

SME Exchanges in Emerging Market Economies

A Stocktaking of Development Practices

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Abstract

In recent years, many emerging market countries have developed or are in the process of developing SME Exchanges to provide financing to SMEs, but few have succeeded. This paper aims to help stock exchanges and policy makers think through the key questions to be addressed to determine if, when, how and for whom to develop an SME Exchange in emerging market countries. It takes stock of some of the actions that exchanges can take to reduce issuance costs, in time and money for SMEs, without compromising the prudential needs of investors.

The paper draws on the experience of seven SME Exchanges and the World Federation of Exchanges that participated in a workshop organized and led by the WBG

to discuss these and other questions. It does not recommend a specific model to follow and does not address specific context issues, however the analysis suggests approaches that are widespread and/or could be beneficial to consider such as (1) focus on SMEs with a sizeable growth rate, (2) have the SME exchange legally related to the main board, (3) do not reduce disclosure content to reduce costs, (4) allow private placements, (5) have well regulated advisors to vet issuers and provide comfort to investors about the quality of the issue, (6) have outreach, public awareness campaign and training for SMEs, (7) consider tax incentives for investors. The report is the first in a series on this topic, and subsequent reports will address and expand on related and broader issues.

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SME Exchanges in Emerging Market Economies: A Stocktaking of Development Practices

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Acronyms and Abbreviations

AA	Authorized Advisor
AIM	Alternative Investment Market
ASX	Australian Securities Exchange
ATP	Alternative Trading Platform
BNDES	Banco Nacional do Desenvolvimento Econômico e Social (Development Bank of Brazil)
CVM	Comissão de Valores Mobiliários (Securities and Exchange Commission of Brazil)
DA	Designated Advisor
ESB	Emerging Stock Board
EMC	Emerging Market Country
EU	European Union
GDP	Gross Domestic Product
IPO	Initial Public Offering
IT	Information Technology
MM	Market Maker
NC	NewConnect
OTC	Over-The-Counter
PE	Private Equity
SEBI	Security and Exchange Board (of India)
SME	Small and Medium Enterprise
TSXV	TSX Venture Exchange
VC	Venture Capital
VCT	Venture Capital Trust
WBG	World Bank Group
WSE	Warsaw Stock Exchange

Currencies are in U.S dollars unless stated otherwise.

I. Context: Setting the Stage for SME Exchanges in Emerging Market Countries

Small and Medium Enterprises (SMEs) play a strong role in economic development in many countries around the world. Over the years, numerous countries and exchanges have approached the World Bank Group (WBG) asking for advice on how to develop SME exchanges. While SME exchanges may be valuable to have, many countries have attempted to develop them but few have succeeded. There are some successes in developed countries, such as the Alternative Investment Market (AIM) in the United Kingdom, TSX Venture Exchange (TSXV) in Canada, and the Australian Securities Exchange (ASX) in Australia, but several less so.

Developing SME exchanges in emerging market countries (EMCs) is a more difficult challenge, largely because the size of the SMEs is so small. GreTai Securities Market in Taipei and Warsaw Stock Exchange (WSE) NewConnect in Poland have had some success. Others, with significant numbers of SMEs in their economies, have had more modest success and are struggling to understand why. A key issue is how to reduce the costs of issuance in time and money for the SMEs given their small size, but without compromising the prudential needs of investors. There are other difficult challenges as well.

This paper takes stock of the actions that several SME exchanges have taken to help reduce issuance costs, in time and money, to encourage new issuance and investment. It draws on the experience of seven SME exchanges and the World Federation of Exchanges that participated in a workshop organized and led by the WBG to discuss critical questions, including the following:²

- If and when an SME exchange should be developed
- Which types of SMEs it might serve
- Which types of investors should participate
- How the operation should be set up legally
- What type of regulatory approach works to reduce issuance costs and requirements without harming investors
- If incentives should be given and if so what type

The goal is to provide a document that helps stock exchanges, and policy makers, think through the key questions that need to be addressed to determine if, when, how, and for whom to develop an SME exchange.

The paper does not address two important areas:

- It does not address the broader issues that need to be considered when building any marketplace, such as whether there are sufficient SMEs and investors, a supportive legal and regulatory context, institutional capacity, and political-economic context. It focuses

² The seven exchanges are NSE India Emerge (India), JSE AltX (South Africa), GreTai Securities Market (Taipei) BM&FBOVESPA Bovespa Mais (Brazil), WSE NewConnect (Poland), BIST ECM (Turkey), and TSX Venture Exchange (Canada). The CEO of the World Federation of Exchanges also participated. They were selected to participate in the stocktaking because they have operating SME exchanges and have experiences to share in developing them, some more successful than others. Many have the conditions in place to support the SME exchanges.

primarily on technical steps exchanges might adopt related to exchange operations. Before applying these actions, an intensive diagnostic would be needed to assess whether the broader context is conducive. Taking the measures discussed in this paper alone will not spark a successful SME exchange.

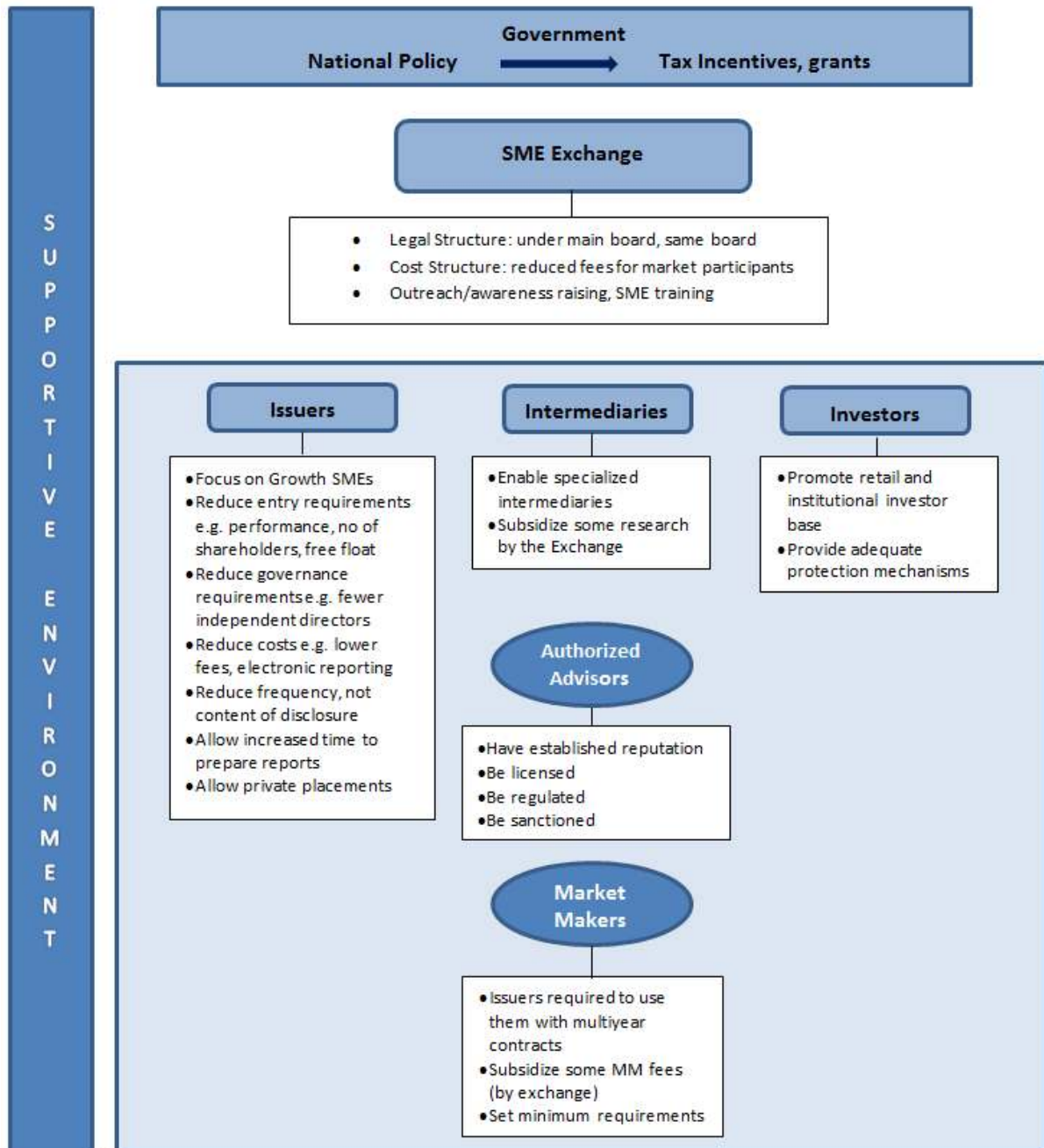
- It does not propose a specific model to follow. Each exchange would need to consider how to apply and combine the elements noted.

Although a specific model is not proposed, there are approaches that this analysis suggests are widespread and/or could be beneficial to consider (see Figure 1). The stocktaking showed that most exchanges:

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

This paper is the first in a series on this topic. Several additional questions will be addressed in future papers, including the preconditions for an SME exchange, the SME exchanges' relationship with the main board, why investors invest in SME exchanges, and the nature and impact of reducing corporate governance requirements.

Figure 1. Key Conclusions



Note: MM = market maker; SME = small and medium enterprise.

II. The Current State of SME Exchanges

A. What Is an SME?

There is no standard definition of what constitutes an SME. Definitions of an SME vary widely across countries and regions, although the criteria include a maximum level for one or more of the following criteria: number of full employees and/or annual sales turnover.³ These differing SME definitions across countries can make an international comparison ambiguous. However, for the purpose of this paper, instead of taking into account any specific SME definition, we will rely on each country's own national criteria for an SME definition (see Table 1).

