



Commission of the European Communities

Special stock market segments for small company shares:

Capital raising mechanism and exit route for investors
in new technology-based firms



Report

EUR 9235 EN

Commission of the European Communities

Special stock market segments for small company shares:

**Capital raising mechanism and exit route for investors
in new technology-based firms**

H. Schmidt,
Institut für Geld- und Kapitalverkehr, Universität Hamburg, BR Deutschland

with contributions of

E. Wymeersch,
Seminarie voor Handels- en Ondernemingsrecht, Rijksuniversiteit Gent, België

A. Young,
School of Management, Syracuse University, Syracuse, New York, USA

H. Reuter,
Dresdner Bank, Frankfurt, BR Deutschland

H.-M. Domke,
Institut für Geld- und Kapitalverkehr, Universität Hamburg, BR Deutschland

Ch. Herms,
Institut für Geld- und Kapitalverkehr, Universität Hamburg, BR Deutschland



Directorate-General
Information Market and Innovation

Published by the
COMMISSION OF THE EUROPEAN COMMUNITIES

**Directorate-General
Information Market and Innovation**

**Bâtiment Jean Monnet
LUXEMBOURG**

LEGAL NOTICE

Neither the Commission of the European Communities nor any person acting on behalf of the Commission is responsible for the use which might be made of the following information

Cataloguing data can be found at the end of this publication

Luxembourg, Office for Official Publications of the European Communities, 1984

ISBN 92-825-4840-6

Catalogue number: 

© ECSC-EEC-EAEC, Brussels • Luxembourg, 1984

Printed in Belgium

PREFACE

In September 1982 Mr. Dennys Watson, Coordinator for Innovation, DG XIII, Commission of the European Communities, asked me to do this study. Previous research commissioned by his group had shown that financing of unseasoned innovative enterprises may well be the paramount impediment to the growth of these firms. During their start-up and extended early development phases, young innovative enterprises usually do not generate cash flows that are, as to amount and reliability, sufficient to meet the fixed payment schedules of debt instruments. Thus, any efforts to close the financing gap have to focus on external equity financing. Against this background, there is an obvious need to analyse the feasibility and desirability of access of innovative firms to organized secondary stock markets at the earliest possible date after start up.

Early access to secondary stock markets may favourably affect the equity raising of small innovative firms in two ways. First, investors who engage in private equity financings are more likely to contribute capital to immature innovative firms if the time for which they anticipate to be locked into their investments is reduced. Early access to stock markets could certainly shorten the locked-in time by providing a readily available exit route. Second, early access opens up the opportunity to young innovative firms to raise capital publicly.

Two of the requirements that the study had to meet should be mentioned at this point. The report of study had to be finished in time for the fourth European symposium on the financing of innovation in Luxembourg, scheduled for November 1983. Moreover, all Member States had to be covered for the core of this report, a detailed review of all stock market segments that are accessible to small industrial companies. Since I could not perform this task single-handedly, the Commission authorized me to subcontract some of the country reports. I am very much obliged to the authors of these country reports:

- Professor Dr. Eddy Wymeersch contributed the country reports on Belgium and France. He is Director of the Seminarie voor Handels- en Ondernemingsrecht, Rijksuniversiteit Gent. Among his publications on securities markets his 1978 report to the Commission of the European Communities is probably best known.
- Professor Dr. Allan Young authored the country report on Greece. In 1983 he was Visiting Professor of Finance at the University of Hamburg. In our work to this study, he provided us with valuable advice and encouragement. His continuing interest in securities markets dates back to the early sixties, when he followed up on the landmark Special Study. Since then, he published a book and numerous articles in scholarly journals on topics related to securities markets.
- Dr. Hermann Reuter wrote the report on Italy. He became familiar with Italian securities markets in 1975, when he worked with me on my earlier report to the Commission. In recent years, he has been in investment banking. He is the author of a well received book on information, investors and share prices.

- Diplom-Volkswirt Hans-Martin Domke contributed the report on Ireland. Previously, he worked in the loan and securities departments of a regional bank. He currently is on my staff and prepares a dissertation on the small-firm effect on German stock exchanges.

- Diplom-Kaufmann Christoph Herms authored the country report on Luxembourg. He worked for a number of years in the securities business, and he also has been on my staff at the Institut für Geld- und Kapitalverkehr of Hamburg University.

Since important developments relevant to the study occurred throughout 1983, it was inappropriate to use for all country reports a uniform cut-off date whereafter all developments had to be disregarded. In addition, the country reports were prepared in sequence. Field work was completed for the Germany report in December 1982, for the reports on Denmark, the Netherlands and the United Kingdom in March 1983; for Ireland and Greece in June 1983; for Belgium, France, Italy and Luxembourg early in October 1983. In some important respects the reports on Denmark and Germany were repeatedly updated.

Without the invaluable support from many sides it would have been impossible to submit this report. Many entrepreneurs, stock exchanges, brokers, bankers and supervisory authorities kindly provided information. I am most grateful to those experts who made themselves available for interviews and patiently answered question after question. The names of the ladies and gentlemen whose answers and comments contributed to this report are listed on pages 526-529 ahead of the bibliography.

I also wish to thank Mr. Dennys Watson and Mr. René Guth of the Task Force for Industrial Innovation, DG XIII of the Commission, for their support and for their motivating interest in the progress of this study. I am very grateful to my assistants Dipl.-Kfm., Dipl.-Handelslehrer Wolfgang Bessler, M.B.A. and Dipl.-Kfm., Dipl.-Handelslehrer Rolf Ratzlaff for their helpful comments and for pitching in whenever necessary. Most of all I am indebted to Mrs. Ingrid Metscher, who typed the bulk of this report with speed and care. Thanks are also due to Ms. Gudrun Lagenstein for proofreading.

H. Schmidt

Hamburg, December 31, 1983

TABLE OF CONTENTS

	<u>Page</u>
List of tables	XV
Executive summary	XVII
 <u>PART 1</u>	
The importance of secondary markets in external equity financing of small firms	1
 A. Importance of equity financing of small firms for the economy	
	1
 B. Secondary markets as a means of facilitating external equity financing of small firms	
	9
 C. The contribution of a secondary market to external equity financing of small firms	
	16
I. Determinants of the contribution of a secondary market	
	16
II. Organized secondary markets and other exit routes open to investors	
	28
 <u>PART 2</u>	
The secondary markets for equity instruments of small companies in the Member States of the European Communities	35
 A. The segments of the secondary market for equity instruments of small companies in the United Kingdom	
	35
I. Environment and survey	
1. Number and forms of business organizations	35
2. Frequently used instruments for equity financing	38
3. Investors and investment motives	39
4. Issuing houses for shares of small companies	41
5. Survey of the secondary market	44

	<u>Page</u>
II. Exchange segments	49
1. The Listed Securities Market as a segment for small company shares	49
a) Listing	50
b) Trading	56
2. The Unlisted Securities Market	59
a) Requirements for entry	60
b) Trading	64
3. The occasional-bargains facility	67
III. The British over the counter market	69
1. The Nightingale concept	69
2. The broker-dealer-approach	75
IV. Summary	80
B. The segments of the secondary markets for equity instruments of small companies in Ireland	88
I. Environment and survey	88
1. Number and form of business organizations	88
2. Frequently used instruments of equity financing	92
3. Investors and investment motives	93
4. Issuing houses for shares of small companies	97
5. Survey of the secondary market	100
II. Exchange segments	104
1. The listed securities market as a segment for small company shares on the Stock Exchange-Irish	104
a) Listing	104
b) Trading	106
2. The Unlisted Securities Market	108
a) Requirements for entry	108
b) Trading	111
3. The occasional-bargains facility	112
III. The Irish over the counter market	114
IV. Summary	115

	<u>Page</u>
C. The segments of the secondary market for equity instruments of small companies in Denmark	120
I. Environment and survey	120
1. Number and forms of business organizations	120
2. Frequently used instruments for equity financing	122
3. Investor and investment motives	123
4. Issuing houses for the shares of small companies	128
5. Survey of the secondary market	129
II. Exchange segments	132
1. The traditional exchange segment for small company shares	132
a) Listing	132
b) Trading	135
2. The new exchange segment for small company shares	137
a) Listing	139
b) Trading	141
III. Summary	142
D. The segments of the secondary market for equity instruments of small companies	149
I. Environment and survey	149
1. Number and forms of business organizations	149
2. Frequently used instruments for equity financing	151
3. Investors and investment motives	153
4. Issuing houses for shares of small companies	157
5. Survey of the secondary market	159
II. Exchange segments	162
1. The traditional-official-market segment for small company shares	162
a) Listing	163
b) Trading	165
2. The parallelmarkt for officially listed securities	167
a) Listing	168
b) Trading	171
3. The parallelmarkt for officially not listed securities	173

	<u>Page</u>
III. Summary	176
E. The segments of the secondary market for equity instruments of small companies in the Federal Republic of Germany	183
I. Environment and survey	183
1. Number and forms of business organizations	183
2. Frequently used instruments for equity financing	186
3. Investors and investment motives	188
4. Issuing houses for the shares of small companies	190
5. Survey of the secondary market	194
II. Exchange segments	200
1. Official trading at one collective price only	200
a) Listing	200
b) Trading	206
2. Geregelter Freiverkehr	211
a) Requirements for entry	213
b) Trading	216
3. Ungeregelter Freiverkehr	219
4. Off-exchange segments	222
a) The over the counter market in the shares of public limited companies	222
b) Transactions in the equity instruments of other businesses	224
III. Summary, recent proposals and developments	225
F. The segments of the secondary market for equity instruments of small companies in the Grand Duchy of Luxembourg	235
I. Environment and survey	235
1. Number and forms of business organizations	235
2. Frequently used instruments for equity financing	239
3. Investors and investment motives	240
4. Issuing houses for shares of small companies	243
5. Survey of the secondary market	245
II. Exchange segments	248

	<u>Page</u>
1. The official-market segment	248
a) Listing	248
b) Training	248
2. Ventés publiques	255
a) Admission	255
b) Trading	256
 III. Off-exchange trading	 257
 VI. Summary	 258
 G. The segments of the secondary market for equity instruments of small companies in Belgium	 261
I. Environment and survey	261
1. Number and forms of business organizations	261
2. Frequently used instruments for equity financing	265
3. Investors and investment motives	267
4. Issuing houses for shares of small companies	269
5. Survey of the secondary market	272
 II. Exchange segments	 279
1. The traditional stock exchange market for small company shares	 279
a) Listing	280
1) Prospectus	281
2) Admission requirements	282
b) Trading	283
2. The auctions of unlisted securities	286
a) The daily auctions	286
b) The monthly or weekly auctions	286
1) Requirements for entry	287
2) Trading	288
 III. Reform proposals	 289
 IV. Summary	 292

	<u>Page</u>
H. The segments of the secondary market for equity instruments of small companies in France	299
I. Environment and survey	299
1. Number and forms of business organizations	299
2. Frequently used instruments for equity financing	301
3. Investors and investment motives	304
4. Issuing houses for shares of small companies	310
4. Survey of the secondary market	313
II. Exchange segments	317
1. The traditional official market segment for small company shares	317
a) Listing of shares	317
b) Trading	320
2. The "second marché"	322
a) Listing requirements	324
b) Trading	325
3. The "Hors cote" market	328
III. Summary	330
J. The segments of the secondary market for equity instruments of small companies in Italy	342
I. Environment and survey	342
1. Number and forms of business organizations	342
2. Frequently used instruments for equity financing	346
3. Investors and investment motives	349
4. Issuing houses for shares of small companies	354
5. Survey of the secondary market	359
II. Exchange segments	364
1. The Borsa Valori market as a segment for small company shares	364
a) Listing	364
b) Trading	369
2. The Mercato Ristretto	372
a) Listing	374
b) Trading	375

	<u>Page</u>
III. Off-exchange segments	377
1. Off-exchange trading in listed shares	377
2. The terzo mercato	378
IV. Summary	379
K. The segments of the secondary market for equity instruments of small companies in Greece	392
I. Environment and survey	392
1. Number and forms of business organizations	392
2. Frequently used instruments for equity financing	393
3. Investors and investment motives	394
4. Issuing houses for shares of small companies	396
5. Survey of the secondary market	400
II. Exchange segments	401
1. The listed securities market as a segment for small company shares	401
a) Listing	402
b) Trading	405
III. Summary	408

PART 3

Factors facilitating or impeding securities market equity financing of small industrial companies	419
A. Forms of business organization acceptable for secondary markets	421
Summary and recommendations	429
B. Frequently used instruments for equity financing	431
Summary and recommendations	439
C. Investor, investment motives and investment restrictions	440
Summary and recommendations	446

	<u>Page</u>
D. Issuing houses and availability of investment banking services	448
Summary and recommendations	459
E. Secondary markets for small company equity instruments	462
I. Market features desirable for the equity financing of small companies	462
II. Market segments needed for small company equity instruments	464
III. Listing requirements	468
1. Sponsorship	468
2. Dimensions of the class of securities to be listed	471
3. Disclosure	478
a) General background	478
b) Bottom level segments for small companies	482
c) Advanced level segments for small companies	487
4. Costs of listing	490
IV. Trading and trading incentives	498
1. General background	498
2. Improving the quality of prices of small company equity instruments	499
3. Facilitating transactions in small company equity instruments	510
Summary and recommendations	516
References	525
1. Experts consulted	526
2. Monographs	530
3. Articles in periodicals	535
a) Signed articles	535
b) unsigned articles	545
4. Other sources	546

LIST OF TABLES

	<u>Page</u>
Core requirements for access to advanced level small company segments	XXXIX
Core requirements for access to bottom level small company segments	XL
Number of registered firms in the United Kingdom at December 31, 1982	36
Number of Irish companies having a share capital	90
Average nominal share capital of companies in Ireland	90
Number of Irish companies registered with a share capital during the years 1978, 1980 and 1981 classified according to the amount of their nominal share capital	91
Number and forms of business organizations in Denmark at December 31, 1980	120
Equities on the Copenhagen Stock Exchange by segment at the end of 1982	130
Number and forms of business organizations in the Netherlands as of January 1, 1983	150
Number and forms of business organizations in the Federal Republic of Germany	183
Number of quoted operating domestic German companies by segment and by financial center at December 31, 1981	198
Number of Luxembourg commercial companies	236
Average capital of limited liability companies in Luxembourg	236
Public share issues of Luxembourg stock companies	243
Share listed on the Luxembourg Stock Exchange	246
Formation and dissolution of Belgian companies	263
The public issue of securities in Belgium	270
Monthly and weekly auctions volume in Belgium	287
Number and forms of business organizations in France	300
The issue of securities in France	311

	<u>Page</u>
New share issues of companies traded on the "hors cote" market	329
Number and forms of business organizations in Italy at the end of 1981	343
Number of companies listed on the Athens Stock Exchange according to number of employees as of December 31, 1982	401
Admissable form of business organization and case of conversion	425
Use of instruments with limited voting rights	436
Small company investment	444
Small company investment banking	452
Listing requirements and trading characteristics according to small company trading segments in the EC Member States	473
Flotation costs of first public offerings in the United States 1968 - 1981	497

EXECUTIVE SUMMARY *

* This summary has previously been published in the Working Document for the EC-Symposium "Developing capital markets for the regeneration of industry", Luxembourg, November 23-25, 1983, pp. 69-98.

TABLE OF CONTENTS OF EXECUTIVE SUMMARY

	<u>Page</u>
Importance of small company equity financing for the economy	XX
Earlier views on secondary markets	XXII
Special European stock market segments for small company equity instruments	XXIII
The case for bottom level segments	XXVI
Requirements for access to small company segments of the secondary market	XXX
Disclosure requirements	XXXI
Forms of business organizations acceptable for listing	XXXII
Equity instruments acceptable for listing	XXXIII
Dimensions of the class of securities to be listed	XXXIV
Costs of going public	XXXV
Survey of core requirements for access to small company segments of secondary markets in the Member States	XXXVII
Availability of investment banking services to small companies	XLI
Investors and investments restrictions	XLII
Trading small company equity instruments	XLIV

.

IMPORTANCE OF SMALL COMPANY EQUITY FINANCING FOR THE
ECONOMY

1. Small companies enhance innovation and competition, they increase the resilience of the economy and the variety of employment opportunities. As various studies have shown, the share that small companies contribute to newly created jobs is much higher than the share of small companies in total employment. Yet the entrepreneur trying to establish a small company faces hurdles, which he is at a disadvantage to overcome compared to the larger company engaged in various lines of business. In particular, he faces the task of raising the capital required for the early years during which the capacity for scheduled debt service is rather limited. Thus, the source of funds to be relied on is the increase in equity capital. As the Piatier Study has shown, insufficient equity financing is the main barrier to innovation and growth in Europe.

2. Because of their important contributions to employment growth and to innovation small companies have been given special support in most Member States. There are various direct and indirect ways to strengthen the equity position of small firms. Direct ways include equity injections by subsidies and by participations of development companies. Indirect ways facilitate equity financing by government guarantees and tax concessions. This study foccusses on a different indirect approach that is standard practice with large firms. This indirect approach is providing special organized secondary markets for shares and other equity instruments in order to increase the availability of equity capital to small innovative companies.

3. Small company secondary markets in the Member States of the European Community are the focal point of this study. The principle question of the study is:

Do secondary markets respond to the needs of small growing innovative companies wishing to raise equity capital?

Or, stated differently:

What are the factors inhibiting the access of small growing companies to secondary markets?

4. Equity capital will not be forthcoming unless the investor has some way out of his investment at reasonable prices. Basically, there are four such exit routes. First, the shares may be sold to a company in the same or in a related line of business. This is the major exit route though most undesirable from a competition policy point of view. Second, the issuing company may buy back or redeem the shares, which a growing company is usually unable to do. Third, the investor may sell his shares to a party not mentioned above with little or no assistance by financial institutions, which amounts to giving the shares away below value. Fourth, there is the only realistic and desirable exit route: organized secondary markets.

5. It is well known that external equity financing of large firms owes much of its success to the fact that shares or other junior securities can at any time be sold on the stock exchange or on another secondary market. The primary market (or new issues market) therefore presupposes the existence of a secondary market.

EARLIER VIEWS ON SECONDARY MARKETS

6. It is not entirely clear why this indirect method has long been neglected and only sporadically examined for small company financing. One important reason for this is a widespread notion of the sixties and seventies that stock exchanges must be organized on one standard model. This model requires uniformly high disclosure and a homogeneous trading system, which is transparent to supervisory authorities and investors. This idealized picture of a highly safeguarded homogeneous secondary market clouds the opportunities for external equity financing of small firms. Fortunately, it is at variance with actual facts.

7. As documented in an extensive report that the author submitted to the Commission in 1977, neither the stock exchanges nor the off-exchange secondary markets have a homogeneous structure. They rather comprise different market segments. This situation is desirable. As elsewhere in industry, procedures for mass production differ from those used for small batch production. There are shares that are dealt in hundreds of times a day and others that only trade few times a week. Accordingly, trading methods geared to these different turnover characteristics should be used, not one standardized trading procedure. Similarly, since turnover characteristics are closely linked to the number of holders of a stock, disclosure requirements should be differentiated and less demanding for inactive stocks.

8. This principle of vertical segmentation was stressed in the 1977 report. The report pleaded for a stock market policy that gives adequate scope for appro-

priate vertical segmentation. Vertical segmentation enhances procedural efficiency. The author recommended four vertical segments for each national stock market, two segments for less actively traded small companies and two upper segments. In countries without very large companies one upper segment suffices.

SPECIAL EUROPEAN STOCK MARKET SEGMENTS FOR SMALL COMPANY EQUITY INSTRUMENTS

9. In recent years widespread and successful efforts have been made to create and to restructure stock market segments for companies of small and medium size. The probably best known junior stock markets are the unlisted securities market in the United Kingdom and Ireland, the parallelmarkt in Amsterdam, the French second marché and the share market III in Copenhagen. However, there have been other important developments. In Italy a court ruled a long established lower market segment illegal in 1975, but this attempt at homogenizing the Italian stock markets failed and in 1978 a new mercato ristretto was established. In addition, the terzo mercato developed as the third secondary market segment below the mercato ristretto. In the United Kingdom an over-the-counter market that focusses on small companies and dates back to the early seventies gained momentum as more securities firms entered this market. In Germany the two lower stock market segments (geregelter Freiverkehr, ungeregelter Freiverkehr) were rediscovered as secondary markets for unlisted small young companies going public; more recently, plans for a second official market are being discussed. In Belgium,

there are plans to reorganize the daily auctions of unlisted securities, a market segment instituted in the sixties that uses the trading procedure of the official spot market. This reform proposal aims at creating a market geared to the needs of small companies. In Greece a new semi-official market for small company shares is being considered. All these new markets are expected to become operative in 1984.

10. To a superficial observer all these developments may appear consistent and aimed at facilitating access to the secondary market for small and medium sized companies. Penetrating analysis, however, reveals pronounced differences from country to country. There are three different groups of reorganizations. The first comprises the unlisted securities market, the second marché and the proposed second official market in Germany. In the countries concerned stock exchange facilities for small unlisted companies have been available for many years and, in principle, these facilities remain unaffected by the reforms (occasional bargains facility, hors cote market, Freiverkehr). But for various reasons, these facilities do not seem to provide the appropriate trading environment for those small and medium sized companies that have attained some stature. Unfortunately, requirements for access to the listed securities market appear to be onerous and too ambitious for these companies. Thus, special intermediate market segments have been designed for companies that can pass a threshold of quality that is advanced though still below the threshold of full listing.

11. By contrast, attempts at reform in Belgium and Greece focus on the lowest segment in stock market

hierarchy. In Greece a bottom level segment will be organized for the first time. In Belgium upgrading the bottom level segments and encouragement of its use seem to be the central issues.

12. The third group comprises Denmark, the Netherlands and, less clearly, Italy. These countries traditionally enjoyed an unofficial market that was accessible to small company shares (inofficial efterbørs, incurante markt, old mercato ristretto). The traditional lower level segment was split up into two segments. As a result, an advanced level segment and a bottom level segment were created. This step was most pronounced in Amsterdam, where the incurante markt was split into the official parallelmarkt and the unofficial parallelmarkt. In Italy and Denmark the new regimes developed over an extended period. Quite appropriately, the final reorganization step in Denmark involved all market segments in order to bring about a convincingly segmented stock market.

13. Obviously, the advanced level segment of the secondary market and bottom level segments aim at different kinds of companies. Accordingly, entry requirements and other segment features will have to be different and geared to the kind of company that the segment is supposed to serve. No less than two clearly different market segments should be open to small companies. Most small companies have been in business for some years and achieved profitability before they apply for entry to the secondary market. They prefer to signal that they can pass some standard threshold of quality and they should be able to do so by entering the market at the second lowest segment. The lowest segment caters to young and high-risk companies that cannot meet this standard.

14. In some Member States much more than in others, there is a need to increase the general acceptance of a bottom level segment and to encourage its use. No stock exchange or association of securities firms should enjoy the monopoly of a national market organizer unless it operates a special segment for young and high-risk companies.

15. If a stock exchange chooses not to offer special segments for small company shares, this decision should be respected. Securities market regulation should permit other market organizers to provide secondary market services to companies which have a form of business organization or other quality characteristics that make them unacceptable to the stock exchange.

THE CASE FOR BOTTOM LEVEL SEGMENTS

16. The recently gained acceptance for formerly unofficial secondary markets and for new advanced level segments is most desirable. Unfortunately, this acceptance frequently does not extend down to the bottom level of stock market hierarchy. Any emphasis on bottom level segments tends to be met with scepticism or even with outright opposition.

17. Many hold the position that bottom level segments are highly undesirable. They believe in the principle that any investment vehicle available to the public should be reasonably safe and stable. High-risk investments, it is thought, should not be readily accessible to the public. Thus, any companies that do not pass a standard threshold of quality should not

obtain funds from public investors, and existing bottom level segments should be upgraded in order to firmly establish this standard.

18. This quality control doctrine and the principle of vertical segmentation agree on the need to provide the public with highly safeguarded investment opportunities such as bank deposits, government bonds and high quality stocks. Contrary to the traditional doctrine, vertical segmentation advocates no minimum quality requirements beyond adequate disclosure. There are four reasons for this:

- Individual and institutional investors in today's securities markets and their advisers predominantly seem to be well aware of the risk and return characteristics of available investments. A proper vertical segmentation will contribute to this awareness if the higher riskiness of lower segment stocks is made clear to the investing public. Beyond adequate disclosure requirements, any restrictions on the public availability of small company shares are unlikely to benefit any number of investors to speak of.
- Diversification strategies now are widely followed by investors. The risk of a particular small company share may appear unacceptably high if one looks at it individually. In spite of this, the share may well be most desirable in a portfolio context. Any regulatory restrictions based on business risk characteristics of individual companies are misguided.

- Even the average individual investor has ready access to a wide range of domestic and foreign¹⁾ high risk investment vehicles. As it is obvious in the case of options, the invested amount frequently will be completely lost. Against this background any regulatory efforts to restrict the investment in the shares of small domestic companies appear arbitrary.
- The riskiness of small company shares is not artificially created. It reflects the innovativeness of the firm and other business characteristics. For employment and other economic reasons it is desirable to take advantage of the growth of independent small firms which assume these risks. This requires external equity financing. In contrast with former years of high employment, restrictions on small company equity financing are likely to carry a much higher economic cost.

19. Others maintain that bottom level segments are not at all necessary for the equity financing of young and innovative small firms. Small and high-risk companies, it is claimed, should gradually establish an institutional shareholder base and should not go public before their high-risk characteristics fade. This opinion implies that there should be no secondary market for small and high-risk companies and that these companies should raise their equity privately.

20. However, many an entrepreneur strongly resents the high level of outside influence that comes with private capital raising and prefers public equity

1) Save investors in countries that have imposed exchange controls,

issues to a wide spread of shareholders at an early stage in the development of his company. This is not unrealistic. In the United States and, to some extent in the United Kingdom, public issues of small young companies have been brought to the market.

21. Prior to trading on an efficient secondary market a reliable valuation of long-term equity instruments with full upside potential is not available. This adds to the well known reluctance of small companies to accept outside shareholders and considerably complicates external financing as witnessed by the use of temporary external equity financing instruments. To eliminate this impediment, small companies should have access to a secondary market at an early stage in their development.

22. Raising equity capital publicly at an early stage of the development of an innovative enterprise and subsequent trading of the shares on a bottom level market segment is an alternative and a useful supplement to financing privately. However, it should not be construed as being the superior approach. It simply opens up an additional choice to young companies. Even where this choice is available many unseasoned enterprises may prefer to place a minority interest with venture capitalists, development companies or with other institutional investors. These enterprises appreciate the ready access to expertise and guidance, the opportunity to build an institutional shareholder base before going public, and they want to avoid the exposure to conflicting views that may develop among public shareholders during the difficult years of early development. Nonetheless, going public is the more encompassing approach.

23. The resultant secondary markets are most desirable and benefit even companies that have yet to go public. The prices established in these markets facilitate the fair valuation of equity instruments which are to be used in private placements. Moreover, investors accepting minority interests in unquoted companies are well aware that the most profitable exit route is the public sale of their interest in a secondary market. Exit via a larger industrial company usually requires a majority interest. The existence of easily accessible bottom level segments assures participants in private financings that a secondary market could also be established for the shares in which they invest. The public issue of shares of small and high-risk companies is a very desirable component of any equity financing system and should be fostered.

REQUIREMENTS FOR ACCESS TO SMALL COMPANY SEGMENTS OF
THE SECONDARY MARKET

24. It is widely accepted that the initial and continuing requirements which traditionally have been applied or are about to be applied to listing on official markets are onerous for small companies. However, there is little agreement which requirements should be lowered and to what extent. Though it was attempted to cover all relevant requirements in the country reports, the encompassing analysis was limited to disclosure, to the form of business organization required for entry, to financial instruments acceptable for admission, to dimensions of the issue to be listed and to services giving rise to initial listing

costs. The results will be presented below.

Disclosure requirements

25. Corporate disclosure is to facilitate the valuation of capital raising instruments and it should correspond to the requirements of valuation models used by proficient investors and analysts. Many unresolved issues surround disclosure. Accordingly, divergent requirements are found in the Member States even if only secondary market segments of the same level are entered into comparison. The spectrum of disclosure requirements for small public companies extends beyond that for large companies. In some countries disclosure beyond the basic legal requirements is voluntary, in others more extensive or more frequent reporting is required than for large companies.

26. Since disclosure should not be a handicap to small companies, the cost of disclosure should not exceed what disclosure is worth to investors and the company. A broad brush approach is not likely to meet this criterion. Overshooting disclosure requirements burden small companies much more per capital unit raised than large companies. Any undershooting, however, can be easily corrected by voluntary disclosure or by discretionary requests for information by stock exchanges or other market organizers.

27. At the bottom level segment, disclosure requirements should not impose a minimum age on the companies desiring entry. Because the bottom level segment serves capital raising companies and non-capital

raising companies having small numbers of investors, entry should as a matter of principle not give rise to mandatory disclosure beyond what is generally required by law.

28. On the advanced level segment for small companies the additional disclosure requirements should be moderate and geared to the level of entry the market organizer aims at. A prospectus and interim reports should be required, but it should largely be up to the company to decide what information it discloses.

29. Relative to the size of the issue the cost of a prospectus is much more burdensome for small issues than for large. This cost can be avoided and an incentive for the continuing information of investors is provided if the principle is adopted that a company should not be required to disclose information which is already public. As a minimum, this should hold for either small company segment. A company that published a prospectus as required for a small company segment or that voluntarily provided this information and that since has met continuing information requirements must not be required to publish a prospectus when it brings a new issue to this market segment.

Forms of business organizations acceptable for listing

30. The public limited company is the form of business organization exclusively acceptable for stock exchange listing in most Member States. It is not designed for small companies, but many small companies approaching flotation of their shares have sufficiently grown and

are ready to convert to this most perfected form, which adds to the protection of shareholders. Efforts should continue to increase the ease of conversion and to eliminate any taxes that now reduce the attractiveness of conversion to public limited company form, in particular all taxes on conversion-implied transfers of company assets.

31. Small limited partnerships and small private limited companies not yet ready to convert to the desirable public limited company form nonetheless should be able to gain access for their shares to a special stock exchange segment or to another organized secondary market. Restricting the public availability of the shares of these enterprises is not justified in today's investment environment and may carry a high economic cost. Stock exchanges or other market organizers can be expected to ensure by way of their listing requirements adequate disclosure and other essential investor protection measures.

Equity instruments acceptable for listing

32. The desire to win independence is an important motive for becoming an entrepreneur. Most Member States respect this desire for independence and permit nonvoting shares, shares with contingent voting rights or other equity instruments that grant less outside influence on management than shares with full voting rights. To facilitate external equity financing and to enhance growth, all Member States should permit the use of these instruments.

33. In addition to accepted national instruments of this kind, which have divergent features, a common European participating certificate can be expected to stimulate external equity financing. It should carry no voting rights. Like debt instruments, its use would not depend on a specific form of business organization. Restrictions on its use relative to other equity instruments seem not to be necessary. For corporate tax purposes, payments to holders of these certificates should be a deductible expense.

Dimensions of the class of securities to be listed

34. Listing requirements tend to define the class of securities to be listed in terms of total value of the class to be listed, in terms of a percentage that must be available to the public and in terms of a minimum amount to be held by the public. Though related, these requirements aim at different aspects that are relevant for delineating secondary market segments.

35. The minimum amount to be publicly held and the related factors that it implies calibrate the quality of transaction service of the market segment, whereas the percentage requirement is an important factor determining the weight that outside investors will be given in company matters. Thus, it is desirable that markedly distinct values and percentages are used to define the various segments. The widespread use of 25% for the (lowest) official segment, which is in line with the Admission Directive, and of 10% for advanced small company segments seem to be well chosen. The minimum amount to be held by the public is more

difficult to establish for the advanced company segment. Since, contrary to variations at a somewhat higher level, realistic variations of this value below ECU 1 mio are not likely to noticeably impact transaction service quality, the minimum amount to be publicly held may be set at ECU 1 mio.

36. In line with tradition and widespread use, entrants to the bottom level segment should not have to meet any of these requirements. This segment caters to companies that go public with issues just above the economically meaningful minimum size. Depending on the costs of public issue, which slightly differ from country to country, this minimum is close to ECU 0.5 mio or clearly below. Some companies that in principle are prepared to float a larger issue strongly prefer a first public offering merely having economic minimum size and involving only a few percent of capital. The bottom level market should be allowed to play its role in accommodating such companies. Opportunity losses to the entrepreneur that result from underpricing may well impede first public equity financing on all other segments of the secondary market.

Costs of going public

37. The cost of underpricing, which is witnessed by oversubscriptions, appears to be the most important cost of going public. It is the opportunity loss to the entrepreneur that results from selling the issue at a fixed price set intentionally or unintentionally below market price. Underpricing cost may be kept low by competition among investment bankers and, as pointed out above, by initially offering only a small percentage of the class of equity instruments that is used

in going public. Alternatively, underpricing can be avoided by straight tender offers or calibrated by discretionary tender offers to the preferences of the entrepreneur as to outside influence, marketability and shareholder relations.

38. Since underpricing of new technology based firms exceeded 30% or even 50% of market value in a number of cases it is likely to have a highly undesirable impact on the attractiveness of entrepreneurship. Thus, the more frequent use of offers by tender is very important. Unfortunately, investment bankers resist it for obvious reasons. To encourage the use of tender methods and their equivalents it is recommended to exempt from the issue tax up to ECU 1 mio of equity instruments of any company that makes its first public offer of equity instruments by tender. Where tender methods are widely used, the exemption should nonetheless be available, since the issue tax discriminates against small high-risk enterprises.

39. Other costs of going public comprise of the costs of time and effort incurred at the company and expenses actually paid for services rendered. No information has been found that would point toward an unacceptably high level of these costs in any Member State. However, these costs burden small companies more than large ones per unit of equity raised. Since this may impede equity financing and growth of small companies, it is desirable to encourage attempts to reduce these costs. This can be achieved in two ways. First, competition is likely to lower the prices of relevant services. This approach seems to be appropriate for investment banking and related services. Second, listing requirements that do not

yield a net benefit to the issuing company should be abolished. Two requirements warrant special mentioning.

40. The limited size of small company issues generally does not require extensive selling efforts. Mandating publication of disclosure and selling documents in the national press and demanding wide distribution of a printed prospectus are likely to be overshooting dissemination requirements. It is recommended to abolish all dissemination requirements. An issuing company will always be eager to disseminate selling and disclosure documents to an extent beneficial to the company. Thus, there is no need to mandate dissemination. However, to foster efficiency of this process it appears useful that market organizers recommend a number of standardized dissemination procedures.

41. Another important item in countries where bearer securities are used are printing requirements and the resultant costs. Companies should have a choice to have certificates printed in denominations that traditionally have been required or to only make available to depositories the minimum number required by law, which implies that certificates will not be available to investors.

Survey of core requirements for access to small company segments of secondary markets in the Member States

42. The tables below summarize the core requirements for access to the advanced level segment and to the bottom level segment as set forth in the country reports and as recommended above. In some areas it is

recommended not to impose requirements. Many may fear that this void will lead to highly undesirable situations. However, in the sensitive areas of disclosure and corporate opportunity a vacuum is highly unlikely. General legal requirements are applicable. In addition, recommendations of market organizers and agreements between issuers and their investment bankers are likely to contribute to an appropriate balance of the interests of all market participants at the time of issue and thereafter.

43. Not all small company segments were entered into these tables. Among those not included is the pioneering advanced level segment organized by M.J.H. Nightingale & Co. (now Granville) in London. It should also be mentioned that in some countries many small companies are traded on the official secondary market segment one level above the advanced level segments. For example, the 974 listed shares of United Kingdom companies that do not belong to the 1000 largest had an average market value of £ 2 mio at the end of 1982. By contrast, the average market value of the 135 companies traded on the unlisted securities market at the end of 1982 was £ 9 mio. However, these official market segments are clearly not favoured by young companies going public. The preference for junior stock market segments is rooted in the less demanding access requirements, in the lower threshold of quality that these requirements imply and in the novelty and growth company image that some of the new markets convey on their companies. Nonetheless, as experience has shown, if at a later time the status of a mature company is achieved, the corresponding stock market status tends to be sought by applying for a full listing.

Core requirements for access to advanced level small company segments

Segment (country)	Minimum amount to be held by the public in mio of local currency	Minimum percentage of stock to be held by the public	Use of flotation methods that tend to avoid underpricing	Press advertisement of prospectus	Interim reports	Standard minimum age of company in years	Accessible only to public companies
Unlisted securities market (United Kingdom and Ireland)	not required	10%	rare	one or two box advertisements required	required	3	yes
Aktiemarked II (Denmark)	2.5	15%	required	one or two box ads. req.	voluntary	1	yes
Official parallelmarkt (Netherlands)	0.25	10%	no	box advertisement required	required	0	no
Geregelter Freiverkehr (Germany)	not required	not required	no	voluntary, prospectus not required	voluntary	1	yes
Official market (Luxembourg)	50	not required	no	voluntary	required	3	yes
Parquetmarkt (Belgium)	not required	not required	no	voluntary	voluntary	5	yes
Second marché (France)	2-4 ¹⁾	10%	attempted	voluntary, prospectus not required	required	0	yes
Mercato ristretto (Italy)	200 ³⁾	20%	no	full prospectus	voluntary	2 ²⁾	yes
Official market (Greece)	25 ³⁾	not applicable	no	voluntary	required	3 ²⁾	yes
Recommended	ECU 1 mio	10%	incentive for use recommended	voluntary	required	3	yes

1) Tentative and preliminary.

2) Profits must have been reported for the latest two or three financial years respectively.

3) Calculated on the basis of related requirements.

Core requirements for access to bottom level small company segments

Segment (country)	Minimum amount to be held by the public in mio of local currency	Minimum percent- age of stock to be held by the public	Use of flotation methods that tend to avoid underpricing	Press advertise- ment of pro- spectus	Interim reports	Standard mini- mum age of com- pany in years	Accessible only to pub- lic companies
Broker-dealer OTC (United Kingdom)	not re- quired	not re- quired	no	voluntary	volun- tary	1	yes
Occasional bargains facility (Ireland)	not re- quired	not re- quired	not appli- cable	not appli- cable	volun- tary	1	no
Aktiemarked III (Denmark)	1	15%	required	one or two box ads. req.	volun- tary	1	yes
Non-official parallelmarkt (Netherlands)	not re- quired	not re- quired	no	voluntary, pro- spectus not re- quired	volun- tary	o	no
Ungeregelter Freiverkehr (Germany)	not re- quired	not re- quired	no	voluntary, pro- spectus not re- quired	volun- tary	o	yes
Off-exchange trading (Luxembourg)	not re- quired	not re- quired	no	voluntary	volun- tary	o	yes
Ventes publiques (Belgium)	not re- quired	not re- quired	not appli- cable	not appli- cable	volun- tary	o	yes
Marché hors cote (France)	not re- quired	not re- quired	no	voluntary, pro- spectus not re- quired	volun- tary	o	yes
Terzo mercato (Italy)	not re- quired	not re- quired	no	voluntary, pro- spectus not re- quired	volun- tary	o	yes
Recommended	not re- quired	not re- quired	incentive for use recommend- ed	voluntary, pro- spectus not re- quired	volun- tary	o	no

AVAILABILITY OF INVESTMENT BANKING SERVICES TO SMALL
COMPANIES

44. Even perfectly organized special secondary market segments will not benefit small innovative companies if they cannot find an investment banking firm that brings them to the market. Unfortunately, the country reports have shown that investment banking services to small companies that desire to go public are not always available though most established investment bankers are in principle inclined to provide these services. Since high risk implies failure as a likely outcome and since failure of a company, because of ingrained faulty thinking, tarnishes the reputation of the investment bank which brought it to the market, established investment bankers prefer to guard their reputation and credibility. Providing three or four vertical market segments and stressing the high-risk character of companies assigned to the bottom level segment may be one set of measures to increase the involvement of established investment bankers in small company public issues.

45. The successful investment banking activities of firms from outside the mainstream of traditional investment banking, which have been observed in some countries, point to another important set of measures. To avoid gaps in investment banking service to small high-risk companies and to foster competition in investment banking, ease of entry to investment banking and to related financial services should be assured in all Member States. A licensed dealer status, as it is currently known in the United Kingdom, should be made available in all Member States. Since these

licensed dealers are designed to compete, they should be permitted to operate outside the banking and the exchange system if they choose to do so.

46. The licensing and supervision should rest with an agency other than the supervisor of banks. The regulation of these licensed dealers should be concerned with the safety and integrity of their operations, not with the safety of the instruments they offer. Any minimum disclosure requirements must not give rise to costs that render it uneconomical for small companies to go public. As in the United States, mandated disclosure at the time of issuance should be scaled as to the size of the company, the amount to be raised and the kind of investors involved.

INVESTORS AND INVESTMENT RESTRICTIONS

47. The number of investors and the volume of their funds committed to equities are most important determinants of the degree of sophistication, competitiveness and depth of an equity capital market. These qualities are essential for new technology based firms that want to raise equity capital publicly or privately. Unfortunately, only in few Member States these qualities are sufficiently developed. Regulatory restrictions contribute to this.

48. In most Member States equity investment of certain institutional investors in unlisted and, less frequently, in listed securities is subject to regulatory discouragement or even to outright prohibition. Restrictions on investments in unlisted and unquoted

equities are a regulatory quality control that tends to discriminate against small companies. First, it unfavourably affects the competitiveness of the small company segment markets. Second, the restrictions withhold the benefits of the privileged tax status of investment funds, insurance companies and pension funds from small companies. To encourage the involvement of institutions in all segments of the securities market these restrictions should be abolished.

49. Similar and even more stringent restrictions exist in most Member States on the purchase of foreign shares. These restrictions should also be abolished. Due to the limited number of domestically traded shares, desirable diversification effects may only be attainable if domestic and foreign shares are held. Thus, the restrictions may depress domestic share prices and impede domestic equity financing. The involvement of proficient domestic investors in foreign markets is likely to contribute to a competitive valuation of domestic stocks also because it increases the familiarity with international valuation standards that foreigners are at a disadvantage to apply, particularly to small domestic company equities.

50. To limit the power of financial institutions legislators or regulators have placed ceilings on the interest that certain institutional investors may hold in a company. A widely used ceiling is 5 % of the shares. A 5% or even a 15% stake in a small company cannot be expected to yield an adequate return if the costs of valuation, monitoring and management are taken into account. To foster a competitive environment for small company equity financing, percentage ceilings on the stake in a company should not apply for investments of ECU 1 mio or less.

51. The attractiveness of equity investment relative to investment in government bonds and real estate seems to be unfavourably affected by differences in tax treatment. Tax measures of some Member States designed to counter this imbalance testify to the need for strengthening the investor base by reducing the fiscal bias against equity investment.

TRADING SMALL COMPANY EQUITY INSTRUMENTS

52. Trading procedures are designed to facilitate transactions directly and indirectly by lowering transaction costs, which include a number of complex component costs. The reduction of these costs serves to close the gap between the prices at which it is economical to sell and the prices at which it is economical to buy. In other words, the buyer can afford a higher and the seller a lower price compared to a situation without an organized secondary market. This effect, which is at the heart of stock exchanges' attractiveness, rests on continuing trading of securities after their issue. Continuing trading has led to procedurally efficient execution and settlement systems. Similarly, the continuing trading encourages certain transactors to engage in continuing investment research on a limited number of securities and to try to cover the costs of this activity by short term trading profits or by selling advice. Either way a certain balance of marketability and price quality is likely to develop and the information and valuation costs, which in case of small company shares are incurred only by a small number of proficient investors, tend to be spread over all transactors. In this process, a

much higher price volatility is to be expected with small company stocks than with large issues.

53. The trading procedures actually used for small company equity instruments in the Member States permit execution of investors' orders at adequately low commissions. It should be assured that all company equities can be entered into national clearing and settlement systems. To encourage the involvement of investors who engage in investment research and for other reasons the trading procedures used on small company segments should allow for transactions at any time during trading hours. Unfortunately, this approach is not followed by some stock exchanges. Restricting investors' trading opportunities to once or twice a week is not recommended. It inhibits the development of a self balancing market.

54. Trading procedures, whether based on the auction principle, the market maker principle or on both, do have some impact on price quality. However, price quality is mainly determined not by the trading procedure used but rather by the basic marketability of the stock. Marketability determines one important component of transaction costs and depends on the volume held by the public and by the resultant turnover characteristics of the stock. Since the volume of small company public issues is low, their price quality will be rather low most of the time. The reliability of stock prices is a crucial factor in the financing decisions of the entrepreneur and in the attractiveness to investors. Thus, it is most important to improve marketability if organized secondary markets for equity instruments of small, young innovative firms are to work.

55. The only way to achieve this is to increase the turnover in small company stocks. One measure to that effect is to further reduce transaction related costs. It is recommended to exempt transactions in small company equity instruments from all incidental indirect taxes. A second way is to motivate to trade by the prospect of undiminished capital gain those who think that a stock is undervalued or overvalued. It is further recommended, therefore, to exempt from individual and corporate income tax all capital gains on small company equity instruments. For the purpose of these exemptions a small company should be defined by a market value of equity not exceeding ECU 25 mio and by an age of less than 10 years.

56. For banks, brokers and for various proficient investors that now have to pay tax on such income it would become interesting to engage in small company investment research and to trade for long-term or, preferably, for short-term profit. This would be one source of enhanced marketability and price quality. The second source is an increase of the volume of small company equities publicly held. Because the exemption covers capital gains by the entrepreneur, it is likely that a larger portion of company equities will be publicly issued during the early years. Thirdly, the tax exemptions, if implemented, will give a certain prominence and publicity to small company equities. Beyond the desired impact on marketability all this also would add to the attractiveness of entrepreneurship: of contributing to growth and employment.

57. Conflicting opinions have been voiced as to the location of small company shares trading. One opinion holds that trading these shares should be the task of regional exchanges. Trading small companies in the core area of their activity is believed to stimulate the interest of business associates, of employees and of other persons with a close knowledge of the company. Attracting far away investors is thought to require more disclosure and selling efforts than a small company can afford. In marked contrast, others have suggested to establish one centrally located European secondary market for new technology based firms. This would focus investor interest on these future oriented companies and facilitate setting up well diversified small company portfolios.

58. Neither proposal is realistic. The number of small public new technology based firms and the pace at which additional firms go public make it highly unlikely that these firms will sustain, in regional capitals or even in a new financial center in the heartlands of Europe, sufficient numbers of scientific and engineering oriented expert analysts and a special separate secondary market organization. Fortunately, adequate investment research and trading facilities are available for large company investment and can be used or adapted to small company needs. Small technology based firms stand the best chance for a fair and competitive valuation if they enlist investment banking and trading services at financial centers where a very large volume of investment business generates the expertise they require. Only in these centers of expertise a quality service can be rendered to new technology based firms with a limited incremental effort and at acceptable costs.

59. Since only a few European financial centers seem equipped to appropriately service new technology based firms, the access to these centers should be facilitated. Thus, it is recommended to foster the European wide activity of investment bankers and of other firms in the securities business. In addition, a European innovation finance journal aiming at growth companies and at would-be entrepreneurs could be an effective way of spreading and improving the knowledge of successful approaches to equity financing, of sources of capital and of competent intermediaries at home and abroad. It also could be an excellent forum to champion the cause of innovative enterprise and to case by case give public recognition to the achievements and contributions of entrepreneurs who went public. Broad public acceptance of entrepreneurship and the example of successful entrepreneurs going public will assure more than any other remedy that special market segments for small company shares will actually perform the economic function for which they were skillfully designed.

P a r t 1

THE IMPORTANCE OF SECONDARY MARKETS IN EXTERNAL EQUITY
FINANCING OF SMALL FIRMS

A. IMPORTANCE OF EQUITY FINANCING OF SMALL FIRMS FOR
THE ECONOMY

External equity financing of small firms is one of the fundamental unresolved problems of the capital market. The Wilson Committee, which studied this matter in depth, summarized the position as follows: "There is no doubt that, compared to large firms, small firms are at a considerable disadvantage in financial markets. Loans are more expensive and security requirements are generally more stringent. External equity is more difficult to find and may be obtainable only on relatively unfavourable terms. Venture capital is particularly hard to obtain"¹⁾. Although in recent years some progress has been achieved in the provision of finance for small businesses, both in the United Kingdom - partly as a result of the Wilson Report - and in some other Community countries, the above statement remains true, not only of the United Kingdom, but also of the other Community countries where equity markets are less well developed. The Piatier Report, investigating obstacles to innovation in the countries of the European Community, much of which is undertaken by small businesses²⁾, concludes that problems of financing constitute the main obstacle to innovation³⁾.

Since borrowing presupposes the existence of equity capital, equity financing is the key problem. The equity needs of small businesses are met predominantly from the funds of the entrepreneurs and their associates and from retained earnings. At young and innovative firms these sources tend to be insufficient or not yet available. The resulting problem of financing equity needs of such firms lies at the heart of this study. This problem would be more easily solved if any shares to be issued in order to raise capital could later be sold on a well organized secondary market. This idea already appears in the Report of the Bolton Committee, but is rejected⁴⁾. Recent developments in some Member States suggest, however, that secondary markets for small company shares are feasible. Thus, the environment which they require and their impact on small firm equity financing deserve further study.

In terms of volume this problem is a minor one. Equity financing of small businesses in the United States is generally seen as the model to follow. Therefore, statistics of American public issues may provide some perspective. If we take total public share issues as an indicator of total organized demand for equity capital, and issues by small businesses offering shares to the public for the first time as an indicator of organized demand for equity capital from small firms, the demand for equity capital by small businesses between 1979 and 1981 averages 1.9% of total demand⁵⁾. Quantitatively, therefore, the problem of organized equity finance for small firms might be considered negligible.

If the problem is looked at qualitatively, however, its great importance immediately becomes apparent. In the eighties, a well researched finding in the United States is likely to be most relevant: The major part of new jobs is created by small independent businesses⁶⁾. Although the results of similar studies are not available for European countries, small businesses probably will substantially contribute to relieving unemployment also in Europe⁷⁾. Sustained growth rates of 20%-30% are not unusual among small innovative businesses. Therefore the number of employees in such firms may well increase tenfold in ten years. Examples of such expansion are frequently being pointed out⁸⁾. Among small high technology firms in the United States the average increase in new jobs was found to be almost nine times that of all other business sectors⁹⁾. At a time when the national economies are operating far below capacity, it would be tragic if the stimulus provided by small businesses were to falter because of a lack of equity capital and if their potential for growth could not be realised.

Of course it is fast growing firms which are most likely to experience a lack of capital. Sufficient internal equity contributions do not tend to come until growth slows down as the firm reaches maturity¹⁰⁾. Before then, equity capital must repeatedly be brought in from outside. The ready availability of funds is crucial, since attaining profitability is more likely if the emerging firm captures a major share of the new market fast. It is essential not to delay or scale down production or to fall short of the desired market position. If this is forced on a firm by lack of equity capital, profitability would be endangered¹¹⁾.

An obvious means of overcoming a lack of equity capital, which continues to be used very frequently, is affiliation to another firm in the same line of business, which will in most cases already be established in the market. This method arouses some reservations, although it meets the need for equity capital and may contribute to securing the position of the firm making the takeover by improving the structure of its product portfolio. At best this method misses opportunities for gradual deconcentration and at worst leads to greater concentration. From a competition viewpoint, therefore, it would be better for the shortage of capital to be relieved by other means. Further means would in any case be welcome, since the more ways there are of obtaining equity capital, the more easily can a shortage of equity financing be avoided.

Yet the qualitative significance of the problem of equity financing does not rest on labour market and competition policy aspects alone. Other factors such as innovation, external trade position and tax yield are also important. It has been demonstrated that small businesses make a substantial, if not indeed a predominant, contribution to industrial innovation¹²⁾. A high level of innovation secures and strengthens a country's external trade position. The importance of sufficient equity financing for small businesses may be summed up and illustrated by the results of a study carried out by the American Electronics Association in 1978, which covered 77 firms between one and five years old. According to this study, an input of \$ 100 of equity capital in 1976 was accompanied by the following effects in these small fledgling companies: Exports amounting to \$ 70, \$ 33 in R&D

expenditure, \$ 15 in corporation tax, \$ 15 in income tax based on new jobs, \$ 5 in other taxes¹³⁾.

These comments may suffice to underline the importance of the problem of adequate equity financing of small firms. There have been many attempts and experiments, particularly over the last twenty years, to overcome or at least mitigate small firms' lack of capital. Private investors, financial institutions and government agencies have all played a part in this, either separately or jointly. In most cases a direct route was chosen to inject equity into small firms, such as:

- equity participation companies for all kinds of small companies¹⁴⁾ or especially for new technology based firms¹⁵⁾, in some cases with a government sharing the risks¹⁶⁾;
- development and use of financial instruments in the spectrum between subordinated loans and preference shares¹⁷⁾;
- subsidies¹⁸⁾.

But indirect methods of strengthening the equity position of small firms and making it easier for them to obtain finance have also been tried, such as:

- tax concessions on the provision of equity capital to firms in general¹⁹⁾ or to small firms in particular²⁰⁾;
- guarantees from government agencies²¹⁾;
- exemption from investor protection requirements for issues by small firms²²⁾.

All these methods may fill the equity gap. However, this study will focus on a different approach.

Footnotes

- 1) Committee to Review the Functioning of Financial Institutions (Wilson Committee), Report, London: HMSO, 1980, p. 388.
- 2) OECD, Innovation in small and medium firms, Paris 1982, pp. 12-17, 27-30.
- 3) A. Piatier, Les obstacles à l'innovation dans les pays de la Communauté européenne, Commission des Communautés européennes, ed. (EUR 7528), Bruxelles-Luxembourg 1981, pp. 188-193. See also: A Policy for Industrial Innovation - Strategic Lines of a Community Approach, Communication from the Commission to the Council, COM (81) 620, pp. 10-11, and Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung, Jahresgutachten 1982/83, Stuttgart und Mainz: Kohlhammer, 1982, p. 190. Judgements on the situation in various Member States, which for some countries are at variance with the above cited sources, may be found in W.A. Adam, European experience in innovation financing, in: Commission of the European Communities, ed., Financing more innovation at less risk, Proceedings of the symposium held in Luxembourg, 15-17 December 1981, Luxembourg: Infobrief, 1982, pp. 33-36. Differing assessments of the funding possibilities for small firms appear frequently in the relevant literature. These differences are largely based on conflicting opinions on the magnitude of the capital costs a small business can reasonably be expected to bear. This point will be discussed in detail in section C below.
- 4) Committee of Inquiry on Small Firms (Bolton Committee), Report, London: HMSO, 1971, pp. 180-183.
- 5) If issues under Regulation A are included in equity demand from small firms, the figure is 2.3%. In 1981 the percentage was extremely high, at 3.1% or 3.5% respectively. In the difficult years 1974-78 the average percentage was 0.2% or 0.4%. A. Young, Small business in the United States: Failures and public financing; Syracuse University Faculty Research and public Series, Syracuse 1982, pp. 28, 30.
- 6) The state of small business, A report of the President transmitted to Congress March 1983, Washington: USGPO, 1983, pp.61-88, provides a review of recent studies of job generation of small business. According to a very recent report of the Brookings Institution, from 1976 to 1980 small independent firms with fewer than 100 employees generated 51% of new jobs in the

United States although they only accounted for 35.8% of existing jobs (p.87). Other studies resulted in much higher contributions of small firms (pp. 64, 85). The frequently cited 82% contribution of businesses with fewer than 100 employees is based on a study by David L. Birch. This 82% figure includes the contributions of both independent small firms and of small businesses owned by larger firms. It relates to the years 1969 to 1976 (p. 85).

- 7) H.C. Pfohl, ed., Betriebswirtschaftslehre der Mittel- und Kleinbetriebe, Berlin: Erich Schmidt, 1982, p. 46.
- 8) An extremely high rate of employment growth was reported by the Toronto Stock Exchange for a sample of 10 successful high technology companies which were founded in the seventies and which now are more than five years old. These firms increased employment at 38% per annum. Toronto Stock Exchange, Nothing ventured, Investing in Canada's winners, Toronto 1980, p. 29.
- 9) S.E. Pratt, The United States venture capital investment market place, Commission of the European Communities, ed., Financing more innovation at less risk, op. cit., p. 19.
- 10) J.R. Beevor, Obstacles to amalgamating technology and finance, Commission of the European Communities, ed., Financing more innovation at less risk, op. cit., pp. 45-50, OECD, op. cit., pp. 32, 119.
- 11) As Ralph Biggadike established in a study of the development of 68 innovative industrial products, the larger the output initially planned in relation to the potential market volume, the greater the likelihood of economic success (largely because of experience curve effects); as Biggadike puts it: Faint heart never won fair lady. Accordingly, economic success requires a generous injection of capital. R. Biggadike, The risky business of diversification, A bold approach can make all the difference in new ventures, Harvard Business Review, May-June 1979, pp. 108-110.
- 12) S.E. Pratt, op. cit., p. 19; OECD, op. cit., pp. 12-17, 27-30.
- 13) Quoted from S.E. Pratt, op. cit., pp. 19-20. Even more striking study results can be found in the following article: Venture capital, Bank of England, Quarterly Bulletin, December 1982, p. 512.
- 14) Klaus Schlegelmilch, Die Kapitalbeteiligungsgesellschaften in der Bundesrepublik Deutschland, K. Juncker und K. Schlegelmilch, eds., Die Kapitalbeteiligungsgesellschaft in Theorie und Praxis, Frankfurt: Knapp, 1976, pp. 35-47.

- 15) W.A. Adam, op. cit., pp. 29-31.
- 16) For example, the Federal Republic of Germany is prepared to make good losses of the Deutsche Wagnisfinanzierungsgesellschaft for an initial period of 15 years. Max Pohl, Die Deutsche Wagnisfinanzierungsgesellschaft, Sparkasse, Vol. 95, 1978, p. 79.
- 17) E. ter Meulen, Der Beteiligungsvertrag, K. Juncker und K. Schlegelmilch, ed., op. cit., pp. 103-115; OECD, op. cit., e.g. pp. 135, 161, 217.
- 18) OECD, op. cit., e.g. pp. 133, 150, 161, 228.
- 19) Reference is made here to the Monory Law and to similar regulations in Belgium and Norway.
- 20) D.L. Cohen, Small business capital formation, Board of Governors of the Federal Reserve System, ed., Public policy and capital formation, Washington 1981, pp. 261-263.
- 21) OECD, op. cit., e.g. pp. 185;218.
- 22) D.L. Cohen, op. cit., pp. 258-260.

B. SECONDARY MARKETS AS A MEANS OF FACILITATING
EXTERNAL EQUITY FINANCING OF SMALL FIRMS

Another indirect method of facilitating external equity financing, which is standard practice in the case of large firms, has been largely neglected until recently: trading in existing company shares on the stock exchange or on another secondary market. It is well known that external equity financing of large firms owes much of its success to the fact that the new shares or other junior securities can at any time thereafter be resold on the stock exchange and can therefore circulate among investors. If the organized secondary market did not exist, many investors would doubtless not be prepared to subscribe for new shares. A primary market (or new issues market), a market on which companies can obtain new, additional funds, therefore presupposes the existence of a secondary market (market for securities already in circulation).

It is not entirely clear why this indirect method has long been neglected and only sporadically examined for its feasibility. Some of the relevant factors emerged in the course of this investigation and will be dealt with below. Here we shall discuss only an important one, namely the belief, widespread in the sixties and seventies, that secondary markets must as a matter of principle be organized on one standard stock exchange model. This would serve two objectives: firstly, a uniform high level of disclosure for all publicly traded company securities accessible to all investors, and secondly, a centralized and homogeneous trading system, which is well organized and transparent both to supervisory authorities and to investors.

This idealized picture of homogeneous secondary markets, derived from stock markets for large and relatively stable public companies, tends to distract attention from the possibilities of fostering equity financing for small firms through secondary markets. The Bolton Committee, for instance, concluded its consideration of a secondary market for shares in small firms with the following judgement: "If the present regulations governing the issue of securities to the public were so far relaxed as to permit the marketing of many small securities, the likely consequences would be the entry into the market of undesirable operators who would engage in high-pressure selling of dubious stocks, the loss of their investments by a number of small savers, and a swift return to stringent controls"¹⁾.

This view is shared by various supervisory authorities even today. It supports their related position that an investment accessible to the public must be a relatively safe investment, which certainly cannot be taken for granted in the case of innovative firms, simply because of the high business risk. In the opinion of the Bolton Committee, the financing problems of small businesses should therefore be solved not by the issue of and trading in their shares, but rather by borrowing and internal financing supported by tax concessions²⁾.

Although this conclusion is open to attack because of the limited substitutability of equity financing and debt financing and because young innovative firms usually cannot accumulate reserves, it is consistent with the Committee's strong preference for a highly safeguarded stock market. However, another conclusion

would also have been perfectly possible, if the Committee had asked itself whether the potential burdens and disadvantages for supervisory authorities and some investors, which it so clearly saw in a market for shares in small firms, might not be counterbalanced by advantages for the small businesses themselves and for the economy as a whole.

The idealized picture of homogeneous secondary markets has taken other authors a step further than the Bolton Committee. They define small and medium-sized businesses simply as businesses which are not capable of issuing securities³⁾. For them, the problem of secondary markets for shares in small businesses thus does not exist. This definition is not accepted here. The many qualitative and quantitative features⁴⁾ normally used to define small businesses, such as the degree of labour intensiveness and the degree of formalization of the organizational structure, are of minor relevance to this study. In this paper, therefore, small businesses will be defined by only two characteristics: management by one or more owners, and a small number of employees. According to the common international definition, firms with less than 200 employees are classed as small firms, whereas firms with between 200 and 500 employees should be regarded as medium-sized firms⁵⁾. The small size of the business, indicated by the small number of employees, is reflected in a low capitalization. One of the aims of this study is to determine what capitalization is absolutely necessary for a workable secondary market.

Unfortunately, the idealized picture of homogeneous secondary markets derived from stock markets for large public companies clouds the opportunities for external

equity financing of small firms through the securities market. Moreover, it does not correspond to the actual facts.

As an earlier study carried out by the author for the Commission of the European Communities has shown, in fact neither the stock exchanges nor the off-exchange secondary markets have a homogeneous structure⁶⁾. The countries investigated, the then nine Member States, Japan and the United States, exhibited on the contrary a distinct vertical and horizontal segmentation: that is to say, a differentiation of disclosure requirements and trading procedures either in accordance with the market value of the equity capital and the number of shareholders, or, respectively, in accordance with the volume of individual transactions.

It can readily be appreciated that such differentiation and segmentation is appropriate. If there were no differentiation of market practices by reference to the volume of the individual transaction, in other words, if there were no horizontal segmentation of the securities market, orders concerning five or ten shares would have to be negotiated in the same way as those concerning fifty, a hundred, ten thousand or twenty thousand shares. The fixed dealing costs per transaction of a certain trading procedure, on the one hand, and the low probability of a market equilibrium resulting from the random influx of a corresponding block order on the other hand, require separate dealing procedures for small and for very large transactions.

If there were no differentiation in the securities market by the market value of an issue and the number

of shareholders and the resulting frequency of turnover of a share, in other words, if there were no vertical segmentation of the securities market, the same trading procedure would have to be followed and corresponding facilities maintained for shares which may be dealt in hundreds of times a day as for shares which may be traded only two or three times every week or month. This would be highly unsatisfactory, since there are available a variety of trading procedures, designed especially for securities that are infrequently transacted. They reduce trading time to a few minutes a day or week, or use market makers, and thus reduce the cost of a deal and also help to improve investor protection. There is therefore no case for standardizing the secondary market and restricting it to one procedure only. As elsewhere in industry, the procedures used for mass production differ from those used for small batch production.

Vertical segmentation is also to be considered with regard to disclosure requirements. If no differentiation were made and the same requirements were applied to large companies with many thousands of shareholders as well as to small one with at most a few hundred shareholders, then the absolute costs to the companies would be about the same, and these disclosure and dissemination costs may in many cases represent an insuperable barrier to small firms seeking access to the secondary market⁷⁾.

The principle of vertical segmentation of the securities market, discussed at length by the author in his earlier study, has since 1980 been stressed more strongly by major European stock exchanges, some of

which have abandoned the homogeneity of the secondary stock markets which they had earlier attained or aimed at. We may mention the new special markets for small firms at the stock exchanges in London, Amsterdam, Copenhagen and Paris, which will be discussed in detail below. These new markets have dispelled former doubts that a secondary market can successfully be employed as an indirect means of stimulating external equity financing also of small firms. It will be the task of this study to describe effective secondary markets for shares in small firms in the Member States, to indicate opportunities for their improvement and to provide perspectives for further developments that foster small firm equity raising and amplify the incentives for entrepreneurship.

Footnotes

- 1) Committee of Inquiry on Small Firms (Bolton Committee), Report, London: HMSO (Cmnd. 4811), 1971, p. 182.
- 2) Ibid., p. 192.
- 3) U. Hielscher, G. Dorn and G. Lampe, Innovationsfinanzierung mittelständischer Unternehmungen, Stuttgart: Poeschel, 1982, pp. 1-3 (further to G. Roesner). See also H.C. Pfohl, ed., op. cit., p. 31.
- 4) H.C. Pfohl, ed., op. cit., pp. 29-31, 20; Bolton Committee, op. cit., pp. 1-4.
- 5) OECD, op. cit., pp. 5-8.
- 6) H. Schmidt, Advantages and disadvantages of an integrated market compared with a fragmented market, Commission of the European Communities, ed., Collection Studies, No. 30 Competition - Approximation of legislation Series, Luxembourg: Office for official publications of the European Communities, 1977.
- 7) Other considerations too militate in favour of differentiation, albeit sometimes with contrasting emphasis. For instance it could be argued that small firms should report more frequently

than large firms, since small firms are less subject to assessment by investors, particularly by teams of analysts from institutional investors or their advisers. To put it another way, whereas the market obtains relevant information on large firms largely by its own efforts, in case of small firms it may well need the regular stimulus of interim reports.

C. THE CONTRIBUTION OF A SECONDARY MARKET TO EXTERNAL EQUITY FINANCING OF SMALL FIRMS

I. DETERMINANTS OF THE CONTRIBUTION OF A SECONDARY MARKET

If there is an effective secondary market for shares, investors are not locked into their investments. They may sell their shares in the market and convert them into cash any time. Basically, the contribution of secondary markets to equity financing rests on this service. Without a secondary market newly issued shares could not be readily sold at a reasonable price; thus, many investors would not be prepared to subscribe for shares at issue since the shares would be difficult to liquidate. Only if an effective secondary market already exists or if there is a credible promise of a secondary market for a class of shares, a major number of investors will accept these shares as investments and thus contribute to the external equity financing of the issuer. Not surprisingly, most short and medium term investors will act in this way. However, even the investor who wants to hold the shares for a long term will very much appreciate the liquidity of the shares provided by a secondary market. Investors generally are well aware that a situation may arise where they have to prematurely liquidate their investments.

This provides a rough sketch as to how a secondary market contributes to external equity financing. For most purposes this sketch is sufficient. However, more detailed analysis of this contribution will facilitate

the discovery of opportunities for stimulating external equity financing of small firms. The determinants of this contribution of secondary markets will be best understood if the objectives of investors serve as the point of departure. Moreover, it is assumed that investors are proficient themselves or retain professional advisers.

Such investors know that the greater the risk of an investment, the higher will be the expected rate of return. They also are well aware of the going rates of return to be expected if a certain level of risk is assumed. Thus, they will subscribe for small company shares only if issue price, dividends to be expected and the anticipated proceeds from the sale of the shares at the end of the holding period point to a rate of return that is commensurate with the risk assumed. This adequate risk-related rate of return will be called standard rate of return hereafter.

At most young innovative companies dividends cannot be expected for an extended number of years. As a result, investors will calculate the expected rate of return simply on the basis of the issue price and of the proceeds from the sale of the shares. To a considerable extent these proceeds depend on the quality of the secondary market for the class of shares involved. An example may serve to illustrate this important point.

Assume that there is the following situation: A small company needs additional funds. A share issue is the only available way of raising these funds. The issue price is 10 currency units (CU) per share. The standard rate of return is 15% p.a. There will be no dividends

during the five year period after issue. At the end of this period the price of the share is expected to be at a level consistent with net proceeds from the sale of the shares of 20 CU per share, if the shares then are traded on an organized secondary market.

The calculation of the expected rate of return based on this information yields 15% p.a. (the reader who checks the calculation will find that the exact result is slightly lower but the difference due to rounding should be disregarded). Thus, the shares yield the standard rate of return, the expected rate of return available in the market on investments of comparable quality, and the shares offered will in principle be acceptable to investors. However, investors would certainly not purchase the shares at a price of 10 CU, if an organized secondary market for the shares would not exist. The five reasons for this will be discussed below.

The first reason is that the investor will incur higher information costs and valuation costs if there is no organized secondary market. According to the above example the investor wants to sell the shares after five years. Since an organized market would not exist, a price for the shares would not be quoted. The investor who wants to sell the shares and a prospective buyer would have to find out the appropriate price themselves. Therefore, an investor who intends to subscribe for the shares in our example must take into account the situation of a potential buyer. Most likely, the potential buyer would not have ready access to information on the issuer. The costs of obtaining and analyzing this information and of assessing the value of the shares would be much higher

compared to a situation where an organized market exists. It is well known that participation companies and other investors in strictly unquoted shares spend weeks on obtaining, analyzing and assessing information before an investment decision is taken.

Coming back to the above example it is assumed that the additional information costs and valuation costs amount to 2000 CU. It is further assumed that the assessment by the potential buyer based on the standard rate of return and the information obtained results in a value of 20 CU per share. In other words, 20 will be the maximum price that the potential buyer will be prepared to pay. Of course, this maximum price includes the information and valuation costs per share that the potential buyer incurs. This is the crucial point and its impact depends on the size of the transaction. Obviously, it would make no sense whatsoever to subscribe for 100 shares or less. Even a subscription of 200 shares would be without investment merit, since after five years the potential buyer would at most pay 10 CU per share; the seller would have a rate of return of zero. If the investor subscribes for 1000 shares he could sell at a price of 18. Not surprisingly, it takes rather large transactions to render negligible the additional information and valuation costs. Even if the transaction would involve 10,000 shares the additional information and valuation costs would still be about 1% of the consideration since the price would be 19.8 CU.

As the example demonstrates, it takes investors commanding considerable resources to participate in the equity financing of unquoted companies. Information and valuation costs will turn away smaller investors.

Even if the company would substantially reduce the issue price, the shares would still not become attractive to many smaller investors.

Two additional points may serve to emphasize the importance of information and valuation costs. First, the impact of these costs is amplified by the fact that the information and valuation process will frequently end with a reject decision. This adds to the cost burden that is to be born by the investments effected. Second, the impact is also amplified as the holding period shortens. To sum up, the additional information and valuation costs which a potential buyer of unquoted shares incurs compared to a buyer of shares that are traded on an organized secondary market can be expected to have a substantial impact on the price at which unquoted companies can issue shares. An unquoted company will have to issue its shares at a price clearly below the price a comparable quoted company could fetch. This will permit investors who are ready to commit considerable resources for extended periods to earn at least the standard rate of return. However, this will not suffice to make the shares offered attractive to smaller investors.

The second reason that impedes equity financing of unquoted companies are the additional information and valuation costs of the seller of unquoted shares. Their impact can be discussed along the above lines. This discussion is not presented here since it merely underlines the result stated in the preceding paragraph.

The third reason are additional monitoring costs.

Monitoring costs also arise from information and valuation activities, but these activities are not related to a transaction. Monitoring costs are continuing costs that are incurred while a share is held. Obviously for unquoted shares they will be higher than for quoted shares. Like the transaction related information and valuation costs they will have some impact on the price that investors are prepared to pay for a share and on the spread of shareholders that can be achieved. Since, as pointed out above, shareholders investing in unquoted companies will usually command substantial resources, there will be a small number of major shareholders. As a result, the monitoring of these shareholders is likely to include some costs of guiding the management and costs of consulting that is free of charge for the company. This adds to the additional costs of monitoring.

A fourth impeding factor is related to the three reasons already mentioned: Only few investors will be interested in the shares of unquoted companies. This will have an impact on the proceeds from the sale of the shares. If an organized market for these shares does not exist, competition among buyers for any shares offered cannot be expected to develop. Thus, the seller most likely will have to settle for a price below the value of his shares. A potential buyer will usually not go wrong in assuming that other buyers are not at hand, and he will try to get the shares for less than value adjusted for information, valuation and monitoring costs¹⁾. Investors in shares that do not enjoy an organized secondary market tend to be well aware that there is very little they can do to protect themselves against unyielding buyers. This further reduces the

expectation that the proceeds from the sale of unquoted shares will measure up to their value. Because the standard rate of return is available to all investors this, of course, also tends to reduce the price at which unquoted companies may hope to issue shares.

The fifth and last²⁾ factor are the execution and settlement costs of the transaction. If the secondary market for shares is poorly organized or not organized at all, the execution and settlement costs tend to be a multiple of the corresponding rates prevailing on well organized markets. This mirrors the difficulties of transacting if organized markets are not available.

These five factors cumulatively burden at the time of issue any unquoted company desiring to raise equity. If we look again at the illustrative example used above, the combined result of these factors could be expected net sale proceeds of 15 CU per share, in contrast with expected net sale proceeds of 20 CU per share for companies enjoying a well organized secondary market. Consequently, because of the standard rate of return of 15% the relevant investors only would buy the shares at an issue price of 7.50 CU or below. Since the five burdening factors account for the additional costs of the lack of an organized market, the shares could be sold at an issue price of 10 CU if the shares of the issuing company would enjoy an organized secondary market³⁾.

It has been suggested to compensate this negative impact on issue price by simply issuing a larger number

of shares (one third more shares in the above example). Issue proceeds would be the same. Obviously, 7.50 CU is the appropriate issue price in view of the above discussion. Issuers, regardless whether they are large or small companies, cannot expect more for their shares than the appropriate price. However, the suggestion to issue a larger number of shares is at best misleading. If an entrepreneur would sell all the shares in his company, there is no way to increase the issue proceeds. If the number of shares offered would be increased, this obviously would be a splitting of the original shares. The issue price will have to be reduced accordingly, and an increase of the issue proceeds cannot be expected. Splitting the shares to be issued does not have an effect on the value or on the yield of the project to be financed. Thus, it is not possible to make up reductions in the issue process by an increase in the number of shares offered, regardless whether all shares in the company or a certain interest is to be offered to outside investors.

It may be useful to take a somewhat different perspective in order to fully recognize the unfavourable repercussions of a low issue price. The capital that a company may be able to raise at a low, albeit appropriate issue price will in at least some cases be not sufficient to fund the project for which the capital is needed. Then the project has to be abandoned. According to the example used above, a project that yields a rate of return of 15% is required to sustain an increase in the value of the shares from 10 to 20 CU over a five year period. This refers to the case of a company enjoying an organized market for its shares. Because of the five burdening factors a project at an unquoted company would have to sustain an increase of

the value of the shares from 7.5 to 20 CU. In other words, the project has to yield a rate of return of close to 22%. Only then the investors will earn the standard rate of return of 15% that is available in the market on comparable investments of the same risk class. If the project of an unquoted company does not yield at least 22% in the above example, the project cannot be carried out because the capital needed will not be available. In general terms this may be summed up as follows: Projects to be financed by outside investors in unquoted companies will only attract sufficient funds if they yield a rate of return that is substantially above the yield of publicly financed projects of quoted companies. This difference in the project rate of return mirrors the five burdening factors and their impact on the issue price.

The five burdening factors discussed so far emanate from the lack of an organized secondary market. In addition, there may well be burdening factors related to the organization of the primary market (new issues market). Investment banking services and the costs of flotation will most likely not be the same for quoted and unquoted companies. The costs of flotation will have an impact on the net issue proceeds raised by a company and thus on the minimum rate of return that a company must earn in order to raise with outside investors the capital needed. In order to keep the analysis as simple as possible these factors were not entered into the above discussion. Debt financing and the effects of taxation were not mentioned for the same reason. If these additional matters were taken into account the conclusion drawn above would still hold: It takes a much higher rate of return at an unquoted company to raise a certain

amount of equity from outside investors than at a comparable company that enjoys an effective secondary market for its shares. For small unquoted companies the rates of return that are sufficient to attract the needed amount of capital may be well beyond the rates that projects can reasonably be expected to yield. Thus, the availability of sufficient capital may be the exception rather than the rule.

This result is consistent to the findings of other authors. It has been stated that the price-earnings ratios of companies whose shares are traded on a defective secondary market tend to be very low⁴⁾. Issuing new shares at this low level frequently cannot be justified. The Wilson Committee concluded in this context: "The terms on which it is offered frequently deter proprietors of small businesses from accepting further equity finance even where it is available"⁵⁾.

The above analysis is also consistent with what may be called the financing paradox of small companies. Banks and institutional investors generally assert that capital certainly is available to small enterprises since they will always be ready to provide funds at terms that currently prevail in the market. In contrast, entrepreneurs who run small businesses frequently complain that they cannot obtain sufficient funds⁶⁾. Of course, funds will be available at the prevailing terms, at the appropriate issue price. However, as pointed out above, the appropriate price is likely to imply an extremely high rate of return of the project to be financed. Thus, only extremely profitable projects of small unquoted companies will attract sufficient funds and will be implemented.

Inspite of this extremely high rate of return the investors who finance the project will merely earn the standard rate of return. Thus, statements may indeed be without merit which maintain that investors are unduly reluctant to provide capital to small unquoted firms. However, if an organized secondary market is created for the shares of unquoted companies and if this development was not anticipated by the investors at the time of issue then the shares will tend to yield a rate of return that is higher than the standard rate. The transition period from an unorganized to an organized secondary market will then turn out to be a very rewarding holding period⁷⁾.

The above analysis clearly suggests the creation of organized secondary markets for small company shares, which will permit these businesses to issue shares at higher prices. This would improve the availability of sufficient capital. More importantly, the above analysis points to the areas on which efforts to further develop secondary markets should focus.

As pointed out, five factors related to secondary market quality burden the external equity financing of unquoted companies:

1. Additional information and valuation costs of the buyer;
2. additional costs of information and valuation of the seller;
3. additional monitoring costs;

4. higher discounts because the unorganized secondary market lacks competition among buyers;
5. additional execution and settlement costs.

Efforts to develop and improve secondary markets for small companies therefore should focus on measures which

1. reduce the costs of informing investors and potential investors and in many cases dispense with analysis and valuation;
2. bring about competition of buyers in the secondary market or reduce by other means the discounts due to a lack of market depth;
3. contribute to a reduction of execution and settlement costs.

Emphasis will be placed on these three areas in the description and analysis of secondary markets for small company shares that now exist in the Member States. A fourth area of emphasis will be flotation since a reduction of flotation costs also tends to increase net issue proceeds. Of course, measures aimed at the three areas mentioned above will give rise to costs. The organizers of secondary markets tend to shift these costs to the issuers by requiring disclosure, shareholder services and listing fees. These costs to be borne by the issuer may more or less fully counterbalance any impact of the measures on the net issue proceeds. If this happens a contribution to external equity financing will not materialize. Con-

sequently, effective measures aimed at the relevant areas which do not involve substantial costs and which thus may bring about a net increase in net issue proceeds deserve special mention. They are central to the study and will be emphasized in the country reports.

II. ORGANIZED SECONDARY MARKETS AND OTHER EXIT ROUTES OPEN TO INVESTORS

The preceding section focussed on the contribution of organized secondary markets to external equity financing. Basically, an issuer's point of view was taken, and, ultimately, the contribution was traced down to the net increase of net issue proceeds that is brought about by improvements of market organization. However, the preceding section also stressed the importance of some exit route open to investors. At some point the typical investor who holds a substantial interest in an unquoted company will want to depart from the stage of his involvement and take cash for his shares. His exit route may or may not be an organized secondary market. Basically, an exit route must meet merely two requirements: It must generate cash in exchange for shares and mitigate the effects of the five burdening factors discussed above which generally apply to exit routes.

This study was commissioned to explore in detail the potential of organized secondary markets as an exit route for investors in unquoted new technology based firms. But a brief survey of other exit routes may

provide some perspective. Until recently, it was generally believed that effective secondary markets for the shares of small and unseasoned companies are unfeasible or at least inappropriate. Consequently, there were efforts to develop other exit routes. Basically, there are three other exit routes, which will be briefly discussed below.

A first and simple approach to the exit problem seems to be an agreement between the company and the investor that the shares will be redeemed at a set date. Alternatively, the shares may be held under a repurchase agreement to which the investor and the company are parties. The redemption price or the repurchase price may be fixed at the time of the original investments. These arrangements obviously aim at reducing the costs of information, valuation and execution. Other variants of this approach may closely resemble subordinated loans, but they tend to render the same results. The issuer frequently is required to make periodic payments to the investor (dividends or interest, partial repayment of principal). This is likely to lead to cash flow problems for the company, particularly during the stage of early development of innovative firms. Of course, redemptions may have been scheduled for a time when the project to which the funds have been committed generates sufficient sales. However, the success of the project may be delayed or the investors may not have been prepared from the outset to commit the funds for the period required by the cash flow pattern of the project. As a result,, the company will have to find other outside investors who put up the funds needed to effect the required payments to the original investors. Thus, inspite of the design of this first

type of exit agreements the burdening factors will come into play. Of course, the original investors are not burdened formally, but the company is. The original investors will find out at the time of repayment or repurchase whether the company is strong enough financially to assume this burden. If not, the burden will fall back on the original investors.

A second and frequently used exit route is the sale of the company, of a majority interest or at least of a substantial participation to an enterprise in the same or in a related line of business. Because it knows the industry, the acquiring enterprise is likely to have lower information and valuation costs than an outside investor. Moreover, there tends to be some competition among potential purchasers. Usually the purchaser will be able to use the same exit route should he want to terminate his involvement in the company. If this second approach is used it is generally considered as an advantage to have a majority interest. A majority interest will enable the purchaser to cause changes in undesirable situations which may exist at the company. Those who want to use this exit route may enlist the services of professional agents at banks, brokers or specialized independent firms. As pointed out in section A above, this second approach arouses some reservations because it may have undesirable effects on competition.

Like the first, the third other exit route has a number of variants. This third approach encompasses all liquidations of investments to which neither the issuing company (route 1) nor another firm in a related line of business (route 2) is a party. In addition, the

investment must not be realized on an organized secondary market. This delineation points to the somewhat theoretical sale of unquoted shares that is not at all facilitated by some degree of market organization. This variant served as a useful case of reference in section B above. Another variant is the sale of the shares that is supported by a more or less rudimentary market organization. This second variant of the third exit route may be seen as an early development stage of a well organized secondary market. It is used rather frequently as witnessed by special pages in newspapers for the advertisement of unquoted investments and by agency services offered with varying degrees of regularity and proficiency by chambers of commerce, solicitors, accountants and banks. These arrangements will not generate the full benefits to issuers and investors that flow from an organized secondary market.

To sum up: Those exit routes that are most attractive to investors will also be in the best interest of issuers. Only two exit routes seem to be attractive, the sale of majority interests to firms in a related line of business and the realization of an investment in an organized secondary market. Because of the potential unfavourable effects of the majority interest transactions on competition, organized secondary markets are the exit route that should be further developed in order to enhance external equity financing of small innovative firms.

Footnotes

- 1) Although there will also be very few sellers in the market, a seller will not be able to take advantage of this fact. If a seller asks for a price that would not permit the buyer to earn the standard rate of return, the buyer will simply turn down the offer and invest his money at the standard rate of return in the open market.
- 2) A complete analysis of the relevant factors can be found in the 1977 study (H. Schmidt, op. cit., pp. 21-32, 408-423). A factor which has not been dealt with above are the costs of safeguarding against transaction risks. This factor has been excluded for clarity and simplicity.
- 3) This overall discount of 25% seems to be realistic. It was suggested to the Wilson Committee that the raising of unquoted equity capital can involve a discount of over 20%, and possibly as much as 50%, compared with an equivalent listed security. Committee to Review the Functioning of Financial Institutions, Interim report: The financing of small firms, London: HMSO (Cmnd. 7503), 1979, p. 14 at 30.
- 4) The results of a somewhat dated albeit still instructive survey were published by S.H. Archer and L.G. Faerber, Firm size and the cost of externally secured equity capital, Journal of Finance, Vol. 21, 1966, pp. 69-83.
- 5) Wilson Committee, Interim report, op. cit., p. 16 at 35.
- 6) Very much to the point is the statement of an expert who closely watched the work of the Wilson Committee: "We said, money was available, so did the banks, but the Committee believed the shouting entrepreneurs." - In order to close the financing gap a part of the financing must be based outside the enterprise. Such additional funds may be based on personal assets of the entrepreneur or on guarantees by some government agency. Alternatively, the entrepreneur will appreciate very much offers of capital that are geared to the costs of the project and place less emphasis on future prospects.
- 7) If the organization of the secondary market for a share improves, one is inclined to expect that prices will tend to rise and the cost of capital will tend to decrease. A reduction of the cost of capital is also thought to occur if the shares of the company obtain access to a secondary market that is better organized than the market on which the share is traded so far. An example for this may be a listing on the New York Stock Exchange of shares which were previously traded over the counter. However, investigations that tested this hypothesis led to ambiguous results. Two relevant recent studies, which also refer to earlier work, are: H.K. Backer and J.

Spitzfaden, The impact of exchange listing on the cost of equity capital, *Financial Review*, Vol. 17, 1982, pp. 128-141; Frank J. Fabozzi, Does listing on the Amex increase the value of equity? *Financial Management*, Vol. 10, Spring 1981, pp. 43-50. Unfortunately, for lack of data and for other reasons it is impossible to explore the effects on price and cost of capital of the first access to an organized secondary market. Thereafter a small growing company is likely to experience a continuing improvement of the quality of the secondary market for its shares. This adjustment process, which extends over many years, may contribute to the small firm effect that seems to work in favour of investment in small company shares. For a survey of research on the small firm effect see G.W. Schwert, Size and stock returns and other empirical regularities, *Journal of Financial Economics*, Vol. 12, June 1983, pp. 3-12.

P a r t 2

THE SECONDARY MARKETS FOR EQUITY INSTRUMENTS OF SMALL
COMPANIES IN THE MEMBER STATES OF THE EUROPEAN
COMMUNITIES

A. THE SEGMENTS OF THE SECONDARY MARKET FOR EQUITY
INSTRUMENTS OF SMALL COMPANIES IN THE UNITED KINGDOM

I. ENVIRONMENT AND SURVEY

1. Number and forms of business organizations

The common form of business organization in the UK is the company limited by shares. Usually the limited company comes in its private company version. The private company has no minimum share capital requirement. It is easily recognized by the word "limited" in its name. There are some private companies large and small enjoying a substantial number of shareholders. However, Section 15 of the Companies Act 1980 makes it an offence, if a private limited company offers any shares or debentures to the public (or makes them available to a third party with a view to any of these shares or debentures being offered for sale to the public).

Number of registered firms in the
United Kingdom at December 31, 1982

Form of business organization	England and Wales	Scotland	Northern Ireland
Public companies	5,058	266	300
Private companies	761,883	40,610	10,827
Limited partnerships	664	408	.

Source: Registrars of Companies in Cardiff and Edinburgh; Companies Registry in Belfast; Department of Trade and Industry, Companies in 1982, London: HMSO, 1983, p. 7.

Thus, if a company desires equity financing by the public, it has to file with the registrar for the status of a public limited company (plc) evidenced by a certificate of incorporation. There is a minimum share capital requirement for a plc currently standing at £ 50,000 (Section 85 Companies Act 1980). A private company can be changed to a plc rather easily by reregistering as a plc according to Section 5 Companies Act 1980.

The Stock Exchange will admit to dealings companies in plc form only, though the Stock Exchange Council may permit specific bargains in the securities of private companies under Rule 163(2)(b). The special legal requirements for the plc and for the change into plc form protect outside investors in many ways, e.g. against the watering down of their shares by employees' share schemes (Section 6 Companies Act 1980), but as these requirements do not seem to burden a company in any substantial way, the retention of the private company form by companies having external shareholders appears to be more a matter of convenience than of principle.

Other forms of business enterprise such as sole traders, partnerships and "alternative" forms of small business seem to have very limited importance among industrial firms. Statistical information has not been obtained as only companies and limited partnerships must register. Anyone desiring to buy or sell a share in such a firm will usually turn to solicitors or accountants for help or place an advertisement in a newspaper; there are no organized markets for such shares. "Alternative" forms of business organization, workshops and worker co-operatives, have received special attention though very limited in number¹⁾.

For the growing industrial company none of these other forms is appropriate. In addition to the advantage of a public company in the raising of equity capital, the limited company is preferred for tax reasons. One aspect of this is the relative level of corporate and personal income tax rates. Currently the corporation tax rate is 38% for corporate income distributed or retained up to £ 100,000, increasing gradually above that amount to the full rate of 52% on incomes above £ 500,000. Alternatively, the marginal personal income tax rate is 40% at about £ 15,000 and reaches 60% for annual incomes above £ 36,000.

2. Frequently used instruments for equity financing

Ordinary shares are clearly the most important instrument of equity finance of small companies raising capital publicly. The individual investor, who still is a very important force when it comes to the issue of shares of high risk enterprises, prefers a straight, uncomplicated instrument. For simplicity the issuing company may prefer ordinary shares too, in order to have the value of the business reflected as clearly as possible by the market price of the shares. Warrants and convertible debentures are based on a market for the underlying shares and tend to be used by established and larger companies. However, even small companies have used various classes of shares. There are a number of reasons for this.

Some institutional investors favour cumulative participating preference shares, convertible cumulative redeemable voting preference shares or other shares combining desirable features. Deferred shares subject to certain restrictions are used in employee profit-sharing schemes, the restrictions being eliminated over a seven-year holding period; this approach aims at maximum tax-free benefits²⁾.

Deferred shares may also have a voting disadvantage in order to indirectly give voting privileges to promising managers lacking capital but holding ordinary shares enabling them to control their company, though providing less capital than institutional investors. Finally, as founder managers may be reluctant to permanently give up a part of control and of the equity at a low price, it has been suggested that this potentially important barrier to growth could be overcome by redeemable ordinary shares and by a repurchase of shares by the company³⁾. Both approaches have been provided for by the Companies

Act 1981, Section 45 and Section 46 respectively. The acceptance of redeemable ordinary shares remains to be seen.

One should not be misled by this variety as to the relative importance of instruments actually used. Two years after the dealings on the Unlisted Securities Market commenced, the ordinary shares of 123 companies were traded on this market, but only 11 of these companies had one additional equity instrument traded there (3 convertible debentures, 3 convertible cumulative redeemable preference shares and 5 other classes of equity instruments). A similar view is obtained by looking at the equity issues of listed industrial and commercial companies in 1982: net issues of ordinary shares were £ 946 mio, while those of convertible debentures and preference shares amounted to only £ 10 mio and £ 8 mio respectively⁴⁾.

