

# Small and Medium-Sized Enterprises and SME Exchanges

A joint report of the World Federation of Exchanges and the Milken Institute





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## Introduction

Small- and medium-sized enterprises (SMEs) play a vital role in generating economic growth in the world's economies. In developing countries, SMEs play a significant part in creating jobs, building thriving private sectors, and diversifying economies. Based on enterprise survey data collected from 99 developing economies for the 2006-10 period, a World Bank study found that SMEs with 250 employees or fewer accounted for 86% of the jobs in the median country in the study.<sup>1</sup>

Despite their economic importance, however, SMEs struggle with access to finance.<sup>2</sup> While this is true in many countries--across advanced, emerging, and developing economies--it is particularly pronounced in economies with less developed financial sectors. The IFC estimates the finance gap for formal SMEs in developing countries to be around US\$1 trillion. The financial crisis and regulatory responses have compounded this problem. Under new Basel III capital requirements and banking regulations, for example, SMEs can find access to bank finance even more difficult and expensive.<sup>3</sup>

In the more challenging post-global financial crisis period, policymakers and donors have increasingly emphasized the importance of expanding SMEs' financial access to non-bank sources of funding, including public equity financing. This has taken a variety of forms including, for example, promoting the creation of dedicated SME exchanges.

In the past few decades, an increasing number of stock exchanges worldwide have set up specialized SME boards or market segments with the intention of expanding SMEs' financial access (among other reasons). Many of these boards encourage listings by having different entry standards than the main board,<sup>4</sup> streamlining the listing process and reducing the associated costs.

Few studies have comprehensively examined the effectiveness of equity markets, and SME exchanges specifically, in meeting the financial and other listing motives of SMEs, especially from the perspective of SMEs themselves. The World Federation of Exchanges (WFE) and the Milken Institute Center for Financial Markets (CFM) both recently published new research findings examining how and why SMEs access stock exchanges, as well as the role of stock exchanges in financing SMEs. Although the specific focus areas of our two organizations differed somewhat, the two studies have large areas of overlap and complementarity.<sup>5</sup> The WFE and the Milken Institute fielded an almost identical, jointly developed survey questionnaire targeting listed and unlisted companies across Jamaica, South Africa, and India (Institute focus countries) and South Africa, Canada, China, Nigeria, and Mexico (WFE focus countries). The Milken Institute also surveyed senior stock exchange managers while the WFE surveyed retail and institutional investors and market intermediaries in their respective focus markets.

1 Ayyagari, Demirguc-Kunt, and Maksimovic, *Small vs. Young Firms across the World: Contribution to Employment, Job Creation, and Growth* (World Bank Policy Research Working Paper: 2011).

2 OECD, *Financing SMEs and Entrepreneurs 2015*.

3 See, e.g., Demirgüç-Kunt, Martínez, and Tressel, "The Impact of the Global Financial Crisis on Firms Capital Structure," 2015; and World Bank, *Global Financial Development Report 2015/16: Long-term Finance*, 2015.

4 These standards typically relate to required years in existence, financial track record, number of shareholders, minimum size, etc.

5 Focus areas differed in jurisdictions covered, surveyed participants, and findings. The full reports can be accessed at the following links: [[WFE Report: SME Financing and Equity Markets](#)] and [[Milken Institute report: Can Stock Exchanges Support Growth of Small to Medium-sized Enterprises?](#)].

This report builds on the individual reports by consolidating the main findings across nearly the full set of countries covered in the original reports<sup>6</sup> and highlighting points of commonality and difference. By assembling a large, combined dataset for listed and unlisted companies in Canada, China, India, Jamaica, and South Africa, we are able to enhance our analysis of the results. Finally, the report selectively discusses some of the specific findings from the original reports where these perspectives augment our combined findings and conclusions.

In this joint report, we address the following questions:

- Why do SMEs list, and where?
- Does listing help SMEs access finance? If so, how?
- Would listed firms list again?
- What keeps unlisted firms away?
- How could listing be made more accessible?

We acknowledge at the outset that geographic and market-specific conditions limit, in some instances, the ability to aggregate results. We address this by reporting cross-border points of commonality where they exist, while simultaneously highlighting geographically-specific results.