Country	Number of Employees	Annual Sales Turnover
India	—	—
South Africa	<200	<\$6.2 million
Taiwan	<200	<\$3.3 million
Brazil		
Industrial sector	<500	—
Service sector	<100	—
Poland	<250	<\$68 million
Turkey	<250	<\$12 million

Source: WBG compilation of exchange information.

Note: — = not available.

- SMEs in the European Union (EU) are defined as enterprises that have fewer than 250 employees and do not have sales that exceed €50 million (\$68 million) or an annual balance sheet that exceeds €43 million (\$58 million). As a member of the EU, Poland adopts this definition.
- South Africa applies differing criteria for different business sectors. The definition of SMEs in South Africa is set out in the National Small Business Amendment Act of 2003. The classification distinguishes between different sectors and takes full-time employees (less than 200), annual turnover, and total gross asset value into account.
- Brazil adopts the number of employee criteria for the definition of SMEs; this differs according to business sector (industrial sector fewer than 500 employees, service and commercial sector fewer than 100 employees).
- In India, SMEs are defined in the Micro, Small and Medium Enterprises Development Act, 2006, and the definition for enterprises engaged in manufacture, production, processing, or preservation of goods is investment in plant and machinery in their business of less than Re 100 million (\$1.6 million).

³ See Edinburgh Group, "Growing the Global Economy through SMEs"; Enterprise and Industry Publications, European Commission, "The New SME Definition"; Reserve Bank of India, "Micro, Small and Medium Enterprises."

B. The Current State of SME Exchanges

As we have noted, building an SME exchange is difficult to do successfully, even in advanced economies and particularly in EMCs where the SMEs are significantly smaller in size (see Table 2).

The United Kingdom's Alternative Investment Market (AIM), the London Stock Exchange's international market for smaller growing companies, is most commonly cited as a successful SME exchange, having listed more than 3,400 companies from around the globe since it was established in 1995.⁴ Attempts have been made to duplicate the AIM model in a number of emerging market jurisdictions: particularly its use of a Nominated Advisor, or Nomad, to provide support for SMEs before and after listing on the exchange and to assess the appropriateness of the SME to be listed; access to a knowledgeable advisory community; and a balanced regulatory framework that facilitates ease of entry and less onerous requirements for SMEs while offering appropriate investor protection.

The AIM framework, however, may need to be customized for the smaller EMCs, whose SMEs are much smaller than AIM companies and require a low cost structure, and whose advisors are less established. AIM relies on a supportive ecosystem, including the following:

- Nomads that have an established business and reputation (e.g. advisors with corporate finance experience, who may not exist in EMCs).
- Nomads that are sanctioned if they bring poor quality companies to market, not only by the exchange, but also by a knowledgeable investor base.
- The AIM system does not reduce costs for the issuer; the exchange is not marketed as a low-cost exchange. AIM maintains a significant regulatory framework, and in addition sponsors bring direct costs to the issuer. This implies higher costs that smaller emerging market issuers may not be able to bear.

The average market capitalization of AIM companies is \$80 million, although the median is \$20–25 million.

Experience with SME exchanges in EMCs is on the whole more recent. Although it is still early to measure success for many, several exchanges at the workshop felt that their growth did not match the role of SMEs in their economies. Some SME exchanges have reached a large number of companies. These examples are typically found in the larger EMCs such as China, and although like AIM their companies may be larger than the typical EM SMEs, they offer valuable insights and lessons. Most notable are the following:

- Shenzhen Stock Exchange's SME board (established in 2004) and ChiNext (established in 2009), which have 1,500 SMEs listed, of which 23 percent are high-tech. Listed companies come from the central and western parts of China; thus the capital market has promoted less developed regions.
- Poland's WSE NewConnect Market (established in 2007), which lists 442 SMEs as of March 2014 and 508 SMEs since its launch.

⁴ AIM has faced challenges resulting from the global financial crisis as weaker companies left the market during the recession. At year end 2013 it had approximately 1,100 companies listed, down more than a third since 2007.

- Taipei's GreTai Securities Market, established in 1994, which has listed a total of 1,133 companies since its launch.

Some exchanges have faced key challenges to growth:

- South Africa's Johannesburg Stock Exchange AltX, established in 2003, with 106 companies listed since the exchange began, currently has 60 companies listed. It was based on the AIM model and has raised \$2.03 billion from launch until the end of December 2013. Between 2003 and 2008, AltX grew significantly in terms of listings and market capitalization. This declined in the wake of the 2008 financial crisis, and the number of listings has continued to shrink.
- Brazil's BM&FBOVESPA Bovespa Mais, launched in 2005, suffers from a lack of investor demand. It subsequently revised its approach in 2011 to target a new generation of entrepreneurs in medium-sized companies (not only the traditional family owned) that wanted to go public but were too small to list and raise capital on Novo Mercado. It has listed nine companies and raised \$37.05 million.

Others are very new, such as NSE India's Emerge platform, which was launched in 2012 and now has five companies listed.

Table 2. Information on SME Exchanges									
Exchange	Launch Date	Target Companies and Startups	Number of Companies Listed since Launch	Number of Companies Listed as of March 2014	Current Sector Breakdown	Total Capital Raised since Launch	Average Issue Size of an IPO	Total Market Cap as of March 2014	Average Market Cap of Issuers
NSE India Emerge	2012	No specific sector or type of company targeted. Post issue paid-up capital > \$4.16 million. Startups allowed.	5	5 (no foreign listings)	80% manufacturing, 20% service industries	\$14.4 million	\$2.9 million	\$49.8 million	\$10 million
JSE AltX	2003	No specific sector or type of company targeted. Share capital > \$200,000. No startups allowed.	106	60 (has foreign listings)	71% financials, 15% industrials, 7% technology, 5% basic materials, 1% consumer goods, 1% remaining sectors	\$2 billion	\$18 million	\$2.3 billion	\$38 million
GreTai	1994	No specific sector, type, or size of company targeted. No startups allowed.	1,133	663 ^a (22 foreign listings)	70% electronics, 14.5% biotech and medical care, 8.4% traditional business, 7.1% other	\$14.1 billion ^b	\$12.4 million ^c	\$119 billion	\$180 million
BOVESPA MAIS	2005	No specific sector, type, or size of company targeted. Startups allowed.	9	9 (no foreign listings)	22% noncyclical consumer, 22% IT, 22% public utilities, 11% basic materials, 11% capital goods, 11% telecommunications	\$37.1 million ^d	\$18.5 million	—	—
WSE NewConnect	2007	No specific sector or type of company targeted. Issuer capital > \$ 0.16 million. No startups allowed.	508	442 (11 foreign listings)	15% retail, 13% support services, 10% financial services, 9% IT, 8% media, 8% technology, 7% construction, 5% health care, 5% investment services, 4% real estate, 16% other	\$551 million ^e	\$1.1 million	\$3.54 billion	\$8 million
BIST ECM	2009	No specific sector, type, or size of company targeted. Startups are allowed.	23	22 (no foreign listings)	9% agriculture, 4.5% apparel, 4.5% financial services, 13.6% food and beverages, 54.5% industrial goods and services, 9% investment companies, 4.5% wholesale trade	\$102 million	\$4.4 million	\$358 million	\$16 million

Source: WBG compilation of exchange information.

Note: IT = information technology; — = not available.

a. In addition to 663 listed companies on GreTai listed board, 253 companies (seven foreign) are registered with the GreTai Emerging Stock Board.

b. Total capital raised on GreTai from 2002 to March 2014.

c. The average size of an IPO on GreTai listed board between 2011 and 2013 is \$10.5 million.

d. Only two companies conducted an IPO on Bovespa Mais.

e. Total capital raised through secondary offerings on WSE NewConnect is \$595 million.

III. The Need for SME Exchanges

The importance of SMEs to the economy and their financing constraints are well known (see Table 3). SMEs account for a large part of emerging market economies and their job creation. A recent WBG report found that SMEs are the biggest contributor to employment (above 60 percent) in developing countries. Although their contribution to economic fundamentals varies across countries—from 16 percent of gross domestic product (GDP) in low-income countries to 51 percent of GDP in high-income countries—they are a high percentage of firms.⁵ Their ability to get funding is key to economic growth and job creation.

For many SMEs, access to finance is a primary obstacle to growth. Recent International Finance Corporation (IFC) data show the financing shortfall for the 25–30 million formal SMEs in EMCs at around \$1 trillion.⁶ For the reasons discussed above, SMEs are a priority for many EMCs' development and growth agenda. They have, and will increasingly have, space in the policy agenda.

Table 3. The Importance of SMEs			
Country	SMEs as % of GDP	SMEs as % of Firms	SMEs as % of Employment
India	20%	—	40%
South Africa	52–57%	91%	61%
Taiwan	—	98%	78%
Brazil	20% (excluding medium)	99%	60%
Poland	72%	>99%	69%
Turkey	60%	99%	76%

Source: WBG compilation of exchange information.

Note: — = not available.

A. SME Financing: The Role of Exchanges

SME exchanges are one of many options for SME financing along a spectrum or ladder that is frequently linked to the life cycle or stage of growth of the SME. This ladder typically progresses from the startup phase, which is usually funded by entrepreneurs' capital and family and friends, to an early stage where debt is taken on through bank loans. After this the shareholder structure broadens to include venture capital (VC), and in a growth phase, private equity (PE) financing is often sought. Capital market funding is usually seen as being at the end of the financing spectrum.

This funding life cycle is being increasingly compressed, particularly for high-growth companies in the innovative or technological sectors that are looking for capital or visibility at earlier stages. This is occurring as those companies observe the initial public offerings

⁵ Ayyagari, Beck, and Demirguc-Kunt, "Small and Medium Enterprises across the World: A New Database," World Bank Group.

⁶ IFC Enterprise Finance Gap Database (2011).

(IPOs) of technology companies such as Google and Facebook on international exchanges and become familiar with the concept of equity valuation. This is relevant for SME exchanges as they consider which companies to target and how to create the regulatory framework to best fit the target companies.