3. Investors and investment motives

The relative importance of individual investors, holding about 36% of the equities of listed UK companies⁵⁾, has been decreasing over the years, as the institutions gained a clearly dominant position. Yet the individual investors still play an important role in small and high-risk company share dealings. As do some institutional investors they hold such shares on the principle that, on the one hand, high growth rates over extended periods of time are much more likely with small companies and, on the other, not more than 100% of an investment can be lost. Some individual investors also find it challenging and personally and financially rewarding to identify and assess earlier than others the profit potential of young growth firms and to stay with these invest-

ments for an extended period of time. Investments in large companies lack this attraction as the assessment of their business may prove a task too complex for most individuals. Also the opportunity for attaining the status of one of the few early outside shareholders has passed for large firms.

Finally, individual investors have been attracted to small company shares since 1980 by increasing financial incentives. At first, income tax relief was granted for losses incurred investing in new shares of new companies, provided a number of other requirements were met. Later, relief became available for the amount invested regardless of losses. In 1983 this Business Start-Up Scheme was turned into a Business Expansion Scheme providing for tax relief for up to £ 40,000 of investments in new issues of new and existing unquoted trading companies⁶⁾.

The wide range and high degree of sophistication of institutional investors are the most remarkable features of the British markets for equities. Pension funds, insurance companies, investment trusts, unit trusts, banks and public authorities have very substantial holdings of equity investments⁷⁾. At the end of 1980 pensions funds, insurance companies, investment and unit trusts held 53% of all listed UK ordinary and deferred shares and 67% of all fixed interest UK company securities listed⁸⁾. A fair number of these institutions are backing specialized organizations focussing on equity investments in small or even new companies. A survey in the Investors Chronicle lists 59 sources of development and venture capital in the UK with investments of abt. £ 1,500 mio in several thousands of companies⁹⁾. In addition, there are unit trusts and discretionary accounts focussed on shares of small quoted and unquoted companies.

As several milliards of pounds become available annually for investment in equities, the development of new sources of equity instruments is actively supported by institutional investors. The resulting competition for equity instruments has contributed to the employment, e.g. of engineers or physicists, in order to strengthen teams of financial analysts specializing in certain industries. The competition has also led to a surprising diversity of terms on which institutional investors make equity available.

4. Issuing houses for shares of small companies

Over the last three years (1980-1982) the average net issue of shares of listed UK companies was £ 1,288 mio¹⁰⁾. The average net issue of bonds was more than six times that amount¹¹⁾. Both statistics seem to indicate a relatively high level of equity financing as compared with other countries of the European Community. This is borne out by the frequency of offers for sale and of placings of shares of companies large and small. Recently this has become very visible.

In the mid-seventies many people felt there was a dearth of new equity issues, caused by an unfavourable socio-economic climate accompanied by low price-earnings ratios and high absolute costs of going public. Issues below £ 6 mio sponsored by traditional merchant banks had become very rare, and there was very little investment banking activity by brokers, contributing to the decline in the number of listed companies¹²⁾.

To others, this dearth of new issues merely reflected the

surface of the equity market, as institutional investors continued to obtain new issues of shares via private placings. To some extent capital transfer tax advantages of unlisted securities and the threat of a wealth tax may have added to the tendency to prefer an "underground" equity market where prices are more difficult to ascertain and are depressed by the lack of marketability. Private placements continue to be a very important part of the activities of a fair number of brokers and merchant banks. Their institutional and individual clients will acquire in these placings ordinary shares of private or public companies, fully or partly paid, with an aggregate market value frequently less than £ 1 mio. The broker or bank will usually have a man on the board to watch the investment and keep the clients informed. A proper placing of the shares will aim at a spread of shareholders facilitating further placings of the company and the development of trading in its shares.

A fair number of shares issued previously have surfaced on the Unlisted Securities Market. An indicator of this are the 46 introductions to the Unlisted Securities Market from Rule 163(2) and Rule 163(3) tradings; in addition, there were 10 other introductions¹³⁾. However, there were more placings (52 by brokers and 33 by merchant banks and other investment bankers), 15 issues and offers for sale and 4 rights issues giving rise to permissions to deal on the Unlisted Securities Market. These 160 entries to the Unlisted Securities Market do not give the full picture of the activity in the primary market during the last years, but they include the majority of cases where shares of small and medium sized companies have become available to the public. In addition, some small companies had their new shares listed on the official market, and other new issues were offered to the public by dealers in the over-the-counter market.

A small company desiring to raise funds by selling shares usually will be able to choose among a wide range of organizations offering investment banking services. About fifty of the members of the Issuing Houses Association engage in equity financing. Of course, the 221 stock-broker-member firms of the Stock Exchange¹⁴⁾, mainly the bigger firms, will handle equity issues too, and it is only through them that a listing on the Stock Exchange can be obtained. Moreover, there are licensed deposit takers, consortium banks, licensed dealers in securities and development capital and venture capital organizations with a record of offering share issues to the public.

The most prestigious firms may be guarding their reputation to an extent that they are not prepared to back high-risk companies. But the diversity among and within the various groups should effectively assure the ready availability of investment banking services. An important factor contributing to this are the rather easily met market entry requirements for licensed dealers in securities¹⁵⁾. By the more discriminating issuing houses and firms of stock-brokers the result is not always welcomed, as it is felt that an issue should not be brought to the market on the basis of sufficient information only. An issue, from their point of view, must meet a certain standard of investment quality not applied by some of the lesser firms. Potential issuers not meeting these standards will certainly appreciate a different approach demanding the investors to engage in an active assessment. It is in line with this approach that, as a matter of principle, new shares should be offered for sale and must not be placed with discretionary accounts.

5. Survey of the secondary market

The secondary market for equity instruments in the UK is dominated by the Stock Exchange. There is also a small British over-the-counter market. This survey will cover only the vertical segments of the secondary market, i.e. the hierarchy of submarkets each geared to a class of securities with similar volume and quality characteristics¹⁶⁾.

The Stock Exchange, a private, selfregulating organization, currently provides three segments: the "full listing" market, the Unlisted Securities Market (USM), and the specific-bargains facilities under Rule 163(2)¹⁷⁾. The full listing market or listed securities market is the surprisingly broad traditional market segment encompassing shares of companies with capitalizations ranging from several milliards of pounds to well below half a million pounds. 974 classes of ordinary shares of UK companies were listed at the end of 1982 (1981: 2058) representing a market value of £ 121.6 mrd (1981: 99.4)¹⁸⁾. The market value of the 1000 largest classes of ordinary shares was £ 119.8 mrd at the end of 1982¹⁹⁾. The average size of the 974 listed share issues of UK companies not belonging to the 1000 largest is £ 2 mio clearly indicating that the listed market continues to serve a substantial number of small companies²⁰⁾.

The Unlisted Securities Market (USM) is a segment of the Stock Exchange established recently to provide secondary market services to small companies at a price they can afford. A special segment for small companies had been discussed by the Exchange for about three years before dealings commenced on November 10, 1980. For reasons outlined in Section 4 above, very few small companies

sought a listing in these years. In addition, some over the counter market firms with a different approach to the issue and trading of shares of small companies were increasingly successful, most notably a licensed dealer firm²¹⁾, M J H Nightingale & Co Limited who have provided investment banking and secondary market services since 1972²²⁾. Though the competitive pressure from these firms was rather limited²³⁾ owing to their small size, it was magnified by the resulting political pressure. The listed market was thought to be too expensive or even inappropriate for small companies, and pointing to alternative approaches, improvements in the market mechanisms for dealing in small company shares were demanded²⁴⁾.

The Exchange initially encouraged trading of unlisted securities under Rule 163(2). An alternative to going public and to full listing developed: private placings of unlisted shares and the ensuing development of a secondary market and a broadening of the shareholder base via a "163 quote"²⁴⁾. In principle, this approach is still characteristic for the USM today; placings, though not private placings, are generally used. Other methods of flotation are available but rarely employed.

The USM has been very successful. When dealings commenced on November 10, 1980, the shares of 11 companies could be traded. 18 had been admitted by the end of that month, 23 by the end of the year²⁶⁾. In 1981 61 companies joined, bringing the total to 86 at year end. Turnover during 1981 was £ 282 mio²⁷⁾. At the end of 1982 135 companies²⁸⁾ were traded, the 1982 turnover was £ 620 mio²⁹⁾. Though the total market value of the equity of the USM companies is on average £ 9 mio, the median is just half this amount and only 31 of the 135 companies have more than 200 employees³⁰⁾. Many firms raised less than £ 1 mio

when entering the USM. A wide range of industries is represented, communications and technology companies are prominent as are oil and oil related firms. The USM has been in the focus of investor and financial press interest. This may have contributed to rather high price-earnings ratios for USM shares; the prices of some USM shares are substantially higher than comparable shares fully listed³¹⁾.

The specific bargains facility under Rule 163(2) on the Stock Exchange is designed to provide for occasional transactions only, as frequent dealings would give the companies whose shares are traded the benefit of the exchange's secondary market service without meeting the listing requirements or the entry requirements of the USM. Still, a company with a 163 quote has an ongoing relationship to the Exchange as does a listed company. There even tends to be a sponsoring broker³²⁾. But all the Stock Exchange requires are the latest accounts and the articles of association of the company. For each transaction the parties involved must file for permission of the bargain by the Quotations Department of the Stock Exchange.

As indicated above, for some time trading under Rule 163(2) was encouraged and permission was granted regularly. But in 1981 companies enjoying frequent dealings under this facility were asked to either apply for listing or for the USM. Further, jobbers are no longer allowed to make a market, they may only match buy and sell orders. If there are more than about ten transactions a day or if dealings occur regularly, it has become very likely that the Stock Exchange will cease to permit transactions³³⁾.

The occasional-bargains facility serves a fair number of firms. Recently about 50 companies have been traded with some degree of regularity. Reports on earlier years indicate an even more frequent use of this facility³⁴⁾.

The British over the counter market (OTC market) is sometimes thought to include 163(2) dealings as they may occur off the floors operated by various administrative units of the Stock Exchange in London and, on a much smaller scale, in Belfast, Birmingham, Glasgow, Liverpool and Manchester³⁵⁾. However, this applies to transactions in listed securities as well as to USM securities; it is always up to a broker whether he wants to deal with the jobber face to face on the floor or on the phone. Certainly, a jobber will be involved in a smaller part of the transactions under 163(2) as for these transactions dealing through a jobber is not mandatory³⁶⁾. In other words, these transactions may occur off the floor and need not involve a jobber. But neither criterion should be used to delineate exchange and OTC segments in the UK.

Since the off-floor criterion is used in the US, it should be noted, however, that the US exchange trading system is based on competitive open outcry, on the double auction in the crowd requiring trading on the floor (or automated or computer assisted trading along the same lines). In contrast, the jobbing system of the Stock Exchange in the UK is based on the market maker principle³⁷⁾, which obviously lends itself very well to off-floor trading as it merely requires a contact between market maker and broker or sequences of such two-person contacts, not the simultaneous interaction of a larger number of traders. This is recognized by the Stock Exchange in the UK, who have never shown any interest in a ban of off-floor trading by their members, contrary to some American exchanges.

Thus, for the UK the distinction of off-floor trading and floor trading is useless in this context. All transactions on or off the floor should be considered exchange transactions if they are effected by exchange member firms

according to the Stock Exchange's rules and regulations. Consequently, the term "over the counter market", the use of which has become fairly widespread in the UK during the last five years, is to be interpreted differently than in the US. It is understood to cover only the trading of company securities by non-exchange-member firms³⁸⁾.

There are about half a dozen OTC firms in the UK who are known to organize markets in certain securities. Two of these organize markets in more than ten securities, though their approaches to organizing markets is very different. The established firm is M J H Nightingale & Co. Limited organizing match markets for 20 companies³⁹⁾ and relying heavily on a substantial number of institutional clients. The approach of the firm has been to inject equity capital into small firms by private placings with a few clients and to continuously build a shareholder base by providing a facility for matching orders advertising the bid and asked prices of that facility daily in the financial press. This has generated interest in the shares. In some respects, this approach is now widely followed.

The second firm is Harvard Securities Limited, a licensed dealer currently maintaining market making positions in 11 classes of shares⁴⁰⁾. The company aims at a much higher number by the end of 1983. Harvard Securities relies, as do some other OTC firms, on individual investors. The firm has attracted these clients in large numbers (Harvard claims to now serve 22,000 individual investors) mainly with small accounts taking advantage of the concentration of most securities firms on the large and institutional investor.

New issues of smaller and sometimes quite young firms are brought to the market by Harvard and are offered for sale

or placed with clients supported by an undertaking of Harvard to make a market in the shares. The quotes are advertised as in the case of Nightingale. However, the different client base and the market making (for own account) contrast this approach sharply to Nightingale's.

II. EXCHANGE SEGMENTS

1. The Listed Securities Market as a segment for small company shares

As pointed out in the above section the majority of small company shares enjoying a secondary market are still traded on the "full listing" market. However, it is generally accepted that the listing requirements will tend to deter small companies from entering the exchange via this segment due to the costs involved in meeting the listing requirements, if the company has not been traded on the USM. The most economic approach to a full listing appears to be to move up from Rule 163(2) trading to the USM and then up to the listed securities market sufficiently broadening the shareholder base along the way. As a growing company will have a strong interest to provide the investors with a signal as to the breadth of the shareholder base and the resultant marketability of the shares, this route seems to be attractive. When a higher rung of the ladder of marketability has been reached, the financial press will report it. In addition, the image of an established firm may well require a full listing. In fact, a number of USM companies successfully applied for a full listing.

a) Listing

The relevant provisions are based on Rule 159(2) and the three appendices named therein. They are set forth and interpreted in the yellow book entitled "Admission of Securities to Listing" issued by authority of the Stock Exchange⁴¹⁾. All applications for listing must be submitted by a broker member firm of the Stock Exchange, even if the flotation is handled by an issuing house and not by a broker. The application should normally be supported by two jobbers who are prepared to register as dealers in the security.

A listing may or may not involve the issue of new shares. The yellow book explicitly recognizes ten ways of bringing securities to the market in connection with a listing. For companies coming to the Stock Exchange for the first time four of these methods of flotation of securities are most relevant:

- the public offer of newly issued securities⁴²⁾ by the company for subscription through an investment banker (prospectus issue)
- the sale of preferably newly issued securities or of securities already in issue by an investment banker
 - to the public (offer for sale)
 - to own clients and to the jobbers of the securities (placing)⁴³⁾
- the transfer of trading of a class of securities to the listed market from another market (introduction).

The listing requirements depend to some extent on the method of flotation used by the applicant.

The more important general listing requirements are listed below:

1. The listed securities are expected to have an initial market value of at least £ 200,000 (provided the market value of the issuing company is at least £ 500,000) in order to facilitate satisfactory marketability. However, in exceptional cases less than £ 200,000 may be acceptable to the Stock Exchange.
2. As the above requirement will be easily met even by most small companies the part of the issue to be publicly held is more important. Until 1977 the flotation had to lead to a 35% share in the hands of the public. Since then the part of the class of securities to be publicly held is 25%⁴⁴), except for very large issues where a smaller percentage may be allowed.
3. A prospectus with extensive disclosures on the history of the firm, on its current and expected situation and on its management. The details are set out in Schedule II Part A of Appendix 34 to the Rules. The head of the prospectus must carry a statement of the directors of the company that there are no material facts the omission of which would make any statement in the prospectus misleading. Great emphasis is placed on an accountants' report. An accountants' report is required by the Fourth Schedule of the Companies Act 1948. It must contain a profit and loss and dividend payment review for the five completed financial years immediately preceeding the issue of the prospectus. The Exchange requires the report to include additional information, e.g. a statement on sources and uses of funds. Also going beyond the provisions of the Act there is no exemption from the five year trading record requirements in the Exchange's rules.

4. Inclusion in the Extel Statistical Services. The initial Extel cards will contain the information provided in the prospectus in standardized format suitable for cabinet filing. These cards are generally on file with all securities firms for reference (in due course the initial cards will be updated by news cards and annual cards).
5. Advertisement of the prospectus in two leading daily newspapers. If a prospectus issue or offer for sale is used⁴⁵⁾, the advertisement must appear two days before the listing decision of the Quotations Committee is expected. In case of a placing, one prospectus advertisement and one box advertisement will do. A box advertisement is an advertisement of a size which is appropriate to the volume of the shares offered. It contains only a few lines from the head of the prospectus. In the case of an introduction two box advertisements in leading daily newspapers are sufficient and the prospectus may be available solely in the form of an Extel initial card. Though a printed prospectus in pamphlet form is not required, it is generally provided at least where newly issued securities are offered.
6. The issuer must provide the temporary documents of title and the definitive certificates in the form required by Schedules III and IV to Appendix 34. As registered shares are used in the UK, no major printing expenses are incurred because of the above requirements.
7. The shares normally have to be fully paid.
8. The articles of association should include certain investor protection stipulations and a number of provisions to ensure that certain services like transfers

and certificate replacements are effected without charge to shareholders (Schedule VII, Part A).

9. The listing agreement, which is a standard resolution passed by the board of directors of the company (Schedule VIII, Part A) obliging the company, among other things, to immediately release material information, publish an interim report, and make certain disclosures in the annual report. The directors are required by the listing agreement to submit to the Model Code for Securities Transactions by Directors of Listed Securities aimed at the prevention of dealing on inside information.

On the surface these extensive requirements may appear to ensure clearly sufficient initial and continuing information to investors and ready marketability of the securities. However, some less evident elements of the requirements intentionally build up a rather high threshold of quality, which an issue must pass before listing. This provides assurances of quality to the investors.

The listing decision of the Council of the Exchange through the Quotations Committee and the preparation thereof by the Quotations Department is the ultimate step in a thorough screening process. The Committee rely on rigorous checks by the sponsors. The sponsors are expected to scrutinize the accuracy of the information, to assume responsibility for the fairness of the impression given by the prospectus, and to ensure themselves that the directors meet high standards of responsibility and professionalism⁴⁶⁾ The sponsors, in turn, prefer to retain for the prospectus work prestigious accountants and solicitors. As everybody involved is very conscious of his reputation, the fact that the solicitors, the accountants and the sponsors

put their names on the line is an assurance of quality closely related to the quality of sponsorship.

The resultant threshold of quality is not easily overcome by a small company, even if it has been in business for the minimum period of five years. High business risk, a characteristic of small firms due to an obvious lack of diversification within the firm, may be perceived as unacceptable to investors or as a threat to prestige.

The listing requirements also imply considerable cost. For a small firm a placing is the method of flotation most likely used. Thus, a placing will be assumed in looking at the costs of listing of ordinary shares with a market value of £ 1 mio.

The most expensive item (all amounts in £ 000) is the prospectus advertisement with 50-75. The solicitors to the company and to the placing will require about 30, the accountant 10-15, the broker about 20. The printing and distribution of the prospectus is 10-15. The Extel Service will cost 5, as will the registrar and printing of the securities. Finally, there is 1-2 for the box advertisement and a listing fee of 1.1-2.6 depending on the percentage of shares placed. Thus, the total listing and flotation costs will amount to about 130-170⁴⁷⁾ or 13-17% of the amount placed. If a merchant bank is involved providing the issuer with the benefit of the bank's name, the listing and flotation costs could be around 20%.

There are also continuing requirements. The annual listing charges in the above case are £ 350 to £ 900, and the charges for the share register, the carrying of the share price in a leading daily newspaper⁴⁸⁾ and sundry shareholder services should be about £ 5,000. The costs of

the printing and distribution of reports to shareholders are substantial, but could have been incurred even without listing for these or other reports presenting the company.

A cost aspect which appears very significant is underpricing. Brokers and merchant bankers state that they try to avoid it. However, substantial oversubscriptions are the rule. For shares coming to the market for the first time price increases of 20, 50 or 80% on the first day of trading have occurred. Though investment bankers and issuers stress the need to offer the shares at a reasonable price allowing the placing of the securities with quality shareholders, the price changes on the first day may well imply underpricing, and hence imputed listing costs which at times will exceed cash costs of flotation and listing. Thus, the risk of underpricing may be an effective deterrent to listing. If 25% of all ordinary shares are to be made available to the public, when coming to the market for the first time, this can result in a tremendous opportunity loss for the issuer. For the USM this requirement has been set at 10%, thus substantially reducing the total imputed costs of the risk of underpricing.

Even on the USM some risk of underpricing remains. Underpricing may be intentional to ensure the complete sale of the issue, to stimulate investor demand for new issues generally, to reciprocate for the business obtained from institutions and to fuel activity in the after market. Underpricing may also result from problems in getting the price right. Off and on offers for sale by tender⁴⁹⁾ have been used, usually combined with a minimum price, to eliminate the risk of underpricing. However, a tender is not the perfect solution either. If the issue clears

at a price generally perceived as too high, the price in the secondary market will be under pressure for a long time leaving the company with disgruntled shareholders and a negative impact on its image. A straight tender may also put the shares in the hands of only a few shareholders. There is neither a case for offering new issues at a fixed price nor for a straight tender, leaving the issue with the highest bidders. However, there is much to be said for a mixture, for a tender allowing oversubscriptions in order to reduce both the risk of improper pricing and the risk of poor marketability due to the concentration of shareholdings. It should also be noted that concentration of shareholdings implies a risk of unwanted outside control of the issuing company; a certain degree of underpricing may be quite acceptable in order to avoid this. In a balanced approach the price would have to be set in view of the tenders received at the discretion of the sponsoring investment banker⁵⁰⁾.

b) Trading

In principle, it is mandatory for member firms in the UK to transact every deal with a jobber. Members of the exchange are either jobbers or brokers⁵¹⁾. Jobbers do not have private clients, as the principle of single capacity requires that a firm should either deal for its own account (and be remunerated by realized spreads) or act as an agent for others (and earn commissions). Dual-capacity firms are not permitted by the Exchange. Brokers will generally execute a client's order immediately by trading with the jobber who offers the best price for the client among the jobbers specializing in the relevant class of securities.

In the normal dealing procedure jobbers act as market makers⁵²⁾, that is at any time during trading hours on the floor (9.30 a.m. to 3.30 p.m.) they are willing to immediately buy or sell marketable quantities of securities in which they are registered as jobbers for the account of their firm and on the basis of quotations which they themselves determine. Jobbers will usually register in at least a few dozen securities. For shares of a small company there will generally be two competing jobbers. Unless they prefer to trade at their offices, the jobbers are found at their pitch on the floor of the exchange, where they quote or deal either in person or by telephone.

When a broker receives an order he will first ask the appropriate jobber or jobbers on the floor for their quotations without revealing whether he wishes to buy or sell. He will then phone any other jobbers e.g. on other floors. Only then will he deal with the jobber offering the price most favourable to his client. All company securities are dealt in for the "account", i.e. they are traded forward and the dealings of two weeks are bulked together for a single settlement. This reduces the necessity of transfers in short-term trading and facilitates the carrying of trading positions by jobbers.

The normal procedure bears out the principle that all orders are executed immediately as it is mandatory to deal through a jobber. The jobber constitutes an immediately available counter-party. However, in small company shares it may happen that a jobber's quotation is only one-way, i.e. he quotes only a bid or an offer. Limited immediacy services may also result from the jobbers' unwillingness to execute more than a part of a normal-sized order. Orders or parts of orders not executed (owing to the above circumstances or because a bid or offer is not

acceptable to the broker and to his client) may be left with the jobber with or without limit for later execution. Orders left with the jobber have priority over the jobber's bids or offers for his own account, regardless of any position the jobber may have⁵³⁾.

The put-through is a further very important variant to the normal trading procedure. Usually, a put-through arises in large transactions. A broker will frequently be able to obtain for a larger order of one client a matching order from another client. As the jobber will generally reduce his bid if more than marketable quantities are offered (or increase his offer if substantial quantities are sought)⁵⁴⁾, this prearranged matching will be a service of the broker well received by his clients. The resultant matching orders, opposite in way, must not be crossed by the broker but, since dealing through jobbers is mandatory, must be put through the book of a jobber. In a put-through a jobber renders two services. First, since the put-through implies the sale of shares to a jobber and the simultaneous repurchase by the broker involved at a slightly higher price to compensate the jobber, the jobber is party to either transaction assuming settlement risk and guaranteeing payment and delivery. Second, his involvement is to assure both clients a fair price. In some transactions these mandatory services may be very valuable to an investor⁵⁵⁾.

It is not compulsory, except in certain cases, e.g. in case of a put-through, to report the prices of transactions. Basically, members are free whether or not to report prices for publication in the official list. The daily official list carries the closing quotation and the prices of bargains "marked" (reported). Turnover data are available neither on individual transactions nor on daily volume

of individual classes of securities. The financial press reports middleprices based on closing quotations. Throughout the day middleprices are chalked up by jobbers on their pitches, which may be outdated at times. Thus, for electronic dissemination of midprices during the day, price collectors will use quotations ascertained from jobbers.

The cash transaction cost incurred by an investor in a listed-market transaction has five components. First, there is the fixed minimum commission of the broker required by the Stock Exchange. For transactions in company shares it is 1.65% on the consideration in transactions up to £ 7,000⁵⁶⁾. Second, the value-added tax on the commission has to be paid. Third, there is the compensation of the jobber which is included in the price at which the jobber dealt. The compensation for his immediacy service, pricing-service and settlement-guaranteeing service cannot be ascertained⁵⁷⁾. However, on average the compensation will tend to be clearly higher than in a put-through where the jobber will receive the equivalent of half the minimum commission even though he is rendering no immediacy service at all. As in the normal trading procedure the jobber does render all three services, his compensation will tend to be higher. Fourth, a contract stamp must be paid for each transaction (10-60 pence). Finally, there is a transfer stamp duty of 2% on the value of each purchase (not on sales) involving a transfer of shares.

2. The Unlisted Securities Market

As pointed out in the survey of secondary markets, the USM was established to provide a competitive exchange market segment attracting small companies discouraged to

seek a listing due to the listing requirements. Differences with the listed market were originally conceived for both entry requirements and trading procedures. However, today it appears that the relevant differences concern the entry requirements and the image of the new segment.

a) Requirements for entry

The requirements for first entry to the USM should be seen against the background of the listing requirements set forth in Section 1a above. Thus, the following points will focus on the major differences⁵⁸⁾:

1. There is neither a minimum requirement for the capitalisation of the issuing company nor for the aggregate value of the class of shares for which permission to deal on the USM is requested.
2. The part of the issue to be made available to the investing public is 10% as opposed to 25% for the listed market, significantly reducing the effect of any underpricing that may occur. In the case of a placing, which is the dominant method of flotation used in connection with entering the USM, at least 25% of the amount placed should be offered to jobbers to ensure a wider spread of shares.
3. A prospectus with extensive disclosures is required as for full listing. However, there are two major differences. First, the minimum time period to be covered is normally only three years; in exceptional cases, young companies with an even shorter trading record

but a project fully researched and costed may successfully apply. This compares with a five year business record requirement for admission to listing. Second, an accountant's report is not required by the exchange. However, an accountant's report is mandatory if the company or a party connected with the company wants to market shares (Section 38 of the Companies Act 1948).

4. Inclusion in the Extel Service is required as it is for listed companies.
5. No advertisement of a prospectus in a leading daily newspaper is mandatory. In case of a placing or introduction one box advertisement will do. Even in case of an offer for sale only two box advertisements are required. However, it is expected that a much larger supply of prospectuses will be available than in the case of a placing. In any case the advertisement must state where the printed prospectus or Extel particulars card may be obtained.
6. With respect to printing requirements for documents of title and certificates there are no differences to full listing.
7. Partly paid shares will be considered.
8. There are no differences as to the provisions to be included in the articles of association.
9. The listing agreement is replaced by a "USM general undertaking" containing the same requirements except for some items of limited importance.

These differences in the requirements do affect the

threshold of quality an issue must pass. The major factor for this is the reduction in the years in business required. A five year track record provides a more reliable basis for a judgement than a three year business history, not to speak of the limited objective information available on a green-field company also allowed to enter the USM. There is some reluctance to sponsor and grant permission to rather young companies. But some did enter the USM, though most firms on the USM are more mature and many would have been eligible for full listing.

The advantage of the USM for the more mature company is the entry cost advantage as compared to listing. This advantage may be appreciated by focussing again on a placing of ordinary shares with a market value of £ 1 mio involving, as most USM placings, both newly issued and previously outstanding shares. For the various cost categories set out in Section 1a above the same amounts appear realistic as to the fees for the broker, the lawyers, the accountant, the registrar and the Extel Service. This also holds for the cost of printing and the expenses for the box advertisement. However, the saving of the initial listing fee - there is no USM entry fee - and of the cost for advertising the prospectus takes off £ 50,000 - £ 75,000, resulting in a total cash entry cost of about £ 80,000 - £ 90,000, or 8-9% of the amount placed. The costs are even lower where only one solicitor is retained and where no prospectus in pamphlet form is provided. The costs may be higher than stated above where the sponsoring broker, required for filing the application to grant permission to deal on the USM, acts jointly with or on the initiative of a merchant bank or of a licensed dealer.

The continuing costs are about the same as for listing, though the scaled annual listing fee is replaced by a flat annual USM fee of £ 1,000. The requirement to make available to the public at least 10% of the issue instead of 25% has great significance for the imputed listing costs resulting from the risks of mispricing. The reader is reminded of this important point that has been discussed in Section 1a above. An entrepreneur may also prefer to have less shares initially publicly held for other reasons.

A growing company may need additional equity finance a year or two after entering the USM. Basically, the alternatives to obtain the funds are, on the one hand, the use of partly paid shares initially and a call on shareholders as the need arises, or, on the other hand, the issue of additional shares. By comparison to the second, the first alternative requires the issue of more shares initially, thus increasing the exposure to mispricing risk though obviating additional entry costs at the time additional finance is needed. The alternative to be chosen generally cannot be determined on the basis of the net balance of the above stated factors alone. However, the efforts of the Stock Exchange to reduce the costs required to obtain permission to deal on the USM for additional shares may well tip the balance in favour of the second alternative.

Contrary to the listed market there will be no exchange fee for any additional amount raised. The exchange does not require any advertisement, except if a new class of securities is offered. With respect to the prospectus it should be noted that no accountants' report is required due to a disapplication provision in Section 38 of the Companies Act 1948, though an extensive report would be required by the exchange on the listed market⁵⁹). It should be also noted that, contrary to the procedure with further listings, the prospectus (which may take the form

of a letter) need not repeat information carried on an Extel card which remains correct. As most of the legal work required will have been done in connection with the initial permission to deal, the legal fees should also be relatively low. Finally, the market price is known and mispricing is very improbable. Thus, moderate flotation costs for additional shares can be expected.

Once 25% of the shares of a USM company are publicly held, which could result from additional issues of new shares, the company may want to transfer to the listed market by way of introduction. This is the most economical method leading to listing. In this case there will again be no prospectus advertisement required and no substantial additional other requirements if the company entered the USM on the basis of a full prospectus (accountants' report covering five years)⁶⁰. There must be a new Extel particulars card and a listing agreement filed with the application for listing. As in the case of any listing by way of introduction, two box advertisements are mandatory. Finally, the listing fee must be paid.

b) Trading

In designing the USM a situation was perceived in which the trading procedures of the listed market could prove inadequate. Thus, it would be in order for the sponsoring broker to apply for permission to deal without being supported by two jobbing firms who are prepared to register as market makers in the security. The sponsoring broker may apply to act as a matching broker instead if the support of two jobbing firms is not forthcoming.

Indeed, for very small issues this approach could be appropriate. As pointed out in Section 1b above, the jobber may act in principle as a matching broker in small issues where he is not willing to provide immediacy services. If a small issue is placed by a regional firm of brokers and, as a result, is held by the broker's clients predominantly, there is a very strong point to be made for letting this broker, and not two jobbers, act as a matching broker.

However, this alternative trading procedure has yet to be put to a test. There are a number of reasons for this. As indicated in Section I 5, the average size of USM companies is more than four times the average size of the 974 listed UK companies not belonging to the 1000 largest listed UK companies. As a result, the market value of 10% of a USM company tends to be higher than 25% of a listed company; the alternative trading procedure may deserve testing on the listed market in the first place.

Further, it would be a misconception to assume that a share enjoying a match market provided only by a jobber for some period will remain a match market share. Usually, there are periods of inactivity and periods of active trading in a share. During the active periods a jobber will offer immediacy services, thus providing most investors trading in the issue with these services. These investors would most likely be deprived of immediacy services if the alternative approach was used. This result is only acceptable if the investors do not desire immediacy services or if they are not prepared to pay the price for these services implicitly charged by the jobbers.

In the active periods the price would move in response to the trading position of the jobbers reflecting supply and

demand. In a dull period the price will usually stay at the level established by the last active trading, and the broker or the jobber will be trying to match orders at this level. Looking at active and inactive periods, the flexibility of the jobbing system appears preferable to the rigid matching broker regime. Finally, the jobbing firms have made it a point to support all USM applications. As a result, there will not be a lack of support in the foreseeable future and, therefore, the alternative approach, trading through a matching broker, will not be tested.

Thus, trading on the USM is subject to the normal procedure employed in the listed market and to its variants. The jobbing firm Bisgood, Bishop & Co. Ltd. are dealers in all USM stocks concentrated at one pitch. Competing firms of jobbers are registered as dealers in varying numbers of USM securities, though none trades the whole range of USM stocks. Many USM stocks tend to enjoy active trading, as there is great investor interest in the USM, though there are others with hardly any bargains in the book for recent accounts.

The commission rules of the Stock Exchange apply to the USM as well (see Section 1b above). There are no differences. With two exceptions, the same holds with respect to price reporting. First, the Daily Official List does not report quotations for USM securities. They still remain unquoted securities in a legal and fiscal sense. The prices of USM bargains marked are published at the end of the official list. Second, an electronic publishing firm has made arrangements to obtain up-to date information on USM quotations and publishes midprices, and other information usually provided in the price tables of the financial press, on Prestel, the British viewdata service, already accessible by local calls from more than 90% of the telephone locations in the UK⁶¹).

3. The Occasional-Bargains Facility

Under Rule 163(2) the Quotations Committee may permit specific bargains in securities of domestic public or private companies neither listed nor traded on the USM. The permission will be granted only if some requirements are met. Thus, if a broker anticipates a need for transactions in the shares of a company among his clients following a private placing (which is generally permitted by Rule 164 regardless of a listing application) or for other reasons, he will most likely take the initiative to meet the requirements, and he will then act as the sponsoring broker for the company. He may already have an established continuing relationship with the company; in preparing the private placing the broker or merchant bank will usually improve the financial control system of the company and in some kind of undertaking reserve the right to select an outside director of the board of the company.

The broker will have to file with the Quotations Department the latest accounts, any subsequent circular to shareholders and any recent prospectus. Accounts with materially qualified auditors' reports will normally make a company ineligible for access to the facility.

Once the Committee is in a position to grant permissions of occasional transactions as there is a satisfactory company file with the Department, such transactions may be forthcoming. Any orders of clients may be matched in house by the sponsoring broker or by another broker. Broker-to-broker matching of orders is also a possibility. It is up to the broker where he will look for a counterparty. He may even be prepared to deal with the client for his own account. Jobbers frequently facilitate

transactions in Rule 163(2) securities. The jobber is supposed to match orders only, he must not maintain a market maker position⁶²⁾. The prices of any deals will be determined by the judgement of the broker or brokers involved unless clients put limits on their orders. No transaction may be consummated without the permission of the Committee to the individual transaction. The commission rules apply for any transactions permitted. The prices of all bargains will be recorded and published in the Exchange's Weekly Official Intelligence and in the Saturday Financial Times, which helps to develop investors interest.

The permission is usually withheld where an active market is developing or appears likely to develop. In fact, it was withheld on a number of occasions, but to the displeasure of the investors and member firms involved⁶³⁾. As expected, the withholding of permissions occurred when both sides to a substantial number of transactions were put together awaiting permission for confirmation, and then the matching efforts were in vain. Thus, the facility should not at all be regarded as a regular secondary market providing marketability to small company shares. To some extent the facility is merely a means to allow member firms to effect legitimate transactions in securities not suitable for active trading. It also serves to curb trading in securities neither listed nor dealt in on the USM.

More importantly, the facility may serve to develop a spread of shareholders sufficient for entry to the USM or even to the listed market by way of an introduction. It is this aspect of gaining low-cost access to these markets that makes the facility relevant to a growing small firm. If this route is chosen, the initial placing should, as a rule of thumb, involve about £ 500,000 in order to

allow 10-12 institutional investments of about £ 30,000 each. Investments in lesser amounts tend to be sold soon; the continuing costs of monitoring are spread over too small an amount. More recently, institutions seem prepared to hold on to somewhat smaller investments. They perceive a rapid change in the structure of industry and are anxious to take on a stake in small promising companies. This tendency effectively lowers the minimum demand of a company for equity which is required to access the lowest Stock Exchange segment clearly below the amounts that are economical for USM entry or listing.

III. THE BRITISH OVER THE COUNTER MARKET

Any of the many non-exchange-member firms engaged in investment banking in the UK will, e.g. subsequent to placings, from time to time also become involved in secondary-market transactions. Their clients' needs may call for replacings, for the sale of shares to meet tax payments, or for the investment in unquoted securities. These demands will usually be met. But there are only about half a dozen non-member firms which organize markets in certain stocks and advertise these facilities. As pointed out in the survey, there are two leading firms offering secondary market services using distinctly different approaches. These approaches will be outlined below.

1. The Nightingale Concept

M.J.H. Nightingale & Co. Limited was founded in 1966 and has been providing a secondary market for small companies

since 1972. The company provides comprehensive and integrated primary and secondary market services to independent small and medium sized companies of above average quality and of interest to institutional investors. Many elements of the Nightingale concept are now widely used. Though the volume of the services of the firm is rather limited, the clarity of the concept makes it very useful as a point of reference.

The central objective of the firm is to thrive by channeling funds from institutional investors to small companies. The reluctance of institutions to invest in shares of small companies will be overcome only if the institution gets the same kind of service that is available for large listed companies:

- quality investment selection based on thorough industry and company analysis,
- continuing investment reports on the performance of the company,
- a secondary market providing a way out in size.

Obviously, for small company investments these requirements cannot be met along the lines which have been successful for large company investments: competition of member firms in investment research and competition of substantial numbers of individual and large investors for investments. The production of research reports on small companies for an anonymous demand would obviously be a wasted effort. The situation calls for a close relationship with the investors on the one hand and with the company on the other. Of course, the closeness of these contacts, the serving of two masters without the control of direct competition by other firms, could easily result in angry thoughts of one side of being taken advantage of. Thus, the contacts with either side had to be structured in a clear-cut

and convincing fashion.

The Nightingale concept has proven successful. The firm started with 5 institutional investors and 1 company. Now there are 80 institutional investors, holding 80% of the shares marketed by Nightingale, 3000 individual investors, and 20 companies. The firm became a member of the Issuing Houses Association in 1981. Major British institutional investors recently acquired a substantial minority interest in the firm⁶⁴⁾.

At the core of the firm's success is a strong corporate finance department focussing on small companies. To some extent, this force is needed to screen and monitor companies looking for equity capital. More importantly, it is maintained to offer on a fee basis corporate advice to companies who want to grow, stay independent and would like to get financial service beyond technical assistance. Any problems which may stand in the way of a flotation can be identified and, hopefully, resolved. As a consultant involved in the long-term corporate planning, Nightingale is in the position to assess and monitor a company's performance.

If the plans of a company and its shareholders require a flotation of shares, Nightingale & Co. will prepare an investment report. This report emphasizes the strategy of the company and meets in substance the prospectus requirements of the Companies Act. In addition, the company will have to agree to a standardized "OTC General Undertaking", which is very similar to a listing agreement or USM general undertaking. This undertaking obliges the company to make proper disclosures and to ensure arm's-length transactions between the company and its directors or major shareholders (or any associate of these). The

undertaking is very restrictive with respect to insider dealing compared to the Stock Exchange Model Code for transactions of directors. In short, insiders are not permitted to deal except during the month after the release of the interim report and during the period between the announcement of the annual results until two months after the annual general meeting⁶⁵⁾. Insiders may not hold securities for periods of less than twelve months.

The investment report or a prospectus, if required by law, will be circulated among prospective investors. Nightingale & Co. do not believe in a large minimum spread of shareholders. Initially there should be no more than 50 and later no more than 300 shareholders. The investment merits of the issue ought to attract no more than a handful of institutions initially. Any non-institutional investors should somehow be initially related to the issuing company (suppliers, employees). The initial placement desired is 10-15% of the ordinary share capital, but the percentages actually experienced have ranged from 4% - 100%.

Once an issue is placed, institutions and other investors will tend to leave limit orders and indications of interest with Nightingale. Thus, transactions may be triggered by these orders to be settled every other Monday. The bids and offers of the clients will indicate the valuation of the investors. These limits are adjusted by the investors as the economic conditions change and as reports on the company are released either by Nightingale or by the company. The quality of the prices established in trading depends, as in other markets, on the quality of the assessments made by the investors. Institutional and related investors seem to provide a reliable basis. Up-to-date company information is available from Nightingale

as the clients place and discuss their orders. The fundamental investment report on each company is updated annually. Share prices and related information are included in Nightingale's price list for all their OTC stocks advertised daily in the national press (Times, Financial Times, Daily Telegraph) and on Prestel.

Nightingale & Co. do not maintain trading positions, they act only as a matching broker. It is a key point that the orders of the buyers are executed at the same price as the matching orders of the seller. Any substantial dealing for their own account could well cast doubts on the fairness of the market organizer. Nightingale employees are not permitted to deal in any OTC securities.

If an institution wants to deal in size, the other side of the transaction has to be assembled. The indications of interest left by institutions and the knowledge of all investors in a stock will greatly facilitate this. It is another key point to know all holders of OTC stock and to not arrange purchases for persons who either do not respect the independence nor support the management of an OTC company.

The initial and continuing valuations of shares in the Nightingale OTC market are said to be competitive compared to those in other market segments. Entry and trading costs also appear to be competitive. However, any comparisons suffer from the different scope of services. For example, the commission rate of 1.25% cannot be compared with the rates charged by member firms of the Stock Exchange without a detailed analysis; the absence of the jobber's turn, increasing with the size of the transaction, makes this rate look competitive, the speed of execution may or may not. The same holds for Nightingale's flat

annual "listing" fee of £ 5,000, as it includes price advertisements in the national press and advisory services not included in the exchange fee. The cash cost of placing charged by Nightingale is not easily compared with entry costs to other segments, mainly because Nightingale will ask for long-term deferred warrants expiring after ten years on about 5% of the issued share capital. Nightingale will acquire the warrants from the issuer at an arm's length price; this may be viewed as a conversion of commission money having no lasting incentive effect into a form of compensation superior in the investors' and the company's view. Warrants provide a powerful incentive to contribute to the successful development of a client company. Warrants acquired in this way also signal a commitment to the company by a group of persons who are in the position to best judge the company's investment merits. This is apt to increase the confidence of outside investors in relying on the shares offered as a long-term, strategic investment.

The typical client company for the OTC services will be an established family-controlled company with a market capitalisation of £ 1 mio or more at the time of the initial offer. Another Nightingale service focusses on even smaller companies. As such small companies seem to be overburdened with the task of maintaining relations with a fair number of outside shareholders and reacting to their various opinions, they are offered development capital from one of the funds managed by Nightingale and backed by major institutional investors. The entrepreneur will be concerned with only one outside shareholder and can concentrate on the innovation and production side of his business. If the company is successful and grows to a size appropriate for the OTC market the fund may sell all or a part of the investment by an initial offer in the OTC market. Then a spread of shareholders can be

developed in subsequent trading. This may ultimately lead to a further progression in the financial status of the company. Two Nightingale companies were introduced on the Stock Exchange, one entered the USM, the other went to full listing.

The Nightingale concept achieves quality investment selection, monitoring of the investment and secondary market service for the investor. It also achieves strategic financial advice, fund raising and assurance of independence for the company. The high degree of credibility of these services is visibly based on the absence of information trading by Nightingale and by company insiders, and on the long-term commitment of the market organizer to the interest of all shareholders generated by the warrant scheme. It should be remembered that this concept has been designed and put to work by a small financial firm.

2. The Broker-Dealer-Approach

More recently than Nightingale a small number of firms have entered the OTC. They are licensed dealers in securities and use their legal capacity to effect transactions, both as agent and as principal, following the traditional approach of US OTC firms. This way of engaging in the securities business, though to a foreign observer it may appear hardly worth mentioning, is in sharp contrast to the concept of the Stock Exchange. One of the foundations of the present Stock Exchange organization is the principle of single capacity, brokers transacting for their clients in the capacity of agents at arm's length with principal-capacity jobbers. Dual-capacity firms are banned under the Stock Exchange rules. But most British OTC firms are just

that as they are structured on the American model. The three components of a traditional OTC broker-dealer firm are brokerage business for a large number of individual clients, investment banking and market making. The market making will tend to be concentrated in the securities the firm brought to the market as an investment banker and either activity will flourish only on a strong client base.

Surprisingly, the OTC firms managed to attain a sufficient client base in the competitive London environment. Harvard Securities Limited, founded in 1973 and now the largest of the OTC broker-dealer firms, claims well above 20,000 clients. Their success may have been facilitated by the tendency of established securities firms to concentrate on the institutional investor and on the wealthy and older individual. Firms such as Harvard seem to focus on individual clients with the following characteristics:

1. He or she enjoys a reasonably good grasp of economic and financial interdependencies and likes to turn his or her assessments of foreseeable situations into investment profits.
2. The client is prepared to spend some time on his or her investments and would not want to let somebody else manage the funds.
3. The funds available for investment are, at least initially, rather limited and may be insufficient to be accepted at some established securities firms. Even if not turned down, the investor may feel uncomfortable, as his or her small and frequent transactions are not appreciated and appear cumbersome to those involved in the execution.

4. Due to his or her limited funds and for other reasons the client prefers a non-established, down-to-earth securities firm.

The successful firms seem to be well geared to clients of this kind. They operate outside the city and tend to show a discount-broker image. They welcome smaller transactions. The newsletter that Harvard Securities distributes monthly to clients is void of sophisticated tax planning aspects; the focus is on investment in domestic and foreign shares which may benefit from recent developments⁶⁶⁾. The following paragraphs will concentrate solely on trading in shares brought to the market by an OTC firm, though the principal activity of an OTC firm may well be the commission business in shares dealt in on the Stock Exchange or traded on foreign markets.

The focus in investment banking again is on a market niche. First, the companies may be very young. Harvard Securities generally requires a minimum of one year's audited accounts and a sales forecast for the current year. Second, it is up to the company as to how much of the share capital is made available to the public. Third, even issues below £ 0,5 mio are taken care of, and it appears that the percentage cost of flotation, including the costs of a printed prospectus, is not higher than for large issues. It should be noted that these placing costs appear, in the limited evidence available, to be well above 10% and clearly higher than in case of entry to the USM via a placing. However, OTC placings do have characteristics of a USM offer for sale which is more expensive than placings.

In addition to the three points already mentioned, the investment banking services offered may be attractive to companies not prepared to accept the outside influence which tends to come with the concentration of share-

holdings either with a few institutions, or through a sponsoring broker enforcing exchange standards or to some extent through a listing agreement or undertaking. Some OTC firms do not use general undertakings. The issuer does not have to accept a close relationship with the investment banker⁶⁷⁾, and the OTC placing of the shares with a large number of individual shareholders will clearly help to avoid outside influence. Further, as there is no need to go through the penetrating routine of a Stock Exchange application procedure, which usually adds two weeks to a placing timetable, a placing can be prepared and effected within about two months. Finally, OTC firms are prepared to place high-risk issues with their clients who tend to be appreciative.

Once an issue has been placed, the OTC firm will, according to the commitment made in the prospectus, make a market in the shares. The substantial number and wide spread of shareholders will prove very valuable. The price will be guided by the market maker position. The immediacy services of the market maker provide ready marketability of OTC investments held by individual clients. As on the Stock Exchange, trading is for the "account".

Market making by OTC firms is still at a competitive disadvantage with market making by jobbers. A jobber has an advantage since he only pays a 50 pence transfer stamp, instead of the regular 2% transfer stamp duty, on transfers resulting from the change in the market making position compared to the position at the end of the last account⁶⁸⁾. This advantage is quite important when an OTC company enters the USM or the listed market and the OTC firm continues to make a market in the shares.

The investor will not be charged a commission when dealing with an OTC market maker. Even though the spread⁶⁹⁾ seems to be competitive with the spread of jobbers in comparable securities, the investor sells net at the bid and buys net at the offer. Of course, the contract stamp has to be paid and, where applicable, the transfer stamp as well on purchasing. However, there is no VAT on the commission as there is none from a taxation point of view. Most OTC quotations are carried in a financial weekly magazine. In addition, they may be carried on Prestel or on Reuter. Harvard Securities advertises its quotes daily in the Evening Standard and once a week in the Daily Mail and the Sunday Telegraph (advertising expenses run £ 70,000 a year).

Favourable comments will hardly be heard on the OTC broker-dealer firms. Certainly, there are elements in their business which may give rise to critical comments. Obviously, there is neither a competing market maker nor a built-in checking of the market maker by the client's representative. A small new OTC firm could also try to unload securities without investment merits on the public. There is much to be said for establishing rules of fair practice by self-regulation and for a subsequent adjustment of the licensing of dealers in securities⁷⁰⁾; the extensive activities of broker-dealers in the US may be acceptable only as they are guided by a well developed body of regulations. This work is under way and a National Association of Security Dealers and Investment Managers (NASDIM) has been formed attracting 146 member firms by November 1982. But any criticism leveled at broker-dealers in the British OTC market and any attempts at regulation should recognize that this vertical market segment is the lowest in the hierarchy providing equity finance to small companies which may be successful but, at least in some cases, cannot pass a higher

threshold of quality than a very low one at this stage in their development. Any upgrading of regulation is likely to restrict the ease of entry to the market for primary and secondary market services and to reduce the choice of companies as to the timing and the conditions of their equity financing. There is a borderline between disclosure and quality control that should not be crossed in the bottom segment.

IV. SUMMARY

Small companies desiring to have their shares traded in a secondary market will most likely be able to choose among five market segments. Though accessible even for companies with rather low market capitalisations, the top segment, the listed market, will frequently not be a first choice because of the 25% of the shares to be made available to the public, the five year trading record and the advertisements required. The relaxations of these three requirements brought about by the USM in 1980 have made the Stock Exchange more attractive. If a company is not prepared to distribute 10% of its shares to the public or to meet other requirements for USM entry, there may still be a good chance to get on the Nightingale market, to have a market made by a broker-dealer or to gain a first experience in the secondary market using the occasional-bargains facility of the Stock Exchange. In contrast to the USM and the listed market, these markets all provide for single-firm responsibility for both investment banking and secondary market services to the issuer, in other words, for an integrated, one-stop capital market service. Any of these points of entry to the secondary market encourage the investor to take on the shares and may, as experience has shown, allow progress to full

listing effectively and efficiently.

To the advantage of small companies in the United Kingdom there is price and quality competition among the suppliers of both investment banking and secondary market services. This is fostered by the flexible attitudes of the relevant regulators⁷¹⁾ leaving it to the private institutions to determine the structure of the market and the quality of shares offered. Capital market services may be offered by a wide range of financial institutions, and entry into the securities industry is easy by any standards. This competitive environment has no doubt played an important role in bringing about changes in the market organization. Both the opening up of the occasional-bargains facility and the USM are results of quality competition⁷²⁾.

The driving force behind all primary and secondary market activities is the strong investment and investment services demand by institutional and individual investors. Its strength and scope have led to both specialized teams of industry analysts and early interest in small companies. At least in public offers this combination results in price-earnings ratios for small company shares not attained by small companies in Continental market places. This strongly reinforces issuer interest in equity financing. In addition, investor interest in small company shares has been helped by the marketing impact of the USM focussing general investor interest on a rather small supply of equity instruments, thus contributing to a frothy sentiment. Recently, tax incentives also have been fuelling interest in small company shares⁷³⁾.

The apparent success of secondary markets for small company shares in the United Kingdom cannot be attributed to any single factor or ingenious decision. It flows mainly from

the liberal approach to the regulation of securities markets and from the scope of institutional and individual equity investment, which in turn is rooted in various arrangements such as pension schemes much less used in other countries. In short, this success is the result of the British financial system and of the competitiveness and professionalism it fosters.

Footnotes

- 1) Wilson Committee, Interim Report: The Financing of Small Firms, London: HMSO, 1979 (Cmd. 7503), p. 21.
- 2) R. Burr, Employee profit-sharing given fresh boost by Chancellor, Financial Times, March 16, 1983, p. 23.
- 3) Wilson Committee, Interim Report, l.c., p. 13.
- 4) Central Statistical Office, Financial Statistics, February 1983, p. 118. Cf. Stock Exchange Fact Book, December 1982, Table B 5, for gross "new issue" proceeds of listed companies indicating that participating redeemable preference shares contributed 11% to gross share "issue" proceeds of £ 2056 mio in 1982 (this amount includes sales of existing shares to the public, e.g. the offer for sale of 51% of Britoil).
- 5) Shareholders Analysis, Supplement to the Stock Exchange Fact Book, December 1980, pp. 1-3.
- 6) T. Dickson, Small business: Record number of new measures, Financial Times, March 16, 1983, p. 25. Cf. Wilson Committee, Interim Report, l.c., p. 18, where this approach has been viewed not as a concession but as an offset to an existing fiscal bias. Cf. note 73 infra.
- 7) Pension schemes, about 85,000 in number, have held half of their £ 31 mrd assets in ordinary shares (Wilson Committee, Report, l.c., p. 469). At the end of 1980 they held UK listed securities valued £ 22.8 mrd, which is 27% of all such securities (Stock Exchange Fact Book, March 1982, p. 46). The tax treatment of pension funds makes them very attractive. Insurance companies held domestic ordinary shares worth £ 19.4 mrd at the end of 1981 amounting to 26% of all insurance companies assets (Central Statistical Office, Financial Statistics, February 1983, pp. 83-84). At the end of 1981 investment trusts and unit trusts held domestic ordinary shares valued £ 8.24 mrd (ibid., pp. 80-82).
- 8) Stock Exchange Fact Book, March 1982, p. 46.
- 9) A guide to development and venture capital facilities, Investors Chronicle, February 19, 1982, pp. 29-40.

- 10) Central Statistical Office, Financial Statistics, February 1983, p. 118.
- 11) Ibid., p. 32, 117, 118.
- 12) From year end 1973 to year end 1980 the number of listed ordinary shares declined from 3301 to 2283 (Stock Exchange Fact Book, March 1982, p. 42).
- 13) Bisgood, Bishop & Co. Ltd., U.S.M. Manual (March 15, 1983). Dealings on the Unlisted Securities Market commenced November 10, 1980.
- 14) Stock Exchange Fact Book, March 1982, p. 47. In addition, there are 17 firms of jobbers, who may participate in the underwriting of a new issue.
- 15) Cf. Prevention of Fraud (Investments) Act Licensing Regulation 1944, Sec. 3-10, requiring references by a bank manager, an exchange member and a lawyer, and Prevention of Fraud (Investment) Act, 1958, sec. 3 and 4, requiring an application fee and a deposit of £ 500. It should be noted that the licence is up for renewal annually. The renewal will be helped if any problem or query of clients received full and proper response (cf. Sec. 5 of the Act).
- 16) Horizontal segments which are either competing submarkets for securities traded in a certain vertical segment or submarkets complementing the vertical segment, will not be discussed, though some foreign banks and brokers in London do make markets in listed foreign securities competing with the jobbers of the Exchange. Further, the Stock Exchange operates an option market, which is also an horizontal segment. Finally, Ariel, the computer assisted trading system of institutional investors, should be mentioned. It is designed to be both a block-trading complement and a competing market allowing transactions to occur without the intervention of a jobber (for details see H. Schmidt, l.c., pp. 69-73).
- 17) Under Rule 163(3) securities of mineral exploration companies approved by the Council of the Exchange may be dealt in for a limited period. This fourth segment for shares is not discussed as it provides a temporary market for only non-industrial company shares.
- 18) Stock Exchange Fact Book, December 1981 and 1982, Table A 3. In addition, there were 1138 classes of preference shares (1981:1220) with a market value of £ 1.1 mrd (1981:0.9).
- 19) The Stock Exchange, 1000 Largest Listed United Kingdom Companies, December 1982.
- 20) Among the listed companies there are quite a few with market capitalisations of £ 0.1 mio and £ 0.2 mio (Classification of equity securities by Institute of Actuary groups, Supplement to the Stock Exchange Fact Book, December 1982). The smallest USM companies have market capitalisations of £ 0.3 mio.
- 21) In 1981 the firm became a member of the Issuing Houses Association.

- 22) H. Schmidt, l.c., pp. 74-75. Wilson Committee, Interim Report, l.c., pp. 14-15.
- 23) Still, it has been said: "The USM was formed by the Stock Exchange in November 1980, partly to counter the somewhat embarrassing success of Nightingale". W. Kay, Twinlock turns key, Sunday Times, August 22, 1982.
- 24) Wilson Committee, Interim Report, l.c., p. 16.
- 25) Even the term "Unlisted Securities Market" was used in this context. Charterhouse Japhet, Capital raising - alternatives to going public, London 1979, pp. 2-5. Wilson Committee, Interim Report, l.c., p. 14.
- 26) Stock Exchange Fact Sheet, January 1981.
- 27) Jobbers sales and purchases; turnover should be halved for comparison with volume of pure match markets. Stock Exchange Fact Sheet, December 1981.
- 28) Stock Exchange, 1000 Largest United Kingdom Companies, December 1982, p. 28.
- 29) Stock Exchange Fact Sheet, December 1982.
- 30) Stock Exchange, 1000 Largest United Kingdom Companies, December 1982, pp. 26-28. The figure may be slightly higher than 31 as no employment data were provided for some companies.
- 31) G. Ross Russell, Unlisted Securities Market review, New firms rally to challenge, Times, February 14, 1983.
- 32) G. Ross Russell, Unquoted companies - creating a market, Tolleys Tax Planning, 1982, p. 691.
- 33) A case in point is Intervision Video. The Exchange withdrew its facilities in March 1982 though it was unpracticable for the company to apply for the USM. Harvard Securities, a licenced dealer and OTC market maker in London, gladly commenced to make a market in the shares (Bisgood, Bishop & Co. Ltd., U.S.M. Manual, Intervision Video PLC information sheet).
- 34) Charterhouse Japhet, l.c., p. 4, report that from June 1978 to June 1979 "the securities of more than 230 conventional industrial or commercial companies were dealt in". The Wilson Committee, Interim Report, l.c., p. 14, state: "As at October 1977 the securities of over 830 companies had been traded at some time ... over the previous five years, though a comparatively small number are dealt in regularly. Forty-two of these 830 are tea and rubber companies, 36 sports companies and 39 municipal or utilities stocks. The majority of the remainder are industrial companies with some retail, insurance and investment trust companies."
- 35) The Stock Exchange's Irish Administrative Unit providing a floor in Dublin and secondary market services in Ireland will be covered in a special chapter.

- 36) However, owing to Rule 200(2) it may well be to the advantage of the broker to deal through a jobber.
- 37) For a detailed explanation of the market maker principle and its alternative, the auction principle, see H. Schmidt, l.c., pp. 424-431. The Stock Exchange is now employing the auction principle for traded-options dealings.
- 38) For a quick survey of the much wider scope of the US OTC market the reader is referred to a diagram in H. Schmidt, l.c., p. 215.
- 39) M.J.H. Nightingale & Co., Over-the-Counter Market Statistics, July 1982.
- 40) Harvard Securities Newsletter, March 1983, p. 4.
- 41) A special publication is available for foreign securities.
- 42) There are six other ways involving newly issued securities only: rights issue, open offer for subscription (as rights issue, but holders of old securities may subscribe otherwise than in proportion to their existing holdings), exercises of warrants, conversion issues, capitalization issues and vendor consideration issues.
- 43) Placings of companies seeking initial entry to the listed market or to the USM will be permitted only if the placing does not exceed a market value of £ 3 mio and if the total capitalization of the company does not exceed £ 15 mio (Quotation Department letter to member firms dated March 24, 1982, which also sets forth limits for the placing of further tranches). In case either limit is exceeded the Stock Exchange does not see any justification for limiting the direct access to the securities to clients of the sponsoring investment bankers only.
- 44) In the case of securities partly convertible into equity 30% should be offered to the public.
- 45) In case the company would have been eligible for admission by way of a placing, the advertisement provisions for a placing apply. Else, there would be a strong and undesirable incentive to avoid offers for sale and prospectus issues even though they are preferable to a placing as they make the securities offered more readily available to investors at large.
- 46) Cf. admission of securities to listing (loose leaf edition revised June 1982), p. 3.
- 47) The author has obtained undetailed estimates from experts ranging from £ 100,000 to £ 250,000 for a placing of shares valued £ 1 mio. Listings tend to have to be offers for sale. Nevertheless, to facilitate comparison with the USM, where placings dominate, the example uses a placing. An uncomplicated offer for sale will cost £ 200,000 and more.

- 48) The Financial Times charges an annual fee of £ 600 for this service.
- 49) For an explanation see H. Schmidt, l.c., pp. 411-412.
- 50) B. Riley, The problems of taming the stags, Financial Times, March 26, 1983, p. 17.
- 51) On March 25, 1982, there were 221 firms of brokers with 4073 persons entitled to deal and 17 firms of jobbers with 586 persons entitled to deal (Stock Exchange Fact Book, March 1982, p. 47).
- 52) For an in-depth analysis of market making see E. Mildenstein, Die Kurspolitik der Marketmaker auf Aktienzirkulationsmärkten, Schwarzenbek and Hamburg: Martienss, 1982.
- 53) Stock Exchange Code of Dealings, p. 22. Usually the jobber will ascertain that the order is still open as it may have also been left with a competing jobber who may have already executed it (conditional limit). The same applies for a different reason if the jobber obtained an indication of interest to deal at a certain price (indicational limit).
- 54) For a systematic explanation see H. Schmidt, l.c., pp. 432-440.
- 55) For more details on put-throughs see Rules 90, 205; Code of Dealing, pp. 25-29; H. Schmidt, l.c., pp. 62-65.
- 56) At least £ 7 on purchases and £ 10 on sales except for transactions amounting to less than £ 300 on which the commission is at discretion. For the next £ 8,000 consideration the minimum commission rate is 0.55%, on the next £ 115,000 thereafter 0.5%. For rates on larger transactions see Appendix 39 to the Rules.
- 57) For an analysis see H. Schmidt, l.c., pp. 58-61.
- 58) The following paragraphs have benefitted from the Exchange's green pamphlet: "Unlisted Securities Market".
- 59) Paragraph 14 of Schedule II, Part B, of Appendix 34 to the Rules. Most of the information which the report would contain will be presented in the prospectus by the directors of the company instead of the accountants, in statements of financial statistics and in comments thereto.
- 60) If not, the new Extel particulars card will have to meet the requirements of a full prospectus.
- 61) It should be noted that this publisher, The London Over The Counter Market Limited, also carries prices established in the Rule 163(2) and Rule 163(3) facilities.

- 62) In fact he will usually receive orders already matched at a certain price. This seems to be inefficient, but, as an effect of this, the broker avoids acting between two clients. In this case he could charge a commission on only one side according to Rule 200(2). The interposition of a jobber will allow the broker to charge a commission on the other side as well.
- 63) Cf. note 33 supra.
- 64) N. Gilbert, *Nightingale sings a different tune*, Sunday Times, November 1, 1982.
- 65) Insiders may deal, however, with one another provided they are not in the possession of material inside information. Irrevocable orders given by insiders during a period when they can deal may also be executed at any time.
- 66) Harvard Securities now and then operate on weekends in order to contact their clients when they have time to take care of their investments.
- 67) The existence of such a link has been viewed as highly desirable by the Wilson Committee (Report, l.c., p. 216 at 767).
- 68) Cf. Wilson Committee, *Interim Report*, l.c., p. 16 at 38.
- 69) Harvard Securities follows a 10% spread policy.
- 70) Wilson Committee, *Report*, p. 318.
- 71) Cf. *The City's Place in the world, Foreign Banks in London*, Supplement to *Euromoney*, April 1983, p. 4.
- 72) Commission of the European Communities, *Towards a European stock exchange*, proceedings of a symposium held in Brussels on 13 and 14 November 1980, pp. 143-145 (statement by N. Goodison).
- 73) Cf. note 6 supra. The Business Expansion Scheme grants tax relief for investments in unquoted shares in a narrow sense only, not for USM shares (D. Lawson, *Quoted and unquoted companies*, The basic difference is marketability, *Financial Times*, April 23, 1983, p. 13). The deduction from assessable income is only available on unquoted ordinary shares of industrial companies if held for five years. For further details see: G.D. Dean, *Collective investment and mutual funds*, EC-Symposium "Developing capital markets for the regeneration of industry", Luxembourg, November 23-25, 1983, Working Document, pp. 32-36.

B. THE SEGMENTS OF THE SECONDARY MARKETS FOR EQUITY
INSTRUMENTS OF SMALL COMPANIES IN IRELAND

I. ENVIRONMENT AND SURVEY

1. Number and forms of business organizations

Irish business firms are organized and structured in very similar ways to the enterprises in the United Kingdom. Historically, the Irish common law system is derived from English law, which is the basis of the legal system in Ireland today. In 1922 the Irish Free State was founded, and in 1937 an Irish Constitution (Bunreacht an hEireann) came into force. Thus legislation has gradually taken on a character of its own¹⁾. However, regarding the field of business, like most other fields, there is still a common base in both countries. As to Irish company law, the Companies Act 1963 follows the British example.

Despite the quite similar legislation and close relations, during recent years some laws and regulations have been set that clearly mirror the special situation of the Irish economy. Examples are foreign exchange control and the tax rates structure. In the financial arena, the currency split in 1979 was a milestone which for the first time led to a quotation of the Irish Pound on the foreign exchange markets.

In Ireland the most common forms of business organization are the sole trader, the general partnership and, parti-

cularly, the private and public versions of companies limited by shares. The two initially mentioned forms are preferred by those entrepreneurs who want a very personal and adaptable structure created without formalities. There are also a few limited partnerships, but this form is rarely used and of no significance. Instead, the incorporated and registered company, especially in its private version, is the most important type of business enterprise.

Only for registered companies statistical data is available. In 1980 (1978) there were 338 (339) public limited companies, which is only 0.6 (0.7) percent of all registered companies having a share capital. In 1981 the quota declined to 0.5 percent (see Table 1). At the end of 1981 there were only 339 enterprises of this kind, but about 65,100 (1980: 59,700) in the private limited form²⁾. More recent data is not yet available. At March 31, 1983 only 80 public limited companies had a quotation on the stock exchange, 76 on the listed securities market.

These figures show that the private company is most popular and clearly preferred to the public version of the limited company. This is the case particularly for small, young and growing enterprises and for subsidiaries established by foreign companies.

In a private company there must be at least two members; the maximum number is limited to 50 members. For incorporating a public limited company a minimum of seven persons is required. Furthermore, the private company is prohibited from inviting the public to subscribe for its shares or debentures (section 33 Companies Act 1963). Up to 1983 no minimum capital has been mandatory for both kinds of business organizations. For becoming registered as a public limited company, the Companies Amendment Bill 1983

Table 1: Number of companies having a share capital

form	1978		1980		1981	
	total	%	total	%	total	%
public limited companies	339	0.7	338	0.6	339	0.5
private limited companies	48,230	99.3	56,716	99.4	65,072	99.5
all	48,569	100.0	60,054	100.0	65,411	100.0

Table 2: Average nominal share capital (IR ₪ mio)
(issued capital in brackets)

form	1978	1980	1981
private limited companies	0.029 (0.014)	0.056 (0.013)	0.081 (0.013)
public limited companies	0.993 (0.712)	1.416 (0.867)	1.577 (0.874)

Source: Department of Trade, Commerce and Tourism, Companies, General Annual Report 1981, p. 15

Table 3

Number of companies registered with a share capital during the years 1978, 1980 and 1981 classified according to the amount of their nominal share capital

Nominal share capital		1978	1980	1981
under	IR £ 1,000	1,088	1,056	1,001
IR £ 1,000 -	5,000	829	601	589
£ 5,000 -	10,000	338	501	358
£ 10,000 -	20,000	835	855	790
£ 20,000 -	50,000	620	489	368
£ 50,000 -	100,000	543	730	789
£ 100,000 -	200,000	563	2,046	2,033
£ 200,000 -	300,000	233	430	437
£ 300,000 -	400,000	11	12	8
£ 400,000 -	500,000	4	5	4
£ 500,000 -	750,000	84	137	219
£ 750,000 -	1,000,000	3	3	7
£ 1,000,000 and over		48	146	163
total		5,199	7,011	6,766

Source: Companies, l.c., p. 14.

will require a minimum share capital of IR £ 30,000.

The status of a public company must be evidenced by a certificate of incorporation issued by the Registrar of Companies. The enterprises has to be willing to publish its accounts. It is one of the main features of that business form that accounts must be audited each year and filed with the Registrar. Thus, disclosure becomes an important characteristic of the public company. Small firms are often not willing to publish such data. But it is necessary for getting quoted on the stock exchange.

There are no organized markets for shares of other forms of business enterprise. The stock exchange will admit to dealings shares of public limited companies only. Nevertheless Rule 163(2)(b) of the Stock Exchange permits occasional bargains, subject to the permission of the Council, in the shares of private companies as well. As equity financing is an important aspect regarding small growing companies, the public form of the limited company is of special interest (Tables 1-3).

2. Frequently used instruments of equity financing

Up to now only a few small companies raised equity capital publicly. During the years 1974-1981 there were no first public issues of big or small companies. From 1982 to March 1983 there were four first public issues. One later became fully listed and three issues are quoted on the Unlisted Securities Market.

Ordinary shares were the only instrument of equity finance of small Irish companies raising capital publicly during the recent years. Other well known forms of equity instruments traded on a secondary market like preference shares, cumulative preference shares, warrants and convertible debentures are insignificant and not used at all by small firms. Mainly private investors hold shares of such companies. They prefer ordinary shares as uncomplicated equity instruments.

Often small companies are traditionally reluctant to accept external influence by shareholders. But younger entrepreneurs seem to be willing to issue shares, because they are aware of the necessity to raise equity capital if they want their enterprise to grow.

3. Investors and investment motives

Shares of domestic companies are mostly held by Irish individual and institutional investors. Today about 190,000 individual shareholders have invested their money in the 76 stocks listed on the stock exchange³⁾. A breakdown based on a statistical survey is not available, but it is believed that 80-90% of all shares are held by institutional investors.

The institutional investors primarily consist of pension funds, life insurance companies, merchant banks and unit trusts. They mainly invest in government bonds and

ordinary shares of larger companies. These investors play an important role on the equities market and their relative importance will probably be increasing as private investors tend to stay away from the market. Regarding small firms institutional investors normally do not intend to influence the management and may be a source of capital. Some of the institutions mentioned above have founded capital development and venture capital organizations which specialize in unquoted small company participations and assist the management if difficulties arise.

Even more so than some other EEC national exchanges the Irish stock market is very much a bond market. Most funds are invested in fixed income securities, largely in government securities. In 1982 the turnover per business day of these securities was one hundred times as large as the turnover of Irish equities⁴⁾.

The relatively low turnover of equities is due to the taxation rules which disadvantage such holders. High levels of income tax (65% for the highest tax bracket) leave the investor less disposable income for investment, thus pushing him towards tax sheltered instruments. However, income tax on government securities is not deducted at source and not liable to capital gains tax. Further, the purchase of properties has become very attractive and popular because rental income is taxfree (section 23 Relief Finance Act 1981). If an investor holds shares, since 1982 his realized inflation-adjusted capital gains are taxed at the rate of 40% to 60% according to the Capital Gains tax legislation (against 30% before)⁵⁾. Now, for short holding periods the tax rates are extraordinarily high. If shares are sold within the first year after purchase,

the capital gains tax rate amounts to 60%. For the second and third year it declines to 50% and stays at 40% if shares are held for more than three years. Taxes are adjusted by the yearly rate of inflation. For example, an investor who has a capital gain of 10% does not owe any capital gains tax when the rate of inflation is officially 10%.

Some members of the financial community feel that the reluctance of Irish investors to hold equity instruments may to some extent be the result of the present Exchange Control Regulations of the Central Bank, which prevent Irish investors from investing in markets of foreign countries. Financial institutions are allowed to place only up to 10% of their funds abroad. These strongly limiting regulations have existed without any change for the private investor since December 1978. The Exchange Control (Continuance) Act 1982 extended the legislation for four years. These restrictions may prevent the investors from achieving the desired degree of diversification of their portfolios.

The individual and institutional investors can potentially hold shares of small companies. The total market capitalization and the size of the Irish stock market are so small, however, that the latter group usually neglects shares of small companies, although there are not any indications that this is impeded by regulatory restrictions. Thus, individual investors can be considered the primary holders of such shares apart from specialized institutions. But many individuals prefer to invest their money in unit trusts because thus they buy shares of diversified portfolios. They are loath to purchase small company shares because they feel a lack of information which is seen as dependent on the com-

pany's size. They feel that only a very small number of investors really know exactly what is going on. Shares of small industrial companies may be of interest to those whose relatives are employed by the respective firm or who have anything to do with it.

On the other hand, at least two of the recent issues on the Unlisted Securities Market have been oversubscribed. There has been substantial public interest in these small companies that are expected to experience rising rates of return in the future. An attractive business environment, low issuing prices and a good performance of past issues led to the big run of investors into new small company shares. In one case the first price quoted was 40% higher than the price at which the shares were initially placed⁶⁾.

Yet there is another reason why institutional investors might invest in smaller industrial companies: there are not enough large corporations. The total market capitalization of Irish shares quoted on the stock exchange amounts to nearly IR £ 1,000 mio. But 69 out of 76 listed companies contribute only about 20% to total market capitalization. In comparison with these data indicating a market clearly dominated by only a few large companies, the annual total cash flow of the investing institutions is about IR £ 300-500 mio. Thus, investments in medium-sized and smaller companies are likely to occur. However, shares inactively traded or shares quoted on the Unlisted Securities Market are definitely ignored.

The most recent development indicates that the interest in small company shares is rising. In June 1983 the Allied Irish Investment Bank launched

the Smaller Companies Unit Fund, which is designed for the pensions market. This fund is believed to achieve a potential of IR £ 5 to IR £ 10 mio within the next two years. It will mainly be investing in small but growing companies. Investments in one or two start-up situations will not be excluded⁷⁾.

4. Issuing houses for shares of small companies

In 1981 IR £ 110 mio and in 1982 IR £ 25 mio were raised in the Irish equity market⁸⁾. On average in recent years, an equity capital of about IR £ 40 mio has been raised annually on the stock exchange⁹⁾. The total amount of bonds issued in 1981 and 1982 was IR £ 1,065 mio and IR £ 1,297 mio respectively. On average new equity capital raised in the market was only 5.4% of the total capital raised. In comparison with other EEC countries the level of equity financing seems to be low.

While in 1965 there were 150 listed companies, by 1983 the number had declined to 76. As in London, for encouraging new placings on the stock exchange, the Unlisted Securities Market (USM) was created in 1980. This could be regarded as a first step towards correcting the lack of new equity issues. Up to now four Irish companies attained quotation on the USM, one of them prior to being able to show profits. At the end of March 1983 these four companies had a total market capitalization of IR £ 30.4 mio. It is somewhat disappointing that up to now there were not more companies seeking a quotation on the USM. However, the time interval of two years may be too short for a judgement, and the USM does not fully reflect the primary market situation, since many issues of shares continue to be pri-

vately placed. Private placings remain important ways to sell newly issued ordinary shares to the institutional or individual public. Many companies avoid the disclosure requirements and the high costs of entry to the stock market; obviously, they accept the lack of marketability discount.

Investment banking services are primarily offered by merchant banks and development capital and venture capital organizations. These organizations support small and young growing industrial companies raising new equity capital and, if the stock exchange requirements can be met, bring the shares to the market. Irish brokers are engaged therein to a limited extent. However, only through the 19 stockbroker-member firms can a listing on the stock exchange be obtained.

Specialized institutions engage in investment banking for small companies. They usually are established by the large banking groups or backed by a wide range of institutional shareholders, mainly by life insurance companies and pension funds. In 1981, such an issuing house, which also is a venture and development capital investor, was the first institution to bring an issue to the USM in Dublin and London (market value IR £ 18 mio). It is remarkable that this and later issues were launched on both stock exchanges. The resulting competitive valuation is believed to have fostered activity and marketability of shares.

There are no relevant barriers to entry for new issuing houses due to regulatory or technical restrictions.

But past experience shows that only an institution backed by a well-known bank or other institutional investors will enter the new issue market successfully. The investor will be more willing to confide in such institutions. About 60% of the underwriting power are held by the two largest banking groups and the largest Irish life insurance company. Normally an Irish issuing house is promoted by an Irish merchant bank. For starting-up as a broker a minimum capital of IR £ 5,000 is mandatory.

Issuing houses with a development and venture capital background are interested in small, young and growing companies, where a reasonable risk-return relationship will be expected. The business must have attractive future prospects. Preferably it should be in the computer or in another high technology field. Such issuing houses provide finance by subscribing for new share capital. They will normally act in a consortium with (its own) institutional shareholders if the capital to be invested exceeds a certain amount, for example IR £ 1 mio. Usually not more than 49% of the shares are held by these institutions. The issuing house and venture capitalist will watch the management of the company by having a representative on the board. Further, they also establish the opportunity for private company shareholders to liquidate their investment. Among Irish investing houses it is a common opinion that sufficient capital is prepared to be invested in small growing companies or in start-ups. Unfortunately, it is felt, there is still a lack of opportunities and of good projects.

The Industrial Development Authority of Ireland (IDA)

plays an important role as well in the business of channelling capital to starting and small growing companies. Executing governmental policy its Small Industries Programme has the objective of assisting the start-up of new projects and of helping small manufacturing firms to expand. It applies to enterprises which have less than 50 employees and fixed assets of not more than IR £ 500,000. Under that program these firms are supported primarily by Government grants non-repayable and by advisory services. Needless to say, for small enterprises applying for grants is more attractive than raising new equity capital. However, this does not seem to be helpful in closing the present equity gap in small Irish companies. Therefore, during recent years the IDA has also encouraged domestic entrepreneurs to start-up or expand manufacturing enterprises offering equity participation by the IDA to a certain extent under its Enterprise Development Programme. In 1981 a comprehensive review of this program estimated the success rate to be about 75% of these projects¹¹⁾.

5. Survey of the secondary market

The secondary markets for Irish shares are structured and organized in nearly the same manner as in Great Britain. However, the characteristics of the stock markets and the importance of its segments have to be regarded against the background of an substantially smaller dimension. Thus, some features have been stressed, others neglected and/or adapted to the political and economic environment of investment in this country.

The stock exchanges of Great Britain and Ireland were merged on March 25, 1973, into an organization now called "The Stock Exchange". The Dublin exchange became an administrative unit of the Stock Exchange like the other exchanges on the British Islands. It is officially named "The Stock Exchange-Irish". In 1971 the Dublin Stock Exchange and the Cork Stock Exchange along with other brokers operating in other cities as members of the Provincial Brokers' Stock Exchange, came together to form the Irish Stock Exchange. Now there is only one exchange in Ireland situated in Dublin.

The Irish unit has followed essentially the Rules and Regulations of the Stock Exchange since. Some special rules were set bearing out the national character of the Irish exchange. They mainly refer to the constitution of the unit and to organizational affairs, to the responsibility of the Irish Minister for Finance for closing the trading floor and to the admission of applicants for membership to the Irish Unit as well as to the settlement of Irish Government gilts. Applicants for membership shall not be admitted unless they have first obtained, from the Minister of Finance, a licence for the purpose of buying and selling Government Funds on commission (Rule 49a of the Irish Administration Unit). In general, the Stock Exchange-Irish is supervised by the "inspector's office" of the Stock Exchange in London.

The Irish exchange is by far the most important secondary market and the only institutionalized and well-organized market for equity instruments in Ireland. There is also an Irish over the counter (OTC) market which is of very little relevance.

The vertical segments which will be covered here correspond to the British stock market. Again, the stock exchange provides the market for fully listed securities, the Unlisted Securities Market (USM), and the specific bargains facility under Rule 163(2)¹²⁾. The full listing market is clearly dominating. The market capitalization of listed ordinary shares and preference shares amounted to IR £ 922.6 (IR £ 845.2) and IR £ 5.6 (IR £ 6.2) mio, respectively, at the end of March 1983 (1982)¹³⁾. Ordinary shares are by far the largest group of equity instruments circulating on the market. In some cases cumulative preference shares are traded as well, however, very infrequently. In Ireland shares other than ordinary shares are often inactive for several months. Regarding the market structure, the largest two Irish banks together with the five largest industrial companies have market valuations of about IR £ 800 mio. Thus, the total market value of the 69 other companies does not exceed IR £ 200 mio. At least 12 companies have a nominal issued share capital of less than IR £ 0.5 mio. In total, 76 Irish companies were fully listed at the end of March 1983¹⁴⁾.

The USM was established in 1980 as a second-tier market for those smaller companies which would be willing to use secondary market services, but are desirous of avoiding the full listing disclosure requirements and are not prepared to pay the high costs of listing. At the end of March 1983 the ordinary shares of only four companies were traded on this segment with a market capitalization of IR £ 30.4 mio.

The third market segment within the three-tier system is known as the specific bargains facility under Rule 163(2) on the stock exchange. It only provides for occasional transactions of shares. The requirements are the same as in London. This facility may be regarded as an appropriate instrument for shares on the way to a stock exchange quotation on the USM. The shares of the first company which achieved such a quotation in 1981 by way of a pure introduction were traded previously on that lower market segment. However, the stock exchange would not give its approval if it became apparent that regular trading in shares of a specific company was taking place. In that case the company should think of the USM as an appropriate place for such dealings. During the 12 months prior to March 1983, some 19 companies obtained permission to trade under Rule 163(2)¹⁵⁾.

The Irish over the counter market is rather inactive. Normally the brokers apply for an occasional bargains facility when shares of small public companies are to be traded. In very few other cases the merchant banks and issuing houses which once placed shares with their clients will arrange replacements usually among institutional investors.

Contrary to the U.K., there are no OTC-firms known to organize secondary markets in certain securities by way of off-exchange trading (as for example, M.J.H. Nightingale & Co. or Harvard Securities Ltd. in London, see section A III). This is due to the relatively small size of the Irish capital market, the strong preference for buying properties or Government gilts and the tendency of shareholders to hold their investment for long periods because of the present tax regulations.

It may also mirror the adequacy of primary and secondary market services rendered by the member firms. There are no regulatory restraints.

Thus, in Dublin no chance is commonly seen for an OTC firm to establish a market in unquoted securities as it has been successfully realized in London.

II. EXCHANGE SEGMENTS

1. The listed securities market as a segment for small company shares on the Stock Exchange-Irish

Small company equity instruments are traded on all three market segments mentioned in the previous section: The listed securities market, the USM and the occasional bargains facility. The relative importance of the segments is quite different. However, there is only a small number of private companies seeking a listing on the stock exchange, either on the listed market or on the USM.

a) Listing

The listing requirements on the Stock Exchange-Irish are identical with the requirements of the Stock Exchange in London. The relevant provisions are published and interpreted in the "Admission of Securities to Listing", widely

known as the "yellow book", and based on Rule 159(2) and the appendices mentioned therein. The application for listing must be submitted by a broker-member firm of the stock exchange.

Again, the essential general listing requirements are briefly the following (for further details see section A II 1):

1. The minimum capitalization of the issuing company has to be IR £ 500,000. For securities to be listed the market value has to be at least IR £ 200,000.
2. The quota of the issue to be held by the public must not be less than 25%.
3. An extensive prospectus; the details are set out in Schedule II Part A of Appendix 34 to the Rules. An accountants' report is required by the Third Schedule of the Companies Act 1963. It must contain a financial review for the past five years.
4. Inclusion in the Extel Statistical Services.
5. Advertisement of the prospectus in two leading daily newspapers in the case of a prospectus issue or an offer for sale. For a placing, one prospectus advertisement and one small box advertisement are required and for an introduction only two small box advertisements are mandatory.
6. The shares normally have to be fully paid.
7. The "listing agreement" which is a disclosure agreement to be signed by the board of directors of the

company with the stock exchange (Schedule VIII, Part A).

There are two grounds deterring companies from the listed securities market. First, many small companies are not prepared to meet the extensive disclosure requirements to publicly uncover their financial activities, though it makes a company more visible. Second, the listing is quite expensive. The most relevant items are the prospectus advertisements, the fees and commissions to the solicitors, the accountant and the broker, and the initial and annual stock exchange charges. For example, the cost of a prospectus advertising in two daily Irish newspapers amounts to about IR £ 25,000¹⁶⁾. The total listing and flotation costs will correspond to the amounts required on the exchange in London outlined in detail in section A II 1.

b) Trading

The members of the stock exchange deal in each security as it is called by the official on duty. Contrary to the London Stock Exchange, there are no jobbers on the Stock Exchange-Irish. Only brokers act on the floor. They execute a client's order by trading with another broker who is offering the securities bid for. Dealings take place at daily call-overs which generally occur twice a day, at 10:00 a.m. and 2:15 p.m. The price at that the selling and the buying broker deal is written down on the Marking Board.

The minimum amount publicly held that allows the development of an effective secondary market has been estimated to be at least IR £ 0.5 mio. Only shares of the big companies are frequently traded.

The buyer and the seller will each get the same price which their respective brokers have agreed on. The clients will have to pay the cash transaction cost in the form of a commission to brokers which is the same as in London. The fixed minimum commission of the brokers which is required for stocks and registered shares is 1.65% on the amount of consideration in the transaction up to IR £ 7,000. Further, there is a transfer stamp duty of 1% on the value of each transfer of shares, which is to be paid by the buyer.

The daily prices are published in "The Stock Exchange Official List-Irish". This list carries the bid/asked price ("market-guide price"), the business done and closing quotations. No turnover data is available at all. The financial newspapers normally publish the closing quotations. On Monday "The Irish Times" reports other data of interest to the community of investors, for instance gross and net dividend yields, net assets per share and price/earning ratios of all equities quoted on the listed securities market or on the USM.

2. The Unlisted Securities Market

In November 1980 the Unlisted Securities Market (USM) was launched. It should be a contribution by the stock exchange to make new listings more attractive and the raising of capital more easily available for small companies. Furthermore, this market should bring the more actively traded companies under formal regulatory control, which would otherwise be using the occasional bargains facility. In the future it will also be possible for small companies to use this third market segment, but on a more restricted basis than during recent years.

The USM was established particularly to encourage young growing companies to seek a listing on the stock exchange. In comparison with the listed securities market it should be more attractive to those companies because of the lower listing requirements.

However, the USM in Ireland has been a bit disappointing up to now. It is a common view that this is primarily due to the high capital gains tax and the very strict exchange control regulations leading to a "poor market". Foreign investors can buy Irish securities, but those regulations will not foster the financial confidence in this country. On the other hand, the United Kingdom has done the opposite by reducing the capital gains tax and removing exchange controls.

a) Requirements for entry

The requirements for entry to the USM and the USM trading

procedure are set forth in section A II 2) above. There is no substantial difference as to the Irish requirements.

The approval for introductions and placings should be sought by the broker of the company. The Irish Listings Committee of the Stock Exchange decides on the application for listing. The important terms and conditions for entry to the USM are briefly summarized in general as follows:

1. No minimum size regarding the total value of shares to be issued is required.
2. When dealings start, not less than 10% of the issue has to be made available to the public. In the case of a placing, not less than 25% of the amount should be offered to brokers in the market who will make them available to their clients. The method of placing is limited to the amount of IR £ 3 mio, provided that the total market capitalization of the company is not expected to exceed IR £ 15 mio. This regulation may be varied at the discretion of the Irish Listings Committee of the Stock Exchange.
3. As for full listing the applicant must submit for approval a prospectus with extensive disclosure. However, an accountants' report is only required in connection with the public marketing of shares (section 44, Third Schedule, Part III, Companies Act 1963).
4. Normally the shares of the company must have been traded for at least three years. Past experience should give some indication that the expected market capitalization will be realized. But an exception is possible for companies with a shorter business history.

In that case a company showing that funds are required to finance a project fully researched and costed may successfully apply.

5. Inclusion in the Extel Unlisted Companies Service is mandatory.
6. Only one box advertisement is required in case of a public marketing in order to keep costs as low as possible. A newspaper advertisement of the full prospectus is not mandatory. The box advertisement in a leading newspaper should only indicate where the printed prospectus or Extel particulars card may be obtained, the issue price of the relevant shares and certain other data.
7. Instead of a listing agreement a "USM general undertaking" is necessary.

All the remarks which were made earlier with regard to the British system are also valid for the Irish USM. For example, this applies to the marketing costs, the continuing obligations to render shareholder services, the method of obtaining additional funds some years after entering the USM and the transfer of a company to the listed securities market by way of an introduction. In the recent past the total flotation costs amounted to IR £ 50,000 to IR £ 70,000 on average.

Despite the reduction in costs to the issuing company

there is an indirect form of entry cost which remains unchanged. Recent placings were clearly oversubscribed, mostly because of very low P/E-ratios. This points toward the continued existence of underpricing. No visible attempts have been made to reduce underpricing, e.g. by tender offers.

Some companies admitted to the USM intend to enter the fully listed securities market as early as possible because a company is commonly regarded as more respectable if it is fully listed.

b) Trading

The trading procedure is the same as on the listed securities market. The USM issues are called by the official on duty and then traded among the brokers which agree on a certain price. However, trading is infrequent. Occasionally only one trade a month or less was observed. For the USM shares brokers cannot provide immediacy services. So, a broker's client sometimes has to wait two weeks or more. He will tend to use the exchange in London. There are jobbers for all the Irish USM issues.

An appropriate valuation cannot be assured. This problem can only be solved by supporting the activity of the market and of the frequency of trading in small company shares. For activating the secondary market the broker-member firms could be allowed to trade shares for their own account. This would increase the investment potential and probably the frequency of trading.

The commission rules correspond to the rules for listed securities. There are differences as well regarding the price reporting. The Stock Exchange Official List-Irish carries all companies traded on the USM and reports market guide prices and closing quotations along with dividend information.

3. The occasional-bargains facility

As pointed out in previous sections, there is an occasional-bargains facility on the Irish stock exchange. Under the provisions of Rule 163(2) of the stock exchange the Irish Listing Committee may permit occasional transactions in shares of Irish companies. Investors seem to be interested in this facility as the permission of 19 companies during the year 1982/83 clearly indicates¹⁷⁾. Exclusively shares of public limited companies are traded. A great variety of industries is represented on the market (insurance, newspaper, import/export trading, retail stores and other industries). The size of the companies ranges from small to very large, and up to now it cannot be stated that this market segment is mostly sought by small and young companies. As the name of the facility implies, there are only few transactions. Some shares are traded twice a month, others twice a year or less. Unusual situations may occur when for speculative reasons some industry is especially favoured. This happened in 1983 in respect of the oil exploration near the Irish coast. As the author was told,

it can roughly be said that for small industrial companies the relative importance of the occasional-bargains facility is greater compared to the USM. It is relatively greater because a young company planning to apply for listing on the stock exchange normally seeks the permission for occasional transactions under Rule 163(2) first.

