EU IPO Report

Rebuilding IPOs in Europe

Creating jobs and growth in European capital markets

Issued by the European IPO Task Force
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Presented to the European Commission as input to the debate on Capital Markets Union

Feedback from market participants is also welcome

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Foreword

With great pleasure, I present to you the report of the IPO Task Force, on behalf of its members and their supporting associations – EuropeanIssuers, the European Private Equity & Venture Capital Association and the Federation of European Securities Exchanges.

This Report makes recommendations to EU policy makers and industry participants to increase EU job creation and drive growth by restoring effective access to the public markets for smaller, high-growth companies. It aims to provide input to EU Commissioner Hill's Capital Markets Union Green Paper consultation.

The European IPO markets need to work better for the real economy. In the last ten years, capital raised through IPOs was only around half of what was raised in the 1990s. This decline comes at the worst possible time for European businesses, coinciding with declining availability on bank lending. Although Europe continues to build and grow businesses with the potential to be world class, the failure of the IPO market to facilitate their access to capital markets hampers their growth and lowers potential employment. According to OECD analysis, a properly functioning IPO market could deliver thousands of extra jobs in Europe. A survey, conducted in 2007, also finds out that 92% of job growth in a company occurs post-IPO. This is an opportunity we cannot afford to miss.

The IPO Task Force is convinced that prompt action is needed to kick start the European IPO market, in support of the Capital Markets Union and the Long Term Investment Plan for Europe. We need to build an equity culture, in which investment through equity becomes an attractive and readily available option for European businesses of all sizes. Work is needed on both the supply of IPO opportunities and the demand for them. On top of that, a zero risk mentality is putting a heavy burden on entrepreneurial skills in Europe and hampering growth. We need to try and turn this around.

To address these issues, we have developed recommendations for policymakers and for participants in the ecosystem necessary to promote the development of capital markets in Europe, which serve the needs of both companies and investors and bridge the gap between them. We believe that capital markets can only be built from the ground up, not from the top down, given that smaller markets are national and are likely to remain so. Priorities for change include;

- Create a more balanced and flexible regulatory environment for small and mid-cap quoted companies, also known as "Emerging Growth Companies";
- Ease constraints that restrict investors' access to IPO markets and to invest in venture capital / private equity;
- Improve the market ecosystem to better serve companies at different stage of growth and different types of investors;
- Create an equity culture in Europe, including education and non-legislative initiatives;
- Improve tax incentives for investment into IPOs and in equity more generally.

We invite the Commission to carefully consider what I believe are practical and achievable recommendations that will have a real positive impact on the EU IPO market, and ultimately on long term growth and jobs. We are committed to further exploring our recommendations together with the Commission and as such, we invite them and other stakeholders to let us know how we can support them.

We hope you find inspiration in the Report.

Best regards,

On behalf of the IPO Task Force team

Philippe de Backer – MEP and Chair

Executive Summary

Introduction

Three associations (**EuropeanIssuers, EVCA and FESE**) have come together to initiate the **European IPO Task Force**. The experts appointed to the IPO Task Force represent the broad spectrum of professionals engaged in the European equity markets from various jurisdictions (annex 1).

The Associations initiated this report because they believe that **European capital markets**, for which the **IPO process** is the entry point and an important barometer, play a **crucial role** in the economy. Although the main direct stakeholders of IPO markets are the companies being financed and the investors that support them, the indirect benefits of well-functioning IPO markets accrue to the whole economy. Europe therefore needs to harness the full potential of its IPO markets to finance sustainable **economic growth**. The experts in this Task Force represent different parts of the market, but share a common vision about how Europe's IPO markets should function.

EU equity markets should facilitate proper communication between investors and companies, be resilient through the business cycle, even during down cycles, provide access for smaller companies, maintain a high level of quality (i.e. high levels of long-term positive performance and minimum levels of bankruptcy, fraud, and value loss), operate with fairness vis-à-vis both companies and investors, and have adequate depth in terms of the volumes available for investment, the mix of investors, and liquidity.

The Task Force is also united in its observation that, despite the recent signs of a recovery in IPOs on equity markets, important structural constraints remain and can only be overcome through a combination of **policy** and **industry** actions. **In particular, the IPO Task Force believes that European IPO markets must become significantly more accessible than they are today to smaller companies**. European companies will need to raise more funding via market finance, as bank finance is being constrained. Furthermore, studies from the US as well as Europe demonstrate the **unique role of equity in providing permanent risk capital**[1] which cannot be financed in the same way by debt that requires a guaranteed return. Hence, the risk capital financing enabled by IPOs contributes to innovation, which is particularly relevant for growth in developed economies[2]. It is not the intention to replace debt or other source of finance with public equity, but to complement and enable other sources of financing in a broad and continuous spectrum of methods available to companies and investors.

Europe needs concrete actions to allow IPO markets to play a more active role in financing the economy. Moreover, the **small and mid-cap companies** typically interested in public equity markets but struggling to gain access to these markets are especially the ones that **are the engines of economic growth, bringing disproportionately high rates of job creation, corporate taxes and significant benefits for investors, the local and regional economies and the European Single Market.**

This report aims at raising awareness of the key obstacles to efficient IPO markets and outlines the key areas where action is needed.

Before making recommendations for European action, it is important to take stock of how European regulation defines **smaller companies** for different purposes, and in particular how the MiFID II SME Growth Market might change the conditions for smaller IPOs[3].

[1] Isaksson M. and Çelik S., "Who Cares? Corporate Governance in Today's Equity Markets"
[2] Wright W., "Driving Growth: making the case for bigger and better capital markets in Europe", pages 52-53
[3] Staff Working Paper

It is worth noting that ITO Task Force report comes on the heels of several important **national initiatives** aimed at individual IPO markets[4]. Some of these were focused on technical aspects of the IPO process, while others were of a broader nature.

The focus of the current Report is to take a pan-European point of view and to look at the structural factors surrounding the IPO market, rather than the technical aspects of the IPO process, national issues, or SME finance in general.

Some of the obstacles discussed in this Report seem to be part of **a global phenomenon/trend** in the sense that the structural factors affecting IPO markets are of a global nature. Several key studies published in the second half of the 2000s analysed these factors and created the intellectual and policy foundation for the US IPO Task Force which in turn led to the creation of the JOBS Act of 2012. An equivalent body of analysis of the European capital markets does not exist at this point. However, the recent data gathered and analytical work done by and for the OECD, covering Europe as well as other regions, provides us with an excellent starting point to understand what is ailing European IPO markets.

The recommendations offered by the experts of the European Task Force, who know first-hand the difficulties faced in their areas, are intended to generate further discussion in Europe about the future of IPOs and to contribute to the debate on EU capital markets. In light of the recently launched Green Paper on Capital Markets Union, we hope that the policy recommendations offered will lead to concrete steps that bring our markets forward for the benefit of the European economy.

The Importance of Emerging Growth Companies

Job creation is strongest among the small and mid-cap companies ("Emerging Growth Companies") which are or could be listed on stock exchanges. While Emerging Growth Companies overall have a large share of the EU economy, the largest Emerging Growth Companies – exactly the ones most likely to access capital markets - have a disproportionately important share of job creation.

A European study by the ESSEC Business School and GE Capital[5], covering France, Germany, Italy and the UK for the period of 2007 to 2010, showed that, while these companies represent a tiny fraction of total companies – ranging from a low of 1.2% in Germany to 1.7% in France – they generate about **one third of private sector revenue and employ about a third of each country's workforce**.

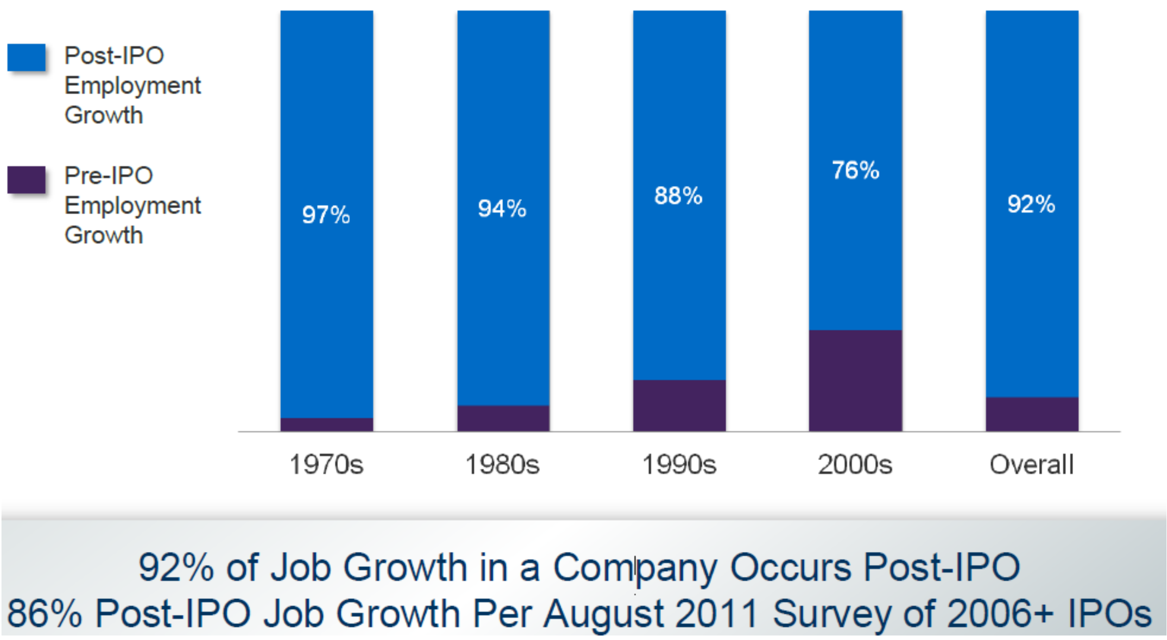
Combined, the middle market in these four European countries listed above contributes €1.11 trillion ($1.48 trillion) to their GDPs, noting that this "makes the middle market in the EU-4 one of the top 10 economies in the world, ahead of India and Russia". The study shows that **these companies created 280,000 new jobs**, while large companies in Europe lost almost 1.5 million jobs in the same timeframe.

A report from Oliver Wyman[6] has estimated that "successful SME capital markets can add up to 0.1-0.2% uplift…to overall GDP each year, while supporting the creation of hundreds of thousands of new jobs globally."

The US IPO Report[7] stated that: "From 1980 to 2005, firms less than 5 years old accounted for all net job growth in the U.S.", while an OECD-commissioned paper[8] estimates that the US economy might have produced between 6 and 19 million more jobs over the last two decades if its IPOs had kept pace with GDP growth.

[4] Staff Working Paper
[5] ESSEC Business Scholl & GE Capital, "The Mighty Middle: Why Europe's Future Rest on its Middle Market Companies"
[6] Oliver Wyman, "Towards better capital markets solutions for SME financing", page 3 and 8
[7] IPO Task Force, "Rebuilding the IPO On-Ramp, Putting Emerging Companies and the Job Market Back on the Road to Growth"
[8] Weild D., Kim E. and Newport L., "Making Stock Markets Work to Support Economic Growth: Implications for Governments, Regulators, Stock Exchanges, Corporate Issuers and their Investors" , page 38

Chart 1 IPOs Finance Significant Job Creation



Source: Venture Impact 2007, 2008, 2009 & 2010 by IHS Global Insight, IPO Task Force August 2011 CEO Survey

The indirect benefits of IPO markets include: enhanced economic growth, greater innovation and an economy more robust to shocks due to a diversified labour base.

However, the EU institutions, national governments and regulators need to recognise that risk capital is not zero-risk, and that the economy stands to gain from allowing investors to take on risks, provided that these risks are transparent and appropriately regulated.

The Importance of IPO Markets

The IPO process is the entry point and an important barometer of the European capital markets and it plays a crucial role in the economy. Although the main direct stakeholders of IPO markets are the companies being financed and the investors that support them, the indirect benefits of well-functioning IPO markets accrue to the whole economy.

Research has shown that capital market size is positively correlated with economic development: "those countries where capital markets – and especially stock markets – seem to be underdeveloped appear to pay a high price in terms of below average growth" [9] The same report states that: "in Europe it is actually the capital market, providing access to debt and equity financing, which determines economic development"[10]. Another report demonstrates that by providing access to equity finance stock markets allow firms to realise growth options (1,559 European companies that went public via an IPO showed substantial growth rates in the 3 years following the IPO) [11]

Studies from the US as well as Europe demonstrate the unique role of equity in providing permanent risk capital[12] which cannot be financed in the way by debt, which requires a guaranteed return. Hence, the risk capital financing enabled by IPOs contributes to innovation, which is particularly relevant for growth in developed economies (and rely more on equity capital)[13]. Moreover, public equity markets complement and enable other sources of financing in a broad and continuous spectrum of methods available to companies and investors.

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[9] Kaserer C. and Rapp M. S., "Capital Markets and Economic Growth: Long-Term Trends and Policy Challenges", page 10
[10] Ibid, page 46
[11] Wright W., "Driving Growth: making the case for bigger and better capital markets in Europe", pages 52-53
[12] Isaksson M. and Çelik S., "Who Cares? Corporate Governance in Today's Equity Markets"
[13] Wright W., "Driving Growth: making the case for bigger and better capital markets in Europe", pages 52-53

The importance of capital markets for the EU economy, as well as the need for their development are recognised in the recently published Commission Green Paper on Capital Markets Union: *"Our equity, debt and other markets play a smaller role in financing growth and European businesses remain heavily reliant on banks, making our economies vulnerable to a tightening of bank lending. (...)European investment levels are well below their historical norm and European capital markets are less competitive at the global level. (...) More integrated capital markets, especially for equity, would enhance the shock-absorption capacity of the European economy and allow for more investment without increasing levels of indebtedness."*[14]

As mentioned above, the main direct stakeholders of IPO markets are companies that are being finance and the investors that are investing in them.

While accessing IPO markets, companies expect fresh capital at a reasonable cost which they can use to finance new entrepreneurial plans without a fixed level of return. In this sense, when compared to all other forms of financing, equity finance is the only one that can handle entrepreneurial risk.[15] They also expect to lower their other financing costs to be able to access markets again in subsequent phases[16], and to strengthen their brand recognition and gain prestige. Moreover, public equity markets play an important role in the "funding escalator" with different modes of financing for companies at different stages of development.

On the other hand, what investors look for in IPO markets are: a higher level of return than less-risky investments, high level of diversification and targeted exposure to certain sectors or companies. Investors may also want to see a certain project succeed, or to fund developments in a particular industry or geographical region.

For more information on the economic and social role of IPOs and their importance to companies and investors see the full Report.

The IPO Market Decline

During 1993-2000, the OECD area had an annual average of about 1170 IPOs. During 2001-2011, this number fell to about 670. During the "recovery" period before the financial crisis, the annual number of IPOs never reached the average number of IPOs during the 1990s. The decrease in the *number* of new listings in OECD markets was accompanied by a decrease in the *amount of equity* that companies raised. The total value of capital raise decreased from an annual average of USD 132.7 billion during 1993-2000 to an annual average of USD 69.9 billion during 2001-2011. According to the OECD, preliminary data for the first half of 2012 indicated modest results that remained below the average for the period 2001-2011. And this decline is relative to GDP.

Recent data from PwC's IPO Watch Europe[17] from the last 6 years confirms the findings from the OECD. While the latest IPO data from 2012 and 2013 from Europe shows a significant recovery compared to 2009 (which was the lowest level in this period), the current number of IPOs for either of these years remains still very modest when compared with the 2001-2011 averages**… especially for smaller companies.**

The exchanges have noted that the main factor explaining the decline in the number of IPO is the decline of smaller companies coming to the market. While IPO markets continue to function well for larger companies they are becoming less and less accessible to smaller companies. This brings down the number of IPOs.

[14] European Commission, "Green Paper: Building a Capital Markets Union"
[15] Isaksson M. and Çelik S., "Who Cares? Corporate Governance in Today's Equity Markets"
[16] Ibid (Part III)
[17] PwC's IPO Watch Europe

In the US, companies with less than 50 million USD market capitalisation have gone down from being 80% of IPOs to 20% of IPOs, while the Task Force reported noted that "companies that make it to the public markets are taking twice as long to do so".

The EU Task Force believes that there are similar issues in Europe. In the Dutch market, for example, 100 million market cap is generally considered as the threshold below which it ceases to be cost effective to list.

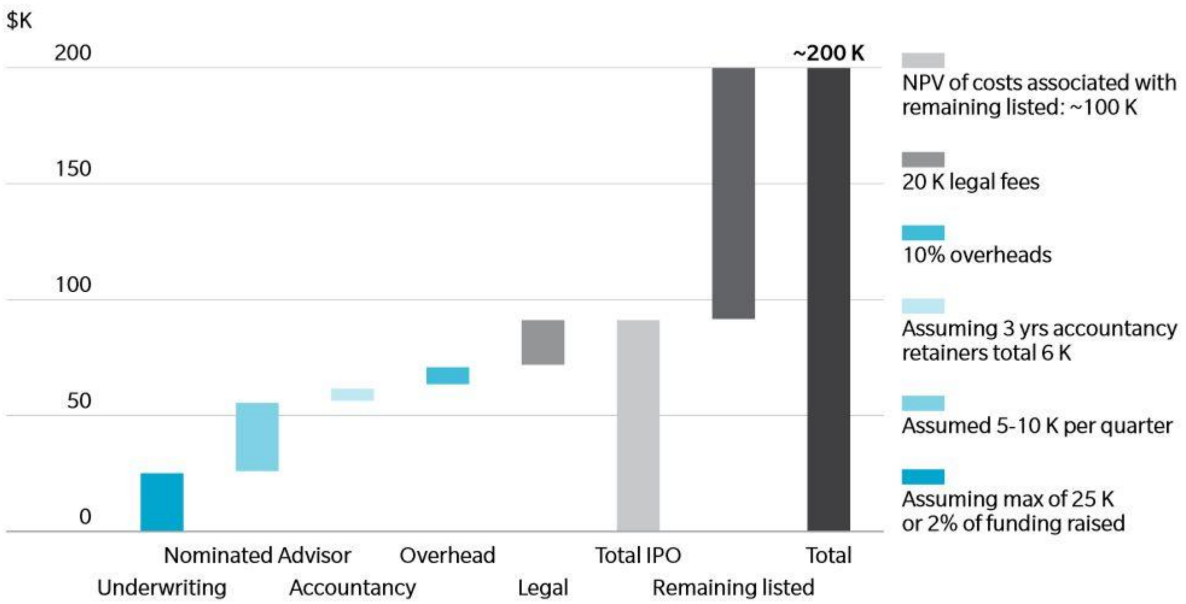
Regulatory Disincentives for Companies (Problems of Supply)

In the recent wave of action to regulate the financial industry, with multiple EU and international measures, several regulatory actions have had the effect of:

- Creating "one size fits all" regulation for companies;
- Driving up costs for all companies looking to go public, thus reducing the supply of small and mid-cap companies in particular;
- Disincentivising investment in smaller companies and in equity overall;
- Shifting the economics of trading shares away from long-term investing and towards more high-frequency trading of larger company shares, thus making the IPO process less attractive to, and more difficult for, smaller companies; this also resulted in erosion of the local ecosystems catering the needs of smaller companies and investors specialising in them.

Many rules and regulations came in response to various scandals or crises, in order to "restore trust" in public markets. However, a side effect has been the slower growth, destruction of companies' and investors' trust in capital markets and in financial regulation. In short the regulatory balance needed has not been achieved but shifted to the other extreme.

Chart 2 Cost of listing on an SME platform: assuming 1x market cap: turnover and 50% float



Source: Oliver Wyman, Towards better capital markets solutions for SME financing, Exhibit 7, page 6.

Given that more recent financial regulation has not been implemented yet, these costs are likely to rise significantly in the near future. Since the costs of going public are very high for Emerging Growth Companies, the management may be forced to choose whether to go public or to seek a trade sale instead.

The losers are not just the companies, but also the employees who might have been hired by Emerging Growth Companies, had they had the option to grow via public markets, government revenues and the economy over the longer-term, as the headquarters of such companies may move outside Europe together with their future potential for growth, value and wealth creation. This will have a long-term impact on the European economy.

Many of these issues are a problem for all companies on public markets, but the impact is particularly hard on the smaller ones. While we wait for the existing wave of regulation to be implemented and reviewed, we believe that immediate action needs to be taken through both regulatory measures and market incentives that would restore the trust of companies and investors alike, create a favourable European as well as local ecosystems supporting companies of different sizes and various types of investors, and induce much-needed growth and jobs. We also believe that there is a need for further, more tailored impact assessments, which specifically consider the different needs of end users, both companies and investors.

Recommendation 1:

We recommend the creation of a more flexible regulatory environment for small and mid-cap quoted companies, also known as "Emerging Growth Companies", including lowering the barriers to entry and the cost of equity capital.