Generally speaking, the suitability of equity financing through an exchange compared with other sources of financing will depend on the SME's requirements in terms of the capital and management support needed. More specifically:

- *Bank financing:* Although bank funding is, and remains, a key source of funding for SMEs throughout their life cycle, it is not always sufficient or appropriate. Bank lending is often short term; and tends to be expensive with high fees and high collateral requirements due to informational asymmetries that create risks in assessing credit worthiness, low revenue per client, and the need for local presence. These collateral requirements can be difficult for SMEs to meet because they may not have enough of the conventional collateral required for bank lending. It needs to be paid back, which puts pressure on cash flows. Moreover, a sustainable business model imposes limits on an SME's indebtedness or leverage ratio, which can constrain how much SME funding can be provided from bank loans.
- *Equity financing:* Equity financing can help SMEs get beyond some of the constraints associated with bank financing because it is longer term, does not need to be paid back, and increases an SME's ability to raise bank financing and take on debt. It can be provided:
 1. *From VC and PE firms:* Is typically more suitable for smaller companies at an earlier stage of development than exchange financing, because a VC or PE partner can help the entrepreneur obtain strategic advice, technology, or support to grow and market their business. It can help the SME improve its overall operations, including governance and financial accounts in ways that can help the SME become a more suitable candidate for an exchange listing.
 2. *From an SME exchange:* Is appropriate when the SME is less interested in obtaining management assistance or restructuring but needs capital to grow. It contributes two critical pieces:
 - By appealing to a broader, more diverse investor base, an IPO can provide access to capital without requiring the SME to relinquish majority control. SME exchanges link issuers requiring long-term financing with a diverse set of investors comfortable with taking equity market risk by providing an infrastructure and regulatory framework that addresses the key risks for both. Exchange financing often increases a company's credit rating due to the transparency required from an exchange listing. It makes them sustainable by avoiding over-leverage in times of growth.
 - It provides early-stage financiers, such as PE or VC, with an exit vehicle, which can, in turn, encourage them to provide more early-stage financing from the comfort that having an exit provides, and allows them to recycle their investment.

While many SMEs list to obtain financing, many others list to increase their visibility, advertise their products, gain credibility often associated with good governance and accounts, and where the SME exchange has a particular focus, such as technology or high growth

companies, win customer recognition that they are a company with those characteristics. The JSE AltX, WSE NewConnect, and GreTai exchanges highlight these as drivers for listings by SMEs on their exchanges.

Thus, the level of new financing does not always have to be the barometer of success for an SME exchange. The SME may be obtaining other types of benefits, such as greater product sales, which also support its economic and employment growth. These sales may translate into the need for additional financing, and from equity exchanges, over time.

As noted earlier, a full diagnostic needs to be done to determine whether a country needs an SME exchange, to evaluate such questions as:

- Is there a sufficient number of SMEs that need funds and are willing to use an equity market to raise them (sharing ownership, disclose information, etc.)?
- Is there a sufficient number of interested investors?
- Is there a supportive macro- and political environment, broader legal and regulatory context, and regulatory capability to oversee the market?

As is the case when considering the development of any marketplace, a full diagnostic would need to be done to assess the broader context and determine whether it is conducive to building an SME exchange.

IV. Building an SME Exchange

A. Structure of the Exchange

1. Legal Structure

SME exchanges can typically be structured as (i) a separate board or market housed under the main market, (ii) part of the main board, and (iii) a completely separate exchange (see Table 4).

(i) Boards or Markets Housed under the Main Market: Most SME exchanges are seldom stand-alone. They are usually a separate board or market housed under the main market, mainly because SME exchanges (a) benefit from the reputation and experience of the main board, which reassures market issuers and investors, and (b) they are seldom viable financially and often need to be subsidized by the main market because of the need to keep costs low for issuers and intermediaries and their smaller issue sizes, fewer companies, and lower liquidity, which translates into low listing and trading fees. The prospect of graduating to the main market may also be a draw for some SMEs. To successfully develop SME exchanges, the main market needs to be willing to accept some risk that the lower quality of the SME exchange in terms of type of companies listed, liquidity, investor perception, and disclosure could potentially impair the credibility of the main market.

For example:

- NSE India describes Emerge as an SME platform. It is a separate board of the NSE. A major reason for choosing this structure was that the SME platform was not expected to be self-sustaining for the first few years of existence.
- Bovespa Mais is described as a separate segment, essentially a board under the main exchange, and is considered one of the special corporate governance segments of BM&FBOVESPA, together with Novo Mercado Level 1 and Level 2. Although Bovespa Mais currently enjoys benefits and exemptions from fees, in the long run, the exchange expects Bovespa Mais to be a self-contained line of business.

EU directives require that EU exchanges are classified as either (a) Regulated Markets, which have to adhere to stricter EU standards for listing and disclosure and are regulated by the national securities regulators, or (b) Alternative Trading Platforms (ATPs), which are considered separate markets operated by a Regulated Market operator and for which certain parts of the regulatory framework are less stringent. The operator is required to present the regulations for the ATP to the regulator for approval. ATPs are thus considered as markets regulated by the stock exchanges themselves (exchange-regulated markets) and are not overseen by capital markets regulators. ATPs offer more flexibility in listing and disclosure standards. To allow for less strict requirements for issuers, both AIM and NewConnect operate as an ATP. As such they are not obligated to comply with EU directives such as those regarding the issuing of a prospectus and can design regulatory frameworks that are less onerous for small issuers.

(ii) Part of the Main Board: The Australian Securities Exchange (ASX) does not have a separate SME board. It has rules that change, or “graduate,” depending on a company’s size. Of its 2,200 listed companies, 1,900 are SMEs. Companies with a size of less than \$300 million have more regulatory flexibility than those of more than \$300 million.

(iii) Stand-alone: GreTai Securities Market is one of the few SME exchanges that is completely stand-alone; it is not linked to the Taiwan Stock Exchange. This arose for historical reasons that may not be relevant to other exchanges. GreTai was launched in 1998 as an over-the-counter (OTC), not-for-profit market for nonlisted companies. As the exchange grew, the regulatory framework and trading system were developed. GreTai now has a listed board and recently developed an OTC Emerging Stock Board (ESB), which is a preparatory market where SMEs are required to list for at least six months before doing an IPO. GreTai EM has 253 companies with an average market size of \$82 million, compared with the average market size of \$180 million for GreTai’s listed board. This paper will refer to GreTai’s listed board when discussing the exchange.

Exchange	SME Exchange Structure	Regulator	Subsidized by the Main Board?
NSE India Emerge	Separate board	SEBI	Yes. Uses main board’s trading, clearing, settlement infrastructure, and related personnel.
JSE AltX	Separate board	JSE	Yes. Uses main board’s trading, clearing, settlement infrastructure, and related personnel.

Bovespa Mais	Separate board	CVM	Not directly. Some benefits and exemptions of fees are cross-subsidized by the stock exchange.
BIST ECM	Separate board	Capital Markets Board of Turkey and Borsa Istanbul	Yes. ECM utilizes trading, clearing, and settlement infrastructure of main board.
WSE NewConnect	Separate market organized and operated by the WSE as an ATP	WSE	No
GreTai	Separate exchange	Financial Supervisory Commission	No

Source: WBG compilation of exchange information.

Note: ATP = Alternative Trading Platform.

The legal structure of SME exchanges is often linked to factors outside the realm of market efficiency. Exchanges such as GreTai, Shenzhen Stock Exchange, and NASDAQ in the United States began life focused on SME listings or as alternative markets to other national blue chip segments. Such examples are mostly found in highly developed equity cultures that can support multiple listing venues. The legal structure of exchanges has significant strategic impact; for example, stand-alone exchanges are less likely to prioritize their largest listed companies “graduating” to a different marketplace or competitor.

2. Branding the Exchange

A key question in considering if and when to develop an SME exchange is which SMEs are appropriate for exchange funding and listing, and whether a particular subsector should be targeted. That is, should the exchange target:

- SMEs in general
- A certain type of company, and if so:
 1. Only high-growth SMEs
 2. Highly innovative companies such as technology, hardware, or product innovators
 3. Other

This decision is linked to how the exchange brands itself, that is, as an SME exchange, a growth market, or something else. The exchanges in the working group had mixed approaches.

A key starting point is that all SME exchanges should focus on growing companies. SMEs that are not growing will not need the capital an exchange can provide and may not be inclined to use the exchange for advertising either. They may resist sharing information with outsiders; the drive for funding will not be strong enough to overcome this reluctance. The focus should be on “gazelles” from the start. These should be companies that do not meet the requirements of the main market or board.

Several exchanges, such as GreTai Securities Exchange, are seen by the market as listing companies with high growth opportunities. This publicly accepted image is reflected in the price earnings ratios of the two national stock exchanges: GreTai with relatively more growth opportunities has 30 times price earnings, whereas Taiwan Stock Exchange, which has larger more mature companies, trades at a lower 18 times price earnings. JSE AltX brands itself as a growth market; however, it has listed companies that fall outside the medium-sized entrepreneurial companies. NSE India Emerge brands itself as an SME exchange; however, it has a sub-platform aimed at startups that is branded as a growth market.

Exchanges such as NewConnect and NSE India Emerge prefer particular types of gazelles, in this case highly innovative companies such as technology, hardware, or product innovators. These companies typically are comfortable with equity market valuations, and many have already been exposed to early-stage financiers such as PE and VC firms and thus have improved accounting and management structures that prepare them for an exchange listing.

There is clearly a strategic trade-off on how an SME market is branded. If the market favors listings from high-tech, high-growth companies, it may result in higher valuations for listed companies but at the expense of excluding other companies in need of financing. In addition, a market heavily weighted toward one sector of the economy or one type of investor will have difficulty surviving a downturn in its core market, as was the case for Neuer Markt in Frankfurt.

3. Graduating to the Main Board

Given that most exchange-listed SMEs will be growth companies, the question arises as to whether to allow and/or encourage companies to graduate to the main board if there is a legal distinction between the two markets, and what impact that will have on the SME exchange's sustainability. The decision is often tied to the SME exchange's profitability and subsidies from the main exchange.