The requirements for permission are exactly the same as on the London Stock Exchange. A broker who wishes to effect a deal in the shares concerned must get the approval by the stock exchange on each such occasion. The permission for such individual transactions may be withheld by the Irish Listings Committee if the price of shares materially exceeds the apparent asset value. It will usually also be withheld if an active market is developing or appears likely to develop.

Before any transactions will be allowed, the latest accounts, any subsequent circular to shareholders and any recent prospectus must be submitted to the General Manager of the exchange. Furthermore, the existence of a genuine business activity usually has to be shown. Auditors' reports will normally not be sufficient.

The trading procedures are very similar to those in London, however, no jobbers take part. It is the broker who has to look for another broker as a counterparty. The prices will be made by the agreement of the two respective brokers; they are daily published by the Stock Exchange Official List-Irish. The occasional bargains facility may play an important role in support-

ing small companies in gradually going public. Some spread of shareholders will be attained this way, perhaps sufficient for a later entry to the USM by way of an introduction. It could be regarded as a first step on the way to an eventual full listing.

Rule 163(2) is the basis of the occasional-bargains facilities for all exchanges in the United Kingdom and the Republic of Ireland. Since the characteristics of that third-level market segment are very similar in either country, see section A II 3 for further details on this area.

III. THE IRISH OVER THE COUNTER MARKET

In Ireland this segment is relatively insignificant and without those conceptual features which were developed on the British OTC-market. No OTC firms are known to organize markets in certain shares. According to a common view in Dublin the market is too small so that, for example, the Nightingale concept (see section A III 1 above) would probably not be successful after the USM was established.

However, there is occasionally a demand for a replacing of shares which are not (yet) admitted to the exchange markets. But equity instruments, usually ordinary shares of a small public limited company, are scarcely traded. On average, transactions of one or two companies' shares occur on the OTC market in Dublin within a year. There are no further statistical details available.

The term "over the counter market" is used according to the interpretation in the UK (see pages 46-47), i.e. only the trading of shares by non-exchange-member firms is covered. The merchant banks and issuing houses play the most important role providing an opportunity for purchase or sale of unquoted ordinary shares. They also offer financial services to those companies and their shareholders in the field of valuation of the shares.

All the Irish stockbrokers are members of the stock exchange. But normally a broker is involved in the process of replacing. He will inform interested clients whereas the investment firm will carry out negotiations and transactions. The transaction costs consist of the spread between the bid and the asked price. Commissions have not been paid. Trading data is not published anywhere.

For small industrial companies and their (potential) investors the OTC-market is not very attractive. Shareholders prefer an active secondary market providing fair valuations and a reliable exit system. Some young growing Irish companies are expected to seek a quotation of their shares on the USM within the next years as they feel that this is the best provision for raising further equity capital in the future.

IV. SUMMARY

If small and growing industrial companies desire to use secondary market services, they are free to choose among three market segments. The top vertical segment is the listed securities market, followed by the USM, which

should be more attractive to smaller companies because of the lower costs and reduced entry requirements as for example the 10%-quota of shares to be made available to the public, the shorter business history and the advertisements required. The third segment, the occasional-bargains facility, will only be available to companies if no active market is developing or appears likely to develop. This market seems to be relevant to small industrial companies for two reasons: First, a company which is not willing or not able to fulfill the requirements for entry on the USM will find the services of a secondary market. Second, a company seeking a permanent quotation on the stock exchange will use this segment as a first step on the way to one of the other two markets.

In Dublin the installation of the USM is commonly seen as an important step. It gives small, young companies an opportunity to publicly raise equity capital using secondary market services. Today only four companies are quoted, but some alert managers, mostly in fast growing industries, intend to apply for listing within the next years. They think of it as the appropriate way to raise equity finance from the public and to prepare full listing for the future.

If small but growing industrial companies want to raise new equity capital on the primary markets or if they want to go public, several merchant banks as well as development capital and venture capital organizations offer their services. An issuing house entering the market for the first time will easily meet the regulatory requirements, however, it should be backed by a well-known merchant bank if it wants to start successfully.

The Irish secondary markets do not enjoy active trading except for the shares of the largest companies. The Irish investors are facing high tax rates on income and capital gains. Domestic investors put their money mainly into gilts and properties. Rental income is free of tax. Furthermore, because of very strict exchange control regulations Irish investors are inhibited to buy shares on other than domestic markets with the exception of the Irish registered securities which are traded in London as well. Finally, there is a lack of foreign investors.

To stimulate a further improvement of the stock market in general and, particularly, of the market for small company shares, the capital gains tax should be reduced or abolished on the way to harmonizing tax rate structures in the European Communities. Special tax incentives would encourage investors to buy shares of small companies.

As the Stock Exchange-Irish is an administrative unit of the Stock Exchange in London since 1973, both places are active under nearly the same rules and regulations. They have also many common features. But the size of Irish securities markets is substantially smaller. Virtually only ordinary shares are traded primarily on the listed market and exclusively on the USM. Contrary to the successful development in the UK, the USM in Dublin did not show much activity up to now. In all cases the shares of the USM values were issued on the London stock market as well. This market is believed to provide a sufficient activity and marketability of shares.

The Irish secondary markets could gain appeal to small companies if they were fostered by the right environment. As long as it is more attractive to those firms to apply for government loans than to raise equity capital, and as long as investors prefer real estate for tax reasons, there will be no chance for the stock exchange to grow under truly competitive conditions.

Footnotes

- 1) Liam O'Malley, *Business Law*, London: Sweet & Maxwell, 1982, p. 2.
- 2) Department of Trade, Commerce and Tourism, *Companies, General Annual Report 1981*, Dublin: Stationary Office, p. 15.
- 3) Equity market no place for pessimists, *Irish Times*, May 18, 1983.
- 4) *The Stock Exchange in Ireland, Report 1982-1983*, p. 24.
- 5) For attracting small individual investors the threshold was increased from IR £ 500 to IR £ 2,000 or IR £ 4,000 for married couples (Finance Act 1982).
- 6) Founders of computer firm raise £ 2 m by share sales, *Irish Times*, June 10, 1983.
- 7) AIIB launches novel unit funds for institutions, *Irish Times*, June 10, 1983.
- 8) *The Stock Exchange in Ireland, l.c.*, pp. 7-9.
- 9) See footnote 3).
- 10) 77.1% owned by the Investment Bank of Ireland Ltd.
- 11) *Small Firms Annual Report 1981*, Dublin: The Industrial Development Authority of Ireland, p. 19.
- 12) See footnote 17) on page 82. Seven Irish mineral exploration companies were traded in 1982 under Rule 163(3). (See: David Fassbender, *The Role of the Unlisted Securities Market, Management*, Vol. 29, 1982, p. 9).
- 13) *Stock Exchange Fact Book*, March 1982 and 1983, pp. 8-9.
- 14) *The Stock Exchange in Ireland, l.c.*, pp. 7-9.

15) Ibid., p. 10.

16) David Fassbender, l.c., p. 9.

17) The Stock Exchange in Ireland, l.c., p. 10.

C. THE SEGMENTS OF THE SECONDARY MARKET FOR EQUITY
INSTRUMENTS OF SMALL COMPANIES IN DENMARK

I. ENVIRONMENT AND SURVEY

1. Number and forms of business organizations

A survey of the number and forms of business organizations in Denmark is provided by the register of firms participating in the settlement of value-added-tax payments. At the end of 1980, there were 392,432 business organizations with total sales of DKr. 748 mrd.¹⁾. The table below breaks down these totals.

Number and forms of business organizations
in Denmark at December 31, 1980

Form of business organization	Number	Percent of total number	Percent of total sales	Average sales in mio DKr
Sole proprietorship	304,600	77.6	21.2	0.5
Limited partnership	24,400	6.2	5.8	1.8
Anpartsselskab	27,284	7.0	7.9	2.2
Aktieselskab	17,550	4.5	45.4	19.4
Cooperative	3,695	0.9	12.2	24.7
Other	14,903	3.8	7.5	3.8

Source: Danmarks Statistik

The limited partnership and the anpartsselskab (ApS), the Danish version of the private limited company, are frequently used by small industrial companies. One might expect some investor interest in their shares. In principle, institutional investors seem to be prepared to take an interest in an anpartsselskab. However, there is general agreement that the very small size of almost all of these businesses disqualifies their shares as investment vehicles at present. Consequently, there have been no reports on any trading in such shares²⁾.

Thus, the focus clearly is on the aktieselskab (A/S), the Danish variant of the public limited company. Organized share markets are available only for shares in aktieselskaber. There are more of these companies in Denmark than in larger countries, and even rather small businesses use this form. The reasons for this are not obvious. The corporate income tax may be a factor. The rate of 40% on retained earnings favourably compares with a taxation of individual income that may exceed 70% at the margin.

In addition, there is a tradition in the Scandinavian countries to have just one form of limited company, suitable for both large and small companies³⁾. In 1973 the Danish parliament passed the lov om anpartsselskaber and provided a second form as required by the EEC. At the same time, the current lov om aktieselskaber was adopted. Both laws are quite similar. Even the law on public limited companies was kept short, flexible and considerate with regard to the needs of small companies. Until 1983, only companies with a capital of DKr 400,000 and more needed an executive board and a board of directors, smaller companies could opt for a sole executive, who assumed the functions of both boards (§§ 49 and 51 lov om aktieselskaber). A change from anpartsselskab to

aktieselskab form is uncomplicated and does not cause any tax liabilities. The company involved has to meet the higher minimum capital requirement, to adjust its articles of association and to reregister. In spite of the reregistration the company remains the same legal entity⁴⁾.

2. Frequently used instruments for equity financing

In principle, all shares of a public company give the same rights to the shareholders (§§ 17, 80 lov om aktieselskaber). However, in § 67 the Act permits the use of shares with up to ten times the regular voting rights. Those multiple-voting shares are referred to as A-shares, the "common" shares are called B-shares⁵⁾. During the last ten years mainly B-shares have been used by companies going public⁶⁾ in order to limit outside influence on management⁷⁾. Though not required by law, B-shares usually have a priority claim on income to be distributed and on liquidation proceeds. Thus, they may be considered as preferred voting shares.

However, many companies use only one class of shares⁸⁾. There were a number of listings of such ordinary shares. More importantly, in direct placements with institutional investors mainly ordinary or A-shares seem to be used. Company law also permits partially paid shares. None of these are listed, save the shares of two insurance companies. According to the companies act, the company must not deliver certificates for partially paid shares to the shareholder, but scrip may be used instead⁹⁾. The companies act also provides for convertible bonds and income bonds. Neither instrument has gained importance in the financing of small industrial companies. Larger companies frequently used convertible bonds in earlier years, when

capital gains on bonds were not taxed. Now capital gains of individuals on shares and bonds held for less than three years are taxable income.

Danmarks Nationalbank has emphasized that loans to business, particularly by commercial banks, also represent some kind of risk capital. The bank pointed to the DKr 5.5 mrd of loan losses by banks in 1980 and 1981, which are considerably larger than special aid granted to business during these two years from public funds¹⁰⁾.

3. Investors and investment motives

Investment in shares seems to be rather exceptional, particularly among individual investors. At the end of 1981 the nominal value of listed bonds was DKr 499.6 mrd, the nominal value of listed shares DKr 14.7 mrd (market value DKr 45.2 mrd)¹¹⁾. Individual investors contribute less than 10% to share sales on the Copenhagen Stock Exchange. Only recently have they shown increasing interest in shares.

The yield on Danish bonds is rather high compared to other member states. For a decade, they have stayed above 12%. The yields peaked at about 21% in the 1979-1982 period, when the annual increase of the consumer price index did not exceed 12%. Relative to the average yield on shares, bond yields have been attractive. Given these yields and the plentiful supply of mortgage bonds and government bonds, few investors have been motivated to hold shares. Thus, the main interest for investment in shares, particularly in small company shares, has been shown by investors who are capable of exerting a substantial degree of control: wealthy families, family trusts and founders. More recently, pension funds and insurance companies have increased in-

vestments in shares to reduce their very heavy reliance on bonds.

During the last years, the need to redirect investment toward equity instruments has been increasingly recognized. Two public pension funds supplementing the social security system¹²⁾ have invested about 10% of their assets in shares, including small investments in the equity of unlisted companies. Most other institutional investors continued to hold about 2% of their assets in shares, though the law permits up to 20%.

However, some pension funds have become quite involved in unlisted domestic equity investment during the last two or three years. Investment in foreign markets are prohibited by the foreign exchange restrictions imposed by the central bank. The rather low total market capitalization of the Copenhagen Stock Exchange results in a lack of depth of the listed share market. Both factors have lead these institutional investors to accept direct investments in unlisted, mostly small companies. The motives for these share investments are primarily diversification and long-term appreciation. In addition, development motives have been important; to increase the national product, to improve exports, to meet imports with competitive domestic products, and to defend jobs¹³⁾. In the small company field, the focus is on ordinary shares¹⁴⁾ of companies with 20-60 employees. Investment proposals may be generated by banks, which have been active for many years in private placements. Recently, the interest of pension funds in ordinary shares has become known and many entrepreneurs approach them directly with their proposals. Alternatively, the funds could actively approach interesting companies. However, this would be considered improper.

The screening process is most extensive in turnaround and

start-up situations. Besides analysis and their own judgment, contacts with other companies in which the fund holds an interest tend to be an important factor in the investment decision. The related negotiations may not lead to a firm price per share. In some cases an arrangement has been used which leaves it up to the success of the company within a set period as to what percentage of equity within a certain range the fund will get for a fixed amount invested. If things go well, the fund will settle for a share at the lower end of the range.

The efforts to invest in shares of small companies are impeded in three ways. First, the usual problems will have to be worked out, which arise when a closely held company managed by the entrepreneur or a few founders opens up to external shareholders. For example

- the fund will want a competent outsider on the board,
- the former management may expect to continue to fix their annual salaries and fringe benefits according to company income,
- the old shareholders will ask the fund to pay the participation in full at the time the fund enters the company, while the fund will prefer a sequence of partial payments linked to performance targets.

Secondly and more importantly, the law (lov om forsikringsvirksomhed) restricts the share of the capital which any pension fund or insurance company may hold to 20%. This provision aims at restricting the power of institutional investors. Since the equity of a small company is frequently worth just a few million kroner, this low percentage may well be prohibitive in view of the screening costs involved. The expansion program of the company may also require more equity finance than available with 20% of the equity. Then the company will be forced to look for

more than one investor. This will result in additional search and screening costs.

In a few important cases, a fair number of pension funds are managed jointly by one management company. Thus one might think the management company would do the screening and allocate less than 20% of the equity of the industrial company to each fund. The negative impact of the 20% restrictions would be avoided. However, since this is thought to concentrate too much power at the management company, the insurance commissioner has ruled in 1982 that no management company may indirectly control more than 20% of the shares of a company¹⁵⁾. Though this very restrictive position has been softened more recently, a management company still has to stay clearly away from control. Their inability to jointly take control when and if required prevents the funds from competing for shares in a variety of interesting high-risk situations.

The third impediment to investment in small company shares is the lack of a way out in size. Banks will only exceptionally take positions though they may hold minority interests in industrial companies (which may be supplemented by "risk capital" in the form of loans), and the big firms and trusts are known to be cautious in their valuations. Occasionally, sales to other shareholders have been made. However, there is hope that the exchange will grow sufficiently to provide a competitive share market.

The modest, though growing interest of Danish institutional investors in the shares of small companies has been dramatically reinforced by a change in taxation in 1983 (lov om en realrenteafgift af visse pensionskapitaler m.v.). Basically, any real income from bonds in excess of a 3.5% real yield will be taxed away (§ 10 of the new law).

However, all income from shares will not be taxed (§ 3 stk 3). The new law applies to pension funds, life insurance companies and to various forms of individual retirement accounts. While the regular share investments of individual investors are still disadvantaged by double taxation, the investment emphasis at pension funds and at insurance companies will shift to dividends and to capital gains in shares. For the reasons outlined above, shares in unlisted companies are most likely to benefit.

An early indication of this is DanVenture Management A/S. This company was set up in 1982 by a group of banks. It will manage closed-end investment funds in A/S form. The shares in these DanVenture Invest A/S will be sold to a limited number of institutional investors. The proceeds will be used for investment in minority participations up to 45% in small unlisted companies with good growth prospects. These companies should have a successful trading record of two years. The minimum investment is DKr 0.5 mio. The management company will take the initiative to obtain shares of interesting companies. In contrast to pension fund management companies and insurance companies, which may have representatives of parties and unions on their boards, a more neutral and professional image is sought.

On the fund raising side, DanVenture aims at institutional investors not large enough to have one or more investment managers specializing in unlisted shares. In addition, the institutional investors and the insurance commissioner may be more prepared to accept higher risk investments if any losses will most likely be balanced by income and capital gains from other holdings in the DanVenture portfolio. Thus, no write-offs or close-outs should be necessary on the books of the institutional investors them-

selves. If successful, individual companies from the investment portfolio or the shares of the investment A/S may be listed on the exchange.

4. Issuing houses for the shares of small companies

Over the last five years (1978-1982) the average amount of shares issued by Danish companies was DKr 321 mio¹⁶⁾. The average net issue of bonds was 125 times that amount¹⁷⁾. Fostered by the unique Danish mortgage credit system, mortgage bonds dominated the primary market for decades. Only in 1981 and 1982 net government issues exceeded net mortgage bond issues.

Traditionally, share issues were brought to the market by the member firms of the Copenhagen Stock Exchange. Currently, there are 34 members distributed over 24 member firms. The number of members has been at about this level for many years. The members are appointed by government; according to section 10 of the Exchange Act (lov om Københavns Fondsbørs) the Danish Minister of Industry grants licences to applicants only if exchange sales and public interest render it necessary¹⁸⁾. The minimum net capital required of a member firm is DKr 600,000¹⁹⁾. About 6-8 member firms are thought to be prepared to act as issuing houses.

Since 1972 a small number of Danish commercial banks have become active as issuing houses for company shares. Member firms will usually seek the cooperation of at least one of the three major banks²⁰⁾ in a share issue. Aside from public offers of shares, the larger commercial banks have engaged in private placements of shares. During the last year the largest savings bank²¹⁾ brought two share issues

to the market. Most recently, an investment adviser acted as lead issuing house; the distribution was handled by a member firm, and there was the unique back-up commitment of a regional bank in case the B-shares could not be successfully sold to the public²²⁾.

5. Survey of the secondary market

The Exchange Act gives the Copenhagen Stock Exchange the exclusive right to operate an organized market for the trading and quotation of capital market securities. The Act and the related Stock Exchange Order (Bekendtgørelse om Københavns Fondsbørs) of the Minister of Industry have been revised and amended from time to time. The Act was amended in 1979²³⁾, and a new Order was promulgated in 1982 in order to bring about important changes in the market structure. These changes aimed at facilitating the entry of small companies to the exchange and at convincingly delineating the exchange segments.

Since February 1, 1982 there have been three segments for share trading, Aktiemarked I, II and III. Three segments are also available for bonds. Share market I may be seen as the successor of the former hovedbørs²⁴⁾. It is the segment for the shares of the actively traded larger companies. At the end of 1982 160 classes of securities (1981:138) of 118 (1981:105) companies were traded, including 68 classes of shares and three convertible bonds of 47 industrial companies. The average market capitalization of a company of this segment was DKr 387 mio (1981:297). The securities of share market I are traded under a call system. Each class of securities is called in a predetermined order²⁵⁾. The unit of trading is DKr 4,000 nominal value.

Share market II may be seen as the successor to the former efterbørs²⁶⁾. Most of the shares of the efterbørs are traded there now. At the end of 1982 113 classes of securities (1981:135) of 91 companies (1981:109) were traded in this segment, including 26 classes of 16 industrial companies. 44 small banks have their shares traded in aktie-marked II. The average market capitalization was DKr 28 mio (1981:129)²⁷⁾ overall and DKr 47 mio for industrial companies. If the three largest industrial companies traded in this segment are excluded, the average capitalization drops to DKr 23 mio. This correctly suggests that this market segment serves small and medium sized companies.

A very special trading procedure is employed. The securities of share market II are divided into three groups according to the issuer's line of business and each group is called up for trading. Trading of each group lasts for a few minutes on each business day. The usual unit of trading is still DKr 2,000 nominal value. Alternatively, the issuer may request DKr 4,000; this unit applies to all recently listed shares.

Equities on the Copenhagen Stock
Exchange by segment at the end
of 1982

Aktie- marked	Classes of secu- rities	Number of com- panies	Nominal value ¹⁾	Market capita- lization ¹⁾	Average market capi- talization ¹⁾
I	160	118	14,625	45,644	386.8
II	113	91	985	2,561	28.1
III	1	1	3	4	4.4

1) Millions of DKr

Source: Københavns Fondsbørs

Share market III is a new exchange segment. On the initiative of the Minister of Industry early in 1981, the exchange appointed a committee to study the feasibility of a special segment for small and medium-sized companies. The committee reported in September 1981.

In order to attract such companies to the exchange, the committee recommended the creation of a special segment. The committee also designed special listing requirements for the new segment. These new standards are somewhat less onerous than those for the other two segments and make additional companies eligible for listing²⁸⁾. These recommendations were taken up in § 20 of the Stock Exchange Order of 1982.

Up to March 1983 share market III attracted two industrial companies with a market capitalization of about DKr 5 mio each²⁹⁾. In the second quarter of 1983 two more industrial companies were added with market capitalizations of DKr 3 and 15 mio. The trading procedure is the same as in share market II. The shares of segment III are jointly called up after the last group of aktiemarked II. However, since this call is made only on Tuesday³⁰⁾, a trading facility is available only once a week.

Beyond these three segments there seems to be no organized secondary share market. Substantial transactions off the exchange do occur in listed shares. Some of these transactions have the character of in-house crossing based on the stock exchange prices³¹⁾. In unlisted shares, which were placed privately by banks or directly by the issuing companies, there will also be transactions from time to time, though no indications of an organized market have been found.

II. EXCHANGE SEGMENTS

Few Danish companies are large by international standards. Even on share market I some companies are just of medium size. However, no industrial companies with market capitalizations of less than ECU 1 mio or DKr 8 mio are found in this segment. Thus, the focus will be on share markets II and III.

1. The traditional exchange segment for small company shares

a) Listing

The relevant provisions are set forth in § 5 of the Exchange Act and in part 3 of the Exchange Order. In addition, the board of the exchange published guidelines on listing. In contrast with the procedure in other member states, the issuing company not a member firm must apply for listing with the board.

The more important requirements for the listing of shares are enumerated below:

1. The minimum nominal value of the class of shares being offered has to be at least DKr 15 mio at the time of listing. This requirement applies to each class of shares (§ 17 Stock Exchange Order).
2. The part of the issue to be offered to the public is 15% or more, at least DKr 2.5 mio nominal³²⁾. As a rule of thumb, the number of shareholders should be one hundredth of one percent of the nominal amount offered³³⁾.

If the exchange would strictly adhere to this rule, a minimum of 250 investors holding the issue would be required. This requirement is to be met before listing. In order to achieve this spread of shareholders and to avoid mispricing, the board of the exchange has recommended as early as 1973 that public offers should be tender offers. The price should be set in a way that allows a proper spread of shareholders³⁴⁾. This recommendation has been widely followed. The tender system still prevails, while the rule of thumb for the spread of shareholders required was replaced recently by a less restrictive and more flexible practice.

3. The company has to make available to the public and to the exchange for distribution to member firms copies of a folder ("introduktionsmappen") including the latest annual report, a report on the company, the articles of association and the "prospekt". The "prospekt" is a very short technical selling document; it includes a form on which investors may submit their scaled tenders. The material information is contained mainly in the report, which usually includes the accounts for the latest three year period or, for young companies, at least the account of one year adopted by the general meeting (§ 17 stk. 2 Stock Exchange Order)³⁵⁾. § 84 of the lov om aktieselskaber requires that the accounts of a company listed or about to be listed have to be audited by two accountants³⁶⁾.
4. An advertisement is required in the Danish Official Gazette and in a Copenhagen daily newspaper, which draws the attention of investors and shareholders to the issue and states where information can be obtained. An issuing company headquartered outside Copenhagen has to publish the box advertisement also in at least one

local daily newspaper (§ 14 stk. 1 No. 4 Stock Exchange Order).

5. The share certificates have to meet the extensive Regulations Applicable to Printing, Text and Design of Securities Admitted to Quotation on the Copenhagen Stock Exchange. There are plans to trade only certificateless shares on the Copenhagen Stock Exchange (§ 1 Danish Securities Centre Act of 1980)³⁷⁾.
6. The shares have to be fully paid.
7. In the articles of association there must be no restrictions on the transfer of shares to be listed³⁸⁾.
8. The issuing company is subject to a number of continuing requirements (§§ 14, 15, 26 of the Stock Exchange Order). Among other things, the general meetings must be advertised in at least one daily newspaper and in the Gazette, the general meetings have to be open to the press, any voluntary semiannual reports to shareholders shall be provided and major decisions of the board of directors have to be announced forthwith³⁹⁾.

The costs of printing the shares⁴⁰⁾ and the information materials and the costs of the services of an issuing house, the lawyer and the accountants will amount to up to DKr 0.5 mio for companies which are just big enough to be eligible for listing on share market II⁴¹⁾. In addition, a new issue of shares draws tax (kapitaltilførselsafgift) at a rate of 1% of the market value of the shares.

Since tender offers are being used, there seems technically to be no underpricing. But a lack of investor interest for shares combined with the requirement to have a fairly large number of shareholders (which was relaxed only recently)

may have forced some underpricing on the issuer. More importantly, the Danish financial community is rather small and limited by foreign exchange restrictions to domestic securities. On this narrow basis, it is hard to employ specialized analysts. Thus, innovative companies or companies off the mainstream of business used to find it hard to have their shares valued at price-earnings ratios which they may fetch in large and very competitive financial centers⁴²⁾. However, it does not seem to be appropriate to use the term underpricing in this context. The first investors who will be able to judge the investment merits of a young company generally will be rather close to the company's activities. In entering the equity market, the company will have to rely on these investors, not on those belonging to a far away, large financial center.

The exchange does not charge an initial listing fee. The continuing listing fee amounts to about DKr 5,000, if the par value of the listed shares totals DKr 5-20 mio⁴³⁾. Other continuing costs will add to it, e.g. the costs of the second accountant and of various shareholder services.

b) Trading

The members and any authorized clerks have the exclusive right to trade on the exchange⁴⁴⁾. However, in addition to these brokers, bank representatives do attend the trading sessions; there they transmit orders to the brokers. Most of the orders originate at the banks. Not all of the orders will be taken to the exchange for execution. The brokers⁴⁵⁾ and the banks will cross orders in house at the price established on the exchange. It is probably only in the share trading of smaller companies that exchange

volume clearly exceeds off-exchange sales⁴⁶⁾. Both banks and brokers may deal for their own account. However, a member is not allowed to trade for his own account in a class of shares if he holds orders relating to these shares and if these orders are unlimited or limited close to the market; even if he executes these orders, he may not trade for his own account himself during the remainder of the day⁴⁷⁾.

Trading in the share market II commences after the end of the share market I auction session⁴⁸⁾. The brokers and bankers rise from their seats and gather in the rear of the share trading room in front of three boards. The names of the securities traded in this segment are displayed on these boards, arranged according to their line of business. The three groups into which these securities are divided, are called up in sequence for trading by an exchange official.

Once the first group has been called, the members cry out their bids and offers for stocks in this group in any order they like. Two exchange employees write these bids and offers down on the relevant board, and they replace them with any higher bids or lower offers. If this results in a sale, they will also note the price and the volume of the sale on the board. When activity begins to tail off, the official announces that trading is coming to an end and switches on a wall-clock, which after 60 seconds - during this time trading again becomes brisk - rings to signal the end of the session.

The other groups then go through the same procedure. Each group's trading normally lasts between 5 and 10 minutes. The participants have to spend only 10 to 20 seconds of their time on each issue. Under the trading procedure just outlined this is sufficient to give the trading of inactive shares the benefit of a competitive environment.

All closing quotations, prices and the sales in each class of securities are published in the official list. Most Danish papers carry at least some of this information. As one would expect, many of the small company shares in this segment are quoted regularly, but only trade from time to time. Total turnover is modest. However, it has steadily increased and doubled over the last decade⁴⁹⁾.

Member firms jointly fix commission rates. For transactions in shares traded on share market II, the rate is 1% of the market value, but at least 1% of the par value transacted⁵⁰⁾. The minimum commission is DKr 25. For orders originating at banks, the same rates apply. The banks will pass on half of the commission to the executing exchange member. In addition to the commission, both buyer and seller pay a stamp duty of 0.25% of the market value.

2. The new exchange segment for small company shares

The share market III was legally established by the Stock Exchange Order of January 19, 1982, which became effective on February 1 of that year. It may be seen as a side effect of earlier regulatory measures. It was not until 1972 that the former efterbørs became a part of the official market. The minimum capital requirement was set at DKr 1 mio. This did not cause any problems. However, the efterbørs, which had traditionally served trading needs not met by the official exchange, became subject to and suffered from an Exchange Act's requirement: any listed security must be made available to and held by the public to an extent that transactions can be expected to occur regularly. In due course, the exchange in 1973, as pointed out above, promulgated specific guidelines that 15% of an issue are to be offered

to the public, but no less than DKr 2.5 mio nominal value (exceptionally 10%, but no less than DKr 1 mio).

Since companies entering the market for the first time tend to be reluctant to offer more than the minimal fraction required, it was widely understood that listing would require a share capital of DKr 15 to 20 mio⁵¹⁾. Consequently, the exchange asked the Minister of Industry to raise the minimum capital requirement in the Stock Exchange Order⁵²⁾.

The development from the unofficial efterbørs with no minimum requirements to an efterbørs integrated into the official market is perfectly in line with the desire to promote a market place that meets high standards of marketability. However, this development obviously opened up a gap on the small company side of the market. The growing concern about the equity financing of these companies led the minister to request a study on the problem of how access of small and medium-sized companies to the market could be improved⁵³⁾. The committee appointed by the exchange to look into the feasibility of a special segment reported in September 1981⁵⁴⁾. Many of the committee's recommendations are mirrored in the Stock Exchange Order of 1982.

The committee saw four reasons why companies do not list⁵⁵⁾:

1. The spread of shareholders required is difficult to achieve, even if considerable efforts are made.
2. Companies are afraid of high costs of listing.
3. The minimum capital requirement is perceived to be rather high (DKr 15-20 mio).
4. The entrepreneur, who generally takes pride in having

achieved independence by creating his own company, is reluctant to share control.

The last point can be easily dealt with (as borne out by the listings of recent years) by establishing two classes of shares; the one with the "reduced" voting rights (B-shares) will be listed. Still, this solution does not seem clearly understood. It is not understood either that reliance on lending when more equity is called for tends to confer control to lenders. Recently, efforts have been increased to offer seminars to businessmen in order to acquaint them with the procedures and advantages of listing. The three points mentioned first involve misconceptions to a lesser extent. In framing the listing requirements of the new share market III, some of the related issues have been dealt with.

a) Listing

The requirements for listing on share market III should be seen against the background of the traditional market listing requirements set forth in Section 1 a above. Thus, the following points will focus on the major differences:

1. The class of shares to be listed must have a total par value of at least DKr 1 mio, but the total nominal capital stock must not exceed DKr 15 mio⁵⁶⁾.
2. The amount to be offered to the public is 15%, at least DKr 1 mio nominal⁵⁷⁾. In contrast with share market II requirements, these shares may be - and usually are - offered and distributed after exchange trading commences. The shares must merely be available to the market, i.e. they will be fed into the market over a period of weeks at prices

established on the floor⁵⁸⁾. Since bearer shares are used, the resulting spread is difficult to establish⁵⁹⁾. After the distribution of the shares, the share capital of the issuing company must be at least DKr 2 mio nominal⁶⁰⁾.

3. In principle, the initial information requirements (introduktionsmappen) have not been lowered. Materially, the exchange will be satisfied if companies applying for share market III meet these minimum information requirements. Larger companies will generally⁶¹⁾ provide voluntarily more information in their report or on request of the exchange. Formally, the introduktionsmappen will contain only the report on the company, the latest accounts and the articles of association. The fourth document, the "prospekt" in the Danish sense, is not needed if interested investors will not file tenders since the shares are sold on the floor; investors will just place orders with their bank or member firm, as they would for the purchase of any shares in the secondary market.
4. Box advertisements have to be published. The general listing requirements apply.
5. The printing standard for the share certificates, the shareholder services to be rendered and the continuing information requirements are the same as for share market I and II. As on these markets, the shares have to be fully paid and must not be subject to any transfer restrictions.

The first two companies listed on share market III are both manufacturers about ten years old and employing less than fifty persons. The first company listed DKr 3 mio of B-shares, of which 2 mio were offered to the public. The second company listed DKr 2.6 mio B-shares publicly offering DKr 1.5

mio⁶²⁾. About DKr 3 mio and DKr 2.7 mio of equity were raised. In the second quarter of 1983, after the completion of the fieldwork for this part of the study, two more companies were listed on share market III. Based on the first two cases, the total flotation costs amounted to about 8-9% of the funds obtained⁶³⁾. The share issue tax is not included in this figure, nor are any of the continuing costs. An element in these is the flat DKr 2,000 listing fee⁶⁴⁾.

b) Trading

The stocks traded on share market III are traded like those on share market II. Technically, they may be considered a fourth group to be called. However, this group is called only on Tuesday⁶⁵⁾. The present exchange environment suggests to proceed in this way. The small amount outstanding and the limited spread of shareholders will tend to result in fewer orders than desirable for daily trading. Since as pointed out, trading by members for their own account is slightly restricted, and since the very short trading period renders active search for a counterparty impossible, the obvious solution is to let orders accumulate by trading less frequently, i.e. weekly instead of daily. This way, there is a higher probability that matching or even competing orders will be in the market and provide a reliable basis on which prices can be established. This purpose may be served even better by concentrating trading in just one session per month⁶⁶⁾.

However, a lack of opportunity to trade may well curtail investor interest. A small company investor tends to be an involved investor. He may want to trade immediately

on his assessment of information which, in his judgement, is likely to impact price. In addition, newspapers may see no need to carry in their daily stock tables securities traded only once a week. Thus, not surprisingly, there is some desire to reconsider weekly trading. This contributes to a much broader discussion on redesigning the traditional trading procedures in all Danish market segments. Prices, sales and closing quotations of share market III stocks are carried in the official list. The commission rates are the same as for share market II securities.

A company listed on share market III will be moved to share market II or I once the nominal share capital is increased to more than DKr 15 mio; a transfer may be effected even without an issue of additional shares if the growth of the equity leads to net assets exceeding DKr 30 mio⁶⁷⁾. Since the continuing requirements are the same for all segments, no complications are to be expected from this. The allocation to share market II or I will depend on the turnover characteristics of the stock involved; actively traded stocks will be assigned to share market I⁶⁸⁾.

III. SUMMARY

The efterbørs and its successor, aktiemarked II, have traditionally provided secondary market services for small firms and thus have facilitated the raising of modest amounts of equity from the investing public. The creation of the aktiemarked III reopens the Copenhagen Stock Exchange to very small companies. It reinforces the position of the exchange as the organizer of the entire share market. Without share market III private placements and replacements of small company shares might have become

very common. Aktiemarked III has been instrumental in raising on the exchange equity in amounts which are, by traditional standards, considered far too low for an offer of shares to the public. Surprisingly, the flotation costs were clearly not far out of proportion to the amounts raised. Any further equity issues along these lines deserve attention, since the low flotation costs seem to rest on low sponsorship costs, which may be related to the limited scope and transparency of the Danish national economy.

The listing requirements contribute to the low flotation costs. In particular, the introduktionsmappen approach is interesting. It replaces the usual prospectus and reduces printing expenses, since some of the required documents are simply reproduced. The plans for the replacement of share certificates by book entries at the Danish Securities Centre hold the promise that printing costs for shares will be eliminated. Currently they are a prominent item adding to the flotation costs of small companies.

Another interesting feature is placing the shares simply by using the regular trading procedure. Since the special primary market flotation procedures are designed to favourably sell large quantities of shares in a short period of time, they may indeed not be called for in cases where rather small amounts are to be placed with the public. It remains to be seen, however, whether weekly matching of orders during very short periods of time is a lasting compromise between effectiveness and efficiency, between the transaction needs of the investors and the more abstract preference for a clean, streamlined trading procedure.

The new focus on equity financing with emphasis on small firms, the commitment of major institutions to this new

approach, and the tax measures designed to ease the fiscal bias against equity investment may well set the stage for an accelerated growth of the Danish equity market. This would increase the scale, the number of participants and most likely the competitiveness of primary and secondary market services. As a result, the rewards for successfully establishing a company and for going public may become more attractive.

Footnotes

- 1) Danmarks Statistik, Statistik Arborg 1982, København: Aarhus Stiftsbogtrykkerie, 1982, p. 103.
- 2) Any such trading would have to occur off the exchange; § 5 stk. 1 of the Stock Exchange Act (lov om Københavns Fondsbørs) only provides for the listing of aktieselskaber.
- 3) B. Gomard, Das dänische Gesetz über Aktiengesellschaften, Frankfurt: A. Metzner, 1976, p. 11. Recent amendments have further weakened the influence of this tradition. The following is only meant to interpret the relative importance of Aktieselskaber prior to 1983.
- 4) B. Gomard, l.c., pp. 74-75; G. Carsten, Das dänische GmbH-Recht und die deutsche GmbH-Rechtsreform, GmbH-Rundschau, 1974, p. 286.
- 5) Formerly these shares were usually referred to as C-shares; B-shares were strictly non-voting. § 67 of the new law does not permit non-voting shares.
- 6) Rapport vedrørende eventuel etablering af et aktiemarked for mindre og mellemstore selskaber afgivet af et udvalg nedsat af Fondsbørsbestyrelsen, København: Københavns Fondsbørs, 1981, p. 18. If, in addition, the shares newly listed in share market III of the exchange are taken into account, 20 of the 26 new listings concerned B-shares.
- 7) Rapport, l.c., pp. 24-25.
- 8) According to B. Gomard, l.c., p. 15, 84% of all companies existing in 1972.
- 9) § 21 stk. 2 lov om aktieselskaber and § 23 respectively. See also § 24 stk. 2. The liability of transferor and transferee is set out in § 13 stk. 3. According to §§ 15 and 16 full payment has to be effected within one year.

- 10) Danmarks Nationalbank , Monetary Review, February 1982, pp. 7-8.
- 11) Copenhagen Stock Exchange, Annual Report 1981, pp. 7 and 10.
- 12) Arbejdsmarkedets Tillaegspension (ATP) and Lønmodtagernes Dyrtidsfond (LD).
- 13) Cf. Pensionskassen for sygeplejersker, Beretning 1981/82, p. 11. This fund has increased its investment in unlisted shares from DKr 17 mio at Sept. 30, 1980 to DKr 47.7 mio at Sept. 30, 1982, spread over 27 industrial and a few other companies. In percent of total assets, this was an increase from 0.7% to 1.4%, while investment in listed shares rose from 4.1% to 5.7%.
- 14) The funds refrain from loans, since this may be perceived as a banking activity. Preferred shares seem undesirable because full voting rights seem necessary. The only way to rescue an investment in non-marketable shares tends to be influence on management ("if you can't sell, you have to fight").
- 15) Pensionskassen for sygeplejersker, l.c., p. 13.
- 16) Danmarks Nationalbank, Monetary Review, February 1983, p. 36.
- 17) Ibidem. For the preceding five years the ratio was 50:1 and share issues averaged DKr 459 mio.
- 18) Cf. section 6 of the Stock Exchange Order of January 19, 1982.
- 19) Cf. section 7 and 43 of the Stock Exchange Order.
- 20) Handelsbank, Danske Bank, Privatbanken.
- 21) Sammensluttede Danske Sparekasser (SDS).
- 22) Salgsprospekt Inotec A/S, May 1983, pp. 5, 6.
- 23) One amendment deleted section 4 of the Act. This section required a two-segment structure (hovedbørs and efterbørs).
- 24) For a survey of the old structure see H. Schmidt, l.c., pp. 76-84.
- 25) For a description of the trading procedure see H. Schmidt, l.c., p. 80.
- 26) Cf. note 24 supra.
- 27) It should be remembered that the 1981 figures relate to the old market structure. Some large companies which were traded on the efterbørs are now traded on share market I. As a result, the average capitalization of companies traded in the second segment is much lower than under the old structure.

- 28) Rapport, l.c., pp. 30-38.
- 29) It should be noted that A-shares of the two companies of nominal Dkr 1,000,000 and 350,000 are not included. At Oct. 31, 1983 8 companies were traded.
- 30) Cf. § 29 stk. 2 Stock Exchange Order. Later in 1983 daily trading was adopted.
- 31) Cf. H. Schmidt, l.c., pp. 85-86.
- 32) Rapport, l.c., pp. 12, 53 (cf. note 6 supra).
- 33) Ibid., p. 8.
- 34) Ibid., p. 13, 61.
- 35) For further details see Rapport, l.c., pp. 54-59 (reprint of "Aktieselskabers optagelse til officiel notering på Københavns Fondsbørs"). Contrary to the practice outlined above, the report is sometimes used as a material selling document, while the financial information, backed up by the accountant's statement, is set forth in the booklet on the three or five latest company accounts. This approach very well bears out the conflicting tendencies found in the prospectus as it is known in other countries. It clearly separates the selling document with an optimistic outlook and the disclosure document which makes the company look bleak in order to avoid liability. Cf. L. Loss, Disclosure as preventive enforcement, Florence, European University Institute, 1983, p. 8.
- 36) For an unlisted company one accountant or registered accountant will do. Of the two accountants of a listed company, one has to be a licenced accountant (licencing requires success in a tough exam, registration the passage of a less severe test).
- 37) Bond certificates have been abolished in March 1983. The claims formerly represented by the certificates are now registered with Vaerdipapircentralen, the Danish Securities Centre.
- 38) There tend to be restrictions on the transfer of A-shares aimed at maintaining control. As pointed out above, B-shares will usually be listed.
- 39) The Code of Conduct of the exchange requires the announcement of material facts without delay.
- 40) About 10 printing houses in Denmark can meet the requirements of the exchange. Rapport, l.c., p. 12.
- 41) Rapport, l.c., p. 24.

- 42) The experience of Novo Industri A/S may be seen as a case in point. A.I. Stonehill and K.B. Dullum, *Internationalizing the cost of capital*, Copenhagen and New York: A. Busck and J. Wiley, 1982, pp. 35-80.
- 43) Below DKr 5 mio the fee is about DKr 2,000, above DKr 20 mio up to 100 mio it is about DKr 9,000 (Rapport, l.c., pp. 17, 74). These fees change from year to year. They are fixed according to the budget of the exchange. 45% of the exchange's expenses have to be recovered from fees levied on listed companies (§ 4 stk. 2 Stock Exchange Order).
- 44) § 16 of the Exchange Act, § 13 of the Stock Exchange Order.
- 45) § 19 stk. 1 Exchange Act.
- 46) For an assessment cf. H. Schmidt, l.c., pp. 359-390. See also pp. 84-86.
- 47) § 18 stk. 2 Exchange Act.
- 48) For a description of the trading procedure see H. Schmidt, l.c., pp. 80-82.
- 49) Copenhagen Stock Exchange, Annual report 1981, p. 12. In 1981, total nominal turnover was DKr 36.6 mio.
- 50) A scaled commission schedule applies for share market I.
- 51) Rapport, l.c., p. 25.
- 52) Ibid., p. 9.
- 53) Ibid., p. 40.
- 54) Ibid. (cf. note 6 supra).
- 55) Ibid., p. 24.
- 56) § 20 stk. 1 Stock Exchange Order of 1982.
- 57) Ibid.
- 58) Any mispricing is likely to cancel out. However, a case of overwhelming demand has pointed to the limits of this method. Thus, discretionary tenders were used for share market III offerings later in 1983.
- 59) Rapport, l.c., p. 33.
- 60) § 20 stk. 1 Stock Exchange Order.
- 61) As an exception, Inotec A/S, a company now listed on aktiemarked III,

voluntarily provided information in excess of that which has been supplied by large companies. The company made it a selling point, that its report of 23 pages met the requirements of the EEC listing prospectus directive.

- 62) There are DKr 1 mio and 0.35 mio respectively of A-shares which are unlisted.
- 63) In order to protect shareholders against watering stock by excessive flotation costs, § 32 stk. 1 no. 9 of the Companies Act (lov om aktieselskaber) limits flotation costs (excluding taxes) to 5% of par value newly issued. Since small companies cannot meet this requirement, they have to file for special permission with the companies registration office. Though the provision serves a useful purpose, a realistic scaled limit, based on market value of shares placed, seems to be more desirable. It would help to avoid any discrimination of small companies.
- 64) The fee would amount to DKr 2,000 if the companies were listed on share market II; cf. note 43 supra. Share market III companies with a nominal value of DKr 5 mio and more save about DKr 3,000 in listing fees. This has been justified by pointing to the reduced trading services (Rapport, l.c., p. 35).
- 65) Cf. Rapport, l.c., p. 35; § 29 stk. 2 Stock Exchange Order.
- 66) Ibid.
- 67) § 20 stk. 2 and 3 Stock Exchange Order.
- 68) Rapport, l.c., p. 38.

D. THE SEGMENTS OF THE SECONDARY MARKET FOR EQUITY
INSTRUMENTS OF SMALL COMPANIES IN THE NETHERLANDS

I. ENVIRONMENT AND SURVEY

1. Number and forms of business organizations

As in other countries sole proprietorship, partnership (vennootschap onder firma), limited partnership (commanditaire vennootschap, C.V.), and two forms of limited companies are the most common forms of business organization in the Netherlands. The public limited company called naamloze vennootschap (abbreviated N.V.) is rather common, as there were about 2,500 enterprises using the N.V. form at the end of 1982¹⁾. The private limited company, the besloten vennootschap met beperkte aansprakelijkheid, abbreviated B.V., is very popular. About 125,000 enterprises in this form were known at the end of 1982.

Though with very small firms the sole proprietorship is more common, there seems to be agreement that the B.V. is clearly the most important form of business organization for small industrial enterprises. The N.V. is less frequent among small industrial enterprises than the partnership²⁾. An appreciated advantage of the B.V. as compared to the N.V. is the limited extent of disclosure required. Under the current law, to be amended later in 1983, even the larger industrial B.V. does not have to publish an income statement, the industrial B.V. with less than Dfl. 8 mio assets and less than 100 employees no accounts at all³⁾. The low minimum capital requirement does not seem to be an equally important factor.

Number and forms of business organization
in the Netherlands as of January 1, 1983

Form	Total	Industrial enterprises only			
		total	less than 5 employees	5 - 100 employees	more than 100 employees
Naamloze vennootschappen	2 512	285	81	104	100
Besloten vennootschappen	125 023	16 768	5 767	9 817	1 184
Vennootschappen onder firma	34 448	4 061	3 410	644	7
Sole Proprietor- ships	252 127	22 499	20 795	1 704	-
Other	32 027	1 048	664	334	50
Total	446 137	44 661	30 717	12 603	1 341

Source: General Register of Enterprises of the Netherlands Central Bureau
of Statistics.

In general, only equity instruments of N.V. form companies are traded in organized secondary markets. However, there are a few examples of trading of B.V. shares or of certificates representing such shares. This is somewhat surprising. In the articles of association of a B.V. there has to be a provision restricting the transfer of shares to others than e.g. existing shareholders. This transfer problem is overcome by the issue and trading of depositary receipts in place of the B.V. shares by an administratiekantoor⁴⁾.

The trading of B.V. shares seems to meet hardly any opposition in principle. A technical point of view focusses on the fact that B.V. shares or receipts ought to be registered securities while an N.V. may use bearer securities. From this point of view the use of the B.V. form is deplored; the more efficient bearer securities will become available by conversion into a N.V. requiring little more than a change of the articles of association. However, in at least one case the cumbersome paper work resulting from registered depositary receipts has been taken over by the computer of the administratiekantoor to the full satisfaction of those involved in the trading. The retention of the B.V. form, though it is not easily appreciated by an outsider, seems to be a point of great importance to many an industrialist not wanting to part with the typical form of organization of a closely held industrial enterprise.

2. Frequently used instruments for equity financing

Though the securities market in the Netherlands accommodates a rather wide spectrum of equity instruments ranging from warrants, participating certificates, traded stock dividends and various shares to convertible debentures, the ordinary

share certificate is the most important instrument for the equity financing of small companies. The ordinary share comes in a number of different forms. In many cases the bearer share certificate is used. However, registered share certificates also play an important role.

In some instances these registered shares are traded, but more frequently they are lodged by the issuer with a depositary providing the investor with depositary receipts, which usually may be exchanged at the holder's request for the underlying securities. The rather common use of a depositary may be explained as a convenient means of providing bearer instruments; of breaking down into desirable size high value shares too heavy for trading; of bypassing legal transfer restrictions; and of controlling at least to some extent the voting of shareholders and thus the risk of being taken over as the shares are voted by the depositaries. However, the depositaries are obliged under the regulations of the Amsterdam Stock Exchange to exercise the voting rights in the best interest of the holders of the depositary receipts⁵⁾. If the exchange no longer consider a depositary independent of the issuing company, they are entitled to request the transfer to an independent depositary⁶⁾.

The amount of equity required by a small growing enterprise cannot be readily determined in advance. A project may turn out to be a failure in the development stage, or the market acceptance of a new product may result in higher or lower financing requirements. As the undertone of the stock market may be hostile to the small company at the time the funds are actually needed, it is desirable to take advantage of periods with share prices favourable to the issuer. This implies the marketing of shares at a time when there is no need to fully commit all the funds that can be raised. Thus, there has been some thought in the

Netherlands to more frequently issue and trade partly paid shares of small companies. Certainly proper timing of the issue, if achieved, and the influx of funds when needed, by calling on the shareholders to pay up, are advantages of partly paid shares. In addition, they may allow a public issue at a time when the company would be considered too small for a public issue of fully paid shares. They may also obviate the need for repeated small share issues each involving high flotation costs. Insurance companies in particular have successfully used partly paid shares in a number of countries. However, the investor's risk of being called upon to pay up because of failure may appear unacceptably high with small industrial companies. Moreover, the trading of such shares is impeded by this risk and the registration required.

3. Investors and investment motives

In 1982 and 1983 there has been a revival of equity issues including the first offer in some years of shares by an industrial company. There was also an issue of an exchange listed Dutch investment company holding at the end of 1981 shares in 50 small and medium-sized innovative companies operating in the US and aiming at a 20% venture-capital component of their portfolio (N.V. Bever Beleggingen)⁷⁾. As the success of these issues has shown, there is substantial demand for equity instruments. A marketing study of the Amsterdam Stock Exchange points in the same direction. The new generation of individual investors, the "young coming men", are quite interested in equity instruments and they prefer above average risk investments such as options or shares of small growing companies. Institutional investors do invest a very substantial part of their assets

in shares⁸⁾, but their role in the market for the shares of small companies is limited due to the lack of market depth and the small size of investments available⁹⁾.

If institutions buy shares in small industrial companies, they seem to prefer a majority holding or some avenue to acquire a majority or a minority interest that, if combined with holdings of other institutions, holds a prospect of being a part of a majority interest. Only a majority interest is seen as offering a high probability for a successful investment, as the most reliable exit route appears to be the sale to an industrial company; there has been little experience with offerings in the secondary market.

Dutch entrepreneurs are rather reluctant to accept outside shareholders¹⁰⁾. However, young generation entrepreneurs often seem to be prepared to open up their companies and to accept outside partners if the price is right, well aware that even a minority shareholder in a B.V. can exert a substantial influence on management. It is hard to tell whether the waryness of Dutch entrepreneurs against outside influence, which is also witnessed by the frequent use of depositary receipts for domestic shares, results from a rather strong tendency of individual or institutional investors to gain control.

Banks do not seem to be an important holder of small company equity. In principle, they are limited to 5% of the equity of any company. This figure is intended to curb the banks' power and conflicts of interest and to promote high solvency and liquidity of banks. However, more importantly for this study, it implies that any investment in a small company is forbiddingly small: a 5% stake in a small company cannot be expected to yield returns covering the cost of time and effort spent in the evaluation and manage-

ment. In line with the practice in other countries it is thought in the Netherlands that an interest in a small unlisted company ought to be at least Dfl. 1 mio. If a bank plans to acquire more than a 5% share in the capital of a company, a declaration of no objection by the Nederlandsche Bank on behalf of the Minister of Finance must be obtained. Though this permission is normally forthcoming if the equity holdings of a bank are well diversified temporary participations and if their total value does not exceed a few percent of the bank's equity capital, the provision seems to restrict bank interest in small company shares.

In 1980 on the initiative of the Minister of Finance a new vehicle for investment in the equity of small companies was developed called particuliere participatiemaatschappij or PPM. For these private participation companies the restrictive policy of the Bank was somewhat relaxed allowing minority participations not exceeding an amount of Dfl. 2.5 mio to be held for a period which should be less than five years¹¹⁾. In 1981 a guarantee scheme of the Dutch government added to the attractiveness of the PPM.

A PPM may engage only in the provision of risk capital to industry and in related activities. Half of any capital losses on investments in fully paid shares, possibly combined with subordinated convertible loans, newly issued by companies with less than 500 employees will be compensated by the government, if these instruments have been held by a PPM recognized by the Nederlandsche Bank. Within five years after recognition none of the minority interests may exceed 20% of total investments. The 50% guarantee is available for a holding period of 10 years, after which it is reduced by 10 percentage points annually¹²⁾.

As of December 31, 1982 there were 21 PPMs holding 38 minority shareholders in 33 companies, which were combined with subordinated convertible loans in seven cases. Though the initial investment amounted to Dfl. 15.3 mio only, a fairly rapid build-up is to be expected as the PPMs complete their second and third year. The PPMs are partly held by banks only, partly jointly by banks, insurance companies and pension funds or enterprises. In the case of joined operation the C.V. form rather than the B.V. (11 PPMs) or the N.V. form (2 PPMs) tends to be used in order to make any losses incurred at the PPM deductible from the taxable income of the partners. This approach might be used if publicly held PPMs were set up. Publicly held PPMs could pay to each private shareholder a dividend of up to Dfl. 1000 exempt from income tax. However, up to now individual investors have not been offered shares in a PPM even though a change in the relevant regulation effected September 1, 1982 aims at facilitating the acquisition of venture capital from individuals by the issue of PPM depositary receipts.

The PPM guarantee scheme hardly affects the risk-reward balance of low-risk participations, but it has had, as intended a strong impact on the attractiveness of high-risk shares. The investors using the PPM may have been motivated by this shift in the risk-reward balance though public pressure and the desire to help the national economy may have had an equally strong influence. The restrictive attitude of the Nederlandsche Bank charged with the supervision of both banks and PPMs with respect to the permissible volume and the duration of the participations has been matched by the optimism of bankers to place the successful participations with investors after a number of years. This has been aided by the creation of the "parallelmarkt", a special segment of the secondary market for small company shares¹³⁾.

4. Issuing houses for shares of small companies

No indications have been found in the Netherlands of a lack of demand for shares. However, the supply of shares has been very limited. This may result from the less favourable tax treatment of income from shares relative to the taxation of income from debt instruments and from the general socio-economic climate placing little emphasis on entrepreneurial activities and rewards. In the seventies the shares publicly issued by industrial and commercial companies amounted to a total of Dfl. 555 mio for the decade, whereas in the sixties this amount was Dfl. 1427 mio¹⁴⁾. Public issues of bank and insurance company shares used to be less than 10% of total public share issues in the early sixties, but in the late seventies they clearly dominated the primary share market. The net issue of exchange listed domestic bonds greatly exceeded the share issues. During the years 1978-1980 these net issues of bonds averaged Dfl. 7.8 mrd a year whereas share issues were Dfl. 350 mio¹⁵⁾ on average resulting in a ratio of 22:1.

This result seems to be unaffected by the way share issues are taken care of by the Dutch issuing houses. The members of the Vereniging voor de Effectenhandel enjoy a monopoly in the trading of securities encompassing secondary and primary market activities. The monopoly flows from a ministerial decree promulgated in 1947. Thus, the Vereniging is the national association organizing and controlling the securities market in the Netherlands and it operates the Amsterdam Stock Exchange¹⁶⁾.

The member firms of the Vereniging active in the primary market are the so called commissiehuizen. These firms deal with the public whereas the hoeklieden may deal with

other member firms only. In 1981 there were 95 commissiehuizen and 49 firms of hoeklieden¹⁷⁾. 36 of the commissiehuizen were banks, the remaining 59 were brokers (commissionars). 20 of these brokers had the status of a securities bank (effektenkredietinstellingen) and were subject to bank regulation and supervision. As with all banks this implies monthly reports to the Nederlandsche Bank and the supervision by the Bank's staff, which is close and continuous, but does not involve any fees for audits. The 39 remaining firms are niet-kredietinstellingen, i.e. non banks. These non-bank brokers are subject to the regulation by the Vereniging only. Contrary to the brokers with bank status these firms must not carry deposits for investors though they may with the permission of the Vereniging hold their clients' securities if sufficient capital is provided¹⁸⁾.

Currently the minimum equity capital required is Dfl. 5 mio for banks and Dfl. 1 mio for brokers with bank status (up from Dfl. 0.5 mio for either type of institution). This new requirement introduced in 1982 will be applied to previously existing institutions in 1987. According to the experience with earlier increases of the minimum capital requirement even this differentiated increase is expected to drive out of the securities business a number of firms. This may lead to further concentration and less choice for both issuers and investors.

Fortunately, the number of non-bank brokers has increased recently. The minimum capital requirement of the Vereniging stands at Dfl. 100,000, and it appears that Dfl. 500,000 would be sufficient to obtain the permission from the Vereniging to carry securities for clients¹⁹⁾. These rather small non-bank brokers tend to operate very efficiently, and they may prefer lower minimum commission rates than currently laid down by the Vereniging.

The variety of member firms outlined above seems to provide the choice the entrepreneur of a small company desires in arranging an issue. Most of the issues are brought to the market by the three big banks, their affiliates and by two medium-sized banks, all of whom act as underwriters. From time to time other banks may join the consortium. However, for small issues brokers engage in underwriting as well. Of course, there is little evidence to base a judgement on because of the scarcity of such issues. Nevertheless, it appears most likely that a small company will find an underwriter among the broker firms or the smaller banks if the issue is too small or inappropriate for a big bank because of its risk characteristics. In addition, the Exchange management will go a long way to make sure that a company with some investment merit desiring to have their shares traded on the Stock Exchange will achieve this goal.

5. Survey of the secondary market

The members of the Vereniging voor de Effectenhandel enjoy the exclusive right to trade in shares, save certain transfers that may be effected without a member's involvement by permission of the Minister of Finance. As a result, the market is clearly structured by the Vereniging, which has from time to time adjusted the structure of the market to the changing needs. Prior to 1982 there was a clear-cut distinction between the official market and the unofficial market for "incourante fondsen" (infrequently traded domestic issues). This unofficial market had been organized for many decades by two member broker firms, D.W. Brand N.V. and Broekman's Commissiebank N.V. These two firms had the right to publish prices of securities not admitted to the official list of the Amsterdam Stock Exchange but traded by these member firms from their offices off the floor of the Exchange²⁰⁾.

Late in 1979 the Vereniging set up the Commissie Incourante Markt. This committee had the task to work out a proposal to bring trading in "incourante fondsen" in line, or at least in parallel line, with the official market, implying direct regulation by the Vereniging rather than delegation to the two specialized member firms.

There were three reasons for this change:

1. Government interest in facilitating the equity financing of small companies leading to the "particuliere participatiemaatschappijen" dealt with above.
2. The erosion of the number of officially listed domestic shares from 455 in 1969 to 229 in 1979 and a comparable erosion of the incurante markt.
3. The desire to have all market segments visibly under control to promote confidence in the competence and effectiveness of the Vereniging by the investing public, legislators and government officials.

The report of the committee led to the creation of the "parallelmarkt", which replaced the "incourante markt" on January 28, 1982. There is a set of rules now for the listing, trading and quotation of previously incurante fondsen paralleling the corresponding regulations for the official market²¹⁾.

The official market and the parallel market are divided into a number of subsegments. The following survey as of year end 1982 will deal with such segments for domestic shares only. There are three such segments of the official market²²⁾:

1. The shares of the five Dutch internationals are traded continuously. After opening direct trading between the representatives of commissiehuizen is permitted in these clearly most active shares. This segment is called trading in "open hoek"²³⁾.
2. The shares of 25 companies are also traded continuously after opening, however, direct trading between commissiehuizen is not permitted. All transactions have to be effected through one of the at least two "hoeklieden" specializing in the share, which is expressed in the term "gesloten hoek" (closed market). The shares assigned to this segment are those which have been among the 30 share issues most actively traded for 10 of the previous 12 months. The list of these shares is revised twice a year, and any issue which has been on the list but has not met the above requirement on three consecutive revision dates will be taken off the list of the segment "continuous trading in gesloten hoek"²⁴⁾.
3. The remaining less active shares of 145 companies are traded non-continuously in gesloten hoek resulting in no more than two official prices per day²⁵⁾.

In case trading in a gesloten hoek becomes extremely active, the floor supervisor may temporarily assign an issue for open-hoek trading (opengaan van gesloten hoek), which has become a very rare occurrence in the recent past.

The parallelmarkt is divided in two segments:

1. The more active share issues of 18 companies have been admitted to the parallelmarkt list and are traded according to a procedure resembling continuous trading in gesloten hoek.

2. Share issues of 160 companies²⁶⁾ not admitted officially to the parallelmarkt enjoy unlisted trading privileges and the prices of any transactions therein are published at the end of the official list in a special section.

Because of the members' monopoly for securities trading and the accommodating segmentation of the exchange market there appears to be no organized off-exchange trading in shares. The shares of small companies are traded only in gesloten hoeken twice a day or in the parallelmarkt. Thus, the following section will focus on these market segments.

II. EXCHANGE SEGMENTS

1. The traditional official market segment for small company shares

On the Amsterdam Stock Exchange small companies have been trading traditionally in "gesloten hoek" non-continuously. Of the 145 companies traded this way 66 have a nominal share capital of less than Dfl. 10 mio²⁷⁾. It is the only segment of the "official" market where shares of such companies are found, as the segments with continuous trading serve larger companies and the two most important issuers of bonds, government and municipal bank. However, the basic listing requirements for shares are the same for all companies on the official market.

a) Listing

The relevant provisions are set forth in the Fondsenreglement of the Vereniging. No issue can be listed unless a member firm dealing with the public files a request. A listing may or may not involve newly issued shares. The Fondsenreglement recognizes three kinds of "introductions", three ways of bringing securities to the secondary market and of admitting them to the official list:

- the introduction of newly issued shares implies issuing and applying for listing simultaneously (introduction by issue)
- introduction of not newly issued shares
 - a secondary offering accompanied by an application for listing (introduction by secondary offering)
 - application for listing of shares which have been traded in the parallelmarkt or formerly in the incurante markt in sufficient quantities (introduction by trading).

The more important issuer and issue characteristics required for the introduction of domestic shares are listed below:

1. The minimum market value of the class of shares issued at the time of listing has to be at least Dfl. 2.5 mio divided in no less than 4000 units of delivery.
2. The minimum amount to be offered to the public for subscription in case of an introduction by issue or available for trading in the case of an introduction by trading must be at least Dfl. 1.5 mio divided into not less than 2000 units of delivery (the minimum amount to be offered increases with the amount of shares outstanding as laid down in Artikel 4 Fondsenreglement).

3. The share certificates or depositary receipts have to meet the printing standards laid down in Appendix E to the Fondsenreglement, which any well equipped printing house should be able to meet according to the intentions of the Exchange stated in Section 2 of that Appendix.
4. A prospectus signed by the issuer and by one or more member commissiehuizen (for the contents of the prospectus cf. Artikel 9 Fondsenreglement; two prominent requirements are an auditor's statement on the accounts for the latest financial year and the statement of the management that they are not aware of any facts the publication of which would essentially affect the contents of the prospectus).
5. Announcement of the availability of the prospectus in the advertisement section of the official list and distribution of the prospectus on the following day at member offices to interested investors. Thus, a sufficient number of prospectuses must be sent to other member firms (cf. Artikel 7 and Artikel 19 lit. b Fondsenreglement).
6. The issuer must sign a listing agreement requiring the company among other things to publish at least one interim report and immediately announce material facts, render certain shareholders services in Amsterdam and consult the Vereniging before proposing any changes in the articles of association.

Thus, at the time of listing the issuer will incur substantial costs. In order to meet the printing and publication requirements about Dfl. 100,000 is required. Underwriting spread and selling concessions to be allowed to the member firms bringing the issue to the market will vary with issue

characteristics. However, even for small issues rather small percentages seem to suffice (about 3%). To the disadvantage of the issuing company underpricing may be more pronounced than elsewhere (about 15%). A new issue also draws a tax (kapitaalbelasting) of 1%. The Exchange charges a handling fee of Dfl. 1000 for a simple prospectus, of Dfl. 3000 for a standard prospectus and Dfl. 6000 for a prospectus requiring involved analysis by the Executive Committee²⁸⁾. In addition, a listing fee of 1 per mill on the market value of the shares listed is required. On an issue with a market value of Dfl. 3 mio the fees due to the exchange and to banks and related cash payment for printing and publication would amount to 6-7% (tax and underpricing not included).

There is also a continuing listing fee, based on a fee structure repeatedly changed. Further changes and increases may be forthcoming later in 1983 as the EEC-directives will lead to an increased workload resulting in higher continuous listing fees²⁹⁾. Currently, a small company will have to pay Dfl. 4000 a year as this is the fee for a nominal capital listed of up to Dfl. 10 mio (or, if there is no nominal capital, up to Dfl. 10 mio market value). Along with these continuing costs shareholder servicing costs have to be considered. These servicing costs seem to be minor, as e.g. the fee for dividend payments is borne by the shareholders in most cases though tax experts may suggest to proceed differently.

b) Trading

Trading on the traditional market segment available for small companies' shares is done in gesloten hoeken. "Hoek"

is the Dutch term for the positions on the floor of the exchange at which dealings in certain securities are concentrated. An imaginary grid delineates 82 squares and these are occupied by markets or "hoeken". It is mandatory to deal through a "hoekman" on a "gesloten hoek"³⁰⁾. For each issue there are two "hoeklieden"³¹⁾. They collect all orders, and on this basis they jointly establish one or two collective prices after advising any floor representatives of the commissiehuizen at the market of the price to be expected.

The first price is established during the first official trading period, 11.30 a.m. - 12.15 p.m.³²⁾. Immediately thereafter it has to be available for the floor commissioner for publication in the official list. It is a collective price since, contrary to continuous trading at individual prices, all orders on the floor are executed at this price and at the same time, i.e. all orders to sell unlimited or limited at or below the price and all buy orders unlimited or limited at or above the price³³⁾. If the price does not clear the market completely, the hoekman has the right, but is not obliged, to satisfy or take up at this price for his own account any excess demand or excess supply. If he does not, the commissiehuis having placed the order with the hoekman may do so³⁴⁾.

If additional orders come in, a second collective price may be established towards the end of the second period from 12.45 - 13.15. This requires, except by permission of the floor commissioner, that there were transactions at the first price³⁵⁾. Between the two collective prices individual bargains may be made by the hoekman at the first price. For a substantial number of shares dealt in this segment the official list carries a first-period price only. In exceptional situations the floor commissioner

may allow, if the need arises, continuous trading and the publication of more than two prices³⁶⁾. In addition to the price information the official list provides information on total sales in each class of shares and indications of any excess demand or excess supply.

The commission of the member firm dealing with the public amounts to 1.5% on the first Dfl. 5,000 market value transacted. Any exceeding amount up to a total of Dfl. 20,000 will add to the commission at a rate of 1% of this excess. The rate is 0.7% for amounts around Dfl. 20,000. In addition, the client is charged a handling fee of Dfl. 7.50. 11% of the commission will be handed over to the hoekman³⁷⁾. There is also a contract tax of 1.2 per mill.

2. The parallelmarkt for officially listed securities

As pointed out above the incurante markt, from which the parallelmarkt developed, had been an off-floor market for many decades before it was regulated directly by the Vereniging and brought to the floor of the exchange on January 28, 1982. Originally, the incurante markt covered a broad range of securities of small and even large private and public issuers. Securities of large companies have become fewer and fewer over the years. Now, the new market is geared to the small company, which may be hesitant to apply for a full listing in the traditional meaning. The parallelmarkt is aimed at such companies and it tries to make an exchange listing more attractive, compared to the traditional market, by:

- lowering the initial cost of listing
- lowering minimum capital requirements
- lowering the continuing costs of listing³⁸⁾.

It is also intended to improve the service of the market to the investor.

a) Listing

There is a special listing regulation for the parallelmarkt³⁹⁾ paralleling in many ways the Fondsenreglement. However, the listing requirements differ to some extent:

1. The minimum nominal value of the class of shares issued must be no less than Dfl. 2.5 mio.
2. At least Dfl. 250,000 nominal must be publicly held. If the nominal capital exceeds Dfl. 2.5 mio, the amount publicly held and available for trading may be less than 10% of the capital⁴⁰⁾.
3. The printing standards have been lowered.
4. The prospectus signed by the issuer and by one or more member commissiehuizen may take a number of forms, e.g. the form of an annual report with additional information provided in an accompanying letter. It also may be published in the advertisement section of the official list at a special rate. Even a fill-in standard form prospectus may be used. The prospectus, if not published in the press, must be available to member firms at request, but does not have to be sent out to them in sufficient numbers.
5. Some of the prospectus disclosure requirements which appear less relevant have been omitted, others have been lowered, e.g. income statements are required for the

last three years rather than for five. However, as in the traditional market, this requirement does not imply a minimum age of the company; listing right after start up is permitted⁴¹⁾.

6. Announcement of the prospectus in the official list.
7. The issuer must sign a listing agreement requiring the company to render shareholder services, to publish interim reports and to immediately disclose material facts. The agreement is different in form, but not in substance, from the agreement used for official market listing. Some reporting requirements, e.g. in case of new minority interests, have been replaced by a general provision requiring that companies provide the exchange with all information which they deem to be useful for the protection of the investors and the efficient functioning of the market.
8. A major difference is that only a part of an issue may be listed.

It is hard to judge the cost impact of these differences. As far as the prospectus is concerned, the companies which came to the parallelmarkt recently put their best foot forward rather than economizing on printing expenses. Usually they have voluntarily disclosed more information than required in the prospectus for the parallelmarkt. The issuers seem to perceive the prospectus as a marketing and selling instrument and not as a regulatory burden. Though cost effects may have some role to play, the encouragement resulting from requirements which are easily met and the rather limited percentage of capital to be made available to the public⁴²⁾ seem to be more important.

The handling fee at the time of listing is Dfl. 1000, the continuing listing fee amounts to Dfl. 2000 regardless of size.

The listing on the parallelmarkt confers the status of an officially listed issue. This makes such issues fit for purchase by institutional investors⁴³⁾.

In January 1982 the market started up with 14 classes of equity securities of 12 companies. They met all material requirements. Under a change-over provision they were listed without a prospectus. At yearend 27 issues of 18 companies were traded including one convertible bond and one class of participating certificates⁴⁴⁾. Of the 18 companies 14 have outstanding a share capital of less than Dfl. 10 mio nominal. Four companies have listed a share capital of less than 1 mio. In one case the nominal amount listed is only Dfl. 315,000 with a market value of Dfl. 268,000 at the end of 1982. Except for one other case, the market value of the shares listed by each firm is above Dfl. 1 mio, which is considered sufficient for the maintenance of a secondary market.

The shares of one company initially listed on the parallelmarkt were later listed on the "official" market. It has been suggested, to move from the "official" market to the parallelmarkt a number of companies which do not meet the listing standards of the traditional market anymore because these requirements have been increased from time to time. At first sight, this appears to lead to a more operationally convincing market segmentation. However, the idea was opposed under the marketing aspect. A mixing of small, non-growing old firms and companies rising by growth gradually from unlisted status would badly blur the image of the new market segment.

b) Trading

Trading of small company shares on the traditional market is concentrated within rather short periods usually resulting in two collective prices only. In contrast, trading on the parallelmarkt is continuous and lasts from 9.30 a.m.⁴⁵⁾ to 4.30 p.m. There are also other differences to be emphasized. An important type of order in parallelmarkt securities is not even permitted on the official market⁴⁶⁾. This "waarschuw-order" is not a firm order and needs confirmation whenever trading becomes possible. These indications of interest become officially relevant only if for five trading days there has not been a transaction. However, the rather close contact between the specialist and the investor, either direct or indirect through other member firms, remains a distinctive characteristic of the parallelmarkt. Since this contact is maintained by phone, it follows that trading both on and off the floor have a role to play on the parallelmarkt.

The two commissionairs, Broekman's Commissiebank and D.W. Brand, who were at the center of the incourante markt, have become the "specialisten" of the parallelmarkt. They receive orders from other member firms and their responsibilities are similar to those of a hoekman. However, they are called "specialisten", who continue to have non-member clients, a practice which is not allowed for a hoekman. It is mandatory to deal through a specialist in parallelmarkt securities.

The opening of the market is handled at the offices of the specialists. The shares showing most investor interest are opened first. Each specialist determines the opening price likely to evolve. He then advises by phone the relevant member and non-member clients of this price and finds out

their trading intentions. Close contact with the clients is considered extremely important for the quality of the price of less frequently traded shares⁴⁷⁾. Thereafter, the two specialists phone each other and jointly fix the opening price, which is then reported by phone with the respective volume of either specialist to the guidebank (quotation office on the floor). The opening price is a collective price relevant for all orders held by the specialists which can be executed at this price. The rules for determining this price and the orders to be executed are the same as those for collective prices on the official market⁴⁸⁾.

At 11 a.m. three specialists from each specialist firm stop trading at their offices and start trading on the floor. They provide the members on the floor with quotation sheets carrying the quotes as of this morning for securities traded on the parallelmarkt. Bargains at individual prices will be done between specialist and public-order members. The two specialists for each issue keep in touch in order to avoid price discrepancies, which otherwise could easily develop, e.g. when a sizable sell order hits the quote of one specialist and a buy order the quote of the other. Trading of the specialists for their own account is permitted only if it facilitates the execution of orders.

At 3 p.m. the specialists leave the floor and any trading till 4.30 p.m. is done by phone. Prices and related volume are reported to the guidebank. All prices and the related volumes are published in the official list, which is unique, as even for trading in open hoek total volume figures are published only. In addition, the list will carry indications of any excess demand or excess supply or, instead of prices, bids or offers.

The commission of the member firm dealing with the public is 1.875% on the first Dfl. 5,000 market value transacted. Any exceeding amount, up to a total of Dfl. 20,000, will add to the commission, at a rate of 1.25% of the excess. The rate is .875% above Dfl. 20,000. In addition, the client is charged a handling fee of Dfl. 7.50 per transaction. If delivery cannot be effected by book entry, the handling fee is Dfl. 17.50. 40% of the commission has to be handed over to the specialist. There is also a contract tax of 1.2 per mill.

The parallelmarkt for officially listed securities has been successful in its first year. The relative share of the securities traded there of the total volume of the specialist firms has increased greatly, in other words, the relative share of the parallelmarkt securities not officially listed declined during this period. Investors seem to appreciate the transparency unparalleled in the official market and the opportunity to trade all day long. It is conceivable that investors anticipate in the afternoon a poorer price tomorrow and thus prefer not to delay trading until then. Any claims that the parallelmarkt shares are more volatile due to the speculative attitude of the investors involved or less volatile because of the long-term appreciation objectives of parallelmarkt investors are difficult to disprove on the basis of one year's data.

3. The parallelmarkt for officially not listed securities

The majority of the securities traded on the incurante markt have been officially listed. Thus, there are 650 classes of securities not officially listed, including the shares of 160 Dutch and 40 Indonesian companies⁴⁹⁾. Among the

domestic companies there are a number of firms who changed from N.V. to B.V. Disclosure tends to get graded down in such cases. There are also registered N.V. shares. In either case the approval of any transfer of shares by the company may be required. Thus, the shares are difficult to trade.

The specialist firms continue to admit securities to their dealings if the issuer approaches them and continuously provides the relevant information⁵⁰⁾. Initially a company will have to provide the last annual report and information on any relevant developments not yet reported. Usually, companies well known in the industry will be involved. Any unknown company will be checked with special care as to legal basis and investment merit.

Over time the specialist firms have built up impressive files on the companies, their issues and on the investors interested in them. A major incentive for this long-term service - both specialist firms date back to the last century - seems to result from high commission income to be gained when one of the share issues develops broad investor interest. In a recent case the volume of such an issue finally became close to half of the specialists' total volume before the issue became officially listed (without prior official listing on the parallelmarkt).

Trading follows the regulations applicable for the parallelmarkt. However, the issues not officially listed tend to be less active and transactions in such issues may occur once a year only. Any orders will require an active search for a counterparty by the specialist aided by the issue file. A matching order is neither readily available nor can be expected. This traditional pattern of trading of incurante fondsen has dramatically changed for the issues listed officially on the parallelmarkt. Daily quotations

in the official list have built volume and made people come to the specialist.

If any transactions occur in a not officially listed class of securities, the particulars of this class, transaction price and related volume are published in the official list of that day⁵¹⁾. In addition, the specialist firms continue to publish each Thursday a prominent four-page section in the *Financiele Koerier*, an investors' weekly, comprised of a one-page report and three pages of prices and quotations for about 280 issues. The most complete publications on the parallelmarkt are published after yearend by each of the specialist firms (*Gids voor Parallelmarkt Fondsen*).

The commission scale is the same for not officially listed and officially listed parallelmarkt fondsen. The more active not officially listed issues have been included in the exchange's clearing system reducing the cost of trading and the use of messengers and mail in the delivery process.

In principle, the parallelmarkt for officially not listed securities covers all trading in unlisted securities. As pointed out before, the member firms of the *Vereniging* have the exclusive right to trade in stocks and bonds⁵²⁾, and the *Vereniging* has made it mandatory to effect transactions through *hoeklieden* or specialists. However, the latter principle may not be fully enforced. There are indications of primary and secondary market activities of small commissionairs not involving a specialist firm. Certainly, if a commissionair has placed an issue among his clients, he is in a very good position to take care of any arising trading needs. Thus, it is hard to say whether the provision of complete secondary market services by some small member firms should be considered an additional market segment or

merely a temporary deviation from a principle established only recently. In any event it is an indication of readily available primary and secondary market services.

III. SUMMARY

Both primary and secondary market services have been available to small companies in the Netherlands for many years. There are no indications that the market organisation, which has been subject to some changes from year to year, caused any problems to speak of for the equity market. The very substantial decline of companies and shares traded over the years and the obvious dearth of new entrants to markets was caused by forces outside the scope of this study. The creation of the parallelmarkt was partly a result of this erosion. It was an effort to further improve the market structure and to facilitate entry into a more visible market segment for companies who were reluctant to step into the official market, because this appeared to them to be too large a step or because of objective reasons. Partly the effort was an early effect of changing trends in the socio-economic environment.

The parallelmarkt provides a new choice to small and medium companies prepared to bring to the market only shares of a nominal value of Dfl. 250,000 or more,⁵³⁾ but unable or unwilling to make available a nominal value totalling Dfl. 1.5 mio⁵⁴⁾. Of the officially listed parallelmarkt companies only five fall within this range.

For the larger company the parallelmarkt offers a new choice to companies with 10% or more but less than 20% of the share capital available to the investing public. Only one

company falls within this range. The remaining 12 companies officially listed on the parallelmarkt could have been listed on the official market, where they would rank among the relatively small companies.

The development of the parallelmarkt has only increased the choices available to companies both large and small, as none of the previously existing options was terminated. The parallelmarkt for securities not officially listed remains a choice. Certainly, this choice is relevant for companies considering a new issue of shares, though none of their previously existing shares has been traded. In this situation the risk of mispricing may be kept in rather narrow limits by an issue amounting to much less than 10% of the equity capital.

The findings suggest a number of theses:

1. The direct regulation of the incurante markt is a precautionary measure intended to bolster the image of the Vereniging as regulator. It also prepares for the unlikely event of a further reduction of the number of market organizers in this market, which the Vereniging is not willing to accept, as this would result in a monopoly of one specialist firm. In addition, the new market results in a welcome increase in the number of listed companies.
2. The continental tradition of trading shares of smaller companies at collective prices only may be inadequate for the tier of really small companies, thus requiring a special market segment. Only a special market segment will attract small companies. Thus, the parallelmarkt should be a pilot scheme for all small companies⁵⁵⁾.
3. The parallelmarkt for officially listed companies is not

really a market for small company shares. It is rather a marketing tool for focussing the attention of the investor on a few companies which have risen from unlisted status and which convey the impression of growth potential. Any differences in market organization are merely useful accessorial elements. It remains to be seen whether this marketing tool will have any long term impact.

4. The parallelmarkt quite properly provides a special market segment both in the operational and in the marketing sense. Under the marketing aspect the focus is on growth potential. Operationally, the resulting investor interest is accommodated by allowing continuous trading and the listing of firms which, though not really open to investors now, will open up within a number of years as growth forces them to do so. The degree to which the socioeconomic climate is friendly to long term growth will be the main factor for the new segment's success.

These theses will have to be dealt with in the third and fourth part of the study looking at the experience in other countries. Theses 2 and 4 seem to be favoured in Amsterdam. A substantial growth of the parallelmarkt would be most welcome: only a market attracting skilled investors and advisors specializing in innovative companies will render price earnings ratios which are attractive to such companies. This will stimulate entrepreneurial and financial activity.

Footnotes

- 1) H.M. Hessenhouwer, *Incourante Fondsen, Bank- en Effectenbedrijf*, Vol. 21, 1971, p. 237, provides a breakdown by size of 37,872 N.V. at the end of 1967 when the law did not provide for the B.V. form.
- 2) Cf. J.B.Th. Hugenholtz, *Venture Capital*, Thesis Erasmus Universiteit Rotterdam, 1979, p. 54.
- 3) Artikel 214 Burgerlijk Wetboek.
- 4) Dutch term for an institution holding shares and having in circulation depositary receipts backed up by the shares held. Such depositaries are quite common in the Netherlands. Among other things, they serve to restrict outside influence on management. For the rules imposed on the depositaries cf. note 5 infra.
- 5) Bijlage B and Bijlage C to the Fondsenreglement.
- 6) Fondsenreglement, Bijlage C, No. 2; Bijlage C applies to "niet royeerbare", to permanent depositary receipts only as in the case of redeemable receipts the displeased receipt holders may request the shares.
- 7) The Dutch tax environment does not impede the formation of such companies. No corporate income tax is due if, among other things, the annual income is paid out to shareholders except for any net capital gains earmarked for reinvestment (Art. 28 Wet Vennootschapsbelasting 1969).
- 8) Vereniging voor de Effectenhandel, *Statistische Data*, Juni 1981, tables 36 and 37.
- 9) Very critical J.B.Th. Hugenholtz, l.c., p. 65, but institutions have shown some interest since.
- 10) A case in point are the survey results of J.B.Th. Hugenholtz, l.c., p. 56, 57, 68.
- 11) J.H. du Marchie Sarvaas, *Participation by banks in the risk-bearing capital of enterprises*, *Nederlandsche Bank Quarterly Statistics*, 1980, No. 3, p. 97. It should be noted that this relaxation applies to directly held minority interest too. However, this route is not attractive as government guarantees are available only for participations via a PPM. This relaxation obviously came about with some reluctance: "It must be pointed out, however, that when the new Act on the Supervision of the Credit System was being considered in the Second Chamber of Parliament in 1978, some uneasiness came to light about the concentration of power of the banks. The question arises whether this uneasiness has disappeared in the course of 1978 or even made way for a plea to augment the power of the banks by allowing participations in non-bank enterprises virtually unhampered." *Ibid.*, p. 96.

- 12) For details on the rather tight supervision by the Nederlandsche Bank and on the conditions of compensation see J. H. du Marchie Sarvaas, Guarantee scheme for private venture capital companies 1981, Nederlandsche Bank Quarterly Statistics, 1981, No. 1, pp.90-94, and Ministries of Finance and Economic Affairs, Private Participation Companies Guarantee Order 1981. It should be noted that PPMs not affiliated with banks are less tightly supervised. For an account of an expert involved in the development of the program cf. C.A. Troost, The Dutch scheme, in: The needs of new technology-based enterprises, proceedings of the symposium held by the Commission of the European Communities, Directorate-General "Information Market and Innovation", Luxembourg: Infobrief, 1983, pp. 49-61.
- 13) For a survey of pre-PPM participation companies and venture related government programs cf. J.B.Th. Hugenholtz, l.c., pp. 75-103.
- 14) Vereniging voor de Effectenhandel, Statistische Data, Juni 1981, tabel 14 (source: CBS). No adjustments have been made to account for inflation.
- 15) Ibid., tabel 23 and tabel 13 respectively.
- 16) Until 1974 a Nederlandse Organisatie van het Effectenbedrijf existed as there were exchanges in Rotterdam and Den Haag operated by local associations. The members of these local associations remaining active have become associated with the Vereniging in Amsterdam making the latter the only and thus national association for the trading of securities. The European Options Exchange and its member firms may deal in options only, but not in the underlying securities (unless they are also member firms of the Amsterdam Stock Exchange).
- 17) Vereniging voor de Effectenhandel, Statistische Data, Juni 1982, tabel 1.
- 18) Cf. Artikel 4 Ledenreglement.
- 19) Cf. Artikel 2 and Artikel 4 Ledenreglement.
- 20) H.M. Hessenhouwer, l.c., pp. 237-240, H. Schmidt, l.c., p. 95.
- 21) Rapport van de Commissie Incourante Markt, p. 14.
- 22) Reglement voor de Effectenhandel.
- 23) The Dutch term "hoek" refers to the square on the trading floor on which dealings in a particular issue take place. It is limited by an imaginary grid delineating 82 squares or "hoeken".
- 24) Some of the shares traded here plus the shares traded in open hoek are subject to option trading at the European Options Exchange. Cf. footnote 16 supra.

- 25) For the more active of these shares there are a number of special provisions concerning off-hours and off-floor trading. For example, it is permissible in 10 shares traded officially twice a day in gesloten hoek to be dealt in without a hoekman if such transactions are done with foreign banks or brokers ("arbitrage fondsen", Artikel 16 of the Reglement voor de Effectenhandel). This also holds for all continuously traded issues. Artikel 15 allows trading before and after official hours generally covering domestic orders too; for such trading dealing through a hoekman is mandatory.
- 26) Broekman's Commissiebank N.V., Gids voor Parallelmarkt Fondsen 1983, Amsterdam 1983, pp. 2-7. Indonesian companies listed there have not been taken into account (about 40). Cf. the listings in D.W. Brand N.V., Gids voor Parallelmarkt Fondsen, Amsterdam 1983.
- 27) Amro Bank, Kerngetallen van Nederlandse Effecten, Januari 1982
- 28) Artikel 34 of the Fondsenreglement as amended December 30, 1982.
- 29) Vereniging voor de Effectenhandel, Interne Circulaire 82-61, last page.
- 30) Artikel 12 Reglement voor de Effectenhandel. For blocks special rules apply.
- 31) In some of the open hoeken there are more than two.
- 32) Artikel 13 Reglement voor de Notering.
- 33) Ibid. Cf. Artikelen 5-10 Reglement voor de Effectenhandel.
- 34) Artikel 12 Reglement voor de Effectenhandel.
- 35) Artikel 13 Reglement voor de Notering.
- 36) Artikel 14 Reglement voor de Notering.
- 37) Artikel 2 Provisiereglement.
- 38) H.P. Quarles van Ufford, De parallelmarkt bidt financieringsmogelijkheden voor jonge ondernemingen, Bank- en Effectenbedrijf, Vol. 31, 1982, p. 5.
- 39) Reglement houdende bepalingen inzake Toelating van Fondsen tot de Parallelmarkt.
- 40) H.P. Quarles van Ufford, l.c., p. 6.
- 41) For further details cf. Artikel 9 Fondsenreglement and Artikel 7 Reglement houdende bepalingen inzake Toelating van Fondsen tot de Parallelmarkt. The disclosure requirements dropped are found in Artikel 9 Section 2 Fondsenreglement mainly. They concern rather

- technical details. More importantly, the
- known major shareholders
 - any interest of the issuer in listed companies
 - certain articles of association most pertinent to shareholders and
 - capital history since the establishment of the firm
- do not have to be disclosed in the prospectus.
- 42) For a discussion of the risk of mispricing the issue cf. the part on the United Kingdom, section II 1 a.
 - 43) A.P.J.M.M. van der Stee, Parallelmarkt baant weg naar open kapitaalmarkt, Beursplein 5, Vol. 22, Januari 1982, p. 5.
 - 44) Straight bonds, though the rules provide for them, were not on the list.
 - 45) This information was obtained from the two firms of specialists; according to the Reglement trading commences at 10 a.m. Trading hours of the incourante markt used to be 9 a.m. - 5 p.m.
 - 46) Cf. Reglement voor de Effectenhandel, p. 4 (introduction) and Reglement voor de Handel op de Parallelmarkt, Algemene Toelichting, p.3. Commissie Incourante Markt, Rapport, p. 7.
 - 47) Unfortunately, the trend toward centralisation of banks' securities business at the head offices in Amsterdam has cut off close contacts with local branches making informal valuations more difficult.
 - 48) Cf. Reglement voor de Handel op de Parallelmarkt, Artikelen 3-11 and Reglement voor de Effectenhandel, Artikelen 5-13.
 - 49) Broekman's Commissiebank, l.c.
 - 50) H.M. Hessenhouwer, l.c., p. 240. Ch. Batchelor, Active dealings in unlisted stocks, Financial Times, July 17, 1979.
 - 51) It may be worth noting that these prices, as those of the official market, are disseminated by financial reporting services.
 - 52) As noted above, the members of the European Options Exchange have the exclusive right to deal in options, but they may not trade in the underlying securities unless they are members of the Vereniging too.
 - 53) Provided there is a total nominal share capital of Dfl. 2.5 mio.
 - 54) More specific: Dfl. 1.5 mio plus 20% of the nominal capital placed in excess of Dfl. 7.5 mio provided that the market value of all shares placed is no less than 2.5 mio.
 - 55) The reader should be aware that the Vereniging obtains 4,85% or 2,85% of the commission obtained from investors on official market transactions or on parallelmarkt transactions respectively (Artikel 11 Provisiereglement).

E. THE SEGMENTS OF THE SECONDARY MARKET FOR EQUITY
INSTRUMENTS OF SMALL COMPANIES IN THE FEDERAL
REPUBLIC OF GERMANY

I. ENVIRONMENT AND SURVEY

1. Number and forms of business organizations

The best survey of the number and forms of business organization in the Federal Republic is provided by statistics that are published biannually and account for all firms which pay value added tax. Since the figures for 1982 were not available at the time this country report was completed, the 1980 figures will be used. Small manufacturing enterprises will generally be organized in one of the four legal forms listed below. In total there were 353,075 (1978: 303,658) firms¹⁾.

