



Access of SMEs with growth potential to the capital markets

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Documentos de Trabajo
Nº 52



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Abstract

The main aim of this paper is to contribute towards the debate on how to boost the funding of newly created companies and those with high growth potential through the market and other external sources other than bank credit. The debate currently revolves around four key issues: how to ensure a sufficiently wide investor base, how to overcome possible barriers which hinder companies accessing the market, the design of markets for small and medium capitalisation securities and the role of regulation. As is to be expected, the reflections on the use of tax incentives play a significant role with regard to the first two issues. In the third issue, the debate focuses above all on how to resolve the problems of visibility which affect the markets for small and medium capitalisation securities and whether or not an exclusively national framework is sufficient for guaranteeing growth in these markets. With regard to the role of regulation, the discussion focuses on whether it would be beneficial to adapt the requirements to an “SME scale” and the impact this would have on investor protection.

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1 Introduction

At the end of 2010, SMEs accounted for 99.9% of the Spanish non-financial business sector in terms of number of enterprises, and contributed 76% of the employment and 68% of the added value of that sector.¹ These percentages, which are ten percentage points higher than the same figures for the European Union (EU) as a whole, underline the greater preponderance of SMEs in our economy, which is even more apparent if we compare the Spanish situation with that of the main EU economies. Thus, while in 2010 major Spanish companies generated 24% of the employment in non-financial enterprises, this percentage rises to 40% in France, 39% in Germany, and 46% in the United Kingdom. With regard to the generation of added value, the contribution of 32% of the total added value of the economy by large Spanish companies contrasts with 44%, 46% and 59%, respectively, for the three countries quoted previously. Among the major economies of the EU, only in Italy can we see a situation similar to the Spanish one; large-scale companies in Italy contribute just 19% to employment and 29% of added value.

Given the importance of SMEs to the European economy and particularly to the Spanish economy, the concern aroused by the financing problems faced by these enterprises since the beginning of the financial crisis in 2007 should come as no surprise.² As we see in this article, these problems are growing more acute in Spain due to SMEs' great reliance on bank financing and the minor role played by other sources of external financing, such as different types of venture capital funding and financing through the securities markets. Thus, in some countries where the role of the markets is more developed, there is evidence of a compensatory effect of market financing with regard to the contraction of bank credit under the present financial crisis.³

Concern regarding the financing of SMEs is not only the result of the current difficulties due to the impact of the financial crisis. A significant role is also played by certain medium-term uncertainties and, in particular, the possibility of bank credit making a slow recovery, as happened in the 1993-94 crisis, and the possible contractive effects on the conditions of access to bank credit for SMEs of new prudential

1 The European Commission considers SMEs to be companies with fewer than 250 employees, with an annual turnover of under 50 million euros or a balance sheet total of less than 43 million euros. See European Commission (2010 and 2011).

2 Two good examples of this concern can be found in the permanent forum to monitor the market situation and encourage new approaches to improve access to finance for SMEs, set up by the European Commission in 2010 (http://ec.europa.eu/enterprise/policies/finance/financing-environment/sme-finance-forum/index_en.htm), and in the recommendations issued that same year by the OECD Working Group on SMEs and entrepreneurship (OECD, 2010).

3 Supporting evidence is to be found in chapter 2 of the CNMV Annual Report for 2010 (CNMV, 2011).

regulation, designed within the framework of a global response to the problems causing the financial crisis.

In this context of current difficulties and future challenges, it is even more necessary to promote other forms of external financing of SMEs as alternatives to the banking channel. This need is especially apparent in the case of the financing of the early stages of companies with growth potential which, in many cases, are of strategic importance to the economy due to their innovative profile. The specialised formulas applicable to these early stages, such as formal venture capital, informal venture capital (business angels), and the securities markets (particularly alternative markets) are generally still underdeveloped both in our country and in other European countries. In some economies of our region, the authorities have developed policies supporting the financing of expanding companies, including certain types of tax incentives. Concern for the financing of SMEs is also being reflected, at an EU level, in the current process of review of the most important directives affecting the securities markets. In this case, a number of proposals aimed at establishing an “SME scale” of the regulation are being put to debate with a view to flexibilising the requirements for small- and mid-cap securities.

This paper aims to contribute to the reflection on how to promote the financing of early stage companies with a high growth potential through the market and from other external sources as an alternative to bank credit. In the debate currently underway, four issues stand out in particular: how to ensure a sufficiently broad investment base; how to overcome the possible barriers hindering companies’ market listing; the design of markets for small- and mid-cap securities; and the role of regulation. As is to be expected, reflection concerning the part to be played by tax incentives plays a significant role with regard to the first two issues. For the third issue, the debate is focused above all on how to address the problem of visibility affecting small- and mid-cap securities markets and whether or not it is advisable to rely on an exclusively domestic framework to ensure the growth of those markets. With regard to the role of regulation, the discussion is centred on the advisability of adapting requirements to an “SME scale” and on the impact that this would have on investor protection.

The paper is structured as follows. In section 2 we review the structure of the financing of SMEs and compare it with that of large-scale enterprises. In section 3 we analyse the impact of the latest financial crisis on the financing of SMEs. In section 4 we describe the main challenges faced by SMEs with regard to financing. In section 5 we present the main strands of the current debate on how to encourage the participation of SMEs in capital markets. Finally, in section 6 we present some final considerations.

2 The financing structure of SMEs

One of the most influential theories in the field of corporate finance suggests that there is a bias towards internal sources of business finance and against external sources, due to the fact that the informational disadvantages of potential external investors tend to make external sources more expensive.⁴ Given that, in general, informational asymmetries are greater in the case of smaller or younger companies, it is to be expected that access conditions to external finance are relatively less favourable for smaller companies, as would seem to be evidenced by a good number of empirical studies.⁵ Meanwhile, when smaller companies go to external sources of financing, they often prefer to get into debt before financing themselves through equity instruments, mainly due to the fact that the core shareholders try to prevent interference in their control of the company.

Surveys aimed at entrepreneurs tend to confirm this pattern of behaviour. Thus, for example, in the European Central Bank's survey on the access to financing of SMEs corresponding to the first half-year of 2009, only 6.4% of the Eurozone companies included in the sample say that they would opt for equity funding to achieve their growth targets if they needed external financing.⁶ However, the capture of new shareholders may be crucial for certain projects, such as when an early stage company operating with innovative technologies or products needs to deliver relatively fast growth. Obtaining financing for this type of companies is, in any event, difficult due to the high risk inherent to these types of projects and to the fact that there is often a lack of tangible assets to be used as collateral.

An analysis of the structure of the liabilities of non-financial enterprises provides evidence regarding the real importance of external funds in business finance. This can be seen, for example, in chart 1, which shows aggregated data based on annual harmonised financial statements for Spain and another three major European countries, concerning the structure of liabilities of SMEs and large-scale companies during the period 2000-2009. Looking solely at debt (bank financing and other liabilities), we

4 Myers and Majluf (1984) contains some of the seminal contributions in relation to this theory. Later, the idea of informational asymmetries and the agency problems that can arise as a result prompted the production of a large percentage of recent macro-financial literature examining the macro-economic impact of certain financial frictions, such as business borrowing restrictions or the requirements of guarantees or collateral in loan operations. See, for example, Bernanke and Gertler (1989), Hart and Moore (1994) and Kiyotaki and Moore (1997).

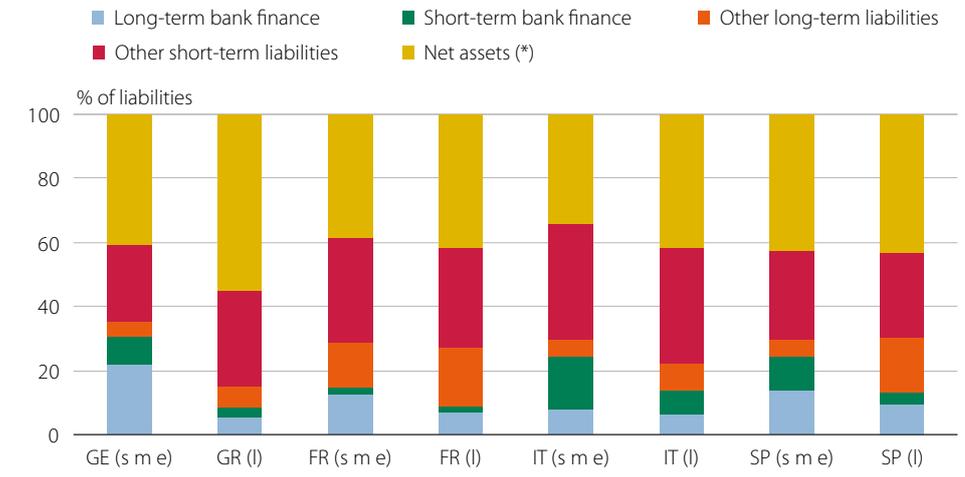
5 See, for example, Carpenter and Petersen (2002), Cassar (2004), Ramalho and Vidigal (2007), and Kitching *et al.* (2009).

6 Answer to question number 20 of the survey (European Central Bank, 2009). However, it should be noted that, at least in some countries, the predisposition of SMEs to making use of equity funding is greater the larger the company. This is what happens in, for example, France and Germany, where there was evidence of such a disposition in over 15% of the larger-scale SMEs included in the sample.

see that, with the exception of large German companies, this type of external finance accounted, on average, for over half the liabilities of both large-scale companies and SMEs during the period in question. In the case of Spanish SMEs, debt in that period accounted for 57% of liabilities, while in the other three countries surveyed this percentage was even higher, in the region of 62% on average.

Structure of the liabilities of non-financial companies
Average 2000-2009

CHART 1



Source: BACH.

(*) Includes capital, reserves, provisions and accruals.

l: Large-scale enterprises.

s m e: Small and medium-sized enterprises.

GE: Germany; FR: France; IT: Italy; SP: Spain.

