European Economic and Social Committee

INT/856
Small listed companies

OPINION

European Economic and Social Committee

Proposal for a Regulation of the European Parliament and of the Council amending Regulations (EU) No 596/2014 and (EU) 2017/1129 as regards the promotion of the use of SME growth markets
[COM(2018) 331 final – 2018/0165 (COD)]

Rapporteur: **Mihai IVAŞCU**

Referral	European Parliament, 11/06/2018 Council, 21/06/2018
Legal basis	Article 114 of the Treaty on the Functioning of the European Union
Section responsible	Single Market, Production and Consumption
Adopted in section	04/09/2018
Adopted at plenary	19/09/2018
Plenary session No	537
Outcome of vote (for/against/abstentions)	196/1/1

1. Conclusions and recommendations

1.1 The EESC supports the Commission's proposal to make capital markets a credible alternative for financing and believes that a balance should be achieved between the three main objectives of the proposal: growing the SME markets, alleviating burdens and raising the liquidity level. The European Commission (EC) must not overregulate, but maintain a level of barriers that will discourage unprepared companies.

1.2 The EESC expresses its belief that the current proposal, although a step in the right direction, is not enough to tackle the existing barriers on the SME Growth Markets. While there is indeed a need for a holistic approach, each individual step must carry its own weight.

1.3 Compared with companies in the United States, those in the EU still seek bank loans as a financing option in a much larger number, sometimes even by accepting significant additional costs. Further financial education is needed, as the EU public markets have struggled to attract new issuers and the number of IPOs has not significantly increased.

1.4 The EESC stands by its previous opinions that the low level of communication[1] and bureaucratic approaches[2] are significant barriers and much more effort must be put into overcoming these obstacles. Communication from Brussels should always target the bottom of the chain – the SMEs themselves –, by involving SME associations, social partners, chambers of commerce, and so on.

1.5 The proposal of maintaining only permanent insider lists for SMEs and the proposed two-day extension to the deadline for disclosing managers' transactions are very much welcomed. Regarding these, the EESC can only suggest that the EC explores further methods of removing burden from the SMEs and move it to other stakeholders, such as the National Competent Authorities (NCAs), for example.

1.6 The alleviated prospectus is indeed a significant reduction in burden, but the EESC considers that further possibilities should be examined of gradually simplifying the transfer prospectus for companies that have proven their maturity by being listed on SME Growth Markets for a significant number of years.

1.7 The EESC is in favour of the proposed changes to the market sounding regime and would like to caution against overly detailed and/or prescriptive explanation requests from the NCAs.

1.8 The EESC advises the EC to look into the possibility of attracting institutional investors, such as private pension funds, to invest in these SME Growth Markets, by providing incentives, especially concerning tax treatment. Member States should explore possibilities for further attractive investment support schemes at national level.

1 OJ C 345, 13.10.2017, p. 15.

2 OJ C 345, 13.10.2017, p. 15.

1.9 The liquidity contracts are extremely welcomed, especially for the underdeveloped markets. The EESC believes that the 29th regime on liquidity contracts prepared by the European Commission will create an additional option for issuers, alongside national legislation.

1.10 The EESC would like to point out that a thorough and regular impact assessment is warranted. Done yearly, these assessments could provide valuable information for future changes to the regulatory framework.

2. The European Commission's proposal

2.1 This proposal for a Regulation is part of the Capital Markets Union agenda and focuses on specific changes to the functioning of the SME Growth Markets, which have been regulated as of January 2018. The EU has made considerable progress in terms of increasing sources of funding as firms gradually scale up, and making market-based finance more widely available across the EU. New rules are already in place to boost EU venture capital funds' (EuVECA) investment in start-ups and medium-sized companies. Together with the European Investment Fund, the Commission has also launched a Pan-European Venture Capital Funds-of-Funds programme (VentureEU).

2.2 The main goal of the proposal is to make it easier for small and medium-sized enterprises to be listed and to use capital markets to finance their growth. The proposal includes a fine-tuning of the initial framework that represents a step forward towards improved and more effective regulation.