## A note on methodology<sup>7</sup>

Broadly defined, both the WFE and Milken Institute research programs sought to assess the efficacy of equity markets in providing access to finance for SMEs. In determining which markets to target, we both (independently) reviewed the relevant literature and analysed time series data on listing activity and market capitalization of SME boards. Based on the results of this research and analysis, each organization targeted markets with relatively successful SME exchange offerings from various geographies. The points of difference in approach and methodology are set out below:

### **Milken Institute survey sample and data analysis**

- **methodology:** Following a review of the secondary literature and analysis of time series data collected by WFE and the Milken Institute on listing activity and market capitalization of SME boards

in emerging markets, the Milken Institute identified South Africa, India, and Jamaica as its focus countries. With South Asia, Sub-Saharan Africa, and the Americas represented, broad geographic coverage was ensured. The universe for listed SMEs included all firms listed on SME boards in the three focus countries. Firms listed on the main board were classified as SMEs for the survey universe if they had a market capitalization at or below the median market capitalization of the country's SME exchange as of mid-2016. For the universe of unlisted firms, the Milken Institute used a criterion of 100-200 employees<sup>8</sup> (a common, but not universal, definition for unlisted medium-sized companies).

When analysing the survey findings and presenting the results, the Milken Institute included all (unweighted) responses and used simple averages.

6 To enhance comparability of results and findings, we excluded responses from Mexican companies (as Mexico does not have an SME market) and Nigerian companies (as the Nigerian market is very new and consequently very small).

7 The original WFE and Milken Institute reports used different analytical methodology and techniques and had slightly different focuses when analysing survey results. The full detail is set out in the reports.

8 There is one unlisted South African firm in the sample that has 400 employees.

**WFE survey sample and data analysis - methodology:** The WFE similarly identified geographically diverse markets with successful, dedicated SME offerings (South Africa, Canada, and China) but also included a market without a specific SME exchange (Mexico) and a market where the SME offering was much newer (Nigeria). For purposes of determining which companies to survey, the WFE focused on all companies listed on the SME exchange (if there was one) as well as companies that fell below a market capitalization threshold, and unlisted companies with fewer than 1000 employees.<sup>9</sup> For the purpose of analysis, we included all companies (listed and unlisted) with less than 1000 employees. This allowed us to include responses from some larger markets without dedicated SME boards, or markets where companies could not graduate from the SME board to the Main Board. Nonetheless, most companies included in the dataset fall below the 200-employee threshold.

When analysing the survey findings, the WFE used a “number of employees” criterion to determine which listed companies to include in the analysis, weighted the responses, and used a variety of statistical techniques to enable cross-market comparability.

#### Joint report - survey sample and data analysis methodology

Despite slight differences in determining which SMEs to survey and more substantial differences in how the data was analysed in the two reports, the fact that we used a virtually identical survey across all the jurisdictions enables us to produce a joint report using a combined data set. Therefore, for the purposes of this joint report, we did not collect new data but instead drew on the survey responses collected during the original research conducted by each of our organizations.

This report therefore analyses survey responses from listed and unlisted companies in the following set of focus countries:

- Canada
- China
- India
- Jamaica
- South Africa

The results are drawn from the full SME survey response dataset collected by the Milken Institute and a subset of the responses gathered from the WFE research.<sup>10</sup> Analyses are unweighted for population size or representativeness and, in general, consist of simple averages. The only exception being where we used statistical tests to compare listed and unlisted company responses to assess whether differences in results were statistically significant. We have set out the full universe of respondent companies, categorized by jurisdiction, below. The stock exchange, investor, or intermediary perspectives presented are derived from the analyses conducted as part of the original research by our organizations.

**Table 1: Breakdown of surveyed SMEs by focus country**

Country	Unlisted	Listed	Total
Canada	0	8	8
China	0	15	15
India	25	26	51
Jamaica	29	14	43
South Africa	32	12	43
<b>Total</b>	<b>86</b>	<b>75<sup>11</sup></b>	<b>161</b>

9 The full methodological approach is set out in the WFE report. We found, given the different sizes of companies listed across the jurisdictions, it was not possible to use a consistent market-capitalization defined approach across all markets. We therefore addressed the comparability problem in the analysis.