Most exchanges encourage graduation, particularly where the larger exchange subsidizes the SME market, because the SME exchange is then seen as a feeder of pipeline companies for the main board:

- The JSE's AltX was created specifically to allow small companies to raise capital and act as an enabler for their growth, eventually resulting in their listing on the main board. AltX listing requirements state that when issuers reach the stage where they comply with the main board criteria, the JSE may transfer their listing to the main board. Since it started, AltX has seen 24 of the 106 companies that have listed graduate to the main board on a voluntary basis.
- Bovespa Mais companies enjoy benefits and exemptions from fees of the stock exchange because Bovespa Mais is subsidized by the stock exchange. In return, it is expected that its companies will migrate to the main market.
- NSE India Emerge has a simple process for migration to the main board: All companies with equity capital greater than \$160 million have the option to migrate to the main board with a simple process including a special resolution by a majority of nonpromoter shareholders, and a compulsory migration is required when a companies' equity capital surpasses \$400 million.

- TSXV companies voluntarily graduate to the main board. Although it is more expensive, the main board is viewed as having more cachet.

Graduation has pros and cons. On the plus side for the SME exchange, graduation frees up often limited institutional investor appetite for SMEs and allows successful companies to benefit from the main board's greater liquidity, investor pool, and credibility. Allowing graduation, however, implies by definition losing the more liquid and larger companies. Not all SME exchanges allow graduation. Companies that list on Chinext or the SME board of the Shenzhen Stock Exchange are not eligible to apply for a subsequent listing on the country's larger exchanges.

Table 5 shows graduation requirements that must be met, in addition to first meeting the main board's standard requirements.

Table 5. Graduation to the Main Board			
Exchange	Allow/Encourage Graduation?	Requirement	No. of Companies Graduated
NSE India Emerge	Yes	May graduate after a minimum of two years on the SME platform; migration policy is in place, specifying paid-up equity, profitability	None
JSE AltX	Yes	Meet the requirements of the main board	24
GreTai	Yes	Nothing additional	312 to Taiwan Stock Exchange.
Bovespa Mais	Yes	Must comply with main board rules (if Novo Mercado: 25% free float and 20% independent board members, among other rules)	None
WSE NewConnect	Yes	Capital requirement to be listed on main market is reduced for companies previously listed on NewConnect (€12million vs. €15 million)	26
BIST ECM	Yes	Must have more than 250 shareholders	1

Source: WBG compilation of exchange information.

A. Market Participants

1. Issuers and Issuance

What size company to allow on the SME exchange and whether to implement minimum size requirements are key considerations. The experience across emerging market exchanges varies considerably. Again, Table 1 notes how an SME is defined in different countries.

As shown in Table 6, a wide variety of company sizes are served by SME exchanges, from NewConnect's 68 percent of companies with a market capitalization below \$5 million to GreTai's 30 percent above \$100 million.

- WSE NewConnect has brought very small companies to market: 68 percent of companies on NewConnect have a market capitalization of less than \$5 million, and 30 percent are even smaller than \$1 million. As of March 2014, the average market capitalization of a company is \$8 million, and the average size of an initial offering is around \$1.1 million.
- GreTai has 663 companies listed, as of March 2014; the average market capitalization of companies is \$133 million. The average IPO size is \$14.60 million for 2011, 2012, and 2013. The average market size of a GreTai ESB company is smaller at \$82 million.
- Since 2011, Bovespa Mais has targeted a new generation of entrepreneurs with medium-sized companies (not only the traditional family owned) that wanted to go public but were too small to list and raise capital on Novo Mercado. These companies even considered listing outside of Brazil

Exchange	% below \$5 million	% between \$5 and \$20 million	% between \$20 and \$50 million	% between \$50 and \$100 million	% above \$100 million
NSE India Emerge	0%	0%	20%	80%	0%
JSE AltX	35%	40%	12%	8%	5%
GreTai	0.7%	9%	32%	27%	31%
Bovespa Mais	0%	50%	50% ⁷	0%	0%
WSE NewConnect	68%	23%	7%	1%	1%
BIST ECM	9%	55%	36%	0%	0%

Source: WBG compilation of exchange information.

Two questions frequently raised are whether to allow startups and micro-companies. It is generally accepted that micro-companies are not suitable for capital markets, because costs such as prospectuses, annual general meetings, and advisors are too expensive and the personnel requirements to meet ongoing listing requirements are not available. Often, however, policy makers push for them to be included, because they make up the bulk of SMEs.

Allowing startups requires a higher tolerance for failures and challenges to quality that may be damaging for the exchange's reputation, particularly in the early years, when a loss of investor trust in the market's integrity is extremely hard to mend.

- NewConnect allowed startups to list but then stopped after a number of startups failed or changed their business model after listing. It now has minimum size requirements of approximately \$160,000 in own equity and requires financial statements for one year prior to listing.

⁷ Only two companies have conducted an IPO and therefore have a market capitalization based on public prices. The other companies' shares are not traded on the market.

2. Investors

Two main questions are asked concerning investors: who should the investors be, and how should they be regulated and supported?

Investors in SME exchanges tend to be local, and mostly retail. Local because information about SMEs is typically more available to local than to foreign investors, and predominantly retail because, for many institutional investors, SME issues are too small and lack the liquidity, reputation, access to information, governance, and risk profile they need. At the same time, retail investors can be scared off by the potential risks of investing in SMEs. Moreover, the retail investor base in many EMCs is small, raising questions about the viability of the exchange. Several successful SME exchanges have a knowledgeable and active retail investor base. However, as with most marketplaces, a mix of retail and institutional investors is ideal.

The participating exchanges evidenced both these situations and related some experiences on how to address them.

- As noted in Table 7, 69 percent of NewConnect’s investors are individual, and 24 percent are institutional. The exchange was built mainly by retail investors. The dominance of retail investors is linked to several factors, most notably:
 - Retail investors are comfortable with a higher risk profile (Polish retail investors are the most active investors in the derivatives market, which indicates their high risk appetite).
 - They manage their risk by using a portfolio approach, investing in a number of SMEs with the expectation that some will fail but a small percentage will earn high returns.
 - They get support from the Association of Retail Investors, which supports listed SMEs and holds a twice yearly event for SMEs to meet retail investors. SMEs have a stand at no cost and a platform to market their company.
- TSXV and AIM are dominated by retail investors but have large institutional investor bases that they built over time through outreach and education, particularly educating institutional investors on the benefits of using a portfolio approach to investing in SMEs.
- AltX suffers from a lack of institutional investors, mostly because their investment mandates have size and liquidity restrictions, and AltX markets to retail investors. Lack of institutional investment together with the low savings and investment culture in South Africa are the key reasons why the AltX market is not growing.
- Like AltX, Bovespa Mais faces challenges developing a domestic investor base. It is working to increase the number of local investors, but this is a challenge for the main board as well. Seventy percent of investors in main board IPOs are foreign. They are looking for large opportunities and high liquidity—and do not want to invest in small IPOs.
- Foreign investors are interested in both exchanges in the Toronto Stock Exchange Group; however, this is less likely for EMC SME exchanges.

Exchanges that rely mainly on individual investors need to give particular consideration to protecting them. Some exchanges such as NSE India Emerge have restricted investing in SMEs to institutions and high-net-worth individuals who know how to evaluate risk. The Security and Exchange Board (SEBI) has set minimum investing and trading amounts at Re

100,000 and imposed minimum trading lots of that amount. However, this excludes India's large retail investor base from the SME market, reducing liquidity.

Table 7. Investor Types of SME Exchanges			
Exchange	Domestic Investors		Foreign Investors
	Retail	Institutional	
NSE India Emerge	90%	10%	0%
JSE AltX	—	—	—
GreTai	84%	10%	6%
Bovespa Mais	15%	55%	18%
WSE NewConnect	69%	24%	7%
BIST ECM	—	—	—

Source: WBG compilation of exchange information.

Note: — = not available.

C. Regulations, Fees, and Other Requirements

Given the small size of SME issues, a key challenge is to reduce the costs in time and money of issuance so it is economically viable and doable for the SME, but in ways that do not create prudential problems for the investors. Regulatory requirements cannot simply be shrunk with regard to the main board until they become attractive to the issuer.

Getting the right regulatory balance is at the heart of the challenge in developing an SME exchange. Workable structures are being employed in different exchanges that involve reducing fees and preparatory time without significantly reducing prudent elements such as the content and value of disclosure and transparency.

1. Workable Cost Structures

Time and money are key reasons why many SMEs hesitate to list on an exchange (see Table 8). Exchanges such as NewConnect and Bovespa Mais find that IPO costs of less than 5 percent are workable for most SMEs, but are still not feasible for very small companies. Bovespa MAIS and NewConnect estimate all-in IPO costs as 4.5 percent.

Many exchanges are lowering exchange and regulatory costs for issuers without significantly reducing the quality and quantity of information provided to investors, most notably:

i. Lowering or waiving fees for listing, custody, and market maker services:

- The Borsa Istanbul lowered listing, post trade, and custody fees to one-tenth of the normal market fee and gave a 50 percent discount on market makers fees for BIST ECM.

- NSE Emerge provides subsidies across the spectrum, including not charging listing or transaction fees. With such low fees and small number of companies listed, NSE Emerge needs to be subsidized by the main board during its startup phase.

ii. Reducing ongoing costs: These costs can be high, such as for information disclosure and investor relations. Disclosure costs and investor communications can be reduced by using the exchange to disseminate information and waiving requirements for printed documents.

iii. Reducing financial services fees: Although the SME exchange can lower some costs, advisor, legal, and brokerage fees can be high, and the exchange cannot often directly influence them. It can, together with the capital markets regulator and other capital market entities, help create a competitive environment for intermediaries and advisors by encouraging a number of these intermediaries to enter the market.