2.3 The proposal will apply to all the companies that are listed on the SME Growth Markets, be they SMEs or not. This ensures, first of all, that fast-growing companies are not penalised for their positive economic performance; and second, that these markets will be able to attract large companies as well. By introducing these new rules, the Commission expects that more Multilateral Trading Facilities (MTFs) will register as SME Growth Markets (so far, only 3 out of 40 have done so).

2.4 The proposal includes alleviations that would:

- lower the burden for SMEs regarding recording and disclosure obligations while preserving market integrity and a comprehensive flow of information to investors;
- create common rules for liquidity contracts on the SME Growth Markets, allowing an increase in the liquidity of shares;
- allow issuers to produce an alleviated prospectus when trying to move to a regulated market (a new category of transfer prospectus will allow issuers who have been listed for at least three years to move more easily to access the main stock exchanges, hence targeting better liquidity and a larger number of investors).

3. General comments

3.1 SMEs account for 99.8% of all non-financial enterprises in the EU, generating about 58% of total added value and employing over 90 million people. However, every year, around 200 000 SMEs go bankrupt, affecting over 1.7 million workers[3].

3.2 According to the EIB Investment Survey 2016/2017, SMEs usually depend on internal funds for investment (over 60%)[4]. The remainder is mostly made up of banking instruments. Market-based finance is not fulfilling its potential. The EESC believes that increasing this is crucial for innovative companies, or for those with a high risk-return profile.

Table 1. Source of investment finance in the last financial year, EU28[5]:

	Micro %	Small %	Medium %	Large %
Internal funds or retained earnings	71	64	59	57
External finance	28	35	38	38
Bank loans	60	60	57	54
Other bank finance	11	8	10	11
Leasing	18	23	24	23
Factoring	2	3	3	4
Loans from family/friends	4	2	1	1
Grants	4	3	4	3
Bonds	0	0	1	4
Equity	0	0	0	1
Other	1	1	1	1
Intra-group funding	0	1	3	5

Note: All firms who invested in the last financial year (excluding don't know/refused responses).

3.3 The EESC would like to point out the reluctance of SMEs in seeking financing from capital markets and their willingness to suffer the increased costs of financing through bank credit. This cultural characteristic is one of the main differencing factors from the more successful US capital markets and the lower dependence of American companies on bank loans. Further financial education is of paramount importance.

3.4 In other opinions, the EESC has already mentioned its belief that a "bureaucratic approach and the complexity of administrative rules are still prevalent in EU SME policies and the current support mechanisms, despite the constant efforts at EU level to minimise the administrative burden"[6].

3.5 The EESC has previously expressed its support for other proposals aimed at reducing the administrative burden of drawing up prospectuses for all issuers, in particular for SMEs,

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3 Marcin Szczepanski, "Helping European SMEs to grow: Start-up and scale-up initiatives for business ventures in the EU".

4 "EIBIS 2016/2017: Surveying Corporate Investment Activities, Needs and Financing in the EU", European Investment Bank, 2017.

5 Apostolos Thomadakis, "Developing EU Capital Markets for SMEs: Mission impossible?", *ECMI Commentary* No. 46, 4 September 2017.

6 OJ C 345, 13.10.2017, p. 15.

frequent issuers of securities and secondary issuances[7]. Furthermore, the EESC has explained that "While bank loans are a reality, access to equity as a financial tool is also needed but is not sufficiently developed in Europe due to punitive tax regimes, lack of equity culture, poor financial literacy and fragmented insolvency regimes"[8].

3.6 The EESC is in favour of the European Commission's initiative to reduce the administrative burden on SMEs, allowing them to have easier access to capital markets and to diversify their financing sources. The EESC also supports the stated objective of this proposal to increase liquidity of shares issued by SME Growth Market issuers.

3.7 Although the advantages for SMEs of being listed on the dedicated markets are obvious, and although this improves and diversifies their financing opportunities, the EU public markets have actually struggled to attract new issuers, and the number of initial public offerings is not increasing significantly. Only 3 000 out of over 20 million existing SMEs are listed and there are only half as many IPOs compared to before the financial crisis. Insufficient liquidity on these markets translates into higher costs for issuers to raise capital and reluctance to invest on the part of capital holders, and means that market intermediaries are less inclined to support small listed companies.