In particular, we recommend that the EU:

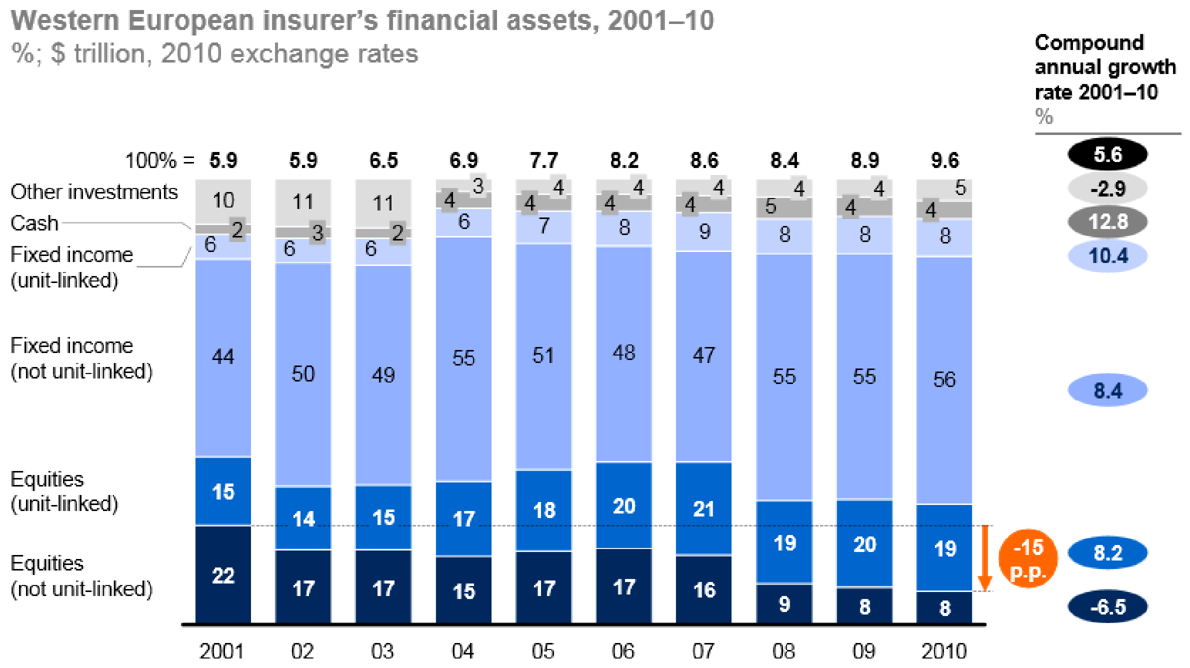
- **Encourage a diverse and attractive funding base in European public markets for companies of all sizes;**
- **Promote the concept of "Think Small First" in EU financial regulation affecting Emerging Growth Companies;**
- **Revise EU financial regulation to reduce administrative costs of listing for companies by 30-50%.**

We make more detailed recommendations as to how to achieve each of these in the full list of recommendations and in the accompanying working documents.

Difficulties for Investors in terms of Access and Regulatory Constraints

Investors are supposedly the main subject of financial regulation. However, retail investors complain that they are excluded from access to financial markets, while institutional investors complain that regulation is forcing them to reduce their investments in certain asset classes. Thus we see fewer equity holdings by insurers and pension funds.

Chart 3 European insurers decreased their allocation to equities outside their unit-linked businesses from 22 to 8 percent over 10 years



1 Includes investments for which policyholders bear the risk.
NOTE: Numbers may not sum due to rounding.

Source: Roxburgh C., Lund S., Dobbs R., Manyika J., and Wu H., The emerging equity gap: Growth and stability in the new investor landscape, McKinsey Global Institute, exhibit A15, page 79.

Regulators try to protect investors from risks. However, risks take many forms and tackling one risk can lead to others becoming more prominent. It may be possible, for example, to protect EU citizens from the immediate credit risks of Emerging Growth Companies, by making it difficult for investors to access their shares. But by so doing we may simultaneously increase the impact on these same individuals of poverty in retirement coming from longevity and inflation risk leading to, precisely because of the lack of equities and growth potential in their portfolios.

We also see that direct communication between companies and shareholders is difficult, due to a variety of factors. Intermediaries have a role to play, but this role should facilitate communication in equity markets.

Recommendation 2:

We recommend that EU policymakers ease constraints that restrict investors' ability to access IPO markets & to invest in venture capital / private equity.

In particular, we recommend that the EU:

- **Create a single market for retail investors to directly access public equity markets cross-border in Europe (in addition to investment with financial intermediation);**

- **Ensure that EU legislation does not restrict investors' ability to invest;**

- **Promote investor confidence and understanding.**

We make more detailed recommendations as to how to achieve each of these in the full list of recommendations and in the accompanying working documents.

Changes to Market Structure (Problems of the Ecosystem)

The **erosion of the local and regional ecosystems** in Europe and the need to re-build such ecosystems was noted in a report by the **EFC's High Level Expert Group**[18], which called on Member States to *"investigate (and report on) as a matter of urgency what is required in their market to (re)build an ecosystem comprised of dedicated analysts, brokers, market makers, ratings etc., that can both advise and support issuers and investors, and foster the liquidity of equity growth markets. This will aid in the development of small and mid-cap financing through equity growth markets and will also support the private placement mechanism which relies on the same ecosystem*."

Due to a complex set of regulatory and technological changes both in the US[19] and in Europe, most capital market activity has focused on blue chips, while trading has become automated, highly efficient, and inexpensive. While these changes are to be welcomed from the perspective of the intermediaries serving this market segment and the investors trading in blue-chips, they have also led to the disappearance of smaller brokers, analysts and advisers who are incentivised to invest time and resources into building the demand for smaller IPOs.

The benefits of pan-European rules have tended to accrue to the larger global players, who are able to conduct cross-border trading more efficiently. "*As the financial sector has grown, relationships... have become more complex and opaque. The orientation of the financial sector has become increasingly skewed towards large and international. As a result, the links between savers, the original providers of capital, and the financial markets, which allocate that capital, have become less coherent*[20]."

However, the ecosystem for the smaller players has been disrupted. As a result, two important factors have emerged, both of which suppress IPO markets: First, IPOs of smaller companies in particular have become less **visible.** Second, the **fixed costs of IPOs** have become larger for the smaller companies, since the institutions providing these services tend to be larger ones catering to the largest companies.

Only 50% of companies on Euronext are currently covered by financial analysts, for example. Business information services may be provided by a wider range of firms in the future, but this area is still developing.

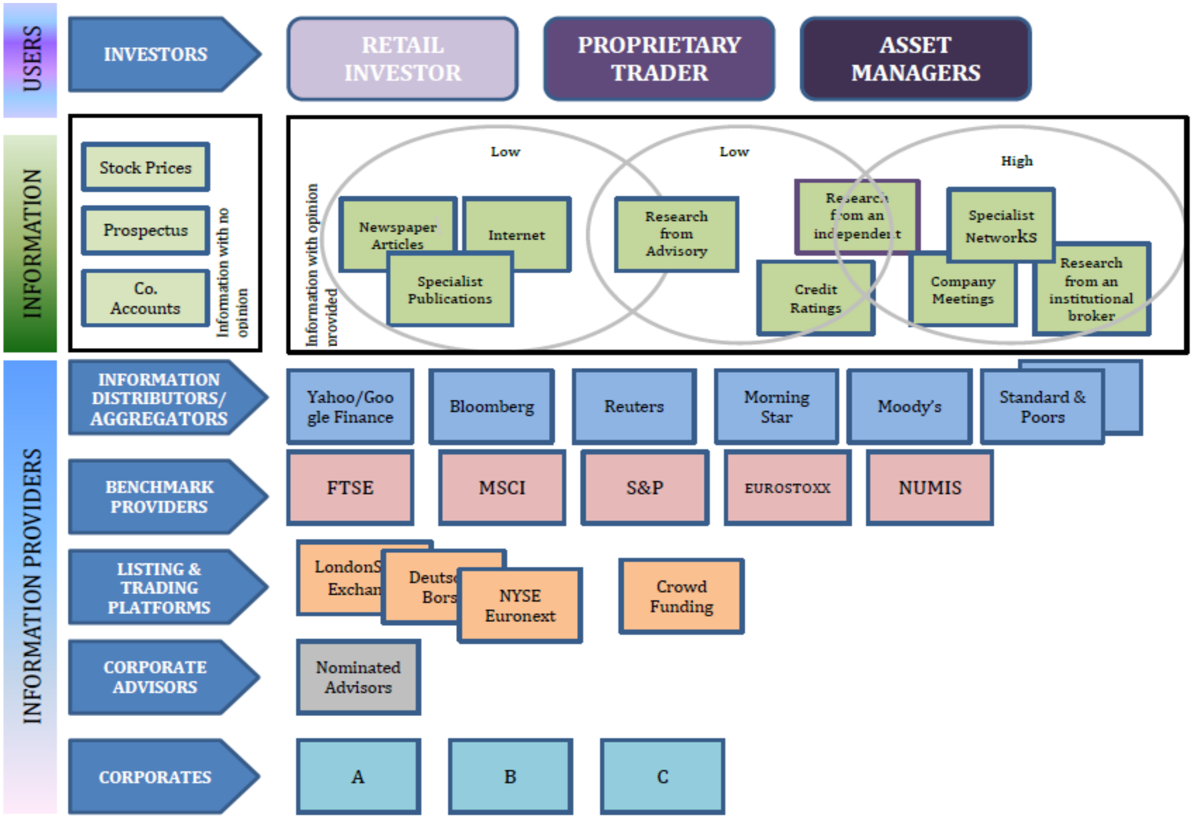
Market infrastructure needs to bring companies and investors together, to allow the dissemination of information, and to provide fair and transparent costs.

[18] Economic & Financial Committee High Level Expert Group, "Finance for Growth: SME & Infrastructure Financing"

[19] Weild D., Kim E. And Newport L., "Making Stock Markets Work to Support Economic Growth", page 55 and 60

[20] Williams G., "Slow Finance: Why Investment Miles Matter", page 3

Chart 4 Market Participants and the range of information provided



Source: ECSIP Consortium, Improving the market performance of business information services regarding listed SMEs, Figure 2.1, page 9

Recommendation 3:

We recommend improvements to the ecosystem of IPOs and market structures to better serve companies at different stages of growth and different types of investor.

In particular, we recommend that the EU:

- **Increase connectivity and encourage better dialogue between European companies and their investors, including end investors, both pre and post IPO;**
- **Improve the provision of analyst research and / or other third party business information services regarding small and mid-cap companies;**
- **Improve the "after-market incentives" for brokers;**
- **Set up an EU industry expert group of advisers that would develop proposals as to how to reduce the cost of supplementary services faced by issuers.**

We make more detailed recommendations as to how to achieve each of these in the full list of recommendations and in the accompanying working documents.

The Need to Create an Equity Culture in Europe

Compared with the US market **Europe lacks an equity culture**. This is due to a variety of historical, cultural and structural factors. However, as bank regulation has meant that banks have reduced some of their previous lending, companies may need to access capital markets more. Meanwhile as governments find themselves with ageing populations and pressure on tax receipts, with the retirement age lengthening, there is pressure on individuals to save more for their own retirement. Individual investors may thus need greater access to capital markets.

However, both companies and investors may lack the requisite knowledge of how to get the best out of capital markets.

Recommendation 4:

We therefore recommend that policymakers set the goal of creating an equity culture in Europe, including the provision of education and non-legislative initiatives.

In particular, we recommend that the EU:

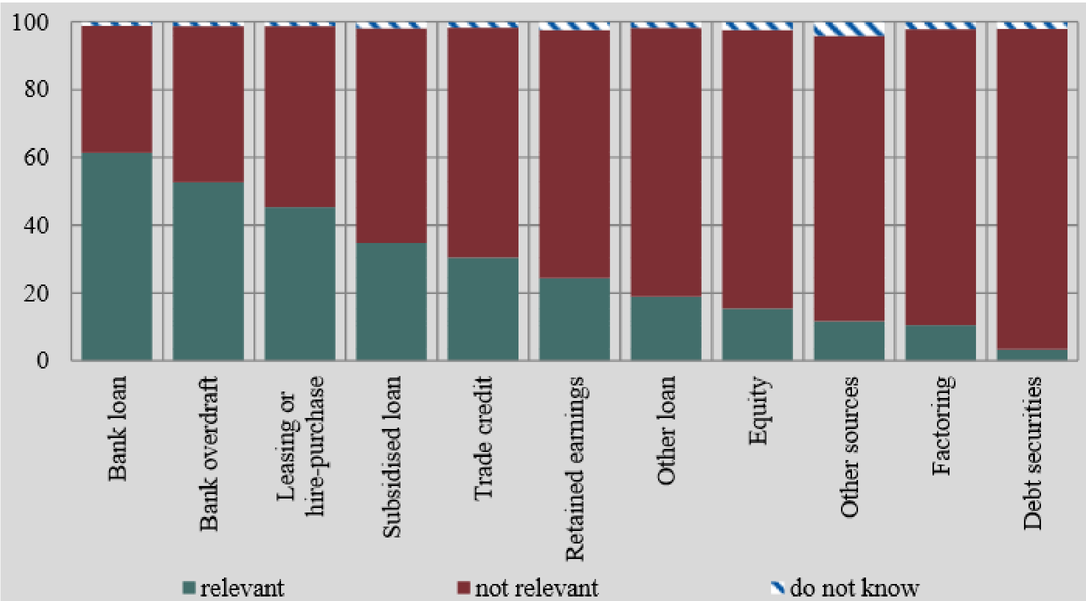
- **Promote the financial education of both investors and companies as users of capital markets;**

- **Develop proposals for new pricing structures which align incentives, and balance the long-term health of the company / post IPO performance, with the need to get the IPO away;**

- **Enhance the availability of EU data and research by standardising and improving data collection, in order to enable both companies and investors to understand the comparative costs and benefits of different services provided by capital market participants.**

We make more detailed recommendations as to how to achieve each of these in the full list of recommendations and in the accompanying working documents.

Chart 5 Financing structure of euro area SMEs



Source: ECB, Survey on the access to finance of Enterprises in the euro area, chart 6, page 8.

Taxation

Taxation is crucial in the functioning of IPO markets. We understand that taxation is the competence of the Member States. Nonetheless, we feel that Member States should be encouraged to use tax policy to encourage long-term investing and to ensure the fair treatment of debt and equity financing. The EU should monitor the situation in different countries and encourage the sharing of best practices. The EU could also make cross-border information more accessible to investors.

Recommendation 5:

We therefore recommend improvements in tax incentives for investment into IPOs and equity more generally.

In particular, we recommend that the EU and its Member States:

- **End tax discrimination of equity towards debt and other forms of investments;**
- **Provide tax incentives to encourage investment both for the longer-term and in Emerging Growth Companies;**
- **Ensure consistent tax treatment and exchange of best practice;**
- **Ensure that tax systems are not a barrier to cross-border savings.**

We make more detailed recommendations as to how to achieve each of these in the full list of recommendations and in the accompanying working documents.

Taken together, these recommendations would enable companies to reconnect with public markets and contribute to European economic growth and the creation of new jobs, while providing investors with a greater range of investments and a better range of opportunities to participate in that growth.

Summary Conclusion

"Regulatory policy has given little attention to issues of market structure and the nature and effectiveness of competition, instead developing detailed and often prescriptive rules governing market conduct, with substantial cost and limited success. Regulation should focus on the establishment of market structures which provide appropriate incentives, rather than the fruitless attempt to control behaviour in the face of inappropriate commercial incentives. We look forward to a future of less intrusive and more effective regulation, the product of a new emphasis on the incentives market participants face, and to the creation of trust relationships which can give savers and companies confidence that the equity investment chain meets their needs and serves their interests."

John Kay, "Kay review of UK equity markets and long-term decision making: final report", 2012

Eurostat estimates that the EU 28 still has an unemployment rate of almost 10%, and the euro area well above 11%. With the scope for significant additional public investment constrained in many countries by the size of existing debt and deficit levels it is clear that private investment will have to play a key role in getting Europe back to work.

To do that European companies need investment, to grow, to enter new markets, to develop new products and to create jobs. A healthy, well-functioning IPO market, and in particular one that attracts both Emerging Growth Companies and investors to European markets is a critical route to channel such investment.

President Juncker asked Jonathan Hill as the Commissioner for Financial Services to create a Capital Markets Union for Europe. The Green Paper on Capital Markets Union[21] published on 18 February 2015 notes that "*capital market based financing in Europe is relatively underdeveloped. Our equity, debt and other markets play a smaller role in financing growth and European businesses remain heavily reliant on banks, making our economies vulnerable to a tightening of bank lending*". It also asks "*whether measures can be taken to create a better environment for... initial public offerings to ensure better exit strategies for investors and boost the supply of venture capital to start-ups".*

The members of the EU Task Force believe that enacting the recommendations in this Report will benefit the Capital Markets Union, as well as entrepreneurs who have developed successful Emerging Growth Companies, investors who seek returns from long-term savings with fair regulation, individuals who may benefit from future jobs, governments who seek future tax returns from growing companies and the European economy as whole.

For the full Report, read on...

[21] European Commission, Green Paper: Building a Capital Markets Union

FULL REPORT

Background

What Is an IPO

An Initial Public Offering (IPO) is the process by which the owners of a company sell shares in it to the public for the first time, joining the primary market via a stock exchange. After the IPO the company becomes subject to various new ongoing obligations that stem from being listed on a public market. There are approximately 13.000 companies with shares publicly traded on European exchanges, of which c. 20% are quoted on the smaller, exchange-regulated (Growth) markets[22].

Post IPO, investors are able to buy and sell shares in the company on the exchange, in what is known as the secondary market, when they buy from and sell shares to each other. At a later stage the company may issue additional shares, through a further public offering, in order to finance further growth.

For Whom Do The IPO Markets Exist?

While the indirect benefits of well-functioning IPOs accrue to the whole economy, the **main direct stakeholders of IPO markets** are the **companies** that are being financed and the **investors** that are investing in them. It is important to note what the needs of these two key stakeholders are from IPO markets, and to ensure that European policy measures the benefits of capital markets from their perspective.

Companies: In accessing IPO markets, **companies** expect in principle fresh capital at a reasonable cost which they can use for organic growth (e.g. for new physical/technological investments and/or job creation). Ultimately, companies expect to be able to finance new entrepreneurial plans without a fixed level of return; in this sense, when compared to all other forms of financing, equity finance is the only one that can handle entrepreneurial risk.[23] They also expect to lower their other financing costs to be able to access markets again in subsequent phases[24], and to strengthen their brand recognition and gain prestige.

Investors: In investing in IPO markets, **investors** expect a higher level of return than less-risky investments, high level of diversification and targeted exposure to certain sectors or companies. Investors may also want to see a certain project succeed, or to fund developments in a particular industry or geographical region. Different investors have different criteria for investment. Some seek an absolute return; others seek to balance their investments across different asset classes. Fundamental investors have more interest in researching the underlying company, rather than viewing the share purely as a financial instrument which can be traded.

Economic And Social Roles of the IPOs

The IPO process is the entry point and an important barometer of the European capital markets and it plays a crucial role in the economy. Although the main direct stakeholders of IPO markets are the companies being financed and the investors that support them, the indirect benefits of well-functioning IPO markets accrue to the whole economy. The IPO markets finance enterprises - which in turn generate jobs and taxes, foster innovation and create long-term value for investors, thus providing retirement benefits in old age. Research has shown that capital market size is positively correlated with economic development: "those countries where capital markets – and especially stock markets – seem to be underdeveloped appear to pay a high price in terms of below average

[22] Source: FESE stats, LSE and Borsa Italiana stats at 31 December 2014
[23] Isaksson M. and Çelik S., "Who Cares? Corporate Governance in Today's Equity Markets"
[24] Ibid (Part III)

growth" [25]. The same report states that: "in Europe it is actually the capital market, providing access to debt and equity financing, which determines economic development"[26]. Another report demonstrates that by providing access to equity finance stock markets allow firms to realise growth options (1,559 European companies that went public via an IPO showed substantial growth rates in the 3 years following the IPO) [27]

Studies from the US as well as Europe demonstrate the unique role of equity in providing permanent risk capital[28] which cannot be financed in the way by debt, which requires a guaranteed return. Hence, the risk capital financing enabled by IPOs contributes to innovation, which is particularly relevant for growth in developed economies (and rely more on equity capital)[29]. Moreover, public equity markets complement and enable other sources of financing in a broad and continuous spectrum of methods available to companies and investors.

Europe therefore needs to harness the full potential of its IPO markets to finance sustainable economic growth.

EU Political Context

Europe 2020 was intended as the EU's economic growth strategy. More financing via capital markets could help to achieve not just greater levels of financing, but also higher innovation, better risk management, better mobilisation of savings and job creation. Capital markets could serve the EU's other objectives on employment, innovation, education, social inclusion and climate.

President Juncker has highlighted[30] the need for a "Capital Markets Union" to improve the financing of the economy, cut the cost of raising capital, notably for SMEs, help reduce Europe's very high dependence on bank funding and increase the attractiveness of Europe as a place to invest.

Commissioner Hill published a Green Paper on Capital Markets Union on 18 February, seeking feedback on many different subjects, including IPOs.