Number and forms of business organization
in the Federal Republic of Germany

Form of business organization	1980	1978
Offene Handelsgesellschaft	120,683	114,969
Kommanditgesellschaft	89,651	88,369
Gesellschaft mit beschränkter Haftung	140,977	98,329
Aktiengesellschaft	1,764	1,991

Source: Umsatzsteuerstatistik

On average the public limited companies (Aktiengesellschaften) have larger sales than businesses using other forms of business organization. However, many public limited companies are rather small: About one third of the Aktiengesellschaften had sales below DM 5 mio in 1980; 62% had a nominal capital of DM 10 mio or less at the end of 1981, 22% even had a nominal capital of DM 1 mio or less.

Only equity instruments of Aktiengesellschaften are traded on organized secondary markets, save a few exceptional cases. German company law designed only the Aktiengesellschaft for public equity raising. The number of Aktiengesellschaften has been declining for decades. Usually this is seen as the result of unfavourable tax treatment; corporations in Germany have to pay a corporate wealth tax on their net assets in addition to a corporate income tax. Domestic investors may set off against their individual income tax liability any corporate income tax that was paid on the dividends which they received. By contrast, this system does not apply to corporate income tax paid on retained earnings, which are taxed at a rate of 56%. The corporate wealth tax amounting to 0.7% of the net assets of the corporation also cannot be set off against tax liabilities of investors. The private limited company (Gesellschaft mit beschränkter Haftung, GmbH) is also subject to this tax treatment. The number of GmbHs has rapidly increased during the last years, and the GmbH has become even more widespread than partnerships, which receive a more favourable tax treatment.

Thus, the number of Aktiengesellschaften most likely has declined for other reasons. There are differences between the GmbH and Aktiengesellschaft in a number of

areas. Compared to the AG Act (Aktiengesetz) the GmbH Act is reasonably short and comprehensible. An audit of the accounts of the GmbH is not required²⁾. Moreover, disclosure of the accounts is not required³⁾. Contrary to the Aktiengesellschaft a GmbH may do without a board of directors⁴⁾. Decisions of the shareholders of a GmbH do not need to be certified by a notary public. Entrepreneurs seem to prefer the GmbH because of these differences. Given the nature of the differences this preference may reflect a desire of entrepreneurs to avoid outside influence. A detailed analysis of codetermination aspects would also yield this conclusion.

Neither this attitude nor the above mentioned features of the GmbH Act are likely to attract outside investors who will only exceptionally hold shares in a GmbH. There have been no reports on GmbHs with a public shareholder base, and shares of GmbHs have not been traded in an organized market. Even if a GmbH would voluntarily accommodate outside investors, e.g. by publishing its accounts, in order to establish a spread of public shareholders, it would be very difficult to trade the shares. § 15 Abs. 3 of the GmbH Act requires that GmbH shares are sold before a notary public.

Partnerships also were not designed by company law to serve as the form of business organization for publicly held companies. Nevertheless, in recent years a large number of publicly held limited partnerships have been organized. The public limited partners of these companies may set off any start-up losses of the company against their taxable income from other sources. Once the start-up phase is over and the company becomes profitable, the company is not subject to corporate income tax and corporate wealth tax. Because of the emphasis on start-up losses these public companies

are referred to as "Abschreibungsgesellschaften". Only in a few cases this approach has been used to finance innovative manufacturing companies. In a few other cases the public limited company form has been used to finance participation companies that acquire minority interests in small firms (Publikums-Beteiligungsgesellschaften).

Off and on there have been discussions as to the desirability of trading the shares of limited partners in an organized market, but no serious attempts have been made so far to create such a market. Since a number of court decisions have substantially improved the protection of investors in public limited partnerships and since the shares in a limited partnership may be sold without the assistance of a notary, it is difficult to explain why an organized market has not been developed so far. Some experts point to technical reasons, others to the fact that the shares of limited partners placed by certain major institutions would sell far below issue price on an organized market. Thus, there may be some tendency to avoid the visibility of an organized secondary market and to restrict activities to the new issues market.

2. Frequently used instruments for equity financing

The instruments most frequently used by small companies to raise equity are ordinary shares and preferred shares with contingent voting rights. Larger businesses also issue participating certificates, convertible bonds and bonds with warrants attached. Participating

certificates may be used regardless of the form of business organization of the issuer; only a few issuers have employed them to raise funds. Certificate holders do not have voting rights at all. This gives rise to concern, since some bankers strongly feel that public capital raising should be linked to outside control of the company.

Preferred shares are denounced by certain banks and investors and appreciated by some issuers for the same reason. Preferred shares stand right in between ordinary shares and participating certificates. They balance the desire of the entrepreneur for a high degree of independence and the request of the holders of equity instruments to control management. §§ 139 and 140 of the Aktiengesetz permit to refuse voting rights to shareholders if in exchange cumulative preference is granted, in other words, if the holders of the preference shares rank before the holders of the ordinary shares with respect to a cumulative minimum dividend. However, voting rights cannot be refused if the company fails to pay the minimum dividend; more precisely, if the company does not make up any arrears within one year, the preference shares carry voting rights. The degree of outside control is linked to the financial success of the company. In contrast with participating certificates, there is a ceiling on the use of preference shares. The total nominal value of preference shares with contingent voting rights must not exceed the total nominal value of other shares issued by the company.

3. Investors and investment motives

Shares in small companies are often held by individual investors well versed in commercial matters. Frequently, these investors have personal or business contacts to the issuing company. They generally aim at above average yield over an extended period resulting from dividends and capital gains. Capital gains of individual investors realized after a six months holding period are tax free. Nevertheless, there seems to be a fair number of investors who invest for short term capital gains. Small and medium sized companies that offered their shares to the public did not experience any difficulties in selling their shares in recent years. Most new issues were heavily oversubscribed.

Investment motives other than those mentioned above have been observed occasionally. Two groups of investors are relevant in this context. Investors belonging to the first group utilize their share in a small company merely to get detailed information on the line of business or to protect a business relation. By contrast, investors of the second group use their shares as a first step toward an active participation; these individuals aim at a majority interest and they want to prove themselves in an executive position.

Entrepreneurs generally try to avoid investors of the second kind. If they issue shares to the public they will use preference shares or they will try to achieve a wide spread of shareholdings by underpricing and by scaled down allotments to applicants. Alternatively,

equity capital may be raised by placing shares with participation companies which, as a matter of principle, will only hold minority interests.

Institutional investors tend to show little interest in the shares of small companies. Factors contributing to this are the rather high valuation costs per currency unit invested, poor marketability, legal restrictions on mutual funds and on insurance companies and restrictive guidelines of the insurance supervisor. However, a number of commercial banks and savings banks are prepared to invest in shares of small and medium sized companies directly⁵⁾ or indirectly through participation companies. Some of the recently established participation companies aim at new technology based firms; some of the banks involved placed shares of their participation companies with their clients. Some wealthy families and industrial companies also founded participation companies, in some cases by joint action.

There are no statistics encompassing all participation companies. But it appears safe to state that participation companies in Germany hold at least 1,000 participations with an average value of DM 1 mio⁶⁾. There are a few participation companies organized as limited partnerships which exclusively raise their capital with individual investors. The number of these limited partners and the amount of capital raised clearly suggest a stock exchange listing. However, this currently would require conversion to public limited company form. This step is not taken since corporate wealth tax and corporate income tax would reduce the yield to the individual investors⁷⁾.

4. Issuing houses for the shares of small companies

Even first public offerings of small and unseasoned companies have been met with widespread investor interest. There are no indications at all for insufficient demand for equity instruments. However, the supply of equity instruments is rather limited, and almost all of it results from rights issues of large companies. Until the present corporate tax regime was introduced in 1977, there were very few first public offerings. Thereafter until the end of 1982 18 first public offerings of public limited company shares occurred. 11 first public offerings were made in 1983. In perspective the new issue of equity instruments of public limited companies is relatively small; in recent years it amounted on average to DM 3 mrd per year, which is only about 5% of the net new issue of bonds⁸⁾. This gives rise to the question why companies and issuing houses do not offer more shares to the public.

Investment banking for public limited companies is generally believed to be the domain of banks. New issues are usually sold by a consortium of banks, led by one of the major banks. Although this approach is appropriate if the issues of large companies are concerned it does not seem to fit new issues of small company shares. The future development of small companies tends to hinge on one or at best a few projects and products. Assessments of the potential of these companies are much more prone to error than forecasts for well diversified larger companies. If such a small company is brought to the market and if its development, in the first or second year after the issue, turns out to be unsatisfactory, all the issuing houses involved in

the selling group are likely to draw bad publicity. It is felt that this would negatively affect the relations with clients even beyond the investment business. Since with small and unseasoned companies there tends to be a noticeable probability for poor performance, many banks are reluctant to engage in investment banking for small enterprises.

In addition, there is a regulatory factor that may not foster the availability of investment banking services to small companies, the DM 6 mio of net assets that are required to obtain a license from the supervisor of banks. Relative to the resultant minimum size of banks and the commensurate earnings, investment banking for small companies will only yield minor contributions. Thus, a bank is well advised not to commit much time and talent to this service. Not surprisingly, a non-bank, PM Portfolio Management in Munich, has been clearly the most active and successful issuing house for small and unseasoned companies, although only one partner of this firm has developed its investment banking services.

Others may follow the example of this issuing house. But this will increase the threat of regulatory action. If the supervisor of banks would claim jurisdiction, capital requirements and the continuing costs of supervision could impose a burden on these issuing houses that is onerous given the limited scope of their business. These requirements would by far exceed the requirements imposed on plain investment banking firms in the United Kingdom and in the United States; in the United States investment banking services to small firms are usually provided by small local and

regional broker-dealer firms⁹⁾.

Besides the current level of investment banking activity in Germany, the attitude of German entrepreneurs may contribute to the scarcity of first public offerings. There appears to be general agreement that German entrepreneurs are most reluctant to make shares in their company available to the public¹⁰⁾. However, until recently small companies had not gone public. Thus, the idea was foreign to German entrepreneurs and there was no example to follow. Now, after some successful entrepreneurs did go public, there is hope that their example and the arguments advanced in the financial press in favour of going public will greatly encourage public equity raising.

An additional fact inhibiting public equity financing is the need to convert to public limited company form. As pointed out in section 1 above, small companies usually do not start up as public limited companies. Consequently, if they want to raise capital publicly, they must assume the burdens of conversion which are substantial in Germany. If a partnership converts to public limited company status, it has to pay indirect taxes on the transfer to the public company of certain assets of the partnership, and, of course, the corporate income tax and corporate wealth tax are incurred¹¹⁾. As a result of conversion, the company may also become subject to codetermination. Not surprisingly, some thought has been given to an approach that avoids or delays conversion.

Participation companies in the form of a public limited company or of a publicly held limited partnership serve as a means towards this end. In contrast with the

banks of the nineteenth century which took in participations and raised the required funds by the issue of their shares to the public, the shares of German participation companies are not available to the public, save the shares of limited partners of publicly held limited partnership participation companies. Also in contrast with the traditional approach, today's participation companies have not taken an interest in a company out of their portfolio in order to offer it to the public, except for a very recent case¹²⁾. However, as some experts see it, the participation companies are likely to bring more of their participations to the market in the years ahead and some of them may assume issuing house functions.

In spite of their attractions participation companies have only been moderately successful. The reluctance of entrepreneurs to offer participations is generally believed to be the critical restricting factor. This is consistent with the belief that entrepreneurs prefer bank loans. Because of this, participation companies are thought to face difficulties in their attempts to diversify and, as a result, they cannot get involved in high risk companies. In addition, the reluctance of entrepreneurs to make shares available to participation companies is said to have frustrated those who thought they could earn a living by setting up participation companies and selling their shares to the public. Thus, they turned to the distribution of the shares of limited partnerships owning hotels, ships and other substantial assets that more readily can be obtained or created than an interest in an industrial company.

This view may appear to provide an explanation of both the limited success of participation companies and the

absence of vigorous investment banking activities aimed at emerging industrial companies. However, it does not explain why entrepreneurs are reluctant and why banks grant loans in situations where equity capital is warranted. These questions lead back to some of the factors discussed above. An encompassing treatment of the factors impeding securities market equity financing of small companies will be given in part 3 of the study.

5. Survey of the secondary market

Equity instruments of Aktiengesellschaften are predominantly traded on the eight German stock exchanges. As mentioned above, organized markets for other equity instruments do not exist. Basically, the German stock exchanges are organized on the same model. They provide four market segments, if option trading is disregarded since it concerns the shares of large corporations. The four segments are:

1. Handel zu fortlaufenden Kursen (continuous trading);
2. Handel nur zu Einheitskursen (trading at one collective price only);
3. Geregelter Freiverkehr (regulated Freiverkehr);
4. Ungeregelter Freiverkehr (unregulated Freiverkehr).

The first two are official segments, the Freiverkehr markets are unofficial segments. The federal exchange act (Börsengesetz), the constitutions of the various exchanges and the uniform trading rules contain most of the regulations that are relevant for official trading. While the uniform trading rules for official

trading became effective in 1983, the Freiverkehr trading rules have been uniform since 1912 although some exchanges apply additional regulations. Special trading rules for the ungergelte ("unregulated") Freiverkehr have not been laid down so far.

Continuous trading serves the shares, convertible debentures, bonds with warrants and warrants of larger companies. In principle, those instruments are assigned to this top segment which generate a flow of orders that tends to give rise to transactions throughout the trading session. However, merely at five exchanges just the most active officially listed securities are allocated to this top segment, while the other officially listed securities trade at collective prices only. At this next lower segment, the securities of each class are dealt in just once a day at one collective price. All orders are executed at this price, unless the orders carry limits that do not permit execution. By and large, this procedure also governs trading on the Freiverkehr segments. The shares of small companies usually trade at collective prices only or on the Freiverkehr segments.

Besides, a kind of over the counter market does exist. Few people know about it; this is not surprising since volume on this vertical segment is low and most of the companies are rarely traded. It is well known, however, that most of the trading in listed bonds and a substantial part of the trading in listed stocks is effected off the exchanges. Moreover, it is a widely held view that the unregulated Freiverkehr is an off-exchange segment, which it is not, and the frequently used alter-

native designation "Telefonverkehr" (telephone dealings) is a misnomer. The prices of this bottom exchange segment are established on the floors, they are carried in an appendix to the official lists or in separate inofficial lists controlled by a group of exchange members. In due course, these prices also are published by the Börsen-Zeitung, the reputable national stock market daily newspaper that carries unique comprehensive exchange price tables.

By contrast, at the end of 1981 the equity instruments of 442 German companies appeared only in price lists other than those mentioned above. Roughly two thirds of these are inactive companies, but a vertical segment serving about 150 operating companies should not go unnoticed. At the end of 1981 there were four securities firms that each published such a list. Although these firms are exchange members and may exceptionally trade on the floor in the equities of these 442 unlisted companies, indications to this effect have not been found. Because of the small publicly held amounts of equity in these companies and because of the inactivity of the shares, they do not seem to lend themselves to floor trading. This lowest vertical segment clearly displays essential characteristics of a traditional small company over the counter market. Since no contrasting German designation is in use, the term over the counter market (OTC) is applied to this segment.

The table on page 197 shows by vertical segment the number of operating companies traded in the eight financial centers where stock exchanges are located. Even smaller companies frequently are quoted on more than one exchange. In some cases these companies are traded

on the same vertical market segment wherever they are listed, e.g. they may trade only at collective prices in Berlin, Munich and Düsseldorf and there may be no quotation at other centers. In other cases a company officially listed in Bremen may, in addition, have an unregulated Freiverkehr quotation at the stock exchange in Hamburg. In compiling the totals of the table all such multiple listings and cross segment multiple listings have been eliminated.

The following sections will outline listing requirements and trading procedures. Usually listing requirements can be clearly attributed to certain segments. Of course, this also holds for Germany, however, there is a unique set of regulations. They contain provisions which in other countries would be a part of the listing requirements. This set of regulations was developed by the standing committee of stock exchange experts (Börsensachverständigenkommission) with the competent federal minister, and the leading trade associations recommended that their members comply with these regulations¹³⁾. In order to attain the desired improvement of the functioning of the capital market mandatory compliance was not imposed. It was felt that the regulations would be voluntarily applied wherever they are in the best interest of issuers and investors. In this context, the regulation on interim reports¹⁴⁾ and the regulation on insider trading¹⁵⁾ are relevant.

The interim report regulation is aimed at officially listed companies. They are supposed to publish interim reports biannually. The interim reports should be released no later than two months after the reporting period ends. It seems fair to state that larger companies are more likely to comply than small ones.

Number of quoted operating¹⁾ domestic companies by segment and
by financial center at December 31, 1981

	Continuous trading	Collective price only	Geregelter Freiverkehr	Ungeregelter Freiverkehr	Over the counter ²⁾	Total
Frankfurt	92	102	15	90	126	425
Düsseldorf	83	104	19	34	-	240
Hamburg'	136	-	24	88	100	348
München	63	94	12	18	22	209
Berlin	82	112	64	14	-	272
Stuttgart	37	45	23	5	7	117
Hannover	57	-	22	42	-	121
Bremen	42	-	11	34	-	87
Total ³⁾	175	202	80	70	146	673

Source: Official and unofficial lists of exchanges, Börsen-Zeitung, price lists of four OTC firms; compilations by E. Grigat. - 1) Companies that did publish accounts for 1981 until June 20, 1983 (though a fair number of other companies are known to be quoted and a few of those are still in business). - 2) All those companies quoted OTC have been excluded that are traded on a higher segment and thus enjoy an official or unofficial exchange quotation. - 3) Columns do not add to totals due to multiple listings. Companies were assigned to the highest segment on which they were traded at the end of 1981.

This may be illustrated by the compliance of companies listed on the Hanseatic Stock Exchange Hamburg. Out of the 15 companies that have a capital of less than DM 10 mio listed on the exchange, 12 do not publish interim reports, two were behind schedule and only one small company complied at the time of writing (December 1982). By contrast, out of the 42 companies that have a listed capital of more than DM 200 mio, 36 complied, three were behind and three did not submit to the regulation. Investors can take this information from the official list. Non-compliance will not trigger sanctions.

The companies traded on the Freiverkehr segments are outside the scope of the interim report regulation. One might expect that these companies do not publish interim reports. But this does not hold. A fair number of these companies do publish interim reports. Those companies brought to the unofficial market by PM Portfolio Management have voluntarily published a prospectus and they have even undertaken therein to voluntarily publish quarterly reports within four or six weeks after the end of the reporting period. This is in line with a widely held view that small companies should disclose at shorter intervals than large companies, since small companies are followed by less investors and analysts who try to discover undervaluations or overvaluations. Thus, it is less likely that all available information is reflected in the prevailing prices¹⁶⁾.

The insider trading regulation aims at all companies traded in one of the three upper segments (official segments and geregelter Freiverkehr). The companies

that voluntarily comply with this regulation oblige by agreement their insiders to abstain from the direct or indirect use of inside information. Since an improvement in the functioning of the capital market can be achieved under this regulation by mere abstention and since there is no continuing burden on the company as in the case of interim reports, the insider trading regulation was met with a comparatively more favourable response. Out of the 15 small companies mentioned above no less than 9 and out of the 42 large companies 39 companies have agreed to comply with the insider trading regulation in its original or updated form.

II. EXCHANGE SEGMENTS

1. Official trading at one collective price only

Trading at collective prices only is a very prominent exchange segment. No other segment serves more companies. Of course, continuing trading is more important by volume. However, since the equity instruments of larger companies tend to be traded continuously, this top segment of the official market will not be dealt with.

a) Listing

The listing requirements are set forth in §§ 36-49 of the Exchange Act (Börsengesetz) and in the well thought-out Listing Regulation of 1910 (Bekanntmachung betreffend

die Zulassung von Wertpapieren zum Börsenhandel vom 4. Juli 1910). The Association of German Stock Exchanges has compiled and complemented these provisions and other regulations that have a bearing on listing: The Association published a 42 page manual ("Arbeitsunterlage"), which is updated from time to time. The listing decision is taken by the listing committee at the stock exchange where the listing application has been filed. Generally, the application has to be submitted by a bank that is a member of the stock exchange concerned (§ 5 Abs. 1 and 4 of the Regulation). This bank most likely will have been involved in the issue of the securities to be listed.

The more important requirements for the listing of shares are enumerated below:

1. The minimum nominal value of the class of shares to be listed is DM 500,000.
2. The company has to submit to the listing committee a prospectus which usually contains the accounts for the latest five years along with information required by §§ 6-8 of the Regulation. However, only the latest accounts are required. Exceptionally, a young company in its first year may submit a statement of assets and liabilities (§ 8 Abs. 1 No. 10 of the Regulation). The prospectus has to be signed by the issuer and by the issuing houses involved.
3. Advertisements in at least one national newspaper are required of the listing application and, later in the listing procedure, of the full prospectus. Moreover, these advertisements also are published

in the German official gazette (Bundesanzeiger) though at most box advertisements in the gazette are legally required beyond the newspaper advertisements (§ 38 Exchange Act, §§ 12, 16 of the Regulation). In addition, the prospectus is usually printed in pamphlet form and distributed to interested investors.

4. The share certificates have to meet the extensive regulations on the printing of securities.
5. The issuing company is subject to a number of continuing requirements. Among other things, the audited accounts and various notices to shareholders like invitations to general meetings have to be published in a widely distributed newspaper that carries a substantial business section. Qualifying newspapers are designated by the exchange. These advertisements are required in addition to those imposed by law (cf. §§ 25, 121, 177, 178, 186 Aktiengesetz). The issuer is also required to provide in the city where the exchange is located facilities for the lodging of shares in connection with general meetings (cf. § 123 Aktiengesetz) and for the payment of dividends. These and other shareholder services have to be rendered to the shareholders free of charge.

These requirements imply considerable costs to the issuer. Many writers tend to emphasize the listing fee in their discussion of listing costs. However, there is only an initial listing fee that is of little account. The German exchanges levy the listing fee according to a uniform schedule, although legally each exchange could fix its own fees. The listing fee is scaled and rather

low even for small share issues. DM 300 are due per million of nominal value listed or fraction thereof up to DM 20 mio. The minimum fee is DM 500. Thus, for small companies the listing fee will usually not exceed DM 2,000.

A more important item is the cost of printing the shares. It is likely to amount to DM 30,000 in the case of a small company. It depends on the nominal amount of the issue and on the denominations of the share certificates. There does not seem to be an exchange rule that clarifies how many certificates in what denominations are to be printed. Recently, a printing shop offered to print the certificates for a DM 1.75 mio issue for DM 230,000. The printer assumed that only small denomination certificates should be produced. This offer may mirror the fact that the listing committees, as a result of the requirements, generally accept certificates produced by only two domestic printers.

The costs of printing, distributing and advertising the prospectus are a substantial item. A company going public will have to spend at least DM 50,000 on this and on advertising the listing application. While the federal gazette asks DM 2,500 for a one page advertisement, the publishers of national newspapers will charge between four and ten times as much per page.

Although all the above costs will add to about 2-3% of the issue proceeds of a small company going public, they do not contribute the major part of the cost of listing. The various investment banking fees, the commissions for advising the company, handling, underwriting and applying for listing amount to 5-10%. Thus,

it appears that total issuing and listing costs are 7-13% of issue proceeds. These rates may appear high, but in the United States issues of comparable size are burdened with 15-23%¹⁷⁾. However, there may be differences in the cost of underpricing that should enter any comparison. At least some German issuing houses aim at a 10% underpricing. Another complicating factor is the use of warrants and cheap stock for compensating underwriters, a rather common practice in the United States that is not appreciated and rarely encountered in Germany. Finally, the issuing company has to pay a tax of 1% on the issue proceeds.

Continuing listing requirements will also give rise to costs, e.g. to a fee of 0,25% of the dividends distributed and to publishing expenses for the advertisement of accounts and notices in qualifying newspapers.

The costs of conversion into public limited company form have not been included and may further add to the costs of listing. If a partnership converts to public limited company form, the conversion costs may well be the second largest cost of listing item. If the company wants to go public, an audit of its latest accounts will be undertaken and an outside incorporation audit may become necessary. In addition, substantial fees to the notary public and to the register have to be paid. Depending on the kinds of assets to be transferred from the partnership to the corporation, indirect taxes will be incurred, notably realty transfer tax. Companies changing over to public limited company status must not be officially listed until they have been on the register for one year and published their first accounts in the federal gazette (§ 41 Exchange Act).

In contrast, as pointed out above, very young companies that were established as public limited companies may be officially listed immediately after incorporation; companies less than one or two years old merely have to provide special information in their prospectus. This is clearly stated in the Listing Regulation. Moreover, the relevant provision of the Act is based on the assumption that any issues to the public will undergo the listing procedure before they are placed (§ 36 Exchange Act)¹⁸⁾.

Although there have been three public issues of green field companies since 1958, unseasoned companies were not officially listed. Contrary to the Listing Regulation, it is a frequently stated and widely accepted listing "requirement" that a company must have distributed adequate dividends for the last five years¹⁹⁾. There are various reasons for this which cannot be dealt with here. At this point, however, the task should be mentioned that the Exchange Act assigns to the listing committee. Beyond full disclosure of material facts the committee has to provide for protection against issues that will obviously lead to disadvantages to the investing public. If such an imposition is suggested, e.g. by the supervisor of banks or by the press it will be, particularly in the case of very young companies, extremely difficult for the committee to disregard these views.

For related reasons, banks will be reluctant to serve as issuing house and to file the listing application for companies that are unseasoned and difficult to assess. It would stain the bank's reputation if the committee would decline to list the company or if the shares to be listed turned out to be a poor investment. Moreover,

new issues by young companies merely generate investment banking commissions that are insignificant relative to a bank's total earnings. This and the scarcity of new issues by unseasoned firms add to the reluctance of banks. Since the equity of German companies decreased to about 20% of total assets, the need to raise equity by public share issues has been stressed by government officials, business men, bankers and the financial press. In spite of this, few companies have gone public.

b) Trading

In principle, a class of shares that is traded at one collective price only will be dealt in daily. The dealings will last a few minutes only. Each class of securities is assigned to a Kursmakler, the German variant of the specialist. The other exchange members will generally leave with this Kursmakler all orders in this class of shares, regardless whether these orders are for member firm account or originate with clients. There is no need to observe a unit of trading, the Kursmakler will accept orders of any size. Fixing the collective price requires a number of steps. First, on the basis of the limited and unlimited orders collected, the Kursmakler determines the differences of supply and demand at all relevant prices. Then, at the time set for the fixing, any interested traders gather at the Kursmakler's elevated stand. If supply and demand balance at a particular price, he will cry out this preliminary price. If they do not balance there will be, except for unusual situations, a price at which excess supply is at its lowest level and, consequently, excess demand at the next lower relevant price.

Instead of a preliminary price the Kursmakler will call these two prices or any other two prices between which he expects to find the equilibrium price.

At this point the traders on the floor may enter new orders or cancel those which they left with the Kursmakler. Thereafter the market may clear at the preliminary price or at a price in between the two previously called prices. Otherwise, the Kursmakler will cry out a new preliminary price or a new quotation, and the procedure is repeated. Finally, the market will clear at a preliminary price or within the quotation that the Kursmakler called. No new orders or cancellations will be accepted thereafter, and the Kursmakler will fix the price at which supply and demand balance or most nearly balance; however, he may enter orders for his own account to eliminate any remaining excess demand or excess supply.

This final price is the collective price. It is the result of a collective negotiation and it is based on all orders collected. It is the price at which all those parties simultaneously consummate transactions who have orders in the market executable at that price. Thus, in contrast to the individual price, it applies not just to a single deal but to a fairly large number of simultaneous transactions. The Kursmakler has the orders executed at the collective price processed by the exchange computer system, which identifies the parties to each of the deals, prints out the contract notes and prepares settlement.

Collective prices of the shares of smaller companies will be published in the official lists of the exchanges

and in a few of financial daily newspapers. Along with the prices letters are published, which indicate whether the market cleared at the price or whether there was excess demand or excess supply. Investors, who placed an executable order are entitled to execution. If there is only demand or only supply for a share, the highest bid or the lowest offer will be published. For transactions in shares banks charge a commission of 1% on the value transacted. In addition, the client has to pay 1 per mill commission for the services of the Kursmakler and a contract stamp of 2.5 per mill. The minimum commission to the Kursmakler is DM 0.50. Banks usually charge a minimum commission of DM 10.

Trading at one collective price only is generally believed to be an excellent procedure, in particular for the trading of small company equity instruments. The procedure is very efficient. Usually it takes just a few seconds to trade a class of shares. Moreover, concentrating all orders by trading only once a day results in the highest degree of competition among buyers and among sellers that can be achieved. Only the buyers with the highest bids and the sellers with the lowest offers will succeed in this competition. By contrast, orders to buy limited below the collective price and orders to sell limited above will not be executed. This result conforms to the auction principle, on which the collective price procedure rests. There seems to be no more appropriate way of fixing a price.

However, this is not meant to imply that the collective price procedure meets all requirements. Critics point to deficiencies such as the following:

- There may be unlimited orders only. If the traders on the floor do not show any interest in a share, fixing the price is at the discretion of the Kursmakler. There will be no competition among buyers and sellers.
- Although there generally is a sufficient volume of limited orders, these limits may not at all reflect the situation of the issuer. This will impede the quality of the prices established, unless the assessment by traders or by the Kursmakler results in orders leading to an appropriate price.
- Large orders, if they are not executed off the exchange, can be expected to have a rather strong impact on the collective price of small company shares. Orders on the other side of the market will be not sufficient to provide a desirable degree of market depth.
- Investors cannot deal throughout the trading session. This is believed to impede the development of investor interest in small company equity instruments.

The reader should imagine what would happen in the above situations if one would attempt to execute all orders immediately upon their arrival on the floor at individual prices instead of waiting for the collective negotiation. Obviously, it is very much open to debate whether this approach would have more built-in corrective features. Of course, trading at individual prices permits transactions throughout the trading session. It should be mentioned at this point, that traders on the exchanges in Hamburg, Hannover and Bremen do have a choice between executing orders immediately or at the next collective price, since all officially listed

shares may be continuously traded. Orders concerning small company shares, it appears, are frequently delayed until a collective price is established.

It is difficult to state the minimum market value of an issue that will generate an order volume sufficient for trading at collective prices. According to most experts consulted, a certain degree of competition among buyers and among sellers can be expected and a stock will trade almost every day if DM 3-5 mio are publicly held by a wide spread of shareholders. The resultant level of trading will still generate qualified²⁰⁾ prices, and individual investors have a high probability that they can sell their shares within one or two days. It is also held that it should not take longer than two days to liquidate standard sized share holdings. Since German exchanges provide for the daily trading even of small company shares, investors are likely to be surprised if liquidation could not be achieved within two days. If dissatisfied with the liquidity of small company shares, investors may become reluctant to consider them for investment.

Official trading at one collective price only is a method suitable for trading the equity instruments of small and medium-sized companies. A fair number of small companies, about 10% of the officially listed, have their shares traded on this market segment. Some of these are regional companies listed and traded at only one exchange. During recent years, a few small companies have become officially listed. These companies had an extended trading record. By contrast, most small companies, including some unseasoned firms, applied to have the shares traded in the regulated

Freiverkehr. An important factor contributing to these decisions has been ease of access.

2. Geregelter Freiverkehr

The regulated Freiverkehr is a very versatile market segment. Usually it is believed to be the dooryard or the antechamber leading to official exchange listing. However, there are very few issuers who have their securities traded in the regulated Freiverkehr and who aspire to having their shares officially listed. If we look at bonds first, since bonds and other debt instruments clearly dominate the exchange list, there are no indications that issuers use the regulated Freiverkehr because they do not yet meet the listing requirements. The Freiverkehr is mainly used for notes, mortgage bonds and municipal bank bonds. The issuing banks appear to be very conscious of the higher costs of an official listing and thus prefer the regulated Freiverkehr, particularly for their short and medium term debt instruments²¹⁾. It also happens that a bank has a class of securities officially listed at one or more exchanges, while the same class is traded in the regulated Freiverkehr at other exchanges. Very frequently this pattern of multiple cross segment listing applies to shares. But, as in the case of debt instruments, many issuers of equities rely on this exchange segment for secondary market services. 80 companies which are not officially listed have their shares traded in the regulated Freiverkehr at one or more exchanges. Most of these have used this segment for many years, others were taken off the official list at some time. More importantly, a few young com-

panies that went public in recent years have entered the regulated Freiverkehr.

The status of a security traded exclusively in the regulated Freiverkehr is little different from that of an officially listed security. As far as investment funds are concerned there is no difference (§ 8 Abs. 1 of the German Law on investment companies). A similar provision applies to insurance companies, which may invest an amount not exceeding 20% of their legal reserves in the shares of German companies. The legal advantages of an official price do not appear to give rise to material disadvantages of the regulated Freiverkehr. First, as pointed out in the previous section, an official price may entitle an investor to have his order executed and, second, an official price is the basis for an agent's right to deal, on his principal's behalf, with himself (Selbsteintrittsrecht). At times, these advantages are stressed. As far as the first is concerned, it appears that it results from the unfortunate legal prohibition to publish Freiverkehr prices in the same manner as official prices (§ 43 Exchange Act). This is not a critical point, but it has some bearing. The second advantage of an official price has been at the center of much discussion. Its importance has been reduced to that of a simple device which contributes to the efficiency of executions on the exchange²²⁾. Very much the same result is achieved in the Freiverkehr, because banks execute clients' orders, by contrast with official trading, as dealers.

The following sections on access and trading will underline the points made above; in many respects the regulated Freiverkehr is an effective low cost substitute for the official market.

a) Requirements for entry

If a class of shares enters the regulated Freiverkehr, this is not at all considered to be a listing. Rather, the term inclusion (Einbeziehung) is always used. Thus, at least terminology complies with § 43 Exchange Act, a provision that requires amendment²³⁾. According to this provision, exchange facilities must not be used for inofficial trading. For many years exchanges and supervisors have not enforced this provision, which is impractical given the limited volume of securities trading in Germany and the institutional framework wherein it takes place. However, the authority for inclusion does not rest with the listing committee. At each exchange there is a Freiverkehr committee (Ausschuß für amtlich nicht notierte Werte), which is charged with this task. The committee is elected by the board of the exchange. The inclusion procedure is mainly based on guidelines and practices established by these committees. Though they are largely uniform certain differences among exchanges do exist.

Only an exchange member bank may file the application for inclusion. Exceptionally, the committee may include a security without application if there is an obvious trading need. However, this exception in principle aims at securities that are officially listed at another exchange. In the case of a small company that just went public the committees have never applied this exception. Thus, in all cases relevant for the study, the company going public has to find an exchange member bank that is prepared to file the application. If the company is not successful, this will impede

or even prevent public equity raising.

This is not merely a theoretical argument. In 1982 Electronic 2000, a young company from Munich, had to be included into the regulated Freiverkehr at the stock exchange in Hamburg. The consortium of the company was headed by a German nonbank. At first a foreign bank was the only other member. Finally, after considerable efforts, a member bank of the Hamburg stock exchange joined the consortium and successfully applied for inclusion. Probably in response to similar cases, there has recently been a debate among banks on this matter. It has been suggested that the issuing company should be entitled to apply for inclusion. It also has been recommended to permit exchange member banks to apply on behalf of a company at any German stock exchange, regardless whether the applying bank is a member of the exchange at which it files the application.

The requirements for inclusion concerning the issue and the issuer are delineated in the guidelines in a very general fashion. The applying bank has to submit a report (Exposé) that provides the information required for an assessment of the issue. The committee may ask for additional documents. It may also grant inclusion on the condition that the issuing company will meet certain initial or continuing requirements.

In substance, the requirements for inclusion are generally the same as for listing. Because of the very similar status of listed shares and shares traded in the regulated Freiverkehr for investment company and insurance company investment purposes this is to be expected. The continuing requirements imposed on the

issuer are the same for listed and for included shares (shareholder services, advertisements of accounts and various notices in qualifying newspapers). Companies that apply for inclusion also have to meet the regulations on the printing of securities²⁴⁾.

However, there are a few differences between listing and inclusion requirements that should be mentioned. The minimum nominal value of the class of shares to be listed may be less than DM 500,000. While a green field company may legally be listed, accounts for a full business year that were approved at the general meeting are required for inclusion. By contrast with a listing, companies that recently converted to public limited company status may be included right after conversion. This appears to be one of the more important material differences that favour inclusion. Most differences are hardly worth mentioning, for example the inclusion fee. The minimum fee for listing and inclusion is the same (DM 500). However, only DM 150 (instead of DM 300) are due per million of nominal value included or fraction thereof²⁵⁾.

To some issuers, the most important difference is initial advertisement expense. There are no advertisement requirements. Even the report, which is the substitute for the prospectus, does not have to be advertised in a newspaper. Contrary to banks issuing bonds or notes, this difference will hardly benefit small companies going public. They tend to voluntarily publish a prospectus in pamphlet form and they also advertise it in newspapers in order to develop interest among investors and investment advisors and to achieve a wide spread of shareholders.

Consequently, the costs of inclusion may in some cases be hardly less than the costs of listing. The preference of small companies for the regulated Freiverkehr seems to rest on two other reasons. First, an application for inclusion is more likely to be successful. This reflects a tendency of stock exchange authorities to have the shares of companies without an extended record traded in the Freiverkehr and not in the official market. The law does not require, but it may suggest this approach. Second, contrary to listed companies, included companies may issue additional shares to the public solely on the basis of their continuing information since the advertisement of a prospectus is not required.

b) Trading

Trading in the regulated Freiverkehr takes place on the floor. At some exchanges, an observer would hardly notice any differences to official trading. Procedures are basically the same, although the governing regulations originate from different sources.

A Kursmakler must not get involved in unofficial trading. Thus, there is a special class of exchange members (Freiverkehrsmakler) that assume the responsibilities of a specialist²⁶⁾. If there is more than one Freiverkehrsmakler, the Freiverkehr committee will assign to each of these a part of the included classes of securities. The Freiverkehrsmakler will receive orders in the securities assigned to him. On the basis of these orders he will fix collective prices according to the procedure used on the official market.

In principle, all included securities may be traded any time at individual prices, but this procedure is regularly employed only at very few exchanges.

Prices established in the regulated Freiverkehr must not be published. This is prohibited by § 43 Exchange Act. Instead, quotations are published in an appendix to the official list. These quotations are interpreted to mirror supply or demand. Consequently, they are not prices. Except by chance, the bids and offers published do not reflect actual orders. To the contrary, they are fictitious. Such fictitious quotes serve a useful function. The difference between bid and ask is standardized and scaled according to the price level. If a standardized spread is published, it straddles the price fixed by the Freiverkehrsmakler. Thus, the investor who reads the quotations knows that business was transacted at the middle price. Of course, the investor will be uncertain if different prices were fixed in a class of shares during one trading session, since only one quotation is published. The lack of letters indicating excess supply or excess demand adds to this. However, this awkward procedure takes care of the law and meets investor needs in most situations. Reputable financial papers like "Handelsblatt" and "Blick durch die Wirtschaft" even go one step beyond this. In spite of the legal threat of a fine up to DM 10,000 they publish actual Freiverkehr prices.

For his agency services the Freiverkehrsmakler will charge a commission of 1 per mill on the market value of the shares transacted. The contract stamp and the commission that the bank charges to the investor are also the same as for listed shares. However, since banks act as principals in Freiverkehr securities, some

banks prefer not to separately indicate the commission charge on the confirmation. The amount that is e.g. added to the price at which the shares were actually purchased may be more or less than the regular 1% commission.

To sum up, the differences in trading between the regulated Freiverkehr and official trading at one collective price are minor. Thus, with respect to trading procedure, the regulated Freiverkehr appears to be a segment as well suited for small companies as the relevant official segment. Of course, since there are no relevant differences, the regulated Freiverkehr does not seem to be particularly adapted to serve small companies. Exactly as for the relevant official segment a widely spread amount of DM 3-5 mio is believed to be necessary if transactions are to take place daily and if investors should have the opportunity to liquidate a regular sized holding within two days.

However, as in the area of entry requirements where the less exacting inclusion requirements provide for flexibility, there is more latitude for special arrangements that improve small company share marketability. Some of these arrangements are used in both the official and the unofficial market. Usually, there is a sponsoring bank which maintains a small trading position and attends the price fixing by the specialist. It is likely to take care of any excess supply or excess demand, particularly of any excess unlimited orders. Moreover, a Freiverkehrsmakler is required to meet higher capital requirements than a Kursmakler, he also is under a less restrictive regime as to trading for his own account. Furthermore, by contrast

with a Kursmakler, a Freiverkehrsmakler may have at his disposal the trading position of a third party, for example a sponsoring bank. Any improved solutions for enhancing the marketability of small company shares could easily be implemented because of the flexibility of the current regulatory framework.

3. Ungeregelter Freiverkehr

The term "ungeregelter Freiverkehr" has many uses. Some people use it as the designation for all dealings in securities other than those officially listed or included in the regulated Freiverkehr. Others use it synonymous with telephone dealings or off-exchange trading. Here, however, it is used in line with exchange practice as the designation for on the floor dealings in securities that are neither listed nor included in the regulated Freiverkehr. This market segment is of considerable importance particularly to a number of small companies that are exclusively traded there. However, as in the regulated Freiverkehr, many securities that are traded in the unregulated Freiverkehr are officially listed or included in the regulated Freiverkehr at one or more domestic or foreign exchanges. The unregulated Freiverkehr is a market for equity instruments or equity related instruments only, straight bonds are not being traded there²⁷⁾. Those equities that are exclusively traded in the unregulated Freiverkehr must not be held by mutual funds, they are also not eligible for legal reserve investment of insurance companies.

Entry to this market segment does not require an elaborate procedure as with listing or inclusion. Practice varies considerably at the eight exchanges. At least at one exchange the editors of the quotation sheet will content themselves that sufficient continuing information is available before a share will be quoted. In addition, it is also considered essential that a member bank declares that it will be executing client orders or deal in a share in the future. If a bank expresses such trading needs to a Freiverkehrsmakler, he usually will try to accommodate the bank and he will try to get the share concerned on the relevant quotation sheet or on the appendix to the official list.

As pointed out in section 1 a) above, German public limited companies have to publish their accounts in the federal gazette. Since only public limited company equity instruments are being traded in the unregulated Freiverkehr, investors are not at a disadvantage compared with listed company shares as far as continuing disclosure is concerned, save that there is no requirement to also publish the accounts in a designated qualifying newspaper. However, companies traded in the unregulated Freiverkehr are much less likely to voluntarily comply with the interim report regulation and with the insider regulation. In contrast with the other exchange segments, compliance is the exception rather than the rule.

Trading basically follows the same pattern as in the regulated Freiverkehr. Orders are usually executed by a Freiverkehrsmakler. In the less active shares a Freiverkehrsmakler will usually have to actively search for a counterparty. In doing so, he will fre-

quently contact the sponsoring bank or any other bank that has clients interested in the relevant share. Since a Freiverkehrsmakler is not allowed to have clients of his own, he must not contact clients directly.

Prices in the unregulated Freiverkehr are usually fixed toward the end of the trading session. This is a consequence of multiple cross listing. Of course, a Freiverkehrsmakler will be reluctant to fix a price before he knows e.g. the official price at the main market. The Freiverkehrsmakler will usually delay price fixing in the unregulated Freiverkehr until the prices at the senior market segments on other exchanges become known.

This gives rise to the question why trading in particular of small company shares is not concentrated at one exchange. Some people believe that this is the more efficient approach. However, it may not be in the interest of investors to yield to this view. Multiple listing or multiple trading fosters competition among specialists at various exchanges. The specialists have a strong interest to attract as much business as possible and to keep it at their exchange. Specialists would most likely be less keen to serve clients if trading in each class of shares was concentrated at one exchange. Some specialists will guarantee execution within one day, even for shares of small companies. Without competition, there would be no incentive for such guarantees, since clients could not route any unexecuted orders to other exchanges. Moreover, competition among market makers on the American over the counter market is generally believed to be highly desirable. Multiple trading implies that there will be some competition among exchange specialists that should have similar effects.

Finally, multiple listing and trading saves commissions for those banks that are a member of only one exchange. Usually these are the smaller banks, which may well serve as issuing houses for small companies. Without regional exchanges and multiple trading these banks may find it very difficult to stay in the securities business.

The quotations of the unregulated Freiverkehr are published in the same way those of the regulated Freiverkehr are. However, special unregulated Freiverkehr quotation sheets or appendices to the official lists are being used. Many newspapers publish some of the unregulated Freiverkehr prices.

4. Off-exchange segments

- a) The over the counter market in the shares of public limited companies

Off-exchange share trading is usually done by telephone or telex. In contrast with bond trading, where clearly the major part of total volume is transacted over the counter, over the counter trading in shares is rather small compared to exchange share volume. Over the counter trading comprises

- transactions in shares of domestic companies that are traded on an exchange (transactions before and after the trading session, block transactions);

- transactions in shares of foreign companies;
- transactions in shares of domestic companies not traded on an exchange.

Only the last category is relevant for the study. About 300 companies occasionally quoted on this market segment are inactive (companies that operated in the eastern part of Germany or in former colonies, companies being liquidated). In addition, the shares of a somewhat smaller number of active domestic companies that have a few outside shareholders are traded there now and then. These transactions are concentrated with a handful of exchange member banks and at least one other exchange member that have established a name for themselves as agents in a few or in a wide range of "unquoted" shares. Some of these member firms publish quotation lists. Two encompassing lists used to be published twice a year. More recently, one of the banks involved ceased business and the other bank took most inactive companies off its list.

Potential buyers and sellers will usually contact one of these banks directly or indirectly. The bank will then try to find a counterparty aided by special knowledge of the relevant shareholders and interested investors. In this market segment, special knowledge of the relevant persons and a good judgement as to the value of the shares involved seem to be the major factors contributing to successful agency. Though some degree of organisation has developed in this market segment, it does not seem to qualify as an organized secondary market. In recent years, there has been no example of a company that went public and thereafter has exclusively relied on this segment for secondary market service.

However, some companies that consider going public seem to use it to test what price the market is prepared to pay for their shares.

b) Transactions in the equity instruments of other businesses

Equity instruments of businesses not using public limited company form do not enjoy an organized market. However, a fair degree of secondary market organization can be found in the following areas:

- Trading of participating certificates, income bonds, sleeping partnership shares and similar instruments that some larger companies issued to their employees. In some cases a fairly elaborate trading mechanism has been set up in order to facilitate the ensuing transactions among employees.
- Specialized agents, bank subsidiaries and bank departments act as agents for the purchase and sale of majority and minority interests and charge commissions of 3-5% for their service.
- Some banks and distributors of shares in public limited partnerships engage in the replacing of such shares. Usually the shares of more successful real estate partnerships will be involved.

These markets do not contribute to the equity financing of small industrial companies. However, the replacing of shares of public limited companies could serve as a model for industrial businesses. The discussion on

this topic continues, although it is widely held that firms desiring to go public and to publicly raise equity should convert to public limited company form and apply for listing.

III. SUMMARY, RECENT PROPOSALS AND DEVELOPMENTS

The German stock exchanges as currently structured are in the position to provide in three of the four exchange segments well developed secondary market services to small and medium sized companies. However, little use is made of these facilities for various reasons:

- Public limited company status is required for entry. Company law and tax disadvantages tend to militate against the use of this form.
- There are some indications that entrepreneurs are reluctant to accept outside shareholders though the reasons for this are not entirely clear.

Even if it has attained public limited company status, a business may find it difficult to enter one of the three segments.

- Very few issuing houses focus their investment banking activities on small companies. Thus, there is also little marketing of secondary market services to small companies. Indirect and direct regulatory action seems to contribute to this.
- Entry requirements are not convincingly delineated. They do not appropriately reflect the hierarchy of market segments. In addition, arbitrary restrictive

interpretations of the open and well balanced Listing Regulation of 1910 have left issuers unclear and uncertain as to their chances to successfully apply for listing. The profile of the requirements of entry to the two lower exchange segments also is vague and indistinct.

- It may be difficult to retain an exchange member bank in order to file the application for listing or inclusion if a non-member investment bank handles the issue. Although the Listing Regulation provides for exceptions from applying through member banks, the state governments never have used their powers to permit certain classes of issuers to apply themselves for listing, e.g. those companies that by way of direct placement have achieved a sufficient spread of shareholders.

In a proposal dated April 18, 1983, which was made known to the public two months later in Berlin, the committee of stock exchange experts with the federal minister of finance addressed some of these problems. The committee proposed a second official market, a new market segment between full listing and the regulated Freiverkehr in stock market hierarchy. Trading would be only at collective prices and it would be modelled after the official segment in order to entitle investors, limits permitting, to execution. However, second market trading would be restricted to less than five days per week.

The proposed second market listing requirements are clearly more demanding than those that now prevail on the official market, though below those anticipated for the official market after the pending adaption of

national law to EEC directives. A nominal capital of at least DM 1 mio would be required for second market entry (only a part of company stock need to be listed), and, in addition, three years in business and two audited accounts. A short prospectus would be required, which may no longer have to be signed by the sponsoring bank if an auditing firm signs it instead. Advertisement of the prospectus may not be necessary. Interim reports, by contrast, will be required. The disclosures aimed at are less extensive than those that are now demanded by the regulation on voluntary interim reports.

Application for entry to the second market could be filed by any member bank at any German exchange. For example, contrary to the situation that now prevails, a Hamburg Stock Exchange member bank could file an application to list a company at Munich Stock Exchange.

It has been repeatedly stated that the second market will become operative in 1984. However, extensive discussions are under way as to the need of a fifth exchange segment. Many other points have been raised, e.g. EEC directives do not provide for reduced listing requirements of any second official market; why should the prevailing standards of interim report disclosure not be applied to second market companies; why should there be no daily and continuous quotations; who is to assume the specialist function in second market trading; who should decide on listing.

The need for a fifth segment is challenged because the more relevant features of the second market do not open up new choices to issuers and investors. It would merely be another choice within the range of secondary market services that are now available. In regard of investor

needs, companies that went public in recent years have voluntarily subjected themselves to initial and continuing disclosure standards more rigorous than those proposed for the second market. Companies that merely meet the proposed requirements would probably not be a choice of great interest to investors, clearly not a new one. Such companies may make it even very difficult to establish an attractive growth company image, which could be the second market's greatest and most desirable asset. If issuers indeed are desirous of a secondary market with lenient entry requirements and are to be accommodated, their choice would be a Freiverkehr segment. To them, the higher standards of the second market would be unattractive.

The creation of the second market as the fifth exchange segment may hamper the effective functioning of the existing segments since repercussions are to be expected on the Freiverkehr segments²⁸⁾. There have been calls to abolish the Freiverkehr once the second market is created. However, in the course of 1983 it has become obvious that for small company equity raising these lower segments are needed. Of the eleven domestic companies that went public in 1983 three had capitalizations too small to be eligible for the second market. It also has become evident that the hitherto largely forgotten unregulated Freiverkehr has been rediscovered as secondary market for very small companies going public, probably because of the ease and the low cost of access. Four companies entered this market segment, two of these were high technology firms. A somewhat larger young high technology company was included in the regulated Freiverkehr.

A truly new choice for small emerging companies would become available if a secondary market for public limited partnership shares was created²⁹⁾. The tax disadvantages of the public limited company form would be avoided. Start-up and early development losses would reduce the taxable income of investors. Investor protection could be provided by standardized articles of partnership, which any partnership desiring market entry would have to adopt. Any claims that existing company law is onerous for small companies in view of the economic importance of their external equity financing could be given due regard in the drawing up of such standard articles. However, potential market organizers are discouraged by the strong preference of major banks that the public limited form is to be employed for public equity raising and by the threat of tax authority counteraction if organized use was made of the limited partnership option by industrial companies.

Footnotes

- 1) There are 1.3 mio sole proprietorships. They have not been included. Probably not many of these are industrial firms, the exact number of which is not known. Cooperatives are excluded also since they are not specifically listed in the statistics. The figures listed above include forms of business organizations other than those shown. For example, there is a Kommanditgesellschaft auf Aktien. Companies using this form are included in the Aktiengesellschaft figures. The figures for offene Handelsgesellschaft include companies in various similar forms (Partenreederei, stille Gesellschaft, Grundstücksgemeinschaft, Arbeitsgemeinschaft). Businesses with sales of less than DM 20,000 and legally independent subsidiaries that are in fact divisions are not included. As a result, the total number of companies in the above listed forms is actually higher than stated. This is reflected in the statistics compiled on the basis of registers (Handelsregisterstatistik). According to these statistics, at the end of 1980 there were 255,940 Gesellschaften mit beschränkter Haftung and 2,141 Ak-

tiengesellschaften (Statistisches Bundesamt, ed., Statistisches Jahrbuch 1981, Stuttgart and Mainz: Kohlhammer, 1981, p. 116). Register statistics are not available for partnerships.

- 2) As a result of the adaption of German company law required according to the Fourth EC Directive audits will become required for private limited companies if they exceed two out of the following three benchmarks: 50 employees, DM 2.85 mio total assets, DM 5.7 mio net sales. The costs of a required audit amount to about DM 5,000 in very straightforward situations and to about DM 100,000 in rather complex situations.
- 3) When German company law will be adapted to the requirements of the Fourth EC Directive, private limited companies will also have to disclose their accounts. At present, only very large GmbHs have to publish accounts under the Publizitätsgesetz.
- 4) There is an exception to this. GmbHs must have a board of directors if they are subject to the codetermination legislation, which applies generally to companies with more than 2,000 employees or to steel and mining companies employing more than 1,000 persons.
- 5) Direct equity interests may be limited by two different ceilings: First, the holdings of participations by a bank combined with other long term assets must not exceed the equity capital of the bank. Second, there have been plans to limit the equity interest of a bank in an individual company to 5%, 15% or 25% of that company's capital stock. With a view to small companies the second ceiling is most undesirable. The participations that the restriction would permit will generally be too small to be economical. Today it is widely held that diseconomies of scale require a DM 1 mio minimum size of participations. Thus, small companies could not at all rely on banks as a source of equity. As far as the first ceiling mentioned above is concerned, it may speed up the placement of participations with the public. However, it may also prevent that banks take an active part in the equity financing of small firms. Cf. W. Gerke, Zum Beteiligungsbesitz der Banken, Zeitschrift für das gesamte Kreditwesen, Vol. 34, 1981, pp. 50-54.
- 6) M. Schneider, Die Instrumente sind da, Manager Magazin, April 1982, p. 46. Schneider states that the holdings of participations amount to DM 1.1 mrd. Much lesser amounts are set forth by other sources. A participation company states DM 600-700 mio (Gesellschaft für internationale Investitionen und Innovationen mbH, GeBeKa, Angebot von Gesellschaftskapital für deutsche Unternehmen, Frankfurt 1982, p. 7). Most likely this latter figure is based on a survey similar to that published in a recent issue, that was mainly devoted to participation companies, of Zeitschrift für das gesamte Kreditwesen (Vol. 36,

1983, p. 253). This survey of 26 participation companies yielded 1055 participations valued at DM 753 mio at the end of 1982. From this and a related survey (G. Leopold, Eine neutrale Eigenkapitalquelle für Mittelunternehmen, Blick durch die Wirtschaft, 2. August 1982, p. 3) it becomes clear that e.g. AGAB, an exchange listed major participation company holding participations of DM 184 mio at the end of 1981 (Finanzanlagen und Beteiligungen), has not been included in these surveys (Schneider did not include AGAB either). Usually, it is held that Deutsche Beteiligungsgesellschaft mbH is the largest participation company (participation holdings of DM 160 mio at the end of 1981). For 1979 H. Schlesinger values total holdings of German participation companies at DM 300 mio (Finanzielle Schwachpunkte der deutschen Wirtschaft, Kredit und Kapital, Vol. 15, 1982, p. 480). Schlesinger relies on E. Freyer, Die Kapitalgesellschaft als Instrument der Wirtschaftspolitik, Thun and Frankfurt: H. Deutsch, 1981, p. 205.

- 7) Of course, these participation companies using the limited partnership form also prefer to take participations in partnerships. This is the result of raising capital with individual investors. If, by contrast, the capital of a participation company is provided by a corporate entity, the above preference would not exist and, from a tax point of view, even a public limited company status of the participation company would be acceptable.
- 8) Statistische Beihefte zu den Monatsberichten der Deutschen Bundesbank, Reihe 2, Wertpapierstatistik.
- 9) D.L. Cohen, l.c., p. 256.
- 10) In particular, it is widely felt that there is a great fear of loss of influence. The somewhat dated survey referred to by U. Fritsch testifies to this (U. Fritsch, Mehr Unternehmen an die Börse, Köln: O. Schmidt, 1978, p. 76).
- 11) Cf. B. Ertl, Warum nicht mehr Unternehmen an die Börse gehen, Börsen-Zeitung, 18. März 1982; Sachverständigenrat, l.c., pp. 193.
- 12) In 1983 preferred shares in Tewidata were offered to the public by the participation company Abitel when Tewidata went public. In addition, the going public of SM Software in 1983 was probably aided by the fact that a reputable participation company continued to be among its shareholders (Deutsche Wagnisfinanzierungs-Gesellschaft mbH). In previous years, at least one German "Abschreibungsgesellschaft" placed an equity interest in a company with the public and had the shares of the company listed on a foreign exchange. E. Freyer, l.c., p. 170,

claims that Deutsche Beteiligungsgesellschaft mbH achieved a domestic listing for a domestic company. The executive director of Deutsche Beteiligungsgesellschaft, however, clearly stated in the 1982 article cited above that there had been no placement of participation company holdings so far (G. Leopold, l.c., p.3).

- 13) G. Oppermann and H. Degner, *Börsen- und Wertpapiergeschäfte*, 4th ed., Frankfurt: Wertpapier-Mitteilungen, 1981, pp. 52-54.
- 14) *Ibid.*, pp. 74-76, 282-289.
- 15) H. Rodrian, *Insider-Regelungen*, Berlin: E. Schmidt, 1977.
- 16) For a lucid discussion cf. S.J. Grossman and J.E. Stiglitz, *On the impossibility of informationally efficient markets*, *American Economic Review*, Vol. 70, 1980, pp. 393-408.
- 17) A. Young, l.c., p. 36. W. Holman and A. Young, *Small business in the United States: Failures and public financing*, *Strathclyde Convergencies Issues in Accountability*, No. 9, October 1983, p. 29. Cf. also D.L. Cohen, l.c., p. 258, and B.M. Neuberger and C.A. La Chapelle, *Unseasoned new issue price performance on three tiers: 1975-1980*, *Financial Management*, Vol. 12, Autumn 1983, pp. 23-28.
- 18) E. Schwark, *Börsengesetz (commentary)*, München: Beck, 1976, note 4 at § 36.
- 19) Cf. U. Fritsch, l.c., p. 117. The undesirable impact of this requirement, which was practiced at least for some time, is mirrored by a statement of the president of the board of a company that has been planning to go public. As he said late in 1982, his company still wants to attain a stock exchange listing. However, since a loss had to be reported in 1980/81, the company would need to go through an extended profitable phase - he referred to the former five year rule - before it could go to the stock exchange. At this point, the company reported its best results in ten years. Nino-AG: *Bestes Ergebnis nach 10 Jahren*, *Handelsblatt*, 15./16. October 1982, p. 17. Fritsch mentions a number of other requirements that have no legal base but may be imposed on companies applying for listing: 25% of stock publicly held, DM 5 mio minimum amount to be offered to the public, a minimum age not explicitly stated (younger companies will be referred to the *Freiverkehr*), a company applying for listing should be among the most reputable medium-sized industrial companies. P. Herlitz, *Der Gang an die Börse*, *Zeitschrift für das gesamte Kreditwesen*, Vol. 35, 1982, p. 172, strongly opposes the DM 5 mio minimum amount.

- 20) H. Schmidt, l.c., pp. 424-434.
- 21) Mortgage bonds, municipals and bonds issued by special large banks (Kreditinstitute mit Sonderaufgaben) are eligible as collateral for central bank advances if they have been included in the regulated Freiverkehr and if their original time to maturity does not exceed ten years.
- 22) H. Schmidt, l.c., p. 103.
- 23) E. Schwark, l.c., note 3 at § 43.
- 24) There is an exception that applies to notes (appendix to § 33 Abs. 2 Usancen der Ständigen Kommission). This exception is not relevant in this context.
- 25) Above DM 20 mio nominal the listing fee is DM 200 per additional million listed, above DM 50 mio nominal it is DM 100 per additional million listed. Thus, for a large issue the listing fee may be lower than the inclusion fee. However, in the context of this study, issues with a nominal value above DM 10 mio are of little interest.
- 26) Usually, only three classes of exchange members authorized to deal are distinguished: Banks, Kursmakler and Freimakler. Freiverkehrsmakler are believed to be the same as Freimakler or a subgroup thereof. As far as admission of members is concerned, this view is correct. However, under trading aspects it is quite appropriate to distinguish four classes. The Freiverkehrsmakler or "notierender Freimakler" is a specialist, i.e. he only deals in classes of securities that have been allocated to him as does the Kursmakler. By contrast, the Freimakler is a generalist, as are the bank members, and he may deal in any class of securities.
- 27) Debt instruments, of course, could be traded in the unregulated Freiverkehr, but they would not be eligible to serve as collateral for advances by the German central bank. The fact that bonds and notes are not traded in this segment points to the considerable importance which issuers attach to this eligibility. Aside from this, it would be difficult to understand why issuers of marketable debt instruments always apply for a listing or an inclusion since these instruments are mainly dealt in off the exchange floors. Exceptionally bonds and notes will be traded in the unregulated Freiverkehr prior to their listing or inclusion. In addition, in periods of high interest rates, some issuers have brought to the market notes with original time to maturity of less than 2 1/2 years, which is the minimum original time to maturity that is acceptable for inclusion. Listing committees will not consider a note for listing unless its original time to maturity is at least 3 1/2 years.

- 28) H. Degner, Neuer Spezialmarkt, Börse braucht zügige Realisierung, Handelsblatt Magazin, Nr. 1, Sept. 30, 1983. p. 43.
- 29) Cf. U. Meyer-Cording, Belebung des Kapitalmarktes durch neue Möglichkeiten der Zertifizierung, Betriebs-Berater, Vol. 37, 1982, pp. 897-899.

F. THE SEGMENTS OF THE SECONDARY MARKET FOR EQUITY
INSTRUMENTS OF SMALL COMPANIES IN THE GRAND
DUCHY OF LUXEMBOURG

I. ENVIRONMENT AND SURVEY

1. Number and forms of business organizations

The Luxembourg company law is treated in the law of August 10, 1915 concerning commercial companies. In the basic structure of the law and in its further development one finds close similarities to Belgian company law. There is a clear distinction between commercial companies and holding companies. Holding companies may take the same legal forms as commercial companies but are subject to a special legislation and supervision. They are not considered in this context.

The law provides six forms of business organization for commercial companies; each one represents a legal entity. For some of them there are restrictions concerning the negotiability of shares. Merely the shares of the Société en commandite par actions (s.e.c.a.) and those of a Société anonyme (S.A.) are freely transferable. At present, the form of a s.e.c.a. is not existent in Luxembourg.

Number of Luxembourg commercial companies (at end of year)

Business organization	1978	1980	1982
Société anonyme	1,350	1,458	1,586
Société à responsabilité limitée	2,396	2,811	3,391
Société en commandite par actions	-	-	-
Société en nom collectif	246	216	190
Société en nom simple	152	164	182
Société cooperative	94	98	66

Source: Direction de l'enregistrement et des domaines

A classification of the companies with regard to their capital or the number of employees is not available. Estimates designate the number of companies holding a capital below LF 10 mio to 80% of all Luxembourg companies. On the average, public limited companies (S.A.) disposed of a capital of about LF 70 mio in 1982; 470 companies had a share capital below LF 1 mio¹⁾.

Average capital of limited liability companies
(in LF million)

Business organization	1980	1982
S.A.	65	70
s.à.r.l.	1.8	1.7

Source: Statec

The increasing significance of the Société à responsabilité limitée as compared to the Société anonyme is based on the less stringent requirements for the administrative organization as well as on the absence of disclosure requirements. The s.à.r.l. may be run by one manager, while the S.A. requires at least three members of the Conseil d'Administration. For a s.à.r.l. with less than 25 associates, there is no need for annual company meetings; the associates themselves may exercise supervisory control of the management whereas in the S.A. and in the large s.à.r.l. this is the responsibility of a control commissioner elected by the associates. Finally, the Société à responsabilité limitée is not obliged to publish its annual accounts.

A considerable number of Luxembourg companies are family businesses that rarely use limited liability form. The limited partnership seems to be the preferred form of business organization. These enterprises are characterized by a rather steady volume of business. Yet, they usually work quite profitably, so that equity capital needs can be covered by undistributed profits or capital implements by the existing associates. If an increased demand for equity capital cannot be covered by the existing circle of associates, a takeover by a larger, probably foreign corporation might be initiated. However, such procedure has very rarely become necessary.

Besides, a change of the legal form would be conceivable. Commercial companies are permitted to change their legal form without losing the status as a corporation by doing so. Thus they are exempted from the one per cent taxation on the capital which in case of a foundation would have to be paid. This way, the

expenses of adapting the company's business organization to altered needs are reduced. Actually, this possibility is very seldom taken advantage of.

Recent legislative measures reduced the number of founders necessary for a S.A. from seven to two; this number is also required for the foundation of a s.àr.l. At the same time, the minimum equity capital for a S.A. was fixed at LF 1.25 mio; this amount exceeds considerably the amount of LF 100,000 requested for a s.àr.l. As a consequence, the willingness of small companies to take the form of a S.A. may be further diminished. Existing limited companies have to change their legal form if they do not meet the new requirements for equity capital after a three-year transition period.

The lately founded Luxembourg limited companies often are subsidiaries of foreign companies. The parent company, as the only or at least majority shareholder, has a dominant influence. In addition, investment funds and holding companies were set up in Luxembourg. A multitude of such companies has been attracted by public measures promoting the inland economy. The Luxembourg legislation strongly favours foundations by foreigners. No native has to participate in a Luxembourg company; the share capital may be stated in any currency; the constitution may be written in English, French or German. In addition, foreigners are being attracted by a moderate fiscal legislation and the free transferability of money and capital.

2. Frequently used instruments for equity financing

Companies may come to the Luxembourg capital market with quite different equity instruments. They can issue their shares in bearer or registered form (actions au porteur, actions nominatives) and implement them as ordinary or preferred shares (actions ordinaires, actions privilégiées). The privileges and conditions linked with the shares are treated rather liberally by the law. Thus, the companies enjoy considerable freedom in designing their shares within their statutes.

The rights granted to ordinary shareholders usually depend on their part of the share capital. This affects their proportional voting rights in general meetings, their claim to a proportionate payment of dividends and distribution of a liquidation value. To the holders of preferred shares often a minimum dividend is guaranteed; in some cases they are entitled to a priority repayment in case of a company's liquidation. On the other hand their voting rights are usually excluded save some situations which directly concern the holders of the preferred shares.

Beside these shares a company may issue reimbursed shares (actions de jouissance) or founders' shares (parts de fondateurs). The holders of founders' shares may be empowered by the articles to vote in general meetings. Convertible bonds are not commonly used; they are merely issued by big companies such as banks.

Notwithstanding the above mentioned feasibility of developing different classes of shares, ordinary

bearer shares are the most commonly used form. They represent an equity instrument that, because of its commonness and straight design, is valued with less effort and difficulty than preference shares embodying special rights and they are transferable without formal restrictions. A further reason for the absence of preference shares may result from the fact that companies hardly esteem the advantages of an exclusion of voting rights. According to Art. 71 II of the law concerning commercial companies, in a general meeting any shareholder is allowed to vote at the most one fifth of the distributed shares or up to two fifth of the capital represented at the meeting. Thus, the law renders a certain protection against the domination of the company by single shareholders.

Only in rare cases registered shares have been admitted to listing. In order to obtain the admission, the shares have to be transferable according to the corporate statutes. In addition, the company has to provide transfers in the share register regularly and within short periods, finally a Luxembourg-resident agent de transfer has to be designated. This agent services shareholder and company in case of transfers. He examines the legitimation of buyer and seller, supervises the observance of legal formalities and takes care of the necessary transcriptions in the share register.

3. Investors and investor motives

In recent years mainly banks and enterprises of the energy sector have publicly issued shares; none of the

issuing companies was small or medium-sized. No other domestic corporation has been granted a stock exchange listing. Therefore and for other reasons, it is difficult to characterize origin and motives of investors interested in small or medium-sized Luxembourg company shares.

A considerable number of small public limited companies is completely or to a large extent family-owned and closely held. Shares are rarely sold to outsiders. The owners are usually intensely engaged in the management of their companies. They are not interested in widening the circle of associates for fear of influence by new shareholders.

Experts believe that private Luxembourg investors are averse to risk. Stocks are frequently regarded as permanent investment. In case of capital increases the additional shares offered are taken up by existing shareholders. By contrast, new investments are placed rather in bonds than in shares. Besides, the taxation system promotes the preference for bonds, because distributed corporation earnings are subject to double taxation with both the company and the shareholder. As the only country in the EC, Luxembourg has not yet introduced a tax credit system that allows a shareholder to deduct from his personal tax due a part of the corporate income tax paid by his company.

Institutional investors hardly participate in Luxembourg companies. Some of them are not allowed to engage in company equities. For investment funds the investment opportunities seem not sufficiently attractive. Furthermore, the range of investment opportunities offered by domestic companies is too limited to attract their

attention. Even funds that are allowed to take the shares of unlisted companies into their portfolio are held back by the scanty volume of participations available. Managing such small investments that lack marketability seems a task too difficult.

Banks only exceptionally take participations not directly linked with their line of business. Existing participations partially result from a conversion of loans to equity capital.

The foundation of the Société Nationale de Crédit et d'Investissement (SNCI) in 1977 has centralised in one hand the instruments of economic policy and of public measures for structural change. Except for the granting of different kinds of credits, the SNCI is permitted to take part in company foundations and to hold minority participations in corporations established according to Luxembourg law. In general, the SNCI takes share capital only exceptionally and temporarily; some of the holdings result from a conversion of loans.

Participations are normally based on political decisions in order to protect enterprises and to procure employment. Thus they are linked with an intense influence on the management of the companies concerned.

At present the SNCI holds eight participations with a concentration in the steel sector. One steel sector company contributes about 80% of the entire volume of SNCI participations.

4. Issuing houses for shares of small companies

At present no institution in Luxembourg is specialized in promoting the public financing of small or medium-sized firms. The lack of such promoters is said to be merely based on the fact that they cannot find a sufficient potential of enterprises ready and willing to go public. Furthermore, they do not expect a fair number of companies to meet the requirements for going public. Finally the domestic investor is not considered willing to engage in shares of young companies or in companies run so far as family-owned enterprises.

Generally one cannot state a lack of demand for shares; in recent years listed as well as unlisted Luxembourg companies were able to carry out issues of remarkable volume considering the size of the country.

Public share issues of Luxembourg stock companies
(LF million)

	1979	1980	1981	1982
Listed companies	346	237	283	187
- thereof financial sector	346	-	283	187
Unlisted companies	99	180	90	306
- thereof financial sector	90	180	90	306

Source: Statec

It is evident from the table that the financial firms, especially banks, raise the overwhelming part of equity capital. For listed companies this is not surprising as the financial sector is properly represented on the official list with regard to the number and capitalization of all companies listed.

The great number of unlisted non-financial stock companies is not represented in the above table. An enlarged circle of their associates would be attainable by means of a public share offering. Yet, there are two obstacles: First, a public issue of shares means arranging for a dossier which must be submitted to the Luxembourg Monetary Institute for examination. This implies considerable expenses. Still more important seems the distinct lack of interest in broadening the shareholder base. This reserved attitude bears on a stock exchange listing: If new shareholders are not required or even resented, a stock exchange listing makes no sense. The most recent admission of a Luxembourg industrial company to stock exchange listing occurred in 1962.

On the occasion of issues accomplished by foreign companies or by companies which conform to Luxembourg law usually a bank acts as issuing agent. Normally this is the same bank which is entrusted with the preparation of the prospectus and the dossier and which signs the listing proposal together with the issuing company. The stock exchange regulations require that the listing application is sustained by a stock exchange member.

However, banks are not actively searching for companies that could bring to the market public issues or might apply for a stock exchange listing. To some extent

this attitude is explained by a system of banks that are allowed to transact all types of banking business and voluntarily cover their customers' financial needs by way of loans. The main issuing transactions affect the loans of foreign issuers that for the last twenty years have increasingly dominated the Luxembourg official list.

5. Survey of the secondary market

The Luxembourg secondary stock market comprises three segments. The stock exchange, a private stock company with public concession for the stock exchange business, offers one segment. Here the shares of quite differently sized companies with varied share turnover are traded according to a standard procedure. Noteworthy is the exceptionally high number of foreign companies listed. As to the extent and frequency of transactions the stock exchange segment is the main market for equity instruments. However, loans capture the main portion of turnover; their part in the total exchange turnover amounts to about 80%.

The second segment of the secondary market are the ventes publiques. They are organized by members of the stock exchange and take place on the trading floor. On request, unlisted securities can be traded there once a month. The prices quoted in ventes publiques assume a special legal quality as they are fixed with the assistance of a justiciary.

Finally, there is off-exchange trading between banks in listed and unlisted securities. However, off-

exchange trading is clearly dominated by bargains in interest-bearing securities; trading in shares is not very active.

At the end of 1982, the shares of 250 companies were listed on the Luxembourg stock exchange. This fairly high number of securities must be related to two characteristics of the official list: There are many foreign companies and a great number of investment funds quoted on the stock exchange.

Shares listed on the Luxembourg Stock Exchange

Origin \ Security	domestic	foreign
Shares of commercial companies	32	124
Shares of investment funds	60	34

Source: Cote officielle de la Bourse de Luxembourg of December 30, 1982

The listed companies established according to Luxembourg law are of very different size. The capitalization value ranges from ECU 0.11 to 530 mio²⁾, the mean is about ECU 52 mio. For nine companies the capitalization comes to less than ECU 5 mio. The 32 domestic shares have been issued by 31 companies. Many of them have foreign founders and managers and show a strong foreign participation. Only a few shares can be regarded as shares of Luxembourg companies. Of these, the securities issued by the

banking and steel sector are most important.

Foreign companies desiring access to the Luxembourg capital market have to submit to the same rules and regulations as domestic enterprises. The stock exchange even facilitates entry by permitting a foreign-currency listing since 1981. Some American shares are quoted in dollars. A strong presence of Japanese securities, usually represented by European deposit rights (EDRs), results from the quotation of convertible bonds. The convertible bonds and the related shares are usually listed in tandem.

Some foreign companies choose Luxembourg for quotation since the procedure of admission is uncomplicated and the expenses for entering and remaining on the official list are low. Investment funds often may only acquire shares of listed companies. The frequency of transactions in foreign equity instruments is generally very low. In such cases the quotations rarely change; if the occasion arises, the prices are adapted to those of a principal market without transactions taking place in Luxembourg.

The ventes publiques, which form a market for bargains in unlisted securities, are seldom arranged. They serve only to a small extent for the trading of private investors; rather banks and sheriff's officers act in ventes publiques since they need publicly fixed prices when they sell collateral securities.

Off-exchange bargains of private persons are usually effected by banks. The trading activity is low. In fact, there is but a small number of unlisted companies whose shares are widely spread among shareholders³⁾. Most

unlisted companies are too small for the development of a market in their shares. Furthermore, the shareholders often regard such shares as a permanent investment.

The off-exchange trading volume in listed shares is small. There is an understanding between the stock exchange and the banks that clients' orders should be executed on the stock exchange.

II. EXCHANGE SEGMENTS

1. The official-market segment

a) Listing

The procedure of admission to the Luxembourg stock exchange is characterized by flexibility and unbureaucratic processing of listing applications. Thus, trading may start within one month after filing the application for listing.

Companies intending a new issue or a listing of their shares are subject to a double control: first, all disclosure documents are examined by the Luxembourg Monetary Institute (Institut Monétaire Luxembourgeois); then the stock exchange decides on the listing application⁴⁾. The two stages of control are autonomous in principle; however, an informal cooperation is being attained.

The Monetary Institute acts as a controller. It does not have the competence to select issuers on the basis of its own criteria. However, since no applicant is allowed to publish any prospectus or advertisement without the Monetary Institute's preliminary consent, a certain selection takes place. Some applicants were discouraged from issuing when the Monetary Institute indicated that the submitted documents were insufficient with regard to the disclosure requirements⁵⁾.

A fortnight before filing the listing application the company has to present a "dossier" to the Monetary Institute. The dossier consists of three parts:

1. A prospectus with detailed disclosures. There are basic rules for the issuing of a prospectus for different types of securities; deviations are permitted, provided that they improve the transparency and clarity of the prospectus.

The basic rules apply to all companies; there is no reduced version for small firms. Exceptions may only be granted for information that could damage the issuing company in case of publication. The prospectus is divided into six sections that analyse the company, its capital stock, the administration and supervision of the company, the line of business, the financial situation of the company with a focus on the project for which the funds are to be raised and the securities offered.

2. In the second part of the dossier, the applicant renders all information that should have been included in the prospectus but has been omitted for an important reason. It also furnishes any partic-

ulars the Monetary Institute cared to request beyond standard requirements.

3. The third part contains among others documents that proof the legitimation of the issue (certificate of incorporation, resolution of associates); the outline of a notice légal that announces the projected issue to the court of justice (Tribunal d'Arrondissement); planned announcements and other advertising material; finally the declaration of the responsible persons that all information has been given truthfully.

The Monetary Institute examines the dossier with regard to its completeness and with the objective to prevent fraud. There is no material examination of the statements. A material investigation by other institutions is not required; the submitted accounts do not have to be certified by an auditor. In no case the investigation extends to the profitability of an offer or to the assessment of the issuing company. If the Monetary Institute sees special risks connected with the securities offered, it may ask the issuer to clearly point this out in the prospectus⁶⁾.

The Monetary Institute grants a "nihil obstat" if the dossier meets the existing requirements or if the issuer is willing to make editorial modifications or changes with regard to the contents. Now the issuer may publish the prospectus, announcements and all other publications related to the issue. Yet, the approval of the authorities may not be used as means of advertising.

The application for listing is filed with the Conseil d'Administration of the stock exchange. It has to be signed by a member of the stock exchange. Usually this

is one of the large Luxembourg banks that run specialized issue departments. Often this bank executes all tasks connected with an issue, as for instance the arrangement of prospectus, dossier and listing application according to the requirements of the Monetary Institute and the stock exchange. Rarely companies carry out these tasks themselves in order to lower the issuing expenses.

The most important requirements to be met by public limited companies filing a listing application are listed below:

1. The share capital of the company should not be less than LF 100 mio. The stock exchange may list smaller companies with a view to the EC admission directives that would permit a minimum amount of LF 50 mio.
2. Companies seeking a stock exchange listing should have a minimum age of three years. Exceptions from this rule may be granted; admission to listing soon after the company's foundation is possible. In practice, the admission of very young industrial companies is impeded by the common problem of such companies to describe their situation in the prospectus in a way that allows potential subscribers to form a well-founded and assured opinion on the company and the offered securities. However, that is what the Monetary Institute and the stock exchange require. The exceptional listing of young companies has been provided especially with regard to investment funds.
3. The prospectus with the Monetary Institute's approval and additional declarations required by the stock ex-

change have to be submitted. For the additional information the stock exchange has developed a questionnaire in which the company has to describe the company itself, number and structure of the shareholders and existing or proposed listings on other stock exchanges.

4. The company has to publish annual accounts, convocations of associates and other announcements to the shareholders in a Luxembourg newspaper.
5. The company has to agree to publish half yearly reports. Companies that have not yet reached an age of three years are requested to publish quarterly reports. This requirement for more frequent disclosure aims at facilitating the timely and reliable valuation by the market of the young, often only slightly diversified companies. This regulation burdens young industrial companies with extra expenditures for the preparation and publication of the reports. In contrast, investment funds do not seem to be burdened by the quarterly reporting requirement since they regularly compute and publish the market value of their portfolios.
6. A Luxembourg bank acting as paying agent must be nominated.

The stock exchange has not fixed a minimum amount of capital that should be publicly offered nor does it require a certain distribution of the shares in the hands of the public. It is not obligatory that a company requesting a listing has achieved profitability. However, in such case the prospectus should contain a clear notification of the company's special situation.

The Commission de la Bourse, which is charged with the management of the stock exchange, examines the listing application and hands it to the Conseil d'Administration with a proposal for decision. The Conseil resolves the application; it is not obliged to state the reasons for its decision.

The expenditures arising from a stock exchange listing (all amounts in thousands of LF) include a fee of 50 for the examination by the Monetary Institute, an admission fee of 25 charged by the stock exchange, publishing costs that depend on the kind and extent of publications (printing expenses for the prospectus are about 80, total publishing costs about 300), and the costs of the bank functioning as issuing house of about 200. Further expenses result from the preparation of all publications, from control work and public notary's fees. All together, the expenses even for a small issue may amount to at least LF 1.5 mio.

b) Trading

Trading on the Luxembourg stock exchange takes place "à la criée". During the session, from 11 a.m. to 1 p.m., a clerk of the stock exchange sitting at the ring for shares calls up the securities successively as they appear in the official list. The member firms' representatives then show interest by calling out bids or asks. On this basis, the dealers determine the price at which all or at least most of the orders can be executed. In other words, a collective price is established based on the auction principle⁷⁾. Usually the

number of orders to be taken into consideration is small, often just two dealers will be involved. Before fixing the opening price definitely, the clerk calls it up again loudly. If none of the dealers indicates further interest, this price is considered as established and is published in the official list (Cote officielle de la Bourse de Luxembourg). The Société de la Bourse has the exclusive right of fixing and publishing prices⁸⁾.

The dealers are allowed to deal again in securities already called up while the "criée" continues. If they want an official fixing and publishing of the prices negotiated, they have to name them to the clerk who advertises them to the dealers. Provided that no other dealer intervenes, the bargain is concluded and the price is fixed. Prices negotiated after the "criée" can also be passed to the clerk for publishing. Trading usually takes place at the opening price; frequently there are only buyers or only sellers on the market with the result that a bid or ask is quoted.

A dealer who intends to establish an official price by crossing orders has to call out loudly and clearly the security's name and the price he wishes to establish. If there are other dealers interested in buying or selling at this price, they may intervene with the result that a normal transaction between dealers takes place. Otherwise, the clerk fixes the price and publishes it in the official list. Crossings that result in an official quotation are rare.

The persons permitted to trade on the Luxembourg stock exchange floor are normally employees of banks and brokers. Some of them are specialised in certain secu-

rities⁹⁾, but there are no market makers that might offer immediacy service. However, the stock exchange does not really claim that each security is traded with a certain regularity. The stock exchange does not publish figures on the turnover. It is known that some securities, especially foreign shares, are not traded for extended periods. Transactions of small volume indicate that the listing of such securities serves private customers¹⁰⁾. Larger transactions also take place off the exchange, directly between banks¹¹⁾.

The costs for transactions on the exchange are low. For buying or selling shares, investors are charged with a commission fee of 8% of the value exchanged. At prices below LF 500, the commission fee is scaled and amounts to LF 1-4 per share. The minimum commission per contract is LF 100. There is no tax or further fee on securities trading.

2. Ventes publiques

a) Admission

Once a month there is an opportunity to trade shares of unlisted companies on the floor of the Luxembourg stock exchange. The Commission de la Bourse organizes these "ventes publiques"¹²⁾, which a justiciary supervises¹³⁾.

An inclusion of securities into the ventes publiques is available at low expense. Company law disclosure regulations for public offerings do not apply. Furthermore, ventes publiques are not subject to the Grand

Ducal Decree of June 19, 1965 that requires the preparing of a dossier¹⁴⁾. Since this facility has not been improperly used an upgrading of relevant regulations is not being considered¹⁵⁾.

To effect a share transaction in the ventes publiques, a member of the stock exchange has to have the securities registered in a list of offers a fortnight before the trading occurs. The application is made at the liquidation office where the share certificates also have to be deposited at least six days before the trading. With the deposition of the shares a registration fee of 5%o is due. It has to be paid even in case the securities are not sold. Further expenses for the inclusion do not arise. The Commission de la Bourse publishes the register of securities for sale in the official list and on boards in the rooms of the stock exchange.

b) Trading

Since exchange trading of unlisted securities is infrequently required, ventes publiques only occur two or three times a year. The lack of interest results mainly from the fact that banks in the rare case that a client wishes to trade in unlisted securities often know the potential counterparties. They provide for a direct agreement between buyer and seller within a short time and without payment of a fee for entry to the ventes publiques.

The positions that are sold in the ventes publiques

usually result from inheritances or from the liquidation of collaterals by banks that have to be effected at officially fixed prices. The items of the selling list are called up and sold by auction among the present stock exchange members. The number of participating dealers usually is small. Frequently the banks themselves buy the securities left with them by borrowers now in default. Banks are also willing to act as counterparty with the result that normally all items on the list can be sold. In case the banks act for private clients at ventes publiques, they charge them the normal commission of 8‰.

III. OFF-EXCHANGE TRADING

A very small number of unlisted company shares is regularly traded. In a few securities transactions occur sporadically or there is a temporary interest in trading. The volume of off-exchange trading in shares of Luxembourg companies is low.

An investor wishing to buy or sell shares of an unlisted company turns to his bank. There is no institution specialized in off-exchange trading in shares. Attempting to execute the order, the bank will first contact other banks, for instance during the stock exchange session. If it does not discover any interest there, it musters a counterparty by drawing the attention of private clients or of commercial establishments to the present order, for frequently their interest in certain securities is commonly known. This way the bank usually succeeds to quite rapidly find a counterparty and to execute the order.

The prices quoted at such transactions are usually determined by the "valeurs d'estimation". They originate from a price list set up by the stock exchange in cooperation with the association of banks and bankers and the public limited companies affected. The list is published annually at yearend. Primarily the quotations serve as basis for the taxation of shareholdings and for the computation of fees for securities taken into custody. Beyond that, buyers and sellers make use of the valeurs d'estimation in negotiating prices. This way they avoid a valuation of the shares on their own. The published prices achieved such importance that the search for a counterparty may become difficult with asks quoted above or bids quoted below the listed price. Banks charge their clients a commission fee of 8% of the market value for off-exchange transactions.

The Banque Générale du Luxembourg S.A., whose shares are not listed on the stock exchange, employs an exceptional approach to trading its shares. The bank is prepared to act as a market maker for dealings in its own shares many of which are held by individual investors. Transactions occur quite often, even large quantities are dealt.

IV. SUMMARY

The present environment is quite favourable for trading equity instruments of small public limited companies. The requirements to be met by companies that want to list their shares on the stock exchange and the listing process seem to reasonably balance the interests of investors and issuers. The costs of entry as well as the

continuing costs of a stock exchange listing are low as are the costs of stock exchange transactions.

The public offer of domestic company shares may be impeded by the absence of specialized issuing houses. Moreover, the stock exchange does little to attract new companies for listing. The absence of small and medium-sized industrial companies from the capital market also results from the special situation of the domestic industries, e.g. the lack of raw material base and the small size of the country. As a result, companies tend to stay small and may have little to gain by raising equity capital publicly.

Public measures to promote innovation consist of loans at a reduced rate of interest. From the investor's point of view, the fiscal treatment of dividend income is unfavourable compared to alternative investments. Particularly in times of high interest rates the double taxation of distributed company earnings can severely reduce the attractiveness of equity financing.

Footnotes :

- 1) L. Wurth-Polfer, G. Bernard, La réforme des sociétés anonymes, p. 9.
- 2) At the end of 1982 1 ECU was about equal to LF 46.
- 3) Rapport du Commissaire au Contrôle des Banques 1945-1975, p. 75.
- 4) Regulations concerning the entry into the Luxembourg capital market are Art. 33-36 of the law concerning commercial companies of August 10, 1915; Art. 26-38 Règlement d'Ordre Intérieur of the stock exchange and the Grand Ducal Decree of June 19, 1965 that has been concretized in some Circulaires of the Commissaire au Contrôle des Banques.
- 5) Rapport du Commissaire au Contrôle des Banques 1945-1975, p. 49.

- 6) Risks requiring special mention may result from the financial situation of the company or from the line of business. Foreign companies engaged in exploiting oil reserves or in biotechnology had to make such notice in their prospectus. Jean Krier, Für Euroanleihen wurde Luxemburg zum idealen Notierungsplatz, Handelsblatt, November 29, 1982, p. 26.
- 7) For details of establishing collective prices see H. Schmidt, Advantages and disadvantages of an integrated market compared with a fragmented market, pp. 424-431.
- 8) Art. 39 Règlement d'Ordre Intérieur.
- 9) A.M. Courssement, Les Bourses de Valeurs au Luxembourg, in: Institut d'études bancaires et financières (ed.), Les Bourses de Valeurs dans le Monde, p. 299.
- 10) Jean Krier, l.c., p. 26.
- 11) Jasper Becker, Stock Market Showing Vigor, International Herald Tribune, June 24, 1981.
- 12) Art. 5 No. 6 Règlement d'Ordre Intérieur.
- 13) Art. 94 fig. 1 Règlement d'Ordre Intérieur.
- 14) Art. 36 law concerning commercial companies of August 10, 1915; Art. 22 Grand Ducal Decree of June 19, 1965.
- 15) Rapport du Commissaire au Contrôle des Banques 1945-1975, p. 47. However, the Commission de la Bourse may refuse the inclusion of a security without indicating its reasons.

G. THE SEGMENTS OF THE SECONDARY MARKET FOR EQUITY
INSTRUMENTS OF SMALL COMPANIES IN BELGIUM

I. ENVIRONMENT AND SURVEY

1. Number and forms of business organizations

Under present Belgian company law, only the enterprises organised under the forms of the company limited by shares or n.v. (naamloze vennootschap, société anonyme) or of the cooperative society (coöperatieve vennootschap, société coopérative) are entitled to issue shares publicly. A third form, the "limited liability partnership issuing shares" (commanditaire vennootschap op aandelen, société en commandite par actions), is very rarely used and will be replaced by the company with variable capital once the long overdue reform of the Companies Act will enter into force.

Small businesses very often use the form of the "private company limited" ("personenvennootschap met beperkte aansprakelijkheid, société de personnes à responsabilité limitée"). Transfer of shares is restricted and needs the assent of the other shareholders. Although the rule will probably be abolished, bodies corporate are not entitled to hold shares in these companies (1), nor may they have more than 50 shareholders. Transfers that violate both these rules will be void (2). Finally, an express rule, with fines attached, forbids the public offer of shares in these companies (art. 201, 2° Companies Act) (3). For all these reasons, the following description will be limited to the two first mentioned types of companies. As to the cooperative societies, although they may be used for a public issue of their shares, it is hard to

organize a secondary market as, i.a., their shares may not be transferred to third parties (art. 141, § 2, Companies Act).