Table 8. Cost Structure of SME Exchanges	
Exchange	Cost Structure
NSE India Emerge	About 40% of main board costs.
JSE AltX	A separate fee structure exists for initial listing of securities and annual listing fees. For 2014, the cost of initial listing is capped at \$2,800, and annual listing fees are capped at \$3,000. Documentation fees remain the same as main board applicants.
GreTai	The cost of initial listing is a flat rate of \$16,667 (NT\$500,000). The after-listing annual fee is based on company capitalization.
Bovespa Mais	Exempts the company from a number of fees, such as register fee, offering liquidity fee, and gradual discount on annual fee until fourth year.
WSE NewConnect	Fees related to trading are based on flat rates and do not depend on company capitalization, at around \$1,000 a year.
BIST ECM	Exchange and depository fees reduced to 1/10th of the main market. Capital markets board fees reduced to 1/20th. Registration fee of 0.01% of offering value (0.2% for main market).

Source: WBG compilation of exchange information.

2. Reducing Regulations and Protecting Investors

A key challenge with SME markets is how to create a regulatory regime that SMEs can meet and that achieves the prudential needs of the investors as well. The regulatory requirements cover performance, disclosure, and governance requirements. These may be lowered, compared with the main market, to reduce costs to the issuer. SMEs can be more risky than larger companies, although they are also less complex; lowering regulatory requirements can reduce investor protection and investor confidence.

i. Easing Entry Requirements

To facilitate the listing of smaller companies that have been in existence for a short period of time with short profit histories, many SME exchanges relax entry requirements compared with the main board, as shown in Table 9. Requirements that can be lowered concern:

- Performance/earning and size (company size, minimum market capitalization)
- Number of shareholders
- Percentage of free float.

GreTai has reduced capitalization requirements, and WSE NewConnect reduced earnings and entry requirements compared with the main market.

Table 9. Entry and Prospectus Requirements		
Exchange	Minimum Entry Requirements versus Main Board	Prospectus Requirement
NSE India Emerge	<ul style="list-style-type: none"> • 3-year track record vs. 3 years of profitability • Minimum of 50 shareholders in the IPO vs. 1,000 for the main board 	<ul style="list-style-type: none"> • Same as main board
JSE AltX	<ul style="list-style-type: none"> • Share capital of >\$192,000 vs. \$240 million • No profit history required. The applicant issuer must produce a profit forecast for the remainder of the financial year during which it will list and for one full financial year thereafter, unless the applicant provides historical financial information for 3 years. • No pretax profit applicable vs. \$770,000 • Business model and plan in place, management team, and financial director • Shareholder spread of 10% vs. 20% • Number of public shareholders 100 vs. 300 • Free float 10% of each class of equity security • The directors of the issuer, as well as the Designated Advisor, must present, in person, a detailed business plan (including but not limited to historic and forecast financial information) to the AltX Advisory Committee before being granted a listing • Subsequently, the AltX Advisory Committee shall advise the JSE as to the eligibility of the issuer 	<ul style="list-style-type: none"> • Same as main market
GreTai	<ul style="list-style-type: none"> • Minimum \$1.64 million paid-in capital • Operating history of 2 full financial years • Profitability: for the last year, no accumulated losses, minimum net profit before tax of 4% of the capital, or for each of the last two years, minimum yearly net profit before tax 3% of the capital, or for the last two years, minimum average yearly net profit before tax 3% of the capital and the net profit of the last year higher than the previous year, and the last year's net profit must be more than \$0.13 million • Free-float shareholding (minimum 300 minority shareholders, with overall holding >20% of the total outstanding shares) • Must have been registered in the ESB for at least 6 months • For qualified "high-tech" and "innovative" companies, profitability and operating history requirements can be waived. Companies can apply for the "qualification certificates" with the relevant government agencies. 	<ul style="list-style-type: none"> • Identical to the main market
Bovespa Mais	<ul style="list-style-type: none"> • No minimum size requirement • No profit or operational history requirement • Start-ups to be approved by Securities Listing 	<ul style="list-style-type: none"> • IPO prospectus required

	Commission of BM&FBOVESPA <ul style="list-style-type: none"> • Free float of 25% in 7 years 	
WSE NewConnect	<ul style="list-style-type: none"> • Audited financial statement for last financial year required (since June 2013) • Minimum capital of issuer increased from Zl 100,000 to Zl 500,000 • A minimum of 15% of shares must be held by at least 10 shareholders, each of whom holds no more than 5% of the total number of votes 	<ul style="list-style-type: none"> • Same as main market • For offerings of <\$3.5 million an information memorandum may be considered as an admission document
BIST ECM	<ul style="list-style-type: none"> • No quantitative criteria such as profitability, company age, or capital size required • Year-end financial tables required 	<ul style="list-style-type: none"> • Same as main board for IPO • In private placements, prospectus and circular not required for private placement, instead a simplified Trading Information Form.

Source: WBG compilation of exchange information.

ii. Private Placement

Many exchanges allow or have plans to introduce the ability for SMEs to list through a private placement (termed “listing by introduction”) as well as public offering (see Table 10). This reduces requirements such as to produce a prospectus if the placement is made to a restricted number of investors. Private placement not only reduces costs by removing the more expensive and onerous public offer requirements, but also often reduces the time it takes to come to market.

As is common with private placements, given the reduced information requirements, shareholders are restricted by type, for instance, to high-net-worth individuals or institutional investors who are assumed to be better able to evaluate risk, and/or by imposing a maximum number of shareholders.

- WSE NewConnect limits the number of investors in a private placement to 149, although the actual number is usually closer to 10 to 20 investors. Most NewConnect listings (70%) were issued through a private placement, attesting to its more attractive structure.
- NSE Emerge and JSE’s AltX also have a private placement mechanism. Bovespa Mais is likely to introduce one in late 2014.

It is important to note that once listed by private placement, SMEs have to comply with the ongoing disclosure and governance requirements of the SME exchange, because once their shares are traded on the secondary market they are open to all investors. In some cases, shares bought in a private placement cannot be sold during a lock-up period that allows the company time to meet the disclosure requirements of the exchange.

Experiences with private placement have not been hassle free. NewConnect faced an unanticipated problem regarding minority investor rights as companies decided not to list after organizing a private placement in which investors were locked in and had no market through which to exit. Polish investors approached the exchange for recourse, but the exchange was unable to intervene because the listing had not occurred.

Table 10. Do SME Exchanges Allow Private Placements?	
Exchange	Private Placement
NSE India Emerge	Yes
JSE AltX	Yes, without any restriction except in the Companies Act. Requirements: 50% of the shareholding of each director and the Designated Adviser held in trust from the date of listing until the date the financial results are released; 50% of the shareholding in trust released in the first year thereafter and the remainder after that.
GreTai	Yes. Shareholder restriction: 35 shareholders maximum and 3 years lock-up period.
Bovespa Mais	No. CVM likely to introduce a restricted offering, (set number, qualified investors, lower disclosure requirements) in late 2014.
WSE NewConnect	Yes. Maximum of 149 shareholders. Informational document approved by an Authorized Adviser and information memorandum replaces prospectus.
BIST ECM	Yes. Maximum of 100 shareholders. No obligation to issue prospectus and circular, instead trading information form. Only new shares allowed for private placement, and sales by a shareholder after listing are not allowed.

Source: WBG compilation of exchange information.

iii. Reducing Disclosure Requirements

It is typically thought that to achieve an attractive cost structure for issuers and facilitate issuance, disclosure content for SMEs needs to be significantly reduced relative to the main board requirements. On the contrary, most SME exchanges do not reduce these requirements because of the inherently riskier nature of investing in SMEs. Investors need adequate and clear information. In fact, some SME boards, such as ChiNext, have higher disclosure requirements than the main board (see Table 11).

Although content disclosure is not often reduced, other disclosure requirements can be amended to lower costs in time and money. Examples found in many SME exchanges are the following:

- *Allowing longer time to prepare reports:* In addition to making the preparation less intense, this can reduce costs because it moves financial report verification out of high peak periods for auditors and accountants. Brazil plans to give SMEs more time to prepare reports, 60 days for SMEs compared with 45 days for main board companies. TSXV allows 15 days longer for quarterly reports and an extra 30 days for the production of annual reports.
- *Reducing the frequency of reporting:* NSE Emerge requires half-year reporting for SMEs compared with quarterly for the main market; NewConnect is semiannual compared with the main board's quarterly requirement. To compensate for reduced reporting, listed companies should be encouraged to increase their communication with investors.
- *Requiring only online reporting through exchange websites,* and remove requirements to print reports. Websites can also be used to reduce the cost of investor relations and communications more generally.

Table 11. Reduced Disclosure Requirements			
Exchange	Content Requirements	Frequency of Reporting	Form of Publication
NSE India Emerge	Similar to main board	Half yearly vs. quarterly	
JSE AltX	Similar to main board	Same as main board, biannually	Announcements must be published on SENS, the issuer's website (where one exists) and on the AltX website. This is only a minimum, and the JSE encourages voluntary publication in the press.
GreTai	Same as main board	Same as main board	In both paper and electronic form
Bovespa Mais	Same as main board	Same as main board	Exemption from publishing in printed newspaper for companies with market cap <R\$700 million (approximately \$350 million)
WSE NewConnect	Similar though smaller range of information required	Semiannual vs. quarterly Longer period to prepare information	In electronic files through stock exchange Electronic Information Base system
BIST ECM	Semiannual financial statements do not need to be independently audited	Semiannual vs. quarterly	In electronic files through Public Disclosure Platform

Source: WBG compilation of exchange information.

iv. Governance Requirements

Governance requirements for SME exchanges are often reduced compared with the main board. For example (see Table 12), JSE AltX companies are not required to comply with all aspects of the King Code of Corporate Governance, Bovespa Mais has reduced board requirements, and AIM has no formal corporate governance requirements. Others, such as TSXV and NSE Emerge, where issuer governance requirements are strong, do not reduce their standards compared to the main board.