Chart 1 also reveals the existence of significant differences between SMEs and large-scale companies with regard to the composition of their liabilities. These differences are mostly apparent in the composition of debt, since the relative importance of equity on the liabilities side is not very different between one or the other type of enterprise, except in the case of Germany, where the financing of large-scale companies is based on a greater contribution of shareholder equity. In particular, one of the most significant differences is in regard to the relative importance of bank financing in companies' debt structure, which is clearly greater among SMEs than it is for large-scale companies. This is consistent with the idea that the latter have more options for diversifying their sources of finance than the former. Thus, while bank financing accounts for an average 39% of the total debt of the SMEs surveyed, this percentage falls to 20% for large-scale companies. In the case of Spain, the banking channel accounts for 42% of SMEs' total debt, while it represents around 24% of total liabilities. For large Spanish enterprises, this type of debt represents 24% of total debt, representing 13% of all liabilities. Meanwhile, available evidence suggests that the relative importance of the banking channel in the financing of companies varies appreciably depending on the activity sector.⁷

⁷ In the case of Spain, the sector which is most dependent on bank financing is construction and real estate development. During the period 2000-2009, the relative importance of this type of financing on the liabilities side was, on average, 37% for both large-scale companies and SMEs.

The different composition of debt is especially apparent in the case of long-term financing, which is essential for companies' growth. In chart 1 it can be seen that, in the case of SMEs, bank credit clearly predominates over non-bank credit in long-term financing. However, for large-scale companies, the contributions of both types of debt are either more balanced or tend more towards long-term non-bank debt, which includes, among other components, recourse to the securities markets through fixed income issues.

To calculate the weight of external funding on the liabilities side of non-financial companies' balance sheets, in addition to debt it is necessary to take into account the contributions of share capital made over time by partners other than the founders or their circle of friends and relatives. Surveys and, generally speaking, field-work suggest that such contributions are limited in the case of SMEs and that the entrepreneurs controlling this type of firms tend to consider external financing through the issue of shares as a last resort. According to some studies conducted in the United Kingdom at various times in recent years, only between 1% and 3% of SMEs resort to this type of financing.⁸

Thus, data based on the balance sheet shows that bank financing plays a central role in the external sources of funding for SMEs and that financing based on the securities markets, whether through fixed income issues or through the capture of new shareholders, is minimal. As has been indicated, surveys aimed at entrepreneurs suggest that the banking channel is the first choice for the financing of new investment projects. This is evidenced, in particular, by the European Central Bank survey on the access of SMEs to financing corresponding to the first half-year of 2009, in which 73% of SMEs say they would prefer this financing channel to achieve their growth targets in the event of needing external funding. This percentage contrasts with the 6.4% of companies which, as mentioned previously, would prefer to bring new partners into their capital.⁹

8 See, for example, Fraser (2005) and Department for Business, Innovation and Skills (2009).

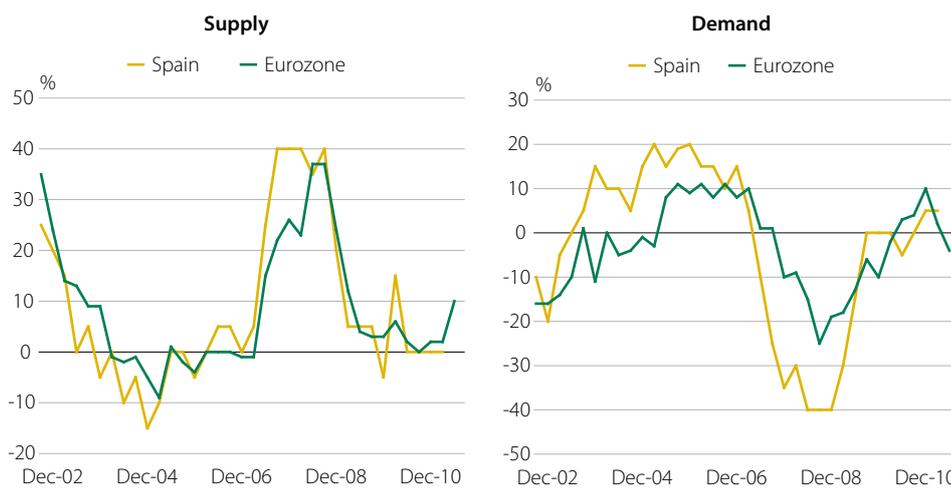
9 See European Central Bank (2009).

3 The impact of the crisis on the financing of SMEs

Given its importance, it is not surprising that SMEs' funding-related problems arouse the interest of public opinion and of the authorities, especially in a scenario in which credit and economic activity are experiencing severe contraction. In fact, the present financial crisis has impacted particularly strongly on the bank finance channel which, as we have seen, is a crucial source for smaller enterprises. Specifically, the collapse of several wholesale markets, essential for the provision of liquidity to financial institutions, including the interbank market and the securitisation market, gave rise to a general toughening of the credit approval criteria applied by banking institutions for loans to companies, as we can see in the left-hand panel of chart 2, which reflects the opinion of the institutions themselves on the trend in the conditions of access to credit during the period under study. Although these conditions tended to stabilise in the Eurozone early in 2009, partly due to the measures adopted by the Eurosystem and the various governments, these criteria continue to be considerably stricter than before the crisis, within a framework in which the solvent demand for credit from companies has weakened appreciably (see the right-hand panel of chart 2).

Survey on bank loans.¹ Loans to companies

CHART 2



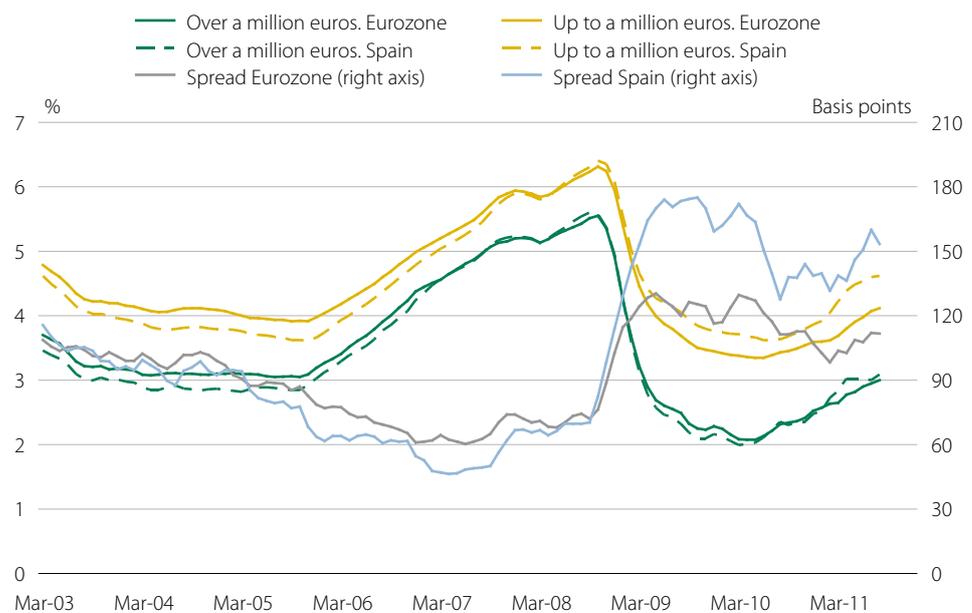
Source: European Central Bank and Bank of Spain. Data to third quarter of 2011 for the Eurozone and to second quarter for Spain.

- 1 Supply: An increase/decrease of the rate indicates the tightening/relaxation of the conditions of access to credit compared with the previous quarter. Demand: An increase/decrease indicates the increase/decrease of the demand for credit of non-financial enterprises. Indicator = % of entities showing a considerable increase (x 1) + % of entities showing a certain increase (x ½) – % of entities showing a certain decrease (x ½) – % of entities showing a considerable decrease (x 1).

Despite the fact that the measures adopted by the economic and monetary authorities resulted in a general drop in interest rates, the gap between the costs of bank financing borne by SMEs and those borne by large-scale companies widened significantly due to the crisis. This can be seen in the behaviour of the spread between the cost of business loans of less than a million euros and the cost of loans of a higher amount (see chart 3). In Spain, the widening of the gap during the peak of the financial crisis was especially acute and, although there has been a certain decrease in the size of the gap since then, it continues to be considerably wider than in the period before the crisis and is clearly more pronounced than that seen in the Eurozone as a whole. The greater impact of the crisis on the financing of SMEs compared with large-scale companies can also be seen in the trend over time of bank credit granted to one or other kind of company. This is suggested, for example, by chart 4, which shows the trend of credit operations for non-financial companies involving amounts of up to a million euros and above. As can be seen in this chart, once the crisis began, operations of the former type began to diminish sharply about a year before those of the second type.

**Interest rate of bank loans to non-financial companies
New business¹**

CHART 3

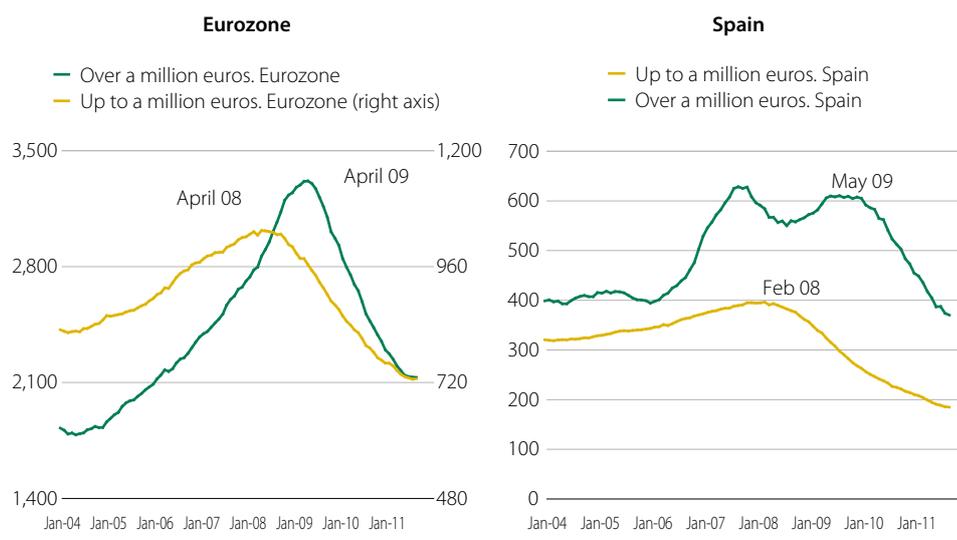


Source: European Central Bank and Bank of Spain.