10 As mentioned above, to enable aggregation of the survey results we excluded the Mexican and Nigerian companies from this report. The analytical methodology used in this report meant the Nigerian company results, specifically, would have been overwhelmed in the larger dataset. We also excluded the larger Chinese companies (those with more than 500 employees) to avoid these responses “overwhelming” the dataset. Only four listed companies in the current dataset (two from Jamaica, one from South Africa, and one from India) have more than 500 employees. Given the geographic spread and the fact that they were included in the original Milken Institute report, we have left them in for purposes of this report.

11 Out of a total of 75 surveyed listed firms, 51 (68%) are listed on the SME board, while 24 (32%) are listed on the main board.

## Discussion of Findings

### I. Why do SMEs list?

While much of the current enthusiasm for SME-focused equity markets stems from a desire to bridge the SME finance gap, our research also sought to understand the listing motivations more broadly. Therefore, through our joint survey instrument, the WFE and the Milken Institute explored the main motives that drove listed SMEs in our studies' focus countries to go public. The Institute also examined whether there is any disconnect between SMEs' top motives for listing and the relevant stock exchanges' perceptions of the main listing drivers.

The results clearly show that stock markets are not just for raising capital, and a listing needs to be viewed as much more than just a financing option. Surveyed companies said they listed for a variety of reasons, and the relative importance of these reasons differed across the focus countries. While improved access to finance was indeed an important reason for listing, companies appear to perceive listing as providing more than just finance.

In fact, the most common reason given for listing across our set of focus countries was to position the firm for growth.<sup>12</sup> This was cited by 69% of listed SMEs in our sample who accessed equity finance at the time of listing. A significant majority of Canadian, Chinese, Jamaican, and South African firms selected this option. One possible explanation for this finding could be that many of these SMEs were at early growth phases of their business life cycles.

Improved financial access was an important reason for listing across the aggregated sample. Sixty percent of all surveyed SMEs said that raising capital at lower cost was an important driver of their listing decision, making this the second most frequently mentioned reason for listing. Just under half (46%) of SMEs surveyed indicated that the

related reason of enhancing creditworthiness was important in their listing decision, and nearly one-quarter of total participating SMEs said the ability to raise additional finance, including funding from banks, was a core driver.

Diversifying the investor base, which was cited by 56% of total surveyed SMEs, was the third most frequently mentioned listing motive. Companies typically take more interest in diversifying their investor base as they grow and mature in their listing cycle.<sup>13</sup> In their survey of stock exchange managers, the Milken Institute found that at least some of the participating stock exchanges may be underestimating the importance SMEs place on diversifying the investor base as a major driver in listing on SME exchanges.

Just under half of all surveyed companies said they listed to improve the company or brand reputation. Increasing market visibility was a particularly important driver for Chinese companies.

Turning to less frequently cited reasons for listing, only 19% of companies said they listed to provide early investors with an opportunity to exit. For listed SMEs in selected focus countries, however, this was an important motive. For example, over the past five years, a majority of new listings on South Africa's SME market, AltX, were firms seeking exit for early-stage investors such as venture capital and/or private equity. In contrast, this reason was the least-commonly given among surveyed listed firms in India, reflecting the fact that only 5% of total listings on the BSE's SME Platform have represented exits by early-stage investors.

While listing may have the effect of improving financial reporting and transparency standards, only 26% of listed companies gave this as a reason for listing. In fact, in its survey of stock exchanges, the Milken Institute found that stock exchange managers in all of its focus countries may overestimate the importance that SMEs attribute to improved financial reporting and transparency as a direct benefit of listing. This result may be less of an anomaly than it appears to be.

<sup>12</sup> We analysed survey responses as given in reply to a question asking firms to indicate their primary listing motives from a set of options, which included "to access capital at lower cost". In practice, one or more of these motives may be interconnected and access to finance would certainly improve a firm's ability to grow. But the selection of this specific option when a narrower capital access option was also available suggests attribution of additional benefits.

<sup>13</sup> See discussion on pages 61-63 of Baldock and Mason (2015) on the SME funding escalator and how funding needs evolve according to the level of the development of the company.