An important question is what elements of corporate governance are investors willing and not willing to forfeit for SMEs? Lowering requirements, such as removing the need for an audit committee or the number of independent directors, might not substantially harm investors in SME equity, but other reductions, for instance, related to mandatory tender offers or the need to notify about substantial and insider holdings on related party transactions, may affect the value of a company and minority shareholder rights.

Table 12. Governance Requirements	
Exchange	Governance
NSE India Emerge	Similar to main board
JSE AltX	Similar to main board except: <ul style="list-style-type: none"> • Need at least 3 (or 25%) nonexecutive directors • Not required to have separate CEO and chairman • Must appoint audit committee and invite DA to attend committee meetings as an observer

GreTai	Self-assessment and/or external assessment of corporate governance required: <ul style="list-style-type: none"> • Remuneration committee is mandatory for all listed companies • Independent directors will be mandatory for all listed companies by 2017 • Audit committee will be mandatory for listed companies with paid-in capital greater than NT\$10 billion by 2017
Bovespa Mais	Board of directors of at least 3 members; independent members is not obligatory; tag along of 100%, (1) in case of delisting or share acquisition public offer (OPA), 100% of economic value, (2) in case of selling the block of control, same price practiced for majority shareholder
WSE NewConnect	Requirement to publish a descriptive report on compliance with the corporate governance rules with the annual report and ongoing reports on violation of the corporate governance rules
BIST ECM	Exemption from corporate governance obligations

Source: WBG compilation of exchange information.

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

1. Advisor Requirements

Even if disclosure content is not significantly reduced, as is true for most SME exchanges, there are still many challenges to investing in SMEs, because of their often riskier nature, less extensive corporate experience, and typically larger information asymmetry between issuers and investors. Bridging this information gap is critical for an SME exchange's success. Building the exchange so that issuers find their footing, while providing adequate information and protection to investors, is key.

Using nominated or authorized advisors is an important way to help bridge these information gaps. These are institutions that are regulated by the SME exchange and serve two main roles, both of which help investors decide whether a company is a good one in which to invest. The advisors:

- Assist companies in the various steps to an offering and oversee that the SME complies with ongoing listing requirements after the listing. Advisors assist SMEs, many of which are unprepared, to meet listing, disclosure, and governance requirements. They help prepare and approve the information documents.
- Assist investors by providing a stamp of approval for an SME's suitability to access the market. Advisors need to support successful companies to preserve their reputations and livelihood. Their support for a company is an indicator to investors that a company is a good investment.

AIM and NewConnect use their advisors most effectively and extensively:

- AIM was the first exchange to use Nominated Advisors, or Nomads. Nomads are highly selective in whom they bring to market since their accountability for ensuring compliance continues long after the IPO, and their reputation hinges on this.
- NewConnect's use of Authorized Advisors (AAs) has helped bring companies to market. The advisors are regulated and have to have successful listings. If they support too many SMEs that are not successful, they will lose their license.

Several elements are needed for these advisors to create confidence among investors in the companies they support and for their support to be well placed. Most critically:

- The individual advisor, and the advisory company, is licensed and regulated by the exchange and/or capital markets regulator. Certification and criteria for admission are key to market credibility and investor confidence.
- The advisor's reputation is based on how often it supports successful companies and, conversely, unsuccessful ones.
- The regulator needs to be willing and able to use enforcement actions when the advisor does not do its job well, including revoking the advisor's license.

Both AIM and NewConnect had problems with advisors bringing poor quality companies to market. There were a number of bankruptcies and failures. In the interest of market quality and safety, NewConnect tightened its disclosure obligations and requirements for AAs. NewConnect's approach to licensing and regulating its AAs is a key reason for its success at creating an active and quality marketplace for a large number of SMEs, including many small ones (see box 1). The JSE AltX has similar requirements and will disqualify a Designated Advisor (DA) for poor performance. GreTai advisors are licensed by the Financial Supervisory Commission and are assessed on an ongoing basis by GreTai.

The advisor model is by no means universal. Bovespa Mais has no advisor model because its target companies are medium-sized enterprises that are able to fulfil requirements. Bovespa Mais felt the advisor model would add too much to the costs for these companies. They will consider introducing advisors for smaller companies.

Some exchanges do not like the advisory model because it implies reducing the exchange's responsibility to vet companies that come to market: the advisor assesses a company's readiness and suitability to list. Once the exchange steps in and certifies the advisor's selection, the exchange takes on the role, and reputational risk of the stamp of approval.

This is the case for TSXV, which does not have an advisor model because it believes that the exchange should do the final vetting of an SME's suitability to list. TSXV wants to have the final say in quality control over what is listed, particularly for early-stage companies. TSXV has a sponsorship model and provides intermediaries with standards for due diligence for bringing a company to market. The exchange puts a lot of weight on the sponsor's opinion but does their own vetting. This practice is in response to quality and reputational issues that arose in the 1990s that put the viability of the junior market in Canada at stake.

NewConnect on the whole has had a positive experience with its AAs, who have played a large role in the exchange's success. Their approach to regulating AAs is illustrative of ways to do this successfully:

- License the AAs
- Assess them annually, and receive an annual report of their activities.
- Require the AAs to demonstrate that:
 1. The companies they support have complied with various requirements, such as disclosing information, capital raising, dispersion of investors, average cost of issue, cooperation with the exchange, and information on the appropriate webpages.

2. They help develop the market. NewConnect assesses AAs on their contribution to developing the market, for example, through promotion and education events.
- Require them to accompany the SME for three years after listing.
 - AAs face fines, sanctions, and removal from the register of AAs if they breach rules and regulations. If AAs fall into the bottom 30 percent of firms according to their annual assessment, NewConnect removes them from the list of AAs.

It is important to create clear regulation against conflict of interest between advisors and the SMEs they bring to market. Advisors are being paid by the company and at the same time are responsible for assessing their readiness for market and ongoing disclosure. Therefore, advisors should not be appointed to any company they are connected with and should not be allowed to cooperate with the issuer. JSE AltX companies have to appoint a DA. Advisors can be paid in shares of the company as fees; however, at no time may the DA's holding exceed 20 percent of the total issued securities of the class of shares concerned. On GreTai, advisors can hold up to 3 percent of the shares of a company they introduce, which allows them to have a financial interest that is tied to the company they recommend.

Box 1. What Makes WSE NewConnect Successful?

The Warsaw Stock Exchange, the biggest in Central and Eastern Europe, operates NewConnect (NC), an EU Alternative Trading Platform. NC opened on August 30, 2007, just before the global economic crisis.

NC has listed a total of 508 companies since its launch, raising more than \$1.2 billion in capital, including secondary offerings. As of March 2014, the exchange has 442 companies listed with market capitalization of \$3.5 billion, which makes it Europe's second largest SME exchange in terms of number of listed companies, following the United Kingdom's AIM.

Key elements for its success include the following:

- 1) *Good timing*: External conditions supported the setup of NC as bank deleveraging during the global economic crisis reduced financing to SMEs, who then went to NC.
- 2) *Dynamic SME base*: Although a young economy, Poland has a dynamic private sector with 4 million regulated companies, of which 1.8 million are active. More than 99 percent of Poland's companies are SMEs. In 2009 a Czech company was the first foreign debut. Eleven foreign companies are now listed.
- 3) *Strong retail investor base*: A large number of knowledgeable retail investors comfortable with risk taking, who were already active traders in the derivative and foreign exchange markets.
- 4) *Receptive policies and flexible and less onerous regulation*:
 - i) Reduced entry requirements, lower cost than main market
 - ii) Reduced ongoing reporting frequency and more time to deliver information
 - iii) Private placement mechanism, used by the vast majority of issuers
- 5) *Well-regulated Authorized Advisors*: To support companies through the listing process and vet the company for investors. AAs can lose their licenses if they support too many unsuccessful companies.
- 6) *Willingness to address problems*: 2011 saw a record 172 offerings on NC. However, they included some companies of lower quality. Growing reputational problems (accusations of insider trading, bankruptcies) saw trading volumes and offerings fall during 2012 and 2013. In 2013 the WSE announced higher requirements for companies and AAs from June 1, 2013, in

the interest of market quality and safety. This was to make the market more attractive for investors and shift the focus from quantity to quality.

2. Who Can Be an Advisor?

The types of companies that can be advisors is large and varied, including financial advisors, brokers, legal firms, merchant banks, and consulting firms (see Table 13). The choice is often determined by, first, which institutions can provide the needed services, and then which of those institutions the exchange has regulatory authority over. For example, banks are typically regulated by the banking supervisory authority and thus cannot be sanctioned by the exchange.

Being an advisor to SMEs has become an important business line for these firms:

- NewConnect has approved about 70 AAs, mainly financial advisory companies, some legal firms, and a few brokers. Advisors run the gamut from large bulge bracket firms to niche players that developed in response to the market.
- In South Africa, DAs are a combination of large and small boutique corporate finance firms or investment banks. DAs are regulated by the JSE.
- In Istanbul, BIST Nomads are licensed by the exchange and are intermediaries. The Capital Markets Board wanted full supervision over the advisors, including the ability to end their license and take them to court in case of a breach. This approach excluded a number of very experienced people and financial institutions from the market. Instead, BIST selected the advisors and invited them into the market. Twenty-five to 30 companies now play the role.

Table 13. Advisor Models of SME Exchanges

Exchange	Advisor Model	Certification	Ongoing Assessment	Penalties and Sanctions	Duration of Appointment
NSE India Emerge	Not officially but several merchant banks play a similar role	—	—	—	—
JSE AltX	Yes	Yes	The JSE arranges courses relating to the listings requirements, and all Approved Executives (individuals within the DA firms) must attend these to remain registered	Yes	Throughout the listing life on the SME board

GreTai	Yes	Licensed by the Financial Supervisory Commission	Yes, conducted by the exchange	Exchanges may reject IPO applications associated with punished Advisor for a certain period of time	For at least 6 months
Bovespa Mais	No	—	—	—	—
WSE NewConnect	Yes	Yes. Authorized by the WSE	Yes	Yes	At least 3 years after the listing date
BIST ECM	Yes	Yes. Licensed by the Capital Markets Board and authorized by BIST	Yes	Yes	Throughout the listing life on the SME board

Source: WBG compilation of exchange information.

