subject to different exchange listing requirements. For example, the minimum listing requirements of the TSX differ significantly from the minimum listing requirements of the TSX-V.

C. Junior-Issuer-Focused Stock Exchanges

Canada has had junior-issuer-focused stock exchanges since the establishment of the Vancouver Stock Exchange, the Alberta Stock Exchange and the Winnipeg Stock Exchange in the early 1900's. The existence of these junior-issuer-focused stock exchanges has positively impacted the development of SME access to capital for all issuers. Moreover, the development of junior-issuer-focused stock exchanges, together with the adoption of industry specific requirements in National Instrument 43-101.

Standards of Disclosure for Mineral Projects and National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities, have contributed to a vibrant market place in Canada for a broad range of issuers in the extractive industries. These issuers range from exploration and development stage companies with no operating revenues and market capitalizations below \$5 million to multinational producing issuers with market caps in excess of \$1 billion.

Currently, there are two junior markets in Canada:

- *TSX-V*: The TSX-V is the largest of the junior markets in Canada. It has offices across Canada. It operates as a separate exchange but is owned by the TMX Group, the same entity that owns the TSX. The TMX Group was recently acquired by the Maple Group. The TSX-V has three subdivisions: (i) Tier 1, for the larger more advanced venture issuers; (ii) Tier 2, where most of the venture issuers on the TSX-V trade; and (iii) NEX, a separate board for inactive companies (i.e. companies that do not meet the criteria for continued listing on the TSX or TSX-V but are otherwise in good standing with the exchange).
- *CNSX*: The Canadian National Stock Exchange (**CNSX**) is the second junior market in Canada. It only operates a junior market. The CNSX was established in 2003. Previously it was an over-the-counter platform known as the Canadian Trading and Quotation System Inc.

The following is a summary of our junior market profile, with a focus on the TSX-V:¹²⁹

- *Number of listings*: As at August 31, 2012, the TSX-V had 2 266 listed issuers.
- *Market capitalization*: As at August 31, 2012, the market capitalization of the TSX-V listed issuers was approximately \$42.5 billion, resulting in an average market capitalization per issuer of approximately \$18.8 million. By contrast, the average market capitalization of TSX listed issuers was approximately \$1.3 billion.
- *Trading volume*: As at August 31, 2012, the year-to-date trading volume on the TSX-V was 29.3 billion shares. By contrast, the year-to-date trading volume on the TSX was 56.5 billion shares.

¹²⁹ Data source: The MiG Report August 2012 issued by The Market Intelligence Group at TSX and TSX Venture Exchange.

• *Issuer profile by industry:* As at August 31, 2012, the top five industries for TSX-V listed issuers was as follows:

- Mining: 58 percent of issuers representing 51 percent of total market capitalization;
- Oil and Gas: 12 percent of issuers representing 27 percent of total market capitalization;
- Diversified Industries: 7 percent of issuers representing 4 percent of total market capitalization;
- Technology: 5 percent of issuers representing 3 percent of total market capitalization;
- Clean Technology: 3 percent of issuers representing 2 percent of total market capitalization.

• *New listing activity:* In the year-to-date period ended August 31, 2012, 175 issuers obtained new listings on the TSX-V, which included 30 initial public offerings (**IPOs**) and 12 reverse takeovers. One hundred and three of the remaining new listings related to the TSX-V Capital Pool Company (**CPC**) program. The CPC program permits a shell issuer to raise, in an IPO, funds up to a maximum of \$4.75 million for the purpose of facilitating a reverse takeover by an active business (a qualifying transaction under the CPC program). There were 59 CPC IPOs and 44 qualifying transactions over this period.

• *Capital raising:* In the year-to-date period ended August 31, 2012, venture issuers raised approximately \$3.8 billion of which approximately \$121.1 million were from IPOs, and approximately \$932.5 million from other prospectus offerings. Venture issuers also raised approximately \$2.7 billion through prospectus-exempt offerings over this period.

Analysis and Development of SMEs to Access the Capital Markets

The existence of junior-issuer-focused stock exchanges and the tailoring of securities law requirements to venture issuers has resulted in a vibrant public market place in Canada for issuers across a broad spectrum of market capitalisations, especially in the extractive industries. Nevertheless, Canadian securities regulators are engaged in a number of policy projects seeking to improve our regulatory regime. We currently have three securities regulatory initiatives underway that relate to SMEs: (i) exempt distributions; (ii) proportionate regulation; and (iii) marketing and pre-marketing.