The WFE research found that institutional investors in particular<sup>14</sup> rated corporate governance and disclosure requirements as important drivers of their confidence and willingness to invest in SMEs. Thus, it may not be that exchanges think companies value improved financial reporting and transparency in itself, but rather that they perhaps over-estimate the extent to which companies pre-listing understand the importance investors place on these issues. This disconnect may point to an opportunity for stock exchanges to engage in more education and awareness-raising with current and prospective listed firms on this aspect of a listing.

These findings taken together underscore the broader value that firms attribute to listing. As the table below shows, the top reasons for listing across the set of focus countries go well beyond accessing finance at better terms.

**Table 2: Top three reasons for listing by jurisdiction<sup>15</sup>**

<b>China</b>	
Enhanced ability to attract talent	100%
Improved competitive advantage	100%
Improved brand or reputation	93%
<b>Canada</b>	
Position the firm for growth	100%
Diversify the investor base	88%
Lower costs of funds	63%
<b>India</b>	
Enhance credit-worthiness	67%
Diversify the investor base	58%
Lower cost of funds	58%
<b>Jamaica</b>	
Position the firm for growth	62%
Lower cost of funds	46%
Increase firm's competitive advantage	38%
<b>South Africa</b>	
Position the firm for growth	86%
Diversify the investor base	71%
Improve brand and reputation	57%

## II. Does listing help SMEs access finance and how?

For SMEs to contribute meaningfully to broader economic growth and development, they need (amongst other things) access to affordable finance. The core proposition underpinning stock exchanges (and particularly SME-focused exchanges) is that they aim to enhance the ability of, at least those SMEs able to comply with the rigors of being a public listed company, to access cost-effective finance. While our research does not allow us to comment on the broader efficacy of markets in achieving this objective, it appears that, at least for the companies surveyed across our five focus countries, exchanges are performing this very important financing function.

Looking at the aggregated results, over 90% of all surveyed listed firms raised capital at the time of listing and a further 22% raised additional equity capital post-listing. In line with the theory that equity capital offers a more affordable source of finance than some of the alternatives<sup>16</sup>, 76% of firms cited lower cost of capital as their reason for raising public equity capital as a means of financing. Thirty-five percent of listed firms that answered positively when asked if they would list again said the ability to raise funds at lower cost was one of the reasons they would (see also section III). Finally, amongst unlisted firms that said that they would consider listing in the future, the opportunity to raise capital at lower cost was the second most frequently given reason.

<sup>14</sup> By contrast, retail investors ranked "revenue growth" as their most important investment consideration.

<sup>15</sup> Responses for surveyed SMEs listed on SME boards in Milken Institute focus countries: India, Jamaica, and South Africa.

<sup>16</sup> See Pagano, Panetta, and Zingales (1998).

Our findings also suggest (in line with the theory) that when firms improve corporate governance and financial reporting to meet listing criteria, they may also improve their ability to access finance from banks and other sources.<sup>17</sup> In other words, listing may help at least a subset of SMEs<sup>18</sup> to reduce the overall financing constraint they tend to experience. While surveyed listed and unlisted companies were equally reliant on bank financing as a source of external finance, unlisted companies were more reliant than listed companies on shorter-term sources of finance such as trade credit and retained earnings.<sup>19</sup> Unlisted companies were also more finance constrained<sup>20</sup> than listed companies. Thirty-five percent of unlisted companies claimed they had not been able to access any or only some of the financing they had sought in the previous three years, while a further 8% said financing was provided at worse terms than they had hoped. This contrasts with listed firms, where only 19% reported being constrained in their access to finance and just under 5% accessed finance on worse terms.<sup>21</sup> In addition, most SMEs that were surveyed about whether they accessed additional medium- to long-term financing following their IPO replied positively.<sup>22</sup> This group includes most of the firms that listed to improve their access to finance.

However, these results should be interpreted cautiously; it may be that at least some of the firms that choose to list are, relative to their peers that choose not to list, already more financially sound

and have better growth prospects. Therefore, these firms opting to list may be in a better position to raise external finance even before they list. It is obviously not possible to conclude that the fact of being listed intrinsically improves broader financial access; country and financial market context are also important determining factors. Nevertheless, this is an interesting finding that holds across our larger aggregate dataset.