Note: — = not available.

E. Improving Trading and Liquidity

1. The Need for Specialized Secondary Market Intermediaries

Larger intermediaries often do not find it economically viable to be active in the SME market. Bulge bracket firms typically do not want to work with companies with less than \$50 million market capitalization because they are less financially viable for them as the time and effort going into an SME listing is the same as for that of a large firm, and commissions are typically charged as a percentage of offer size.

As a result, SME exchanges need to encourage a layer of small, specialized intermediaries to support SME equity issues. In some SME markets such as Poland, a group of specialized intermediaries, usually brokers or small investment banks, have arisen to fill this niche. These specialized intermediaries are often less expensive than the bulge bracket firms.

Thus the ability of intermediaries to be profitable from the SME exchange is key because there is little trading and liquidity. Many small-scale intermediaries lack the experience to originate companies. It is often useful to pair them with investment banks that have origination capabilities but that do not have a distribution network to exchange investors. A multibroker system, whereby specialist intermediaries can syndicate capital raising in a more efficient way, can be considered. A final consideration is to look for ways in which the exchange can extend the time whereby specialist intermediaries are with companies as the company and market capitalization grow. Specialized brokers tend to lose SMEs to bulge bracket firms as they grow.

2. Improving Secondary Market Liquidity

Secondary market liquidity remains an unsolved challenge for most SME exchanges in EMCs, and this affects investor appetite for SME paper. The small size of the issues will always constrain liquidity, as will smaller shareholder numbers, lower dispersion of investors, and lack of research and information. In most cases, SME equity will not trade like equities of larger companies.

The question is how much liquidity is actually needed. Although difficult to exactly quantify, *investors* require enough liquidity to feel reasonably assured that they can exit from an SME investment should the need arise. AltX's lack of liquidity is a significant concern for investors. The limited ability to sell shares when required and the limited free float makes it difficult for investors to take significant stakes. The AltX market has a liquidity ratio of 13 percent compared with 39.2 percent on its main board.

Many *issuers* are not concerned about the lack of liquidity of their shares, once they have raised capital. It is in the exchanges' interest to educate issuers about the importance of liquidity if a company is to do a secondary offering, and liquidity is needed if a company is to graduate to a main board.

The SME exchange might also require participation by a diverse set of investors to encourage liquidity, which may require listing rules focused on dispersion, for example, a minimum number of shareholders. NewConnect's requirement for distribution of investors is that 15 percent is held by minority shareholders. This can help, but here too the small issue size commonly seen in SME markets will be a constraint.

Exchanges are trying various other approaches to increase liquidity, from auctions to market makers. A number of exchanges, including Bovespa Mais and NSE Emerge, tried to introduce *auctions* for stocks; however, the experience was not good. Problems arose in Brazil, where brokers did not commit to the auctions, believing they were for failed companies. The approach ended up reducing, instead of increasing, liquidity. NSE Emerge tried a call auction for their first SME listing but reverted back to continuous trading, also because companies saw the auction as a stigma, indicating a poor stock.

Many exchanges encourage *market making* for SME listings to encourage liquidity (see Table 14). For example:

- BIST, NewConnect, and Bovespa Mais offer subsidies to market makers to participate in smaller, less liquid stocks, for example, reduced trading fees for market makers. In return there is often a minimum requirement. Bovespa Mais exempts trading fees for market makers but requires minimum size and spread requirements.
- NSE Emerge has requirements for market makers of minimum depth and within stipulated bid offer spreads.

Some exchanges require companies to have a contract with a market maker:

- NewConnect requires the issuer to have a contract with a market maker when they list.
- NSE India requires a market maker for an SME for three years after listing. All members of the exchange are eligible to act as a market maker for SMEs provided they meet exchange criteria and are registered.

Unlike the case on many main boards, short selling is typically not allowed on SME exchanges and would be difficult given the small size and often illiquidity of the float. Market makers are required to subscribe to an offering and hold shares to facilitate market making. This may lead to conflicts of interest because market makers have a financial stake in the SMEs.

Table 14. Market Maker Models and Other Incentives of SME Exchanges	
Exchange	Market Maker Requirement
NSE India Emerge	Yes, for 3 years after listing
JSE AltX	No
GreTai	No for GreTai main board. Yes for the OTC GreTai Emerging Stock Board.
Bovespa Mais	Not required. The company hires a market maker, who is on the list of BM&F BOVESPA accredited market makers, and the exchange validates the conditions of the contract in terms of spread and minimum volume. Approved market makers have a trading fee exemption.
WSE NewConnect	Yes, market maker is mandatory (after 2 years of company debut WSE checks liquidity parameters periodically and decides if the company could be listed without market maker)
BIST ECM	Not mandatory

Source: WBG compilation of exchange information.

3. Encouraging Research

Very little research analyst coverage is available for listed SMEs, because analysts typically do not find it commercially viable to cover small companies, because of both size and the difficulty of getting information. Lack of research and knowledge has a negative impact on investors and means that small stocks are not exposed to institutional investors by research houses once they are listed. This reduces liquidity.

As a result, some SME exchanges take steps to encourage research, including *paying for research for a period of time, including paying analyst fees* (see Table 15). NSE pays for research on all SMEs for a two-year period, and analysts are paid to do multiple companies at one time, with a cost of around \$1,000 per company. Bovespa Mais subsidizes research for its companies for two years, and the cost is \$15,000 for two reports a year. JSE AltX pays for two or three reports per year. To help both the exchange and companies, a broker or analyst association often assigns an analyst to the company.

Table 15. Paying for Research	
Exchange	Subsidize Research?
NSE India Emerge	Exchange has a third-party research organization provide research on companies listed on SME platform. Exchange bears the cost.
JSE AltX	Yes, 2 or 3 reports each year
GreTai	No
Bovespa Mais	Yes, two reports each year, by two different firms during the first two years after the IPO
WSE NewConnect	—
BIST	No

Source: WBG compilation of exchange information.

Note: — = not available.

Box 2. The Case of Bovespa Mais

BM&FBOVESPA launched Bovespa Mais in 2005. Nine companies are listed, and only two issued IPOs. Some problems are the following:

- Bovespa Mais applied the rules of the main board to the SME segment, although companies had up to seven years to comply with the financial rules.
- Bovespa Mais does not have an advisor model.

Brazil has a large number of medium-sized companies with clear financing needs that wanted to go public but were considered too small to list and raise capital on the main exchange. In 2011 Bovespa Mais was reorganized to target these companies.

The key issue for Bovespa Mais is investor demand, and it has faced challenges in developing a domestic investor base for SME markets. It is working to increase the number of local investors on the main board as well. Retail investors reduced their participation in the stock markets during the 2008–2009 financial crisis. Domestic institutional investors are traditionally buyers of government bonds; however, as interest rates are falling, they are now looking at different asset classes including SMEs. Seventy percent of investors in main board IPOs are foreign and want large opportunities and high liquidity.

In 2012, BM&FBOVESPA visited seven countries (Australia, Canada, China, Poland, Republic of Korea, Spain, and the United Kingdom) to learn from their experiences of building SME exchanges. Based on the findings, in 2013 Bovespa Mais undertook a review of its regulations and operations, which came into effect in 2014.

This was driven by and supported by a group of regulatory bodies including BM&F BOVESPA, the CVM, the Securities and Exchange Commission, the National Development Bank of Brazil (the main source of capital for SMEs), the Federal Innovation Agency (which funds companies with investment in innovation), and the Brazilian Industrial Development Agency.

In July 2014, a tax exemption until 2023 for investors acquiring stocks of SMEs directly or through funds investing a minimum of 67 percent in SMEs was published, completing a set of measures that also included creating a closed-end fund dedicated to SMEs, expanding the limits for PE funds to invest in listed companies, eliminating the obligation for companies to publish in newspapers and offerings publications, a restricted offering to qualified investors, and a simplified prospectus.

F. Providing Other Incentives to List and Invest

Given the importance of SME financing, some governments and exchanges offer incentives to encourage the development of SME exchanges by improving the attractiveness for issuers and investors.

1. Government Support and Incentives

Governments can offer various types of incentives and support, including tax incentives for issuers and investors, investing directly in the SME market, and providing grants for issuers to cover listing costs, which they do to varying degrees in SME exchanges.

Tax incentives: Very few jurisdictions offer tax incentives to issuers. Some offer tax incentives for retail and institutional investors, although often not specifically for listed SME investments.

AIM benefits from a package of government incentives for retail and institutional investors in early-stage financing that includes SME offerings, for example:

- The *UK Enterprise Investment Scheme*—Offers tax relief to individual investors in SMEs. It is designed to help smaller companies raise finance by offering an offset against an individual's income tax liability up to 30 percent of the cost of new shares in an SME.
- The *UK Venture Capital Trust (VCT) Structure*—Offers investors income and capital gains tax relief. VCTs are tax efficient publicly traded private equity companies listed on the London Stock Exchange, whereby the fund managers apply for the tax concession on behalf of investors.
- Receive favorable tax status for AIM shares in individual savings accounts (ISA).
- Have AIM shares classified as business property, so they are exempt from inheritance tax if held for a two year period.
- From 2015, stamp duties on the trading of AIM shares will be abolished.

Grants: For SME issuers, nontax incentives such as grants are often provided to pay a portion of IPO costs. These are successful because many companies express concern about having to spend on fixed costs such as a prospectus, and then not having a successful IPO. For example:

- Borsa Istanbul with the government provides grants of \$50,000 to \$70,000 for initial spending by SMEs on IPO costs.
- The Polish Agency for Industrial Development provides grants that cover 50 percent of listing costs on NewConnect, which is used by many companies.