We believe that there is an opportunity for the European economy to develop its IPO markets, in order to create a Capital Markets Union that truly serves the needs of its end users, being issuers and investors. One goal of the EU Capital Markets Union should be for the EU to aim to attract both issuers and investors to Europe, both to raise capital and to invest savings.

Public policy influences the incentives that market participants face; it sends signals about the desirability of equity as a form of finance; and it impacts directly on the cost of accessing it. Market participants need encouragement: entrepreneurs need to be willing to seek equity finance; and holders of capital need to be ready to invest in a wide range of IPO opportunities, particularly those coming from smaller companies.

This report makes recommendations as to how IPOs could contribute to well functioning Capital Markets Union.

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[25] Kaserer C. and Rapp M. S., "Capital Markets and Economic Growth: Long-Term Trends and Policy Challenges", page 10
[26] Ibid, page 46
[27] Wright W., "Driving Growth: making the case for bigger and better capital markets in Europe", pages 52-53
[28] Isaksson M. and Çelik S., "Who Cares? Corporate Governance in Today's Equity Markets"
[29] Wright W., "Driving Growth: making the case for bigger and better capital markets in Europe", pages 52-53
[30] Juncker J-C., "A New Start for Europe: My Agenda for Jobs, Growth, Fairness and Economic Change", July 15.

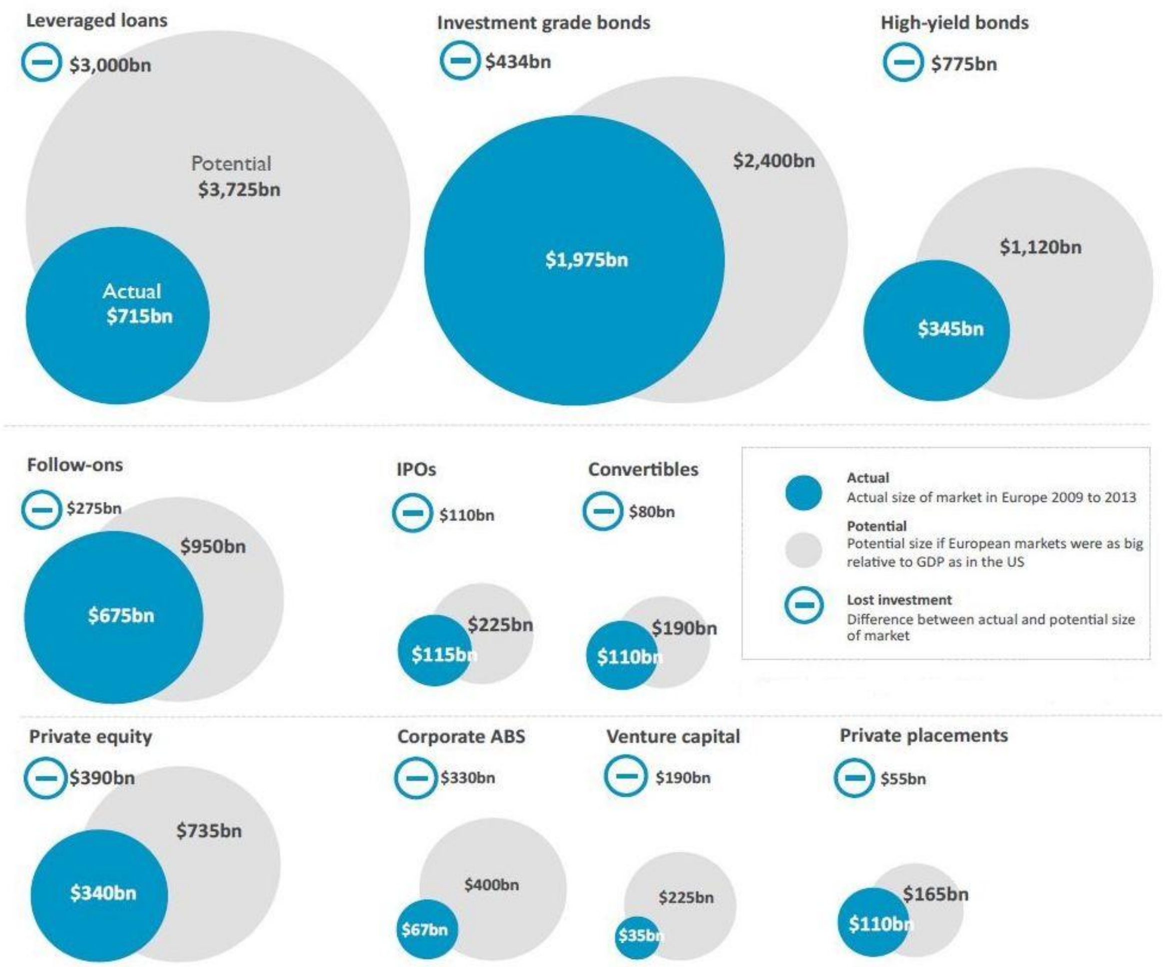
The State of European IPO Markets and the Global Context

Europe's reliance on shrinking bank lending is well-documented and is increasingly recognised as a barrier to the return of sustainable growth and jobs. Europe needs to build an equity culture, in which investment through equity becomes an attractive and readily available option for European businesses of all sizes. A report by Oliver Wyman[31] notes that only 5% of SMEs in Europe issued tradable equity and 2% issued debt, but that up to 20% of SME funding could be sourced from the capital markets.

NewFinancial has estimated[32] that there was a shortfall of $1 trillion between what European companies actually raised in the capital markets and their potential. NewFinancial also estimates the average value of stock markets in Europe at 69% of GDP, compared with 166% in the US. In relative terms, this means that European stock markets are 59% as large as they would be, if they were as deep as in the US. The report estimates the size of EU IPO markets at 51% of US markets.

For smaller companies, however, the overall market is only one third of the size. "European markets do a worse job than the US in providing access to capital for mid-sized companies in the €100-€500m range.[33]"

Chart 6 The 'lost investment' in the European economy

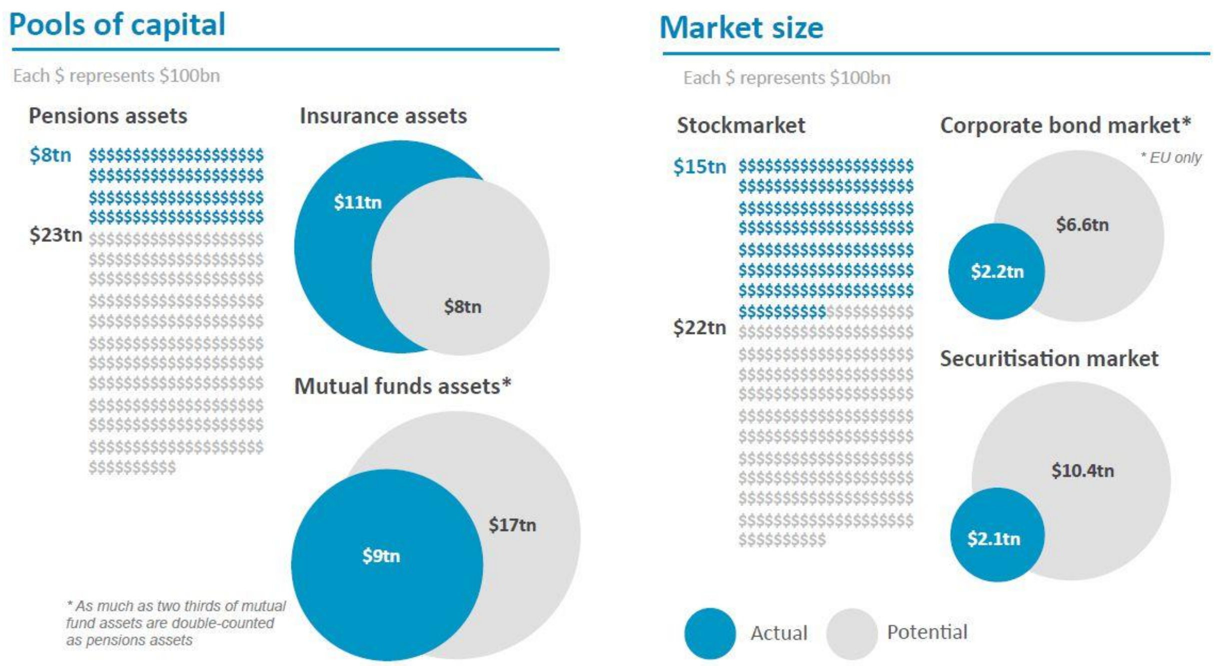


[31] Oliver Wyman, "Towards Better Capital Markets Solutions for SME Financing", page 3 and 8.
[32] Wright W., "Driving Growth: making the case for bigger and better capital markets in Europe"
[33] Ibid, page 8.

Source: Wright W., "Driving Growth: Making the case for bigger and better capital markets in Europe", New Financial, October 2014, page 6

The NewFinancial report also estimates that the US corporate bond market is three times the size of the EU market, which currently stands at $2.2tn.

Chart 7 The depth of pools of capital in Europe



Source: Wright W, "Driving Growth: Making the case for bigger and better capital markets in Europe", New Financial, October 2014, page 7

The data below shows that the European IPO market is facing a long term decline, with capital raised in the last ten years only around half that raised in the 1990s. We provide further, more detailed analysis of this decline in Annex 2. The decline comes at the worst possible time for European businesses, coinciding with the declining availability of bank lending.

While debt finance will always play an important part in any economy there needs to be a new recognition amongst European businesses, investors, other market participants, and amongst policymakers, of the advantages that equity brings, particularly for small businesses. Equity's durability through the economic cycle makes it a powerful form of stable, long term finance.

Chart 8 Cross-border IPOs between Europe and US

Source: Dealogic, PwC analysis, as per 30 September 2014

Overall perceptions of IPO markets are:

- In terms of the **quality** of IPOs, we believe in the need to be vigilant in terms of maintaining quality, while at the same time focussing on what is most material, since this is key to both investor and corporate confidence in the longer-term.
- In terms of **fairness for investors**, we find that IPO markets treat investors globally with sufficient fairness but there are aspects to improve. The development of EU securities regulation has followed the path of US regulation, with a focus on the equality of publicly disclosed information provided to different types of investors and some diversification at the level of the prospectus, but certain types of investors (retail) could and should be given greater access to the single market and especially IPOs than they have today.
- In terms of fairness **for companies**, some have questioned whether markets are working as well as they could. For example, the Kay Report on UK Equity Markets stated that: "*Equity markets today should primarily be seen as a means of getting money out of companies rather than a means of putting it in… It is a measure of priorities that regulation admits, even encourages, market participants to gain an advantage over others by reacting more quickly to data, but prohibits market participants from gaining an advantage over others by obtaining better information*." Such disenchantment can also be seen in other EU markets; in some markets, significant portions of companies have left the market in recent years.

In order to be able to fulfil their important economic and social functions and to deliver value to companies and investors as their two key customers, we believe that IPO markets should possess the following characteristics:

- **Communication:** Markets should enable companies and investors to communicate directly with one another, in order to understand one another's expectations and to enable companies to manage their business via resolutions at shareholder general meetings, and in order to ensure that there is sufficient trust and confidence for future capital raising.
- **Resilience:** Ability to remain in business despite changes in economic cycles. Economic cycles will determine both corporate profitability and the availability of equity capital; therefore, a certain degree of contraction will be expected for economic down cycles. However, in our view, an optimally-functioning IPO market would remain in business – i.e., not shut down - even during down cycles.
- **Access:** A key feature of a well-functioning IPO market in our view is for it to be accessible for Emerging Growth Companies. A market that is only accessible by large or well-established companies would not be good at fostering innovation and dynamic job growth. As we have seen above, Emerging Growth companies are especially important for job creation. It is also important to consider differences among quoted companies further, since micro companies below 50 million EUR market capitalisation may have different needs from those at €1 billion market cap.
- **Quality:** A well-functioning IPO market will have high levels of long-term positive performance and minimum levels of bankruptcy, fraud, and value loss. Our vision is not one of a market that produces large numbers of IPOs that soon lose value for their investors, but rather of a market that is reliable, relatively predictable, and trustworthy. This does not mean that there will be only one level of risk and return offered by the IPO market (inevitably, in a risk-taking environment, there will be some failures as well as successes); rather, a healthy equity market will produce a diverse pipeline of IPOs. However, in our view, the majority of firms that list should perform in the long run as investors would reasonably expect them to, based on the information disclosed at the IPO stage, and to continue to generate value in the long run.
- **Depth:** Sufficient depth in terms of the volumes available for investment, the mix of investors, and liquidity. Obviously, the depth of equity markets depends on many extraneous factors, including the size of capital market in general and the balance between equity and debt markets. It is also clear that Emerging Growth Companies' shares will be less liquid than those of the larger companies included in mainstream indices.
- **Fairness:** Finally, the IPO market needs to be open to all investors on equal terms and treat them fairly. A market that only offers good prices to insiders, or which subsidises short-term trading over long-term investment, would in the long run not benefit the economy (and would also not be sustainable). In addition, the market needs to be fair to both companies and investors, as both sides are needed for the market to function.

Currently, the European IPO market is not working for as many companies and investors as it could. There is some way to go before we can say that European IPO markets meet the criteria above and although Europe continues to build and grow businesses with the potential to be world class, the failure of the IPO market to facilitate companies' access to capital hampers their growth and lowers potential employment.

IPOs are important to the European economy. EU policymakers should consider the role of these markets as part of the broader ecosystem of capital markets, and pay attention to the health of the IPO markets, if we want to provide funding for the Emerging Growth Companies and investment opportunities for the savers of the future. Reforms to regulation, to the tax regime, and to market practices are required to address these structural problems.

Findings

1.0 Costs of Equity Capital for Companies and Regulatory Disincentives (Problems of Supply)

1.1. Supply of Companies in a General Sense

The starting point for healthy IPO markets is the supply of successful, innovative and sustainable European companies that are at a point of needing external finance, and specifically permanent equity capital.

The supply of such companies is affected by a number of factors, such as the overall entrepreneurial culture and environment, corporate and other forms of taxation, technology, corporate law, availability of seed and start-up capital, regulatory and administrative barriers and burdens, etc.

Looking at the trends in Europe over the last decade, we can conclude that the overall supply of smaller companies has been decreasing: since the onset of the financial crisis in 2007, we have seen a continuous decline in new lending (based on the monthly data on new loan volumes with a maturity of more than one year and up to 1 million). There is insufficient availability of equity funding also. In recent years, there has been an absolute decrease in new funds raised and in the relative share of government agencies among investors[34].

1.2. Companies' Need for and Availability of Finance

For every market to function, you need demand and supply. Consequently, for IPO markets to function there needs to be some companies in need of financing, as well as some financing available. In simple terms, the external financing needs of a company are determined by the desired investment minus profits.[35] When the desire for investment goes down, or profitability goes up, a company would generally have less need for external financing such as public equity. Hence, corporate growth strategies and profitability of firms inevitably affect how much external finance firms need during *specific economic cycles* (i.e., these factors generally cannot be reasons for the long-term trends of IPOs).

It has sometimes been argued that higher profitability of larger firms and lower profitability of smaller firms sustained over a long period of time could explain the disappearance of smaller IPOs. This is usually referred to as the "economies of scope" hypothesis. For example, Jay Ritter et al have explained that for smaller US companies, organic growth is no longer the most viable strategy, and therefore smaller IPOs are on the decline not because investor demand is contracting but rather because smaller firms are bringing fewer IPOs to the market.[36] Moreover, Ritter et al have also looked at IPO activity in Europe and concluded that the decline in the number of IPOs is partly attributable to the economies of scope explanation.[37] They present evidence of an "increased difficulty for small firms to remain profitable, their underperformance, and their higher propensity to be acquired soon after the IPO, relative to large firms".

While this theory could be one of the factors explaining why smaller company IPOs are going down, it may not explain the long-term decline in the *overall* number of IPOs.

The Task Force analysed a wide range of factors which do influence companies' decision on whether to tap on capital markets' financing which range from regulatory and administrative burdens, through markets' structure to much less tangible equity culture. All those aspects are analysed in detail in the following part of the report, but while talking about demand and supply of finance, we need to touch upon availability of other course of finance which do influence companies' decision whether to go public or not.

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[34] Source: DG Growth
[35] Isaksson M. and Çelik S., "Who Cares? Corporate Governance in Today's Equity Markets", page 21
[36] Gao X., Ritter J. R. and Zhu Z. (2013), "Where Have All the IPOs Gone?", as well as The Harvard Law School Forum on Corporate Governance and Financial Regulation, "Considering Causes and Remedies for Declining IPO Volume".
[37] Ritter Jay R., Signori A. and Vismara S. (2013), "Economies of scope and IPO activity in Europe", pages 11 - 34

Many companies have an established track record of financing themselves via **bank debt**. As long as this route is open to them at a reasonable price, they have limited incentives to investigate alternative options especially as this way the entrepreneurs/owners keep the independence of the decision making including strategic tactics. But, as a downside, this may restrict their ability to grow and create jobs and also contributes to the culture of indebtedness[38]. **In practice, bank financing has usually been cheaper than market finance** especially in numerous countries that offer tax incentives in favour of bank finance (e.g. tax deductibility of bank interest).

Venture capital/private equity and equity/bond private placements are also alternatives to listing (or early stage options pre listing). Their relative attractiveness to companies when compared with IPOs – and the ideal sequence of combining them - has changed over time around the world and in Europe. Indeed, the changes made to the regulation of private placements in the US that led to greater liquidity for private placements in the last few decades could explain the trend of companies waiting longer before doing an IPO and the eventual decline of IPOs to some extent.[39]

However, an analysis of trends in the US and in Europe does not support the hypothesis that IPOs are showing a trend of long-term decline simply because of the ample availability of these other sources of capital.[40] On the contrary, IPO markets do need flourishing and healthy venture capital and private equity that will finance and help grow the companies that are too small to enter capital markets. Consequently, the reduction of venture capital in particular leads to fewer IPOs by reducing the venture capital-backed IPOs. At the same time venture capital and private equity do need healthy IPO markets where companies that are ready can enter the 'next level' of financing. The contraction of IPO markets has a negative effect on venture capital and private equity by reducing the possibilities for exits.

This brings us to the importance of **business progression** and the '**funding escalator'**.

Consideration should be given to the **need for business progression for companies at different stages of growth and their financing needs**. Providing a central information portal for EU companies on the different mechanisms for raising capital cross-border could be an excellent resource.

Companies should be encouraged to develop and grow at different stages of development. This also requires different markets, to suit those needs, in line with the different investment cultures across Europe. Many of these markets may be local or regional, rather than European. Unfortunately, EU rules for quoted companies tend to be designed around the financial sector and / or the Eurostoxx50, not for all 13.225 quoted companies in Europe. Companies should be able to choose the markets most appropriate to them, and then to opt in to more stringent global regulation at a later stage as they grow.

We therefore recommend a more intelligent and flexible, rather than one size fits all approach to regulation, with more emphasis on the need for business progression.

[38] There is some disagreement amongst economists regarding two different models of supporting growth: one model supports taking loans that are used to finance investment and expansion (the advantage is that you grow the economy at this very moment and you repay the loans from the profit) versus focusing on savings that finance investment. The proponents of the latter system criticize the culture of indebtedness, saying that it creates a vicious circle of debt: you use the profits of the venture to repay one loan, but for further investment you need to take a new one (unless the investment/venture was extremely lucrative). As a result, you end up being always indebted.
[39] Coffee J. Jr., "Gone With the Wind: Small IPOs, the JOBS Act, and Reality"
[40] Isaksson M. and Çelik S., "Who Cares? Corporate Governance in Today's Equity Markets", page 23

1.3. The Role of SME Growth Markets

We would like to promote the so-called alternative markets, catering for the needs of smaller companies. Those exchange-regulated markets (including AIM and ISDX in the UK, Alternext in France, FirstNorth in Scandinavia, NewConnect in Warsaw, etc) serve a very important function by helping smaller and growing companies raise the capital they need for expansion.

These markets, labelled and potentially recognised as SME Growth Markets in MIFID II, can be a first step for companies into the public markets. They allow the companies to get used to their new situation with external shareholders, new disclosure requirements, new ways of managing the company. They can help companies to prepare for the next step, main market listing, both in terms of finance (to have resources to cover the costs), and behavioural and cultural change. “Growth markets” constitute an important element of the funding escalator necessary for business progression.

In order to ensure that these markets can fulfil their role, there have to be some reduced listing and disclosure requirements in comparison with the main markets. For instance, there should be a simplified prospectus regime for smaller companies, which could possibly apply to crowdfunding as well.

Regarding MiFID II, while we appreciate the recognition of SME Growth Markets, at the level of secondary legislation, particular attention must focus on creating a market segment that allows issuers to raise finance effectively leaving maximum flexibility to the market operators who serve them.

1.4. Corporate Confidence in Capital Markets

Most studies of capital markets look at investors’ views of markets; however, companies also judge whether or not and, if so, when to list. The Kay Report on Equity Markets noted that new equity issuance in the UK has been negative over the last decade, and that obtaining a listing is no longer a natural step in the development of a new business. Professor Kay suggested that there is considerable disenchantment amongst UK companies with public equity markets, as smaller, mostly newer, businesses have found it particularly difficult to access the funding they need since the financial crisis. In addition, the report found that the cost of equity capital is high by historical standards and in absolute terms.