### III. Company experience of listing: Would listed firms list again?

Our research also sought to understand the company experience of being listed and how this experience compared with expectations at time of listing. As a starting point, companies were asked whether, given their experience and what they now know about being listed, they would list again. Nearly three-quarters of all surveyed companies (74%) said they would. This positive result also holds at a country level with a majority of companies in each of our focus jurisdictions agreeing they would list again.

17 Pagano, Panetta, and Zingales (1998) report that one of the most important benefits of listing on a stock exchange is the ability to reduce borrowing constraints and gain greater bargaining power with banks. Joeever (2013) mentions that unlisted firms “face larger information asymmetries, which makes their access to external finance more costly” than listed firms. Wehinger and Nassr (2015) suggest that listed SMEs’ “public accountability, increased transparency, and reporting implicitly or explicitly required by the markets encourage better management practices, governance, and performance monitoring”. Jointly considered, these statements suggest that the better corporate governance practices and reporting standards implied by a listing would facilitate access to finance from other sources and reduce companies’ financial constraints.

18 Empirical research by the World Bank (2014) and others argue that public-equity financing should not be seen as a broad solution to SME financing challenges, but rather as a solution for a particular subset of SMEs. See, e.g., World Bank, Global Financial Development Report 2014: Financial Inclusion, 2014. SMEs typically have less capacity and fewer resources to meet the financial costs and disclosure requirements for getting and staying listed. SMEs seeking public-equity financing must therefore be sufficiently institutionalized to handle the reporting and corporate governance requirements. See, e.g., OECD, “G20/OECD Support Note on Diversification of Financial Instruments for SMEs,” 2016.

19 This difference in results is statistically significant.

20 Defined as not being able to access all or some of the financing they had sought in the previous three years.

21 It must be noted, however, that a subset of the surveyed listed firms were not listed for the entire three-year period referred to in the survey question. It is therefore possible these firms were more financially constrained during the portion of the three-year period when they were still unlisted.

22 SMEs that answered this survey question were based in India, Jamaica, and South Africa.

Companies were then asked to indicate whether their experience of being listed was better than, worse than, or in line with their pre-listing expectations across a range of factors.<sup>23</sup> While there are significant differences across indicators and geographies, companies across jurisdictions consistently reported a better or worse than expected listings experience for certain indicators. The areas where companies consistently<sup>24</sup> reported a better than expected experience were:

- Impact on visibility and reputation
- Effect on financial performance/profitability
- Corporate social responsibility

On the other hand, a reasonable proportion of companies<sup>25</sup> reported a worse than expected experience across these factors:

- Time and costs of aligning financial record keeping and reporting with listings requirements
- Level of liquidity of the stock
- Volatility of the stock price
- Time and costs associated with meeting ongoing listings requirements

Within these results, Canadian firms reported that the experience of listing was worse than expected for most of the surveyed factors. This was particularly pronounced for factors such as “time and costs of reforming corporate governance structures” and meeting ongoing listings requirements. Despite this, 75% of surveyed Canadian firms said they would list again. This may be because – at least for the surveyed firms – they were heavily reliant on equity finance as a source of funds.<sup>26</sup>

At the other end of the spectrum, both Chinese and Jamaican firms reported a better than expected overall listing experience. Chinese companies said their experience of listing was in line with or better than their expectations across almost all indicators (80%). All Chinese companies said they would list again. Jamaican companies also ranked their experience with listing as being in line with or better than expected across the

majority of indicators (60%). However, this was particularly pronounced for the impact on visibility and reputation, which was cited as better than expected by 62% of surveyed Jamaican firms. The vast majority of listed Jamaican SMEs in the sample said they would repeat the listing process. Jamaican companies saw the corporate governance and reporting changes they had to make to meet the listing requirements as improving how their firms are run.

While Indian companies were not as positive as Jamaican or Chinese companies, a majority reported that the listing experience was at least in line with their expectations for all indicators. And for a majority of surveyed Indian firms listed on the SME platform, their experience exceeded expectations in the core area of “effect on financial performance/profitability”. In India, two-thirds of listed SMEs would repeat the listing process based on their positive experiences, and increasing access to finance was the core factor determining their satisfaction.