A. Exempt Distributions

On November 10, 2011, we published CSA Staff Consultation Note 45-401 *Review of Minimum Amount and Accredited Investor Exemptions (Consultation Note)*. The Consultation Note provided information about two prospectus exemptions (the accredited

investor and minimum amount investment exemptions) and set out 31 consultation questions. The review was initiated to consider whether these two key capital raising prospectus exemptions continue to be appropriate for our capital markets in their current form, taking into account both the capital-raising needs of businesses and investor protection.

The comment period for the Consultation Note ended on February 29, 2012. We received 109 comment letters and feedback from over 300 people who attended consultation sessions held across Canada. Stakeholders expressed a wide range of views in the written comments and in the consultation sessions.

On June 7, 2012, we published CSA Staff Notice 45-310 *Update on CSA Staff Consultation Note 45-401 Review of Minimum Amount and Accredited Investor Exemptions (Update Note)* updating market participants on the status of the Consultation Note. Given the number of comments and the diversity of the feedback provided, we decided to take more time to complete our review and consider the feedback. We will finalize this review and publicly report on its conclusions in 2013.

The Update Note also stated that some Canadian jurisdictions are considering expanding their review to include other capital raising prospectus exemptions, as well as research about exemptions in other jurisdictions, such as the United States, the United Kingdom and Australia. For example, the Ontario Securities Commission (**OSC**) published OSC Staff Notice 45-707 *OSC Broadening Scope of Review of Prospectus Exemptions* on June 7, 2012 in which the OSC announced that it was broadening the scope of its exempt market review to consider whether it should introduce any new prospectus exemptions that may assist capital raising for business enterprises while protecting the interests of investors.

This review of prospectus exemptions will ensure that appropriate capital raising prospectus exemptions continue to be available to businesses, including SMEs, and will consider whether new prospectus exemptions are warranted.

B. Proportionate Regulation

On July 29, 2011, we published for comment proposed rules and rule amendments which introduce a new mandatory regulatory regime for venture issuers. The new regime is intended to further streamline and tailor venture issuer disclosure to reflect the needs and expectations of venture issuer investors and to make the disclosure requirements for venture issuers more suitable and more manageable for issuers at this stage of development.

The proposals will streamline and tailor prospectus, continuous disclosure and governance requirements for SMEs that are venture issuers. By creating streamlined and tailored prospectus and continuous disclosure requirements for venture issuers, it may also facilitate SME IPOs.

We received 69 comment letters on the proposals from a range of stakeholders including issuers, accounting and legal advisers, stock exchanges, shareholders' advocacy groups and transfer agents. As a result of these comments, the CSA revised the proposals and republished proposed rules and rule amendments for comment on September 13, 2012. The comment period closes on December 12, 2012. We anticipate final adoption in 2013.

C. Marketing and Pre-Marketing

On November 25, 2011, we published for comment proposed pre-marketing and marketing amendments to the prospectus rules. The proposed reforms will increase the range of permissible pre-marketing and marketing activities in connection with prospectus offerings of issuers other than mutual funds.

We received 16 comment letters on the proposals. We have considered the comments received, as well as the pre-marketing provisions in the U.S. JOBS Act. We expect to finalize the rule amendments in 2013.

The proposed amendments will assist issuers, including SMEs and venture issuers that wish to raise capital in a prospectus offering. In particular:

- The proposed testing of the waters exemption for IPO issuers will permit a private company, through an investment dealer, to determine interest in a potential IPO through limited confidential communication with institutional investors. The exemption will allow the private company to see if there is enough investor interest before starting the IPO process and incurring costs.
- The proposed amendments will expressly allow investment dealers to use marketing materials and conduct road shows during the "waiting period" (the period between the filing of a preliminary prospectus and the filing of a final prospectus) and following the receipt of the final prospectus. By increasing the range of permissible marketing activities, issuers and investment dealers will face fewer regulatory burdens and restrictions in trying to successfully complete a prospectus offering.
- The proposed amendments will also clarify certain matters relating to the existing bought deal exemption (e.g., when bought deals and bought deal syndicates can be enlarged). By way of background, the bought deal exemption allows an investment dealer to solicit expressions of interest before a public company files a preliminary short form prospectus, if certain conditions are met. The amendments will provide clear rules and a "level playing field" for market participants.

Conclusion

The existence of junior-issuer-focused stock exchanges and the consequential tailoring of securities law requirements to venture issuers has resulted in a vibrant public marketplace in Canada for issuers across a broad spectrum of market capitalizations, especially in the extractive industries. Currently, we have three CSA initiatives underway that are intended to provide direct or indirect benefits to SMEs in Canada. We continue to engage with international organizations like IOSCO and COSRA and other securities regulators around the world for ideas to facilitate the financing of SMEs through the capital markets.