¹ Quarterly moving average to August 2011.

Bank credit to non-financial companies. New operations¹

CHART 4



Source: European Central Bank and Bank of Spain.

¹ 12-month accumulated data to August 2011. Amounts in billions of euros.

In this difficult context, the implementation of a number of public initiatives aimed at improving the conditions of access to financing of SMEs has helped mitigate the contractive effects on the bank credit supply. For example, according to the European Association of Mutual Guarantee Societies, the amount of public guarantees granted to credit operations for small-sized companies increased by 58% in the Eurozone in 2009, compared with an annual growth rate of 8.2% between 2002 and 2008.¹⁰ Nevertheless, despite their extraordinary relative growth, guarantees have only benefited 8% of European SMEs and, given the sharp increase in the debt levels of Public Administrations and the current pressure on them to reduce those levels, it is hard to imagine guarantees having a much greater coverage. On the domestic front, data based on surveys conducted on SMEs¹¹ indicate that, among SMEs requesting loan finance, recourse to mutual guarantee societies has increased significantly, rising from 3.2% of the total in March 2009 to 11% in March 2011, as shown in the bottom right-hand panel of chart 5. In this same panel we can also see a considerable increase between those two dates in the percentage of SMEs seeking external financing who have applied to the Official Credit Institute (ICO), an entity which has strengthened and widened its scope of action by setting up new mediation facilities aimed at financing the working capital requirements of this type of company. To be precise, the percentage of ICO funding applicant companies over the total number of external financing applicants rose from 24.2% in the first quarter of 2009 to 37.5% in the same period of 2011.

However, it now seems clear that a significant proportion of SMEs are experiencing the difficulties to access bank financing that tend to accompany a financial crisis and general economic recession such as the one we are currently suffering from, and are therefore drawing on accumulated internal funds or even the personal

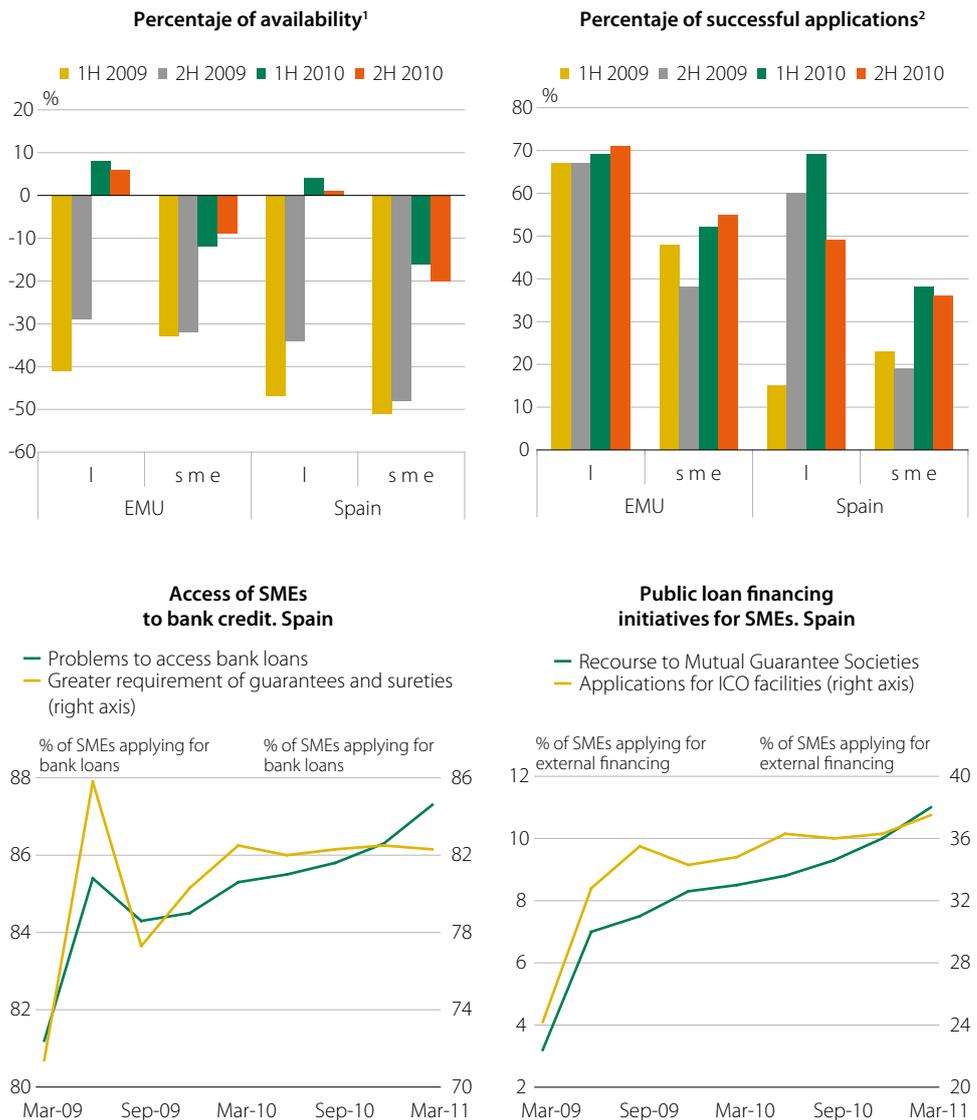
¹⁰ See European Association of Mutual Guarantee Societies (2010).

¹¹ See High Council of Chambers of Commerce (2011).

assets of their entrepreneurs. Thus, the most recent data from the survey conducted by the European Central Bank on the current situation and the short-term outlook regarding conditions of access to bank credit of SMEs in the Eurozone suggests that the difficulties encountered by such enterprises have not yet begun to abate either in Spain or in the Eurozone as a whole (see the two uppermost panels of chart 5). In the case of Spain, the survey on the access of SMEs to external financing conducted by the High Council of Chambers of Commerce points in the same direction, as can be seen in the bottom left panel of chart 5.

Indicators of access and availability of bank credit for non-financial companies

CHART 5



Source: Survey on the Access to Finance of SMEs in the Euro Area (European Central Bank) and Survey on the Access to External Financing of SMEs (High Council of Chambers of Commerce).

1 Percentage of enterprises indicating an improvement of the availability of this type of financing, less the percentage of enterprises which indicate a worsening of availability.

2 Percentage of enterprises to which the financing requested was granted in full less the percentage of enterprises whose request was denied.

l: Large-scale enterprises; s m e: Small and medium-sized enterprises.

Meanwhile, the financial crisis and the economic recession have also had a negative impact on other sources of financing and, in particular, on financing through the issue of equity instruments. One of the possibilities of financing through this channel involves the participation of specialised investors in the company's share capital, such as business angels, who are individual investors specialised in the earliest stages of start-ups, and private equity entities, who undertake investments of a greater size, usually in later stages of companies' development. This type of investment declined sharply after the outbreak of the financial crisis. In the case of private equity entities, in Europe these investments represented 0.6% of GDP in 2007; the same figure fell to just 0.2% in 2009. In Spain, the equivalent percentages are 0.3% and 0.1%, respectively. In the years prior to the crisis, most private equity investments had tended towards major, heavily leveraged transactions, which basically affected only large-scale companies, and so the credit squeeze had a substantial impact on these activities. Within what can be described as private equity investment, the investments most commonly targeting SMEs are those made by venture capital entities. Like business angels, these entities focus their activity on business projects of relatively recent creation, although the target companies are normally more mature and the investment volumes tend to be significantly larger. Venture capital investments in early stages of business projects in 2009 accounted for just 5% of total private equity investments both in Spain and in Europe as a whole.

With regard to placements of equity on the market, the periods of turbulence and the sharp increase in volatility which have characterised the behaviour of stock markets since August 2007 have not encouraged recourse to this method of financing either. Thus, in most reference countries, there has been a significant decline in the volume of capital captured by means of stock market listings during this period (see the central panel of chart 6). However, capital increases have shown a more positive trend during the crisis and, in fact, in some of the most important areas, including the United States and the United Kingdom, recourse to this type of financing has grown in the last three years (see the first panel of chart 6). In this context it should be noted that, as we can see in the third panel of chart 6, since the beginning of the crisis Spanish large-scale companies have gone to the stock market just as much as other major European countries.

Domestic equity issues by size of the transaction¹
Non-financial companies

CHART 6



Source: Dealogic and IMF.

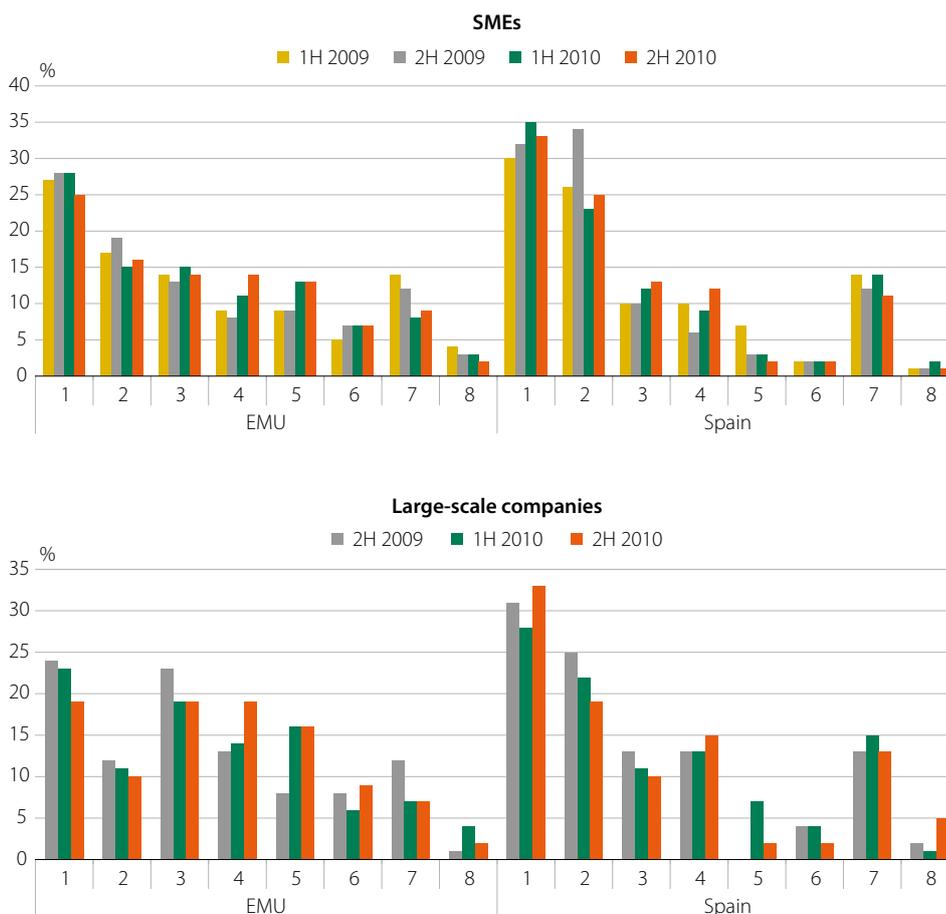
¹ Includes transactions on alternative markets.