Finally, South African companies overall found the listing experience to be slightly worse than expected, with companies ranking their experience on only four of the 15 indicators as in line with or better than expectations. Nonetheless, the majority (58%) of companies would list again.

We need to be cautious about drawing conclusions about the exchange itself from these jurisdiction-specific findings. In Canada, for example, many of the firms listed on TSX Venture (the Canadian SME market) are commodity-focused firms, and at the time of the survey, commodity firms generally were experiencing particularly difficult market conditions. Mining exploration firms also tend to have significantly fewer employees than other types of firms, which may make the compliance burden more onerous for these firms. In China, by contrast, the market has performed particularly well over the last few years. It is not possible to know the extent to which this would be reflected in surveyed SMEs’ perceptions.

23 Companies were asked to rate, on a scale from 1 to 3, where 1 = worse than expected; 2 = in line with expectations; 3 = better than expected, across a range of factors, how the company experience of listing was in relation to expectations. The average across all indicators and all jurisdictions was 1.96.

24 With the exception of Canadian companies

25 With the exception of Chinese companies

26 Nearly 100% of Canadian respondents reported being financing constrained i.e. they were only able obtain some of the financing they sought.

## IV. What keeps unlisted firms away?

In addition to examining the motivations and experiences of listed firms, we also sought to understand what prevented unlisted firms from using public equity markets. A quarter of surveyed unlisted firms said they had qualified for and considered listing, but decided not to list.<sup>27</sup> For these firms, the reasons for their decision not to list varied considerably across (and within) the focus countries. In India, SMEs decided that listing was too costly while firms in both India and South Africa felt that meeting the listing requirements would involve changing too many internal business processes. South African SMEs were particularly concerned about costs of *maintaining* a listing though this was also given as a reason for not listing by some Indian and Jamaican firms. In Jamaica, a lack of information about listing contributed to the decision-making process of this group.

Among the unlisted firms that said they had *not* considered listing, the reasons similarly varied both across and within countries. Several Indian and South African companies mentioned concerns about the need to comply with various regulations, reporting standards, and associated costs, while a few companies in all jurisdictions mentioned unwillingness to lose control of the company. In Jamaica, in line with the response that companies felt they didn't know enough about listing, a third of firms said they had never considered listing.

Interestingly, very few companies that either considered listing and decided against it, or who had not considered listing, gave the availability of alternative sources of funding as a reason for not listing. This finding seems to reinforce the existence of a funding gap and the need to continue focusing on finding viable funding options for capital-constrained SMEs.

Firms were also asked about their associations with being a listed company. Unlisted SMEs in India and South Africa had relatively unfavourable views of what it means to be a listed company. However, based on what surveyed firms said they associate with being a listed company, some of these views may be based on misperceptions about the experience of being listed on a main board rather than an SME board. Both in India and South Africa, the views of unlisted SMEs seemed to be shaped more by the experience of firms listed on the main boards than by those listed on the SME segments. In India, for example, unlisted firms strongly associated being listed with greater shareholder pressure and loss of company control—two outcomes that more closely reflect the experience of surveyed firms on the main market than on the SME platform. Likewise, in South Africa, strong associations of listing with shareholder pressure and illiquid trading more closely align with the reported experiences of smaller firms on Johannesburg Stock Exchange's main market. In both cases, there may be an opportunity for stock exchanges to emphasize the experience of firms on the alternative boards to counter these views among the pool of SMEs they will target for future listings.

In contrast to India and South Africa, a large majority of surveyed unlisted SMEs in Jamaica have more favourable associations with being a publicly listed firm. Ninety percent of surveyed unlisted Jamaican SMEs thought listing would have a positive impact on their visibility and reputation. Related to this, three-quarters expected that listing would lead to greater public scrutiny. And over three-quarters of these Jamaican firms expect that listing would enhance their financial access. This would suggest that in Jamaica the decision not to list is a function more of a lack of information than a negative perception about listing.