Recommended Practices for Other Jurisdictions

We hope our experiences will help inform policy makers in other jurisdictions. In particular, tailored venture issuer regulation as well as the future outcomes of our ongoing initiatives may suggest alternative regulatory approaches to support SMEs. However, we think it is important for policy makers to be mindful that local social and economic factors may impact the appropriateness of duplicating the Canadian approach in another jurisdiction. In this regard, consideration should be given to whether regulation can evolve with the development of capital markets, and the sophistication of issuers and investors.

7) SINGAPORE

Singapore's Current SME Landscape

Small and medium enterprises (“SMEs”) in Singapore are defined as enterprises with annual sales turnover of not more than S\$100million, or with employment size of not more than 200 workers. SMEs are important to Singapore’s economy. They employ 70 percent of Singapore’s workforce and contribute half of Singapore’s GDP. 99 percent of Singapore companies are SMEs, serving as the bedrock of Singapore’s economy. Many of these SMEs grew from small enterprises into large globally-competitive companies.

Standards, Productivity and Innovation Board (SPRING) Singapore and International Enterprise Singapore are currently conducting a holistic review of Singapore’s SME strategies, taking into account the changes in the global and domestic environment since 2010. SMEs will continue to be critical to Singapore’s economic growth.

According to the Economic Strategies Committee Report published in 2010, feedback from both local companies and the financial sector suggests that there is room to develop and catalyse market financing for SMEs. SMEs with good capabilities, particularly those in non-high-tech sectors, face challenges in raising growth potential as they are typically not large enough to interest private equity, nor able to provide sufficiently attractive returns in a relatively short time horizon for venture capital firms. The sponsor supervised listing platform “Catalyst” was launched in 2007 to serve as a fund raising platform for fast-growing local and international companies. It was designed to offer faster time-to-market and more flexibility in fundraising and corporate transactions after the Initial Public Offering.

SMEs Access to Capital Markets: Overview of the Catalyst market in Singapore

Genesis of Catalyst

The Singapore Exchange Limited launched “Catalyst” in November 2007 through the re-branding and re-positioning of SESDAQ as a vibrant and dynamic market in Asia for high-growth companies. The Catalyst rules were effected on 17 December 2007 and Catalyst officially commenced business on 5 February 2008 with the introduction of the pioneer group of Sponsors.

Purpose and Objective of Catalyst

The primary rationale for the creation of Catalyst was to improve the market quality and performance of SESDAQ. Defined specifically, this involves (a) rejuvenation of SESDAQ; (b) making available professional guidance for companies in their formative years; (c)

offering a more expeditious listing process and time to market for listing aspirants; and (d) raising the quality of issue managers (i.e. Sponsors) through enforcement of stringent entry criteria and ongoing supervision.

The vision for Catalyst is to be Asia’s leading fund raising platform for fast growing companies. This is achieved by allowing companies to list on Catalyst with the introduction of a more scalable Sponsor-supervised regime.

In a Sponsor-supervised market, SGX continues to regulate companies through its admission and continuing obligation rules. It also retains the power to discipline them when there is a rule breach. However, approved Sponsors undertake the direct supervision of the companies. At IPO, the Sponsors assess suitability to list and prepare the companies for listing. Post-IPO, Sponsors advise and supervise listed companies on responsibilities in a public market.

How Catalyst has helped SMEs with their Funding Needs

Catalyst is designed to allow for faster time-to-market and greater flexibility. Companies are able to respond to business opportunities and expansion plans quickly, as subsequent fund raising and acquisitions/disposals can be undertaken more easily with higher thresholds.

Since inception till 30 September 2012, there were 50 new listings (including reverse takeovers) on Catalyst, raising a total of US\$375 million. In addition, Catalyst companies raised US\$1.4 billion via corporate fund raising activities.

Catalyst also aims to attract fast growing companies in new sectors and industries, as well as companies in their early stage of development with limited track record. On this front, Catalyst introduced new listing rules for listing of exploratory companies in the mineral, oil and gas (“MOG”) sector with effect from February 2011. We have since listed a gold mining company on Catalyst, with enquiries from a few MOG listing aspirants.

Catalyst companies may apply for transfer to the Mainboard (i.e., the Main Market) on their volition subject to compliance with the Mainboard listing requirements. Since inception, six Catalyst sponsored companies have successfully transferred to the Mainboard.