3.8 Equity finance is key for innovative companies that create value and growth, and especially for companies that have a high risk-return profile. Seed and early stage equity finance can boost firm creation and development, whereas other equity instruments, such as specialised platforms for the public listing of SMEs, can provide financial resources for growth-oriented and innovative SMEs. Additionally, equity financing may be more suitable than debt financing for SMEs that lack collateral, have negative or irregular cash flows, or require longer maturities for their investments to pay off[9].

3.9 The EU markets are still fragmented and they do not seem able to support a large number of IPOs. Europe seemingly has a strong position in growing innovative high-tech firms, but when these companies are in need of robust capital investments, they usually go bankrupt. Fast-growing companies also often leave the EU market in favour of the United States, searching for more accessible stock option schemes.

3.10 Listed companies are less dependent on bank financing, can access a larger investment base, and have a higher public profile. Despite this, more needs to be done to develop a more conducive regulatory framework to support access to public funding for small and medium-sized enterprises, especially by promoting the SME Growth Market label. The right balance between investor protection and market integrity should also be struck by means of proper regulation.

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7 OJ C 177, 18.5.2016, p. 9.

8 OJ C 288, 31.8.2017, p. 20.

9 Iota Kaousar Nassr and Gert Wehinger, "Opportunities and limitations of public equity markets for SMEs", *OECD Journal: Financial Market Trends* 2015/1, 49-84.

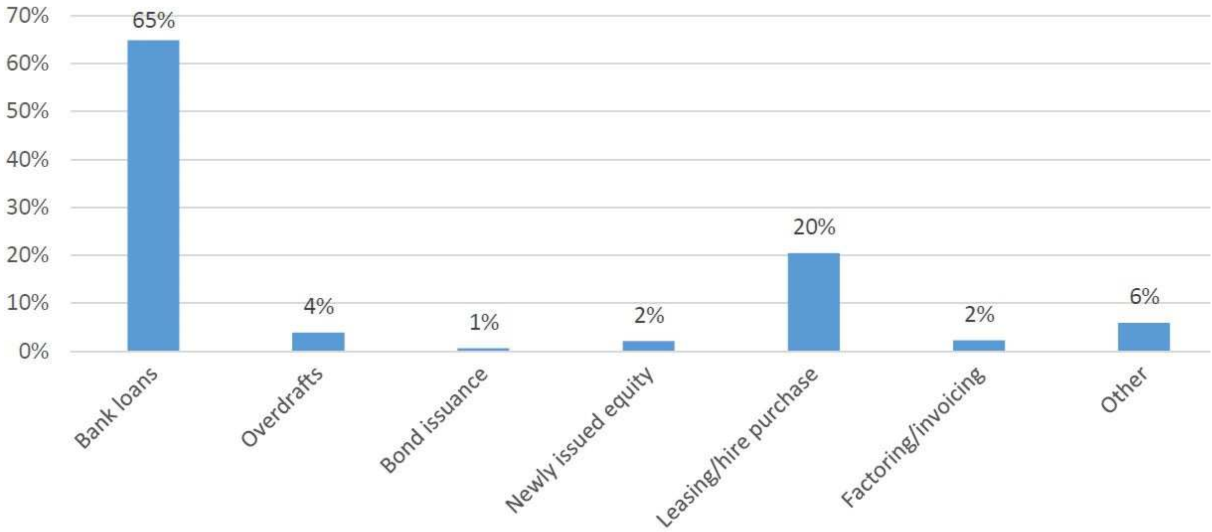
3.11 SMEs with diversified financing sources are more robust and competitive, benefiting from reduced costs and better development perspectives. This allows for a stronger job market and better opportunities for citizens seeking a job regardless of their level of training.

3.12 The EESC recommends that the European Commission consider further alleviations to the SME Growth Markets rules and requirements, so as to better differentiate them from regulated markets and make them more attractive as entry-level markets.