Most commentaries consider markets as a one-way process; with information flowing from companies to investors and concerns focussed on investor confidence. However, the flow of information the other way, and the question of trust in the marketplace itself, applies equally to companies.

One example which measures confidence in the UK economy and in UK small and mid-caps’ business prospects, and thus gives an insight into corporate confidence also, is the QCA / BDO Small and Mid-Cap Sentiment Index[41]. This survey has asked on two occasions recently whether, in the UK, equity markets are helping or hindering a company’s development. Over this time, there has been a marked change in sentiment. In April 2014, 58% of companies said that equity markets were helping their company’s development. In September 2011, only 14% of companies had held that view. It should be noted that both times there was a significant minority that expressed the view that equity markets were hindering their development. The index regularly asks whether it is easy or difficult to access finance. Public equity is the preferred form of finance for public companies if they were to raise finance over the next 12 months. However, about one-third of companies consistently describe it as hard to raise finance.

One important factor influencing the decision as to whether to go public are the **implications for owner-entrepreneurs**. At the small to mid cap end of the market, the decision to make an initial

[41] QCA/BDO Small and Mid-Cap Sentiment Index

listing – or indeed to seek equity investment from any source - represents a profound change for the founding entrepreneur(s), marking a shift from being an entrepreneur with complete control to a manager accountable to others. This is a huge change for which many companies are not prepared, which in turn highlights the need for training and educational initiatives for companies (we elaborate on companies' education further in the section dedicated to equity culture). At the same time it is also influenced by companies' **confidence in investors, in intermediaries, and in financial regulation**.

Companies envisaging the listing need to trust that they will be able to secure a stable investor base and that those investors will act as 'real owners', having best, long-term interest of the company in mind, and not just treating it as a mere opportunity for speculation or 'quick money'. Of course there are a lot of 'good' investors around, who look for 'good' companies to invest in. But there are also many investors who 'trade' only for short-term speculative gains, not really interested in companies whose shares they purchase/sell. As long as these are relatively 'small investors' or small stakes that are purchased, it won't do too much harm and will contribute to the liquidity of the market. But in case of larger investors, like hedge funds, this kind of behaviour can be harmful to companies.

Hence the **importance of two-way communication and engagement**. Investors and fund or asset managers also need to communicate and disclose to companies, as well as their clients, their intentions and reasons for their actions. What we believe is best practice in this respect, are **stewardship codes**.

Other good recommendable ways of promotion of more direct engagement of companies and investors are:

- stimulating institutional minority investors to take larger stakes in companies. This will promote a more stable shareholder base for companies, but also make shareholders better known;

- encouraging entrepreneurs and management of the future listed company to develop a dialogue with a number of investors with long-term investment horizons at an early stage in the process, at least a year before the IPO. Early planning of the IPO process and a sustainable long-term investor base is crucial for a successful business. This advice to companies could be given by advisers or during one of the preparatory trainings organised for companies preparing for listing (see section 4 on Equity Culture and Company Education for more details).

An additional way to increase companies' trust and confidence in capital markets is to help companies connect with the right prospective investors.

Building direct relationships between smaller companies and investors is identified as an important factor in the recent ECSIP report[42] on business information services. It should be made easier for companies to identify both their existing shareholders and their prospective shareholders. Companies should thus be able to pursue relevant shareholder relationships, in order to build a share register of investors who understand the business model, support the long-term strategy of the company and share the company values.

For existing shareholders, the draft shareholder rights proposal made in April 2014 should be supported and improved, to enable companies themselves to better identify their existing shareholders. The existing Transparency Obligations directive requirements are insufficient.

In addition, it should be made easier for companies to identify prospective shareholders. Given that corporate brokers are protective of their own investor lists, one could create greater central public access to lists of investors investing in given sectors (e.g. biotech)[43]. There is a need to improve the

[42] ECSIP Consortium, "Improving the market performance of Business Information Services regarding listed SMEs"

[43] Examples of such useful information could be the existing information on the UK Financial Reporting Council website from stewardship code disclosures by individual investors / information on individual funds' investment styles via companies such as Morningstar.

information currently available. Companies could then target those shareholders whom they would like to join their share register[44].

1.5. Benefits of Going Public

When a company owner is faced with the choice of going public, (s)he will compare the benefits with the costs. While in the next section we deal with the costs, it is important to start with a review of the benefits of listing, and what might affect them.

1.5.1. Ability to Access Permanent Risk Capital

The most important and unique benefit of listing is the **ability to access permanent risk capital** i.e. capital that does not have to be repaid at a certain time and can be used to finance true enterprise risk. The permanence of this investment and the willingness of its supplier to share in the risk associated with the business make equity finance so valuable.

1.5.2. Scale of Funding

Moreover, equity finance can offer **scale of funding** not available to the company through bank loans, or other forms of debt finance.

1.5.3. Secondary Raisings

Additional benefit of going public is the possibility for secondary raisings, although unfortunately in the last couple of years less companies use that option and it seems that the IPO process has turned into a "one-time deal" instead of the start of a long-term relationship by which companies can raise money from their shareholders again over time. We elaborate further on this one in the section IPO process.

1.5.4. Share Options for Employees

The ability to issue share options (not only to management but also to all employees) is cited as a significant reason for a company to go to IPO, both to reward employees and to ensure that their incentives are aligned to the growth of the company[45].

This is vital for "new economy" companies in the high tech, med tech sectors who are increasingly important for the EU IPO pipeline. These companies must compete for increasingly scarce talent, often against a US incentivisation model. The tax treatment of share options in Europe varies amongst Member States. In many, share options are taxed in the hands of the employee upon issue, rendering them very unattractive and not a valued incentive. The higher the IPO price, the higher the employee tax impact.

The European Federation of Employee Share Ownership (EFES)[46] has reported that, for the third consecutive year in 2014, the number of employee shareholders decreased in Europe; the overall decrease was c. 300.000, of which the numbers in continental Europe decreased by 500.000 persons (-8%) from 2007 to 2014, while they increased by 200.000 persons in the UK (+8%).

EFES considers that "these changes are clearly related to the regressive fiscal policies in many European countries, while in contrast, the UK chose to double the fiscal incentives for employee share ownership, considering it is a key element of recovery and an investment for the future".

We encourage Member States to understand the importance of fiscal incentives for companies and their potential impact on the IPO pipeline.

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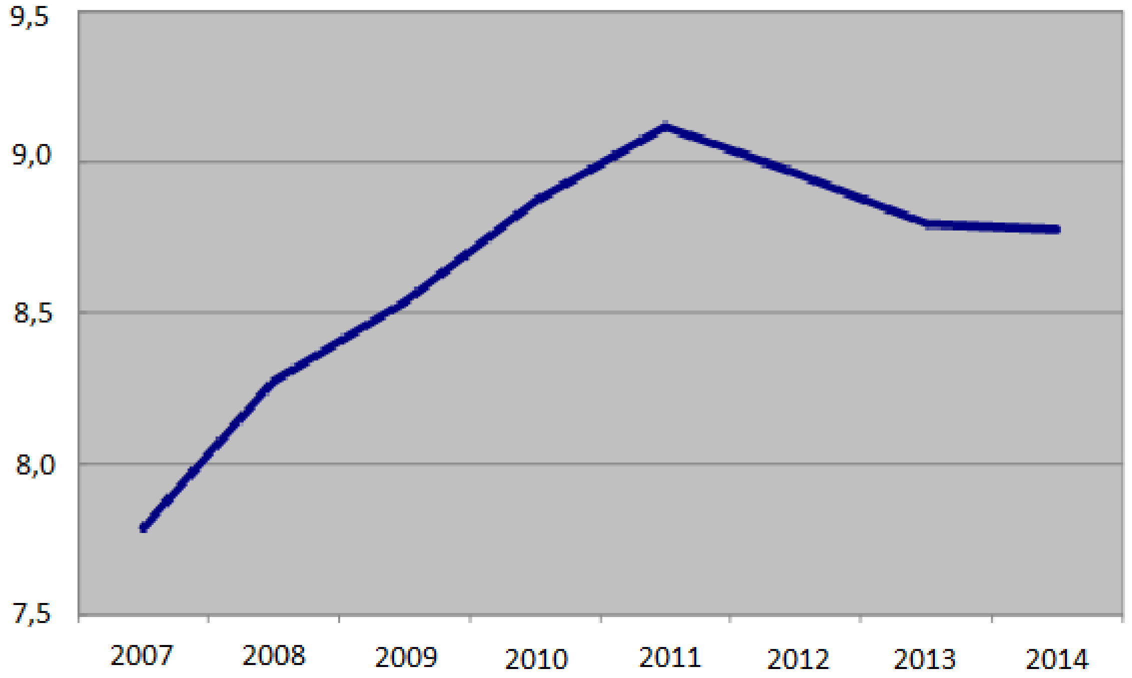
[44] McKinsey, "Business, society, and the future of capitalism"

[45] Inter-University Centre for the EC's DG MARKT, "The Promotion of Employee Ownership and Participation",

[46] Mathieu M., European Federation of Employee Share Ownership (2015), "Annual Economic Survey of Employee Ownership in European Countries"

Chart 9 Employee owners in European companies 2007 – 2014 (in millions)



Source: Mathieu M., European Federation of Employee Share Ownership (2015), "Annual Economic Survey of Employee Ownership in European Countries", graph 5, page 14

In addition, and in particular in Europe, it is also difficult for companies to set up a cross-border scheme for employees. We therefore welcome the recent Commission report "The Promotion of Employee Ownership and Participation", which recommends some non-binding policy instruments and non-legislative measure promoting employee share ownership.

EU law often imposes additional regulatory requirements on companies. While there may be good reasons for such additional obligations (for example to ensure the ongoing integrity of markets for listed equities) there is also a risk that such requirements risk becoming a barrier to listing, by raising the costs associated with being a listed company. The current proposal to reform the Shareholder Rights Directive is one example of this[47].

1.5.5. Intangible Benefits – Profile, Brand, Promotion, Value etc

Last but certainly not least, there are also other, more intangible benefits that come from the status of being listed, e.g. improved standing in the eyes of potential suppliers and customers, etc. Therefore, more visibility should be given by the EU authorities and market actors (e.g. exchanges) to the commercial value of being listed on a European exchange through more active promotion of the value of a European listing. This should not come at the expense of the individual brand value of the listing on a given exchange (although there should be more market development and promotion by the exchanges and the intermediaries), but should be supplementary to it. *"If there is no benefit to the EU brand, then there is no benefit to having EU rules. Instead these might as well be left to the national stock exchanges."*

We therefore recommend that the exchanges and company advisers promote the benefits of going public through company educational initiatives (see section 4.0 for more details) and other initiatives by different actors, e.g. stock exchanges.

[47] See section 1.6.2.3 below.

This should be combined with strengthening of the brand value of being listed on a European exchange, which should not come at the expense of the individual brand value of the listing on a given exchange but be complementary to it.

1.6. Regulatory and Administrative costs

As mentioned in the section above, while taking a decision on whether or not to go public, companies weigh expected benefits against the costs. If costs are higher than benefits or if alternative sources of funding propose better ratio, companies will decide against listing. Therefore, it is crucial to look closely at the costs of listing.

The **fixed cost of becoming listed** (exchange fees, underwriting and non-underwriting costs) and the **ongoing cost of remaining listed** (annual retainer for sponsors estimated by ECSIP at approx. €50k, brokerage services, sometimes independent research providers, exchange listing fees which vary considerably by Member State) are important determinants of the overall cost of public equity – and they can explain the longer term trends.

In addition to these direct financial costs, issuers also take into account the **complexity** of the initial and ongoing process of listing, the **time** it requires from the management team, and the **risks** involved in the process.

Listing on the market brings with it **new compliance and regulatory burdens**, some of which represent upfront costs prior to listing, some ongoing. These have to be weighed against the expected (and not guaranteed) benefits of listing. In addition to the cost of a regulatory requirement, the time it takes or the **uncertainty** it entails (e.g. the prospectus approval times) are also important elements of the cost and **reputational risk of going public**. These factors will determine whether the company owners will believe that costs of listing will be balanced by the expected benefits.

Many of the costs of listing come from the services required from different advisers. The main advisers for the IPO include corporate finance advisers, corporate brokers, accountants & auditors, lawyers, registrars, investor relations advisers, and security printers. There are also fees to the stock exchange and to the national financial services authority[48], which may vary considerably. For some company segments, in certain countries, the costs of listing may be too high.

Given the complexity and the amount of elements that are part of the costs related to listing, to enable companies to make an informed decision as well as provide policy makers with information they need to take appropriate decisions regarding new measures, **we suggest measuring the total and relative costs of raising equity** in Europe over time. This would also enable policymakers to measure the benefits (or otherwise) of the single market in this area.

To give an example of the changes in terms of listing costs, e.g. costs for the IPO transaction, estimated by one of the Task Force members, were 2-2.5% twenty years ago[49].

[48]Lazzari V., Geranio M. and Zanotti G. (2011), "Trends in the European Securities Industry", on comparative fees in Europe, which showed that in 2010, EU companies were paying between 5.500 € and 3.000.000 € for stock exchange listing fees, while fees to the national financial services authority varied between 8.000 € and 2.500.00 €.

[49] Accurate and comparable EU data on past and present costs is difficult to find, but the ACCA Research Report No. 82 estimated the costs of the UK listing process in 2003 at 10-20% of proceeds, depending on company size and amount raised. The opportunity cost of management time was perceived as the main concern. The same report cites:

a. Evidence given to the Wilson Committee (1977) which estimated the direct costs of a placing at 2.6%, the costs of rights issues at 4% and IPO costs at 7.6%;
b. research by Benoit (1999) which suggested that the total annual costs of maintaining a listing for firms of £100m range from 0.25 to 0.35% (of which 20% represented merchant bank and solicitors' fees, while stockbroker, public relations consultancy and accountancy costs were 10%) and
c. research by Armitage (2000), which estimated the mean costs of rights issues as 5.78%, of which around a quarter was for underwriting fees.

In other markets, a report commissioned by Deutsche Börse: Kaserer C. & Schiereck D. (2011), "Primary Market Activity and the Cost of Going and Being Public – An Update" estimated the average total flotation cost (underwriting fees paid to investment banks, plus fees paid to auditors and lawyers) for a new issue recorded over the period 01/01/1999 to 03/31/2011 was 7.6% of gross offering proceeds at Euronext, 8.0% at NYSE, 8.3% at Deutsche Börse, 9.7% at NASDAQ, 12.0% at LSE and 13.2% at HKEX. The ongoing costs of

The Federation of European Securities Exchanges has estimated the costs now to be approximately:

I. 10 to 15% of the amount raised from an initial offering of less than EUR 6 million:
II. 6 to 10% from less than EUR 50 million;
III. 5 to 8% from between EUR 50 million and EUR 100 million;
IV. 3 to 7, 5% from more than EUR 100 million.

The US JOBS Act focused on reducing the regulatory costs and the complexity of the process for smaller US firms. While the regulatory requirements for IPOs are different across the Atlantic (e.g. Europe has had an MTF-only admission standard at national level for some time), the regulatory costs are among the most cited factors discouraging firms from doing an IPO in Europe.

Hence, reducing the regulatory costs for issuers is one of the main areas that need to be addressed. But this needs to be done without undermining investor confidence. That balance may not always be easy to find, but **as public policy is developed, appropriate recognition needs to be given to ensure that the pursuit of investor confidence and protection does not simply kill off investment opportunities in the first place**.

While considering the measures to lower regulatory costs related to listing, we can differentiate between those that aim at changes to the legislation and those that may stem from legislation, but address the issue with market based or voluntary/best practice solutions. We will analyse them accordingly.

1.6.1. Regulatory Measures

Most of the ongoing costs of listing would seem to come from mandatory regulation. Some of this is necessary to inform investors, but we would question whether the overall costs are not too high. We would like to see **EU policymakers adopt the ambition to reduce the regulatory and administrative costs of listing by 30-50%, in line with the target proposed by the US IPO Task Force for American markets in 2011**.

1.6.2. Better Regulation for companies

Quoted companies may be caught intentionally or not by the costs of regulation targeted at other market participants; e.g. auditors, brokers, central securities depositories, clearing houses, credit rating agencies, custodian banks, stock exchanges, etc. The problem is magnified by the fact that most legislative proposals are very technical and are aimed at the financial intermediaries with little or no analysis of the possible impact on the end users. Few quoted non-financial companies are well-informed about these measures and therefore do not participate in discussions with EU policymakers about them.

The lack of emphasis in recent years on better regulation has led to a great deal of scepticism about the benefits of EU regulation, due in part to concerns about quality control and in part to the inability to connect to the real economy.

We also believe that a **cumulative regulatory impact assessment with the focus on listed companies should be performed** and **followed by a review of the most burdensome regulatory requirements**. Legislators should also look at and define where and how regulation works best at EU / regional / national levels.

Another important aspect is the issue of not always having consistent national implementation and "goldplating". Even when primary legislation may be reasonable, issuers, investors and stock exchanges are often negatively affected by gold plating at national level, when EU regulation is

being public (secondary offerings' underwriting fees etc) were estimated as equal to 2.3% at HKEX,2.8% at LSE, 3.0% at Deutsche Börse, 3.6% at Euronext, 3.8% at NYSE and 5.1% at NASDAQ.

implemented. **Careful consideration should be given by national regulators (and monitored by EU policymakers) to ensure that they abide by the principles of Better Regulation.**

1.6.2.1. Think Small First: focus on Emerging Growth Companies

Another important point is that the EU capital market should not be considered as a single entity, but rather as different markets for different categories of liquid and illiquid stocks, to ensure that smaller companies are not discriminated against via policies designed for other parts of the stock market. **Rules need to be appropriate to the size of the company listing**. Often the costs of listing that may be fully appropriate for larger companies are disproportionate for smaller companies. In Europe, the **regulatory focus** is on the 5-10% biggest companies, which renders it **inappropriate for the majority of companies seeking a listing**.

In that respect **consideration could be given to developing an asset-class definition of smaller quoted companies:** this might enable policymakers to carve out smaller companies from certain regulations designed for the larger, global issuers. Similarly, investors could be incentivised to invest in such companies. However, it is not clear whether a single definition would work for all EU countries, so some flexibility with an upper limit might need to be left to the Member States. However, as a starting point, **consideration could be given to the adoption of a new category of "Emerging Growth Companies".** All companies below this threshold[50] should be exempted from many EU disclosure requirements; we make specific proposals below.

EU impact assessments should keep looking at smaller companies as a separate category in order to ensure that the benefits outweigh the costs. However, consideration should be given to the possibly different needs of small and mid market companies, or to the needs of smaller quoted companies, in addition to the needs of microenterprises. Given that few companies make use of cross-border activity in public equity markets until they are global in nature, dual EU and national regulation may be an additional burden for smaller companies. Therefore the **need to define where and how regulation works best at EU / regional / national level** is required. Many of the disclosure requirements for Emerging Growth Companies could be set nationally by the exchanges.

1.6.2.2. Disclosure Requirements

The compliance costs of **information disclosure**, being mainly fixed costs, weigh heavily on listed companies, especially smaller ones (see examples are provided in the case studies in the report on business information services by the ECSIP Consortium[51]). Over the years, listed companies have been used to advance objectives – such as gender equality or climate change – which may be societally valuable. These disclosures should be made by all larger companies (regardless of whether or not they are listed), or else eliminated or made voluntary. Such measures raise the cost of securing equity by adding to the cost burden a company faces when it finances itself from this route. **Existing disclosures should be reviewed for usefulness and materiality**, since otherwise useful information can become lost in information overload. Also, **disclosure requirements that only apply to quoted companies but that do not directly serve investor protection or market integrity should be removed.** The recent removal of quarterly reporting is a useful example of good practice.

It is also important to streamline the frequency of ad hoc and continued disclosure imposed on issuers to ensure it is cost-effective. For instance, we have heard of the example of a dual listed Canadian company, where the CEO invested 100 pounds sterling per month but the company had to pay 70 pounds sterling per month to make the required Regulatory News Service announcement each month (until deciding to delist from Europe).

[50] The US Jobs Act defined such companies as those listed but with under $1billion revenues or newer companies within 5 years of their listing.

[51] ECSIP Consortium, "Improving the market performance of business information services regarding listed SMEs", pages 83, 118, 133

Disclosures of manager transactions and requirements for issuer lists under MAR in particular may be disproportionate[52][53].

1.6.2.3. Corporate Governance

While companies accept that some corporate governance rules may help to attract investors, they may fear that others will undermine their ability to run their company. For example, the recent proposal for a directive on shareholder rights contains very wide-ranging new powers for shareholders on related party transactions. These are widely perceived by companies and their legal advisers[54] to have a likely impact on day to day operations. While some oversight may be advisable, the extent of such proposals may also be a disincentive to listing, if the existing owners and management feel that the company will be hampered in its decision-making by going public.