4 Future challenges facing the financing of SMEs

From the analysis made in the previous section on the recent trend and present situation of financing conditions for SMEs we can conclude that the process of normalisation of those conditions is still at a very early stage. The opinion of the entrepreneurs themselves, expressed in European Central Bank (ECB) surveys on the access to financing of SMEs, reflects this appreciation. As can be seen in chart 7, at the end of 2010 problems related to access to financing were the second most serious concern of these companies, preceded only by the weakness of the demand for their products. In Spain, this concern is significantly greater than in other Eurozone countries and more acute in the case of SMEs than for large-scale companies.

Most pressing problem facing companies

CHART 7



Source: Survey on the access to finance of SMEs in the euro area (ECB).

1: Lack of consumers; 2: Access to financing; 3: Competition; 4: Production costs; 5: Availability of qualified staff; 6: Regulation; 7: Other; 8: Don't know / Don't answer.

The speed and intensity of the process of normalisation of the financing conditions for SMEs will, in turn, be a determining factor in the production sector's return to its normal operational capacity, once the general economic outlook favours a return to a solvent demand for business lending. However, in the specific case of SMEs, these companies are facing other challenges in matters of financing which go beyond difficulties directly associated with the present financial crisis and which are closely linked to a number of changes of a very persistent or even permanent nature, which may alter the parameters determining the conditions of access to bank credit by SMEs.¹²

One of the factors to take into account in the post-crisis scenario, due to its more than likely impact on bank financing conditions during a not inconsiderable time frame, is the strong persistence of the deceleration in bank credit after a financial crisis of the dimensions of the present one, as we saw after the crisis which occurred in the early 90s of the last century and which, according to the data available to date, is also happening now.

Another factor worth mentioning concerns the new banking regulation which is emerging in response to the financial crisis. In effect, the new international framework for prudential banking regulation, known as Basel III, will call for stricter capital requirements for credit institutions than those in force up to now. These institutions will, as a general rule, have to hold higher levels of capital and strengthen the composition of that capital, as the range of instruments eligible to be considered as top-quality capital is reduced. At the same time, Basel III will penalise high risk activities more severely in terms of capital and will establish mandatory capital reserves to be accumulated during boom periods. Other innovative complementary elements include the introduction of liquidity requirements to discourage imbalances between the maturity profiles of assets and liabilities, and also maximum leverage ratios in order to prevent banking institutions from having an excessive level of debt.

We can expect the strengthening of the prudential framework, which the crisis has proved to be absolutely necessary, to reduce the intermediation capacity of the banking system as a whole. Although it is now difficult to estimate the overall effect of the above mentioned measures on the flow of business lending,¹³ it would seem reasonable to expect smaller companies and start-ups to feel more directly the effects of tighter conditions of access to credit, since investment in this type of company normally involves higher risks, and their financial liabilities are less liquid

12 For a more detailed analysis of the factors presented in the main text below, see chapter 2 of the CNMV Annual Report for 2010 (CNMV, 2011), on the financing of the Spanish business sector in recent years.

13 A recent study conducted by OECD economists estimates that the application of the new capital requirements in the scheduled time frame will lead to a fall in the GDP annual rate of change of between 0.05 and 0.15 percentage points for OECD member countries for the five years following its application (Slovik and Cournède, 2011). This estimate represents an upward revision of the estimate made in 2010 by the Macroeconomic Assessment Group, jointly set up by the Financial Stability Board and the Basel Committee on Banking Supervision, which put the annual decline in GDP for this reason between 0.03 and 0.05 percentage points (Macroeconomic Assessment Group, 2010). Slovik and Cournède estimate that, in order to achieve the capital ratios forecast for 2015 (4% for core capital and 6% for Tier 1) and 2019 (7% for core capital and 8.5 for Tier 1), the spread applied in bank loans (margin over the cost of funds to the bank) will increase, on average, by 15 and 50 basis points, respectively.

than those of larger companies. This means that an important challenge for this type of company will be to find alternative channels of financing which will make them less vulnerable to a possible tightening of the banking channel.

In this context, one alternative which needs to be promoted is financing through equity which, broadly speaking, includes venture capital and the capture of capital on the securities markets. As has been stated previously, available evidence suggests that SMEs are not very predisposed towards this type of financing, although it cannot be ruled out that in many cases this circumstance is linked to the limited expectations that many entrepreneurs have with regard to the potential of their business. However, when the promoters of a company want to reach their growth targets relatively quickly, financing through shares may become an appropriate option. One key element which should be taken into account with regard to this type of projects is that their growth potential tend to be based on their innovative capacity (in terms of the design of the product or service, its marketing, or its production). Therefore, making financing options available to this type of company also becomes a challenge to those shaping public policies aimed at fostering economic growth.

In the more developed countries, the market, sometimes with the backing of the public sector, has created different formulas for investing in equity which more or less meet the needs of enterprises at different stages of their existence. These formulas are often associated with the idea of a financial ladder, whose first rungs, or seed stage, would tend to be covered by the project promoters' own funds, while the higher rungs, when the company is capable of generating regular profits, would lead to the securities markets. Between the two ends of the ladder, the company's financing would be based on the investment of specialist agents such as business angels (start-up and early stage), on venture capital entities and, in the stages of relative maturity, on other private equity formulas.

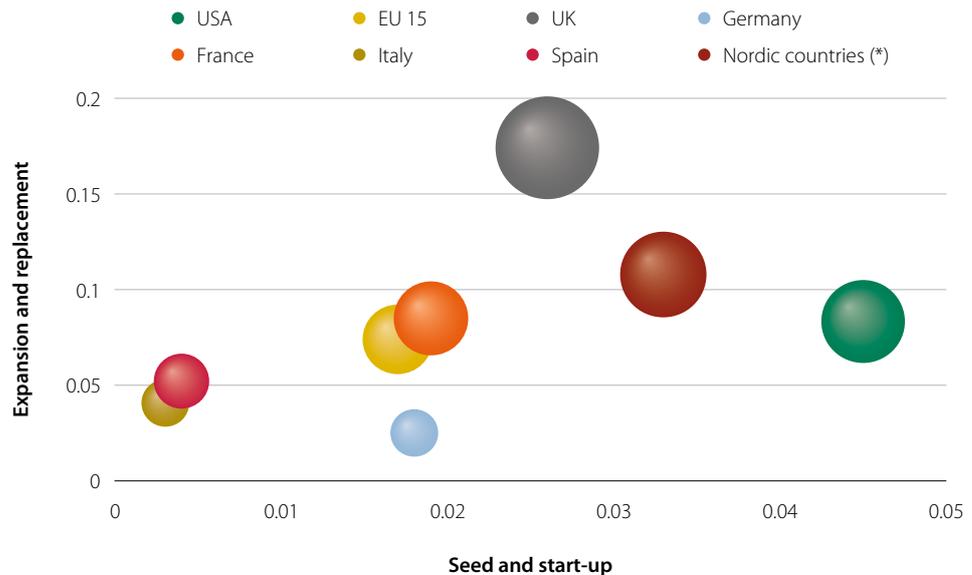
The continuity of the above mentioned process depends, to a large extent, on the good functioning of the various cogs in the system and the absence of any significant discontinuities in financing between one growth stage and another. So, for example, a powerful network of venture firms may help the development of the business angels network, since it would mitigate the latter's fear regarding the lack of liquidity of their investments. For the same reason, the existence of equity markets may help increase venture capital and private equity activity, provided that the market is seen to have enough liquidity. These beneficial effects also work in the opposite direction. In particular, the existence of a dense network of investors specialised in the non-listed stage of companies may be positive for the growth of the activity in the securities markets, given that it may help increase the number of listed companies, especially through market flotations, and thereby attract the attention of new investors to the markets and generate a critical mass in their activity which enables economies of scale to be achieved in trading, marketing, analysis, and other processes.

This characterisation of a sequence of stages and a combination of ideal ingredients to ensure the natural progression of a start-up company up the financial ladder does not hold true either in Spain or in Europe, where the development of formal venture capital activities (venture capital firms and funds) or informal ones (business angels) is still insufficient, with the exception of the United Kingdom and the Nordic

countries (see chart 8). Also, as has already been mentioned, venture capital investment and private equity investment in general has experienced a significant downturn since the onset of the financial crisis. In this context it is no surprise that concern for the financing of enterprises in their early stages has grown and that several proposals have been put forward aimed at holding investors' attention on these formulas, as we explain later on.

Classic venture capital investment¹ in 2009 by stage of development (% of GDP)

CHART 8



Source: Eurostat. The size of each country's bubble is proportional to the classic venture capital investment as a percentage of the GDP in that country.

¹ Includes the initial stages of private equity; i.e. the seed capital, start-up and other early stages, as well as the expansion and replacement stages. Therefore, leveraged operations (LBO, MBO, MBI and LBU) are excluded, as they tend to target more mature companies.

(*) Nordic countries include Finland, Norway and Sweden.

The financial difficulties experienced by expanding companies and by SMEs in general have also revived interest in promoting the access of these enterprises to the stock markets. In addition to their potential for financing business growth, listing on these markets may help solve certain problems, for example by giving the business continuity through shareholder restructurings in the case of family firms, by providing a divestment option to temporary partners, or by bringing about changes in the company's management by establishing the market as a benchmark element. Another frequently quoted reason why companies decide to list on the stock market is because of the visibility they obtain in the eyes of customers, suppliers and potential investors. Also, by being subjected to the rules of transparency and conduct required by stock market regulations, companies may improve their reputation, which would benefit them in their commercial and financial activities.