Key Statistics

Overview of Companies on Catalyst

	As at End of Transition Period (February 2010) ^{Note 1}	As at 30 September 2012
No. of Companies on Catalyst	130	140

	As at End of Transition Period (February 2010) ^{Note 1}	As at 30 September 2012
Market Capitalization (billion USD)	4.6	5.5
Average Market Capitalization (million USD)	35	39

Note 1 - New Catalyst rules were introduced in November 2007 and Catalyst opened for business in February 2008. SESDAQ companies were given two years, till February 2010 to appoint Sponsors and transit to the Catalyst sponsorship regime.

Overview of New Listings / Reverse Takeovers on Catalyst

There were 50 new listings / reverse takeovers from inception of Catalyst till 30 September 2012. Market capitalization of these new listings / reverse takeovers as at the point of IPO and as at 30 September 2012 is as follows:

New Listings / Reverse Takeovers	As at the point of IPO	As at 30 September 2012
No. of New Listings / Reverse Takeovers	50 (Singapore operations – 38; Foreign operations – 12)	48 ^{Note 2} (Singapore operations – 37; Foreign operations – 11)
Market Capitalisation of New Listings / Reverse Takeovers on Catalyst (million USD)	3,000	2,800

Note 2 – One Company has since transferred to the Mainboard and another company delisted on its own volition.

Conclusions: Assessment of Catalyst and the Key Challenges Faced

How Catalyst Has Met Objectives

Catalyst has met its objectives of improving market quality and performance of SESDAQ, as evidenced by the increase in overall market capitalization of companies on Catalyst, from US\$4.6 billion as at the end of the transition period in February 2010, to US\$5.5 billion as at 30 September 2012. In addition, Catalyst serves as Asia's leading fund raising platform for fast growing companies, as evidenced by the 50 new listings (including reverse takeovers) on

Catalyst since inception. Of these, 24 percent have principal place of operations outside of Singapore.

Although the market capitalization of new listings (including reverse takeovers) on Catalyst has remained relatively flat at approximately US\$3 billion, we noted that six companies chose to list on Catalyst despite having market capitalization of more than US\$80 million. As at 30 September 2012, nine of the 50 new listings (including reverse takeovers) on Catalyst have market capitalization in excess of US\$80 million.

The first company listed on Catalyst, Mencast Holdings Ltd, has since grown sizeable and has transferred to the main board. As stated in the above paragraph, new rules for listing of exploratory companies in the mineral, oil and gas (“MOG”) sector came into effect in February 2011. We have since listed a gold mining company on Catalyst, with enquiries from a few MOG listing aspirants. There are currently 9 Full Sponsors and 9 Continuing Sponsors approved to undertake initial and continuing sponsorship activities respectively. This is sufficient to meet the demands of our existing Catalyst issuers, as well as fulfill the needs of SME listing aspirants.

Key Challenges Faced

There is a limited pool of sponsors which are active in bringing companies to list on Catalyst. Since inception, three Full Sponsors accounted for 96 percent of all new listings (including reverse takeovers) on Catalyst. We envisage that this will change with the higher Mainboard admission criteria effective from August 2012. As is the case for SME boards in other jurisdictions, we noted that institutional investors are lacking in the Catalyst market. This is not surprising as the mandates for institutional investors would typically be restricted to companies with higher market capitalisation.

8) UNITED KINGDOM

Evolution and current landscape

As in many economies, small and medium sized enterprises (SMEs) form the backbone of the UK economy. There are 4.8 million SMEs in the UK and economic recovery in the UK can only be achieved by harnessing the growth of these companies.

Only a small percentage of these SMEs are traded on a capital market. In the UK there are three public markets which trade SMEs: the Main market and AIM, both operated by the London Stock Exchange and Plus sx. The Main market does not have a specific SME segment, whereas AIM and Plus sx. were set up as markets for smaller, growing companies.

A Grant Thornton study published in 2010 found that UK AIM companies directly contributed £12 billion to UK GDP and supported 250,000 jobs. Additionally, they indirectly contributed a further £9 billion to UK GDP and supported 320,000 jobs through supply chain and multiplier effects¹³⁰.

As a result of the global financial crisis, SMEs' own financial resources have deteriorated, leading to lower generation of internal cash flow and hence to greater external financing needs. This has led SMEs to deleverage their own balance sheets and to create liquidity cushions to take into account the uncertainty in bank lending over the near future.

Reviews have suggested that in the wake of the current financial crisis banks are generally, and to an even larger degree than historically, shying away from financing SMEs as they need to deleverage their balance sheet. This restricts credit to businesses even in those cases where companies generate a positive cashflow which would allow for the servicing of debt. Smaller, younger and still developing companies are considered riskier, and banks prefer to concentrate their resources on lending to sovereigns (0 percent risk weighted), and larger companies, typically blue chip, where information asymmetries are smaller and where failure is less likely. In addition, banks have reduced cross-border lending which has led global companies to increasingly rely on their own domestic financial institutions further reducing the availability of debt capital for SMEs¹³¹.