4. Specific comments

4.1 The EESC fully supports ongoing efforts to make capital markets a credible alternative for financing, as part of the Capital Markets Union agenda. However, it still seems doubtful that the current efforts are enough to reduce the considerable barriers that currently exist on the market. SMEs do not seem to be changing their financing behaviour; therefore, more needs to be done. The EC has recognised that it is just one step forward and not a complete solution to all the challenges of the capital markets.

Table 2. Types of finance that SMEs wish to see more in the financing mix over the next three years, EU28[10]:



4.2 While it remains to be seen if they will indeed reduce compliance costs, alleviate burdens and promote market liquidity – as all these objectives are quite ambitious –, the EESC believes that the measures proposed are a step in the right direction.

4.3 The EESC believes that the low number of SMEs that get access to market-based financing is also due to the lack of low-level communication. The messages and tools at EU level are not reaching the bottom of the chain – i.e. the SMEs that are targeted. This is due to several reasons, most importantly the insufficient proactive communication and interaction from Brussels to the

10 Apostolos Thomadakis, "Developing EU Capital Markets for SMEs: Mission impossible?", *ECMI Commentary* No. 46, 4 September 2017.

Member States and to SME associations, the social partners or chambers of commerce. The EESC warned about this in a previous opinion[11], but has seen hardly any improvements so far.

4.4 On the other hand, the low number of institutional investors in the SME shares and bonds markets can be explained by the lack of incentives provided for these investors, especially concerning tax treatments. The EESC advises the Commission to look into this possibility.

4.5 The EESC welcomes the proposed two-day extension to the deadline to make managers' transactions public. This is an important tool for preserving the transparency and symmetry of the junior markets, but the three-day deadline was a critical constraint for the SMEs. The EESC believes that the proposed amendment will lead to a more streamlined procedure in more difficult or busy periods for companies. The EESC recommends that the Commission should explore ways to remove the administrative burden from companies and shift it to other actors, such as the NCAs.

4.6 The EESC has already expressed its full support for simplifying and streamlining the requirements for the prospectus published when securities are offered on regulated markets, making them more cost-effective and more useful for investors in terms of the information they contain[12]. Any new proposal that works towards this goal is more than welcome. Considering the large amount of information that companies on the SME Growth Markets are required to disclose under the Market Abuse Regulation and Directive 2014/65/EU, the EESC considers that a simpler transfer prospectus is sufficient for companies moving to a regulated market.

4.7 Furthermore, the EESC would support the gradual simplification of the prospectus for transferring to the regulated market for companies that have been listed for a reasonable number of years on an SME Growth Market.

4.8 The EESC welcomes the proposal of maintaining only permanent insider lists for companies listed on the SME Growth Markets, as the number of employees with access to insider information is limited and mostly the same. This represents a significant burden reduction.

4.9 The EESC is supportive of the modifications to the market sounding regime as the proposed amendments will facilitate the issuance of corporate bonds by SME Growth Market issuers. Concerning the justifications to be provided by SME Growth Market issuers when the public disclosure of inside information is delayed, the EESC believes that the explanations requested by the NCAs on an ad hoc basis, following notification by the issuer, should not be too detailed or overly prescriptive.

4.10 The Market Abuse Regulation is a source of administrative and legal costs and can be seen by non-EU issuers as a barrier to listing on EU markets. The EESC recommends that further amendments should be made to tailor the requirements for the SME Growth Markets.

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11 OJ C 345, 13.10.2017, p. 15.

12 OJ C 177, 18.5.2016, p. 9.

4.11 While liquidity contracts are welcomed, especially for undeveloped markets, a proposal at European level would create a level playing field on which local conditions can be built. The EESC believes that the 29th regime on liquidity contracts, which the EC is currently working on, will create the possibility for market issuers to establish a liquidity contract either on the basis of national legislation, where it exists, or on the basis of Europe-wide regulation.

4.12 The EC's proposal is a definitive step forward. However, the EESC suggests that there should be regular impact assessments with a wide access to non-confidential data and analyses based on quantitative indicators.

Brussels, 19 September 2018

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The president of the European Economic and Social Committee