For these reasons, only the type of the company by shares or n.v. really matters for the present investigation. When private limited companies want to turn to the capital market, they can easily do so by changing their legal form to n.v. Some important companies had to make this change before they could issue shares publicly and obtain a quotation on the stock exchange (e.g. Solvay, Bekaert).

According to the Companies Act, the companies that open themselves up to the public are subject to a few additional rules. So will they have to appoint, as supervisor, a professional auditor ("bedrijfsrevisor", "réviseur aux comptes"), member of the officially recognised auditors' association. This rule is only applicable to those companies that have themselves issued shares or whose shares are listed on the main stock exchange market. It does not apply to companies in the shares of which a spontaneous market springs up, nor to companies dealt in on the "parallel markets" (to be described below). According to a bill pending before Parliament, all companies of a certain size, whether company limited by shares or cooperative societies, will have to appoint an officially recognized auditor (4). There will be no further distinction whether their shares are listed or not. This means that the main legal difference between companies limited by shares that have access to the public market and those that are closely held will have disappeared. Except where the articles of incorporation restrict the transfer of shares - a clause that, under the prevailing opinion, will be most easily enforced against third parties if the shares are registered - all limited companies can publicly issue shares or have their shares distributed among the public.

In fact, very few have; most of these companies are closely held, and their shares very exceptionally reach the public markets, e.g. in the case of compulsory sales such as for the settlement of estate duties or as part of the administration of an estate of a minor.

The following statistics mention the number of companies that have been founded, according to their types. As to the number of companies in existence, very little information is available. The number of companies listed obviously is a very small percentage of the overall number of companies in existence.

TABLE I

Formation (+) and dissolution (-) of
Belgian Companies

	Companies limited by shares and limited liability partnerships issuing shares		Private company limited		Cooperative societies		Trading partnership & Limited liability partnership	
	n.v. s.a.	c.v.a. s.c.a.	p.v.b.a. s.p.r.l.		coop.v. s.coop.		v.o.f. s.n.c.	c.v. s.c.s.
	+	-	+	-	+	-	+	-
1972	1,570	486	3,379	952	106	134	40	56
1973	1,965	507	3,379	1,053	112	171	35	59
1974	1,990	554	3,850	1,074	135	165	50	53
1975	2,032	525	4,212	1,066	100	128	58	61

Source: Nationaal Instituut voor de Statistiek, Statistisch Jaarboek, 1981, nr. 101, tabel 27, p. 508.

Other forms of business enterprise are frequent, but represent a very small interest for the study of public financing. Not unfrequently, small enterprises, sole traders or unlimited liability partnerships try to attract by newspaper advertisements, circulars etc., new capital or additional partners etc. These attempts have been restricted both by case law and especially by the Banking Commission, as being the public issue of a share in a company and therefore subject to the disclosure control procedures (5). As a consequence, this form of financing only takes the form of private contacts, whereby it happens that banks, brokers or other financial institutions may act as go-betweens. Very little information is available as to these aspects.

For small businesses, tax considerations and the social security impact often play the determinant role in the choice of the type of company. Small private companies may opt out of the system of separate taxation of the legal entity (6), whereby the managing director, who is also a shareholder, will usually not qualify as an "employee" for social security purposes. This right of option does not exist for the n.v., but taxation levels may make the choice for the n.v. attractive : presently the corporate tax rate is 48 %, lowered to 33 % under 1 million BF of income, and gradually increased to 48 % above 15 million BF whereas the marginal personal income tax rate is officially 67.5 % (but in fact substantially higher). The managers of n.v. are more readily considered as falling under the "employee" status. Finally, the n.v. usually have bearer shares, which opens much appreciated tax perspectives, e.g. for estate duties; moreover company law is clearly more flexible for the n.v. than for the other types. The minimum capital requirement (1,250,000 BF for the n.v. and 250,000 BF for a p.v.b.a.) may limit some people's access to the n.v. form (7).

2. Frequently used instruments for equity financing

Although there are very few restrictions in the Belgian Companies Acts on the use of different types of securities, the most commonly used form of instrument for equity financing is the ordinary capital share, with full, proportional (i.e. to the capital contribution) voting rights (8) and usually with equal dividend and liquidation rights. Rather exceptionally preference shares are found, giving a right of first dividend or other preferences (9). This large uniformity may be due both to the action of the Banking Commission and to the limited creativity of the parties, their legal advisers and the notaries involved in drafting the articles of incorporation. As to the action of the Banking Commission, it has always come up in favor of the existence of one single class of shares, mainly to avoid manipulation.

Special rules apply to the "unification of shares" whereby different classes of shares are merged into one (10). This action has resulted in a status in which practically no companies listed on the Stock Exchange have "founders' shares" (winsteffecten of winstaandelen, titres ou parts bénéficiaires) outstanding. These shares have voting rights, although they have been issued without a contribution of monetary value (e.g. for promoter's efforts).

Convertible bonds have often been used by both large and small enterprises, especially to enable public institutions to participate in these businesses' financing without taking the full risk of the shareholder. These issues are subject to a simplified control procedure by the Banking Commission (11).

The absence of other types of securities, such as the non-voting shares, often is invoked as one of the explanations for the tinyness of the Belgian parallel market. Under the Companies Reform bill, it was provided

that companies could, under certain conditions (max 1/3rd of the outstanding voting shares; 5 % dividend preference; preferential liquidation rights) issue non-voting shares (12). The bill has not been passed. This section, however, was taken over in another law that organized the state help to the ailing textile industry (13). As most textile enterprises are small privately held businesses, it was considered inappropriate that the State's participation in the capital would cause a change in the proprietary or voting situations that existed beforehand, also taking into account that the State's participation was considered to be merely temporary.

One of the major obstacles for the public flotation of shares in closely held companies is the loss of control that may result. Very few answers have been given to this question as it is considered, by leading legal writers, that all oligarchic structures or clauses would be contrary to Belgian Company Law and financial ethics. The only technique that has thus far passed the scrutiny of the Banking Commission is the clause in the articles of incorporation whereby a certain category (that is in all other respects equal to the other shares) may not be validly acquired by legal persons, such as other companies or financial institutions. Thus, the controlling group can try to avoid a take-over, at least in its most frequent appearance.

Public issues of securities other than by the already listed companies have been extremely rare (see table infra). Several reasons may be pointed out for the explanation of this situation : in the past stock exchange prices were very depressed; the disclosure requirements of the Banking Commission were so thorough that only a handful of companies dared to take the leap to the stock exchange. After a public issue, a listing would

in most cases be deemed indispensable; very few companies wanted to dilute the control exercised mostly by family groups. The access of companies to loan funds had been made very easy, so that the need for capital was not felt so eagerly as during the nineteneighties. Tax advantages of bonds and loans (especially deductibility of interest) can help explain a few issues of bonds, especially of convertible bonds, while with rather depressed stock prices, the issue of shares was considered relatively more expensive. The absence of specialised issuing houses and the psychological deterrence of a full public issue with subsequent listing may also have contributed. The capital market was moreover strongly solicited by the public authorities, the electric power enterprises, whose shares behave as fixed income bonds, and the banks, whether listed or unlisted, as these are subject to the Banking Commission's solvability and capital requirement.

During the last months, however, this situation seems to have changed quite rapidly. Tax measures have been taken to promote the issue, whether public or private, of new shares (14). They are based on a Monory-type of law, whereby monies contributing to the capital of companies are declared on the one hand deductible from personal income, and on the other hand partially exempted from company taxation.

3. Investors and investment motives

For several decades, the public issue of shares has de facto been reserved to a few banks, a few public utilities and some major industrial enterprises. Banks are under regulatory pressure to increase their capital, and public utilities, especially in the electric power sector, have engaged into a capital intensive nuclear plant program.

Since the early seventies, only a couple of new companies came to the market and/or issued new shares (Solvay, Bekaert, Colruyt). This situation has changed quite drastically since 1982, when the Government took several measures to reinforce the private enterprises' profitability and granted the above mentioned tax advantages for new investment in shares. Although no new companies became effective since these measures or applied for admission to the stock exchange, at least the existing listed companies have massively issued new shares and had these listed on the exchange. Many closely held enterprises have also issued new shares, but these have been subscribed by their existing shareholders and have not reached public markets.

Belgian closely held enterprises are mostly family owned and family managed. Therefore the controlling shareholders are very reluctant to sell shares to third parties, and even then would restrict the free transfer by private covenants. Under economic pressure the family sometimes is willing to accept an outside partner, very often one of the State-controlled financial investment companies (Nationale Investeringsmaatschappij - Société nationale d'investissement; Gewestelijke Investeringsmaatschappijen - Sociétés régionales de développement) (15). These partners will, however, often prefer to obtain full or majority control of these enterprises. Special measures have been taken for the salvage of certain industrial sectors, whereby small businesses have been included in restructuration schemes (e.g. in the textile sector). Certain private companies or practically State owned enterprises are also willing to take risks in new ventures.

Banks are not entitled to hold shares under present banking laws, except for the purpose of their public issue or as collateral for their loans (16).

Private holding companies, some of which are up-stream

associated with the major banks, hold themselves out as willing to contribute to the capital financing of new existing enterprises, in order to stimulate local economic activity (17). Their shareholdings may, but do not necessarily, amount to majority or control shareholdings. In at least some cases, these holding companies stated their intention not to keep their holdings indefinitely, but rather resell them, once the project had come to maturity.

Institutional investors, especially pension funds, are reported to show interest in the purchase of unlisted shares. They use for that purpose the telephone market mentioned below (18). Some insurance companies may also show interest in unlisted shares, although the reports of the Insurance Control Office do not mention these shares apart from all shares in Belgian companies. Moreover, shareholdings in Belgian companies by insurance companies are restricted to 5 % of any single company, and 25 % of the insurer's technical reserves (19). In fact, however, insurance companies prefer to invest in other assets and only 6 to 7 % of their technical reserves were used for the acquisition of shares, whether in listed or in unlisted companies (20).

4. Issuing houses for shares of small companies

There are no indications in Belgium that there is a lack of demand for new shares. Quite substantial amounts of new shares have been issued by listed companies since the Monorytype tax measures were introduced. However, in the years preceding these tax measures, the public issue of shares was much more limited : Table n° II gives precise indications as to the amounts of capital attracted by private enterprises by way of a public issue of securities.

Table II

The Public¹⁾ Issue of Securities in Belgium (Million BF)

Year	1978	1979	1980	1981	1982	1983 ⁵⁾
<u>Shares of Belgian companies</u>						
nominal amount	10,095	5,624	1,575	385	20,397	21,994
number of companies	8	9 ²⁾	8 ²⁾	8 ²⁾	19	33
new listing	1	0	0	0	0	0
<u>Bonds of Belgian companies</u>						
straight bonds	-	-	4,988	4,963	35	.
convertibles	-	2,500	-	-	-	.
number of issues	-	1	1	1	-	.
<u>Real Estate Investment Certificates</u>						
	1,136	2,491	396	-	-	.
For comparison:						
<u>Private Placement³⁾ of bonds</u>						
Belgian company straight	8,565	14,778	13,835	10,205	20,301	.
Belgian convertibles	702	31,877 ⁴⁾	5,149	51,611	3,370	.
Eurobonds	11,019	17,224	18,505	31,702	46,622	.

Source: Banking Commission, Annual Report.

1) Issues to 50 or more persons.

2) Of which 4 were listed, 4 were banks, and 1 was an unlisted nonfinancial enterprise. For 1980, these figures are: 7, 1, 0; for 1981: 4, 1, 3.

3) As far as these issues have been communicated to the Banking Commission by the banks or brokers.

4) A large part of this amount relates to bonds issued as part of the reconstruction of the steel industry.

5) As of September 30, 1983.

Very few of the public issues relate to unlisted shares. Many privately held companies have increased their capital to take advantage of the tax favors introduced in 1982, but these shares have not come on the market. In at least one case, the company, an important regional bank, issued new shares publicly, as its shares had been traded for decades. There was a very acute shortage of paper, and if three times as many shares would have been issued, it was reported, they would all have been subscribed.

These few observations tend to indicate that there is (also) a lack of supply of shares, and that many profitable smaller enterprises may take advantages of the possibilities offered by the capital market.

The public issue of securities is mostly organized by banks. Brokers play a limited role. There have been no cases reported of issues directly placed by the issuing company itself, although the Stock Exchange Law explicitly exempts the issue by a company of its own shares from the general obligation to pass all securities transactions to a broker or a bank (21). The practical difficulties, the lack of experience with the administrative procedures, the existence of long-standing relationships with one or more of the principal Belgian banks, all these factors explain why public issues have rarely been made except with the assistance of the banks. Especially the four large deposit banks have in the past fulfilled the function of issuing house, assisting the issuer in preparing the administrative files, registering the issue with the Banking Commission and with the Quotations Committee and pursuing contacts with these bodies, insuring as firm underwriters or as guarantors the outcome of the public issue and making efforts to place the securities with their numerous clients. Most of the issues of new shares are rights issues. Subscription rights are traded on the stock exchanges.

There can be no oversubscription in these cases. In a few cases, existing shareholders offered their still unlisted shares to the public, i.e. without preemptive rights. Massive oversubscription took place especially by the banks; as a consequence the brokers claimed not to be able to secure a fair share of the issue for their clients. At present, smaller banks or other financial institutions have not undertaken any specific action to bring securities to the market. This may in part be due to their dual capacity, acting both as deposit-taking and credit-granting institutions and as broker for securities. Brokers, i.e. members of the stock exchange, have but very rarely brought new Belgian securities on the market. On a few occasions, foreign investment funds were launched or placed by Belgian brokerage houses, but no comparable action was undertaken for Belgian shares. The competition of the eurobond-issues, with high, de facto tax free interest coupons may have contributed to this lack of interest. If some interest for small company securities had to be mentioned, it more directly relates to the transfer, between shareholders and through the broker's office, of small and sometimes larger packages of shares.

There are no other institutions or professionals active in the new issues market, nor does the stock exchange undertake any systematic search or action to attract new securities. During recent months, however, the discussion was started whether measures to achieve this goal should not be taken (see infra, Section III).

5. Survey of the secondary market

Under Belgian legislation, securities transactions have to be executed by a broker, member of one of the stock exchanges, or by a bank. This rule is not applicable to :

(a) the issue of securities by the company itself; (b) take-over bids; (c) transfers of securities between companies or individuals none of whom frequently deal in securities, or gifts of securities; (d) transfers of blocks, i.a. above 10 million BF per single category of shares (22). All larger share deals, even in listed securities, by-pass the stock exchange and are directly negotiated between buyer and seller, sometimes with a bank or broker as go-between; more and more foreign brokers are specialised in this so-called third market, even for Belgian listed shares (23).

All other transactions should be submitted to a bank or a broker, whether for execution on the stock exchange by the broker - the banks have no access to the stock exchange - or for the drawing up of an official sales slip ("borderel - bordereau"). Brokers are sometimes asked to find a counterparty among their clients, e.g. by the banks to whom these securities have been offered. Compliance with the above-mentioned trading privileges is enforced by criminal sanctions. In practice, prosecutions are extremely rare. The Banking Commission and the Stock Exchange Commission have rarely used their powers to supervise the securities transactions of banks or brokers respectively except in a rather general way.

Trading of securities takes place on the official market and on the different segments of the unofficial market. The secondary market for equity instruments is dominated by the stock exchanges. There are four of them, located in Brussels (more than 90 % of total turnover), Antwerp (about 7 %), Liège and Ghent. The stock exchange, managed by the professional associations of the brokers (agents de change), mainly provides a market for the officially listed securities. At the end of 1982, there were 212

Belgian shares listed in Brussels. Another 11 Belgian shares were listed in Antwerp, along with many shares also listed in Brussels; Liège and Ghent listed only shares that are simultaneously listed in Brussels. Total market capitalisation in Belgian shares on the Brussels Exchange amounted to BF 402 mrd with a turnover of 17 mrd on the spot and 32 mrd on the forward market (24). On the Brussels and Antwerp Stock Exchanges shares of officially listed small companies are traded on a segment of the spot market ("parket" - "parquet"). The Brussels forward market serves the larger companies (33 Belgian and 140 foreign shares). In addition, there still exists the Corbeille, a spot market segment for the more actively traded shares. The differences between both segments of the spot market are fading away. Activity on the spot market represents about 1/3rd to 1/2 of the forward market. The number of Belgian listed companies has steadily been declining : from 606 in 1960 to 370 in 1970 and 212 in 1983. For the period from 1975 to 1982, a few new shares were admitted : 6 in 1975, 3 in 1977 and 1 in 1978; during the other years no Belgian shares were admitted, although several foreign shares were listed. Actively traded securities belong to the large financial and industrial companies with a capital of several milliards BF. But also many smaller companies are listed; many of them were listed before the 1930' s, i.e. before the prudential controls were introduced. Turnover in these shares is very thin, and the limited number of shareholders involved exposes them as targets of speculative moves. Before the tax incentives of the Monory type mentioned above, these small companies very rarely issued new shares. During 1982, several of these smaller companies issued shares to their shareholders (for the Brussels market, see below for details).

Apart from the official stock exchange market, there are

several other market segments for shares that need to be mentioned. Since there is no forward trading, the segment may be considered as unofficial part of the spot market. The first segment of the market in unlisted securities is called the "daily auctions" ("bijkomende veilingen - ventes publiques supplémentaires"). Under the Brussels Stock Exchange ordinance (25), the Stock Exchange Commission has the right to organize additional auctions in securities that are not officially listed. This market was created during the sixties in order to officialize the trading in unlisted securities that was taking place in the stock exchange. These securities have not been officially listed, as the issuers did not want to apply for listing, whereas compulsory listing, although introduced by a law in 1967, was considered impracticable (26). On the Brussels Stock Exchange, five Belgian shares, one foreign share and three investment fund shares are traded on these daily auctions; some of the same shares are also traded in Antwerp, with one additional local share (27). For stock exchange purposes, these securities have the status of listed securities in almost all respects (28).

The population of companies traded on these daily auctions demand some further explanation. Two of these companies are major and profitable firms in their line of business, while the others are experiencing severe difficulties. The investment funds are two leading American mutual funds, that were introduced on the Belgian market by a stock broker several years ago, but for which no official listing has been procured. There is also one German investment fund traded on this submarket : turnover figures indicate that this share belongs to the most actively traded of the spot market (29).

Another segment of the unlisted market are the "monthly or weekly auctions" (maandelijkse of wekelijkse veilingen - ventes publiques mensuelles ou hebdomadaires). By contrast

with the daily auctions which come very close to the official market in securities, except that the issuers do not have the status of listed company, the monthly auction market is open to any security. Trading takes place as on the traditional auctions, i.e. the security being offered for sale, whereas potential buyers can only offer a price, but no additional sellers can come in (29).

The securities traded on this segment of the market are, to a very large percentage, bonds issued by financial institutions. These bonds have been placed with an individually fixed maturity date and therefore are unfit for stock exchange trading. Purchasers very often belong to the circles of the issuer, if not the issuer itself, to avoid depreciation of the public standing of these bonds (30). This segment of the bond market will not be dealt with below.

As far as shares are concerned, these securities may be offered on this auction market by anyone. Very often shares are offered by individuals who have purchased or inherited them and have been unable to find a purchaser. The list of shares offered on these auctions therefore differs from one auction to another. Some shares happen, however, to be frequently offered on these auctions. In a leading manual of listed securities, fourteen of them are mentioned as regularly traded : a leading Belgian sugar refiner, a regional bank (one of the more important Belgian banks), one of the biggest European beer brewers, etc. The capital of these companies often runs into several hundreds of million BF. Practically, all of these companies have entrusted the supervision of their accounts to an officially recognized auditor.

Some issuers prefer to see their shares trade on the monthly auctions rather than on a continuous market. They mention that, when a shareholder wants to sell, the

company's management usually attempts to find a new shareholder. Only exceptionally do shares arrive on the auctions. Issuers prefer a market where there can only be sellers and this for a preannounced quantity. The company or its main shareholders will keep a close eye on price movements, and transfers of too many shares out of the group of reliable shareholders will be kept in hand.

Apart from these frequently traded shares, shares of any other unlisted company may be offered on these auctions. Although shares in larger companies are offered frequently, there is also a substantial variety of small company shares coming on this market. If it would appear that a share in a closely held company to be offered more frequently on the auction, the Banking Commission may frown upon it and consider this to be part of a public issue of the shares. This finding would lead to the obligation to issue a full prospectus, while for foreign shares the authorization of the Minister of Finance would also be required. Although outside the scope of this report, one may call attention to the very active off-the-floor market in eurobonds, which is mainly a professional market. Apart from bonds (straight and convertible), several Japanese shares are traded in this way : these are the European depositary receipts for the original Japanese shares. One also finds some trading in South African gold mine shares and in two or three Dutch shares. Quotes are published in the newspapers as bid and ask quotes.

Several of the more important brokerage firms tend to act as market makers in Belgian shares, especially before or after the opening hours of the stock exchange and in periods of greater market activity. Their market making activity is, however, not a continuous one : once the interest of the public for a certain share has disappeared, they will stop to deal in this share for their own account.

In unlisted Belgian shares, the activity of financial intermediaries seems to be very limited. The stock exchange brokers rarely have sufficient capital to engage in market making activity : they hesitate to use it for listed shares and certainly would not do so for unlisted shares. A few brokers seem to be willing to note somebody's interest to sell, and look for a potential buyer. These brokers will have direct access to the company's board, or its main shareholders and will only offer the shares on the monthly auctions when none of these insiders is interested (31). Brokers, or banks, also intervene as buyers or sellers of shares for their own account to facilitate the anonymous transfer of the shares from the seller to the buyer. The broker here appears almost simultaneously as buyer and seller. Anonymity is desired especially for tax purposes.

In the field of real estate leasing certificates, the issuing houses that have originally brought these securities on the market also have organised a secondary market, based on matching the intentions to sell with intentions to buy. During its early years this market was very active; due to the rise of interest rates, the trend has been downward, and the issuing house, that acted as a market maker on certain occasions, refrained from further taking risks. Therefore quotes published are tentative. Some of these certificates are offered from time to time on the monthly auctions, but attempts to activate this type of trading in leasing certificates were not successful.

According to the Stock Exchange Law, several other sub-markets could be set up, see e.g. article 103 that deals with an "interbank market" ("bankmarkt" - marché en banque).

In 1969, the Government was empowered to organize markets in securities not admitted to the Stock Exchange; no use has been made of this provision.

II. EXCHANGE SEGMENTS

1. The traditional stock exchange market for small company shares

The Belgian small companies are traded on the spot market. On the Brussels spot market, shares of about 200 companies were listed at the end of 1981. Of these 69 companies had a statutory capital of less than 100 million BF, and 131 companies had a capital ranging from above 100 million BF to about 20 milliard BF. Thirty companies had a capital of 40 million BF or less and would therefore fall below the 1 million ECU-limit for listing under the 1979 EEC-Directive (33). Six companies had a statutory capital of 10 million or less, the lowest being 2.3 million; in several cases, these companies became so thinly capitalized as a consequence of their write-off of losses or are enterprises left over from the colonial past of Belgium.

The same companies under the 100 million BF limit have most of the time been established in the last century or at the beginning of this century. Only two of them have been founded after W.W.II, 1957 being the most recent birth date. The oldest one goes back to 1860. Of these companies, all of them were listed in Brussels and eight in Antwerp as well.

Recently, the stock exchange authorities have started a review program in order to strike off from the price list some of these more rarely traded shares. This action will gain momentum after the implementation of the reform proposals, currently under consideration (see further).

In 1982 the Belgian Government introduced tax measures to stimulate the issue of shares and to attract new risk capital. Larger companies have massively made use of this facility, the

total amount of capital increases amounting to 70 milliard BF (34). Smaller listed companies had much more difficulty to take advantage of them, probably because their profit record was too weak : for the period up to April 1983, only six of these 69 companies with a capital under 100 million BF have taken advantage, for a total sum of 219 7 million BF.

On the Antwerp Stock Exchange, there are only a few shares that are not simultaneously listed in Brussels. Of these 11 shares of Belgian companies, only in two cases did the issuer dispose of a capital in excess of 100 million BF, while in five of these the capital did not exceed 10 million BF.

a) Listing

Listing requirements for large and small companies are substantially the same. In practice, very few smaller companies have been admitted these last twenty years. The listing procedure therefore tends to be geared to the situation of the larger company especially to the issue of additional shares to which tax advantages are attached.

Listing requirements are enacted, on the one hand by the Banking Commission, on the other hand by the Quotations Committee (Noteringscomité - Comité de la Cote), an administrative body separate from the Stock Exchange Association. The Banking Commission is in charge of the disclosure requirements and the related questions of ethical conduct of listed companies, while the Quotations Committee decides upon formal admission, after having analysed the feasibility of the admission on the basis of market-technical considerations.

Foreign securities moreover are subject to the authorization of the Minister of Finance, as well on public issue as on admission to the stock exchange (35).

These listing requirements will be revised in the not too distant future as the Belgian Parliament will have to modify quite substantially the existing legislation in order to implement European Community directives.

(1) Prospectus

Under present regulations, a prospectus has to be published both on issue and on admission of the securities to the stock exchange. A full prospectus is also required on listing additional shares, e.g. issued as consequence of a capital increase. Exceptions apply to bonus shares, upon conversion of convertible bonds, admission up to three months after issue provided a full issue prospectus has been published, etc.

Prospectuses both on issue and on listing are in practice always prepared with the assistance of the bank that will also file with the Banking Commission. The content of the prospectus is based on a standard scheme, to which, on a case to case basis, additional elements are added. The prospectus must be signed by duly authorised representatives of the issuer and contain their statement of sincerity. Audited accounts for the last three years must be included in the prospectus as well as consolidated accounts. The prospectus is published and circulated as a brochure. There is no requirement to place advertisements in the newspapers. Issuers of securities are expected to submit themselves to the Banking Commission's rules of financial ethics, e.g. with respect to equal treatment of all shareholders, e.g. upon transfer of controlling shares, the interdiction of circular shareholdings, etc. These rules equally - and possibly more

forcefully-apply to small issuers.

In the future, the intervention of the Banking Commission will be more formalized. The content of the prospectus will be fixed by regulation or circular. The present practise of a "declaration of no objection" will be replaced by an "approval" by the Commission. Very important will be that the commission's surveillance powers will extend to the secondary market, i.e. to the annual report, to the compulsory semi-annual and to the other interim information published by listed issuers.

(2) Admission requirements

The admission is not subject to any specific detailed admission requirements. The Quotations Committee therefore disposes of large discretionary powers to refuse or admit new securities. In fact, on very few occasions have demands for listing not be granted.

According to the present ordinance of the Brussels Quotations Committee, issuers have to file an application either themselves or with the assistance of a bank or a broker. There are no strict minimum capital requirements, nor rules relating to the distribution of the shares. The Ordinance only provides that the shares should be freely transferable, that the certificates have to meet certain requirements as to their format, and that the issuers must provide an information file, containing its articles of incorporation and copies of the main officially published information (including annual accounts). It is reported that usually the Committee requires that the company has been operating for at least five years. Issuers are obliged to regularly inform the Committee (e.g. annual accounts, drawing lists, etc.) and to offer shareholders financial services in Brussels, mostly free of charge. Special rules apply to foreign issuers.

After the implementation of the EEC-Directives in Belgian Law, several of the rules that were within the discretionary powers of the authorities will have to be made explicit. These criteria will bind the stock exchange authorities, and an appeal will lie firstly before the Appeals Commission of the stock exchanges, or ultimately before the Council of State.

The public issue of securities and the subsequent listing create considerable costs to the issuer. According to the information published in the prospectuses, these costs can be divided into legal, fiscal and administrative expenses (about 1.6 % of the amount raised), placing commissions (about 1.5 %), and, where applicable, the underwriting fee (1 %, both for firm and guarantee underwriting, although higher rates have been charged to less well known issuers, e.g. 2 %). The Banking Commission levies an administrative charge of 0.1 % of the amount of the issue for the supervision of the prospectus (36). Other expenses and fees, such as printing, auditors, notaries, etc. are included in the legal and administrative expenses. The total cost of a public issue oscillates between 3 and 5 %, depending upon the intervention of the underwriters.

Upon admission to the Stock Exchange, an initial fee is levied of 50,000 BF; annually a fee of 5,000 or 10,000 BF is levied according to whether market capitalization does not or does exceed 50 million BF.

b) Trading

Price fixing procedures are somewhat different on the Brussels exchange in comparison to Antwerp, due to the intervention in Brussels of "specialists" (markthouder - teneur de marché). The procedures followed in Antwerp are outlined below. They more closely reflect the Stock Exchange Ordinance.

Before a certain deadline (13.30) all sale or purchase orders must be centralized. This is done by lodging the order slips in a box. Orders introduced after 13.30 (in fact after 14.00), participate in the next day's fixing. Order confrontation results in a public call, whereby a representative of the stock exchange will attempt to establish an equilibrium in the market at a price that does not diverge more than 5 % from the price of the previous day. Within this range, all brokers present can still introduce orders, but only in the direction opposite to the prevailing market trend. If the market would e.g. be "à la hausse", only sellers of the shares may still intervene at this for all the shares for which inexecuted orders are still available. The resulting price is fixed and is valid for all transactions. It is not customary to announce the status of the inexecuted orders, nor the volume of the orders executed.

If the market cannot be equilibrated within this 5 % limit, the official of the stock exchange may artificially put the market in equilibrium by reducing the number of buy or sell orders, fixing the price at the maximum 5 % difference. In this case, the published price will receive the special mention "buyers reduced" or "sellers reduced" ("kopers" or "verkopers verminderd" - "acheteurs" or "vendeurs réduits"). Where the market cannot be put into equilibrium within the 5 % limit, the official may, upon demand of a broker present, register a tentative price, being at most the preceding price plus (or minus) the maximum allowed price difference. At this price the broker is bound to deal until the next day. This provisional price will be accompanied with an appropriate mention (gewijzigde bied- of laatkoers - cours modifié papier - cours modifié argent). This mention will attract the investors' interest to the special situation of that share. Provisional prices may also be published where

the market equilibrium is fundamentally distorted.

On the Brussels Stock Exchange, buy and sell orders are centralized by "specialists", i.e. representatives of larger brokerage houses. These specialists will attempt to equilibrate the market, most of the time by adding, as principals, buy or sell orders to the orders of the public. From this equilibrium a provisional price is drawn which is then transmitted to the representative of the Stock Exchange. Where more than one specialist is active for the same share, they establish the provisional price after concertation. Specialists may also propose prices "sellers reduced - buyers reduced". Very often the price proposed by the specialist will be formally adopted as the stock exchange price. However, all brokers present are entitled to ask for an official call. This demand is transmitted to the specialist as well. The ensuing call procedure is the same as explained above for Antwerp. It is also the normal procedure for shares for which no specialist is active in Brussels.

The intervention of specialists is a specific part of the functioning of the Brussels Stock Exchange and has often been severely criticized, e.g. as falling under the statutory prohibition of floor market making (art. 99, al. 1, Stock Exchange Law). As there is no depth in these markets, it is considered essential that specialists ensure some liquidity(37).

The commission fee for execution on the spot market is composed of three elements : a handling fee of 100 BF per transaction, to which is to be added a transaction fee, based on a decreasing scale (from 10 %, on the first 2 million BF to 6 % above 10 million BF) and an "additional right", being a fee paid in favor of the Stock Exchange Commission (0.4 % charge on the broker, 0.25 % on the broker's client). In addition, a state tax of 1.4 % is levied by the broker.

2. The auctions of unlisted securities

As mentioned above, the structured part of the market in unlisted securities is on the one hand composed of the "daily auctions", on the other hand of the "monthly or weekly auctions".

a) The daily auctions

In order to curb unhealthy speculation in over the counter trading and to enhance the transparency of the market, it was decided in the early sixties to establish "daily auctions". Upon recommendation of the Banking Commission, the stock exchange commissions both in Brussels and in Antwerp decided to start trading in a few unlisted shares that had previously been actively traded among brokers (38). Very few shares have since that period joined these daily auctions.

In fact, this market can be considered to be an on-the-floor market in not-officially listed securities. The regulation permits trading to take place like trading on the spot market, and not - as will be seen hereafter - according to the rules of the auctions.

The commission rate for execution of orders on these auctions are 7.5 ‰, with an additional right of 0.65 ‰ (0.40 ‰ being paid by the broker), plus tax (3.5 ‰).

b) The monthly or weekly auctions

This segment of the market is organized and regulated by the Stock Exchange Commission. According to art. 77bis of the Brussels Stock Exchange Ordinance, the Commission organises once a month or more frequently a public auction

for unlisted securities. Under the present practice, auctions are held monthly for bonds and shares in Brussels, and weekly in Antwerp. The turnover in shares is very limited, as shown in the following table.

Monthly and weekly auctions volume
(in mio BF)

	BRUSSELS				ANTWERP
	BONDS	SHARES	FOREIGN BONDS & SHARES	TOTAL	ALL SECURIT.
1976	1,906	80.6	3.3	1,989.9	136
1977	2,178	38.6	2.3	2,566	206
1978	2,292	52.2	2.8	2,347.4	301
1979	3,132	67.9	2.9	3,203.4	331
1980	4,013	63.1	3.9	4,090.9	585
1981	6,032	139	2.9	6,173.3	980
1982	5,755	181.8	4.2	5,940.3	635

(1) Requirements for entry

There are practically no requirements for entry to the public auctions save that no officially listed securities can be auctioned (39), nor any securities the trading in which would be prohibited by law (40), nor, more exceptionally, any bonds drawable by lot (41). Although all securities can be offered, there is no right to obtain access to the

auctions. The Commission of the Stock Exchange may at any time refuse a security; the Commission does not have to state its reasons (42). These powers have been designed to avoid that fraudulent or all too dubious securities are offered on the auctions. It has been used to bar access to persons who wanted to have newly issued securities (both domestic and foreign) offered to the public by putting them on the auction and this without having to comply with the supervision requirements of the Banking Commission. The Banking Commission has intervened on some occasions, claiming its competency if the security happened to be offered too frequently, on the considerations that too frequent an offer may amount to a subreptitious public offer.

A detailed procedure exists for putting the security on the auction list (43). The Commission may request that the security be submitted for inspection. All securities are offered with a price limit, but this limit may be changed up to the day before the auction. Offers may be retracted up to the last day before the auction (44).

These offer lists are widely circulated on the stock exchange, and printed in the financial newspapers, identifying the security and the last price at which the security has been sold on the auction, plus the date of this sale (45). The names of the sellers and their price limits are, of course, not published (46).

(2) Trading

The auction is held with the assistance of the Stock Exchange Commission, but it takes no responsibility as to the trading that takes place at the auction, nor for its personnel that is in charge of it (47).

The auction is not accessible to the public at large : only brokers may offer securities or place a bid. The auction procedure is based on a call, with increasing prices. All offers at the same price limit are put together; the orders with the lowest price will be first executed, and so on upwards, till no further bids are made. All offers at prices higher than the last highest bid are considered lapsed. If the number of securities offered at a certain price is not fully taken up, there is a proportional spreading of the bid over all the offers at that price (48).

Under both the Brussels and the Antwerp Ordinances the Stock Exchange Commission is entitled to annul all transactions that have been effected on the auctions within 15 days or 1 month (49). Although the Commission does not have to state its reason, this power can be put into force in cases of fraudulent trading or of bribery.

After the auction, transactions are settled spot, i.e. that the documents of title have to be delivered 10 days after the auction date (50).

Fees and expenses for trading on the monthly or weekly auctions are : 4 % as transaction fee, with 2 BF minimum per offer as handling fee; for unexecuted offers a 0.25 % charge with a maximum of 25 BF per offer is calculated. All these fees, and the taxes, are due from the seller.

III. REFORM PROPOSALS

Under the present government, discussions about facilitating access of small companies to the public capital markets are part of a larger scheme to reinforce the capital basis of private enterprises, whether by tax measures (e.g. the above mentioned Monory-type law, tax advantages for investments) or more rarely by institutional changes. Several tendencies can be distinguished : it is considered by some people that the

reform of the trading mechanism is central, in order to facilitate the sale of shares by existing shareholders, thus enabling them to put in new funds in their companies; others prefer tax advantages, more especially to high technology companies and venture capital. These tax advantages could consist of increased deductible allowances for high risk investment or for research; the reduction of the capital gains tax on these shares; the formation of new investment companies through which the public could participate in new ventures without losing the tax advantages of direct investment in high risk ventures.

Focussing on reform of the securities markets, there have been discussions on a high level, consisting of the reform of the "daily auctions" mentioned above. These auctions would also include securities that are presently relatively actively traded on the "monthly auctions" or in the telephone market. Very little would have to be changed in the present trading procedures, as they refer to the rules of the spot market. One important change would be that these auctions would not be held daily, but with certain intervals, e.g. weekly or fortnightly, according to the interest shown by the public. It could be envisaged to hold auctions with a great variety of frequencies : daily, weekly, monthly, etc., allowing the inclusion of even less actively traded securities. Furthermore, these auctions could also be used as the market for trading these many shares that are listed today, but in which trading is extremely thin.

The enlargement of the present daily auctions gives, however, rise to certain hesitation especially from the Banking Commission's side. The Commission insists upon the fact that the "inscription" of securities on these auctions leads to the same disclosure obligations as upon full listing on the official market, including the publication of a prospectus. However, this prospectus does not have to conform to the higher disclosure standards that will be

applicable to companies with a full listing. The form, even the content and its detail could be adapted to the needs of and to the questions involved in smaller companies. The obligation to organize a financial service, often free of charge to the investor, could be dropped.

Another difficulty relates to the accounting and auditing requirements. Although present requirements are fairly high, their implementation by the smaller companies is due to be strengthened. Another deterrent to small enterprises is the obligation to respect the codes of ethics, applicable to listed companies and relating to transfers of controlling blocks and the ensuing responsibility towards the minority shareholders, the obligation to keep to a stable dividend policy, the recommendations with respect to insider dealing etc. With entrepreneurs used to decide independently, the obedience to these rules is expected to be rather loose.

As most private companies are family dominated, the sale of a substantial block of shares on the market may endanger their hold on the enterprise. Belgian company law knows no adequate techniques for stabilizing control. The planned introduction of non-voting shares may first be necessary.

As to market equilibrium, it is felt by some that price formation cannot entirely be left to the market forces, and that therefore the intervention of a "specialist" will be necessary. As under present prevailing practice, this specialist would have an understanding with the controlling shareholders or with an investment fund, whereby market stabilization would be organized.

Less frequently mentioned issues relate to the minimum admission requirements (some plead for a case by case approach), the status of the shares struck off from the official market, the minimum amount of shares to be

distributed and the distribution techniques, etc. Finally, this reform can be realized without any change in the law, although some points will have to be dealt with in a "code of conduct" (e.g. disclosure).

Finally, assurances have been given as to the existence of a genuine demand for this kind of market, both from traditionally family owned enterprises and from new technological industries. Here a certain element of international competition can be felt: some of the candidates have shown their interest for similar markets in the neighbouring countries.

IV. SUMMARY

Under present conditions, small business disposes of a variety of organizational forms, one of which enables them to obtain access to the public securities markets. Very few enterprises have used the possibility of a public issue of shares : fear of outside interference, coupled with the absence of non-voting shares, and regulatory impediments may explain this phenomenon. Moreover, very few financiers have been interested in acquiring shares in small enterprises. Public institutions, designed to that purpose, have but limited means, but had to contribute these to reorganizations. The existing financial intermediaries (banks, brokers) have not shown active interest in the distribution of shares of unlisted enterprises. Their legal and de facto monopoly prevents competitors to take up this function.

The stock exchanges trade a substantial number of shares of smaller enterprises. It is generally recognized that trading on the official market is inappropriate, as turnover is too low. A few of these are traded on the "daily auctions", an on-the-floor market for unlisted securities.

All unlisted securities may be offered on the monthly or weekly auctions, and a few shares are regularly offered for sale there. Finally, there also exists a telephone market, but this is very irregular as far as unlisted shares are concerned.

In order to facilitate trading in the shares of smaller companies, negotiations are under way whereby the "daily auctions" would become the trading market for their shares. It is expected that this facility will start early in 1984. A few important questions are still open for debate, especially with respect to the trading frequency (one or two times a week ?) and the disclosure regime (listing prospectus, continuing disclosure).

Finally, it cannot be said, from previous experiences, that there is a lack of interest of the investors for unlisted shares. But many obstacles, organizational as well as legal, regulatory or fiscal will have to be removed before the public will be willing to directly contribute to the financing of small businesses.

FOOTNOTES

- 1) Art. 119, § 1, Companies Act; the abolition of this restriction was announced by the Government in July 1983.
- 2) But the company itself would not be affected; see i.a. Fredericq, *Traité droit commercial Belge*, v. 5, nr. 621, p. 881; as to transfers will have no legal effect, as long as the approval has other shareholders, it is a generally accepted opinion that these transfer will have no legal effect, as long as the approval has been granted, art. 126 of the Companies Act (calling the transaction "void") notwithstanding.
- 3) Even mere invitations to enter negotiations to participate in a p.v.b.a. would come under the investor protection rules administered by the Banking Commission.
- 4) Parliam. Documents, House of Representatives, nr. 552 (1982-1983), nr. 1.
- 5) According to Royal Decree nr. 185 of 9th. July 1935, art. 26 e.s., the public offer of securities, whether existing or to be created, is subject to notification to the Banking Commission. The Commission will scrutinize the information to be disclosed to the subscribers, and, if it finds it misleading, will veto the issue. This control procedure is generally considered quite burdensome, especially for small enterprises or for newcomers on the market.
- 6) Art. 95 of the Income Tax Code; therefore, personal income of the partners and company results will be added into one tax return.
- 7) There is no general rule obliging young companies to have an adequate start capital. If the company goes bankrupt within three years of its creation and it appears that the capital provided was manifestly inadequate in relation to the projected activity, the founders may be held liable for all or part of the liabilities of the bankrupt company (art. 35,6°, Company Law).
- 8) It is a rule of public policy that voting rights of shares that represent the capital are proportional to their share in the capital : art. 74, § 2, Companies Act.
- 9) Of the 69 small companies listed on the Brussels Stock Exchange at the end of 1981, only 9 had more than one class of shares. In 7 cases, the different categories of shares were listed.
- 10) Art. 71, Companies Act. In practice, the Banking Commission very often insists on the "unification" of the shares into one category.
- 11) Art. 101 bis to octies of the Companies Act. Statistical data as to the amounts of these securities issued can be found in Table II.

- 12) Parliam. Documents, House of Representatives, nr. 387 (1979-1980), nr. 1, art. 71.
- 13) See Royal Decree nr. 20 of 23 March 1982 (official Gazette, 25th. March 1982); for a comment, see Schrans, G., De invoering van "non-voting shares" in de textielsector - een regeling van economisch privaatrecht, in Liber Amicorum Dumon, Antwerp, 1983, p. 245-257.
- 14) Royal Decree nr. 15 of 9th. March 1982, Official Gazette, 12th. March 1982, Err., 27th. April 1982; see also notices of the Finance Ministry, Official Gazette, 27th. April 1982 and 27th. May 1982, and Royal Decree nr. 150 of 30th. December 1982, Official Gazette, January 1983.
- 15) See art. 2, § 1, Law 24th. April 1962, relating to the National and to the Regional State owned investment companies. Several specialized subsidiaries of the National Investment Company have been created for the reorganisation of ailing industrial sectors, such as steel, coal mining, textile, shipbuilding. The subsidiaries were amalgamated into one "National Corporation for the Restructuration of the National Industrial Sectors" which has remained of the Central Government's competency. See also art. 75, L. 5th. August 1978.
- 16) See art. 14, Royal Decree, nr. 185 of 9th. July 1935; an exemption could be introduced by Royal Decree, but this power has not yet been implemented.
- 17) Three out of the four major Belgian financial holding companies have created specialised subsidiaries for the financing and advisory assistance of small enterprises. In only one of the groups (i.e. the former Parisbas Group) has this activity been openly declared as a substantial objective of the group or of its subholding companies. Similar instruments were organized by other private groups, or in collaboration with the public sector.
- 18) See p. 277
- 19) Art. 17, § 1, 4, Royal Decree of 12th. March 1976; no distinction is made whether these securities are listed or not.
- 20) Controledienst van de verzekeringen, Annual Report.
- 21) Art. 75, § 3, 2°, Stock Exchange Law (Code of Commerce, Book I, Title V).
- 22) Art. 75, Stock Exchange Law.
- 23) It is not clear whether this activity is compatible with the Belgian Stock Exchange Law.
- 24) Data based on Commission de la Bourse de Bruxelles, Indices et Statistiques, Monthly, Dec. 1982. There are no separate figures available as to the turnover on the other stock exchanges.

- 25) Each of the four stock exchanges has a separate ordinance, approved and enacted by Royal Decree in 1935, and modified several times since. The Brussels Ordinance was approved by Royal Decree of 1st February 1935. For the full updated text, see e.g. W. Van Gerven, Wetboek Economisch-Financieel Recht.
- 26) Introduced as art. 104 bis, in the Stock Exchange Law, by art. 12 of Royal Decree nr. 61 of 10 November 1967. It has not yet been applied.
- 27) This additional share counts among the most important local shares in Antwerp.
- 28) See § 2, al. 3 of art. 22 of the L. 10th. June 1964, assimilating, the "inscription" on the daily auctions to the full listing on the stock exchange, therefore making the supervision of the Banking Commission applicable.
- 29) See art. 77 bis e.g. Brussels Stock Exchange Ordinance; also traded on the market are real estate investment certificates.
- 30) In cases in which the issuer or its agents had given assurances to the subscriber as to the issuer's willingness to repurchase its bonds before maturity, the Banking Commission has severely criticized this practice. In practice, however, it appears that major banks continue to repurchase, what offers part of the explanation for the decline in bond turnover on the monthly auctions.
- 31) A few Brussels brokerage houses publish price lists, mentioning on a purely informative basis, the price at which the share was last traded, even if this is several years old.
- 32) See art. 100 bis and 103, Stock Exchange Law; it is not very clear what was meant by this market, except that it was meant to be a parallel market, organized between banks, where listed securities could be dealt in. According to the same article, this market could be organized by the Stock Exchange Ordinance : it is quite clear that the Stock Exchange Commission has never used its power in this field.
- 33) Council Directive of 5 March 1979 coordinating the conditions for the admission to the official stock exchange listing, Schedule A, I,2, Official Journal, 1979, nr. L.66/26.
- 34) No figures have officially been published. Senator Cooreman, "father of the tax exemption" of the R.D. nr. 15, made a private count for the nine months of 1982 during which these measures were applicable : 1,117 new n.v.'s and 4,638 new p.v.b.a.'s were founded, with a capital of 12 mrd BF. Capital increases amounted to 55 mrd. and 1 mrd. BF. respectively. Of these, 17 were stock exchange listed companies (increase of 23 mrd.). For the period Jan-Aug. 1983, 21 listed companies issued shares for 20 mrd. BF, with 26 mrd. expected for the last four months (see B.B.L. - berichten, n° 18, 1983).
- 35) Art. 108 Stock Exchange Law

- 36) Art. 1, Royal Decree, 17th. May 1979.
- 37) See the Report of the "Commission to study appropriate measures for a better protection of investors", dated 5 June 1931, published in Parliam. Documents, Sénat 1930-31, nr. 211, p. 50-54 e.s., see also : F.H. Teirlinck, L'organisation des marchés financiers, Office de Publicité, Brussels, 1948, p. 68 e.s.
- 38) Pursuant to art. 77 bis of the Brussels and 109 of the Antwerp Ordinance.
- 39) Art. 80 bis, Brussels Ordinance; however the Stock Exchange Commission can grant an exemption for securities the listing of which has been suspended.
- 40) Art. 98, al. 1, Antwerp Ordinance; this probably refers to securities the trading of which has been forbidden, e.g. by decision of the Minister of Finance (art. 108, Stock Exchange Law, comp. art. 32 R.D. nr. 185 of 9 July 1935) or under art. 47 Companies Act.
- 41) Art. 80 bis of the Brussels Ordinance ("premie-effecten" - lots à primes). This prohibition probably refers to the restrictions on the public sale of bonds drawable by lot, imposed by R.D. nr. 41 of 15th. December 1934.
- 42) Art. 80 bis, al. 3, Brussels Ordinance. The terms of art. 100 of the Antwerp Ordinance are somewhat more restrictive.
- 43) Art. 83 bis of the Brussels Ordinance confers the Commission the power to organize this procedure.
- 44) Art. 81 bis of the Brussels Ordinance. No comparable rule in Antwerp.
- 45) Additional mentions relate to : Non-fully paid shares (mention of the sum remaining due; sale prices do not include this sum); express mention of possibly irregular documents of title; coupons must be attached; for bonds, prices include interest, and this contrary to the prevailing rule.
- 46) Art. 105 Antwerp Ordinance.
- 47) Art. 78 bis Brussels Ordinance; art. 101 Antwerp Ordinance.
- 48) Art. 84 bis, Brussels Ordinance; art. 102, al. 1, Antwerp Ordinance that even further refines the rule by introducing time priority for the fraction of the share, after having proportionately allocated the bids to the partially unexecuted offers.
- 49) Art. 84 bis, al. 4, Brussels Ordinance; art. 103 Antwerp Ordinance.

50) Art. 87 bis, Brussels Ordinance; art. 104 Antwerp Ordinance.
In case of late or not forthcoming delivery, a special procedure is provided for, whereby the Commission invites other brokers or the public to tender similar securities; all expenses are, of course, borne by the defaulting seller (art. 87 bis, Brussels Ordinance). The Ordinance also provides for the case that the shares offered cannot be transferred except with the consent of the issuer : the offeror is then bound to find another buyer that is agreeable to the company (art. 88 bis, Brussels Ordinance). The Antwerp Ordinance mentions a rule comparable to a "call of more" condition : where an offer has only partially be executed, the bidder has the right, after the auction, to take up all the remaining securities offered at the last price. Therefore the offeror remains bound.

H. THE SEGMENTS OF THE SECONDARY MARKET FOR EQUITY
INSTRUMENTS OF SMALL COMPANIES IN FRANCE

I. ENVIRONMENT AND SURVEY

1. Number and forms of business organizations

In France, the entrepreneur has a wide range of business forms at his disposal. Apart from sole proprietorship, most of the firms are companies, whether commercial or civil. Since the beginning of the century and accelerating since the 1960's, several new forms of companies have been introduced. Only those that are allowed to issue shares publicly will be dealt with here in some detail.

The most important company types are the société anonyme (s.a.) and the société à responsabilité limitée (s.a.r.l.). The s.a.r.l. is not entitled to issue securities publicly (1), the number of its shareholders being moreover limited to 50 (2). The s.a. is therefore the usual form for the public issue of shares, along with the more rarely used "société en commandite par actions". The minimum capital for the foundation of a s.a. is FF 250,000, however, if shares will be publicly issued, the capital must be FF 1,500,000 at least. Although restrictions on the transfer of s.a. shares may be introduced, it is considered to be a matter of policy that these should not tie up a shareholder. Negotiability is therefore considered an essential characteristic of s.a. shares and should be maintained, even among shareholders (3).

As of the middle of 1981, the number of enterprises in existence were (4):

- sole proprietorship	1,953,067
- partnership	17,713
- limited liability partnership	3,760
- profit-sharing ventures	3,961
- s.a.r.l.	340,811
- s.a.	261,473
- unorganized partnerships	49,931
- cooperative societies	33,907
- groupement d'intérêt économique	9,475
- "civil" companies	104,542
T o t a l :	<u>2,778,640</u>

Civil companies, being partnerships and companies that are not framed as commercial companies and have an exclusively civil purpose (such as liberal professions, enterprises in the real estate construction business), are not entitled to issue securities to the public (5). An express derogation was introduced for the real estate promotional enterprises (sociétés civiles autorisées à faire publiquement appel à l'épargne), the purpose of which must be expressly limited to the acquisition and the management of rented real estate (6). Their minimum capital was fixed at FF 1 million, and detailed rules designed for the protection of the public investors were introduced; the supervision of the Commission des opérations de bourse was declared explicitly applicable (7).

Also entitled to issue shares publicly are the Sociétés d'investissement à capital variable, or SICAV (8), in fact open-end investment companies, organised as sociétés anonymes with a variable capital and exclusively engaging in investments in securities. The same finan-

cial function can be exercised by "investment funds" (fonds communs de placement) organised as an undivided securities portfolio, the rights in which are represented by a transferable document of title (9).

By law of 3rd January 1983 (10) the rules relating to the protection of investors were rendered applicable to the public offer of "investment contracts". These investment formulae were defined as contracts whereby rights relating to real estate or chattels are offered to the investors, without the investors assuming the management or the administration of the goods. In practice, the contracts relate to participations in forests, in transport containers, in cattle herds, etc. The issuer itself cannot be considered to be a separate corporate body. This new law has already been applied on several occasions.

Shares in SICAVES, certificates of "investment funds" and the aforementioned investment formulae are not eligible for stock exchange trading.

2. Frequently used instruments for equity financing

French company law has restricted the types of securities that companies may issue publicly. The most frequently used equity security is the share, representing part of the capital of the company and issued against a consideration in kind or in cash. Shares have voting rights, that are proportional to their capital contribution (11). However, the articles of incorporation may provide that a holder of registered shares that have been inscribed in his name for the last two years will be entitled to a double vote per share, it being further allowed to restrict this double vote to Frenchmen and to EEC-resi-

dents (12). Shares of French companies must have a nominal value, fixed at FF 100 per share, which may be reduced to FF 10 for listed shares or shares issued to employees of the company (13).

Other types of shares may be issued (14). The law of 1966 forbids, however, the further issue of founders' shares (15). These had been used mainly to remunerate contributions that were difficult to evaluate or of doubtful value. They had no voting rights but received part of the profits of the company. Abuses were frequent. Companies may validly issue shares with certain preferential rights attached, e.g. dividend preferences, but these shares afford full voting rights.

Since the late seventies, the Government introduced several measures to strengthen the capital base of the enterprises, especially by granting tax reliefs. To that purpose, new types of equity or equity related instruments were introduced.

"Preferential non-voting shares" ("actions à dividende prioritaire sans droit de vote") were permitted by the Monory law in 1978 (16). Companies that have realized profits (17) for at least two of the three last years are entitled to issue these shares, up to one fourth of the amount of their capital. Voting rights are granted on occasions where the rights of the holders of these shares are endangered (18).

Partly paid shares are of limited importance in France, as all shares have to be fully paid up within 5 years of their issue (19).

Shares in French s.a. type companies are issued in bearer or in registered form. Under the Budget Law 1982 (loi des finances, 1982) all companies will have to convert their bearer shares into registered shares (20). Unwilling shareholders will see their rights sold on the stock exchange and the proceeds of the sale kept at their disposal (21). Transfers will be registered, whether in the company's books or by a registrar recognized by the Minister of Finance. Sicovam, the central transfer and clearing agency may accept to act as transfer agent for the registered shares of non-listed securities. The shares issued by companies listed on the stock exchange or on the second market have to be deposited with one of the recognized registrars, transfers being cleared by bookkeeping entry through Sicovam (22). Bearer certificates will therefore disappear from the actual circulation among investors, except with respect to bonds drawable by lot and issued before the reform became applicable. French shares will further circulate abroad in bearer form, the bearer certificates being issued by Sicovam (23). This fundamental reform was implemented in order to enforce the property tax (impôt sur les grandes fortunes).

Companies limited by shares may also issue bonds, either convertible into shares, or more recently, bonds with warrants attached (24).

Also recently introduced were "investment certificates" (certificats d'investissement) (25). These certificates may be issued by any company, whether limited by shares or other, and therefore are designed to the financing purposes of small businesses. Investment certificates are composed of two bundles of rights. The "financial rights certificate" (certificat d'investissement représentatif des droits pécuniaires) is a negotiable document of title conferring to its holder the financial rights

inherent in a share in the capital (dividend right, liquidation distributions, preferential subscription right, and similar rights). Corresponding to each "financial rights certificate", there will also be issued a "voting rights share" being a registered interest in the company. It will be non-negotiable except upon death, by way of a gift, or accompanied with the "financial rights certificate". Both elements form the share: therefore the certificates can be created either upon a new issue of shares, or by way of "fragmentation", i.e. a split of existing shares. Only 25 % of the shares issued can be split this way.

Innovative is also the introduction of "profit sharing certificates" ("titres participatifs"). These certificates are issued by s.a. of the public sector and cooperative societies and mainly serve the financing of the nationalized industries (26). The certificates entitle to an interest, part of which is fixed, the other part being based on the company's increase in turnover (27). These certificates have a right to a part of the proceeds of the liquidation of the company and are redeemable by the company itself.

3. Investors and investment motives

Although still the most important group of holders of shares, the role of individual investors tends to diminish. According to a survey, established as of the end of 1979, about 36 to 38 % of French listed shares were held by private individuals. This quota tends to decrease while the part of the institutional investors has substantially increased.

The Government took several measures to increase the interest of the small investors for shares. The Monory law of 13th July 1978 allows the individual investor to deduct from his taxable income the sums spent for the acquisition of newly issued shares or of SICAV parts (28). This measure led to a substantial increase, not in direct shareholdings (from 1 to 1.15 million) but especially in SICAV holders (from 0.5 to 0.95 million) (29). In later years this measure was further refined, especially by the introduction of the CEA (compte d'epargne en actions). Under the CEA-rules, individuals may deduct part of the invested sums from their taxes provided they enter into a five years savings plan, imposing annual investment up to a certain sum (30).

French investors are reported to be rather hesitant to invest in shares. For the last 7 to 8 years, shares stood for only one fifth of the securities issued, 80 % being bonds. Of these shares, public issues represented only 4 to 7 %; the remaining 13 to 16 % were issued by closely held business. Shares of unlisted companies stood for only 0.2 to 0.4 % of share issues (31).

Institutional investors seem to take over the place of the private individual. For the year 1981 it was estimated that private households subscribed through SICAVES more than twice the amount of shares issued on the public markets. One observator calculated that out of the FF 24 mrd of issues of new shares by companies limited by shares, only FF 3.2 mrd went to listed companies. More striking is the fact that the French entrepreneurs were not able to take out more than FF 1 mrd from new shareholders (others than their traditional financiers such as controlling shareholders, institutional investors). Out of

this FF 1 mrd, about half came from specialised development agencies to be mentioned below (32).

These financing difficulties may be due to several factors. The traditional financial institutions, such as banks, insurance companies and even investment companies (33), have shown little interest for taking up shares in smaller enterprises. Regulatory limitations do not seem to have played an important role. The fact that the now mostly nationalized deposit banks are allowed to invest 20 % of their capital in non-bank enterprises does not explain their absence from this segment of the capital market (34). The same observation applies to the insurance companies, who may invest in up to 5 % of the shares of quoted non-insurance businesses. Here a factor of skill and of staffing to select and follow these ventures is mentioned (35).

It is striking, however, that though these financial institutions do not usually take shares themselves in businesses that do not belong to their sector, they have actively contributed to the financing of some of the specialised agencies or companies that are effectively aiding small businesses in their capital building. Some of the nationalized banks have set up, sometimes with others, specialised subsidiaries for the participation in other companies, which do not aim at controlling management (36). Their activity is more comparable to that of the "investment banks", very few of which are still in existence (37). Others have been set up or organized by special laws, while another category mainly stems from initiatives of local authorities.

A first type of the institutions are the "regional development companies", introduced in 1955, 15 of which are

operating (38). These companies have been formed to contribute to the capital of small businesses, to prepare them for take-off and lead them eventually to a listing on one of the regional stock exchanges. They are owned in part by the banks, whether national or regional, and by public or private enterprises. Financing of these companies has often been obtained by public share or bond issues, while some have gathered their resources on the euro-markets. Convertible bonds, subordinated profit-linked loans ("prêts participatifs") and long term credit could also be used to finance their activities. With respect to their share-taking, this has been restricted to 25 % of the capital of the small enterprise. Their stake should always be considered temporary. Only 25 % of their assets can be devoted to investment in shares (39).

Apart from one or two exceptions, their success has not been overwhelming. According to one analyst, this seems due to the very low return on their share investments, the need to maintain a financial equilibrium and their strictly limited regional role (40).

Direct government involvement in small business financing can also be established in the case of the specialized development agencies, especially the Institut de développement industriel (41).

The Industrial Development Institute or I.D.I. is a société anonyme, founded in 1970 by the government, and the principal nationalized and private financial institutions (42). It acts in the public interest. Its task includes the capital assistance to medium sized and larger companies, essentially those with considerable growth potential or with substantial export perspectives (43).

The present activities of the Institute can be divided into three lines. The first is direct financial assistance, where the Institute usually acquired minority shareholdings; assistance often takes the form of convertible bond subscriptions or loans that are subordinated and profit linked (44). The second line of its business relates to its participation in so-called "regional participation enterprises" (45), and other specialised development institutes (46), which are more directly involved in the capital financing of smaller and regionally important businesses (47). A third line of its business concerns its advisory activities, especially through subsidiaries one of which acts both as issuing house and as advisor of management and for family shareholding reorganization questions (48).

These findings seem to indicate that, except through the traditional, established circuits, capital financing needs to be improved. More and more attention was paid to the financing needs of small business as the conscience of their leading role in job creation and product renovation grew. The Government commissioned in September 1981 a report that was delivered in May 1982 under the title "The development of investments and the protection of savings" (so-called "Rapport Dautresme") (49). Several of its conclusions fall directly within the scope of the present study.

According to this report, it was felt that the transformation gap between savings and risk capital for small businesses should, in a first stage at least, be bridged by the financial institutions, especially by the banks, as the normal meeting places for offer and demand of capital. The exceptional risks of starting new enter-

prises should more appropriately be borne by institutional investors, small business agencies, even by wealthy individuals rather than by the public at large. The role of the entrepreneur, especially his freedom of decision, could be preserved by attracting money as "subordinated profit - linked loans" or by using minority shareholdings or contractual techniques.

In another section of the report, attention was paid to the liquidity of these shareholdings. In the stage before the company reaches the public markets, investors should take shares only in investment funds. Liquidity would be achieved by imposing the obligation to maintain a certain percentage of readily negotiable listed securities. A reform of the market in unlisted securities was recommended and has been implemented in 1983.

Furthermore one can point to several other specialized development companies, the organization of which is due to private and public initiative. From an analysis of the portfolios of these companies it appears that they hold minority shareholdings (10 to 35 %), exceptionally also majority shareholdings, in French companies only. Where foreign affiliates are involved, shares are held by French parents (50).

These specialized companies tend to be jointly financed by a wide range of banks, financial institutions, institutional investors, and private individuals (51). Sometimes even foreign interests are involved (52). All these shareholders take up only small, non controlling percentages of the development company's capital, illustrating their function as subsidiaries of the French financial sector for high risk ventures, a function that could not be exercised by the participating enterprises.

In all the analysed cases, the large investing public has not been involved in the capital financing of small businesses. Although several of the institutions have been acting with a view to bringing their shareholdings to the financial markets, in only one case has the market offered an exit. This case involved the Zodiac company, listed in 1982 on the "second market" after the Industrial Development Institute has proceeded to a thorough financial and management reorganization after the company had got into financial difficulties. It is reported that another case may be forthcoming, proposed by the Industrial Development Institute (53).

Among the measures already taken to implement these recommendations, one should mention the "Risk Investment Funds" ("fonds de placement à risque") (54), several of which have already been created. These funds are modelled on the same basis of undivided ownership as applied to the funds with risk spreading. The main difference relates to the obligation to invest for at least 40 % in shares or bonds of unlisted companies, whereby the limitation imposed on the other funds are declared inapplicable (55). Severe restrictions on the redemption facility are introduced (56). Finally, the shares of risk investment funds must not be publicly offered.

4. Issuing houses for shares of small companies

There is no evidence that there is a lack of interest for new shares in France. Especially after the nationalization measures, the number of available shares was severely reduced ; the tax measures, such as the Monory law, incited many tax payers to invest in shares. There is evidence that the interest of investors for the shares firstly offered on the "second marché" was so intense that prices rose very

steeply during the introduction period (57) (see infra).

From the following table, it appears that share issues represent only one fifth of the total amount of securities issues, whether by public issue or by private placement. Public share issues stood for a very small percentage throughout the period ; even more limited were the issues of s.a.r.l. shares.

The issue of securities in France (in milliard FF)

<u>I. Shares</u>	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
1. Public issues registered with the Cob	4.7	3.2	3.5	3.1	3.5
a. Listed companies	4.4	3.0	3.2	2.7	3.1
b. Non-listed comp.	0.3	0.2	0.3	0.4	0.4
2. Private issues	11.3	13.4	20.7	21.7	24.1°
Total 1 + 2	15.8	16.6	24.2	24.8	27.6°
 <u>II. Bonds</u>					
1. Convertibles	0.7	0.8	1.4	0.1	0.6
2. Straight (Government)	57.1	64.7	110.3	106.8	153.8
 <u>III. Total</u> (I + II)	73.6	82.1	135.9	131.7	182.0°

° estimates.

Source : Commission des opérations de bourse, rapport annuel 1982, p. 104 ; not included are s.a.r.l. shares which represented for each of these years : 1.3 ; 4.4 ; 1.8 ; 2 ; not available.

Securities are brought to the market by banks or brokers. Though brokers enjoy a monopoly for the trading of securities on the secondary markets, banks may also intervene to place securities on issue. In the vast majority of cases, new shares are issued and simultaneously listed on the stock exchange:

Under French law, brokers, although merchants, are civil servants and therefore are appointed by the Minister of Finance (58). Their number is severely restricted (end of 1982 : 99 brokers in 61 firms) and new brokers are appointed only when a member has left the profession. Moreover, access is made onerous, as the newcomer has to take over his predecessor's share in the Corporation of the brokers, including his share in the guaranty fund. In order to finance their participation, brokers are entitled to organize their firm as a partnership, either with other brokers or with other partners the liability of which will be restricted. The firm can also be organized as a s.a. (59).

Brokers form part of the Corporation of the brokers, the Compagnie des Agents de change, headed by the Chambre syndicale. Among members, there exists unlimited joint liability for stock exchange debts. The Corporation therefore exercises close scrutiny upon its members' activities and risks. Brokers, as a matter of rule, may only act as agents.

The French authorities, i.e. the Chambre syndicale and the Commission des opérations de bourse, have deployed considerable efforts, especially these last years, to bring new securities to the stock exchange. These efforts are doubled now that the "second market" greatly facilitates access to the public securities markets. In the past, these efforts have been based on moral suasion toward unlisted companies. In no case has use been made of the statutory powers to list a security by force (60). It is expected that these efforts will lead to a substantial increase of the number of medium sized companies with shares traded on the "second marché" (61).

Banks and other financial institutions have mainly been involved in the issue of shares of established previously listed companies. It seems as if they have not undertaken systematic efforts to bring new shares to the markets. Regional development companies in a few cases have offered new shares (62).

The above-mentioned specialized or regional investment companies state among their objectives the monitoring of small or medium sized companies in order to bring them to the securities market. At least one share has reached the second marché in close cooperation with the Industrial Development Institute. This Institute therefore created in 1980 a specialized subsidiary, the Compagnie de développement industriel et financier, with the stated purpose to prepare small or medium sized enterprises for a stock exchange listing in liaison with the broker or bank (63).

5. Survey of the secondary market

According to French law (64) all transfers of securities are subject to the intervention of the "agent de change". This rule is referred to as the "privilège de l'agent de change" and applies both to listed and unlisted shares. Certain types of transactions are exempted (gifts ; occasional transfers among individuals), but these do not significantly modify the compulsory intervention of the broker.

With respect to French shares, all orders have to be brought to one of the seven French stock exchanges. Listed shares must be included in the price formation system described below, unlisted shares are also offered on the

stock exchange but after the initial offer trading tends to lack regularity. The market is therefore divided into two segments : the market for listed shares, further to be divided into the principal market ("la cote officielle") and into the second market ("second marché"), and the market for unlisted shares ("hors cote") where any other share can be offered. This market structure is found on each of the seven French stock exchanges.

At the end of 1982, 793 (888 in 1981) French companies had their shares listed on French stock exchanges, 588 of which were listed in Paris and 205 on the regional exchanges. The "second marché" had not yet started. This number has been steadily decreasing over the last ten years, i.a. as a consequence of the periodical review of the list, undertaken by the Commission des opérations de bourse. Shares in which only a very thin market subsisted were stricken off and negotiations transferred to the hors cote. Moreover in 1981, several major shares were delisted as a consequence of the nationalization measures. In the same period, only 79 shares were listed, and the trend of net additions to the list seems to be weakening (65).

On the six regional exchanges, 205 shares were traded, issued by 177 French companies. The number of the shares traded on an individual exchange varies between 12 (Nantes) and 41 (Nancy). Here as well, a decrease of the number of shares or issuers can be found, although in 1977 the authorities launched special measures to give more life to the regional exchanges.

Turnover on the official market section of the 7 stock exchanges amounted to FF 46 mrd in 1982, FF 28 mrd of which was realized on the forward and FF 18 mrd on the

spot market. On the regional exchanges, FF 1 mrd was traded in mostly French shares.

Market capitalization amounted to FF 199.4 mrd for Paris and FF 7.5 mrd for the regional exchanges, down 12 % from the 1981 figures (66).

Trading in shares is strictly centralized by the French legislation. All orders have to be brought to the market and, in principle at least, included in the order confrontation mechanism. There is no dual trading with the regional exchanges, and since October 1983 the shares are traded either on the spot or on the forward market, so that the slightly different price for spot deals in securities also traded forward disappeared. On the forward market, one only finds shares of more actively traded issues and a few bonds. The decision to trade on this market is taken by the Chambre syndicale : 166 out of 793 French shares were traded forward as of the end of 1982. Settlement generally takes place at the end of the month. The trading procedure is based on a voicy confrontation of offer and demand whereby the representative of the Chambre syndicale moves the proposed price up and down and so finds out the equilibrium in an almost auditive way.

The "second marché" was started in February 1983 both in Paris and on the regional exchanges. This market segment was organized to attract shares of smaller companies in which sufficient turn-over could be expected. Conditions for listing are considerably lower than for the official market, as will be shown in detail below. For the period February 1st - August 31st 1983, 29 shares of French companies were listed on this market segment. Of these,

19 (including 3 foreign) shares were transferred from the "compartiment spécial", the second market's predecessor, while 5 had previously been actively traded on the hors cote market and 1 was omitted from the list. The remaining 6 are real newcomers. The market capitalization at the end of the period amounted to FF 3 mrd, to which individual companies contribute from a minimum of 22 million to a maximum of FF 1.2 mrd.

The "hors cote" section serves as an execution device for all other shares. Here any share may be exposed to the interest of the public without any condition to be met. Access is therefore automatic. Some of these shares are offered more regularly, while others appear once in a while. With respect to the more active part, the Commission des opérations de bourse introduced the "compartiment spécial" in 1977. This was aimed at preparing the shares for a listing on the official market. Access to the "compartiment" implied the submission by the issuer to rules on disclosure and on conduct that could bring the company to the level of a listed company within a three year period. This approach proved not to be very successful and was abandoned and replaced by the "second market".

As the "hors cote" is freely accessible, there is no definite number of shares that are traded here. As of the end of 1982, the Paris official price list mentioned in its annex 374 French shares and 88 foreign shares. Only 11 bonds were traded here. Turnover amounted to FF 1.5 mrd for Paris and FF 176 mio for the regional exchanges, corresponding to 3.5 % of the turnover on the total official market.

There exist no other organized markets except the above mentioned.

II. EXCHANGE SEGMENTS

1. The traditional official market segment for small company shares

Small company shares are traded on the spot segment of the official market, the forward section being reserved to the larger companies. On the Paris Stock Exchange, shares of 19 companies with a capital of less than FF 7.5 million were traded as of the end of 1982 (67). Several of these companies had a capital of FF 1 to 2 million, the smallest one being the Tour Eiffel Company, with FF 918,000. A similar situation is found on the regional exchanges (68).

Listing of a small company on the official market is subject to the same conditions and procedures as those applicable to shares of large companies. Trading conditions are somewhat different as only the spot market is open to the trading of these shares.

a) Listing of shares

Several techniques are followed to bring the shares of new issuers to the stock market. In several cases, listing is a mere transfer from the "hors cote" segment, the shares having achieved a sufficient degree of distribution. In several other cases, the listing was preceded or accompanied by a distribution of the shares among the public at large. Therefore the shares were

sold through the regular trading mechanism or by public offering directly to the investors. Finally one can also mention cases where the shares proceeded from the reorganization of already listed companies or had previously been distributed to the issuers' personnel.

Obtaining a listing on the stock exchange for French shares is a quite elaborate process. The assistance of an experienced bank is necessary, although not obligatory. A broker also will have to be appointed. Entry to the market requires two proceedings. Application for listing must be filed with the Commission des opérations de bourse (Cob). The Cob will not grant the listing unless "the company has given evidence of a healthy financial situation, of its genuine profit making capacity and of good prospects as to its future development" (69). Due to this approach, and to the eventual liability that may flow from it, the Cob is very exacting in its scrutiny before granting the listing. Simultaneously the demand for listing is to be lodged with the stock exchange authorities, i.e. the Compagnie des Agents de change which, as organizer of the market, will give its opinion as to the technical feasibility of the listing.

The requirements for listing are set out in a December 1977 document, called "Instruction sur l'admission à la cote officielle des valeurs françaises nouvelles". This document is reported to incorporate the EEC requirements on prospectuses (70).

The more significant requirements are :

1. Minimum amount of securities to be distributed is 25 % of the share capital, representing at least 80,000 shares for a listing in Paris, and 20,000 for a listing

on a regional exchange. There are no explicit minimum capital or minimum age requirements.

2. A thorough financial audit must be undertaken by an accountants' firm recognized by the Cob; very precise instructions are given as to the scope of the audit executed under the Cob's supervision.
3. Disclosures to be made relate to a formal announcement in an official gazette (71) and to a prospectus to be distributed to everyone interested. This prospectus, called "note d'information", is supervised by the Cob and has to meet its rather precise directives, i.e. the 1981 "Instruction relative aux notes d'information".
4. The share certificates have to be deposited with either SICOVAM or a recognized depository, as bearer securities are no longer in circulation in France.
5. There is no "listing agreement", as most continuous listing conditions (e.g. with respect to disclosure) flow directly from the law (72). However, it is usual that the Cob requires an undertaking whereby the company promises to have the audit programmes strictly executed according to the guidelines established in liaison with the Cob.
6. The Cob states that it will not admit shares unless they represent "an interest for French investors". No cases are reported in which French shares were refused (73).

During the introduction period, the issuers should refrain from acts that could upset the market, e.g. by launching a too voicy press campaign (74).

With respect to shares of companies that were listed for the first time on the stock exchange, the experiences have been by and large similar to the more recent one described below within the framework of new listings on the second marché (75). A case in point is the listing of the Bic shares in 1972. Massive oversubscription (more than 20 times the shares offered) led to artificial reduction of demand by refusing offers at excessive prices and by serving only partially (8 %) the other orders. Finally, the market price was established at about one fourth above the original introduction price (76).

There are no fees due to the Commission des opérations de bourse, nor to the Compagnie des Agents de change, neither upon listing nor subsequently. Other costs involved are banker's fees, printing expenses, financial advertisements, etc. The Cob calculated that as of the end of 1981 the average cost of a public issue would amount to 3.6 % for a straight bond issue, 2.6 % for a share issue without underwriting and 4.9 % for shares issues with guaranty underwriting. Both last mentioned figures include the 1 % tax on capital increases (77).

b) Trading

All trading of shares is centralized by the brokers on the stock exchange where the shares are listed. Trading techniques on the forward market differ from the ones used on the spot market. As small company shares are

traded on the spot market, only this procedure will be detailed.

Trading is organized "by boxes" ("par casiers") and effected in writing by one of the brokers. Brokers act as "specialists" ("spécialiste") to whom a certain number of shares are assigned. During the market period (in principle 12 - 12.30) the specialist will compile the buy and sell orders of other brokers, deposited in the box of the share at a designated area of the exchange building. He then proceeds to the price fixing for the day. The price is set at the level where the market clears, more specifically at the level at which the largest volume of orders can be executed. Prices may show a difference of 3 % at most in comparison to the prices of the preceding day. With the authorization of the representative of the Chambre syndical this percentage can be increased to 4 %. If the market continues to show a disequilibrium, further variations may be granted by one of the members of the Chambre syndicale. If even this intervention appears insufficient, the Chambre syndicale may allow a reduction of the number of orders : an appropriate mention in the price list is required. Reductions may only take place where at least 25 % of the orders may be executed. Beyond this limit, only a provisional price can be published : it will differ between 4 to 5 % from the previous day's price. Transactions may not take place at this price. Orders that remain unexecuted stay on the specialist's book until the end of the month, except where the order was given for one day.

A somewhat different procedure may be declared applicable by the Chambre syndicale in cases in which it fears that the price formation needs close supervision ("par boîtes").

In this procedure, the task of the specialist is performed by the Chambre syndicale itself.

On the regional exchanges trading takes place according to the call procedure (criée) (78).

Commission rates are fixed by Government decree (79). Under the present rate schedule, the rate relating to shares, convertible bonds and other equity linked instruments is 6.3 per mill for the Paris Stock Exchange and 7.3 per mill for the regional exchanges.

Taxes are levied by the State, on the one hand as a "stock exchange transaction tax", fixed at 3 per mill of the order value, and as value added tax at 18.6% on the commissions earned by the intermediaries.

As a very large part of the stock exchange orders are received by banks and transmitted to the brokers, it is customary that part of the broker's commission is given up to the bank, which very often adds an additional commission. The percentage of the give up was fixed at 27.5% in 1977; the commission levied by the bank is not regulated. In general, one third of the transaction costs paid by the investors on a standard order goes to the broker, one third to the bank and one third to the state (80).

2. The "second marché"

As a direct consequence of the "Report on the development of investments and the protection of savings", the French authorities introduced, starting February 1983, the "second marché". This market segment is design-

ed to correspond to a full stock exchange listing, although at less exacting conditions than those applicable to the official market or "cote officielle". With respect to the application of a long list of laws and regulations, the "second marché" is put on the same footing as the "cote officielle". This is e.g. the case for the rules relating to the definition of the securities that are eligible for investment by investment companies, for the application of the Monory law, etc. (81).

The motives for the organization of the second market are several (82). The conscience that there exists an intermediate market between "cote officielle" and "hors cote" had already taken roots with the "compartiment spécial" mentioned above. Here, however, the conditions for access are less exacting. The deliberate will to bring new securities to the market after the nationalization measures and the observation of a shortage of securities has also played a role, certainly in the perspective that the second market will prepare the issuer for a full listing on the "cote officielle". The impracticability of imposing the European directives e.g. on disclosure, and admission to the securities market may also have played a role. The creation of a less exacting market may convince several companies to apply for listing especially with a view of insuring the liquidity of the shares. This has proved to be necessary before new shares are issued on the capital market, before mergers are agreed to or reorganizations among the controlling families can be worked out (83).

The basic idea upon which the second market is presented to rest is that it offers a public trading place with no definite pre-established conditions for access : no listing prospectus, no special audit of the accounts, only a small percentage of the shares must be distributed. In

exchange, the company promises to adhere to the required disclosure and auditing practices within a three year period, during which it can gradually step up the procedures and attitudes (84).

a) Listing requirements

The shares of a company can only be traded on this market at the request of the company and by decision of the Commission des opérations de bourse, after consultation with the Chambre syndicale. The Cob has spelt out its listing conditions in an Instruction of 4th January 1983.

The conditions for listing have been considerably relaxed : no prospectus, only a short form announcement in the official gazette (85) ; no special audit of the accounts, obviously a much feared investigation; no minimum capital requirement, although the Cob declared it would prefer larger companies, with tens of million FF as capital (86).

The only directly applicable requirement relates to the distribution among the public (87) of at least ten percent of the shares. This distribution can be achieved in several ways as will be explained later.

The main thrust of the listing requirements relates to the "covenants" the issuer has to subscribe vis-à-vis the Cob. These agreements mainly relate to the disclosure (88) to be made by the issuer; simultaneously accounting (89) and auditing practices should be brought at the level expected from listed companies. These obligations are expected to be implemented within a three year time span.

The listing is announced publicly in the official price list of the stock exchange (90).

It is the intention of the Cob to review the situation of the companies listed on the "second marché" after a three year period. At that moment the Cob may invite the company to join the "cote officielle". This pre-supposes, of course, that the disclosure and accounting requirements for a full listing are met, while at least 25 % of the shares will have been distributed (91). The Cob may also decide to "delist" the company which will then be traded on the "hors cote" market (92). The company can, of course, also remain on the second market.

The Cob has announced that it will require less extensive disclosures to be made on listing on the "cote officielle" by those second market companies that have fully adhered to its reporting obligations (93). Similar incentives were used by the Cob with respect to listed companies (94).

A listing on the "second marché" is also less expensive than a listing on the "cote officielle" : with respect to smaller issues a 1 to 6 proportion was mentioned (96). Introductions take place with the assistance of both a broker and a bank or another financial institution that will remain involved in the post-introduction monitoring (see below).

b) Trading

The rules with respect to trading are based on the rules applicable to the spot market, except that here the specialist has a price stabilizing role, at least during the first year of trading on this market.

According to the rules of the spot market, price fixing

will take place by "casiers", and price variations are limited to 3 %. During the first year of existence, order confrontation was scheduled not to take place daily but once a week. In practice, due to the success of this market, transactions take place on a daily basis.

During the first months of its existence, much attention has been given to the introduction period because the price-stabilizing techniques being used have given rise to some problems.

There have been very little difficulties with the shares of those companies that were previously traded on the hors cote market. These seem to have enjoyed a stable price evolution, while turnover has increased.

More problems have been experienced with the shares that were newly introduced, mainly due to strong demand. The introduction techniques, applicable to the second marché are the same as applicable to the cote officielle, where they have also raised a few questions (97).

The usual technique, called therefore the "procédure ordinaire", consists of a public announcement of the availability of a specified amount of shares at a stated minimum price through the regular trading mechanism on the exchange. The broker in charge of the introduction receives the buying orders and attempts to equilibrate the market within the existing rules (i.e. of price variation, reductions of orders, etc.). In the five cases in which this procedure was followed in 1983 there has been an excessive demand for the new shares (from 10 to 100 times the amount of shares offered). It seems that in all these cases the offering price was substantially below

the minimum price at which the controlling shareholders had declared themselves ready to sell. The difficulties were even greater in the case in which the share had been put on the market by the procedure of "mise en vente", where the securities are offered at a prefixed price. Here the Chambre syndicale had to step in to refuse certain orders, and to service others at an increased price (98).

During the introduction period, but more significantly in the period thereafter, measures have to be taken to insure the smooth and continuous functioning of the market. To that purpose, arrangements can be made between the sponsoring broker - who acts on the market as the specialist - and the controlling shareholders, or the financial institution that wants to divest itself of its shareholding (e.g. one of the above-mentioned investment institutes) (99), or any other party. These arrangements put at the broker's disposition a certain amount of shares or funds with which he can equilibrate the market acting as an agent or for his own account. The resultant interventions must be aimed at facilitating the price formation and at reinforcing the market's liquidity (100). The Chambre syndicale has given precise instructions (101) on how this function may be organized and how it will supervise it. It is quite clear that this is generally felt to be a fundamental change in stock exchange trading that was up to now mainly based on agency.

These agreements contain also provisions to be followed by the existing major shareholders during the introduction period. They spell out when these shareholders may intervene in the market, when they later on may sell shares and in which cases they should at least keep the sponsoring broker informed. In general one can say that these agreements

charge the broker to organize a fair and orderly market for the account - and with the funds - of the supporting shareholders (102).

It is still too early to give any precise information on how these agreements have functioned during the first eight months, but the general feeling is that, also due to a renewed interest in share investment, the result is quite satisfactory. They seem to have worked quite well as the price evolution seems relatively stable.

The Chambre syndicale publishes, in a separate section of the official price list, the prices for these securities. Moreover it will, in its documentation center, open information files containing all the data available about these companies. These files are open to the public (95).

3. The "Hors cote" market

On this market segment are traded all French and even some foreign securities (103) that are not listed on the official or second market. Anyone may order his broker to offer - or demand - a certain security on the "hors cote" market. There are no listing conditions, and the inscription on the "hors cote" price list is an automatic procedure. The Chambre syndicale intervenes, however, to check on which of the exchanges the securities have to be offered. According to French law, securities may only be traded on the stock exchange in the region where the issuer has its principal office. The Chambre syndicale could not, however, refuse a security to be offered "hors cote", neither for reasons of inadequate disclosure, nor for any other reason.

The number of securities traded on this market is essen-

tially variable. Some tend to be traded more frequently, others appear only once in a while. The price list therefore mentions when the last transaction took place, which may date back several years; the price is also published.

The Chambre syndicale proceeds to a review of the hors cote price list about every month. Securities that have not been traded for more than one month are omitted from the list. If there is renewed interest, the security will be immediately reintroduced. The rule is somewhat different for securities that are traded for the first time or that have not been traded for more than three months : here a three day waiting period is imposed, and only bid or ask prices are published before a transaction can take place.

Formally there are no introductions of shares on the hors cote market. Sometimes, however, unlisted companies proceed to public issues of shares that may later be traded on the hors cote market. Thus, one finds for the last three years public issues of shares by companies traded on the "hors cote" market (104) as follows.

	<u>1980</u>	<u>1981</u>	<u>1982</u>
1. Number of issues	14	13	15
2. Funds collected	283 m.	342.2 m.	375.8 m.
3. 2 as a % of total public issues of shares	8%	11.2%	10.6%

These issues relate to small enterprises who have once offered new shares to the public. In one case a new company was founded by public subscriptions.

It would seem that many of these issues fall under the Monory law, although non-voting shares were not used (105).

The trading procedures follow the rules of the "cotation par casiers", also applicable to the spot market. However, price differences in comparison to the preceding fixing may amount to 8 % and the prices fixed may not be published unless the approval of a representative of the Chambre syndicale has been obtained. The same procedure is followed on the regional exchanges.

In 1973, a different trading procedure was started, based on the intervention of a "contre-partiste" or market maker. After two years, this procedure was abandoned. A major reason for this was lacking acquaintance of the other professional traders with a two side offer price (106).

With respect to fees and taxes, the same rules as applicable to the spot market are applicable to the hors cote.

It is unclear what the future prospects of the "hors cote" market are, now that the second market has taken away many of the most interesting securities. It is generally felt, however, that the "hors cote" will continue to play a role for more or less occasional transactions, while it may contribute to act as a start-up market for the second market.

III. Summary

Up to a few years ago, several legal and organizational factors could be pointed at as preventing the access of smaller enterprises to the securities markets. Most of these impediments have been removed: along with tax incentives, especially the Monory law, new forms of securities were introduced, enabling the existing shareholders to maintain control, while a new market segment was installed, the "second marché", to which access

could be obtained without undergoing the relatively heavy disclosure, accounting and conduct rules applicable to the official market. More generally, different measures were introduced, aiming at or resulting in a renewed interest in securities financing and investment. With respect to small enterprises, several measures are planned or have been taken to facilitate their risk capital financing, e.g. by the organization of risk investment funds. The active involvement of the government and of the public authorities in the implementation of these measures contributed to a change in climate.

Although this action was started only three to two years ago, its results are already perceptible. The most striking is the successful "second marché", on which many new shares have been inscribed. The interest from the side of the investors has been massive. Some of the issuers use this market as a preparation for a listing on the official market, while others will remain traded on the "second marché" on a more permanent basis. The functioning of this market has proved to be quite efficient, except with respect to the introduction period.

Simultaneously, the market for unlisted securities (hors cote) will remain in existence, but its importance will be decreasing.

FOOTNOTES

- 1) Art. 42 & 43 Company law of 1966; see, however, under the Law 83.1 of 3 Jan. 1983, the possibility to issue "investment certificates" mentioned below.
- 2) Art. 36 Company law.
- 3) 10 March 1976, Juriscl. périod, 1976, IV, 18406, ann. Rabut.
- 4) Statistic published by I.N.S.E.E., and reported by Rev. Trimestrielle de droit commercial et économique, 1981, p. 762; different figures are found in I.N.S.E.E., Annuaire statistique de la France, 1981, table 3.02.
- 5) Art. 1, L.70-1300 of 31 Dec. 1970. These companies are also called "sociétés civiles de placement immobilier"; their securities are not traded on the stock exchanges.
- 6) Art. 1 al. 2, L.70-1300.
- 7) Art. 34, L.70-1300.
- 8) Ord. 45-2710 of 2 Nov. 1945, title II, modified by L.79-12 of 3 Jan. 1979; these securities are not traded on the stock exchanges.
- 9) L.79-594 of 13 July 1979, and Décret 79-835 of 27 Sep. 1979; these documents of title are not considered to be "valeurs mobilières", and therefore are not eligible for stock exchange trading.
- 10) Art. 36, L.83-1 of 3 Jan. 1983; see the Cob's Instruction relative aux propositions de placements en biens divers visées par l'art. 36 de la loi n° 83-1 du 3 janvier 1983, dated 3 May 1983; see also Cob, Bulletin, n° 160, June 1983, p. 29-30 and n° 161, July 1983, supplement p. 4.
- 11) Art. 174, Company law.
- 12) Art. 175, Company law; art. 492 of the Law maintains previously existing arrangements instituting plural voting rights, e.g. ten votes per share, but only in public sector companies; s.165 of the Company law further provides that the articles of incorporation may bar access to the general shareholders' meeting to any person not holding at least ten shares.
- 13) Art. 268 Company law and art. 206 of the Décret.
- 14) Only the "parts de jouissance" being capital shares on which a

certain amount of the paid-in capital has been reimbursed can be mentioned here.

- 15) Art. 264, relating both to founders' shares (parts de fondateur) and "beneficial shares" (parts bénéficiaires), being essentially the same but issued subsequently to the foundation of the company; for further information, see e.g. Lagarde G., Droit Commercial, Vol.2 (1980) n° 566 e.s., p.293 e.s. Previously issued founders' shares were kept in existence : art. 504, Company law.
- 16) Art. 177, 1°, Company law, as modified by art; 14, L.83-1 of 3 Jan. 1983.
- 17) By the law of 3rd Jan. 1983 this requirement was changed by replacing the requirement that dividends have been declared for at least three years by the present requirement that profits have been made.
- 18) For instance upon liquidation of the company or where for three or more years dividends to preferential shareholders have been passed : see art. 269-1 to 269-9 of the Company law, introduced by L.78-741 of 13 July 1978, "relative à l'orientation de l'épargne vers le financement des entreprises", as modified by art. 14 to 18 of L.83-1 of 3 Jan. 1983. Listed companies have very rarely taken advantage of the possibility to issue non-voting shares : the first case was reported in 1982 (Société générale de fonderie); due to a change in the law, more cases are forthcoming in 1983. Total capital increases for 1983 (7 months) reach 5.5 mrd against 3.5 mrd for 1982 (12 months). Very few are non-voting shares (1978-81 : 4 cases).
- 19) Art. 75 Company law. Moreover, companies that have not fully paid-up shares outstanding, are not entitled to issue additional shares or bonds (art. 182 Company law). Shares issued for a contribution in kind must be fully paid from the outset (art. 75, 3rd al. Company law).
- 20) Art. 94-1 Loi des finances pour 1982; as far as registered shares are concerned, the register is kept by the company or by a third party who acts as registrar; where bearer securities were involved, only recognized depositaries can keep the register; see in general : circulaire du 8 août 1983, Journal Official, 28 août 1983.
- 21) See art. 13 e.s., Décret 83-359 of 2nd May 1983, for listed companies, where the deadline was fixed at May 1988; for closely held enterprises, the sales have started, the deadline being 1 Oct. 1982.