<sup>27</sup> Thirty-nine percent of surveyed unlisted firms had considered listing but did not meet the listings requirements.

## V. How could listing be made more accessible?

While acknowledging geographic and market differences, the consolidated survey results suggest the following:

- Even those companies that have the institutional capacity to meet the listings requirements may battle to meet the initial and ongoing compliance requirements of being a public, listed company.
- Unlisted companies seem to either not know about listing or have the impression that listing is overly onerous.

The difficulty in simply extending the more traditional equity market solution to SMEs is that the nature of SMEs (given their smaller size and often fewer years in existence) means that the relative costs of listing and compliance (initial and ongoing) may be higher than they are for larger, more established companies. Their more limited institutional capacity also means the quality of their disclosure is likely to be lower than that of larger, more established firms.<sup>28</sup> Finally, SMEs are also often intrinsically riskier than more established firms. Therefore, the challenge for exchanges and securities regulators is to find ways to reduce the cost burden without unduly compromising investor protection. We suggest this could be done by addressing both direct and indirect costs of listing while also improving prospective firms' understanding of what it means to be listed, including their ability to meet the listings requirements.

## Containing the costs

Both listed and unlisted surveyed firms rated a "low cost of listing and compliance" as very important to creating a successful listings environment for SMEs. The first and most direct way to make listing more accessible is to reduce the fees associated with listing. Many exchanges offer reduced initial and ongoing listings fees for the SME market which may assist in rebalancing the cost-benefit equation.

To address the indirect costs of listing, market regulators—or exchanges, where they have the necessary discretion—could identify ways to simplify the listings procedures and disclosure requirements. As mentioned in section IV above, most listed companies across jurisdictions experienced difficulties with these compliance aspects. Furthermore, when asked what they believed was important for creating a viable listings ecosystem for SMEs, both listed and unlisted companies emphasised simplified listings procedures and disclosure requirements. In addition, qualifying unlisted firms in India and South Africa reported that a top change they would like to see in order to reconsider listing would be a further simplification of listing procedures. These findings (together with the need to ensure appropriate levels of investor protection) suggest that rather than focusing on reducing what information is required, stock exchanges and regulators could explore whether requirements could be tailored to be more accessible and intelligible for SMEs. They may also be able to facilitate the listing process for qualifying SMEs by identifying opportunities for streamlining or automating disclosure where possible.

Exchanges and securities regulators could also alleviate the compliance burden by reducing how frequently companies are required to report. For example, some jurisdictions with quarterly reporting requirements for firms listed on the main board have reduced reporting frequency for companies listed on the SME board (to bi-annually).

<sup>28</sup> This is borne out by the WFE findings where investors rated "a mechanism supporting SMEs to prepare disclosure documents" and "financial education for SMEs" as among the most important factors in creating a successful listings environment for SMEs.

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## Improving firms' understanding of listing and ability to meet the requirements

While simplifying the listings requirements should improve firms' ability to comply with these requirements, they may nonetheless still require additional support. Advisors can play an important role in helping firms understand and meet the listings requirements, thereby ensuring that investors receive the information they need. Listed companies across the focus countries indicated that they found the assistance and services provided by authorized market intermediaries to be very helpful in navigating the listing process. Qualifying unlisted firms in Jamaica said technical assistance to prepare for operating as a public company would likely encourage them to reconsider listing. In addition, both listed and unlisted firms across all jurisdictions rated the existence of quality, affordable advisory services and mechanisms to support SMEs in preparing their disclosure documents as being critical to enhancing the listings environment for SMEs. Retail and institutional investors similarly gave high ratings to the existence of mechanisms to support SMEs with their disclosure.<sup>29</sup> Despite the acknowledged importance of advisors, these services add to the overall cost of listing for SMEs. Moreover, it may not always be economically viable for advisors to service this segment of the market. As shown in the original WFE research, only 58% of surveyed market intermediaries (advisory service providers) indicated they provided services to SMEs because it was profitable to do so. This conundrum needs to be addressed.