2. Participating as a PE Investor in SMEs

Government can also support SMEs by participating as a PE investor in SMEs, through development finance institutions or government-funded PE funds, providing support to issuers, adding liquidity for other investors, and exiting through an SME exchange. They can also invest directly through an SME exchange (see Table 16).

In Brazil:

- The Development Bank of Brazil (BNDES) invests directly in small companies and exits through the capital markets.
- BNDES is proposing to be able to invest in listed SMEs directly, asking companies to list on Bovespa Mais, even as a private placement. This would reduce their cost of supervision and improve governance and transparency because companies would need to adhere to the market's standards. BNDES also announced a program to participate as anchor investor for IPOs in Bovespa Mais.
- Brazil is also looking to establish a new type of closed-end fund that specializes and invests in small companies through public or private investments and can act as an anchor investor in IPOs.

GreTai has a large domestic retail investor base and therefore does not require investor incentives. They have had an innovative program for primary market issues since 2009, which has proven successful. Companies in the technology innovation, agriculture innovation, and culture creativity sectors that cannot fulfil the listing requirements of minimum setup years and two-year profitability requirement can apply to the Ministry of Economy, Ministry of Agriculture, or Ministry of Culture to receive a letter of approval. The letter will recognize the product or technology as marketable with potential for growth and allows GreTai to waive the two criteria. This has to date allowed around 30 smaller or startup companies to apply for IPOs, none of which have failed (although some have been bought out or delisted).

Table 16. Government Incentives and Support		
Exchange	Issuer Incentives	Investor Incentives
NSE India Emerge	None	No or very small capital gains tax if traded on exchange platform and upon paying Securities Transaction Tax
JSE AltX	None	None; however, a number of programs (including tax incentive) encourage investment in SMEs more generally
GreTai	None	None
Bovespa Mais	None	Individual investors are exempt from capital gains tax investing directly or through funds dedicated to SMEs (with minimum revenue, size, and corporate governance requirements) for a minimum 67% exposure
WSE NewConnect	50% of listing costs by Polish Agency for Industrial Development	No stamp duty for exchange trades
BIST ECM	“Emerging Companies Market SME Support Program” formed by the “Small and Medium	None

	Sized Enterprises Development Organization” (KOSGEB-governmental institution) with nonrefundable support for SMEs up to \$50,000 to pay for listing costs.	
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Source: WBG compilation of exchange information.

3. Exchange Incentives and Support—Outreach and Training

As noted earlier, many SMEs in EMCs do not want to list, because they do not understand the benefits, do not want to share information or ownership, and find listing to be expensive and complicated.

i. Outreach

The exchange has a role to play in educating companies about the benefits of going to the market compared with other sources of finance, and in which circumstance an equity market listing is the preferred route for an entrepreneur. For many exchanges, outreach is a daily activity.

- China’s Shenzhen Stock Exchange did outreach to more than 5,000 potential companies.
- NSE Emerge offers the NSE Capital Market Awareness Program for SME promoters to make them aware of the capital market for capital raising.

Outreach is often in partnership with intermediaries, auditors, and commerce and industry associations. In some cases, the exchange has involved nongovernmental organizations and government to support the outreach efforts. An exchange may need to create a national campaign to bring the full range of supporters around the topic. For example, Borsa Istanbul’s “National IPO Campaign” partnered with Chamber of Commerce offices in cities around Turkey. BIST trained the liaison officers in each city.

Investor information days are useful to promote the exchange and showcase listed companies, providing investors with an efficient opportunity to meet several companies in one day. They are instructive for SMEs, who learn what investors are looking for.

ii. Training

Exchanges often offer special training programs to educate SMEs on the benefits of listing. Pre listing training covers corporate governance, information disclosure, and capacity building, and includes support for preparing offering documents and advice on valuation, pricing, and how to attract investors. Post listing extends to managing investor relations, exchange compliance, and ongoing investors’ coverage and visibility. For example:

- AltX offers mandatory Directors Induction Courses. The JSE has duplicated the NASDAQ Issuer Services Model, bringing together education and training to executives of listed companies, investor relations, and public relations executives. Training includes listing requirements, targeting investors, investor relations, and financial media management. Services also includes providing venues for financial results announcements, Annual General Meetings, or any other activity companies may wish to host. The JSE also has a media center that houses Bloomberg (yet to go live), CNBC Africa, SABC, and a radio station (Power FM). The JSE has a customer relationship management team, with one person focusing on AltX companies. This function is outside

of the DA and has the objective to engage with companies and pick up early warning signs of potential problems.

- NSE Emerge has a voluntary Capital Markets Certification Program to ensure that Compliance Officers and/or CFOs of the SME exchange understand the pre- and postregulatory processes.

Exchanges can also provide courses and seminars to educate investors in investing on the SME exchange.

Table 17 shows various exchanges' activities in the areas of outreach and training.

Table 17. Outreach and Training		
Exchange	Outreach	Training
NSE India Emerge	<ul style="list-style-type: none"> • Awareness programs/marketing effort to popularize SME platform to all stakeholders • Roadshows to investors 	<ul style="list-style-type: none"> • Handholding through the entire process of listing • Marketing and PR support
JSE AltX	<ul style="list-style-type: none"> • Dedicated business development team focusing on attracting listings in South Africa and Africa • Showcasing listed companies to potential investors 	<ul style="list-style-type: none"> • Directors Induction Program in partnership with Institute of Directors South Africa • Regular current issue seminars
GreTai	<ul style="list-style-type: none"> • "Corporate Day," periodically initiated and organized by the exchange 	<ul style="list-style-type: none"> • Corporate governance, investor relations, regulation compliance • Seminars on IFRS adoption for companies and investors
Bovespa Mais	<ul style="list-style-type: none"> • Outreach programs with market agents, industry, and business associations to approach companies countrywide, and investors 	<ul style="list-style-type: none"> • Training programs, on the IPO process, culture of a public company, and investor relations programs. • Programs to introduce executives and entrepreneurs to service providers (investment banking, auditors, lawyers, advisors).
NewConnect	<ul style="list-style-type: none"> • Marketing and special programs dedicated to shareholders and financial community 	<ul style="list-style-type: none"> • Corporate governance, investor relations, conferences and meetings organized by WSE
BIST ECM	—	—

Source: WBG compilation of exchange information.

Note: — = not available.

4. Creating a National Campaign: Combining Government and Exchange Efforts

Developing a national campaign can enhance public awareness about the importance of SME finance to the national economic development plan and how the SME exchange can help provide that finance. Government and exchange efforts can then be combined to support the SME exchange in playing this role. For example:

- The Warsaw Stock Exchange convened a group that included the Ministry of Finance to build consensus around the market development, align goals, and connect the SME exchange to the government's economic plan when developing its WSE NewConnect SME market.
- In Brazil, a group of regulatory bodies concerned with economic growth, which included BM&FBOVESPA, the CVM (the Securities and Exchange Commission of Brazil), the National Development Bank of Brazil (the main source of capital for SMEs), the Federal Innovation Agency (which funds companies with investment in innovation), and the Brazilian Industrial Development Agency, created a common agenda and concern around the issue of SME financing and in 2013 launched measures to improve SME access to the market. Most measures were implemented by mid-2014.
- In setting up the SME exchange in Turkey, the Istanbul Stock Exchange approached the Ministry of Industry and nongovernmental organizations to gain support for developing the SME Exchange and secured financial support from the SME development agency and grants from international organizations as a result.

V. Conclusion

Developing an EMC SME exchange is clearly a challenge, given the small size of the issues and issuers and the often underdeveloped nature of local equity markets more generally. Before working to develop an SME exchange, countries need to determine if they have the appropriate and supportive context, most critically a supply of growing SMEs that are willing to use public equity markets to raise financing, interested investors, and a supportive macropolitical, legal, and regulatory environment. Government commitment is also key, because government efforts can affect the SME exchange's ultimate success. As is true with developing any marketplace, technical challenges are significantly easier to address than structural ones such as the corporate culture, size of the local investor base, and macroeconomic and political environment.

This paper assumes that the broader context is on the whole conducive to developing the SME exchange. It focuses on and takes stock of the types of actions exchanges can take to make the requirements for listing and trading on the exchange doable by SMEs.

The goal is to provide a document that helps stock exchanges think through the key questions that need to be addressed to determine if, when, how, and for whom to develop an SME exchange. The paper does not address two important areas:

- It does not address the broader issues that need to be considered when building any marketplace, such as whether there are sufficient SMEs, investors, and a supportive legal,

regulatory, institutional capacity, and political-economic context. It focuses primarily on technical steps that exchanges might adopt related to exchange operations. Before applying these actions, an intensive diagnostic would be needed to assess whether the broader context is conducive. Taking the measures discussed in this paper alone will not spark a successful SME exchange.

- It does not propose a specific model to follow. Each exchange would need to consider how to apply and combine the elements noted.

Although a specific model is not proposed, there are approaches that this analysis suggests are widespread and/or could be beneficial to consider (see Figure 1). Most exchanges:

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

Developing an SME exchange is a complex topic and raises many critical questions, many of which are not addressed here. This paper is the first in a series on developing SME exchanges. Subsequent papers will address and expand on related issues, including the following:

- The preconditions for developing an SME exchange.
- Whether SME exchanges can be sustainable in small market countries.
- Partly related to that, whether an SME exchange can be created if a main board does not exist and, whether the SME exchange then becomes the main board. If so, is another entity needed to subsidize the exchange, such as the government, and will it?
- The performance of the larger SME exchanges such as AIM and TSXV during times of crisis and how might smaller SME markets perform in a challenging environment.
- What elements of corporate governance do investors want to see for SMEs? As smaller firms, SMEs may not need as extensive corporate governance as larger firms, but what corporate governance elements are investors willing and not willing to give up?