- 22) Registered shares may not be negotiated on the stock exchange unless a "recognized" intermediary has opened a registry for these shares (compte d'administration); s. art. 5, Décret 83-359 of 2nd May 1983.
- 23) Art. 7, Décret n° 83-359 of 2nd May 1983.
- 24) See art. 194.1 to 208 Company Law; the first article was introduced by the law of 3th Jan. 1983. The warrants are negotiable separately.
- 25) See art. 183-1 to 5 Company Law, introduced by L. 83-1 of 3th Jan. 1983.
- 26) Art. 283-6 to 7 Company Law, introduced by L. 83-1 of 3th Jan. 1983; several issues have taken place of the certificates, e.g. by Havas and Rhône-Poulenc.
- 27) The formula is rather complex : see Décret 83-363 of 2nd May 83.
- 28) See L. nr. 78-741 of 13th July 1978.
- 29) See for further details, B. Letellier, *Les actionnaires, les français et le marché des actions, la documentation française*, Paris, 1981.
- 30) Art. 51, L. des finances pour 1983 and Décret n° 83-389 of 16th May 1983 for analysis of the rather complex system see C. Chéron, *Le compte d'épargne en actions, Banque*, 1983, 967. See also, the "compte pour le développement industriel", L. n° 83-607, 8th July 1983, art. 5 e.s. and Arrêté 29th Nov. 1983 (Codevi)
- 31) See further the table on the issue of securities in France.
- 32) G. Nebot, *L'expérience de l'I.D.I.A. sur l'apport de fonds propres aux entreprises; dispositions susceptibles d'accroître la collecte de l'épargne et son orientation vers ce type de placements*, in: *Le développement de la protection de l'épargne, Documents contributifs*, Paris, 1982, p. 545.
- 33) Sicaves may hold up to 15 % of their portfolio in unlisted shares; art. 5 L.79-12 of 3th January 1979. Fonds de placements, originally conceived as instruments for employee participation, later had their purpose broadened to any securities holding. They may not invest more than 20 % in unlisted securities (art. 19, L. 79-594 of 13th July 1979).
- 34) Deposit banks may invest 20 % of their capital in non-bank shares : see art. 5, 1° L. 2nd December 1945, as modified by Décret of 23th December 1966; this rule is also applicable to "banques de crédit à long et moyen terme".
- 35) Vizioz, J., *Le financement des entreprises non cotées*, in : *Le développement et la protection de l'épargne, Documents contributifs*,

- Paris 1982; insurance companies are allowed to invest 1 % of their legal reserves in the shares of at least four unquoted businesses or venture capital companies.
- 36) E.g. Banexi, belonging to the Banque nationale de Paris group; see also Soginnove, created in 1973 by the group of the Société Générale, which disposes of about 60 minority shareholdings for an amount of FF. 39 million.
 - 37) "Banque d'affaires" under the French banking law are not limited in their venture undertakings, except that they may not use short term deposits to finance shareholdings (art. 5(6) L. 2nd December 1945). After nationalization, the "investment banks" still functioning act rather as advisors.
 - 38) Décret no. 55-876 of 30th June 1955; also Décret 7th Oct. 1955; Décret 76-438 of 20th May 1976. They are aided by a government subsidy, fixed at 25 % of the investment; if it relates to a new enterprise, even 50 % can be subsidized. Similar subsidies are granted to the "Sociétés financières d'innovation", while tax advantages reinforce their financing possibilities.
 - 39) And no more than 35 % of its assets in any single enterprise.
 - 40) J. Vizioz, o.c., p. 357, mentions a 0.9 to 5 % gross return on a selection of 5 larger portfolios (1980); therefore these companies had to devote more and more of their assets to high yielding assets, such as bonds.
 - 41) The I.D.I. invested in 226 enterprises for a total amount of FF 2.6 milliard, the Sociétés de développement régional invested in 1400 cases, for FF 750 million; less important, because of a more recent date are the so-called regional participation institutes (150 cases, FF 161 million) and the innovation financing companies (266 cases, FF 164 million).
 - 42) The Government itself with 49.95 %, the Crédit Agricole with 14.2 % and the Crédit National with 10.34 % are the principal shareholders in a capital of FF 1 mrd.
 - 43) Therefore it has contributed to several high technology ventures or enterprises where new products or techniques are being developed. The institute also acts, either for its own account or for account of the Government, as reorganization agency for larger groups with financial difficulties. Finally, it has developed considerable expertise in management advisory functions.
 - 44) The so-called "prêts participatifs".
 - 45) E.g. the regional institutes as Auxitex (Bordeaux), I.A.D. (Marseille), I.P.O. (Nantes), I.R.D.I. (Toulouse), Participex (Lille), Siparex (Lyon), Sofimac (Clermont-Ferrand). The most

important of these institutes are referred to below.

- 46) E.g. the Institut de développement des industries agricoles et alimentaires (I.D.I.A.), the Institut de développement des industries de composant automobiles (I.D.I.C.A.), Finovelec (innovating projects in the electric power and utensils sector), Finovectron (innovating projects in the electronics and telecommunication sector).
- 47) Also to be mentioned are : Sopremec - I.D.I., focusing on capital assistance to small enterprises with too rapid a growth rythm; Sofiparil concentrating on the Paris region small enterprises and Sofirind, specialised in high risk small businesses, where capital reinforcement can reestablish financial equilibrium.
- 48) One can mention here Sadef, specializing in the diagnosis of and assistance to ailing enterprises and Codif, management and shareholding reorganization assistance.
- 49) Le développement des investissements et la protection de l'épargne, 3 vol., Documentation française, Paris, 1982, especially chapters 7 & 8.
- 50) Based on the data published by Dafsa, Les liaisons financières, 1983 édition, 2 vol.
- 51) About 40 % of the shares of Participex in Lille are held by institutional investors, 40 % by bankers and financial enterprises, 17 % by individuals (Chamber of Commerce). Institut de participation de l'Ouest in Nantes presents a similar picture with even more widely scattered shareholdings, one could also mention the Société alsacienne de développement, in Strasbourg.
- 52) Siparex, in Lyon, numbers among its shareholders Finance for Industry (U.K.) (7 %); Union de banque suisse (1.3 %); Koweit (9.8 %); main shareholders are a long list of French financial institutions; see also S.A.D.E. (Société alsacienne de développement), where Société de banque suisse has a small stake.
- 53) In 1982, the Industrial Development Institute actively contributed to the proposed listing of the Benson company; the company was, however, taken over by a larger group.
- 54) Art. 39-1 to 3 L.83-1 of 3rd January 1983, Décret n^o. 83-357 of 2nd May 1983 and Arrêté, 30th June 1983.
- 55) I.e. the fund may acquire more than 10 % of the shares or voting rights of a certain company, and more than 10 % of the portfolio may be invested in one single issuer (comp. art. 19 of the L. 79-594 of 13th July 1979).
- 56) No redemption may take place within the first three years after entry or after 10 years of participation in the fund.

- 57) See for a detailed analysis, B. Mirat, Les introductions sur le second marché, Banque, 1983, 1127.
- 58) Art. 1 Décret of 7th. October 1890.
- 59) Art. 75-1 of Code of Commerce, book I, as modified by L.72-650 of 11th July 1972; as of the end of 1982 there were 34 firms organized as limited liability partnerships (société en commandite simple), and 23 firms as s.a.
- 60) According to art. 12, § 4 L.290 of 14th February 1942. This power has never been used.
- 61) According to a survey, established by the consultants firm of McKinsey, 400 French enterprises would qualify for trading on the second market. A similar calculation (400 to 600) was made by Mr. Flornoy, Syndic (Chief executive) of the Compagnie des Agents de change.
- 62) E.g. the Société de développement régional Picardie has placed 21 % of the shares of the Société française d'emballage et de conditionnement among the investors.
- 63) A similar service is offered by a Centre d'informations boursières pour les P.M.E.-P.M.I., in Paris.
- 64) Art. 16 L.64-1278 of 23th December 1964.
- 65) For an overview of this 11 year period, see Commission des opérations de bourse, rapport annuel 1982, p. 141.
- 66) See Année Boursière, 1982, p. 112 e.s.
- 67) Count based on Dafsa, annuaire des sociétés et des administrateurs, 1983.
- 68) The numbers related to the total number of listed shares as follows : Bordeaux (7/23), Lille (7/29), Lyon (8/40), Marseille (16/32), Nancy (12/41) and Nantes (3/12).
- 69) See the Instruction sur l'admission à la cote officielle de valeurs françaises nouvelles, December 1977.
- 70) Although the Cob announced in its 1981 annual report (p.51) that it would revise the Instruction, it would seem that it has abandoned this revision.
- 71) This relates to the publication of the "notice légale", in the Bulletin des annonces légales obligatoires, or BALO (L. 30 Jan. 1907, art. 3).

- 72) With a notable exception for the "occasional information" or price sensitive information, the disclosure of which is rendered obligatory by a mere Cob Instruction.
- 73) But at least in one case, a South-African gold mine share was not admitted.
- 74) The Cob also recommended that no blocks of shares be transferred the year before the introduction, as some investors would appear to be unduly privileged.
- 75) See infra section 2 b.
- 76) See Cob, Annual Report, 1972, p. 162; this action of the Chambre syndicale was not generally welcomed as it led to a change of the rules during the offer period. It would seem that the introduction procedures by way of a massive offer (mise en vente) need to be revised, but a revision of these procedures, announced in 1972, does not seem to have been pursued.
- 77) See Cob, Bulletin, December 1981, p. 4 to 13. These figures do not take into account the amount of the issue or the amount subscribed by the public; for further details, relating to the underwriting commission, see p.9 of the same Bulletin issue. Not included are the quite variable fees due to the accountants' firm charged with the special audit referred to above.
- 78) See Mirat, B., La bourse et ses acteurs, Dunod, Paris 1977; relevant parts of this work were reprinted in : La modernisation du marché des valeurs mobilières, 1981, Annex 2, p.86-95.
- 79) Décret nr. 65-143 of 25 February 1965.
- 80) See : La modernisation du marché des valeurs mobilières, 1982, Annex 1, p. 79 e.s.
- 81) See art. 47 of L. 83-1 of 3th January 1983; see for a list of these rules, the brochure published in January 1983 by the Cob "Textes concernant le Second Marché". However, this assimilation of the second marché with the "cote officielle" is only partial : e.g. art. 10-1 of the Ord. 67-833 of 28th. September 1967, as modified by art. 35, L.83-1 of 3th. January 1983, prohibiting insider dealing, is only applicable to transactions on the "cote officielle".
- 82) Other incentives relate to the reliability of the evaluation of the shares for tax purposes (especially for the "impôt sur les grandes fortunes", or for estate duties); but the distribution of a mere 10 % may boost the share price and therefore be detrimental to the remaining shareholders (see : Prévisions, 10th. February 1983). This market segment could also serve for the trading of shares stricken off from the "cote officielle".

- 83) This was reported in the press as the reason why Delsey found itself obliged to become part of a larger group.
- 84) It is reported that the preparation of a full listing on the official market requires a very lengthy preparation, and the continuous activity of 2 to 3 people within the company. The processing of the demand only requires 2 to 3 months, both at the Cob and at the Chambre syndicale.
- 85) "Notice légale". See note (71).
- 86) In broad terms, the target companies were unofficially described as having a FF 300 million turnover, a 15 % profit record and liabilities less than two times capital plus reserves (cfr. Mr. Y. Flornoy's speech in Toulouse, on 17th March 1983). According to one author (Raynal, A., Le second marché boursier, Les Petites Affiches, nr. 49, April 1983) further requirements are applicable but these are not mentioned in the official instructions. So the issuer has to file with the Chambre syndicale copies of its articles of incorporation, annual reports for the last two years, a list of its principal shareholders, a description of its business activity and it has to promise to keep the Chambre syndicale informed. As to the Cob, the issuer must have the Cob's approval as to the auditors appointed, with respect to their independence as well as with respect to their technical capacities; if necessary a programme to reinforce auditing procedures has to be agreed on.
- 87) Being anybody not related to the issuer, its directors or controlling shareholders, but including the employees.
- 88) Annual reports must conform to the Cob standard; quarterly reports mentioning turnover should be disclosed; price-sensitive information should be timely disclosed.
- 89) A second official auditor has to be appointed; if necessary, the Cob will invite the company to adapt its procedures.
- 90) Art. 112 of the Règlement général de la Compagnie des Agents de change : the decision is only valid for a certain number of shares; upon subsequent share issues a new application must be introduced.
- 91) In this case a full prospectus must be released.
- 92) It would seem that at the end of this 3-year period the company can opt out of the second market. It is still unclear whether the Cob could use its powers of compulsorily listing in such a case.
- 93) Without being able to exempt them, the Cob can allow the publication of a short-form prospectus, rather than the full "note d'information".

- 94) See Cob, annual report, 1973, p. 105.
- 95) Art. 112-6 of the Règlement général de la Compagnie des Agents de change.
- 96) FF 0.5 million for Zodiac, (about FF 20 mio share issue) . in comparison to more than FF 3 million for Promodès on the "cote officielle", according to L' expansion, Nouvelle vague à la bourse, 4-17 February 1983, p.65
- 97) Art. 112-5 referring to art. 31 and 32 to 37 of the Règlement Général de la Compagnie des Agents de change.
- 98) For further details, see the very informative article of B. Mirat, Les introductions sur le second marché, Banque, 1983, 1127-1134. Due to the many difficulties it has been suggested that institutional investors and professionals should refrain from buying during the introduction period, as it also appears that part of the shares flow back to the market after the introduction period and may put the prices under pressure, as has happened on the official market.
- 99) E.g. a regional development company that has brought the shares to the market; the issuer also may be party to the agreement, as French company law probably permits a company to purchase its own shares in such a case (see art. 217-2, that is not expressly applicable to companies the shares of which are listed on the second marché). Other enterprises, possibly without the sponsoring broker, could also intervene in the market: at least one non-broker firm advertised its service, as part of its assistance to companies to obtain a listing. The indicated price was FF 24,000 for one year of monitoring. The broker firm may act as agent or for its own account after having acquired the shares from the company or from an important shareholder.
- 100) Art.112-7, Règlement général de la Compagnie des Agents de change.
- 101) These arrangements are not compulsory but "highly recommended", when the shares are transferred from the "hors cote" or where there was a public sale; when the shares are put at the disposition of the broker, this technique is automatically to be followed. It is reported that for the first year of functioning of the "second marché" no use had to be made of these price maintenance agreements.
- 102) There is no strict obligation to intervene , as the broker will have discretionary power. But according to the model contract prepared by the Chambre syndicale the broker is bound to insure liquidity and the frequency of fixings as determined by the Chambre syndicale. Also these interventions are not subject to commission nor to the stock exchange transactions tax (art.980 bis, Code général des impôts).

- 103) Foreign securities may be traded on the "hors cote" only after they have been authorized by the Minister of finance (see art. 5 of the Décret n° 67-78 of 27th January 1967, applicable to all market segments). The Chambre syndicale has established a list of the foreign securities authorized. Several of these are actively traded: on the Paris Stock Exchange, of a total turnover on the hors cote market of FF 2.7 mrd, FF 1.1 mrd was accounted for by the shares of the Dutch investment company Rorento.
- 104) Commission des opérations de bourse, rapport annuel, 1982, p.106-107.
- 105) The annual publication of the Stock Exchange "Année boursière", 1982 issue, p.113, lists more than 75 companies who had issued, publicly or in private, shares in order to qualify for the Monory tax advantages in 1982.
- 106) See Année boursière, 1975 - valeurs négociées au 31 décembre 1975 selon la procédure spéciale; also in: La modernisation du marché des valeurs mobilières, Documentation française, Paris, 1981, Annexes vol.1, p.221.

J. THE SEGMENTS OF THE SECONDARY MARKET FOR EQUITY

INSTRUMENTS OF SMALL COMPANIES IN ITALY

I. ENVIRONMENT AND SURVEY

1. Number and forms of business organizations

Most Italian business associations are organized in the form of sole proprietorship or private partnership (società semplice, società in nome collettivo - S.n.c. -, società in accomandita semplice - S.a.s. -)¹⁾ and these almost exclusively belong to the small business sector.

The major companies, but also a very great number of small to medium-sized firms have adopted forms with limited liability. These comprise the private limited company (società a responsabilità limitata - S.r.l. -), the public limited partnership (società in accomandita per azioni - S.a.a. -) and the public limited company (società per azioni - S.p.a. -).

Number and forms of business organizations in Italy at the end of 1981²⁾

Forms	Number
Ditte individuali - individual firms	2,283,694
Limited companies (of which: Public limited companies s.p.a.)	521,466 (80,000)
Others	36,000
	2,841,160

Several surveys cast some light on the structure of small and medium-sized companies and their importance for the Italian economy³⁾. According to recent sources of the Department of Industry⁴⁾ there are more or less six times as many small companies in the Italian manufacturing sector as e.g. in the United Kingdom or in West Germany. The share of companies with less than 200 employees was some 99 %; on the average, each manufacturing company employed eight people.

A certain regional specialization can be observed with regard to the goods produced⁵⁾. This goes hand in hand with the phenomenon that often many small companies in one town or area are linked to each other - not only by family ties - and each one performs on its own the role of producing prefabricated, unfinished or accessory goods. In other countries this would preferably be organized in different segments within a larger firm.

Other companies in the area assemble these products and maintain marketing channels and a sales force. Such positive synergy effects are often reinforced through cross-shareholdings. The majority of small companies and the output of their co-operation is export-oriented; one survey⁶⁾ lists 83 % of the companies covered in the sample as manufacturers of products predominantly intended for outlets abroad. It is believed that small business accounts for 30 - 40 % of all Italian exports⁷⁾.

Italy's economy is facing problems of profitability. The big state-owned companies and conglomerates are chronically running losses. It appears that small to medium-sized companies generally have a better economic background. An annual cross-sectional survey of Mediobanca on some 1,200 companies of all sizes shows for 1982⁸⁾ that the companies reviewed have on average an indebtedness of Lire 830 per Lire 100 equity capital, with the state-owned enterprises having an indebtedness of Lire 1,540, private industrial companies of Lire 510 and small to medium-sized industrial companies of Lire 300. (In 1968 the figures were Lire 320, Lire 170 and Lire 200 respectively per Lire 100 equity capital.) Losses have increased in recent

years; four fifth of the overall losses in the sample must be attributed to the state-owned companies, but also more small to medium-sized companies than in the years before have touched unprofitability. Financial subsidies appear to be swallowed mainly by the state-owned companies. Per Lire 100 equity capital, they received Lire 540 soft loans from banks whereas that figure was Lire 200 for the private industry in general and only Lire 100 for the small to medium-sized companies. Nevertheless, a great number of small to medium-sized companies are financially sound, and these companies in Northern and central Italy are considered the backbone of the Italian economy.

As in other countries only the share-issuing enterprises offer the prerequisites for reasonable primary and secondary market activities. Due to the scarcity of the S.a.a., the following outline focusses on the società per azioni.

The formation of a public limited company takes place through the execution of a constituting act (atto costitutivo) by at least two founder shareholders before a notary public and registration in the company register⁹⁾. There are no formation audits. The minimum capital for the S.p.a. amounts to Lire 200 million¹⁰⁾. This figure was required as of April 30, 1981¹¹⁾; the increase from the formerly valid amount of Lire 1 million had obviously forced some thousands of under-capitalized S.p.a. to change into another form of incorporation, preferably into the S.r.l., the minimum capital of which had simultaneously been increased in the same law from Lire 50,000 to Lire 20 million¹²⁾.

But the attractiveness of the S.p.a. for small business entities seems to be unbroken as evidenced by the number of some 80,000 as of end-1981; more current information even proceed on a figure of some 90,000 S.p.a. in the middle of 1983¹³).

2. Frequently used instruments for equity financing

Ordinary shares (azioni ordinarie) are the most commonly encountered type of equity instrument issued by the s.p.a.¹⁴), and they are usually the only type of shares of small companies. They can have different denominations ranging from nominal values of Lire 10 to Lire 20,000¹⁵). On the stock exchange nominal values of Lire 500 or 1,000 and multiples thereof are desired. However, uneven values can also be found, e.g. Lire 120, 162, 350, 675, etc.¹⁶). Ordinary shares grant usual voting, examination and subscription rights and entitle the holder to dividends and liquidation proceeds, if any. Shares traded on secondary markets are mostly ordinary shares.

Besides that, stock companies have the possibility to issue preferred shares (azioni privilegiate or azioni di priorità) entitling the holder to preferential treatment concerning the distribution of profits at the cost of giving up his voting rights¹⁷). On the other hand, plural voting rights are prohibited. Some companies offer cumulative preference rights, occa-

sionally limited to a number of years. Preferred shares do not constitute a meaningful contribution to Italian equity finance¹⁸⁾ and are not particularly popular with small companies.

The scope of an innovative equity instrument is meant to be performed by the saving shares (azioni di risparmio) which were introduced in 1975¹⁹⁾. So far they can only be issued by companies with exchange-listed ordinary shares and are themselves listed de iure²⁰⁾. These shares are non-voting and offer the investor preferential and cumulative rights on dividends and on repayment of capital, if any. Their attractiveness lies in the preferential tax treatment in the declaration of income²¹⁾ and in their availability in bearer form. Companies see incentives in the issuance of saving shares, as dividends distributed on such instruments may be accounted for as costs and are therefore deductible for corporate tax purposes²²⁾.

Saving shares can be created either through a new issue or through the conversion of already existing ordinary shares. At the same time they carry the right of conversion (or re-conversion, as the case may be) into the ordinary shares of the company under certain provisions.

The total nominal value of saving shares and preferred shares may not exceed 50 % of the company's equity capital.

So far the volume of saving shares issued in Italy has been relatively moderate, although with increasing growth rates. In fact, in 1982 the major contribution

to new listings of classes of shares on the Milano stock exchange was derived from saving shares²³). Proposals for reform of the Italian finance system include the advice to extend the right of issuing saving shares to unlisted companies as well, provided they are of a certain size, have their accounts audited and will apply for listing of their shares at a later stage²⁴).

Finally there are types of shares in Italy that are issued in an employees participation scheme (azioni a favore dei prestatori di lavoro), and there are beneficial shares (azioni di godimento) which are issued in special cases when equity capital is paid back²⁵). Both forms are rarely used.

In Italy all shares must be registered securities with the exception of saving shares which can also be issued in bearer form²⁶). The clearing of transactions in ordinary and privileged shares is either evidenced in the company's stockholders book (libro soci) which will be the case if the shares change their ownership only rarely. On the other hand, said shares can also be transferred by endorsement on the back of the certificate (trasferimento mediante girata)²⁷). Italian banks may endorse the shares by proxy; for frequently traded issues this is the customary way to avoid the encumbrances of the registration system. Transfer by endorsement is fully valid towards third parties, also without a respective entry in the shareholders' register. Nevertheless, the company concerned need only recognize the person duly registered as a shareholder²⁸).

In general, the articles of association may also provide restrictions on the transfer of shares. In particular, they may declare a transfer subject to the approval of the directors of the company²⁹⁾.

Partly paid issues are known. However, official listing can only be granted for fully paid shares.

3. Investors and investment motives

The annual survey of the Bank of Italy on shareownership helps to identify the relative importance of investor groups. It is based on a computation of the market values of the shares derived from the balance sheets of a broad cross-sectional sample of Italian stock corporations³⁰⁾. At the end of 1982 the total value of these shares of Lire 212,660 mrd was to 17.4 % (1981: 16.1 %) attributable to listed companies, the remainder of 82.6 % (1981 : 83.9 %) to unlisted companies.

Classes of investors comprise the company sector and state-owned holdings, private individuals, the banking system and other intermediaries, and investors from abroad. 62.2 % (1981: 62.7 %) of the total value of shares was held by the company sector, a figure which had almost doubled compared to the average of the ten years from 1967 to 1977³¹⁾. Within this sector the main contributors to shareownership can be found among the finance companies (società finanziarie). Their relative

importance, compared to the shareholding of other types of companies, has increased throughout the last years and they have considerably institutionalized shareholding in Italy. Further types of institutional investors which are prominent in other countries, like pension funds and insurance companies, do not play a significant role in shareownership. This is due to their limited assets which in turn is caused by the comparatively less developed pension and insurance schemes in Italy³²). Finally the large share of the company sector reflects cross-shareholdings between companies to a certain extent³³).

The big Italian stateholding companies (enti pubblici) held 11.8 % (1981: 10.6 %) of the total share volume³⁴).

Against this background the shareownership of private individuals of 12.4 % (1981: 14.2 %; yearly average 1967 - 1977: 27.4 %) becomes less meaningful.

But as these statistics do not subdivide the total market value of companies' shares into different classes corresponding to sizes of the companies, the relative importance of private investors does not become fully evident. As a rule, the vast number of small s.p.a. with low to medium-sized capitalization only have a few shareholders each. They are controlled by family members or by a small group of business associates - a set-up which harmonizes with the structures of the Italian small business world mentioned at the beginning. These small stock companies are mostly run as "closed shops" (strutture di proprietà "chiuse")³⁵). The strengthening of their equity basis is achieved

through undistributed profits or equity capital implements by the few already existing shareholders - only on very limited occasions through an offer to outside public or private investors. Long-term debt capital is generally readily provided by the banking system. This often substitutes needed equity capital and causes undercapitalization³⁶⁾. The degree of concentration of equity capital of a firm in one or only a few hands is generally high among Italian small to medium-sized companies. Of 1,000 companies in a representative sample³⁷⁾ 17 % showed an equity capital concentration of less than 70 %, 10 % of the companies were between 70 - 95 %, and 73 % had a concentration grade of 95 % and more. Of the companies reviewed, more than two thirds were not at all interested to enlarge their shareholder base; with those interested a high correlation with the degree of indebtedness could be observed. Less than one fifth of the companies showed an inclination to consider a stock exchange listing and trading of their shares on a secondary market³⁸⁾.

This abstinent attitude to raising equity capital in the public and having the shares traded on secondary markets finds its equivalent in the hesitant propensity of private investors to acquire shares of small to medium-sized companies in a more or less open, anonymous market. If not directly engaged as managing capitalist or at least with possibilities to closely control the risk and reward of an investment in a company³⁹⁾, it appears that Italian investors often enough prefer the easy way to invest in saving deposits, in tax-free government bonds or in other high-yielding fixed-interest bonds of the public

sector, like those issued by the specialized credit institutions, or they try to bring funds abroad⁴⁰). The portion of household savings invested in shares, which in the fifties still amounted to 30 %⁴¹), went down via 25 % in 1963 to a low of 0.7 % in 1977. It is presently lingering around 4 to 5 %, in good stock exchange years like 1981 going up to 8 %⁴²).

Only a small portion of shares are held by the banking sector and other financial intermediaries (1982: 3.8 % and 1.6 %, as against 1981: 2.4 % and 1.5 %, respectively)⁴³). Banks are not allowed to carry institutional shareholdings⁴⁴).

Shareowners from abroad accounted for 8.2 % of share-ownership (1981: 8.6 %, yearly average 1967 - 1977: 17 %). Their relative weight has diminished recently; they include i.a. the only investment funds operating in Italy so far⁴⁵). These are incorporated under Luxembourg law and are authorized to operate in Italy if all the net-funds entrusted to them for portfolio management are exclusively invested in Italian companies⁴⁶).

On the legal basis established in early 1983 mutual investment funds (fondi d'investimento; unit trusts) of the open end type will start operation under Italian law probably late in 1983 or early in 1984⁴⁷). Only joint stock companies with paid-up capital of not less than Lire 2 mrd will be entitled to manage investors' funds. Promoters of the funds will be major commercial and savings banks as well as finance and insurance companies⁴⁸).

Three funds per holding company will be permitted⁴⁹). The companies must be authorized by the Ministero del Tesoro after consultations with the Bank of Italy. The latter exerts regular control and must authorize each investment fund issue. The Consob⁵⁰) will control the gesture of management and pertinent disclosure⁵¹).

The operation of these funds and their contribution to the investing community are awaited with high expectations⁵²). Very optimistic estimates say that already in 1984 the unit trusts might attract some 7 % of annual Italian savings⁵³). Of course, others are more sceptical. The expected contribution to an improvement of small business finance lies in the possibility and recommendation to invest up to 10 % of the portfolio in shares of unlisted companies. Up to 5 % of each fund's assets may be invested in securities of any one company which means, provided no bonds are held, that share-ownership in a company is restricted accordingly. On the other hand, one fund may not hold more than 5 % of the shares of one company⁵⁴). These portfolio diversification rules might cause marketability problems in the Italian situation. Only few companies have a high market-capitalization and abundant floating material not in firm hands. Once their share in the funds' portfolios is filled up (including debt titles) there might be some market-narrowness. On the other hand, small to medium-sized companies would profit because investments would have to be directed towards them. This might further stimulate them to expand their equity base and break up the psychological barrier against going public.

The funds need not carry government or other public institutions securities. Besides there are fiscal incentives to invest in the productive sector of the economy. Generally an investment fund is subject to an annual tax of 0.25 % of its assets as calculated on an averaging scheme. This rate will be reduced to 0.10 % if at least 55 % of the assets are invested in Italian industrial shares or convertible bonds⁵⁵⁾.

4. Issuing houses for shares of small companies

In 1982 activity in new issues of shares in Italy had a gross value of Lire 6,892 mrd. This is obviously less than in the record year 1981, with its gross volume of Lire 8,812 mrd, but still well ahead of the long standing average 1970 - 1977 of Lire 1,593 mrd which had already been surpassed in 1979 and 1980 with Lire 3,894 mrd and Lire 4,133 mrd, respectively⁵⁶⁾. In 1982, 43.2 % of the total amount could be attributed to share issues of listed companies, and the remainder of 56.8 % to non-listed companies. In 1981 the figures were 61.1 % and 38.9 %, respectively; the average for the years 1970 - 1977 amounted to 17.6 % and 82.4, respectively. The percentage figure for 1982 for listed companies can be further broken down: beside the issues of state-controlled companies⁵⁷⁾ and major private firms, share issues of listed small and medium-sized companies accounted for 1.5 % of the total volume. Over recent years this figure fluctuated around 1 %. The issues of unlisted small and medium-sized companies amounted to 21.1 % of the total volume. This figure

fluctuated in recent years between one fifth and one third of the respective gross new issue volume of shares.

These figures still include credit institutions: after their deduction, the volume in 1982 issued by private sector commercial and industrial companies amounted to around Lire 1,500 mrd (25 % of the overall volume)⁵⁸), but this figure cannot be further broken down and contains major and small companies.

In 1982, the net issues of bonds of Lire 68,835 mrd (inclusive of BOT - buoni ordinari del Tesoro)⁵⁹) exceeded net share issues and accounted for a ratio of 11.5 : 1; the average ratio for the years 1980 - 1982 was 9.3 : 1. The respective average figures for the years 1970 - 1979 were 7.5 : 1, for the years 1961 - 1970 3.9 : 1⁶⁰).

Investment banking in Italy is based on techniques and legal documentation generally used in Europe⁶¹). Share issues (rights issues) are underwritten by a consortium which guarantees to take up the entire issue, possibly with risk-subparticipations from minor underwriters. The consortium also provides for the subsequent sale of the shares, possibly supported by a selling group. Such consortium members are commercial banks (intermediari finanziari bancari), specialized credit institutions (istituti di credito speciale - a medio termine), and finance companies (intermediari finanziari non bancari - società finanziarie). If the offering, particularly in the case of listed companies, is assisted by a selling group, some of their members usually are commission

brokers (intermediari di borsa - società commissionarie). The Italian official brokers (agenti di cambio) are not allowed to participate in an underwriting consortium because they are not permitted to carry shares for their own account⁶²).

Issues of small companies require only a small consortium, often only one managing intermediary. The services rendered include financial consulting before, during and after the public or private placement of the shares, the underwriting and selling of the shares, and, if necessary and possible, market-making or other sponsoring activities on the secondary market. Particularly issues of small companies are often not publicly offered but are privately placed with already existing shareholders (direct placement)⁶³).

Shares are, in general, offered or placed at a fixed price. Specific methods to avoid underpricing are not used. This risk becomes particularly evident if, as it is still the case in Italy, there is a long time gap between the sale or placement and the subsequent exchange listing.

Some names should be mentioned which can be connected with the field of share issuing for small to medium-sized companies. Often companies will revert to investment banking units or divisions, if existent, of the commercial banks with which they already do credit and other banking business⁶⁴). Recent proposals for innovation of Italian corporate finance aim at promoting merchant bank activities also within the banking sector; the Bank of Italy reportedly has a favourable attitude towards such proposals⁶⁵).

Specialized credit institutions participate from time to time in new issues, either themselves or through one of their numerous subsidiaries. Among these institutions, the largest one is the IMI (Istituto Mobiliare Italiana)⁶⁶). This institute gives special consideration to small and medium-sized companies and particularly to those from less industrialized regions of Italy. Also concentrated on the small to medium-sized range of companies are among others the Mediobanca, the Efibanca, the Interbanca and the Centrobanca⁶⁷). Further to be mentioned here are state-owned, specialized finance institutes which operate one in each region of Italy, like the Finanziaria Regionale Lombarda (Finlombarda) or the Finanziaria Regionale Umbria (Finumbra), etc.

The finance companies combine in themselves investment banking and brokerage functions. Many of these companies are listed on the stock exchange. In 1982, five of them were among the thirty most actively traded shares of the Milano stock exchange: I.F.I. - Istituto Finanziario Industriale, La Centrale, Italmobiliare, Agricola Finanziaria, Bonifiche Siele⁶⁸). To some extent also foreign banks are competing to get a stake in Italy's corporate finance, like Barclays International Finanziaria⁶⁹) and Citifin, subsidiary of Citicorp.

In the last years, by contrast to the vast number of società per azioni in Italy only a few small companies were newly brought to the market.

The subject of venture capital finance has just recently attracted some interest on a broader scale. News was spread about the risk-finance company Finnova, subsidiary of the finance company Pas and founded only in January 1983, which in the middle of 1983 was about to finish its first two venture finance operations in the countervalue of some Lire 2 mrd⁷⁰). Behind the Finnova are founders with names of reputation in the Italian economy⁷¹). The requests for risk financing, estimated to be around fifty in the short period since the incorporation of Finnova, came from engineers and technicians with companies yet to be established (about 50 %), and from small companies already in existence for two or three years and in need of risk capital for expansion (another 50 % of requests).

Other venture capital promoters are for example the Lombardia Fincapital and the Finberg. They are prepared to subscribe to shares of small innovative companies, hold the shares for several years, at least until the break-even point in operations and profitability is achieved, and then place them with other investors, possibly connected with an exchange listing⁷²). These finance companies mainly base the feasibility of a risk participation on an assessment of the personal capability of the entrepreneur. Participations of up to Lire 600 million⁷³) in each company are considered; four such investments were close to completion in mid-1983.

The Mediocredito Centrale has founded a subsidiary, the Sofipa, which after a short time of existence already was about to increase its own equity capital from

Lire 2 mrd to 20 mrd to meet financing demands. It particularly invests in small growing companies which specialize in traditional products⁷⁴).

Obviously venture capital companies in Italy are still in their startholes. But incentives might come from major Italian companies which realize the potential in their own country. Olivetti, for example, has invested in 21 venture companies in the U.S. since June 1980, six of which are traded over-the-counter there. Prerequisites for investment are operations that fit into Olivetti's strategy and a solid finance scheme⁷⁵). Such possibilities should be traceable in Italy as well and should also fit into the strategies of other industrial companies.

5. Survey of the secondary market

The secondary market for equity instruments in Italy shows a dichotomy. On the one hand, there is the official segment comprising the stock exchanges (Borsa Valori) and - since its legal revitalization in 1978 - the regulated market for transactions in securities not admitted to official quotation on the stock exchanges (mercato ristretto, second market). On the other hand, there is reportedly extensive off-exchange trading in officially listed securities in the banking and finance system, and there is an unregulated market for unlisted securities (terzo mercato). Unlike the official segment, available information on the second segment is scarce.

In Italy there are ten stock exchanges⁷⁶⁾ and six mercati ristretti⁷⁷⁾.

The rules and regulations on the Borsa Valori are identical for major and small to medium-sized companies. The same holds true for the mercato ristretto.

Legal supervision of the official stock-market lies in the hands of the Consob - Commissione nazionale per le società e la borsa - which was established in 1974⁷⁸⁾. It has its headquarters in Rome and consists of five members: one chairman and four commissioners. Since its inauguration the Consob has assumed various functions formerly executed by the local stock exchange bodies, the Ministry of Treasury, the Ministry of Industry, and the local chambers of commerce. In general, it has absolute authority and discretion in the pursuance of its tasks. The responsibilities and recent actions taken with regard to officially traded companies include the following⁷⁹⁾:

- Making decisions on the admission of shares to, and the temporary suspension or definitive removal from the official list of the Borsa Valori or the mercato ristretto, as the case may be⁸⁰⁾. The Consob also has the power to have the shares of a company listed "di ufficio". This will be done e.g. if the off-exchange trading of a title has reached volumes that make it eligible for regular quotations on the exchange or the mercato ristretto⁸¹⁾.

- The Consob disciplines listed companies as to their compliance with disclosure requirements and monitors the publication of annual reports and interim information for investors (not yet mandatory). It has the obligation to set up rules for the balance sheet and profit and loss account. The Consob is entrusted with the transposition of EEC-directives into national law⁸²). It has the right to insist on publication of consolidated statements and can inspect the companies' accounting. In a major effort the auditing of companies' accounts is currently being introduced in Italy⁸³).

- The Consob has the responsibility of public supervision of stock exchange trading. It determines the brokers' commission and other fees, sets up the stock exchange calendar, governs specific regulations concerning public offers for subscription or for sale and take over bids⁸⁴). It has the right to temporarily suspend trading on the entire stock exchange, to limit trading to cash transactions instead of usual forward transactions, and the right to institute margin requirements⁸⁵). Furthermore, it determines the quotation system and the minimum lots for trading.

- The Consob has corresponding power as to the regulation of the mercato ristretto⁸⁶).

Currently the Consob appears to be unable to perform above duties properly. At the time of writing it was shaken by the resignation of its chairman and a commissioner. The accompanying public quarrel was

commonly regarded as an expression of more profound underlying problems. The Consob has not yet achieved the prerequisite for its well-functioning: a reliable independence from the political and economic structures in Italy⁸⁷).

The more technical organization of the stock exchange is left with the local executive committee of the stockbrokers (Comitato Direttivo degli Agenti di Cambio) which is elected by the stockbrokers every two years. There is a Comitato del Mercato Ristretto designed to take up equal functions.

Some responsibilities still remain with the Ministry of Treasury, the local chamber of commerce, and the Deputazione di Borsa. There have been complaints about the overlapping of powers⁸⁸).

By law only stockbrokers (agenti di cambio) may be members of the exchange and are privileged to deal on the floor of the Borsa and on the mercato ristretto⁸⁹).

In August 1983, there were 205 classes of shares listed on the ten Italian stock exchanges, issued by 168 companies (1975: 216 classes of shares of 200 companies). Multiple listings are allowed and occur to a great extent.

There are also small to medium-sized companies officially listed on the Italian stock exchanges. The listino ufficiale of the Borsa Valori di Milano showed 188 classes of shares issued by 142 companies in August 1983⁹⁰). After the deduction of 54 companies belonging to the insurance, banking and finance sector, there

were 88 industrial or commercial companies listed on that exchange. Out of this remainder, 24 companies could be considered as medium-sized having a nominal capital of less than ECU 5 million⁹¹⁾, four companies of which could be classified as small having a capital of less than ECU 1 million. But these shares generally did not belong to the actively traded issues. Some further issues were suspended from trading at the time of writing.

The Italian mercati ristretti listed 38 classes of shares of 37 companies in September 1983.

Most of the companies traded here are regional, cooperative or saving banks, some are finance or insurance companies. Of the remaining 6 industrial companies, four have nominal capital amounts between ECU 1.4 and 3.5 million⁹²⁾.

Corresponding figures for the terzo mercato are not available. Since it is an unregulated market, no systematic statistics are at hand. A publication by the finance company Cofindi⁹³⁾ includes a table with the names of 54 companies traded on the terzo mercato as of mid-1981, 27 of which were industrial or commercial companies. Names mentioned in a daily information column on the terzo mercato in "Il Sole - 24 Ore"⁹⁴⁾ only represent a selection of shares that were subject to off-exchange trading on the previous working day. Here the majority of issues are bank, finance, and insurance titles as well; few industrial names appear from time to time in this section.

Regarding the size of the companies traded on the third market, capital amounts were not available for comparison. Estimates of Italian bankers indicate that the population on the terzo mercato is quite heterogeneous. Some well capitalized banks are traded practically every day; the few industrial companies comprise medium-sized to very small firms. Prices at which the sporadic transactions in shares of small industrial companies occur will, as a rule, not be published in a newspaper.

II. EXCHANGE SEGMENTS

1. The Borsa Valori market as a segment for small company shares

The Borsa Valori is the traditional market for shares of all public companies. The small and medium-sized companies traded here are subjected to the standard listing requirements and trading procedures. Except for continuous trading, which only large companies enjoy, no adjustments have been made with a view to company size.

a) Listing

Since the Consob has so far not used its right to reform rules on the admission of securities to official listing, the pertinent requirements are still essentially governed by the Stock Exchange Law of 1913⁹⁵):

1. The company applying for an official listing must be incorporated as S.p.a. or S.a.a. having issued regular, typical share titles. So far atypical share titles (participation certificates) are not admitted. However, this might change upon implementation of the pertinent EEC-directives⁹⁶).
2. The company applying must have a nominal capital of at least Lire 500 million fully paid-up, and its latest balance sheet must show a minimum amount of capital plus net reserves (patrimonio netto) of Lire 1,500 million⁹⁷). These minimum standards are uniform throughout the various sectors of the Italian economy. The amounts certainly will be increased within the framework of the EEC-directives.
3. The balance sheet of the two most recent fiscal years must show positive results; this means implicitly that the company must already have existed for at least two years. A dividend payment must have been disbursed at least in the year prior to the listing application. No minimum dividend amount or ratio is required. No such profit requirements have to be maintained once the company has been listed.

Before negotiations on the stock exchange start the company must have appointed an auditor who is also to be acknowledged by the Consob. However, so far the balance sheets submitted together with the listing application need not yet be officially audited, although this

requirement can be made by the Consob at any time⁹⁸). On the other hand, this is an item where companies seeking a listing would voluntarily go beyond existing rules.

4. The share certificates must have all the necessary coupons attached and must be definitive, freely transferable documents. If a simultaneous listing of different classes of shares of one company is intended, a separate application for each class has to be made and a separate, though probably simultaneous permit will be given by the Consob.
5. The shares must be sufficiently distributed among the investing public; in praxi a public distribution of at least 20 % of each class of shares is considered to be satisfactory. In order to assess actual diffusion, the company has to state in its listing application the names of shareholders registered in the libro soci. Reference can also be made to the frequency of transactions if that very title has already been previously traded on the mercato ristretto or the terzo mercato. A sufficient distribution can be safely assumed if the shares to be admitted had recently been subject to a public offer for sale or a public share placing.
6. Due to the still missing Consob regulation, in particular a listing prospectus is not required to date. Yet this is another item for voluntary disclosure with a view to pending legislation and demand of potential shareholders⁹⁹).

The listing application must be submitted directly to the Consob by the issuing company, duly signed by the company's chairman. Banks, finance companies or other stock-exchange related institutions need not sign or support the application, although their consultation on the operation will in any case be sought for. The application has to be accompanied by legal documentation and information on the company's economic and financial history¹⁰⁰).

The listing procedure is quite time consuming. The time span from the first decision by the board of managing directors to have the shares listed to the date of first quotation is estimated to be 10 months on average. This period will increase to 13 months if the listing is connected to a public share placement and to 20 months in case of a public offer for subscription. The processing of the application by the Consob is estimated to take 7 to 8 months on average¹⁰¹).

The costs connected with listing on the Borsa Valori are broken down as follows¹⁰²):

1. The publication of a notice on the listing application in the press is estimated to cost Lire 750,000 to 1 million.
2. The cost for an expert opinion of the Comitato Direttivo degli Agenti di Cambio is calculated according to the following table: 1 per mille for up to and including Lire 10 mrd of share capital for which listing is applied for, 0.5 per mill

for more than Lire 10 mrd and up to and including Lire 35 mrd countervalue, and 0.25 per mille for more than Lire 35 mrd. Thus for a small company with Lire 5 mrd share capital the expert opinion would cost Lire 5 million.

3. Printing cost for share certificates, if not yet printed.
4. Printing and publication cost for prospectus, if voluntarily circulated or if so required de facto in a public offer for sale or subscription.
5. Auditor's remuneration, if so required de facto.
6. Underwriting commission and selling concession, to be paid to the consortium banks if a public distribution of the shares is connected with the listing.

Estimates of the total cost range from 3 to 8 % of the share issue, depending whether only listing is sought for or whether it is connected with a share offer or placement.

There is no initial listing fee. A continuous listing fee (tasse camerale) is payable in January of each year on the listed capital as of December 31 of the year just ended¹⁰³). It amounts to Lire 200 per million of the first Lire 50 mrd of capital, and Lire 100 per million of the capital exceeding Lire 50 mrd. A small company with a share capital of Lire 5 mrd would be subject to a continuous listing fee of Lire 1 million

per annum which appears to be a reasonable amount. Newly admitted shares are not subject to this fee for the first year of listing, in the second year the amount due is reduced by 50 %, in the third and fourth year by 25 %.

Finally to be considered are the continuous servicing costs, including coupon and paying agency services, administration of annual and extraordinary general assemblies, and the maintenance of relations with shareholders, the investing community, the stock exchange institutions, banks, and the press. A rough calculation estimates these cost items to be 0.5 % per annum of the listed amount.

b) Trading

Any trading on the Borsa Valori and the official quotation must be effected through an agente di cambio¹⁰⁴). These official stock exchange intermediaries may be assisted in their activities on the floor of the exchange (alle grida) by up to three representatives, acting in the name, on behalf and under the responsibility of their principal. Entry to the trading floor is also granted to representatives of finance companies and of banks having a paid-up capital of at least Lire 100 million, as well as to commission brokers (commissionarie). All these pass on orders to the agenti but otherwise have only an observer status on the exchange.

There is official trading on working days during the stock exchange hours from 10 a.m. to 1.45 p.m. This period may be extended or shortened depending on the actual turnover. Trading takes place at rings (corbeilles) to which the different shares are allocated and where the agenti and their representatives meet. The shares of each ring are traded consecutively, one by one as they appear on the respective list using the call system. After a title has been called up by a stock exchange clerk, the broker and their representatives ascertain prices in collective negotiations. They call out bids and offers (denaro e lettera) to each other, referring to round lots (quantitativi minimi di contrattazione) or multiples of lots which are established by the Consob individually for each company. The agenti have no legal obligation to execute odd-lot orders. As in the French procedure "à la criée", a price at which supply and demand balance is more or less quickly established. Generally, on the Italian exchanges there are two price calls, including an opening price (prezzi di apertura) and the fixing of the official price, the closing price (prezzi di chiusura, prezzi del listino). In Milano there is currently due to the comparatively high overall volume only one price fixing each day at the official closing price. If there are no transactions an estimated price (prezzo nominale) is quoted which is sometimes the case for small companies. In frequently traded issues there are also continuous individual prices (prezzi durante) but this obviously does not hold true for small company shares. In 1982, on the Milano stock exchange the thirty most active shares accounted for some 78 % of the total turnover volume¹⁰⁵). A lot of shares, particular those of small companies, are quite inactive.

All shares are traded forward. The transactions have to be settled on the monthly account day which is fixed by the Consob's annual stock exchange calendar and which is usually as close to the end of the month as possible.

This system facilitates the piling up of speculative positions. In order to prevent an overheating of stock exchange bargaining with an ensuing crash of prices, as it happened in mid-1981, the Consob has since then introduced compulsory margin requirements, amounting to deposits of 30 % on any purchase and 70 % on any sale of shares on the official market¹⁰⁶). During the speculative turmoil of that time, the Consob had even closed down the exchange for some days. After reopening, forward transactions were suspended for some time and only cash settlements were allowed.

In addition to regular forward trading there is also an option market but practically only for major shares. Carryover transactions (contangoes) are also possible.

The prices of shares are displayed on the Milano trading floor by means of illuminated boards and are communicated to the delivery system, to news agencies, banks and other interested parties in real time via the stock exchange EDP centre¹⁰⁷). On other exchanges these services are not yet developed to such an extent. The official list (listino ufficiale) is published after each trading session and contains the official prices as well as other quotations, if any, and turnover figures.

A central securities depository system called "Monte Titoli" entered into operation in November 1981¹⁰⁸). It handles among others dividend payments of the titles deposited there. But it does not yet serve the function of an overall clearing system because settlement and flow of funds out of stock exchange transactions are still left to the local clearing houses (stanza di compensazione) of the Bank of Italy. For the vast majority of shares, particularly those of small companies, the share certificates must physically change hands at the end of the monthly account period.

The standard commission rates¹⁰⁹) applied by the agenti to their private clients for a purchase or sale of shares or option rights are 7 per mille of the contract amount, with a minimum commission of Lire 4,000. Presently there are no scaled rates for large orders. The respective rates for banks, commission agents, fiduciary, trust and finance companies amount to 3.5 per mille, for investment funds to 4.5 per mille. There is commission sharing between the agenti and banks¹¹⁰).

On each transaction a stamp duty is levied. This amounts to Lire 75 for forward transactions and Lire 50 for cash transactions, calculated per Lire 100,000 of the volume.

2. The Mercato Ristretto

The forerunners of today's mercato ristretto date back to some decades ago¹¹¹). An early market for unlisted securities in Milano could already be found in the

1930s; after the Second World War some degree of organization was applied to trading procedures and persons involved.

In the mid-seventies mercati ristretti existed in Milano, Roma, Genova, Torino, Firenze, and Napoli. In 1975, a total of 127 classes of shares of 124 companies were traded at weekly sessions, 109 companies of which in Milano. The turnover was significant even in comparison with trading on the Borsa Valori; sales on the Milano mercato ristretto often exceeded the turnover of the small Italian official exchanges.

These lively and well functioning, though semi-official markets came to a halt on May 12, 1975 when the Court of Appeal ruled that the weekly reunions were illegal and incompatible with Article 9 of the Law No. 272 of March 20, 1913. Agenti di cambio had participated in the assemblies and, according to a restrictive interpretation of said article, therefore would have had to be excluded from trading on the Borsa Valori.

After its closing down the need for trading of mercato ristretto titles was still alive. New off-floor markets developed spontaneously, particularly with the participation of banks and finance companies. This sustained economic demand for trading possibilities in unlisted shares made the Consob consider with priority the revitalization of the mercati ristretti under its supervision.

After a period of pending illegality, the Delibera Consob No. 233 of June 24, 1977 created the framework for the new official market for unlisted securities. The first meeting took place in Milano on May 10, 1978¹¹²⁾.

As a concept, the mercato ristretto was meant to regain its former function, with a level of regulation distinctly lower than on the Borsa Valori. But apparently, the Consob rules for a formerly essentially self-regulating market and the awkward situation that the legal entry requirements and procedures for the mercato ristretto are about as strict as those for the Borsa Valori, did not allow this second market to develop as had been hoped¹¹³⁾. Presently, it has lost the function of a trial market for an envisaged subsequent listing on the Borsa Valori¹¹⁴⁾. The predominance of banks has existed ever since its re-opening. A major motive for many co-operative banks (banche popolari) to have their shares listed here is the possibility to maintain the shareholder pre-emption clause and yet enjoy the privilege of being traded on a recognized securities market¹¹⁵⁾. The maintenance of this clause is not possible on the Borsa Valori where unrestricted fungibility must be provided for.

a) Listing

To be mentioned are mainly the differences to the above requirements of the Borsa Valori¹¹⁶⁾.

1. The company must be incorporated in Italy.
2. Capital plus net reserves must be at least Lire 1 mrd; there is no minimum nominal capital .

3. The accounts of the last two financial years must show positive results; the distribution of a dividend is not required. By discretionary power of exceptional decision, the Consob can determine also recently created companies to be eligible for listing on the mercato ristretto.
4. At least 20 % of the share capital must be publicly distributed.
5. A listing prospectus has to be compiled¹¹⁷⁾. The contents must be in line with the Sixth EEC-Directive. It must be published in at least one newspaper of local importance for the area where the mercato ristretto is situated or, preferably, in a newspaper with national circulation.

The application for admission to quotation on the mercato ristretto has to be made, separately for each class of shares, by the company itself, signed by the legal representative(s). The request has to be accompanied by a heavy file of enclosures.

Fees, commissions, and expenses connected with admission are presently about the same as for the Borsa Valori.

b) Trading

Trading on the mercato ristretto takes place in reunions once a week. In Milano this weekly meeting is held on Wednesdays, starting at 3.30 p.m. The other five mercati ristretti have their dealings on different

weekdays¹¹⁸). Since we find multiple listings here as well, an investor will, in principle, not have to wait a week for the execution of his order in the case of the companies concerned. But more realistically than having his order executed on an exchange far away, it will be matched with a bank or finance company. This particularly holds true for the shares of small companies.

An order seeking a quotation on the mercato ristretto has to be passed through an agente di cambio. Here shares are also traded under the call system. There is principally one collective price quoted for each company's shares during a session. By contrast with the Borsa Valori, trading and execution are for cash only. Settlement and delivery of the transactions have to be effected within three days.

Shares of the mercato ristretto can also be deposited with the Monte Titoli provided they have no shareholder pre-emption clause or other restrictions to fungibility. This mostly concerns the banche popolari mentioned above.

Prices are published in the listino ufficiale del mercato ristretto, compiled by the local chamber of commerce.

Fees and commissions for investors are the same as on the Borsa Valori.

III. OFF-EXCHANGE SEGMENTS

1. Off-exchange trading in listed shares

Shares listed on the Borsa Valori or on the mercato ristretto are to a considerable extent subject to off-exchange trading. There are estimates that generally only 20 - 25 % of the orders in listed shares reach the stock exchange; the remainder is compensated in the institutional network of the banks and finance companies, or through commission agents¹¹⁹⁾. Put-throughs are not mandatory and are rare. Such intermediaries also match clients' orders inhouse for their own account. Odd-lot orders are usually executed this way, with the official price of the exchange as benchmark. Hence, the shares of small listed companies in particular will be dealt outside the exchange. If the client agrees to it, orders will also be executed on the telephone market for listed shares before and after stock exchange hours.

In addition, this segment comprises special markets for blocks of shares and for majority and minority interests in companies¹²⁰⁾. These are fairly intransparent markets; hear-say about them and sometimes headline stories about mergers or attempts to seek control are not of the type to make the majority of small company owners more inclined to open up their shareholders' basis and to increase public participation.

2. The Terzo Mercato

With the same instruments with which they are active on the off-exchange markets in listed securities, the banks, finance companies, and commission agents also deal in unlisted securities.

Many of the companies that were traded on the former mercato ristretto until its closure can now be found on the terzo mercato¹²¹). This marketplace is generally much less structured and organized than its forerunner.

Still, as its forerunner, it has two main functions:

- to provide trading possibilities for unlisted shares and thus satisfy an evident economic demand
- to serve as "anticamera" to a subsequent official listing.

There are no fixed trading dates or periods. Investors just have to contact an intermediary, of course running the risk that the bank or finance company approached is not interested in that particular share or exploits the intransparency and quotes an off-market price. There is interbank trading on the terzo mercato as well.

Given the heterogeneous population of the terzo mercato it comes as no surprise that some shares are traded very irregularly and that details about the negotiations are not published (in fact because they might not be

too interesting to a broader public). Some issues are traded frequently, even daily. Their price is published e.g. in "Il Sole-24 Ore" but usually only some of these are small company shares¹²²).

There is no listing and there are no admission requirements.

Trading is for cash, with cash settlement and mostly physical delivery of the shares.

The terzo mercato also uses the commission structure of the official market as a reference. Major investors with large orders can achieve reduced rates. Infrequent trading in small business shares will not enable an investor to negotiate.

IV. SUMMARY

Primary and secondary markets for shares of small and medium-sized companies are comparatively less developed in Italy. The reasons can be found on two levels.

The first aspect entails trading possibilities. The official segment with the Borsa Valori and the mercato ristretto is embedded into a system of public regulation and supervision. Since its establishment in 1974 the Consob, as well as numerous reform measures and proposals¹²³), could not solve imminent problems and improve the reputation of the stock exchange. In fact, the Consob encumbered stock exchange life with

its internal problems and a public quarrel about the choice of its commissioners. It is common understanding that the Consob currently does not function properly. Stock exchange trading is professionalized on a broad scale - the latest attempt to raise interest also on the retail level broke down in the price crash of mid-1981.

Comparatively little consideration is given in Italy to the issuance and trading of small to medium-sized companies' shares. The mercato ristretto, formerly also a self-regulated trial market for subsequent stock exchange listing, has presently lost this function. Since 1978 it is officially administered by the Consob, and current regulations do not allow a perceivable distinction from those of the Borsa Valori.

So far the terzo mercato could not achieve the vitality of the former mercato ristretto. The population here is quite heterogeneous - it ranges from large banks and some insurance companies to small companies. But there are only a few such small industrial companies on the terzo mercato. They are infrequently traded and their number is almost negligible compared to the total number of stock companies in Italy.

But even if issuance and trading possibilities for small companies' shares particularly on the mercato ristretto or terzo mercato should improve, there is a second level of obstacles. At least as far as small to medium-sized companies are concerned, reproaches should possibly not be made against the stock exchange and the terzo mercato if they do not offer services for which

there is not even a genuine demand. The small companies' world in Italy is characterized by ownership of families and business associates. There is generally a "closed-shop" mentality. Small company finance depends on bank loans, reinvestment of profits and capital implements by the already existing circle of shareholders. For the vast majority of small companies in Italy going public is not yet the point. Potential benefits from the public distribution of shares and trading on a secondary market are far overcompensated by the fear of losing control and having to carry the burden of disclosure.

Recently, there have been some incentives for venture capital financing and getting more companies listed on the stock exchange. It remains interesting to observe if developments in other EC-countries will also find fertile soil in the Italian company and finance structures.

Footnotes

- 1) The terminology and essential company legislation are contained in the Codice Civile of March 16, 1942, Fifth Book "Del Lavoro", Title V "Delle Società", Articles 2,247 - 2,510. The law text and commentary can be found in: Dieter Henrich, Remo Cereghetti, *Das italienische Aktienrecht*, 2. ed., Frankfurt am Main 1976. Cf. also Robert R. Pennington, Frank Wooldridge, *Company Law in the European Communities*, London 1982, Chapter 3: Italy, pp. 69 - 95.
- 2) Source: Istituto Centrale di Statistica, Roma, Rilevamento Istat 1981. More recent statistical data is not yet available but the dimensions and structures are discernible and did not undergo any important change since 1981.
- 3) The surveys cited here differ in sample, method and period covered. Still they give a fairly consistent picture of Italy's small business world. For an abstract of findings cf. Giorgio Pivato, *Le strutture finanziarie delle medie imprese industriali. Capitali sociali, riserve ed accantonamenti per autofinanziamento*, *Giornale degli economisti e annuali di economia*, Vol. 38, 1979, pp. 831 - 870. Pivato reverts to a study by Mediobanca, *Dati cumulativi di 828 società italiane, 1968 - 1977*, and to a study by the Stockbrokers' committee of the Milano stock exchange, *Inquiry on medium sized industrial companies*, Milano 1979. This latter study has a sample of 100 medium-sized, independent companies from the Lombardia.
- 4) James Buxton, *Small firms ready to respond*, *Financial Times*, March 28, 1983.
- 5) *Ibid.* With the industrial triangle Milano, Torino and Genova still considered as the heartland, further manufacturing centres have developed, e. g. Reggio Emilia for farm machinery industry, Parma for food processing and food processing machinery, Bologna and Modena for machine tools, Montebelluna (Veneto) for skiboats and sports shoes, Carpi (Modena) for knitwear, Prato (Florence) for cloth, Barletta and Trani (Puglia) for shoes, Solofra (Napoli) for leatherwork, etc.
- 6) Antonio Duva, *Come rafforzare la media impresa nella competizione internazionale*, *Il Sole - 24 Ore*, June 6, 1980. The sample comprised 1,200 companies from Liguria, Lombardia and Piemonte which were interviewed and participated or at least supported the Third Workshop on small and medium-sized companies in Gardone 1980.
- 7) Paul Lewis, *Firms in Italy prove small is beautiful*, *International Herald Tribune*, March 18, 1980.

- 8) Osvaldo de Paolini, A picco "l'azienda Italia", Il Sole - 24 Ore, July 1983. Italiens Industrie auf Talfahrt, Börsen-Zeitung, August 11, 1983.
- 9) R. R. Pennington, F. Wooldridge, l. c., pp. 70 - 72. Paul R. Müller, Gesellschaftsrecht, Steuern, Buchführung und Rechnungsprüfung in Italien, Bern 1981, pp. 10 - 12.
- 10) 1 ECU = Lire 1,386.78
- 11) Law No. 904 of December 16, 1977 - the "Pandolfi-bill". It mainly introduced an imputation system in the taxation of companies, dividends, capital increases and other corporate fiscal matters. Cf. the English summary compiled by the Stockbrokers' committee of the Milano stock exchange.
- 12) Per la prima volta in diminuzione il numero delle società per azioni, Il Sole - 24 Ore, February 25, 1981.
- 13) Estimation by Italian bankers, obtained by the author.
- 14) Articles 2,346 - 2,362 of the Codice Civile contain the regulations concerning shares. Cf. Banca Commerciale Italiana, The Italian stock market for nonresidents, Folder, May 1981, Part A - 3.
- 15) Siegfried Bley, Börsen der Welt, Frankfurt am Main 1977, p. 335.
- 16) Taken from the listino ufficiale of the Milano stock exchange.
- 17) But Eternit s.p.a., for example, has issued so-called azioni preferenziali which retain voting rights.
- 18) R. R. Pennington, F. Wooldridge, l. c., p. 73.
- 19) Law No. 216 of June 7, 1974 which is considered as the current stock exchange reform law. Cf. also Law No. 576 of December 2, 1975 ("Legge Visentini").
- 20) Banca Commerciale Italiana, l. c., Part B - 3, p. 2
- 21) Ibid. Cf. also R. R. Pennington, F. Wooldridge, l. c., p. 73. Borsa Valori di Milano, Rapporto annuale 1979, pp. 63 and 92.
- 22) Stockbrokers' committee of the Milano stock exchange, The Milan stock exchange, Milano 1983, p. 8.
- 23) Borsa Valori di Milano, Rapporto annuale 1979, p. 64; Rapporto annuale 1982. p. 46.

- 24) Mario Monti, Francesco Cesarini and Carlo Scognamiglio, Report on the Italian credit and financial system, Special issue of the Banca Nazionale del Lavoro Quarterly Review, Rome, June 1983, p. 78.
- 25) Paul R. Müller, l. c., p. 13.
- 26) Ibid.
- 27) Credito Italiano, The Italian stock exchange, edition 1979, p. 9 f.
- 28) R. R. Pennington, F. Wooldridge, l. c., p. 74 f.
- 29) Ibid.
- 30) Banca d'Italia, Relazione annuale 1982, pp. 273 - 296. Appendice 1982, pp. 98 - 102, with methodological notes p. 148. Cf. also the English version of the Annual Report 1982, pp. 107 - 121.
- 31) Ibid., p. 118
- 32) Bruno Bianchi, Banca centrale e mercato finanziario, Bancaria, Vol. 38, August 1982, p. 885.
- 33) Cf. the description of the personal and capital links between companies at the beginning of the country report.
- 34) To be cited are among others EFIM, Enel, ENI, IRI, Autostrade.
- 35) Giorgio Pivato, l. c., p. 85
- 36) Paul Stoneham, Major stock markets of Europe, 1982, pp. 170 - 172. Carlo Patrucco, Le piccole e le medie aziende industriali di fronte al capitale di rischio, Bergamo, April 1983, p. 7. Mario Massari, La media impresa in Italia, Caratteristiche economiche e finanziarie, Milano 1977, p. 137.
- 37) Giorgio Pivato, l. c., pp. 842, 846 and 854. Mario Monti et al., l. c., pp. 67 and 200.
- 38) Ibid.
- 39) Paul Stoneham, l. c., p. 148 f.
- 40) Ibid., p. 136.
Stocks are struggling to regain momentum, International Herald Tribune, May 3, 1982. David Shireff, Italian banking, Euromoney, August 1983, p. 94. For example, bank deposits yield 13 %.

- 41) Ettore Fumagalli, *La Borsa rivendica strutture a misura dei Fondi*, *Il Sole - 24 Ore*, August 17, 1983.
- 42) Banca d'Italia, *Rapporto annuale 1982*, p. 288. Bruno Bianchi, l. c., p. 882. There is some crowding-out to the advantage of government paper and other debt titles at the cost of shares. For example, in January 1982 the volume of newly issued buoni ordinari del Tesoro exceeded the market value of all shares listed on the Italian stock exchanges. Cf. Günther Depas, *Italien braucht einen soliden Aktienmarkt*, Interview mit Prof. Guido Rossi, *Finanz und Wirtschaft*, January 16, 1982.
- 43) Banca d'Italia, *Rapporto annuale 1982*, p. 288.
- 44) Paul Stoneham, l. c., p. 167
- 45) The Banca d'Italia has taken up 9 licensed foreign mutual funds into their statistics. Cf. Banca d'Italia, *Rapporto annuale 1981*, p. 284; *Rapporto annuale 1982*, p. 288. *Il Sole - 24 Ore* names 12 of them in its daily section with bid and ask prices. According to an article in the *Economist* they invested Lire 300 billion in 1982: *Italian stockmarket, Permission to be trusted*, *The Economist*, March 26, 1983.
- 46) The funds still carry non-Italian stocks from former times. 50 % of the proceeds from foreign stocks must be invested in Italy. *Il Sole - 24 Ore* also publishes bid and ask prices of approx. 50 investment funds not authorized in Italy, mostly managed by banks in Switzerland.
- 47) Law No. 77 of March 23, 1983.
- 48) Banca d'Italia, *Rapporto annuale 1982*, p. 289.
- 49) Cf., for example, *Saranno probabilmente tre i fondi del S. Paolo (Bancario San Paolo di Torino)*, *Il Sole - 24 Ore*, August 27, 1983.
- 50) Commissione nazionale per le società e la borsa, cf. chapter I. 5.
- 51) Stockbrokers' committee of the Milano stock exchange, l. c., p. 12.
- 52) Ettore Fumagalli, l. c. Renzo Ginbergia, *Va stretto ai Fondi quel limite del 5 %*, *Il Sole - 24 Ore*, August 4, 1983
- 53) *The Economist*, l. c.
- 54) This double 5 % - clause is known from other capital markets.

- 55) Stockbrokers' committee of the Milano stock exchange, l. c., pp. 12 f.
- 56) Banca d'Italia, Rapporto annuale 1982, p. 287; appendice pp. 100 f. Bruno Bianchi, l. c., p. 878 - 880.
- 57) In 1982, the issues of three state-controlled companies (Finsider, STET, SIP) alone accounted for more than 27 % of the total volume of new issues.
- 58) Banca d'Italia, Rapporto annuale 1982, p. 286.
- 59) For a characterization of BOTs and other government paper cf. E. Victor Morgan, Richard Harrington, Capital markets in the EEC, The sources and uses of medium and long-term finance, Westmead 1977, p. 194, in particular Footnote 1.
- 60) Banca d'Italia, Rapporto annuale 1982, appendice pp. 98 - 101. Bruno Bianchi, l. c., p. 878.
- 61) Cofindi (Compagnia Finanziaria di Investimenti s.p.a.), Guida alla quotazione: Borsa Valori, Mercato ristretto, Milano 1981, pp. 39 - 43.
- 62) Stockbrokers' committee of the Milano stock exchange, l. c., p. 4.
- 63) Carlo Patrucco, l. c., pp. 9 f.
- 64) At the end of 1982 there were 1,085 banks in Italy. For a grouping of banks cf. Banca d'Italia, Rapporto annuale 1982, appendice, pp. 194 f. Among these there are 3 banche maggiori (Banca Nazionale del Lavoro, Banca Commerciale Italiana, Credito Italiano), 7 banche grandi (Banco di Roma, Banco di Napoli, Istituto Bancario S. Paolo di Torino, Monte dei Paschi di Siena, Banca Popolare di Novara, Banca Nazionale dell'Agricoltura, Banco di Sicilia), 11 banche medie, 24 banche piccole, and 165 banche minori. Furthermore, there is one cassa di risparmio maggiore (Cassa di Risparmio delle Province Lombarde), one cassa di risparmio grande (Cassa di Risparmio di Torino), 5 casse di risparmio medie, and 31 casse di risparmio piccole.
- 65) Giorgio Brunetti, Con la Merchant Bank il rinnovo del sistema, Il Sole - 24 Ore, August 26, 1983. David Shireff, l. c., p. 94.
- 66) E. Victor Morgan, R. Harrington, l. c., pp. 203 - 205.
- 67) David Shireff, l. c., pp. 93.

- 68) Borsa Valori di Milano, Rapporto annuale 1982, p. 79. For a characterization of these and other listed companies cf. Banca Nazionale del Lavoro, La meridiana dell'investitore, Roma, ed. 1983. There are other companies prominent in Italian investment banking, like Euromobiliare s.p.a. which in 1981 still was traded on the terzo mercato and was listed on the Borsa Valori in early 1982.
- 69) David Shireff, l. c., p.92.
- 70) Jody Vender si fa le ossa con Finnova, Rivista dei fondi comuni d'investimento, No. 5, July 1983, p. 5. - In der Schublade Patente - doch das Geld fehlt, Wagnisfinanzierung in Italien - Olivetti inszeniert Kongreß in Venedig, Blick durch die Wirtschaft, August 10, 1983, p. 1.
- 71) Ibid.
- 72) Wagnisfinanzierung in Italien, l. c. Marco Marcello, Il venture capital deve diffondersi in Italia, Il Giornale; June 30, 1983.
- 73) about ECU 440,000
- 74) Wagnisfinanzierung in Italien, l. c.
- 75) Giancarlo Mazzuca, Per Olivetti "Venture capital" e sbarco a Wall Street, Corriera della Sera, June 30, 1983. Elserino Piol, Come l'Olivetti ha investito in 21 società d'avanguardia, Rivista dei fondi comuni d'investimento, No. 5, July 1983, pp. 15 - 17. Osvaldo de Paolini, Venture capital: modo nuovo di "Fare impresa", Il Sole - 24 Ore, June 30, 1983.
- 76) In Milano, Roma, Torino, Genova, Napoli, Firenze, Bologna, Venezia, Trieste, and Palermo, with Milano being by far the most important one generally accounting for some 80 - 90 % of total turnover.
- 77) In Milano, Roma, Torino, Genova, Napoli, Firenze.
- 78) Law No. 216 of June 7, 1974, complemented by several decrees since then. For an overview of Consob's activities cf. the annual Relazione sull'attività svolta and the annual Documentazione a rilevanza esterna.
- 79) Hartmut Schmidt, Advantages and disadvantages of an integrated market compared with a fragmented market, l. c., p. 164.
- 80) Delistings exceeded listings since 1977. Cf. Paul Stoneham, l. c., p.150. Currently some 15 - 20 companies are considered as candidates for a forthcoming listing on the Borsa Valori.

- 81) Such action of the Consob in regard of the shares of the Banco Ambrosiano in 1982 has caused divergence of opinions. The Consob had been informed about irregularities with this institute through the supervision of the Banca d'Italia already in 1978. The official listing di ufficio of the shares of the Banco Ambrosiano, formerly traded on the mercato ristretto, was aiming at coercing the institute to disclose matters hidden so far. The listing on the Borsa Valori had to be recalled only 32 days later, making the Consob subject to reproaches not to have acted in the sense of investors' protection. This finally led to the resignation of the then presiding chairman of the Consob. - Präsident stürzt über den Fall Ambrosiano, Handelsblatt, August 13/14, 1982. Rossis Rücktritt, Börsen-Zeitung, August 14, 1982.
- 82) Until today, this is only the case for the mercato ristretto. Cf. below.
- 83) For the time being this will only be compulsory for stock exchange listed companies in the following steps: Major industrial companies with a capital exceeding Lire 50 billion must have had an authorized auditor (as specified in Consob's albo speciale) engaged by April 13, 1981, and the 1983 balance sheet will have to be audited. Listed companies with a capital of Lire 10 to 50 billion must have their 1984 balance sheet audited, and for the year 1985 the accounts of all other listed companies will have to carry an auditor's certificate, except for listed banks which have a grace period until 1986. Cf. Stockbrokers' committee of the Milano stock exchange, l. c., p. 10. Paul Stoneham, l. c., pp. 163 f.
- 84) Public offer for subscription (Offerta pubblica di sottoscrizione - OPS) and public offer for sale (Offerta pubblica di vendita - OPV). Cf. Banca Commerciale Italiana, l. c., A - 5, pp. 4 f. On these matters as well as on takeover bids the stockbrokers' committee of the Milano stock exchange has developed codes of conduct which, pending pertinent legislation, are voluntarily adhered to. By law the Consob has to be informed of such activities in advance, and companies must prepare a prospectus on such matters. Cf. Stockbrokers' committee of the Milano stock exchange, l. c., p. 7.
- 85) Paul Stoneham, l. c., pp. 158 - 160.
- 86) Cofindi, l. c., pp. 25 f. Unione Fiduciaria s.p.a., Il mercato ristretto - tutto quello che conviene sapere.
- 87) Urbano Aletti, Questa Consob non è da buttare, Il Sole - 24 Ore, November 1, 1983. Donato Speroni, Consob - Il burocrate e i Milanesi, Il Mondo, November 7, 1983. Offener Streit in Italiens Börsenaufsicht, Frankfurter Allgemeine Zeitung, October 27, 1983.
- 88) Ettore Fumagalli, l. c.

- 89) Stockbrokers' committee of the Milano stock exchange, l. c., p. 2. In recent years, also stockbrokers have become insolvent.
- 90) Official list of August 3, 1983; not counting shares of companies suspended from trading.
- 91) ECU 1 million = approx. Lire 1,386 mrd;
ECU 5 million = approx. Lire 6,930 mrd.
- 92) Cf. any recent listino ufficiale del mercato ristretto.
- 93) Cofindi, l. c., pp. 134 f.
- 94) Cf. the daily section "Altre di Borsa - Prezzi informativi - Titoli non quotati in Borsa o al ristretto".
- 95) Law No. 272 of March 20, 1913; R. D. No. 1068 of August 4, 1913; complemented by Delibera Camerale of May 20, 1960.
- 96) Vincenzo Matturri, Titoli atipici: tutto quello che la Consob non garantisce, Il Sole - 24 Ore, August 24, 1983. Banca d'Italia vigilerà su tutti i titoli atipici, Il Sole - 24 Ore, September 9, 1983.
- 97) Cofindi, l. c., p. 22, also for the following outline.
- 98) Article 2, D.P.R. No. 136 of March 2, 1975. Article 8, D.P.R. No. 138 of March 31, 1975.
- 99) Stockbrokers' committee of the Milano stock exchange, l. c., p. 6. Joachim Klages, Die Richtlinien der EG über den Börsenzulassungsprospekt - Ein Vergleich mit den heutigen nationalen Regelungen, Baden-Baden 1981, pp. 80 f.
- 100) A list of requirements is e. g. contained in Banca Commerciale Italiana, l. c., A - 4, p. 2.
- 101) Stockbrokers' committee of the Milano stock exchange, p. 6. Cofindi, l. c., pp. 48-55.
- 102) Cofindi, l. c., pp. 57 - 59.
- 103) Ibid.
- 104) Stockbrokers' committee of the Milano stock exchange, l. c., pp. 2 f. Hartmut Schmidt, l. c., pp. 162 f.
- 105) Borsa Valori di Milano, Rapporto annuale 1982, p. 70.
- 106) In the case of a sale no deposit is required if the shares are delivered within three days.

- 107) Stockbrokers' committee of the Milano stock exchange, l. c., p. 4.
- 108) Ibid., p. 11.
- 109) Credito Italiano, l. c., enclosures.
- 110) Paul Stoneham, l. c., p. 147.
- 111) Hartmut Schmidt, l. c., pp. 170 - 173.
- 112) Unione Fiduciaria, l. c.
- 113) Francesco Masera, *Negoziazione dei titoli non ammessi alla quotazione ufficiale, Problematica e soluzioni in Italia e all'estero*, *Rivista di Politica Economica*, Vo. 68, April 1978, p. 605 - 629. Franco Cellino, *Qualche proposta innovativa per migliorare le Borse, Anche per il mercato ristretto sono necessari urgenti provvedimenti*, *Il Sole - 24 Ore*, January 29, 1980.
- 114) Una riforma del mercato ristretto necessaria per frenare la caduta, *Il Sole - 24 Ore*, September 20, 1983.
- 115) Cofindi, l. c., p. 33. Stockbrokers' committee of the Milano stock exchange, l. c., p. 6.
- 116) Banca Commerciale Italiana, l. c., A - 4, p. 3.
- 117) Ibid.
Cofindi, l. c., p. 46; appendix p. 97.
- 118) Monday: Genova, Napoli. Tuesday: Torino. Wednesday: Milano. Thursday: Rome. Friday: Firenze.
- 119) Stockbrokers' committee of the Milano stock exchange, l. c., p. 4.
- 120) Paul Stoneham, l. c., pp. 149 f.
Hartmut Schmidt, l. c., p. 170.
- 121) Cofindi, l. c., pp. 69 f.
- 122) Renato Cantoni, *Le borse italiane nel 1982*, *Bancaria*, No. 12, 1982, p. 1360.

123) Recent reforms include: The a. m. law "Visentini bis" which among others permits companies to revalue their assets with fiscal exemption. This allows scrip increases in the equity capital and share splits which are expected to have a positive impact on the stock exchange performance. Law No. 169 of May 4, 1983 supplies fiscal incentives for large holding companies to dispose of some of their industrial subsidiaries and have these shares listed on the stock exchange.

A most copious set of recommendations was delivered by the Senate Commission of Inquiry in autumn 1977. For details cf. StockBrokers' committee of the Milano stock exchange, l. c., pp. 10 f. Only recently a new approach was made by the committee to the Consob on reform of the stock exchange, containing the main points: (1) Concentration of trading of listed securities on the stock exchange (2) Formation of entrepreneurial partnerships between agenti di cambio (3) Formation of an autonomous Stock exchange body - l'Ente Borsa. Cf. Ettore Fumagalli, l. c. Reportedly also the Confindustria - Confederazione Generale dell'Industria Italiana, Roma, is preparing a major documentation on the Italian finance system which together with pertinent recommendations will be submitted to the government in the course of 1983.

K. THE SEGMENTS OF THE SECONDARY MARKET FOR EQUITY
INSTRUMENTS OF SMALL COMPANIES IN GREECE

I. ENVIRONMENT AND SURVEY

1. Number and forms of business organizations

There are four common forms of business organizations in Greece as follows:

- (1) the Public Limited Company or Société Anonyme¹;
- (2) the Private Limited Company²;
- (3) the Limited Partnership; and
- (4) the Unlimited Partnership.

Of the above business forms, the first one, the public limited company or société anonyme, is the most common form employed by large and medium sized firms. It entails limits on the extent of the financial exposure of their equity owners. This is the only type of business which can become listed on the Athens Stock Exchange (ASE).

There are about 2,500 public limited companies in Greece, of which 116 are traded on the ASE, up from 76 in 1967.

2. Frequently used instruments for equity financing

The most common form of new equity financing by small firms in Greece is non-voting preferred stock; the public issuance of common shares by such companies is far less popular. There are no other forms of equity financing commonly used by small firms in Greece. Such securities as income bonds are not employed, although a société anonyme may issue them.

Though convertible bonds may also be issued by a société anonyme, their use is rare. Common shares cannot be issued without voting rights or with diminished voting rights (Law 2190/1920 as modified by Royal Decree 174 of 1963, and subsequently amended, Article 30 (1)). This prohibition against the issuance of common shares with diminished voting rights may make small firms reluctant to issue new common stock which can threaten the control of their founders. The prohibition may thus hinder equity financing by small firms and the authorities might consider its repeal.

Preferred shares are more popular than common as a financing vehicle by small firms in Greece because of the overriding concern of such companies with maintaining family control in all financing operations. (There is no voluntary or statutory regulation of take-overs). In Greece the vast preponderance of preferred shares carry no provision for voting rights. On the other hand, the predominant advantage of preferred shares to small Greek firms over the public or private issuance of debt is the discretionary nature of preferred dividends vis-à-vis the mandatory interest payments carried by debt instruments. However, a limiting feature to the

present issuance of new preferred shares is a 1977 law limiting the quantity of preferred shares to 40 percent of the amount of common shares outstanding. To the extent that preferred shares participate in profits there is upside potential from the point of view of the investor.

3. Investors and investment motives

Far and away the vast preponderance of the ownership shares of small Greek companies resides in the hands of the families of their founders and operators. Greek entrepreneurship is characterized by such a condition and the overriding concern for the maintenance of family control. Another factor inhibiting the public issuance of common shares by small Greek companies is the inactive nature of the market for such securities. Current high interest rates and the consequent greater public interest in debt instruments are major factors in the present arid nature of the Greek equity market. Relatively low risk fixed income securities are currently yielding about 21 percent. As a result there is relatively little (by historical standards) investor interest in the equity securities of Greek firms across the board, whether large or small. While at one time (early 1970's) oversubscription to Greek new issues was commonplace, such is no longer the case as investor interest in such securities has waned dramatically. Thus, both the supply and the demand for new Greek equity issues has all but evaporated at the present time.

Just as the desire to retain control within the family

of smaller Greek companies is one of the prime factors inhibiting share issuance, there appears to be little or no interest on the part of outside investors in acquiring control of such firms. Smaller Greek companies are controlled almost exclusively by the family members of their founders and operators.

The tax environment for investors in Greece is not at all unfavorable. Interest is tax free. Dividends paid by ASE listed firms are tax exempt up to a yearly 25,000 drachmas (drs) per company per person, to a limit of 100,000 drs for all of an individual's investments³. 100,000 drs in dividends can be received tax free from an investment company (whether open or closed end) by an individual who receives no other dividend income. Dividends in excess of the exempt amount are taxed as follows:

	<u>Registered</u>	<u>Bearer</u>
Shares listed on the ASE	42% (38%)*	45% (41%)*
Shares not listed on the ASE	47% (43%)*	53% (47%)*

*(Percentages in parentheses were those in force prior to Law 1249/1982). Common rates apply to domestic and foreign corporations, limited liability companies and partnerships.

Furthermore, in Greece, capital gains are tax free (Emergency Law 148/1967, as amended).

A provision of Greek law which may hinder small firms and militate against retained earnings financing is that for a société anonyme at least some part of its annual profits must be distributed to its shareholders. While under some rather restrictive circumstances this need to distribute profits to shareholders may be reduced, this can occur only when the firm's general

reserves exceed 30 percent of its share capital and, irrespective of the amount of its reserves, only by capitalizing profits once every five years (Law 148/1967, Article 1(3)).

A provision of Greek law which softens the impact of the need to distribute dividends is that domestic corporations are taxed on that part of their profits which remain after dividends are distributed. Thus, double taxation of corporate profits is entirely avoided. (In this sense, the Greek tax system is extremely favorable to holding companies). However, dividends, fees, fringe benefits, etc., for Board members, managers and investors are subject to a withholding tax collected by the companies.

Tax incentives are given to taxpayers for the purchase of ASE listed shares. They are allowed to deduct from their net income subject to tax, varying sums depending upon the size of their family, for the purchase of new shares of companies quoted on the ASE, provided the capital of such companies increases in cash. Tax deductions for the purchase of new units of mutual funds are also granted. In both cases, however, the buyer is required to deposit with a bank for a period of twelve months the new shares or mutual fund units acquired.

4. Issuing houses for shares of small companies

The prime institutional investors interested in the equity instruments of small Greek companies are three types of investment bankers which are unique to the Greek environment. These investment bankers are:

- (1) the Investment Bank (a private institution);
- (2) the National Investment Bank for Industrial Development (a private institution); and
- (3) the Hellenic Industrial Development Bank (a state-owned institution).

These banks were founded for the purpose of enhancing the development of the capital markets in Greece. Their primary functions are to extend medium and long-term credit to industry, to participate in the equity financing of private enterprises, to issue and underwrite new issues of shares and bonds and to provide technical and managerial assistance to their clients.

In contrast to more developed economies, insurance companies in Greece do not represent an important force in the capital markets. Real estate is their primary investment outlet with only minor participation in fixed income securities and equities. The underdeveloped nature of the capital market in Greece, with the uncertain and limited liquidity of shares, is the main reason for the small participation of insurance companies in business financing.

On the other hand, while pension funds do not exercise an independent investment policy in Greece, as they are required by law to invest all their funds in the form of deposits with the Bank of Greece, some of these funds eventually find their way into business financing.

Banks are required to invest 15% of their total drachma deposits in long-term bonds for productive investment or in bonds or preferred stock of industrials. However,

the direct investment of banks in private sector securities is low ranging, during the 1970's, from 3.5% to 5.2% of the total assets of the commercial banking system. When engaging in such investments banks use the ASE⁴.

As of the end of 1982, the National Investment Bank for Industrial Development had a portfolio of equity investments which included shares of 69 companies. The acquisition value of these shares amounted to 4.4 mrd drs at that time. This compares with 65 companies and an acquisition value of 2.4 mrd drs at the end of 1979. In each year most of this portfolio consisted of common stock with the remainder being preferred stock. The National Investment Bank for Industrial Development does not participate in the management of its portfolio companies and maintains a firm policy of only acquiring minority positions in such businesses.

Other than the three entities mentioned above as the prime institutional investors for small company shares, Greek institutional investors have virtually no interest in very small firms. The distinct lack of liquidity of the shares of small Greek firms is one of the prime reasons for the lack of institutional interest in such securities. Since there is at present virtually no means for very small Greek firms to attain a listing on the ASE, the equity instruments of such enterprises are largely illiquid. There is no Greek over-the-counter market, but a law has been introduced into the Greek Parliament for the creation in the near future of a semi-official market in which smaller firms which cannot meet the ASE listing requirements can be traded. Thus, secondary market trading in small company shares is at present solely accomplished through private dealing between principals, a condition which prevents any real

interest in such securities on the part of institutional investors who normally require greater assurance of liquidity. This may change, however, with the advent of the semi-official market.

Tending in the same direction is the consideration that the share capital of Greek investment companies may only consist of contributions in cash, Greek Government securities, and shares and bonds listed on the ASE. The funds available to investment companies or mutual funds shall be invested exclusively in shares or bonds listed on the ASE. Further, should a Greek investment company or mutual fund take a position in a small firm the holding would likely have to be quite modest and perhaps not feasible in terms of the effort involved and the portfolio needs of the investment company or mutual fund. This is so since investment companies shall not invest in securities or shares of a société anonyme an amount exceeding, at purchase prices, one tenth of the share capital of this société anonyme or one tenth of the paid-up share capital of the investment company. A similar provision obtains for mutual funds (Legislative Decree 608/1970 Concerning Investment Companies and Mutual Funds, Chapter 1, Articles 3(1), 4(1a), and 4, (2) and Chapter 2, Article 17 (2a) and 17 (4)). Thus, it would appear that the shares of very small firms are of little interest to Greek investment companies⁵.

There are no issuing houses, underwriters, or investment bankers in Greece other than those mentioned above. Private placings are almost non-existent in Greece. Given the inactive nature of the Greek security market at the present time and over the past five years, there have been very few cases of companies publicly issuing new securities for the first time during this period⁶. This lack of supply of new issues, in addition to a

reluctance to compromise family control as mentioned above, has been accompanied by a distinct drying up of demand for such issues. However, in the event of a new public issue it is mandatory that the issuing firm seeks and be granted a listing on the ASE. In order for a newly issued security to be listed on the ASE it is necessary that the issue be underwritten. Yet, as mentioned above, there have been very few such new issues for the past five years.

5. Survey of the secondary market

There is, at present, only one stock exchange in Greece, the Athens Stock Exchange⁷. However, an information and public relations office of the ASE has existed in Salonica since May, 1979.

The ASE is a semi-governmental institution which is controlled by the state. It was first established in 1876 (Law 30/9/1876) and functioned for a number of years according to articles 70-89 of the Commercial Code. Subsequent legislation brought the ASE to its current status, (L.D. 14/8/1919, Law 2197/1920 and Law 3632/17-6-1928 as amended by Laws 6410/1940, 2341/1940 and 3078/1954).

The ASE is comprised of a maximum of 60 individuals, who are allowed to act as brokers (banks cannot be members of the stock exchange). Of these maximum allowable seats, the Minister of Commerce (who has overall supervisory authority over the ASE) has authorized to date the creation of 35 seats. However, as of this writing there are only 29 brokers operating on the ASE, so that

six seats remain vacant.

There are no specialists on the ASE; however, brokers can engage in both a public commission and a floor trading business. Trading for their own account by brokers can only be done on a cash settlement basis. However, most of the activities of ASE brokers are concerned with a public commission business.

Trading of financial instruments on the ASE is in terms of preferred stock, common stock and both long and short-term bonds. As of December 31, 1982, there were 114 companies listed on the ASE. The overall breakdown of these firms as to size (number of employees) is as follows⁸:

<u>Number of Employees</u>	<u>Number of Companies</u>
100 or less	24
101 - 500	46
501 - 1,000	21
1,001 - 5,000	15
5,000 or more	4
Not available	<u>4</u>
Total	<u>114</u>

Not all of these companies are actively traded. In addition, the overall small size of the preponderance of these firms is rather obvious.

II. EXCHANGE SEGMENTS

1. The listed securities market as a segment for small-company shares

a) Listing

Listing applications are submitted by the issuing company. Publicly issued securities must be listed on the ASE within one year after the date of issue (Law 2190/1920, as codified by the Royal Decree 174/1963). However, for companies with publicly distributed shares which are not presently listed on the ASE, as the result of past frauds it is now prohibited for such firms to claim that they are about to achieve an ASE listing.