Finally, firms may be better prepared for listing and better able to comply if they understand what is required to operate as public, listed companies and the benefits that flow from accurate, timely and relevant communication with shareholders. Exchanges, together with other relevant stakeholders, could provide SMEs with this more targeted education.<sup>30</sup> Companies in our focus countries (neither listed nor unlisted) did not rank financial education for SMEs as being particularly important, but retail and institutional investors, as well as market intermediaries, in the WFE research ranked this as important. This type of training should enhance companies' engagement and communication with investors, with a potentially positive impact on the benefits that companies derive from listing.

To the extent that firms are not listing because of misperceptions about listing itself, exchanges may look to address these through improving awareness and understanding. The perception that listing is difficult can be as much a deterrent as the actual procedures and processes involved. In particular, unlisted SMEs' overall lack of understanding (based on company feedback from Jamaica, India, and South Africa) about the actual ongoing costs and requirements of operating a public company suggests an opportunity for capital markets stakeholders to bridge this information gap with qualifying, unlisted firms. Clearer communication by capital markets stakeholders (including intermediaries) to unlisted, qualifying SMEs about the actual costs and requirements may address their concerns and provide them with the information they need to make a more informed decision about going public.

<sup>29</sup> Investors did not, however, place much importance to the presence of advisors in the ecosystem. This suggests that while investors recognise the importance of assisting SMEs in meeting their disclosure obligations, they do not have a view that this is necessarily achieved through the use of advisors.

<sup>30</sup> Increasing numbers of exchanges are introducing formal, targeted pre-IPO education programmes for companies. These will often include aspects of compliance, investor relations, and corporate governance. See the 2016 [WFE Report on SME Exchanges](#).

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## Conclusions

Our research suggests that stock exchanges can contribute positively to SME growth. While public equity markets, at least as currently conceived, are unlikely to ever fully substitute for other types of financing, they can be a potentially important source of finance and other benefits for at least a subset of SMEs. The extent to which public equity markets play this role will depend on particular country and market contexts. Even within markets where public equity finance could be an alternative for SMEs, listing will likely be most suitable for certain larger SMEs that have the growth potential and institutional capacity to handle the financial reporting and corporate governance requirements of public markets.

Companies appear to largely recognise the financing and other benefits of listing. In fact, our findings support the idea that stock markets are not just for raising capital. The participating SMEs across our focus countries listed for a variety of reasons, and the relative importance of these reasons differed across jurisdictions. Stock exchanges that become more aware of the specific reasons SMEs in their jurisdictions seek to list may be able to improve their ability to target and attract new, suitable candidates for listing.

The Milken Institute further found that, for its focus countries, most surveyed firms accessed additional medium- to long-term financing subsequent to their IPO. These findings support the idea that when firms improve corporate governance and financial reporting in order to meet listing criteria, they can also improve their ability to access finance from banks and other sources. This finding should be interpreted carefully, however, since many of the firms that choose to list may have been more financially sound and have better growth prospects than their unlisted counterparts.

It is clear from our joint findings that companies incur not insignificant costs when listing – particularly due to indirect costs associated with the required restructuring for purposes of listing and the ongoing disclosure and compliance. Feedback from surveyed SMEs across jurisdictions supports the finding that companies believe advisors can assist them in meeting these requirements and preparing for a listing. However, this assistance can increase costs for SMEs, at least in the short run, and it is not clear that the current economic models are sustainable. The services advisors provide to SMEs are not necessarily hugely profitable business lines. This may be partially addressed through simplification of processes and requirements and enhanced understanding by SMEs of what is required and why.

Stock exchanges and securities market regulators appear to recognise these impediments to listing and have introduced a variety of mechanisms to address them. Our joint findings support recommendations in the existing literature that SME boards should look to reduce costs not by reducing disclosure or governance requirements but by reducing disclosure frequency where appropriate and by streamlining and simplifying the listings and disclosure process.

We also found that confusion on the part of participating unlisted SMEs in our focus countries<sup>31</sup> about the ongoing costs of being listed could be as much a deterrent to making the decision to go public as the actual financial and operational costs. Targeted and clear communication to prospective listing candidates about the costs and requirements of getting—and staying—listed would better equip them with the information they need to make a well-informed decision.

31 Unlisted SMEs in India, Jamaica, and South Africa participated in this survey question.

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SME Exchanges**

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the Milken Institute

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