However, if we analyse the trend followed by stock markets in Europe in the last twenty-five years, we see that the presence of low-cap enterprises in these markets has been diminished, with two exceptions of a short duration, mainly to do with the eco-

conomic cycle. The first of these arose in the mid-80s of the last century. In a context of substantial economic expansion which brought about an increase in companies' need for finance, the most important stock exchanges created what are known as "junior markets", conceived as a trading space to act as a stepping stone to the main market and in which companies are governed by more flexible criteria both in terms of transparency and trading. These junior markets stagnated in the late 80s and those that still survive, such as the Spanish one, scarcely do any business.

The second exception corresponds to the wave of "new markets" in the second half of the 90s, driven by the expansion of the economy and, more particularly, by the boom of new technology companies. In this case, important new features were introduced in the regulations to facilitate the incorporation of technological companies to these markets, especially with regard to track-record requirements (age of the enterprise) and profits prior to admission to trading. These new markets, which were also set up as separate segments from the main market, entered into a decline in the year 2000.

In Europe, the main exception to the downward trend in new markets described above is the Alternative Investment Market (AIM), which belongs to the London Stock Exchange. This market, created in 1995, targets institutional investors and benefits from the visibility and the economies of agglomeration and scale of London as an international financial hub. Also, in comparison with other European markets, the AIM benefits from the higher level of development of formal and informal venture capital activities that exists in the United Kingdom. Late in 2010 a total of 1,195 companies were listed on the AIM, with an average capitalisation of 77 million euros. Since its creation, the companies listed on this market have captured funds amounting to 60,971 million euros, representing a yearly average of over 3,800 million euros.

In recent years the success of the AIM has served as a model for the creation of markets of a similar nature in other countries. Among markets of this type in Europe we would highlight Alternext, with French, Dutch and Belgian securities, the Entry market of the Frankfurt Stock Exchange, in the form of the NYSE-Euronext and the Deutsche Börse Group, respectively, and First North, with Swedish, Finnish and Icelandic securities. Outside Europe we would highlight the Canadian market TSX Venture and the Growth Enterprise Market of Hong Kong (see exhibit 1).

In Spain, in March 2008, the Spanish Stock Market, Bolsas y Mercados Españoles (hereinafter BME), also created a segment for enterprises in expansion: the Alternative Stock Market (hereinafter referred to by its Spanish acronym, MAB). By the end of 2010 a total of 12 companies were listed on this market (15 by July 2011), with an average capitalisation of 24 million euros. The volume of funds captured by listed companies since the inception of the market amounts to 78 million euros. The enterprises listed on the MAB carry on activities related to consumer services and, to a lesser extent, technology and communications. The number of enterprises listed on this market is still low compared with other alternative European markets, which is explained, at least in part, by its relative youth and the fact that, unlike other markets, when it was created there was no transfer of small- and mid-cap enterprises listed on the regulated market to the new market.¹⁴

14 Sánchez de la Peña (2008) provides a detailed description of the nature of this market.

Main alternative markets

EXHIBIT 1

Alternative market	Operator	Country	Date of creation	Capitalisation ¹ at end of 2010	Number of companies ² at end of 2010	Volume captured since creation ³
Europe						
AIM	London SE Group	United Kingdom	1995	92,056	1,195	60,971
Entry Standard	Deutsche Börse	Germany	2005	12,984	129	1,485
Alternext	NYSE Euronext	Belgium, France and Holland	2005	5,020	155	1,325
First North	NASDAQ OMX Nordic Exchange	Finland, Iceland and Sweden	2005	2,536	124	902
AIM	Borsa Italiana	Italy	2008	357	11	24
MAB Expansión	BME	Spain	2008	286	12	78
Rest of the world						
TSX Venture Exchange	TSX Group	Canada	1998	54,049	2,376	25,830
Growth Enterprise Market	Hong Kong Exchanges	Hong Kong	1999	12,914	169	6,241

Source: Dealogic and World Federation of Exchanges (WFE).

1 In million euros.

2 As at 18 July 2011, there were 15 expanding companies listed on the MAB.

3 In million euros. Volume captured to 1 June 2011, with the exception of MAB Expansión (to 18 July 2011).

5 The debate over how to boost the participation of SMEs in the capital markets

The European experience in markets for enterprises with growth potential suggests that the continuity and consolidation of this third generation of specialised markets is not assured. In the following part of this article we reflect on a number of issues that may be useful to address this challenge. Firstly we reflect on the advisability of implementing public policies aimed at growing the investor base interested in expanding companies and alternative markets. Secondly, we look at possible company support policies aimed at encouraging their participation in the market as listed companies. Thirdly, we discuss whether a purely domestic scope is best for this type of market or whether a European-wide market would be preferable. Finally, we analyse whether it is advisable to continue maintaining markets aimed at high-growth securities separate from the main markets. This last issue has been raised indirectly in the context of the forthcoming review of the Transparency Directive by a number of experts who propose introducing some changes to the regulation of EU regulated markets in order to encourage small- and mid-cap companies to list on these markets and to lighten the regulatory burden for those companies already listed.

Expansion of the investment base

As has already been stated, the financial crisis and the evolution of the economic cycle have significantly increased the difficulties for smaller-sized enterprises to find investors. These difficulties have been apparent throughout every stage of the financial ladder and have affected practically all industrialised countries, including those where this type of investment had reached a higher level of development prior to the crisis, such as the United States, the United Kingdom, Canada or Israel. One generalised reaction of the venture capital industry and, in many cases, of markets specialising in high-growth securities has been to call for an upward revision of existing tax incentives for this type of activity.¹⁵

Tax incentives are one of the main ingredients of policies aimed at stimulating investment in small enterprises with growth potential but with little track record. The establishment of this type of incentive is mainly based on the argument that the informational asymmetry between the company and potential investors is very accentuated in this type of company, which substantially reduces the number of investors willing to participate in their share capital. Typically, those who invest in unlisted enterprises of this type, in addition to taking on the high level of risk inherent

15 See, for example, URS (2010) and Thornton (2010), referring to the United Kingdom, and EBAN (2010a) regarding the stimulation of business angel activity in Europe.

to the investment, also bear due diligence costs, which normally include a significant fixed fee component regardless of the amount invested, and they should be willing to hold an active position in the administration of the company to defend their interests (hands on investors). In stock market flotations or when the enterprise is already listed, these requirements can be relaxed, although a low free-float, which limits the liquidity of the security and, therefore, the possibility of divesting rapidly, will usually oblige investors to keep a much closer watch on the company than would be necessary in the case of a consolidated listed company if a significant investment has been made.

Thus, due to the fact that the above mentioned difficulties impose a socially sub-optimal limitation on the financing of business projects with growth potential in their early stages, several countries have set up tax incentive schemes aimed at investors in order to facilitate companies' access to external financing during their early stages of development. A variety of formulas have been adopted, both in terms of choice of the type of enterprise which can capture investment eligible for the incentives and in terms of the types of investment or the types of tax benefit applicable. With regard to the type of investment, the most commonly used formula is to reward the direct investment by private persons in a certain type of enterprise, but in some countries incentives have also been offered to those investing through UCITS and other investment vehicles. In terms of the type of incentive, the main options used are credits on income tax linked to the amount invested, and exemptions or credits on the tax levied on capital gains and dividends.

Thus, for example, in 2010 a total of eight European countries (Belgium, France, Italy, Ireland, Germany, Luxembourg, Portugal and the United Kingdom) and 21 states of the USA offered tax incentives aimed at direct investors in the early stages of SME development, that is, in a scope of investment akin to that of business angels.¹⁶ In Spain, until recently only a few autonomous communities had established tax breaks for direct investment, limited, as will be explained later, to enterprises listed on the MAB. Since July 2011, there is also a system of incentive on a national scale aimed at encouraging small investments from third parties in small-sized companies not listed on regulated markets, a limitation which, in principle, does not exclude enterprises listed on the MAB, although, as we will see later, this measure is unlikely to affect the companies listed on this market due to other restrictions. In terms of incentives targeting investment through special vehicles, we would highlight those implemented in the United Kingdom and France. In both cases the incentives target the acquisition of participations or shares issued by certain collective investments schemes, which are obliged to have a large percentage of their portfolios invested in expanding companies not listed on regulated markets. Companies listed on alternative markets, in this case AIM and Alternext, are unlisted companies for the purpose of these incentives and may benefit from tax breaks on investments in this type of scheme, provided that they meet the requirements established.

The United Kingdom already has a certain degree of experience of tax incentives in support of investment in the early stages of company growth, where they were first put in place in 1981. Since this country also has the best developed financing structure

¹⁶ See EBAN (2010b).

for expanding companies, it is interesting to look into its tax incentive system in greater detail. British tax incentives aimed at private investors are structured into two different schemes.¹⁷ The first targets direct investment in companies by private individuals, through what are known as Enterprise Investment Schemes (EIS). Companies participating in an EIS can capture up to GBP 500,000 a year per investor through the issue of ordinary shares, with a yearly limit per company of two million pounds sterling. The investors cannot have any prior relationship with the companies. The companies must have at least 50 employees and their assets may not be in excess of seven million pounds sterling. The tax benefits offered include a tax credit of 30% of the annual investment amount on the companies' income tax liability, exemption from capital gains tax after three years, and the possibility of offsetting losses, either against income tax liabilities or against capital gains tax.¹⁸ It also allows companies to defer the payment of capital gains tax on the capital gains obtained by other assets reinvested in shares issued under a scheme of this nature.¹⁹ Investors are committed to holding their shares for at least three years.