An effort should be made to reduce the impacts that increase the regulatory burden brought about by the EU shareholder rights directive proposal on addressing remuneration and related party transactions at Annual General Meeting at EU level and, if necessary, on national implementation.

The US IPO Task Force recommended that Emerging Growth Companies be subject to simplified financial and remuneration reporting, particularly regarding “Say on Pay” and pay ratios.

We note that there was never any proper analysis undertaken of the implementation of the 2007 shareholder rights directive, nor of the 8th company law directive, including its provisions on audit committees, before subsequent legislation was proposed.

We therefore recommend that Emerging Growth Companies be exempt from the proposed provisions of the EU Shareholder Rights Directive on remuneration and related party transactions, as well as the more detailed governance requirements relating to company audit committees in the recent EU Audit Regulation and Directive.

1.6.2.4. Prospectus Regime

Task Force members agreed that the changes proposed to make the time and costs of publication of prospectus documents more proportionate for smaller companies and more user friendly to investors during the last review of the Prospectus Directive were insufficient to achieve this purpose, and that further changes are required. Given the recent publication of the review of the Prospectus Directive alongside the Green Paper, we highlight below some key points, but several members will respond in more detail to the actual consultation.

Secondary Market Offer

With the aim of improving the secondary offerings climate and thereby companies’ abilities to finance growth, it was agreed that the disclosure requirements for companies doing a secondary public offer on both regulated and SME Growth Markets should be simplified. With this in mind, it was recommended to **allow the proportionate prospectus regime for rights issue to apply to all forms of secondary pre-emptive offers** (i.e. including open offers). For example, the **pre vetting requirements could be simplified** elsewhere as per the AIM market, where admission documents are often more flexible and do not require prior approval by the authorities, but rather rely on a sponsor (nominated adviser).

[52] Elstob P., “MAR hearing : Insider lists must contain detailed personal information, ESMA insist”
[53] Comments by EuropeanIssuers to ESMA’s Policy Orientations on possible implementing measures under the Market Abuse Regulation dated 29 January 2014, page 9-11 and earlier comments on the draft Regulation dated 25 January 2013, page 17
[54] Linklaters LLP, “European related party transaction rules: the impact on on listed companies”

Threshold

The Prospectus Directive has relatively low thresholds that trigger full prospectus requirements which are disproportionate for smaller companies (e.g. the requirement to produce a prospectus when a company has increased its share capital by more than 10% in a 12-month period).

Task Force members also agreed on an **increase of the number of investors per jurisdiction that an offer can go to before a company needs to produce a prospectus – from 150 to 500 people**[55] (Article 3 (2) b of the Prospectus Directive). However, it was felt that the priority should be an improvement in the Qualified Investor list, which would then enable people on that list to be excluded from the calculation of members of the public.

It was also agreed that **companies on SME Growth Markets should be allowed to incorporate information by reference in prospectuses** (Article 11 of the Prospectus Directive).

Another important aspect is to **eliminate uncertainties about what constitutes a public offer**. Through the revision of Prospectus Directive, companies – or analysts covering them – should have greater reassurance with regard to what does not constitute an offer, so that certain information can be made publicly available without triggering disclosure obligations (e.g. research).

Increasing the fundraising threshold above which a company must produce a prospectus from €5m to €20m (Article 1 (2) h of the Prospectus Directive) was discussed but investors said that they would need further consideration as the revision of Prospectus Directive was still quite recent. However, they did feel that they could accept **2 rather than 3 years past disclosure**, provided that there is still the overall requirement for information disclosed to be fair and accurate.

Role of Competent Authority

Several advisers felt that the requirement for competent authority approval may reduce the number of IPOs and increase trade sales, because the requirement narrows the window of opportunity to list and adds both time and cost to the process. Most felt that the advisers were best placed to do the job, although it was important to ensure that the current ecosystem (discussed separately in this report) will be able to carry out this role as previously. It was also mentioned that requiring the approval of regulators is a key reason why prospectuses are 300 pages with 40 page risk disclosures, while earlier documents pre prospectus directive were much shorter.

It was agreed that **abolishing the requirement of the approval by the competent authority requires further investigation and that the benefits (or otherwise) of the competent authority pre-vetting and approval process** (Article 13 of the Prospectus Directive) **should be addressed during the revision of the Prospectus Directive**.

Simplification

There are complaints from investors, especially retail ones, that currently prospectuses are not user friendly. They complain about usage of legal jargon, which is not easy to comprehend. They would also like to see changes to the "summary prospectus", which currently very few people read.

1.6.2.5. IFRS

European companies still need to produce at least two set of accounts. IFRS is the accepted international accounting standard for investor information, which is required to access regulated markets, but increasingly also by banks with increased documentation and rating requirements. However, national GAAP still serves as the basis of taxation and domestic regulatory reporting. This creates duplication and, in the case of companies operating in more than one European country,

[55] The US Jobs Act increased the equivalent registration threshold from 500 to 2,000 shareholders AND included a requirement that the company have more than $10 million in assets AND that the company be listed on a US exchange.

a multiplication of accounting costs and complexity. The lack of harmonization of taxation and national reporting may also complicate financial analysis, since analysts need to familiarize themselves with all the details of national accounting and taxation rules. Especially for smaller countries, the willingness of investors to research smaller companies on exchange-regulated markets may be lower, if this involves comparison of multiple national GAAPs.

The development of alternative IFRS for smaller quoted companies in SME Growth Markets might enable investors to compare information more easily cross-border. However, in order to avoid problems experienced for larger companies with IFRS, care would need to be taken to ensure that adjustments to IFRS for SME standards should only be made if deemed necessary and according to an agreed timeline.

We are aware that the current standards for SMEs are stated by the IASB not to be aimed at listed companies, but it is unlikely that the status of growth markets was adequately considered. In any event, the EU institutions can decide for themselves whether to enable their adoption within Europe.

We are also aware that IFRS may be still considered as complex and costly by Emerging Growth Companies and have been subject to varying degrees of political controversy in different Member States.

1.7. Recommendations

We recommend the creation of a more flexible regulatory environment for small and mid-cap quoted companies, also known as "Emerging Growth Companies", including lowering the barriers to entry and the cost of equity capital.
In particular, we recommend that the EU:

- **Encourage a diverse and attractive funding base in European public markets for companies of all sizes;**
- **Promote the concept of "Think Small First" in EU financial regulation affecting Emerging Growth Companies;**
- **Revise EU financial regulation to reduce administrative costs of listing for companies by 30-50%.**

We make more detailed recommendations as to how to achieve each of these in the full list of recommendations and in the accompanying working documents.

2.0 Difficulties for Investors - Market Access, Regulatory Constraints (Problems of Demand)

2.1. Demographic Factors

At the most general level, attitude towards equity risk is influenced by factors such as demographic change[56]. Such factors cannot be changed by financial sector policy or industry action and need to be taken into account as a given constraint. However, some of the policy effects of such ageing can be managed.

In particular, there may be a need for individuals to continue to invest in equities, if they are likely to live for another 20-30 years post retirement. This is all the more urgent, given the certainty of low absolute returns in current bond markets and the lack of any meaningful growth other than index-linked bonds that are standing at even lower yields.

2.2. Investor Confidence

One of the most important factors underlying investors' interest and willingness to invest in an IPO is **confidence** – confidence in financial markets in general and confidence in equity markets and the IPO process, in particular. Confidence is influenced both by facts and by perception. The **performance** of equity markets and IPOs in particular, is an important element determining investor confidence in the expected returns from IPOs. It has been argued that this could be a factor to explain the lesser investor interest in the smaller IPOs, since smaller IPOs have performed generally less well than larger IPOs.

According to John Coffee from the US, "Overall, the loss in investor confidence has been cumulative, because since 2000, the number of IPOs has never recovered to more than 25 percent of that 1996 level"[57]. In the words of Prof. Coffee, "the greatest enemy of job creation today is not overregulation, but the loss of investor confidence. In particular, American investors have lost confidence in the [IPO] process and in the integrity of the mechanisms for capital raising.[58] In the words of US SEC Commissioner Luis A. Aguilar, [t]he research scandals of the dot-com era and the collapse of the dot-com bubble buried the IPO market for years."[59]

On a more general level, it is likely that the **big decline in confidence in capital markets after the 2008 crisis** could affect investors' attitudes towards IPO markets, especially when taking into account the accumulative effect of subsequent crises since 2000. Only 15% of the public trusted stock markets as of December 2013, compared to 35% trust expressed for banks, 31% for mutual funds and 17% for large corporations[60]. (The trust towards stock markets and banks showed a downward trend over 2013). While an equivalent poll does not exist for Europe, it is reasonable to expect that the last crisis has led to a similar loss of confidence in European capital markets as well – which came on top of the severe impact on confidence of the last crisis in 2000. Although, it is clear that the financial crisis of 2008 originated in the less regulated parts of the debt market which had little to do with the public equity markets, and that the stock exchanges in particular remained healthy, robust and transparent all throughout the crisis, all parts of the market have been affected by a loss of confidence.

Affecting investors' returns is another factor that may lead to the impression that the **IPO process** itself is not fair vis-à-vis certain investors. For example, Prof. Coffee believes that "[t]his sense that the game is rigged can produce a negative reaction independent of the overall success or failure of IPOs, as it leads at least a portion of the market to withdraw."[61]

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[56] Roxburgh C., Lund S., Dobbs R., Manyika J., and Wu H, "The emerging equity gap: Growth and stability in the new investor landscape"
[57] Coffee J. Jr., "Gone With the Wind: Small IPOs, the JOBS Act, and Reality"
[58] Coffee J. Jr., "John Coffee Jr. Testifies on Capitol Hill About Facebook, IPOs, and Securities Regulation".
[59] Aguilar Luis A., "Public Statement by Commissioner: Investor Protection is Needed for True Capital Formation: Views on the JOBS Act"
[60] Chicago Booth/Kellogg School Financial Trust Index
[61] Coffee J. Jr., "Gone With the Wind: Small IPOs, the JOBS Act, and Reality"

Good corporate governance codes can also play an important role in promoting investor confidence post IPO, as companies grow and develop. Markets should encourage codes which are designed to help companies (and their investors) who are at differing stages of development, rather than have one size fits all designed around the larger companies[62]. Trust between companies and investors can be fostered by company behaviours which demonstrate the desire to create long-term value for the end shareholder through a well-articulated business model and strategy.

Investors' trust can certainly be also greatly increased by financial education (of investors and other citizens who are potential investors). Please see the section below dedicated to equity culture in that respect.

In addition, investor trust can be built by pilot programmes to see what works in practice. The UK's Financial Reporting Council has a Financial Reporting Lab[63], which allows new disclosure requirements to be tested by companies with investors. Such pilot projects can give investors the reassurance that they will receive the information they need, while potentially allowing the companies to disclose in the most efficient way and therefore reduce costs. The EU and other Member States could develop similar pilot projects in the future.

2.3. Regulatory Restrictions on Investors

Regulatory restrictions for investors are key determinants of the ability of investors to invest in IPOs (and equity more generally). In this regard, many commentators have highlighted the negative effects of regulation on the costs of IPOs in Europe.

Concerns about regulatory restrictions are true of Solvency II in particular. Under the new Solvency II regime insurers must, in principle, hold a 39% capital charge for owning shares in listed companies in the developed markets and a capital charge of 49% for other categories of shares. Depending on the (exceptional) development of share prices, the regulatory authority has the power to adjust this capital requirement upwards or downwards by no more than 10%.[64] A capital charge of 22% applies to participations of a strategic nature. Debt-related instruments are potentially less expensive and they are subject to a capital charge of 15%.

There is no capital charge whatsoever for treasury bonds issued by Eurozone Member States. Since insurers and possibly regulatory authorities as well are already anticipating the new rules, insurers are in the process of disposing of a significant volume of the equity investments that they hold at their own expense. Some insurers have completely stopped investing in equities, which means that equity funding via the capital markets may not be an option for as many companies, at the same time as bank funding may be scaled back.

As highlighted by the OECD[65], "*Compared to Australia, Canada and the United States, institutional investors in Europe's larger countries typically allocate a smaller portion of their assets to public equity. This is also reflected in the fact that equity allocations of European asset managers are considerably lower than their allocation to bonds.*"

Other problems include the suggestion that all shares on exchange-regulated markets (primary market MTFs) should be considered complex under MIFID, and appropriateness tests under MIFID, which may push fund managers to focus on factors such as volatility risk rather than long-term value.

There may also be national restrictions which could be reviewed; e.g. we understand that the Romanian regulator prohibits pension funds from investing in listed companies operating in the real

[62] For example, the UK Quoted Companies Alliance and Middlenext in France have both developed codes for smaller companies, while other codes may distinguish between large and smaller companies (e.g. Spain)
[63] Financial Reporting Lab
[64] Article 106 Solvency II directive.
[65] Çelik S. and Isaksson M., "Institutional Investors as Owners: Who Are They and What Do they do?", page 17

estate sector. It might be useful to ask Member States to provide the European Commission with a list of any such restrictions, in order to compare the differences in investment options. This would also help the European Commission to consider whether any such requirements may constitute barriers to the free movement of capital.

We note that the SME report from ESMA's Stakeholder Group made various recommendations back in 2012, which have not yet been implemented.

In addition, EU law imposes additional regulatory requirements on shareholders, the introduction of additional obligations on institutional investors and asset managers who are shareholders of listed companies' risks acting as a disincentive to undertake an IPO. If investors in a company will face a significant additional reporting or disclosure burden should that company decide to list the company may be discouraged from undertaking an IPO, for fear of losing investor interest. EU law – such as UCITS or AIFMD – already places obligations on investors and asset managers to report and disclose information. Additional reporting as currently proposed by the Shareholder Rights Directive should only be introduced as "comply or explain" codes rather than legislation, perhaps in stages for different sizes of investors, given the potential downsides.

2.4. Retail investor Participation

Access for different groups of investors, such as **retail investors**, is not only a factor in influencing the fairness of the IPO process and the subsequent market, but also one that affects the overall volumes available for investment. While the IPO markets that are vibrant have very strong institutional investor engagement, they also do benefit from retail investors whose behaviour typically is different (buy-and-hold) and do not need high levels of liquidity. Moreover, according to the interviews performed by EuroFinuse/'Better Finance for all' for their response to the Green Paper on Capital Markets Union, market participants from the IPO industry signal that retail investors participate approximately twice as much in the listed SME markets than they do in the overall market, which could indicate genuine interest of retail investors in the SME markets. Hence, for smaller IPOs, retail investor access is important. In this regard, the access of European retail investors to EU capital markets shows great diversity, with some markets being very accessible (France, Poland, the UK) while others appear relatively closed to retail investors.

The choice of distribution channels may play a role: retail investors may have the choice to invest directly by themselves via an independent stockbroker or platform, with the assistance of an independent financial adviser or one which may also offer brokerage services, or via a third party distributor, which may either sell its own funds, or those of others. However, while UCITS funds are widely distributed, most of the distribution channels are restricted to those residing in the same Member State, restricting free movement of capital. For example, an online platform such as Fidelity Funds Supermarket offers retail investors direct access to funds and shares, but only for UK residents. There do not appear to be truly pan-European web platforms in this area. This may increase the costs and difficulties for retail investors in accessing information and entering into dialogue with the companies.

2.5. Qualified Investors

In recent years, it has become more difficult for retail investors to be eligible as qualified investors. In the past, this provided a good way for high net worth individuals to participate in equity offerings. The retail investors would like to see this option brought back (see also comments above re Prospectus Directive in 1.6.2.4).

2.6. Behaviour of Institutional Investors

It is important to differentiate between investors: different types of investors have different needs, behave differently and need different protection levels (institutional vs. retail, local vs. international, etc.) For a healthy IPO market, one needs, ideally, all of these different types of investors. Moreover, certain behaviours among investors tend to be particularly supportive of (or harmful to) healthy IPO markets.

Some studies consider the **changing business models of investors** as a factor behind the decline of European IPO markets.[66] The long-term changes that might have led to more of a trading- and speculation-based market are usually seen as the reason why investors are less willing to invest long-term and less willing to invest in companies the risks of which they need to analyse (as opposed to indexing).

In sum, some of the factors are:

- Pressure on risk minimizing that led to the outgrowth of institutional investors,
- Liquidity premium: institutional investors have a preference (internally generated or mandated by public policy) for more liquid assets, which drives them towards large cap equities,
- Availability of Institutional Investors: in some markets public policy is dismantling the private pension sector, thereby undermining a key investor base,
- Narrow institutional focus and index bias: focus on short term performance and outperforming others; institutional investors have been able to achieve 'good enough' returns from investing in other asset classes, or by tracking a few (large cap) indices / cheap credit – see arguments in Slow Finance,
- The ageing population (investors have less need of deposits when they start to reach pensionable age) and the change in pension systems (from defined benefit to defined contribution) may also have a negative impact on the inclination of traditional institutional investors to invest in public equity.

There remains an identifiable group of small-cap institutional investors. These are distinct from the mainstream institutional investors running the larger funds, which because of their size and mandates, are currently unable to invest in small and mid-size quoted companies. However, this group forms only a small part of the marketplace.

2.7. Financial Regulation

Regulation of other market participants may increase one-off and ongoing costs for companies or investors; e.g. short selling regulations had an impact on the willingness of market makers to remain involved in illiquid securities, committing capital in order to provide continuous two-way prices.

Therefore, policy makers should exert caution while designing new financial regulation because of the potential for unintended consequences. As standard procedure, EU regulatory impact assessments should be performed which measure not just the potential impact on financial market participants such as the banks, but also on the end users, being issuers and investors.

The key drivers here are: what is the purpose of EU financial regulation and whose interests should financial markets serve? Since the adoption of the Financial Services Action Plan (FSAP)[67] in 1999, there has been a significant change of the in the purpose of EU financial regulation. While FSAP focused on end users ("ensuring deep and liquid capital markets, which serve both issuers and investors better"), in 2010 ESMA's objective was set[68] to "protect the public interest by contributing to financial stability and effectiveness of the financial system, for the economy, citizens and business" with citizens and business at end of queue. In recent years the focus on financial stability and financial institutions of the policy makers has been omnipresent. End users (companies and investors) have often felt excluded by central banks, other financial regulators and financial

[66] Isaksson M. and Çelik S., "Who Cares? Corporate Governance in Today's Equity Markets", page 24
[67] European Commission, "Financial Services Action Plan (FSAP)"
[68] Official Journal of the European Union, "Regulation (EU) No 1095/2010 Of The European Parliament and of The Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority), amending Decision No 716/2009/EC and repealing Commission Decision 2009/77/EC"

institutions. We question the current purpose of financial regulation and would like to refocus it on serving the end-users, being companies and investors.

2.8. Recommendations

We recommend that EU policymakers ease constraints that restrict investors' ability to access IPO markets & to invest in venture capital / private equity.

In particular, we recommend that the EU:

- **Create a single market for retail investors to directly access public equity markets cross-border in Europe (in addition to investment with financial intermediation);**
- **Ensure that EU legislation does not restrict investors' ability to invest;**
- **Promote investor confidence and understanding**

We make more detailed recommendations as to how to achieve each of these in the full list of recommendations and in the accompanying working documents.

3.0 The Ecosystem and Market Structures

3.1. What is the Ecosystem and why does it matter?

Companies and investors do not exist in a vacuum. They interact with one another in a complex environment which is composed of **institutions that provide services to them** (e.g. exchanges, brokers, market makers, sponsors, underwriters, financial analysts, auditors, accountants, central securities depositories, etc). We consider these institutions very important because of their ability to enable companies and investors to meet with one another, but we do not see them as the key stakeholders of the IPO markets. Nonetheless, this group of institutions, which we will call collectively the "**ecosystem**" of IPO markets, is essential for the functioning of markets, and will be an important area of consideration when looking for improvements.

Different geographic/market levels of the ecosystem (local, regional, pan-European, global) may be needed to access the IPO markets at different levels.

3.2. Ecosystems Supporting IPOs

The **erosion of the local and regional ecosystems** in Europe (and in the US) is cited as a major contributor to the IPO market trends. The need to re-build ecosystems was noted in the 2013 report from the **EFC's High Level Expert Group**[69], which called on Member States to "investigate (and report on) as a matter of urgency what is required in their market to (re)build an ecosystem comprised of dedicated analysts, brokers, market makers, ratings etc., that can both advise and support issuers and investors, and foster the liquidity of equity growth markets. This will aid in the development of small and mid-cap financing through equity growth markets and will also support the private placement mechanism which relies on the same ecosystem."

Due to a complex set of regulatory and technological changes both in the US[70] and in Europe, most of the capital market activity has focused on blue chips, and the trading has become automated, highly efficient, and inexpensive. While these changes are to be welcomed from the perspective of the intermediaries serving this market segment and the investors trading in blue chips, they have also led to the disappearance of smaller brokers, analysts and advisers who are incentivised to invest time and resources into building the demand for smaller IPOs. The benefits of pan-European rules have tended to accrue to the larger global players, who are able to conduct cross-border trading more efficiently. However, the ecosystem for the smaller players has been disrupted.