As a result of the implementation of Basel III/CRD IV and Solvency II, banks and insurance companies face new tougher own funds requirements and greater liquidity constraints. This further reduces the ability of banks and insurance companies to invest into equity creating a

¹³⁰ Grant Thornton: Economic Impact of AIM and the role of fiscal incentives <http://www.grant-thornton.co.uk/en/Media-Centre/News/2010/Study-reveals-AIMs-21bn-contribution-to-UK-economy/>

¹³¹ Financial Times. May 4, 2012" *Banks look to farm out portion of SME loans*".

disproportionate effect on SMEs compared to bigger companies and sovereigns. Larger companies may also be able to tap the corporate bond markets - an option typically less available for SMEs.

Analysis and development of SMEs to access the capital markets

AIM has helped over 3,300 companies raise more than USD 120.12 billion since its launch in 1995. At the end of September 2012, AIM had 1,105 companies quoted on its market valued at over USD 93.6bn, by comparison to Plus sx, which had only 133 companies and so this paper will concentrate on the experiences of AIM.

AIM is an exchange regulated market outside the scope of most of the EU directives and the comments that follow should be seen in the context of that regulatory structure.

What has worked and why

AIM has been a success due to a mix of factors:

Expert adviser network – there is a large and experienced community of “nominated advisers” to help companies join AIM and support them once they are trading on the market.

Regulatory framework – the rules of the market are sufficiently different from the Main Market and provide an environment which is specifically tailored to support the needs of smaller companies.

Fiscal incentives – there are a number of fiscal incentives for investors and companies.

Geographical reach and wide sector coverage – AIM caters for a diverse coverage of sectors and regions, with companies from 40 different industries from over 28 countries, which means it is not reliant on a particular sector such as technology for example.

International investor base – London provides access to a wide and diverse range of institutional and retail investors.

Equity research – independent equity research is increasingly regarded by investors as a useful source of consolidated company information. The unbundling of research as a result of regulatory changes in the UK has prompted the growth in independent research. As institutional investors have reduced their reliance on the traditional broker research model, they have increased their use of independent research to satisfy their continued need for comprehensive analysis.

Indices – trading in AIM securities is encouraged and supported through a number of indices

that have been developed to improve investors' ability to benchmark and trade AIM securities in a variety of ways. The FTSE AIM Index Series includes the FTSE AIM UK 50 Index, FTSE AIM 100 Index, FTSE AIM All-Share Index and FTSE AIM All-Share Supersector Indices.

Trading platforms – AIM companies have a market maker in their company's securities, whose role is to improve liquidity. Maximizing this liquidity is a key focus for a company once on the market. However, other models exist as well, as some market participants believe that the market maker model does not propose enough transparency.

What has not worked and why

The main barriers to accessing markets for SMEs are described below:

High cost of capital – companies incur costs when going public and once they are listed, they incur ongoing regulatory costs as well as trading costs. These costs can be disproportionate for SMEs.

Lack of insufficient research coverage – there are still many companies with insufficient research coverage.

Low liquidity – 13 percent of Europe's largest companies (i.e. which have a market capitalization of over 1.71 bn USD) account for 93 percent of Europe's market cap, 85 percent of the number of trades and 96 percent of turnover¹³². In comparison to blue chips, SMEs' trading volumes tend to be low, which can be explained by a number of factors.

SMEs are often less attractive to large, institutional investors and recent market developments like the entry of high frequency traders have tended to reinforce the attractiveness of blue-chips, sometimes at the expense of SMEs in terms of trading. Furthermore, AIM has no minimum shares in public hands requirement and company owners can be reluctant to divest too much control.

Higher transparency requirements – issuers believe that increased regulatory requirements from the EU can represent a challenge for SMEs, resulting in a sub-optimal time allocation for SMEs' board and management and ensuing increased costs. The smaller the company, the more disproportionate these are to the benefits of being traded on a public market.

Regulatory framework – The balance of regulation on AIM has not always been optimal. Originally the AIM rules catered only for companies; given the importance of the role of the

¹³² Based on internal research by the Federation of European Securities Exchanges (FESE)

Nominated advisor, AIM rules for advisers were later introduced. Also the rules for Mineral companies and for cash shells have had to be tightened, due to several corporate failures in these areas.

Company profile – As previously mentioned, AIM was set up for smaller growing companies, but since there is no maximum market capitalization over the years a number of large companies have joined the market, arguably for the wrong reasons.