The present listing requirements of the ASE are as follows:

- (1) Share capital plus reserves must be at least 150 mio drs. Paid-up share capital alone must be at least 100 mio drs. The firm must have at least 100,000 outstanding shares and the nominal value of each share cannot exceed 1,000 drs.
- (2) The company's shareholders must make an agreement with the ASE to distribute to the public (through one underwriting bank) 25% of the firm's outstanding shares. These shares must be derived from an increase in the firm's share capital.
- (3) The company must keep adequate accounting records for a period of at least three years prior to listing (new firms) or five years prior to listing (all other firms). The company must produce a prospectus prior to listing. There must have been profits for at least three years prior to listing. The listing application must

contain a statement showing that a decision of the board of directors has been made to seek a market quotation of the corporation's shares. The company's articles of association, its balance sheets and annual reports of the board of directors for the preceding five years, as well as all other pertinent information concerning its financial condition, must also accompany the listing application. The listing application must also disclose the shareholders of the firm, the directors, and the distributed dividends for the past 10 years.

In addition, the issue must be underwritten in the case of a firm not presently listed⁹. The issue price is to be fixed by the underwriter. The underwriter is to make stabilizing transactions for a period of six months after initial issuance and guarantee the issue price. The company must deposit at least 70% of the firm's common stock with a bank for a period of one year (this is to prevent the deposited shares from affecting the trading price of the security)¹⁰. Finally, the board of directors must agree to keep close contact with the stock exchange and give any information about any change in the company's organization, share capital and, in general, any information which may be considered in the public interest.

These are both the formal and informal listing requirements. Issuers rarely voluntarily go beyond these standards¹¹. However, as is evident from these standards and the number of employees of listed firms shown above, the ASE does not appear to be the exclusive habitat of large firms. In fact, of the 100 biggest manufacturing corporations in Greece, only 24 have their shares listed on the ASE¹².

A way for firms which do not meet the above listing requirements to achieve a listing on the ASE (for example, small firms) is through the following provision of the Legislative Decree 608/1970 Concerning Investment Companies and Mutual Funds:

At the request of the management company (of the mutual fund) and at the expense of the mutual fund, shares belonging to the mutual fund may be listed on the ASE with the consent of the issuing corporation and of the ASE authorities, in deviation from the general provisions in force at any given time.

The listing of shares on the ASE in accordance with the provision of the preceeding paragraph shall only refer to common and preferred shares of domestic and foreign sociétés anonymes (Legislative Decree 608/1970 Concerning Investment Companies and Mutual Funds, Chapter 2 Article 27 (1) and (2)).

There are no fees for initial listing. However, listed firms must pay a quotation fee which, in effect, is a maintenance fee for listing. These maintenance fees are proportionately higher for smaller firms. However, even for such companies they do not appear to be particularly onerous. The minimum quarterly maintenance fee is 12,500 drs and increases for larger firms. For the establishment of the first quarterly fee of newly listed shares the fee is calculated on the basis of the initial exchange trading price. Listed firms must also make a one time deposit of 2,000 drs with the ASE. Finally, a stamp tax at a rate of 2.4% is imposed on the quarterly maintenance fee.

In cases where corporations with shares quoted on the ASE fail to comply with the above requirements they can be delisted from the stock exchange with a decision taken by the Capital Market Committee established by Emergency Law 148/1967. Such action is initiated by the Stock Exchange Committee. Specifically, a corporation's shares must be delisted from the exchange if: (a) its share capital is less than 50 mio drs, (b) the transactions of its shares in the stock exchange have been limited to less than 0.5% of listed shares for the year 1980 and 1% per year for the year 1981 and, thereafter, (c) it has not given dividends for three consecutive years beginning with the year 1980 and (d) it does not comply with the general requirements put forward by the Capital Market Committee and/or the ASE. The consequence of a delisting is very little trading in the security and that only in private dealings.

b) Trading

Trading is either for settlement next morning or for the "account". An account order means that a transaction should be settled between the two brokers involved (acting as agents of the seller and buyer) at the end of the fortnightly accounting. The settlement days in this case are the 2nd and 17th of each month. Thus, all transactions executed during a fortnight should be settled on the first forthcoming settlement date, unless a "report" takes place and the settlement is shifted to the next settlement date. In both cases the settlement should take place through the stock exchange clearing office.

An interesting point with respect to "account" transactions is that both the buyer and seller (each to his broker) should provide margin for the execution of their contracts. The margin should be paid in cash or equal value of quoted securities, but its amount is flexible, determined by a decision of the stock exchange committee. Each broker should deposit the margin in the treasury of the ASE and can withdraw it when the transaction is completed. If money is deposited with a broker as security (margin), a special stock exchange receipt must be requested¹³.

Each stockbroker can have only one authorized clerk who can enter the trading floor. However, he can maintain an unlimited number of unauthorized clerks who work in his private office¹⁴. Some investors are granted the privilege of sitting on the trading floor near the locus of trading which takes place in a circular area. For an annual fee of 6,000 drs such investors can enter the trading floor (though not the immediate trading area) if they are recommended for such a privilege by two ASE brokers.

Trading on the ASE is on the basis of a two way call auction system. Securities are called by industry grouping and trading in any group takes place for a half hour each trading day. Buying brokers cry out their bid prices, while selling brokers similarly cry out their asked prices. All trading in any security is confined to its industry's designated trading period.

Brokers announce their bid or asked prices for a particular security by shouting the name of the issue and indicating, by the position of their hands, whether they wish to buy or sell. Eventually, the results of this trading are recorded manually on the quotation board and

help comprise the Daily Official List of Quotations of the ASE¹⁵. This is a listing of securities listed on the ASE giving the number of shares listed, their nominal value, dividends per share, the date of last payment, the yearly high and low trades in the security, and, on a daily basis, the high, low and last trading prices and the last bid and asked quotes.

There is no ASE ticker tape; however, prices at any particular time are available through a special telephone number.

In terms of trading activity during 1982, total turnover of shares on the ASE was about 2,500 mio drs. Of this, bank shares accounted for 54.4%, industrials 38.2% and commercial and insurance companies 7.4%. Comparable figures for 1980 were 3,675 mio drs in total turnover, with bank shares accounting for 64.5%, industrials 33.9% and commercial and insurance company shares 1.6%.

To avoid large fluctuations of individual prices during a trading session, Law 876/1979 grants special powers to the Chairman of the Stock Exchange Committee. He may sometimes decide at his discretion to stop trading in a particular stock.

ASE commissions are fixed and depend upon the drachma amount involved in any trade as follows:

- for amounts up to 1 mio drs, 1%,
- for amounts from 1,000,001 drs to 3 mio drs, 0.75%, and
- for amounts over 3 mio drs, 0.5%.

If there is a transfer of registered shares, an additional rate of 0.3% of their value is paid as a transfer fee.

Repurchasing of their own common stocks by a société anonyme is severly restricted. This may hinder the process of capital allocation (as slower growing firms are normally the ones to purchase their common stock and the funds are usually reinvested by investors in more rapidly growing enterprises) and also eliminates a possible source of demand for securities.

The prohibition against repurchasing (Law 2190/1920 as modified by Royal Decree 174 of 1963, and subsequently amended, Article 16 (1)), however, does not apply; (a) to the reacquisition of shares for the purpose of cancellation; (b) to acquisitions made on a reduction of capital; (c) to acquisitions pursuant to the execution of a judgment or for the purpose of satisfying a debt due to the company; or (d) to acquisitions made by banking companies on behalf of a third party (Law 2190/1920 as modified by Royal Decree 174 of 1963, and subsequently amended Article 16 (2)).

However, the articles of incorporation may provide that shareholders may be repaid capital which they have contributed to the company by amortizing shares held by them. This must be done by the drawing of lots and the payment must be made out of the company's profits.

III. SUMMARY

In recent years the Greek economy has languished with a high rate of inflation, low private investment and high interest rates.

The ASE perhaps typifies what is at once unique and noble in the Greek character, the ability to live pas-

sionately with both triumph and tragedy, but somehow always to live. The bull market of the early seventies with the normally attendant excesses (such as lines outside the ASE to buy newly issued shares and excessive first day price increases in new issues) has now given way to a deep and protracted bear market. Still plans, though slow in developing, are now underway to revitalize the trading atmosphere and under the optimum external environment, may prove successful.

Trading volume on the ASE in 1982 declined considerably from its level in the early 1970's. Moreover, the first six months of 1983 saw trading volume decline still further. The main reason for this deep drop in depth on the ASE is the high rate of inflation and the resultant rise in risk free short-term fixed income security rates to 21%. Thus investors have turned away from equity investments. This has made the raising of equity capital extremely difficult at the present time, particularly for small firms. It has also called into question the liquidity of the ASE for the trading of many of its listed securities.

There is both a low supply and a low demand for equities and such prices have fallen and remained depressed in recent years. This has resulted in heavy losses to investors who bought equities during the bull market of the early 1970's. It has also reduced investor interest and resulted in even greater difficulty in the raising of equity capital.

Thus, over the past five years no new initial public equity issues by small non-financial Greek companies have been floated. Not that small Greek firms have been anxious to go public. On the contrary, the desire

to maintain family control has continued to be a major inhibiting factor and non-voting preferred shares the only seemingly desirable equity route.

Another limiting factor is the existence of exchange controls which have made it very difficult for foreign investors to buy any shares, whether those of large or small firms.

It has been estimated that 20 mio drs or 10,000 to 20,000 shares are necessary as the minimum size of an issue that allows an effective secondary market to develop. This is not beyond the scope of many small firms should they choose to go public. However, entrepreneurs prefer bank to equity financing in order to retain equity control within the family. This is so despite the rather limited disclosure provisions of public equity issues and the considerable number of recent bankruptcies which have resulted from small firms trying to meet the fixed payment schedules of debt instruments. Greek firms which have refrained from equity issues and utilized bank financing in its place because of concern over possible loss of control seem to be unable to recognize that extensive and exclusive use of bank financing also carries control implications.

In most cases privately owned firms seek introduction of their equity securities into the stock exchange not to obtain equity financing but to obtain subsequent loans from banks, using the equity shares retained privately as collateral for the loan¹⁶. This is so because only shares quoted on the ASE can be used as collateral. Normally, the amount of the loan obtained by a corporation equals 60% to 80% of the market value of the shares used as collateral. Another advantage of

going public for small Greek firms is for death duty purposes. In the case of the valuation of an estate for death duty purposes the price of the company's shares in the market, on the date of death of the decedent, is used. If the market price of the shares can be artificially depressed on the date of death below their net asset and earning power value, the death taxes are correspondingly reduced vis-à-vis what they would have been had the shares remained unlisted¹⁷. Needless to say, both from a micro financial management point of view and a macro concern with the optimum allocation of financial resources, the above reasons for an initial public equity issuance are patently suboptimal.

On their part, investors, particularly institutional investors, seem to prefer the shares of larger firms. The Legislative Decree 608/1970 Concerning Investment Companies and Mutual Funds, as discussed above, has provisions, some of which favor and others of which inhibit, such institutional investors from holding small company shares. However, on balance, this legislation seems to be mostly unfavorable for the holding of small company shares by investment companies and mutual funds. Further, while the importance of institutional investors has been growing in recent years, the interest of such investors in the shares of small firms continues to be low. Institutions now account for about 80% of all ASE trading. They have gone into support the market as individual investors have reduced their interest in equities as the result of recent losses occasioned by excess speculation in earlier years. This, on balance, has resulted in reduced overall investor interest in small company shares since institutions prefer the shares of larger firms. Needless to say, the illiquidity of small company shares is a con-

siderable factor in the absence of institutional investor interest in such securities. Thus, the development of alternate listing means, such as the proposed semi-official market, for the shares of small firms is of considerable importance if such firms are to be able to raise equity capital particularly from institutions¹⁸.

Some measures which would help revive the ASE and make it more available to the small firm are:

- (1) Education of the small businessman as to the value of equity financing. He needs to become less fearful of loss of control.
- (2) Education of the public as to the meaning of a stock exchange and the appropriate place of equities within their investment portfolio. Many Greeks think of the ASE solely as a place to buy gold coins. Middle and small class investors need to be educated to change their investment habits from land, buildings and gold sovereign hoardings to security investments.
- (3) The development of further tax incentives favorable to investors. For example, the tax on dividends beyond the non-taxable limit could be lowered and an exemption on taxes could be made for some reserves.
- (4) Domestic monetary, debt and fiscal policies conducive to a lowering of interest rates.

- (5) The Greek Parliament should be encouraged to adopt at an early date the proposal for a semi-official market.

- (6) The money market should be encouraged to develop further so that a wider variety of financial institutions participate. This would provide for a more effective and flexible network of capital raising than the current excessive reliance on the banking system. Similarly, the range of short-term financial instruments should be broadened so as to encompass, among others, industrial acceptances, certificates of deposit, commercial paper, and options, etc., (all of which exist in countries with more highly developed financial markets) which could then be traded on the ASE.

- (7) The promotion of companies and the underwriting, issuance and distribution of securities should be fostered through the development of specialized agencies.

- (8) Assuming the supply of new issues could be enhanced and the liquidity of ASE trading assured, institutions such as insurance companies, social security organizations, pension funds, etc., should be encouraged to invest their surplus funds in the securities of small, innovative and growing firms.

Footnotes

- 1) All such companies must have at least two auditors (Law 2190/1920 as modified by Royal Decree 174 of 1963, and subsequently amended, Article 36 (1)). The functions of the auditors of a Greek société anonyme are wider than those of the auditors of a British public company (Robert R. Pennington and Frank Wooldridge, *Company Law in the European Communities*, 3rd ed., 1982, Chapter 6, p. 161). The auditors must make any necessary suggestions to the board of directors, and report any violation of the law or the articles of the company to the Minister of Commerce. This report must clearly state whether the financial position of the company is properly shown in the balance sheet, and whether income is properly presented in the profit and loss account (Law 2190/1920 as modified by Royal Decree 174 of 1963, and subsequently amended, Article 37 (1)). The hiring of two auditors may be expensive for a small firm. Moreover, it should be noted that these auditing responsibilities are greater than for U.S. auditors who are not required to report violations of a client's articles to governmental authorities. Also, U.S. auditors are merely required to attest to the conformance and consistency of accounting records with U.S. generally accepted accounting principles and need not deal with whether the balance sheet or income statement is properly presented.
- 2) The private limited company was introduced into Greek law by Law 3190/1955 and is now very common in that country. Many former public limited companies have been converted into private limited companies and many newly formed companies are private limited companies. Shares of private limited companies may not be represented by a negotiable instrument in registered or in order or bearer form (Pennington and Wooldridge, *Ibid.*, pp. 167 and 169). Thus, this form of business organization is not as readily adaptable as is a public limited company to secondary market trading and this form may therefore not be as viable in terms of initial capital raising. However, in terms of disclosure, the private limited company may be more flexible than the public limited company and a more appropriate business form for the small firm. An annual balance sheet must be drawn up by the managers and submitted to the members in a general meeting for their approval. There is, however, no requirement that the annual accounts shall be audited (Law 3190/1955 and Pennington and Wooldridge, *Ibid.*, p. 170).
- 3) For a société anonyme, before any distribution can be made of the net profits, a sum fixed by law or by the articles of the company, which must be at least one-twentieth of these profits, must be transferred to the general reserve until it amounts to at least one third of the share capital of the société anonyme or the greater amount specified in the articles of the company (Law 2190/1920 as modified by Royal Decree 174 of 1963, and

subsequently amended, Article 44). A deduction is next made from profits of a sum necessary for the payment of the first dividend. This sum is to be at least 6 percent of the paid-up capital or 35 percent of the company's net profits, whichever is greater (Law 2190/1920 as modified by Royal Decree 174 of 1963, and subsequently amended, Articles 44 and 45 (2)). The distribution of 35 percent of the net profits may only be prevented by a resolution passed by a 3/4 majority vote at the annual meeting (Law 148/1967, Articles 2 (1) and (2) and Pennington and Wooldridge, *Ibid.*, p. 163). All of the above may limit the ability of small firms to engage in retained earnings financing.

- 4) George D. Demopoulos, *Financial Markets and Institutions in Greece*, Commission of the European Communities, *European Economy*, No. 15, March 1983, pp. 150 and 151.
- 5) However, Greek investment companies are permitted, if they choose to invest in shares not listed on the ASE, to invest up to an amount not exceeding, at purchase prices, one fifth of the investment company's paid-up share capital, subject to special permission by the Capital Market Committee. A similar provision obtains for mutual funds. For Greek mutual funds the value of securities or shares not listed on the ASE shall be determined in accordance with regulatory decisions laid down by the Capital Market Committee (Legislative Decree 608/1970 Concerning Investment Companies and Mutual Funds, Chapter 1, Article 4 (1b) and Chapter 2, Articles 11 (1c) and 17 (2c)).
- 6) During the period 1980-1982 there were 4 cases of new equity issues. Each of these was a financial or investment development company. While long-term credit to the private manufacturing sector in 1982 amounted to 30,000 mio drs, the total of new issues of corporate shares in that year was less than 1,200 mio drs. In 1980 the relevant figures were 30,700 mio drs vs. 130 mio drs. Moreover, the total amount of equity capital raised in the primary market in each of the past three years was only from 2 to 7 percent of the total net inflow of private deposits into banking institutions (Anestis S. Constantinides, *Greek Securities Markets*, Bank of Greece, Economic Research Department, Athens, Greece, 1981, pp. 2 and 3). The prime factors leading to the overriding reliance on debt rather than equity financing, are as follows:
 - a) The nature of the Greek banking system which makes borrowing easily accessible and relatively low cost.
 - b) The predominance of small family owned unincorporated firms along with a seemingly all consuming desire on the part of their owners to avoid undertaking any action which might alter their control of the business in the slightest.

c) The demand for capital in general has been low as the result of the sluggishness of private investment demand in recent years (Op. Cit., Demopoulos, p. 153).

7) As mentioned above, a semi-official market in Greece (sometimes in other countries called a parallel market) in which trading will take place in the shares of smaller firms, which cannot meet the regular ASE listing requirements, is currently being considered by the Greek Parliament.

8) Annual Bulletin - The Athens Stock Exchange, 1982, The Athens Stock Exchange, Athens, Greece, p. 12. For additional information on listed firms see, Year Book of the Athens Stock Exchange - 1982, Athens Stock Exchange, Athens, Greece. A breakdown of these 114 firms as to industry is as follows:

Banks	14
Insurance and Investment Companies	9
Textiles	22
Railways - Canals	2
Chemical Products	7
Building Materials, Cement	8
Mining	1
Metallurgical	16
Food	10
Flour Mills	5
Tobacco	3
Paper Mills	2
Hotels	2
Miscellaneous	13
	<hr/>
Total	114
	===

9) It should be noted that there have been no such listings to date.

10) Banks, insurance companies and all government controlled companies are exempt from this listing requirement.

11) It is compulsory for investment company shares to be listed on the ASE; the normally required conditions for listing not having to be fulfilled. In order to obtain a listing, the investment company shall submit an application to the Stock Exchange Committee within one month from the publication of its statutes in the Government Gazette (Legislative Decree 608/1970 Concerning Investment Companies and Mutual Funds, Chapter 1, Article 3 (3)).

12) Anestis S. Constantinides, Op. Cit.

13) Op. Cit., Annual Bulletin - The Athens Stock Exchange, 1982, p. 77.

- 14) Nikitas A. Niarchos, *The Stock Market in Greece: A Statistical Analysis*, The Athens Stock Exchange, 1972, Athens, Greece.
- 15) Much of the foregoing description of the mechanics of trading on the ASE and the examples which follow were drawn liberally from Niarchos, *Ibid.*, pp. 54-55.

For example, the quotation board might read as follows:

Bank of Greece	18,500	18,600	--
Hercules Cement	800	--	780
ETMA	--	--	400
National Bank of Greece	--	10,500	--
Viochalco	5,000	--	--

In the case of the Bank of Greece, the board indicates that a trade took place at 18,500 drs. There is no asked price recorded, however, which means that either there are no sell orders left, or any such orders which exist are at a price higher than the bid price, and are not recorded on the board. For Hercules Cement, the board shows that there is a transaction price, but that there are still unexecuted sell orders left. A bid price is not recorded. This means that either there are no buyers, or that their bid price is lower than the asked price and is not recorded on the board. The board for ETMA means that no transactions have taken place in the current trading session and that only sell orders at 400 drs. remain unexecuted. It might also indicate that there are buyers, but that their bid price is lower than the asked price and not recorded on the board. The board for the National Bank of Greece tells us that no trading has occurred in the current trading session and that there are only buy orders left unexecuted. This board might also indicate that there are sellers, but that their asked price is higher than the bid price, and not recorded on the board. Finally, the board for Viochalco demonstrates that trades have taken place in the current session at 5,000 drs. but that neither unexecuted buy or sell orders are left. It should be noted that only two prices, at the maximum, can ever be recorded on the board because trading will take place until either all buy orders or all sell orders at the best auction prices are used up.

- 16) A listing prohibition against this practice might perhaps be in order.
- 17) *Op. Cit.*, Niarchos, p. 27.
- 18) A slight negative factor in a firm achieving an ASE listing is that normally listed shares can only be sold on the exchange - there is, at present, no over the counter market allowed for listed securities. However, in special cases and with the consent of the ASE, private agreements can be arranged whereby off-exchange dealings utilizing the services

of a broker are allowed. Of course, for unlisted securities, private agreements are the only means of liquidation since there is now no effective over the counter market in Greece. Another advantage of listing is shown in the fact that in Greece the most common way of raising new equity capital by an ASE listed firm is through the issuance of rights to existing shareholders.

Part 3

FACTORS FACILITATING OR IMPEDING SECURITIES MARKET

EQUITY FINANCING OF SMALL INDUSTRIAL COMPANIES

The country studies presented in part 2 provide a wealth of information on the secondary and primary (or new issue) markets for shares of small industrial companies and on the relevant environment in the Member States of the European Community. This part is based on these studies. It will provide a comparative analysis, from which conclusions will be drawn as to the factors facilitating or impeding equity financing of small industrial companies through securities markets.

The comparative analysis does not aim at a complete coverage of all factors addressed by the country studies. Some factors are quite specific and seem to affect small companies in only one country. A case in point is the Danish company law stipulation which requires that the expenses incurred in issuing shares must not exceed 5% of the nominal value of the new shares¹⁾; strict and unenlightened enforcement of this provision could severely impede small company equity financing and growth. Other factors, though important and touched on in the country reports, do not lie at the heart of this study and will not be discussed in any detail. Most of these other factors are related to taxation, company law and mainstream political thought.

1) Cf. part 2, section C, footnote 63.

The focal question of this study may be stated in two ways:

1. Do secondary markets respond to the needs of small growing innovative companies wishing to raise equity from the public?
2. What are the factors impeding the access of small growing companies to secondary markets?

These questions guided the country studies and they will be used in extracting the focal information therefrom. For ease of reference, the uniform outline of the country reports will be used to structure the comparative analysis.

A. FORMS OF BUSINESS ORGANIZATION ACCEPTABLE FOR
SECONDARY MARKETS

As the country reports indicate, access to the stock exchanges or to any other secondary markets in the Member States is available only to one or, exceptionally and only in a few countries, to two forms of business organization. The generally accepted form is the public limited company or its foreign equivalent, which has been perfected by many generations of lawyers, legislators and business men. There cannot be any doubt that this admirable form provides a very high degree of protection to lenders, investors and employees. It has greatly contributed to the growth of equity markets.

In some countries, however, this form was never intended to serve small companies. Its high degree of perfection and the wide scope of intricate mandatory provisions make this form a second or third choice with entrepreneurs of small growing companies, who usually are rooted not in law but in science and technology. The available statistics seem to lend support to the thesis, that the higher the degree of mandatory protective perfection, the less frequent the public limited company is being used. Since in most countries only public limited companies may obtain a listing or market their shares, the high degree of perfection may well inhibit or unacceptably delay external equity financing. As a result growth opportunities are lost.

The retarding impact of the public limited company requirement for external equity financing via public equity markets rests on continuing and initial burdens,

which cannot be fully discussed in this study. The continuing burdens referred to so far are consequences of protective provisions in the national company laws governing the public limited company. Other continuing burdens result from taxation. Compared to a sole trader or to a partnership the limited company may be unattractive because of corporate income tax and corporate wealth tax. Initial burdens are imposed by conversion requirements.

Like the continuing burdens, the initial burdens are not equally pronounced in all Member States. Germany levies indirect taxes, e.g. a 2% tax on the value of any real estate of an enterprise that changes over to public limited company status; in addition, many cumbersome formal requirements are to be met. In other countries, a conversion will be effected by merely adjusting the articles of association and reregistering. The Danish company law is even more considerate with respect to small company growth and external equity financing. Disapplication provisions geared to the size of the company make the Danish public limited company an accepted form of business organization among small firms, which thus do not face the need to convert. The degree of protection increases as the company grows.

To sum up, in most countries the public limited company form is infrequently used by small companies, but this form is required for gaining access to secondary markets. The resulting barrier to small company external equity financing can be lowered by facilitating conversion. Alternatively, disapplication provisions based on company size may be used to make the public limited company more attractive to small companies. A third

approach, which - contrary to the second - would maintain the clear, fairly undifferentiated character of the public limited company form in most countries, is the admission to specialized secondary markets of less perfected and protective forms of business organization. This controversial approach, which has been adopted by the Amsterdam Stock Exchange, will be discussed below.

The preference of the organizers of secondary markets to list the equity instruments of only public limited companies is in line with the traditional preference for listing larger and established companies. It serves the goal of making the general public and the regulators perceive the investment in shares as reasonably safe and stable. This image appears to be most desirable, since it is a widely accepted principle that risky investments should not be available to the general public.

The point should not be lost, however, that this principle is squarely at variance with vertically segmented securities markets. The principle backs the traditional view of the homogeneous stock exchange; any company desiring the benefit of a public and organized secondary market must pass a certain threshold of quality. If it does not qualify, the company should not obtain funds from public investors. The fact that such non-qualifying companies managed to place their shares and had their shares traded used to be met with varying degrees of disapproval and with efforts to subject these companies to the standard requirements.

It is quite a different rationale that underlies the widespread recent recognition of specialized stock market segments for young and small companies. The traditional threshold of quality only applies to the upper segment or segments, whereas for the small company segment a lower threshold is used. The lowest segments seem to have hardly any threshold at all. If a broader perspective is taken, both the traditional principle and the modern approach agree on the need to provide the public with highly safeguarded investment opportunities, such as bank deposits, government bonds and high quality shares. Contrary to the traditional principle, however, the new approach advocates no minimum quality requirements beyond adequate disclosure for investments available to the public.

There are a number of reasons for this:

1. Individual and institutional investors in today's securities markets and their advisers predominantly seem to be well aware of the risk and reward characteristics of available investments. A proper vertical segmentation will contribute to this awareness, if the higher riskiness of lower segment stocks is made clear to the investing public. Beyond adequate disclosure requirements, any restrictions on the public availability of small company shares are unlikely to benefit any number of investors to speak of.
2. Diversification strategies now are widely followed by investors. The risk of a particular small company share may appear unacceptably high if one looks at it individually. In spite of this, the share may well

Admissable form of business organization
and ease of conversion

Country	A	B
United Kingdom	no	minor
Ireland	no	minor
Denmark	yes	minor
Netherlands	exception- ally	minor
Germany	no	major
Luxembourg	no	minor
Belgium	no	minor
France	no	minor
Italy	yes	minor
Greece	no	minor

A. Is the form of business organization used by small growing companies admitted to stock exchange trading?

B. What efforts and expenses are usually required to change to the admissable form?

be most desirable in a portfolio context. Any regulatory restrictions based on business risk characteristics of individual companies are misguided.

3. Even the average individual investor has ready access to a wide range of domestic and foreign¹⁾ high risk investment vehicles. As it is obvious in the case of options, the invested amount frequently will be completely lost. Against this background any regulatory efforts to restrict the investment in the shares of small domestic companies appears arbitrary.
4. The riskiness of small company shares is not artificially created. It reflects the innovativeness of the firm and other business characteristics. As discussed at length in part 1 of this study, it is desirable for employment and other economic reasons to take advantage of the growth of independent small firms which assume these risks. This requires external equity financing. In contrast with former years of high employment, restrictions on small company equity financing are likely to carry a much higher economic cost..

This general discussion of two fundamental principles of regulation provides a background against which the question can be tackled whether companies using another than the most perfected form of business organization should be given access to stock exchanges or to other secondary markets. Under the traditional principle of quality control it is clearly desirable to exclude

1) Save investors in countries that have imposed exchange controls.

by appropriate measures any factors that could give rise to investment risks. Thus, only the most perfected and protective form is to be considered for listing.

Under the modern disclosure-oriented approach the most perfected public limited company form remains a cornerstone of the high quality which stock exchanges endeavor to offer to the public in the top market segment. However, since a lower threshold of quality is used for the lower segments, it is not at all obvious that this form should be required for companies which desire entry to these segments. Investors are expected to analyze and judge the earnings potential and the related risk when they buy and sell. In case of new technology based small firms, which are most desirable applicants for entry to specialized small company stock exchange segments, this task requires a very high degree of expertise. Compared to that, the analytical skills appear to be minor which are required to assess the potential impact of certain protective provisions that are mandatory at public limited companies but absent at private companies or limited partnerships.

Thus, it is well justified that the Amsterdam Stock Exchange grants access to the parallelmarkt to companies that have only private company status and do not want to convert to public company form. It is an acceptable way of facilitating small equity financing. The private limited company statutes were upgraded in recent years, partly in compliance with harmonisation directives. As a result, the fundamental protective provisions are incorporated in this form of business organization.

Moreover, in admitting companies to their secondary market segments the stock exchanges impose by listing agreements or equivalent measures procedures on these companies that are deemed essential for the protection of the investor. This approach, which in the past has frequently generated provisions that later became mandatory legal requirements, can be expected to standardize, at a protective level acceptable to small companies and sufficiently attractive to investors, the forms of business organization that are unfit for a top segment listing but should be considered for lower segment admittance. As the country studies have shown, the two forms that are likely candidates for trading on specialized secondary markets are the private company, which is favoured by small companies in most countries, and the limited partnership, the shares of which are in some countries preferred by small company investors for tax reasons.

The prestige of a stock exchange is based on the proficiency of market organization, the quality of the financial services rendered by member firms, and the quality of the companies that have their shares traded on the exchange. As the example of the New York Stock Exchange demonstrates, an exchange may choose to maintain a very high threshold of quality and leave it up to other market organizers to offer secondary market services to lesser companies. This contributes to the investing public's awareness of quality differences. In contrast, most European stock exchanges have organized upper and lower market segments and they recently have increased efforts devoted to the lower segments. However, if a stock exchange chooses not to organize a lower segment for small company shares, this decision should be respected. It should

then be left to other market organizers to provide secondary market services to companies which have a form of business organization or other quality characteristics that make them unacceptable to the stock exchange. As borne out by the American experience, this may contribute to the ready availability of security market services to small companies¹⁾.

Summary and recommendations

1. The public limited company is the form of business organization acceptable for stock exchange listing in all Member States. It is not designed for small companies, but many small companies approaching flotation of their shares have sufficiently grown and are ready to convert to this most perfected form, which adds to the protection of shareholders. Efforts should continue to increase the ease of conversion and to eliminate any taxes that now reduce the attractiveness of conversion to public limited company form, in particular all taxes on conversion-implied transfers of company assets.
2. Small limited partnerships and small private limited companies not yet ready to convert to the desirable public limited company form nonetheless should be able to gain access for their shares to a special stock exchange segment or to another organized secondary market. Restricting the public availability of the shares of these enterprises is not justified in today's investment environment and is

1) H. Schmidt, l.c., pp. 343-358.

likely to carry a high economic cost. Stock exchanges or other market organizers can be expected to ensure by way of their listing requirements adequate disclosure and other essential investor protection measures.

3. If a stock exchange chooses not to offer special segments for small company shares, this decision should be respected. Securities market regulation should permit other market organizers to provide secondary market services to companies which have a form of business organization or other quality characteristics that make them unacceptable to the stock exchange.

B. FREQUENTLY USED INSTRUMENTS FOR EQUITY FINANCING

Contrary to what one would expect, the most favoured instruments for small company equity raising considerably differ from country to country. Factors contributing to this are the relative strength of issuer and investors, company law provisions, preferences of regulators and the stage of their development at which companies approach private or public flotation for the first time.

The basic problem, however, that these instruments solve, is the same in all countries. Stated simply, the entrepreneur wants to raise capital but does not want to give up control. The desire to win independence seems to be the foremost motive for becoming an entrepreneur and for starting a business. Anticipating future growth, the entrepreneur in the first round of external equity financing aims at limiting outside influence at a low level for three reasons. First, a low initial level allows him to maintain control when further rounds of equity financing increase outsiders' shareholdings. Second, the market value of the shares will not be known until trading in an organized secondary market commences and underpricing tends to be a feature of earlier transactions. To avoid selling below market value, the entrepreneur will want to hold on to as much of the stock as possible. Third, in the stage of early development, the entrepreneur is likely to expect that the market value of the shares will be much higher once the company reaches maturity, in other words, the entrepreneur expects a yield in excess of that available in the market. He will not want to forgo

this opportunity by early sales of shares to outsiders¹⁾.

As these reasons indicate, the reluctance to offer company shares to outsiders is rooted in a control problem and a valuation problem. The control problem can be solved by equity instruments carrying no, contingent or reduced voting rights. These instruments may grant, however, a proportional claim on company earnings and thus have unlimited upside potential. Various forms of preference shares and participating certificates exemplify such instruments.

Solving the valuation problem takes, in a commercial environment, instruments that yield a risk adequate return. They must not confer a proportional claim on company earnings, at least not for any extended period. They may, however, confer voting rights or other means of control to the financier. The best known of these instruments is the bank loan with or without control features. Others include redeemable shares and shares sold under repurchase agreement or with the option to repurchase at a set price. In each case, the upside potential is limited.

Both problems squarely impede external equity financing of small growth firms as long as the shares of a company are not traded on an efficient secondary market. During this period any solutions to the valuation problem make the control problem more difficult to handle,

1) Since efficient financial markets can be relied on to anticipate any excess return, the third reason is little more than a faulty interpretation of the second. Nonetheless, if the entrepreneur believes in it, it does affect his financing decisions.

since investors in high risk financial instruments with limited upside potential will require control, at least when financial results are dangerously below targets. This contingent control may be based directly on agreements or on contingent conversion rights or options that entitle the financier to acquire a majority. If the entrepreneur does not perform, the financier may take over or try to regain the investment by selling the majority interest. On the other hand, any sales of instruments with unlimited upside potential are subject to considerable valuation uncertainties prior to secondary market trading. Moreover, investors who cannot readily sell their shares also tend to insist at least on contingent control features¹⁾. Obviously, in this early phase prior to secondary market trading it is a most difficult task to structure the external financing to the needs of the company and of the entrepreneur²⁾.

Once the shares of a company are traded on a secondary market, the valuation problem disappears. The market mechanism can be relied on to provide an adequate valuation. The marketability of the shares makes acceptable to investors non-voting shares, shares with contingent³⁾ voting rights and other equity instruments that grant less outside influence than shares with

-
- 1) A case in point is Denmark, where recently listed shares were predominantly B-shares; most unquoted companies, however, had to place A-shares to raise equity.
 - 2) For instructive examples see N.E. Cross, Tailoring financial packages to need, Commission of the European Communities, ed., The needs of new technology-based enterprises, proceedings of the symposium held in Luxembourg November 17-19, 1982, Luxembourg: Infobrief, 1983, pp. 147-153.
 - 3) An example are German preference shares, which may contribute up to 50% of nominal capital and which give the shareholders voting rights if the company cannot make up any arrears of usually modest minimum dividends within one year.

full voting rights. This eases the control problem and reduces the reluctance to raise equity capital externally. As set forth in the country reports, some of these instruments have features mandated by company law (e.g. the minimum voting rights of Danish B-shares or the contingent voting rights of German preference shares). Other instruments such as non-voting participating certificates and the influence restricting Dutch depositary receipts are designed to qualify for favourable tax treatment or to conform to stock exchange requirements.

To sum up, all equity instruments with limited voting rights facilitate the financing of growing companies for which a highly uncertain future income stream is characteristic. In contrast with debt instruments, payments to holders are generally geared to profits and do not burden a company with rigid payment schedules. If used properly, they do not allow the control problem to impede necessary external capital contributions and thus growth.

However, some Member States discourage the use of these instruments. Belgium is a case in point. Only a simple capital structure with merely one class of equity instruments is seen to provide the desirable high degree of protection to investors. If a company is financed by the investing public, it is thought, the company should be controlled by all these investors and control should not be bestowed on a few by permitting restrictions on voting rights. More importantly, if there is no threat of removal and takeover, the management may not strive for high performance.

These and similar points are not without merit as witnessed by lower market prices of shares with limited

voting rights compared to ordinary shares of the same company with equal or even inferior participation in earnings. In other words, the market valuation process can be relied on to punish the issuer and to compensate investors for limitations of voting rights. Why then should those investors who get compensated for the risk of lack of outside control and who, in exchange, respect the desire of the management group for independence as a central incentive for entrepreneurial activities be prevented from doing so? There seems to be no justification unless one clings to the traditional principle of quality control that implies the absence of astute, capable and competitive investors. As pointed out in the preceding section, this view is inappropriate for today's investment and economic environment.

To facilitate the external equity financing, the use of instruments with limited voting rights should be permitted in all Member States. Since most national company laws contain restrictions on the extent to which the main national type of these instruments may be used, reforms may be considered in this area. However, an easier solution seems the use of other than these typical national instruments, e.g. the use of participating certificates that carry no voting rights. The advantages of this approach are discussed below.

Even if the use of equity instruments with limited voting rights is permitted and not disapproved by regulators, it may not be easy to bring them to the market. Established issuing houses have been known to discourage their use. There are at least three reasons for this. First, these instruments usually are not the standard product which can be sold with the least

Use of instruments with limited
voting rights

Country	C	D
United Kingdom	yes	no
Ireland	no	no
Denmark	yes	yes
Netherlands	yes	yes
Germany	yes	yes
Luxembourg	yes	not appli- cable
Belgium	no	not appli- cable
France	to some extent	no
Italy	yes	no
Greece	yes	preferably

- C. Are there commonly used equity instruments available which provide the investor with the full upside potential but which nevertheless permit less outside influence on management than shares with full voting rights?
- D. Are these instruments predominantly used by small companies when they apply for listing?

effort and the lowest cost. Second, if there are no voting rights, a seat on the board, which would facilitate the monitoring of the company, may be not available. Third, as a matter of fact, in most countries there are few of these instruments traded on the market. Thus, in contrast to ordinary shares, valuations cannot be firmly backed by reference to companies in the same or in a similar industry. International comparisons may be difficult because of the peculiar features of the national instrument. As a result, a company may have to settle for a placing of ordinary shares in its first round of public external equity financing.

When further growth requires a second round, however, the market value of the ordinary shares provides a reliable basis for valuing limited voting right equity instruments. Obviously, as the use of such instruments becomes widespread, it is easier for other companies to rely on them even in the first round. A case in point is Denmark, where B-shares are predominantly used.

To facilitate comparisons for valuation purposes between markets in the Member States, an instrument with common features should be promoted in all Member States. In some Member States limited voting right instruments already are well accepted and widely used. But the features of these instruments vary widely from country to country. It seems difficult to develop a common form based on the national instruments. This might also disturb the use of accepted instruments. Thus the common instrument should be an additional instrument.

The participating certificate seems to be well suited for this purpose. It has full upside potential since it provides a share in the dividend and since it has

no due date. It carries no voting rights, like debt instruments, its use does not depend on a specific form of business organization. Restrictions on its use relative to other equity instruments seem not to be necessary. As with other limited voting instruments, economic disincentives to the issuer will force a balanced relative use.

At this point, a short note on the tax treatment of payments to holders of participating certificates may be in order. Even where, as in Germany, these payments are considered interest payments geared to profit and are thus a deductible expense for corporate income tax purposes, this instrument is rarely used today. Of course, to some extent this mirrors the reluctance of issuing houses. More importantly, however, it is felt that tax authorities could view these certificates as instruments of tax evasion. If the present sporadic occurrences would give way to frequent use, tax authorities are more likely to take that view and to close what they then regard as a loophole.

An assurance that a favourable tax treatment will be available in the future in the Member States would be most helpful in gaining acceptance for the European participating certificate as an instrument for the early rounds of external equity financing of small growing firms.

Summary and recommendations (cont'd)

4. Prior to trading on an efficient secondary market a reliable valuation of long-term equity instruments with full upside potential is not available. This adds to the well known reluctance of small companies to accept outside shareholders and considerably complicates the external financing as witnessed by the use of temporary external equity financing instruments. To eliminate this impediment, small companies should have access to a secondary market at an early stage in their development.

5. The desire to win independence is an important motive for becoming an entrepreneur. Most Member States respect this desire for independence and permit non-voting shares, shares with contingent voting rights or other equity instruments that grant less outside influence on management than shares with full voting rights. To facilitate external equity financing and to enhance growth, all Member States should permit the use of these instruments. In addition to accepted national instruments of this kind, which have divergent features, a common European participating certificate can be expected to stimulate external equity financing. For corporate tax purposes, payments to holders of these certificates should be a deductible expense.

C. INVESTORS, INVESTMENT MOTIVES AND INVESTMENT
RESTRICTIONS

The investor is the most crucial element in any equity financing system that employs securities markets. The number of investors and the volume of their funds committed to equities are the most important determinants of the degree of investment sophistication which a country enjoys. A large number of individual and institutional investors will generate a considerable volume of transactions in equities, and the competition for this business will sustain professional analysts and teams of analysts at many banks or firms of brokers. Some of the larger investors will themselves employ expert analysts to gain a competitive edge. It is this environment that leads to thorough and competitive valuations of shares and other equity instruments which are being issued or already traded. The existence of such an environment, not the more technical trading mechanism of the stock exchange, is paramount for the reliability of stock market prices¹⁾.

A developed and competitive capital market environment will greatly foster the equity financing of innovative and new technology-based firms. Whether these firms want to go public or want to raise funds privately with institutions, they are likely to find expert analysts who, frequently aided by other experts, can judge the investment merits of the project and assess

1) For a detailed analysis cf. H. Reuter, Aktienmarkt und Aktieninformationsmarkt, Göttingen: Vandenhoeck and Ruprecht, 1980.

the value of the equity instruments to be placed. Where larger amounts of funds are earmarked for equity investment, there will also be a good chance to find portfolios for which even sizeable high-risk investments are suitable and desired. A fair number of entrepreneurs who started a company and contributed to employment growth will attain high financial rewards. Others will be encouraged to follow their example.

Where only very limited portfolios for high-risk investment exist, there will obviously be problems for innovative firms to raise equity. Any larger project may require equity contributions that would imbalance these portfolios. Moreover, there also will be few or no analysts commanding the relevant expertise. Even if a bid for his shares materializes, the entrepreneur may consider the valuation unacceptably low. At best, as pointed out in the preceding section, the entrepreneur will find temporary funds. He may also turn to a foreign, more developed capital market. At worst, he has to sell his firm or to give up. His example may well serve as a deterrent.

The capital markets in the Member States rank between the extremes illustrated above. The existence and commonness of private institutions specializing in participations in small companies are rough indicators for the level of development. This information is given in column F of the table below. For details the reader is referred to the country reports. Small businesses place shares with such institutions, if they are too small or not yet structured for a public issue. Most of these institutions, as a matter of policy, respect the desire of the entrepreneur for independence and accept a minority interest. In recent years an increasing number

of these institutions has been prepared to back small firms in the early development phase or even at start-up. Since this, particularly with innovative firms, implies extended periods without returns, the central investment motive is capital gain on successful participations in the portfolio.

How the prominent position of the United Kingdom evidenced in column F developed cannot be traced here. However, the very considerable direct and indirect involvement of pension funds, insurance companies, investment funds and banks in equities appears to be a major contributing factor. There are very few restrictions on these activities. Even these restrictions give latitude like a 25% of assets ceiling on unlisted holdings and a 5% ceiling on unquoted holdings of unit trusts, which are much criticized since investors can be trusted to know which securities are suitable for their portfolios. In other countries, pension schemes frequently do not require funding and are much less prominent in the securities markets. Equity investments of institutional investors are generally more tightly restricted. Investment in unlisted equities or even in all kinds of equities is in some cases prohibited or discouraged because it is considered too risky. Obviously, this will not foster the development of a competitive and sophisticated environment for equity investment. Moreover, the prohibition of investments in unlisted equities is a quality control that discriminates against small companies.

Some people believe these restrictions are most desirable. They grant, unlike some bank and insurance company regulators, that most of the risk can be diversified away and that remaining risks can be taken care

of by solvency stipulations, e.g. by in some way linking a bank's equity investments to bank capital. To them, the overriding issue is restricting the power of financial institutions. Their assumption, that this is best achieved by restricting equity investment, is open to question.

If equity financing is restricted and loan financing is not, debt frequently will be used instead of equity. These loans will carry risk, and lenders will insist on loan agreements that grant them the right to call the loan if certain targets are not achieved. The power of lenders in an environment of low equity ratios is pronounced and it can be applied in ways not available to shareholders, who have to follow procedures provided by law and the articles of association. Usually, competition among lenders eases the degree of control that a borrower has to accept. However, because of the high risk of loans to heavily leveraged firms, even keen competition among lending institutions will not eliminate these controls.

Thus, prohibiting equity investment of institutions is not a desirable way to limit power. A more sensible approach is to permit all kinds of equity investments but to restrict the share an institution may hold in any company. A widely used ceiling permits holding an interest of up to 5% in a company. This will hardly affect the equity financing of large companies, unless tax advantages will only be available at higher levels of participation. However, such ceilings tend to be most inhibiting with small companies, since they permit only forbiddingly small investments. A 5% or even 15% stake in a small company frequently will be much less than ECU 0.5 mio, which most institutions regard as

Small company investment

Country	E	F	G
United Kingdom	no	very many	few
Ireland	no	some	no
Denmark	few	some	yes
Netherlands	no	many	yes
Germany	no	many	some
Luxembourg	yes	few	no
Belgium	no	some	few
France	no	some	few
Italy	yes	few	no
Greece	yes	few	no

E. Have there been recent indications of a lack of investor interest in small company shares?

F. Are there private institutions specializing in participations in small companies?

G. Have there been any recent indications that the efforts of institutional investors to acquire small company shares are impeded by regulatory restrictions?

the minimum investment. Any smaller stake cannot be expected to yield an adequate return if the cost of time and effort spent in valuation, monitoring and management of the participation is taken into account. To foster a competitive environment for small company equity financing, percentage ceilings on the stake in a company should not apply for investments of ECU 1 mio or less.

As column E of the above table points out, recent indications for a lack of investor interest in small company shares seem to be the exception. However, this finding of the country studies is to be seen against the background of a low volume of public issues and the underpricing employed by issuing houses, which is intended to ensure a wide spread of shareholders, to facilitate trading in the secondary market and to avoid concentrated outside influence. It is often claimed that without underpricing it would become obvious that the number of relevant individual and institutional investors is quite small and will not permit a much higher activity in the new issues market. Most investors are believed to expect higher yields (adjusted for risk) in other areas than company equity instruments, e.g. in government bonds and in real estate.

This point has been frequently encountered and it merits detailed analysis, which is beyond the scope of this study. Important factors are the tax treatment of capital gains, the taxation of company income and company net assets, and the relative tax treatment of dividends, interest payments and current income on real estate. The ad-hoc tax measures in France, Belgium, Denmark, The Netherlands and the United Kingdom aim

at increasing the relative attractiveness of small company share investment or of investment in domestic equities generally. These measures testify to the need for strengthening the investor base.

Summary and recommendations (cont'd)

6. The number of investors and the volume of their funds committed to equities are most important determinants of the degree of sophistication, competitiveness and depth of an equity capital market. These qualities are essential for new technology-based firms that want to raise equity capital publicly or privately. Unfortunately, only in few Member States these qualities are sufficiently developed. Regulatory restrictions contribute to this. In most Member States equity investment of certain institutional investors in unlisted and, less frequently, in listed securities is subject to regulatory discouragement or even to outright prohibition. Restrictions on investments in unlisted equities are a regulatory quality control that tends to discriminate against small companies. To encourage the involvement of institutions in all segments of the securities market, these restrictions should be abolished.

7. To limit the power of financial institutions legislators or regulators have placed ceilings on the interest that certain institutional investors may hold in a company. A widely used ceiling is 5% of the shares. A 5% or even a 15% stake in a small company cannot be expected to yield an adequate

return if the costs of valuation, monitoring and management are taken into account. To foster a competitive environment for small company equity financing, percentage ceilings on the stake in a company should not apply for investments of ECU 1 mio or less.

8. The attractiveness of equity investment relative to investment in government bonds and real estate seems to be unfavourably affected by differences in tax treatment. Tax measures of some Member States designed to counter this imbalance testify to the need for strengthening the investor base by reducing the fiscal bias against equity investment.

D. ISSUING HOUSES AND AVAILABILITY OF INVESTMENT
BANKING SERVICES

During the start-up phase of a small company the equity capital required will generally be provided by the founding entrepreneur. To some extent, subsequent financings may be achieved by direct placements of equity instruments with family members, business associates or with one or more institutional investors. As the further development requires larger amounts of external equity capital, the services of a specialized firm are usually retained which undertakes it to publicly or privately sell the instruments to investors. As the country studies have shown, a wide range of financial service firms have acted in this capacity and, because they perform the same basic function, all firms offering investment banking services are called issuing houses here.

This study focusses on the organized trading of small company shares in a secondary market and on the preceding public issue, which gives rise to the secondary market trading. Certainly, direct and private placements greatly contribute to the equity financing of growing firms in their early development, but the encompassing approach is external equity financing by public issue. There are three reasons for this.

First, venture capitalists or institutional investors accepting minority interests in unquoted companies are well aware that in case of successful development the most profitable exit route is the public sale of their interest in a secondary market. The exit via a larger

industrial company usually requires a majority interest. In some countries, where investment banking services for small companies are not available, institutional investors have even assured themselves of the future cooperation of an issuing house before taking on minority interests. Second, as pointed out in section B above, valuations of small company equity instruments are made easier if such instruments of comparable other companies are already publicly traded. In other words, a functioning public issue market will facilitate private and direct placements.

Third, even the placement of a minority interest generally involves a rather close relationship between the company and a representative of a small number of shareholders or of an institution, who will sit on the board and monitor performance. Many companies appreciate the resultant access to expertise and guidance. They may even welcome a hands-on approach. They also may want an institutional shareholder base before they go public, since this will be a strong selling point at the time of public issue. Moreover, if a number of institutional investors have familiarized themselves with the company, they are likely to sell or buy, depending on the price, and they will thus contribute to a reliable and competitive pricing of the shares once the company enters the secondary market. However, other companies strongly prefer a higher degree of independence and resent a big brother from a major institution on the board. The acceptable approach to them is the public issue to a large number of investors. Thus, they will try to go public at an early stage.

To sum up, whether institutional capital contributions are privately obtained or bypassed, the availability

of public issue investment banking services to small companies is a crucial factor. If these services are difficult to obtain, this obviously inhibits going public, but it also impedes private equity financing. The point should not be missed that this holds even if a perfectly organized small company secondary market segment exists. A company may simply not find an issuing house which takes it there.

Large companies generally will be able to obtain investment banking services at leading banks, which have a long and unbroken record in this field. Surprisingly, for small companies it is different. To identify for each Member State just one issuing house for small companies with a long and unbroken records seems a task that cannot be mastered. Of course, many an issuing house claims that it always has been prepared to service small companies, but it has not brought their issues to the market with any regularity. Moreover, an interesting finding of the country studies is that first public offerings of small company shares are frequently handled by financial firms that have no record in this field at all or at least no recent record. In other words, the issuing houses taking on small companies tend to be initially outside the mainstream of investment banking. They have a varied regulatory background and include small brokers, savings banks, licensed dealers, development companies and investment advisers. In some cases, it is known that they were the issuing house of last resort, since the client had been turned down by an established investment bank before approaching an outsider.

An explanation for this is not readily available, but risk, size and record seem to be relevant factors. Small company first public offerings usually are high-risk. Simply stated, an issuing house with a perfectly clear view of the client company going public anticipates various chains of future events which will lead to different paths of company development. In case of larger and diversified firms, these paths tend to generate financial results within a reasonably narrow range. In marked contrast, at a risky small firm, these paths lead to disparate results. Moreover and no less important, the probabilities for a number of extreme outcomes like failure and record growth are pronouncedly higher at small firms. All this is to be captured in one number, in the price at which the stock is offered. The related disclosure spells out the risk.

As time passes, the probabilities for future events change and these changes impact the price of the stock in the secondary market. The path that the company will actually follow generally becomes known. Depending on this path, the price may rise or drop sharply. The invested amount may be completely wiped out within a year or two. To the clearheaded investor there is nothing wrong with this result. It was a result associated with one or more paths of development and there was a certain probability for it at the time of issue.

Surprisingly few people accept this straightforward view though they readily understand it. They would never complain if their lottery ticket fails to draw a price. But to them, investment is different. A stake in a lottery may be lost, but a stake in a business got to be reasonably safe. Most people were brought up with this notion and it is reinforced by experience due to

Small company investment banking

Country	H ₁	H ₂	I	J
United Kingdom	many	some	some	yes
Ireland	several	one	few	yes
Denmark	some	one	probably	yes
Netherlands	one	none	very few	yes
Germany	some	none	very few	no
Luxembourg	none	none	no	no
Belgium	few	none	no	no
France	some	none	probably	yes
Italy	few	none	no	no
Greece	none	none	no	yes

H Have small companies gone public during the last three years

H₁ - at all?

H₂ - prior to achieving profitability?

I Have there been issuing houses which have brought shares of high-risk small companies to the market?

J Are different regulatory settings available to issuing houses?

the widespread application of quality control.

To an issuing house even the most unfavourable development of a high-risk company that it brought to the market might be of no account if it faced only professional and clearheaded investors. However, the press is known to write stories on new issues that fell below issuing price. From hindsight, a perfectly good assessment at the time of issue may appear to be poor judgement. This may give rise to suspicions of fraudulent behaviour. In addition, as pointed out in some country reports, there are small company investors who do not view their investment merely as a financial operation. They want to prove their superior business acumen to themselves and to others. Some of these are likely to look for somebody to blame if one of their investments does not return the desired results.

Thus, an issuing house may strain some relations with investors even if an issue was perfectly handled. It may also be exposed to adverse publicity. This is a more serious matter, since it is likely to affect the attitude of all clients toward the issuing house, regardless whether they do securities business or only use other banking services. Any issuing house is obviously well advised to take the potential impact of an unfortunate development at a client company into account. Bad publicity carries a negative value. The larger the issuing house, the more client relationships can be affected, and the more careful an issuing house will be guarding its reputation.

Of course, issuing houses will earn commissions on their investment banking services to small companies. However, since the volume of such issues is modest,

some recent issues amounted to less than ECU 0.5 mio, the commissions are negligible compared to the potential impact of bad publicity on the good name of a major bank. As a result, large banks and other big issuing houses generally will not offer high-risk small company shares to the public. Applicants are turned down or effectively kept away by high minimum fees.

Some of the larger and established houses deplore this situation. They would like to serve small innovative companies and guard their reputation at the same time. They have suggested to create specialized secondary markets for high-risk company shares. They feel that poor performances of client companies allocated to this market would be understood as consequences of ubiquitous risk and would not give rise to accusations of failure to properly control the quality of investment offered to the public. The point is well taken. However, even where market segments with different thresholds of quality exist, most financial papers disapprove of price volatility in the lowest segments (though this is exactly what one should expect) and register loudly cheering the low number of failures of companies traded on a certain junior stock market segment. This hardly contributes to the clear-sightedness that could encourage established issuing houses to service small innovative firms.

A number of conclusions can be drawn at this point:

- If side effects are not taken into account, there is no reason why high-risk companies should not be able to obtain investment banking services.

- Since high risk implies as one possible outcome poor performance or even failure and since this outcome usually tarnishes the reputation of the issuing house involved, high-risk companies will find it generally difficult to retain an issuing house. These difficulties tend to be more pronounced the larger the issuing houses and the smaller the company desiring to go public.
- A regulatory environment that forces all financial institutions which may engage in investment banking to meet high minimum capital requirements (and thereby imposes a high economic minimum size) tends to impede the availability of investment banking services.
- Special secondary market segments for high-risk companies may contribute to the availability of investment banking services.
- If the nature of high risk was better understood, much adverse publicity could be avoided and investment banking services would be less difficult to obtain.
- Chances of a high risk company for going public are markedly better early in a business upturn when the probability of failure is generally considered to be low.
- At other points of the business cycle, when less optimistic views prevail, a small company that cannot enlist the services of an investment banker for going public will have to rely on direct or private placements or delay expansion. This is in line with the statement of experts that the primary market for equities "went underground" in periods of great uncertainty.

- In spite of an excellent upside potential small innovative companies may not be able to go public until their products have been successfully tested in the market and their high-risk character fades.

These conclusions underline the findings of the country studies that there seem to be hardly any sources of continuous investment banking service to small companies. However, there are ways to improve the situation. Certainly, if widespread acceptance and understanding of high-risk equity finance could be achieved, this would be a breakthrough. Unfortunately, it is hard to see how it could be attained. A less obvious but more realistic approach is to facilitate entry into the investment banking business.

In the United Kingdom, the revival of small company investment banking frequently has been traced to licensed dealers¹⁾. It merely takes three references and a deposit of £ 500 to obtain a licence. In Germany, the only or at least the most active relevant issuing house is an investment adviser, which is not subject to high minimum capital requirements imposed on banks and, as a non-bank, must not carry securities accounts. In Denmark, an analyst arranged a small public offering. These investment bankers try to follow the model of the US over-the-counter market, where entry requirements are modest and where small broker firms provide investment banking services to small companies. The

1) For recent comments to that effect cf. The unlisted securities market, Bank of England Quarterly Bulletin, Vol. 23, 1983, pp. 227, 231.

appearance of these investment bankers and of similar firms outside the framework of traditional investment banking indicates that the established investment banks, because of their own choice or because of their design, do not service small companies effectively.

If entry to investment banking is easy, any gap in investment banking services is likely to attract new entrants. Their activities will also tend to influence established issuing houses, which will find it more difficult to convince their client companies that they are too young and too small for public issue and should accept a private placement. Established houses will be reluctant to lose clients to the newcomers. They are aware of the growth potential of small company clients, which may well become their major clients in the future. Those who serve them now will then be their strongly preferred partners. Competition of new entrants makes it difficult to guard reputation and to secure future market position at the same time. However, the danger that the failure to service small companies will reduce market share depends on the regulatory environment. If regulatory restrictions do not permit new entrants to grow with their clients and to achieve full issuing house status or if they make this result highly unlikely, the competitive pressure generated by new entrants will be negligible.

To avoid gaps in investment banking services to small high-risk companies and to foster competition in investment banking, a licensed dealer status should be available in all Member States. As a minimum, these licensed dealers should be permitted to offer securities to the public, to make markets in issues which they

sponsored and in other issues, and to carry securities accounts for clients. No attempt should be made to fit them into the banking system or into the exchange system. They are there to compete, not to cooperate. They are likely to be small firms highly motivated even by commissions which can be gained on issues of modest size. If they build the right client base, they are much less exposed to effects of adverse publicity than larger firms engaged in a more general business.

Though any adverse publicity may not affect their client relations, it may cause a tightening of controls and added regulatory burdens. The current discussion in the United Kingdom is a case in point. For some time there have been admonitions and requests to upgrade the regulation of licensed dealers. In some areas an upgrading will yield net benefits to all concerned. Examples are efforts to safeguard clients' accounts and measures against high pressure selling, churning and creating a false market. However, "upgrading" of entry requirements is likely to impede the supplemental and corrective function of licensed dealers, and the call for improving the quality of disclosure at the time of issue may in effect be a request for control of issue quality. It should be recognized that the quality of disclosure at young companies markedly increases as the trading record lengthens. There is a danger, that "upgraded" initial disclosure requirements inhibit the public issue of small young companies and effectively grant to institutional investors a privilege to privately acquire small company equity instruments in the early years. "Upgraded" initial disclosure requirements also are

likely to escalate the costs associated with public issues. This may further increase the size and thus the age that a company must achieve before it can economically raise equity capital by public issue. Moreover, as pointed out above, for small companies it is crucial to utilize favourable markets. Meeting elaborate initial disclosure requirements takes time and restricts the freedom of action.

Those who point to the disclosure requirements of the United States Securities and Exchange Commission (SEC) are well advised. Many small companies in the United States go public during their first or second year. Regulation A of the SEC provides reduced disclosure requirements for small company issues up to \$ 1.5 mio annually and permits public issues on the basis of unaudited financial statements. Contrary to Regulation A, which in most cases requires that investors are provided with an offering circular, small companies may issue shares to the public up to \$ 0.5 mio annually without any disclosure document under Regulation D. More than 20,000 companies in the United States enjoy an effective secondary market for their securities, but only about 7,500 are registered with the SEC and thus have to meet the SEC disclosure requirements.

Summary and recommendations (cont'd)

9. An opinion frequently encountered holds that equity capital raising by public issue should be the privilege of larger and mature companies. Small and high-risk companies should gradually establish an

institutional shareholder base and should not go public before their high-risk characteristics fade. This opinion implies that there should be no secondary market for small and high-risk companies and that these companies should raise their equity privately. However, many an entrepreneur strongly resents the high level of outside influence that comes with private capital raising and prefers public equity issues to a wide spread of shareholders at an early stage in the development of his company. This is not unrealistic. In the United States and, to some extent, in the United Kingdom public issues of small young companies have been brought to the market. The resultant secondary markets are most desirable and benefit even companies that have yet to go public. The prices established in these markets facilitate the fair valuation of equity instruments which are to be used in private placements, and their existence assures participants in private financings that a secondary market could also be established for the shares in which they invest. The public issue of shares of small and high-risk companies is a very desirable component of any equity financing system and should be fostered.

10. Unfortunately, the country reports have shown that investment banking services to small companies that desire to go public are not always available, even though most established investment bankers are in principle inclined to provide these services. Since high risk implies failure as a likely outcome and since failure of a company, because of ingrained faulty thinking, tarnishes the reputation of the investment bank which brought it to the market

established investment bankers prefer to guard their reputation and credibility. Establishing three or four vertical market segments and stressing the high-risk character of the company assigned to the lowest segment may be one set of measures to increase the involvement of established investment bankers with small company public issues.

11. The successful investment banking activities of firms from outside the mainstream of traditional investment banking, which have been observed in some countries, point to another important set of measures. To avoid gaps in investment banking service to small high-risk companies and to foster competition in investment banking, ease of entry to investment banking and to related financial services should be assured in all Member States. A licensed dealer status, as it is currently known in the United Kingdom, should be made available in all Member States. Since these licensed dealers are designed to compete, they should be permitted to operate outside the banking and the exchange system if they choose to do so. The licensing and supervision should rest with an agency other than the supervisor of banks. The regulation of these licensed dealers should be concerned with the safety and integrity of their operations, not with the safety of the instruments they offer. Any minimum disclosure requirements must not give rise to costs that render it uneconomical for small companies to go public. As in the United States, mandated disclosure should be scaled as to the size of the company, the amount to be raised and the kind of investors involved.

E. SECONDARY MARKETS FOR SMALL COMPANY EQUITY INSTRUMENTS

I. MARKET FEATURES DESIRABLE FOR THE EQUITY FINANCING OF SMALL COMPANIES

The four preceding sections established a number of desirable features of a secondary market for small company equity instruments:

1. Since the public issue of equity instruments of small companies at an early stage of their development is a desirable component of any equity financing system, organizers of secondary markets should not fail to cater to companies that are young, small and highly risky.
2. A secondary market for equity instruments should consist of different segments. The level of risk implied, among other things, in the threshold to be passed by companies that want to have their equity instruments traded there should be markedly different between the bottom level segment and the advanced level segment. This will contribute to the perception and understanding by the public and by regulators of differences in risk. It may also increase the availability of investment banking service to small companies.
3. If the national variant of the public limited company is not suitable for small companies or if the costs of conversion to this form are high, the equity

instruments of small companies that use a different form of business organization should be admitted to the lowest or the lower segments.

4. Entry to the lowest segment of the secondary market must not be impeded by minimum requirements as to age, size, intrinsic risk, level of outside influence or by high entry costs or continuing fees.
5. Organizers of secondary markets should, as a matter of principle, grant permission to deal for equity instruments carrying only limited voting rights.
6. The trading process should generate prices that are reliable indicators of the value of the underlying instruments.

These in some respects conflicting features will guide the comparative analysis of the secondary markets in the Member States. Of course, there are other desirable features that will be entered into the analysis below as required.

II. MARKET SEGMENTS NEEDED FOR SMALL COMPANY EQUITY INSTRUMENTS

As the surveys of the secondary markets in the country reports have shown, there are, with the exception of Greece, various segments available for equity instruments. To many it may come as a surprise that even stock exchanges have catered to small companies and frequently provided special segments. This clearly applies for Denmark, Germany, France, Italy, Belgium and the Netherlands. The exchanges in the United Kingdom, in Ireland, Luxembourg and Greece traditionally have had or had had only one segment, which, in principle, is accessible to reasonably small companies. Because of the onerous listing requirements, which inhibit the access of small companies, the Stock Exchange also started a special small company segment, the unlisted securities market²⁾. At present, only exchanges in two countries, which do not enjoy a high volume of transactions in domestic shares, do not offer a special small company segment.

For various reasons other stock exchanges rearranged their special small company segments. In Paris the small

2) The facilities under Rule 163(2) and Rule 163(3) are not viewed as market segments in this connection, though for a limited period the occasional bargains facility was suitable for companies even after a public issue. As Rule 163(2) (b) clearly indicates, the occasional bargains facility is not intended to serve companies that went public, it caters to companies that raised funds privately. By contrast, the facility under Rule 163(3) is a segment that facilitates the public financing of high-risk companies, but it is not open to manufacturing companies.

company segments were repeatedly improved. The mercati ristretti in Italy, which had served small companies for forty years, were closed down when a court ruled them illegal in 1975. Thus, there was a need to reorganize this segment. In the Netherlands, a new focus on small companies led to a restructuring of the traditional small company segment, which was subdivided into two segments and subjected to regulations paralleling those that apply for the larger-company segments. In Denmark, a revision of stock exchange regulations was about to firmly establish the recent development that tended to keep very small companies away from the exchange. But this development was reversed and a new segment for what some people consider tiny companies was established.

Taking a broader perspective, the Dutch and the Danish developments are very similar. A formerly unofficial¹⁾ market serving small companies was subdivided into two segments. Because of a number of developments in the seventies this is less obvious in Copenhagen than in Amsterdam.

Some of the stock exchanges in the remaining countries may also feel an urge to keep up with the rest. In Greece, a special market segment should indeed be established for companies that do not meet the rather high

1) In Copenhagen both segments are now official, in Amsterdam just one. Due to the stringent admission directives of the EC, which never were intended to apply to the unofficial markets of the sixties and seventies a de-officialisation appears likely. The officialisation is to some extent a device to make small company shares a permissible investment for institutions. The deregulation of institutional investment powers seems to be the more desirable approach to this end (cf. Recommendation 6).

listing standards. Even though it may not be an instant success attracting a fair number of companies, the opportunity is likely to generate some interest. In Belgium and in Germany, where special segments have been available for many years, there is some discussion aimed at establishing a new small company segment. In both countries there may well be a need to clarify the access requirements, to segment the exchanges clearly and convincingly and to encourage the listing of new companies. Unfortunately, a proposal for a second official market widely discussed in Germany would add a fifth exchange segment with more onerous listing requirements than those currently prevailing for ambitious small companies that desire an official listing.

Any restructuring should place emphasis on market segments for companies with growth potential. Since these companies are likely to be young, small and highly risky, it is the lowest segment that should be stressed and access to this segment by public issue should be encouraged. However, these bottom level segments like the lower Freiverkehr segment, the broker-dealer run part of the British over the counter market and the unofficial part of the parallelmarkt are rarely recommended. It is likely to take some time until the recently gained acceptance for segments below the top level extends down to the bottom level.

Some people who favor the less competitive and less visible private financing approach for unseasoned companies may even claim that bottom level segments should be either upgraded or outlawed. They point to the fact that most small companies that went public never entered the secondary market via its lowest segment. Most small companies going public have been in business for a fair

number of years and have reported profits recently. By bypassing the bottom level segment and by applying to the next higher segment, small companies want to indicate that they have already attained some threshold of quality.

However, this should not be seen to imply that there should be no segment for truly young and high-risk companies. The reader is referred to the discussions which led to Recommendations 4 and 9. It rather implies that there ought to be a small company segment that can only be entered if some advanced threshold of quality can be passed. In other words, there should be no less than two market segments for small company shares.

It also implies what may be more, that companies tend to have their equity instruments traded in the highest segment for which they qualify. Thus, the fear that companies will use the market with the lowest and least protective entry and continuing requirements seems to be ill founded. This happens where differences in segment quality have been permitted to fade. If a market is, as is recommended here, clearly segmented, those companies which are stable and mature will try to indicate this and will not stay among the unseasoned and highly risky. If they are ready to move to full listing they will. This will signal their ascent way beyond the investing public.

III. LISTING REQUIREMENTS

1. Sponsorship

Some companies now well known managed to go public but could not find an exchange member that was prepared to take it to the stock exchange. Consequently, it has been suggested to eliminate any requirements as to who may apply for listing. It is thought that this may greatly increase the use of the small company segments since exchange members guard their reputation and are not prepared to endanger their credibility by taking to the exchange companies still small and unsteady.

At a first glance, it seems desirable indeed that others than exchange members may apply for listing. Certainly, the additional burden which this would place on the committee reviewing the applications is no valid argument against this proposal. However, if the company, its consultant or its non-member investment banker were permitted to apply and if entry was granted this would merely be a formal act. Nobody may care to look after the company's shares thereafter.

With small companies this result may well occur. A small issue generates little investor interest. Institutional interest may not develop at all. Any orders may be without a limit as to price. Even if they carry one, it may not be based on investment analysis. As will be pointed out in section IV below, the specialist's job is to permit the market to clear, not to get absorbed in analysis. Where there was no sponsoring exchange member transactions have occurred at price levels established

long ago even after the company failed, in other words, transactions are likely to occur at unrealistic prices if there is no sponsoring exchange member. There must be someone on the exchange who is engaged in continuing analysis of the company, who, as a result, knows which price range is currently realistic and who, if necessary, facilitates transactions within this range by being prepared to act as counterparty for investors who want to deal. This is the role of the sponsoring exchange member.

If there is nobody to take on this function for a class of small company securities, this class should not be allowed to enter the market. There is no need to make the sponsoring member publicly known, it merely must exist. Therefore, the suggestion to abolish the sponsoring exchange member requirement has merit only if a member is willing to act as sponsoring member, but not prepared to file the application. This may occur if high risk companies are involved. Thus, for the lowest segment the issuing company should have the right to apply for entry, but there must be the requirement that a member has agreed to take on the continuing responsibilities of the sponsor. This is a sensible approach that is practiced in some Member States.

At some exchanges not all members are permitted to serve as sponsoring members. Generally, this is a useful approach that increases the number of built-in controls and slightly adds to the pricing quality of the exchange mechanism. However, if no exchange member of the right class is prepared to serve as sponsor, but if a member from another class is ready to do so, there seems to be not enough justification to deny access to the ex-

change. Thus, for the bottom level segment any member ought to be acceptable as sponsor¹⁾. This no doubt will be an incentive to established sponsors not to decline sponsorship now with a view to assuming it at some later time.

On some exchanges there must be sponsoring members from more than one class. Entry would be impossible if sponsors are available from only one class. This result should not be allowed to occur in lower segments. The Stock Exchange solution designed for the unlisted securities market says that if sponsoring jobbers cannot be found the sponsoring broker will suffice. He then is even permitted to arrange transactions for other members by acting as a matching broker in the issue that he sponsors. This provision has certainly been an incentive to jobbers not to decline sponsorship.

In general terms, on lower segments any lack of sponsorship should not be sufficient to deny access as long as there is one sponsoring member. This member should be entitled to act as matching broker or as market maker.

If there is no exchange member prepared to act as sponsor for a small company, it still should be able to have a secondary market arranged for its instruments. Any banks, brokers or licensed dealers should be permitted to act as matching broker or market maker off the ex-

1) The German Börsensachverständigenkommission has suggested to facilitate access to the second official market that it proposed by granting member banks of other exchanges the right to apply. Unfortunately, this does not assure the presence of a sponsoring member in the market.

change (cf. the discussion leading up to Recommendations 3 and 9). This will be an incentive for all exchange members not to decline sponsorship.

Some banks are known to act as matching brokers or market makers in their own shares. Some company secretaries or a special department of certain companies act as matching brokers in equity instruments of their company. Neither situation is desirable. Nonetheless, it may be necessary to use this approach.

2. Dimensions of the class of securities to be listed

Listing requirements tend to define the offer of a company in terms of total value of the class of securities involved and the percentage that must be available to the public. Moreover, some exchanges require a minimum absolute value of the securities publicly held. For details the reader is referred to the country reports and to columns L_1 , L_2 and L_3 of the table below. Finally and relatedly, the offer is characterized by certain acceptable methods of flotation which in turn bear on the way the price of the offer is established.

The rationale for the requirement that a minimum amount must be publicly held is obvious. No secondary market can function unless there is some number of investors interested in a particular issue. For entry to top segments, where the exchanges aim at a very high quality of transaction service, a large number of investors tends to be required. For the lowest segment, where the market organizer will have to settle for a minimum quality of transaction service, a small number will suffice.

If the corresponding minimum number of holders is thought by experts to be about 50 and if the average investment of a holder in securities of this kind is believed to be around ECU 10,000, the minimum market value is likely to be seen at ECU 0.5 mio. However, calculations like this rely on assumptions that can easily be challenged in specific cases where broad institutional sponsorship has been achieved, where each subscribing investor will only get a small allocation, where high risk causes investors to hold a smaller than average investment in a company, where trading is expected to be more active or where additional issues will soon become available.

Thus, the difficulty to fix the requirement at the appropriate level is as obvious as the rationale for the requirements. If the level set is not really crucial, which is the case in delineating the upper segments of the secondary market, any amount within a realistic range will do. Any company affected by the requirement will still be able to enter some secondary market segment. However, at the lowest segment, the level chosen is crucial. As recent experience and the figures used in some countries show, there is little latitude in setting this amount to be publicly held since a minimum below ECU 0.5 mio appears appropriate. Of course, relevant underlying factors like minimum investment per company acceptable to investors change from time and from country to country.

One solution to the problem has been widely practiced. Market organizers of the lowest segments have always tended to make full use of the given latitude. Since the quality of the transaction service in the lowest segment is unlikely to be affected by variations in

Country	K	L ₁	L ₂	L ₃	L ₄	L ₅	L ₆	L ₇	L ₈	L ₉
United Kingdom	5	no	no	10%	rarely	box(es)	yes	exceptionally	flat	yes
Ireland	3	no	no	10%	no	box(es)	yes	exceptionally	flat	yes
Denmark	2	2	1	15%	always	boxes	yes	after 1 year	flat	no
Netherlands	3	2.5	0.25	10%	no	box	yes	yes	flat	yes
Germany	3	0.5	no	no	no	no	no	after 1 year	no	yes
Luxembourg	2	50	no	no	no	no	yes	exceptionally	flat	yes
Belgium	3	no	no	no	no	yes	yes	n.a.	n.a.	no
France	2	no	2-9	10%	no	no	yes	yes	no	no
Italy	3	no	no	no	n.a.	no	no	yes	no	yes
Greece	1	n.a.	25	n.a.	no	no	yes	after 3 years	scaled	no

- K Number of market segments used for the trading of
small company shares
- L On the segment most frequently used¹⁾ recently by newly
admitted small companies .
- L₁ - there is a minimum capital requirement for the class
of shares admitted of (millions of local currency)
- L₂ - a certain set minimum amount is to be offered to the
public (millions of local currency)
- L₃ - a certain set percentage of the class of shares admitted
has to be publicly held
- L₄ - flotation methods have been used during the last
three years which tend to avoid underpricing
- L₅ - advertisement of prospectus is required
- L₆ - interim reports are required
- L₇ - companies which just started their activities may
be admitted
- L₈ - there is a continuing listing fee
- L₉ - transactions may be effected at any time during
trading hours.

1) Unlisted securities market (United Kingdom and Ireland), share
market III, official segment of parallelmarkt, geregelter Frei-
verkehr, official market, proposed Belgian second market, second
marché, terzo mercato, Athens Stock Exchange.

the relevant range, the market organizers have left it to the issuers and investment bankers to determine the minimum amount to be publicly held. Consequently, there is a tradition that no minimum requirements for the issue size exist for entry to the lowest segment. This practice continues in some countries where regulation was recently imposed. The Amsterdam Stock Exchange has not regulated entry to the lower segment of the parallel-market. Even on the advanced level of the unlisted securities market in Ireland and the United Kingdom no minimum has been set. By contrast, Denmark requires a minimum amount to be held by the public for entry to the lowest segment (share market III). However, this amount is very low (less than ECU 0.2 mio) and may be seen as an encouragement to small companies to apply for listing.

Neither this encouragement approach nor the no-requirement approach will impede small company equity financing. The minimum amount offered to the public tends to be sufficiently large for trading in the lowest segment because of the costs that a public issue involves. Moreover, issuing companies are generally anxious to achieve a good spread of shareholders. In order to maintain a low level of outside influence they try to avoid any concentration of shares offered to the public. Thus, formal minimum amount requirements and minimum spread requirements seem to yield no benefits.

The minimum total amount of the class of securities seems to be in itself a listing requirement of little relevance unless it is thought that the secondary market should be open only to companies of above average size and prestige. There is no need for it on lower market segments.

The minimum percentage to be made available to the public may be just seen as the link between total amount and amount to be publicly held. This formal view is inappropriate. The transaction quality for each segment can be calibrated by absolute minimum value requirements, a percentage requirement is not needed for this purpose.

The percentage to be publicly held is a requirement in its own right. Where it is used in this way, it is set at different levels depending on the market segment, e.g. in London and Paris it is 25% for full listing and 10% for the unlisted securities market and the second marché. It obviously is a measure for the degree to which the company has opened up to the public and an indicator for the weight outside investors are likely to be given in company matters. A 25% outside share will usually make the company markedly different from a company with a 10% share. For the lowest segment, as with the minimum amount publicly held, it is no easy matter to find a convincing level. Since 10% is used for the advanced level segments and since it implies a level of outside influence that some entrepreneurs may be reluctant to accept, a figure around 5% may be considered.

However, it is difficult to argue that a company making only 4% or 3% of a class of equity instruments available should not be admitted. No difference in company character seems to flow from variation within this or any other relevant range. Investor protection considerations may be guided by percentages that permit to bring shareholder action against the company or by the principle that the controlling group is the less likely to take improper advantage of outside investors the higher the share of the controlling group is. This prin-

ciple for minority situations advises against a percentage requirement for the lower segments. If the various situations are taken into account in which the lowest segment has a role to play, the widespread practice to not apply a percentage requirement for entry to the lowest segments appears acceptable. With the exception of Denmark, no such requirement is in force on any of the bottom level segments studied.

Even for companies which want to open up to the public an initial offer of only a few percent of shares or other equity instruments is frequently a more desirable step than offering 10% or more. Usually placements or offers for subscription are made at a fixed price. Particularly with innovative firms mispricing is widespread. It generally takes the form of uncontrolled underpricing. The background for this has been spelled out at some length at the end of section II 1a in the country report on the United Kingdom. Uncontrolled underpricing seems to be more pronounced on the Continent, where small companies have hardly a chance to retain an expert investment banker. Uncontrolled underpricing results in an opportunity loss to the entrepreneur which has been higher at times than the proceeds from the issue. One way to limit this part of the cost of going public is to first issue only a few percent of the class concerned. Once the price level is established, a second issue will follow without underpricing. Of course, this approach requires a secondary market segment where public issue of a few percent of a class can give rise to a permission to deal. Any percentage requirement is likely to impede this sensible approach to public equity financing and reduce the incentive to the entrepreneur to go public.

Alternatively, one could follow the Danish model. As pointed out, the Copenhagen Stock Exchange operates a bottom level market segment and it does apply there a percentage requirement, unlike all other lowest segment organizers. However, there are no fixed price offers on this segment and technically there can be no underpricing. As the reader will recall, the securities offered are distributed at the prevailing price through the stock exchange trading mechanism. A disadvantage of this procedure is the difficulty of achieving a desirable balance of the five ends of the issue process: complete sale of the issue, no underpricing, no concentration of outside influence, spread of holders conducive to good marketability, and a firm basis for agreeable investor relations. Other flotation and pricing procedures with controlled underpricing on the basis of tenders are likely to better balance these ends. Unfortunately, they are rarely used.

3. Disclosure

a) General background

Corporate disclosure is one of the most widely discussed and researched topics. After a review of literature Phillips and Zecher conclude that the economic case for mandatory disclosure is extremely weak. In their opinion, the chances for reducing the many milliards of disclosure cost are slim in spite of this, since two relatively small, well organized groups, professionals who produce the disclosure documents and professionals who receive them free, have a strong incentive to pre-

serve and to expand the mandatory disclosure system while other groups have little incentive to organize in opposition of the system¹⁾.

Taking a different and more specific perspective, an authoritative body has in effect argued that mandating disclosure by small companies is adding insult to injury²⁾. Regulatory restrictions on the investment in small company shares prevent institutional investor interest in small companies. In spite of the resultant neglect of small company shares by analysts, regulators by mandating disclosure require small companies to produce costly reports designed for use by such analysts.

Neither assessment should be taken lightly (cf. Recommendations 6 and 7). However, it ought to be stressed that no objections are raised against disclosure per se. The importance of disclosure is not at all denied, but there is much doubt that mandating disclosure is the appropriate way of generating the information required for the reliable valuation and pricing of equity instruments and for the effective functioning of the capital market.

Those who think that they can take a firm position with respect to these doubts are likely to have overlooked one or more of the issues involved. Such issues are:

1) Susan M. Phillips and J. Richard Zecher, *The SEC and the public interest*, Cambridge, Mass.: MIT Press, 1981, p. 51.

2) Advisory Committee on Corporate Disclosure, *Report to the Securities and Exchange Commission*, Washington D.C.: Government Printing Office, 1977, pp. 532, 514-519.

- Voluntary disclosure efforts seem to be quite extensive and no mandatory disclosure may be needed.
- Mandatory disclosure aims at the average analyst. For proper valuations information for expert analysts is needed, particularly if innovative companies are concerned.
- Those who support mandatory disclosure tend to believe that company disclosure can provide all material facts necessary to make an investment and allocation decision. By contrast, others hold that these decisions are largely based on information on the economy and on industry. Company disclosure offers relatively little. Investment decisions have to be seen in a portfolio context, in other words, much of the detailed company information required will be ignored by investors since any impact it may have will be diversified away.
- Investors use valuation models to assess the value of financial instruments. Models for the valuation of equities and their acceptance among investors have changed over time and the information needs of analysts and investors have been shifting accordingly. It is hard to conceive that regulators reliably trace this process and adjust format and content of mandatory disclosure.
- There is no agreement what kind of information is to be disclosed and how much, hard or soft information, past data or projections, detailed information on business or on people in the business.
- The frequency of disclosure gives rise to conflicting investor protection concerns. Since annual and interim reports seem to have none or no lasting impact on prices, some challenge the wisdom of interim report

requirements. They point to the fact that trading volume tends to increase close to the reporting date and that exchanges operated by brokers were the first to require interim reports.

- There are conflicting views as to the quality, extent and frequency of small company disclosure. Some would prefer to increase, others to reduce the requirements compared to large companies.

In addition to these issues concerning the quality, extent and frequency of corporate disclosure views vary widely on the way to be used for the dissemination of the information. The spectrum extends from those who hold that information on public companies ought to be advertised in the national press to others who maintain that a readily accessible file at the company or at some register suffices.

It is not the objective of this study to solve these knotty issues. They were set forth to provide a background against which the merits of disclosure requirements at the various levels of the secondary market hierarchy are more readily appreciated. In reviewing the prevailing requirements for the lower segments a judgement may become possible what characteristics a desirable disclosure regime should have.

The results of the previous sections also do have a bearing on disclosure. As a matter of principle, it was pointed out, companies should be able to publicly issue equity instruments and to enter the secondary market regardless of age, size, intrinsic risk and level of outside influence. Disclosure results in costs which in turn determine a certain minimum size. Moreover, dis-

closure requirements tend to set a certain minimum age. These aspects will be relevant for the discussion of disclosure requirements in the segment by segment approach that will be followed below.

b) Bottom level segments for small companies

The lowest segment is the most interesting for two reasons. First, it is the point of entry for small, young and high-risk companies. Second, there are frequently no disclosure requirements imposed by market organizers. Thus, voluntary disclosure is likely to occur. The following paragraphs will focus on countries where some relevant activity has been observed.

In the United Kingdom company law requires a prospectus for the public marketing of shares. Private placements, however, do not constitute a public marketing. Due to transactions following a private placement a growing shareholder base may develop. The occasional bargains facility takes care of the resultant transaction needs of private and public company investors. Access to the facility does not require a prospectus, but there must be audited accounts. The lowest British segment for public issues is the broker-dealer run part of the OTC market. There, of course, a prospectus is required including at least one year's audited accounts and a sales forecast.

On the non-official part of the parallelmarkt in Amsterdam a unique situation prevails. Unless there is a public issue, where a prospectus is usually available, the two specialist firms obtain relevant information from the

company and from other sources. They make this information available to investors who consider transactions. Some may be inclined to fear that the information is not used in the best interest of the investors. However, such fears are based on the fly-by-night model of enterprise that is generally inappropriate for long-term customer-firm relations businesses. These relations rest on trust and reputation that cannot be attained in a short term. The small Dutch specialist firms have been in operation for some generations and the long-term orientation of these firms makes abuses highly unlikely. They have to rely on a rather small basis of professional investors and any improper action would damage client relations and erode the client base.

Beyond company law annual reporting, there are no formal disclosure requirements for a company desiring to have its equity instruments traded in the ungerregelte Freiverkehr in Germany. A very small new technology based firm entered this segment in June 1983. The company voluntarily issued a prospectus and voluntarily undertook to publish quarterly reports. Generally this segment has similar functions as the British occasional bargains facility though, by contrast, there are no trading restrictions. Therefore, it is the secondary market for public companies that do not meet the entry requirements of the advanced level segment. The Belgian regulators are even more restrictive than the British. The comparable Belgian segment (bijkomende veilingen - ventes publiques supplementaires) must not serve small companies that do not meet the listing requirements because the Banking Commission will not allow this.

The share market III in Copenhagen stands for a bottom level segment with formalized disclosure requirements. The disclosure of the accounts of at least one year audited by two accountants and disclosure of the articles of association are the hard core of these initial requirements. The report, which is also required, provides general and soft information. In addition, box advertisements in the press are required and, more importantly, semiannual reports. These requirements mark the minimum requirements for all Danish segments. Though the requirements at the higher levels will change as a result of Community directives, changes in the bottom level segment for small companies are neither desired nor anticipated. One very small technology-based company has recently provided voluntarily much more than the required information.

Though the small number of functioning bottom level segments does not permit strong conclusions, the findings seem to provide some orientation. The rather high general requirements for public issues in the United Kingdom and in Belgium appear to be so stringent that they hardly give rise to voluntary disclosure. They do seem to give rise, however, to the desire to gain access to secondary markets where these legal entry requirements can be avoided. Thus, they may be too restrictive. By contrast, very modest requirements, regardless whether formalized or not, have not led to substandard disclosure since the companies going public and their investment bankers have tried to put their best foot forward and voluntarily undertook to disclose what they thought was relevant to investors.

The divergent disclosure regimes of the bottom level segment should be seen against their double function. The

first is to serve as the segment of entry for capital raising companies that are not eligible for admission to other segments since they are too young, too risky or too small. Their external equity raising would be inhibited if they had not access to this segment. The second function is to serve the transaction needs of investors in non capital raising companies that have been in business for years and that now happen to have the number of shareholders which requires a secondary market facility. Under the trading aspect that tends to dominate secondary market organization, both groups of companies and any variants in between can be taken care of together since their securities tend to have the same turnover characteristics¹⁾. Under the disclosure aspect, however, they are different.

The non capital raising companies are not likely to care much about investors and are unlikely to accept avoidable disclosure burdens. The existence of a few trading outside investors does indeed not justify the costs of special disclosure. If interim reports or a prospectus would be the entry requirement, these companies would just not enter. However, the trading needs would still be there and transactions would occur either invisibly or visibly elsewhere. By contrast, the capital raising companies, as the country reports show, are in principle ready to disclose directly or by way of e.g. the newsletter of their investment banker what is relevant to investors and they probably would not mind disclosure requirements tailored to their needs. Accordingly, the Danish bottom level segment, that caters to capital

1) In the system used in the earlier study, they would be classified as Segment 4 companies. Cf. H. Schmidt, l.c., pp. 321-331.

raising companies only, does have mandatory disclosure beyond the general legal requirements, whereas the Belgian bottom segment, which must not serve capital raising companies, does not.

The organizers of bottom level segments catering to both groups tend to aim at a situation where all disclosure documents which become available are on file outside the company. They do not impose disclosure requirements of their own. Higher requirements do not seem to be sensible. The development of a company that so far has considered itself in the capital raising group may at any time force it into the non capital raising group. The disclosure regime of a segment should allow for this situation that, in the bottom segment, means very few shareholders and no justification for added disclosure burdens. In other situations in the bottom level segment, where warranted voluntary disclosure is insufficient in view of the risk of the company or because of the kind and large number of investors concerned, the market organizer should have and use the power to impose special disclosure obligations on individual companies.

c) Advanced level segments for small companies

As to be expected, the disclosure requirements become more stringent and formalized at the next higher level in the secondary market hierarchy. In principle, the same information requirements as for even higher segments apply in most Member States. But compared to these higher segments there are some interesting differences. In Luxembourg, small young companies have to publish three interim reports, whereas mature companies publish two. The British OTC segment run by the issuing house Nightingale uses extensive contractual disclosure requirements. Not unlike the Dutch specialist firms, the issuing house has a central role in the information process and in the enforcement of its unmatched restrictions on insider transactions. Companies entering the unlisted securities market do not have to disseminate the prospectus by publishing it in the press. Dissemination requirements are also slightly lower for the official segment of the parallelmarkt in Amsterdam.

In two countries, there are markedly lower disclosure requirements at the advanced level small company segment compared to the official segment higher up in the hierarchy. In France, a prospectus is not mandatory for the admission of domestic companies to the second marché. The company is expected to introduce itself to the investors by the methods which it considers suitable. Similarly, entry to the geregelter Freiverkehr requires an extensive report to the governing committee, but whether and how this information is disclosed to the public is left up to the company. Some have published a full prospectus in the press. Most companies seem to

provide printed prospectuses and do undertake to publish interim reports voluntarily.