As a result, two important factors have emerged, both of which suppress IPO markets: First, IPOs of smaller companies in particular have become less **visible.** Second, the **fixed costs of IPOs** have become larger for the smaller companies, since the institutions providing these services tend to be larger ones catering to the largest companies.

"As the financial sector has grown, relationships... have become more complex and opaque. The orientation of the financial sector has become increasingly skewed towards large and international. As a result, the links between savers, the original providers of capital, and the financial markets, which allocate that capital, have become less coherent[71]."

Companies need help in finding brokers who fit their needs. While the marketplace should accommodate all types of issuers – e.g. those who see the IPO market as a transaction versus those who seek a longer-term relationship with investors – the current environment favours the former and makes it difficult to encourage the latter. It would be useful to clarify the role of brokers and the expectations of issuers – through, for example, a standard charter on the rights and duties of underwriting that can be agreed between the representatives of brokers, issuers, long-term investors and exchanges on a voluntary basis. This should deal explicitly with conflicts of interest issues and

[69] Economic & Financial Committee High Level Expert Group, "Finance for Growth: SME & Infrastructure Financing"
[70] Weild D., Kim E. and Newport L., "Making Stock Markets Work to Support Economic Growth", page 55 and 60
[71] Williams G., "Slow Finance: Why Investment Miles Matter", page 3

areas of potential misunderstanding[72]. Since most companies only list once, the inequality of information is very high. Exchanges should be aware of those brokers that take companies to market and then become less involved thereafter, so may need to take action to protect issuers also (possibly via approved sponsor regimes).

3.3. Market Structures

Linked to the above factor, many commentators and experts believe that the current market structures are not adapted to companies' or investors' needs. Some have called into question whether the competition set among trading venues is conducive to a stock exchange model that can remain focused on listing.

The move from mutually owned to publicly traded exchanges had led to an ever decreasing amount of revenue from SME trading and primary market activities. This in turn may have lead to a lack of innovation in modernising the IPO process, raising awareness of the benefits of listings and encouraging a culture of equity ownership.

At the same time, well-functioning secondary markets are necessary in order to attract investors. If investors do not feel that there is a functioning secondary market for an asset, they are much less likely to invest in the primary market. This is particularly the case for institutional investors, who have higher degrees of liquidity expectations.

In this context, for shares already suffering from low liquidity, the effect of a new regulation such as a potential FTT could be devastating in terms of erasing the current low levels of liquidity in that stock.

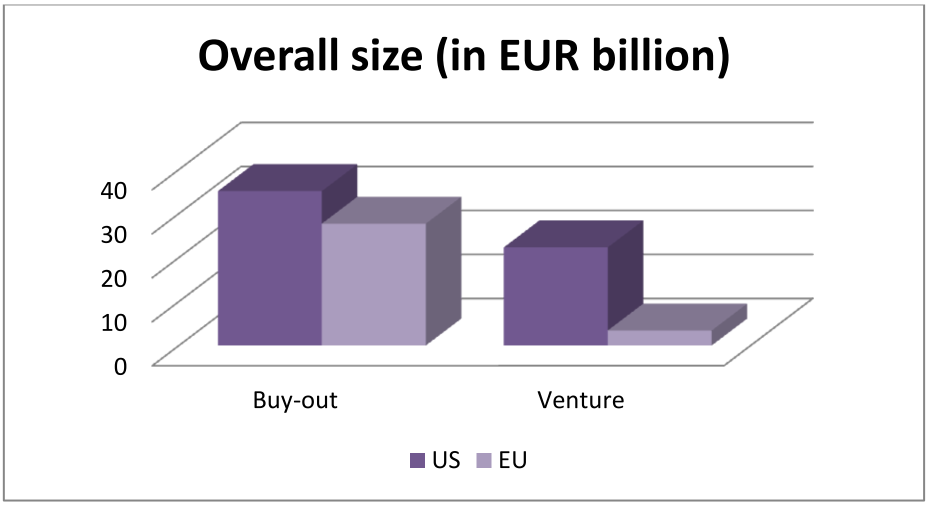
There is also a gap between what companies need at different stages and what the markets are delivering; compared to the US (which suffers from an IPO decline even more acute than that of Europe), the EU lacks the depth of private equity and venture capital that would be needed to provide a steady pipeline of growth companies. Companies need access to different types of funding at different stages of their development; e.g. crowdfunding, business angels, venture capital, private placement, IPO onto growth market, secondary capital raisings, IPO onto main market, including the possibility of accessing different market segments (standard then premium), etc.

Finally, the interaction with the EU Single Market is an important factor in the growth of IPO markets. Local capital markets are more likely to demonstrate an interest in local companies, but may not have the depth to finance the range of potential listings. Europe needs the local, regional and pan-European levels to work much better together.

In addition to the diversity of market segments and services that exchanges currently provide to their companies and investors (e.g. primary listing MTFs; improvements in trading models to accommodate illiquid stocks; as well as dialogues established with companies and investors), **exchanges could also play an increasingly important role in bridging the two basic modes of financing for a company, through markets and banks**. This could take the form of early education and networking for companies in the pre-IPO stage (e.g. ELITE programme later in this section) as well as other pre-IPO services.

[72] ACCA, "A Behavioural Finance Perspective on IPOs and SEOs", page 56 of the Report cites the example of a broker that had allocated shares without the company's knowledge, leaving the company's preferred fund manager without an allocation.

Chart 10 By overall size: Buy-out and VC (i.e. excludes mid-market PE)



Source: EVCA (EU); Bloomberg (US)

3.4. Investment Research & Analysis

Few small-mid cap companies have been subject to research / analysis by brokers and intermediaries, raising the 'discovery cost' for potential investors in comparison to large cap or already-listed companies (information asymmetries therefore emerge that raise the perceived risk of investment in smaller companies). Smaller companies are usually covered by analysts within smaller brokers, who may be more local or regional. There is some move towards specialisation by sector among smaller brokers, but analysts covering smaller companies need to be familiar with the different local environments, including accounting, taxation, company law, etc.

The World Federation of Exchanges has calculated that 35-40% of all publicly traded equities have no research coverage. As part of the December 2011 Action Plan to improve access to finance for SMEs, the ECSIP Consortium carried out a study on behalf of DG Enterprise and Industry to properly identify, analyse and help remedy any shortcomings in current market performance that negatively affect the optimal provision of high quality business information on listed SMEs. The aim was (a) to make such SMEs more visible and attractive for potential investors and (b) to assist existing and / or new commercial players to develop business models for research on listed SMEs that should be self-sustaining in the longer run.

The report notes that "domestic investors are usually the ones who invest in SMEs, whether on an individual basis or via a managed retail fund. This is because i) the information available is often only in the local language, ii) the risk involved in dealing across borders sometimes in a different currency, often deters investors and iii) the illiquidity of the stock makes it harder for larger sized investors to become involved."[73] Retail investors account for a higher proportion of market share in local SMEs than in the investment of larger regional enterprises, and may obtain their information from delayed stock exchange price data and from newspapers and magazines. In addition, evidence from the US suggests that local analysts who are geographically close to the assets in which they invest may have an information advantage over other analysts, which can translate into better performance. This is found to be particularly strong in small firms, firms located outside the most populated cities, and firms located in remote areas.[74]

Professional and retail investors have different information needs. Retail investors access the following sources of business information before making their investment decisions: literature,

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[73] ECSIP Consortium , "Improving the market performance of business information services regarding listed SMEs", pages 12-13
[74] Malloy C. J., "The Geography of Equity Analysis"

media, internet, friends and family, and professional service providers.... they tend to focus more on the (shorter) management report than on the full annual report[75].

Professional investors use the financial statements and the related footnotes in the annual reports. They usually get real-time information and are likely to meet with company management.

Payment for analyst research has traditionally been done via commissions paid to brokers providing the research. However, in recent years there has been a trend to unbundle the information provided to investors, so that they can choose what information they want to receive (and pay for). ESMA consulted on the possibility of an EU ban on commissions in 2014[76]; many industry participants proposed commission sharing agreements as an alternative.

Various models have been tried. What works best is likely to depend upon the local market circumstances. The ECSIP report states that "the current broker model is no longer viable as the brokers cannot make enough income to maintain the analysts." However, the "unbundling of research provision has made it harder for some banks and brokerages to cover research costs but has allowed new providers of business information to become established[77]."

The case studies in the ECSIP report show that low research coverage of SMEs is mainly caused by low investor interest for these companies as SME stocks lack liquidity and often have associated risk.[78] Institutional investors often have other priorities and mandates from their clients when it comes to allocating funds.

"Users of a lot of information want to have it aggregated and they also want to have analytical tools that help to evaluate and compare the information they receive."[79] What would be useful is to encourage alternative business information service providers (exchanges and other information service providers) to provide central information on analysts / research available on smaller companies, in addition to allowing companies to post such information on their websites with the permission of the analyst / once a certain time has elapsed, in order to make the business of analysis worthwhile. There have been cases in the past where there have been concerns as to whether regulation would allow this. This would provide more accessible information for investors and possibly facilitate their investment in small and mid caps.

3.5. Recommendations

We therefore recommend improvements to the ecosystem of IPOs and market structures to better serve companies at different stages of growth and different types of investors.

In particular, we recommend that the EU:

- **Increase connectivity and encourage better dialogue between European companies and their investors, including end investors, both pre and post IPO;**
- **Improve the provision of analyst research and / or other third party business information services regarding small and mid-cap companies;**
- **Improve the "after-market incentives" for brokers;**
- **Set up an EU industry expert group of advisers that would develop proposals as to how to reduce the cost of supplementary services faced by issuers.**

We make more detailed recommendations as to how to achieve each of these in the full list of recommendations and in the accompanying working documents.

[75] Ibid, page 15
[76] ESMA Consultation Paper MIFID / MIFIR, 22 May 2014
[77] ECSIP Consortium , "Improving the market performance of business information services regarding listed SMEs", pages 39 and 44
[78] Ibid, page 69
[79] Ibid, page 13

4.0 The Need to Build an Equity Culture in Europe

Europe does not currently enjoy an 'equity culture' – listing on a public market does not have the positive connotations that it would in other markets. There is a political ambivalence towards IPOs at the EU level, contrary to the US where the value of capital markets is seen as a benchmark for economic growth. The recent announcement of a "Capital Markets Union" and the appointment of a new Commissioner with responsibility for this area may offer an opportunity to promote such a culture, but this will take time.

One reason for the existing equity culture in the US and more financing from the capital markets, mentioned at the conference co-organised by the European Commission and Italian President on "Finance for Growth" in Brussels, was the lack of mandatory institutional pensions and individual pensions accounts in Europe. Such pension funds may motivate citizens to invest their savings on capital markets with the aim of safeguarding a decent retirement. Another important factor that can influence culture is education for both companies and investors. Promotion of positive stories can also play a role; for example, the EU Small & Mid-Cap Awards supported by the European Commission have shown how individual companies can raise finance from the capital markets to promote their businesses and grow. Finally, we think that more direct communication between investors and companies could be helpful in the creation of an equity culture.

4.1. Market Based Measures

IPO costs are disproportionately high for smaller companies. So consideration should be given to the ways in which underwriters and advisers could adjust their revenue models for IPOs of such companies. In addition, there are various initiatives on enabling computer rather than human analysis of some types of data, which should be encouraged[80], although these are less likely to impact the analysis of smaller companies.

The fees paid to underwriters and advisers often consist of a fixed component and a variable component. The allocation of the variable component of the fee should be explicitly based on criteria that reflect the success of the IPO after the listing, such as: the stability of the share price of the new company, the degree to which shares have been taken up by stable long-term shareholders, and the quality of the prospectus and the other documentation in the eyes of investors.

It would be also important to ensure that companies are educated and aware of what kind of services that can be offered and what they can negotiate and/or expect. The US IPO Task Force recommended that there should be improved disclosure of underwriting relationships, and more education provided to companies as consumers of investment banking services, particularly as regards choice of banking syndicate in order to encourage the allocation of shares to long-term investors as well as the banks' largest trading counterparts, increasing the issuer's role in the IPO allocation process and improving investor communication.

Other similar reports on how to educate issuers as financial consumers include the UK Institutional Investor Council Report[81] and the ABI Guidelines on Encouraging Equity Investment[82] .

The UK IIC made several recommendations, including:

- Disclosure of underwriting fees paid;
- Involvement of issuers in compiling the sub-underwriting list and ensuring that they are given a copy of the final list by their advisers;
- Independent advice, where the Board is not experienced in equity capital raising;

[80] Waters R., "Investor rush to artificial intelligence is real deal"
[81] Investment Management Association and Association of British Insurers, "Institutional Investor Council: Rights Issue Fees Inquiry"
[82] Association of British Insurers, "Encouraging Equity Investment"

- Greater use of tenders for underwriting services, with no automatic assumption that all issues should be fully underwritten. Issuers should decide what proportion of the issue should be underwritten, by whom and at what price;
- Institutional shareholders should engage more with companies, to provide feedback on support for rights issues;
- A model sub-underwriting agreement; and
- Greater support from registrars and custodian banks as regards the provision of information.

Although these recommendations were aimed at UK rights issues, they may be relevant to wider equity capital raising in Europe.

The ABI Report recommended inter alia:

- Earlier engagement between issuers and investors;
- Greater access for non-connected analysts to the IPO analysts' presentation;
- Greater clarity as to the role of and fees paid to investment banks, with unbundled fees for underwriting services;
- Shorter prospectuses;
- Standard sub-underwriting agreements to reduce costs; and
- Improved distribution of documents by custodian banks.

4.2. IPO Process

An important change over the last few years is that the IPO process has turned into a "one-time deal" instead of the start of a long-term relationship by which companies can raise money from their shareholders again over time.

While secondary raisings are still possible (and booming in some markets), many public companies seem to think of their listing as not providing them with a permanent relationship with their shareholders. Intermediaries are, more and more, incentivised on a deal by deal basis through transaction fees, rather than through fees for ongoing advice. Some intermediaries may be incentivised to allocate shares to short-term investors rather than to long-term investors with the capacity to provide further rounds of equity investment. The soon-to-be public company has an interest not only in securing the right price for the shares but also in ensuring the right profile of shareholder – those with an interest in the company's long term health.

Coming back to the long-term relationship of companies with its investors, an insufficient number of smaller companies currently use markets for bonds or additional equity raisings *after* their IPOs. It is essential to **make it easier for such companies to issue public bonds or undertake an additional equity capital raising where such capital raising is via existing shareholders, using only the initial prospectus and then ordinary disclosures such as annual and interim reports**. At the moment, many smaller companies do placings, but do not raise money from the public via secondary offerings because they are too expensive.

In order to simplify the process, automation of the IPO process and standardisation of the paying agent contract would be beneficial. To make those changes in an appropriate and sustainable way, we need to look at the entire process and (needed) ecosystem: pre-IPO, IPO and post-IPO on one axis and the ecosystem on the other.

We think that more direct communication between investors and companies could be helpful in the creation of an equity culture. Therefore, we would recommend arranging pre-IPO days at an early stage, involving companies and investors, without intermediaries being present. This would allow an open conversation between the parties and help companies to determine the costs and benefits of listing. It could also help investors to have more time to consider the attractiveness of companies from different sectors and with innovative technologies that cannot easily be understood in a 45 minute IPO roadshow presentation. Investor clubs and/or shareholder associations (see for instance Fédération des Investisseurs Individuels and des Clubs d'Investissement) can be also helpful in organising regular roadshows during which companies and investors meet and become engaged in useful discussion.

4.3. Shareholder Identification

Shareholder identification therefore has an important role to play, but research by Capital Precision[83], Computershare[84] and the European Central Bank[85] has shown that there is a marked difference in shareholder transparency between markets. As previously mentioned**,** the proposal for a directive on shareholder rights[86] should introduce a right for companies to identify their shareholders, although the details will be left to the Member States. In order for that to be effective, companies need the right to impose sanctions on those who do not reply[87].

In those countries where the shareholder register is open to the public, and the shareholder identification laws allow investors holding below the register to be identified, the brokers (or the company itself) are better able to locate those investors who might be interested in similar companies coming to market. This makes listing companies in the UK easier than in, say, Switzerland. It also makes direct contacts between companies and shareholders easier. This may not be so much of an issue if the company has controlling majority shareholders, but is important if the company wants to be able to manage its share register and to target like-minded investors.

4.4. Company Education

Educational programmes can equally prepare and encourage companies to enter capital markets, and prepare them to engage with shareholders and other market participants.

Too few companies that have the potential to access capital markets appear to be aware of the short and long term pros and cons; this lack of awareness stymies the supply of companies seeking a listing. In addition, many companies fear that the burdens of being listed will outweigh the benefits and so will not even consider preparations. Given the complexity of the IPO process, companies need training and support. This can be provided by various actors: e.g. stock exchanges or/ and advisers. ELITE[88] is a platform by Borsa Italiana and London Stock Exchange to facilitate long-term structured engagement between private businesses, industry experts, corporate advisers and investors (venture, private equity and institutions), helping to prepare and structure these businesses for further growth and external investment. In Italy and the UK, ELITE is delivered through a three-part program:

- Get Ready – A comprehensive program for founders and managers, delivered in collaboration with a business school (Bocconi in Italy and Imperial College Business School in the UK) and external experts, to stimulate organisation review and change.
- Get Fit – Reflection on company specific issues and planning for change with the support of the advisory community.
- Get Value – Capitalising on the benefits of the first two phases, companies gain insight from the investor community to help access new funding options and business opportunities.

Whilst the overall structure of the programme is the same in Italy and the UK, given the different business practices in the two countries the delivery of the programme has to be tailored accordingly. For example, in Italy a greater proportion of businesses sustain themselves as family run businesses for longer, whereas in the UK businesses may seek external equity finance through the business

[83] Capital Precision, "Research into the current legal rights of issuers to identify the holders of their shares"
[84] Computershare, "Transparency of Ownership, Shareholder Communications and Voting"
[85] European Central Bank, "T2S Taskforce on shareholder Transparency – final report to the T2S Advisory Group"
[86] European Commission proposal for revision of the shareholder rights directive dated 9 April 2014
[87] EuropeanIssuers' comments on the revision of the SRD.
[88] ELITE

angel and venture community at a much earlier stage. The entrepreneurial, advisory and investor involvement in the programme is therefore designed for the specific market and in fact for cohort specific needs.

4.5. Company Valuation by Capital Markets

Another important determinant of the cost of capital is the **pricing** demanded by investors and the **valuation** of the company. These factors in turn are influenced by whether shareholders are selling, the depth of the markets, the volumes available for investment, the knowledge of the investors, the information available about the company, etc. This is an area where fund manager attitudes can fluctuate abruptly, as for example with the sizeable changes in 2008 and again in 2009.

Fund managers may employ different methods to value company shares; the valuation process that seeks the intrinsic value of a security is known as fundamental analysis.[89] Other forms of analysis may focus less on the underlying value of the share, than on its perceived value by market participants.

A recent BIS Research Paper[90] stated that "Only 15% of portfolio turnover was attributable to opinions about companies." Other factors included: views about other asset classes, maintaining portfolio volatility risk, etc.

However, the Stewardship report[91] stated that: "It would become a serious concern if these methods of analysis (i.e. non-fundamental) dominated stock selection, because the market would fail to accurately price risk. Flows of funds would dictate the direction of the markets rather than the pursuit of fair value. This would have implications on the allocation of new capital and possibly have a pro-cyclical effect on the normal market cycle, by both heightening market peaks and deepening market troughs."

The longer the time horizon, the more investors should generally commit to fundamental value and the less to momentum trading. However, institutions are so wary of taking liquidity risk that they are leaving around 3% per annum on the table in large caps and considerably more for smaller companies[92]. Longer term investors seem to be happy to take more liquidity risk in certain parts of the investment world, and yet they appear to have very little appetite to take some rather lesser liquidity risk in their portfolios of equities, generally steering their managers to invest almost exclusively in the largest companies in Europe.

4.6. Investor Education

One factor that can influence the culture is education. By educating potential investors, they will be able understand and analyse the adviser's recommendations and make a more informed decision. They will be able to search and compare offers and better understand the underlying risks and potential rewards. Given that the benefits of financial education would take time, this would not be a short-term solution; however, in the long-term it would be more effective to allow investors to take more control of their risks.

In the US, there are a lot of investor clubs that not only serve as fora to meet and exchange ideas and information, but also organise training, both for adults and teenagers alike (see National Association of Investors Corporation for more information). The latter are often organised in co-operation with high schools and universities. These programmes familiarise people and encourage direct investment, they also provide tools for building knowledge on how to successfully invest while managing the risks.

There are similar initiatives in some European countries, but few and usually on a smaller scale e.g. by Aktiespararna (Swedish Shareholder Association), Polish Shareholders Association (which amongst

[89] Cronin C. and Mellor J., "An investigation into Stewardship", Appendix I, page 32
[90] BIS (UK Department for Business, Innovation & Skills), "Metrics and models used to assess company and investment performance"
[91] Cronin C. and Mellor J., "An investigation into Stewardship"
[92] Williams G., "The Future is Small", pages 46-48

others developed Investomierz, an educational which allows retail investors to make their own simulations of investments which received assistance from the EU Regional Development Fund, etc.