Conclusions

AIM has survived against a very difficult economic background because of its critical mass and diversity and its unique community of professionals working in the market – Nominated advisors, brokers, accountants, lawyers and public relations and investor relations firms.

The UK was the first country to introduce the Nominated adviser concept, a concept which has now been replicated in a number of other jurisdictions. Each company applying to AIM must appoint and retain a Nominated adviser to guide it through the process and advise it during its time as a public company. It is the adviser who judges the suitability of the company and unless it is making a public offer, the admission document does not have to be vetted, which provides great flexibility and keeps costs low.

AIM also has developed a regulatory framework which is sufficiently different from the Main market, but still is of a standard which satisfies investors. For example, when a company is on the market and makes an acquisition, it does not have to get shareholders' approval unless the company it is acquiring is the same size allowing the AIM company to grow quickly at minimum cost. However, this framework needs constant monitoring to ensure the right balance is achieved.

In summary, an effective capital market for SMEs must seek to ensure an appropriate regulatory framework for issuers that do not prove burdensome for them and also wins investor confidence and attract a wider set of investors to smaller growing businesses by reducing regulatory and fiscal burden on SME investors.

Recommended practices for other markets

There is no 'one-size fits all' solution for all countries, but some of the measures which should be considered are:

The need for balanced regulation – in order to increase investment flow into SMEs, it is crucial to ensure investor confidence. This is even more important for retail investors. The challenge is therefore to find the right balance between an adequate level of investor protection and the right level of obligations for issuers on those markets.

Flexibility is required for disclosure requirements applicable to SMEs. Regulators generally take longer to approve the prospectus of SMEs than to approve those of other companies. This can be particularly damaging to SMEs because the window for going public can be very short and is more harmful to SMEs because of the relatively high fees.

Keep cost of capital low - in order to help lower the cost of capital there is a need to reduce the barriers to investing in small caps. When companies seek access to capital markets, they expect to raise capital at a reasonable cost. Ultimately, the value of the markets is measured through increased investor and stakeholders' interest.

For example, consider making the application of International Financial Reporting Standards (IFRS) optional for SMEs. The review of prospectuses of companies seeking admission to SME markets could be delegated by the Home Competent Authority to the Market Operator and/or key adviser. This would help lower the cost of capital for smaller companies.

Keeping cost of access and maintenance of the listing of SMEs low – keep the costs charged by all parties involved in a listing of an SME's securities, for both the admission to trading as well as the maintenance of the listing as low as possible.

Keep the minimum capitalization low - lighten the burden of publishing accounts: for example, allow half yearly accounts (at least for the first years after being admitted to listing) to be published one or two months later than larger companies (to allow a greater focus on these accounts by researchers, as they cannot pay attention to them while having to analyse published accounts of the largest companies in the market).

Streamline governance criteria – for example, do not require the separation of the function of Chairman and CEO.

Diversify the investor pool – populations around the world are aging and well-capitalized pension funds are no longer net investors in the market. Therefore, it is important to encourage retail investors to invest more in SMEs.

Ensure good availability of investment research and ratings information - research on SMEs (as for any type of company) is costly and investors are generally not eager to pay for it. Research and ratings information should be made available to a wide set of potential investors helping to reduce information asymmetries associated with smaller companies. Provide incentives to foster independent research and ratings of SMEs.

Fiscal policy - allow for effective incentive schemes to be adopted recognising the role of expansion capital as genuine risk capital. Consider tax reforms in order to encourage more long-term holdings

Education of SMEs - increase awareness and education of entrepreneurs to ensure they understand the different sources of finance available to them.

9) UNITED STATES OF AMERICA

Costs and challenges for SMEs in accessing the capital markets

- A.** Often there is minimal or no distinction between SMEs and larger issuers in terms of reporting requirements. For example, SMEs are often required to comply with same legal requirements as larger, more sophisticated, and better funded issuers.
- B.** Costs associated with going public can be expensive for SMEs.
 - 1. A company can go public in two ways in the United States:
 - a) issuing securities in an offering registered under the Securities Act of 1933 (Securities Act); or
 - b) registering the company's outstanding securities under the Securities Exchange Act of 1934 (Exchange Act) requirements.
 - 2. Either will trigger ongoing SEC reporting obligations and the Exchange Act also subjects a company's officers, directors, and significant shareholders to reporting requirements.
 - 3. Compliance with complex legal and securities rules can be costly for SMEs that already lack sufficient capital. For example, listing requirements (*i.e.* underwriting, legal, and financial fees) can be particularly costly and administratively difficult for SMEs with less sophisticated staff.
- C.** Profit margins for SMEs can be small, inhibiting their ability to hire experienced staff with capital markets and financial knowledge.
- D.** Other methods of raising capital may be perceived as less costly to an SME than accessing the capital markets in certain jurisdictions. For example, many SMEs in the United States raise capital via angel investors and venture capitalists.
- E.** Broker-dealers and advisors often are reluctant to assist SMEs find investors in the market place. Some of the more common challenges facing intermediaries include:
 - 1. SME investors can be retail investors with small ownership positions in the SMEs because institutional investors often lack financial incentives
 - 2. Founders and management of SMEs frequently are the largest shareholders and often with a controlling interest.