Since small growing firms tend to plan future issues the discretion that they have with respect to the prospectus is important to them. When they go public they generally see a need to introduce themselves and to inform about their activities in a prospectus irrespective of requirements. This also applies to interim reports. However, once this continuing information process is operating, they certainly see no need at the time of an additional issue to spend executive time and money on a prospectus that contains the information already made public. The prospectus requirement also makes it more difficult to take advantage of favourable market conditions. The principle that adequate continuing information eliminates the justification for most standard prospectus requirements is recognized and applied on some advanced level segments. Unfortunately and for reasons very much open to question, prospectuses and their advertisement are nonetheless required on others and on many official segments in line with the listing prospectus directive.

As to the general question how much, how frequent and how broadly information should be made available by small companies two extreme positions can be recognized behind current disclosure requirements at advanced level segments. One position holds that the tendency of investors to neglect small companies should be counterbalanced by disclosure efforts that should in principle exceed those of larger companies. The high-risk character of small companies also seems to require more frequent reporting.

The other position points to the fact that high disclosure costs discriminate against small companies and that trading record requirements exclude young firms. As a result, these companies tend to be forced to raise funds in a less competitive environment. Limited investor interest is seen to be caused by lack of market depth that cannot be overcome by improved and more frequent reporting. Since there is no public interest in small company shares, it is not justified to impose in the public interest the same disclosure requirements on companies small and large. It is also argued that the detailed prospectus requirements with emphasis on financial data and on finer points of investor protection aim at the standard large mature corporation. They are inappropriate for the small company where the focus should be on the entrepreneurial concept, on management background and competence, and on scenarios of future development. Therefore, the format, extent, frequency and dissemination of information should be left up to the company.

It is difficult to reconcile these positions. Nonetheless, the principle that disclosure should not be a handicap to small companies seems to be an acceptable point of departure. This implies that the cost of disclosure should not exceed what the disclosure is worth to investors and to the company. A broad brush approach is not likely to meet this criterion. More importantly, small companies obviously will be hurt much more by overshooting disclosure requirements than large companies. Any undershooting is easily corrected by voluntary action. Given this result and the many unresolved issues surrounding disclosure, considerable wisdom seems to lie in the Greek approach to require a prospectus and interim reports but to leave it largely up to the

company what information is disclosed. Since most market organizers are entitled to request relevant information and to impose disclosure obligations on individual companies, any deficiencies can be corrected.

The method and scope of dissemination also is a question that the company and its investment banker may decide, save that the market organizer or a register readily accessible should obtain a copy of each disclosure document.

4. Costs of listing

The costs of listing give rise to the now familiar problem that the cost burden per unit of capital raised is higher for small companies than for large ones. As a result, it may be uneconomical for certain smaller companies to raise equity, which in turn, as pointed out before, may impede growth and employment.

The activities that give rise to listing costs, are not wasteful. They are intended to benefit the issuing company. Nevertheless, the benefit derived in certain situations may not balance the cost. As just pointed out for the special case of disclosure, any overshooting requirements will tend to hurt small companies much more than large ones. They may even effectively ban small companies from public equity markets. Undershooting requirements, by contrast, do not hurt. Should there be any deficiencies, they can easily be corrected by voluntary action.

The costs of listing or, more general, the costs of market entry are taken here to include the costs of going public, save any costs that arise out of the conversion into the public limited company form (cf. Recommendation 1 and the related analysis). Basically, they have three components, the costs incurred at the company, the costs actually paid for services rendered and the opportunity costs that result from underpricing. The costs incurred at the company have not been subject of this study. Obviously, the extent of required disclosure has a major impact on these costs. Most of the following will be devoted to the second component, because the third, the cost of underpricing, was discussed in section 2 above.

The managing investment banker, in many small company issues no more than one investment banker is involved, will coordinate all activity leading up to the issue. These activities include, among others, the analysis of the company, adjusting company structure and articles of association to a standard acceptable to investors, determining kind and number of instruments to be floated, preparing and lodging documents relevant for listing, arranging the printing of securities, valuation, underwriting and selling of the securities. From country to country there are considerable differences as to the extent the managing investment banker gets involved in these activities beyond coordinating. Accordingly, the investment banking commission varies.

The degree to which the investment banker is involved also seems to have an impact on total listing costs. A case in point is the practice in the United Kingdom. The legal work is left to independent lawyers, most of the investigation work to an independent accountant.

In other words, the company enters into three or more contracts, though there is only one elsewhere. Of course, the reputation of these professionals retained must be commensurate with the status of the investment banker. Still, the company does have a choice, and since there is competition among lawyers and among accountants, as there is among investment bankers, the unbundling of the investment banking service package into three or more parts is likely to reduce total costs of going public.

There seems to be no other way than competition, possibly aided by unbundling, to reduce the cost of this service package that contributes more than any other item to the second component of listing costs (cf. Recommendation 11). Three other important items are dissemination costs, printing costs and issue tax.

As pointed out in the previous section, dissemination of the prospectus will be very much in the interest of the issuer and the investment banker. There is no need at all to require dissemination though, to foster efficient dissemination procedures, some standardization may be called for. In this case some low cost alternatives ought to be available. The importance of this point may be stressed by reminding the reader that in the area of service costs the main advantage of the unlisted securities market compared to the listed market is the absence of a requirement to publish the prospectus in the press.

Printing costs are a major listing cost element in some countries where bearer instruments are used. In France, by contrast, the share certificate was abolished in 1983. In Denmark, this step is being considered after

the dematerialization of bonds was effected in March 1983. Not all investors appreciate this approach. Nonetheless, it seems rather unlikely that a company will obtain a noticeably lower price for its instruments if it does not make certificates available to holders. Differences as to this price impact may exist depending on the kind of the company and the country of issue. It should be up to the company to decide whether certificates will be printed or not. Thus, in countries where bearer instruments are generally used, entry requirements for small company segments should offer the choice to the company to have certificates printed in denominations that traditionally have been required or, alternatively, to only make available the minimum number required by law, which implies that certificates will not be available to investors.

The issue tax, which, owing to harmonization efforts, generally is 1% of the value of equity instruments issued, discriminates against equity financing. Since innovative enterprises require more equity relative to debt than an average firm, they are placed at a disadvantage. For the small, undiversified enterprise this disadvantage is most pronounced. Since the current budget position of most Member States is conducive to minor tax cuts at the most, it is recommended to exempt the first ECU 10 mio of equity raised by any company. It may be desirable to grant the exemption only if certain conditions are met.

As pointed out repeatedly, the opportunity loss resulting from underpricing is a cost of going public that in many instances considerably exceeded the amount of all service related costs. This cost is readily avoided by straight tender offers, the infrequent use of which

may be partly attributed to a lack of competition among investment bankers (cf. Recommendation 11 and the analysis leading up to it) and partly to undesirable side effects of straight tender offers. The same applies to the flotation through the exchange trading mechanism, which is suitable for small distributions.

Either method in principle leads to a price that clears the market and thus will avoid any oversubscriptions or undersubscriptions. Technically, there can be no mispricing. However, as discussed in section 2 above and in section II 1a of the report on the United Kingdom, a disadvantage of these methods is that an undesirable concentration of outside influence may result and that the spread of shareholders may turn out to be inappropriate for good marketability. In addition, if the issue price is bid up too high the company may be left with disgruntled shareholders and a negative impact on image. Thus, the use of discretionary tenders should be encouraged where, as is the case with new technology-based firms, mispricing is likely to occur. With a discretionary tender, entrepreneur and investment banker can in view of the tenders received take an informed decision on the extent of underpricing that should be accepted to avoid unwanted outside influence, to attain good marketability and to provide a firm basis for agreeable investor relations.

A number of stock exchanges have been trying to encourage the use of tenders. Only the Copenhagen Exchange has been successful. As one would expect, the resistance of investment bankers to tenders and their preference for fixed-price subscriptions have been strong. Of course, fixed-price offers entail less efforts, and, what is more, the placement of underpriced shares is

an excellent way to ingratiate investors, to reciprocate business and to make sure that the issue sells rapidly and completely. In the absence of keen competition among investment bankers, there is no incentive to bother with straight or discretionary tender offers. Taking a broader view, this result is undesirable. There is no reason why the entrepreneur should have to settle for less than market value. Because it is the entrepreneurial initiative that contributes to growth and employment, it is the entrepreneur who should be financially rewarded, not those who happen to be clients of the investment banker. These financial rewards to entrepreneurs become known and serve to attract others to follow the model of the successful entrepreneur. The attractiveness of entrepreneurship is very important to the economy, not the attractiveness of a particular investment banker.

Straight tenders and tender offers that allow for underpricing at the discretion of the entrepreneur, not at the discretion of the investment banker, are more likely than any other method to achieve this desired result. Since neither the current level of competition among investment bankers nor the encouragement by exchanges so far have brought about the frequent use of tender methods, some may consider to force this method upon issuing houses by regulation. This approach could well reduce the availability of investment banking services and could have other undesirable side effects; it should not be considered at all. A better approach is certainly to provide an incentive to those who use a tender method. This will give the method of pricing an issue the prominence it deserves in the negotiations between entrepreneur and investment banker and force both sides to carefully weigh advantages and disadvan-

tages. One way to provide this incentive is to grant the issue tax exemption to companies only that make their first public offer of equity instruments by tender.

In section II 1a of the country report on Germany the costs of going public in Germany and in the United States were contrasted. The reader may expect to find more encompassing information at this point. However, any attempts to compare or to merely put into contrast single elements of the costs of going public seem to be misguided because these elements are interrelated. Obviously, underpricing facilitates selling and underwriting. Thus, a relatively low level of fees charged for investment banking services rendered may simply reflect a relatively high level of underpricing. Moreover, remuneration elements like warrants and cheap stock, which are widely used in the United States, do not readily lend themselves to comparisons. Further, even vague information on the cost of going public was only most reluctantly provided in some countries. Finally, in most countries there were few first public issues and the information obtained is not comparable because it relates to issues of different size. Thus, no synoptic information is provided. The following table is provided to illustrate the impact of the cost of going public relative to firm size, not for comparative purposes.

Flotation costs¹⁾ of first public offerings
in the United States 1968 - 1981²⁾

- in percent of gross proceeds -

Issue Size (\$ mio)	1968-73	1974-78	1979-81
≤ 0.50	21.6	22.0	23.0
0.51-1.00	17.4	18.4	19.3
1.01-2.00	13.9	16.0	17.1
2.01-5.00	11.0	12.5	14.6
5.01-10.00	9.1	10.6	11.6
10.01-20.00	7.5	9.3	9.7
20.01-50.00	7.0	7.5	8.4

Source: W. Holman and A. Young, l.c., p. 29.

1) Costs paid for services rendered (underwriting spread or commission plus payments for flotation related services).

2) For earlier years cf. D.L. Cohen, l.c., p. 258.

IV. TRADING AND TRADING INCENTIVES

1. General background

Basically, secondary market trading of securities serves two functions. Firstly, it is to provide for transactions at low cost. Secondly and relatedly, it ought to establish qualified prices. To fully grasp what it takes to fulfil these functions on advanced understanding of institutional securities markets arrangements and of the activities of the participants is necessary. The reader may readily appreciate the complexity of the meaning of "low cost" if it is pointed out that transaction costs include information costs, valuation costs, costs of order processing, execution, clearing and settlement, cost of immediacy depending on the market depth and cost of protection against transaction risk depending on investor protection arrangements. Low transaction costs are the result of a skillful balancing of these components. Low transaction costs facilitate the trading of all investors and market participants, but, most importantly, they encourage buying and selling by astute, resourceful and competitive investors. If a proper trading procedure focusses their activities, they visibly translate into qualified prices, which, contrary to plain prices, tend to be highly reliable indicators of the value of the securities traded.

The reader who looks for a systematic and detailed analysis of these and other general aspects of trading is referred to the earlier study¹⁾. For the purpose

1) H. Schmidt, l.c., pp. 1-41, 424-440.

of this study the importance of low transaction costs has been demonstrated in part 1, section C I. As pointed out there, high transaction costs in the secondary market cause issuing prices that are disadvantageous or even unacceptable to entrepreneurs and thus impede external equity financing. The importance of reliable valuations of equity instruments for small companies has been dealt with in sections B and D above. As pointed out there, the absence of reliable prices for small company equity instruments will understandably make entrepreneurs very reluctant to raise equity capital even if they would very much like to do so at the right price.

This section will deal with two issues. Price quality mainly depends on the number and kind of investors involved and, relatedly, on the turnover characteristics of the underlying security. Obviously, small companies are at a disadvantage here. Thus, the question will be discussed how the quality of prices of small company equity instruments can be improved. This will provide the background for the more technical question what can be done to lower some crucial components of transaction costs.

2. Improving the quality of prices of small company equity instruments

The most reliable prices are found in the top segment of the secondary market. There the shares of the very largest companies are traded. These markets are characterized by great depth, that is to say that a substantial number of shares can be bought or sold with no

or a very small impact on price. This situation tends to make the discovery of any undervaluations or overvaluations of a class of securities a most profitable event for investors who have considerable financial resources and to analysts who cater to such investors. Even the anticipation of rather small price changes due to such inaccurate valuations by the market can give rise to trading profits that greatly exceed the costs of time and effort spent for information, valuation and other costs related to the transaction. As a result, considerable numbers of investors and analysts monitor prices of top segment shares and all related news that become available. This interest and the resultant orders, which frequently carry a price limit, reinforce the depth of the market and thus the incentive to search for overvaluations or undervaluations. As a result of this competitive process, it can be expected that all relevant information that is available to analysts and investors is reflected in the prices at top level segments.

Unfortunately, as we move down to the lower levels of stock market hierarchy, the situation becomes markedly different. There the shares of rather small companies are traded and markets are rather narrow or even thin. Purchases of a few round lots will move up the market price and the market price is likely to drop on a few round lot of sales of these securities. Thus, any undervaluation or overvaluation has to be much larger to make it profitable for astute and resourceful investors to engage in the analysis of small companies and to purchase or sell in order to gain by the reverse transaction as the misvaluation disappears. The thinness of the market in lower level segments also tends to reduce the number of investors who do not aim at short

term trading profits but who are committed to buy securities and who prefer the most undervalued among comparable classes and thus contribute to improving price quality. Thinness tends to be so pronounced at the lower segments that it is difficult to recapture the costs required to identify undervalued stocks. If a stock attracts few buyers of this kind, there will be few sellers when overvaluations occur. As a result, compared to prices at the top segment, prices at lower level segments can be expected to less reliably reflect the available information.

It is often thought that it is the trading procedure employed by stock exchanges or by other market organizers that brings about the high quality of stock prices. Indeed, the trading procedure does have an effect. Trading procedures of organized secondary markets are based on the auction principle, the market maker principle or on both¹⁾. The auction principle subjects the bid or offer of any exchange member to the judgement of all others at the market. Though finally there are only two parties to a transaction, the price represents the judgement of a much larger number of traders since it is the highest bid and the lowest offer that merge in a transaction. Competitive bids tend to be at the market slightly below the transaction price and competitive offers slightly above. As in other auctions, the most competitive participants will actually trade and it is the immediate availabi-

1) For a systematic survey see H. Schmidt, l.c., pp. 424-431.

lity of other competitive bids and offers each based on a more or less thorough assessment of the value of the stock that will force the price to stay reliably close to its value¹⁾.

However, as the reader probably has noticed, the impact of the trading procedure on the valuation process is limited. The trading procedure merely focusses investor supply and demand and facilitates it to periodically or continuously establish the price that does clear the market. Of course, exchange members of some exchanges are permitted to deal for their own account and they, according to their assessment of the stock, will add to investor demand and investor supply, but this activity is a function of investor interest and not a completely independent force in the valuation and pricing process. Compared to a stock publicly held by tenths of thousands of investors, a small company stock will generate only few orders, which in turn induce little interest by exchange members. As a result, competition among buyers and among sellers is not really keen. It may even be absent for extended periods, and the sponsoring member will then have to search for a counterparty if any order arrives at the market. The resultant price does not qualify for the reliable brand "established under the auction principle". The positive impact of the trading method will only be felt during periods of active dealing.

1) The above interpretation focusses on individual prices. Of course, continental exchanges employ collective prices that merge the group of highest bidders and the group of the lowest sellers. As a result, all parties belonging to these groups will transact at one price. For details and for discussion of collective double auction see H. Schmidt, l.c., pp. 428-431. There is no need to discuss collective prices at this point because the underlying principle pointed out above for individual prices also applies for collective prices.

The range of stocks to which the auction principle can be successfully applied is extended on some exchanges by accumulating orders over certain periods and by executing them only once a week or once or twice a day. As discussed in detail in the earlier study report, procedures based on the market-maker principle are well suited for stocks that, even if orders are accumulated¹⁾, do not enjoy turnover characteristics giving rise to sufficient competition among buyers and sellers. Of course, as the British jobbers and the American Nasdaq indicate, more active stocks are also traded by market makers. However, very small inactive issues will only exceptionally attract a market maker.

The basis of the market-maker principle is the judgement of the market maker as to the correct price. Unlike the judgement of an ordinary buyer or seller, the market maker's judgement is of special quality. In the ideal case the market maker will buy or sell at the same price any quantity desired. In doing so he subjects himself to some kind of feedback control system. If his judgement is incorrect and if his price is too low, he will sell more than he buys; a short position builds up. He has to raise his price. If his price is too high, he will accumulate a long position that sooner or later forces him to lower his price. Only if his judgement is correct he will buy and sell, and he will not build up a position since the market clears at the right price. Of course, this principle also works in the realistic case where the market maker buys somewhat below the price he considers correct and sells

1) H. Schmidt, l.c., pp. 321-331, 425, 432-440.

slightly above and where he increases the spread if larger than normal transactions are desired by investors¹⁾.

Obviously, the feedback control mechanism works best if the market maker is exposed to a continuous flow of orders. If the market maker services a typical bottom level segment stock, chances are that there is no such flow. There tend to be days or sometimes weeks without orders. Any price changes will tend to reflect other factors than changes in market maker position. Thus, even if such a stock attracts a market maker, the prices he deals at do not qualify for the reliable brand "price established under the market-maker principle". The market maker's price will then not be superior in quality to the price established by any sponsoring exchange member or other market organizer. Only during periods of active trading of the stock this superior quality can be attained.

To sum up, the choice of the trading procedure cannot fundamentally change the result, that price quality varies widely according to the turnover characteristics of a stock, which is closely related to the depth of its market. If market segments are clearly and convincingly delineated, the quality of prices to be expected given the characteristics of a class of equity instruments will be an important factor in allocating secu-

1) For an advanced discussion of pricing by market makers see E. Mildenstein, Die Kurspolitik der Marketmaker auf Aktienzirkulationsmärkten, Martienß: Schwarzenbek und Hamburg, 1982.

rities to these segments¹⁾.

At this point, the critical reader may question whether the trading of a small company stock on the bottom level segment improves the quality of valuation at all. The answer appears to be no, if the upper segment price quality is the basis of comparison. But this view is unrealistic, as small company shares are not suited for these segments. Realistically, a small company has the choice between direct or private placements of equity instruments on the one hand and public issue combined with access to the bottom level segment on the other. In the private capital market, if there is a fair number of institutional investors, shopping around will be helpful. At best it may result in a price that is close to a public issue price save the discount owing to the absence of a secondary market. After the completion of the private financing, however, a competitive monitoring of the price will not occur at all. The company will lack guidance in further rounds of financing, in exchanges of shares and for other purposes.

If the alternative open capital market is chosen, the price of the company's stock will be regularly quoted. As pointed out, investor interest will be limited. Frequently, a price established at some time will simply be carried forward. But it is possible at any time

1) This perspective yields four vertical segments (cf. H. Schmidt, l.c., pp. 321-331). This result is consistent with a bottom level segment called Segment 4 in the earlier study, an advanced level small company segment and two upper segments, the highest of which may be not necessary in some countries owing to the absence of very large companies.

for any investor to challenge this price. As experience in small company stock trading shows, now and then short or extended periods of active dealing will occur and during these periods even bottom level markets will generate qualified prices. In contrast with private placements, these prices are visible and guide in their financing decisions the issuer and other companies that have not yet gone public. This is a considerable improvement over the situation in the private capital market where valuations tend to be biased in favour of the investor.

Still, the prices of lower level segment company stocks are likely to be somewhat depressed because of their poor marketability. Above average yields on small company shares come in line with this hypothesis¹⁾. Recently, the "frothy sentiment" and the resultant high-price earnings multiples of many unlisted securities market stocks may have shed some doubts on this hypothesis of long standing. This recent experience in the United Kingdom seems to be the result of a number of factors that emphasize the importance of small company investment²⁾. In addition, the novelty of the unlisted securities market and the ensuing publicity stimulated investor interest. The impact of these factors may be temporary, but this experience shows that it is pos-

1) For tests of this hypothesis, risk, marketability and yield must be measured. Unfortunately, the market price related measure of risk is inapplicable to smaller company stocks with high serial dependencies due to the carry forward pricing during periods of inactive trading. Cf. note 7) on p. 33, See also R. Roll, A possible explanation of the small firm effect, *Journal of Finance*, Vol. 36, 1981, pp. 879 - 888, who points to infrequent trading, and H.R. Stoll and R.E. Whaley, Transaction costs and the small firm effect (commented by P. Schultz), *Journal of Financial Economics*, Vol. 12, June 1983, pp. 57 - 88.

2) Unlisted securities market, Bank of England, *Quarterly Bulletin*, Vol. 23, 1983, p. 230.

sible to counter the lack of market depth of small company stock and to further improve price quality. Measures which promise a long term impact would be most desirable.

The root of the problem is the small volume of first public issues and the resultant poor marketability, which tends to reinforce itself since investors holding the stock will be reluctant to sell it. They know that the price tends to drop even on the sale of rather small amounts. Poor marketability is also self reinforcing because it seems to be the most important non-regulatory reason for the great reluctance of institutional investors to invest in small company stock¹⁾. The only way to improve this situation is to improve the turnover characteristics of the issue in spite of the small volume publicly held. In other words the disincentives to trading flowing from poor marketability must be compensated by incentives to trade. Those should be motivated to trade who think that the stock is incorrectly priced. Their incentive is the short term capital gain. This incentive is perfectly geared to improving price quality and rests solely on the investment merit of the company. Thus, this incentive should be allowed to take its full effect.

The first step toward this end is to eliminate regulatory restrictions on investments in lower level segment securities (cf. Recommendation 6). The second

1) This statement was frequently made by the experts interviewed. A special survey in the United States also yielded this result, Joint Industry and Government Committee, Report on small business financing, Washington, D.C.: NASD, 1979, pp. 15, 16, 19, 20.

step is to exempt from individual and corporate income tax capital gains on small company equity instruments. The third step is to exempt transactions in small company equity instruments from all incidental indirect taxes such as turnover tax, value added tax on commissions, contract stamp duty or transfer tax.

For purposes of these exemptions, a small company should be defined by a market value of equity instruments not exceeding ECU 25 mio. Since a small company first public issue will frequently encompass about 10% of total equity capital, ECU 25 mio seems to be on the low side. Instead of increasing this ceiling, one might think of basing the exemption on the amount publicly held. However, the exemption should be based on total equity market value and not on the amount publicly held since this would, in principle, make the exemption available to almost all companies if they care to reduce their public float. This is clearly undesirable.

These exemptions seem to be of little relevance from a fiscal point of view. Nonetheless, a more restrictive line may have to be taken. In this case the exemptions may be granted only for companies less than 10 years old. Innovative enterprises generally complete start up and early development phases well within a ten year period. A further or alternative restriction requiring capital gains reinvestment in small company equities in order to enjoy the exemption would certainly reduce the fiscal impact, but also the effectiveness of the measure. Moreover, it obviously is cumbersome and should be avoided also for that reason.

The exemption of capital gains as stated above intentionally covers any gains that entrepreneurs realize. This will tend to increase the amount of stock an entrepreneur is prepared to sell to the public. Thus, the exemption will also in this way add to marketability. Moreover, it increases the financial attractiveness of entrepreneurship, of contributing to growth and employment. This incentive is desirable irrespective of public issue. The exemption also intentionally covers qualifying capital gains realized by investors in the private capital market. Equity financing by venture capitalists, participation companies and investment bankers specializing in private placements is a competitive approach to raising equity publicly and must not be discriminated against.

Though the taxation of capital gains is less pronounced in some Member States than in others, these measures, if implemented, are highly likely to bring about a marked increase in the turnover of small company securities in all Member States. Competition for capital gains will be keen. As a result, the auction principle and the market-maker principle become effective for many small company equities and qualified prices will be established. In addition, the tax exemption will give a certain prominence to small company equities. Special lists will be circulating and this publicity will add to investor interest. Further, the investor interest, the competitive valuation and the improved marketability of small company shares is likely to greatly facilitate the public and private equity financing of small companies. Finally, the improved marketability is likely to attract larger numbers of small companies to the lower segments.

3. Facilitating transactions in small company equity instruments

Trading procedures are designed to facilitate transactions directly by bringing buyers and sellers together and indirectly by reducing transaction costs. As pointed out, transaction costs, in line with the use of the term in economic literature, are broadly defined here. Thus, reducing information and valuation costs will be addressed later in this section.

The trading procedures in use in the various Member States are appropriate and any deficiencies, with one exception, do not warrant discussion in the context of this study. Of course, the trading procedures employed on lower level segments in the Member States differ in formal appearance. In substance and effect, however, differences seem to be on the petty side. For example, on lower level segments in the United Kingdom and in The Netherlands dealing through a jobber, market maker or specialist is mandatory though it may be most desirable to allow public orders to directly meet on all markets. But this issue, which is the great issue of trading procedure on the upper segments, appears to be a non-issue on the lower segments. Due to the lack of activity, the services of a specialist or a sponsoring member will be used regardless whether this is mandatory. Of course, where market makers' spreads are not competitive, only voluntary use of market makers readily offers ways to remedy the situation. The only issue that seems worth reporting is the problem of trading frequency. One position is, as pointed out in section II 2b of the Denmark report, to let orders accumulate and to generate a reliable basis for qualified prices.

As a result, trading once a week or once a month is preferred. Others strongly feel that a lack of opportunity to trade will curtail trading interest of investors who trade on new information, in other words, who will contribute most to price quality and marketability.

To stimulate the interest of these investors continuous trading is encouraged or at least permitted on most lower market segments. As set forth in section 2 above, trading based on the market-maker principle tends to be more appropriate for small company stocks than auction based procedures that may indeed require order accumulation. Since market making is designed to permit transactions at any time during trading hours, it is consistent with the second position. On lower segments trading should be possible at any time during trading hours. As will be seen later, this is likely to facilitate the spread of information and valuation costs. Weekly or monthly trading is not recommended.

In section C I of part 1 it was emphasized that the contribution of organized secondary markets to external equity financing of small companies rests on low transaction costs, most importantly on

- lower information and valuation costs as compared to a situation without organized secondary markets,
- lower costs of order execution and settlement services,
- competition among buyers to lower the costs of immediacy.

The discussion of marketability in section 2 above has stressed the openness of the public capital market that,

in contrast with the private market, permits any interested investor to compete with others. In addition, measures were proposed to improve marketability and, as one result, competition among buyers. Thus, this important point already has received proper attention.

As a result of the procedural efficiency that exchanges generally have attained in the execution settlement sphere, the costs of order execution and settlement services in the Member States for transactions on lower level segments do not differ much from the commissions additionally charged on securities transactions. Not surprisingly, they tend to be slightly higher. This, in some cases, rests on the fact that for regulatory or economic reasons small company equities are not included in the national clearing and settlement system for securities. Though it was difficult to obtain hard information on the cost of these transaction services in private markets, it can be safely stated that the costs of these services are clearly lower for transactions on the small company segments studied. This also contributes to competition on buyers and tends to improve price quality. For various reasons the commissions or commission equivalence charged seem to be close to what one would expect under a system of negotiated commissions. Any future indications suggesting a shift to a non-competitive commission level for lower segment stocks should give rise to serious concerns.

It is more difficult to address the question how information and valuation costs are lowered by organized secondary markets. The easiest way to deal with this question is to put oneself into the place of a buyer or seller. In an non-organized, private capital market

environment all information most likely must be assembled from scratch. An organized market, as pointed out in the section on disclosure above, implies that there is a file with standardized company information prepared or screened by identifiable investment bankers, accountants and lawyers and updated by annual and interim disclosure. Specialized publishing services condense this information and distribute it widely. In marked contrast to the private environment, information efforts are incremental and information cost is much reduced for this reason. A similar effect facilitates valuation. In contrast with a private environment, the information that over time became available on the company, the industry and the economy can be matched with corresponding price information. This can be checked against the market valuations of comparable companies. Model information can be derived from such data in order to assess the price impact of anticipated events. The basis for valuations is much improved. Still, the cost of such investment research appears to be high and prohibitive for transactions of small volume.

However, unlike the private market purchaser or seller who has to engage in a valuation effort for a single transaction, repeated use of valuation work is possible if there is a secondary market. Incremental costs are low in case of repeated use. Frequent transactions serve to recapture these costs. The research departments of large banks, securities firms and institutions follow dozens or even hundreds of stocks that way for their own trading and for advice to clients.

Small company equities are not likely to be among the stocks widely followed. The sponsoring member or market organizer will follow it. An excellent sponsor

will try to keep the price very close to the changing value. For this he may be directly or indirectly remunerated by fees paid by the issuer or by investors. Limited trading profits may also accrue to him as a result. If he would not proceed in this way, the price would deviate from value to an extent that in spite of the thinness of the market investment research would become profitable for others. To avoid with a high degree of probability such unfavourable balance of marketability and price quality, sponsor-independent research is most desirable. The importance of allocating shares with a view to future marketability was stressed repeatedly above. If sufficient allocations are made to institutional investors or to proficient individual investors or to the clients of such firms whose research department will monitor the stock, independent research will be available and competitively balance marketability and price quality. Of course, the tax measures recommended in the previous section will, if implemented, favourably affect this balance.

Coming back to the question of information and valuation cost, the situation is obviously quite different if an organized market exists. In the private market environment, any buyer or seller is burdened with information and valuation costs. Organized secondary markets considerably reduce this burden since only incremental efforts are necessary. Moreover, there seem to be two classes of transactors. For the first class information and valuation efforts are profitable, for the second they are not. Thus, the second class may engage in such efforts only superficially or not at all. Nonetheless these investors do transact because they have convinced themselves that market prices are

sufficiently reliable. In other words, they accept a certain degree of secondary market mispricing that is likely to be lower with large than with small company stock. In doing so, they provide opportunities for trading profits to transactors of the first class and, in a way, pay those who are more efficient at valuation. Consequently, the competitive duplication of information and valuation work is kept within limits and the cost is spread over all investors based on the volume transacted.

Since investors can buy research directly or via commissions, the line dividing the two classes is fluent. The line itself is of little interest. The important point is the spreading of the incremental costs over the total volume transacted. The relatively high volatility of small company stock prices should be recognized and accepted as a part of this desirable spreading process¹⁾.

To sum up, information and valuation costs of a transactor in an organized secondary market favourably compare to the situation without an organized secondary market. There the transactor must assume the full²⁾ costs, not merely a proportional share of the incremental burden. As a result, small transactions are economically feasible on organized markets, on others they are not. In general terms, an organized secondary

1) Of course, intrinsic risk characteristics also add to price volatility.

2) In some cases, the contrast will be slightly less pronounced. In situations of mutual trust, information and valuation work by both the buyer and the seller may be avoided. They may join forces and share the costs.

market increased the price at which it still is economical to buy and it decreases the price at which it is still economical to sell. In other words, organized secondary markets have the unique tendency to close the gap between these prices that is caused by transaction costs. The closing of this gap is the secret behind the attractiveness of secondary markets as exit route for investors. This, in turn, explains the dominating role of stock exchanges in the public issue of all financial instruments that require intricate valuation efforts. Organized secondary markets clearly have an important role to play in the external equity financing even of small innovative companies. To play this role it takes suitable forms of business organization, equity instruments acceptable to the entrepreneur, it takes investors, competitive investment bankers, small company segments and scaled entry requirements. Most of all it takes transactions.

Summary and recommendations (cont'd)

12. The secondary markets in almost all Member States provide special segments for small company equity instruments. No less than two clearly different market segments should be open to small companies. Most small companies have been in business for some years and achieved profitability before they apply for entry to the secondary market. They prefer to signal that they can pass some standard threshold of quality and they should be able to do so by entering the market at the second lowest segment. The lowest segment caters to young and high-risk companies that cannot meet this standard. In

some Member States much more than in others, there is a need to increase the general acceptance of a bottom level segment and to encourage its use. No stock exchange or association of securities firms should enjoy the monopoly of a national market organizer unless it operates a special segment for young and high-risk companies (cf. Recommendations 3, 4 and 9).

13. It has been claimed that access to exchanges is inhibited by requirements that a company desiring to enter must be sponsored. At most exchanges, only a member of a certain class may apply for the listing of a client company. This and similar requirements are likely to improve the quality of pricing, particularly if small company equity securities are concerned. Nonetheless, to eliminate any unnecessary restrictions on access, an issuing company should be entitled to apply itself for entry to the lowest exchange segment. As practiced at some exchanges, the applicant, however, must file with the application the undertaking of an exchange member to accept the continuing responsibilities of a sponsor. If these responsibilities are assumed by a member of a class that usually is not eligible for sponsorship, this should not cause the exchange to deny entry to the junior exchange segment. The member assuming responsibility should be permitted to act as matching broker or market maker if no other member assumes this function (for cases where no exchange member is prepared to assume responsibility see Recommendation 11).
14. Listing requirements tend to define the class of securities to be listed in terms of total value

of the class to be listed, in terms of a percentage that must be available to the public and in terms of a minimum amount to be held by the public. Though related, these requirements aim at different aspects that are relevant for delineating secondary market segments. The minimum amount to be publicly held and the related factors which it implies calibrate the quality of transaction service of the market segment, whereas the percentage requirements are an important factor determining the weight that outside investors will be given in company matters. Thus, it is desirable that markedly distinct values and percentages are used to define the various segments. The widespread use of 25% for the (lowest) official segment, which is in line with the Admission Directive, and of 10% for advanced small company segments seem to be well chosen. The minimum amount to be held by the public is more difficult to establish for the advanced company segment. Since, contrary to variations at a somewhat higher level, realistic variations of this value below ECU 1 mio are not likely to noticeably impact transaction service quality, the minimum amount to be publicly held may be set at ECU 1 mio. In line with tradition and widespread use, entrants to the lowest segment should not have to meet any of these requirements. It would cater to companies that go public with issues just above the economically meaningful minimum size. Depending on the costs of public issue, which slightly differ from country to country, this minimum will be close to ECU 0.5 mio or clearly below. Moreover, the lowest market segment has a role in avoiding opportunity losses to the entrepreneur that result from

underpricing and that impede first public equity financing on all other segments of the secondary market.

15. Corporate disclosure is to facilitate the valuation of capital raising instruments and it should correspond to the requirements of the valuation models used by proficient investors and analysts. Many unresolved issues surround disclosure. Accordingly, divergent requirements are found in the Member States even if only secondary market segments of the same level are entered into comparison. The spectrum of disclosure requirements for small public companies extends beyond that for large companies. On the one hand, any disclosure beyond the basic legal requirements is voluntary, on the other more frequent reporting is required than for large companies. Since disclosure should not be a handicap to small companies, the cost of disclosure should not exceed what disclosure is worth to investors and the company. A broad brush approach is not likely to meet this criterion. Overshooting disclosure requirements burden small companies much more per capital unit raised than large companies. Any undershooting, however, can be easily corrected by voluntary disclosure or by discretionary requests for information by stock exchanges or other market organizers. At the bottom level segment, disclosure requirements should not impose a minimum age on the companies desiring entry. Because the bottom level segment serves capital raising companies and non capital raising companies having small numbers of investors, entry should as a matter of principle not give rise to mandatory disclosure beyond what is generally required by law. On the

advanced level segment for small companies the additional disclosure requirements should be moderate and geared to the level of entry the market organizer aims at. A prospectus and interim reports should be required, but it should largely be up to the company to decide what information it discloses.

16. Relative to the size of the issue the cost of a prospectus is much more burdensome for small issues than for large. This cost can be avoided and an incentive for the continuing information of investors is provided if the principle is adopted that a company should not be required to disclose information which is already public. As a minimum, this should hold for either small company segment. A company that published a prospectus as required for a small company segment or that voluntarily provided this information and that since has met continuing information requirements must not be required to publish a prospectus when it brings a new issue of the same class to this market segment.

17. The costs of listing or, taking a somewhat broader view, the costs of going public burden small companies more than large per unit of equity raised. They may greatly impede equity financing and growth of small companies. There are two basic ways to reduce these costs. First, competition is likely to lower the prices of relevant services. Second, listing requirements that do not yield a net benefit to the issuing company should be abolished. The costs of listing comprise the costs incurred at the company, the costs actually paid for services rendered and the cost of underpricing. The costs

paid for investment banking and related services are likely to be favourably affected by competition (cf. Recommendation 11), possibly aided by unbundling the investment banking service package. Overshooting dissemination costs are easily avoided; it is recommended to abolish dissemination requirements. The company will always be anxious to disseminate selling and disclosure documents to an extent beneficial to the company. To make this process efficient, the exchange may offer a choice among a number of standardized dissemination procedures. Another important item in countries where bearer securities are used are printing requirements and the resultant costs. Companies should have a choice to have certificates printed in denominations that traditionally have been required or to only make available to depositories the minimum number required by a law, which implies that certificates will not be available to investors.

18. The cost of underpricing, which is witnessed by oversubscriptions, appears to be the most important cost of going public. It is the opportunity loss to the entrepreneur that results from selling the issue at a fixed price set intentionally or unintentionally below market price. Underpricing cost may be kept low by competition among investment bankers and by initially offering only a small percentage of the class of equity instruments that is used in going public (cf. Recommendation 14). Alternatively, underpricing can be avoided by straight tender offers or calibrated by discretionary tender offers to the preferences of the entrepreneur as to outside influence, marketability and shareholder relations. Since underpricing of new technology

based firms exceeded 30% or even 50% of market value in a number of cases it is likely to have a highly undesirable impact on the attractiveness of entrepreneurship. Thus, the more frequent use of offers by tender is very important. Unfortunately, investment banker resist it for obvious reasons. To encourage the use of tender methods and their equivalents it is recommended to exempt from the issue tax up to ECU 10 mio of equity instruments of any company that makes its first public offer of equity instruments by tender. Where tender methods are widely used, the exemption should nonetheless be available, since the issue tax discriminates against small high-risk enterprises.

19. Trading procedures are designed to facilitate transactions directly and indirectly by lowering transaction costs, which include a number of complex component costs. The reduction of these costs serves to close the gap between the prices at which it is economical to sell and the prices at which it is economical to buy. In other words, the buyer can afford a higher and the seller a lower price compared to a situation without an organized secondary market. This effect, which is at the heart of stock exchanges' attractiveness, rests on continued trading of securities after their issue. Continuing trading has led to procedurally efficient execution and settlement systems. Similarly, the continuing trading encourages certain transactors to engage in continuing investment research on a limited number of securities and to try to cover the costs of this activity by short term trading profits or by selling advice. Either way

a certain balance of marketability and price quality is likely to develop and the information and valuation costs, which in case of small company shares are incurred only by a small number of proficient investors, tend to be spread over all transactors. In this process, much higher price volatility is to be expected with small company stocks than with large issues. The trading procedures actually used for small company equity instruments in the Member States permit execution of investors' orders at adequately low commissions. It should be assured that all company equities can be entered into national clearing and settlement systems. To encourage the involvement of investors who engage in investment research and for other reasons the trading procedures used on small company segments should allow for transactions at any time during trading hours. Unfortunately, this approach is not followed by some stock exchanges. Restricting investors' trading opportunities to once or twice a week is not recommended. It inhibits the development of a self balancing market.

20. Trading procedures, whether based on the auction principle, the market-maker principle or on both, do have some impact on price quality. However, price quality is mainly determined not by the trading procedure used but rather by the basic marketability of the stock. Marketability determines one important component of transaction costs and depends on the volume held by the public and by the resultant turnover characteristics of the stock. Since the volume of small company public issues is low, their price quality will be rather low most of the time. The reliability of stock prices is a crucial

factor in the financing decisions of the entrepreneur and in the attractiveness to investors. Thus, it is most important to improve marketability if organized secondary markets for equity instruments of small, young innovative firms are to work. The only way to achieve this is to increase the turnover in small company stocks. One measure to that effect is to further reduce transaction related costs. It is recommended to exempt transactions in small company equity instruments from all incidental indirect taxes. A second way is to motivate to trade by the prospect of undiminished capital gain those who think that a stock is undervalued or overvalued. It is further recommended, therefore, to exempt from individual and corporate income tax all capital gains on small company equity instruments. For the purpose of these exemptions a small company should be defined by a market value of equity not exceeding ECU 25 mio and by an age of less than 10 years. For banks, brokers and for various proficient investors that now have to pay tax on such income it would become interesting to engage in small company investment research and to trade for long-term or, preferably, for short-term profit. This would be one source of enhanced marketability and price quality. The second source is an increase of the volume of small company equities publicly held. Because the exemption covers capital gains by the entrepreneur it is likely that a larger portion of company equities will be publicly issued during the early years. Thirdly, the tax exemptions, if implemented, will give a certain prominence and publicity to small company equities. All this would add to the attractiveness of entrepreneurship, of contributing to growth and employment.

REFERENCES

1. Experts consulted

- Emanuele Alecci, Istituto Mobiliare Italiano -IMI-,
Roma.
- Francesco Alfonso, Banca d'Italia, Roma.
- Gian Carlo Arduino, Euromobiliare S.p.a., Milano.
- Patrick F. Barbour, Barbour Index Ltd., Windsor.
- Anna Bisgaard, J. Langkjaer Staldinventar A/S, Vildbjerg.
- Silvano Bronconi, Cassa di Risparmio di Firenze, Frank-
furt a.M.
- Luciano Caminada, Credito Italiano, Frankfurt a.M.
- André Canac, Institut de développement industriel,
Paris.
- Michel Cardon de Lichtbuer, Banking Commission, Brussels.
- Etienne Cooreman, Member of the Belgian Senate, Brussels.
- J.B. Davy, J. & E. Davy, Dublin.
- Gerrit H. de Marez Oyens, Vereniging voor de Effecten-
handel, Amsterdam.
- Stan De Smet, Nationale Kas voor Beroepskrediet,
Brussels.
- E.R. Deves, Holland Venture Beheer Mij BV, Amsterdam.
- Wilfried Dierckx, Antwerp Stock Exchange, Antwerp.
- J.D. Dodwell, The Stock Exchange, London.
- Peter Dölling, TEWIDATA Aktiengesellschaft für technisch-
wissenschaftliche Datenverarbeitung, München.
- Stewart Douglas-Mann, Charterhouse Japhet plc, London.
- Johannes Drerup, Deutsche Wagnisfinanzierungs-Gesellschaft
mbH, Frankfurt.
- Malcolm G. Duncan, Borsa Valori di Milano, Milano.
- M. Duvezin-Caubet, Commission des opérations de bourse,
Paris.

Bernd Ertl, PM Portfolio Management GmbH, München.

David Fassbender, ICC Corporate Finance Ltd., Dublin.

Jim Flavin, Development Capital Corporation Ltd.,
Dublin.

Heinrich Fleischhacker, Hch. Fleischhacker OHG, Frank-
furt.

Yves Flornoy, Compagnie des agents de change, Paris.

R.O. Fock, Koninklijke Verkade Fabrieken B.V., Zaandam.

Ove Franz, Bankhaus Wölbern & Co., Hamburg.

Peter Freitag, Freiverkehrsmakler an der Hanseatischen
Wertpapierbörse, Hamburg.

Francesco Galli, Confederazione Generale dell'Industria
Italiana, Roma.

John A. Garvey, Dudgeon, Dublin.

P. Gowran, The Stock Exchange, Dublin.

Robin W. Grant, Charterhouse Japhet plc, London.

Claus G. Hansen, Sammensluttede Danske Sparekasser
(sds), København.

Alfons Hendrickx, Antwerp Stock Exchange, Antwerp.

Richard Hooper, Investment Bank of Ireland Ltd., Dublin.

Kurt Skov Jakobsen, Pensionskassernes Administrations-
kontor (pka), Virum.

Klaus Juncker, Deutsche Bank AG, Frankfurt.

Charles Kiefer, Institut Monétaire Luxembourgeois,
Luxembourg.

Jeffrey R. Knight, The Stock Exchange, London.

Peter Koveos, Syracuse University, Syracuse, N.Y.

Claude Lanners, Ministère de l'économie et des classes
moyennes, Luxembourg.

Jens Erik Larsen, Danmarks Nationalbank, København.

Pierre Lenfant, Commission des opérations de bourse,
Paris.

Michel Lentz, Banque Générale du Luxembourg S.A.,
Luxembourg.

H. Lohuis, Broekman's Commissiebank N.V., Amsterdam.

Claude Luty, Ministère des Finances, Luxembourg.

George MacDougall, Simon & Coates, London.

Michel Maquil, Bourse de Luxembourg, Luxembourg.

Mario Massari, Borsa Valori di Milano, Milano.

Carl P. McCann, FII Ltd., Dublin.

Barry McGovern, Industrial Development Authority, Dublin.

Rolf Meyerding, Bank Robert Meyerding, Hamburg.

Bernard Mirat, Compagnie des agents de change, Paris.

C.H. Nicholas Moy, M.J.H. Nightingale & Co. Limited,
London.

Siegfried Neumann, Info-Brief S.A.R.L., Luxembourg.

Nikitas A. Niarchos, Athens Stock Exchange, Athens.

D.W. Nugteren, D.W. Brand N.V., Amsterdam.

George Philippatos, University of Tennessee, Knoxville,
Tennessee.

Klaus Pildal, DanVenture Management A/S, København.

Jean Reyers, Brussels Stock Exchange, Brussels.

Marie-Claude Robert, Commission des opérations de
bourse, Paris.

G. Ross Russell, Laurence, Prust & Co., London.

Hellmut Rother, Gesellschaft für Beteiligungen und
Kapitalverwaltung, Hamburg.

Joseph Schwaller, Banque Internationale à Luxembourg
S.A., Luxembourg.

Peter J. Scott, Wight Collins Rutherford Scott P.L.C.,
London.

Jan Sercu, Bank van Roeselare en West-Vlaanderen,
Roeselare.

Chandra Singh, Ravensdale Securities Limited, London.

Poul Erik Skaanning-Jørgensen, Københavns Fondsbørs,
København.

Frederik Smeets, Antwerp Stock Exchange, Antwerp.

Peter Sommer, The London Over The Counter Market Limited,
London.

Günter Sostmann, Gesellschaft für Beteiligungen und
Kapitalverwaltung, Hamburg.

Gaetano Spadaro, Banca Nazionale del Lavoro, Milano.

W.R. Stuttaford, Framlington Unit Management Limited,
London.

Brian Timmons, Irish Life Assurance Company, Dublin.

Bert W.M. Twaalfhoven, N.V. Indivers, Schipohl.

Stuart P. Valentine, The Stock Exchange, London.

Claude Vallon, Caisse nationale du crédit agricole,
Paris.

Jan Van Dyck, Fiskoloog, Antwerp.

Willem A. Verburg, Amsterdam-Rotterdam Bank N.V.,
Amsterdam.

Louis Verhaegen, Antwerp Stock Exchange, Antwerp.

A. Verhoeven, De Nederlandsche Bank N.V., Amsterdam.

Michel Verset, Antwerp Stock Exchange, Antwerp.

Jacques Verteneuil, Banking Commission, Brussels.

Raymond Vertongen, Brussels Stock Exchange, Brussels.

T.G. Wilmot, Harvard Securities Limited, London.

R.M.A. Wilson, Hoare Govett Ltd., London.

Brian M. Winterflood, Bisgood, Bishop & Co. Ltd.,
London.

2. Monographs

- A r e n d t , Ernest, and G e o r g e s , Alain.
Das luxemburgische Aktienrecht. Frankfurt am
Main: A. Metzner, 1968.
- B l e y , Siegfried.
Börsen der Welt. Frankfurt am Main: Knapp, 1977.
- Commission Dautresme.
Le développement des investissements et la protection
de l'épargne, Vol. 3, Paris: Documentation française,
1982.
- Commission des opérations de bourse.
Les fonds communs de placement, évolution 1969-
1979. Paris: Documentation française, 1981.
- Commission Pérouse.
La modernisation du marché des valeurs mobilières,
Vol. 3, Paris: Documentation française, 1980.
- Committee of Inquiry on Small Firms (Bolton Committee).
Report. London: HMSO (Cmnd. 4811), 1971.
- Committee to Review the Functioning of Financial Insti-
tutions (Wilson Committee).
Interim report: The financing of small firms.
London: HMSO (Cmnd. 7503), 1979.
- Committee to Review the Functioning of Financial Insti-
tutions (Wilson Committee).
Report. London: HMSO (Cmnd. 7937), 1980.
- Coopers and Lybrand Conseils.
Study of fiscal aspects of possible options of
financial inventions in favor of innovative enter-
prises. Luxembourg: Commission of the European
Communities, 1983.
- F a s t , Norman D.
The rise and fall of corporate new venture divisions.
UMI Research Press, 1978.
- F r e d e r i c q , Louis.
Traité de droit commercial belge. Brussels-Ghent:
Fechey, 1945-1950.
- F r e y e r , Eckard.
Die Kapitalbeteiligungsgesellschaft als Instrument
der Wirtschaftspolitik. Thun und Frankfurt: H.
Deutsch, 1981.

- F r i t s c h , Ulrich.
Mehr Unternehmen an die Börse. Köln: O. Schmidt,
1978.
- G a l a m i s , Dem.
Sources and methods of financing investment in
Greek industry. Athens: Bank of Greece, 1963.
- G o m a r d , Bernhard.
Das dänische Gesetz über Aktiengesellschaften.
Frankfurt am Main: A. Metzner, 1976.
- G o t z e n , P.
Die Gesellschaft mit beschränkter Haftung in den
Niederlanden. 2nd ed. Düsseldorf: Deutsch-
Niederländische Verlags GmbH, 1978.
- H a l i a k i a s , D.T.
Money and credit in a developing economy: The
Greek case. New York: New York University Press,
1978.
- H e n r i c h , Dieter, and C e r e g h e t t i ,
Remo.
Das italienische Aktienrecht. 2nd ed. Frankfurt
am Main: A. Metzner, 1976.
- H i e l s c h e r , Udo; D o r n , Gerhard; and
L a m p e , Gerhard.
Innovationsfinanzierung mittelständischer Unter-
nehmungen. Stuttgart: Poeschel, 1982.
- H o p t , Klaus J.
Börsliche und außerbörsliche Geschäfte von Verwal-
tungsmitgliedern in Papieren der eigenen Gesell-
schaft oder konzernangehöriger Gesellschaften.
Deutsche Landesreferate zum Privatrecht und Handels-
recht, XI. Internationaler Kongreß für Rechtsver-
gleichung, Caracas 1982. Heidelberg und Karlsruhe:
C.F. Müller, 1982.
- H u g e n h o l t z , J.B.Th.
Venture capital, An analysis of the need and avail-
ability in the Netherlands. Thesis, Erasmus Uni-
versiteit Rotterdam, 1979.
- K l a g e s , Joachim.
Die Richtlinien der EG über den Börsenzulassungs-
prospekt - Ein Vergleich mit den heutigen nationa-
len Regelungen. Baden-Baden: Nomos, 1981.

- K n i e h l , H.-J.
Praktische Erfahrungen mit der Emission von Aktien.
L. Mühlhaupt and H. Wielens, eds. Unternehmensfi-
nanzierung heute. Frankfurt: Knapp, 1978, pp.
227-246.
- K ü b l e r , Friedrich.
Gesellschaftsrecht. Heidelberg und Karlsruhe:
C.F. Müller, 1981.
- L a g a r d e , Gaston.
Droit commercial. Paris: Dalloz, 1980.
- L a m a l , Emile.
Les bourses de valeurs mobilières en Belgique.
Brussels: Bruylant, 1934.
- L e t e l l i e r , Brigitte.
Les actionnaires, le Français et le marché des
actions. Paris: Documentation française, 1981.
- L o s s , Louis.
Disclosure as preventive enforcement. Florence:
European University Institute Colloquium Papers,
1983 (Doc. IUE 27/83 Col. 14).
- L o t t e r , Lando.
Die englische GmbH. London: Deutsche Industrie-
und Handelskammer in Großbritannien und Nordir-
land, 1974.
- M a s s a r i , Mario.
La media impresa in Italia. Caratteristiche
economiche e finanziarie. Milano, 1977.
- M e i e r , Ulrich.
Struktur ausländischer Bankensysteme: Struktur
des Bankwesens in Luxemburg. Schriftenreihe des
Instituts für Banken und Industrie, Geld und Kredit
der Freien Universität Berlin, Heft 7, Manfred Hein,
ed. Frankfurt am Main: Knapp, 1975.
- M i l d e n s t e i n , Eckart.
Die Kurspolitik der Marketmaker auf Aktienzirkula-
tionsmärkten. Schwarzenbek und Hamburg: Mar-
tiens, 1982.
- M o r g a n , E. Victor, and H a r r i n g t o n ,
Richard.
Capital markets in the EEC. The sources and uses of
medium and long-term finance. Westmead, 1977.

- M ü l l e r , Paul R.
Gesellschaftsrecht, Steuern, Buchführung und
Rechnungsprüfung in Italien. Bern und Stuttgart:
Haupt, 1981.
- M ü l l e r - S t a h l , Ingo.
Der geregelte Freiverkehr. Doctoral dissertation
published by the author, Universität zu Köln, 1971.
- N A S D.
Small business financing. Report of the Joint
Industry/Government Committee on Small Business
Financing. Washington: NASD, 1979.
- N i a r c h o s , Nikitas A.
The stock market in Greece: A statistical analysis.
Athens: The Athens Stock Exchange, 1972.
- O E C D.
Innovation in small and medium firms. Paris: OECD,
1982.
- O ' M a l l e y , Liam.
Business law. London: Sweet & Maxwell, 1982.
- O p p e r m a n n , Georg, and D e g n e r , Harald.
Börsen- und Wertpapiergeschäfte. 4th ed. Frank-
furt: Verlag Wertpapier-Mitteilungen, 1981.
- P a t r u c c o , Carlo.
Le piccole e le medie aziende industriali di
fronte al capitale di rischio. Bergamo, 1983.
- P e n n i n g t o n , Robert R., and W o o l -
d r i d g e , Frank.
Company law in the European Communities. 3rd ed.
London: Oyez Longman, 1982.
- P f o h l , Hans-Christian, ed.
Betriebswirtschaftslehre der Mittel- und Klein-
betriebe. Berlin: Erich Schmidt, 1982.
- P i a t i e r , A.
Les obstacles à l'innovation dans le pays de la
Communauté européenne, Commission des Communautés
européennes, ed. (EUR 7528), Bruxelles-Luxembourg,
1981.
- P r a t t , Stanley E., and the editors of Venture
Capital Journal.
How to raise venture capital. A guide to locating
start-up and development capital and dealing with
venture capitalists. New York: Charles Scribner's
Sons, 1982.

- Rapport vedrørende eventuel etablering af et aktiemarked for mindre og mellemstore selskaber afgivet af et udvalg nedsat af Fondsbørsbestyrelsen. København: Københavns Fondsbørs, 1981.
- R e u t e r , Hermann.
Aktienmarkt und Aktieninformationsmarkt, Göttingen: Vandenhoeck und Ruprecht, 1980.
- R o d r i a n , Heinrich.
Insider-Regelungen. Berlin: Erich Schmidt, 1977.
- S c h m i d t , Hartmut.
Advantages and disadvantages of an integrated market compared with a fragmented market. Commission of the European Communities, ed. Collection Studies, No. 30 Competition - Approximation of legislation series. Luxembourg: Office for official publications of the European Communities, 1977.
- S E C. Government-Business Forum on Small Business Capital Formation.
Final report. Washington: U.S. Securities and Exchange Commission, 1982.
- S t o n e h a m , Paul.
Major stock markets of Europe. Aldershot: Gower, 1982.
- S t o n e h i l l , Arthur I., and D u l l u m , Kare B.
Internationalizing the cost of capital. Copenhagen and New York: A. Busck and J. Wiley, 1982.
- T e i r l i n c k , Francois H.
L'organisation des marchés financiers. Brussels: Institut Solvay, 1948.
- V a n R y n , Jean, and H e e n e n , Jacques.
Principles de droit commercial belge, Vol. 3. Brussels: Bruylant, 1960.
- W i l s o n C o m m i t t e e.
Cf. Committee to Review the Functioning of Financial Institutions.
- W y m e e r s c h , Eddy.
Control of the securities markets in the European Economic Community. Commission of the European Communities, ed. Collection Studies, Nr. 31 Competition - Approximation of legislation series. Luxembourg: Office for official publications of the European Communities, 1978.

W y m e e r s c h , Eddy.

Supervision of the securities markets in the Member States of the European Community. Reports on the national systems of control. Part 1: United Kingdom, Italy, Luxembourg, Netherlands. Commission of the European Communities, ed. Collection Studies, No. 32 Competition - Approximation of legislation series. Luxembourg: Office for official publications of the European Communities, 1980.

Y o u n g , Allan.

Small business in the United States: Failures and public financing. Syracuse: Syracuse University Faculty Research Working Paper Series, 1982.

3. Articles in periodicals and compilations

a) Signed articles

A d a m , B.A.

European experience in innovation financing. Commission of the European Communities, ed. Financing more innovation at less risk. Proceedings of the symposium held in Luxembourg, December 15-17, 1981, Luxembourg: Infobrief, 1982, pp. 28-38.

A l b a c h , Horst.

Venture Capital Firmen in Japan und den USA. Zeitschrift für Betriebswirtschaft, Vol. 53, 1983, pp. 993-1002.

A l e t t i , Urbano.

Questa Consob é da buttare. Il Sole - 24 Ore, November 1, 1983.

A r c h e r , Stephen H., and F a e r b e r ,
Le Roy G.

Firm size and the cost of externally served equity capital. Journal of Finance, Vol. 21, 1966, pp. 69-83.

B a k e r , H. Kent, and S p i t z f a d e n , James.

The impact of exchange listing on the cost of equity capital. Financial Review, Vol. 17, 1982, pp. 128-141.

- B a t c h e l o r , Charles.
Active dealings in unlisted stocks. Financial Times, July 17, 1979.
- B e e v o r , J.R.
Obstacles to amalgamating technology and finance. Commission of the European Communities, ed. Financing more innovation at less risk. Proceedings of the symposium held in Luxembourg, December 15-17, 1981, Luxembourg: Infobrief, 1982.
- B e z a r d , Pierre, and R o b e r t , Marie-Claude.
Bourse de valeurs. Dalloz Encyclopédie. Paris: Dalloz, n.d. (Loose-leaf service).
- B i a n c h i , Bruno.
Banca centrale e mercato finanziario. Bancaria, Vol. 38, 1982, pp. 876-886.
- B i g g a d i k e , Ralph.
The risky business of diversification, A bold approach can make all the difference in new ventures. Harvard Business Review, Vol. 57, May - June 1979, pp. 103-111.
- B r a c d e l a P e r r i è r e . Gilles.
L'introduction des moyennes entreprises en Bourse. Banque 1983, pp. 174-180.
- B r o n t e , Stephen.
Wall Street woos the high techs. Euromoney, July, 1983, pp. 78-82.
- B r u n e t t i , Giorgio.
Con la Mercant Bank il rinnovo del sistema. Il Sole - 24 Ore, August 26, 1983.
- B u r r , Rosemary.
Employee profit-sharing given fresh boost by Chancellor. Financial Times, March 16, 1983, p. 23.
- B u r r , Rosemary.
Where to go for advice. Financial Times, April 23, 1983, p. 7.
- B u x t o n , James.
Small firms ready to respond. Financial Times, March 28, 1983.
- C a n t o n i , Renato.
Le borse italiane nel 1982. Bancaria, Vol. 38, 1982, pp. 1351-1363.

- C a r s t e n , Gebhard.
Das dänische Aktienrecht. Aktiengesellschaft,
Vol. 21, 1976, pp. 151-158.
- C a r s t e n , Gebhard.
Das dänische GmbH-Recht und die deutsche GmbH-
Rechtsreform. GmbH-Rundschau, 1974, pp. 283-286.
- C e l l i n o , Franco.
Qualche proposta innovativa per migliorare le
borse. Anche per il mercato ristretto sono necessari
urgenti provvedimenti. Il Sole - 24 Ore, January
29, 1980.
- C h é r o n , Clotilde.
Le compte d'épargne en actions. Banque, 1983,
pp. 967-970.
- C l a u s s e n , Carsten P.
Der neue zweite Markt. Über die Notwendigkeit und
Gestaltungsmöglichkeiten eines neuen Wertpapier-
marktes. Sonderdruck aus Zeitschrift für Unter-
nehmens- und Gesellschaftsrecht, Vol. 13, 1984,
pp. 1-22.
- C o h e n , David L.
Small business capital formation. Board of Gover-
nors of the Federal Reserve System, ed. Public
policy and capital formation. Washington 1981,
pp. 251-264.
- C o l l m e r , C.
Surprising rises in share prices. Financial Times,
April 24, 1973.
- Commission des opérations de bourse.
Le premiers mois de fonctionnement du second
marché. Bulletin, No. 162, 1983, pp. 3-6.
- C r a c c o , E.; P a q u a y , A.; and
R o u s s e a u , P.
Les obstacles rencontrés par les petites et moyennes
entreprises de l'U.E.B.L. dans le cadre des
incitants publics à l'innovation technologique.
Annales de Sciences Economiques Appliquées, Vol.
36, No. 4, 1980.
- C r o s s , N.E.
Tailoring financial packages to needs, The British
approach. Commission of the European Communities,
ed. The needs of new technology-based enterprises.
Proceedings of the symposium held in Luxembourg,
November 17-19, 1982, Luxembourg: Infobrief, 1983,
pp. 147-153.

- D e g n e r , Harald.
Neuer Spezialmarkt, Börse braucht zügige Realisierung. Handelsblatt Magazin, No. 1, September 30, 1983, pp. 42-44.
- d e P a o l i n i , Osvaldo.
Venture capital: modo nuovo de "Fare impresa". Il Sole - 24 Ore, June 30, 1983.
- d e P a o l i n i , Osvaldo.
A picco "l'azienda Italia". Il Sole - 24 Ore, July 1983.
- D e p a s , Günther.
Italien braucht einen soliden Aktienmarkt. Interview mit Prof. Guido Rossi. Finanz und Wirtschaft, Januar 16, 1982.
- D e m o p o u l o s , George D.
Financial markets and institutions in Greece. Commission of the European Communities, European Economy, No. 15, March 1983, pp. 145-155.
- D i c k s o n , Tim.
Small business: record number of new measures. Financial Times, March 16, 1983, p. 25.
- D o w n e s , David H., and H e i n k e l , Robert.
Signaling and the valuation of unseasoned new issues. Journal of Finance, Vol. 37, 1982, pp. 1-10.
- d u M a r c h i e S a r v a a s , J.H.
Guarantee scheme for private venture capital companies 1981. Nederlandsche Bank Quarterly Statistics, No. 1, 1981, pp. 90-94.
- d u M a r c h i e S a r v a a s , J.H.
Participation by banks in the risk-bearing capital of enterprises. Nederlandsche Bank Quarterly Statistics, No. 3, 1980, pp. 95-97.
- D u v a , Antonio.
Come rafforzare la media impresa nella competizione internazionale. Il Sole - 24 Ore, June 6, 1980.
- E n g e l k e n , H.G.
Die Kapitalbeteiligungsgesellschaften als Instrument der Mittelstandsförderung. K. Juncker und K. Schlegelmilch, eds. Die Kapitalbeteiligungsgesellschaft in Theorie und Praxis. Frankfurt: Knapp, 1976.

- E r t l , Bernd.
Warum nicht mehr Unternehmen an die Börse gehen.
Börsen-Zeitung, March 18, 1982.
- F a b b o z z i , Frank J.
Does listing on the Amex increase the value of equity? Financial Management, Vol. 10, Spring 1981, pp. 43-50.
- F a s s b e n d e r , David.
The role of the unlisted securities market.
Management, Vol. 29, 1982, pp. 8-11.
- F l a v i n , Jim.
The role of the venture capitalist. Venture and Development Capital. A one-day workshop held in Dublin, June 16, 1983, A business and finance special supplement, 1983.
- F l o r n o y , Yves.
Le second marché, Banque, 1983, pp. 263-272.
- F l o r n o y , Yves.
"Second marché", Der dritte Weg. Börsen-Zeitung, April 9, 1983, p. 9.
- F u m a g a l l i , Ettore.
La borsa rivendica strutture a misura dei fondi.
Il Sole - 24 Ore, August 17, 1983.
- G a r b a d e , Kenneth D., and S i l b e r , William L.
Best execution in securities markets: An application of signaling and agency theory. Journal of Finance, Vol. 37, 1982, pp. 493-504.
- G e r k e , Wolfgang.
Was kann die Wagnisfinanzierungs-GmbH leisten?
Zeitschrift für das gesamte Kreditwesen, Vol. 28, 1975, pp. 761-763.
- G e r k e , Wolfgang.
Zum Beteiligungsbesitz der Banken. Zeitschrift für das gesamte Kreditwesen, Vol. 34, 1981, pp. 49-54.
- G i l b e r t , Nick.
Nightingale sings a different tune. Sunday Times, November 1, 1982.
- G i n b e r g i a , Renzo.
Va stretto ai fondi quel limite del 5%. Il Sole - 24 Ore, August 4, 1983.

- G i v o l y , Dan; P a l m o n , Dan; and
S c h n e l l e r , Meir.
Perception of stock similarity by security analysts.
Financial Review, Vol. 16, 1981, pp. 30-43.
- G r o s s m a n , S.J. and S t i g l i t z , J.E.
On the impossibility of informationally efficient
market. American Economic Review, Vol. 70, 1980,
pp. 393-408.
- H e r l i t z , Peter.
Der Gang an die Börse. Zeitschrift für das gesamte
Kreditwesen, Vol. 35, 1982, pp. 172-175.
- H e s s e n h o u w e r , H.M.
Incourante fondsen. Bank- en Effectenbedrijf,
Vol. 20, 1971, pp. 237-240.
- H o l m a n , W., and Y o u n g A.
Small business in the United States: Failures and
public financing. Strathclyde Convergencies Issues
in Accountability, No. 9, October 1983, pp. 19-34.
- K a p s c h - W i n c k l e r , Christina.
Investmentsparen in Frankreich. Bank, 1983,
pp. 128-130.
- K a y , William.
Twinlock turns key - and open the Nightingale
cage. Sunday Times, August 22, 1982.
- K r i e r , Jean.
Für Euroanleihen wurde Luxemburg zum idealen Notie-
rungsplatz. Handelsblatt, November 29, p. 26.
- K r i p k e , Homer.
Where are we on disclosure after the advisory
committee report? Journal of Accounting and
Finance, Vol. 2, 1978, pp. 4-32.
- L a w s o n , Dominic.
Quoted and unquoted companies. The basis difference
is marketability. Financial Times, April 23, 1983,
p. 13.
- L e o p o l d , Günter.
Eine neutrale Eigenkapitalquelle für Mittelunter-
nehmen, Aufgaben und Rolle der Kapitalbeteiligungs-
gesellschaften. Blick durch die Wirtschaft, August
2, 1982, p. 3.
- L e u s c h e l , Roland.
Risikokapital, Das belgische Modell, Bank, 1982,
pp. 550-554.

- L e w i s , Paul.
Firms in Italy prove small is beautiful. International Herald Tribune, March 18, 1980.
- L o n g s t r e t h , Bevis.
The SEC's role in financial disclosure. Journal of Accounting, Auditing and Finance, Vol. 7, 1984, pp. 110-122.
- M a r c e l l o , Marco.
Il venture capital deve diffondersi in Italia. Il Giornale, June 30, 1983.
- M a r i n , Xavier.
Valeurs mobilières. Dalloz Encyclopädie. Paris: Dalloz, n.d. (Loose-leaf service).
- M a s e r a , Francesco.
Negoziazione dei titoli non ammessi alla quotazione ufficiale. Problematica e soluzioni in Italia e all'estero. Rivista di Politica Economica, Vol. 68, 1978, pp. 605-629.
- M a t u r r i , Vincenzo.
Titoli atipici: tutto quello che la Consob non garantisce. Il Sole - 24 Ore, August 24, 1983.
- M a z z u c a , Giancarlo.
Per Olivetti "Venture capital" e sbarco a Wall Street. Corriere della Sera, June 30, 1983.
- M c C o n e l l , Donald K., Jr.
Are the big 8 increasing their share of the NYSE, AMEX and OTC audit markets? Journal of Accounting, Auditing and Finance, Vol. 7, 1984, pp. 178-181.
- M e y e r - C o r d i n g , Ulrich.
Belebung des Kapitalmarktes durch neue Möglichkeiten der Zertifizierung. Betriebs-Berater, Vol. 37, 1982, pp. 896-899.
- M i r a t , Bernard.
Les introductions sur le second marché. Banque, 1983, pp. 1127-1134.
- M o n t a g n o n , Peter.
Rapid increase of securities but low turnover. Financial Times, September 11, 1981, Luxembourg Banking, p. VII.

- M o n t i , Mario; C e s a r i n i , Francesco;
and S c o g n a m i g l i o , Carlo.
Report on the Italian credit and financial system.
Special issue of the Banca Nazionale del Lavoro
Quarterly Review, Rome, 1983.
- N e u b e r g e r , B.M., and L a C h a p e l l e
C.A.
Unseasoned new issue price performance on three
tiers: 1975-1980. Financial Management, Vol. 12,
Autumn 1983, pp. 23-28.
- N o u v e l l e t , Dominique.
La prise de participation minoritaire dans les
sociétés non coté. Banque, 1983, pp. 181-185.
- P i o l , Elserino.
Come l'Olivetti ha investito in 21 società
d'avanguardia. Rivista dei fondi comuni d'investi-
mento, No. 5 1983, p. 15 f.
- P i v a t o , Giorgio.
Le strutture finanziarie delle medie imprese
industriali. Capitali sociali, riserva ad accan-
tonamenti per autofinanziamento. Giornale degli
Economisti e Annuali di Economia, Vol. 38, 1979,
pp. 831-870.
- P o h l , Max.
Die Deutsche Wagnisfinanzierungsgesellschaft.
Sparkasse, Vol. 95, 1978, pp. 78-81.
- P r a t t , Stanley E.
The United States venture capital investment market
place. Commission of the European Communities, ed.
Financing more innovation at less risk. Proceed-
ings of the symposium held in Luxembourg, Decem-
ber 15-17, 1981, Luxembourg: Infobrief, 1982.
- Q u a r l e s v a n U f f o r d , H.P.
De parallelmarkt biedt financieringsmogelijkheden
voor jonge ondernemingen. Bank- en Effectenbedrijf,
Vol. 3, 1982, pp. 4-6.
- R a y n a l , André.
Le second marché boursier. Les petites affiches,
Paris, No. 49, April 1983.
- R e c h t e r , Serge.
Les bases du marketing bancaire. Marketing Bancaire,
Marketing Financier, October 1974, pp. 116-120.

- R i l e y , Barry.
The problems of taming the stags. Financial Times, March 26, 1983, p. 17.
- R o l l , Richard.
A possible explanation of the small firm effect. Journal of Finance, Vol. 36, 1981, pp. 879-888.
- R o n e n , Joshua, and L i v n a t , Joshua.
Incentives for segment reporting. Journal of Accounting Research, Vol. 19, 1981, pp. 477-481.
- R o s s R u s s e l l , G.
Unlisted securities market review. New firms rally to challenge. Times, February 14, 1983.
- R o s s R u s s e l l , G.
Unquoted companies - Creating a market. Tolleys Tax Planning, 1982, pp. 690-700.
- S c h l e g e l m i l c h , Klaus.
Die Kapitalbeteiligungsgesellschaften in der Bundesrepublik Deutschland. K. Juncker und K. Schlegelmilch, eds. Die Kapitalbeteiligungsgesellschaft in Theorie und Praxis. Frankfurt: Knapp, 1976.
- S c h l e s i n g e r , Helmut.
Finanzielle Schwachpunkte der deutschen Wirtschaft. Kredit und Kapital, Vol. 15, 1982, pp. 473-491.
- S c h n e i d e r , Michael.
Die Instrumente sind da. Manager Magazin, April 1982, pp. 44-48.
- S c h r a n s , Guy.
De invoering van "non-voting shares" in de textiel-sector - een regeling van economische privaatrecht. Liber Amicorum Fredericq Dumon, Antwerp 1983, pp. 245-257.
- S c h ü r m a n n , Walter, and K ö r f g e n , Kurt.
Die Wiederentdeckung des Genußscheins für die Eigenkapitalbeschaffung. Jahresbericht 1982 der Bayerischen Börse in München. Vorstände des Münchener Handelsvereins und der Bayerischen Börse, eds. München 1982, pp. 8-13.
- S c h u l t z , Paul.
Transaction costs and the small firm effect, comment. Journal of Financial Economics, Vol. 12, June 1983, pp. 81-88.

- S c h w e r t , G. William.
Size and stock returns and other empirical regularities. Journal of Financial Economics, Vol. 12, June 1983, pp. 3-12.
- S h a w , John.
The how and why of the USM. Accountancy, Vol. 92, February 1981, pp. 99-100.
- S h i r e f f , David.
Italian banking. Euromoney, August 1983.
- S p e r o n i , Donato.
Consob - Il burocrate e i Milanesi. Il Mondo, November 7, 1983.
- S t o l l , Hans R., and C u r l e y , Anthony J.
Small business and the new issues market for equities. Journal of Financial and Quantitative Analysis, Vol. 5, 1970, pp. 309-322.
- S t o l l , Hans R., and W h a l e y , Robert E.
Transaction costs and the small firm effect. Journal of Financial Economics, Vol. 12, June 1983, pp. 57-79.
- S t ü t z e l , Wolfgang.
Die Eigenkapitalknappheit in der Wirtschaft. Zeitschrift für das gesamte Kreditwesen, Vol. 36, 1983, pp. 1087-1094.
- t e r M e u l e n , E.
Der Beteiligungsvertrag. K. Juncker and K. Schlegelmilch, eds. Die Kapitalbeteiligungsgesellschaft in Theorie und Praxis. Frankfurt: Knapp, 1976.
- T r o o s t , C.A.
The Dutch scheme. Commission of the European Communities, ed. The needs of new technology-based enterprises. Proceedings of the symposium held in Luxembourg, November 17-19, 1982, Luxembourg: Infobrief, 1983, pp. 49-61.
- v a n d e r S t e e , A.P.J.M.M.
Parallelmarkt baant weg naar open kapitaalmarkt. Beussplein 5, Vol. 22, January 1982, p. 4-5.
- W a l k e r , Victor.
Greek investment incentives win favor. The Journal of Commerce, (New York), June 17, 1982.

b) Unsigend articles

AG für Anlagen und Beteiligungen: Neues Kapital für neue Beteiligungen. Handelsblatt, May 21/22, 1982, p. 22.

AIIB launches novel unit funds for institutions. Irish Times, June 10, 1983.

Banca d'Italia vigilerà su tutti i titoli atipici. Il Sole - 24 Ore, September 9, 1983.

Börsenhandel mit Kommanditanteilen, Experiment in Luxemburg mit kanadischen Lehndorff-Titeln. Blick durch die Wirtschaft, July 6, 1982, p. 6.

De FV Aandelen, Eerste balans na 18 maanden. BBL-Berichten, 1983, No. 18, pp. 1-9.

Equity market no place for pessimism. Irish Times, May 18, 1983.

Founders of computer firm raise £ 2 m by share sales. Irish Times, June 10, 1983.

FV-aandelen: 300 miljard in minder dan twee jaar. De Standaard, October 16, 1983, p. 15.

GeBeKa: Kapitalgeber für nicht emissionsfähige Firmen. Handelsblatt, December 14, 1978, p. 17.

How capital gains tax hits Ireland's stock market. Irish Times, October 2, 1982.

In der Schublade Patente - doch das Geld fehlt. Wagnisfinanzierung in Italien - Olivetti inszeniert Kongreß in Venedig. Blick durch die Wirtschaft, August 10, 1983.

Italian stockmarket. Permission to be trusted. Economist, March 26, 1983.

Italiens Industrie auf Talfahrt. Börsen-Zeitung, August 11, 1983.

Japan, A broader over-the-counter market takes off fast. Business Week, November 21, 1983, p. 50.

Jody Vender si fa le ossa con Finnova. Rivista dei fondi communi d'investimento, No. 5, 1983, p. 5 f.

Nino AG: Gutes Ergebnis seit zehn Jahren. Fahrplan geht in Richtung Börseneinführung der Aktie. Handelsblatt, October 16/17, 1982, p. 17.

Offener Streit in Italiens Börsenaufsicht. Frankfurter Allgemeine Zeitung, October 27, 1983.

Opérations de banque et de bourse. Répertoire pratique du droit belge, Vol. 9. Brussels: Bruylant, 1951.

Per la prima volta in diminuzione il numero delle società per azioni. Il Sole - 24 Ore, February 25, 1981.

Präsident stürzt über den Fall Ambrosiano. Handelsblatt, August 13/14, 1982.

Rossis Rücktritt. Börsen-Zeitung, August 14, 1982.

Saranno probabilmente tre i fondi del S. Paolo. Il Sole - 24 Ore, August 27, 1983.

Stocks are struggling to regain momentum. International Herald Tribune, May 3, 1982.

The city's place in the world. Foreign Banks in London. Supplement to Euromoney, April 1983, pp. 1-6.

The unlisted securities market. Bank of England Quarterly Bulletin, June 1983, Vol. 23, pp. 227-231.

Una riforma del mercato ristretto necessaria per frenare la caduta. Il Sole - 24 Ore, September 20, 1983.

Venture capital. Bank of England Quarterly Bulletin, December 1982, Vol. 22, pp. 511-513.

Venture - Capital für Innovationen. Börsen-Zeitung, September 1982, p. 4.

4. Other sources

Advisory Committee on Corporate Disclosure.

Report to the Securities and Exchange Commission.
Washington D.C.: Government Printing Office, 1977.

Année boursière.

Annual report of the compagnie des agents de change.
Paris, 1979-1982.

Arbeitsgemeinschaft der deutschen Wertpapierbörsen.

Arbeitsunterlage der Zulassungsstellen vom Frühjahr
1966 in der Fassung vom 1. Juli 1974.

- Banca Commerciale Italiana.
The Italian stock market for nonresidents.
Milano, 1981.
- Banca d'Italia.
Relazione annuale. Years 1980-1982. Roma, n.d.
- Banca Nazionale del Lavoro.
La meridiana dell'investitore. Roma, ed. 1983.
- Bisgood, Bishop & Co. Ltd.
U.S.M. Manual, March 15, 1983.
- Borsa Valori di Milano, Comitato Direttivo degli
Agenti di Cambio.
English summary of law No. 904 of December 16,
1977 introducing modifications to the norms which
regulate the fiscal taxation of companies, divi-
dends, capital increases and other fiscal matters
as well as an increase in the minimum capital
requisites for companies.
- Borsa Valori di Milano, Comitato Direttivo degli
Agenti di Cambio.
Inquity on medium-sized industrial companies.
Milano, 1979.
- Borsa Valori di Milano, Comitato Direttivo degli
Agenti di Cambio.
The Milan Stock Exchange. Milano, 1983.
- Borsa Valori di Milano, Comitato del Mercato Ristretto.
Il mercato ristretto di Milano. Rapporte annuale.
Years 1980-1982.
- D.W. Brand N.V.
Gids voor parallelmarkt fondsen. Amsterdam, 1983.
- Broekman's Commissiebank N.V.
Gids voor parallelmarkt fondsen 1983. Amsterdam, 1983.
- Cardon de Lichtbuer, Michel.
Het innovatiekapitaal op de belgische kapitaalmarkt.
N.p., 1983.
- Chambre de Commerce du Grand-Duché de Luxembourg ed.
L'établissement d'entreprises nouvelles au Grand-
Duché de Luxembourg. Guide de L'entrepreneur.
Luxembourg, 1983.
- Cofindi (Compagnia Finanziaria de Investimenti S.p.A.).
Guida alle quotazione: Borsa Valori, Mercato ri-
stretto. Milano, 1981.

- Commissaire au Contrôle des Banques ed.
Rapport du commissaire au contrôle des banques
1945-1975. Luxembourg, n.d.
- Commission de la bourse de Bruxelles.
Indices et statistiques. Brussels, 1979-1983.
- Commission des opérations de bourse.
Rapports annuels and monthly bulletin, 1978-1983.
N.p., n.d.
- Commission des opérations de bourse.
Textes concernant le second marché. Paris, 1982.
- Commission of the European Communities.
Toward a European stock exchange. Proceedings of
a symposium held in Brussels on November 13 and
14, 1980 (XV/231/81).
- Commission of the European Communities.
Study of fiscal aspects of possible options of
financial interventions in favour of innovative
enterprises. Report. Luxembourg: Office for
official publications of the European Communities,
1983.
- Constantinides, Anestis S.
Greek securities markets. Athens: Bank of Greece,
Economic Research Department, 1981.
- Credito Italiano.
The Italian stock exchange. Ed. 1979.
- Danmark Statistik.
Statistik Arborg 1982. København: Aarhus Stifs-
bogtrykkerie, 1982.
- Dafsa.
Les liaisons financières. Edition 1983, Paris:
Dafsa, 1983.
- Dean, Gordan D.
Collective investment and mutual funds, EC-Symposium
"Developing capital markets for the regeneration
of industry", Luxembourg, November 23-25, 1983.
Luxembourg: Working Document, pp. 32-36.
- Department of Trade and Industry.
Companies in 1982. London HMSO, 1983.

- Department of Trade, Commerce and Tourism.
Companies. General annual report 1981. Dublin:
Stationary Office, 1982.
- Gesellschaft für internationale Investitionen und
Innovationen mbH.
GeBeKa, Angebot von Beteiligungskapital für
deutsche Unternehmen. Frankfurt, 1982.
- Grigat, Eckart.
Charakterisierung notierter deutscher Aktiengesell-
schaften. Unpublished master thesis, University
of Hamburg, 1983.
- National Bank of Greece.
Investing in Greece. Athens, 1961.
- Istituto Centrale di Statistica, Roma.
Rilevamento istat 1981.
- Kasmas, George.
Money and monetary policy in a developing economy:
The case of Greece 1956-1966. Ph.D. Dissertation,
University of Manchester, January 1972.
- Lagenstein, Gudrun.
Publizitätsvorschriften der U.S. Securities and
Exchange Commission für kleine Gesellschaften.
Unpublished master thesis, University of Hamburg,
1983.
- Mediobanca.
Dati cumulativi di 828 società italiane, 1968-1977.
N.p., n.d.
- National Investment Bank for Industrial Development.
Annual reports, 1979-1982. Athens, various dates.
- Politik der industriellen Innovation. Leitlinien für
eine Gemeinschaftsstrategie. Mitteilung der Kommission
an den Rat, Kom (81) 620.
- Poos, Jaques F.
Crise économique et petites nations. Le modèle
Luxembourgeois. Lausanne, 1977.
- Rapport van de Commissie Incourante Markt. Amsterdam:
Vereniging voor de Effectenhandel, 1981.
- Reyers, Jenn.
President's message. Brussels: Stock Exchange, 1982.

Sachverständigenrat zur Begutachtung der gesamtwirtschaftlichen Entwicklung.

Gegen Pessimismus. Jahresgutachten 1982/83.
Stuttgart and Mainz: Kohlhammer, 1982.

Schwarck, Eberhard.

Börsengesetz (Kommentar). München: Beck, 1976.

Service central de la statistique et des études économiques.

Annuaire statistique du Luxembourg. Luxembourg, various dates.

Service central de la statistique et des études économiques.

L'économie Luxembourgeoise en 1978 et 1979.
Luxembourg, 1980.

Service central de la statistique et des études économiques.

L'économie Luxembourgeoise en 1980 et 1981.
Luxembourg, 1982.

Service central de la statistique et des études économiques.

Note trimestrielle de conjoncture. Luxembourg, various dates.

Small firms annual report 1981. Dublin: The Industrial Development Authority of Ireland, n.d.

Société de la Bourse de Luxembourg S.A.

Zusammenstellung relevanter Gesetze. Anordnungen und das Règlement d'Ordre Intérieur de la Bourse de Luxembourg. Luxembourg, 1980.

Société Nationale de Crédit et d'Investissement.

Rapport et bilan. Luxembourg, various years.

Supplement to Euromoney: Greece - Riding the waves, Nestor House. London, April 1983.

Thede, Jürgen.

Mehr Risikokapital über die Börse. Kiel: Manuskripte aus dem Institut für Betriebswirtschaftslehre der Universität Kiel, No. 135, November 1983.

The Stock Exchange-Irish.

Handbook of Irish Securities. December 1982. Dublin: Bishopsgate Press Ltd., 1983.

Toronto Stock Exchange.

Nothing ventured, Investing in Canada's winners. Toronto, 1980.

Unione Fiduciara S.p.a.

Il mercato ristretto, Tutto quello che conviene sapere, N.p., n.d.

Weckel, P.

La fiscalité et la stimulation de l'innovation industrielle dans la communauté. Commission of the European Communities. Luxembourg: Office des publications officielles de communautés européennes, 1983.

Wurth-Polfer, Lydie, and Bernard, Guy.

La réforme des sociétés anonymes. Banque Internationale à Luxembourg S.A., ed. Cahiers économiques, No. 3, 1982.

European Communities — Commission

**EUR 9235 — Special stock market segments for small company shares:
Capital raising mechanism and exit route for investors in
new technology-based firms**

H. Schmidt


Luxembourg: Office for Official Publications of the European Communities

1984 — XLVIII, 551 p. — 21.0 × 29.7 cm

Innovation series

EN

ISBN 92-825-4840-6

Catalogue number: 

Price (excluding VAT) in Luxembourg:

ECU 39.46 BFR 1 800 IRL 28.80 UKL 23.50 USD 33

In order to stimulate the financing of small and medium-sized enterprises, the traditional conditions of access to the Stock Exchange, adapted to the cases of major firms, have to be modified, taking into account the characteristics of a market for small company shares, where a limited number of investors may warrant a special trading procedure.

In order to facilitate the access of innovative high-risk companies to organized securities' markets, the author recommends measures in areas such as investment banking, regulation of institutional investors and taxation.

**Salg og abonnement · Verkauf und Abonnement · Πωλήσεις και συνδρομές · Sales and subscriptions
Vente et abonnements · Vendita e abbonamenti · Verkoop en abonnementen**

BELGIQUE / BELGIË

Moniteur belge / Belgisch Staatsblad
Rue de Louvain 40-42 / Leuvensestraat 40-42
1000 Bruxelles / 1000 Brussel
Tél. 512 00 26
CCP / Postrekening 000-2005502-27

Sous-dépôts / Agentschappen:

**Librairie européenne /
Europese Boekhandel**
Rue de la Loi 244 / Wetstraat 244
1040 Bruxelles / 1040 Brussel

CREDOC

Rue de la Montagne 34 / Bergstraat 34
Bte 11 / Bus 11
1000 Bruxelles / 1000 Brussel

DANMARK

Schultz Forlag
Møntergade 21
1116 København K
Tlf: (01) 12 11 95
Girokonto 200 11 95

BR DEUTSCHLAND

Verlag Bundesanzeiger
Breite Straße
Postfach 10 80 06
5000 Köln 1
Tel. (02 21) 20 29-0
Fernschreiber:
ANZEIGER BONN 8 882 595

GREECE

G.C. Eleftheroudakis SA

International Bookstore
4 Nikis Street
Athens (126)
Tel. 322 63 23
Telex 219410 ELEF

Sub-agent for Northern Greece:

Molho's Bookstore
The Business Bookshop
10 Tsimiski Street
Thessaloniki
Tel. 275 271
Telex 412885 LIMO

FRANCE

**Service de vente en France des publications
des Communautés européennes**

Journal officiel
26, rue Desaix
75732 Paris Cedex 15
Tél. (1) 578 61 39

IRELAND

Government Publications Sales Office

Sun Alliance House
Molesworth Street
Dublin 2
Tel. 71 03 09

or by post

Stationery Office

St Martin's House
Waterloo Road
Dublin 4
Tel. 78 96 44

ITALIA

Licosa Spa

Via Lamarmora, 45
Casella postale 552
50 121 Firenze
Tel. 57 97 51
Telex 570466 LICOSA I
CCP 343 509

Subagente:

Libreria scientifica Lucio de Biasio - AEIOU

Via Meravigli, 16
20 123 Milano
Tel. 80 76 79

GRAND-DUCHÉ DE LUXEMBOURG

**Office des publications officielles
des Communautés européennes**

5, rue du Commerce
L-2985 Luxembourg
Tél. 49 00 81 - 49 01 91
Télex PUBOF - Lu 1322
CCP 19190-81
CC bancaire BIL 8-109/6003/200

Messengeries Paul Kraus

11, rue Christophe Plantin
L-2339 Luxembourg
Tél. 48 21 31
Télex 2515

NEDERLAND

Staatsdrukkerij- en uitgeverijbedrijf

Christoffel Plantijnstraat
Postbus 20014
2500 EA 's-Gravenhage
Tel. (070) 78 99 11

UNITED KINGDOM

HM Stationery Office

HMSO Publications Centre
51 Nine Elms Lane
London SW8 5DR
Tel. 01-211 3935

Sub-agent:

Alan Armstrong & Associates

European Bookshop
London Business School
Sussex Place
London NW1 4SA
Tel. 01-723 3902

ESPAÑA

Mundi-Prensa Libros, S.A.

Castelló 37
Madrid 1
Tel. (91) 275 46 55
Telex 49370-MPLI-E

PORTUGAL

Livraria Bertrand, s.a.r.l.

Rua João de Deus
Venda Nova
Amadora
Tél. 97 45 71
Telex 12709-LITRAN-P

SCHWEIZ / SUISSE / SVIZZERA

Librairie Payot

6, rue Grenus
1211 Genève
Tél. 31 89 50
CCP 12-236

UNITED STATES OF AMERICA

**European Community Information
Service**

2100 M Street, NW
Suite 707
Washington, DC 20037
Tel. (202) 862 9500

CANADA

Renouf Publishing Co., Ltd

2182 St Catherine Street West
Montreal
Quebec H3H 1M7
Tel. (514) 937 3519

JAPAN

Kinokuniya Company Ltd

17-7 Shinjuku 3-Chome
Shinjuku-ku
Tokyo 160-91
Tel. (03) 354 0131

NOTICE TO THE READER

All scientific and technical reports published by the Commission of the European Communities are announced in the monthly periodical 'euro-abstracts'. For subscription (1 year: BFR 2 400) please write to the address below.

CDNA09235ENC

Price (excluding VAT) in Luxembourg

ECU 39.46 BFR 1 800 IRL 28.80 UKL 23.50 USD 33



OFFICE FOR OFFICIAL PUBLICATIONS
OF THE EUROPEAN COMMUNITIES

L-2985 Luxembourg

ISBN 92-825-4840-6



9 789282 548400