There is a debate in Europe on independent advisers versus financial education, which several European countries lack. Some advocate focusing first on independent investment advice as the results can be seen more quickly. One question is: is it at all possible to have completely independent advice? Even if inducements are eradicated (which was the objective of MiFID II), there will inevitably be certain human preference/ bias, or easier access to certain other instruments or products. Finally, it is important that it is clear to investors where the distinction lies between marketing and advertising, and education.

4.7. Risk and Regulation

Another big problem seems to be the perception of **smaller and mid-cap quoted companies as riskier and therefore unsuitable for retail investors.** However, there are different types of risk. Research shows that in some cases, smaller companies can outperform the market. The Numis Smaller Companies Annual Review 2014 on Risk and Liquidity and Risk Analysis shows how the constituents of the NSCI can be both less volatile and more volatile than the constituents of the All-Share, and goes on to highlight the diversification benefits of small-caps. Another study states that, "[o]ver the long-term, UK smaller companies have delivered greater investment returns than larger ones... the annualised rate of return on the FTSE all-Share index was 12.2% per annum, compared with 15.6% for the RBS HGSC index."[93] This represents 2 % of the total value of the quoted companies on the London Stock Exchange (the smallest end of the market).

Similarly, research by Davies, Fama and French[94], which used data from the New York Stock Exchange, calculated that the smaller company universe outperformed by 0.2 per cent on average per month. An active example of investment into smaller quoted companies is the Miton Group's Diverse Income Trust, which comprises 70% investment into small and micro-cap companies, while it is less volatile than many peer funds invested into larger companies.

We question whether there may be a tendency on the part of regulators to focus on certain types of risk at the expense of others; e.g. short-term credit risk v long-term performance, with the potential for detriment to investor savings for their old age. We therefore believe that there is a need for further research in this area.

4.8. Recommendations

We therefore recommend that policymakers set the goal of creating an equity culture in Europe, including the provision of education and non-legislative initiatives.

In particular, we recommend that the EU:

- **Promote the financial education of both investors and companies as users of capital markets;**
- **Develop proposals for new pricing structures which align incentives, and balance the long-term health of the company / post IPO performance, with the need to get the IPO away;**
- **Enhance the availability of EU data and research by standardising and improving data collection, in order to enable both companies and investors to understand the comparative costs and benefits of different services provided by capital market participants.**

We make more detailed recommendations as to how to achieve each of these in the full list of recommendations and in the accompanying working documents.

[93] Ibid, page 123.
[94] Davies J.L., Fama E.F., French K.R., "Characteristics, Covariances and Average Returns: 1929-1997", Journal of Finance LV

5.0 Tax Incentives in Member States

Taxation is crucial in the functioning of IPO markets. Member States should be encouraged to use tax policy to encourage long-term investing and to ensure the fair treatment of debt and equity financing.

5.1. Taxation – Companies

The net cost of public equity capital for a company is also determined by the tax treatment of this financing as opposed to other avenues of financing (e.g. the treatment of dividends as opposed to interest paid on loans). Currently in many European Member States we either observe a lack of positive tax incentives, or the presence of significant disincentives, whereby the tax system is more favourable to debt issuance than to equity.

The fiscal environment supporting the AIM market should be considered as an example of best practice. In particular, the UK Enterprise Investment Scheme and Venture Capital Trust Scheme[95] have been highlighted as important to AIM's ability to operate. One reason is that the funds have up to 2-3 years to invest the money, which helps to prevent the cliff edge effect during market downturns and creates more long-term investment incentives. This is particularly important in smaller company markets.

A recent ECMI / CEPS report gives an overview of the national initiatives on debt and equity in five EU countries and calls for greater emphasis on market-based solutions, rather than public subsidies. The report notes that, among public initiatives targeting equity, "the UK government provides the broadest range of tax incentives for investments in SMEs equity capital. Direct public support, contrary to other countries, is relatively lower and consists of a single fund with financing capacity of £100m."[96]

SMEs may have limited access to loan financing[97] and will need more access to share capital in the future. Most national legislation currently in force is discriminatory, insofar as from a tax perspective it is more efficient to finance the business through loans, since the loan costs are deductible in the business before tax, while the costs of share capital are not. Thus, this discrimination provides an incentive for SMEs to finance the business through borrowed capital. This discrimination should be ended by Member States.

5.2. Taxation – Investors

Similarly, the **tax treatment** of the income received from IPOs/equity for investors is also a factor in determining the return for the investor. Favourable treatment of assets other than public equity (e.g. sovereign debt may be treated more favourably than corporate debt) which enjoy more favourable treatment under prudential capital regimes, may reduce the appetite for other asset classes.

- **Propagate Member States' best practices in terms of tax incentives:** use open method of co-ordination to share and compare.
- **In general terms, we support a competitive tax system** across the EU that ensures consistent tax calculations, minimum duplication and a diversity of taxes. Taxation should not be an obstacle in cross-border savings. At the same time, it would be useful to encourage Member States to put in place tax incentives that encourage investment flows into less liquid listed companies (which especially stand ready to benefit from such incentives). Direct investment in shares is often more heavily taxed than investment in funds or property. Eliminating or reducing taxation on capital

[95] London Stock Exchange & Baker Tilly, "A guide to AIM UK tax benefits"
[96] Infelise F., Supporting Access to Finance by SMEs: Mapping the initiatives in five EU countries
[97] European Central Bank, "Survey on the access to finance of Enterprises in the euro area, October 2012 – March 2013"

gains would be a particularly powerful tool for encouraging more investment flows into public equity.

- **Differentiating between short-term trading profits (e.g. under 12 months) and long-term investment gains in fiscal policy** would also be a useful way of incentivising the appropriate behaviour. Consistent tax policies (e.g. long-term tax incentives such as IHT, EIS and VCTs for AIM in the UK) have been key to generating investor appetite and confidence.
- If an EU Financial Transaction Tax were to be introduced - which we do not support - consideration could be given to exemption for transactions in shares in listed companies with a market capitalisation of less the 1 billion euro.

5.3. Recommendations

We therefore recommend improvements in tax incentives for investment into IPOs and equity more generally.

In particular, we recommend that the EU and its Member States:

- **End tax discrimination of equity towards debt and other forms of investments;**
- **Provide tax incentives to encourage investment both for the longer-term and in Emerging Growth Companies;**
- **Ensure consistent tax treatment and exchange of best practice;**
- **Ensure that tax systems are not a barrier to cross-border savings.**

We make more detailed recommendations as to how to achieve each of these in the full list of recommendations and in the accompanying working documents.

6.0 Conclusions

Policymakers' View of Capital Markets

A number of fundamental changes have occurred in financial markets around the world and in Europe in recent decades, with important negative consequences for the core function of capital markets: to finance companies and entrepreneurship, via the provision of permanent risk capital. As analysed in detail in the full Report, these changes have led to a shift away from the financing of smaller companies through public equity markets.

Despite the recent signs of a recovery in IPOs on equity markets, important structural constraints remain and can only be overcome through a combination of policy and industry actions. European IPO markets must become significantly more accessible than they are today to smaller companies. European companies will need to raise more funding via market finance, as bank finance is being constrained. Europe needs concrete actions to allow IPO markets to play a more active role in financing the economy. Moreover, the small and mid-cap companies typically interested in public equity markets are struggling to gain access to these markets. These companies are the engines of economic growth bringing disproportionately high rates of job creation, corporate taxes and significant benefits for not only to investors but to the local and regional economies as well as the European Single Market.

At a time when Europe will be compelled to reduce its reliance on bank financing, and when prospects of economic recovery from the crises of the last decade are still uncertain, Europe needs to reverse the existing trends and to tap into the full potential of its capital markets to finance dynamic companies that will fuel the economy and generate long-term value for the end investors.

The European IPO Task Force believes that this goal is within reach if governments and industry representatives come together with common purpose.

As a first step, we believe that governments and regulators need to change the way they view capital markets. They must accept that risk capital is not zero-risk, and that the economy stands to gain from allowing investors to take on these risks, as long as they are transparent and regulated appropriately. Hence we urge policymakers to focus their efforts on actively encouraging well-regulated capital markets as a major engine of economic growth.

Key Characteristics of Well-Functioning IPO markets

We believe that EU equity markets should facilitate proper **communication** between investors and companies, be **resilient through the business cycle,** even during down cycles, provide **access** for smaller companies, maintain a high level of **quality** (i.e. high levels of long-term positive performance and minimum levels of bankruptcy, fraud, and value loss), operate with **fairness** vis-à-vis both companies and investors, and have adequate **depth** in terms of the volumes available for investment, the mix of investors, and liquidity.

The Report makes a number of recommendations for policymakers as well as industry, in order to promote the confidence of both companies and investors in EU capital markets.

The common objective of these recommendations is to ensure that IPO markets are more innovative, more resilient, more accessible to Emerging Growth Companies, and more efficient. Our ideas are designed to encourage an open exchange of views on these recommendations and contribute to the legislative debate.

We welcome comments and additional suggestions from other stakeholders.

7.0 Full list of Recommendations

The full set of recommendations is listed below, with further explanations provided in the accompanying staff working papers. Task Force members believe that these recommendations would enable companies to reconnect with public markets and contribute to European economic growth and the creation of new jobs, while providing investors with a greater range of investments and a better range of opportunities to participate in that growth.

In the table below, EU includes the European Commission, the European Parliament, the European Supervisory Authorities.
Member states includes: national parliaments, regulators, governments.
Industry includes: stock exchanges, brokers, corporate financial advisors, lawyers, issuers, investors.

Recommendation 1:

Create a more flexible regulatory environment for small and mid-cap quoted companies, also known as "Emerging Growth Companies", including lowering the barriers to entry and the cost of equity capital.

Aims	Recommendations	Directed to:		
		EU	Member State	Industry
1.1. Encourage a diverse and attractive funding base in European public markets for companies of all sizes	1.1.1. Provide companies with access to different regulatory, administrative & fiscal environments appropriate to their financing needs at different stages of growth	✓	✓	✓
	1.1.2. Provide a central information portal for companies with information on the different mechanisms for raising capital cross-border	✓		✓
	1.1.3. Enable investment into less liquid stocks (e.g. creation of indices with equal weight per company, not just market cap)			✓
	1.1.4. Create an SME asset-class definition for national markets that would serve to calibrate appropriate rules for listed companies of different sizes	✓	✓	
	1.1.5. Public acknowledgement by EU policymakers of the link between IPOs and growth and commit to improvements in European listings vis-a-vis rest of the world	✓		
1.2. Promote the concept of "Think Small First" in EU	1.2.1. Support alternative exchange markets (SME Growth Markets) with more flexible and calibrated	✓	✓	✓

financial regulation affecting Emerging Growth Companies	requirements than the main markets[98]			
	1.2.2. Ensure maximum flexibility to the market operators of Growth Markets	✓	✓	
	1.2.3. Enable the adoption of IFRS for SMEs in Growth Markets	✓	✓	✓
1.3. Revise EU financial regulation to reduce administrative costs by 30-50%	1.3.1. Redefine the purpose of EU capital market regulation to serve the end users, being both companies and investors	✓		
	1.3.2. Create a separate new impact assessment, which considers the cumulative effect of EU regulation on issuers	✓		
	1.3.3. Revise the Prospectus Directive and simplify the disclosure requirements for secondary public offers	✓		
	1.3.4. Eliminate the requirement for issuer lists in MAR and simplify the reporting of managers' transactions	✓		
	1.3.5. Simplify remuneration and related party transactions in the Shareholder Rights proposal / exempt EGCs from some provisions	✓		

Recommendation 2:

Relax constraints that restrict investors' ability to access IPO markets & to invest in venture capital / private equity

Aims	Recommendations	Directed to:		
		EU	Member State	Industry
2.1. Create a single market for retail investors to directly access public equity markets cross-border in Europe (in addition to investment with financial	2.1.1. Create greater flexibility for retail investors who wish to be treated as professional investors (qualified investors)	✓		
	2.1.2. Lower the costs of execution-only investment accounts by removing barriers to the development of platforms providing direct access to retail investors, such as cross-border brokerages or	✓	✓	✓

[98] 1.2.1.1. Amend the Anti-Money Laundering Directive to allow companies on alternative markets to rely on market disclosures
1.2.1.2. Exempt SME Growth Markets from the 2014 Audit Regulation & Directive and the remuneration provisions in the Shareholder Rights Directive

intermediation)	exchanges			
	2.1.3. Create a more level playing field between packaged and non-packaged products available to retail investors	✓	✓	
	2.1.4. Improve private pensions in Europe by encouraging EU citizens to take greater responsibility for their own retirement investments and removing barriers to the creation of a portable personal pension account	✓	✓	
2.2. Ensure that EU legislation does not restrict investors' ability to invest:	2.2.1. Create a separate new impact assessment, which considers the cumulative effect of all EU financial regulation 2009-2014 for its impact on investors	✓		
	2.2.2. Eliminate undue restrictions in EU and national legislation (e.g. SOLVENCY II, gold plating in UCITS), which restrict institutional investors' ability to invest in IPO markets	✓	✓	
	2.2.3. Encourage institutional investors to invest in less liquid stocks through more diversified indices			✓
	2.2.4. Reassess how risk in long term, relatively illiquid, assets is measured in order that prudential capital requirements reflect the characteristics of such assets	✓		
	2.2.5. Shareholder Rights Directive: ensure that investors and asset managers who already face appropriate transparency or disclosure requirements under existing EU legislation are not faced with additional burdens	✓		
2.3. Promote investor confidence and understanding	2.3.1. Encourage national corporate governance codes, and different market segments for quoted companies, which are designed to help companies and investors understand what to expect at different stages of the company's development	✓	✓	
	2.3.2. Develop pilot programmes such as those run by UK Financial Reporting Lab to test disclosures	✓	✓	

Recommendation 3:

Improve the ecosystem of IPOs and market structures to better serve companies at different stages of growth and different types of investors

Aims	Recommendations	Directed to: EU	Member State	Industry
3.1. Increase connectivity and encourage better dialogue between European companies and their investors, including end investors, both pre and post IPO	3.1.1. Help companies' connect with the right prospective investors at least a year before the IPO[99]			✓
	3.1.2. Empower companies with the right to identify their shareholders and ensure an efficient and cost effective cross-border shareholder identification system in Europe	✓	✓	
	3.1.3. Promote Stewardship Codes for institutional investors such as fund managers to communicate their investment approach to companies and to report their activities to their beneficial owners (pension funds, retail investors)	✓	✓	
3.2. Improve the provision of analyst research and / or other third party business information services regarding small and mid-cap companies	3.2.1. Compare the effectiveness of the alternative national approaches and different providers highlighted in the ECSIP report on business information services	✓		✓
	3.2.2. Investigate the pros and cons of different options for the most cost effective and user friendly provision of central or regional information on smaller companies to small-cap investors	✓		✓
3.3. Improve the "after-market incentives" for brokers	3.3.1. Tick sizes in MiFID II should be designed with the needs of smaller companies duly taken into account; we would encourage the development of a pilot project to test this	✓		✓
	3.3.2. Review ESMA CSDR proposals on settlement fails that could fine trading in illiquid stocks more heavily	✓		

[99] 3.1.1.1. Arranging pre-IPO days at an early stage, involving companies and investors, without intermediaries being present.
3.1.1.2. Promoting the creation of investor clubs, shareholder associations, online platforms / fora and organisation of roadshows during which companies and investors can meet.
3.1.1.3. Investigating greater central public access to lists of investors investing in given sectors (e.g. biotech) – possibly as a public-private venture – in order for European companies to be able to target potential cross-border investors.
3.1.1.4. Improving the IPO allocation process to include a sufficient quantity of investors with long-term investment horizons, in addition to those that make short-term trades

	than in liquid ones			
3.4. Set up an EU industry expert group of advisers that would develop proposals as to how to reduce the cost of supplementary services faced by issuers		✓		✓

Recommendation 4:

Create an equity culture in Europe, including the provision of education and non-legislative initiatives

Aims	Recommendations	Directed to:		
		EU	**Member State**	**Industry**
4.1. Develop proposals for new pricing structures which align incentives, and balance the long-term health of the company / post IPO performance, with the need to get the IPO away				✓
4.2. Promote the financial education of both investors and companies as users of capital markets	4.2.1. Promote the financial education of investors[100]	✓	✓	✓
	4.2.2. Promote the financial education of companies[101]	✓	✓	✓
	4.2.3. Encourage the development of best practice guidance for companies when dealing with advisers and comparing services provided[102]	✓	✓	✓

[100] 4.2.1.1. Educate investors in basic financial concepts, starting in schools
4.2.1.2. Educate investors as to how capital markets operate, and the characteristics of different investment structures (UCITs v direct shareholdings, equity v debt, etc.
4.2.1.3. Educate investors in dealing with different financial advisers (banks, fund managers, independent financial advisers, etc).
4.2.1.4. Support investors' organisations in the provision of best practice and education programmes (e.g. fundamental analysis of company shares, mock-up investments for practice).

[101] 4.2.2.1. Educate companies on how capital markets operate and the features of different funding options (e.g. ELITE programme re difference between equity listing v private equity v debt raising etc)
4.2.2.2. Educate companies in what to expect from and how to deal with financial advisers (investment banks, other corporate finance advisers, financial communications, etc

[102] 4.2.3.1. Model sub-underwriting agreement as recommended by UK Institutional Investor Council Report
4.2.3.2. Charter for broker-issuer relations, including e.g. 10 top questions for companies to ask their broker

4.3. Enhance the availability of EU data and research by standardising and improving data collection, in order to enable both companies and investors to understand the comparative costs and benefits of different services provided by capital market participants	4.3.1. Standardise and measure the total and relative costs of raising equity (the costs of the IPO process and the ongoing costs thereafter) in order to enable both intra-EU comparisons, as well as between the EU and US / Asia etc)	✓	✓	✓
	4.3.2. Measure the importance of raising capital via the stock exchange and IPOs to the EU economy	✓	✓	✓
	4.3.3. Measure companies' as well as investor confidence in EU capital markets	✓	✓	✓
	4.3.4. Standardise and collect better data on the underlying ownership of EU companies	✓	✓	✓
	4.3.5. Conduct comparative research into the real risks associated with investment into EU small and mid-cap companies	✓		✓
	4.3.6. EU to adopt goal that stock market capitalisation should account for 75% of GDP by 2025	✓		

Recommendation 5:

Improve tax incentives for investment into IPOs and equity more generally

Aims	Recommendations	Directed to:		
		EU	**Member State**	**Industry**
5.1. End tax discrimination of equity towards debt and other forms of investments	5.1.1. Extend tax allowances available for debt financing to equity financing e.g. tax deductibility for advisory and other costs		✓	
5.2. Provide tax incentives to encourage investment both for the longer-term and in Emerging Growth Companies	5.2.1. Provide fiscal incentives for investors who take a long-term investment as opposed to short-term trading view: (e.g. no capital gains tax relief for holding for less than 12 months; staggered CGT relief on length of holding; exemption from CGT for illiquid Emerging Growth Company shares)		✓	

4.2.3.3. Online guide to going public developed by the European Commission, EuropeanIssuers, and FESE
4.2.3.4. Information on how to proceed with formalities for cross-border employee share ownership

	5.2.2. Avoid the introduction of financial transaction taxes or at least exempt transactions that support Emerging Growth Companies	✓	✓	
	5.2.3. Provide fiscal incentives for companies offering employee share ownership/stock options		✓	
5.3. Ensure consistent tax treatment and exchange of best practice	5.3.1. Ensure consistency of tax policies over several years in order to ensure continued, long-term investor appetite and confidence		✓	
	5.3.2. Use the open co-ordination method to share best practices in terms of tax incentives	✓		
	5.3.3. Allow companies to file accounts created using IFRS for SMEs for their tax returns		✓	
5.4. Ensure tax system is not a barrier to cross-border savings	5.4.1. Provide a more consistent approach to the taxation of cross-border employee share options schemes, which moves to taxation upon exercise or deferment of the tax		✓	
	5.4.2. Investigate barriers to the establishment of cross-border brokerage platforms for retail investors	✓		
	5.4.3. Investigate barriers to the creation of a portable personal pension for individual EU citizens	✓		
	5.4.4. Investigate barriers to cross-border taxation for investors in UCITS and other EU fund structures	✓		

8.0 Chart index

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Annex 1: About the IPO Task Force

In March 2013, the European Commission adopted the Green Paper on Long-Term Financing of the European economy. The intention of the Commission was to initiate a broad debate about how to foster the supply of long-term financing and how to improve and diversify the system of financial intermediation for long-term investment in Europe. In particular the Commission recognised that while the merits of heavy dependence on bank debt was questionable, alternatives being corporate bond, equity and securitisation markets in Europe remain relatively underdeveloped compared to other economies. Moreover, non-bank financing remains largely inaccessible to SMEs.[103]

Following the consultation launch, EuropeanIssuers, EVCA and FESE realised that they shared some common concerns about the way that European capital markets may or may not serve companies and investors, and decided to create an IPO Taskforce that would look at how to facilitate listings and reduce the equity gap in Europe.

The associations also wanted to change the policy debate on financial regulation from financial stability to a debate about how financial regulation can help financial markets to deliver better outcomes for companies and investors.