3. Limited coverage by analysts and few research reports regarding SMEs places a greater burden on investors (and dealers) to do their own research and follow SME developments.
4. Debt securities issued by SMEs often are characterized by comparatively poor credit ratings: poor credit ratings can impair an SME's eligibility for investment by some regulated institutional investors.
5. Transaction size for an SME capital raising is likely to be small, reducing the profitability of the engagement for financial intermediaries and limiting the potential for an active aftermarket.

F. Many SMEs are closely-held, family businesses.

1. Principals often are unwilling to disclose firms' financial statements or business operations
2. Shareholders typically are reluctant to extend management to "outsiders."
3. Small staff may deem it too difficult to implement corporate governance measures (internal control processes to minimize conflicts of interest, self-dealing, participation of independent directors on boards, etc.).

Regulatory responses that facilitate access to public markets

A. Tailored or Proportionate Regulation

1. SEC regulations provide varying regulatory treatment of companies based on measures such as:
 - a) the amount of securities being offered;
 - b) a company's annual revenues and number of shareholders; and
 - c) the size of the company's "public float" (aggregate market value of common equity held by persons that are not affiliates of the company).
2. Many SMEs have no reporting obligations to the SEC since they do not:
 - a) list their equity securities on a national exchange;
 - b) have more than \$10 million in assets and 2,000 or more holders of record (or 500 or more persons who are not accredited investors) of equity securities; or
 - c) have a completed a registered public offering of securities.

3. SMEs can take advantage of rules for “smaller reporting companies” (SRCs).
 - a) SRCs benefit from a scaled disclosure regime because they can elect to use simplified reporting for smaller issuers.
 - b) The determination of whether a company qualifies as a “smaller reporting company” is done annually.
4. Securities Act § 3(b) exempts certain securities offerings of less than \$5 million from registering with the SEC under Regulation D.
5. Particular consideration is given to the impact of SMEs when the SEC conducts rulemaking activity. For instance, when adopting amendments implementing the “say-on-pay” provisions of Dodd-Frank, the SEC provided a two-year phase-in period for smaller reporting companies. By doing so, the SEC balances the way the rules could disproportionality burden SRCs.

B. Private Placements

1. Securities Act § 4(a)(2): exempts from registration “*transactions by an issuer not involving any public offering.*”
2. Regulation D: establishes three exemptions from Securities Act registration.
 - a) Rule 504 provides an exemption for companies when they offer and sell up to \$1 million of their securities in any 12 month period.
 - b) Rule 505 allows offering securities under \$5 million in any 12 month period to an unlimited number of accredited investors and up to 35 people who are not sophisticated investors.
 - c) Rule 506 lets companies raise an unlimited amount of money by selling its Securities to an unlimited number of accredited investors and up to 35 other purchasers (must be sophisticated).
3. Other opportunities for SMEs in the nonbank capital markets include:
 - a. Accredited Investor Exemption (Securities Act § 4(a)(5));
 - b. Exemption for Sales of Securities through Employee Benefit Plans (Rule 701);
 - c. Intrastate Offering Exemption (Rule 147);
 - d. Regulation A; and
 - e. California Limited Offering Exemption (Rule 1001)

C. Junior listings/special segments of exchanges or other special market place arrangements. Some exchanges have quantitative listing standards that are more easily satisfied by smaller firms. Examples in the United States include:

1. **OTC Markets:** OTC Markets is a quotation platform and not technically an Exchange, so it has no listing requirements as such. OTC Markets provides three different trading tiers, primarily differentiated by the level of disclosure provided by the issuer (e.g., Exchange Act reporting, compliance with OTC Market's Alternative Reporting Standard).
2. **NYSE MKT LLC:** a US equities market owned by NYSE Euronext that lists and trades small growth companies. The NYSE MKT provides four different levels of listing standards based on different criteria (e.g., pretax income, market Capitalization, etc.).
3. **BX Venture Market:** NASDAQ OMX Group, Inc. received SEC approval for the BX Venture Market last year though it has not yet been launched.
 - a) The exchange plans to provide issuers that would not otherwise qualify for an exchange listing the option to list and trade their shares.
 - b) For issuers already trading in the over-the-counter markets, contemplating an initial exchange listing or those delisted from a national securities exchange, the BX Venture Market provides another listing alternative.
 - c) Listing standards for this market will require companies to comply with many of the same corporate governance requirements as are required for listing on other securities exchanges and maintain basic quantitative standards.