The second scheme rewards investment through a specific investment vehicle, known as a Venture Capital Trust (VCT). These are collective investment schemes, listed on the main market of the London Stock Exchange, which distribute their investments among a certain number of small enterprises. Three years after their creation, these vehicles are obliged to hold a minimum of 70% of their portfolio in shares of small enterprises not listed on regulated markets, which includes, as mentioned previously, securities traded on the AIM. Investment in new issue shares of these vehicles, up to a maximum yearly total of GBP 200,000, is rewarded by a tax credit of 30% of its amount on the income tax liability for the current tax year, provided that the shares are held for a minimum of five years. Also, those investing in shares issued by a VCT, whether new or not, benefit from an exemption from tax payable on dividends and capital gains. The United Kingdom also offers incentives related to inheritance tax which have a certain impact on the AIM.²⁰

Current tax incentive schemes in the United Kingdom are being reviewed at present. In fact, in the case of EIS, in April 2011 the income tax credit on for such investments rose from 20% to 30% and later an increase of the limits on the yearly capture of funds per investor was proposed, and the amount will double in April 2012. At the same time, the British Treasury has released a document for public consultation containing reform proposals which, among other measures, call for the creation of a third scheme aimed at encouraging investment in the very early stages of companies, with stricter limitations than the EIS scheme for companies wishing to avail

17 There is a third type of scheme, called Corporate Venturing Schemes (CVS), aimed at encouraging investment in SMEs by other companies without any prior connection with those SMEs and without the intention to gain control. Generally speaking, the tax benefits and the requirements of CVS schemes are the same as those established for EIS schemes that are described in the main text, adapted to the corporate environment.

18 Credits on income tax for investment or to offset losses may be applied both to tax liabilities for the current tax year and to those of the previous year.

19 The deferral of capital gains tax liabilities is applicable to investments in EIS shares made in a period starting one year prior to the sale of the asset in question and ending three years after its sale. The application of this benefit has no limit in terms of the amount invested.

20 See, for example, Thornton (2010).

themselves of the scheme and also greater restrictions on the maximum amount of investment relief that can be claimed for.²¹

With regard to tax incentives in Spain, we should first mention the tax treatment enjoyed by venture capital companies registered with the CNMV, which only have to pay 1% corporate income tax. As stated previously, up until July 2011, no direct fiscal incentives were offered to investors at a nation-wide level in Spain. Until that date, this type of incentive was only available in Catalonia, Madrid, Galicia and Aragon, for investments in securities listed on the MAB. Specifically, the above mentioned autonomous communities offer a tax credit on the regional tranche of personal income tax amounting to 20% of the investment in shares of local enterprises listed on the MAB, provided that the investor acquired shares issued in capital increases (i.e. the incentive is for financing the company, not for buying on the secondary market), does not hold more than 10% of the company's share capital, and holds the shares for a minimum of two years. The maximum amount of the credit is 10,000 euros, which would imply a maximum investment relief of 50 thousand euros per personal income taxpayer.

As has been stated, in July 2011 a tax incentive scheme of a national scope to encourage direct investment by third parties in small early stage companies was introduced for the first time in Spain. The scheme was framed within a package of measures aimed at promoting business activity and other provisions.²² The tax incentive consists of the exemption from capital gains under personal income tax for third parties investing in shares or participations issued by companies not listed on a regulated market. At the time of the investment the companies must be no more than three years old, with equity of no more than 200 thousand euros. Investments eligible for relief may not exceed 25 thousand euros a year or 75 thousand euros in three consecutive years. Furthermore, investors may not hold over 40% of the company's share capital and must hold the shares for a period of between three and seven years. As mentioned earlier, the regulation does not exclude companies listed on the MAB, but it is unlikely to affect such companies to any significant extent, given the limited size of the companies at which it is aimed.

Spain's limited experience in the field of tax incentives for private external financing for small and medium-sized enterprises in comparison with other major European countries, invites reflection on the advisability of this type of incentive and, if they are advisable, what is the most efficient way of applying them. This reflection is in line with the provisions of the Third Additional Provision of Law 4/2008 which, under the title "Analysis of new schemes to promote the creation of small and medium-sized enterprises", calls for the conduct of a study of existing formulas in comparative law to promote the creation of SMEs and provide support to entrepreneurs, including the applicable legal and tax regimes.²³

21 See HM Treasury (2011).

22 Royal Decree-Law 8/2011 of 1 July, on measures of support for mortgage debtors, control of public spending and cancellation of debt with companies and self-employed workers contracted by local entities, development of business activity, and the promotion of (real estate) rehabilitation and administrative simplification.

23 Law 4/2008 of 23 December abolishing the Wealth Tax levy, generalising the Value Added Tax monthly refund system, and introducing other amendments to the regulation of the tax system.

If this channel is to be adopted, it may be advisable to establish a general framework, over and above any specific initiatives that the autonomous communities might adopt in this respect. By generalising the approach it may be possible to develop networks of both professional (business angels) and non-professional investors on a national scale. In fact, the main association of this sector of investors at a European level has called for the harmonisation of tax incentives between EU countries in order to make them more effective, by encouraging the development of European networks of investors with cross-border activity, and to prevent possible distortions (EBAN, 2010a). At a European level, Demarigny's proposal (2010) is equally interesting; he proposed creating a new category specialised in investment in small and medium-sized enterprises, within the collective investment schemes regulated by the UCITS (Undertakings in Collective Investment Schemes) Directive.

In principle, this type of initiative, implemented on a European scale, could have a positive effect on the investment base of enterprises with growth potential, by attracting new investors and extending the investment horizon beyond national boundaries. However, prior to adopting any option making use of this type of incentive, careful thought should be given to the design and to the externalities that such an option might give rise to. Thus, for example, the requirement that the investment be tied up for relatively long periods may have a negative impact on the liquidity of the security. In the case of a listed security, the tying up of the investment after a stock market flotation may be temporarily advisable for the controlling shareholders, but it may lessen the appeal of the share if applied to other investors.

Regardless of the debate on whether or not it is advisable to offer tax incentives, the Spanish tax treatment of investments in securities issued by small and medium-sized enterprises, particularly investments in securities listed on the MAB, leaves certain room for improvement in terms of correcting certain asymmetries which put these investments at a disadvantage compared with those made in securities listed on official secondary markets. These disadvantages are particularly apparent in some articles of the respective personal income tax rules for residents and non-residents, which establish provisions solely applicable to investments in securities listed on official secondary markets.²⁴ So there may be a case for applying a similar tax treatment in both cases.

Initiatives for promoting companies' participation in the markets

Two types of barrier tend to be identified with regard to this matter: cultural and economic. The former are associated with the understandable lack of familiarity with securities markets of many entrepreneurs. Far from being a trivial matter, this

24 In the case of IRPF (Personal Income Tax), the absence of fiscal neutrality is evidenced, for example, by the application of different criteria to quantify capital gains and losses, by the longer delay between the purchase and sale of a security permitted in regulated markets for the application of losses, by the also longer time frame allowed for the application of the exemption provided for dividends, and by the worse treatment of unlisted securities and, therefore, of those quoted on the MAB, in the case of transfers of preferential subscription rights. In the case of Non-Resident Income Tax, non-resident investors in MAB securities may not benefit from the double tax-exemption for income generated by the transfer of securities listed on official secondary markets when the investor resides in a State with which Spain has entered into an agreement of this nature with information exchange clauses.

circumstance tends to result in biases against the option of going to the markets. These biases may originate, for example, from an overestimation of the costs of being listed on a market, especially those directly related to the actual flotation and to reporting and conduct requirements, and an underestimation of the benefits in terms of diversification of financing sources, and reputation and image. The basic antidote to these problems is information, and the financial intermediaries working with the securities markets and the companies managing the trading systems should play a fundamental role in providing such information. As far as the Public Administrations are concerned, as part of their schemes to help small and medium-sized enterprises, it may be useful to set up information and advice lines to help SMEs bear in mind and consider this possibility.

With regard to economic barriers, the most commonly used measures to encourage companies to list tend to include some type of economic incentive. Thus, in most countries in our region, public policies in support of small and medium-sized enterprises (subsidies, government credit, guarantees for access to bank credit, tax breaks, aid programmes in various sectors, etc.) have been in place for a long time. Some of these aids specifically target certain kinds of expanding companies, in particular those involved in technological innovation.²⁵

In Spain, the catalogue of support policies targeting SMEs has grown recently with the establishment of aid schemes intended to facilitate the access of companies to the market. These aid schemes are orientated towards the partial financing, by means of loans or subsidies, of the expenses associated with the MAB listing process or the previous viability studies. In addition to financial aid, these schemes also include technical support. The State owned company Empresa Nacional de Innovación (National Innovation Enterprise; Spanish acronym: ENISA), reporting to the Ministry of Industry, Tourism and Trade, plays an important role in the provision of technical assistance and financial aid to promote entrepreneurship and the growth of SMEs. Among other credit facilities, ENISA grants two-year loans of up to 1.5 million euros, interest free and without fees, aimed at financing MAB listing expenses.

At an autonomous community level, the Instituto Madrileño de Desarrollo (Madrid Institute of Development; Spanish acronym: IMADE) offers non-recoverable grants of up to 80 thousand euros to regional enterprises wishing to list on the MAB. In Galicia, the Instituto Gallego de Promoción Económica (Galician Institute for Economic Promotion; Spanish acronym: IGAPE) can subsidise up to 50% of all consulting and technical assistance costs, and up to 10 thousand euros for pre-listing surveys and up to 50 thousand euros for the actual flotation process. Finally, the Instituto de Fomento de la Región de Murcia (Institute for the Development of the Region of Murcia; Spanish acronym INFO) offers subsidies of up to 45% of the adaptation costs for the listing process, up to a total limit of 83 thousand euros.

The main reason for offering this type of public aid is the cost and complexity of the listing process for companies deciding to choose this path, since the obstacles can

25 In the case of Spain, the Centro para el Desarrollo Tecnológico e Industrial (Centre for Industrial Technological Development; Spanish acronym CDTI) offers several aid programmes in this area which are available to companies of this type.

be especially dissuasive for small enterprises. In a work which examines the listing process in a number of different markets, Kaeser and Schiereck (2008) estimate that the average direct cost of these operations were, for the period 1999-2008, in the region of 7.6% to 11.1% of the captured volume in the case of several alternative European and US markets, compared with a range of 5.5% to 8.1% for major securities trading on official markets.²⁶

Public support can undoubtedly play a positive role in facilitating the market listing of SMEs, especially in those cases where there are disproportionately high entry costs for smaller enterprises, as available evidence seems to suggest. However, the type of instrument chosen to provide such support needs to be the subject of careful consideration. Thus, in addition to direct subsidies and tax breaks, it may be a good idea to examine other formulas which are less of a burden on public funds and more effective in terms of encouraging more diligent behaviour on the part of the beneficiary companies. Specifically, it is reasonable to consider the possibility of basing part of public incentives on loans, at better than market conditions, which will enable companies to bear the initial market listing costs. This formula will probably also enable more funds to be put at the disposal of companies than subsidy-based schemes, which, in principle would seem to be a critical factor, especially in a process whose objective is to increase the financial resources available to companies. In any event, as in the case of tax incentives aimed at investors, it may also be advisable to set up a minimally harmonised framework which, in the case of aid granted by autonomous communities, would cover access requirements to these incentives and their content.