The Task Force has brought together a whole range of market participants from throughout Europe, from issuer representatives, investors both institutional and retail, venture capital and private equity, exchanges, brokers & market makers, lawyers, and auditors, in order to discuss the decline of IPOs in Europe, investigating the reasons for possible capital markets failures, as well as looking for concrete solutions.

The initiative was welcomed by the European Commission in its Communication on Long-Term Financing of the European Economy[104].

The members of the Task Force come from a range of backgrounds – company representatives, stock exchanges, venture capitalist, private equity representative, retail investor, small-cap fund manager, institutional investor representative, regional investment bank, auditor, lawyer.

Members

Philippe De Backer, European Parliament, Chairman, Belgium

Magnus Billing, NASDAQ OMX, Sweden

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Staffan Lindstrand, Healthcap, Sweden

Axel Maack, BDO, Germany

Julian Palfreyman, Winterflood Securities, UK

Ramon Hernandez Peñasco, Santander, Spain

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[103] European Commission, "Green paper on Long-Term Financing on the European Economy"
[104] European Commission, Communication on Long-Term Financing of the European Economy, page 8

Alexander Pietruska, the Carlyle Group, UK

Volker Potthoff, CMS HS, ArMiD, Germany

John Romeo, Oliver Wyman, USA

Deirdre Somers, Irish Stock Exchange, Ireland

Tim Ward, Quoted Companies Alliance, UK

Gervais Williams, Miton Group, UK

Observers

Pierre Di Toro, European Commission

Almoro Rubin de Cervin, European Commission

Mats Isaksson, OECD

Role of the members and observers

The views expressed by members, at meetings and in their support for this report, are views of the individuals and should in no way be seen as representing the official views of the organisations for which they work. Those organisations have their own procedures on place for reaching and conveying official views. The recommendations in the report represent a compromise between the different market participants.

Representatives from the European Commission services were observers in the IPO Task Force. As this report makes recommendations to the Commission, the participation of the Commission services in the taskforce should be not considered as an endorsement of the report's findings and recommendations.

Staff

EuropeanIssuers: Susannah Haan, Aleksandra Palinska, Kasia Rusek

EVCA: Michael Collins

FESE: Rainer Riess, Burçak Inel, Tracey Roberts, Sara Baldi

Meetings

The IPO Task Force met in face-to-face meetings on 2 June, 22 July and 30 September 2014.

Annex 2: Additional Economic Background and the Role of Public Equity Markets:

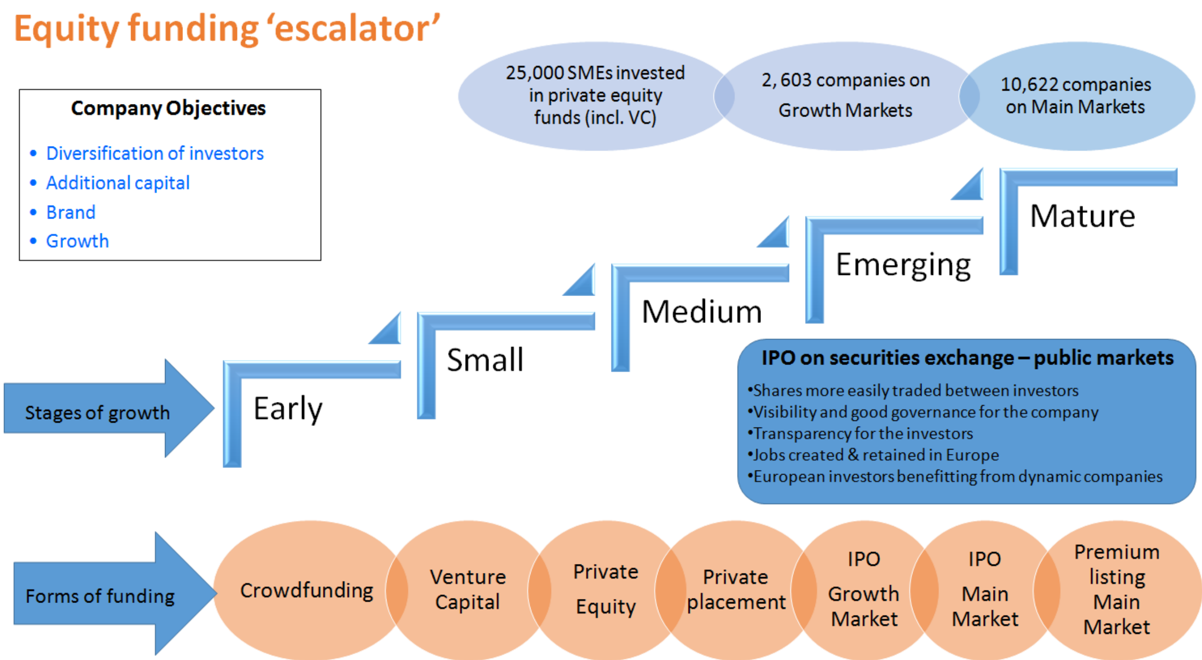
The Role of Public Equity Markets

Public equity markets are not only important on their own, but also play an important role in the "funding escalator" with different modes of financing for companies at different stages of development. For example, IPOs, through their role as an exit for venture capital, become a positive contributor to the funding of innovation.

Before entering the public equity markets, companies may obtain private equity capital from crowdfunding, venture capital and private equity.

Once companies have joined the public markets, they may still be able to climb the funding escalator via access to exchange-regulated or Growth markets, the main EU Regulated markets, and segments within those markets.

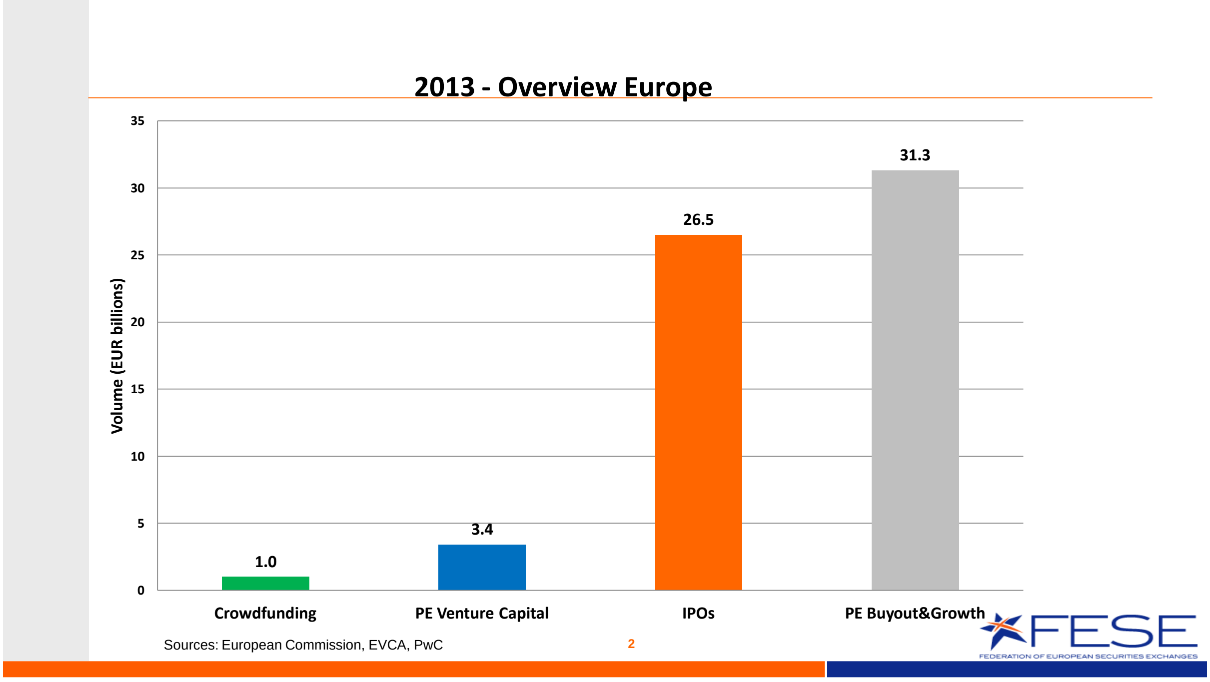
Chart 11 The Funding escalator



Source: FESE stats, LSE and Borsa Italiana stats

It is important to note that different avenues exist for different stages of development (not necessarily in a sequential way, but sometimes in an overlapping way). The following chart shows the amount of funding available collectively from these sources.

Chart 12 Overview of different equity funding models



Source: FESE

Moreover, IPO markets also play an important social role by allowing broad groups of investors to benefit from the long-term profitability of dynamic companies.

More broadly, public equity (and non-equity) markets promote stability because of the high standards of corporate governance, transparency and supervision underlying to the instruments issued. The transparency that comes with being listed enhances the quality of the management of a company and also prevents a company from losing its entrepreneurial focus on its corporate goals.

The Decline in IPOs

Overall, IPO markets have been contracting…

Although IPO markets are in a current phase of rebound it is not clear whether this will be sustained over the coming months and years. Long-term data shows that IPO markets across the world have actually been **contracting by number and volume.**

The analysis from the OECD[105] (supplemented by data from PwC[106]) shows the following:

- In the world, as shown in the Chart below, during 1993-2000, the OECD area had an annual average of about 1170 IPOs. During 2001-2011, this number fell to about 670. During the "recovery" period before the financial crisis, the annual number of IPOs never reached the average number of IPOs during the 1990s. The decrease in the number of new listings in OECD markets was accompanied by a decrease in the amount of equity that companies raised. The total value of capital raise decreased from an annual average of USD 132.7 billion during 1993-2000 to an annual average of USD 69.9 billion during 2001-2011.[107] According to the OECD,

[105] Isaksson M. and Çelik S., "Who Cares? Corporate Governance in Today's Equity Markets"
[106] PwC's IPO Watch Europe
[107] "…throughout the 1990s, companies from OECD countries dominated the global IPO scene by receiving about 82% of all of the risk capital that was raised in public equity markets worldwide. This dominance ended quite dramatically by the turn of the century, when the absolute amount of capital raised by OECD companies was cut in half compared with the annual average of the previous decade. This resulted in an increased share of capital going to companies in non-OECD countries, which in 2003 was about 35%, compared to 20% in 2000. During the subsequent IPO "recovery" between 2004 and 2007, the relative amount of equity raised by companies from non-OECD

preliminary data for the first half of 2012 indicated modest results that remained below the average for the period 2001-2011.

- Similarly, the study commissioned by the OECD[108] (utilising separate data sources) finds a steady decline in the overall number of global offerings. It notes that from 1993 to 2012, the global number of IPOs declines from over 2000 a year in the early 1990s to less than 750 in 2012. It concludes that the IPO decline "is widespread and not confined to U.S. markets and therefore, likely precipitated by the proliferation of computer-based trading and low- transaction-cost-electronic markets."

- In Europe, data from PwC's IPO Watch Europe from the last 6 years confirms the findings from the OECD. The average number of IPOs for the period 2008-2012 was 299. While the latest IPO data from 2012 and 2013 from Europe shows a significant recovery compared to 2009 (which was the lowest in this period), the current number of IPOs for either of these years remains still very modest when compared with the 2001-2011 averages.

- While IPOs are systematically down in the US and in Europe, there are a few markets which have been able to produce a greater number of IPOs in the recent years. One often cited example in the EU is the Warsaw Stock Exchange, which reported the highest number of new IPOs in 2012: in aggregate, there were 105 IPOs on the WSE markets, representing 39.5% of all European IPOs. In terms of the value of IPOs (EUR 739 million), WSE ranked fifth in Europe (PwC, IPO Watch Reports).[109]

- Although no simplistic conclusions should be drawn from a comparison of the number of IPOs on different markets, and while underlying macroeconomic conditions[110] and a history of privatisations[111] also play an important role, certain structural characteristics of the WSE climate could help explain the higher number of IPOs on their markets:

  - ✓ **Lots of small IPOs:** Every year, a few IPOs are large, but the bulk of the market is very small companies. This is the strength of the market. It reflects the fact that 99% of Polish companies are SMEs.

  - ✓ **Stable and diversified base of domestic and foreign investors:** With a large institutional investor asset pool, Poland has a strong pension fund system and a diversified mutual fund landscape. Foreign investors generated 50% of equity turnover in Q1 2013.

  - ✓ **Pension funds invest in public equity**: Polish pension fund law states that a high percentage of assets should be in equity. The European Commission has challenged this, but it is widely seen by observers as one of the main reasons behind the high pension fund investment in public equity in this country.

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countries continued to increase. During this phase, however, their increased share is not explained by a fall in equity raised by companies based in OECD countries. Rather, it is the result of a faster absolute increase in equity raised by companies from non-OECD countries. In 2003, non-OECD companies raised a total of USD 16 billion of equity worldwide, which in 2007 had risen to USD 130 billion. As a consequence, during the four "recovery" years before the 2008 financial crisis, non-OECD companies received almost 40% of all equity raised in the world. This share has increased even further in the period following the financial crisis. Between 2008 and 2012, almost 60% of all new risk capital raised worldwide went to companies from non-OECD countries."

[108] Weild D., Kim E. and Newport L., "Making Stock Markets Work to Support Economic Growth", page 34

[109] The WSE reports that, the WSE is strong in terms of capitalization and value of turnover in shares, and that the global downtrend in equities trading volumes in 2012 resulting from the financial crisis was less adverse on WSE compared to the rest of Europe. As at 15th October 2013, WSE has reported 15 new listings on the Main Market and 36 new listings on NewConnect Market. WSE attracted foreign companies from the CEE region and beyond. Currently, there are 55 foreign companies listed on both equity markets originating from 20 countries (6 companies newly listed in 2012 and 4 in 2013YTD).

[110] Stable and favourable macroeconomic environment plays a role. The WSE reports that, according to the Eurostat forecasts, Poland's GDP growth will be 1.1% in 2013 (average forecast for EU27 is -0.1%), and 2.2% in 2014 (average forecast for EU27 is 1.4%). The above-average dynamics of Polish economy growth creates favourable conditions both for price increases of shares listed on WSE and for increased interest in securities listed on WSE on the part of domestic and international investors.

[111] Privatisations via IPO: The WSE reports that some of the most publicised and successful IPOs of state-owned companies in recent years, including PZU in 2010 and PGE in 2009, were very large in CEE standards and were mid-cap by the standards of most advanced and liquid markets.

- ✓ **High number of retail investors:** Out of a population of 39 million, there are 1.5 million individual accounts, which compares very favourably with many other countries. Out of these, 300,000 are very active investors who routinely participate in IPOs. They are the driving force behind the IPOs as well as the futures and options market.

- ✓ **Diversified base of Exchange Members, including small brokers ready to act in the small/midcap market:** Currently, there are 33 local brokerage houses and 25 foreign investment companies originating from 11 countries which act as Exchange Members.

- ✓ In conclusion, the key elements can be summarised as:

    - High number of small/mid size brokers
    - High number of retail investors
    - Government support.

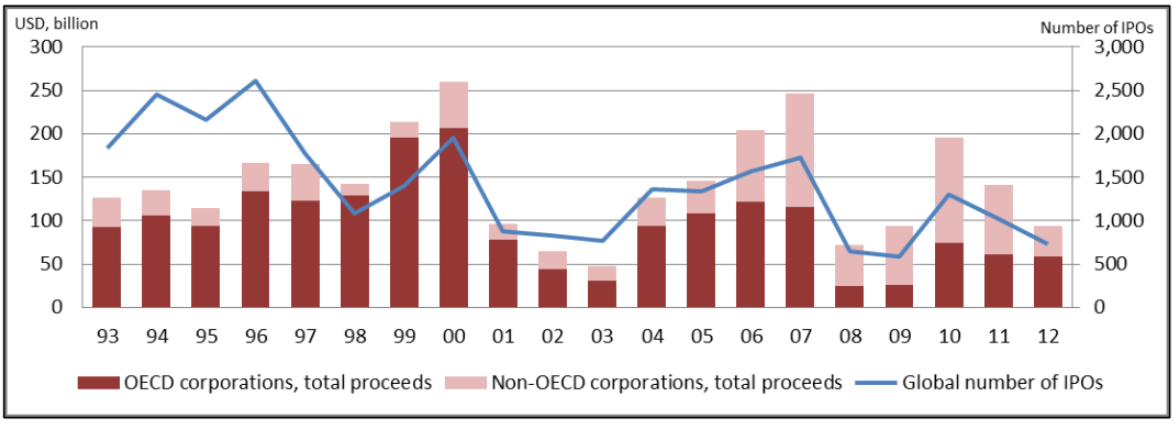
- While certain aspects of the WSE experience cannot be replicated in other markets, the structural elements are important to bear in mind as Europe seeks to increase IPOs, especially by smaller companies. In particular, they highlight the importance of brokers and investors who are at the same "scale" as an SME, i.e. small and medium.

- Access to capital plays a key role in the overall competitiveness of a company. A public listing is one way a company can secure the capital needed to grow. However, IPO activity in Europe has declined from a level of 666 new listings in total in 2007 to 165 in 2012, according to the Federation of European Securities Exchanges."

- Looking at individual country data, the OECD analyses the UK market, for example, and notes that the increase in the period 2005-2007 before the crisis when compared with 1993-2000 was largely explained by capital raising by non-UK corporations.

- In the United States, the OECD finds "a relatively clear downward trend" starting from the late 1990s. According to the data, "the annual average number of companies that made an initial public offering in the period 1993-2000 was 525. For the period 2001-2012, that number had fallen by about 80% to 116. The amount of capital raised also fell quite dramatically between the two periods, from an annual average of USD 65 billion to USD 30 billion…the average value of an IPO approximately doubled in real terms, from USD 123 million in the period 1993-2000 to USD 259 million in the period 2001-2012… the average market value of the companies that sought funding in public equity markets in the United States was about USD 1 billion…the absolute amount of equity raised by non-US firms through an IPO in US markets has also decreased quite considerably compared to the period from 1993 to 2000."

Chart 13 Global Trends in Primary Equity Markets Since the 1990s (2012, USD, billions)



Source: Isaksson M. and Çelik S. (2013), "Who Cares? Corporate Governance in Today's Equity Markets", exhibit 7, page 35

Is this a Cyclical or Structural Trend?

It is often assumed that the IPO trends follow macroeconomic cycles. As evidence, it has been suggested that the higher IPO figures in Asian (and more generally in emerging) countries in the last few years can be principally explained by the higher economic growth rates in these regions. Indeed, macroeconomic factors such as interest rates and the availability/cost of banks loans and public debt do influence the relative cost of public equity, and could therefore explain short-term IPO trends for the period in which these macroeconomic factors prevail.

However, there are strong signs that the trends demonstrated above point to a *structural* decline of IPOs, rather than a *cyclical* one. The first reason is that the decline has been observed over a long time period that encompasses several economic cycles, and that even during times of economic recovery, the IPOs have remained at lower levels than at the start of the observation period.

More importantly, there is evidence that the IPO decline observed in the OECD countries is not only a nominal decline but one that is *relative to GDP*. The study commissioned by the OECD looks at how well the IPOs are keeping pace with GDP growth by calculating a domestic IPO "efficiency rate" for the 26 jurisdictions in their sample from 2008 to 2012 (see chart 13).

The conclusion is that the countries that are doing well in IPOs are not simply doing well because of higher GDP growth, but because their IPO markets are keeping pace with their GDP growth. In other words, the study concludes, we observe the decline in IPOs in the US and in Europe because their IPOs are not rising despite GDP growth.

The Consequences for Economic Growth

The above trends are the exact opposite of what we need in Europe: we need to see market-based financing increase in relative terms to its GDP to make up for the decline in bank financing and to finance sustainable economic growth to generate jobs and bring innovation to the real economy.

A key feature of a well-functioning IPO market is to create access to permanent equity capital for smaller companies. A market that is accessible only by large or well-established companies would not be good at fostering innovation, dynamic job growth and new investment opportunities. Smaller quoted companies are especially crucial for job creation.[112]

When capital markets finance companies, including smaller public companies, the economy gains jobs. As an example, the OECD-commissioned paper estimates that the US economy might have produced between 6 and 19 million more jobs over the last two decades if its IPOs had kept pace with GDP growth. This is consistent with a major US study that showed that 92% of the new jobs created by companies come after becoming public. The US IPO Task Force recommended that US policymakers focus on the needs of smaller quoted companies, which they called ***Emerging Growth Companies***. As the world's biggest economic bloc, the EU could expect to benefit from job creation on a similar scale.

The current situation of overall decline is particularly worrisome from an economic growth point of view, because **job creation is strongest among these Emerging Growth Companies which are or could be listed on exchanges.** While SMEs overall have a large share of the EU economy, the largest SMEs – exactly the ones most likely to access capital markets - have a disproportionately important share of job creation[113].

[112] In this context, we define small companies as any company under 1 billion EUR market capitalisation, but it is also possible to differentiate among these companies further, e.g. micro companies below 50 million EUR market capitalisation.
[113] ESSEC Business School & GE Capital, "The Mighty Middle: Why Europe's Future Rest on its Middle Market Companies"