D. The SEC also has resources directed to supporting SMEs in meeting their regulatory requirements and other financing options.

1. The SEC's Division of Corporation Finance has the "Office of Small Business Policy" (OSBP), which specialises in matters related to SMEs.
 - a) Staff in the Office of Small Business answers questions on disclosure and other issues relating to small public companies, including those classified as smaller reporting companies and on private and intrastate offerings of securities.
 - b) Questions are answered by phone, online forms, and emails and OSBP considers letters requesting a no-action position or interpretive advice.
 - c) OSBP acts as the Division of Corporation Finance's liaison to the state securities regulators on corporate finance issues and the Small Business Administration (SBA).

- d) The SEC's website includes links under the Division of Corporation Finance to assist small businesses with information on US securities laws.
2. Since 1982, the SEC has annually hosted a forum focused on the capital Formation concerns of small business called the SEC Government - Business Forum on Small Business Capital Formation.
 - a) The forum provides a platform for small businesses to highlight perceived unnecessary impediments to the process of raising capital.
 - b) Previous forums developed numerous recommendations seeking legislative and regulatory changes in the areas of securities and financial services regulation, taxation and state and federal assistance.
 - c) Participants in the forum typically include small business executives, venture capitalists, government officials, trade association representatives, lawyers, accountants, academics and small business advocates.
 3. In 2011 the SEC established the Advisory Committee on Small and Emerging Companies. This provides a formal mechanism for the SEC to receive advice and issue recommendations on privately held small businesses and publicly traded companies with a market capitalisation of less than \$250 million.
 4. In 2012, the Investor Advisory Committee established by the Dodd-Frank Act was constituted. This committee advises the Commission on regulatory priorities, the regulation of securities products, trading strategies, fee structures, the effectiveness of disclosure, and on initiatives to protect investor interests and to promote investor confidence and the integrity of the securities market place.

New initiatives underway to facilitate capital formation for SMEs

- A. Title II of the Jumpstart Our Business Startups Act (JOBS Act) requires the Commission to relax the prohibition against general solicitation and advertising in offerings made under Rule 506 under certain circumstances. It also requires the Commission to amend Rule 144A (which permits resales of securities to "qualified institutional buyers", or QIBs) to allow offers to non-QIBs., including by means of general solicitation and advertising, so long as all purchasers are or are reasonably believed to be QIBs.
1. The SEC is required by law to amend its rules to permit issuers to offer and sell securities under Rule 506 without restrictions on general solicitation and advertising, provided that all purchasers in the offering are "accredited investors." The rules must also require issuers

to take “reasonable steps to verify” that all the purchasers of the securities solicited in this manner be accredited investors. The SEC proposed rules on this in August.

2. The proposed rule amendment also provides that securities may be offered under Rule 144A to persons other than QIBs, including by means of general solicitation or general advertising, provided that securities are sold only to people that the seller reasonably believes are QIBs.

B. The JOBS Act also created an IPO “on-ramp” for “emerging growth companies” (EGCs).

1. An EGC is an issuer that has annual revenue of less than \$1 billion during its most recently completed fiscal year.
2. The “on-ramp” provisions provide a number of accommodations intended to make initial public offerings more attractive to EGCs.

C. The JOBS Act directs the Commission to add a new small issue exemption (similar to existing Regulation A) (Title IV).

1. The new exemption will have an offering cap of \$50 million per year, compared to \$5 million per year under existing Regulation A, and will include a new requirement for issuers to file annual audited financial statements with the Commission.
2. Purpose is to lower compliance costs to an expanded set of small companies and facilitate capital raising.
3. It has been noted, however, that lower disclosure requirements may increase the incidence of fraud and make enforcement more difficult.

D. JOBS Act directs the Commission to adopt new rules permitting crowd funding (selling small amounts of equity to many investors).

1. The purpose is to make it easier for small, private businesses to raise money from the public.
2. Companies will be permitted to offer and sell \$1 million of securities over a 12 month period based on certain conditions.
3. An intermediary (broker or funding portal) must be used, and these intermediaries will be required to register with the SEC.