Domestic markets versus pan-European markets

One important issue concerning markets for small capitalisation with growth potential is that regarding the geographic scope of the market. Up until now, these markets have been set up in Europe on a national scale. In this respect, experience accumulated over the years points to a number of factors such as the size of the economy, the deep-rootedness of the entrepreneurial spirit and the incentives which can drive it, the educational level of the population, or the investment in research and innovation which, among others, may impact on a country's capability to generate enough enterprises in the short-term with the potential to be listed on a small-cap market.

A market which does not reach critical mass in terms of the number of listed companies may find it hard to attract the attention of investors. A small sized market in terms of the number of securities listed or total capitalisation and trading may cause investors to have a negative perception of the liquidity of the listed securities, particularly when, in general, these are already inherently illiquid in the case of small

26 Direct costs are the explicit costs which arise in the listing process (remuneration of placement agents, professionals contracted, advertising, initial listing fees, etc.). In addition to these costs, the company may have to pay indirect costs which arise after the listing process. The most important of these tends to be risk of the shares being undervalued in the public offering. The European and US small cap markets compared in the above mentioned survey were Alternext, Entry Standard, AIM, Nasdaq Small Caps, and NYSE Small Caps.

enterprises. Also, the larger the market, the greater its capacity to attract the attention of analysts and brokers who are essential for ensuring the consolidation of the market.

It is therefore no surprise that some experts, like Demarigny (2010), give considerable importance to the visibility of small- and mid-cap securities markets and recommend the establishment of a European-wide trading platform for this type of security. In line with their recommendations, the platform proposed is conceived as a single access point for investors to small and mid-cap securities listed on regulated European markets. In this way the *status quo* is maintained in terms of the permanence of the listing of these securities on the regulated domestic market, without it being necessary to enter into merger processes. In this respect, the above mentioned author suggests that, in order to facilitate the setting up of such a multilateral trading platform, its management should be entrusted to an entity which is neutral in respect of competitive market strategies, namely the European Investment Bank. He also suggests that the new European securities markets authority, ESMA (European Securities and Markets Authority) be responsible for the supervision of the platform.

The idea of creating trading platforms on a European scale is not new. In the late 90s of the last century a similar idea was mooted unsuccessfully for application in primary markets. As was proven then and in the course of the many merger and acquisition processes which have taken place in the European markets in recent years, the main obstacle to the development of joint initiatives like those being proposed is the fact that the European stock exchanges compete with one another and that the main ones at least already have their strategies defined. In spite of this difficulty, the above mentioned proposal has a sound basis in the context of a policy aimed at promoting market financing for SMEs, on both a domestic and European scale, and should be considered by the promoters of market infrastructures and by the authorities.

Although proposals to date have focused on regulated markets, the promotion of a pan-European market for small- and mid-cap securities may also be considered in the context of alternative markets. In fact, as we analyse later in this document, a clear separation of the markets specialising in SMEs, with adapted admission and continuing obligations, and the regulated markets, with a more stringent regulation, is advantageous in terms of investor protection.

Regardless of the debate on the advisability of a European dimension of the markets for small- and mid-cap securities, the managers of trading infrastructures for this type of security are promoting initiatives aimed at increasing market visibility. In this respect we would highlight a recent initiative from BME in the area of analysis services. The availability of an independent analysis service with a sufficiently broad and diverse scope is essential to attract and hold the interest of investors. With this purpose in mind, in September 2011, BME reached an agreement with the Instituto Español de Analistas Financieros (Spanish Institute of Financial Analysts; Spanish acronym: IEAF) for them to manage an analysis service called InResearch, which could be contracted both by the companies trading on the main market and by those listed on the MAB. The agreement established a protocol regarding the conditions the analysts had to meet and the procedure employed to select them.

Market regulation-related issues

As mentioned earlier, stock exchanges have developed specific trading areas for small-cap enterprises with growth potential. These markets are not regulated markets in the sense established by the Markets in Financial Instruments Directive (MiFID) and they are not, therefore, obliged to adhere to the European legislation applicable to such markets in terms of admission and continuing obligations.²⁷ Market rules are established by the managing body, although they must be authorised by the national supervisory authority.

In general, these rules are more flexible in the alternative markets than in the regulated ones. Thus, for example, with regard to free-float at the time of admission, while the above mentioned directive requires a sufficient number of shares to be distributed among the public, setting 25% of the total as a guiding criterion, some alternative markets, such as the British AIM, do not set any criterion and others, such as the Spanish and Italian markets, do, but apply very unrestrictive criteria in this respect, intended more for a market aimed at institutional investors than for a market open to retail investors. Similarly, with regard to the company's track record prior to admission, while the above mentioned directive sets the benchmark at a flexible three years, the alternative markets opt for shorter periods, usually two years. With regard to continuing obligations, the alternative markets also include the duty to submit an audited annual report and an unaudited report with a similar content to the former, corresponding to the first six months of the year. Both reports are similar to those called for by the Transparency Directive for regulated markets. However, the submission time frame is longer for alternative markets. Thus, in most of these markets a deadline of six months tends to be set for the annual report and three months for the half-yearly one, versus the four and two months, respectively, required by the Transparency Directive. In the case of the MAB, the submission time frame for the annual report is set at six months, while for the half-yearly report it is three months. Also, the two interim management statements required by the Transparency Directive are not required in the alternative markets.²⁸

In spite of the greater laxity with which the transparency requirements are generally applied, the alternative markets also have some requirements intended to give investors confidence which are not to be found in regulated market rules. Thus, for example, it is usual to require the presence of entities which accompany the enterprise during part or all of its life as a listed company as advisors or liquidity providers, or to require the outsourcing of certain services, such as information to shareholders via the Internet. Particularly important is the requirement that companies contract the services of a registered entity to advise them on compliance with market rules and, in general, on the regulation of securities. In the case of the British AIM, the market delegates a large part of its supervisory duty regarding compliance with market rules to these advisors. With regard to the contracting of an intermediary to provide the security with liquidity, this is a measure intended to make this

27 The most important reference directives on this matter are the Consolidated Admission Requirements Directive, the Prospectus Directive, the Transparency Directive, and the Market Abuse Directive.

28 The interim management statements must be submitted during each of the two half-years, between the corresponding annual report (half-yearly) and the half-year report (annual).

type of security, which are generally characterised by poor liquidity in the secondary market, more attractive. Another measure aimed at giving investors confidence is the establishment of a minimum period, usually a year, during which the reference shareholders and directors, or those who, due to their position, have greater access to non-public information which could affect the share price, undertake not to sell their shares (lock-in clause). Some alternative markets, such as the Spanish MAB, also provide safeguards for minority shareholders in the case of takeovers. In regulated markets, these safeguards are covered by the Takeover Directive.

Thus, in the field of regulation, markets for expanding companies try to maintain a certain balance between investor protection and the burden of regulation for the companies. On the one hand, it is supposed that the companies targeted by these markets are not always willing to meet the obligations of transparency or the economic cost associated with compliance with the regulations of the main markets. On the other hand, regulation starts from the premise that these markets are aimed at qualified investors, especially institutional investors, who do not require the same level of protection as retail investors for buying into this type of security and trading with them. From the point of view of the less qualified investors, the separation of this kind of trading from the regulated markets sends a useful signal which warns them that they are dealing with securities of a different nature in terms of risk, especially in matters of liquidity, and that the levels of protection assured by regulation are also different.

In the context of the review process of the Transparency Directive provided for in Article 33 of this regulation, in May 2010 the European Commission (EC) drew up a questionnaire aimed at regulators and market participants to ask their opinion on various ways the Directive might be modified. Some of the questions concerned a possible adjustment of the transparency requirements for small-cap enterprises in regulated markets, in order to reduce continuity costs and attract new companies.²⁹ Among the measures considered, the questionnaire asked about the advisability of extending the submission time frame for periodic reporting in these enterprises and exempting them from the requirement to submit interim management reports (quarterly management reports) and other elements currently included in the periodic reporting required from enterprises listed on regulated markets, all of which, in principle, would reduce the cost for the issuer of continuing as a listed company. The document also looked at a number of measures to improve the comparability of the information provided to investors in the different markets and to accelerate and flexibilise its dissemination on a Europe-wide scale.

If the transparency regime were to be adjusted in the manner considered in the European Commission questionnaire, the requirements applied to small-cap securities listed on regulated markets would not be very different from those which are currently established in alternative markets for expanding companies. The above consideration underlies the current debate as to the advisability of undertaking a reform of this type, in a context in which, as we have already pointed out, there are already alternatives in existence which have been developed by the stock exchanges; i.e. by the managers of the regulated markets.

29 The European Commission questionnaire can be found at http://ec.europa.eu/internal_market/securities/docs/transparency/directive/consultation_questions_in.pdf.

Some experts argue in favour of this option, pointing out that there are investors who do not feel comfortable with the level of protection and the low levels of liquidity provided by the alternative markets. Along these same lines they argue that some small and medium-sized enterprises choose to list on regulated markets for tax or regulatory reasons. Thus, for example, in some European countries, property investment companies may benefit from a favourable tax treatment if they are listed on a regulated market. It is also argued that sometimes there are restrictions on regulated institutional investors investing in securities not listed on regulated markets. However, as mentioned earlier, this line of argument does not in itself seem enough to justify a reduction in the transparency requirements of the regulated market.

Others suggest flexibilising other rules relating to the admission and continuance requirements for small- and mid-cap companies in the regulated markets. Thus, in the scope of the Prospectus Directive, among other measures, there is a proposal to raise the volume of securities above which it is mandatory to publish a prospectus, and to simplify the content of the historical information required when a company is admitted to trading. In the area of accounting rules, for small- and mid-cap companies there is a proposal to reconsider the obligation to use international financial reporting standards when presenting consolidated accounts. In the sphere of corporate governance, there is a recommendation to produce reference codes adapted to the needs of this type of company. An example of such codes is the “comply or explain” principle, already implemented by the British market AIM. In the scope of the Market Abuse Directive, there is a proposal to exempt small- and mid-cap companies from the obligation to draw up lists of insiders; i.e. to keep an up-to-date list of the employees of the firm or any other people who, due to their professional involvement, are in possession of information of a non-public nature which could affect share prices. Finally, there are recommendations to promote the liquidity of the market through intermediaries specialised in this activity. To this end, it is proposed to issue a European passport to these entities so that they can operate in any regulated market within the European Union, provided that they have the appropriate “Chinese walls” in place. The Market Abuse Directive calls for this activity to be recognised as an “accepted market practice”.³⁰

Thus, both the issues included in the European Commission’s questionnaire and Demarigny’s recommendations (2010) invite reflection on the advisability of adapting and promoting regulated markets as an appropriate trading platform for enterprises with growth potential and, in general, for small and medium-sized enterprises. In this respect we should make the following observations.

First of all, as has been stated, if the admission and continuing obligations for regulated markets are made more flexible in the manner described, these requirements will move closer to those governing alternative markets today. In particular, if the different regulatory treatment between small- and large-cap securities proposed by regulated markets is properly defined, there is no certainty that an investor’s perception of the liquidity of these securities or their confidence regarding the level of investor protection in regulated markets will be significantly better than the current perception of alternative markets in this respect.

30 According to the present wording of this directive, such recognition is optional for each Member State.

Secondly, the presence of enterprises in the regulated markets for tax reasons or because of the regulatory restrictions placed on institutional investors regarding investment in unlisted shares is not sufficient reason for lowering transparency requirements. In this respect, we would need to examine to what extent these restrictions play a significant role in companies' decisions to list on one type of market or another. In other words, if in the absence of these restrictions, once the decision was taken to list on a market, companies continued to choose regulated markets, the argument would be invalid. However, if the restrictions were significant in the sense we have described, it would not seem reasonable to propose a reduction in transparency requirements without examining other options. In particular, it might be more effective in the long term for the solution to these problems to be addressed within the scope of the public policies where the distortions originated.

Thirdly, some of the measures of a cross-border nature that have been suggested might have a positive effect on small- and mid-cap securities in regulated markets. In particular, the establishment of requirements regarding the reporting format which would improve the comparability of financial reporting, the more efficient distribution of that reporting between countries, and the creation of a European passport for entities specialising in the provision of liquidity to the securities listed. These measures could be applied and have a positive impact on alternative markets.

The fourth observation refers to the advisability of taking into account the impact that a certain reduction in transparency may have on the liquidity of the securities affected. Such securities tend, in themselves, to be rather illiquid due to the fact that their capital tends to be small and their distribution among shareholders other than the controlling partners tends to be minimal. Some academic studies suggest that changes of market or regulatory regime may have a negative effect on price and liquidity when the change represents a negative effect on the quality of the regulation.³¹

The fifth observation has to do with the impact on investor protection and the reputation of the market. If a different regulatory treatment for small- and large-cap securities is decided upon in regulated markets, it would be advisable, at the very least, to segment these markets, giving investors a proper indication of the guaranteed protection levels. One probably more appropriate solution would be to preserve the regulated markets as top-quality markets in terms of investor protection and to set up another category of market where small- and mid-cap securities would receive a differentiated treatment. This latter solution would be more useful to investors due to the greater clarity of the signal being sent and it would be compatible with a certain level of regulation certificated by European legislation.

The sixth observation refers to the advisability of encouraging institutional investment in small- and mid-cap securities through regulation. In particular, as has already been mentioned, the creation of a category of vehicle specialising in small- and mid-cap securities has been mooted within the framework of the UCITS Directive. Harmonised collective investment institutions can invest in any kind of

31 See, for example, López (2008), where a summary of the relevant academic literature on this subject is provided.

financial asset, particularly in listed and unlisted shares of small and medium-sized enterprises. The creation of a category of UCITS specialising in this type of security could encourage cross-border investment in both regulated and alternative markets.

The final observation refers to market supervision. As we have said, unlike regulated markets, alternative markets are not subject to MiFID and in many cases enjoy considerable independence in terms of regulation and supervision. However, general experience in matters of self-regulation and, in particular, the recent experience of these markets, suggests that the supervisory authority should continue to keep a close watch on the markets and on the supervisory functions of the managing bodies of those markets. In the case of the MAB, the CNMV is responsible for its supervision, in the certainty that it can help create greater confidence in the market.

6 Conclusions

SMEs play a very important role in the creation of employment and added value in the Spanish economy, substantially greater than in most other countries of the European Union. As in other countries of our region, the banking channel plays a vital role in the financing of SMEs and there is scant development of other sources of external financing, such as venture capital or the securities markets. This reliance on bank credit has accentuated the negative impact of the financial crisis, which started in 2007, on the financing of these enterprises, due to the liquidity constraints faced by financial institutions in some key wholesale markets, such as the interbank market of the securitisation market, and due to the deleveraging strategies followed by these entities in order to shore up their solvency.

Available information shows that the situation regarding financing continues to be difficult in these times for Spanish SMEs. The short- and medium-term outlook is also cause for concern due to the uncertainty regarding the normalisation of credit and the impact of the new prudential legislation on the bank sector's intermediation capacity. The experience of the crisis which affected the Spanish economy in the early 90s of the last century suggests that it could be wrong to rule out a slow recovery of bank credit after the impact of such a severe financial crisis as the one which started in 2007.

In this context of difficulties and uncertainties, we need to examine the possibility of developing alternative financing channels. In the case of early stage enterprises with high growth potential, of great importance to the economy due to their potential to innovate and create employment, this need is particularly obvious. The development of alternative formulas for these enterprises in their early stages includes both venture capital activities (business angels and formal venture capital entities) and the development of financing through the securities markets. Special attention should be paid to the so-called alternative markets which, like the Spanish MAB, have been set up in recent years, inspired by the success of the British AIM. These markets, which are not regulated markets in the sense of the MiFID Directive but are essentially self-regulated markets, provide small- and mid-cap securities and their investors with a more flexible framework in terms of disclosure to the market and other requirements.

Concern regarding the financing of SMEs, especially early stage companies with growth potential, is arousing a wide-ranging debate in the European Community and in several other countries, including Spain. Among the issues raised, especially important are those concerning the advisability of expanding the investment base, the setting up of aid schemes for enterprises wishing to go to the market and, with regard to markets for small- and mid-cap securities, the design of the market and the role that regulation might play in its promotion.

Tax incentives may play an important role in the first two issues. With regard to the search for new investors, several countries have set up significant tax breaks to reward investment in the early stages of small expanding companies. This type of incentive is mainly justified by the existence of informational asymmetries which act as a barrier to investment at these early stages. In Spain, incentives of this type, set up by autonomous communities and intended to relieve investment in enterprises listed on the MAB, have existed for some time. Also, since July 2011, there has been a State scheme of aid generally applicable to very small companies not listed on regulated markets. Although these aids could, in principle, benefit companies listed on the MAB, this is highly unlikely due to the substantial limitation on the size of the firm (equity no greater than 200 thousand euros). Regardless of the incentives introduced, we should be aware of the existence of a number of asymmetries in the income tax payable by residents and non-residents which may, without any apparent reason, place at a disadvantage securities listed on the MAB compared with securities listed on official secondary markets.

Public aid to encourage SMEs to list on the market is also sometimes justified by the existence of barriers which hinder access to the market, mainly informational barriers and barriers posed by the high cost of the listing process. In Spain, several autonomous communities and public enterprises offer help in the shape of credits and subsidies to encourage SMEs to list on the market.

The matter of the design of the market mainly hinges on the low visibility which tends to characterise the markets or trading segments for small- and mid-cap securities in comparison with those for large cap securities. These problems are associated with the attention that analysts and brokers tend to pay these securities. Therefore, among other proposals, some experts call for the promotion of markets of a pan-European nature, which are likely to reach a sufficient size faster than domestic markets and so be able to attract the attention of analysts, brokers, enterprises and investors. The desire to increase the visibility of markets has also given rise to initiatives aimed at the managers of trading platforms in order to promote a supply of independent analysis covering the securities listed on those platforms. In Spain it should be noted that in September 2011 the BME set up an analysis service of this nature for both the regulated market and the MAB, run by the Instituto Español de Analistas Financieros (IEAF, its acronym in Spanish).

With regard to the role of regulation, the current debate coincides with a wide-ranging review process of EC rules governing the securities markets, and focuses on whether or not it is advisable to set up an “SME scale” in the regulation, adapting the requirements set out in the main directives to the situation of small- and mid-cap securities, even if they are listed on regulated MiFID markets. If it were decided to admit different levels of regulatory requirements within the same market, it would be advisable to have a clear segmentation of the market based on the type of regulation applied so that investors had a clear picture of the situation. However, it is not clear that a decision of this nature would be an improvement on the current situation since, on the one hand, the regulated markets provide the most stringent requirements across the board for all securities listed on them and, on the other hand, the alternative markets already offer requirements adapted to SMEs which the investors participating in these markets seem to have no problem accepting.

Also, from the viewpoint of regulation, it has been proposed that the UCITS Directive cover the creation of harmonised vehicles specialised in small- and mid-cap securities. A measure of this type could be useful for encouraging cross-border investment in the above mentioned securities, both in the areas of regulated markets and alternative markets.

Finally, the general experience regarding market self-regulation suggests that the total inhibition of the public supervisor does not tend to be positive in terms of maintaining investor confidence. Therefore, despite the wide-ranging autonomy enjoyed by the alternative markets in matters of regulation and supervision, it is advisable for there to be an active monitoring of the functioning of the market and of the exercise of the relevant market authority's autonomous duties of supervision. In the case of the CNMV, this monitoring duty has been incorporated into the agency's functional framework.

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